On-again, Off-again: Corporate Political Actions between Political and Corporate Governance in Transition Economies

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Abstract: This paper addresses the loose connection between political and corporate governance and identifies the contingencies under which the connection facilitates or hinders corporate political actions. Specifically, we examine whether and when firms are more likely to engage in active and passive political actions simultaneously in the private sector of transition economies. Drawing on resource based view, resource dependence theory and institutional theory we argue that the nature of firms – being reformed or conventional – will affect their propensity of political actions in transition economies. This relationship is moderated by whether firms adopt modern governance measures and internalize political convictions. We test hypotheses using a unique firm-level survey dataset on nationwide samples of privately owned firms in China in 2006. Results lend substantial support to hypotheses.

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Thank you for your comments and suggestions!

INTRODUCTION

What kind of relationships should firms cultivate and maintain with political authorities? A bourgeoning literature in nonmarket strategy (Baron, 1995; Baron, 1999; Baron & Diermeier, 2007; Lawton & Rajwani, 2015) and corporate political activity (Hillman, Keim & Schuler, 2004; Lawton, McGuire & Rajwani, 2013) has addressed the relationship. While the former literature stream has a broader appeal including social, political and legal arrangements and investigates issues, institutions, interests and information pertaining to nonmarket environment, the latter is more specific about political strategies and examines antecedents, types, outcomes, and performance implications of corporate political actions.

Current research defines corporate political actions (CPA) as firms' efforts to influence political decisions and public policies for private ends (Hillman et al., 2004). An implicit assumption of existing literature lies in the separation between political systems on the one hand and firms on the other, or the separation between – what we call – *political* and *corporate governance*. By *political governance* we refer to political actors with the capacity to impose legal constraints in a specific territory. By *corporate governance* we refer to the conduct of business by firms. Only then, relationships and ties between political authorities and firms can be established and preserved, which in turn justify such actions and contribute to firms' performance. Notwithstanding many studies examining antecedents of CPA including firm, industry, institutional level characteristics and issues (Hillman & Hitt, 1999; Hillman et al., 2004; Lawton et al., 2013; Lux, Crook & Woehr, 2011), how the boundary between *political* and *corporate governance* affects corporate political actions is still an underexplored topic. This is rather surprising since it is widely known and taken for granted that government-business relationship varies over time and between countries (Coen, Grant & Wilson, 2010). In particular, this relationship has significant impact at the firm and societal level in transition economies, where market economy has not been fully developed and institutional changes are still in progress (Peng, 2000).

Our paper is based on the premise that political and corporate governance are not necessarily strictly decoupled as presumed, but loosely (de)coupled. Rather than considering political and corporate governance as separate matters that need to be connected through corporate political actions, this paper aims to address the loose connection between political and corporate governance and identify the contingencies under which the connection facilitates or hinders corporate political actions. Specifically, we examine whether and when firms are more likely to engage in proactive and passive political actions *simultaneously* in the private sector of transition economies. Drawing on resource based view, resource dependence theory and institutional theory we argue that the nature of firms – reflected in the interdependency between political and corporate governance – will affect their propensity of political actions in transition economies. *Reformed* firms – politically and organizationally transformed from the central planning system to the market economy system, compared to *conventional* firms, are more likely to passively (upon government's request) engage in political actions. Concurrently, they are less likely to proactively (governance's proposal) engage in such actions. Two moderating conditions may alter this relationship. The first factor relates to whether firms adopt modern governance measures and the second factor relates to whether firms publicly convey political intimacy.

This paper tests its hypotheses using a unique firm-level survey dataset on nationwide samples of privately owned firms in China in 2006. Results lend substantial support to our hypotheses. By so doing, our paper makes three contributions. Firstly, it contributes to the CPA literature by advancing our knowledge of the relationship and boundary between political and corporate governance. Moreover, it also contributes to the emerging research on firms' political strategies by identifying proactive and passive actions simultaneously. Lastly, it broadens our understanding of CPAs in the context of transition economies.

THEORETICAL DEVELOPMENT AND HYPOTEHSES

CPA between Political and Corporate Governance

Extant literature often views CPA as "legal, firm-level engagement with institutionalized actors and structures" (Lawton et al., 2013: 87). Firms need to and are willing to engage in CPA to influence government processes and public policy, because "the political process is so complex that it is virtually impossible for corporation to understand all of its aspects and procedures" (Hillman, Zardkoohi & Bierman, 1999). Firms can adopt proactive and defensive CPA to influence and shape policies or they can adopt reactive or anticipatory CPA to monitor or comply with policy changes (Oliver & Holzinger, 2008; see also Blumentritt, 2003; Hillman & Hitt, 1999; Meznar & Nigh, 1995). Resting on resource based view (Barney, 1991; Keim, 2001; Penrose, 1959) and resource dependence theory (Hillman, Withers & Collins, 2009; Pfeffer & Salancik, 1978; Wry, Cobb & Aldrich, 2013); current studies assume the external nature of inter-organizational interdependence and therefore a clear boundary political and corporate governance. Consequently, the uncertainty of government-business relationship can be addressed by leveraging resources and managing dependencies through building and cultivating ties and relationships (Zheng, Singh & Mitchell, 2015).

A clear boundary between political and corporate governance can be expected in contexts with well-developed market structures and mature rules of games. By contrast, in places with weak market economy system and ongoing institutional changes, such boundary may be blurred because of sociopolitical reasons. Therefore, CPA requires additional qualification and redefinition. Firms' engagement in CPA may be motivated and bounded by specific circumstances beyond institutional, industry, and firm level characteristics presented in current research mainly focusing on the western context (Hillman et al., 2004; Lux et al., 2011). More specifically, our paper investigates the boundary between political and corporate governance in transition economies and how the boundary affects firms' engagement in CPA.

Resource Dependence Theory and CPA *(this section is still under development. Apologies for the inconvenience and thank you for your feedback on our presentation)*

CPA in Transition Economies

Broadly speaking, transition economies are "former Communist countries that experienced a centrally controlled, institutional system through 1990 but since then have been moving toward market-based systems albeit at different rates" (Shinkle & McCann, 2013: 1245; see also Peng, 2003). They can be located between controlled economies and developed economies in terms of the extent of economic reforms and the openness of economic systems (Hoskisson, Eden, Lau & Wright, 2000; Svejnar, 2002). In addition to the market orientation, institutional contexts also include regulatory frameworks, normative expectations, and shared cultural understandings (Scott, 2014), which shape the boundary between political and corporate governance.

In transition economies, political and corporate governance are mutually dependent across political and economic domains (Stark & Bruszt, 1998). Instead of being strictly decoupled, the government-business interface is often characterized by being loosely (de)coupled (Bromley & Powell, 2012; Meyer & Rowan, 1977; Orton & Weick, 1990). In line with the concept of sources of ambiguity including preferences of decision makers; unrelatedness between problems, solutions and actions; self-interests; and fragmented and incomplete information (March, 1987), loose (de)coupling occurs. In particular, we suggest “a spectrum of connectedness” (Bromley & Powell, 2012: 520) that is contingent on the resource deployment and dependence between political and corporate governance. On the one hand, political governance’s successful transition requires the transformation of corporate governance. Politically and legally, government encourages reform of firms from being owned by and entirely dependent on government to being privatized and independent and participating in market building (*reformed* firms). Government also encourages entrepreneurial venturing establishing a viable community of brand new private firms (*conventional* firms). Therefore, corporate governance is not simply an economic matter, but a political task that contributes to the continuity and stability of political authority and the long-term prosperity of a country. On the other hand, corporate governance of both reformed and conventional firms also relies on political governance’s preferences and policies. *Reformed* firms were born within government and are now seeking self-governance, so they require a relatively stable context and buffering zone that warrant favorable initial conditions and facilitate its independence and further development. By contrast, *conventional* firms need to legitimize themselves and accumulate social and political capital by establishing relationships with government. Following this line of reasoning, corporate governance is inherently a political matter in which political governance is considered being responsible for setting the ground for competition.

The uncertainty of expectation and reciprocity between political and corporate governance suggests that CPA in transition economies can be understood as a two-sided coin: simultaneous *passive* and *proactive* engagements are required. Both *reformed* and *conventional* firms can be mobilized by government as contributors to institutional transition, and both types of firms can also search for opportunities to expand and thrive. We refer to *passive* engagement as CPA upon government's request and *proactive* engagement as CPA of firms' proposal.

Reformed firms are an integral part and carriers of government's plan to transition from central planning economy to market based economy. The determination of government to reform such firms may prevent from assigning extra tasks to them, because the detachment of *reformed* firms from government may create difficulties and historical baggage. Those firms may be less equipped cognitively and materially to participate in market competition. Thus, *reformed* firms should focus more on building capabilities and accountability in the market context rather than engaging in political actions *proactively*. However, *reformed* firms are still considered kin of government. In case of politically sensible tasks, they are more likely to be identified as loyal and trustworthy contributors. In order to assure a smooth market transition at the government level, *reformed* firms are more likely to be chosen to engage in CPA *passively*. By contrast, *conventional* firms are different because they are not government related. Their independency and familiarity with market rules serve as a clear signal to government that they may be less interested in being closely attached to government. In the context of market transition, government should behave in a neutral manner in requesting firms to engage in political actions. However, *conventional* firms may need gain and manage political legitimacy in order to be recognized as appropriate players in institutional transitions. Because of different backgrounds and motivations, *reformed* and *conventional* firms will differ in their engagement in CPA. We propose accordingly,

H1a: The likelihood of *passively* engaging in political actions is higher for *reformed* firms than for conventional firms.

H1b: The likelihood of *proactively* engaging in political actions is lower for *reformed* firms than for conventional firms.

Adopting modern governance measures

Market transition includes both government-level policies, e.g. liberalization and privatization; and governance-level strategies, experimenting with modern governance approaches and pursuing trial-error tests in market competition. As the goal of government is to facilitate governance to be more market oriented, policies are emplaced to facilitate the adoption of modern governance measures. In the private sector, governance is required to change its mindset from serving the government to serving shareholders so that owners of firms can participate in strategic decision making. For *reformed* firms, adopting modern governance measures presents not only its willingness to detach from government, but also its inclination towards market economy. By so doing, *reformed* firms send positive signals to exchange partners and potential customers, which can help *reformed* firms' integration into market competition. Moreover, governance's attempt to be independent will also be considered as a success of market transition of government. The reduction of levels of resource dependence between government and governance constitutes a favorable contribution to institutional transition. Thus, *reformed* firms, upon adopting modern governance measures, will be reluctant and less willing to engage in CPA, both *passively* and *proactively*. By contrast, *conventional* firms are used to market rules and familiar with competitive environment. Adopting additional corporate governance measures may not have additional effects on their intention to engage in CPA, neither *passively*, nor *proactively*. Therefore, we propose:

H2a: Upon adopting modern corporate governance measures, the *higher* likelihood of engaging *passively* in CPA for *reformed* firm relative to *conventional* firms will *decrease*.

H2b: Upon adopting modern corporate governance measures, the *lower* likelihood of *proactively* engaging in CPA for *reformed* firm relative to *conventional* firms will *decrease.*

Publicly conveying political intimacy

Nevertheless, political and organizational reorganization of *reformed* firms may change firms' ownership and lead to ceremonious conformity to market rules; they cannot easily and radically change entrenched value systems and norms. *Reformed* firms, established under pre-transition ideology, may exhibit their political convictions within organizations by conducting politically value-laden activities and establishing political interest group. Public conveying political intimacy may serve as a reminder of historical heritage, and also as potentially exploitable kin. Due to the fact that political convictions are visible to the whole market, to delineate the market-politics boundary more clearly and forcefully, *reformed* firms will be less likely to be called upon duty to engage in CPA. In other words, *reformed* firms internalizing political convictions will be less likely to *passively* engage in CPA. Still, political intimacy represent also networks and connections that can potentially help *reformed* firms to do business "as usual" through securing additional resources from government. In addition, political intimacy may amplify *reformed* firms' perceived obligation and responsibility in institutional transition, so that *reformed* firms are intrinsically motivated to support and contribute to government's market transition plan. Therefore, *reformed* firms that publicly conveying political intimacy will be even more likely to engage in CPA *proactively*. For *conventional* firms, publicly conveying political intimacy may help them reach political recognition and endorsement, which in turn may attract attention from government. To sustain the role of promoting market economy, government may behave neutrally and request *conventional* firms to engage in passive political actions. Yet, conventional firms are more market oriented, when engaging in proactive political actions, cost-benefit analysis may prevail and serve as the first and foremost criterion. Consequently, we suggest:

> H3a: Upon conveying political intimacy, the *higher* likelihood of engaging *passively* in CPA for *reformed* firm relative to *conventional* firms will *decrease*.
>
> H3b: Upon conveying political intimacy, the *lower* likelihood of *proactively* engaging in CPA for *reformed* firm relative to *conventional* firms will *increase*.

DATA AND METHODS

Data source

To answer the research questions posted above, this paper exploits a nationwide survey data of Chinese private firms. Since 1993, a series of survey of Chinese private firms have been conducted by the Privately Owned Enterprises Research Project Team (thereafter "the Team"), as part of an ongoing national project that collects information from representatives of the Chinese private sector to facilitate the central government's policymaking processes. Using multi-stage stratified sampling across administrative regions and industries, the research team generated a nationwide random sample of Chinese private firms. The survey involves an intensive interview of the owners, with questions covering the firm (e.g., basic financial information and business development plan) as well as the owner (e.g., educational background and occupational history). By far, the dataset is the most comprehensive one for studying entrepreneurs in China and has been used in several recent studies (Ang & Jia, 2014; Jia; 2014; Li et al., 2006; Li et al., 2008).

The 2006 survey was drawn for the current study. Implemented from March to July 2006, the Team sampled 4720 firms, or 0.1% of the total population nationwide. With careful preparation and support from government, the Team received 3837 returned questionnaires, a response rate of

81.29%. Given our research interest, we restricted our sample to small and medium-sized enterprises (SMEs), defined by OECD as firms with less than 250 employees and an annual turnover of euro 50 million or less. This limitation leads us to exclude 1469 large enterprises. To control for the quality of the data, the Team assured the owner that there were no right or wrong answers, and that “don’t know” was a legitimate option. The final sample consists of 1471 firms. An average firm in the sample is 7 years old and hires 22 employees.

Dependent variables

Our dependent variables are passive engagement in political actions and proactive engagement in political actions. Passive engagement in political actions was obtained by asking the business owner “whether the firm has ever acquired a loss-generated and/or bankrupt business, upon request of government to relieve its burden?”. It is a dummy variable that takes 1 when the business owner reported yes and 0 when otherwise. 49 firms, or 3.33% of the sample firms, reported yes on passive engagement in political actions. To capture proactive engagement in political actions, we rely on the question that asks “whether the firm has ever initiated proposal to government to acquire a loss-generated and/or bankrupt business, in order to gain land or discount government loans?” Again, it is a dummy variable that takes 1 when the business owner reported yes and 0 when otherwise. 41 firms, or 2.79% of the sample firms, reported yes on proactive engagement in political actions.

Explanatory variables

Our main explanatory variable is *reformed firms*. We utilized the question that asks “whether your firm is a reformed business?” It is a dummy variable that takes 1 when the firm is a reformed business and 0 when otherwise. Of the 1471 firms, 314 firms (21%) are reformed businesses. We also have two moderators. We created a dummy variable *Board of Shareholders (BoS)* to measure adoption of modern governance measures, which equals to 1 if the firm has a board of shareholder and 0 if otherwise. Among the 1471 firms, 868 (59%) have a board of shareholder. To capture internalization of political convictions, we used a dummy variable *CCP branch* which equals to 1 if the firm has a CCP (Chinese Community Party) branch and 0 if otherwise. 30% of the sample firms, or 439 firms, have CCP branches.

Control variables

To account for alternative explanations, we controlled for a number of firm level characteristics. Specifically, we control for *founding capital, firm age, firm size, location of the firm, region of the firm* and *type of business*. Founding capital is the logarithmic value of the firm's initial investment. Firm age is captured by the years that the firm has founded as a private business. Firm size is captured by logarithmic value of employee count. Because rural and urban areas might differ in their institutional environment, location of the firm is captured by whether the firm locates in rural area or urban area. Taking into account imbalanced economic and political development in China, we also control for the region of the firm at the province level. Finally, type of business reflects whether the firm is a trading firm, a manufacturing and trading firm, a business corporation, or a business group. Besides firm level characteristics, we also control for owner's government experience, an important factor for affecting the firm's political actions.

RESULTS

We analyze our data with STATA 13. Our dependent variables of passive engagement in political actions and proactive engagement in political actions are likely related. Therefore, our analytical strategy consists of the estimation of a bivariate probit (or biprobit), which allows us to incorporate common determinants that affect both dependent variables with two simultaneous equations (Green, 2003: 701-719). Our empirical estimation involves three steps. In step one; we include all control variables and our main explanatory variable as the baseline model. In step two, we add the two moderating variables to the baseline model. Finally, we add the interaction terms separately and also run a complete model with two interaction terms together.

The preliminary regressions show that our model is robust to different specifications. On the control variables, firm size and firm age are positively associated with passive engagement in political actions; while founding capital and firm size are positively associated with proactive engagement in political actions. On the effect of our main explanatory variable – reformed business, we found a positive and significant coefficient (b=0.445, p<0.05) on passive engagement in political actions and a negative and significant coefficient (b=-0.272, p<0.01) on proactive engagement in political actions. These results are consistent with H1a and H1b.

On the moderating variables, CCP branch increases the likelihood of passive engagement in political actions and proactive engagement in political actions while board of shareholder is positively associated with proactive engagement in political actions only. On moderating effect of board of shareholder, we found negative and significant interaction terms on both passive engagements in political actions (b=-1.017, p<0.05) and proactive engagement in political actions (b=-.0681, p<0.05). In line with H2a and H2b, these results suggest that board of shareholder reduces the positive effect of reformed business on passive engagement in political actions, meanwhile enhances the negative effect of reformed business on proactive engagement in political actions. On moderating effect of CCP branch, the interaction term on passive engagement in political actions is negative but insignificant (b=-10, n.s.) while the interaction term on proactive engagement in political actions is positive and significant (b=4.567, p<0.00). We therefore conclude that there is strong evidence in support of H3b, which argues that the negative effect of reformed business will be attenuated by CCP branch.

CONCLUSIONS

Arguing that political and corporate governance are loosely (de)coupled, this paper examines firms' engagement in corporate political actions. In the context of transition economies, we highlight the conceptual distinction between reformed firms and conventional firms, and empirically demonstrate how these two types of firms differ in their engagement in proactive and passive political actions. Furthermore, we explore conditions that may moderate the relationship between business types and corporate political actions. Specifically, we show that adoption of modern governance measures reduces the likelihood of reformed firms engaging in both passive and proactive political actions; meanwhile internalization of political convictions will increase the likelihood of reformed firms engaging in proactive political actions.

Our results contribute to the rapidly emerging literature on corporate political actions. On the one hand, acknowledging the interdependency between government and business, our study simultaneously examines both passive and proactive political actions. On the other hand, we propose and demonstrate that the origin of the firm, i.e., being reformed or conventional, will significantly affect the firm's propensity to engage in corporate political actions.

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