

The Paradox of Political Legitimacy: Political Inclusion and Firm Strategies of Entrepreneurs

ABSTRACT

This paper examines the paradoxical impact of political legitimacy by exploring the relationship between legitimacy due to political inclusion by the state and subsequent strategic actions by entrepreneurs in both domestic and global contexts in a transition economy. We argue that political legitimacy from the state affects a firm's strategies in different ways due to both benefits and constraints associated with acquired legitimacy. With a unique dataset of more than six thousand privately-owned enterprises in China, we demonstrate that after an institutional change signifying the inclusion of entrepreneurs into the elite political systems (the Communist Party of China) in China in 2001, private firms were more motivated to invest in their domestic production, but became less incentivized to form international cooperation strategies. We further find that the impact of the legitimacy from political inclusion on domestic production was less pronounced for firms in places where the market economy was more established and when entrepreneurs are female. For entrepreneurs with past working experiences in the government or in state-owned enterprises (SOEs), the negative impact of political inclusion on global cooperation was strengthened. These findings have important implications for the research of legitimacy, entrepreneurship, and business strategy.

Keywords: entrepreneurship; political legitimacy; firm strategy; political inclusion; marketization; female entrepreneurs

INTRODUCTION

There is a scholarly consensus that start-ups normally lack legitimacy in part because of the uncertainty about their future prospects (Bruton, Ahlstrom, & Li, 2010; Zimmerman & Zeitz, 2002). Legitimacy can be understood as “the perceived appropriateness of an organization to a social system in terms of rules, values, norms, and definitions” (Deephouse et al., 2017, p. 31). Any legitimacy that founders or leaders can bring to a start-up can be crucial to its survival (Delmar & Shane, 2004; Fisher, Kotha, & Lahiri, 2016). Literature has documented that entrepreneurs work hard to build market legitimacy in order to receive support for their ventures from various stakeholders (Bruton et al., 2010; Navis & Glynn, 2010; Lashley & Pollock, 2020). However, while the existing literature has paid considerable attention to the positive effects of legitimacy on entrepreneurial activities, there could be possible constraints associated with entrepreneurs’ acquired legitimacy. As illustrated in prior literature on legitimacy, an action that brings organizations the benefits of legitimacy from one stakeholder could result in disapproval from other stakeholders (Sonpar et al., 2010) since organizations are often constrained by conflicting demands in an institutional environment (Oliver, 1991; Pache, & Santos, 2010). It is thus important for us to explore the multifaceted roles of legitimacy in entrepreneurial activities in different contexts to enable a more comprehensive understanding of the relationships between entrepreneurs and external stakeholders.

In this study, we explore the paradoxical impact of political legitimacy by examining the strategic consequences of the inclusion of entrepreneurs as insiders by the state in both domestic and global contexts. By political legitimacy of entrepreneurs, we refer to the generalized perception or assumption that entrepreneurs’ existence and business activities are desirable and appropriate within a particular political system. The elites in business or government often form

a closed group with clear boundaries separating them from outsiders (Moore, 1988). Prior literature has suggested that entrepreneurs can acquire political legitimacy from established institutions that make decisions and exert power in the development of new ventures (Díez-Martín, Blanco-González, & Prado-Román, 2016), while being recognized as a legitimate member of the state could provide them with additional resources, information, power and prestige, and, not least, a sense of identity (Dow & Reed, 2013). It is important to understand whether such benefits of legitimacy come with constraints, and subsequently how entrepreneurs adjust their domestic and global strategic actions. Understanding these issues will broaden scholarly understanding of the paradoxical impacts of legitimacy and also help explain the interactive relationships between entrepreneurs and the state.

We investigate our research questions in the context of the emergence of the private sector and entrepreneurs in China. In particular, we focus on the political inclusion and recognition that the Communist Party of China (CPC) granted to private entrepreneurs in 2001. As a party rooted in Marxism and Leninism that emphasizes the interests of the so-called proletariat and denies private ownership rights, private entrepreneurs were not viewed as “insiders” by the CPC, despite the economic reforms and the open door policy since 1978 (Brink, 2012). For example, few laws were established to protect the rights of private owners and to recognize the legitimacy of their business activities (Nee, 1992; Bai, Lu, & Tao, 2006). This situation did not change until July 1st, 2001 when Zemin Jiang, then the general secretary of the party, delivered his speech at the 80th anniversary of the CPC. This speech, with the key focus on the “Three Represents¹”, recognized the political status of entrepreneurs of private firms and allowed them to join the CPC. Being recognized as insiders, private entrepreneurs are thus politically included in the

¹ “Three Represents” eventually became the Party's Mission Statement: http://en.people.cn/200211/13/eng20021113_106747.shtml, last accessed January 30, 2021.

ruling party. Such political inclusion provides private entrepreneurs with regulative, normative and cultural-cognitive foundations of legitimacy (Deephouse et al., 2017).

Building on the theory of legitimacy (Powell & DiMaggio, 1991; Suchman, 1995; Sullivan et al., 2007), we theorize that having received recognition as insiders by the ruling party in China, entrepreneurs are likely to acquire a higher level of political legitimacy affecting subsequent entrepreneurial strategic choices. While multiple benefits from the legitimacy of political inclusion could increase the investment by private firm entrepreneurs in their own domestic production, stronger alignments with CPC in this legitimization process could lead to negative perceptions by overseas stakeholders about the influence of the CPC on the firms' operations (e.g., the controversy over Jack Ma being a CPC member²), potentially decreasing the opportunities in forming international cooperation. We further theorize that internal and external factors, including entrepreneur gender, past working experiences and provincial marketization levels, moderate the paradoxical impact of legitimacy from political inclusion.

Our study makes several important contributions to the literature. First, we contribute to entrepreneurship research by investigating the impact of insider recognition by an elite stakeholder in a society (the CPC in our study), an area that has been insufficiently explored in studies on individual entrepreneurs. Earlier studies on entrepreneurs have mostly focused on how entrepreneurs achieve market legitimacy (Fisher et al., 2017; Navis & Glynn, 2010). We therefore extend the research on entrepreneurial legitimacy by examining the impact of such legitimacy endowment by elite groups on strategic implications for private firm entrepreneurs. By doing so, we look at entrepreneurship research through an institutional lens and respond to

2 Why is Jack Ma a member of the Communist Party of China? <https://www.bbc.com/news/business-46353767>, last accessed January 30, 2021.

the call for more research grounded in the institutional environment (Bruton et al., 2010; Puffer, McCarthy, & Boisot, 2010). Second, our findings will enrich the research on legitimacy in organizational settings (e.g., Bitektine & Haack, 2015; Ruef & Scott, 1998; Suchman, 1995) by revealing that legitimacy enhancement of private firm entrepreneurs could be a double-edged sword: while the legitimacy could be conducive to domestic business operations, it might be detrimental to entrepreneurs' international operations.

Third, this research contributes to studies of top management by highlighting the importance of institutional environment in shaping the influence of top managers on firms' strategic decisions (Hambrick, 2007; Hambrick & Mason, 1984). By doing so, we respond to the call to consider the interactions of firm elites' attributes and institutional forces in the studies of top management (Hambrick et al., 2005; Yamak, Nielsen, & Escribá-Esteve, 2014).

THEORY AND HYPOTHESES

Political Inclusion and Political Legitimacy

As demonstrated in prior literature, entrepreneurs prefer not to be isolated from external stakeholders in their business endeavors. External stakeholders play important roles in entrepreneurs' business activities. For instance, entrepreneurs or entrepreneurial firms display various behaviors in order to acquire legitimacy from certain groups (Garud, Schildt, & Lant, 2014; Fisher, Kuratko, Bloodgood, & Hornsby, 2017). In emerging markets, it is even more important for entrepreneurs to gain legitimacy from external stakeholders as the legal or societal uncertainties are greater and their new ventures more vulnerable (Ahlstrom, Bruton, & Yeh, 2008; Tsang, 1996). The importance of external stakeholders to entrepreneurs is also reflected in situations where entrepreneurial activity might be initially viewed as illegitimate (Tornikoski &

Newbert, 2007). While the existing literature has carefully examined how entrepreneurs gain market legitimacy by pursuing relationships with external stakeholders, it has largely ignored the impact of the state's actions toward entrepreneurs on the latter's perceptions and strategic actions and has paid little attention to legitimacy constraints that could affect a firm's domestic and global strategies.

Under the planned economic system in China before the economic reform in 1978, private business activities were strongly discriminated against and private entrepreneurs had low political and social status. Supporters of private businesses were called "dogs of the capitalists". This situation remained unchanged for many years even following the economic reform in 1978, as the CPC continued to emphasize close relationships with state-owned firms. A well-known example is that Guangjiu Nian, founder of 'Fool's Melon Seed' (*Shazi Guazi*) in Anhui Province of China, was imprisoned in 1991 for management practices such as selling products with prizes. In the early 1980s, he even encountered problems when hiring over 100 employees for his company, regarded as inconsistent with the principles of socialism (Zhang & Alon, 2009). Although Nian made a considerable amount of money, he never achieved high legitimacy in the eyes of the society or the CPC.

By acknowledging private entrepreneurs as part of the ruling party and providing them with access to policy decision-making, the reform in 2001 changed the political and social environment for business operations, and entrepreneurs were praised as the "builders and contributors" of China's development. Private business activities were no longer a threat but seen as beneficial to the country (Dickson, 2007). Entrepreneurs were endowed with political legitimacy by being recognized as insiders of the powerful ruling party. Specifically, since entrepreneurs could join the CPC, the CPC started to build its committees or branches in these

private firms ever since then (Cheng, 2022; Ma & He, 2018). Statistics show that 1.9 million (about 68%) private firms have established party branches by 2016 (The Organization Department of the CPC, 2017). Party membership enables private entrepreneurs to acquire resources, information, and access to the government's attention (Ma & He, 2018). Second, due to this political inclusion policy, entrepreneurs have been incorporated into the political system as deputies to the People's Congress or members of the Chinese People Political Consultative Conference (Tian, Gao, & Cone, 2008). Such institutional arrangements could allow private entrepreneurs to formally achieve legitimacy and have a say in the political system. CPC and the government also start to use other channels to incorporate the private sector such as inviting private entrepreneurs to join the All-China Federation of Industry & Commerce (a semi-government chamber of commerce under the leadership of the CPC) and regularly holding seminars or symposia to collect opinions from the private sector (Tian et al., 2008). Overall, these new arrangements played important roles in legitimizing the private sector (Guiheux, 2006).

Prior literature has revealed that a firm's elite personnel can significantly influence the decision-making processes of the firm (Hambrick & Mason, 1984). As firms tend to reflect the views of top executives such as the CEO (Carpenter, Geletkanycz, & Sanders, 2004; Hambrick, 2007), firm behavior is the product of the values, beliefs, and cognition of these executives (Carpenter et al., 2004). Accordingly, the enhanced legitimate standing of entrepreneurs is likely to influence a firm's strategic choices. In this research, we argue that the enhanced legitimacy experienced by the private firm entrepreneurs as a result of the political endowment by the party are likely to be positively associated with firms' investments in their domestic production, whereas the decisions of the firms are closely linked to the role of state policies and expectations.

At the same time, firms would be less devoted to foreign markets, where close associations with the CPC might give negative impressions.

Endowed Legitimacy and Firms' Market Strategies by Entrepreneurs

A high level of legitimacy is likely to give private firm entrepreneurs more confidence in their local business. Political uncertainty is a major distortion factor in the entrepreneurship especially in emerging economies (Shi, Markóczy, & Stan, 2014). Start-up companies often attempt to reduce such uncertainty by building political connections and acquiring exclusive information and resources, usually resulting in more investment and better performance (Bazerman & Schoorman, 1983; Certo, 2003; Gale & Buchholz, 1987; Shaffer, 1995). In the context of this study, the enhanced legitimacy from the political inclusion could influence the strategic choices of the entrepreneurs by inducing changes to entrepreneurs in terms of the institutional environment faced them, the nature of their social and cultural embeddedness, and the transaction costs by the firms in the market. On the one hand, political legitimacy from political inclusion could be highly conducive to entrepreneurs' business operations in the domestic business environment. First, possessing higher legitimacy from the political inclusion as an insider of the CPC indicates that the entrepreneurs would have more control over the institutional environment in which their business operates. Such enhanced legitimacy and subsequent close relationships with the ruling party could help the entrepreneurs acquire support from other stakeholders who are under the influence of the party and the government. Consequently, entrepreneurs could more efficiently access needed information and resources that are important for their development in an institutional environment supported by the party (Ma & He, 2018). Second, the embeddedness of the entrepreneurs in the political system also allows them to obtain attention and approval from the CPC and the government, and as a result, private

firm entrepreneurs could have more convenient channels to communicate with different levels of the party committee (Chen, 2015). Furthermore, higher legitimacy could embolden the entrepreneurs to build political ties to acquire additional resources for expansion in different provinces of China. Chinese provinces are protective of their provincial markets, entry into which often requires additional help from local government (Young, 2000). New political ties and additional resources thus could help firms overcome internal market barriers, reduce search and negotiation costs, and expand more smoothly in the domestic Chinese market. Improved market access would lead to increased willingness of entrepreneurs to invest in their businesses. Therefore, political inclusion enabled political legitimacy is likely to lead firms to operate more efficiently and effectively in the domestic business environment.

On the other hand, however, as the domestic environment becomes more friendly with the enhanced political legitimacy, such enhanced legitimacy level could also decrease a firm's emphasis on the global market, due to possible constraints associated with the legitimacy of being insiders of the ruling CPC. The enhanced legitimacy from the CPC political inclusion is likely to induce different changes in the institutional environment, social and cultural embeddedness, and transaction costs in an international environment. First, the literature on firm cross-border activities has shown that international expansions can be costly and risky (Zaheer, 1995). Close associations with the CPC could raise suspicion and fear among overseas stakeholders about the influence and interests of the Chinese government on a firm's strategic actions (Globerman & Shapiro, 2009; Kolstad & Wiig, 2012). As a result, those endowed by the CPC and with close associations with China's ruling party may experience increased uncertainty in the institutional environment, making international business increasingly costly and risky. Second, the suspicion and the fear among overseas stakeholders could hamper Chinese

entrepreneurs' efforts to be culturally integrated into the overseas environment, increasing the cultural distance between the focal country and the hosting country. Cultural difference, which is the difference in the value set between different countries, was revealed to be influential in firms' internationalization process (Beugelsdijk & Mudambi, 2014). Firms were found to be less likely to invest in a country with a high cultural distance (Beugelsdijk et al., 2018). Subsequently, those with the endowment from the CPC could be deterred from investing overseas when facing increased cultural distance. An unfriendly institutional environment and increased cultural barriers will likely increase the costs for the entrepreneurs to search, negotiate, and execute agreements in foreign markets during the internalization process, thus deterring their investment in such environments.

Further, firms will need to comply with the expectations of the ruling party and the government. During the period when the government prefers firms to invest more in the domestic market, those with enhanced political legitimacy are likely to feel obliged to conform to government expectations. During the period we are examining, China encouraged domestic investment to boost economic development and maintain local employment. Thus, private firm entrepreneurs with endowed legitimacy were likely to follow party and government expectations. With their attention on domestic investment and with limited resources, private firm entrepreneurs are less likely to engage in overseas cooperation. Given the deterrent factors from the overseas markets and pulling forces from the domestic market, therefore, an increase in the political legitimacy of private entrepreneurs due to the political inclusion is likely to expand their domestic business but reduce their tendency of cooperating with international partners.

Hypothesis (H1). *Political inclusion by CPC in 2001 is positively associated with an entrepreneurial firm's investment in its domestic production.*

Hypothesis (H2). *Political inclusion by CPC in 2001 is negatively associated with an entrepreneurial firm's tendency to form international cooperation.*

We argue that the above effects may have certain boundary conditions. Although political inclusion was granted to private firm entrepreneurs, strategic choices by the entrepreneurs with the enhanced legitimacy could vary depending on internal and external factors that affect how private firm entrepreneurs respond to such an induced change in legitimacy from the political inclusion and validate the paradoxical impact of legitimacy. On the internal side, we focus on the characteristics of entrepreneurs. Due to gender differences in China's political participation, the reform would differently impact male and female entrepreneurs. Entrepreneurs' past working experiences in the government or SOEs can also influence how entrepreneurs respond to political reform and, in turn, the entrepreneurial firms' strategies. On the external side, we investigate the impact of provincial marketization, an environmental factor reflecting the development of the market where a firm operates. We explain the rationale in more details below.

Moderating Roles of Internal and External Factors

Existing studies have shown a significant gender difference in China's political participation (Tong, 2003). Although there is a call for gender equity, women's participation in the political system has not significantly improved and is not comparable to many western developed countries (Zeng, 2014). For instance, there are relatively few women occupying high profile political positions in China, particularly in the central committees of the CPC and in central government. The perceived stereotype of women as less competent or suitable for engaging in politics is also a constraint on their political participation (Guo, Zheng, & Yang, 2009; Wang & Dai, 2013). Also, there is a lack of systematic support for women's engagement in local power structures, despite the fact that men and women have a similar level of self-awareness that they

have the abilities to engage in political matters (Guo et al., 2009, p145). This gender inequality in China's political landscape suggests that in the domestic market, male entrepreneurs are more likely to have information and resource benefits with enhanced legitimacy from political inclusion. As suggested by the rule of homophily, individuals are likely to interact with others similar to them, such as the same gender (McPherson, Smith-Lovin & Cook, 2001), male entrepreneurs are thus more likely to have access to information and resources in the control of male counterparts in the institutional environment. Further, the homophily rule also suggests that political ties coming along the enhanced legitimacy from political inclusion are much easier to establish for male entrepreneurs than female ones since individuals with the same traits tend to form stronger ties (Ruef, Aldrich & Carter, 2003). Consequently, male entrepreneurs are more likely to benefit from the enhanced legitimacy of political inclusion and an entrepreneurial firm with a male leader is more likely to invest domestically. In international markets, however, male entrepreneurs could face more institutional and cultural barriers due to their closer connections to the government. The negative effect of enhanced legitimacy from political inclusion can be heightened for entrepreneurial firms with a male leader. Therefore, the effect of enhanced legitimacy on domestic investment and international cooperation intention would be stronger for firms with male entrepreneurs. Thus, we have the following hypotheses:

Hypothesis (H3a). *The positive effect of political inclusion on an entrepreneurial firm's investment in domestic production is stronger for firms with male entrepreneurs.*

Hypothesis (H3b). *The negative effect of political inclusion on an entrepreneurial firm's intention of international cooperation is stronger for firms with male entrepreneurs.*

Furthermore, an entrepreneur's past working experiences in the government or SOEs should affect how they responded to the political reform in 2001 and their strategic choices. Among

private firm entrepreneurs, a certain proportion of them worked previously as employees in the government or state-owned enterprises. To illustrate, in the year 1992, inspired by Xiaoping Deng's talk during his trip to Shenzhen, more than 120,000 officials resigned and started to do business in the private sector. Many of them founded their own enterprises (Dickson, 2007). Their entrepreneurial actions acquired a unique name in Chinese: *XiaHai* (literally translated as "into the sea", meaning to join the private business sector) (Huang & Chen, 2016; Dickson, 2007).

When private firm entrepreneurs received political recognition and legitimacy from the state after the 2001 reform, we argue that those with working experiences in the government and state-owned enterprises would respond to the policy change even more strongly and their strategic choices are more likely to be influenced by the changes in legitimacy from political inclusion. As we explained earlier, private entrepreneurs typically face a less favorable and less friendly institutional environment in China (Fan, Wong, & Zhang, 2007), often threatened by political hazards. For example, unauthorized levies and appropriation as well as limited formal protection of property rights lead private entrepreneurs to have a substantial level of uncertainty and a sense of insecurity when doing business (Bai, Lu, & Tao, 2006; Jia & Mayer, 2017). For entrepreneurs who had earlier working experiences in the government or SOEs, their earlier employment experiences could help them to better utilize the benefits of their political legitimacy through their political connections. After acquiring legitimacy through political inclusion as entrepreneurs, they are likely to react to the policy change more positively and became more inclined to invest domestically. Further, with enhanced legitimacy from political inclusion, it would be much easier for entrepreneurs with earlier working experiences in government and state enterprises to develop and expand their political ties to acquire necessary information and

resources. As a result, they would further increase their investment domestically. Meanwhile, however, their earlier government or SOE working experiences would incur even more concerns that overseas stakeholders might view them as less independent and more associated with the ruling party – that is, the CPC. Therefore, they are likely to experience an even higher level of uncertainty in international cooperation as well as more cultural and institutional barriers, leading to further reduced international cooperation with overseas partners. In sum, the paradoxical effect of the legitimacy of political inclusion would be strengthened if an entrepreneur has earlier working experiences in the government or SOEs. Thus, we have the following hypotheses:

Hypothesis (H4a). *The positive effect of political inclusion on an entrepreneurial firm's investment in domestic production is stronger for firms whose owners had working experience in the government or state-owned enterprises.*

Hypothesis (H4b). *The negative effect of political inclusion on an entrepreneurial firm's intention of international cooperation is stronger for firms whose owners had working experience in the government or state-owned enterprises.*

We finally hypothesize on how an external factor, the marketization level of the province where the firm is located, would moderate the effect of legitimacy enhancement on firm strategies. According to institutional theory, the institutional environment shapes firm behavior and strategy (North, 2005; Peng, 2003; Peng, Wang, & Jiang, 2008). Marketization is a form of institutional development indicating the extent to which the market can meet the needs of business activities (Chan, Isobe, & Makino, 2008). A high level of marketization can indicate well-developed economic, social, and political institutions (Meyer & Nguyen, 2005). For example, in places with a high level of marketization, the market can allocate resources and

determine the prices of products, legal enforcement tends to be strong, and developed intermediaries abound (Meyer & Nguyen, 2005). China's transformation from a planned economy to a more market-oriented one involves a systematic reform of its social, economic, and legal systems. However, as is often the case in emerging economies, the process is not uniform across different regions or provinces (Zhou, Gao, & Zhao, 2017). In general, the eastern part of China has better market development than the western part of China (Fan, Wang, & Zhu, 2011). As China undergoes reform, continues to open up, and continues to be actively involved in globalization, the market development of each province is also changing rapidly (Fan et al., 2011).

We expect that private firm entrepreneurs would value political legitimacy more in relatively less developed provinces. In the provinces where markets are better established, firms are less worried about improper government intervention or appropriation (Jia & Mayer, 2017) and firms are less likely to rely on political legitimacy and political ties for information and resources for business operations since the market can serve as an effective alternative channel for information exchange and resource allocation (Peng et al., 2008). On the other hand, since the market as a channel for information exchanges and resource allocation is weak in less developed provinces, the information and resource benefits from the enhanced legitimacy of political inclusion become more important to entrepreneurs in these locations. Therefore, the effect of association with political parties should be more important for firms operating in provinces with worse market development. In these places, the acquired political legitimacy derived from being recognized as an insider of the elite group would have more impact on firm strategy. Consequently, private firm entrepreneurs in less marketized provinces will be more likely to engage in domestic investment. In the international markets, however, the negative effect of legitimacy from

political inclusion can be strengthened for entrepreneurs in less marketized regions due to their reliance on the government. The even closer relationships with the government as a result of the enhanced legitimacy from political inclusion in less developed areas lead to a higher level of uncertainty, and even more institutional and cultural barriers in the international business environment. Therefore, we suggest the following hypotheses indicating an increased paradoxical effect of legitimacy from political inclusion:

Hypothesis (H5a). *In provinces with lower levels of marketization, the positive effect of political inclusion on entrepreneurial firm's investment in domestic production will be stronger.*

Hypothesis (H5b). *In provinces with lower levels of marketization, the negative effect of political inclusion on entrepreneurial firm's intention to form international cooperation will be stronger.*

METHODS

Data

In this study, we utilize data from a nationwide longitudinal survey of privately owned enterprises (POEs) jointly conducted by the All-China Federation of Industry and Commerce, the China Society of Private Economy at the Chinese Academy of Social Sciences, and the United Front Work Department of the Central Committee of the CPC. The survey comprises multistage stratified random samples of POEs across all provinces and industries and has been conducted every two years since 1993. These POEs represent both large firms and individual household enterprises drawn from 31 provinces across mainland China. Data was collected through detailed interviews with private firm owners, focusing on their backgrounds and views as well as their

firms' size, history, financial conditions and business plans. Thus, the data quality can be ensured. Some earlier published research focusing on state-firm interactions in China used this series of data (e.g., Jia, 2014; Jia & Mayer, 2017; Ma & Parish, 2006). We selected two main samples from the years 2000 and 2002 for our analysis because our focal policy change – the announcement that granted private firm owners the right to join the CPC – took place fourteen months after the fourth wave of the survey (2000) and nine months before the fifth wave (2002). The timeline of events is illustrated in Figure 1. With information both before and after the announcement, we could study its consequences. In the following empirical section, we examine how this announcement affects firm strategies.

[Insert Figure 1 here]

The other part of our dataset comes from the NERI index of marketization at the province level in China (Fan et al., 2011). The original authors compiled this aggregate index as a general measure of business freedom and institutional development in each province, by combining official economic statistics and field surveys. This index has often been used in prior China-related studies in well-known journals (e.g., Jia, 2014; Zhou et al., 2017).

Dependent Variables

Firm's investment in domestic market was indicated by earnings (in 10,000 Chinese *yuan*) that a private firm allocated and invested in their own production over a year. This amount was reported by entrepreneurs in the survey. Investment in their firm's production shows the entrepreneurs are committed to developing their business on their own (Jorgenson, 1972). For Chinese entrepreneurs during that time period, their own production business is mostly domestic.

Firm's intention of establishing international cooperation was indicated by a survey question on whether the firm currently cooperates and shares resources with a foreign company.

Respondents were asked in a multiple-choice question whether they have established relationships with foreign companies and if not, whether they were planning to. Specifically, the choices available were: “We have ongoing collaborations with foreign companies”; “We are contacting foreign companies”; “We intend to establish foreign contact in the next three to five years”; “Neutral”; and “We do not want to cooperate with foreign companies”. Our dependent variable takes the value of “1” if firm owners indicate they have ongoing collaborations with foreign companies (the first choice). It takes the value of “0” if the owner answered otherwise. We note that our results may be sensitive to how we code this variable. In the Online Appendix A, we show that if we include those firms that were contacting foreign companies during survey time (the second choice) and code them as “1” too, estimation results remain robust.

Independent Variable

Our independent variable, *political inclusion*, was indicated by the CPC announcement of inclusion policy in 2001. We used an indicator that takes the value of “1” for the sampled firms in year 2002 and zero for the sample in 2000. We compared firm strategies before and after the announcement of CPC inclusion policy in 2001.

Moderators and Control Variables

Gender is a dummy variable which takes the value of “1” for male entrepreneurs and “0” for female ones. Because we have hypothesized that male entrepreneurs would benefit more from the reform and consequently, they were more responsive to the change, we classified them as the treatment group. Female entrepreneurs are the control group.

Working experience in the government or state-owned enterprises (SOEs) is an indicator variable that takes the value of “1” if a surveyed firm owner reported that she/he had worked in

the government or SOEs prior to the founding of the company. It takes the value of “0” otherwise.

Local institutional environment can affect how private firms react to the policy change. To address this, we included a dummy variable, *Low Marketization*, to account for the marketization level in the provinces the firms reside in. The raw score on marketization was taken from Fan et al. (2011) and their research on institutional development progress in China. The score of this index ranges from 1 to 10, with higher values indicating better institutional development. We adopted a binary transformation of the index to account for its highly skewed distribution (skewness = 1.89 with most provinces having a low score), to avoid the influence of extreme values and to directly demonstrate the differences between firms in less marketized areas and those in more developed areas.³ In each year, we divided the sample of firms by the median of the marketization index of the provinces. A value of “1” was given to companies in the lower half as we assumed that they were potentially more responsive to the reform. We assigned the value of “0” to the higher half of firms in more marketized regions.

We used a set of important control variables in our models. Following Li et al. (2008), we controlled private firm owners’ ethnicity, political affiliations, education level, age as well as the industry, history, number of employees, and net profit of their respective companies. *Minority* is a dummy indicator variable that takes the value of “1” if the surveyed entrepreneur belongs to an ethnic minority (i.e., not *Han* individuals) in China. *Political affiliations* are a series of indicator variables measuring whether the surveyed private firm owner is a member of the CPC, is a member of other parties, is on the National People’ Congress (at any administrative level), is on the Chinese People’s Political Consultative Conference (CPPCC, at any administrative level), is a

³ Analyses using the raw scores of raw marketization index were also conducted and all our results still hold.

member of the All-China Federation of Industry and Commerce⁴ (ACFIC), or is a member of any industry associations. For conciseness we refer to this set of variables collectively as political affiliations.

We also controlled for owners' age and education levels. *Education level* was taken as the highest level reported by the individual private firm owner. This ordinal variable could take one of five values: "stopped attending school before or at primary level"; "finished middle school"; "finished high school"; "finished college degree"; or "received graduate degree or higher".

In the surveys, private firm owners were asked to report information about their business in the previous year. We included the *industry* fixed effects according to the main business sector those entrepreneurs reported⁵. We controlled for *firm age*, i.e. the number of years since the firm was founded. We also included the *(log) number of employees* and *net profit* of the firms prior to the survey year in case firm size or business cycles affected private firm owners' decisions.

Finally, it is possible that to fulfill the expectations of the local or central government, for instance, the opening-up policy, private firms may also be motivated to align their internationalization efforts with these policies. We controlled the *number of historical treaty ports* between 1840 and 1943 in each province (Nield, 2015). The treaty ports in China were opened to foreign trade mainly by unequal treaties with foreign powers during the late Qing dynasty, while the other parts of the country remained closed. The treaty port cities became active centers that subsequently had an enormous impact on the Chinese economy and society.

⁴ The All-China Federation of Industry and Commerce is a non-governmental chamber of commerce, established in 1953: http://www.chinachamber.org.cn/About_Us/

⁵ The sector of business could be one of the following: (1) agricultural, forestry, farming and fishing, (2) mining, (3) manufacturing, (4) electricity and gas, (5) construction, (6) hydropower, (7) transportation, (8) catering, (9) financial and insurance, (10) real estate, (11) utilities, (12) health care and sports, (13) education and culture, (14) scientific research and technology, and (15) others.

After China began to open up after the 1980s, these cities and their nearby regions were the first to take advantage of the new development opportunities (Jia, 2014).

Estimation Specification

To assess how the legitimacy of private firm owners altered their behavior, we compare two batches of survey data (fourth and fifth waves) immediately before and after the reform. To reiterate, our focal reform – the announcement that granted private firm owners the right to join the CPC – took place fourteen months after the fourth wave of the survey and nine months before the fifth wave. The most significant reason for any changes in the perceived status or business strategies of private firm owners is likely to be due to this reform. Although it would be best if we were able to track the behavior of individual private firm owners over time and examine their individual reactions to the political reform, we are unable to do so due to survey anonymity. However, due to the random sampling scheme, we can still determine whether *on average* Chinese private firm owners changed their strategies.

To further support our casual claims, we exploit the variations in exposure to the reform and analyze the heterogeneity of the policy impact with the difference-in-differences (DID) setup. The significance of the reform varies as entrepreneurs have different personal characteristics and reside in different provinces. Entrepreneurs may thus be more or less responsive to the reform due to their personal and firm characteristics. The differences in the responsiveness of these two groups can help us identify the moderating as well as causal effects. Since we used individual traits that are time invariant to define the treatment groups, we could effectively address the concern about the issue of self-selection into the treatment group (Finkelstein, 2007, Hanushek et al., 2017)⁶.

⁶ By comparing the impact of the policy change on the groups, we find that in groups (exogenously) receiving a higher level of treatment, the impact is also stronger. This finding can effectively reduce the concern about self-selection into treatment group.

In addition to the main analysis, we checked other alternative explanations and reported them in the Online Appendix. We included a series of robustness tests, showing that our results were not driven by an underlying time trend (Online Appendix B) or other policy changes at the same time (Online Appendix C). We also provided evidence that the effects were not a result of direct government mandates in the Online Appendix D.

Our base model is as follows:

$$y_{it} = c' + \beta \cdot I_t(\text{Year 2002}) + \Gamma \cdot X_{it} + \varepsilon_{it}.$$

y_{it} measures our dependent variable of interest from subject i in year t . $I_t(\text{Year 2002})$ is our independent variable and has the value of “1” for all respondents in the year 2002 survey; X_{it} includes a set of control variables as described above; c is the included constant; and ε_{it} is the i.i.d. error term. The estimates of β are our primary interest, as we are trying to find out how private firm owners’ behavior changes following the political reform.

Our heterogeneity analysis augments the baseline specifications by considering the differential impact of the reform on different firms (owners):

$$y_{it} = c + \beta \cdot I_t(\text{Year 2002}) + \gamma \cdot Z_{it} + \theta \cdot I_t(\text{Year 2002}) \times Z_{it} + \Gamma \cdot X_{it} + \varepsilon_{it}.$$

Z_{it} refers to one of the three moderators that reflect the firm owner’s attributes or environmental attributes. We focus on θ , the coefficient on the interactions between the time indicator and Z_{it} , which captures the differential effect of the reform on firms that responded differently. While there may be systematic changes to all firms in the two years, θ captures to what extent did those who were more affected by the reform differ with those who were less affected. With these additional moderating effects, we address the concerns for common method bias (Podsakoff et al., 2003). Unlike the main effect, the interaction effects cannot be inflated through common method variance (CMV) (Chang et al., 2010; Siemsen et al., 2010). Siemsen et al. (2010, p456)

further demonstrate that “...interaction effects cannot be artifacts of CMV. On the contrary...interaction terms can be severely deflated through CMV, making them more difficult to detect through statistical means”. We would observe persistent (spurious) correlations between two variables if the common method bias is present. However, we show that the magnitude of the policy impact we are examining varies systematically according to certain personal and firm attributes, suggesting no big concerns for the effect of a common method bias. We included a series of parallel trend tests in Online Appendix E to reduce concerns about other confounding factors that can invalidate our DID analyses (Kahn-Lang & Lang, 2020).⁷

RESULTS

We present the summary statistics and correlations of the variables used in this study in Table 1.

[Insert Table 1 and Figure 2 here]

In Figure 2, we observe significant differences in the firms’ strategic choices before and after the reform announcement. First, their investments in their own production increased on average after the announcement. On the left side of Figure 2, we see the average investment amount in 2000 was 2.89 after the logarithm, or about 180 000 *yuan*. It increased to 3.48, or 325 000 *yuan* in 2002, indicating a rapidly growing interest among local firm owners in expanding their businesses. However, we observe a decline in firms’ engagement in international

⁷ As Kahn-Lang and Lang (2020) summarized, there are in general two ways that researchers can find support for parallel trends in periods prior to a treatment. The first approach is to provide a balance test on key characteristics of the control and treatment groups prior to the treatment. The second is to replicate the model on two periods before the treatment. In this case, the second period becomes the placebo treatment period. We conducted both tests to support that the parallel trend assumption does hold in our context. The two tests are included in the Online Appendix E. Overall the results support the parallel trend assumption. The control and treatment groups of entrepreneurs are mostly similar on key attributes according to the balance test. And the placebo test suggests that it is not likely that there exist other confounding factors that could threaten our causal claim.

cooperation. As shown on the right side of in Figure 2, the year 2002 had a significant decrease, with the average percentage dropping from 9.27% to 7.21%.

[Insert Table 2 here]

In Column 1 and 2 of Table 2, we report the results of our baseline model specifications. In the Column 1, our results show that the reform in fact boosted private firms' investments in their own production. The estimated coefficient on the time indicator is 0.48 ($p = 0.003$). This means that after controlling for other factors, firms in year 2002 invested around 48% more in their production. This is equivalent to about 86,400 *yuan* in net value. Our Hypothesis 1 is therefore strongly supported.

Column 2 of Table 2 shows that the reform led to a decrease in the percentage of firms that had ongoing cooperation with foreign companies. The estimated coefficient is negative and significant ($b = -0.05, p = 0.003$). This indicates that following the reform, 5% less of the firms had cooperation with foreign companies. Our hypothesis 2 is also supported.

The directions of our control variable estimates are also as expected. Importantly, we note that firm size and market performance positively drive amounts of domestic investment (Column 1) and levels of international cooperation (Column 2). These are consistent with the literature on factors affecting firm investment and internationalization decisions. For instance, Angelopoulou and Gibson (2009) found that larger firms with fewer financial constraints are more likely to invest. Calof (1994) and Ucbasaran et al. (2001) found that firm resources are positively correlated with its internationalization level. The low marketization level in the province hinders the firms' international cooperation ($b = -0.024, p = 0.09$). Meanwhile, the effect of the number of historical treaty ports on entrepreneur internationalization efforts is positive and significant ($b = 0.016, p = 0.04$) in Column 2. This is consistent with the explanation that private firms may be

more motivated to strengthen their internationalization efforts when the local economy and society are more marketized and open. Finally, being an ethnic minority reduces the willingness of the entrepreneur to engage in international cooperation ($b = -0.057, p = 0.001$) as shown in Column 2. This effect could be due to the lack of same-ethnic networks in foreign countries (Casella & Rauch, 2002, Gokmen et al., 2018). Such networks, which are more prevalent among ethnic Han Chinese, facilitate international communication and trade by transmitting information and building trust relationships.

Fixed effects including entrepreneur age, affiliations, education, firm age, and industry are absorbed during estimation of the model (Correia, 2017).

Moderation effects

To further validate our casual arguments, we summarize our moderation effects in the rest of Table 2 and discuss them below.

We hypothesized that male entrepreneurs would be more responsive to the reform and more likely to increase their production investment and increase their international cooperation as compared with female entrepreneurs. This is partially confirmed by our estimation results in Columns 3 and 4 of Table 2. The interaction of the gender indicator with the time indicator is positive and significant ($b = 0.66, p < 0.001$) when the dependent variable is a firm's own production investment. This shows that male entrepreneurs are indeed more willing to increase their domestic production investment following enhanced political legitimacy, confirming Hypothesis 3a.

However, we observe that the entrepreneurs show no gender differences in decisions to form global business partnerships ($b = -0.004, p = 0.926$). Hypothesis 3b therefore is not supported. This might suggest that the constraints associated with the legitimacy acquired by being included

into the CPC are similar for male and female entrepreneurs, leading to a similar uncertainty level and barriers for both genders in forming international cooperation. We discuss this further in our discussion section.

We also hypothesized that entrepreneurs with working experience in the government or SOEs are more likely to respond to the reform. The results in Column 5 and 6 of Table 2 partially support our hypotheses. We find that the interaction term is negative and significant ($b = -0.044$, $p = 0.051$) when the dependent variable is firms' international cooperation. This confirms our Hypothesis 4b. However, our Hypothesis 4a, which states that entrepreneurs with working experiences in the government or SOEs are more likely to increase their domestic investment, is not supported by the results. We will further discuss this finding in the discussion section.

Finally, we hypothesized that in provinces where the market institution is more developed, the impact of political legitimacy on entrepreneurs' decision-making processes would be weaker. As indicated in Column 7 and 8 of Table 2, our findings partially support the hypotheses. The interaction between our time indicator and the marketization index is positive and significant ($b = 0.48$, $p = 0.077$) when the dependent variable is own production investment. This finding shows that in places where the market was less developed, enhanced political legitimacy contributed more to entrepreneurs' decision to invest in the firms' production. Hypothesis 5a is thus supported. However, Hypothesis 5b is not supported. When the dependent variable is whether the firm has established foreign cooperation, the interaction term is not significant ($b = -0.02$, $p = 0.524$), although its direction is negative as expected.

Supplementary Analyses

In order to verify the mechanism of legitimacy, we conducted additional analyses examining the relationship between the CPC recognition and the changes in Chinese entrepreneurs'

perceived social and political status. There are two major reasons leading us to believe that an enhanced social and political status indicates an enhanced level of legitimacy. First, status is closely linked to legitimacy (Sullivan et al., 2007), and the legitimacy with which private firm entrepreneurs are endowed is directly linked to their perceived status (Tsang, 1996; Ahlstrom et al., 2008). Status implies the positions of actors in a hierarchical relationship (Sine, Shane, & Gregorio, 2003) and is closely related to the prevalent norms of society (Suchman, 1995). For instance, as illustrated earlier, the lack of normative acceptance of mechanizing activities by the entire institution was the major cause of the low status of private firm entrepreneurs (Peng, 2003). This impact of legitimacy is consistent with a series of studies that find legitimacy to be fundamental to the formation of status (Sullivan et al., 2007). An enhanced status perception after the CPC recognition, therefore, indicates an increased level of political legitimacy.

Second, the enhanced legitimacy of recognition as insiders by an elite stakeholder (i.e., the CPC) could elevate the status of private entrepreneurs in the political system. The political reform of 2001 has allowed private entrepreneurs a greater role in China's political system, and an increasing number of private entrepreneurs have joined the CPC since 2001 (Dickson, 2003, 2007), many of whom have also started to participate in various political organizations. They began to occupy important political positions (i.e., as members of the National People's Congress) or to serve as advisory members in the Chinese People's Political Consultative Conference (Dickson, 2007; Li et al., 2008). Such positions are likely to enable the entrepreneurs to view themselves more highly within the political system, giving rise to a higher perceived political status.

In the original survey, respondents were asked to rate their relative social and political status on a 1-10 scale in decreasing order. That is, a value of "1" indicates the highest self-perceived

status and “10” the lowest. We reverse-coded the two variables and regressed them over the post announcement indicator. As shown in Table 3, our empirical results provide strong evidence indicating that the CPC recognition in 2001 is positively associated with the entrepreneurs’ perceptions of social and political status. On average both social and political status increased by about 0.3 ($p = 0.001$ and $p = 0.003$ respectively). It is also interesting to note that entrepreneurs’ personal status is positively correlated with their political and business activities, including being a member of the CPC, the ACFIC, etc. Overall, these results give us more confidence about our argument that Chinese entrepreneurs acquired legitimacy in China as a result of the political recognition by CPC.

[Insert Table 3 here]

Finally, to address the concern about the issue of self-selection into the sample, we ran tests on the parallel trend assumption. Our tests on the parallel trend assumption (see Online Appendix E) indicate that the control and treatment groups of entrepreneurs are mostly similar on key attributes. And the placebo test also suggests that the two groups behave similarly before the policy change. Therefore, we are confident that our results do not suffer from selection into the sample problem.

DISCUSSION AND CONCLUSION

In this study, utilizing a unique dataset of private entrepreneurial firms in China, we investigate the relationship between acquired legitimacy as a result of being recognized as insiders by a powerful stakeholder (i.e. the ruling party) and subsequent changes to firm strategies made by entrepreneurs in both domestic and global contexts. We demonstrate the paradoxical effects of political legitimacy by revealing that legitimacy acquired through

recognition by a powerful stakeholder could have benefits and constraints, leading to both positive and negative impacts on a firm's business strategy.

In considering an exogenous policy change to include entrepreneurs into the CPC's political system, we find that the legitimacy associated with such political inclusion serves as a double-edged sword, affecting firms' domestic and global strategies: it is positively related to a firm's investment in domestic production, but negatively related to its international cooperation intention. We argue that although gaining political legitimacy and being accepted into an elite group (i.e., the CPC) enable private entrepreneurs to acquire more resources and encourage them to pursue strategies consistent with the CPC's expectations domestically, such legitimacy could backfire in the international market as firms would worry about such close connections with the CPC might be a risk. That is, international cooperation becomes increasingly uncertain and risky once the entrepreneurs become insiders of the CPC. We further reveal that managers with past working experiences in the government or SOEs could strengthen the effect of the CPC recognition on international cooperation intention. In addition, the marketization level of the provinces where the firm is located weakens the effect of the CPC recognition on a firm's domestic investment. And, female entrepreneurs tend to be less affected than males in the context of domestic investment. An interesting note is that both gender and the level of marketization do not seem to exert different impacts in the context of international cooperation, though female entrepreneurs or entrepreneurs in areas with a stronger market force are less likely to invest in domestic production after the 2001 political inclusion policy. While this is consistent with our assertion that women are in a disadvantaged position in China's political system and that firms in areas with higher levels of marketization rely less on political legitimacy, it also suggests that entrepreneurs of different gender or from different markets in China face similar international

reactions once they become insiders in the CPC. This set of results suggests that legitimacy constraints rather than resource re-allocations could be the main drive for different impacts of political inclusion on domestic and international strategies, as the reduced level of domestic investment for firms with female entrepreneurs or firms in a region with a strong market force did not transfer to international cooperation activities. However, it may also suggest the presence of other factors in the international market affecting the investment preferences of these entrepreneurs. Future research would benefit from a more systematic examination of gender and marketization differences in business strategies under the influence of political inclusion by the CPC.

We also reveal that entrepreneurs with past working experiences in the Chinese government or SOEs do not show differences in the influence of political inclusion on a firm's domestic investment. This finding suggests that after the political inclusion policy, entrepreneurs with or without government or SOE working experiences respond to the external policy change similarly in the domestic market. It might suggest that entrepreneurs with past working experiences in the Chinese government or SOEs did not receive more legitimacy as a result of the inclusion policy. It could also suggest that regardless of the working experiences in the government or SOEs, entrepreneurs face similar unfriendly and sometimes even hostile environment. Even with prior government or SOE working experiences, these entrepreneurs were still treated as outsiders by the CPC and the state. Future research could explore how earlier insider experiences would affect certain entrepreneurs' cognitive and motivational processes and in turn influence their entrepreneurial business strategies.

Theoretical contributions

This study contributes to entrepreneurship theories by examining the paradoxical impact of legitimacy and focusing on the response of entrepreneurs to inclusion policies that increase their political legitimacy and enable them to become insiders of an elite group in society. In this way, we extend the literature of political legitimacy in entrepreneurship literature (Ahlstrom, Bruton, & Yeh, 2008; Bruton et al., 2010; Garud et al., 2014; Nell, Puck, & Heidenreich, 2015). Although there has been considerable work on legitimacy building of entrepreneurs, the current literature focuses mostly on market legitimacy, seeming to take the political legitimacy of entrepreneurship for granted. We present evidence of the effect on entrepreneurial action of gaining political legitimacy from powerful stakeholders, highlighting the importance of how powerful stakeholders treat entrepreneurs in social and political activities particularly in emerging markets. By demonstrating how entrepreneurs respond to changes in the institutional environment, this study is also one of the first to consider the effect of inclusion by powerful stakeholders through the institutional lens of entrepreneurship research.

More importantly, our findings reveal the constraints of political legitimacy. The extant literature has argued that obtaining legitimacy enables firms to survive and grow (Suchman, 1995). On the other hand, and studies have argued that the legitimacy could also bring conflicting demands and constraints for organizations (Oliver, 1991; Pache, & Santos, 2010). Going beyond the current literature, we have shown that the legitimacy constraints might have impacts on both domestic and international strategies: endowed legitimacy by the CPC, while encouraging local investment, could also hinder a firm's tendency of international cooperation. We thus echo earlier research on institutional duality arguing that MNE subsidiary firms need to strive for both host and home country legitimacy (Hillman & Wan, 2005), and showing that endowed legitimacy in the domestic environment could lower a firm's focus on the international

context. Our study also enriches the research on political inclusion, especially in the Chinese context. Whereas prior literature on the political inclusion of the private sector in China has demonstrated that the private sector's integration into the political system might affect private firms' identification with the state's policies such as better protection of labor rights (Cheng, 2022) and local production (Ma & He, 2018), the potential constraint is less examined. Our findings can therefore provide directions for future research as a cautionary tale of the possible constraints associated with political inclusion for organizations.

Third, we contribute to research into firms' upper echelons (Hambrick & Mason, 1984; Carpenter et al., 2004; Hambrick, 2007) by integrating it with an institutional perspective and legitimacy theories. Previous upper echelons research has often taken the institutional environment as given and examined the impact of firm elites' attributes on firm behavior and outcomes without considering the institutional environment (see Qian, Cao, & Takeuchi, 2013 for one exception). This study considers the impact of the institutional environment on firm elites and examines the interaction effects of firm elites' attributes and institutional forces (marketization) on firm strategies, highlighting the importance of integrating the upper echelons and the institutional perspective.

Fourth, our study contributes to the literature on firms' globalization choices. Previous research has identified both macro and micro factors affecting firms' internationalization process. At the macro level, institutional factors such as structural changes, government reform, and policy changes would affect a firm's globalization choices and foreign investment (Cuervo-Cazurra & Dau, 2009a, 2009b; Luo et al., 2010). At the micro level, corporate factors such as state ownership, executive political connections, and the founder's ideological imprint would affect a firm's internationalization process (Liang et al., 2015; Cui & Jiang, 2012; Marquis &

Qiao, 2020). Our paper extends this research by examining how political inclusion and endowed political legitimacy might affect a firm's domestic and international strategies simultaneously.

Our supplementary analyses on the impact of political inclusion on entrepreneurs' social and political status adds to status theories in management literature (Magee & Galinsky, 2008; Blader & Yu, 2017; Berger, Cohen, & Zelditch, 1972) by evidencing that the status perceptions of a certain social class (private firm entrepreneurs in this study) can be enhanced by changes in the political environment, and that such enhancement has important implications for firm strategies. In addition, by showing the relationship between the status perceptions of firm elites and firm strategies, our findings encourage future research to explore further the profound implications of status dynamics (Blader & Chen, 2014; Chen et al., 2012).

Practical implications

Our findings can provide some important practical implications. First of all, this research points out the possibility that the government's inclusion policies could be used as a control mechanism by the state to encourage private business sectors to align their interests with those of the government. Thus, policymakers could well use inclusion policies to provide incentives for the private sector to expand their business in local markets. Second, our findings can also provide important implications for private business entrepreneurs in considering a proper response to government expectations and requests in a complex institutional environment. Private firm entrepreneurs could make a wise choice when faced with the government's inclusion policies. More importantly, they should consider such environmental changes in their firms' strategic plan formulation process. Finally, since our context is in China – an emerging economy, our findings could have relevance for managers or entrepreneurs in other emerging markets. Specifically, private business sectors in emerging markets could be cautious about the

tendency that endowed political legitimacy might lead to decreased attention to the international market. Thus, they could aim to achieve a balance of their focus between the domestic market and global markets.

Limitations and future research

The current study does however have limitations that need to be addressed in the future. First, we theorized that endowed legitimacy by the CPC could reduce a firm's opportunities for international cooperation. However, foreign investors might be more interested in Chinese firms with leadership within the circle of the ruling party so as to reduce uncertainty in the Chinese market. This would suggest increased cooperation for the focal firm included as an insider of the party. Although our empirical results failed to support that there were increased opportunities for international cooperation after the political inclusion policy, future research could benefit from more detailed examinations of how do foreign investors perceive the political associations of Chinese firms with the ruling party in China. Second, the data used in this study are not longitudinal in nature, thus preventing us from fully claiming the causal effects hypothesized in our study. Future studies could show more robust causal relationships by using longitudinal data or examining our theory using qualitative methods. Third, the variables we used in this study were self-reported. However, self-reported data are widely used in management research and our study also included some firm-level variables answered by firm managers rather than the focal entrepreneurs to alleviate the concerns of common method bias. Nevertheless, future research could further validate our findings with more objective measures.

Conclusion

To conclude, this study provides a theory of paradoxical legitimacy to explain how recognition as insiders by powerful stakeholders (the state in our study) affects entrepreneurial

firm strategies in opposite ways in different contexts. We found that political legitimacy acquired by being recognized as insiders by CPC can have different impacts on a firm's domestic and international strategies as such legitimacy with one powerful stakeholder may backfire with other stakeholders. We also found that entrepreneurs' past working experience in the government or SOEs amplifies the effect of political legitimacy on a firm's international cooperation intention. But firms with female entrepreneurs and in regions with higher local marketization were less affected in their domestic strategic choices. Our findings make important contributions to entrepreneurship literature, research on firm strategies in emerging markets as well as studies of legitimacy.

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Tables and Figures

Table 1. Summary Statistics and Correlation

Variables	N	Mean	S.D.	Correlation Coefficients															
				1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	
1. After-announcement (indicator)	6,260	0.51	0.50	1.00															
2. Own production investment (log)	4,907	3.20	2.10	0.16	1.00														
3. Intl. cooperation	6,260	0.17	0.38	-0.06	0.09	1.00													
4. Gender (Male)	6,260	0.89	0.32	0.03	0.10	0.01	1.00												
5. Gov./SOE experience	6,260	0.42	0.49	0.03	0.01	0.01	-0.06	1.00											
6. Low Marketization	6,250	0.51	0.50	0.07	0.05	-0.06	0.01	0.08	1.00										
7. Minority	6,211	0.04	0.20	-0.01	-0.03	-0.05	-0.09	0.03	0.13	1.00									
8. Net profit	5,035	0.09	0.23	0.05	0.40	0.11	0.06	0.02	-0.06	-0.04	1.00								
9. Employee size (log)	6,013	4.14	1.28	0.09	0.52	0.11	0.12	-0.03	0.02	-0.04	0.40	1.00							
10. Number of historical treaty ports in the province	6,260	1.36	1.25	-0.07	-0.04	0.06	-0.01	-0.05	-0.45	0.00	0.02	-0.01	1.00						
11. People’s Congress representative	4,989	0.21	0.41	0.01	0.17	0.05	0.04	-0.11	0.01	0.01	0.10	0.28	0.01	1.00					
12. CPPCC member	5,465	0.44	0.50	0.01	0.13	0.02	0.00	0.02	0.14	0.05	0.11	0.21	-0.04	0.09	1.00				
13. CPC member	6,211	0.25	0.43	0.11	0.08	0.01	0.08	0.01	0.03	0.01	0.04	0.15	-0.05	0.15	-0.09	1.00			
14. Other party member	6,210	0.06	0.24	0.02	0.04	0.05	-0.03	0.08	0.04	0.00	0.06	0.04	-0.03	0.06	0.18	-0.14	1.00		
15. ACFIC membership	6,242	0.82	0.38	-0.10	0.04	0.00	-0.02	-0.01	0.03	0.01	0.01	0.06	0.02	0.04	0.17	-0.20	0.03	1.00	
16. Industry association membership	6,253	0.54	0.50	-0.14	0.03	0.00	0.00	-0.02	-0.05	-0.01	0.02	0.04	0.03	0.08	0.12	-0.04	0.05	0.12	1.00

Table 2. Baseline and Moderation Results of the Policy Impact

DV:	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Domestic	Global	Domestic	Global	Domestic	Global	Domestic	Global
After announcement	0.48*** (0.15)	-0.049*** (0.015)	-0.11 (0.20)	-0.046 (0.042)	0.56*** (0.17)	-0.031** (0.014)	0.25 (0.21)	-0.040* (0.020)
After announcement × Gender (Male)			0.66*** (0.17)	-0.0035 (0.038)				
After announcement × Gov./SOE experience					-0.19 (0.15)	-0.044* (0.023)		
After announcement × Low Marketization							0.48* (0.27)	-0.020 (0.031)
Gender (Male)	0.19 (0.11)	-0.0075 (0.017)	-0.24** (0.10)	-0.0051 (0.032)	0.19* (0.11)	-0.0071 (0.017)	0.17 (0.11)	-0.0071 (0.017)
Gov./SOE experience	0.0085 (0.078)	0.00071 (0.013)	0.0088 (0.079)	0.00070 (0.013)	0.14 (0.097)	0.032 (0.020)	0.015 (0.080)	0.00043 (0.013)
Low Marketization	0.15 (0.13)	-0.024* (0.014)	0.14 (0.13)	-0.024* (0.014)	0.15 (0.13)	-0.025* (0.014)	-0.19 (0.19)	-0.0095 (0.028)
Minority	-0.097 (0.18)	-0.057*** (0.016)	-0.12 (0.18)	-0.057*** (0.016)	-0.095 (0.18)	-0.056*** (0.016)	-0.11 (0.17)	-0.056*** (0.016)
Net profit	2.15*** (0.29)	0.068* (0.035)	2.13*** (0.29)	0.068* (0.035)	2.15*** (0.29)	0.068* (0.035)	2.18*** (0.29)	0.067* (0.035)
Employee size	0.67*** (0.031)	0.027*** (0.0066)	0.67*** (0.031)	0.027*** (0.0066)	0.67*** (0.031)	0.027*** (0.0065)	0.67*** (0.031)	0.027*** (0.0065)
Number of historical treaty ports	-0.020 (0.066)	0.016** (0.0075)	-0.022 (0.064)	0.016** (0.0074)	-0.021 (0.065)	0.015** (0.0075)	-0.028 (0.070)	0.016** (0.0073)
Constant	-0.56*** (0.163)	0.065* (0.0321)	-0.059 (0.23)	0.039 (0.042)	-0.49* (0.25)	0.030 (0.033)	-0.26 (0.28)	0.033 (0.035)
Fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
<i>N</i>	3097	3491	3097	3491	3097	3491	3097	3491
<i>R</i> ²	0.373	0.059	0.374	0.059	0.373	0.060	0.375	0.060

Robust standard errors clustered at province level are shown in parentheses. * $p < 0.1$ ** $p < 0.05$ *** $p < 0.01$. Exact p-values of our key coefficients are described in the main text. We obtain all results after controlling for fixed effects including entrepreneur age, affiliations, education, firm age, and industry fixed effects. Affiliations are a set of dummies including whether the entrepreneur is a member of the CPC, a People's Congress representative at any level, a member of the Chinese People's Political Consultative Conference, a member of the ACFIC, a member of any industry associations, or a member of parties other than the CPC.

Table 3. The Policy Impact on Perceived Social and Political Status

DV:	(1) Social Status	(2) Political Status
After announcement	0.31*** (0.071)	0.33*** (0.099)
Gender (Male)	0.0098 (0.11)	-0.024 (0.13)
Gov./SOE experience	-0.17** (0.071)	-0.20** (0.085)
Low Marketization	0.14* (0.076)	-0.021 (0.18)
Minority	-0.14 (0.18)	-0.055 (0.22)
Net profit	-0.034 (0.19)	-0.28 (0.21)
Employee size	0.25*** (0.031)	0.13*** (0.035)
Number of historical treaty ports	-0.027 (0.030)	-0.027 (0.075)
NPC representative	0.60*** (0.082)	1.05*** (0.087)
CPPCC member	0.51*** (0.068)	1.23*** (0.099)
CPC member	0.39*** (0.075)	0.70*** (0.079)
Other party member	-0.066 (0.15)	0.26 (0.17)
ACFIC member	0.26*** (0.090)	0.55*** (0.13)
Industry association member	0.18*** (0.066)	0.20** (0.076)
Constant	-1.05*** (0.19)	-1.95*** (0.34)
<i>N</i>	3252	3246
<i>R</i> ²	0.208	0.253

Robust standard errors clustered at province level are shown in parentheses. * $p < 0.1$ ** $p < 0.05$ *** $p < 0.01$. Exact p -values of our key coefficients are described in the main text. We obtain all results after controlling for other fixed effects including entrepreneur age, education, firm age, and industry fixed effects.

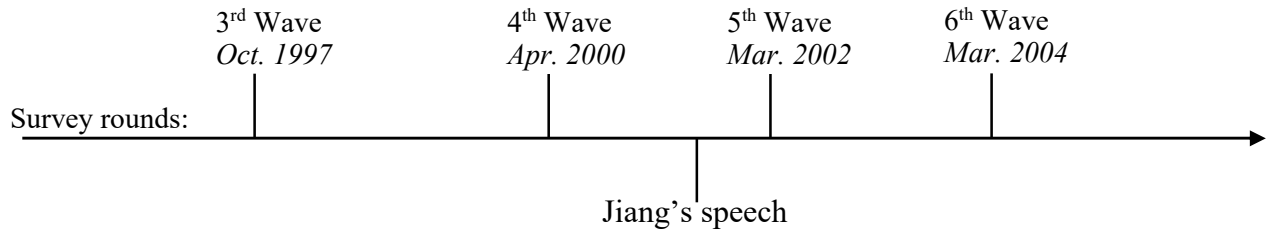


Figure 1 Timeline

Our focal policy change, the announcement that granted private entrepreneurs the right to join the CPC, took place fourteen months after the fourth wave of the survey and nine months before the fifth wave.

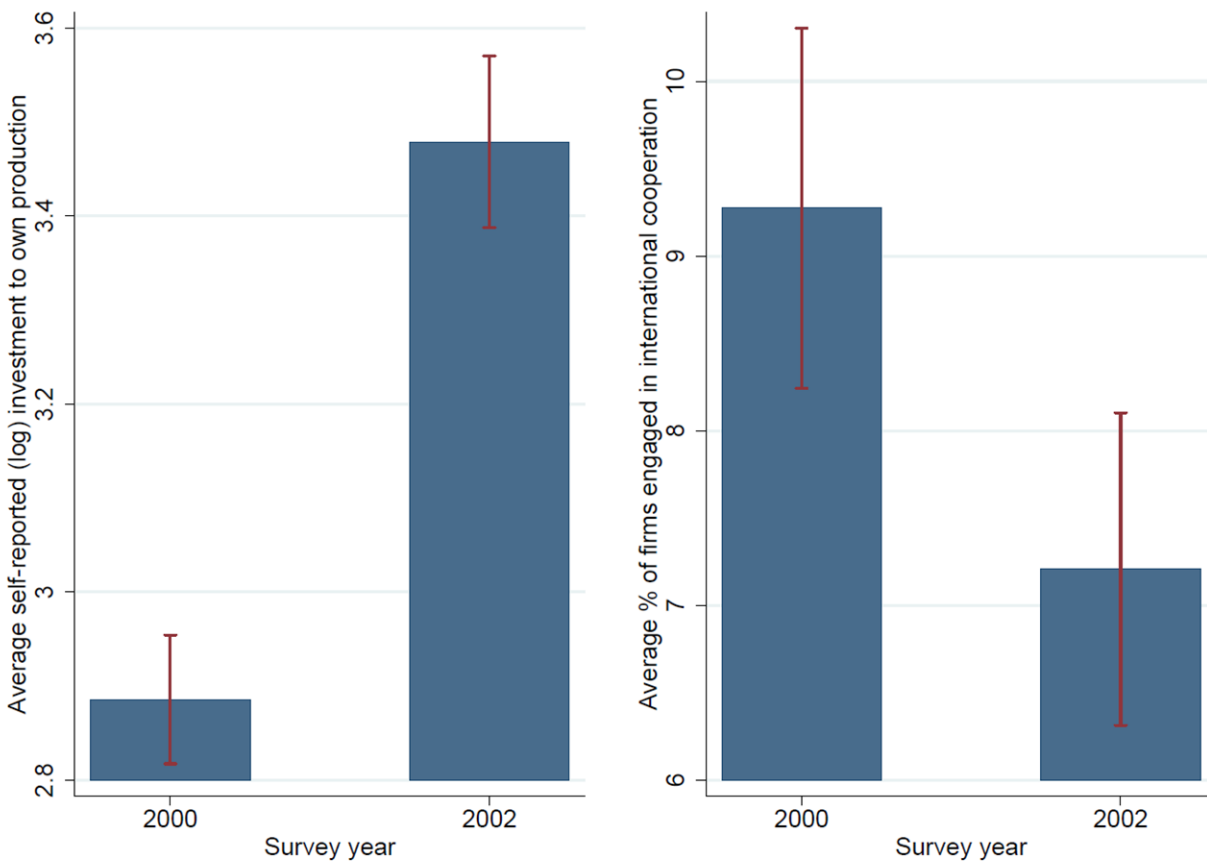


Figure 2 Univariate Comparison of Dependent Variables (with 95% Confidence Interval)