HOW IDEOLOGIES INFLUENCE THE LEGITIMACY OF STATE INVOLVEMENT IN CORPORATE GOVERNANCE

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HOW IDEOLOGIES INFLUENCE THE LEGITIMACY OF STATE INVOLVEMENT IN CORPORATE GOVERNANCE

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Title of Study: HOW IDEOLOGIES INFLUENCE THE LEGITIMACY OF STATE INVOLVEMENT IN CORPORATE GOVERNANCE

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Abstract: The Central Government of China is the largest controlling owner of many publicly traded Chinese firms and the CEOs of many Chinese firms are former officials with the Central Government. This study explores how these forms of state involvement in corporate governance are perceived by foreign investors. I posit that the legitimacy of state involvement is influenced by the dominant ideology in the foreign capital market. I tested hypotheses using a sample of Chinese listed firms which are cross-listed on the United States and the Hong Kong stock markets, two markets with very different ideologies about the role of government. My findings show that central government ownership positively affects legitimacy among Hong Kong investors and negatively affects legitimacy among United States investors. Surprisingly, I found that CEO political connections with the central government have a positive effect on legitimacy in both markets.

Keywords: Cross-listing, legitimacy, government ownership, CEO political connections, ideology

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CHAPTER I

INTRODUCTION

The globalization of capital markets enables firms to seek equity capital in foreign markets. Many firms that have already listed on home markets cross-list on one or multiple foreign capital markets (Moore *et al.*, 2012). One of the fundamental problems cross-listed firms encounter is a legitimacy deficit (Bell, Moore, and Al-Shammari, 2008; Bell, Filatotchev, and Rasheed, 2012). Organizations achieve legitimacy to the extent that their characteristics and practices are consistent with the expectations investors have about firms (Zajac and Westphal, 2004; Ioannou and Serafeim, 2015). Prior work has investigated several important governance characteristics that influence how investors perceive foreign firms in the host country, such as board independence (Bell, Moore, and Filatotchev, 2012; Moore *et al.*, 2012; Bell, Filatotchev, and Aguilera, 2014), managerial incentives (Moore *et al.*, 2012; Bell *et al.*, 2014), insider ownership (Bell *et al.*, 2008), founder-CEO, and board interlocks (Moore *et al.*, 2012). However, very little work has been done to understand how state involvement in corporate governance affect foreign investors' perceptions of organizational legitimacy.

To date, most of the research on foreign investors' perception of legitimacy has focused on governance mechanisms that are common in the US market. Many foreign firms, however, have corporate governance mechanisms that are rare and not well understood in the US. Specifically, the home country government is often directly

involved in the corporate governance of a firm either through state ownership or political connections with the CEO. Foreign investor perceptions of such state involvement in corporate governance are likely influenced by the prevailing host-country ideologies regarding state interactions with corporations and prevailing perceptions of the home-country government. Here I define state involvement in corporate governance as a direct involvement of government in a firm's corporate governance through government ownership or prior political appointment of the CEO (Fan, Wong, and Zhang, 2007; Liang, Ren, and Sun, 2015).

State involvement in corporate governance is an important component of corporate governance in many economies. State ownership of publicly listed firms 'remains pervasive around the world and has been increasing in recent years' (Pargendler, 2012: 2917). Worldwide, state-owned enterprises account for one-fifth of global stock market capitalization (Pargendler, 2012; Liang, *et al.*, 2015). In China the central government exercises influence in the economy by maintaining a controlling interest in a majority of firms (Luo, Wang, and Zhang, 2016). A CEO's prior employment with the government is another form of state involvement (Fan, Wong, and Zhang, 2007). These types of state involvement are particularly prevalent in China, where the state plays a much larger role than any other major economy.

In 1978 the Chinese government began to allow the private ownership of companies. Prior to that all firms in China were either state owned or owned by township collectives. The growth of private ownership of firms accelerated in 1990 with the opening of the Shanghai and Shenzhen stock exchanges. In that year the Chinese economy was the eleventh largest in the world and less than one-tenth the size of the U.S.

economy. Today the Chinese economy is the second largest in the world and predicted to overtake the U.S. economy in the next decade. Although private ownership has increased, most publicly traded companies have significant levels of state ownership and many CEOs were former officials with central government.

Along with this extraordinary growth in the economy, the stock exchanges in Shanghai and Shenzhen have grown to become the fifth and eighth largest exchanges in the world. The growth of these exchanges is remarkable because the shares traded on these exchanges are, for the most part, only allowed to be bought and sold by Chinese citizens. These restrictions are being relaxed as the Chinese economy becomes more integrated with the rest of the world. As foreign investors have more opportunities to purchase equities in China, the perceptions these foreign investors have of state involvement will become more important. Chinese firms that are cross-listed in foreign markets provide an opportunity to study how foreign investors perceive government ownership and CEO political connections and whether these perceptions differ across international capital markets.

In this study, I develop and test hypotheses about how state involvement in corporate governance affect firm legitimacy in foreign capital markets. Building on institutional theory, this study focuses on ideology as a component of the host country's institutional environment, and explores how ideologies regarding the government shape investor perceptions of government ownership and CEO political connections. I posit that investor perceptions of state involvement in corporate governance are related to the dominant ideologies of the capital market and so state involvement is negatively related

to firm legitimacy perceived by U.S. investors, but positively related to firm legitimacy perceived by Hong Kong investors.

The US government is characterized as a rule-based government, where firms with state involvement are rare and U.S. investors assume that firms' competitive advantages are not dependent on government intervention. Thus, in the U.S., ideologies regarding government hold that government should intervene little in business in order to ensure a transparent business environment. In contrast, the governments of many East Asian countries are characterized as authoritarian governments, where firms with state involvement are common and investors assume that firms' competitive advantage rely on direct connections to the government. Thus, in East Asia ideologies regarding government emphasize positive effects of government involvement. Therefore, ideological conflicts are likely to arise when U.S. investors consider cross-listed firms with government ownership or CEO political connections.

This study addresses two research questions: (1) how is state involvement in firm corporate governance perceived by foreign investors, (2) do these perceptions differ across international capital markets. To answer these two research questions, I chose to focus on Chinese firms that cross-list in either the U.S. or Hong Kong. Cross-listing refers to a strategic choice of the firm to list its equity shares on one or multiple overseas markets in addition to its domestic listing (Karolyi, 2012). The Chinese government plays an important role in encouraging Chinese firms to cross-list in foreign markets, especially Hong Kong and New York. The results support my argument that central government ownership is positively related to legitimacy in the Hong Kong market and negatively

related to legitimacy in the U.S. market. I also found that CEO political connections are positively associated with legitimacy in both markets.

CHAPTER II

LITERATURE REVIEW

Cross-Listing

Cross-listing is a strategic choice made by a firm to list its equity shares on one or multiple overseas markets in addition to its domestic listing (Karolyi, 2012). Prior studies have identified two motivations for cross-listings: to increase the shareholder base and to provide a signal (Karolyi, 2006, 2012; Roosenboom and van Dijk, 2009).

Firms cross-list to overcome regulatory restrictions and information problems that cause investment barriers for foreign investors (Miller, 1999; Karolyi, 2004; Lins, Strickland, and Zenner, 2005). Cross-listings enable foreign investors to trade shares easily (Abdallah and Goergen, 2008). Cross-listings enable investors on the host markets to buy securities of foreign firms without the inconvenience of cross-border transactions (Saunders, 1993). For firms that have cross-listed in developed foreign markets, their shares become more accessible to investors, who are often restricted from trading the firms' domestic shares because of investment barriers.

Cross-listing on a developed stock exchange (such as the U.S. or Hong Kong) is also perceived as a signal of the firms' commitments to higher standards of investor protection and corporate governance (Reese and Weisbach, 2002; Doidge, Karolyi, and Stulz, 2004; Hail and Leuz, 2009). Cross-listings reflect confidence of top managers in their ability to meet listing requirements of the foreign capital markets (McGuinness,

1999). Fuerst (1998), and Melvin and Valero (2009) suggested that firms use cross-listing as a means to distinguish themselves from firms with weak governance because high levels of disclosure and legal requirements in global markets makes cross-listings more costly for firms with low governance quality.

Chinese Firms Cross-Listed on the U.S. and Hong Kong Stock Markets

In the following sections, I briefly introduce A-Shares, ADRs, and H-shares. The Chinese stock market comprises of the Shenzhen Stock Exchanges (SZSE) and the Shanghai Securities Exchanges (SHSE), and there is no fundamental difference between the two exchanges in terms of regulation and legislation (Tian and Estrin, 2008). A-shares refer to domestically listed (either on Shanghai Stock Exchanges or Shenzhen Stock Exchanges) shares of Chinese firms that are available to Chinese investors only (De Jonge, 2008). H-shares (Hong Kong listed shares) and A-shares (mainland listed shares) are traded in separate markets (McGuinness, 1999; De Jonge, 2008).

Firms with better performance and corporate governance are more likely to cross-list abroad. Zhang and King (2010) found that larger firms with higher profitability are more likely to list ADRs compared to domestic counterparts. Similarly, Pan, Lin, and Yang (2013) demonstrated that cross-listed firms, compared to firms only listed in the domestic market, have better corporate governance and better performance. Sami and Zhou (2008) found that cross-listed firms have lower information asymmetry risk and higher firm value (measured by Tobin's Q) than non-cross-listed firms in the domestic market, which is consistent with Doidge and colleagues' (2004) findings.

The Chinese government plays an important role in directing the location pattern of Chinese firms' foreign listings, especially for firms with government ownership. In

order to create national prestige and increase global visibility, the Chinese government encourages firms to list on foreign markets, especially New York and Hong Kong. Accordingly, many flagship state-owned enterprises, directed by the central government, are listed on the U.S. and Hong Kong markets (Pan and Brooker, 2014). The US stock market is the main destination favored by Chinese state-owned firms, because of its "gold standards" for corporate governance, the most established financial standards and financial regulations (Pan and Brooker, 2014). The central government aims to coerce state-owned firms to improve corporate governance and practices, and thus encourage firms to list in the U.S. since New York is the global financial center and an ideal listing destination. The Hong Kong stock market is also favored by Chinese state-owned firms because of geographical and cultural advantages. A number of studies have highlighted the effect of proximity on decisions for cross-listings (Sarkissian and Schill, 2004; Pirinsky and Wang, 2006). Proximity preferences include economic proximity, cultural proximity, and geographical proximity (Pan and Brooker, 2014). Hong Kong has been a popular destination since1997 when Hong Kong was returned to China. A growing number of Chinese firms are listed on the Hong Kong stock market (Karreman and van der Knaap, 2012). Yang and Lau (2006) provided some descriptive information about Chinese firms listed only domestically, and firms listed on the U.S. or Hong Kong stock market. They found that firms listed only in the domestic market are smaller than firms listed abroad. In addition, they demonstrated that cross-listed firms receive higher analyst coverage, which is consistent with Baker, Nofsinger, and Weaver's (2002) findings that cross-listed firms experience a significant increase in visibility.

Cross-Listing in the US (ADRs)

Foreign firms trade in the U.S. stock markets through American Depositary Receipts (ADRs). An American Depositary Receipt (ADR) is a certificate representing shares of a non-US firm. An ADR represents a specified number (multiple shares or a fraction of a share) of the corresponding security at home market (Arquette, Brown, and Burdekin, 2008). The depositary bank set a ratio of ADRs-to-ordinary shares. For example, one-for-five (1:5) backing means that one ADR covers five underlying shares. The underlying shares are retained by a custodian bank at the home market. ADRs are denominated in U.S. dollars, and traded through U.S. broker-dealers during U.S. trading hours. The depositary bank in the U.S. manages local taxes and currency issues. The first ADR was created and launched in 1927 by JPMorgan. To date, there are over 2,000 ADRs available that represent shares of firms incorporated in more than 70 countries.

There are three types of ADRs, and each type has different regulatory standards and is offered to investors through different outlets. Level I ADRs require the least amount of regulatory oversight and compliance. Firms issuing Level I ADRs are required to file an F-6 registration statement, but the firm is exempt from full SEC reporting requirements. The Form F-6 registration statement lists the information with respect to the rights of ADR holders, obligations of the depositary, and the depositary mechanism. The depositary bank is required to provide the SEC with information on a semi-annual basis concerning the number of depositary shares, and the name of dealers having depositary shares. Level I ADRs are traded over the counter (OTC) in the U.S., and the prices are reported to the U.S. Financial Industry Regulatory Authority (FINRA). Investors can obtain such information through sources such as OTC markets, Bloomberg, and Reuters (BNY Mellon, 2015).

Compared with Level I ADR issuers, firms issuing Level II ADRs have greater exposure in the U.S. Foreign firms issuing Level II ADRs are mandated to submit an F-6 registration statement, SEC Form 20-F (an equivalent of Form 10-K for U.S. firms), and annual reports in line with either US Generally Accepted Accounting Principles (GAAP) or International Financial Reporting Standards (IFRS). Firms are required to file Form 20-F within 6 months following the end of the fiscal year and disclose information regarding the firms' management, business properties, securities and finances. Level II ADRs are listed on major U.S. stock exchanges.

Firms issuing level III ADRs can raise capital through a public offering in the U.S. Different from Level II ADR issuers, firms issuing level III ADRs are required to file a Form F-1 with the SEC to register the public offering.

The majority of ADRs in mainland Chinese stocks fall within the Level I category (McGuinness, 1999). In other words, most of the ADRs in mainland Chinese stocks are traded over the counter.

Issuing ADRs enables foreign firms to have a broader investor exposure in the U.S. It is costly and difficult for investors to invest in foreign securities because of cross-border settlement issues. ADRs pay dividends in U.S. dollars, which is desirable to U.S. investors, especially retail investors (McGuinness, 1999). In addition, some institutional investors, such as U.S. pension funds, cannot buy foreign stocks. ADRs provide 'a legitimate vehicle through which international corporate earning streams can be accessed by such bodies' (McGuinness, 1999: 200).

Many firms issue Level I ADRs because Level I ADRs have minimal disclosure requirements, and they are an inexpensive means for foreign firms to gauge interests in

their securities, and they tap into the equity markets in the U.S. Once foreign firms establish Level I programs, they start building a U.S. investor base. Thus, Level I ADRs serve as a useful way of raising foreign firms' profiles in the world's most developed economies (McGuinness, 1999). In addition, Level I ADRs also serve a useful role in preparing ADRs for Level III status.

ADRs are created when brokers purchase shares on the firms' home market and deliver them to the local custody bank. The custodian bank instructs the depositary bank in the host market to issue ADRs (BNY Mellon; Gande, 1997). Take a Chinese firm (Firm X) issuing Level I ADRs for an example. When U.S. investors want to invest in Firm X, they call the broker to buy a certain number of ADRs, say 1000 ADRs of Firm X. Because there are no prior ADRs outstanding in the U.S., the broker goes to the Chinese stock market, buys 1000 shares and deposits them in a depositary bank, such as the Bank of New York. Once they are deposited, the depositary bank issues 1000 ADRs of Firm X in the U.S. market.

Once ADRs are issued, they can be traded like any regular securities. When another investor wants to buy 100 Firm X ADRs, the broker can either repeat the ADR creation process by going to the Chinese stock market, or by buying the ADRs that already exist in the U.S. market. If, for example, an investor owns 100 Firm X ADRs and wants to sell them but cannot find a buyer in the U.S. market, then the broker can cancel those ADRs and release the actual shares back to the Chinese market.

Cross-Listing in Hong Kong (H-Shares)

The Hong Kong stock market is regarded as a separate and independent market from the mainland Chinese market (Zhang and King, 2010). Under the policy of one

country two systems, Hong Kong has a high degree of autonomy in most areas. In 1993, the China Securities Regulatory Commission (CSRC) and the Stock Exchange of Hong Kong (SEHK) signed a memorandum of understanding on Sino-Hong Kong regulatory cooperation. The door was opened for the listing of mainland Chinese firms in the Hong Kong stock market. There are a growing number of mainland Chinese firms listed on the SEHK in the form of H-shares (Sun, Tong, and Zhang, 2013). H-shares refer to stocks of firms incorporated in mainland China but are listed and traded on the Hong Kong Stock Exchanges (McGuinness, 1999). H-shares are denominated in Hong Kong dollars. H-shares and A-shares are segmented in terms of listing and trading locations (Li, Yan, and Greco, 2006). More specifically, H-shares are traded by investors in Hong Kong, whereas A-shares are traded by local investors in mainland China. H-shares are currently not convertible to A-shares, and vice versa (Arquette *et al.*, 2008).

There are several requirements for firms to issue H-shares. According to Rule 8.09 regarding market capitalization, the expected market capitalization of a mainland Chinese issuer at the time of listing must be greater than HK$200 million, of which the public should hold at least 25 percent of the securities (De Jonge, 2008). With respect to board independence, the firm is required to have at least three independent directors, and at least one independent director has to have accounting or financial management expertise (Rule 3.10). In addition, firms issuing H-share are required to have at least one-third of independent directors.

Organizational Legitimacy

Cross-listed firms suffer from the liability of foreignness in the foreign capital market. Similar to firms selling in foreign product markets, cross-listed firms are

unfamiliar to investors in the foreign capital market, and therefore encounter a variety of problems (Bell *et al.*, 2012a). It is critical for cross-listed firms to overcome the liability of foreignness and acquire legitimacy to succeed in the foreign capital market. Organizational legitimacy is a generalized perception that organizational practices are desirable or appropriate within the socially constructed system of norms and beliefs (Suchman, 1995). Legitimacy is a socially conferred status, and is based on the shared beliefs of a referent social group within the institutional environment (Moore *et al.*, 2012).

Country-Level Factors that Influence Legitimacy in Foreign Capital Markets

The home country's institutional factors have influence on the legitimacy of foreign firms seeking IPOs in foreign capital markets. Recently, Bell and colleagues (Bell *et al.*, 2008; Bell *et al.*, 2012b; Moore *et al.*, 2012; Bell *et al.*,, 2014) examined factors that influence organizational legitimacy in foreign capital markets. Their findings demonstrate that the home country's regulatory and legal environments have a significant influence on the success of IPOs in foreign capital markets. For example, Bell and colleagues (2008) examined the legitimacy of foreign IPO firms in the U.S. and they found that firms incorporated in countries with higher level of economic freedom are less underpriced. Foreign firms originating from countries with regulatory institutions similar to those of the host countries obtain high levels of legitimacy (Kraatz & Block, 2008; Bell *et al.*, 2014). Firms originating from countries with stronger regulatory environments and better investor protections are perceived as more legitimate by U.S. investors (Bell *et al.*, 2012b).

Firm-Level Governance Factors that Influence Legitimacy in Foreign Capital Markets

In addition to the home country's institutional environment, foreign firms' legitimacy in host capital markets is also influenced by the extent to which foreign firms' governance characteristics conform to the institutional environment of the host country. Firms adopting governance practices similar to those that have already been taken for granted within institutional environments provide symbolic signals to investors (Bell *et al.*, 2012b; Moore *et al.*, 2012; Bell *et al.*, 2014). Investors put large weight on firms' internal corporate governance quality when making investment decisions (Bell *et al.*, 2012b; Gillan and Starks, 2003). Investors in the host country typically have sparse information with which to make a systematic evaluation of foreign firms. Thus, investors rely on signals by gauging whether foreign firms' corporate governance practices are acceptable or appropriate (Li, Yang, and Yue, 2007). Investors are likely to invest in foreign firms with corporate governance practices legitimated in the host institutional environment (Moore *et al.*, 2012).

Prior studies have found several important governance characteristics that influence legitimacy in the host country such as board independence (Bell *et al.*, 2012b; Moore *et al.*, 2012; Bell *et al.*, 2014), managerial incentives (Bell *et al.*, 2014; Moore *et al.*, 2012), insider ownership (Bell *et al.*, 2008), founder-CEO, and board interlocks (Moore *et al.*, 2012). In the U.S., shareholder value maximization has become the dominant logic (Lok, 2010). The common approach to resolving conflicts between managers and shareholders relies on managerial incentive alignment (Moore *et al.*, 2012) and board independence (Certo, Daily, & Dalton, 2001). Stock-based managerial incentives are prevalent in the U.S. (Coombes & Watson, 2001). Prior IPO studies have demonstrated that U.S. investors perceive IPO firms providing managerial stock options

as more legitimate (Certo, 2003; Sanders & Boivie, 2004; Bell *et al.*, 2008). In addition to managerial incentives, board independence serves as one of the most important signals to U.S. investors (Bell *et al.*, 2012b). Board independence signals to potential investors that the firm has a high level monitoring and is willing to adhere to high governance standards. In other words, board independence indicates that the foreign firm has adopted governance practices that U.S. investors are accustomed to (Certo, 2003; Bell *et al.*, 2012b). Thus, foreign firms adopting the prevailing governance practices – having a large percentage of board independence - are perceived as more legitimate. Bell and colleagues (2012b) demonstrated that board independence is one driver of foreign IPO success.

Research Gap

To date, the research examining how firm-level governance factors influence investor perceptions in host countries mainly focuses on governance mechanisms that are common in the U.S. (e.g., Bell *et al.*, 2014). Other corporate governance factors, such as state involvement in corporate governance, likely influence organizational legitimacy in the host country. However, these factors are not well understood in the U.S. and have received little attention in the management literature. In addition, extant studies on legitimacy of foreign firms' governance practices use the IPO context. No prior research has utilized cross-listings as a setting to examine organizational legitimacy. The analysis of cross-listings gives insight into how existing Chinese firms will be perceived by foreign investors, an issue that will become increasingly important as the Chinese capital market becomes more integrated with the global capital market.

CHAPTER III

THEORY AND HYPOTHESES

Ideologies about the Government's Role in the Economy

The concept of ideology comprises a set of attitudes and beliefs that are shared by members of a group (Fine and Sandstrom, 1993; Zald, 2000; Blee and Currier, 2005; Den Hond and De Bakker, 2007). Ideology provides the rationales for challenging or defending certain social conditions and arrangements (Den Hond and De Bakker, 2007). Organizational scholars define ideology as a set of shared beliefs and ideas reflecting social experiences, potent in a particular context at a particular time (Brunsson, 1982; Dunbar, Dutton, and Torbert, 1982; Starbuck, 1982; Weiss and Miller, 1987). I focus on ideologies regarding the government's role in the economy.

Based on the government's role in directing corporate activities, Okuno-Fujiwara (1997) identifies two major types of government: authoritarian government and rule-based government. Authoritarian governments are characterized by centrally-held jurisdictional power and minimally separated functional powers. An authoritarian government has 'the means to guide and even to force the private sector to act in ways it prefers in achieving a certain goal' (Okuno-Fujiwara, 1997: 395). When unforeseen issues make original plans unworkable, authoritarian governments can freely and easily adjust policies to achieve goals. Because of centralized jurisdiction, authoritarian governments have greater ability to coordinate macro resource allocation. Authoritarian

governments are often criticized for their lack of transparency in decision making because of power concentration and limited functional separation of powers (Okuno-Fujiwara, 1997).

Compared to authoritarian governments, rule-based governments provide a more transparent business environment. Rule-based governments provide multiple routes (e.g., the legislative and judicial branches) for firms 'to have their voices heard in the government' (Okuno-Fujiwara, 1997: 397). Rule-based governments rely on the 'legislative branch as the major forum for coordinating the interests of the society', rather than direct government intervention (Okuno-Fujiwara, 1997: 397).

Ideologies in countries with rule-based governments conflict with ideologies in countries with authoritarian governments (Aoki, Murdock, and Okuno-Fujiwara, 1997; Okuno-Fujiwara, 1997). More specifically, ideologies in countries with rule-based governments hold that governments intervene little in business. Ideologies in countries with rule-based governments emphasize the role of private sectors, and hold that economic coordination should be achieved through the market mechanism (Aoki *et al.*, 1997). The role of rule-based governments is limited to 'providing a legal infrastructure for market transactions' (Aoki *et al.,* 1997: 1). Rule-based governments are assumed to sustain the market mechanism using coercive measures such as taxation and regulation (Okuno-Fujiwara, 1997). Market imperfections are resolved by private sectors.

In contrast, ideologies in countries with authoritarian governments hold that governments intervene in business. Ideologies in countries with authoritarian government emphasize government intervention as a mechanism for the resolution of market failure (Aoki *et al.*, 1997). Authoritarian governments are considered as 'endogenous players

interacting with the economic system' instead of 'neutral, omnipotent agents exogenously attached to the economic system' (Aoki *et al.*, 1997: 2).

The governments of many East Asian countries are controlled by parties that have 'an asymmetrically strong political power in the society' (Okuno-Fujiwara, 1997: 403). Observations about state-business relationships in East Asian countries, such as China, Korea, and Singapore, suggest that regimes of these countries are characterized as authoritarian (Okuno-Fujiwara, 1997). In contrast, the government in the U.S. plays "a much reduced role in the economy" (Xia and Walker, 2015: 576). The government in the U.S. is considered close to the rule-based government, where 'the separation of functional power is strict' (Okuno-Fujiwara, 1997: 379).

In this study, I argue that investor perceptions are structured by the prevailing ideologies in the host market where firms are cross-listed. The prevailing ideologies regarding the government's role in the economy shape investors' interpretation of state involvement in corporate governance. The governments of many East Asian countries are characterized as authoritarian governments, where firms with state involvement are very common and investors assume that firms' competitive advantage relies on direct connections to the legislative branch. Thus, they are likely to view state involvement as legitimate and good for firms' future performance.

In contrast, the U.S. government is characterized as a rule-based government, where firms with state involvement are very rare in the local market and U.S. investors assume that firms' competitive advantage is not dependent on direct connections to the legislative branch, but exercised in a competitive market. Thus, in the U.S. the general belief about government holds that state involvement is illegitimate and bad for firms'

future performance. Therefore, ideological conflicts are likely to arise when U.S. investors interpret foreign firms with state involvement.

In the following section, I explain how prevailing ideologies in the U.S. and Hong Kong influence investor perceptions of legitimacy of cross-listed firms.

U.S. Investor Perceptions of Government Ownership

In the United States, government ownership of private firms is viewed negatively (Janson and Yoo, 2013) because there is not a legacy of government ownership of industrial firms and government ownership has become increasingly uncommon in the twentieth century in the U.S. (Pargendler, 2012). Compared to other countries around the world, government ownership is rare in the U.S. except for temporary takeovers during wartime (Kole and Mulherin, 1997; Pargendler, 2012). For example, telephone systems in many countries are owned and operated by the government (Janson and Yoo, 2013) but not in the U.S. Although a few firms have some degree of government ownership in the U.S., the public generally reacts negatively to such government intervention.

The financial crisis of 2008 prompted the U.S. government to directly intervene with some public companies. American International Group (AIG) approached the government for support and the government invested $85 billion to prevent AIG from going bankrupt. An additional $49.5 billion was invested through the Troubled Asset Relief Program (TARP) in General Motors. Both interventions were politically controversial but even those not ideologically opposed to the bailout were skeptical about the ability of the government to benefit, rather than harm, the economy through direct intervention. Moreover, as mentioned by Black (2010: 562), ‘government, the American taxpayer, and business alike all fervently wish for an end to government bailouts, for the

alliance of government and business has been an uneasy one.' According to 2009 Gallup Poll, more than 55 percent of Americans disapproved of the U.S. government's investment in General Motors, making the government the majority owner of the firm (Gallup, 2009).

In addition to the negative public reaction, businesses and investors were also critical of the government's intervention. Creditors perceived a high level of political risk created by the U.S. government's intervention in General Motors' and Chrysler's reorganization in 2009 (Anginer and Warburton, 2014). When the Treasury became a substantial shareholder of AIG and Citigroup, investors were disappointed with the level of company disclosure regarding the effects of the government's stock ownership (Black, 2010). These types of negative reactions had a significant financial cost. For example, Fratianni and Marchionne (2013) found that intervention announcements directed at specific banks were associated with negative cumulative abnormal returns.

U.S. investors are suspicious of government ownership because government ownership is rare in the U.S. (Pargendler, 2012), public reactions to government ownership are negative (Gallup, 2009), and the government is not perceived as a good shareholder (Black, 2010). Thus, there is an ideological bias against government ownership, even when the owner is the U.S. government. In addition to the negative perceptions of government ownership in general, U.S. investors are particularly suspicious about the Chinese government.

U.S. investors tend to associate their perceptions of the political image of the Chinese government with firms incorporated in China. As Steven (2009: 24), a Financial Times columnist and consultant, described, 'The country I worry about most is China,'

and he suggested that China is 'emboldened to intervene more brazenly than ever in its local stock markets. Government intervention in Chinese equity markets is already beyond the pale and is likely to get much, much worse' (Steven, 2009: 24). According to the 2015 annual index and ranking created by the Heritage Foundation and *The Wall Street Journal*, the economic freedom score of the United States is 76.2, ranking it the 12th freest in the world. The freedom economic score of mainland China is 52.7, making its economy the 139 freest in the world (Heritage Foundation, 2015).

The free-market ideology in the U.S. emphasizes that firms should maximize shareholder value (Rappaport, 1983) but government owners often pursue political and social objectives, rather than shareholder value maximization (La Porta, Lopez-de-Silanes, Shleifer, and Vishny, 2000). Furthermore, Chinese cross-listed firms with central government ownership carry the image of the government power of China, often overriding their business images (Cui and Jiang, 2012). As noted by prior studies, Chinese government controlled firms convey motivations, such as national pride, when they conduct businesses in foreign countries (Hope, Thomas, and Vyas, 2011). It is difficult for investors, the key constituents in the host market, to have positive perceptions of the practices of firms that are strongly associated with the Chinese government (He and Lyles, 2008; Globerman and Shapiro, 2009; Cui and Jiang, 2012).

In addition, the Chinese government-owner is different from state ownership in other countries because the Chinese Communist Party, as the single-ruling party, controls important institutions in business, media, academia, and every sphere in China (Lin, 2013: 744). The Chinese Communist Party is 'the real hand in the gloves of state ownership in China' (Lin, 2013: 744). Although Chinese firms with central government

ownership are undergoing substantial reforms in their management and operations (He and Lyles, 2008; Cui and Jiang, 2012), U.S. investors still hold a negative view toward Chinese firms with central government ownership.

U.S. investors are particularly suspicious of the Chinese central government because the Chinese central government is likely to use firms to fulfill social goals (Zou and Adams, 2008). As such, U.S. investors tend to view firms controlled by the government as less legitimate. Of course, this is not to imply that every investor in the U.S. is influenced by the overarching ideology, and perceive government ownership as illegitimate. Instead, I posit that whether or not investors themselves are directly concerned about government intervention, they recognize that other investors may translate their concerns into an unwillingness to invest. As a result, it is likely that Chinese cross-listed firms with central government ownership will be perceived as less legitimate by U.S. investors. This suggests the following hypothesis:

Hypothesis 1: Central government ownership of Chinese firms cross-listed on the U.S. stock market is negatively related to investor perceptions of firm legitimacy.

U.S. Investor Perceptions of CEO Political Connections with the Central Government

Resource dependency theory argues that political connections are a mechanism of influence that operates in two directions (Pfeffer and Salancik, 1978). When executives have connections with the government, these connections may provide access to critical resources for the firm. However, this same political connection can be a mechanism through which the government coopts the firm in order to achieve public ends. In the U.S.

there is evidence that political connections provide financial benefits for firms (Hillman, Zardkoohi, and Bierman, 1999; Hillman, 2005). However, political connections in China are qualitatively different and are likely to favor the influence of the government over the resource acquisition of the firm (Fan *et al.*, 2007; Sun, Hu, and Hillman, 2015).

A major difference between U.S. and Chinese political connections is that in the U.S., former government officials may be hired by private-sector firms but in China, government officials are often appointed to a leadership position in a state-owned enterprise (Shi, Markóczy, and Stan, 2014). This difference between hiring and appointing top managers carries over into expectations for future gain. In the U.S., a public-sector job provides limited prospects for financial gain but government experience is rewarded in the private-sector. In China, however, the future career prospects of top managers appointed by the government are influenced by how well the firm achieves social goals (Fan, Morck, and Yeung, 2011). A further difference is that the judicial system is highly vulnerable to political influence from the strong central government. This, combined with the single-party rule of the Communist party, means that the costs of political cooptation are likely to outweigh the benefits of political benefits associated with political connections (Peng, 2003).

U.S. investors see CEO political connections in China differently from how they see political connections in the U.S. Investors are likely to perceive cross-listed firms with politically-connected CEOs as illegitimate because of the appointment process of CEOs and the strong political intervention of the Chinese government, which may potentially decrease the value of politically-connected firms (Fan *et al.*, 2007). This suggests the following hypothesis:

Hypothesis 2: For Chinese firms cross-listed on the U.S. stock market, CEO political connections with the central government are negatively related to investor perceptions of firm legitimacy.

Hong Kong Investor Perceptions of Government Ownership

The ideology among Hong Kong investors is very different from that among U.S. investors both because of different assumptions regarding the role of the government and because of closer social and economic ties to mainland China. As suggested by Okuno-Fujiwara (1997), the societies of East Asian countries expect stronger intervention by the government in the economy. The government is perceived to play an important and positive role in the economy in East Asia (Wade, 1990; Lee, 2002) where the government is often the main resource allocation mechanism in the economy (Aoki, Kim, and Okuno-Fujiwara, 1997), and functions as substitutes or complements of other institutional actors, such as markets, organizations, and intermediaries. The role of the government in East Asia is to help achieve an efficient allocation of resources, and create conditions that help to guarantee policy implementation through powers of enforcement (Lau, 1997). Government ownership, rather than being a rare anomaly as it is in the U.S., is seen as a legitimate tool of economic development in East Asian societies.

While U.S. investors have an ideological suspicion of the Chinese government, investors in Hong Kong have a strong cultural link through their shared heritage and culture and this link has strengthened since Hong Kong was integrated into mainland China under the 'one country, two systems' arrangement that began in 1997 (Lau, 1997). While the laissez-faire government of Hong Kong intervenes less than the Central Government in China, the future economic development of Hong Kong depends on

further integration with mainland China. Hong Kong is considered an ideal cross-listing destination due to its social and cultural proximity to the mainland China (Fung, Su, and Gul, 2013; Pan and Brooker, 2014). As suggested by Karrenman and Van der Kanaap (2009), 'the influx of mainland China affiliated shares provides a considerable contribution to the development of the Hong Kong Stock Exchange' (p. 571). Since the early 1990s, Hong Kong has been the major destination for Chinese firms (Pan and Brooker, 2014). A large percentage of firms listed on Hong Kong market are influenced by Chinese institutions. Specifically, as of the end of 2014, the Hong Kong stock market had 1,671 listed firms, of which 50 percent - compared to 23 percent by the end of 2001 and less than one percent in 1991 (Ma, 2003) - were incorporated in mainland China.

Hong Kong investors are likely to hold a positive view on Chinese government ownership because of further economic integration of Hong Kong and Mainland China. Investors prefer to invest in familiar stocks (Grinblatt and Keloharju, 2001; Yang and Lau, 2006). Investors tend to perceive firms that they are familiar with as legitimate. State-owned firms still dominate capital markets in mainland China (Pargendler, 2012), although the proportion of firms with the government as controlling shareholders declined from 97 percent in 1997 to 75 percent in 2003, and to 60 percent in 2007 (Liebman and Milhaupt, 2008; Pargendler, 2012). As more and more Chinese firms with government ownership are listed in the Hong Kong capital market, investors in the market become more familiar with firms having government ownership.

In summary, influenced by prevailing ideologies regarding the government's role in East Asia, the cultural ties to mainland China, and a familiarity with government

ownership, investors in Hong Kong are likely to perceive firms with central government ownership as more legitimate.

Hypothesis 3: Central government ownership of Chinese firms cross-listed on the Hong Kong stock market is positively related to investor perceptions of firm legitimacy.

Hong Kong Investor Perceptions of CEO Political Connections with the Central Government

In East Asia, a firm's competitive advantage relies on direct connections to the legislative branch. Hong Kong investors, influenced by prevailing ideologies that hold positive views on government intervention in East Asia, are likely to perceive cross-listed firms with politically-connected CEOs as more legitimate.

CEO political connections increase the firm's legitimacy in the eyes of investors. The institutional voids in China generate difficulty for investors to evaluate firms listed in such markets (Wu, Li, & Li, 2013). Thus, investors tend to rely on signals, such as firms' political connections to evaluate firms (Peng, 2004; Wu *et al.*, 2013). For instance, in Southeast Asia, political connections, instead of fundamentals such as productivity, are the primary determinants of investors' investment decisions (Fisman, 2001). The benefits of political connections in China are compelling, in that the governments control a wide range of regulatory and financial resources (Sun, Mellahi, and Thun, 2010). Therefore, firms with politically-connected CEOs are likely to obtain higher levels of legitimacy among Hong Kong investors.

Hypothesis 4: For Chinese firms cross-listed on the Hong Kong stock market, CEO political connections with the central government are positively related to investor perceptions of firm legitimacy.

(See Table 1 for summary of hypotheses)

CHAPTER IV

METHOD

Sample

I tested the hypotheses using a sample of Chinese firms which were listed on the Shanghai or Shenzhen markets (A-shares) and were also cross-listed on the U.S. (American Depositary Receipts) or Hong Kong (H-shares) stock markets. A large number of cross-listed firms in the developed stock markets are from China (Pagano, Röell, and Zechner, 2002; Southam and Sapp, 2010). Among cross-listed firms, a large percentage of Chinese firms have government ownership and political connections. The Chinese government plays a crucial role in 'shaping firm behavior, and in distributing government-controlled resources' (Wang, Hong, Kafouros, and Wright, 2012: 665). A-shares and H-shares represent the same ownership stake in the same firm (Arquette, Brown, and Burdekin, 2008), but are traded on separate markets. H-shares are currently not convertible to A-shares, and vice versa. American Depositary Receipts (ADRs) of Chinese firm are certificates representing the underlying A-shares on the home market. Given that institutional environments are very different between Hong Kong and the U.S., using Chinese firms cross-listed on the U.S. and Hong Kong stock markets makes it possible to investigate whether investors in different host countries have different perceptions of the legitimacy of political connections. Thus, Chinese cross-listings serve

as a good setting to investigate foreign investor perceptions of government ownership and CEO political connections.

In order to test Hypothesis 1 and Hypothesis 2 regarding firm legitimacy in the U.S. market, I created Sample 1 which consists of firms incorporated and listed in mainland China and also cross-listed on the U.S. market (referred to as A-ADR sample hereafter). In order to test Hypothesis 3 and Hypothesis 4 regarding firm legitimacy in the Hong Kong market, I created Sample 2 which consists of firms incorporated and listed in mainland China and also cross-listed on the Hong Kong market (referred to as A-H sample hereafter).

The dataset begins in 2006 and ends in 2014 to include firms after China's split-share reform during late 2005 (Jia and Tomasic, 2010). I obtained stock price and trading volume of ADRs and H-shares from DataStream International. Ownership and accounting data for these firms were obtained from the Chinese Stock Market and Accounting Research (CSMAR) database. I also cross checked ownership data with information provided in the annual reports. After merging these databases and removing observations that are missing key explanatory variables, I had a sample of 58 firms cross-listed on the U.S. market (A-ADR sample), and 84 firms cross-listed on the Hong Kong market (A-H sample).

Specifically, for the A-ADR sample (firms listed in mainland China and cross-listed in the U.S.), I downloaded the ADR list from BNY Mellon. Since this study mainly focuses on cross-listings, I excluded firms that only list on the U.S. market without home-market listings. As of January 2015, there are 75 Chinese firms issuing ADRs that also have corresponding A-share on home market. For each ADR-issuing firm, I collected

daily stock price and trading volume data from DataStream international. I excluded 17 firms that have no trading volume data in DataStream.

For the A-H sample (firms listed in mainland China and cross-listed in Hong Kong), I downloaded the list of firms that were incorporated in mainland China and have issued H-share on Main Board in the Hong Kong market. I obtained an initial sample of 186 firms that have H-share from the website of Hong Kong Stock Exchanges. I searched the website of each firm and checked whether they also issue A-share (i.e., list in mainland China). After excluding 102 firms that are not listed on the Shanghai or Shenzhen markets, I obtained the final A-H sample of 84 firms that both have A-share and H-share. In sum, the final dataset consists of 303 firm-year observations for A-ADR sample, 544 firm-year observations for A-H sample.

Measures

Dependent Variable

Legitimacy is defined as 'a generalized perception or assumption that the actions of an entity are desirable, proper, or appropriate within some socially constructed system of norms, values, beliefs, and definitions' (Suchman, 1995: 574). Firms obtain legitimacy when their attributes or practices are accepted by its institutional environment (DiMaggio and Powell, 1983; Suchman, 1995; Kostova and Zaheer, 1999).

Prior studies examining legitimacy have used proxies such as media coverage (Coombs, 1992; Deephouse, 1996; Brown and Deegan, 1998; Deephouse and Carter, 2005; Kuilman and Li, 2009), post IPO valuation (Bell *et al.,* 2012b), IPO price premium (Bell *et al.*, 2014), and IPO underpricing (Bell *et al.*, 2008). Researchers often use media data to measure legitimacy conferred by the general public. For example, Brown and

Deegan (1998) utilized media attention as a measure of legitimacy. The level of media attention is calculated as the number of print media newspapers and journals relating to the environment. Coombs (1992) used the Washington Post and the New York Times to measure the legitimacy of President Ronald Reagan's Task Force on Food Assistance. Hybels, Ryan, and Barley (1994) used business periodical abstracts to indicate the legitimacy of biotechnology firms. Kuilman and Li (2009) measured legitimacy by public acceptance, which is measured as the number of reports in the Times of London and in the New York Times in two years.

Studies on capital markets have used IPO data and market valuation to measure firm legitimacy. For example, Bell and colleagues (2008) examined the influence of country of origin on foreign IPO legitimacy. They measured IPO legitimacy by foreign IPO underpricing (i.e., the difference between the stock's closing price on the first day of trading and the initially offered price). Bell *et al.* (2014) used a legitimacy framework to examine investor perceptions of foreign IPO value. They used price premium as a measure of investor perceptions. Price premium is computed as the difference between offering price and net tangible book value per share after offering divided by offering price. Bell *et al.* (2012b) examined the relationship between investor protection and firm legitimacy perceived by U.S. investors. They used four financial indicators as a measure of IPO success and firm legitimacy: pre-money market valuation, net proceeds of the IPO offerings, the 90-day and 180-day post IPO valuation. Paruchuri and Misangyi (2015) studied investor perceptions of firms' financial misconduct, and examine market valuations for firms following restatement events. The authors measured market

valuation by the cumulative abnormal returns (CARs) (calculated as the sum of the abnormal daily returns of each firm over the event window).

I utilized trading volume as a measure of firm legitimacy for both conceptual and practical considerations. Conceptually speaking, the level of organizational legitimacy in the host market is related to investors' trading activity. Legitimacy is a 'multidimensional concept linked to a variety of stakeholders' (Deephouse and Carter, 2005: 336). Prior studies have examined legitimacy from perspectives of the general public and government regulators (e.g., Deephouse, 1996; Deephouse and Carter, 2005). For example, Deephouse and Carter (2005) measured regulatory legitimacy using federal government's regulatory ratings, and measured public legitimacy using content analysis of local newspapers. In this study I examine organizational legitimacy from the market investors' perspective. Given that organizational legitimacy is the endorsement by key social actors (Deephouse, 1996), investors, as a key relevant social actor, have the standing to confer organizational legitimacy. In addition, higher levels of legitimacy means a larger number of investors are interested in and willing to purchase the stock. Trading volume reflects the number of investors and the amount of information. As suggested by Sabherwal (2007), trading volume is directly related to the mass of traders in the market. Trading volume is dependent on how many potential investors are willing to trade stocks. Large trading volume indicates there are a large number of investors interested in purchasing the firm's stock. New information about a firm also drives trading volume but I can control for the amount of information driving trading volume by including the trading volume in the Chinese market as a control.

Practically speaking, trading volume captures different variations of organizational legitimacy over time and across capital markets. Since this study seeks to capture the change of organizational legitimacy corresponding to firm-level factors over time, IPO price measures cannot be used for this study because they are one-time measures. In addition, this study attempts to capture different associations between state involvement in corporate governance and firm legitimacy across international capital markets. Domestic A-share and cross-listed H-share represent the same ownership stake in the same firm, but A-share can only be traded in mainland Chinese market while H-share is traded in Hong Kong market. Because of market segmentation, trading volume reflects investor perceptions in each market.

In sum, trading volume reflects investor acceptance (Lee, 2001) and provides an indicator of investors' interest (Sabherwal, 2007) and demand for the stock (Pollock and Rindova, 2003). Therefore, I used trading volume of ADRs and H-shares associated with Chinese cross-listed firms to measure the level of organizational legitimacy in the U.S. and Hong Kong capital markets. As suggested by Scott (1994: 35), absolute trading volume, instead of relative trading volume (i.e., the annual trading volume divided by the number of shares outstanding), is ‘a better indicator of the number of investors seeking information.’ Therefore, I used the absolute trading volume to capture investors’ interests in the firm. I calculated dollar volume, using the total number of shares traded multiplied by the stock price (James and Edmister 1983; Lo and Wang, 2000). Dollar volume_ADR and Dollar volume_H were calculated as the log of trading volume of ADRs and H-shares respectively.

I used the period between April 1st of the current year and March 31st of the next year to compute the trading volume measure. I chose this time period because the annual reports of Chinese firms are usually released by the end of March. For example, for the fiscal year 2010, the annual report is often released in March, 2011. Hence, corresponding to the financial and corporate governance information in fiscal year 2010, I computed dollar volume based on data from April 1st 2011 through March 31st 2012. I assume that investors' knowledge of the governance characteristics is based on information disclosed in the annual report.

Independent Variables

Since the hypotheses pertain to investor perception of organizational legitimacy, it has to be plausible that investors have awareness of the particular characteristics. In this study, central government ownership and CEO political connections, are salient among investors, because information regarding changes of ownership and CEO's profiles are documented in the annual report released to investors. Government ownership and CEO political connections influence investor perceptions of firm legitimacy in the host market. The perception of firm legitimacy affects investors' investment decision, trading behavior and ultimately trading volume in the host market.

Following Luo and colleagues (2016), central government ownership is measured by a dummy, coded as one if the central government or its agencies are the dominant shareholder, and zero otherwise. I obtained detailed information on shareholders from the CSMAR database. Chinese public firms are required to disclose the identity of ten largest shareholders and the number of shares owned in the annual reports.

CEO political connections, coded as *Political connection_central gov*, is measured by a dummy variable, which equals to one if the CEO is a former officer of the central government (Fan *et al.*, 2007; Li and Qian, 2013; Liang *et al.*, 2015). I obtained the CEO's profile from the 'Profile of Directors and Senior Managers' section of the annual report.

Control Variables

I controlled for firm characteristics, corporate-governance factors, and other related factors that may influence investors' perception and trading activities. For firm-level factors, I controlled for firm performance, cross-listing age, market capitalization, foreign ownership, and the percentage of non-tradable shares. For corporate-governance factors, I controlled for board independence, CEO duality, and managerial incentive pay. In addition, I controlled for industry, year, A-H-ADR dummy and stock exchanges.

Firm Performance. Firms with greater financial resources and better firm performance are likely to be perceived as more legitimate. Therefore, I controlled for firm performance. I used Tobins_Q and Return on Assets (ROA, calculated as net income divided by total assets) as measures of firm performance.

Firm Age. Investors are likely to view firms with a longer history as more legitimate (Bell *et al.*, 2012a). Therefore, I expect that cross-listing age will influence the firm's visibility, which in turn will influence firm legitimacy. In this sense, cross-listed firms that have a longer history will be viewed as more legitimate by foreign-market investors. Cross-listing age is measured by the number of years since the firm cross-listed on the host market (Sabherwal, 2007). For A-ADR sample, I measured cross-listing age

as the number of years after issuing ADRs. For A-H sample, I measured cross-listing age as the number of years after issuing H-shares.

Market Capitalization. Firms with larger-capitalization often have more active trading (Lo and Wang, 2000). Thus, I controlled for the market capitalization of the firm. Market capitalization for each stock is calculated as the number of shares outstanding multiplied by its closing price per share.

In addition, I also controlled for foreign ownership (the percentage of shares owned by foreign individuals and firms), and the percentage of non-tradable shares. Shares in the Chinese capital market are divided into non-tradable shares and tradable shares. Non-tradable shares cannot be traded on stock exchanges, and can only be transferred by private sale, which in most cases requires government approval.

I controlled for corporate governance factors because the quality of corporate governance may influence firms' future prospects and investor perceptions of the firm. Thus, firms' corporate governance practices are likely to influence investors' trading behavior. I controlled for board independence (Boon, Field, Karpoff, and Raheja, 2007), CEO duality (Basu, Hwang, Mitsudome, and Weintrop, 2007; Bhagat and Bolton, 2008), and CEO stock options (Bell *et al.*, 2014).

Board Independence. Board independence is measured as a ratio calculated as the number of independent directors divided by the number of total board members. Board independence serves as one of the most important governance indicators when foreign-market investors evaluate the cross-listed firms (Bell *et al.*, 2012b; Moore *et al.*, 2012). Investors in the U.S. market prefer boards consisting of at least half independent directors (Moore *et al.*, 2012). Therefore, cross-listed firms will be viewed as more legitimate by

foreign-market investors if they have more independent directors on their boards. In this sense, a greater percentage of independent directors are associated with greater legitimacy. Therefore, I controlled for board independence. CEO *stock options* are controlled in the analysis. CEO stock option is a dummy variable, which is coded as 1 if CEO has stock option and zero if not. I also controlled for CEO *duality*, which is coded as 1 if CEO is also the Chairman of the Boards, and zero if not.

In addition, there are several other factors that may influence the attractiveness of ADRs and H-shares. It is likely that different trading volumes across firms are partly impacted by industry membership. For example, U.S. investors may be optimistic about the prospects for firms in the technology industry (Arquette *et al.*, 2008), while Hong Kong investors may be more interested in industrial goods (BNY Mellon, 2015). Thus, *industry dummies* are added in this study in order to control for the effect of industry on trading volume. To control for a potential time effect, I included *year dummy* variables in the analysis. Firms cross-listed on the U.S. stock exchanges are assigned one while firms cross-listed over the counter are assigned zero. Trading volume of ADRs and H-share will also be influenced by the trading volume of corresponding A-share in mainland China. Therefore, I controlled for Dollar volume_A, calculated as the log of trading volume of A-share. Additionally, I controlled for A-H-ADR dummy, which equals to one if the firm is both cross-listed in the U.S. and Hong Kong markets, and zero otherwise.

Analysis

The dataset consists of unbalanced panels of observations because not all of the firms have observations in every year of the panel. The two independent variables of interest were central government controlling interest and the political connection of CEO

to the central government. There is significant cross-sectional variance in these variables but much less change over the time-frame of my study. Specifically, only 13 firms have changed their central government ownership, and 3 firms have changed their CEO political connections to the central government. Since a fixed-effects model would only allow the analysis of within-firm variation in these variables, I estimated a random-effect model with maximum likelihood estimator allowing me to observe cross-sectional effects of political connections while addressing the non-independence of repeated observations of the same firm. I lagged all independent and control variables (except for the dollar volume of A-share) by one year. To assess the potential threat of collinearity, I computed the variance inflation factors (VIFs), and found a mean variance inflation factor (VIF) of 1.60 and a maximum VIF of 3.85 for A-ADR sample, and a mean VIF of 1.39 and a maximum VIF of 2.73 for A-H sample, well below the recommended ceiling of 10 (Hair *et al.*, 2006).

CHAPTER V

RESULTS

Table 2 and Table 3 present descriptive statistics and correlations for A-ADR sample and A-H sample respectively. Table 4 displays the model results for A-ADR sample and A-H sample. I conducted regressions in two steps. First, I included control variables in the model (Model 1 and 3 in Table 4). Second, I ran the full model (Model 2 and 4) by including both independent variables (i.e., central government ownership and CEO political connections).

Insert Table 2 and Table 3 about here

It is interesting to note that trading volume among Chinese A-shares is a stronger and more significant predictor of trading volume in Hong Kong ($\beta = 0.436$) than in the US ($\beta = 0.208$). This reflects the strong geographic, political and cultural ties between the Chinese and Hong Kong stock markets. The influence of market capitalization is nearly identical in both markets. Finally, the A-H-ADR dummy reveals something interesting about the influence of cross-listing on legitimacy. In the U.S. market, firms that are also cross-listed in Hong Kong are less legitimate ($\beta = -0.825$) though this effect is not statistically significant. In the Hong Kong market, firms that are also cross-listed in the U.S. are more legitimate ($\beta = 0.199$) and this result is significant ($p < 0.05$).

Hypothesis 1 predicts that central government ownership of firms cross-listed on the U.S. market is negatively associated with investor perceptions of firm legitimacy. According to the results of Model 2 (using A-ADR sample, the U.S. market), the coefficient of central government ownership is significant (β= -0.623, $p < 0.05$). Therefore, Hypothesis 1 is supported. In Hypothesis 2, I posit a negative association between CEO political connections and firm legitimacy. Model 2 (using A-ADR sample, the U.S. market) in Table 4 demonstrates that CEO political connections are positively associated with legitimacy (β= 0.984, $p < 0.05$). The sign of the coefficient is opposite to my argument. As such, Hypothesis 2 is not supported since it is not in the direction that I predicted. These effects are economically significant. Since the dependent variable is the natural log of trading volume, the coefficient value of -0.623 means that a firm with controlling interest by the central government would have 46 percent less trading volume. The coefficient value of 0.984 means that a firm with a CEO that is a former central government official would have 170 percent more trading volume.

Hypothesis 3 predicts a positive association between central government ownership of firms cross-listed on the Hong Kong market and investor perceptions of firm legitimacy. The coefficient for central government ownership in Model 4 (Table 4) is positively significant at $p < 0.01$ level, supporting Hypothesis 3 (β=0.245). This coefficient corresponds to a 27 percent increase in trading volume for firms with central government controlling interest. Hypothesis 4 argues that for firms cross-listed on the Hong Kong stock market, CEO political connections are positively related to investor perceptions of firm legitimacy. According to the results of Model 4 in Table 4, CEO

political connections are positively associated with firm legitimacy (β=0.592, $p < 0.01$ for the A-H sample, Hong Kong market). Therefore, Hypothesis 4 is supported. This coefficient corresponds to an 81 percent increase in trading volume for a firm with a former central government official as CEO.

Insert Table 4 about here

Post-hoc Analysis

To gain additional insights, I conducted four sets of post-hoc analyses in this section. First, in order to check whether there are important differences between firms that cross-listed in Hong Kong, the U.S., and both markets, I tested hypotheses using the A-H-ADR sample (the subsample of firms listed in both Hong Kong and the U.S.) and the A-H-only sample (the subsample of firms listed in Hong Kong but not in the U.S.). In the second post-hoc section, I checked alternative measures of two independent variables. In addition, I tested potential interaction effects between central government ownership and CEO political connections. Finally, I estimated some alternate model specifications.

Post-hoc Section 1: Test Hypotheses using A-H-ADR sample and A-H-only sample

To check whether there are important differences between firms that listed only in Hong Kong and firms that listed in both Hong Kong and the U.S., I tested hypotheses using the A-H-ADR sample and the A-H-only sample. The A-H-ADR sample includes firms that were cross-listed in both markets. Among 58 firms cross-listed on the U.S. market (the A-ADR sample) and 84 firms cross-listed on the Hong Kong market (the A-H sample), I found 52 firms cross-listed on both the U.S. and Hong Kong markets (the A-

H-ADR sample). The final dataset consists of 274 firm-year observations (52 firms) for the A-H-ADR sample.

The results of control models and full models using the A-H-ADR sample are presented in Table 5. Tests utilized the same analytic techniques used in hypotheses testing. The results in Table 5 show that conclusions about the effects of ownership and political connections in the U.S. are consistent in the overlap subsample. According to the results of Model 6, the coefficient of central government ownership is negatively significant ($\beta = -0.787$, $p < 0.01$). Therefore, Hypothesis 1 is supported, which is consistent with my findings when using the A-ADR sample. According to the results of Model 6 in Table 5, the coefficient of CEO political connections is positive and significant ($\beta = 1.150$, $p < 0.01$), consistent with findings when I used the A-ADR sample.

In the Hong Kong market, CEO political connections are positively related to firm legitimacy ($\beta = 0.471$, $p < 0.01$, Model 8 in Table 5), which is consistent with findings using the A-H sample. However, the coefficient of central government ownership is not significant when I used the overlap sub-sample, which indicates some differences in firms only listed in Hong Kong and firms listed in both markets.

Insert Table 5 about here

To better understand firms that are only cross-listed in Hong Kong, I conducted another post-hoc analysis using the A-H-only sample. The A-H-only sample includes firms that were not cross-listed in the U.S., but only cross-listed in the Hong Stock market. Among 84 firms (544 firm-year observations) cross-listed on the Hong Kong market (the A-H sample), I found 60 firms cross-listed only in the Hong Kong market.

The final dataset consists of 270 firm-year observations for the A-H-only sample, about 50 percent of observations compared to the A-H sample.

Using the A-H-only sample I tested Hypothesis 3 and 4 regarding investor perceptions of legitimacy in Hong Kong. Model 2 in Table 6 tested the positive effects of central government ownership and CEO political connections on legitimacy. I found a significant and positive effect of central government ownership on legitimacy among Hong Kong investors (β=0.406, $p < 0.01$), providing support for Hypothesis 3. However, I found a nonsignificant and positive relationship between CEO political connections and legitimacy (β=1.072).

Insert Table 6 about here

In general, the results of using the A-H-ADR sample and the A-H-only sample are very similar compared to the A-ADR and the A-H sample. It is noteworthy that, even when the sample is limited to firms that are listed in all three markets (Mainland China, Hong Kong and U.S.) the effect of central government ownership is more negative in the U.S. than in Hong Kong, a finding that is consistent with my claim of a strong ideological difference between the two markets.

In addition, the differences in the coefficient for central government ownership in the Hong Kong market among the A-H sample, the A-H-only sample, and the A-H-ADR sample indicate some differences in firms cross-listed in both markets and firms only cross-listed in Hong Kong. Table 7 and 8 report the means, standard deviations, and correlation coefficients of the variables in the A-H-ADR sample and the A-H-only sample. According to the means reported in Table 7 and 8, I found several meaningful

differences between firms cross-listed in both markets and firms only cross-listed in Hong Kong. I expected that firms with central government control would be less likely to cross-list in the U.S. However, according to the descriptive statistics in Table 7 and 8, I found that among firms cross-listed both in the U.S. and Hong Kong markets, a much higher percentage of firms have central government control (51.5%) compared to 32.2% of observations among firms that were only cross-listed in Hong Kong. In addition, firms only cross-listed in Hong Kong have a much lower percentage of CEO political connections (0.7%) compared to 8% of observations among firms cross-listed in both markets. The insignificant findings about CEO political connections using the A-H-only sample may be caused by small within and between firm variances (only 1 firm has CEO political connections to the central government). In the A-H-only sample, I only found 1 firm (2 observations) (out of 60 firms with 270 firm-year observations) that has CEO political connections to the central government. In other words, firms listed in both markets have much stronger government involvement than firms that were cross-listed only in Hong Kong.

Insert Table 7 and 8 about here

Post-hoc Section 2: Alternative Measures of Central Government Ownership and CEO Political Connections

I also conducted a post-hoc analysis using a number of alternative measures of government ownership and political connections. I tested the following alternative measures of government ownership: *state_ownership_pct* and *controller_central_pct*. *State_ownership_pct* is calculated as the percentage of share ownership by the

government, including central and local governments and agencies (Delios, Wu, and Zhou, 2006; Pan et al., 2013). *Controller_central_pct* is the percentage of shares owned by the central government when the central government is the largest shareholder.

In addition, I tested the following alternative measures of managerial political connections: *ceo_gov_rank, ceo_npc, ceo_cppcc,* and *ceo_communist*. I obtained CEO's profile from the 'Profile of Directors and Senior Managers' section of the annual report. *Ceo_gov_rank* is a rank order of CEO political connections. The range of *ceo_gov_rank* is from zero to eight. If CEO is not a former official at any level of government agencies, then *ceo_gov_rank* is coded as 0. If CEO was former officer with chief position in the central government, then ceo_gov_rank is coded as 8. Assistant position in the central government is coded as 7, chief position in the provincial government coded as 6, assistant position in the provincial government coded as 5, chief position at the bureau level coded as 4, assistant position at the bureau level coded as 3, chief position at the county level equals to 2, and assistant position at the county level is coded as 1. *Ceo_npc* is a dummy variable. If CEO is a current or former member of the National People's Congress (NPC), the legislative body in China, then *ceo_npc* is coded as 1, and zero otherwise. *Ceo_cppcc* is also a dummy. If CEO is a current or former member of the Chinese People's Political Consultative Conference (CPPCC), an advisory board for the Chinese government, then *ceo_cppcc* is coded as 1, and zero otherwise (Fan et al., 2007; Li and Qian, 2013; Liang et al., 2015). *Ceo_communist* is a dummy variable. If CEO is a member of the communist party, then *ceo_communist* equals to 1, and zero if not.

Alternative Measures for A-H Model

Table 9 reports descriptive statistics and correlations among alternative measures of central government ownership and CEO political connections for A-H model. For A-H sample, *controller_central_dummy* is highly correlated with alternative measures. In addition, two alternative measures of government ownership are also significantly correlated with each other. The average of *controller_central_dummy* is 41.9%, which means over forty percent of firms cross-listed on the Hong Kong stock exchanges are controlled by the central government.

With regards to alternative measures of CEO political connections, *ceo_gov_central* is significantly correlated with *ceo_gov_rank*, *ceo_npc,* and *ceo_cppcc*, but not significantly correlated with *ceo_communist.* Among alternative measures of CEO political connections, *ceo_communist* is not significantly correlated with *ceo_gov_rank* and *ceo_npc*. *ceo_communist* is negatively correlated with *ceo_cppcc*, because a large number of *cppcc* members are members of non-communist party, such as China Zhi Gong Party, Jiu San Society, China Association for Promoting Democracy, National Construction Association, and Democratic League. *ceo_gov_central, ceo_npc* and *ceo_gov_rank* are highly correlated (correlation coefficients are greater than 0.5), which indicates that CEO who was officer at a higher level is often a member of NPC, having large influence on policy making.

Insert Table 9 about here

The results of post-hoc analyses regarding the effect of government ownership using alternative measures on investor perceptions of firm legitimacy in Hong Kong are presented in Table 10. Tests utilized the same analytic techniques used in hypotheses testing. When using *controller_central_pct* as a measure of government ownership,

results are consistent with those found from hypotheses testing using central government ownership dummy as a measure. Hypothesis 3 are supported ($\beta = 0.490$, $p < 0.01$). When government ownership is measured by *state_ownership_pct*, the coefficient for *state_ownership_pct* is positive but not significant. The nonsignificant findings when using the percentage of state ownership as a measure may be explained by the fact that market investors tend to be more sensitive to the nature of the controlling shareholder, instead of the exact number of the percentage.

Insert Table 10 about here

The results of post-hoc analyses regarding the effect of CEO political connections using alternative measures on investor perceptions of firm legitimacy in Hong Kong are presented in Table 11. Post-hoc analysis was conducted to investigate whether the findings from hypotheses testing regarding CEO political connections were sensitive to the measurement of variables. Results of post-hoc analyses were in agreement that Hypothesis 4 was supported except for *ceo_cppcc* measure. Table 12 is a summary of alternative measures and corresponding findings.

Insert Table 11 and Table 12 about here

Alternative Measures for A-ADR Model

Table 13 reports descriptive statistics and correlations among alternative measures of central government ownership and CEO political connections for A-ADR model. Consistent with findings for A-H sample, For A-ADR sample *controller_central_dummy* is significantly correlated to alternative measures of government ownership. The average

state_ownership_pct is 56.5% for A-ADR sample, and 53.2% for A-H sample. *Controller_central_pct* is 27.5% for A-ADR sample and 20.0% for A-H sample.

With regards to alternative measures of CEO political connections, the majority alternative measures of political connections are significantly correlated except for *ceo_communist*. Specifically, *ceo_communist* is not significantly correlated with *ceo_gov_rank* and *ceo_npc.* The average of *ceo_npc* is 12% for A-ADR sample and 7% for A-H sample. The average of *ceo_communist* and *ceo_gov_rank* are also higher for A-ADR sample. As such, I may conclude that relatively speaking firms cross-listed in the U.S. have stronger CEO political connections.

Insert Table 13 about here

The results of post-hoc analyses regarding the effect of government ownership using alternative measures on investor perceptions of firm legitimacy in the U.S. (Hypothesis 1) are presented in Table 14. None of the alternative measures provide support for the hypothesized relationships in post-hoc analyses. When government ownership is measured by *controller_central_pct*, the coefficient is very close to that of central government ownership dummy. However, the percentage measure is not significant, which may indicate that market investors are likely to be more sensitive to the largest shareholder instead of the percentage of shares.

Insert Table 14 about here

The results of post-hoc analyses regarding the effect of CEO political connections using alternative measures on investor perceptions of firm legitimacy in the U.S.

(Hypothesis 2) are presented in Table 15. Among four alternative measures, *ceo_npc and ceo_cppcc* are significant ($\beta = 0.717$, $p < 0.1$; $\beta = 0.995$, $p < 0.05$). However, the direction is opposite to my argument. Coefficients for *ceo_gov_rank* and *ceo_communist* are positive and nonsignificant. Therefore, none of the alternative measures provide supporting results. Table 16 is a summary of alternative measures and corresponding findings.

Insert Table 15 and 16 about here

Post-hoc Section 3: Potential Interaction Effects

I further conducted post-hoc analysis to investigate whether government ownership and CEO political connections complementarily affect legitimacy. When firms have both central government ownership and CEO political connections, strategies made by top managers lead by politically-connected CEO are more likely to be consistent with government goals. Given that Hong Kong investors have positive views on state involvement in corporate governance because of shared culture and close economic linkage, such firms are likely to obtain higher level of legitimacy among Hong Kong investors. In other words, central government ownership and CEO political connections are expected to have complementary effects in Hong Kong.

> *Hypothesis 5: Central government ownership and CEO political connections complementarily affect investor perceptions of firm legitimacy. The presence of CEO political connections will strengthen the positive relationship between central government ownership and legitimacy among Hong Kong investors.*

Similarly, when firms have both central government ownership and CEO political connections, government has two mechanisms through which (ownership mechanism and top managers lead by politically-connected CEO) government could intervene corporate governance. Given that U.S. investors have negative views on state involvement in corporate governance, such firms are likely to obtain much lower level of legitimacy among U.S. investors. In other words, the presence of CEO political connections will strengthen the negative association between central government ownership and investor perceptions of legitimacy in the U.S.

Hypothesis 6: Central government ownership and CEO political connections complementarily affect investor perceptions of firm legitimacy. The presence of CEO political connections will strengthen the negative relationship between central government ownership and legitimacy among U.S. investors.

To test Hypotheses 5 and 6, I generated the interaction term *controller_dum * ceo_gov* utilizing central government ownership dummy as a measure of government ownership and *CEO_central gov* dummy as a measure of political connections. Hypothesis 5 regarding the complementary effects of state ownership and political connections on legitimacy in Hong Kong was tested in Model 4 in Table 17. The results of interaction terms *controller_dum * ceo_gov was* nonsignificant. Hypothesis 6 was tested in Model 2 in Table 17, which assessed the complementary effects of state ownership and political connections on legitimacy in the U.S. The coefficient of the interaction term is positive and nonsignificant, which indicates that government ownership and CEO political connections may have separate mechanism of influence on

legitimacy in the foreign market. In the post-hoc analysis, I did not find any significant interaction effect between two forms of government involvement.

Post-hoc Section 4: Model Specifications

The commonly used approaches to estimate population parameters from a random sample are maximum likelihood estimator (MLE) and generalized method of moments (GMM) estimator. The generalized method of moments (GMM) estimator is the standard random-effects regression estimator (use xtreg, re option in stata). The GMM estimator produces a matrix-weighted average of the within and between estimators. The Maximum Likelihood Estimator (MLE) maximizes the likelihood of the random-effects regression model. GMM estimator and ML estimator are different estimators for the random effects regression. The mle and re option in stata yield essentially similar results except when the total observations are less than 200 (Stata, 2013). Both MLE and GMM estimators provide consistent results for large complete data sets. However, for small sample designs, the MLE option is better because the estimated variance is smaller and the parameter estimates are more precise. Therefore, in the previous method section, I utilized ML random-effects regression estimator (use xtreg, mle option in stata).

According to the results of random-effects GLS regression presented in Table 18, the coefficient estimates provide consistent support for Hypothesis 1, 3 and 4. Model 4 demonstrated that central government ownership and CEO political connections positively affect legitimacy among Hong Kong investors ($\beta = 0.245$, $p < 0.01$; $\beta = 0.592$, $p < 0.01$). Compared to the estimates in Model 4 Table 4 using maximum likelihood estimators, the coefficients are very close, and standard errors are slightly different. Model 2 in Table 18 showed that central government ownership negatively influence

investor perceptions of legitimacy in the U.S. (β = - 0.625, $p < 0.1$). The coefficient for the central government ownership in Model 2 Table 4 is also positively significant (β = - 0.623, $p < 0.05$). According to Table 4 and Table 18, I may conclude that random effects ML estimator and GMM estimator provide similar results in my dataset.

Fixed effects (firm-specific heterogeneity)

Firms may differ over time in a consistent manner that is unobserved. If unobserved variables are fixed over time and affect the dependent variable, the estimates may be biased (Certo and Semadeni, 2006; Greene, 2008). In my sample firm-specific heterogeneity may exist. Therefore, I ran models using fe option in stata, and checked whether results are largely different from random effects models. Table 19 presents results using fixed effects regressions, providing similar coefficient estimates. Model 4 demonstrated that in Hong Kong market, central government ownership and CEO political connections are positively related to legitimacy, providing support for Hypothesis 3 and 4 (β = 0.194, $p < 0.1$; β = 0.466, $p < 0.1$). Fixed effects model also provided similar estimates for investor perceptions of legitimacy in the U.S.

Among firms that were cross-listed in the U.S. or Hong Kong stock market, within-firm variances are very small. Specifically, the majority firms in the sample have no variance in central government ownership and CEO political connections. Only 13 firms have some variances in government ownership and 3 firms have variances in CEO political connections during the periods between 2006 and 2014. However, there is much larger cross-sectional variance in these variables, and thus random effects model is more appropriate in this situation.

CHAPTER VI

DISCUSSION

The Chinese economy is the second largest in the world. As it grows to become the largest in the world, its capital market must eventually be integrated with the other major economies in the world. This means that foreign investors will have the same access to Chinese companies as they have to German, U.S. or Japanese companies and will, therefore, have to evaluate and value the corporate governance of these firms. State involvement in corporate governance, through government ownership and CEO appointments of government officials, is a common practice in China but a practice that is unique to China. I have argued that the legitimacy of this practice is influenced by the ideology and that this ideology varies significantly around the world, most notable between the U.S. and Hong Kong.

My results demonstrate that government ownership and CEO political connections do affect the legitimacy of Chinese firms listed on foreign markets but not exactly in the way that I expected. The central government ownership has a strong negative impact on perceived legitimacy in the U.S. and a smaller positive effect on perceived legitimacy in Hong Kong. U.S. investors are wary of government ownership in general and are particularly suspicious of the Chinese government. Hong Kong investors, on the other hand, have stronger cultural, social and economic ties to the Chinese mainland and appear more optimistic about the benefits of government ownership. This

result is the clearest demonstration of the ideological differences embedded in the two exchanges. Despite the fact that government ownership is perceived negatively in the US, a higher number of firms in the U.S. have central government control than firms cross-listed only in Hong Kong. As demonstrated by the descriptive statistics, central government is the largest controlling shareholder in 52 percent of the firms cross-listed in the United States and 42 percent of the firms cross-listed in Hong Kong. These findings are actually consistent with Pan and Brooker's (2014) findings. The Chinese government plays a crucial role in directing the location pattern of Chinese firms' foreign listings. In order to create national prestige, the Chinese government encourages firms to list on foreign markets, especially New York.

The differences in ideology was not seen in the effect of CEO political connections on legitimacy. Since most firms in China began as state-owned enterprises, it is common in China for CEOs to be former government officials. However, only eight percent of the firms listed in the U.S. and four percent of the firms listed in Hong Kong have a CEO who is a former official with the central government. I anticipated that these political connections would be perceived positively in Hong Kong but negatively in the U.S. However, my results show a strong positive effect in both markets. A political connection to the Chinese government may make the firm more open to political manipulation at the expense of shareholders. On the other hand, a political connection may also provide the firm with access to the information, resources and influence of the government. I hypothesized that U.S. investors would focus on the negative aspects of this connection while Hong Kong investors focused on the potential benefits. Instead, my

results demonstrate that both sets of investors perceive the benefits of political connections.

Contribution

This study makes three contributions to the literature. The first contribution of this study is the demonstration that ideology is an important component of the host country institutional environment. Thus, I extend institutional theory by suggesting that firm-level attributes may be perceived differently because of different ideologies dominant in international capital markets. Prior studies such as Bell *et al.* (2014) used foreign firms from multiple home countries to examine their legitimacy in the U.S. host market. My study, however, examines institutional differences (ideologies regarding government) across different host country institutional environments. My study demonstrates that cross-listed firms are exposed to different institutional pressures in each capital market where the firm is listed. The legitimacy of state involvement in corporate governance varies across different host country institutional environments. Institutions in each host market are shaped through the unique processes of social constructions (Kostova and Zaheer, 1999). This study extends institutional theory by explaining differential effects of state involvement on firm legitimacy in host markets where prevailing ideologies regarding government is different. In the host countries where government intervention is rare, and market efficiency is secured by the strong rule of law, the dominant ideologies hold a negative view on government intervention. Foreign firms with central government ownership in such host country institutional environments are likely to face ideology conflict and have a lower level of legitimacy. In contrast, in host counties where leading

ideologies expect government intervention in business, ownership by the central government is positively related to legitimacy.

I also expand the literature on corporate governance by exploring the perceived legitimacy of CEO political ties to the central government. To my knowledge, no prior studies have examined how CEO political ties to the central government influence organizational legitimacy as perceived by investors. Recent studies investigating the effect of corporate governance on organizational legitimacy have mainly focused on governance mechanisms that are common in the U.S. market, such as board independence and managerial incentives. In contrast to prior studies, I examine the influence of state involvement in corporate governance, which are not well understood in the U.S. Contrary to my expectations, CEO political ties increase the legitimacy of cross-listed firms regardless of whether the ideology of the host market. I argued that, for U.S. investors, the cooption of government-appointed CEOs would outweigh potential benefits of better access to government resources. However, I found that investors in the U.S. and Hong Kong, both favor companies that have CEOs who were former government officials.

Finally, I extend the scope of research on government-business relationships. State involvement in corporate governance, an important aspect of government-business relationships, has received limited attention in management literature (Okhmatovskiy, 2010). Prior studies examining the government's role in business (e.g., Shaffer, 1995; Russo, 2001) often emphasize government as a regulator, and investigate how government policies influence an organization. For example, Shaffer (1995) examined the effect of government policies on the competitive environment of the firm. However,

in addition to regulatory role, the government also interacts with corporations in many other ways. This study examines the role of state involvement in corporate governance through central government ownership and CEO political connections.

Limitations and Future Research

This study has several limitations, which offer opportunities for future researchers. This study is based on empirical analysis of Chinese firms cross-listed in the U.S. and Hong Kong. I only study firms incorporated in one country, which may limit the generalizability of the results to some other contexts. My findings may be more applicable to firms originated from emerging economies, where the government plays a strong role in the economy and market institutions are relatively weak.

In addition, this study only examines the influence of CEO political connections with the central government. Future studies can explore how foreign investors perceive political connections of the Chairman of the board. In many Chinese firms, the most powerful position is the Chair, equivalent to the combined CEO/Chairman position in the U.S. (Chen *et al.*, 2006; Luo *et al.*, 2016). It would be interesting to compare the influence of Chair's political connections on legitimacy in different capital markets, and compare the influence of CEO's and Chair's political connections with central government.

This study only focuses on the main associations between political ties to the central government and firm legitimacy. Future studies can examine the potential moderators that may mitigate the negative influence of government ownership on investor perceptions of firm legitimacy in the U.S. For example, future research may explore potential moderators such as industry regulations, overseas education background

of the CEO, managerial ownership, and so forth. Industry regulation refers to 'the extent to which governments supervise a specific industry' (Wu *et al.*, 2013: 1096). I may predict that the negative relationship between government ownership and firm legitimacy will be stronger in highly regulated industries, such as natural public utilities, natural resources, real estate, and finance. In addition, I may also check the moderating role of overseas education background of the CEO. It is very likely that CEO's foreign education background can help to improve investor perceptions of the firm to some extent. Further, cross-listed firms may improve investor perceptions of firm legitimacy in foreign capital markets by employing good corporate governance practices, such as managerial ownership. High level of managerial ownership may serve as a signal of good governance practices, which are likely to associate with high level of legitimacy in foreign capital markets (Sanders and Boivie, 2004; Bell *et al.*, 2008). Therefore, it would be very interesting to investigate the interaction effect of managerial ownership and government ownership, and check whether high level of managerial ownership can improve investor perceptions of firm with central government ownership.

CHAPTER VII

CONCLUSION

This study expands of the obstacles that firms face when accessing international financial markets. While prior work has mostly focused on the foreign IPOs, my study showed that the foreign investors' perceptions of legitimacy influence investment decisions long after the initial public offering. In addition, my study showed that some governance characteristics are perceived differently by investors in different institutional contexts. While I am surprised that CEOs that were former government officials had a positive effect on legitimacy in both the Hong Kong and United States market, my results did show that government ownership was perceived positively in Hong Kong but negatively in the United States. My findings need to be interpreted in light of some limitations. The segmentation of the Chinese stock market from the U.S. and Hong Kong markets is a unique situation and I expect this segmentation to decrease over time as the Chinese capital market becomes more integrated with the global economy. I also recognize that my measures of government ownership and political connections are somewhat exploratory. In contrast to measures of board independence and institutional ownership that are used in studies of U.S. firms, the governance characteristics of Chinese firms are not as standardized nor as well understood by U.S. investors. I hope that this study will motivate further exploration of how government involvement in corporate governance affects the legitimacy of these firms in foreign capital markets.

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APPENDICES

Table 1. Summary of Hypotheses

Hypothesis	Independent Variable	Dependent Variable	Relationship
H1	Central government ownership	Organizational legitimacy in the U.S. stock market	Negative
H2	CEO political connections	Organizational legitimacy in the U.S. stock market	Negative
H3	Central government ownership	Organizational legitimacy in the Hong Kong stock market	Positive
H4	CEO political connections	Organizational legitimacy in the Hong Kong stock market	Positive

TABLE 2. Descriptive Statistics and Correlations for A-ADR Sample

Variables	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1. Dollar volume_ADR	16.62	3.72	1.00													
2. Central government ownership	0.52	0.50	0.08	1.00												
3. Political connection_central gov	0.08	0.27	-0.07	-0.18	1.00											
4. Foreign ownership	0.93	5.20	0.02	0.04	-0.05	1.00										
5. Non-tradable shares	0.25	0.28	0.19	-0.01	-0.04	0.08	1.00									
6. Tobins_q	1.27	0.56	0.07	-0.21	-0.01	0.00	0.37	1.00								
7. Dollar volume_A	22.77	1.11	0.33	-0.05	0.18	-0.05	-0.03	0.00	1.00							
8. Stock exchanges	0.30	0.46	0.75	0.30	-0.19	0.07	0.26	0.07	0.08	1.00						
9. Market capitalization	24.77	1.39	0.52	0.05	0.02	-0.05	0.03	0.19	0.47	0.22	1.00					
10. ROA	0.04	0.05	0.07	-0.26	0.10	-0.02	0.10	0.34	0.04	-0.05	0.09	1.00				
11. Cross-listing age	6.67	4.86	0.54	0.25	-0.12	0.07	0.04	-0.02	-0.09	0.78	-0.02	-0.07	1.00			
12. CEO duality	0.08	0.28	0.09	-0.12	0.14	-0.01	0.14	0.16	0.02	0.01	-0.06	0.07	0.06	1.00		
13. Board independence	0.38	0.08	-0.13	0.25	0.05	0.03	0.01	-0.04	0.11	-0.10	0.03	-0.07	-0.14	0.04	1.00	
14. Stock option	0.02	0.15	-0.15	-0.03	0.20	-0.03	-0.08	0.01	0.12	-0.10	-0.01	0.03	-0.12	0.03	0.18	1.00
15. A-H-ADR dummy	0.90	0.29	0.02	-0.06	0.01	-0.06	0.07	0.08	-0.03	0.00	0.11	0.01	0.10	0.06	-0.20	-0.10

Notes: N=303. The table reports the means, standard deviations, and correlation coefficients of the variables.

TABLE3. Descriptive Statistics and Correlations for A-H Sample

Variables	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1. Dollar volume_H	21.30	1.90	1.00													
2. Central government ownership	0.42	0.49	0.15	1.00												
3. Political connection_central gov	0.04	0.20	0.16	-0.09	1.00											
4. Foreign ownership	1.00	4.23	0.13	0.04	-0.05	1.00										
5. Non-tradable shares	0.28	0.27	0.10	-0.03	-0.05	0.18	1.00									
6. Tobins_q	1.35	0.65	-0.09	-0.10	-0.04	-0.04	0.24	1.00								
7. Dollar volume_A	22.43	1.31	0.75	0.06	0.17	0.11	-0.02	-0.07	1.00							
8. Stock exchanges	0.15	0.36	0.23	0.26	-0.09	0.06	0.15	0.02	0.12	1.00						
9. Market capitalization	24.12	1.69	0.86	0.17	0.09	0.15	0.06	0.03	0.66	0.27	1.00					
10. ROA	0.04	0.05	0.17	-0.13	0.10	-0.04	0.09	0.20	0.15	0.00	0.16	1.00				
11. Cross-listing age	10.54	5.37	-0.47	0.06	-0.14	-0.20	-0.23	0.09	-0.44	0.13	-0.50	-0.04	1.00			
12. CEO duality	0.08	0.28	-0.06	-0.15	0.17	-0.01	0.07	0.16	-0.02	0.02	-0.08	0.08	-0.01	1.00		
13. Board independence	0.38	0.07	-0.02	0.14	0.12	0.02	-0.02	0.01	0.07	-0.09	-0.05	-0.02	-0.12	0.00	1.00	
14. Stock option	0.02	0.15	-0.04	0.06	0.03	-0.04	-0.09	-0.04	0.09	-0.07	0.01	0.03	0.04	0.00	0.11	1.00
15. A-H-ADR dummy	0.50	0.50	0.44	0.19	0.17	-0.04	-0.07	-0.10	0.25	0.42	0.41	0.08	-0.01	0.01	0.02	-0.04

Notes: N=544. The table reports the means, standard deviations, and correlation coefficients of the variables.

TABLE 4. A-ADR Sample and A-H Sample
Random-Effects ML regression of Central Government Ownership and Political Connections on Foregin Market Legitimacy

	U.S. Market		Hong Kong Market	
Variables	Model 1 (controls)	Model 2	Model 3 (controls)	Model 4
Central government ownership		**-0.623* (H1)**		**0.245** (H3)**
		(0.309)		(0.092)
Political connection_central gov		**0.984* (H2)**		**0.592** (H4)**
		(0.436)		(0.192)
Foreign ownership	0.013	0.011	-0.005	-0.004
	(0.013)	(0.013)	(0.006)	(0.006)
Non-tradable shares	-0.327	-0.404	0.050	0.075
	(0.377)	(0.374)	(0.136)	(0.134)
Tobins_q	-0.271	-0.404†	-0.135*	-0.120*
	(0.227)	(0.228)	(0.057)	(0.057)
Dollar volume_A	0.248*	0.208	0.449***	0.436***
	(0.126)	(0.125)	(0.041)	(0.041)
Stock exchanges	4.243***	4.571***	-0.003	-0.080
	(1.115)	(1.112)	(0.231)	(0.223)
Market capitalization	0.638***	0.693***	0.662***	0.664***
	(0.182)	(0.180)	(0.056)	(0.054)
ROA	-0.415	-0.825	0.676	0.695
	(1.636)	(1.612)	(0.554)	(0.549)
Cross-listing age	0.149†	0.144†	0.016	0.018
	(0.088)	(0.087)	(0.014)	(0.014)
CEO duality	0.855*	0.812*	0.012	0.033
	(0.337)	(0.332)	(0.112)	(0.111)
Board independence	-1.597	-1.364	0.662	0.585
	(1.524)	(1.506)	(0.521)	(0.514)
Stock option	-0.774	-0.890	-0.317†	-0.353*
	(0.570)	(0.564)	(0.169)	(0.167)
A-H-ADR dummy	-0.929	-0.825	0.199*	0.196*
	(0.844)	(0.837)	(0.080)	(0.079)
Constant	-3.328	-3.858	-4.186**	-4.008**
	(4.893)	(4.825)	(1.355)	(1.315)
LR chi2	129***	139***	521***	536***
Observations (N)	303	303	544	544
Number of firms	58	58	84	84

Standard errors in parentheses; † $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$
All models include dummy variables for year and industry; dummy variables were omitted for clarity.

TABLE 5. A-H-ADR Sample
Random-Effects ML regression of Central Government Ownership and Political Connections on Foregin Market Legitimacy

	U.S. Market		Hong Kong Market	
Variables	Model 5 (controls)	Model 6	Model 7 (controls)	Model 8
Central government ownership		**-0.787**** **(H1)**		**-0.060** **(H3)**
		(0.299)		(0.106)
Political connection_central gov		**1.150**** **(H2)**		**0.471**** **(H4)**
		(0.414)		(0.150)
Foreign ownership	0.017	-0.015	-0.006	-0.006
	(0.017)	(0.017)	(0.006)	(0.006)
Non-tradable shares	-0.321	-0.447	-0.063	-0.064
	(0.374)	(0.370)	(0.134)	(0.133)
Tobins_q	-0.279	-0.470*	-0.105	-0.142†
	(0.227)	(0.227)	(0.081)	(0.082)
Dollar volume_A	0.331**	0.280*	0.385***	0.369***
	(0.125)	(0.123)	(0.045)	(0.044)
Stock exchanges	4.048***	4.457***	-0.106	-0.104
	(1.129)	(1.072)	(0.246)	(0.246)
Market capitalization	0.654***	0.743***	0.591***	0.624***
	(0.180)	(0.175)	(0.064)	(0.064)
ROA	-0.391	-0.823	0.548	0.436
	(1.583)	(1.551)	(0.569)	(0.559)
Cross-listing age	0.146	0.135	0.018	0.027
	(0.088)	(0.083)	(0.024)	(0.023)
CEO duality	0.760*	0.722*	-0.067	-0.067
	(0.339)	(0.331)	(0.120)	(0.118)
Board independence	-2.326	-1.940	0.595	0.607
	(1.586)	(1.556)	(0.568)	(0.561)
Stock option	-0.533	-0.589	-0.118	-0.133
	(0.551)	(0.540)	(0.199)	(0.195)
Constant	-6.323	-7.374	-0.440	-0.914
	(4.898)	(4.743)	(1.754)	(1.730)
LR chi2	128***	143***	296***	306***
Observations (N)	274	274	274	274
Number of firms	52	52	52	52

Standard errors in parentheses; † $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$
All models include dummy variables for year and industry; dummy variables were omitted for clarity.

TABLE 6. A-H_only Sample (Firms cross-listed in Hong Kong but not in the U.S.)
Random-Effects ML regression

	Hong Kong Market	
Variables	Model 1 (controls)	Model 2
Central government ownership		**0.406** (H3)**
		(0.131)
Political connection_central gov		**1.072 (H4)**
		(0.680)
Foreign ownership	0.013	0.016
	(0.012)	(0.011)
Non-tradable shares	0.424†	0.437†
	(0.242)	(0.239)
Tobins_q	-0.169*	-0.150†
	(0.081)	(0.080)
Dollar volume_A	0.542***	0.534***
	(0.068)	(0.067)
Market capitalization	0.695***	0.636***
	(0.090)	(0.089)
ROA	0.165	0.357
	(0.934)	(0.914)
Cross-listing age	0.036*	0.031†
	(0.016)	(0.016)
CEO duality	0.133	0.122
	(0.173)	(0.175)
Board independence	1.215	0.613
	(0.803)	(0.806)
Stock option	-0.458†	-0.534*
	(0.256)	(0.252)
Constant	-7.659***	-5.898**
	(1.989)	(2.027)
LR chi2	301***	312***
Observations (N)	270	270
Number of firms	60	60

Standard errors in parentheses; † $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$
All models include dummy variables for year and industry; dummy variables were omitted for clarity.

TABLE 7. Descriptive Statistics and Correlations for A-H-ADR Sample

Variables	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1. Dollar volume_ADR	16.65	3.63	1.00													
2. Central government ownership	0.51	0.50	-0.01	1.00												
3. Political connection_central gov	0.08	0.27	-0.05	-0.16	1.00											
4. Foreign ownership	0.82	4.28	0.08	0.11	-0.06	1.00										
5. Non-tradable shares	0.26	0.29	0.18	-0.03	-0.03	0.13	1.00									
6. Tobins_q	1.29	0.56	0.11	-0.19	-0.03	0.02	0.38	1.00								
7. Dollar volume_A	22.76	1.08	0.30	-0.11	0.19	0.01	-0.07	0.02	1.00							
8. Stock exchanges	0.30	0.46	0.73	0.27	-0.19	0.12	0.27	0.10	0.02	1.00						
9. Market capitalization	24.82	1.40	0.51	0.02	0.00	-0.02	-0.01	0.19	0.45	0.18	1.00					
10. ROA	0.04	0.05	0.09	-0.26	0.09	-0.03	0.09	0.34	0.04	-0.05	0.09	1.00				
11. Cross-listing age	6.83	4.92	0.53	0.25	-0.12	0.12	0.05	0.00	-0.15	0.78	-0.06	-0.06	1.00			
12. CEO duality	0.09	0.28	0.10	-0.14	0.15	-0.01	0.13	0.17	0.03	0.02	-0.08	0.07	0.06	1.00		
13. Board independence	0.38	0.07	-0.24	0.18	0.10	0.10	0.00	0.02	0.03	-0.16	-0.05	-0.07	-0.19	0.00	1.00	
14. Stock option	0.02	0.13	-0.12	0.02	0.06	-0.03	-0.06	-0.02	0.12	-0.09	-0.02	0.00	-0.10	0.05	0.30	1.00
15. Dollar volume_AH	22.13	1.41	0.57	-0.08	0.13	-0.04	-0.01	0.03	0.60	0.09	0.79	0.13	-0.14	-0.04	-0.06	-0.03

Notes: N=274. The table reports the means, standard deviations, and correlation coefficients of the variables.

TABLE 8. Descriptive Statistics and Correlations for A-H-only Sample

Variables	Mean	S.D.	1	2	3	4	5	6	7	8	9	10	11	12
1. Dollar volume_H	20.46	1.96	1.00											
2. Central government ownership	0.32	0.47	0.20	1.00										
3. Political connection_central gov	0.01	0.09	0.10	-0.06	1.00									
4. Foreign ownership	1.19	4.18	0.33	-0.01	-0.02	1.00								
5. Non-tradable shares	0.30	0.26	0.29	0.00	-0.08	0.23	1.00							
6. Tobins_q	1.42	0.73	-0.09	-0.01	0.00	-0.10	0.12	1.00						
7. Dollar volume_A	22.10	1.43	0.81	0.12	0.09	0.21	0.05	-0.08	1.00					
8. Market capitalization	23.42	1.67	0.85	0.17	0.07	0.37	0.19	0.01	0.75	1.00				
9. ROA	0.03	0.05	0.17	-0.04	0.10	-0.04	0.10	0.11	0.20	0.18	1.00			
10. Cross-listing age	10.60	6.06	-0.58	0.09	-0.13	-0.39	-0.30	0.13	-0.55	-0.60	-0.16	1.00		
11. CEO duality	0.08	0.27	-0.09	-0.18	0.29	-0.02	0.00	0.17	-0.06	-0.12	0.10	-0.12	1.00	
12. Board independence	0.38	0.07	-0.01	0.09	0.24	-0.06	-0.03	0.01	0.09	-0.06	0.02	-0.05	0.00	1.00
13. Stock option	0.03	0.17	-0.02	0.11	-0.02	-0.05	-0.13	-0.05	0.09	0.06	0.06	0.16	-0.05	-0.04

Notes: N=270. The table reports the means, standard deviations, and correlation coefficients of the variables.

TABLE 9. Descriptive Statistics and Correlations for Alternative Measures of Government Ownership (AH)

Variables	Mean	S.D.	1	2	3	4	5	6	7
1. controller_central_dummy	0.419	0.494	1.000						
2. state_ownership_pct	0.533	0.229	0.294	1.000					
3. controller_central_pct	0.200	0.256	0.924	0.402	1.000				
4. ceo_gov_central	0.042	0.201	**-0.086**	**-0.120**	**-0.055**	1.000			
5. ceo_gov_rank	0.673	1.853	-0.095	-0.131	**-0.081**	0.832	1.000		
6. ceo_npc	0.074	0.261	-0.239	-0.311	-0.221	0.571	0.506	1.000	
7. ceo_cppcc	0.046	0.210	-0.186	**-0.082**	-0.172	0.259	0.243	0.174	1.000
8. ceo_communist	0.695	0.461	0.150	0.130	0.180	**0.040**	**0.090**	**0.049**	-0.141

Notes: N=544. The table reports the means, standard deviations, and correlation coefficients of the variables.

TABLE 10. Post-hoc Analysis
Alternative Measures of Government Ownership

	Hong Kong Market		
Variables	Main Model	IV1=state_own_pct	IV1=controller_pct
Central government ownership	**0.245** (H3)**		
	(0.092)		
IV1=state_own_pct		**0.081 (H3)**	
		(0.195)	
IV1=controller_pct			**0.490** (H3)**
			(0.175)
Political connection_central gov	**0.592** (H4)**	**0.574** (H4)**	**0.588** (H4)**
	(0.192)	(0.194)	(0.192)
Foreign ownership	-0.004	-0.005	-0.004
	(0.006)	(0.006)	(0.006)
Non-tradable shares	0.075	0.049	0.090
	(0.134)	(0.135)	(0.134)
Tobins_q	-0.120*	-0.134*	-0.119*
	(0.057)	(0.057)	(0.057)
Dollar volume_A	0.436***	0.440***	0.440***
	(0.041)	(0.041)	(0.041)
Stock exchanges	-0.080	-0.003	-0.099
	(0.223)	(0.225)	(0.222)
Market capitalization	0.664***	0.672***	0.658***
	(0.054)	(0.055)	(0.054)
ROA	0.695	0.626	0.736
	(0.549)	(0.552)	(0.550)
Cross-listing age	0.018	0.020	0.020
	(0.014)	(0.014)	(0.013)
CEO duality	0.033	0.008	0.035
	(0.111)	(0.111)	(0.110)
Board independence	0.585	0.659	0.491
	(0.514)	(0.517)	(0.516)
Stock option	-0.353*	-0.319†	-0.317†
	(0.167)	(0.168)	(0.167)
A-H-ADR dummy	0.196*	0.184*	0.199*
	(0.079)	(0.080)	(0.079)
Constant	-4.008**	-4.286**	-3.887**
	(1.315)	(1.327)	(1.313)
LR chi2	536***	529***	537***
Observations (N)	544	544	544
Number of firms	84	84	84

Standard errors in parentheses; † $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$
All models include dummy variables for year and industry; dummy variables were omitted for clarity.

TABLE 11. Post-hoc Analysis
Alternative Measures of CEO Political Connections

	Hong Kong Market				
Variables	Main Model	IV2=ceo_gov_rank	IV2=ceo_npc	IV2=ceo_cppcc	IV2=ceo_communist
Central government ownership	**0.245**** **(H3)**	**0.243****	**0.248****	**0.244****	**0.225***
	(0.092)	(0.092)	(0.093)	(0.093)	(0.093)
Political connection_central gov	**0.592**** **(H4)**				
	(0.192)				
IV2=ceo_gov_rank		**0.051**** **(H4)**			
		(0.019)			
IV2=ceo_npc			**0.321*** **(H4)**		
			(0.153)		
IV2=ceo_cppcc				**0.236** **(H4)**	
				(0.217)	
IV2=ceo_communist					**0.132†** **(H4)**
					(0.074)
Foreign ownership	-0.004	-0.006	-0.005	-0.005	-0.005
	(0.006)	(0.006)	(0.006)	(0.006)	(0.006)
Non-tradable shares	0.075	0.063	0.078	0.069	0.070
	(0.134)	(0.134)	(0.135)	(0.135)	(0.135)
Tobins_q	-0.120*	-0.127*	-0.131*	-0.117*	-0.116*
	(0.057)	(0.057)	(0.057)	(0.057)	(0.057)
Dollar volume_A	0.436***	0.440***	0.434***	0.448***	0.448***
	(0.041)	(0.041)	(0.042)	(0.041)	(0.041)
Stock exchanges	-0.080	-0.102	-0.054	-0.064	-0.110
	(0.223)	(0.227)	(0.229)	(0.231)	(0.230)
Market capitalization	0.664***	0.657***	0.660***	0.642***	0.652***
	(0.054)	(0.055)	(0.055)	(0.056)	(0.055)
ROA	0.695	0.689	0.740	0.768	0.784
	(0.549)	(0.549)	(0.550)	(0.551)	(0.550)
Cross-listing age	0.018	0.016	0.015	0.013	0.015
	(0.014)	(0.014)	(0.014)	(0.014)	(0.014)
CEO duality	0.033	0.031	0.035	0.041	0.049
	(0.111)	(0.111)	(0.111)	(0.112)	(0.111)
Board independence	0.585	0.594	0.554	0.583	0.566
	(0.514)	(0.515)	(0.517)	(0.518)	(0.517)
Stock option	-0.353*	-0.346*	-0.351*	-0.343*	-0.342*
	(0.167)	(0.168)	(0.168)	(0.168)	(0.168)
A-H-ADR dummy	0.196*	0.203*	0.186*	0.212**	0.213**
	(0.079)	(0.079)	(0.080)	(0.080)	(0.080)
Constant	-4.008**	-3.889**	-3.813**	-3.759**	-4.003**
	(1.315)	(1.329)	(1.336)	(1.349)	(1.337)
LR chi2	536***	534***	531***	528***	530***
Observations (N)	544	544	544	544	544
Number of firms	84	84	84	84	84

Standard errors in parentheses; † $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$
All models include dummy variables for year and industry; dummy variables were omitted for clarity.

Table 12: Summary of Alternative Measures and Results for A-H Sample

Sample	Measures of government ownership	Measurement	Coeff	Hypotheses	Supported
A-H	controler_central_dummy	A dummy variable, which was coded as 1 if the central government is the largest shareholder, and zero otherwise	**0.245****	**H3**	**Y**
	state_ownership_pct	The percentage of shares owned by the government (including central and local governments and agencies)	0.081	H3	N
	controller_central_pct	The percentage of shares owned by the central government when the central government is the largest shareholder	**0.490****	**H3**	**Y**

Sample	Measures of political connections	Measurement	Coeff	Hypotheses	Supported
A-H	ceo_gov_dummy	A dummy, which was coded as 1 if CEO was former official with the central government, and zero otherwise	**0.592****	**H4**	**Y**
	ceo_gov_rank	ceo_gov_rank is a rank order of CEO's political connections. The range of ceo_gov_rank is from 0-8. If CEO is not a former official at any level of government agencies, then ceo_gov_rank is coded as 0. 8=Chief position in the central government 7=Assistant position in the central government 6=Chief position in the provincial government 5=Assistant position in the provincial government 4=Chief position at the bureau level 3=Assistant position at the bureau level 2=Chief position at the county level 1=Assistant position at the county level	**0.0511****	**H4**	**Y**
	ceo_npc	If CEO is a current or former member of the National People's Congress (NPC), the legislative body in China, then ceo_npc is coded as 1, and zero otherwise.	**0.321***	**H4**	**Y**
	ceo_cppcc	If CEO is a current or former member of the Chinese People's Political Consultative Conference (CPPCC), an advisory board for the Chinese government, then ceo_cppcc is coded as 1, and zero otherwise	0.236	H4	N
	ceo_communist	If CEO is a member of the communist party, then ceo_communist equals to 1, and zero if not	**0.132†**	**H4**	**Y**

TABLE 13. Descriptive Statistics and Correlations for Alternative Measures of Government Ownership (ADR)

Variables	Mean	S.D.	1	2	3	4	5	6	7
1. controller_central_dummy	0.525	0.500	1.000						
2. state_ownership_pct	0.565	0.238	0.486	1.000					
3. controller_central_pct	0.275	0.281	0.934	0.528	1.000				
4. ceo_gov_central	0.076	0.265	-0.176	-0.220	-0.145	1.000			
5. ceo_gov_rank	1.083	2.365	-0.121	-0.252	-0.116	0.840	1.000		
6. ceo_npc	0.119	0.324	-0.386	-0.467	-0.360	0.588	0.523	1.000	
7. ceo_cppcc	0.059	0.237	-0.264	-0.161	-0.247	0.297	0.287	0.210	1.000
8. ceo_communist	0.769	0.422	0.231	0.127	0.220	**0.009**	**0.076**	**-0.017**	-0.227

Notes: N=303. The table reports the means, standard deviations, and correlation coefficients of the variables.

TABLE 14. Post-hoc Analysis
Alternative Measures of Government Ownership

	U.S. Market		
Variables	Main Model	IV1=state_own_pct	IV1=controller_pct
Central government ownership	**-0.623* (H1)**		
	(0.309)		
IV1=state_own_pct		**1.058 (H1)**	
		(0.565)	
IV1=controller_pct			**-0.696 (H1)**
			(0.508)
Political connection_central gov	**0.984* (H2)**	**1.047* (H2)**	**1.017* (H2)**
	(0.436)	(0.435)	(0.436)
Foreign ownership	0.011	0.015	0.010
	(0.013)	(0.013)	(0.013)
Non-tradable shares	-0.404	-0.315	-0.396
	(0.374)	(0.370)	(0.377)
Tobins_q	-0.404†	-0.347	-0.386
	(0.228)	(0.223)	(0.229)
Dollar volume_A	0.208	0.240	0.206
	(0.125)	(0.126)	(0.125)
Stock exchanges	4.571***	4.186***	4.489***
	(1.112)	(1.130)	(1.127)
Market capitalization	0.693***	0.651***	0.707***
	(0.180)	(0.180)	(0.182)
ROA	-0.825	-0.504	-0.896
	(1.612)	(1.607)	(1.624)
Cross-listing age	0.144†	0.146	0.144
	(0.087)	(0.089)	(0.088)
CEO duality	0.812*	0.948**	0.812*
	(0.332)	(0.334)	(0.334)
Board independence	-1.364	-1.596	-1.289
	(1.506)	(1.500)	(1.525)
Stock option	-0.890	-0.864	-0.888
	(0.564)	(0.562)	(0.566)
A-H-ADR dummy	-0.825	-1.107	-0.865
	(0.837)	(0.862)	(0.848)
Constant	-3.858	-3.867	-4.235
	(4.825)	(4.826)	(4.861)
LR chi2	139***	138***	137***
Observations (N)	303	303	303
Number of firms	58	58	58

Standard errors in parentheses; † $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$
All models include dummy variables for year and industry; dummy variables were omitted for clarity.

TABLE 15. Post-hoc Analysis
Alternative Measures of CEO Political Connections

	U.S. Market				
Variables	Main Model	IV2=ceo_gov_rank	IV2=ceo_npc	IV2=ceo_cppcc	IV2=ceo_communist
Central government ownership	**-0.623* (H1)**	**-0.648* (H1)**	**-0.635* (H1)**	**-0.611* (H1)**	**-0.659* (H1)**
	(0.309)	(0.309)	(0.309)	(0.310)	(0.310)
Political connection_central gov	**0.984* (H2)**				
	(0.436)				
IV2=ceo_gov_rank		**0.070 (H2)**			
		(0.043)			
IV2=ceo_npc			**0.717† (H2)**		
			(0.375)		
IV2=ceo_cppcc				**0.995* (H2)**	
				(0.504)	
IV2=ceo_communist					**0.380 (H2)**
					(0.251)
Foreign ownership	0.011	0.010	0.011	0.011	0.009
	(0.013)	(0.013)	(0.013)	(0.013)	(0.013)
Non-tradable shares	-0.404	-0.425	-0.414	-0.432	-0.428
	(0.374)	(0.376)	(0.374)	(0.374)	(0.376)
Tobins_q	-0.404†	-0.429	-0.433	-0.376	-0.334
	(0.228)	(0.232)	(0.231)	(0.228)	(0.230)
Dollar volume_A	0.208	0.225	0.215	0.235	0.249*
	(0.125)	(0.125)	(0.125)	(0.124)	(0.125)
Stock exchanges	4.571***	4.494***	4.662***	4.715***	4.453***
	(1.112)	(1.101)	(1.114)	(1.115)	(1.104)
Market capitalization	0.693***	0.676***	0.701***	0.607***	0.649***
	(0.180)	(0.180)	(0.182)	(0.182)	(0.180)
ROA	-0.825	-0.822	-0.715	-0.637	-0.181
	(1.612)	(1.625)	(1.615)	(1.615)	(1.650)
Cross-listing age	0.144†	0.145	0.139	0.134	0.149
	(0.087)	(0.086)	(0.087)	(0.087)	(0.086)
CEO duality	0.812*	0.794*	0.808*	0.821*	0.841*
	(0.332)	(0.334)	(0.333)	(0.333)	(0.336)
Board independence	-1.364	-1.422	-1.369	-1.339	-1.162
	(1.506)	(1.514)	(1.509)	(1.509)	(1.517)
Stock option	-0.890	-0.851	-0.847	-0.768	-0.802
	(0.564)	(0.566)	(0.564)	(0.562)	(0.564)
A-H-ADR dummy	-0.825	-0.840	-0.844	-0.862	-0.775
	(0.837)	(0.829)	(0.836)	(0.835)	(0.833)
Constant	-3.858	-3.624	-4.2	-2.459	-4.106
	(4.825)	(4.836)	(4.860)	(4.884)	(4.85029)
LR chi2	139***	139***	136***	137***	138***
Observations (N)	303	303	303	303	303
Number of firms	58	58	58	58	58

Standard errors in parentheses; † $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$
All models include dummy variables for year and industry; dummy variables were omitted for clarity.

Table 16: Summary of Alternative Measures and Results for A-ADR Sample

Sample	Measures of government ownership	Measurement	Coeff	Hypotheses	Supported
A-ADR	controler_central_dummy	A dummy variable, which was coded as 1 if the central government is the largest shareholder, and zero otherwise	**-0.623***	**H1**	**Y**
	state_ownership_pct	The percentage of shares owned by the government (including central and local governments and agencies)	1.058	H1	N
	controller_central_pct	The percentage of shares owned by the central government when the central government is the largest shareholder	-0.696	H1	N

Sample	Measures of political connections	Measurement	Coeff	Hypotheses	Supported
A-ADR	ceo_gov_dummy	A dummy, which was coded as 1 if CEO was former official with the central government, and zero otherwise	**0.984***	**H2**	**Y**
	ceo_gov_rank	ceo_gov_rank is a rank order of CEO's political connections. The range of ceo_gov_rank is from 0-8. If CEO is not a former official at any level of government agencies, then ceo_gov_rank is coded as 0. 8=Chief position in the central government 7=Assistant position in the central government 6=Chief position in the provincial government 5=Assistant position in the provincial government 4=Chief position at the bureau level 3=Assistant position at the bureau level 2=Chief position at the county level 1=Assistant position at the county level	0.070	H2	N
	ceo_npc	If CEO is a current or former member of the National People's Congress (NPC), the legislative body in China, then ceo_npc is coded as 1, and zero otherwise.	**0.717†**	**H2**	**N**
	ceo_cppcc	If CEO is a current or former member of the Chinese People's Political Consultative Conference (CPPCC), an advisory board for the Chinese government, then ceo_cppcc is coded as 1, and zero otherwise	**0.995***	**H2**	**N**
	ceo_communist	If CEO is a member of the communist party, then ceo_communist equals to 1, and zero if not	0.380	H2	N

TABLE 17. Post-hoc Analysis
Interaction Effects of Central Government Ownership and CEO Political Connections

	U.S. Market		Hong Kong Market	
	Model 1	Model 2	Model 3	Model 4
Variables	Main Model	Inteactions	Main Model	Inteactions
Central government ownership	**-0.623* (H1)**	**-0.623* (H1)**	**0.245** (H3)**	**0.243** (H3)**
	(0.309)	(0.309)	(0.092)	(0.092)
Political connection_central gov	**0.984* (H2)**	**0.955† (H2)**	**0.592** (H4)**	**0.548* (H4)**
	(0.436)	(0.490)	(0.192)	(0.215)
Interactions		**0.141 (H5)**		**0.214 (H5)**
		(1.079)		(0.473)
Foreign ownership	0.011	0.011	-0.004	-0.004
	(0.013)	(0.013)	(0.006)	(0.006)
Non-tradable shares	-0.404	-0.405	0.075	0.075
	(0.374)	(0.374)	(0.134)	(0.134)
Tobins_q	-0.404†	-0.403†	-0.120*	-0.120*
	(0.228)	(0.228)	(0.057)	(0.057)
Dollar volume_A	0.208	0.209†	0.436***	0.437***
	(0.125)	(0.125)	(0.041)	(0.041)
Stock exchanges	4.571***	4.567	-0.080	-0.084
	(1.112)	(1.111)	(0.223)	(0.223)
Market capitalization	0.693***	0.695	0.664***	0.665***
	(0.180)	(0.181)	(0.054)	(0.054)
ROA	-0.825	-0.819	0.695	0.697
	(1.612)	(1.613)	(0.549)	(0.549)
Cross-listing age	0.144†	0.144†	0.018	0.019
	(0.087)	(0.087)	(0.014)	(0.014)
CEO duality	0.812*	0.813	0.033	0.034
	(0.332)	(0.332)	(0.111)	(0.111)
Board independence	-1.364	-1.361	0.585	0.590
	(1.506)	(1.506)	(0.514)	(0.514)
Stock option	-0.890	-0.889	-0.353*	-0.352*
	(0.564)	(0.564)	(0.167)	(0.167)
A-H-ADR dummy	-0.825	-0.833	0.196*	0.196*
	(0.837)	(0.838)	(0.079)	(0.079)
Constant	-3.858	-3.915	-4.008**	-4.052**
	(4.825)	(4.842)	(1.315)	(1.317)
LR chi2	139***	139***	536***	536***
Observations (N)	303	303	544	544
Number of firms	58	58	84	84

Standard errors in parentheses; † $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$
All models include dummy variables for year and industry; dummy variables were omitted for clarity.

TABLE 18. A-ADR Sample and A-H Sample
Random-Effects Regression of Central Government Ownership and Political Connections on Foregin Market Legitimacy

	U.S. Market		Hong Kong Market		
Variables	Model 1 (controls)	Model 2	Model 3 (controls)	Model 4	
Central government ownership		**-0.625†**		**0.245****	**(H3)**
		(0.351)		(0.121)	
Political connection_central gov		**0.979†**	**(H2)**	**0.592****	**(H4)**
		(0.522)		(0.102)	
Foreign ownership	0.018	0.011	-0.005	-0.004	
	(0.018)	(0.017)	(0.006)	(0.006)	
Non-tradable shares	-0.328	-0.404	0.057	0.077	
	(0.367)	(0.368)	(0.125)	(0.123)	
Tobins_q	-0.279	-0.408†	-0.138*	-0.121*	
	(0.237)	(0.225)	(0.058)	(0.059)	
Dollar volume_A	0.248†	0.208	0.446***	0.436***	
	(0.150)	(0.148)	(0.053)	(0.054)	
Stock exchanges	4.235***	4.568***	-0.022	-0.083	
	(0.814)	(0.782)	(0.191)	(0.204)	
Market capitalization	0.645***	0.696***	0.671***	0.666***	
	(0.189)	(0.201)	(0.060)	(0.057)	
ROA	-0.390	-0.816	0.680	0.696	
	(2.371)	(2.326)	(0.671)	(0.646)	
Cross-listing age	0.149†	0.144†	0.017	0.018	
	(0.088)	(0.082)	(0.014)	(0.014)	
CEO duality	0.863**	0.815**	0.016	0.033	
	(0.297)	(0.298)	(0.092)	(0.092)	
Board independence	-1.587	-1.358	0.687	0.588	
	(2.196)	(2.091)	(0.537)	(0.555)	
Stock option	-0.787†	-0.897	-0.324	-0.355*	
	(0.458)	(0.548)	(0.204)	(0.198)	
A-H-ADR dummy	-0.934	-0.827	0.206	0.197	
	(1.021)	(1.172)	(0.096*)	(0.092*)	
Constant	-3.493	-3.927	-4.361*	-4.036*	
	(5.240)	(5.375)	(1.779)	(1.725)	
R-square	0.76	0.77	0.85	0.86	
Wald chi2	522***	516***	1379***	1725***	
Observations (N)	303	303	544	544	
Number of firms	58	58	84	84	

Standard errors in parentheses; † $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$
All models include dummy variables for year and industry; dummy variables were omitted for clarity.

TABLE 19. A-ADR Sample and A-H Sample
Fixed-Effects Regression of Central Government Ownership and Political Connections on Foregin Market Legitimacy

	U.S. Market		Hong Kong Market	
Variables	Model 1 (controls)	Model 2	Model 3 (controls)	Model 4
Central government ownership		**-0.525 (H1)**		**0.194† (H3)**
		(0.371)		(0.115)
Political connection_central gov		**1.254* (H2)**		**0.466† (H4)**
		(0.507)		(0.241)
Foreign ownership	0.013	0.012	-0.004	-0.003
	(0.013)	(0.013)	(0.007)	(0.007)
Non-tradable shares	-0.296	-0.348	0.020	0.025
	(0.410)	(0.407)	(0.150)	(0.149)
Tobins_q	-0.032	-0.190	-0.045	-0.043
	(0.247)	(0.250)	(0.063)	(0.063)
Dollar volume_A	0.257†	0.210	0.484***	0.476***
	(0.138)	(0.138)	(0.045)	(0.045)
Stock exchanges				
Market capitalization	0.341	0.443†	0.425***	0.446***
	(0.244)	(0.245)	(0.079)	(0.079)
ROA	-0.939	-1.235	0.749	0.709
	(1.720)	(1.700)	(0.575)	(0.573)
Cross-listing age	-0.015	-0.006	-0.064**	-0.068***
	(0.061)	(0.060)	(0.020)	(0.020)
CEO duality	0.646†	0.650†	-0.050	-0.023
	(0.370)	(0.367)	(0.123)	(0.123)
Board independence	-1.860	-1.738	0.393	0.382
	(1.715)	(1.698)	(0.581)	(0.578)
Stock option	-0.455	-0.478	-0.204	-0.230
	(0.621)	(0.613)	(0.176)	(0.176)
A-H-ADR dummy			0.087	0.102
			(0.087)	(0.087)
Constant	3.146	2.025	0.738	0.385
	(5.986)	(5.973)	(1.698)	(1.698)
R-square	0.27	0.20	0.77	0.78
F	3.54***	3.69***	29.12***	26.81***
Observations (N)	303	303	544	544
Number of firms	58	58	84	84

Standard errors in parentheses; † $p < 0.1$, * $p < 0.05$, ** $p < 0.01$, *** $p < 0.001$
All models include dummy variables for year; dummy variables were omitted for clarity.

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