Demystifying the dark side of board political capital

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Abstract

Politically-connected directors help firms build 'board political capital' that may give them preferential access to benefits but it could also make them indulge in corrupt activities that in turn could lead to regulatory enforcement by authorities. However, it is still not clear which attributes of board political capital may expose firms to such negative outcomes. We address this gap by using an overarching dark side perspective of board political capital to hypothesize that regional (vs. central) board political capital, proportion of male (vs. female) politically-connected directors and perk consumption have positive effects on the incidence of regulatory enforcement. We also hypothesize that proximity to the regulatory authorities has a negative effect on regulatory enforcement and it negatively moderates the link between board political capital and regulatory enforcement. Data on 762 pairs of publicly listed Chinese firms supports most of the hypotheses. We discuss the theoretical and managerial implications of these results.

Keywords: board political capital; gender diversity; perk consumption; regulatory enforcement

1. Introduction

Corporate corruption and fraud are common phenomena worldwide and have become increasingly serious, particularly in those transitional economies where the formal system of law is still under development (Cabestan, 2017; Deng, Yan, & Sun, 2019). Past research explores the role of ethical blind spots in organizations that may undermine moral agency resulting in corporate corruption (Moberg, 2006) or uses a contractarian business ethics view that goes beyond the general theories of business ethics, such as Kantianism, pragmatism, utilitarianism, virtue ethics, and stakeholder model (Wempe, 2008). In this context, 'democratic business ethics' view holds corporations to account for their actions and disrupts corporate sovereignty (Rhodes, 2016), while others acknowledge the presence of firms' political connections as a potential source of corruption as it may involve misuse of power by government officials for unlawful private gain (DiRienzo & Redington, 2014; Sharma, Cheng, & Leung, 2020).

In order to obtain political favors from the government officials to help foster business success, entrepreneurs and managers develop close relationships with government officials and politicians, resulting in 'crony capitalism', which represents a dark form of business-to-business (B2B) relationships (Guzmán et al., 2020; Oh, Chang, & Jung, 2019). Such fee-for-service contracts between politicians and firms, although not in written form, may represent a form of bribery (Kroszner & Stratmann, 1998). In this context, current literature refers to the presence of politicians or directors with political connections on corporate boards as 'board political capital' (Sun, Hu & Hillman, 2016) and it includes both human (knowledge and experience in dealing with government units) and social (ties with government units) capital. Board political capital can be a crucial resource for firms as it may provide them invaluable political resources to help them overcome external environmental complexities (Child & Rodrigues, 2012) and have a positive influence on firm performance (Tihanyi et al., 2019).

Interestingly, recent research highlights a 'dark side' of board political capital that could have an adverse impact on the firms by exposing them to regulatory actions by the authorities (Sun et al., 2016). Moreover, the impact of board political capital on firm performance may not always be positive, stable or homogeneous (Sun, Mellahi, & Liu, 2011; Sun, Mellahi, & Thun, 2010; Sun, Wright, & Mellahi, 2010). Specifically, past research shows that political connections may have a diminishing positive or even a negative effect on firm performance (Sun et al., 2010) and firm value (Sun, Mellahi, & Wright, 2012; Sun, Mellahi, Wright, & Xu, 2015) as well as the quality of financial reporting, board independence, and corporate disclosure, which may lead to higher cost of capital (Liedong & Rajwani, 2018). Others argue that politically connected independent directors may not be as motivated to monitor the managers or shareholders as non-politically connected independent directors (Shi, Xu, & Zhang, 2018). Thus, it is clear that board political capital can be a double edged sword for the firms (Yan & Chang, 2018).

One major consequence of the growing role of board political capital is the growing incidence of regulatory enforcement against corporate fraud in recent years, including activities such as, inflated profits, asset fabrication, unauthorized change of fund use, false statement, major failure of information disclosure and embezzlement committed by a firm (e.g., Wu, Johan, & Rui, 2016). However, current research on the impact of political connections on regulatory enforcement by authorities ignores the impact of specific characteristics of board political capital (Mutlu et al., 2018), which makes it difficult to identify those politically-connected directors who are more likely to expose firms to regulatory enforcement, compared to others. In addition, there is mixed evidence about the effects of board political capital on firm performance, with some showing a positive influence (e.g., Cooper, Gulen, & Ovtchinnikov, 2010; Fisman, 2001) while others showing a negative impact (e.g., Fan, Wong, & Zhang, 2007; Sun et al., 2016). Most of these studies only consider the quantitative characteristics of board political capital (e.g., number or proportion) and ignore its qualitative aspects (e.g., level and gender). We address all these gaps by

using an overarching dark side perspective of board political capital to develop an integrative conceptual model with direct and indirect effects of two characteristics of board political capital (level - central vs. regional and gender – female vs. male) and two external factors (perk consumption and proximity to regulatory authorities) on regulatory enforcement.

We use data from 762 pairs of Chinese firms with and without regulatory enforcement outcomes between 2010 and 2013, to explore the moderating role of two factors (regional vs. central board political capital and proximity to the regulatory authorities) on regulatory enforcement. We also investigate the direct effects of board gender diversity (proportion of male politically-connected directors) and perk consumption on regulatory enforcement. We find support for most of our hypotheses and our results are robust for different econometric techniques to address the selection bias and endogeneity concerns that can confound the interpretation of the results. This paper extends current research on corruption by using an overarching dark side perspective to examine its legal, political, and gender diversity dimensions. We also discuss some useful conceptual contributions of this study for academic researchers and practical implications for the firms, investors, and regulators. We conclude with a discussion of the limitations of this study and some useful directions for future research.

2. Theoretical background and hypotheses

2.1. Dark side of board political capital

According to the resource dependence theory, government is one of the main sources of external dependency for firms as government policies affect different aspects of their business (Hillman & Hitt, 1999). The relationship between government and business is interdependent rather than unidirectional similar to any typical B2B relationship (Dieleman & Boddewyn, 2012). In order to survive and succeed, firms devise corporate political strategies to create an exchange with political decision makers so as to establish a favorable public policy environment (Hillman & Hitt,

1999). Politically connected firms can benefit from a lower cost of equity capital and easier access to external finance (Boubakri et al., 2012; Khwaja & Mian, 2005) but may also suffer from poorer financial reporting disclosure quality (Chaney, Faccio, & Parsley, 2011).

Most firms depend upon government decisions in one way or another, hence it is not surprising to see many firms take actions that could help them influence government decisions in their favor through public policy or any other means (Sun et al., 2016). In this context, it is a common practice to appoint people with political connections to the board of directors, to build board political capital (Sun et al., 2016). Board political capital can help firms reduce environmental uncertainty and transactions costs (Faccio, 2006; Hillman, 2005; Shi, Markoczy, & Stan, 2014; Zheng, Singh, & Mitchell, 2015). Firms use political mechanisms to create an environment that serves their interests not only in the present but also in future (Pfeffer & Salancik, 2003). Board political capital also provides firms with "organizational legitimacy, opportunities to network with political actors, and a wide range of regulatory and financial resources controlled by political institutions" (Sun et al., 2016: 1803) and gain access to capital or financial assistance (Faccio, Masulis, & McConnell, 2006).

In contrast, others suggest that the impact of board political capital on firm performance may not always be positive, stable or homogeneous (Sun, Mellahi, & Liu, 2011; Sun, Wright, & Mellahi, 2010). For example, Sun, Mellahi and Thun (2010) use a longitudinal study of Chinese automobile sector to show that political embeddedness by MNEs may have a declining or even negative effect in a politically stable emerging economy. Sun, Mellahi, and Wright (2012) identify three mechanisms by which strong corporate political ties may become liabilities and erode firm value, which include, a) potential agency conflict between shareholders and politically connected managers, which results in these managers using valuable political ties to make themselves irreplaceable; b) vulnerability caused by over-dependence on a few well-connected managers with the ability to develop and nurture political ties; and c) unwillingness or inability of

managers to terminate unproductive political ties.

Sun, Mellahi, Wright and Xu (2015) extend this research stream by showing a negative effect of managerial ties to municipal government and a non-significant effect of government ownership ties on valuations during an unanticipated, high-profile political event in China. They also discover significant differences in the influence of managerial and ownership political ties. A more recent meta-analysis of 210 studies across 139 countries by Tihanyi et al. (2019) shows that political connections have a strong impact on the firm strategies, such as financial leverage, R&D intensity, and internationalization, which in turn mediate the state ownership–firm performance relationship. Thus, firms need to manage diverse types of corporate political ties to navigate the uncertain political environment in emerging economies (Tihanyi et al., 2019).

Recent research also reveals a 'dark side' of board political capital because of its role in enabling blockholder rent appropriation by the firms (Sun et al., 2016). For example, Liedong and Rajwani (2018) show that greater board political capital may lead to lower levels of financial reporting quality, non-financial information disclosure and board independence, which in turn could result in higher cost of debt, particularly from private (vs. public) banks. Similarly, Shi, Xu and Zhang (2018) show that politically connected independent directors could destroy firm value because they may be less effective in monitoring managers or shareholders, and more likely to divert political resources than non-politically connected independent directors. Despite growing realization that board political capital can be both an asset and a liability for a firm (Yan & Chang, 2018), there is hardly any research on the heterogeneity in the impact of different board political capital characteristics on various aspects of firm performance. In this paper, we address this gap by using the dark side perspective of board political capital to investigate the impact of its different characteristics on the regulatory enforcement by the authorities.

2.2. Board political capital and regulatory enforcement

Political corruption has become a serious problem in China since its economic reform in 1978, resulting in what is commonly known as 'power-money deals' (*quánqián jiāoyi*). Kimber and Lipton (2005) argue the Chinese economy is relation-based rather than rule-based. According to the "grabbing hand hypothesis", it is possible for the governments and government officials to expropriate wealth from firms through misappropriation of funds and requests for perks (Shleifer & Vishny, 1998). Such expropriation of wealth is made easier with politically connected directors on board. According to Li (1999), about $14.18 billion of Chinese government capital vanishes in the form of favors. Guanxi is a form of B2B relationship that provides an informal network of social relationships through which those connected can get round the bureaucratic inefficiency of governments, and acts as a strategic tool by which the connected can obtain additional advantages which are unavailable otherwise (Xin & Pearce, 1996). Firms can achieve this by recruiting politician directors to build board political capital but this may expose them to the possibility of corruption and fraudulent activities, which in turn may result in regulatory enforcement by the authorities, thus revealing a dark side of this relationship (Dieleman & Boddewyn, 2012).

The political economy literature models the effect of political influence on enforcement decisions (Grossman & Helpman, 1994). When there are lawsuits against the politically connected firms, the politician directors can make use of their political capital to "flex their muscles" to regulatory officials on the one hand (Gordon & Hafer, 2005); while on the other hand, regulators may also be under pressure to impose disciplinary action on politically connected firms. Allen, Qian, and Qian (2005) suggest that legal regulations are not effectively enforced when a politically connected party is involved. Thus, board political capital can protect the firms from the legal rules and regulations, and reduce the number of enforcement actions by regulatory agencies (Sun et al., 2016). Firth, Rui, and Wu (2011) show that politically connected firms are more likely to suffer smaller shareholder wealth losses and enjoy favorable appeals in litigation cases. They are also able to buffer the discipline of the sanctions against lower quality reporting disclosure

(Chaney et al., 2011). The probability of detecting fraudulent activity is also lower (Yu & Yu, 2011) and the punishment for regulatory enforcements is less severe (Fulmer & Knill, 2012) for politically connected firms.

Despite such overwhelming evidence about the link between political connections and the regulatory enforcements by the authorities, past research on board political capital mostly focuses on its quantitative nature (e.g., number or proportion) and not on its qualitative characteristics (e.g., level – central vs. regional and gender composition) and other factors that may influence its impact (e.g., perk consumption and proximity to the regulatory authorities). Moreover, most past studies rely on resource dependence theory to explain the positive effects of board political capital but there is hardly any theoretical explanation for its dark side. In this paper, we combine resource dependence theory with several other theories, such as agency, institutional, fraud-triangle and risk-aversion theories, to provide an overarching dark side perspective of board political capital with a more nuanced view about its characteristics and other factors that could influence regulatory enforcement by authorities.

2.2.1. Regulatory enforcement and board political capital by level.

Politically connected firms are also less likely to be involved in SEC enforcement actions (Correia, 2014). Wu, Johan, and Rui (2016) find that political connection reduces the likelihood of enforcement action against fraud in China. These studies show that board political capital determines if a firm can be granted relief from the enforcement action. However, the ability of the board political capital of a firm to insulate it from regulatory enforcement and the probability of receiving such relief may depend on the level and the strength of its board political capital. Hou and Moore (2010) show that a higher state ownership is related to a lower incidence of regulatory enforcements against fraud. The pressure from politician directors with stronger connections should be more effective in reducing the likelihood of enforcement (Correia, 2014).

China Securities Regulatory Commission (CSRC), which is an institution of the State Council (the chief administrative authority of China), is authorized to oversee the nationwide securities market with the power to regulate, investigate, and penalize illegal activities related to securities issuers. In the market, the Chinese government has the dual roles of the regulator (represented by CSRC) and the controlling shareholder of state-owned enterprises (SOEs). Consequently, the CSRC is not independent but is related to the SOEs through the direct influence of state ownership and politician directors through the indirect influence of board political capital. Following this logic, the connections at the national level should provide the firms with greater protection against the regulatory discipline which is administered by the central authority (CSRC). Therefore, we expect the connections at the central level to provide the firms with greater protection against the regulatory discipline of the CSRC (Du, Bai, & Chen, 2019).

On the contrary, as the CSRC is ranked at the highest level of the political hierarchy, regional board political capital, limited to their specific jurisdictions, may not be enough to insulate the firms from regulatory discipline by the central authorities (Du et al., 2019). In fact, Bardhan and Mookherjee (2000) show that regional political officials, as compared to their central counterparts, are not only more vulnerable to regulatory enforcement due to their higher frequency of personal interactions with business entrepreneurs but they are also likely to be less careful in managing these interactions and the resulting perceptions. Hence, we expect firms with connections at the regional level to be less likely to have protection against the regulatory discipline of the CSRC and be more prone to face regulatory actions. Therefore, we hypothesize as follows:

H1. Compared to central board political capital, regional board political capital has a stronger positive effect on regulatory enforcement.

2.2.2. Regulatory enforcement and board political capital by gender.

Business ethics literature generally identifies female executives as being more ethically

sensitive than males (Cohen, Pant, & Sharp, 1998) and hence are less likely to conduct any unethical or illegal activities (Elliott & Stead, 2018). According to risk aversion theory, males are less risk-averse, more over-confident and conservative than females, implying that females are less likely to take risk (Byrnes, Miller, & Schafer, 1999; Jianakoplos & Bernasek, 1998; Olsen & Cox, 2001). Since corrupt activity is considered to be risky, risk-averse females with concern about the risk of getting caught and punished should avoid any steps leading to corruption. Selby (2001; p. 239) suggests "*directors with diverse skills, experiences and backgrounds are more likely to raise questions that add to, rather than simply echo, the voice of management".* Adams and Ferreira (2009) also find it more likely for female directors to have better attendance records, sit on monitoring-related committees, and hold CEOs accountable for poor corporate performance (audit and corporate governance committees) than male directors. There is a positive relationship between female participation and earnings quality (Srinidhi, Gul, & Tsui, 2011).

In this context, Cumming, Leung, and Rui (2015) draw on ethicality literature, risk aversion theory, and diversity theory to explain the effect of board gender diversity on the frequency of fraud. They argue that there is a lower likelihood of fraud in firms with more gender-diverse boards. Dollar, Fisman, and Gatti (2001) report a lower level of political corruption when there is a greater female representation in the government. Based on these studies, females should be ethically sensitive, risk-averse and effective monitors to prevent their firms from committing corrupt activity. Therefore, a board with a higher proportion of female politician directors exercises more effective monitoring to reduce the likelihood of corrupt activity and enforcement actions by the CSRC. In contrast, over-confident males may be less aware of the ethics code and the risk of violating regulation resulting in a higher frequency of regulatory actions by authorities for a firm with a larger proportion of male politician directors. Thus, based on the diversity theory, female directors are expected to provide benefits to the firms with respect to greater awareness of ethicality and security. Accordingly, we hypothesize:

H2. Proportion of male politician directors has a stronger positive effect on regulatory enforcement, compared to the proportion of female politician directors.

2.3. Regulatory enforcement and perk consumption

Misappropriation of firms' resources through perk consumption is recognized as one type of corruption (financial fraud) by the agency theorists (Jensen & Meckling, 1976). Shleifer & Vishny (1994) developed a model for an exchange of favors where the politicians, who help the firms to obtain financial aid and subsidies, are offered personal benefits and bribes such as votes and monetary rewards. In the Chinese context, perk spending is essential to build connections. For example, Tung and Worm (2001) suggest that practicing guanxi is important for business-dealings in China and the exchange of favors (gifts) can help to establish and maintain a guanxi-based network. Cai, Fang, and Xu (2011) report that firms use entertainment expenses to bribe and gain influence over government officials, which may result in it being considered synonymous with corruption by some (Dunfee & Warren, 2001).

In this context, Faccio and Hsu (2017) find that targets of politically connected private equity firms have more employment in the states with a higher level of corruption, a finding which is consistent with the exchange of favors story. Correia (2014) also reports findings consistent with the argument of the exchange of favors to explain the connection between political contributions and regulatory leniency. The seriousness of the luxurious spending has been revealed by the imposition of a "frugal working style" rule (in effect on October 1, 2012) on civil servants, disallowing them from making extravagant spending and accepting expensive gifts, including entertainment activities, lavish banquets, properties, and cars (Wee, 2012). Central authorities are likely to be watchful of extravagant expenditure by firms and punish those firms where they find cases of corruption. Therefore, we hypothesize that excessive use of perk consumption may lead to greater regulatory enforcement, as follows:

H3. Perk consumption has a positive effect on regulatory enforcement.

2.4. Governance mechanism: Proximity to regulatory authorities

Past studies on corruption focus on the role of economic and structural policies through which institutions can influence corruption. For example, Svensson (2005: 20) argues that, "*corruption is an outcome – a reflection of a country's legal, economic, cultural and political institutions*"; thus, we examine how institutional factors such as the effectiveness of government supervision affect the incidence of regulatory action by the enforcement authorities. According to 'fraud triangle' theory, opportunity is one of the causes of fraud (Cressey, 1973), hence, ineffective government supervision may create opportunities for corrupt activity (Goel & Nelson, 2010). Although there are a number of anti-corruption measures, many of them are not implemented effectively. In addition, the corruption techniques have also grown in scope and complexity. Goel and Nelson (2010) also suggest that the geography of a country affects its monitoring ability and hence the incidence of corruption. China is a vast country (31 provinces, autonomous regions and municipalities) with geographic heterogeneity and so the influence of the state (central government) may vary across regions, and this diversity may be one reason for the failure of the regulatory enforcement.

In China, the central government holds the utmost control, with various local government units being the administrative arms to help implement the central government's policies. There is a possibility that the central government may lose control of the local governments because it is a long distance away. This is the situation described by Zhong (2003: 3) which says, "*the sky is high and the emperor is far away*", implying that firms located further away from the central government (i.e., the emperor) are under weaker regulatory influence and hence are more likely to deviate from, ignore, and shy away the directives imposed by the central government. Kim, Pantzalis, and Park (2012) argue that a firm's proximity to political power does matter and firms may be exposed to greater opportunities and more risk depending on their closeness to the control

of the ruling party. Therefore, we expect that the firms located closer to regulatory authorities are under closer regulatory supervision and are less likely to face regulatory enforcement, as follows:

H4. *Proximity to the regulatory authorities has a negative effect on regulatory enforcement.*

H5. *Proximity to the regulatory authorities negatively moderates the positive effects of, a) regional (vs. central) board political capital, and b) male (vs. female) politician directors, on regulatory enforcement.*

Figure 1 summarizes all these hypotheses.

< Insert Figure 1 about here >

3. Methodology

3.1. Research setting

China is well-known for its guanxi culture and bribery-corruption relationship (Mutlu et al., 2018; Yang et al., 2018). According to a CNN article by Zhang (2013), "*... For any Chinese businessman, guanxi is essential. ... excessive dining, drinking and occasional visits to prostitutes that are part of the tiresome game of guanxi. ... business can't survive a day if you are not corrupt. ... 3% to 5% of operating costs goes to guanxi. Such practice drives entrepreneurs to seek senior officials as their patrons because politicians in China have the power to approve projects and allocate resources*". China also has a long history of the rule of man (rénzhi) and a tradition of using personal relationships (guanxi) to conduct business, which are developed and cultivated using personal gifts and favors (Cheng, Chan, & Leung, 2018). These practices may drive corrupt business practices (e.g., doing business through the backdoor) and represent a dark side of B2B relationships in the Chinese context.

According to a recent article in Huffington Post by Cabestan (2017), "*... the Chinese Communist Party (CCP) consolidated its monopolistic control of politics and kept large*

segments of the economy under its administration. This political environment inevitably created close ties between politics and business ... businesspeople are eager to join these rather powerless parliaments, ..., but also because of the additional political and business connections that they bring. There is an unhealthy and close connection between political power and business activities in China. The CCP's leading cadres' corrupt practices are likely to continue ...". China scored between 37 and 41 during 2015-18 and ranked 87 among 180 countries, on the Corruption Perceptions Index (CPI), leading global indicator of public sector corruption compiled by Transparency International (https://www.transparency.org). In fact, it is quite common to have corrupt power-money deals (*quánqián jiāoyi*) between government officials and businesspeople in China, which are well-documented by media reports.

In the 18th National Congress, ex-President Hu Jintao announced that it was the Party's objective to combat corruption and promote political integrity. There should be anti-corruption laws to fight corruption at all times and levels. Seriousness of the corruption problem in China is seen in the imposition of the 'frugal working style' rule on October 1, 2012, which recommends government officials not to spend public funds on luxurious banquets, cars and residential properties, as well as accept gifts (Wee, 2012). Cumming, Hou, and Lee (2016) identify a wide range of ethical issues that affect businesses in China, including intellectual capital protection, gender equality, political connections, regional development, investor protection, corporate stewardship, trust and corruption, and corporate transparency. Thus, China provides a suitable setting for this research on the link between board political capital and regulatory enforcement.

3.2. Data sources

We use the data from various sub-databases of the China Stock Market and Accounting Research (CSMAR) Database for the four-year period from 2010 to 2013[1]. The firms from the financial

[1] The sample period is up to 2013 due to the issue of Rule 18 in October 2013, which disallows the government and party officials (who have retired from public offices within the last three years or are concurrently holding

sectors are excluded from the sample. The information about the regulatory violations is from the China Securities Regulatory Commission's (CSRC) Enforcement Actions Research Sub-Database. The financial characteristics, such as the firm size, leverage, and profitability are retrieved from the Stock Market Financial Statements Research Sub-Database. The board characteristics, such as the board size, number of independent and female directors, and board political capital, are obtained from the Corporate Governance Research Sub-Database, the source of which is from the "biographies of directors, supervisors and senior management" in the annual reports. Perks data is from Stock Market Financial Sub-Database – Statement Notes, which is covered under the disclosure of "other cash payment related to operating activities" in the notes of accounts. Finally, the information about the regional domestic products and gross domestic products is from the National Bureau of Statistics of China (www.stats.gov.cn).

Propensity score matching. Firms with and without regulatory violations may differ from each other and this could lead to selection bias. Hence, we use the propensity-score matching (PSM) technique (Zaefarian et al., 2017) to form a sample that would allow us to examine the relationship between board political capital and regulatory enforcements for firms that are with and without regulatory enforcements. In addition, there may be a possibility of firms self-selecting their directors (politicians), thus creating potential self-selection bias in the models. The PSM method is also useful for controlling the self-selection bias. Following Cumming et al. (2015), we start the PSM procedure by running a logit regression of a binary variable (1 being a firm with regulatory enforcements and 0 otherwise) against the independent variable of firm size (total assets in logarithm form), leverage (ratio of total debts to total assets), and exchange location (1 for firm being listed on the Shanghai Stock Exchange and 0 otherwise) for each industry group in each year. A firm with no regulatory

public offices) from serving as directors for publicly listed firms. To allow an examination of the relationship between regulatory enforcement for corrupt activity and political connections in a clean setting free from regulatory intervention, analysis is not extended beyond 2013.

enforcements is a firm with no record of regulatory violations of rules over the sample period. The logit regression generates a predicted probability which is the propensity score for each observation. We adopt the nearest neighbor matching method to select the firms with and without regulatory enforcement that are closest to each other in their propensity scores.

In order to have comparable pairs of firms with and without regulatory enforcements among firms with different listing locations and ownership structure, POEs (privately-owned enterprises) listed on the Shanghai Stock Exchange with and without regulatory enforcements, with the closest propensity score are matched with each other. The same procedure is done for central and local SOEs. Firms are paired without replacement. The final sample consists of 1,524 observations with 162 central SOEs (81 and 41 pairs of central SOEs from Shenzhen and Shanghai Stock Exchanges respectively); 360 local SOEs (78 and 102 pairs of local SOEs from the Shenzhen and Shanghai Stock Exchanges, respectively); and 1,002 POEs (402 and 99 pairs of POEs from Shenzhen and Shanghai Stock Exchanges, respectively).

***Regression models*:** Equation 1 shows the direct effects of all the explanatory variables (board political capital, perk consumption, and proximity to regulatory authorities) on the dependent variable (regulatory enforcement) as well as the moderating effect of proximity to regulatory authorities on the direct effects of board political capital on regulatory enforcement, while controlling for all the control variables and the industry and year fixed effects.

$$\textit{Regulatory Enforcement} = \alpha_0 + \beta_1 \textit{Regional – Central BPC Difference} + \beta_2 \textit{Male – Female BPC Difference} + \beta_3 \textit{Perk} + \beta_4 \textit{Proximity to Beijing} + \beta_5 \textit{Regional – Central BPC Difference*Proximity to Beijing} + \beta_6 \textit{Male – Female BPC Difference*Proximity to Beijing} + \beta_7 \textit{Control} + \textit{Industry Fixed Effects} + \textit{Year Fixed Effects} + \varepsilon \quad (1)$$

Regulatory enforcement. We measure regulatory enforcement with *Regulatory Enforcement* at both time t and t+1, a continuous variable (censored at zero) for the number of regulatory

actions against a firm. Following Cumming et al. (2015), we study regulatory enforcements due to violation of securities rules, which include inflated profits, asset fabrication, false statement, delay in statement disclosure, major failure of information disclosure, fraud, unauthorized change of fund use, misappropriation of assets, insider trading, illegal securities trading, manipulation of share price, and embezzlement. All these violations are not ranked in any particular order and appear to be similar in nature, hence it is not possible for us to quantify them in terms of severity. Accordingly, we use the total number of these violations rather than their severity as the measure in this paper. The information about the violation of securities rules is from the CSRC's Enforcement Actions Research Sub-Database of CSMAR. When listed firms commit corrupt practices or violate the securities regulations of CSRC, Shanghai and Shenzhen stock exchanges or other regulatory authorities, the misconduct information is disclosed by the regulatory authorities and reported by media such as *Securities Times* and *Shanghai Securities Daily*.

Board political capital. Board political capital refers to the connections between firms and government units or officials. In China, politician directors can be government or party officials entering the corporate world or entrepreneurs becoming politicians as members of legislative (People's Congress) and advisory (People's Political Consultative Conference) authorities in China's political system[2]. We operationalize *Board Political Capital* as the proportion of politically connected directors to the total number of directors on the board. In this context, a director is "*politically connected if the director is an ex-government official, a representative of the People's Congress, or a member of the People's Political Consultative Conference*" (Cheng et al., 2018; p.93). For a deeper analysis of the impact of board political capital on the likelihood of corrupt activity, board political capital is further divided into two categories by (1) level of

[2] Membership of the People's Congress and People's Political Consultative Conference (PPCC) are part-time representational positions elected at different levels (e.g., national, provincial, prefecture, and county). Li and Liang (2015) report that 356 of the 500 (71%) richest Chinese business people ranked by Forbes in 2013 have political representations in the People's Congress and PPCC.

connections (connections at the central (national) level or local (regional) level) and (2) gender of politician-director (female politician or male politician). *Regional Board Political Capital* is the proportion of directors with political connections at regional (province, prefecture, county, or town) level and *Central Board Political Capital* is the proportion of directors with political connections at the central level. To test our hypotheses, we calculate *Regional-Central BPC Difference*, which is the difference in the proportion of directors with political connections at the regional level (*Regional Board Political Capital*) and the proportion of directors with political connections at the central level (*Central Board Political Capital*). *Male Board Political Capital* is the proportion of male directors with political connections and *Female Board Political Capital* is the proportion of female directors with political connections. We also calculate *Male-Female BPC Difference*, which is the difference in the proportion of male directors with political connections (*Male Board Political Capital*) and the proportion of female directors with political connections (*Female Board Political Capital*). All these proportions are scaled by the total number of directors on the board.

Perk consumption. Firms need to make an effort to obtain political favors. In the survey by Tung and Worm (2001), the four means through which guanxi can be created are offering payment for trips, throwing extravagant parties for entertainment, giving presents, and making use of an intermediary to set up B2B relationships. Entertainment expense is related to grease money and political corruption (Cai et al., 2011). Perk consumption includes expenses for travel, entertainment, overseas training/travel, board of directors, company cars and conferences (Gul, Cheng, & Leung, 2011). As perk consumption is used to build board political capital, which should lead to higher profitability, the perk consumption amount is adjusted for a firm's size by standardizing by revenue. *Perk* is the ratio of the perk consumption amount to sales.

Proximity to regulatory authorities. The CSRC with its headquarters in Beijing is the enforcement institution for the violation of securities rules in China. *Proximity to Beijing*, which

measures the closeness to the regulatory authorities in Beijing, is the inverse of the geographical distance (in miles) between the firm and CSRC located in Beijing plus one.

Control variables. We control for a number of variables that could influence our dependent variable, *Regulatory Enforcement,* which is the number of regulatory enforcements against a firm. For example, ownership type (*POE* is a dummy coded 1 if the firm is not a state-owned enterprise and 0 otherwise); financial characteristics such as profitability (*ROA* is return on assets); financial risk (*Leverage* is the ratio of debt to assets); firm size (*Firm Size* is the dollar value of total assets in logarithm form); and firm value (Tobin's Q is the ratio of market value to the book value of assets (Bebchuk, Cremers, & Peyer, 2011)).

According to fraud triangle theory, one of the causes of fraud is the opportunity to commit corrupt activity. Hence, we control for internal and external monitoring measures. Following Cumming et al. (2015), we control for *Board size* (the number of directors in logarithm form); *Board Independence* (measured by the proportion of independent directors); *CEO Duality* (a dummy coded 1 if the chairperson and the CEO are the same person and 0 otherwise); and *Board Gender Diversity* (the proportion of female directors on the board). We also control for the reputation of the audit firm with a dummy variable *Top Auditor* to represent if the audit firm is a top audit firm or not, and another dummy variable, *Audit Opinion*, which may indicate the likelihood of corrupt activity and the subsequent regulatory enforcement action. *Integrity and Law-abiding Index* is measured based on the degree of integrity and law-abiding of the government officials in the region in which a firm operates its business. The data for *Integrity and Law-abiding Index* is retrieved from Wang, Fan, and Ma (2017). Goel and Nelson (2010) suggest that economic prosperity is related to the likelihood of corrupt activity. The *Ratio of Regional Domestic Products to GDP*, which is the ratio of regional domestic products to gross domestic products, is used to indicate the differential economic development across regions as well as the fixed effect for regions. *Industry* and *Year* dummies are included to control for the

industry and time fixed effects. Appendix A shows all the variable definitions.

***Endogeneity*:** To address the potential endogeneity problem between the incidence of regulatory enforcement as the dependent variable and all the explanatory variables, we use several techniques. First, as explained earlier, we use the propensity score matching method, which is commonly employed to correct endogeneity bias, to select matching firms with and without regulatory enforcements to address the self-selection bias. Next, as recommended by Bebchuk et al. (2011), we use industry-adjusted measures of explanatory variables, calculated by subtracting the industry mean perk consumption and board political capital respectively, from the values for these variables in each industry for each year.

4. Data analysis and results

4.1. Descriptives and correlations

Table 1 exhibits the means, standard deviations, and correlation coefficients of the variables. The final sample consists of 1,524 firms, with 762 firms with and without regulatory enforcements each. The average number of violations is 2.16 for the firms with regulatory enforcements. The mean perk consumption to sales is 0.59%. The proportion of politician directors is 17.79%. The percentages of directors with regional board political capital and central board political capital are 14.08% and 3.72%, respectively. About 1.45% are female politicians and 16.34% are male politicians. Firms are located 712.94 miles from Beijing, the city where the headquarters of the CSRC is situated. There are 522 SOEs, of which 162 are central SOEs and 360 are local SOEs. The number of POEs is 1,002. On average, the return on assets, the debt to assets ratio, and Tobin's Q are 0.04. 0.42, and 2.31, respectively. The total assets are RMB 6,387 million. There are 8.78 directors on boards, about one-third (37.2%) of them being independent. In 27.95% of the observations, a CEO is also a chairperson. The proportion of female directors is 14.41%. There are 358 firms (23.49%)

audited by the top auditor in a region and 48 firms (0.03%) receive modified audit opinion. The mean of integrity and law-abiding index is 3.39. The ratio of regional domestic products to gross domestic products is 5.52%. To ensure that the models do not suffer from the multicollinearity problem, the variance inflation factor (VIF) values are calculated and the tolerance levels of the independent variables are non-significant. We also mean-center the component variables making up the interaction terms for the models with interaction terms in order to minimize multi-collinearity problem.

< Insert Table 1 about here >

4.2. Hypotheses testing

Table 2 presents the results of the moderated multiple regression Poisson model used to test all our hypotheses about the impact of board political capital, perk consumption, and governance mechanism (government supervision) on the likelihood of regulatory enforcements. We estimate the Poisson model with the dependent variable, *Regulatory Enforcement* at time t and time t+1, which is a continuous variable (censored at zero) for the number of regulatory enforcements against a firm. Board political capital is measured by the proportion of politician directors (by level and gender) on the board. We report the results using industry-adjusted measures of board political capital and perk consumption. However, we do not use the term "*Industry-adjusted*" in the main body of the paper for the sake of brevity.

< Insert Table 2 about here >

First, the regression coefficients for *Regional - Central BPC Difference* are non-significant for both t and t+1. Hence, firms with higher regional board political capital do not seem to have a significantly higher incidence of regulatory enforcement compared to those with higher central board political capital, providing no support to H1. Next, the coefficient for *Male - Female BPC Difference* is significantly positive ($p < 0.01$) in time t but not in t+1;

hence, firms with a larger proportion of male politician directors are more likely to have a higher incidence of regulatory enforcement. Thus, H2 finds partial support.

Next, *Perk* has significant positive effects on regulatory enforcement in both t ($p < 0.10$) and t+ 1 ($p < .01$), hence perk consumption increases the incidence of regulatory enforcement, showing full support for H3. In contrast, *Proximity to Beijing* has significant negative effects ($p < 0.01$) in both t and t+1; hence, firms located farther away from the regulatory authorities are more likely to experience regulatory enforcement, showing full support for H4.

Finally, we test the moderating effects of the proximity to regulatory authorities on the impact of regional (vs. central) and male (vs. female) board political capital on regulatory enforcement, we include the interaction terms of both these difference variables with *Proximity to Beijing* and report the results in Table 2. First, *Regional-Central BPC Difference*Proximity to Beijing* interaction has a marginally significant ($p < 0.10$) positive effect in t and non-significant positive effect in t+1; hence, H5a is not supported. However, *Male-Female BPC Difference*Proximity to Beijing* has significant negative coefficients in both t and t+1; hence, firms with a greater proportion of male directors may be less likely to experience regulatory enforcement if they are located closer to Beijing, which would indicate proximity to the regulatory authorities, and vice versa. Thus, H5b is supported.

4.3. Robustness checks

We performed a number of additional tests to assess the robustness of the results. First, we repeated our analysis using the full sample of firms with and without regulatory enforcements (N=8778) and found similar results, as reported in Table 3, indicating the robustness of our findings. Next, we used industry medians to compute the industry-adjusted measures and found similar results, as shown in model (1) and model (5) in Table 4. Finally, we used alternate measures for gender diversity – a gender Blau's index following Blau (1977) in

model (2) and model (6); Tobin's Q - an alternative computation based on Chung and Pruitt (1994)) in model (3) and model (7); and level of economic prosperity (measuring regional domestic products in logarithm form) in model (4) and model (8). Using these alternate measures did not make any significant difference to our results.

< Insert Tables 3 and 4 about here >

5. Discussion and implications

This paper uses an overarching dark side perspective of board political capital to test the effects of its different levels (central vs. regional), gender diversity, perk consumption, and proximity to the regulatory authorities on the regulatory enforcement against politically-connected firms. We argue that board political capital may be a double-edged sword, because while it can help the firms obtain more government resources and support beneficial to their performance, the exchange of political favors may also lead to a higher likelihood of regulatory enforcement. We provide a comprehensive analysis of the impact of board political capital on corruption by dividing board political capital by level (regional vs. central) and by gender (male vs. female). We also show that perk consumption has positive effects on the incidence of regulatory enforcement, while proximity to the regulatory authorities has a direct negative effect on regulatory enforcement as well as negatively moderates the impact of male (vs. female) board political capital difference on regulatory enforcement.

Overall, this paper makes several important conceptual contributions. First, it shows that the effects of board political capital can be decomposed into different categories to address the mixed evidence on the effects of board political capital with some showing a positive influence (e.g., Cooper et al., 2010; Fisman, 2001) and others negative (e.g., Fan et al., 2007; Sun et al., 2016). Most studies only consider the quantitative measure (i.e., number or proportion) of board political capital without taking into account its qualitative nature (i.e., level and gender).

Specifically, board political capital is indicated either by the presence of a politically connected key person (chairperson, CEO, or director) or by the proportion of politically connected members on the board. Many studies treat board political capital as a homogeneous construct but there is growing evidence that it differs in strength depending on the level of the connections (Correia, 2014) or in attributes depending on the gender of the politically connected persons concerned (Cumming et al., 2015). This paper provides a comprehensive analysis of the impact of board political capital on the regulatory actions by the authorities.

Second, Tan, Li, and Xia (2007; p.787) argue the "*unique institutional structure in the Chinese economy is characterized by all firms being controlled by hierarchically structured governments, including: (1) the central government, (2) provincial governments, (3) municipal or prefectural governments, (4) county governments, (5) township governments. The control system in Chinese is called lìshǔ (meaning "belonging or subordinate to" or "directly controlled by)*". Their result implies that the higher the level of government in the hierarchy, the more monopolized and superior resources can be provided to the firms related — that is, the firms which have the "direct *lìshǔ* relation" should have the extra privileges to achieve better performance. Based on this logic, we divided board political capital into central connections and regional connections to examine the differences in their ability to insulate the firm from regulatory sanctions. However, contrary to our expectation, we did not find a significant difference in the impact of regional (vs. central) board political capital on the incidence of regulatory enforcements. We believe this could be due to the limitations of our sample that we selected using propensity score matching approach. To test this explanation, we retest our model with our full dataset (8778 observations) and find a marginally significant and positive effect of regional – central board political capital difference on regulatory enforcement at time t ($p < 0.10$).

Third, board gender diversity has recently been a central theme in corporate governance worldwide. The diversity literature has examined widely how female CEOs and female

directors behave differently from their male counterparts in the boardrooms under a variety of circumstances. Little is known about the impact of female politician directors. By linking gender diversity, political capital, and corporate governance, this paper adds value to the literature by providing a novel insight into how gender matters in board political capital. Specifically, because of the cognitive differences between them, females are tougher and more effective monitors and are willing to make more effort to monitor than males. We find that firms with a greater proportion of female politician directors are less likely to have regulatory enforcement for corrupt activity. On the contrary, there is a higher incidence of regulatory sanctions for firms with a greater ratio of male politicians on the board. These findings are consistent with the ethicality literature, risk aversion theory, and diversity theory. Further, we show a greater number of female politicians over male politicians on a board can minimize the likelihood of regulatory enforcement for corrupt activity, suggesting that the monitoring carried out by female politician directors constitutes an effective board governance mechanism to prevent firms from committing corruption. These results should provide practical implications for board gender diversity policy and corporate political strategy.

Fourth, this study explores the impact of perk consumption on regulatory enforcement. Allen et al. (2005; p.67) explain that the reason for the ineffective law enforcement in China is due to the "*intrinsic conflict of interest between 'fair play' in practicing law and the monopoly power of the single ruling party, especially in cases in which government officials or their affiliates are involved".* In this paper, we combine resource dependence theory with agency theory to argue that the corrupt activities of the firms with richer political resources are less likely to be detected for enforcement actions. The political resource does not need to come from state ownership only and directly, but can come from the interpersonal board political capital (Tihanyi et al., 2019). Chinese government has attempted to implement a variety of anti-corruption measures for many years but these anti-corruption measures have been ineffective, especially

when the corrupt activities grow in scope and complexity and involve high-level politicians and politically-connected directors on company boards who use their entertainment expenses and perks to build and nurture their guanxi networks, which in turn may expose them to greater regulatory actions by the authorities.

This finding is consistent with the view of the corruption of the rich, wherein a group of economic elites is motivated to pursue power in the political sphere in a market with rapid modernization (Zhang, 2013). Corruption provides a connection between those with political power and those with wealth, through which one party exchanges political power for money and another party trades money for political power. This theory of corruption of the rich appears to suit the situation in China. Many millionaire entrepreneurs become participants in the Chinese political system by holding seats in the parliament (People's Congress) and advisory body (PPCC). In the National People's Congress and National PPCC of 2017, 209 delegates are super-rich business entrepreneurs, all of whom are millionaires and more than half of them are billionaires with a combined wealth close to RMB 3.5 trillion (US$507 billion).[3] These politician entrepreneurs can enjoy a reputation boost and political protection through their representations in the political system. This view of corruption of the rich echoes the Chinese notion of power-money deals (*quánqián jiāoyì*).

Next, this study explores the impact of proximity to regulatory authorities on the incidence of regulatory enforcement. One unique institutional aspect of China is the possible misalignment of goals and priorities among the government units of different levels, which can be explained by the geographical distance between the local SOEs and the central government. After the decentralization, the local SOEs are under the supervision of regional government owners (provincial governments, prefectural governments, county governments, and township governments). Specifically, the implementation of central government's anti-corruption

[3] Source: Reuters article—China's billionaire lawmakers keep getting richer and richer" (http://fortune.com/2017/03/02/china-rich-parliament-wealth/).

measures may be less effective when the regional government units are stationed far away from the central government. The regional government units are not motivated to follow the policies imposed by the central government. Instead, the various regional government units are more interested in developing their own dukedom economy (*zhūhóu jīngjì*). Consequently, the central government's directive of prohibiting SOEs from spending extravagantly and consuming luxurious perks may not be complied with at all times.

Next, we find no significant moderating effect of proximity to Beijing on the impact of regional (vs. central) board political capital difference on regulatory enforcement, which probably reflects the non-significant direct effect of this difference variable, as reported and discussed earlier in this section. Finally, we find a significant negative effect of proximity to Beijing on the positive effect of male (vs. female) board political capital difference on regulatory enforcement, as expected. This result once again highlights the important role played by female politicians serving on the Chinese firms' boards of director in insulating them from regulatory actions and more importantly, the further level of protection that those firms may enjoy who are located closer to the regulatory authorities based in Beijing. This finding should make the Chinese authorities more vigilant about the firms located farther away from Beijing and those with a higher proportion of male politically connected directors as potential targets for regulatory actions.

6. Limitations and future research

This study has a few limitations that future research may address. First, our sample is based on detected regulatory enforcement for corrupt activities, which may not fully represent the actual level of corruption. Moreover, this study examines regulatory enforcements in the context of different types of securities violations that are similar in the level of severity, using the number of regulatory enforcements as the outcome variable, which may limit the

generalizability of these results. Hence, future studies may explore the regulatory enforcements in other types of corruptions to test the generalizability of our model by incorporating the severity level of the regulatory enforcement for corrupt activities as an explanatory variable. This paper proposes that the politician directors with central political connectedness use their strong influence over the regulatory body to prevent their connected firms from being exposed to regulatory sanctions, while female politician directors may stop their connected firms from committing corruption. However, it is also possible that politician directors with central ties may dissuade their firms from committing corruption and female politician directors may use their ties to persuade the regulatory body not to expose the corrupt activities of their connected firms. Future research may aim to clarify this issue. Finally, compared to most developed common-law markets, China has weaker financial market regulation and investor protection systems (Deng et al., 2019). Hence, future research may aim to replicate our findings from China in other markets with similar weak legal systems.

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Figure 1. Conceptual model

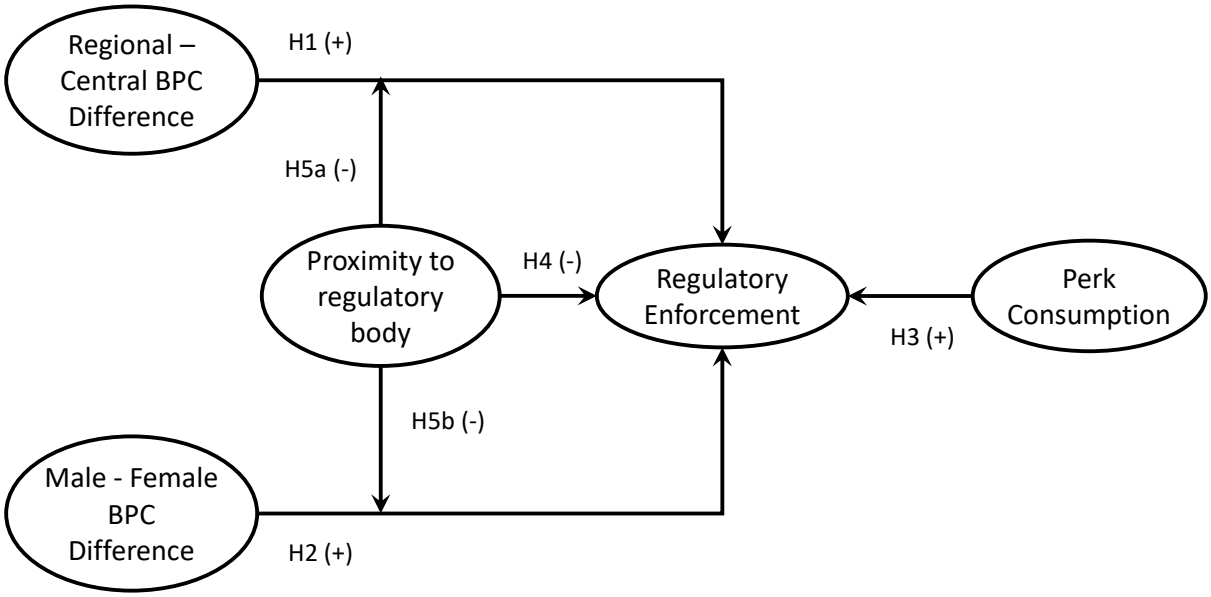

Table 1. Descriptive statistics and correlations

		Mean	Standard deviation	1	2	3	4	5	6	7	8
1	*Regulatory Enforcement at t*	1.08	1.43	1.00							
2	*Regulatory Enforcement at t+1*	0.57	1.27	0.65**	1.00						
3	*Regional-Central BPC Difference*	-0.01	0.17	-0.05	-0.02	1.00					
4	*Male- Female BPC Difference*	-0.01	0.17	-0.06*	-0.03	0.55**	1.00				
5	*Perk*	0.00	0.01	0.06*	0.05*	0.00	0.04	1.00			
6	*Proximity to Beijing*	0.06	0.23	-0.08**	-0.06**	0.16**	0.03	-0.03	1.00		
7	*POE*	0.66	0.47	-0.02	-0.02	0.00	0.06*	0.08**	-0.07**	1.00	
8	*ROA*	0.04	0.05	-0.09**	-0.07**	0.05*	0.04	-0.09**	0.01	0.10**	1.00
9	*Leverage*	0.42	0.22	0.09**	0.12**	-0.04	-0.09**	-0.10**	-0.04	-0.37**	-0.30**
10	*Firm Size*	21.67	1.16	-0.04	-0.01	0.01	-0.15**	-0.24**	0.05	-0.37**	-0.01
11	*Tobin's Q*	2.31	1.48	0.00	0.00	0.06*	0.08**	0.13**	0.04	0.14**	0.24**
12	*Board Size*	2.15	0.19	-0.02	-0.05	0.00	-0.02	-0.07**	0.05*	-0.26**	0.04
13	*Board Independence*	0.37	0.05	0.04	0.04	-0.02	-0.06*	0.02	-0.04	0.07**	-0.02
14	*CEO Duality*	0.28	0.45	0.04	0.02	0.02	0.03	0.04	0.00	0.26**	0.04
15	*Board Gender Diversity*	0.14	0.13	0.01	0.03	0.02	0.19**	0.03	-0.04	0.13**	0.01
16	*Top Auditor*	0.23	0.42	-0.05	-0.04	-0.03	-0.05*	-0.01	-0.12**	0.00	0.03
17	*Audit Opinion*	0.03	0.17	0.17**	0.13**	-0.01	0.02	0.07**	0.01	-0.03	-0.16**
18	*Integrity and Law-abiding Index*	3.39	0.21	-0.05	-0.08**	0.01	0.02	-0.01	0.07**	0.22**	0.02
19	*Ratio of Regional Domestic Products to GDP*	0.06	0.03	0.01	0.00	-0.01	0.03	-0.06*	-0.19**	0.24**	0.04

		9	10	11	12	13	14	15	16	17	18	19
9	*Leverage*	1.00										
10	*Firm Size*	0.52**	1.00									
11	*Tobin's Q*	-0.25**	-0.46**	1.00								
12	*Board Size*	0.16**	0.30**	-0.09**	1.00							
13	*Board Independence*	-0.03	0.01	0.00	-0.46**	1.00						
14	*CEO Duality*	-0.20**	-0.20**	0.08**	-0.17**	0.11**	1.00					
15	*Board Gender Diversity*	-0.06*	-0.11**	0.02	-0.08**	0.01	0.04	1.00				
16	*Top Auditor*	0.03	0.08**	-0.03	0.02	-0.01	-0.03	-0.06*	1.00			
17	*Audit Opinion*	0.12**	-0.07**	0.08**	0.01	-0.01	0.05	0.05*	-0.04	1.00		
18	*Integrity and Law-abiding Index*	-0.20**	-0.06*	-0.11**	-0.10**	0.04	0.11**	0.06*	0.12**	-0.04	1.00	
19	*Ratio of Regional Domestic Products to GDP*	-0.16**	-0.11**	-0.04	-0.06**	0.01	0.13**	0.02	-0.08**	-0.03	0.21**	1.00

* $p < 0.05$, ** $p < 0.01$

Table 2. Multiple moderated Poisson regression analysis output (Matched sample, N = 1524)

H#	Independent variables (t)	DV: Regulatory Enforcement	
		(t)	(t+1)
	Intercept	1.92*	1.54
H1	*Regional-Central BPC Difference*	-0.19	-0.32
H2	*Male- Female BPC Difference*	0.58**	0.18
H3	*Perk*	5.17†	12.66**
H4	*Proximity to Beijing*	-0.50**	-1.24**
H5	*Regional-Central BPC Difference*Proximity to Beijing*	2.24†	0.60
	*Male-Female BPC Difference*Proximity to Beijing*	-3.36**	-7.64**
F1	*POE*	-0.02	0.10
F2	*ROA*	-0.55	-0.59
F3	*Leverage*	0.59**	1.29**
F4	*Firm Size*	-0.11**	-0.08†
F5	*Tobin's Q*	-0.03	-0.05
B1	*Board Size*	0.08	-0.41*
B2	*Board Independence*	0.99*	1.33*
B3	*CEO Duality*	0.11*	0.14†
B4	*Board Gender Diversity*	0.13	0.48†
A1	*Top Auditor*	-0.15*	-0.20*
A2	*Audit Opinion*	0.67**	0.73**
A3	*Integrity and Law-abiding Index*	-0.05	-0.10
A4	*Ratio of Regional Domestic Products to GDP*	0.25	0.96
	Year Effects included	Yes	Yes
	Industry Effects included	Yes	Yes
	R-square	0.04	0.08
	LR Chi-square	176.69	298.34
	p-value	0.00	0.00
	Number of Observations	1524	1524

†p< 0.10, * p < 0.05, ** p < 0.01

Table 3. Multiple moderated Poisson regression analysis output (Full Sample, N = 8778)

H#	Independent variables (t)	DV: Regulatory Enforcement	
		(t)	(t+1)
	Intercept	1.69**	2.27**
H1	*Regional-Central BPC Difference*	0.02	0.06
H2	*Male- Female BPC Difference*	0.25†	0.23†
H3	*Perk*	3.17†	6.76**
H4	*Proximity to Beijing*	-0.84**	-0.70**
H5	*Regional-Central BPC Difference*Proximity to Beijing*	1.62†	0.10
	*Male-Female BPC Difference*Proximity to Beijing*	-3.76**	-1.84*
F1	*POE*	0.34**	0.42**
F2	*ROA*	-2.32**	-3.09**
F3	*Leverage*	1.05**	1.03**
F4	*Firm Size*	-0.12**	-0.12**
F5	*Tobin's Q*	-0.03*	-0.03*
B1	*Board Size*	-0.09	-0.21*
B2	*Board Independence*	0.43	0.23
B3	*CEO Duality*	0.09*	0.12**
B4	*Board Gender Diversity*	-0.02	-0.16
A1	*Top Auditor*	-0.21**	-0.21**
A2	*Audit Opinion*	0.79**	0.48**
A3	*Integrity and Law-abiding Index*	-0.19†	-0.16
A4	*Ratio of Regional Domestic Products to GDP*	0.92	0.19
	Year Effects included	Yes	Yes
	Industry Effects included	Yes	Yes
	R-square	0.06	0.07
	LR Chi-square	1192.01	1289.02
	p-value	0.00	0.00
	Number of Observations	8778	8778

†p< 0.10, * p < 0.05, ** p < 0.01

Table 4. Multiple moderated Poisson regression analysis output (Robustness checks)

Independent variables (t)	**DV: Regulatory Enforcement (t)**				**DV: Regulatory Enforcement (t+1)**			
	(1)	**(2)**	**(3)**	**(4)**	**(5)**	**(6)**	**(7)**	**(8)**
Intercept	1.90*	1.89*	1.93*	1.76†	1.46	1.52	1.53	1.34
Regional-Central BPC Difference		-0.20	-0.19	-0.19		-0.33	-0.32	-0.32
Male- Female BPC Difference		0.60**	0.58**	0.58**		0.20	0.18	0.17
Industry Median-adj Regional-Central BPC Difference	-0.18				-0.32			
Industry Median-adj Male- Female BPC Difference	0.57**				0.05			
Perk	5.27†	5.15†	5.19†	5.28†	12.99**	12.60**	12.67**	12.57**
Proximity to Beijing	-0.55**	-0.50**	-0.50**	-0.49**	-1.56**	-1.24**	-1.24**	-1.26**
*Regional-Central BPC Difference*Proximity to Beijing*		2.22†	2.24†	2.24†		0.55	0.60	0.59
*Male-Female BPC Difference*Proximity to Beijing*		-3.35**	-3.36**	-3.36**		-7.60**	-7.64**	-7.64**
*Industry Median-adj Regional-Central BPC Difference*Proximity to Beijing*	1.85				-1.53			
*Industry Median-adj Male-Female BPC Difference*Proximity to Beijing*	-3.33**				-8.53**			
POE	-0.02	-0.02	-0.02	-0.02	0.10	0.10	0.10	0.11
ROA	-0.55	-0.56	-0.54	-0.55	-0.58	-0.61	-0.60	-0.59
Leverage	0.59**	0.59**	0.60**	0.60**	1.29**	1.29**	1.29**	1.28**
Firm Size	-0.11**	-0.11**	-0.11**	-0.11**	-0.08†	-0.08†	-0.08†	-0.08†
Tobin's Q	-0.03	-0.03		-0.03	-0.04	-0.05		-0.04
Alternative Measure of Tobin's Q			-0.03				-0.04	
Board Size	0.07	0.07	0.08	0.08	-0.42*	-0.43*	-0.41	-0.41*
Board Independence	0.99*	0.99*	0.99*	1.00*	1.34*	1.34*	1.34*	1.33*
CEO Duality	0.11*	0.11*	0.11*	0.11*	0.14†	0.14†	0.14†	0.14†
Board Gender Diversity	0.13		0.13	0.13	0.47†		0.48†	0.47†
Board Gender Diversity (Blau's Index)		0.19				0.50*		
Top Auditor	-0.15*	-0.14*	-0.15*	-0.14*	-0.20*	-0.19*	-0.20*	-0.20*
Audit Opinion	0.67**	0.67**	0.67**	0.67**	0.73**	0.72**	0.72**	0.72
Integrity and Law-abiding Index	-0.04	-0.05	-0.05	-0.07	-0.10	-0.11	-0.10	-0.08
Ratio of Regional Domestic Products to GDP	0.28	0.25	0.25		0.97	0.94	0.96	
Regional Domestic Products in Logarithm Form				0.03				0.02
Year Effects included	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry Effects included	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
R-square	0.04	0.04	0.04	0.04	0.08	0.08	0.08	0.08
LR Chi-square	175.97	177.74	176.76	177.11	299.99	300.15	298.28	297.75
p-value	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Number of Observations	1524	1524	1524	1524	1524	1524	1524	1524

†p< 0.10, * p < 0.05, ** p < 0.01

APPENDIX A. Operationalization of variables

Variable	Definition
Regulatory enforcement	a continuous variable (censored at zero) for the number of corrupt activities (such as inflated profits, asset fabrication, unauthorized change of fund use, false statement, major failure of information disclosure and embezzlement) committed by a firm
Board Political Capital	proportion of politically connected directors (either former or current government officials; and/or representatives of the People's Congress; and/or committee members of the People's Political Consultative Conference (PPCC)) to the total number of directors on board
Regional Board Political Capital	proportion of directors with political connections at the regional (province, city, or county) level to the total number of directors on the board
Central Board Political Capital	proportion of directors with political connections at the central (national) level to the total number of directors on the board
Female Board Political Capital	proportion of female directors with political connections to the total number of directors on the board
Male Board Political Capital	proportion of male directors with political connections to the total number of directors on the board
Regional-Central BPC Difference	difference in the proportion of directors with political connections at the regional level and the proportion of directors with political connections at the central level
Male- Female BPC Difference	difference in the proportion of male directors with political connections and the proportion of female directors with political connections
Perk	ratio of the perk consumption amount (travel expenses, entertainment expenses, overseas training/traveling expenses, board of directors' expenses, company car expenses and conference expenses) to sales
Industry-adjusted	Industry-adjusted measure is calculated by subtracting the industry mean in each industry of each year
Proximity to Beijing	the inverse of the geographical distance (in miles) between the firm and CSRC located in Beijing plus one
POE	a dummy coded 1 if the firm is a not a state-owned enterprise and 0 otherwise
ROA	return on assets
Leverage	ratio of debt to assets
Firm Size	dollar value of total assets in logarithm form
Tobin's Q	ratio of market value to book value of assets following the methodology of Bebchuk et al. (2011)
Board Size	number of directors in logarithm form
Board Independence	proportion of independent directors to total number of directors
CEO Duality	a dummy coded 1 if the chairperson and the CEO are the same person and 0 otherwise
Board Gender Diversity	proportion of female directors to the total number of directors
Top Auditor	a dummy coded a if the firm is audited by a top auditor in a region and 0 otherwise
Audit Opinion	a dummy coded 1 if the firm receives a modified audit opinion and 0 otherwise
Integrity and Law-abiding Index	an index which indicates the degree of integrity and law-abiding of the government officials in the region in which a firm operates its business
Ratio of Regional Domestic Products to GDP	ratio of regional domestic products to gross domestic products