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# Social Capital, Informal Governance, and Post-IPO Firm Performance: A Study of Chinese Entrepreneurial Firms

Jerry X. CAO

*Singapore Management University, [jerrycao@smu.edu.sg](mailto:jerrycao@smu.edu.sg)*

Yuan DING

*China Europe International Business School*

Hua ZHANG

*China Europe International Business School*

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**Social capital and post-IPO firm performance:  
A Study of Chinese Entrepreneurial Firms**

By

Jerry X Cao  
Singapore Management University

Yuan Ding\*  
China Europe International Business School (CEIBS)  
and

Hua Zhang  
China Europe International Business School (CEIBS)

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\*Address for correspondence: Yuan Ding, ([dyuan@ceibs.edu](mailto:dyuan@ceibs.edu)). The authors acknowledge financial support from the CEIBS Research Fund. Yuan Ding gratefully acknowledges the generous support of Jiangsu Jinsheng Industry Co. Ltd.

## **Social capital and post-IPO firm performance: A Study of Chinese Entrepreneurial Firms**

### Abstract

This paper explores the links between entrepreneurs' social capital and post-IPO firm performance in China's unique capital market and regulatory setting. Using hand-collected data on entrepreneurs' political connections and firm financial information, we construct original measures for various types of social capital and examine their roles in determining the accounting and financial performance of entrepreneurial firms after an IPO. On one hand, firm accounting performance is enhanced by entrepreneurs' bridging social capital such as political connections or a willingness to share power with external investors. On the other hand, bonding social capital such as intra-group related party transactions causes performance to decline. A similar effect exists on financial performance, such as a 3-year post-IPO abnormal stock return. Board size or independence, however, does not explain firm performance. The results suggest that entrepreneurs' social capital serves a positive governance role in the capital market.

**Key words:** performance, bridging social capital, bonding social capital, agency theory, IPO, entrepreneur, related party transaction, political connection, China

## Introduction

This paper investigates the performance of Chinese entrepreneurial firms going public in the Chinese stock market, in order to address two important questions raised in the IPO literature ([Ritter & Welch, 2002](#)): what drives post-IPO performance, and can it be predicted? Using hand-collected data from China's unique regulatory context, we construct an original measure of entrepreneurial firms' social capital by reference to the theory of social capital ([Adler & Kwon, 2002](#); [Nahapiet & Ghoshal, 1998](#)) and examine its impact on post-IPO firm performance. Our research attempts to shed more light on these two important issues in entrepreneurial firm performance.

The finance literature has been reporting a deterioration in entrepreneurial firms' performance after an IPO, for a number of reasons: (1) entrepreneurs' pursuit of private benefits, (2) window-dressing of the accounts before going public, and (3) timing the IPO to coincide with periods of unusually good performance. Some researchers use agency theory to seek to understand this post-IPO performance drop, focusing on firms' ownership-related corporate governance features. [Jain and Kini \(1994\)](#), for example, show that ownership retention by pre-offering shareholders is positively related to post-IPO accounting performance. In contrast, [Mikkelson et al. \(1997\)](#) use certain ownership-related proxies, such as shareholding concentration, existence of blockholders or secondary sales, and show that not all of these factors can explain the decline in post-IPO accounting performance. Since the empirical evidence is far from conclusive, we propose a new measure to examine IPO performance -- entrepreneur's social capital in the context of China.

Pure agency theory<sup>1</sup> may not be relevant to Chinese entrepreneurial firms, where the relationship network (Guanxi) or informal governance is often important. We therefore explore the potential of such informal governance mechanisms, by transplanting social capital theory from sociology into finance. [Adler and Kwon \(2002\)](#) define social

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<sup>1</sup> In contrast to the agency problem when ownership is diffused, the main conflict in China is between controlling and minority shareholders, because controlling shareholders have highly concentrated ownership ([Shleifer & Vishny, 1997](#)). According to [Bae et al. \(2012\)](#), controlling shareholders' incentives to expropriate minority shareholders are the key channel through which corporate governance affects firm value.

capital as a mechanism to capture the collective actions and resultant outcomes associated with inter-individual interaction between groups. In their pioneering work applying social capital theory in an organizational setting, Nahapiet and Ghoshal (1998) propose that social capital is “the sum of the actual and potential resources embedded within, available through, and derived from the network of relationships possessed by an individual or social unit” (p. 243). Adler and Kwon (2002) present two distinctive views of social capital: the first reflecting an actor’s relations with other external actors, and the second related to the structure of relations between actors in a collectivity. “A focus on external relations foregrounds what has been called "bridging" forms of social capital, whereas a focus on internal ties within collectivities foregrounds "bonding" forms of social capital” (p. 19).

Building on all this theoretical work, we expand the scope of proxies to capture various dimensions of the entrepreneur’s social capital. For bridging social capital, we focus on two major attributes (the existence of a political connection and social relationship with external investors). These external relationship features of social capital are relevant in emerging markets in general, and in China in particular, for two reasons. First, the existing studies on entrepreneurship in emerging economies show that entrepreneurs’ capability of creating an effective political network is a key success factor in those contexts ([Ireland, Tihanyi, & Webb, 2008](#); [N. T. B. Le & Nguyen, 2009](#); [Morck & Yeung, 2004](#)); and second, the existing literature also confirms that in emerging markets, because of the prevalence of large blockholders, the type II agency problem (conflicts between large shareholders and minority investors) eclipses the traditional type I agency problem between owners and managers ([La Porta, Lopez-de-Silanes, & Shleifer, 1999](#); [Villalonga & Amit, 2006](#)). The way the entrepreneur/controller deals with external shareholders before and after an IPO thus becomes a key component of bridging social capital in such a context. For bonding social capital, we focus on whether the entrepreneur/controller emphasizes networking in his/her controlled business group through intra-group related party transactions. It is common in Eastern Asia (including China) for a business group (often a conglomerate) to list part of its business while

keeping the rest away from market scrutiny<sup>2</sup>. Such related party transactions define internal boundaries of intra-group firms as a business group.

By linking entrepreneurs' social capital attributes to firms' post-IPO performance, this study makes several contributions. First, we propose and construct a new measure of entrepreneur's social capital. This social capital measure, derived from entrepreneurial firms' political connections, is very relevant in China's unique institutional environment. Second, our research reveals that informal governance mechanisms such as relationship-based social capital play an important role in entrepreneurial firms' post-IPO performance. In contrast, formal governance measures such as board size or independence do not provide any explanation for firm performance. This research thus sheds some light on the effects of social capital developed by entrepreneurs in an emerging market. Third, our proposed measures of bridging and bonding social capital separate external and internal relationships, enabling us to understand the different governance roles related to disciplining and entrenchment effects. The network of relationships or "Guanxi" plays an important role in emerging markets such as China, but has been largely ignored in the governance literature.

The remainder of the paper proceeds as follows. The second section develops the institutional background of entrepreneurial firm IPOs in China. The third section summarizes social capital theory, to develop hypotheses on the relationships between bridging and bonding social capital and the post-IPO performance of listed entrepreneurial firms. The fourth section presents the sample, the data source and construction of the variables. The fifth section discusses the results of our empirical analysis. Conclusions are finally drawn in the sixth section, along with theoretical and practical implications, limitations, and future research directions.

## **Institutional Background of entrepreneurial firm IPOs in China**

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<sup>2</sup> One explanation is offered by Khanna and Palepu (2000). They argue that when the institutions that contribute to the efficiency of input and output markets are under-developed, family firms and business groups can act as substitutes for external capital and labor markets, ultimately mitigating market failures caused by agency and information problems.

The stock market has gained considerable momentum in China since the early 1990s. Chinese shares were valued at 21.15 trillion yuan (2.79 trillion US dollars) on August 9, 2007, exceeding the nation's previous-year GDP for the first time<sup>3</sup>. At the end of October 2011, 2,304 companies are listed on the Shanghai and Shenzhen Stock Exchanges, with total market capitalization of 24.30 trillion yuan (3.86 trillion US dollars). As stated by the Chinese government, the main purposes of launching the stock market twenty years ago were to raise much-needed capital for state-owned enterprises (SOEs), and to facilitate SOEs' restructuring as "modern corporations" (*gongsihua* in Chinese). Financing through the Chinese equity markets thus shows a tremendous bias in favor of SOEs over non-SOEs. However, the number of privately-owned firms listed on the Chinese stock market has still increased substantially, in both a reflection and a consequence of general private sector development.

China's first privately-owned listed company appeared in 1992, but during the period 1992-1997 the number of privately-owned listed companies was negligible compared to the rapid increase in market capitalization and the total number of listed companies. In 1997, fewer than 6% of listed companies were privately-owned, despite the private sector's increasing importance in the Chinese economy. 1998 then saw the start of a boom in privately-owned listed companies. As of 2007, 491 (34%) of the 1,453 publicly listed firms were private firms, some being privatized former SOEs and some newly-founded within the private sector. For this study, only the second group - entrepreneurial firms - are included in the sample. Since private ownership in China was given a new lease of life and all private companies were built from scratch only after the economic reform of 1978, the founders of these firms are still actively involved in their management, and de facto control the companies.

Consistent with the important role played by the Chinese government in China's economic reform, the government is heavily involved in the stock market as regulator. Due to certain unique features of the regulatory setting in the Chinese stock market, our sample provides a good research laboratory to study IPOs.

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<sup>3</sup> "Mainland Stocks become world giants after defying global rout", South China Morning Post, August 15, 2007, p. B20.

Firstly, due to the IPO approval system in China it is very difficult for a firm to obtain listing status. Every proposed IPO must be approved by the CSRC's Public Offering Examination Committee, and the process is lengthy. The firm must first go through a so-called "restructuring period", when it is restructured into a limited stock corporation. This period lasts a minimum of one year for a firm which was already a corporation; for other firms it can last up to three years. Then comes a one-year "tutorship" period, during which the firm adopts modern corporate governance structures. After these two stages, the firm will be examined by the CSRC's Public Offering Examination Committee mainly in terms of the companies' ownership structure, large shareholders, quality of accounting information and growth prospects. This process lasts for six months. If the firm qualifies, the stock exchange (there are two in China, Shanghai and Shenzhen) will work with it to arrange the IPO. So if all goes well, it takes a firm on average 3 years to prepare for an IPO. The maximum can be more than 4.5 years<sup>4</sup>. Furthermore, the process can be interrupted and prolonged by macroeconomic policy considerations. Since SOEs often benefit from preferential "fast-track" listing, our sample excludes such companies, and only comprises purely private entrepreneurial firms.

Secondly, Chinese IPOs cannot involve secondary share sales (when existing shareholders sell their shares), and only new shares can be issued to the public. The lock-in period for the largest shareholders is 3 years, the longest in the world, and the controlling shareholder is not allowed to sell his shares for all of that time. This unique regulation means that controlling shareholders do not actually sell their equity ownership. For each firm included in our study, we clearly identify the controlling shareholder, who is the entrepreneur/founder of the firm. The top management team is often the founder him/herself, plus family members or delegates close to the family. Therefore, for our whole six-year study period around the IPO (three years before and three years after the IPO), the entrepreneur/founder/controlling shareholder is the force behind all the major decisions made by newly-listed entrepreneurial firms. Further evidence of this control structure is found in the firm's disclosed filing statements.

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<sup>4</sup> Since the Chinese stock market was not doing well in the period 2002-2006, for some firms in our sample the whole process took four or even five years.



Our sample only includes entrepreneurial firms going through initial public offerings. Entrepreneurial companies, unlike their state-owned counterparts, have full autonomy to make their IPO decision, meaning that the decision is not driven entirely by political considerations. Therefore, their IPO motivations are largely consistent with those documented in US studies. The extant literature shows that the two prominent reasons for IPOs are (1) raising funds to further grow the firm and (2) creating a public market for entrepreneurs' (and other shareholders') to cash in their shares (for details, see the literature review by Ritter and Welch (2002) (p. 1796) and the CFO survey by [Brau and Fawcett \(2006\)](#)). Furthermore, Chinese regulatory restrictions such as the prohibition of secondary sale during the IPO and the ensuing 3-year lock-in period make immediate cashing in during or just after an IPO impossible for the entrepreneur. Therefore, if the main motivation for an IPO is to create a public market so the entrepreneur can cash in his investment in the future, a rational entrepreneur should only open up the minimum required capital to external investors, just enough to achieve listed status; opening the capital wider should signal the entrepreneur's willingness to develop a better and stronger relationship with external investors ("bridging").

## **Literature Review and Hypotheses**

To explain the impacts of social capital on listed entrepreneurial firms' post-IPO performance, this study uses the two types of social capital: bridging social capital and bonding social capital.

### **Social Capital Theory**

Social capital is created through social relations that can be mobilized to facilitate the attainment of the resources, influence, and sponsorship needed ([Adler & Kwon, 2002](#)). Social capital is embedded in relationships that facilitate collaboration and cooperation to achieve mutual benefits. Network relationships include feelings of gratitude, reciprocity, respect, and friendship ([Carolis, Litzky, & Eddleston, 2009](#)). Other researchers ([Dess & Shaw, 2001](#)) point out that firms' social capital can be difficult to quantify, since social capital reflects not only a complex set of dynamic relationships within a group, but also

the unique circumstances and interactions between the group and its external environment.

According to [Adler and Kwon \(2002\)](#), social capital is a form of capital because it has the following six features: 1. It is a long-lived asset into which other resources can be invested, with the expectation of a future flow of benefits. 2. It is both appropriable and convertible. 3. It can either be a substitute for or can complement other resources. 4. It needs maintenance. 5. Some forms of social capital are collective goods, in the sense that they are not the private property of those who benefit from them. 6. Investments in the development of social capital do not seem amenable to quantified measurement.

Being embedded in a network promulgates mutual knowledge and recognition (Bourdieu, 1985). The benefits derived from a firm's social capital can take the shape of tangible and intangible assets, i.e., funding and financial information ([Jonsson & Lindbergh, 2011](#)). They are sources of information and opportunities, and in certain circumstances may be used as a form of social status or reputation. Social capital has been found to be important in providing legitimacy (H. E. [Aldrich & Fiol, 1994](#); [Zimmerman & Zeitz, 2002](#)), mitigating the liability of newness ([Stinchcombe, 1965](#)), firm growth ([Zimmerman & Zeitz, 2002](#)), and preventing failure ([Miner, Amburgey, & Stearns, 1990](#); [Westhead, 1995](#)). Social capital links the entrepreneur with opportunities crucial to a firm's success ([Bull & Willard, 1993](#); [Ellis, 2000](#)), provides support, credibility, and contact for entrepreneurs ([Ostgaard & Birley, 1996](#)), and facilitates innovation and reduces risks ([Lipparini & Sobrero, 1994](#)).

Since institutions constrain possible opportunities within acceptable boundaries, they tend to determine the way entrepreneurs may legitimately explore and exploit opportunities ([Clemens & Cook, 1999](#)). North (1990) breaks institutions into formal and informal institutions. "Formal institutions" refer to the rules, regulations, laws, and supporting apparatuses that establish order in economic, legal, and political frameworks. "Informal institutions" include the norms, beliefs, values, and similar conventions that form the socio-cultural relations in a society. In transitional economies, "while formal institutional policies and structures supporting capitalism have steadily emerged, informal institutions remain divided between old and new economic systems. By deterring widespread adoption of entrepreneurial behavior, informal institutions persisting from the

socialist system undermined the transition of formal institutions during the 1990s that were intended to promote entrepreneurship. Furthermore, economic turmoil, lack of social justice, growing inequality, and deteriorating welfare services have created dissatisfaction with the emerging capitalist economic system” (Ireland et al., 2008, p. 108). Therefore, the social capital (which belongs to informal institutions) becomes even more crucial for entrepreneurs operating in such economies.

In their study on Vietnamese entrepreneurial firms, Le and Nguyen (2009) state that “networking is crucial for small and medium-sized enterprises (SMEs), particularly in emerging economies as they seek to access resources for development” (p. 867). According to Le and Nguyen, in the absence of effective market institutions, networks play an important role in spreading knowledge about a firm’s existence and practices. Networks also help a firm learn appropriate behavior, and therefore obtain necessary support from key stakeholders and the general public. Therefore, personal relationships and networks are often seen as an effective substitute for well-established institutions (Ahlstrom & Bruton, 2006; [Xin & Pearce, 1996](#)). The extant literature suggests that networking between entrepreneurs, bankers, government officials, and friends and relatives may increase a firm’s legitimacy and play an important role of help to both lending institutions and corporate borrowers (Ahlstrom & Bruton, 2006; T. B. N. [Le, Venkatesh, & Nguyen, 2006](#); [M. Peng, 2001](#); [M. Peng & Luo, 2000](#)). For corporate borrowers, networks can act as a vehicle to gain access to resources, information, and support from other parties ([Hoang & Antoncic, 2003](#)).

## **Bridging Social Capital and Firm Performance**

Adler and Kwon (2002) distinguish between bridging and bonding social capital. “The bridging view focuses primarily on social capital as a resource that inheres in the social network tying a focal actor to other actors. On this view, social capital can help explain the differential success of individuals and firms in their competitive rivalry: the actions of individuals and groups can be greatly facilitated by their direct and indirect links to other actors in social networks” (p. 19).

“The bridging form of social capital is most prominent in the entrepreneurship literature given its relevance to the formation of new ventures” (Carolis et al., 2009, p. 529). Burt has suggested that social capital creates an advantage in “... the way in which social structure renders competition imperfect by creating entrepreneurial opportunities for certain players and not for others” (Burt, 1992, p. 57). Literatures in both entrepreneurship (H. [Aldrich & Zimmer, 1986](#); [Birley, 1985](#); [Uzzi, 1996](#); [Walker, Kogut, & Shan, 1997](#)) and social capital ([Adler & Kwon, 2002](#); [Burt, 1992](#); [Nahapiet & Ghoshal, 1998](#); [Tsai & Ghoshal, 1998](#)) have stressed the importance of connections and networks in the establishment and success of new ventures.

There are two direct benefits of the bridging form of social capital: information and influence. Social capital may facilitate access to information, which is a critical component of entrepreneurial opportunities ([Shane & Venkataraman, 2000](#)). Social capital accelerates the timing, relevance, and quality of information ([Adler & Kwon, 2002](#); [Burt, 1992](#)). For example, “individuals with close ties to universities, perhaps through alumni associations, may develop relationships with researchers and thus have access to information about emerging technologies that can be commercialized. These individuals then have early access to promising technologies before this becomes public knowledge” (Carolis et al., 2009, p. 530). Another benefit of social capital is influence. Individuals may accumulate obligations from others in their network and then call in those obligations at a later date.

Several previous studies find that bridging social capital helps people or firms to improve performance in general ([Burt, 2004](#); [Maurer & Ebers, 2006](#); [Shaw, Duffy, Johnson, & Lockhart, 2005](#)). “The concept explains resources that are leveraged through collaborations with external agents” ([Aarstad, Haugland, & Greve, 2010](#), p. 1003). In fact, Burt (1992, p. 8) names social capital as “... the structure of the player’s network and the location of the player’s contacts in the social structure of the arena [that] provides ... [an] advantage”.

In the context of transitional economies, among all the forms of bridging social capital, those linked to the political sphere attract particular interest from researchers. In their work on Central and Eastern Europe, Ireland, Tihanyi et al. (2008) emphasize the importance of studying the impact of politico-economic systems on entrepreneurs’

behavior, and argue that interactions between political and economic systems remain especially salient in emerging and transitional economies. “Understanding the economy is not possible without taking into account the political system and the ease with which changes may occur in it” (p. 109). They further comment that “the attitudes of political actors toward entrepreneurship have significant implications for how value (in all forms) is produced, distributed, and exchanged throughout a society” (p. 110). The predominantly political dimension in entrepreneurs’ social capital in this context may be explained by certain features common to all emerging countries, and other features unique to transitional economies.

On one hand, as mentioned earlier, most emerging countries have weak formal institutions. Recent research argues that substitutive informal institutions exist in environments where formal institutions are either not routinely enforced, or state structures are weak and lack authority (Helmke & Levitsky, 2003; [North, 1990](#)). For instance, in post-Soviet Russia, managers draw on an extensive network of connections and relationships governed by informal norms of reciprocity (“You help me, and I’ll help you”) to find a way around formal procedures; such connections are useful for arranging favorable borrowing terms, postponing payments, jumping queues, speeding up bank operations, or settling business disputes (Tonoyan, Strohmeier, Habib, & Perlitz, 2010). These networks also help private firms to protect against lack of ownership rights, contract laws, and arbitrary enforcement of business regulations (Ahlstrom & Bruton, 2006). A system where actors draw disproportionately on “closed business networks” with friends, relations and national bureaucrats to compensate for the shortage of formal institutions magnifies the return to political rent-seeking by this elite, and is conducive to corruption, as it provides the right environment for sealing and honoring corrupt deals ([Fischer & Reuber, 2007](#); [Morck & Yeung, 2004](#)).

On the other hand, in former and current socialist countries, the state still plays a larger role in distributing scarce resources; compared with SOEs, privately-owned SMEs receive little support from the government and typically lack market legitimacy. In such countries, the market mechanism often coexists with (and is impacted by) a government-led redistributive mechanism, suggesting that government officials still have a strong influence on business practices (Boisot & Child; [Li & Zhang, 2007](#); Nguyen et al., 2005).

The political dimension has a greater impact on entrepreneurs' action in a country like China, where the state plays a larger role in distributing scarce resources, as "the party-state is crucial to just about everything that a business needs to obtain or know about: land, energy, accounting standards, tax regimes, implementation of regulations or bank loans. It is also the key integrator of China and its market, and is the sole conduit for hearing political demands and settling political differences" (Story, 2012).

Managers' ties with government officials—the official networks—represent a special type of managerial resource in these countries (Chung, 2006; Li & Zhang, 2007; Nguyen, Le, & Freeman, 2006; M. Peng & Luo, 2000). They help private firms to navigate through cumbersome procedures with state agencies, gain access to scarce resources, and enter closely-regulated industries, and thereby improve their business performance (Chung, 2006; M. Peng, 2001; M. Peng & Luo, 2000; Xin & Pearce, 1996). This is evidenced in various emerging economies (M. Peng, 2001), such as China (Li & Zhang, 2007; M. Peng & Luo, 2000; Xin & Pearce, 1996), Vietnam (Le and Nguyen 2009), and Eastern European countries (Smallbone & Welter, 2001). Story (2012) even states that "Cultivating relations with officials is not just a fact of life for doing business in the mainland (China) - it can mean the difference between success or failure".

**Hypothesis 1:** Post-IPO performance increases with the listed entrepreneurial firm's bridging social capital, specifically the political connections of the founder and his/her team.

Another important feature of emerging markets is the prevalence of large blockholders in listed companies, a very different situation from the Berles and Means thesis (1932). As a result, conflicts between large internal shareholders and small external shareholders become the predominant corporate governance issue in those markets. Claessens et al. (Claessens, Djankov, Fan, & Lang, 2002) (on Asian listed companies), and Faccio and Lang (Faccio & Lang, 2002) (on European listed companies) both find that the market tends to discount the stock price of companies that have more severe conflicts of interests between insiders and outsiders. Some controlling shareholders, aware that the relationships and interactions between controlling internal shareholders and small external shareholders is of crucial importance to the firm's long-run performance, make various attempts to mitigate small external shareholders' concerns by

voluntarily submitting themselves to scrutiny by external shareholders, for instance through promoting the role of the shareholders' meeting and the board ([Wan & Ong, 2005](#)), increasing board independence ([Rosenstein & Wyatt, 1990](#)), improving information disclosure ([Eng & Mak, 2003](#)) and auditing quality ([Becker, Defond, Jiambalvo, & Subramanyam, 1998](#)), or paying out more dividends ([Chen, Cheung, Stouraitis, & Wong, 2005](#); [Faccio, Lang, & Young, 2001](#)), which will eventually enhance the firms' value. Also, external shareholders are also becoming more active in exerting influence on their firms, not only by monitoring but also by advising and providing business connections. In that sense, the checks and balance, advice and other resources provided by external shareholders can be viewed as the benefits received by internal controlling shareholders through the bridging social capital built up by the latter with the former. However, the entrepreneur/controller's attitudes towards external investors vary considerably from one company to another. While some are open and willing to share power with outsiders, others still prefer tight control and low transparency. As explained in the first section, given the regulatory restriction on secondary sale of existing shares and the 3-year lock-in period for founders, cashing in is not an option for the founder at the time of the IPO. Therefore, more shares floated to the public during the IPO can be considered to indicate that the entrepreneur/controller is open to external shareholders, and willing to dilute his/her position, with the possible result of more intensive monitoring.

**Hypothesis 2:** The post-IPO performance increases with the listed entrepreneurial firm's external investor bridging social capital, measured by the percentage of shares floated during the IPO.

## **Bonding Social Capital and Firm Performance**

In contrast to the bridging view of social capital as a resource located in the external linkages of a focal actor, the bonding view focuses on collective actors' internal characteristics. In these views, the social capital of a collectivity (organization, community, nation, and so forth) lies not so much in that collectivity's external ties to other external actors as in its internal structure—in the linkages between individuals or

groups within the collectivity and, specifically, in those features that give the collectivity cohesiveness and thereby facilitate the pursuit of collective goals ([Adler & Kwon, 2002](#)). Dense connections between parties in a group or collective enhance self-enforcing values and behaviors, allowing the group to function and achieve common goals ([Carolis et al., 2009](#)).

In the context of emerging economies, the accumulation of bonding social capital may create more value for the entrepreneur. As seen earlier, most of these countries have poorly-developed formal institutions ([North, 1990](#)), and this influences not only the effectiveness of regulation and enforcement, but also the availability of external financial and labor resources. When institutional efficiency is low, there will be more “relational contracting”, i.e. relationship-based, personalized exchanges, while arm’s-length transactions are more prevalent in a high-efficiency institutional context (M. W. [Peng, 2003](#)). Consistent with the above theories, Khanna and Palepu (2000) find that diversified business groups in India generally outperform their peers due to the existence of an intra-group “internal market”; this can act as a substitute for external capital and labor markets, ultimately mitigating market failures caused by agency and information problems when the institutions that contribute to the efficiency of input and output markets are under-developed. In such cases, the entrepreneur/controlling shareholder’s bonding social capital is beneficial for the post-issue performance of IPO firms.

However, there is an alternative, dark side to this “internal market”. Many entrepreneurs pursue overall value maximization for the whole business group, sometimes at the expense of external investors holding shares in one particular listed entity of the business group ([Chang, 2003](#)). When this happens, the accumulation of bonding social capital through intensive intra-group connections could have a negative impact on a listed entity’s post-IPO performance.

Related party transactions have been widely used as a measure of intra-group connections, and researchers find they are one of the main channels through which controlling shareholders attempt to prop up listed companies ([Friedman, Johnson, & Mitton, 2003](#)) or tunnel them (Johnson, Porta, Lopez-de-Silanes, & Shleifer, 2000). Even when the aim is to prop up rather than to tunnel, a greater number of related party transactions will also hamper the listed entity’s independence and cause a soft budget



constraint issue, which will make the companies unaccountable and inefficient ([Kornai, 1979](#); [Stiglitz, 1994](#)).

In this study, we use the intensity of an entrepreneurial firm's related party transactions within its business group as a proxy for intra-group bonding social capital. Although the existing theories presented earlier do not provide any grounds for a directional link between bonding social capital and the post-IPO firm performance, we do expect the former to have some (positive or negative) impact on the latter. [Fischer and Reuber \(2007\)](#), for example, developed the notion of reputational "stickiness", which means that evaluations (positive or negative) become entrenched such that they have an ongoing impact on the firm's performance.

Based on this theoretical prediction, the overall relationship between intra-group related party transactions and the post-IPO performance of the sample companies will depend on the relative magnitude of positive and negative effects.

**Hypothesis 3:** Post-IPO performance is impacted by the listed entrepreneurial firm's bonding social capital, measured by the intensity of intra-group related party transactions.

## Methodology

### Data and Sample

Our sample includes all entrepreneurial firms that conducted IPOs from the initial establishment of the Chinese stock market in 1996 until 2007. This cut-off year is chosen to allow for inclusion of three years of post-IPO data. Unlike their state-owned counterparts, privately-owned entrepreneurial companies have full autonomy in making their IPO decision, which is driven entirely by economic rather than political considerations.

In China, there are two ways for private companies to become listed on the stock market: by an IPO or by "backdoor" listing, for example through a reverse takeover. Our sample does not include backdoor-listed private firms, as information on their pre-listing performance is not available. It includes all IPO firms with available data on financials and corporate governance for three years before and three years after the IPO year. The

final sample consists of 181 private firm IPOs. The time distribution of the IPOs is shown in Table 1.

**(Insert Table 1 around here)**

## **Description of Variables**

Return on assets (ROA) is used as the main measure of accounting performance, and return on equity (ROE) is used as a robustness check. ROA is a popular measure of profitability and the efficiency of asset utilization, while ROE measures the return for shareholders. However, ROA and ROE for the period immediately after an IPO have a downward bias, as the proceeds raised will increase assets immediately but there will be a time lag before the proceeds are invested and the output of those investments translates into net income. We control for this bias by adding IPO proceeds as a percentage of pre-IPO equity in a regression analysis. The pre-IPO (post-IPO) accounting performance is measured by the average ROA and ROE for the three consecutive years before (after) the IPO year, while the change in accounting performance is the difference between the average ROA and ROE before and after the IPO. For market performance, we use the post-IPO 3-year abnormal stock return, which is the sample company's stock return during the period of three calendar years starting from the first trading day after the IPO, net of market returns during the same period.

As presented in the hypothesis development section, we use three proxies to capture the entrepreneur's social capital:

(1) Political connections of the entrepreneur and the top management<sup>5</sup> (dummy variable equal to one if the entrepreneur or one of the management team has political connections, defined as whether the person has past working experience in government or state-owned enterprises, is a member of the National People's Congress or National Political

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<sup>5</sup>Usually, in Chinese entrepreneurial companies, the founders are actively involved in the management of their firms. Of the 82 sample companies that have political bridging social capital, there are only 5 in which the entrepreneurs do not occupy any management position. It could be argued that these firms still display the entrepreneur's efforts to build political bridging social capital by engaging managers with such social capital.

Consultative Conference, or a Chairman of a National Industry Association). This variable is the proxy for the entrepreneur's political bridging social capital.

(2) Percentage of new shares floated as a measure of existing shareholders' ownership retention. As secondary sale is not allowed in a Chinese IPO and only new shares can be issued to the public, the percentage of new shares floated directly indicates the ownership retention of existing shareholders, and their willingness to share power with incoming external investors. This variable is the proxy for the entrepreneur's external investor bridging social capital.

(3) Intensity of intra-group transactions, measured by the ratio of total related party transactions in the three post-IPO years over total sales in the three post-IPO years. This variable is the proxy for the entrepreneur's intra-group bonding social capital.

When we run the regression analysis, we also control for the following corporate governance and financial variables influencing firm performance:

- (1) whether the chairman of the board is also the CEO (dummy);
- (2) the change in managerial shareholdings before and after the IPO;
- (3) board size (natural log of number of board directors);
- (4) board independence (ratio of number of independent directors over total number of board directors);
- (5) IPO proceeds as percentage of pre-IPO equity;
- (6) total assets in log form;
- (7) total market capitalization in log form.

## **Empirical Results**

### **Summary statistics**

Table 2 and Figure 1 summarize the change in accounting performance and market performance before and after the IPO year. The mean and median differences in ROA before and after the IPO are -6.13% and -5.40% respectively, and the change is statistically significant in terms of both the t-test and the Wilcoxon sign rank test. The ROE shows an even more significant post-IPO decline relative to its pre-IPO level.

One possible explanation for the post-IPO decline in accounting performance is that the investments of the IPO proceeds may not give quick payoffs. Therefore, we also look at three other measures: change in sales as a percentage of the pre-IPO level, change in asset turnover (the ratio of sales over total assets), and gross margin. The mean and median changes in sales are 213.28% and 147.23% respectively, which indicates that more than half of the sample companies doubled their sales after their IPO. The asset turnover rate drops significantly after the IPO, indicating that asset utilization declined even though sales increased significantly. Altogether, the summary statistics show that the overall accounting performance deteriorates after an IPO despite strong sales growth, which is consistent with the findings in the extant literature ([Jain & Kini, 1994](#); [Mikkelsen et al., 1997](#)). However, the possibility that post-IPO investment has not yet translated into increased sales cannot be ruled out without running the multivariate regression by controlling for other contributing factors.

Regarding market performance, the mean and median 3-year abnormal stock returns are 22.0% and -14.1% respectively, indicating that more than half of the sample firms were outperformed by the market during the 3-year post-IPO period.

**(Insert Table 2 and Figure 1 around here)**

Panel B Table 2 reports the social capital characteristics of the sample firms. In total, 82 firms have built up political bridging social capital; 58 of these firms began this before the IPO, and 32 after the IPO<sup>6</sup>. On average the sample firms issue 30% new shares to external investors. Regarding the intra-group bonding social capital, the related party transactions represent an average 0.64% of the sales in value.

Panel C Table 2 shows the sample firms' corporate governance and financial characteristics. For 23.76% of the sample firms, the chairman of the board is also the CEO. The average number of directors on the board is 9.12, and 22.2% of directors are independent.

Before the regression analysis, we first conduct univariate tests to investigate the relationship between social capital and accounting and market performance. The results

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<sup>6</sup> Among these 32 firms, 8 have already had pre-IPO political bridging social capital.

are reported in Table 3. The sample is broken down by (1) overall political bridging social capital, (2) external investor bridging social capital, (3) intra-group bonding social capital. Univariate tests show that political bridging social capital has a strong bearing on both accounting and market performance after an IPO, while for external investor bridging social capital, and intra-group bonding social capital, the effect is less substantial.

**(Insert Table 3 around here)**

### **Post-IPO accounting performance and the firm's social capital**

We now relate the change in accounting performance to firms' social capital proxies by an OLS regression analysis. The results are reported in Table 4.

**(Insert Table 4 around here)**

The dummy variable political bridging social capital variable is positively and significantly associated with the change in ROA, indicating that in an emerging and transitional economy like China, the political dimension of bridging social capital is vitally important for entrepreneurial firms' performance.

Secondly, the percentage of new shares issued (external investor bridging social capital) is also significantly and positively associated with the change in ROA. This result implies that internal controlling shareholders' openness and willingness to share power with external shareholders will create bridging social capital, which favors the post-IPO performance.

The coefficient for related party transaction intensity (intra-group bonding social capital) is significant and negative, indicating that the more related party transactions a firm conducts, the worse the post-IPO accounting performance is.

Note that in column one, the independent variables only include social capital variables, and control variables with financial characteristics. Corporate governance characteristics are added to the regression model in column 2. Control variables also

include two variables related to the IPO first-day return, since in China during our study period, the IPO issue price was determined by the regulator based on a fixed PE ratio, and the first-day return reflects investors' expectations of the firms' future performance rather than firms' decision to leave money on the table. Furthermore, to capture the investors' impression of the overall market performance, we use not only the sample firm's IPO first-day return, but also the average IPO first-day return of all companies conducting an IPO in the same month our sample company went public. In addition, as discussed before, there may be a time lag before the IPO proceeds are invested and the outputs of those investments translate into net income: we control for that factor by adding the ratio of IPO proceeds over pre-IPO equity of the sample firm. With all the control variables added, the direction and significance of coefficients for the social capital variables remain stable.

In the unreported robustness check, we also test the change in ROE performance. The results remain broadly similar.

### **The Endogeneity issue and Causality**

Since entrepreneurs do not randomly establish social capital, there is an endogeneity concern. To better understand the relationship between social capital and post-IPO performance, the issue of endogeneity needs to be addressed.

Regarding the percentage of shares floated - our proxy for external investor bridging social capital - an alternative explanation is that the causal relationship runs from post-IPO performance to shares floated, as founders usually have the information advantage and are better able to predict future performance. However, if that is the case, we should see a negative association between the percentage of shares floated and post-IPO performance, because if insider information leads the founder to anticipate a drop in performance, he will try to sell more shares to the public in the IPO, and vice versa.

For political bridging social capital, the reverse causality explanation would be that a firm with better performance is better able to develop political connections. To address this concern, we split political connections into those developed pre-IPO and post-IPO. Post-IPO political connections are more likely to be developed by firms with superior post-IPO firm performance.

58 of our sample firms have pre-IPO political connections while 32 have post-IPO political connections. It is interesting to note that pre- and post-IPO political connections overlap for very few sample firms. Of the 58 firms with pre-IPO political connections, only 8 developed further political connections post-IPO, indicating that pre- and post-IPO political connections are substitutes, and those companies without pre-IPO political connections are more eager to develop them after the IPO.

Columns 3 and 4 of Table 4 respectively report pre-IPO and post-IPO political connections; the coefficient remains significant, but the significance declines slightly compared with Column 1 or 2. The reason is that as the firms with pre- and post-IPO political connections seldom overlap, then the two dummies indicate the contrast not only between firms with and without political connections, but also between firms with pre- and post-IPO political connections when both have superior performances. These findings show that endogeneity is not likely to be a serious issue here. However, for reasons of prudence, the following analysis focuses solely on pre-IPO political connections. There is arguably still a possibility that good prospects are more likely to attract managers with political connections to join the entrepreneurial company. As we only look at the post-IPO performance change net of pre-IPO performance, that concern can be greatly mitigated. Meanwhile, the time lag between pre-IPO political bridging social capital and post-IPO performance makes causation clearer. For the intra-group bonding social capital proxy, i.e. related party transaction intensity, as there are contradictory theoretical predictions regarding its effect on post-IPO performance, endogeneity is less likely to be an issue.

### **Post-IPO market performance and the firm's social capital**

After an investigation into the effect of social capital on the post-IPO accounting performance of Chinese entrepreneurial companies, we explore whether those factors have a bearing on post-IPO market performance.

**(Insert Table 5 around here)**

In Table 5, the dependent variable is the post-IPO 3-year abnormal stock return, which is the sample company's stock return during the period of three calendar years starting the next trading day after the IPO, net of the market return during the same period. If a firm undertakes an IPO on April 1<sup>st</sup> 2005, then this period runs from April 2<sup>nd</sup> 2005 (if it is a trading day) to April 2<sup>nd</sup> 2008 (or if that day is not a trading day, the last trading day prior to April 2<sup>nd</sup> 2008). The market return is calculated as the arithmetic mean return for all stocks outstanding on the market during the same period. If the alternative measure of weighted average market return is used, the results remain stable.

The independent variables are largely the same as in Table 4, except that firm size is now proxied by the average year-end market value (in log form) during the three-year period. We also control for accounting performance by using the post-IPO change in ROA, since higher abnormal stock returns may simply be due to better accounting performance. Table 5 shows that the percentage of shares floated is not significant. However, the direction and significance of the coefficients for pre-IPO political social bridging capital and intra-group bonding social capital show that these two factors have the same impact on market performance as on accounting performance.

## **Determinants of Entrepreneur's Establishment of Social Capital**

What types of entrepreneurial firms are most likely to establish social capital? Table 6 reports regression results that link the probability of establishing social capital. While overall, no variables are related to the likelihood of a firm establishing social capital, the chairman/CEO is more likely to build pre-political connections, but less likely to share power with external investors in issuing additional portions of shares. On the other hand, poor pre-IPO performance firms are more likely to issue greater portions of new shares.

Overall, the results in Table 6 suggest that establishment of social capital is not motivated by firm performance, quality or corporate governance considerations. This means our previous findings are unaffected by endogeneity concerns: high-quality firms tend to have social capital in place before going public.

## **Discussion**



The empirical results obtained in the statistical analysis above clearly validate the hypotheses we developed based on social capital theory. The results for political bridging social capital and intra-group bonding social capital are consistent and statistically significant for both post-IPO accounting and post-IPO market performance; while the positive impact of external investor bridging social capital is significant for accounting performance, but not for market performance. It is important to note that all these results are obtained after controlling for major firm-level corporate governance and financial characteristics that have been proved in previous literature to impact firm performance.

Firstly, we find that political social capital is positively associated with post-IPO accounting and market performance. This suggests that in China, like other transitional and emerging economies, political bridging social capital plays an important role in the growth of entrepreneurial firms, given that the State still controls the lion's share of economic resources (Story, 2012) and entrepreneurs often feel insecure about their legitimacy in society ([Li & Zhang, 2007](#)).

Secondly, the percentage of shares issued is significantly and positively associated with a change in post-IPO accounting performance, although this link is not validated for post-IPO market performance. As explained previously, in China the type II agency problem is predominant, as opposed to the US where the type I agency problem predominates. Therefore, the internal controlling shareholder may create a stronger external investor bridging social capital by issuing more shares. External investors tend to play their monitoring and consulting roles more actively, and to help the listed entrepreneurial firm improve corporate governance quality. As a result, the firm does better in its accounting performance.

Thirdly, the intensity of related party transactions after the IPO is found to be significantly and negatively associated with the post-IPO accounting and market performance. As related party transactions capture the intra-group bonding social capital, this evidence suggests that although intra-group bonding social capital may add value to the whole business group controlled by the entrepreneur through the "internal market", the negative effect, i.e. lack of independence and accountability and a likelihood of expropriation, still outweighs its positive effect on firm performance.

## **Conclusion**

### **Theoretical Implications**

This paper examines the post-IPO accounting and market performance of entrepreneurial listed firms in China. The uniqueness of China's regulatory and institutional background allows us to examine the role played by the entrepreneur's social capital in these two types of performance.

We find that political bridging social capital improves the post-IPO accounting and market performance, while the intra-group bonding social capital has an adverse effect on both types of performance. We also find that external investor bridging social capital has a positive impact on the accounting performance.

Our study contributes both to the entrepreneurial finance literature and to social capital studies.

Unlike most existing literature in this field drawing exclusively on agency theory, this study takes a new angle to analyze entrepreneurial firm performance in the context of an emerging and transitional economy. We develop and test several proxies for social capital in the context of China's capital market. Specifically, the distinguishing feature of emerging economies is their low institutional efficiency and the prevalence of the relational contract. Social capital therefore exerts a huge influence on firms' performance, and in sharp contrast, formal governance mechanisms such as board size or board independence have no explanatory power for IPO performance. For a transitional economy, the still influential role of the state and the relatively low legitimacy of private firms further add to the importance of political social capital. Moreover, the concentrated ownership structure in these economies makes the relationship between controlling internal shareholders and small external shareholders another important dimension of social capital. The prevalence of business groups in emerging economies leads to the issue of interaction between the business group and its listed entities.

We find that political bridging social capital, as the most important type of social capital, helps improve companies' post-IPO performance, while the bridging social capital developed from interaction between controlling internal shareholders and small external shareholders is also beneficial for post-IPO performance. However, the bonding

social capital deriving from the connections between the business group and the listed entity reduce the firm's post-IPO performance.

In sum, we put forward three measures that capture specific aspects of social capital in an emerging and transitional economy and further link them to the post-IPO performance of entrepreneurial companies. This enhances the understanding of social capital and its impact on entrepreneurial companies' post-IPO performance, and therefore add to both the entrepreneurial finance and the social capital literature.

## **Practical Implications**

In addition to its academic contribution, this study also yields strong practical implications.

Firstly, for entrepreneurs in an emerging and transitional economy, acquiring adequate political bridging social capital needs to be understood as part of the business strategy. The win-win cooperation between internal and external shareholders is of crucial importance to firm performance, and attention should also be paid to “investor relations” with small external shareholders. Furthermore, the benefit and cost of intra-group bonding capital should be carefully balanced. Although related party transactions may benefit the listed entity and the whole group in some circumstances, their “dark side” should not be ignored, especially as regards the interests of external shareholders who only invest in the listed entity.

For investors, our findings provide some insights to help screen promising and trustworthy entrepreneurial companies from the pool. Moreover, with the promotion of “investor activism”, our findings can also be a roadmap for external investors if they intend to scrutinize the firms' management more closely.

For regulators and policymakers in emerging and/or transitional economies, the first implication of our findings is that development of the market economy and construction of formal institutions should be the highest priorities. Although political social capital benefits entrepreneurial companies, there are of course side-effects. In the long run, such “relational transactions” need to gradually recede and be replaced by “arm's-length transactions”. The second implication is that regulators can play an effective role in the protection of small external investors and monitoring the internal

controlling shareholders' behavior, and thus facilitating win-win cooperation between them.

## **Limitations and Future Research**

Despite the above contributions both to theory and practice, this study presents some limitations, which also indicate some directions for future research.

Firstly, our study focuses on China. Although China is the largest and fastest-growing emerging transitional economy in the world, the generalizability of our conclusion requires further testing for other economies. A cross-country comparison between various emerging and transitional economies is therefore one possible direction for future study.

Secondly, there is the issue of the validity of variable measurement. Our measures probably capture only a few aspects of social capital. Given the breadth and complexity of social capital, future research could use the theoretical framework constructed in this study to develop appropriate social capital measures for each country's unique institutional environment.

Thirdly, this study examines the associations between social capital and entrepreneurial firm performance. However, the impact of social capital is profound and systematic, and it would thus be interesting to link social capital with other outcome measures such as access to resources, firm riskiness, and the probability and ease of entrepreneurial exit.

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Table 1: Summary of IPOs and IPO characteristics by Year

Year	No. of IPOs	Percentage of total number of IPOs	Average proceeds (RMB million)	Average first-day return
1996	4	2.17%	83.50	171.52%
1997	16	8.08%	187.00	158.64%
1998	6	6.06%	278.00	229.62%
1999	10	10.64%	374.00	136.90%
2000	22	16.30%	446.00	155.44%
2001	9	11.39%	398.00	176.58%
2002	10	14.71%	342.00	90.94%
2003	15	22.39%	333.00	57.01%
2004	36	36.00%	265.00	68.12%
2005	7	50.00%	247.00	22.55%
2006	29	43.94%	279.00	97.65%
2007	17	13.49%	332.00	213.83%

Table 2 Summary Statistics

Panel A Change in accounting and market performance				
Stats	Mean	Median	T test	Wilcoxon sign rank test
Change in sales as percentage of pre-IPO sales	213.28%	147.23%	10.26	11.51
Change in asset turnover	-0.32	-0.29	-7.79	-10.12
Change in ROA	-6.13%	-5.40%	-15.40	-11.17
Change in ROE	-5.74%	-2.78%	-20.34	-11.53
Post-IPO 3-year abnormal stock return	22.0%	-14.1%	-	-

  

Panel B Social capital variables			
	Mean	Median	Standard Deviation
Political bridging social capital (dummy variable)	0.27	0.00	0.45
Pre-IPO political bridging social capital (dummy variable)	.33	0.00	.47
Post-IPO political bridging social capital (dummy variable)	.18	0.00	.38
External investor bridging social capital (Percentage of new shares issued)	30.21%	28.00%	6.37%
Intra-group bonding social capital (related party transactions)	.64%	.37%	.88%

  

Panel C Corporate Governance and financial Characteristics			
	Mean	Median	Standard Deviation
Chairman is CEO	23.76%	0.00%	42.68%
Number of board directors	9.12	9.00	2.41
Number of independent directors as percentage of total	22.20%	33.33%	17.45%
Proceeds raised as percentage of pre-IPO equity	258.51%	225.21%	157.11%
Ln(total asset)	19.44	19.38	0.67
Ln(market value)	20.99	20.96	0.57

Table 3 Univariate test results

Panel A

	Firms with no political bridging social capital		Firms with political bridging social capital		T test	Wilcoxon rank-sum test
	mean	p50	mean	p50		
Change in sales as percentage of pre-IPO sales	1.83	1.37	2.56	1.68	-1.71*	-1.25
Change in asset turnover	-0.39	-0.36	-0.22	-0.18	-2.10**	-3.29***
Change in ROA	-0.07	-0.06	-0.05	-0.05	-2.75***	-3.39***
Change in ROE	-0.18	-0.17	-0.15	-0.13	-2.07**	-2.34**
Post-IPO 3-year abnormal stock return	-0.01	-0.14	0.49	-0.12	-1.33	-1.11
No. Obs.	99		82			

Panel B

stats	Firms with low external investor bridging social capital		Firms with high external investor bridging social capital		T test	Wilcoxon rank-sum test
	mean	p50	mean	p50		
Change in sales as percentage of pre-IPO sales	2.01	1.42	2.24	1.53	-0.57	-0.09
Change in asset turnover	-0.39	-0.35	-0.27	-0.24	-1.46	-1.91*
Change in ROA	-0.07	-0.06	-0.06	-0.05	-1.33	-0.90
Change in ROE	-0.17	-0.15	-0.17	-0.16	0.14	0.36
Post-IPO 3-year abnormal stock return	0.52	0.02	-0.05	-0.20	1.58	1.90*
No. Obs.	85		96			

Panel E

stats	Firms with low intra-group bonding social capital		Firms with high intra-group bonding social capital		T test	Wilcoxon rank-sum test
	mean	p50	mean	p50		
Change in sales as percentage of pre-IPO sales	2.53	1.55	1.73	1.37	1.95*	1.41
Change in asset turnover	-0.28	-0.26	-0.36	-0.33	0.89	1.00
Change in ROA	-0.06	-0.05	-0.06	-0.05	0.51	0.43
Change in ROE	-0.16	-0.15	-0.18	-0.16	0.84	0.72
Post-IPO 3-year abnormal stock return	0.49	-0.12	-0.05	-0.17	1.50	0.79
No. Obs.	91		90			

Table 4 OLS regression of the effect of social capital on post-IPO accounting performance

Dependant variable	Change in ROA				
	(1)	(2)	(3)	(4)	(5)
Political bridging social capital	0.026***	0.023***			
	(3.417)	(3.084)			
Pre-IPO Political bridging social capital			0.017*		0.025***
			(1.972)		(2.616)
Post-IPO political bridging social capital				0.022**	0.015
				(2.074)	(1.387)
External investor bridging social capital	0.260***	0.269***	0.282***	0.279***	0.341***
	(4.095)	(3.968)	(4.089)	(4.056)	(4.274)
Intra-group bonding social capital	-0.017***	-0.017***	-0.016***	-0.015***	-0.015**
	(-4.015)	(-4.017)	(-3.727)	(-3.605)	(-2.539)
Proceeds raised	-0.010***	-0.009**	-0.009**	-0.008*	-0.009**
	(-3.148)	(-2.236)	(-2.220)	(-1.919)	(-2.040)
Ln (total assets)	0.019***	0.024***	0.024***	0.024***	-0.039**
	(2.908)	(3.317)	(3.320)	(3.372)	(-2.211)
If CEO is chairman		0.007	0.006	0.012	0.002
		(0.754)	(0.659)	(1.358)	(0.168)
Board size		-0.025	-0.025	-0.028*	-0.039**
		(-1.458)	(-1.452)	(-1.671)	(-2.211)
Board independence		-0.054	-0.050	-0.048	-0.078
		(-0.908)	(-0.824)	(-0.813)	(-1.346)
IPO first-day return (firm)		0.007	0.007	0.009	0.004
		(1.047)	(0.993)	(1.460)	(0.623)
IPO first-day return (market)		-0.000	-0.000	-0.000	0.000
		(-0.477)	(-0.430)	(-0.515)	(0.299)
constant	-0.453***	-0.491***	-0.500***	-0.510***	-0.485***
	(-3.527)	(-3.330)	(-3.329)	(-3.424)	(-3.171)
Adjusted R <sup>2</sup>	0.279	0.278	0.251	0.249	0.341
F statistic	5.095	4.085	3.687	3.741	3.293
No. Obs.	170	169	169	175	169

Table 5 OLS regression of the effect of social capital on post-IPO market performance

Dependent variable	Post-IPO 3-year stock abnormal return				
	(1)	(2)	(3)	(4)	(5)
Political bridging social capital	0.835**	0.853**			
	(2.224)	(2.093)			
Pre-IPO Political bridging social capital			1.022**		1.187**
			(2.248)		(2.504)
Post-IPO political bridging social capital				1.452***	1.351**
				(2.704)	(2.597)
External investor bridging social capital	-0.586	-1.582	-1.172	-2.132	-0.299
	(-0.183)	(-0.425)	(-0.315)	(-0.590)	(-0.071)
Intra-group bonding social capital	-0.446**	-0.466**	-0.431*	-0.418*	-0.547*
	(-2.109)	(-2.048)	(-1.921)	(-1.948)	(-1.908)
Proceeds raised	-0.140	-0.099	-0.122	-0.034	-0.144
	(-0.886)	(-0.506)	(-0.616)	(-0.183)	(-0.688)
Ln (market value)	1.806***	1.879***	1.872***	1.810***	1.526***
	(5.323)	(5.112)	(5.104)	(5.074)	(4.290)
If CEO is chairman		-0.119	-0.191	0.027	0.078
		(-0.247)	(-0.396)	(0.059)	(0.162)
Board size		-0.627	-0.584	-0.719	-0.102
		(-0.707)	(-0.660)	(-0.856)	(-0.117)
Board independence		-2.078	-1.773	-2.190	-3.766
		(-0.683)	(-0.584)	(-0.752)	(-1.321)
IPO first-day return (firm)		0.166	0.097	0.230	-0.057
		(0.538)	(0.312)	(0.799)	(-0.183)
IPO first-day return (market)		-0.002	-0.001	-0.002	0.001
		(-0.329)	(-0.254)	(-0.310)	(0.163)
Change in ROA		0.708	1.374	1.837	-2.422
		(0.167)	(0.332)	(0.465)	(-0.573)
constant	-37.226***	-36.398***	-36.295***	-34.920***	-29.937***
	(-5.042)	(-4.403)	(-4.401)	(-4.358)	(-3.682)
Adjusted R <sup>2</sup>	0.147	0.122	0.126	0.143	0.277
F statistic	2.855	2.065	2.104	2.314	2.654
No. Obs.	173	169	169	175	169

Table 6 Determinants of Entrepreneurial Firm to Establish Social Capital

	Political bridging social capital	Pre-IPO Political bridging social capital	Post-IPO political bridging social capital	External investor bridging social capital	Intra-group bonding social capital
	Logit	logit	logit	OLS	OLS
If CEO is chairman	0.45	1.398**	-0.739	-0.018*	0.027
	-0.88	(2.289)	(-0.944)	(-1.973)	(0.205)
Board size	-0.443	-0.388	-0.582	0.042**	-0.107
	(-0.459)	(-0.358)	(-0.363)	(2.456)	(-0.419)
Board independence	1.95	1.839	-1.682	-0.034	0.382
	(0.698)	(0.632)	(-0.435)	(-0.660)	(0.503)
ln_asset	-0.271	-0.434	-0.353	-0.039***	0.113
	(-0.785)	(-1.052)	(-0.732)	(-6.169)	(1.200)
average pre-ipo roa	-7.708	-6.184	-9.502	-0.512***	-1.678
	(-1.539)	(-1.094)	(-1.169)	(-6.003)	(-1.326)
constant	25.053***	27.872	10.801	0.872***	-0.831
	(3.508)	.	(1.032)	(6.479)	(-0.416)
Adjusted R <sup>2</sup>				0.531	0.465
F statistic				7.146	5.730
No. Obs.	148	148	98	175	175

Figure 1 Change in performance over sample period

