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Contingent value of political capital in bank loan acquisition: Evidence from founder-controlled private enterprises in China

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ABSTRACT

In this study, we combine the persistent and progressive perspectives of institutional theory with corporate governance to explore the contingency value of political capital on bank loan acquisition in the context of China's transition economy. Using a large set of national survey data on founder-controlled private firms in China, we find that the positive effect of political capital on acquiring bank loans is weakened under conditions characterized by low government intervention and more developed intermediate institutions. We also find that the facilitating role of political capital in bank loan acquisition is significantly dampened for firms that have adopted more governance mechanisms. Theoretical and managerial implications are discussed.

1. Executive summary

Resource acquisition features prominently in the field of entrepreneurship research. Among various factors affecting the acquisition of resources, founders' political capital in the form of political connections is often considered important, particularly in the context of transition economies. Nonetheless, there is no consensus on whether the value of this political capital always remains constantly positive, and the findings of existing studies are mixed. This study reconciles the persistent and progressive views of institutional theory and proposes the contingency value of the political capital of founder-controlled private enterprises in China.

Specifically, this paper maintains that the effects of political connections on resource acquisition cannot remain constantly positive when institutional environments improve in the process of transitioning from a planned economy towards a more market-based economy. In testing this proposition, this study examines three contingencies of political connections: the reduction of government intervention, the development of intermediate institutions, and the adoption of corporate governance practices. Based on the analysis of 1870 founder-controlled private firms operating in 17 industries and 30 provinces in China, this study finds that the reduction of government intervention in economic activities, the extensive presence of intermediate institutions, and the adoption of corporate governance mechanisms significantly weakens the role of political connections in acquiring bank loans.

Overall, this study contributes to this stream of entrepreneurship literature by advancing a contingency explanation of political connections possessed by founder-controlled private firms. The results of this paper clarify the inconsistent findings of the extant research and are in line with the progressive view of the institutional theory that the development of market-supporting institutions can create dampening effects on the value of political capital. That is, when market forces are prevalent in the transition

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process, entrepreneurs' reliance on political connections as conduits to access financial resources become less effective and questionable.

2. Introduction

Entrepreneurial firms rarely possess all the resources and capabilities required to pursue opportunities and to survive. In the realm of the entrepreneurship literature, acquiring external resources is widely recognized a vital entrepreneurial task (Evans and Leighton, 1989; Starr and MacMillan, 1990; Sirmon and Hitt, 2003) and even "the greatest challenge faced by entrepreneurs" (Brush et al., 2001: 71).

Existing entrepreneurship research has examined a wide range of determining factors that are helpful for obtaining external resources. Broadly, these determinants fall into several categories, consisting of human capital factors, such as founders' education (e.g., Robinson and Sexton, 1994; Colombo and Grilli, 2010), the prominence of prior employment (e.g., Burton et al., 2002), the caliber of the founding team (Eisenhardt and Schoonhoven, 1990), and "star scientists" (Zucker et al., 1998); social capital variables, such as strong personal ties to resource providers (Aldrich and Zimmer, 1986), working relationships and community ties (e.g., Starr and MacMillan, 1990), direct and indirect social ties between investors and founders (e.g., Shane and Cable, 2002; Katila et al., 2008), networks with prominent organizations (Stuart et al., 1999), and directorship in other organizations (Florin et al., 2003); symbolic actions, such as founders' credibility, skillfulness, and the quality of stakeholder relationships (Zott and Huy, 2007), patenting as a factor attracting venture capital (Baum and Silverman, 2004), and category affiliations (e.g., Higgins and Gulati, 2003; Wry and Lounsbury, 2013); and narrative capabilities, such as the effects of founders' storytelling on gaining external resources (e.g., Lounsbury and Glynn, 2001; Martens et al., 2007) and on the speed of microlending in 39 developing countries (Allison et al., 2013).

An increasing number of entrepreneurial studies have also investigated the role of political capital in acquiring resources and highlights the distinctive challenges that an unstable and hostile institutional environment has on the entrepreneur's access to scarce financial capital. It is proposed that, in the weak institutional environment, entrepreneurs' networking and political connections play a crucial role in helping access resources (e.g., Smallbone and Welter, 2011; Aidis et al., 2008; Peng and Heath, 1996; Dinc, 2005). However, theoretically, there are two opposing views (persistent and progressive) about the roles of political capital in the transition process, and the empirical findings are also mixed. The persistent view argues that in an incomplete transition, the inertial forces rooted deeply in former socialist institutions provide the structural basis for the persistent advantages of political connections (Bian and Logan, 1996; Walder, 2003). For instance, it contends that political connections through, for example, a prior political career can be converted into economic advantages to remain a main source of continuity in the transition process (Róna-Tas, 1994, p. 740).

Conversely, the progressive view holds that the reduction of the redistributive power of government in the transition process inevitably facilitates entrepreneurial activities (Smallbone and Welter, 2011; Lu and Tao, 2010) and shifts resource control from political authorities to market institutions. Given the market efficiency logic (Nee, 1989, 1992; Guthrie, 1998; Cao and Nee, 2000), the progressive view predicts that the relative value of political capital will decrease because the transition from a state-centered economy to a mixed economy with increasing market demands for efficiency can generate significant reductions in the value political connections. Empirically, studies have also shown incongruent results. Some found the positive impacts on various performances (e.g., Johnson and Mitton, 2003), on loan borrowing (Khwaja and Mian, 2005; Zhou, 2009) and on opportunity captures (Li et al., 2014). Others, however, found the opposite (e.g., Leuz and Oberholzer-Gee, 2006; Fan et al., 2007; Faccio, 2010).

With these divergent theories and mixed empirical findings, recent studies of the effects of political connections call for further examination of its conditional effects (Siegel, 2007; Li et al., 2009), and entrepreneurship research also emphasizes the need to view entrepreneurship within the wider political, economic and social contexts in which it takes place (Baker and Nelson, 2005; Zahra and Wright, 2011) and the role of more refined dimensions of the institutional context (Zhou, 2013) Therefore, resonating with these calls, we attempt to address an underexplored question in the context of transition economies. Where a lack of financial resources is a common plight among entrepreneurial firms (Smallbone and Welter, 2013): does political capital possessed by the founders of private enterprises always have a positive and monotonic effect on the acquisition of resources (bank loans in this study)?

In answering this question, we combine the persistent and progressive views and corporate governance to examine three underexplored contingencies on the effects of the political connections of founder-controlled private enterprises[1]: the level of government intervention; the development of intermediate institutions; and the adoption of corporate governance. We argue that if the institutional environment shapes entrepreneurs' incentives to cultivate political connections to gain legitimacy and economic benefits (DiMaggio and Powell, 1991; Marquis and Zhou, 2014), then it is predictable that political connections established out of expediency to address the institutional deficiencies claimed by institutional theory (Peng, 2004; Chen et al., 2010) will lose their value when market-support institutions become more prevalent in the transition process. Specifically, given that the market liberalization and the reform of corporate governance consist of two important dimensions of institutional change in emerging economies (Hoskisson et al., 2000; Cuervo-Cazurra and Dau, 2009), we expect that the reduction of government intervention along with the growth of intermediate institutions attenuate the effects of political connections on acquiring bank loans by creating more entrepreneurial opportunities and alternative sources of financial resources. Additionally, we propose that the adoption of

[1] Consistent with prior entrepreneurship literature (e.g. Pollock et al., 2009; He, 2008), founder-controlled private enterprises refer to the privately held enterprises controlled by the founders who still own and actively manage the firms as CEOs or executives.