THREE ESSAYS ON CORPORATE INDEPENDENT DIRECTORS IN EMERGING MARKETS

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Abstract

This dissertation investigates the impact of independent directors' connections to a powerful third party such as the state on (1) independent directors' monitoring, (2) directors' career outcomes and (3) corporate donations.

Study 1 (Chapter 3) investigates how the power relationship between independent directors and (majority) shareholders impact independent directors' monitoring. By exploiting a director-level dataset, this study finds that directors' connections to a powerful third party such as the government countervail the influence of majority shareholders and thereby positively influence their monitoring. However, independent director compensation associated with dependency asymmetry negatively affects their monitoring.

Study 2 (Chapter 4) extends research on directors' monitoring by investigating whether directors will be rewarded for their effective monitoring. Drawing upon signalling theory, I posit that diligent monitoring, despite the same type of signal, is evaluated differently by varying groups of stakeholders and in turn influences directors' careers. Specifically, diligent monitoring is not positively evaluated by the focal firm, as reflected by directors' lower probability of re-appointment after current director term expires. However, diligent directors are rewarded for their duties in the form of more new board seats. Moreover, for directors with connections to the state, diligent monitoring is also rewarded as this is consistent with the state's interests.

Study 3 (Chapter 5) examines heterogeneous political connections and their impacts on corporate social responsiveness (i.e. donation). Using data on earthquake donations by Chinese publicly listed firms in 2008, I show that firms with higher proportions of directors embedded in the political system will donate less, due to the fact that disaster relief efforts, viewed as the state's responsibility, may de-legitimize the state. However, firms with higher proportions of directors peripheral in the political system will donate more due to public pressure for corporate social responsibility. This study provides insights into the nature of political connections and enriches our understanding of corporate social responsiveness in the context of emerging economies.

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DECLARATION OF ORIGINALITY

This is to certify that:

(i) The dissertation comprises only my original work towards the PhD except where indicated

(ii) Due acknowledgement has been made in the text to all other material used,

(iii) Due acknowledgement has been made in the text to my co-authors with whom I have worked on research manuscripts,

(iv) The dissertation is less than 100,000 words in length, inclusive of table, figures, bibliographies, appendices and footnotes.

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Now I keep wondering how my original "ice-cream glove" ideas evolve from their stupidity and finally turn into novelty that being recognized by other scholars. Every time I read my work, it reminds me of the time I discussed with my supervisors or colleagues and also those mistakes or debates we had together.

People told me that it's great to have a single-authored paper that clearly signals your efforts for your paper, which may help you land a good job. But I know it's not all my efforts to make this

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CHAPTER 1 INTRODUCTION AND MOTIVATION

1.1 INTRODUCTION

Conventional wisdom holds that independent directors are viewed as an important internal corporate governance mechanism to alleviate managerial opportunism (Fama, 1980; Fama & Jensen, 1983). Independent directors are those directors without direct connections with the focal firm other than through the employment of this independent directorship (Nguyen & Nielsen, 2010), and their monitoring has been shown to be important in reducing agency problems and improving firm performance (Guo & Masulis, 2015; Liu, Miletkov, Wei, & Yang, 2015). After a spate of corporate scandals such as Enron and WorldCom in early 2000s, the role of independent directors has attracted greater attention from both scholars as well as policy makers. For instance, the United State Congress enacted the Sarbanes-Oxley Act of 2002 (SOX), which regards the independent director system as a key factor for firms' internal control (Chhaochharia & Grinstein, 2007; Linck, Netter, & Yang, 2009; Valenti, 2008).

Given the growing importance of independent directors, emerging markets have also initiated corporate governance reforms in the last two decades. For example, China adopted an independent director system in 2001 (Jiang, Wan, & Zhao, 2015), India in 1999, and Malaysia in 2000. However, due to social, legal or cultural differences (Hoskisson, Eden, Lau, & Wright, 2000), it's still unclear about whether the direct transplantation of the independent director system into emerging markets produce the intended outcomes (Aguilera & Jackson, 2010). Therefore, there has been a huge debate regarding whether the "best practice" model originated from the U.S could translate into improved corporate governance practices in emerging markets (Desender, Aguilera, Lópezpuertas-Lamy, & Crespi, 2014; Geng, Yoshikawa, & Colpan, 2015; Peng, 2004).

The literature on comparative corporate governance has suggested that one potential factor for this divergence is the composition of those independent directors (Aguilera & Jackson, 2010). As an independent directorship is usually an individual's secondary employment, previous studies, mostly conducted in the context of the United States, have implicitly assumed that independent directors are corporate executives in other companies (Boivie, Graffin, Oliver, & Withers, 2015b). These studies have primarily focused on directors' home organizations within the market environment, usually characterized by different market players such as private equity firms, venture capitalists and other listed firms. However, in the case of emerging markets, most independent directors come from a different background, i.e. nonmarket organizations such as the governments, political parties or universities (Mellahi, Frynas, Sun, & Siegel, 2015). To date it still remains an open question about whether and how nonmarket organizations influence directors' monitoring and related corporate strategies.

Against this backdrop, this dissertation examines one particular type of nonmarket actor, i.e. the government. Given growing government intervention after the financial crisis in 2008, the government has played a more visible role in directing and coordinating economic activities (Guo, Nguyen Huy, & Xiao, 2016), which holds especially true for emerging markets where the government tends to dominate economic activities.

This dissertation first focuses on the impact of independent directors' connections to the state on directors' monitoring, one of the most important functions of independent directors. Although previous studies have typically explored the effect of market home organizations on monitoring (Boivie, 2015), the impact of the state on monitoring still remains a major omission in the corporate governance literature.

Moreover, as major corporate decisions usually come from the boardroom (Boivie, 2015), it's expected that independent directors also influence corporate strategies such as corporate donations. Previous studies in the context of developed countries have explored the drivers for corporate donations, usually drawing upon stakeholder theory. For instance, more profitable firms are expected to donate more due to stakeholders' expectation (Wang, Choi, & Li, 2008). A recent burgeoning literature has demonstrated the importance of political ties in influencing corporate social responsibility (CSR) (Wang & Qian, 2011). In this respect, we still know little about the impact of political ties on corporate donations in emerging markets.

This dissertation seeks to fill these gaps by investigating the impact of independent directors' connections to the state on individual directors' monitoring, their career outcomes, and corporate nonmarket strategies such as donations. In this dissertation, I use a large sample of independent directors in Chinese publicly listed firms from 2004 to 2014 to examine these research topics.

This study selects China as a setting to explore how independent directors' connections to the government influence their monitoring in their focal firms, directors' career outcomes, and corporate decisions such as donations. This is a well-suited context to test my ideas for the following reasons. First, China initiated its independent director system in 2001, which required all listed firm to install independent directors on the board and independent directors should account for at least one third of board membership. This initiation of independent director system also responds to the recent call for improving corporate governance after China's entry into World Trade Organizations (WTO) (Clarke, 2006). Second, China, as the second largest economy in the world, is characterised by great interdependencies between firms and the state. While previous studies have suggested that the role of the state is important (Shi, Markóczy, & Stan, 2014; Sun, Mellahi, Wright, & Xu, 2015b), few studies have explored to what extent the state, as a powerful third party, influences independent directors' monitoring and also directors' career outcomes. Third, unlike most independent directors in the U.S. whose primary occupations are corporate executives, independent directors in China are mainly consisted of current or retired government officials (Chizema, Liu, Lu, & Gao, 2014), which provides a setting to examine the impact of nonmarket forces on independent directors' monitoring. Fourth, information about directors' monitoring is disclosed at the director level in China (Jiang et al., 2015; Ma & Khanna, 2015), helping capture more accurately directors' monitoring at the individual level and also examine the relationship among an independent director, the focal firm and the state. However, previous studies tend to use a relatively coarse board-level measure (Desender et al., 2014). Lastly, to test the impact of heterogeneous political ties on corporate donations, this dissertation uses data on corporate donations following the Sichuan Earthquake in 2008, serving as a quasi-natural experiment setting helping provide direct evidence about the casual impact of heterogeneous political ties on donations.

This dissertation mainly focuses on independent directors with connections to the government, referred to politically connected independent directors. Following previous studies (Sun, Hu, & Hillman, 2015a; Wang, 2015), politically connected independent directors are defined as those independent directors who currently hold or previously held positions in the following organizations: (1) the party, i.e. Communist Party of China (CPC), (2) the executive branch, i.e. local or central governments, and (3) the two legislative branches, i.e. People's Congress (PC) or Chinese Political Party Consultative Committee (CPPCC).

This dissertation comprises of three empirical studies examining the monitoring behaviour of politically connected independent directors and also exploring how politically connected independent directors influence corporate strategies. China is characterized by the concentrated ownership structure, which is also common around the world (Porta, Lopez-de-Silanes, & Shleifer, 1999). The agency problem is not between managers and shareholders but the conflicts between majority shareholders and dispersed minority shareholders, i.e. the principal- principal agency problem where the powerful majority shareholders are likely to expropriate minority shareholders by pursuing their own private goals (Young, Peng, Ahlstrom, Bruton, & Jiang, 2008). In such a case, independent directors are responsible for monitoring majority shareholders on behalf of minority shareholders, and the whole arguments in this dissertation are developed based on this assumption.

1.2 DEVELOPMENT OF THE THREE RESEARCH QUESTIONS

The overarching research topic of this dissertation is about politically connected independent directors and also their impacts on corporate strategies. This dissertation consists of three empirical papers. Although each of them explores separate research question with a particular focus, they collectively form a coherent set of works examining the impacts of political connections on directors' monitoring, individual director's career outcomes and corporate nonmarket strategies such as donations. Therefore, this dissertation, as a whole, addresses the research gaps in the literature on corporate governance, political connections, and nonmarket strategies. Figure 1-1 illustrates the primary focus of this dissertation. Specifically, this dissertation explores independent directors with connections to nonmarket home organizations such as the state, while traditional research has predominantly focused on independent directors connected to market organizations such as publicly listed firms. Figure 1-2 presents the connections between the three research questions. Study 1 and Study 2 explore the impact of political connections on individual directors' monitoring and whether their diligent monitoring is valued by market or nonmarket actors. Study 3 differentiates different types of political connections. Specifically, this study examines the differential impacts of political ties inside and peripheral in the political system on corporate donations. To be more specific, the following three research questions are answered:

- To what extent do independent directors' connections to a powerful third party such as the government influence their power relationships with (majority) shareholders and in turn their monitoring behaviour?
- To what extent do different stakeholders in the market environment (i.e. the focal firm and other listed firms) and nonmarket environment (i.e. the state) evaluate directors' monitoring and its impact on career outcomes, i.e. gain or loss of directorships?
- To what extent do interdependent directors' different political ties influence corporate nonmarket decisions such as corporate donations following a natural disaster?

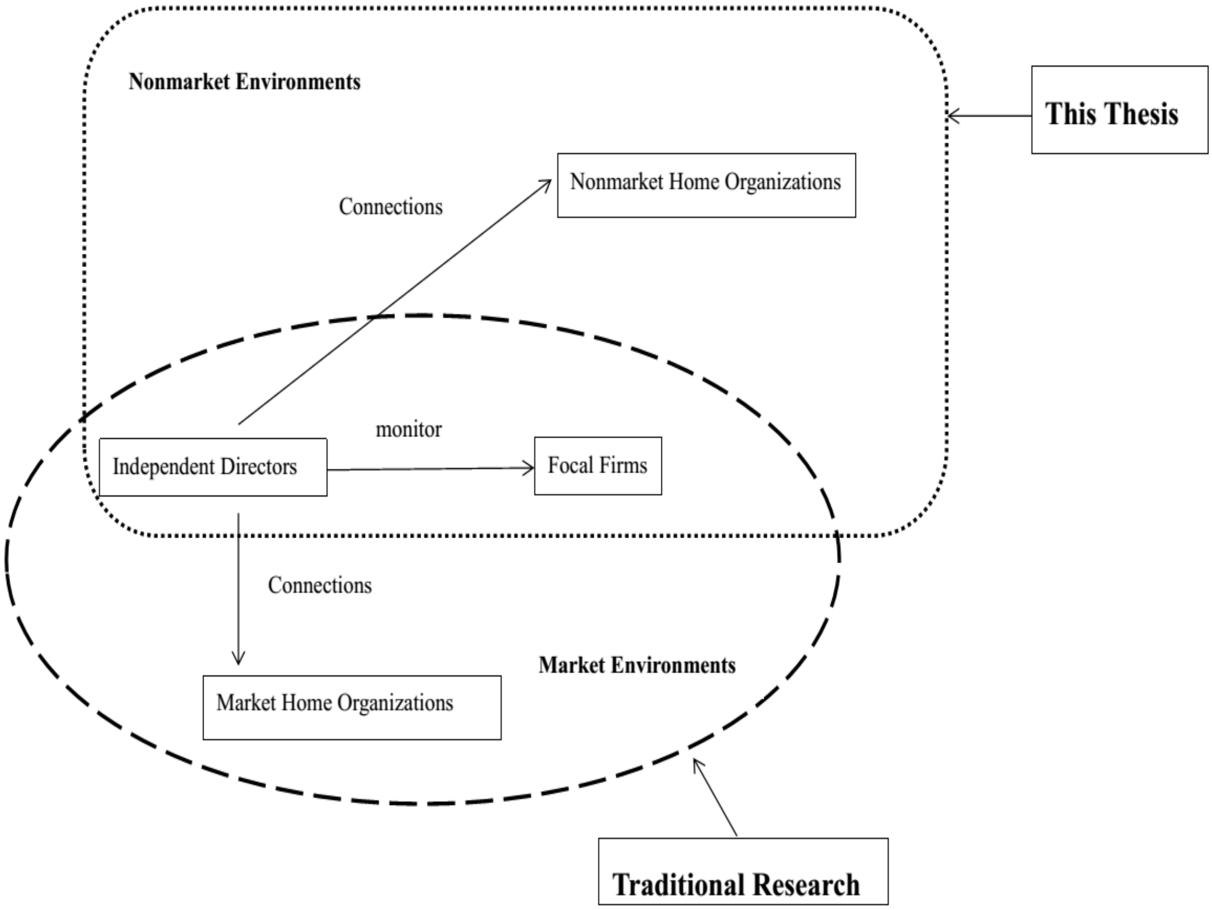

FIGURE 1-1: Focus of Dissertation

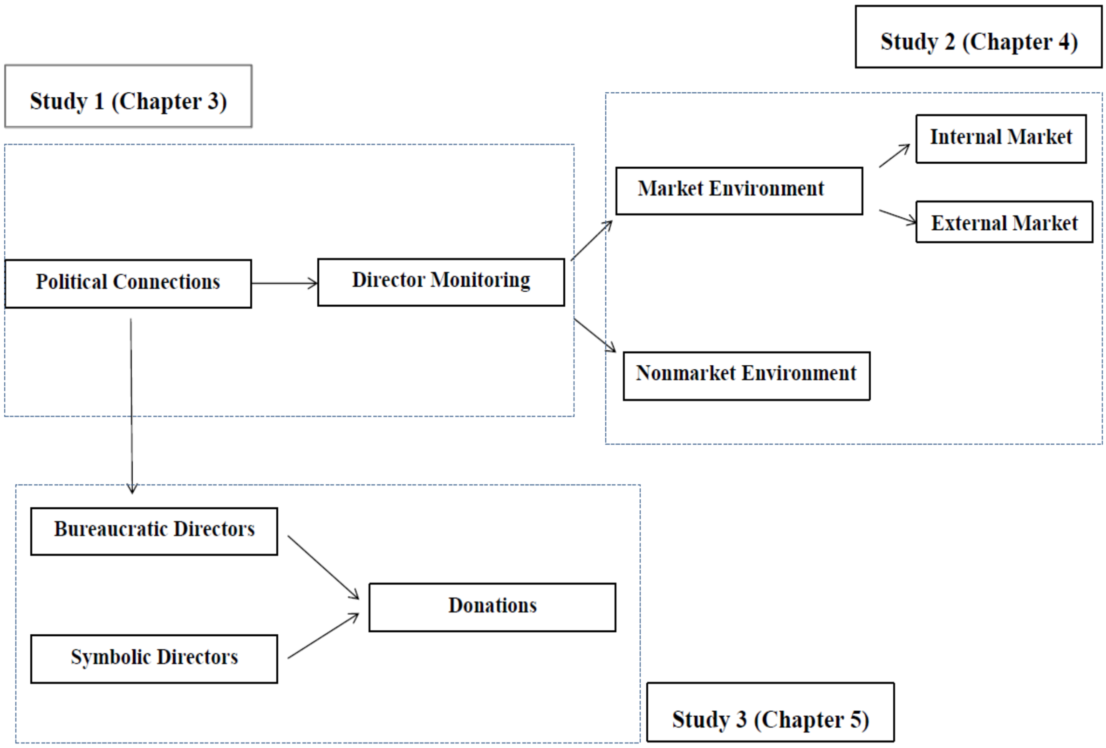

FIGURE 1-2: Organization of Dissertation

1.3 DATA SOURCES

In this section, I introduce the data sources of my three empirical studies. This dissertation consists of three empirical studies focusing on independent directors in listed firms in the Shanghai and Shenzhen Stock Exchanges in China. I mainly draw on data from China Stock Market Trading Database (CSMAR), complemented by China Core Newspapers Database (CCND) Newspaper and China's Regional Institutional Level Index form National Economic Research Institute (NERI) databases.

1. **China Stock Market Trading Database (CSMAR)**

My sample of this study consists of all A-share publicly listed firms in the Shanghai and Shenzhen Stock Exchanges. Firms' basic financial information is from China Stock Market

Trading Database (CSMAR). In addition to financial information, CSMAR also provides related information for the career path of the CEOs, chairman, and board of directors (including independent directors). The CSMAR database is the leading database for Chinese publicly listed firms and has been used in previous studies (Giannetti, Liao, & Yu, 2015; Luo, Wang, & Zhang, 2016a; Qian, Wang, Geng, & Yu, 2016).

The information for politically connected independent directors also comes from this database. All Chinese listed firms are required to disclose the backgrounds for their CEOs and board of directors. The background information includes age, gender, past working experience, and academic background. By checking the career paths for CEOs/board of directors, I manually classified whether an independent director works or has worked in government (-related) agencies, including Communist Party of China (CPC), Chinese People's Political Consultative Conference (CPCC), People's Congress (PC), and local or central governments.

For voting outcomes of board meetings, I also retrieved all of these details from CSMAR. Typically, a proposal is voted by inside directors and independent directors at board meeting and the passage of the proposal requires a majority vote.

2. China Core Newspapers Database (CCND)Newspaper Database

China Core Newspapers Database (CCND) is a sub-database of China National Knowledge Infrastructure (CNKI). CCND collects news reports from major newspapers in mainland China since 2000. To date this database covers more 700 newspapers and about 8 million new articles with an annual increase in around 1.2 million news articles. Like Factiva, CCND allows me to search key words and report the results in a structured way.

3. **China’s Regional Institutional Level Index form National Economic Research Institute (NERI)**

The province-level institutional indices are provided by National Economic Research Institute (NERI), China Reform Foundation (Fan & Wang, 2003). NERI Index of Marketization of China’s Province is a relative assessment of the market development level across 31 provinces in China from 1999 to 2009 and is wildly used in strategy research (Sun et al., 2015a). The data source is from government statistics or household/enterprise surveys. The index is classified into five fields and totally contains 23 indicators. The five fields include: *government and market relations*, *development of the non-state sector*, *development of the commodity market*, *development of the factor market*, *market immediacies and the legal environment for the market*. Higher scores reflect better institutional development in each province. This dataset has been used in management research (Qian et al., 2016; Sun et al., 2015a). Table 1-1 summarizes the datasets used in the three studies.

Table 1-1: Databases for the Dissertation

	Study 1	Study 2	Study 3
1.China Stock Market Trading Database (CSMAR)	✓	✓	✓
2.CCND Newspaper Database			✓
3.China’s Regional Institutional Level Index form National Economic Research Institute (NERI)			✓

1.4 ORGANIZATION OF THE DISSERTATION

The dissertation is composed of six chapters. After the first introductory chapter, Chapter 2 provides an overview of the research context with a particular focus on the independent director system in China. This chapter also presents two policy changes related to the independent director system.

Chapter 3 examines the first research question about to what extent independent directors' power relationships with (majority) shareholders influence their monitoring behaviour. The monitoring behaviour is in the form of directors' issuing a dissenting opinion at board meetings, which viewed as a type of directors' passive monitoring activities (Tirole, 2001). Drawing on the theoretical insights from resource dependency theory (Pfeffer & Salancik, 1978), I first examine to what extent connections to the government influence the monitoring of politically connected independent directors. I theorise that, for politically connected independent directors, their connections to a powerful third-party shift the power balance from (majority) shareholders to independent directors, thus empowering directors to monitoring (majority) shareholders. However, majority shareholders influence independent directors through creating dependency asymmetry in the form of independent director compensation. That is, higher-paid independent directors are less vigilant in monitoring. Empirical evidence on the voting patterns of 750 unique independent directors in 206 Chinese public firms from 2004 to 2014 supports my predictions. This study thus provides a full picture of the power relationship between individual independent directors and majority shareholders. My empirical results remain robust by employing different econometric methods such as a conditional logistic model, the correlated random effects method and the instrumental variable regression with generalized method of moments estimators (IV-GMM) after addressing endogeneity issues.

Chapter 4 explores the career outcomes of those diligent independent directors. Following study 1, study 2 examines the career outcomes of independent directors after their issuance of dissenting opinions at board meetings. Directors' career outcomes are measured by the gain or loss of directorships. Most current studies have explored directors' career outcomes from the perspective of ex post settling up (Fama and Jensen 1983; Fama 1980), which holds that directors will be rewarded or penalized by market actors. Despite these insights, we know little about whether diligent monitoring is valued by nonmarket actors or not. This study provides a more comprehensive list of evaluators both in the market and nonmarket environments. Adopting signalling theory, this study explores how diligent monitoring is evaluated by stakeholders within the market environment (i.e. the focal firm and other listed firms) and in the nonmarket environment (i.e. the government). My empirical results reveal that directors' dissent has a negative impact on the re-appointment of current directorship but a positive effect on new board seats in a three-year time window. However, for those politically connected independent directors, I use an exogenous policy regulation that required politically connected independent directors to resign their current directorship by the end of 2013. By using a propensity score matching method comparing those politically connected independent directors with at least one dissent (i.e. the treatment group) and those without any dissents (i.e. the control group), my results reveal that those dissenting politically connected independent directors are more likely to stay in the directorship market, indicating that their diligent monitoring in the form of dissents enhances their legitimacy in the eyes of the government and buffers them from unwanted government pressure.

Chapter 5 focuses on the extent to which politically connected independent directors affect corporate nonmarket decisions such as corporate donations. In this study, I examine how heterogeneous political connections affect corporate social responsiveness (i.e. donation). Specifically, politically connected independent directors' decisions may be influenced by their positions in the political system. Using data on earthquake donations by 1,498 Chinese publicly listed firms in 2008, I show that firms with a higher proportion of directors embedded in the political system will donate less, due to the fact that active disaster relief efforts, viewed as the state's responsibility, may de-legitimate the state in an authoritarian regime. However, firms with higher proportions of directors peripheral in the political system will donate more, due to their susceptibility to public pressure. This study contributes to the literature on political connections and enriches our understanding of corporate social responsiveness in the context of emerging economies.

Chapter 6, which is the last chapter in the dissertation, concludes with this dissertation's contributions to management research and provides managerial implications. Limitations, which provide future research opportunities, are also presented.

CHAPTER 2 RESEARCH BACKGROUND

2.1 INDEPENDENT DIRECTOR SYSTEM IN CHINESE PUBLICLY LISTED FIRMS

The notion of independent directors first appeared in China in *The Guiding Opinion for Listed Corporations' Articles of Incorporation* issued by the China Securities Regulatory Commission[1] (CSRC) in December 1997. However, it only suggested that Chinese listed firms are *advised* to appoint independent directors. By the end of 2000, around 5% of listed firms had appointed independent directors on their board, but whether those independent directors are eligible for this role were still questionable.

After that the Shanghai Stock Exchange on November 3, 2000 issued *The Guiding Opinion for Governance of Listed Corporations* suggested that at least two independent directors should be nominated on a board and account for at least 20% of the entire board. The importance of independent directors has been gradually recognized. The most influential regulation for the independent director system is the guiding opinion issued by the CSRC in 2001, called *The Guidelines for Introducing Independent Directors to the Board of Directors in Listed Companies (the Guideline hence after),* which mandated that all publicly listed firms were required to adopt the independent director system with a minimum of one third of the board members shall be independent directors by June 30, 2003. Moreover, at least one of those independent directors should be an accounting professional. The Guideline also prohibits an individual from serving more than 5 independent directorships in Chinese listed firms.

[1] The CSRC is the highest regulatory authority for domestic capital market in China, like Securities and Exchange Commission (SEC) in the U.S.

According *the Guideline*, an independent director is defined as "a director who does not hold any position in the company other than director and who has no relationship with the listed company or its principal shareholders that could prevent them from making independent and objective judgments." A director is *not* independent if a director is:

(1) An employee or his/her immediate family members (the spouse, parents, and children etc) working in the listed company and its related subsidiaries ;

(2) a personal shareholder or his/her immediate family member who directly or indirectly holds more that 1% of the listed company's shares, or who is one of top ten shareholders of the listed company;

(3) a personal shareholder or his/her immediate family member who directly or indirectly holds more that 5% of the listed company's shares, or who is one of top five shareholders of the listed company;

(4) a person who is classified as one of the above three circumstances in the previous year;

(5) One who provides financial, legal, consulting and other personnel services for the listed company or its subsidiaries;

(6) One who is specified in the listed company's articles of association;

(7) One who is determined by the China Securities Regulatory Commission (CSRC)

In February 2004, the State Council of China (the national executive branch in China) issued *Some Opinions on Promoting the Reform, Opening and Steady Growth of the Capital Market*, which also recognized the importance of independent directors in developing and reforming the domestic capital market. In October 2005, the legal status of independent directors in

China is finally formally established, as the National People's Congress, China's top legislature, amended the Corporate Law by incorporating independent directors.

2.2 ROLES OF INDEPENDENT DIRECTORS IN CORPORATE GOVERNANCE

The nature of the responsibility of independent directors mainly depends on the ownership structure. The concept of independent directors, traced back to the U.S. as early as 1930s, was originally designed to curb corporate governance problems in corporations with a relatively disperse ownership structure where the dispersion of ownership required independent directors to monitor managerial opportunistic behaviour.

The introduction of independent directors in China is similar to the spirit in the U.S. but of a slightly different purpose: to prevent majority shareholders from expropriating minority shareholders. According to *the Guideline*, independent directors are expected to "protect the interest of the whole listed firm and, in particular, the interest of small shareholders" and "carry out their duty independently from the influence of the company's major shareholders and ultimate controllers."

The Guideline also stipulated that independent directors are authorized to fulfill the following duties: (1) approval of material related-party transactions before submission to board meetings, (2) hiring or dismissing of Certified Public Accountant (CPA), (3) assembling general shareholder meetings, (4) nomination of directors of listed companies, (5) appointment or dismissal of senior management personnel, (6) remuneration of directors and senior management, (7) hiring external audit and advisory bodies, and (8) other matters that may harm the interests of minority shareholders.

Independent directors are also authorized to give independent opinions on corporate major matters. According to *the Guideline*, independent directors are expected to give their independent opinions on the following material issues (1) nomination, appointment or removal of directors, (2) the appointment or dismissal of senior management, (3) remuneration of directors and senior managers, (4) loans or transactions with the total value more than Chinese RMB 3 million or more than 5% of the listed company's most recent net asset values, (5) any issues that may harm the interests of small shareholders and (6) other matters stipulated in the company's article. With regard to those issues, an independent director should express one of the following opinions: (1) agreement, (2) qualified opinions, (3) adverse opinions, (4) disclaimer opinions, (5) abstention opinions, and (6) disagreement opinions

In 2004 the CSRC further required public listed firms to disclose independent directors' opinions on proposals on a timely basis according to *Code of Information Disclosure for Listed Firms' Annual Report*. The purpose of this regulatory change is to enhance transparency and convey timely corporate information to the market. The disclosed information includes the votes, the topics and content of proposals, and the name of directors and directors' opinions.

2.3 NOMINATION OF INDEPENDENT DIRECTORS

The Guideline also stipulates that those (including the incumbent board members, the board of supervisors, or the shareholders jointly or individually) who hold more than 1% of outstanding shares have the right to nominate independent directors. Then those nominated ones will then be formally elected during the annual shareholder meeting.

In reality, independent directors are mostly selected by majority shareholders, either by themselves or through the board. Around 70% of independent directors in the Shanghai Stock Exchange are nominated by controlling shareholders (usually the State) according to a report issued by the Shanghai Stock Exchange. This concentrating ownership in China causes paradoxical results. That is, independent directors, usually nominated by majority shareholders, represent the interests of majority shareholders instead of those of minority shareholders.

Even the CSRC also admitted that "Many corporations' independent directors were nominated by major shareholders or management. Such a mechanism cannot guarantee the independence of the appointees." But it happens that the CSRC does not approve some appointments of independent directors due to directors' "under the table" connections with controlling shareholders or top managers.

2.4 TENURE OF INDEPENDENT DIRECTORS

A distinctive characteristic of the independent directors system in China is that independent directors are allowed to serve on the same board for a maximum of two terms, i.e. each term of three years. After two terms, independent directors are required to leave. However, there is no term limit for listed firms in most countries.

2.5 CASE ILLUSTRATION OF PRINCIPAL-PRINCIPAL CONFLICT IN CHINA

Due to the weak legal system in China, there are limited laws or regulations to protect the interests of minority shareholders. It's common in China that majority shareholders expropriate the interest of minority shareholders through directly expropriating corporate assets or guarantee loans, both known as tunneling in the corporate governance literature (Jiang, Lee, & Yue, 2010; Johnson, La Porta, Lopez-de-Silanes, & Shleifer, 2000).

Siphoning corporate assets

Direct expropriation of corporate assets refers to the fact that the major shareholder takes goods or other assets directly from the listed companies, and usually recorded as "other receivables" on the balance sheet. If the controlling shareholder doesn't return or give back the asset, this will eventually be written off as "bad debts." This usually cause major huge losses for the listed company.

For example, Jinan Qingqi Motorcycles Co. Ltd (stock code: SH600698) was listed in the Shenzhen Stock Exchange in 1993, The controlling shareholder had since occupied a large amount of cash from Jinan Qingqi Co. Motorcycles Ltd. In 2002, Jinan Qingqi Motorcycles Co. Ltd filed for RMB 400 million provisions for bad debts, of which 397 million was reported as net loss in the current year. In that year Jinan Qingqi Motorcycles Co. Ltd was the company with the greatest loss among all listed firms.

Guarantee loans

Majority shareholders may also expropriate minority shareholders in the form of guarantee loans. For example, Monkey King Co. Ltd (stock code: SZ000535) was listed in the Shenzhen Stock Exchange in 1993, with Monkey King Group as the largest shareholder. Monkey King Co. Ltd, as one listed company, provided guarantee loans for his parent company Monkey King Group, as high as 300 million Yuan. However, in 2001 Monkey King Group unexpectedly declared bankruptcy, and Monkey King Co. Ltd had to pay off all these debts, which caused a huger loss for Monkey King Co. Ltd.

2.6 CHINA'S POLITICAL SYSTEM

This section provides a brief overview of the political system in China. China is featured by its one-arty regime. Since the Communist Party of China (CPC) took over China in 1949, the CPC has established a pyramid structure that tightly controls every part of China, which featured that the Party dominated the political system. To date, the Party has more than 8 million party members, which is the biggest political party in the world (more than the total population of the U.K. or Germany).

As shown in Figure 2-1, the Party commands the highest position in the political system. Within the Party, the party's political bureau (politburo) is the most powerful decision-making organization. The 24 members in the politburo are the most powerful people in China, which usually decided policies affecting 1.3 billion people in China. These members are elected by the central committee of the Party.

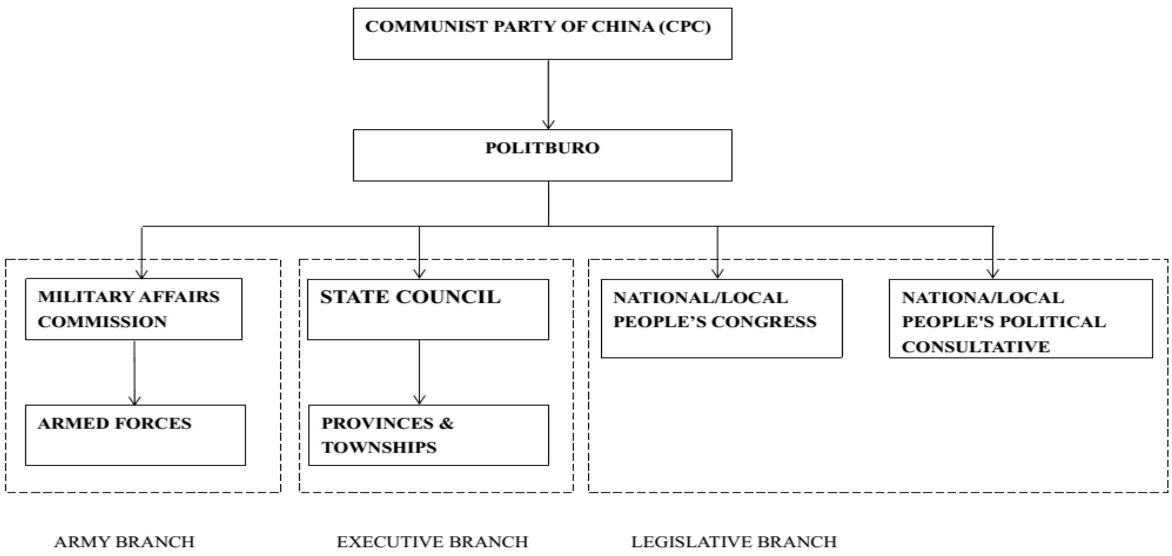

FIGURE 2-1: China's Political System [2]

[2] Figure 2-1 is adapted from BBC "How China is ruled?"
http://news.bbc.co.uk/1/shared/spl/hi/in_depth/china_politics/government/html/4.stm

As the most powerful body in China, the politburo controls the three most important organizations in China, including executive branch (the State Council and local governments), the legislative branch (National/Local People’s Congress and National/Local People's Political Consultative Conference), and the army (Military Affairs Commission).

In this dissertation, politically connected independent directors are those who hold or have held positions in the Party system, the executive branch and the legislative branch. I don’t include the army body as they’re usually not allowed to serve directorship in listed firms.

2.7 POLITICALLY CONNECTED INDEPENDENT DIRECTORS IN CHINESE PUBLICLY LISTED FIRMS

Since China formally introduced the independent director system in 2001, most publicly listed firms have appointed more than one third of independent directors on a board by the end of 2004. However, in spite of the domestic economic reform in 1979, the Chinese government still holds great control over the economic activities. Therefore, private firms try to establish connections with the Party or key government officials to overcome their ideological discrimination or economic-disadvantaged positions in society (Shi et al., 2014). One common way to build these connections is through the appointment of independent directors with working experience in state or party agencies.

According to *Xinhua News Agency*, an interview with a board secretary of a Shanghai-based listed firm mentioned that “I tend to choose those who are well-connected and can be helpful to the company.” Furthermore, Xinhua also mentioned that “...instead of inviting qualified and competent professionals to serve on their board, public firms have been inclined to reserve such seats for prominent government officials and scholars in exchange for their political and social influence...”

Some scholars doubted the qualifications of those politically connected independent directors, as this type of independent directors may not possess required knowledge of auditing, taxation, or human resources that are usually an essential part of independent directors' duties. Even worse, some worry that this type of rent-seeking activities may distort the economic allocation of society in the long run. Related ethical issues have also been raised such as "Officials have strong political connections and hiring people with such background as directors raises questions over ethical practices and breeds collusion between business and government," said Zhang Huiming, a professor in economics at Fudan University (*Xinhua News Agency*)

According to *China Youth Daily*, in September 2013, among all 5,760 independent directors employed in listed companies on the Shanghai and Shenzhen Stock Exchanges, 2,590 independent directors have working experienced in state-related organizations, around 44.9 percent of the total number of independent directors. It further revealed that more than 30 of them were retired officials who held positions at the ministerial level, and more than 100 used to be mayors. More than 720 reportedly had assumed posts equivalent to head of a county.

2.8 FIRST-WAVE GOVERNMENT REGULATION FOR INDEPENDENT DIRECTORS IN 2013

After more than ten years' implementation of independent director system in China since 2002, politically connected independent directors are common in Chinese listed firms (Chizema et al., 2014; Wang, 2015). However, the prevalence of politically connected independent directors has raised concerns about their ethical and legal issues (Clarke, 2006). Since Xi Jinping became President of China in March 2013, he has waged a series of anti-corruption campaigns targeting the misuse of political connections. Xi said that bribes and grafts would pose a threat to the legitimacy of the Party, and these regulations were expected to preserve the lasting dominance of the CPC

As part of this campaign, The Organization Department of Communist Party of China (CPC) Central Committee on Oct. 14 2013 issued *File 18: The Directive on Further Disciplining Party and Government Officials Holding Full-time (Part-time) Positions in Corporations,* which required politically connected independent directors in Chinese listed firms to resign. File 18 stipulated that "authorities at all levels of government shall formulate their specific rules in the spirit of the directive..." and that "those who retired more than three years are allowed to assume positions in companies but should also be approved by related authorities. " The Organisation Department claimed that banning senior officials from businesses would help build "a sound market order." Like other Chinese regulations, related authorities still reserved the discretion in the implementation of this regulation.

After that, there was an unprecedented wave of resignation of politically connected independent directors. On November 11 2013, China International Travel Service announced that one independent director, Wang Kaiyuan who was former deputy president of China International Airlines, resigned. This was the first case of provincial-level politically connected independent director resignation after the issuance of File No. 18. File No.18 was frequently mentioned as the main reason for independent director resignation. For example,

Independent director resignation announcement by Jiang Pharmaceutical Co. Ltd.

The company received a written resignation from one independent director. Mr. He Weibin on March 27th, 2014. In order to follow the regulation by The Organization Department of Communist Party of China (CPC) Central Committee's File 18 (The Directive on Further

Disciplining Party and Government Officials Holding Full-time (Part-time) Positions in Corporations), Mr. He Weibin resigned from his position.

Until mid-2014, nearly 200 listed firms have reported resignations of their board members, including high-level government officials after the issuance of "File 18."

2.9 SECOND-WAVE GOVERNMENT REGULATION FOR INDEPENDENT DIRECTORS IN 2015

After the first-wave of exodus of government official directors at the end of 2013, university professors filled in most of those empty vacancies. Chinese listed firms appointed these professors as independent directors mostly due to their reputation, social status and related knowledge in accounting or law fields. However, some scholars questioned the value of those "professor directors" due to their lack of real-world business experience and doubt that whether those independent directors could actually fulfil their duties and make contributions to the firm [3]

As most Chinese university are state controlled, the government also holds great influence over universities. In 2015 Xi Jinping's three-year-old anticorruption campaign now targeted university professors with administrative responsibilities such as dean or associate dean.[4] These types of professors with administrative responsibilities are also regulated by the CPC. Ministry of Education China in November mandated universities to follow the same directive in 2014 (i.e. No.18) that barred party or government officials from assuming positions in the corporate world. The specific directive targeting university professor is called *Inspection of the Situation of Government and Party Officials Doing Corporate Part-Time Jobs*.

[3] "China's Message to Its Professors: Get Back to the Classroom" *Bloomberg News* (January 3, 2016)
[4] In China professors with administrative responsibilities are usually Party members and hence regulated by the Party.

On Dec, 1, the Ministry of Education announced that Liu Ya, a vice principal of the University of International Business and Economics in Beijing, was fired because he held six directorships from 2009 to 2014. Officials also confiscated his independent director compensation, around 1.2 million RMB (US$185,000) in total. Another example is that Tang Guliang, a dean at the university's business school, was demoted because he was an independent director at four companies.

In 2015, around a third of independent directors appointed by Chinese listed firms are university professors, around a total of 9,000 independent directors. According to *China National Radio*, 274 academics director resigned their directorship as of Dec. 22 2015 (around four weeks after the regulation).

The removal of politically connected board members in 2013 and university professor board members in 2015 caused a sudden shortage of independent directors in China. These two regulations, either government official or professor independent directors, mainly target party members of the CPC. In a country where the number of Communist Party members is around 80 million (exceeding the total population of the U.K.), these regulations may cause a shortage of independent directors in China. According to *Bloomberg News*[5], these should not be a concern, as these Chinese listed companies could recruit independent directors from accounting or law firms or other "junior academics who aren't subject to the director ban as they don't hold leadership positions at their universities." Moreover, *Bloomberg News* also suggested these regulations provided a great opportunity for sound development of independent director system in China.

[5] "China's Message to Its Professors: Get Back to the Classroom " *Bloomberg News* (January 3, 2016)

CHAPTER 3 POWER WITH POLITICS: EVIDENCE FROM INDEPENDENT DIRECTOR BEHAVIOUR IN CHINESE LISTED FIRMS

Abstract

This study examines how the power relationships between independent directors and majority shareholders affect directors' monitoring, i.e. their voting behaviour at board meetings. By exploiting a director-level dataset, this study finds that directors' connections to a powerful third party such as the government countervail the influence of majority shareholders and thereby positively influence their propensity to issue a dissenting opinion. However, independent director compensation associated with dependency asymmetry negatively affects their dissents, and this positive relationship between political connections and dissent becomes weaker as director pay increases. Empirical evidence on the voting patterns of independent directors in Chinese public firms supports my predictions.

Key words: independent director, resource dependency, independent director compensation, emerging market, China

3.1 INTRODUCTION

Independent directors play an important role in monitoring managerial opportunism (Zahra & Pearce, 1989). This type of opportunism could also be alleviated by ownership concentration (Shleifer & Vishny, 1986). However, increased ownership concentration causes the principal-principal agency problem whereby the majority shareholders likely expropriate minority shareholders (Young et al., 2008). In such a case, majority shareholders typically have the right to select independent directors, which may restrict the monitoring role of independent directors as they are likely captured by majority shareholders (Sun, Hu, & Hillman, 2015).

Contemporary research suggests that the capture of directors is affected by directors' power relationships within the firm, such that directors appointed by CEOs are less vigilant in monitoring (Coles, Daniel, & Naveen, 2014; Ma & Khanna, 2015). Despite these insights, it overlooks such relationships outside the firm. More specifically, as an independent directorship is usually an individual's secondary employment, an independent director's connection to a third party – usually his/her home organisation – influences the power relationship with (majority) shareholders (Feldman, 2015) and thereby the impetus of his/her monitoring.

Moreover, majority shareholders usually decide the level of director compensation, which may also give them the power to influence the monitoring behaviour of independent directors. In their seminal study, Fama and Jensen (1983: 315) proposed that directors' reputation concerns work only "when the direct payments to outside directors are small," indicating the potential dependent relationship resulted from compensation may influence directors' monitoring. However, there has so far been only limited effort to examine the implications of independent director compensation and its impact on directors' monitoring (Boivie, Bednar, & Barker, 2015a).

This study aims to provide a better understanding of the capture of independent directors and its impact on monitoring by examining directors' power relationships with majority shareholders in the form of third-party connections and independent director compensation. Building upon resource dependency theory (RDT), this study views independent directors' monitoring as an outcome reflecting the power relationship among independent directors, third parties and majority shareholders. Although directors may conform to majority shareholders' pressure in a concentrated ownership structure, I theorise that independent directors with connections to a powerful third party, such as the government (i.e. politically connected independent directors), are empowered to monitor. However, majority shareholders may manipulate director compensation to influence monitoring. Specifically, looking through the lens of dependence asymmetry (Gulati & Sytch, 2007), this indicates that the less-powerful actor depends more on the more-powerful actor, and higher-paid independent directors are more inclined to succumb to demands from majority shareholders. In addition, director compensation weakens the positive relationship between political power and the propensity to dissent.

I further highlight that the extent of dependency asymmetry may be contingent on two factors: ownership concentration and directors' temporal horizons. This holds particularly in the case of politically connected independent directors, where the negative (moderating) impact of compensation becomes stronger when the ownership concentration is higher. However, this impact is weakened if directors are near the completion of their directorship, i.e. in their final term.

Furthermore, while previous empirical studies have measured directors' monitoring by firm-specific outcomes (e.g. firm performance or CEO turnover–performance sensitivity) (Desender et al., 2014), these measures do not directly reveal the process through which directors come to a specific conclusion. In order to deepen our understanding of directors' monitoring, I propose to use a novel measure, i.e. director voting at board meetings. I have chosen this proxy for the following reasons: First, voting offers a direct measure of director behaviour at an individual level. Moreover, as independent directors usually explain the reasons why they dissent, dissent conveys corporate information to external stakeholders and, therefore, could be regarded as one type of passive monitoring (Jiang et al., 2015; Tirole, 2001).

To test my arguments, I focus on Chinese publicly listed firms over the period from 2004 to 2014. This setting is suitable for my research questions for several reasons. First, Chinese listed firms are required to publicly disclose independent directors' voting in a timely manner if directors issue a non-agreement [6] opinion. Second, data about independent director compensation are disclosed at the director level (Ye, 2014). Third, independent directors could serve the same firms at most for two terms (three years for each term), allowing me to examine the effect of director temporal horizons.

My findings reveal that independent directors' connections with the government enhance their propensity to dissent. Additionally, I find that independent director pay, as decided by majority shareholders, causes dependence asymmetry, thereby negatively affecting independent directors' propensity to dissent. Director compensation also weakens the positive relationship between political connection and dissent, which not only confirms Fama and Jensen's (1983: 315) argument but also extends it from the context of a *diverse* ownership structure to a *concentrated* ownership structure.

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[6] Non-agreement opinions include qualified opinions, adverse opinions, disclaimer opinions, abstention opinions, and disagreement opinions. For brevity, I use the term "dissent" and "non-agreement" opinion interchangeably in this study.

This study contributes to the literature on corporate governance in several ways. While previous studies have examined director motivations for serving on a board (Boivie, Graffin, & Pollock, 2012), I go one step further by exploring director's monitoring behaviour during their directorship — from a simple *board-level* measure to a *director-level* measure (Desender et al., 2014). While current studies have typically examined directors' power relationships within the firm, this study offers a theoretical framework incorporating such relationships outside the firm, i.e. connections to a third party, and show this connection shifts the power from majority shareholders to directors. Indeed, this study views directors' monitoring as the result of directors' power relationships with majority shareholders, captured by third-party affiliation and independent director compensation. My examination of power relationships also extends previous studies from a CEO/director–majority shareholders dyad (Li & Qian, 2013) to a triad between independent directors, political organizations and majority shareholders.

For the growing literature on politically connected directors, in particular, my findings help reconcile the mixed results about the effectiveness of politically connected directors' monitoring (Chizema et al., 2014; Zhu & Yoshikawa, 2015) by showing that the monitoring of politically connected directors depends on third-party connections and their level of payment. While majority shareholders appoint politically connected directors to benefit from their resource provision, these directors may bring in power that enables them to make decisions in conflict with majority shareholders.

With regard to resource dependency theory, the previous literature has predominantly focused on the extent to which firms rely on directors to reduce environmental uncertainty (Zheng, Singh, & Mitchell, 2014). I show that it is important to appreciate the other side of dependency, i.e. directors' dependency on the firm. I make a further theoretical contribution to the emerging literature that extends the resource dependency perspective from an organizational-level to an individual-level analysis (Bermiss & Greenbaum, 2015). As an independent directorship is a highly sought-after position in China (Jiang et al., 2015), I hypothesize that the degree to which a director is dependent on the focal firm influences his or her monitoring. Also, I find that the dyadic relationship between independent directors and majority shareholders is different for directors with a powerful third-party affiliation (Hallen, Katila, & Rosenberger, 2014; Xia, Ma, Lu, & Yiu, 2014) , providing a socially contextualized view of resource dependency theory (Gomulya & Boeker, 2015; Wry, Cobb, & Aldrich, 2013).

3.2 RESEARCH CONTEXT

Independent Director System in Chinese Listed Firms

In an attempt to improve corporate governance in China, the China Securities Regulatory Commission (CSRC) introduced an independent director system in 2001. According to *The Guidelines for Introducing Independent Directors to the Board of Directors of Listed Firms,* the CSRC mandated all publicly listed firms to adopt the independent director system, such that at least one-third of board members should be independent directors by mid-2003. CSRC also mandated that independent directors could serve at most two terms at the same firm, with a maximum of three years per term. Independent directors were defined as those without direct relationships with the company, i.e., they cannot be relatives of the company's top executives or major shareholders, and they cannot hold more than 5% of company shares either directly or indirectly. The main responsibility of independent directors was defined as "protecting the interest of the whole listed firm and, in particular, the interest of minority shareholders" and "carrying out their duty independently from the influence of the company's major shareholders and ultimate controllers."

During their directorship, independent directors are given the right to agree or disagree with such important board proposals as the hiring of the CEO, the selection of board members, or related-party transactions at board meetings. In 2004, CSRC further required public firms to disclose its independent directors' opinions on important board proposals in a timely manner, using the "Code of Information Disclosure for Listed Firms: Annual Report." The purpose of this regulatory change was to convey timely information to the market. Disclosed information includes votes, the topics and content of proposals, the names of directors, and directors' opinions.

The following illustrates a typical example of an independent director non-agreement opinion, in this case about a guaranteed loan:

Independent directors Yang Lu and Jiangxi Ming think that the total amount of external guarantees goes beyond the regulations of "Issues on Regulating External Guarantee of Listed Company" [CSRC No.56] , and thus issued a dissenting opinion.

From the above example, it can be inferred that an independent director issues a non-agreement opinion if they consider the proposal potentially detrimental to the interests of minority shareholders. In some case the directors also provide an explicit justification for a dissent. Chinese publicly listed firms are required to appoint only one third of independent directors on a board. It's likely that even all independent directors vote against a proposal, and this proposal still passes[7]. Even where saying "no" may not necessarily stop a proposal from passing, their vote could be regarded as an evaluation of the company's corporate governance practices, i.e. the *expressive* view of director dissent (Sauerwald, Van Oosterhout, & Van Essen, 2015). Moreover, as indicated by Tirole (2001), dissents could be defines as

[7] The passage of proposal requires a majority vote, and independent directors usually account for only one -third of board membership.

one type of director passive monitoring activities. Passive monitoring refers to monitoring that "measuring rather than affecting the value of assets in place" and it "takes a picture of the health of the firm" (Tirole, 2001:9). Active monitoring acts to "prevents bad behaviour" while passive monitoring only provides "performance measurement" of the focal firm's corporate governance practices (Tirole, 2001:12).

3.3 RELATED RESEARCH

Board Monitoring

The literature on independent directors' monitoring has widely received scholar attention (Liu et al., 2015). From the perspective of agency theory, independent directors serve the role of mitigating agency problems between shareholders and managers (Fama, 1980). Empirical research on corporate governance emphasized the importance of effective monitoring. This study intends to classify existing empirical studies into four types based on two dimensions. The first dimension is the *measurement* of monitoring and the second dimension is the *evidence* of monitoring.

The first dimension is *measurement* of directors' monitoring could be classified into types: *board-level* measurement and *director-level* measurement. For *director-level* measurement, the backgrounds of a director such as gender or expertise are commonly used in the literature. The board-level measurement is usually the aggregate of individual directors, i.e. the ratio of a certain type of director on a board (Almandoz & Tilcsik, 2015; Cumming, Leung, & Rui, 2015; Wang, 2015).

The second dimension is *evidence* of monitoring. Most studies provide *indirect* evidence on the evaluation of monitoring such as frim performance, innovation outputs and the incidence of corporate fraud. These are indirect measure, as they don't directly capture board dynamics and they are likely influenced by some unobservable factors. Some studies have started to provide more *direct* evidence on monitoring. For example, CEO dismissal is commonly used as direct evidence for monitoring. Based on these two dimensions, I illustrate a two by two matrix that illustrates the classifications of empirical studies in the literature, as shown in Table 3-1.

TABLE 3-1: Summary of Empirical Studies about Board Monitoring

		Measurement of monitoring	
		Director-level	Board-level
Evidence of monitoring	Direct evidence	**4**	1
	Indirect evidence	3	2

Note:

Quadrant 1: ex. the impact of the ratio of independent directors on CEO dismissal

Quadrant 2: ex. the impact of ratio of independent directors on firm performance

Quadrant 3: ex. the impact of the number of an independent director board meeting attendance on tunnelling

Quadrant 4: ex. an independent director opinion on a proposal (i.e. agreement or dissent)

Classification of Research on Monitoring

Studies in Quadrant 1 are about *board-level* measurement and *direct* evidence of monitoring. This board-level monitoring is usually the outcome of group decisions, usually reflected by the voting on a board. The common direct evaluation of monitoring is CEO-performance sensitivity. For instance, Coles et al. (2014) focus on how the ratio of co-opted directors impacts CEO turnover. Guo and Masulis (2015) find that after the 2003 listing rule in NYSE (New York Stock Exchange) and NASDQA (National Association of Securities Dealers Automated Quotations), majority independent director structure increase CEO turnover. Despite these studies providing direct evidence on monitoring, we have to be cautious that the evidence is based on group decision making that may plagued by some unobservable board-level factors. For instance, it is likely that this board decision is highly driven by some powerful directors. Even if an independent director votes against this dismissal, he is still regarded as a fiduciary monitor under this board-level measure, which suggests a need for further investigation inside the board room.

Quadrant 2 includes studies related to *board-level* measurement and *indirect* evidence of monitoring. Most studies in the literature on corporate governance are mostly in this quadrant. For instance, Liu et al. (2015) finds that the ratio of independent director has a positive impact on firm performance or reduce the probability of earnings restatement (Guo & Masulis, 2015). The ratio of co-opted independent directors exerts a positive impact on investment (Coles et al., 2014). Recent studies have started to explore other dimensions of the composition of corporate board. For example, Cumming et al. (2015) find that gender diversity per se, not the ratio of female directors, exerts a negative impact on corporate fraud. Almandoz and Tilcsik (2015) find that board expertise may instead lead to the early failure of community banks. Armstrong, Core, and Guay (2014) find that a sudden increase in the ratio of independent directors enhances firm transparency. The average director tenure on a board improves firm monitoring (Dou, Sahgal, & Zhang, 2015).

Despite these insights, the above studies using the *board-level* measurement may ignore the heterogeneity of individual directors and implicitly regard individuals as a homogenous group that pursues the same goal. These measures may not tell the whole story about what motivate an independent director to monitor or not, suggesting a need for a more fine-grained analysis. Then studies in Quadrant 3 and Quadrant 4 are all director-level measurement but differ in terms of types of evaluation.

Quadrant 3 contains works associated with *director-level* measurement and *indirect* evidence of monitoring. Recent studies have provided more empirical evidence in this quadrant. Using a regulatory shock, Lamoreaux, Litov, and Mauler (2014) examines the effects of lead independent director (i.e. the leader among all independent directors inside a firm) on firm performance. Nguyen and Nielsen (2010) use the sudden death of an independent director to examine its impact on shareholder value. Fogel, Ma, and Morck (2014) also find that leave of a powerful director has a negative impact on shareholder value. Liu, Wang, and Wu (2014) also find that independent director's attendance on a board meeting reduces the probability of tunnelling in Chinese publicly listed firms. Despite individual director attendance is a director-level measure; this measure provides limited information, as we don't know what's going on in a boardroom except for their attendance information.

Lastly, Quadrant 4 reflects the combination of *director-level* measurement and *direct* evidence of monitoring. Only few studies are in this line of literature, most probably due to the unavailability of data. Most recently, some studies using data from Chinese publicly listed firms have provided direct evidence on director-level monitoring. For instance, Ma and Khanna (2015) find that an independent director is more likely to issue an "yes" opinion if he is appointed by the current chairman of board. Jiang, Wan, and Zhao (2013) also find that independent directors are more likely to say “no” due to their reputation concerns.

Overall, the literature on independent directors’ monitoring has provided important insights into the types and evaluation of directors’ monitoring. However, these board–level measurements may mask the sociopolitical dynamics inside the boardroom and indirect evaluation of monitoring may overlook some aspects of directors’ monitoring, suggesting a need for a more nuanced understanding of independent directors’ monitoring.

The Monitoring Role of Independent Directors

Independent directors, as representative of shareholders, play an important role in internal monitoring and shaping corporate governance practices. The literature on corporate governance suggests that directors fulfil their monitoring role by lowering excessive CEO compensation (Sauerwald, Lin, & Peng, 2014), replacing CEOs after corporate financial frauds (Gomulya & Boeker, 2015), or hiring new CEOs (Tian, Haleblian, & Rajagopalan, 2011).

Previous studies indicate that effective board monitoring is largely dependent on board independence (Gomulya & Boeker, 2015). More recent studies suggest that director independence is influenced by directors’ power relationships with stakeholder such as managers or shareholders inside a firm. Coles et al. (2014) explained that directors appointed by CEOs, called co-opted directors, seem to be less vigilant in monitoring CEOs, as reflected by lower CEO performance-turnover sensitivity and higher CEO compensation. Ma and Khanna (2015) find that independent directors appointed by chairmen are less likely to “say no” at board meetings. In contrast, Gomulya and Boeker (2015) find that inside directors are instead more likely to replace CEOs after a financial fraud.

It is important to note that this literature has typically overlooked the fact that directors' power relationship *within* the firm may only capture one type of dependencies that influences directors' monitoring. This study suggests that directors' connections outside the firm also merit further investigation. For instance, connections between a director and a powerful third party, such as the government, may influence director's power relationship with shareholders or managers. Moreover, directors may depend on their compensation from firms if that compensation is an important supplement to the directors' income. This relationship may be true especially for directors with relatively lower salaries from their home company.

In summary, a review of the existing literature shows that current studies have not systematically examined how directors' monitoring is influenced by directors' power relationships with shareholders, particularly in the form of powerful third-party connections and independent director compensation. In the following section, I adopt RDT to examine the extent to which these factors influence directors' monitoring.

3.4 HYPOTHESIS DEVELOPMENT

In a concentrated ownership structure, previous studies have suggested that independent directors are likely to be captured by majority shareholders (Su, Xu, & Phan, 2008). However, the theoretical *mechanisms* through which majority shareholders influence independent directors remain underspecified. To this end, this study views independent director dissents as an outcome reflecting the power relationships between directors and majority shareholders. I first hypothesise that directors' third-party connections help countervail the influence of majority shareholders. However, majority shareholders influence the power relationships by exploiting the level of director payment. In particular, I expect that independent directors are less vigilant in monitoring when they are paid more due to increased dependency asymmetry.

Furthermore, I also suggest that the power of third- party connections may vary depending on independent director compensation. Figure 3-1 summarizes my predictions.

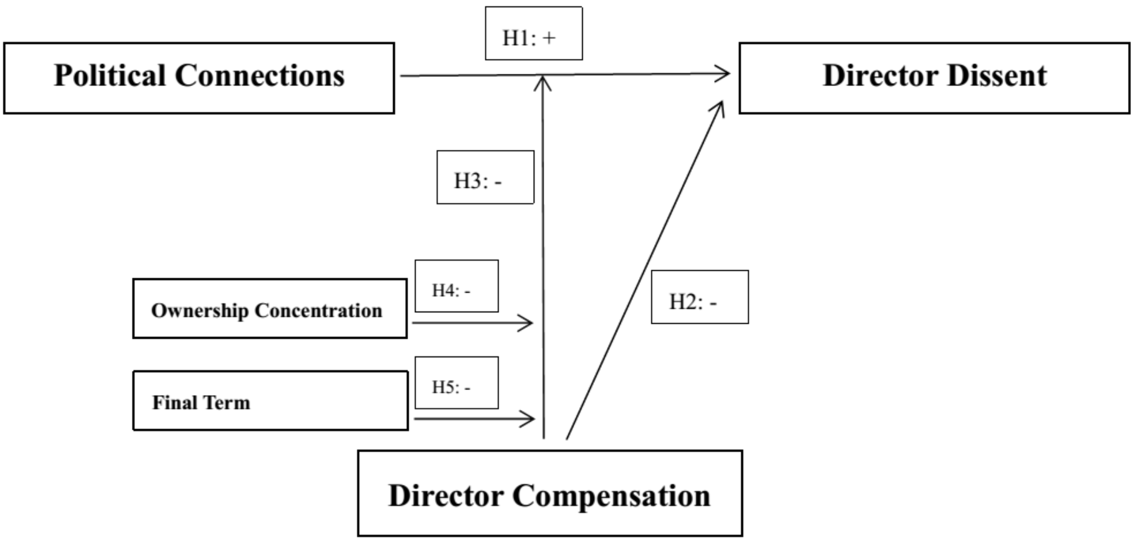

FIGURE 3-1: General Framework of Director Dissent

Independent Director Political Connections and Dissent

As independent directorships are usually a secondary form of employment, recent studies have demonstrated that directors' behaviour is likely to be influenced by their primary occupation (Boivie et al., 2015b). In this regard, independent directors may be influenced by their connection to their home organizations. For instance, Boivie et al. (2015b) find that individuals' incentives to serve directorships come from the possibility of being promoted in their home company. Their primary focus on corporate networks is important as most independent directors are corporate executives in the U.S. context. However, in emerging markets such as China, most independent directors are not corporate executives but government officials, directors' connections to political organizations in the political network may be worth exploring given the growing importance of the role of government after the recent financial crisis. In the following section, I explore to what extent directors' external source of power, in the form of connections to the government, enables them to countervail the influence of majority shareholders.

In China, directors with political connections are quite common (Chizema et al., 2014). Politically connected directors usually hold or have held positions in the central/local governments or in the CPPCC (Chinese Political Party Consultative Committee) or the PC (People's Congress) (Chizema et al., 2014; Wang, 2015). For instance, using a sample of Chinese publicly listed firms from 2003 to 2012, Wang (2015) finds that around 19% of independent directors had political affiliations.

I argue that politically connected independent directors are more likely to dissent, for two reasons. First, political connections are an alternative mechanism for mitigating the influence of majority shareholders. Independent directors' connections with a powerful third party, i.e. the government, may countervail the power of majority shareholders. Despite the economic reform in 1979, the Chinese government still exerts a strong influence over economic activities and represents an important type of external power (Pfeffer & Salancik, 1978). Politically connected actors therefore have more power over the distribution and allocation of resources in society. Relatedly, scholars have found that political capital could buffer politically connected CEOs from dismissal, often called the 'CEO-entrenchment effect' (You & Du, 2012). From the resource dependency perspective, directors' connections with the government represent a countervailing force against the more powerful actor (Xia et al., 2014). Compared to politically unconnected independent directors who are easily persuaded by majority shareholders, politically connected independent directors have more power over their own decision making, even when their decisions may be in conflict with the desires of majority shareholders.

Moreover, while previous studies have suggested that possessing power does not necessarily translate into using that power (Gulati & Sytch, 2007), independent directors have incentive to use their power if it is in the interest of the powerful third party (Feldman, 2015). Given that the Chinese government established the independent director system with the aim of improving corporate governance practices, politically connected independent directors have incentive to use their power to espouse governments' policy. For instance, issuing a non-agreement opinion may be an avenue for improving corporate governance in China. Accordingly, politically connected independent directors are on average more likely to dissent if they detect something fraudulent in a company, especially when their dissent is publicly disclosed. Overall, directors' connections with the government can empower and incentivize directors to dissent. I therefore hypothesize:

Hypothesis 1 (H1): Politically connected independent directors are more likely to dissent.

Independent Director Compensation and Dissent

In a concentrated ownership structure, independent directors are supposed to monitor majority shareholders on behalf of minority shareholders (Young et al., 2008). Agency theory may suggest that independent directors are compensated to fulfill their monitoring responsibilities in a diverse ownership structure. However, viewing such relationship in this manner in a concentrated ownership structure may be incomplete because majority shareholders are different from traditional shareholders in that they have significant control rights and superior power to influence directors. Likewise, agency theory may ignore independent directors' desire to keep directorship as well as director compensation, likely causing directors' dependency on majority shareholders. This relationship is especially true when an independent directorship is a highly sought-after position. Hence, the function of independent director compensation in a concentrated ownership structure should be better understood from the perspective of power relationships, in which case RDT provides an appropriate theoretical lens to capture this relationship. Figure 3-2 and Figure 3-3 illustrate these relationships.

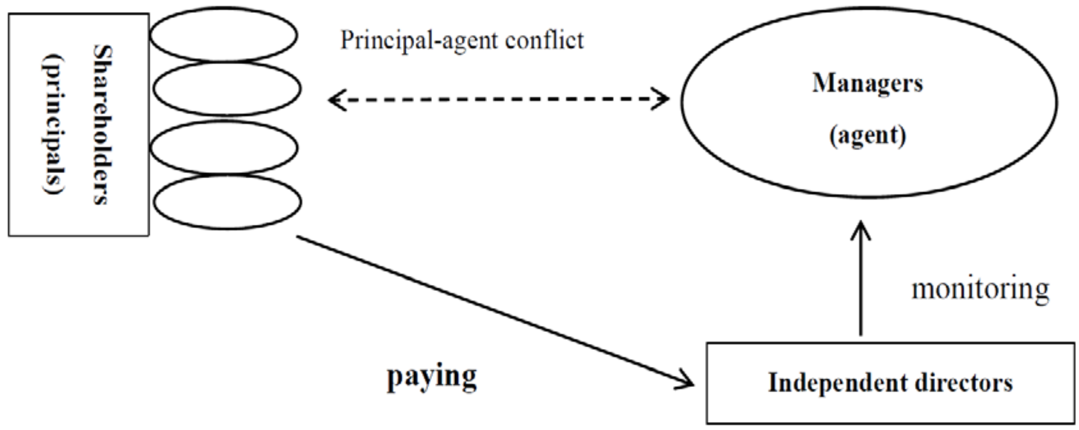

FIGURE 3-2: Independent directors' monitoring to reduce the principal-agent conflict (Fama and Jensen, 1983) Context: Diverse ownership structure[8]

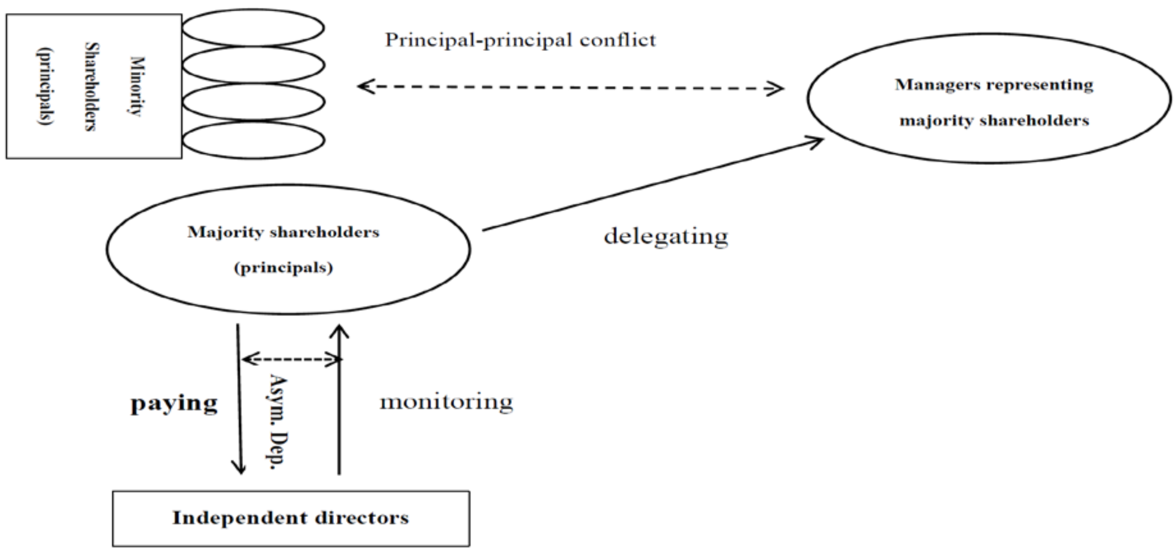

FIGURE 3-3: Independent directors' monitoring to reduce the principal-principal conflict (this study) Context: Concentrated ownership structure

[8] Figure 3-2 and Figure 3-3 are adapted from Li and Qian (2013) and Young et al. (2008: 200). Asym. Dep. in Figure 3-3 denotes asymmetric dependence.

This study further argues that directors' motivation to retain a directorship and obtain director compensation may lead them to become dependent upon the focal firm. In this situation, dependency results when majority shareholders control resources that directors value but cannot obtain elsewhere, i.e. director compensation. Dependency asymmetry thus arises when the director is more dependent on the focal firm than the reverse (Casciaro & Piskorski, 2005; Gulati & Sytch, 2007). In such a situation, the more powerful exchange partner likely "dictate[s] the terms of the relationship by threatening to withdraw from the exchange" and "expropriate[s] a larger portion of the overall benefits accruing from the exchange" (Casciaro & Piskorski, 2005:172), using this power to his advantage (Feldman, 2015). Building on these theoretical insights, I relate the idea of dependence asymmetry to director compensation and examine its impacts on directors' monitoring.

I propose that independent director compensation leads to behaviour outcomes that uphold the interests of the more powerful actor. RDT suggests that dependency asymmetry creates uncertainty and constraints for the less powerful actor due to his/her overreliance on the powerful counterpart for valued resources (Kramer, 1996). Given greater uncertainty and constraints, the power-disadvantaged actor will attend more to the demands of the powerful actor than to his own. In this study, as independent directors are paid more, their reliance on majority shareholders increases. In turn, they pay more attention to majority shareholders' needs. As director dissent may elicit negative stock market reactions (Tang, Du, & Hou, 2013), reputational damage (Hillman, Shropshire, Certo, Dalton, & Dalton, 2011), or even legal investigation (Jiang et al., 2015), majority shareholders tend to avoid director dissent and pressure directors not to issue dissenting opinions. Hence, independent directors who are over reliant on their director compensation will be more likely conform to demands from majority shareholders.

It follows that the degree to which a director is reliant on the focal firm determines the extent of dependence asymmetry and influences directors' propensity to vote against a proposal. Specifically, the magnitude of dependence asymmetry in a dyad between individual independent director and majority shareholders rises as an independent director is paid more, thus making directors more obliged to conform to the demands of majority shareholders. In summary, therefore, I predict:

Hypothesis 2 (H2): Independent director compensation has a negative impact on independent director dissent.

Moderating Effect of Independent Director Compensation

While I have argued that politically connected independent directors are more likely to dissent, there's reason to believe that their propensity to dissent will vary with their level of dependency on the majority shareholder. As argued above, RDT suggests that independent director compensation causes dependency asymmetry, leading to behaviour outcomes that more often meet the demands of the powerful actor. This effect can be expected to moderate the impact of political connections on director dissent.

Due to their relatively low salaries, government officials in China have incentive to find alternative ways to supplement their income (Dong & Torgler, 2013). For instance, the literature on political economy suggests that local government officials engage in predatory actions to benefit themselves (Jia & Mayer, 2015). Moreover, these government officials, especially regulatory officials, may be 'captured' by interest groups and thereby be influenced to make policies favorable to firms that provide them with financial or political support (Stigler, 1971). Following a similar logic, when politically connected independent directors are paid more, they become more likely to make decisions favoring the interests of majority shareholders relative to their counterparts whose compensation is lower. From the perspective of RDT, then, higher independent director compensation increases directors' dependency asymmetry on majority shareholders, thus reducing the power of independent directors with political connections. Accordingly, politically connected independent directors with higher levels of director compensation will be more likely to behave in the interests of majority shareholders. Formally:

Hypothesis 3 (H3): The higher the level of independent director compensation, the weaker the positive relationship between politically connected independent directors and dissent.

Moderating Effect of Ownership Concentration for Politically Connected Independent Directors

I also expect that the negative moderating impact of independent director compensation on dissent by politically connected independent directors is moderated by the following two factors: ownership concentration and director term limits. Even though most Chinese firms have a concentrated ownership structure, firms still vary in their level of concentration and in turn face different regulations. For instance, in 2002 CSRC announced that majority shareholders with more than 30% of shareholding are advised to adopt a cumulative voting (instead of majority voting) system in shareholder meetings to protect the interests of minority shareholders (Chen, Li, & Lin, 2015), indicating that shareholders with more than 30% of shareholding more easily expropriate minority shareholders.

When ownership becomes more concentrated, majority shareholders have greater incentive to influence corporate decisions, such as the selection of directors or CEOs. They are more likely to make more decisions to their own benefits (Li & Qian, 2013). Majority shareholders even engage in related-party transactions that transfer wealth from minority shareholders to themselves in a country with weak institutional environments. It's expected that the dominance of majority shareholders may influence directors' monitoring.

In the case of higher ownership concentration, majority shareholders may control most of, or even the entire firm. Politically connected directors' power to dissent is more constrained by the dominance of majority shareholders, so those directors with a given level of compensation are less likely to dissent. Conversely, in firms with lower ownership concentration, majority shareholders don't exert absolute control of the firm. If they want to make decisions to their own benefits, they may have to ally with other majority shareholders and this alliance may require different majority shareholders sharing similar goals or interests. As such, politically connected directors' power to dissent is less constrained by a single majority shareholder. Therefore, this provides politically connected directors with a given level of payment some leeway to monitor.

RDT suggests that, as ownership concentration rises, majority shareholders exert greater control over the company; thereby strengthening the negative moderating impact of independent director compensation on the dissent of politically connected independent directors. Thus, I predict:

Hypothesis 4 (H4): The negative moderating impact of independent director compensation on dissent becomes stronger for politically connected independent directors in firms with a higher level of ownership concentration.

Moderating Effect of Director Term Limit for Politically connected Independent Directors

Finally, directors' temporal horizons can affect the moderating impact of independent director compensation for politically connected independent directors. In Chinese publicly listed firms, independent directors are allowed to serve at most two terms in the same firm. In a parallel study, Ma and Khanna (2015) found that independent directors are more likely to dissent in their final term due to the expected breakup of social relationships with the firm. Here, I expect that the two-term limit will alter directors' power relationship, and will therefore influence the relationship in Hypothesis 3.

As argued before, as director compensation rises, politically connected independent directors become less likely to dissent due to their dependence asymmetry on compensation. However, politically connected independent directors in their second and final term will therefore be more attentive to whether their behaviour during a directorship will enhance their political careers. Directors may engage in monitoring actions, such as dissent, because they believe it will enhance their prospects for promotion in the political system due to the fact that dissent is generally consistent with government goals. Therefore, politically connected directors nearing the end of their term become less dependent on majority shareholders. RDT suggests that dependency asymmetry associated with director compensation will be reduced, thus making director compensation less effective in discouraging the monitoring behaviour of politically connected independent directors. These arguments lead to the following hypothesis:

Hypothesis 5 (H5): The negative moderating impact of independent director compensation on dissent becomes weaker for politically connected directors in their final term.

3.5 EMPIRICAL STRATEGY

Sample Construction

This study begins with selecting proposals from a total of 30,352 independent directors' opinions issued by all public firms listed on the Shanghai and Shenzhen stock exchanges from 2004 to 2014.[9] I retrieved all of these reports from *China Stock Market and Accounting Research Database (CSMAR)*, a leading information provider for Chinese publicly listed firms and one that has been used widely in management research (Ma & Khanna, 2015). Typically, a proposal is voted by inside directors and independent directors at board meeting and the passage of the proposal requires a majority vote. I identified those proposals with at least one non-agreement opinion by an independent director in a proposal (i.e. qualified opinion, adverse opinion, disclaimer opinion, abstention opinion or disagreement opinion). I classified these non-agreement opinions as 'dissent',[10] obtaining 392 proposals containing at least one dissenting opinion from independent directors. It's possible that only one independent director dissents while the rest of other independent directors vote for this proposal. The rare occurrence of dissent in my sample is consistent with previous studies showing that director dissent is not common in the U.S. (Marshall, 2010) or in Israel (Schwartz-Ziv & Weisbach, 2013). It's interesting to note that the number of dissenting proposal decreases from 55 in 2004 to 23 in 2013. For a proposal with at least one director dissent, I obtained the date and content of the proposal, those who attended the meeting, and their voting behaviour. Based on the identity of independent directors, I matched this dataset to the other CSMAR datasets containing directors' personal backgrounds such as age, gender, education, and career path.

My empirical design is confined to those proposals with at least one independent director dissent, which has several advantages[11]. First, as my study focuses on the impact of director-level characteristics on voting behaviour (i.e. director-level analysis), focusing on proposals with at least one director dissent allows me to exploit within-proposal variations. Specifically,

[9] I'm aware that in October 2013 there was a regulation dictating that politically connected independent directors are required to resign in Chinese listed firms, i.e. File 18. I did analysis again only for a subsample of independent directors from 2003 to 2013 or a smaller sample for 2014 and 2015, and found that this regulation did not change my empirical results.

[10] As *the Companies Law of China* requires that a proposal must receive a majority vote to be effective, non-agreement opinions do not contribute to the passage of a proposal.

[11] A more detailed discussion will be in the 'estimation method' section.

for an independent director issuing a dissenting opinion in a proposal, those independent directors who vote for the proposal become an ideal matched sample, as they had the chance to dissent but refused to do so. Therefore, my study only compares dissenting directors with non-dissenting directors within the same proposal. In a parallel study, Ma and Khanna (2015) didn’t explicitly deal with this rare event issue and only compared dissenting directors with other non-dissenting directors in all Chinese public firms. Finally, this sample contains 1,321 observations at the director–proposal level, with 764 unique independent directors and 205 firms. The unit of analysis is the director-proposal making the outcome variable dissent at the director level. The data source of all other variables is the *CSMAR* dataset, unless otherwise noted.

As my study only selects those firms with at least one dissent, there may be systematic differences between those firms with at least one dissenting event and those with none. To alleviate this concern, I undertook t-tests between firms with at least one dissent and those with no dissents, by year, on the following key firm characteristics: total assets, the ratio of independent directors on a board, the total number of directors, the shareholding of the largest shareholder, the average age of independent directors, the ratio of male directors, the ratio of directors with political connections, and the average compensation of independent directors. Results reported in Table 3-2 show there no systematic difference between these two groups in general, indicating that sample selection bias is not a major issue.

TABLE 3-2: Two Group T-statistics between Firms with at Least One Dissent and Those with no Dissents

	Number of Firms		Total Asset				% independent directors				Number of Directors				Majority Shareholding			
	sample	rest	sample	rest	t-test	p-value	sample	rest	t-test	p-value	sample	rest	t-test	p-value	sample	rest	t-test	p-value
Year																		
2004	30	1348	$4,680,000,000	$1,780,000,000	0.544	0.587	0.342	0.342	-0.031	0.975	9.833	9.664	-0.396	0.692	33.096	42.088	2.909	**0.004**
2005	69	1305	$4,750,000,000	$5,330,000,000	0.135	0.892	0.350	0.348	-0.303	0.762	10.072	9.495	-2.152	**0.032**	38.950	40.543	0.795	0.427
2006	65	1391	$9,560,000,000	$16,500,000,000	0.225	0.822	0.353	0.352	0.000	0.949	9.320	9.758	-1.540	0.124	36.751	32.285	2.298	**0.022**
2007	18	1553	$386,000,000,000	$22,400,000,000	-4.729	**0.000**	0.331	0.359	2.486	**0.013**	10.111	9.162	-1.587	0.113	33.118	36.240	0.842	0.400
2008	4	1621	$264,000,000,000	$29,400,000,000	-1.275	0.202	0.333	0.362	0.772	0.440	4.500	8.994	3.524	**0.000**	20.723	36.405	2.016	**0.044**
2009	10	1763	$3,000,000,000	$35,100,000,000	0.231	0.817	0.345	0.365	1.201	0.230	9.500	9.077	-0.615	0.538	22.800	36.671	2.727	**0.006**
2010	16	2111	$12,200,000,000	$40,800,000,000	0.222	0.824	0.366	0.367	0.081	0.936	9.750	8.974	-1.441	0.150	31.526	36.713	1.286	0.199
2011	7	2356	$28,600,000,000	$43,700,000,000	0.071	0.943	0.344	0.369	1.232	0.218	9.143	8.926	-0.283	0.777	29.846	36.311	1.087	0.277
2012	20	2471	$7,440,000,000	$48,200,000,000	0.295	0.768	0.382	0.370	-0.936	0.349	8.850	8.972	0.287	0.774	32.709	36.463	1.066	0.287
2013	13	2521	$5,400,000,000	$52,800,000,000	0.254	0.799	0.401	0.373	-1.802	**0.072**	8.615	8.860	0.469	0.639	32.772	36.227	0.783	0.434
2014	15	2637	$3,510,000,000	$57,000,000,000	0.287	0.774	0.410	0.373	-2.641	**0.008**	8.600	8.696	0.203	0.839	24.074	35.637	2.877	**0.004**

	% Male IND				Age of IND				% Political connections IND				Compensation of IND			
	sample	rest	t-test	p-value	sample	rest	t-test	p-value	sample	rest	t-test	p-value	sample	rest	t-test	p-value
Year																
2004	0.887	0.887	0.017	0.986	45.962	49.882	3.084	**0.002**	0.262	0.294	0.740	0.460	42867.90	37754.77	-1.031	0.303
2005	0.902	0.882	-0.878	0.380	48.594	50.550	2.311	**0.021**	0.295	0.295	0.003	0.997	40929.30	38307.26	-0.746	0.456
2006	0.870	0.881	0.451	0.652	49.611	51.262	1.937	**0.053**	0.261	0.301	1.335	0.182	37071.76	38497.22	0.425	0.671
2007	0.853	0.860	0.288	0.773	46.766	47.223	0.582	0.560	0.251	0.167	-2.922	**0.004**	271850.30	143651.60	-2.284	**0.022**
2008	0.771	0.874	1.096	0.273	46.552	51.585	1.589	0.112	0.302	0.335	0.263	0.793	178734.40	46259.82	-6.901	**0.000**
2009	0.917	0.867	-0.803	0.422	49.813	51.906	1.053	0.292	0.177	0.345	2.099	**0.036**	38255.26	50584.69	0.453	0.650
2010	0.870	0.860	-0.198	0.843	52.871	52.246	-0.388	0.698	0.366	0.345	-0.309	0.757	51928.25	51860.32	-0.009	0.993
2011	0.936	0.854	-1.040	0.298	48.140	52.827	2.031	**0.042**	0.324	0.352	0.285	0.776	58243.10	56874.19	-0.106	0.916
2012	0.936	0.848	-1.920	**0.055**	52.079	53.654	1.165	0.244	0.281	0.351	1.185	0.236	53221.89	61118.46	0.896	0.370
2013	0.870	0.846	-0.423	0.672	52.648	54.116	0.925	0.355	0.474	0.343	-1.874	**0.061**	47878.79	61807.27	1.243	0.214
2014	0.936	0.839	-1.889	**0.059**	49.461	54.093	3.292	**0.001**	0.179	0.314	2.157	**0.031**	65378.17	58752.50	-0.663	0.507

Note: 'Sample' denotes firms with at least on dissent in year t, while 'rest' denotes firms without any dissents in year t.
'IND' denotes independent directors. P-values in bold are smaller than 0.1

Dependent Variable

The *China Stock Market and Accounting Research* (CSMAR) *Solution* database provides information about independent director voting behaviour. From this dataset, I first identified that a dissent occurred, because an independent director issued a non-agreement opinion on a proposal. I next identified which independent director issued the dissenting opinion in the proposal. I created the *dissent* variable, which is equal to 1 if the independent director issued a dissenting opinion (i.e. qualified opinion, adverse opinion, disclaimer opinion, abstention opinion or disagreement opinion) and 0 otherwise. This director–proposal level of analysis allows me to test the extent to which independent director pay influences independent directors' propensity to dissent.

Independent and Moderating Variables

The first independent variable is independent directors' political connections. I obtained data about independent directors' political connections from their curricula vitae in the CSMAR dataset. To measure independent directors' political connections, the political connections variable is an independent variable that is equal to 1 if a director works or has worked in the central/local government, the Chinese People's Congress (CPC), or the Chinese Political Party Consultative Committee (CPPCC), and 0 otherwise.

The second independent variable of this study is independent director pay. I obtained data from the *CSMAR* dataset. When independent directors accepted directorship in a firm, they've already agreed on the level of their payment, which is set by majority shareholders. In other words, director payment is predetermined, and reverse causality between independent director compensation and dissent is unlikely to be a concern. Moreover, while previous studies have found that director compensation is "fairly uniform" across the board

(Boivie, Bednar, & Barker, 2015a; 1589), these studies don't provide evidence on *independent* director compensation. In a recent study that explores outside director compensation in a sample of Standard & Poor's 1,500 company (Fedaseyeu, Linck, & Wagner, 2015), the authors found that outside director compensation varies in the same board. In the current study I observed variations in independent director compensation within a board. The *director compensation* variable measures the log value of independent director pay for an independent director in a focal firm.

For the first moderating variable, I measure ownership concentration by *majority shareholding*, representing the percentage of shares held by the largest shareholder, as controlling shareholders may have more power to influence director opinions (Li & Qian, 2013). The second moderating variable is *final term*, which is a dummy equal to 1 if an independent director is in his/her second (and therefore final) term, and 0 otherwise.

Control Variables

I added an array of control variables to control for other influence. For director-level control variables, I added the following variables: To control for gender difference, I added the *gender* variable, which is equal to 1 if the director is male and to 0 otherwise. The *age* variable measures the age of the director to control for age effect, as older directors may have different career concerns. The *number of outside directorship* variable measures the log value of the number of directorships a director holds (excluding the focal firm); this is to control for director status in the directorship market (Flickinger, Wrage, Tuschke, & Bresser, 2015). The *international experience* variable is also a dummy variable that takes the value of 1 if the director has worked or works in a foreign company; it helps capture directors' exposure to foreign corporate governance systems (Masulis, Wang, & Xie, 2012). The *financial industry experience* variable is a dummy variable equal to 1 if the director has worked or works in a financial industry; it helps to capture directors' financial expertise (Masulis et al., 2012). To control for the social relationship between majority shareholders and independent directors (Ma & Khanna, 2015), I added the *coopted independent director* variable. It is a dummy that takes the value of 1 if the director takes office after the current chairman takes office, and 0 otherwise.

Estimation Method

As this study explores to what extent director characteristics impact their propensity to dissent, a simple pooled regression linking director characteristics and their dissent may cause concerns about endogeneity. Specifically:

$$Dissent_{i,j,k,t} = \alpha + \beta Directorfactors_{i,j,k,t} + \gamma Contorls + e_{i,j,k,t}$$

$Dissent_{i,j,k,t}$is a dummy that equal to 1 if independent director i dissents on proposal j in firm k at time t. $Directorfactors_{i,j,k,t}$ are other director-level characteristics that describe independent director i in proposal j in firm k at time t. *Controls* represent other firm-level control variables, including majority shareholding, and $e_{i,j,k,t}$ is the residual.

This simple specification may raise concerns about unobserved board-level heterogeneity influencing director characteristics and their dissents. According to Jiang et al. (2015), the endogenous problems come from the composition of directors and the inclusion of a proposal at a board meeting, which have long challenged empirical corporate finance research. For instance, firms with better corporate governance practices are more likely to appoint more diligent directors. However, these firms (i.e. majority shareholders) are also less likely to include proposals that are detrimental to minority shareholders at board meetings. This unobserved factor is likely to bias coefficient β.

Following the same identification strategy in Jiang et al. (2015), this study includes proposal fixed effects in the regression to alleviate endogeneity between director characteristics and their dissent.

$$Dissent_{i,j,k,t} = \alpha + \beta Directorfactors_{i,t} + \gamma Contorls + \eta_j + \varepsilon_{i,j,k,t}$$

where $e_{i,j,k,t} = \eta_j + \varepsilon_{i,j,k,t}$

By adding the proposal fixed effect η_j, this study alleviates endogeneity issues resulted from unobserved heterogeneity at the proposal, board, firm, and time period levels[12]. Specifically, all between-group variations are filtered out, and what is left is the within group (i.e. proposal) variation and this is what this study is interested in, i.e. director characteristics. However, this identification strategy depends on the variation of directors' voting outcomes within the same proposal (also in the same firm and year). Therefore, proposals with all dissents will be dropped during estimation[13]. Despite this trade-off, this method ensures that any variation in voting outcomes is attributed to differences among director-level factors.

This identification strategy runs the cost of focusing on proposals that exhibit within-board variation in voting outcomes, a smaller sample compared with the population of all proposals. This strategy therefore identifies a "local average treatment effect" conditional on the occurrence of dissent on a proposal, rather than a "population average treatment effect" on the full sample. This trade-off is similar to the spirit of instrumental variable (IV) estimator and fuzzy set regression discontinuity design where they also only identity a "local average treatment effect,"i.e. the impact of the treatment only for the subgroup affected by the instrument (Imbens & Angrist, 1994). Conditioned on a sample including at least one dissent,

[12] If proposal-level fixed effects are added, these fixed effects directly filter out board, firm, and year level factors as a proposal is nested in a board, a firm and a year.

13 Conditional logit can only estimate proposals with within-proposal variation in voting outcomes. The number of observations drops from 1,264 to 994 due to 96 proposals with all independent directors dissenting. In the robustness check, the Mundlak and the IV-GMM methods contain all observations and produce similar results.

I ran a conditional logit model with proposal fixed effects for H1 and H2. As my theorising includes several moderating effects (i.e. H3, H4, and H5)[14], I ran a logit model to visualize the effects of these interaction terms because the conditional logit model cannot plot this type of graph. All the explanatory variables are lagged by one year.

3.6 EMPIRICAL FINDINGS

Table 3-3 shows the descriptive statistics and correlation matrix for all variables. The variance inflation factors (VIF) show that the average VIF index is 1.13 (well below the threshold value of 10), indicating no concerns regarding multicollinearity.

[14] A conditional logit model also produced similar results, i.e. the sign and significance of the interaction terms.

TABLE 3-3: Descriptive Statistics and Correlation Matrix

	Mean	S.D.	Min	Max	1	2	3	4	5	6	7	8	9	10	11
1. Dissent	0.485	0.5	0	1	1										
2. Political connections	0.142	0.349	0	1	0.01	1									
3. Director compensation	10.28	2.137	0	13.49	-0.085*	0.026	1								
4. Majority shareholding	32.5	15.19	5.9	77.89	-0.013	0.004	-0.023	1							
5. Final term	0.311	0.463	0	1	0.047	-0.009	0.134*	0.008	1						
6. Gender	0.908	0.288	0	1	-0.046	0.051	0.03	0.019	0.017	1					
7. Age	49.69	9.82	31	82	-0.055*	0.264*	0.081*	0.084*	0.067*	0.088*	1				
8. Number of directorship	0.93	0.34	0.693	2.079	0.036	0.108*	0.084*	0.04	0.045	0.03	-0.035	1			
9. International experience	0.048	0.215	0	1	0.12*	-0.082*	0.055*	-0.013	-0.023	0.025	0.023	0.075*	1		
10.Financial industry experience	0.468	0.499	0	1	0.136*	-0.115*	-0.023	-0.007	-0.027	-0.085*	-0.111*	0.237*	0.014	1	
11.Coopted independent director	0.237	0.425	0	1	0	0.034	-0.081*	-0.053*	-0.141*	-0.017	-0.007	0.061*	-0.016	0.051	1

Notes. *$p<0.05$, Number of observations = 1,321.

a Logged, $e^{10.281}$=29,173 (RMB)

TABLE 3-4: (Conditional) Logit Models Predicting the Likelihood of Director Dissent

	Model 1	Model 2	Model 3 (Logit)	Model4 (Logit)	Model5 (Logit)
	dissent	dissent	Dissent	dissent	dissent
	Odds Ratio	Odds Ratio	Odds Ratio	Odds Ratio	Odds Ratio
Gender	0.789	0.847	0.902	0.878	0.605
	(0.205)	(0.222)	(0.244)	(0.898)	(0.744)
Age	0.989	0.996	0.986	0.983	0.985
	(0.009)	(0.008)	(0.009)	(0.022)	(0.022)
Number of outside directorships	1.70**	1.993**	1.858**	1.775	1.589
	(0.449)	(0.528)	(0.510)	(1.222)	(1.126)
Final term	0.929	1.034	1.023	2.423	9.261
	(0.193)	(0.220)	(0.219)	(1.457)	(9.583)
International experience	6.333***	6.024***	6.731***	dropped	dropped
	(2.313)	(2.187)	(2.541)		
Financial industry experience	1.642***	1.622***	1.589***	2.005	1.736
	(0.264)	(0.262)	(0.261)	(1.099)	(0.986)
Coopted independent director	0.524**	0.540***	0.451***	0.462	0.477
	(0.132)	(0.139)	(0.119)	(0.254)	(0.268)
Majority shareholding	0.732	0.724	0.754	1.331	0.968**
	(16.939)	(19.54)	(8.099)	(0.212)	(0.013)
H1: Political connections	**2.041*** **		**12.98*** **		
	(0.462)		(4.201)		
H2: Director compensation		**0.840*** **	**0.869** **	**0.839**	**0.543***
		(0.009)	(0.049)	(0.193)	(0.197)
H3: Political connections x director compensation			**0.317*** **		
			(0.134)		
H4: Director compensation x majority shareholding				**0.971** **	
				(0.014)	
H5: Political connections x director compensation x final term					**0.456**
					(0.298)
Observations	948	948	948	157	157
Log-Likelihood	-313.4	-309.6	-813.85	-84.66	-85.99

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Note. The number of observations drops from 1,321 to 948 because there are some proposals with all dissents (i.e. all independent directors vote against a proposal), these observations were dropped during estimation (as the identification of a conditional logit model requires variation in outcome variable in a group, i.e. in a proposal in this case. There are proposal with all dissents and 84 observations are dropped during estimation.

Hypothesis 1 predicted a positive relationship between politically connected independent directors and their propensity to dissent. To test Hypothesis 1, I added the *political connections* variable. As shown in Model 1, the odds ratio of *political connections* is significant and greater than 1 (odds ratio = 2.041, p-value < 0.001).

I find support for Hypothesis 2, which predicted that independent director pay has a negative impact on dissent. In Table 3-4, the odds ratio of *director compensation* in Model 2 is smaller than 1 and highly significant (odds ratio = 0.840, p-value < 0.001).

Hypothesis 3 predicted that the positive impact of political connections on the propensity to dissent becomes weaker for higher-paid directors. I added the interaction term of the *political connections* variable and the *director compensation* variable. As shown in Model 3, the odds ratio of the interaction term is significant and smaller than 1 (coefficient = 0.317, p-value < 0.01), thereby supporting Hypothesis 3.

Previous studies have suggested that the interpretation of an interaction term cannot be directly inferred from the coefficient of the interaction term (Hoetker, 2007). One common way to resolve this issue is to calculate the value of the marginal effect using the mean value of all variables and assesses its significance. I illustrate these results in Figure 3-4. Figure 3-4 presents the interaction effect of *political connections* and *director compensation* based on Model 3 of Table 3-4. Figure 3-4 plots the predicted probability that an independent director will dissent (y axis) against political connections (x axis), for politically connected independent directors at a higher level of compensation (dotted line) and at a lower level of compensation (solid line), holding all other continuous variables at their mean values and dummy variables at a value of 1. Figure 3-4 illustrates that politically connected directors with a higher level of compensation are less likely to dissent, while directors with a lower level of compensation are instead more likely to dissent.

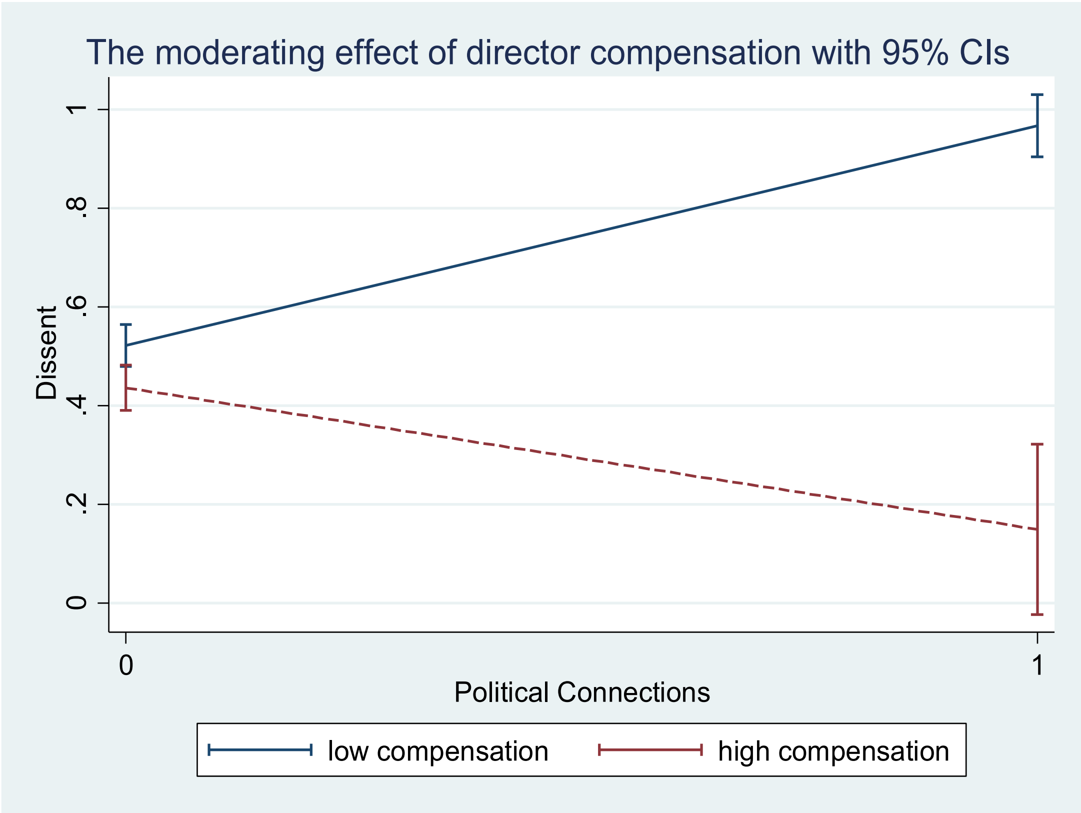

FIGURE 3-4: Graphic Presentations of the Interaction Effect between Political Connections and Compensation

Notes:

- Figure 3-4 graphs the predicted probability of dissent between independent directors with a higher level of director compensation (i.e. the log value of director compensation = 12.418) and those with a lower level of director compensation (i.e. the log value of director compensation = 8.144) in the 95% confidence interval, while all other continuous variables are held at their mean values and dummy variables are held at the value of 1 in Model 3 in Table 3-4. The dashed line denotes directors with a higher level of director compensation, while the solid line denotes directors with a lower level of director compensation.

Hypothesis 4 predicted that the propensity to dissent becomes weaker for politically connected directors in firms with more concentrated ownership. To test this hypothesis, I conducted analyses in a sub-sample consisting of only politically connected directors and added the interaction term between *director compensation* and *majority shareholding*. Results, shown in Model 4, indicate that the odds ratio of the interaction term is smaller than 1and significant (odds ratio = 0.971, p-value < 0.05).

As mentioned above, the interpretation of the interaction term in nonlinear model should be illustrated. Figure 3-5 presents the interaction effect of *director compensation* and *majority shareholding* based on Model 4 of Table 3-4. Figure 3-5 shows that the predicted probability of dissent is significantly different at the 95% confidence interval for politically connected independent directors in firms where ownership is more concentrated or less concentrated. As illustrated in Figure 3-5, there's a statistically significant difference in politically connected independent directors' propensity to dissent, where the negative moderating impact of independent director compensation is stronger, in firms with more shares controlled by majority shareholders. This result supports H4.

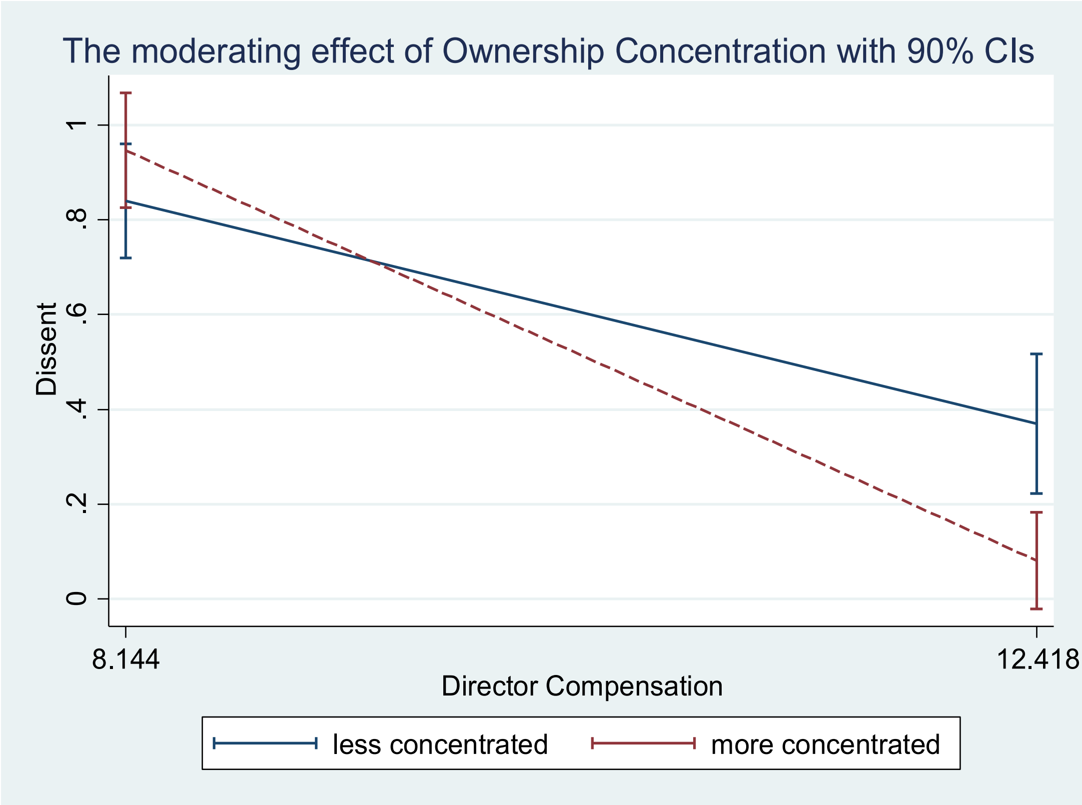

FIGURE 3-5: Graphic Presentations of the Interaction Effect between Compensation and Ownership Concentration

Notes:

- Figure 3-5 graphs the predicted probability of dissent between politically connected independent directors in firms with a lower level of ownership concentration (one standard deviation below the mean, i.e. 17%) and with a higher level of ownership concentration (one standard deviation below the mean, i.e. 48%) in the 95% confidence interval, while all other continuous variables are held at their mean values and dummy variables are held at the value of 1 in Model 4 in Table 3-4. The dashed line denotes firms with high shareholding, while the solid line denotes firms with low shareholding.

Hypothesis 5 predicted that the propensity to dissent becomes weaker for politically connected directors in their second (and final) term. To test this hypothesis, I conducted analysis in a sub-sample consisting of only politically connected directors and added the interaction term between *director compensation* and *final term* variable. I find that the interaction term is not significant (odds ratio = 0.456, p-value > 0.1), as shown in Model 5. Following the previous steps, I also illustrated this interaction term in Figure 3-6 and found no significant difference among politically connected directors' propensity to dissent, suggesting no support for Hypothesis 5. I also repeated the same analysis focusing on a sub-sample containing only politically unconnected independent directors and found that the coefficient on the interaction term is significant. Empirical results are also illustrated in Figure 3-7, indicating that the power relationship changes in the final term only for politically unconnected independent directors.

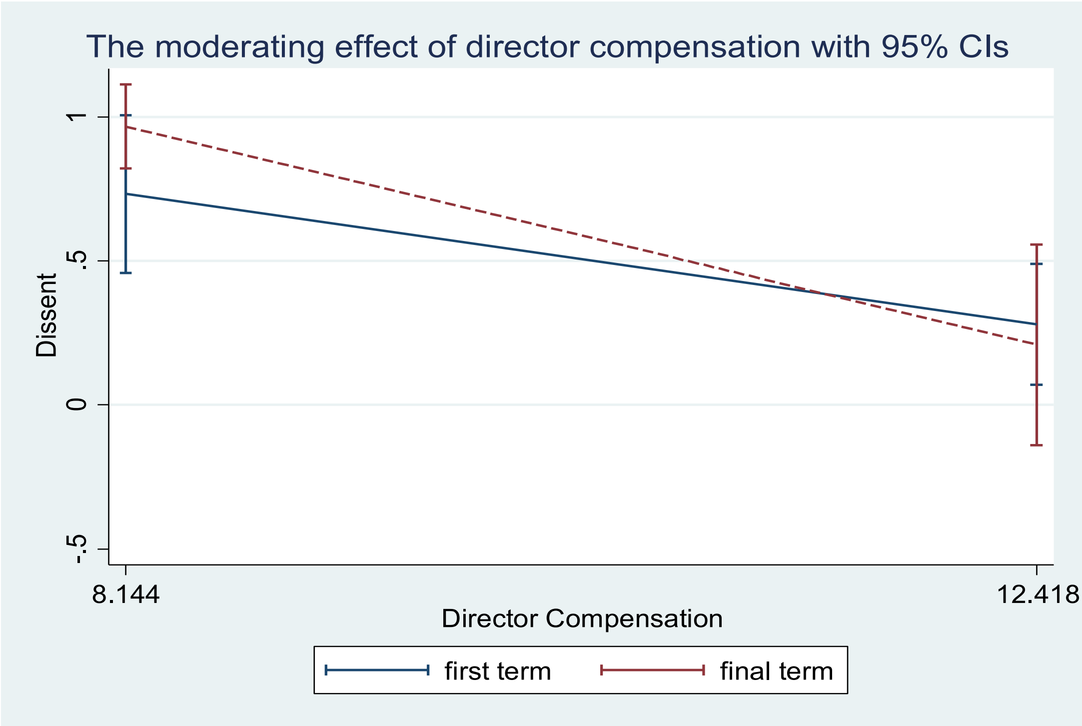

FIGURE 3-6: Graphic Presentations of the Interaction Effect between Director Compensation and Final Term for Politically Connected Directors and Politically Unconnected Directors

Notes:

- Figure 3-6 graphs the predicted probability of dissent between politically connected independent directors in the first and final terms, in the 95% confidence interval, while all other continuous variables are held at their mean values and dummy variables are held at the value of 1 in Model 5 in Table 3-4. The dashed line denotes directors in the final term, while the solid line denotes directors in the first term.

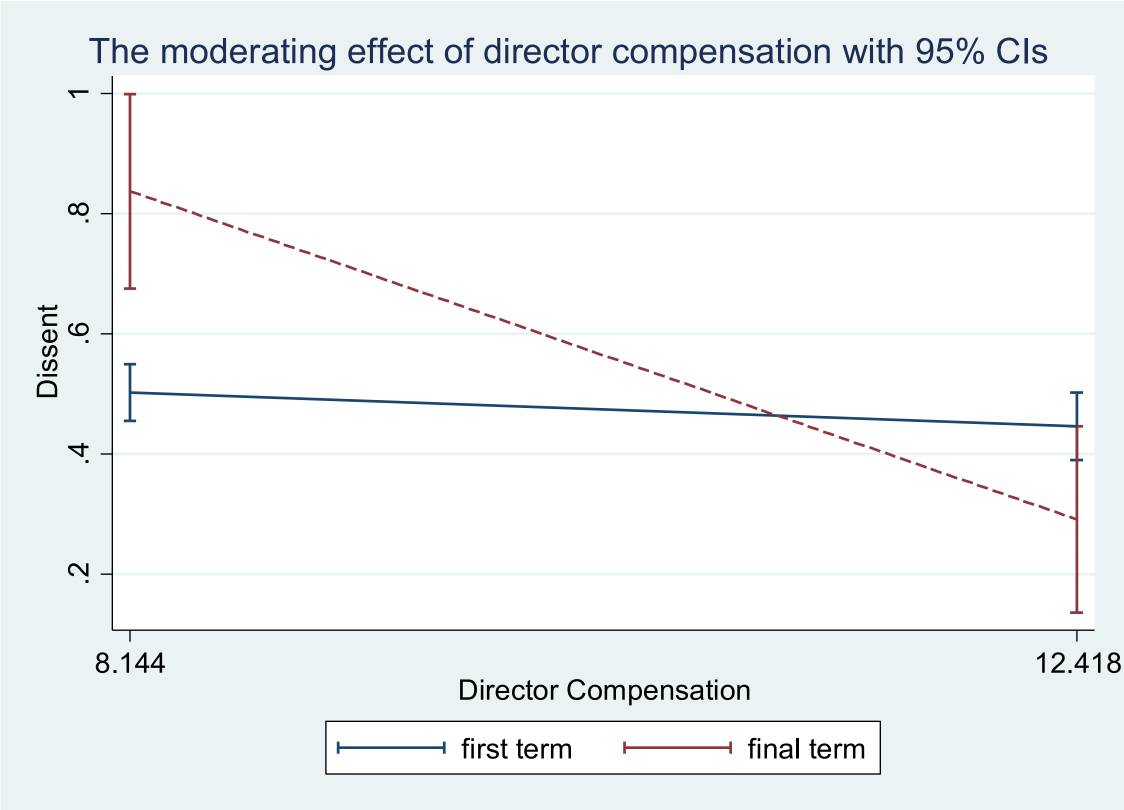

FIGURE 3-7: Graphic Presentations of the Interaction Effect between Director Compensation and Final Term for Politically Unconnected Directors

Notes:

- Figure 3-7 graphs the predicted probability of dissent between politically unconnected independent directors in the first and final terms, in the 95% confidence interval, while all other continuous variables are held at their mean values and dummy variables are held at the value of 1. The dashed line denotes directors in the final term, while the solid line denotes directors in the first term.

With regard to control variables, empirical findings are based on Model 4. Results show that independent directors in the final term are no likely to dissent (*coefficient* = -0.052, p-value > 0.1). Independent directors with working experience in the financial industries are more likely to dissent (coefficient = 0.491, p-value < 0.01). A coopted independent director is less likely to dissent (coefficient = -0.910, p-value < 0.01), consistent with results in Ma and Khanna (2015).

Robustness Checks

Although I have provided strong evidence at the director level on the relationship between political connection/independent director compensation and directors' propensity to dissent, I conducted several robustness tests to confirm my previous findings.

Mundlak instruments (Correlated random effects model)

Instead of including proposal fixed effects, another way to alleviate concerns about unobserved proposal-level heterogeneity is to add Mundlak instruments (Wooldridge, 2011). It's known ordinary linear squares (OLS) estimates are biased if the unobserved (board-level) factor is correlated with explanatory variables. Chamberlain (1984) and Mundlak (1978) proposed that unobservable heterogeneity could be modeled as the conditional distribution given a set of observable factors, which allows for correlation between unobserved heterogeneity and covariates. The advantage of this method is that it's easy to implement and interpret. For non-linear models, as the case here, this method also avoids the incidental parameters problem but runs the cost of restricting conditional heterogeneity distributions.

As above, I have a simple regression where I cannot control for unobserved proposal-level heterogeneity:

$$Dissent_{i,j,k,t} = \alpha + \beta Directorfactors_{i,j,k,t} + \gamma Contorls + \eta_j + \varepsilon_{i,j,k,t}$$

Mundlak (1978) proposed that unobserved proposal-level heterogeneity could be modeled by the average of each director-level characteristics within the same proposal. In this case, the component correlated with covariates is 'instrumened' by proposal-specific average values of director-level covariates. That is,

$$\eta_j = \lambda(\overline{Directorfactors_j}) + \delta_j$$

$$,\text{where } \overline{Directorfactors_j} = \frac{\sum_{i \in j} Directorfactors_{i,j,k,t}}{\sum_{i \in j} i}$$

$$Dissent_{i,j,k,t} = \alpha + \beta Directorfactors_{i,j,k,t} + \overline{Directorfactors}_{j,t} + \delta_j + \varepsilon_{i,j,k,t}$$

where δ_j is a true random effect not correlated with the covariates. By estimating the last equation, I control for unobserved board-level heterogeneity (Wooldridge, 2011).This method has recently been used in management research (Choi, Jia, & Lu, 2014). Empirically, I ran[15] a random effect logit model including Mundlak instruments. For example, for the *age* variable, I created the $\overline{age}$ variable that is the average age of independent directors within the same proposal and added it in the regression as a control. I also add other mean-type variables in the regression. Following previous steps, this method produced similar results, as reported in Table 3-5. For instance, the coefficient estimate on political connections is positive and significant (coefficient = 0.687, p-value < 0.01). The coefficient estimate on director pay is negative and significant (coefficient = -0.161, p-value < 0.01). For H3, the coefficient on the moderating effect is also significant (coefficient = -0.787, p-value < 0.05). H4 is also supported (coefficient = -0.059, p-value < 0.05). As before, H5 is not supported (coefficient = -1.073, p-value > 0.1).

[15] As this method employs a random effect model, this estimation approach keeps those proposals with all dissents (by independent directors).

TABLE 3-5: Robustness Checks I (Logit model with Mundlak instruments)

	Model 1 dissent	Model 2 dissent	Model 3 dissent	Model 4 dissent	Model 5 dissent
Gender	-0.312	-0.221	-0.274	-0.0375	-0.762
	(0.252)	(0.250)	(0.254)	(1.468)	(1.398)
Age	-0.0115	-0.00530	-0.0106	-0.0696**	-0.0695**
	(0.00840)	(0.00823)	(0.00858)	(0.0339)	(0.0333)
Number of outside directorships	0.373	0.514**	0.466*	0.935	0.781
	(0.256)	(0.256)	(0.259)	(1.015)	(1.029)
Final term	-0.203	-0.0962	-0.0925	-0.286	11.61
	(0.207)	(0.210)	(0.211)	(0.948)	(13.92)
International experience	1.724***	1.709***	1.718***		
	(0.380)	(0.380)	(0.382)		
Financial industry experience	0.467***	0.419***	0.421***	0.491	0.245
	(0.152)	(0.152)	(0.154)	(0.684)	(0.669)
Coopted independent director	-0.720***	-0.678***	-0.783***	-1.317	-1.194
	(0.252)	(0.252)	(0.255)	(1.030)	(0.980)
Majority shareholding	-0.00117	-0.000456	-0.000528	0.603**	-0.0364**
	(0.00427)	(0.00427)	(0.00431)	(0.264)	(0.0161)
H1: Political connections	0.687***		9.069***		
	(0.228)		(3.339)		
H2: Director compensation		-0.161***	-0.148**	-0.145	-1.552**
		(0.0575)	(0.0592)	(0.610)	(0.774)
H3: Political connections x director compensation			-0.787**		
			(0.312)		
$\overline{\text{Gender}}$	-0.392	-0.523	-0.484	1.245	1.279
	(0.487)	(0.487)	(0.494)	(1.783)	(1.767)
$\overline{\text{Age}}$	-0.00383	-0.0113	-0.00463	0.0502	0.0793
	(0.0137)	(0.0133)	(0.0139)	(0.0626)	(0.0591)
$\overline{\text{Number of outside directorships}}$	-0.965**	-0.904**	-0.794**	0.547	0.815
	(0.394)	(0.394)	(0.402)	(1.675)	(1.624)
$\overline{\text{Final term}}$	0.778***	0.683**	0.715**	3.738***	2.719**
	(0.289)	(0.291)	(0.294)	(1.416)	(1.297)
$\overline{\text{International experience}}$	-1.135*	-1.108*	-1.081*	-4.261	-5.046
	(0.626)	(0.620)	(0.631)	(3.285)	(3.151)
$\overline{\text{Financial industry experience}}$	0.0781	0.0608	0.105	1.878	1.343
	(0.293)	(0.290)	(0.300)	(1.222)	(1.170)
$\overline{\text{Coopted independent director}}$	0.649**	0.475	0.583*	0.455	0.231
	(0.317)	(0.321)	(0.325)	(1.335)	(1.285)
$\overline{\text{Political connections}}$	-0.696*		-0.739*	1.384	0.928
	(0.417)		(0.425)	(1.548)	(1.487)
$\overline{\text{Director compensation}}$		0.108	0.114	1.206**	1.022*
		(0.0690)	(0.0715)	(0.564)	(0.618)
H4: Director compensation x majority shareholding				-0.0590**	
				(0.0242)	
H5: Director compensation x final term					-1.073
					(1.261)
Constant	2.399***	2.827***	2.482***	-10.42	6.515
	(0.752)	(0.822)	(0.851)	(7.994)	(5.003)
Year fixed effects	Yes	Yes	Yes	Yes	Yes

Proposal type fixed effects	Yes	Yes	Yes	Yes	Yes
Observations	1,321	1,321	1,321	157	157
Log-Likelihood	-772.9	-766.4	-755.5	-68.77	-71.23

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

IV-GMM Estimation

Even though the inclusion of proposal fixed effects or the method proposed by Mundlak (1978) have already alleviated concerns about unobserved heterogeneity, I also ran generalized method of moments (GMM) instrumental variable (IV) regressions[16] using the "ivreg2" command in Stata. Compared with a simple IV estimator, the GMM- IV method has the advantage of efficient estimation even in the presence of unknown form heteroskedastic standard errors (Stock & Yogo, 2005).

Stock and Yogo (2005) suggest that valid instruments should satisfy the exclusion and the relevance conditions. To this end, this study employs two instruments: the average level of independent director compensation in a focal firm's 3-digit CSRC industry in a given year (*industry director compensation*) and Chinese provincial governments' staggering policies to attract foreign talents (*policy change*). For the first instrument, firms are likely to benchmark their level of director compensation to other firms in the same industry and this is expected to positively related to the level of independent director compensation. The second instrument exploits Chinese provincial governments' staggering policies to attract foreign talents from 1999 to 2006. Due to China's local (i.e. provincial) directorship market, most Chinese firms recruit their independent directors from their headquarters' provinces. Giannetti et al. (2015) find that most of those foreign talents are appointed as corporate directors, resulting in a plausibly exogenous increase in the supply of corporate directors in a firm headquarter' s

[16] A simple two-stage least squares regression produced similar results.

province. Given the sudden increase in the supply of corporate directors, this staggering policy is expected to negatively influence independent director compensation.

This policy has the following features. First, the main objective of this policy is to attract emigrants of foreign high-skilled talents by offering them generous benefits such as tax incentives or business loans or subsidized housing benefits. Therefore, these returnees are usually distinguished academics or scientists which may help fill in senior positions in listed firms. Second, as this policy is not designed specifically to listed firms in China, it's unlikely that these listed appeal to provincial governments to attract more eligible foreign talents and lower director compensation. Instead, the implementation of these policies (i.e. content and timing) is more driven by provincial officials' personal career concerns, which catering to those central government official in the hope of promotion.

Table 3-6 presents the year of the adoption of this policy. Among those early adopters, these provinces include provinces both in developed and less developed areas, indicating that the adoption of this policy is less likely influenced local provincial needs for foreign talents. The *policy change* dummy takes the value of 1 in years following the implementation the policy in a province.

Taken together, these two instruments are likely to influence independent director compensation but not directly influence director dissent other than though compensation.

TABLE 3-6: Policy to Attract Foreign Skilled Talents

Province	Adoption Year	# of unique directors	# of director-proposal-year **Total**	**Before**	observations **After**
Anhui	1994	4	4	0	4
Beijing	2000	49	93	0	93
Chongqing	2005	15	23	11	12
Fujian	2000	23	56	0	56
Gansu	2003	6	9	0	9
Guangdong	1999	107	235	0	235
Guangxi	2005	14	17	6	11
Guizhou	2003	6	6	0	6
Hainan	2001	18	26	0	26
Hebei	2001	6	8	0	8
Heilongjiang	2002	24	28	0	28
Henan	1992	23	26	0	26
Hubei	2002	22	40	0	40
Hunan	2001	52	98	0	98
Inner Mongolia	2001	2	6	0	6
Jiangsu	2004	46	51	6	45
Jiangxi	2003	8	8	0	8
Jilin	2001	6	6	0	6
Liaoning	1999	27	56	0	56
Ningxia	2003	7	7	0	7
Qinghai	1999	6	18	0	18
Shaanxi	1995	28	41	0	41
Shandong	2005	16	18	4	14
Shanghai	2005	75	122	24	98
Shanxi	2007	5	5	5	0
Sichuan	2005	45	102	52	50
Tianjin	2001	7	11	0	11
Tibet	N/A	12	16	16	0
Xinjiang	2003	33	84	0	84
Yunnan	2001	24	38	0	38
Zhejiang	2001	41	63	0	63
Total		757	1321	124	1197

Notes: This table reports the year of the policy implementation in a province, the number of unique independent directors in my sample, and the number of independent directors before and after the policy change in my sample. The sample period is 2004-2014. “Adoption year” denotes the year when the policy was adopted. “After” indicates the number of observations after the adopting year. “Before” stands for the number of observations before and during the adopting year.

Empirical results are reported in Table 3-7. In the IV-GMM method, I also add an array of firm-level controls including the number of board directors, the ratio of independent directors on a board, state ownership, and foreign ownership. Lastly, consistent with the literature on board proposal (Ma & Khanna, 2015), I added proposal-subject fixed effects in the regression, as certain types of proposal are more likely to incur director dissent. The CSMAR dataset classifies proposals into the following types: personnel, compensation, financial reports, audit, related-party transactions, guaranteed loans, merger and acquisitions, changes in ownership, financing issues, disposal of assets, and other miscellaneous issues.

For the first-stage linear regression, the average independent director compensation in a focal firms' industry positively influences independent director compensation (coefficient = 0.001, p-value < 0.01), while the policy dummy exerts a negative impact (coefficient = -0.712, p-value < 0.01). The Hansen test fails to reject the null hypothesis that all instruments are uncorrelated with the error terms (Sargan statistic = 2.010, p = 0.156), suggesting that the two instruments are exogenous. The first-stage F statistics is 11.94, more than the general threshold of 10 for the relevance of instruments. The coefficient estimate on director pay is negative and significant (coefficient = -0.110, p-value < 0.05), lending further support to my argument that director pay has a negative impact on the propensity to dissent.

Sample Construction

To alleviate concerns that this sample may include highly dissenting independent directors (those independent directors dissent multiple times in each firm-year), I only include one proposal for each firm-year. Empirical results show similar findings for all hypotheses.

Further Exploration: Different Types of Political Connections

Administrative connections vs. legislative connections. My discussion has thus far stated that politically connected directors are more likely to dissent due to their power borrowed from political organizations. Recent studies have demonstrated that political connections are heterogeneous rather than homogenous in its nature (Zheng et al., 2014), and that a multi-faced view of political ties is needed to understand them. For instance, Marquis and Qian (2013) argue that firms with administrative ties to government are more likely to engage in substantive (rather than symbolic) CSR reporting, as these firms are exposed to the tight control of government . In contrast, firms with only legislative ties are less subject to government control, and hence engage more symbolic (less rather than substantive) CSR reporting.

Following these arguments, it's intriguing to investigate whether heterogeneous political connections have a differential impact on dissent. Following this line of literature (Marquis & Qian, 2013), I divided politically connected independent directors into two types: directors with administrative connections (*admin. connections)* and directors with legislative connections (*legislator connections*). The coefficient of *admin. connections* is expected to be positive as these organizations are usually more powerful, and indeed the coefficient is significantly positive (coefficient = 0.624, p-value < 0.01). The coefficient of *legislator connections*, however, is not significant (coefficient = -0.787, p-value > 0.1). These results suggest that, as admin-type independent directors control more resources and have more power, they are more likely to dissent. In contrast, as legislative-type directors are more 'symbolic' in China, and their power is more limited, their power to dissent may be limited and hence exerts no impact.

Central/local admin. connections vs. central/local legislative connections. In the previous section I divided politically connected independent directors into two types: directors with administrative connections (*admin. connections)* and directors with legislative connections (*legislator connections*). However, heterogeneous political ties could also be defined by hierarchies in the political system, as government officials at different levels may have different power.

To test my argument, I added four dummies in my analysis. The first two dummies are the *central admin. connections* variable and the *local admin. connections* variable. The *central admin. connections* variable is equal to 1 if an independent director has worked or works in a central administrative organization, and 0 otherwise. The *local admin. connections* variable is equal to 1 if an independent director has worked or works in a province, city, or county-level administrative organization, and 0 otherwise. The other two dummies are *central legislator connections* and *local legislator connections*. The c*entral legislator connections* variable takes the value of 1 if an independent director is or was a member of national CPC or CPPCC, and 0 otherwise. The *local legislator connections* variable is equal to 1 if an independent director is or was a member of province-, city-, or country-level CPC or CPPCC, and 0 otherwise.

Empirical results in Table 3-7 show that only the coefficient on *central admin. connections* is positive and significant (coefficient = 0.743, p-value < 0.01), while the coefficients on the other three dummies are not significant. These results suggest that if an independent director occupies a central position in the administrative system, he/she is more likely t o dissent. This is consistent with my arguments in RDT because it shows that central-level directors with more power are more likely to dissent. It is also consistent with findings in Luo et al. (2016a), which found that firms with organizational institutional linkage to the central government in China are more likely to espouse government policy.

Retired and non-retired politically connected independent directors. To further verify my power arguments for politically connected independent directors, I conducted additional analysis taking into account the age of directors. Due to data limitation, I was not able to directly differentiate between whether the politically connected independent directors in my study are retired or not, and a retirement effect could influence their power to dissent. Instead I used age to proxy for retirement. In China, the official retirement age for most government officials is 65. Hence, I expect that politically connected actors over the age of 65 may have less power and consequently show a lower propensity to follow government policy.

Following previous scholars (Shih, Adolph, & Liu, 2012), the age of 65 is the threshold in my analysis (around 10% of independent directors in my sample). The *age above 65* variable takes the value of 1 if an independent director is over 65, and 0 otherwise. Here this study only focuses on admin-type independent directors, as government officials in administrative organizations have more specific regulations for the age of retirement. I added the interaction term between *admin. connections* and *age above 65*. Results, in Table 3-7, show that the interaction term is significant and negative (coefficient = -2.471, p-value < 0.01), indicating that admin-type independent directors over 65 are less likely to dissent. As these independent directors are approaching the end of their political careers, this finding lends supports to my argument about the importance of power for politically connected independent directors.

Further explorations: Strong vs. Weak Dissents

Although I have found that politically connected independent directors are more likely to dissent due to the state's demand, I guess that politically connected directors, as socially savvy directors, may not want to anger the focal firm out of their career concerns in the directorship market. Therefore, I expect that among dissenting directors, politically connected independent directors may tend to issue a different type of dissenting opinions that are less likely to anger the focal firm, i.e. weak dissents.

To further explore the strength of different non-agreement opinions, I classify dissents into substantive vs. weak types of dissents. Specifically, the *substantive dissent* variable is equal to 1 if an independent director issues an adverse opinion or disagreement opinion, and it is 0 if an independent director issues a qualified opinion, disclaimer opinion, or abstention opinion. Using *substantive dissent* as the dependent variable, I explore whether politically connected directors are less likely to issue strong dissents. Focusing on a sample of all dissenting independent directors, I ran a random effect logit regression. My empirical findings show that the coefficient of *political connections* is negative and highly significant (coefficient = -0.586, $p\text{-value} < 0.1$), indicating that among dissenting independent directors, politically connected directors are less likely to issue strong dissents.

This finding suggests that politically connected directors, faced with the unenviable task of trying to reconcile conflicting pressures from the state and the controlling shareholders, tend to issue weak dissenting opinions, such as disclaimer opinions or abstention opinions, instead of more substantive dissents such as adverse opinions and disagreement opinions.

Taken together, these empirical results provide a more nuanced view of politically connected directors by taking into account their political connections in different political organizations, their positions in the political hierarchy, and the stage of their political career (i.e. age). These findings support my view that directors' willingness to dissent largely depends on their power borrowed from the government.

TABLE 3-7: Robustness Checks II

	Model 1 IV-GMM 1^{st} stage	IV-GMM 2^{nd} stage	Model 2 Conditional Logit	Model 3 Conditional Logit	Model 4 Conditional Logit
		dissent	dissent	dissent	dissent
IV1: industry director compensation	0.001***				
	(0.0001)				
IV2: policy change	-0.699***				
	(0.222)				
Director compensation		**-0.103****			
		(0.049)			
Gender	0.085	-0.069	-0.218	-0.196	-0.132
	(0.201)	(0.050)	(0.259)	(0.262)	(0.263)
Age	-0.011*	-0.002	-0.0103	-0.0101	-0.0178
	(0.006)	(0.002)	(0.00887)	(0.00895)	(0.0119)
Number of outside directorships	0.669***	0.03	0.436	0.423	0.488*
	(0.177)	(0.055)	(0.267)	(0.267)	(0.270)
Final term	0.553***	0.119***	-0.157	-0.152	-0.172
	(0.134)	(0.042)	(0.211)	(0.211)	(0.214)
International experience	0.058	0.421***	1.703***	1.701***	1.716***
	(0.269)	(0.066)	(0.363)	(0.364)	(0.366)
Financial industry experience	-0.232*	0.106***	0.455***	0.455***	0.428***
	(0.121)	(0.031)	(0.163)	(0.163)	(0.163)
Coopted independent director	-0.567***	-0.108**	-0.726***	-0.705***	-0.833***
	(0.142)	(0.042)	(0.256)	(0.257)	(0.259)
Majority shareholding	-0.001	-0.001	-0.281	-0.354	-0.280
	(0.004)	(0.001)	(11.37)	(65.29)	(11.31)
Central admin. connections				**0.743****	
				(0.308)	
Local admin. connections				0.470	
				(0.306)	
Central legislator connections				-14.85	
				(1,322)	
Local legislator connections				-0.119	
				(0.252)	
Admin. connections			**0.624*****		1.015***
			(0.232)		(0.255)
Legislator connections			-0.787		
			(0.600)		
Age above 65					0.656*
					(0.379)
Admin. connections X Age above 65					**-2.471*****
					(0.759)
Year fixed effect	Yes	Yes			
Proposal type fixed effects	Yes	Yes			
Observations	1,216	1,215	948	948	948
Log-Likelihood			-312.4	-311.0	-306.7

Standard errors in parentheses
*** p<0.01, ** p<0.05, * p<0.1

3.7 DISCUSSION AND CONCLUSION

By conducting a director-level analysis, this study argued that directors' monitoring is an outcome involving the complex power relationship between directors, a powerful third party, and majority shareholders. Specifically, independent directors seek to maintain their independence via the external power from a third party, while majority shareholders intend to control directors through dependency asymmetry in the form of director compensation. Drawing upon resource dependency theory, I argue that directors' connections to a powerful party from their primary occupation influence their monitoring have a positive impact on the propensity to dissent, and that this relationship weakens as independent director compensation rises. I theorised that independent director compensation has a negative impact on monitoring, i.e. it lowers directors' propensity to dissent. I also explored the boundary conditions of the moderating effects of independent director compensation and found that concentrated ownership strengthens the effect of compensation on dissent for politically connected independent directors. Overall, by viewing director dissent as the result of power relationships among these three key actors, my results opened the black box of director behaviour inside the boardroom and shed light on the intricacies of how power relationship affect directors' monitoring.

Despite finding general support for my arguments, I did not find support for Hypothesis 5, which predicted that the negative moderating impact of independent director compensation would weaken during a politically connected independent director's final term on a board. Instead, results showed that politically connected independent directors may exhibit a similar propensity to dissent across the two terms that China allows. It's possible that politically connected independent directors are primarily concerned about their political careers in the political system, and that they may therefore care less about seeking other directorship opportunities after completing their current appointment. In contrast, in unreported results I observed that politically unconnected independent directors did change their propensity to dissent across two terms, with a lower likelihood of dissent in their final term. This result suggests that politically unconnected independent directors may care more about positioning themselves for other directorship opportunities after their current appointment ends, and dissent less in an effort to develop good relations with the focal firm. This finding shows how a specific type of independent directors manage their dependencies over time and how this changing nature of power relationships influences their voting behaviour, while previous research on resource dependency has not explicitly considered this temporal dimension.

This work offers critical insights for the literature on corporate directors in several ways. It extends previous studies that explore motivations for directors serving or exiting (Boivie et al., 2012; Marcel & Cowen, 2014) by examining director actions (i.e. voting) during their directorship, thus opening the black box inside the boardroom. It also contributes to the literature on shareholder dissent by illuminating the impact of reducing "information asymmetry" and providing insights about "the individual contributions of the directors" inside the boardroom (Hillman et al., 2011: 4). Additionally, the study is, to my knowledge, the first in the corporate governance literature to extend the 'director compensation' argument in Fama and Jensen (1983). For the emerging literature on politically connected directors (Zhu & Yoshikawa, 2015), I provided evidence on monitoring behaviour where previous studies focused predominantly on directors' role in resource provision. Though boards of directors are typically conceptualized as operating with group decision making (Boivie, 2015) or as coalitions (Greve & Zhang, 2016), my research on individual director behaviour highlights the importance of understanding variations *within* a board.

This study also contributes to the literature on resource dependency theory. A central question in resource dependency theory is the extent to which power relationships between actors shape actors' behaviour. However, previous studies in my context have implicitly assumed that directors or CEOs in a concentrated ownership structure (Su et al., 2008) are unilaterally captured by majority shareholders. While my findings support part of this argument, they give a more nuanced perspective than previous studies—that is, they show that the extent to which independent directors are captured by majority shareholders depends on how much those directors are paid by the firm. Also, my findings show that directors derive their power through connections with a powerful third party, i.e. the government, and the power borrowed depends on the nature (i.e. the type and the level) of that third party. My investigation of this power relationship, in the form of political connections, also answered the recent call in Wry et al. (2013) to leverage the power notion "beyond dyadic relationships" (2013: 445), thereby enriching the under-socialized view of resource dependency theory in general and the contextualized view of corporate governance in particular.

Practical Implications

This study offers several managerial implications. Due to the recent awareness of corporate governance practices after corporate frauds, the role of boards of directors has become much more important. By considering the primary employment of independent directors, my results provide insights into directors' motivations for monitoring. Moreover, my exploration of director voting behaviour provides preliminary guidelines for shareholder selection (i.e. election) of more 'diligent' directors. My exploration of director term limit also provides new insights on the debate over director term limits. Proponents suggest that director term limits enhance director independence and avoid cronyism between directors and majority shareholders. However, opponents to term limits argue that directors with longer tenure may accumulate firm-specific knowledge, giving them a better understanding of a firm's long-term strategies. My findings revealed that director term limits do, indeed, alter monitoring activities for certain types of independent directors, and thereby provide a more nuanced perspective on the extent to which director term limit may influence the oversight directors contribute.

Limitations and Suggestions for Future Research

This study has some limitations that open opportunities for future research. First, by using a director-level dataset to explore voting behaviour, I took an initial step toward understanding director behaviour in the boardroom. Nevertheless, my study captured only one particular type of board monitoring activities — i.e. voting. Other board activities, such as unannounced company visits, are also worth exploring.

Second, because my arguments are developed in the context of a concentrated ownership structure, it is important to be cautious when interpreting the results. While this structure is among the most common, corporate governance practices in this context remain largely unexplored (Porta et al., 1999).

This study explored different types of political connections— administrative vs. legislative — and also different levels of connections— local vs. central. But it also focused on a country with an authoritarian regime—that is, a country where the careers of politically connected directors are tightly controlled by the government (Li & Zhou, 2005). However, the nature of political connections may be different in a democratic country, such that their effect on director behaviour may change. Specifically, politically connected directors may be more concerned about their constituents, e.g. local communities, as they are often under pressure for re-election. Future studies should be cautious in terms of exploring to what extent political connections alter directors' monitoring behaviour in other settings.

Due to data limitations, I did not have access to salary information for independent directors from their primary employment, and hence I could not directly compare the proportion of their salary derived from the independent directorship. My findings instead show that, other things being equal, higher independent director compensation compromises directors' monitoring. My focus on politically connected independent directors—who typically command low salaries in China—also provides important insights about the effects of director compensation. This study is thus an important first step toward better understanding how independent director compensation affects directors' monitoring—one that could be fruitfully continued if more detailed data become available.

Also, while this work mainly focuses on the motivation for director activities, it would be worthwhile to explore the career outcomes of dissenting directors. Due to information asymmetry (Spence, 1973), director dissent could be regarded as signals sent by diligent independent directors to differentiate themselves from other more 'passive' directors. To explore the career outcomes of directors who dissent, signalling theory may be an appropriate theoretical lens (Xia, Dawley, Jiang, Ma, & Boal, 2015).

Although this study has mainly explored the monitoring function of independent directors, independent directors also provide advice for the focal firm (Field, Lowry, & Mkrtchyan, 2013). Future research may investigate the impact of the government on the advising role of independent directors.

Finally, as this study exploits within-board comparisons to establish the relationship between director compensation and director dissent, I acknowledge that my empirical results don't provide direct evidence on this causal relationship. Future studies can use exogenous shocks, i.e. exogenous variation in director compensation, to identify the causal relationship between director compensation and dissent.

Conclusion

This study was inspired by a desire to clarify the role of power in the relationship between independent directors and majority shareholders. From the perspective of resource dependency theory, I found that politically connected independent directors are more likely to dissent due to their powerful third-party connections. However, director compensation is a tool that majority shareholders may use to capture independent directors, thereby reducing an individual director's likelihood of dissent. In summary, my findings unravelled the complex power relationship between independent directors and majority shareholders and its impact on directors' monitoring in the context of a concentrated ownership structure.

CHAPTER 4 ONE SIGNAL WITH MULTIPLE RECCEIVERS: EVIDENCE FROM INDEPENDENT DIRECTORS IN CHINESE LISTED FIRMS

Abstract

This study extends research on directors' monitoring by investigating whether directors will be rewarded for their effective monitoring. Drawing upon signalling theory, I posit that diligent monitoring, despite the same type of signal, is evaluated differently by varying groups of stakeholders and in turn influences directors' careers. I find that diligent monitoring is not positively evaluated by the focal firm, as reflected by directors' lower probability of re-appointment after current directorship expires. However, diligent directors are rewarded for their duties in the form of more new board seats, but those new board seats mostly come from smaller firms. Moreover, for directors with connections to the state, diligent monitoring is also rewarded if this is consistent with the state's interests. Using director voting patterns for proposals in Chinese publicly listed firms, I find support for these predictions.

Key words: signalling theory, director reputation, directorship market

4.1 INTRODUCTION

Independent directors are an important internal corporate governance mechanism to alleviate agency problems (Fama, 1980). Independent directors' monitoring has long proven important in reducing agency problems (Guo & Masulis, 2015; Liu et al., 2015). However, recent research has found that norms of acquiescence are common inside the boardroom (Hambrick, Misangyi, & Park, 2015; Westphal & Bednar, 2005), and it is still unclear whether independent directors will be penalized or rewarded by their (non-) acquiescence in the boardroom.

Most studies have relied on the *ex post* "settling up" arguments proposed by Fama and Jensen (1983), which states that directors are penalized for their oversight of monitoring during directorship. Conflicting evidence, however, exists regarding whether directors will be penalized or rewarded for their monitoring. Some studies show that directors incur reputation penalties in the directorship market after corporate frauds, especially in the case of earnings restatement or security class lawsuits (Brochet & Srinivasan, 2014; Srinivasan, 2005). In contrast, some find weak evidence of whether the directorship market rewards or penalizes directors (Agrawal, Jaffe, & Karpoff, 1999; Ertimur, Ferri, & Maber, 2012). These mixed findings are probably attributed to great information asymmetry between corporate insiders and external stakeholders. Specifically, these positive or negative firm-level outcomes cannot help external stakeholders hold a specific director accountable for such corporate misbehaviour (Brochet & Srinivasan, 2014). In other words, the boardroom still largely remains a black box for outsiders.

This study seeks to overcome these challenges by using a director–level measure of directors' monitoring. I use voting patterns of independent directors in Chinese publicly listed firms, with a particular focus on those non-agreement votes usually viewed as a type of director passive monitoring. Directors' dissenting, serving as signals (Spence, 1973), is a director-level signal that could be directly evaluated by different receivers, and this evaluation may in turn influence their careers in the directorship market.

While previous studies have paid attention to the career outcomes of directors either in the directorship market or CEO market, they typically examined evaluators within the market environments (Boivie et al., 2015b). This study extends this line of research by taking into account evaluators in the nonmarket environment. As independent directors usually assume multiple roles with linkages to some organizations beyond the market environment, our understanding may be incomplete if we fail to take into account such organizations. Therefore, this study considers both receivers or evaluators in the market environment (the focal firm and other listed firms) and the nonmarket environments (the state) and examines how these actors evaluate directors' monitoring and in turn influence directorships.

These receivers, with different evaluation criterion, cause differential impacts on career outcomes of independent directors, either positively or negatively. This study provides a more comprehensive list of career outcomes of independent directors likely caused by different receivers' evaluations. First, focal firms (internal market actor) have an impact on independent directors' reappointment of independent directors. Second, other listed firms (i.e. external market actors) influences directors' board seats outside the focal. Finally, the state, as the most dominant nonmarket actor, influences the directorship of those independent directors with linkages to the state, i.e. politically connected independent directors who usually assume or have assumed political positions in the political system and whose careers are highly regulated by the state.

Drawing upon signalling theory (Spence, 1973) and the literature on the social political view of corporate governance (Westphal & Zajac, 2013), I propose that independent directors who issued dissenting opinions are less likely to be appointed by the focal firm after their current directorship expires. Moreover, the directorship market positively evaluated their diligent monitoring, as reflected by more new board seats after the issuance of dissenting opinion. Moreover, for politically connected independent directors, their diligent monitoring, consistent with the state's goal, is also positively evaluated by the state.

I test these ideas by using a proprietary dataset recording director voting patterns for board proposals in Chines public firms in the Shanghai and Shenzhen Stock Exchanges from 2004 to 2013. In China, publicly listed firms are required to disclose the voting patterns for board proposals involving at least one non-agreement voted by board directors (Jiang et al., 2015; Ma & Khanna, 2015), providing an ideal context to examine effective directors' monitoring. This study focuses on those proposals involving at least one dissent but still passed by the firm and compares the career outcomes of those dissenting and non-dissenting independent directors within the same proposal.

I find that after an independent director dissents at board meetings, he/she is less likely to be reappointed in the focal firm after his/her current directorship expires. However, my empirical results reveal that these dissenting independent directors will be rewarded for new board seats outside the focal firm, but they tend to join smaller firms. For politically connected independent directors, this study shows that dissenting independent directors are likely exempt from the state's pressure, because they are more likely to keep current directorship in the face of regulations that require them to resign from boards.

This study contributes to the literature on corporate governance in several ways. First, my findings explain the result why dissent, as a credible signal to build directors' reputation as diligent monitors, don't increase yearly (Ma & Khanna, 2015). My findings reveal two opposing forces that drive this phenomenon. That is, dissents are negatively evaluated by market actors (the focal firm) but positively by the nonmarket actor (the state). Hence, directors may not always dissent to gain more directorships.

Second, this study enriches the director career outcomes not only evaluated by market actors but also nonmarket actors. Theoretically, by adopting signalling theory, I also demonstrate that to what extent the same type of signal is evaluated by different receivers (i.e. the focal firm, firms outside the focal firm, and the state) and how this evaluation influence directors' career outcomes. Finally, while previous studies mainly focus on director turnover after corporate frauds (Boivie et al., 2012; Cowen & Marcel, 2011), I extend this line of literature by highlighting that director will be rewarded or penalized by their effective monitoring, thus enriching our understanding of the dynamics of director turnover in the directorship market.

4.2 RESEARCH SETTING

Independent Director System in Chinese Listed Firms

The China Securities Regulatory Commission (CSRC) implemented the independent director system in 2001, with the aim of improving corporate governance practices in China. In particular, all publicly listed firms have to meet the requirement that at least one-third of board members should be independent directors by mid-2003. Independent directors are expected to protect the interests of minority shareholders and carry out their duties independent of the influence from the management team as well as the controlling shareholder.

Independent directors are also required to attend board meetings annually and play an important role in corporate decision making. Specifically, independent directors have the right to vote against a proposal if they view some proposals as detrimental to the interests of minority shareholders.[17]

In this study, I view an independent director's dissent as a signal of his/her diligent monitoring and examine how external stakeholders, i.e. the focal firm, other listed firms and the state, evaluate this signal and consequently influence an independent director's gain or loss of his/her directorship. Figure 4-1 summarises the predictions in this study.

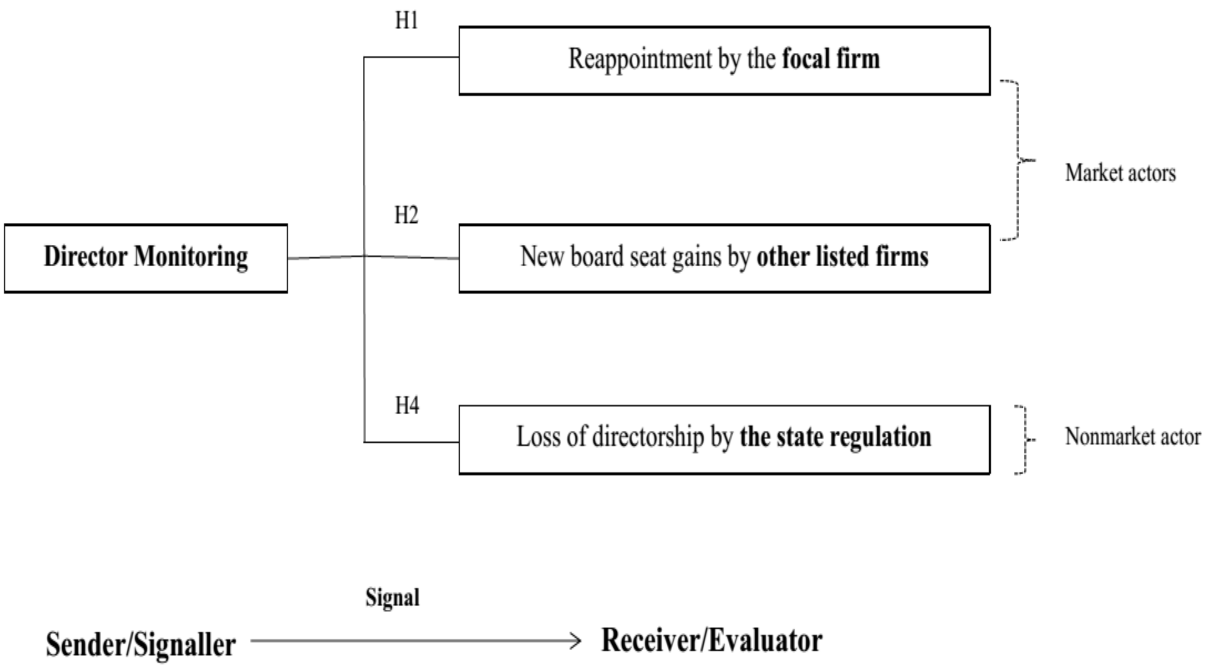

FIGURE 4-1: General Framework of Directors' monitoring and Career Outcomes

4.3 THEORY AND HYPOTHESIS DEVELOPMENT

Director Dissent and Director Careers in Internal Directorship Market

Independent directors have the fiduciary duties to monitor managers in a typically diverse ownership structure or controlling shareholders in a concentrated ownership structure. In a

[17] More details about the independent director system in China are in Chapter 3.

diverse ownership structure, prior studies have found that CEOs will try to punish those who take actions counter to their interests in a variety of ways. For example, journalists who criticized or issued unfavorable statements about a firm, its strategy, or its leadership were subsequently less able to communicate with the CEO (Westphal & Deephouse, 2011) and experienced social distancing by other CEOs (Shani & Westphal, 2015). Similarly, analysts who downgraded a stock lost favors and access to executives (Westphal & Clement, 2008), and directors who promoted corporate governance changes that limit managerial autonomy were shunned by directors on other boards (Westphal & Khanna, 2003). In a similar vein, I argue that, following directors' dissents, the majority shareholder is likely to distance themselves socially from those dissenting independent directors.

The dissent signals to the focal firm that these directors may not follow the interests of the management and controlling shareholders, and instead are violating the norms of reciprocity (Ma & Khanna, 2015). For instance, after two independent directors, Zheng Lixin and Xu Zhuang, in Tianmu Pharmaceutical dissented at a board meeting, the CEO of Tianmu Pharmaceutical stated that their dissents "cause negative media coverage, exert a negative impact on firm reputation, and damage shareholder values" (China Youth Daily, 2014). Therefore, it is likely that firm leaders distance themselves from those directors following dissents, and thus, compared with non-dissenting directors, an independent director issuing a dissenting opinion is less likely to be reappointed for the next term.

H1: An independent director's dissent is negatively evaluated by an internal market actor (i.e. the focal firm).

Director Dissent and Career Outcomes in External Directorship Market

Thus far, I have only discussed the implications of directors' dissent and their careers in the focal firm. I now investigate how other listed firms evaluate dissents, and how their evaluation influences dissenting directors' employment by other listed firms. Although the extant literature suggests that CEOs of different firms often support and help each other in a variety of ways (McDonald & Westphal, 2010; Westphal, Park, McDonald, & Hayward, 2012), including socially distancing those who behave in ways that threaten the interests of the corporate elite (Shani & Westphal, 2015; Westphal & Khanna, 2003), I suggest that the impact of director dissent on subsequent employment opportunities in the director market differs between the focal firm and other firms.

In our sample period, the Chinese capital market experienced several major financial scandals (Cumming et al., 2015), thus making corporate governance practices more salient in the eyes of the public, and creating incentives for firms to improve their corporate governance practices in order to avoid being painted by the same negative brush as the tainted firms (Yu, Sengul, & Lester, 2008; Zavyalova, Pfarrer, Reger, & Shapiro, 2012)). In order to signal to their stakeholders that they take corporate governance seriously (Sanders & Boivie, 2004), however, firms would need to take actions that would be visible and noticeable to these stakeholders (Gomulya & Mishina, 2016).

Appointing qualified independent directors would be a visible way for firms to signal their responsiveness. However, given the number of scandals, stakeholders may be concerned that those independent directors would be decorative "flower vases" in the boardroom, without taking real responsibility for vigilant monitoring. Because directors dissents are publicly disclosed, said dissents may be viewed as signals of directors' unobserved monitoring ability. Consequently, both investors and the state are likely to pressure firms to employ directors who have dissented in the past. Hence, I hypothesize:

H2: An independent director's dissent is positively evaluated by external market actors (i.e. other listed firms).

Despite the positive effect of signals, I further highlight that only certain types of listed firms are more likely to value director diligent monitoring. Specifically, I propose that those smaller firms are more likely to employ diligent monitors. Even though dissent can be a signal of diligent monitoring, smaller firms may tend to install this type of independent directors due to their need for impression management. Previous studies show that CEOs take verbal impression management techniques in response to negative stock analyst appraisal (Westphal & Graebner, 2010). Also, CEOs are also more likely to disclose unrelated positive news if an M&A is not positively evaluated by the stock market (Graffin, Haleblian, & Kiley, 2015). In a similar vein, smaller firms usually have limited resources to signal to the capital market about their quality of corporate governance, and they are likely to employ those dissenting directors to improve their images in the eyes of the capital market. Thus, I predict:

H3: An independent director's dissent is more positively evaluated by smaller external market actors (i.e. other smaller listed firms).

Politically Connected Directors' Dissent and Career Outcomes

Independent directorship is usually an individual's secondary employment, and it's expected that independent directors are not only concerned about their monitoring role on a board but also their career prospects in their primary employment (Boivie et al., 2015b). It's likely that directors' effective monitoring will not only be evaluated by market actors in the directorship market but also by nonmarket actors if these directors' home organizations are nonmarket organizations such as the state. In this section, I focus on to what extent diligent monitoring of politically connected independent directors is evaluated by one dominant nonmarket actors, i.e. the state.

As the Chinese government aims to improve corporate governance practices after their entry into World Trade Organization (WTO) in 2001 (Clarke, 2006), the state has implemented a series of policies that aims to achieve this goal. For example, CSRC introduced the independent director system in 2001 and also the cumulative voting system in 2002 (Chen et al., 2015; Xi & Chen, 2014), in an effort to protect the interests of minority shareholders. Along this line, it's expected that the state is more likely to value those politically connected independent directors who advance the state's goal such as diligent monitoring. Compared with non-dissenting politically connected independent directors, dissenting politically connected independent directors signal their diligent monitoring to the state, thus enhancing their legitimacy in the eyes of the government and promoting their careers. Therefore, I propose:

H4: For politically connected independent directors, their past dissents are positively evaluated by the state.

4.4 EMPIRICAL METHOD

Sample Construction

This study examines the conflict between the board and independent directors and its impact on subsequent independent director turnover. I obtained information of 30,533 board proposals for a period of 10 years from 2004 to 2014 of all Chinese public firms in the Shanghai and Shenzhen Stock Exchange from the *CSMAR (China Stock Market and Accounting Research)* dataset. Among all these proposals, I find 392 cases involving at least one independent voting against a proposal on a board. Typically, in a proposal containing at least one director dissent and the rest of other directors vote for this proposal.

After the identification of those proposals with at least one dissent, I constructed the sample for analysis of directors' career outcomes. In each director-year, I only included the first dissent of a specific independent director (to avoid multiple dissenting directors). Moreover, if an independent director dissents in year t, then he/she will not be included in the control group in the following years in the sample. My final sample consists of 948 observations, with 764 unique independent directors from 206 firms.

Dependent variable

For H1, H2, and H3, I compare the career outcomes of dissenting and non-dissenting independent directors within the same proposal. For H1, I define re-appointment as an independent director's being appointed as an independent directors again in the same focal firm after the expiration of his/her current directorship. The *reapp* variable is a dummy equal to 1 if an independent director is re-appointed after his/her first term, and 0 otherwise. By construction, this sample only contains all first-term independent directors.

For H2 the dependent variable is the new board seat gains outside the focal firm after three years of the issuance of dissents. The use of three years is that each directorship is three years in China and the three-year time window is more conservative. Previous studies tend to measure the net changes in the number directorship and don't look into the nature of these changes (Fich & Shivdasani, 2007). To capture to what extent the external directorship market evaluates dissenting, I use a more nuanced way to calculate new board seat. Specifically, if independent director *i* holds directorship in firm A, B, and C in year t, and holds board seat in firm B, C, and D in year t+3. Then the new board seat gain is 1, i.e. firm D. The reason why independent director *i* still hold positions in frim A and B is that he is re-appointed after his first term in firm A and B, which is considered the outcome in the internal directorship market. If I used the traditional method and compared the number of directorships in year t and year t+3, then the net change is 0, which fails to account for how external directorship market exactly evaluates director dissent. By construction, the dependent variable (*new board seats*) is a non-negative integer number.

For H3, this dependent variable should represent whether these dissenting independent directors are employed by smaller firms following a dissent. I use market capitalization to measure the size of firms. Then the dependent variables, *Market Cap*., is the ratio of the average value of market capitalizations of those new firms[18] where an independent director holds board seats in year t+3 to the average value of market capitalization of firms where an independent director holds directorship in year t. If *market Cap*. is smaller than 1, it means that the average market values of those new firms is smaller than the average market values of those old firms.

H4 evaluates whether effective directors' monitoring is positively evaluated by the government. To this end, I employ an exogenous shock that regulated politically connected independent director (more details will be discussed in the estimation method section). The regulation, called File No. 18, is issued on 18 October 2013. I obtain information about the list of all politically connected independent directors in Chinese listed firms at year t-1 (one year before the policy change) and also the listed of all politically connected independent directors in year t+1. Then I compared the list of politically connected independent directors in year t-1 and year t+1. The dependent variable *director leave* is 1 if an independent director appears in year t-1 but disappears in the directorship market in year t+1, and 0 otherwise. Therefore, if an independent director stays in the focal firm after the regulation, it is similar to the director reappointment case in H1.

Independent variables

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[18] The definition of new firms is the same as the one used for H2, i.e. *new board seats*.

I operationalize the explicit expression of dissenting opinion if an independent director votes against a board proposal at a board meeting. The disapproval of a proposed by an independent director is denoted as 1, whereas a vote in favor of a proposal is denoted as 0.

Control variables

I also include several director-level controls. To investigate the influence of gender in the director decision making, I add the *gender* dummy variable, coded with 1 for male and 0 for female. I control for the impact of age by adding a continuous variable *age*, as older directors may have different career concerns from young directors (Jiang et al., 2015). I also include the *financial industry experience* dummy variable equal to 1 if the director has worked or works in the financial industry to capture director's financial expertise and 0 otherwise (Ma & Khanna, 2015). I also add the *political connection* dummy variable equal to 1 if a director has working experiences in the government, e.g. central/local government or Chinese People's Congress (CPC) and Chinese Political Party Consultative Committee (CPPCC) and is 0 otherwise (Marquis & Qian, 2013).

Estimation Method

Conditional logit model for H1

As this study explores the extent to which directors' dissent affects directors' re-appointment, a simple pooled regression linking directors' dissent and their re-appointment may cause concerns about endogeneity. Specifically:

$$Reapp_{i,k,t+3} = \alpha + \beta Dissent_{i,j,k,t} + \gamma Contorls + e_{i,j,k,t}$$

$Dissent_{i,j,k,t}$ is a dummy that equal to 1 if an independent director i dissents on proposal j in firm k at time t. $Reapp_{i,k,t+3}$ is also a dummy equal to 1 if an independent director i is reappointed for the second term at time *t+3*. *Controls* represent other director-level control variables, including gender, age, political connections, financial industry background, international experience and $e_{i,j,k,t}$ is the residual.

This simple specification may raise concerns about unobserved board-level heterogeneity influencing director dissent and their re-appointment. This unobserved factor is likely to bias coefficient β.

Following the same identification strategy in Jiang et al. (2015), this study includes proposal fixed effects in the regression to alleviate endogeneity between director dissent and their re-appointment.

$$Reapp_{i,k,t+3} = \alpha + \beta Dissent_{i,j,k,t} + \gamma Contorls + \eta_j + \varepsilon_{i,j,k,t+3}$$

where $e_{i,j,k,t+3} = \eta_j + \varepsilon_{i,j,k,t+3}$

By adding the proposal fixed effect η_j, this study alleviates endogeneity issues resulted from unobserved heterogeneity at the proposal, board, firm, and time period levels[19]. Specifically, all between-group variations are filtered out, and what is left is the within group (i.e. proposal) variation. However, this identification strategy depends on the variation of director re-appointment within the same proposal (also in the same firm and year). Therefore, proposals with all director re-appointment will be dropped during estimation. Despite this trade-off, this method ensures that any variation in re-appointment is attributed to differences among director-level factors. That said, by including proposal fixed effects, I compare the career outcomes between dissenting directors and non-dissenting director within the same proposal. Specifically, if the coefficient of *dissent* is negative and significant, then H1 is supported.

Negative Binomial Regression for H2

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[19] If proposal-level fixed effects are added, these fixed effects directly filter out board, firm, and year level factors as a proposal is nested in a board, a firm and a year.

The dependent variable for H2 is a count variable, i.e. new board seats gain. Poisson regressions are often employed for count data. However, Poisson regression assumes that the mean and the standard deviation of the dependent variable are equal. However, the data exhibits overdispersion, indicating that the conditional variance exceeded the conditional mean. Therefore, I employ a negative binomial regression, which includes a gamma-distributed term to take into account such overdispersion in the data. Moreover, to make meaningful comparisons between dissenting independent directors and those non-dissenting ones with in the same proposal, I add proposal fixed effects in the regression. As noted by Allison and Waterman (2002), an unconditional negative binomial regression with fixed effects shows no concerns about incidental parameters problem and also exhibit better sampling properties than conditional fixed-effects Poisson regression.

Heckman Selection Model for H3

H3 states that dissenting independent directors are more likely to join smaller firms in year t+3, compared with their old board seats in year t. Since only independent directors with new board seats in year t+3 are included in this analysis and directors with zero new board seats in year t+3 may not be randomly distributed, I employ a Heckman two-stage model (Heckman, 1979) where the first stage is a probit regression predicting an independent director's propensity to gain new board seats and the second stage is a ordinary least square (OLS) regression with the average market capitalizations of those new firms as the dependent variable.

To identify a Heckman selection model, it's commonly suggested to have a variable that is related to the first-stage outcome variable but unrelated to the second-stage outcome variable. In this case, I need a variable that is related to an independent director's likelihood of gaining new board seats but unrelated to the average values of market capitalizations of those board seats in new firms. To this end, I exploit Chinese provincial governments' staggering policies to attract foreign talents from 1999 to 2006. Due to China's local (i.e. provincial) directorship market, most Chinese firms recruit their independent directors from their headquarters' provinces. Giannetti, Liao and Yu (2015) find that most of those foreign talents are appointed as corporate directors, resulting in a plausibly exogenous increase in the supply of corporate directors in a firm headquarter' s province. Given the sudden increase in the supply of corporate directors, this staggering policy is expected to negatively influence an independent director's probability of gaining new boards. I then calculate the inverse Mills ratio from the first-stage probit regression, and then add this term as a control in the second stage OLS regression.

Propensity Score Matching for H4

To explore the political careers of those politically connected independent directors, two empirical challenges exist. First, the sample size of dissenting politically connected independent directors and those non-dissenting ones is too small to draw any statistical inference. Second, after a broad searching of the career paths of those politically connected independent directors in my sample, information about their promotion or demotions in their political careers is not available, which may be a measure reflecting the state's evaluation of politically connected independent directors.

Instead, a recent regulatory change in China provides a great opportunity to test my arguments. Specifically, I focus on one recent policy regulation, the No.18 reform issued at the end of 2013, which required politically connected independent directors to resign from their boards. As part of President Xi Jinping anti-corruption campaigns, this regulation aims to prevent the abuse of political connections and restore market order.

This study explores whether politically connected independent directors who have issued at least one dissent in the past will be less likely to leave the directorship market. The rationale for this is that director dissent, as a signal to the government, may enhance director's legitimacy in the eyes of the state and buffer those independent directors from government pressure. If directors' dissents exert a negative impact on their leave, this may indicate that their 'diligent' monitoring is recognized and also valued by the government.

To exploit this exogenous change and the dissenting information in this study, I use a different sample that consists of all politically connected independent directors in Chinese listed firms in 2012. I first identified whether a politically connected independent directors has issued a dissent in the past (i.e. from 2004 to 2012) based on the list of all politically connected independent directors in Chinese listed firms by the end of 2012. I then compared the list of politically independent directors at end of 2012 and 2014, and checked who have left the directorship market, i.e. *director leave* is equal to 1 if one politically connected independent directors appeared in 2012 but disappeared in 2014. Then I run a logit model with *director leave* (at the period of 2014) as the outcome variable and *dissent* (at the period of 2012) as the explanatory variable. If my arguments are correct, I expect that the coefficient on *dissent* is negative. I identified 275 director departures of all 3,920 politically connected independent directors by the end of 2014.

However, simply regressing director leave on director dissent could not establish causality, as politically connected independent directors who have issued a dissent before may be significantly different from those politically connected independent directors who have never done so. For instance, female directors may be more likely to dissent and be more likely to leave the directorship market after the regulation, independent of their dissents.

To mitigate such concerns, I employ the propensity score matching method to construct a matched sample. Propensity score matching creates a quasi-experimental environment that helps alleviate confounding factors by matching firms based on observable characteristics (Rosenbaum & Rubin, 1983). As stated by Rosenbaum and Rubin (1983: 41) "[t]he propensity score is the conditional probability of assignment to a particular treatment given a vector of observed covariates. Both large and small sample theory shows that adjustment for the scalar propensity score is sufficient to remove bias due to all observed covariates." After the matching process, the treated and non-treated groups should be comparable on observable factors.

Previous studies suggest that independent directors' likelihood of dissent is related to their individual characteristics (Ma & Khanna, 2015). I matched politically independent directors on gender, age, political positions, finance industry background, and academic background. Specifically, I first estimated a logistic regression predicting politically connected independent directors' propensity to dissent using director gender, age, political positions, finance industry background, and academic background as explanatory variables. I then calculated the propensity score for politically independent directors' predicted propensity to issue a dissent. Next, I constructed a subset of politically independent directors (i.e. the control group) that have never dissented but with similar propensity scores to the treatment group on all observable factors. To determine whether the propensity scores were eligible for the inclusion in the control group, I used the nearest-neighbour matching with a caliper of 0.25 standard deviations. Finally, I obtained a matched pairs of politically connected independent directors that were comparable on observables except for receiving the treatment (i.e. dissent), which includes 155 politically connected independent directors with at least one dissent and 310 without any dissents.

To examine the quality of the matching, I checked whether the two groups of politically connected independent directors are similar on observable characteristics. To this end, I first checked the percentage bias between the two groups on director age and their political position, and found that it's smaller than the commonly suggested threshold of 5% (Rosenbaum and Rubin, 1983). I also undertook t-tests to examine whether there are significant differences between the two groups and results revealed that there are no significant differences ($p > 0.05$). For other indicator variables such as gender, academic background, and finance industry background, I also followed the previous steps and found no significant differences between the two groups. These post-hoc tests revealed that the overall match is satisfactory, and issuing a dissent can be viewed as exogenous to the extent that all observable factors have been ruled out. Figure 4-2 illustrates the propensity score for the treatment and control groups before and after matching.

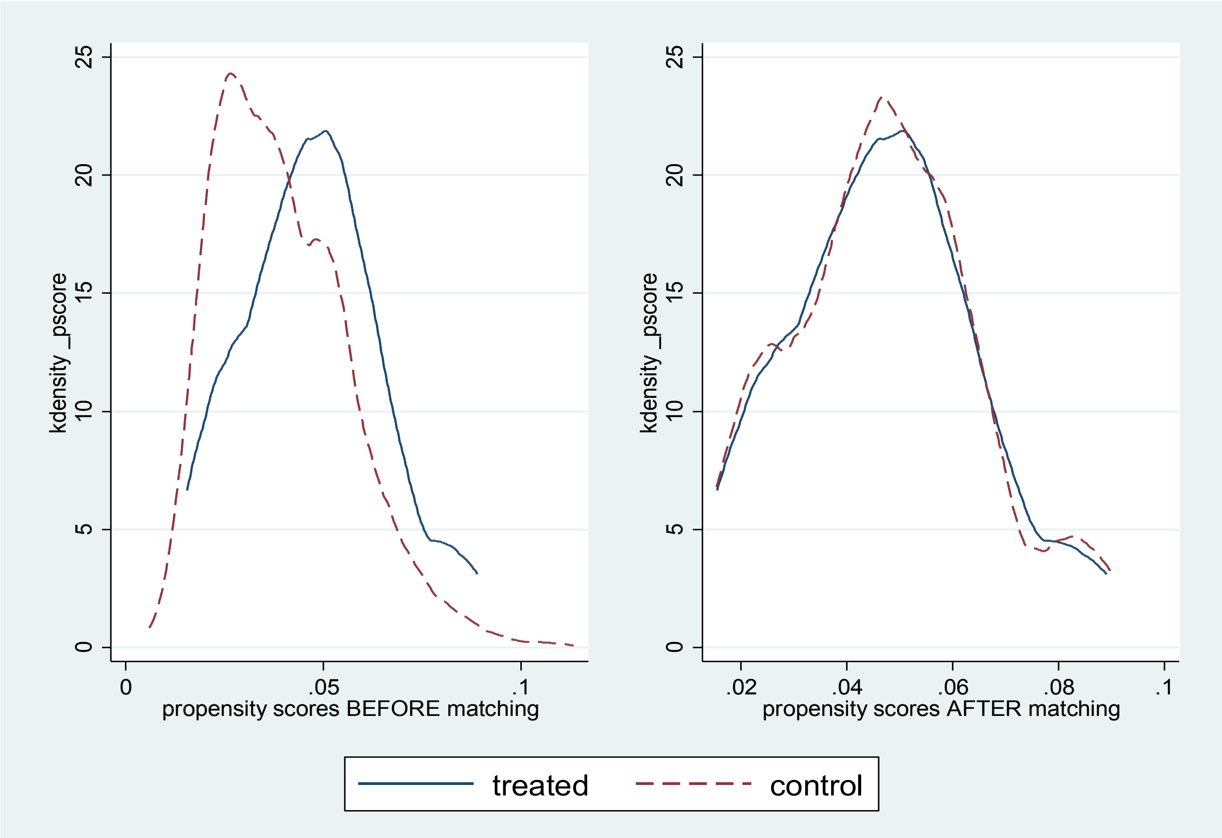


FIGURE 4-2: Propensity Score of Treatment (Dissenting Politically Connected Independent Directors) and Control (Non-Dissenting Politically Connected Independent Directors) Groups before and after Matching for Samples Used in H4

We have to be bear in mind that propensity score matching cannot completely alleviate concerns about endogeneity because matching can only be done based on observable factors. It's possible that the bias still remains after matching if factors that simultaneously drive both the dependent variable and independent variables are unobservable. Yet, matching could still alleviate such bias to the extent that the unobservables are associated with observables.

In the second stage, I run the logistic regression predicting the likelihood of director leave based on the match-paired sample where the treated and control groups are also reweighted based on their propensity (Hirano, Imbens, & Ridder, 2003). In the regression, I include such director-level controls as gender, age political positions, academic background, financial industry background and those firm-level controls such as firm size (the log value of total asset), return on asset (ROA), state ownership and province fixed effects. Results presented below are based on weighting propensity score.

To fully exploit the data structure, I also run a continuous-time event history analysis predicting how quickly a politically connected independent director resigns from the focal firm since the issuance of the No.18 file on 18 October 2013. I checked whether a politically connected independent director submitted his/her resignation report to the focal firm between 19 October 2013 and 30 June 2014. If so, an event occurs for this politically independent director. I identified 253 politically independent director departures in this period (I exclude those cases that director resignation due to the expiration of directorship, i.e. two terms of six years in total). I used the Gompertz model, which assumes a decreasing base donation rate (Zhang & Luo, 2013). For comparison, a model with Weibuil distribution also yielded similar results. As dissents don't occur randomly across politically connected independent directors, I used the propensity scores to adjust this event history regression (Hirano et al., 2003). I reweighted the observations using the propensity score, such that this sample would be adjusted to be representative of the population from which they were drawn.

Specifically, the treatment group and control groups are reweighted by the propensity score. Supposed p is the calculated propensity score, I assign the weights of 1/p to a politically independent director who had a higher propensity to dissent (politically connected independent directors with at least one dissent before) and 1 / (1− p) to one that had a lower propensity to dissent (politically independent directors who have never dissented before). In the event history regression, I also include such director-level controls as gender, age, political positions, academic background, financial industry background and those firm-level controls such as firm size (the log value of total asset), return on asset (ROA), state ownership and province fixed effects.

4.5 EMPIRICAL FINDINGS

Table 4-1 illustrates the descriptive statistics and correlation matrix for all the variables in my empirical analysis. I first checked the variance inflation factors (VIF) and found that its value is far below the threshold of 10 (VIF = 1.14), thereby suggesting that multicollinearity is not a concern is this study.

TABLE 4-1: Descriptive Statistics and Correlation Matrix

	Mean	S.D.	Min	Max	1	2	3	4	5	6	7	8	9	10	11
1. Reapp	0.532	0.499	0	1	1										
2. New board seats	0.202	0.679	0	6	0.051	1									
3. Dissent	0.485	0.5	0	1	-0.083*	0.043	1								
4. Gender	0.908	0.288	0	1	0.038	0.04	-0.046	1							
5. Age	49.685	9.82	31	82	0.091*	-0.058*	-0.055*	0.088*	1						
6. Number of directorship	1.488	0.968	0	9	0.045	0.274*	-0.003	0.041	-0.02	1					
7. Final term	0.311	0.463	0	1	0.489*	0.02	0.047	0.017	0.067*	0.041	1				
8. International experience	0.048	0.215	0	1	-0.016	0.045	0.12*	0.025	0.023	0.044	-0.023	1			
9. Financial industry experience	0.468	0.499	0	1	0.02	0.104*	0.136*	-0.085*	-0.111*	0.146*	-0.027	0.014	1		
10. Coopted independent director	0.237	0.425	0	1	0.021	0.001	0.001	-0.017	-0.007	0.082*	-0.141*	-0.016	0.051	1	
11. Political connections	0.142	0.349	0	1	-0.021	0.083*	0.01	0.051	0.264*	0.119*	-0.009	-0.082*	-0.115*	0.034	1

Notes. *p<0.05, Number of observations = 1,264.

I find support for my Hypothesis 1 which predicted that director dissent has a negative impact on directors' re-appointment. In Table 4-3, the coefficient of the dissent variable in Model 1 is negatively significant (coefficient = 0.900, $p < 0.01$)

Hypothesis 2 predicts that director dissent has a positive impact on career outcomes in the external directorship market, i.e. new board seat gains outside the focal firm. As shown in Model 2, the coefficients of *dissent* is significant and positive (coefficient = 0.416, $p < 0.01$), indicating that director dissent positively influences new board seats and thereby supporting Hypothesis 2.

Hypothesis 3 states that those dissenting independent directors are more likely to join smaller firms. As shown in Model 3, the coefficients of the *dissent* is marginally significant and negative (coefficient = -7.334, $p < 0.1$), supporting Hypothesis 3.

Hypothesis 4 states that, for politically connected independent directors their dissents are positively evaluated by the state. Model 4 reveals that the coefficients of dissent is negative and significant (coefficient = 1.75, $p < 0.05$), indicating that directors' dissent negatively influences directors' departure. Model 5 then presents results for the re-weighted continuous time event history regression. The coefficient of dissent is also negative and significant (coefficient = -2.372, $p < 0.01$), suggesting that those dissenting politically connected independent directors submit their resignation reports later. Taken together, these results show that dissents buffer directors from unwanted government pressure and support H4.

TABLE 4-2: Regressions Predicting Director Career Outcomes

	Model 1 (H1)	Model 2 (H2)	Model 3 (H3)	Model 4 (H4)	Model 5 (H4)
DV	Reapp	New board seats	Market Cap.	Director leave	Director leave
Model	Logit Model	Negative Binomial Model	Heckman Second Stage	Logit Model	Event History Model
Dissent	**-0.900******	**0.416******	**-7.334***	**-1.75****	**-2.372******
	(0.235)	(0.161)	(4.96)	(0.891)	(0.770)
Gender	0.137	0.627*	-2.438	-0.443	1.098*
	(0.443)	(0.326)	(2.764)	(1.108)	(0.632)
Age	-0.005	-0.025**	-0.463	0.115***	0.032
	(0.012)	(0.011)	(0.281)	(0.039)	(0.029)
Number of directorship	0.352***	0.208***	-1.941	-0.669*	0.069
	(0.135)	(0.067)	(2.072)	(0.387)	(0.191)
Final term	2.977***	0.775***			
	(0.422)	(0.236)			
International experience	-1.116**	0.802**	-0.800		
	(0.544)	(0.337)	(3.277)		
Financial industry experience	-0.209	0.329*	-4.568*	-0.405	0.612
	(0.238)	(0.184)	(5.269)	(0.607)	(0.486)
Coopted independent director	0.780**	0.587**			
	(0.335)	(0.279)			
Political connections	-0.147	0.371	-1.131*		
	(0.335)	(0.237)	(2.061)		
Political level				-0.186	-0.523*
				(0.364)	(0.299)
Constant		-1.461	48.604*	-5.017	-12.884**
		(1.146)	(27.065)	(5.832)	(6.188)
Proposal fixed effect	Yes	Yes	No	No	No
Province fixed effect	No	No	Yes	Yes	Yes
Industry fixed effect	No	No	No	Yes	Yes
Observations	224	941	114	293	620
Log-Likelihood	-129.41	-275.44		-41.93	-26.44
Degree of freedom	82	353	110	11	45

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Note. Model 1 only includes those first-term independent directors. As Model 1 is a conditional logit model with proposal fixed effect, the identification of this model requires variation in the outcome variable within the same proposal, i.e. at least on non-reappointment or re-appointment. During estimation, the number of observations drops to 224.

The sample in Model 2 is as stated in the 'sample construction' section.

Model 3 is a Heckman two-stage model and only the second-stage results are reported. The number of observations for the first stage is 941, which includes independent directors with zero new board seats and those with more than one new board seat. As only 114 observation with more than 1 new board seat, the second stage observation drops to 114. The coefficient of the first stage instrument is negative and significant (coefficient= -0.261, $p < 0.01$).

For Model 4 and Model 5, I use a different sample containing all politically connected independent directors in2013 to test the impact of government regulation on their turnover. Model 4 is a propensity scored-weighted logit model and Model 5 is a propensity-score weighted Gompertz model. Model 4 and Model 5 both include controls such as firm size, firm age, state ownership, and return on asset (ROA)

Robustness Checks

To test the robustness of my predictions, I re-estimate the model using different specifications.

Alternative measure of director departure for H1

In the previous analysis, the evaluation of the focal firm is measured by independent director reappointment after the completion of their first term. It's also likely that one independent director is dismissed (voluntarily or involuntarily) before the completion of current directorship. To explore this possibility, the outcome variable is measured by whether an independent director leaves before the completion of their current directorship (either in their first term or the second term), and find similar results (coefficient = 2.071, $p < 0.01$).

Alternative measure of new board seat gains for H2

For H2, I used a negative binomial regression with proposal fixed effect given that the dependent variable is a non-negative count number. I also measure new board seat gains by the log value of (1+new bard seat gain) and run an ordinary least square (OLS) regression with proposal fixed effects and robust standard errors. Empirical results find support for H2 (coefficient =0.042, $p < 0.1$).

Cumulative dissents

For H1 and H2, I've only provided evidence about the relationship between dissents and directors' reappointment or new board seats. It's likely that the impact of dissents on directors' reappointment or new board seats may be dependent on the number of dissents an independent director has issued. To test this argument, I created the *cumulative dissent* variable which represent the number of dissent an independent director has issued as of his/her current dissent. For H1, I find that independent directors are less likely to be reappointed if they have issued more dissents before (coefficient = -0.586, $p < 0.1$). For H2, I also find that an independent director who has issued more dissents before will gain more new board seats (coefficient = 0.355, $p < 0.1$). Overall, the empirical findings yielded similar results to the previous section.

The role of weak/strong dissents in re-appointment/new board seats

In the post-hoc analysis, I also examine whether internal or external stakeholders may perceive different types of dissents differently. In particular, I classify dissents into two types: strong dissents such as an adverse opinion or disagreement opinion and weak dissents such as qualified opinion, disclaimer opinion, or abstention opinion. The *substantive dissent* variable is equal to 1 if an independent director issues an adverse opinion or disagreement opinion, and is equal to 0 if an independent director issues a qualified opinion, disclaimer opinion, or abstention opinion.

Focusing on a sample of dissenting directors, I explore the effect of strong dissents on reappointment. I ran a random effect logit model and found that the coefficient of *substantive dissent* is not significant (coefficient = -0.037, p-value > 0.1), indicating that the focal firm or controlling shareholders don't perceive these two types of dissents differently.

Like the previous analysis, I also explore how other listed firms perceive strong dissents, i.e. the effect of strong dissents on new board seats. In a sample of all dissenting directors, I employed a random effect negative binomial regression and found that the coefficient of *substantive dissent* is negative and significant (coefficient = -0.52, p-value < 0.1), suggesting that other listed firms more negatively evaluate strong dissents. This finding is also consistent with previous studies stating that firms tend to respond to pressures to enhance corporate governance practice with visible or symbolic practices in order to demonstrate compliance with stakeholder demands while still retaining their autonomy (Westphal & Graebner, 2010; Westphal & Zajac, 1998).

4.6 DISCUSSION AND CONCLUSION

Discussion

This study explores the career outcomes of diligent directors by taking into account the perceptions of different stakeholders including the focal firm, the directorship market and the government. Drawing upon signalling theory, this study shows that the same signal, i.e. directors' dissent, is interpreted differently by receivers and in turn affects directors' careers. In particular, I find that dissent is negatively evaluated by the focal firm, thus reducing directors' likelihood of re-appointment after their current directorship. However, the external directorship market (i.e. other listed firms) positively evaluates this signal, as reflected by more new board seats for those diligent directors. As an independent directorship is usually an individual's part-time occupation, independent directors are likely influenced by their primary affiliation. This study shows that directors' home organizations such as the state also reward these diligent directors if this is consistent with the state's goal.

This study offers important implications for the corporate governance literature in several ways. First, while directors' monitoring is important for corporate governance monitoring (Fama & Jensen, 1983), I propose that rewarding directors' monitoring should be situated in social contexts, rather than just an individual-level characteristic. That is, the rewarding is strongly influenced by stakeholders' perceptions of effective monitoring. Moreover, by considering to what extent stakeholders or receivers evaluate effective monitoring, this study provides insights into the dynamics of director turnover in the directorship market (Levit & Malenko, 2015).

The examination of directors' monitoring also contributes to the literature on signalling theory (Connelly, Certo, Ireland, & Reutzel, 2011). I theorise that the same signals is interpreted in a different way by multiple receivers. By linking directors' dissents to directors' career outcomes, I provide evidence on the impact of a specific type of signal on senders.

This study makes contributions to the literature on the firm-state relationship (Piotroski & Zhang, 2014). By using a recent policy regulation that targeting politically connected independent directors, this study sheds light on how the state influences corporate strategies in the form of directors' monitoring. Previous studies have demonstrated that these political connections benefit firms by reducing environmental uncertainties (Zheng, Singh, & Mitchell, 2015). However, these politically connected actors may carry the state's goal (Greve & Zhang, 2016) and influence corporate operations through director turnover.

Managerial Implications

This study provides several managerial implications. First, as directors' monitoring is important for corporate governance, dissent, as a type of monitoring, may be a good signal. When firms need to appoint new independent directors, it's very hard for them to find qualified or eligible candidates for these vacancies due to information asymmetry between firms and independent directors. Dissent may be a good selection criterion for firms or shareholders when they aim to appoint diligent monitors (Brochet & Srinivasan, 2014; Cai, Garner, & Walkling, 2009; Hillman et al., 2011). Second, when selecting independent directors, firms may have to pay attention to home organizations to which these independent directors are connected. These home organizations, especially those in the nonmarket environment, may influence corporate decision making differently. Lastly, even though I find that the focal firm tends to less likely to re-appoint those dissenting independent directors, it may be a good impression-management technique for these smaller firms to reappoint dissenting directors to improve corporate reputations, especially after events of corporate fraud. This may also show firms' commitment to improve corporate governance and likely restore stakeholders' confidence.

Limitations and Implications for Future Research

Despite my efforts to establish the relationship between director dissent and their career outcomes, my study still has some limitations which provide opportunities for future research. First, the empirical context of my study is in an emerging economy, i.e. China, and we have to be cautious that whether my results could be extended to other developed countries. However, as China has become the second largest economy, the understanding of corporate governance systems still presents an important research question worth exploring. Second, this study identifies directors' dissent, albeit an important and understudied one, as a mechanism for external market evaluation. But there are other factors that also likely influence director appointment and departure. Therefore, it's also important not to orveremphasize a few (i.e. dissent) by ignoring the others. Nevertheless, the findings suggest dissent has a clear impact on director career outcomes.

Conclusion

This study sheds light on the career outcomes of diligent directors by theorising how receivers evaluate these signals and its impact on director careers. This study highlights that diligent monitoring exerts a negative impact on the internal directorship but a positive impact on external directorship. Furthermore, I find that the state positively evaluates diligent directors if effective monitoring is consistent with the state's goal. Overall, this work offers a more complete understanding of the impact of diligent monitoring on career outcomes as well as director turnover dynamics in the directorship market.

CHAPTER5 POLITICALLY CONNECTED DIRECTOR HETEROGENEITY AND CORPORATE SOCIAL RESPONSIVENESS IN CHINA

Abstract

This study explores the impact of heterogeneous political connections on corporate social responsiveness (i.e. donation). Using data on earthquake donations by Chinese publicly listed firms in 2008, I show that firms with higher proportions of directors embedded in the political system (i.e. bureaucratic directors) will donate less, for fear that disaster relief efforts may de-legitimate the state. However, firms with higher proportions of directors peripheral in the political system (i.e. symbolic directors) will donate more, due to public pressure for donations. This study contributes to the literature on political connections and enriches our understanding of corporate social responsiveness in the context of emerging economies.

Keywords: political connections, corporate social responsiveness, China

5.1 INTRODUCTION

The literature on corporate social responsibility (CSR) has lent support to the view that CSR contributes to firm accounting or market performance (Barnett & Salomon, 2006; Wang et al., 2008). Specifically, firm engagement in social initiatives improves firm performance through eliciting positive responses from key stakeholders such as suppliers, consumers, or non-government organizations (NGOs) (Wang & Qian, 2011). These studies generally assume that corporate social initiatives take place in a developed country with high CSR awareness. However, institutional differences may exist that curb the realization of expected CSR benefits (Jones, 1999). Specifically, in a country where CSR practices are not institutionalized and media is still highly regulated, the economic benefits of CSR are elusive. In this situation what drives a firm's participation in social responsible practices?

This study seeks to address this question by examining the case of corporate donations following a natural disaster under government CSR pressure[20]. Corporate donation, or corporate social responsiveness after a disaster, is one of the most visible and comparable types of CSR activities (Brammer & Millington, 2008; Crane, 2008; Jia & Zhang, 2013; Zhao, 2012) . It can be conceptualized as a strategic tool to manage the firm-state relationship and its magnitude can be regarded as firms' responsiveness to government pressure. Previous research on corporate social responsiveness mainly draws on stakeholder theory, which posits that firms behave in a socially responsible way in order to meet the demands/interests of stakeholders (Flammer, 2013, 2015). However, existing research on corporate social responsiveness remains limited in the sense that the role of government and other political factors such as corporate political ties are less explored.

[20] One unique characteristic of Chinese CSR practices is that firms mainly focus on discretionary CSR activities such as philanthropic contributions, while firms in developed countries pay more attention to long –term activities such as local community relationship. CSR in China is at an infant stage and CSR sometimes is equal to corporate philanthropy. Hence, I argue that the study of corporate donation, to a greater extent, is representative of CSR practices in China.

The government, as the most important stakeholder in an emerging economy, plays a dominant role in almost all aspects of business operation. Stakeholder theory recognizes that meeting stakeholder requests is critical for firm survival, as stakeholder (i.e. the government) discontent would be a potential threat to organizational legitimacy and growth. Recent studies have demonstrated that politically-connected firms are more likely to donate due to the expected government support in the future (Li, Song, & Wu, 2014). However, these works tend to regard political connections as homothetic and ignore the fact that powers of different political ties may have an impact on firms' response to government CSR demands.

This work examines how firm characteristics, especially different political ties, affect the variations in firms' responsiveness to government CSR pressure. Building upon the literature on political CSR (Scherer & Palazzo, 2007), this study differentiates two types of political connections: connections to insiders in the political system (i.e. bureaucratic politicians) and connections to peripherals (i.e. symbolic politicians) in the political system. While the literature on political CSR suggests that firms assume part of the state's responsibility to fulfil "governance voids", I posit that active CSR activities may instead de-legitimate the state, as this likely signal the state's incapacity to effectively deal with natural disaster management. Therefore, firms with certain types of political connections may instead curb CSR activities. However, firms with connections to officials peripheral in the political system positively influence corporate donations due to their visibility and susceptibility to public pressure.

I develop my theoretical arguments and test my hypotheses in the context of the Sichuan earthquake donations of all Chinese publicly listed firms in 2008, which provides several advantages for this study. First, this earthquake was the most catastrophic disaster in the past 30 years, claiming the lives of around 69,000 people and leaving 18,900 homeless. After this earthquake, there are no precedents for firms to follow about how to respond to this catastrophic event. Hence, corporate donations would be a good proxy for firms' responsiveness to government CSR pressure. Second, China is a country that achieves spectacular economic growth despite limited political reforms, and the state government still holds great control of economic and political resources. After the earthquake, the Chinese government did not mandate corporate donation but indicated that individuals and firms are 'encouraged' to donate (Jia & Zhang, 2011). Hence, firms' responsiveness to government pressure could be conceptualized as firms' motivation to manage the firm-state relationship. Third, political ties are stable and path-dependent (Siegel, 2007). This disruptive event providing a *natural experiment setting* helps us verify the causality between political ties and donation and further allows me to unravel the impacts of differential political ties on firms' strategic responses to government pressure.

My empirical findings confirm that firms with more directors peripheral in the political system (i.e. symbolic directors[21]) will donate more generously due to their relatively disadvantaged power status in the political institution and susceptibility to public pressure. In contrast, firms with more directors more embedded in the political system (i.e. bureaucratic directors) will make far fewer donations because donations may delegitimize the role of the state. Then I examine the contingent factors that weaken or strengthen the relationship between political ties and donation and find that corporate performance and political legacy will condition this relationship.

This study makes several contributions. First, the extant literature on CSR only provides an economic perspective of CSR but ignores other social-political factors that may also drive firms' willingness to be socially responsible. Drawing upon the literature on political CSR, I extend current research on the antecedents of CSR by incorporating political connections that

[21] All congressmen in China are part-time politicians, which is different from congressmen in the U.S. context.

drive firms' social actions. For the literature on stakeholder theory, I identify heterogeneity within the stakeholder group, i.e. insiders and peripherals within the political system, while previous studies tend to view the state as a homogenous stakeholder group (Wang & Qian, 2011).

Second, I extend research on political ties to the context of CSR, which is of strategic importance for firms. In particular, I distinguish the heterogeneity of political ties, usually considered homogenous in previous literature (Wang & Qian, 2011). My theoretical extensions also explain why and how certain types of political connections are more receptive to corporate social responsiveness and motivate firms to take actions beyond regulatory demands. By identifying the institutional sources of political tie heterogeneity and how such heterogeneity influences corporate social behaviour, this paper provides new perspectives on the sources of variations in firms' strategic choice. Overall, this paper not only contributes to the literature on corporate social responsiveness but also provides empirical evidence on the importance of political ties.

5.2 RESEARCH CONTEXT

CSR in China

After the Communist Party assumed control of China in 1949, the social welfare system has since been a highly centralized system. The communist government has the tradition of state control and assistance, including social welfare services. One salient example is that most NGOs in China are not privately owned in a conventional sense; instead they are 'guided' by the Chinese government, so are in fact government-organized NGOs (GONGOs), which is distinctly different from western countries (Spires, 2011). For instance, the Red Cross in China is in effect a partial-governmental organization and the directors or leaders of that organization are quasi- government officials. The central planning of the social welfare system has limited the role of civil organizations and corporations, thus it is widely accepted that it is the government's responsibility to provides social welfare services. There was even anecdotal evidence showing that after the Sichuan earthquake in 2008, the immediate response of the government was not to allow the private sector and international search-and-rescue teams to enter the earthquake-stricken area, as the government preferred to take full control of the rescue process. Before the Sichuan earthquake in 2008, general civil society was still reticent about the social responsibilities of corporations and CSR in China was still at an early stage. Overall, until 2008 China still represented a state-led CSR society, and corporate social engagement remained limited.

5.3 THEORY AND RELATED RESEARCH

Political CSR

The literature on political CSR emphasizes the political role of corporations civil society, suggesting that corporates are expected to participate in activities that are traditionally regarded as government responsibilities such as education or infrastructures (Scherer & Palazzo, 2007). Some corporates have started to assume part of the state's role (Crane, Matten, Moon, & Moon, 2008) and played an important role in the provision of public goods such as education or social security to address those "governance gaps."

The political CSR literature also shows that corporate engagement in these social initiatives may vary deepening on corporations' vulnerability to public pressure, suggesting that firms' CSR practices may be shaped by their firm characteristics as well as political environments. For instance, firms are expected to fill governance void left by the weak government (Scherer & Palazzo, 2007). Also, firms not only care about demands from the state but also cater to a wider range of stakeholders such as civil society in general and local communities in particular. Therefore, corporates, to a certain degree, are expected to help advance the interests of citizens or even resolve societal problems (Matten & Crane, 2005).

Despite these insights, this line of literature tends to be more normative and the mechanisms about what types of firms are more likely to engage in political CSR still remain relatively unexplored. However, the active role of corporates in these social problems may undermine the state's capacities and even de-legitimize the existence of the state, as it is expected that the government should provide those social welfare such as education or health care services.

In this study, I draw upon the literature on political CSR and suggest that directors, occupying a higher position inside organizations, may exert differential effects on corporate philanthropy due to directors' linkages to the state. Considering the recent rise of a new class of politicians in China, I differentiate two types of political ties: connections to government officials embedded in the political system and connections to members of the congress peripheral in the political system. Specifically, I expect that directors who are or were government officials (i.e. bureaucratic directors) have a negative impact on the amount donated, while directors who are or were parliament members (i.e. symbolic directors) exert a positive effect, due to their different susceptibility to public pressure. Table 5-1 provides a summary of the two types of directors with connections to the government (i.e. bureaucratic directors) and congress (i.e. symbolic directors) respectively. Moreover, I also suggest that these relationships will be moderated by organizational factors such as firm recent performance and political legacy. My hypotheses are summarized in Figure 5-1.

TABLE 5-1: Comparisons of Bureaucratic and Symbolic Officials in the Political System

Type	**Bureaucratic officials**	**Symbolic officials**
Definition	Government officials	Mainly Congressman-type
Job type	Full-time	Part-time
Political institution	State Council, Ministry of Foreign Affairs, Ministry of Public Security, etc.	People's Congress (PC) Chinese People's Political Consultative Conference (CPCC)
Government function	Administrative affairs	PC: the passage of law CPCC: consultancy
Example	Directors with working experiences in the state institutions	Private entrepreneurs (17% in 2008) who become members in the above two political institutions

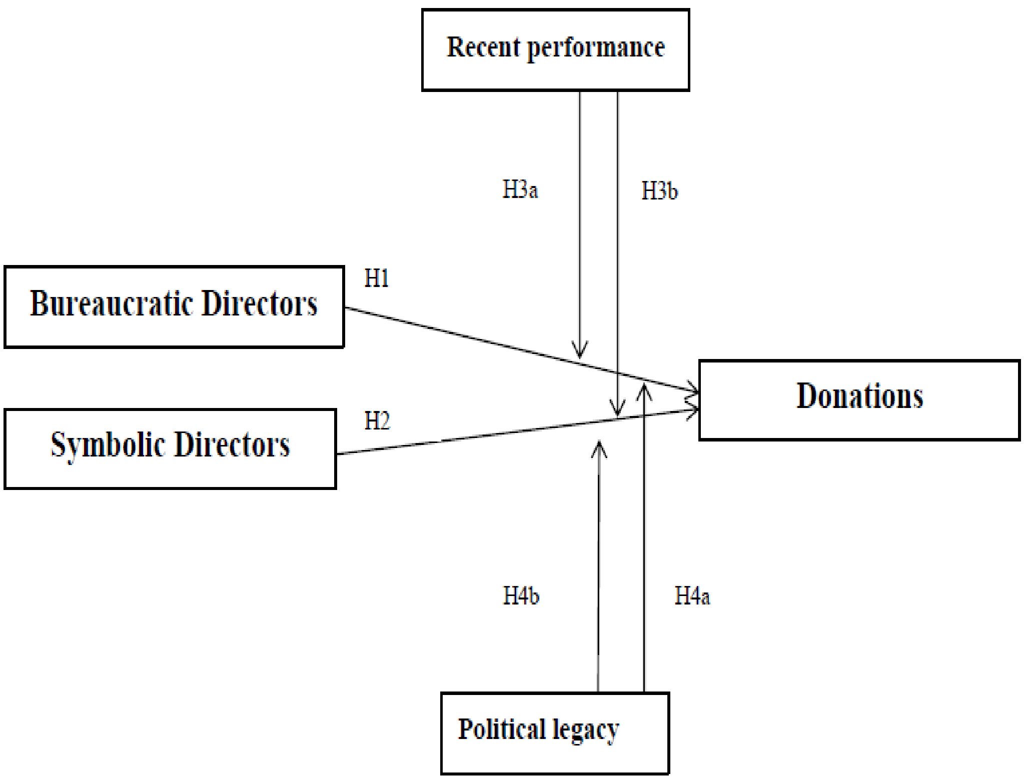


FIGURE 5-1: Model of the Impact of Bureaucratic/ Symbolic Directors on Donations

5.4 HYPOTHESIS DEVELOPMENT

The Role of Bureaucratic Directors in Corporate Donations

Bureaucratic directors are directors who hold or held positions in current/former central or local governments which are more inside the Communist Party system[22]. In the following section, I explore how bureaucratic directors in a focal firm will impact corporate donations and expect that bureaucratic directors may exert a negative impact on corporate donations for the following two reasons.

First, bureaucratic directors are more likely to regard disaster relief efforts as the responsibility of the government instead of the firm (Scherer & Palazzo, 2011). As outlined in the previous section, after the CPC takeover in 1949, China traditionally established a disaster relief system featuring central control with the State Council responsible for disaster relief efforts. By building a multi-layered governmental organization, central and local governments have their respective responsibilities for disaster relief. Specifically, the central government sets up different organizational units such as the National Commission for Disaster Reduction responsible for providing social services such as shelter or housing. Local governments set up corresponding units in order to implement rules from the central government. In an authoritarian regime such as China, the state legitimates its sovereignty by its capacity to govern the state, especially in periods of economic downturns or financial crisis. In the case of disaster relief efforts, bureaucratic directors may be concerned that corporate active engagement in CSR may instead de-legitimize the state in the eyes of the public because the state should take the full responsibility of disaster relief efforts. That is, corporate donations may signal the state's incapacity to manage natural disasters, thus likely undermining the state's capacity to deal with the societal problems.

[22] In China legislators are part-time politicians holding positions in the legislative bodies as well as in central or local governments. Government official are full-time politicians. In our empirical analysis, if someone holds/held positions in the legislative bodies and government- systems at the same time, we coded them as bureaucratic directors. This ensures that symbolic directors all come from the private sector.

Second, bureaucratic directors, as insiders in the political system, are more insulated from public pressure due to their direct linkages to the Party. Even though the public pressured firms to engage in disaster relief efforts, either through media or the Internet (Luo, Zhang, & Marquis, 2016b; Zhang & Luo, 2013), firms with more bureaucratic directors are more likely to remain legitimate in the eyes of the public due to directors' direct linkages to the Party. Therefore, firms with more bureaucratic directors are more immune from public pressure. Accordingly, this type of firms will be more cautious in ratifying the amount of donations after this disaster and will have a negative impact on the amount donated. Thus I predict:

Hypothesis 1 (H1): Firms with higher proportions of bureaucratic directors will donate less than firms with lower proportions of bureaucratic directors.

The Role of Symbolic Directors in Corporate Donations

Symbolic directors are defined as those independent directors who occupy more peripheral positions in the political system, such as members of Chinese People's Political Consultative Conference (CPCC) and People's Congress (PC). Unlike their counterparts (i.e. congressman) in the U.S., this type of politicians in China are all part-time politicians. For instance, national level symbolic politicians are only required to convene once a year. Another typical feature is that these politicians have no real power over resource allocation and have limited influence over policy making by only providing advice or suggestions to the government. CPCC is a political advisory body and provides political consultation on government-related matters under the leadership of Chinese Communist Party. PC, by Chinese constitution, is the highest organ of state power in China (equivalent to Congress in the U.S.) and takes the responsibility for enacting and passing the law (but in reality the PC is just the rubber stamp for the Communist Party). Theoretically, the members of CPCC and PC[23] are 'elected' by people or members of other lower levels of CPCC or PC. But in reality the candidates for the elections are first 'screened' by the Communist Party and the election results are mostly manipulated or controlled by the Communist Party (O'Brien, 2008). As a previous legislator in PC, Hu Xiaoyan, said "As a legislative representative, I don't have any real power" (Truex, 2014). In sum, both the PC and the CPCC have limited influence in the government administrative system (Lieberthal, 1995).

For symbolic politicians, their political status is mainly conferred by the government. It is obtaining favours from the state instead of winning votes that plays a key role in their admission into these political positions (Liew, 2005). Therefore, their political status is less stable because there are no specific rules to win governments' favours. In recent years behaving in a socially responsible way has played an important role in the membership selection process (Lu, 2014). Due to their limited power in the political system, this type of directors, more peripheral in the political system, will be more attentive to stakeholders' demands. Hence, firms with more symbolic directors may be more susceptible to public pressure for corporate social responsiveness such as donations. Moreover, symbolic directors may also take this disaster donation as an opportunity to show their social conscience and accountability to local communities. Following these lines, I expect that symbolic directors have a positive impact on the amount donated due to their caring for the general society. I propose the following hypothesis:

Hypothesis 2 (H2): Firms with higher proportions of symbolic directors will donate more than firms with lower proportions of symbolic directors.

Moderating Mechanisms

[23] Both PC and CPCC have five administrative levels: nation, province, city, county, and township.

The moderating role of corporate recent performance

The impact of different political ties can vary substantially across different organizations. In the context of corporate donations, I highlight two key organizational factors — corporate recent performance and political legacy — that may moderate the impact of political ties on donations.

The first moderating factor is corporate recent performance, which plays an important role, as firms' willingness and ability to donate are highly contingent on the availability of corporate resources. Past studies have demonstrated that better-performing firms usually donate more, indicating that firms are willing to do CSR if they have sufficient financial resources (Orlitzky, Schmidt, & Rynes, 2003). Building on these arguments, I expect that the relationship between political ties and corporate donations may depend on corporate performances, with directors inside and peripheral in the political system influenced differently.

If a director peripheral in the political system is more susceptible to public pressure, they will be less sensitive to the adverse effects of downturns in firm performance. When corporate recent financial performance is not satisfactory, they still donate as they will regard it as an important way to manage relationships with key stakeholders such as community or states. Along these lines, it's likely that directors peripheral in the political system are less sensitive to corporate performance, as they support corporate philanthropy regardless of whether firms perform well or not. Hence, I suggest that the relationship between directors peripheral in the political system and donations is less likely influenced by firm performance.

In contrast, directors inside the political system, who are more skeptical of the value of corporate donations, likely regard disaster relief efforts as the government's responsibility. If corporates actively engage in disaster relief efforts, they may think that corporate philanthropy may de-legitimize the state. Therefore, directors inside the political system are more likely to support corporate philanthropy only if their firms can afford to do so. Moreover, disaster relief usually attracts great public attention so firms are also under pressures from other stakeholders such as consumers or Internet users. For example, recently Internet users in China used online forums to encourage people to donate and even criticized companies that donated less earthquake relief (Zhang & Luo, 2013). Also, Vanke Real Estate Group, one of the largest real estate companies in China, was criticized for its modest donations of about RMB 2 million, compared with its annual sales of RMB 44 billion in 2007. Bureaucratic directors may compromise their concerns about corporate donations only when firms have available resources to do so, hence, the negative impact of bureaucratic directors on the amount donated will become weaker for firms with greater financial resources. To sum up, I propose:

Hypothesis 3a: The moderating effect of firm's recent performance exerts a positive impact on the relationship between higher proportions of bureaucratic directors and the amount donated.

Hypothesis 3b: However, the moderating effect of firm's recent performance exerts no impact on the relationship between higher proportions of bureaucratic directors and the amount donated.

The moderating role of political legacy

While the arguments of different political ties have been developed in the previous section, I suggest that the effect of political ties is also likely contingent on the institutional environments in which actors are embedded, with imprinting theory suggesting that this environment at foundation could imprint on an organization's practices, structure and strategies (Marquis & Tilcsik, 2013). Marquis and Tilcsik (2013: 201) further demonstrate that imprinting is "a process whereby, during a brief period of susceptibility, a focal entity develops characteristics that reflect prominent features of the environment, and these characteristics continue to persist despite significant environmental changes in subsequent periods." In other words, this imprinting view suggests that organizations inherit characteristics such as sticky capabilities (Szulanski, 1996), stable routines (Nelson & Winter, 2009) or rigid cognitive schemas (Levitt & March, 1988) from their past. Hence, it is expected that the founding era of firms is likely to moderate the impact of political ties on the amount donated.

Recent studies have suggested that institutional environments at firms' foundation consistently shape firms' internal routines relating to subsequent strategies and organizational structures (Zhang, Tan, & Tan, 2014). Moreover, the socialist imprinting effect is even more salient for countries that underwent slow and gradual market reforms such as China (Han, Zheng, & Xu, 2014). For instance, firms established in the socialist era may therefore exhibit inertia when the changing market environments call for different strategies. Specifically, Chinese state-owned enterprises imbued with the socialist institutional logics of managing labor relations, tend to provide social insurance policies for workers even in the face of the market economy (Han et al., 2014). Marquis and Qian (2013) also find that older Chinese firms are less likely to pursue new CSR practices such as the issue of CSR reports, as they cannot adapt to the new trend of CSR. Similarly, Zhang et al. (2014) find that socialist imprinting affects firms' subsequent network actions and configurations, because the old cohort of Chinese ventures is more likely to develop strong political ties while the new cohort of ventures is more inclined to establish more diverse market ties. These findings suggest that the founding era of firms has a long-lasting imprinting effect on subsequent corporate behaviour. These arguments suggest that older firms, founded in the socialist era when the government played a dominant role in providing social welfare services, inherit more socialist routines and may be skeptical of corporate philanthropy. From the perspective of organization imprinting theory (Marquis & Tilcsik, 2013), older firms may be expected to inherit a more socialist legacy and this socialist legacy may inhibit firms' adaptation to new market practices such as corporate disaster donations.

In the case of corporate donation, firms founded in a socialist period are more likely to be imbued with the social legacy that sees corporate philanthropy as incompatible with their principles. For bureaucratic directors more embedded in the political system, they are more likely to find that organizational routines or the culture of older firms are compatible with their socialist logic. They do not feel the obligation to donate and also tend to decide on a lower level of corporate donations, as doing so is consistent with the established traditions of older firms. In contrast, directors peripheral in the political system are originally prone to donate more, but their decisions may be constrained by organizational routines or culture. For example, older firms may not exhibit those routinized practices that allow for immediate responses to disaster donations. The socialist culture or legacy may even hinder the development of philanthropic values espoused by directors peripheral the political system, i.e. symbolic directors. Taken together, it would be expected that the negative impact of bureaucratic directors on the amount donated will become stronger for older firms. Moreover, the positive impact of symbolic directors on the amount donated will become weaker for older firms. Hence, I propose the following hypotheses:

Hypothesis 4a: The negative relationship between firms with higher proportions of bureaucratic directors and the amount donated will become stronger for older firms.

Hypothesis 4b: The positive relationship between firms with higher proportions of symbolic directors and the amount donated will become weaker for older firms.

5.5 EMPIRICAL ANALYSIS

My empirical analysis is based on the amount of corporate donations after the Sichuan Earthquake in 2008. This setting is similar to previous studies using corporate philanthropic behaviour after natural disasters (Tilcsik & Marquis, 2013). To obtain a comprehensive picture of corporate politically connected directors, the sample includes all listed firms in China. Donation information is based on firms' self-reporting donation amount[24], consistent with the approach in previous works (Muller & Whiteman, 2009). I also searched for related news from China Core Newspapers Database (CCND), which provides some donations news from listed firms. After deleting observations with missing values, the sample includes 1,498 listed firms of which 296 donated after the Sichuan earthquake. Other firm-level variables are also from CSMAR.

There may be concerns that firms that donate may be systematically different from firms which did not, thus leading to selection bias (Heckman, 1979). To address this concern, I used Heckman's two-stage selection where the first stage is a probit model to investigate firms' propensity to donate and the second stage investigates the impact of politically connected directors on the amount donated. Although the Heckman two-step procedures are more commonly employed in management research, the estimators are less efficient (Green, 1999); so I employ the full information maximum likelihood (FIML) method which estimates the two steps simultaneously. To control for potential correlations among observation in a certain region (6 regions) and industry (22 industry classifications), I cluster the standard errors at the level of the region-industry pair (Cameron & Miller, 2013). To alleviate

[24] Given the fact that donations will bring firms reputation effects and attract positive media coverage, it is unlikely that firms which donated did not report the amount.

concerns of reverse causality, all independent and control variables are lagged by one year in my analysis.

In order to satisfy exclusion restrictions, the Heckman method requires that at least one variable included in the first stage model is excluded from the second stage. I choose as the instrumental variable the stock exchange where the firm is listed. *Stock exchange* is a dummy variable that is equal to 1 if the firm is listed in the Shanghai Stock Exchange and is equal to 0 if the firm is listed in the Shenzhen Stock Exchange. I choose this dummy variable as an exclusion restriction, as the headquarters of firms listed in the Shanghai Stock Exchange are usually far away from the Sichuan province, thus reducing firm's exposure to this earthquake and their likelihood to donate. I expect that this dummy is not related to the amount donated, as there is no prior theoretical relationship between the stock exchange listing and the amount donated.

Dependent variable

The dependent variable (*donation*) is the amount of corporate donation for the Sichuan earthquake. I collected donation information from the media and most popular websites in China such as *sina.com* or *beidu.com.* (the two most popular search engines in China). This event was the most catastrophic event in the last four decades, and the media paid great attention to this event and Internet users also kept an eye on corporate donation amounts. Moreover, I also collected donation amounts from the Shanghai and Shenzhen Stock Exchange official website. I take the natural logarithm of this variable, as the distribution of the variable is skewed[25](Zhang & Luo, 2013).

Independent variables

[25] We used the *sktest* command in Stata and reject the null hypothesis that the original donation amount is normally distributed ($p<0.001$).

Like previous studies (Chizema et al., 2014), I focus on the role of independent directors and collected background information on the board of independent directors from the "Profile of Directors and Senior Managers" section in the annual reports of the companies in my sample. I classified an independent director as a bureaucratic director if he/she holds or held political positions in the Chinese central or local governments, while I classified an independent director as a symbolic director if he/she holds or held positions in PC or CPPCC. I then derived my variable *Bureaucratic directors* as the ratio of the number of bureaucratic independent directors to the total number of independent directors. Similarly the *Symbolic directors* variable is equal to the ratio of the number of symbolic independent directors to the total number of independent directors. Thus for each firm I obtained two continuous variables one measuring the relative strength of bureaucratic directors and one measuring the relative strength of symbolic directors.

To illustrate the career paths of bureaucratic and symbolic independent directors, I report in Table 5-2 the background information for two directors in my sample. Director A spent most of his life in government institutions. He held several positions in local government ranging from city mayor to party secretary of the city. In contrast, director B spent most of his career in the private sector and was later elected as a member of the CPPCC in the Shaanxi province. This clearly shows that although both directors held political positions their career paths are completely different, which results in very diverse political power in the political system.

TABLE 5:2: Examples of Independent Director Career Path

	Career path	Type of directors
Director A	• **Former deputy party secretary** of Wujiang Municipal • **Government Mayor** • Member of the Municipal Committee	Bureaucratic directors
Director B	• General manager of China Electronics Import and Export Shaanxi Corporation • Managing Director of Hong Kong Li Shan • Executive Director of Hong Kong Hui • Executive director of the Australian Tat management companies • Chairman of China Southern Light Shenzhen • Executive vice president and honorary president of Hong Kong Shaanxi Association, • Member of **Shaanxi Provincial CPPCC**	Symbolic directors

Moderating variables

To measure firms' recent performance, I used return on equity (ROE), which is defined as the ratio of net profits to shareholder's equity. Information on company financial reports was taken from the CSMAR database. *ROE* captures firms' recent financial performance (Fang, Nofsinger, & Quan, 2015). To measure a company political legacy, I used the number of years since the firm was established (*Age*). I assume that older firms are imbued with communist ideology while firms established more recently are less so (Marquis & Qian, 2013).

Control variables

To control for the potential impacts of other factors that may confound the effects of politically connected directors, a number of control variables at the firm, the board and the province level are included. The level of financial leverage measured by the ratio of total debt to total assets (*Debt ratio*) was included to control for any variation in firms. *Firm size*, measured by the logarithm value of the number of employees, was included to control for the resources available for donation (Zhang, Rezaee, & Zhu, 2010). I also control for the social linkages between the firm and the province affected by the earthquake by including a dummy variable (*Social capital*) which is equal to 1 if the chairperson of a firm's board of directors worked or studied in the Sichuan province. I can expect chairmen with such linkages to the disaster-stricken areas to exert a strong pressure on the board of directors to donate more. The amount donated will also be a function of whether the firm is located in disaster-stricken regions (Crampton & Patten, 2008; Muller & Whiteman, 2009). To control for this, I included a dummy variable (*Affected*) which is equal to 1 if the firm's headquarters are in Sichuan province.

In order to capture the firm's previous CSR commitment I measured average corporate donations in the past three years (2005 to 2007) (*Average donation*), collected from the CSMAR database. I also control for firms' previous CSR activities by including a dummy that is equal to 1 if firms issued a CSR report in 2007 and 0 otherwise (*CSR report*). The influence exerted by each director on the amount donated will be affected by the size of the board. So, to control for this effect I included a variable *Number of directors* which measures the total number of directors in each firm. The composition of the board of directors in terms of those with international experience and in consideration of gender composition can also have an impact on the donations made by a firm. I calculated the ratio of the number of independent directors working or studying abroad to the total number of independent directors (*International directors*) to control for the potential effect of exposure to more advanced CSR and philanthropic practices on the decision of the board. Women have been found to be more sensitive to CSR-related issues (Ben-Amar, Chang, & McIlkenny, 2015). I therefore control for this potential gender impact by measuring the share of female independent directors to the total number of independent directors (*Female directors*). The ownership structure of a firm will also play an important role in determining the level of funding that a company will be willing to donate; in particular foreign owned firms will be more inclined to donate more as they may face more pressure from foreign investors. However, I expect that state owned firms may donate less as their decision-making is more constrained by the government. I control for whether a company is foreign owned by including a dummy variable equal to 1 if the ultimate controller of a firm is a foreign institution (*Foreign ownership*). Similarly, I include a dummy variable (*State ownership*) equal to 1 if the ultimate controller of the firm is local or central government.

The regional context in which a company operates and especially the level of development in institutions supporting the functioning of the market mechanisms and facilitating market transactions can also affect the amount donated. I control for provincial differences in institutional environment (*Institutional level*) by using the provincial-level index developed by the National Economic Research Institute (NERI) database that measures the level of market development in each province and has been widely used in previous management research and is reflective of the market development in China (Chang & Wu, 2013; Jia, 2014). Finally to capture other unobserved heterogeneity at the provincial and industry level I added province and industry fixed effects. Table 5-3 summarizes the definition and sources of these variables.

TABLE 5-3: Definition of Variables

Variables	Definition	Source
Dependent Variable		
Donation	The log value of the amount donated for the Sichuan Earthquake	Sina and Baidu website
Independent Variables		
Bureaucratic directors	= number of bureaucratic independent directors/ total number of independent directors	CSMAR
Symbolic directors	= number of symbolic independent directors/ total number of independent directors	CSMAR
Moderating variables		
ROE	Net profit/total equity	CSMAR
Age	The log value of the number of years since the since the firm was incorporated	CSMAR
Control Variables		
Debt ratio	= total debt/total asset	CSMAR
Firm size	The log value of firm total assets	CSMAR
Social capital	= 1 if the board chairman is from the Sichuan province; =0 otherwise	CSMAR
Affected	= 1 if the stock was not traded after the earthquake; =0 otherwise	CSMAR
Average donation	The average amount of corporate donations in 2005 to 2007	CSMAR
CSR report	= 1 if the firm issued CSR report in 2007; =0 otherwise	Company website
International directors	= number of female independent directors/ total number of independent directors	CSMAR
Female directors	= number of independent directors with international experience/ total number of independent directors	CSMAR
Number of directors	The number of board of directors	CSMAR
State ownership	= 1 if the ultimate controller of the firm is local/central government; =o otherwise	CSMAR
Foreign ownership	= 1 if the ultimate controller of the firm is foreign institution; =o otherwise	CSMAR
Institutional level	The market development index in NERI	NERI
Instrument		
Stock exchange	= 1 if the firm is listed in the Shanghai Stock Exchange; = 0 if in the Shenzhen Stock Exchange	CSMAR

TABLE 5-4: Descriptive Statistics and Correlation Matrix

	Mean	S.D.	Min	Max	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
1. Donation[a]	4.928	1.343	0	8.613	1																
2. Debt ratio	0.756	4.137	0	124.022	0.102	1															
3. Firm size[b]	21.465	1.438	14.158	29.793	0.125	-0.215	1														
4. Social capital	0.053	0.225	0	1	0.059	0.076	-0.069	1													
5. Affected	0.04	0.195	0	1	0.011	-0.008	-0.046	0.426	1												
6. Average donation	6.387	56.443	0	1520	0.189	-0.004	0.138	-0.009	-0.005	1											
7. CSR report	0.033	0.177	0	1	0.037	-0.01	0.002	-0.011	-0.037	0.015	1										
8. Number of directors	9.578	2.168	5	19	0.023	-0.034	0.251	-0.013	-0.023	0.06	0.009	1									
9. International directors	0.019	0.084	0	1	0.014	-0.01	0.16	0.017	-0.01	0.017	0.029	0.033	1								
10. Female directors	0.845	0.234	0	1	0.031	-0.015	0.11	0.001	0.05	0.012	0.024	0.057	0.029	1							
11. State ownership	0.628	0.484	0	1	0.096	-0.066	0.311	-0.044	-0.035	0.044	-0.026	0.122	-0.049	0.072	1						
12. foreign ownership	0.035	0.183	0	1	0.038	0	0.02	0.02	-0.001	-0.013	-0.015	-0.01	0.158	-0.017	-0.246	1					
13. Institutional level	8.863	2.119	4.25	11.71	-0.022	0.004	0.068	-0.086	-0.104	0.005	0.035	-0.003	0.098	-0.052	-0.127	0.037	1				
14. ROE	0.356	0.567	-3.15	5.53	0.037	0.072	0.264	-0.037	-0.01	0.13	0.02	0.088	0.029	0.013	0.008	-0.002	0.058	1			
15. Age[b]	2.529	0.354	0.693	3.367	0.176	0.075	-0.02	0.086	0.121	-0.038	-0.039	-0.075	-0.043	-0.052	0.08	0.042	-0.017	-0.136	1		
16. Bureaucratic directors	0.069	0.182	0	1	-0.068	0.085	-0.018	0.022	0.003	-0.024	0.038	0.012	0.036	0.017	-0.007	0.023	-0.007	-0.009	0.034	1	
17. Symbolic directors	0.023	0.112	0	1	0.008	0.078	0	-0.01	-0.037	-0.006	-0.022	0.012	-0.017	0.017	-0.006	-0.04	0.007	0.062	-0.058	0.043	1

Notes. The number of observations is 1,496. * Significant at the 5% level.

a The donation amount is calculated as log (donation value). Descriptive statistics of *Donation* are based on 296 observations.

b Logged.

5.6 FINDINGS

Table 5-4 shows the descriptive statistics and correlation matrix for all the variables. The variance inflation factors (VIF) further show that the average VIF index is 1.12 (well below the threshold value of 10), indicating no concerns about multicollinearity between these variables.

The first stage probit model predicts the propensity of firms to donate. The results in Table 5-5 show that firms in the Shanghai Stock Exchange (i.e. instrumental variable) are less likely to donate (coefficient = -0.191, $p < 0.05$)[26]. The Wald test for independent equations between the selection equation and the outcome equation indicates that selection bias is not affecting my results (Chi-square (1) = 0.05, $p = 0.8305$).

[26] In the first-stage analysis, we added the instrumental variables and all control variables included in the second stage, except for the interaction terms.

TABLE 5-5: Heckman Selection Model (FIML Method)

	Model 1	Model 2	Model 3	Model 4	Model 5	Model 6	Model 7	selection
Stock exchange								**-0.191****
								(0.087)
Debt ratio	0.205	0.172	0.202	0.168	0.156	0.175	0.167	-0.059
	(0.254)	(0.240)	(0.253)	(0.240)	(0.250)	(0.236)	(0.254)	(0.078)
Firm size	0.025	0.023	0.025	0.023	0.026	0.035	0.037	0.021
	(0.071)	(0.069)	(0.071)	(0.070)	(0.069)	(0.069)	(0.069)	(0.035)
Social capital	0.307	0.275	0.295	0.265	0.271	0.214	0.202	0.256
	(0.434)	(0.379)	(0.433)	(0.380)	(0.444)	(0.410)	(0.597)	(0.203)
Affected	-0.306	-0.404	-0.252	-0.346	-0.459	-0.487	-0.615	0.796
	(0.783)	(0.626)	(0.780)	(0.632)	(0.775)	(0.613)	(0.979)	(0.788)
Average donation	0.011***	0.011***	0.011***	0.011***	0.011***	0.012***	0.012***	-0.001
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.001)
CSR report	0.078	0.097	0.081	0.101	0.021	0.110	0.029	-0.018
	(0.343)	(0.338)	(0.343)	(0.339)	(0.309)	(0.327)	(0.301)	(0.271)
Number of directors	0.023	0.029	0.022	0.028	0.036	0.014	0.026	0.005
	(0.037)	(0.035)	(0.037)	(0.036)	(0.036)	(0.034)	(0.036)	(0.018)
International directors	0.379	0.268	0.385	0.278	0.200	0.473	0.320	0.570
	(0.689)	(0.566)	(0.677)	(0.562)	(0.668)	(0.598)	(0.892)	(0.426)
Female directors	0.105	0.117	0.102	0.115	0.046	0.055	-0.027	0.240
	(0.457)	(0.440)	(0.458)	(0.441)	(0.436)	(0.431)	(0.471)	(0.174)
State ownership	0.095	0.089	0.100	0.094	0.016	0.074	-0.004	0.034
	(0.218)	(0.216)	(0.216)	(0.214)	(0.213)	(0.216)	(0.223)	(0.086)
Foreign ownership	0.601	0.613	0.609	0.622	0.595	0.442	0.435	0.270
	(0.446)	(0.436)	(0.445)	(0.434)	(0.423)	(0.431)	(0.485)	(0.207)
Institutional level	-0.199	-0.188	-0.187	-0.176	-0.194	-0.202*	-0.217*	-0.016
	(0.126)	(0.123)	(0.121)	(0.118)	(0.120)	(0.116)	(0.116)	(0.068)
ROE	0.092	0.085	0.078	0.071	-0.099	0.082	-0.084	0.029
	(0.167)	(0.160)	(0.172)	(0.165)	(0.198)	(0.167)	(0.210)	(0.069)
Age	0.677**	0.716***	0.683**	0.721***	0.729**	1.028***	1.017**	-0.224**
	(0.299)	(0.266)	(0.307)	(0.274)	(0.313)	(0.295)	(0.415)	(0.103)

H1: Bureaucratic directors		**-0.811****		**-0.812****	**-2.414*****	**8.083****	**4.108**	**-0.110**
		(0.365)		(0.367)	(0.571)	(3.266)	(3.112)	(0.222)
H2: Symbolic directors			**0.373**	**0.375**	**0.208**	**2.944*****	**3.037****	**0.056**
			(0.825)	(0.823)	(0.948)	(1.045)	(1.182)	(0.330)
H3a: ROE x bureaucratic directors					**3.919*****		**3.606*****	
					(0.948)		(0.842)	
H3b: ROE x symbolic directors					**0.0245**		**0.0492**	
					(0.912)		(0.876)	
H4a: Age x bureaucratic directors						**-3.564*****	**-2.559****	
						(1.327)	(1.263)	
H4b: Age x symbolic directors						**-1.183***	**-1.312****	
						(0.643)	(0.618)	
Province fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry fixed effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Constant	4.201*	4.178**	4.087*	4.053**	4.360**	3.656*	4.127	-0.992
	(2.205)	(1.874)	(2.134)	(1.837)	(2.155)	(1.877)	(2.876)	(1.117)
Observations	296	296	296	296	296	296	296	1,498
p-value	0.477	0.308	0.469	0.294	0.606	0.459	0.831	0.831
Log-Likelihood	-1184.069	-1182.188	-1183.915	-1182.028	-1175.222	-1177.922	-1172.327	-1172.327
Degree of freedom	62.000	63.000	63.000	64.000	66.000	65.000	67.000	67.000

Notes. Clustered standard errors by region-industry are in the parentheses.
*** p<0.01, ** p<0.05, * p<0.1

In Table 5-5, Model 1 is my baseline model including only my control variables. Models 2 and 3 add my main independent variables, i.e. *Bureaucratic directors* and *Symbolic directors* independently, while Model 4 includes both variables at the same time. Model 5 adds the interaction term of firm recent performance and bureaucratic directors. Model 6 adds the interaction term of firm age and symbolic directors. Model 7 is my full model with all the interaction terms.

I find support for Hypothesis 1 which predicted that bureaucratic directors have a negative impact on the amount donated. The coefficient of the *bureaucratic director* variable in Model 2 is negative and highly significant (coefficient = -0.811, $p < 0.05$). The coefficient of the *Symbolic director* variable in Model 3 is not significant but it is positive and significant in my full Model 7 (coefficient = 3.037, $p < 0.05$), supporting Hypothesis 2. In unreported analysis based on the coefficient estimates of Model 7, I calculated the marginal effects of my main explanatory variables and found that one additional bureaucratic director in a board of directors of 10 members will reduce the amount donated by RMB 24,133 on average, while one additional symbolic director in a board directors of 10 members will increase the amount donated by RMB 202,064 on average.

Hypothesis 3a predicts that the moderating effect of firms' recent performance on the amount donated is significant only for bureaucratic directors. As shown in Model 5, the coefficients of the interaction term between the *ROE* variable and the *bureaucratic directors* variable is significant and positive (coefficient = 3.919, $p < 0.01$). This indicates that bureaucratic directors are more sensitive to firms' recent financial performance. Namely, firms with higher proportions of bureaucratic directors are more likely to donate more only when the firm has better financial performance, supporting Hypothesis 3a. In Figure 5-2 the dashed line illustrates that this moderation effect is strong enough to make the negative effect of the *bureaucratic directors* variable positive when company performance is relatively high (i.e. *ROE* is equal to one standard deviation above and below the mean).

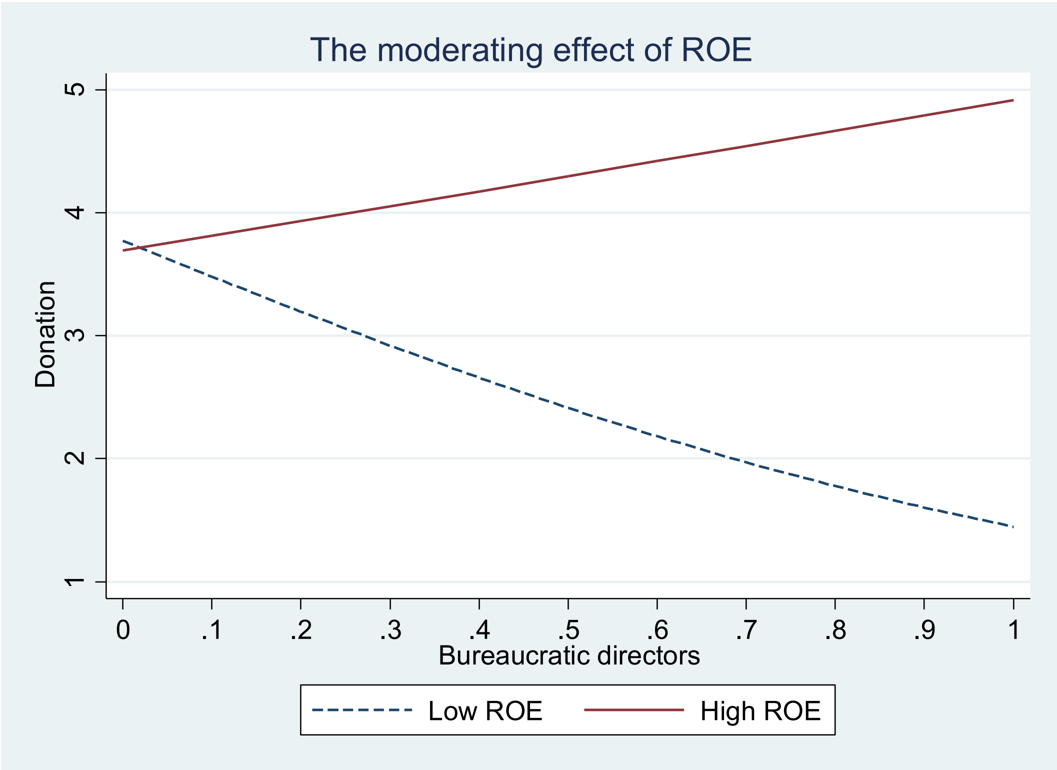


FIGURE 5-2: Graphic Presentations of the Interaction Effect between *Bureaucratic Directors* and (High/Low) *ROE*.

- Figure 5-2 graphs the predicted amount of donations between firms with a higher level of ROE and with a lower level of ROE, while all other explanatory variables are held at their mean values in Model 5 in Table 5-5. The solid line denotes firms with a higher level of ROE, while the dash line denotes firms with a lower level of ROE.

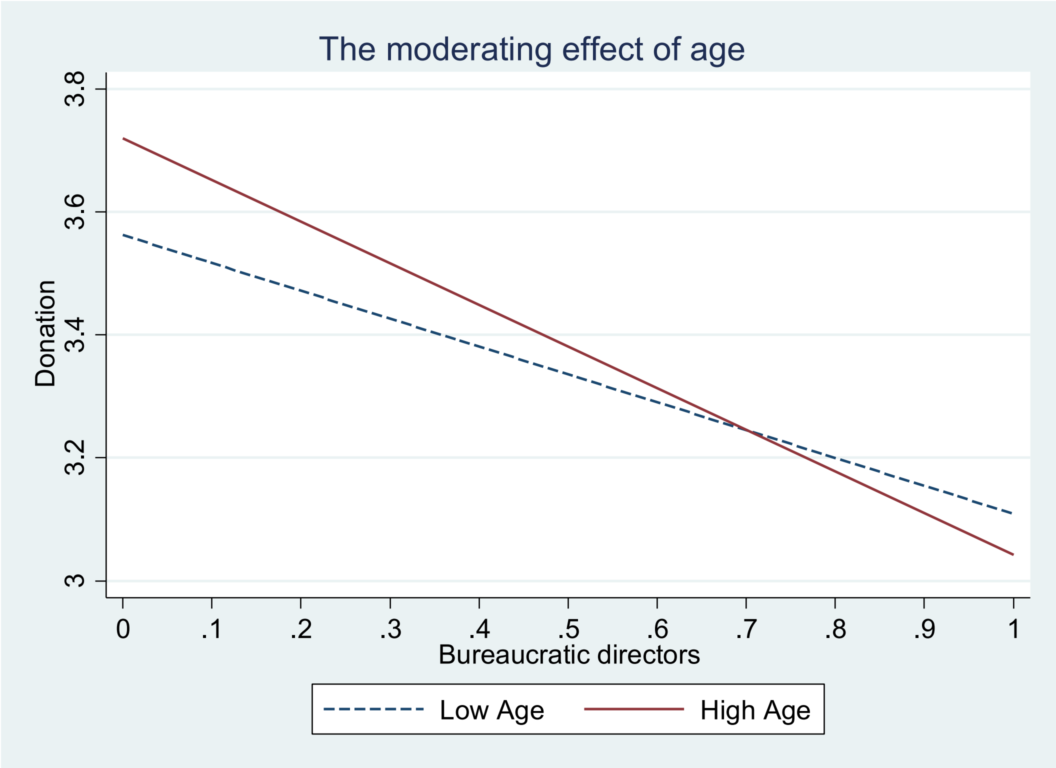
To test hypothesis 3b, I need to use power analysis. It's widely recognized that failure to reject the null hypothesis does not necessarily mean that the null hypothesis is true, as noted by Cohen (1992) who argued that, the null hypothesis could be "accepted" only if it's found to exert a trivial or negligible effect on the dependent variable. Following previous studies, I use power analysis to test the null hypothesis, a common method in behavioural sciences and management research (Cohen, 1992; Sun et al., 2015b). To proceed with power analysis, I first set the significance level α (the risk of type I error) to be equal to 0.05 and the power of the test to be 0.8 (i.e. the type II error risk $\beta = 0.2$), which are 'a convention proposed for general use' (Cohen, 1992). Moreover, given my interests in the effects of political connections on donations, my analysis is more appropriate in using the 'medium size' effect, which 'represents an effect likely to be visible to the naked eye of a careful observer'' (Cohen, 1992). Lastly, I also need to decide on sample size to attain the above power for the specified type I and type II errors. From Table 2 in Cohen (1992), I find that my sample size (i.e. 296) is larger than the minimum sample size (i.e. 107) required to test my null hypothesis.

My main estimation method is the Heckman selection model, but there are no ready procedures for power analysis in a selection model. As I do not suffer from selection bias in my analysis, my estimations based on ordinary least square (OLS) method do not significantly bias my empirical results. To simplify the procedures in power analysis, I turn to the OLS method to test H3b, which is also consistent with the method in Sun et al. (2015b). First I run an OLS regression containing all variables in Model 4, then I add the interaction term between the *symbolic director* variable and the *ROE* variable. From unreported analysis, I find that the coefficient for this interaction term is insignificant and the R^2 is far below the medium-sized threshold value (i.e. 0.13). Based on Cohen (1992), I consider that the effect is trivial as the resultant R^2 from my power analysis is smaller than 0.13. Hence I conclude that H3b could be accepted with the power of 0.8.

Hypotheses 4a and 4b assume that the negative impact of bureaucratic directors is stronger for older firms, while the positive impact of symbolic directors on the amount donated is weaker for older firms. In Model 6 the coefficients of the interaction terms between the *Age* variable and the *bureaucratic directors* and *symbolic directors* variables are both significant and negative (coefficient = -0.3564, $p < 0.01$; coefficient = -1.183, $p < 0.1$).

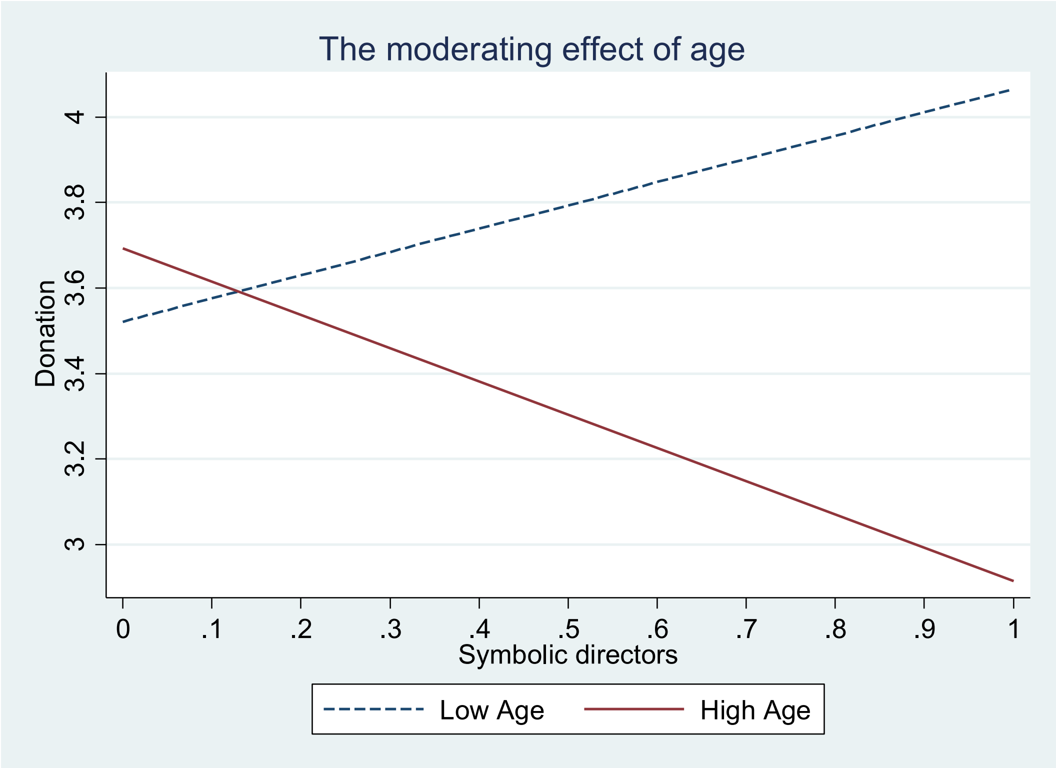
To better understand the overall impact of the moderation effect of age I plotted these moderation effect in Figure 5-3 which illustrates the impact of bureaucratic directors on the amount donated at high and low levels of age where high indicates one standard deviation above the mean (17.99 years) and low equals to one standard deviation below the mean (8.75 years).

FIGURE 5-3: Graphic Presentations of the Interaction Effect between *Bureaucratic Directors* and (High/Low) *Age*.



- Figure 5-3 graphs the predicted amount of donations between firms with a higher level of age and with a lower level of age, while all other explanatory variables are held at their mean values in Model 6 in Table 5-5. The solid line denotes firms with a higher level of age, while the dash line denotes firms with a lower level of age.

FIGURE 5-4: Graphic Presentations of the Interaction Effect between *Symbolic Directors* and (High/Low) *Age*.



- Figure 5-4 graphs the predicted amount of donations between firms with a higher level of age and with a lower level of age, while all other explanatory variables are held at their mean values in Model 6 in Table 5-5. The solid line denotes firms with a higher level of age, while the dash line denotes firms with a lower level of age.

Finally, from Model 7 my results for the control variables show a strong positive and significant effect of the average donations in the past three years (coefficient=0.012, $p < 0.01$) and a negative and significant effect of the institutional environment at the provincial level (coefficient= -0.217, $p < 0.1$). It is interesting to observe that the coefficient for the *state ownership* dummy variable is not significant, that may suggest that measuring political-connectedness with state ownership might be too crude to fully capture how the state influences the private sector.

Robustness

The findings thus far support my arguments that bureaucratic directors have a negative impact and symbolic directors have a positive effect on the amount donated. This section tests my hypotheses by using different operationalization of my main independent variables.

Alternative measures

I control for the robustness of my results when I use the *number* of bureaucratic independent directors and the *number* of symbolic independent directors in a firm rather than the share of such directors. Results are qualitatively similar to my previous findings, as reported in Table 5-6. Model 1 is the full model and the results are qualitatively similar to my previous findings. For instance, the *symbolic directors* variable has a positive impact on the amount donated (coefficient = 2.690, $p < 0.1$). The coefficient on the interaction term of the *bureaucratic directors* variable and the *Age* variable is significantly negative (coefficient = -0.8431, $p < 0.05$).

TABLE 5-6: Heckman Selection Regression (Robustness test)

	Model 1	Select	Model 2	Select
Stock exchange		**-0.198****		**-0.188***
		(0.083)		(0.129)
Debt ratio	0.179	-0.064	0.191	-0.058
	(0.228)	(0.078)	(0.243)	(0.078)
Firm size	0.043	0.022	0.023	0.021
	(0.067)	(0.035)	(0.070)	(0.036)
Social capital	0.179	0.260	0.303	0.256
	(0.520)	(0.203)	(0.384)	(0.201)
Affected	-0.725	0.798	-0.444	0.784
	(0.825)	(0.783)	(0.663)	(0.819)
Average donation	0.012***	-0.001	0.011***	-0.001
	(0.002)	(0.001)	(0.002)	(0.001)
CSR report	-0.030	-0.012	0.087	-0.022
	(0.287)	(0.269)	(0.335)	(0.281)
Number of directors	0.015	0.006	0.027	0.005
	(0.034)	(0.018)	(0.036)	(0.018)
International directors	0.311	0.584	0.307	0.560
	(0.767)	(0.422)	(0.585)	(0.441)
Female directors	-0.068	0.349**	0.100	0.240
	(0.502)	(0.161)	(0.441)	(0.173)
State ownership	-0.095	0.031	0.081	0.032
	(0.217)	(0.086)	(0.215)	(0.087)
Foreign ownership	0.355	0.282	0.595	0.268
	(0.458)	(0.206)	(0.436)	(0.216)
Institutional level	-0.213*	-0.014	-0.209	-0.018
	(0.110)	(0.069)	(0.130)	(0.067)
ROE	-0.172	0.019	0.108	0.031
	(0.204)	(0.069)	(0.165)	(0.068)
Age	1.086***	-0.211**	0.694***	-0.226**
	(0.371)	(0.102)	(0.359)	(0.105)
H1: Bureaucratic directors	**1.143**	**-0.081**		
	(1.029)	(0.082)		
H2: Symbolic directors	**2.690***	**0.081**		
	(1.379)	(0.138)		
H3a: ROE x bureaucratic directors	**1.575*****			
	(0.276)			
H3b: ROE x symbolic directors	**-0.010**			
	(0.136)			
H4a: Age x bureaucratic directors	**-0.843****			
	(0.426)			
H4b: Age x symbolic directors	**-1.081***			
	(0.599)			
H1: Political directors			**-0.521**	-0.069
			(0.359)	(0.170)
H3: ROE x political directors				
H5: Age x political directors				
Province fixed effect	Yes	Yes	Yes	Yes

Industry fixed effect	Yes	Yes	Yes	Yes
Constant	4.223	-1.127	4.364**	-0.975
	(2.610)	(1.119)	(1.922)	(1.111)
Observations	296	1,498	296	1,498
Wald test	0.026	0.026	1.012	0.031
p-value	0.871	0.871	0.314	0.859
Log-Likelihood	-1172.567	-1172.567	-1182.918	-1175.171
Degree of freedom	67.000	67.000	63.000	65.000

Notes. Clustered standard errors by region-industry are in the parentheses.
*** p<0.01, ** p<0.05, * p<0.1

It might be argued that it is not necessary to distinguish between different types of politically connected directors, as political ties are homogenous in its nature. I therefore test my hypotheses by constructing a new variable, in line with previous studies on political ties (Chizema et al., 2014), *Political directors* which is equal to the ratio of the number of independent directors with political experience to the total number of independent directors in a firm. The definition of independent directors with political experience means those who hold/held political positions in the government or members of PC or CPPCC without differentiating whether they started their career in the private sector or whether they have always being part of the political system. In Table 5-6, Model 2 shows that the coefficient of *Political director*s is not significant, indicating that without differentiating between different political ties I may underestimate the negative impact of bureaucratic directors. This lends support to my theoretical reasoning bureaucratic and symbolic directors exert opposing impacts on corporate social responsiveness.

5.7 DISCUSSION AND CONCLUSION

My work is motivated by a lack of understanding in the impact of multiple political ties on corporate social practices, especially for firms in emerging economies. Using data from earthquake donations from all Chinese publicly listed firms in 2008, I observe that the presence of a particularly type of politically connected director leads to significant differences in the amount donated. I also find that these relationships between different political ties and corporate donations are also conditioned by other factors such as firms' financial performance and political legacy. This work makes the following contributions.

First, this study complements the literature on political connections. Based on resource dependency theory, previous studies focus on the instrumental value of political ties, which could help firms build relationships and reduce environmental uncertainty. However, political connections may be different in its nature. I extend this line of literature to show that different political ties exert an impact on corporate donations. After considering the insiders and outsider (i.e. peripheral) perspective of political ties, my arguments provide a more nuanced view of political connections.

Second, I also contribute to the CSR literature by exploring the drivers of CSR in general and corporate philanthropy in particular. Recently these studies have paid attention to how different political values affect CSR in the US (Chin, Hambrick, & Treviño, 2013) and I complement this literature by theoretically developing and empirically testing the impact of different political ties in a non-democratic country. Compared to the debate on political conservatism versus political liberalism in democratic countries (Chin et al., 2013), I find that the origins of different political ties are of a different nature in a one-party country such as China. Regarding politicians in a one-party state as entirely homogenous simplifies our understanding of the function of political ties. By exploring different political ties, I also provide the micro-foundation of why some firms engage in political CSR activities.

Third, this work supplements the existing literature on corporate responses to critical events such as natural disasters (Muller & Kräussl, 2011) which has predominantly stressed that corporate donations serve as a strategic response to pressures from stakeholders such as the government, consumers or Internet users (Muller & Kräussl, 2011). By uncovering different political ties, I demonstrate different political ties are susceptible to public pressure differently and in turn impact corporate donations.

LIMITATIONS AND FUTURE RESEARCH

I acknowledge several limitations in my study that give rise to opportunities for further research. First, as I only consider the impact of political ties on CSR, the generalizability of the results may be limited. I chose corporate donation, as this increases comparability among firms and helps us to obtain a consistent measure of firms' response to government pressure. Though previous scholarship on CSR has adopted a similar approach (Muller & Kräussl, 2011), the empirical findings may not hold for other CSR activities (e.g., environmental protection, energy conservation, workplace safety or product quality). Also this study only considers cash donation as the indicator of corporate responsiveness, I do not take corporate in-kind donations into account, as it is very difficult to obtain a comparable measure. Moreover, future studies could extend my findings to different corporate strategies such as diversification or innovation and examine how different types of political ties may enable or constraint such corporate strategies. Finally, as this study focuses on multiple political ties, I only focus on one aspect of directors; other aspects such as gender or expertise are also worth exploring.

CONCLUSION

Recent studies have demonstrated the importance of the role of political ties in the field of management research (Briscoe, Chin, & Hambrick, 2014; Chin, Hambrick, & Treviño, 2013). This study deepens our understanding by adopting the insider/outsider perspective and deepening our understanding of the relationship between political ties and corporate philanthropy. Drawing upon a sample of Chinese publicly listed firms, I investigate the sources of different political ties and their impacts on corporate donations after a natural disaster. In doing so, I identify the existence of heterogeneous political ties in an authoritarian regime and also highlight that the nature of political ties should be understood in the historical or cultural context.

CHAPTER 6 CONCLUSIONS

Given the growing importance of nonmarket actors in corporate strategies, this dissertation, as a whole, serves as an initial to step to theorise and empirically test the extent to which independent directors' connections to the state influence their monitoring, directors' career outcomes and corporate nonmarket strategies such as donations. By using data from independent directors in Chinese listed firms from 2004 to 2014, this dissertation explores the impact of government on corporate governance at both the director level and corporate level. This chapter summarizes major findings and contributions in this dissertation and also provides managerial insights for corporate governance practices.

6.1 MAJOR FINDINGS

This first study focuses on to what extent independent directors' power relationship with majority shareholders influences independent directors' monitoring in the context of a concentrated ownership structure. This study uses a novel measure to proxy directors' monitoring at the individual level, i.e. director voting patterns in Chinese publicly listed firms from 2004 to 2014. In particular, independent directors' connections to the government shift the power balance within the organizations, such that this enhances directors' propensity to vote against a proposal. However, majority shareholders create independent directors' dependency asymmetry by deciding the level of independent director compensation. This study finds that compensation reduces directors' likelihood of dissenting. This study also shows that for politically connected independent directors, their propensity to dissent is weakened as director compensation rises. Moreover, for those politically connected independent directors, their dependency asymmetry is greater if they are in firms with greater ownership concentration. To conclude, this study provides a full picture of the power relationship between an individual independent director, the majority shareholders, and the state. This study also use different sets of empirical methods such as a conditional logit model with proposal fixed effects, a correlated random effect model, and the IV-GMM method, and results remain similar.

Following the first study, this second study analyses the careers outcomes of those dissenting independent directors and non-dissenting independent directors. Specifically, this study examines whether diligent independent directors will be rewarded by related stakeholders. Adopting the signalling theory, this study argues that diligent monitoring in the form of issuing dissenting opinions is evaluated by stakeholders in the market environment (i.e. the focal firm and other listed firms) and nonmarket environment (i.e. the state) and in turn influences independent directors' career outcomes in terms of the gain or loss of directorship. Empirical findings show that diligent monitoring is not positively evaluated by the focal firm, as reflected by directors' lower probability of re-appointment after current directorship expires. Moreover, diligent directors tend to be employed by smaller firms after diligent monitoring. For directors with connections to the state, i.e. politically connected independent directors, diligent monitoring is also rewarded, as this is consistent with the state's interests. This study also employs a set of empirical methods such as the Heckman selection model and the propensity score matching and find supports for my predictions.

The third study explores heterogeneous political connections and their impacts on corporate social responsiveness (i.e. donation). Using data on earthquake donations by Chinese publicly listed firms in 2008, I show that firms with a higher proportion of directors embedded in the political system (i.e. bureaucratic directors) will donate less, due to concerns that corporate donations may de-legitimize the state. However, firms with higher proportions of directors peripheral in the political system (i.e. symbolic directors) will donate more, due to public pressure for corporate social responsiveness. This study contributes to the literature on political connections and enriches our understanding of corporate social responsiveness in the context of emerging economies.

6.2 CONTRIBUTIONS

The dissertation, as a whole, makes several contributions to the following literatures.

Literature on Corporate Governance

The first study generally posits that independent directors' power relationship influence their monitoring and theorises that power relationship within and outside the focal firm jointly determines directors' monitoring. While previous studies have examined the effectiveness of directors' monitoring at the board level and hence develop related theoretical arguments (Desender et al., 2014), this dissertation advances this line of literature by developing related theory at the director level and also captures the power dynamics in the form of director compensation (i.e. within the focal firm) and connection to a third party such as the state (i.e. outside the focal firm).

Corporate governance is a theory about power and influence within organizations (Aguilera & Jackson, 2010). Recent studies have called for attentions to the role of external governance mechanisms (Aguilera, Desender, Bednar, & Lee, 2015). These studies have mainly explored specific external governance mechanisms such as the market for corporate control, external auditors, stakeholder activism, rating organizations and the media (Aguilera et al., 2015). In such a situation, the role of the government is mainly through amending laws or regulations that influence rating organizations or promote shareholder activism, such as the Sarbanes-Oxley Act of 2002 and Dodd-Frank Act of 2010 in the U.S.

However, the role of the state may be of a different nature in emerging markets. Specifically, the government in emerging markets, also creating laws or regulations, may (un) internationally improve governances practices through firms' appointment of independent directors with connections to the state. Therefore, my theoretical propositions show that, independent directors, albeit a type of internal corporate governance mechanisms, are inevitably influenced by external forces thorough directors' connections to their home organizations.

The literature on board of directors has mainly conceptualized independent directors as a whole group, overlooking the power relationship within a group. My focus of director level analysis also corresponds to the recent call from Hambrick et al. (2015) advocating the importance of identifying a single diligent director. They argue that effective board monitoring largely relies on one single diligent monitor who possess the following qualities independence, expertise in that domain, bandwidth, and motivation. Although board directors are typically conceptualized as a group, my focus on individual directors also improves our understanding of the relationships between directors and (majority) shareholders, thus also shedding light on our understanding of effective director monitoring.

Additionally, the dissertation also contributes to the literature on director compensation (Adams & Ferreira, 2008; Boivie et al., 2015a; Ye, 2014; Yermack, 2004). While previous have mainly explored the determinant of director compensation (Boivie et al., 2015a), less has been known about the impact of director compensation. Drawing upon the seminal perspective in Fama and Jensen (1983), this dissertation shows that higher compensation compromises directors' monitoring, one of the first studies documenting this relationship at the director level in the corporate governance literature.

For research on director turnover in the directorship market, previous studies, mainly drawn from the perspective of ex post settling up from Fama and Jenson (1983), suggest that directors will be penalized by market actors if they don't fulfill their monitoring role (Brochet

& Srinivasan, 2014; Srinivasan, 2005). This dissertation highlights that director turnover is not only influenced by market actors (i.e. firms) but also *nonmarket* actors such as the state. The incorporation of the state in the theory is critical for independent directors in emerging markets where nonmarket forces exert great influence over economic activities. Moreover, I find that these dissenting independent directors are more likely appointed by smaller firms, also contributing to dynamics in the directorship market (Masulis & Mobbs, 2014).

Literature on Political Connections

A broader range of theoretical perspectives have been applied in the literature on political connections. For example, resource dependency theory suggests that political connections reduce environmental uncertainty (Zheng et al., 2015); the resource based view holds that political connections is a type of strategic resources to improve firm performance (Guillen, 2000; Zheng et al., 2015); or the institutional theory suggests that political connections enhance the legitimacy in the eyes of the state (Baum & Oliver, 1991). These studies generally hold that political connections have a positive impact on firm performance (Faccio, 2006; Fisman, 2001; Hillman, 2005) or some hold the contingency view of political connections (Li & Zhang, 2007; Li, Poppo, & Zhou, 2008).

Despite various theoretical perspectives, these studies have documented the positive effects of political connections, such as in the case of corporate (un)related diversification (Schuler, Rehbein, & Cramer, 2002; Zhu & Chung, 2014), IPO activities (Yang, 2013), access to financing such as bank loans (Claessens, Feijen, & Laeven, 2008; Johnson & Mitton, 2003; Mian & Khwaja, 2004; Zhao & Lu, 2016), and foreign direct investment (Lu, Liu, Wright, & Filatotchev, 2014). However, political connections may enable those politically connect firms to evade regulations (Calomiris, Fisman, & Wang, 2010), such that those firms could avoid compliance regulations and hence have higher workplace fatalities (Fisman & Wang, 2015).

Some studies also have differentiated different types of political connections, such as organizational vs. individual level of political connections (Shi et al., 2014; Sun et al., 2015b), connections to different political parties (Cooper, Gulen, & Ovtchinnikov, 2010; Ridge, Ingram, & Hill, 2016; Zhu & Chung, 2014), or connections to different levels of governments (Wang, Hong, Kafouros, & Wright, 2012; Zheng et al., 2015). The value of political connections may diminish due to regime changes (Fisman, 2001; Siegel, 2007) or in countries with different political institutions or institutional environments (Amore & Bennedsen, 2013; Choi et al., 2014). Despite these insights, few studies have theorised about the impact of political connections at the individual level and also to what extent this shifts the power balance within organizations and influences directors' monitoring. I add to this line of literature by theorising and empirically testing the impact of political connections on monitoring in the first study. The state, by shifting the power balance with the organization, enhances the monitoring power of independent directors, providing a more nuanced understanding of the interdependencies between the firm and the state. I also highlight that these political connections may be heterogeneous in its nature in the third study. By adopting the insider/peripheral perspective on political connections, I examine how different political ties may expose firms to more public pressure or less so. This dissertation contributes to this emerging literature on the impact of political ties on corporate nonmarket strategies such as donations.

Literature on Nonmarket Strategy

The nonmarket literature has typically explored the link between the adoption of nonmarket strategies and organizational performance (Baron, 2001; Mellahi et al., 2015), usually focusing on corporate social responsibility (CSR) and political campaign contributions. Studies about CSR strategies have mainly explored whether CSR improves firm performance or not, either from the stakeholder theory (Flammer, 2013; Wang et al., 2008) or institutional theory perspective (Wang & Qian, 2011). The improvement of empirical methods such as the regression discontinuity design (RDD) has also advanced our understanding of the impact of CSR (Flammer, 2015). However, these arguments may not hold for countries where stakeholder power is limited. By differentiating different political ties, I provide a more nuanced perspective on corporate donations. Specifically, directors more embedded in the political system are more likely to behave in the best interests of state, thus negatively influencing corporate donations. However, directors more peripheral in the political system are more susceptible to public pressure and therefore positively influence corporate donations.

Altogether, this dissertation makes contributions to the following two theoretical perspectives.

Resource Dependency Theory

This dissertation contributes to resource dependency theory in several ways. First, the first study shows directors' dependency on focal firms, while previous studies have predominantly focused how firms' reliance on directors to reduce environmental uncertainty (Zheng et al., 2014). Second, another theoretical contribution is that I extends the resource dependency perspective from an organizational-level to an individual-level analysis (Bermiss & Greenbaum, 2015) by showing that directors' dissent is the outcome of the power relationships between an independent director and majority shareholders. Lastly, I theorise that the dyadic relationship between independent directors and majority shareholders is dependent on directors' connections to a (powerful) third-party affiliation (Hallen et al., 2014; Xia et al., 2014), thereby providing a more socially contextualized view of resource dependency theory (Gomulya & Boeker, 2015; Wry et al., 2013).

Signalling Theory

With regard to signalling theory, the second study examines whether director diligent monitoring will be rewarded or not. While previous studies tend to regard receivers as a homogenous group (Connelly et al., 2011), I theorise that director dissents, despite the same type of signal, are evaluated differently by multiple receivers. This study takes into account market evaluators (i.e. the focal firm and other listed firms) and nonmarket evaluator (i.e. the state). Moreover, I also link a specific group of receiver to a specific type of director career outcomes. For instance, dissents reduce an independent director's likelihood of reappointment but help those dissenting directors gain more new board seats. The state also positively evaluates directors' dissent, as reflected by directors' stay in the current directorship in the face of government regulation. In summary, director dissent could serve a credible signal that help external stakeholders evaluate directors' monitoring.

Recent studies have paid attention to the dynamic view of signalling theory. For instance, Gomulya and Mishina (2016) provide a dynamic perspective of signalling theory by showing that investors shift their relative reliance on a particular signal to another type following a firms' earning restatement. Xia et al. (2015) also show that stakeholders' support for a bankrupt firm also depends on the dynamic signals sent by the focal firm. My dissertation adds to this line of discussion by exploring the evaluation of heterogeneous groups of receivers/evaluators and linking evaluations to directors' career outcomes, as reflected by directors' gain or loss of directorship.

6.3 MANAGERIAL IMPLICATIONS

This research offers a broad range of implications for managers as well as policy makers. In particular, it improves our understanding of causes and consequence of diligent monitoring at the director level, and potentially helps firms select more capable independent directors and avoid those incapable ones. Moreover, I highlight that independent directors' connections to nonmarket organizations not only influence their incentives to monitor but also their power to monitor by shifting the power balance within organizations. In addition to those nonmarket forces that directly influence firms, those forces may affect firms through focal firms' appointment of independent directors. Also, the incorporation of the state in the monitoring framework also shows the way through which the state influences the firm, shedding new light on the firm-state relationship. Lastly, the political ties suggest that the decision making of those directors are subject to the types of ties in the political system, and organization should take this factor into account in their selection of independent directors.

6.4 LIMITATIONS AND FUTURE RESEARCH

This dissertation has some limitations that open opportunities for future research. First, by using a director-level dataset to explore voting behaviour, I took an initial step toward understanding director behaviour in the boardroom. Nevertheless, my study captured only one particular type of board monitoring activities — i.e. voting. Other board activities, such as unannounced company visits, are also worth exploring.

Second, the whole dissertation is developed in the context of a concentrated ownership structure, it is important to be cautious when interpreting the results. While this structure is among the most common, corporate governance practices in this context remain largely unexamined (Porta, Lopez-de-Silanes, & Shleifer, 1999).

While there are many different types of nonmarket organisations such as the government or political parties (Mellahi et al., 2015), in this dissertation the government is equal to the political party due to the one-party authoritarian regime in China. Although this dissertation has differentiated between the administrative branch and the legislative branch, we have to bear in mind that the legislative branch in China is still at an early stage and largely dominated by the CPC (Truex, 2014). The nature of political connections may be different in a democratic country, such that their effect on director behaviour or corporate donations may be different. Specifically, politically connected directors may be more concerned about their constituents, e.g. local communities, as they are often under pressure for re-election. Also, considering the growing number of different nonmarket actors such as non-governmental organizations (NGOs) (Briscoe & Gupta, 2016) and intergovernmental organizations (Jandhyala & Phene, 2015), it's important to explore their effects on corporate strategies (Briscoe & Gupta, 2016).

Lastly, although I've collected data for from multiple reliable data sources, most of data used in this dissertation is from archival sources such as newspapers and company annual reports. Despite the richness of the data, the limitation is that my results may lack first-hand insights from independent directors and related policy makers. Future research could benefit from conducting interviews with independent directors or corporate executives that may provide more qualitative insights.

6.5 CONCLUSION

This dissertation was inspired by a lack of understanding of to what extent independent directors' connections to a powerful third party in the nonmarket environment such as the state influence individual directors' monitoring, their career outcomes, and corporate nonmarket strategies such as donations. I developed related theoretical reasoning and empirically tested these arguments. This dissertation demonstrates that power relationship within organizations is indeed important and influences independent directors' monitoring. Furthermore, different political connections may shape organization decision making differently. To conclude, by theorising and analysing the presented three research questions, this dissertation extends our knowledge of the role of the state in corporate governance practices in emerging markets, especially China, and also provides insights into corporate nonmarket strategies such as corporate giving.

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