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Institutional Divide, Political Ties, and Contested Corporate Governance Reform in Taiwan

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ABSTRACT This study attempts to address the question of *under what conditions* political ties buffer firms from, or bind firms to, political pressure. We draw attention to the institutional divide between the executive and legislative branches of a presidential democracy. Using the case of Taiwan, a 'third wave' democracy with relatively strong state intervention, we argue that the two branches differ in their respective institutional roles, basis of legitimacy, and resources in a context in which the regime is seeking to fulfil its national agenda and please floating voters. We posit that corporate ties to these respective branches exert divergent influence on the adoption of government-initiated but highly contested corporate governance reforms. Ties to the executive branch push firms to reform because they depend on the government for resources, while ties to the legislative branch act as a buffer to reform as legislators court the support of firms in pursuit of electoral gains. Empirical analysis of reforms to enhance board independence from 2002 to 2005 supports our thesis. Our study contributes to research on corporate political strategy and corporate governance reform, revealing how the structural fragmentation of the state can give rise to conflicting roles of political ties to different branches.

Keywords: corporate political ties, institutional divide, corporate governance reform, presidential democracy

INTRODUCTION

An important goal of corporate political strategy is to influence policy-making in firms' favour and buffer them from unfavourable changes to policy (Hillman et al., 2004;

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Mellahi et al., 2016). Ties to political actors enable firms to access timely information, ensure their stance is represented, and receive protection (Correia, 2014; Fisman, 2001). Nevertheless, the literature on corporate political ties also finds that they serve as a conduit of state influence, pressuring firms to conform to government demands and expectations (Zhang et al., 2016). While firms may gain resources such as subsidies, bank loans, government contracts, or bailouts in an economic crisis (Faccio et al., 2006; Goldman et al., 2013; Khwaja and Mian, 2005), they may equally become dependent on the government. Resource dependence may in turn constrain corporate discretion and subject firms to political pressures (Marquis and Qian, 2014; Pfeffer and Salancik, 1978). If both mechanisms are at work, it is important to understand *the conditions under which political ties bind firms to, or buffer firms from, political pressures*. Not addressing this question would prevent us from understanding the actual effects of political ties and the sources of such effects.

We propose that the answer to this question partly resides in the institutional divide – the separation of powers between the executive and legislative branches of the state. Although there is some theory and anecdotal evidence of the different policy inclinations of state administrators and legislators (Nielson, 2003; Samuels, 2001; Samuels and Shugart, 2003; Shugart and Haggard, 2001), how the separation of powers, and ties to these two branches, influence business practices has not been systematically examined. It is plausible that given the different goals and resources of these two branches, ties to the executive vs. legislative branches can give rise to divergent and even opposing influences on firms when controversial issues arise. Neglecting the potentially distinct effects of corporate ties to the two branches may conceal the actual effects of these ties, preventing us from developing a more comprehensive and nuanced understanding of corporate political strategy.

We address this theoretical gap by investigating how ties to the different state branches influence corporate governance reforms, often described as a highly 'contested terrain' (Ahmadjian and Robbins, 2005; Fiss and Zajac, 2004; Sanders and Tuschke, 2007). Corporate governance reforms involve adopting practices such as board independence and information disclosure, which seek to protect minority shareholders but may result in a transformation of decision-making dynamics within a firm. Controlling shareholders may resist such initiatives that allow external investors to better monitor and influence corporate decisions, particularly in emerging markets in which insider control prevails yet foreign investment is critical for economic growth (Yoshikawa et al., 2007). Reforms to corporate governance in such contexts can thus create a tension among various stakeholder groups, such that the impact of corporate ties to the executive and legislative branches of the state may diverge.

Taiwan provides an ideal context in which to examine how political ties influenced firms' engagement in state-initiated corporate governance reform during a period when the regime was seeking to pursue a national agenda and, at the same time, court floating voters. In the interests of national objectives such as economic growth, political actors pressured firms to abide by state policy, yet when they were in pursuit of electoral gains (votes), they were obliged to consider firms' interests. As the Taiwanese state transitioned from an authoritarian to a democratic regime (Tien, 1989), the executive branch continued to pursue growth, control resources, and derive legitimacy from policy implementation. However, to survive periodic elections, legislators tend to prioritize the demands of local constituencies, which are not always aligned with the government's overarching goals (Downs, 1957; Mainwaring, 1999). Given this distinction, we posit that firms with ties to administrators of the executive branch ('administrative ties') were pressured to conform with state initiatives because of their dependency on the government for resources, while firms with ties to legislators ('legislative ties') were buffered from state pressure because, in pursuit of electoral support, legislators are inclined to represent electoral interests, particularly those of private businesses that contributed to their election campaigns. Thus, the mechanisms of resource dependence and interest representation embedded in administrative and legislative ties, respectively, led to opposing influences on firm behaviour.

In testing the opposing effects of the two types of ties, we also consider the moderating influence of domestic blockholders and the global capital market. While foreign institutional investors pushed for reforms to protect their investments and returns, domestic blockholders (such as business families) resisted government reforms for fear of losing their control over firms (Ahmadjian and Robbins, 2005). These conflicting influences impacted the two types of ties differently as a result of the mechanisms of resource dependence and interest representation.

Our 'time window' to observe how corporate ties with the two branches influenced firms' adoption of independent directors in Taiwan is the period from 2002 to 2005. In 2002, the practice was advocated by the administration after Taiwan became a member of the World Trade Organization (WTO), albeit it was voluntary for the firms in our sample until 2006. Our empirical tests support the argument of opposing impacts of ties to the executive vs. legislative branches on the appointment of independent directors and the moderating effects of firm ownership. In supplementary analyses we examine an additional practice (to complement board independence) advocated by the Taiwanese government during the same period: information disclosure. Again, the diverging influences of administrative and legislative ties occur, albeit the effect of administrative ties is weaker.

Our study contributes to research on corporate political strategy by uncovering the distinct influences of corporate ties to the executive vs. legislative branches. Although recent studies have disaggregated corporate political ties based on level of government, political parties, and individual politicians' incentives (Luo et al., 2017; Zheng et al., 2015; Zhu and Chung, 2014) to understand the impact of various political ties, we know little about *the conditions under which* politically connected firms are subjected to the state's agenda (referred to as 'binding') or, conversely, are able to influence policy-making to their advantage (referred to as 'buffering'). Our finding regarding the institutional divide of a democracy – i.e., the separation of powers between the two branches – helps identify a critical condition and adds nuances to our understanding of corporate political strategy. Although based on the context of Taiwan, our theory sheds light on the contingency of corporate political ties and has implications for other presidential democracies with similar attributes.

In addition, we contribute to corporate governance research by highlighting the state as a source of contestation for corporate governance reform. Previous studies that view such reforms as contested terrain have primarily focused on conflict between foreign investors and domestic blockholders (Ahmadjian and Robbins, 2005; Fiss and Zajac, 2004), overlooking the possibility that the institutional divide within a state can give rise to opposing impacts on corporate governance practices. Our findings on political ties and their contingent effects enrich prior research by presenting a more complete picture of how corporate governance reforms are jointly shaped by different political actors and powerful firm owners.

SEPARATION OF POWERS BETWEEN EXECUTIVE AND LEGISLATIVE BRANCHES IN TAIWAN

Given the idiosyncratic political and institutional environments in emerging markets (Khanna and Palepu, 2010; Marquis and Raynard, 2015), existing studies have leveraged country-based contexts to develop theories about how political ties shape firm behaviour. This approach complements the established literature on corporate political strategy, which is largely based upon developed economies. For instance, Siegel (2007) conceptualized the history of regional elite high schools as sources of identity and political tie formation in South Korea. Kozhikode and Li (2012) suggested that the social and political pluralism in India led to political party competition and shaped the expansion of bank branches. More recently, Haveman et al. (2017) described the economic transition and political embeddedness of firms during China's economic transition and developed a theory on how political ties influence firm profitability in a context of market growth and political inertia. Inspired by these efforts, we situate our study in Taiwan, a political context characterized by a more proactive state role in the economy (than most advanced wealthy countries) and nascent democracy to develop a theory on how institutional divide can give rise to divergent influences of corporate political ties.

Taiwan moved to a democratic system from an authoritarian regime in the latter half of the 20th century in response to domestic and international pressures (Huntington, 1991; Tien, 1989), as manifested in the separation of the executive and legislative functions. The separation of the executive and legislative functions of the state is a central feature of presidential democracies (e.g., South Korean, Taiwan, and the USA). Unlike the parliamentary system, in which the prime minister and cabinet ministers are also parliament members, administrators and legislators in a presidential system are appointed or elected separately, have distinct institutional roles and functions, and cannot overlap (Verney, 1992).

With the institutional divide between executive and legislative branches in the new system, the influence of the Taiwanese state on business and the economy became incoherent, especially when state policies were controversial. The different election cycles in Taiwan – for presidential and legislative elections – could lead to the pursuit of disparate goals by the president and legislators in seeking to appeal to their constituencies (Samuels and Shugart, 2003). During our research period, the president of Taiwan was elected every four years by universal suffrage, whereas legislators were elected every three years by 33 district constituencies. Hence their campaign agendas and promised deliverables might diverge.

With a legacy of an authoritarian state and bureaucratic infrastructure, state administrators are responsible for allocating resources, providing industrial-supporting institutions, implementing policies, and enforcing regulations (Fuller, 2020; Wu, 2004). After democratization, achieving economic growth continued to be a priority goal and the main source of legitimacy for the administrators. The executive branch garnered legitimacy from the successful implementation of new national policies such as improving governance and attracting foreign investment, enabling professional bureaucrats to enhance their reputation and career prospects. It also controlled tangible resources such as capital allocation (see Wu, 2005).

Meanwhile, the legislative branch was more accountable to voters. Local scholars described its transition from being a 'rubber stamp' before democratization to a 'roaring lion' afterwards (Liao, 2005). Legislators not only oversaw government budgets but also held tacit information regarding the laws or potential loopholes in the implementation of regulations, which allowed them to negotiate with bureaucrats. While the executive branch continued to take the lead in policy-making, its power was monitored and constrained by elected legislators after democratization.

The newly established (or resuscitated) legislative branch in Taiwan was more accountable to local communities (Wu, 2007). Legislators gain legitimacy by relaying feedback and even resistance from their supporters to the government. This creates an electoral incentive centred on local constituencies (Noble, 1998; Shugart and Haggard, 2001). A survey revealed that two-thirds of the legislators in Taiwan prioritized the concerns of their constituencies when there was a conflict between government policies and their constituencies (Sheng, 2003).

Like other democracies in the so-called 'third wave' (late 20th century), Taiwan held elections before establishing the corresponding democratic institutions and culture (Huntington, 1991), a sequence dubbed 'democratization backwards' that often leads to more floating voters and greater electoral volatility (Mainwaring, 1999; Rose and Shin, 2001), intensifying the pressure created by elections. This is especially the case for legislative elections, which tend to be held in small constituencies. In the absence of a culture and institutions of mature democracy – free mass media, strong civil society, corporate donations (e.g., political action committees), and an independent judiciary – the nascent democracy in Taiwan gave legislators substantial leeway to please their constituencies (Mezey, 1983).

We propose that because of these differences, the two branches varied in their susceptibility to business influence and their ability to influence firms. We examine how corporate ties to the two branches influenced corporate responses to the government-initiated corporate governance reform in Taiwan between 2002 and 2005.

Corporate Governance Reform in Taiwan

Taiwan is a typical example of emerging market corporate governance reform in the early 2000s (Credit Lyonnais Securities Asia, 2001). Such reforms were the result of two important events. First, Taiwan became a member of the WTO on 1 January 2002. This put pressure on the administration to align Taiwan's institutions, including corporate governance rules, with global standards. Second, the Asia Financial Crisis led to the formation of the OECD Asia Corporate Governance Roundtable in 1999 (Johnston, 2003, pp. 106–7), which became a major channel of influence on the Taiwanese government. Sixteen Taiwanese officials and experts participated in the meetings of this Roundtable, and many of them became members of the task force established by the Administrative Yuen to plan and oversee corporate governance reform in 2002 (Task Force for Corporate Governance Reform, 2002). The regulatory changes made during this period reflected a growing awareness of, and eagerness to strengthen, monitoring of the financial market and listed corporations.

HYPOTHESES

Ties to Executive and Legislative Branches and Corporate Governance Reform

Based on the differences between the two branches in Taiwan outlined above, our hypothesis is that administrative ties put firms under pressure to comply with corporate governance reform since state administrators, in their role as upholders of state policy, are able to leverage the firms' dependence on the government for resources. The binding effect of administrative ties will be particularly strong when the initiative concerned is part of the national agenda. As administrators face heightened monitoring and are evaluated on the implementation of such initiatives, they have reasons to push firms to comply with reforms. Both incumbent and former administrators may have roles in companies (Lester et al., 2008). Indeed, in Taiwan, full-time administrators are allowed to serve in the private sector as shareholders, while part-time positions (which are typically the highly prestigious appointments as members of presidential advisory councils and ministerial committees) can be held by top business executives and board members. Incumbent administrators with ties to businesses have an incentive to push firms to implement government-initiated corporate governance practices due to concerns for their political careers. Former administrators with business links can also come under pressure to comply from ex-colleagues in the administration.

State administrators, in comparison with legislators, are relatively insulated from election pressure, and hence less likely to succumb to business interests. Bureaucrats and appointed politicians are insulated from elections and focus on a clear career path with pension at the end (Evans and Rauch, 1999). Even though presidents may face re-election pressure, they need to consider the voices of many other constituencies – not simply business interests – such as minority shareholders, labour unions, and environmentalists, in the national general election (Evans, 1997).

The executive branch thus has an incentive to pressure connected firms to comply with reforms and is likely to obtain compliance because of the resource dependence created by the connection (Pfeffer and Salancik, 1978). Since political ties serve as a conduit for channelling resources such as government contracts and bank loans (Goldman et al., 2013; Khwaja and Mian, 2005), firms' dependence on these ties makes them more likely to comply with the expectations of state administrators (Oliver, 1991; Pfeffer and Salancik, 1978). Pfeffer and Salancik (1978, p. 183) observed that a consequence of coordinating with other organizations is that 'external influence over the [focal] organization is increased and its own discretion is simultaneously constrained even as it increases the certainty of its environment'. Firms dependent on external constituents for resources thus need to adjust their structures and practices to the expectations of such constituents.

Admittedly, administrators may also attempt to exert pressure on unconnected businesses, but without resource dependence as a lever the outcome of such pressure will be uncertain (Zhang et al., 2016). Hence, administrative ties expose firms with ties to stronger government pressure, leading to higher levels of corporate conformity to state-initiated corporate governance reform.

Hypothesis 1: Firms with more administrative ties will engage in corporate governance reform more than firms with fewer such ties.

Conversely, ties to the legislative branch buffer firms from state pressure to make reforms to corporate governance, since interest representation comes into play, especially at election time. It is not uncommon for legislators to challenge government policy in the interests of their constituencies, essentially because they depend on those constituencies for support. When facing periodic election pressure, legislators may also rely on the corporate sector for campaign contributions (Samuels, 2001). The analysis of political action committee (PAC) contributions made by US firms between 1980 and 2006 shows that on average firms spent $40,000 annually while some may spend up to $2 million (Correia, 2014). In Taiwan, the cost of an election campaign was estimated to range between US$6.6 and $20 million, and 90 per cent of the candidates allegedly had large corporate donors (Peng, 1995). Prior to the election of January 2008, Taiwan had a single non-transferable vote (SNTV) system. This encouraged extremely localized and factionalized politics, similar to what was found in Japan under the same system (Göbel, 2012).

In the context of corporate governance reform, our analysis of the minutes of government meetings with firms and top business associations regarding board independence in Taiwan revealed a high level of negativity towards this practice among legislators, especially those who served in business roles in the private sector (Council for Economic Planning and Development, 2003). Among six business-linked legislators who participated in the meetings, five held a negative view and used bargaining and buffering tactics in their rhetoric. For example, one of these legislators argued, 'When government agencies take initiative to strengthen corporate governance practices, they should focus on encouraging or educating companies to adopt practices such as independent directors rather than making it compulsory by law' (Council for Economic Planning and Development, 2003, p. 246).

In addition, ties to legislators can provide a means to buffer the connected firms from compliance. Legislators may provide tacit and private information to help firms navigate the bureaucracy (Bonardi et al., 2005; de Figueiredo, 2009). Legislators' status and expertise can also provide some legitimacy to offset the 'discounted' legitimacy of firms that do not comply with government initiatives (Lester et al., 2008). More importantly, the social networks of legislators can help firms locate alternative resources in the market. Our interviews with insiders in the Taiwanese parliament indicate that Taiwan's legislative body is a centre of information flows and business networks because various economic policies and regulations (e.g., monetary issues, foreign trade, labour, and tax) are all discussed and debated in the parliament. For connected firms, such tacit and timely information and contacts may reduce their pressure to respond to the government's call for governance reform. We hence propose the following hypothesis:

Hypothesis 2: Firms with more legislative ties will engage in corporate governance reform less than firms with fewer such ties.

Firm Ownership and Effect of Administrative Ties

To validate the theoretical mechanisms we propose, we next consider how firm ownership can affect the opposing impact of the two types of corporate political ties. If, as we have argued, administrative ties channel the pressure for compliance to the tied firms because of these firms' resource dependence on the state, we should expect such pressure to be contingent on the firms' owners, who supply critical resources needed by the firms. Similarly, consistent with the interest representation mechanism for the buffering effect of legislative ties, we expect such an effect to be contingent on the interests and inclination of the corporate owners regarding corporate governance reforms. We consider two important firm owners in our research context, controlling families and foreign owners, who hold opposing stances towards the reforms and varying types of resources (Lins, 2003). The resources and distinct interests of these powerful owners can shape the way through which the two types of political ties influence firms' engagement in corporate governance reform.

Since the controlling family and global capital markets can provide firms with alternative resources, we expect the ownership by dominant family and global investors may reduce the resource needs and thus the leverage administrators could use to influence firms.

Specifically, the controlling family can provide firms with alternative resources because the networks and resources of family owners are transferred to the firms and become the firms' social capital and resources. The firms' networks were often based on the family members' networks and influenced the subsequent development of the firms' social capital (Arregle et al., 2007). Furthermore, compared with their non-family counterparts, family owners are more likely to develop enduring and personal relationships with key stakeholders such as employees, suppliers, and alliance partners due to family owners' long-term orientation. The superior social capital and resources of family firms have been confirmed by large-scale studies (Miller et al., 2008; Zahra, 2010). Such social capital and resources may reduce the firms' dependence on state administrators for resources and weaken the reform pressure channelled through administrative ties.

Hypothesis 3a: The positive effect of administrative ties on firms' engagement in corporate governance reform is weakened when the tied firms are family-dominated.

Similarly, access to a larger, global pool of financial resources can substitute resources channelled through administrative ties. The amount of liquidity available in the global capital market is often much larger than that provided by domestic banks in emerging markets. Siegel (2009) studied 183 public firms in Mexico and confirmed that gaining access to the global capital market is often viewed as an alternative to obtaining local bank loans via administrative ties and that firms seldom use both simultaneously.

In addition, participation in the global capital market may constrain firms from utilizing resources through administrative ties because of the closer scrutiny by international market intermediaries, which makes firms less capable of tapping into the resources provided by state administrative authorities. For example, Leuz and Oberholzer-Gee (2006, p. 416) found that political ties and global market exposure functioned as substitutes in Indonesia, as additional scrutiny from foreign market intermediaries (such as security analysts and professional business media) could expose 'political favors of questionable legality' and make it difficult and costly for firms to use such ties for financing.

As access to the global capital market reduces firms' resource dependence on administrative ties, we argue that the binding effect of administrative ties on firms' corporate governance reform will be weakened. Although the preference of the global capital market for higher governance standards can echo the call for governance reform by state administrations (i.e., having a positive main effect), we emphasize that exposure to the global capital market negatively moderates the effect of administrative ties because of the access to a significantly larger pool of financial liquidity it provides and the constraints it places on leveraging administrative ties.

Hypothesis 3b: The positive effect of administrative ties on firms' engagement in corporate governance reform is weakened when the tied firms have more exposure to the global capital market.

Firm Ownership and the Effect of Legislative Ties

The interest representation mechanism of legislative ties may be shaped by the interests of different firm owners. Firms embedded in traditional governance models may resist the advocated new governance practices. Institutional change is often contested if the practices to be changed are 'deeply embedded' institutionalized practices, such as family ownership and control (Claessens et al., 2000; Lins, 2003). For family owners, family business (including public-listed firms controlled by the family) is the family asset that should be kept intact and passed on to future generations. Board seats are largely occupied by members with family and kinship ties or long-term employees (Yeh et al., 2001). Corporate governance reform challenges the model of family control as it dilutes such control and heightens the risk of information leakage and business loss.

The negative effect of legislative ties on corporate compliance may be reinforced for family-dominated firms due to the high interdependence between legislators and family businesses. Since the exchange relationship between legislators and business is repetitive in nature and sometimes falls into a grey area, legislators may find firms with family dominance to be better partners than non-family firms due to the long-term orientation of family businesses (Morck and Yeung, 2004). Compared with professional CEOs of non-family firms, family firm founders and their descendants often have longer tenure even when firm performance does not meet market expectations (Gibson, 2003). Long tenure of family executives reduces the 'transaction costs' of repeated and elusive exchanges between politicians and firms, making family firms preferable partners for legislators. At the same time, in order to protect family assets and avoid political upheavals such as regime changes, firms with family dominance are also more likely to support legislators who defend their position and maintain such support for an extended period of time.[1] The high interdependence between family owners and legislators seeking re-election can motivate the legislators to defend the family owners' interests and their opposition to corporate governance reforms. We hence suggest that legislators will be more motivated to represent the opposing stance of family-controlled firms and help these firms to avoid compliance.

Hypothesis 4a: The negative effect of legislative ties on firms' engagement in governance reform is strengthened when the tied firms are family-dominated.

In contrast, the globalization of capital markets exposes firms to the pressure of adopting new practices. In order to gain legitimacy and tap into the global pool of funds, firms are expected to follow the 'global standards' of corporate governance (Desender et al., 2016; Okhmatovskiy and David, 2012). Conforming to such standards is essential in the US market and to US-based institutional investors, who view the purpose of corporate governance as protecting shareholder rights and maximizing shareholder return (Fligstein, 2001).

There are two major ways through which firms in Taiwan can be exposed to the global, particularly US, capital market. First, local firms can be owned by US-based institutional investors, who actively invest in overseas stock markets for better returns. This ownership creates substantial pressure for local firms to adopt practices deemed legitimate by these investors even though such practices may contradict local customs. A study by Ahmadjian and Robinson (2001) showed that US-based institutional investors pressured Japanese managers to adopt large-scale layoffs when stock prices dropped despite the long tradition of a lifetime employment system in these Japanese firms. Second, local firms can be cross-listed in the US market or issue American depositary receipts (ADRs). Research found that Russian firms that issued ADRs were more likely to adopt corporate governance codes to enhance their governance profile (Okhmatovskiy and David, 2012).

Participation in the global capital market can reduce firms' internal resistance to corporate governance reform and thus diminish their demand for legislators to represent their opposing stance. Resistance from firm insiders may become softened due to the legitimacy of new corporate governance practices in the eye of the global capital market and US institutional investors. As a result, the need for these firms to use their legislative ties to resist reform diminishes. We hence propose the following hypothesis:

Hypothesis 4b: The negative effect of legislative ties on firms' engagement in corporate governance reform is weakened when the tied firms have more exposure to the global capital market.

METHOD

Data and Sample

The empirical focus of our study is the appointment of independent directors, which was the most critical measure of corporate governance reform identified by the

OECD Asia Corporate Governance Roundtable. Under the government initiative, in February 2002 the Taiwan Stock Exchange (TSE) revised the rules for reviewing IPO applications to require *newly listed* firms to appoint at least two independent directors. But this practice remained voluntary for other listed firms. The TSE then provided a clear definition of independent directors (Allen, 2004), which not only specified requirements for educational and professional qualifications but also provided negative listings for candidates whom the company should not appoint.[2] The requirement that *all* listed firms must appoint at least two independent directors became legally mandatory on 7 January 2006.

The period between 2002 and 2005 thus provides an ideal window of opportunity to observe the impact of political ties on firms' *voluntary* appointment of independent directors. Figure 1 shows an upward trend of firms with such a voluntary reform. Note that only one firm in Taiwan had appointed independent directors before 2002; within four years, 37 per cent of publicly listed firms in our sample (i.e., firms that became listed before February 2002) had appointed independent directors voluntarily.

We used publicly listed firms on the main board of the TSE between 2002 and 2005 (inclusive) as our empirical setting. We restricted our sample to firms that became publicly listed before February 2002, i.e., firms that were not subject to the aforementioned 2002 mandate of independent director appointment for newly listed firms. Ninety-one firms that became listed after February 2002 were thus removed from the test sample. After excluding observations with missing values on key variables, we had four years of data for analysis, comprising 466 distinct firms and 1425 firm-year observations with a one-year lag for all independent variables. Our sample firms represent more than 70 per cent of the population of listed firms in Taiwan.

We collected firm-level financial data from the TEJ (*Taiwan Economic Journal*) database, which is the most comprehensive database for listed companies in the Asia-Pacific region. We manually collected the information on political ties by cross-checking

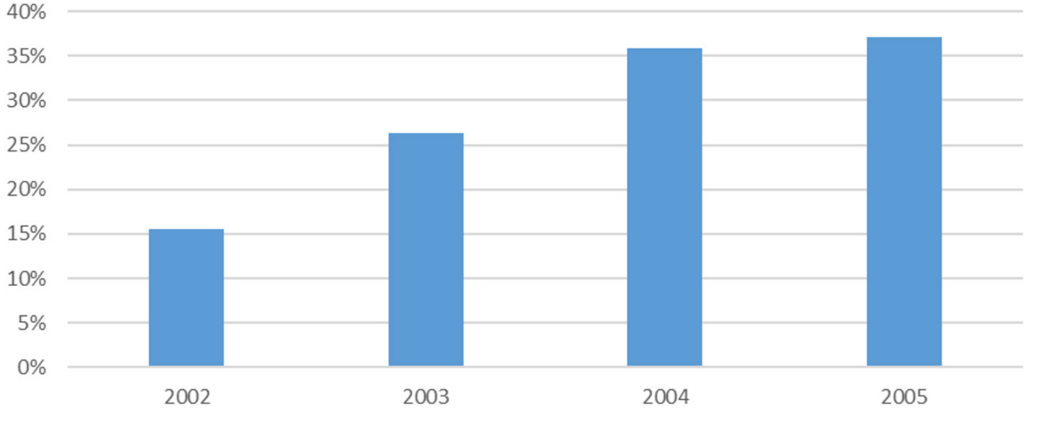

Figure 1. Percentage of publicly listed firms with independent directors, Taiwan, 2002–05 [Colour figure can be viewed at wileyonlinelibrary.com]

Note: This percentage is based on the firms that became listed before February 2002.

individuals' names in the listed firms and the Taiwanese government. First, we recorded the names of all the board members, CEO and top business executives, and major shareholders of each sample firm. The names were collected from the TEJ database. Second, we collected the names of politicians and officials in the executive and legislative branches. For the executive branch at the central government, we collected the names of (1) the premier of the executive branch, ministers, and vice ministers of ministries and members of various commissions, (2) directors and deputy-directors of all the departments and commission members one level below the ministries, and (3) advisors and councillors to the president. For Taipei City and Kaohsiung City, which have municipal governments directly under the central government, we collected the names of the mayor and deputy mayor, and those of chiefs and deputy chiefs of all the administrative agencies one level below the mayor. For other counties and cities, we collected the names of executive heads and deputy heads. We included the names of these administrators between 1986 and 2005, the end year of our study period, in order to identify ties established by firms involving current as well as former (i.e., retired) officials (see Lester et al., 2008). The names of government officials were collected from the website of the directory of the Taiwanese government (http://twinfo.ncl.edu.tw). For the legislative branch, the names of current and former legislators were collected from the parliament website (http://www.ly.gov.tw). In total, we had 15,867 distinct names of business firms and 4753 names of administrators and legislators. Following prior research on political ties (Faccio, 2006; Hillman, 2005; Zhu and Chung, 2014), we then cross-checked the names to identify ties between listed firms and the political regime. Appendix 1 lists the distribution of administrative and legislative ties across different business roles in our sample firms.[3]

Dependent Variable

Our primary dependent variable is the number of *independent directors* on a firm's board annually. To complement our primary dependent variable of independent director appointment, we also examined another corporate governance reform, information disclosure, a complementary practice the Taiwanese administration promoted in order to strengthen monitoring and accountability (see more details in Supplementary Analyses).

Independent Variables

Following prior literature (Faccio, 2006; Hillman, 2005), we focused on the total number of political ties a firm has. We distinguished between *administrative ties* (ties to administrators) and *legislative ties* (ties to legislators). An *administrative tie* was recorded if a firm's chairman, board member, top executive, or major shareholder had held or was holding a senior executive position in national or local government, while a *legislative tie* was recorded if one of these corporate individuals had previously served or was concurrently serving as a legislator. In total, among all identified political ties, 286 (80.3 per cent) were administrative ties and 70 (19.7 per cent) were legislative ties. Only eight firms had both administrative and legislative ties.

Moderators

Family ownership and control was measured by *family domination*, a dummy variable indicating the type of firm in which the family was the largest shareholder and family members served as board chair and general manager (the top decision-making positions) (coded 1; otherwise, 0). Family shareholding includes shares directly controlled by family members and those indirectly owned by the private firms, listed firms, and non-profit organizations that are controlled by the family (La Porta et al., 1999).

Foreign ownership was measured by (a) *foreign institutional ownership* and (b) firms' issuance of ADRs. *Foreign institutional ownership* was measured by the percentage of shares controlled by foreign institutional investors (most of which were from the USA or the UK) who invested in firms through the Taiwan Stock Market. *ADR* was a dummy variable indicating whether a firm issued ADRs in the US capital market (coded 1; otherwise, 0), and this variable captures foreign ownership by institutional investors based in the USA. It was coded from the Bank of New York ADR database. A firm that issued ADRs in a given year was considered as having ADRs issued for the remaining years of our research period.

Control Variables

We included a set of control variables that may affect firms' corporate governance reform and formation of political ties. The percentage of *government ownership* was included to control for other sources of influence from the state. We controlled for *firm size* by the logarithm of firm's total sales. *Firm age* was measured by the number of years since the firm's founding. *Ownership concentration* was the percentage of shares held by the largest shareholder. To control for the potential impact of a firm's performance, we included firms' *return on assets* (*ROA*). We controlled for *board size* by the number of directors a firm had. Business groups are prevalent in Taiwan; the indicator variable *business group affiliation* was coded 1 if a firm was a member of one of the 100 largest business groups (in terms of sales), and 0 otherwise. This information is sourced from *Business Groups in Taiwan* (published by China Credit Information Sources). We used *export ratio*, measured as foreign sales divided by total sales, to proxy a firm's access to and reliance on foreign product markets.

We controlled for regional politics through an indicator variable, *Green region*, coded as 1 if a firm was headquartered in one of the six 'green' counties and cities that lean towards the Democratic Progressive Party (DPP), which was the party in power during our research period.[4] We also accounted for firms' historical alignment with the two major political parties (i.e., DPP and Kuomintang [KMT]) by controlling for a firm's historical ties with the two parties, respectively. *Historical DPP ties* is a count variable and records the number of ties when a firm's chairman, board member, top executive, or major shareholder used to be affiliated with the DPP. Similarly, *Historical KMT ties* records the number of ties when a firm's chairman, board member, top executive, or major shareholder used to be affiliated with KMT.

To control for peer influence from firms in the same industry (DiMaggio and Powell, 1983), we included the cumulative percentage of firms in a firm's industry (excluding the focal firm) that had appointed at least one independent director the year before (i.e., at $t-1$) (*independent directors in peer firms*). In addition, informal social relationships arising from kinship and friendship ties between business leaders and political actors (e.g., former classmates or in the same social club) might also influence firms' adoption of governance reform. We measured *informal ties* as the number of such social ties between a firm and political actors. Such data were collected primarily from the Excellent Business Database System (EBDS) (http://ebds.anyan.com.tw).[5] Moreover, we controlled for *leader education*, measured by the number of years of education that a firm's top leader received. Information on firm leaders' biographical background was collected from directories of *Managers in Taiwan*, (also published by CCIS). Finally, we included a set of *industry* and *year dummy* variables to control for the industry and temporal effects.[6]

Table I presents descriptive statistics of our sample firms and the pair-wise correlations between the variables in our models. The number of independent directors shows significant variation in our sample. Political connectedness was common: some firms in our sample had as many as nine ties to the executive branch and five to the legislative branch. About one-third of our sample firms were family dominated. Average foreign ownership was not high, but some had up to 65 per cent. The independent variables were only moderately correlated with an average VIF (variance inflation factor) score of 1.89 for the final model, and no individual item scored higher than 3. This indicates that multicollinearity was unlikely to be a concern for this study.

Analysis

Given that the two types of political ties may not be randomly distributed among firms and that there might be unobservable factors affecting both formation of the political ties and firm engagement in governance reform, we used the instrumental variable approach to account for potential endogeneity. We used four variables as instruments based on theoretical antecedents of political tie formation and the Taiwanese contexts. For administrative ties, we used two instruments: (1) percentage of peer firms with administrative ties in the same city (*peer firm administrative ties*), calculated as the number of firms in the focal firm's city with administrative ties divided by the total number of firms in this city, annually; and (2) a variable indicating whether the firm had *historical administrative ties* before the beginning of our analysis period (i.e., 2002), coded 1 if yes, and 0 if no. Similarly, for legislative ties, we used two instruments: (1) percentage of peer firms with legislative ties in the same city (*peer firm legislative ties*), calculated as the number of firms in the focal firm's city with legislative ties divided by the total number of firms in this city, annually; and (2) a variable indicating whether the firm had *historical legislative ties* before the beginning of our analysis period (i.e., 2002), coded 1 if yes, and 0 if no.

These instruments are conceptually valid because they represent peer and historical influences and are thus likely to have strong associations with a firm's current political ties, but unlikely to be strongly correlated with the error term of the second-stage regression. Moreover, we found statistical support for instrument validity. Table II reports first-stage results predicting the formation of administrative ties and legislative ties, respectively, using the instruments and key control variables from our main models. The regression results suggested strong associations between these variables and political ties; first-stage F-statistics indicate that the instruments are strong. In

Table I. Summary statistics and correlations (N = 1425)

Variables	*Mean*	*SD*	*Min.*	*Max.*	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*
1. Independent directors	0.27	0.66	0	5	1.00									
2. Administrative ties	0.35	0.87	0	9	0.04	1.00								
3. Legislative ties	0.12	0.45	0	5	−0.03	0.17	1.00							
4. Family domination	0.31	0.46	0	1	−0.04	−0.06	−0.07	1.00						
5. Foreign institutional ownership	0.08	0.12	0	0.65	0.05	0.07	−0.04	−0.16	1.00					
6. ADR	0.08	0.28	0	1	0.14	0.22	−0.04	−0.05	0.31	1.00				
7. Government ownership	0.01	0.05	0	0.47	0.01	0.54	0.20	−0.11	0.08	0.18	1.00			
8. Firm size	15.75	1.20	12.66	20.05	0.07	0.23	0.04	−0.13	0.38	0.49	0.19	1.00		
9. Firm age	28.59	11.38	4	60	−0.01	0.10	0.13	0.07	−0.02	−0.11	0.10	0.14	1.00	
10. Ownership concentration	0.17	0.11	0	0.74	−0.02	−0.01	−0.01	0.02	0.07	−0.09	−0.05	−0.14	0.08	1.00
11. ROA	3.46	9.20	−100.7	50.64	0.02	0.05	−0.07	0.01	0.27	0.06	0.08	0.18	−0.04	0.00
12. Board size	7.15	3.08	3	26	0.06	0.19	0.15	−0.11	0.08	0.10	0.13	0.34	0.28	−0.11
13. Group affiliation	0.54	0.50	0	1	0.07	0.10	−0.05	−0.13	0.15	0.25	0.03	0.48	0.04	−0.12
14. Export ratio	0.41	0.36	0	1	0.02	−0.13	−0.08	0.06	0.16	0.14	−0.05	0.09	−0.33	−0.11
15. Green region	0.16	0.36	0	1	−0.05	0.04	0.02	0.03	−0.02	−0.09	0.02	−0.03	0.02	0.02
16. Historical KMT ties	0.16	0.42	0	4	−0.01	0.39	0.28	−0.06	0.01	0.05	0.05	0.18	0.12	0.05
17. Historical DPP ties	0.02	0.16	0	2	−0.01	0.14	0.46	−0.04	−0.04	−0.01	0.34	0.01	0.13	−0.05
18. Independent directors in peer firms	0.22	0.17	0	0.50	0.08	−0.07	−0.07	0.00	0.12	0.19	−0.10	−0.01	−0.42	−0.09
19. Informal ties	5.15	10.14	0	98	0.06	0.27	0.14	−0.13	0.11	0.22	0.07	0.45	0.25	0.01

(Continues)

Table I. (Continued)

Variables	*Mean*	*SD*	*Min.*	*Max.*	*1*	*2*	*3*	*4*	*5*	*6*	*7*	*8*	*9*	*10*
20. Leader Education	15.32	3.43	6	22	0.09	0.14	0.07	−0.03	0.06	0.19	0.12	0.08	−0.05	−0.11
21. Peer firm administrative ties	0.21	0.10	0	1.00	−0.01	0.27	0.02	−0.03	0.10	0.09	0.18	0.15	0.15	0.10
22. Historical administrative ties	0.14	0.35	0	1	0.01	0.50	0.20	−0.09	0.10	0.18	0.34	0.27	0.21	−0.01
23. Peer firm legislative ties	0.08	0.04	0	0.50	−0.04	0.02	0.12	−0.09	0.00	−0.06	0.02	−0.02	0.10	0.04
24. Historical legislative ties	0.07	0.26	0	1	−0.03	0.10	0.40	−0.05	−0.11	−0.08	0.15	0.00	0.13	0.01

Variables	*11*	*12*	*13*	*14*	*15*	*16*	*17*	*18*	*19*	*20*	*21*	*22*	*23*	*24*
11. ROA	1.00													
12. Board size	0.02	1.00												
13. Group affiliation	0.04	0.14	1.00											
14. Export ratio	0.11	−0.11	0.09	1.00										
15. Green region	0.06	0.03	−0.04	−0.01	1.00									
16. Historical KMT ties	−0.04	0.19	0.07	−0.12	0.11	1.00								
17. Historical DPP ties	−0.05	0.15	−0.06	−0.05	−0.02	0.05	1.00							
18. Independent directors in peer firms	0.01	−0.16	0.00	0.49	−0.16	−0.08	−0.05	1.00						
19. Informal ties	0.02	0.39	0.24	−0.15	−0.03	0.35	−0.04	−0.16	1.00					
20. Leader Education	−0.01	−0.08	0.03	0.00	−0.18	−0.01	0.03	0.15	0.06	1.00				
21. Peer firm administrative ties	0.02	0.07	0.12	−0.15	0.21	0.15	0.03	−0.04	0.09	0.03	1.00			

(Continues)

Table I. (Continued)

Variables	*11*	*12*	*13*	*14*	*15*	*16*	*17*	*18*	*19*	*20*	*21*	*22*	*23*	*24*
22. Historical administrative ties	0.01	0.26	0.10	−0.11	0.09	0.34	0.10	−0.07	0.36	0.07	0.17	1.00		
23. Peer firm legislative ties	−0.01	0.03	−0.03	−0.14	0.44	0.10	0.03	−0.11	0.04	−0.07	0.13	0.05	1.00	
24. Historical legislative ties	−0.14	0.10	−0.02	−0.11	0.03	0.16	0.19	−0.09	0.09	0.05	0.02	0.21	0.13	1.00

Note: r > 0.05 significant at the 0.05 level.

Table II. First-stage regressions predicting presence of political ties (N = 1425)

	(1)	*(2)*
Dependent variable	*Administrative ties*	*Legislative ties*
Peer firm administrative ties	1.15	
	(0.000)	
Historical administrative ties	0.61	
	(0.000)	
Peer firm legislative ties		0.66
		(0.001)
Historical legislative ties		0.46
		(0.000)
Family domination	0.06	−0.03
	(0.093)	(0.165)
Foreign institutional ownership	−0.09	0.04
	(0.539)	(0.575)
ADR	0.28	−0.08
	(0.000)	(0.017)
Government ownership	7.74	0.07
	(0.000)	(0.683)
Firm size	−0.03	0.00
	(0.078)	(0.650)
Firm age	−0.01	0.00
	(0.000)	(0.475)
Ownership concentration	0.09	−0.03
	(0.553)	(0.673)
ROA	0.64	−0.11
	(0.001)	(0.278)
Board size	0.02	−0.01
	(0.001)	(0.104)
Group affiliation	−0.02	−0.05
	(0.621)	(0.014)
Export ratio	−0.00	0.00
	(0.002)	(0.075)
Green region	−0.07	−0.04
	(0.143)	(0.090)
Historical DPP ties	−0.07	0.87
	(0.593)	(0.000)

(Continues)

Table II. (Continued)

	(1)	*(2)*
Dependent variable	*Administrative ties*	*Legislative ties*
Historical KMT ties	0.53	0.20
	(0.000)	(0.000)
Informal ties	0.00	0.00
	(0.082)	(0.000)
Leader education	0.02	0.01
	(0.001)	(0.028)
Constant	0.19	−0.13
	(0.520)	(0.403)
Industry and year fixed effects	Yes	Yes
R-squared	0.48	0.25
F-stat	96.59***	35.18***

Note: The F-statistic indicates change over models without instrumental variables. All are significant and above the critical value suggested by Stock et al. (2002), indicating that instruments are strong. P-value in parentheses.
***$p < 0.001$.

addition, none of these variables had a significant effect on the dependent variable, independent directors (untabulated). The non-significant Hansen's (1982) J-statistics (reported in Table III) suggested that the instruments were uncorrelated with the error term and that the instruments were correctly excluded from the estimated structure equation.

Since the number of independent directors is a count variable, following Lizardo (2006), we estimated Poisson regression models with instrumental variables using the QVF package in Stata.[7] This procedure accounts for the intra-firm correlations through clustering for firms.

RESULTS

We report results for hypotheses testing in Table III. Model 1 is the baseline model that includes only control variables, Models 2 through 6 test the hypotheses with the instrumental variables approach, and Model 7 is the full model with all variables. Using deviance goodness-of-fit, we found significant improvement of model fit for our models of interest over the baseline model ($p < 0.05$).

Hypothesis 1 predicts a positive effect of administrative ties on firms' engagement of corporate governance reform. Consistent with this prediction, we found the effect of *administrative ties* to be positive for firms' appointment of independent directors (Model 2: $b = 0.16$, $p = 0.042$). The marginal effect of administrative tie on independent directors with all other variables at their mean values is 0.15 ($p = 0.040$). One additional administrative tie increases the number of independent directors by 0.15. This is an economically

Table III. Effects of administrative and legislative ties on independent directors (N = 1425)

		Poisson	Poisson with instrumental variables					
DV: # Independent directors		*(1)*	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*
Administrative ties	**H1**		0.16	0.33	0.39	0.16	0.13	0.38
			(0.042)	(0.012)	(0.045)	(0.089)	(0.117)	(0.024)
Legislative ties	**H2**		−4.45	−4.38	−5.75	−4.41	−4.39	−5.99
			(0.004)	(0.004)	(0.009)	(0.002)	(0.004)	(0.003)
Administrative ties × family domination	**H3a**			−0.88	−0.89			−1.02
				(0.041)	(0.043)			(0.018)
Administrative ties × foreign ownership	**H3b**				−1.81			−0.48
					(0.244)			(0.779)
Administrative ties × ADR	**H3b**				−0.90			−0.38
					(0.087)			(0.064)
Legislative ties × family domination	**H4a**					−5.13	−3.68	−4.91
						(0.003)	(0.004)	(0.003)
Legislative ties × foreign ownership	**H4b**						2.91	2.72
							(0.002)	(0.004)
Legislative ties × ADR	**H4b**						4.84	16.05
							(0.014)	(0.012)
Family domination		0.15	−0.09	0.35	0.26	−1.02	−0.61	−0.36
		(0.174)	(0.675)	(0.202)	(0.422)	(0.012)	(0.040)	(0.348)
Foreign institutional ownership		1.03	0.68	0.90	−0.50	0.74	0.26	−2.16
		(0.012)	(0.347)	(0.218)	(0.714)	(0.293)	(0.729)	(0.224)
ADR		0.79	−0.04	0.09	0.76	0.57	0.12	0.70
		(0.000)	(0.916)	(0.821)	(0.114)	(0.071)	(0.687)	(0.193)

(Continues)

Table III. (Continued)

	Poisson	*Poisson with instrumental variables*					
DV: # Independent directors	*(1)*	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*
Government ownership	−5.45	−7.01	−10.46	−7.94	−5.51	−5.65	−9.18
	(0.019)	(0.077)	(0.013)	(0.159)	(0.176)	(0.145)	(0.107)
Firm size	−0.26	−0.22	−0.20	−0.22	−0.32	−0.26	−0.20
	(0.000)	(0.105)	(0.136)	(0.183)	(0.017)	(0.036)	(0.182)
Firm age	−0.01	−0.00	0.00	0.01	0.01	−0.00	0.00
	(0.238)	(0.970)	(0.926)	(0.585)	(0.545)	(0.977)	(0.874)
Ownership concentration	1.46	2.31	2.54	2.65	1.66	1.77	2.13
	(0.001)	(0.011)	(0.005)	(0.017)	(0.025)	(0.013)	(0.010)
ROA	0.03	0.01	0.02	0.01	0.02	0.01	0.01
	(0.000)	(0.254)	(0.213)	(0.367)	(0.072)	(0.295)	(0.509)
Board size	0.09	0.04	0.04	0.02	0.07	0.08	0.08
	(0.000)	(0.354)	(0.365)	(0.733)	(0.096)	(0.051)	(0.098)
Group affiliation	0.06	−0.34	−0.33	−0.46	−0.19	−0.17	−0.12
	(0.624)	(0.219)	(0.239)	(0.208)	(0.424)	(0.459)	(0.648)
Export ratio	−0.00	0.28	0.23	0.38	0.31	0.36	0.49
	(1.000)	(0.356)	(0.437)	(0.304)	(0.287)	(0.209)	(0.177)
Green region	−0.49	−0.31	−0.25	−0.20	−0.19	−0.20	0.00
	(0.006)	(0.303)	(0.390)	(0.575)	(0.530)	(0.497)	(0.998)
Historical DPP ties	0.87	8.52	8.65	10.80	6.72	6.75	8.61
	(0.007)	(0.009)	(0.008)	(0.016)	(0.010)	(0.010)	(0.011)
Historical KMT ties	0.07	1.74	1.79	2.25	1.26	1.13	1.31
	(0.637)	(0.023)	(0.021)	(0.025)	(0.028)	(0.036)	(0.041)

(Continues)

Table III. (Continued)

	Poisson	*Poisson with instrumental variables*					
DV: # Independent directors	*(1)*	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*
Independent directors in peer firms	3.14	3.52	3.40	3.30	3.63	3.42	3.20
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Informal ties	−0.03	0.01	0.01	0.03	−0.01	−0.01	−0.01
	(0.001)	(0.559)	(0.672)	(0.419)	(0.499)	(0.527)	(0.477)
Leader education	0.02	0.07	0.07	0.09	0.01	0.03	0.03
	(0.353)	(0.046)	(0.045)	(0.048)	(0.650)	(0.315)	(0.337)
Constant	0.67	−0.39	−0.84	−0.77	1.86	0.90	−0.18
	(0.497)	(0.849)	(0.681)	(0.766)	(0.356)	(0.629)	(0.934)
Industry and year fixed-effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Kleibergen-Paap rk Wald F[a]		57.00	54.58	29.92	39.03	42.41	26.80
Hansen J stat [p-value][a]		3.62[0.2]	3.39[0.2]	3.60[0.2]	3.04[0.2]	3.56[0.2]	3.81[0.1]

Note: p-value in parentheses; standard errors clustered at firm level.
[a]This statistic was obtained from OLS IV regression models. The Kleibergen-Paap rk Wald F substantially exceeded the Stock and Yogo (2005) critical values, rejecting the null hypothesis of weak instruments. The Hansen J statistic tests over-identifying restrictions, with the null hypothesis that instruments are uncorrelated with the error term and correctly excluded from the estimated equation; the null hypothesis is not rejected in all models.

substantial effect given the mean value of 0.27 of the independent directors of our sample firms. Hypothesis 1 is supported.

We argued in Hypothesis 2 for a negative effect of legislative ties on firms' engagement in governance reform. The variable *legislative ties* in Model 2 is negatively associated with the number of independent directors (b = −4.45, p = 0.004). The marginal effect of a legislative tie on independent directors with all other variables at their mean values is −0.66 (p = 0.005), which means that one additional legislative tie reduces the number of independent directors by 0.66, a substantial effect economically. Hypothesis 2 is supported.

In Hypothesis 3a, we posit that family ownership and control will weaken the positive effect of administrative ties on corporate governance reform. In Model 3, *family domination* negatively moderates the effect of *administrative ties* (b = −0.88, p = 0.041), and this effect also remains in the full model (Model 7). Figure 2a illustrates that administrative ties have a weaker positive effect for firms with family domination than for other firms. These results suggest that Hypothesis 3a is supported.

In Hypothesis 3b we argued for a negative moderation effect of foreign ownership on the relationship between administrative ties and corporate governance reform. As shown in Model 4, the interaction term between *administrative ties* and *foreign institutional ownership* is not significant (b = −1.81, p = 0.244), but the interaction term between *administrative ties* and *ADR* is negative (b = −0.90, p = 0.087) (albeit with lower significance level), and this effect remains in the full model as well (Model 7). We further plotted the marginal effect of administrative ties for firms with and without ADR issuance in Figure 2b. Firms with ADR issuance are less influenced by administrative ties compared with those without such access in their appointment of independent director. Hypothesis 3b is moderately supported. The absence of moderating effect of foreign institutional ownership indicates that having foreign institutional investors did not weaken the influence of corporate ties to the administrators. This is probably because the resources provided by foreign institutional investors are not sufficient to substitute for those controlled by the administrative agencies due to the relatively low level of shareholding (mean = 8 per cent; median = 2 per cent) (Desender et al., 2016).

We argued in Hypothesis 4a that family domination will strengthen the negative effect of legislative ties on corporate governance reform. As predicated, the interaction term between *legislative ties* and *family domination* has a negative effect on independent directors (Model 5: b = −5.13, p = 0.003). This effect remains in the full model (Model 7). We further plotted the marginal effect of legislative ties for firms with and without family domination in Figure 2c. Hypothesis 4a is supported.

We argued in Hypothesis 4b that foreign ownership will weaken the negative effect of legislative ties. In Model 6, the interaction between *legislative ties* and *foreign institutional ownership* is positive (b = 2.91, p = 0.002), and the interaction between *legislative ties* and *ADR* is also positive (b = 4.84, p = 0.014). In firms with a higher share of foreign institutional ownership or with ADR issuance, the negative effect of legislative ties on independent director appointment is reduced. The interaction effects between legislative ties and foreign ownership (both foreign institutional ownership and ADR) remain in the full model (Model 7). Figure 2d,e illustrate that legislative ties have a weaker negative effect for firms with higher levels of foreign institutional ownership and ADR issuance. Taken together, these results provide support for Hypothesis 4b.

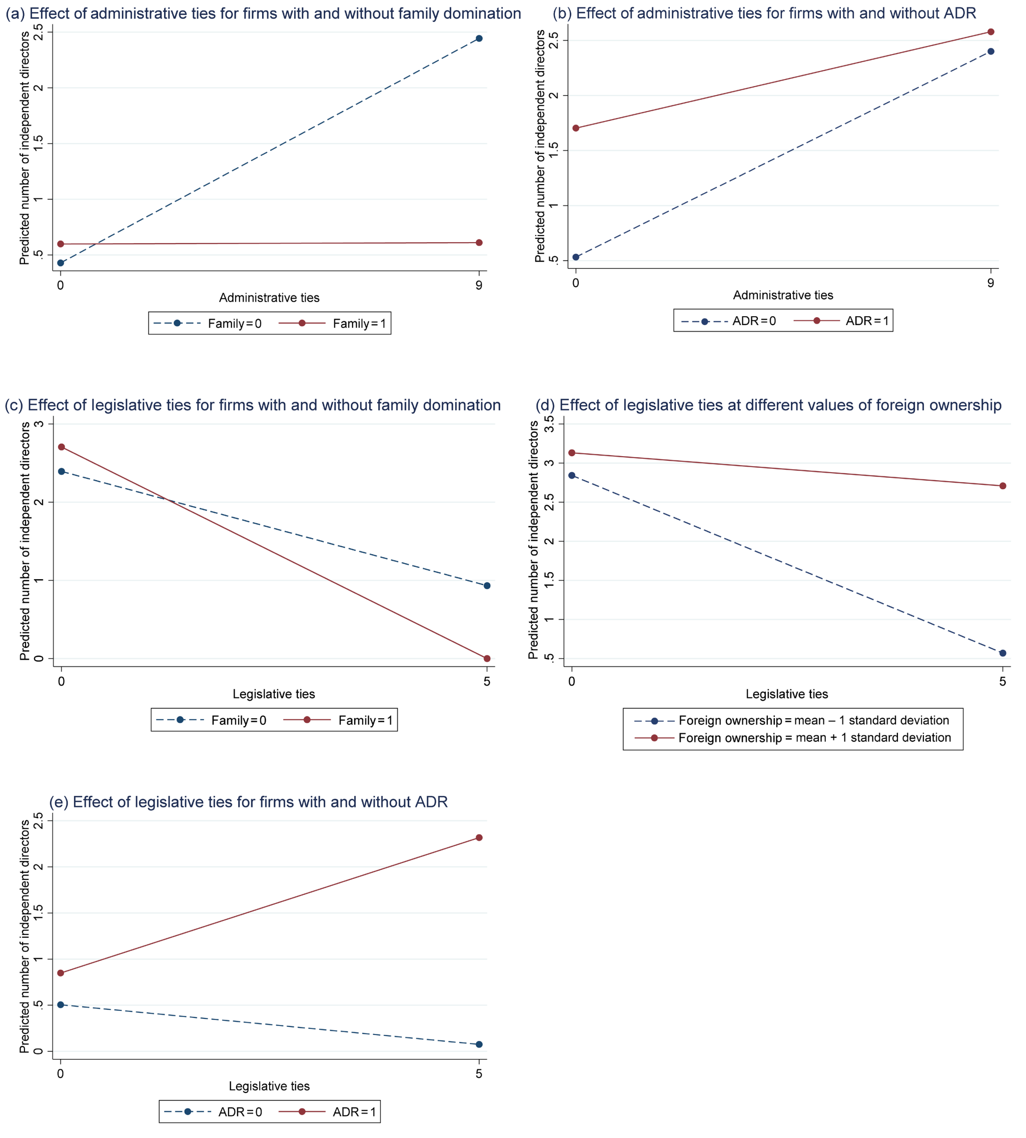

Figure 2. Moderating effects of family domination and foreign ownership on the relationship between two types of political ties and firm independent directors [Colour figure can be viewed at wileyonlinelibrary.com]

Split-Sample Analysis

To further confirm the interaction effects in non-linear models, we followed Lee et al. (2015) to split our sample into two subgroups based on whether the firm is family-dominated (*family domination* = 1) or not (*family domination* = 0), the median value (i.e., 2 per cent) of *foreign institutional ownership*, and whether a firm issued ADRs (*ADR* = 1) or not (*ADR* = 0), respectively. In each set of the subsamples, we first examined the effects of *administrative ties* and *legislative ties*, respectively, and then tested the statistical significance of the difference between the two coefficients using a Wald test (Greene, 2003). The split-sample analyses yielded generally consistent results with those from the full sample analyses (results available from the authors).

ROBUSTNESS TESTS

Propensity Score Matching (PSM)

We conducted several robustness checks to further validate our findings. In addition to the instrumental variable approach used in our primary analysis, we also adopted the propensity score matching approach to further reduce potential endogeneity concerns (Dehejia and Wahba, 2002; Rosenbaum and Rubin, 1983). We first used logistic regression to predict the propensity for a firm to be politically connected (i.e., the treatment group) in a given year using all control variables in the main model, and obtained a propensity score for each firm annually. We then matched each politically connected firm with two firms that were not politically connected (i.e., the control group) but had the closest propensity score to the connected firm, using 1:2 nearest-neighbour matching with a calliper of 0.25 standard deviations to ensure both efficiency and quality of matching. All matches not within this calliper were dropped. After matching, the differences between the treated and the control firms became non-significant in all dimensions except for political ties. Based on the matched sample, we re-ran the models testing the effects of administrative and legislative ties and presented the results in Model 1 of Table IV. Results were consistent with those reported in our main analysis (i.e., Model 2 from Table III).

Controlling for Political Party Affiliation

Given that the administrative and legislative branches of the Taiwanese government in our study period were dominated by different parties, i.e., KMT (the major opposition party) and the DPP (the ruling party), we examined whether our results could be driven by party affiliation of the political ties. We estimated a model including variables measuring ties with the two branches as well as ties with the two parties. The opposing effects of the two types of ties remained (Model 2, Table IV), confirming that the institutional divide of the two branches led to opposing influences on corporate governance reform, independent of the influence of political party.

Alternative Measures and Estimation Methods

We adopted alternative measures for the dependent variable. Given the concern that some independent directors may lack independence from corporate management, we further restricted independent directors to be those who had professional expertise and held prestigious positions, such as university presidents and CEOs of multinational corporations. These directors had a high stake in protecting their professional reputation and hence could be less beholden to the interests of firm management. The effects of the two types of political ties on such 'elite' independent directors were consistent with the results presented earlier (Model 3, Table IV).

Table IV. Robustness checks

	A. PSM for endogeneity	*B. Control for party affiliation*	*C. 'Elite' independent directors*	*D. Percentage of independent directors*	*E. Negative binomial model*	*F. OLS*	*G. Test of reverse causality*	
	Independent directors	*Independent directors*	*Independent directors*	*Independent directors divided by board size*	*Independent directors*	*Independent directors*	*Administrative ties*	*Legislative ties*
Dependent variable	*(1)*	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*	*(8)*
Administrative ties	0.15	0.35	0.35	0.15	0.16	0.17		
	(0.049)	(0.009)	(0.000)	(0.022)	(0.051)	(0.037)		
Legislative ties	−13.95	−6.74	−2.66	−2.27	−4.36	−14.10		
	(0.000)	(0.012)	(0.024)	(0.020)	(0.003)	(0.000)		
DPP ties		2.90						
		(0.119)						
KMT ties		−2.44						
		(0.439)						
Independent directors							0.12	−0.00
							(0.173)	(0.999)
All controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Constant	0.74	−0.26	−1.91	1.15	−0.40	0.58	12.06	11.18
	(0.765)	(0.916)	(0.523)	(0.411)	(0.837)	(0.792)	(0.955)	(0.976)
Observations	876	1425	1425	1425	1425	1425	1425	1425

Note: p-value in parentheses; standard errors clustered at firm level; Industry and year fixed-effects included.

To further explore whether the appointment of independent directors led to any changes in observable corporate governance practices, we compared a few key corporate governance practices for firms that appointed independent directors between 2001 (before they appointed any independent directors) and 2005. Based on t-tests (untabulated), we found that firms that appointed independent directors also appointed more independent auditors and experienced more CPA turnovers subsequently. This indicates that independent directors were associated with some subsequent changes to financial monitoring of the firm, though they were not able to alter the highest level of the power structure (e.g., CEO-chair duality).[8]

Next, we used the percentage of independent directors in a firm and estimated random-effects OLS models with instrumental variables (XTIVREG in Stata) and found similar results (Model 4, Table IV). In addition, instead of a Poisson model, we adopted a negative binomial model with instruments, as well as OLS estimation without instrumental variables. These analyses yielded results similar to those of our main analysis (Models 5 and 6, Table IV).

Finally, we addressed the potential concern of the possibility of reverse causality, that is, board independence may influence political tie building. We tested the effect of independent directors (at year t) on firms' two types of political ties (at year $t+1$) and found no significant effect (Models 7 and 8, Table IV). This suggested that reverse causality was not likely to be an issue in our study.

SUPPLEMENTARY ANALYSES

Additional Test of Mechanisms: Resource Dependence and Interest Representation

We argued that the opposing influences of administrative and legislative ties occur because of the resource dependence and interest representation mechanisms embedded in the two types of ties. To further validate these mechanisms, we tested two additional boundary conditions closely related to the two mechanisms, respectively. First, firms' resource dependence on the government can be captured by whether the firm's primary industry was a heavily *regulated industry* (e.g., construction). Firms in such industries may depend on the administration-controlled resources more than firms in other industries (e.g., for access to land, permits, licences, regulatory approval) (Hillman, 2005). Second, research showed that *election year* may increase legislators' inclination to represent corporate interests (e.g., Dinç, 2005). We thus created an indicator variable, *election year*, which equals 1 if it was 2004, the election year for Legislative Yuen in Taiwan, and 0 otherwise.

Our results showed a positive effect of *administrative ties * regulated industry* (Model 1, Table V: $b=1.43$, $p=0.020$), consistent with our argument that the key mechanism for administrative ties to pressure connected firms for corporate governance reform is through resource dependence. Similarly, we found a negative effect for *legislative ties * election year*: election year strengthens the negative effect of legislative ties (Model 2, Table V: $b=-3.66$, $p=0.008$). This finding supports our theory that legislators buffer connected

Table V. Further test of the resource dependence and interest representation mechanisms

DV: # Independent directors	*(1)*	*(2)*
Administrative ties × regulated industries	1.43	
	(0.020)	
Legislative ties × election year		−3.66
		(0.008)
Administrative ties	0.27	0.29
	(0.006)	(0.012)
Legislative ties	−3.13	−3.94
	(0.003)	(0.008)
Regulated industries	1.11	
	(0.047)	
Election year		−0.85
		(0.007)
Family domination	0.04	0.04
	(0.795)	(0.842)
Foreign institutional ownership	0.71	0.34
	(0.255)	(0.600)
ADR	0.06	0.01
	(0.866)	(0.979)
All controls	Yes	Yes
Constant	−0.53	−1.13
	(0.765)	(0.541)
Observations	1425	1425

Note: p-value in parentheses; standard errors clustered at firm level; Industry and year fixed-effects included.

firms from the government-initiated corporate governance reform in order to win votes in legislative elections. Meanwhile, the interaction between administrative ties and election year was *not* significant.

Additional Dependent Variable: Information Disclosure

We examined one additional practice advocated by the Taiwanese government, information disclosure, which complements board independence in strengthening corporate governance. In 2002, the TSE started to conduct annual ranking of information disclosure of listed firms, and the first ranking was published in 2003. We used the annual transparency score each firm received from the TSE to measure firms' information disclosure. For this analysis, the sample size was 1393 firm-year observations as data for this dependent variable were available only from 2003. We estimated ordered probit models with instrumental variables, as the dependent variable was an ordinal variable.

Results (in Appendix 2) showed that on average, administrative ties did not have a significant effect on information disclosure (Model 1), but such ties had a positive and significant effect on firms in *regulated industries* (Model 2). This indicates that administrative ties channelled pressure for enhancing information disclosure effectively only to firms with strong resource dependence on the government. In addition, legislative ties had a negative effect on information disclosure, consistent with the results for board independence. Overall, these results support the diverging effects of the two types of ties on information disclosure.

Collectively, the findings indicate that issue salience may have influenced the impact of administrative ties. Between the two practices advocated by the Taiwanese administration, information disclosure was not as novel and controversial as board independence. The latter directly challenged the power centre in the prevailing governance model and led to heated contestation. The government thus gave more attention and priority to promoting the practice of independent directors, and hence we observed a strong effect of administrative ties on the use of independent directors in firms.

DISCUSSION AND CONCLUSIONS

Our study was motivated to disentangle the binding and buffering effects of corporate political ties from the perspective of the institutional divide within the state. Using the context of highly contested corporate governance reform in Taiwan, we examined how corporate ties to executive vs. legislative branches influenced firms' engagement in corporate governance reform. We found that ties to the executive branch pressured firms to conform to the government's initiative, whereas ties to legislators kept firms rooted in the traditional governance model. Consistent with the mechanisms of resource dependence and interest representation, family and foreign ownership moderated the impact of the two types of political ties.

Our study contributes to research on corporate political strategy (in particular, political ties) by separating ties to different state branches and showing their opposing effects on firms in a presidential democracy. This is an important insight. The corporate political strategy literature tends to emphasize one of the two roles of corporate political ties: either such ties provide better access to state-controlled resources and information and allow firms to influence policy-making to their advantage (Bonardi et al., 2005; Faccio, 2006; Goldman et al., 2013), or such ties create resource dependence on the state and allow the state to pressure firms to succumb to political demands (Luo et al., 2017; Marquis and Qian, 2014). If both mechanisms are simultaneously at work, it is important to understand under what conditions political ties bind firms to, or buffer firms from, political pressures. In response, some recent studies point to the importance of disaggregating political ties to better understand the boundary conditions under which political ties buffer or bind the firms to the state demands (e.g., Zhang et al., 2016).

We join and advance this emerging research stream by considering how the separation of powers between the executive and legislative branches may influence the buffering vs. binding effects of political ties. Although it is generally accepted that the executive and legislative branches may differ in their policy inclinations in presidential democracies

(Nielson, 2003; Samuels and Shugart, 2003; Shugart and Haggard, 2001), it is not clear how corporate political ties to these two branches influence firm behaviour. Situating our study in a regime with a proactive state role and nascent democracy, our approach underscores the mechanisms of resource dependence and interest representation underlying the administrative and legislative ties, respectively, and propose opposing effects for such ties in corporate adoption of contested practices. Our findings indicate that not differentiating ties to the two branches can disguise the critical impact of ties, as the opposing influences can offset each other. Future research can no longer view political ties as homogeneous, especially when examining contested corporate practices in which firm interests contradict the national agenda.

In addition, our study extends corporate governance research by recognizing the state as a source of contestation for corporate governance reform. Studies that view corporate governance reform as a 'contested terrain' have primarily focused on the conflict between the global capital market and domestic blockholders (Ahmadjian and Robinson, 2001; Desender et al., 2016). This stream of literature has not considered the possibility that for such contested practices as corporate governance reforms, the state and actors within the state may have their own interests and inclinations, serving as a source of contestation. Meanwhile, studies that examined the role of the state in corporate governance reform have typically not examined the resistance from within the state (Guillén and Capron, 2016; Okhmatovskiy and David, 2012; Yoshikawa et al., 2007). As a result, the state as a source of contestation has been largely ignored in this literature. This is a significant gap given that the state is often responsible for designing and implementing regulations on capital markets and corporate governance.

We address this research gap by bringing to the forefront the diverging interests within the state and how such divergence can serve as a source of contestation in shaping the outcome of corporate governance reforms. In our context of Taiwan, an emerging market with a democratic regime, we found that the state branches exerted conflicting influences on connected firms' appointment of independent directors, and the strength of these influences is also affected by firm ownership. Specifically, firms endowed with less foreign ownership through the global capital market could have been less motivated to appoint independent directors; however, with administrative ties, these firms experienced stronger pressure from state administrators to appoint independent directors. While family owners can be reluctant to engage in reform, it was through their legislative ties that family-dominated firms were able to resist or delay the reform. Our study thus enriches prior research by presenting a more complete and nuanced picture of how corporate governance reform is jointly shaped by the state, the global capital market, and firms' embeddedness in local social systems.

Generalizability

It is important to note the boundary conditions of our argument as it is built on the case of Taiwan. The functioning of political ties is closely dependent on their context (Cui et al., 2018). The highly contested nature of the issue, the proactive role of the state administration, the late empowerment of the legislature, and the relatively weak democratic institutions are important boundary conditions. We therefore expect to see our theory most applicable in contexts with similar institutional attributes. Our context is by no means unique. Research on countries that have experienced similar development processes attributes the rapid industrialization and economic growth of these economies to their effective administrative bureaucracies that design industrial policies and co-opt business firms into implementation (Amsden, 1989; Evans, 1995; Marquis and Qian, 2014; Wade, 1990; Wu, 2005). Admittedly, state intervention in Taiwan and some of these states has become constrained more recently (Wong, 2011). Nonetheless, the administrative bureaucrats have maintained their policy orientation towards economic growth and power in policy implementation. At the same time, the emergence of the legislature as the quintessential democratic institution has been seen throughout Asia, Eastern Europe, and Latin America (Mainwaring and Samuels, 1999; Mezey, 1983; Mishler and Rose, 1994). Recognizing the divided nature of the state and understanding the attributes of such an administration and legislature can better predict the impact of the associated corporate political ties.

At the conceptual level, the mechanisms of resource dependence and interest representation are at work in other political regimes. Although the specific ways in which such mechanisms are embedded in different types of political ties may differ in different contexts, it is useful to examine which mechanism is more dominant for ties with different political positions. Future studies can investigate various structural divides in other political regimes to disentangle the two mechanisms in order to better understand the impact of corporate political ties.

Limitations and Future Research

Our study has some limitations that provide opportunities for future research. First, although Taiwan provides a good context for us to study the institutional divide between the two branches of the state, the lack of variation in the dominant party in our study period prevented us from a rigorous test of the impact of party vs. branch affiliation of ties. While we conducted further tests controlling for the party affiliation of the ties, future research can test our framework under other conditions of political party and branch alignment. Second, the nature of the contested issue may influence the binding vs. buffering role of ties to the two branches we observed in this study. We examined board independence (as well as information disclosure) that was central to the corporate governance reform in Taiwan. Future studies can examine other socially contested practices such as national health insurance, minimum wage, and clean energy. Despite these limitations, our study takes an important step forward in understanding the contingent nature of corporate political ties based on the structural divide of the state.

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NOTES

[1] Non-family firms would also support legislators who defend their positions and interests. However, compared with family firms, top executive turnover in non-family firms is frequent, leading to changes of inclinations and strategic interests of the firms. The firms may thus change their political allies as a

result. The tendency of maintaining a stable relationship with legislators is not as strong in non-family firms as in family firms.

[2] For example, the candidates for independent directors should have a master's degree (or above) in the areas of business, finance, accounting, or law, with at least five years of working experience in related fields. Candidates who are employees of the company or other related businesses of the company, who own more than 1 per cent of the company's (or related businesses') shares, who are spouses or close relatives of the directors and shareholders of the company, or who provide legal, financial, or accounting services to the company are considered not 'independent'. See the related provisions at http://www.tse.com.tw/ch/listed/governance/cg_02.php.

[3] Six political ties (or 1.7 per cent) were created by positional interlocks between administrators and corporate independent directors. These independent directors (from two firms) were included in our dependent variable. Excluding them did not affect our results.

[4] During our research period (2002–05), the DPP was in power and enjoyed strong support from the Green regions. Green is the colour of DPP and Green regions refer to the following cities and counties: Yunlin, Chiayi, Tainan, Kaohsiung, Pingtung, and Yilan.

[5] To identify such relationships, we checked the Excellent Business Database System (EBDS) (http://ebds.anyan.com.tw), which covers more than 200 periodicals and newspapers published in Taiwan and provides reports on informal relationships between business leaders and political actors. We also surveyed autobiographies of business leaders, dissertations, and books devoted to the subject of political-business relationships (Hong, 2006; Wang, 2006) to locate such informal social ties. A firm was considered as having an informal social tie with the state if any of its business leaders were reported as having social relationships with political actors, such as having been classmates at university or playing golf together at the same social club.

[6] Following the industry codes assigned by the Taiwan Stock Exchange, we controlled for 18 sectors: Cement, Food, Plastic, Textile, Electric Machinery & Machinery, Electric Appliance & Wires, Chemical & Biological Medicine, Glass, Paper & Pulp, Steel & Iron, Rubber, Auto, Electronic and Computer, Construction, Transport, Tourism, Retailing and Department Store, and others. Our sample did not include firms from Banking & Insurance due to the more restrictive corporate governance regulations in that sector.

[7] Coefficient estimates were obtained from a Poisson family generalized linear model (GLM) estimated with iteratively re-weighted least squares (IRLS) based on a log link function. This approach was used in prior research dealing with similar statistical issue as ours (Lizardo, 2006).

[8] We compared the difference between 'elite independent directors' and other independent directors and did not find significant differences regarding the subsequent changes in three out of the four corporate governance practices examined. However, firms appointing elite independent directors subsequently had significantly smaller deviation between cash flow and voting rights than those appointing other independent directors. This indicates that 'elite independent directors' may exert stronger monitoring in certain domains.

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APPENDIX 1
Distribution of Corporate Political Ties with Legislative and Executive Branches across Business Roles in Firms

	Administrative ties					
	Political appointees	*Civil bureaucrats*	*Advisor and committee members*	*Total administrative ties*	*Legislative ties*	*Total (percentage)*
Board chairs	0	12	20	32	6	38 (10.7%)
Top business executives	0	27	19	46	24	70 (19.7%)
Major shareholders	0	68	14	82	11	93 (26.1%)
Board members	0	65	55	120	29	149 (41.9%)
Independent directors	0	5	1	6	0	6 (1.7%)
Total (percentage)	0 (0)	177 (49.7%)	109 (30.6%)	286 (80.3%)	70 (19.7%)	356 (100%)

Note: The administrative and legislative ties established by firms involved current as well as former (i.e., retired) officials.

APPENDIX 2
Additional Dependent Variable: Information Disclosure

DV: Information disclosure	*Ordered probit estimates with instrumental variables*						
	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*
Administrative ties	0.04	0.05	0.04	0.07	0.04	0.05	0.08
	(0.280)	(0.123)	(0.226)	(0.082)	(0.226)	(0.195)	(0.045)
Legislative ties	−0.20	−0.18	−0.20	−0.19	−0.14	−0.14	−0.12
	(0.012)	(0.030)	(0.011)	(0.022)	(0.080)	(0.083)	(0.139)
Administrative ties × regulated industry		0.14					
		(0.008)					
Administrative ties × family domination			0.05	0.05			0.07
			(0.413)	(0.390)			(0.237)
Administrative ties × foreign ownership				0.02			−0.02
				(0.925)			(0.938)
Administrative ties × ADR				0.07			0.06
				(0.221)			(0.281)

DV: Information disclosure	*Ordered probit estimates with instrumental variables*						
	(1)	*(2)*	*(3)*	*(4)*	*(5)*	*(6)*	*(7)*
Legislative ties × family domination					−0.25 (0.011)	−0.25 (0.013)	−0.27 (0.008)
Legislative ties × foreign ownership						−0.39 (0.258)	−0.36 (0.301)
Legislative ties × ADR						0.38 (0.007)	0.36 (0.012)
All controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	1393	1393	1393	1393	1393	1393	1393

Note: p-value in parentheses; standard errors clustered at firm level; Industry and year fixed-effects included.