

# Stakeholder orientation and financial performance of NPOs: development and testing of a mediating model

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## Abstract

Literature examining how stakeholder-oriented strategy helps non-profit organizations (NPOs) cope with environmental uncertainty is limited. Thus, this study builds and tests a mediating model to investigate the relationships among stakeholder orientation, social performance and financial performance of NPOs. Data from 32 NPOs were collected in east China. Multiple regression analysis was employed to examine the relationships among the variables. The results revealed that stakeholder orientation has a positive and significant relationship with both social performance and financial performance. Meanwhile, it was discovered that social performance is significantly related to financial performance. Further, the results provided empirical evidence that the relationship between stakeholder orientation and financial performance was fully mediated by social performance. The limitations and future research directions were also discussed. This paper not only contributes to the theory of stakeholder orientation but also provides practical implications for NPOs on how to improve organizational performance.

*Keywords:* stakeholder orientation, NPOs, social performance, financial performance

## 1 Introduction

Over the past few decades non-profit sector has become “the third sector” that is independent of government and enterprise (for-profit sector), playing an important role in defusing “government failure” and “market failure” [1]. China’s non-profit sector has also experienced an unprecedented development and become an indispensable part in building “socialist harmonious society” with its wide range of involvement in social welfare, health care, education, community services, etc. However, non-profit organizations (NPOs) are commonly operating in a more highly competitive environment which is characterized by the increasing demands of stakeholders and the declining grants from governments. China’s NPOs, which are currently undergoing a comprehensive social and economic reform, are no exception to this trend. There has been a great deal of academic and practitioner interests in the concept of stakeholder orientation and its impact on organizational performance. Stakeholder orientation is critical for any organization to succeed in a fast-paced, global and turbulent environment. Thus, how to use stakeholder-oriented strategies to access external resources and to meet stakeholders’ requirements has become a practical problem to be solved for NPOs.

Despite the acknowledgment of the importance of stakeholder-oriented strategy to NPOs, scholars and practitioners are faced with a significant gap in knowledge about this subject, especially in developing countries like China which undergoes comprehensive reform and transition, and where the visibility of NPOs is a fairly new phenomenon. Meanwhile, we have also

observed another two noticeable theoretical gaps in literature. First, the stakeholder orientation literature has focused primarily on enterprises, which produced implications that are not necessarily applicable to NPOs. Second, in the analysis of stakeholder orientation and performance, most scholars have treated organizational performance as a single-dimensional construct, which neglected the multi-dimensional performance characteristics of NPOs. This study attempts to make some contributions by examining the relationships among stakeholder orientation, social performance and financial performance in China’s non-profit context.

The conceptual model is shown in Figure 1. The key interest for this research is whether the relationship between stakeholder orientation and financial performance is direct, indirect or both direct and indirect in the non-profit context. The rest of this paper is organized in the following manner. We first provide a brief review of the relevant literature and develop hypotheses. This is followed by discussions of the research methodology and results of the empirical study. We conclude the paper with the implications of the findings and give some suggestions for future research.

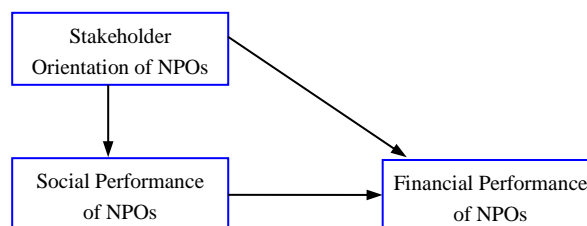


FIGURE 1 Conceptual model

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## 2 Hypotheses and conceptual model

### 2.1 CONCEPTUAL FOUNDATIONS

In the late 1990s, scholars extended the research scope of market orientation to NPOs and conducted fruitful exploration. According to market orientation theory, customer orientation and competitor orientation should be well coordinated. However, market orientation is mainly the comprehensive measurement of two kinds of stakeholders of customers and competitors, and the consideration of other stakeholder groups seems insufficient [2,3]. With the integration of the stakeholder concept, scholars and practitioners began to focus on more types of stakeholders and studies relating to stakeholder orientation have emerged.

American Marketing Association (AMA) proposed a new definition for marketing in 2004. According to AMA, marketing is the activity, and processes for creating, communicating, and delivering values for customers, clients, partners, and society at large. Berman et al. defined stakeholder orientation as how the organization manages different stakeholders through resource allocation decisions [4]. In this vein, Greenley et al. defined stakeholder orientation as the strategic focuses on the interests of various stakeholders and management behaviours to meet different stakeholder's requirements by corporate capabilities and assets [5]. In view of the previous scholars did not pay enough attention to the measurement of stakeholder orientation, Yau et al. developed a stakeholder orientation scale of four dimensions: customer orientation, competitor orientation, shareholder orientation and employee orientation [6].

### 2.2 HYPOTHESES DEVELOPMENT

Sargeant et al. objected to apply the concept of market orientation to non-profit sector directly and put forward the concept of social orientation, in which the "stakeholder concerns" was treated as a sub-dimension of social orientation [7]. Padanyi and Gainer also argued that single emphasis on customer orientation cannot reflect the characteristics and diversified missions of NPOs [3]. Kelly proposed that NPOs should balance the interests of multiple stakeholders [8]. Hsieh argued that stakeholder orientation is related to performance and verified stakeholder orientation toward different stakeholder impacts performance differently in the non-profit art context [9].

However, currently no literature has provided evidence of this relationship using China's NPOs as samples. Given the multi-dimensional performance characteristics of NPOs, we used both social performance and financial performance as performance indicators. Therefore, the following two hypotheses are advanced:

H1: Stakeholder orientation positively influences social performance in NPOs,

H2: Stakeholder orientation positively influences financial performance in NPOs.

Social performance may affect financial performance by increasing organizational reputation and stakeholder trust. For one thing, positive reputation often leads to good relationships with stakeholders. For another, trust is critical to augment stakeholder satisfaction and interactive behaviour. Customer satisfaction results in customer retention and loyalty, and provides increased financial outcomes [10]. Anderson et al. confirmed that non-financial performance was positively related to economic returns on a sample of 77 enterprises in Sweden [11]. Accordingly, we conclude that, for NPOs, social performance can affect financial performance through social reputation and stakeholder satisfaction. Our discussion leads to the following hypothesis:

H3: Social performance positively influences financial performance of NPOs.

As mentioned earlier, some studies have investigated the relationship between stakeholder orientation and organizational performance while others have tested the inter-relationships among different dimensions of performance such as non-financial performance and financial performance. Since a mediator variable accounts for a significant portion of the relationship between a predictor variable and criterion variable, there is a great need to clarify whether social performance is capable of mediating the relationship between stakeholder orientation and financial performance in the non-profit context. Hence, the following hypothesis is advanced:

H4: Social performance mediates the relationship between stakeholder orientation and financial performance of NPOs.

## 3. Methods

### 3.1 SAMPLING AND DATA COLLECTION

This study selects industrial associations and community health service institutes, which act as the representatives of China's "public benefit" and "mutual benefit" NPOs respectfully, as samples for empirical analysis. All samples were taken from east China's Jiangxi province. In addition, organizations which were established less than 2 years were excluded from this study for too young organizations might not have regular stakeholder management activities. Data were collected by distributing questionnaires to the respondents that were required should be high ranking executives. Using convenience sampling method, totally 32 valid questionnaires were recovered, including 11 industrial associations and 21 community health service institutes.

### 3.2 MEASURES

To ensure the questionnaire items used in previous studies were applicable in China's non-profit sector, first, two-way translation of the items between English and

Chinese was carefully conducted; second, structured interviews with 5 high ranking executives from NPOs were made; third, a pilot test was undertaken. Based on the above three steps we determined the final survey questionnaires. All items were described by seven-point Likert scales ranging from 1 = completely disagree to 7 = completely agree. Following previous researches [6, 9], the present study utilized customer orientation, employee orientation and government orientation to measure stakeholder orientation. A ten-item scale reflects the extent to which the compliance between items and the organization's actuality.

Organization size and age were included as control variables because of their potential impact on organizational performance. Organization size is measured by the number of the organization's full-time employees and organization age is measured by the years of establishment.

3.3 STATISTICAL TECHNIQUES

Reliability analysis was carried out to examine the reliability of measures. Correlation analysis was conducted to find the correlations between variables. Multiple regression analysis was applied to examine the relationships among stakeholder orientation, social performance and financial performance.

4. Results

4.1 RELIABILITIES AND CORRELATIONS

The Cronbach's alpha for stakeholder orientation, social performance and financial performance were 0.925, 0.832 and 0.903 respectively, which exceeded minimum acceptable level of 0.70. The reliability coefficients for the three dimensions of stakeholder orientation ranged from 0.862 to 0.929. Since all the measures have good reliability, the average score of the multi-items for each variable was computed and used in further analysis. Pearson's correlation analysis was used to demonstrate the correlations of control variable, independent variable and dependent variable. As shown in Table 1, stakeholder orientation, social performance and financial performance were significantly and positively correlated as expected.

TABLE 1 Means, standard deviations and correlations

Variable	Correlation matrix		
	1	2	3
1. Stakeholder orientation	0.925	0.434*	0.365*
2. Social performance		0.832	0.704**
3. Financial performance			0.903

Note: N=32, \*p<0.05; \*\*p<0.01; Cronbach's alpha on the diagonal

4.2 MULTIPLE REGRESSION ANALYSIS

To test the hypotheses of this study, multiple regression analysis was used. Table 2 illustrated the results of the

regression analysis. Model1a and model 1b are the base models that include the controls. They are both non-significant (p>0.05).

Model 2a demonstrated the direct impact of stakeholder orientation on social performance. It is significant at p<0.05 level (R2=0.228) and explained an additional 21.0% variance over Model1a. Accordingly, this result supported Hypothesis 1 which states stakeholder orientation positively influences social performance of NPOs. Model 2b demonstrated the direct impact of stakeholder orientation on financial performance. It is significant at p<0.05 level (R2=0.187) and explained an additional 16.8% variance over Model 1b. Accordingly, this result supported Hypothesis 2 which states stakeholder orientation positively influences financial performance of NPOs. Model 3 showed the relationship between social performance and financial performance. It is significant at p<0.001 level (R2=0.532) and explained an additional 51.3% variance over Model 1b. Accordingly, this result supported Hypothesis 3 which states that Social performance positively influences financial performance of NPOs.

This study follows Baron and Kenny's [12] procedure to analyse the potential mediating effect of social performance in the relationship between stakeholder orientation and financial performance. See Figure 2 for a simple statistical mediation model.

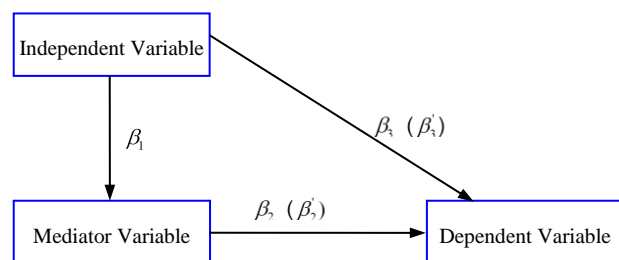


FIGURE 2 Mediation model

Step 1: Use the mediator (M) as the dependent variable in the regression equation and X as an independent variable. In Equation (1),  $\beta_1$  should be significant.

$$M = \beta_0 + \beta_1 X + \varepsilon_1 \tag{1}$$

Step 2: Use Y as the dependent variable in the regression equation and M as an independent variable. In Equation (2),  $\beta_2$  should be significant.

$$Y = \beta_0' + \beta_2 M + \varepsilon_2 \tag{2}$$

Step 3: Use Y as the dependent variable in the regression equation and X as an independent variable. In Equation (3),  $\beta_3$  should be significant.

$$Y = \beta_0'' + \beta_3 X + \varepsilon_3 \tag{3}$$

Step 4: Use  $Y$  as the dependent variable in the regression equation and  $X$  and  $M$  as independent variables simultaneously. In Equation (4),  $\beta_2'$  should be significant.

$$Y = \beta_0'' + \beta_3'X + \beta_2'M + \varepsilon_4. \tag{4}$$

If all these conditions hold and are in the predicted direction, then the effect of  $X$  in Equation (4) must be less than in Equation (3). Full mediating effect exists if  $X$  has no effect when the mediator is controlled.

According to the above procedure, the first step in this study is to examine the relationship between the independent variable and the mediator. As model 2a showed that stakeholder orientation relates significantly to social performance.

The second step in this study is to examine the effect of the mediator on the dependent variable. As model 3 showed that social performance positively influences financial performance.

The third step in this study is to examine the impact of the independent variable on the dependent variable. As model 2b showed stakeholder orientation positively influences financial performance.

The fourth step in this study is to include the dependent variable and the mediator simultaneously in the model to examine whether the mediator reduces the effect of the independent variable on the dependent variable. As model 4 showed, the relationship between social performance and financial performance is positive and significant, indicating the direct effect of social performance on the dependent variable. In addition, social performance reduced the effect of stakeholder orientation on financial performance to non-significance. Thus social performance played a full mediating role in the relationship between stakeholder orientation and financial performance. Accordingly, the result supported Hypothesis 4 which states Social performance mediates the relationship between stakeholder orientation and financial performance in NPOs.

TABLE 2 Results of regression analysis

Variable	Social Performance		Financial Performance			
	Model1a	Model2a	Model1b	Model2b	Model3	Model4
Control Variables						
Organization Size	0.158	0.104	-0.159	-0.208	-0.274	-0.278
Organization Age	-0.112	-0.120	0.121	0.113	0.202	0.195
Independent Variable						
Stakeholder Orientation		0.462*		0.414*		0.102
Mediator Variable						
Social Performance					0.723***	0.676***
$R^2$	0.018	0.228	0.019	0.187	0.532	0.540
$\Delta F$	0.250	7.060	0.260	5.389	28.561	19.211

Note:  $N=32$ , \* $p<0.05$ , \*\*\* $p<0.001$

## 5. Conclusions and implications

### 5.1 CONCLUSIONS AND DISCUSSION

Echoing previous research's suggestions [13], this study develops a mediating model to examine the relationships among stakeholder orientation, social performance and financial performance in the context of NPOs.

The findings of this study indicate that stakeholder orientation has significant influences on both social performance and financial performance in NPOs. This result is consistent with the theoretical argument proposed by Maignan et al. [14] in that stakeholder-oriented strategy will contribute to improved non-financial and financial performance. This analysis has also supported previous empirical findings that stakeholder orientation is a critical determinant of performance of non-profit performing arts organizations [9]. Besides, the results reported here suggest that social performance is also a mediating variable, through which stakeholder orientation impacts on financial performance. A recent study performed by Mahmoud and Yusif [15] is further enhanced with our result, as the non-economic performance was seen to fully mediate the relationship between market orientation and economic performance of

NPOs. Thus, this study adds to the current body of knowledge that social performance plays very important role in understanding the relationship between strategic orientation and financial performance.

### 5.2 IMPLICATIONS

This study makes two major theoretical contributions by providing a better understanding on the relationships among stakeholder orientation, social performance and financial performance. Firstly, while some scholars have studied the relationship between stakeholder orientation and firm performance, research in emerging economies and in non-profit context is largely neglected. This present study, which has been performed on NPOs in China's transitional economy, adds to the theory of stakeholder orientation and NPOs. Secondly, studies on the mediating mechanism in the relationship between stakeholder orientation and financial performance are scarce. This study extends extant literature by examining how stakeholder orientation allows a non-profit organization to improve its social performance through which to improve financial performance.



From the managerial viewpoint, the findings of this study guide the practitioners of NPOs to a better understanding of the essentiality of stakeholder-oriented strategy. With the increasing demands from stakeholders and the growing competition for funds, NPOs are facing more competitive pressures in fulfilling organization's mission and achieving financial sustainability. Stakeholder orientation should be regarded as a key operation concept for China's NPOs to better obtain external resources to meet stakeholder requirements. A non-profit organization hoping to enhance its social and financial performance should pay attention to stakeholder-oriented practices. Specifically, practitioners of NPOs should emphasize the implementation of a set of practices, including assess and meet the beneficiary's demands, stimulate employees' creativity, create a harmonious working environment, and actively undertakes affairs entrusted by local government etc.

In addition, practitioners of NPOs should not take it for granted that efforts to increase stakeholder orientation will automatically enhance financial performance in the non-profit context. Since social performance plays a full mediating role in the relationship between stakeholder orientation and financial performance, practitioners of NPOs should commit to build stakeholder trust and good

social reputation which are critical antecedents of financial sustainability in uncertain environments.

## 6 Limitations and future research

This research is not without its limitations and should be developed in future research. The first limitation is that our data collection does not include multiple respondents. Since social performance measures in our study involve stakeholder trust and social reputation, future studies should gather information by establishing direct contact with stakeholders. Secondly, as the study employed a cross-sectional research design, a longitudinal research could provide more insight into the relationships investigated in this study. The last limitation is that empirical samples used in this study mainly came from one province in east China and were non-randomly selected, so research data will inevitably have limitations. More types of NPOs from larger scope should be used as samples to further test the views and conclusions presented in this study.

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