

# *Guanxi* and corporate governance: Waging war on best practice

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### MY EARLIEST CHINA/CEE/ EE/GUANXI RESEARCH

- □ Peng and Heath (1996 AMR): The growth of the firm
- ☐ Inspired by Penrose (1959), P&H (1996) extends firm growth and strategy research to EE
- ☐ Identified a *network*-based strategy of growth
- ☐ Triggered a wave of *guanxi* research

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THE GROWTH OF THE FIRM IN PLANNED ECONOMIES IN TRANSITION: INSTITUTIONS, ORGANIZATIONS, AND STRATEGIC CHOICE

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# TWENTY (+) YEARS OF CHINA/EE RESEARCH

- □ Peng, Lebedev, Vlas, Wang, and Shay (2018 APJM): The growth of the firm in (and out of) emerging economies
- ☐ Since Peng and Heath (1996), network capitalism and institutional transitions for network-based growth have emerged as a major theme

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The growth of the firm in (and out of)
cenerging economies

Mile W. Peng\* - Sergey Lebebra\* Cristins O. Visa\* \* Jayor C. Wang\* - Jason S. Shay\*

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# FIRST MAJOR EMPIRICAL STUDY ON GUANXI

- □ Peng and Luo (2000 AMJ): Managerial ties and firm performance
- ☐ Inspired by Mizruchi and Galaskiewicz's (1994) call to look for alternative contexts
- ☐ For the first time in the literature, separating managerial ties in two dimensions: (a) ties with top executives at other firms and (b) ties with government officials

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MANAGERIAL TIES AND FIRM PERFORMANCE IN A TRANSITION
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The Ohio State Universi

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## **GUANXI** VERSUS MARKET TRANSITIONS

- □ Peng (2003 AMR): Institutional transitions and strategic choices
- ☐ During the early phase of transitions: *Guanxi* is king!
- ☐ During the late phase of transitions: Switching to more market-based capabilities is a must
- ☐ Li, Peng, and Macaulay (2013 SO): Market-political *ambidexterity*

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#### INSTITUTIONAL TRANSITIONS AND

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# FIRST MAJOR STUDY ON CORPORATE GOVERNANCE

- ☐ Peng (2004 SMJ): First China study in the mgmt literature using archival data
- ☐ Do outside directors make a difference in firm performance?
  - No, for financial performance (such as ROE)
  - But yes, for sales growth
- ☐ Agency theory-based "best practice" (such as appointing outside/independent directors) is highly *questionable*

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MIKE W. PENG\*

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Do ontake directors on corporate boards make a difference in first performance? Agency theory augusts that a board competed of a greater prespond on of tasked factors, that to their proportion of contake directors, that to their performance (Jenes and Meckling, 1976). Sheller performance (Jenes and Meckling, 1976). Sheller performance (Jenes and Meckling, 1976). Sheller performance (Johns et al., 1998; Fisial-Intellection and Hamman (Jenes and Jenes an

Key words: outside directors; firm performance; institional transitions; China formal transitions; China Commondens in Mar W. Peng, Fisher Cellege of Busines The Ohio State University, 2000 Noll Am., Columbus, C 0220-1144, U.S.A. E-mail; pung.516mn.ndu

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itional perspectives such as resource depence and institutional discories may be particularly applied in advancing this research. Specifically, applied in advancing this research. Specifically, properties of the properties of the properties of the into resources these contributes may being (Pferf. 1972), On the other hand, institutional theory use that appointing outsiders to the board may rely appressed firms attempts to comply with interioral pressures, and, therefore, may not onetically resuals in being resources (DMAgriely resuals in being resources (DMAgriely resuals in being resources (DMAg-

ulthough the debate on the link between board sponsition and firm performance is hardly resolin developed economies, appointing outsiders corporate boards has become an increasingly sepread practice in emerging concomies going sugh institutional transitions such as China, ch provides an interesting "research laboratory" enkar and von Glinow, 1994: 56). Institutional

Final revision received 8 October 2003

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# A RECENT STUDY ON CEO COMPENSATION

- □ Peng, Sun, and Markoczy (2015 JMS): The impact of human capital (international experience vs. political ties) on CEO compensation
- Market transition theory: International experience +
- ☐ Power conversion theory: Political ties +
- ☐ Both seem valuable, with different moderating variables

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#### JOURNAL OF MANAGEMENT STUDIES

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Human Capital and CEO Compensation during

Mike W. Peng, Sunny Li Sun and Livia Markóczy

samuer: Ferm appoint CIOs with different type of human capital in order to manage resource dependence. How CIOs are composated than can be comparationed as valuation process of how bounds wise the value of CIOS's human capital. Two types of human capital—international experience and political in—the emerged as ported allows not have manufactured to the composate of the composate of the composate of the composate of the har remained unders. We develop a resource dependence-based, contingues of transcents in force on the release and seized factors that enable or contents human capital in sepace CIOS composations. Because of the tremendous regional deverlay which Ciois, externally, we focus to the level of marketination of the region in which from an headquarter. Internally, we pay attention to two corporate governance mechanisms policially connected under developnant composation committee. Due from 11/26 from-year deversions of 19 per rest of the development of the composation of the co

Keywords: CEO compensation, human capital, international experience, institutional transitions collisiest consume dependence

#### INTRODUCTION

As a leading theoretical perspective advocated by Pfeler and Salancik [1978], resourdependence theory point that firms engage in strategy actions to enhance their contro of the resources needed for survival and prosperity [Dees and Heugens, 2013; Hilms et al., 2009, Way et al., 2013. The theory suggests that appointing chief executiofficers (CEOs) represents one of the most important strategic actions in managin resource dependencies (Finlektrin et al., 2009).

Having appointed CEOs, boards need to properly compensate and motivate CEOs. Different CEOs bring in different types of human capital, which broadly refers to the Adhes for spine: Male W. Peng, Jodal Chair of Chold Sentop, Jodal School of Management, University of Tesus at Dallas, 100 West Campbel, SM43, Richaelson, TX 75/080, USM [indepengificablia cels].

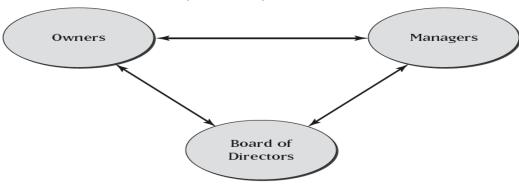
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### WHAT IS CORPORATE GOVERNANCE?

• The relationship among various participants in determining the direction and performance of corporations.

### The Tripod of Corporate Governance



Source: Adapted from R. A. G. Monks & N. Minow, 2001, Corporate Governance (cover), Oxford, UK: Blackwel

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Figure 11.1

11–8



### **CORPORATE GOVERNANCE** IN THE LAND OF GUANXI

- ☐ Mutlu, Van Essen, Peng, Saleh, and Duran (2018 JMS): A meta-analysis
- ☐ Question 1: How do agency theoryprescribed "best practice"—(1) board independence and (2) removal of CEO duality—affect firm performance in China?
- Question 2: How do these relationships change as China's market institutions develop over time?

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#### **JOURNAL OF MANAGEMENT STUDIES**

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Corporate Governance in China: A Meta-Analysis

Canan C. Mutlu<sup>a</sup>, Marc Van Essen<sup>b,e</sup>, Mike W. Peng<sup>d</sup>, Sabrina F. Saleh<sup>b</sup> and Patricio Duran<sup>a</sup> Cols Golley of Busines, Konessue State Unionity, "Data Mure School of Busines, Union South Caroline," Etc. ITM Busines School, "Judal School of Management, Unionity of To

#### INTRODUCTION



#### **INSIGHTS AND DEBATES FROM CHINA**

- Strong economic growth despite relatively underdeveloped institutions
- Corporate governance reforms toward "modern enterprise system" since the 1990s
- Waging war on "best practice" in the absence of strong evidence (Peng, 2004 SMJ)
- In a relationship-based society, the applicability and effectiveness of arm's-length monitoring and alignment may be questionable (Young, Peng, Ahlstrom, Bruton, & Jiang, 2008 JMS; Jiang & Peng, 2011 APJM).

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#### **BOARD INDEPENDENCE**

- China required publicly listed firms to appoint outside directors on corporate boards as of 2001 (Peng, 2004 SMJ)—ahead of SOX in the U.S.
- China's relationship-based culture may affect board dynamics.
- Outside directors' concern for reputation and credibility matters.
  - Outside directors tend to be more vocal when firm performance suffers or in case of corporate frauds (Ma & Khanna, 2013 SMJ).
- Hypothesis 1a. Board independence is positively related to firm performance.



#### **BOARD INDEPENDENCE OVER TIME**

- The ratio of outside directors has increased from 6% in 2001 to 34% in 2005.
- Recent amendments have further expanded the role of outside directors through election mechanisms, terms of reference, and responsibility investigation in China (OECD, 2011).
- As market institutions improve, the sensitivity of outside directors for reputation and credibility in the labor market for directors may increase.
- **Hypothesis 1b.** The relationship between board independence and firm performance becomes more positive over time.

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#### **CEO DUALITY**

- Standard agency theory criticisms: CEO duality gives excessive power to the CEO
- Counterargument: In times of rapid change, CEO duality facilitates decision speed and eliminates top-level conflicts (Peng et al., 2007 MOR; 2010 APJM).
- Control versus collaboration (Krause, 2017 SMJ)
- **Hypothesis 2a.** CEO duality is negatively related to firm performance.







#### **CEO DUALITY OVER TIME**

- The performance effects of personal and political relations may diminish as market institutions prevail (Peng, 2003 AMR).
- The decline of the state's influence leads managers to be accountable to external market forces rather than to the state or political connections.
- **Hypothesis 2b.** The relationship between CEO duality and firm performance becomes more negative over time.

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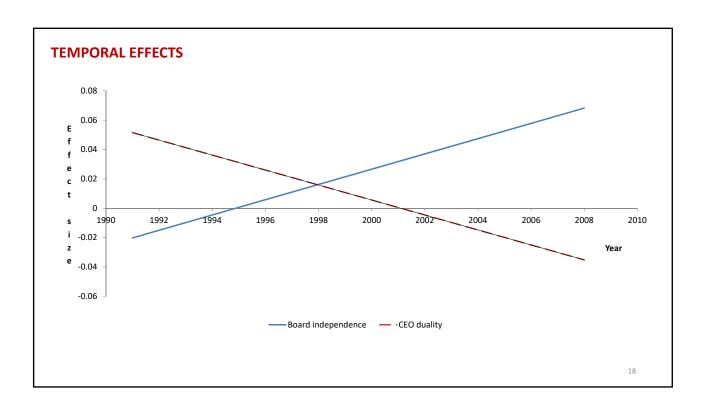
#### **META-ANALYSIS METHODS**

- Four search strategies to identify studies:
  - Prior review articles.
  - Electronic databases: (1) ABI/INFORM Global, (2) EconLit, (3) Google Scholar, (4) JSTOR, and (5) SSRN.
  - Manual search of leading economics, finance, and management journals.
  - References of the retrieved studies.
- A final sample of 84 primary studies, 684 effect sizes, and 547,622 firm observations



#### **KEY FINDINGS**

- H1a and H1b supported: A positive relationship between board independence and firm performance, which becomes stronger over time
- H2a not supported: A near zero relationship between CEO duality and firm performance
- H2b supported: The CEO duality-firm performance relationship does become more negative over time.





#### IN THE GLOBAL CONTEXT

### Board independence CEO duality

- Dalton et al. (1998: U.S. firms) Near zero relationship Near zero relationship
- Van Essen et al. (2012: Asian firms) Near zero relationship Near zero relationship
- OUR STUDY (Mutlu et al. 2018) Positive relationship, which becomes which becomes more stronger over time
  - Relative to the U.S. and Asia, our meta-analysis actually finds that one best practice recommended by agency theory—board independence—is more strongly supported in China.

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#### **CONTRIBUTIONS**

- Providing the first meta-analysis on the rapidly expanding CG literature on China.
- Contributing to corporate governance research by showing that agency theory-prescribed "best practice" can help firm outcomes *over time*.
- Advancing a dynamic institution-based view (Peng et al., 2008 JIBS; 2009 AMP).



#### POLICY IMPLICATIONS AND FUTURE RESEARCH

- From a policy standpoint, enhancing board independence is a +
- When waging war on best practice, be cautious with policy banning/discouraging CEO duality
- *Guanxi* between chairman of the board and the CEO remains fertile ground for future research (Krause, 2017 SMJ)
- CG will become more important with more SOE internationalization efforts (Bruton et al., 2015 AMP; Peng et al., 2016 APJM)

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#### **CONCLUSION**

- As a "best practice," board independence is indeed helpful, and is more so over time
- But CEO duality continues to be a puzzle
- Corporate governance research is *quanxi* research
- CG by definition deals with the *guanxi* among three groups of players—managers, board directors, and shareholders
- From Peng and Heath (1996 AMR) to Peng et al. (2018 APJM), the growth of the firm in China (and emerging economies) requires a deeper understanding of crucial *relationships*