

**Does the Political Participation of Entrepreneurs and the Political Resources of Small and Medium-Sized Enterprises Lead to Preferential Treatment from Government? Evidence from China.**

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**Does the Political Participation of Entrepreneurs and the Political Resources of Small and Medium-Sized Enterprises Lead to Preferential Treatment from Government? Evidence from China.**

**Abstract:** Drawing on survey data from 150 small and medium-sized enterprises this study examines whether the political participation of entrepreneurs improves their ability to obtain preferential treatment from the Chinese government authorities. Entrepreneurs who were members of higher level legislative bodies or acted as government advisors, were found to obtain preferential treatment than those who did not. In contrast, membership of the Communist party did not always influence the ability of entrepreneurs to obtain preferential treatment. This study also made an important contribution to the literature by developing a scale for the political resources of an enterprise. The totality of an enterprise's political resources was found to influence their access to preferential treatment from government to a high degree of significance. These findings are discussed in relation to the institutional context in which the research was undertaken, and their policy implications explored.

**Keywords:** China; entrepreneurs; political participation; preferential policies; small and medium-sized enterprises

## 1. Introduction

Over the past three decades the opening-up and reform policies introduced by the Chinese government have led to the rapid growth of Chinese small and medium-sized enterprises (SMEs) (Anderson et al., 2003; Atherton, 2008). The SME sector now accounts for more than 75 per cent of all employment and more than 50 per cent of GDP (Farrell et al., 2006). The movement away from a centrally-planned economy to a socialist market economy has been achieved primarily from the decentralization of decision making from government to individual enterprises. However, as in other transition economies, the government continues to maintain significant control over the market, influencing the free allocation of economic resources and hampering the development of new enterprises (Carlisle and Flynn, 2005; Feng and Wang, 2010). SMEs, especially those that are privately-owned, tend to be discriminated against in favor of larger state-owned firms, who continue to receive preferential treatment from the government authorities (Atherton, 2008; Newman et al., 2011).

In order to circumnavigate the institutional constraints facing them and enhance their organizational legitimacy, entrepreneurs are forced to develop their connections with government and participate in politics (Ahlstrom and Bruton, 2001; Tsai, 2005; Ahlstrom et al., 2008; Chen et al., 2008; Chen and Touve, 2010; Feng and Wang, 2010; McNally and Wright, 2010). This enables them to shape their institutional environment, influencing policy formation to achieve outcomes that serve their interests (Dickson, 2003; Zhou, 2009; Li et al., 2006) There is a growing body of evidence to suggest that the political participation of entrepreneurs and political resources of their enterprises is positively related to firm performance and the ability

of the firm to access external financing, especially in transition economies where SMEs face significant institutional biases against them (Fisman, 2001; Johnson and Mitton, 2003; Khwaja and Mian, 2005; Li et al., 2005; Bai et al., 2006; Faccio, 2006; Zhou, 2009; Chen and Touve, 2010). Despite this growing literature, there has been limited work examining whether the political participation of entrepreneurs and the political resources of their enterprises improves the ability of SMEs to obtain preferential treatment from government, other than regards access to financing.

This study contributes to the existing body of literature by examining the influence of political participation on access to preferential treatment from the government authorities in the context of a transition economy, namely China. This is done using a sample of 150 SMEs from one coastal province in the east of the country. Specifically, the extent to which membership of the Chinese People's Congress (CPC), the Chinese People's Political Consultative Committee (CPPCC) and the Communist Party enable firms to obtain preferential policies, assistance in land purchase and contracts from the Chinese government authorities is investigated. In addition, a political resource index is developed to examine the impact of the firm's political resources on its ability to obtain preferential treatment from the government authorities. Previous research has typically focused on the influence of the entrepreneur's political participation without considering the potential influence of other members of the organization (Choi and Zhou, 2001; Bai et al., 2006; Li et al., 2008). This study therefore increases our knowledge on the relative importance of political resources vis-a-vis the political participation of entrepreneurs in obtaining preferential treatment from governments in transition economies.

The paper is structured as follows. Section 2 introduces the institutional background faced by SMEs in China and the literature on political connections and firm performance. Research hypotheses are then developed that examine the impact of political participation and political resources on the preferential treatment accorded by the government authorities. Section 3 introduces the methodology of this research, examining how the data was obtained and econometric techniques applied. In Section 4 the empirical findings of the research are presented. Finally, in Section 5 the findings of the research are discussed and policy implications outlined.

## **2. Literature Review**

### **History of SME development**

In this section we will briefly examine the history of SME development and the institutional environment in which SMEs operate. This will further our understanding of the importance of political participation for Chinese entrepreneurs and provide a basis on which to develop hypotheses.

In the early 1980s the Chinese government introduced legislation that allowed the registration of private enterprises, but prevented them from employing more than seven workers (Atherton, 2008). As a result of such reforms SME activity grew during the 1980s, and by 1987 over 20 million SMEs were registered with the government authorities (Chen et al., 2006). Despite such reforms the institutional environment was hostile towards SMEs, which were dominantly

privately-owned, and entrepreneurs were denied from applying for membership of the Communist Party. They faced prejudice from government officials, and citizens in general, who viewed them as bourgeoisie and untrustworthy (Li et al., 2008). Nationwide crackdowns on private SMEs occurred frequently during the 1980s and entrepreneurs were denied entrance into the political establishment (Li et al., 2006). As a result, many newly emerging private SMEs were forced to wear a 'red hat', in other words affiliate themselves with state-owned or collectively-owned enterprises in order to seek protection and obtain resources from local government (Naughton, 1994; Chen, 2007).

In 1988 the growth in SMEs really began to take off with legal recognition of private enterprises with seven or more employees under the Provisional Regulations on Private Enterprises (Atherton, 2008). As a result an increasing number of SMEs were able to take off their 'red hat' and operate in accordance with the law (Chen, 2007). SME development was given a further boost in 1997 when the Fifteenth Communist Party Congress, recognizing the importance of private enterprises to the Chinese economy, gave them equal rights as state-owned enterprises and initiated the privatization of state-owned and collective SMEs under the *zhuada fangxiao* 'Let go of the small, keep the big' policy. From the late 1990s onwards the SME sector has developed quickly, becoming the engine of growth in the Chinese economy (Poutziouris et al., 2002; Chen, 2006). In 2007 the introduction of the Law on Property Rights provided a further boost to SMEs (Atherton, 2008). It enshrined the concept of private ownership into the Chinese law and banned appropriation of business assets by the state. This development marked a significant policy change for the Chinese government. For the first time since the establishment

of the People's Republic of China the law had granted equal status to private and public ownership.

Despite the introduction of policies aimed at providing private SMEs equal status under the law, the institutional environment they operate in today is far from perfect. At present they continue to face a number of barriers to operation and expansion compared to their larger private and state-owned counterparts. Due to continuing government direction of the economy and control over key resources such as land and capital, larger enterprises, especially those under government control or affiliated to government, continue to enjoy preferential access to finance and other key inputs (Farrell et al., 2006; Brandt and Zhu, 2007; Li and Zhang, 2007; Tan et al., 2007; Hsu, 2009). SMEs are also subject to the arbitrary application of administrative fees by local government departments and frequent changes in government policy (Tsai, 2002; Atherton, 2008; Feng and Wang, 2010). The ability of government to compulsorily acquire land without any means of legal redress or right to compensation has also served to destabilize promising businesses.

### **Political participation and firm performance**

As highlighted in the above discussion, the lack of a developed legal and regulatory environment in China, as in other transition economies, means that political participation should be helpful for Chinese enterprises looking to benefit from preferential treatment from the government authorities (Alston, 1989; Nee, 1992; Xin and Pearce, 1996; Park and Luo, 2001; Luo, 2003; Ahlstrom and Bruton, 2006; So and Walker, 2006). Political participation has been defined as 'participation in the formation and execution of public policy through legally

sanctioned channels' (Chen and Touve, 2010: 3). It is especially important for private firms, who have less institutional support than state or collectively-owned firms (Nee, 1992). Political participation allows firms to circumnavigate significant institutional barriers and gain access to a whole host of resources, which may include obtaining information on regulatory changes, being granted access to restricted markets and gaining access to scarce resources under government control (Tsang, 1999; Fan, 2002; Tan et al., 2009).

There is a growing literature examining the impact of political connections on firm performance (Fisman, 2001; Johnson and Mitton, 2003; Faccio, 2006). These studies generally find that political participation enables firms to gain preferential treatment over their competitors, enhancing their performance. Despite this, only a limited number of studies have investigated the impact of political participation of firm performance in China (Choi and Zhou, 2001; Li et al., 2008). Choi and Zhou (2001) using data on 1440 entrepreneurs throughout China find that the entrepreneur's membership of the Communist party has a positive effect on the profitability of the enterprise. Work by Li et al. (2008) on 3258 firms throughout China produces similar findings. They find that politically connected firms have better performance than those without such connections, when human capital and other variables are controlled for.

Another stream of research has examined the impact of the entrepreneurs' political participation on the firm's ability to access external financing from the banking sector (Khwaja and Mian, 2005; Bai et al., 2006; Li et al., 2008; Zhou, 2009; Chen and Touve, 2010). Khwaja and Mian (2005) find that banks forward greater credit to politically connected firms in Pakistan, who have politicians on the board of directors, than those without. Bai et al. (2006) find that access to bank loans is significantly easier for entrepreneurs who belong to the Chinese



People's Congress. However, membership of the Chinese People's Political Consultative Committee and the Communist Party had a limited effect on access to bank loans. Likewise, although Zhou (2009) found that membership of legislative bodies improved entrepreneur's access to bank loans, especially for SMEs. However, membership of the Communist Party alone was found to have limited influence on access to bank loans. Li et al. (2008) find that entrepreneurs who are party members or who have had previous managerial experience in state-owned firms are less likely to feel discriminated against by state-owned banks than their contemporaries that are not party members. In contrast to the previous studies, recent work by Chen and Touve (2010) found a positive relationship between membership of the Communist Party and access to loans from state-owned banks. These previous studies indicate that political participation may help SMEs to obtain assistance from financial institutions under government direction.

### **Hypothesis development**

Although entrepreneurs were prevented from seeking party membership during the early stages of opening-up and reform period, the introduction of the '*san ge daibiao*' or 'three represents policy' by Jiang Zeming in 2000 signalled a sea-change in ideological thinking towards the political participation of entrepreneurs (Dickson, 2003). Under this policy the Communist Party charter was revised to allow entrepreneurs to join. The government authorities recognized the economic benefits that might be obtained through the political participation of entrepreneurs and actively encouraged them to join the ranks of the party. As a

result of these reforms the number of entrepreneurs with party membership steadily grew (Liu, 2003). A 2003 study found that around 34 per cent of all entrepreneurs were members of the Communist Party (Tsai, 2005).

Membership of the Communist party confers a certain degree of social status upon entrepreneurs due to the continuing existence of the one-party political system. In an institutional environment in which mistrust and skepticism towards entrepreneurs continues to exist, close links with the ruling party are a sign that the firm can be trusted. Party membership indicates that the entrepreneur has gone through a careful screening process and is willing to conform to the government agenda and ideology (Chen and Touve, 2010). As a result the government will tend to favor those entrepreneurs with party membership who will not threaten its legitimacy. Recent studies suggest that entrepreneurs seek membership of the party primarily for instrumental reasons, perceiving that party membership will bring with it substantial benefits such as greater access to resources controlled by the government and better protection from competition (Shih, 2004; McNally and Wright, 2010). In line with the findings of previous studies which reveal the positive impact of party membership on firm performance and access to finance from state-owned banks (Choi and Zhou, 2001; Li et al., 2008; Chen and Touve, 2010) we might expect party membership to improve the ability of entrepreneurs to obtain preferential treatment from the government authorities. This leads us to posit the following:

*H1a: SMEs whose CEOs are members of the Communist Party will obtain greater access to preferential policies from the Chinese government authorities than those who are not.*

*H1b: SMEs whose CEOs are members of the Communist Party will obtain greater assistance in land purchase from the Chinese government authorities than those who are not.*

*H1c: SMEs whose CEOs are members of the Communist Party will obtain more contracts from the Chinese government authorities than those who are not.*

In recent years more and more entrepreneurs have begun to actively participate in politics at the highest levels. A large number of them have obtained membership of political advisory and legislative bodies such the Chinese People's Congress (CPC) and the Chinese People's Political Consultative Committee (CPPCC), or act in an advisory capacity to government (Li et al., 2005; McNally and Wright, 2010). Recent empirical work indicates that entrepreneurs make up a significant proportion of the local policy elite in many parts of the country (Yang, 2006). The CPC is the highest lawmaking body in China. There is a People's Congress at each administrative level of government, including the central, provincial, county and township levels. These PCs have extensive powers to draft and enact local legislation, and to elect and dismiss government officials. At the national level the CPC has the power to enact new laws and policies, as well as electing top officials in the central government. The CPPCC is a collection of experts who act in an advisory capacity to the CPC and the government authorities. The main work of the CPPCC is to engage in political consultation and supervise the work of the government and the party. Before major legislation is implemented the CPPCC is provided with a chance to offer its advice and suggestions for improvements.

Membership of the CPC and CPPCC is beneficial to entrepreneurs in two main ways. Firstly, it signals the recognition of their contribution to the economy and society by the party, improving

their social standing and influence in the local community (Zhou, 2009). Secondly, it allows them to cultivate close relationships with government officials who are members of both bodies. This should afford them preferential treatment by the state, enabling them to gain access to resources that are not accessible on the free market, circumnavigate complex government red tape, and obtain legal or non-legal protection for their business (Dickson, 2003; Shih, 2004; Li et al., 2008; Feng and Wang, 2010). This leads us to posit the following:

*H2a: SMEs whose CEOs are members of the China People's Congress or Chinese People's Political Consultative Committee, or act in an advisory capacity to government, will obtain greater access to preferential policies from the Chinese government authorities than those who are not.*

*H2b: SMEs whose CEOs are members of the China People's Congress or Chinese People's Political Consultative Committee, or act in an advisory capacity to government, will obtain greater assistance in land purchase from the Chinese government authorities than those who are not.*

*H2c: SMEs whose CEOs are members of the China People's Congress or Chinese People's Political Consultative Committee, or act in an advisory capacity to government, will obtain more contracts from the Chinese government authorities than those who are not.*

In addition to political participation of the entrepreneur, the political resources of the enterprise, defined as the extent to which employees of the enterprise participate in politics, might also be expected to impact on a firm's ability to obtain preferential treatment from the government authorities. An increasing percentage of SMEs have hired former government

officials and managers of larger state-owned enterprises, with positions of influence in the Communist Party and legislative bodies, as senior executives in order to assist in building relations with government (Ahlstrom et al., 2000). In addition, many enterprises have begun to establish party branches within their organizations and actively encouraged their employees to become party members as a way of furthering their links with government (Li et al., 2008). These political resources should enable the enterprise to cultivate close relationships with government officials, assisting it to obtain preferential treatment over its competitors. This leads us to posit the following:

*H3a: SMEs whose have greater political resources will obtain greater access to preferential policies from the Chinese government authorities than those who do not.*

*H3b: SMEs whose have greater political resources will obtain greater assistance in land purchase from the Chinese government authorities than those who do not.*

*H3c: SMEs whose have greater political resources will obtain more contracts from the Chinese government authorities than those who do not.*

### **3. Methodology**

#### **Data**

The data used in this study came from a survey of SMEs conducted from July to December 2009 by researchers in the Changzhou Institute of Technology, in conjunction with the Changzhou SME Bureau. Changzhou is a city located in Jiangsu Province in the affluent Yangtze Delta region

of China. It borders the provincial capital of Nanjing to the West and is not far away from Shanghai, the main metropolis in the area. As a result of its location its economic development has progressed at a very rapid pace. In 2009 the GDP per capita of Changzhou reached over US \$10000 per head, ranking it third in the province (KPMG, 2010). It was also recently ranked as one of the most competitive cities for private investment in China in the 'China City Competitiveness Annual' (KPMG, 2010) making it an ideal location for our research study.

The sample of enterprises used in this study was chosen randomly from a list provided by the local SME Bureau. As the main focus of the study was on the entrepreneur as the unit of analysis, survey questionnaires were distributed by hand to a single key respondent in each enterprise and collected in person by a member of the research team. The respondents were key shareholders and decision makers (CEOs) in the surveyed business.

### **Variable Description**

#### *Dependent variables*

Three dependent variables were included in our analysis. The first variable, preferential policies (PREPOL), was calculated as the average of four items. Respondents were asked to rank on a scale of 1 to 5, where 1= never and 5= frequently, the extent to which they had received preferential policies from government in the following four areas. (1) Legal assistance in terms of obtaining administrative approval, certification of products and intellectual property protection. (2) Financial assistance in terms of obtaining preferential tax rates, financial subsidies, industrial support, low-interest loans and credit guarantees. (3) Research and development support, such as government sponsorship of technology projects and provision of

incentives to technological innovation. (4) Financial or administrative support in merger and acquisition activity. For the second variable, access to land (ASSLAN), respondents were required to rank how frequently the government has provided them with assistance in land purchase. As for the previous variable, respondents were asked to rank their response on a scale of 1 to 5, where 1= never and 5= frequently. For the third variable, government contracts (GOVCON), respondents were required to rank how often their firm obtained government contracts on a scale of 1 to 5, where 1= never and 5= frequently. Information on the individual responses of firms provided in relation to the dependent variables is presented in Table 1.

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Insert Table 1 about here  
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#### *Independent variables*

Three independent variables were included in the analysis. The first, membership of the CPC or CPPCC (MEMPOL) was constructed as a dummy variable. Enterprises whose entrepreneurs were not members of the CPC or CPPCC, or did not act as government advisors were coded 0 and those that did were coded 1. Likewise, party member (PARMEM) was constructed as a dummy variable. Enterprises whose entrepreneurs were not party members were coded 0 and those who had party membership were coded 1. Table 2 provides descriptive statistics on these two variables.

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Insert Table 2 about here  
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Finally, a scale was developed to measure the third variable, political resources (POLRES), using six indicators. Respondents were asked to indicate how many employees of their organization held membership of, or acted as officials and advisors in, certain political organizations, where 1= none and 5= many. These were (1) membership of the CPC; (2) membership of the CPPCC; (3) officials of business associations; (4) government officials; (5) government advisors; and (6) membership of the Communist Party Committee. The rank of each item was added together to form the political resource index of the firm, with double weight given to items 1 and 3, and triple weight given to items 4 and 6. In the view of the research team these political positions or memberships were of greater importance than items 2 and 5.

#### *Control variables*

A number of control variables were entered into the analysis to control for the effects of factors other than political participation and resources on a firm's ability to obtain preferential treatment from government. These included firm size (SIZE) and firm age (AGE). SIZE was measured as amount of registered capital in Chinese Renminbi (RMB), and was coded ordinally from 1 to 6 within the ranges as shown in Table 3. AGE was measured as a continuous variable, as age since establishment in years. Larger and older firms might be expected to have better relations, and therefore obtain preferential treatment from government than younger and



smaller firms without a track record. Industrial association (INDASS) was also included to control for the effects of the entrepreneurs being members of a private enterprise association. In total 65.35 per cent of entrepreneurs were members of such associations. Industrial associations are typically government-sponsored and are intended to both maintain state control over entrepreneurs as well as protect their interests (Dickson, 2003; McNally and Wright, 2010). Membership of such associations should enable entrepreneurs to build good relationships with government, and might therefore lead to the receipt of preferential treatment. Dummy variables were also entered into the regression to control for the effects of ownership type. Categories were included for private enterprises, state-owned enterprises, collectively-owned enterprises, wholly foreign-owned enterprises and Sino-foreign joint ventures. Private enterprises accounted for around 72 per cent of the firms in our sample.

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#### 4. Data Analysis and Results

Table 4 presents the means, standard deviations and correlations of all variables used in the study.

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To test the hypotheses, ordinary least squares (OLS) hierarchical regression models are presented in Tables 5 to 7. In the first stage of the regression for each dependent variable the control variables were entered. In the second stage of the regression the independent variables were entered allowing us to determine the change in r-squared contributed by political participation and resources. As the correlation between the independent variables measuring political participation and political resources were very high, the three independent variables were entered one by one into the regression instead of all together, to avoid issues of potential multicollinearity.

Models 1 to 4 in Table 5 examine the factors which influence the ability of the enterprise to obtain preferential policies from the government. In Model 1 the control variables were entered. Only size was significant, albeit at the 10 per cent level of significance. This indicates that larger firms are more likely to receive preferential policies than smaller firms. Both age and membership of an industrial association had a negligible impact. In Models 2 to 4 the

independent variables were entered into the regression. In line with hypothesis 2a, enterprises whose entrepreneurs had membership of the CPC, CPPCC, and/or acted as a government advisor were found more likely to obtain preferential policies from government than those without. However, party membership of the entrepreneur only influenced the propensity of the enterprise to obtain preferential policies from government at the 10 per cent level of significance, providing some but weak support for hypothesis 1a. In line with hypothesis 3a, the political resources of the enterprise were positively related to their ability to obtain preferential policies from the government. By looking at the additional r-squared contributed by each independent variable it seems that the political resources of the enterprise as a whole are much more influential in enabling firms to gain access to preferential policies than the political participation of the entrepreneur alone.

Models 5 to 8 in Table 6 examine the factors which influence the ability of the enterprise to obtain preferential treatment from the government as regards assistance in land purchase. In Model 5 the control variables were entered. Neither firm size, age or membership of a business association significantly influenced the enterprise's ability to obtain assistance in land purchase. In Models 6 to 8 the independent variables were entered into the regression. In line with hypothesis 2b, enterprises whose entrepreneurs had membership of the CPC, CPPCC, and/or acted as a government advisor were found more likely to obtain assistance in land purchase from the government authorities than those without. Likewise, in line with hypothesis 3b, the political resources of the enterprise were positively related to their ability to obtain assistance in land purchase. However, party membership had only a limited influence on assistance in land purchase at the 10 per cent level of significance providing only limited support for hypothesis

1b. As in Table 4, it is evident that the political resources of the enterprise as a whole are much more influential in enabling firms to gain access to preferential assistance in land purchase than the political participation of the entrepreneur alone.

Models 9 to 12 in Table 7 examine the factors which influence the ability of the enterprise to receive preferential treatment from the government as regards obtaining government contracts. In Model 9 the control variables were entered. Only firm size, at the 10 per cent level of significance, positively influenced the ability of the firm to obtain government contracts. In contrast, firm age and membership of a business association had no significant impact. In Models 10 to 12 the independent variables were entered into the regression. In line with hypothesis 2c, enterprises whose entrepreneurs had membership of the CPC, CPPCC, and/or acted as a government advisor were found more likely to obtain contracts from the government authorities. Likewise, in line with hypothesis 1c, party membership of the entrepreneur significantly influenced the propensity of the enterprise to obtain government contracts. In line with hypothesis 3c, a positive relationship was also found between the political resources of the enterprise and the receipt of government contracts. As for the other dependent variables, the political resources of the enterprises were more influential in enabling the firm to obtain government contracts than the two variables measuring political participation of the entrepreneur.

In order to test the robustness of the results we did several things. Firstly, we re-ran the regressions using an ordered probit estimation method, looking at the marginal effect of independent variables, and got similar results. Secondly, we changed the weighting of

components in the political resource index and re-ran the regressions using the new variable.

Similar results were obtained as in the original regression.

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## Conclusion

This study adds to understanding surrounding the impact of the political participation of entrepreneurs and the political resources of SMEs on their ability to obtain preferential treatment from government authorities, in the context of a transition economy, namely China. It demonstrates that the entrepreneur's participation in higher level legislative bodies and the total sum of a firm's political resources enable enterprises to obtain preferential treatment from the government authorities. However, in contrast to previous empirical work our findings indicate that limited benefits accrue to entrepreneurs from being a member of the Communist party alone (Choi and Zhou, 2001; Li et al., 2008). Why might this be the case? One reason might be the fact that Communist party membership does not confer significant political influence on the member to the same extent as it might have done in the past, especially in areas of the country with good political governance (Zhou, 2009). This may be due to the fact that lower level party committees have gradually lost most of their political and economic decision-making functions over the course of the last two decades (Zhou, 2009). As Zhou (2009) points out the value of Communist Party membership has been severely reduced during the process of economic reform due to the fact that the central government has encouraged more open and transparent political participation. In the present system it is only senior officials and higher level legislative bodies that continue to exert significant influence over resource allocation in the Chinese economy (Dickson, 2003; Bai et al., 2006).

Our study makes a significant contribution to the literature by examining the contribution made by political resources to the ability of SMEs to obtain preferential treatment from the government authorities. Previous studies have focused overwhelmingly on the influence of the

entrepreneur's political participation without considering the potential influence of other members of the organization (Choi and Zhou, 2001; Bai et al., 2006; Li et al., 2008). The findings of this study demonstrate that the totality of a firm's political resources play more of an influential role in determining access to preferential treatment from the government authorities than political participation of the entrepreneur alone.

In conclusion, the findings of this study suggest that political factors continue play an important role in SME development in China. In order to run a successful business in China, an entrepreneur should consider undertaking significant investment in political activities. Specifically, enterprise owners should consider hiring senior executives with political connections and membership of higher level political organizations in order to develop the political resources of the firm. Without such resources, SMEs face greater difficulty in accessing preferential treatment from government, which could impact on their ability to prosper and ultimately survive, especially in highly-regulated industries. However, entrepreneurs should also be aware that participation in politics at a lower level may also not bring the benefits that might have been expected in the past.

Our findings are not good news for newly established SMEs, which are typically less likely to have political resources. The time and energy required to develop political resources might distract them from concentrating on the core competencies of their businesses, and negatively impact on their capacity to innovate. In order to spur innovation in the SME sector the Chinese government should encourage greater marketization and loosen their control over resource allocation. This should ensure that Chinese SMEs are more competitive in the global market.



Future research may examine the generalizability of our research findings to more underdeveloped regions of China and other transition economies. As Changzhou, the city in which our research was conducted, is located in one of the most developed areas of China with reasonably good political governance, it is likely that impact of political participation and political resources on the ability of SMEs in less developed regions to obtain preferential treatment will be more pronounced. Longitudinal work is also required to enable consideration of the impact of political participation and resources on firm access to preferential treatment over time. It would also be of benefit to include performance measures in future research to understand the extent to which preferential treatment accorded to firms impacts on their competitive position vis-à-vis other firms.

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**Table 1: Access to preferential treatment from government**

| <b>Preferential Treatment</b> | <b>1</b> | <b>2</b> | <b>3</b> | <b>4</b> | <b>5</b> | <b>Observations</b> |
|-------------------------------|----------|----------|----------|----------|----------|---------------------|
| Legal assistance              | 31.58    | 30.08    | 29.32    | 8.27     | 0.75     | 133                 |
| Financial assistance          | 25.56    | 25.56    | 33.83    | 14.29    | 0.75     | 133                 |
| R&D support                   | 38.17    | 25.95    | 24.43    | 10.69    | 0.76     | 131                 |
| Support in M&A activity       | 39.69    | 27.48    | 26.72    | 3.05     | 3.05     | 131                 |
| Assistance in land purchase   | 34.35    | 16.79    | 35.88    | 9.16     | 3.82     | 131                 |
| Government contracts          | 41.98    | 25.19    | 24.43    | 7.63     | 0.76     | 131                 |

**Note: Figures are in percentage form. 1= never and 5= frequently**

**Table 2: Descriptive statistics on political participation of entrepreneurs**

| <b>Variable</b>   | <b>Percentage</b> | <b>N</b>      |
|---|-------------------|---------------|
| CPC/CPPCC membership and/or<br>in advisory role to government | 40.1%             | 54 out of 132 |
| Party membership  | 44.4%             | 60 out of 135 |

**Table 3: Breakdown of the Sample by Firm Size**

| <b>Size of Firm</b>   | <b>Code</b> | <b>Total (%)</b> |
|-----------------------|-------------|------------------|
| Below 0.5 million RMB | 1           | 8.67%            |
| 0.5-1 million RMB     | 2           | 22.67%           |
| 1-5 million RMB       | 3           | 18.67%           |
| 5-10 million RMB      | 4           | 12.67%           |
| 10-30 million RMB     | 5           | 12.67%           |
| Above 30 million RMB  | 6           | 24.67%           |



**Table 4: Spearman rank correlation matrix**

|        | PREPOL | ASSLAN | GOVCON | MEMPOL | PARMEM | POLRES | SIZE  | AGE   | INDASS |
|--------|--------|--------|--------|--------|--------|--------|-------|-------|--------|
| PREPOL | 1.000  |        |        |        |        |        |       |       |        |
| ASSLAN | 0.798  | 1.000  |        |        |        |        |       |       |        |
| GOVCON | 0.663  | 0.538  | 1.000  |        |        |        |       |       |        |
| MEMPOL | 0.442  | 0.392  | 0.434  | 1.000  |        |        |       |       |        |
| PARMEM | 0.367  | 0.345  | 0.436  | 0.431  | 1.000  |        |       |       |        |
| POLRES | 0.618  | 0.573  | 0.551  | 0.658  | 0.450  | 1.000  |       |       |        |
| SIZE   | 0.328  | 0.296  | 0.340  | 0.096  | 0.197  | 0.159  | 1.000 |       |        |
| AGE    | 0.310  | 0.268  | 0.334  | 0.167  | 0.244  | 0.262  | 0.315 | 1.000 |        |
| INDASS | 0.148  | 0.154  | 0.106  | 0.198  | 0.040  | 0.113  | 0.365 | 0.091 | 1.000  |

Table 5: OLS Regression Analysis

| <b>Dependent variable: Preferential policies</b>                    |                   |                    |                  |                    |
|---|-------------------|--------------------|------------------|--------------------|
|   | <b>Model 1</b>    | <b>Model 2</b>     | <b>Model 3</b>   | <b>Model 4</b>     |
| <b>Control variables</b>  |                   |                    |                  |                    |
| SIZE  | 0.138**<br>(2.57) | 0.130**<br>(2.71)  | 0.130*<br>(2.46) | 0.126**<br>(2.75)  |
| AGE   | 0.013 (1.67)      | 0.012 (1.76)       | 0.009 (1.09)     | 0.012 (1.87)       |
| INDASS  | 0.201 (1.15)      | 0.037 (0.23)       | 0.217 (1.24)     | 0.100 (0.67)       |
| Ownership dummies   | Yes               | Yes                | Yes              | Yes                |
| $\Delta R^2$  | 0.167             | 0.167              | 0.167            | 0.167              |
| <b>Independent variables: Political participation and resources</b> |                   |                    |                  |                    |
| MEMPOL  |                   | 0.743***<br>(4.78) |                  |                    |
| PARMEM  |                   |                    | 0.382*<br>(2.16) |                    |
| POLRES  |                   |                    |                  | 0.052***<br>(6.91) |
| $\Delta R^2$  |                   | 0.125              | 0.037            | 0.237              |
| <b>Overall model</b>  |                   |                    |                  |                    |
| $R^2$   | 0.167             | 0.292              | 0.204            | 0.404              |
| N   | 126               | 125                | 122              | 123                |

Notes: T-values in parentheses. \*, \*\*, \*\*\* indicate significance at the 10%, 5% and 1% levels respectively

Table 6: OLS Regression Analysis

| <b>Dependent variable: Assistance in land purchase</b>              |                |                    |                  |                    |
|---|----------------|--------------------|------------------|--------------------|
|   | <b>Model 5</b> | <b>Model 6</b>     | <b>Model 7</b>   | <b>Model 8</b>     |
| <b>Control variables</b>  |                |                    |                  |                    |
| SIZE  | 0.124 (1.85)   | 0.128*<br>(2.00)   | 0.107 (1.61)     | 0.122*<br>(2.01)   |
| AGE   | 0.009 (0.94)   | 0.006 (0.67)       | 0.006 (0.61)     | 0.009 (1.00)       |
| INDASS  | 0.217 (0.98)   | 0.077 (0.36)       | 0.234 (1.07)     | 0.145 (0.72)       |
| Ownership dummies   | Yes            | Yes                | Yes              | Yes                |
| $\Delta R^2$  | 0.091          | 0.091              | 0.091            | 0.091              |
| <b>Independent variables: Political participation and resources</b> |                |                    |                  |                    |
| MEMPOL  |                | 0.804***<br>(3.82) |                  |                    |
| PARMEM  |                |                    | 0.592*<br>(2.67) |                    |
| POLRES  |                |                    |                  | 0.055***<br>(5.28) |
| $\Delta R^2$  |                | 0.095              | 0.052            | 0.174              |
| <b>Overall model</b>  |                |                    |                  |                    |
| $R^2$   | 0.091          | 0.186              | 0.143            | 0.270              |
| N   | 123            | 122                | 120              | 122                |

Notes: T-values in parentheses. \*, \*\*, \*\*\* indicate significance at the 10%, 5% and 1% levels respectively

Table 7: OLS Regression Analysis

| <b>Dependent variable: Government contracts</b>                     |                  |                    |                    |                    |
|---|------------------|--------------------|--------------------|--------------------|
|   | <b>Model 9</b>   | <b>Model 10</b>    | <b>Model 11</b>    | <b>Model 12</b>    |
| <b>Control variables</b>  |                  |                    |                    |                    |
| SIZE  | 0.135*<br>(2.37) | 0.136*<br>(2.50)   | 0.127*<br>(2.36)   | 0.128*<br>(2.49)   |
| AGE   | 0.014 (1.60)     | 0.011 (1.39)       | 0.005 (0.61)       | 0.013 (1.72)       |
| INDASS  | 0.039 (0.21)     | -0.090<br>(0.49)   | 0.078 (0.44)       | -0.036<br>(0.21)   |
| Ownership dummies   | Yes              | Yes                | Yes                | Yes                |
| $\Delta R^2$  | 0.191            | 0.191              | 0.191              | 0.191              |
| <b>Independent variables: Political participation and resources</b> |                  |                    |                    |                    |
| MEMPOL  |                  | 0.684***<br>(3.60) |                    |                    |
| PARMEM  |                  |                    | 0.628***<br>(3.49) |                    |
| POLRES  |                  |                    |                    | 0.045***<br>(5.19) |
| $\Delta R^2$  |                  | 0.082              | 0.114              | 0.151              |
| <b>Overall model</b>  |                  |                    |                    |                    |
| $R^2$   | 0.191            | 0.273              | 0.305              | 0.342              |
| N   | 122              | 121                | 119                | 122                |

Notes: T-values in parentheses. \*, \*\*, \*\*\* indicate significance at the 10%, 5% and 1% levels respectively

