

Chapter 3

Business and Government

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To run an enterprise in China, what is the most important thing to learn? Political economics! What is political economics? It is business integrating with politics. Being entrepreneurial is not merely about selling product in a market, but also about acquiring favorable treatments from governmental authorities. This is knowledge! What if we only learn politics? No, that is out-of-date. A socialist market economic system has now taken shape in China. Only learn economics? Likewise no, it's not the time yet. The Chinese government still plays a dominant role in domestic market. (Interview notes, Nov. 21, 2007)

This is how Mr. Wang, CEO of a private company, explained his understandings of China's institutional environment to us during an interview in the year of 2007. At that moment, as we looked back on the past 30 years of China's Economic Reform, Mr. Wang and his colleagues told us about their 17-year business journey. From rushing to a blooming special economic zone in 1990 to wearing a "red hat" (being attached to a state-owned enterprise before 1992); from getting their first pot of gold in the Hainan gold rush in 1993 to getting involved in the real estate business by taking full advantage of government policy in 1995; from taking their business forward to the Yangtze River delta, where the economy was exploding in 1998, to the acquisition of state-owned listed enterprises and thus opening financing channels in 2000; from significantly expanding their business by moving with the SOE (state-owned enterprises) privatization wave in 2002 to becoming a diversified corporation in 2004; the story of Mr. Wang is typical in the history of China's economic reform. From this, we can see that, behind each turning point of this private firm's development, there were deep imprints of government action and changes of policy. During the long history of the transformation from planned

The research is financially supported by the National Science Foundation of China (70872001) – "Research on political activities of China's private business: institutional perspective".

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economy to market economy, the evolvement of China's institutional environment was like every fast changing city in China: old buildings hadn't been pulled down, while new buildings had already been built; the foundation of traditional culture was still alive, while new orders were secretly growing; the old and the new were overlapping, the traditions and the new knowledge were experiencing intensive conflict. The inertia of the planned economy, the potential of market rules, the dawning of legal civilization, the remaining influence of the "official rank-oriented standard" (*guan ben wei*), the balancing of all kinds of old and new powers, along with the overwhelming rise of private business, constitute our focus in this chapter – the Chinese-style government-business relationship.

During the past 30 years, China's private sector has been evolving from being called "speculation" (*touji daoba*) at the very beginning, to the "beneficial supplement to public ownership, and then to "infrangible private property rights". China's incremental economic reform was actually the evolution of the relationship between public authorities and private business. During this process, which was full of twists and turns, the factors related to government intervention became the most complicated, influential and unpredictable of all the factors that enterprises had to face. How did entrepreneurs keep full awareness of the macro-economy while developing their own business? How did they follow the logic of the market while still being politically sensitive? How did they keep their autonomy in decision making while making full use of the policy? How did they operate between the government and the business without being trapped? . . . Keeping a "proper distance" between the government and the business is a big challenge for Chinese business leaders who have been growing up between the cracks of the systems.

The former president of CHANGHONG, Mr. Ni Runfeng, described the relationship of business-government as "cannot separate from, but unreliable", based on his experience. These few words explain all the difficulties and helplessness of business. The president of Vantone Group, Mr. Feng Lun, used the phrase: "cannot avoid, but like walking on the ice" to describe the same relationship. Driven by profit-orientation, the private business attaches itself to the state and acts upon the official's needs to seek benefits, but often becomes trapped in political struggles and loses everything. It often tries to seduce officials and trades money for benefits, but often digs its own grave while corrupting the officials. Finance writer Wu Xiaobo indicated after years of observation that the "government-business puzzle" was one of the main reasons for business failure in China: the conflict of interests between governments and enterprises during the clarification of SOE ownership, the remediation to private business under macroeconomic control, as well as inter-jurisdiction political competition among Chinese local governments, all become institutional threats which entrepreneurs have constantly faced during the economic transformation.

All these direct us to our core question: how can we understand the relationship between the government and the enterprise during institutional evolution? What kinds of activities are Chinese private entrepreneurs taking to interact with the government? What kinds of changes are happening to the Chinese government-business relationship during the co-evolution of business organizations and the

institutional environment? In this chapter, we employ the state-firm exchange perspective used in corporate political strategy research in the West, and view government officials and entrepreneurs both as rational actors within China's local political market: enterprises expect the government to provide beneficial policies and treatments, while government officials need to use the enterprises' performance to build their own political records and also seek personal benefits. Therefore, both sides expect something from each other, so they all take what they need from each other, which constitutes a resource dependence relationship. Based on this assumption, we start from the perspective of incentive orientation, to explain the intention and behavior of the two major groups of actors in China's economy – private entrepreneurs and government officials, in an effort to open the black box of the Chinese business-government relationship.

3.1 Characteristics of Government Officials

On one hand, it was the “top leader is responsible for all”. Political security of CCP was the most important thing. You had to be extremely cautious to prevent mistakes from happening. No mistakes! On the other hand, it was the frequent rotation of official positions. People had to retire when they reached a certain age. The competition is choking! so if you only did routine work without achieving rapid GDP growth by helping private businesses, how could you expect to make any political achievements in only a few years? Am I supposed to go to the Political Consultative Committee and wait for retirement when I'm 45? We've been hard working for our whole lives just for one word: “promotion”! ... (Interview notes, Sept. 26, 2009)

In the afternoon of Sept. 26, 2009, Ms. Zhang, who was the vice county magistrate of Y County, told us about the confusion and troubles of being a government official, during our interview in a hotel in Shanghai. During the economic transformation of China, government officials are the key actors. Due to the insufficient protection of the property rights and ineffective legal systems, private businesses depend more on government policies and official discretion to survive and succeed. During the process of developing the market economy, the Chinese government has never been separated from the market. As a matter of fact, the local business system is greatly influenced by the interaction of local government officials and private entrepreneurs. And the local officials themselves are not solely information delivery between the central government and the micro business organizations, they are self-interested actors with multiple objectives. This has caused the complexity of Chinese government-business interaction during the institutional transition.

What kinds of motivations and behavioral characteristics do Chinese government officials have? Political scientists indicate that, after the 30 years' reform, government officials in today's China are no longer the “revolutionary cadre” in the strictest sense. However, neither are they becoming the “modern bureaucrat” in Max Weber's hierarchy (Lu 1999). In current China's environment with prevailing

materialism, government officials are just like entrepreneurs; they are self-interested actors who seek various personal interests. Governmental officials' behavior cannot be judged absolutely by the values of right or wrong; they either give support or seek rents during the development of private business. Therefore, in this chapter, we start from the analysis of the incentives of government officials in an effort to explain the behavioral patterns of governments during market transformation.

In the current political and economic circumstances, the promotion of Chinese government officials is mainly subject to the cadre evaluation system. The four principles of this system were raised by Deng Xiaoping during late 1970s to early 1980s. The four criteria against which officials are evaluated are: loyalty to the Party, knowledge, youthfulness, and professionalism. Among these four, loyalty to the Party is very important, but it is very vague and subjective. So, in practice, the most objective one –youthfulness – became the compulsory rule for promotion. In order to enforce the age standard, the central government abolished the lifelong tenure system and set a mandatory age for retirement, and even set age limits for candidates for government positions at each level. For example, in the leadership team at county level, candidates for all key positions (including secretary and deputy secretary of the county party committee, county magistrate and vice county magistrate) cannot be older than 45 years when they first report to duty; at least one member in the standing committee has to be younger than 35 years old (Zhong 2003).

The compulsory age standard has had a great influence on the career path of Chinese government officials. To a large extent, the age standard directly produces two types of officials: “promotable official”, which means officials who have the possibility to be promoted or to be switched to more ideal positions; and “terminal officials”, which refers to those who cannot be promoted any further due to the limitation of the age standard, but have not yet reached the retirement age. The two completely different career prospects mean these two kinds of officials have completely different motivations (Zhong 2003).

To most of the “promotable officials”, promotion is their priority. In order to smoothly climb up the ladder of bureaucracy, they try all means to meet the criteria of the assessments carried out by upper-level governments. Currently, the central government is trying to motivate local government officials by dual control of personnel and finance. From the perspective of personnel control, the central government carries out “championship contest” to promote local officials, which compares the performance of local government officials (especially the “top leader” of each region) by measuring local economic development with leaders at the same level in neighboring cities or counties. Winners of the contest get promoted (Li and Zhou 2005). This mechanism has stimulated the strong pursuit of political performance by “promotable officials”.

From the perspective of finance control, the tax sharing reform enforced in 1994 divided the tax revenues and the “administrative duties” between the central and local governments. Under this system, the central government took most of the tax revenue. According to data for the 10 years from 1995 to 2004, central fiscal

revenue accounted for 52 % on average of total tax revenue, but central expenditure accounted for only 29.8 % on average of total fiscal expenditure; in contrast, regional fiscal revenue only accounted for 48 % of total tax revenue, and its expenditure accounted for 70.2 %. Since 2004, the proportion of regional fiscal revenue in total fiscal revenue has continued to decrease, while the proportion of its expenditure has continued to increase. This unbalanced structure has created big financial pressure on local governments. “Lack of money” has become a pressing issue for local government officials. Therefore, increasing revenue sources became another important target for “promotable officials”.

In order to increase revenue sources as well as their own political performance, “promotable officials” have very strong incentives to develop local economy under their jurisdiction. In order to win in the championship of contest, government officials in neighboring administrative regions were in hot competition in GDP growth, employment rates, tax revenue, export and other major economic indicators. To promote local economic growth, they actively support the development of private business by investing in infrastructure, formulating regional development plans, supporting major industries, assisting in capital raising/planning of local enterprises, facilitating cooperation between business organizations, etc. Meanwhile, governments of many regions made policies on taxation, land prices and services to attract investment. Especially in the past 10 years, BT and BOT projects, which include many different kinds of preferential policies, have constantly appeared, and the mode of “using culture to set up the stage and the economy to put on a show” has been widely used throughout the country. From this point, Chinese local governments have shown a very obvious characteristic of being a strong developmental state. The strong support by Taizhou city government in Zhejiang province for Zhejiang Geely Holding Group recorded by Ngo was one of the typical cases:

When Taizhou city government decided to include automobile manufacturing in its development plan... in order to get Geely the production permit, the Taizhou government specially sent officials to Beijing to lobby the central government. Meanwhile, the city government invited research institutions and the think tank of the central government to visit the headquarters of Geely, and presented to them the development prospects of Geely Group, so they would speak favorably of Geely to the ministries. In 2001, after Geely Automobile obtained a production permit, the city government, in the name of promoting the development of new industry and high tech industries, provided Geely with a large amount of direct subsidies, preferential policies, land ... the development of Geely Automobile had already become part of the city planning of Taizhou. The strong pursuit of investment, tax revenue, employment, economic and social performance and other indicators of political achievements, as well as the big pressure of competing with neighboring cities, caused the alignment of interests in the relationship between private business and local governments... (Ngo 2008)

In contrast with the craving of personal political achievements and local fiscal income of “promotable officials”, “terminal officials,” who have no hope of being promoted, normally only care about personal benefits. Due to the age limitation, “terminal officials” have to end their career earlier. They are either appointed to insignificant positions in People’s Congress or Political Consultative Committee, or

to non-functional posts and wait for retirement. Officials at this stage of their careers certainly have no hope of promotion. Due to their frustration with this career prospect and their anxiety about their standard of living after retirement, many “terminal officials” are no longer interested in fulfilling their official duty but instead, they are more interested in rent-seeking. Because “their power will soon expire no matter whether they use it or not”, they tend to use their power to seek personal benefit. The well-known “phenomenon of age 59” (which means that many officials at age 59 become corrupted) is a vivid illustration of the behaviors of “terminal officials”. Various corruption cases also show that there is a much higher chance of getting involved in corruption, rent-seeking or nepotism among “terminal officials” than “promotable officials” (Zhong 2003).

Meanwhile, the institutional environment of the transitional economy has provided government officials with various opportunities of rent-seeking. Just like governments of other countries in economic transition, the current “weak institutions” cannot stop the “grabbing hands” of government officials. In many regions, especially the areas where marketization level is low, government intervention has blurred the line between the market and the government. The “Report of the developing trends and existing problems of private business in Guangdong province” shows that 44 % of the private entrepreneurs who were surveyed reported they were often busy working on cultivating/maintaining relationships with government officials, which cost them a lot of time and energy; and 60 % said they had lost opportunities to develop new projects due to the low efficiency and complicated procedures of some government agencies. An entrepreneur in the restaurant business in Xinjiang province said there were nearly 33 government agencies which he needed to treat nicely. The research team on enterprise affairs of the National Statistics Bureau reported that 66.7 % of the enterprises they investigated said there were “three unjustifiabiles” (unjustified levies, unjustified charges, unjustified fines) in their areas; and 54 % of the enterprises indicated they had encountered instances of “eat and take” behavior among local government officials.

The rent-seeking of governments has generated nonproductive incentives, and also bred a tendency of dependence of business upon government. Many entrepreneurs fell into the paradox of mixing business logic and political logic: on the one hand, they are angry about the monopoly of resources by state-owned enterprises and governments; on the other hand, they are eager to build political connections to seek rent, which is a way to develop their “big dreams” at minimum cost and with maximum return (Xiao 2008). Therefore, Western political scientists believe that predatory governments are becoming the biggest obstacle to the development of China’s private business: entrepreneurs cannot use the legal system to protect their interests, so their only choice is to build personal connections with government officials to carve a political patronage relationship . . . the vertical relations which Chinese enterprises have with the government even override their horizontal cooperation with business partners (Kennedy 2002).

Even though, to a large extent, the division of “promotable officials” and “terminal officials” is only theoretical, the objectives and behaviors of the two types of officials cannot be distinguished easily from surface. As such, the Chinese

local governments are presenting a vivid double-edged character: developmental states and rent-seeking states. From the personal perspective, among the group of government officials, there are promotable officials who eagerly pursue political achievements by promoting local economic development, and there are also rent-seeking officials who are seeking personal benefits; from the organizational perspective, governments at all levels are strong developmental states at the formal institutional level, and they are also the rent-seeking type of governments at the informal institutional level. The binary institutional structure of “developmental” together with “rent-seeking” on the one hand leads to private business developing a special relationship with government officials in order to not become the rent-seeking targets; while, on the other hand, provides opportunities and space for private business to meet governments’ demands and gain support and protection from the governments.

Given this institutional environment, what kinds of practices are Chinese private entrepreneurs adopting to interact with government officials? In the next section, we will introduce main types of Chinese private business’s political activities.

3.2 Political Activities

Chinese enterprises no longer just sit there and wait for governments to issue policies, and then decide either to accept or not. Through interviews with hundreds of Chinese local entrepreneurs, high-level managers of foreign companies, and government officials, we found that, in today's China, the action of entrepreneurs taking initiatives to lobby governments is like the surging water of the Yangtze River in a hot summer...

This is how American political scientist Scott Kennedy (2005a) described the political behaviors of Chinese enterprises in the “Financial Times” on Sept. 27, 2005. The study of corporate political strategy tells us that the competition between business organizations is never mere the competition of products on the market. Winning in the public decision-making arena and gaining competitive advantages in the market by political connections is also a feasible choice across the world. This is especially true for Chinese entrepreneurs in transitional period. Compared with business leaders in the mature market, Chinese managers have to balance two tasks: building up good relationships with suppliers and clients is only a small part of their work, they need to spend more energy on cultivating and maintaining a good relationship with government officials, maximizing economic benefits while minimizing social political risks. In a word, Chinese private entrepreneurs have binary needs: one is market success; the other is social legitimacy (government officials are the people who can provide them with legitimacy) (Yang 2000). So, to most Chinese enterprises, cooperation with governments and thus maintaining a good business-government relationship can remarkably increase the value of their tangible assets as well as intangible assets (Krug and Hendrischke 2008).

Based on the institutional conditions of Western democracies, scholars observe that European and American companies mainly use three political strategies – information, financial incentives, and constituency building– to fulfill government officials’ needs of being elected and re-elected, and thereby influence officials’ preferences in decision-making in exchange for preferential policies. In the Chinese institutional environment, in which developmental and rent-seeking orientations co-exist, how do Chinese private entrepreneurs implement their political activities?

Combining various views from both academic and practitioners, and based on case studies of China’s famous private enterprises, as well as analysis of interviews with a series of small- and medium-sized enterprises, we observe that Chinese private enterprises are using five strategies to influence government officials: political participation, information communication, political connection, “red hat” and material incentive (see Table 3.1). Next, we will introduce these five strategies in detail by theoretical categorization illustrated by typical cases.

3.2.1 The Strategy of Political Participation

“Political participation” refers to entrepreneurs or other high-level managers participating in political organizations through institutionalized channels, such as the People’s Congress (PC) (the legislative body in China, equivalent to congress in the West), Chinese People’s Political Consultative Conference (CPPCC), Federation of Industry and Commerce organized by government, Party representatives, etc. Participation in politics helps entrepreneurs gain political and social status and increases their power (or voice) in making public policies. It also gives them more opportunities to get to know officials or other important people, which may create beneficial conditions for the development of their enterprises. “China Business Times” published the “Top Ten news of China’s private business of 2003” on Dec. 29, 2003, one of which was “Private entrepreneurs opened the door to dance with politics”. At least 65 of the members of the 10th session of National Chinese People’s Political Consultative Conference were from non-public sectors, which accounted for more than 2.9 % of the total members. Both the number and proportion were up on the previous session. The “Research report on China’s Private Business in 2002” shows that, up until the end of 2002, 17.4 % of the private business owners in China were elected as members of the People’s Congress, 35.1 % were elected as members of the Political Consultative Conference, and 29.9 % joined the Communist Party. In Wenzhou city, where private business is most developed in China, 956 private entrepreneurs in 2006 were elected members of the People’s Congress or members of Political Consultative Conference at county level or above. This number was 414 more than the previous session. Comparative analysis undertaken by American scholar Thomas Heberer shows that, driven by the unique conditions of the country, Chinese private entrepreneurs’ passion for participating in politics was rising strongly. It was strong, not only in comparison to European and American counterparts, but even compared to their

Table 3.1 The political activities of Chinese private enterprises

Strategy type	Activities	Corresponding government character
Political participation	Participation in and deliberation of state affairs; participation in the formulation of state policy	Developmental state
Information communication	Obtaining information on policy from governments; Presenting information about enterprises/industry to governments; Seeking help from governments directly when encountering difficulties	Developmental state
Political connection	Aligning business activities with government's objectives and fulfilling government's needs; Hiring government officials, building connections with government; Inviting government officials to visit or endorse (inviting government officials to be present at important occasions, inviting government officials to visit); Performing corporate social responsibility (establishing charity funds, supporting education, sports, health, poverty reduction and environment protection projects, actively participating in disaster relief, donating to social welfare etc.); Affiliation with government agencies or state-owned enterprises; Co-investment with state-owned property;	Developmental state
"Red hat"	Doing business by using the name of state-owned enterprise	
Material incentive	Participating in or supporting activities organized by governments financially, providing a service to governments; Funding government officials' travel, giving gifts during holidays, providing jobs for their children, or other personal services; Providing bonuses to key officials, promising senior officials power options, giving power shares/ discounted shares, commissions, bribes etc.	Rent-seeking state

counterparts in Vietnam and other transitional economies (Heberer 2003). Western academia has even coined a term for Chinese private entrepreneurs who get involved in politics: “Red Capitalists”.

The main way of political participation is direct participation in and deliberation of state affairs. Almost every one of China’s most famous private entrepreneurs carries many political titles. For example, Liu Chuanzhi, Wang Wenjing, Lu Guanqiu, Zong Qinghou and Li Dongsheng were all members of the National People’s Congress (some still are); Liu Chuanzhi and Wang Wenjing are (or were) even vice chairman of the National Federation of Industry and Commerce. The vice president of a well-known Internet company told us how his company didn’t pay much attention to participating in politics at the beginning. Then he participated in a conference as a member of the Haidian district (in Beijing) Political Consultative Conference and discovered that many high-level managers from other companies in the same industry were all members. Some companies even had three members. Then he realized his company had lagged far behind and he decided to participate actively in politics from then on.

Participation in politics provides entrepreneurs with opportunities to get involved in the deliberation of state affairs; meanwhile, it also provides entrepreneurs with opportunities to use institutional means to protect their own interests. Professor Li Hongbin and his colleagues from the Chinese University of Hong Kong have investigated the status of participation in politics by top managers at 3258 Chinese private enterprises. They suggest that private entrepreneurs use political participation as a substitute for market failure and institution failure. The lower the marketization level there is in an area, the higher the passion that exists for participation in politics. Gao Yongqiang, Tian Zhilong, and Wei Wu (2003) interviewed the members of Wuhan People’s Congress who are from businesses at both city/district levels, and found that, among the proposals raised by these members, 60 % or above were directly or indirectly related to the interests of their own companies. Gao Yongqiang and Tian Zhilong (2005) conducted further investigations into the proposals of members from enterprises and found a big proportion of them were about improvements to the environments of business, business social burdens, and government intervention in business affairs. Especially in recent years, more and more entrepreneurs are using the PC & CPPCC as official channels to submit their proposals. And such proposals reflect their policy preferences. For example, after the dispute between China’s Wahaha and France’s Danone involving their joint venture, Zong Qinghou (the owner of Wahaha) as a member of the National People’s Congress, submitted the “Suggestions concerning legislation on limitations of foreign capital monopolizing China’s industries to maintain the security of the economy” in March 2007, which sought to legislate for the clear identification of hostile acquisitions by foreign capital, and strictly limit the conditions of foreign capital purchasing Chinese companies.

The benefits of political participation are disclosed by various scholarly research and business cases. Hu Xuyang (2006) from Zhejiang province conducted research into the top 100 private businesses of Zhejiang in 2004, and found that political connections greatly helped these firms in their financing, which in turn promoting

their growth. The comparison of the following two companies in ERP business is illustrative. UFIDA – as a political connected company – got listed on China’s Shanghai Stock Exchange in April 2001 when IPO was government controlled by quota, and raised 900 million Yuan after IPO; but its competitor, Kingdee, listed on the Hong Kong Exchanges, and only raised 90 million Yuan. In addition, UFIDA purchased 400,000 m² of land in Beijing Yongfeng High Technology Industrial Base at a discounted price – a place like Zhongguancun, where the price of land is as expensive as gold. Despite its own capacity and status in the high tech industry, these two moves, which were important to the growth of UFIDA, would have been very difficult without Wang Wenjing’s (the owner of UFIDA) political connections.

The other way in which private entrepreneurs enterprises participate in politics is by being involved in governments’ policy making process. For example, one famous IT company established its own market research center to collect and provide relevant information and industrial reports to the local government every month to facilitate government decision-making. The Vanke Group – the largest real estate developer, which had insisted on doing business in transparency and eschewing bribing officials, recently started to change its stance from a “go close to the policy” approach to a “go inside the policy-making” approach. Besides doing professional and long-term policy analysis itself, in order to create a friendly environment for its own development, Vanke now is getting more involved in the policy making at the national level. The Ministry of Housing and Urban-rural Development sometimes will ask Vanke’s opinions when making industrial policies; Vanke also presents the information of the real estate industry to the Ministry. It is said that, during the time of policy making, Vanke even sends its own staff to work in the Ministry of Housing. Of the policies covering macroeconomic control of the real estate industry issued by the central government in 2007, one third was drafted by Vanke. The purpose of being actively involved in policy making, besides performing the duty of a corporate citizen as claimed by Wang Shi (the Chairman of Vanke), is to create a more preferential institutional environment for the company and the industry.

3.2.2 Information Strategy

“Information strategy” refers to the political behavior that an enterprise reports to government the condition of itself or the condition of the industry; providing relevant information, to seek government’s understanding and support. The main activities include seeking policy or relevant information from government, and reporting to government the conditions of itself and the industry. Western political scientists see the collective practice of the information strategy as the symbol of Chinese entrepreneurs officially getting involved in the public space. In recent years, with China’s political environment becoming more open, the practice of information strategy is becoming more institutionalized. The successful lobbying of the “Postal Law” draft, “Property Law” and “Company Law” by private

entrepreneurs, as well as the case of software companies convincing central government to reduce VAT, are considered model cases. American political scientist Scott Kennedy recorded Chinese software companies' achievement of reducing the VAT rate on their products in detail:

In 1994, China enforced tax sharing system reform. One of the taxes was to collect 17 % VAT from all commodities. At that time, the way to calculate VAT was to use sales income minus cost and then multiply by the 17 % tax rate. This calculation didn't consider the most important cost of software companies – the intelligence cost. Therefore, software companies were paying a tax rate which was much higher than they were supposed to pay. This unreasonable tax rate violated the common interests of the software industry. For this reason, all the middle-sized and above software companies in China filed complaints to the Ministry of Finance, Ministry of Information Industry, Ministry of Science and Technology, and State Administration of Taxation together. They sent out invitations to government agencies for meetings through industrial associations; many entrepreneurs paid visits to government officials on their own behalf, and sent different kinds of applications and reports to relevant government agencies, and lobbied in many ways. The lobbying activities of software companies lasted for several years, and the central government finally responded to this complaint. From June of 1999, the VAT for software companies in Beijing decreased to 6 %; six months later, this rate applied to the whole software industry in the country (Kennedy 2005a).

This successful case represents the emergence of collective political action in business communities in China. However, most cases of information communication between businesses and governments are carried out privately and by individual firms. On one hand, the government doesn't encourage the formation of collective action on behalf of independent interest groups. Most of the associations of industry and commerce, business associations, industrial associations, and associations of medium- and small-sized enterprises are official or semi-official associations. They do not have enough power in public decision-making. As a result, Chinese business leaders seldom pursue their interests by collective actions (Kennedy 2005b). On the other hand, due to the imperfection of China's legal infrastructure, most public decisions are issued as "business policy" instead of legislation to keep flexibility. "Business policy" mainly reflects governments' varying attitudes in terms of supporting, restricting or guiding business organizations from micro aspects. In many circumstances, certain policies only apply to certain individual enterprises (Wang 2000). Consequently, many business executives make direct contacts with government officials and lobby on an individual base (not collectively call on legislation), which constitutes the core of information communication strategy.

Among the famous private enterprises, Lenovo has been very good at reporting its requirements to government authorities during its development, and in seeking support of the government in order to create a better external environment for the enterprise. In 1994, when nationalist sentiment was very intense, Liu Chuanzhi decided to make full use of this "nationalism" wave, while using his own specialty of pleading, to present petitions for Lenovo.

On Sept. 13, 1994, he and all the top executives visited Minister Hu Qili of the Ministry of Electronic Industry. The attendees of the meeting also included two vice ministers and at

least four officials. Using this precious opportunity, Liu Chuanzhi mainly focused on “the possibilities of retaining national PC brands”. He firstly outlined how several big domestic PC manufacturers at the time were forced to give up their own brands and cooperate with foreign companies, which would result in China losing its own brands. Then he talked about how he restructured the company, and reengineered the process of PC manufacturing and sales. His statement made the officials at the meeting realize there was still hope and a chance for Chinese PC brands to survive. At the end, Hu Qili declared his determination to support national PC brands: “never give up, must have our own brands.” Then Liu Chuanzhi made some requests. He hoped the government could pay attention to Lenovo, he also hoped the government would formulate government purchasing policies which were preferential to the national industry, specifically to purchase domestically made commodities in circumstances where they were cost competitive (Ling 2005).

Another means of information communication is to directly seek governments’ support when facing difficulties. For example, in 2004, Mengniu adopted this strategy when facing an anonymous attack saying that Mengniu had produced poisoned milk. At the end of February of that year, Wuhan received 16 anonymous letters that used claims of “poisoned milk” to threaten Mengniu. Later, Guangdong province and other places also received the same kind of anonymous letters. The authorities immediately sent out notifications to stop selling all Mengniu products. Mengniu was facing a crisis of survival. In that situation, Mengniu had no other choice but to write to the Premier Wen Jiabao. The letter was sent on March 30. On April 1, Premier Wen’s response appeared on the “Yesterday’s important affairs” summary of the State Council: “This issue needs to be taken care of carefully, in order to protect the interests of the enterprise and the interests of consumers, and to maintain social security and stability.” Zhou Yongkang, Minister for the Ministry of Public Security at the time, subsequently ordered that public security departments needed to solve this case as soon as possible. Ten days later, all the suspects were captured, which closed the Mengniu “poisoned milk” case (Zhang 2006).

3.2.3 The Strategy of Political Connection

“Political Connection” refers to the strategy of an enterprise associating its business activities with government officials’ needs and preferences, increasing the relatedness and dependence of government on enterprise in order to advance the enterprise’s interests. Compared with other forms of political strategies, the strategy of political connection more directly suits the development orientations and needs of government. It also satisfies the need of political achievement of government officials. Based on our research, the most common practice of political connection is aligning business activities with the objectives of government. Governments at various levels with typical development-oriented characters all have the main objective of promoting local economic development. If business organizations can use their own capacities to help governments, to carry out business activities in the areas recommended by government officials, good relations with governments are easier to build up. Almost every successful private enterprise has had

some experience of this during their growth. Himin Solar Corporation set up its political connection with the Dezhou municipal government of Shandong Province by integrating the enterprise's strategy with the city's development strategy.

Along with the rapid growth of Himin Solar Corporation, he (Himin president Huang Ming) started to make efforts to present to the local officials the development direction of the solar industry, and the bright future of Himin. When the Dezhou government saw the thriving development of the solar industry, and started to hope it would become the pillar industry of the region, higher level government-enterprise cooperation was planned.

In early 2005, the party secretary and the mayor convened several meetings with Himin Company to discuss the development plan. After rounds of discussion, Himin Corporation came up with a whole series of plans for building a China solar city – the corporation and the government developing a city brand jointly. At the end of August, the CPC Dezhou municipal committee launched the strategic deployment for building the China solar city. Starting from the end of 2005, Himin suggested the Dezhou government bid for the sponsorship of the 4th International Solar Cities Initiative World Congress in 2010. . . this could combine corporate marketing, strategic planning and city development together . . . to achieve the goal of common existence and prosperity of both the corporation and the city. Now, this has become a major task for both Shandong provincial government and Dezhou municipal government (Wang 2006).

Geely is another case of exploiting the political connection strategy. Despite failing to obtain a permit to produce cars, Geely still enjoyed the protection of Zhejiang provincial government because Geely fulfilled the wish of Zhejiang government of having an automobile manufacturer in the province. When Geely's first car came off the production line, Li Shufu (Geely Chairman and president) prepared a large banquet to celebrate; however, he found that none of the VIPs he had invited was coming. That was when Li Shufu thought of Ye Rongbao, the vice governor of Zhejiang Province. Wan Runlong, the chief correspondent of Wenhui Newspaper in Zhejiang recorded what happened then:

Li Shufu thought of Ye Rongbao, who was the vice governor of Zhejiang province at the time. So he tried to send a fax to this female vice governor, whom he had never met or talked with, to invite her to the ceremony of celebrating Geely's first car. Less than one hour after the fax was sent, Ye Rongbao called Li Shufu back, saying that she would attend the ceremony. Since a vice governor was attending the ceremony, of course the leaders from the cities and counties would also want to come. The ceremony was a great success.

When they met, the vice governor asked Li Shufu: "What made you think of sending me a fax?" Li Shufu said: "Because I heard from a friend that you once organized a group of managers of car parts factories to visit outside the province, hoping to get more business for those factories, but got nothing. On your way back, you swore that you wish that Zhejiang has its own automobile factory." What Geely did, just fulfilled vice governor Ye's wish.

From then on, Ye Rongbao went out her way to work on getting Geely a legitimate status, and became Geely's protector and supporter (Zheng 2007).

In the history of the development of Wahaha Group, the merger of Hangzhou Can Factory set up a good foundation for its relationship with the government. After a preliminary successful period, Wahaha urgently needed to expand its production scale, thus, it needed more land. But its requests didn't get timely responses from authorities. On Aug. 14, 1991, Party Secretary Shen Zheshou and other officials of the Hangzhou government visited Wahaha. After learning of Wahaha's difficulties,

Shen Zheshou thought of letting Wahaha merge with the state-owned Hangzhou Can Factory, which was struggling financially. In this way, the can factory could provide its spare space to Wahaha, which could solve Wahaha's problems of lacking of space, and the can factory would be rescued. It would be a win-win solution. This idea received the strong support of Hangzhou government leaders. Wahaha accepted the proposal after consideration, and was quickly able to turn around the can factory's debt situation. Through this merger, Wahaha won the favour of Hangzhou government. When Wahaha was planning on expanding its business to Jiangsu market but encountered an investigation from the food and health supervision department of Nanjing, the Hangzhou government sent a negotiation team led by a vice mayor to Nanjing to negotiate. Two city governments sat together to negotiate the selling of one product, which fully reflected Wahaha's good relationship with the Hangzhou government.

During its development, Mengniu made great efforts to satisfy governments' needs and seek governments' support. When it first moved into the Shengle business zone in Horinger County, Mengniu very smartly hoisted the flag of developing local economy, which was well received by the local government. When CCTV publicized and criticized Mengniu for destroying forests to its build factories, the county magistrate, Lv Huisheng, stood up for Mengniu. Lv said Mengniu had come into the business zone and built factories at the invitation of the county: "If you really need to punish someone, punish me". Later, Mengniu used a similar approach in Inner Mongolia. It used the slogan, "cheering for Inner Mongolia", and actively tried to get the honorary name of "Milk Capital of China" for Hohehaote – the capital city of Inner Mongolia – together with other milk companies. Mengniu won the goodwill and support from the Inner Mongolian Government and the Hohehaote government through these activities. Mengniu put its own company brand under the name of the whole region and the whole industry, skillfully telling the world of its importance to the region and the industry. It also positioned itself as the biggest job-creating machine in the northwest of the country, rather than a money-making machine. All these initiatives have created enough reasons and legitimacy for Mengniu to win the support of governments (Zhang 2006).

The second approach of developing political connection is to hire government officials and set up connections. Hiring officials who are retired or hiring current officials to work as consultants in enterprises is an effective way to build political connections to serve business interests. Jianjun Zhang and Zhi-Xue Zhang recorded how a well-known enterprise in Wenzhou set up its connections with relevant authorities by hiring the retired former chief of the city finance bureau to work as its CFO. This person had been the chief of the city finance bureau for three terms and the current officials in city finance bureau and tax bureau were all his previous subordinates. Another person who used to work in the city's People's Congress now works as the chief of general office in this company. He explained the reasons business companies hired people like him were "to use the 'four remainings' of us: remaining capacity, remaining power, remaining authority, remaining networks.

Besides our experience, our connections in the governments are good assets for them.” (Zhang and Zhang 2005: 98)

Among the private enterprises we are focusing on, the former CEO of Geely Group, Xu Gang, used to be the chief accountant in Zhejiang’s local tax bureau; he was one of the most promising director-general level officials in Zhejiang Province. In 2004, Li Shufu made an offer to the previous vice mayor of Wenzhou city, Wu Minyi, who had entered the business field, asking him to be in charge of Geely’s business in Beijing. Similarly, many people in the founding team of UFIDA had backgrounds of working in governments, and these backgrounds certainly contributed to the early development of UFIDA. Wang Wenjing and Su Qiqiang used to work in the Government Offices Administration of the State Council. They learned accounting computerization quite early, and had relevant experience; meanwhile they were familiar with the needs of governments, which helped them win many customers for UFIDA. One of the most important issues at that time, and the biggest uncontrollable factor in the whole industry, was obtaining a national license from the government. UFIDA smoothly passed the examination of the Ministry of Finance and obtained a national license. This success was mostly due to the backgrounds of the two company founders, Wu Tie and Guo Xiping, who used to work in the Ministry of Finance.

The third approach of political connection is inviting government officials to visit or provide endorsement. Concrete ways include inviting officials to be present at important occasions, inviting government officials to visit the company, etc. TCL’s success in acquiring THOMSON of France by using the opportunities presented by the China-France Culture Year and President Hu Jintao’s visiting France was a very good example of this approach. TCL realized that the China-France Culture Year wasn’t only about culture communication, it was also about economic cooperation. So, when Li Dongsheng – the founder and CEO of TCL – heard about the culture year and President Hu’s planned visit, he immediately asked his PR department to contact relevant business associations and, through introductions to certain people, organize for his proposal to buy THOMSON to be delivered to Zhongnanhai, the center of China’s political leadership in Beijing. Normally, when the president of the country visits overseas, a number of business cooperation agreements go along with him. Li Dongsheng wanted his proposal to be one of them, and he was determined to add some political honor to this merger by leveraging the China-France culture exchange and the visit of President Hu. On Jan. 28, 2004, Li Dongsheng and the CEO of THOMSON of France signed the cooperation agreement establishing the TCL-THOMSON Electronic Co., Ltd in the Prime Minister’s Palace of France, with President Hu and the president of France attending the ceremony. This deal has become a typical model for Chinese enterprises to “go out”. Using this opportunity, TCL achieved some very influential publicity, and also brought itself to the notice of the country’s leaders.

Skillfully performing corporate social responsibility is another route to setting up a political connection. Ways to carry out social responsibilities include: establishing a charity fund; supporting education, sports, healthcare, poverty reduction and environmentally friendly projects; actively participating in disaster relief;

and donating for social welfare etc. Private enterprises performing social responsibility, to some extent, mainly aim at showing goodwill to society and governments. Especially since the objective of a “harmonized society” was adopted as the official objective; participating in charity programs became an essential tool for enterprises seeking to gain the recognition of governments. Shao Jie commented on the political behavior of Zhejiang Green Town Group as follows:

Even though supporting the football industry is a money-consuming job, Green Town Group is still walking down this road with no doubts... the slogan of Green Town is: Change the current desert-like situation of Zhejiang football. This is a slogan with a very strong social charitable color. Behind this slogan, there is another hidden purpose: Governments should reward enterprises who make distinguished contributions to social charity. For the real estate industry, the government's reward normally is deducting or exempting the land fee of real estate enterprises ... this kind of deduction and exemption doesn't really have very clear regulations to follow, normally being issued as governmental administrative orders or rules, so there is a lot of room for flexibility... (Shao 2002)

Mengniu Group also often plays the charity game to strengthen its relationship with governments. In 2003, during the SARS epidemic, Mengniu made the first contribution when other enterprises hadn't even responded, which won the company a good reputation. In April 2006, when Premier Wen Jiabao was visiting Chongqing, he said: “I have a wish: let every Chinese person have one cup of milk every day.” Soon after the premier's wish became known, Mengniu carried out a marketing campaign under the slogan of “one kilo of milk per day, makes the Chinese people strong”. It donated 1 year's volume of fresh milk to some rural areas in poverty in cooperation with government agencies, research institutions, industrial associations, media and many other organizations in China.

For 10 years, Wahaha has been making a range of contributions: supporting education in Hangzhou city, providing assistance to immigrants from the Three Gorges reservoir area, undertaking a merger that brought relief to three debt-ridden enterprises in Fuling city, setting up branch companies in Yichang city in Hubei Province in the Three Gorges area, Hongan city in Hubei Province – a national poverty zone area, Guangyuan in Sichuan Province, Jianguyu in Jilin Province and other places, and building HOPE elementary schools all over China. These are all examples of Wahaha making political connections through charity activities.

3.2.4 The Strategy of “Red Hat”

“Red Hat” refers to private enterprises cooperating with state-owned departments (government or state-owned enterprises) in terms of ownership, through co-investment or by paying an administration fee to attach to state entities and thus setting up a relation of common interest, in order to increase their institutional legitimacy and to gain support from governments in terms of taxation, financing, access admittance etc. During China's marketization reform, the concrete actual methods of the “Red Hat” strategy have evolved changed a lot. From the 1980s to

the early 1990s, the red hat strategy mainly presented as thus: due to the lack of protection of private property rights, private entrepreneurs had to register their enterprises as state-owned or collective-owned, or give part of the property rights or profits to local government. In this way, they were able to hide their real ownership identities, so as to cope with the political or ideological risks which private property rights might have, and to gain the legitimacy. In September 1997, the CCP 15th National Congress declared the non-public economy was an important part of China's socialist market economy. This indicated that private property rights were being recognized officially by the central government. This change of policy caused a big wave of "taking off the Red Hat" by private entrepreneurs and individual business people all over China. All kinds of "Red Hat" enterprises which were affiliated to various levels of government agencies (including township and village governments) or state-owned enterprises were able to resume their real ownership identity. A few years later, with the deepening of privatization, "Red Hat" strategy characterized as vague ownership almost disappeared.

However, the "Red Hat" strategy did not die out. On the contrary, under the institutional conditions in which huge differences still exist between state sectors and private sectors in terms of political status and access to resources, the strategy of "Red Cap" evolved into new forms. In many industries that private businesses are less legitimate, especially in those state monopolized industries, private business chose to cooperate or co-invest with state-owned properties, and formed the so called "mixed ownership". This allowed private business to keep their flexibility, while enjoying the protection of government, and the advantages of having a state background.

The experience of Far East Group in putting on and taking off the "Red Hat" twice is an excellent example of the evolvement of this strategy. In 1991, the fast-growing Far East Group encountered the difficulty of having insufficient operating capital, while their products were in short supply. Constrained by the policy at that time, its identity as a private enterprise meant it could not apply for loans from state banks. With the company's long-term development in mind, the founder of the enterprise, Mr. Jiang Xi-Pei, decided to hand over his company worthing seven million Yuan to the town government. In January 1992, Far East Group changed from being privately owned to a township government-run enterprise, thereby becoming eligible for preferential policies on bank loans, entitlements for employees, taxation etc. Two years later, Far East Group had developed extremely fast, and its net capital had increased ten times what it was before it "put on the cap".

While its performance was rapidly and soundly improving, the deep contradiction of collective property rights came along. Inside the enterprise, the powers and responsibilities were mixed, incentives were misaligned, and the performance of the enterprise was declining. In order to solve the problems brought by unclear property rights, Far East Group made its second change amid a wave of large-scale privatization of collective enterprises in south Jiangsu. In 1995, Far East Group took the lead in becoming a shareholding cooperative enterprise, in which the employees invested and became shareholders.

However, twists and turns occurred after Far East Group took off the “Red Hat”. In 1996, there was fierce competition in the power cable industry and profits across the entire industry were largely declining. Meanwhile, the industry of the power grid construction, where profits were high, was monopolized by the state. This blue sea was not open to private enterprises. In order to gain market access, Jiang Xi-Pei decided to adopt the “Red Hat” strategy again. In April 1997, Far East Group invited four state-owned shareholders, and established the Jiangsu New Far East Power Cable Co., Ltd. The mixed ownership – the new “Red Hat” – meant Jiang Xi-Pei again lost his controlling ownership, but it won him an advantage in the more profitable market. From then on, Far East Group changed from being a challenger wandering around the edge of the industry to the industry’s core. Far East Group wore its second “Red Hat” for 5 years; taking it off in 2002 when the environment for private enterprises in the electronic power industry improved.

The “Red Hat” journey of Far East Group is definitely not the single example. Among the famous enterprises we are studying, Lenovo and Vantone both can be considered practitioners of the “Red Hat” strategy. Throughout Lenovo’s maturing and development, its biggest state-owned shareholder – “the open-minded mother-in-law” Chinese Academy of Computer Science – has served as a big umbrella providing protection for the company. According to Ling Zhijun’s book, “Lenovo Storm”, when the company faced the “original sin” doubts from the public in the early days, when it went public in the Hong Kong stock market in 1994, and when its “employee shareholding” plan was implemented in 1997, at every key historical moment of the company, the Chinese Academy of Science provided strong support to it.

Mr. Feng Lun, the president of Vantone Group, uses “finding a sugar daddy” as a metaphor to describe how Vantone sought cooperation with large-scale, state-owned enterprise – Tianjin TEDA Group. In Feng Lun’s eyes, under China’s current institutional environment, private business has always been the supplement and attachment to state property. Therefore, wearing the “Red Hat” became Vantone’s means of self-protection: “cooperate or co-invest with state property, use our professional skills and strict management to preserve and increase the value of state property, meanwhile get the recognition of society and create a safe development environment.”

Besides the tactics of “being affiliated with a state-owned enterprise” in early times and “inviting state-owned capital to become a shareholder” in recent years, in practice, there is another unofficial way of practicing the “Red Hat” strategy. Under this strategy, private enterprises carry out activities by using the name of state-owned enterprises on some special occasions. Z Group provides us with a case: in 2004, Z Group intended to buy a state-owned industrial company in W Province. At that time, erosion of state property was a hot issue, so the local government kept ambiguous attitude for fear of political risk. Z Group used a method whereby it paid an administration fee to L Group, a large state-owned enterprise, and let L Group buy the targeted industrial company. In the next 8 months, L Group gradually transmitted its shares to a branch company of Z Group. By using L Group’s “Red Hat”, Z Group decreased the political risk of acquiring a state owned company under the particular institutional conditions of the time.

3.2.5 *The Strategy of Material Incentive*

“Material incentive” refers to the behavior of directly or indirectly providing governments (or government officials) with financial support or other supports. In Western countries, material incentives mainly present as political contributions, which are legal political activities under regulation. But in the current institutional environment in China, the strategy of material incentives is frequently in the grey area between legal and illegal. Material incentive not only include some officially allowed activities, for example, participating in or supporting activities organized by governments financially, or providing labor and services to governments, or giving souvenirs to government officials. There are also behaviors which are at the edge of regulation, for example, financing a government official’s travel (particularly their travel overseas), giving gifts to officials on holidays, providing jobs for their children, providing personal services, etc. There are even some practices which are cross the legal line, for example, providing bonuses to officials, promising power options, giving commissions or even bribes (Tian and Gao 2006).

In General, the practices of this strategy used by some famous private enterprises are more formal and standardized. They pay attention to avoid risks, and operate it very skillfully. For example, when UFIDA was promoting its ERP software, it committed a big amount of human resources and financial resources to organize ERP training programs in cooperation with local governments all over China, and sponsored the “Informatization of China’s enterprises 10000-miles tour” and similar seminars for other industries for the purposes of increasing the skills of customers. They invited government officials to attend all those programs and seminars. Sohu adopted the method of providing services to governments instead of direct material incentive. For example, it took over the construction of Beijing city’s portal website, Beijing.cn, and provided equipment and services to the Beijing Government.

Apart from legitimate financial and labor supports, we have to say that practices of material incentive going beyond the law are prevalent in reality. Tian Zhilong and Gao Haitao (2006) described the details of how entrepreneurs give gifts to government officials like this: “B mentioned, it is a quite common thing to give gifts to government officials, the types of gifts are various. In the early times, gifts were mainly local special products; in recent years, the types are getting more and more diverse, paintings, stamps, antiques, and other arty stuff are getting popular. . .E mentioned, it is an essential task to go to visit some leaders or key persons and give some gifts.”

Jianjun Zhang and Zhixue Zhang (2005) outlined business-government coopted practices ranging from power shares, discounted shares, to co-founded companies, among others. The general phenomenon is that entrepreneurs give shares to government officials or run businesses together with government officials to tie both sides’ interests together in order to get the support and protection of government officials. Detailed practices include: entrepreneurs give government officials shares without asking for real inputs (power share); government officials contribute very little

inputs but get larger proportion of enterprises' shares (discounted share); entrepreneurs and government officials found and run business together; and division of labor between family members (some family members work in government, while others run business). These behaviors set up a long-term relationship between businesses and government officials. Such relationships go beyond unidirectional dependence and become symbiotic, which transform government officials into advocates or protective umbrellas for enterprises. . .

Further, during our interviews, an interviewee told us what she knew about a long-term political patronage relationship between a founder of a small size real estate company and a government official:

President Zhou and Mayor Wang knew each other long before. . . President Zhou graduated from college in 1978, and was assigned to a big state-owned enterprise. His professional skill was very good, and he was good at writing. He was famous for his talents in the industry. At that time, Mayor Wang was the vice magistrate in a county. One year at the tree planting Day, the city government organized people to plant trees in an area. President Zhou also went with his leaders. That was when President Zhou and Mayor Wang met. . . After Mayor Wang was transferred to the city government, he appointed Zhou as the secretary of the city government, later sending him to work in customs for several years. In 1994, the real estate business was still quiet. President Zhou resigned from his post and started a real estate business. . . During these years, he had been following the mayor around. Mayor Wang transferred to T city, he developed his real estate business in T city; Mayor Wang transferred to R city, he followed to R city. Mayor Wang was very good to Zhou; he gave Zhou many preferential policies on loans. Zhou was also very smart. In the mid-1990s, every time he visited the mayor's home, he would bring fur clothes, watches of famous brands, which were difficult to buy in the country at the time. He even personally sent the two children of Mayor Wang's to colleges. . . these kinds of relationships are not built overnight. President Zhou made a big fortune during these years, but he never tells, he is very careful, never makes trouble for Mayor Wang. . . (Interview notes, Dec.3rd 2007)

All these cases paint a full picture of China's private businesses' political activities. After 30 years of Reform and Opening-up, Chinese private entrepreneurs are no longer the group of people who live on the edges, but become the new social forces dancing on China's economic and political platform. The double-edged characteristics of government is what caused the "double faces" of private enterprises in their political activities. On the one hand, under the strong development orientation of governments, private entrepreneurs actively pursue the preferential policies available from government: they lobby politicians, keep constant communication; they get involved in politics themselves, create their own voice; they satisfy the government's needs; they "faithfully" e, perform the responsibility and duty of being the "beneficial supplement of the public sector". On the other hand, in corresponding to rent-seeking government, private entrepreneurs are unlikely to resist the temptation of seeking political rent at low cost: they give gifts, bribes to corrupt officials, make full use of all kinds of possible means; they struggle between the political traps and the legal line, but cannot help themselves; they become the servant of rent-seeking officials, and risk their whole life's efforts to the guillotine of political struggle.

Then, what kinds of intentions and objectives do private entrepreneurs have to implement these political activities? Through enforcing political strategies, what do

private entrepreneurs expect? In the next section, we will discuss the objectives of corporate political activities.

3.3 The Purpose of Corporate Political Strategy

Always have to drink with this director, that chief, of course I'm so fed up! Last night, I had to play poker with them until 2 am, I even canceled the meeting of my own company. . . but you have to admit, there are huge amounts of resources in these officials' hands! If they draw a line with their pens (means the proportion of land for sale), make some deduction here, or give some discounts there, let's say, how many years does a salaryman have to work to earn this? We develop industry for governments, or arrange jobs for employees of state-owned enterprises, all for one purpose: to get privileges on land policy. . . . once the land is out for sale, normally it is 1.5 million per mu (a unit of area). But if your project can be listed as the city's key project or your enterprise designed as the key enterprise, the price would be 0.6 million, plus all kinds of deductions and exemptions. You tell me, how can I not be friends with governments? (Interview notes, Oct. 9, 2008)

That was the response of a young manager of a real estate company to our inquiry about the purpose of corporate political activities during an interview on Oct. 9, 2008. A few sentences vividly revealed the temptation and frustration of business people in business-government relations. Political activities with Chinese characteristics are the product of the institutional environment with Chinese characteristics. As we mentioned previously, “double faced” governments caused the double faces of business political behaviors, and behind the “double faced” political behaviors of enterprises, there are also the double expectations of private entrepreneurs.

On one hand, in order to decrease institutional risks associated with private ownership, and to defend themselves from governments or other external stakeholders, Chinese private entrepreneurs are seeking legitimacy on the legal level through political connection, political participation, “Red Hat” and other political activities. Private entrepreneurs carry out duties, perform social responsibilities, use their own expertise and organizational capacity to add value for state property and so on. All these behaviors not only tighten the tie between governments and enterprises, but are also helpful in strengthening the social and political recognition of private enterprises from the perspective of the public and dominant political ideology.

In the process of transforming from a planned economy to a market economy, the dominance of the public ownership means that “Red Hat” is still the first choice for private enterprises to deal with the risk of legitimacy. According to partial statistics, before 1992, among 240,000 collectively owned enterprises in Wenzhou, Zhejiang province, 110,000 of them were “Red Hat” enterprises (i.e., private businesses registered as collectively owned). Under the current situations of weak market institutions and insufficient protection of property rights, private enterprises use the practice of giving up part of their residual claims or submitting administration fees in exchange for resources and protection. Even with deepening of China's

marketization, in some industries (particularly those on state monopolized industries) where private business has low legitimacy, the “Red Cap” strategy is still a good option for private enterprises to improve their legitimacy. The case of Ningbo Jianlong Steel Company, which recovered from the jaws of death under the state’s macroeconomic control in June 2004 by cooperating with the state-owned Hangzhou Iron & Steel Group, illustrating the intentions of private enterprises behind the strategy of “Red Hat”.

Besides the “Red Hat” strategy, political participation and political connection are also common ways used by private enterprises to increase their institutional legitimacy. Research into Chinese private enterprises participating in politics undertaken by Professor Li Hongbin and his colleagues shows that joining the People’s Congress, Political Consultative Conferences or other official institutions can help private business leaders increase the recognition of their enterprises by the government, thereby defending themselves from external threats and institutional risks (Li, Meng, and Zhang 2006). During our interviews, we even found that, in some industries where private enterprises can hardly gain access or are easily involved in public controversy (e.g. real estate, banking, energy, telecommunications etc.), private entrepreneurs are using investment in other areas of businesses like industry, agriculture, culture and sports or other “government-pleasing” areas to ease the lack of legitimacy of their main business, thereby increasing the overall legitimacy of their enterprises. An interviewee from a real estate business explained his intention of investing in ecological farming as follows:

If only talking about money, doing business in agriculture is definitely not profitable. Even Liu Yonghao (CEO of New Hope Group) said that the profit from the agriculture business in 10 years couldn’t compare with the profit from real estate in one year! Everybody knows about this.....but engaging in agriculture is following the call of the government. Government officials love and hate real estate, but to agriculture, the whole country will give you applause! Since you want to do something for governments, it’s better to do something governments would be happy to hear and see, try not to do things against the trend of policy... (Interview notes, July 26, 2008)

Similarly, an interviewee from another real estate company frankly told us that their company’s investment in basic manufacturing had two political purposes: one was to respond to the call of the municipal government for “developing manufacturing industry to boost the city”, so it was used to trade for favorable policies in real estate; the second was to remedy the low legitimacy of its major business (real estate), “we have the industrial zone there, which helps to demonstrate that we are not just profiteering real estate developers”:

Developing an industrial park is really a costly business...but if we don’t do something in industry, we would not stand this firmly in F city, we would not have a good image in front of the government and the banks... Everybody thinks real estate is easy to do. Actually, doing real estate is full of suffering! After every round of macroeconomic control, governments and banks all avoided us like we were ghosts! Now we have built an industrial zone, things are much better. You may know, household appliance manufacturing is the foundation of F city... Just recently, our industrial zone was exposed in CCTV II’s “Economics half hour”. That really made the government officials of our city feel honored, they are happy now, so the banks are also much nicer to us. We just used the name of the industrial

zone to get an 80 million Yuan midterm loan. Otherwise, at this moment (referring to global financial crisis), which private real estate company can easily get loans from the Industrial and Commercial Bank of China? Now we even have two packs of business cards, one for real estate, one for industry. We choose which occasions to give which business cards. . . (Interview notes, Oct. 13 2008)

Seeking legitimacy is only one of the goals of political behaviors. More cases show that, in front of various government controlled resources and accesses, such as development priority, monopoly, market access and other kinds of favorable policies, private enterprises cannot resist the temptation of seeking political rent. “Political rent” refers to private enterprises using political power to gain abnormal financial returns. Entrepreneurs get “political rent” from government officials mainly through the following three methods: ① gaining access to a monopolized market, where they can sell commodities at a higher price, so the “rent” is the increase in its profit margin; ② buying resources at a price which is lower than the market price then selling dear on market, gaining an economic surplus from the price difference; ③ getting a direct subsidy from government, e.g. tax deduction, import and export tax exemption, financial allocation etc. (Ngo 2008)

During China’s market transition, because transaction cost is high due to ineffective legal and market systems, and because governments at various levels still control critical resources and accesses, political rent is everywhere. Consequently, Chinese private entrepreneurs are employing various political strategies to obtain competitive advantage from government officials, as well as monopoly rights for certain businesses or regions, trade quotas, price controls, industry access, production licenses, favorable loans and land supply, deductions and exemption from taxes or other charges, direct financial allocation, resource mobilization, local protection and other kinds of “political rent”. Since the Chinese governments are characterized by both developmental and rent-seeking, the kinds of political rents we mentioned above include the rent “unconsciously” set by governments with development orientation to remedy market failure and intervene in business activities, and also include the rent created “on purpose” by local governments to enforce local protectionism, safeguard the vested interests of state property, or even for personal benefit.

Let’s consider the role of governments as developmental states or even entrepreneurial states. The formal institution gives local officials the power to plan and allocate political rents to boost local economic development; therefore, to private business owners, the exchange of political rent with government officials is accepted and even encouraged by the current system. Ngo (2008) recorded in detail the process of Zhejiang Geely Group obtaining political rent from Zhejiang Taizhou city government. The rent included “monopoly rent” and “economic surplus”, which included tax deductions, government rewards and other direct government subsidies:

If we convert the favorable policies of Geely Group obtained from Taizhou city government to market value, the number is amazing. For example, in 2002, Luqiao district government provided 3000 mu of land to Geely for its coach production. Even though this 3000 mu was open to public bidding, the bidding guideline was clearly made for Geely, other enterprises

could not meet those standards. . . From this 3000 mu of land alone, Geely gained an economic surplus of 380 million Yuan. This is only a conservative calculation. . . Not long after, the price of land rapidly increased, and the fixed assets of Geely increased by 750 million Yuan.

In addition, Geely also obtained different kinds of administrative privileges and a large amount of fee exemptions. According to estimates, governments at all levels in Taizhou city provided tax exemptions and deductions for Geely: almost 80 million per year. In 2005, the city government gave Geely 600,000 Yuan cash as a reward for Geely's six new types of cars coming off the production line. . . The local government also bought 10,000 cars from Geely through government purchasing or other ways. All these actions were carried out in the name of supporting local industry. . . Without the support of local government, we doubt if Geely could have the capacity to compete with other state-owned monopoly automobile enterprises in the car industry. . . (Ngo 2008)

Ngo argues that the huge amount of political rent which Geely Group obtained from Taizhou government is absolutely not rare. . . In fact, this has become a common way of regional governance. Many private enterprises use the political rent they obtained from governments for competitive advantage with other companies in the same industry. . . The examples we listed above are only the political rents at the official institutional level which were set in the name of industrial development. There are still many kinds of privileges that private entrepreneurs got from government officials from time to time that are not included yet.

Therefore, we argue that there are double motivations driving Chinese style corporate political activities. There is the pursuit of institutional legitimacy, and also the seeking of political rent. The enthusiasm for political activities by private entrepreneurs is grounded in both defensively avoiding harm and offensively seeking benefits. It is precisely the co-existence of motivations for "legitimacy" and "political rent", which look contradictory but are actually harmonious, causes complex, diverse, twisted and dishonored political activities of China's private business.

3.4 The Evolution of Business-Government Relations

On March 14, 1993, the first session of the Eighth National Political Consultative Conference opened. The president of Sichuan New Hope Group, Mr. Liu Yonghao, walked into the Great Hall of the People. . . In this political consultative conference, there were also another 22 members who were from private business circles, including Zhang Hongwei, who walked in together with Liu Yonghao. They were all holding cell phones, and they were the representatives of the flourishing private business sector, which attracted the attention of most Chinese and foreign journalists. They were only 1 % of the total 2093 members; however, they signaled an important change which means that private entrepreneurs have entered China's politics (Wu 2008).

In the 30 years of China's Reform and Opening-up, new systems and old institutions often intermingled together. From the moment private entrepreneurs returned to the political arena, China's business-government relations have evolved. Private ownership is no longer a taboo in China, the rights for individuals to pursue

their own interests and the differentiated life values have become public topics. Political behaviors are more and more up to private entrepreneurs' individual choices, instead of being solely influenced by the external institutional environment. With the co-evolution of private enterprises and their institutional environment, the political behaviors of enterprises and business-government relations also evolved.

First of all, with the change of the composition of the national economy in terms of ownership types, the importance of private sector in China's economy is more obvious. Along with the rise of their economic status, private entrepreneurs are gradually becoming an independent social class. They are no longer just a vague symbol living in the cracks between a planned economy and a market economy. As aforementioned, we can see how political participation and information communication as new types of political strategies are becoming popular. Chinese business elites are therefore engaging conversations with political elites with more and more independent interests and views. Western political scientists have described private entrepreneurs as "the new strategic force of China": the rapid rise of this social group not only represents the emergence of a new interest group; more importantly, their voices and behaviors have instilled new values and cultural icons to traditional Chinese society (Heberer 2003).

Indeed, the rise of private business indicates that Chinese business-government relations are transforming from corporatism to pluralism. But the growing path of the Chinese entrepreneurial class is strikingly different from what is described in mainstream political theory. During China's institutional transition, the growth of private entrepreneurs did not necessarily create interest and cultural conflicts between businesses and governments like what some Western scholars expect; on the contrary, business elites who grew up in China almost unexceptionally cultivate their close ties with governments and government officials with a cooperative attitude. Some Chinese entrepreneurs feel grateful for the government that implemented economic reform and carved space for them. They not only comply with government with a cooperative mode, but also actively participate in various government organized industrial and commercial associations, trade unions and other kinds of semi-official associations, actively building their relationships with government officials (Tsai 2008). Djankov, Qian, and other scholars (2008) conducted a research on a total of 414 entrepreneurs from Beijing, Shanxi, Guangdong and Hubei, and the results suggest: Chinese entrepreneurs hold a much more positive view about the institutional environment compared to other social groups. Compared with other social groups, entrepreneurs are more likely to look at taxation, macroeconomic control, regional government behaviors, corruption and a series of other hot issues from a positive perspective.

Secondly, with their increasing influence in terms of control of resources, business-government relations have evolved from unidirectional dependence of business upon government at the beginning of economic reform to symbiotic relations between the two. From a sociologist Keng Shu's interviews with enterprises in Beiyuan town, Jinan city in Shandong Province, we found that, over time, the scale and scope of networks of entrepreneurs have expanded rapidly in the business world. Suppliers, customers, competitors and other business partners are

becoming increasingly important in entrepreneurs' networks, which has decreased the importance of government officials as stakeholders that entrepreneurs used to depend on. Another factor is that the official evaluation and promotion system of CCP has also been reforming: the promotion of officials is more and more subject to their capacity to manage the local economy and their political achievements. Consequently, business-government relationship is no longer a vertical connection, but a horizontal connection forged by their symbiotic resource dependence (Keng 2001).

Western political scientists describe the dependence of government officials on entrepreneurs in the following way. On one hand, to formulate development plans, government officials need to have certain knowledge of the relevant industries. And entrepreneurs are the perfect source to provide the information. On the other hand, business prosperity is crucial to economic growth, employment, tax revenues as well as other aspects. All these indicators are the key part of the government official's performance evaluation. Therefore, government officials would certainly leave some space for entrepreneurs on the negotiation table of public policy decisions (Kennedy 2007).

The prevalence of the strategy of political connection provides evidence that government and enterprises are going into this partner relationship as equals. As we discussed previously, government officials provide favorable policies to private enterprises, and private entrepreneurs contribute to government officials' promotion. The interaction behind this political strategy is very much like the "political market" in the Public Choice Theory: the entrepreneur is the demander of public policy, and the government official is the supplier of public policy; entrepreneurs use all kinds of political "contributions" to "buy" favorable public policies. In the "political market", which constitutes both demand and supply sides, economic actors no longer show up as conformers, but play the role of resource exchangers. Activities of building political connections are everywhere, from which we can see that business government exchange is gradually being accepted by both political and business actors. China's commercial system has already grown out of the traditional patron-client era; the patronage relationship between governments and enterprises is not the key feature of Chinese business-government relations anymore.

Finally, along with the improvement in market development, business political activities are no longer necessary choices for private enterprises to avoid risks, they are becoming discretionary options influenced by entrepreneurs' value orientation and concept of competition. To most private enterprises, the effects of political behaviors to business organizations are more and more like market investment activities; entrepreneurs have more discretion to decide whether and how to participate in political activities. Let's use the strategy of "Red Hat" as an example: if we say, in the early stage of reform, the "Red Hat" strategy was an option in which private enterprises had to trade their ownership for survival, then, since the CCP's 15th National Congress in 1997, which acknowledged the legitimate status of private ownership, "Red Hat" has become a rational choice of private enterprises based on calculation of benefits and costs. Similarly, information communication in early times only happened in emergencies; but, in recent years, enterprises have

started to take the initiative to communicate with governments. In software and other new industries, strong industrial associations are having a big influence. This means enterprises' political behaviors have become a strategy for private enterprises to cope with the institutional environment, and are no longer a compromise to the pressure of the institutions. Government agencies are no longer the only supplier in China's institutional environment; the participation in institutional innovation by entrepreneurs has become one of the features of China's business-government relations. Private enterprises are using various political behaviors to interact with the stakeholders of the system, through which the co-evolution of business organizations and the institutional environment are being pushed forward.

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