

The Influence of Party Organization's Participation in External Governance on the Innovation of China's State-Owned Enterprises

Yue Wang

Jinan University, Guangzhou, China
Email: 1720638890@qq.com

How to cite this paper: Wang, Y. (2020). The Influence of Party Organization's Participation in External Governance on the Innovation of China's State-Owned Enterprises. *Open Journal of Political Science*, 10, 347-362.
<https://doi.org/10.4236/ojps.2020.102022>

Received: March 30, 2020

Accepted: April 27, 2020

Published: April 30, 2020

Copyright © 2020 by author(s) and Scientific Research Publishing Inc. This work is licensed under the Creative Commons Attribution International License (CC BY 4.0).

<http://creativecommons.org/licenses/by/4.0/>



Open Access

Abstract

Under unique institutional background, the governance of China's state-owned enterprise (SOE) has a distinctive characteristic. The paper aims at researching the impact of Chinese Communist Party's participation in external governance on the innovation of China's state-owned enterprises. Since the 18th National Congress of the Communist Party of China, the Central Commission for Discipline Inspection began to inspect the central state-owned enterprises. The paper uses the political event as natural experiment to research the impact of inspections on corporate innovation, which is an important external mechanism of corporate governance. Through the test of multi-period difference-to-differences (DID) model, the empirical results show that the inspection of the Central Commission for Discipline Inspection promoted the innovation of central state-owned enterprises.

Keywords

Party Organization, Corporate Governance, State-Owned Enterprise

1. Introduction

The environment of policy and system generally plays a fundamental role in the development of enterprises, especially for state-owned enterprises. State-owned enterprises are legal entities that are controlled by government in order to participate in commercial activities on the government's behalf, which constitute an important pillar of China's economy, therefore the governance of China's state-owned enterprises has attracted the attention of researchers. Corporate governance is the structure of rules, practices, and processes used to direct and control a company, providing the framework to balance the interests of a company's

stakeholders. The present system of state-owned enterprise governance is an institutional arrangement supported by the government and adapts to the adjustment of institution. Under the background of Chinese communist party acting as the only ruling party, the Chinese Communist Party leads the institution and economic reform. As a result, grassroots organizations of the Chinese Communist Party participate in corporate governance, which is the distinguishing feature of corporate governance in China. The Chinese Company Law and the Charter of the Chinese Communist Party provide the basis of the establishment and operation of party organizations in the company.

Beginning in 1994, China's reform entered the new stage to establish a socialist market economic structure. The reform of state-owned enterprises aimed at establishing a modern enterprise system, shareholders' meeting, board of directors and board of supervisors became the main body of corporate governance structure, weakening the participation of party organizations in corporate governance. Instead of directly leading the decisions making, the party committees play the role of political core in state-owned enterprise. There are discussions about the impacts of the involvement of political control on state-owned enterprises. On the one hand, the supporters of grabbing hand theory argue that the political control may have negative influence on the corporate's performance because politicians tend to use firms to achieve political and social objectives. On the other hand, the supporters of the helping hand theory consider that political control may generate a positive impact on the performance of corporate due to they prevent managers from the pursuit of individual objectives at the expense of corporate development and help the firm get access to scarce resources in the imperfectly competitive market (Qian, 1996; McGregor, 2001, Xu et al., 2002; Pan et al., 2008). Different from previous researches that do not distinguish between political control exerted by governments and political control exerted by party organizations, the paper mainly studies the control exerted exactly by party organizations.

The process of Party organizations participating in corporate governance can be divided into several stages. The participation of party organizations in corporate governance began in the period of China's planned economy. In 1954, the factory director responsibility system was implemented, factory director shall assume overall responsibility for the production activities of enterprises. The debate that the factory director responsibility system would weaken the leadership of the party caused the system to change. In 1956, party organization began to participate in the management of state-owned enterprise, called direct factory manager responsibility system under the leadership of the party, party organizations play a direct leadership role on the decision and management of enterprise, which leads to low efficiency of the enterprise management.

In 1978, the Chinese communist party held the third plenary session of the 11th central committee, which made the decision of the economic system reform. Meanwhile, the reform of state-owned enterprises has become the core content. In 1984, the third plenary session of the 12th CPC central committee

determined the principle of reform is to separate governmental functions and enterprises management, the factory director acted as legal representative to lead the enterprise. In 1993, the third plenary session of the 14th CPC central committee proposed the goal of the state-owned enterprises reform is to build up a modern enterprise system, including general meeting of shareholders, board of directors and the board of supervisors, the party organization acts as the political core of the enterprise.

The involvement of party organizations in corporate governance has a profound impact on state-owned enterprises, including the innovation of the enterprises. Innovation occupies a prominent position in the enterprises development and helps enterprises to form core advantage in market competition (Li & Song, 2010). Meanwhile, innovation is also accompanied by high risk, it usually requires sustained investment and is difficult to achieve breakthrough progress, therefore, enterprise managers prefer to apply the methods which can improve short-term performance rather than invest in the risky research and development projects. Hence, the innovation of enterprises should not only rely on the initiative consciousness of managers, but also use governance mechanisms to stimulate and constrain managers to undertake the responsibility of promoting enterprise innovation (Dang et al., 2015; Tang & Zuo, 2014). Therefore, the paper explores the influence of governance involvement of party organizations on the innovation of China's state-owned enterprises.

Moreover, the paper distinguishes between the internal mechanism and external mechanism of the involvement of party organizations. The recent researches on the focus on the internal governance involvement of party organizations, whose objects are the party organizations inside the enterprises (Cheng et al., 2017; Huang et al., 2017; Hao & Ma, 2018; Ma & Wang, 2012), however, the superior party organizations of the enterprises also play an important role in the governance. Further, the article distinguishes between the party committees and discipline inspection committees, both are part of party organizations of Chinese Communist Party. The discipline inspection commission is responsible for supervision and inspection on the enterprises in implementing the Party's principles and China's laws and regulations, at the same time it is responsible for supervision and inspection on the Party and administrative leadership and its members in upholding the Party's political disciplines, in implementing democratic centralism, in selecting and appointing senior officials and in building a clean and honest management.

The existing research shows that although party organizations can influence on the corporate governance of state-owned enterprises, the efficiency of their governance function relies on the independence. As the supervision organization of the party, the internal discipline inspection commission of the enterprise can restrain the self-interested behavior of the managers through the restraint mechanism (Chen et al., 2014), however, the internal discipline inspection commission oversees the party committees at the same level and is led by the party committees at the meanwhile, limiting the independence of the commission. As

a result, the involvement of discipline inspection commission in the internal governance of state-owned enterprises is usually affected by the independence, which makes it hard to realize the supervisory function. Only by combining with external involvement of superior party organization can the effect of governance be strengthened.

Since 2012, China's Central Discipline Inspection Commission (CDIC) has conducted an unprecedented work to inspect the state-owned enterprises whose property rights belong the central-government and power of manager appointments are belong to organization department of the CPC central committee, providing a creative form for the party organization to involve in corporate governance. The inspection work is able to overcome the problem of restricted independence of internal supervision of party organization inside the enterprises. On this basis, the thesis focuses on the influence of CDIC inspection on the corporate innovation, which is the new method of external involvement of party organizations in corporate governance. At the same time, the CDIC inspection provides a natural experiment as an exogenous policy event, so the difference in difference method is applied to study the impact of party organization's participation in external governance on the innovation of state-owned enterprises. Through theoretical analysis, the paper researches the meaning of the involvement of part organization in corporate governance, compares the party organization's internal involvement and external involvement, explores the transmission mechanism of the external governance of the party organization on the enterprise innovation. With the evidence of empirical test, the thesis concludes that the inspection of Central Discipline Inspection Commission is of significance to state-owned enterprise innovation.

The innovation of the thesis lies in the following description. Firstly, the paper provides theoretical and empirical evidence of the role of party organizations in the innovation of state-owned enterprises, different from the previous studies focusing on the involvement of party organization in internal governance of state-owned enterprise, the paper contributes a new view that the external governance of the party organization to state-owned enterprise. Secondly, the paper applies large sample empirical study to explore the influence of CDIC inspection on the innovation of enterprise.

2. The Literature and Hypotheses

The recent researches about the political connection focus on the influence of party's election and ruling party on the political affiliated enterprises. In terms of the influence of party elections on enterprises, [Yonce \(2010\)](#) found that during the presidential election of the United States, the political fluctuations were large, which would reduce the investment expenditure of enterprises. [Julio and Yook \(2012\)](#) found that political elections also transmitted uncertainty from politics to economy, causing companies to reduce investment.

As for the relationship between the ruling party and politically related enter-

prises, most researchers conclude that politically related enterprises are more likely to get the protection and help from the government, thus bringing benefits to enterprises. Boubakri et al. (2008) found that among politically connected enterprises, the participation of government officials made it easier for them to compete for government orders, and the higher the residual ownership of the government in the enterprise, the higher the political connection. Sapienza (2004) found that political parties would affect the loans of state-owned Banks, and enterprises could obtain loans at a lower interest rate by establishing ties with the ruling party. In terms of the relationship between party elections and corporate performance, Cooper et al. (2010) found that enterprises associated with the party that won the presidential election had a high return on stock investment and a significant increase in the contract of government procurement, which increased with the rise of political power of the party. Cooper et al. (2010) found that an increase in the number of candidates donated by the company would increase the future value of the company's shares.

Recently, there are researches about the participation of China's party organization in corporate governance. They distinguish the influence of government and party organization. "two-way access and Cross appointment" is the method of party organization to participate in the governance, Ma & Wang (2012) found "two-way access" has an inverted "U-shaped" relationship with the level of corporate governance, and has a positive impact on directorate efficiency. "Cross appointment" can significantly impact the level of corporate governance. The president as secretary of the party committee against improves the level of corporate governance. Chen et al. (2014) finds that the governance involvement of disciplinary commission has the significant negative influences on the managers' non-monetary private benefits.

As an important decision of enterprise strategy, innovation can improve the conversion rate of key productive factors of the enterprise and constantly bring forth the new production to enhance the market competitiveness. However, the uncertainty of the research outcomes and the huge cost required can't be ignored, which may impact on the innovation investment decision of manager. Hence, it is significant to improve the governance of the enterprise to inspire management's enthusiasm for innovation and restrain the self-interest behavior of management.

Under the unique institutional background and property rights structure, the corporate governance of state-owned enterprises in China is characterized by the participation of party organization. The role of party organization in corporate governance changes with the development of China's institution and economic reform.

The emergence of the modern company is accompanied by the separation of residual claim and control right, especially the state-owned enterprise, the profits of state-owned enterprises owned by the state, the government agencies are lack of residual claims but own the control right, driven by political interests the government officials tend to support the special interest group who is in favor of

state ownership and helpful to the victory of their election (Shleifer & Vishny, 1997), the separation of residual claims and control right will cause the control right became cheap voting right, the management's selection will be affected by the unfair mean of bribery, so that the really talented operators can't be employed. In the process of the reform of state-owned enterprises in China, the residual claim is constantly changing. Initially, all the profits of state-owned enterprises turned over to the state. In 1993, separation of profit from tax was implemented, the state receives revenue by the form of income tax, state-owned enterprises independently arrange the use of after-tax profits, which has lasted 14 years. Until 2007, the Ministry of Finance uniting the SASAC issued the measure for the collecting and management of central state-owned enterprises' revenue, restore confiscate the SOEs' profits and regulation three grades of charge proportions, the revenue shall be turned over to the ministry of finance.

The 16th National Congress of the Communist Party of China proposed the establishment of the state-owned assets supervision and administration commissions (SASAC) at all level government to exercise the power of shareholders on behalf of the country, which broke the confusion that different administrative departments implemented supervision on state-owned enterprises. However, it didn't solve the problems caused by the separation of residual claims and control rights. First, in the terms of residual claim, SASAC is responsible for organizing the turning over of capital gains, but the main body of collection is the ministry of finance, SASAC has limited residual claim right and does not undertake the due obligations for the loss of capital. Meanwhile, the SASAC is responsible for appointing and dismissing enterprises' managers, but the right is restricted. Among the 96 enterprises which are under the supervision the SASAC, the personnel management of the former 48 enterprises is owned by the central organization department management, the SASAC regulates the personal management of the rest 48 enterprises. On the whole, both the residual claims and control right of SASAC are weak.

At the same time, the system of state-owned enterprises in China is characterized by the integration of party, government and enterprise. The state-owned enterprises are not only the units which are responsible for the management of production, but also the grass-roots organization in the party and the country's political system. Therefore, China's State-owned enterprises are rich in the characteristics of political attributes, which bring double identity to the managers of state-owned enterprises. On one side, the managers are the operators of enterprises, on the other side, they are cadre of the state with administrative level which gives them strong incentive to pursue political promotion. The principle of the Party assuming the responsibility for cadres' affairs of state-owned enterprises enable the party organizations to represent the shareholders to exert the voting right, combining with the managers' pursuing of political promotion, the party organizations oversee the heads of state-owned enterprises politically and play the substitution function for the supervision of the ownership on enterprise management. The involvement of party organization in the governance fills the

“gap” in the contract of state-owned enterprises.

In 1993, the third plenary session of the 14th CPC central committee set the goal of the state-owned enterprises reform is to establish a modern enterprise system, general meeting of shareholders, board of directors and the board of supervisors were introduced to the state-owned enterprise management system, the function of party organization was the political core of the enterprise which is the principle that has been insisting on. However, there are conflicts between the functions and powers of the party committee and the board of directors. Therefore, it creatively proposes “two-way access and cross appointment” to clarify the ways of the party committee to participate in corporate governance. Both the Chinese Company Law and the Charter of the Chinese Communist Party have made more explicit provisions on the participation of party organizations in corporate governance. The course of reform insists on the political core status of the party and explores the modern enterprise system which is more applicable to the socialist market economy.

The essence of party organizations’ participation in corporate governance is serving the production of enterprise, promoting the benefit of enterprise and enhancing the value of state-owned assets. The way of party organization’s participation is divided into internal and external mechanism.

The internal mechanism of party organizations’ participation in corporate governance includes four parts. Firstly, the party committee plays the role of the political core within the state-owned enterprises. As a grass-roots party organization, the party committee of state-owned enterprises supervises the implementation of the party and state policies in the state-owned enterprises. Secondly, the party organization participates in the decision of major issues through the way of “two-way access and cross appointment”. “Two-way entry” refers to the mutual entry between the members of the party committee and the members of the board of directors, the board of supervisors and the management. “Cross-office” means that the secretary of the party committee concurrently serves as the chairman of the board. Thirdly, the principle of the party assuming the responsibility for cadres’ affairs of state-owned enterprises ensures the right to party organization to appoint the managers, which provides an important balance power to restrict “insiders control” (Qian, 2000). Finally, party organizations have the supervisory function, including political, economic and personnel supervision. The supervision body of the party organization includes the party committee and the discipline inspection commission, the party committee supervises the major decision-making, while the commission for discipline inspection is the “supervision of supervision”, with supervision as its primary responsibility.

At present, the problems of party organizations’ participation in internal governance are mainly manifested in two aspects. On the one hand, there is the problem of “vacancy” in party organizations. The party organization of the enterprise is not a legal part of the corporate governance structure, the function of the party organization is gradually weakened. Some enterprise party organizations do not participate in the major decisions, and the working system of the

party organization has not kept pace with the development of modern enterprise. Meanwhile, the supervision role of the commission for discipline inspection is limited under the leadership of the party committee. On the other hand, there is a “conflict” between the party organization and the board of directors. The rights of the party organization and the board of directors are overlapping. The board of directors plays a central role in modern corporate governance which is given by the law, the party organization participates in the decision making and has the right to appoint the middle managers, therefore, the two sides may be in conflict in making decisions.

To solve the problems of internal involvement of party organization in governance, the external involvement of party organization is important for the improvement of governance. The external involvement of party organization includes the superior party committee and superior party discipline inspection commission.

After the 16th National Congress of the Communist Party of China, central and all levels of governments set up state-owned assets supervision and administration commission to manage the state-owned enterprises, but there is a large proportion of state-owned enterprises’ management appointed by the superior party committee organization department, according to the principle of Party-managing cadre. On the one hand, the superior party organization has the residual control right, which replaces the voting right of the owner; on the other hand, it makes up for the lack of market competition among the managers of state-owned enterprises and plays the role to restrict and inspire the managers of state-owned enterprises.

Although the superior organizational department controls the residual claim, the department does not take the risk of the operation of enterprise, resulting in the problem of cheap voting right. At the same time, the independence of internal discipline inspection is restricted. Therefore, it is necessary to apply the superior discipline commission to inspect the state-owned enterprises. Since the 18th CPC national congress of the party, discipline inspection system was used to enhance the inspection of the state-owned enterprises. The discipline inspection commission will focus on violations of political disciplines and regulations, aiming to rectify the four undesirable work styles of formalism, bureaucratism, hedonism and extravagance. The inspection group conducted in-depth investigation on the internal governance of the central enterprises. It reported that problems existed in the central enterprises and put forward suggestions.

The inspection acts as an important external governance mechanism of state-owned enterprises, through a series of measures to find and solve problems, reducing the obstacles for enterprise innovation. Central inspection group sent by the central commission for discipline inspection and the central organization department has the leadership on the enterprise, so it can overcome the weak of enterprise internal discipline inspection commission to fulfill their duties of supervision. The inspection on enterprise influenced on the enterprise innovation through two channels. Firstly, it restrained the behavior of enterprise managers and prevented them from giving up innovation activities for their own

interests in disregard of the long-term development of enterprises. Second, through the fight against corruption, the behavior of the government rent-seeking was restricted which will save the resource to support innovation.

Innovation is conducive to the formation of the core competitiveness of enterprises and able to help enterprises achieve long-term development. In principal-agent theory, enterprise ownership and business right are separated, the difference of fundamental interests between shareholders and management lead to principal-agent problem (Jensen & Meckling, 1976). The results of innovation activities can bring high profits to enterprises, which is in line with the interests of shareholders. However, there is great uncertainty in the research process (Nie et al., 2008). Meanwhile, innovation takes a long time and requires continuous investment causing financial pressure, the main long-term benefits of innovation are hard to pay off in the short term. While, the compensation and appointment of managers are mainly affected by the current performance, so they may pursuit short-term gains and give up the innovation activities that contribute long-term value to the enterprise (Bebchuk et al., 2001). The inspection restrained managers from neglecting the long-term development of enterprises for their own interests and strengthen their attention to innovation activities.

Anti-corruption campaigns are a central part of the inspections, which are aimed at deterring the management by conducting investigations into rent-seeking corruption. The inspections will not only curb corporate leaders' own efforts to profit from corruption, but also cut off their access to corporate funds to bribe government officials. The ways in which enterprises establish government relations to seek rent from government officials include banquets and entertainment consumption, which will be recorded in the detailed accounts of business hospitality or travel expenses in financial statements (Cai & Sevilir, 2012). While business hospitality and travel expenses are the focus of the inspections, which look into unusual expenses and thus discourage companies from seeking government rent. According to the rent-seeking theory, the absence of formal system will encourage enterprises to focus on the choice of non-market strategy, strengthen the relationship with government officials by using relational capital investment, which will occupy a lot of funds and increase the financing constraint burden of enterprise innovation (Song et al., 2014; Shen & Zhao, 2016). The inspection of the anti-corruption campaign against the management of central enterprises will restrict the political rent-seeking behavior of enterprises by entertaining business travel expenses. Enterprises will adjust their business strategies to emphasize and the innovation.

In conclusion, the paper presents the first hypothesis that:

H1: the external participation of party organization will promote the state-owned enterprise innovation.

At the same time, the impact of inspection on enterprise innovation also needs more comprehensive analysis. Inspection will distract managers' attention from operation in a short period of time, so that they have no energy to pay attention to the progress of enterprise innovation R & D during the short period.

Second, inspection reduces the implicit private benefits of managers (such as on-the-job consumption), may make managers is lack of motivation for the long-term development planning of enterprise and ignore the enterprise innovation. Thirdly, the strong regulatory effect of limiting the autonomy in operation of the manager may lead them are unwilling to bear the risk of innovation brought about by the failure, thus reducing innovation investment of the project.

Hence, the paper presents the second hypothesis that:

H2: the external participation of party organization will hamper the state-owned enterprise innovation.

3. Research and Design

3.1. Samples and Data

In this article, we take the case of Central Commission for Discipline Inspection's inspection of central enterprises as an atural experiment to analyze the influence of inspection on enterprise innovation. This article sets the sample period from 2011 to 2018. The inspection data is manually arranged according to the official website of the Central Discipline Inspection Commission. The list company's R & D information and the data of control variables came from CSMAR database, China Research Data Service Platform, Ruisi Database and the annual report of listed companies. The sample data deletes the financial company and ST companies, finally collected panel data of 639 listed companies.

3.2. Research Variables

3.2.1. Explained Variable

This article uses listed companies' the number of authorized invention patents (patent) and R & D investment intensity (R & D) to be explained variable, according to Wahal & McConnell (2000) and Hsu et al. (2014).

3.2.2. Explanatory Variables

The variable $treat_{i,t}$ is explanatory variable and affected by two factors, as shown in **Table 1**, the variable becomes 1 when the sample belongs to the experimental group and the period after the inspection.

3.2.3. Control Variables

The control variables are used to control the influence of other factors rather than inspection, represented by "control_{i,t}", including the total return on assets, Tobin Q, financial leverage, book-to-market ratio, the sale expenditure, operating income growth rate, government subsidy, management's shareholder ratio, the management salary, the independent director proportion, age and size.

3.3. Model Design

Given that the special inspections were carried out in 2014 and 2015, the research was conducted using the multi-point difference-to-difference model with fixed effects. The bidirectional fixation effect model of panel data is a generalized

Table 1. The definition of variables.

	Explained variable
Patent	the numbers of invention patent authorization
R & D	Ln (the research and found investment/operation income + 1)
	Explanatory variable
treat	The dummy variable = treatment * post
	Control variables
ROA	Net income/Total asset at the end of the year
Tobin Q	Total Market Value of Firm/Total Asset at the end of the year
Lev	Finacial leverage = total debt/total asset at the end of the year
Bm	Book to market ratio = equity/market cap
Fs	First shareholding/Total equity
Sale	Sales expenditure/Operation income at the end of year
opgr	Operation income growth rate = (Operation income at this year – Operation income at last year)/Operation income at last year
Gov	Government subsidy/Operation income at the end of year
Ms	Management shareholding/Total equity
lnsalary	Ln (salary of directors and executive management + 1)
inder	The numbers of independent directors/Total directors
age	Company registration age
size	Ln (total asset at the end of the year + 1)

dual difference estimation model (Cameron & Trivedi, 2005), they have a consistent estimation principle behind them, which can identify the treatment effect and make use of cross-sectional variation and time variation of samples.

For R & D:

$$R \& D_{i,t} = \beta_0 + \beta_1 \times \text{treat}_{i,t} + \beta_2' \times \text{control}_{i,t} + \mu_i + \tau_t + \varepsilon_{i,t} \quad (1)$$

In model (1), $R \& D_{i,t}$ is the explanatory variable R & D investment intensity (R & D). $\text{Treat}_{i,t}$ is the explanatory variable representing the inspection event, $\text{control}_{i,t}$ is the control variable group, the company individual effect μ_i and the time effect τ_t , $\varepsilon_{i,t}$ are random disturbance terms. The coefficient β_1 is a measure of the policy effect.

A study by Cameron and Trivedi (2005) found that the appropriate distribution of corporate patent data is assumed to be Poisson distribution, and the results of ordinary OLS estimation may be biased. Therefore, this paper further adopts poisson panel model for research.

$$E(\text{Patent}_{i,t} | x_{i,t}, c_i) = \exp(\beta_1 \times \text{treat}_{i,t} + \beta_2' \times \text{control}_{i,t} + \mu_i + \tau_t + \varepsilon_{i,t}) \quad (2)$$

In the two models, the experimental group is the inspected central SOEs, and the control group includes the non-inspected central SOEs and non-state-owned listed companies.

4. Empirical Test

4.1. Descriptive Statistics of Variables

In **Figure 1**, the trend of invention patent authorization in the experimental group and the control group is described. Before the implementation of the policy in 2014, the trend of the two groups is basically parallel, so DID method can be used for empirical test. After the implementation of the policy, the growth rate of patents in inspected companies was significantly higher than the control group, indicating that the inspection may increase the patents of central SOEs.

4.2. Regression Analysis

In **Table 2**, the first column is the regression results of patent. The coefficient of treat is $e^{0.41}$, representing that the policy effect is significant at 1% level and the impact of inspections on patent is positive. The second column is the regression results of the R & D, coefficient of the policy effect is 0.0081, which is significant at 1% level. Therefore, the inspection will promote the central state-owned enterprises innovation, the hypothesis H1 is true and the hypothesis H2 is false.

4.3. Robustness Test

4.3.1. Parallel Trend Test

The difference-to-difference model requires the variable is parallel trend (Bertrand & Mullainathan, 2003; Jia, 2014). Use the following model:

$$R \ \& \ D_{it} = \alpha_0 + \alpha_1 * before_{it} + \alpha_2 * after_{it} + \beta_1 * treat_{it} + \beta_2 * control_{i,t} + \mu_i + \tau_t + \varepsilon_{i,t} \tag{3}$$

In model (3), “before” is dummy variable to represent the period before the inspection, “after” is dummy variable to the period after the inspection. If the event has an impact on innovation, the coefficients should be significant after and at the inspection period.

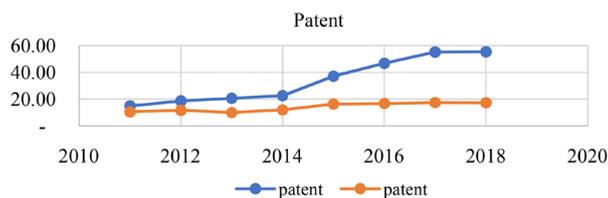


Figure 1. Patent trend.

Table 2. Double difference regression results.

variable	Patent	R & D
treat	0.4102	0.0081
X	-4.81	-4
year	control	control
individual	Yes	Yes
cons	Yes	Yes
rho		0.0764
		0.6397

According to **Table 3**, the regression empirical data of both models shows that the coefficients of policy effect in the two phases before inspection are not significant, and the current and three phases after inspection are significantly positive, meeting the requirements of parallel trends. The effect of the policy has been gradually strengthened. The test results indicate that the increasing of innovation is caused by the implementation of inspection policies.

4.3.2. PSM Match Test

The DID test also requires that the selection of the experimental group and the control group are random. This article uses the propensity matching analysis to match the experimental group and the control group. In **Table 4**, the coefficients of treat in the two models are both significant at the level of 1%, the result indicates that the conclusion of this paper remains unchanged after controlling the self-selection problem.

Table 3. Parallel trend model.

variable	Patent	R & D
b2	0.0401 (-0.36)	0.0006 (-0.3)
b1	0.0362 (-0.35)	0.001 (-0.37)
treat	0.2493** (-2.21)	0.0049* (-1.82)
a1	0.2311** (-2.46)	0.0036** (-2.05)
a2	0.2922** (-2.05)	0.0049** (-2.03)
a3	0.2673** (-1.98)	0.0071** (-2.67)
X	control	control
year	Yes	Yes
individual	Yes	Yes

Table 4. PSM-DID test results.

	1	2
	Patent	R & D
Treat	0.4443*** -3.21	0.0086*** -3.33
X	control	control
year	Yes	Yes
individual	Yes	Yes
cons		-5.6442
rho		0.7743

4.4. Test Summary

The paper combined descriptive statistics and difference-to-difference model to research the impact of party organization' participation in external governance on the innovation of state-owned enterprises. Both the two methods show that the inspection improved the innovation of China's state-owned enterprises. Through the parallel trend test and the PSM-DID test, the paper proves the robustness of empirical results to enhance the reliability of research results.

5. Conclusion and Inspiration

The participation of party organizations in corporate governance is based on the institutional background of China, which has a unique impact on the development of Chinese enterprises. By analyzing the status of traditional party organizations' participation in corporate governance, this article finds that the governance effect of party organizations in internal governance is restricted. With the establishment of the modern enterprise system, the party organization is gradually marginalized in the governance structure, and the channels for participating in governance are not smooth. The influence on important corporate decisions cannot be effectively exerted. The construction of party organizations within state-owned enterprises needs to be compatible with enterprise development. On the other hand, there is also the role conflict between the party organization and the board of directors. The division of responsibilities needs to be clarified. How to effectively integrate the party organization and the corporate governance structure needs to be further explored. The external participation of the party organization will make up for the internal party organization's participation. Governance is inadequate. Governance effects are exerted through restriction and incentive mechanisms, affecting managers' operational decisions. The Central Commission for Discipline Inspection's inspection of central enterprises is one of the important ways for party organizations to participate in the company's external governance. The inspections have a clear positioning and have a strong effect. They restrict and supervise corporate managers and promote the improvement of the governance level of central enterprises, thereby affecting the long-term development of enterprises and technological innovation.

This article analyzes the theoretical basis and realistic basis of the party organization's participation in governance, compares the methods and contents of party organization's internal and external participation, and uses the inspection of Central Discipline Inspection Commission on central state-owned enterprises as a natural experiment to study the impact of party organization's participation in external governance on corporate innovation. The empirical test results concluded that the external participation of the party organization will have a positive impact on corporate innovation. At present, research on its role has only seen short-term effects, and it is necessary to continue to track its long-term impact in the future.

Conflicts of Interest

The author declares no conflicts of interest regarding the publication of this paper.

References

- Bebchuk, L. A., Fried, J. M., & Walker, D. I. (2001). Managerial Score and Rent Extraction in the Design of Executive Compensation. *The University of Chicago Law Review*, *69*, 751-846. <https://doi.org/10.2307/1600632>
- Bertrand, M., & Mullainathan, S. (2003). Enjoying the Quiet Life? Corporate Governance and Managerial Preferences. *Journal of Political Economy*, *111*, 1043-1075. <https://doi.org/10.1086/376950>
- Boubakri, M., Cosset, J. C., & Saffar, W. (2008). Political Connections of Newly Privatized Firms. *Journal of Corporate Finance*, *14*, 654-673. <https://doi.org/10.1016/j.jcorpfin.2008.08.003>
- Cai, Y., & Sevilir, M. B. (2012). Connections and M&A Transactions. *Journal of Financial Economics*, *103*, 327-349. <https://doi.org/10.1016/j.jfineco.2011.05.017>
- Cameron, A. C., & Trivedi, P. K. (2005). *Microeconometrics: Methods and Applications*. Cambridge: Cambridge University Press. <https://doi.org/10.1017/CBO9780511811241>
- Chen, S. H., Jiang, G. S., Li, W. A., & Wang, C. L. (2014). Can the Governance Involvement of State-Owned Companies' Disciplinary Commission Effectively Inhibit the Managers' Private Benefits. *Economic Research Journal*, *10*, 139-151.
- Cheng, B., Xuan, Y., & Pan, F. (2017). The Signaling Effect of Party Organization Governance in SOEs: Analysis Based on Auditor Choice. *Journal of Finance and Economics*, *43*, 69-80.
- Cooper, M. J., Gulen, H., & Ovtchinnikov, A. V. (2010). Corporate Political Contributions and Stock Returns. *Journal of Finance*, *65*, 687-724. <https://doi.org/10.1111/j.1540-6261.2009.01548.x>
- Dang, L., Yang, R. L., & Yang, J. D. (2015). Anti-Corruption and Firm's Innovations: An Explanation from Political Connections. *China Industrial Economics*, *7*, 146-160.
- Hao, Y. H., & Ma, S. (2018). A Study of the Governance Effect of Party Organizations in State-Owned Enterprises in the Context of Classified Reform: Also on the Mode Selection of Party Organizations Embedded in Corporate Governance in State-Owned Enterprise. *Contemporary Finance & Economics*, *6*, 72-80.
- Hsu, P., Tian, X., & Xu, Y. (2014). Financial Development and Innovation: Cross-Country Evidence. *Journal of Financial Economics*, *112*, 116-135. <https://doi.org/10.1016/j.jfineco.2013.12.002>
- Huang, W. F., Zhang, J. Q., & Huang, L. (2017). Governance of State-Owned Companies' Party Organization, Board Informal Hierarchy and Company's Performance. *Business Management Journal*, *3*, 6-20.
- Jensen, M. C., & Meckling, W. H. (1976). Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, *3*, 305-360. [https://doi.org/10.1016/0304-405X\(76\)90026-X](https://doi.org/10.1016/0304-405X(76)90026-X)
- Jia, R. X. (2014). The Legacies of Forced Freedom: China's Treaty Ports. *Review of Economics and Statistics*, *No. 96*, 596-608. https://doi.org/10.1162/REST_a_00458
- Julio, B., & Yook, Y. (2012). Political Uncertainty and Corporate Investment Cycles. *Journal of Finance*, *67*, 45-83. <https://doi.org/10.1111/j.1540-6261.2011.01707.x>
- Li, C. T., & Song, M. (2010). Innovation Activities in Chinese Manufacturing Firms: The

- Roles of Firm Ownership and CEO Incentives. *Economic Research Journal*, 5, 30-37.
- Ma, L. F., & Wang, Y. F. (2012). Can the Party Organization of China's State-Owned Companies Reduce Agency Cost? A Perspective Based on "Insiders Control" of Management Review. *China Industrial Economics*, 8, 82-95.
- McGregor, R. (2001). The Little Red Book of Business in China. *Financial Times*, 8 July.
- Nie, H. H., Tan, S. T., & Wang, Y. F. (2008). Innovation, Enterprise Scale and Market Competition: Panel Data Analysis Based on Chinese Enterprises. *The Journal of World Economy*, 7, 57-66.
- Pan, H. B., Xia, X. P., & Yu, M. G. (2008). Government Intervention, Political Connections and the Mergers of Local Government-Controlled Enterprises. *Economic Research Journal*, 4, 41-52.
- Qian, Y. Y. (1996). Enterprise Reform in China: Agency Problems and Political Control. *Economic of Transition*, 4, 427-447.
<https://doi.org/10.1111/j.1468-0351.1996.tb00181.x>
- Qian, Y. Y. (2000). *Government Control in Corporate Governance as a Transitional Institute: Lesson from China*. Working Paper, College Park, MD: University of Maryland.
- Sapienza, P. (2004). The Effects of Government Ownership on Bank Lending. *Journal of Financial Economics*, 72, 357-384. <https://doi.org/10.1016/j.jfineco.2002.10.002>
- Shen, Y., & Zhao, J. M. (2016). The "Gains" and "Losses" of Eating and Drinking Corruption: Evidence from Investment and Financing Efficiency of Chinese Listed Companies. *Journal of Financial Research*, 3, 140-156.
- Shleifer, A., & Vishny, R. W. (1997). A Survey of Corporate Governance. *Journal of Finance*, 52, 737-783. <https://doi.org/10.1111/j.1540-6261.1997.tb04820.x>
- Song, Z. J., Tan, L. M., & Xing, M. (2014). State-Ownership, Political Participation of Private Entrepreneurs and the Convenience of Enterprise Financing: An Empirical Research on China's Private-Controlled Listed Companies. *Journal of Financial Research*, 12, 133-147.
- Tang, Y. J., & Zuo, J. J. (2014). Ownership Property, Block-Holders Governance and Corporate Innovation. *Journal of Financial Research*, 6, 177-192.
- Wahal, S., & McConnell, J. (2000). Do Institutional Investors Exacerbate Managerial Myopia? *Journal of Corporate Finance*, 6, 307-329.
[https://doi.org/10.1016/S0929-1199\(00\)00005-5](https://doi.org/10.1016/S0929-1199(00)00005-5)
- Xu, L. X., Zhu, T., & Lin, Y.-M. (2002). *Political Control, Agency Problems and Ownership Reform: Evidence from China*. Working Paper, Hong Kong.
<https://doi.org/10.2139/ssrn.368420>
- Yonce, A. (2010). *Uncertain Growth Cycles, Corporate Investment and Dynamic Hedging*. Ph.D. Program, Berkeley, CA: University of California, Business Administration.