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## Private Entrepreneurs' Political Participation and Strategy Making of their Firms: Evidence from China

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## **PRIVATE ENTREPRENEURS' POLITICAL PARTICIPATION AND STRATEGY MAKING OF THEIR FIRMS: EVIDENCE FROM CHINA**

The organization literature has long recognized the existence of political behaviors by corporations (Baysinger, 1984; Hillman & Hitt, 1999; Shaffer & Hillman, 2000). As firms operate in environments that are often subject to public policies and regulations, their ability to affect government policies to their favor may have a significant impact on their performance (Keim & Baysinger, 1988; Shaffer, 1995). While traditional attention on corporate political strategies has been focused on large companies in advanced economies, more recently there is a growing interest in managerial political networking by firms in transitional economies (Li & Zhang, 2007; Peng & Luo, 2000). Due to the underdevelopment of market-supporting institutions, managers seek and maintain contacts with government officials as a substitute for the insufficient formal infrastructure so as to obtain resources that are otherwise not available in the market (Luo, 2003). Researchers have also provided evidence that ties with government officials enhance firm performance in China, the largest transition economy in the world (Li & Zhang, 2007; Peng & Luo, 2000).

While prior studies have generated valuable insights on how a firm's political strategies may affect performance, several deficiencies remain. First, one far-reaching outcome of economic transition is the generation of the private sector with a large and ever growing number of private businesses and private entrepreneurs (Peng & Heath, 1996). However, little attention has been directed to this particular, important sector to study the varying implications of political behaviors by these private entrepreneurs. Extant literature simply treats private firms as an aggregated category and points out that they benefit from their political strategies more than state-owned firms (Li & Zhang, 2007; Peng & Luo, 2000) without specifying how these private firms themselves may be different among one another in this regard. Second, while prior research largely focuses on firm/managerial activities targeting at influencing or connecting with political decision makers, a recent trend in a number of transition economies is that entrepreneurs directly participate in politics as a way to overcome market, state, and legal failures (Li, Meng, & Zhang, 2006). So far little is known about the organizational consequences of such a phenomenon. Third, although evidence exists that firm/managerial political behaviors bring about economic benefits for the firm (Fisman, 2001; Li & Zhang, 2007; Peng & Luo, 2000), no research has explicitly examined the process within this black box, particularly how a firm's strategy making may be affected, an important step towards nuanced understanding of the organizational impact of political behaviors.

Recognizing these literature gaps, in this research, we focus on entrepreneurs in the private sector (termed as "private entrepreneurs") of a transition economy – China, and study how their direct participation in politics, as a specific kind of political behavior, affects their strategy making for their ventures. Different from political networking, political participation offers private entrepreneurs with a more aggressive way of obtaining political capital. While political networking helps entrepreneurs and their firms resources that are otherwise not easily available through markets, private entrepreneurs' political participation goes beyond that by not only expanding their access to valuable resources at lower costs, but also providing them with an enhanced status as well.

In this research, we examine two distinct but related characteristics of strategy making by private entrepreneurs – *strategic deviation* and *strategic risk-taking*. Strategic deviation, refers to the extent to which a firm’s strategies deviate from the central tendency of the entire industry, that is, adopting novel and unique strategies (Finkelstein & Hambrick, 1990; Hiller & Hambrick, 2005). Strategic risk-taking, according to Sanders and Hambrick (2007), refers to strategic moves that involve big outlay, high variance of potential outcomes, and the likelihood of extreme loss. We deem these two aspects of strategy making particularly relevant as to some extent they both indicate a firm’s degree of differentiation, and allow us to detect the extent to which private firms with politically active entrepreneurs differ from those without in strategy making. Set in the context of China as a transition economy, our argument is that when private entrepreneurs participate in politics, as represented by their membership in two powerful political bodies, People’s Congress (PC) and Chinese People’s Political Consultative Conference (CPPCC), their firms tend to pursue deviant as well as risk-taking strategies.

We identify two reasons, as reflected in two mediating mechanisms, for these relationships. For one, political participation increases the private entrepreneurs’ self-perceived social status, which prompts their willingness to undertake non-conforming and risky strategies. Social status refers to the amount of respect, influence, and prominence one has in the eyes of others (Anderson, John, Keltner, & Kring, 2001; Flynn, 2003). In China, obtaining membership in these two political bodies (the PC and the CPPCC), esp. at the national level, are conferred as great honor and prestige. Especially for entrepreneurs who are from a newly legitimized private sector, which is still considered as inferior to the public sector due to historical reasons, their recognition by the society and the government through the PC or CPPCC membership is even more significant to add to their self-evaluation and self-worth, and thus perceive themselves at the higher status of the social hierarchy.

This boosted self-perception of social status drives the private entrepreneurs towards certain characteristics of strategy making. Psychological research has found that higher status individuals often experience an expectancy-confirmation process called the “Pygmalion effect” (Eden & Shani, 1982; Rosenthal & Jacobson, 1968). That is, higher status individuals are expected by others to possess better qualities, and as a result, they will be motivated to meet that expectation (Magee & Galinsky, 2008). In the case of private entrepreneurs who perceive themselves of high social status related to their PC or CPPCC membership, they are likely to strive to maintain the expectation from the public that they are capable leaders. In this regard, undertaking deviant and risky strategies for their firms creates opportunities for them to demonstrate their capabilities as expected by the public and further reinforce their status claim.

*H1: Private entrepreneurs’ political participation has a positive relationship, via their self-perceived social status, with deviant strategy making of their firms.*

*H2: Private entrepreneurs’ political participation has a positive relationship, via their self-perceived social status, with risky strategy making of their firms.*

Have articulated the motivational mechanism of how political participation by private entrepreneurs affects their firms' strategy making, we next elaborate on another mediating mechanism, that is, how political participation facilitates the private entrepreneurs' resource acquisition and subsequently affects private entrepreneurs' actual capability to carry out deviant and risky strategies.

Firms are often constrained by resources in implementing strategies (Penrose, 1959). This is especially true for private firms in transitional economies who are in a weaker position than state-owned firms in resource acquisition as the latter tend to enjoy preferential treatment and protection from the government due to their ownership nature. We argue that for private entrepreneurs, political participation is an effective way to facilitate their acquisition of needed resources for their firms in several ways. First, their membership in the PC or the CPPCC bestows them an identity as policy makers. They therefore have more and clearer knowledge on major public policies than those without such membership. Second, the membership enables them to easily approach certain government officials through work relationships (Li et al., 2006) and in turn cultivate informal ties through which they may obtain preferential access to resources that otherwise are not available through market mechanisms (Li & Zhang, 2007; Peng & Luo, 2000). Third, other than getting to know more government officials, these private entrepreneurs can also network with other members in the PC or the CPPCC, typically coming from a large variety of industries and social organizations, and turn these formal connections into interpersonal contacts. This also significantly expands these entrepreneurs' network from which they may draw critical resources for their firms. Fourth, serving in the PC or the CPPCC will provide them with more opportunities as well as lower cost of forging new relationships other than what are discussed above. Importantly, membership in the PC or the CPPCC gives private entrepreneurs some measure of political power embodied in higher reputation and reliability, such that they themselves become attractive targets for networking, and enjoy advantage in extracting resources from these ties and garnering requisite support of key constituents, such as customers, suppliers, and skilled employees. In sum, political participation is an effective tool for these private entrepreneurs to gain critical, and often not publicly accessible, resources for their firms.

Such superior resource acquisition ability facilitates their firms to pursue deviant and risky strategies. Extant research has pointed out that adopting novel strategies often incurs heavy investment (Boulding & Christen, 2001; Lieberman & Montgomery, 1988). In a similar vein, strategic risk-taking involves substantial and irreversible resource commitment (Sanders & Hambrick, 2007). Private entrepreneurs who are in advantageous positions of resource acquisition are more capable of pursuing strategic deviation for their firms or engaging in strategic risk-taking.

*H3: Private entrepreneurs' political participation has a positive relationship, via their resource acquisition, with deviant strategy making of their firms.*

*H4: Private entrepreneurs' political participation has a positive relationship, via their resource acquisition, with risky strategy making of their firms.*

We implement our study using a nationwide survey of privately owned enterprises that was conducted in 2008 jointly by the All China Industry and Commerce Federation, the China Society of Private Economy at the Chinese Academy of Social Sciences, and the United Front Work Department of the Central Committee of the Chinese Communist Party. The multi-stage stratified random sample contains 4,071 privately owned enterprises, which represents around 1% of the total number of privately owned firms nationwide. Excluding responses that have missing data on our key variables, the final sample in our study includes 3616 private entrepreneurs/firms. The average age of our sample firms is 5.91 years old and the average size is 178 employees.

*Political participation.* We measure a private entrepreneur's political participation with two components – the highest administrative level of the PC or the CPPCC in which he/she participates in, and his/her highest hierarchical position in that political body. In specific, we coded the highest administrative level of the political body in which a private entrepreneur has membership and the highest hierarchical position that the private entrepreneur assumes in that political body. Both are ordinal measures. The higher the score, the greater the extent of political participation of the private entrepreneur.

*Self-perceived social status.* In the survey, private entrepreneurs were asked to indicate, compared with other people around them, their perceived positions in the society in terms of 1) the social hierarchy and 2) the political hierarchy. They were asked to make such evaluation on two visual ladders from '1=very high to '10=very low.' Responses regarding these two aspects are highly correlated (0.76), we summed their answers to these two items to yield an overall measure of perceived social status of private entrepreneurs.

*Resource acquisition.* For the private sector, financial capital is typically considered as the most needed resource that can be used to purchase other inputs (Li et al., 2006). We therefore measured this variable in terms of private firms' ability to obtain bank loans. In the survey, respondents were asked to report the amount of loans their firms had obtained from the following four major types of banks, i.e., state-owned banks, joint-stock banks, city commercial banks, and urban credit cooperatives. We then summed up the amount of loans from these banks and used the natural logarithm of it to measure resource acquisition.

*Deviant strategy making.* Adapting Finkelstein and Hambrick's (1990) as well as Geletkanycz and Hambrick's (1997) measure of strategic conformity, we evaluated a firm's deviant strategy making with the extent to which a firm's strategy is different from the industry tendency along a number of key dimensions. In particular, we focused on research and development (R&D) strategy (R&D expenses as percentage of total sales), marketing strategy (advertising expenses as percentage of total sales), and financial strategy (the debt to asset ratio). To construct the variable of deviant strategy making, we first standardized each strategic dimension by industry. We next calculated the absolute difference between a firm's score on a strategic dimension and the average score for all sample firms in that industry. Deviant strategy making was then created by summing the above absolute difference on all three dimensions.

*Risky strategy making.* Internationalization is typically considered as a risky strategy, and it is particularly so for private firms in transition economies. Firms may engage in different modes of internationalization, including manufacturing for foreign businesses, direct exporting, strategic alliance/joint ventures, and greenfield investment. These modes incur different levels of risk, with manufacturing for foreign businesses being the most conservative and greenfield investment being the most risky (Etta & Beamish 2008). As firms may engage in a variety of international activities, we used its most risky mode of internationalization to indicate its risk taking. Specifically, risky strategy making was coded as 0 if the firm did not engage in any international activities, 1 if it engaged in manufacturing for foreign businesses, 2 if it engaged in direct exporting, 3 if it engaged in strategic alliances/joint ventures overseas, and 4 if it had greenfield investment overseas. A higher score thus represents a higher degree of risky strategy making by the firm.

We also include control variables of both the firms and the entrepreneurs to capture possible confounding effects. Our preliminary results provide good support to our predictions. Due to page limit, we cannot display our 2-page descriptive statistics of all variables but move on to report our results.

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 Insert Figure 1 & Table 1 about here  
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Figure 1 shows the best-fitting, hypothesized model with standardized path coefficients. Private entrepreneurs' political participation was a significantly meaningful predictor of the results of perceived social status and resource acquisition ( $\beta = 0.115$  and  $0.052$ , both  $p < 0.001$ , respectively). Perceived social status was significantly associated with risky strategy making ( $\beta = 0.074$ ,  $p < 0.001$ ) but not with deviant strategy making ( $\beta = -0.027$ ,  $p < 0.1$ ). Resource acquisition was also positively associated with risky strategy making ( $\beta = 0.083$ ,  $p < 0.001$ ) and deviant strategy making ( $\beta = 0.654$ ,  $p < 0.001$ ).

To test the mediated relationships, we used bootstrapping approach and reported their two-tailed significances for each indirect effect (Preacher and Hayes, 2008). As shown in Table 2, perceived social status significantly mediated the relationship between political participation and risky strategy making (with indirect effect  $\alpha\beta = 0.008$ ,  $p < 0.01$ ), but statistically did not mediate the relationship between political participation and deviant strategy making ( $\alpha\beta = -0.003$ ,  $p < 0.1$ ). Resource acquisition had a significant mediating effect on the relationship between political participation and risky strategy making ( $\alpha\beta = 0.004$ ,  $p < 0.05$ ) and on the relationship between political participation and deviant strategy making ( $\alpha\beta = 0.028$ ,  $p < 0.5$ ).

This study endeavors to make the following contributions. First, this paper adds to the entrepreneurship literature, which has traditionally focused on entrepreneurial actions in the marketplace, such as new product introduction and internationalization. So far little attention has been directed to a related entrepreneurial drive – their political actions with the purpose of achieving business goals and how the decisions related to these actions are made. Our

paper presents evidence of such an entrepreneurial drive and the relationships between entrepreneurial actions in political and business arenas. This thereby further enriches our understanding on the means and processes through which entrepreneurs engage in proactive shaping of their competitive as well as institutional environment.

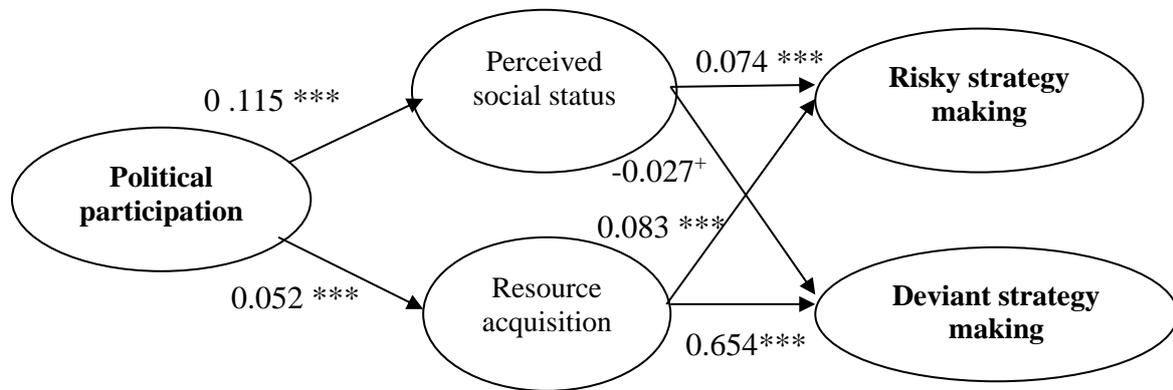
We also add to the literature on corporate political strategies by not only extending this line of research to a novel, under-examined context – private sector in a transition economy, but also disentangling the intermediary processes regarding the organizational implications of political strategies. Our theoretical elaboration on, and empirical test of, two mediating processes in this black box, reveal that private entrepreneurs' willingness to adopt deviant and risky decisions are due to their political participation as well as their capability of doing so. Moreover, as political participation is one manifestation of political capital, our study compliments the general management literature that traditionally emphasizes human capital (knowledge and experience) and social capital (network connections) of individuals or managers.

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**Figure 1 Estimated path coefficients for the theoretical model**



*Note.* Standardized parameter estimates are presented in the model.

\*\*\*  $p < 0.001$ ; \*\*  $p \leq 0.01$ , \*  $p \leq 0.05$ , +  $p < 0.10$

**Table 2 Indirect effects**

Dependent variable	Independent variable	Indirect effect	Two-Tailed Significance
Deviant strategy making	Political participation through perceived social status	-0.003	$P < 0.10$
	Political participation through resource acquisition	0.028	$P < 0.05$
Risky strategy making	Political participation through perceived social status	0.008	$P < 0.01$
	Political participation through resource acquisition	0.004	$P < 0.05$

*Note.* Standardized parameter estimates are presented in the table.

\*\*\*  $p < 0.001$ ; \*\*  $p \leq 0.01$ , \*  $p \leq 0.05$ , +  $p < 0.10$