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Why Firms Should Care About the Career Stage of China's Officials

Tasked with a broad range of objectives, government officials will prioritise different ones depending on their career stage and mobilise firms accordingly.

Governments typically set a wide range of goals. This is reasonable and expected: For a society to grow sustainably, social stability-related targets are just as critical as economic ones. Faced with a broad array of objectives and limited hours in a day, government officials will prioritise projects that befit their career stage. This, in turn, may affect local firms more than they realise.

For instance, younger officials will pay more attention to hard KPIs that could lead to a promotion. Meanwhile, older ones will focus on softer targets that could bring them personal benefits after retirement or at least ensure a smooth transition when they leave office. They may not be as interested in pushing large economic growth-enhancing projects whose results may come too late to help their career.

In our newly published article, **"Running out of steam? A political incentive perspective of FDI inflows in China"** (co-authored with **Zhitao Zhu** and **Shuo Chen**), we looked at foreign direct investments (FDI) inflows into 224 Chinese cities at the prefecture level, from 2003 to 2010. We showed that the political term, as a core feature of career advancement in state bureaucracy, influences newly appointed government officials' efforts to attract FDI.

In Chinese bureaucracy, large-scale leadership turnover happens every five years, right on the heels of the Party's National Congress. Think of it as a window of opportunity for promotions, but with a few constraints. First, the law often mandates how many terms an official can serve in one specific position. Second, promotions are based on tournaments rewarding quantified economic objectives. Third, depending on their rank, officials must retire by age 55, 60 or 65. Under these rigid career progression rules, the optimal strategy is to keep moving before reaching retirement age.

Goals may be set at the national level, but decisions are often made locally

A promotion creates momentum in the career of government officials. Past **research** showed that 86 percent of promotions are given to first-term leaders, while the likelihood of promotion decreases after the first term of office. These odds are not lost on officials. In our study, we show that newly promoted officials – motivated by their fast-tracking potential – work harder to attract FDI inflows. Conversely, officials who remain at the same level for a second term are less inclined to achieve the state's objectives, considering their reduced chances of success in the next round of competition.

We ruled out a vast array of alternative explanations for the differences we observed between the cities and provinces we studied. Our results remained robust to every control we applied, such as a region's history of attracting FDIs, the leaders' other personal characteristics and a host of other factors found to influence the location of FDIs.

Overall, first-term leaders were associated with a 19.1 percent increase in FDI inflows to their cities compared with sitting leaders. However, the closer the leaders were to retirement, the smaller the difference was between the two types of leaders, showing the influence of the career stage.

For the majority of firms, considering the career incentives of government officials is sound corporate political strategy. China is not alone in having taken measures to curb corruption by aligning objectives with its officials' incentives. If a governor is rewarded for bringing in FDIs, the community at large gains via increased employment opportunities. This is in direct contrast with bribery, which solely lines the pockets of the corrupt official – often at the expense of the community. So, when a firm helps a local official advance their career, it can start a virtual cycle where everyone benefits.

Diversifying to contribute to social stability

In an earlier paper, **"Retire in Peace: Officials' Political Incentives and Corporate Diversification in China"**, we showed that under pressure from government officials, Chinese firms might decide to diversify, especially into unrelated industries, whether or not their internal needs, resources and characteristics justify such a diversification.

We looked at Chinese publicly listed firms between 2001 and 2011, a time when the Chinese government undertook market reforms to enhance economic competitiveness. Many insolvent state-owned enterprises (SOEs) were encouraged to declare bankruptcy. At the behest of local officials, some firms diversified into unrelated industries by acquiring bankrupt SOEs and reemploying their workers. This was more likely to occur when the governor of the firm's home province was closer to retirement, as preventing social unrest became more important than economic development from the governor's point of view.

When diversifying in this manner, firms may invoke some rationale in a corporate statement. One such explanation might be the need to fill a void in the market in order to best pursue the firm's mission. For example, a firm might engage in road building to facilitate the distribution of its products. But based on our data, factors outside of the firm clearly led to the adoption of this diversification strategy.

In our interviews with executives, we found that many didn't seem to be fully cognisant of the role the government had on their decisions. They would mention how the government favoured this diversification and how the firm would receive bank loans and tax subsidies. However, our data showed a clear link between governors' characteristics (and career incentives) and the decisions made by firms.

Beyond economics, firms are social actors

In our sample, this unrelated diversification didn't economically benefit the firms over a two- or three-year timeframe. Which is not necessarily a bad thing, if firms are to be **fundamentally committed** to all their stakeholders. As the famous 2019 Business Roundtable statement suggested, firms should not think strictly about their return on assets. Instead, they should see themselves as the social actors that they are.

A caveat is that firms should be aware how government officials can influence them, especially in emerging markets where the state may hold the key to more resources. Executives should be clear-headed about the social forces that shape their decision making. Many successful entrepreneurs already understand the importance of managing their stakeholders in a balanced way. This is how a firm can endure for the long term.

The relationship between business and the state could be used to benefit society as a whole. As long as the government is not corrupt and smartly motivates its officials to attain objectives that benefit society in some way, corporate resources can be put to good use. For instance, through such incentives, governments can create opportunities for investors and attract FDIs that boost employment.

Business literature teaches foreign firms to pick their entry point based on market factors. These include costs, market size, abundance of resources or the quality of the formal and informal institutions in a given region. While those are indeed very important, our research shows that in emerging markets, it is also key to understand the career incentives of local officials in order to secure the best deals.

Of course, the firm also needs to think about the consequences of its presence. Beyond the short-term incentives, can a firm really bring benefits to the community in a sustainable way? If its preferred area is one where the local official is nearer to retirement – and thus motivated to help bring in more pro-social firms – it is even more important to have answers to this question.

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