A Reinvestigation of Managerial Ties and Firm Performance in China’s Transition Economy

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Abstract: This paper explores the paths between manager’s two types of ties (business ties and political ties) and firm’s two kinds of related performance (financial performance and innovative performance) through the mediating roles of organizational learning. Results show that these two kinds of ties have positive direct effects on financial performance. But the two kinds of ties have different effects on innovative performance. Manager’s business ties have positive effect on innovative performance. But, it has positive indirect effect on innovative effect through mediating role of organizational learning. Manager’s political ties reduce the level of organizational learning and finally restrain firm’s innovation, indicating that political ties harm firm’s growth finally. Based on the results, these two kinds of managerial ties should be treated differently.

Keywords: business ties; political ties; organizational learning; firm performance; transition economy

1 Introduction

A great many researchers have explored manager’s personal ties, however, most studies focus on the micro-micro link between manager’s personal ties and his/her career success. Peng and Luo tried to subdivided managerial ties into two dimensions—horizontal business ties and vertical government ties, and for the first time they built a micro-macro link between these personal ties and firm performance.[1] Almost every researcher agrees that managerial ties have positive effects on firm’s financial performance. In addition, the ties also influence new enterprise’s growth, innovation, formation of strategic alliance, and diversification strategies of enterprise cluster. Moreover, some scholars found that the relationships between managerial ties and firm outcomes are moderated by firm characteristics (i.e. ownership) and industrial factors (i.e. competitive intensity).

Some Chinese researchers stressed that guanxi which is a basic element for Chinese enterprises doing business, is essentially important, but they ignored the subdivision of managerial ties. The existing empirical studies mostly focus on the influence of enterprise’s networks on its performance. Although researchers differ in the performance measurement, it can be agreed that the networks enterprises have and their position in the networks can influence their performance. This is a kind of macro-macro linkage, and few studies have explored the micro-macro linkage between managerial ties and firm performance.

The existing empirical studies focus on the micro-macro linkage and its contingencies, whereas few have explored the paths between managerial ties and firm performance. This is one of the main contributions of this research. Another one is this research subdivides firm performance into two dimensions, that is, financial performance and innovative performance, the former measures firm’s short-term financial outcomes which most existing researchers adopt to measure performance, the latter measures firm’s long-term outcomes relating to firm growth.

2 Theory and Hypotheses

2.1 Managerial ties and firm performance

Managerial ties are a kind of manager’s social capital that can bring some personal benefits such as career success, which has been testified by various studies. This is a micro-micro level link between personal ties and personal success. In the existing few studies on manager’s personal ties and firm performance, most agree that managerial ties can promote firm performance. For example, Park and Luo came up with the hypothesis that two kinds of managerial ties can both promote firm performance[3]. Li and Zhang proposed that political ties can improve firm’s innovative performance and this link is moderated by industrial factors[4]. Some Chinese researchers have also tested the positive relationship between manager’s business ties and firm’ innovation level with a pure Chinese high technology firms, and they find another moderate variable absorptive capacity. Luk et al. concluded that managerial business ties and political ties can both promote firm’s administrative innovation[4]. It should be noted that firm performance is actually financial performance in these studies. Although researchers measure firm performance with different financial indicators, they agree that managerial ties can promote firm performance. In accordance with former studies and as a re-test of the relationship, we propose the following hypotheses:

Hypothesis 1: Managerial business ties are positively...
related to firm’s financial performance.

Hypothesis 2: Managerial political ties are positively related to firm’s financial performance.

However, the linkage between two types of managerial ties and firm’s innovative performance maybe different. Corporate’s business partners including suppliers and competitors hold rich information about product market. But it is hardly possible for an individual corporate to grasp so rich information. Therefore, individual corporations have to cooperate with each other in order to know well about product market. Managers’ good personal ties with counterparts from other corporates may make the communication between corporates more easily. Thus, this kind of managerial ties will enhance firm’s product innovation level. On the other hand, it will be much easier for firms to find partners if their managers know each other very well, and this kind of cooperation’s transaction costs and risks are certainly low. This kind of ties is long orientated and managers cultivate this type of ties do not mean to get business interests for the time being. On the contrary, ties between managers and government officials are different. Managers want to gain direct financial benefits from government in a short term. This may be much easier to happen during economic transition with a lack of transparent decision-making mechanism of government, especially when the government controlling lots of resources. This means, under the circumstances of weak resource flow, market segmentation, incomplete information and strong market demand, managers possibly allocate firm resources in building good relationship with government officials other than in product innovation. And the more resources managers allocate in ties building, the less firms can spend on innovation. Financial resources are fundamental for a firm to survive in fierce competition. Even if managers build a good relationship with government officials, it does not necessarily mean that managers themselves will not use these ties for personal purposes. Over time, this strategic thinking will become habitual and firm’s development will be badly impacted. In short:

Hypothesis 3: Managerial business ties are positively related to firm’s innovation performance.

Hypothesis 4: Managerial political ties are negatively related to firm’s innovation performance.

2.2 Organizational learning and firm performance

Knowledge-based theory treats firms as a set of various knowledge firms have accumulated, and firms have to accumulate various knowledge to gain competitive advantage. Organizations can get access to various knowledge through learning, and accumulated knowledge in turn can promote future learning. Previous studies separated organizational learning into three dimensions—shared vision, open-mindedness and commitment to learning, and the exploitation of existing organizational knowledge and exploration of new organizational knowledge are two facets of organizational learning. It is widely accepted that organizational learning has positive effects on firm performance. On the one hand, organizational learning can enhance financial performance by improving existing products, accumulating successful experience, improving efficiency and reducing costs. Luo and Peng testified that organizational learning can improve firm’s overall financial performance. On the other hand, organizational learning can also enhance firm’s product innovation level. Some researchers find that organizational learning has a positive effect on R&D investment which is an indicator of innovation. Organizations can also learn knowledge and ideas from others to accelerate new product R&D, which has been proved by existing studies. In brief, we hypothesize:

Hypothesis 5: Organizational learning is positively related to firm’s financial performance.

Hypothesis 6: Organizational learning is positively related to firm’s innovative performance.

2.3 Managerial ties and organizational learning

Existing studies emphasize organization’s roles in knowledge absorption, dissemination, interpretation and memory processes. Organizational researchers believe that organizational learning is greatly impacted by environmental and organizational factors. On the one hand, the higher the uncertainty in the external environment, the more urgent the organization feels to learning. On the other hand, organizational learning is also influenced by accumulated knowledge. During economic transition, turbulent environment forces organizations to learn in order to enhance competitive ability. But as discussed above, informal institutions are so strong that organizations are reluctant to obey formal rules or there are no formal rules at all. Thus organizations are in pursuit of managerial ties with government officials to obtain resources and ignore organizational learning. So, different managerial ties have different impact on organizational learning, that is,

Hypothesis 7: Managerial business ties are positively related to organizational learning.

Hypothesis 8: Managerial political ties are negatively related to organizational learning.

Previous studies have found that firm can get more marginal profit from innovative products[5], so innovative performance will enhance financial performance. Only if firm growth is guaranteed, can financial performance continuously promoted. As global market is becoming more and more open, new product will be more and more important for firm prosperity. As to innovative performance and financial performance, it is proposed that:

Hypothesis 9: Firm’s innovative performance is positively related to financial performance.
3 Method

3.1 Sampling and data collection

The data for this study were collected from senior executives—chief executive officers (CEOs) or managing directors (MDs) and their deputies, and heads of the finance/accounting function—of manufacturing and service firms operating in High-tech Development Zone and High-tech Industrial Development Zone of the capital of Northeast China’s Jilin Province. We randomly selected 80 firms according to the business directory and yellow pages provided by the two administrative committees. The survey was administered in person through a face-to-face interview or by e-mail. 400 questionnaires were delivered and a total of 172 completed ones received with a respond rate of 43%. Of the 172 received surveys, 80% of the managers have worked in the firm for over two years; 68% of the firms are state owned and 32% of the firms are non-state owned.

3.2 Measures

Financial performance. In China, publicly available information about the objective performance data of firms is difficult to obtain because most firms are reluctant to provide such information. Therefore, we relied on the firms’ subjective evaluation of their performance relative to competitors. The respondents were asked to rate their firms on four measures of performance (growth of sales, growth of market share, growth of net income or profits, growth, and return on sales) relative to the major competitors in their industry in the past year.

Innovative performance. Innovative performance is taken from López, JMM Peón, and Ordás. In order to characterize the degree of innovativeness in companies, we follow the relative number of radical innovations and incremental innovations compared with competitors, as an expression of a corporation’s technological innovativeness.

Managerial ties. We follow Batjargal and Liu and Peng and Luo’s perceptual measures of managerial ties: we treat managerial ties as a composite factor that consists of business and political ties. Business ties involve three items that assess top managers’ ties with managers of other firms (i.e., buyers, suppliers, and competitors); political ties contain three items examining top managers’ use of connections with political leaders at various levels of government, officials in industrial bureaus, and officials in regulatory and supporting organizations during the past year.

Organizational learning. Scale of organizational learning is taken from Baker and Sinkula, which measures organizational learning in three dimensions—commitment to learn, shared vision, and open-mindedness, each dimension has six items.

All the variables above were measured by participants’ responses to questions on 5-point Likert-type scales ranging from “strongly disagree” to “strongly agree”.

Controls. Previous studies showed that organizational and industrial factors have impacts on firm performance. So we include firm size (logarithms of employees), ownership (1 for state owned, 0 for other), firm age (the number of years of operation by the firm), as control variables. In addition, to assess the extent of competition in different areas, we use the item “Competition is intense in our local environment” (1=“strongly disagree”, 5=“strongly agree”) to indicate competitive intensity.

4 Results

4.1 Reliability and validity

Questions were derived from the literature, validity and reliability of scales have been tested by researchers. In order to assure the measurement quality, Harman’s one-factor test was used to check for the presence of common method variance. The results of the tests indicate that no single factor accounted for a majority of the variance. Discriminant validity of the constructs was tested by comparing a constrained model in which correlations between two constructs were constrained to 1 with an unconstrained model. The results of the pairwise tests among the constructs indicated that in each case the χ2 difference was significant at the p < 0.01 level, and the fit of the unconstrained model was significantly better than the constrained model, providing evidence of discriminant validity. In addition, all scales had reliabilities above the 0.70 threshold.

4.2 Test of hypotheses

To test the hypotheses, we used AMOS 4.0, which is a replacement of LISREL by SPSS Inc. Business ties and political ties both had a positive effect on financial performance, lending support to both Hypothesis 1 and Hypothesis 2. Business ties were positively related to innovative performance, but political ties’ negative relationship with innovative performance is not supported. As hypothesized, organizational learning is positively related to innovative performance, but surprisingly not positively related to financial performance. Furthermore, business ties’ positive effect on organizational learning and political ties’ negative effect on organizational learning are both supported. Finally, it was testified that innovative performance could enhance financial performance. In a word, all the nine hypotheses are supported except Hypothesis 4 and Hypothesis 5.

It shows that organizational learning mediates the relationship between managerial ties and firm performance. But in short term, political ties can bring more benefit than its negative effects on financial performance (total
net positive effect of political ties on financial performance $= 0.65 - 0.39 \times 0.73 \times 0.30 > 0$). So to managers, they should pay more attention to innovation and spend more resources on organization development itself not to lay too more importance on government officials.

References