

Too much reciprocity? The invisible impact of home political connections on the value creation of Chinese multinationals

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Abstract

Purpose - Using the evidence of Chinese outbound mergers and acquisitions (M&As) enacted between 2006 and 2014, this study investigates the role played by home political connections on the cost implications of Chinese multinationals. It also examines whether home political connections—at different levels and of different configurations—impact the operational cost of Chinese multinationals.

Design/methodology/approach - The data were analysed using a multivariate regression model. To examine their heterogeneous effect on Chinese multinationals, the political connection data were further split into higher and lower level political connections and in CEO and Chairperson political connections.

Findings - This study implies the negative effect of home political connections on the internationalisation of Chinese multinationals. At the same time, the impact of lower-level political connections is stronger than that of their higher-level counterparts. Moreover, CEO political connections have a stronger effect on the operational costs of Chinese multinationals than their Chairperson equivalents.

Originality/value - By unravelling the ‘black box’ of Chinese internationalisation from the social exchange perspective, through the informal political connection networking ties between Chinese firms and the government, this study advances emerging market multinational theory, contributes to the understanding of the

heterogeneous nature of political connections, and sheds new light on social exchange theory from the perspective of the emerging phenomenon of Chinese internationalisation.

Keywords Political connection, Outbound M&As, Operational cost, China, Social exchange

Introduction

Chinese multinationals have experienced significant growth in the last decade since the Chinese government promoted its going-global strategy. A great number of firms build up their business overseas. In particular, state-owned enterprises (SOEs) have been dominating internationalisation from China for a long period of time. Arguably, a distinct linkage between business and politics characterises international activities from China (Morck, Yeung, & Zhao, 2008).

A large body of literature has focussed on the role of ownership in Chinese internationalisation (Deng, 2013; Luo, Xue, & Han, 2010). It suggests that, due to their natural and formal linkages with the government, SOEs, despite enjoying precedence in the exploitation of key resources, face more institutional constraints when engaging in outbound activities (Deng, 2013).

Nonetheless, business-political linkages are heterogeneous; some are natural, apparent and formal, while others are opportunistic, hidden and informal (Boisot & Child, 1996; Sun, Mellahi, Wright, & Xu, 2015). Political connections, which may belong to the latter (Deng, Yan, & van Essen, 2018), refer to informal networking ties between firms and the government or state (Faccio, Masulis, & McConnell, 2006). The extant research argues that political connections help firms gain business advantages such as tax benefits (Wu, Wu, & Rui, 2012), bank loan (Cull & Xu, 2005), government bailouts (Faccio et al., 2006), and domestic trade expansion (Lu, 2011); however, they remain underexplored in the field of internationalisation (Deng et al., 2018).

Furthermore, political connections *per se* are complex and heterogeneous (Zhou, 2013). Different levels of political connections may generate varying effects. From the governmental point of view, governments, at different levels, have different

motives and objectives and thus hold different expectations (Bai, Lu, & Tao, 2006; Wang, Hong, Kafouros, & Wright, 2012). Higher-level governments, such as the central government and provincial governments, are more open and outward looking, and are thus more supportive to the cross-border strategies of focal firms (Li, Cui, & Lu, 2014). In contrast, lower-level governments, such as municipal or county ones, focus more on local economic and social stability and growth; thus, the support of firm outbound activities are not their priority (Li, Cui, & Lu, 2014). As a result, firms with higher-level contacts have easier access to strategic resources and are thus favourably positioned in their home country for their international strategies. As a consequence, these firms are likely to strategically restructure their resources into cross-border activities in order to fulfil the interests of higher-level government. Conversely, firms with lower-level political connections are more likely to spend effort, time, and money to please local officials and to commit to expand their investment in local areas in order to gain key resources and the local government's support for their internationalisation. Overall, as different political connection levels can leverage different resources and advantages, and generate different constraints and pressures (Wang et al., 2012), they require different forms of reciprocity and, as a consequence, may generate different outcomes. This scenario prompts the question of whether the heterogeneity of political connections creates differences in the internationalisation of Chinese multinationals.

As a common global phenomenon, political connections have important economic implications (Faccio, 2006). Although prior research has identified the significant role played by ownership in Chinese internationalisation, our knowledge of how the heterogeneity of political connections influences the performance of Chinese multinationals remains incomplete (Brockman, Rui, & Zou, 2013; Deng et

al., 2018; Schweizer, Walker, & Zhang, 2017). To address the research gap associated with political connection heterogeneity and the performance of Chinese multinationals, this research employed social exchange theory to examine how the home political connections of Chinese multinationals affect their performance. China is well known for being a *guanxi*-based economy (Boisot & Child, 1996; Xin & Pearce, 1996). As a type of *guanxi* or informal networking tie, political connections entail a reciprocal relationship between firm managers and government officials. Thus, political connections become a tool through which Chinese firms obtain key resources and favourable treatment (Xin & Pearce, 1996). These key resources may complement the ownership advantage of and add value to focal firms. However, maintaining and taking advantage of political connections often involves firms becoming indebted and liable to government officials (Sun, Mellahi, & Wright, 2012). Politically connected managers sometimes have to maintain the long-term continuity of their reciprocal relationships at the cost of the short-term interest of the focal firm (Sun, Mellahi, & Thun, 2010). Based on this, we hypothesised that political connections lead to higher operational costs for multinationals. This is because, although political connections facilitate trust, and information and resource exchange between the government and focal firms, they also sometimes become a reciprocated burden to managers and may backfire in the operation of internationalisation. We found strong evidence to support this cost-increasing hypothesis.

This research contributes to the literature mainly on two fronts. First, it provides new insights into the internationalisation of Chinese multinationals because it incorporates political connections, a type of informal networking ties. On top of that, it takes the heterogeneous nature of political connections into consideration by examining how the performance of multinationals is influenced by the heterogeneity

of political connections. Under social exchange theory, to maintain their relationships with the government, the focal firms reciprocate with reinvestment, employment, or other inputs; we demonstrate that political connections of different levels all have negative effects on the operational costs of Chinese multinationals. Moreover, lower-level political connections show a relatively more negative impact than higher-level ones. We further identify the different effects of CEO and Chairperson political connections. In this way, we open up the operational ‘black box’ of Chinese multinationals using evidence drawn from Chinese outbound mergers and acquisitions (M&As). Second, this research advances the understanding of political connections and extends it to the international business field by going beyond the surface of political connections to investigate the different valuation effects of heterogeneous political connections on Chinese multinationals, thereby extending the literature on the effects of political connection to the emerging phenomenon of internationalisation from emerging markets.

The remainder of the article is organised as follows. Section 2 introduces a review of the literature on the social exchange, political connections, and internationalisation by Chinese multinationals. Section 3 develops the hypotheses. Section 4 describes the data sources, selection procedure, and variable measurement. Section 5 presents the empirical results. Section 6 discusses the implications of the findings and their limitations.

Literature review

China provides a particularly useful setting to examine the effects of political connections on the performance of multinationals from emerging markets. The reasons for this are twofold. First is the prevalence of *guanxi* in Chinese society (Xin

& Pearce, 1996). *Guanxi* is an interpersonal connection, motivated by mutual interest and benefit, in which people exchange favours and expect to be repaid in the future for any favours done (Kiong & Kee, 1998; Yang, 1994). Political connections, as a type of *guanxi*, can involve governmental support to focal firms (Claessens, Feijen, & Laeven, 2008; Fan, Wong, & Zhang, 2007). Second, the Chinese government plays an important role in the international activities of Chinese multinationals (Du & Boateng, 2015; Luo et al., 2010; Wang et al., 2012). This is mainly due to the Chinese government control of some strategic resources, and to its discretionary power in the legitimacy of Chinese multinationals. Overall, examining the role of home political connections in the internationalisation of Chinese multinationals is of relevance.

Social exchange theory

Social exchange theory posits that the process of social exchange is used to transfer social resources, such as access to partners, disambiguating information, and advice to help hone a firm's strategic position (Cropanzano & Mitchell, 2005; Huang & Knight, 2017). Social resources are of an indeterminate and abstract nature, and thus cannot be clearly defined in contracts. Partly because of this reason, the exchange process of social resources takes place through informal engagements in the presence of a strong sense of trust and affection between the parties involved (Gertler, 2003).

The flow of such ill-defined social resources is guided by expectations of reciprocity, which serve as the mechanism governing social exchange (Blau, 1964; Lincoln, Gerlach, & Takahashi, 1992; Molm, Peterson, & Takahashi, 1999). Reciprocity refers to the general obligation of an actor to give a benefactor something in return for what it has received (Uzzi, 1996). Social exchange can only be achieved under the assumption that the actors accept some costs and uncertainty in the short

term, and that the value of the favours will be reciprocated in some way at some time (Molm et al., 1999). Thus, reciprocity is not a one-shot contractual governance mode, but a long-term orientation with the expectation of a return of favours at an undefined future date (Gouldner, 1960).

As social exchange is maintained in the long term through the governance mechanism of reciprocity, the actors are obliged to achieve their commitment of reciprocity by ‘paying back’ and ‘paying forward’ the benefactors who have done them favours. O’Brien and David (2014) believed that actors may use their privileged positions to ‘pay back’ their benefactors with generous terms, such as quality and price adjustments, and to ‘pay forward’ by finding ways to instigate growth opportunities suited to benefit their benefactors in the future. In this way, the relationship involved in social exchange can be safeguarded in the long term.

In the following sections, we illustrate how social exchange occurs in the outbound M&A process via the political connections between Chinese multinationals’ managers and government officials, and how it influences the performance of Chinese multinationals.

Political connections

Political connections have become an increasingly popular topic (Faccio, 2006; Fisman, 2001). Political connections refer to informal social networking ties with governments (Claessens et al., 2008; Faccio, 2006; Fan et al., 2007). Unlike formal governmental ties, political connections are implicit, informal, and bottom-up ties motivated by individual interest (Xu & Zhou, 2008).

The extant research posits that political connections have proved to be an important factor in determining firm performance (Sun et al., 2012). Some literature

implies that political connections have a positive effect on firm performance. For example, a S&P 500 analysis shows that politically connected boards are positively correlated to abnormal stock returns (Goldman, Rocholl, & So, 2009). A study of Latvian firms shows that politically connected CEOs improve firm value by gaining governmental support (Dombrovsky, 2011). In contrast, other streams of literature suggest that political connections have negative impacts on firms. Shleifer and Vishny (1994) noted that governments might share any benefits generated through political connections to achieve political goals. A study of Chinese listed firms shows that, in the long term, politically connected firms have poorer post-IPO performance than non-politically connected ones (Fan et al., 2007). Thus, governments act as grabbing hands towards firms with political connections, and negatively affect their value and performance (Frye & Shleifer, 1996).

Despite being a worldwide phenomenon, political connections may play a more significant role in emerging and transitional countries (Faccio, 2006) such as China. In China, such ties are generally built in two ways: by executives serving as members of the Chinese People's Political Consultative Conference (CPPCC) or as deputies in the National People's Congress (NPC), or by the appointment of current or former government officials as corporate executives (Zhou, 2013).

From the viewpoint of social exchange, political connections can be seen as an opportunistic and instrumental dimension of company relationships, reflecting informal social connections to the government or state. Political connections facilitate a firm's exchange with the government for those relatively highly particularistic and abstract social resources that are mostly in the control of the latter; for example, financial bailouts, and privileges and convenience in accessing new policy explanations. Consequently, politically connected firms are motivated to adhere to

political objectives and to help the government to achieve its political goals (Fan et al., 2007; Shleifer, 1998). For example, Jia and Zhang (2013) found evidence that CEOs with political connections have higher probability of making donations aimed at satisfying the needs of the government. However, in some cases, firms are likely to damage their value at the expense of sacrificing the benefits of other stakeholders (Hovey, Li, & Naughton, 2003).

Internationalisation by Chinese multinationals

China's 2001 going-global strategy has greatly accelerated the internationalisation of Chinese firms (Luo et al., 2010). Over the past few decades, the strategy of Chinese firms has changed from acquiring the status of national giants within China to becoming global players. Outbound M&As have been the dominant means of internationalisation adopted by Chinese firms (Child & Rodrigues, 2005; Deng, 2004; Luo et al., 2010). By acquiring existing firms with advanced technologies, Chinese multinationals have gained access to the latter's strategic assets (Ai & Tan, 2018; Zheng, Wei, Zhang, & Yang, 2016), which refers to those resources and capabilities that are valued for their potential to contribute to the acquiring firms' competitive advantage (Deng, 2004).

With the development of Chinese multinationals and emergence of outbound M&As from China, the Chinese government exploits regulations and restrictions to safeguard its home assets, benefit the state's interests, and prevent potential capital flights (Cui & Jiang, 2010; Deng, 2013; Luo et al., 2010). Considerable obstacles contribute to the relatively higher complexity of Chinese outbound M&As. The first of these obstacles is related to the rigid approval system. According to regulations, overseas investment projects over a certain amount must be submitted to the relevant

authorities for ‘step by step approval, and quota management’ (Ministry of Commerce of China, 2009). Potential Chinese acquiring firms not only have to get permission from the government before entering into any formal bidding and negotiation process with their target firms, but also have to endure the scrutiny of multiple agencies ranging from provincial government branches to the central government (Tan & Ai, 2010). Whereas, from the government’s perspective, such a system may ensure that all investments are closely aligned with the state’s strategic geopolitical objectives, from the perspective of Chinese acquiring firms, this overly rigid regulatory arrangement exposes them to great risk in the enactment of cross-border M&As. The second obstacle is associated with the financing of outbound M&As, which require financial support to succeed. However, Chinese acquiring firms are subject to financial restrictions in terms of the extent of domestic loans and foreign exchange. Such financial support restrictions limit their financing capacity in outbound M&As, causing them to miss some opportunities.

Correspondingly, part of the extant research is mainly focussed on how Chinese multinationals respond to the institutional pressures exerted by the Chinese government (e.g., Cui & Jiang, 2010). In particular, most research has examined the role played by ownership in Chinese outbound investment from the formal political network perspective (Luo et al., 2010; Sun, Peng, Ren, & Yan, 2012). However, little is known about the role played by informal political networks in the outbound investments of Chinese multinationals.

The next section attempts to link Chinese multinationals with informal political networks. Drawing upon social exchange theory, we build hypotheses on the relationship between political connections and the operational costs of Chinese multinationals.

Hypotheses development

Political connections serve as reciprocal relationships between firms and the government. First, political connections may help firms to gain additional tangible resources. Politically connected firms can leverage their links with the government to gain priority access to government-controlled resources, such as foreign currency (Faccio et al., 2006), which are key and particularistic resources in cross-border investment activities. Second, politically connected firms are likely to make a good impression and further obtain intangible favourable treatment from regulatory authorities. For instance, political connections may reduce the information asymmetry of Chinese firms and enable firms to effectively shorten their communication channels with the government. Considering the time-consuming regulatory approval system, good relations with 'key persons' in the government can make approval processes more time efficient. As such, in China, politically connected firms may face less regulatory barriers than non-politically connected ones, and are thus more likely to be presented with outbound investment opportunities.

However, as discussed above in relation to social exchange theory, although political connections bring benefits to focal firms, politically connected firms need to repay any debts accrued for the benefits gained (Yang, 1994). This reciprocity may neutralise such benefits, increasing operational costs and the likelihood of investments failing (Bertrand, Kramarz, Schoar, & Thesmar, 2018). The reasons for this are as follows. First, politically connected multinationals may increase their investments as a tacit reciprocity commitment to the government. Bertrand et al. (2018) showed that political connected firms are burdened by excessive human resource costs because political connected CEOs create more job opportunities in areas characterised by

higher levels of political competition. Similarly, Boycko, Shleifer, and Vishny (1996) found that public firms employ excess labour to meet political objectives. Sun, Vinig, and Hosman (2017) posited that Chinese multinationals make much inefficient investment due to their connections with the government. Either new investment or re-investment fit in exactly with the government officials' wishes because such behaviours may create job opportunities and future economic growth potential. As a consequence, the social exchange mechanism of reciprocity may play a negative role in the operation of internationalisation by Chinese multinationals, and result in increases in operational costs.

Based on this analysis, the following hypothesis is proposed:

H1: Political connections are likely to be positively correlated to the operational costs of Chinese multinationals.

Different political connection levels also have an effect on the value creation of Chinese multinationals. This may derive from the heterogeneity of governmental bodies in terms of their interests and objectives (Bai et al., 2006; Wang et al., 2012; Wu et al., 2012) and from the specific forms of support that political connected firms can obtain.

Lower-level governments focus mainly on local social stability and economic output. Firms politically connected at lower levels are more encouraged and supported to expand their business within local regions (Lu, 2011; Wang et al., 2012). Thus, these firms may experience harder communication with local-level regulatory approval authorities. After succeeding in going global, Chinese multinationals are often obliged to reciprocate those local government bodies that had done them favours. In most cases, reciprocity takes on the form of increased investment in local

regions. Firms may build new manufacturing bases, R&D and logistics centres, or make further investment. In doing so, they create potential opportunities for local future growth in terms of employment, talent cultivation, and knowledge transfer. However, in some cases, the regions the local governments of which offered help to the focal firms do not possess any location advantage of either investment or reinvestment. Some regions may be distant from the relevant market, thus making the building of manufacturing factories or logistics centres uneconomic, while others may not be suited to the establishment of R&D centres due to serious talent outflow. Due to the favourable treatment received from local government bodies, Chinese multinationals can be very likely to reciprocate by partly sacrifice their own interest. As a result, this may increase the invisible operational costs of internationalisation of those Chinese firms that have lower level political connections.

By contrast, higher-level government bodies possess more political resources, are empowered to approve cross-border investment (Luo et al., 2010), and hold the expectation that outbound investment may reinforce China's national security and competitiveness in the international arena. Therefore, they hold a more international and outward looking perspective (Wang et al., 2012). Meanwhile, higher-level political connections imply a relatively stronger capability of either the management or the focal firm. Thus, high-level government bodies have a propensity to endorse these firms with more opportunities, intermediary governmental services, and privileged information. Such relationship-based advantage may reduce the focal firms' transaction costs with the government, and thus add value to them. In reciprocity to these higher-level government bodies, the focal firms are likely to restructure their resources to balance their international strategic initiatives in the interest of the state. The focal firms will further expand their collaboration with their

foreign counterparts in the form of joint ventures, R&D centres, and manufacturing bases both in China and abroad. When the focal firms become globally competitive they highly align themselves with the strategic priorities of higher-level government bodies and fulfil the interest of the state.

On basis of this discussion, we propose the following hypothesis:

H2: Lower-level political connections are likely to generate more operational costs for Chinese multinationals than their higher-level counterparts.

Research design

Data sources and sample selection

The hypotheses were tested based on a sample of Chinese firms engaged in outbound M&As between 2006 and the first quarter of 2014. Outbound M&As from China have been in full swing over the last two decades, while both value and volume start to rise since 2006 (Sun, 2018). Chinese firms were listed primarily on Shanghai and Shenzhen stock exchanges. Information about M&As were sourced from the Zephyr Database, which provides abundant information on M&As such as names of acquiring and acquired firms, deal value, deal completion date, industrial sector, and location. Information about characteristics of Chinese top management team was sourced from the Chinese Stock Market Research (CSMAR) Database. CSMAR incorporates up-to-date information and less missing data. Specifically, M&A performance data was extracted from the section of the financial index of Chinese listed firms, and data of political connection was extracted from the section of top managers' characteristics of listed firms.

The initial population consisted of 2475 M&A completed deals by Chinese firms. To improve the accuracy and objectivity, the research sample was selected based on the following restrictions: (1) M&A deals by financial firms were eliminated. This is mainly because financial firms have a different accounting system, which may bias results. (2) ST firms were eliminated. (3) Firms listed in B stock market and H stock market were eliminated, due to the use of different accounting and reporting systems. (4) Because data of non-listed firms usually are unavailable, M&A deals by non-listed firms were eliminated. (5) M&A deals must be completed for more than one year, so that we can test the long-term firm performance. Therefore, the deals completed less than one year were eliminated. (6) If two or more than two outbound deals by the same acquiring firm occurred in the same year, the first completed M&A deal was selected. If there were different outbound deals by the same acquiring firm in different years, these deals were incorporated as individual M&A event into the sample. After eliminating the preliminary sample, the final sample consisted of 225 M&A deals.

Variable measurement

As for the dependent variable, the research used the one-year-after accounting performance (Yeung, Lee, & Yeung, 2013). The reason for using accounting performance instead of stock performance is that financial returns may not highlight the effects of political influence (Ding, Jia, Wu, & Zhang, 2014). In our research, we used operating expense ratio to measure the operational cost (Cannon & Homburg, 2001). In addition, we defined the time frame of operating expense ratio by trailing twelve months (OERTTM) to make sure that the operational cost is measured in a long-term range (Cannon & Homburg, 2001).

In terms of the independent variable, political connection was measured if CEO

and/or Chairperson of a firm is formerly or currently the government officer, deputy of NPC or member of CPPCC (Chan, Dang, & Yan, 2012; Wu et al., 2012; Zhou, 2013). Three types of measurement are usually adopted to measure political connection, including assignment measurement (Du, Chen, & Du., 2010), ratio measurement (Fan et al., 2007), and dummy variable measurement (Faccio, 2006). The assignment measurement regards the value of political connection as the level of political position. For example, the officer at central level, provincial level, city level and the level below is assigned different value from “4” to “1” and no political connection assigned “0” (Du et al., 2010). The ratio measurement estimates the percentage of CEO and/or Chairperson who is politically connected in the entire management team (Fan et al., 2007). The dummy variable means that political connection is coded “1” if the firm has a politically connected CEO and/or Chairperson, and “0” otherwise.

Although the dummy variable is dominant in the measurement of political connection, the problem is that the dummy variable leads to a limited understanding towards the variant effects of political connection at different levels. Taking it into consideration, we adopted a mixed approach by using the assignment measurement and ratio measurement. To be specific, we estimated the percentage of politically connected management in the entire management team (PC). Furthermore, we categorised political connection into political connection with higher-level government (H_PC), such as the central or provincial government and PC with lower-level government, such as the municipal and county government (L_PC) (Li et al., 2014). We used the percentage of CEO or Chairperson in the entire management team to measure if CEO or Chairperson of the firm is politically connected (PC_CEO and PC_CHA, respectively) at higher level (H_CEO and H_CHA, respectively), or at

lower level (L_CEO and L_CHA, respectively). By doing so, not only the disadvantage of dummy variable is offset, the heterogeneous nature of political connection is manifested.

This research also introduced some control variables. First, we took ownership, measuring by the ratio of state-shares in the total outstanding shares (Li, Sun, & Zou, 2009) as one of the control variables. As discussed above, state ownership unavoidably brings political objectives into corporate decision making, which can change corporate value (Du & Boateng, 2015). Second, the study used the total asset to control the acquiring firm size. Firm size indicates that acquiring firms have the capacity to generate value through economies of scale and scope (Du & Boateng, 2015). Third, the firm with higher leverage is easier to get the long-term loan, which is positively related to the long-term performance of the firm. Thus, the leverage of the firm was controlled. Fourth, as firm age indicates acquiring firms' experience of doing business, which may influence the corporate performance, the firm age, measured by the number of established years of the firm, was controlled. Fifth, the industrial sector was controlled as dummy variable in our model. In total, five industrial sector dummy variables were generated, ranging from public utility, real estate, agriculture, and manufacturing to commercial industry. Sixth, as the target countries have different institutional system, whether the target countries are developing or developed countries may affect the cost performance, therefore, location was under controlled as dummy variable. It was coded "1" if the target countries are developing countries, otherwise "0". Finally, as macroeconomic situation varies in different years, the M&A completion years were controlled as year dummy variable. Table I provides the variable measurement and descriptive statistics.

[Insert Table I about here]

Analysis and results

Descriptive analysis

Table II presents the industry distribution and M&A completion year distribution. Panel A shows that the sample covered 5 industrial sectors, among which the manufacture industry accounted for 76.4% of the 225 outbound M&A deals, while the real estate industry accounted only for 2.2%. Besides, the public utility industry, agricultural industry and commercial industry made up for 13.8%, 3.1% and 4.4%, respectively. Panel B reports that only 5 outbound M&A events took place in 2006. The deal number grows rapidly, from 18 deals in 2007 to 58 deals in 2012.

[Insert Table II about here]

Table III demonstrates the distribution of the target location. Half of outbound M&A deals were target in HK, America, and Germany, accounting for 20.9%, 20.4%, and 11.6%, respectively. For the rest of the target countries, the distribution was rather decentralised.

[Insert Table III about here]

Table IV reports correlation matrix of the variables. It shows that in terms of independent variables, PC is significantly related to political connections at different levels and of configurations, and OERTTM. In terms of other variables, the correlations are fairly low, and variance inflation factor scores are within the cut-off point of 10, thus multi-collinearity appears not to be a problem.

[Insert Table IV about here]

Results of the empirical analysis

In order to analyse the explanatory power of political connection related to the value creation of outbound M&As by Chinese multinationals as indicated by the research hypothesis above, and we employ multivariate regressions to relate political connection to the M&A cost performance. Specifically, we estimate the following (basic) regression model:

$$\begin{aligned} \text{CostPerformance} &= \alpha_0 + \alpha_1 \text{PoliticalConnection} + \alpha_2 \text{Controls} \\ &+ \sum \beta_i \text{YearDummy} + \sum \gamma_j \text{IndustryDummy} \end{aligned}$$

where the dependent variable is cost performance. As described above, we used OERTTM as the performance measure. The major independent variable is political connection. In different regressions, political connection can be replaced by PC, H_PC, L_PC, PC_CEO, PC_CHA, L_CEO, H_CEO, L_CHA, and H_CHA, which are described in Table I. Control variables are also present in Table I. Following Bouwman, Fuller & Nain (2009), year and industry dummies are included to control for year and industry effects, respectively. Year and industry dummies are included in the regression, but not reported to save space.

Table V presents the empirical results. Model 1 shows that political connection has a positive impact on the operational cost of Chinese multinationals, as the impact of PC on OERTTM is significantly positive. Moreover, both H_PC and L_PC are positively related to OERTTM. Therefore, H1 is supported. Comparing Model 2 and Model 3, it indicates that political connections at lower level generate slightly higher operational cost in outbound M&As than political connections at higher level. The finding is consistent with H2.

[Insert Table V about here]

Furthermore, we tested the impact of CEO and Chairperson's political connection at different levels on the operational cost of Chinese multinationals in Table VI. It shows that the effect of lower-level political connections of CEO and Chairperson has a huge difference compared to that of higher-level political connections of CEO and Chairperson. Model 4 shows that political connection of CEO at higher level is positively but insignificantly related to the operational cost of Chinese multinationals. In contrast, Model 5 suggests that political connection of CEO at lower level is both positively and significantly related to Chinese multinationals' operational cost. Similarly, while higher-level political connection of Chairperson has no significant effect, as shown in Model 6, lower-level political connection of Chairperson has a significantly positive impact on the operational cost, as shown in Model 7. Taking together, the empirical result supports H2, too.

We then examined the effect of political connection of CEO and Chairperson on the operational cost of Chinese multinationals, respectively. Model 8 and Model 9 report the results. It shows that political connection of CEO has a significant and positive effect while that of Chairperson has insignificant effect. Looking at Model 5 and Model 7, the results suggest that politically connected CEO has a stronger impact than politically connected Chairperson at lower level. Thus, the results are consistent. It indicates that politically connected CEO is more important than politically connected Chairperson in the daily operation of Chinese multinationals engaging in outbound investment.

[Insert Table VI about here]

Discussion and conclusion

This study has investigated the role played by political connections in the operational costs of Chinese multinationals. Using a sample of 255 outbound M&A deals enacted by Chinese multinationals between 2006 and the first quarter of 2014, we have unravelled the ‘black box’ of Chinese internationalisation from the perspective of informal business-political linkages.

This study makes significant contributions on three fronts. First, it advances the understanding of the internationalisation of firms from emerging markets by researching informal networking ties—i.e., political connections. The extant literature has mainly focussed on the role played by ownership, a formal institutional relationship, in the internationalisation process of Chinese multinationals. Little is known about whether and how informal networking ties play a role in this new phenomenon. The empirical results show a negative correlation of political connections with the operations of Chinese multinationals. We argue that such negative correlation is due to the reciprocity of the latter’s commitments and behaviours to the government. In doing so, this study specifies the significant role played by political connections in the value creation of Chinese multinationals.

Second, this research furthers the literature on political connections by taking their heterogeneity into consideration. It implies the negative effect of political connections—and that of lower level ones in particular—on the value creation of Chinese multinationals. We find evidence that the operational costs of Chinese multinationals increase significantly as a consequence of lower-level political connections. It indicates that political connections increase the indebtedness of firms to government bodies. Moreover, the much stronger damaging impact of lower-level political connections on the performance of Chinese multinationals is attributed to the

diverse objectives of governments at different levels, with lower level politically connected firms returning any favours to local governments by promptly investing or reinvesting in local regions to satisfy the latter's political objectives. Conversely, higher-level government bodies are generally more long-term focussed and more supportive of the further outbound expansion of politically connected firms. In addition, the results indicate that CEO political connections have a stronger effect on value creation compared to Chairperson ones. This may be because CEOs take charge of the daily decision-making and routine matters and are the principal decision executors; thus, CEO political connections may be more instrumental in raising the potential information and legitimacy benefits of firms (Wu, Li, & Li, 2013). By contrast, rather than being involved in daily trivialities, Chairpersons are in charge of macro issues, and their political ties are thus less essential to their firms' operation. In this way, our research contributes to a more comprehensive understanding of political connections.

Third, this research has employed social exchange theory to explain the interaction between firms and government bodies in the specific area of Chinese internationalisation. Based on the social exchange view, this study indicates that reciprocity is the governance mechanism that maintains the long-term social exchange via political connections with the government. The reciprocal repayments enacted by beneficiary politically connected firms entail their loyalty and commitment to the government bodies. The forms taken by this reciprocity vary depending on the interests of the specific government bodies. In the case of outbound M&As, it often takes the form of providing (paying back) higher quality products to domestic customers, or of paying forward potential opportunities for economic growth and social development. However, sometimes, such reciprocity comes at a cost to the

beneficiary firms. As a consequence, the social exchange and reciprocity mechanism increases the operational costs of politically connected Chinese multinationals.

With regard to practical implications, most international scholars and business professionals have increased their focus on state ownership, but have neglected the significant role played by invisible political connections on the value of Chinese multinationals. Our findings may remind Chinese multinationals of the invisible side of political connections and of the resulting reciprocity in their internationalisation. Moreover, the host country target firms should also be aware of the damaging effects of their Chinese counterparts' invisible networking ties.

This study presents several limitations that provide possible directions for future research. First, there is a lack of specific interpretations of the intrinsic mechanisms governing the effects of CEO and/or Chairperson political connections—either higher or lower level ones—on the value creation of Chinese multinationals. Second, this study has only taken the target locations into consideration. However, as some scholars suggest, home political connections with government bodies in different domestic areas does exert heterogeneous influences on investment performance (e.g. Zhou, 2013), thus the effects of location or home country areas in the relationship between political connections and investment performance should be investigated. We suggest that future studies should extend both theoretical and empirical research to reveal these specific aspects.

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