

COMMUNIST CONTROL, CORPORATE GOVERNANCE AND FIRM PERFORMANCE IN CHINA

Submitted by

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A thesis submitted in total fulfilment
of the requirements for the degree of
Doctor of Philosophy

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June 2016

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List of Abbreviations

2-SLS on IVs	2-stage least-square regression based on instrumental variables
CCP	Chinese Communist Party
CG	Corporate Governance
CPPCC	Chinese People's Political Consultative Conference
CPSC	Central Politburo Standing Committee
CSE-TD	Clustered Standard Errors in Two Dimensions
CSRC	China Securities Regulatory Commission
GDP	Gross Domestic Product
GIP	Gross Industrial Production
NPC	National People's Congress
OLS	Ordinary Least Squares
PLA	People's Liberation Army
POE	Privately-Owned-Enterprise
PRC	People's Republic of China
SASAC	State-owned Assets Supervision and Administration Commission
SOE	State-Owned-Enterprise

Abstract

The purpose of this study was to investigate the impact of the political influence of the Chinese Communist Party (CCP) that operates within the Corporate Governance (CG) system on firm performance.

The contributions of this study include the follows. First, the political influence of the CCP and intervention by the CCP, rather than the modern CG structure and mechanisms, are the most influential factors with regard to the operation and decision-making processes in Chinese enterprises, and that in turn they have a direct impact on performance. In addition, such political influence is exerted by an organ called “CCP committee”. Second, this study utilised the most appropriate direct measurement of CCP influence at the corporate level in China, which is the degree of overlap and domination of the corporate CCP committee over the CG system in Chinese firms. Thirdly, this study strictly differentiated between the two dissimilar patterns of the CCP’s influence in SOEs and POEs, and accordingly, two distinct terms were prudently chosen. The term “CCP control” is employed to depict the CCP’s influence in SOEs as they are overtly governed and controlled by the CCP; while the term “CCP connection” is used to delineate the valuable bonding or affiliations between the CCP and POEs, which cannot be described as tight control.

Fourth and most importantly, the empirical analysis utilised in this study provided results on both the general effect of the CCP’s influence on the performance of Chinese listed firms, as well as the specific and differential influences of the CCP on the performances of the top listed SOEs, top listed POEs and the smaller listed SOEs. Based on the complete sample of all the Chinese listed firms analysed, the CCP’s influence through the chairman of the board of directors and CEO were generally found to be significantly and positively associated with firm performance. Specifically, CCP control evidently helps to enhance the performance of the top SOEs. The top POEs’ political connections with the CCP may function as a strong stimulus for them to achieve a high level of performance. However, CCP control in small SOEs was evidently detrimental to their performance. These results, generated via main pooled ordinary least squares (OLS) regression analysis, were verified as robust by a series of sensitivity tests.

Statement of Authorship

Except where reference is made in the text of the thesis, this thesis contains no material published elsewhere or extracted in whole or in part from a thesis submitted for the award of any other degree or diploma.

No other person's work has been used without due acknowledgements in the main text of the thesis.

This thesis has not been submitted for the award of any degree or diploma in any other tertiary institution.

Guanglu (Luke) Xu

29 May 2016

Acknowledgement

I am grateful for the PhD journey at La Trobe University, during which I have experienced the most significant personal growth and development in all my life. I would like to express my sincere gratitude to many people who have provided highly valued contributions to the completion of my thesis.

First, I am thankful to my previous principal supervisor, Associate Professor Xudong Ji. It was him who introduced me to the area of accounting research. He taught me precious research skills through his patient and instructive supervision, and by sharing his expertise and research experience without reservation since the year of my honours degree until the second half of the fourth year of my PhD program. He was my great mentor and cared about me in many aspects. I am grateful for the career and life advice that he gave me.

Second, I am indebted to my current principal supervisor, Professor Kamran Ahmed, who supervised me at the last and most important stage of my PhD program. Although he was very busy all the time, he still tried to make time to give me helpful guidance and instructions at each step. He always provided me with all the necessary help and assistance. Without him, the completion of this thesis would not be possible. Also, I thank my current co-supervisor, Associate Professor Jahangir Ali, for his help. Third, I would like to particularly thank Associate Professor Darren Henry and my fellow PhD colleague, Puwanenthiren Premkanth, for their assistance in my data analysis.

Next, I am grateful to Dr. Judy Louie for her ongoing support and encouragement, and for giving me the opportunity to obtain valuable experience in teaching. Dr. Louie has been a wonderful mentor and friend to me. Also, I thank my fellow PhD colleagues, Ustash Pillay, Oheneba Assenso-Okofu, Luisa Unda, Teddy Ossei Kwakye, Shawgat Kutubi, Joni Kho, Sandra Osirio, Stephen Sim and Sadegh Khaksar, for all their encouragement and support. Working with them has made my life in La Trobe enjoyable.

Finally, I thank my parents, my wife, my parents-in-law, and all my family, for all their love and support. I am grateful to my parents for raising me up and helping me to be who and where I am today. My special thanks go to my wife for her priceless love and for always believing in me, especially during the hardest times. She witnessed my growth during my whole PhD journey. This thesis is dedicated to all the people that I love and care about, including my unborn child, and to everyone who love and care about me.

Chapter 1. Introduction

1.1. Statement of the Problem

The accounting and finance literature suggests that the impact of corporate governance (CG) structure and mechanisms on the performance of firms is a major issue. Generally, studies that are conducted based on the agency theory suggest that advanced CG systems have positive impacts on firm performance as they are associated with reduced agency costs (Jensen and Meckling, 1978; Fama and Jensen, 1983; Shleifer and Vishny, 1986; Johnson et al., 2000). However, the relationship between CG systems and firm performance is often affected by political factors such as the direct involvement of the government at the corporate level, or firms' political connections with officials (Alchian, 1965; Krueger, 1974; Fisman, 2001; Ang et al., 2006; Faccio, 2006; Niessen and Ruenzi, 2009; Najid and Rahman, 2011). This is a particularly common phenomenon in developing countries where the market and legal systems are underdeveloped. The purpose of this study was to investigate the impact of the political influence of the Chinese Communist Party (CCP) that operates within the CG system on firm performance.

Agency theory holds that agency costs generally result from two main sources. The first is conflicts of interest between shareholders and management, where management—as the agent that operates the corporation on behalf of the shareholders—engages in opportunistic behaviours in pursuit of personal benefits rather than maximizing corporate values (Jensen and Meckling, 1978; Fama and Jensen, 1983). The second is conflicts of interest that exist between controlling shareholders and minority shareholders, which is also known as the “tunnelling problem”, where large-scale shareholders who possess controlling power over major corporate operations undertake exploitative behaviours at the expense of minority shareholders (Shleifer and Vishny, 1986; Johnson et al., 2000).

Agency theory suggests that CG mechanisms such as the board of directors, independent directors appointed to the board, and the supervisory board should be utilised to solve or mitigate the agency problems stated above. Firstly, the board of directors works as a powerful and effective mechanism in the CG system as it performs monitoring and advisory functions, whereby directors hire the members of the management team and evaluate their performance with regard to ensuring the best interests of shareholders, and providing advice to management based on their expertise (Jensen, 1983; Hermalin and Weisbach, 1998; Parker, 2000; Raheja, 2005). Secondly, conventional wisdom with regard to appointing independent directors to the board suggests that these directors have the power to review and monitor managers' contracts and their compensation, which constitutes an effective device for disciplining managers, particularly their discretionary and opportunistic behaviours. They also provide specialist knowledge and advice that assists managers (Maug, 1997; Black and Bhagat, 2002). Thirdly, although the supervisory board does not have direct executive power, it is in charge of the monitoring, supervision and consultation of the executive board and the management team (Bremert and Schulten, 2008).

A modern CG system was officially implemented in China in the 1990s, as a result of China's economic and institutional reform and development. The implementation of a modern CG in China was realised via the formation of China's domestic stock market, which includes the Shanghai and Shenzhen Stock Exchanges, the China Securities Regulatory Commission (CSRC) and the promulgation of China's Company Law. Subsequently, an increasing number of studies have been conducted in the Chinese context (Bai et al., 2004; Peng et al., 2007; Cheung et al., 2008; Jiang et al., 2008; Bhabra and Li, 2009; Cho and Rui, 2009; Ma and Tian, 2009; Zheng and Wei, 2010). Although China has been approaching a market-oriented economy since the commencement of economic and institutional reforms in 1978, the CG system in China could be viewed as unique in comparison with that of other countries because it is characterised by the conspicuous and enduring political

influence exerted by the CCP.

There are three main theories that can be utilised when assessing the potential impact of political influence on firm performance in the Chinese context: resource dependence theory, stakeholder theory and rent-seeking theory. According to resource dependency theory, controlling power over corporate decision-making and the provision of resources, which are crucial to the survival, development and success of corporations, are directly linked (Emerson, 1962; Pfeffer and Salancik, 1978; Davis and Cobb, 2009). Specifically, the importance of certain resources to corporations and discretion and control over the distribution of these resources jointly lead to corporations' dependence on resource providers. Stakeholder theory suggests that modern corporations are social entities that are accountable to a group of stakeholders that are vital to their survival and success; and that in this context, the government and regulators are included as major stakeholders (Freeman and Reed, 1983; Freeman et al., 2004; Friedman and Miles, 2006). In China, all essential resources, natural and capital, are governed by the CCP. All natural resources, including coal, oil, water and electricity are exploited and distributed by state-owned factories or enterprises. As the main finance providers, all major banks are owned by the Chinese central government. The State Council and the CSRC of the State Council supervise the Chinese domestic stock market. With regard to Chinese state-owned enterprises (SOEs), a significant proportion of shareholder ownership is possessed by the Chinese government. Therefore, based on the resource dependency and stakeholder theories, the CCP is a principal stakeholder with tight control at the corporate level in China, particularly with respect to SOEs.

Rent-seeking theory explains the associations between political connections or interventions and firm performance from the perspectives of both industrial corporations and governments or politicians, especially in the developing markets in which an effective legal system and strong protection for market investors are

generally lacking (Alchian, 1965; Kumar, 2004; Patibandla, 2006). In cases where governmental supervision and restrictions upon business and economic activities exist, corporations are likely to compete for the resources (“rent”) by way of either legal market competition mechanisms or illegal bribery and corruption (Krueger, 1974; Li et al., 2008). In this context, political connections with the government or key officials can constitute powerful instruments that corporations strive to obtain influence over, in order to secure an advantageous position when competing for these so-called rents, and achieve favourable firm performance. Conversely, the theory also helps to explicate the phenomenon of governments or politicians endeavouring to become involved in corporate operations in order to achieve political objectives or personal wealth, rather than maximizing corporate values (Shleifer and Vishny, 1997; Sutter et al., 1999; Rosa and Perard, 2010). In such cases, political connections and interventions would generally be negatively correlated with firm performance. A good example of rent-seeking theory in the Chinese context is the so-called “wearing a red hat” strategy that is adopted by Chinese privately-owned enterprises (POEs), which refers to POEs’ attempts to obtain beneficial connections with the CCP in order to compete for rents (Young, 1989; Li et al., 2006). Further, both resource dependency and stakeholder theories also acknowledge the importance of political connections with the CCP to Chinese POEs.

1.2. Motivations of the Study

In the Chinese context, the impacts of the CG system and political influence on firm performance have been extensively researched. However, prior studies have yielded inconsistent and inconclusive results. Some studies have reported positive influences of the Chinese CG system on firm performance, with regard to parameters including board size and board independence (Peng et al., 2007; Bhabra and Li, 2009; Cho and Rui, 2009; Ma and Tian, 2009). Other studies have reported opposite findings (Tang et al., 2005; Gu and Long, 2006; Chen and Chi, 2007; Hu and Zhu,

2008; Zheng and Lu, 2009; Hu et al., 2010). In addition, some studies (Cho and Rui, 2009; Zheng and Wei, 2010) have reported that the effect of the supervisory board on firm performance in China is insignificant. These inconsistent results may result from discrepancies in the research methods utilised, including differences in sample size, study duration, the types of companies investigated, or the different measurements of firm performance. However, as is argued in this current study, the main reason is that the CG system is not the deciding factor that ultimately determines outcomes in the decision-making process in Chinese firms. Rather, the Chinese CG system could be viewed as a mere window-dressing system. This concept is explored in further detail in the “Contributions of this Study” section of this manuscript.

Previous studies investigating the impact of political influence on firm performance in China have employed different measures of political influence and shareholder ownership by the Chinese government or top executives’ personal political backgrounds, and examined different types of Chinese firms (state-owned or private) (Tian, 2001; Chang and Wong, 2004; Li et al., 2008; Hu et al., 2010; Li, 2010; Ma et al., 2010; Du, 2011; Le and Chizema, 2011; Hu and Leung, 2012; Wu et al., 2012). This current study argues that these prior studies have two major limitations.

Firstly, the measurements of the CCP’s influence employed by prior studies conducted in China have generally been indirect. This is because they neither captured the substance of the Chinese institutional background, nor clearly specified that the CCP’s influence is a real factor that directly influences Chinese companies. Such studies have typically measured the influence of the CCP based on the personal political background or past governmental work experience of senior corporate executives (Li et al., 2006; Li et al., 2008; Hu and Leung, 2012). However, the review of the institutional background in China and the quasi case study conducted in the research reported herein explicitly show that Chinese society is unquestionably governed and dominated by the CCP in almost every aspect, including the

government, the national economy, the political and social systems, and national defence. More importantly, this study reveals that the control and influence of the CCP are exerted through a political mechanism; the CCP committee. This political control pattern exists throughout Chinese society from the highest state level to the village level. For example, the supreme decision-making body in China's core political system is the Central CCP Committee. In Chinese state-owned firms, all important decisions are also made by their CCP committee. Therefore, it is reasonable to argue that the CCP's control or connections in Chinese firms should be directly measured by the overlap and influence of the corporate CCP committee over the CG structure, for example, by way of corporate CCP committee members acting as chairmen of the board or the CEOs, or the percentage of corporate CCP committee members serving as executives within the CG structure (directors, supervisors or senior managers). Such parameters could help to generate a more clear and prudent representation of the influence of the CCP on firm performance in China.

Secondly, as mentioned above prior studies have investigated all listed Chinese firms together, or have only investigated a certain group of Chinese firms, such as SOEs or POEs. It is reasonable to expect that CCP influence is likely to have different impacts on the performance of dissimilar groups of Chinese listed companies, due to differences in corporate ownership structure, firm characteristics, industries and market positions. The positive and negative impacts of CCP influence in different groups of Chinese listed firms may offset each other when all groups are examined together, which prevents the generation of clear and conclusive results and conclusions. The aim of this study was to fill the gaps in the literature described above, by defining a precise research objective and questions that are described in the next section.

1.3. Research Objective and Questions

The objective of this study was to investigate the impact of the CCP's influence on firm performance, while taking into consideration the influence of the Chinese CG system. In order to accomplish this objective and to fill the gaps in the literature described in the previous section, the following research questions were addressed:

1. Which is the deciding factor with regard to the decision-making process in Chinese firms, the CG system or the influence of CCP?
2. What is the most appropriate measurement of political influence in the Chinese context?
3. Does CCP influence exert identical or dissimilar impacts on the performance of different groups of Chinese firms in terms of ownership structure and firm size?

The accomplishment of the above research objective could expand current understanding of the influences of the CG system and political factors on firm performance in the Chinese context, and may provide an explanation for the often-witnessed inconclusive and inconsistent results with regard to the impacts of CG and political influence on firm performance.

1.4. Contributions of this Study

This study makes the following contributions to the debates among scholars in the literature pertaining to the impacts of the CG system and political influence on

firm performance, especially in Chinese society.

Firstly, this study explicitly shows that the political influence of the CCP and intervention by the CCP, rather than the modern CG structure and mechanisms, are the most influential factors with regard to the operation and decision-making processes in Chinese enterprises, and that in turn they have a direct impact on performance. This is clearly demonstrated by a review of China's institutional background and a quasi case study conducted as part of this current study.

China qualifies as an appropriate setting to investigate the association between political influence and firm performance, due to the CCP's dominating status in Chinese society. The CCP's ruling position and sovereign status have been the most distinctive symbol of China since its establishment in 1949, as illustrated by the CCP's dominance in Chinese society via an organisation called the CCP committee, from the supreme core political system to every field of people's daily life, including Chinese enterprises. The Chinese core political system consists of four institutions¹: the National People's Congress (NPC), the Chinese People's Political Consultative Conference (CPPCC), the State Council, and the People's Liberation Army (PLA). These four political institutions are endowed with board authority on paper only, and they are all subject to leadership by the CCP, which is the real decision-making

¹ The functions of these four Chinese institutions are defined and stated by the Constitution of the People's Republic of China (PRC). The NPC is China's unicameral legislature and the highest authority of state power. The CPPCC has three major responsibilities: political consultation on the major issues in state policies, national politics, the economy, culture, and social life; democratic monitoring of the enforcement of the state constitution and laws, the implementation of major state policies, and the work of state authorities; and participation in the administration and discussion of state affairs (http://news.xinhuanet.com/ziliao/2002-02/20/content_283254.htm). The PLA could be viewed as the armed wing of the CCP, rather than a force for the state and the Chinese people, as evidenced by Mao Zedong's famous proposition that "the Party rules guns". "The PLA must be under the absolute leadership of the CCP, its highest level of the leadership and command authority is in the hands of the Central CCP Committee and the Central Military Committee" (Political action regulations of the PLA, Chapter 1, Article 4).

authority in China². For example, the highest CCP committee is the Central Politburo Standing Committee (CPSC) of the CCP, which has a status similar to that of Cabinets in developed countries. The members of the CPSC occupy the key positions in the four institutions that comprise the Chinese core political system³. The first ranked official who takes the role of the General Secretary of the CCP will always serve as the President of the People's Republic of China (PRC) and the General Chairman of the Central Military Commission. The second ranked official is always the Prime Minister of the State Council. The third ranked official serves as the Chairman of the NPC Standing Committee. The fourth ranked official acts as the Chairman of the CPPCC. According to David Zweig⁴, this pattern of the CCP's dominance exists at every level of administrative structure and in organisations ranging from the ministerial or state level down to the village level.

The quasi case study conducted as part of this research provides evidence of the CCP's leadership in SOEs and its significant influence in POEs through the corporate CCP committee. From theoretical and documental perspectives, according to the Constitution of the PRC, any enterprises that have more than three CCP members should establish a branch CCP committee⁵, and such grass-roots organisations of the CCP at corporate level should play a core political role, and guarantee and supervise the implementation of the guidelines and policies issued by the CCP. In SOEs, key members of the corporate CCP committee should take part in corporate operations including the chairman of the board of directors, directors, CEO and vice CEO. Major decision-making on corporate issues, including the appointment

² Jiang Zemin, 2006, The anthology of Jiang Zemin, Volume 1, pp.112, "... organs of political power at all levels, including NPC, government, court of justice, and procuratorate, must be subject to the leadership by CCP" [sic].

³ Organizational structure of the 18th session of the central CCP committee, the CCP news website, <http://cpc.people.com.cn/GB/64162/351757/>

⁴ David Zweig, Comparative Politics, SOSC 152, Division of Social Science, The Hong Kong University of Science and Technology.

⁵ The Constitution of the CCP, Chapter 5, Article 29.

and dismissal of key executives, important corporate operations and reorganisations are always controlled and supervised by the corporate CCP committee⁶. In POEs, although the corporate CCP committee conventionally does not directly or visibly influence the decision-making process with regard to corporate operations, it is a very important mechanism for communicating with the CCP and relevant governmental authorities. This is a good demonstration of POEs' "wearing a red hat" strategy. These aforementioned governmental instructions and POEs' political connections are clearly evidenced by the appointment of Mr Jiang Jiemin as chairman of the board of directors, the decision-making process regarding a major asset swap transaction conducted in 2011 involving the largest Chinese SOE PetroChina Company Limited, and the political background of the key corporate executives and the members of the CCP committee in the largest POE, Jiangsu ShaGang Company Limited in 2011. With regard to the latter, the members included the chairman of its board of directors Mr Lu Jinxiang, the CEO Mr Li Peisong, and the founding and actual controlling member Mr Shen Wenrong. They are also clearly evidenced by the operations of the CCP committee of a small SOE, SiChuan ChangHong Electric Company Limited.

Therefore, the CG system in the Chinese firms could be viewed as a window-dressing system, where CG structure in the Chinese listed firms only exists on paper and becomes a mere formality over time. Such point is supported by some scholars (Zhang, 2009).

Secondly, based on the above considerations, the CCP influence at the corporate level in China is measured directly by the degree of overlap and domination of the corporate CCP committee over the CG system in Chinese firms. Specifically, six variables were constructed as proxy indicators of the CCP's influence in Chinese

⁶ "The guiding instructions on the participation of corporate CCP committees in major corporate decision-making in SOEs" issued by the General Office of the CCP Central Committee under the supervision of the Organization Department of the CCP Central Committee and State-owned Assets Supervision and Administration Commission (SASAC) in October 2004.

firms. The first three are dummy variables which indicate whether the senior corporate executive positions within the CG structure, such as the chairman of the board, CEO, and the chairman of the supervisory board are held by the corporate CCP committee cadres. The other three are percentage variables designed to denote the percentages of corporate CCP committee members on the board of directors, supervisory board and the management team. In this way, in contrast with prior studies which have solely examined associations between the CG system and firm performance, or the impact of political influence on firm performance, this current study examined the effect of the CCP influence that operates within the Chinese CG system on the performance of top listed firms in China.

Thirdly, this study strictly differentiated between the two dissimilar patterns of the CCP's influence in SOEs and POEs, and accordingly, two distinct terms were prudently chosen. Previous studies have tended to obscure the difference between the patterns of political influence apparent in SOEs and POEs, and have only used one term—"political connection" (See Pan, 2011; Hu and Leung, 2012; Wu et al., 2012). In contrast, in the current study, as SOEs are overtly governed and controlled by the CCP the term "CCP control" is employed to depict the CCP's influence in SOEs; while the term "CCP connection" is used to delineate the valuable bonding or affiliations between the CCP and POEs, which cannot be described as tight control.

Fourth and most importantly, the empirical analysis utilised in this study provided results on both the general effect of the CCP's influence on the performance of Chinese listed firms, as well as the specific and differential influences of the CCP on the performances of the top listed SOEs, top listed POEs and the smaller listed SOEs. Based on the complete sample of all the Chinese listed firms analysed, the CCP's influence through the chairman of the board of directors and CEO were generally found to be significantly and positively associated with firm performance. Specifically, CCP control evidently helps to enhance the performance of the top SOEs.

The top POEs' political connections with the CCP may function as a strong stimulus for them to achieve a high level of performance. However, CCP control in small SOEs was evidently detrimental to their performance. These results, generated via main pooled ordinary least squares (OLS) regression analysis, were verified as robust by a series of sensitivity tests.

1.5. Structure of the Thesis

This thesis is divided into nine chapters, which are briefly described below

Following this introduction chapter, the next two chapters contain a review of the existing literature pertaining to the effects of the CG system and political influence on firm performance. Chapter 2 begins with a general introduction to CG and its development, followed by a critical review of the empirical findings of prior studies on the influence of CG on firm performance in countries around the globe, including China. Chapter 3 contains a critical discussion of the empirical findings of previous studies on the effects of political influence on firm performance using data from various market settings. The theoretical perspectives regarding the associations between CG, political influence and firm performance, which include agency theory, resource dependency theory, stakeholder theory, and rent-seeking theory are also discussed in these two chapters.

Chapter 4 introduces the institutional background of China, beginning with a review of the development and growth of China's enterprises since the initiation of economic reform in 1978, which is supplemented by a review of the establishment and expansion of China's stock market, which includes the Shanghai and Shenzhen stock exchanges (Section 4.1). The second section of Chapter 4 discusses the development of the CG system in China (Section 4.2). The significant influence of the

CCP in Chinese society and enterprises is then discussed in detail (Section 4.3). This includes the CCP's dominating status in Chinese society, how China's SOEs are tightly controlled by the CCP through corporate CCP committees, and the major patterns of the political connections between the CCP and China's POEs.

Chapter 5 presents a quasi case study on the CG structure and CCP influence in three Chinese listed companies, a top SOE, PetroChina Company Limited; a small SOE, Sichuan ChangHong Electric Company Limited; and a top POE, Jiangsu ShaGang Company Limited. The main purposes of Chapter 5 are to provide supplementary information on how SOEs are tightly controlled by the CCP, and to illustrate the political connections between Chinese POEs and the CCP.

Chapter 6 presents the construction of the theoretical framework of this study based on agency theory, resource dependency theory, stakeholder theory, and rent-seeking theory. The hypotheses of this study are then developed based on these theories, the findings reported in the literature, as well as the evidence demonstrated in Chapters 4 and 5.

Chapter 7 discusses the research methodology employed in this study to test the hypotheses. Specifically, it discusses the nature of the research approach and the data used in this study; the data sources and the procedure and methods used for sample selection and data collection; the definition and measurement of the variables used to explore the research questions; and the analysis design and statistical instruments utilised to generate empirical results and arrive at conclusions.

Chapter 8 presents and interprets the results generated in the hypothesis testing by applying the research methods and regression models, which comprise the descriptive and regression results of the main statistical analysis. In addition, the design and results of the sensitivity tests conducted in this study to prove the

robustness of the main analysis results are presented in this chapter. These sensitivity tests include alternative measures of firm performance, and the alternative regression approach of “clustered standard errors in two dimensions” (CSE-TD) to the main analysis using pooled OLS regression models. Tests for the potential endogeneity problem in the main tests—including OLS regression using the 1-year-ahead firm performance and 2-stage least-square regression based on instrumental variables (2-SLS on IVs)—are also presented in Chapter 8.

Chapter 9 summarises the entire thesis and the conclusions drawn. In addition, the potential limitations of this study are discussed, and the recommendations for future research are provided.

Chapter 2. Corporate Governance and Firm Performance

2.1. Introduction

The main focus of this study was the assessment of the impact of the political influence of the Chinese Communist Party (CCP) that operates within the Chinese corporate governance (CG) system on the performance of the top listed Chinese firms. This chapter begins with a general introduction of CG and its development, followed by a review of the relevant literature on the influence of CG on firm performance in countries around the globe, including China.

A review of the literature suggests that the influence of CG on firm performance has been a controversial issue, and previous studies have measured CG quality in various different ways. Some have investigated board characteristics, including the size of the board of directors (Lipton and Lorsch, 1992; Halebian and Finkelstein, 1993), the independence of board members (Black and Bhagat, 2002) and CEO “duality” (Amaral-Baptista et al., 2011), which indicates whether the positions of CEO and the chairman of the board are occupied by the same person. Some have examined the role of a two-tiered board system incorporating a supervisory board in addition to the board of directors (Rose, 2005; Bremert and Schulten, 2008). Studies that have investigated the associations between CG and firm performance in China are reviewed in this chapter (Peng et al., 2007). The studies reviewed in this chapter have reported mixed and conflicting findings with respect to the influences of different aspects of CG on firm performance. For example, Lipton and Lorsch (1992) reported a negative association between large board size and firm performance, while Halebian and Finkelstein (1993) reported a positive association. Such discrepancies in the literature may result mainly from differences between countries, and differences between the datasets utilised (Iwu-Egwuonwu, 2010).

The remainder of this chapter is organised as follows. Section 2.2 presents a

brief introduction to CG and its development. Sections 2.3 and 2.4 contain critical reviews of studies investigating associations between CG and firm performance conducted in both developed and developing countries, including China. Lastly, this chapter ends with a summary and conclusion section (Section 2.5).

2.2. Corporate Governance⁷

CG has long been a focus of researchers in the fields of accounting, management and finance. It was stated by the Cadbury Committee (Cadbury Report, 1992. para. 2.5) that “Corporate governance is the system by which companies are directed and controlled”. Shleifer and Vishny (1997), in the most frequently cited paper in the CG literature, stated that “Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment”. These two well-known definitions underpin a cognizance that CG is a system that equips the stakeholders of corporations with the ability to monitor and control managerial behaviours and the allocation of firms’ resources, which in turn guarantees desirable returns on their investment. Overall, CG could be viewed as a framework that aligns the interests of various stakeholders, including shareholders, creditors and investors, among others, in obtaining business success, the fair

⁷ According to a relatively comprehensive review of the CG literature by Brown et al. (2011), CG mechanisms can be classified into two categories, determined by whether they are internal or external to firms. Internal CG components include the characteristics of the board of directors, such as board size, the percentage of independent or non-executive directors on the board, and “duality”, which refers to whether the chairman of the board and the CEO are the same person. They also include characteristics and the effectiveness of the supervisory board, and characteristics of the audit committee such as the independence of its members. External corporate governance mechanisms include monitoring by controlling shareholders and market analysts, external auditors, competition and takeovers, and regulation and legal enforcement. The focus of this current study is on internal CG mechanisms. This is because in underdeveloped markets, including China, there is normally a dearth of external legal and regulatory institutions or systems for market investors (Li et al., 2008; Hu and Leung, 2012; *etc.*). Therefore, in this chapter the literature review on the CG-firm performance relationship is accordingly structured from the perspective of the influence of each CG component (mainly internal corporate governance mechanisms) on firm performance.

distribution of returns or profits, and in maximizing corporate value and shareholder returns in the long run (Cadbury Committee, 2002).

However, the issue of CG remains contentious in terms of what characteristics of CG mechanisms are effective and powerful, and in turn could help business to succeed. Such contention is well illustrated by the mixed results and findings in the literature, which are discussed in detail in the following parts of this chapter. Alternative insights on this issue have emanated from some leading theories in the accounting, management and finance literature, namely agency theory, resource dependency theory and stakeholder theory. CG is discussed from the perspective of each of these three theories, below.

Agency Theory and Corporate Governance

It could be argued that the CG research literature is dominated by agency theory. This could be explained by the fact that to a large extent agency theory explains the essence or nature of the problems in corporate operations, which is known as the agency problem, and in turn provides CG mechanisms with a theoretical foundation and helps corporations to deal with operational issues and obtain corporate success. In general, agency theory suggests that a better-governed firm is expected to perform better and be valued higher due to lower agency costs. Within this theory, there are basically two types of agency problems: the principal-agent problem between shareholders and managers (Jensen and Meckling, 1978; Fama and Jensen, 1983), and the power and information asymmetry between dominant or controlling shareholders and minority shareholders (Shleifer and Vishny, 1986; Johnson et al., 2000).

The agency problem that has been most frequently examined is the principal-agent problem between shareholders and managers. Jensen and Meckling

(1978) suggested that the separation of ownership and control in corporations with a dispersed ownership structure gives rise to the agency problem between shareholders and managers. They explained that as the agent, managers will not always make decisions in the best interests of shareholders—and conversely, agency costs in the form of monitoring expenditures are incurred when shareholders aim to limit any managerial behaviours that are not in their best interests. Fama and Jensen (1983) argue that as a result of the separation of ownership and control, or the well-known interest conflicts between shareholders and managers, when managers are not at the same time the bearers of the wealth effects of their important decisions, they may take actions that deviate from the goal of maximizing corporate value and shareholder returns. In addition to the first type of agency problem stated above, researchers increasingly focus on the second type, conflicts of interest between major controlling shareholders and minority or outside shareholders, or the so-called “tunnelling problem”. Shleifer and Vishny (1986) first introduced the notion of exploitative behaviours by dominant shareholders at the expense of minority shareholders. They suggested that large shareholders who possess controlling power over major corporate operations are likely to exploit smaller shareholders. Johnson et al. (2000) coined the term “tunnelling” to describe asset and profit appropriation by controlling shareholders at the cost of minority shareholders’ interests.

In order to solve or mitigate these two types of agency problems, a series of CG mechanisms should be implemented or strengthened, such as the establishment of a supervisory board in conjunction with the board of directors in a two-tier board system, and independent directors. According to Raheja (2005), corporate boards play a central role in CG and have two main functions, monitoring and advising. Fama and Jensen (1983) suggest that the advisory function of the board normally involves the provision of expertise to management, and the monitoring function involves hiring the management team members, especially the CEO, and evaluating their performance in order to ensure that management operates in the best interests of the shareholders

(Hermalin and Weisbach, 1998). Theoretically, these two functions render the board of directors a powerful and effective CG mechanism that helps to ensure that corporate resources are used to fulfil the goals of the firm, particularly profit maximisation which represents overall corporate success (Parker, 2000). It is often asserted that the independence of board members is an important CG mechanism. Regarding board independence, there is a conventional wisdom which states that independent directors have the power to review and monitor managers' contracts and compensation. This constitutes an effective device with which to discipline and regulate managers, especially their discretionary and opportunistic behaviours (Maug, 1997; Black and Bhagat, 2002).

Bremert and Schulten (2008) asserted that the two-tier board system separates the management and supervision of a corporation, where management is responsible for steering and controlling the corporate business, while the supervisory board—which does not have direct executive power—is in charge of the monitoring, supervision and consultation of the executive board. A review of the literature on the influences of these CG mechanisms on firm performance in both developed and developing countries is provided in the following sections of this chapter.

Corporate Governance from the Perspectives of Resource Dependence Theory and Stakeholder Theory

Besides agency theory, other theories also yield insights into CG. Resource dependence theory and stakeholder theory provide theoretical explanations that are generally more applicable to CG problems in Asian or developing countries. According to Pfeffer and Salancik (1978), what is at the core of resource dependence theory is the notion that controlling power over corporate affairs and the provision of the resources that are critical to the survival and success of firms, such as capital or certain business licenses, are directly linked. This is because firms are dependent on

resources to survive and develop. In many Asian countries and other developing markets, the government or politicians tend to function as the main resource providers to firms. Given this, resource dependence theory provides strong theoretical support for the roles of governmental control or political connections in corporate success. This constitutes a pre-eminent feature of CG in countries where the institutional systems are dissimilar to those in the developed western markets. In addition, such theory emphasizes the functions of the board of directors in providing key resources such as information, expertise or skills, as well as personal relationships or connections with external parties including suppliers, creditors, potential investors and various government agencies (Hillman et al., 2000).

Similar to resource dependence theory, stakeholder theory also advocates the role of government control or political connections as significant components of CG in Asian or developing countries. Freeman and Reed (1983) state that a firm can be viewed as a social entity that is responsible to a broad range of stakeholders who are external to the firm. These include shareholders, creditors, employees, and other interest groups. These stakeholders or groups are vital to the survival and success of corporations (Freeman et al., 2004). Notably, Friedman and Miles (2006) suggests that the government and regulators could be regarded as major stakeholders, especially in cases where the government is also the controlling shareholder of the firm.

2.3. Prior Studies on the Influence of Corporate Governance on Firm Performance

2.3.1. Board Characteristics and Firm Performance

The literature contains numerous empirical studies on the impacts of board

characteristics on firm performance. In the literature, board characteristics mainly involve the size of the board of directors, the independence of board members (for example, Black and Bhagat, 2002; Cho and Kim, 2007; Ararat et al., 2010; Iwu-Egwuonwu, 2010; Liu, 2011), CEO duality (Bathula, 2008; Chen et al., 2008; Ramdani and Witteloostuijn, 2010; Amaral-Baptista et al., 2011), and other factors, such as the education level of board members (Bathula, 2008).

Various theoretical arguments regarding the relationship between board size and firm performance have been presented in the literature. Jensen (1993) suggested there is a positive association between corporate boards with less than seven directors and better firm performance, and argues that “When boards get beyond seven or eight people they are less likely to function effectively and easier for the CEO to control” (page 865). Lipton and Lorsch (1992) suggest that the major disadvantages of large sized boards are that they render communication more difficult and costly, and that effective coordination and decision making are harder to achieve with large boards than with small boards. They demonstrated that where the number of directors exceeded ten, it was more difficult for each individual board member to express their thoughts and opinions. This argument is supported by an abundance of empirical evidence generated in subsequent studies. Yermack (1996) reported a statistically significant negative relationship between board size and firm performance in terms of both market valuation and financial performance measures using a sample of 452 large US listed firms for the period from 1984 to 1991. Eisenberg et al. (1998) found a negative association between board size and firm performance in a sample of 879 private firms from Finland using return-on-assets (ROA) as a proxy indicator of firm performance. Conyon and Peck (1998) conducted a study investigating the correlation between board size and firm performance in firms from five European countries (Denmark, UK, Italy, France and the Netherlands) over a sample period from 1992 to 1995. They also demonstrated a negative correlation. Cheng et al. (2008) drew the same conclusion, after analysing a sample of 350 firms from various industrial sectors

listed on the Forbes 500. Numerous other studies have also concluded that firms with smaller boards generally outperform firms with larger boards in countries including Switzerland (Loderer and Peyer, 2002), Japan (Bonn et al., 2004) and Malaysia (Mak and Kusnadi, 2005; Haniffa and Hudaib, 2006).

On the other hand, there are also researchers who endorse the advantages of large boards. Zahra and Pearce (1989) suggested that boards with more seats are more difficult to manipulate. Halebian and Finkelstein (1993) argue that larger boards facilitate a larger collective of information among board members with regard to the firm's operating environment and factors that influence the firm's market value. Anderson et al. (2004) agree that large boards can have a positive impact, stating that they may increase investor confidence in firms, as investors may believe that such firms are monitored better, which is likely to reduce financing costs, which in turn has positive impacts on firm performance. These theoretical arguments are also supported by many studies that have reported positive or insignificant associations between board size and firm performance using samples from various countries and various industries, and utilised various sampling periods (Black and Bhagat, 2002; Adams and Mehran, 2005; Belkhir, 2009; Larmou and Vafeas, 2009; Tanna et al., 2011).

Besides board size, the relationship between the effectiveness of corporate boards and firm performance could also be investigated from the perspective of the composition of the board, namely the percentage of independent directors it contains. According to Maug (1997), independent directors have the power to review and monitor managers' contracts and compensation, which constitutes an effective mechanism with which to discipline managers, particularly with regard to their discretionary and opportunistic behaviours. From this point of view, appointing more independent directors to the board would be likely to alleviate conflicts of interest between owners and managers of the firm, and encourage the investment of the firm's resources in profitable projects, which would improve firm performance and

guarantee reasonable shareholder returns. As suggested by Black and Bhagat (2002), this concept has become conventional wisdom, especially in the American context where the boards of most large American public listed companies are occupied by a majority of independent directors. However, Black and Bhagat (2002) report that such conventional wisdom lacks empirical support based on their research on US firms. Using a sample of 934 large US firms and a study period from 1985 to 1995, Black and Bhagat (2002) demonstrated that firms with boards dominated by independent directors did not achieve better financial performances.

The relationship between board independence and firm performance is controversial, even in the same research context. Liu (2011) questioned the linear regression research method used by Black and Bhagat (2002), and suggested that the relationship between board independence and firm performance may be nonlinear in that "... greater board independence may produce better performance in some pieces of the nonlinear function but inversely influence the latter in other pieces" (Liu, 2011, page 2). He thus adopted nonlinear regression research models to analyse a longitudinal sample of 1,143 firms selected from the S&P 1500 list, and utilised a study period from 1997 to 2006, a more recent period than that used by Black and Bhagat (2002). Liu (2011) reported a significant inverted U-shaped correlation between board independence and firm performance, indicating that firm performance increased as the proportion of independent directors on the board rose, up to a point; but when the proportion of independent directors on the board reached 62%, firm performance began to decrease, and decreased further as the percentage of independent directors increased.

Iwu-Egwuonwu (2010) comprehensively reviewed the existing literature on the effect of independent directors on firm performance, and concluded that the empirical evidence provided by previous studies is not only mixed, but also influenced by different cultures. Specifically, Iwu-Egwuonwu (2010) found that

studies conducted in the US generally reported no positive relationship between the presence of independent directors and firm performance, while others conducted in developing countries reported a positive relationship. Iwu-Egwuonwu (2010) argues that while the quality of governance may not necessarily translate to superior firm performance, most researchers still advocate the conventional wisdom stressing the importance of having independent directors on boards.

According to Iwu-Egwuonwu (2010), studies conducted in developing countries tend to generate empirical results that support the conventional wisdom. Cho and Kim (2007) investigated the association between the effectiveness of outside directors on boards and firm performance using a sample of companies from South Korea. Their study was conducted during Korean CG reform, whereby in as of 1998 all domestically listed Korean firms were required to appoint at least 25% of the positions on corporate boards to independent directors. Using ROA as the measurement of firm profitability, Cho and Kim (2007) confirmed the hypothesis that there is a positive association between independent director participation and firm performance. Ararat et al. (2010) investigated the impact of board independence on firm performance using a sample of 118 firms listed in Turkey, where protection for investors is relatively weak. After classifying corporate directors as either independent or affiliated, they found a significant negative correlation between board independence and firm performance in Turkey.

There are also studies that have examined the influence of other board characteristics, such as CEO duality, on firm performance. Fama and Jensen (1983) argued that CEO duality indicates a lack of separation between decision-making and control over the firm. This idea is supported by Rechner and Dalton (1991) who reported that CEO duality is likely to result in a lack of board independence and control, as well as vigilance of management, which in turn leads to more severe agency problems, and ultimately inferior firm performance. On the other hand,

stewardship theory argues that CEO duality results in unanimity of command at the top of corporations, which helps to avoid confusion and conflict among management, shareholders and other employees. This leads to increased speed and higher efficiency of decision-making, and ultimately, improved firm performance (Donaldson and Davis, 1991; Brickley et al., 1997; Bathula, 2008). A contingency perspective suggests that the impact of CEO duality on firm performance may be contingent upon other factors, such as the scarcity of resources and environmental dynamism. Based on a sample of American firms, Boyd (1995) also reported the beneficial influence of CEO duality on firm performance. Notably, there are also some studies that have found no significant correlation between CEO duality and firm performance (Baliga et al., 1996; Dalton et al., 1998; Chen et al., 2008).

In addition to the studies reviewed above, others have examined the association between board independence and firm performance using research methods other than standard ordinary least squares (OLS) linear regression. Ramdani and Witteloostuijn (2010) utilised quantile regression analysis to investigate the influences of board independence and CEO duality on firm performance for four Asian countries including Indonesia, Malaysia, South Korea and Thailand. They argued that the dominant research approach, standard OLS linear regression, may be the main reason for the inconsistent results regarding the influence of board independence on firm performance reported in the literature. They suggested that quantile regression was more powerful than standard linear regression, as quantile regression can generate estimates for all conditional quantiles of the distribution of the dependent variable. After dividing their dataset into 0.1, 0.25, 0.50, 0.75 and 0.90 quantiles based on firm performance, they found that CEO duality significantly and positively affected firm performance in both the 0.50 and 0.75 quantiles.

Some studies have investigated the influence of multiple board characteristics on firm performance. Bathula (2008) conducted a comprehensive

examination of the relationship between firm performance and key board characteristics including size, shareholdings by directors, CEO duality, gender diversity, the educational background of directors and the frequency of board meetings. This study used board size as a moderating variable to explore how other board characteristics are affected by board size. Using a sample of all firms listed on the New Zealand stock exchange from 2004 to 2007, the study reported that board size, CEO duality and gender diversity had positive impacts on firm performance. They also reported that board size had a moderating effect on the associations between firm performance and other board characteristics.

2.3.2. Supervisory Board and Firm Performance

The majority of studies are almost entirely based on data from Anglo-American systems, and they focus on the influence of the one-tier board system; the board of directors. Limited evidence concerning the effects of the presence of a supervisory board, or the two-tier board system on firm performance has been provided by previous studies. Rose (2005) stated that in the traditional sense, the one-tier board system originates from common law countries, while the two-tier board system generally prevails mainly in “Continental European” countries, where a civil law tradition is followed. It is argued that the supervisory board within the two-tier board system may control the board of managing directors. Bremert and Schulten (2008) suggest that the two-tier board system separates management and the supervision of a corporation, where management is responsible for the steering and control of corporate business; while the supervisory board—which does not have direct executive power—is in charge of the monitoring, supervision and consultation of the executive board. Specifically, they describe five major functions of the supervisory board. Firstly, it helps to select, appoint and dismiss the members of the management team, including the CEO, which has a strong influence on the firm’s management culture. Secondly, the supervisory board is responsible for the evaluation

of the target achievements of managers, based on which the supervisory board negotiates managers' compensation contracts. Thirdly, the supervisory board limits managerial discretion over major corporate decisions. Fourthly, it supervises managers' work and controls the process of the external supervision of auditors. Lastly, it provides management with advice and consultation. Based on this, it could be argued that while management strives to maximize the firm's value and performance, the supervisory board works as a regime with the capability to adjust the firm's risk-return position for the benefit of shareholders and other stakeholders.

Rose (2005) investigated associations between the supervisory board and firm performance based on a sample of all Danish publicly listed firms, excluding banks and other firms from the financing sector, from 1998 to 2001. All firms listed in Denmark are required by the Danish Corporate Act (1973) to have both a supervisory board and a board of managing directors. In comparison to other "Continental European" countries with a "pure" two-tier board system, in Denmark half of the seats in the supervisory board are allowed to be occupied by executive directors. Using Tobin's Q as the surrogate for firm performance, and taking into account other variables such as firm size, growth and industry, Rose (2005) reported that neither the size of the supervisory board nor the proportion of managing directors on it were significantly associated with firm performance in Denmark. Only the age of the supervisory board members was found to have a significantly negative impact on firm performance.

Jungmann (2006) conducted an empirical comparison of the effectiveness of the one-tier and two-tier board systems using a sample of firms from the UK and Germany. That study was mainly motivated by ongoing discussions regarding the relative effectiveness of these two CG systems, the potential benefits or otherwise of replacing one board system with the other, and the potential convergence of these two CG systems. The UK and Germany were chosen as the sample countries because they

are paradigms of these two major corporate board systems. In Europe, the UK is a prominent country with a single corporate board system, which consists of both executive and non-executive directors; while in Germany a dual CG system consisting of a management board and a separate supervisory board is traditionally employed. In that study, the effectiveness of these two board systems was assessed in terms of their influence on firm performance. Samples of 25 listed firms were randomly selected from the London Stock Exchange and the German Stock Exchange for the period from 1994 to 2003. The study reported that overall, both the one-tier and the two-tier board systems were effective CG mechanisms. However, it was concluded that it was impossible to determine which was superior to the other.

Bremert and Schulten (2008) explored whether the results obtained in studies conducted in countries with one-tier corporate board regimes were also applicable in countries where the two-tier system is prevalent. Using a sample of 140 of the largest listed firms in Germany and a study period of 2006 and 2007, they found that the average compensation of the supervisory board members was significantly positively associated with firm performance, as measured by both ROA and Tobin's Q. Notably, the establishment of an audit committee by the supervisory board was negatively associated with both accounting and market-based firm performance. In addition, the number of board meetings was negatively associated with accounting-based firm performance, and the number of non-executive directors on the supervisory board was negatively associated with market performance. Other characteristics and functions of the supervisory board, such as size and whether they had an established compensation committee had no significant influence on firm performance.

2.4. Studies Conducted in the Chinese context

The effects of CG and political influence on firm performance in the

Chinese context has become an increasingly popular area of investigation. There are several reasons for this, including China's recent economic growth and success, as well as the economic and institutional reforms that began in the late 1980s. A notable illustration of this is that China implemented a modern CG structure and mechanisms in the 1990s⁸. Consequently, an increasing number of researchers have examined the influence of the adopted Western CG system on firm performance in China. Some have focused on the influence of certain aspects of CG such as CEO duality or board composition and activity on firm performance (Peng et al., 2007; Bhabra and Li, 2009; Ma and Tian, 2009; Peng et al., 2009). Because all firms listed in China are required to have a board of directors and a supervisory board, *i.e.* the two-tier corporate board system, some studies have examined the influence of the effectiveness of a supervisory board on firm performance (Cho and Rui, 2009; Zheng and Wei, 2010). Additionally, they have explored whether the influences of CG mechanisms exerted in the context of other developed economies also apply in China.

Peng et al. (2007) examined the influence of CEO duality on firm performance during China's institutional transition periods. They evaluated the argument that the separation of the positions of chairman of the board and CEO is likely to enhance firm performance because such a strategy enables monitoring and control of the CEO. Using a sample of 403 Chinese listed firms and a study period from 1992 to 1996, they found a significant positive effect of CEO duality on firm performance. Their results also support the contingent perspective that there is an association between CEO duality and firm performance, in that in the Chinese context—where the economy is characterised by a scarcity of resources and a highly dynamic environment—CEO duality has a positive impact on firm performance.

⁸ The formal establishment of a CG structure and mechanisms in China is indicated by three major events: the founding of China's domestic stock market in 1990, the establishment of the China Securities Regulatory Commission (CSRC) in 1992, and the development of China's Company Law. The development of CG in China is discussed in detail in later chapters of this thesis.

As well as the influence of CEO duality, some studies have examined the impact of board independence on firm performance in China. Bhabra and Li (2009) investigated the influence of appointing independent directors to the board on corporate performance as measured by Tobin's Q⁹. They investigated whether such CG development achieved its intended effect. Using a sample of 2646 firm-year observations for the period from 2001 to 2003, they reported that this CG development in China significantly improved board independence in Chinese companies. In addition, the performance of the sampled firms was significantly enhanced by that increased level of board independence, and state-owned companies experienced greater increases in performance than the private sector.

Ma and Tian (2009) investigated the impacts of board characteristics (including board size and the independence of board members) and board activity on the performance of Chinese listed firms. They argued that while the board of directors could play a monitoring role and influence management to operate in the best interests of shareholders, only boards with a sufficient number of independent directors actually achieved this desired effect. Using a sample of domestically listed firms in 2003 and 2004 and Tobin's Q to represent market performance, Ma and Tian (2009) found that board size had no significant effect on market performance. They also reported that the presence of independent directors on the board significantly enhanced firm performance. While the frequency of board meetings was negatively associated with firm performance, the frequency of shareholder meetings was positively associated with it. These research findings provide empirical support for the positive influence of CG on firm performance in the Chinese context.

⁹ In 2001, a regulation named "Guidelines for Establishing Independent Director System in Listed Firms" (No.102) was issued by the Chinese Securities Regulatory Commission (CSRC), which recommends that at least two board members should be independent, by 2002. In 2003, the revised version of this regulation required at least a third of the board members to be independent directors. The main purposes of such regulation were to enhance the quality of CG and protect the interests of minority shareholders.

According to the 1993 Corporate Law of the People's Republic of China (PRC), all firms listed in China are required to form both a board of directors and a supervisory committee. This represents the official establishment of a two-tier corporate board system, the "Continental European" model, in China. The 1993 PRC Corporate Law and the 2002 Code of Corporate Governance for PRC listed firms set out the responsibilities and functions of these two boards. According to these regulations, the supervisory board is charged with the overseeing, supervision and control of the board of directors and the management team, with the aim of improving the quality of China's CG. However, to date there is limited empirical evidence of the effectiveness of supervisory boards with regard to their impact on firm performance in China.

Cho and Rui (2009) explored the effects of China's two-tier board system and ownership structure on firm performance using a sample of firms listed on China's domestic stock exchanges over the 1999 to 2003 period. They used market-to-book ratio as an indicator of firm performance, and examined the influence of board size, board independence and the frequency of board meetings, for both the board of directors and the supervisory board, on firm performance. They reported that overall, the independence of the board of directors and the frequency of supervisory board meetings had statistically significant positive impacts on firm performance in China. When comparing the data from 1999–2001 with that from 2002–2003, they found that the 2002 Code of Corporate Governance for PRC listed firms effectively enhanced the power of both the board of directors and the supervisory board, which suggests that these internal CG regimes do fulfil the expected role, and the quality of China's CG has increased.

Zheng and Wei (2010) examined the influence of supervisory board size on firm performance using a sample of listed companies issuing A-shares in both Shanghai and Shenzhen stock exchanges for the period from 2001 to 2007. According

to their literature review, previous studies suggest that supervisory committees in China work less effectively and have limited impact in reducing agency costs. This is because the supervisory and monitoring functions of the supervisory board largely overlap with the monitoring role of directors (Xu and Wang, 1997; Dahya et al., 2003; Li and Hao, 2006; Gao and Song, 2007). A supervisory board does not have the power to dismiss directors, but it can report any abuses of power or opportunistic behaviour by directors and management team members (Gao and Song, 2007). Thus, the establishment of a supervisory board is often seen as a window-dressing strategy, conducted solely to comply with the relevant regulations. Zheng and Wei (2010) noted that the aforementioned studies did not draw clear conclusions with regard to associations between supervisory boards and firm performance, and this comprised the main motivation for their research. They use ROA as an indicator of firm performance, arguing that market-based firm performance measures such as Tobin's Q have limited applicability in the Chinese context because the Chinese stock market is less developed than more established stock markets, the proportion of institutional investors is low and individual investors are less mature. They found that overall, the size of the supervisory board in listed state-owned companies was significantly larger than it was in the private sector; however, the correlation between supervisory board size and firm performance was not significant.

2.5. Conclusion

According to the aforementioned review of the literature on the influence of various CG mechanisms on firm performance, prior studies generally suggest that sound CG mechanisms are positively associated with improved accounting performance and market valuation. However, the influence of some CG mechanisms such as the size of corporate boards, the independence of board members, and the presence of a supervisory board on firm performance remain to be empirically determined, as different studies conducted in different contexts using different

samples and research methods generally generate inconsistent results and conclusions. This is illustrated by findings reported by Iwu-Egwuonwu (2010), that studies conducted in the US generally detect no positive relationship between the presence of independent directors and firm performance, while studies conducted in developing countries report a positive relationship. Iwu-Egwuonwu (2010) argues that while higher quality governance may not necessarily translate to superior firm performance, most researchers still tend to advocate the conventional wisdom stressing the importance of having independent directors on the board.

The influence of the supervisory board on firm performance is a separate issue, because most prior studies examining the impact of CG on firm performance have been conducted in countries where the Anglo-American corporate board system (a one-tier board system) prevails. In some “Continental European” countries, such as Germany, the Netherlands, Austria, Finland and Denmark, the two-tier board system which relies on a separate supervisory board is generally employed. Therefore, the impact of supervisory boards on firm performance deserves more attention from researchers. Currently, this is a relatively underdeveloped area and the literature contains limited empirical evidence.

Chapter 3. Government Control, Political Connections and Firm Performance

3.1. Introduction

The main focus of this current study is the impact of the political influence of the Chinese Communist Party (CCP) on the performance of Chinese firms. Accordingly, the literature review in this chapter contains discussion of the theoretical views on the associations between political influence and firm performance, and more importantly, critical review of the empirical findings provided by previous studies on the associations between political control/connections and firm performance using data from various market settings.

The theoretical perspectives on the influence of political control/connections on firm performance are mainly drawn from resource dependence theory, stakeholder theory and rent-seeking theory. As discussed in the previous chapter, resource dependence theory and stakeholder theory provide theoretical support for government/political control at the firm level (Pfeffer and Salancik, 1978; Freeman and Reed, 1983; Freeman et al., 2004; Friedman and Miles, 2006). Rent-seeking theory is also likely to be of relevance in this respect (Krueger, 1974). Firms strive to obtain political connections with the government or politicians in order to compete for “rent”, which is defined as economic benefits, financial resources, or licenses for business operations. In this context, political connections are a valuable asset to firms as they may bring favourable governmental treatment, such as preferential access to financing resources (Claessens et al., 2008).

China constitutes a distinct study setting for the examination of the influence of political control/connections on firm performance. This is because although China has been approaching a market-oriented economy since the economic and institutional reforms initiated in 1978, the Chinese Communist Party (CCP) still unquestionably maintains dominant status in Chinese society, including at the

corporate level¹⁰. The literature contains abundant empirical findings on the associations between political control/connections and firm performance, derived from data from various different settings. In this chapter, many distinct studies will be critically reviewed. This literature review shows that prior studies have used various proxy indicators of political control/connections, such as state ownership, corporate executives' personal political backgrounds, and their past governmental work experience, among others. However, it could be argued that in the Chinese context such measures are comparatively indirect, because the ultimate decision-making entity at the corporate level is the corporate CCP committee, which will be discussed in greater detail in the following chapter.

The rest of this chapter continues as follows: Section 3.2 contains a review of studies conducted in countries other than China. Major research findings yielded by studies using Chinese data are reviewed in Section 3.3, and the final section presents the conclusions of the chapter.

3.2. Prior Studies on Political Influence and Firm Performance

The bulk of the literature implies that corporations owned by the state often exhibit inferior performances in comparison to privately owned corporations. Some scholars who criticize the adverse impacts of state ownership on firm performance rely on the property rights theory of the firm. Alchian (1965) suggested that firms owned by the state do not perform as well as privately owned firms, mainly because property rights tend to be more attenuated in state-owned enterprises (SOEs) than in privately-owned enterprises (POEs). Many studies in the literature have provided

¹⁰ The CCP Constitution requires that enterprises, villages, governmental offices, schools and universities, academic institutions, residential districts, PLA companies, and other grassroots units that have more than three formal CCP members establish a CCP branch (Constitution of CCP, Chapter 5, Article 29).

empirical evidence of the negative influence of state ownership on firm performance. Vining and Boardman (1992) stated that “ownership does matter and there is strong evidence of superior private corporate performance” based on a review of the results of more than 90 studies that investigated the influence of ownership structure on firm performance.

Chhibber et al. (1998) examined the impact of state ownership on firm performance using a sample of 1100 Indian domestically listed firms for the period from 1989 to 1994. They argued that previous studies that provided empirical support for the assumption that SOEs often exhibit inferior performance in comparison to POEs are problematic because the sample firms analysed were from the public sector and operated as either monopolies or duopolies. They further argued that such sample sets were likely to obscure whether the inferior performance of SOEs is due to the effects of ownership or monopoly. In contrast, the sample firms selected in their study were not monopolies or duopolies, and they were classified into three categories: firms with low government shareholdings (less than 25%), firms with moderate government shareholdings (26% to 50%), and firms with high government shareholdings (more than 50%). Chhibber et al. (1998) reported that in their study, firms with less government shareholding ownership did not demonstrate positive accounting performance. However, these firms outperformed those firms with majority government shareholdings.

Kocenda and Svejnar (2003) explored the influence of ownership on firm performance during a large-scale corporate privatisation program, using a sample of medium and large sized firms in the Czech Republic for the period from 1996 to 1999. They aimed to investigate whether private firms exhibited better performances than SOEs, and whether privatising formerly state-owned firms improved their performance. They found that the state tends to be a more economically and socially beneficial agent in periods of economic distress, such as when unemployment is

increasing. They also shed light on the impacts of foreign ownership and ownership concentration on firm performance, reporting that concentrated foreign ownership was positively associated with firm performance, in accordance with agency theory.

Najid and Rahman (2011) investigated associations between government ownership and firm performance using a sample of “government-linked companies” (GLCs) and a control sample of non-GLCs in Malaysia from 2001 to 2006. In the literature, criticisms of GLCs include claims that they are too risk-averse, that they are often short of sufficient entrepreneurial drive, and that certain investments by GLCs are often motivated by political rather than commercial purposes. Thus, governmental intervention in companies may have a negative impact on firm performance. Although the results of their univariate tests seem to support this criticism¹¹, the main result of their multiple regression analysis was that government involvement in GLCs had a significantly positive impact on firm performance. They concluded that this positive impact resulted from investors’ confidence in GLCs. For example, GLCs enjoy the advantages associated with governmental support, such as bail-out policies during hard times. The study suggested that in some Asian countries where the government plays a major role, the public acknowledges the value of political connections, which is in turn reflected in market investors’ confidence and investment decisions.

The literature on the value of political connections could be deemed as being developed based on the rent-seeking theory¹² described by Krueger (1974). Krueger (1974) noted that rent-seeking can take place in legal forms, however, it can

¹¹ The descriptive data analysis of Najid and Rahman (2011) shows a significant difference between the performance of GLCs and non-GLCs, which is represented by both financial and market performance measures (ROA, ROE, Tobin’s Q, *etc.*). This implies that most GLCs tend to have lower corporate performance than non-GLCs.

¹² Krueger (1974) suggested that in market-oriented economies, government restrictions upon economic activities would give rise to “rents” of various forms. Rents here refers to any economic benefits, financial resources, *etc.*, that have already been created. Rent-seeking refers to people subject to government restrictions competing for those rents. One example of rent-seeking behavior under government restrictions offered by Krueger (1974) is competition for import licenses.

also take other forms such as bribery, corruption, smuggling and black markets. From this perspective, many researchers argue that politicians try to get involved in corporate operations to achieve political goals and personal benefits, and an increasing number of studies are examining the value and influence of political connections on firm performance. Many of them have documented the positive correlation between political connections and firm performance based on analyses conducted in countries with both weak and strong legal systems (Fisman, 2001; Ang and Ding, 2006; Faccio, 2006; Niessen and Ruenzi, 2009; Dombrovsky, 2011, and others). These studies all draw the conclusion that political connections tend to be a valuable asset for firms, as they are associated with advantageous treatment from government, such as preferential access to financing resources as suggested by Claessens et al. (2008).

Fisman (2001) assessed the effect of political connections on firm performance during the economic recession in Indonesia in late 1997. That study suggests that in Indonesian firms political connections are of vast importance, as they are the driving force of corporate decision-making, and firms' values are likely to depend on their political connections. That study used the Suharto Dependency Index (1995) developed by the Castle Group, which is a leading economic consulting firm in Jakarta, to measure political connections. Fisman (2001) found that in cases of adverse political rumours, such as those relating to Suharto's health for example, the market performance of firms with strong political connections was significantly lower than that of other less politically connected firms. Thus, political connections and the severity of political rumours were also significantly associated. Based on these results, Fisman (2001) concluded that the value of firms with strong political connections in Indonesia may be derived largely from those political connections.

Ang and Ding (2006) explored the relationship between political connections and firm performance in Singapore, controlling for the impact of the CG

system. They aimed to investigate whether political corruption is the premise for why political connections are valuable. Singapore was chosen because it has low corruption and it is surrounded by countries with the highest corruption rankings¹³. In that study, political connections were defined as having at least one board member that is a current or former cabinet minister or senior civil servant of the Singapore government, or having at least one board member that is a current or former member of the Singapore Parliament. Using a sample of 387 newly listed IPO firms from 1990 to 2000, they found that political connections generally brought little to the value of firms. However, in industries that are subject to tight government regulations, political connections were often of great value with regard to corporate operations and performance.

Faccio (2006) provided a comprehensive analysis of the impact of political connections on firm performance using a sample of 20202 publicly traded firms from 47 countries. The descriptive data analysis of that research showed that political connections are a common phenomenon around the world. Specifically, politically connected firms were found in 35 of the 47 countries in the sample, and they accounted for 7.72% of the world's market capitalisation. In addition, that study demonstrated that the benefits of political connections included preferential treatment by government, favourable taxation policies, preferential positions in the competition for government contracts, and relaxed regulatory oversight of questionable firms. Three forms of political connections were measured: connections with members of parliament, connections with a minister or the head of state, and firms' close relationships with a top official. That study found that overall there was a positive correlation between political connections and corporate market performance.

Niessen and Ruenzi (2009) investigated the impact of political connections on firm performance in the context of a new transparency law issued in 2007 in

¹³ 2010 edition of the global corruption perceptions index released by Transparency International.

Germany. Under this law, all the members of the German Parliament are required to disclose detailed information on any income they derive from non-parliamentary activities. In that study, political connections were measured based on manually collected data on non-parliamentary job activities from all 611 parliament members, and politically connected firms were defined by the employment of a parliament delegate. Niessen and Ruenzi (2009) suggested three possible reasons for the positive association between political connections and firm values. Firstly, government officials may engage in corporate operations to maintain contact with voters in order to obtain information regarding the demands of the population. For reputation purposes, they are likely to choose highly performing firms. Secondly, politicians are often outsiders to corporations, which allows them to provide independent ideas and opinions to corporate operations, which may have a positive effect on firm performance. This is in line with the agency theory, which emphasizes the positive impacts of board independence on firm performance. Thirdly, political connections may provide firms with preferential treatment from government and regulatory authorities, such as easier access to debt financing, lower taxation, the awarding of government contracts, and reduced regulatory requirements. Using a sample of 605 listed German firms and a study period of 2006 and 2007, that study found that firms with political connections tended to be larger in size, risk-averse, and that they had less market variations, less investment opportunities and marginally better performances in terms of accounting performance measures than unconnected firms. From the perspective of corporate market performance, they reported that politically connected firms significantly outperformed others in 2006.

Dombrovsky (2011) examined the impact of political connections on firm performance in Latvia. Latvia was selected as it has a high level of corruption, a characteristic feature of its economy and weak democratic institutions. In such circumstances, political connections are likely to bring greater value to companies. In that study, political connection was measured using the same method that was adopted

by the studies reviewed above (Ang et al., 2006; Faccio, 2006; Niessen and Ruenzi, 2009). Politically connected firms were defined as those with a current or former politician on the board or serving as a major shareholder. The study used a sample of 1108 firms registered in Latvia from 1996 to 2005. A positive correlation was found between political connections and firm performance. Notably, politically connected firms experienced a mean increase of 24% in their earnings when the party of the politicians that they were connected to were in power. On average, the earnings of politically connected firms decreased by 34% in the year of the establishment of the political connection, then increased by 63% the following year. When the politician's party lost authority and moved to the opposition, the connected firms suffered an average decrease of 17% in earnings.

3.3. Prior Studies on Government Control, Political Connections and Firm Performance in China

China has adopted a market-oriented economy since the initiation of economic reform in 1978, and with the rapid growth and development of China's stock market Chinese firms tend to operate in ways that are more and more similar to those of western economies. However, the Chinese government and the CCP still retain significant control and powers of intervention at the firm level. Political control in China takes two main forms: non-tradable state ownership and the presence of government officials and CCP members on the boards and management teams of large Chinese listed firms. More interestingly, there has been a trend of China's POEs striving to obtain political connections with the Chinese government or the CCP due to the related benefits and preferential treatment, which is known as "wearing a red hat" (Li et al., 2006). The motivation for such a strategy is easier access to resources, information on regulations and new policies, and protection from competition. Guiheux (2006) has summarised private entrepreneurs' ways of wearing a red hat: 80% of private entrepreneurs had become CCP members before starting a business; serving

as delegates in local or national People's congress; contesting elections for local administration posts and joining business associations that link the state and the private sector; and affiliation with government administration. In this section of the thesis, studies that have examined the influence of political control on firm performance through both state ownership and political connections are critically reviewed.

Tian (2001) investigated the influence of state ownership on firm performance using a sample of 826 Chinese listed firms for the period from 1994 to 1998. He suggested that the Chinese government played a key role in the operations and survival of these modern Chinese firms despite China's economic reform and development, and the modern reconstruction of Chinese SOEs¹⁴. In that study, the political control exerted by the Chinese government over the Chinese listed firms was represented by the ratio of the Chinese government shareholdings to the total number of the remaining shares. Tobin's Q and the ROA ratio were employed as indicators of firm performance. The major finding of that study was that corporate value increased as state ownership increased when the government was the largest shareholder.

Hu et al. (2010) investigated the influence of concentrated ownership by the Chinese government on firm performance in China from the perspective of agency theory. They argued that the conventional agency problem between shareholders and managers that is widely recognised in developed countries is of less significance in emerging markets where concentrated ownership is predominant. Some researchers suggest that the principal agency problem in emerging markets tends to be between

¹⁴ Tian (2001) firstly reviews the economic reforms launched by the Chinese government, including how the formerly well-known loss-making Chinese SOEs had been restructuring to incorporate mixed ownership structures. They are characterised by clearly-defined property rights, modern CG mechanisms and strong cash flows. Surprisingly, Tian (2001) also reports highly concentrated government ownership. The Chinese government is still the largest shareholder of more than one third of firms listed on China's stock markets. Thus, it is suggested in that report that the Chinese government plays a key role in the operations and survival of these modern Chinese firms.

controlling and minority shareholders (Dharwadkar et al., 2000; Young et al., 2008). Based on a sample of 304 Chinese publicly listed firms for the period from 2003 to 2005, Hu et al. (2010) found that the highly concentrated state ownership in Chinese listed firms had a significant negative impact on their performance. Further, the positive influences of other CG mechanisms such as the functions of the board of directors and the supervisory board were hindered by highly concentrated state ownership.

Ma et al. (2010) investigated the impact of ownership and ownership concentration on the performance of Chinese listed firms. They suggested that it is important to recognise the differences between ownership and ownership concentration, and total ownership concentration and tradable ownership concentration. The major differences they describe are that, first, ownership refers to the attributes of or the capital contributions made by the owners; while ownership concentration is the controlling power that top owners have in the decision-making of a firm. Second, total ownership concentration differs from tradable ownership concentration as total ownership concentration includes shareholders without complete shareholder's rights as their shares are non-tradable, and they can control the firms. In contrast, the tradable ownership concentration provides the shareholders with the opportunity to influence the share prices. The results of Ma et al.'s (2010) research indicate that ownership concentration rather than state or legal person ownership is a more powerful determinant of a firm's performance. Tradable ownership concentration, in comparison with non-tradable state ownership, has a more significantly positive influence on firm performance.

Le and Chizema (2011) suggest that prior studies that have examined the associations between state ownership and firm performance in countries around the world and under the circumstances of economic transitions have yielded mixed and inconclusive results because of differences in institutional contexts. They argue that

the economic development path in China differs from that of other countries as the Chinese economy has been transformed without corresponding reform of its political system. Using a sample of 1154 listed firms for 2004 and 1255 listed firms for 2005, they reported that state ownership in China was positively associated with accounting-based firm performance, and state ownership in Chinese listed firms was used as a strategic asset to boost firm performance in terms of accounting-based returns. However, such a strategy is perceived differently in China's stock markets.

Few studies have directly measured the political influence of the CCP's involvement in the corporate decision-making process in China. Chang and Wong (2004) investigated the involvement of the local CCP committee in the decision-making process in listed firms in China, and its impact on firm performance¹⁵. Their results illustrate that CCP control over managers is negatively associated with accounting-based firm performance, while CCP control over the largest shareholders is positively associated with firm performance. That study made a distinct contribution, as it revealed that political control by the CCP was exerted at the corporate level through the local CCP committee. However, the study had limitations. Firstly, they did not differentiate the Chinese listed firms. In China, there are two main types of listed firms, SOEs and POEs, and the CCP's influence operates differently in each type. In listed SOEs, a corporate CCP committee is the ultimate decision-making body, and the senior corporate executives such as the CEO and chairman of the board are also members of the corporate CCP committee. They mainly transmit and

¹⁵ The involvement of local CCP committees is explored based on a survey containing 63 decisions regarding aspects of the daily operations, accounting practices, finance and investment, and appointment and dismissal of key personnel of the sample firms on a five-point scale. A score of 1 indicates no involvement at all and a score of 5 suggests complete influence. The CCP control measurement procedure consists of two steps. Firstly, based on the survey results, three indexes have been established: the decision-making power of the local CCP committees (PI), the largest shareholders (SI) and managers (MI). Secondly, two ratios are calculated to measure the CCP's control over the largest shareholders and managers: PS (the ratio of PI to SI) and PM (the ratio of PI to MI). A high value for either of these ratios implies that the local CCP committees have a strong influence on the largest shareholders or managers in the firm's decision-making.

implement the decisions made by the corporate CCP committee. In POEs, a corporate CCP committee could be viewed as a mere demonstration of the firms' political connection with the CCP, and it does not have any significant power over corporate affairs. Secondly, the structure of the corporate CCP committee, the influence of CG structure and mechanisms, and the domination of the CCP committee over CG structure were not measured by Chang and Wong (2004). In addition, some key data and variables were constructed based on survey information. This method may introduce bias into the data, as some information gathered by surveying CCP members may be unreliable with regard to truthfulness¹⁶. These factors may all have had unfavourable impacts on the research results.

Li et al. (2008) examined the CCP's influence on firm performance from the perspective of the role of affiliation with the CCP in the operations of Chinese private firms. In their study, politically connected private entrepreneurs specifically referred to CCP members and former government employees who had quit their government positions to enter the private business sector in China. This is known as "plunging into the sea" (xiaohai). One of their major findings was that CCP membership of Chinese private entrepreneurs had a positive effect on the performance of their firms, and such membership worked as a driving force for the profitability of private firms. Secondly, CCP membership enhanced firms' access to loans and capital from banks or other state-owned institutions, and provided them with more confidence and better conditions in the legal system. Thirdly, CCP membership was found to be of more importance to firm performance in regions where market-supporting institutions and legal protection for private firms were weaker. Li et al. (2008) reported a significant

¹⁶ For example, the interviewees in the survey of Chinese SOEs were all senior executives, and most of them were also members of the corporate CCP committee. They mainly transmit and implement decisions made by the corporate CCP committee. Their promotion and personal welfare are directly linked with their loyalty to the CCP. In POEs, the members of CCP committee generally do not hold positions in CG structure, and they do not possess have control over corporate affairs. The operations of the CCP committees in Chinese corporations are discussed in detail in subsequent chapters in this thesis.

positive association between political connections and firm performance, but their study had some limitations. They did not demonstrate a difference in the patterns of political influence between Chinese state-owned companies and private companies, as only private companies were considered in the study. Also, they did not empirically measure the CCP's influence on CCP committees.

Li (2010)¹⁷ investigated the influence of political connections on firm performance and the Chinese CG system using a sample of all firms listed on the Shanghai and Shenzhen stock exchanges for the period from 2001 to 2006. They demonstrated that the Chinese CG system was dysfunctional, and that rather than advancing firm performance it merely granted executives high compensations. Further, political connections weakened the effectiveness of the Chinese CG system, but they did not negatively affect firm performance.

Du (2011) examined the associations between firms' political connections and their ability to raise capital in the bond market in China. Some previous studies, including Claessens et al. (2008), suggest that firms with political connections tend to obtain preferential access to corporate finance in emerging economies. However, others such as Chaney et al. (2011) suggest that political connections can lead to lower accounting quality, which has negative consequences such as higher financing costs. Du (2011) presented three arguments in an effort to explain the above discrepancies. The reputation enhancement theory supports the positive effects of political connections on preferential access to capital, in that it suggests that political connections enhance the reputations of firms with lower quality disclosure. The social lending argument also explains the positive association between political connections

¹⁷ The study notes two unique features of the CG system in China. Firstly, China's CG system is a combination of both the Anglo-American model and the German system, and consists of both a board of directors and a supervisory committee. It includes two monitoring entities, the independent directors and the supervisory committee. Secondly, Chinese listed firms are often characterised by their close political connections with the Chinese government, because most of them were transformed from SOEs during China's economic transition to a market-oriented economy.

and preferential access to capital, stating that firms that engage in high risk socially beneficial projects may acquire favourable government treatment. These firms are more likely to obtain these projects because of their political connections, and because they have politicians on their boards, and the government that oversees the bond issuing process aims to improve social welfare. The collusion argument explains that firms' executives may be able to influence the bond issuing process, especially approval decisions, by colluding with politicians who govern the process. Based on this premise, Du (2011) used the bond offering amount as an indicator of a firm's access to bond capital, and in that study political connections were represented by three dummy variables reflecting whether the CEO, CFO and executives of a company held bureaucratic positions before joining the company. Du (2011) found that in the subsample of firms in poor informational environments, such as non-publicly listed firms and non-Beijing headquartered firms, political connections were positively associated with the amounts of financing offered and issuer credit ratings.

Hu and Leung (2012) investigated the appointment of politically connected top executives when firms were financially distressed, and their subsequent performance in China. They aimed to provide a better understanding of the role of the government in corporate operations in the Chinese context, where the managerial labour markets are often less developed, and management appointment decisions may be influenced by political factors. Political connections in that study were determined when a newly appointed executive either worked in central-level or local-level government, or held the position of CCP committee secretary, was a Central CCP Committee member, or was a representative of the National People's Congress. Financially distressed firms were defined as those with poor accounting-based firm performance, negative net profit, high leverage risk, or firms that violated any regulations or laws. Using a sample of 696 listed Chinese SOEs for the period from 2001 to 2005, Hu and Leung (2012) found that politically connected executives were

more likely to be appointed to SOEs when the firms were financially distressed. In addition, as a consequence of these appointments, those SOEs subsequently exhibited improved performance. These results may suggest that in China, the political control of the CCP and the Chinese government is likely to work as a powerful and effective device to boost undesirable firm performance.

Wu et al. (2012) examined the influence of political connections on the performance of Chinese firms by exploring whether political connections in China provided firms with preferential treatment from the Chinese government in terms of tax benefits or lower tax rates. Both state-owned and private companies were considered in that study, and the sample included 1408 Chinese listed firms that issued A-shares for the period from 1999 to 2007, excluding those firms with foreign controlling shareholders. In that study, a firm was considered to be politically connected if the Chairman of its board or the CEO currently or formerly worked as an officer of the central or local government or military. The firms were classified into three categories: central SOEs controlled and owned by the central government or its various authorities, local SOEs owned by the local government, and POEs owned by non-government entities. Wu et al. (2012) found that politically connected POEs exhibited better accounting and market performances than other POEs, and were more likely to receive tax benefits. At the local level, politically connected SOEs generally underperformed compared to SOEs that did not have political connections. That study had a major limitation in that the measurement of political connections was based on the senior corporate executives' personal political backgrounds. In fact, all companies in the Chinese public sector are owned and controlled by the Chinese government, therefore they are all politically connected. Thus, the second finding of that study regarding the performance comparison between local SOEs may not have significant theoretical or empirically derived implications.

3.4. Conclusion

The literature on political connections presented from the perspective of rent-seeking theory suggests that in countries with a high level of corruption or weak political institutions, political connections are likely to be used by politicians to derive personal benefits or for political purposes (Niessen and Ruenzi, 2009). It also suggests they can be used by firms to obtain preferential treatment from the government or other regulatory authorities, such as easier access to financing resources, lower taxation, preferential positions in the competition for government contracts, and relaxed regulatory oversight (Faccio, 2006).

Many studies have provided empirical evidence on the impact of political connections on firm performance, and most of them suggest that political connections are likely to bring advantages and enhance firm performance (Fisman, 2001; Faccio, 2006; Niessen and Ruenzi, 2009; Dombrovsky, 2011). There are also studies that have investigated the influence of a country's level of corruption on the association between political connections and firm performance. For example, Ang and Ding (2006) found that political connections are more positively associated with firm performance in countries where the level of corruption is high.

Previous studies have generally reported significant relationships between various types of ownership structure and firm performance measured by accounting profitability and market valuation. Kumar (2004), Douma et al. (2006), Filatotchev et al. (2007) and Patibandla (2006) have all reported that foreign institutional shareholdings have a positive effect on firm performance. However, the relationship between certain types of ownership structure and firm performance is likely to be viewed as an empirical issue, because numerous studies using different research methodologies, such as simple linear regression and piecewise regression, and samples collected from different countries and for different sample periods have

generated controversial and conflicting results and conclusions. For example, regarding the influence of managerial shareholdings on firm performance, there are two competing arguments. Jensen and Meckling (1976) reported a mitigating influence of managerial shareholdings on agency problems, meaning that managerial shareholdings helped to align the interests of shareholders and management. Conversely, other researchers have argued that higher levels of managerial shareholdings exacerbate agency problems between owners and the managers, as the increased managerial shareholdings are likely to entrench managers' controlling power (Demsetz, 1983; Fama and Jensen, 1983).

Many empirical studies have generated varied and conflicting results on this issue. Demsetz and Lehn (1985) first documented a statistically non-significant association between managerial shareholdings and firm performance. However, Morck et al. (1988) argued that Demsetz and Lehn's (1985) failure to detect a significant relationship between managerial shareholding and firm performance may have resulted from the fact that a simple linear methodology is unlikely to identify a non-monotonic relationship. Instead, they explored the relationship between managers' stock ownership and firm performance as measured by Tobin's Q using the segmented regression research method, and they detected a significant non-monotonic relationship. Morck et al.'s (1988) results are supported by the research of Hermalin and Weisbach (1991), however, Khan et al. (2007) have reported opposite results to those of Morck et al. (1988) and Hermalin and Weisbach (1991). With regard to the influence of state or government ownership on firm performance, prior studies generally support the premise that corporations owned by the state are often seen to exhibit inferior performances compared to privately owned corporations. However, other studies performed in countries such as Malaysia (Najid and Rahman, 2011) have demonstrated positive effects of state ownership and involvement on firm performance.

Chinese society is still characterised by the dominant status of the CCP, despite the fact that China has launched a series of economic and institutional reforms in pursuit of a market-oriented economy. It is suggested in some reports that China's CG system is unique because it is characterised by the political intervention of the Chinese government, and more importantly the CCP. Some researchers have argued that the quality of CG is reduced by political control, which in turn has a negative impact on firm performance (Tian, 2001; Chang and Wong, 2004; Hu et al. 2009; Li, 2010). Conversely, others have argued that in developing countries with underdeveloped markets, weak legal systems and poor protection for market investors, political connections tend to work as powerful instruments for firms' survival, and are associated with enhanced firm performance (Li et al., 2008; Du, 2011; Le and Chizema, 2011; Hu and Leung, 2012; Wu et al., 2012).

Chapter 4. Institutional Background in China

4.1. Introduction

China has been transitioning to a market-oriented economy since it initiated economic and institutional reforms in 1978. The transition has mainly involved the privatisation and corporatisation of China's state-owned enterprises (SOEs) and the rapid growth of privately-owned enterprises (POEs). During this process, a modern corporate governance (CG) system has been implemented and adopted in China. However, the Chinese CG system differs from those of other developed countries. Firstly, it is a combination of both the Anglo-American model and the European model, as it comprises both a board of directors and a supervisory board. More importantly, it is characterised by tight control by the Chinese Communist Party (CCP) and the Chinese government at the firm level. For example, all Chinese SOEs are required to have a CCP committee which has controlling power over major decisions, such as the appointment and dismissal of top executives. Given the CCP's dominance of the public sector in China's national economy, POEs strive to obtain political connections with the CCP in order to obtain scarce resources, such as tax benefits, easier access to financing capital and certain business licences, in order to survive and further develop.

In order to capture an overall picture of the effects of the Chinese CG system and the political influence of the CCP on firm performance in China, in the following sections a review of China's institutional background is provided. Section 4.2 discusses the development and growth of China's enterprises since the initiation of economic reform in 1978, as well as the establishment and expansion of China's stock market. Section 4.3 discusses the development of the CG mechanisms and structure in China's enterprises. Lastly and most importantly, Section 4.4 explains how China's SOEs are tightly controlled by the CCP through the supervising entity, the corporate CCP committee, and POEs' political connections with the CCP are also discussed.

4.2. The Development of China's Enterprises and Stock Market

4.2.1. China's State-Owned Enterprises

4.2.1.1. The Development of China's State-Owned Enterprises

From the establishment of the People's Republic of China (PRC) in 1949 until the 1950s, SOEs were set up by the Chinese government through a “catch and takeover” strategy (Yang and Zhang, 2000), whereby enterprises established before 1949 by national capitalists were taken over. Until the late 1970s, China's national economy was entirely centrally planned and the public sector was completely controlled by the government. At the beginning of this period, the catch and takeover strategy and the centrally planned system were efficient, as China's economy developed significantly. Subsequently however, particularly during the late 1970s, the economic system and SOEs faced severe problems and the development of China's economy reached an impasse. For example, China's economy bordered on collapse due to the disastrous impact of the “cultural revolution” in 1976, and China's SOEs performed poorly. In order to mitigate or resolve these problems, a series of economic reforms were launched by the Chinese government. These reforms were aimed at introducing a market-oriented economic system, incorporating fair market competition, encouraging China's private sectors to develop, and establishing effective market regulations.

The reform and development of China's SOEs was initiated through corporatisation and privatisation in 1978, when the “reform and open” policy was first introduced by the Chinese government, and remains ongoing (Zhang, 1999; Yang and Zhang, 2000; Zhou and Xia, 2008). As a result, China has been steadily approaching a market-oriented economy and SOEs have been restructured into modern corporations, at least in form.

According to Zhou and Xia (2008), the development and reform of China's SOEs occurred in three major stages. The first was the preliminary exploration of China's SOE reform from 1978 to 1992. This mainly involved the decentralisation of decision-making power over firms' operations from the central government to local governments and enterprises, the separation of corporate operations from governmental administration, and the separation of ownership and management. During this period, several forms of SOE reform appeared: the implementation of the manager responsibility system, the contract managerial responsibility system in the majority of China's SOEs, corporate operations under lease in small SOEs, and the experimental establishment of a shareholding system and corporatisation in a few eligible enterprises. However, due to some long-standing historical problems, such as the information asymmetry between internal management and external supervision, and the lack of a normative restraining system and insider control, the effects of this stage of SOE reform were undesirable.

The second stage of China's SOE reform occurred from 1993 to 2003, and was mainly characterised by institutional innovations aimed at establishing a socialist market economic system and a modern corporate system¹⁸. Another major aim of this stage was the adjustment of the role and position of SOEs in China's national economy. Specifically, the plan was that China's state-owned economy should maintain the leading role, but the number of SOEs and the proportion of firms they accounted for in the national economy should be reduced in order to enhance the quality and efficiency of China's state-owned economy. The ultimate goal of this corporatisation reform was to relieve the financial stress on China's SOEs, which had

¹⁸ In 1993, the Third Plenary Session of the Fourteenth Central Committee of the CCP explicitly stipulated the direction of China's SOE reforms, stating that the aim of this stage of reform was to establish modern corporate institutions that could acclimatize to the market economy and the requirements of large-scale socialized production. These modern corporate institutions were also characterised by defined property rights, explicit rights and responsibilities, the separation of corporations from governmental and political administration, and scientific modern corporate management.

resulted from several severe problems including the high debt ratio, large number of redundant personnel, heavy social burden and responsibilities, and low staff enthusiasm. In order to achieve this goal, the Chinese government adopted two major measures, the introduction of shareholding ownership and management of POEs into SOEs, and expanded of the scope of the experimental corporatisation and shareholding system from a few eligible SOEs to approximately 2500. Unfortunately, this stage did not bring the expected results as the financial difficulties faced by SOEs were ultimately not overcome.

In the third stage, from 2004 to the present, China has continued to promote the reform of its SOEs by three principal means: the ongoing development of a modern corporate system, changes in the management of state-owned assets, and reform of China's stock markets. As a result, a form of modern corporatisation and CG structure has been established in SOEs, although the CCP still maintains tight control through direct or indirect shareholding ownership and political agencies, such as the CCP committees at the firm level. According to the evidence provided by previous studies reviewed in the previous chapters, the CG system in China's SOEs has had positive functions (Peng et al., 2007; Cho and Rui, 2009; Zheng and Wei, 2010).

4.2.1.2. The Role and Position of State-Owned Enterprises in China

The Chinese public sector, namely Chinese SOEs, has played a critical and leading role in China's society and economy. The role of SOEs in the Chinese national economy is explicitly stated in both the fundamental law of the state, the Constitution of China¹⁹, and the framework document of the CCP, the CCP Constitution. The state

¹⁹ The position and role of SOEs were recognised for the first time in the First Constitution of China, which is also known as the Fifty-four Constitution as it was passed in the First Plenary Meeting of the First National Congress in 1954. The role of SOEs is also stated in the current Constitution of China.

guaranteed that the development of the state-operated economy was a priority. According to the Constitution of China, state ownership, namely the ownership by the whole of the people, is a major type of ownership in China (Chapter 1, article 5), is the foundation for the socialist economic system of China (Chapter 1, article 6), and is the leading force of the national economy (Chapter 1, article 7). The CCP also highly values the position and status of China's state-owned economy. The current CCP Constitution states that the "... state-owned-economy should be consolidated and developed unhesitatingly and confirmedly" (General Principles chapter of the 1956 CCP Constitution).

Chinese SOEs have played a leading role in China's key industries and fields directly linked to China's national security, and are the lifeline of China's national economy. These industries include petroleum and petrochemicals, aerospace, electricity and power, telecommunications, transportation and national defence (Li, 2008). The position and role of Chinese SOEs can be further illustrated with concise statistics, including the number of SOEs that exist, the value of their total assets, their gross industrial production (GIP) and profits after tax, and the total number of people they employ (which is an indication of the social responsibilities of SOEs).

Table 4.1 illustrates some of the major patterns and trends of the development and reform of China's SOEs. Firstly, besides a slight increase from 1992 to 1993, the number of SOEs progressively decreased from almost 2 million in the early 1990s to a mere 17,050 in 2011. Accordingly, during this same period the number of employees in SOEs decreased from over a 100 million in the early 1990s to approximately 18 million in 2011. Surprisingly, although the number of SOEs has reduced significantly, their size as indicated by total assets and performance in terms of GIP and profit before tax has increased steadily and considerably. This is evidence

The current Constitution of the PRC, which was passed in the Fifth National Congress in 1982 and experienced four amendments in the Seventh, Eighth, Ninth and Tenth National Congresses in 1988, 1993, 1999 and 2004 respectively is China's fourth constitution.

of the expected desirable impacts of the Chinese government's SOE reform policies, which aimed to improve the quality and performance of SOEs through corporatisation and the introduction of various forms of ownership and management. The decrease in the number of SOEs is mainly a result of the implementation of policy-oriented closures, and bankruptcy of those SOEs which had been loss-making entities for a long period of time. Meanwhile, the size and profitability of SOEs have substantially increased. Therefore, the quality of China's SOEs has been markedly improved. A report by the State-Owned Assets Supervision and Administration Commission in 2012 also presents similar arguments.

Table 4.1: Summary statistics indicating the role and position of SOEs in China's national economy²⁰

	1978	1992	1993	2003	2004	2011
Number of Enterprises (1,000)²¹		1743.90	1908.30	56.80	52.90	17.05
Number of Employees (million)	74.51	108.89	109.20	38.87	35.78	18.12
Total Assets (billion RMB)	320.14	1451.30	1770.44	9451.98	10159.37	28167.39
Gross Industrial Production (billion RMB)	423.70	2995.90	3918.90	5340.79	7655.75	22103.63
Profit Before Tax (billion RMB)	79.07	194.41	245.47	686.18	878.71	2586.41

The importance of SOEs to China's national economy can also be assessed based on their contributions to China's annual gross domestic product (GDP) in terms

²⁰ This table presents statistics obtained from the China Statistical Yearbooks 1996 to 2012 available on the website of the National Bureau of Statistics of China. All these statistics and analyses were conducted according to the time-frame of SOE development and reform during the 33-year period from 1978 to 2011, which covers the three main stages of the SOE development process.

²¹ According the current Constitution of China (Chapter 1, article 6), public ownership under China's socialism included ownership by the whole of the people, and collective ownership. Therefore, in this table the number of SOEs is calculated as the total number of enterprises under state-ownership and collective ownership.

of annual sales revenue derived from primary operations. As illustrated in Table 4.2 below, China's SOEs contribute a significant proportion of China's annual GDP, accounting for more than 46% in all years from 2005 to 2011 except 2009. In addition, during this period the contribution has steadily increased despite the significant decrease in the number of SOEs. This constitutes further evidence of the positive impacts of the Chinese government's SOE reform policies.

Table 4.2: Contribution of SOEs in terms of annual sales revenue and China's annual GDP²² (in billion RMB)

	2005	2006	2007	2008	2009	2010	2011
Revenue	8557.42	10140.46	12261.71	14750.79	15170.06	19433.97	22890.01
GDP	18493.74	21631.44	26581.03	31675.17	34562.92	40890.30	48412.35
Revenue/ GDP	46.27%	46.88%	46.13%	46.57%	43.89%	47.53%	47.28%

4.2.2. China's Privately-Owned Enterprises

In the period from the establishment of the PRC in 1949 to the late 1970s, China's private economy was almost completely destroyed as a consequence of the "catch and takeover" policy. China's POEs were developed concurrently with the progress of China's reform and open policy, initiated in the late 1970s. After the redefining of the role of POEs in China's national economy by the Chinese central government and more importantly by the CCP in 1978, POEs experienced a revival and were afforded the opportunity to develop. With the rapid growth that has occurred since then, China's POEs have acquired a significant position in China's economy, as illustrated by the following considerations. In 1997, the Chinese president at the time

²² This table is designed based on the data limited to 1997 to 2007 from China Statistical Yearbooks, 1998, 2010 and 2012.

Jiang Zemin²³ stated that the non-state-owned economy was an important component of China's socialist market economy. According to Zhou (2008), by 2004 the contribution of POEs to the national economy had exceeded 60%, the number of employees had reached over 100 million, and more than 70% of China's exports were derived from POEs.

4.2.2.1. Privately-Owned Enterprise Models and their Development in China

Political Reinstatement of the Position and Role of China's POEs and their Development Progress

Under China's reform policies, POEs have developed significantly in terms of number, firm size and their role in China's national economy. According to Quan (2008), the development of China's POEs has progressed in three major stages during the period from 1978 to the present. In the first stage, from 1978 to 1992, the private economy became a supplementary force to China's socialist economy. Most importantly, its legal and economic position was acknowledged by the Chinese government and the CCP²⁴. In the second stage, from 1992 to 2002, the private economy became an important component of China's socialist market economy. For example, the resolutions of the National People's Congress and the National Congress of the CCP explicitly stated that POEs were an important component of China's national economy, and the fundamental economic institution of China was centred by

²³ Fifteenth National Congress of the CCP.

²⁴ The CCP acknowledged that the private sector was a necessary and advantageous supplement to China's publicly-owned economy, and that it should be encouraged and supported to develop suitably (12th, 13th, 14th National Congress of the CCP). In April 1988, the constitution amendments passed in the First Session of the Seventh National People's Congress asserted that the state allowed the private sector to exist and develop within the scope of the law, and the state protected the legal rights and benefits of the private economy.

the public sector and supplemented by the private sector²⁵. The recognition of non-public sectors of the economy by the Chinese government and the CCP provided the non-public economy with institutional guarantees and momentum for further development. Consequently, during this period, the development of China's private economy was accelerated and legitimately integrated into China's national economic development. In the third stage, from 2002 to the present, Chinese POEs developed further. During this period the Chinese government has firmly encouraged, supported and guided the development and growth of POEs, has attempted to eliminate institutional hurdles for the development of POEs, and endeavoured to protect property rights equally in both the public and private sectors²⁶. In 2005, the Chinese State Council issued the governmental document entitled "Several opinions regarding the encouragement, support and guidance for the development of the non-public sectors of the nation economy [*sic*]", which was the first policy document on the subject of the promotion of China's non-public economy since the establishment of the state in 1949.

A research report by the China Labour Bulletin in 2004 also illustrates the growth of China's POEs in terms of their political treatment by the Chinese government and their social status. This report summarises three major points. Firstly, the owners of private businesses are allowed to join the CCP and the statistics show that approximately 29.9% of POE owners are members of the CCP. Secondly, an increasing number of POE owners are participating in the discussion and administration of governmental and state affairs. According to Dai (2002), 5400 POE owners serve as People's Congress (PC) representatives and 8500 are members of the Chinese People's Political Consultative Conference (CPPCC) at the county level. At the provincial level, 372 POE owners are PC representatives and 895 are CPPCC members. Forty-eight POE owners are representatives at the National People's

²⁵ The resolutions issued at the 14th, 15th, 16th National Congress of CCP and the Second session of the 9th National People's Congress of China.

²⁶ This is stated in the resolutions passed at the 16th and 17th National Congresses of the CCP.

Congress, and 46 are members of the National CPPCC. Thirdly, more and more POE owners are obtaining political power by taking advantage of their capital strength. A reporter from “Liaowang News Weekly” has asserted that in the provinces of Hebei and Jilin, a large number of the local POE owners have attained high positions in local governments, courts of justice, and governmental agencies such as the Bureau of Labour at the county level.

Development Models of China’s Privately-Owned Enterprises

According to Zhou (2008), there are several models of development of China’s POEs. In the period from the early 1980s to the late 1990s, there were four main POE development models or patterns. One was the “SuNan Model”, which refers to the development of collectively owned enterprises from rural areas in southern Jiangsu province, including cities such as Suzhou and Wuxi. This model ended with the reform of these enterprises in 1996, and was replaced by the POEs’ reform of the modern corporate shareholding structure. The “Wenzhou Model” refers to the development model of individual private businesses in the region of Wenzhou, Zhejiang province. It was characterised by family workshops and industries. The “Pearl River Delta Model” refers to the growth of export-oriented manufacture enterprises in the Pearl River Delta region, and these enterprises received capital from off-shore investors living in Hong Kong and Macao. This development model still exists, as it remains a viable developmental strategy. Lastly there is the “Zhongguancun Model”, which originated in the Zhongguancun district in the city of Beijing and refers to the growth of privately-owned science and technology enterprises or businesses established by elites. These enterprises relied on scientific research institutes and universities, and initially operated under the names of specific scientific research institutes or governmental agencies. After a few years of operation, the ownership structure of these privately-owned high-tech enterprises became unclear and ambiguous, and the reform of these enterprises seemed essential to their

survival. In the late 1990s, those privately-owned high-tech enterprises tended to have a clear ownership structure and strong innovativeness, and they became an important and distinct group of POEs in China. Zhou (2008) demonstrated that the main characteristics of these four development models were influenced by the institutional, environmental, social, political, economic, cultural, resource-based and traditional factors faced by POEs in certain historical periods.

Entering into the 21st century, another four models or patterns of POE development emerged in China. The first is the “supporting” development model, which refers to POEs that strive to develop by manufacturing secondary components or associated accessory equipment or products for large or foreign enterprises. The second is the “supplement” development model, characterised by POEs that survive and develop by finding and filling the gaps in the market through meticulous in-depth market research, analysis and forecasts. The third type is the “cluster” development model, which refers to a situation whereby a number of enterprises cooperate, communicate and support each other in certain industries or in the manufacturing of certain products within the same or related regions due to specific geographical resources, historical relationships or cultural considerations. This development model is often seen in Guangdong Dongguan and cities in Zhejiang. Lastly, some POEs rely on scientific and technological innovation as their primary resource and fundamental means of development, which is known as the “innovation” development model. Most of these enterprises engage in internet-based or high-tech related industries, and they tend to have strong vitality as they derive their competitiveness from ongoing innovations.

Development of China’s Privately-Owned Enterprises and their Roles in China’s National Economy

As for China’s SOEs, the roles of China’s POEs in the national economy

during different development phases can be illustrated by a series of official statistics, specifically the number of enterprises, the number of employees, total assets, GIP, net profit, and their contributions to China's national economy as indicated by the proportion of China's annual GDP that is derived from industrial POEs' annual sales revenue from primary operations. These statistics, from 1998 to 2011, were obtained from the China Statistical Yearbooks compiled by the National Bureau of Statistics of China and are presented and analysed in this subsection. This time-frame covers the period during which China's national economy experienced the most remarkable and rapid growth, and it includes the second and third development stages of China's POEs.

As shown in Table 4.3, Chinese POEs experienced steady and significant development and growth in terms of some major aspects of corporate operations and profitability during the 14-year period from 1998 to 2011. Firstly, the number of POEs increased from approximately 10,700 in 1998 to around 180,600 in 2011, with an average annual growth rate of 27.74%. Although there was a noticeable decrease in this number in 2011 from 273,300 in 2010, was mainly due to a change in the statistical standards set by the National Bureau of Statistics of China regarding enterprises above a designated size. The enterprises included in the China Statistical Yearbooks refer to those above a designated size, which prior to 2011 was those enterprises whose sales revenue from principal business activities was above 5 million RMB. In 2011, this threshold was changed to above 20 million RMB. The number of employees involved in the private sector of China's national economy demonstrates the same growth pattern. In terms of corporation size as measured by year-end total assets, China's POEs also grew considerably from 149 billion RMB in 1998 to 12775 billion RMB in 2011, regardless of the decrease in the number of enterprises in 2011.

Table 4.3: Major statistics indicating the role and position of POEs in China's national economy²⁷

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Number (1,000)²⁸	10.7	14.6	22.1	36.2	49.2	67.6	119.4	123.8	149.7	177.1	245.9	256.0	273.3	180.6
Employees (million)	1.61	2.29	3.46	5.42	7.33	10.28	15.15	16.92	19.71	22.53	28.72	29.74	33.12	29.56
Total Assets (billion RMB)	149	229	387	590	876	1453	2372	3033	4051	5330	7588	9118	11687	12775
GIP (billion RMB)	208	324	522	876	1295	2098	3514	4778	6724	9402	13634	16203	21334	25233
Net Profit (billion RMB)	7	12	19	31	49	86	143	212	319	505	830	968	1510	1816

In addition to the rapid increase in POE number and size, the performance and profitability of POEs in terms of GIP and net profit also increased substantially. As shown in Table 4.3 above, the GIP of these industrial POEs increased from 208 billion RMB in 1998 to 25.2 trillion RMB in 2011, an increase of over 120 times, with a stunning average annual growth rate of 45.55%. Even more surprisingly, net profit increased by almost 260 times over the 14-year period, from 7 billion RMB to 1.8 trillion RMB, equating to an average annual growth rate of 54.95%.

²⁷ This table was compiled using statistics obtained from China Statistical Yearbooks (1996 to 2012) via the website of the National Bureau of Statistics of China.

²⁸ In this table, the POEs included were those industrial enterprises above certain size designated by the National Bureau of Statistics of China. Prior to 2011, that included enterprises whose sales revenue from principal business activities was above 5 million RMB. In 2011, this threshold was increased to above 20 million RMB.

Table 4.4: Contribution of industrial POEs to China's national economy²⁹ (in billion RMB)

	2005	2006	2007	2008	2009	2010	2011
Revenue	4580.14	6481.77	9027.78	13152.54	15660.36	20783.82	24727.79
GDP	18493.74	21631.44	26581.03	31675.17	34562.92	40890.30	48412.35
Revenue/GDP	24.77%	29.96%	33.96%	41.52%	45.31%	50.83%	51.08%

The growth and development of China's industrial POEs can also be illustrated by their increasingly important role in the national economy as measured by the contribution of their annual sales revenue to China's national GDP. As shown in Table 4.4, during the period from 2005 to 2011 the annual revenue of Chinese industrial POEs increased by approximately 5.4 times from 4.58 trillion RMB to 24.73 trillion RMB. This indicates the substantial development of Chinese POEs. More importantly, the percentage of their contribution to the Chinese GDP increased steadily and significantly over this period, from approximately 25% to more than 51%.

The statistics and related analysis provided above demonstrate that Chinese POEs developed substantially, grew into large enterprises with strong profitability, and made substantial contributions to the national economy during the 30-year period from the start of China's market reforms in 1978. This supports the positive advantageous impact of the Chinese central government's economic policies that reinstated the position and role of the private sector in the economy, and encouraged the growth and development of Chinese POEs.

²⁹ This table includes data from 1998 to 2007 from the 1998, 2010 and 2012 China Statistical Yearbooks.

4.2.3. The Development of China's Stock Market

China's stock market was established in the early 1990s under the direct supervision of the China Securities Regulatory Commission (CSRC), which became the regulator of China's securities market in April 1998, with the primary aim of providing Chinese enterprises with more powerful financial support. There are two domestic stock exchanges, the Shanghai Stock Exchange which was established in November 1990 and opened for stock trading in December that same year³⁰, and the Shenzhen stock exchange which was established in December 1990³¹.

The domestic stock market in China aims to facilitate the raising of capital by both SOEs and POEs, via public listing. The China Capital Market Development Report (2010) issued by CSRC states that China's domestic stock market plays a significant role in society and fosters the growth of Chinese enterprises. According to Zhou and Xia (2008), after the implementation of the "Bo Gai Dai"³² investing and financing policy by the Chinese central government in the mid 1980s during the period of SOE reform, with the increasing operating deficit and bad debts from banks to SOEs, the immense demand for capital by SOEs could not be met by indirect financing from bank loans. The development of direct financing via the capital market functioned as a necessary component of the reform and development of China's SOEs. Wang et al. (2004) have also argued that public listing tends to work as an essential reform approach for China's large SOEs. They used a panel of pre- and post-listing data from all Chinese companies listed on the Shanghai and Shenzhen Stock Exchanges in the period from 1994 to 2000 to examine the relationships between public listing and firms' ownership structure, financing methods and corporate

³⁰ Shanghai Stock Exchange website.

³¹ Shenzhen Stock Exchange website.

³² "Bo Gai Dai" policy refers to the change in financing methods for SOEs made by the Chinese central government in the mid 1980s, from the direct allocation of governmental funds to bank loans in order to enhance the efficiency of the use of the state's fiscal funds.

performance in the post-listing period. They found that state ownership was significantly reduced as a result of public listing, and reliance on financed debt was also effectively slashed. Thus, corporate performance in the post-listing period was affected by the changed ownership structure.

From the perspective of China's POEs, capital raising through public listing should be regarded as an essential financing method, critical for their survival and development. By the end of 1999 the private sector in China had become the second largest economy, and accounted for approximately 27% of the national GDP. Based on a 1999 survey of over 600 Chinese POEs³³, Gregory and Teney (2001) revealed that despite this, Chinese POEs tended to rely primarily and heavily on self-financing, and their capital financing accounted for only 1% of bank loans and 1% of China's domestic stock market financing. They argued that increased access to bank loans and equity financing was crucial in order for Chinese POEs to survive and thrive. Similarly, Huang and Jin (2007) showed that POEs tended to receive discriminatory treatment with regard to credit financing from the national banks, thus public listing was an important financing method to enable fast-growing POEs to develop further and enhance their competitiveness. As the relevant statistics in Table 4.5 below show, the Chinese domestic stock market has developed and grown significantly since its establishment.

³³ In this paper, Gregory and Teney (2001) define the private sector of China's national economy as those enterprises owned by Chinese entities other than state, and collective ownership, but they exclude foreign ownership.

Table 4.5: The development and growth of China's domestic stock market³⁴ (in billion RMB)

		1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Number of Listed Companies	National	10	14	53	183	291	323	530	745	851	949	1088	1160	1224	1287	1377	1381	1434	1550	1625	1718	2063	2342
	Shanghai Stock Exchange	8	8	29	106	171	188	293	383	438	484	572	646	715	780	837	834	842	860	864	870	894	931
	Shenzhen Stock Exchange	2	6	24	77	120	135	237	362	413	465	516	514	509	507	540	547	592	690	761	848	1169	1411
	Domestic Raised Capital				31	14	12	34	93	80	90	154	118	78	82	86	34	246	772	354	572	1019	965
GDP				2692	3533	4820	6079	7118	7897	8440	8968	9922	10966	12033	13582	15988	18494	21631	26581	31405	34090	40120	47156
Market Capitalisation				105	353	369	347	984	1753	1951	2647	4809	4352	3833	4246	3706	3243	8940	32714	12137	24394	26542	21476
Market Capitalisation/GDP				3.9%	10.0%	7.7%	5.7%	13.8%	22.2%	23.1%	29.5%	48.5%	39.7%	31.9%	31.3%	23.2%	17.5%	41.3%	123.1%	38.6%	71.6%	66.2%	45.5%

³⁴ This table is derived from statistics provided in the 2012 China Securities and Futures Statistical Yearbook issued by the CSRC, and the 2012 China Statistical Yearbook issued by the National Bureau of Statistics of China, Shanghai and Shenzhen Stock Exchanges.

Since the establishment of China's stock market, the total number of companies listed domestically has surged considerably, from 10 in 1990 to 2342 in 2011, an increase of over 234 fold. In 1990, there were 8 companies listed on the Shanghai Stock Exchange and only 2 listed on the Shenzhen Stock Exchange. After 20 years' of development, in 2011, the numbers of companies listed on these two stock exchanges have increased significantly, to 931 and 1411 respectively. The amounts of capital raised and the total market capitalisation of all listed companies have both also experienced significant growth. In 1993 the total amount of capital raised domestically was only 31 billion RMB, but it had increased more than 31 fold to 965 billion RMB by 2011. Total market capitalisation increased from 105 billion RMB in 1992 to 21.5 trillion RMB in 2011, an increase of almost 205 fold. In addition, total domestic market capitalisation now accounts for a substantial proportion of the national GDP.

Table 4.6: Development and growth of China's enterprises on the domestic stock market

	Total No. ³⁵	Listed SOEs		Listed POEs ³⁶	
		No. of Firms	Annual Growth Rate	No. of Firms	Annual Growth Rate
1993	183	181		2	
1994	291	281	55.2%	10	400.0%
1995	323	313	11.4%	10	0.0%
1996	530	514	64.2%	16	60.0%
1997	745	715	39.1%	30	87.5%
1998	851	803	12.3%	48	60.0%
1999	949	879	9.5%	70	45.8%
2000	1088	975	10.9%	113	61.4%
2001	1160	1013	3.9%	147	30.1%
2002	1224	1034	2.1%	190	29.3%
2003	1287	1045	1.1%	242	27.4%
2004	1377	1050	0.5%	327	35.1%
2005	1381	1031	-1.8%	350	7.0%
2006	1434	1029	-0.2%	405	15.7%
2007	1530	964	-6.3%	566	39.8%
2008	1604	994	3.1%	610	7.8%
2009	1700	1020	2.6%	680	11.5%
2010	2063	1093	7.2%	970	42.6%
2011	2342	1101	0.7%	1241	27.9%

³⁵ Source: The 2012 China Securities and Futures Statistical Yearbook issued by the CSRC.

³⁶ Source: Chen et al., The Empirical Research on the Development of China's Privately-Owned Listed Companies (2008), Shenzhen Exchange Research Institute.

Table 4.6 above is based on the available official data, and shows the growth of Chinese domestically listed firms, including both SOEs and POEs, from the establishment of the Chinese stock market in 1993 to 2011. Firstly, it illustrates that the size of the Chinese domestic stock market increased almost 13 fold from 183 firms in 1993 to 2342 firms in 2011. Secondly, it shows that SOEs accounted for a significant proportion of China's domestic stock market, especially in the early period. Particularly, before 2000 almost all listed firms were SOEs. For example, of a total of 183 Chinese listed firms in 1993 the number of listed SOEs was 181. Thirdly, during this 18-year period, the numbers of listed SOEs and POEs demonstrated different growth rates. The number of listed SOEs increased from 181 to 975 during the 8-year period from 1993 to 2000. However, from 2001 to 2011, the number of listed SOEs increased only marginally, and the annual growth rates were below 8%. The number actually decreased in 2005, 2006 and 2007. On the other hand, the number of listed POEs increased significantly from 2 in 1993 to 1241 in 2011. With the exceptions of 1995, 2005 and 2008, the annual growth rates were all above 10%. In 2011, the number of listed POEs exceeded the number of listed SOEs. These statistics confirm China's economic growth, as well as the development and reform of Chinese SOEs and POEs, from the perspective of the domestic stock market.

4.3. The Development of Corporate Governance Structure and Mechanisms in China

This institutional background section describes how CG structure and mechanisms were introduced in China. The establishment and development of CG in China could be viewed as a necessity resulting from China's economic and institutional reforms initiated in late 1970s. In general, this process can be subdivided into two periods: a pre-1990s period and a period comprised of the years thereafter. In the pre-1990s period, a modern western CG structure and mechanisms did not exist in China, and China's corporate management system was characterised by a centrally

planned economy. This period of corporate management in China can be further subdivided based on two important periods. The first began in the year of 1956 when the centrally planned economy system was officially inaugurated, and includes the following two decades, when Chinese enterprises and factories were under the complete domination and direction of the Chinese central government and the CCP, both on paper and in practice. The second began in the year of 1978, when China's economic and institutional reforms were initiated. Since the early 1990s, the establishment of China's stock market, the endorsement of company law by the Chinese central government, and the promulgation of a series of stock market regulations by the CSRC have all served as symbols of the establishment and development of CG in mainland China.

The periods in China's CG development described above, which were accompanied by distinct economic development phases in China, are presented in Table 4.7 below. The major characteristics of the CG structure in each development phase are discussed in detail in the rest of this chapter, in chronological order. While China has, at least on paper, transitioned from a centrally planned economy to a market-oriented economy and adopted a modern CG system, Chinese society and CG in Chinese firms are still dominated by the CCP. For example, CG development in China has proceeded under the direct instruction and supervision of the Chinese central government, the State Council, which is dominated by the CCP. This feature of the Chinese CG system differentiates it from those of developed markets, and will be discussed in greater detail in Chapter 5, and illustrated by the findings contained in the case study presented in that chapter.

Table 4.7: The chronology of China’s CG development³⁷

Time Period		Economic Development Phase	Characteristics of CG
Pre-1978	1949–1956	Establishment of China’s state-owned economy, “the three great reconstructions”	Gradual elimination of individual ownership and management in business
	1956–1977	Centrally planned economy formally established, “joint state-private ownership and management”	Domination of the CCP sectary in enterprises
1978–1990		Introduction of a market economy	A system under which the factory or enterprise director assumes full responsibility
Post-1990		Establishment of a socialist market economy with Chinese characteristics, and China’s stock market	Establishment of modern CG structure and mechanisms

4.3.1. Corporate Management in China During the Pre-1990s Period

After the founding of the PRC in 1949 and before the official establishment of China’s domestic stock market in 1990, China experienced a period of revolution, reforms and development lasting approximately 40 years. While the corporate control and management system in China underwent some changes on paper during this period, the dominant status of political control by the CCP and the Chinese central government at the business and factory levels was gradually cemented and became unchallengeable. This period of corporate management development in China can be divided into three phases based on two important time-points in the history of China’s economic and institutional reforms: the year of 1956 when the “Centrally Planned Economy” system was instituted, and the year of 1978 when China initiated historic economic reforms that ultimately resulted in universally acclaimed development and success. In this section of the thesis, the features of corporate management during each of these phases are summarised.

After its founding in 1949, the PRC began to transition from an

³⁷ This table was constructed based on the references used in this chapter.

underdeveloped or quasi-market economy to a centrally planned economic system (Zhang, 2000)³⁸. During this short period, individual or privately owned businesses and enterprises still existed, which were known as the Chinese national bourgeoisie or capitalists. Business management at that time was characterised by owner control or family control. In 1953, the CCP embarked on the socialist reconstruction of capitalist industry and commerce, nationwide³⁹. This is known as “the three great reconstructions”⁴⁰. In early 1956 this reconstruction was completed, signifying the official establishment of a centrally planned economic system⁴¹ under the ownership of the Chinese people as a whole. During the period from 1956 to the late 1980s, corporate control and management in China was relatively simple, as all corporate managers and factory directors were supervised and controlled by the CCP and the Chinese central government through the CCP committee, and they did not have much decision-making power over corporate or factory operations.

In 1978, China launched a series of economic and institutional reforms known as the “reform and open” policy⁴². This was first presented at the Third

³⁸ Zhang Tao (2000), The Historical Perspective on the Launch of Market Economy in China, *Historiography Monthly*, Issue 2 (see <http://suxin.taoshumi.com/paper/economics/004/6898.html>).

³⁹ In June 1953, the CCP central committee drafted “The opinion on utilizing, limiting and reconstructing capitalist industry and commerce”, which was presented at the All-China Federation of Industry and Commerce congress in October that same year (see http://news.xinhuanet.com/ziliao/2003-09/03/content_1060054.htm).

⁴⁰ “Three great reconstructions” policy refers to the reconstruction of agriculture, capitalist industry and commerce, as well as the handicraft industry, conducted by the CCP in China nationwide. The purpose was to establish a centrally planned economy and an economic system that was under the ownership of the whole of the Chinese people (see http://news.xinhuanet.com/ziliao/2003-09/03/content_1060054.htm). This is attempted via a “joint state-private ownership and management” strategy, which is also known as the “catch and takeover” strategy. Under this strategy, businesses, enterprises and factories were directly taken over by the PRC.

⁴¹ Nove (1987) explains that under such an economic system the state owns most of the production resources, and the allocation of resources is under governmental control rather than being determined by market prices. The government issues “... binding instructions to subordinate management, telling it what goods and services to provide, from whom to obtain the required inputs [*sic*], and, as we shall see, much else besides.”

⁴² The “Reform and Opening-Up” policy refers to a series reforms that aimed to reform China’s

Plenary Session of the 11th Central Committee of the Chinese Communist Party in December 1978. As a result, management systems at the corporate and factory levels underwent changes. In 1986, the Central Committee of the CCP and the Chinese Central Government (the State Council) promoted a “system under which the factory or enterprise director assumes full responsibility”⁴³. Under this corporate and factory management system, the corporate or factory directors took full responsibility over production, as well as the administration of the business. The corporate or factory CCP committee, at least in theory, played a supervisory role in the intervening period. In reality however, they exerted considerable influence over decision-making with regard to corporate or factory operations and management. These significant reforms and policies provided the foundation for the introduction of CG structure and mechanisms in Chinese corporations.

4.3.2. Establishment and Development of CG Structure and Mechanisms in China Since the 1990s

After 1978, a modern CG structure was gradually introduced in China as a result of economic reforms involving shareholding and corporatisation reform⁴⁴ in

domestic institutions and open China’s domestic market to the world. The ultimate goal was to establish China’s socialist market economy system, and achieve economic development and success (see <http://baike.baidu.com/view/48598.htm>).

http://news.xinhuanet.com/ziliao/2003-01/20/content_697755.htm

⁴³ “The three rules on the industrial enterprises under the ownership by the whole Chinese people issued by the Central Committee of CCP and the State Council” in 15 September 1986, http://news.xinhuanet.com/ziliao/2005-02/06/content_2553542.htm

⁴⁴ Zhou and Xia (2008) demonstrate that experimental shareholding reform was firstly proposed in 1986, which aimed at only a few qualified large or median SOEs. In 1994, the central government selected 100 qualified large or median SOEs to conduct the experimental establishment of corporatisation system. In 1997, 2343 SOEs took part in such experiment, 84.8% of which implemented various forms of modern corporatisation system and the legal person governance or CG structure was preliminarily established. Report on China’s Economic Development and Institutional Reform-China: 30 Years of Reform and Opening-Up (1978-2008), Chapter 12, Section 1, <http://theory.people.com.cn/GB/68294/131889/index.html>.

SOEs, as well as the revival and growth of POEs. A modern CG structure was officially founded in the early 1990s, as indicated by the establishment of China's domestic stock market (in the form of the Shanghai and Shenzhen stock exchanges), the CSRC, and the promulgation of China's Company Law. This section discusses the establishment and development of CG structure and mechanisms in China in view of these three indicators.

The establishment and development of a stock market functioned as a major stimulus for the development of CG structure in China. As mentioned in earlier chapters, in 1990 the Shanghai and Shenzhen stock exchanges were founded, signalling the formal foundation of China's domestic stock market. One of the aims was that China's domestic stock market would function as a means by which both SOEs and POEs could raise capital via public listing (China Capital Markets Development Report, 2008). However, in order to be listed on these two stock exchanges, companies are subject to strict scrutiny and are required to comply with specific listing rules and regulations. In October 1992 the CSRC was established, and it became a ministerial public institution and the specialist supervisory authority for China's stock and futures market in April 1998⁴⁵.

In December 1993 the Company Law of the PRC (1993)⁴⁶ was passed at the 8th National People's Congress, and it came into force on the 1st of July 1997. This 1993 Company Law officially introduced a modern CG structure into China in the form of law for the first time. It requires that all Chinese companies, whether limited liabilities (Chapter 2) or joint stock limited companies (Chapter 3), have a board of directors (articles 45, 68, 82), a supervisory board (articles 52, 82) and a management

⁴⁵ The Chinese Securities Regulatory Commission website,
http://www.csrc.gov.cn/pub/csrc_en/about/who/intro/200811/t20081130_67718.html.

⁴⁶ Hu Jintao, 2005, *The President Order of the People's Republic of China*, No. 42,
http://www.gov.cn/flfg/2005-10/28/content_85478.htm and
<http://www.jus.uio.no/lm/china.company.law.1993/>.

team, and hold shareholders' general meetings (articles 37, 102). The chairman of the board is designated as the legal representative of a company (articles 45, 113). The 1993 Law stipulates corresponding rights, powers and responsibilities pertaining to the shareholders' general meetings, the board of directors, the supervisory board and managers. This indicates the preliminary establishment of the so-called two-tier board CG structure in China. The CCP and the Chinese central government required that companies carry out the reorganisation of modern corporatisation according to the requirements of the Company Law, and achieve the normative operations of listed companies (Zhou and Xia, 2008)⁴⁷. The Company Law was amended at the 9th and 10th National People's Congresses in 1999 and 2004. The current Company Law was passed on the 27th of October 1995, and came into effect in the 1st of January 2006⁴⁸. The CSRC has issued a number of important rules and regulations regarding the CG structure in Chinese listed companies. These rules and regulations brought specific CG mechanisms into Chinese firms, and they are shown in Table 4.8 below.

Table 4.8: The rules and regulations issued by the CSRC in the 2000s⁴⁹

Year	Rules and Regulations by the CSRC
2001	The Guidance for Introducing Independent Directors to the Board of Directors of Listed Companies
2002	The Code of Corporate Governance for Listed Companies
2005	The Measures for the Administration of the Equity Incentives of Listed Companies
2006	The Guidance on Articles of Association of Listed Companies
2006	The Rules for General Meeting of Shareholders of Listed Companies

⁴⁷ The Third Plenary Session of the Fourteenth Central Committee of the CCP, "The decision by CCP and the central government regarding several issues related to the establishment of socialist market economy", see <http://cpc.people.com.cn/GB/64162/134902/8092314.html>.

⁴⁸ The website of The Central People's Government of the PRC, see http://www.gov.cn/flfg/2005-10/28/content_85478.htm.

⁴⁹ Zhang Xiaochuan (2009), An Introduction to the Corporate Governance Development in China, CSRC.

These CSRC rules and regulations provide Chinese listed companies with important instructions and supervisory tools with regard to their CG structure and mechanisms. For example, in 2001 the CSRC required that at least a third of the positions on the boards of all companies listed in China be occupied by independent directors. This is in accordance with the conventional wisdom which holds that having more independent directors on the board alleviates conflicts of interest between owners and managers, because independent directors have the power to review and monitor managers' behaviours and compensation contracts, which constitutes an effective device with which to discipline managers. This in turn enables firms to invest in profitable projects and improves firm performance (Maug, 1997; Bhagat and Black, 2000). In 2011, the number of companies listed in China reached 2342, and it is widely believed that the main rules and measures issued by the CSRC greatly optimised CG structure in China.

Although the Company Law and CSRC regulations have brought a modern western CG structure to China, there are still limitations and drawbacks in the Chinese CG system. The quality of CG mechanisms in China was ranked 44th out of 49 countries surveyed in a study by the World Economic Forum in 2003 (RAND Corporation, 2008). In a report by Transparency International, China was assigned the highest rating with regard to the level of corporate corruption, among other major developing countries (the so-called "BRISC" economies, Brazil, Russia, India, China and South Africa)⁵⁰. Kang, Shi and Brown (2008) identify five major problems in the development of the Chinese CG system. The most severe is the overwhelming concentration of state ownership, which is the source of numerous obstacles. They suggest that as a result of the high concentration of state ownership, there is likely to be a lack of board independence as the key corporate executives are appointed and removed by the largest shareholder, the Chinese central government. Another is

⁵⁰ The 15th biennial International Anti-Corruption Conference in Brasilia, November 2012. (see <http://www.reuters.com/article/us-companies-transparency-idUSBRE99G05D20131017>)

uncontrollable insider trading. Insiders of those SOEs with non-tradable shares are often found to increase personal wealth on stock offerings at the expense of benefits to the state and market investors. Another problem is that the mechanisms that control false or misleading financial reporting are weak. Lastly, the Chinese capital market is highly underdeveloped. As a result of tight political control by the CCP or the Chinese central government, Zhang (2009) argues that CG structure in some Chinese listed firms only exists on paper. Some CG mechanisms, such as the general shareholders' meetings, board meetings, and supervisory board meetings are likely to become just a formality over time. Some studies also argue that the supervisory board has insignificant influence because it does not have the power to dismiss directors, but can only report any power abuse or opportunistic behaviours of directors or managers at the general meeting of shareholders, or directly to external regulators such as the CSRC. The major functions of the supervisory board largely overlap with those of the audit committee and independent directors (Xu and Wang, 1997; Dahya et al., 2003; Rose, 2005; Gao and Song, 2007).

Although a modern CG structure has been established as a result of laws and regulations, Zhou (2008) state that most of China's POEs have features of "family management", which refers to a CG structure whereby family members are not only the owners of these enterprises but they are also members of the corporate management. In such cases, the operations and management of these enterprises are often highly centralised and are based on family relationships and geographical relationships. A report by the China Labour Bulletin in 2004 demonstrates that POEs that developed from individual businesses tend to exhibit highly centralised management authority. The Fifth National Sample Survey on POEs in 2002 convened by the United Front Work Department of the CCP Central Committee, All-China Federation of Industry and Commerce and China Society of Private Economy Research stated that 85.5% of the 3258 POEs investigated were invested in by one person, and the owners of 96% of these POEs were also the top managers. Highly

concentrated management authority is also a common feature of those reformed POEs. The 2002 Sample Survey shows that 25.7% of these sample POEs were formed from previously state-owned or collectively-owned enterprises, of which 60.6% of the entrepreneurs of these reformed POEs were also the people in charge of the enterprises before they were reformed. Even in the reformed shareholding enterprises, the managers of the original enterprises have taken a proportion of shareholdings and in turn they have controlled the decision-making in the reformed enterprises.

Zhou (2008) summarised three major drawbacks of a family control and management type of CG. First, it hinders the attraction of employees with relevant expertise in professional management and technology, as family management is based on nepotism, thus only those with close relationships with the owners of the enterprises will be appointed to certain important positions. In a related point, while highly skilled professional managers or executives, and elites with advanced expertise are a scarce resource, they typically have a strong preference for SOEs in the Chinese context as there are more available resources in the SOE sector, and it is a more secure environment. Therefore, the lack of professional managers and other professionals functions as a major bottle-neck for POEs' growth and development. Secondly, in family businesses, the ownership and management authority, family assets and corporate assets are not separated, which can result in convoluted internal financial and accounting systems. Also, as these enterprises are financed by the owners' private capital and their development is mainly based on the owners' ongoing investment and the enterprises' own accumulation of capital, large-scale financing and investment are highly impeded, which in turn restricts ongoing expansion and competitiveness in a fiercely competitive environment. Lastly, family enterprises tend to be small in size and to produce low-tech products. With increasing market competition, these companies can engage in short-term strategies such as reducing prices in order to compete for market share. As they don't have the corporate capacity to reduce costs in order to reduce prices in a normal way, they may sacrifice

workmanship, cut down on materials, produce fake or inferior products or engage in tax evasion and fraud, among other undesirable strategies, in an effort to cut costs. All of these drawbacks of family control and management function as obstacles to POEs' competitiveness, advancement, diversification and international development.

4.4. The Significant Influence of the CCP in Corporate Operations

This section provides a detailed introduction and discussion on the significant influence or control of the CCP over corporate operations in China. The main purpose is to clarify how every major decision in SOEs is tightly supervised by the CCP, and how sound connections to the CCP are vital to the survival and prosperity of the private sector of the national economy; despite the fact that Chinese companies have adopted a modern CG structure and mechanisms.

4.4.1. China's Political System and the CCP's Dominance in Chinese Society

In terms of nominal annual GDP, China became the second largest economy in the world in 2010, which is mainly attributable to the ongoing "reform and open policy" and economic liberalization that has occurred since 1978. During this 30-year period China was the fastest-growing economy in the world, with an average annual growth rate of over 10%⁵¹. According to statistics compiled by the United Nations⁵², China's is now also the world's largest exporter and second largest importer of goods, and the largest manufacturing economy.

⁵¹ International Monetary Fund, Report for selected countries and subjects, see http://www.imf.org/external/pubs/ft/weo/2013/01/weodata/weorept.aspx?sy=1980&ey=2018&sort=country&ds=.&br=1&pr1.x=40&pr1.y=0&c=924&s=NGDP_RPCH%2CPPPPC&grp=0&a=.

⁵² United Nations Statistics Division, see <http://unstats.un.org/unsd/snaama/dnlList.asp>.

China today could be included among the world's major economic powers in some respects. However, it has been argued that China's political and economic systems are unique, and that it is somewhat of a laggard, because China is the only Communist Party-led country in the world's major economies, including all member countries of the G-20⁵³. Although China is no longer labelled as a highly centralized economy or as being subject to dictation by a single paramount leader, the CCP still maintains unchallenged controlling power in most fields in China, via its core status in the Chinese political system. The political system in China has a sound organisational theoretical basis. However, major political institutions such as the National People's Congress (NPC) only have broad powers on paper. In addition, despite the fact that the CCP is officially the representative and vanguard of China's people, including the workers and proletariat⁵⁴, in reality, nowadays the CCP constitutes a minority that possesses and controls the majority of China's wealth⁵⁵.

The Chinese political system was formally established at the same time as the PRC in 1949. From 1949 to 1997, the Chinese political system had a single paramount leader, and these included Mao Zedong⁵⁶, Hua Guofeng⁵⁷, and Deng

⁵³ The G-20 comprises 19 major economies plus the European Union. G-20 members account for approximately 85% of global GDP, more than 75% of global trade, and approximately two-thirds of the world's total population. See the G20 website: https://www.g20.org/about_g20/g20_members.

⁵⁴ The CCP constitution.

⁵⁵ John Lee (2011) China's Rich Lists Riddled With Communist Party Members. <http://www.forbes.com/2011/09/14/china-rich-lists-opinions-contributors-john-lee.html>.

⁵⁶ Mao was the founding father of the PRC and held the office from 1949 until his death in 1976. He governed the PRC as the chairman of the state, the chairman of the central CCP committee, the chairman of the central politburo of the CCP, and the chairman of the CCP central military commission. During his time in office, he was worshiped as the "Red Sun" and savior by all Chinese people. His influence in Chinese society still exists to an extent, to this day. See http://en.wikipedia.org/wiki/Mao_Zedong.

⁵⁷ Hua served as the premier of the PRC, the chairman of the central CCP committee, and the chairman of the CCP central military commission from 1976 to 1981. He was selected by Mao himself because of his absolute loyalty to Mao. He had a famous saying as the national leader that "We must advocate every decision made by Chairman Mao and we must unswervingly follow every instruction issued by Chairman Mao". See http://en.wikipedia.org/wiki/Hua_Guofeng.

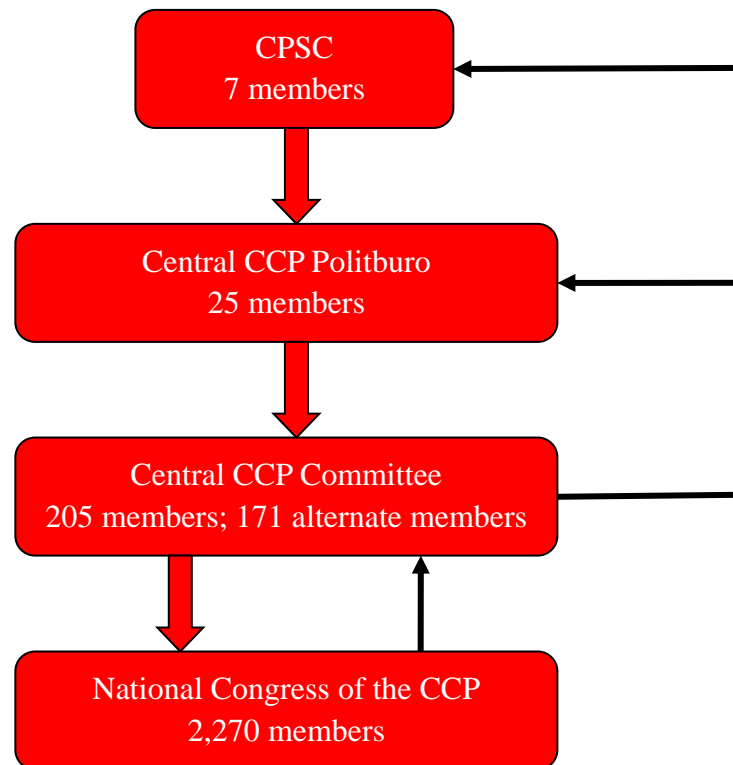
Xiaoping⁵⁸. After the death of Deng in 1997, the tradition of having one paramount leader vanished and was succeeded by collective leadership. Since then China has no longer had a single supreme leader, but is led by a committee with seven seats, which is the highest decision-making authority and governs the CCP, the PRC and the Central Politburo Standing Committee (CPSC) of the CCP. The members of the CPSC are selected by the National Congress of the CCP which constitutes the CCP hierarchy at state level.

Figure 4.1 illustrates the state-level central CCP hierarchy. In this figure, the red arrows indicate the process of decision transmission within the top CCP hierarchy, and the solid black arrows represent the election of members of the Central CCP Committee, the Central CCP Politburo, and the CPSC, in the National Congress of the CCP. Firstly, the Central CCP Committee is established by the election of all members in the National Congress of the CCP. Afterwards, the members of the CPSC and the Central CCP Politburo are elected in the plenary meetings of the Central Committee of the CCP. This national-level CCP hierarchy is the main mechanism by which the CCP maintains tight control over the Chinese political system and society⁵⁹.

⁵⁸ The era of Deng Xiaoping began in 1978 when he was re-appointed to the positions of vice chairman of the CCP Central Military Commission and the vice premier of the State Council and ended upon his death in 1997. Deng initiated the “Reform and Open policy” and a series of economic reforms in China. He led China towards a market economy and has been referred to as the “General Architect” of China’s modernization and economic development (see http://en.wikipedia.org/wiki/Deng_Xiaoping).

⁵⁹ The current 18th session of the Central Committee of the CCP has 205 members, which include the top leaders of the CCP and the state, chief executives of departments directly affiliated with the Central CCP committee, the chief executives who are CCP members in the departments of the state council, all the chief military executives in the state-level departments of the People’s Liberation Army (PLA), all CCP secretaries and executives of all provinces, autonomous regions, and municipalities, chief executives of important backbone SOEs and financial administrative institutions, and chief executives of major public organizations. The 171 alternate members of the Central CCP committee are generally the deputy executives of the above mentioned institutions or authorities. Wang Xin (2012), An interpretation of the purport of the 18th National Congress of CCP, Su Zhou university.

Figure 4.1: The Hierarchy at the Top of the CCP⁶⁰



The Chinese political system is mainly comprised of the NPC, the CPPCC, the State Council, and the People's Liberation Army (PLA). In theory, these institutions are endowed with strong powers over state affairs. However, their authority tends to exist on paper only, and they are dominated by the CCP. According to the Constitution of the PRC, the NPC, which is China's unicameral legislature, is the highest state power. It has the power to govern constitution-related affairs, enforce and amend laws, supervise the national economy and social development, appoint and dismiss top officials of state and judiciary departments, and provide guidance and instructions to the state council, PLA and Supreme People's Court. In fact however, the NPC is led by the CCP⁶¹, and it only exercises many of these powers nominally. It

⁶⁰ Organizational structure of the 18th session of the central CCP committee, the website of CCP news, <http://cpc.people.com.cn/GB/64162/351757/>

⁶¹ Jiang Zemin (2006), The anthology of Jiang Zemin, Volume 1, pp.112, "Organs of political power at all levels, including NPC, government, court of justice, and procuratorate, must be subject to the leadership by CCP" [*sic*].

is stated in the Constitution of the PRC that the CPPCC⁶² is an important united front organisation that is under the CCP-led system of multi-party cooperation and political consultation. The CPPCC is more like a window-dressing institution that shows off the Chinese democracy to the world⁶³. In addition, the PLA could be viewed as the armed wing of the CCP rather than a force for the state and the Chinese people, which originates from Mao Zedong's famous proposition that "the Party rules guns". This proposition has become a main tenet of the PLA, and it has been legally and institutionally guaranteed⁶⁴.

Table 4.9 below provides a more detailed illustration of the CCP's dominance in China's core political system. The 18th CPSC of the CCP, which is the highest decision-making body in China, is comprised of seven members. Each has a ranking, 1 to 7, with a higher ranking indicating a more important role in decision-making. In order to secure tight political control, the CPSC members simultaneously act as the top leaders of other institutions in the Chinese political system⁶⁵. Firstly, the current highest leader of the CCP, Xi Jinping, is also the supreme leader of China, the State President. Xi also possesses the highest level of power over China's military, as the Chairman of both the Central CCP Military Commission and the State Military Commission. Secondly, in theory (on paper) the highest state power

⁶² The CPPCC has three major responsibilities: political consultation on the major issues pertaining to state policies, national politics, the economy, culture, and social life; democratic monitoring of the enforcement of the state's constitution and laws, the implementation of major state policies, and the work of state authorities; and participation in the administration and discussion of state affairs (see http://news.xinhuanet.com/ziliao/2002-02/20/content_283254.htm).

⁶³ The CPPCC consists of the CCP and eight other democratic parties, and it is under the leadership of the CCP. All eight of these democratic parties are absolutely loyal to the CCP and they advocate all CCP decisions and guidance. Zhong bo (2008), *The illusion and truth about Mao Zedong*, Hong Kong Ha Fai Yi, publication limited (in Chinese, see <http://chinainperspective.com/ArtShow.aspx?AID=3410>).

⁶⁴ "The PLA must be under the absolute leadership of CCP, its highest level of the leadership and command authority is in the hands of the Central CCP Committee and the Central Military Committee". The political action regulations of the PLA, Chapter 1, Article 4.

⁶⁵ The list of members of CPSC (see <http://cpc.people.com.cn/18/n/2012/1115/c350826-19590370.html>)

authority is the NPC of the PRC. The No. 3 ranked member of the CPSC, Zhang Dejiang, also serves as the Party secretary and the Chairman of the Standing Committee of the NPC. Thirdly, according to the Constitution of the PRC, the State Council of the PRC is the executive organ of the NPC and concurrently the highest state administrative authority⁶⁶. The second and seventh ranked members of the CPSC, Li Keqiang and Zhang Gaoli respectively, are also the Premier and the No.1 ranked vice Premier of the State Council. In addition, Li and Zhang simultaneously work as the Party secretary and vice Party secretary of the CCP Committee of the State Council. Lastly, the fourth ranked member of the CPSC, Yu Zhengsheng, is the CCP secretary and Chairman of the Standing Committee of the CPPCC.

Table 4.9: The CCP and public positions of the members of the 18th CPSC of the CCP⁶⁷

Rank	Name	CCP Positions	Other Public Positions
1	Xi Jinping	General Secretary of the CCP; Chairman of the Central CCP Military Commission	President of the PRC; Chairman of the State Military Commission
2	Li Keqiang	CCP Secretary of the State Council	Premier of the State Council
3	Zhang Dejiang	CCP Secretary of the Standing Committee of the NPC of the PRC	Chairman of the Standing Committee of the NPC of the PRC
4	Yu Zhengsheng	CCP secretary of the CPPCC	Chairman of the CPPCC
5	Liu Yunshan	Member of the CCP Secretariat; Principal of the Central CCP College	
6	Wang Qishan	Secretary of the Central CCP Disciplinary Inspection Commission	
7	Zhang Gaoli	Vice CCP Secretary of the State Council	No. 1 ranked Vice Premier of the State Council

⁶⁶ “The State Council of the People’s Republic of China, namely the Central People’s Government of the PRC, is the highest executive organ of the highest authority of state power, and the supreme state administrative authority”. Article 85, the Constitution of the PRC.

⁶⁷ The Gazette of the 1st plenary session of the 18th Central CCP Committee, the website of the Central People’s Government of the PRC, see http://www.gov.cn/jrzq/2012-11/15/content_2266767.htm.

The above pattern of the CCP's dominance in the Chinese political system exists at every level of China's regime and in all administrative organs. The sovereign power of the CCP penetrates from the highest ministerial and state levels down to village level⁶⁸. For example, nominally the highest authority in a province is the Provincial People's Congress. There is also a Provincial Committee of the CPPCC. These two political institutions at the provincial level are dominated by the Provincial Committee of the CCP, which in fact is the highest provincial decision-making body, in that it is the agency that transmits the instructions, guidance and decisions of the CCP Committee at a higher level, the Central CCP Committee or the CPSC. The organisational form, role and function of CCP Committees is described in greater detail in the next section.

4.4.2. The Significant Influence of the Chinese Communist Party in the Operations of State-Owned and Privately-Owned Enterprises

The significant influence of the CCP in corporate operations in China appears to be an embodiment of the CCP's incontrovertible dominance in Chinese society since the establishment of the PRC in 1949. This control is mainly exerted and transmitted through the grassroots organisation of the CCP, the CCP committee, at every level and in all institutions. The CCP Constitution requires that all enterprises, villages, government offices, schools and universities, academic institutions, residential districts, PLA companies, and other grassroots units that have more than three formal CCP members establish a CCP branch⁶⁹. The CCP has issued strict regulations on the establishment procedure, organisational form, roles and

⁶⁸ David Zweig, Comparative Politics, SOSC 152, Division of Social Science, The Hong Kong University of Science and Technology.

⁶⁹ The Constitution of the CCP, Chapter 5, article 29.

responsibilities of corporate CCP committees⁷⁰. The political influence of corporate CCP committees takes different forms and involves different organisational structures and responsibilities in the two main types of enterprises in China, SOEs and POEs, because they have different positions and roles in China's national economy.

4.4.2.1. Chinese Communist Party Control in State-Owned Enterprises

The position and role of SOEs have long been well recognized in constitutional documents in China⁷¹. The leading role of SOEs in China's national economy is also reflected in official statistics, as discussed in Section 3.1.2. Therefore, the CCP is committed to sustaining absolute control over SOEs⁷². In general, the development of CCP control at the corporate level occurred in two phases. The first was from 1949 to 1978, when the "reform and open" policy was initiated. This period encompassed the beginnings of a centrally planned economy. Under such an economic system, the state owns most of the production resources, and the allocation of resources is under governmental control rather than being determined by market forces. The government issues "... binding instructions to subordinate management, telling it what goods and services to provide, from whom to obtain the required inputs

⁷⁰ The Newest Workbook on the Construction of CCP Branch (2010), People Daily Press

⁷¹ The first Constitution of the PRC, which is known as the Five-Four Constitution, states that "The state-owned economy is the socialist economy under public ownership, is the leading force of the national economy and the material foundation for the state to realize socialist transformation. The state preferentially guarantees the development of state-owned economy" (the 1954 Constitution of the PRC, Chapter 1, article 6). The current constitution also emphasizes the important status and role of SOEs (1982 Constitution of the PRC, Chapter 1 article 7).

⁷² It is stated in the Constitution of the CCP that the "... public economy is the principal part of China's fundamental economic system ... we need to unswervingly consolidate and develop the public sector of the national economy" (the chapter of general principles), and that "... the grass-roots organizations of CCP at corporate level should play the role of political core, guarantee and supervise the implementation of the guidelines and policies issued by CCP and the central government" (Chapter 5, article 32).

[sic], and ... much else besides⁷³.” This meant that everything at the corporate level was absolutely controlled by the CCP both in theory (on paper) and in practice.

The second phase began in 1978 and continues to the present day. After a series of economic reforms were initiated in 1978, a modern CG structure was established under which listed Chinese SOEs developed. This mainly resulted from the genesis of Company Law endorsed by the PRC, and CSRC regulations. Surprisingly, the CCP still maintains tight control and supervision at the corporate level, via corporate CCP committees. The role of corporate CCP committees with regard to the political core of SOEs was written into the CCP Constitution in 1987⁷⁴. In 1997, the CCP and the Chinese central government issued the “Notice of Further Strengthening and Improving the Construction of CCP in SOEs”. The most important part of this Notice states that the political leadership of the CCP in SOEs should be insisted upon; *i.e.*, that the corporate CCP committee’s role as the political core of the SOE should be fully implemented. The notice also explicitly states that the corporate CCP committee should take part in major decision making in SOEs. For example, there should be a binding regulation that the secretary of the corporate CCP committee should also be appointed as the chairman of the board⁷⁵. In addition, in June 2013 the Chinese central government issued a clear regulation regarding the participation of corporate CCP committees in major decision-making in SOEs⁷⁶. This procedure is illustrated in Figure 4.2 below.

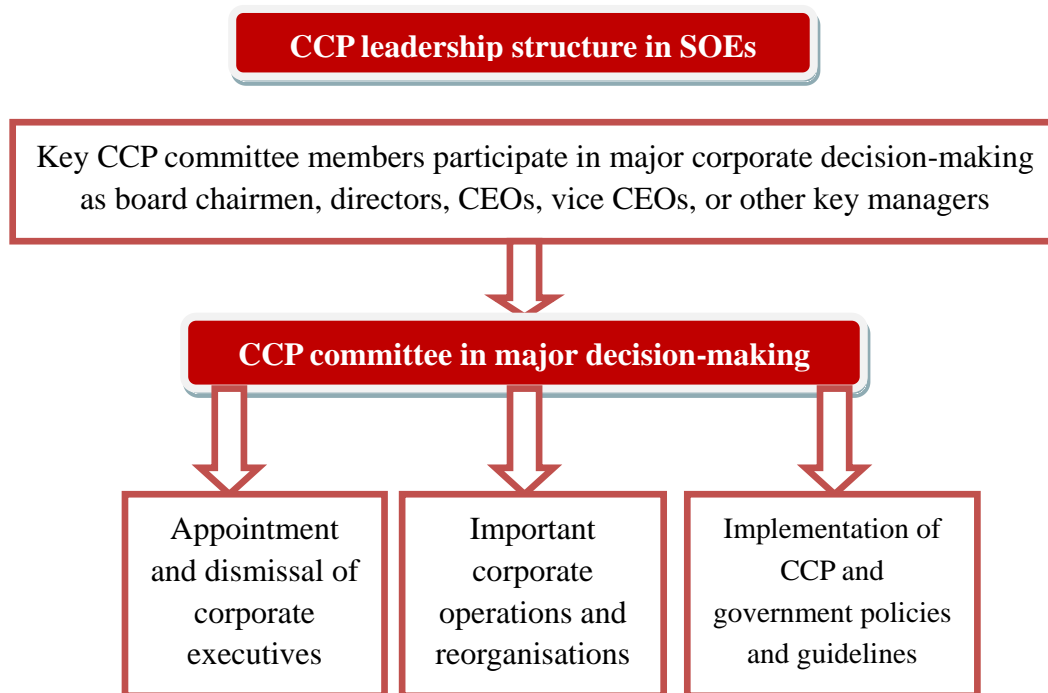
⁷³ Alec Nove, Planned economy, The New Palgrave: A Dictionary of Economics, 1st edition, Palgrave Macmillan (1987), The New Palgrave Dictionary of Economics Online, Palgrave Macmillan, see http://www.dictionaryofeconomics.com/article?id=pde1987_X001701.

⁷⁴ The 4th Plenary Session of the 13th Central CCP committee.

⁷⁵ Joseph Fan, Randall Morck and Bernard Yeung (2012) Translating Market Socialism with Chinese Characteristics into Sustained Prosperity, Capitalizing China, National Bureau of Economic Research Conference Report.

⁷⁶ “The guiding instructions on the participation of corporate CCP committees in major corporate decision-making in SOEs”, The General Office of the Central CCP Committee, the Organization Department of the Central CCP Committee, and the State-Owned Assets Supervision and Administration Commission, June, 2013.

Figure 4.2: CCP Leadership in SOEs



As shown in Figure 4.2, CCP control over SOEs is implemented through a corporate CCP committee. Within this structure, key corporate positions such as board chairman, directors, CEOs, vice CEOs and other key managers are all occupied by CCP committee members. For example, in most SOEs the positions of chairman of the board and CEO are occupied by either the secretary or vice secretary of the CCP committee. Figure 4.2 also shows that all major decision-making is controlled by the CCP committee. These major corporate decisions include the appointment and dismissal of corporate executives, important corporate management and operations, and the implementation of CCP and governmental policies and guidelines.

The most important corporate decisions relate to the appointment and dismissal of top key executives. While in theory all Chinese listed companies abide by an established modern CG structure where the a corporate board makes all major decisions, in Chinese SOEs personnel decisions are in fact not made by corporate boards. Instead, such decisions are under the control of the Organisation Department of the CCP, which is a key department of the CCP and the real human resource

administrative organ⁷⁷, and the Politburo of CCP, at different regime levels (Downs and Meidan, 2011). In contrast to the standard CG practice in developed countries, key positions in Chinese SOEs such as Chairman of the board or CEO are first selected by the Organisation Department of the CCP, and ultimately approved by the Politburo of the CCP. All of these nominated or appointed executives have strong political backgrounds and governmental work experience. For example, Jiang Jiemin was the Chairman of the board of PetroChina Company Limited, which is the largest Chinese listed SOE at the ministerial level, from 2007 to 2013⁷⁸. Before he joined PetroChina, he served as the main leader of the Shengli Petroleum Administration Bureau and the Qinghai Petroleum Administration Bureau in the early 1990s⁷⁹. From 2000 to 2003, he successively served as the vice governor, member of the Provincial Standing CCP Committee and vice secretary of the Provincial CCP Committee of Qinghai province. In 2003, he was appointed as the director of the State-Owned Assets Supervision and Administration Commission (SASAC) and the alternate member of the 17th Central CCP Committee by the Politburo of the Central CCP Committee⁸⁰. This procedure of personnel management is strictly followed at every administrative level in the Chinese political system. For example, the top executives of a provincial or municipal level SOE are appointed and dismissed by the Organisation Department and Politburo of the CCP Committee in that province or city.

⁷⁷ The Organisation Department of the Central CCP Committee is the mechanism by which the CCP maintains control over personnel decisions throughout every level of government and industrial enterprise (Richard McGregor, *The Party Organizer*, Financial Times, September 30, 2009).

⁷⁸ 2011 Annual Report of PetroChina Company Limited.

⁷⁹ These two administration bureaus govern the two largest oilfields in China, the Shengli and Qinghai oilfields.

⁸⁰ See http://en.wikipedia.org/wiki/Jiang_Jiemin.

Figure 4.3: Procedure of a CCP committee's participation in major decision-making

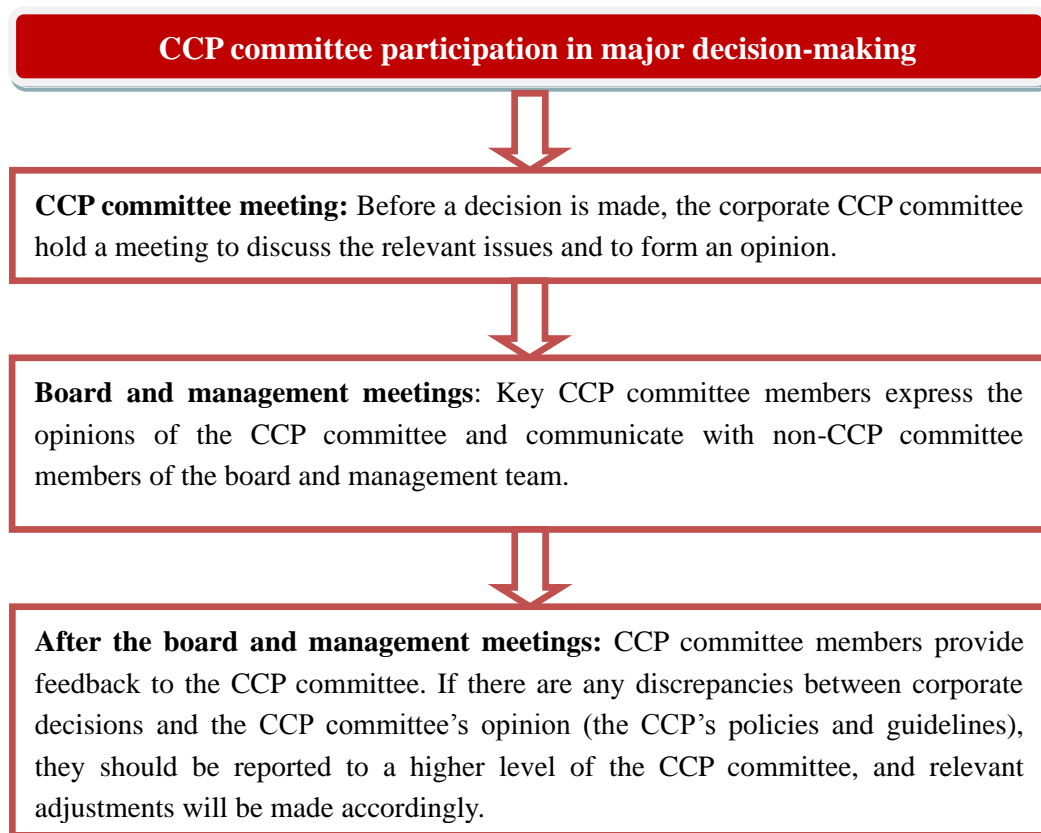


Figure 4.3 shows how major decision-making is tightly controlled by the CCP through the corporate CCP committee. Firstly, before a decision is made the corporate CCP committee should hold a meeting to discuss the relevant issues and form an opinion or decision. Board and management meetings will then be held, in which key CCP committee members such as the secretary or vice secretary of the CCP committee will express the opinions of the CCP committee and communicate with non-CCP committee members on the board and the management team. After the board and management meetings, CCP committee members provide feedback to the CCP committee, and if there are any discrepancies between corporate decisions and the CCP committee's opinions or decisions (which are sanctioned by the CCP policies and guidelines), they should be reported to a higher level CCP committee and adjustments should be made accordingly.

4.4.2.2. Chinese Communist Party Connections and Influence in Privately-Owned Enterprises

In comparison with SOEs, the CCP does not seem to have solid and tight political control over POEs. This is because the management of private enterprises in China is generally patriarch-based⁸¹, whereby all major decisions are usually made by private entrepreneurs within the company. However, a solid relationship or connections with the CCP are often vital for the survival and prosperity of Chinese POEs. Such connections could be viewed as bidirectional. Firstly, the CCP may from time to time proactively award outstanding or influential private entrepreneurs positions as representatives of the People's Congress or CPPCC at either the state or regional level. The main purpose of this is to absorb these elites into the Chinese political system in order to increase the influence of the CCP. The phenomenon of private entrepreneurs being selected as representatives in the NPC of the PRC began in the 16th NPC in 2002, when there were seven POE-representatives. This number increased to 17 in the 17th NPC in 2007, and to 24 in the 18th NPC in 2012⁸². In the 11th CPPCC in 2008, there were more than 100 POE-representatives⁸³. For example, Xu Jiayin is the chairman of Evergrande Real Estate Group Limited, which is the largest Chinese listed private real estate company. Mr Xu is also the secretary of the CCP committee of Evergrande Real Estate. He became a committee member of the 11th CPPCC and a member of the Standing Committee of the 12th CPPCC.

⁸¹ According to Zhou (2008), most of China's POEs operate via "family management", which refers to a CG structure whereby family members are not only the owners of these enterprises but they are also the members of corporate management. In such cases, the operations and management of these enterprises are often highly centralized, and based on family relationships and geographical relationships.

⁸² "The POE-CCP representatives in the 18th NPC", South Weekend, see <http://www.infzm.com/content/79190>.

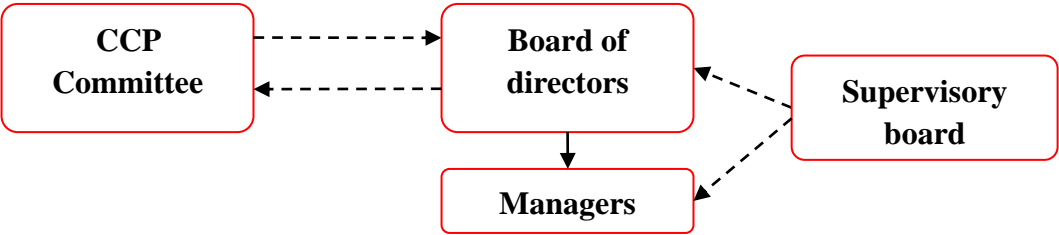
⁸³ "More than 100 private entrepreneurs became the representatives in the 11th Chinese People's Political Consultative Conference" (2008, see http://news.xinhuanet.com/politics/2008-02/04/content_7563016.htm).

On the other hand, there has been a trend of China's POEs striving to obtain political connections with the Chinese government or the CCP due to the related benefits and preferential treatment, a phenomenon known as "wearing a red hat" (Li et al., 2006). The motivation for such a strategy is to obtain easier access to resources, information on regulations and new policies, and protection from competition. Guiheux (2006) summarised four major ways in which private entrepreneurs wear a red hat. Eighty percent of private entrepreneurs are already CCP members before starting a business; serving as delegates in local congress or the NPC; contesting elections for local administration posts and joining business associations that link the state and the private sector; and affiliations with government administration.

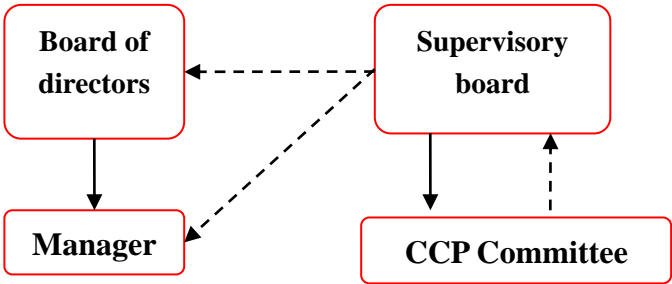
There are two basic patterns of POEs' political connections with the CCP. In Figure 4.4 below, the solid lines indicate firm control and supervision, and the dotted lines indicate that the supervisory boards in Chinese companies can only give advice and oversee the board of directors and the management team. The first pattern is that the CCP committee operates in parallel with the CG structure. In this situation, the CCP committee does not have solid control over the board of directors; the two entities only give advice to each other. The second pattern is one in which the CCP committee is subordinate to the CG structure, and it only plays an advisory role.

Figure 4.4: Patterns of POEs’ political connections with the CCP

a. Parallel to CG structure



b. Subordinate to CG structure



Chapter 5. The Chinese Communist Party's Influence in Chinese Firms: A Study of Three Cases

This chapter contains a series of quasi case studies of the Corporate Governance (CG) structure and Chinese Communist Party (CCP) control or connection patterns in three companies, a top state-owned enterprise (SOE), PetroChina Company Limited; a medium SOE, Sichuan ChangHong Electric Company Limited; and a top privately-owned enterprise (POE), Jiangsu ShaGang Company Limited. These three case studies are presented in three separate sections within this chapter. The main purpose of this chapter is to provide supplementary information on how SOEs are tightly controlled by the CCP and the Chinese central government, as well as how sound political connections with the CCP are vital to the survival and prosperity of Chinese POEs.

In each section, the background of each company, including establishment date, main business, and position in the industry are presented. The CG structure of the company is then discussed, including a detailed description of the members of the board of directors, the supervisory board and the management team. Lastly and most importantly, the CCP's control or connections with these companies are demonstrated. This includes the involvement of CCP committee members, the dominance of the CCP committee over CG structure, and how major decision-making is firmly controlled by the CCP at the corporate level.

5.1. Case 1: A Top State-Owned Enterprise, PetroChina Company Limited

5.1.1. Company Profile and Background⁸⁴

PetroChina Company Limited is a subsidiary of China National Petroleum Corporation (CNPC)⁸⁵. PetroChina plays a dominant role in the oil and gas industry in China, and it is the largest listed company in China in terms of market capitalisation and total assets. In 2011, PetroChina's market capitalisation was US \$227.86 billion, and the amount of its total assets reached US \$304.589 billion. By the end of 2011, PetroChina had 552,810 employees. On the 5th of November 1999, PetroChina Company Limited was established under the Company Law of China and the Special Regulations on the Overseas Offering and Listing of Shares by Joint Stock Limited Companies issued by the Chinese State Council. On the 6th of April 2000, PetroChina was listed on the New York Stock Exchange with the stock code "PTR", and it was listed on the Stock Exchange of Hong Kong (stock code 857) the following day. It was also domestically listed on the Shanghai Stock Exchange on the 5th of November 2007 with the stock code 601857.

⁸⁴ The company's profile was obtained from the websites of the China National Petroleum Corporation (CNPC) and PetroChina (see <http://www.cnpc.com.cn/en/aboutcnpc/companyprofile/history/?COLLCC=347968384&> and http://www.petrochina.com.cn/Ptr/About_PetroChina/Company_Profile/).

⁸⁵ CNPC is a large ministerial SOE under the direct supervision of the Chinese central government. It is the largest oil and gas producer and supplier in China, and is also one of the major oilfield service providers around the globe. The core businesses of CNPC include the exploration, production and refining of crude oil and natural gas, marketing, pipelines, oilfield services including petroleum engineering construction, the manufacture of petroleum equipment, the exploitation of new energy sources, as well as capital management, such as finance and insurance services. By the end of 2011, crude oil production and natural gas production accounted for 53% and 74% of total crude oil and natural gas productions in China, respectively. Based in China, as at 2011 CNPC possessed petroleum and natural gas assets and interests in more than 30 countries from Africa, Central Asia-Russia, South America, the Middle East and the Asian-Pacific. It provided oilfield and petroleum engineering construction services in 63 countries globally, and was ranked 4th out of the world's 50 largest petroleum companies, and 6th in the Fortune 500 companies.

Figure 5.1: The ownership structure of PetroChina in 2011⁸⁶

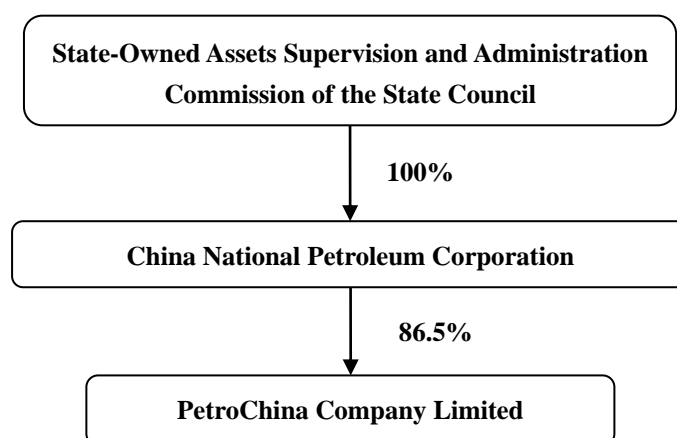


Figure 5.1 above shows that in 2011 more than 86% of PetroChina shares were possessed by CNPC, which is directly controlled, and 100% were owned by the Chinese government through the State-Owned Assets Supervision and Administration Commission (SASAC) of the State Council. Table 5.1 below shows the top 10 shareholders of PetroChina. Besides the second largest shareholder, Hong Kong Securities Clearing Company (HKSCC) Nominees Limited, the rest of the top shareholders possessed marginal share ownerships of PetroChina in 2011.

Table 5.1: Top 10 shareholders of PetroChina in 2011⁸⁷

Shareholder Name	Nature of the Shareholder	Ownership (%)
CNPC	State-owned	86.350
HKSCC Nominees Limited	Overseas, legal person	11.370
National Council for Security Fund of the People's Republic of China	State-owned, legal person	0.219
China Life Insurance Company Limited-005L-FH002 Shanghai	Domestic non-state-owned, legal person	0.036
China Life Insurance Company Limited-005L-CT001 Shanghai	Domestic non-state-owned, legal person	0.033

⁸⁶ PetroChina 2011 annual report, pp. 14, the website of CNPC, <http://www.cnpc.com.cn/en/aboutcnpc/companyprofile/history/?COLLCC=216988642&>

⁸⁷ PetroChina 2011 annual report, p. 11.

Industrial and Commercial Bank of China-China Universal SCI Index Securities Investment Fund	Domestic non-state-owned, legal person	0.025
Guangxi Investment Group Limited	State-owned, legal person	0.022
Industrial and Commercial Bank of China-Shanghai 50 Index ETF Securities Investment Fund	Domestic non-state-owned, legal person	0.021
Bank of Communications-Yi Fang Da 50 Index Securities Investment Fund	Domestic non-state-owned, legal person	0.015
Shanghai Liangneng Construction Engineering Company Limited	Domestic non-state-owned, legal person	0.014

5.1.2. Corporate Governance Structure of PetroChina

The purpose of this section is to describe the CG structure of PetroChina, based on which the next section will demonstrate the overlap and domination of PetroChina's CCP committee over its CG system. PetroChina has an established modern CG structure and mechanisms, which include a board of directors and a supervisory board, in accordance with the relevant laws and regulations. These include the Company Law of China⁸⁸, the relevant regulations issued by the Chinese Securities Regulatory Commission (CSRC), the Listing Rules of Hong Kong Exchanges and Clearing Limited (HKEx)⁸⁹, and the Articles of the Association of the Company (the Articles of Association, PetroChina⁹⁰).

⁸⁸ The Company Law of the People's Republic of China (2005) Chapter 4, the website of the Central People's Government of the PRC, http://www.gov.cn/flfg/2005-10/28/content_85478.htm.

⁸⁹ See <http://www.hkex.com.hk/eng/rulesreg/regulatory.htm>.

⁹⁰The Articles of Association of the Company, PetroChina Company Limited, see http://www.petrochina.com.cn/Resource/pdf/xwygg/ew-Proposed%20Amendments%20to%20Articles%20of%20Association%20_ENG_.pdf.

Profile of PetroChina's Board of Directors

Table 5.2: The board of directors of PetroChina in 2011⁹¹

Corporate Position	Name	Gender	Age	Profession in Accounting	CCP Position
Chairman	Jiang Jiemin	M	56	No	CCP Committee secretary
Vice Chairman, CEO	Zhou Jiping	M	59	No	CCP Committee member
Directors					
Non-executive	Li Xinhua	M	58	No	CCP Committee member
Vice CEO	Liao Yongyuan	M	49	No	CCP Committee member
Non-executive	Wang Guoliang	M	59	Yes	CCP Committee member
Non-executive	Wang Dongjin	M	49	No	CCP Committee member
Non-executive	Yu Baocai	M	46	No	CCP Committee member
Vice CEO	Ran Xinquan	M	46	No	CCP member
Independent Directors (Non-executive)	Liu Hongru	M	81	Yes	CCP member
	Franco Bernabè	M	63	No	Non-CCP member
	Li Yongwu	M	67	No	CCP member
	Cui Junhui	M	65	Yes	CCP member
	Chen Zhiwu	M	49	No	Non-CCP member

Table 5.2 above shows the Fifth session of PetroChina's board of directors in 2011, which consists of thirteen directors, including four non-executive directors and five independent non-executive directors. Independent directors account for 38.5% of the total number of directors, and two independent directors, Liu Hongru and Cui Junhui, are trained in accounting. This is in accordance with the relevant regulations issued by the CSRC⁹² and the HKEx Listing Rules, which require that independent directors account for at least 1/3 of the membership of the board of directors in listed companies, and that there be at least 1 independent director who is an accountant by profession. Notably, as at 2011 there were no female directors on PetroChina's board. In the year 2011, the corporate board of PetroChina convened 4 regular and 6

⁹¹ More detailed profiles of each director, including their educational background and past work experience can be found in PetroChina's 2011 annual report, in the Information on the Directors section, pp.75-79, see http://www.petrochina.com.cn/Ptr/Investor_Relations/Periodic_Reports/Annual_Report/.

⁹² "Guidelines for Introducing Independent Directors to the Board of Directors of Listed Companies", August 2001, The Chinese Securities Regulatory Commission.

extraordinary board meetings, during which 30 corporate resolutions were passed⁹³. These resolutions covered major aspects of the company's operating, financing and investment activities.

Profile of PetroChina's Supervisory Board

Table 5.3: The Supervisory Board of PetroChina in 2011⁹⁴

Corporate Position	Name	Gender	Age	Profession in Accounting	CCP Position
Chairman of the Supervisory Board	Wang Lixin	M	55	No	CCP Committee member, Secretary of the CCP Disciplinary Inspection Committee
	Guo Jinping	M	54	No	CCP member
	Wen Qingshan	M	53	Yes	CCP member
	Sun Xianfeng	M	59	Yes	CCP member
Employee representative supervisor	Wang Guangjun	M	47	No	CCP member
Employee representative supervisor	Yao Lei	M	55	No	CCP member
Employee representative supervisor	Liu Hehe	M	48	No	CCP member
Independent supervisor	Wang Daocheng	M	71	Yes	CCP member

Table 5.4 presents the members of the Fifth session of the Supervisory Board of PetroChina in 2011. There were three supervisors who were appointed by the employees' representatives and one independent supervisor. Notably, three out of the total of eight supervisors were trained in the profession of accounting. However, as at 2011 there were no female members on PetroChina's supervisory board. Six supervisory board meetings were held in 2011, at which important proposals and documents were reviewed and approved and some major decisions were made⁹⁵. Those proposals and documents included the financial report of 2011, the draft profit distribution of 2011, a report on the assessment of the achievement of performance

⁹³ PetroChina 2011 Annual Report, pp. 67-68.

⁹⁴ PetroChina 2011 Annual Report, p. 79.

⁹⁵ PetroChina 2011 Annual Report, p. 71.

targets by the CEO's work team for 2010, the report of the supervisory board, the supervisory board's work summary for 2010, a work plan for 2011, and the 2010 PetroChina Annual Report. The supervisory board also actively participated in the annual general shareholders' meeting and the general and extraordinary meetings of the board of directors as non-voting attendees, to discuss relevant issues and provide supervision and objective opinions⁹⁶. Overall, the supervisory board of PetroChina did not present any objections to the motions and decisions made by the company, it was satisfied with the achievements of the company during the fiscal year, and it was confident about the prospects of PetroChina.

Profile of Senior Managers

Table 5.4: The management team of PetroChina in 2011⁹⁷

Corporate Position	Name	Gender	Age	Profession in Accounting	CCP Position
Vice Chairman, CEO	Zhou Jiping	M	59	No	CCP Committee member
Vice CEO	Liao Yongyuan	M	49	No	CCP Committee member
Vice CEO	Ran Xinquan	M	46	No	CCP member
Vice CEO	Sun Longde	M	49	No	CCP member
Vice CEO	Liu Hongbin	M	48	No	CCP member
CFO	Zhou Mingchun	M	44	Yes	CCP member
Vice CEO	Li Hualin	M	49	No	CCP member
Vice CEO	Zhao Zhengzhang	M	55	No	CCP member
Vice CEO	Bo Qiliang	M	49	No	CCP member
Vice CEO	Sun Bo	M	51	No	CCP member
Chief Engineer	Lin Aiguo	M	53	No	CCP member
Chief Geologist	Wang Daofu	M	56	No	CCP member
Vice CEO	Huang Weihe	M	54	No	CCP member
Vice CEO	Xu Fugui	M	54	No	CCP member

⁹⁶ PetroChina 2011 Annual Report, p. 72, Supervisory Committee's Presence [at] Other Meetings and Performance of Other Obligations.

⁹⁷ PetroChina 2011 Annual Report, pp. 75-77, 82-85.

Table 5.4 above illustrates PetroChina's senior management profile. According to the company's Articles of Association, the duties and responsibilities of the CEO and other senior managers mainly involve the management of production and operations, as well as implementation of the resolutions passed at the board meetings and the annual shareholders' general meetings.

5.1.3. Chinese Communist Party's Control Over Corporate Decision-Making in PetroChina

While PetroChina does have an established modern CG system, the decision-making process in top SOEs is still tightly controlled by the CCP. Under the instructions of the Central CCP Committee and the SASAC⁹⁸, CNPC and PetroChina always focus on the construction of CCP grassroots organisations. In the beginning of 2011, CNPC had 449,206 on-duty CCP members, 157,766 retired CCP members and 24,003 other CCP members. CNPC also had 2,041 CCP committees, 2,869 general CCP branches and 32,697 CCP branches. In addition, CNPC also has the CCP organisational structure of the Communist Youth League of China⁹⁹.

In flagship ministerial SOEs such as PetroChina, political control by the

⁹⁸ The SASAC of the State Council was established in 2003. It is a minister-level department directly affiliated with the State Council. Its major responsibilities include: performing the duties required of a contributor to top SOEs according to the Company Law of the PRC, which is empowered by the State Council; assigning the supervisory board to large SOEs on behalf of the state and supervising the daily operations of the supervisory board; administering the appointment and dismissal of senior corporate executives through legal procedures and evaluating the performance of these executives based on corporate performance; and supervising the value maintenance and enhancement of state-owned assets in SOEs via statistics and auditing (<http://www.sasac.gov.cn/n1180/n3123702/n3123717/n3162319/index.html>).

⁹⁹ The Communist Youth League of China is a large organisation run by the CCP, consisting of Chinese youths aged 14–28 who have communist beliefs. See http://en.wikipedia.org/wiki/Communist_Youth_League_of_China and <http://www.gqt.org.cn/ccylmaterial/regulation/>.

CCP takes two forms with regard to corporate decisions. Firstly, the most important decisions, namely the administration of senior corporate executives and other personnel, are controlled by the Organisation Department¹⁰⁰ and the CCP Central Committee¹⁰¹. This personnel administration system originates from the CCP principle that “the Party controls cadres”¹⁰² and the “political appointment system of cadres”¹⁰³. Secondly, other major corporate decisions regarding the company’s operating, financing and investing activities are controlled by another CCP authority, the SASAC of the State Council. All these decisions are subsequently transmitted to SOEs through the corporate CCP committee. Therefore, the corporate CCP committee is the ultimate decision-making body in Chinese SOEs. All the members of a corporate CCP committee are subject to strict political scrutiny during their nomination and election, and they must have strong and deep political backgrounds and governmental work experience.

¹⁰⁰ The Organisation Department of the CCP is one of the most powerful branches of the CCP. It has significant power over personnel decisions in China, and plays an essential role in the CCP’s control over the government and SOEs at every level (http://en.wikipedia.org/wiki/Organization_Department_of_the_Communist_Party_of_China_Central_Committee).

¹⁰¹ Downs and Meidan (2011) *Business and Politics in China—The Oil Executive Reshuffle of 2011*, China Security, Issue 19, pp. 3-21, 2011 World Security Institute.

¹⁰² “The Party controls cadres” principle is the most quintessential principle of CCP personnel administration. It is an important organisational guarantee, and more importantly, it is the fundamental principle that ensures the CCP’s leadership (see the official news website of the CCP, <http://dangshi.people.com.cn/GB/165617/173273/10415257.html>); “The Notification on the Enhancement of CCP Construction Issued by the CCP Central Committee”, 28th August, 1989, <http://cpc.people.com.cn/GB/64184/64186/66697/4494965.html>.

¹⁰³ In the system of cadres appointment, the appointment and dismissal of cadres and the allocation of work duties to cadres are all centrally controlled by the CCP. The appointment and dismissal of senior executives in every department directly affiliated with the State Council and every large or important SOE are first provisionally decided by the Organization Department of the Central CCP Committee and then approved by the State Council. See “The list of the position titles of cadres that are administrated by Central CCP Committee”, http://blog.sina.com.cn/s/blog_48d111f90100c1e1.html.

Table 5.5: The CCP Committee of PetroChina in 2011¹⁰⁴

Name	Gender	Age	Corporate Position	Party Position
Jiang Jiemin	M	56	Chairman of the Board	CCP Committee Secretary
Zhou Jiping	M	59	Vice Chairman of the Board, CEO	CCP Committee member
Li Xinhua	M	58	Non-executive Director	CCP Committee member
Liao Yongyuan	M	49	Vice CEO	CCP Committee member
Wang Guoliang	M	59	Non-executive Director	CCP Committee member
Wang Dongjin	M	49	Non-executive Director	CCP Committee member
Yu Baocai	M	46	Non-executive Director	CCP Committee member
Wang Lixin	M	55	Chairman of the Supervisory Committee	Secretary of the CCP Disciplinary Inspection Committee

As shown in Table 5.5 above, the CCP's control over corporate decision-making in PetroChina is illustrated by the fact that the most important corporate executive positions are all occupied by the PetroChina's CCP committee members. For example, the position of the chairman of PetroChina's board of directors is held by the CCP committee secretary, Jiang Jiemin. The vice chairman of the board and CEO, Zhou Jiping, and the vice CEO Liao Yongyuan are both members of the CCP committee. Wang Lixin, who holds the position of the chairman of the supervisory board is also a member of the CCP committee, and the secretary of the CCP disciplinary inspection committee¹⁰⁵.

As mentioned earlier, all of these senior executives have extensive political backgrounds and governmental work experience, which is well illustrated by the personal resume of PetroChina's chairman of the board and CCP committee secretary, Jiang Jiemin¹⁰⁶. Jiang holds a Master's degree and graduated from the Central Party

¹⁰⁴ The website of CNPC, Top Management, <http://www.cnpc.com.cn/cn/gywm/jtld/>.

¹⁰⁵ The CCP disciplinary inspection committee is a branch of the CCP. According to the CCP Constitution (article 44), its major duties are to uphold and CCP Constitution and relevant party laws and regulations, monitor and supervise party members' conduct, and engage in anti-corruption work (http://news.xinhuanet.com/ziliao/2002-11/18/content_633225_9.htm). In Chinese SOEs, the role and functions of the supervisory board are overshadowed by the CCP disciplinary inspection committee.

¹⁰⁶ Personal resume of Jiang Jiemin (<http://www.sasac.gov.cn/n1180/n1549/n15206520/n15206539/index.html>).

School of the CCP¹⁰⁷. He began his career in the petroleum industry at the ShanDong Shengli oilfield as a technician in 1972. In 1993, he was appointed as the deputy director and CCP standing committee member of ShengLi Petroleum Administration Bureau. The next year, he became the CCP committee secretary of the QingHai Petroleum Administration Bureau. He joined CNPC as the assistant CEO, the director and vice CEO of PetroChina in 1999. In 2000 he was appointed as the vice governor¹⁰⁸ of QingHai province, and he became the vice secretary of the QingHai provincial CCP committee in 2003. In 2004, he was transferred back to CNPC as the vice CEO and vice CCP committee secretary. He was appointed as the chairman of the board, CEO and CCP committee secretary of PetroChina in 2007. On the 14th of November 2012, he was elected as a member of the 18th session of the Central CCP Committee, which is a core element of China's political system. On the 18th of March 2013, he was appointed as the head of the SASAC of the State Council¹⁰⁹.

The mechanisms by which the CCP exerts control over the top Chinese SOEs are illustrated by the appointment of Jiang Jiemin to PetroChina. At CNPC's CCP committee meeting In November 2006, the then vice minister of the Organisation Department of the Central CCP Committee Mr Wang Dongming announced Jiang Jiemin's appointment as the CCP committee secretary of CNPC and the chairman of the board of PetroChina¹¹⁰. On the 16th of May 2007 this resolution was first passed, at the second extraordinary meeting of PetroChina's board of

¹⁰⁷ The Central Party School of the CCP is a prestigious political and academic institution established by the CCP to train and cultivate the CCP's middle and high level officials. It is directly affiliated with the Central CCP Committee (http://www.ccps.gov.cn/ccps_overview/201207/t20120720_18914.html)

¹⁰⁸ According to the Constitution of the People's Republic of China, the governor of a province is the second highest leader of that province and has a ministerial rank (it is the 3rd ranked governmental position in China's regime system). The highest leader of a province is the party secretary of the provincial CCP standing committee (<http://baike.baidu.com/view/619379.htm>).

¹⁰⁹ See http://news.xinhuanet.com/energy/2013-03/19/c_124473887.htm.

¹¹⁰ See http://news.xinhuanet.com/fortune/2006-11/16/content_5338018.htm and <http://news.eastday.com/eastday/node81741/node81762/node172126/u1a2449105.html>).

directors¹¹¹. On the 20th of that same month, PetroChina officially announced the appointment of Jiang Jiemin as the company's chairman of the board¹¹². The resolution on the appointment of Jiang was officially passed at the 1st meeting of PetroChina's board of directors on the 16th of May 2008¹¹³.

Although the annual general shareholder meeting is the supreme corporate decision-making body according to China's Company Law and company's Articles of Association, the appointment of Jiang as PetroChina's chairman of the board did not appear in the announcements of PetroChina's annual general shareholders' meetings from 2006 to 2008¹¹⁴. The above timeline of the appointment procedure explicitly demonstrates that major decisions in China's top SOEs are first made by the Central CCP Committee and the State Council through relevant departments, such as the Organisation Department and SASAC. These decisions are then transmitted to corporate level through the corporate CCP committee. Lastly, these decisions are passed in the form of resolutions at corporate board meetings and annual general shareholders' meetings.

Besides the appointment and dismissal of top executives, the CCP also has decision-making power over corporate operations. This is illustrated by the asset swaps between CNPC and PetroChina under the supervision and approval of the SASAC of the State Council. On the 25th of August 2011, PetroChina sold the PetroChina Northeast Engineering Company, which was a wholly-owned subsidiary

¹¹¹ PetroChina 2007 Annual Report, The Daily Operations of the Board of Directors, p. 57.

¹¹² PetroChina Company Limited, Board Chairman Announcement
(<http://www.petrochina.com.cn/PetroChina/xwygg/tzgg/gg070521C0940.htm>).

¹¹³ PetroChina 2008 Annual Report, The Daily Operations of the Board of Directors, p. 56.

¹¹⁴ PetroChina's 2006, 2007 and 2008 announcements of the annual general shareholders' meetings, Shanghai Stock Exchange
(http://www.sse.com.cn/assortment/stock/list/stockdetails/announcement/index.shtml?COMPANY_CODE=601857); PetroChina's company announcements
(<http://www.petrochina.com.cn/PetroChina/xwygg/tzgg/gg070516C110.htm>).

of PetroChina, to CNPC for RMB 281.27 million¹¹⁵. The PetroChina Northeast Engineering Company had an after tax net loss of RMB 228.41 million at the end of the fiscal year of 2009¹¹⁶. On the 27th of October 2011, PetroChina purchased the CNPC South Oil Exploration and Development Company Limited from CNPC for RMB 1.67 billion¹¹⁷. The after tax net profit of South Oil as at the 31st of December 2009 was RMB 365.05 million. It is mentioned in these two company announcements that “Since the applicable percentage ratio for the Acquisition is more than 0.1% but less than 5%, these acquisitions are only subject to the reporting and announcement requirements and are exempt from the independent shareholders’ approval requirement under the Listing Rules.¹¹⁸” More importantly, the final appraised values of these equity transfers were first set by the SASAC, and then the final decision on the transfers had to be approved by the SASAC before they could actually be conducted¹¹⁹. These two inter-group transactions imply that the CCP may supervise the transfer of bad assets from a listed subsidiary to the parent company, and the transfer of profitable assets from the parent company to the listed subsidiary, with the purpose of making the financial position of the listed subsidiary, in this case PetroChina, look more attractive to market investors.

Based on the undeniable evidence presented above, it can be concluded that the modern CG mechanisms and structure that have been implemented in Chinese SOEs could be viewed as mere window-dressing that is mainly used to ensure

¹¹⁵ Company announcement on the disposal of assets, 26th of August 2011, (http://www.petrochina.com.cn/Ptr/News_and_Bulletin/Notices_and_Announcements/Connected_Transaction_%EF%BC%8D_Disposal_of_Assets.htm).

¹¹⁶ Consideration, the company announcement on assets disposal, 26th of August 2011, p. 2.

¹¹⁷ Company announcement on the connected transaction, 28th of October 2011 (http://www.petrochina.com.cn/Ptr/News_and_Bulletin/Notices_and_Announcements/Connected_Transaction11.10.27.htm).

¹¹⁸ The last paragraphs on the face pages of these two company announcements.

¹¹⁹ One of the prerequisites of the disposal and acquisition is that such disposal or acquisition of assets be approved by the SASAC of the State Council, under the condition (c) in the asset disposal company announcement on the 26th of August 2011, and condition 2 (f) in the assets acquisition announcement on the 28th of October 2011.

compliance with the relevant laws, regulations and listing rules. Most importantly, the real factor that matters in Chinese SOEs is the incontrovertible political control exerted by the CCP through corporate CCP committees.

5.2. Case 2: A Medium SOE, SiChuan ChangHong Electric Company Limited

5.2.1. Company Profile and Background¹²⁰

SiChuan ChangHong Electric Company Limited is a municipal level SOE located in the city of Mianyang, Sichuan province. It is a listed subsidiary of Sichuan ChangHong Electric Group. The company was officially established in June 1988 as a result of shareholding and corporatisation reform. The main operations of ChangHong include the manufacture of televisions (including smart 3D TVs), digital light processing projectors, air conditioners, fridges, washing machines and other small household appliances and digital products. Today, ChangHong is China's second-largest television producer¹²¹ and it was included in the "Top 500 Global Brands"¹²² list issued by the World Brand Lab¹²³. In 2004, approximately 90% of the TVs imported by the US from China were produced by ChangHong¹²⁴. In 2011, ChangHong's total sales reached US \$8.25 billion, with a net profit of US \$64.54 million. Its market capitalisation and total assets were US \$1.60 billion and US \$8.23

¹²⁰ The official website of ChangHong, <http://cn.changhong.com/>. See also <http://en.wikipedia.org/wiki/Changhong>, and <http://zh.wikipedia.org/wiki/长虹电器>.

¹²¹ "ChangHong, Jianghuai Auto, TCL, Zijin: China Equity Preview", Bloomberg, 3 August 2010.

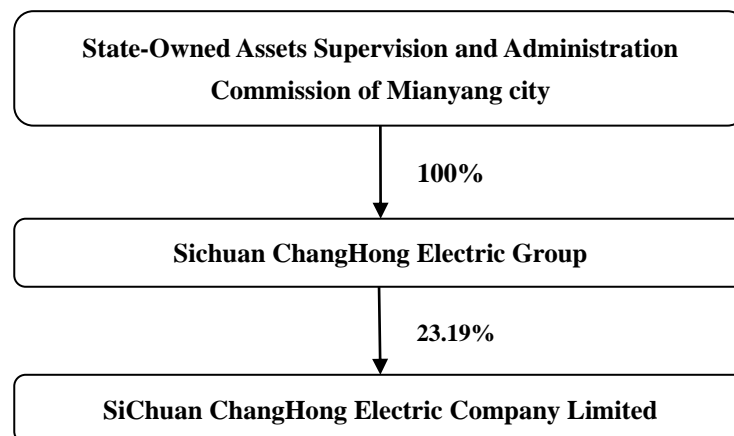
¹²² 2013, The 10th World's 500 Most Influential Brands (<http://www.worldbrandlab.com/world/2013/china.htm>).

¹²³ The World Brand Lab was established in New York in 2003, and is the leading independent consultancy for brand valuation and marketing strategy in the world (http://www.worldbrandlab.com/aboutus_2.htm).

¹²⁴ Buckley Chris, "ChangHong, China's largest TV exporter, announces a huge loss", The New York Times, 29 December 2004.

billion respectively. In that same year, ChangHong had 60,398 employees¹²⁵. On the 11th of March 1994, Sichuan ChangHong was listed on the Shanghai Stock Exchange with the stock code 600839.

Figure 5.2: The ownership structure of ChangHong in 2011



As shown in Figure 5.2 above, in 2011 Sichuan ChangHong Electric Group was the controlling shareholder, with 23.19% share ownership of Sichuan ChangHong Electric Company Limited. The actual controller of the listed subsidiary is the Sichuan Provincial SASAC, which possessed 100% of share ownership of Sichuan ChangHong Electric Group in 2011¹²⁶. As shown in Table 5.6 below, as well as the parent group there was another SOE in the top ten shareholders, Mianyang Technology City Development and Investment Group, which held 1.36% of ChangHong's shareholding ownership in 2011. The remaining eight of the top ten shareholders were all domestic non-state-owned companies.

Table 5.6: Top 10 shareholders of ChangHong in 2011¹²⁷

Shareholder Name	Nature of the Shareholder	Ownership (%)
Sichuan ChangHong Electric Group	State-owned	23.19
Construction Bank of China Company Limited-Changsheng	Domestic non-state-owned, legal	2.06

¹²⁵ These data were extracted from the ThomsonONE database (ThomsonONE.com Investment Banker).

¹²⁶ ChangHong 2011 Annual Report, p. 12.

¹²⁷ ChangHong 2011 Annual Report, pp. 8-9.

Tongqing Separably Tradable Securities Investment Fund	person	
Mianyang Technology City Development & Investment Group	State-owned, legal person	1.36
Bank of China Company Limited-Ping An-UOB Industry Pioneer Securities Investment Fund	Domestic non-state-owned, legal person	0.78
Industrial and Commercial Bank of China-Small-Cap Growth Stocks Hua Securities Investment Fund	Domestic non-state-owned, legal person	0.65
Sichuan Hongyang Investment Company Limited	Domestic non-state-owned, legal person	0.56
Bank of China-Jiashi Shanghai & Shenzhen 300 Index Securities Investment Fund	Domestic non-state-owned, legal person	0.44
Agricultural Bank of China-Cathay Pacific Taurus Innovation Growth Securities Investment Fund	Domestic non-state-owned, legal person	0.42
Industrial and Commercial Bank of China-Huaxia Shanghai & Shenzhen 300 Index Securities Investment Fund	Domestic non-state-owned, legal person	0.34
Bank of China-Golden Eagle Constituent Preferential Securities Investment Fund	Domestic non-state-owned, legal person	0.31

5.2.2. Corporate Governance Structure of Sichuan ChangHong

According to the Company Law of China, the relevant regulations issued by the CSRC, the listing rules of the Shanghai Stock Exchange¹²⁸, and the Articles of Association of ChangHong¹²⁹, Sichuan ChangHong Electric Company Limited has an established modern CG structure and mechanisms. The CG structure and mechanisms of ChangHong, including the board of directors, supervisory board, and board meeting will be described in detail in the next section.

¹²⁸ All these regulations were stated in detail in the previously presented PetroChina case study, and the Shanghai Stock Exchange listing rules can be found at http://biz.sse.com.cn/sseportal/en/c02/p1116/c1502_p1116.shtml.

¹²⁹The Articles of Association of ChangHong is provided at http://file.finance.sina.com.cn/211.154.219.97:9494/MRGG/CNSESH_STOCK/2012/2012-6/2012-06-19/928295.PDF.

Profile of ChangHong's Board of Directors

Table 5.7: The board of directors of ChangHong in 2011¹³⁰

Corporate Position	Name	Gender	Age	Profession in Accounting	CCP Position
Chairman	Zhao Yong	M	48	No	CCP committee secretary
Vice Chairman, CEO	Liu Tabin	M	48	Yes	CCP committee member
Directors					
Vice CEO	Lin Maoxiang	M	49	Yes	CCP committee member
Vice CEO	Zheng Guangqing	M	53	No	CCP committee member
Vice CEO	Wu Yingjian	M	53	No	CCP committee member
Vice CEO	Wu Jiang	M	47	No	CCP committee member
Independent Directors	Gao Lang	M	59	No	CCP member
	Qian Pengxiao	M	68	No	CCP member
	Gao Xiaosu	F	65	No	CCP member
	Huang you	M	49	Yes	CCP member
	Jia Xiaoliang	M	54	No	CCP member
	Ning Xiangdong	M	46	No	CCP member

Table 5.7 above illustrates the 8th session of ChangHong's board of directors in 2011, which comprised twelve directors, including three with accounting expertise. Independent directors accounted for 50% of total number of directors on the board. This is in accordance with the CSRC regulations. There was only one female director on ChangHong's board, an independent director Mrs Gao Xiaosu. During 2011, ChangHong's board of directors convened 15 board meetings and passed 29 resolutions regarding the operating, financing and investment activities of the company¹³¹.

¹³⁰ ChangHong 2011 Annual Report, pp. 12-15.

¹³¹ ChangHong 2011 Annual Report, pp. 33-35.

Profile of ChangHong's Supervisory Board

Table 5.8: The Supervisory Board of ChangHong in 2011¹³²

Corporate Position	Name	Gender	Age	Profession in Accounting	CCP Position
Chairman	Fei Minying	F	53	Yes	CCP Committee member, Secretary of the CCP Disciplinary Inspection Committee
Supervisor	Yang Dan	M	45	No	Non-CCP member
Supervisor	Yuan Bing	M	52	No	CCP Committee member, Vice Secretary of the CCP Disciplinary Inspection Committee
Employee representative	Wu Xiaogang	M	40	No	CCP committee member
Employee representative	Tang Dechao	M	34	No	CCP committee member

Table 5.8 above presents the members of the ChangHong's supervisory board in 2011. It was comprised of five members and included one female, Mrs Fei Minying who was the chairman and the only supervisory with expertise in accounting. During 2011, ChangHong's supervisory board convened five board meetings and passed seven resolutions¹³³. In addition, the supervisory board actively supervised and participated in the company's operations. It examined the company's financial status and audited the periodic financial reports, based on which it issued objective opinions. Moreover, in this reporting period the supervisory board checked and approved the assessment report on internal control, and investigated insider information, the actual investment of raised funds, the purchase and disposal of long term assets, the company's compliance with relevant state regulations and the company's Articles of Association¹³⁴. Overall, the supervisory board did not convey any objections to the motions and decisions made by the company.

¹³² ChangHong 2011 Annual Report, pp. 13-14.

¹³³ The Report of ChangHong's Supervisory Board, pp. 4-8, ChangHong 2011 Annual Report, pp. 38.

¹³⁴ ChangHong 2011 Annual Report, pp. 38-39.

Profile of Senior Managers

Table 5.9: The management team of ChangHong in 2011¹³⁵

Corporate Position	Name	Gender	Age	Profession in Accounting	CCP Position
Vice Chairman, CEO	Liu Tabin	M	48	Yes	CCP committee member
Vice CEO	Lin Maoxiang	M	49	Yes	CCP committee member
Vice CEO	Zheng Guangqing	M	53	No	CCP committee member
Vice CEO	Wu Yingjian	M	53	No	CCP committee member
Vice CEO	Wu Jiang	M	47	No	CCP committee member
Vice CEO	Li Jin	M	44	No	CCP committee member
Vice CEO	Guo Dexuan	M	49	No	CCP committee member
Vice CEO	Tan Mingxian	M	47	No	CCP committee member
CFO	Ye Honglin	M	40	Yes	Non-CCP member
Investment manager	Yang Jun	M	41	No	CCP member

As shown in Table 5.9 above, ChangHong's management team in 2011 consisted of ten senior managers, including one CEO, seven vice CEOs, one CFO and one investment manager. Three of the senior managers had expertise in accounting, and all were males. Notably, ChangHong's management team was largely dominated by its CCP committee and CCP influence. Only one manager, the CFO Mr Ye Honglin was a non-CCP member. Eight managers were members of ChangHong's CCP committee.

5.2.3. CCP's Control Over Corporate Decision-Making in ChangHong

In medium or small SOEs, such as ChangHong, the CCP still strives to maintain tight control. As is the case for PetroChina, although a modern CG structure has been established, such a system merely plays a window-dressing role and in reality the decision-making process is under the political control of the CCP. Specifically, major decisions are first made by a governmental branch of the CCP

¹³⁵ ChangHong 2011 Annual Report, pp. 12-15.

such as the Organisation Department or the SASAC at various regime levels, then these decisions are forwarded to the corporate level through the corporate CCP committee. Therefore, a corporate CCP committee is the supreme decision-making body at the firm level, and its members usually have extensive political backgrounds and governmental working experience.

Table 5.10: The CCP Committee of ChangHong in 2011¹³⁶

Name	Gender	Age	Corporate Position	Party Position
Zhao Yong	M	48	Chairman of the Board	CCP Committee Secretary
Liu Tabin	M	48	Vice Chairman of the Board, CEO	CCP Committee member
Lin Maoxiang	M	49	Vice CEO	CCP Committee member
Zheng Guangqing	M	53	Vice CEO	CCP Committee member
Wu Yingjian	M	53	Vice CEO	CCP Committee member
Wu Jiang	M	47	Vice CEO	CCP Committee member
Li Jin	M	44	Vice CEO	CCP Committee member
Guo Dexuan	M	49	Vice CEO	CCP Committee member
Tan Mingxian	M	47	Vice CEO	CCP Committee member
Fei Mingying	F	53	Chairman of the Supervisory Board	Secretary of the CCP Disciplinary Inspection Committee
Yuan Bing	M	52	Supervisor	Vice Secretary of the CCP Disciplinary Inspection Committee
Wu Xiaogang	M	40	Employee Representative Supervisor	CCP Committee member
Tang Dechao	M	34	Employee Representative Supervisor	CCP Committee member

Table 5.10 above shows that in 2011 ChangHong had a large corporate CCP committee comprised of 13 members. The CCP's control over corporate decision-making is evidenced by the fact that ChangHong's CG structure is actually dominated by its CCP committee. In 2011 CCP committee members accounted for 50%

¹³⁶ ChangHong 2011 Annual Report, pp. 12-15, and ChangHong's company website, <http://www.changhong.com.cn/touzizheguanxi.htm#2>.

of the seats on the board of directors, 80% of the seats on the supervisory board, and more importantly, all senior corporate positions were held by CCP committee members. The secretary of ChangHong's CCP committee, Mr Zhao Yong, held the position of chairman of the board of directors. The chairman of the supervisory board, Mrs Fei Minying, was also a member of the CCP committee and the secretary of the CCP disciplinary inspection committee¹³⁷. On the management team, the positions of CEO and all vice CEOs were occupied by CCP committee members.

In order to be selected as the members of the CCP committee and to attain senior corporate positions, all of these executives required extensive political backgrounds and government work experience, and they were subject to strict political vetting. This is illustrated by the resume of ChangHong's chairman of the board, Zhao Yong¹³⁸. Zhao has a doctorate in engineering awarded by Tsinghua University. He became a CCP member in December 1998. He joined the predecessor of ChangHong, the state-owned ChangHong Machinery Factory as the chief engineer in July 1993. In May 2000, he was appointed as the vice chairman of the board of Sichuan ChangHong Electric Company Limited and a member of the company's CCP standing committee. From June 2001 to June 2004 he was the deputy mayor of the city of Mianyang, Sichuan province, and a member of the CCP committee of Mianyang municipal government. In May 2007, Zhao was elected as a member of the 9th session of Sichuan provincial CCP committee, and he was also elected as a representative of the 17th National Congress of the CCP.

In the following section, the CCP's control over corporate decision-making

¹³⁷ Refers to the role and functions of a CCP disciplinary inspection committee in the case study on PetroChina.

¹³⁸ "Case study in Financial Analysis", 1st of July 2006, Tsinghua University Press, Edited by Hu Yiming, Chapter 7, p. 189, see <http://baike.baidu.com/subview/138203/9734362.htm> and http://news.xinhuanet.com/fortune/2004-07/08/content_1584788.htm. ChangHong 2011 Annual Report, p. 14.

in ChangHong is illustrated by the procedure of the appointment of key executives and the passing of resolutions pertaining to the major operating, financing and investment activities of the company. Zhao Yong was appointed as the chairman of the board of ChangHong in 2004. On the 8th of July 2004, the Sichuan provincial CCP committee, the Sichuan provincial government and the Sichuan provincial SASAC jointly announced at ChangHong's CCP committee meeting that Zhao Yong had been appointed as ChangHong's chairman of the board and secretary of the CCP committee¹³⁹. On the same day, ChangHong convened the 14th meeting of the 5th session of the company's board of directors, during which Zhao was nominated as a candidate board member¹⁴⁰. On the 12th of August 2004, during the 17th meeting of the 5th session of the company's board of directors, Zhao was elected as the chairman of the board. On the same day, the company held an extraordinary shareholders' meeting, and the election of Zhao Yong as a board member was considered and passed¹⁴¹. At a 2004 annual shareholders' meeting convened on the 29th of June 2005, Zhao was officially announced as ChangHong's chairman of the board¹⁴². The timeline of Zhao's appointment clearly demonstrates that the CG structure and mechanisms in ChangHong amount to mere window-dressing. All major decisions are made by the CCP, then passed down to corporate level via the corporate CCP committee in the form of corporate board or shareholders' meeting resolutions.

The CCP also controls decision-making pertaining to the major operating, financing and investment activities of the company. For example, on the 30th of November 2006, the "Plan on the assets exchange between ChangHong Electric Company Limited and ChangHong Electric Group" was approved by the SASAC of

¹³⁹ The official news website of the Chinese central government, http://news.xinhuanet.com/fortune/2004-07/08/content_1584788.htm.

¹⁴⁰ ChangHong 2004 Annual Report, p. 18.

¹⁴¹ ChangHong 2004 Annual Report, p. 13.

¹⁴² ChangHong 2005 Annual Report, p. 8-10.

the city of Mianyang¹⁴³. On the 10th of April 2007, ChangHong's plan regarding the acquisition of Hefei Meiling Company Limited shares was approved by the SASAC of the State Council¹⁴⁴. These CCP decisions were subsequently transmitted to corporate level in the form of board resolutions, as was the case in the appointment of Zhao Yong.

5.3. Case 3: A Top POE, Jiangsu ShaGang Company Limited

5.3.1. Company Profile and Background¹⁴⁵

Jiangsu ShaGang Company Limited is a listed subsidiary of Jiangsu ShaGang Group, which is the largest privately-owned steel enterprise in China. It is located in the city of Zhang Jiagang in Jiangsu province. The business domains of the Jiangsu ShaGang group involve the production and sales of steel products under the brand name "ShaGang". The ShaGang group was first listed on the Fortune Global 500 in 2009¹⁴⁶, wherein it was the only POE from mainland China, ranked 444. By 2013, the group's Fortune Global 500 ranking had risen to 318. In 2011, the company reported total sales of US \$2.4 billion and a net profit of US \$44.1 million. In the same year, the market capitalisation of the company reached US \$1.0 billion and its total assets amounted to US \$1.6 billion. The company's total number of employees in that year was 5,419¹⁴⁷. In 1996, the group was transformed into "Jiangsu ShaGang

¹⁴³ Company announcement 2006-042, see http://static.sse.com.cn/disclosure/listedinfo/announcement/c/2006-12-16/600839_20061216_1.pdf.

¹⁴⁴ Company announcement 2007-007, see http://static.sse.com.cn/disclosure/listedinfo/announcement/c/2007-04-10/600839_20070410_1.pdf.

¹⁴⁵ Group Brief Introduction, company website, see <http://www.sha-steel.com/eng/index.html>, <http://zh.wikipedia.org/wiki/江苏沙钢集团> and http://en.wikipedia.org/wiki/Shagang_Group.

¹⁴⁶ The full Fortune Global 500 list: http://money.cnn.com/magazines/fortune/global500/2009/full_list/401_500.html.

¹⁴⁷ All these figures and data were derived from the ThomsonONE database, ThomsonONE.com Investment Banker.

Group Company Limited” as a result of China’s shareholding and corporatisation reform. In 2010 the group became a publicly listed company, GaoXin ZhangTong Company Limited¹⁴⁸, with the stock code 002075¹⁴⁹. On the 8th of April 2011, Jiangsu ShaGang Company Limited was officially re-listed on the Shenzhen Stock Exchange.

As shown in Figure 5.3 below, in 2011 the controlling shareholder of the company was Jiangsu ShaGang Group Company Limited, with 75% shareholding ownership, and the actual controlling person was the chairman and the controlling shareholder of the group, Mr Shen Wenrong, who possessed 29% of the shareholding ownership. Notably, although Jiangsu ShaGang is a POE, the ownership structure of the company in 2011 also included state-owned shareholding of 7.54%, which was owned by the State Council through the China GaoXin Investment Group Company Limited¹⁵⁰.

¹⁴⁸ GaoXin ZhangTong Company Limited was a SOE under the controlling ownership of China GaoXin Investment Group Company Limited, which is under the direct control of the State Council through the SASAC. GaoXin ZhangTong 2009 Annual Report, pp. 7-9.

¹⁴⁹ See disclosure.szse.cn/m/finalpage/2010-07-07/58142231.PDF.

¹⁵⁰ Jiangsu ShaGang 2011 Annual Report, pp. 6-8.

Figure 5.3: The ownership structure of ShaGang in 2011¹⁵¹

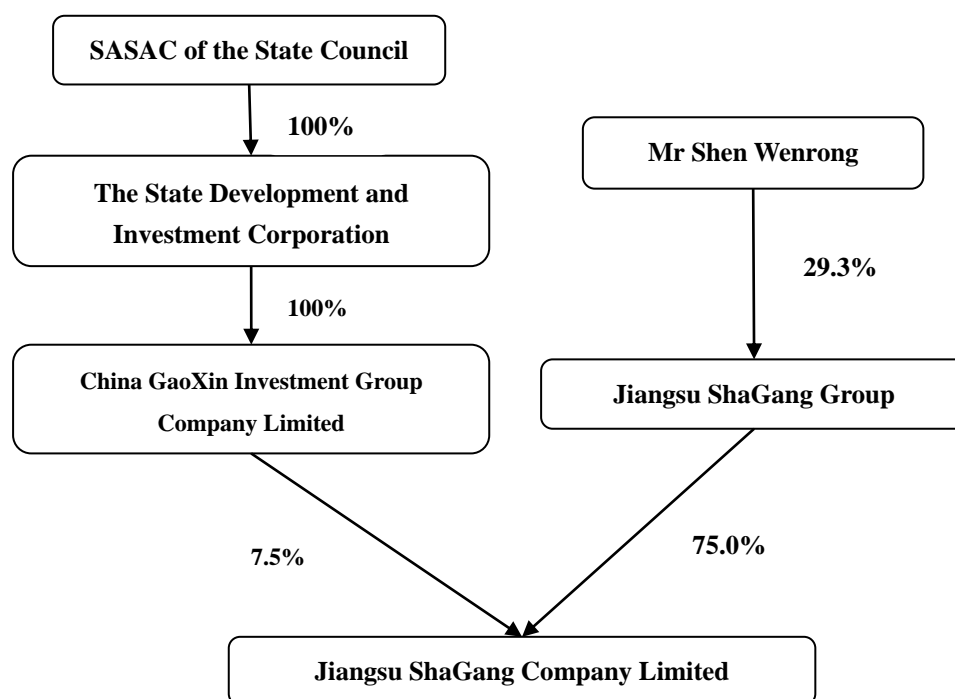


Table 5.11 below shows the top 10 shareholders of ShaGang in 2011. Of these, besides the largest shareholder, ShaGang group, there is only one SOE and the remaining eight shareholders are either domestic non-state-owned legal entities or domestic natural entities.

Table 5.11: Top 10 shareholders of ShaGang in 2011¹⁵²

Shareholder Name	Nature of the Shareholder	Ownership (%)
Jiangsu ShaGang Group	Domestic non-state-owned legal person	75.00
China GaoXin Investment Group Company Limited	State-owned legal person	7.54
Zhang Jiagang City Yangshe County Assets Management Company	Domestic non-state-owned legal person	1.86
Huang Wenyao	Domestic natural person	1.22
Guo Zhaoxiang	Domestic natural person	0.90
Xu Jun	Domestic natural person	0.62
Zhou Jianqing	Domestic natural person	0.49
Taikang Life Insurance Company	Domestic non-state-owned legal person	0.33

¹⁵¹ Jiangsu ShaGang 2011 Annual Report, p. 8.

¹⁵² ShaGang 2011 Annual Report, pp. 6-7.

Limited-Dividend-Personal Dividend-019L-FH002 Shenzhen		
Taikang Life Insurance Company Limited-Equity Linked-Personal Equity Linked	Domestic non-state-owned legal person	0.23
Deng Liqin	Domestic natural person	0.16

5.3.2. Corporate governance of Jiangsu ShaGang

As a listed company, Jiangsu ShaGang has established the modern CG structure and mechanisms under the Company Law, relevant CSRC regulations, listing rules of the Shenzhen Stock Exchange, and the company's own Articles of Association.

Profile of ShaGang's Board of Directors

Table 5.12: The board of directors of ShaGang in 2011¹⁵³

Corporate Position	Name	Gender	Age	Profession in Accounting	CCP Position
Chairman	Lu Jinxiang	M	62	No	CCP committee member
Vice Chairman	Han Dali	M	50	No	CCP committee member
Directors					
CEO	Li Peisong	M	46	No	CCP member
CFO	Cong Guoqing	M	45	Yes	CCP member
Independent directors	He Ciqin	F	65	Yes	CCP member
	Huang Xiong	M	49	No	CCP member
	Ge Min	F	43	No	Non-CCP member

As shown in Table 5.12 above, ShaGang's 4th session of the board of directors in 2011 included seven directors. The number of independent directors accounted for almost 43% of the total, and one had expertise in accounting, which complies with the CSRC regulations and listing rules. There were two female

¹⁵³ ShaGang 2011 Annual Report, pp. 9-11.

directors on the board. During 2011, the board of directors convened 10 board meetings.

Profile of Supervisors and Supervisory Board Activities

Table 5.13: Supervisory Board of ShaGang in 2011¹⁵⁴

Corporate Position	Name	Gender	Age	Profession in Accounting	CCP Position
Chairman of the supervisory board	Lian Guizhi	F	42	Yes	Non-CCP member
Supervisor	Wei Yiliang	M	41	No	CCP member
	Mo Anjian	M	60	No	CCP committee member
	Chen Jianlong	M	48	No	CCP committee member
	Zhuang Yingming	M	44	Yes	Non-CCP member

Table 5.13 above shows the composition of the 4th session of ShaGang's supervisory board, which consisted of five members including the chairman and four other supervisors. Two of the supervisory board members had expertise in accounting, and one of these was female. During the reporting period, the supervisory board held 6 board meetings and passed 11 board resolutions¹⁵⁵. The supervisory board earnestly performed their due duties under the relevant laws and regulations, with the purpose of faithfully protecting the interests of minority shareholders. The board presented at all shareholders' meetings and the meetings of the company's board of directors, investigated the corporate performance and financial status of the company, and supervised the company's operations and information disclosure processes.

¹⁵⁴ Executive profile, ShaGang 2011 Annual Report, pp. 9-10.

¹⁵⁵ All these supervisory board resolutions were disclosed in the China Security Journal and <http://www.cninfo.com.cn>.

Profile of senior managers

Table 5.14: The management team of ShaGang in 2011¹⁵⁶

Corporate Position	Name	Gender	Age	Profession in Accounting	CCP Position
CEO	Li Peisong	M	46	No	CCP member
CFO	Cong Guoqing	M	45	Yes	CCP member
Vice CEO	Wang Zhongying	M	45	No	CCP member
Vice CEO	Wei Bi	M	41	No	CCP member

5.3.3. ShaGang's Political Connections with the Chinese Communist Party

In contrast to Chinese SOEs, where the CCP maintains tight political control over corporate decision-making, Chinese POEs endeavour to establish connections with the CCP in order to obtain preferential governmental treatment, easier access to resources, information on forthcoming regulations and policies, and protection from market competition. This strategy is known as “wearing a red hat”¹⁵⁷. There are several ways for POEs to establish CCP connections. A POE can directly establish a corporate CCP committee. Many corporate executives and employees of POEs have CCP membership, and the CCP Constitution requires that all enterprises with more than three formal CCP members establish a CCP branch¹⁵⁸. There are also other ways. Eighty percent of private entrepreneurs are already CCP members before starting a business. Other strategies include serving as delegates in local congress or the National People's congress, contesting elections for local administration posts and joining business associations that link the state and the private sector, and harbouring

¹⁵⁶ Executive profile, ShaGang 2011 Annual Report, pp. 9-10.

¹⁵⁷ Li et al., (2008) and Chen (2007).

¹⁵⁸ The CCP Constitution requires that enterprises, villages, government offices, schools and universities, academic institutions, residential districts, PLA companies, and other grassroots units with more than three formal CCP members establish a CCP branch. Chapter 5, article 29.

affiliations with government administration¹⁵⁹. In many cases multiple CCP connections co-exist, as is evident in the case of Jiangsu ShaGang Company Limited.

Firstly, Jiangsu ShaGang has a complete CCP structure. As at 2013, the Jiangsu ShaGang group had more than 30,000 employees¹⁶⁰, 20 established main CCP branches, 57 CCP branches, and there were 2,530 CCP members¹⁶¹. Secondly, a CCP committee—the highest political organ at corporate level—was established within the listed subsidiary. As shown in Table 5.15, below, ShaGang’s 3rd session of the CCP committee did not overlap substantially with its CG structure, which differs from the CCP control pattern evident in Chinese SOEs, as previously illustrated by cases of PetroChina and Sichuan ChangHong. Only the key positions of chairman of the board, CEO and vice CEO were occupied by CCP committee members. In addition, two supervisors were CCP committee members. Other CCP committee members did not hold executive positions in the listed company. Instead, these CCP committee members worked as corporate executives in the subsidiary of the listed company, Jiangsu ShaGang HuaiGang TeGang Company Limited.

¹⁵⁹ G Gilles (2006), The Political "Participation" of Entrepreneurs: Challenge or Opportunity for the Chinese Communist Party?, *Social Research: An International Quarterly*, Volume 73, Number 1, pp. 219-244.

¹⁶⁰ ShaGang’s website, <http://www.sha-steel.com/eng/index.html>.

¹⁶¹ The website of “CCP construction in the Chinese non-state-owned enterprises”, <http://www.fgdjw.gov.cn/fgdjw/system/2013/04/10/016305116.shtml>.

Table 5.15: The CCP Committee of ShaGang (listed company)¹⁶²

Name	Corporate Position	Party Position
Lu Jinxiang	Chairman of the Board	CCP Committee Secretary
Li Peisong	Director, CEO	Vice CCP Committee Secretary
Ma Yi		CCP Committee member
Mo Anjian	Supervisor	Vice CCP Committee Secretary, Secretary of CCP Disciplinary Inspection Committee
Chen Jianlong	Supervisor	Vice Secretary of CCP Disciplinary Inspection Committee
Wang Zhongying	Vice CEO	CCP Committee member
Liu Xiang		CCP Committee member
Tang Mingbing		CCP Committee member
Gao Wenping		CCP Committee member
Yuan Wenjun		CCP Committee member
Zhou Sijun		CCP Committee member

ShaGang's political connections with the CCP are demonstrated by the political background and governmental work experience of its top executives¹⁶³. Firstly, the chairman of the board of directors and the secretary of the CCP committee, Mr Lu Jinxiang, was the representative of the local People's Congress in Jiangsu province¹⁶⁴. The independent director, Mrs He Ciqin, was the deputy director and vice CCP committee secretary of Handan Commercial Bureau in Hebei province. The supervisor, Mr Wei Yiliang, worked in the State Planning Commission of China¹⁶⁵. Another supervisor, Mr Zhuang Yingming, was the member of the standing committee of the 7th session of the Chinese People's Political Consultative Conference (CPPCC) in Qingfu District. In addition, the actual controlling person Mr Shen

¹⁶² Executive profile, ShaGang 2011 Annual Report, pp. 9-11; the website of ShaGang, <http://www.shaganggf.com/about/Leader.asp>, <http://www.huaigang.com/News.asp?page=7>.

¹⁶³ Executive profile, ShaGang 2011 Annual Report, pp. 9-11.

¹⁶⁴ Mr Lu is the representative of GangZha District People's Congress. GangZha District is an administrative region in the city of Nantong in Jiangsu province. See http://www.js.xinhuanet.com/2014-01/10/c_118917393.htm.

¹⁶⁵ The State Planning Commission was a department within the State Council, which was responsible for Chinese Central Government's planning for the national economy. It was transformed into the National Development and Reform Commission in March 2003; see <http://zh.wikipedia.org/wiki/中华人民共和国国家计划委员会>.

Wenrong—who is also the chairman of the board and CCP committee secretary of the ShaGang group—served as chairman of the CPPCC in the city of Zhang Jiagang from February 1993 to November 1995 and vice CCP secretary of Zhang Jiagang City’s CCP committee from December 1997 to December 2001. He was also elected as a representative of the 9th, 16th and 17th China’s National People’s Congresses. All of these factors may be relevant to ShaGang’s success in China’s iron and steel industry as a POE.

While ShaGang does have an established CCP structure and organisations, no explicit evidence is apparent regarding the participation of ShaGang’s CCP committee in the company’s major decision-making processes. The CCP Central Committee has stipulated the responsibilities of CCP committees in POEs¹⁶⁶, and CCP committees in POEs only play an advisory and political propaganda role; they do not have any significant or explicit influence over corporate decision-making, at least in theory. For example, on the 1st of July 2013, ShaGang’s CCP committee held a solemn party meeting to celebrate the 92nd anniversary of the founding of the CCP¹⁶⁷. On the 18th of March 2014, the company convened a party meeting to mobilize and educate employees with regard to the practices of the CCP¹⁶⁸.

¹⁶⁶ The General Office of the CCP Central Committee (2012-2011), The Opinion on the Improvement of CCP Establishment and Development in POEs. The responsibilities of POE CCP committees include implementing the instructions and policies of the CCP, uniting employees, maintaining the interests and benefits of all interested parties, helping to establish advanced corporate culture, *etc.*

¹⁶⁷ Company news website,
http://www.huaigang.com/show_new.asp?id=917&newlb=%B9%AB%CB%BE%B6%AF%CC%AC&page=3.

¹⁶⁸ See
http://www.huaigang.com/show_new.asp?id=977&newlb=%B9%AB%CB%BE%B6%AF%CC%AC&page=1.

Chapter 6. Theoretical framework and Hypothesis Development

6.1. Introduction

The primary purpose of this chapter is to develop the theoretical framework of this study based on the theories and findings provided in the literature, as well as the evidence presented in the previous chapters. Chapter 4 reviewed the development process of the corporate governance (CG) system in China and described how a modern CG structure and mechanisms have been adopted and established as a consequence of China's economic and institutional reform and development. Chapter 2 outlined the extant literature on the influence of CG on firm performance, including studies conducted in the Chinese context. On the basis of agency theory, researchers have suggested that CG structure and mechanisms help to mitigate or resolve the conflicts of interest between corporate owners and managers (Fama and Jensen, 1983; Hermalin and Weisbach, 1998; Bhagat and Black, 2000), and between controlling shareholders and minority/outside shareholders (Shleifer and Vishny, 1989; Johnson et al., 2000). This in turn may lower agency costs, which has positive effects on firm performance.

The Chinese CG system is unique due to the conspicuous political control exerted by the Chinese Communist Party (CCP). Chapter 4 discussed the dominant status of the CCP in Chinese society and the significant influence of the CCP at the corporate level. The case studies presented in Chapter 5 demonstrated that the real controlling factor in Chinese firms, especially in Chinese state-owned enterprises (SOEs), is political control by the CCP, and that the fundamental decision-making organ is the corporate CCP committee. On the other hand, it is vital for privately-owned enterprises (POEs) to foster close connections with the CCP or the government in order to survive and develop further (the “wearing a red hat” strategy, Li et al., 2006). Such corporate management systems and features reduce the impacts

of CG mechanisms, and may even render them mere window-dressing in Chinese corporations. Based on these considerations, it is reasonable to expect that while CG structure and mechanisms may affect firm performance to an extent in the Chinese context, CCP control and connections have a stronger influence. Notably, that influence may operate differently in Chinese firms in different industries, of different sizes, and with differing ownership structures (*i.e.* state or private).

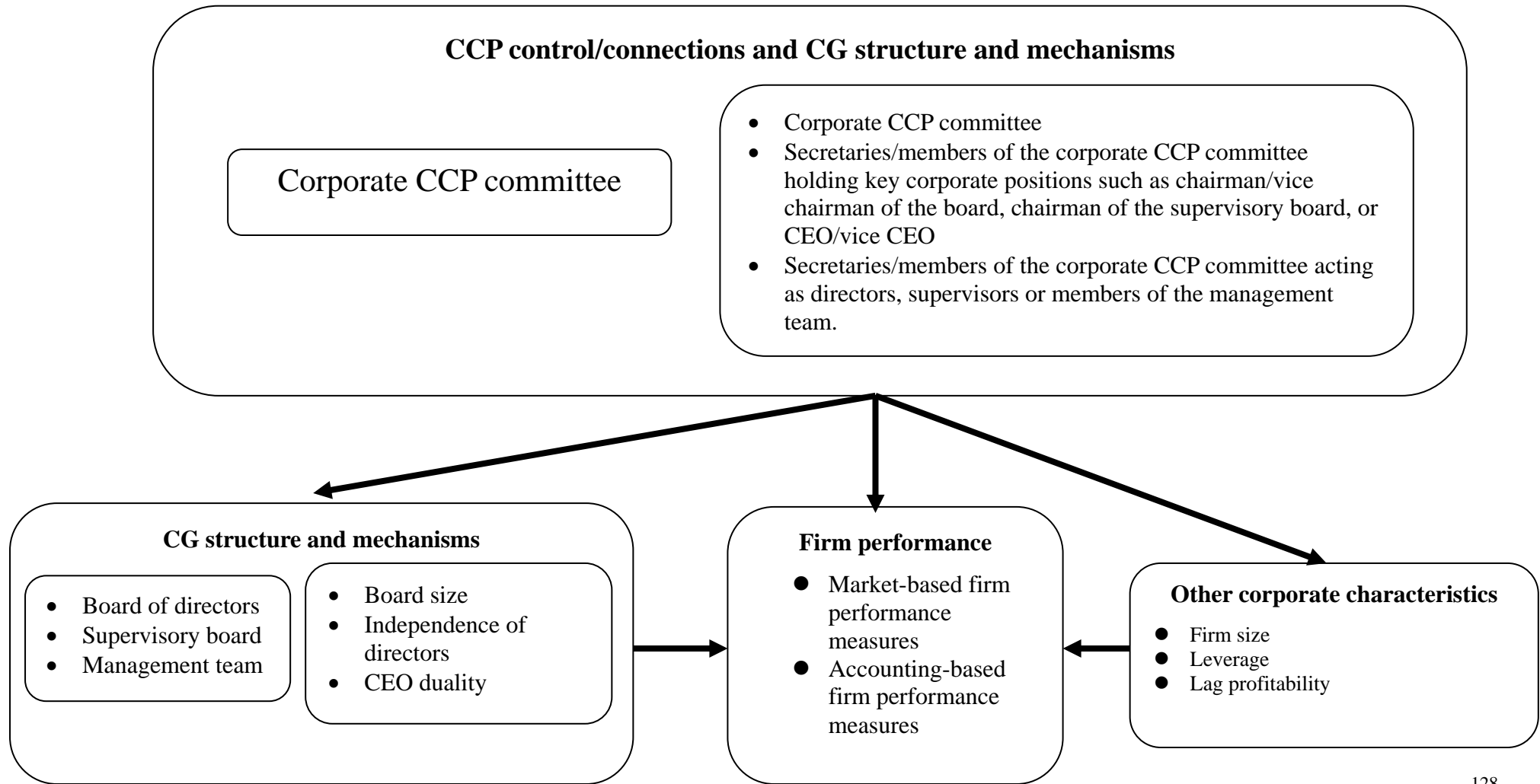
Section 6.2 of this chapter explains the conceptual framework of this study. Section 6.3 develops the hypotheses based on theories relating to the impact of political influences, the empirical findings of prior studies, and the evidence contained in the previously presented investigation of the Chinese institutional background and case studies. Lastly, Section 6.4 presents a summary and conclusions on the important points made in this chapter.

6.2. Theoretical Framework

This section discusses the theoretical framework of this study, based on which the research hypotheses are developed in the following sections of the chapter. A diagrammatic depiction of the theoretical framework and the major variables employed to investigate the research questions of this study is presented in Figure 6.1 below. As the main aim of this study was to investigate the influence of the CCP control/connections and the structure and mechanisms embedded in the CG system on firm performance, the theoretical framework of this study consists of the leading theories pertaining to these issues. These include agency theory, resource dependence theory, stakeholder theory and rent-seeking theory.

Figure 6.1

The research framework of the study of CCP control, CG and firm performance in China



In Figure 6.1 above, the arrow pointing from CG structure and mechanisms to firm performance indicates the influence of CG on firm performance, which is mainly supported and explained by agency theory, which dominates the CG research literature. At the core of agency theory there are two types of conflicts of interest, those between shareholders (the principal) and managers (the agent), and those between controlling shareholders and minority shareholders. The first type of agency problem mainly results from the separation of ownership and control in companies with a dispersed ownership structure (Jensen and Meckling, 1978; Fama and Jensen, 1983). In this situation, when managers do not directly bear the wealth effects of their decisions, they are likely to engage in opportunistic behaviours. This means that they will not always make decisions in the best interests of shareholders, rather they may make decisions designed to enhance their own personal wealth (Fama and Jensen, 1983). Such opportunistic managerial behaviours will incur co-called “agency costs”, and have negative impacts on firm performance.

Agency theory suggests that a sound CG structure and a series of advanced CG mechanisms should be established and implemented in order to mitigate or resolve these two types of agency problems (Jensen and Meckling, 1978; Fama and Jensen, 1983; Shleifer and Vishny, 1986; Johnson et al., 2000). The main theoretical postulate is that a CG structure and mechanisms can work as powerful and effective devices to monitor and limit managers’ opportunistic behaviours and control the effects of expropriation by majority shareholders on minority shareholders. This in turn would have positive impacts on firm performance. The influence of CG structure and mechanisms on firm performance is a field that has been increasingly investigated by researchers in recent years.

Resource dependence theory is derived from the work of Emerson (1962), which was further developed by Pfeffer and Salancik (1978) (Davis and Cobb, 2009). Emerson (1962) suggested that party A’s power over party B stems from the control of resources that B gives prominence to. According to Pfeffer and Salancik (1978), the importance of certain resources to corporations, the discretion over the allocation and use of such resources, and the concentration of control over such resources collectively result in corporations’ dependence on the resource providers. In this

regard, control, power and the provision of resources are directly linked. As capital resources are crucial to the survival, development and success of modern corporations, the resource dependence theory implies that these corporations are dependent on the resource providers, and the resource providers in turn have power over the corporations. Under the stakeholder theory, an organisation is viewed as a social entity that is responsible to a broad range of stakeholders (Freeman and Reed, 1983; Friedman and Miles, 2006). Stakeholders are defined by Freeman et al. (2004)¹⁶⁹ as “those groups who are vital to the survival and success of the corporation”. According to Friedman and Miles (2006), stakeholders generally include shareholders, customers, employees, creditors, and other interest groups. Notably, Friedman and Miles (2006) also regards government and regulators as major stakeholders. As shown in Table 6.1 below, Chinese SOEs are characterised by highly concentrated governmental shareholding ownership.

Rent-seeking theory is another theory that is frequently utilised by researchers in the field of political connection. According to Krueger (1974), under the circumstance of governmental restrictions on business and economic activities, corporations are likely to compete for resources (“rents”)¹⁷⁰ such as economic benefits, financial resources and certain licenses for business operations. Rent-seeking behaviours by corporations could take either the form of legal market competition or the illegal forms of bribery and corruption. From this perspective, political connections with the government or relevant officials are therefore a very powerful device that the industrial corporations endeavour to secure in order to attain an advantageous position in the competition for the resources or rents (Li et al., 2008). This theory has been utilised by researchers investigating the positive impact of political connections—especially in enterprises in the private sector—on firm performance (Tian, 2001; Ang and Ding, 2006; Niessen and Ruenzi, 2009; Dombrovsky, 2011; Hu and Leung, 2012).

Notably, rent-seeking theory does not work in a unitary manner. In addition to rent-seeking behaviours by industrial enterprises, the theory also suggests that

¹⁶⁹ RE Freeman is regarded as the “father of the stakeholder concept”, according to Fontaine et al. (2006).

¹⁷⁰ Krueger (1974) uses the import license as an example of “rent” in this context.

politicians are likely to get involved in corporate operations and decision-making processes to achieve political objectives or personal benefits rather than maximizing firm values (Shleifer and Vishny, 1998; Sutter et al., 1999; Rosa and Pe´rard, 2010). In this regard, the rent-seeking theory may explain the negative association between political influence and firm performance reported in prior studies, especially those conducted in developing markets where there is a lack of a sound legal system and strong protection for market investors (Alchian, 1965; Kumar, 2004; Patibandla, 2006).

Figure 6.1 above also includes an arrow between firm characteristics and firm performance. As is suggested by prior studies, firm characteristics generally have significant impacts on firm performance (Baumol, 1967; Jensen, 1986; Chang and Wong, 2004; Wong et al., 2004; Niresh and Velnampy, 2014). Last but not least, the arrow between CCP control/connections and firm performance signifies the influence of the CCP on firm performance, which is discussed in the next section.

6.3. Hypothesis Development

The development of appropriate hypotheses is of essential importance when constructing regression models to investigate the research question concerning the influence of political control by and connections with the CCP on firm performance in China. In this section, three hypotheses will be developed based on the theories that comprise this study’s conceptual framework (which have been presented in the former section), the explicit and strong evidence generated in the review of institutional backgrounds and the case studies, as well as the empirical findings provided in the extant literature. These hypotheses are constructed in accordance with the Chinese CG structure, which consists of a board of directors, a supervisory board and a team of executive managers, and they are designed to cover the main Chinese CG mechanisms. Section 6.3.1 below demonstrates that CCP influence is the real decision-making factor at the corporate level in China by applying the theories, evidence and findings discussed above. The hypotheses on the impact of CCP control/connections on firm performance in different groups of Chinese enterprises are established in Section

6.3.2.

6.3.1. The Chinese Communist Party's Significant Influence in China and at the Corporate Level

6.3.1.1. Application of the Theoretical Framework in the Chinese Context

Agency theory suggests a positive association between CG and firm performance. A modern CG structure and mechanisms have been adopted in China, as is indicated by three major benchmarks: the enactment of China's Company Law, the establishment of China's domestic stock market and the establishment of a stock market regulator, namely the Chinese Securities Regulatory Commission (CSRC). However, the Chinese CG system is unique in comparison with other developed markets because it has the distinctive characteristic of the substantial political influence of the CCP. The issue of political factors in corporations is the focus of the three theories that constitute the conceptual framework of this study: resource dependency theory, stakeholder theory, and rent-seeking theory.

Resource dependency theory and stakeholder theory indicate that when the government or a political party acts as the main provider of resources that are vital to the survival and development of corporations, they qualify as major stakeholders who possess significant power over corporate decision-making and operations. In the Chinese context, all essential resources are controlled by the CCP, such as natural resources (coal, oil, water and electricity) that are exploited and distributed by state-owned factories or organisations, capital resources (loans provided by state-owned banks, and the domestic stock market is also supervised by the CSRC of the State Council), and any licences for business operations that are administrated and issued by governmental departments.

Ownership structure is highly concentrated in China (Ma and Tian, 2009; Ma et al., 2010), as is illustrated in the Table 6.1 below. In Chinese SOEs, the CCP is the largest shareholder that provides capital resources. The average controlling

ownership in the top SOEs is 54.75% and the highest percentage is 86.51%. Small and medium SOEs also have a highly concentrated ownership structure. Therefore, according to these two theories, the CCP should be considered a major stakeholder in SOEs, with significant power.

Table 6.1 Statistics on controlling ownership (%) in China from 2009 to 2011¹⁷¹

	Top SOEs	Top POEs	Small SOEs
Mean	54.75	43.44	40.22
Median	54.27	41.86	40.57
Maximum	86.51	89.41	93.61
Minimum	14.92	11.39	10.12

These two theories, together with rent-seeking theory, also provide theoretical support for the significance of CCP connections in Chinese POEs. As China's national economy is dominated by the public sector or the state-owned economy, it could be argued that the survival and development of enterprises in the private sector is difficult (Young, 1989; Li et al., 2006). Therefore, Chinese POEs adopt the “wearing a red hat” strategy (Li et al., 2006) to obtain connections with the CCP in order to compete for “rents”, which in this context includes acquiring advantageous governmental and regulatory conditions, and easier access to capital resources (Li et al., 2008; Du and Girma, 2010). As such rents in the Chinese context are controlled and regulated by the government and the CCP, it is valuable and expedient for Chinese POEs to “wear a red hat” in their quest for rents. In this respect, Chinese POEs rely on resources controlled and provided by the Chinese government or the CCP, which renders them major stakeholders in POEs.

6.3.1.2. Evidence from the Institutional Background

Since its founding in 1949, China has had the undeniable and most

¹⁷¹ This table contains data extracted from the ThomsonOne database. The sample firms include the top SOEs, top POEs, and small SOEs listed on either the Shanghai Stock Exchange or the Shenzhen Stock Exchange. The selection of this sample will be discussed in detail in Chapter 7, in the Research Methodology section.

conspicuous attribute of the CCP's ruling and sovereign status, and almost every field of Chinese society is governed by the CCP. This is primarily demonstrated by the CCP's domination in the Chinese political system. The political system in China consists of four major components: the National People's Congress (NPC), the Chinese People's Political Consultative Conference (CPPCC), the State Council, and the People's Liberation Army (PLA). It could be argued that these political organisations have relevant authority on paper only, while in fact the real decision-making authority is the CCP. For example, the Constitution of the People's Republic of China (PRC) states that the NPC is the supreme organ of the state's power, where state affairs are discussed and where decisions are arrived at collectively by all representatives. However, this process is tightly monitored and controlled by the CCP. This is clearly illustrated by the fact that the paramount policy-making organ is actually the Central CCP committee, which could be viewed as having a similar status to cabinets in developed countries. The highest ranked officials in the Central CCP Committee occupy all the key positions in the four organisations that comprise the Chinese political system. The first ranked official, who takes the role of the General Secretary of the CCP, will always serve as the President of the PRC and the General Chairman of the Central Military Commission. The second ranked official is always the Prime Minister of the State Council. The third ranked official serves as the Chairman of the NPC Standing Committee, and the fourth ranked official acts as the Chairman of the CPPCC. This pattern of CCP dominance is common knowledge in Chinese society, as the CCP is always positioned ahead of the government when state affairs are discussed or reported in the media.

According to David Zweig¹⁷², this pattern of CCP dominance exists at every level of administration, and in organisations from the ministerial or state level down to the village level. CCP committees maintain exclusive control at all levels of the hierarchy within China's political and administrative system. This means that the CCP committee supervises and monitors the government at every level, and dominates local decisions. Further, the CCP has a strict and rigid hierarchical system whereby a

¹⁷² David Zweig, Comparative Politics, SOSC 152, Division of Social Science, The Hong Kong University of Science and Technology.

lower level CCP committee must obey and report to a superior CCP committee¹⁷³ (such as a municipal level CCP committee and a provincial level CCP committee), or alternatively, decisions made by a lower level CCP committee must be approved by a superior CCP committee before they can be passed.

6.3.1.3. Chinese Communist Party Committee at the Corporate Level

The CCP constitution requires any enterprise with more than three CCP members to establish a branch CCP committee¹⁷⁴, and such grass-roots organisations of the CCP at corporate level should function as a political core, guaranteeing and supervising the implementation of the guidelines and policies issued by the CCP and the central government¹⁷⁵.

In SOEs, the ruling status of corporate CCP committees could be considered representative of the general dominance of the CCP in China, and these committees intervene in major decision-making processes in SOEs¹⁷⁶. There is also a binding regulation that the secretary of the corporate CCP committee also serve as the chairman of the board. The Chinese central government¹⁷⁷ requires that key members of corporate CCP committees take part in corporate operations as chairmen of the board of directors, directors, CEOs or vice CEOs. Major decision-making on corporate issues, including the appointment and dismissal of key executives, important corporate operations and reorganisations are always controlled and supervised by the CCP through a corporate CCP committee. Specifically, before a decision is made, the corporate CCP committee is required to hold a meeting to

¹⁷³ The Constitution of the CCP, Chapter 2, The Organisation System of CCP, article 10, No. 1.

¹⁷⁴ The Constitution of the CCP, Chapter 5, article 29.

¹⁷⁵ The Constitution of the CCP, Chapter 5, article 32.

¹⁷⁶ Corporate CCP committees' role as a political core was written into the CCP Constitution in 1987 during the 4th Plenary Session of the 13th Central CCP Committee. Further, the Central CCP Committee and the State Council released the "Notice of Further Strengthening and Improving the Construction of CCP in SOEs", which required operation of CCP committees at the corporate level.

¹⁷⁷ "The Guiding Idea Regarding CCP Committees in SOEs Participating in Major Corporate Decision-Making" issued by the General Office of the Central CCP Committee under the instruction of the Organization Department of the central CCP committee and State-Owned Assets supervision and Administration Commission in June 2013.

discuss the relevant issues and form an opinion or decision. Next, the board and management meetings are held, in which the secretary or vice secretary of the CCP committee expresses the opinions of the CCP committee and communicates with non-CCP committee members on the board and management team. After the board and management meetings, CCP committee members provide feedback to the CCP committee and if there are any discrepancies with the CCP policies and guidelines, they are reported to a higher level CCP committee and adjustments are made accordingly.

In POEs, although the corporate CCP committee conventionally does not exercise direct interference in the decision-making process with regard to corporate operations, the establishment of such a political organ is an important means by which to foster a channel of communication with the CCP and relevant governmental authorities. Importantly, based on these above considerations the terms used hereafter in this study to describe the influence of the CCP in SOEs and POEs are strictly differentiated. Previous studies have tended to obscure the differences between the two patterns of political influence in SOEs and POEs, with many only using one term, “political connection” (See Pan, 2011; Hu and Leung, 2012; Wu et al., 2012). In contrast, in this study, as SOEs are overtly governed and controlled by the CCP the term “CCP control” is employed to depict the CCP’s influence in SOEs; and the term of “CCP connection” (or “connections”) is used to refer to the valuable bonding or affiliations with the CCP—which cannot be described as solid control—in POEs.

6.3.1.4. Further Evidence from the Case Studies

The aforementioned evidence derived from China’s official documents can be clearly and strongly verified by the findings yielded by the previously presented case studies¹⁷⁸, which will be discussed and summarised in this section. The most important decisions in corporations involve the appointment and dismissal of senior executives, as well as significant corporate operations. In Chinese SOEs, these decisions are all firmly controlled by the CCP through corporate CCP committees.

¹⁷⁸ In the case studies, the year 2011 was chosen as the investigation year.

Chinese Communist Party Control in PetroChina Company Limited

Firstly, PetroChina's CG system is largely dominated by its CCP committee. In 2011, PetroChina's CCP committee consisted of eight CCP officials who all took senior executive positions in the company's CG structure. Seven out of thirteen seats on the board of directors were occupied by CCP committee members, and all leading positions were occupied by the company's CCP committee members, including the chairman and vice chairman of the board of directors, the chairman of the supervisory board, the CEO and the vice CEO.

Secondly, the appointment of the chairman of PetroChina's board of directors, Jiang Jiemin, was directly decided by the CCP. Jiang acted as the chairman of the board of directors and the secretary of the CCP committee at the same time in PetroChina. On the 15th of November 2006, this appointment resolution was made and announced by the Central CCP Committee and transmitted to PetroChina's CCP committee. On the 16th of May 2007 this decision was passed at a meeting of PetroChina's board of directors, and on the 16th of May 2008 PetroChina officially announced Jiang's appointment to the public. Although the annual general shareholders' meeting is in theory the highest decision making body in corporations, this appointment resolution did not even appear in the official announcement documentation issued at PetroChina's annual shareholders' meetings during the above process from 2006 to 2008.

Thirdly, decisions on major business operations in PetroChina were also found to be supervised by the CCP, as illustrated by an asset swap transaction between PetroChina and its parent company, China National Petroleum Corporation (CNPC). On the 25th of August 2011, PetroChina sold a loss-making subsidiary, Northeast Engineering Company, to CNPC for RMB 281.27 million. This subsidiary's net loss in 2009 was RMB 228.41 million. On the 27th of October that same year, PetroChina purchased a profit-making company, South Oil Exploration and Development

Company Limited, from CNPC for RMB 1.67 billion. That company's net profit in 2009 was RMB 365.05 million. These two transactions were exempt from independent directors' approval. However, the final appraised values in these transactions were set by the CCP through the State Council, and the transactions required final approval by the State Council before they were conducted.

Similar evidence of this pattern of CCP control in SOEs was apparent in the investigation of a medium SOE, Sichuan ChangHong Electric Company Limited. These findings all contributed to the application of the theoretical framework in the Chinese context.

Chinese Communist Party connections in Jiangsu ShaGang Company Limited

Jiangsu ShaGang's connections with the CCP can be demonstrated in the following ways. First, although the ultimate owner of Jiangsu ShaGang is a domestic legal person, Mr Shen Wenrong, the state possessed 7.54% of the company's shares. Second, Jiangsu ShaGang has a complete CCP structure. The company's CCP committee included eleven CCP officials, and five of them held senior positions within the CG structure, including the chairman of the board of directors, CEO, vice CEO, and two supervisors. Third, the most conspicuous of Jiangsu ShaGang's CCP connections was the personal political backgrounds of the firm's top executives. Mr Shen Wenrong was the controlling person of Jiangsu ShaGang, as he served as the chairman of the board of directors and the secretary of the CCP committee in Jiangsu ShaGang's parent company, the ShaGang Group. He acted as the chairman of the CPPCC in the city of Zhang Jiagang where Jiangsu ShaGang is located, and the vice CCP secretary of the Zhang Jiagang City CCP Committee. He was also elected as the representative of the 9th, 16th and 17th of China's National People's Congresses. Mr Lu Jinxiang, who was the company's chairman of the board and the secretary of the CCP committee was elected as the representative in the Local People's Congress in the province. Mrs He Ciqin, who was an independent director worked as the deputy director and vice CCP committee secretary of the Handan Commercial Bureau in Hebei province. Two supervisors, Mr Wei Yiliang and Mr Zhuang Yingming also have extensive political backgrounds.

The study on Jiangsu ShaGang is an excellent demonstration of the rent-seeking theory in the Chinese context, and of Chinese private entrepreneurs utilising the “wearing a red hat” strategy.

6.3.2. Hypotheses on the Associations Between Chinese Communist Party Influence and Firm Performance

This study suggests that the CCP’s influence is the most significant factor in Chinese corporations, where CCP control is the real functioning determinant in Chinese SOEs, and POEs’ connections with the CCP are their most valuable asset. These contentions are supported by this study’s theoretical framework, the evidence generated in the review of China’s institutional background and the case studies, as well as the empirical findings provided by previous studies. Therefore, it was expected that this study would demonstrate that the CCP’s influence has a significant impact on firm performance in China. In addition, the Company Law of China requires that all Chinese companies establish a board of directors, a supervisory board and a management team, which is also known as the two-tier board system. Thus, the hypotheses of this study are constructed in accordance with this CG structure in China. Specifically, three sets of hypotheses were developed. The first relates to the effects of the CCP’s influence over the board of directors on firm performance. The second set relates to the impact of the CCP’s influence, which is embedded in the supervisory board, on firm performance. The last set of hypotheses concerns the effects of the CCP’s influence within the management team on firm performance.

6.3.2.1. Chinese Communist Party Influence Over the Board of Directors

A corporate board is the central and most important mechanism in the modern CG system, and it mainly performs monitoring and advisory functions (Fama and Jensen, 1983; Hermalin and Weisbach, 1998; Parker, 2000; Raheja; 2005). It was

expected that this study would show that corporate boards function as a principal channel for the CCP to exert political influence. Therefore, the first hypothesis developed was as follows:

H1: The CCP's control over or connections with the **board of directors** is expected to have significant impact on firm performance in China.

Some studies in the literature have measured political influence based on senior corporate executives' personal backgrounds (Ang and Ding, 2006; Faccio, 2006; Niessen and Ruenzi, 2009; Wu et al., 2012; Yang et al., 2014), such as whether the chairman of the board of directors or CEO is a current or former government official. In this current study, a similar form of measurement was utilised. However, as the corporate CCP committee is the main influential factor in Chinese corporations, in this study CCP influence was measured based on whether the positions of the chairman of the board and CEO were occupied by members of the corporate CCP committee. In addition, in order to capture the more general influence of the corporate CCP committee over the board of directors, the CCP's influence was also measured by the percentage of corporate CCP committee members on the board of directors¹⁷⁹. Thus, H1 was subdivided into the following two hypotheses:

H1a: In Chinese firms, if the position of **chairman of the board** is held by a corporate CCP committee member, it is expected to have a **significant** impact on firm performance.

H1b: In Chinese firms, the percentage of corporate **CCP committee members** on the **board of directors** is expected to have **significant** impact on firm performance.

This study suggests that the influence of the CCP may function differently in firms with different types of ownership (SOEs or POEs) and firms of different sizes. Firstly, it was expected that CCP control would have a positive impact on the performance of the top SOEs. It is stated in the Constitution of the CCP that the public

¹⁷⁹ A more detailed account of the construction of variables is provided in the next chapter.

economy is the principal part of China's fundamental economic system, and that it needs to be unswervingly consolidated and developed¹⁸⁰. The Chinese public economy is also stated as the principal and leading force of China's national economy and fundamental economic system in the Constitution of the PRC¹⁸¹. In other words, the public economy, especially the top SOEs, is the backbone of China's national economy. PetroChina Company Limited for example, as one of China's largest SOEs, is often referred to as the "magic cudgel"¹⁸² of China's stock market. The fluctuation or stability of the market performance of top SOEs such as PetroChina Company Limited directly result in undulation or steadiness of China's stock market. Further, as is universally acknowledged, China's national economy has demonstrated the fastest growth of any economy in the world in recent years. Therefore, it is reasonable to expect that the CCP or the Chinese government is likely to retain or even further enhance the performance of the top SOEs with the primary aims of maintaining the development speed of China's national economy, preserving the CCP's reputation and ruling status, and increasing people's confidence in China's economy both domestically and globally. This expectation is substantiated by the asset swap transactions between PetroChina and the CNPC discussed earlier in Section 6.3.1.4. The parent company in these transactions, CNPC, which could be viewed as a direct agency of the State Council or CCP, sold a highly profitable company to its listed subsidiary PetroChina in exchange for a loss-making company. In this way, the performances of top SOEs are likely to be boosted and the state bears the related costs. In addition, Chinese SOEs are likely to enjoy the distinct advantage of easier access to resources, which can have positive impacts on their performance.

From the perspective of Chinese POEs, CCP connections are also expected to have a positive impact on firm performance. According to the theoretical framework, as the Chinese government or the CCP is a major stakeholder that governs vital resources, it is advantageous for firms to foster solid connections with the CCP when competing for "rents". This theoretical argument has been proposed and empirically supported by a great number of studies (Tian, 2001; Ang and Ding, 2006;

¹⁸⁰ CCP Constitution, Chapter of General Principles.

¹⁸¹ Constitution of the PRC, Chapter 1, articles 6 and 7.

¹⁸² The term "magic cudgel" originates from an ancient Chinese myth that refers to a cudgel at the bottom of a vast ocean that keeps the ocean peaceful.

Guiheux, 2006; Li et al., 2008; Niessen and Ruenzi, 2009; Dombrovsky, 2011; Du, 2011; Hu and Leung, 2012).

In contrast to the above two groups of Chinese firms, CCP control in medium SOEs that are engaged in less strategic industries may have a negative impact on firm performance. Fan et al. (2007) and Civilize et al. (2015) suggest that the pattern and influence of political connections differ depending on firm size and industry. In China, it is reasonable to expect that the CCP would invest more in top SOEs that operate in more important industries than it invests in small SOEs. Thus, the influence of CCP control would be different, because the purpose and patterns of investment are different. From this perspective, rent-seeking theory suggests that the negative association between political influence and firm performance may be associated with the politicians involved pursuing political objectives or personal benefits rather than endeavouring to increase corporate value. This contention has been supported in previous studies, by both theoretical arguments and empirical evidence (Alchian, 1965; Shleifer and Vishny, 1998; Sutter et al., 1999; Kumar, 2004; Patibandla, 2006; Rosa and Pe´rard, 2010).

Based on the above considerations, H1a and H1b were further subdivided as follows, and the same logic was applied when constructing hypotheses 2 and 3 regarding the CCP’s influence over the supervisory board and management team, presented in the remainder of this section.

H1a-SOE: In **top SOEs**, if the position of **chairman of the board** is held by a corporate CCP committee member, this is expected to have a significant **positive** impact on firm performance.

H1a-POE: In **top POEs**, if the position of **chairman of the board** is held by a corporate CCP committee member, this is expected to have a significant **positive** impact on firm performance.

H1a-match: In **match SOEs**, if the position of **chairman of the board** is held by a corporate CCP committee member, this is expected to have a significant

negative impact on firm performance.

H1b-SOE: In **top SOEs**, the percentage of **corporate CCP committee members** on the **board of directors** is expected to be **positively** associated with firm performance.

H1b-POE: In **top POEs**, the percentage of **corporate CCP committee members** on the **board of directors** is expected to be **positively** associated with firm performance.

H1b-match: In **match SOEs**, the percentage of **corporate CCP committee members** on the **board of directors** is expected to be **negatively** associated with firm performance.

6.3.2.2. Chinese Communist Party Influence Over the Supervisory Board

The CG system in China is the so-called two-tier board system, which consists of a board of directors and a supervisory board. This system separates the management and supervision of a corporation, whereby supervisors mainly play a supervisory, consultative and monitoring role, but do not have direct executive power over corporate affairs (Bremert and Schulten, 2008). However, previous studies suggest that the major function of a supervisory board largely overlaps with the roles of the audit committee and independent directors, and it has limited influence as supervisors do not have the power to dismiss directors or managers (Xu and Wang, 1997; Dahya et al., 2003; Li and Hao, 2006; Gao and Song, 2007). In addition, in the Chinese context, some scholars have argued that some CG mechanisms, such as the supervisory board, tend to amount to a mere formality that only exists on paper (Lin, 2004; Zhang, 2009).

In terms of empirical findings, most previous studies in the literature have reported insignificant associations between supervisory boards and firm performance

(Rose, 2005; Jungmann, 2006; Zheng and Wei, 2010). This suggests that while supervisory boards may have broad authority over corporate operations in theory, in reality they may not have a substantial influence on firm performance. Therefore, the CCP's control over and connections with the supervisors is measured based on whether the chairman of the supervisory board is also a corporate CCP committee member, and the percentage of corporate CCP committee members on the supervisory board. Hypothesis 2 is subdivided into alternative hypotheses as follows, incorporating two perspectives.

H2: The CCP's control over and connections with the **supervisory board** is expected to have an **insignificant** influence on firm performance in China.

H2a: In Chinese firms, if the position of **chairman of the supervisory board** is held by a corporate CCP committee member, this is expected to have an **insignificant** impact on firm performance.

H2b: In Chinese firms, the percentage of **corporate CCP committee members** on the **supervisory board** is expected to be **insignificantly** associated with firm performance.

6.3.2.3. Chinese Communist Party Influence Over the Management Team

Bremert and Schulten (2008) suggest that managers, including the CEO, are an important component of the CG system as they are responsible for the practical steering and control of corporate operations and affairs, and all of a firm's important decisions are implemented by managers. Thus, the management team is expected to be another major channel via which the CCP can exert political influence. Furthermore, the political backgrounds of the top executives on the management team, including the CEO, are a commonly employed measure of political influence in the literature (Hu and Leung, 2012; Yang et al., 2014). Therefore, following the same logic and arguments used to construct the above hypotheses, the hypotheses relating to the CCP's influence over the management team in Chinese firms were as follows:

H3: The CCP's control over or connections with the **management team** are expected to have a significant influence on firm performance in China.

H3a: In Chinese firms, if the position of **CEO** is held by a corporate CCP committee member, this is expected to have a **significant** impact on firm performance.

H3a-SOE: In **top SOEs**, if the position of **CEO** is held by a corporate CCP committee member, this is expected to have a significant **positive** impact on firm performance.

H3a-POE: In **top POEs**, if the position of **CEO** is held by a corporate CCP committee member, this is expected to have a significant **positive** impact on firm performance.

H3a-match: In **match SOEs**, if the position of **CEO** is held by a corporate CCP committee member, this is expected to have a significant **negative** impact on firm performance.

H3b: In Chinese firms, the CCP's influence over the **management team** is expected to have a **significant** impact on firm performance.

H3b-SOE: In **top SOEs**, the CCP's control over the **management team** is expected to have a significant **positive** impact on firm performance.

H3b-POE: In **Top POEs**, the CCP's connections with the **management team** are expected to have a significant **positive** impact on firm performance.

H3b-match: In **Match SOEs**, the CCP's control over the **board of directors** is expected to have a significant **negative** impact on firm performance.

6.4. Summary and Conclusions

In conclusion, this chapter presented a series of testable hypotheses based on the theoretical framework of this study, the evidence generated in the review of China's institutional background, and the case studies conducted on three typical Chinese companies, as well as empirical findings provided in the literature. The political influence of the CCP on firm performance in China is predicted by these hypotheses. As the Chinese CG system comprises a board of directors, a supervisory board and a management team, the above hypotheses are organised into three separate groups in order to comprehensively determine the specific CCP influences over each of these CG system components. Hypothesis 1 relates to the impacts of the CCP's influence over the board of directors on firm performance. Hypothesis 2 relates to the impacts of the CCP's influence over the supervisory board on firm performance. Hypothesis 3 relates to the impacts of the CCP's influence over the management team on firm performance.

In addition, this study argues that the influence of the CCP operates differently in Chinese companies with different ownership types (*i.e.* private or state-owned) and companies of different sizes. Thus, the three sets of hypotheses above are further subdivided accordingly. In summary, the CCP's control in top SOEs was expected to have a positive impact on firm performance, the influence of CCP connections in top POEs was predicted to be positive, and in smaller SOEs engaged in less strategic industries, the CCP's control was expected to have negative effect on firm performance. The hypotheses are summarised in the table below.

Table 6.2 List of Research Hypotheses

H1	The CCP's control over or connections with the board of directors is expected to have significant impact on firm performance in China.
H1a	In Chinese firms, if the position of chairman of the board is held by a corporate CCP committee member, it is expected to have a significant impact on firm performance.
H1a-SOE	In top SOEs , if the position of chairman of the board is held by a corporate CCP committee member, this is expected to have a significant positive impact on firm performance.
H1a-POE	In top POEs , if the position of chairman of the board is held by a corporate CCP committee member, this is expected to have a significant positive impact on firm performance.
H1a-match	In match SOEs , if the position of chairman of the board is held by a corporate CCP committee member, this is expected to have a significant negative impact on firm performance.

H1b	In Chinese firms, the percentage of corporate CCP committee members on the board of directors is expected to have significant impact on firm performance.
H1b-SOE	In top SOEs , the percentage of corporate CCP committee members on the board of directors is expected to be positively associated with firm performance.
H1b-POE	In top POEs , the percentage of corporate CCP committee members on the board of directors is expected to be positively associated with firm performance.
H1b-match	In match SOEs , the percentage of corporate CCP committee members on the board of directors is expected to be negatively associated with firm performance.
H2	The CCP's control over and connections with the supervisory board is expected to have an insignificant influence on firm performance in China.
H2a	In Chinese firms, if the position of chairman of the supervisory board is held by a corporate CCP committee member, this is expected to have an insignificant impact on firm performance.
H2b	In Chinese firms, the percentage of corporate CCP committee members on the supervisory board is expected to be insignificantly associated with firm performance.
H3	The CCP's control over or connections with the management team are expected to have a significant influence on firm performance in China.
H3a	In Chinese firms, if the position of CEO is held by a corporate CCP committee member, this is expected to have a significant impact on firm performance.
H3a-SOE	In top SOEs , if the position of CEO is held by a corporate CCP committee member, this is expected to have a significant positive impact on firm performance.
H3a-POE	In top POEs , if the position of CEO is held by a corporate CCP committee member, this is expected to have a significant positive impact on firm performance.
H3a-match	In match SOEs , if the position of CEO is held by a corporate CCP committee member, this is expected to have a significant negative impact on firm performance.
H3b	In Chinese firms, the CCP's influence over the management team is expected to have a significant impact on firm performance.
H3b-SOE	In top SOEs , the CCP's control over the management team is expected to have a significant positive impact on firm performance.
H3b-POE	In Top POEs , the CCP's connections with the management team are expected to have a significant positive impact on firm performance.
H3b-match	In Match SOEs , the CCP's control over the board of directors is expected to have a significant negative impact on firm performance.

The next chapter contains a detailed description and discussion of the research methods and the variables employed to test the hypotheses stated above.

Chapter 7. Research Methodology

7.1. Introduction

This chapter presents the research methods employed in this study to test the hypotheses presented in the previous chapter. Section 7.2 contains the justification of the research methods, including the nature of the research approach and data used in this study. Section 7.3 presents the sources, procedure and methods of sample selection and data collection used. Section 7.4 describes the definition and measurement of the variables that were used to explore the research questions. Section 7.5 outlines in detail the analysis design and statistical tests used to generate the empirical results. Lastly, Section 7.6 presents the summary and conclusion.

7.2. Justification of the Research Methodology

In order to examine the research questions of this study in an objective manner, archival data extracted from the firms' annual reports, corporate websites and official documents were initially utilised, in conjunction with a quantitative research method. The archival research method serves as the prevailing or dominant methodology in the accounting research area, and it mainly refers to the use of secondary data sources, where the data included in an archived repository are analysed (Hageman, 2015). The 'Archival' data used in this study was numerical. Specifically, the data and information contained in the aforementioned sources were extracted in a quantitative form, and then they are quantified into numerical values (Rubin and Babbie, 1993). The archival data were ultimately analysed using quantitative research methods in a systematic empirical manner, which employed mathematical models, theories and hypotheses regarding the research question or topic investigated, in order to obtain objectively derived results and conclusions (Stemler, 2001).

The influences of the political control exerted by the Chinese Communist Party (CCP) and the Chinese government on the performance of the Chinese listed

firms were examined, while taking into consideration the impacts of other corporate factors, including corporate governance (CG) structure and mechanisms, and firm characteristics. The main empirical analysis incorporated two sets of models. The first set was tested to analyse the research question based on the whole sample of firms, by investigating the influence of each measure of CCP control individually. Secondly, the association between CCP control and firm performance was explored in each of the three groups of firms: the top state-owned enterprises (SOEs), top privately-owned enterprises (POEs) and a “matched” group of SOEs that were of a similar size and engaged in the same industries as the top POEs. This research design, consisting of the measures of CCP control, sample selection and research plan are explained in greater detail in the following sections.

Some studies have investigated the influence of political control or connections on firm performance using other research instruments, such as surveys (Chang and Wong, 2004). Although this research method may allow researchers to obtain information pertaining to the degree of political control or connection, it inevitably suffers from several major limitations. Firstly, in the process of selecting participants for surveys, bias can be introduced¹⁸³. Secondly, there is often a low response rate¹⁸⁴, and it is not feasible for researchers to investigate the reasons this. Thirdly, as the survey data are extracted based on survey participants’ personal perceptions, the corresponding measures of political control or connection are subjective. All these limitations are likely to introduce bias into the research analysis process and results, thus the archival method is mainly used by researchers (Hageman, 2008), especially the studies reviewed in this research. This study adopted a quantitative research method using archival data because it would generate more reliable data (the data extracted from annual reports are available from databases so this method would not suffer from bias or low response rate), and corporate websites and official documents provide the information that could be used to construct more objective and reliable measures of the structure and mechanisms of political control or

¹⁸³ For example, Chang and Wong (2004) measured political control by the CCP using a questionnaire to investigate the degree of CCP interference in the corporate decision-making process. They chose secretaries of the board of directors as participants rather than the real decision-making executives at corporate level, such as the chairman of board or CEO.

¹⁸⁴ The conventional wisdom regarding the survey methodology states that higher response rates are associated with higher accuracy of results, and the quality of survey-derived data is normally evaluated by response rates (Backstrom and Hursh, 1963; Rea and Parker, 1997; Biemer and Lyberg, 2003).

connections at corporate level.

In addition, panel data analysis was adopted to address the research question of this study. As the panel data were cross-sectional and had multiple time dimensions, a greater number of observations could be generated, which substantially enhanced the amount, quality and informativeness of the data (Hsiao, 2003), and in turn improved the objectivity and reliability of the results obtained.

In addition to the quantitative research method utilising archival data justified above, case studies were also utilised in this research. Case studies were conducted on three Chinese listed firms, a top SOE, a top POE and a medium SOE that was of similar size and was from the same industry as the top POE included as one of the case studies. The primary objective of employing this additional research method was to provide explicit and complementary evidence on the decision-making process in the Chinese listed firms, and to develop hypotheses. In this way, a combination of both quantitative and qualitative research methods was utilised, which improved the research investigation by balancing the possible limitations of one research method by also using another (Carvalho and White, 1997).

7.3. Sample Selection and Data Collection

7.3.1. Sample Selection and Sampling Justification, Criteria and Procedure

The process of this study's sample selection began with the "Top 500 Chinese Enterprises" list issued by the China Enterprise Confederation (CEC)¹⁸⁵ in

¹⁸⁵ The CEC was founded in 1979 under the approval by the Chinese State Council. It was established and has developed in the course of China's economic "reform and open" process. The major roles of the CEC include promoting China's economic reform and development, providing the Chinese enterprises and economic administration departments with training, professional consultation, information and research findings, enhancing the management of Chinese enterprises, and facilitating communication between the government and enterprises. The "Top 500 Chinese Enterprises" list is issued annually by the CEC and the firms are selected according to their annual sales revenue. This list represents an authoritative ranking of Chinese domestic companies. (see <http://www.cec-ceda.org.cn/english/>).

2011. The firms were selected according to their annual sales revenue. This list was chosen because it represents an official and authoritative ranking of domestic firms in China. The sample used in this study consisted of 150 Chinese listed firms that were selected in descending order for the period from 2009 to 2011.

First, by starting from the CEC list, the large Chinese listed firms which included the top Chinese SOEs and POEs were selected. This was likely to facilitate the investigation of the influence of political control exerted by the CCP and the Chinese government. According to Roe (2003), large firms—as indicated by firm size based on any one of three factors, total assets, market capitalisation or total annual sales revenue—are more likely to be subject to such political influence.

Second, the sample of 150 Chinese listed firms was divided into three sub-samples: the first group consists of the top 50 SOEs, the top 50 POEs formed the second group, and third group comprises another 50 SOEs that were matched to the top 50 POEs in that they were of similar size and from the same industries. Some studies in the literature have adopted a similar strategy when constructing their samples (Wu et al., 2012). In the Chinese context, based on the review of China's institutional background, it was shown that the top SOEs served as the foundation of the national economy, they were engaged in more strategic industries and contributed more significantly to China's national economy than the other two groups. For example, in 2007 the contribution of the Chinese industrial SOEs in terms of their industrial added value (IAV) accounted for more than 15% of China's annual GDP. As a result, the CCP or the Chinese government may impose tighter political control or influence over the top SOEs, with the ultimate purpose of achieving dominance over the development and growth of China's national economy.

From the perspective of the private sector of the economy, some studies (Guiheux, 2006; Li et al., 2006) have proposed the well-supported argument that it is vital for private firms to develop connections with governmental authorities in order to obtain favourable governmental treatment in the form of easier access to various business resources, advantages with regard to market competition, and ultimately to survive and develop. Therefore, the CCP's control over or connections with these two

sub-samples of Chinese top enterprises is expected to be strong, and evident to a large extent. The analysis of these two sub-samples may expedite the research on political control and connections in the Chinese context.

The third sub-sample consisted of medium SOEs that were selected to match the top POEs in terms of firm sizes and industries. The principal research purpose of this sample was to enable further comparison of the impacts of political control between SOEs and POEs. It was hoped that this would generate direct evidence on the different patterns of political influence in firms with different ownership structures.

In addition to the CEC enterprise list, other sample selection criteria included the following. As one of the major aims of this study was to directly measure CCP control or connections at the firm level based on the corporate CCP committee, rather than senior corporate executives' personal political backgrounds, only those firms for which the required information on their CCP committee was available were included. Next, only the firms on the CEC list that were also publically listed on the Shanghai or Shenzhen stock exchanges were selected. This restriction facilitated the collection of the required financial data, as such data is generally attainable from various databases. In addition, financial companies or institutions were excluded if they had special firm characteristics or were subject to substantial differences in their information disclosure requirements, as is a common practice in the financial research area.

The process of gathering information on corporate CCP committees for each year of the sample period, including who acted as the CCP committee secretaries or vice secretaries, whether these political positions were concurrently held by any corporate executives (chairman of the board, CEO), all members of the CCP committee and their corporate executive positions, proved to be excessively detailed, meticulous and formidable. This is mainly because the disclosure of such information is not mandatory, and thus it was not systematically available from uniform sources. Such data had to be sourced from annual reports, company websites, official/government documents, or even in news. This major obstacle of information

availability in the data collection process limited the size of the research sample to a large extent. Each sub-sample comprised 50 Chinese listed firms, resulting in a total number of 150 firms in the final sample.

Another important aspect of the sample is the sample period, which was from 2009 to 2011 in this study. This period was chosen as it could be argued that it was relatively stable and up to date with regard to China's economy and politics. The years of 2007 and 2008 were excluded mainly because of the well-known influence of the Global Financial Crisis (GFC). The 2008 GFC¹⁸⁶ originated in the US and had a substantially adverse impact on economies around the world, including China. The GFC forced major developed countries to decrease consumption and demand for Chinese imports, which in turn caused a significant decrease in China's exports and economic growth (Liu, 2009; te Velde et al., 2009; China Digital Times, 2010). This is further evidenced by statistics issued by the National Bureau of Statistics of China (NBSC). China's economic growth rate started to exhibit downtrend in 2007, and dropped significantly in 2008. Park et al. (2010) suggest that the GFC influenced exports and firm performance in the Chinese economy. However, due to prompt and effective reactions and policies by the Chinese government, which mainly involved the 4 trillion RMB stimulus package¹⁸⁷, China's national economy quickly recovered back to a normal level in 2009 (Yu, 2009). Additionally, a further reason for eliminating the period before and including 2007 was the adoption of the International Financial Reporting Standards (IFRS) by China in 2007. Wang and Campbell (2012) argue that the adoption of the IFRS may have had substantial effects on firm performance. Therefore, based on these aforementioned considerations, it was thought that a sample period from 2009 to 2011 would yield clear and broadly representative findings on the associations between political influence and firm performance, without being subject to interference by other factors. In conclusion, the sample of 150 Chinese listed firms for the fiscal years from 2009 to 2011 generated a panel data of 450 firm year observations.

¹⁸⁶ According to Lahart (2007), the 2008 GFC originated in the US around 2005 and 2006, due to a related event known as the subprime mortgage crisis.

¹⁸⁷ This 4 trillion RMB stimulus package was officially announced by the then Prime Minister of China Wen Jiabao at a meeting of the State Council on the 5th of November 2008. It was launched by the Chinese government to combat the influence of the GFC on China's economy, and the money was invested in thousands of projects, such as infrastructure construction, social projects and people's livelihood programs (<http://finance.people.com.cn/GB/1037/8306806.html>).

7.3.2. Data Collection Sources and Methods

As stated previously, archival data extracted from secondary sources were utilised in this study. The primary data on the political control by or connections with the CCP or Chinese government in the Chinese SOEs and POEs selected in this study were manually collected from the firms' annual reports, company websites or any relevant official corporate or governmental documents that were attainable. This information was used to construct the variables described in the following section. Other financial data, such as firm performance measures, industry group variables and firm characteristics variables were harvested from the OSIRIS and ThomsonONE databases. Extreme percentiles (at both the 1st and 99th) of the distribution for all data were winsorized.

7.4. Description and Measurement of Variables

A discussion on the definition and measurement of all the main variables, including the dependent variables of firm performance, the principal test independent variables of CCP control and connections in the Chinese listed firms, control variables of CG and firm characteristics, is contained in this section. The development of CCP control and connections variables is one of the major contributions of this study. The important set of control variables, the CG variables, include the size of the board of directors, the size of the supervisory board, the independence of board directors and supervisors, and CEO duality, which are commonly employed in the literature.

7.4.1. Dependent Variable—Firm Performance

Firm performance was utilised as the dependent variable in this study, and it has been commonly employed in prior accounting studies in the area of political control or connections, as well as CG (Alchian, 1965; Chhibber and Majumdar, 1998; Tian, 2001; Faccio, 2006; Hu et al., 2012). Hoopes et al. (2003) suggest that firm performance serves as a reliable indicator in the field of organisational studies. Further,

firm performance in this study was measured by both accounting based and market based metrics. The purpose of such a strategy was to provide a more comprehensive and prudent investigation on the impact of contributing factors, such as the effects of political control, political connections and CG mechanisms on firm performance. In investigating the associations between political influence or CG mechanisms and firm performance, studies that utilise different performance measures may draw mixed conclusions (Niessen and Ruenzi, 2009; Le and Chizema, 2011). This implies that a contributing factor could have certain effects on accounting performance but that the market may react differently to it, and adopting both accounting and market based firm performance measures is a common research strategy in the literature (Tian, 2001; Filatotchev et al., 2007; Bremert and Schulten, 2008).

In this current study, the ratio of Return on Assets (ROA) was employed as a proxy for accounting based firm performance. According to Carlon et al. (2012)¹⁸⁸, ROA ratio “measures the overall profitability of assets in terms of the rate earned on each dollar invested in assets.” It is calculated as the percentage of net income at the end of the fiscal year over closing total assets. This ratio is a well utilised accounting based firm performance measure in the literature (Eisenberg et al., 1998; Cho and Kim, 2007; Hu and Leung, 2012). On the other hand, market based firm performance is represented by the Tobin’s Q ratio. Brainard and Tobin (1968) suggested that this ratio compares a physical asset’s market value, which is the current market price for exchanging the asset, with its replacement value, which represents the market price for the newly produced asset¹⁸⁹. Some calculation methods have been provided in the literature, and they all use the market value of equity and liabilities as the numerator and the book value of total assets as the denominator. Chung and Pruitt (1994) developed a formula for the calculation of Tobin’s Q ratio, which is presented as follows:

¹⁸⁸ Carlon et al., (2012). *Accounting: building business skills*. Milton OLD, Australia: John Wiley & Sons. Chapter 12, p. 713.

¹⁸⁹ In other words, Tobin’s Q ratio compares the market value with the book value of a company’s equity and liabilities (or “total assets”). It is often used as an indicator of a company’s growth or investment opportunities and the market expectation for this company (Chappell and Cheng, 1982; Adam and Goyal, 2000). Specifically, when the ratio is 1.0, the book value of a company’s total assets is perfectly reflected by the market value; a high Tobin’s Q ratio (> 1) generally indicates higher market expectation and investment opportunity, and vice versa.

$$\text{Tobin's } Q = \frac{\text{MVCS} + \text{BVPS} + \text{BVLTD} + \text{BVINV} + \text{BVCL} - \text{BVCA}}{\text{BVTA}}$$

In this formula, MV stands for market value and BV for book value. CS represents the common shares component of equity, PS is the preferred shares, LTD is the long-term debts, INV symbolises inventories, CL and CA represent current liabilities and current assets, and TA is the total assets. In this Chung and Pruitt (1994) formula, one component of the numerator is the book value of preferred shares, which did not exist until 2013¹⁹⁰. As the year 2013 is beyond the research period of this study (2009 to 2011), the BVPS component of the numerator was excluded and the above formula was amended as follows:

$$\text{Tobin's } Q = \frac{\text{MVCS} + \text{BVLTD} + \text{BVINV} + \text{BVCL} - \text{BVCA}}{\text{BVTA}}$$

Bai et al. (2004) provided same suggestions on the application of the Tobin's Q formula in the Chinese context, and other studies in the literature (Ang and Ding, 2006; Najid and Rahman, 2011) have employed very similar methods to Tobin's Q calculation. The main aim of the above formula is to divide the sum of the market value of the common shares and the book value of most liabilities net of the current assets by the book value of total assets. Dahya et al. (2008) utilised a similar calculation method containing less variables in the formula, which was the method adopted by this current study, and it is presented as below.

$$\text{Tobin's } Q = \frac{\text{BVTA} - \text{BVE} + \text{MVE}}{\text{BVTA}}$$

In the numerator of the above formula, BVTA (book value of total assets) minus BVE (book value of equity) generates the book value of total liabilities. Thus, the numerator component of this formula still represents the market value of a company's total assets, which conforms with the original aim of Brainard and Tobin's

¹⁹⁰ Preferred shares were started in China through experiments that were initiated and instructed by the Chinese State Council on 30th November 2013.
http://www.gov.cn/zwgk/2013-11/30/content_2539046.htm

(1968) in constructing the Tobin's Q ratio. Furthermore, this Dahya et al. (2008) approach, which was ultimately adopted in the current study, is more straightforward to apply.

7.4.2. Independent Variable-Proxy for CCP Influence in the Chinese Firms

One of the most important contributions of this study is the measurement of political control by the CCP in Chinese SOEs, and the measurement of Chinese POEs' political connections with the CCP. In this sub-section, the construction of the key test independent variables regarding CCP control and connections in Chinese corporations is stated in detail.

The impact of political control and connections on firm performance is a well investigated area, and previous studies have suggested different measures of political control and connections at the corporate level. Some studies have utilised governmental or state ownership, and these studies are mainly derived from the resource dependency theory and stakeholder theory. They suggest that control or power over corporate decision making and the provision of the resources that are vital to the survival and development of the firm are inherently linked (Pfeffer and Salancik, 1978; Chhibber and Majumdar, 1998; Tian, 2001; Kocenda and Svejnar, 2002; Najid and Rahman, 2011).

Many studies have measured the control or connections based on the personal political backgrounds or past governmental work experience of senior corporate executives. These studies may arise from rent-seeking theory, where politicians seek to be involved in corporate operations in order to achieve political goals or personal welfare (Krueger, 1974), and firms—especially those from the private sector in markets that lack a strong legal system—also strive to attain solid connections with the government or key officials for the primary purpose of acquiring various vital resources (Li et al., 2006). For example, Faccio (2006) measured

political influence at the corporate level based on firms' connections with parliament members, the minister or president of the state, and top senior governmental officials. Li et al. (2008) quantified the political connections in Chinese private firms using the personal political backgrounds or past governmental work experience of the firms' private entrepreneurs.

Some studies have investigated the influence of political factors on firm performance via other variables, such as the bureaucratic or jurisdictional ranking of state-owned company, the industry a company is in, or its market position. Hu and Leung (2012) investigated government control in Chinese listed firms based on a panel of variables including jurisdictional level, which refers to whether a SOE is governed by central, provincial, municipal or county government; a firm's monopolistic position (as the government is more likely to exert more control over a firm with higher market share); a firm's engagement in a more strategic industry; and by the concentration of state ownership within a firm.

Few studies have measured political influence based on governmental intervention in the decision-making process. Chang and Wong (2004)¹⁹¹ shed some light on the involvement of the CCP in decision-making in Chinese listed firms. However, their study utilised a survey instrument to obtain data on CCP control in Chinese firms, which may have introduced bias as personal opinions were involved.

Given the institutional background, social and political environment, and the unique CG structure in China, it could be argued that the above measurement methods only explore the influence of the Chinese government or CCP indirectly. The review of the institutional background in China and the quasi case studies conducted in this study reveal the following facts. Almost every aspect of Chinese society is governed and dominated by the CCP, in almost every field, including the Chinese government, the national economy, the political and social system, and national defence. The control and influence of the CCP are transmitted from the state level to grass-roots level through a political entity known as the CCP committee. According to

¹⁹¹ More details about Chang and Wong (2004) are given in the literature review chapter of this thesis, in the section entitled "Prior Studies on Government Control, Political Connections and Firm Performance in China".

the CCP Constitution, all organisations, including various levels of government, industrial companies, schools, universities, and hospitals, which have more than three CCP members must establish a CCP committee. In most cases, the CCP committee is the real decision-making entity at all levels of Chinese society. For example, the position of State President of China will always be occupied by the General Secretary of the central CCP committee. The position of Prime Minister of the State Council is held by the official who is ranked second in the central CCP committee. The findings yielded in the case studies show that all the key corporate positions are held by members of the corporate CCP committee, and all significant corporate decisions, such as the appointment and dismissal of corporate executives, major business acquisitions and sales, are first made at or transmitted to the corporate CCP committee, and then they are subsequently announced at board meetings and general meetings of the shareholders.

Therefore, it is reasonable to argue that the direct measurement of CCP control or connections in Chinese firms based on the domination and overlap of the corporate CCP committee with the CG structure may help to generate a clearer and more prudent representation of the influence of the CCP on firm performance in China. Accordingly, six variables were constructed as proxy indicators of CCP control and connections in Chinese firms. In addition, as the CG system in China consists of a board of directors, a supervisory board and a management team, these six CCP variables were designed in accordance with the structure of these three components of the Chinese CG system.

The first three CCP variables are dummy variables that were employed to indicate whether the senior corporate executive positions within the CG structure, such as the chairman of the board, CEO, and chairman of the supervisory board were held by corporate CCP committee cadres. Specifically, “DCHA” takes the value of 1 if the chairman of the board is also the secretary or a member of the corporate CCP committee, and 0 otherwise. “DCEO” takes the value of 1 if the CEO on the management team is also the secretary or a member of the corporate CCP committee, and 0 otherwise. “DSC” takes the value of 1 if the chairman of the supervisory board is also the secretary or a member of the corporate CCP committee, and 0 otherwise. In

order to capture the general control, domination and overlap of the corporate CCP committee with the CG structure, another three percentage variables were used. “PD” indicates the percentage of corporate CCP committee members on the board of directors. “PS” indicates the percentage of supervisors who are also members of the corporate CCP committee. “PM” indicates the percentage of corporate CCP committee members on the management team.

7.4.3. Control Variables

In accordance with prior studies, control variables were utilised in the regression equations of this study, and the primary purpose of adopting this research method was to control for the effects of omitted-variable bias on the research results (King et al., 1994). In this section, two sets of control variables, CG structure and firm characteristics, are defined.

7.4.3.1. Corporate Governance Variables¹⁹²

The CG structure in the Chinese context includes the board of directors, a supervisory board and the management team, and these major components of CG have been well studied in the literature. According to Bremert and Schulten (2008), the management and supervision of a corporation are separated in a so-called two-tier board system that includes a board of directors and a supervisory board. Within such a system, managers are responsible for the steering and control of corporate operations, and the supervisors do not generally possess direct executive power but are responsible monitoring, supervision and consultation with members with particular expertise on the executive team. This qualifies the supervisory board as a potentially potent instrument for alleviating conflicts of interest between managers and shareholders, at least in theory.

Within this general CG structure, the effectiveness of several mechanisms

¹⁹² The CG structure and mechanisms are discussed in extensive detail in the literature review chapter of this thesis.

as CG devices has been the subject of intensive research. Board characteristics including the size of the board of directors and the independence of board members are commonly examined CG mechanisms (Lipton and Lorsch, 1992; Jensen, 1993; Cho and Kim, 2007; Iwu-Egwuonwu, 2010; Liu, 2011). The Chinese Company Law requires that at least a third of the board of directors should be independent from the company. Another commonly explored CG mechanism is CEO duality, the situation where the senior corporate positions of the chairman of the board and CEO are held by the same executive (Fama and Jensen, 1983; Rechner and Dalton, 1991; Brickley et al., 1997; Ramdani and Witteloostuijn, 2010).

In accordance with prior studies (Ding et al., 2014), the first set of control variables utilised in this study were constructed based on these aforementioned CG mechanisms and structural components. “BS” was used to represent the size of the board of directors, and “BI” was used to represent the independence of the board of directors. The supervisory board was analysed in terms of board size only, represented by “SS”, and lastly “DUAL” was used to represent CEO duality.

7.4.3.2. Firm Characteristics

The firm characteristics used in the current study were the same as those used by almost every study in the accounting literature in this field, including firm performance, CG, earnings quality, and political influence. In line with prior studies, three control variables with regard to firm characteristics were used in this study, firm size, leverage and previous year’s operating profit. First, the effect of firm size on firm performance could be explained by the concept of scale economies (Shepherd, 1972; Scherer, 1973; Lee 2009). This theory suggests that large firms have the benefits of stronger market competition power and easier access to capital. Conversely, other studies have argued that large firms may suffer from the more serious agency problem of managers’ self-interest-based goals (Niresh and Velnampy, 2014). Some previous studies suggest a significant influence of leverage on firm performance, but there are discrepancies between the empirical findings of these studies as to whether the influence is positive or negative. Jensen (1986) argues that debt financing places pressure on management to strive for better firm performance. However, Myers (1977)

acknowledges the higher agency costs imposed by higher leverage, due to the conflicts of interest between debtholders and shareholders. Finally, lagged performance measures is another often used control variable, and adopting this method attempts to account for the endogeneity problem (causality issue) between the dependent and independent variables (Chang and Wong, 2004; Wong et al., 2004). In addition to these above theoretical arguments, Chang and Wong (2004) suggest that the association between political control and firm performance is affected by these firm characteristics, which constitutes theoretical support for the use of these factors as control variables in this study.

The control variables of these three firm characteristics have previously been used in research on the associations between political influence and firm performance (Chang and Wong, 2004; Li et al., 2008; Ma and Tian, 2009; Pan, 2011; Hu and Leung, 2012). Therefore, three control variables were employed in this study. “SIZE” was used to represent firm size, calculated as the natural logarithm of total assets at year end. Leverage, denoted by LEV, was calculated as the ratio of total debts at year end divided by the closing total assets. PEBIT was used to represent previous year’s operating profit, which is net profit before interest and tax, scaled by previous year’s total assets. The industry dummy variable (“IND”), which was developed based on the 4-digit Global Industry Classification Standard (GICS) code, and the year dummy variable (“YEAR”) that indicates each year within the period from 2009 to 2011 were also included in the main regression equations of this study, in order to identify industry-specific and year-specific effects (Mitton, 2002).

All the variables employed in the main regression equations of this study are presented in Table 7.1 below, together with their abbreviations and definitions.

Table 7.1 Definitions of variables

Variable		Definition
Firm Performance	ROA	Return on Assets (net income/total assets)
	TQ	Tobin's Q (Dahya et al., 2008)
CCP Control/Connections	DCHA	1 if the chairman of the board is a CCP committee member, 0 otherwise
	DCEO	1 if the CEO is a CCP committee member, 0 otherwise
	DSC	1 if the chairman of the supervisory board is a CCP committee member, 0 otherwise
	PD	The percentage of corporate CCP committee members on the board of directors
	PS	The percentage of corporate CCP committee members on the supervisory board
	PM	The percentage of corporate CCP committee members on the management team
CG Structure	BS	Size of the board of directors
	BI	Independence of the directors
	SS	Size of the supervisory board
	DUAL	1 if the positions of chairman of the board and CEO are occupied by the same executive, 0 otherwise
Firm Characteristics	SIZE	Natural logarithm of total assets at year end
	LEV	Leverage calculated as the ratio of total debts at year end divided by the closing total assets
	PEBIT	Previous year's net profit before interest and tax scaled by the previous year's closing total assets
Other	YEAR	Year dummy value
	IND	Industry dummy value based on 4-digit GISC code

7.5. Statistical Analysis

This section presents the plan, research strategies and design of the data analysis used in this study in order to test all the hypotheses developed, and to generate the results on the impact of CCP control and connections in Chinese corporations on firm performance. Section 7.5.1 provides a general account of how the data analysis was designed, what the procedures involved were, and what statistical and econometric methods were used in the regression equations. Section 7.5.2 explains the main regression models that were developed to test the hypotheses.

7.5.1. Data Analysis Plan and Strategy

Before the data analysis of this study was conducted, the data were winsorized in order to exclude the extreme values in the data, which are commonly known as outliers, as they are likely to have a serious influence on the distribution of data (Pallant, 2007). This is a conventional strategy in quantitative research (Hastings, et al., 1947) and it is often adopted financial accounting studies (Bartov et al., 2000; Liu et al., 2015). Specifically, in order to eliminate the impact of outliers and to achieve a normal data distribution, the data were winsorized at the 1st and 99th percentiles.

This study's data analysis began with the descriptive statistics, which refers to the discipline of quantitatively describing the basic or primary features of the data used in a study (Mann, 1995)¹⁹³, or the quantitative description itself. The aim of this step is merely to summarise the data, rather than actually draw inferences or conclusions based on the data. The second step in the data analysis process involved a univariate test conducted on the dependent variable, firm performance, the independent variable of CCP control over and connections with Chinese firms, as well as the control variables relating to CG structure and mechanisms and firm characteristics in Chinese firms. Particularly, the equality tests by classification method was utilised. The aim of conducting this form of data analysis was to generate evidence relating to comparisons of the above variables between the top Chinese SOEs and top POEs, between the top SOEs and the medium SOEs, and between the top POEs and the medium SOEs. For example, the results of this univariate test indicate which Chinese firm group, SOEs or POEs, has the higher performance level, which firm group demonstrates tighter CCP control or stronger CCP connections, and whether the CG structures and firm characteristics of the firm groups differ significantly. Finally and most importantly, the influences of CCP control and connections in Chinese firms on firm performance were investigated using the pooled Ordinary Least Square (OLS) multiple regression method. The regression models and design are discussed in detail in Section 7.5.2 of this chapter.

¹⁹³ PS Mann (1995) *Introductory Statistics* (2nd edition), Wiley.

In addition, the integrated data analysis process included a series of sensitivity tests, such as using alternative measurement methods for the dependent variables, the regression method of clustered standard errors, and a test for endogeneity between the dependent variable, firm performance, and the test independent variables, CCP control and connections. The purpose of the sensitivity tests was to ensure the robustness of the results generated by the main pooled OLS regression analysis.

7.5.2. Empirical Model

This section presents the regression equations used to address the research questions of this study. During this step of the data analysis, a regression model was first developed and run for the whole sample including all three groups of Chinese firms in order to examine the general effects of CCP control and connections on firm performance. The regression model was staged as below:

$$\begin{aligned} FP_{i,t} = & \alpha_0 + \alpha_1 SOE_{i,t} + \alpha_2 POE_{i,t} + \alpha_3 CCP_{i,t} + \alpha_4 BS_{i,t} + \alpha_5 BI_{i,t} + \alpha_6 SS_{i,t} \\ & + \alpha_7 DUAL_{i,t} + \alpha_8 LEV_{i,t} + \alpha_9 SIZE_{i,t} + \alpha_{10} PEBIT_{i,t} + \alpha_{11} IND_{i,t} \\ & + \alpha_{12} YEAR_{i,t} + \varepsilon_{i,t} \end{aligned} \quad (1)$$

Where:

$FP_{i,t}$ is firm performance measured by either ROA or Tobin's Q.

$SOE_{i,t}$ is a dummy variable that takes the value of 1 if a firm-year observation belongs to a top SOE, and 0 otherwise.

$POE_{i,t}$ is a dummy variable that takes the value of 1 if a firm-year observation belongs to a top POE, and 0 otherwise.

$CCP_{i,t}$ is one of the six CCP control/connection variables listed below:

- $DCHA_{i,t}$ is a dummy variable that takes the value of 1 if the position of chairman of the board is held by a corporate CCP committee member, and 0 otherwise.
- $DCEO_{i,t}$ is a dummy variable that takes the value of 1 if the position of CEO is held by a corporate CCP committee member, and 0 otherwise.

- **DSC_{i,t}** is a dummy variable that takes the value of 1 if the position of chairman of the supervisory board is held by a corporate CCP committee member, and 0 otherwise.
- **PD_{i,t}** is a percentage variable calculated by dividing the number of corporate CCP committee members who are also directors on the board by the total number of directors.
- **PS_{i,t}** is a percentage variable calculated by dividing the number of corporate CCP committee members who are also supervisors by the total number of members of the supervisory board.
- **PM_{i,t}** is a percentage variable calculated by determining the number of corporate CCP committee members who are also managers by the total number of managers.

BS_{i,t} is the total number of directors, indicating the size of the board of directors.

BI_{i,t} represents board independence, calculated as the percentage of the total number of directors that are independent directors.

SS_{i,t} is the total number of supervisors, indicating the size of the supervisory board.

DUAL_{i,t} is a dummy variable that takes the value of 1 if the positions of board chairman and CEO are occupied by the same executive, and 0 otherwise.

LEV_{i,t} is the leverage ratio calculated by dividing total debts at year by the closing total assets.

SIZE_{i,t} represents firm size, as indicated by the natural logarithm of total assets at year end.

PEBIT_{i,t} is previous year's net operating profit, the net earnings before interest and tax expenses (EBIT), scaled by previous year's closing total assets.

IND_{i,t} is a dummy variable that indicates the industries that the sample firms are engaged in.

YEAR_{i,t} is a dummy variable representing each year within the sample period from 2009 to 2011.

Initially, this main regression model was run for the whole sample of 150 Chinese firms, taking into consideration one of the six CCP control/connection variables at a time, while all other variables remained the same. This research method has been adopted by other studies (Yang et al., 2014). Then, separate models were run in each of the three groups individually, to explore the specific patterns of CCP control or connections in the different firm groups. The regression equation was

staged as follows:

$$\begin{aligned}
 FP_{i,t} = & \alpha_0 + \sum_{m=1}^6 \alpha_m CCP_{i,t} + \alpha_7 BS_{i,t} + \alpha_8 BI_{i,t} + \alpha_9 SS_{i,t} + \alpha_{10} DUAL_{i,t} + \alpha_{11} LEV_{i,t} \\
 & + \alpha_{12} SIZE_{i,t} + \alpha_{13} PEBIT_{i,t} + \alpha_{14} IND_{i,t} + \alpha_{15} YEAR_{i,t} + \varepsilon_{i,t} \quad (2)
 \end{aligned}$$

In this above regression model, all other variables remain the same except for the following changes in comparison with the first equation. First, the two dummy variables used to indicate the identity of a sample firm, SOE and POE, are eliminated. Also, the six variables constructed to investigate CCP control and connections in Chinese firms are included in the same regression equation as a group.

7.6. Summary and Conclusion

The research methodology employed in this study has been described and discussed in detail in this chapter. In order to address the main research questions posed in this study, which involve the effects of CCP control and connections in Chinese SOEs and POEs on firm performance, both quantitative and qualitative research methods were adopted. With regard to qualitative methods, case studies were conducted which provided clear and strong evidence relating to the CCP's control over and connections with Chinese firms. Collectively with the findings provided in the institutional background in China chapter of the thesis, the hypotheses were robustly supported, and developed. On the other hand, quantitative methods constituted the backbone method of this study, as indicated in the discussion presented in this chapter. The final results and definitive findings were reached via a series of quantitative research approaches and techniques.

The sample used in this study included 150 Chinese listed firms selected from the "Top 500 Chinese Enterprises" list issued by the CEC in 2011, for the period from 2009 to 2011. The key data regarding the structure and mechanisms of CCP control and connections in these Chinese firms were manually collected based on the firms' publicly available information sources such as company websites and annual

reports, and any related official government documents. The CG data were also manually collected based on the sample firms' annual reports, and other financial data were collected from the ThomsonOne database. All the variables constructed based on the data collected were also described in detail in this chapter.

The data analysis process used to test the hypotheses developed in Chapter 6 comprised utilised descriptive statistics, univariate tests, and main pooled OLS regression analysis. This method of data analysis was described in detail in this chapter. In addition, in order to ensure the robustness of the results obtained via the data analysis, a set of carefully designed sensitivity tests were developed, and they will be described in the following chapters.

Chapter 8. Empirical Results and Discussion

8.1. Introduction

This chapter presents the results generated in the hypothesis testing by applying the research methods and regression models, with the aim of providing empirical evidence on the impacts of CCP influence on the performance of different groups of Chinese firms. Section 8.2 provides the descriptive statistics derived from the CG variables, CCP variables and other control variables employed in the empirical models. In Section 8.3 the results of the univariate tests are presented and discussed. The purpose of the univariate tests was to compare the CG structures and the patterns of CCP influence among the top Chinese SOEs, top Chinese POEs, and small SOEs. Section 8.4 contains the results of the correlation analysis conducted on the independent variables utilised in the regression models. Section 8.5 is the focus of this chapter, wherein the results obtained from the main regression analysis examining the influence of CCP control and connections on firm performance are interpreted and discussed, generally in the whole sample, and specifically in each of the three groups of Chinese firms. In order to assess the robustness of the results of the main hypothesis testing, a series of sensitivity tests including alternative measures of firm performance, alternative regression methods, and a test for the potential endogeneity problem in the main regression analysis were conducted, and the methods and results are described in Section 8.6. Lastly, Section 8.7 summarises the main findings and concludes this chapter.

8.2. Descriptive Statistics

The analysis of the descriptive statistics of the main variables employed in the empirical models of this study began with the CCP influence variables. All variables, excluding the dummy variables, were winsorized at both the 1st and 99th percentiles in order to reduce the impacts of outliers (Bartov et al., 2000; Wu et al., 2012), and to improve the normality of data¹⁹⁴.

¹⁹⁴ This research strategy and its influence are discussed in greater detail in Chapter 7, in the section

Table 8.1: Descriptive statistics derived from the CCP influence, firm performance, CG, and other control variables for the whole sample

Variables	Mean	Median	Maximum	Minimum	Std. Dev.
<u>CCP Influence</u>					
DCHA	0.832	1.000	1.000	0.000	0.374
DCEO	0.764	1.000	1.000	0.000	0.425
DSC	0.603	1.000	1.000	0.000	0.490
PD	0.312	0.333	0.667	0.000	0.181
PS	0.308	0.333	1.000	0.000	0.265
PM	0.291	0.250	1.000	0.000	0.261
<u>Firm Performance</u>					
TQ	2.341	1.621	21.012	0.355	2.574
ROA	0.039	0.031	0.191	-0.094	0.043
<u>CG Structure and Mechanisms</u>					
BS	10.035	9.000	16.000	5.000	2.281
BI	0.383	0.364	0.667	0.250	0.074
SS	4.213	3.000	9.000	0.000	1.657
DUAL	0.227	0.000	1.000	0.000	0.419
<u>Other Control Variables</u>					
LEV	0.328	0.319	0.723	0.000	0.180
SIZE	7.966	7.881	12.100	3.787	1.700
PEBIT	0.058	0.050	0.296	-0.485	0.066

DCHA is a dummy variable that takes the value of 1 if the position of the chairman of the board is held by a corporate CCP committee member; DCEO is a dummy variable that takes the value of 1 if the position of CEO is held by a corporate CCP committee member; DSC is a dummy variable that takes the value of 1 if the position of supervisory board chairman is held by a corporate CCP committee member; PD is a percentage variable calculated by dividing the number of corporate CCP committee members who are also the directors on board by the total number of directors; PS is a percentage variable calculated by dividing the number of corporate CCP committee members who are also supervisors by the total number of supervisors; PM is a percentage variable calculated by dividing the number of corporate CCP committee members who are also managers by the total number of managers.

TQ is Tobin's Q ratio calculated in accordance with Dahya et al. (2008); ROA is the Return on Total Assets ratio calculated by dividing the percentage of net income at the end of the fiscal year by closing total assets.

BS is the size of the board of directors; BI is the independence of directors calculated as the percentage of independent directors on the board; SS is the size of the supervisory board; DUAL refers to CEO duality, which is a dummy variable that takes the value of 1 if the positions of board chairman and CEO are occupied by the same executive, and 0 otherwise.

LEV is the leverage ratio calculated by dividing total debts at year end by the closing total assets; SIZE is firm size as indicated by the natural logarithm of total assets at year end; PEBIT is the previous year's net operating profit, the net earnings before interest and tax expenses (EBIT), scaled by previous year's closing total assets.

Table 8.1 above presents the descriptive statistics derived from these main variables for the whole sample of all 150 firms. The results provide a general depiction of the structure of CCP influence, CG system, and firm characteristics in the

companies included in this study. The means DCHA, DCEO and DSC means were 0.832, 0.764 and 0.603 respectively, indicating that in the whole sample, on average, 83.2% of the chairmen, 76.4% of CEOs and 60.3% of supervisory board chairmen were members of the companies' CCP committees. The PD, PS and PM means reveal that approximately a third of the sample firms' directors, supervisors and senior managers were also members of the CCP committee. In particular, the maximum values of PS and PM were both 1, indicating that all supervisors and senior managers in some companies were members of the CCP committee. These results of the descriptive statistics analysis suggest the domination of the CCP at the corporate level in China.

Table 8.1 also shows the general structure of the CG system in the top SOEs, top POEs and small SOEs in China. The average board size (BS) was 10.035, with a maximum of 16 and a minimum of 5. The average proportion of independent directors on board was 0.383, which conforms to the requirement issued by the Chinese Securities Regulatory Commission (CSRC) on board independence that at least a third of the directors on the board in the Chinese listed companies should be independent. The average size of the supervisory board was 4.213. Lastly, in 22.7% of the sample firms, the positions of the chairman of the board of directors and CEO were occupied by the same executives. These descriptive statistics are consistent to a large extent with previous studies that have examined the influence of CG in the Chinese context (Bhabra and Li, 2009; Cho and Rui, 2009; Ma and Tian, 2009; Wu et al., 2012; Ding et al., 2014).

The descriptive statistics derived from the firm performance and characteristics variables are also reported in Table 8.1. On average, Tobin's Q ratio was 2.341 and ROA was 3.9%. These two ratios are relatively higher than those reported by some previous studies conducted in China (Wu et al., 2012; Ding et al., 2014). A probable reason is that those studies investigated all the firms listed in China, while in contrast, most of the sample firms examined in this study were large and top listed companies in China, which are expected to exhibit higher performances and have higher market valuations (Wong et al., 2004). The results of the current study were consistent with those of Yang et al. (2014).

Table 8.2: Descriptive statistics derived from the main variables in top SOEs, top POEs and matched SOEs

Panel A: Top SOEs					
Variables	Mean	Median	Maximum	Minimum	Std. Dev.
<u>CCP Control</u>					
DCHA	0.993	1.000	1.000	0.000	0.085
DCEO	0.978	1.000	1.000	0.000	0.146
DSC	0.827	1.000	1.000	0.000	0.379
PD	0.424	0.444	0.667	0.125	0.126
PS	0.409	0.333	1.000	0.000	0.218
PM	0.422	0.375	1.000	0.000	0.258
<u>Firm Performance</u>					
TQ	1.555	1.312	6.016	0.802	0.732
ROA	0.034	0.025	0.138	-0.094	0.039
<u>CG Structure and Mechanisms</u>					
BS	10.914	11.000	16.000	5.000	2.558
BI	0.411	0.364	0.667	0.250	0.095
SS	4.669	5.000	9.000	3.000	1.779
DUAL	0.201	0.000	1.000	0.000	0.403
<u>Other Control Variables</u>					
LEV	0.329	0.302	0.723	0.015	0.188
SIZE	9.698	9.612	12.100	6.850	0.989
PEBIT	0.055	0.046	0.278	-0.070	0.049

Refer to the footnotes directly below Table 8.1 for a description of the abbreviations used in this table.

Table 8.2 shows the descriptive statistics derived from the main variables in each of the three groups of Chinese firms, top SOEs, top POEs and matched SOEs. In Panel A, the results indicate that the strength of CCP control was highest in the top SOEs, which constitutes statistical support for the research expectation that the top SOEs were likely to be the most tightly controlled by the CCP, and these results justify this study's measure of CCP influence based on the corporate CCP committee in Chinese firms. The means of all the CCP control variables were above the means derived from the whole sample. The DCHA mean was 0.993, indicating that in 99.3% of the 50 largest SOEs in China the position of chairman of the board was occupied by a member of their CCP committee. The DCEO mean was 97.8% and the DSC mean was 82.7%. This indicates that the positions of CEO and the chairman of the supervisory board were also usually held by a member of the corporate CCP committee. The PD, PS, and PM means were all above 40%, suggesting that more corporate CCP committee members in the top SOEs serve as directors, supervisors and senior managers. The descriptive statistics in Panel A also reflect the CG structure

and mechanisms in the top SOEs. The results reveal that the top SOEs had larger board sizes (BS mean 10.914), more independent directors on the board (BI mean 0.0411), and more supervisors (SS mean 4.669) than the full sample as a whole. However, in these firms the positions of CEO and the chairman of the board of directors were less likely to be held by the same executives (DUAL mean 0.201, lower than the full sample mean of 0.227). Lastly, the means of both accounting and market performance in the top SOEs were slightly below those of full sample as a whole.

Panel B: Top POEs					
Variables	Mean	Median	Maximum	Minimum	Std. Dev.
<u>CCP Connection</u>					
DCHA	0.529	1.000	1.000	0.000	0.501
DCEO	0.362	0.000	1.000	0.000	0.482
DSC	0.232	0.000	1.000	0.000	0.424
PD	0.127	0.111	0.500	0.000	0.120
PS	0.099	0.000	0.667	0.000	0.174
PM	0.087	0.000	0.600	0.000	0.134
<u>Firm Performance</u>					
TQ	2.993	1.997	21.012	0.355	3.417
ROA	0.048	0.039	0.191	-0.094	0.049
<u>CG Structure and Mechanisms</u>					
BS	9.304	9.000	15.000	5.000	1.943
BI	0.357	0.333	0.500	0.250	0.048
SS	3.543	3.000	7.000	0.000	1.362
DUAL	0.319	0.000	1.000	0.000	0.468
<u>Other Control Variables</u>					
LEV	0.344	0.348	0.723	0.000	0.177
SIZE	7.032	7.126	10.252	3.787	1.333
PEBIT	0.065	0.066	0.296	-0.485	0.091

Refer to the footnotes directly below Table 8.1 for a description of the abbreviations used in this table.

Panel B of Table 8.2 contains the descriptive statistics derived from the main variables in the 50 largest POEs in China. The overlay of the corporate CCP committee in the CG system indicates an affiliation of these POEs with the CCP. Almost 53% of the chairmen of the board and more than 36% of the CEOs in these firms were also members their firm's CCP committee. The PD, PS and PM means were 0.127, 0.099 and 0.087 respectively. Thus, more than 12% of directors and almost 10% of supervisors and directors in the top POEs served on the CCP committee at the same time. The top POEs also exhibited a better performance mean

than the mean of both the full sample and the top SOEs, as the TQ and ROA means were 2.993 and 0.048 respectively. Furthermore, these private firms tended to have smaller board sizes (BS mean 9.304), fewer independent directors on board (BI mean 0.357), and smaller supervisory boards (SS mean 3.543). However, the DUAL mean (0.319) was the highest of any group, demonstrating the CG feature of family or founding entrepreneur control in these Chinese POEs¹⁹⁵.

Panel C: Matched SOEs					
Variables	Mean	Median	Maximum	Minimum	Std. Dev.
<u>CCP Control</u>					
DCHA	0.966	1.000	1.000	0.000	0.182
DCEO	0.938	1.000	1.000	0.000	0.241
DSC	0.740	1.000	1.000	0.000	0.440
PD	0.380	0.400	0.667	0.111	0.132
PS	0.410	0.333	1.000	0.000	0.262
PM	0.359	0.333	1.000	0.000	0.241
<u>Firm Performance</u>					
TQ	2.483	1.805	21.012	0.355	2.599
ROA	0.035	0.028	0.191	-0.094	0.040
<u>CG Structure and Mechanisms</u>					
BS	9.890	9.000	15.000	5.000	2.021
BI	0.380	0.364	0.571	0.300	0.061
SS	4.411	5.000	9.000	3.000	1.600
DUAL	0.164	0.000	1.000	0.000	0.372
<u>Other Control Variables</u>					
LEV	0.312	0.295	0.647	0.000	0.175
SIZE	7.105	7.151	10.340	4.414	1.131
PEBIT	0.054	0.046	0.264	-0.102	0.050

Refer to the footnotes directly below Table 8.1 for a description of the abbreviations used in this table.

The descriptive statistics derived from the main variables for the matched SOEs are presented in Panel C of Table 8.2. The results derived from the CCP control variables show that as these companies are owned directly by the Chinese government, they are firmly controlled by the CCP. The results suggest a degree of CCP control that is in between that of the top SOEs and the top POEs. For example, the percentage of CCP committee members acting as the chairmen of the board of directors in the 50 match SOEs was 96.6%, lower than the top SOEs (mean 99.3%) but greater than the top POEs (mean 52.9%). This comparison pattern was evident for other CCP control variables, firm performance, and the CG system variables.

These above considerations based on the descriptive statistics derived from

¹⁹⁵ This feature of the CG system in Chinese POEs is discussed in the review of the Chinese institutional background and the development of CG in China presented in Chapter 4, Section 4.3.

the main variables employed in the empirical models of this study provide some initial indications of the differences in the CCP's influence, CG system and firm performance between the three groups of Chinese firms. Clear and more revealing comparisons of these variables are presented in the following section.

8.3. Univariate Tests

A series of univariate tests¹⁹⁶ on the differences between the means of the main variables between the three groups of Chinese firms was conducted. The purpose of these tests was to determine the statistical significance of the differences in CCP control/connection patterns, CG structure and mechanisms, and firm performance among the top SOEs, top POEs and small SOEs.

Table 8.3 presents the results of tests on the differences between the CCP influence variable means between the three groups of firms. Panel A shows that CCP control in the top 50 SOEs and the top 50 POEs' affiliation with the CCP through the corporate CCP committee differed statistically significantly. A *t*-test conducted on the relevant DCHA means yielded a significance value of $p < 0.001$.

The positions of CEO and chairman of the supervisory committee were statistically significantly more likely to be occupied by CCP committee members in the top SOEs than in the top POEs (DSC means 97.9% vs. 36.2% and DSC means 82.8% vs. 23.2%, respectively). The *t*-tests on PD, PS and PM means also revealed statistically significantly stronger CCP influence in the top SOEs in comparison with the top POEs, as the positions of directors, supervisors and senior managers in the former are more likely to be taken by the corporate CCP committee members. The level of statistical significance of all of these differences was $p < 0.01$.

¹⁹⁶ Univariate analysis is a form of statistical analysis which involves one variable. In this study, it was employed to compare means of the main variables among the three groups of Chinese firms.

Table 8.3 Comparison of CCP influence among three groups of Chinese firms

CCP Influence Variables	Mean	Std. Dev	Mean	Std. Dev	t-Test p Value
Panel A: Comparisons between top 50 SOEs and top 50 POEs					
	Top SOEs		Top POEs		
DCHA	0.993	0.084	0.529	0.501	< 0.001 ***
DCEO	0.979	0.144	0.362	0.482	< 0.001 ***
DSC	0.828	0.379	0.232	0.424	< 0.001 ***
PD	0.423	0.125	0.127	0.120	< 0.001 ***
PS	0.409	0.218	0.099	0.174	< 0.001 ***
PM	0.433	0.267	0.087	0.134	< 0.001 ***
Panel B: Comparisons between top 50 POEs and 50 matched SOEs					
	Top POEs		Matched SOEs		
DCHA	0.529	0.501	0.966	0.182	< 0.001 ***
DCEO	0.362	0.482	0.938	0.241	< 0.001 ***
DSC	0.232	0.424	0.740	0.440	< 0.001 ***
PD	0.127	0.120	0.380	0.132	< 0.001 ***
PS	0.099	0.174	0.410	0.262	< 0.001 ***
PM	0.087	0.134	0.359	0.241	< 0.001 ***
Panel C: Comparisons between top 50 SOEs and 50 matched 50 SOEs					
	Top SOEs		Matched SOEs		
DCHA	0.993	0.084	0.966	0.182	0.107
DCEO	0.979	0.144	0.938	0.241	0.086*
DSC	0.828	0.379	0.740	0.440	0.069*
PD	0.423	0.125	0.380	0.132	0.005 ***
PS	0.409	0.218	0.410	0.262	0.969
PM	0.433	0.267	0.359	0.241	0.013 **

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Refer to the footnotes directly below Table 8.1 for a description of the abbreviations used in this table.

Panel B of Table 8.3 above shows a comparison of CCP influence between the 50 top POEs and the 50 small SOEs. By design, these two groups of firms were very similar in terms of firm size and the distribution of industries. The means of all the CCP influence variables in the small SOEs were significantly higher than those of the top POEs. These results show that the influence of CCP control in the small SOEs was significantly higher than the influence of the CCP connections in the top POEs.

In Panel C of Table 8.3 above, with the exceptions of DCHA and PS, the means of the CCP control variables in the top SOEs and the small SOEs differed significantly. This suggests that the top SOEs were more tightly controlled by the CCP than the small SOEs. Such a finding implies that firm size matters in investigations of political influence in the Chinese context. However, the differences were not as significant as those reported in Panels A and B. In summary, all the above statistical results provide support for the research expectation that as SOEs are the most important component of the Chinese national economy—which is explicitly

recognised by the CCP and clearly stated in China's official documents—they are likely to be subject to a higher level of political control or interference by the CCP, and the largest SOEs would be under the most intensive CCP control.

The results of comparisons of the CG system and firm performance variable means among the three groups are reported in Table 8.4. In Panel A, the analysis shows that the top SOEs had a significantly larger mean board size than the top POEs (BS 10.894 vs. 9.304), as well as more independent directors on the board (BI 41.2% vs. 35.7%), and more supervisors on the board (SS 4.669 vs. 3.543). However, in the top POEs CEO duality was much more common than it was in the top SOEs (DUAL 31.9% vs. 19.7%). Consistent with the empirical findings of some previous studies (Alchian, 1965; Vining and Boardman, 1992; Kocenda and Svejnar, 2002), the significant differences in firm performance means suggested that the top POEs had both superior market and accounting performances than the top SOEs (TQ 2.993 vs. 1.555, ROA 0.048 vs. 0.034). All these differences in means were statistically significant at the level of $p < 0.01$, except for CEO duality, where the difference in means was significant at the $p < 0.05$ level.

Panel B of Table 8.4 below reveals the same pattern of differences between the CG and firm performance variable means of the top POEs and small SOEs as the pattern evident in Panel A. These results suggest that when firm size and industry distribution are largely comparable, Chinese POEs tend to have better accounting performance than SOEs (ROA 0.048 vs. 0.035), as well as higher levels of CEO duality (DUAL 31.9% vs. 16.4%), but smaller sized boards of directors and supervisory boards, and fewer independent directors (BS 9.304 vs. 9.89, SS 3.543 vs. 4.411, BI 35.7% vs. 38%). The difference between the market performance means of these two groups, Tobin's Q, was not statistically significant.

Table 8.4: Comparisons of CG system and firm performance means among three groups of Chinese firms

CCP Influence Variables	Mean	Std. Dev	Mean	Std. Dev	t-Test p Value
Panel A: Comparisons between top 50 SOEs and top 50 POEs					
	<u>Top SOEs</u>		<u>Top POEs</u>		
BS	10.894	2.534	9.304	1.943	< 0.001***
BI	0.412	0.095	0.357	0.048	< 0.001***
SS	4.669	1.779	3.543	1.362	< 0.001***
DUAL	0.197	0.399	0.319	0.468	0.020**
TQ	1.555	0.732	2.993	3.417	< 0.001***
ROA	0.034	0.039	0.048	0.049	0.007***
Panel B: Comparisons between top 50 POEs and 50 matched SOEs					
	<u>Top POEs</u>		<u>Matched SOEs</u>		
BS	9.304	1.943	9.890	2.021	0.013**
BI	0.357	0.048	0.380	0.061	0.001***
SS	3.543	1.362	4.411	1.600	< 0.001***
DUAL	0.319	0.468	0.164	0.372	0.002***
TQ	2.993	3.417	2.483	2.599	0.149
ROA	0.048	0.049	0.035	0.040	0.012**
Panel C: Comparisons between top 50 SOEs and 50 matched SOEs					
	<u>Top SOEs</u>		<u>Matched SOEs</u>		
BS	10.894	2.534	9.890	2.021	< 0.001***
BI	0.412	0.095	0.380	0.061	0.001***
SS	4.669	1.779	4.411	1.600	0.199
DUAL	0.197	0.399	0.164	0.372	0.471
TQ	1.555	0.732	2.483	2.599	< 0.001***
ROA	0.034	0.039	0.035	0.040	0.837

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Refer to the footnotes directly below Table 8.1 for a description of the abbreviations used in this table.

When the top SOEs and match SOEs were compared (Panel C of Table 8.4, above), the only means that differed statistically significantly were board size, independence of directors and the market performance (BS 10.894 vs. 9.89, BI 41.2% vs. 38%, TQ 1.555 vs. 2.483). These results suggest that large SOEs are likely to have more directors in total, more independent directors, but inferior market performance compared to match SOEs. In addition, supervisory board size and accounting performance were similar in these two groups, but the level of CEO duality was equally low in the Chinese SOEs, regardless of firm size. The regression analysis of this study suggests some possible reasons for the significant differences in the means of some firm performance indicators between the top SOEs, top POEs and small SOEs, and the regression results are presented and discussed in detail in the following sections of this chapter, to identify the most important empirical findings of this study.

8.4. Correlation Analysis

A correlation analysis of all the important variables employed in the main regression models, performed via the Pearson product-moment correlation method, is presented in this section. The purpose of this analysis was to test for the existence of collinearity and multicollinearity problems¹⁹⁷. Previous studies suggest that a high degree of multicollinearity is associated with detrimental effects on analyses, such as the generation of improbable and unconvincing coefficients of the predictor variables, erroneous coefficients of determination of the regression, where such coefficients are high but none or only a few of the predictor variables are statistically significant (Belsley et al., 1980; Belsley, 1991; Pallant, 2007). Therefore, it is of great importance to test and control for such problems before the regression analysis is conducted.

Multicollinearity can be initially detected by the magnitude of the correlation coefficients among independent variables. Gujarati (1995) suggested that a correlation of 0.8 or greater would indicate the presence of a multicollinearity problem, and this threshold is adopted by most recent studies in the literature (Cooper and Schindler, 2008; Mawanza et al., 2013; Esa and Zahari, 2016). There are also studies suggesting 0.7 as a threshold for the detection of a multicollinearity problem (Tabachnick and Fidell, 2007). Another measure that quantifies the seriousness of multicollinearity is the variance inflation factor (VIF), which is defined as a function of the regression coefficient of determination. A rule of thumb when using VIF is that it is greater than 10, multicollinearity should be considered high and potentially detrimental to the analysis (Belsley et al., 1980; Kutner et al., 2004; O'Brien, 2007).

The results of the correlation analysis are shown in Table 8.5 below. Many variables were significantly correlated, but none of these correlations could be regarded as high or harmful based on the criteria discussed earlier. Firstly, all CCP influence variables are significantly correlated at the $p < 0.01$ level. This implies consistence within the CCP influence structure, meaning that when CCP influence exists in one component of the CG system, other CG structure components also

¹⁹⁷ Collinearity refers to the linear association between two independent variables, and multicollinearity is the phenomenon where two or more predictor variables in a multiple regression model are highly correlated.

demonstrate significant levels of CCP control/connections. For example, the correlation coefficient between DCHA and PM was 0.38, indicating that when a sample firm's chairman of the board of directors is a member of the firm's CCP committee, an average of 38% of the senior managers are also CCP committee members. In addition, all possible combinations of two of these CCP influence variables were omitted in otherwise identical regression analyses of the full sample in order to further control for multicollinearity, and to clarify the individual influence of each of these variables.

Secondly, the results presented in Table 8.5 show a significant correlation between CCP influence and the CG system in the full sample. Specifically, the majority of these significant correlations are positive, implying that when the level of CCP influence changes, the CG system varies in the same direction. For example, the correlation coefficients between PD (the percentage of CCP committee members compared to the total number of directors) and BI (the percentage of independent directors on board), PD and SS (the size of supervisory board) are both significantly positive at the $p < 0.01$ level (0.142 and 0.228 respectively). This suggests that as the number of CCP committee members that are also directors increases or decreases by 1, the number of independent directors on board and the size of the supervisory board increases or decreases by 0.142 and 0.228 respectively. DUAL (CEO duality) was only significantly negatively correlated with PD (-0.214), indicating that the level of CEO duality decreased or increased by 0.214 when the number of CCP committee members acting as directors increased or decreased by 1. This significantly negative association may help to explain the difference in CEO duality in the Chinese SOEs and POEs revealed in the univariate tests. In addition, some CG variables were significantly correlated. Board size (BS) was positively correlated with SS (0.366), and negatively correlated with BI (-0.296) and DUAL (-0.087). SS was also negatively correlated with DUAL, with a coefficient of -0.2.

Thirdly, some significant correlations were evident between firm characteristics and CCP influence variables, and between CG system variables. For example, firm size (SIZE) as measured by the natural logarithm of year-end total assets was significantly positively associated with all other main variables except

DUAL. This suggests that in large firms, the level of CCP control/connections tends to be higher, and there will be more directors and supervisors on boards, as well as more independent directors.

Lastly, the VIF values of these main variables are also reported in Table 8.5 below, and all these values are clearly low, below 3. Therefore, comparing these VIF values with the critical value of 10, or applying the aforementioned rule of thumb regarding the magnitude of correlation coefficients, it is reasonable to draw the conclusion that serious multicollinearity problems did not exist among these variables.

Table 8.5: Pearson correlation matrix and VIFs

<u>Variables</u>	<u>DCHA</u>	<u>DCEO</u>	<u>DSC</u>	<u>PD</u>	<u>PS</u>	<u>PM</u>	<u>BS</u>	<u>BI</u>	<u>SS</u>	<u>DUAL</u>	<u>LEV</u>	<u>SIZE</u>	<u>PEBIT</u>
<u>DCHA</u>	1.000												
<u>DCEO</u>	0.502 < 0.001***	1.000											
<u>DSC</u>	0.393 < 0.001***	0.477 < 0.001***	1.000										
<u>PD</u>	0.619 < 0.001***	0.608 < 0.001***	0.489 < 0.001***	1.000									
<u>PS</u>	0.363 < 0.001***	0.425 < 0.001***	0.602 < 0.001***	0.460 < 0.001***	1.000								
<u>PM</u>	0.380 < 0.001***	0.617 < 0.001***	0.441 < 0.001***	0.581 < 0.001***	0.379 < 0.001***	1.000							
<u>BS</u>	0.092 0.061*	0.143 0.004***	0.214 < 0.001***	0.073 0.138	0.064 0.191	0.019 0.699	1.000						
<u>BI</u>	0.147 0.003***	0.249 < 0.001***	0.229 < 0.001***	0.142 0.004***	0.300 < 0.001***	0.304 < 0.001***	-0.296 < 0.001***	1.000					
<u>SS</u>	0.144 0.003***	0.211 < 0.001***	0.223 < 0.001***	0.228 < 0.001***	0.045 0.366	0.084 0.088*	0.336 < 0.001***	-0.008 0.877	1.000				
<u>DUAL</u>	-0.059 0.235	-0.006 0.906	-0.034 0.493	-0.214 < 0.001***	-0.066 0.181	0.049 0.320	-0.087 0.076*	0.071 0.150	-0.200 < 0.001***	1.000			
<u>LEV</u>	0.018 0.721	-0.025 0.617	0.013 0.789	0.050 0.310	0.064 0.194	-0.031 0.535	0.035 0.478	-0.076 0.125	-0.050 0.314	-0.032 0.513	1.000		
<u>SIZE</u>	0.279 < 0.001***	0.340 < 0.001***	0.347 < 0.001***	0.394 < 0.001***	0.198 < 0.001***	0.324 < 0.001***	0.301 < 0.001***	0.219 < 0.001***	0.235 < 0.001***	-0.006 0.906	0.107 0.030***	1.000	
<u>PEBIT</u>	-0.088 0.076*	0.040 0.417	-0.066 0.182	-0.114 0.021**	-0.052 0.292	-0.112 0.022**	0.092 0.062*	-0.002 0.962	0.071 0.150	0.049 0.321	-0.184 < 0.001***	0.171 0.001***	1.000
<u>VIF</u>	1.737	2.200	1.984	2.857	1.839	2.049	1.526	1.485	1.279	1.161	1.097	1.603	1.181

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Refer to the footnotes directly below Table 8.1 for a description of the abbreviations used in this table.

8.5. Regression Results and Discussion

This section presents the results generated from the main regression analysis that was utilised to test the hypotheses of this study, with the aim of generating empirical evidence on the associations between the political influences exerted by the CCP on firm performance in the Chinese context. Firstly, regression model 1 was run to investigate the effects of CCP influence on firm performance in the full sample of all 150 Chinese firms, and the six measures of CCP influence at the corporate level were included in this regression model. Regression model 2 was run to examine the different patterns of CCP influence in each of the three groups of Chinese firms, including the top 50 SOEs, the top 50 POEs, and the 50 matched SOEs. CCP influence variables in these models served as the main test variables, which were regressed on the dependent variable, firm performance, as determined by both accounting and market measures. The regression models also took into account the effects of two sets of control variables, CG and firm characteristics. The multivariate analysis reported in this section was performed via Ordinary Least Squares (OLS) regressions.

As the hypotheses developed in Chapter 6 are presented in the form of alternative hypotheses, the null form of these hypotheses state that CCP influence through each of the three components of the Chinese CG system (the board of directors, supervisory board and the management team), is not significantly associated with firm performance in the Chinese context. In addition, this study applied the statistical research convention regarding a significance level of $p < 0.05$ when determining whether each of these null hypotheses should be rejected, and in turn whether the alternative hypotheses should be accepted.

Regression Results in the Full Sample

Table 8.6 presents the regression results on the associations between CCP influence and firm performance for the whole sample of 150 Chinese firms, controlling for the effects of CG system and firm characteristics. In order to generate these results, regression model 1 was run six times, with only one of the six measures

of CCP influence via CG structure at the corporate level included each time. The results contained in column 1 primarily show that CCP influence as a function of corporate CCP committee members acting as chairmen of the board (DCHA) was significantly positively associated with accounting performance as measured by ROA, with a coefficient of 0.0128 ($p < 0.05$). In column 4, the coefficient of PD, which indicates the percentage of CCP committee members on the board of directors, was -0.0291 which was statistically significant ($p < 0.05$). The coefficient of DCEO in column 2 was 0.0122, which was also statistically significant ($p < 0.05$). This result indicates that when the position of CEO in a company is held by one of its CCP committee members, the company is likely to exhibit higher accounting performance. Notably, the coefficients of the other CCP influence measures, DSC, PS and PM, were not statistically significant. This suggests that CCP does not have significant effects on accounting performance via the supervisory board or senior managers. In Table 8.7 below, only the CCP's influence via the position of the CEO (DCEO) was significantly positively associated with market-based firm performance (TQ) in the full sample, and the coefficient of 0.9664 was highly significant ($p < 0.01$). These results suggest that the CCP influence that operates via the board of directors and the position of CEO on the management team have significant impacts on firm performance. Thus, hypotheses 1 and 3 and sub-hypotheses 1a, 1b and 3a were preliminarily supported.

Table 8.6: CCP influence on firm performance (accounting measure) for the full sample

<u>Variables</u>	<u>ROA</u>					
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>
<u>SOE</u>	-0.0047 (0.4030)	-0.0055 (0.3285)	-0.0070 (0.2170)	-0.0072 (0.1968)	-0.0067 (0.2355)	-0.0064 (0.2530)
<u>POE</u>	0.0170 (0.0003***)	0.0185 (0.0003***)	0.0104 (0.0192**)	0.0038 (0.4761)	0.0113 (0.0173**)	0.0122 (0.0076***)
<u>DCHA</u>	0.0128 (0.0178**)					
<u>DCEO</u>		0.0122 (0.0190**)				
<u>DSC</u>			-0.0024			

			(0.5455)			
<u>PD</u>				-0.0291 (0.0352**)		
<u>PS</u>					-0.0006 (0.9402)	
<u>PM</u>						0.0030 (0.7050)
<u>BS</u>	-0.0004 (0.6079)	-0.0005 (0.5636)	-0.0005 (0.5352)	-0.0011 (0.2292)	-0.0006 (0.4967)	-0.0006 (0.5194)
<u>BI</u>	-0.0676 (0.0089***)	-0.0752 (0.0037***)	-0.0687 (0.0089***)	-0.0818 (0.0019***)	-0.0706 (0.0079***)	-0.0728 (0.0058***)
<u>SS</u>	0.0004 (0.7298)	0.0002 (0.8269)	0.0004 (0.7084)	0.0004 (0.6999)	0.0004 (0.7510)	0.0004 (0.7440)
<u>DUAL</u>	-0.0009 (0.8275)	-0.0012 (0.7667)	-0.0002 (0.9534)	-0.0014 (0.7275)	-0.0004 (0.9207)	-0.0006 (0.8871)
<u>LEV</u>	-0.0787 (< 0.001***)	-0.0809 (< 0.001***)	-0.0801 (< 0.001***)	-0.0804 (< 0.001***)	-0.0800 (< 0.001***)	-0.0796 (< 0.001***)
<u>SIZE</u>	0.0038 (0.0131**)	0.0041 (0.0083***)	0.0046 (0.0030***)	0.0053 (0.0008***)	0.0045 (0.0037***)	0.0044 (0.0057***)
<u>PEBIT</u>	0.2323 (< 0.001***)	0.2255 (< 0.001***)	0.2277 (< 0.001***)	0.2233 (< 0.001***)	0.2292 (< 0.001***)	0.2300 (< 0.001***)
<u>Constant</u>	0.0224 (0.2258)	0.0280 (0.1184)	0.0343 (0.0546*)	0.0503 (0.0088***)	0.0352 (0.0492**)	0.0349 (0.0502*)
<u>Industry</u>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>
<u>Year</u>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>
<u>R²</u>	0.4806	0.4805	0.4736	0.4790	0.4731	0.4733
<u>Adjusted R²</u>	0.4499	0.4498	0.4424	0.4482	0.4419	0.4421
<u>No. of Obs.</u>	413	413	413	413	413	413
<u>F-Statistic</u>	15.6506	15.6416	15.2138	15.5522	15.1841	15.1955
<u>Probability (F-stat)</u>	< 0.001	< 0.001	< 0.001	< 0.001	< 0.001	< 0.001

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$; p values are reported in parentheses below each coefficient.

The dependent variable is the Return-On-Assets ratio (ROA).

SOE and POE are two dummy variables used to indicate whether a firm-year observation belongs to a top SOE or a top POE, respectively.

Dummy variables for Year and Industry were included in the regression models, but the corresponding results are not included due to space constraints.

Refer to the footnotes directly below Table 8.1 for a description of the other abbreviations used in this table.

Table 8.7: CCP influence on firm performance (market measure) for the full sample

<u>Variables</u>	<u>TQ</u>					
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>
<u>SOE</u>	0.0630 (0.8776)	0.1150 (0.7764)	0.0757 (0.8533)	0.0402 (0.9213)	0.0362 (0.9292)	0.0332 (0.9353)
<u>POE</u>	0.9165 (0.0072***)	1.3554 (0.0002***)	0.9218 (0.0045***)	0.9772 (0.0138**)	0.7161 (0.0371**)	0.7892 (0.0179**)
<u>DCHA</u>	0.2490 (0.5138)					
<u>DCEO</u>		0.9664 (0.0094***)				
<u>DSC</u>			0.2555 (0.3756)			
<u>PD</u>				0.6479 (0.5190)		
<u>PS</u>					-0.2937 (0.5923)	
<u>PM</u>						-0.0720 (0.8988)
<u>BS</u>	0.1298 (0.0413**)	0.1346 (0.0328**)	0.1213 (0.0576*)	0.1379 (0.0353**)	0.1291 (0.0423**)	0.1268 (0.0473**)
<u>BI</u>	1.7964 (0.3404)	1.1929 (0.5262)	1.5048 (0.4306)	2.0010 (0.2959)	2.0163 (0.2971)	1.8270 (0.3400)
<u>SS</u>	0.0366 (0.6438)	0.0235 (0.7654)	0.0317 (0.6896)	0.0345 (0.6627)	0.0335 (0.6733)	0.0373 (0.6376)
<u>DUAL</u>	-0.0242 (0.9328)	-0.1246 (0.6651)	-0.0329 (0.9089)	0.0108 (0.9703)	-0.0125 (0.9652)	-0.0100 (0.9725)
<u>LEV</u>	-1.6456 (0.0326**)	-1.6588 (0.0296**)	-1.6636 (0.0304**)	-1.6815 (0.0288**)	-1.6311 (0.0349**)	-1.6878 (0.0297**)
<u>SIZE</u>	-0.4962 (< 0.001***)	-0.5126 (< 0.001***)	-0.5015 (< 0.001***)	-0.5035 (< 0.001***)	-0.4857 (< 0.001***)	-0.4829 (< 0.001***)
<u>PEBIT</u>	4.6689 (0.0124**)	4.1660 (0.0247**)	4.7624 (0.0110**)	4.7081 (0.0119**)	4.6198 (0.0132**)	4.5751 (0.0147**)
<u>Constant</u>	3.5946 (0.0070***)	3.3516 (0.0098***)	3.9053 (0.0027***)	3.5007 (0.0108**)	3.8024 (0.0034***)	3.7943 (0.0035***)
<u>Industry</u>	Yes	Yes	Yes	Yes	Yes	Yes
<u>Year</u>	Yes	Yes	Yes	Yes	Yes	Yes
<u>R²</u>	0.1915	0.2044	0.1922	0.1914	0.1912	0.1906
<u>Adjusted R²</u>	0.1480	0.1617	0.1488	0.1480	0.1477	0.1471
<u>No. of Obs.</u>	413	413	413	413	413	413
<u>F-Statistic</u>	4.4091	4.7849	4.4303	4.4085	4.4009	4.3849
<u>Probability (F-stat)</u>	< 0.001	< 0.001	< 0.001	< 0.001	< 0.001	< 0.001

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$; p values are reported in parentheses below each coefficient.

The dependent variable is the Tobin's Q ratio (TQ).

SOE and POE are two dummy variables used to indicate whether a firm-year observation belongs to a top SOE or a top POE, respectively.

Dummy variables for Year and Industry were included in the regression models, but the corresponding results are not included due to space constraints.

Refer to the footnotes directly below Table 8.1 for a description of the other abbreviations used in this table.

The results presented in Tables 8.6 and 8.7 suggest that the Chinese POEs tended to exhibit better accounting and market performances than the Chinese SOEs, as the coefficients of the POEs reported in these two tables were all significantly

positive. This is consistent with the univariate test results of this study, and the findings of previous studies (Vining and Boardman, 1992; Kocenda and Svejnar, 2003). In addition, the regression analysis provided empirical evidence of an association between firm performance and CG, and the impacts of firm characteristics on firm performance. As shown in Table 8.6, board independence had a negative impact on the ROA measure of accounting performance, and the coefficients generated in the six regression models were all highly significant ($p < 0.01$). This finding seems to contradict the conventional wisdom regarding board independence, which holds that independent directors have the power to discipline managers and monitor corporate operations, and thus having independent directors on the board would be advantageous for firm performance (Maug, 1997). However, other researchers have suggested that this conventional wisdom lacks empirical support, and that whether the association between board independence and firm performance is significant or not depends on market and cultural contexts (Bhagat and Black, 2002; Iwu-Egwuonwu, 2010). Importantly, a large number of studies have reported significantly negative impacts of independent directors on firm performance (Zahra and Stanton, 1988; Fosberg, 1989; Daily and Dalton, 1993; Agrawal and Knoeber, 1996; Yermack, 1996; Klein, 1998; Anderson et al., 2000; Bhagat and Black, 2002; Beiner et al., 2004; Bhagat and Bolton, 2008; Ararat et al., 2010). There are also many studies reporting no correlation between board independence and firm performance (Baysinger and Butler, 1985; Chagati et al., 1985; Rechner and Dalton, 1986; Dalton et al., 1998; Duchin et al., 2010). In addition to these above studies conducted in other countries, the results of the current study reported in Table 8.6 are consistent with many studies conducted in the Chinese context (Tang et al., 2005; Gu and Long, 2006; Chen and Chi, 2007; Hu and Zhu, 2008; Zheng and Lu, 2009; Hu et al., 2010).

The results in Table 8.7 show that the size of the board of directors (BS) had a significantly positive effect on market performance as measured by Tobin's Q ratio (TQ). This finding is consistent with some previously reported studies (Zahra and Pearce, 1989; Halebian and Finkelstein, 1993; Anderson et al., 2004; Adams and Mehran, 2005; Larmou and Vafeas, 2009; Tanna et al., 2011). These studies suggest that as the collective of information regarding corporate operations is more likely to be shared on a large board, it is less likely to be manipulated, and investors'

confidence in the company is increased.

Regarding the association between firm performance and firm characteristics, the results of this study suggest that the leverage level of Chinese firms had significantly negative effects on both accounting and market performance. This implies that Chinese firms with higher amounts of long term debt are likely to exhibit inferior performances. As indicated by the significantly positive coefficients of firm size (see Table 8.6) and previous year's performance, the results suggest that the sampled Chinese firms with large size and better profitability in the previous year were likely to exhibit better accounting performance in the current year. However, large firms were found to exhibit lower market performance (see Table 8.7). These findings are consistent with those reported by prior studies (Chang and Wong, 2004; Cheung et al., 2008; Hung et al., 2012; Wu et al., 2012; Yang et al., 2014; Liu et al., 2015).

Regression Results in Each of the Three Sub-Samples

Top 50 SOEs

The regression analysis results regarding the impacts of CCP control, CG and firm characteristics on firm performance in the top SOEs are shown below in Table 8.8, and generally suggest a positive impact of CCP control on firm performance.

Table 8.8: Influence of CCP control on firm performance in the top SOEs

<u>Variables</u>	<u>ROA</u>		<u>TQ</u>	
	<u>Coefficient</u>	<u>Probability</u>	<u>Coefficient</u>	<u>Probability</u>
<u>DCHA</u>	0.001	0.968	-0.251	0.675
<u>DCEO</u>	0.049	0.024**	1.069	0.017**
<u>DSC</u>	0.007	0.419	0.512	0.003***
<u>PD</u>	-0.029	0.279	-0.683	0.213
<u>PS</u>	-0.010	0.477	0.165	0.577
<u>PM</u>	-0.010	0.464	-0.339	0.227
<u>BS</u>	-0.002	0.111	-0.018	0.563
<u>BI</u>	-0.090	0.030**	-1.758	0.040**
<u>SS</u>	0.000	0.932	0.005	0.903
<u>DUAL</u>	0.013	0.087*	0.204	0.199
<u>LEV</u>	-0.073	< 0.001***	-1.141	0.002***

SIZE	0.001	0.882	-0.291	< 0.001***
PEBIT	0.278	< 0.001***	2.318	0.071*
Constant	0.086	0.204	4.032	0.003***
Industry	<i>Yes</i>			<i>Yes</i>
Year	<i>Yes</i>			<i>Yes</i>
R²	0.573			0.508
Adjusted R²	0.499			0.422
No. of Obs.	136			136
F-Statistic	7.7131			5.9340
Probability (F-stat)	< 0.001			< 0.001

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Refer to the footnotes directly below Table 8.1 for a description of the abbreviations used in this table.

The DCEO coefficients shown in Table 8.8 above for ROA and TQ (0.049 and 1.069 respectively) were both statistically significantly positive in the regression models ($p < 0.05$). This suggests that CCP control in the largest SOEs had positive effects on firm performance via corporate CCP committee members serving as CEOs, and that the market reacted positively to this factor. In addition to the position of CEO, the CCP's control via the supervisory board chairman also had a positive impact on market performance in the top SOEs (0.512, $p < 0.01$). These results constitute strong empirical support for sub-hypothesis H3a-SOE, and partial support for sub-hypothesis H2a. Regarding CG structure and mechanisms in the sampled Chinese firms, board independence was not found to have the desired effects on firm performance held by conventional wisdom. This finding implies that as the most important factor in corporate decision-making and operation process is CCP control, the intervention of independent directors is unlikely to have a favourable influence. Some studies further suggest that the monitoring role of theoretically "independent" directors may be marginal due to a lack of actual independence in practice or their affiliations with the controlling shareholders (Patton and Baker, 1987). Such arguments hold particularly true in the case of Chinese SOEs, as many independent directors have deep political backgrounds and solid connections with the CCP. For example, in the largest SOE Sinopec Limited, in 2011 all five independent directors were members of the CCP, all had extensive work experience in the Chinese government or a related high level authority, and some of these governmental agencies or authorities were closely affiliated with Sinopec Limited. CEO duality was also positively associated with the accounting performance of the top SOEs (0.013, $p < 0.10$). This correlation was not statistically significant at the $p < 0.05$ level, but arguably it constitutes support for the

positive impacts of CCP control on firm performance in the largest Chinese SOEs because in these firms both the positions of chairman of the board of directors and CEO were often occupied by CCP committee members, as evidenced by the descriptive statistics reported earlier in this chapter. Lastly, firm characteristics were also found to be significantly correlated with both accounting and market performance in this group of firms.

Top 50 POEs

Table 8.9 presents the regression analysis results regarding the influence of political connections with the CCP on firm performance in the top Chinese POEs, controlled for the effects of CG and firm characteristics. These results suggest that POEs' political connections with the CCP via key employees (including the chairman of the board of directors and the CEO) being appointed as CCP committee members can significantly positively impact accounting and market performance.

Table 8.9: Influence of CCP connections on firm performance in top POEs

<u>Variables</u>	<u>ROA</u>		<u>TQ</u>	
	<u>Coefficient</u>	<u>Probability</u>	<u>Coefficient</u>	<u>Probability</u>
<u>DCHA</u>	0.030	0.009***	-0.589	0.422
<u>DCEO</u>	0.024	0.076*	3.377	< 0.001***
<u>DSC</u>	-0.016	0.254	-0.005	0.996
<u>PD</u>	-0.119	0.021**	0.912	0.788
<u>PS</u>	0.048	0.146	-2.404	0.300
<u>PM</u>	-0.018	0.730	-4.619	0.205
<u>BS</u>	0.000	0.837	0.444	0.011**
<u>BI</u>	-0.136	0.131	12.177	0.057*
<u>SS</u>	0.005	0.062*	-0.477	0.021**
<u>DUAL</u>	0.002	0.844	-0.143	0.838
<u>LEV</u>	-0.077	0.003***	-0.730	0.644
<u>SIZE</u>	0.005	0.150	-0.723	0.002***
<u>PEBIT</u>	0.168	< 0.001***	-2.681	0.382
<u>Constant</u>	0.053	0.265	0.173	0.960
<u>Industry</u>		<i>Yes</i>		<i>Yes</i>
<u>Year</u>		<i>Yes</i>		<i>Yes</i>
<u>R²</u>		0.489		0.527
<u>Adjusted R²</u>		0.401		0.435
<u>No. of Obs.</u>		136		136
<u>F-Statistic</u>		5.5130		5.7330
<u>Probability (F-stat)</u>		< 0.001		< 0.001

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

When ROA was regressed, the coefficient of DCHA was 0.030 which was statistically significant ($p < 0.01$). DCEO was positively associated with both ROA and TQ (0.024 and 3.377 respectively), although the significance of the association between ROA and DCEO was only marginal ($p = 0.076$). These results suggest that connections with the CCP via an established corporate CCP committee, and having CCP committee members acting as chairmen of the boards of directors or CEOs may function as advantageous factors that enhance firm performance in Chinese POEs; and such factors may be favourably acknowledged by those investing in the Chinese domestic market. These findings are consistent with the results of some previous studies, and they suggest that political connections may enhance the ability of POEs to obtain preferential governmental treatment, including tax benefits and easier access to capital, which in turn may help to advance their performance (Guiheux, 2006; Li et al., 2008; Du, 2011; Wu et al., 2012). Notably however, the PD coefficient was negative (-0.119) when the dependent variable was ROA, and this result was significant at the $p < 0.05$ level. This implies that while political connections via key corporate positions may improve the performance of POEs', as the level of political intervention in the board of directors increases, their accounting performance may be adversely affected. The above findings are of relevance to the H1a-POE and H3a-POE hypotheses, as discussed below.

With regard to the CG system in the Chinese top POEs, the positive impacts of large board size (BS 0.444, probability 0.011) and board independence (BI 12.177, probability 0.057) are evident. The BI results support the agency theory, and indicate that the CG structure and mechanisms in Chinese corporations may only be influential when the level of CCP influence is reduced. In comparison with previous studies reporting insignificant correlations between the size of the supervisory board and firm performance, the results of this study suggest that the size of the supervisory board in Chinese POEs has a positive but marginal effect on ROA (coefficient of 0.005, $p < 0.10$), and that the Chinese stock market reacts negatively to the size of the supervisory board (-0.477, $p < 0.05$). These findings are consistent with some prior studies (Bremert and Schulten, 2008; Cho and Rui, 2009; Zheng and Wei, 2010;

Dombrovsky, 2011). Although the CG system in the Chinese POEs is characterised by family or founding person control, CEO duality was not significantly associated with either accounting performance or market performance. Lastly, firm characteristics such as leverage level and firm size were found to have significant impacts on the performance of Chinese POEs.

Matched SOEs

The results reported in Table 8.10 show the influence of CCP control on the performance of a group of SOEs that were of similar size and are from the same industries as the top 50 POEs. In this matched SOEs group, CCP control through the board of directors (PD) had a statistically significant negative impact on the accounting performance (-0.053, $p < 0.01$). Having the position of CEO occupied by a CCP committee member (DCEO) also had a significant negative effect on market performance (-2.106, $p < 0.01$). These findings suggest that as the level of CCP control through directors increased, these SOEs' accounting performances decreased, and CCP control through the position of CEO had a negative effect on market performance. These observations confirm this study's research expectations, and are consistent with prior studies (Fisman, 2001; Ang and Ding, 2006; Najid and Rahman, 2011). Collectively, these studies suggest that one of the reasons for the negative association between political connections and firm performance is that politically connected firms are often motivated by political goals rather than the purpose of maximizing firm value. Therefore, H3a-match and H1b-match were empirically supported.

Table 8.10: Influence of CCP control on firm performance in matched SOEs

<u>Variables</u>	<u>ROA</u>		<u>TQ</u>	
	<u>Coefficient</u>	<u>Probability</u>	<u>Coefficient</u>	<u>Probability</u>
<u>DCHA</u>	-0.008	0.550	-0.320	0.730
<u>DCEO</u>	0.002	0.837	-2.106	0.007***
<u>DSC</u>	-0.003	0.593	-0.328	0.490
<u>PD</u>	-0.053	0.009***	-0.240	0.864
<u>PS</u>	0.000	0.973	-0.348	0.652
<u>PM</u>	0.014	0.231	0.341	0.675
<u>BS</u>	-0.001	0.359	-0.025	0.801
<u>BI</u>	-0.011	0.816	6.737	0.031**
<u>SS</u>	-0.001	0.483	-0.156	0.191

DUAL	-0.006	0.373	-0.022	0.964
LEV	-0.086	< 0.001***	-5.880	< 0.001***
SIZE	0.008	0.003***	-0.290	0.121
PEBIT	0.393	< 0.001***	11.882	0.001***
Constant	0.026	0.344	5.999	0.008***
Industry	<i>Yes</i>		<i>Yes</i>	
Year	<i>Yes</i>		<i>Yes</i>	
R²	0.608		0.487	
Adjusted R²	0.535		0.376	
No. of Obs.	141		141	
F-Statistic	8.3326		4.3720	
Probability (F-stat)	< 0.001		< 0.001	

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Refer to the footnotes directly below Table 8.1 for a description of the abbreviations used in this table.

Similar to the results derived from the top POEs, board independence (BI) had a positive impact on market performance in the matched SOEs. This implies that as these SOEs were smaller in size and operated in less strategic industries than the largest SOEs, the level of CCP control was lower—which was evidenced by the univariate test results in this study—and thus CG had the desired effect. In terms of firm characteristics, matched SOEs that had a lower proportion of long term debt (LEV -0.086 vs. -5.880, $p < 0.01$), larger firm size (SIZE 0.008, $p < 0.01$) and higher profitability in the previous year (PEBIT 0.393 vs. 11.882, $p < 0.01$) had a higher mean performance than other small SOEs.

8.6. Robustness Checks and Sensitivity Tests

In the previous section, the main empirical results were presented, and they demonstrated an association between CCP influence and firm performance in three different groups of Chinese firms, including the largest SOEs, the largest POEs and small or medium SOEs. In order to verify the sensitivity of these empirical results and to ensure the robustness of the findings generated from the main regression analysis, a series of additional sensitivity tests were conducted and the results are reported in this section. Firstly, to determine the validity of the results generated by the OLS regression analysis, *i.e.* whether the OLS standard errors were biased or not, an alternative regression estimation method of clustered standard errors by two dimensions (CSE-TD), year and firm, was employed. The results of this analysis are

reported in Section 8.6.1. Next, alternative measures of the dependent variable, firm performance, were utilised in the regression models, and these analyses are discussed in Section 8.6.2. Lastly, the potential endogeneity problem between firm performance and the political influence of the CCP was addressed in two ways. One involved the regressions using lagged independent variables or a one-year-ahead dependent variable, and the other utilised the two-stage least squares (2SLS) regression method based on instrumental variables (IVs). The results yielded by the main initial series of statistical tests were confirmed to a large extent by the results of the sensitivity tests. Therefore, the main OLS test results could be viewed as highly robust.

8.6.1. Clustered Standard Errors by Two Dimensions

With the purpose of supplementing the pooled OLS regression results, the panel structure of the sample data was reanalysed using the CSE-TD regression estimation method¹⁹⁸. Following the structure of the main regression analysis, a CSE-TD analysis was first conducted on the full sample of all 150 Chinese firms to examine the general associations between CCP influence and firm performance. Separate analyses using this regression method were then performed for the top 50 SOEs, largest 50 POEs and the matched SOEs, in order to provide supporting evidence on the different impacts of CCP control and connections on the performance of groups of Chinese firms that were differentiated in terms of controlling ownership and firm size.

¹⁹⁸ It is generally agreed that the standard errors generated by OLS regression are unbiased when the residuals are independent and normally distributed, otherwise the true variability of the coefficients estimates would be incorrectly estimated, which leads to invalid results and conclusions. Petersen (2009) addressed two general forms of correlations in the residuals: the unobserved firm effect, where the residuals of a given firm are likely to be correlated across years, and the time effect, where the residuals of a given year are correlated across different firms. The regression estimation method of CSE-TD of firm and year is argued by Petersen (2009) to be effective for managing potentially biased OLS standard errors resulting from either or both of these two forms of correlations in residuals. “Cluster” refers to a unit, which may be a firm or an entire industry.

Table 8.11: CCP influence on firm performance in the full sample (CSE-TD)

<u>Variables</u>	<u>ROA</u>		<u>TQ</u>	
	<u>Coefficient</u>	<u>Probability</u>	<u>Coefficient</u>	<u>Probability</u>
<u>DCHA</u>	0.0069	< 0.001***	-0.2431	0.728
<u>DCEO</u>	0.0116	0.054*	0.8916	0.116
<u>DSC</u>	-0.0025	0.743	0.3931	0.356
<u>PD</u>	-0.0482	0.120	-0.4347	0.507
<u>PS</u>	-0.0006	0.932	-1.1953	0.023**
<u>PM</u>	-0.0043	0.694	-0.9349	0.117
<u>BS</u>	-0.0012	0.494	0.0662	0.318
<u>BI</u>	-0.0845	< 0.001***	1.5925	0.171
<u>SS</u>	0.0011	0.328	-0.0290	0.653
<u>DUAL</u>	-0.0028	0.344	-0.0264	0.942
<u>LEV</u>	-0.0676	< 0.001***	-1.0377	0.095*
<u>SIZE</u>	0.0049	< 0.001***	-0.5017	< 0.001***
<u>PEBIT</u>	0.3502	< 0.001***	5.0794	0.128
<u>Constant</u>	0.0438	0.137	5.2787	< 0.001***
<u>R²</u>		0.4854		0.1523
<u>No. of Obs.</u>		413		413
<u>F-Statistic</u>		21.80		5.58
<u>Probability (F-stat)</u>		< 0.001		< 0.001

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Refer to the footnotes directly below Table 8.1 for a description of the abbreviations used in this table.

Standard errors are clustered in two dimensions by firm and year.

Table 8.11 above shows the results of an analysis of the full sample conducted using the CSE-TD method. The results show that CCP influence via the key corporate position of the chairman of the board of directors (DCHA 0.0069, $p < 0.01$) had a statistically significant positive impact on ROA. However, CCP influence via the CEO only had a marginal impact on ROA (DCEO 0.0116, $p = 0.054$). The results regarding the CG system and firm characteristics were also mostly consistent with the main OLS test results. Board independence (BI) was significantly negatively associated with ROA (-0.0845, $p < 0.01$). The correlations between firm characteristics variables and firm performance measures followed the same pattern as those of the main OLS test.

Table 8.12: Influence of CCP control on firm performance in top SOEs (CSE-TD)

<u>Variables</u>	<u>ROA</u>		<u>TQ</u>	
	<u>Coefficient</u>	<u>Probability</u>	<u>Coefficient</u>	<u>Probability</u>
<u>DCHA</u>	-0.0007	0.904	-0.1646	< 0.001***
<u>DCEO</u>	0.0511	< 0.001***	0.7797	< 0.001***

<u>DSC</u>	0.0042	0.159	0.5405	0.012**
<u>PD</u>	-0.0052	0.850	0.3211	0.457
<u>PS</u>	0.0003	0.984	0.1963	0.064*
<u>PM</u>	-0.0257	< 0.001***	-0.6183	0.046**
<u>BS</u>	-0.0006	0.679	0.0158	0.292
<u>BI</u>	-0.0578	< 0.001***	-0.3764	0.237
<u>SS</u>	0.0008	0.185	0.0022	0.923
<u>DUAL</u>	0.0097	< 0.001***	0.1171	0.262
<u>LEV</u>	-0.0708	< 0.001***	-1.0313	< 0.001***
<u>SIZE</u>	0.0042	0.125	-0.3213	< 0.001***
<u>PEBIT</u>	0.2684	0.001***	2.9348	0.006***
<u>Constant</u>	-0.0110	0.299	3.8049	< 0.001***
<u>R²</u>		0.4413		0.3226
<u>No. of Obs.</u>		136		136
<u>F-Statistic</u>		7.41		4.47
<u>Probability (F-stat)</u>		< 0.001		< 0.001

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Refer to the footnotes directly below Table 8.1 for a description of the abbreviations used in this table.

Standard errors are clustered in two dimensions by firm and year.

Table 8.13: Influence of CCP connections on firm performance in top POEs (CSE-TD)

<u>Variables</u>	<u>ROA</u>		<u>TQ</u>	
	<u>Coefficient</u>	<u>Probability</u>	<u>Coefficient</u>	<u>Probability</u>
<u>DCHA</u>	0.0224	< 0.001***	-0.8456	0.578
<u>DCEO</u>	0.0190	0.151	3.8792	0.032**
<u>DSC</u>	-0.0198	0.296	0.2888	0.880
<u>PD</u>	-0.1059	< 0.001***	4.3504	0.447
<u>PS</u>	0.0394	0.001***	-3.9616	0.286
<u>PM</u>	0.0020	0.970	-8.5944	0.231
<u>BS</u>	-0.0013	0.773	0.4628	0.080*
<u>BI</u>	-0.1410	0.166	11.7353	0.097*
<u>SS</u>	0.0041	0.068*	0.16605	0.423
<u>DUAL</u>	-0.0037	0.032**	-0.2840	0.642
<u>LEV</u>	-0.0722	< 0.001***	0.1319	0.904
<u>SIZE</u>	0.0055	0.025**	-0.5841	0.013**
<u>PEBIT</u>	0.3161	< 0.001***	1.8480	0.755
<u>Constant</u>	0.0524	< 0.001***	-2.4279	0.544
<u>R²</u>		0.5276		0.1867
<u>No. of Obs.</u>		136		136
<u>F-Statistic</u>		7.38		1.76
<u>Probability (F-stat)</u>		< 0.001		0.0578

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Refer to the footnotes directly below Table 8.1 for a description of the abbreviations used in this table.

Standard errors are clustered in two dimensions by firm and year.

Table 8.14: Influence of CCP control on firm performance in matched SOEs (CSE-TD)

<u>Variables</u>	<u>ROA</u>		<u>TQ</u>	
	<u>Coefficient</u>	<u>Probability</u>	<u>Coefficient</u>	<u>Probability</u>
<u>DCHA</u>	-0.0123	0.057*	0.6061	0.154
<u>DCEO</u>	-0.0006	0.928	-1.1496	0.001***
<u>DSC</u>	-0.0042	0.001***	0.2330	0.557
<u>PD</u>	-0.0464	0.018**	-0.4098	0.597
<u>PS</u>	0.0053	< 0.010***	-0.0458	0.903
<u>PM</u>	0.0136	0.243	0.2837	0.524
<u>BS</u>	-0.0011	0.191	0.0113	0.872
<u>BI</u>	-0.0282	0.002***	1.6294	0.562
<u>SS</u>	-0.0013	0.423	-0.0891	0.673
<u>DUAL</u>	0.0012	0.636	-0.0888	0.754
<u>LEV</u>	-0.0850	< 0.001***	-3.2900	0.026**
<u>SIZE</u>	0.0084	< 0.001***	-0.5843	0.013**
<u>PEBIT</u>	0.4157	0.003***	12.9156	0.066*
<u>Constant</u>	0.0290	0.163	6.9426	< 0.001***
<u>R²</u>		0.5840		0.3422
<u>No. of Obs.</u>		142		142
<u>F-Statistic</u>		13.82		6.02
<u>Probability (F-stat)</u>		< 0.001		< 0.001

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Refer to the footnotes directly below Table 8.1 for a description of the abbreviations used in this table.

Standard errors are clustered in two dimensions by firm and year.

The CSE-TD results for each of the three groups of Chinese firms are presented in tables 8.12, 8.13 and 8.14 above. These results regarding the impacts of CCP control and connections, CG structure and mechanisms, and firm characteristics on the performances of the largest SOEs, the top POEs and the matched SOEs were almost entirely consistent with those of the initial main tests. Specifically, as shown in in Table 8.12 CCP control via the CEO had a significant positive impact on both the accounting and market performances of the largest SOEs (DCEO 0.0511 for ROA and 0.7797 for TQ, $p < 0.01$ for both). Regarding the CG system, board independence (BI) and CEO duality (DUAL) were negatively and positively associated with ROA respectively (-0.0578 and 0.0097, $p < 0.01$ for both). As shown in Table 8.13, in the top POEs' political connection with the CCP via the chairman of the board of directors (DCHA) was positively associated with ROA (0.0224, $p < 0.01$). Political connection with CCP via the CEO (DCEO) also had a significant positive impact on TQ in this group (3.8792, $p < 0.05$). Also consistent with the main tests, as the CCP's intervention on the board of directors increased, accounting performance in the top

POEs was likely to be reduced (PD -0.1059, $p < 0.01$). Board size (BS) and board independence (BI) were both positively associated with market performance, although these correlations were marginal. As shown in Table 8.14, CCP control in the matched SOEs had significant negative impacts on both accounting and market performance (via PD on ROA, -0.0464, $p < 0.05$; via DSC on ROA, -0.0042, $p < 0.01$; via DCEO on TQ, -1.1496, $p < 0.01$). In summary, the results presented above largely confirmed the results generated by the main pooled OLS regression tests.

8.6.2. Alternative Measures of the Dependent Variable

This study also utilised alternative measures of firm performance to test the robustness of the main OLS test results. Besides the definitions of ROA and TQ used in the main regression analysis, previous studies reported in the literature have also other measures of firm performance, including Return on Equity (ROE) as an indicator of accounting performance, and the Price-to-Book (P/B) ratio as an indicator of market performance. These firm performance measures are commonly employed by studies in the literature either in their main tests or as alternative measures in their robustness tests (Chang and Wong, 2004; Cheung et al., 2008; Najid and Rahman, 2011; Hu and Leung, 2012; Wu et al., 2012; Liu et al., 2015).

The definition of ROE that was followed in this study was current year's closing net income divided by current year's closing total shareholders' equity. This ratio indicates how well a company utilises the investments from shareholders to generate earnings. On the other hand, the P/B ratio compares a company's current market share price to its book value per share. A high value for this ratio indicates high market expectation, where market investors expect the corporate management to create more value using a particular amount and structure of assets. Following previous studies, the definition of P/B ratio adopted in this study was company's current year's closing share price divided by the result of dividing the company's book value of its common shares by the total number of common shares outstanding (Cheung et al., 2008; Najid and Rahman, 2011). Although these results are not reported in detail in this section, the main findings generated in the initial analyses remained unchanged after using these alternative measures of ROA and TQ in the

main OLS regression models.

8.6.3. Tests for Endogeneity

Endogeneity refers to the phenomenon where one or more independent variables are correlated with the error term in the regression model (Zulehner, 2007; Katchova, 2013). The issue of endogeneity is commonly addressed in the areas of quantitative accounting research, such as political influence and CG, mainly because such a problem could potentially compromise the validity of OLS regression estimates, causing these estimates to be biased and inconsistent (Larcker et al., 2007; Boubakri et al., 2008; Larcker and Rusticus, 2010). There are three ways in which this could happen. One is via correlated omitted variable bias, where a variable that affects both the dependent and the independent variables is not included in the regression. Another is simultaneous causality bias, where a loop of causality between the dependent and independent variables exists¹⁹⁹. Lastly, there may be variable measurement error bias, where the independent variables are measured with errors (Zulehner, 2007; Bhagat and Bolton, 2008; Larcker and Rusticus, 2010).

In the accounting research literature, political influence variables, which mainly involve the measurement of political influence based on senior corporate executives' personal political background, are often viewed as endogenous (Boubakri et al., 2008; Dahya et al., 2008; Chang and Wong, 2009; Hung et al., 2012; Yang et al., 2014). Previous studies have utilised two approaches to address the potential problem of endogeneity. One is regression models with lagged independent variables, where the dependent variable of period " t " is regressed on the independent variables of a previous period " $t-1$ " (Chang and Wong, 2009; Peng and Jiang, 2010; Yang et al., 2014). The other is the 2SLS regression method based on IVs, which is the more commonly employed method (Boubakri et al., 2008; Dahya et al., 2008; Guest, 2009; Brown et al., 2011; Yang et al., 2014). In this current study, both of these methods were employed to address the potential for endogeneity in the main OLS regression

¹⁹⁹ A loop of causality between the dependent and independent variables refers to a situation where the dependent and explanatory variables are simultaneously determined, *i.e.* where the independent variable, X, explains the dependent variable, Y; and Y causes X simultaneously.

analysis.

One-Year-Ahead Performance

Using lagged independent variables to regress the dependent variable of the current period is a strategy designed to address the possibility of the second type of threat that is posed by endogeneity, namely reverse-causality between the dependent and independent variables. The main aim of this method is determine whether the dependent variable in the present year (“ t ”) affects the independent variable of the previous year (“ $t-1$ ”) (Yang et al., 2014). In terms of the association between political control by the CCP and firm performance in China, the aim was to determine whether firm performance in the present year (t) was associated with CCP influence in the previous year ($t-1$). The method was modified slightly in this current study in terms of the time period, where firm performance of the one-year-ahead period “ $t+1$ ” was utilised in the main regression models, while keeping the period of the independent variables unchanged. Therefore, the sample period for the independent variables was 2009 to 2011, and that for the dependent variable was 2010 to 2012.

Table 8.15: Test for endogeneity 1 - full sample (one-year-ahead accounting performance)

<u>Variables</u>	<u>ROA</u>					
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>
<u>SOE</u>	0.004 (0.612)	0.002 (0.800)	0.001 (0.894)	-0.001 (0.890)	-0.001 (0.919)	0.000 (0.948)
<u>POE</u>	0.016 (0.005***)	0.011 (0.089*)	0.008 (0.158)	0.001 (0.911)	0.011 (0.071*)	0.010 (0.070*)
<u>DCHA</u>	0.014 (0.041**)					
<u>DCEO</u>		0.001 (0.939)				
<u>DSC</u>			-0.006 (0.221)			
<u>PD</u>				-0.034 (0.048**)		
<u>PS</u>					0.003 (0.719)	
<u>PM</u>						0.003 (0.765)
<u>BS</u>	0.0012 (0.2503)	0.0011 (0.3025)	0.0012 (0.2495)	0.0002 (0.8746)	0.0007 (0.5154)	0.0007 (0.4933)
<u>BI</u>	-0.0155	-0.0178	-0.0112	-0.0490	-0.0393	-0.0384

	(0.6256)	(0.5790)	(0.7279)	(0.1330)	(0.2332)	(0.2398)
<u>SS</u>	0.0002	0.0002	0.0004	-0.0002	-0.0001	-0.0002
	(0.8886)	(0.8540)	(0.7724)	(0.8980)	(0.9243)	(0.8900)
<u>DUAL</u>	-0.0077	-0.0072	-0.0067	-0.0094	-0.0083	-0.0084
	(0.1206)	(0.1462)	(0.1763)	(0.0585*)	(0.0932*)	(0.0913*)
<u>LEV</u>	-0.0681	-0.0692	-0.0694	-0.0684	-0.0689	-0.0680
	(< 0.001***)	(< 0.001***)	(< 0.001***)	(< 0.001***)	(< 0.001***)	(< 0.001***)
<u>SIZE</u>	0.0014	0.0020	0.0024	0.0029	0.0020	0.0019
	(0.4769)	(0.2856)	(0.2051)	(0.1393)	(0.2906)	(0.3357)
<u>PEBIT</u>	0.2370	0.2359	0.2326	0.2204	0.2281	0.2289
	(< 0.001***)	(< 0.001***)	(< 0.001***)	(< 0.001***)	(< 0.001***)	(< 0.001***)
<u>Constant</u>	0.0035	0.0122	0.0098	0.0261	0.0081	0.0087
	(0.8790)	(0.5897)	(0.6641)	(0.2700)	(0.7133)	(0.6948)
<u>Industry</u>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>
<u>Year</u>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>
<u>R²</u>	0.370	0.364	0.366	0.364	0.358	0.358
<u>Adjusted R²</u>	0.335	0.328	0.330	0.330	0.323	0.323
<u>No. of Obs.</u>	413	413	413	413	413	413
<u>F-Statistic</u>	10.4329	10.1325	10.2393	10.6576	10.3749	10.3720
<u>Probability (F-stat)</u>	< 0.001	< 0.001	< 0.001	< 0.001	< 0.001	< 0.001

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$; p values are reported in parentheses below each coefficient.

The dependent variable is the return-on-assets ratio (ROA).

SOE and POE are two dummy variables used to indicate whether a firm-year observation belongs to a top SOE or a top POE respectively.

Dummy variables for Year and Industry were included in the regression models, but the results are not shown due to space constraints.

Refer to the footnotes directly below Table 8.1 for a description of the other abbreviations used in this table.

Table 8.16: Test for Endogeneity 1 - full sample (one-year-ahead market performance)

<u>Variables</u>	<u>TQ</u>					
	<u>1</u>	<u>2</u>	<u>3</u>	<u>4</u>	<u>5</u>	<u>6</u>
<u>SOE</u>	0.499 (0.312)	0.725 (0.126)	0.726 (0.129)	0.675 (0.157)	0.673 (0.158)	0.714 (0.134)
<u>POE</u>	0.652 (0.110)	1.259 (0.004***)	0.915 (0.017**)	0.742 (0.113)	0.744 (0.068*)	0.962 (0.014**)
<u>DCHA</u>	-0.544 (0.246)					
<u>DCEO</u>		0.909 (0.039**)				
<u>DSC</u>			0.422 (0.214)			
<u>PD</u>				0.060 (0.959)		
<u>PS</u>					0.055 (0.933)	
<u>PM</u>						0.890 (0.181)
<u>BS</u>	0.181 (0.017**)	0.149 (0.047**)	0.135 (0.074*)	0.145 (0.062*)	0.144 (0.056*)	0.152 (0.044**)
<u>BI</u>	1.779 (0.430)	-0.936 (0.675)	-1.046 (0.643)	-0.608 (0.790)	-0.671 (0.770)	-1.134 (0.617)
<u>SS</u>	0.017	-0.076	-0.075	-0.067	-0.066	-0.067

	(0.854)	(0.429)	(0.435)	(0.489)	(0.498)	(0.483)
DUAL	-0.120	-0.244	-0.212	-0.177	-0.180	-0.231
	(0.732)	(0.477)	(0.539)	(0.609)	(0.600)	(0.503)
LEV	-1.346	-0.977	-0.837	-0.842	-0.850	-0.759
	(0.136)	(0.262)	(0.337)	(0.335)	(0.333)	(0.385)
SIZE	-0.553	-0.664	-0.666	-0.641	-0.639	-0.672
	(< 0.001***)	< 0.001***)	(< 0.001***)	(< 0.001***)	(< 0.001***)	(< 0.001***)
PEBIT	4.301	1.799	2.378	2.126	2.116	2.311
	(0.056*)	(0.430)	(0.300)	(0.355)	(0.355)	(0.312)
Constant	3.365	4.183	4.789	4.622	4.642	4.641
	(0.040**)	(0.007***)	(0.002***)	(0.005***)	(0.003***)	(0.003***)
Industry	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>
Year	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>
R²	0.144	0.176	0.170	0.167	0.167	0.171
Adjusted R²	0.096	0.129	0.123	0.120	0.120	0.124
No. of Obs.	412	412	412	412	412	412
F-Statistic	2.9847	3.7739	3.6234	3.5390	3.5392	3.6366
Probability (F-stat)	< 0.001	< 0.001	< 0.001	< 0.001	< 0.001	< 0.001

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$; p values are reported in parentheses below each coefficient.

The dependent variable is the return-on-assets ratio (ROA).

SOE and POE are two dummy variables used to indicate whether a firm-year observation belongs to a top SOE or a top POE, respectively.

Dummy variables for Year and Industry were included in the regression models, but the results are not shown due to space constraints.

Refer to the footnotes directly below Table 8.1 for a description of the other abbreviations used in this table.

Tables 8.15 and 8.16 present the regression results using the one-year-ahead firm performance for the full sample of all 150 Chinese firms. These results confirm the findings generated by the main regression tests to a large degree. Firstly, the results on the association between CCP influence and accounting performance contained in Table 8.15 show that CCP influence via the chairman of the board of directors (DCHA) had a significant positive effect on ROA (0.014, $p < 0.05$). CCP influence over the board of directors (PD) was negatively correlated with ROA (-0.034, $p < 0.05$). With regard to the CG system and firm characteristics, the results are also largely consistent, except for the marginal effects of board independence (BI) and firm size (SIZE) on ROA suggested by the statistically non-significant coefficients of these two variables. In Table 8.16, the OLS regression results using present year's CCP influence, CG system and firm characteristics, and the one-year-ahead market performance are reported. These results are also largely consistent with those generated by the initial main tests. For example, CCP influence via the CEO (DCEO) was significantly and positively correlated with TQ (0.909, $p < 0.05$).

Table 8.17: Test for endogeneity 1 - top SOEs (one-year-ahead performance)

<u>Variables</u>	<u>ROA</u>		<u>TQ</u>	
	<u>Coefficient</u>	<u>Probability</u>	<u>Coefficient</u>	<u>Probability</u>
<u>DCHA</u>	0.000	0.996	-0.077	0.853
<u>DCEO</u>	0.053	0.009***	0.567	0.065*
<u>DSC</u>	0.005	0.469	0.182	0.114
<u>PD</u>	-0.006	0.814	-0.134	0.716
<u>PS</u>	0.010	0.451	0.516	0.008***
<u>PM</u>	-0.014	0.270	-0.185	0.286
<u>BS</u>	0.0001	0.930	0.015	0.485
<u>BI</u>	-0.029	0.443	-0.569	0.312
<u>SS</u>	-0.001	0.761	0.008	0.766
<u>DUAL</u>	0.006	0.431	0.033	0.762
<u>LEV</u>	-0.080	< 0.001***	-0.395	0.108
<u>SIZE</u>	0.002	0.572	-0.104	0.045**
<u>PEBIT</u>	0.401	< 0.001***	1.698	0.049**
<u>Constant</u>	-0.030	0.996	1.258	0.167
<u>Industry</u>	<i>Yes</i>		<i>Yes</i>	
<u>Year</u>	<i>Yes</i>		<i>Yes</i>	
<u>R²</u>	0.649		0.458	
<u>Adjusted R²</u>	0.588		0.369	
<u>No. of Obs.</u>	136		136	
<u>F-Statistic</u>	10.6478		5.1494	
<u>Probability (F-stat)</u>	< 0.001		< 0.001	

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Refer to the footnotes directly below Table 8.1 for a description of the abbreviations used in this table.

Table 8.18: Test for endogeneity 1 - top POEs (one-year-ahead performance)

<u>Variables</u>	<u>ROA</u>		<u>TQ</u>	
	<u>Coefficient</u>	<u>Probability</u>	<u>Coefficient</u>	<u>Probability</u>
<u>DCHA</u>	0.048	0.002***	-2.249	0.119
<u>DCEO</u>	0.026	0.153	3.743	0.031**
<u>DSC</u>	-0.064	0.001***	-1.108	0.539
<u>PD</u>	-0.243	< 0.001***	4.154	0.502
<u>PS</u>	0.142	0.002***	0.490	0.911
<u>PM</u>	-0.004	0.956	-3.323	0.621
<u>BS</u>	0.003	0.307	0.948	0.002***
<u>BI</u>	-0.003	0.979	8.951	0.416
<u>SS</u>	0.003	0.382	0.100	0.767
<u>DUAL</u>	-0.020	0.160	-0.485	0.734
<u>LEV</u>	-0.035	0.283	-2.768	0.372
<u>SIZE</u>	0.001	0.788	-1.079	0.017**
<u>PEBIT</u>	0.135	0.016**	5.492	0.294
<u>Constant</u>	-0.025	0.712	-2.767	0.642
<u>Industry</u>	<i>Yes</i>		<i>Yes</i>	
<u>Year</u>	<i>Yes</i>		<i>Yes</i>	

<u>R²</u>	0.396	0.256
<u>Adjusted R²</u>	0.266	0.094
<u>No. of Obs.</u>	136	135
<u>F-Statistic</u>	3.0341	1.5805
<u>Probability</u> (F-stat)	< 0.001	< 0.001

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Refer to the footnotes directly below Table 8.1 for a description of the abbreviations used in this table.

Table 8.19: Test for endogeneity 1 - matched SOEs (one-year-ahead performance)

<u>Variables</u>	<u>ROA</u>		<u>TQ</u>	
	<u>Coefficient</u>	<u>Probability</u>	<u>Coefficient</u>	<u>Probability</u>
<u>DCHA</u>	-0.001	0.949	0.172	0.763
<u>DCEO</u>	-0.009	0.563	-1.081	0.016**
<u>DSC</u>	0.005	0.606	0.062	0.820
<u>PD</u>	-0.022	0.445	-0.062	0.940
<u>PS</u>	-0.013	0.424	-0.390	0.407
<u>PM</u>	0.022	0.176	0.132	0.778
<u>BS</u>	-0.001	0.458	-0.007	0.900
<u>BI</u>	0.006	0.926	3.174	0.086*
<u>SS</u>	-0.001	0.677	-0.093	0.178
<u>DUAL</u>	-0.015	0.132	-0.145	0.621
<u>LEV</u>	-0.103	< 0.001***	-3.536	< 0.001***
<u>SIZE</u>	0.009	0.016**	-0.291	0.009***
<u>PEBIT</u>	0.367	< 0.001***	5.897	0.007***
<u>Constant</u>	0.016	0.689	5.801	< 0.001***
<u>Industry</u>	Yes		Yes	
<u>Year</u>	Yes		Yes	
<u>R²</u>	0.479		0.534	
<u>Adjusted R²</u>	0.387		0.452	
<u>No. of Obs.</u>	141		135	
<u>F-Statistic</u>	5.2145		6.4917	
<u>Probability</u> (F-stat)	< 0.001		< 0.001	

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Refer to the footnotes directly below Table 8.1 for a description of the abbreviations used in this table.

Tables 8.17, 8.18 and 8.19 present the regression results regarding the different impacts of CCP control and connections in the largest SOEs, top POEs and matched SOEs, using one-year-ahead accounting and market performance, and controlling for the effects of the CG system and firm characteristics. The findings generated in the initial main tests were supported by those of these supplementary

tests to a large extent. In the top SOEs, CCP control via the CEO (DCEO) had significant positive impacts on both ROA and TQ (Table 8.17). In the top POEs, political connections with the CCP via the key corporate positions of chairman of the board of directors (DCHA) and CEO (DCEO) had significant positive effects on ROA and TQ respectively (Table 8.18). In the matched SOEs, CCP control via the CEO (DCEO) was negatively associated with TQ (Table 8.19, coefficient of -1.081, $p < 0.05$).

2-Stage Least-Square Regressions on Instrumental Variables

The most commonly employed method for dealing with the potential problem of endogeneity is 2SLS regression based on IVs (Larcker and Rusticus, 2010). According to Zulehner (2007) and Katchova (2013), IVs can be used to address the three major types of bias and threats that may result from endogeneity. For example, IVs may capture unobserved effects on potentially endogenous independent variable(s) that are not included in OLS regression models. Notably, as is widely acknowledged, identifying valid IVs that are only correlated with the endogenous variables but are themselves exogenous is the most critical factor when implementing this approach (Zulehner, 2007; Guest, 2009; Hung et al., 2012; Katchova, 2013).

In this current study, three variables that were most likely to satisfy these criteria were identified and employed by examining some prior studies. In accordance with Boubakri et al. (2008), Hung et al. (2012) and Yang et al. (2014), firm location or regional marketization and institutional environment, which is indicated by the Chinese Provincial NERI Market Index²⁰⁰, was selected as the first IV. According to Sun et al. (2005) and Hung et al. (2012), institutional environment may affect political influence and intervention at the corporate level. Similar to the IVs selected by Hung et al. (2012), strategic industry²⁰¹ and bureaucratic ranking²⁰² were employed as the

²⁰⁰ Fan Gang, Wang Xiaolu, Zhang Liwen, April 2001, Annual Report 2000 Marketization Index for China's Provinces, see cerdi.org/uploads/sfCmsContent/html/192/Fangang.pdf.

²⁰¹ Strategic industry is a dummy variable indicating whether a firm-year observation belongs to any of the industries covered by the stimulus package launched by the Chinese State Council in 2008 to mitigate the impact of the Global Financial Crisis (GFC) on China's economy. This stimulus package amounted to US \$580 billion (or 4 trillion RMB) and involved thousands of projects, and more than 60% of it was invested in the construction of infrastructure including railways, highways and airports. Other projects mainly included direct subsidies for the purchase of household appliances, agricultural

second and third IVs, as it was expected that the level of CCP intervention and influence would be higher in firms engaged in more strategic industries and in firms ranked higher in the Chinese bureaucratic system. This expected positive association between CCP influence and bureaucratic ranking was verified by the results of this study's univariate tests to a large extent (see Table 8.3).

The 2SLS regression based on IVs was implemented in accordance with previous studies (Boubakri et al., 2008; Dahya et al., 2008; Guest, 2009; Brown et al., 2011; Hung et al., 2012; Yang et al., 2014). Specifically, a first-stage model was estimated by regressing the endogenous variables on IVs and controls, then at the second stage the predicted values of the CCP influence variables derived from the first stage were utilised in place of these variables.

The results of the 2SLS regressions using IVs for the full sample are shown in Table 8.20 below, and they are consistent with the results generated by the main OLS regression models. Firstly, as indicated by the positive coefficients of POE in both the regressions for ROA and TQ (0.013 and 0.807, $p < 0.01$ for both), the largest Chinese POEs were likely to have both higher accounting performance and higher market performance. More importantly, the IVs for CCP influence via the chairman of the board of directors and CEO were both positively associated with ROA, with an IVDCHA coefficient of 0.014 ($p < 0.01$) and an IVDCEO coefficient of 0.012 ($p < 0.05$). IVDCEO also had a positive impact on TQ, albeit of only marginal significance (0.637, $p < 0.10$). In addition, the results regarding the effects of the CG system and firm characteristics yielded by this IV approach were also consistent with the results of the initial analysis.

machinery and tools (People's Daily, <http://finance.people.com.cn/GB/1037/8306806.html>).

²⁰² Bureaucratic ranking is a dummy variable that takes the values of 4, 3, 2 or 1 depending on a firm is at the ministerial, provincial, municipal or county levels respectively. For POEs, it takes the value of 0 because they are not part of China's bureaucratic system.

Table 8.20: Test for endogeneity 2 - full sample (2-stage IV models)

<u>Variables</u>	<u>ROA</u>				<u>TQ</u>			
	<u>Coeff.</u>	<u>p Value</u>	<u>Coeff.</u>	<u>p Value</u>	<u>Coeff.</u>	<u>p Value</u>	<u>Coeff.</u>	<u>p Value</u>
<u>SOE</u>	-0.004	0.519	-0.004	0.478	0.035	0.933	0.163	0.680
<u>POE</u>	0.013	0.001***	0.014	0.001***	0.807	0.008***	0.781	0.008***
<u>IVDCHA</u>	0.014	0.009***			-0.010	0.978		
<u>IVDCEO</u>			0.012	0.021**			0.637	0.079*
<u>BS</u>	-0.0004	0.605	-0.001	0.522	0.128	0.045**	0.091	0.141
<u>BI</u>	-0.067	0.009***	-0.077	0.003***	1.783	0.345	-0.783	0.672
<u>SS</u>	0.001	0.638	0.0004	0.687	0.037	0.637	-0.058	0.459
<u>DUAL</u>	-0.001	0.794	-0.002	0.705	-0.015	0.959	0.014	0.960
<u>LEV</u>	-0.079	< 0.001***	-0.081	< 0.001***	-1.675	0.030**	-1.560	0.030**
<u>SIZE</u>	0.004	0.010***	0.004	0.005***	-0.485	< 0.001***	-0.565	< 0.001***
<u>PEBIT</u>	0.231	< 0.001***	0.225	< 0.001***	4.599	0.014**	1.813	0.332
<u>Constant</u>	0.034	0.057*	0.037	0.038**	3.793	0.004***	5.750	< 0.001***
<u>Industry</u>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>
<u>Year</u>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>
<u>R²</u>		0.482		0.480		0.191		0.257
<u>Adjusted R²</u>		0.452		0.449		0.147		0.214
<u>No. of Obs.</u>		413		413		413		413
<u>F-Statistic</u>		15.7593		15.6256		4.3840		5.8643
<u>Probability (F-stat)</u>		< 0.001		< 0.001		< 0.001		< 0.001

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

IVDCHA is the fitted value of DCHA generated by regressing DCHA on three IVs, including Location (NERI Market Index), Strategic industry and Bureaucratic ranking.

IVDCEO is the fitted value of DCEO generated by regressing DCEO on three IVs, including Location (NERI Market Index), Strategic industry and Bureaucratic ranking.

Refer to the footnotes directly below Table 8.1 for a description of the other abbreviations used in this table.

The IV approach results for each of the three groups of Chinese firms are presented in Tables 8.21, 8.22 and 8.23. The findings generated by the main OLS regression models were supported to a large extent, for all groups. In the largest SOEs (Table 8.21), the predicted values of CCP control via the CEO (IVDCEO) suggested positive effects on both ROA (0.031, $p < 0.05$) and TQ (0.563, $p < 0.10$), although the association between TQ and IVDCEO could be viewed as marginal. In the top POEs (Table 8.22), IVDCEO was significantly positively correlated with TQ, with a coefficient of 1.920 ($p < 0.01$). CCP control in the matched SOEs had a negative impact on market performance (IVDCEO, coefficient of -1.822, $p < 0.01$). In these tables, consistent results are also presented with regard to the influences of the CG system and firm characteristics. For example, the independence of directors (BI) had negative effects on ROA and TQ in the top SOEs, significant positive effects on market performance in the top POEs, and a positive but marginal effect on market performance in the matched SOEs

Table 8.21: Test for endogeneity 2 - top SOEs (2-stage IV models)

<u>Variables</u>	<u>ROA</u>				<u>TQ</u>			
	<u>Coeff.</u>	<u>p Value</u>	<u>Coeff.</u>	<u>p Value</u>	<u>Coeff.</u>	<u>p Value</u>	<u>Coeff.</u>	<u>p Value</u>
<u>IVDCHA</u>	0.031	0.210			0.392	0.488		
<u>IVDCEO</u>			0.031	0.029**			0.563	0.071*
<u>BS</u>	-0.0001	0.912	-0.001	0.357	0.014	0.635	0.003	0.906
<u>BI</u>	-0.067	0.065*	-0.075	0.032**	-0.818	0.290	-1.459	0.051*
<u>SS</u>	-0.0002	0.907	0.001	0.554	-0.007	0.856	-0.001	0.967
<u>DUAL</u>	0.002	0.825	0.009	0.185	0.041	0.786	0.191	0.203
<u>LEV</u>	-0.059	< 0.001***	-0.070	< 0.001***	-0.812	0.022**	-0.746	0.029**
<u>SIZE</u>	0.003	0.266	0.001	0.696	-0.229	0.001***	-0.276	< 0.001***
<u>PEBIT</u>	0.384	< 0.001***	0.298	< 0.001***	4.254	0.001***	2.321	0.073*
<u>Constant</u>	0.031	0.448	0.066	0.094*	3.714	< 0.001***	4.367	< 0.001***
<u>Industry</u>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>
<u>Year</u>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>
<u>R²</u>	0.520		0.549		0.382		0.444	
<u>Adjusted R²</u>	0.464		0.497		0.311		0.380	
<u>No. of Obs.</u>	136		136		136		136	
<u>F-Statistic</u>	9.3596		10.5230		5.3496		6.8979	
<u>Probability (F-stat)</u>	< 0.001		< 0.001		< 0.001		< 0.001	

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

IVDCHA is the fitted value of DCHA generated by regressing DCHA on three IVs, including Location (NERI Market Index), Strategic industry and Bureaucratic ranking.

IVDCEO is the fitted value of DCEO generated by regressing DCEO on three IVs, including Location (NERI Market Index), Strategic industry and Bureaucratic ranking.

Refer to the footnotes directly below Table 8.1 for a description of the other abbreviations used in this table.

Table 8.22: Test for endogeneity 2 - top POEs (2-stage IV models)

<u>Variables</u>	<u>ROA</u>				<u>TQ</u>			
	<u>Coeff.</u>	<u>p Value</u>	<u>Coeff.</u>	<u>p Value</u>	<u>Coeff.</u>	<u>p Value</u>	<u>Coeff.</u>	<u>p Value</u>
<u>IVDCHA</u>	0.012	0.163			-0.796	0.186		
<u>IVDCEO</u>			0.008	0.399			1.920	0.002***
<u>BS</u>	0.0004	0.877	0.0003	0.893	0.515	0.001***	0.608	< 0.001***
<u>BI</u>	-0.077	0.385	-0.090	0.305	15.086	0.016**	15.680	0.011**
<u>SS</u>	0.005	0.057*	0.005	0.058*	-0.509	0.013**	-0.513	0.012**
<u>DUAL</u>	0.002	0.847	-0.003	0.776	0.459	0.543	-0.067	0.928
<u>LEV</u>	-0.094	< 0.001***	-0.098	< 0.001***	-2.988	0.094*	-0.438	0.772
<u>SIZE</u>	0.008	0.026**	0.009	0.005***	-0.474	0.060*	-0.843	< 0.001***
<u>PEBIT</u>	0.163	< 0.001***	0.155	< 0.001***	-3.593	0.251	-1.835	0.541
<u>Constant</u>	0.020	0.679	0.016	0.724	-3.415	0.313	-1.240	0.694
<u>Industry</u>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>
<u>Year</u>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>
<u>R²</u>	0.456		0.452		0.525		0.526	
<u>Adjusted R²</u>	0.373		0.373		0.437		0.444	
<u>No. of Obs.</u>	136		136		136		136	
<u>F-Statistic</u>	5.4559		5.7197		5.9913		6.3860	
<u>Probability (F-stat)</u>	< 0.001		< 0.001		< 0.001		< 0.001	

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

IVDCHA is the fitted value of DCHA generated by regressing DCHA on three IVs, including Location (NERI Market Index), Strategic industry and Bureaucratic ranking.

IVDCEO is the fitted value of DCEO generated by regressing DCEO on three IVs, including Location (NERI Market Index), Strategic industry and Bureaucratic ranking.

Refer to the footnotes directly below Table 8.1 for a description of the other abbreviations used in this table.

Table 8.23: Test for endogeneity 2 - matched SOEs (2-stage IV models)

<u>Variables</u>	<u>ROA</u>				<u>TQ</u>			
	<u>Coeff.</u>	<u>p Value</u>	<u>Coeff.</u>	<u>p Value</u>	<u>Coeff.</u>	<u>p Value</u>	<u>Coeff.</u>	<u>p Value</u>
<u>IVDCHA</u>	-0.005	0.681			0.245	0.776		
<u>IVDCEO</u>			0.009	0.356			-1.822	0.004***
<u>BS</u>	-0.001	0.371	-0.001	0.371	-0.015	0.878	-0.004	0.968
<u>BI</u>	-0.001	0.982	-0.010	0.807	2.343	0.398	3.964	0.145
<u>SS</u>	-0.001	0.486	-0.001	0.741	-0.103	0.389	-0.203	0.074*
<u>DUAL</u>	-0.006	0.369	-0.006	0.341	-0.272	0.544	-0.219	0.613
<u>LEV</u>	-0.083	< 0.001***	-0.083	< 0.001***	-5.737	< 0.001***	-5.873	< 0.001***
<u>SIZE</u>	0.006	0.027**	0.006	0.033**	-0.389	0.029**	-0.336	0.052*
<u>PEBIT</u>	0.401	< 0.001***	0.389	< 0.001***	10.723	0.002***	12.438	< 0.001***
<u>Constant</u>	0.018	0.533	0.019	0.505	6.811	0.001***	6.356	0.001***
<u>Industry</u>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>
<u>Year</u>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>	<i>Yes</i>
<u>R²</u>	0.611		0.614		0.458		0.496	
<u>Adjusted R²</u>	0.543		0.545		0.363		0.406	
<u>No. of Obs.</u>	141		141		141		141	
<u>F-Statistic</u>	8.9155		8.9998		4.7941		5.5657	
<u>Probability (F-stat)</u>	< 0.001		< 0.001		< 0.001		< 0.001	

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

IVDCHA is the fitted value of DCHA generated by regressing DCHA on three IVs, including Location (NERI Market Index), Strategic industry and Bureaucratic ranking.

IVDCEO is the fitted value of DCEO generated by regressing DCEO on three IVs, including Location (NERI Market Index), Strategic industry and Bureaucratic ranking.

Refer to the footnotes directly below Table 8.1 for a description of the other abbreviations used in this table.

The results generated by both the OLS regressions using one-year-ahead performance measures and the 2SLS regression models based on IVs suggest that the results of this study's tests for endogeneity are consistent with the results produced by the main OLS regression analysis. Therefore, it can be safely concluded that the degree of endogeneity in the main tests was unlikely to be significant enough to introduce any obvious bias or to impose any substantial adverse effects.

8.7. Conclusion

This chapter reported and discussed the descriptive statistics for all variables employed in the main pooled OLS regression models, and the results of the univariate tests comparing the structures and patterns of CCP influence and the CG system among the three groups of Chinese firms. The most important results of the empirical analysis of the impacts of CCP influence on firm performance—controlling for the CG system and firm characteristics—in both the full sample and each individual group, as well as the results of the sensitivity tests, were also presented and discussed.

The univariate tests suggested that the level of CCP influence in the Chinese SOEs, especially the largest ones, was higher than it was in the top POEs. In these SOEs, key corporate positions such as the chairman of the board of directors, CEO, and chairman of the supervisory board were more likely to be occupied by members of their CCP committee. These CCP committee members were also more likely to serve as directors, supervisors and senior managers. The top POEs were had both higher accounting and higher market performances as measured by ROA and Tobin's Q. With regard to the CG system, the Chinese SOEs—especially the top SOEs—had larger sized boards of directors and supervisory boards, and more independent directors on their boards, while the positions of chairman of the board of directors and CEO were more likely to be occupied by the same executive in the top POEs.

The most important part of this chapter is the presentation and discussion of the empirical results regarding the associations between CCP influence and firm performance in the full sample and each individual group which were generated by

the main pooled OLS regression models. In the full sample, CCP influence via the chairman of the board of directors and the CEO were generally found to be significantly positively associated with firm performance. Specifically, CCP control was associated with enhanced performance in the top SOEs, and in the top POEs political connections with the CCP were associated with a high level of performance. However, CCP control in the matched SOEs was evidently detrimental to the performance of these firms. The main hypotheses of this study were strongly supported by these empirical results.

The empirical results generated by the pooled OLS regression models were verified as robust by the sensitivity tests conducted in this study. These sensitivity tests included pooled OLS regression models using alternative measures of firm performance, the alternative regression approach of CSE-TD, and methods to test for the potential endogeneity problem in the main tests, including OLS regression analysis using one-year-ahead firm performance and 2SLS regressions based on IVs. The results yielded by these tests largely confirmed the main OLS regression results.

Chapter 9. Conclusions and Implications of This Study

9.1. Introduction

The primary purpose of this concluding chapter is to summarise the main results of the study, the contributions these findings make to the collective knowledge-base, and the potential implications of the results of the research. The potential limitations of the study are also discussed, and possible avenues for future research are suggested. The next section of this chapter (Section 9.2) contains an overview of the main contents of all of the previous chapters contained in the thesis. Section 9.3 describes the major findings that were generated in this study pertaining to the impact of CCP influence on firm performance, controlling for the influence of CG system and firm characteristics, and discusses the contributions that the results of this study make to the collective knowledge-base. Section 9.4 discusses the implications of the results of this study, and the potential relevance of these results to academic researchers, governments and market regulators. Section 9.5 acknowledges and discusses the potential limitations of the study, and provides suggestions for future research. Lastly, concluding remarks are presented in Section 9.6.

9.2. Overview of This Thesis

The purpose of this study was to examine the impacts of the political influence of the Chinese Communist Party (CCP) that operates within the Chinese Corporate Governance (CG) system on the performance of the top listed Chinese firms. Chapters 2 and 3 review theoretical arguments supporting the significance of the CG system and political influence, and prior studies that have provided empirical evidence regarding the influences of these two factors on firm performance in markets around the globe, including China. From a theoretical perspective, agency theory suggests that advanced CG structure and mechanisms such as the establishment of a board of directors and a supervisory board, and the appointment of independent directors on the board, may reduce agency costs resulting from conflicts of interest between managers and shareholders, as well as between controlling shareholders and minority shareholders (Jensen and Meckling, 1978; Fama and Jensen, 1983; Shleifer

and Vishny, 1986; Johnson et al., 2000). The importance of political influence in markets where a sound legal environment and strong protection for market investors are lacking is mainly advocated by resource dependency theory, stakeholder theory and rent-seeking theory (Emerson, 1962; Alchian, 1965; Krueger, 1974; Pfeffer and Salancik, 1978; Kumar, 2004; Freeman et al., 2004; Friedman and Miles, 2006; Davis and Cobb, 2009). These theories propose that the political influence of relevant government authorities may function as a valuable and effective mechanism that encourages corporations to acquire advantageous resources for business operations, such as financial capital, certain licences for business operations, favourable government treatment, tax benefits, and ultimately to achieve business success.

The literature review provided in Chapters 2 and 3 revealed that prior studies have yielded mixed and contradictory results with regard to the relationship between CG systems, political influence and firm performance, particularly in the Chinese context. Some prior studies suggest a negative effect of large corporate boards on firm performance (Lipton and Lorsch, 1992; Haniffa and Hudaib, 2006; Cheng et al., 2008), while others suggest a positive effect (Haleblian and Finkelstein, 1993; Anderson et al., 2004). The influences of other aspects of CG on firm performance, such as board independence and CEO duality, are also debateable (Fama and Jensen, 1983; Baliga et al., 1996; Brickley et al., 1997; Bhagat and Black, 2000; Bathula, 2008). Prior studies investigating the effects of political influence on firm performance may not have yielded clear, conclusive, irrefutable findings because they measured political influence based solely on top corporate executives' (*i.e.* the CEO or the chairman of the board of directors) personal political backgrounds (Sutter et al., 1999; Tian, 2001; Ang and Ding, 2006; Niessen and Ruenzi, 2009; Rosa and Pe´rard, 2010; Wu et al., 2012; Hu and Leung, 2012). In view of this, the current study aimed to achieve the following research objectives in order to clarify the reasons behind the inconsistent results presented in the literature and generate more conclusive findings regarding the associations between the CG system, political influence and firm performance in China:

1. Determine whether the CG system or the political influence of the CCP is the most influential factor with regard to the operations, decision-making

processes and performances of firms in China.

2. Identify what the most appropriate measurement of political influence in the Chinese context may be.
3. Investigate whether CCP influence has similar or dissimilar effects on the performance of different groups of Chinese firms in terms of firm ownership structure and firm size.

The review of China's institutional background presented in Chapter 4 provided clear answers to the primary research question stated above. This chapter first reviewed the development and growth of Chinese enterprises and the domestic stock market, which was followed by the establishment and development of a modern CG system in China. More importantly, it demonstrated the dominant status and undeniably significant influence of the CCP generally in Chinese society and Chinese firms. Although China has been approaching a market-oriented economy and modern CG system in recent decades, the CCP still maintains an incontestably dominating position in China at all levels, ranging from the core political system to people's everyday living; and this influence extends to Chinese enterprises. In this context, the CCP's influence is exerted and transmitted via an entity known as the CCP committee. The members of various CCP committees hold key positions either in government or at the corporate level. For example, senior members of the paramount CCP committee, which is the highest decision-making body in China, also occupy the positions of chairman of the PRC, prime minister of the State Council, chairman of the Chinese army, and chairman of China's National People's Congress. In Chinese enterprises, particularly state-owned enterprises (SOEs), major decisions such as the appointment and dismissal of key executives and those relating to major business operations are all tightly supervised by the firm's corporate CCP committee. The case studies of three Chinese listed companies, a top listed SOE (PetroChina Company Limited) a top listed privately-owned enterprise (POE), Jiangsu ShaGang Company Limited, and a small listed SOE (SiChuan ChangHong Electric Company Limited) presented in Chapter 5 provide strong evidence attesting to the above assertions.

The methods used to generate empirical results relating to the research questions and hypotheses of this study were based on the theoretical framework and

theories presented earlier, a comprehensive review of the relevant literature, a review of China's institutional background, and objective evidence derived from the case studies presented in Chapter 5. One of the primary hypotheses of this study was that CCP influence may work in different ways and have dissimilar impacts on the performances of Chinese listed companies differing in status by way of ownership structure and firm characteristics. Notably, SOEs are viewed by the CCP and the Chinese government as the backbone and leading force of China's national economy, which has exhibited a stunning rate of growth in recent decades. Also, the market performance of the top listed SOEs in China directly affects the undulation or steadiness of China's stock market. Thus, the hypotheses tested in this study were related to whether CCP influence was likely to maintain or further strengthen the performance of top listed SOEs in order to maintain the rapid growth rate of China's national economy, or sustain or increase people's confidence in China's economy, or perpetuate the CCP's or the Chinese government's reputation and ruling position. These possibilities are strongly suggested by the asset swap transactions between PetroChina Company Limited and its parent group, China National Petroleum Corporation (CNPC) described in Chapter 5. In 2011, the CNPC, which could be considered a direct agency of the CCP and the State Council, sold a highly profitable subsidiary to PetroChina in exchange for a loss-making subsidiary of PetroChina.

Based on the theories comprising this study's theoretical framework, Chinese POEs' strategy of "wearing a red hat", and the empirical findings of prior studies (Tian, 2001; Ang and Ding, 2006; Guiheux, 2006; Li et al., 2008; Niessen and Ruenzi, 2009; Dombrovsky, 2011; Du, 2011; Hu and Leung, 2012), the second set of hypotheses designed to investigate possible correlations between CCP connections and firm performance in the top listed POEs were formulated.

According to prior studies, the patterns and impacts of political influence differ depending on variations in firm size and industry (Fan et al., 2007; Civilize et al., 2015). It is reasonable to expect that the CCP may invest greater effort and support in top SOEs engaged in more strategic industries than in smaller SOEs engaged in less important industries. In addition, rent-seeking theory suggests a negative influence of political connections on firm performance if politicians pursue political objectives or

personal wealth rather than the maximisation of firm values. This is verified by empirical findings in the literature (Alchian, 1965; Shleifer and Vishny, 1998; Sutter et al., 1999; Kumar, 2004; Patibandla, 2006; Rosa and Pe´rard, 2010). Accordingly, the third series of hypotheses tested in the current study were designed to assess the influence of CCP control on the performance in small listed SOEs.

In Chapter 7, the research methods utilised to test the stipulated hypotheses and generate empirical conclusions regarding the associations between CCP influence and firm performance in China were presented and discussed. In this study, archival data extracted from companies' annual reports were used to construct finance-based variables such as firm performance and firm characteristics. Information on corporate CCP committees and CG structure were manually collected to derive relevant data pertaining to CCP influence and CG variables. The final sample included the top 50 listed SOEs, top 50 listed POEs, and 50 listed SOEs that were of similar size and operated in the same industries as the top 50 POEs, for the period from 2009 to 2011. The research design included descriptive statistics and univariate tests relating to CCP influence and CG structure and mechanisms, and firm characteristics variables reflecting the status and differences in/among the three groups of the Chinese listed firms investigated. The regression models utilised were designed to investigate the impacts of CCP influence on firm performance, both generally (in the full sample as a whole) and specifically in each of the three distinct groups of firms investigated, while controlling for the effects of CG system and firm characteristics. A series of sensitivity tests designed to verify the robustness of the empirical results generated in the main regression analysis was also performed.

In Chapter 8, the results of this study's hypothesis testing were presented and interpreted. In general, the main hypotheses of the study were supported. The results suggested that CCP control had a positive influence in the top SOEs but a negative influence in the small SOEs, and that CCP connections had a positive influence in the top POEs. The results of the supplementary sensitivity tests verified that the results of the main analysis were robust. A summary of the main research findings and contributions are presented in the next section.

9.3. Summary of the key Findings and Contributions of This Study

A series of major research findings that could make valuable contributions to the existing literature on the relationships between political influence and firm performance were generated by this study's empirical analyses. These key findings are presented and discussed in this section.

First, this study clearly demonstrated that CCP influence is the main factor that exerts a decisive effect on the decision-making process in Chinese SOEs, and that it is also of great significance in Chinese POEs. Although various previous studies reported in the literature have clearly acknowledged the importance of the influence of the Chinese government at corporate level in China (see Fan et al., 2007; Du, 2011; Hu and Leung, 2012), they have not specified what the main body that wields political influence in Chinese society and enterprises is, the degree of political intervention in Chinese firms, or the functional differences in this political influence in different groups of Chinese companies. All these points may help to explain the indirect measures of political influence based on corporate executives' personal political backgrounds that these studies employed. In this current study, the documented evidence generated in the review of China's institutional background and the case studies conducted on three Chinese firms explicitly demonstrated the dominant status of the CCP in Chinese society, from the supreme core political system to people's daily life, including enterprises. The evidence also confirmed that the political influence of the CCP is applied through CCP committees at various levels, that the corporate CCP committee is the real decision-making body in SOEs, and that it is the most effective means for POEs to foster solid connections with the CCP. The study also revealed that although a modern CG system has been established in Chinese firms, it is not the deciding factor at the corporate level.

Second, based on the findings stated above, this study utilised a direct measure of CCP influence at corporate level—the overlap between corporate CCP committees and the CG structure. Specifically, the CCP's influence in Chinese firms was measured in the following ways, in accordance with the Chinese CG structure: whether key corporate positions such as chairman of the board of directors, CEO, and

chairman of the supervisory board were occupied by members of the company's CCP committee; and the percentages of a company's CCP committee members on the board of directors, supervisory board and management team.

Third, the terminology utilised to describe the CCP's influence in Chinese firms was carefully chosen, and differed for different groups of Chinese firms. This is in contrast to previous studies that have only used the phrase "political connection". As Chinese SOEs are distinctively subject to the supervision and leadership of the CCP, and the CCP committee is the real decision-making body with regard to SOEs, the term "CCP control" was used to refer to the CCP's influence in these firms. On the other hand, because CCP committees in Chinese POEs conventionally do not exercise direct or overt interference in the decision-making process, but the establishment of CCP committees is an effective mechanism by which POEs can foster connections and a beneficial relationship with the CCP—which is of vast importance for their survival and success—the term "CCP connection" (or "connections" depending on grammatical context) was used to allude to Chinese POEs' connections with the CCP.

Fourth, this study generated significant and conclusive empirical results on the associations between CCP influence and firm performance in China, while controlling for the effects of CG and firm characteristics. Descriptive statistics and univariate tests revealed significant differences in the CCP's influence and CG system between Chinese SOEs and POEs. In SOEs, the positions of the chairmen of the board of directors and supervisory board, as well as CEO, were more likely to be held by CCP committee members than in POEs. SOEs' CCP committee members were also more likely to simultaneously hold positions as directors, supervisors or senior managers than was the case in POEs. With regard to CG structure and mechanisms, SOEs tended to have more seats on the board of directors and supervisory board and more independent directors on their boards, but exhibited a lower level of CEO duality in comparison with POEs. The results of the main regression analysis indicated the following findings: generally, the CCP's influence through the key corporate positions of chairman of the board of directors and CEO had a statistically significant positive effect on both the accounting and market performances of the top SOEs, top POEs and small SOEs; in the top SOEs the CCP's control via the CEO was

significantly positively associated with their performance; the top POEs' connections with the CCP via the CEO and chairman of the board of directors was associated with enhanced performance; CCP control in small SOEs tended to have a detrimental effect on firm performance. All the above results significantly supported the relevant research hypotheses developed in this study, and they were verified as robust by a series of sensitivity tests.

Table 9.1 Summary of Results

H1	The CCP's control over or connections with the board of directors is expected to have significant impact on firm performance in China.	Supported
H1a	In Chinese firms, if the position of chairman of the board is held by a corporate CCP committee member, it is expected to have a significant impact on firm performance.	Supported
H1a-SOE	In top SOEs , if the position of chairman of the board is held by a corporate CCP committee member, this is expected to have a significant positive impact on firm performance.	Partially supported, not significant
H1a-POE	In top POEs , if the position of chairman of the board is held by a corporate CCP committee member, this is expected to have a significant positive impact on firm performance.	Supported
H1a-match	In match SOEs , if the position of chairman of the board is held by a corporate CCP committee member, this is expected to have a significant negative impact on firm performance.	Partially supported, not significant
H1b	In Chinese firms, the percentage of corporate CCP committee members on the board of directors is expected to have significant impact on firm performance.	Supported
H1b-SOE	In top SOEs , the percentage of corporate CCP committee members on the board of directors is expected to be positively associated with firm performance.	Not supported
H1b-POE	In top POEs , the percentage of corporate CCP committee members on the board of directors is expected to be positively associated with firm performance.	Not supported
H1b-match	In match SOEs , the percentage of corporate CCP committee members on the board of directors is expected to be negatively associated with firm performance.	Supported
H2	The CCP's control over and connections with the supervisory board is expected to have an insignificant influence on firm performance in China.	Supported
H2a	In Chinese firms, if the position of chairman of the supervisory board is held by a corporate CCP committee member, this is expected to have an insignificant impact on firm performance.	Supported
H2b	In Chinese firms, the percentage of corporate CCP committee members on the supervisory board is expected to be insignificantly associated with firm performance.	Supported

H3	The CCP's control over or connections with the management team are expected to have a significant influence on firm performance in China.	Supported
H3a	In Chinese firms, if the position of CEO is held by a corporate CCP committee member, this is expected to have a significant impact on firm performance.	Supported
H3a-SOE	In top SOEs , if the position of CEO is held by a corporate CCP committee member, this is expected to have a significant positive impact on firm performance.	Supported
H3a-POE	In top POEs , if the position of CEO is held by a corporate CCP committee member, this is expected to have a significant positive impact on firm performance.	Supported
H3a-match	In match SOEs , if the position of CEO is held by a corporate CCP committee member, this is expected to have a significant negative impact on firm performance.	Supported
H3b	In Chinese firms, the CCP's influence over the management team is expected to have a significant impact on firm performance.	Not supported
H3b-SOE	In top SOEs , the CCP's control over the management team is expected to have a significant positive impact on firm performance.	Not supported
H3b-POE	In Top POEs , the CCP's connections with the management team are expected to have a significant positive impact on firm performance.	Not supported
H3b-match	In Match SOEs , the CCP's control over the board of directors is expected to have a significant negative impact on firm performance.	Not supported

9.4. Implications of This Study

Several of the key findings of this study are potentially useful to academic researchers in the areas of political influence and firm performance, and to the Chinese government and relevant market regulators. The review of the ongoing development of the CG system in China clearly suggests the official establishment of CG in Chinese enterprises as a result of China's economic and institutional reform and growth. This is illustrated by the laws and regulations issued by the Chinese government and market regulators. The Company Law of the People's Republic of China (PRC) was passed in 1993, and it came into force in 1997. This law requires all Chinese companies to establish a board of directors and a supervisory board. This constitutes China's official adoption of the so-called "two-tier board structure", the so-called "Continental European model".

The emergence and development of China's domestic stock market, which aimed to provide Chinese corporations with the opportunity to raise capital resources via public listing, functioned as a major stimulus for the development of a CG system in China. In addition to the listing rules and regulations issued by the Chinese stock exchanges, the Chinese Securities Regulatory Commission (CSRC) was established in 1992 as a direct affiliate of the Chinese State Council, in order to incorporate immediate governmental supervision and administration into the Chinese domestic stock market. Notably, all listing rules of China's stock exchanges must first be reviewed and approved by the CSRC before they are issued. The regulations and instructions released by the CSRC further require the adoption of related CG mechanisms. For example, a CSRC directive announced in 2011 required that all companies listed in China appoint independent directors to their board of directors, and that independent directors must account for at least a third of the total number of directors. This is in accordance with common CG practices adopted by companies listed in other developed markets, and the conventional wisdom pertaining to the independence of the board of directors. The CSRC also issued other instructions and regulations to companies listed in China, such as the general code of CG and rules applying to general shareholders' meetings. Therefore, it can be concluded that a modern CG structure and mechanisms have been established in China, and relevant CG organs, such as the board of directors, supervisory board, independent directors, and shareholders (via general shareholders' meetings) are all endowed with a degree of power and authority with regard to corporate decision-making and operations, at least on paper.

The most important finding of this study was that Chinese society is still unquestionably characterised by the dominant status of the CCP, which exerts its influence via CCP committees at various levels. The results of the study also suggested that CCP influence via the corporate CCP committee in Chinese SOEs was highly influential in the decision-making process, and had a significant impact in the Chinese POEs. The above considerations render the CG system in Chinese enterprises mere window-dressing. This argument is strongly supported by the case of Huawei, a Chinese telecommunications company that was under investigation by the U.S.

Congress in 2012 for threats to national U.S. security.²⁰³ Several principal findings contained in the report by the House Permanent Select Committee on Intelligence of the U.S. Congress on the case of Huawei indicate that the CG structure and decision-making processes of the company remain dependent on the Chinese government. The report noted that Huawei maintained a CCP committee and a solid relationship with the Chinese government.

Based on the above arguments and findings, future studies that aim to explore the impact of political influence in the Chinese context or studies that will be conducted in related research fields may choose to adopt this direct and apposite measurement of CCP influence by CCP committees at various levels, rather than relying solely on the executives' personal political backgrounds. On the other hand, findings of this study that may be of interest to the Chinese government and market regulators include results suggesting that the current Chinese CG system is inadequate. This is mainly because the focus of the Chinese regulator is more likely to depend primarily on modality and structure, rather than substance. Thus, the CCP and the Chinese government may need to decentralise their controlling power at the corporate level, such that Chinese companies attain greater autonomy and can attract more professional managers who possess the required expertise in financial management and business administration; rather than the current system that favours those with extensive political backgrounds. Such a strategy may render Chinese companies more likely to operate by standard market rules, and ultimately, the Chinese CG system could truly incorporate advanced international CG practices in substance.

9.5. Limitations of This Study and Avenues for Future Research

This study did yield a number of outstanding results with important implications, and these results may subsequently contribute to the collective knowledge-base in the literature with regard to the impacts of political influence on firm performance. This study did have some limitations however, which are identified

²⁰³

<https://intelligence.house.gov/committee-report/investigative-report-us-national-security-issues-posed-chinese-telecommunications>

and discussed as below. The discussion of the limitations of this study below may simultaneously suggest avenues for future research in the same area or related areas.

With regard to the direct measurement of political influence in Chinese firms based on the structure and operations of corporate CCP committees, the process of gathering the required information for each firm and year investigated proved excessively time-consuming, and thus formidable. This was mainly attributable to the fact that the disclosure of such information is not mandatory for Chinese companies, and thus acquiring it required the perusal of a diverse variety of sources, including annual reports, company websites, official/governmental documents, and even in “the news” or other forms of documented popular media. The relevant information required to construct the research variables included the backgrounds of all members of the corporate CCP committees analysed, who the secretaries or vice secretaries of those CCP committees were, and whether members of the CCP committees simultaneously acted as chairmen of the board of directors or the supervisory board, directors, supervisors or senior managers at the same time. The detailed nature of the information required, combined with the often limited availability of such information was a major obstacle in the data collection process, and inevitably, time constraints limited the size of the research sample substantially. It is possible that research sampling more firms and assessing them over longer periods of time may provide stronger evidence on the associations between CCP influence and firm performance in China.

While this study investigated the direct relationships between CCP influence and firm performance, other factors that may affect such relationships and function as means by which the CCP influences firm performance may be relevant. For example, earnings management is likely to be of relevance to the CCP’s influence and manipulation of reported earnings, or the accounting based firm performance of Chinese listed firms, particularly SOEs, and previous studies have yielded some empirical findings on government assisted earnings management in the Chinese context (see Chen et al., 2008). In view of this, earnings quality indicators measured via discretionary accruals and/or real earnings management activities could be included as a variable of interest in regression analyses designed to investigate

associations between firm performance and political influence. Furthermore, “related-party transactions” (RPTs), where controlling shareholders or parent groups engage in so-called “tunnelling” or “propping” activities and transactions to either transfer/syphon profits out of the listed subsidiaries (Johnson et al., 2000) or boost the performance of listed subsidiaries by providing additional support in terms of capital or assets may also be of relevance (Bai et al., 2005). In the case of listed Chinese SOEs, their parent groups are all majority owned by the Chinese government and subject to the leadership of the CCP. Therefore, it is reasonable to expect that the CCP would exercise tunnelling or propping (or both) in SOEs in order to achieve certain purposes, which is likely to have direct effects on these subsidiaries’ performances. Prior studies have investigated various aspects of RPTs in the China, while controlling for the effects of political influence (for example, see Peng et al., 2011). Thus, Future studies investigating associations between firm performance and political influence that take into account the influences of factors such as earnings management and RPTs may yield more comprehensive conclusions.

9.6. Conclusion

This chapter contains a summary of the entire thesis, including the research objectives, findings, potential contributions to the collective knowledge-base, study limitations and suggestions for future studies in the similar or related areas, as well as the potential implications of the results for academic researchers, relevant governments and market regulators. This study explored various aspects of CG in the Chinese context, while taking into account the significant impact of the political influence exerted by the CCP. Although China has been approaching a market-oriented economy and a modern CG system has been officially established as a result of China’s institutional reforms and extraordinary economic development and growth in recent decades, the CCP still maintains a dominant position in Chinese society. Therefore, this study aimed to investigate the impacts of the political influence of the CCP that operates in the Chinese CG system on the performance of Chinese listed firms.

significant influence of the Chinese government in Chinese firms (see Fan et al., 2007; Chen et al., 2008; Hu and Leung, 2012), generally these studies have not explicitly stated the degree of political influence, or how it is consummated at the corporate level in China. Also, such studies have tended to adopt indirect measures of political influence in Chinese firms based on senior corporate executives' personal political backgrounds, and they have utilised the somewhat ambiguous term of "political connection".

This study makes a number of significant contributions to the existing literature. The review of the Chinese institutional background conducted as part of this study showed that the CCP maintains a ruling status in almost every field of Chinese society, via an organ known as the "CCP committee". It also revealed that the dominant influence of the CCP committee in Chinese SOEs is merely an extension of the CCP's general position in Chinese society. Resource dependency theory, stakeholder theory and rent-seeking theory all provide support for the CCP's control in Chinese SOEs. In addition, these theories also suggest that in Chinese POEs, solid connections with the CCP are a valuable asset with regard to obtaining critical resources and achieving business success. Consideration of the "wearing a red hat" strategy frequently employed by Chinese POEs from the perspective of rent-seeking theory implies that the establishment of a CCP committee in POEs is the most effective way to foster connections with the CCP.

Therefore, this study directly measured CCP influence based on the dominance of the corporate CCP committee over CG structure via six parameters: whether the key corporate positions of chairman of the board of directors, chairman of the supervisory board, and CEO of the management team were occupied by members of a corporate CCP committee, and the percentages of the members of the corporate CCP committee concurrently acting as directors, supervisors and senior managers in the CG system. In addition, as the patterns of CCP influence in SOEs and POEs are dissimilar—because SOEs are majority owned and tightly controlled by the CCP, whereas a POE's CCP committee does not overtly participate in decision-making or corporate operation processes, but solid connections with CCP are of beneficial to the company's survival and development—the terminology used in this study to describe

the CCP's influence in Chinese firms was carefully selected in an effort to differentiate between these situations. Specifically, the phrase "CCP control" was utilised for Chinese SOEs, and the phrase "CCP connection" (or "connections") was used with reference to POEs.

The empirical results of this study's main regression analysis confirmed the main research hypotheses regarding the CCP's influence at firm level. The CCP's control over the top listed SOEs had a positive impact on firm performance. POEs' connections with the CCP were associated with enhanced performance. Conversely, however, the performance of the small listed SOEs was likely to be reduced by CCP control, confirming the theoretical argument derived from rent-seeking theory that in some cases, politicians or governments intervene in corporate operations to achieve political goals or personal wealth, rather than to maximise firm values. All of these results were verified as robust via a series of sensitivity tests designed and conducted in this study.

The findings of this study have a number of implications for the Chinese government, market regulators, and future research in similar or related areas, especially in the Chinese context. While a modern CG system has been adopted in China in theory, in reality it could be construed mere window-dressing due to the dominant influence of the CCP. The CG system in China is focused on modality and structure, rather than substance. The CCP and the Chinese government may need to decentralise their controlling power at the corporate level, to enable the Chinese CG system to functionally adopt the modern CG practices characteristic of other developed markets. From a research perspective, future studies—particularly those conducted in China—could adopt direct measurements of political influence. Other factors that exert significance effects on the associations between political influence and firm performance such as earnings management and related party transactions could also be taken into account, in an effort to achieve a more comprehensive understanding of how political influence impacts firm performance.

Appendix**List of Sample Firms**

No.	Company Name
1	CHINA PETROLEUM & CHEMICAL CORPORATION
2	PETROCHINA COMPANY LIMITED
3	CHINA RAILWAY GROUP LTD.
4	CHINA RAILWAY CONSTRUCTION CORPORATION LIMITED
5	CHINA STATE CONSTRUCTION ENGINEERING CORPORATION LTD
6	SAIC MOTOR CORPORATION LIMITED
7	CHINA COMMUNICATIONS CONSTRUCTION COMPANY LIMITED
8	CHINA TELECOM CORPORATION LIMITED
9	METALLURGICAL CORPORATION OF CHINA LTD
10	BAOSHAN IRON & STEEL COMPANY LIMITED
11	CHINA UNITED NETWORK COMMUNICATIONS LIMITED
12	CHINA SHENHUA ENERGY COMPANY LIMITED
13	DONGFENG MOTOR GROUP COMPANY LIMITED
14	MINMETALS DEVELOPMENT CO., LTD.
15	ALUMINUM CORPORATION OF CHINA LIMITED
16	HEBEI IRON & STEEL CO., LTD.
17	HUANENG POWER INTERNATIONAL, INC.
18	SINOHYDRO GROUP LTD.
19	CHINA COSCO HOLDINGS COMPANY LIMITED
20	ANGANG STEEL COMPANY LIMITED
21	SHANXI TAIGANG STAINLESS STEEL CO., LTD.
22	AIR CHINA LTD
23	CHINA SOUTHERN AIRLINES COMPANY LIMITED
24	JIANGXI COPPER COMPANY LIMITED
25	WUHAN IRON & STEEL CO., LTD.
26	CHINA EASTERN AIRLINES CORPORATION LIMITED
27	CHINA COAL ENERGY COMPANY LIMITED

- 28 SHANGHAI CONSTRUCTION CO., LTD
- 29 CSR CORPORATION LIMITED
- 30 SHANGHAI ELECTRIC GROUP COMPANY LIMITED
- 31 MAANSHAN IRON & STEEL COMPANY LIMITED
- 32 WEICHAI POWER COMPANY LIMITED
- 33 CHINA CNR CORPORATION LIMITED
- 34 DATANG INTERNATIONAL POWER GENERATION COMPANY LIMITED
- 35 HUNAN VALIN STEEL COMPANY LIMITED
- 36 BEIQI FU TIAN VEHICLE CO., LTD.
- 37 HUADIAN POWER INTERNATIONAL CORPORATION LIMITED
- 38 CHINA COMMUNICATIONS SERVICES CORPORATION LIMITED
- 39 CHINA NATIONAL MATERIALS CO. LTD.
- 40 INNER MONGOLIA BAOTOU STEEL UNION CO., LTD.
- 41 PANGANG GROUP STEEL VANADIUM & TITANIUM CO., LTD.
- 42 DAQIN RAILWAY CO., LTD.
- 43 GANSU JIU STEEL GROUP HONG XING IRON & STEEL CO., LTD.
- 44 DONGFANG ELECTRIC COMPANY LIMITED
- 45 CHINA GEZHOUBA GROUP CO., LTD.
- 46 ANHUI CONCH CEMENT COMPANY LIMITED
- 47 CHINA SHIPPING CONTAINER LINES CO., LTD.
- 48 YANZHOU COAL MINING COMPANY LIMITED
- 49 HENAN SHENHUO COAL & POWER CO., LTD.
- 50 JINAN IRON AND STEEL CO., LTD.
- 51 SHAANXI BAOGUANG VACUUM ELECTRIC DEVICE CO., LTD.
- 52 SICHUAN NITROCELL CORPORATION
- 53 BEIJING AEROSPACE CHANGFENG CO.,LTD
- 54 SINOTEX INVESTMENT & DEVELOPMENT CO., LTD.
- 55 SHENZHEN TEXTILE (HOLDINGS) CO., LTD.
- 56 SHAANXI AEROSPACE POWER HI-TECH CO.LTD

- 57 WEIFANG YAXING CHEMICAL CO.,LTD.
- 58 CREATE TECHNOLOGY & SCIENCE CO., LTD.
- 59 XINJIANG TALIMU AGRICULTURE DEVELOPMENT CO., LTD.
- 60 SAINTY MARINE CORPORATION LTD.
- 61 SHANGHAI NEW WORLD CO., LTD.
- 62 SHIJIAZHUANG CHANGSHAN TEXTILE CO., LTD.
- 63 ANHUI HUAMAO TEXTILE CO., LTD.
- 64 CHINA DALIAN INTERNATIONAL COOPERATION (GROUP)
HOLDINGS LTD.
- 65 XINJIANG YOUHAO (GROUP) CO., LTD.
- 66 SHANDONG HAIHUA CO., LTD.
- 67 HENAN YUGUANG GOLD & LEAD CO., LTD.
- 68 BRIGNT DAIRY & FOOD CO., LTD.
- 69 SHENZHEN TONGE (GROUP) CO., LTD.
- 70 TIANMA MICROELECTRONICS CO., LTD.
- 71 SHENZHEN ZHENYE (GROUP) CO., LTD.
- 72 HANGZHOU HIKVISION DIGITAL TECHNOLOGY CO., LTD
- 73 TANDE CO.,LTD.
- 74 WUHAN ZHONGBAI GROUP CO., LTD.
- 75 HANG ZHOU IRON & STEEL CO., LTD.
- 76 GUIZHOU CHITANHUA CO., LTD
- 77 JIANGLING MOTORS CO., LTD.
- 78 CHINA HAINAN RUBBER INDUSTRY GROUP CO., LTD.
- 79 TELLING TELECOMMUNICATION HOLDING CO., LTD.
- 80 SHENZHEN AGRICULTURAL PRODUCTS CO., LTD.
- 81 YUNNAN ALUMINIUM CO., LTD.
- 82 SUZHOU NEW DISTRICT HI-TECH INDUSTRIAL CO., LTD.
- 83 BEIJING SHOUGANG CO., LTD.
- 84 LUSHANG PROPERTY CO., LTD.
- 85 YANTAI WANHUA POLYURETHANES CO., LTD.

- 86 BLUE STAR NEW CHEMICAL MATERIALS CO., LTD.
- 87 PINGDINGSHAN TIANAN COAL. MINING CO., LTD.
- 88 TSINGTAO BREWERY CO., LTD.
- 89 HARBIN PHARMACEUTICAL GROUP CO., LTD.
- 90 SGIS SONGSHAN CO., LTD.
- 91 BEIQI FU TIAN VEHICLE CO., LTD.
- 92 HENAN SHENHUO COAL & POWER CO., LTD.
- 93 HUBEI ENERGY GROUP CO., LTD.
- 94 CHINA FIRST HEAVY INDUSTRIES CO., LTD.
- 95 SICHUAN CHANGHONG ELECTRIC CO., LTD.
- 96 XIAMEN C&D INC.
- 97 ZHEJIANG MATERIAL INDUSTRIAL ZHONGDA YUANTONG GROUP CO., LTD.
- 98 CHONGQING CHANGAN AUTOMOBILE CO., LTD.
- 99 CHINA SHIPPING DEVELOPMENT CO., LTD.
- 100 POLY REAL ESTATE GROUP CO., LTD
- 101 JIANGSU SHAGANG CO., LTD.
- 102 SUNING APPLIANCE CO., LTD.
- 103 GEELY AUTOMOBILE HOLDINGS LIMITED
- 104 HAINAN AIRLINES CO., LTD.
- 105 XINJIANG GUANGHUI INDUSTRY CO., LTD.
- 106 NANJING CENTRAL EMPORIUM (GROUP) CO., LTD.
- 107 ZHEJIANG GUANGSHA CO., LTD.
- 108 NEW HOPE LIUHE CO., LTD.
- 109 ZHEJIANG HAILIANG CO., LTD.
- 110 SANY HEAVY INDUSTRY CO., LTD.
- 111 BYD COMPANY LIMITED
- 112 EVERGRANDE REAL ESTATE GROUP LTD.
- 113 SHANGHAI FOSUN INDUSTRIAL CO., LTD.
- 114 JIANGSU HONGTU HIGH TECHNOLOGY CO., LTD.

- 115 WUMART STORES, INC.
- 116 HENGYI PETROCHEMICAL CO., LTD
- 117 INNER MONGOLIA YITAI GROUP CO.,LTD
- 118 YOUNGOR GROUP CO.,LTD.
- 119 JIANGSU SANFANGXIANG INDUSTRY CO., LTD.
- 120 TONGWEI CO., LTD.
- 121 SUNING UNIVERSAL. CO., LTD
- 122 JIANGSU SUNSHINE GROUP CO., LTD.
- 123 JIANGSU HONGDOU INDUSTRIAL CO., LTD
- 124 MACROLINK REAL ESTATE CO., LTD.
- 125 NINGBO SANXING ELECTRIC CO., LTD.
- 126 RONGSHENG PETROCHEMICAL CO., LTD.
- 127 HUAFANG TEXTILE CO.,LTD
- 128 SICHUAN HONGDA CO., LTD
- 129 ZHEJIANG CHINT ELECTRICS CO., LTD.
- 130 JIANGSU CHENGXING PHOSPH-CHEMICALS CO.,LTD
- 131 SHAN DONG SUN PAPER INDUSTRY JOINT STOCK CO., LTD
- 132 SHANDONG JIANGQUAN INDUSTRY CO.,LTD
- 133 JOINTOWN PHARMACEUTICAL GROUP CO., LTD.
- 134 LIANYUNGANG IDEAL GROUP CO., LTD.
- 135 TONGKUN GROUP CO., LTD.
- 136 ZHEJIANG DUN'AN ARTIFICIAL ENVIRONMENTAL EQUIPMENT CO.,LTD
- 137 SHENZHEN HEUNGKONG HOLDING CO., LTD.
- 138 JIANGSU ZHONGNAN CONSTRUCTION GROUP CO., LTD.
- 139 WENFENG GREAT WORLD CHAIN DEVELOPMENT CORPORATION
- 140 SHANDONG HUATAI PAPER CO., LTD
- 141 TBEA CO., LTD.
- 142 INNER MONGOLIA YILI ENERGY COMPANY LIMITED.
- 143 SHANDONG HIKING INTERNATIONAL CO., LTD.

- 144 JIANGSU FASTEN CO.,LTD.
- 145 HENGTONG OPTIC-ELECTRIC CO.,LTD.
- 146 YIN YI REAL ESTATE CO.,LTD.
- 147 LIFAN INDUSTRY (GROUP) CO., LTD.
- 148 NINGBO FUBANG JINGYE GROUP CO., LTD.
- 149 V V FOOD & BEVERAGE CO., LTD.
- 150 ZHEJIANG JINGGONG SCIENCE & TECHNOLOGY CO., LTD

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