2016 Observation Report
on China’s Third Sector –
Resource-Reputation Exchange Theory
And Its Application in Nonprofit-Corporate Collaboration

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Introduction
Since the economic reforms of the late 1970s, corporations and nonprofits have developed rapidly and are playing increasingly important roles in the Chinese society. In the recent years, with accumulative corporate profits and growing public attention towards social welfare, corporations and nonprofits have established closer collaboration. Policies that guide and encourage corporate participation in social services also have contributed to the trend. Numerous successful nonprofit-corporate collaboration cases have generated great social impact.

The nonprofit-corporate collaboration has many forms, such as donation, mutual transaction, and joint project implementation. No matter which form is used, it is a win-win process. In general, corporations earn good reputation, which enhances their financial interests; nonprofits receive various resources, ranging from capital to technology. With efforts from both sides, a good collaboration can achieve a tripartite win that benefits the corporation, the nonprofit, and the society. But it is not uncommon to see negative consequences from the collaboration. Some corporations collude with nonprofits to deceive the public; some take advantages of nonprofits, which harm both sides and the society. For example, in the Suntech Donation Fraud case, the China Charity Federation charged the Suntech Company CNY $50,000 for providing a tax-deductible donation receipt of CNY $15 million. Cases like this call for us to question: Why did this collaboration end up a fraud? What are the factors that lead to a successful collaboration or a failed one? What are the differences across the collaborations? And what causes these differences?

Systematic and thorough analyses are needed to address these questions. The nonprofit-corporate collaboration has long been discussed and studied. A growing body of literature has built a solid foundation for our study. For example, at the Charity-Business Collaboration Seminar in Beijing on December 17, 2011, the Research Report on Nonprofit-corporate Collaboration was published and 24 Chinese foundations joined the Nine Codes of Conduct for Nonprofit-corporate Collaboration initiative. Two years later, the Charity-Business Collaboration Forum was held in Hangzhou on August 26, 2013. Despite the progress, however, the rules and frameworks of nonprofit-corporate collaboration remain unclear. Without theoretical frameworks, it is difficult to explain the collaborations and identify future strategies.

Based on resource-reputation exchange theory and case analyses, this report makes exploratory contribution to clarify the logic behind nonprofit-corporate collaboration. It should be noted that while acknowledging that there is a great number of positive collaboration cases, our report focuses on negative cases, which provide lessons from failure.

In this report, first we propose the framework of nonprofit-corporate collaboration. In other words, why corporations collaborate with nonprofits, how the collaborations are formed, and what outcomes the collaborations produce. We then elaborate on the core characteristics and reasons of negative collaboration through case analyses. Last, the report concludes with specific policy implications.

I. Logic of Nonprofit-corporate Collaboration: Theoretical Model of Resource-Reputation Exchange

The nature of collaboration is the exchange of interests to obtain scarce resources, so is the nonprofit-corporate collaboration. Corporations are created to maximize stakeholders’ profits, and unquestionably, good reputation is one of the vital elements. For corporations, reputation is a scarce resource that has to be obtained from external social environments. Nonprofits, on the other hand, lacks financial resources but are empowered by the society to “grant reputation to other entities.” The resource complementation between corporations and nonprofits consequently forms the basis of collaboration.

Corporate reputation is defined by how much society trusts the corporation, which manifests the corporation’s ability to build and maintain trust with society. In other words, society is the source of reputation. Society also provides resources for the development of nonprofits; and more importantly, it gives nonprofits the power of awarding reputation. Therefore, nonprofit-corporate collaboration should be examined in the context of a macro-level society, which includes the public, the media, and the government.
1. Good Reputation helps corporations gain profits

Composed of public image, position in the industry, media response, and social responsibility, reputation is a comprehensive capital for corporations. As corporations pursue profit maximization, reputation capital plays a critical role, even though it is not directly shown on balance sheets and income statements. Theory and practice have demonstrated that good reputation offers corporations more benefits, especially financial profits. Reputation, however, is a scarce resource that accumulates gradually in daily corporate operation. Inter-organizational collaboration helps corporations deal with the shortage of resources in an unstable market. The nonprofits, which can award reputation to other entities, are therefore ideal partners for corporations to rapidly build up reputation. Yet it should be noted that corporations always prioritize their stakeholders’ benefits when making financial decisions and allocations. Since many stakeholders have implicit demands for corporate reputation, the collaboration with nonprofits is usually a means to maximize profit.

Corporations normally start collaborations with philanthropic programs that align with their business strategies and brand marketing, or simply with making donations. After communicating their philanthropic goals and contributions to the public, corporations collect public credibility and establish good reputation. In the short term, collaborations’ operating costs may increase; but in the long run, it is an “investment” on the basis of social exchange. This “investment” can convert reputation to “soft power” to enhance the corporations’ competitiveness. Nonprofit-corporate collaboration also helps corporations with public relations, crisis management, corporate image, employee loyalty, and potential employee recruitment. It will ultimately increase the sale of products and services, which creates greater profits.

(1) Maintain Public Relations

From the perspective of public relations, in any market, corporations must be involved in a network with local governments, the public, and local communities. Many corporations even invent a slogan that “Public relations are the first productive force.” International corporation practice demonstrates that one of the best public relations approaches is to actively participate in philanthropic activities. Most well-developed corporations, especially the international ones, have included this approach in their corporate cultures or strategic plans. No matter what objectives the corporations have, their participation in philanthropic activities fosters good public relations. By frequently collaborating with nonprofits, corporations effectively expand visibility, win favorable public impression, and enhance public trust in their products and services. Therefore, customers are more likely to choose their products, which bring more profits. Kotler put forward the idea of cause marketing—an effective approach to build corporate competitiveness through reputation and credibility. For example, considering its major customers are housewives who care about children, Procter & Gamble have established extensive collaboration with the China Youth Development Foundation (CYDF), the sponsor of the well-known Project Hope, for child welfare initiatives. With the collaboration, Procter & Gamble has earned great reputation among female customers and indirectly promoted its corporate image as well as its sales.

From the perspective of crisis management, reputation protects corporations’ social legitimacy in public relations crisis. On the one hand, good reputation reduces potential financial and network loss when corporate business activities affect certain stakeholders’ interests. On the other hand, good reputation improves organizational legitimacy and stability in daily operations.

(2) Promote Corporate Image

The economy today is sometimes considered an “attention economy.” Information development is about public attention rather than information itself. There are two types of attention: negative and positive. Corporations can either capture public attention with negative news, which will eventually destroy the organization, or with taking social responsibility, which gains more sustainable and positive attention. It is also only from positive attention that corporations will benefit.

Corporate image not only embodies corporate scope, products, and management skills, but also presents its commitment to social responsibility and obligation. Therefore, a philanthropic image is an essential component. It resonates with the public’s compassion, maintains social relations, promotes public credibility, improves customer loyalty, and increases corporate market share.

Corporations today are expected to take on more social responsibility. In response, corporations collaborate with nonprofits to demonstrate their values of the public good. These efforts allow corporations to shape a “responsible corporate image” that they are actively pursuing better values. A U.S. survey of 469 companies showed that both the returns on assets and sales were significantly positively correlated with corporate philanthropic performance.

Theoretically, cause marketing also highlights the importance of intangible resources, which include pub-
lic relations, corporate image, and corporate reputation. Accumulated through philanthropic activities, the intangible assets can influence corporations’ costs and benefits. In nonprofit-corporate collaboration, corporations should deliberately select philanthropic partners and programs and widely publicize their philanthropic activities. According to the cause-branding strategies, nonprofit-corporate collaboration has two ends. One end is corporations’ passive donation under the pressure of public opinion, which contradicts the corporations’ financial interests. Without financial motivation, the passive donation cannot sustain. The other end is the strategic donation, which is excessively narrow and sets an over-ambitious goal for corporations—who, based on the theory, will only benefit from charitable activities that impact their competition environment. As a result, many corporations may lack the confidence in making strategic donations. In between these two ends, Carol Cone and colleagues proposed the theory of cause-branding strategies. The theory argues that the purpose of corporate philanthropic activities is to improve corporate image and brand. By turning social obligations into valuable intangible assets, cause-branding strategies help to achieve both business goals and societal goals. In addition, Cone outlines five principles for cause-branding strategies: carefully select philanthropic projects, carefully select philanthropic partners, focus on specific social issues, fully leverage current resources, and finally, fully communicate the programs to the public.

(3) Foster Corporate culture
Corporate philanthropy influences not only external environment, but also internal factors, particularly corporate culture. Corporate culture, which is embodied in employees, is the soul of a corporation and cannot be copied by other corporations. Corporate culture guides the whole process of corporate operation. Corporate philanthropy mainly influences employees through the enriched philanthropic culture and increased corporate cohesion. When corporations engage in philanthropy, they are also intentionally cultivating a positive corporate culture.

Corporate reputation can attract and maintain employees, increase their sense of belonging, and improve employee loyalty and productivity. Employees and corporations are in an interest-exchange relationship, which is sustained by mutual benefit. Between employees and corporation, there is an “implicit contract,” which stresses employee satisfaction. When a corporation offers good working environment, a job that meets one’s career orientation, a sense of belonging, fair pay, training, professional development, and promotional opportunities, employees would be more satisfied. For instance, when employees think highly of the corporate image and culture of social responsibility, they are more loyal to the corporation. With higher satisfaction, employees carry out their responsibilities as agreed in the implicit contract and contribute to the corporation with a more positive attitude.

In terms of attracting potential employees, nonprofit-corporate collaboration improves corporation image, which raises their employees’ social status, therefore attracts potential applicants. At the same time, corporation sends multiple signals to society, including corporate values, which reduces the information asymmetry problem between employees and corporation and attracts job applicants who share corporate values. As a result, corporations have more human capital, competitive advantages, and ultimately greater corporate performance.

(4) Philanthropy Rent-seeking
Corporations with better social images win government support and social reputation more easily, which increases their market competitiveness. With the reputation gained through collaboration with nonprofits, corporations rent-seeking from society (mainly from governments) to increase revenues or lower costs. In general, a corporation frequently collaborates with nonprofits to package itself as a local “philanthropic corporation.” It then asks the local government to restrict market competition to consolidate its monopoly status and profits. The corporation may also apply for government subsidies, assistance, and preferential policies to lower its cost.

The rationale for this “rent-seeking” behavior lies in the “exchange” between governments and corporations. Government exchanges preferential policies with corporations’ rich resources. While corporations gain policy support and corporate owners gain individual political honor, governments gain corporate financial resources to invest in nonprofits. Through nonprofits, market resources are transformed into public goods, which promote state governance and legitimacy.

(5) Increase Corporate Sales or Product Price
Nonprofit-corporate collaboration improves the relationship between corporations and consumers, increases product demands, and improves corporate performance. For instance, the Nongfu Spring Company’s project, “One Cent,” is a typical case of increasing sales with growing reputation. Starting from supporting Beijing’s bid for Olympic Games in 2001, this project has been going on for four terms, with different themes almost every two years. The theme for the second term
in 2002 was “Sunshine Project;” in 2004, the theme was “Think about headwaters while drinking.” From sales of 500 million bottles of water, Nongfu Spring raised CNY 5 million to found an educational fund for children in the headwater regions together with the Soong Ching Ling Foundation. Through a series of cause marketing campaign, Nongfu Spring not only built a positive corporate image, but also gained financial success and took the lead of cruel “water industry battle” at that time.

In addition to influencing social recognition with reputation, the consumer-perceived risk theory also explains why nonprofit-corporate collaboration raises sales and product price. When product quality is similar, consumers tend to purchase brands that meet their expectations. In addition to the inherent pursuit of “kindness” in humanity, consumers often believe that an honest and socially responsible corporation produces high-quality products. More specifically, there are four possible explanations. First, through deductive reasoning, consumers believe that corporations who collaborate with nonprofits overall have no safety hazard. Purchasing their products would lower quality risks and physical loss. Second, in general, consumers believe that philanthropic corporations do not pursue excessive profits and set reasonable prices. Therefore, purchasing their products lowers price risk and financial loss. Third, consumers generally believe that philanthropic corporations care about their reputation and pay more attention to customer service. Thus, purchasing their products lowers after-sale risks and time loss. Last, many consumers see their purchasing from philanthropic corporations as a return to the society, which supports corporate philanthropic activities and manifests their own social responsibility indirectly. Consumers also tend to believe that philanthropic corporations value consumers’ feelings in product safety, reasonable price, and after-sales service. This is particularly important for fast-moving consumer goods industries that involve people’s daily life and food safety.

2. Nonprofits rely on resources, while they can represent society to award reputation

(1) Meet the demand on resources

Nonprofits are facing increasing social demands on public services. Resource not only sustains nonprofits, but also sustains the services they provide. Nonprofits need stable and sustainable resources to better serve society. As society imposes higher requirements on nonprofits, certain nonprofits’ limitations in management become a significant barrier.

Nonprofits can gain resources from society, governments, and corporations. Many corporate resources fit perfectly with nonprofits’ needs. These resources include money, management skills, media connections, media networks, and collaborative relations with governments. Good corporations also have the brand effect. By collaborating with large, famous corporations with good reputation, nonprofits raise their own social status, public attention, and credibility.

Although nonprofits can gain resources from the public and the government, corporate resources diversify nonprofits’ funding sources. Nonprofit-corporate collaboration also reduces nonprofits’ dependence on governments, which increases their autonomy. If the collaboration is long-term, corporate support, compared with public donation, is usually more stable and sustainable.

(2) Endorse corporate philanthropy

Nonprofits devote themselves to promoting public welfare and solving social problems, which concern public interests. Various actions of nonprofits conform to individuals’ psychological needs of doing good works, meet public interests, and align with the social division of labor. Hence, nonprofits follow public moral values, conform to social norms, represent public interests, and possess strong social legitimacy. For instance, nonprofits—such as those working on environmental protection, poverty alleviation, women and children’s rights, and animal protection—represent public willingness to work on these issues. Nonprofits, empowered by the public, act professionally to fulfill the public’s social responsibilities and rights to do good works.

Consequently, nonprofits have the right to raise funds from society and implement various programs for public good. At the same time, nonprofits prove to society which individuals or organizations have provided resources and made contributions to the public interest. The proof can be donation receipts or honors awarded. That is to say, nonprofits can endorse resource providers’ (including corporations) philanthropic activities. They can also award resource providers reputation on behalf of society.

The credibility, social impact, and social recognition of the reputation awarded by nonprofits, however, depend on the public trust of the nonprofits, which is determined by the public’s subjective judgment. The higher nonprofits’ reputation, the higher the social impact, recognition, and credibility of the reputation they award, and the higher social reputation the resource providers gain.

Nonprofits’ own reputation, on the other hand, also influences the level of support from government, society, and public. To a certain extent,
nonprofits’ reputation can be directly measured by how many social resources they collect, including annual or accumulative donations. Nonprofits’ reputation is accumulated over a long period through a time-consuming and complicated process. One misconduct or bad record, however, can ruin the years of accumulation, and then impair nonprofits’ abilities to fundraise from various resource providers. The government may not consider the nonprofits in government purchases; corporations may not want to involve with the nonprofits. Therefore, to a certain extent, nonprofits’ social reputation is also its lifeline.

This also suggests that when nonprofits are selecting partners, they need to consider the partner’s reputation and the appropriateness of the collaboration. Misconducts in nonprofit-corporate collaboration can damage the nonprofits’ reputation and image. Nonprofit-corporate collaboration is a cross-sectoral process that involves many stakeholders, including donors, corporations, recipients, and the public. In this complicated process, any mistake in the collaboration may cause high stakes. In addition, nonprofits represent not only themselves but also public interests. Certain nonprofits’ damaged reputation can harm the whole philanthropic sector. For instance, The Beijing Cigarette Factory and the Hope Project Beijing Branch co-founded the Zhongnanhai Charity Foundation and co-sponsored the philanthropic project 2010 Zhongnanhai Delivery of Love—Run for Love for low-income youths. The project, however, was criticized by many, as experts question whether the corporation was taking advantage of the Hope Project’s reputation for marketing cigarettes. The collaboration also impacted the Hope Project Beijing Branch’s reputation.

3. Society makes nonprofit-corporate “resource-reputation” exchange possible
The above analysis explains the process of how corporations gain reputation and nonprofits award reputation on behalf of society. Both take place in the background of “society.” Nonprofit-corporate collaboration is the exchange of “resource” and “reputation” via society between corporations and nonprofits. It is society that enables the match between corporations’ and nonprofits’ advantages and demands.

Moreover, nonprofit-corporate collaboration is a mutual-beneficial approach. Corporations invest resources in nonprofits, nonprofits show society on behalf of public interests, society trusts the information, society positively accepts the corporations, and corporations gain reputation and then profit. From the perspective of society, nonprofit-corporate collaboration promotes public welfare, which makes it a tripartite win as shown in Figure 1.

Of course, corporations can earn reputation through their own charitable projects, but collaborating with nonprofits gives them a philanthropic label, along with more social trust and recognition.

Reputation is a psychological transformation process of public perception. Good nonprofit-corporate collaborations result in tripartite win. This can be explained by the indirect reciprocity theory.

Social exchange theory posits that interpersonal interaction in essence is a type of exchange; society is the result of exchanges of individual actions and behaviors. Specifically, social exchange refers to the society’s psychological and behavioral exchange through interpersonal relationships. Its core is the principle of reciprocity. Reciprocity satisfies every party in social exchange. In 1987, Richard Alexander, in his The Biology of Moral Systems, first proposed the concept of indirect reciprocity to explain massive human collaboration behaviors. He argued that the helper provides help to recipients; the repay of such grace does not necessarily come from the recipient but from other recipients helped by other helpers. In addition, Alexander proposed the groundbreaking theory of reputation mechanism. Formed with presence of other people, the reputation mechanism contains the perspective of evolution. Reputation embodies people’s impressions, recognitions, and quality signals. In reciprocal exchange, everyone takes what he/she needs. It does not simply aim at profits, but other things that one desires. For instance, people pay money, goods, and manpower in exchange for honor, recognition, and emotional fulfillment. The media of reciprocal exchange may not necessarily be money, but social connections and moral values. The main motivation for reciprocal exchange is trust and moral belief between exchange parties.

The resource-reputation exchange originates from social morality. The operation of society needs rules, which protects the collective interests of organisms (e.g. tribes, ethnic groups, and nations) during economic production and daily life. The essence of morality is norm. Social norms consist of moralities and laws. The high cost of law enforcement limits its application. If every behavior that violates social norms is addressed by law, society would spend excessive resources on law enforcement (making relevant laws, lawsuits, etc.). Morality, on the other hand, restricts human behaviors and maintains social order through people’s beliefs, conventions, and consensus. It sustains social norms at low-
er costs. Society needs moralities as well as incentives and systems (such as laws and policies, socializing mechanisms, and rewards/sanctions) for moral behaviors. Among others, reputation mechanism is the tool that morality uses to maintain society norms. When there is potential “resource-reputation” exchange between nonprofits and corporations, collaborations become possible. As nonprofits are entitled to provide tax-deductible donation receipts, corporations have further incentives for collaboration. Currently, Chinese governments encourage corporate philanthropy and reduce or exempt tax for philanthropic donations. The central government allows pre-tax deduction for corporations engaged in philanthropic donations. In other words, the governments incentivize corporations to participate in public welfare at the cost of reducing tax revenue.

II. Extended Model of the Resource-Reputation Exchange Theory

One of the most important features of reputation is that it belongs to a subject but comes from others’ (society and government) evaluation. Society acquires information that is conveyed by nonprofits and corporations. Sometimes nonprofits, corporations, or both take advantage of information asymmetry and convey false information. If the truth is concealed, corporations and nonprofits may gain what they want—reputation and social recognition; but when the truth is revealed, both parties’ reputation is damaged and public interests are hurt.

Figure 2 presents the “social feedback matrix” of nonprofit-corporate collaboration. The matrix consists of four collaboration types across two dimensions: whether corporations and nonprofits convey factual information and whether society trusts such information.

The first type is when corporations and nonprofits convey factual information that the society trusts, corporations, nonprofits, and society achieve tripartite win. The second type is when corporations and nonprofits convey factual information but society distrusts the information, society benefits from the collaborations but corporations and nonprofits have no gain (this rare type is not included in this report). The third type is when corporations and nonprofits convey false information and society trusts the information, social interests are jeopardized. The fourth type is when corporations and nonprofits convey false information that society distrusts, all three parties lose from the collaboration. The first type is positive collaboration; the third and fourth are both negative collaborations. Figure 3 shows the extended model of negative nonprofit-corporate collaborations. Taking type three as an example, corporations invest low-value resources, lie to society, and gain uncoordinated reputational evaluation. Corporation obtains benefits much higher than their costs, which improves corporate financial performance. Nonprofits, on the other hand, award corporations the reputation of “philanthropists” in exchange for resources. During or after the collaboration, either the corporation or the nonprofits conveys information and outcomes to society, demonstrating that “the outstanding corporation made contribution to public welfare.” As the falsity of information is concealed, society gives positive evaluation and feedback to the collaboration, which benefits both the nonprofits and the corporation. But as the philanthropic goals are not achieved as claimed, social interest is impaired. Such collaboration contains high risk that the fraud can be discovered anytime, which will harm both the nonprofits and corporation’s reputation.

The fourth type is similar to type three. The only difference is that in the third type, society recognizes corporations’ good deeds while being deceived; but in type four, society discovers the fraud and disapproves the corporations’ behavior. The fourth category depicts common philanthropic scandals.

For instance, in collaboration with a corporation, a nonprofit organizes a commercial project while awards the corporation philanthropic labels and communicates the information with the society. When the public uncovers the false information, they fiercely criticize the corporation and the nonprofit. Although the collaboration offers the nonprofit financial resources, it ruined its reputation. As society believes that this nonprofit did not exercise its power as promised, society punishes the nonprofit through declined reputation and supply of social resources.

If a corporation provides low-quality products or services for philanthropic activities and the nonprofit over-advertises the corporation’s contribution, the consequence gets even worse. Such behavior not only is against nonprofits’ mission for public interests, but also damages the nonprofit and the corporation’s reputation, public image, and credibility.

III. Case Study: Positive/Negative Collaboration

1. Equal resource-reputation exchange
Corporations invest philanthropic resources in exchange for the reputation of “a good corporation,” but direct financial profit does not come immediately. When corporations or nonprofits communicate their collaborations and
outcomes to society, the public positively responds and awards reputation. The reputation eventually turns into corporate financial profits. In the exchange of resources and reputation, the invested resources and the returned reputation are balanced counterparts. For instance, donating CNY 100 million brings much greater reputation than donating CNY 100 thousand, as society receives much larger benefits from the donation. Although reputation cannot be quantified, it should be measured by the investment. To yield high return, corporations need to bear high costs.

Case 1. A Positive Collaboration with Tripartite Win

Scene 1: A medical equipment supplier (Company A) planned to donate certain medical equipment to a nonprofit (Organization B). Company C is the manufacturer of the medical equipment. The representative from Company A claimed that the market price of the equipment was CNY 9.8 million. After negotiation, Organization B determined to set the final donation value for each piece of the equipment as CNY 5 million. Company A also claimed its registered assets as CNY 100 million.

Scene 2: Organization B held a press conference for Company A’s donation and invited a governmental official to present. Company A was awarded the honor of “Philanthropist.” Organization B also issued an official document on the donation, which claimed that Company A donated 30 pieces of the aforementioned equipment (worth CNY 5 million/piece) with a total value of CNY 150 million. Later, Organization B told the press that the market price of equipment was CNY 9.8 million each.

Scene 3: A total number of 30 hospitals were eligible for the donation. Each hospital paid Organization B with CNY 600,000 administrative fee and promised to provide free medical services to low-income patients. Organization B stated that 80 percent of the administrative fee was transferred to Company A for equipment purchase, shipment, installation, tests, maintenance, personnel training, and other related activities. The rest would be used for Organization B’s management and publicity cost.

Scene 4: After one year, the press confirmed that the market price of the equipment was 9.8 million yuan. A total of 5,000 patients had received free services in the 30 hospitals. Organization B, Company A, and the hospitals won public praise.

Analysis: In this case, Company A, although charged certain service fee, offered a price much lower than the market price. Company A and Organization B delivered real information to society. Society trusts the information and recognizes the efforts made by the corporation and the nonprofits. At the same time, Company A marketed its products, built up its reputation, expanded its market, and obtained public recognition as a “philanthropist.” Thirty hospitals also received the resource, which helped vulnerable groups enjoy advanced medical technology and quality services.

2. Unequal “resource-reputation exchange”

With excessive pursuit of “low input–high output,” certain corporations think about further lowering its costs; some even try to earn reputation with zero investment. To reduce investment, these corporations will facilitate the resource-reputation exchange by any means.

Normally, corporations can make two moves. One is to “talk more and do less” to exchange more reputation from society with fewer resources. Some corporations even “exploit” non-profits by making profits through the collaboration. The other move is to “talk only and do nothing.”

(1) Talk-more-and-do-less corporations

Among the negative nonprofit-corporate collaborations, corporations “talk more and do less” are fairly common.

Case 2. Negative Collaborations with Tripartite Loss

Scene 1, 2, 3, and 4: Same as case 1. However, there can be four negative collaboration scenarios.

Negative Collaboration Scenario 1: After one year, in the internal evaluation process, Organization B confirmed that the market price of the equipment was CNY 9.8 million. But Company A only donated 5 equipment instead of 30 as promised.

As society still believes that Company A has made a donation of CNY 150 million, Company A managed to gain great reputation with little investment. In reality, it is common to see such cases. For instance, a corporation promised to donate CNY 10 million. But it only donated CNY 100,000 annually for several years and then ceased its donation. The corporation failed to fulfill its promise but still left the public with an impression of donating CNY 10 million.

Negative Collaboration Scenario 2: The press reported that Company A used to sell the equipment for only CNY 120,000 per piece and that Company A only had a registered asset of CNY 200,000. It is impossible for Company A to donate 150 million.”

If this report was true, Company A in fact only donated CNY 3.6 million (120,000*30) based on the equipment’s market value. In addition, Company A
received 80% administrative fee from each hospital, totaled CNY 14.4 million (600,000*80%*30). In other words, Company A made a large profit from selling the equipment to hospitals with a much higher price than the actual market value. Organization B, as the broker, earned CNY 3.6 million (600,000*20%*30) from this process. The hospitals bought the equipment at five times the market price. Moreover, society still believes that Company A has made a donation of 150 million. Thus Company A gained both money and excessive reputation.

Negative Collaboration Scenario 3. Scene 3 is replaced with “30 eligible hospitals did not need to pay any fees. They only need to sign an acknowledgement to receive the equipment marked CNY 5 million worth.” Scene 4 is replaced with “It was reported that Company A used to sell the equipment for only CNY 120,000 per piece.”

This case is uncommon. As beneficiaries, the hospitals accepted the boasted price since they were provided with free equipment. Therefore Company A exchanged the reputation that is worth CNY 150 million with a 3.6 million cost.

Negative Collaboration Scenario 4. The first two scenes stay the same. Scene 3 is replaced with “30 eligible hospitals did not need to pay any fees. They only need to sign an acknowledgement to receive the equipment marked CNY 5 million worth.” Scene 4 is replaced with “It was reported that Company A used to sell the equipment for only CNY 120,000 per piece.” Scene 5 is added: “Company A made an extra donation of CNY 50,000 to Organization B. Organization B provided Company A with a donation receipt of CNY 150 million.”

To Organization B, the donation receipt is only a piece of paper. Company A bought the paper with CNY 50,000 but claimed a much higher donation. Company A therefore receives tax deduction, which may be greater than the 50,000 cost.

(2) Nonprofits are deceived by agents

In the negative collaboration cases, the nonprofits either are deceived by or collude with the corporation. The collusion, however, usually does not involve the whole nonprofits, but certain agents. For instance, in the case of negative scenario 4, Company A bribed Organization B’s executive director (i.e. the agent). Urged by the agent, Organization B provided a false donation receipt for Company A.

IV. Underlying Reasons for Negative Collaborations

There are many reasons for negative collaborations across corporations, nonprofits, and society. This may include: in corporations, excessive pursuit of financial profits and corporate leaders’ low morals; in nonprofits, the organizational dual management dilemma and inadequate management skills; in society and governments, information asymmetry, weak public scrutiny, and inadequate laws and regulations. Different from negative corporate-corporate collaborations, the underlying reasons for negative nonprofit-corporate collaborations are nonprofits’ “soft” financial logic and dual management dilemma.

1. Nonprofit soft financial logic fosters contexts for negative collaborations

In most of negative nonprofit-corporate collaborations, corporations play tricks on the amount or price of invested resources. Many of these tricks succeed because of nonprofits’ “soft” financial logic.

First, under current policies, the asset accounting in charitable donations follows the accrual basis. The rules of accounting system sometimes deviate from substantial responsibilities. Put it simply, in-kind donations can be converted into money, and more important, the final say of this conversion value goes to nonprofits. By law, the currency value of in-kind donations should be in accordance with following rules: imported goods are based on the customs price; commercial products are based on actual market price; corporation-self-produced goods are based on cost; second-hand products are based on the market price of similar commodity, with pricing departments and assessment agencies’ advice. But in reality, nonprofits can easily decide the final price by themselves. Moreover, some nonprofits lack operational and financial transparency. The public has no information where the nonprofits spent their money. These financial operations, although may pass government review, eventually cannot avoid the public’s “impartial trial.”

Second, charitable recipients usually have a mindset of “Anyway I get something and pay nothing,” which makes them rarely consider cost effectiveness. Also, if recipients refuse to acknowledge the over-valued donation, nonprofits can always choose other recipients. Such logic motivates some corporations to collude with charities. For instance, a corporation donates a product that is worth CNY 10 to a charity, the charity labels its value as CNY 100 and claims so to the recipient. With the mindset of “Anyway I get something and pay nothing,” the recipient acknowledges the over-valued donation. Therefore, the account books present no problem.

In corporate-corporate collaborations, however, the above-mentioned
situation will not happen. No corpora-
tions will purchase a CNY 10 material
with 100; no consumers will pay 100
for a CNY 10 material. But in phi-
thropy, the boasted price often occurs
because consumers receive the mate-
rials for free. In addition, if recipients
refuse to accept donations because of
the concern of its values, then it may
affect their relationships with future
donors. Since the hoax does not show
in account audit, it goes on and on.
Corporations can boldly “talk more
and do less” without true contribution
to nonprofits.

2. Dual entrustment challenge in
philanthropic sector increases
chances of negative collaboration
A robust financial logic and account-
ing system is an important basis for
avoiding adverse selection and moral
hazard in entrustment of agent. Cur-
cently there is a gap in Chinese non-
profit financial logic, which increases
changes of negative nonprofit-
corporate collaborations.

Society expects nonprofits to
raise larger donations to provide more
programs and benefit more people.
Therefore, nonprofits receive better
reputation and demonstrate greater
performance if they (in fact or claim to)
have raised more money. This, howev-
er, is not the main reason of charities’
collision with corporations to deceive
society. If there is adequate self-
regulation inside corporations and
nonprofit, corporations and nonprofits
can hardly “play tricks” without being
noticed. The main reason for negative
collaborations, therefore, lies in chari-
ties’ dual entrustment challenge.

Charities’ first challenge is to
entrust board of directors. Since non-
profits represent public interests, theo-
retically, charities’ board of directors,
who are responsible for organizational
policymaking, should be entrusted by
the public. In actual operation, howev-
er, it is impossible for the entire society
to select board of directors. Some non-
profit, therefore, lack responsible
boards in this initial entrustment pro-
cess. In fact, the boards of directors in
many China’s nonprofits failed to ful-
fill their roles.

The second challenge is to en-
trust executives with daily manage-
ment tasks. In this entrustment, execu-
tives may try to maximize their own
interests, sometimes at the cost of or-
ganizational efficiency and outcomes.
China’s lagging legal scrutiny, philan-
thropic self-regulation, and accounta-
Bility system all intensified this chal-
lenge. For instance, while many do-
nors worry about charities’ accounta-
bility, some call for increasing account-
ability. Certain nonprofit, however,
consider these donors hostile.

The dual entrustment chal-
lenge is confirmed in reality. Charities’
boards of directors and executives
have many chances to sacrifice organi-
izational interests for their own. Take
the Guo Meimei scandal as an exam-
ple, one China Red Cross leader col-
luded with Guo Meimei’s friend for
his own interests. As the media report-
ed the scandal, both China Cross and
the public’s interests were threatened.

Of course, the dual entrust-
ment challenge by no means suggests
that all boards of directors and execu-
tives are irresponsible. While recog-
nizing the success of positive nonprofit-
corporate collaborations, we caution
that such challenge fosters negative
collaborations. In the positive collab-
orations, the win-win outcomes usually
result from organizational self-
regulation, boards of directors and
executives’ high moral standards, so-
cial responsibilities, and appropriate
judgment. When charities’ interests are
threatened, boards of directors and
executives should reflect on the organi-
zational system, their own morality
and responsibility, and sometimes
their own capacity.

V. How to Restrain the Occur-
rence of Negative Collabora-
tions

The analyses suggest that nega-
tive nonprofit-corporate collaborations
result from corporations and charities’
inherent limitations. According to the
rational economic man theory, levels of
risk—which involve public exposure
and sanction—determine how likely
corporations deceive the public. To
avoid negative collaborations calls for
charities’ self-regulation and external
scrutiny.

Since internal and external scruti-
ny each has its strengths and weak-
nesses, effectively integrating both is
the basis for positive nonprofit-
corporate collaborations. In terms of
strengths, charities’ internal monitors
can acquire more information and thus
have stronger scrutiny capabilities.
Internal scrutiny departments, with
legitimacy, also avoid conflict of indi-
vidual interests. External scrutiny, on
the other hand, has a variety of partici-
pants and oversees more aspects of
organizational operation. But both ap-
proaches have weaknesses. Internal
scrutiny usually neglects external
stakeholders’ interests, and over-strict
internal scrutiny may limit managers’
creativity. The main issue with exter-
nal scrutiny lies in the interest diver-
gence among monitors, which makes
them hard to cooperate. Also, without
legal power, external scrutiny is chal-
leading and unsustainable. In sum,
positive collaborations call for an effec-
tive and comprehensive scrutiny sys-
tem that involves self-regulation, mutu-
al-regulation, and external regula-
tion.
1. Nonprofits need to discern their values and corporations’ purposes

The society is divided into three distinctive sectors. The significance of the third sector is that it excludes logics of capital and market. In this sector, something else organizes people, realizes their dreams, and creates an ideal society. Shareholders and political coercion are not allowed in this sector. Governments and corporations provide resources but cannot do whatever they want. Every sector has its own operating logic, ideology, and rules. Capital tends to penetrate its influence into governments and the third sector, expanding to the broader world.

Corporations desire to raise or renovate their public image and impress consumers through cross-sectoral collaborations, particularly through working with charities. In addition, nonprofits help corporations save advertising and marketing costs as the collaborations bring free media exposure and many new public relation resources. Corporations can also connect to charities’ clients, employees, board of directors, and donors, who become potential consumers. All these direct and indirect resources motivate corporations to collaborate with charities. Nonprofit, however, should discern their own values, roles, and goals of collaborations.

(1) Systematically manage the reputation-award process

Therefore, nonprofits should recognize their own value. From the perspective of market economy, a charity’s most valuable asset is its image and reputation, especially its right to award social reputation. Income from nonprofit-corporate collaborations is only a secondary asset. Only when organizational reputation steadily increases, will the charity generates income, or attracts financial support from all sectors of society, especially governments and the public. Over-dependence on collaboration with corporations brings great risks to charities’ operation and brand.

To be specific, nonprofits should improve brand management during cross-sectoral collaborations. The first step is to protect its own brand and image by giving corporations strict requirements in using the charity’s name and logo in commercial activities. Second, when awarding reputation, nonprofits should sign agreements with corporations that regulate both parties’ rights, obligations, and boundaries to include the charity’s brand in commercial activities. While encouraging nonprofit-corporate collaborations, nonprofits should ensure the collaboration does not contradict its philanthropic mission. Nonprofits should forbid their corporate partners to use their names and logos in irrelevant commercial activities. Finally, nonprofits should strengthen scrutiny of corporations’ commercial activities. If nonprofits find corporations abuse their brand for commercial purposes, they should stop related activities and pursue legal sanction.

(2) Rigorously select corporate partners

As stated above, corporations’ innate motive for nonprofit-corporate collaboration is to promote its public image and financial performance. Therefore, nonprofits cannot depend on organizational development on nonprofit-corporate collaborations. To lower the risks during collaborations, nonprofits must choose their partners carefully.

Before collaboration, nonprofits should first consider whether corporate objectives are in accord with their organizational mission. Also, nonprofits should investigate more about potential partner corporations to reduce information asymmetry. Systematic investigation prevents inappropriate choice of partners, ensures collaboration quality, and maximizes charities’ mission and objectives. Investigation also avoids collaborations that threaten charities’ financial safety and maintains the value of philanthropic assets.

2. Nonprofits need to address the soft financial logic and dual entrustment challenge through self-regulation

Naturally corporations seek to maximize their profits. It is understandable that they start from their own interests in decision-making. But nonprofits can address their own limitations to reduce moral risks. When institutional scrutiny is well established, corporations’ misconduct is more likely to be discovered, which reduces the chance of such problem. Every charity needs to set behavioral standards, code of ethics, and internal management system to regulate its own members, namely, self-regulation.

(1) Refine governance and facilitate internal accountability

Nonprofits carry great social expectation and responsibility. Filling in the gap between market and government, nonprofits are expected to promote social justice and humanistic care.

To fulfill their mission and responsibilities, it is essential for nonprofits to refine their governance and facilitate internal accountability. One important function of governance is to prevent corruption. Many Chinese charities’ governance, however, relies on the leaders’ charisma, participants’ passion, and organizations’ common belief rather than a comprehensive administrative system to lower the risk of corruption.
(2) Establish information disclosure system
Information disclosure is an important tool for charities’ self-regulation and accountability. It also powerfully influences organizational behavior and protects stakeholders’ interests. Unlike corporations, nonprofits have no rights of keeping organizational secrets. Established for philanthropic purposes, they are obliged to disclose financial, activity, and governance information to the public. According to Justice Louis Brandeis, “Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants.” Strengthening financial scrutiny of nonprofits include various aspects. For instance, nonprofits should have official financial regulations and processes to avoid financial misconduct. This may include expenditure approval, expenditure monitor, financial report, monthly account checking with banks, and strict reimbursement requirements. All staff, including employees, volunteers, managers, and boards of directors, should know and follow the financial regulations and related sanctions. Nonprofits should make budget according to donation income, service fee, and estimate expenditure; staff should be involved in the process. Nonprofits should expend fund according to the budget and donors’ mission, check financial accounts at least every three months, provide annual financial reports and audit results, and improve financial transparency, which allows employees, donors, and other stakeholders to check organizational financial performance anytime. Charity should also release important financial information in brief reports or on social media. The comprehensiveness of information disclosure may vary by organization size. Larger organizations should disclose more information. In Britain, all charities’ information disclosure follows the same prudent regulations as listed corporations. Although information disclosure brings certain costs, it increases organizational credibility and financial efficiency in the long term.

(3) Establish internal report system
Most “revealed” misconduct comes from internal reporting. Therefore, nonprofits should set up an internal report system.

Information asymmetry and interest conflict between external scrutiny and charity itself situate the two parties in a gaming dynamic. Once there is a gap in external scrutiny, charities’ chances of misconduct increase. Driven by individual interests, nonprofits may break rules without effective external scrutiny due to information asymmetry. A report system inside nonprofit, on the other hand, can make up for the information asymmetry as “whistle blowers.” An internal report system lowers scrutiny cost, increases penalty cost for charities’ misconduct, and forces nonprofits to abide by rules.

3. Strong external scrutiny can resolve the current problems and eliminate the root causes.

External scrutiny mainly comes from three parties: the philanthropic sector, governments, and society.

(1) Sectoral self-regulation
While the philanthropic sector enjoys tax benefits and public donations, it is obliged to achieve its mission and advance public interests. Sectoral self-regulation means that various organizations jointly develop and follow a set of behavioral and moral standards. In many countries, this usually involves professional associations. Although participation in these associations is voluntary, compliance with the sectoral rules are sometimes a prerequisite. To the philanthropic sector, this type of regulation is conducted by itself; but to individual member nonprofit, this regulation is voluntary and mutual. Compared with individual organization self-regulation, sectoral regulation has more normative standards and more powerful effects. In comparison with other types of external regulation, sectoral regulation is more organized, standardized, and coercive.

Currently, the China Union of Self-Disciplinary Organizations (USDO) and China Foundation Center both have made a difference in sectoral regulation. On December 17, 2011, the Center for Charity Law of Peking University hosted the Charity-Business Collaboration Seminar, sponsored by the Narada Foundation and Tencent Foundation. At the seminar, 24 foundations declared their willingness of accepting the Nine Codes of Conduct for Nonprofit-corporate Collaboration. All of these foundations promised to follow the regulations when collaborating with corporations and engaging in commercial activities. As providing sustainable philanthropic resources via cross-sectoral collaborations, nonprofits also guarantee the righteousness and credibility of the philanthropic cause.

In western countries, sectoral regulation mainly takes the following forms: first, sectoral approval. The association acknowledges a charity as its member, which increases the charity’s social legitimacy. When members break the rules, they may be criticized by and expelled from the association. Second, sectoral reward. The association evaluates members’ performance and rewards the outstanding ones. This increases the outstanding members’ credibility and imposes invisible
pressure on those underperformed members. Third, sectoral rule-setting. The association designs and implements feasible operational standards and requirements for members. By standardizing individual organizational behaviors, the association regulates the whole profession.

(2) Governments must “do something”
It is generally assumed that governments, which represent the public’s rights of governing society, are responsible for social development and public interests. They are responsible for making laws and policies and supervising other social entities, which include nonprofit, who receive governments’ financial support and tax-preferable policies.

Currently, Chinese nonprofit, including social organizations, private non-enterprise units, and institutional organizations, are inspected annually. The lack of accountability measures, however, makes the annual inspection superficial. The inadequate supervision of nonprofits has increased chances of corruption. Therefore, establish an effective and government-oriented inspection system is imperative.

First, on the legislative level, laws and regulations should be amended. Chinese governments need to strengthen the legislation on charities’ operational process, rather than initial registration. While the Chinese philanthropic sector develops fast, related legislation is lagging. Well-developed legislation maintains sectoral order, cultivates a healthy policy environment, constraints charities’ misconduct, and judges the legitimacy of organizational behaviors. Charity-related legislation includes accreditation, operational process monitor, and audit and evaluation. In the United States, Japan, and west Europe, where nonprofits are rather well-developed, legal registration is not the most important measure for organizational legitimacy. Instead, the regulations mainly focus on monitoring organizational behaviors, among which tax payment is the most important. Chinese legislation, however, concentrates on charities’ registration status rather than organizational actual operation process. Therefore, Chinese governments should strengthen scrutiny on charities’ financial performance, taxation, and revenue and expenditure management through national, targeted, and specific legislation. The legislation on charities’ “soft financial logic” should also be improved. A stronger financial logic, or accounting system, is the important basis on which adverse selection and moral hazard in entrustment of agent can be avoided. In China, huge flaws in public welfare financial logic not only create conditions for corporations taking advantage of nonprofit, but also make the entrustment process more problematic. The key issue is to prevent conversion of donated materials into funding.

Of course, to encourage nonprofit-corporate collaboration, government should provide nonprofits with legal implementation and protection on tax preferences. In this way, nonprofit organization has the relevant advantages when engaging in commercial activities and could raise more money as well as other relevant resources. Most importantly, government should also provide legal regulation and guidance when charity is collaborating with other organizations. Regarding nonprofit-corporate collaboration, government offers tax reduction and exemption for collaborating corporations to raise corporation motives and to create a favorable social atmosphere in which people do good works according to law. Matched policies concerning charity-government or nonprofit-corporate collaboration should also be formulated to protect both parties’ right and to prompt better collaboration.

Second, on the executive level, a comprehensive sanction mechanism can reduce gaps in law enforcement. As charities’ main supervisor, governments’ sanction power guarantees their effective scrutiny. To effectively exert this power, Chinese governments should strengthen their supervision on charities. There are two possible approaches. One is to appoint independent regulatory entities or government departments to carry out legislative, executive, and judicial function. The other is to establish a specialized supervising institution with clear labor division. For instance, a specific institution in Department of Civil Affairs can be established to supervise nonprofits and conduct process and quality scrutiny.

With their sanction power, governments should investigate and punish nonprofits and corporations when they break laws or have organizational misconduct. This may include nonprofits sacrifice their mission for financial benefits and corporations manipulate nonprofits to take advantage from philanthropic activities.

(3) The public and media’s scrutiny and pressure
Without external scrutiny, nonprofit-corporate collaboration becomes opaque. Without media exposure and consensus pressure, nonprofits are likely to pursue interests against their mission. When moral cost is higher than incentive for immoral behaviors, however, misconduct can be prevented. Therefore, negative nonprofit-corporate collaborations can be constrained by increasing moral cost. Individual and organizational misconduct should be punished by not only laws, but also the media and public opinions.
The effectiveness of public and media scrutiny is closely related to charities’ information disclosure. As discussed before, unlike for-profit organizations, nonprofits must disclose their revenues, expenditures, activities, and management information to the public. Therefore, the basis of social scrutiny is charities’ information disclosure, mandatory or voluntary.

Second, the public need more participatory approaches to shift their passive participation to more active scrutiny. As the public’s main information source, the media not only represents views of the media industry, but also influences public opinions and has wide-spread social effects. Therefore, the media can effectively guide and restrain charities’ behaviors. To enhance media scrutiny, the Chinese governments should further relax controls on freedom of the press, namely, give media the space and opportunities for self-expression. The governments should also prevent media’s unintended consequences, represented by “network violence.”

More important, the awareness, capacity, and efficiency of public scrutiny need to enhance. Philanthropic causes are value-oriented. Although philanthropy needs to be regulated by law, it is supported by moral values, the ideological foundation of human behaviors. To eliminate nonprofit-corporate misconduct calls for establishing individual moral standards and regulating behaviors.

The public include donors, volunteers, beneficiaries, and a variety of other stakeholders. They represent the common interests of the whole society. Therefore, the public should strengthen their awareness of scrutiny, monitor nonprofits through inquiry, investigation, discussion, group communication, and policy participation. Public participation will urge nonprofits to take legal and social responsibilities, enhance accountability, and eventually protect public interests.

Exposure of the Guo Meimei and the China Red Cross scandal is a good example of how the public and media played their scrutiny roles. In this scandal, the public showed great awareness, strong ability, and high efficiency in researching the details and revealing the truth. This scandal was first discussed on Sina Weibo, the representative of new media communication in the personal-media era. With Sina Weibo’s wide-spread active users, the scandal immediately captured public attention. In personal media, everyone can be the source of news and influence public opinion. This personal-media trend is effectively strengthening public and media scrutiny.

Media scrutiny, however, should be fair. As a social instrument, the media has the responsibility to strengthen scrutiny of charities. It provides information to regulatory agencies, governments, and the public. It can impose substantial pressure on charities. Despite these unique advantages, sometimes the media mislead the public or cause social debate chaos to increase its social influence. Thus, media scrutiny also requires fairness.

As nonprofit-corporate collaborations become increasingly prevalent, governments or professional institutions’ supervision alone may cause high administrative costs and low efficiency. As a necessary complementary supervisor, the media has large coverage and offers the public easier access to relevant information. In addition, the unprecedented speed and scope of the information dissemination through media is exerting greater influence on nonprofits and corporations. Misconduct spreads rapidly and widely more than ever. With media scrutiny, nonprofits and corporations will pay more attention to regulating their behaviors, as the costs are beyond their control. The severe consequences, therefore, lower the chances of organizations harm public interests for their own benefit and sustain positive nonprofit-corporate collaborations.

In conclusion, external scrutiny is essential in nonprofit-corporate collaboration. It urges nonprofits to work independently with corporations and focus on their mission and public interests. It also forces corporations to treat nonprofits equally in their collaborations in exchange for good reputation.

Note: The English version of the report is an excerpt from the Chinese version of the report. For complete information, please see the Chinese version of the report. Yiqi Zhang and Jin Ai are researcher at China Philanthropy Advisors. Translated by Jiaqi Guo and Shung Lu.
Figure 1. The Basic Model of Resource-Reputation Exchange Theory in Nonprofit-corporate Collaboration

Figure 2: The “Social feedback matrix” of nonprofit-corporate collaboration
Figure 3: The Extended model of “Resource-Reputation Exchange” Theory in Nonprofit-corporate Collaboration.