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Government governance, executive networks and enterprise R&D Expenditure



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ABSTRACT

The increasingly competitive market environment makes independent innovation the core of the enterprise's and even the country's competitiveness. In order to solve the problem of its own limited R&D resources, firms need to find access to outside resources. Since the government mainly provides policy and financial support, the information diffusion and learning effects of executive networks can effectively compensate for the shortage of formal institutional arrangements. In view of this, we manually collect data on R&D expenditures and executive networks having common management members in China A-share listed companies from 2007 to 2010. Combined with corporate governance and government governance data, this paper empirically tests the influence of government governance and executive networks on enterprise innovation. The empirical results reveal that the governance efficiency of the government where the enterprise is located determines the efficiency of resource allocation firms are faced with, which provides institutional constraints on corporate R&D intensity, and that the establishment and scale of executive networks do contribute to R&D decisions. Further testing shows that compared with non-state-owned enterprises, state-owned enterprises are faced with relatively weaker restraints and pressures in terms of policy, finance, technology and competition. Thus, they show no obvious reliance on government governance quality and the information diffusion of executive networks. The findings of this study help us to understand the role of informal systems in social economics, such as relationship networks and social capital, in the context of China's economic development, and provide relevant

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evidence and enrich macro and micro studies of “government and market” and “market and enterprise” relationships.

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1. Introduction

Enterprise R&D activities enable them to make innovations in products, technologies and procedures, which determine companies' competitive advantages and growth in the future (Scherer, 1984; Ettl, 1998). The process of innovation not only promotes technological progress, but also becomes the main impetus of endogenous economic growth. In spite of China's economy growing miraculously, the sustainability of economic growth is still worrying; therefore, it is imperative to transfer the mode of economic growth, and encourage independent innovation by enterprises. As a result, the state has put forward the strategic objective of building an innovation-oriented country,¹ and is treating these micro-economic entities as main players so as to highlight their importance in the whole innovation system.

According to the “China Statistical Yearbook on Science and Technology”, from 1995 to 2009, the average annual growth rate of national R&D expenditures was up to 20.12%, much higher than GDP growth over the same period and showing an upward trend. The statistical report of the Ministry of Science and Technology in 2011² also shows that, 71.7% of R&D funds in 2010 are derived from enterprises, and 73.4% of R&D operating departments are also in enterprises. But the Global Competitiveness Report (2011–2012) reveals that the firm-level technology absorption capacity of Chinese mainland enterprises ranks only 61st³ in 142 countries and regions, indicating that the technological innovation of Chinese mainland enterprises is still not competitive on a global scale. This mismatch of inputs and outputs is subject to the country's overall level of technology development, government investment intensity and selection of investment objects. It is also influenced by their own resource constraints and strategic decisions.

Meanwhile, enterprises have to confront increasingly intense global competition in the new economic environment characterized by knowledge and information. On the one hand, in order to maintain continual motivation to develop and endure competitive strength in an increasingly keen competitive environment, most enterprises have deeply realized that independent innovation is their impulsion for survival and development. On the other hand, with the current guidance to build an innovation-oriented country, a series of preferential policies and security mechanisms to avoid R&D risk have stimulated enterprises' enthusiasm to innovation. Under both internal and external stimulus, innovation undoubtedly becomes the driving force of firms' development and progress, while investment in R&D is inevitably an important corporate expenditure.

“Fiscal Federalism” in China's transition process and performance-driven “Official Promotion System”, strongly stimulate local government to progress economic development. The differences in historical conditions and natural resource endowments result in diverse institutional constraints on economic development and in government efficiency in different areas. Under the pressure of horizontal competition, local government essentially becomes the regulating subject for the regional economy, playing the role of quasi-market subject, and directly or indirectly joining in enterprises' operating activities. Therefore, governance as a formal arrangement can be either the supporter of the sustainable development of enterprises, or the taker of corporate value. That is, efficiency of governance is often an important factor influencing the

¹ July 1, 2008, the new revision of <Law on the Advancement of Science and Technology of PRC> was formally upheld, which was replenished by a new sector “technological progress”, clarifying enterprises as the main subjects in technological innovation, meanwhile requiring government to guide and support enterprises' technological innovations by fiscal and tax policy, industrial policy, capital market, and a technology intermediary service system.

² [http://www.sts.org.cn/sjkl/kjtjdt/data2011/science and technology statistical data 2011.pdf](http://www.sts.org.cn/sjkl/kjtjdt/data2011/science%20and%20technology%20statistical%20data%202011.pdf).

³ World Economic Forum, 2011, The Global Competitiveness Report 2011–2012, pp. 491.

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