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Independent directors' political connections and CEO compensation: Evidence from China

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ABSTRACT

This study investigates the relationship between independent directors' political connections and chief executive officer (CEO) compensation in Chinese listed firms from 2009 to 2018. Our empirical analysis reveals that politically connected independent directors (PCIDs) significantly reduce excessive CEO compensation. Channel tests demonstrate that this effect stems from PCIDs' enhanced negotiation power relative to CEOs. The negative association between PCIDs and CEO compensation is attenuated in firms with politically connected CEOs but amplified in firms benefiting from substantial preferential bank loans and government subsidies. Heterogeneity analysis further shows that this negative relationship weakens in firms with stronger corporate governance mechanisms and state-owned enterprises (SOEs), while intensifying among firms led by experienced and talented CEOs. Our results remain robust across a battery of endogeneity checks and alternative specifications.

1. Introduction

More than two decades ago, regulatory agencies initiated board structure reforms,¹ motivated by the expectation that including independent directors would enhance the monitoring of managerial actions and strengthen investor protection against managerial expropriation. Existing research suggests that the effectiveness of board independence (i.e., the proportion of independent directors) in monitoring depends on firm-specific characteristics, such as business complexity (Coles et al., 2008), the ease of information acquisition for directors (Duchin et al., 2010), and the role of independent directors (monitoring vs. advisory) (Faleye et al., 2011). Similarly, empirical studies have examined how independent directors' characteristics influence their monitoring effectiveness, including factors such as reputation (Masulis & Mobbs, 2023) and industry-related experience (Wang et al., 2015). Given that government work experience or political connections play a significant role in corporate governance—particularly in China (Calomiris

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¹ In the United States, both the NYSE and Nasdaq implemented regulations in 1999 requiring that audit committees consist solely of independent directors. This mandate was further reinforced and expanded by the Sarbanes-Oxley Act of 2002. Additionally, in 2003, the NYSE and NASD introduced new rules stipulating that a majority of board members must be independent directors. In China, the China Securities Regulatory Commission (CSRC) issued the *Guidelines for Introducing Independent Directors to the Boards of Listed Companies* in 2001, mandating that by June 30, 2003, at least one-third of each listed company's board consist of independent directors.

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et al., 2010)—this study follows prior work (e.g., [Hu et al., 2020](#); [Li & Guo, 2022](#); [Wang, 2015](#)) to investigate the monitoring effectiveness of politically connected independent directors (PCIDs), with a specific focus on their impact on CEO compensation.

CEO compensation is a central board function for aligning managerial incentives through well-designed contracts ([Faleye et al., 2011](#)). However, since CEOs often influence director nominations ([Shivdasani & Yermack, 1999](#)), simply increasing the number of independent directors does not automatically lead to more effective constraints on CEO pay - particularly when these independent directors may themselves be CEO-nominated. Empirical evidence on this relationship remains inconclusive ([Chhaochharia & Grinstein, 2009](#); [Guthrie et al., 2012](#)), suggesting that the impact of independent directors on CEO compensation is highly context-dependent ([Faleye et al., 2011](#); [Wang et al., 2015](#)). These dynamics may also create tensions and generate competing hypotheses regarding the effect of PCIDs on CEO compensation.

On the one hand, [Chhaochharia and Grinstein \(2009\)](#) demonstrate that the success of regulatory reforms targeting independent directors depends crucially on whether these changes strengthen directors' bargaining power. In the Chinese context, [Liu et al. \(2015\)](#) find that independent directors in government-controlled firms contribute positively to firm performance. Building on these insights, we propose that politically connected independent directors can leverage their political ties to benefit firms, thereby gaining greater negotiation power to help restrain excessive CEO compensation (Negotiation Power Hypothesis). Specifically, political connections can improve access to financial resources, reducing firms' financing costs—for example, by facilitating greater bank financing ([Claessens et al., 2008](#)) and lowering loan costs ([Houston et al., 2014](#)). They can also ease access to government subsidies ([Johnson & Mitton, 2003](#)). On the other hand, the presence of PCIDs may also generate significant agency costs. First, firms with PCIDs exhibit a greater propensity for tunneling activities - the diversion of corporate resources to controlling shareholders at the expense of minority investors - which both extracts firm value and reduces growth potential ([Berkman et al., 2010](#); [Wang, 2015](#)). Second, political connections may create distorted decision-making incentives, leading CEOs to favor politically expedient investments over economically optimal ones, resulting in inefficient capital allocation ([Chen, Sun, et al., 2011](#)). These dual agency costs could weaken PCIDs' monitoring effectiveness regarding CEO oversight, particularly in executive compensation oversight (Agency Cost Hypothesis). Nevertheless, China's distinctive institutional environment - characterized by government entities as ultimate controlling shareholders and reinforced by the 2013 regulatory ban on officials serving as independent directors (aimed specifically at preventing rent-seeking) - suggests that PCIDs are more likely to constrain rather than enable excessive CEO compensation. Our study is therefore motivated to examine the such relationship between PCIDs and CEO compensation, given these competing theoretical perspectives and empirical tensions.

The Chinese context provides a unique platform to consider PCIDs' role. The Chinese government, compared with its counterparts in other countries, is more directly involved in the corporate sector largely because of its multiple roles including those of a shareholder and regulator of listed firms ([Li et al., 2008](#)). Consequently, political connections are quite prevalent and important in the Chinese business sector (e.g., [Li et al., 2008](#); [Fan et al., 2017](#)). First, the government is a controlling shareholder in state-owned enterprises (SOEs) and thus tends to appoint government-affiliated independent directors to represent its interests. Second, privately controlled firms in China assign politically affiliated persons as independent directors to develop connections with the government; that is, Chinese listed firms might appoint retired politicians as independent directors because their previous work experience in the government or at SOEs enables them to establish crucial connections with important government officials to provide firms with political advantages ([Wang, 2015](#); [Wu et al., 2012](#)). Therefore, this study examines how PCIDs influence CEO compensation in China and explores the underlying mechanisms driving this relationship. Our empirical results demonstrate that PCIDs significantly constrain excessive CEO compensation. Through further analysis of the economic channels, we find that PCIDs' stronger negotiation power serves as the primary mechanism for their effective monitoring role, consistent with the negotiation power hypothesis. This conclusion is supported by several key findings: the restraining effect is weaker in firms with politically connected CEOs but stronger in firms that benefit more substantially from political connections, particularly through preferential bank loans and government subsidies. Additional heterogeneity analysis reveals that the negative association between PCIDs and excessive CEO compensation is less evident in firms with stronger corporate governance mechanisms and in state-owned enterprises, but more pronounced in firms led by experienced CEOs and those with superior managerial ability. We address potential endogeneity concerns through multiple rigorous approaches, including Heckman selection models and a difference-in-differences (DID) design that exploits an exogenous shock from [China Regulates Officials Working in Enterprises](#), Regulation 18. The robustness of our main findings is confirmed through alternative measures of both PCIDs and CEO compensation. Additional analysis indicates that the compensation-restraining effect of PCIDs is particularly strong in firms with boards characterized by greater gender diversity (higher proportion of female directors), older members, and more highly educated directors.

Our work contributes to the existing research in the following two aspects. First, our study relates to a growing body of literature concerning the economic consequences of corporate political connections (e.g., [Cheng & Leung, 2016](#); [Goldman et al., 2009, 2013](#); [Li et al., 2015](#)). While most relevant studies only focus on CEOs' and chairpersons' political connections (e.g., [Li et al., 2015](#)), those concerned with the influence of independent directors' political connections are limited to corporate market value ([Shi et al., 2018](#)), investment ([Wang, 2015](#)), and corporate social responsibility performance ([Li & Guo, 2022](#)). However, following [Yu \(2010\)](#), we examine the board's value in mitigating agency problems through constraints on CEO pay. Our study differs from [Yu's \(2010\)](#) research in the following ways. First, we target listed companies in mainland China whereas [Yu \(2010\)](#) studies the Taiwanese context. The mainland Chinese market's independent director system, compensation design, and corporate political connections present some indigenous characteristics (e.g., [Li et al., 2015](#); [Cheng & Leung, 2016](#)). Second, [Yu \(2010\)](#) only study CEOs' equity-based compensation whereas we consider excessive CEO compensation and pay-performance sensitivity to identify abnormal CEO pay more precisely ([Bugeja et al., 2016](#); [Core et al., 2008](#)). Third, our study concentrates on PCIDs' impact on CEO compensation rather than that of entire boards' political connections as in [Yu \(2010\)](#). Furthermore, we acknowledge that the effects of affiliated and independent directors'

CEO behavior monitoring roles differ (e.g., [Gomulya & Boeker, 2016](#)). Fourth, our study overcomes the possible endogeneity issues in [Yu \(2010\)](#) such as omitted variable bias and reverse causality.²

Second, this study contributes to the vast literature on independent directors' monitoring and supervisory roles (e.g., [Fama, 1980](#); [Fama & Jensen, 1983](#)) as well as on how heterogeneity among independent directors influences the board of directors' efficacy (e.g., [Duchin et al., 2010](#); [Bernile et al., 2018](#); [Chen et al., 2019](#)). Our study focuses on independent directors' political networks and supervisory role in the firm given that the existing studies have presented mixed findings on their impact on CEO compensation (e.g., [Chhaochharia & Grinstein, 2009](#); [Guthrie et al., 2012](#)). Our study supports [Chhaochharia and Grinstein's \(2009\)](#) findings and sheds new light on PCIDs' impact on CEO compensation and the underlying economic mechanisms.

The remainder of this paper is organized as follows. Section 2 develops the hypotheses. Section 3 presents the data and methodology. Section 4 discusses the main results, economic mechanisms, and robustness checks. Section 5 is a discussion, and Section 6 concludes.

2. Literature review and hypotheses development

2.1. Corporate governance role of independent directors

As key corporate governance institutions, independent directors serve critical monitoring functions on corporate boards. Their primary responsibilities include overseeing managerial behavior, mitigating agency problems, and safeguarding shareholder interests ([Fama, 1980](#); [Fama & Jensen, 1983](#)). This monitoring role stems from their presumed greater motivation to supervise management compared to insider directors ([Kroll et al., 2008](#)). However, the theoretical independence of directors does not always translate into effective governance in practice. CEOs frequently influence the independent director recruitment process ([Shivdasani & Yermack, 1999](#)), thereby gaining leverage in their relationships with these directors ([Baker & Hall, 2004](#)). This dynamic can lead to the formation of close CEO-director relationships that may result in collusion rather than effective oversight ([Khedmati et al., 2020](#)).

Furthermore, the impact of independent directors on corporate governance effectiveness depends on both firm characteristics ([Coles et al., 2008](#); [Faleye et al., 2011](#)) and the specific attributes of the independent directors themselves ([Masulis & Mobbs, 2023](#); [Wang et al., 2015](#)). In particular, independent directors' industry experience and professional expertise significantly influence their governance effectiveness ([Wang et al., 2015](#); [Qin and Zhang, 2019](#)).

2.2. The value proposition of politically connected independent directors

Political connections represent a distinctive form of industry experience that can provide specialized expertise for independent directors. Their previous work experience in government or state-owned enterprises enables them to establish important connections with key party and government officials ([Fan et al., 2007](#); [Wu et al., 2012](#)). Specifically, politically connected independent directors (PCIDs) create substantial value for firms through their unique political capital, operating through multiple channels that enhance both financial and operational performance ([Hu et al., 2020](#); [Xia et al., 2019](#)).

From an institutional theory perspective, in emerging markets like China where government plays a dominant economic role, political connections serve as crucial non-market strategies that help firms navigate institutional voids and regulatory complexities ([Peng & Luo, 2000](#); [Xin & Pearce, 1996](#)). These advantages manifest through several concrete mechanisms. First, PCIDs significantly reduce bureaucratic friction by leveraging their government expertise and networks. Their understanding of regulatory processes and personal connections with officials enable more favorable policy interpretations ([Faccio, 2006](#)) and early access to information about regulatory changes. Second, in financial markets, PCIDs facilitate access to preferential financing through both formal and informal channels. Their presence signals political endorsement to lenders, resulting in lower interest rates ([Claessens et al., 2008](#)) and longer loan maturities ([Faccio, 2006](#)). Third, PCIDs enhance firms' ability to capture government resources through superior intelligence about subsidy programs and more effective grant applications. As [Wu et al. \(2012\)](#) document, politically connected firms receive more government subsidies. The resource-based view suggests these political resources become particularly valuable during economic downturns or policy transitions when government discretion increases ([Hillman, 2005](#)). The cumulative effect of these advantages creates an "institutional advantage" ([Mellahi et al., 2016](#)) that explains why firms with PCIDs show higher market valuations in emerging markets ([Goldman et al., 2019](#)).

2.3. The negotiation power hypothesis

Building on [Bebchuk et al.'s \(2002\)](#) managerial power framework, we propose that PCIDs possess stronger negotiation power relative to CEOs. The resource dependency mechanism suggests that PCIDs' political capital makes them particularly valuable to the firm. As [Chhaochharia and Grinstein \(2009\)](#) demonstrate that the success of regulatory reforms targeting independent directors depends crucially on whether these changes strengthen directors' bargaining power. Political capital enhances independent directors'

² For instance, CEO compensation may also be reduced for other reasons (i.e., poor firm performance), which also influences the proportion of the aforementioned directors. Meanwhile, CEOs engage in the process of nominating independent directors ([Cavaco et al., 2017](#)), which may lead to variations in both the proportion of politically connected directors and CEO compensation. We attempt to address these concerns through several endogeneity tests (i.e., the Heckman selection test and a DID estimation).

negotiation power, making CEOs less likely to interfere with their appointment or challenge their oversight.

The reputational mechanism indicates that PCIDs have stronger incentives to maintain their professional standing. Their political connections make them more visible to regulatory bodies and the public, increasing their motivation to fulfill governance responsibilities diligently (Shi et al., 2018). Additionally, the bargaining power mechanism suggests that PCIDs can more effectively counterbalance CEO influence in compensation decisions. Unlike regular independent directors whose positions may be more vulnerable to CEO preferences, PCIDs' unique value to the firm strengthens their position in compensation negotiations. These mechanisms collectively weaken CEOs' traditional advantage in director appointment processes while enhancing PCIDs' capacity to limit excessive compensation.

2.4. The Agency Cost Hypothesis

PCIDs' valuable political capital may come at the expense of heightened agency costs. This hypothesis draws upon agency theory to examine how PCIDs might inadvertently facilitate value extraction and distort corporate decision-making (The Agency Cost Hypothesis). First, PCIDs' political networks may facilitate tunneling activities by enabling the systematic diversion of corporate resources from minority shareholders to controlling interests. These resource transfers frequently occur through sophisticated related-party transactions designed to circumvent regulatory scrutiny (Berkman et al., 2010). These activities not only directly extract firm value but also erode long-term growth potential by reducing available capital for productive investments (Wang, 2015). The tunneling phenomenon appears particularly acute in firms where PCIDs maintain active political ties, suggesting that their connections may serve as conduits for resource diversion rather than value creation. The second source of agency costs stems from investment distortions, as PCIDs' political objectives may compete with shareholder value maximization. This conflict of interest can skew capital allocation toward politically expedient projects rather than economically optimal investments, resulting in suboptimal resource deployment. Studies show that firms with PCIDs tend to over-invest in politically favored projects, even when such investments offer suboptimal returns (Hu et al., 2020; Wang, 2015). This misallocation stems from PCIDs' dual loyalties - to shareholders and to their political networks - creating governance tensions that conventional monitoring mechanisms struggle to resolve. These agency costs collectively undermine PCIDs' monitoring effectiveness, especially regarding executive compensation oversight. When political considerations influence governance decisions, compensation packages may be structured to reward political alignment rather than performance. This helps explain empirical findings that PCID-containing firms often exhibit weaker pay-performance sensitivity (Chizema et al., 2015). The agency cost hypothesis thus predicts that PCIDs' political connections may compromise their ability to serve as effective monitors of executive pay.

However, China's evolving institutional landscape introduces important contingencies to this hypothesis. The government's dual role as both regulator and controlling shareholder creates inherent checks against extreme expropriation. Moreover, the 2013 regulatory reforms - particularly the prohibition on active officials serving as independent directors - significantly altered the calculus of political connections. By severing direct ties between PCIDs and current government positions, these reforms reduced the most egregious forms of rent-seeking, making PCIDs more accountable for their monitoring responsibilities. This institutional context suggests that in contemporary China, the agency costs associated with PCIDs may be substantially mitigated. Rather than enabling excessive compensation, PCIDs in the post-reform environment are more likely to leverage their political capital to constrain managerial excesses. Given these competing perspectives, we ultimately favor the Negotiation Power Hypothesis over the Agency Cost Hypothesis in explaining PCIDs' governance role. This theoretical positioning leads to our first formal hypothesis:

H1. Firms with PCIDs exhibit lower CEO compensation compared to those without PCIDs, due to the enhanced negotiation power of politically connected directors.

Agency theory establishes that incentive compensation and monitoring function as complementary mechanisms for mitigating agency problems (Core et al., 1999). Building on this foundation, the Negotiation Power Hypothesis (Baker & Hall, 2004) suggests that CEO compensation reflects the relative bargaining power between executives and their monitors, such as boards and shareholders. This theoretical framework implies that the effectiveness of incentive compensation depends fundamentally on the quality of corporate governance mechanisms (Conyon & He, 2012).

Existing research demonstrates that robust governance structures significantly influence compensation outcomes. For example, institutional investors, such as pension funds and mutual funds, possess both the incentives and expertise to rigorously scrutinize executive pay (Hartzell & Starks, 2003). Similarly, independent directors strengthen board monitoring capacity, leading to more restrained CEO compensation through enhanced oversight mechanisms (Chhaochharia & Grinstein, 2009). These findings suggest that in firms with strong existing governance structures, PCIDs diminished marginal influence on CEO compensation. Effective governance systems already provide comprehensive monitoring of executive pay, implement appropriate compensation controls, and maintain balanced power dynamics between executives and monitors. Based on this theoretical and empirical foundation, we propose the following hypothesis:

H2. Strong corporate governance weakens the negative impact of PCIDs on excessive CEO compensation.

We next examine how state ownership moderates the relationship between PCIDs and CEO compensation within China's unique political and business context. State ownership functions distinctly from traditional corporate governance mechanisms (e.g.,

independent directors, institutional shareholders) in safeguarding shareholder interests. While effective corporate governance typically aligns managerial actions with minority shareholders' interests, state owners often prioritize political objectives over shareholder wealth protection (Huyghebaert & Wang, 2012). The distinctive governance features of state-owned enterprises (SOEs) may attenuate PCIDs' influence through five key mechanisms.

First, SOEs face stringent compensation regulations and heightened political scrutiny, which systematically constrain executive pay (Chen et al., 2009). As Borisova, Brockman, Salas, and Zagorchev (2012) demonstrate, state ownership imposes "visible hand" restrictions on compensation decisions, limiting PCIDs' capacity to affect pay outcomes. Second, in Chinese SOEs, government authorities exert substantial control over board appointments—including PCIDs (Conyon & He, 2011) and CEOs (Hu et al., 2012)—thereby diluting PCIDs' monitoring effectiveness. Third, due to inherent property rights issues in SOEs, independent directors exhibit weaker oversight of CEO compensation compared to non-SOEs (Luo et al., 2018). Fourth, PCIDs' negotiation power is less consequential in SOEs, as these firms already enjoy abundant political resources, such as preferential bank loans (Cao et al., 2023) and government subsidies (Xiongyuan & Shan, 2013). Fifth, SOE's CEO compensation is typically subject to fixed-term caps (Chen, Ezzamel, & Cai, 2011) and greater public scrutiny, reducing opportunities for self-interested pay manipulation. Instead, SOE's CEOs may prioritize political capital over personal economic gains (Bradshaw et al., 2019).

Given these institutional constraints, we anticipate that the negative relationship between PCIDs and CEO compensation will be significantly weaker in SOEs. This leads to our second hypothesis:

H3. State ownership weakens the negative relationship between PCIDs and excessive CEO compensation.

Finally, this study extends the Negotiation Power Hypothesis by proposing that CEO capacity - defined as the combination of professional experience and managerial skills - amplifies the negative relationship between PCIDs and CEO compensation. The theoretical foundation for this proposition stems from the dynamic interplay between executive characteristics and board governance in compensation determination.

The literature suggests that a CEO's experience and capabilities are economically significant (e.g., Ryan & Wiggins, 2001), as firms can achieve higher profits by attracting managers with strong managerial skills and extensive experience (Custódio & Metzger, 2014). High-ability CEOs possess greater negotiation leverage due to their unique expertise and firm-specific knowledge. CEOs with more experience and ability are also more likely to be associated with agency problems, enabling them to appropriate firm value for personal gain (Nelson, 2005; Shen, 2021). This enhanced bargaining power and self-interested motivation often lead to higher compensation levels for skilled and experienced executives (Song & Wan, 2019). At the same time, these dynamics create a greater need for effective monitoring by PCIDs.

The presence of high-capacity CEOs may increase the value of political connections to the firm. Ambitious growth strategies pursued by skilled executives often require the resources, networks, and government relations that politically connected directors can provide. Consequently, in firms with more capable CEOs, PCIDs are likely to exercise their negotiation power more assertively, ensuring that managerial compensation packages are closely tied to performance outcomes. This dynamic creates a self-reinforcing cycle where strong CEOs demand higher pay, while PCIDs leverage their political capital to enforce stricter performance contingencies on that compensation. As a result, we conduct the following hypothesis:

H4. Stronger CEO capacity intensifies the negative impact of PCIDs on CEO compensation.

3. Data and methods

3.1. Data selection and sources

Our sample data are obtained from the China Stock Market and Accounting Research (CSMAR) database. We include all A-share firms listed on the Shanghai and Shenzhen Stock Exchanges from January 1, 2009 to December 31, 2018, except those in the financial sector and those with special treatment. We also use hand-collected data on important variables such as independent directors' and CEOs' demographic, educational, and career backgrounds and political connections. Using their resumes to supplement the CSMAR data, we determine the independent directors' political connections and the CEOs' characteristics. To mitigate the influence of outliers, all continuous variables are winsorized at the 1 % and 99 % levels.

Consequently, we obtain 16,986 observations, of which 9.6 % of the sampled firms are deemed to have political connections through their independent directors. The average for excessive CEO compensation is 0.033. Table 1 provides additional details of the key variables' summary statistics, and Appendix Table I presents the variables' definitions.

3.2. Empirical model

To test H1, we use the following regression models to estimate PCIDs' impact on CEO compensation:

$$EXCESS_COMP_{it} = \beta_0 + \beta_1 POLITICAL_CONNECTION_{it} + \beta_2 Control_{it} + \mu_i + \eta_t + \varepsilon_{it}, \quad (3.1)$$

where $POLITICAL_CONNECTION_{it}$ is an indicator variable that equals one if any of the independent directors of firm i is politically connected and zero otherwise. Following the methodologies applied in the literature on Chinese executives' political connections (e.g., Conyon et al., 2015; Fan et al., 2007), we define PCIDs as having held a prior position in the central or local government or the military or having been a deputy in the National People's Congress or a member of the National Committee of the Chinese People's Political

Table 1
Summary statistics.

Variable	Observation Numbers	Mean	Standard deviation	Minimum	First quartile	Median	Third quartile	Maximum
EXCESS_COMP	16,986	0.033	0.559	-2.205	-0.329	0.031	0.393	2.237
TOTAL_COMP	16,986	746,625	756,669	93,950	331,350	538,850	858,450	4,849,600
POLITICAL_CONNECTION	16,986	0.096	0.295	0.000	0.000	0.000	0.000	1.000
POLITICAL_CONNECTED_CEO	16,986	0.028	0.166	0.000	0.000	0.000	0.000	1.000
POLITICAL_CONNECTED_INSB	16,986	0.137	0.159	0.000	0.000	0.000	0.000	1.000
BANK_LOAN	16,986	0.238	0.257	0.000	0.036	0.219	0.410	0.895
SUBSIDY	16,986	0.658	0.701	0.000	0.000	1.000	1.000	1.000
HCG	16,986	0.466	0.398	0.000	0.000	0.000	1.000	1.000
MA_SCORE	16,986	-0.003	0.177	-0.704	-0.297	-0.002	0.265	0.571
LEVARAGE	16,986	0.462	0.208	0.062	0.302	0.458	0.616	0.937
INSTITUTION_OWN	16,986	0.297	0.249	0.000	0.076	0.233	0.490	1.000
SOE	16,986	0.425	0.494	0.000	0.000	0.000	1.000	1.000
DUAL	16,986	0.237	0.425	0.000	0.000	0.000	0.000	1.000
BOARD_SIZE	16,986	8.926	1.930	5.000	7.000	9.000	10.000	15.000
IND	16,986	0.372	0.056	0.308	0.333	0.400	0.532	0.671
LARGEST_OWN	16,986	0.049	0.127	0.003	0.244	0.364	0.529	0.601
BOARD_OWN	16,986	0.088	0.164	0.000	0.023	0.089	0.105	0.127
BIG4	16,986	0.197	0.398	0.000	0.000	0.000	0.000	1.000
SIZE	16,986	22.438	1.485	19.082	21.495	22.190	23.105	27.862
SALES_GROWTH	16,986	0.138	0.313	-2.912	21.495	22.190	23.105	5.897
FIRM_AGE	16,986	16.702	5.677	2.930	12.582	16.660	20.648	30.440
TOBINQ	16,986	1.890	1.634	0.149	0.884	1.399	2.348	10.005
ROA	16,986	0.066	0.108	-0.488	0.034	0.072	0.123	0.369
CEO_DEGREE	16,986	3.645	1.227	1.000	3.000	4.000	4.000	4.000
CEO_AGE	16,986	49.773	6.347	28.000	46.000	50.000	56.000	75.000
CEO_GENDER	16,986	0.936	0.245	0.000	1.000	1.000	1.000	1.000
CEO_OVERSEA	16,986	0.072	0.259	0.000	0.000	0.000	0.000	1.000
IND_FEMALE	16,986	0.012	0.111	0.000	0.000	0.000	0.000	1.000
IND_DEGREE	16,986	3.064	0.958	2.000	3.000	4.000	4.000	4.000
IND_AGE	16,986	52.390	8.535	29.000	45.000	54.000	59.000	81.000

Notes: Table 1 presents the detailed summary statistics for all key variables in our estimations. The detailed definitions of the variables are in Appendix Table I.

Consultative Conference.

Following Core et al. (2008) and Bugeja et al. (2016), we compute excess CEO compensation ($EXCESS_COMP_{it}$) by taking the difference between actual and expected CEO compensation.³ First, we estimate the total expected compensation ($EXPECT_COMP_{it}$) by regressing the natural logarithm of total actual CEO compensation ($TOTAL_COMP_{it}$) against proxies for the economic determinants of CEO compensation, as proposed by Core et al. (2008), as shown in Equation (3.2). The regression controls for the natural logarithms of CEO tenure ($TENURE$), the lagged firm sales ($LSALES$), the lagged Shanghai and Shenzhen 300 index indicator (LSS), the lagged book-to-market ratio (LBM), stock return (RET), the lagged stock return ($LRET$), return on assets (ROA), the lagged return on assets ($LROA$), as well as industry (μ_i) and year (η_t) fixed effects.

$$\ln(TOTAL_COMP_{it}) = \beta_0 + \beta_1 Control_{it} + \mu_i + \eta_t + \varepsilon_{it} \quad (3.2)$$

The expected compensation ($EXPECT_COMP_{it}$) is then derived by taking the exponential of the predicted values obtained from Equation (3.2).⁴ We then calculate the percentage residual of compensation ($EXCESS_COMP_{it}$) by taking the difference between the natural logarithm of actual total compensation ($TOTAL_COMP_{it}$) and the natural logarithm of expected compensation ($EXPECT_COMP_{it}$), as follows:

$$EXCESS_COMP_{it} = \ln(TOTAL_COMP_{it}) - \ln(EXPECT_COMP_{it}) \quad (3.3)$$

To control for various firm characteristics that may influence excessive CEO compensation, we refer to previous studies (e.g., Brick et al., 2006; Conyon et al., 2015; Conyon & He, 2011) and include the following control variables related to firm i : $BOARD_SIZE$, the number of members on the board of directors; IND , the proportion of independent directors on the board; ROA , the ROA for profitability; $DUAL$, a dummy variable that equals one if the firm's CEO is also the chairman of the board of directors and zero otherwise; $LEVARAGE$, the leverage ratio of total debt to total assets; $INSTITUTION_OWN$, the institutional holding percentages; $TOBINQ$, the ratio between the market value of the firm's physical assets and the replacement value; $SALES_GROWTH$, the firm's sales growth rate; $SIZE$,

³ Following Firth et al. (2007) and Conyon and He (2011), we use the natural logarithm of total CEO compensation to re-estimate all the regressions and derive consistent results.

⁴ We present the results of Equation (3.2) in Appendix Table II and find that the significance of most control variable coefficients aligns with findings from previous literature (Core et al., 2008).

the natural logarithm of the firm's total assets; *FIRM_AGE*, the number of years the firm has been listed, *BIG4*, a dummy variable that equals one if the firm's auditor is a big four auditing firm and zero otherwise; *LARGEST_OWN*, the firm's largest shareholders' ownership percentage; *BOARD_OWN*, the firm's board of directors' ownership percentage; and *SOE*, a dummy variable equal to one if the controlling shareholder is the state and zero otherwise. Finally, following Conyon et al. (2015), we control for the CEO's political connections using *POLITICAL_CONNECTED_CEO*, a dummy variable that equals one if the firm's CEO has political connections as per the previous definition and zero otherwise. Following the literature (e.g., Brick et al., 2006), we control for important CEO characteristics including education, age, gender, and overseas experience. Finally, since we aim to ascertain whether the PCID effect is unique to independent directors, we also control for the political connections of the chairman of the board and those of executive (insider) board members using *POLITICAL_CONNECTED_INSB*,⁵ a dummy variable that equals one if the firm's chairman of the board, or executive board members, possesses political connections per the previous definition. We further control the firm fixed effect μ_i and the year fixed effect η_t to control for any possible systematic variation in CEO compensation across firms and years. Standard errors are clustered at the firm level.

3.3. Model of economic mechanisms

To identify the economic mechanism underlying the findings, we apply the following interaction model models:

$$\begin{aligned} EXCESS_COMP_{it} = & \beta_0 + \beta_1 POLITICAL_CONNECTION_{it} + \beta_2 MODERATOR_{it} + \beta_3 POLITICAL_CONNECTION_{it} * MODERATOR_{it} \\ & + \beta_4 Control_{it} + \mu_i + \eta_t + \varepsilon_{it}. \end{aligned} \quad (3.4)$$

First, we aim to ascertain whether PCIDs' negotiation power with CEOs arises from their political resources. We expect that PCIDs would show strong monitoring effects, especially regarding CEOs without political connections, because firms will not fully rely on PCIDs' political resources if their CEOs also have political connections. We use *POLITICAL_CONNECTED_CEO* as our first moderating variable (*MODERATOR_{it}*) and expect the coefficient of the interaction term (β_3) to be significantly positive since PCIDs' negotiation power will be weakened in firms with politically connected CEOs. β_1 indicates the impact of the political connection to the firms when firms without political connected CEO (*POLITICAL_CONNECTED_CEO* = 0). β_2 indicates the impact of the political connected CEO on the firms without political connections (*POLITICAL_CONNECTION* = 0).

Second, we sought to confirm that PCIDs' monitoring effects are linked to the benefits they bring firms. Specifically, we expect PCIDs' monitoring effects to become more pronounced when the firm receives benefits through their political connections. As previously mentioned, Chinese firms with political connections are more likely to receive preferential bank loans (Claessens et al., 2008) and government subsidies (Wu et al., 2012). Consequently, following Claessens et al. (2008) and Wu et al. (2012), we use preferential bank loans and government subsidies as proxies for the corporate benefits reaped from political connections.

Following Claessens et al. (2008), we first compute the ratio of bank loans, measured as total bank loans divided by the total assets of firm *i* at year *t*. We then use *HBANKLOANS*, a dummy variable that equals one if the firm's ratio of bank loans is above the sample firm average in year *t* and zero otherwise, as an indicator of corporate bank borrowing capacity. Government subsidies are represented by *SUBSIDIES*, a dummy variable that equals one if firm *i* received government subsidies in year *t* and zero otherwise. Consequently, we use *HBANKLOANS* and *SUBSIDIES* as our second and third moderating variables (*MODERATOR_{it}*), respectively, in Eq. (3.4).

Assuming the validity of the negotiation power hypothesis, we expect the coefficients of main interest of coefficients -the interaction term (β_3) for these two cross-sectional tests to be significantly negative. It is because political connections have stronger negotiation power when they bring more preferential bank loans (Claessens et al., 2008) and government subsidies (Wu et al., 2012) to the firms, which help them provide stronger monitoring mechanism for the CEO compensation. β_1 indicates the impact of the political connection to the firms when firms receive less bank loans (*HBANKLOANS* = 0) and government subsidies (*SUBSIDIES* = 0). β_2 indicates the impact of the high bank loans and government subsidies on the firms without political connections (*POLITICAL_CONNECTION* = 0).

4. Empirical findings

4.1. Correlation tests

Table 2 shows the Pearson correlation test results for our empirical models' key variables. According to the correlation matrix, excessive CEO compensation is negatively correlated with PCIDs in line with H1. Additionally, the key control variables *ROA*, *DUAL*, *CEO_DEGREE*, *CEO_AGE*, *CEO_OVERSEA*, and *POLITICAL_CONNECTED_CEO* are positively associated with excessive CEO compensation. Meanwhile, *INSTITUTION_OWN*, *BOARD_SIZE*, *IND*, and *LARGEST_OWN* are negatively associated with excessive CEO compensation, echoing the existing findings (e.g., Brick et al., 2006; Conyon et al., 2015).

⁵ If the same effect is observed for politically connected executive (insider) directors, the focus is on the power balance between the CEO and (all) the directors (Ding et al., 2015).

Table 2
Correlation tests.

	EXCESS_COMP	SOE	POLITICAL_CONNECTION	LEVARAGE	INSTITUTION_OWN	DUAL	BOARD_SIZE	IND	LARGEST_OWN
EXCESS_COMP	1								
SOE	-0.025*	1							
POLITICAL_CONNECTION	-0.019*	-0.051***	1						
LEVARAGE	-0.019*	0.248*	0.018*	1					
INSTITUTION_OWN	0.059*	0.089*	-0.009	0.043*	1				
DUAL	0.047*	-0.275*	0.004	0.128*	-0.026*	1			
BOARD_SIZE	0.061*	0.248*	-0.054*	0.200*	0.084*	-0.178*	1		
IND	-0.026*	-0.043*	0.022*	-0.003	0.015	-0.099*	-0.387*	1	
LARGEST_OWN	-0.020*	-0.046*	-0.004	-0.043*	0.312*	-0.045*	-0.057*	0.043*	1
BOARD_OWN	-0.013	-0.438*	-0.015*	-0.2675*	-0.246*	-0.242*	-0.172*	0.065*	0.074*
BIG4	0.048*	0.046*	-0.001	0.059*	0.142*	0.011	0.012	0.068*	0.043*
SIZE	0.013	0.262*	0.030*	0.475*	0.317*	0.133*	0.165**	0.359*	0.038*
SALES_GROWTH	0.032*	-0.051*	-0.004	0.033*	0.079*	-0.022*	0.029**	0.004	0.001
FIRM_AGE	0.004	0.120*	0.012	0.148*	0.255*	0.070*	0.015*	0.007	-0.007
TOBINQ	-0.003	-0.062*	0.002	-0.094*	-0.021*	-0.028*	0.027*	-0.065*	0.020*
ROA	0.035**	-0.007	0.016*	-0.060*	0.024*	0.003	0.051*	0.021*	-0.016*
CEO_DEGREE	0.086**	0.030*	0.009	0.054*	0.073*	-0.020*	0.026*	0.054*	0.017*
CEO_AGE	0.069***	0.093*	0.021*	0.025*	0.132*	0.154*	0.074	0.073*	0.013
CEO_GENDER	0.008	0.075*	0.025*	0.026*	0.003	-0.007	0.126	0.072*	-0.046*
CEO_OVERSEA	0.065**	-0.109*	-0.036*	-0.038*	0.025*	0.064*	0.067**	-0.033*	0.025*

	BOARD_OWN	BIG4	SIZE	SALES_GROWTH	FIRM_AGE	TOBINQ	ROA	CEO_DEGREE	CEO_AGE	CEO_GENDER	CEO_OVERSEA
BOARD_OWN	1										
BIG4	-0.030*	1									
SIZE	-0.216*	0.258*	1								
SALES_GROWTH	0.049*	0.003	0.093*	1							
FIRM_AGE	-0.236*	0.064*	0.146*	-0.021*	1						
TOBINQ	0.021*	-0.011	-0.177*	-0.033*	-0.002	1					
ROA	0.019*	0.012	0.055*	0.059*	-0.019*	-0.008	1				
CEO_DEGREE	-0.032*	0.065*	0.121*	0.027*	0.009	-0.004	0.010*	1			
CEO_AGE	-0.065*	0.070*	0.141*	-0.029*	0.117*	-0.011	0.017*	-0.114*	1		
CEO_GENDER	-0.079*	0.001	0.042*	-0.007	-0.016*	-0.005	-0.009*	0.016*	0.023*	1	
CEO_OVERSEA	0.069*	0.032*	0.025*	0.022*	-0.032*	0.008	0.003*	0.102*	-0.035*	-0.015*	1

Notes: Table 2 presents the Pearson r Correlation Test results for all key variables in our estimations. The detailed definitions of the variables are in Appendix Table I. *, **, and *** denote significance at the 10 %, 5 %, and 1 % levels, respectively.

4.2. Baseline regression findings

We use baseline regressions to examine PCIDs' impact on CEO compensation and the underlying economic mechanism. Column (1) of Table 3 shows that the existence of PCIDs significantly constrains excessive CEO compensation. Regarding economic magnitude, excessive CEO compensation is 4.1 % less for firms with PCIDs than for their counterparts.⁶ This empirical finding is consistent with H1, which derives from Bebchuk et al.'s (2002) managerial power hypothesis. It also echoes Goldman et al.'s (2009, 2013) and Xia et al.'s (2019) findings. The results of multicollinearity tests of all the key variables in the baseline regression model are reported in Appendix Table III. For all the key variables, the variance inflation factor is below ten, indicating no significant multicollinearity issue.

Next, we examine the potential economic mechanism underlying our main finding. Column (2) of Table 3 suggests that the negative relationship between PCIDs and excessive CEO compensation is attenuated when CEOs themselves have political connections. In economic terms, the mitigating effect of PCIDs on CEO compensation is 7.5 % weaker (as captured by β_3 in Equation (3.4)) for politically connected CEOs compared to their non-connected counterparts. This finding aligns with the negotiation power hypothesis: when CEOs possess political connections, PCIDs' ability to negotiate lower compensation diminishes, allowing CEOs to exert greater influence over their own pay.

The coefficient on *POLITICAL_CONNECTION* (β_1 in Equation (3.4)) is significantly negative (-0.042), indicating that in firms with non-connected CEOs (*POLITICAL_CONNECTION_CEO* = 0), PCIDs reduce CEO compensation by 4.2 % relative to firms without PCIDs. This result supports our main hypothesis and is consistent with Column (1) of Table 2. Conversely, the coefficient on *POLITICAL_CONNECTION_CEO* (β_2 in Equation (3.4)) is significantly positive (0.127), suggesting that in firms without PCIDs (*POLITICAL_CONNECTION* = 0), politically connected CEOs receive 12.7 % higher compensation than non-connected CEOs. This further corroborates the negotiation power hypothesis, as CEOs with political connections appear to leverage their advantage when directors lack comparable political influence. Meanwhile, the 7.5 % coefficient on the interaction term also indicates that CEOs with political connections have stronger bargaining power over compensation when the independent director is likewise politically connected. We conjecture that this may be because the independent director can help the CEO better leverage government resources.

Our analysis of Columns (3) and (4) in Table 3 reveals that the negative relationship between PCIDs and excessive CEO compensation is particularly strong for firms enjoying greater access to preferential bank loans and government subsidies.⁷ Economically, PCIDs' mitigating effect on CEO compensation is 3.7 % and 17.7 % more pronounced (as indicated by β_3 in Equation (3.4)) for firms with substantial bank loans and government subsidies, respectively, compared to other firms. This finding further supports the negotiation power hypothesis, suggesting that PCIDs exert greater influence over CEO compensation when their political connections yield tangible benefits for the firm.

The significantly negative coefficients on *POLITICAL_CONNECTION* ($\beta_1 = -0.025$ and -0.027 in Equation (3.4)) demonstrate that even in firms without privileged access to bank loans or government subsidies (where *HBANKLOANS* = 0 and *SUBSIDIES* = 0), PCIDs still reduce CEO compensation by 2.5 % and 2.7 % relative to firms without PCIDs. However, this effect is weaker than that observed in firms with average levels of these benefits (as shown in Column (1) of Table 2), consistent with reduced negotiation power in these circumstances.

The statistically insignificant coefficients on *HBANKLOANS* and *SUBSIDIES* ($\beta_2 = -0.013$ and 0.135 in Equation (3.4)) indicate that in firms lacking PCIDs (*POLITICAL_CONNECTION* = 0), access to bank loans and government subsidies does not significantly affect CEO compensation levels. This suggests these benefits may stem from other firm characteristics rather than independent directors' political connections.

When examining firms with both PCIDs (*POLITICAL_CONNECTION* = 1) and privileged access to financial resources, we find they award -0.5 % (calculated as $-0.037 - 0.013$) and -4.2 % (calculated as $-0.177 + 0.135$) lower CEO compensation in the higher bank loan and subsidy contexts, respectively, compared to their counterparts. Furthermore, in firms with either higher bank loans or subsidies (where *HBANKLOANS* = 0 and *SUBSIDIES* = 0), those with PCIDs pay 5.2 % ($-0.025 - 0.027$) and 0.204 % ($-0.027 - 0.177$) less in CEO compensation than comparable firms without PCIDs. These results strongly align with the negotiation power hypothesis, as PCIDs appear to wield greater influence over compensation decisions when their political connections secure valuable financial benefits for the firm.

4.3. Politically connected independent directors and corporate governance, corporate state ownership status, and CEO characteristics

Firstly, we aim to determine whether PCIDs are playing the same roles as strong corporate governance mechanism or use their political resources to capitalize on their negotiation power. Following Jiang and Yuan (2018), we first apply the corporate governance

⁶ We further derive the meaning of *EXCESS_COMP* in Appendix IV, where we show that *EXCESS_COMP* represents the ratio of excess compensation to expected compensation, which follows the methodology established in prior literature (Core et al., 2008). However, we also consider a more intuitive alternative measure - the ratio of excess compensation to total compensation - which we similarly derive in Appendix IV. This alternative specification provides an economically meaningful interpretation: our results indicate that firms with PCIDs show 3.94 % lower excessive CEO compensation relative to their non-PCID counterparts (calculated as $1/(1/0.041 + 1) = 3.94$ %).

⁷ We use contemporaneous bank loans and subsidies, and we acknowledge that this may suffer from endogeneity issue. For example, firms with high bank loans and subsidies may be financially constrained, potentially leading to lower CEO compensation. Therefore, we re-estimate the models using the one-year lag and the three-year average of bank loans and subsidies; the results remain consistent. In addition, we address endogeneity using a DID approach in Section 4.6.2, and the findings are likewise robust.

Table 3
Main results.

VARIABLES	(1)	(2)	(3)	(4)
	EXCESS_COMP	EXCESS_COMP	EXCESS_COMP	EXCESS_COMP
POLITICAL_CONNECTION	-0.041*** (0.005)	-0.042*** (0.006)	-0.025** (0.011)	-0.027** (0.012)
POLITICAL_CONNECTION*POLITICAL_CONNECTED_CEO		0.075** (0.030)		
POLITICAL_CONNECTION*HBANKLOANS			-0.037** (0.015)	
POLITICAL_CONNECTION*SUBSIDY				-0.177** (0.080)
HBANKLOANS			-0.013 (0.010)	
SUBSIDY				0.135 (0.126)
LEVARAGE	-0.047 (0.093)	-0.062 (0.101)	-0.045 (0.090)	-0.049 (0.078)
INSTITUTION_OWN	0.125 (0.114)	0.123 (0.108)	0.119 (0.105)	0.112 (0.124)
DUAL	-0.034 (0.032)	-0.031 (0.029)	-0.036 (0.037)	-0.032 (0.043)
BOARD_SIZE	0.031 (0.033)	0.033 (0.038)	0.032 (0.030)	0.038 (0.034)
IND	0.075 (0.120)	0.090 (0.123)	0.081 (0.105)	0.069 (0.113)
SOE	-0.005*** (0.001)	-0.006** (0.002)	-0.007*** (0.002)	-0.004** (0.002)
LARGEST_OWN	-0.069 (0.062)	-0.063 (0.061)	-0.067 (0.060)	-0.060 (0.061)
BOARD_OWN	0.062 (0.057)	0.064 (0.058)	0.063 (0.056)	0.065 (0.057)
BIG4	0.171*** (0.020)	0.172*** (0.020)	0.170*** (0.019)	0.168*** (0.021)
SIZE	0.023 (0.019)	0.044 (0.042)	0.025 (0.020)	0.045 (0.043)
FIRM_AGE	0.004** (0.002)	0.005** (0.002)	0.005** (0.002)	0.004*** (0.001)
SALES_GROWTH	0.001 (0.003)	0.001 (0.003)	0.002 (0.003)	0.001 (0.002)
TOBINQ	0.052* (0.024)	0.051 (0.029)	0.048 (0.030)	0.051 (0.027)
ROA	0.013 (0.014)	0.012 (0.009)	0.012 (0.010)	0.010 (0.009)
CEO_DEGREE	0.044*** (0.003)	0.037*** (0.006)	0.045*** (0.010)	0.038*** (0.004)
CEO_AGE	0.009*** (0.002)	0.006*** (0.002)	0.010*** (0.003)	0.005** (0.002)
CEO_GENDER	0.020 (0.022)	0.026 (0.031)	0.023 (0.022)	0.027 (0.030)
CEO_OVERSEA	0.159*** (0.026)	0.186** (0.091)	0.112*** (0.028)	0.174** (0.010)
POLITICAL_CONNECTED_CEO	0.124*** (0.022)	0.127*** (0.020)	0.128*** (0.019)	0.125*** (0.0201)
POLITICAL_CONNECTED_INSB	0.209 (0.195)	0.211 (0.198)	0.210 (0.197)	0.211 (0.195)
Constant	8.181*** (1.026)	7.982*** (1.031)	10.298*** (2.104)	9.103*** (1.478)
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	16,986	16,986	16,986	16,986
F-Fisher	12.710	14.019	14.120	14.058
Adjusted R-squared	0.705	0.707	0.711	0.713

Notes: Column (1) of Table 3 presents empirical results for full sample observations based on the following regression model, which investigates the impact of PCIDs on CEO excessive compensation.

$$\text{EXCESS_COMP}_{it} = \beta_0 + \beta_1 \text{POLITICAL_CONNECTION}_{it} + \beta_2 \text{Control}_{it} + \mu_i + \eta_t + \varepsilon_{it}$$

Column (2) to (4) of Table 3 present empirical results for full sample observations based on the following regression models, respectively, which investigates the possible economic mechanisms of the nature of firm ownership and corporate governance on the relationship between politically connected independent directors and CEO compensation.

$$EXCESS_COMP_{it} = \beta_0 + \beta_1 POLITICAL_CONNECTION_{it} + \beta_2 MODERATOR_{it} + \beta_3 POLITICAL_CONNECTION_{it} * MODERATOR_{it} + \beta_4 Control_{it} + \mu_i + \eta_t + \varepsilon_{it}$$

EXCESS_COMP is the difference between CEO actual and expected compensation. POLITICAL_CONNECTION is an indicator variable that equals one if any of the independent directors of the firm is politically connected and zero otherwise. MODERATOR is POLITICAL_CONNECTED_CEO, HBANK_LOANS, and SUBSIDIES in Column (2), (3), (4), respectively. POLITICAL_CONNECTED_CEO is a dummy variable that equals one if the CEO of firm has political connections and zero otherwise. HBANKLOANS is a dummy variable that equals to one if the firm's the ratio of preferential bank loans is above the average of the sample firm at year t and zero otherwise. SUBSIDIES is a dummy variable that equals to one if firm i receives government subsidies at year t and zero otherwise. Control_{it} includes the following control variables of firm i: BOARD_SIZE, the number of members on the board of directors; IND, the proportion of independent directors on the board; ROA, the return on assets for profitability; DUAL, a dummy variable that equals one if the firm's CEO is also the chairman of the board of directors and zero otherwise; LEVARAGE, the leverage ratio of total debt to total assets; INSTITUTION_OWN, the institutional holding percentages; TOBINQ, the ratio between a firm's physical asset's market value and its replacement value; SALES_GROWTH, the firm's sales growth rate; SIZE, the natural logarithm of the firm's total assets; FIRM_AGE, the number of years a firm has been listed; Big 4, a dummy variable that equals one if the firm's auditor is a big four auditing firm and zero otherwise; LARGES-T_OWN, the firm's largest shareholders' ownership percentage; BOARD_OWN, the firm's board directors' ownership percentage; SOE, a dummy variable equal to one if the controlling shareholder is the state and zero otherwise. CEO_DEGREE, the education level of CEO; CEO_AGE, the age of the firm's CEO. CEO_FEMALE, a dummy variable that equals to one if the firm's CEO is a female and zero otherwise. CEO_OVERSEA, a dummy variable that equals to one if the CEO of the firm has oversea experiences and zero otherwise; POLITICAL_CONNECTED_CEO; and POLITICAL_CONNECTED_INSB, a dummy variable equals to one if the chairman or executive board members of firm i have political connections at year t and zero otherwise. Appendix Table I shows the definitions of all these variables. Firm and year fixed effects are included in all estimations. Standard errors, clustered at the firm level, are shown in brackets. *, **, and *** denote significance at the 10 %, 5 %, and 1 % level, respectively.

index (CGI) to measure firm corporate governance capacity and use it as the moderating variable in Eq. (3.4). The CGI is computed according to eight corporate governance indicators⁸ that are positively related to corporate governance capacity: LARGEST_OWN, MANAGEMENT_OWN, INS_OWN, IND, BH_SHARE, ANALYST_FOLLOWING, BIG4, and SHARE2_10. We rank the firms in descending order according to each indicator for each year. We then divide the ranking by the total number of sample observations in that year and multiply the resulting measure by 100 to obtain a normalized value in the range of 0–100. Finally, firm CGI is calculated as the equally weighted average of all nine rankings for the nine indicators of each firm as follows:

$$CGI_{it} = \sum_{q=1}^8 \left(100 - \frac{RankCG_{itq} - 1}{Number_firms - 1} * 100 \right), \tag{4.1}$$

where q is the qth of the nine corporate governance indicators, and RankCG_{itq} represents the rank of the qth kind of corporate governance indicator for firm i in year t. A higher CGI indicates better corporate governance. We further categorize all the firms into high- and low-CGI firms based on the average CGI. Thus, HCG is a dummy variable indicating that firm i has a higher CGI than the average of all sample firms in year t and zero otherwise.

Column (1) of Table 4 shows that PCIDs' negative influence on CEO compensation is mitigated by firms' corporate governance capacity, which supports our Hypothesis 2. The literature shows that effective corporate governance practices lead to efficient monitoring mechanisms that affect companies' compensation policies (Conyon & He, 2011); thus, CEO compensation is procedurally set and regulated (Core et al., 1999). The likelihood that CEOs will use their power to set pay at will is low, rendering PCIDs' monitoring role regarding CEO compensation less significant.

Next, we apply the following regression model to compare PCIDs' role with strong corporate governance mechanisms:

$$EXCESS_COMP_{it} = \beta_0 + \beta_1 POLITICAL_CONNECTION_CEO_{it} + \beta_2 HCG_{it} + \beta_3 POLITICAL_CONNECTION_CEO_{it} * HCG_{it} + \beta_4 Control_{it} + \mu_i + \eta_t + \varepsilon_{it}. \tag{4.2}$$

Using Eq. (4.2), we focus on the cross-sectional model with the interaction item of HCG and POLITICAL_CONNECTED_CEO (β₃) and the coefficient of HCG (β₂). As shown in Column (2) of Table 4, the coefficient of the interaction item (β₃) is not significant, but the coefficient of HCG (β₂) is significantly negative. Consequently, strong corporate governance can reduce excessive CEO compensation, but this impact will be not significant if the CEOs have political connections; this is because they will have stronger negotiation power with corporate governance teams owing to the political benefits they bring firms. Therefore, strong corporate governance reduces excessive compensation in a different way than PCIDs. The negotiation power that arises from the firm's political connections drives CEOs' and directors'/shareholders' compensation negotiations. Referring to the findings shown in Column (2) of Table 3 and Column (1) of Table 4, PCIDs monitor CEO compensation via their strong negotiation power, whereas strong corporate governance (HCG) relies on effectively designed monitoring mechanisms (e.g., Conyon & He, 2011).

Secondly, we employ a state-owned enterprise (SOE) indicator as a moderating variable in Equation (3.4), where SOE is a dummy variable coded as 1 if the controlling shareholder is the state and 0 otherwise. The regression results presented in Column (3) of Table 4 demonstrate that, consistent with our expectations, the negative relationship between PCIDs and CEO compensation is significantly attenuated in SOEs compared to non-SOEs. These findings support Hypothesis 3 and align with the Negotiation Power Hypothesis,

⁸ We do not include SOE in the CGI since it is used as another moderating variable in subsequent tests. Moreover, we consider state ownership as playing a different corporate governance role in the relationship between PCIDs and CEO compensation as shown in Section 4.4.

Table 4
Channel tests.

VARIABLES	(1)	(2)	(3)	(4)	(5)
	EXCESS_COMP	EXCESS_COMP	EXCESS_COMP	EXCESS_COMP	EXCESS_COMP
POLITICAL_CONNECTION*HCG	0.040*** (0.009)				
POLITICAL_CONNECTION_CEO*HCG		-0.105 (0.097)			
POLITICAL_CONNECTION *SOE			0.072** (0.030)		
POLITICAL_CONNECTION*CEO_AGE				-0.017*** (0.003)	
POLITICAL_CONNECTION*MA_SCORE					-0.125*** (0.040)
HCG	-0.014** (0.007)	-0.015** (0.006)			
MA_SCORE					0.275*** (0.031)
POLITICAL_CONNECTION	-0.055*** (0.007)		-0.090*** (0.014)	-0.062*** (0.005)	-0.071*** (0.009)
LEVERAGE	-0.076 (0.095)	-0.047 (0.093)	0.062 (0.065)	-0.064 (0.080)	-0.059 (0.087)
INSTITUTION_OWN	0.199 (0.215)	0.183 (0.204)	-0.033 (0.032)	0.198 (0.202)	0.133 (0.136)
DUAL	-0.036** (0.011)	-0.041* (0.016)	-0.036** (0.010)	-0.132*** (0.030)	-0.125** (0.053)
BOARD_SIZE	0.029*** (0.004)	0.032** (0.010)	0.012** (0.004)	0.068*** (0.016)	0.027* (0.012)
IND	-0.001 (0.004)	0.002 (0.003)	0.010 (0.015)	0.004 (0.010)	0.008 (0.006)
SOE	-0.003** (0.001)	0.048 (0.157)	-0.004** (0.002)	-0.520** (0.149)	-0.261 (0.250)
LARGEST_OWN	-0.005 (0.008)	-0.004*** (0.001)	-0.006 (0.009)	-0.003*** (0.001)	-0.003*** (0.001)
BOARD_OWN	-0.077 (0.054)	-0.072 (0.057)	0.074 (0.081)	-0.055 (0.060)	-0.055 (0.072)
BIG4	0.199*** (0.020)	0.082*** (0.005)	0.088** (0.042)	0.080*** (0.021)	0.061*** (0.004)
SIZE	0.009 (0.017)	0.004 (0.017)	0.228*** (0.026)	0.227*** (0.044)	0.222*** (0.029)
FIRM_AGE	0.004** (0.001)	0.033* (0.015)	0.004** (0.002)	0.007* (0.003)	0.008*** (0.002)
SALES_GROWTH	0.001 (0.003)	0.004*** (0.001)	0.009** (0.003)	0.022** (0.008)	0.016*** (0.001)
TOBINQ	0.025 (0.018)	0.001 (0.003)	0.008* (0.004)	0.068 (0.060)	0.024** (0.008)
ROA	0.009 (0.017)	0.051 (0.026)	0.034 (0.026)	0.047*** (0.009)	0.027** (0.010)
CEO_DEGREE	0.043*** (0.004)	0.046*** (0.004)	0.022*** (0.003)	0.009*** (0.001)	0.006*** (0.001)
CEO_AGE	0.008*** (0.002)	0.007*** (0.001)	0.003** (0.001)	0.110** (0.046)	0.108** (0.050)
CEO_GENDER	0.022 (0.023)	0.010 (0.023)	0.007 (0.038)	0.150 (0.137)	0.145 (0.133)
CEO_OVERSEA	0.132*** (0.024)	0.156*** (0.029)	0.065* (0.034)	0.119*** (0.023)	0.118*** (0.025)
POLITICAL_CONNECTED_CEO	0.125*** (0.029)	0.099** (0.035)	0.129*** (0.025)	0.122*** (0.022)	0.124*** (0.019)
POLITICAL_CONNECTED_INSB	0.209 (0.195)	0.211 (0.198)	0.225 (0.202)	0.210 (0.197)	0.211 (0.195)
Constant	-7.953** (1.650)	-7.987** (1.354)	-7.934** (0.124)	-7.742*** (1.025)	-7.901*** (0.112)
Firm FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	16,986	16,986	16,986	16,986	16,986
F-Fisher	12.261	13.556	12.863	13.764	12.973
Adjusted R-squared	0.692	0.706	0.705	0.686	0.690

Notes: Columns (1), (3), (4), and (5) of Table 4 present empirical results for full sample observations based on the following regression models, which investigates the possible heterogenous effect of firm and CEO characteristics on the relationship between PCIDs and CEO compensation. $EXCESS_COMP_{it} = \beta_0 + \beta_1 POLITICAL_CONNECTION_{it} + \beta_2 MODERATOR_{it} + \beta_3 POLITICAL_CONNECTION_{it} * MODERATOR_{it} + \beta_4 Control_{it} + \mu_i +$

$\eta_t + \varepsilon_{it}$

MODERATOR is HCG, SOE, CEO_AGE, and MA_SCORE in Column (1), (3), (4), and (5), respectively. HCG, a dummy variable indicating that firm has higher corporate governance index than the average of all sample firms in year t and 0 otherwise. SOE, a dummy variable equal to one if the controlling shareholder is the state and zero otherwise. CEO_AGE, the age of the firm's CEO. MA_SCORE, the score of managerial ability calculated based the methodology developed by Demerjian et al. (2012).

Columns (2) of Table 5 present empirical results for full sample observations based on the following regression models, which investigates the possible heterogeneous effect of corporate governance on the relationship between politically connected CEOs and CEO compensation.

$$EXCESS_COMP_{it} = \beta_0 + \beta_1 \text{POLITICAL_CONNECTION_CEO}_{it} + \beta_2 \text{HCG}_{it} + \beta_3 \text{POLITICAL_CONNECTION_CEO}_{it} * \text{HCG}_{it} + \beta_4 \text{Control}_{it} + \mu_i + \eta_t + \varepsilon_{it} \quad (4.2b)$$

EXCESS_COMP is the difference between CEO actual and expected compensation. POLITICAL_CONNECTION is an indicator variable that equals one if any of the independent directors of the firm is politically connected and zero otherwise. POLITICAL_CONNECTED_CEO is a dummy variable that equals one if the CEO of firm has political connections (as per the previous definition), and zero otherwise. Control_{it} includes the following control variables of firm i : BOARD_SIZE, the number of members on the board of directors; IND, the proportion of independent directors on the board; ROA, the return on assets for profitability; DUAL, a dummy variable that equals one if the firm's CEO is also the chairman of the board of directors and zero otherwise; LEVERAGE, the leverage ratio of total debt to total assets; INSTITUTION_OWN, the institutional holding percentages; TOBINQ, the ratio between a firm's physical asset's market value and its replacement value; SALES_GROWTH, the firm's sales growth rate; SIZE, the natural logarithm of the firm's total assets; FIRM_AGE, the number of years a firm has been listed; Big 4, a dummy variable that equals one if the firm's auditor is a big four auditing firm and zero otherwise; LARGEST_OWN, the firm's largest shareholders' ownership percentage; BOARD_OWN, the firm's board directors' ownership percentage; SOE, a dummy variable equal to one if the controlling shareholder is the state and zero otherwise; POLITICAL_CONNECTED_CEO is a dummy variable that equals one if the CEO of firm has political connections and zero otherwise; POLITICAL_CONNECTED_INSB, a dummy variable equals to one if the chairman or executive board members of firm i have political connections at year t and zero otherwise; CEO_DEGREE, the education level of CEO; CEO_FEMALE, a dummy variable that equals to one if the firm's CEO is a female and zero otherwise; CEO_OVERSEA, a dummy variable that equals to one if the CEO of the firm has oversea experiences and zero otherwise; Appendix Table I shows the definitions of all these variables. Firm and year fixed effects are included in all estimations. Standard errors, clustered at the firm level, are shown in brackets. *, **, and *** denote significance at the 10 %, 5 %, and 1 % level, respectively.

suggesting that PCIDs' influence on compensation negotiations is less pronounced in SOEs due to their inherent political characteristics. The established governance structures and compensation regulations in state-owned enterprises appear to diminish the observable monitoring effect of PCIDs on executive pay.

Thirdly, we use CEO age (CEO_AGE_{it}), the natural logarithm of the CEO's age, as an indicator of CEO work experience (Cheng, 2004). We also use managerial ability (MA_Score_{it}) designed by Demerjian et al.'s (2012) as a proxy of CEO ability. We expect that experienced and talented CEOs would garner executive rewards, whereas PCIDs weaken these CEOs' bargaining power and constrain CEO compensation.

The results presented in Columns (4) and (5) of Table 4 reveal a significantly stronger negative relationship between PCIDs and CEO compensation for more experienced and talented CEOs. These findings provide empirical support for our theoretical arguments regarding the negotiation power dynamics between PCIDs and executive leadership. Specifically, the evidence suggests that politically connected independent directors effectively constrain the compensation bargaining power of high-quality CEOs, consistent with the negotiation power hypothesis.

This pattern emerges because experienced, talented CEOs - while possessing greater human capital and managerial expertise - become more dependent on PCIDs' political resources when pursuing firm growth and development objectives. Consequently, these high-caliber executives face greater limitations in their ability to extract excessive compensation, as their reliance on PCIDs' political capital shifts the balance of negotiation power toward the board. The results substantiate our proposition that PCIDs serve as an important governance mechanism that mitigates potential rent extraction by even the most skilled and experienced executives.

4.4. Endogeneity issues

4.4.1. Heckman's selection models

To mitigate potential selection bias concerns, we employ a Heckman selection model, consistent with established approaches in the political connection literature (e.g., Kim & Zhang, 2016). Specifically, we adopt the approach of Kim and Zhang (2016) by estimating a first-stage probit model with POLITICAL_CONNECTION as the dependent variable to predict the likelihood of firms having PCIDs. This stage incorporates all control variables from Equation (3.1) (Goldman et al., 2009, 2013) and includes an exclusion restriction that affects CEO compensation solely through its impact on political connections—namely, IND_POLITICAL_CONNECTION, defined as the industry-average percentage of firms with PCIDs for firm i in year t . The constructed variable IND_POLITICAL_CONNECTION demonstrates a statistically significant positive correlation with POLITICAL_CONNECTION (as presented in Column (1), Table 5) while satisfying the critical exclusion restriction - influencing CEO compensation exclusively through its effect on political connections without operating through any direct channels. Our empirical procedure involves computing the inverse Mills ratio from this first-stage estimation, which we then include in the second-stage regression together with POLITICAL_CONNECTION. The results presented in Column (2) of Table 5 confirm that our baseline findings retain both statistical significance and economic magnitude, thereby robustly validating the stability of our core results.

Table 5
Endogenous test 1: Heckman’s selection test.

VARIABLES	(1)	(2)
	Heckman’s Selection First Stage	Heckman’s Selection Second Stage
	POLITICAL_CONNECTION	EXCESS_COMP
POLITICAL_CONNECTION		−0.056*** (0.017)
LEVERAGE	0.230** (0.119)	0.447 (0.502)
INSTITUTION_OWN	0.375*** (0.056)	0.255 (0.199)
DUAL	−0.100 (0.097)	−0.119** (0.054)
BOARD_SIZE	0.015 (0.020)	0.007 (0.010)
IND	−0.397 (0.351)	−0.268 (0.382)
SOE	−0.123 (0.109)	−0.118*** (0.040)
LARGEST_OWN	−0.017 (0.026)	−0.010 (0.008)
BOARD_OWN	−0.075 (0.090)	−0.128 (0.129)
BIG4	0.111** (0.048)	0.011** (0.004)
SIZE	0.593** (0.292)	0.259*** (0.045)
SALES_GROWTH	0.045 (0.048)	0.048 (0.051)
FIRM_AGE	0.010 (0.012)	0.008* (0.004)
TOBINQ	0.079*** (0.016)	0.025*** (0.007)
ROA	0.078 (0.075)	0.070 (0.055)
CEO_DEGREE	0.075 (0.063)	0.054*** (0.012)
CEO_AGE	0.103 (0.092)	0.010*** (0.002)
CEO_GENDER	−0.024 (0.039)	−0.013 (0.077)
CEO_OVERSEA	0.188 (0.211)	0.212*** (0.070)
POLITICAL_CONNECTED_CEO	0.118 (0.132)	0.125*** (0.037)
POLITICAL_CONNECTED_INSB	0.109** (0.047)	0.125 (0.111)
IND_POLITICAL_CONNECTION	0.613*** (0.207)	
Constant	3.012*** (0.720)	3.767*** (0.545)
Inverse Mill’s ratio		0.852** (0.401)
Firm FE	Yes	Yes
Year FE	Yes	Yes
Observations	16,986	16,986
F-Fisher	11.731	11.798
Adjusted R-squared	0.580	0.709

Notes: Column (1) of Table 5 presents empirical results for the first stage of Heckman Selection model, as below.

$$Pr (POLITICAL_CONNECTION_{it}) = \beta_0 + \beta_1 Control_{it} + \beta_2 IND_POLITICAL_CONNECTION_{it} + \mu_i + \eta_t + \varepsilon_{it}$$

Column (2) of Table 5 presents empirical results for the baseline regression based on the second stage of Heckman Selection model, as below.

$$EXCESS_COMP_{it} = \beta_0 + \beta_1 POLITICAL_CONNECTION_{it} + \beta_2 Control_{it} + \beta_3 IMR + \mu_i + \eta_t + \varepsilon_{it}$$

EXCESS_COMP is the difference between CEO actual and expected compensation. POLITICAL_CONNECTION is an indicator variable that equals one if any of the independent directors of the firm is politically connected and zero otherwise. Control_{it} includes the following control variables of firm i: BOARD_SIZE, the number of members on the board of directors; IND, the proportion of independent directors on the board; ROA, the return on assets for profitability; DUAL, a dummy variable that equals one if the firm’s CEO is also the chairman of the board of directors and zero otherwise; LEVERAGE, the leverage ratio of total debt to total assets; INSTITUTION_OWN, the institutional holding percentages; TOBINQ, the ratio between a firm’s physical asset’s market value and its replacement value; SALES_GROWTH, the firm’s sales growth rate; SIZE, the natural logarithm of the firm’s

total assets; FIRM_AGE, the number of years a firm has been listed; Big 4, a dummy variable that equals one if the firm's auditor is a big four auditing firm and zero otherwise; LARGEST_OWN, the firm's largest shareholders' ownership percentage; BOARD_OWN, the firm's board directors' ownership percentage; SOE, a dummy variable equal to one if the controlling shareholder is the state and zero otherwise. POLITICAL_CONNECTED_CEO, CEOs of firm i have political connections at year t , and zero otherwise; POLITICAL_CONNECTED_INSB, a dummy variable equals to one if the chairman or executive board members of firm i have political connections at year t and zero otherwise; CEO_DEGREE, the education level of CEO; CEO_AGE, the age of the firm's CEO. CEO_FEMALE, a dummy variable that equals to one if the firm's CEO is a female and zero otherwise. CEO_OVERSEA, a dummy variable that equals to one if the CEO of the firm has oversea experiences and zero otherwise. IND_POLITICAL_CONNECTION indicates the average percentage across the industry of firms with PCIDs for firm i during year t . IMR indicates the Inverse Mill's ratio computed from stage one of the Heckman test. Appendix Table I shows the definitions of all these variables. Firm and year fixed effects are included in all estimations. Standard errors, clustered at the firm level, are shown in brackets. *, **, and *** denote significance at the 10 %, 5 %, and 1 % level, respectively.

4.4.2. Difference-in-differences estimation

Building on the methodological approaches of Hu et al. (2020), Hope et al. (2020), and Li and Guo (2022), we implement a DID strategy that capitalizes on the exogenous shock created by China Regulates Officials Working in Enterprises Regulation 18 (Reg 18) to investigate the relationship between PCIDs and corporate monitoring activities. Issued by the Organization Department of the Communist Party of China (CPC) Central Committee on October 19, 2013, Reg. 18 prohibited both incumbent and recently retired (within three years) government officials from serving as independent directors in publicly listed companies (China Regulates Officials Working in Enterprises; Organization Department of the CPC Central Committee, 2013). This regulatory intervention simultaneously served the broader anti-corruption campaign's objectives by eliminating potential rent-seeking channels between government officials and corporate entities. The implementation of Reg. 18 in 2014 triggered widespread resignations of PCIDs,⁹ abruptly severing valuable political connections for affected firms.

This regulatory change constitutes an ideal quasi-natural experiment due to its exogenous imposition relative to firm decisions and its creation of clean variation in firms' access to PCIDs. Importantly, our identification strategy establishes that observed post-shock changes in CEO compensation governance reflect causal effects of PCID departures rather than unobserved firm heterogeneity. By examining how PCID connections influence CEO compensation through this regulatory shock, our approach offers distinct methodological advantages. The research design exploits firm-level variation in political connections through directors' governmental backgrounds while using the precise timing of the regulatory shock to mitigate concerns about omitted time-varying factors, thereby complementing our cross-sectional baseline analysis.

$$\begin{aligned} EXCESS_COMP_{it} = & \beta_0 + \beta_1 POLITICAL_CONNECTION_LESS_i + \beta_2 REG_t + \beta_3 POLITICAL_CONNECTION_LESS_i * REG_t \\ & + \beta_4 Control_{it-1} + \mu_i + \eta_t + \lambda_c + \varepsilon_{it} \end{aligned} \quad (4.3)$$

REG_t is equal to one if the firm data are in and after 2014 and zero otherwise. $POLITICAL_CONNECTION_LESS_i$ is an indicator variable that equals one if the proportion of politically connected independent directors declined after 2013, and zero otherwise. Firm (μ_i), province (λ_c), and year (η_t) fixed effects are also included. Note that REG_t is absorbed by the time-fixed effects and is thus omitted in Eq. (4.3). Standard errors are clustered at the firm level. Consistent with the methodologies from Hu et al. (2020), our analysis focuses exclusively on firms that experienced a decline in politically connected independent directors ($POLITICAL_CONNECTION_LESS = 1$) and those with no change in such directors ($POLITICAL_CONNECTION_LESS = 0$) after 2013. The DID estimates presented in Column (1) of Table 6 reveal a statistically significant positive coefficient (β_3), indicating that Reg 18 reduced the influence of PCIDs on CEO compensation by 17.6 %. This finding aligns with Hu et al. (2020) in demonstrating how the regulation diminished PCIDs' bargaining power and monitoring effectiveness in compensation negotiations. The attenuated negative relationship between PCIDs and CEO compensation following the regulatory change provides robust support for our primary hypothesis.

To address potential endogeneity concerns arising from firm characteristics that might simultaneously affect both PCID composition and CEO compensation, we implement a propensity score matching (PSM) approach. We pair each treatment firm (experiencing PCIDs declined) with a comparable control firm (with unchanged PCIDs) using nearest neighbor matching with replacement. The first-stage probit model predicts the likelihood of firms (experiencing PCIDs declined, incorporating the same control variables as our baseline regression while controlling for two-digit SIC codes and year fixed effects. The PSM-DID results presented in Column (2) of Table 6 confirm the robustness of our initial DID findings, maintaining both the estimated magnitude and statistical significance of the treatment effect.

Finally, we conduct subsample analysis by partitioning our DID sample based on firms' average bank loan ratios and government subsidies in 2013. This stratification reflects our expectation that firms more dependent on political resources through PCIDs - those with higher bank loan ratios or greater government subsidies - would experience more pronounced effects from Reg 18. As hypothesized, Columns (3) through (6) demonstrate that the regulatory impact on the PCID-CEO compensation relationship remains statistically significant only for firms with above-average bank loan ratios and government subsidies, while showing no significant effect

⁹ Illustrative cases include the resignation of WANG Kaiyuan from China International Travel Service (601888.SH), where he had served as independent director following his position as Deputy Administrator of the Civil Aviation Administration of China; GU Yingqi's departure from Jiangsu Lianhuan Pharmaceutical after serving as Vice Minister of Health (an agency comparable to the U.S. HHS); and GUO Shichang's exit from both Huabei Pharmaceutical (600812.SH) and Fengfan Co., Ltd. (600482.SH) following his tenure as Vice Governor of Hebei Province (Li & Guo, 2022).

Table 6
Endogenous test 2: The inclusion of the independent director fixed effects and difference-in-difference tests.

VARIABLES	(1)	(2)	(3)	(4)	(5)	(6)
	Full DID Sample	PSM-DID Sample	High Loan	Low Loan	High Subsidy	Low Subsidy
	EXCESS_COMP	EXCESS_COMP	EXCESS_COMP	EXCESS_COMP	EXCESS_COMP	EXCESS_COMP
POLITICAL_CONNECTION_LESS	-0.115* (0.065)	-0.114* (0.067)	-0.118** (0.055)	-0.644 (0.473)	-0.115** (0.057)	-0.038 (0.105)
POLITICAL_CONNECTION_LESS*REG	0.176** (0.077)	0.182** (0.079)	0.188** (0.082)	0.091 (0.127)	0.244* (0.135)	0.054 (0.137)
Control Variables	Yes	Yes	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Province FE	Yes	Yes	Yes	Yes	Yes	Yes
Observations	1208	878	610	598	638	570
F-Fisher	11.612	11.821	11.836	11.802	11.834	11.810
Adjusted R-squared	0.624	0.671	0.670	0.671	0.663	0.694

Notes: Column (1) to (6) of Table 6 presents empirical results for the following DID model.

$$EXCESS_COMP_{it} = \beta_0 + \beta_1 POLITICAL_CONNECTION_LESS_{it} + \beta_2 REG_{it} + \beta_3 POLITICAL_CONNECTION_LESS_{it} * REG_{it} + \beta_4 Control_{it-1} + \mu_i + \eta_t + \lambda_c + \varepsilon_{it}$$

DID sample from Column (q) was constructed by only including the firms with the decline of political connected independent directors (POLITICAL_CONNECTION_LESS = 1) and the firms with no changes of the political connected independent directors (POLITICAL_CONNECTION_LESS = 0) from 2013 to 2014. PSM-DID sample from Column (2) was constructed by matching the firms with the decline of political connected independent directors with the firms with no changes of the political connected independent directors based on the propensity scores. Columns (3) and (4) present the subsample DID estimation with high and low bank loan ratio based on the subsamples categorized by the average of the ratio of the bank loans in 2013, the year before the initiation of Reg 18. Columns (5) and (6) present the subsample DID estimation with high and low government subsidy based on the subsamples categorized by the average of the ratio of the government subsidy in 2013, the year before the initiation of Reg 18.

REG_{it} is equal to one if the firm data is after 2013 and zero otherwise. EXCESS_COMP is the difference between CEO actual and expected compensation. POLITICAL_CONNECTION_LESS is an indicator variable that equals one if the proportion of politically connected independent directors declined after 2013, and zero otherwise. Control_{it} includes the following control variables of firm i: BOARD_SIZE, the number of members on the board of directors; IND, the proportion of independent directors on the board; ROA, the return on assets for profitability; DUAL, a dummy variable that equals one if the firm’s CEO is also the chairman of the board of directors and zero otherwise; LEVERAGE, the leverage ratio of total debt to total assets; INSTITUTION_OWN, the institutional holding percentages; TOBINQ, the ratio between a firm’s physical asset’s market value and its replacement value; SALES_GROWTH, the firm’s sales growth rate; SIZE, the natural logarithm of the firm’s total assets; FIRM_AGE, the number of years a firm has been listed; Big 4, a dummy variable that equals one if the firm’s auditor is a big four auditing firm and zero otherwise; LARGES_T_OWN, the firm’s largest shareholders’ ownership percentage; BOARD_OWN, the firm’s board directors’ ownership percentage; SOE, a dummy variable equal to one if the controlling shareholder is the state and zero otherwise. POLITICAL_CONNECTED_CEO is a dummy variable that equals one if the CEO of firm has political connections and zero otherwise; POLITICAL_CONNECTED_INSB, a dummy variable equals to one if the chairman or executive board members of firm i have political connections at year t and zero otherwise; CEO_DEGREE, the education level of CEO; CEO_AGE, the age of the firm’s CEO. CEO_FEMALE, a dummy variable that equals to one if the firm’s CEO is a female and zero otherwise. CEO_OVERSEA, a dummy variable that equals to one if the CEO of the firm has oversea experiences and zero otherwise. The control variables are the same as Table 3, which are omitted in the table for conciseness concerns. REG_{it} is omitted in the estimation since Year FE has been included. Appendix Table 1 shows the definitions of all these variables. Firm, independent director, and year fixed effects are included in Column (1). Firm, year, and province fixed effects are included in Column (2). Standard errors, clustered at the firm level, are shown in brackets. *, **, and *** denote significance at the 10 %, 5 %, and 1 % level, respectively.

for their counterparts. These results further validate the channel through which political connections influence executive compensation.

4.5. Robustness check

We perform additional tests to demonstrate the robustness of our results. First, we employ an alternative measure of political connection strength by using the percentage of PCIDs on the board as a continuous variable. The results presented in Columns (1) through (4) of Table 7 confirm the robustness of our primary findings when using this alternative specification. Specifically, the significantly negative coefficients on POLITICAL_CONNECTION_RATIO (β₁ in Equation (3.4)) in Columns (2)–(4) demonstrate that firms with a greater proportion of PCIDs exhibit substantially lower CEO compensation - by 20.7 %, 24.2 %, and 21.1 % respectively - when three conditions are met: the CEO lacks political connections (POLITICAL_CONNECTION_CEO = 0), the firm has limited bank financing (HBANKLOANS = 0), and receives minimal government subsidies (SUBSIDY = 0). The analysis further reveals that in firms with PCIDs, politically connected CEOs (POLITICAL_CONNECTION_CEO = 1) receive higher compensation (an increase of 0.048, calculated as -0.207 + 0.255). Similarly, firms with PCIDs that have greater access to bank loans show a 35.5 % higher compensation (-0.242-0.113 = -0.355), while those receiving more substantial government subsidies demonstrate 41.7 % higher compensation (-0.211-0.206 = -0.417) compared to their respective counterparts. These findings provide strong corroborating evidence for our

Table 7
Robustness check 1: Alternative proxy of independent directors' political connection.

VARIABLES	(1)	(2)	(3)	(4)
	EXCESS_COMP	EXCESS_COMP	EXCESS_COMP	EXCESS_COMP
POLITICAL_CONNECTION_RATIO	-0.305*** (0.074)	-0.207** (0.095)	-0.242** (0.098)	-0.211** (0.102)
POLITICAL_CONNECTED_CEO		0.127*** (0.020)		
HBANKLOANS			-0.013 (0.010)	
SUBSIDY				0.135 (0.126)
POLITICAL_CONNECTION_RATIO*POLITICAL_CONNECTED_CEO		0.255*** (0.081)		
POLITICAL_CONNECTION_RATIO*HBANKLOANS			-0.113*** (0.015)	
POLITICAL_CONNECTION_RATIO*SUBSIDY				-0.206** (0.089)
Control Variables	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	16,986	16,986	16,986	16,986
F-Fisher	10.374	14.034	14.138	14.070
Adjusted R-squared	0.698	0.710	0.712	0.715

Notes: Column (1) of Table 7 presents empirical results for the baseline regression based on alternative proxy of independent political connection.

$$EXCESS_COMP_{it} = \beta_0 + \beta_1 POLITICAL_CONNECTION_RATIO_{it} + \beta_2 Control_{it} + \mu_i + \eta_t + \varepsilon_{it}$$

Column (2) of Table 7 presents empirical results for the moderating tests based on alternative proxy of independent political connection.

$$EXCESS_COMP_{it} = \beta_0 + \beta_1 POLITICAL_CONNECTION_RATIO_{it} + \beta_2 MODERATOR_{it} + \beta_3 POLITICAL_CONNECTION_RATIO_{it} * MODERATOR_{it} + \beta_4 Control_{it} + \mu_i + \eta_t + \varepsilon_{it}$$

MODERATOR is POLITICAL_CONNECTED_CEO, HBANKLOANS, and SUBSIDY in Column (2), (3), and (4), respectively. POLITICAL_CONNECTION_RATIO is the ratio of political connected independent director in the board of the firm. POLITICAL_CONNECTED_CEO is a dummy variable that equals one if the CEO of firm has political connections and zero otherwise. HBANKLOANS is a dummy variable that equals to one if the firm's the ratio of preferential bank loans is above the average of the sample firm at year t and zero otherwise. SUBSIDIES is a dummy variable that equals to one if firm i receives government subsidies at year t and zero otherwise. EXCESS_COMP is the difference between CEO actual and expected compensation. Control_{it} includes the following control variables of firm i: BOARD_SIZE, the number of members on the board of directors; IND, the proportion of independent directors on the board; ROA, the return on assets for profitability; DUAL, a dummy variable that equals one if the firm's CEO is also the chairman of the board of directors and zero otherwise; LEVERAGE, the leverage ratio of total debt to total assets; INSTITUTION_OWN, the institutional holding percentages; TOBINQ, the ratio between a firm's physical asset's market value and its replacement value; SALES_GROWTH, the firm's sales growth rate; SIZE, the natural logarithm of the firm's total assets; FIRM_AGE, the number of years a firm has been listed; Big 4, a dummy variable that equals one if the firm's auditor is a big four auditing firm and zero otherwise; LARGEST_OWN, the firm's largest shareholders' ownership percentage; BOARD_OWN, the firm's board directors' ownership percentage; POLITICAL_CONNECTED_CEO is a dummy variable that equals one if the CEO of firm has political connections and zero otherwise; POLITICAL_CONNECTED_INSB, a dummy variable equals to one if the chairman or executive board members of firm i have political connections at year t and zero otherwise; CEO_DEGREE, the education level of CEO; CEO_AGE, the age of the firm's CEO. CEO_FEMALE, a dummy variable that equals to one if the firm's CEO is a female and zero otherwise. CEO_OVERSEA, a dummy variable that equals to one if the CEO of the firm has oversea experiences and zero otherwise. The control variables are the same as Table 3, which are omitted in the table for conciseness concerns. Appendix Table I shows the definitions of all these variables. Firm and year fixed effects are included in all estimations. Standard errors, clustered at the firm level, are shown in brackets. *, **, and *** denote significance at the 10 %, 5 %, and 1 % level, respectively.

main results presented in Table 3.

We next examine whether PCID membership on compensation committees influences our main findings. To test this, we replace POLITICAL_CONNECTION with PCIDs_COMMITTEE in our primary regression models, where PCIDs_COMMITTEE is a dummy variable equal to 1 if at least one PCID serves on the firm's compensation committee and 0 otherwise. The results presented in Table 8 demonstrate complete consistency with our baseline findings, while showing stronger effect sizes across all coefficients.

These findings provide further support for the Negotiation Power Hypothesis, as they indicate that PCIDs' monitoring effect becomes more pronounced when they participate directly in compensation committees. This enhanced impact likely occurs because committee membership enables PCIDs to directly exercise their negotiation power during compensation deliberations and implement more effective monitoring mechanisms. The stronger results observed when PCIDs serve on compensation committees suggest that their political connections yield greater influence when they have direct involvement in executive pay decisions.

Furthermore, we apply alternative proxies to the estimation with some moderating factors including SOE and corporate governance indicators. First, we use state ownership percentage as an alternative proxy for SOEs. Second, we adopt the percentage of independent

Table 8
Robustness check 2: Politically connected CEO in the compensation committee.

VARIABLES	(1)	(2)	(3)	(4)
	EXCESS_COMP	EXCESS_COMP	EXCESS_COMP	EXCESS_COMP
PCIDS_COMMITTEE	-0.276*** (0.074)	-0.225*** (0.065)	-0.212** (0.098)	-0.209** (0.101)
POLITICAL_CONNECTED_CEO		0.130*** (0.022)		
HBANKLOANS			-0.016 (0.014)	
SUBSIDY				0.142 (0.133)
PCIDS_COMMITTEE *POLITICAL_CONNECTED_CEO		0.279*** (0.077)		
PCIDS_COMMITTEE *HBANKLOANS			-0.139*** (0.041)	
PCIDS_COMMITTEE *SUBSIDY				-0.261** (0.102)
Control Variables	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	16,986	16,986	16,986	16,986
F-Fisher	12.134	19,287	18,750	17,861
Adjusted R-squared	0.619	0.610	0.614	0.625

Notes: Column (1) of Table 8 presents empirical results for the baseline regression based on alternative proxy of independent political connection. $EXCESS_COMP_{it} = \beta_0 + \beta_1 PCIDS_COMMITTEE_{it} + \beta_2 Control_{it} + \mu_i + \eta_t + \varepsilon_{it}$

Column (2) of Table 7 presents empirical results for the moderating tests based on alternative proxy of independent political connection.

$EXCESS_COMP_{it} = \beta_0 + \beta_1 PCIDS_COMMITTEE_{it} + \beta_2 MODERATOR_{it} + \beta_3 PCIDS_COMMITTEE_{it} * MODERATOR_{it} + \beta_4 Control_{it} + \mu_i + \eta_t + \varepsilon_{it}$

MODERATOR is POLITICAL_CONNECTED_CEO, HBANKLOANS, and SUBSIDY in Column (2), (3), and (4), respectively. PCIDS_COMMITTEE is a dummy variable equal to 1 if at least one PCID serves on the firm's compensation committee and 0 otherwise. POLITICAL_CONNECTED_CEO is a dummy variable that equals one if the CEO of firm has political connections and zero otherwise. HBANKLOANS is a dummy variable that equals to one if the firm's the ratio of preferential bank loans is above the average of the sample firm at year t and zero otherwise. SUBSIDIES is a dummy variable that equals to one if firm i receives government subsidies at year t and zero otherwise. EXCESS_COMP is the difference between CEO actual and expected compensation. Control_{it} includes the following control variables of firm i: BOARD_SIZE, the number of members on the board of directors; IND, the proportion of independent directors on the board; ROA, the return on assets for profitability; DUAL, a dummy variable that equals one if the firm's CEO is also the chairman of the board of directors and zero otherwise; LEVERAGE, the leverage ratio of total debt to total assets; INSTITUTION_OWN, the institutional holding percentages; TOBINQ, the ratio between a firm's physical asset's market value and its replacement value; SALES_GROWTH, the firm's sales growth rate; SIZE, the natural logarithm of the firm's total assets; FIRM_AGE, the number of years a firm has been listed; Big 4, a dummy variable that equals one if the firm's auditor is a big four auditing firm and zero otherwise; LARGEST_OWN, the firm's largest shareholders' ownership percentage; BOARD_OWN, the firm's board directors' ownership percentage; POLITICAL_CONNECTED_CEO is a dummy variable that equals one if the CEO of firm has political connections and zero otherwise; POLITICAL_CONNECTED_INSB, a dummy variable equals to one if the chairman or executive board members of firm i have political connections at year t and zero otherwise; CEO_DEGREE, the education level of CEO; CEO_AGE, the age of the firm's CEO. CEO_FEMALE, a dummy variable that equals to one if the firm's CEO is a female and zero otherwise. CEO_OVERSEA, a dummy variable that equals to one if the CEO of the firm has oversea experiences and zero otherwise. The control variables are the same as Table 3, which are omitted in the table for conciseness concerns. Appendix Table I shows the definitions of all these variables. Firm and year fixed effects are included in all estimations. Standard errors, clustered at the firm level, are shown in brackets. *, **, and *** denote significance at the 10 %, 5 %, and 1 % level, respectively.

directors on the board as the proxy for the impact exerted by independent directors on the board. Third, we use the institutional investor ownership structure as an alternative proxy for corporate governance (Chhaochharia & Grinstein, 2009; Hartzell & Starks, 2003).

As shown in Columns (1) to (4) of Table 9, state ownership percentage (STATE_OWN), independent director percentage (IND), and institutional ownership percentage (INSTITUTION_OWN) significantly attenuate the negative relationship between politically connected independent directors and CEO compensation. These results align with our earlier findings and indicate that our core conclusions are robust to potential biases related to SOE status and corporate governance characteristics.

Furthermore, we find significantly negative coefficients for STATE_OWN, IND, and INSTITUTION_OWN, indicating that state ownership, independent directors, and institutional investors independently reduce CEO compensation levels in firms without politically connected directors (POLITICAL_CONNECTION = 0). These governance mechanisms effectively substitute for political connections by providing alternative monitoring channels and negotiation leverage over executive pay. Specifically, these actors complement PCIDs' oversight role by strengthening overall corporate governance and preserving bargaining power in compensation negotiations. Importantly, even in firms with PCIDs (POLITICAL_CONNECTION = 1), the monitoring effect persists: state ownership

Table 9
Robustness check 3: Alternative proxies for state-owned enterprises and corporate governance.

VARIABLES	(1)	(2)	(3)
	EXCESS_COMP	EXCESS_COMP	EXCESS_COMP
POLITICAL_CONNECTION	-0.043** (0.020)	-0.045** (0.022)	-0.048** (0.017)
STATE_OWN	-0.375*** (0.036)		
IND		-0.684** (0.339)	
INSTITUTION_OWN			-0.269*** (0.046)
POLITICAL_CONNECTION* STATE_OWN	0.277** (0.129)		
POLITICAL_CONNECTION*IND		0.619*** (0.232)	
POLITICAL_CONNECTION* INSTITUTION_OWN			0.205*** (0.003)
Control Variables	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Observations	16,986	16,986	16,986
F-Fisher	11.085	11.127	11.635
Adjusted R-squared	0.712	0.708	0.707

Notes: Column (1), (2), and (3) of Table 9 present empirical results for the following moderating tests based on alternative proxies of SOE and HCG. $EXCESS_COMP_{it} = \beta_0 + \beta_1 Political_Connection_{it} + \beta_2 STATE_OWN_{it} + \beta_3 Political_Connection_{it} * STATE_OWN_{it} + \beta_4 Control_{it} + \mu_i + \eta_t + \epsilon_{it}$

$EXCESS_COMP_{it} = \beta_0 + \beta_1 Political_Connection_{it} + \beta_2 IND_{it} + \beta_3 Political_Connection_{it} * IND_{it} + \beta_4 Control_{it} + \mu_i + \eta_t + \epsilon_{it}$

$EXCESS_COMP_{it} = \beta_0 + \beta_1 Political_Connection_{it} + \beta_2 INSTITUTION_OWN_{it} + \beta_3 Political_Connection_{it} * INSTITUTION_OWN_{it} + \beta_4 Control_{it} + \mu_i + \eta_t + \epsilon_{it}$

EXCESS_COMP is the difference between CEO actual and expected compensation. POLITICAL_CONNECTION is an indicator variable that equals one if any of the independent directors of the firm is politically connected and zero otherwise. Control_{it} includes the following control variables of firm i: BOARD_SIZE, the number of members on the board of directors; IND, the proportion of independent directors on the board; ROA, the return on assets for profitability; DUAL, a dummy variable that equals one if the firm's CEO is also the chairman of the board of directors and zero otherwise; LEVERAGE, the leverage ratio of total debt to total assets; INSTITUTION_OWN, the institutional holding percentages; TOBINQ, the ratio between a firm's physical asset's market value and its replacement value; SALES_GROWTH, the firm's sales growth rate; SIZE, the natural logarithm of the firm's total assets; FIRM_AGE, the number of years a firm has been listed; Big 4, a dummy variable that equals one if the firm's auditor is a big four auditing firm and zero otherwise; LARGEST_OWN, the firm's largest shareholders' ownership percentage; BOARD_OWN, the firm's board directors' ownership percentage; SOE, a dummy variable equal to one if the controlling shareholder is the state and zero otherwise. POLITICAL_CONNECTED_CEO is a dummy variable that equals one if the CEO of firm has political connections and zero otherwise; POLITICAL_CONNECTED_INSB, a dummy variable equals to one if the chairman or executive board members of firm i have political connections at year t and zero otherwise; CEO_DEGREE, the education level of CEO; CEO_AGE, the age of the firm's CEO. CEO_FEMALE, a dummy variable that equals to one if the firm's CEO is a female and zero otherwise. CEO_OVERSEA, a dummy variable that equals to one if the CEO of the firm has oversea experiences and zero otherwise. POLITICAL_CONNECTED_CEO is a dummy variable that equals one if the CEO of firm has political connections and zero otherwise; POLITICAL_CONNECTED_INSB, a dummy variable equals to one if the chairman or executive board members of firm i have political connections at year t and zero otherwise; STATE_OWN, the firm's state holding share percentage. The control variables are the same as Table 3, which are omitted in the table for conciseness concerns. Appendix Table 1 shows the definitions of all these variables. Firm and year fixed effects are included in all estimations. Standard errors, clustered at the firm level, are shown in brackets. *, **, and *** denote significance at the 10 %, 5 %, and 1 % level, respectively.

reduces compensation by 9.8 % (-0.375 + 0.277 = -0.098), independent directors lower compensation by 6.5 % (-0.684 + 0.619 = -0.065), and institutional investors decrease compensation by 6.4 % (-0.269 + 0.205 = -0.064).

Finally, we are concerned that the low excessive CEO compensation might not indicate the existence of a good compensation structure. Therefore, we examine PCIDs' impact on CEOs' pay-performance sensitivity. High pay-performance sensitivity can reduce agency issues between shareholders and managers and protect shareholder wealth (e.g., Baker & Hall, 2004). We therefore with EXCESS_COMP CEO total actual compensation (TOTAL_COMP) with EXCESS_COMP and use the firm performance indicator, ROA, as the moderator to re-estimate Eq. (3.4). Following Zhou et al. (2017), TOTAL_COMP is the natural logarithm of the annual cash compensation for CEOs in firm i in year t. As shown in Table 10, PCIDs significantly enhance CEO pay-performance sensitivity, thereby strengthening the alignment between CEO compensation and corporate financial performance. This result corroborates our baseline findings and supports the negotiation power hypothesis. Importantly, these findings alleviate concerns that PCIDs might simply follow standardized SOE compensation practices rather than actively utilizing their negotiation power to monitor executive pay, which could otherwise lead to predetermined, less performance-based compensation packages in SOEs.

Further analysis reveals distinct patterns based on PCID presence: in firms without PCIDs (POLITICAL_CONNECTION = 0), ROA

Table 10
Robustness test 4: The impact of PCIDs on pay-performance sensitivity.

VARIABLES	(1)
	CEO_COMP
POLITICAL_CONNECTION	−0.051** (0.022)
ROA	0.027 (0.025)
POLITICAL_CONNECTION* ROA	0.136** (0.047)
Control Variables	Yes
Firm FE	Yes
Year FE	Yes
Observations	16,986
F-Fisher	11.863
Adjusted R-squared	0.715

Notes: Columns (1) of Table 10 present empirical results for the impact of PCIDs on CEO pay-performance sensitivity. The empirical results come from following regression models.

$$CEO_COMP_{it} = \beta_0 + \beta_1 POLITICAL_CONNECTION_{it} + \beta_2 ROA_{it} + \beta_3 POLITICAL_CONNECTION_{it} * ROA_{it} + \beta_4 Control_{it} + \mu_i + \eta_t + \varepsilon_{it}$$

CEO_COMP is the natural logarithm of CEO annual cash compensation for firm i at year t. POLITICAL_CONNECTION is an indicator variable that equals one if any of the independent directors of the firm is politically connected and zero otherwise. ROA is the ratio of net profits divided by total assets. Control_{it} includes the following control variables of firm i: BOARD_SIZE, the number of members on the board of directors; IND, the proportion of independent directors on the board; ROA, the return on assets for profitability; DUAL, a dummy variable that equals one if the firm's CEO is also the chairman of the board of directors and zero otherwise; LEVARAGE, the leverage ratio of total debt to total assets; INSTITUTION_OWN, the institutional holding percentages; TOBINQ, the ratio between a firm's physical asset's market value and its replacement value; SALES_GROWTH, the firm's sales growth rate; SIZE, the natural logarithm of the firm's total assets; FIRM AGE, the number of years a firm has been listed; Big 4, a dummy variable that equals one if the firm's auditor is a big four auditing firm and zero otherwise; LARGEST_OWN, the firm's largest shareholders' ownership percentage; BOARD_OWN, the firm's board directors' ownership percentage; POLITICAL_CONNECTED_CEO is a dummy variable that equals one if the CEO of firm has political connections and zero otherwise; POLITICAL_CONNECTED_INSB, a dummy variable equals to one if the chairman or executive board members of firm i have political connections at year t and zero otherwise; CEO_DEGREE, the education level of CEO; CEO_FEMALE, a dummy variable that equals to one if the firm's CEO is a female and zero otherwise; CEO_OVERSEA, a dummy variable that equals to one if the CEO of the firm has oversea experiences and zero otherwise; Appendix Table I shows the definitions of all these variables. Firm and year fixed effects are included in all estimations. Standard errors, clustered at the firm level, are shown in brackets. *, **, and *** denote significance at the 10 %, 5 %, and 1 % level, respectively.

shows no significant effect on CEO compensation. However, in firms with PCIDs ($POLITICAL_CONNECTION = 1$), ROA increases CEO compensation by 8.5 % ($0.136 - 0.051 = 0.085$). This differential effect is consistent with our hypothesis that PCIDs strengthen the relationship between CEO pay and firm performance through their negotiation power.

5. Additional tests

How independent directors' characteristics can mitigate PCIDs' negative impact on CEO compensation is also of interest. Following the literature, we select several independent director characteristics including gender, education level, and age. As reported in Column

(1) of Table 11, the negative association between PCIDs and CEO compensation is more pronounced when the board comprises a higher proportion of women, which is consistent with Bugeja et al.'s (2016) and Mobbs et al.'s (2021) findings: The presence of more women independent directors and compensation committee members can strongly mitigate excessive CEO compensation. Columns (2) and (3) of Table 11 suggest that independent directors' negative effect on CEO compensation is more obvious in the case of older, more highly educated directors. This echoes the findings of Chemmanur and Paeglis (2005) and Kaplan et al. (2012) as well as our main findings that more powerful, experienced independent directors with more extensive networks exert higher monitoring effects.

6. Conclusions

Independent directors' role has been amplified by the development of corporate governance theory. We choose political connections to represent independent directors' negotiation power and explore how the possession of greater negotiation power influences the corporate governance mechanism regarding CEO compensation. Our empirical findings show that PCIDs significantly reduce excessive CEO compensation. The economic mechanism underlying this finding is that PCIDs have stronger negotiation power compared with non-PCIDs since the negative relationship between PCIDs and CEO compensation is less pronounced for firms with politically connected CEOs but more obvious for firms that receive greater benefits through political connections. Further

Table 11
Additional test 1: Independent director characteristics.

VARIABLES	(1)	(2)	(3)
	EXCESS_COMP	EXCESS_COMP	EXCESS_COMP
POLITICAL_CONNECTION	-0.015* (0.008)	-0.012** (0.005)	-0.011* (0.006)
IND_FEMALE	-0.203*** (0.033)		
IND_DEGREE		-0.017 (0.022)	
IND_AGE			-0.117** (0.081)
POLITICAL_CONNECTION*IND_FEMALE	-0.021** (0.009)		
POLITICAL_CONNECTION*IND_DEGREE		-0.212** (0.075)	
POLITICAL_CONNECTION*IND_AGE			-0.085*** (0.011)
Control Variables	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Observations	16,986	16,986	16,986
F-Fisher	12.481	12.572	12.886
Adjusted R-squared	0.707	0.711	0.709

Notes: Columns (1), (2), and (3) of Table 11 present empirical results for the following moderating tests based on alternative proxy of independent director characteristics.

$$EXCESS_COMP_{it} = \beta_0 + \beta_1 Political_Connection_{it} + \beta_2 IND_FEMALE_{it} + \beta_3 Political_Connection_{it} * IND_FEMALE_{it} + \beta_4 Control_{it} + \mu_i + \eta_t + \varepsilon_{it}$$

$$EXCESS_COMP_{it} = \beta_0 + \beta_1 Political_Connection_{it} + \beta_2 IND_DEGREE_{it} + \beta_3 Political_Connection_{it} * IND_DEGREE_{it} + \beta_4 Control_{it} + \mu_i + \eta_t + \varepsilon_{it}$$

$$EXCESS_COMP_{it} = \beta_0 + \beta_1 Political_Connection_{it} + \beta_2 IND_AGES_{it} + \beta_3 Political_Connection_{it} * IND_AGES_{it} + \beta_4 Control_{it} + \mu_i + \eta_t + \varepsilon_{it}$$

EXCESS_COMP is the difference between CEO actual and expected compensation. POLITICAL_CONNECTION is an indicator variable that equals one if any of the independent directors of the firm is politically connected and zero otherwise. Control_{it} includes the following control variables of firm i: BOARD_SIZE, the number of members on the board of directors; IND, the proportion of independent directors on the board; ROA, the return on assets for profitability; DUAL, a dummy variable that equals one if the firm's CEO is also the chairman of the board of directors and zero otherwise; LEVERAGE, the leverage ratio of total debt to total assets; INSTITUTION_OWN, the institutional holding percentages; TOBINQ, the ratio between a firm's physical asset's market value and its replacement value; SALES_GROWTH, the firm's sales growth rate; SIZE, the natural logarithm of the firm's total assets; FIRM_AGE, the number of years a firm has been listed; Big 4, a dummy variable that equals one if the firm's auditor is a big four auditing firm and zero otherwise; LARGEST_OWN, the firm's largest shareholders' ownership percentage; BOARD_OWN, the firm's board directors' ownership percentage; SOE, a dummy variable equal to one if the controlling shareholder is the state and zero otherwise. POLITICAL_CONNECTED_CEO is a dummy variable that equals one if the CEO of firm has political connections and zero otherwise; POLITICAL_CONNECTED_INSB, a dummy variable equals to one if the chairman or executive board members of firm i have political connections at year t and zero otherwise; CEO_DEGREE, the education level of CEO; CEO_AGE, the age of the firm's CEO. CEO_FEMALE, a dummy variable that equals to one if the firm's CEO is a female and zero otherwise. CEO_OVERSEA, a dummy variable that equals to one if the CEO of the firm has oversea experiences and zero otherwise. IND_FEMALE, the independent directors' female percentages. IND_DEGREE, the independent directors' average educational level. IND_AGE, the independent directors' average age. The control variables are the same as Table 3, which are omitted in the table for conciseness concerns. Appendix Table I shows the definitions of all these variables. Firm and year fixed effects are included in all estimations. Standard errors, clustered at the firm level, are shown in brackets. *, **, and *** denote significance at the 10 %, 5 %, and 1 % level, respectively.

heterogeneous tests indicate that the negative relationship between PCIDs and excessive CEO compensation is less pronounced for firms with better corporate governance and SOEs but stronger for more experienced CEOs with superior managerial abilities. Our main findings survive a set of endogeneity robust tests, and additional tests suggest that the negative association between PCIDs and CEO compensation is more pronounced for firms with a board comprising a higher proportion of women and in firms with elder and more educated directors.

This finding has two practical implications that could improve the structure of boards. First, firms could consider constructing a more politically connected board that may provide more insights into how to navigate government bureaucracies while simultaneously producing stronger monitoring effects to reduce agency costs. Second, firms should concentrate on their independent board members' negotiation power as a greater power endowment can lead to more effective firm management and help build more efficient corporate governance mechanisms.

Author statement

Yaohua Qin: Methodology, Validation, Writing- Original draft preparation; Writing- Reviewing and Editing.

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Appendix

Appendix Table 1 Variables Definitions

Variables	Definitions
<i>POLITICAL_CONNECTION</i>	A dummy variable that equals one if any of the independent directors of the firm is politically connected and zero otherwise.
<i>POLITICAL_CONNECTION_RATIO</i>	Following the methodologies from the existing literature on political connections of Chinese firm executives (e.g., Fan et al., 2007 ; Francis et al., 2009; Li & Zhang, 2010), this study defines politically connected independent directors as any independent directors who had a prior position in the central or local government, or the military, or has been a deputy to the National People's Congress or a member of the National Committee of the Chinese People's Political Consultative Conference.
<i>POLITICAL_CONNECTION_LESS</i>	The ratio of political connected independent director in the board of the firm.
<i>EXCESS_COMP</i>	An indicator variable that equals one if the proportion of politically connected independent directors declined after 2013, and zero otherwise.
<i>TOTAL_COMP</i>	Following e.g., Core et al. (2008) and Bugeja et al. (2016) , it is computed based on the difference between CEO actual and expected compensation.
<i>POLITICAL_CONNECTED_CEO</i>	The natural logarithm of CEO annual cash compensation for firm at year <i>t</i> .
<i>POLITICAL_CONNECTED_INSB</i>	A dummy variable that equals to one if the firm's CEO those has political connections (the same as the previous definition).
<i>IND_POLITICAL_CONNECTION</i>	A dummy variable that equals to one if the firm's chairman of the board or executive board members has political connections (the same as the previous definition).
<i>REG</i>	The average percentage across the industry of firms with PCIDs for firm <i>i</i> during year <i>t</i> .
<i>HBANKLOANS</i>	A dummy variable that is equal to one if the firm data is in and after 2014 and zero otherwise
<i>SUBSIDY</i>	Following ssens et al. (2008) , we first compute the ratio of preferential bank loans, which is measured as the total bank loans divided by the total assets of the firm at the year <i>t</i> . <i>HBANKLOANS</i> is a dummy variable that equals to one if the firm's the ratio of preferential bank loans is above the average of the sample firm at year <i>t</i> and zero otherwise.
<i>TENURE</i>	A dummy variable that equals to one if the firm receives government subsidies at the current year <i>t</i> and zero otherwise.
<i>LSALES</i>	The natural logarithms of CEO tenure.
<i>LSS</i>	A year lagged of firm sales.
<i>LROA</i>	A year lagged of Shanghai and Shenzhen 300 index indicator
<i>RET</i>	A year lagged return on assets
<i>LRET</i>	annual stock return of the firm
<i>LBM</i>	A year lagged of annual stock return of the firm.
<i>MA_SCORE</i>	A year lagged of book-to-market ratio.
<i>HCG</i>	The score of managerial ability calculated based the methodology developed by Demerjian et al. (2012) .
<i>SOE</i>	HCG is a dummy variable indicating that firm <i>i</i> indicating firm <i>i</i> has higher corporate governance index (CGI) than the average of all sample firms in year <i>t</i> and 0 otherwise. CGI is constructed based on the methodologies from Xu et al. (2017) and Jiang and Yuan (2018) .
<i>LEVERAGE</i>	A dummy variable that equals to one if the firm is an SOE and zero otherwise.
<i>ROA</i>	The firm's total debt versus total asset.
<i>BOARD_SIZE</i>	The firm's net income versus total asset.
<i>DUAL</i>	The size of the board of the firm.
	A dummy variable that equals to one if the firm's CEO is also the chairman of the board of directors and zero otherwise.

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(continued)

<i>BIG4</i>	A dummy variable that equals to one if the firm's auditor is a big four auditing firm and zero otherwise.
<i>SALES_GROWTH</i>	The firm's annual sales growth rate.
<i>INSTITUTION_OWN</i>	The firm's institutional investor share percentage.
<i>LARGEST_OWN</i>	The firm's largest shareholders' ownership percentage.
<i>BOARD_OWN</i>	The firm's board director's holding share percentage.
<i>STATE_OWN</i>	The firm's state holding share percentage.
<i>SIZE</i>	The natural logarithm of the firm's total assets.
<i>TOBINQ</i>	The ratio between a firm's physical asset's market value and its replacement value.
<i>FIRM_AGE</i>	The firm's listed years.
<i>CEO_DEGREE</i>	A variable indicating the education level of CEO, where $n = 1$ (if the CEO is high school certificate and below), $n = 2$ (if the CEO is college-degree holder), $n = 3$ (if the CEO is university-degree holder), $n = 4$ (if the CEO is with postgraduate degree and above)
<i>CEO_AGE</i>	The age of the firm's CEO.
<i>CEO_FEMALE</i>	A dummy variable that equals to one if the firm's CEO is a female and zero otherwise.
<i>CEO_OVERSEA</i>	A dummy variable that equals to one if the CEO of the firm has oversea experiences and zero otherwise.
<i>PCIDS_COMMITTEE</i>	It is a dummy variable equal to 1 if at least one PCID serves on the firm's compensation committee and 0 otherwise.
<i>IND</i>	The ratio of the independent directors in the board of the firm.
<i>IND_FEMALE</i>	The independent directors' female percentages.
<i>IND_DEGREE</i>	The independent directors' average educational level.
<i>IND_AGE</i>	The independent directors' average age.
<i>MANAGEMENT_OWN_{it}</i>	The firm's managerial ownership percentage.
<i>ANALYST_FOLLOWING_{it}</i>	The natural logarithm of the number of the analysts following of the firm.
<i>BH_SHARE_{it}</i>	A dummy variable that equals one if firm <i>i</i> also issues B or H shares and zero otherwise.
<i>BIG4_{it}</i>	A dummy variable that equals to one if the firm's auditor is a big four auditing industry and zero otherwise.
<i>SHARE2_10_{it}</i>	Sum of the square of ownership of the second to tenth largest shareholders for the firm.

Appendix Table II

The Estimation of CEO Expected Compensation

VARIABLES	(1)
	<i>TOTAL_COMP</i>
TENURE	0.089*** (0.027)
LSALES	0.481** (0.242)
LSS	0.123** (0.056)
ROA	0.915** (0.388)
LROA	0.867** (0.409)
LBM	-0.331*** (0.083)
RET	0.033*** (0.009)
LRET	0.039*** (0.004)
Constant	2.020*** (0.084)
Observations	16,986
R-squared	0.388

Notes: Columns (1) of [Appendix Table II](#) present empirical results for estimate the total expected compensation by regressing the natural logarithm of total actual CEO compensation against proxies for the economic determinants of CEO compensation based on the following equation.

TOTAL_COMP is the natural logarithm of CEO annual cash compensation for firm at year *t*. The regression controls for the natural logarithms of CEO tenure (*TENURE*), the lagged firm sales (*LSALES*), the lagged Shanghai and Shenzhen 300 index indicator (*LSS*), the lagged book-to-market ratio (*LBM*), stock return (*RET*), the lagged stock return (*LRET*), return on assets (*ROA*), the lagged return on assets (*LROA*), as well as industry (μ_i) and year (η_t)

fixed effects. We then calculate the percentage residual of compensation (EXCESS_COMP) by taking the difference between the natural logarithm of actual total compensation (TOTAL_COMP) and the natural logarithm of expected compensation (EXPECT_COMP). Appendix Table I shows the definitions of all these variables. Standard errors, clustered at the firm level, are shown in brackets. *, **, and *** denote significance at the 10 %, 5 %, and 1 % level, respectively.

$$\text{Log}(TOTAL_COMP_{it})_{it} = \beta_0 + \beta_1 \text{Control}_{it} + \mu_i + \eta_t + \varepsilon_{it}.$$

Appendix Table III
Multicollinearity Tests

Variable	VIF	1/VIF
SIZE	1.85	0.54
BOARD_OWN	1.47	0.68
BOARD_SIZE	1.45	0.69
SOE	1.43	0.70
LEVARAGE	1.43	0.70
INSTITUTION_OWN	1.39	0.72
IND	1.29	0.77
TOBINQ	1.24	0.81
LARGEST_OWN	1.18	0.85
DUAL	1.17	0.85
FIRM_AGE	1.16	0.86
CEO_AGE	1.12	0.89
POLITICAL_CONNECTED_CEO	1.10	0.91
POLITICAL_CONNECTED_INSB	1.08	0.93
BIG4	1.06	0.94
CEO_DEGREE	1.05	0.95
ROA	1.05	0.96
CEO_OVERSEA	1.04	0.97
SALES_GROWTH	1.04	0.97
CEO_GENDER	1.02	0.98
POLITICAL_CONNECTION	1.01	0.99
Mean VIF	1.22	0.84

Appendix Table II shows the multicollinearity tests of the results of all key variables of the baseline regression model. VIF of all main key variables is less than 10, which indicates that there is no significant multicollinearity issue for the main key variables.

Appendix IV. The Interpretation and Transformation of Excess Compensation

The equation below formally defines EXCESS_COMP as the ratio of excess compensation to expected compensation, following the methodology established by Core et al. (2008).

$$\begin{aligned} EXCESS_COMP &= \text{Ln}(TOTAL_COMP) - \text{Ln}(EXPECT_COMP) = \text{Ln}\left(\frac{TOTAL_COMP}{EXPECT_COMP}\right) = \text{Ln}\left(1 + \frac{TOTAL_COMP - EXPECT_COMP}{EXPECT_COMP}\right) \\ &\approx \frac{\text{Excess Compensation}}{\text{Expected Compensation}} \end{aligned}$$

The following equation demonstrates the transformation of the coefficient from the ratio of excess compensation to expected compensation into a more intuitive alternative measure: the ratio of excess compensation to total compensation.

$$\frac{\text{Excess Compensation}}{\text{Total compensation}} = \frac{1}{1 + \frac{\text{Expected Compensation}}{\text{Excess Compensation}}} = \frac{1}{\left(1 + \frac{1}{EXCESS_COMP}\right)}$$

Data availability

Data will be made available on request.

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