Does It Pay for Entertaining Your Stakeholders?*

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Abstract

Using a unique dataset on business entertainment expenditure (BEE) spent by Chinese public firms, we study the impact of BEE on firm performance. We find that BEE improves future sales, profitability and valuation, which has not been fully anticipated by investors and analysts. Further analyses indicate that BEE can reduce litigation incidences with other firms, improve the quality of trade credit extended to customers, acquire more trade credit from suppliers, secure more government subsidies, and lower collateral requirement of bank borrowings. Our results suggest that BEE generates benefits to firms by mitigating transaction costs with stakeholders in private sectors and securing favorable outcomes from stakeholders in non-market transactions. We further find that the accessibility to key stakeholders and the existence of managerial agency problem prevent firms from utilizing BEE to maximize the firm value.

Keywords: Business Entertainment Expenditure; Transaction Costs; Favor-seeking; Firm Performance; Stakeholders

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Entertaining business stakeholders is one of longstanding and prevalent corporate activities. Business entertainment expenditure (BEE) is generally considered as necessary operating costs and is granted tax deductible status. For instance, BEE has been deductible since the inception of the nation's revenue laws in the U.S in 1906 (Schmalbeck and Soled, 2009).[1] Business entertainment is also prominent in practices. According to market researcher Chaebul.com, 3.6 million companies in Korea spent about $ 6.24 billion on BEE in 2012, equivalent to 0.19% of the combined sales.[1] In China, the data we complied indicates that BEE accounts for 0.23% of the combined sales and 4.5% of the combined net income from 2004 to 2012. In U.K., Key Note, a market intelligence provider, estimated that the corporate hospitality market accounts for about 0.82% of its GDP in 2011.[2] These numbers imply the prevalence and significant magnitude of BEE.

Although the use of BEE by firms is considerable and widespread, we know very little about why firms want to entertain their stakeholders, whether and how firms benefit from these activities. To our best knowledge, there is no study systematically investigating such issues, probably due to the lack of relevant data. Taking advantage of the unique disclosure practice of BEE by listed firms in China from 2004 to 2014, this paper attempts to explore these questions.

[1] More and more countries in both mature and developing markets have made increased efforts to fight against perceived lavish business entertainment. The deductible rate for BEE has been reduced to a certain rate, but it is still largely deductible. For example, the tax deductible rate for BEE is reduced to 50% now in the U.S and Canada, while remains at 70% in Germany. For BRIC countries, the deductible rate is 50% in Brazil, 100% if BEE is less than 4% of the total annual pay-roll expenses in Russia, 60% if BEE is less than 0.5% of sales in China. These figures suggest that governments continue to recognize BEE as part of firms' necessary operating costs.

[2] To our best efforts, we are still unable to find the BEE data for other countries, except for some anecdotes. For instance, some anecdotes suggest that BEE is also very prominent in Japan. In a report by Reuters in 1985, titled "Expenses for Business Entertainment Exceed the Defense Budget in Japan", it estimated that "For a small company, business entertaining probably amounts to 20% of its costs." A recent report by Financial Times in 2013 confirmed that Japan has had a history of somewhat excessive business entertainment.
http://articles.latimes.com/1985-01-20/business/fi-10764_1_business-entertainment,
http://www.ft.com/intl/cms/s/0/b752ca22-1c5d-11e3-8894-00144feab7de.html,
https://www.keynote.co.uk/media-centre/in-the-news/display/uk-corporate-hospitality-market-shrunk-during-recession/?articleId=780

When firms entertain their stakeholders through business lunches, concert shows, sporting events, or any other activities, they can spend some time together in a relaxed atmosphere, in which most people tend to let their guard down a little and share more personal experiences. This is a good way to know people's personalities and needs, and also good for developing networks and bonding relationships with a firm's major stakeholders. The well-established stakeholder theory (e.g., Freeman, 1984; Donaldson and Preston, 1995) in management studies has proposed that building and maintaining good relationships with stakeholders are essential for firm success (e.g., Freeman, 1984; Donaldson and Preston, 1995, Zingales, 2000; Jensen 2001). We expect that building and maintaining good relationships with stakeholders through entertainment activities can lead to better firm performance for two reasons. First, entertainment activities can mitigate transaction costs that a firm has to overcome in conducting market-based transactions with their business partners (e.g., Dahlman, 1979; Dyer and Chu, 2003; North, 1990). According to Coase (1960), transaction costs refer to the costs involved in market exchange, including the costs of discovering market prices and the costs of writing and enforcing contracts. The root to transaction cost is the lack of information, which can create obstacles for the realization of profitable business opportunities (Dahlman, 1979; North, 1990). As entertaining business partners can facilitate communication and information sharing between firms and their business partners, we expect that they could help to lower the transaction costs faced by firms and realize the profitable business opportunities that might be otherwise thwarted by the high transaction costs.

Second, entertaining stakeholders could help firms to achieve favorable outcomes in public sectors such as governments and state-owned entities. Public choice theorists in

economics and political scientists have long argued that decisions or outcomes in public sectors are not completely determined by objective rules or procedures but can be shaped by the lobbying or other organizing activities of interested groups or powerful economic actors (Bernstein, 1955). The effectiveness of these activities depends crucially on the degree of influences that the interest groups/individual actors can exercise over the decision-making of the bureaucrats. This in turn can be affected by the information sharing between lobbying groups and bureaucrats (Abney and Lauth, 1986; Brudney and Hebert, 1987), the ability of lobbying groups to gain access to bureaucrats (Culhane, 1981), and the perceived power or favorability of the lobbying groups vis-à-vis their competitors in the eyes of bureaucrats due to the existence of psychological bias or direct material benefits (Khwaja and Mian, 2005). We expect that entertaining stakeholders in public sectors allows firms to exercise greater influence over the decision-making of public organizations by facilitating information sharing; gaining access to the relevant administration or even directly title the relatively favorability of a firm relative to its competitor.

Our empirical analyses reveal four main findings. First, we find that BEE can improve firm performance. Our most conservative estimates indicate that one RMB increase in BEE can improve sales, net profit, and firm valuation in the next year by 16.9, 2.1, and 41.0 RMB, respectively. These results suggest that firms can significantly benefit from BEE.

Second, we document evidence that the information embedded in BEE about future firm performance has not been fully realized by investors and analysts. We find that higher BEE firms earn higher risk-adjusted returns in the subsequent 12 months. A hedged portfolio that longs the top quintile BEE firms and shorts the bottom quintile BEE firms earns 6.05% (for

equal-weighted, 10.16% for value-weighted) per year. The predictability of BEE on future stock returns is reconfirmed by the Fama-MacBath regression analysis. In addition, we find that high BEE firms tend to have high future unexpected earnings (defined as the difference between actual earnings per share and the predicted earnings per share by analysts scaled by the stock price two days prior to the earnings announcement), which suggests that analysts also underestimate the benefit of BEE on future firm performance.

Third, to explore the underlying mechanism of the positive effect of BEE on future firm performance, we take a closer look at the benefits of BEE from four main outside stakeholders: customers, suppliers, governments, and creditors. We propose two main channels through which BEE generates benefits to firms: reducing transaction costs for a firm with its stakeholders in market-based transactions and securing favorable treatments from stakeholders in non-market-based transactions. We test the former hypothesis by investigating the effect of BEE on the litigation incidence with other firms, the quality of trade credit extended to customers, and the amount of trade credit acquired from suppliers. The occurrence of legal disputes reveals the de facto existence of disagreements on certain issues about transactions between trading counterparties and failure in coordinating and enforcing contracts. To the extent that BEE is able to reduce information asymmetry and facilitate communications between a firm and its trading partners both before and after transactions, BEE would be negatively related to the occurrence of legal disputes. Customers and suppliers are important stakeholders of firms. The payments of trade credit from customers involve uncertainties arising from business conditions of customers and may even suffer from opportunistic behavior as no collateral is usually set in place to serve as an effective

enforcement device. Similarly, the payments of trade credits to suppliers involve similar uncertainties and risk to the suppliers too. If BEE is able to facilitate information sharing between a firm and its customers and suppliers and facilitate the extension of trade credits in business, BEE would be associated positively with the quality of trade credits extended to customers and the amount of trade credit acquired from suppliers. Our results show that BEE can reduce litigation incidence with other firms, improve the quality of trade credit extended to customers, and acquire more trade credit from suppliers. To further understand the nature and potential drivers of the effect, we further sort firms into high vs. low transaction cost subsamples according to the level of transaction costs faced by a firm. We find that the effects of BEE are stronger for the high transaction cost subsample. These results thus substantiate our hypothesis that BEE generates benefit to a firm by alleviating transaction costs with its stakeholders in market-based transactions.

On the second hypothesis of securing favorable treatments and outcomes from stakeholders in non-market-based transactions, we test it by examining the effect of BEE on the amount of subsidies from government and collateral requirement of bank loans. We consider bank sector in China a hybrid sector because almost all the Chinese banks are state-owned. Recent studies indicate that the lending decisions are still subject to significant influences from governments, though the decisions have become more and more commercialized over time (e.g., Jin and Qian, 1998; Song, Storesletten, and Zilibotti, 2011). We find that BEE is associated with more subsidies from government and lower collateral requirement on bank loans. Further analyses indicate that the effects of BEE on subsides (collateral requirement) are stronger (weaker) when the government-firm relationship is less

well-established. Therefore, these results support the hypothesis that BEE can facilitate the building of stronger connections between firms and government.

Last, we investigate why firms do not further increase BEE given that the marginal effect of BEE on firm performance is significantly positive. We propose two possible reasons to explain the under-investment in BEE. First, the pre-requisite for entertaining business partners is the existence of accessibility to key decision makers of its stakeholders. Such accessibility cannot be taken for granted as it depends crucially on the social capital of an organization. We use a firm's political connectedness and its size to measure its accessibility to stakeholders. We find that the marginal benefit of BEE on firm performance is only positively significant for political unconnected and smaller firms, which are consistent with the conjecture that the accessibility to key stakeholders of a firm is a factor constraining it using BEE to enhance its value.

Traditional managerial agency problems may lead to excessive spending of BEE and a negative relation between BEE and firm performance. We, however, argue that self-serving decisions of managers may also lead to under-spending in BEE. For example, managers may not be willing to spend time to entertain business partners if they cannot capture personal benefits from those activities. We use the existence of managerial incentive scheme and managerial shareholding to capture the incentives for managers to engage in value-enhancing activities. Compared to firms with managerial incentive scheme (more managerial shareholding), those without managerial incentive scheme (with less managerial shareholding) suffer more interest misalignment problem between managers and shareholders and thus have less incentive to use BEE to improve firm performance. Put differently, the marginal effect of

BEE on firm performance should be only positively significant for firms without managerial incentive scheme and with less managerial shareholding if the lack of incentives to maximize shareholder value is a reason impeding firms from expanding BEE to improve firm value. Expectedly, we find empirically supporting results.

Naturally, there are concerns that our findings might be plagued by endogenous problems. One concern is a self-selection bias because a small fraction of firms have not disclosed BEE. We use a Heckman two-stage estimation procedure to correct for this self-selection bias. Two other concerns are omitted variables and reverse causality. We use an instrumental variable approach to address both concerns. Following similar arguments in Nevo (2001) and Cai, Fang and Xu (2011), we use the median BEE of other firms within the same industry at two-digit level in a given year as the instrument. The underlying logic is that firms within the same industry share some common but unmeasurable factors that affect BEE, such as specific product attributes and industry regulations. Therefore, the industry median BEE is correlated with firm BEE but less likely to affect other firm outcomes directly, except indirectly through BEE. Our estimates from an IV approach are very similar to the estimates using an OLS approach.

In addition, we use the anti-corruption campaign in China initiated by the Xi Administration at the end of 2012 as a quasi-natural experiment to further mitigate endogenous concern.[3] On December 4, 2012, the Political Bureau of the Communist Party of China (CPC) Central Committee passed an Eight-provision regulation on how government employees including leaders of SOEs should improve their work style in eight aspects,

[3] Two days after the release of the Eight-provision (Dec 6, 2012), Chuncheng Li was arrested for corruption, who was the deputy secretary of the CPC in Sichuan.

focusing on rejecting extravagance and reducing bureaucratic visits, meetings and empty talks. Therefore, to some extent, the crackdown against corruption would lead to an exogenous increase in the perceived cost involved in the entertaining, which can consequently lead to a reduction in BEE of a firm. Therefore, it is reasonable to expect that there is a reduction in BEE after 2012 around the country, especially for SOEs, because managers or employees in SOEs experience greater pressure from the policy changes imposed by central government. If BEE indeed improves firm performance, we would expect that the reduction in BEE would lead to the decline in firm performance and bigger drop in firm performance for SOEs. Using a propensity score matching procedure, we find a match from private firms for each SOE. This quasi-natural experiment setting therefore allows us to perform a difference-in-difference (DiD) test. Univariate test and DiD regression results are both consistent with these predictions.

Our study contributes to the literature in several ways. First, this is the first study that systemically explores the reasons and benefits of entertaining business stakeholders. The closest study to ours is Cai et al. (2011), who use a World Bank survey dataset to study the effect of Entertainment and Travel Costs (ETC) on firm performance. Entertainment Costs and Travel Costs actually are two separated accounting items, which are reported as a single item in the survey data. Entertainment Costs in ETC are our BEE, while Travel Costs in ETC refer to expenses incurred when an employee conducts business away from home including lodging, meals, or transportation costs.[4] Therefore, our measurement of BEE is different

[4] http://financial-dictionary.thefreedictionary.com/Travel+and+Entertainment+Expense. It is possible that some Travel Costs might include some BEE such as sharing a cab or a meal, while it is reasonable to believe that most parts of Travel Costs should not be related to entertainment costs as firms normally have certain policies on Travel Costs, such as the amount of compensation per day for meals, lodging and transportation. In Cai et al. (2011), the average and median of ETC divided by sales is 1.5% and 0.6%, respectively. However, the average and median BEE divided by sales are 0.46% and 0.27%

from ETC. Cai et al. (2011) use ETC to proxy the level of corruption and find a negative relation between ETC and firm performance.[5] Our study, however, focuses only on entertainment expenses and collects data from actual expenditure as reported by the listed firms. We offer evidence that BEE is performance-enhancing rather than performance-reducing.

Second, we contribute to a young but growing literature on the importance of social networks in corporate finance (e.g., Hochberg, Ljungqvist, and Lu, 2007; Engelberg, Gao, and Parsons, 2012a, 2012b). Prior studies have found that a firm's social networks can facilitate the various corporate activities such as investment performance (Hochberg et al., 2007) and bank borrowing (e.g., Engelberg et al., 2012a). Our study focuses on the activities that build up the social networks. Although BEE only accounts for 2.7% of the SGA in our sample, our results show that firms can reap significant benefits from different stakeholders by engaging in this kind of activity. Our study not only reveals the mechanisms on how social networks can be produced, but also adds further evidence to demonstrate its significant benefits for firms.[6]

The rest of the paper is organized as follows. Section 1 describes the data and summary statistics. Sections 2 to 6 present empirical results. Section 7 concludes the paper. Appendix B includes the definitions of all variables used in this study and their data sources.

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during the similar period (2004 and 2005) in our sample. Their average and median are three times and twice more than the numbers in our sample, which are consistent that BEE is only a part of ETC. In the example in Table B1, Travel Costs are about 36.66 times of BEE, suggesting that Travel Costs may account for a substantial portion of ETC.

[5] To some extent travel cost could imply the difficulty of doing business as firms have to meets with clients or suppliers far away from home. In this sense, their finding is reasonable. Unfortunately, we do not have data on travel costs of a firm.

[6] Although recent studies on organizational capital propose using SGA to capture firms' organizational capital ((Eisfeldt and Papanikolaou, 2013; Li, Qiu, and Shen, 2014) and BEE is a part of SGA, BEE is more related to a firm's social networks than its organization capital. Evenson and Westphal (1995, p. 2237) describe organizational capital as "the knowledge used to combine human skills and physical capital into systems for producing and delivering want-satisfying products".

1. Dataset and Sample Characteristics

1.1 Data Sources

We hand-collect data of BEE from annual reports of all non-financial firms listed on A-share market in either Shanghai or Shenzhen stock exchanges from 2004 to 2014. We exclude financial firms because their financial statements are compiled under different accounting standards. The year 2004 is chosen as the initial year because some data used in our main analyses are available only since 2003 (e.g., data of reserves for account receivables) and we need one year lagged data for some of our analyses. Our detailed data collection procedures are explained in Appendix A.

Similar to disclosure policies in other countries, the publicly listed firms in China are not mandatory to disclose information on BEE. Fortunately, a large fraction of them actually disclose BEE in their annual reports as they are mandated by regulators to list major categories of their main accounting items in footnotes such as SGA. Among our initial sample of 20,496 firm-year observations for 2,613 non-financial listed firms during our investigation period, we find 13,239 firm-year observations for 2,286 firms that have disclosed BEE. After excluding the observations with missing value on our key variables, our final sample includes 17,973 firm-year observations for 2,511 firms and 11,719 firm-year observations have valid BEE.[7] In our empirical analyses, we use the Heckman two-stage

[7] Our initial sample includes 2,613 firms, with a total of 20,496 firm-year observations. Our final sample is obtained after applying the following screening process. 1,231 firm-year observations (824 of them have valid BEE) are excluded due to missing information on the amount of reserves allocated for account receivables as this information is disclosed in the notes of accounts in financial statements and therefore not mandatory. 639 firm-year observations (328 of them have valid BEE) are dropped due to missing information on customer-base or supplier-base concentration. 396 firm-year observations (222 of them have valid BEE) are further discarded with negative equity as these firms are practically bankrupt and their behavior might be systemically different. 165 firm-year observations (89 of them have valid BEE) are eliminated due to missing information on board. Finally, we exclude 257 firm-year (146 of them have valid BEE) observations with missing information on other variables. If we exclude the variables of reserves, customer and supplier concentration, the final sample size can increase to 19,843 firm-year observations. Under this circumstance, the percentage of our firm-year observations with missing information on our explanatory variables is similar to that of Giannetti, Liao and Yu (2014). The empirical

model to correct self-selection bias.

Our main dataset for constructing other variables is China Stock Market & Accounting Research Database, which has been widely used by many prior studies (e.g., Fan, Wong, and Zhang, 2007; Giannetti, Liao, and Yu, 2014). Other databases used in this study include Wind, GW and iFind. Wind is equivalent to the Bloomberg in China, while GW and iFind are well-known databases provided by two listed firms in China.

1.2 Descriptive Characteristics

Panel A in Table 1 presents the summary statistics of BEE by year in our final sample. The pattern of disclosure rates over the years is similar to the one in Table B2 in Appendix B. The disclosure rates are around 37% during the period of 2004 to 2006, increase to about 43% in 2007 and 2008, further jump to 77% in 2009, and then stay around 78% afterwards. This uptrend reflects a series of reforms of Chinese accounting principles since the early 1990s.[8] The magnitude of BEE is fairly large no matter how we scale it. The average (median) value of BEE scaled by total assets, sales and operating profits are 0.26% (0.19%), 0.53% (0.32%) and 10.37% (4.10%), respectively.

Panel B in Table 1 displays the summary statistics of BEE by industry at two-digit level, which is compiled by CSRC and consists of 21 industries. We sort the industry by the median ratio of BEE to total assets. Information Technology industry has the highest ratio of BEE to total assets, total sales and operating profits, followed by Pharmaceutical Products and

results throughout the paper still hold if we use this larger dataset.

[8] The significant jump in year 2009 is largely due to a special notice disseminated by Minister of Finance of China, which required all levels of governments to monitor the implementation of new accounting standards by firms registered in their jurisdictions on December 28, 2010 (http://www.casc.org.cn/2011/0111/92952.shtml). This notice specifically called for particular attention to firms listed in the Growth Enterprise Market in the Shenzhen Stock Exchange (hereafter GEM firms). Consistent with this notice, Table B2 in Appendix B shows that the disclosure percentage for GEM firms is 9%-13% higher than that for firms listed in the Shanghai stock exchange, and about 6%-12% higher than that for SME firms listed in the Shenzhen stock exchange.

Communication & Culture industry. On the other hand, the industries of Utilities, Real Estate and Furniture have the lowest ratios of BEE to total assets. Compared to the industries lie in the bottom of Panel B, the product and/or service qualities of those industries on the top of Panel B seem to be more difficult to be verified. As a result, buyers and sellers need more time to search for eligible trading partners, have more issues to be negotiated before signing the contracts, and require more investment to police the resultant contracts. Put differently, industries on the top of Panel B seemingly face high transaction costs.

Panel C in Table 1 displays the summary statistics for other firm characteristics used in our study. The last column indicates the number of valid observations in our analyses. The subpanel of *Corporate Outcomes* presents summary statistics of corporate outcomes on which the effects of BEE will be examined. The subpanel of *Other Firm Characteristics* displays summary statistics of our main explanatory variables. The natural logarithm of firms' market value has both a mean and a median of around 21.4. SOEs account for 50.2% of all firm-year observations.

[Table 1 here: Summary statistics]

2. Which Firms Spend More on Business Entertaining Activities?

2.1 Measures of Explanatory Variables

A. Key Explanatory Variables

Based on these characteristics of transaction costs, we construct several variables to proxy transaction costs faced by firms in dealing with their stakeholders in private sectors. Inspired by previous studies (e.g., Kalwani and Narayanda, 1995; Kumar, 1996; Patatoukas, 2012), we use customer-base concentration, defined as the proportion of sales to top five customers, to

capture the transaction costs faced by firms in doing business with customers. By definition, more concentrated customer-base means that firms and their customers tend to conduct transactions more frequently and have a greater degree of mutual dependence. Therefore, uncertainty and opportunistic behavior in transactions will be alleviated, which will lower transaction costs for firms in dealing with customers. The similar logic applies to supplier-base concentration, which is defined as the proportion of procurement from top five suppliers, to proxy for the transaction costs encountered by firms in dealing with suppliers.

We construct an additional variable to capture transaction costs faced by a firm in dealing with its customers, which is defined as the ratio of the total amount of reserves for account receivables (AR) to total assets (*Reserves of receivables*). The amount of reserves set for potentially non-collectable AR reflects a firm's difficulty in collecting account receivables and failure in predicting its customers' opportunistic behaviors in payments. This variable is thus expected to be positively related to the transaction costs faced by a firm when it is interacting with customers.

Our fourth proxy of transaction costs is defined as the ratio of related party transactions (RPT) scaled by total assets. RPT refers to the deals between two parties who are related by ownership, or personal ties through mangers or their family members. As firms with more RPT tend to rely less on market transactions, it is reasonable to expect that these firms tend to face less transaction costs in their operations.

Our fifth variable for firms' transaction cost is firms' competitiveness (PCM), defined as sales minus the cost of goods sold (COGS) and SGA divided by sales (Ahern, 2012). A more competitive firm tends to have higher bargaining power vis-à-vis its business partners than a

less competitive firm. As such, its business partners are more likely to provide reliable information before transactions and less likely to engage in opportunistic activities after transactions. Reduced information asymmetry tends to reduce the transaction costs.

The occurrence of litigation incidence is a de facto indicator of the difficulties involved in designing and enforcing contracts. We thus expect that firms with higher litigation risk tend to face higher transaction costs in dealing with their stakeholders. Our sixth proxy for transaction costs faced by a firm, *Litigation Risk,* is set at one if a firm experienced more lawsuits than its industry median in the past three years.[9]

Williamson (1988) predicts that firms with lower transaction costs tend to rely more on debt financing. We thus use leverage, defined as total liabilities divided by total assets, to further capture firms' transaction costs. Finally, firms have been doing business with their business partners since it was established. The older a firm, the more information shared between the firm and its business partners. We therefore employ the variable of firm age, defined as the natural logarithm of the number of years since a firm has been established, as our final proxy for transaction costs faced by a firm.

We use two dummies to capture the incentive of firms to engage in entertainment activities in order to obtain benefit from stakeholders, especially in public and hybrid sectors such as governments and state-owned banks. The first one is the type of ownership (*SOE*), set at one if a firm is controlled by a government agency or a state-owned entity. The second one is political connectedness, set at one if the CEO or board chair of a firm is or was a

[9] The empirical results throughout the paper are qualitatively the same if we construct this variable using litigation records in the past four years or two years. Our data does not classify opponents in court into different types of stakeholders. For same cases, it is very difficult to manually classify them as the relationship between defendant and plaintiff in some lawsuits is very complicated. For instance, a firm could be a third party in a case as it provided some guarantee for one party in a certain transaction, or it might play both roles (seller and buyer) at the same time.

government bureaucrat (Fan et al., 2007; Calomiris, Fisman, and Wang, 2010). It is well-known that governments and state-owned banking sector favor SOEs and firms with political connectedness (Fan et al., 2007; Calomiris et al., 2010; Firth et al., 2009). In addition, the political connectedness of a firm also captures its accessibility to stakeholders, which suggests that the firm may engage in more business entertainment.

B. Control Variables

Managers and employees of firms may simply reimburse some expenses of their personal consumptions as a part of BEE. Thus, BEE may also reflect the severity of agency problems in firms. We therefore introduce a set of variables to capture the role of corporate governance in determining BEE. First, we use three variables to capture the quality of board of directors: *Fraction of outside directors* (the sum of independent directors and unpaid directors divided by total number of board directors), *Duality* (taking one if CEO and chairman are the same person, and zero otherwise), and *Board Size* (defined as the logarithm value of the number of board directors). These board characteristics have been shown by prior studies to be systematically related to the effectiveness of corporate boards in mitigating agency problems (e.g., Weisbach, 1988; Rosenstein and Jeffrey, 1990; Liu and Lu, 2007; Nguyen and Nielsen, 2010). Second, four variables are used to capture a firm's ownership structure because ownership helps to align the incentives of various corporate decision makers so as to enhance firm value (Jensen and Meckling, 1979; Lemmon and Lins, 2003; Sun and Tong, 2003). The ownership variables include *largest shareholder's ownership, managerial ownership, mutual funds' ownership,* and the ownership concentration ratio measured as the Herfindal index for the 2nd to 10th largest shareholders (*Herfindal index (2-10)*). In addition, we include a variable

to capture managerial compensation, defined as the ratio of the total remuneration of the top three executives divided by total assets (*Remuneration*), because effective managerial compensation can mitigate managerial agency problems by aligning their interests with those of shareholders.

We also include three other firm characteristics: firm size, book-to-market ratio and cash holding. Firm size is defined as the natural logarithm of total assets. Book-to-market is to capture firms' growth opportunity, which is computed as the natural log of book-to-market ratio (*lnB2M*). Cash holding is included because the firms with more cash should have a greater capacity to spend more on BEE. As *PCM* is highly correlated with ROA (0.61 in our sample, ROA is defined as net income divided by total assets), we do not include firms' profitability as an additional control variable. In addition, an index indicating the market development of a province is added to control for regional effects, which is obtained from Fang and Wang (2011) and widely used in prior Chinese studies (e.g., Jiang, Lee, and Yue, 2010). Finally, a set of year and industry dummies are used to capture the year and industry fixed effect.

C. Additional Control Variables for Disclosure Decisions

Since the disclosure of BEE is voluntary, we adopt the Heckman two-stage model to correct the self-selection bias when investigating the determinants of BEE. Specifically, we fit a model of disclosure decision and use the estimates to construct an inverse Mills' ratio (*IMR*). The *IMR* is then included as an additional explanatory variable to correct the self-selection bias. We also correct this bias when we examine effects of BEE on corporate outcomes in the next section.

In our model of disclosure decisions, we introduce three additional variables in order to meet the exclusion restriction of the Heckman two-stage model. As displayed in Panel A in Table B2, firms listed in the GME market in Shenzhen Stock Exchange are most likely to disclose BEE, while those in Shanghai Stock Exchanges have the lowest disclosure rates. We thus construct two dummies, set at one for firms listed in the GME market and for those listed on the Shanghai Stock Exchange, respectively. Panel A in Table B2 shows that the disclosure rate in the early years in our sample period is lower. We thus split our sample into two equal subsamples by their listing year and use a dummy variable of one to denote the firms listed in the early years (*Early listers*) and zero otherwise. We include these three additional variables, together with the other explanatory variables that we use to explain the variation in BEE (except for the variable of *firm age* as it is highly correlated with *Early listers*), to fit the disclosure decision.

2.2 Determinants of BEE

In our empirical analysis, BEE is scaled by total assets in percentage. We do not use sales to scale BEE as entertainment with non-market stakeholders like governments and creditors will not directly generate sales. Dividing BEE by sales thus may not be appropriate. Moreover, because most of corporate outcomes, such as ROA, are normalized by total assets, scaling BEE by total assets makes the interpretation of the results easier.

To construct *IMR*, we first estimate the disclosure decisions using a probit model and report the results in Column 1 in Table 2. The dependent variable is set at one if a firm has disclosed its BEE in a given year and zero otherwise. All explanatory variables are measured

concurrently so that we can keep as many observations as possible in the following tests.[10] As expected, early listers are less likely to disclose BEE, while firms listed in GME market are more likely to disclose it. The coefficient of Shanghai SE is in predicted sign, but insignificant.

Columns 2 to 3 report the estimates of the determinants of BEE using one year lagged explanatory variables. To capture time-varying industry characteristics, we control for the industry-year fixed effect in Column 2. Column 3 further includes the firm fixed effect. As we can see, the coefficients of all eight explanatory variables constructed to capture the transaction costs between firms and their stakeholders are in predicted signs in Column 2 and five of them are statistically significant. Specifically, firms with greater customer-base and supplier-base concentration, less reserve ratio of AR, higher leverage, and older age tend to have lower BEE. These results suggest that a part of BEE might be used to mitigate transaction costs in dealing with different stakeholders. The coefficients of SOE and political connectedness are positive, but statistically insignificant. Among variables of corporate governance, the fraction of shares held by the largest shareholders has significantly negative effect on BEE, while the coefficients of board size are significantly positive. These results suggest that BEE might be value-reducing. However, mutual funds' ownership and managerial compensation have significantly positive effect on BEE, which suggests that BEE could be value-enhancing.

Column 3 presents the estimates with the firm fixed effect. The coefficients of some variables become statistically insignificant, which are not surprising because these

[10] The results throughout the paper are qualitatively the same if we use one year lagged explanatory variables.

explanatory variables and BEE are highly persistent over time (the correlation between BEE and its one year lag is 0.87). Nevertheless, the estimates for several variables are still qualitatively similar to those in Column 2. For example, firms with lower customer-base concentration, higher industrial litigation risk and more reserve of receivables tend to have higher BEE. Two results are noteworthy. The coefficient of the fraction of outside directors is significantly negative, which suggests that BEE is reduced when a firm has more outside directors on its board. This implies that outside directors may help curb the abused part of the BEE by managers such as their personal consumption. The coefficient of political connectedness is significantly positive, which suggests that firms tend to have higher BEE when a newly appointed CEO or board chair is or was a government bureaucrat, probably because these firms have better access to their stakeholders.

[Table 2 here: Determinants of Disclosure Decision and BEE]

3. BEE and Firm Performance

3.1 Identification Strategy

The challenge to identify the causal effect of BEE on firm outcomes is that BEE is endogenous. Results from an ordinary least squares model could thus be biased. Besides using one year lagged explanatory variables, we employ an instrumental variable method to mitigate this concern. Following similar arguments in Nevo (2001) and Cai et al. (2011), we use the median BEE of other firms within the same industry at two-digit level in a given year as the instrument. Firms within the same industry share some common but unmeasurable factors that affect BEE, such as specific product attributes and industry regulations. Therefore, the industry median BEE is correlated with a firm's BEE but less likely affects its other

outcomes directly, except indirectly through BEE.[11] Indeed, the firm BEE is significantly related to the industry median BEE. The industry median BEE alone can explain about 12.05% of the total BEE variation, which is more than 48% of the total explained variation in BEE in Column 2 in Table 2. Therefore, the industry median BEE is a strong instrumental variable.

Our baseline model specification that examines the effect of BEE on firm outcomes is as follows:

$$Outcome_{i,j,t+1}=\alpha+\beta BEE_{i,j,t}+\gamma' Z_{i,j,t}+\delta_{j,t}+\varphi_i+\varepsilon_{i,j,t} \qquad (1)$$

where *i*, *j*, *t* index firm, industry and year, respectively. *Outcome* represents one of the outcomes considered in this study. *Z* is a vector of control variables defined in Appendix A. $\delta_{j,t}$ is a set of dummies for industry-year fixed effect, while φ_i is a group of dummies for firm fixed effect. We use the total assets at year t as the deflator when the *Outcome* is scaled by total assets. An advantage of this specification is that we can interpret the coefficient of BEE as β RMB increases in the outcome of interest at year t+1 given one RMB increase in BEE at year t. We cluster standard errors by firm in all regressions throughout the paper.

3.2 Results

We construct two variables to measure firm accounting performance: operating efficiency and profitability. Operating efficiency is defined as the ratio of sales to total assets, while profitability is measured as ROA. Table 3 presents the estimates of the effect of BEE on each proxy of firm performance in Panels A and B, respectively. The model specifications in both panels are the same. Column 1 in both panels reports estimates using OLS with industry-year fixed effects, while Column 2 adds the one year lagged dependent variable. In Column 3, we

[11] Similarly, Nevo (2001) argues that other regional average prices can serve as an instrument for the city-level price as both of them respond to the product's common marginal costs. Cai et al. (2011) also use the average entertainment and travel costs of other firms within the same city and industry as an instrument for a firm's costs.

further include firm fixed effect to control for any unobservable time-invariant firm characteristics that would affect firm performance. Column 4 reports the IV estimates. As the industry median BEE is highly persistent, we do not control for firm fixed effect in the IV estimation.

As expected, the coefficients of BEE are all significantly positive throughout all four columns in Panels A and B. These results indicate that BEE indeed improves firm performance. The effect of BEE on firm performance is not only statistically significant, but also economically prominent. Taking the smallest coefficient of BEE in Column 2 in both panels as examples, one RMB increase in BEE will bring firm 16.7 RMB in sales and 2.1 RMB in net profits.

Panel C in Table 3 relates BEE with firm valuation in the next year, measured as the ratio of the sum of the market value of equity and the book value of total liabilities at the end of April in year t+2[12] over the total assets at year t (Tobin's Q). As we can see, the coefficients of BEE are significantly positive throughout all four columns, which indicate that high BEE firms tend to have high firm valuation. The estimates in Column 2 suggest that one RMB increase in BEE will be associated with 36.6 RMB increase in firm valuation.

[Table 3 here: BEE, Firm Performance and Valuation]

3.3 A quasi-natural experiment

To further mitigate the endogenous concern, we use the anti-corruption campaign in China initiated by the Xi Administration at the end of 2012 - an exogenous shock that lead to a reduction in BEE of a firm especially for SOEs - as a quasi-natural experiment to

[12] The end of April at year t+2 is the deadline of releasing annual report in year t+1.

investigate how BEE affects firm performance. To some extent, the crackdown against corruption would lead to an exogenous decrease in accessibility to and/or an exogenous increase in the perceived cost involved in the entertaining government officials, which can consequently lead to a reduction in BEE of a firm. In addition, the Political Bureau of the Communist Party of China (CPC) Central Committee, on December 4, 2012, passed an Eight-provision regulation on how government employees and leaders of SOEs should improve their work style in eight aspects, focusing on rejecting extravagance and reducing bureaucratic visits, meetings and empty talks. As a result, it is reasonable to expect that there is a reduction in BEE after 2012, especially for SOEs. If BEE indeed improves firm performance, we would expect that the reduction in BEE would lead to the decline in firm performance and bigger drop in firm performance for SOEs.

We start with a univariate difference-in-difference (DiD) analysis in a sample of SOEs and matched non-SOEs based on the propensity score matching approach using the sample with non-missing value on BEE throughout all four years from 2011 to 2014, two years before and after the anti-corruption campaign. Since factors affecting BEE might largely change over time, using too early period as the benchmark is not appropriate. We thus exclude the sample before 2010 when performing propensity score matching procedure. Specifically, we estimate a probit model for each industry using the SOE dummy as the dependent variable and all variables used in explaining BEE as control variables, all measured at the year of 2012. To meet the parallel trends assumption of the DiD approach, we include BEE, Asset Turnover, ROA and Tobin's Q as additional explanatory variables, defined as the average value over years of 2011 and 2012. To better control industry

heterogeneity, we estimate the probit model by industry and then use the predicted probabilities, or propensity scores, perform a nearest-neighbor propensity score matching procedure with a common support. Specifically, we match each SOE to a non-SOE with the closest propensity score within the same industry. We end up with 247 one-to-one pairs of matched firms (988 observations).

Panel A in Table 4 reports the univariate difference-in-difference (DiD) test, with columns 1 and 2 displaying the differences in BEE, Asset Turnover, ROA, and Tobin's Q between pre- and post- anti-corruption periods for SOEs and matched non-SOEs, respectively. As expected, BEE has significantly declined for both SOEs and matched non-SOEs, the difference in declines between SOEs and matched non-SOEs in the last column indicates that SOEs experienced more reduction in BEE after 2012. Similarly, Asset Turnover and ROA for both SOEs and matched non-SOEs also dropped in the post anti-corruption period, while the drops for SOEs are bigger. Due to the bull market in 2013 and 2014, Tobin's Q for both groups increased in these two years relative to 2011 and 2012, but the increase in Tobin's Q is smaller for SOEs. Overall, SOEs experienced more decline in BEE, Asset Turnover, ROA and less increase in Tobin's Q than matched non-SOEs.

We next perform the DiD test in a multivariate regression framework to examine the effect of BEE on firm performance. Panel B reports the DiD regression estimates with Asset Turnover, ROA and Tobin's Q as dependent variables in Columns 1, 2 and 3, respectively. *After* is coded as a dummy variable, taking one for year 2013 and 2014 and zero otherwise. The interaction term SOE and *After* is the DiD estimate that captures the causal effect of BEE on firm performance. As expected, the coefficients of the interaction term are significantly

negative. These results confirm that BEE improves firm performance.

Panel C in Table 4 directly investigates the effect of the reduction in BEE on firm performance in post anti-corruption period. *More reduction in BEE* is defined as a dummy variable, taking one if the amount of BEE is less than 80% of the average of BEE in the past three years and zero otherwise. Among 3,421 firm-year observations, 275 firm-year observations experienced more than 20% reduction in BEE. As shown, more reduction in BEE leads to lower future firm performance. These results echo our previous findings that BEE improves firm performance.

[Table 4 here: The Xi Shock: A Quasi-natural Experiment]

4. BEE, Future Stock Returns and Unexpected Future Earnings

One may wonder whether the earnings information contained in BEE has been fully comprehended by market participates including investors and analysts. In this section, we investigate whether BEE can predict future stock returns and unexpected future earnings.

4.1 Future Stock Returns

Table 5 presents the predictability of BEE on future stock returns. In each year between 2004 and 2014, we sort firms into quintile portfolios based on BEE for each industry at two-digit level. We then compute future returns beginning from May 1 (yeart+1) through April 30 (year t+2). Four factor-mimicking portfolios (MKT, SMB, HML, UMD) are constructed in the same manner as Fama and French (1993) and Carhart (1997), but using the Chinese data. The risk free rate is defined as the concurrent demand deposit rate.

In Panels A and B in Table 5, all stocks are equal-weighted and value-weighted by tradable market capitalization, respectively. In each panel, alphas derived from the CAPM,

three-factor (Fama-French, 1993), and four-factor (Carhart, 1997) models are reported successively. The patterns of these portfolios' performance in both panels are largely similar, and it is monotonically increasing in Panel B. The top and bottom portfolios have the highest and lowest alphas. A trading strategy by longing the top quintile portfolio and shorting the bottom quintile portfolio can significantly generate profits across all models. For instance, the four-factor model indicates that this hedged strategy can earn 6.05% and 10.16% annual return for equal-weighted and value-weighted method, respectively.

We next perform the Fama-MacBeth regression analysis to examine the predictability of BEE on future stock returns. Following Jiang, Lee and Yue (2010), we construct the following control variables: R_MV (scaled quintile rank of market value at the end of April (t+1)), R_BM (scaled quintile rank of the book-to-market ratio), R_STDRET (scaled quintile rank of the standard deviation of daily returns during the month prior to portfolio formation), and R_LEV (scaled quintile rank of leverage, defined as total liability divided by total assets). Panel C in Table 5 reports the estimate. As expected, the coefficient of BEE is significantly positive, which reconfirms our findings in Panel A and B.

[Table 5 here: BEE and Future Stock Returns]

4.2 Unexpected Future Earnings

In this exercise, we relate BEE to unexpected future earnings to investigate whether BEE contains novel information about earnings that has not been realized by analysts. Following Mayew and Venkatachalam (2012), we regress unexpected future earnings (UE) on BEE and a set of control variables including an additional control, SD_FEPS, to capture the standard deviation of forecasted earnings in the past. Specifically, UE is defined as the analyst forecast

error (actual earnings per share minus the median earnings forecast from -12 months to two days prior to the earnings announcement) scaled by the stock price two days prior to the earnings announcement. SD_FEPS is the standard deviation of forecasted earnings per share from -12 months to two days prior to the earnings announcement. As only a part of public firms have been covered by analysts, the sample size is reduced to 5,696 observations in this exercise.

Table 6 presents the estimates with columns 1 and 2 reporting OLS and IV estimates, respectively. As expected, the coefficients of BEE in both columns are significantly positive, indicating that BEE has a significantly positive effect on unexpected future earnings. This result suggests that analysts also underestimate the predictability of BEE on future firm performance.

[Table 6 here: BEE and Unexpected Future Earnings]

5. How Does BEE Generate Benefits to Firms?

To explore how BEE improves firm performance, we look deeper by focusing on four main types of outside stakeholders including customers, suppliers, governments, and creditors in this section. Specifically, we propose two main channels through which BEE generates benefits to firms: reducing transaction costs for a firm with its stakeholders in private sectors and securing benefits from stakeholders in public sectors.

5.1 Reducing Transaction Costs with Stakeholders in Private Sectors

We test this hypothesis by investigating the effect of BEE on the litigation incidence with other firms, the quality of trade credit extended to customers, and the amount of trade credit acquired from suppliers. We will explain further below, to some extent all of them capture the

transaction costs of a firm dealing with other stakeholders in private sectors

Resolving disputes by court is one of the most costly ways for both trading counterparties as it may fundamentally damage their relation. The occurrence of legal disputes exhibits the disagreements on certain issues about transactions between trading counterparties due to the failure in coordinating and enforcing contracts. A better contract might be devised beforehand to avoid potential disagreements over transactions, and these disagreements can be alleviated during the implementation of contracts if trading counterparties understand each other better. We thus expect BEE to lower litigation incidence.[13]

The payments of trade credit suffer heavily from opportunistic behavior as no collateral is usually set in place to serve as an effective enforcement device. For this reason, the quality of trade credit extended to customers can capture the transaction costs that a firm faces in transaction with its customers, and the amount of trade credit acquired from suppliers can proxy the transaction costs that a firm suffers in dealing with its suppliers. Previous studies have shown that improved trust and information sharing help firms to improve the quality of trade credit and also facilitate its utilization (e.g., Smith, 1987; Petersen and Rajan, 1997). We thus expect BEE to improve the quality of trade credit extended to customers and help firms acquire more trade credits from suppliers.

Panel A in Table 7 presents the results, with odd columns reporting OLS estimates and even columns displaying IV estimates. The dependent variable in Columns 1-2 is a dummy variable set at one if a firm experiences any litigation dispute with other firms in the next year,

[13] Whether a firm won the case in court is a more complicated question and it is affected by many factors such as the characteristics of the other party in court. Our data set does not include information of the other party in court and many of them are unlisted firms. In addition, we have very little information on the characteristics of the case. We thus do not examine the effect of BEE on the winning rate in court. Interesting readers could check Lu, Pan and Zhang (2012), who examine the determinants of winning a legal dispute in court.

and zero otherwise. In Columns 3-4, the dependent variable is the quality of trade credit extended to customers, which is defined as the ratio of the provision for bad account receivables (AR) to total AR (*Reserve ratio of AR*). The *Reserve ratio of AR* is essentially an expected default rate of AR. The dependent variable in Columns 5-6 is the trade credit from suppliers defined as the ratio of account payables (AP) at year t+1 to total assets at year t. As predicted, the coefficients of BEE in all columns in Panel A are statistically significant in predicted signs. Specifically, the results show that BEE can significantly lower litigation incidence with other firms, improve the quality of trade credit extended to customers, and help firms acquire more trade credit from suppliers. These results suggest that BEE can generate benefit to firms by mitigating transaction costs with stakeholders in private sectors.

To further investigate whether reducing transaction costs is the underlying mechanism driving the results in Panel A, we next sort firms into high vs. low transaction costs subsamples according to the level of transaction costs faced by a firm. We expect the effect of BEE on these three outcomes to be stronger for the high transaction cost subsample. For litigation incidence with other firms, we use related party transactions as the sorting variable. As firms with more related party transactions tend to rely less on market transactions, it is reasonable to expect that these firms tend to face less transaction costs in their operations, particularly on legal disputes. For trade credit with customers and suppliers, we use customer-base and supplier-base concentration as the sorting variables, respectively. The higher customer-base (supplier-base) concentration, the lower transaction cost faced by a firm with its customers (suppliers).

Panel B in Table 7 reports the subsample estimates. Unless otherwise specified, we sort

firms into terciles and keep the top and bottom tercile only when the sorting variable is a continuous one throughout this study. As expected, the effects of BEE on these three outcomes are all significantly stronger for high transaction costs subsample. These results further corroborate that reducing transaction costs with stakeholders in private sectors is one channel through which BEE generates benefit to firms.

[Table 7: Reducing Transaction Costs with Stakeholders in Private Sectors]

5.2 Securing Benefits from Stakeholders in Public Sectors

We test this hypothesis by investigating the effect of BEE on government subsidy, which is subject to applications and assessed by government agents who enjoy substantial discretion in their decision-making because the related decision-making requires not only hard information but also soft information.[14] The reliance on soft information opens the door for entertainment activities to influence decision-making, because it can facilitate the sharing of soft information.

Entertainment activities can also influence decisions made by the agent because of the agency problems. Given the divergence in interests between agents and their agencies, it is possible for them to provide better terms to firms who have made them happy through entertainment activities. We thus expect BEE to help firms secure benefit from stakeholders in public sectors, and the effect to be stronger when government officials are in their early tenure.

Since some subsides are granted by local government, we include a firm fixed effect when examining the effect of BEE on subsidies so as to control for different local policies on

[14] Government subsidy is the only systematic information that we can find, which is at the discretion of government officials. Contracts from governments could be another good angle to examine how BEE affects the transaction with governments. To our best knowledge, this information is not available for Chinese public firms.

subsidies. Table 8 reports the estimates. The dependent variable is calculated as the amount of government subsidy received at year t+1 scaled by total assets at year t. Columns 1 and 2 display OLS and IV estimates using the full sample. As expected, the coefficients of BEE in both columns are significantly positive, which suggest that high BEE firms tend to get more subsidies from governments.

We next partition firm-year observations into hard vs. easy favor-securing firm-year observations according to the tenure of local government officials. As government subsidy is subject to applications and assessed by government agents, who have substantial discretion in their decision-making, we expect the relation between BEE and subsidy to be stronger when government officials are in their early tenure. The reason is that officials may not have established their own patronage and networks in their early tenure and thus have more room to offer favors to various new constituents (Macey, 1993), or they tend to have less solid political power in their early tenure and therefore subject to stronger influences from lobbying groups (Rausser and Zusman, 1998). In addition, BEE could also serve as information intermediary as officials and firms tend to suffer more information problem in an official's early tenure.

We construct two variables to capture the change of governments. One is at the central government level, which is in charge of macro policy-making. Chinese national party election and government election are spread in two consecutive years. In our sample period, national party election was held in 2007 and 2012, while national government turnover was in 2008 and 2013. We thus define these four years as early period, and the rest of years as late period. The second proxy is defined at the prefecture government level. We focus on governments at

the prefecture level rather than the provincial because it will give us more variation in turnover years as the turnover of the provincial government tends to be more clustered. Unlike the fixed tenure for national leaders, there is no fixed tenure for the mayor and secretary of the communist party of China at the prefecture level. We define the early (late) period as years that both the mayors and the party secretaries are in the first two years (third to fifth year) of their tenure in the office. Mayors and party secretaries are the heads of governments and parties at the prefecture level, who both have influence on subsidy allocation.

Columns 3-6 in Panel A in Table 8 report the subsample estimates. As expected, the effects of BEE on subsidy are significantly stronger during national election years and when local government officials are in their early tenure. These results suggest that BEE can benefit firms by securing benefit from public sectors.

[Table 8: Securing Benefit from Stakeholders in Public Sectors]

5.3 *Reducing Transaction Costs and Securing Benefit in Hybrid Sectors*

The banking sector in China is de facto a hybrid sector. Similar to other profit-driven organizations in private sectors, Chinese banks also intend to pursue profits for their shareholders. Meanwhile, they are predominantly state-owned entities and significantly affected by governments for various political and social objectives (e.g., Jin and Qian, 1998; Firth et al., 2009; Song, Storesletten, and Zilibotti, 2011). In this section, we explore whether BEE can generate benefit to firms through both channels – reducing transaction costs and secure benefit.

To ensure a certain loan will be repaid on time, banks usually ask for some collateral to

secure the lending based on the creditworthiness of borrower, which will be evaluated by loan officer based a set of information including hard as well as soft information (Berger et al., 2005; Agarwal and Hauswald, 2010). For this reason, BEE may matter in the collateral decisions as it entertainment activities can facilitate the sharing of soft information.

We measure the required collateral on bank borrowings by focusing on the ratio of collateralized loans divided by total loans at year t+1.[15] Data on collateral on bank borrowing is available since 2006 and it is a voluntary disclosed item. We only successfully find 6,199 firm-year observations after merging with our main dataset.

To control for the default risk, we introduce an additional control variable, the Z-Score to control for potential default rate. Following Altman (2005), we use the following Z-Score formula for emerging markets to measure the expected default risk:

$$Z\text{-}Score_{i,t} = 6.56\ X_{1,i,t} + 3.26\ X_{2,i,t} + 6.72\ X_{3,i,t} + 1.05\ X_{4,i,t} + 3.25 \qquad (2)$$

where X_1 to X_4 are defined as working capital, retained earnings, operating income and book value of equity scaled by total assets, respectively. The higher the Z-Score, the less likely a firm will default. As a long-term loan is more likely to be required for collateral than a short-term loan as the former is riskier to banks, we also add the ratio of long term loan to total loan as an additional explanatory variable.

Table 9 present the estimates. Columns 1 and 2 in Panel A display OLS and IV estimates using full sample. As predicted, the coefficients of BEE in both columns are significantly negative, which suggest that BEE can significant lower collateral requirement on bank borrowings.

[15] Getting new loans and/or lowering interest rate of borrowings are other benefits that a firm can get from creditors. Unfortunately, we are unable to estimate the amount of new loan granted in each year. Interest rate on bank borrowings is also not mandatory to disclose.

We next investigate the role of financial constraint in mediating the effect of BEE on collateral requirement. For financial constrained firms, it is harder to assess their default risk. Therefore, the lending decisions relating to these firms require more soft information and personal judgments than financially healthy firms. For this reason, these firms suffer high transactions costs in acquiring bank loans such as providing more information about firms to make creditor believe its creditworthiness. Entertainment activities can help to reduce the information asymmetry and mitigate the risk perceived by loan officers, which eventually reduce transactions costs. We use two methods to define whether a firm is financial constrained. The first one is the Z-score that we defined before. For each year, we sort firms into terciles by the Z-score. Firms in the top (bottom) tercile are financial unconstrained (constrained) firms. The second proxy is a dividend payout policy in a given year. Firms paying dividends are regarded as unconstrained ones, while firms not paying dividend are constrained ones. As the estimates in columns 3 -6 in Panel A show that, the effect of BEE on lowering collateral requirement is significantly stronger for financial constrained firms for both proxies.

We next test whether BEE can lower collateral requirements due to the discretion enjoyed by loan officers. The previous literature has documented that state-owned bank sectors favor SOEs and politically connected firms (e.g., Jin and Qian, 1998; Khwaja and Mian, 2005; Firth et al., 2009; Song et al., 2011). We thus expect SOEs and firms with political connectedness are more capable of securing benefit using BEE. That is the benefit of BEE on reducing collateral requirement on bank loans is stronger for SOEs and politically connected firms. Panel B in Table 9 presents the subsample estimates. As expected, the effects of BEE

on lowering collateral requirement are stronger for SOEs and firms with political connectedness.

[Table 9: Reducing Transaction Costs and Securing Benefit in Hybrid Sectors]

6. What Factors Prevent Firms from Spending More BEE?

In this section, we investigate why firms do not invest more in BEE given that the marginal effect of BEE on firm value is significantly positive. Theoretically, we should observe an insignificant relation between BEE and firm value if firms expend BEE to maximize their firm value. In other words, in an unconstrained maximization problem, firms would spend BEE so as to maximize the firm value. We propose two factors to explain why firms may stop investing in BEE: the accessibility of a firm to its key stakeholders and the existence of managerial agency problem.

6.1 The accessibility to key decision makers of stakeholders

We should be cautious when interpreting the findings on the positive effect of BEE on firm value. Because firms do not have perfect access to the key decision makers of their stakeholders, they would stop spending BEE even if BEE would still enhance firm value. In other words, without knowing the stakeholders well, entertaining them may not bring about sufficient benefits for the firm, which could be dominated by the cost of BEE. Therefore, firms with better accessibility to key stakeholders are more likely to spend more on BEE, and thus the marginal effect of BEE on firm performance for them is smaller. We test this prediction by splitting the sample into high vs. low accessibility of firms to their stakeholders.

We construct two variables to capture a firm's accessibility to its stakeholders. The first one is whether a firm has political connectedness. Relative to people without political

connectedness, it is reasonable to believe that people with political connectedness have better access to their stakeholders from public sectors such as government agencies and banks. For stakeholders in the private sectors such as customers and suppliers, people with political connection may also have better access as they can help stakeholders in the private sectors to get access to stakeholders in the public sectors, who could affect firms in many aspects. The second proxy of a firm's accessibility is firm size. Large firms tend to have higher economic and political influence than small firms on government because they pay more taxes and provide more employment. Large firms tend to be big customers to their suppliers and have higher bargaining power over their customers than small firms. Therefore, large firms have better access to their stakeholders in both the private sector and the public sector.

Table 10 presents the estimates on the accessibility to key stakeholders, with Panels A, B and C using Asset Turnover, ROA, and Tobin's Q as dependent variables, respectively. The sorting variables are firms' political connectedness and firm size in Columns 1 - 4 and 5 - 8, respectively. Columns 1 - 2 and 5 - 6 present OLS estimates, while columns 3 - 4 and 7 - 8 report IV estimates. As expected, the coefficients of BEE are only positively significant for small firms and those without political connectedness except for columns 3 and 5 in Panel A when Asset Turnover is used as the dependent variable, while the positive effects of BEE on Asset Turnover are still expectedly smaller for big firms and those with political connectedness. These results confirm that the accessibility to key stakeholders is one factor preventing firms from expanding their BEE to enhance firm value.

[Table 10: Accessibility to Stakeholders]

6.2 The existence of managerial agency problem

The second factor that impedes a firm from spending more BEE is the existence of managerial agency problem, which suggests that the agent would be motivated to act in his own best interests instead of those of the principal. Managers probably make less effort to entertain stakeholders as they may benefit little from entertainment if they do not have enough stake in the firm. Their personal benefit from entertainment could be even negative considering entertaining stakeholders may not be pleasant all the time and the perception from colleagues and shareholders could be negative.

Managers and shareholders can be interest aligned by ownership and managerial monetary incentive scheme. We thus follow previous studies using managerial shareholding (e.g., Agrawal and Knoeber, 1996) and the existence of a managerial incentive scheme (e.g., Bebchuk and Fried, 2003) as two proxies to measure interest alignment between managers and shareholders. Firms with more managerial shareholding or have managerial incentive plan tend to be more interest aligned between managers and shareholders.

Table 11 reports the estimates on the managerial agency problem, with Panels A, B and C using Asset Turnover, ROA, and Tobin's Q as dependent variables, respectively. Columns 1 - 2 and 5 - 6 present OLS estimates, while columns 3 - 4 and 7 - 8 report IV estimates. In columns 1 - 4, the sorting variable is whether a firm has a managerial incentive scheme. As expected, the coefficients of BEE are only positively significant for firms without managerial incentive scheme, which is consistent with the hypothesis that managerial agency problem could be a factor constraining firms from increasing their BEE to improve firm value.[16]

[16] Firms with managerial incentive scheme may have implicitly incentive scheme before. Therefore, using their observations without explicitly incentive scheme may not appropriate. After excluding these observations, we repeat the analyses and find qualitatively the same results. One may argue that firms were self-initiated incentive schemes and they may be systematically different from firms without managerial incentive scheme at all in our entire sample period. Therefore, using these firms as the control group might not be appropriate. After excluding these firms, we repeat the analyses and find

Columns 5 - 8 display estimates using managerial shareholding as the sorting variable. The coefficients of BEE are only positively or less significant for firms with less managerial shareholding when Asset Turnover or ROA as the dependent variable. There is no significant difference in the coefficients of BEE between high and low managerial shareholding subgroups when using Tobin's Q as the dependent variable. Overall, these results are largely consistent with the hypothesis that managerial agency problem could be one factor preventing firms from expanding their BEE.

[Table 11: Managerial Agency Problem]

7. Conclusion

Entertaining business stakeholders is one of long-standing and prevalent corporate activities. Given its history, magnitude and discretionary nature, it is necessary to understand why firms entertain their business stakeholders and what real impacts it may have on firms. This paper performs the first systematic study on the determinants and impacts of BEE on firm performance and the underlying mechanism.

We find that BEE can improve firm operating efficiency, profitability and valuation. However, the performance implications of BEE have not been fully anticipated by investors and analysts. We further find that BEE can help firms reduce litigation incidence with other firms, improve the quality of trade credit, acquire trade credit from suppliers, secure more government subsidy, and lower requirement on collateral for bank borrowings. Further analyses support two channels that drive these outcomes: mitigating transaction costs with shareholders in private sectors and securing favors from stakeholders in public sectors. At last,

essentially the same results. In addition, we also use managerial remuneration as the sorting variable and find qualitatively the same results.

we documents evidence to support that the accessibility to stakeholders and the existence of managerial agency problem prevent firms from increase BEE to maximize benefit from BEE. Overall, our study suggests that entertainment activities can generate benefit to firms from various stakeholders and eventually improve firm value, while the accessibility to key stakeholders and existence of managerial agency problem prevent firms from utilizing BEE as value-enhancing approach.

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Appendix A. Data Collection Procedure

According to Chinese accounting principles, BEE is a secondary accounting item which may be reported in the notes of accounts of the following three sections: "Management Expenses" and "Sales Expenses" Sections in the Income Statement, and "Other Cash Payments for the Expenses Related to Operating Activities" (hereafter "Other Cash Payments") section in the Cash flow Statement. For the entries in the Income Statement, BEE is the amount spent on entertainment activities in a given fiscal year, which is listed under management expenses section and/or sales expenses section. During our data collection, we find that some firms report BEE only under the management or sales expenses, which suggest that it may be difficult for some firms to separate BEE into management expenses and sales expenses or it is just no big enough to be listed independently. BEE in the "Other Cash Payments" is the total amount that a firm actually paid for entertainment activities in a particular year. Table A1 below presents a typical example of how data on BEE is extracted from a firm's annual reports. Three features are noteworthy from this example. First, some expense items are aggregated and listed under the item of "Others". This item may include BEE if it is not disclosed independently. Thereby, it does not necessarily mean that a firm has spent zero on BEE if it has not been listed separately. Second, a firm may disclose BEE in the last year as a reference at the same time but this may not be the case for all firms in all years. Third, the sum of entertainment expenditure listed under the "Management Expenses" and "Sales Expense" sections should be equal to the amount as reported under the "Other Cash Payments" sections if BEE was paid in a given year including all and only those incurred concurrently. Nevertheless, we find that a few observations with data from these two sources do not match with each other. Panel A in Table A2 presents the distribution of firms with BEE

by year and market.

[Insert Table B1 here]

Based on disclosure practices, we define BEE for a firm in given year using following procedures. Panel B in Table A2 displays the distribution of firms with BEE by year and type of account. We classify all disclosure situations into three types. For Type 1 in Panel B, BEE is disclosed under both sections of "Management Expenses" and "Sales Expenses" in the Income Statement. We take the sum of the amounts as disclosed BEE under both sections as the total BEE. For Type 2, BEE is only disclosed in either one of expenses accounts or "Other Cash Payments" account, we take the disclosed BEE as the total BEE.[17] For Type 3, BEE is only disclosed in the "Other Cash Payments" section in the Cash Flow Statement and one expense account in the Income Statement. We compare them and take the larger one as the total BEE. Our choice is due to the consideration that BEE might be aggregated into the item of "Others" if there is no BEE disclosed under the other expenses account.[18]

To ensure the quality of our data on BEE, twelve graduate students majoring in accounting or finance from two well-known universities in mainland China were split into two groups, who collect the data independently. We then compare the data collected by these two groups of students to identify the inconsistent observations. The students are then required to look into the problematic observations and correct the inconsistencies that have been identified. To further guarantee the quality of the data, one of the coauthors double checked all the data by comparing the numbers with those appeared in the annual reports.

[17] BEE is normally classified as one of management expenses. Our empirical results throughout the paper remain qualitatively the same if we drop observations of Type 2-2.

[18] In the robustness test, we also take the average of BEE if the sum of BEEs from two expenses account is not equal to the amount listed in the "Other Cash Payments" account, or drop observations of Type 3-2. Our empirical results remain qualitatively the same.

[Insert Table B2 here]

Table A1. Extract of the Financial Reports with Data on BEE

Stock code: 002370. Year: 2012. Unit: 1RMB.

Sales Expense

Items	current year	last year
Wage	2,876,444.99	3,961,576.83
Travel costs	33,937,028.46	30,504,642.02
Transportation costs	7,951,305.48	6,635,643.27
Sales discount costs	2,663,771.16	1,782,702.69
Advertising and promotion costs	227,370.71	424,703.21
Postal costs	180,256.67	234,392.76
Business entertainment expenses	166,525.00	43,357.50
Conference costs	524,796.37	937,453.53
Others	2,706,148.85	1,124,088.17
Total	51,233,647.69	45,648,559.98

Management expenses

Items	current year	last year
R&D	18,681,360.49	14,446,714.93
Wage	14,424,277.08	11,918,789.10
Depreciation and amortization	4,758,692.43	3,726,823.50
Taxes	2,583,811.62	2,340,730.18
Travel costs	994,936.66	2,404,738.81
Vehicle use costs	994,838.23	1,052,120.13
office costs	1,448,245.42	1,091,721.35
Business entertainment expenses	812,989.40	1,125,236.31
Others	1,692,664.06	1,993,460.78
Total	46,391,815.39	40,100,335.09

Other Cash Payments for The Expenses Related to Operating Activities

Items	current year
Travel costs	34,931,965.12
Transportation and postal costs	8,131,562.15
Business entertainment expenses	979,514.40
office costs	1,448,245.42
Vehicle use costs	994,838.23
Advertising and promotion costs	225,870.71
Fine expenses	1,069,701.66
Others	1,784,515.11
Total	49,566,212.80

Table A2. Distribution of Firms with BEE by Year, Market and Types of Account

Year	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total
Panel A. # Firms with BEE by year										
# Firms with BEE	473	487	550	623	652	1,258	1,555	1,793	1,872	9,263
% Disclosure rate	35.22%	36.32%	39.34%	41.95%	42.15%	76.71%	78.65%	79.55%	77.64%	60.16%
Shanghai Stock Exchange										
# Firms with BEE	278	290	301	317	318	630	654	676	682	4,146
% Disclosure rate	33.90%	35.63%	36.57%	38.29%	38.36%	75.90%	77.12%	76.56%	74.86%	54.65%
Shenzhen stock EX (SME market)										
# Firms with BEE	195	197	249	306	334	596	770	871	891	4,409
% Disclosure rate	37.28%	37.38%	43.30%	46.58%	46.52%	77.00%	78.89%	79.91%	77.82%	63.12%
Shenzhen stock EX (GEM market)										
# Firms with BEE	N.A.	N.A.	N.A.	N.A.	N.A.	32	131	246	299	708
% Disclosure rate						88.89%	85.62%	87.54%	84.23%	85.82%
Panel B. # Accounts disclosed BEE by year										
# Other Cash Payment	460	476	534	590	607	632	728	751	763	5,541
# Management Expense	26	25	42	67	78	1,075	1,394	1,641	1,698	6,046
# Sales Expense	8	9	26	38	47	605	833	1,014	1,051	3,631
Type 1: # Disclosed in both expenses account	5	6	22	28	33	570	780	943	959	3,346
Type 1-1: #Disclosed in "Other Cash Payment" account as well	4	4	16	20	23	272	366	398	398	1,501
Type 2: # Disclosed only in one expense or "Other Cash Payment" account	456	468	515	571	595	476	521	578	630	4,810
Type 2-1: # Disclosed only in the account of Management Expense	10	8	8	18	27	307	380	452	484	1,694
Type 2-2: # Disclosed only in the account of Sales Expense	2	1	2	7	8	21	33	45	64	183
Type 2-3: # Disclosed only in "Other Cash Payment" account	444	459	504	546	560	148	108	81	82	2,932
Type 3: # Disclosed in one expenses account and "Other Cash Payment" account	12	13	14	24	24	212	254	272	283	1,108
Type 3-1: # Disclosed in the account of Management Expense	11	11	12	21	18	198	234	246	255	1,006
Type 3-2: # Disclosed in the account of Sales Expense	1	2	2	3	6	14	20	26	28	102

Appendix B. Variable Definitions

Variable	Definition and Data Source
BEE(Dummy)	Disclosure decision, a dummy variable equals one if a firm disclosed business entertainment expenditure in a given year.
BEE	The ratio of business entertainment expenditure to total assets in percentage. Winsorized at 1% and 99% levels. Source: Manual collection.
Corporate Outcomes	
Asset Turnover	Sales at year t+1 divided by total assets at year t. Winsorized at 1% and 99% levels. Source: CSMAR database.
ROA	Net income at year t+1 divided by total assets at year t. Winsorized at 1% and 99% levels. Source: CSMAR database.
Tobin's Q	Tobin's Q, which is defined as the ratio of the sum of the market value of equity and the book value of total liabilities at the end of April in year t+1 over total assets at year t. Winsorized at 1% and 99% levels. Source: CSMAR databases.
UE	Unexpected future earnings are measured as the analyst forecast error scaled by the stock price two days prior to the earnings announcement. The Forecast error is defined as the actual earnings per share minus the median earnings forecast from -12 months to two days prior to the earnings announcement. Winsorized at 1% and 99% levels. Source: CSMAR database.
Reserve ratio of AR	Total reserves for long-term account receivables divided by total long-term account receivables. Winsorized at 1% and 99% levels. Source: CSMAR database.
AP/TA	Account payables at year t+1 divided by total assets at year t. Winsorized at 1% and 99% levels. Source: CSMAR database.
Subsidy/TA	Government subsidy at year t+1 divided by total assets at year t in percentage. Winsorized at 1% and 99% levels. Source: iFind database.
Collateral	Collateralized bank borrowings divided by total bank loans. Winsorized at 1% and 99% levels. Source: CSMAR database.
Litigation incidence	A dummy variable equals one if a firm has any lawsuits in the next year, and zero otherwise. Source: Wind database.
Other Firm Characteristics	
Early Listers	A dummy variable equals one if a firm was listed in the early years among all public firms for each year, and zero otherwise.
GME market in Shenzhen SE	A dummy variable equals one if a firm is listed at the GME market in Shenzhen Stock Exchange, and zero otherwise.
Shanghai SE	A dummy variable equals one if a firm is listed in Shanghai Stock Exchange, and zero otherwise.
Customer-base concentration	Fraction of sales to top five customers in a given year. Source: GW database.
Supplier-base concentration	Fraction of procurements from top five suppliers. Source: Source: GW database.
RPT/TA	The ratio of total transactions with related parties to total assets. Winsorized at 1% and 99% levels. Source: CSMAR database.
Litigation risk	A dummy variable equals one if a firm experienced more lawsuits than its industry median in the past three years, and zero otherwise. Source: Wind database.
Reserves of receivables	Total reserves for account receivables divided by total assets in percentage. Winsorized at 1% and 99% levels. Source: CSMAR database.

SOE	A dummy variable equals one if a firm's ultimate controller is a government agency or legal entity controlled by governments, and zero otherwise. Source: CSMAR database.
Political connectedness	A dummy variable equals one if the CEO or board chair of a firm is or was a government bureaucrat following Fan et al. (2007) and Calomiris et al. (2010). Source: Manual collection.
Leverage	Total liabilities divided by total assets. Winsorized at 1% and 99% levels. Source: CSMAR database.
Firm age	Natural logarithm of the number of years since a firm is established. Source: CSMAR database.
PCM	Price cost margin, defined as sales minus cost of goods sold (COGS) and selling, general and administrative expenses (SGA), divided by sales. Winsorized at 1% and 99% levels. Source: CSMAR database.
Fraction of outside directors	The proportion of outside directors defined as the sum of unpaid and independent directors. Source: CSMAR database.
Duality	A dummy variable equals one if a firm's CEO and chairman are the same person, and zero otherwise. Source: CSMAR database.
Board Size	Natural logarithm of number of board directors. Source: CSMAR database.
Largest shareholder's ownership	Fraction of largest shareholder's ownership. Source: CSMAR database.
Managerial ownership	Fraction of shares held by the managers. Source: CSMAR database.
Mutual funds' ownership	Fraction of shares held by mutual funds. Source: CSMAR database.
Herfindahl index (2-10)	Herfindahl index, defined as the sum of the square of the fraction of shares held by the 2nd to 10th largest shareholders. Source: CSMAR database.
Remuneration	The ratio of total remuneration of top three executives divided by total assets in percentage. Winsorized at 1% and 99% levels. Source: CSMAR database.
lnMKV	Natural logarithm of firm market value. Winsorized at 1% and 99% levels. Source: CSMAR database.
lnB2M	Natural logarithm of the ratio of the book value of equity to the market value of equity. Winsorized at 1% and 99% levels. Source: CSMAR database.
Cash holding	Cash and equivalents divided by total assets. Winsorized at 1% and 99% levels. Source: CSMAR database.
Marketization index	An annually aggregate index measuring the development of the regional market at the provincial level. The higher this index, the greater regional Marketization index. The latest available data is 2009. We thus use the data of 2009 for the years from 2010 to 2012 in our analyses. Source: Fan and Wang (2011)
SD_FEPS	Standard deviation of forecasted earnings per share from -12 months to two days prior to the earnings announcement. Winsorized at 1% and 99% levels. Source: CSMAR database.
Ratio of long term loan	Long term bank loans divided by total bank loans. Winsorized at 1% and 99% levels. Source: CSMAR database.
Z-Score	Firm financial health, calculated using the formula in Altman (2005). Winsorized at 1% and 99% levels.
IMR	Inverse Mill's ratio constructed using the estimates of the determinants of BEE disclosure decision in Column 1 in Table 2. Winsorized at 1% and 99% levels.

Table 1. Summary Statistics

This table presents the summary statistics for the sample firms between 2004 and 2012. Panel A and B provide the summary statistics of BEE by year and industry, respectively. The 21 industries are based on the official industry classification of the China Securities Regulatory Commission. Panel C reports the summary statistics for the main variables used in this paper. All variables are defined in the Appendix A.

Panel A. Summary statistics of BEE by year

year	#Firm-year	%Disclosure	% BEE/TA			% BEE/Sales			% BEE/Operating Profit		
	with BEE	rate	Mean	Median	S.D.	Mean	Median	S.D.	Mean	Median	S.D.
2004	437	36.06	0.23	0.17	0.22	0.46	0.27	0.56	10.17	4.30	21.53
2005	441	36.63	0.24	0.18	0.22	0.46	0.28	0.55	12.72	5.27	25.30
2006	498	39.81	0.24	0.19	0.23	0.43	0.28	0.49	10.98	4.32	20.76
2007	570	43.35	0.25	0.18	0.24	0.45	0.27	0.61	9.38	3.39	24.12
2008	560	43.34	0.26	0.19	0.26	0.49	0.29	0.65	10.98	4.22	24.25
2009	836	76.84	0.25	0.17	0.26	0.52	0.32	0.64	11.17	4.03	23.63
2010	1,409	79.16	0.26	0.18	0.26	0.54	0.33	0.65	9.07	3.67	19.15
2011	1,667	79.99	0.28	0.19	0.27	0.57	0.34	0.70	10.38	4.00	22.10
2012	1,834	80.37	0.28	0.19	0.27	0.59	0.36	0.69	11.21	4.53	22.66
2013	1,819	78.61	0.26	0.17	0.27	0.56	0.33	0.69	12.31	4.49	25.42
2014	1,648	76.62	0.22	0.14	0.25	0.52	0.28	0.72	11.09	3.86	24.42
Total	11,719	65.20	0.26	0.18	0.26	0.53	0.32	0.67	10.87	4.12	23.06

Panel B. Summary statistics of BEE by industry

Industry	#Firm-year	%Disclosure	% BEE/TA			% BEE/Sales			% BEE/Operating Profit		
	with BEE	rate	Mean	Median	S.D.	Mean	Median	S.D.	Mean	Median	S.D.
Information Technology	942	70.93	0.51	0.39	0.40	1.10	0.80	1.00	17.87	7.75	29.73
Pharmaceutical Products	805	67.82	0.35	0.26	0.31	0.69	0.45	0.74	11.35	4.20	23.76
Communication & Culture	152	76.00	0.31	0.23	0.25	0.64	0.45	0.57	9.40	3.30	22.40
Machinery	2,411	70.09	0.29	0.22	0.25	0.60	0.41	0.61	12.68	5.30	24.50
Retail & Wholesale	562	61.29	0.22	0.20	0.15	0.30	0.17	0.53	9.08	4.50	16.06
Other Manufacturing	127	63.82	0.34	0.19	0.36	0.60	0.30	0.77	12.13	4.67	23.55
Electronic	618	62.93	0.26	0.18	0.26	0.52	0.33	0.57	10.48	4.18	22.21
Agriculture	286	72.59	0.22	0.17	0.16	0.59	0.37	0.79	16.14	6.07	31.29
Food	475	63.50	0.24	0.17	0.22	0.37	0.27	0.36	9.02	3.09	23.66
Construction	251	62.28	0.19	0.17	0.13	0.30	0.24	0.24	8.91	5.38	11.72
Social Services	273	58.21	0.24	0.16	0.25	0.68	0.41	0.85	7.63	3.26	19.56
Apparel	446	62.03	0.20	0.15	0.17	0.37	0.23	0.48	9.76	3.74	20.20
Gas and Chemistry	1,399	69.29	0.21	0.15	0.19	0.35	0.22	0.50	9.06	3.71	20.55
Furniture	53	69.74	0.20	0.14	0.16	0.30	0.25	0.18	8.60	4.35	12.03
Printing	215	61.96	0.22	0.14	0.22	0.41	0.27	0.44	8.65	4.12	16.05
Metal	1,015	63.36	0.18	0.13	0.18	0.35	0.20	0.54	12.49	3.63	27.98
Transportation	257	57.75	0.19	0.13	0.24	0.51	0.40	0.49	7.46	2.91	18.84
Conglomerate	315	50.32	0.20	0.13	0.21	0.65	0.37	0.75	12.13	3.90	27.09
Mining	311	67.32	0.16	0.11	0.17	0.33	0.19	0.39	4.58	1.44	12.95
Real Estate	444	57.07	0.13	0.08	0.17	0.63	0.34	0.85	5.28	1.99	13.42
Utilities	362	57.28	0.10	0.07	0.10	0.31	0.19	0.34	5.01	1.98	12.81

Panel C. Firm Characteristics					
	Mean	S.D.	25th Percentile	Median	75th Percentile
Corporate Outcomes					
Asset Turnover	0.831	0.645	0.431	0.671	1.021
ROA	0.057	0.082	0.015	0.043	0.086
Tobin's Q	3.290	2.401	1.603	2.447	4.020
UE	-0.746	1.437	-0.940	-0.267	0.000
Reserve ratio of AR	0.121	0.165	0.050	0.068	0.115
AP/TA	0.106	0.084	0.046	0.085	0.142
Subsidy/TA	0.581	0.956	0.024	0.231	0.679
Collateral	0.413	0.314	0.141	0.342	0.649
Litigation incidence	0.114	0.318	0.000	0.000	0.000
Other Firm Characteristics					
Customer-base concentration	0.308	0.229	0.138	0.243	0.420
Supplier-base concentration	0.372	0.222	0.202	0.324	0.502
RPT/TA	0.240	0.356	0.021	0.124	0.316
Litigation risk	0.235	0.424	0.000	0.000	0.000
Reserve of receivables	1.066	1.775	0.146	0.519	1.224
SOE	0.502	0.500	0.000	1.000	1.000
Political connectedness	0.303	0.459	0.000	0.000	1.000
Leverage	0.180	0.152	0.040	0.160	0.285
Firm age	2.525	0.436	2.303	2.565	2.833
Price-cost margin	0.093	0.151	0.034	0.085	0.160
Fraction of outside directors	0.602	0.190	0.444	0.571	0.778
Duality	0.197	0.398	0.000	0.000	0.000
Board size	2.292	0.183	2.197	2.303	2.303
Largest shareholder's ownership	0.369	0.157	0.244	0.350	0.485
Managerial ownership	0.089	0.183	0.000	0.000	0.031
Mutual funds' ownership	0.039	0.068	0.000	0.008	0.046
Herfindahl index (2-10)	0.020	0.025	0.002	0.009	0.029
Remuneration	0.070	0.096	0.021	0.045	0.089
lnMKV	21.364	1.221	20.513	21.340	22.114
lnB2M	-0.430	0.911	-0.995	-0.399	0.207
Cash holding	0.196	0.155	0.087	0.150	0.258
Marketization index	8.824	2.086	7.330	8.930	10.420
SD_FEPS	0.109	0.106	0.035	0.072	0.143
Ratio of long term loan	0.268	0.306	0.000	0.146	0.461
Z-Score	9.475	3.678	7.157	9.216	11.357
IMR	0.333	0.391	0.074	0.160	0.411

Table 2. Determinants of disclosure decision and BEE

This table reports the determinants of disclosure decisions in Column 1 and the determinants of BEE in Columns 2 and 3. The dependent variable in Column 1 is a dummy variable, set at one if a firm disclosed BEE in a given year. The dependent variable in Columns 2 and 3 is BEE divided by total assets in percentage. The explanatory variables in Column 1 are measured at concurrent year t and in Columns 2 and 3 are calculated at year t-1. All variables are defined in Appendix A. Industry-year fixed effects are included in all columns. In Column 3, the firm fixed effects are further included. The t-statistics computed with robust standard errors clustered at the firm level are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% level (two-sided), respectively.

	Disclosure Decision		Determinants of BEE			
	(1)		(2)		(3)	
Early listers	-0.128**	(-2.438)				
GME market in Shenzhen SE	0.416***	(2.720)				
Shanghai SE	-0.161*	(-1.761)				
Customer-base concentration	-0.046	(-0.408)	-0.145***	(-7.511)	-0.077***	(-3.538)
Supplier-base concentration	0.196*	(1.778)	-0.083***	(-4.389)	-0.018	(-1.284)
Reserve of receivables	0.001	(0.072)	0.025***	(6.663)	0.008**	(2.466)
RPT/TA	0.019	(0.363)	-0.013	(-1.402)	-0.004	(-0.558)
Litigation risk	0.034	(0.789)	0.011	(1.229)	0.012*	(1.791)
SOE	0.069	(0.991)	0.007	(0.613)	-0.008	(-0.488)
Political connectedness	0.039	(0.867)	0.012	(1.341)	0.011*	(1.822)
Leverage	0.536***	(3.166)	-0.083***	(-2.934)	0.019	(0.722)
Firm age			-0.025**	(-2.002)	-0.006	(-0.173)
Price-cost margin	-0.120	(-0.887)	-0.036	(-1.381)	-0.003	(-0.160)
Fraction of outside directors	-0.358***	(-3.022)	0.010	(0.455)	-0.051***	(-3.002)
Duality	-0.045	(-0.808)	0.011	(0.938)	0.013	(1.388)
Board size	-0.219	(-1.615)	0.042*	(1.727)	0.004	(0.131)
Largest shareholder's ownership	-0.238	(-1.212)	-0.116***	(-3.779)	-0.065	(-1.464)
Managerial ownership	0.630***	(2.786)	0.026	(0.797)	0.074*	(1.708)
Mutual funds' ownership	0.458	(1.426)	0.115*	(1.663)	-0.026	(-0.538)
Herfindahl index (2-10)	-1.891*	(-1.719)	-0.115	(-0.664)	-0.023	(-0.097)
Remuneration	-0.736***	(-3.043)	0.385***	(3.160)	0.127**	(1.987)
Incentive scheme	-0.322***	(-4.529)	0.023	(1.548)	0.015*	(1.728)
Firmsize	-0.257***	(-7.308)	-0.029***	(-3.779)	-0.052***	(-5.951)
lnB2M	0.018	(0.560)	-0.016**	(-2.445)	-0.001	(-0.283)
Cash holding	0.335**	(2.007)	0.059**	(1.966)	-0.030	(-1.306)
Marketization index	-0.112***	(-5.499)	0.009***	(3.358)	0.014	(1.360)
IMR			0.048	(1.082)	0.034	(1.103)
Constant	6.503***	(8.187)	0.737***	(5.010)	1.269***	(5.547)
Industry-year FE	Yes		Yes		Yes	
Firm FE	No		No		Yes	
Observations	17,973		10,162		10,162	
Pesudo R^2 / Adjusted R^2	0.157		0.249		0.767	

Table 3. The Predictability of BEE on Future Firm Performance

This table investigates the predictability of BEE on future firm performance. The dependent variables in Panel A, B, and C are Asset Turnover, ROA, and Tobin's Q, respectively. Columns 1 to 3 in each panel present estimates using OLS, while Column 4 displays the instrumental variable estimates. The instrumental variable is the median BEE of other firms within the same industry at the two-digit level in a given year. All variables are defined in the Appendix A. Industry-year fixed effects are included in all columns. In Column 3, the firm fixed effects are further included. The t-statistics computed with robust standard errors clustered at the firm level are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% level (two-sided), respectively.

Panel A. Asset Turnover

	OLS						IV	
	(1)		(2)		(3)		(4)	
BEE	0.363***	(7.737)	0.167***	(5.733)	0.350***	(5.299)	0.161**	(2.301)
Customer-base concentration	-0.222***	(-4.284)	-0.100***	(-3.738)	-0.078	(-1.488)	-0.101***	(-3.523)
Supplier-base concentration	0.015	(0.225)	-0.017	(-0.576)	-0.015	(-0.306)	-0.018	(-0.606)
Reserve of receivables	-0.025***	(-3.783)	-0.010***	(-2.585)	-0.011*	(-1.732)	-0.010**	(-2.424)
RPT/TA	0.412***	(9.022)	0.127***	(5.593)	0.127***	(4.413)	0.127***	(5.692)
Litigation risk	0.017	(0.685)	-0.017	(-1.313)	-0.013	(-0.887)	-0.017	(-1.327)
SOE	0.043	(1.379)	0.046***	(3.302)	0.105**	(2.162)	0.046***	(3.332)
Political connectedness	0.027	(1.240)	0.007	(0.716)	0.006	(0.397)	0.007	(0.734)
Leverage	-0.353***	(-4.002)	-0.176***	(-3.988)	-0.136*	(-1.853)	-0.176***	(-4.042)
Firm age	-0.029	(-1.195)	-0.011	(-0.987)	0.041	(0.611)	-0.011	(-1.005)
Price cost margin	-0.372***	(-4.577)	-0.309***	(-6.397)	-0.092	(-1.491)	-0.310***	(-6.487)
Fraction of outside directors	0.067	(1.018)	0.006	(0.198)	0.015	(0.315)	0.006	(0.203)
Duality	-0.018	(-0.868)	-0.017	(-1.552)	-0.001	(-0.079)	-0.017	(-1.571)
Board size	0.086	(1.382)	0.044	(1.525)	0.060	(0.943)	0.044	(1.557)
Largest shareholder's ownership	0.318***	(3.968)	0.078**	(2.029)	0.028	(0.242)	0.077**	(1.996)
Managerial ownership	0.020	(0.361)	0.019	(0.725)	-0.078	(-0.667)	0.019	(0.737)
Mutual funds' ownership	0.815***	(5.094)	0.396***	(4.435)	0.547***	(4.726)	0.397***	(4.487)
Herfindahl index (2-10)	0.934*	(1.770)	-0.183	(-0.764)	-0.556	(-0.946)	-0.185	(-0.772)
Remuneration	0.337**	(2.341)	0.172**	(1.989)	0.260	(1.309)	0.176*	(1.888)
Incentive scheme	-0.000	(-0.013)	0.038***	(3.051)	0.013	(0.708)	0.038***	(3.100)
Firm size	0.051***	(3.004)	-0.018*	(-1.951)	-0.274***	(-10.550)	-0.018*	(-1.926)
lnB2M	-0.062***	(-3.804)	-0.067***	(-7.015)	-0.055***	(-3.817)	-0.068***	(-7.054)
Cash holding	-0.169**	(-2.318)	-0.351***	(-8.293)	-0.312***	(-4.992)	-0.351***	(-8.421)
Marketization index	0.030***	(4.549)	0.009***	(3.109)	-0.050**	(-2.106)	0.009***	(3.156)
IMR	-0.069	(-0.693)	0.064	(1.257)	0.319***	(3.476)	0.064	(1.270)
Asset Turnover (t)			0.653***	(28.887)	0.206***	(8.803)	0.654***	(29.181)
Constant	-0.751**	(-2.039)	0.398**	(1.961)	6.004***	(9.094)	0.403*	(1.931)
Industry-year FE	Yes		Yes		Yes		Yes	
Firm FE	No		No		Yes		No	
Observations	10,054		10,054		10,054		10,054	
Adjusted R^2	0.248		0.606		0.754		0.606	

Table 3 - Continued

Panel B. ROA								
	OLS						IV	
	(1)		(2)		(3)		(4)	
BEE	0.025***	(5.901)	0.021***	(5.436)	0.033***	(4.228)	0.033***	(3.777)
Customer-base concentration	-0.006	(-1.531)	-0.007**	(-2.065)	-0.002	(-0.219)	-0.005	(-1.446)
Supplier-base concentration	0.001	(0.236)	-0.002	(-0.617)	-0.006	(-0.952)	-0.001	(-0.318)
Reserve of receivables	-0.003***	(-4.343)	-0.002***	(-3.749)	-0.002***	(-2.816)	-0.003***	(-3.991)
RPT/TA	0.001	(0.319)	-0.001	(-0.309)	0.006	(1.642)	-0.001	(-0.294)
Litigation risk	-0.004*	(-1.817)	-0.005***	(-2.851)	0.001	(0.447)	-0.005***	(-2.901)
SOE	-0.006***	(-2.786)	-0.003*	(-1.767)	-0.015*	(-1.893)	-0.004*	(-1.859)
Political connectedness	0.001	(0.573)	0.001	(0.747)	0.002	(0.906)	0.001	(0.615)
Leverage	-0.090***	(-13.400)	-0.065***	(-11.054)	-0.029***	(-2.741)	-0.064***	(-11.036)
Firm age	0.002	(0.898)	0.001	(0.849)	-0.001	(-0.104)	0.002	(1.048)
Price cost margin	0.138***	(14.410)	0.070***	(7.786)	0.021	(1.577)	0.072***	(7.970)
Fraction of outside directors	-0.002	(-0.491)	-0.003	(-0.663)	-0.001	(-0.180)	-0.003	(-0.716)
Duality	-0.006***	(-3.301)	-0.006***	(-3.629)	-0.003	(-0.978)	-0.006***	(-3.696)
Board size	-0.000	(-0.098)	0.000	(0.122)	-0.003	(-0.366)	-0.000	(-0.004)
Largest shareholder's ownership	0.048***	(7.928)	0.038***	(7.306)	0.089***	(4.896)	0.039***	(7.460)
Managerial ownership	0.011**	(2.214)	0.007*	(1.666)	0.009	(0.372)	0.007	(1.624)
Mutual funds' ownership	0.210***	(14.092)	0.167***	(12.617)	0.124***	(8.063)	0.165***	(12.617)
Herfindahl index (2-10)	0.125***	(3.731)	0.078***	(2.674)	0.263***	(3.224)	0.081***	(2.745)
Remuneration	0.061***	(4.477)	0.052***	(3.535)	0.076***	(3.387)	0.045***	(2.845)
Incentive scheme	0.003	(1.385)	0.004**	(2.375)	0.002	(0.703)	0.004**	(2.241)
Firm size	0.001	(0.521)	-0.000	(-0.298)	-0.032***	(-10.132)	-0.000	(-0.038)
lnB2M	-0.011***	(-6.708)	-0.011***	(-6.953)	-0.012***	(-5.317)	-0.010***	(-6.835)
Cash holding	0.029***	(4.420)	0.003	(0.591)	0.023***	(2.703)	0.004	(0.659)
Marketization index	0.001*	(1.766)	0.001*	(1.810)	-0.001	(-0.417)	0.001	(1.568)
IMR	0.018**	(2.184)	0.014*	(1.896)	0.017	(1.369)	0.014*	(1.828)
ROA(t)			0.265***	(16.751)	0.104***	(6.165)	0.262***	(16.743)
Constant	-0.035	(-1.098)	-0.009	(-0.312)	0.670***	(8.843)	-0.019	-0.631
Industry-year FE	Yes		Yes		Yes		Yes	
Firm FE	No		No		Yes		No	
Observations	10,054		10,054		10,054		10,054	
Adjusted R^2	0.332		0.376		0.500		0.374	

Table 3 - Continued

Panel C. Tobin's Q								
	OLS						IV	
	(1)		(2)		(3)		(4)	
BEE	0.431***	(3.378)	0.366***	(4.025)	0.896***	(5.695)	0.449**	(2.390)
Customer-base concentration	0.407***	(3.502)	0.156*	(1.824)	-0.059	(-0.363)	0.169*	(1.905)
Supplier-base concentration	0.296**	(2.559)	0.151*	(1.831)	-0.181	(-1.334)	0.158*	(1.898)
Reserve of receivables	0.029*	(1.677)	0.019*	(1.722)	-0.026	(-1.364)	0.018	(1.485)
RPT/TA	0.083	(1.147)	0.047	(0.845)	0.119*	(1.929)	0.047	(0.853)
Litigation risk	0.250***	(4.636)	0.089**	(2.313)	-0.004	(-0.077)	0.088**	(2.323)
SOE	-0.163***	(-2.607)	-0.034	(-0.804)	-0.209	(-1.638)	-0.035	(-0.840)
Political connectedness	-0.002	(-0.046)	0.006	(0.185)	0.108**	(2.165)	0.005	(0.152)
Leverage	-0.520***	(-2.937)	-0.371***	(-2.902)	0.358*	(1.680)	-0.367***	(-2.910)
Firm age	-0.030	(-0.392)	0.023	(0.433)	0.868***	(3.707)	0.025	(0.474)
Price cost margin	0.676***	(3.197)	-0.322**	(-2.155)	-0.141	(-0.728)	-0.316**	(-2.129)
Fraction of outside directors	0.064	(0.511)	-0.087	(-0.938)	-0.112	(-0.740)	-0.089	(-0.963)
Duality	-0.052	(-0.906)	-0.092**	(-2.228)	-0.110*	(-1.739)	-0.092**	(-2.267)
Board size	-0.197	(-1.505)	-0.140	(-1.463)	0.153	(0.870)	-0.143	(-1.514)
Largest shareholder's ownership	1.078***	(6.094)	0.532***	(4.161)	1.289***	(3.744)	0.540***	(4.225)
Managerial ownership	0.187	(1.063)	0.027	(0.217)	-0.604	(-1.135)	0.027	(0.217)
Mutual funds' ownership	6.967***	(16.036)	4.016***	(13.376)	2.418***	(7.711)	3.999***	(13.494)
Herfindahl index (2-10)	1.696	(1.610)	-0.528	(-0.683)	1.589	(0.895)	-0.504	(-0.658)
Remuneration	3.412***	(7.090)	2.221***	(5.640)	1.147**	(2.007)	2.171***	(5.446)
Incentive scheme	0.139*	(1.889)	0.189***	(3.579)	0.137*	(1.785)	0.187***	(3.562)
Firm size	-0.890***	(-20.245)	-0.618***	(-18.122)	-1.791***	(-25.658)	-0.615***	(-17.963)
Cash holding	0.398**	(2.058)	-0.896***	(-5.984)	-1.498***	(-7.281)	-0.894***	(-6.025)
Marketization index	-0.098***	(-6.283)	-0.055***	(-5.053)	0.060	(0.890)	-0.056***	(-5.140)
IMR	1.524***	(6.821)	1.094***	(6.709)	0.402	(1.500)	1.089***	(6.730)
Tobin' Q (t-1)			0.438***	(30.261)	0.173***	(13.906)	0.438***	(30.623)
Constant	18.753***	(21.348)	13.067***	(18.893)	36.105***	(21.636)	12.997***	(18.516)
Industry-year FE	Yes		Yes		Yes		Yes	
Firm FE	No		No		Yes		No	
Observations	10,054		10,054		10,054		10,054	
Adjusted R^2	0.513		0.619		0.737		0.619	

Table 4. The Xi Shock: A Quasi-natural Experiment

This table examines how anti-corruption campaign and the Eight Provision initiated in China in the end of 2012 (The Xi Shock) affect the amount of BEE and its impact on Asset Turnover, ROA, and Tobin's Q, respectively. Panel A report the univariate test for matched sample. The treatment group is SOEs, while the control group is non-SOEs. Panel B displays multivariate DiD regression estimates to examine whether SOEs are associated with more reduction in firm performance in the post-shock period. The dummy variable, *after*, is set at one for years 2013 and 2014, and zero for the rest of years. Panel C presents estimates to the direct effect of the reduction in BEE on firm performance during post-shock period. The dummy variable, *More reduction in BEE*, is set at one if a firm experience more than 20% reduction in BEE comparing to the previous year. *Other controls* refer to all explanatory variables used to explain the determinants of BEE in Column 2 in Table 2. All variables are defined in the Appendix A. One year lagged dependent variables and industry-year fixed effect are controlled in both Panels B and C, while firm effect are further included in Panel B. All specifications are estimated using OLS. The t-statistics computed with robust standard errors clustered at the firm level are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% level (two-sided), respectively.

Panel A. Univariate test

	(1)		(2)		(3)	
	SOEs (After - Before)		matched non-SOEs (After - Before)		DiD	
BEE	-0.068***	(-9.764)	-0.036***	(-4.197)	-0.031***	(-3.025)
Asset Turnover	-0.118***	(-6.850)	-0.079***	(-4.002)	-0.039*	(-1.833)
ROA	-0.014***	(-3.801)	-0.014***	(-4.111)	-0.000	(-0.677)
Tobin's Q	0.390***	(3.008)	1.041***	(5.953)	-0.651***	(-3.196)

Panel B. DiD regressions

Dependent Variable	Asset Turnover		ROA		Tobin's Q	
SOE	0.114**	(2.329)	-0.014*	(-1.652)	-0.036	(-0.279)
SOE × After	-0.030**	(-1.972)	-0.006**	(-2.142)	-0.601***	(-9.237)
BEE	0.350***	(5.293)	0.033***	(4.223)	0.894***	(5.633)
Other controls	Yes		Yes		Yes	
Firm, Industry-year FE	Yes		Yes		Yes	
Observations	10,054		10,054		10,054	
Adjusted R^2	0.752		0.497		0.739	

Panel C. The impact of the reduction in BEE on firm performance

Dependent Variable	Asset Turnover		ROA		Tobin's Q	
SOE	0.023	(1.290)	-0.004	(-1.462)	-0.125*	(-1.918)
More reduction in BEE	-0.165***	(-4.973)	-0.015***	(-4.146)	-0.564***	(-5.344)
BEE	0.067*	(1.836)	0.017***	(2.994)	0.120	(0.920)
Other controls	Yes		Yes		Yes	
Industry-year FE	Yes		Yes		Yes	
Observations	3,421		3,421		3,421	
Adjusted R^2	0.614		0.387		0.710	

Table 5. Can BEE Predict Future Stock Returns?

This table tests the predictability of BEE on future stock returns. In Panels A and B, all stocks are equal-weighted and value-weighted by tradable market capitalization, respectively. Reported numbers are alphas derived from the CAPM, three factor (Fama-French, 1993), and four-factor (Carhart, 1997) models for each quintile portfolio formed on BEE. For each two-digit industry in each year between 2004 and 2012, we sort firms into five quintiles based on BEE, and hold the portfolio for 12 months from May 1 (year+1) to April 30 (year t+2). Portfolio 1 contains stocks in the lowest 20 percentiles, and Portfolio 5 contains stocks in the highest 20 percentiles. "5 - 1" holds Portfolio 5 long and Portfolio 1 short. Four risk factors (MKT, SMB, HML and UMD) are constructed from all Chinese stocks using the Fama-French (1993) methodology. Panel C reports Fama-MacBeth regression estimates of monthly returns on R_BEE, R_lnMKV (Market value), R_lnB2M (book-to-market), R_Leverage (total liabilities divided by total assets), R_MOM (Past BHAR from -12 month to -1 month), and R_SDRet (standard deviation of daily returns during the month prior to portfolio formation). These independent variables are quintile ranks based on annual ranking of BEE, lnMKV, lnB2M, Leverage, and monthly ranking of MOM and SDRet, respectively, with 1 for the lowest quintile and 5 for the highest quintile. In total, there are 120 months. The t-statistics computed with Newey-West standard errors (2 lags) are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% level (two-sided), respectively.

Panel A. Equal-weighted (%)

	1 (Lowest)	2	3	4	5 (Highest)	5 - 1	*Annualized*
CAPM alpha	0.922*	1.105**	1.045**	1.219**	1.507***	0.585***	*7.254%*
	(1.830)	(2.202)	(2.047)	(2.420)	(2.834)	(3.380)	
Three-factor alpha	-0.071	0.084	-0.027	0.182	0.386	0.457***	*5.624%*
	(-0.216)	(0.273)	(-0.092)	(0.639)	(1.302)	(2.760)	
Four-Factor alpha	-0.201	-0.014	-0.140	0.074	0.290	0.491***	*6.051%*
	(-0.659)	(-0.047)	(-0.506)	(0.278)	(1.026)	(2.890)	

Panel B. Value-weighted (%, by tradable market capitalization)

	1 (Lowest)	2	3	4	5 (Highest)	5 - 1	*Annualized*
CAPM alpha	0.247	0.416	0.562	0.616	1.353***	1.107***	*14.122%*
	(0.677)	(1.024)	(1.310)	(1.454)	(2.870)	(3.970)	
Three-factor alpha	-0.258	-0.241	-0.209	-0.088	0.524*	0.782***	*9.795%*
	(-0.843)	(-0.758)	(-0.715)	(-0.302)	(1.725)	(3.280)	
Four-Factor alpha	-0.349	-0.331	-0.308	-0.168	0.461	0.810***	*10.163%*
	(-1.182)	(-1.072)	(-1.112)	(-0.590)	(1.540)	(3.390)	

Panel C. Fama-MacBeth regression

R_BEE	R_lnMKV	R_lnB2M	R_MOM	R_Leverage	R_SDRet	Constant	R^2
0.056**	-0.361***	0.007	-0.088	-0.004	-0.257***	3.983***	*0.072*
(2.100)	(-3.613)	(0.110)	(-0.759)	(-0.066)	(-3.287)	(3.569)	

Table 6. Can BEE Predict Unexpected Future Earnings?

This table examines the predictability of BEE on unexpected future earnings. The dependent variable is unexpected future earnings, measured as the analyst forecast error scaled by the stock price two days prior to the earnings announcement. Forecast error is defined as actual earnings per share minus the median earnings forecast from -12 months to 2 days prior to the earnings announcement. Column 1 presents the estimates from ordinary least squares, while Column 2 displays instrumental variable estimates. All variables are defined in Appendix A. Industry-year fixed effects is included. The t-statistics computed with robust standard errors clustered at the firm level are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% level (two-sided), respectively.

	OLS		IV	
	(1)		(2)	
BEE	0.297***	(4.234)	0.274***	(2.843)
SD_FEPS	-4.276***	(-16.134)	-4.275***	(-16.471)
Customer-base concentration	0.128	(1.308)	0.124	(1.291)
Supplier-base concentration	-0.153	(-1.504)	-0.154	(-1.552)
Reserve of receivables	-0.033*	(-1.934)	-0.032*	(-1.898)
RPT/TA	0.052	(0.629)	0.052	(0.643)
Litigation risk	-0.129**	(-2.291)	-0.129**	(-2.341)
SOE	0.072	(1.288)	0.073	(1.323)
Political connectedness	0.006	(0.146)	0.006	(0.156)
Leverage	-0.717***	(-3.555)	-0.720***	(-3.633)
Firm age	0.038	(0.803)	0.037	(0.808)
Price-cost margin	0.462**	(2.291)	0.457**	(2.299)
Fraction of outside directors	-0.042	(-0.333)	-0.041	(-0.334)
Duality	0.031	(0.728)	0.031	(0.746)
Board size	0.243**	(1.976)	0.244**	(2.023)
Largest shareholder's ownership	0.527***	(3.566)	0.526***	(3.635)
Managerial ownership	0.173	(1.580)	0.174	(1.619)
Mutual funds' ownership	1.235***	(4.180)	1.239***	(4.275)
Herfindahl index (2-10)	0.883	(1.019)	0.874	(1.032)
Remuneration	-0.127	(-0.526)	-0.110	(-0.454)
Incentive scheme	-0.003	(-0.063)	-0.003	(-0.057)
lnMKV	-0.051	(-1.417)	-0.052	(-1.471)
lnB2M	-0.039	(-1.065)	-0.040	(-1.096)
Cash holding	0.640***	(4.547)	0.639***	(4.637)
Marketization index	0.019	(1.632)	0.020*	(1.682)
IMR	-0.198	(-0.983)	-0.197	(-1.000)
Constant	0.614	(0.756)	0.634	(0.800)
Industry-year FE	Yes		Yes	
Observations	5,696		5,696	
Adjusted R^2	0.209		0.209	

Table 7. Reducing Transaction Costs with Stakeholders in Private Sectors

This table tests whether BEE can reduce transaction costs for a firm with its stakeholders in private sectors. The dependent variables for Columns 1-2, 3-4, and 5-6 are litigation incidence with other firms, the quality of trade credit extended to customers, and the amount of trade credit acquired from suppliers, respectively. Panel A examines the effect of BEE on these corporate outcomes using full sample, with specifications in odd Columns and even Columns estimated using OLS and IV, respectively. In Panel B, we sort firms into high vs. low transaction costs subsamples to further investigate whether reducing transaction costs in private sectors is one possible channel through which BEE generate benefits for firms, with all specifications are estimated using OLS. The sorting variables for Columns 1-2, 3-4, and 5-6 are related party transactions, customer-base concentration, and supplier-base concentration, respectively. For continuous sorting variables, we sort firms into terciles and keep the highest and lowest tercile only. *Other controls* refer to all explanatory variables used to explain the determinants of BEE in Column 2 in Table 2. All variables are defined in the Appendix A. Industry-year fixed effects is included. "Equal coefficient?" reports the difference in the BEE coefficients between subsamples with Wald test. The t-statistics computed with robust standard errors clustered at the firm level are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% level (two-sided), respectively.

Dependent variable	Litigation incidence		The quality of trade credit extended to customers		The amount of trade credit acquired from suppliers	
Panel A. All Sample						
	OLS	IV	OLS	IV	OLS	IV
	(1)	(2)	(3)	(4)	(5)	(6)
BEE	-0.025**	-0.074***	-0.030***	-0.485***	0.049***	0.219**
	(-2.031)	(-2.948)	(-3.139)	(-2.947)	(7.293)	(2.013)
Observations	10,054	10,054	9,622	9,622	10,054	10,054
Adjusted R^2	0.071	0.070	0.231	0.235	0.273	0.262
Panel B. Subsample						
Sorting variable	Related party transaction		Customer-base concentration		Supplier-base concentration	
	High	Low	High	Low	High	Low
	(1)	(2)	(3)	(4)	(5)	(6)
BEE	0.029	-0.040**	-0.013	-0.033***	0.033***	0.060***
	(0.914)	(-2.147)	(-0.753)	(-3.125)	(3.555)	(5.009)
Equal coefficient?	-0.069**		-0.019*		0.028***	
Observations	3,354	3,355	3,209	3,215	3,354	3,354
Adjusted R^2	0.074	0.071	0.266	0.208	0.172	0.322
Other controls, Industry-year FE in all Panels	Yes	Yes	Yes	Yes	Yes	Yes

Table 8. Securing Benefit from Stakeholders in Public Sectors

This table examines whether BEE can secure benefit for a firm from its stakeholders in public sectors. The dependent variable is government subsidy. Columns 1 and 2 in Panel A report OLS and IV estimates using full sample. All other columns present OLS estimates. In Columns 3-4 in Panel A, the sorting variable is whether a given year is a national election year. The national election years in our sample period are 2007, 2008, 2012 and 2013. National party election and government election are spread in two consecutive years. In Columns 5-6, the sorting variable is whether a given year is in city heads' early tenure. The early (late) period in city heads' tenure is defined as both mayors and party heads at prefecture level are in the first two years (the third to fifth year) in the office. In Panel C, the sorting variables for Columns 1-2, 3-4 and 5-6 are the ownership, political connectedness and firm size of a firm. For continuous sorting variables, we sort firms into terciles and keep the top and bottom tercile only. *Other controls* refer to all explanatory variables used to explain the determinants of BEE in Column 2 in Table 2. All variables are defined in the Appendix A. Firm and industry-year fixed effects are included. "Equal coefficient?" reports the difference in the BEE coefficients between subsamples with Wald test. The t-statistics computed with robust standard errors clustered at the firm level are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% level (two-sided), respectively.

Panel A. All sample and subsamples by political environment

	All sample		National turnover years		City heads' tenure	
			Yes	No	Early	Late
	OLS	IV	OLS			
	(1)	(2)	(3)	(4)	(5)	(6)
BEE	0.425***	0.509***	0.530***	0.121	0.431**	-0.070
	(4.143)	(3.221)	(3.203)	(0.923)	(2.507)	(-0.422)
Equal coefficient?			-0.409**		-0.502***	
Observations	10,054	10,054	4,774	5,280	3,213	1,925
Adjusted R^2	0.517	0.138	0.576	0.540	0.571	0.636

Panel B. Subsamples by ownership and political connectedness, and firm size

	SOE		Political connectedness		Firm size	
	Yes	No	Yes	No	Large	Small
	(1)	(2)	(3)	(4)	(5)	(6)
BEE	0.241*	0.419***	0.309**	0.478***	0.377**	0.496***
	(1.796)	(3.093)	(2.155)	(3.633)	(2.555)	(3.152)
Equal coefficient?	0.178*		0.169*		0.119	
Observations	4,864	5,190	3,021	7,033	3,348	3,348
Adjusted R^2	0.499	0.564	0.630	0.499	0.682	0.448
Other controls, Firm, Industry-year FE in all Panels	Yes	Yes	Yes	Yes	Yes	Yes

Table 9. Reducing Transaction Costs and Securing Benefit in Hybrid Sectors

This table explores whether BEE can reduce transaction cost and secure benefit for a firm from its stakeholders in hybrid sectors. The dependent variable is collateral requirement on bank borrowing. Columns 1 and 2 in Panel A report OLS and IV estimates using full sample. All other columns present OLS estimates. In Columns 3-4 and 5-6 in Panel A, the sorting variables are proxies of financial constraint, Z-score and dividend payout policy in a given year, respectively. Z-score is computed using the formula in Altman (2005). In Panel C, the sorting variables for Columns 1-2, 3-4 and 5-6 are the ownership, political connectedness and firm size of a firm. For continuous sorting variables, we sort firms into terciles and keep the top and bottom tercile only. *Other controls* refer to all explanatory variables used to explain the determinants of BEE in Column 2 in Table 2. All variables are defined in the Appendix A. Industry-year fixed effect is included. "Equal coefficient?" reports the difference in the BEE coefficients between subsamples with Wald test. The t-statistics computed with robust standard errors clustered at the firm level are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% level (two-sided), respectively.

Panel A. All sample and subsamples by financial constraint						
	All sample		Z-score		Dividend payout	
			High	Low	Yes	No
	OLS	IV	OLS			
	(1)	(2)	(3)	(4)	(5)	(6)
BEE	-0.054**	-0.144***	0.019	-0.137***	-0.027	-0.106**
	(-1.966)	(-3.471)	(0.450)	(-2.699)	(-0.785)	(-2.472)
Equal coefficient?			-0.155***		-0.079**	
Observations	6,199	6,199	2,069	2,069	3,968	2,231
Adjusted R^2	0.276	0.273	0.233	0.365	0.244	0.331
Panel B. Subsamples by ownership, political connectedness, and firm size						
	SOE				Political connectedness	
	Yes	No			Yes	No
	(1)	(2)			(3)	(4)
BEE	-0.136***	-0.014			-0.109**	-0.032
	(-3.310)	(-0.377)			(-2.325)	(-0.921)
Equal coefficient?	0.122***					
Observations	2,992	3,207			1,905	4,294
Adjusted R^2	0.264	0.240			0.288	0.279
Other controls, Industry-year FE in all Panels	*Yes*	*Yes*			*Yes*	*Yes*

Table 10. Accessibility to Stakeholders

This table investigates how accessibility of a firm to it stakeholders impedes it from spending more BEE by sorting firms into two subsamples and testing the difference in the sensitivities of BEE on different proxies of firm performance between two subsamples. The dependent variables for Panel A, B and C are Asset Turnover, ROA, and Tobin's Q, respectively. The sorting variables in Columns 1-4 and 5-8 are whether a firm has political connectedness and the firm size, respectively. The specifications for Columns 1-2 (5-6) and 3-4 (7-8) in each Panel are the same as Columns 3 and 4 in the corresponding Panel in Table 3, respectively. For continuous sorting variables, we sort firms into terciles and keep the highest and lowest tercile only. *Other controls* refer to all explanatory variables used to explain the determinants of BEE in Column 2 in Table 2 plus one year lagged dependent variable. All variables are defined in the Appendix A. One year lagged dependent variables, firm and industry-year fixed effects are included. All specifications are estimated using OLS. "Equal coefficient?" reports the difference in the BEE coefficients between subsamples with Wald test. The t-statistics computed with robust standard errors clustered at the firm level are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% level (two-sided), respectively.

	Political Connectedness				Firm Size			
	OLS		IV		OLS		IV	
	Yes	No	Yes	No	Big	Small	Big	Small
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Panel A. Asset Turnover								
BEE	0.123	0.375***	0.134***	0.176***	0.185*	0.382***	-0.067	0.272**
	(1.274)	(4.467)	(3.148)	(3.713)	(1.672)	(4.023)	(-0.148)	(2.306)
Equal coefficient?	0.253**		0.042		0.197***		0.338***	
Observations	3,021	7,033	3,021	7,033	3,448	3,451	3,448	3,451
Adjusted R^2	0.842	0.748	0.640	0.591	0.874	0.639	0.693	0.469
Panel B. ROA								
BEE	0.005	0.039***	0.017	0.034***	0.015	0.042***	-0.102*	0.038**
	(0.353)	(3.958)	(1.463)	(2.884)	(1.079)	(2.970)	(-1.845)	(2.156)
Equal coefficient?	0.034**		0.017**		0.028***		0.140***	
Observations	3,021	7,033	3,021	7,033	3,448	3,451	3,448	3,451
Adjusted R^2	0.561	0.507	0.390	0.373	0.646	0.430	0.440	0.272
Panel C. Tobin's Q								
BEE	0.445	0.935***	0.264	1.068***	0.320	0.725***	0.073	0.691**
	(1.538)	(4.871)	(0.865)	(3.990)	(1.226)	(3.135)	(0.244)	(2.435)
Equal coefficient?	0.490*		0.804**		0.405**		0.617**	
Observations	3,021	7,033	3,021	7,033	3,448	3,451	3,448	3,451
Adjusted R^2	0.775	0.745	0.624	0.613	0.771	0.713	0.594	0.588
In all Panels								
Other controls, Industry-year FE	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*
Firm FE	*Yes*	*Yes*	*No*	*No*	*Yes*	*Yes*	*No*	*No*

Table 11. Managerial Agency Problem

This table examines how managerial agency problem of a firm restrains it from spending more BEE by sorting firms into two subsamples and testing the difference in the sensitivities of BEE on different proxies of firm performance between two subsamples. The dependent variables for Panel A, B and C are Asset Turnover, ROA, and Tobin's Q, respectively. The sorting variables in Columns 1-4 and 5-8 are whether a firm has a managerial incentive scheme and managerial shareholdings, respectively. The specifications for Columns 1-2 (5-6) and 3-4 (7-8) in each Panel are the same as Columns 3 and 4 in the corresponding Panel in Table 3, respectively. For continuous sorting variables, we sort firms into terciles and keep the highest and lowest tercile only. *Other controls* refer to all explanatory variables used to explain the determinants of BEE in Column 2 in Table 2 plus one year lagged dependent variable. All variables are defined in the Appendix A. One year lagged dependent variables, firm and industry-year fixed effects are included. All specifications are estimated using OLS. "Equal coefficient?" reports the difference in the BEE coefficients between subsamples with Wald test. The t-statistics computed with robust standard errors clustered at the firm level are reported in parentheses. ***, **, and * indicate significance at the 1%, 5%, and 10% level (two-sided), respectively.

	Managerial Incentive Scheme				Managerial Shareholding			
	OLS		IV		OLS		IV	
	Yes	No	Yes	No	Big	Small	Big	Small
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Panel A. Asset Turnover								
BEE	-0.085	0.403***	0.079	0.168**	0.104**	0.564***	0.043	0.327***
	(-0.799)	(5.368)	(1.250)	(2.122)	(2.309)	(3.866)	(1.257)	(3.875)
Equal coefficient?	0.488***		0.089		0.460***		0.284**	
Observations	1,249	8,805	1,249	8,805	3,354	3,414	3,354	3,414
Adjusted R^2	0.849	0.747	0.761	0.596	0.869	0.697	0.697	0.515
Panel B. ROA								
BEE	-0.016	0.041***	0.012	0.036***	0.007	0.055***	0.005	0.055***
	(-0.756)	(4.601)	(0.930)	(3.652)	(0.718)	(3.057)	(0.532)	(2.879)
Equal coefficient?	0.056***		0.024**		0.048***		0.050***	
Observations	1,249	8,805	1,249	8,805	3,354	3,414	3,354	3,414
Adjusted R^2	0.647	0.471	0.555	0.348	0.618	0.468	0.435	0.325
Panel C. Tobin's Q								
BEE	0.119	0.989***	-0.574	0.631***	0.831***	0.704**	0.396**	0.479*
	(0.262)	(5.563)	(-0.968)	(3.151)	(3.377)	(1.992)	(2.558)	(1.807)
Equal coefficient?	0.870***		1.205***		-0.127		0.082	
Observations	1,249	8,805	1,249	8,805	3,354	3,414	3,354	3,414
Adjusted R^2	0.806	0.728	0.685	0.603	0.752	0.738	0.610	0.610
In all Panels								
Other controls, Industry-year FE	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*	*Yes*
Firm FE	*Yes*	*Yes*	*No*	*No*	*Yes*	*Yes*	*No*	*No*