

The effect of political influence on corporate valuation: Evidence from party-building reform in China

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ABSTRACT

The party-building reform in China aims to strengthen the party-state control of firms by formalizing the Chinese Communist Party's (CCP) role in corporate charters. We employ the reform as an exogenous shock to examine the effect of political influence on corporate valuation in the state-dominated economy. We first develop a hazard model of firms' responses to the reform and use the predicted hazard rate as a proxy for a firm's *ex ante* political influence. We find a positive correlation between firm valuation changes and the predicted hazard rate in the events of party-building reform announcements and a consistent long-term valuation effect based on the difference-in-differences analyses. We also find that the market reacts negatively when firms elect to adopt charter provisions that allow the CCP to control their personnel decisions. Together, our results are consistent with the hypothesis that the effect of party-building reform on a firm's valuation depends on the trade-off between the benefits from the increased state capture and the costs of state influence in firm governance and that the enhanced political control costs are mitigated for firms with stronger existing political ties. This paper contributes to the literature by introducing a novel and integrated approach to measuring political influence that goes beyond the traditional state ownership measurement and by identifying *ex ante* political influence as an important factor in corporate valuation.

1. Introduction

Extensive literature documents that political influence on firm decision making can harm corporate governance and firm valuation. Most theoretical arguments point to the adverse effect of politicians' use of firm resources for political and social ends (e.g., boosting employment, rectifying market failures, and reducing income inequality) rather than maximizing shareholder value (Shleifer and Vishny, 1994; Boycko et al., 1996; Bai et al., 2000; Clarke, 2003; Bai et al., 2006; Qu and Wu, 2014; Clarke, 2016). The adverse effect of political influence can be significant for both firm performance and economic development, as entrepreneurship can wither and economies stagnate under the excessive influence of the state (Shleifer and Vishny, 1998). The aim of this study is to investigate how the consequences of political influence affect firm valuation in China, an economy where the state's authority is dominant and pervasive.

How do we measure the degree of a state's political influence on a firm in a state capitalism context such as China? Many studies have focused on state ownership as the predominant measure of political influence and have treated the state-owned enterprises (SOEs) as the representatives of Chinese state capitalism. In contrast, Milhaupt and Zheng (2015) argue that as the Chinese government maintains its deciding commands on granting direct subsidies, favorable loan terms, and safeguards for selected economic sectors, many successful Chinese privately-owned enterprises (POEs) – those with minimal state ownership on the book – can also have close state connections and heavy political influence in place (Li et al., 2008; Zhou, 2009; Chow et al., 2012; Milhaupt and Zheng, 2015).¹

If one accepts this argument, studies on the state's political influence based solely on either a contrast between SOEs and POEs or an examination of state ownership can be subject to "ownership bias" (Milhaupt and Zheng, 2015) as well as incomplete regarding Chinese firms. Our

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¹ A survey shows that 50 % of the surveyed foreign institutional investors agree that the Chinese government intervenes in the decision-making of POEs (Asian Corporate Governance Association, 2018).

study exploits a recent major reform in China, the *Dangjian*, or a party-building initiative, that aimed to strengthen party-state control of firms by formalizing the Chinese Communist Party's (CCP) power and role in corporate governance. We use party-building as an exogenous shock to the state's political influence to address three research questions. First, we consider the breadth of state control by creating a novel measure of the degree of the state's political influence, which goes beyond the traditional SOE/POE dichotomy or state shareholding. Our measure is developed based on a *full* sample of Chinese firms with a comprehensive set of firm characteristics (in addition to state ownership). Second, we investigate how corporate valuation responds to this shock of political influence in this state-dominated economy. Third, we develop and test the hypothesis that the cross-sectional variation of firm valuation in response to party-building can be captured by the costs of the suboptimal governance imposed by the reform.

Since 2015, the CCP has implemented the party-building reform to solidify its control of Chinese SOEs. The reform consolidates the legal position of party cells in SOEs and the state's role in corporate governance. Although it is primarily targeted at SOEs, some POEs have also responded to the call for reform. Of the 902 firms that amended relevant charter provisions during our sample period, 289 are controlled by the Chinese central government (central SOEs), 505 by local governments (local SOEs), and 108 by private shareholders (POEs). The response of our sample firms to the party-building reform is consistent with the view in the existing literature that businesses operating in China, whether SOEs or not, stay close to the Chinese party-state and are susceptible to political influence (Milhaupt and Zheng, 2015).

We first develop a new approach to measuring political influence in China, going beyond less precise measures of political influence, such as the SOE/POE dichotomy or the share of direct state ownership (Xie et al., 2022). We examine firms' responses to the party-building reform to evaluate the level of the state's political influence firms currently experience. We infer this influence by conducting a hazard (duration) analysis using the number of days as the dependent variable between September 13, 2015 (the date of the initial announcement of party-building reform) and the date on which the shareholder's meeting passed the inclusion of the party-building provisions in its corporate charter. Our hazard analysis includes a comprehensive set of firm ownership and financial characteristics as the covariates, with the underlying construct that a firm with more significant state influence is more likely to embrace the party-building reform and to do so more promptly. Our analysis indicates that firm size and state ownership strongly relate to a higher hazard rate of party-building adoption, while POEs are strongly correlated with a lower hazard rate. Interestingly, firms with cross-listed shares on the Hong Kong market, in lower tiers of corporate pyramids, or both are associated with a lower hazard rate of adoption. While prior literature only examines the hazard rate of adoption among SOEs (Liu and Zhang 2019), our hazard analysis, which covers non-SOEs' adoption of party-building provisions, is more comprehensive. Our model's predicted hazard rate of party-building adoption is then used to measure a firm's political influence by the state before the adoption (*ex ante* political influence).

While existing literature examines the firm characteristics of adopting firms, factors determining a firm's acceptance of party control, and the voting reactions of foreign investors, very few studies examine the valuation effect of party-building adoption and the resulting enhanced political control (Liu and Zhang 2019, Lin and Milhaupt, 2021, Lin, 2021, Xie et al., 2022). Thus, we investigate investors' reactions to the announcements of the reform policies over time and evaluate how this shock affects the valuation of Chinese listed firms. Consistent with our

hypothesis that investors value the change in political influence as a trade-off between benefits of state capture² and costs of state-supervised governance, we uncover a positive firm valuation change concentrated among firms in the quartiles of a higher predicted hazard rate of party-building adoption, a proxy for *ex ante* political influence. We report the investors' reactions to two critical events in the policy announcements: October 12, 2016, when President Xi publicly endorsed the policy of formalizing the CCP's role in the current corporate governance structure, and January 3, 2017, when the State-Owned Assets Supervision and Administration Commission (SASAC) of the State Council issued guidelines on the party-building provisions for the first time. For the second event, when the investors perceived a more specific path of the reform, we report a positive and significant correlation between the three- and five-day cumulative abnormal returns (CARs) and the fourth quartile (highest) of the predicted hazard rate indicator. This positive correlation tapers off in the third and second quartiles.

Our analysis is further distinguished from existing literature by extending to the eventual adoption announced by boards of directors and examining investor reactions to the details of the charter provisions across adopting firms (Xie et al., 2022). For the 902 adopting firms, we conducted a regression analysis of the three- and five-day CARs on each of the 10 provision indicators and of the aggregate indexes of three categories of provisions after controlling for other firm characteristics as well as industry and province fixed effects. We report a negative and significant coefficient of the personnel-related index as well as of Provision 8 (the party cadre management principle in which the party can appoint managers and directors). The negative market response to the personnel provisions indicates that allowing the CCP to control a firm's personnel imposes high incremental costs and negatively impacts firm value.

Lastly, we conduct a difference-in-differences analysis comparing the Tobin's Q of the adopters with that of non-adopting control firms matched by the predicted hazard rates, and we report a positive longer-term valuation effect. The interaction term of adopters and post-adoption indicators is positively significant at the 1% level. The finding confirms the positive investor reaction to the adopters, with the benefits of state capture outweighing the costs of state-supervised governance after the reform. Our results are robust to including industry and time fixed effects, and our difference-in-differences design is valid in the falsification test.

Our study makes several contributions to the literature. First, it advances the understanding of how to evaluate a state's political influence on firms, which is often not directly observable. Existing research has used either an SOE/POE indicator, state ownership, or a corporate director's affiliation with the party-state as a proxy for political influence, pointing to the possible sources of political influence rather than directly observing firms' action to the level of political influence (Liu and Zhang 2019, Lin and Milhaupt, 2021, Xie et al., 2022). Our study offers an approach whereby political influence can be directly measured based on a firm's response to the party-state's demand for additional control. Consistent with the results of Milhaupt and Zheng (2015), our results confirm that Chinese POEs are not entirely politically independent and that the extent of political influence on a Chinese firm *cannot be fully inferred* from either an SOE/POE indicator or direct state ownership.

Second, our study extends the literature regarding how changes in political influence in a state-directed economy affect a firm's valuation. To the best of our knowledge, our study is the first to use a plausible and exogenous shock in examining the valuation effect of the state's political influence on a *full* sample of Chinese firms. We report a positive correlation between corporate valuation change and *ex ante* political

² As defined by Milhaupt and Zheng (2015), the term "state capture" is used to describe a firm's efforts to obtain special advantages from the national or local governments by aligning itself with the political leadership's interests, goals, and priorities.

influence on firms. For a heavily politically influenced firm with tight control from state-related shareholders to begin with, the benefits from additional party-state support usually outweigh the incremental costs from increased party-state control. This contrasts with a firm that is less intertwined with the state (with a low predicted adoption hazard rate). For this type of firm, the benefits from increased state capture are mostly offset by the costs of prioritizing social or political objectives, which are likely in conflict with shareholder interests. We also document that the market reacts *negatively* when firms elect to adopt charter provisions allowing the party to intervene in personnel decisions. Overall, our evidence supports the hypothesis that investors value the change in political influence as a trade-off between the benefits of state capture and the costs of state-supervised governance, with the enhanced political control costs mitigated for firms with stronger existing political ties.

The rest of the paper is organized as follows. [Section 2](#) describes the party-building event, discusses related research, and introduces our hypotheses. [Section 3](#) presents the data collection and summary statistics. [Section 4](#) reports our main empirical results on the hazard analysis and event studies of party-building adoption. [Section 5](#) presents additional analyses, and [Section 6](#) concludes.

2. Party-building reform, related literature, and hypothesis development

This section provides an overview of the party-building reform introduced by the CCP in 2015, calling for firms to amend their corporate charters to enhance the CCP's control over business decision making. We then describe a dominant institutional feature in Chinese state capitalism, which is that corporate ownership alone cannot fully explain the extent to which the party-state exerts influence on these firms. As a result, using the standard dichotomy between SOEs and POEs can create bias in the empirical analysis of corporate governance in China. Finally, we discuss the valuation implication of political influence on firms in China and present our hypotheses on empirical studies utilizing the party-building event.

2.1. Party-building reform in China

Since President Xi came to power in 2013, there has been a series of SOE reforms in China, including the mixed-ownership reform, the corporatization of SOEs, and the enhanced party leadership in SOEs ([Wang and Tan, 2020](#)). The fundamental guideline is that the CCP, or party-state, should maintain control over SOEs while attracting private capital. In this context, the party-building movement has been a critical initiative. This movement has created a situation never seen in the Western world: a dominant political party inserting itself into corporate charters to influence corporate management. While many SOEs are known to have existing internal party cells or to have party members holding important positions in the CCP as their senior management ([Chen et al., 2011](#); [Lin, 2013](#)), the party-building movement pushes the CCP's influence deeper into corporate governance by having the party's role formally enshrined in a firm's corporate charters ([Yam, 2015](#)). This added state control can raise concerns regarding the quality of corporate governance and the protection of minority shareholders' rights.

On August 24, 2015, the Central Committee of the CCP and the State Council issued "Guiding Opinions on Deepening State-owned Enterprises Reforms" (hereinafter "Guiding Opinions"). This document aimed to strengthen the CCP's leadership of SOEs by consolidating the legal position of party cells in SOEs, especially in corporate governance. Guiding Opinions also described the party cadre management principle

(*dangguan ganbu yuanze*) as strengthening the CCP's control over SOE management. In particular, the Central Committee expects SOEs to include party-building provisions in their corporate charters to formalize the CCP's leadership and party committees' legal status within the companies. A month later, the CCP issued a document reaffirming the need to strengthen its leadership over SOEs.³ After the charter amendment exercise, the CCP would no longer exercise its influence behind the scenes but would have a formal role in SOEs as stipulated by corporate charters.

The party-building movement gained momentum when President Xi publicly endorsed the policy of strengthening the CCP's leadership of SOEs at a national meeting in October of 2016 ([China Daily, 2016](#)). President Xi stated that the "party leadership and building the role of the party are the root and soul for [SOEs]," which is "a major political principle [that] must be insisted on" ([Feng, 2016](#)). Following this meeting, more companies started to amend their corporate charters to include the party-building provisions.

On January 3, 2017, the SASAC, the agency supervising SOEs at the central government level, issued the first notice announcing the party-building model provisions. This was followed by additional notices in March 2017⁴ and April 2017.⁵ The Ministry of Finance issued another notice in May 2017 with similar model provisions for SOEs in the financial sector.⁶ These notices provided a template for SOEs to follow.

In summary, since 2015, the CCP has attempted to strengthen its leadership and control over SOEs. In addition to typical rhetoric and direct or indirect political influence, what is unique about the party-building reform is the explicit goal of formalizing CCP power and influence in the legal regime of SOEs. Although SOEs were the initial target of the movement, the CCP also revealed its intention to impose some degree of party control on joint ventures between Chinese SOEs and foreign partners. One report even suggested that the CCP's efforts have extended to some foreign companies in China ([Lin, 2021](#)). In our study, 902 Chinese listed companies had adopted party-building provisions by August 2018.

2.2. Related literature and hypothesis development

2.2.1. State ownership and political influence of Chinese firms

Despite multiple rounds of market reforms to grant more autonomy to firms following the model of Western companies, the party-state continues to own and exert a strong influence over firms in China. In particular, SOEs receive considerable attention as the primary vehicle for Chinese state capitalism. A notable feature of Chinese SOEs is the presence of the party committee to oversee firms' operations alongside top executives and managers ([McNally, 2002](#); [Chang and Wong, 2004](#)). Furthermore, the Central Organization Department of the CCP directly appoints executives for many top SOEs at the central level ([Lin and Milhaupt, 2013](#)). These state-appointed executives often collaborate to

³ This document, issued by the General Office of the CCP Central Committee, was entitled "Several Opinions on Maintaining the Party's Leadership and Strengthening the Party's Team-building in Deepening the State-owned Enterprise Reform" (Zhong Ban Fa [2015] No. 44, September 20, 2015).

⁴ This notice, issued by the Organization Department of the CCP Central Committee and the Party Committee of the State-Owned Assets Supervision and Administration Commission of the State Council, was titled "Regarding the Promotion of the Requirements of Incorporation of Party Building Work into the Articles of Associations of State-Owned Enterprises" (Zu Tong Zi [2017] No. 11, March 15, 2017).

⁵ This notice, issued by the General Office of the State Council, was titled "Guiding Opinions of the General Office of the State Council on Further Improving the Corporate Governance Structure of State-Owned Enterprises" (Guo Ban Fa [2017] No. 36, Apr 24, 2017).

⁶ Notice issued by the Ministry of Finance, titled "Central Financial Enterprise Writes Party Construction Work Requirements in Guidelines for Revision of Articles of Association" (Cai Jin [2017] No.48, May 27, 2017).

influence the material decisions of the SOEs (Wang, 2014).

However, SOEs are not the only type of firms that are under the influence of the party-state in Chinese state capitalism. The standard dichotomy between SOEs and POEs might not fully capture the extent to which firms are influenced by political factors (Milhaupt and Zheng, 2015). As the state still sets the rules for the economy in China, the institutional environment can cause virtually all large and successful firms, irrespective of ownership, to engage in “state capture.” Capturing firms, in catering to state actors and agencies to access state largesse, must carry out the policies of the ruling political party. In an extreme case, some researchers argue that *no* Chinese firms, irrespective of their official ownership structure, can be considered truly autonomous and independent from the state (Milhaupt and Zheng, 2015).

One aim of this study is to address the ambiguity in categorizing Chinese SOEs and non-SOEs and to better evaluate the state’s political influence on Chinese firms.⁷ As described, the party-building reform aims to formalize CCP’s influence by giving the party committee a legal status in the corporate charter. As the amendments are made at the discretion of present managers and directors before the shareholders’ votes, the state’s *ex ante* political influence will determine to what extent and how quickly the firm can advance the reform. Liu and Zhang’s (2019) study on SOEs shows that state ownership is positively correlated with an SOE’s responsiveness to the CCP’s mandate, while non-state ownership and overseas listings are inversely related. For POEs, Lin and Milhaupt (2021) demonstrate that political connection and state ownership both contribute to the adoption of party-building provisions, with political connection being the main driving force. In this study, we attempt to extend beyond ownership and to create a new measure that estimates the level of overall political influence on a firm, be it an SOE or not. Liu and Zhang (2019) use a firm’s reaction speed to adopt party-building as a proxy to measure the cost of the Chinese government’s pushing forward its policy within a firm. When a firm’s *ex ante* political influence is higher, it will be less costly to push forward party-building policy within the firm and more likely to adopt party-building provisions timely. Following Liu and Zhang (2019), we presume that when the state’s *ex ante* political influence is *higher*, the cost of the government’s pushing forward its policy within the firm is *lower*.⁸ We further quantify such *ex ante* political influence by generating a predicted hazard rate for each firm.

We use a hazard analysis of the party-building reform with a comprehensive set of firm ownership and financial characteristics known to be relevant to political influence, including being an SOE or non-SOE, overseas listing, state shareholding percentage, ownership distance from the state, and firm size. Our hazard analysis, in addition to the inclusion of known variables relevant to political influence in the literature, incorporates *information on a firm’s response time to the party-building policy*. The analysis not only adds to the understanding of the

⁷ To date, it remains a challenge to measure the state’s political influence on Chinese POEs. Milhaupt and Zheng (2015) report the party-state affiliation of entrepreneurs at China’s 100 largest private firms as evidence of the political connections of Chinese POEs. Lin and Milhaupt (2021) measure firms’ political connections by identifying directors or executives who have previously attained certain ranks in the government or CCP in China.

⁸ Alternatively, firms with weak *ex ante* political influence may want to show their loyalty to the party and gain political capital accordingly. As a result, these firms can also be more likely to adopt party-building amendments. However, our results show that these (captor) firms (firms with weak *ex ante* political influence), *even with potential eventual value increase conditional on party-building adoption*, are less likely to adopt party-building provisions. Even if these captor firms adopted relevant provisions, they are usually slower than influential firms in adopting such provisions. One probable reason is that these captor firms would have to confront the enormous cost of pushing the adoption forward within the firm due to the requirement of supermajority shareholder approval for charter amendments (Liu and Zhang, 2019). We thank one referee for pointing out this alternative hypothesis.

determinants of political influence but also generates estimates of the predicted hazard rate as a measure of Party-state’s *ex ante* political influence on individual firms. We then examine the valuation effect of political influence during the event of party-building reform in the next section.

2.2.2. State’s political influence and firm valuation

Large controlling shareholders are known to have ambiguous effects on firm management, operation, and valuation. In a firm with diffuse ownership, agency problems arise due to the conflict of interests between managers and shareholders, but shareholders cannot contract for every possible action of a manager in advance (Jensen and Meckling, 1976). In a firm with large controlling shareholders, these shareholders have a strong incentive to monitor managers, but they also can become entrenched and can expropriate the right of minority shareholders (Claessens et al., 2002).

A state controller can have distinctly different valuation ramifications from other major nonstate shareholders. In China, the party-state has a dominant position in many firms. Its control is exercised either through owning a majority equity stake or through *de facto* political influence. As the state sets the rules for the economy in China, state control can provide firms with significant rents, such as easier access to debt financing, lower taxes, and stronger market power.⁹ In addition, the way state influence affects a firm’s valuation can depend on the mechanism of rent capture and can vary across firms in China. Hellman et al. (2003) illuminate the possible means of state capture. Their model considers two types of powerful firms in an economy with insecure property rights. The “influential firms” are incumbents that are politically well-connected (such as SOEs) with inherited privileged positions (from the previous communist system), while “captor firms,” which are *de novo* private enterprises, choose to engage in “state capture” as a strategy to compete against the influential incumbents. The model generates a critical distinguishing feature between these two types of firms: captor firms “pay” for the state capture benefits (for shaping the rules of the game),¹⁰ whereas influential firms simply enjoy the power of incumbency.

In our setting, firms with strong political influence in place are comparable to the incumbents investigated by Hellman et al. (2003). For instance, for these firms, while adhering to the state’s party-building initiatives reinforces state capture, there is limited incremental political or governance costs due to increased party control. Similar to the incumbents of Hellman et al. (2003), these firms are already subject to state-dominated governance. In contrast, for a firm currently subject to less state influence, comparable to the captor firms of Hellman et al. (2003), the costs of suboptimal governance that result from the party-building reform can be more substantial.

For example, to facilitate state capture, some firms may have to appoint more state-connected directors or managers to utilize their knowledge of government procedures, their insights into government actions, and their ability to enlist the support of government officials

⁹ Whether state ownership/control is efficient *in equilibrium* is beyond the scope of our study. Some economists argue that in competitive markets without significant externalities, government ownership is inferior to private ownership (Boycko et al., 1996; Dewenter and Malatesta, 2001). Some studies provide empirical support for the idea that government ownership is less efficient than private ownership (Vining and Boardman, 1992; Megginson et al., 1994), while others (Caves and Christensen, 1980; Wortzel and Wortzel, 1989; Kole and Mulherin, 1997) suggest that government ownership is not necessarily less efficient.

¹⁰ Milhaupt and Zheng (2015) argue that the mechanism of state capture in China can differ from that in Eastern Europe. Instead of bribes used in Eastern European countries, captor firms in China can use “growth potential” as one key form of payment to access rents from the state due to the party-state’s overriding focus on delivering sustained economic growth to maintain social stability.

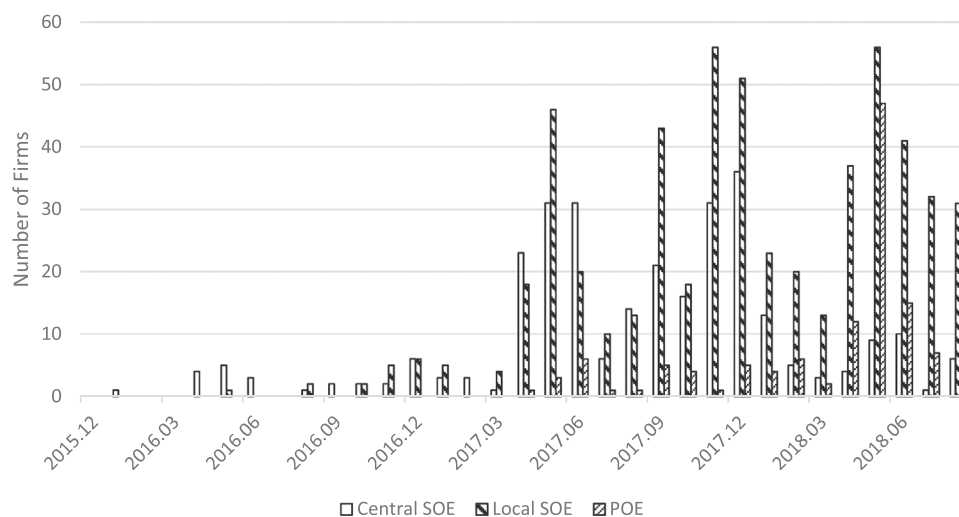


Fig. 1. Timeline of party-building charter amendments by firm type. This figure presents the timeline of the number of firms adopting party-building charter amendments by central SOEs, local SOEs, and POEs in each quarter from December 2015 to August 2018.

(Agrawal and Knoeber, 2001). Firm performance and value can be jeopardized if this new state influence distorts incentives or misallocates investments to account for political or social objectives (Shleifer and Vishny, 1994). In our setting, a firm's decision to adopt party-building provisions is an effort to exploit a "state capture" opportunity, and the net valuation effect of adoption is the difference between the benefits from increased state capture and the costs of suboptimal governance. We extend the argument of Hellman et al. (2003) in that the resulting costs of suboptimal governance (as payment for the state capture benefits) is *inversely* related to the state's *ex ante* political influence on individual firms.

On this basis, the next objective of this study is to evaluate the *net* valuation change of state capture as a function of the state's *ex ante* political influence on individual firms. The *net* valuation effect of the party-building reform on corporate valuation depends on the trade-off between the benefits of increased state capture and the costs of a state-supervised governance structure. For a highly influential firm, adhering to the state's party-building initiatives reinforces the state capture channel and secures additional rents, while the added political costs are limited, given the tight control in place by the state-dominated governance and organization. On the contrary, while a captor firm might gain additional benefits from state capture, the added political costs resulting from a suboptimal governance structure might be greater. Consequently, all else being equal, the *net* valuation of party-building adoption varies with the state's *ex-ante* political influence (as proxied by the hazard rates of adoption) on firms.

Our valuation analysis consists of two key components. First, as the state's *ex ante* political influence is not directly observable and would be poorly measured using ownership variables, we use the predicted hazard rate of party-building adoption imputed in the first stage of our analysis as a proxy of the state's political influence. Second, we use the market reaction to the party-building reform announcement as an expected *net* valuation change. Furthermore, we create a quartile variable of the predicted hazard rate where firms are ranked and categorized into four quartiles according to the level of *ex ante* political influence and then examine the valuation effect of party-building adoption among different quartiles of firms. We create the quartile variable of the predicted hazard

rate to capture any potential non-linear relationship between the state's *ex ante* political influence and firms' *net* valuation change.¹¹

We hypothesize that the *net* valuation change, measured by excess returns or cumulative abnormal returns, will be lower for firms with higher costs of suboptimal governance. Firms with higher costs of suboptimal governance will be concentrated in the lower quartiles of the predicted hazard rate of party-building adoption (with lower *ex ante* political influence). We use firms in the lowest quartile of the predicted hazard rate as the baseline for almost all our analyses. Our hypothesis H1 is as follows:

H1. : All else being equal, the excess returns of a firm on the announcements of party-building reform will be positively correlated with its *ex-ante* political influence.

The second objective of this study is to analyze the eventual adoption of the party-building provisions and to examine whether a cross-sectional variation of the firm valuation effect can be significantly captured by the costs of suboptimal governance imposed by the reform. We assume that investors are Bayesian and include their *expectations* on provisions that firms are going to adopt in the prices well ahead of our third event date. As a result, investors are reacting to new information, not yet known to the public, of the difference between the *actual* announced adopted provisions and their *expectations* on the specific party-building provisions that a company plans to adopt.¹² We use control variables (including industry dummies) to capture the potential variation in benefits of party-building adoption. Our valuation analysis focuses on the *net* valuation change due to adoption in the third event.

We postulate that conditioned on a firm adhering to the party-building reform, charter provisions that allow greater state intervention in the management or personnel decisions of a firm are more likely to distort incentives and misallocate investments to account for political or social objectives and thus increase *additional* costs to the adopting

¹¹ Instead of using the original predicted hazard rate, the creation of the quartile variable can (1) avoid the concern over the skewness of the predicted hazard rate distribution, and (2) mitigate the potential endogeneity (selectivity) concern that minimal (no) valuation changes will be concentrated on firms (in the lowest quartile) choosing not to adopt the party-building reform.

¹² A complete model specification should be a conditional event study (Acharya, 1988); however, as pointed out by Prabhala (1997), our standard event study procedure still remains a well-specified test for detecting the existence of information effects and yields parameter estimates proportional to the true conditional model parameters.

firms. As a result, investors will expect a decrease in valuation upon the announcement of adopting such provisions. Therefore, hypothesis H2 is as follows:

H2. : All else being equal, the excess returns will be negatively correlated with a firm's adoption of provisions that impose costly state-supervised (suboptimal) governance.

3. Data and summary statistics

Our initial sample includes all firms publicly listed for at least one year and traded in the A-share market of the Shanghai and Shenzhen stock exchanges in China at the end of August 2018. We used CNINFO, a search engine designated by the China Securities Regulatory Commission (CSRC), as the official information disclosure website for Chinese listed firms and searched for announcements of party-building corporate charter amendments between September 13, 2015, and August 31, 2018.

We identified 902 firms that adopted relevant party-building charter amendments during our sample period. Of these, 794 firms are owned by the Chinese government (SOEs), and 108 are private enterprises (POEs). Fig. 1 presents the monthly distribution of charter amendments by firm type. Among the adopting firms, about 59 % had shareholder meetings approving their charter amendments in 2017, and about 36 % had shareholder meetings in the first half of 2018. As a result, these firms were early adopters; they adopted the amendments before the CSRC officially incorporated the party-building concept into China's Code of Corporate Governance for Listed Companies in September 2018. The number of adopting firms peaked in May 2018, with 103 firms adopting the charter amendments.

We collected our sample firms' financial information and ownership structure from the China Stock Market and Accounting Research Database (CSMAR), maintained by GTA Information Technology. We recorded financial variables, such as total assets, total liabilities, and shareholder equity (in million yuan), and other firm characteristics, such as industry, location (province), the percentage of direct state ownership, and the SOE indicator. The Holding by State variable is the percentage of direct shareholding of the state, and it captures another aspect of state ownership, as being an SOE does not necessarily mean that the state directly controls a majority of the shares. Some Chinese firms cross-list on foreign markets, so we also created an H Share indicator. It has a value of one if the firm has shares listed on the Hong Kong Stock Exchange and zero otherwise. The variables Assets, Leverage, ROA, and BM Ratio are the logarithms of total firm assets, the ratio of total liabilities to total assets, return on assets, and the book-to-market ratio, respectively.

To measure the probability of adopting party-building provisions, we constructed additional control variables. First, we recorded the wedge between the actual controller's voting rights (controlling percentage) and cash flow rights (ownership percentage) (Separation) from CSMAR. The variable Separation is a proxy of a firm's level within its corporate pyramid. A higher value of Separation indicates that the sample firm is at the lower tier of the corporate pyramid, with an indirect and weaker control by its ultimate owner. The corporate pyramid structure has been shown to reduce government intervention and thus political costs in SOEs (Fan et al., 2013). When state control over an SOE is weak, its managers can exercise more power and are more independent of the state. We hypothesize that firms with a higher degree of Separation are less likely to adopt party-building provisions, as managers are subject to less direct state supervision and influence. Second, we measure the potential resistance by a firm's other large shareholders to the adoption of the party-building reform. We collected share data of the second- to the tenth-largest shareholders (2nd-to-10th Holding) from CSMAR and predicted that the variable 2nd-to-10th Holding would negatively affect a firm's decision to adopt party-building provisions.

To evaluate the net effect of the reform on corporate valuation, we

collected the data from the daily stock returns of our sample firms from the CSMAR and constructed three-day and five-day CARs centered on the three event dates October 12, 2016, January 3, 2017, and the announcement date of the board meeting minutes on party-building amendments for each firm. Although the first policy paper requiring SOEs to incorporate party-building provisions was the Guiding Opinions published on August 24, 2015, this requirement was not adopted by most public companies for two reasons. First, this report is a broad policy paper covering various issues related to SOE reforms. Second, the CCP did not push the party-building proposal until the National Conference on Party-Building and SOE Reforms in October 2016, during which President Xi endorsed the CCP's leadership of SOEs. After carefully reviewing the news related to President Xi's speech at the National Conference on Party-building and SOE Reforms, we found that the first news was published by the Xinhua News Agency after trading hours on October 11, 2016 (Xinhua News, 2016). Therefore, we set October 12, 2016, as our first event date.

The next critical moment in the party-building reform was when the SASAC clarified the specific provisions to be included in the charters. The SASAC officially announced the model provisions on January 3, 2017. Therefore, we set the announcement of the model provisions on January 3, 2017, as our second event date. This event indicates that party-building was no longer just a matter of policy discussion but had become a more concrete agenda item for firms. Fig. 1 confirms the same. There were very few charter amendments before January 2017. The number of companies that amended charters did not increase until April and May 2017, which is the first usual period for public companies in China to hold annual general meetings after the announcement of model provisions. The event signaled a political change with consequences for firm managers.

Although investors had learned about the potential change on the second event date, they did not specifically know the provisions that each company would adopt in their corporate charters until the companies announced the proposed amendment. Therefore, the final critical moment was when each company amended its charters at a shareholders' meeting. Before a shareholders' meeting, Chinese law requires a company to publish the board meeting minutes, including the proposed agenda for discussion at the forthcoming shareholders' meeting. The earliest time at which the market learns of the specific provisions adopted by a company is on the announcement date of the board meeting minutes. Therefore, we set the announcement date of the board meeting minutes on the proposed party-building amendments for each firm as our third event date. The third event might also capture the effect of other concurrent agendas passed by the same board meeting; however, we believe that by aggregating the price effect of all sample firms, the extraneous effect should be offset on the aggregate level.

We calculate the risk-adjusted return using the following procedure. We first obtain the β estimates by regressing the market model: $RET_{i,t} = \alpha_i + \beta_i RM_t + i_t$, where $RET_{i,t}$ is the return on stock i on day t , and RM_t is the Shanghai and Shenzhen 300 value-weighted index return on day t . The model is estimated for each firm over six months of $[-250, -30]$ with a minimum of 100 daily trading records before each relevant party-building event to obtain the estimated coefficients α_i and β_i . For each event date, some firms were eliminated either because they were not trading during the event window or because there were not enough data to estimate the parameters of the market model. The realized market returns, RM_{τ} , and the realized individual firm returns, $RET_{i,\tau}$, during the event windows ($\tau = -1, 0, 1$) and ($\tau = -2, -1, 0, 1, 2$), where 0 is the event date, were used to construct the three- and five-day CARs as the sum of the daily abnormal returns during the event windows. The definitions of all variables are listed in the Appendix.

To collect the list of companies that adopted party-building provisions, we surveyed all Chinese A-share listed companies by searching all corporate documents on the CNINFO website, including the articles of association and the minutes of the board of directors and shareholder meetings, with keywords relating to party-building via a Web crawler,

Table 1

Summary statistics of key variables for subsamples of party-building adopting and non-adopting firms.

	All firms				Adopting firms				Non-adopting firms				Diff in Mean t (or $\chi^2 p$ value)
	N	Mean	Median	Std. Dev.	N	Mean	Median	Std. Dev.	N	Mean	Median	Std. Dev.	
Panel A. Cumulative abnormal return													
3day CAR_1 (%)	2655	-0.002	-0.002	4.819	791	0.322	0.146	4.112	1864	-0.468	-0.404	5.073	-3.872***
5day CAR_1 (%)	2640	-0.006	-0.003	6.916	787	-0.082	0.129	5.822	1853	-0.804	-0.420	7.322	-2.454**
3day CAR_2 (%)	2755	-0.153	-0.110	4.442	813	-0.833	-0.806	3.679	1942	-1.818	-1.290	4.696	-5.335***
5day CAR_2 (%)	2732	-0.235	-0.120	7.776	808	-0.726	-0.442	5.974	1924	-3.034	-1.569	8.325	-7.146***
3day CAR_3 (%)	-	-	-	-	826	-0.069	-0.056	4.300	-	-	-	-	-
5day CAR_3 (%)	-	-	-	-	825	-0.219	-0.436	5.216	-	-	-	-	-
Panel B. Ownership structure													
POE	3526	0.704	1	0.456	902	0.121	0	0.326	2624	0.905	1	0.294	(0.000***)
H Share	3538	0.029	0	0.167	902	0.070	0	0.255	2635	0.014	0	0.119	(0.000***)
Holding by State	2816	3.286	0	11.120	833	8.789	0	17.769	1983	0.973	0	4.985	-17.980***
Separation	2608	4.849	0	7.534	767	3.897	0	7.174	1841	5.246	0.197	7.646	4.178***
2nd-to-10th Holding	2823	23.647	22.133	13.181	834	19.555	16.434	12.954	1983	25.382	24.459	12.903	5.828***
Panel C. Financial characteristics 2015													
Assets	2816	8.367	8.163	1.470	833	9.176	8.887	1.697	1983	8.026	7.916	1.213	-20.274***
Leverage	2816	3.432	2.386	3.380	833	0.531	0.530	0.238	1983	0.397	0.377	0.209	-14.838***
ROA	2816	0.031	0.032	0.073	833	0.019	0.023	0.069	1983	0.037	0.036	0.074	6.010***
BM Ratio	2586	0.325	0.232	0.631	774	0.500	0.375	1.091	1812	0.249	0.197	0.204	-0.251***

This table presents the summary statistics of key variables, including the CARs for the three events, firm characteristics variables and financial controls based on 2015 data. All variables are as defined in the Appendix. *, **, and *** denote significance at the 10 %, 5 %, and 1 % levels, respectively.

and we confirmed all coding with hand-coding.

We categorized the SASAC's guidelines on party-building provisions into ten main types and then hand-coded the provisions adopted by each firm by identifying the key provisions in the announced charter amendments. We constructed the following ten indicators: (1) Provision 1 has a value of one if the provision contains the terms "Constitution of the Chinese Communist Party" and zero otherwise; (2) Provision 2 has a value of one if the provision contains the words "providing financial support for party activities" (or text with a similar effect) and zero otherwise; (3) Provision 3 has a value of one if the provision includes the statement "the board to consult the party committee about material decisions prior to the board meeting" (or text with a similar effect) and zero otherwise; (4) Provision 4 has a value of one if the provision includes "establishing an official party committee within the firm" (or text with a similar effect) and zero otherwise; (5) Provision 5 has a value of one if the provision contains the statement to establish "a party discipline inspection committee" and zero otherwise; (6) Provision 6 has a value of one if the provision contains the statement that the "chairman and party secretary must be the same person" (or texts with a similar effect) and zero otherwise; (7) Provision 7 has a value of one if the provision contains the statement for the "creation of a full-time position of deputy party secretary" (or texts with a similar effect) and zero otherwise; (8) Provision 8 has a value of one if the provision contains "adopting the party's cadre management principle" or "the party has the power to appoint directors and managers" (or text with a similar effect) and zero otherwise; (9) Provision 9 has a value of one if the provision contains "senior management to consult the party committee about material management decisions" (or text with a similar effect) and zero otherwise; and (10) Provision 10 has a value of one if the provision contains "dual appointment of top executives in the firm and representatives of the party committee" (or text with similar effect) and zero otherwise.

Table 1 presents the summary statistics of the CARs, ownership structure, and financial characteristics for the subsamples of party-building adopting and non-adopting firms. We tabulate the number of observations, mean, median, and standard deviation for each subsample for each variable. The last column presents the t statistics (or $\chi^2 p$ value) of the difference in means between adopting and non-adopting firms. The overall reactions to the events are negative. The market

reacted more negatively to non-adopting firms than adopting firms in the first two events. Note that for the events of October 12, 2016 (CAR_1), and January 3, 2017 (CAR_2), we compute the investors' reactions to the relevant announcements for the *full sample* of Chinese listed firms. For both events, the three- and five-day CARs of the adopting firms are significantly higher than those of the non-adopters. We record the investors' reactions to the board meeting minutes announcing the party-building provisions for the *adopting firms only* (CAR_3).

The ownership structure also differs significantly between the two subsamples. For instance, 87.9 % of the adopting firms are SOEs, compared with 9.5 % of non-adopters. Similarly, while the average share ownership of the state is 8.79% for the adopters, the average is significantly lower at 0.97 % for the non-adopters. In addition, 7 % of the adopting firms is cross-listed in Hong Kong, which is significantly higher than the 1.4 % of non-adopters. The summary statistics indicate that state ownership is one crucial factor of whether a firm adopts the party-building charter amendments. There is also a significant difference in financial characteristics between the two subsamples. Adopters have significantly larger assets, use more leverage, and have higher market valuation than non-adopters; however, adopters are not more profitable in terms of ROA than non-adopters.

Table 2 reports the correlation matrix between the variables used in the subsequent regression analysis in the three event windows. Panels A, B, and C present the results of the correlation analysis of the events of October 12, 2016, January 3, 2017, and the announcement date of the board meeting minutes of each firm, respectively. In Panels A and B, POE is positively correlated with Separation, 2nd-to-10th Holding, Leverage, and ROA and negatively correlated with H Share, Holding by State, Assets, and BM Ratio. As expected, POEs have a lower predicted hazard rate than SOEs. Interestingly, both the three- and five-day CARs are significantly negatively correlated with POE, meaning that POEs receive a lower market valuation than SOEs.

Panel C presents the results of the correlation analysis of the variables of the adopting firms at the time the board announced the proposed party-building amendments. In this subsample, POE and Holding by State continue to be significantly and negatively correlated. As this subsample consists of disproportionately large SOEs, there is no significant correlation between the ownership and financial variables. The adopting firms with significant assets use less leverage and have higher

Table 2
Correlation analysis.

Panel A. Event date October 12, 2016												
	Predicted hazard rate	3 day CAR ₁	5 day CAR ₁	POE	H Share	Holding by State	Separation	2nd-to-10th Holding	Assets	Leverage	ROA	BM Ratio
Predicted hazard rate	1.000											
3 day CAR ₁	0.0759*	1.000										
5 day CAR ₁	0.0428*	0.9419*	1.000									
POE	-0.8642*	-0.0741*	-0.0429*	1.000								
H Share	0.1007*	-0.001	0.011	-0.1495*	1.000							
Holding by State	0.4609*	0.0445*	0.012	-0.3242*	0.020	1.000						
Separation	-0.1002*	-0.018	-0.0441*	0.0744*	-0.030	-0.0748*	1.000					
2nd-to-10th Holding	-0.2462*	-0.0538*	-0.033	0.2870*	0.1716*	0.021	-0.0828*	1.000				
Assets	0.4484*	0.004	-0.0611*	-0.3368*	0.4217*	0.1821*	0.0626*	-0.033	1.000			
Leverage	-0.1832*	-0.028	0.014	0.1842*	-0.0893*	-0.0654*	-0.038	0.1470*	-0.3342*	1.000		
ROA	-0.1136*	-0.0737*	-0.0427*	0.1327*	-0.030	0.003	-0.016	0.1574*	-0.023	0.1909*	1.000	
BM Ratio	0.4166*	0.024	-0.002	-0.1838*	0.2830*	0.034	0.040	-0.010	0.4073*	-0.0945*	-0.0505*	1.000
Panel B. Event date January 3, 2017												
	Predicted hazard rate	3day CAR ₂	5day CAR ₂	POE	H Share	Holding by State	Separation	2nd-to-10th Holding	Assets	Leverage	ROA	BM Ratio
Predicted hazard rate	1.000											
3day CAR ₂	0.0835*	1.000										
5day CAR ₂	0.1553*	0.9068*	1.000									
POE	-0.8642*	-0.1024*	-0.1439*	1.000								
H Share	0.1007*	0.032	0.0454*	-0.1495*	1.000							
Holding by State	0.4352*	-0.0648*	-0.0666*	-0.3454*	0.012	1.000						
Separation	-0.0869*	0.035	0.0452*	0.0464*	-0.015	-0.0457*	1.000					
2nd-to-10th Holding	-0.2462*	-0.0675*	-0.1086*	0.2870*	0.1716*	-0.028	-0.1022*	1.000				
Assets	0.4093*	0.1688*	0.1757*	-0.3231*	0.3956*	0.1631*	0.1067*	-0.029	1.000			
Leverage	-0.1805*	-0.1154*	-0.1267*	0.1835*	-0.0904*	-0.0669*	-0.0503*	0.1140*	-0.3418*	1.000		
ROA	-0.019	-0.1025*	-0.1236*	0.0396*	-0.032	-0.012	0.033	0.0509*	-0.0715*	0.0789*	1.000	
BM Ratio	0.2015*	0.0783*	0.0831*	-0.1534*	0.2116*	0.016	0.025	-0.025	0.3640*	-0.0916*	-0.0412*	1.000
This table presents the correlation between key variables for the three event dates in Panels A to C, respectively. *, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively.												
Panel C. Announcement date of the board meeting minutes												
	Predicted hazard rate	3 day CAR ₃	5 day CAR ₃	POE	H Share	Holding by State	Separation	2nd-to-10th Holding	Assets	Leverage	ROA	BM Ratio
Predicted hazard rate	1.000											
3 day CAR ₃	0.011	1.000										
5 day CAR ₃	-0.010	0.8699*	1.000									
POE	-0.5208*	-0.008	0.006	1.000								
H Share	-0.043	-0.030	-0.023	0.033	1.000							
Holding by State	0.2860*	-0.0988*	-0.1612*	-0.1325*	-0.065	1.000						
Separation	-0.1003*	-0.009	-0.047	0.046	-0.031	-0.053	1.000					
2nd-to-10th Holding	-0.1108*	-0.002	0.015	0.2900*	0.3560*	0.0754*	-0.028	1.000				
Assets	0.3199*	-0.051	-0.022	0.029	0.4748*	0.019	0.010	0.2181*	1.000			
Leverage	-0.1444*	-0.036	-0.029	0.0665*	-0.0978*	0.018	0.060	-0.015	-0.3778*	1.000		
ROA	-0.0971*	-0.032	-0.044	0.0752*	-0.032	0.0745*	0.026	0.065	-0.061	0.2925*	1.000	
BM Ratio	0.1929*	-0.003	0.018	-0.012	0.2446*	-0.053	0.003	0.0913*	0.3537*	-0.0972*	-0.031	1.000

BM ratios. Moreover, cross-listed firms are larger and have less growth potential (higher BM ratios). In all panels in Table 2, the variable Predicted Hazard Rate represents the predicted hazard rate of party-building adoption, which is discussed in Section 4.1.

4. Empirical analysis

We examine the *net* valuation effect of state capture as a function of the state's *ex ante* political influence on individual firms in two stages. We first investigate the determinants of the firms' response time in adopting party-building charter amendments and compute a firm's (expected) hazard rate of party-building adoption as a measure of the state's political influence. We then evaluate the relationship between firm valuation change and this hazard rate in an analysis of how Chinese

capital market investors impute the party-building information into stock prices in the three event windows of October 12, 2016, January 3, 2017, and the announcement dates of the board meeting minutes.

4.1. Firms' hazard rate of party-building adoption

In this subsection, we examine the timing of the adoption of party-building provisions in the hazards model. We perform a survival (or duration) analysis, which studies the occurrence and timing of events. We consider party-building adoption a failure event and use the following Cox proportional hazards model (Greene, 2017):

$$\lambda(t_i) = \lambda_0(t_i) \exp(-\beta' X_i). \quad (1)$$

Table 3
Cox hazards model of party-building adoption.

	(1)	(2)	(3)	(4)	(5)	(6)
POE	-3.640*** (0.140)	-3.678*** (0.141)	-3.601*** (0.142)	-3.593*** (0.142)	-3.587*** (0.141)	-3.559*** (0.146)
H Share	-0.422** (0.176)	-0.033 (0.171)	-0.334* (0.192)	-0.341* (0.193)	-0.356* (0.194)	-0.347* (0.203)
Holding by State	0.005** (0.002)	0.007*** (0.002)	0.005** (0.002)	0.005** (0.002)	0.006** (0.002)	0.005** (0.003)
Separation	-0.013** (0.005)	-0.013** (0.005)	-0.013** (0.005)	-0.013** (0.005)	-0.014** (0.006)	-0.015*** (0.006)
Assets	0.137*** (0.033)		0.135*** (0.033)	0.123*** (0.033)	0.128*** (0.034)	0.086* (0.046)
2nd-to-10th Holding		-0.005 (0.004)	-0.005 (0.003)	-0.004 (0.003)	-0.004 (0.003)	-0.004 (0.004)
BM Ratio						0.155 (0.189)
Leverage				-0.026 (0.019)	-0.021 (0.019)	-0.031 (0.022)
ROA					-0.614 (0.702)	-0.809 (0.785)
Industry fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Province fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
N	2554	2554	2554	2554	2554	2352

This table presents the results of Cox hazards model of firms to adopt party-building charter amendment in China. The dependent variable $\lambda(t_i)$ is the hazard rate for firm i at time t or the probability that firm i will adopt party-building provisions at time t , as it has not yet adopted party-building provisions at time t . If a firm adopts party-building provisions on day t , we classify it as an adopting firm and define t as the number of days between September 13, 2015 and the date of its shareholder meeting. Conversely, if a firm has not adopted party-building provisions during our sampling period, we classify it as a "censored" observation and set t as the number of days between September 13, 2015 and the end of our sampling period (August 31, 2018). The control variables include firm characteristics and financial ratios as defined in the Appendix. The financial data is based on the firm's data at the end of 2015. All models in Table 3 include both industry and province fixed effects. Financial firms are excluded. Robust standard errors are reported in parentheses. *, **, and *** denote significance at the 10%, 5%, and 1% levels, respectively.

The dependent variable $\lambda(t_i)$ is the hazard rate for firm i at time t or the probability that firm i will adopt party-building provisions at time t , as it has not yet adopted party-building at time t . If a firm adopts party-building on day t , we classified it as an adopting firm and defined t as the number of days between September 13, 2015, and the date of its shareholder meeting. Conversely, if a firm has not adopted party-building provisions during our sample period, we classified it as a "censored" observation and set t as the number of days between September 13, 2015, and the end of our sample period (August 31, 2018). $\lambda_0(t_i)$ is the baseline hazard rate, capturing the individual heterogeneity of firm i . Cox's partial likelihood method allowed for estimating the coefficient vector β without estimating $\lambda_0(t_i)$.

X_i is a vector of financial and ownership variables. First, as SOEs are the main target of the party-building movement, presumably with heavy political influence already in place, we expect SOEs to adopt amendments earlier than POEs. The same is true for direct shareholding by the state (Holding by State). In contrast, POEs should be slower to adopt party-building provisions, if they do so at all. As our study examines the state's political influence on Chinese firms in general, we use the POE indicator to highlight its effect on the decision to adopt party-building provisions. Second, if the firm is cross-listed in the Hong Kong market (or H Shares), we expect it to be less likely to adopt party-building provisions early due to the potential adverse reactions to share prices in the foreign market. Third, in terms of ownership structure, we expect firms with a higher degree of separation between cash flow rights and voting rights (Separation) to be less likely to adopt party-building provisions, all else equal, as they should be subject to less political influence. Fourth, existing literature has shown that large POEs are subject to more political influence than other POEs and are more similar to SOEs than smaller POEs in this regard (Milhaupt and Zheng, 2015). Therefore, we predict that larger firms are more likely to adopt party-building provisions than others. Finally, we expect that companies with a large second- to tenth-largest shareholding (2nd-to-10th Holding) are less likely to adopt relevant provisions, as the interests of other large shareholders may not be aligned with those of the state, and these shareholders may resist adoption.

Table 3 presents the results of the Cox proportional hazards model. The central concept of a survival analysis is the hazard rate, which is the probability that a sample firm will amend its charter on day t given that it has survived (not amended its charter) until this time t , contingent on a vector of covariates in our analysis. Model (1) builds on the results of Models (2) to (3) and is the model we use to predict the hazard rate. Models (4) to (6) extend Model (3) with different financial controls, including BM Ratio, Leverage, and ROA, to increase the robustness of model selection. The results remain strong after controlling for financial variables. All models in Table 3 include both industry and province fixed effects. We exclude financial firms from our analysis.

Table 3 shows that the variables POE, H Share, Holding by State, and Assets significantly affect the hazard rate of adopting party-building provisions. Consistent with the existing literature, a firm with greater state influence in place will likely respond to party-building reform and will do so more promptly. First, not surprisingly, the SOE (non-POE) indicator and higher direct ownership by the state (Holding by State) relate to an increased hazard rate of adoption for these firms. Second, our analysis indicates that larger firms (either SOE or POE) are more likely to have a higher hazard rate of adoption because virtually all large, successful firms in China, irrespective of ownership, engage in "state capture" and are subject to high degrees of political influence (Milhaupt and Zheng, 2015). Third, Separation, the variable measuring the difference between the voting rights and the cash flow rights of the largest shareholder, has a negative effect on the hazard rate in all models. Separation is higher for firms in lower tiers of corporate pyramids, which are less subject to direct political pressure from the state. Fourth, the H Share cross-listing indicator emerges as a significant negative predictor. Cross-listed firms can be subject to corporate governance requirements in Hong Kong and thus may be more reluctant to adopt the reform. It is also likely that the adoption by H-share firms will be slower due to the need to undergo more procedures, such as the approval by both stock exchanges, to complete their party-building amendments.

In summary, the results in Table 3 are consistent with our assumption that state ownership and firm size positively contribute to a higher

Table 4
Regression analysis on cumulative abnormal returns: Event October 12, 2016.

	3 day CAR ₁ (%)			5 day CAR ₁ (%)		
	(1)	(2)	(3)	(4)	(5)	(6)
Quartile 1 of predicted hazard rate (lowest)	-0.113 (0.167)	-	-	0.060 (0.212)	-	-
Quartile 2 of predicted hazard rate		-0.172	-0.066		-0.302	-0.372
Quartile 3 of predicted hazard rate		(0.208) 0.087	(0.242) 0.240		(0.264) -0.163	(0.304) -0.287
Quartile 4 of predicted hazard rate (highest)		(0.198) 0.492**	(0.343) 0.548		(0.251) 0.372	(0.428) -0.068
Included controls?	No	No	Yes	No	No	Yes
Industry fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Province fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
R ²	0.038	0.043	0.063	0.048	0.051	0.063
N	2355	2355	2290	2342	2342	2279

This table presents the results from OLS regression of cumulative abnormal returns (CARs) of all firms in the sample for the event on October 12, 2016. The dependent variable is the 3-day and 5-day CAR₁. We use the predicted hazard rate from Model (1) of Table 3 to generate dummy variables for each quartile of predicted hazard rate from the lowest (1) to the highest (4) quartile. The control variables, if included, contain POE, H Share, Holding by State, Separation, Assets, 2nd-to-10th Holding, Leverage, ROA, and BM Ratio. We also control for industry and province fixed effect in the models and exclude financial firms from the data. All variables are as defined in the Appendix. Standard errors are reported in parentheses. *, **, and *** denote significance at the 10 %, 5 %, and 1 % levels, respectively.

hazard rate of party-building adoption. In contrast, being POEs, having a greater separation between cash-flow and voting rights, and being H share companies have a lower hazard rate of adoption. As we show in Models (2) and (3), the shareholding percentage of major external shareholders (2nd-to-10th Holding) does not seem to affect a firm's likelihood to adopt party-building provisions. Therefore, in subsequent analyses, we use Model (1) in Table 3 to generate estimates of the predicted hazard rate as a measure of *ex ante* political influence on firms.

Table 5
Regression analysis on cumulative abnormal returns: Event January 3, 2017.

	3 day CAR ₂ (%)			5 day CAR ₂ (%)		
	(1)	(2)	(3)	(4)	(5)	(6)
Quartile 1 of predicted hazard rate (lowest)	-0.440*** (0.154)	-	-	-1.258*** (0.191)	-	-
Quartile 2 of predicted hazard rate		0.009 (0.189)	-0.133 (0.223)		0.571** (0.237)	0.583** (0.271)
Quartile 3 of predicted hazard rate		0.473*** (0.180)	0.143 (0.299)		1.266*** (0.224)	1.057*** (0.358)
Quartile 4 of predicted hazard rate (highest)		0.894*** (0.193)	0.474 (0.512)		2.070*** (0.233)	1.641*** (0.569)
Included controls?	No	No	Yes	No	No	Yes
Industry fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
Province fixed effect	Yes	Yes	Yes	Yes	Yes	Yes
R ²	0.033	0.042	0.054	0.062	0.080	0.096
N	2379	2379	2256	2357	2357	2240

This table presents the OLS regression results of the cumulative abnormal returns of all sample firms for the event on January 3, 2017. The dependent variable is the 3 day and 5 day CAR₂. We use the predicted hazard rate from Model (1) of Table 3 to construct dummy variables for each quartile of predicted hazard rate. The control variables, if included, include POE, H share, Holding by State, Separation, Assets, 2nd-to-10th Holding, Leverage, ROA, and BM ratio. We also control for industry and province fixed effect in the models and exclude financial firms from the sample. All variables are as defined in the Appendix. Standard errors are reported in parentheses. *, **, and *** denote significance at the 10 %, 5 %, and 1 % levels, respectively.

The distribution of the predicated hazard rate is skewed towards zero with 64.55% of the firms fall between zero and one. The median of the predicted hazard rate is 0.16 but the mean is 2.25. To avoid distorted estimation, instead of using the predicted hazard rate, we create a quartile variable that ranked firms according to the predicted hazard rate and categorized firms into four quartiles and examine the valuation effect of party-building adoption among different quartiles of firms in the first two events.

4.2. Firm valuation and hazard rate of party-building adoption

We conduct a regression analysis on the *net* valuation effect of the adoption of party-building provisions. We use the three- and five-day announcement-period CARs as the dependent variables and a wide range of independent variables for the three event dates: (1) October 12, 2016 (President Xi's policy declaration), (2) January 3, 2017 (the official publication of the party-building model provisions), and (3) each firm's announcement date of the board meeting minutes regarding party-building amendments. The first two events apply to the *full sample* of A-share companies listed on the Shanghai and Shenzhen stock exchanges but exclude financial firms. The third event is limited to firms that actually amended their corporate charters to include party-building provisions. Thus, the third event date varies among companies. Since the first two events apply to all firms in the sample on the same dates, we acknowledge that there could be issues of event time clustering and cross-correlation in abnormal returns of the firms (Kolari and Pynnonen, 2010). This may qualify the results presented below. On this basis, we discuss each event in turn.

4.2.1. Event 1: October 12, 2016

We examine how investors re-evaluate firm valuation for the first significant party-building-related event: when President Xi publicly endorsed the policy of strengthening the CCP's leadership of SOEs and incorporating this leadership into corporate governance on October 12, 2016.

Our hypothesis H1 predicts a positive relationship between the change in firm valuation and the predicted hazard rate of adoption, a proxy of a state's political influence. Upon receiving the new incremental information on the details of reform on the event dates, the investors value the change in political influence as a trade-off between benefits of state capture and costs of a state-supervised governance structure. As discussed regarding H1, for a more state-independent firm, the benefits of state capture can be offset by the costs of state-supervised governance, and investors will expect a less positive change in valuation.

In contrast, investors will expect an increase in valuation when a heavily politically influenced firm answers the call for party-building reform.

$$CAR_{i,t} = \alpha + \beta' \text{Quartile Indicators of Hazard Rates} + \gamma' X_i + \Sigma \text{INDUSTRY/PROVINCE} + \varepsilon_i \quad (2)$$

Table 4 presents the results of the regression analysis of Eq. (2) with the announcement-period CAR_1 on the predicted hazard rate quartile indicators after controlling for variables, such as POE, H Share, Holding by state, Separation, Assets, 2nd-to-10th Holding, Leverage, ROA, and BM ratio, for the event of October 12, 2016. We also control for industry and province fixed effects in the models and exclude financial firms from the data. Table 4 presents the results after winsorizing the top and bottom 0.5% of the observations to mitigate the impact of outliers; however, the results between the winsorized and non-winsorized data are similar.

As the results in Table 4 illustrate, there is a monotonic increase in the abnormal returns across quartiles 2–4 of the predicted hazard rate, with or without controlling for other firm characteristics and financial ratios; however, the results are weak in terms of statistical significance, meaning that we only have limited evidence of the positive relationship between the degree of political influence and the abnormal returns, as predicted by Hypothesis H1, on the day when President Xi publicly endorsed the policy of strengthening the CCP's leadership in SOEs.

4.2.2. Event 2: January 3, 2017

We further evaluate investors' reactions when the SASAC published the official party-building model charter provisions on January 3, 2017. Table 5 presents the regression results using the announcement-period CAR_2 centered on this event day as the dependent variable. The models and variables used in the analysis are identical to those shown in Table 4.¹³

Similar to the results in Table 4, those in Table 5 indicate a monotonic increase in the abnormal returns across quartiles 2–4 of predicted hazard rate, with or without controlling for other firm characteristics and financial ratios. The results in Table 5 are much stronger statistically. In particular, the results of Models (1) and (4) indicate that the market reacted negatively to companies in the lowest quartile of predicted hazard rate, which is consistent with hypothesis H1 that *net* firm valuation change will be negative for those mostly independent from the state (ranked lowest by the predicted hazard rate). The results in Models (2), (5), and (6), with firms in quartile 1 as the baseline, indicate a significant increase in abnormal returns across quartiles 2–4 of the predicted hazard rate. In fact, the coefficient estimates of quartiles 3 and 4 are significantly positive in these three models, indicating an expected valuation increase from investors of those firms with strong state political influence upon the SASAC's publication of the model provisions.

Overall, Table 5 supports the prediction that there is a significant positive (piecewise) relationship between the predicted hazard rate and the valuation change due to the incremental increase in state political influence on firms imposed by the party-building reform. The reform's effect on firm valuation depends on the trade-off between the benefits from increased state support and the costs of greater state interference in governance. As a result, for a more state-independent firm, the benefits of state capture are more offset by the costs of a state-supervised governance structure, and investors will expect a lower valuation gain from the party-building reform.

The overall empirical results presented in Tables 4 and 5 support our Hypothesis H1. The effect of a party-building reform announcement on the cumulative abnormal returns of October 12, 2016, and January 3, 2017, is less negative for firms that are subject to higher political

influence (ranked higher by the Predicted Hazard Rate). The market reactions to firms were not significant when President Xi announced the implementation of the party-building reform in SOEs on October 12, 2016. The market responded more strongly and significantly to the 2017 event, when the implementation details were clarified by the announcement of the party-building model charter provisions. The significance of the investor reaction suggests that investors are Bayesian: much uncertainty was resolved regarding how firms would operationalize the reform when more concrete information was revealed by the model provisions on January 3, 2017.¹⁴

4.2.3. Event 3: Announcement of board meeting minutes

Our subsequent analysis considers the eventual adoption of the party-building reform and examines the investor reaction to the details of the charter provisions across adopting firms. The charter amendments of the adopting firms were announced after their approval by each company's board of directors, followed by a vote at the shareholder meetings.

Following Lin and Milhaupt (2021), we categorize the SASAC's guidelines on party-building provisions into 10 main types, constructed the 10 indicators, and regroup the 10 provisions into three major categories.¹⁵ The first group consists of symbolic provisions,¹⁶ including Provision 1 (following the CCP's constitution), Provision 2 (financing the party's expenses), and Provision 4 (having a party committee). The second group consists of provisions related to the company's decision making, including Provision 3 (prior consultation with the party committee by the board) and Provision 9 (prior consultation with the party committee by senior management). The third group consists of provisions on the personnel of the company, including Provision 5 (having a party discipline inspection committee), Provision 6 (dual appointment of the chairman and party secretary), Provision 7 (having a full-time deputy party secretary), Provision 8 (the party cadre management principle), and Provision 10 (dual appointment of top executives and party representatives). In addition, we created an index, Total Index, as a proxy for the degree of charter amendments by aggregating the total number of provisions adopted by the firm.

Table 6 presents the adoption rate of each provision by SOEs and POEs. Among the 10 provisions, 892 firms (98.89 %) adopted Provision 1 with the term "Constitution of the Chinese Communist Party" in their corporate charters, and 900 firms (99.78 %) adopted Provision 4, stipulating the creation of a formal and official party committee within the firm. Almost all adopting firms included symbolic provisions in the charter amendments. In contrast, only 233 firms (25.83 %) adopted Provision 7 (full-time deputy party secretary), and only 305 firms (33.81 %) specified that the chairman and party secretary must be the same person. The adoption rates of these two personnel-related provisions are also low among SOEs at 25.84 % and 35.77 %, respectively. On average, the studied firms adopted 6.48 party-building charter provisions. While SOEs adopted an average of 6.72 provisions, the POEs adopted an average of 4.69 provisions. These results show that SOEs are more likely to adopt more provisions, as the difference in means is statistically significant ($p < 0.001$). This is an expected result. SOEs (and notably central SOEs) are expected to be subject to more substantial political

¹⁴ Romano and Sanga (2017) studied the adoption of exclusive forum clauses (which require shareholder lawsuits to be brought in the court of the incorporation state and to be included in bylaws or charters) and show that midstream adoptions took off after the Delaware Chancery Court ruled that the clauses were valid and not after an earlier Chancery Court had suggested in dicta that companies could incorporate these clauses into their charters.

¹⁵ Lin and Milhaupt (2021) conducted a principal component analysis to gauge the variations in provision adoptions and confirmed the three categories.

¹⁶ Lin and Milhaupt (2021) report that H-share firms that amend their charters tend to include symbolic provisions, consistent with the idea that these charter amendments might not subject adopters to much more political influence.

¹³ For brevity, we do not tabulate the coefficient estimates of control variables in Tables 4 and 5. The full regression results will be available in the online Appendix on the authors' personal website.

Table 6
Party-building charter amendment of adopting firms.

	Total	SOEs	POEs
Individual provision	N (% of 902 total adopting firms)	N (% of 794 adopting SOEs)	N (% of 108 adopting POEs)
Provision 1: provision containing the term "Constitution of the Chinese Communist Party"	892 (98.89 %)	786 (98.99 %)	106 (98.15 %)
Provision 2: provision containing the statement of "providing financial support for party activities"	799 (88.58)	717 (90.30 %)	82 (75.93 %)
Provision 3: provision including the statement "the board to consult the party committee about material decisions prior to the board meeting"	638 (70.73 %)	596 (75.06 %)	42 (38.89 %)
Provision 4: provision including "establishing an official party committee within the firm"	900 (99.78 %)	792 (99.75 %)	108 (100 %)
Provision 5: provision containing the statement to "establish a party discipline inspection committee within the firm"	653 (72.39 %)	609 (76.70 %)	44 (40.74 %)
Provision 6: provision containing the statement that the "chairman and party secretary must be the same person"	305 (33.81 %)	284 (35.77 %)	21 (19.44 %)
Provision 7: provision containing the statement for the "creation of a full-time position of deputy party secretary"	233 (25.83 %)	225 (25.84 %)	8 (7.41 %)
Provision 8: provision containing the statement of "adopting the party's cadre management principle in which the CCP directly appoints managers and directors"	563 (62.42 %)	523 (65.87 %)	40 (37.04 %)
Provision 9: provision containing "senior management to consult the party committee about material management decisions"	360 (39.91 %)	345 (43.45 %)	15 (13.89 %)
Provision 10: provision contains "dual appointment of top executives in the firm and representatives in the party committee"	501 (55.54 %)	462 (58.19 %)	39 (36.11 %)
Firms with at least one symbolic provisions, including Provisions 1, 2 or 4	902 (100 %)	794 (100 %)	108 (100 %)
Firms with at least one decision-making provisions, including Provision 3 or 9	696 (77.16 %)	649 (81.74 %)	47 (43.52 %)
Firms with at least one personnel-related provisions, including Provisions 5–8 or 10	745 (82.59 %)	691 (87.03 %)	54 (50%)
Average of total index	All 6.479	SOEs 6.720	POEs 4.692

This table presents the number of firms, SOEs, and POEs (and percentage over the total number of adopting firms, adopting SOEs, and adopting POEs) of the 10 party-building provisions in charter amendments and dummies for having symbolic, decision-making, and personnel provisions. Total index is the number of adopted provisions out of the ten provisions.

influence.

When the board meeting minutes are published, information on how the firms planned to adopt party-building provisions is revealed to the market.¹⁷ The incremental information during these events includes (1) the firm's management decision and the impending implementation of the party-building reform and (2) details of how the reform would be incorporated into the corporate charter. In practice, the proposal is ultimately approved at the shareholder meeting as a formality. Thus, we use the date when the board meeting minutes were published as the third event date to measure the market reactions. Therefore, we modified Eq. (2) to include and to evaluate the effect of the additional information:

$$CAR_{3t} = \alpha + \beta' \text{Total-Index}_{it} + \gamma \text{Symbolic/Decision Making/Personnel group Indicator}_{it} + \delta \text{Provision (1-10) Indicator}_{it} + \gamma X_i + \sum \text{INDUSTRY/PROVINCE} + \varepsilon_{it} \quad (3)$$

When the boards drafted the party-building provisions to be voted on at the next shareholder meeting, there was a minimal uncertainty about adoption. On the dates of the publication of the board meeting minutes, the investors received detailed information about the charter amendments before the vote. As discussed, the adoption rate and the potential effect of each provision on corporate governance can vary considerably across firms. Therefore, we evaluate the impact of each provision (provisions 1–10) on the abnormal returns in the three- and five-day event windows.

Table 7 shows the regression results of the total index, the three group indices, and each provision to examine the market reaction to the adoption details. In addition, we include firm characteristics, financial controls, as described in Section 3, and industry and province fixed effects in models (2), (4), (6), (8), (10), and (12). All models exclude financial firms. The results are presented in Table 7, with Models (1)–(6) for the regression results on the three-day CAR_3 and Models (7)–(12) for five-day CAR_3 .

As tabulated in Table 7, a firm's adoption of personnel-related provisions is negatively correlated with the 3-day CAR_3 , as shown in Models (3) and (4). The result is driven by the provision of introducing the party cadre management principle (Provision 8), which allows the CCP to control not only the firm's senior executives but also some middle-rank managers. Compared with other personnel-related provisions that focus on more senior executives (e.g., dual role of chairman and party secretary, full-time deputy party secretary, and dual appointment of senior executives and party committee members), the party cadre management principle has a greater impact on personnel decisions and appointments. Hence, this might explain the negative impact of the adoption of Provision 8 compared with other provisions (Chen and Lin, 2021). Our results indicate a negative effect on firm value if the newly added state influence relates to human resources and the appointment of personnel rather than formalizing an existing arrangement (as by symbolic provisions). The results are consistent with Hypothesis H2 that investors will devalue a firm when a firm includes a charter provision that entails costly state-supervised governance.

The investor reaction is less negative for a firm's adoption of

¹⁷ Investors may have included their expectations on provisions firms were to adopt in the prices well ahead of the third event date. As a result, investors were reacting to new information, not yet known to the public, of the difference between the actual announced adopted provisions and their expectations of the specific party-building provisions that a company planned to adopt. A complete model specification should be a conditional event study (Acharya, 1988); however, as pointed out by Prabhala (1997), the standard event study procedure still remains a well-specified test for detecting the existence of information effects and yields parameter estimates proportional to the true conditional model parameters. The significant market reaction to the third event is consistent in that the third event adds information to investors over and beyond what they learned earlier from the second event.

Table 7

CAR regression analysis in the event window of the board meeting minutes announcement on party-building charter amendment.

	3 day CAR ₃ (%)						5 day CAR ₃ (%)					
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
Total Index	-0.101 (0.068)	-0.118 (0.086)						-0.019 (0.089)	-0.035 (0.108)			
Symbolic Index			0.409 (0.387)	0.676 (0.476)					0.679 (0.530)	0.661 (0.601)		
Decision-making Index			0.144 (0.219)	0.073 (0.254)					0.163 (0.265)	0.087 (0.292)		
Personnel Index			-0.212** (0.092)	-0.229** (0.102)					-0.132 (0.112)	-0.122 (0.119)		
P1: CCP Constitution					-2.649** (1.080)	-2.299* (1.343)					-0.933 (1.932)	-2.122 (1.700)
P2: Expenses					0.745* (0.448)	0.892 (0.565)					0.675 (0.604)	0.763 (0.722)
P3: Prior Consultation by the Board					0.202 (0.381)	0.207 (0.437)					0.654 (0.448)	0.599 (0.490)
P4: Establish Party Committee					1.217*** (0.408)	2.201** (1.104)					2.842** (1.260)	4.170** (1.807)
P5: Party Discipline Inspection Committee					0.543 (0.420)	0.390 (0.464)					0.362 (0.495)	0.098 (0.529)
P6: Dual Position					-0.260 (0.348)	-0.610 (0.409)					0.308 (0.432)	-0.003 (0.500)
P7: Full-time Deputy Party Secretary					-0.143 (0.357)	-0.108 (0.400)					-0.118 (0.454)	0.126 (0.500)
P8: Party Cadre Management Principle					-0.992** (0.389)	-0.898** (0.413)					-0.990** (0.468)	-1.047** (0.515)
P9: Prior Consultation by Management					0.067 (0.317)	-0.055 (0.375)					-0.215 (0.382)	-0.317 (0.425)
P10: Dual Appointment					-0.079 (0.395)	0.198 (0.413)					-0.223 (0.466)	0.145 (0.485)
Constant	0.584 (0.490)	9.256** (4.390)	-0.872 (1.028)	6.654 (4.553)	0.905 (1.032)	6.768 (4.598)	-0.099 (0.638)	10.842** (5.317)	-2.018 (1.494)	8.622 (5.597)	-2.698 (2.204)	6.780 (5.749)
Include Controls?	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes
Industry Fixed Effect	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes
Province Fixed Effect	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes	No	Yes
R ²	0.003	0.069	0.008	0.075	0.020	0.087	0.000	0.078	0.004	0.081	0.013	0.092
N	826	719	826	719	826	719	825	718	825	718	825	718

This table presents the results from OLS regression of cumulative abnormal returns of firms that adopt party-building charter amendments in the event window of the board meeting minutes announcement. The dependent variable is the 3 day (model 1–6) and 5 day CAR₃ (model 7–12). The table presents results of total index, symbolic index, decision-making index, personnel index, and each provision. The control variables, if included, contain POE, H share, Holding by State, Separation, Assets, 2nd-to-10th Holding, Leverage, ROA, and BM Ratio. We also control for industry and province fixed effect in the models and exclude financial firms from the sample. All variables are as defined in the Appendix. Robust standard errors are reported in parentheses. *, **, and *** denote significance at the 10 %, 5 %, and 1 % levels, respectively.

Provision 4 (having a party committee), as shown in Models (5), (6), (11), and (12). The reason could be that many of the adopting firms (such as SOEs) probably already had a party committee in place before the reform. Thus, in a way, the adoption of Provision 4 enhanced certainty and transparency concerning the presence of a party committee to outside investors; however, because all adopting firms have one or more symbolic provisions (as shown in Table 6), this may explain why the Symbolic Index has no correlation with the CARs.

To address the concern of systematic bias, where some sample firms might announce their board meeting minutes on the same day because many corporations hold shareholder meetings around the same time-frame of the year, we conduct additional unreported regressions for a robustness check by excluding the largest clustering group of firms or creating dummies for the top five clustering group of firms. Our results remain robust after the check.

5. Additional analysis

While the event studies in Section 4 examine short-term market responses, we assess the longer-term effect of the reform on firm valuation in this section. It might take some time for investors to price in the added political control after the party-building reform correctly, or there might

be price reversal due to investors' short-term mispricing. The longer-term effect analysis can also be less subject to errors when there are concurrent events (other than party-building announcements) in the short event windows, as discussed in Section 4; however, as the party-building reform is still on-going as of the time of writing, the sample in the analysis is limited to the early adopters, consisting of firms that amended their charters before the end of August 2018.

We collect data on Tobin's Q of all A-share listed firms from the first quarter of 2015 to the second quarter of 2020 from the CSMAR database. Tobin's Q is computed as the ratio of market capitalization scaled by the value of (total assets – intangible assets – goodwill). For each early adopter (treated firm) in our sample, we use nearest-neighbor propensity-score matching to select non-adopters based on their predicted hazard rate (a proxy for the state's political influence) with replacement and allow for up to three unique matches per treated firm. ADOPT is a dummy variable, with a value of 1 for firms that amended their charters before the end of August 2018 and 0 for matched non-adopters. POST is a dummy variable, with a value of 1 for the quarters after the year of adoption and 0 otherwise. ADOPT*POST is the interaction term. The control variables, if included, include POE, H share, Holding by State, Separation, Assets, Leverage, ROA, and BM Ratio.

We conduct difference-in-differences regressions comparing the

Table 8
Robustness: Difference-in-differences matching estimator.

	Tobin's Q				Log of Tobin's Q			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
ADOPT	-0.912*** (0.227)	-0.471** (0.227)			-0.228*** (0.036)	-0.032* (0.019)		
POST	-1.019*** (0.139)	-0.080 (0.102)	-0.323** (0.127)	-0.307** (0.130)	-0.319*** (0.016)	0.031*** (0.011)	-0.027 (0.018)	-0.018 (0.012)
ADOPT*POST	0.400*** (0.146)	0.295** (0.143)	0.398** (0.155)	0.326** (0.159)	0.050** (0.019)	0.008 (0.014)	0.037* (0.019)	0.016 (0.014)
Included controls?	No	Yes	No	Yes	No	Yes	No	Yes
Firm fixed effect	No	No	Yes	Yes	No	No	Yes	Yes
Quarter fixed effect	No	No	Yes	Yes	No	No	Yes	Yes
R ²	0.043	0.302	0.110	0.179	0.099	0.783	0.393	0.715
N	22,658	20,417	22,658	20,417	22,658	20,417	22,658	20,417

This table presents the results from OLS regression of Tobin's Q in a difference-in-differences (DiD) specification. The dependent variable is quarterly Tobin's Q for model (1) to (4) and log of quarterly Tobin's Q for model (5) to (8) collected from the first quarter of 2016 to the third quarter of 2019 from the CSMAR database. We define Tobin's Q as market capitalization / (total assets – intangible assets – goodwill). ADOPT is 1 for The DiD design compares the differences in firm valuation between adopting firms (treated group) and matched non-adopting firms (control group) before and after the party-building adoption of firms in the treated group. We use nearest-neighbor propensity score matching method to match non-adopting firms by their predicted hazard rate with replacement and allow for up to three unique matches per treated firm. ADOPT is a dummy variable, = 1 for firms which amended their charters before the year end/year-end, and = 0 otherwise. POST is a dummy variable, = 1 for the quarters after the party-building adoption and = 0 otherwise. ADOPT*POST is the interaction term. The control variables, if included, contain POE, H share, Holding by State, Separation, Assets, 2nd-to-10th Holding, Leverage, ROA, and BM Ratio as defined in the Appendix. Standard errors reported in parentheses are clustered at the firm level. *, **, and *** denote significance at the 10 %, 5 %, and 1 % levels, respectively.

Table 9
Falsification analysis.

	Tobin's Q				Log of Tobin's Q			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
ADOPT	-1.104*** (0.300)	-0.525* (0.297)			-0.253*** (0.039)	-0.025 (0.022)		
POST	-0.534*** (0.143)	-0.044 (0.106)	-0.013 (0.093)	0.044 (0.081)	-0.132*** (0.017)	0.009 (0.012)	0.018 (0.016)	0.007 (0.010)
ADOPT*POST	0.202 (0.150)	0.130 (0.135)	0.214 (0.132)	0.054 (0.111)	0.018 (0.020)	-0.000 (0.013)	0.010 (0.017)	-0.008 (0.011)
Included controls?	No	Yes	No	Yes	No	Yes	No	Yes
Firm fixed effect	No	No	Yes	Yes	No	No	Yes	Yes
Quarter fixed effect	No	No	Yes	Yes	No	No	Yes	Yes
R ²	0.023	0.288	0.069	0.194	0.044	0.771	0.252	0.687
N	12,167	12,130	12,167	12,130	12,167	12,130	12,167	12,130

This table presents the results from OLS regression of Tobin's Q in a difference-in-differences (DiD) design with matched samples but with randomly-assigned shifted event dates. We randomly assign adopting date to each adopting firm between 2015Q4 and 2016Q3, a period before the confirmation of the party-building reform. The dependent variable is a proxy for firm valuation: Tobin's Q for model (1) to (4) and log of Tobin's Q for model (5) to (8). We define Tobin's Q as market capitalization / (total assets – intangible assets – goodwill). The DiD design compares the differences in firm valuation between adopting firms (treated group) and matched non-adopting firms (control group) before and after the randomly-assigned adoption date. ADOPT is a dummy variable that denotes 1 if the firm adopts party-building provisions in the corporate charter and 0 otherwise. POST is a dummy variable, = 1 after the randomly-assigned adopting quarter and = 0 otherwise. ADOPT*POST is the interaction term. The control variables, if included, contain POE, H share, Holding by State, Separation, Assets, 2nd-to-10th Holding, Leverage, ROA, and BM Ratio. All variables are as defined in the Appendix. Standard errors reported in parentheses are clustered at the firm level. *, **, and *** denote significance at the 10 %, 5 %, and 1 % levels, respectively.

early adopters (*ADOPT*) with all other firms in their pre- and post-adoption performance (*POST*). **Table 8** presents the results, with the quarterly Tobin's Q as the dependent variable for Models (1) to (4) and the log of Tobin's Q as the dependent variable for Models (5) to (8).

$$Tobin's\ Q_{it} = \alpha + \beta_1 ADOPT_{it} + \beta_2 POST_{it} + \beta_3 ADOPT_{it} * POST_{it} + \gamma' X_{it} + \Sigma FIRM/QUARTER + \epsilon_i \tag{4}$$

The results in **Table 8** indicate a long-term valuation gain for these early adopters. In six of eight models, the interaction terms *ADOPT* and *POST* are positively significant at the 1 %, 5 %, or 10 % levels. These results comport with our hypothesis H1 that there is a valuation increase for firms with high political influence (our treated sample of early adopters) after actual party-building adoption.

To validate our difference-in-differences research design, we conduct a falsification test. We repeat our analysis in **Table 8** but randomly assign an adoption date to each adopting firm between the fourth quarter of 2015 and the third quarter of 2016, a period before the confirmation of

the party-building reform. If our difference-in-differences experiment is valid, we should observe no significant treatment effect in the falsification test results. As the results in **Table 9** indicate, we find an insignificant coefficient of the interaction term across all specifications. These results validate that the positive valuation effect on adopting firms only occurs around the adopting dates of the party-building provisions. The falsification test confirms our finding that the party-building reform has an average positive valuation effect among firms with high political influence (our treated sample of early adopters) after actual adoption.

6. Conclusion

Considerable research on how the Chinese state's political influence affects firm performance and valuation has focused on examining SOEs as a comprehensive sample of state capitalism. We employ the recent party-building reform in China as an exogenous shock to a change of political influence in the state-dominated economy. The study has

provided consistent evidence that Chinese POEs are not entirely politically independent and that the extent of political influence imposed on a Chinese firm *cannot be fully inferred* from either an SOE/POE indicator or direct state ownership.

We adopt a two-step approach to advance the understanding of how to evaluate the state's political influence on firms, which can often be latent and not directly observable in China. We first use a firm's response to party-building reform to evaluate pre-existing political influence. As the reform formalizes the state's power in a firm's corporate charters, the state's *ex ante* political influence on a firm determines how thoroughly and quickly it embraces the party-building reform. Our hazard analysis on firms' party-building adoption reveals that larger firms (either SOE or POE), an SOE indicator, and state ownership strongly relate to a higher hazard rate of party-building adoption. Interestingly, enterprises in lower tiers of corporate pyramids or that are cross-listed in Hong Kong are more independent, are less subject to political influence, and are associated with a lower hazard rate.

We then employ a firm's hazard rate of party-building adoption to measure the state's political influence and to examine the firm's valuation change on the event dates of relevant policy announcements. The results indicate a positive (piecewise) relationship between the predicted hazard rate and the valuation change, with a higher valuation change concentrated among firms in the higher quartiles of the predicted hazard rate. Our results are consistent with the contention that the effect of party-building reform on a firm's valuation depends on the trade-off between the benefits from increased state capture and the costs of state interference in firm governance and that the enhanced political control costs are mitigated for firms with stronger existing political ties. Additional difference-in-differences analyses show a consistent longer-term positive valuation effect on early adopters (firms subject to stronger political influence).

Finally, we examine investors' reactions to the details of charter

provisions upon the firms' eventual adoption of the party-building provisions. We report that investors' reactions are significantly negative for a firm's adoption of personnel-related provisions allowing CCP to control human resources. The results are consistent with the conjecture that the cross-sectional variation in firm valuation can be significantly captured by the costs of suboptimal governance imposed by the party-building reform.

Data availability

Data will be made available on request.

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Contributors

All authors have approved the final article.

Declarations of interest

None.

Appendix. Variable descriptions

Variables	Description
Dependent variables	
3day CAR ₁	The three-day cumulative abnormal return centered on October 12, 2016 based on the market model, with the estimation period [− 250, − 30]
5day CAR ₁	The five-day cumulative abnormal return centered on October 12, 2016 based on the market model, with the estimation period [− 250, − 30]
3day CAR ₂	The three-day cumulative abnormal return centered on January 3, 2017 based on the market model, with the estimation period [− 250, − 30]
5dayCAR ₂	The five-day cumulative abnormal return centered on January 3, 2017 based on the market model, with the estimation period [− 250, − 30]
3day CAR ₃	The three-day cumulative abnormal return centered on the announcement date of the board meeting minutes based on the market model, with the estimation period [− 250, − 30]
5day CAR ₃	The five-day cumulative abnormal return centered on the announcement date of the board meeting minutes based on the market model, with the estimation period [− 250, − 30]
Control variables	
POE	Dummy for privately-owned enterprises that are not state-owned enterprises
H Share	Dummy for H shares listed on the Hong Kong Stock Exchange
Holding by State	Percentage of direct shareholding by the state
Separation	The difference between the voting rights and cash flow rights (equity rights) held by the actual controller
2nd-to-10th Holding	Percentage of total shareholding by the second to tenth largest shareholders
Assets	Logarithm of total assets
Leverage	Ratio of total liabilities to total assets
ROA	Return on assets
BM Ratio	Book-to-market ratio

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