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Impact of perk expenditures and marketing expenditures on corporate performance in China: The moderating role of political connections

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ABSTRACT

This study examines the performance implications of guanxi-related perk expenditures among listed Chinese firms. Specifically, it investigates how these expenditures influence long-term market-based corporate performance (Tobin's Q and market share) as compared with marketing expenditures. It also examines if political connections moderate this influence. Overall, the findings suggest that guanxi-related perks play an essential marketing role in enhancing long-term corporate success. Furthermore, although marketing expenditures exert much stronger influence on Tobin's Q than guanxi-related perks do, they exert no significant influence on market share. In summary, despite firms' much heavier investments in traditional marketing activities than guanxi-related perk activities, the findings highlight the significant performance contribution that guanxi-related perks can still make to a firm. Moreover, this study reveals that political connections weaken the positive impact of guanxi-related perks on both performance measures, thus reminding executives of the dampening effect of these connections on the effective use of perk spending.

1. Introduction

The literature in the US has documented two opposite views of perquisites ("perks" in short) as they affect managerial as well as corporate performance (Zhang, Song, & Ding, 2015). First, the incentive view argues that perk expenditures serve as part of an optimal compensation contract for motivating executives and mitigating agency problems in the absence of adequate cash incentives (Fama, 1980; Marino & Zábojník, 2008; Rajan & Wulf, 2006). These studies find that firms providing perks to managers have higher productivity and hence higher firm value. From a negative perspective, studies drawing on agency theory have viewed perks as manifesting shareholders' lack of effective control over corporate resources, thus representing the presence of agency problems (Jensen, 1986; Jensen & Meckling, 1976). According to this cost view, perk consumption represents the use of firm resources for the private benefit of the managers at the expense of the shareholders. Higher perks are related to lower growth opportunities, more negative market reaction, and less share price informativeness (Gul, Cheng, & Leung, 2011; Yermack, 2006). Some studies also suggest that perks are a controversial component of managerial compensation, as perk consumption may be considered an unethical behavior (Adithipyangkul, Alon, & Zhang, 2011; Luo, Zhang, & Zhu, 2011).

While perks can be a positive or negative agent in affecting performance and corporate value, the key issue in determining whether they are positive or negative is what internal and external corporate environment perks are being used. From the resource-based perspective, the sustainable competitive advantages of a firm can be enhanced by optimizing the deployment of a unique bundle of resources (i.e., both tangible and intangible assets) to achieve organizational effectiveness (Barney, 1991). Effective usage of rent-generating resources such as perk expenditures in a firm can generate superior performance. Oliver (1997: 697) concludes "that a firm's sustainable advantage depends on its ability to manage the institutional context of its resource decisions. A firm's institutional context includes its internal culture as well as broader influences from the state, society, and interfirm relations that define socially acceptable economic behavior". Therefore, we conjecture that, under a certain combination of external and internal conditions, perks can be a valuable resource in enhancing corporate performance. In particular, we argue that, under the institutional setting in which guanxi and political connections play a strategic role as corporate resources, perks can be used to exert a positive effect on firm performance. In our study, we focus on perk expenditures that are more related to guanxi building for business (i.e., guanxi-related perk expenditures) instead of indirect compensation to employees. We follow

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Cheng and Leung's (2016) definition of political connection as a firm's proportion of directors with political connections.

In fact, most research conducted to date has considered perk expenditures as a corporate governance issue for examination. This inward-looking perspective inevitably neglects the value-enhancing role that these expenditures could play in an emerging economy in which firms rely heavily on interpersonal ties for doing business (Li, Zhou, & Shao, 2009). Indeed, perk expenditures on entertainment, meals, and travel, for example, could help firms in emerging economies nurture and improve guanxi with their important business partners, such as customers and suppliers (Adithipyangkul et al., 2011). The improved guanxi would, in turn, enhance long-term corporate performance (Ai, 2006; Luo & Chen, 1997). Given the strong influence of the collectivist culture on the Chinese people and their heavy reliance on interpersonal ties to facilitate economic exchanges (Li et al., 2009), this marketing-based benefit of perk expenditures is even more apparent among Chinese firms. This is an important topic for international business and multinational companies (MNCs), because, conditional on the local practice of using perks as a form of compensation and its effect on corporate performance, MNCs might need to vary their usage of perks in different countries or regions strategically in order to maximize the benefit of perks on performance on a regional basis.

1.1. The role of perks in China

For developed countries where employee compensation is closely tied to corporate performance and is mainly driven by market forces, the need to use perks as a main incentive to motivate employees may be relatively low. In contrast, in developing countries where the legal system is less mature and in places where the Asian culture of emphasizing long-term relationships (e.g., guanxi in the Chinese setting) dominates the workplace, perks can play a unique role in facilitating business practices and even motivate employees to be more productive. Since President Xi Jingping took leadership of China in November 2012, the Chinese government has placed greater emphasis on curtailing corruption (Branigan, 2015; China Daily, 2016; Xue, Wang, & Zhao, 2016). Despite this belief, there is controversy surrounding the net effect of reducing perk expenditures in the whole country. Based on the archival data of all non-financial firms listed in China, we find that their average perk expenditures to sales ratios for the periods of 2013–2015 (i.e., after Xi took office) and 2010–2012 (pre-Xi era) are 0.4666% and 0.4696%, respectively. These ratios are extremely similar with no statistical difference. This evidence suggests that, while the anti-corruption campaign may have a deterrent effect on excessive perk expenditures for certain firms, the net effect on perk reduction as a whole has yet to be proven as significant. The finding also echoes the view that guanxi is indeed deeply rooted in Chinese business practice (Gold & Guthrie, 2002; Gu, Hung, & Tse, 2008; Uzzi, 1997).

Thus, it is probable that legitimate perk expenditures (i.e., not bribable ones) are still commonly employed by firms to facilitate their business operations (Lin, Morck, Yeung, & Zhao, 2016). Despite the promising marketing role that perks can play in enhancing firms' guanxi with salient external stakeholders and, ultimately, in the long-term market success in China, this issue has received scant research attention. Moreover, although perks may represent a powerful marketing tool in China, firms in today's increasingly competitive marketplace still need to invest heavily in traditional marketing activities to fence their market position. Therefore, it is important to examine the respective performance impacts of perk expenditures and marketing expenditures simultaneously. Yet, to our best knowledge, no research exists to date to address this issue.

1.2. Political connections

Connection (guanxi) in China has been documented as a network of interpersonal ties and social connections that businesses use to improve financial performance (Ambler, Styles, & Xiucun, 1999; Gu et al., 2008; Li, Poppo, & Zhou, 2008). The importance of guanxi in marketing is evidenced by its claim to be marketing's third paradigm (Ambler, 1994) and a link with the concept of relationship marketing (Simmons & Munch, 1996). Among the many types of connection (family, social, and business) created through such relationships, it appears that political connectedness is the most powerful one (Li et al., 2009). Based on institutionalists' prediction for emerging economies including China, firms operating there rely on tie-based mechanisms such as guanxi networks and political connections for business transactions (e.g., Liu, 2006; North, 1990; Xue et al., 2016). There is prevailing evidence of better financial performance among politically connected firms (e.g., Cooper, Gulen, & Ovtchinnikov, 2010; Li & Zhang, 2007). Political connection can help in securing resources, bypassing bureaucratic red tape, obtaining proprietary information, and maintaining a sustainable competitive advantage (Claessens, Feijen, & Laeven, 2008; Dinç, 2005; Goldman, Rocholl, & So, 2009). Calomiris, Fisman, and Wang (2010) show that the gains from political connection prevail over the efficiency cost of state ownership.

Nevertheless, political connection brings costs. The government is likely to have more intervention on the operations of more (vs. less) politically connected firms (Li, Song, & Wu, 2015). This intervention may include a request that they pursue political goals incompatible with corporate objectives (Fan, Wong, & Zhang, 2007) and hire unqualified relatives of government officials to fill high-ranking positions (Warren, Dunfee, & Li, 2004). There are limited opportunities for investors to diversify risk (Faccio, 2006). Fan et al. (2007) show that, when CEOs have strong political connections with the government, their firms are more likely to have weak governance characteristics and low professionalism. In addition, politically connected firms have more asymmetric information problems, poorer earnings quality, and less accurate analyst forecasts (Chaney, Faccio, & Parsley, 2011; Chen, Ding, & Kim, 2010). Wu, Wu, Zhou, and Wu (2012) also show that there are more severe over-investment problems for local SOEs with political connected managers. Overall, these studies suggest that political intervention may have negative effects on managerial practices and firm performance. Consequently, this government intervention may adversely affect the effectiveness of perk expenditures in enhancing corporate performance.

1.3. Relating perks with political connection

There exists a clear difference between perk-related expenditures and political connections. Perk-related expenditures represent the firm's expenses devoted to developing business relationships. On the other hand, political connections include the relationships between the firms' senior executives and the government. Although prior research has investigated the direct effect of political connections on corporate performance (e.g., Li & Zhang, 2007; Wu et al., 2012), their indirect or moderating effect has not been investigated. The present study thus fills this research gap by advancing the current understanding of how the boundary condition of political connections might moderate the performance impact of perk expenditures. Given the high level of political connections of Chinese firms in general and state-owned firms in particular (Li et al., 2009), such an investigation would also provide business executives with useful practical insights into the contingent process underlying the effective translation of perk expenditures into favorable organizational outcomes.

Against the foregoing backdrop, this study aims to examine the marketing role perk expenditures could play in affecting corporate performance. To this end, it specifically examines the direct influence of perk expenditures on long-term market-based performance. To grasp a more comprehensive understanding of the marketing role of perk expenditures when investments in traditional marketing activities are already in place, this study also examines the direct influence of marketing expenditure on the same performance. Moreover, this study