Legal Environment, Government Support, and Substantive vs. Symbolic Restructuring

ABSTRACT

This study examines whether and how institutions matter in shaping firms' decoupling or symbolic actions through analysis of the adoption of substantive vs. symbolic restructuring programs by Chinese listed firms that are subject to delisting pressure in the period of 1998-2004. We argue that firms' decision to pursue more or less substantive restructuring would depend on the institutional environment within which they operate. The higher the level of institutional incongruence, the more likely it is for firms to decouple. In this case, decoupling is driven by firms' ability to arbitrage between local and central institutions. We conduct empirical analysis to investigate how firms' choice of substantive vs. symbolic restructuring is affected by (1) provincial-level legal environment, constructed by contract law, property law and enforcement, (2) provincial-level government support in terms of subsidies, preferential credit access, and local protectionism, and (3) the interaction of the two forms of institutions at the provincial level and the independence of auditors at the firm level. Results confirm the significant effects of local institutions on firms' restructuring decisions.

INTRODUCTION

Decoupling, where formal structures and policies are adopted but decoupled from actual practices, is an important means for firms to conform to external pressures (Meyer and Rowan, 1977; Scott, 1995; Westphal & Zajac, 1994; Zajac & Westphal, 1995). Given the prevalence of organizational decoupling, a growing body of literature has been devoted to understanding variation in firms' decoupling behavior, i.e., when firms are more likely to undertake symbolic rather than substantive actions in response to external pressures. This literature has identified several political, social, and experiential factors—such as managers' voting power, networks, educational background, prior experience of conducting symbolic action—as determinants of organizational decoupling. For example, Westphal and Zajac (1994, 1998, and 2001) have shown that decoupling in corporate governance was more likely to occur when the relative power of CEOs prevailed over the board of directors. Stevens, Steensma, Harrison and Cochran (2005) find that managers with more knowledge/training on principles of ethics codes were more likely to integrate the ethical beliefs of the company from their code of ethics and hence less likely to decouple.

While these studies have shed important light on our understanding of decoupling, they tend to assume institutions as homogeneous and yielding similar pressures on firms. However, firms are increasingly subject to conflicting demands imposed by their institutional environments (Pache & Santos 2010). Despite some common institutional forces, firms are embedded in different local institutions. Therefore, to better understand how firms' decoupling behavior may vary in response to a given set of institutional pressures, it is necessary to take into account the overall institutional environments in which firms operate. Few studies, however, have sought to explore the institutional determinants of firms' decoupling. One explanation for this gap in the literature may be the difficulty of observing and identifying variation across institutional environments in the context of relatively stable developed economies.

An exclusive focus on the firm level risks missing mechanisms external to the firm that are actually driving decoupling behavior. We seek to fill this gap in the literature by studying decoupling

in firms' restructuring programs among loss-making Chinese listed firms in the period of 1998-2004. According to the stock market regulations in China, these firms faced the risk of delisting if they failed to return to profit within two years. Therefore, in order to turnaround and maintain their listed status, most firms have engaged in restructuring programs that are more or less substantive. Under this context, corporate restructuring may represent a subtle form of decoupling, as a symbolic policy that is decoupled from actual practices to varying degree. This gives rise to the critical question: why did some firms adopt more substantive restructuring programs while others adopt more symbolic programs? More specifically, how do local institutions shape the degree of substantiveness of corporate restructuring?

We argue that decoupling is more likely to occur under higher level of institutional incongruence resulting from misalignment between multiple institutions. In the case of China, institutional incongruence manifests as the misalignment between central and local institutions. Decoupling, in turn, is driven by firms' ability to arbitrage between local and central institutions. Given the same institutions and regulations at the central level, the more the local institutions deviate from the central institutions, the higher the degree of institutional incongruence, and the more latitude for firms to decouple by adopting symbolic rather than substantive actions.

To put it differently, despite the same central institutions at the central level, institutional environments vary across regions. As a consequence, firms in different provinces would exhibit different patterns in their choices of restructuring programs. Specifically, we investigate how firms' choice of substantive vs. symbolic restructuring is shaped by (1) legal environment at the provincial-level, constructed by contract law, property law and enforcement; and (2) provincial-level government support in terms of subsidies, preferential credit access, and local protectionism. In addition, the effect of each type of institutions on firms' decoupling behavior is likely to be dependent on firm characteristics. We examine how the independence of auditors interacts with government and legal institutions to shape firms' restructuring decisions. Overall, we seek to address not only the question of whether local institutions matter, but also how they matter by distinguishing between different forms of institutions and unpacking the underlying mechanisms of each.

This study makes several unique contributions to the general symbolic management and institutional literatures. First, we extend the decoupling literature by identifying and measuring a subtle yet important form of decoupling—corporate restructuring. Whether firms pursue symbolic or substantive restructuring has important implications for the well-being of both firms as well as for the larger economies. Second, we fill an important gap in prior research by moving beyond the firm level and examining whether and how institutional environments in which firms operate may impinge on their choices of symbolic vs. substantive actions. Third, we extend the research to the context of emerging economies, which are undergoing rapid economic and social change, which will contribute to the development of more nuanced understanding of decoupling. As some recent studies (e.g., Fiss and Zajac 2010) point out, organizational decoupling is not a purely "American" phenomenon and should be studied in an international corporate context. This study will hence provide some building blocks towards the development a theory of decoupling that transcends national contexts.

THEORY AND HYPOTHESES

Institutions and Decoupling

Institutional theory suggests that firms conduct symbolic action because they need to conform to various forms of institutional pressure including regulatory pressure, normative pressure, and cognitive pressure. Based on this theory, institutions will affect firms' symbolic restructurings through shaping the monitoring mechanism. For example, Levin (2006) shows that firms' symbolic use of total quality management (TQM) is a function of the effectiveness of the monitoring system. When there is a more effective monitoring system, the possibility of being detected and punished for conducting symbolic TQM is high, leading firms to engage in more substantial TQM. Stevens, Steensma, Harrison and Cochran (2005) show that firms are more dependent on market constituents than on non-market constituents for different kinds of resources. If symbolic action is detected by market constituents, the firm is exposed to more severe sanctions. Therefore, monitoring from market constituents is more effective than monitoring from non-market constituents. Accordingly, pressure from market constituents will have a stronger effect in pushing firms to substantially implement codes

of ethics. Based on these studies, I argue that institutions shape firms' symbolic action through influencing the effectiveness of the monitoring system.

Suchman (1995) suggests that firms may conduct symbolic action because they cannot bear the high implementation cost associated with substantial actions. This argument is based on transaction cost theory: because substantial actions are associated with larger investments and higher uncertainty, they will lead to higher internal and external transaction costs. Such internal or external transaction costs may arise from obtaining and processing market information (Alchian & Demsetz, 1972), negotiating contracts (Coarse, 1937; Williamson, 1985), monitoring agents (Bardhan, 1989; Eswaran & Kotwal, 1985), evaluating performance (North, 1989), and enforcing contracts (North, 1989; Milgrom, North, & Weingast, 1990; Greif, 1993; Fafchamps, 1996). When there are no proper institutions to reduce these costs, the cost of implementing substantial action will be too high, especially for firms facing a legitimacy crisis and thus having few affiliations through which to obtain resources. In this case, firms have to choose symbolic action because they cannot afford either the high implementation cost of a substantial action or the ill-effects of doing nothing. Taking symbolic actions appears to be a better alternative than bearing the high cost and uncertainty of substantive actions or doing nothing. In a similar vein, Peng and Heath (1996) suggest that when the rules of the game are highly uncertain, organizations are not able to invest in new capabilities and skills and will therefore continue in their old ways rather than bringing in substantial changes. Whitley and Czaban (1998) maintain that in a setting where the state has no coherent set of policies, short-term ad hoc adjustments to immediate pressure may be more rational than undertaking relatively large-scale and highly risky changes in pursuit of long-run strategic objectives. Therefore, building upon the transaction cost theory, we propose that another channel by which institutions affect firms' symbolic actions is by shaping the transaction costs or implementation costs of such actions.

Under China's decentralized economy, although national institutional characteristics provide the overall framework for economic actions, the specific characteristics and abilities of local institutions often play a more important role in monitoring firm behaviors (Qian and Xu, 1993). Different regions have very different history and policies that influence how the localities organize, monitor, and support

individual firms, which, may or may not be congruent with national policies. Local institutions may differ with regard to the development level of the legal infrastructure. Legal system influences firms' perception and subsequent choice of appropriate means or courses of action to achieve a given goal, through monitoring and shaping the implementation costs. Another key distinction between local institutions is the level of government support to local firms. Government support may influence firms' costs and ability to pursue substantive restructuring. They may also affect firms' underlying goals and objectives, and hence motivation to pursue substantive vs. symbolic restructuring.

Legal Environment and Substantive Restructuring

Legal system constitutes a key dimension of the institutional environment within which organizations operate. Consequently, whether and to what extent firms subject to external pressures can resort to symbolic actions would depend greatly on the state of the surrounding legal infrastructure. For instance, Short and Toffel's (2010) study of US industrial facilities subject to the federal Clean Air Act demonstrates the critical role of the legal environment in making self-regulations more than merely symbolic. They find that organizations are more likely to follow through on their commitments to self-regulate when they are subject to heavy regulatory surveillance. In this study, we argue that the legal environment, composed of legislation and enforcement at the provincial level, will significantly influence the extent to which firms' restructuring programs are substantive vs. symbolic. Specifically, where the legal system is better developed, firms are likely to undertake restructuring program that are more substantive. An effective legal system consisting of enforcement and legislation fosters firms' motivations to restructure substantively by exerting monitoring pressures and by reducing transaction costs respectively.

The state of the enforcement mechanism influences firms' perception and subsequent choice of appropriate action to achieve a given goal. As far as the Chinese loss makers are concerned, the ends of turning loss into profit can be achieved by means of either symbolic or substantive restructurings. Symbolic restructuring in this case typically involves earnings management. It should be noted that the ways and meaning of earnings management in China are substantially different from those in the West, where firms manage earnings by investing considerable effort to smooth the appearance of their

profitability over time to placate the investment community (Wall Street Journal, 1999a). In comparison, earnings management in China often goes beyond adjusting discretionary accruals and is often carried out through related transactions between colluded partied (Calomiris et al., 2010). When legal enforcement in a province is weak, a firm perceives low risk and cost to employ the means of earnings management to achieve the ends of keeping loss off the book, even if it is against laws and regulations. Symbolic restructuring thus appears to be more attractive than substantive restructuring given the lower cost. Under an effective enforcement regime, however, firms are subject to higher regulatory surveillance and consequently perceive illegal earnings management as highly risky and costly in light of the severe penalties. Therefore, in such situations, firms are more likely to resort to substantive rather than symbolic restructuring in their efforts to stay listed.

Furthermore, a better developed legal system will promote more substantive restructuring by promoting the development of an efficient market of M&A and corporate control, where the transaction cost of buying and selling of corporate assets is significantly reduced. According to Acemoglu and Johnson (2005), laws can generally be classified into two types based on the object of regulation. The first type is "contracting law" regulating contracting behavior among business actors. The second type is "property right law" regulating government behavior. When contracting law is well developed, there is a clear template for participants involved in the restructuring plans to follow with respect to asset evaluation, pricing, contracting, and the resolution of disputes over such plans (Ricardo & Mohamad, 2000). Under these conditions, therefore, firms will be more willing to engage in substantive restructuring in light of lower transaction cost.

Likewise, better developed property right law promotes more substantive restructurings by delimiting the power of the government and safeguarding private businesses from predation behavior by the state, through outright expropriation, or less dramatically, from corrupted officials demanding bribes in exchange for favors to the firm (Fernandes & Kraay, 2007). Most of the listed firms have formal or informal connections to government in China (Mooderjee & Yu, 1999; Woetzel, 2008). Substantive restructurings involving the transfer of corporate control often require relevant business actors to deal with the government as the owner or as the approver. In the absence of well-developed

property right law, it is impossible to enter into fair and credible contracts with the government to prevent future expropriation given that the government, with its monopoly over legitimate violence, is the ultimate arbiter of contracts (Acemoglu & Simon, 2003). Under this situation, transactions of property rights will be too costly for business actors to make. As the property right regime develops in a province, firms will have higher motivation to undertake substantive restructurings through external markets. For example, in June 2000, the government of Hainan province issued the *Notice on Managing Arbitrary Fines and Various Fees*, regulating local governments' behavior in charging fines and fees to companies. This has led to a significant increase in the proportion of cases of substantive restructuring afterwards.

In summary, firms tend to maximize their payoffs by breaking the law or breaking their symbolic commitments whenever the benefits of doing so exceed the anticipated costs of potential sanctions. Through increasing monitoring pressure and reducing transaction cost in the external markets, a more developed legal infrastructure will reduce loss-making firms' incentives to decouple and prompt them to undertake more substantive restructuring plans. This line of reasoning leads to the following hypothesis:

> **Hypothesis 1:** *The better developed the legal environment in a province, the higher the degree of substantiveness in a firm's restructuring (i.e., the lower the extent of decoupling).*

Government Support, Legal Environment and Substantive Restructuring

Economics and management scholars have long recognized the crucial role of government in governing economic activities and firm behaviors in emerging economies. What remains a controversial question, however, concerns the role of government intervention: Does government intervention lead to a positive or negative effect on the performance of firms and economic development? Building on the long-standing debate, we analyze whether and how government support may foster or inhibit loss-making firms' motivation to restructure substantively vs. symbolically.

To understand the effect of government support, it is important to begin with the question of why local governments are willing to provide support for the loss-making listed firms. First, under the tight quota system of the Chinese stock market, the listing itself is a very valuable economic resource for both

the listed firm and its province. The delisting of a firm means the loss of a previously allotted quota and could also result in lower quotas allocated to the province in the future. Second, local government has vested interest in the listed firms including the loss-makers. Local governments are the ultimate shareholders in the majority of listed firms. In these companies, the local government either directly holds the shares through the State Asset Investment Management Company, or indirectly controls the listed company through a parent-SOE (Meyer and Lu, 2005). In this case, local government essentially bears the obligation to rescue the listed firms in trouble as their parent or grandparent. Furthermore, listed firms are usually the largest companies in their locales and have great influence on the local economy, whose performance is also an important criterion for evaluating the regional governor's performance. In this situation, the delisting of a listed firm will be regarded as a negative factor in the appraisal of the government officials. Recent studies have shown empirically that the likelihood of promotion of provincial leaders actually increases and the likelihood of termination decreases with a provinces economic performance (Li and Zhou, 2005). The merit-based appraisal systems and performance-based incentive schemes thus reinforce incentives in the local government officials to lend a "helping hand" to the loss makers (Chen, 1999; Li and Lian, 1999). In fact, a considerable number of listed firms under special treatment (ST) have received direct financial support from the local government in the midst of the delisting crisis. For example, ST Synthesis, which was put under special treatment in 2003, has received a total of 120 million yuan from the Chongqing municipal government to facilitate the company's restructuring.

Local government can shape the cost-benefit scheme of substantive restructuring relative to symbolic restructuring by providing various forms of support. Common instruments such as market entry regulation, taxation and loan decisions are part of the tool-kit available to local governments to promote the competitiveness of local firms and local economy (Lu, 2000).

On the one hand, government support may facilitate substantive restructuring through the provision of valuable resources at lower cost. The local government can provide direct fiscal subsidies enabling ST companies to conduct substantive restructuring. Local government can also alleviate the financial burden of these firms by administrative means such as issuing executive orders to write off

their bad debt, making arrangements for redundant labor by providing subsidies or assigning redundant staff to other firms. More importantly, local government can act as the endorser and facilitate the transactions of assets and equity between the loss-makers and other parties. Loss-makers are often perceived as inefficient and incapable, and therefore face a legitimacy crisis, where they are likely to be avoided by transaction partners (Suchman, 1995). For example, banks will not offer credit to loss-makers and suppliers will be unwilling to fulfill orders under the circumstances of uncertainty. As a result, loss-makers may face even higher cost to obtain resources from the external market, further exacerbating their financial distress. Under these conditions, the endorsement of the government plays a critical role for the acquisition of resources for ST firms from external markets and making substantive restructuring possible.

On the other hand, however, government support can lead to less rather than more substantive restructuring in several ways. First, local government support can shield local firms from central regulatory pressures. Chen, Li, and Lee (2003) show that local governments often provide subsidies to help firms to meet financial requirements set by the central government. Such direct support from local government would prompt firms to a quick fix remedy through merely symbolic restructuring when facing delisting pressures. Second, through the extension of preferential loans, tax exemptions and state subsidies, government support is likely to create soft budget constraints at the firm level (Kornai 1980, Shleifer & Vishny, 1994). Direct interference of government dilutes survival and profit-making motives of firms, weakening the institutionalization of market behavior. For the ST firms, government support buffers them from competitive pressures and hence reduces their incentives to undertake substantive restructurings so as to improve efficiency in the long run. With the support from the government, the ends of survival can now be met by the means of symbolic restructuring which is less costly than substantive restructuring. Thus government support is likely to impose a negative effect on the substantiveness of restructuring plans undertaken by ST firms.

Given the presence of contrasting mechanisms, local government support can lead to either more substantive or more symbolic restructuring depending on where and how government support is utilized—to meet the more urgent need of getting rid of loss, or the more important long term goal of

efficiency improvement. This in turn, depends on the state of the legal system. By monitoring local government as well as of firm behavior, legal system moderates the effect of government support on firms' choice of substantive vs. symbolic restructuring.

When legal system is well developed, restructuring procedures can be monitored more effectively. To illustrate with an example, on October 30, 2003, the Sichuan Province promulgated *The Guidance on Regulating and Promoting the Restructuring of Listed Companies*. The guidance clarified several issues on enforcing the restructurings of listed companies: the criteria for selecting transaction parties, the procedure for evaluating restructuring plans, the reporting and approval procedure, who monitors the restructuring procedure, and what aspects of the restructuring procedures conduct should be monitored. Under this Guidance, the local governments are required to supervise and facilitate firm restructurings in ways consistent with central regulations. For instance, before the Guidance, local governments often ordered a firm with cash to help the firm accomplish financial turnaround through arbitrary transactions. This was no longer an option under the new Guidance, which requires asset or equity transaction to be subject to open bids in the markets. As a result, while the level of local government support did not change much after 2003, loss-makers in Sichuan have tended to pursue more substantive restructurings since 2004.

By subjecting both government and firms to higher level of regulatory and monitoring pressures, a better-developed legal system thus provides firms with more incentives to utilize government support to conduct more substantive restructuring. As discussed earlier, effective legal enforcement offsets the negative effects of government support on substantive restructuring by constraining a firm's motivation and behavior to manipulate earnings and engage in other forms of merely symbolic restructuring. Moreover, when the legal system is well-developed, firms are more likely to develop market behavior and take into account the ultimate goal of efficiency in their restructuring efforts. This further reinforces the positive effect of government support on a firm's motivation and ability to restructure substantively.

Therefore, the effect of government support on substantive restructuring will be positively moderated by the level of development in the legal environment, regardless of whether government

support exerts a positive or negative main effect. In summary, our theoretical arguments regarding the role of government intervention and legal environment on the symbolic vs. substantive nature of corporate restructuring suggests the following hypothesis:

> **Hypothesis 2:** *The effect of government support on the substantiveness of corporate restructuring will be positively moderated by the development level of legal environment.*

Auditor Independence, Local Institutions and Substantive Restructuring

The effects of legal and government institutions on firms' choice of substantive vs. symbolic restructuring are likely to vary across firms. Notably, corporate governance provides alternative forms of monitoring mechanisms at the firm level. Since monitoring force has been shown to be one of the main mechanisms by which external institutions influence organizational decoupling or symbolic actions (Levin, 2006; Stevens, Steensma, Harrison & Cochran, 2005; Kraatz and Block, 2010), various components of corporate governance are likely to interact with legal and government institutions to shape firms' restructuring decisions. Independent auditing constitutes an important part of effective corporate governance. Studies of the Chinese financial sector have suggested that the presence of a weak auditing profession is at least partially responsible for the relatively weak corporate governance and the slow growth of China's Listed Sector (Allen et al. 2005). Therefore, we examine the moderating role of auditor independence in the restructuring of loss making listed firms.

The weak auditing profession in China can be traced back to its origin. Prior to 1998, most audit firms were established and sponsored by local governments. In 1997, the Ministry of Finance and CSRC issued regulations to disaffiliate audit firms from their sponsoring government agencies. Despite the dissolution of the official ties between the auditors and the local governments, many Chinese audit firms remain dependent on the local governments. First, Chinese audit firms depend on local governments to access new clients or as well as to retain existing clients (MOF, 2000). For the majority of audit firms that are licensed to provide services to listed companies, their services tend to be locally oriented (Chan, Lin & Mo, 2002). Therefore, Chinese auditors are highly susceptible to the pressures of the local bureaucrats and local clients and as a result, are not able to carry out independent auditing (Chan, Lin & Mo, 2002; Hofstede, 2001). The famous case of Yin Guang Sha is a perfect

illustration of the lack of auditing independence in China. In 2001, Yin Guang Sha was investigated and serious frauds were detected. The company was found to have reported inflated profit for consecutive years. Its auditor, the Zhong Tian Qin accounting firm, had been issuing seriously misleading audit reports including false information. This event eventually led to the collapse of Zhong Tian Qin as well as the company. This case shows the great extent to which auditors depend on their clients. Despite the high stake involved that might engender the survival prospect of the firm, the auditor in this case—Zhong Tian Qin—had nonetheless chosen to conform to the pressure of its client by reporting false auditing information.

In China, there are two types of audit firms: domestic audit firms and internationally affiliated audit firms. Compared with domestic audit firms, internationally affiliated audit firms tend to be more independent for two reasons. First, international audit firms tend to possess a larger stock of resources with respect to professional knowledge, good reputation, and so on, which can be turned into competitive advantages. They are thus less dependent on local governments for access to clients. Second, internationally affiliated audit firms have more incentives to maintain a good reputation by following professional standards, since any misconduct may spillover to other markets and hurt their overall reputation and position in the global market. Therefore, internationally affiliated audit firms are better able to resist pressures from clients and are hence more independent than their local counterparts.

Auditors play an important role in monitoring firm behavior by information disclosure. Through the disclosure of authentic and thorough information, independent auditors constrain firms' ability to manipulate earnings and to engage in symbolic restructurings. Auditing independence can thus substitute for the monitoring effect of legal system to some extent. To elaborate, the effect of legal environment on the substantiveness of a firm's restructuring program will be stronger for firms with domestic auditors which are less independent, and weaker for firms with international auditors, which are more independent.

In a similar vein, the independence of auditor will moderate the effect of government support on substantive vs. symbolic restructuring by mitigating the negative effect of government support. As

argued before, when the monitoring system is weak, government support may prompt firms to opt for the less costly means of symbolic restructuring. The presence of independent auditors delimits the boundary for symbolic actions and prompt firms to pursue more substantive restructuring to utilize government support. Moreover, given the high vested interests, local governments sometimes go as far as exerting direct pressure on auditors in attempting to help the listed firms to meet CSRC requirements. For instance, Chan, Lin and Mo (2006) find evidences of how local governments in China prevent audit firms from disclosing information regarding earnings manipulation to the CSRC. In another study, Wu (2001) shows that to protect local interests, local governments push local auditing firms to overvalue focal firms' assets, thus enabling these firms to polish their financial reports by selling assets at an unfairly high price.[1] Under these conditions, the independence of auditor plays an especially important role in mitigating the negative effect of government interference on the substantiveness of corporate restructuring. Therefore, auditor independence will positively moderate the effect of government support on substantive vs. symbolic restructuring. Specifically, the effect of government support on the substantiveness of a firm's restructuring program will be more positive for firms with international auditors, and less positive for firms for with domestic auditors which are less independent.

In summary, our theoretical arguments regarding the moderating role of auditor independence in the effects of legal environment and government support on the symbolic vs. substantive nature of corporate restructuring lead to the following hypotheses:

Hypothesis 3a: *The effect of provincial legal system on the substantiveness of corporate restructuring will be negatively moderated by the independence of auditors.*

Hypothesis 3b: *The effect of government support on the substantiveness of corporate restructuring will be positively moderated by the independence of auditors.*

METHOD & RESULTS

Sample and Data

[1] Wu (2001) examines a typical example in his study. In the restructuring of Qiongminyuan Company, there was a distinct difference between four valuations of total assets and net assets, ranging from 0.98 billion yuan to 1.669 billion yuan and from 0.73 billion yuan to 1.069 billion yuan, respectively. This great discrepancy did not seem to be explained by operating methods.

Understanding whether and how institutional environments shape firms' decoupling behavior requires first identifying a context where there is a substantial degree of variance across the local institutions within which firms are embedded, while these firms are subject to similar institutional demands simultaneously. Therefore, we sample the loss-makers in the Chinese securities market, who are subject to the same severe delisting pressure from the CSRC at the central level and are also influenced by local institutions in their provinces. This is an ideal context to conduct our empirical study. First, these firms often conduct restructuring merely to manipulate earnings without improving efficiency substantially. Secondly, the loss-makers spread across the 31 provinces, municipalities, and autonomous regions of mainland China and are subject to differing institutional arrangements from local governments, including local legal system and local government intervention. This variance in institutions provides us with an opportunity to examine the effect of institutional variation on firms' symbolic restructuring.

The loss-makers in A-share market from 1998 to 2004 are identified from the *China Stock Market Accounting Research database* (CSMAR). Loss-makers are listed firms who report a negative net profit in their annual financial report. A restructuring could be a response to two consecutive years' losses. We treat the latest loss year before the focal restructuring package as the unique loss year.

All the corporate restructuring information is obtained from CSMAR, *China Center for Economic Research* (CCER) database and the retrieval system of Chinese listed firms (http://220.194.35.3:8080/zq/ggcx/ggcx.htm). Such restructurings include asset sales, asset acquisitions, asset swaps and ownership restructurings. We examine the sample loss-makers' restructuring announcements in the 2 years following the loss year. The restructuring announcements in each year are together viewed as a 1-year restructuring plan. For example, firm A reported losses in 1998. Then it announced 3 restructurings in 1999 and 4 restructurings in 2000. Thus the 3 restructurings in 1999 are treated as a restructuring plan. The 4 restructurings in 2000 are seen as another restructuring plan.

The data on provincial institutions are obtained from the CSMAR region economy database, NERI Index of Marketization of China's Provinces (Fan & Wang, 1999 & 2006) and China Law Info

Database. Financial data, corporate governance data, market performance data and state pressure data are collected from the CSMAR and CCER database.

Measure

Dependent Variable

Substantiveness of 1-year restructuring plan.

As firms often conduct a series of restructurings, we look at the restructuring announcements within each year as a package and measure the symbolism of the one-year restructuring package. We conduct factor analysis on changes of internal routines, including refocusing of business portfolio, change of the ultimate controller, avoiding related party transactions, and avoiding using end-of-year earnings manipulation. Two factors are obtained: symbolism of business restructuring and symbolism of ownership restructuring. The procedure of the factor analysis is described in the Appendix 1. We summate the factor scores of business restructuring symbolism and ownership restructuring symbolism as the index indicating the symbolism of the restructuring procedure.

Based on the symbolism indices, we develop both firm level and provincial level substantiveness indices as dependent variables. The firm level substantiveness indices are obtained by taking the reverse of symbolic indices (calculated as symbolism indices time -1). The indices are continuous variables. The higher the substantiveness indices, the more substantive the restructuring package. The lower the substantiveness indices, the more symbolic the restructuring package.

Independent Variable

Contracting Law Index.

We examine all the regulations that are established by the provincial government and thus are effective throughout the whole province. To measure the quality of contracting law, we examine the objectives of regulation and identify the laws, rules and regulations governing business actors as contracting laws, rules and regulations. We obtain the accumulated count of effective province contracting laws, rules and regulations up to the focal year. As local legal systems are established based on- and as a support system to state legal systems, a larger count measure indicates that the province contracting laws are more sufficiently and consistently in accordance with the state-level

legal system. The detailed procedure of categorization is presented in Appendix 2.

Property right law Index.

Similarly, we examine the objectives of provincial laws, rules and regulations and identify those regulating the behavior of government as the property rights legal institution. We obtain the count of property right laws, rules and regulations.

Enforcement Index.

Prior country-level studies use the surveying index. For example, firms' perceptions about the quality of the courts (Kaufmann, Kraay, & Mastruzzi, 2005). We follow this method and use an index that reflects the firms' perceptions of the judicial system to protect their operations. The index has been developed by Fan and Wang (1999 to 2005)[2].

To make the legal system indices comparable over the years, we follow Fan and Wang (2006) and scale them according to the indices in 1998 as the base.

$$\textit{Provincial legal system index}_{i,t} = \frac{N_{i,t} - \min N_{i,1998}}{\max N_{i,1998} - \min N_{i,1998}} \times 10$$

$N_{i,t}$ is the legal system index in province *i* and in year *t.*

$N_{i,1998}$ is the legal system index in province *i* and in year *1998.*

Year 1998 is taken as the base year.

Legal System Index.

It is calculated as the sum of scaled property right law index, contracting law index, and enforcement index.

Government support

The government often helps business actors in three ways. We use three indices to measure the various forms of government support.

Subsidy Index.

[2] Fan and Wang calculated the index based on a sampling survey. In the survey, the sample firms are required to evaluate the "quality of the jurisdiction system to protect the firms' operation". The evaluations are summated for each province's index. Due to data availability, Fan and Wang used the frequency of lawsuits which is defined as the number of business or economic lawsuits scaled by a location's GDP in constant RMB to measure the quality of legal enforcement from 1999 to 2000.

The first type of government support is by fiscal means, in the form of subsidies from the state budget or of tax concessions, including remission, reduction or postponement of tax obligations (Kornai, Maskin & Roland, 2003). We use fiscal subsidies to enterprises divided by the GDP of the province to proxy the fiscal subsidy index. The fiscal subsidy to enterprises is calculated by adding together the subsidies on innovation, subsidies granted for policy considerations and subsidies to loss-making enterprises. The higher the subsidy index, the more support the local government provides.

Credit Access Index.

The second method of government support involves preferential access to credit. We use the marketization index of financial systems developed by Fan and Wang (1999-2005) as a proxy. The index is calculated by taking the ratio of bank loans received by state-owned enterprises (SOEs) to the total bank loans. A higher share of bank loans received by SOEs in a province indicates that the local government plays a more active role in helping firms with their access to financial resources.

Local Protectionism Index.

A third method of government support consists of various indirect methods of support. For example, the state may rescue a firm suffering from sales difficulties by imposing administrative restrictions on imports or erecting a deterrent tariff barrier to ease pressure from foreign competitors. We use the local protectionism index developed by Fan and Wang (1999-2005) to proxy the indirect methods of local government support. The index is measured by the sum of trade protection measures initiated by the local government divided by the GDP of the province. The higher the local protectionism index, the more support the local government provides.

To make the government intervention indices comparable over the years, we follow the method of Fan & Wang (2006) to scale them into indices:

$$\textit{Provincial government support index}_{i,t,} = \frac{N_{i,t} - \min N_{i,1998}}{\max N_{i,1998} - \min N_{i,1998}} \times 10$$

$N_{i,t}$ is the government support index in province *i* and in year *t.*

$N_{i,1998}$ is the government support index in province *i* and in year *1998.*

Year 1998 is taken as the base year.

Government Support Index.

It is calculated as the sum of scaled provincial subsidy index, credit access index and local protectionism index.

International Auditor.

International MNCs can play as substitute or complementary institution providers. International auditors are such kind of institution providers to promote better corporate governance and company behaviors. In China, listed firms in only listed in A-share security market can choose to employ domestic auditor or joint venture auditors between domestic auditors and international auditors. However, when the firm is listed in B-share market or HK market, they are required to have internaitnal auditors following international accounting standard. Those international auditors are mainly the BIG 4 accounting firms, including KPMG, PricewaterhouseCoopers (PWC), and Deloitte Touche Tohmatsu, and Ernst & Young. Therefore, we create a dummy variable coded as 1 if the firm is audited by an international JV auditor or a wholly-owned international auditor (cross-listed in B or H market), 0 otherwise. According to our hypothesis, those auditors with international background could be an alternative institutional pressure to push firms to do more substantial restructurings.

Other than the main independent variables, we also control several sets of firm characteristics that could affect the substantiveness index following prior studies (Chen, Li, & Lee, 2003; Stevens, Steensma, Harrison & Cochran, 2005; Westphal & Zajac, 1994; Westphal & Zajac, 2001; Zajac & Westphal, 1995). The first set is firms' inertia indicator, proxied by age, size, excessive long-term debt ratio and regulatory industry. Age is calculated as the calendar years since the firm's IPO. Size is measured by the log of fixed assets to measure size (Hambrick & Lei, 1985; Harrigan, 1981). We use a dummy variable indicating if the firm is in the regulated industry. The regulated industry dummy is 1 if the firm primarily operates in the fields of natural resources (the mining, metal, or petroleum industries), public utilities, finance, transportation, electricity or the telecommunications industry, and 0 otherwise (Fan, Wong, & Zhang, 2005; Fan, Wong, & Zhang, 2007; Li, Zhang, & Zhou, 2005). To obtain excessive long-term debt ratio, we first calculate the long-term debt ratio by dividing long-term

debt by total assets. We further scale the focal firm's long-term debt ratio to the provincial long-term debt ratio in order to proxy the focal firm's excessive long-term debt ratio:

$$\text{excessive long - term debt ratio} = \frac{\text{long - term debt ratio}}{\text{average long - term debt ratio of the province}}$$

We predict that when the firm is older, or larger, or in a regulated industry, or has higher level of excessive long-term debt, the firm will perform less substantial restructurings.

The second set is the firm's connection with local government and central government, proxied by two dummies: the provincial or below-province government owner dummy and central government owner dummy.

The third set is the external pressures for substantial change, proxied by ST dummies, negative recommendations from financial analysts and H-market listing status[3]. ST dummy is coded as 1 if the firm has ever been designated "ST" or "PT" in the two years window and 0 otherwise. Negative recommendation from financial analyst is calculated as the number of financial analyst negative recommendations. H-market listing status is coded as 1 if the firm is cross-listed on Hong Kong securities market.

The fourth set is the internal pressures for substantial change, proxied by ROA, debt to asset ratio, ultimate controller's shareholdings, a dummy variable indicating that a dual role of CEO and board chair is occupied by the same individual, and a dummy indicating that the restructuring is conducted in the second year after the firm reports loss.

The fifth set is the endowment of the province. We proxied it by the provincial GDP and the number of listed firms in the province.

Finally, we control the industry and the time period.

The descriptive statistics and correlation matrix can be found in table 1.

**********Insert Table 1 around here**********

Models

We use the firm-level substantiveness index as the dependent variable. Although more than half of

[3] We did not control cross-listing on B-share market because cross-listing on B-market is highly correlated with having an international auditor.

the loss-makers have reported losses more than once during the sample years, they have often avoided reporting losses in consecutive years. This is because firms reporting losses for two consecutive years are labeled “ST” (explain what ST stands for) firms. This adds new restrictions to the trading of their shares. Firms reporting losses for three consecutive years are delisted. Therefore, I treat the sample as pool data, rather than panel data.

As we only have the substantiveness index for the loss-makers who have restructured, the loss-makers who have not conducted restructuring are excluded from the sample. A sample bias could exist if firms that conduct restructurings get more government support, or if firms in the provinces with better legal systems do not conduct restructurings. The OLS results may not be generalizable. Therefore, we employ Heckman Selection Models to correct the potential sample bias (Wesphal & Zajac, 2001). The model is as follows:

$$P_{it} = \beta_0 + \beta_1 X1_{it} + \beta_2 X2_{it} + \beta_3 X3_{jt} + \beta_4 X4_{jt} + \beta_5 X1_{it} X3_{jt} + \beta_6 X1_{it} X4_{jt} + \beta_7 X2_{it} X3_{jt} + \beta_8 X2_{it} X4_{jt} + \beta_9 Z1_{jt} + \beta_{10} Z2_{it} \mu_{it}$$

$$Y_{it} = \beta_0 + \beta_1 X1_{it} + \beta_2 X2_{it} + \beta_3 X3_{jt} + \beta_4 X4_{jt} + \beta_5 X1_{it} X3_{jt} + \beta_6 X1_{it} X4_{jt} + \beta_7 X2_{it} X3_{jt} + \beta_8 X2_{it} X4_{jt} + \beta_9 Z1_{jt} + \beta_{10} Z2_{it} \mu_{it}$$

Where: Y_{it}*: Annual average substantiveness index in province i in year t*

$X1_{it}$*: legal system in province i in year t*

$X2_{it}$*: government support in province i in year t*

$X3_{it}$*: complexity in firm j in year t*

$X4_{jt}$*: auditor independence in firm j in year t*

Z_{jt}*: control variables in firm j in year t*

$Z2_{it}$*: control variables in province i in year t*

μ_{it} *: the error term.*

In the Heckman Selection Model, the first (selection) equation estimates the likelihood of adoption of restructuring package with an event history model for the full sample, and the hazard rate from that model is then included in a second-stage regression model to estimate the degree of substance of restructuring (i.e., among the reduced sample of firms that have adopted a restructuring

package). Thus, parameter estimates from the event history model, which are based on information from all firm-years in the sample, are included in the second-stage models.

When using the Heckman Selection Model, an exclusion restriction is required to generate credible estimates. There must be at least one variable that appears with a non-zero coefficient in the selection equation but does not appear in the equation of interest, essentially an instrument. If no such variable is available, it may be difficult to correct for sampling selectivity. Therefore, in the selection model, I incorporate mimetic pressure (i.e. the prior restructurings by other firms) and learning effect (i.e. the prior restructurings conducted by firms themselves) as predictors. These variables are positively correlated with the adoption of restructuring packages, while having no effect on the substantiveness of the restructuring package. In the models, there are 949 loss-maker-restructuring year observations, with 563 observations by 354 firms who have carried out 1-year restructuring plans, and 386 observations by 247 firms who have not.

Results

We categorized provinces into four types based on the average of provincial institutional index over the period of 1998 to 2006. The four types are: high legal system-high local government support, high legal system-low local government support, low legal system-high local government support, and low legal system-low local government support. Then we examine the average substantive index of the loss-makers' restructurings in these provinces. The results are shown in table 2. The table 2 suggests that with better developed legal system, restructurings always tend to be more substantial, while the effect of government support seems to be not obvious. However, when there is a well-developed legal system, government support leads to more substantial restructurings. In contrast, when the legal system is under-developed, restructurings in the provinces with higher level of government support may be less substantial than those in the provinces with lower level of government support.

**********Insert Table 2 around here**********

Table 3 shows the mean of substantive index of restructurings conducted by loss-makers audited by domestic auditors or international auditors. Results show firms audited by domestic auditors tend to

do less substantial restructurings compared with firms audited by international auditors, although the difference is not at a significant level.

**********Insert Table 3 around here**********

Table 4 reports the results from the Heckman Selection Model. "Legal system" refers to provincial legal system index in models 1a and 1b, provincial contracting law index in models 2a and 2b, and provincial property right law index in models 3a and 3b, and provincial enforcement index in models 4a and 4b.

**********Insert Table 4 around here**********

In table 4, models 1a and 1b test the effect of an aggregated provincial legal system and aggregated provincial government support. Model 1a is the base model showing the main effects of the provincial legal system index and provincial government support index. Model 1b incorporates the interaction between the provincial legal system index and the provincial government support index. Results show that the main effect of the provincial legal system index is positively significant in model 1a (β = 0.07, $p < 0.05$). The provincial government support index shows a negative significance at the 0.01 level in model 1b. None of the main effects of the provincial legal system index or their interaction is significant in model 1b.

Then we more closely examine the legal system in model 2a to model 4b. Because two of the three provincial legal system indices, (i.e., contracting law index and property right law index) are highly correlated (correlation coefficient = 0.97), we put them into models separately. Models 2a and 2b test how contracting laws affect substantiveness index. Models 3a and 3b test how property right laws affect the substantiveness index. In model 2a, contracting law index shows a positive significance (β = 0.21, $p < 0.01$). In model 2b, contracting law index shows a positive significance (β = 0.15, $p < 0.05$). The provincial government support is negatively significant (β = -0.07, $p < 0.01$). The interaction between provincial contracting law index and provincial government support index is positively significant in model 2b (β = 0.01, $p < 0.1$). In model 3a, the property right law index is positive and significant (β = 0.2, $p < 0.01$). The provincial government support is negative and

significant (β = -0.09, p < 0.001). The interaction between the property right law index and provincial government support index is positive and significant (β = 0.015, p < 0.05). Models 4a and 4b test how the enforcement mechanism affects the substantiveness index. The main effect of provincial government support is negative and significant (β = -0.06, p < 0.05). None of the main effects of the enforcement index or the interaction between enforcement index and provincial government support shows significant result. In sum, these results lend considerable support to hypotheses 1, demonstrating that property right laws and contracting laws promote more substantive restructurings. Nevertheless, a third indicator of legal environment development is not significant. Hypothesis 2 is also supported, suggesting that legal system positively moderate the effect of government support by mitigating its negative effect on substantive restructuring.

In table 5, we further unpack the effects of provincial legal system and provincial government support simultaneously. Models 5a and 5b test how the contracting law index and each provincial government support index affect the substantiveness index. In model 5a, the main effect of the contracting law index is positive and significant (β = 0.19, p < 0.05). The main effect of preferential credit access is negative and significant (β = -0.06, p < 0.05). In model 5b, the main effect of contracting law index is not significant. The main effect of preferential credit access remains significant and negatively (β = -0.19, p < 0.01). The interaction between the contracting index and preferential credit access is positive and significant (β = 0.03, p < 0.01). The interaction between the contracting index and subsidy is positive and significant (β = 0.01, p < 0.1). Such results lend further support to hypothesis 2, contributing to a more nuanced understanding about the interaction of legal institutions and government support. Specifically, the effects of provincial government credit and subsidy depend on the development level of contracting laws.

**********Insert Table 5 around here**********

Similarly, Models 6a and 6b test how the property right law index and each provincial government support index affect the substantiveness of corporate restructurings in a province. In model 6a, the main effect of the property right law index is positive and significant (β = 0.15, p < 0.05). The main

effect of preferential credit access shows negative and significant (β = -0.07, $p < 0.05$). In model 6b, the main effect of the property right law index is not significant. The main effect of the preferential credit access is negatively significant (β = -0.22, $p < 0.01$). The interaction between property right law index and credit access is positively significant (β = 0.04, $p < 0.001$). The interaction between property right law index and subsidy is positive and significant (β = 0.02, $p < 0.1$). Such results support hypothesis 3, suggesting that the development of property right laws positively moderate the effect of government credit and subsidy on substantive restructurings.

Models 7a and 7b test how the enforcement index and each provincial government support index affect the substantiveness index. In models 7a and 7b, none of the main effects of the enforcement index or provincial government support indices is significant. In model 7b, the interaction between local protectionism and enforcement is significant but negative (β = -0.03, $p < 0.05$). The results thus provide no support for the interaction effect of enforcement index and government support.

In table 6, we test the interaction between legal system and international auditors. Model 8a tests the interaction between contracting law and international auditors. The main effect of international auditor is positive and significant (β = 0.66, $p < 0.05$). The main effect of contracting law is positive and significant (β = 0.15, $p < 0.1$). The interaction between contracting law and interaction auditor is negative and significant (β = -0.1, $p < 0.1$). Models 8b incorporates the interaction between property right laws and international auditors. The main effect of international auditor is positive and significant (β = 0.49, $p < 0.1$). The main effect of property right law is not significant. The interaction between property right law and international auditor is not significant either. Such results fail to support hypothesis 4a. Models 8c incorporate the interaction between enforcement and international auditors. However, none of the main effect of interactive effect of enforcement and international auditors shows any significant result. These results thus lend partial support to hypothesis 3a, suggesting that auditor independence can partially substitute for the monitoring effect of legal system captured by the contract law index.

**********Insert Table 6 around here**********

In table 7, we test the interaction between government support and international auditors. In model 9a, the interaction between subsidy and international auditor is positive and significant (β = 0.14, $p < 0.05$). Neither the main effect of international auditor nor the main effect of subsidy is significant. In model 9b, the interaction between preferential credit access and international auditor is positive and significant (β = 0.15, $p < 0.001$). The main effect of international auditor is not significant. The main effect of preferential credit access is negative and significant (β = -0.07, $p < 0.05$). In model 9c, the interaction between local protectionism and international auditor is positive and significant (β = 0.1, $p < 0.1$). Neither the main effect of international auditor nor the main effect of local protectionism is significant. These results lend considerable support to hypothesis 3b, suggesting that the independence of auditing as captured by international auditors positively moderates the effect of local government support on substantive restructuring.

**********Insert Table 7 around here**********

DISCUSSION

Despite the importance of institutions in determining firms' symbolism-substantiveness choices, theoretical and empirical studies that seek to examine how variance in institutional environments influences firms' decoupling or symbolic actions are still limited. This could be attributed to the fact that most prior studies were conducted in the United States, where firms face relatively stable and homogenous institutional pressures. This study attempts to fill this gap in the literature. Drawing on the transaction cost theory and institution theory, this study sheds light on our understanding of whether and how institutions affect decoupling in firms' choice of symbolic vs. substantive restructurings in response to certain external pressure.

The research setting is in China, where business actors are subject to institutional arrangements from both central and local government. On the one hand, the central government intends to use the delisting system and a supportive legal system to pressure firms to improve their efficiency through

restructuring. On the other hand, the central government delegates power to local government to develop local regulations and provide support for local business. Business actors' pay-off function for substantive vs. symbolic restructurings thus depends on local institutions, which vary across provinces. We focus on two dimensions of local institutions: legal systems and government support.

In this study, we first separate laws into contracting and property rights laws, then shows that strong local laws promote more substantial restructurings among firms (Acemoglu & Johnson, 2005). As the two types of laws regulate different actions, they affect firms' substantive restructuring in different ways. Strong contracting law not only reduces the implementation costs of substantive restructurings, but also increases the monitoring pressure on symbolic restructurings. Hence, it pushes firms to engage in more substantive restructurings. Property rights law protects firms from local government expropriation, thus giving them an incentive to engage in more substantive restructurings.

We then show that the relation between local government support and the substantiveness of corporate restructurings hinges on the quality of the local legal system. Both contracting and property rights laws provide a clear template for monitoring and evaluating the behavior of business actors and local government. Local government has less space to help business actors to act against central government requirements. Hence, local government support, mainly in the form of subsidies and credit access, promotes more substantive restructurings when laws are well developed, while promoting less substantive restructurings when laws are underdeveloped.

Beyond the main effects, results show that the interaction of international auditor and contracting laws is negative and significant. But the interactions of international auditor and other legal system indicators (property laws and enforcement) are found to be insignificant. These results suggest that international auditors can only partially substitute for legal system in monitoring firms' decoupling behavior. This can be explained by the fact that auditors have limited power to constrain firm behavior beyond the means of information disclosure. In addition, the results also show that international auditors can mitigate the negative effect of local government support in terms of subsidy, credit and protectionism on firms' substantive restructuring. As an implication, monitoring mechanisms at the firm level such as effective governance can play an important role in directing firms to take advantage

of government support for substantive restructuring and growth in the long run.

CONCLUSION

As Wesphal and Zajac (2001) suggest, symbolic action can range from relatively extreme forms of institutional decoupling, such as the non-implementation of formal policies, to relatively subtle forms of decoupling that involve taking actions that are inconsistent with the spirit of a formal policy, although perhaps still consistent with the letter of the plan. Most prior studies have focused on the relative extreme forms of decoupling. Accordingly, analyzing decoupling in the choice of symbolic vs. substantive restructuring programs among loss-making firms offers a unique opportunity to develop a nuanced understanding of an important yet subtle form of symbolic management. We develop a cross-level model to account for whether and how institutions affect firms' decoupling behavior. Our results show that legal environment plays an important role on promoting substantive restructuring. While the main effect of government support turns out to be negative, it is mitigated by the development of legal environment. Besides, we find considerable evidence supporting our predictions on the interaction of auditor independence and legal institutions and government support, suggesting that monitoring mechanisms at the firm level can be substitutive to external institutions. Future studies should explore other factors at the firm level that are likely to complement or substitute for external institutions. By examining how the effect of each type on decoupling varies across different firms, we can shed further light on the mechanisms by which institutions affect decoupling.

Another direction for future studies is to explore the consequences of decoupling. In the case of Chinese listed sector, while loss-making firms can achieve the goal of maintaining their listed status through either symbolic or substantive restructuring, decoupling or symbolic restructuring can have negative consequences on performance in the long run by deterring or substituting for substantive restructuring that is necessary for a successful turnaround of firms. Consequently, whether firms pursue symbolic or substantive restructuring has important implications for the viability of firms as well as for the larger economies.

Table 1 Descriptive Statistics and correlation matrix

		1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	19	20	21
1	sub	1																				
2	gov	-0.06	1																			
3	law1	0.06	-0.17***	1																		
4	informal1	0.01	0.05	-0.07+	1																	
5	lnfixasset1	0.15***	-0.07	0.01	0.16***	1																
6	plocal	-0.07+	0.16***	0.1*	-0.04	-0.09*	1															
7	dlocal	-0.08+	-0.11**	-0.11**	0.04	0.05	-0.19***	1														
8	ratio	0.12**	0.03	0.08*	0.01	0.21***	0.06	0.11**	1													
9	dual1	-0.04	-0.01	-0.07+	0.16***	0.04	-0.03	0.02	-0.07	1												
10	International audit	-0.03	0.04	0.08+	0.02	0.26***	0.06	0.06	0.11**	0	1											
11	foreignbig4	-0.01	0.1*	-0.05	0.08+	0.18***	0.04	-0.06	0.11**	0.02	0.43***	1										
12	h	0	0.05	-0.04	0.12**	0.3***	0.04	-0.02	0.12**	0.01	0.39***	0.53***	1									
13	roa1	0.11*	0.03	0.07	0.1*	0.07+	0.03	-0.01	0.14***	0.01	-0.01	0.05	0.03	1								
14	debtratio1	-0.1*	-0.03	-0.09*	-0.05	-0.05	0.02	0.04	-0.13**	0.04	0.09*	-0.03	-0.02	-0.49***	1							
15	regulate	-0.03	-0.02	0.01	0.05	0.01	-0.05	-0.03	-0.04	0.04	-0.05	-0.01	0.03	-0.01	-0.07+	1						
16	age	-0.06	-0.26***	0.03	0.01	-0.04	-0.09*	-0.02	-0.36***	0.1*	-0.03	-0.06	-0.05	-0.09*	0.19***	0.09*	1					
17	st1	-0.01	0.02	0	-0.02	-0.18***	0.04	0	-0.1*	0.07+	0.06	0.06	0.01	0.02	0.3***	-0.08*	0.13**	1				
18	negative	-0.02	-0.06	0.12**	0.06	0.12**	0.04	-0.02	-0.03	-0.03	0.06	-0.03	0.09*	0.04	-0.03	0.13**	-0.04	-0.05	1			
19	lag2	-0.1*	-0.03	-0.02	0.04	-0.03	0.07+	-0.01	0.04	0.07+	0.08*	0.09*	0.04	0.15***	0.13**	-0.03	0.09*	0.18***	-0.04	1		
20	lngdp1	-0.01	-0.56***	0.32***	-0.03	0.12**	-0.12**	0.16***	0.04	-0.01	0.09*	-0.01	0.04	-0.01	-0.03	0	0.19***	-0.01	0.01	-0.05	1	
21	adjlist1	-0.05	-0.22***	0.51***	-0.05	0.02	0.02	0.15***	0.05	-0.04	0.31***	0.02	0.01	-0.04	0	-0.06	0.09*	0.01	0.03	-0.04	0.65***	1
	Mean	0.00	12.66	17.10	1.03	19.35	0.23	0.11	38.18	0.12	0.15	0.03	0.03	-0.09	0.69	0.20	9.99	0.11	0.03	0.53	17.58	5.19
	Std. Dev.	1.39	4.96	9.66	3.01	1.15	0.42	0.31	16.59	0.33	0.35	0.17	0.16	0.15	0.43	0.40	3.38	0.33	0.19	0.50	0.86	3.70
	Min	-4.85	2.74	3.36	-28.51	15.09	0	0	1.97	0	0	0	0	-1.34	0.07	0	2	0	0	0	14.14	0.26
	Max	2.73	26.66	53.23	20.82	24.06	1	1	84.97	1	1	1	1	0.12	4.79	1	21	2	2	1	19.23	12.72

+ p<0.1 * p<0.05 ** p<0.01 *** p<0.001

Table 2 Provinces and Substantive Index

Government support		
High	Guizhou (-0.48) Henan (-0.65) Qinghai (-1.03) Ningxia (-0.23) Jilin (0.12) Xinjiang (-0.33)	Beijing (0.28) Shandong (0.16) Hubei (0.17) Tianjin (0.12)
Low	Hainan (-0.18) Xinjiang (-0.33) Liaoning (-0.3) Guangxi (-0.35)	Jiangsu (0.21) Fujian (-0.11) Shaanxi (0.19) Sichuan (-0.08)
Legal system	Low	High

Table 3 Substantive index of restructurings under higher/lower international pressure

Is the auditor a domestic one or an international one?		
Domestic auditor (A)	International auditor (B)	Pr(T < t) (A)<(B)
-0.01	.04	-0.05
749	125	

Table4 Do institutions have an effect on the substantiveness of firms' restructurings? Heckman Selection Model (Firm-level Test)

	Legal system		Contracting law		Property right law		Enforcement	
DV: Substantiveness	Model 1a	Model 1b	Model 2a	Model 2b	Model 3a	Model 3b	Model 4a	Model 4b
Government support(H1)	-0.05 (0.03)	-0.08** (0.03)	-0.04 (0.03)	-0.07** (0.02)	-0.05+ (0.03)	-0.09*** (0.02)	-0.06* (0.02)	-0.01 (0.05)
Legal system (H2)	0.07* (0.03)	0.05 (0.03)	0.21** (0.07)	0.15* (0.07)	0.2** (0.07)	0.15* (0.06)	-0.06 (0.06)	0.06 (0.12)
Government support × legal system (H3)		0 (0)		0.01+ (0)		0.01* (0)		-0.01 (0.01)
informal1	0.01 (0.02)	0.01 (0.02)	0.01 (0.02)	0.01 (0.02)	0.01 (0.02)	0.01 (0.02)	0.01 (0.02)	0.01 (0.02)
lnfixasset1	0.18** (0.06)	0.18** (0.06)	0.18** (0.06)	0.17** (0.06)	0.18** (0.06)	0.17** (0.06)	0.17** (0.06)	0.18** (0.06)
plocal	-0.37** (0.13)	-0.37** (0.14)	-0.35** (0.12)	-0.34** (0.13)	-0.36** (0.13)	-0.35* (0.14)	-0.36* (0.14)	-0.35** (0.13)
dlocal	-0.42+ (0.25)	-0.42+ (0.25)	-0.44+ (0.25)	-0.44+ (0.25)	-0.45+ (0.24)	-0.45+ (0.24)	-0.47* (0.22)	-0.46* (0.23)
ratio	0.01* (0)	0.01* (0)	0.01* (0)	0.01* (0)	0.01* (0)	0.01* (0)	0.01* (0)	0.01* (0)
dual1	-0.12 (0.19)	-0.12 (0.19)	-0.11 (0.19)	-0.1 (0.19)	-0.12 (0.2)	-0.1 (0.19)	-0.15 (0.2)	-0.15 (0.2)
International auditor	0 (0.32)	0.01 (0.32)	0.01 (0.31)	0.03 (0.31)	0.01 (0.32)	0.03 (0.32)	0.01 (0.31)	0 (0.31)
JV	-0.29 (0.68)	-0.3 (0.68)	-0.26 (0.69)	-0.27 (0.7)	-0.25 (0.7)	-0.26 (0.71)	-0.21 (0.68)	-0.2 (0.69)
H	-0.49 (0.47)	-0.47 (0.48)	-0.47 (0.47)	-0.44 (0.47)	-0.48 (0.47)	-0.42 (0.47)	-0.44 (0.48)	-0.47 (0.47)
roa1	0.94+ (0.5)	0.95+ (0.51)	0.89+ (0.49)	0.91+ (0.49)	0.93+ (0.49)	0.93+ (0.5)	1.02* (0.48)	1* (0.48)
debtratio1	0.01 (0.22)	0.01 (0.22)	0 (0.22)	0.01 (0.22)	0.03 (0.22)	0.03 (0.22)	0.02 (0.21)	0.02 (0.21)
regulate	-0.29 (0.3)	-0.29 (0.3)	-0.22 (0.32)	-0.24 (0.32)	-0.21 (0.31)	-0.22 (0.32)	-0.35 (0.28)	-0.38 (0.28)
age	-0.02 (0.02)	-0.02 (0.02)	-0.02 (0.02)	-0.03+ (0.01)	-0.02 (0.02)	-0.03* (0.01)	-0.02 (0.02)	-0.02 (0.02)
st1	0.23 (0.19)	0.23 (0.19)	0.25 (0.19)	0.25 (0.19)	0.22 (0.19)	0.23 (0.19)	0.21 (0.19)	0.22 (0.19)
negative	-0.45* (0.22)	-0.43+ (0.22)	-0.47* (0.21)	-0.45* (0.21)	-0.44* (0.22)	-0.41+ (0.22)	-0.48* (0.23)	-0.48* (0.22)
lag2	-0.26** (0.09)	-0.26** (0.09)	-0.25** (0.09)	-0.25** (0.09)	-0.24** (0.09)	-0.24** (0.08)	-0.27** (0.09)	-0.27** (0.09)
lngdp1	-0.7 (0.56)	-0.79 (0.53)	-1+ (0.53)	-1.14* (0.52)	-1.22+ (0.66)	-1.54* (0.63)	-0.41 (0.5)	-0.26 (0.51)
adjlist1	-0.05 (0.17)	-0.01 (0.18)	-0.16 (0.17)	-0.1 (0.18)	-0.08 (0.15)	-0.02 (0.15)	0.12 (0.13)	0.06 (0.14)
Constant	-25.73 (46.13)	-22.78 (46.72)	-85.06+ (51.12)	-88.25+ (49.94)	-82.81 (59.52)	-99.83+ (55.81)	-6.58 (43.56)	-7.12 (40.61)
Wald test(Rho=0)	1.48	1.91	1.80	2.53	1.69	2.93+	0.34	0.41
Log pseudolikelihood	-1529.74	-1529.41	-1527.81	-1526.86	-1529.46	-1527.62	-1533.25	-1532.81
N	949	949	949	940	949	949	949	949
DV: Restructuring								
gov	0.02+ (0.01)	0.02+ (0.01)	0.02 (0.01)	0.02 (0.01)	0.01 (0.01)	0.01 (0.01)	0.01+ (0.01)	0.01+ (0.01)
law1	0.02** (0.01)	0.02** (0.01)	0.03** (0.01)	0.03** (0.01)	0.04* (0.01)	0.04* (0.01)	0.05* (0.02)	0.05* (0.02)
informal1	0 (0.01)	0 (0.01)	0 (0.01)	0 (0.01)	-0.01 (0.01)	-0.01 (0.01)	-0.01 (0.02)	-0.01 (0.02)
dlocal	0.12 (0.11)	0.12 (0.11)	0.12 (0.11)	0.12 (0.11)	0.13 (0.11)	0.13 (0.11)	0.09 (0.11)	0.09 (0.11)
plocal	0.07 (0.13)	0.07 (0.13)	0.07 (0.14)	0.07 (0.14)	0.07 (0.14)	0.07 (0.14)	0.08 (0.13)	0.08 (0.13)
International auditor	0.03 (0.15)	0.03 (0.15)	0.05 (0.16)	0.05 (0.16)	0.06 (0.16)	0.06 (0.16)	0 (0.14)	0 (0.14)
JV auditor	-0.47* (0.21)	-0.47* (0.21)	-0.47* (0.21)	-0.47* (0.21)	-0.47* (0.21)	-0.47* (0.21)	-0.47* (0.2)	-0.47* (0.2)
H	-0.09 (0.26)	-0.09 (0.26)	-0.1 (0.27)	-0.1 (0.27)	-0.1 (0.26)	-0.11 (0.26)	-0.14 (0.26)	-0.14 (0.26)
ratio	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)
roa1	-0.05 (0.34)	-0.05 (0.34)	-0.04 (0.34)	-0.04 (0.35)	-0.04 (0.35)	-0.04 (0.35)	-0.03 (0.34)	-0.03 (0.34)
debtratio1	-0.08 (0.08)	-0.08 (0.08)	-0.08 (0.08)	-0.08 (0.08)	-0.08 (0.08)	-0.08 (0.08)	-0.08 (0.08)	-0.08 (0.08)
size1	0.07 (0.06)	0.07 (0.06)	0.07 (0.06)	0.07 (0.06)	0.07 (0.06)	0.07 (0.06)	0.08 (0.06)	0.08 (0.06)
regulate	-0.02 (0.12)	-0.02 (0.12)	-0.02 (0.12)	-0.02 (0.12)	-0.03 (0.12)	-0.03 (0.12)	-0.01 (0.12)	-0.01 (0.12)
age	-0.01 (0.02)	-0.01 (0.02)	-0.01 (0.02)	-0.01 (0.02)	-0.01 (0.02)	-0.01 (0.02)	-0.01 (0.02)	-0.01 (0.02)
st1	-0.03 (0.1)	-0.03 (0.1)	-0.03 (0.1)	-0.03 (0.1)	-0.04 (0.1)	-0.04 (0.1)	-0.03 (0.1)	-0.03 (0.1)
negative	0.2 (0.25)	0.2 (0.25)	0.2 (0.26)	0.2 (0.26)	0.19 (0.25)	0.19 (0.25)	0.28 (0.27)	0.28 (0.27)
lag2	0.36*** (0.08)	0.36*** (0.08)	0.35*** (0.08)	0.36*** (0.08)	0.35*** (0.08)	0.35*** (0.08)	0.37*** (0.08)	0.37*** (0.08)
priorrst	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0* (0)	0* (0)
priorselfrst	0.05*** (0.01)	0.05*** (0.01)	0.05*** (0.01)	0.05*** (0.01)	0.05*** (0.01)	0.05*** (0.01)	0.05*** (0.01)	0.05*** (0.01)
_cons	-1.97 (1.24)	-1.97 (1.24)	-1.86 (1.23)	-1.86 (1.23)	-1.82 (1.23)	-1.82 (1.22)	-2.19+ (1.33)	-2.19+ (1.32)

Note: + p<0.1 * p<0.05 ** p<0.01 *** p<0.001

Because two of the three legal system indices, i.e., property right law index and contracting law index are highly correlated, they are put into models separately. Legal system refers to legal system index in models 1a and 1b, contracting law in models 2a and 2b, property right law in models 3a and 3b, and enforcement in models 4a and 4b. The dependent variable is measured in year t. The independent variables are measured in year t-1. Standard errors are in the parentheses.

Table 5 Which elements of provincial legal system and provincial government support affect the substantiveness of firms' restructuring? Heckman Selection Model (Firm-level Test)

	Contracting law		Property right law		Enforcement	
DV: Substantiveness	Model 5a	Model 5b	Model 6a	Model 6b	Model 7a	Model 7b
Subsidy (H1)	-0.03 (0.07)	-0.05 (0.13)	-0.02 (0.06)	-0.03 (0.12)	0.03 (0.06)	-0.15 (0.17)
Credit(H1)	-0.06* (0.03)	-0.19** (0.06)	-0.07* (0.03)	-0.22** (0.06)	-0.04 (0.04)	-0.05 (0.12)
Protectionism(H1)	0 (0.09)	-0.02 (0.13)	-0.04 (0.09)	-0.11 (0.16)	-0.11 (0.09)	0.1 (0.14)
Legal system(H2)	0.19* (0.08)	-0.01 (0.1)	0.15* (0.07)	0.03 (0.08)	-0.06 (0.05)	-0.06 (0.15)
subsidy × legal system(H3)		0.02+ (0.01)		0.02+ (0.01)		0.02 (0.02)
credit × legal system(H3)		0.03** (0.01)		0.04*** (0.01)		0 (0.01)
protectionism × legal system(H3)		0 (0.01)		0.01 (0.01)		-0.03* (0.02)
informal1	0.01 (0.02)	0.01 (0.02)	0 (0.02)	0 (0.02)	0.01 (0.02)	0.01 (0.02)
lnfixasset1	0.16** (0.06)	0.16** (0.06)	0.17** (0.06)	0.16** (0.06)	0.17** (0.06)	0.17** (0.06)
plocal	-0.39** (0.13)	-0.4** (0.13)	-0.4** (0.14)	-0.4** (0.14)	-0.38** (0.14)	-0.36** (0.13)
dlocal	-0.41 (0.29)	-0.42 (0.27)	-0.42 (0.29)	-0.43 (0.27)	-0.45+ (0.23)	-0.45+ (0.23)
ratio	0.01* (0)	0.01* (0)	0.01* (0)	0.01* (0)	0.01* (0)	0.01* (0)
dual1	-0.12 (0.2)	-0.15 (0.21)	-0.13 (0.2)	-0.16 (0.21)	-0.14 (0.2)	-0.12 (0.21)
International auditor	0.02 (0.32)	-0.01 (0.3)	0.02 (0.32)	-0.01 (0.3)	-0.02 (0.3)	-0.03 (0.29)
JV auditor	-0.34 (0.71)	-0.3 (0.63)	-0.33 (0.71)	-0.28 (0.63)	-0.2 (0.66)	-0.16 (0.63)
H	-0.24 (0.51)	-0.23 (0.47)	-0.27 (0.51)	-0.21 (0.46)	-0.44 (0.46)	-0.47 (0.46)
roa1	0.78 (0.49)	0.77 (0.52)	0.84+ (0.5)	0.8 (0.52)	0.82 (0.51)	0.84+ (0.51)
debtratio1	-0.01 (0.21)	-0.01 (0.23)	0.02 (0.21)	0.01 (0.24)	-0.02 (0.25)	0 (0.24)
regulate	-0.05 (0.14)	-0.06 (0.15)	-0.07 (0.14)	-0.07 (0.15)	-0.3 (0.33)	-0.32 (0.33)
age	-0.03 (0.02)	-0.04* (0.02)	-0.03 (0.02)	-0.03+ (0.02)	-0.03+ (0.02)	-0.03+ (0.02)
st1	0.31+ (0.18)	0.34+ (0.19)	0.28 (0.18)	0.33+ (0.19)	0.25 (0.19)	0.26 (0.19)
negative	-0.38 (0.24)	-0.38+ (0.21)	-0.38 (0.25)	-0.36+ (0.21)	-0.37+ (0.22)	-0.37 (0.22)
lag2	-0.28** (0.08)	-0.31** (0.09)	-0.28** (0.08)	-0.3** (0.09)	-0.26** (0.09)	-0.26** (0.1)
lngdp1	-0.85 (0.59)	-3.09+ (1.69)	-1.04 (0.66)	-3.21+ (1.66)	-3.02+ (1.74)	-3.3+ (1.74)
adjlist1	-0.15 (0.17)	0.28 (0.22)	-0.05 (0.14)	0.37+ (0.2)	0.18 (0.18)	0.18 (0.19)
Constant	-64.06 (45.56)	-218.47 (144.13)	-58.64 (53.07)	-195.62 (148.27)	-224.99 (150.27)	-251.89+ (152.43)
Wald test(Rho=0)	1.20	1.71	0.88	1.77	2.34	2.57
Log pseudolikelihood	-1537.83	-1529.07	-1539.29	-1528.94	-1520.25	-1519.36
N	949	949	949	949	949	949
DV: Restructuring						
Legal system	0.03+ (0.01)	0.03+ (0.01)	0.03+ (0.01)	0.03+ (0.01)	0.04** (0.01)	0.04** (0.01)
Subsidy	0.04 (0.03)	0.04 (0.03)	0.03 (0.03)	0.03 (0.03)	0.02 (0.03)	0.02 (0.03)
Credit	-0.01 (0.02)	-0.01 (0.02)	-0.01 (0.02)	-0.01 (0.02)	-0.02 (0.01)	-0.02 (0.01)
Protectionism	0.05** (0.02)	0.05** (0.02)	0.05** (0.02)	0.05** (0.02)	0.07*** (0.02)	0.07*** (0.02)
informal1	-0.01 (0.01)	-0.01 (0.01)	-0.01 (0.01)	-0.01 (0.01)	-0.01 (0.01)	-0.01 (0.01)
dlocal	0.15 (0.1)	0.15 (0.1)	0.15 (0.1)	0.16 (0.1)	0.14 (0.11)	0.14 (0.11)
plocal	0.03 (0.14)	0.03 (0.14)	0.02 (0.14)	0.02 (0.14)	0.01 (0.14)	0.01 (0.14)
International auditor	0.03 (0.15)	0.04 (0.15)	0.04 (0.15)	0.04 (0.15)	-0.02 (0.13)	-0.02 (0.13)
JV auditor	-0.48* (0.21)	-0.48* (0.21)	-0.48* (0.21)	-0.48* (0.21)	-0.48* (0.21)	-0.48* (0.21)
H	-0.08 (0.27)	-0.08 (0.28)	-0.08 (0.27)	-0.08 (0.27)	-0.09 (0.27)	-0.09 (0.27)
ratio	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)
roa1	-0.08 (0.34)	-0.08 (0.34)	-0.08 (0.34)	-0.08 (0.34)	-0.08 (0.34)	-0.08 (0.34)
debtratio1	-0.09 (0.08)	-0.09 (0.08)	-0.09 (0.08)	-0.09 (0.08)	-0.1 (0.08)	-0.1 (0.08)
size1	0.08 (0.06)	0.07 (0.06)	0.07 (0.06)	0.07 (0.06)	0.08 (0.06)	0.08 (0.06)
regulate	-0.03 (0.13)	-0.03 (0.13)	-0.03 (0.13)	-0.03 (0.13)	-0.02 (0.13)	-0.02 (0.13)
age	-0.01 (0.02)	-0.01 (0.02)	-0.01 (0.02)	-0.01 (0.02)	-0.01 (0.02)	-0.01 (0.02)
st1	-0.04 (0.1)	-0.04 (0.1)	-0.04 (0.1)	-0.04 (0.1)	-0.04 (0.11)	-0.04 (0.11)
negative	0.19 (0.26)	0.19 (0.26)	0.18 (0.25)	0.18 (0.25)	0.25 (0.26)	0.25 (0.26)
lag2	0.35*** (0.08)	0.35*** (0.08)	0.35*** (0.08)	0.35*** (0.08)	0.37*** (0.08)	0.37*** (0.08)
priorrst	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)	0 (0)
priorselfrst	0.04*** (0.01)	0.04*** (0.01)	0.04*** (0.01)	0.04*** (0.01)	0.05*** (0.01)	0.05*** (0.01)
_cons	-1.91 (1.24)	-1.89 (1.24)	-1.89 (1.24)	-1.87 (1.24)	-2.19+ (1.25)	-2.18+ (1.25)

Note: *** Significant at .001 level; ** significant at .01 level; * significant at .05 level; + significant at .1 level. Two-tailed tests for all variables. Because two of the three legal system indices, i.e., property right law index and contracting law index are highly correlated, they are put into models separately. Legal system refers to legal system index in models 1a and 1b, contracting law in models 5a and 5b, property right law in models 6a and 6b, and enforcement in models 7a and 7b. The dependent variable is measured in year t. The independent variables are measured in year t-1. Standard errors are in the parentheses.

Table 6 Moderating Effect of International Auditors on Legal System
Heckman Selection Model (Firm-level Test)

	Contract law	Property right law	Enforcement
DV: Substantiveness	Model 8a	Model 8b	Model 8d
International auditor × legal system	-0.1+ (0.06)	-0.08 (0.05)	0.04 (0.08)
local legal system	0.15+ (0.08)	0.09 (0.07)	-0.03 (0.06)
Local government support	-0.03 (0.03)	-0.03 (0.03)	-0.03 (0.03)
International auditor	0.66* (0.26)	0.49+ (0.29)	-0.3 (0.74)
informal1	0.02 (0.02)	0.01 (0.02)	0.01 (0.02)
lnfixasset1	0.17** (0.06)	0.17** (0.06)	0.17** (0.06)
plocal	-0.37** (0.13)	-0.38** (0.14)	-0.38** (0.14)
dlocal	-0.45+ (0.25)	-0.46+ (0.24)	-0.46* (0.23)
ratio	0.01* (0)	0.01* (0)	0.01* (0)
dual1	-0.13 (0.21)	-0.12 (0.21)	-0.13 (0.21)
JV auditor	-0.38 (0.54)	-0.34 (0.58)	-0.2 (0.67)
H	-0.57 (0.44)	-0.49 (0.44)	-0.36 (0.48)
roa1	0.75 (0.53)	0.77 (0.54)	0.8 (0.52)
debtratio1	-0.01 (0.25)	-0.01 (0.25)	-0.02 (0.24)
regulate	-0.23 (0.36)	-0.26 (0.35)	-0.29 (0.34)
lnemp1	-0.03+ (0.02)	-0.03+ (0.02)	-0.03+ (0.02)
age	0.27 (0.2)	0.25 (0.2)	0.25 (0.2)
st1	-0.37+ (0.2)	-0.35+ (0.21)	-0.34 (0.22)
negative	-0.25** (0.09)	-0.25** (0.09)	-0.27** (0.09)
lag2	-2.61 (1.7)	-2.53 (1.81)	-2.67 (1.76)
lngdp1	0.02 (0.21)	0.09 (0.19)	0.17 (0.16)
adjlist1	0.02 (0.02)	0.01 (0.02)	0.01 (0.02)
Constant	-203.34 (144.06)	-184.73 (153.85)	-200.06 (153.49)
Wald test(Rho=0)	2.16	2.32	2.02
Log pseudolikelihood	-1520.20	-1522.37	-1524.77
N	949	949	940
DV: Restructuring			
Legal system	0.04** (0.01)	0.04* (0.01)	0.05* (0.02)
Local government support	0.02 (0.01)	0.02 (0.01)	0.01+ (0.01)
informal1	0 (0.01)	-0.01 (0.01)	-0.01 (0.02)
dlocal	0.12 (0.11)	0.13 (0.11)	0.09 (0.11)
plocal	0.07 (0.13)	0.07 (0.14)	0.08 (0.13)
International auditor	0.05 (0.16)	0.06 (0.16)	0 (0.14)
JV auditor	-0.47* (0.21)	-0.48* (0.21)	-0.47* (0.21)
H	-0.1 (0.27)	-0.1 (0.26)	-0.13 (0.26)
ratio	0 (0)	0 (0)	0 (0)
roa1	-0.04 (0.34)	-0.04 (0.34)	-0.02 (0.34)
debtratio1	-0.08 (0.08)	-0.08 (0.08)	-0.08 (0.08)
size1	0.07 (0.06)	0.07 (0.06)	0.08 (0.06)
regulate	-0.02 (0.12)	-0.03 (0.12)	-0.01 (0.12)
age	-0.01 (0.02)	-0.01 (0.02)	-0.01 (0.02)
st1	-0.03 (0.1)	-0.04 (0.1)	-0.03 (0.1)
negative	0.2 (0.26)	0.19 (0.25)	0.28 (0.26)
lag2	0.36*** (0.08)	0.35*** (0.08)	0.37*** (0.08)
priorrst	0 (0)	0 (0)	0* (0)
priorselfrst	0.05*** (0.01)	0.05*** (0.01)	0.05*** (0.01)
_cons	-1.86 (1.23)	-1.82 (1.23)	-2.13 (1.33)

Note: *** Significant at .001 level; ** significant at .01 level; * significant at .05 level; + significant at .1 level.

Table 7 Moderating Effect of International Auditors on Government Support
Heckman Selection Model (Firm-level Test)

	Subsidy	Credit	Protectionism
DV: Substantiveness	Model 9a	Model 9b	Model 9c
International auditor × Local government support	0.14* (0.07)	0.15*** (0.03)	0.1+ (0.06)
local legal system	0 (0.01)	0.01+ (0)	0 (0.04)
Local government support	-0.04 (0.04)	-0.07* (0.03)	-0.15 (0.09)
International auditor	-0.93 (0.58)	-0.54 (0.33)	-0.2 (0.29)
informal1	0 (0.02)	0.01 (0.02)	0.01 (0.02)
lnfixasset1	0.15** (0.06)	0.17** (0.05)	0.15* (0.06)
plocal	-0.31* (0.13)	-0.33* (0.13)	-0.42** (0.13)
dlocal	-0.37 (0.29)	-0.33 (0.25)	-0.43 (0.27)
ratio	0.01* (0)	0.01* (0)	0.01* (0)
dual1	-0.08 (0.2)	-0.09 (0.2)	-0.15 (0.2)
JV auditor	-0.29 (0.69)	-0.35 (0.59)	-0.32 (0.69)
H	-0.24 (0.51)	-0.44 (0.48)	-0.08 (0.54)
roa1	0.49 (0.44)	0.66 (0.43)	0.69 (0.52)
debtratio1	-0.14 (0.16)	-0.08 (0.18)	-0.01 (0.23)
regulate	-0.1 (0.15)	-0.3 (0.34)	-0.08 (0.15)
lnemp1	-0.02 (0.01)	-0.02 (0.01)	-0.03+ (0.02)
age	0.28 (0.18)	0.23 (0.2)	0.31 (0.2)
st1	-0.31 (0.21)	-0.35+ (0.19)	-0.32 (0.22)
negative	-0.3*** (0.08)	-0.26** (0.08)	-0.31*** (0.09)
lag2	-0.08 (0.08)	-0.07 (0.07)	-2.72 (1.79)
lngdp1	-0.01 (0.02)	-0.03+ (0.02)	0.17 (0.23)
adjlist1	0 (0.02)	0.01 (0.02)	0.01 (0.02)
Constant	-1.03 (1.66)	-1.83 (1.46)	-165.37 (134.94)
Wald test(Rho=0)	3.88*	4.83*	1.59
Log pseudolikelihood	-1551.06	-1535.17	-1532.39
N	949	949	949
DV: Restructuring			
Legal system	0.02* (0.01)	0.02* (0.01)	0.05** (0.02)
Local government support	0.04 (0.03)	0 (0.01)	0.01** (0)
informal1	0 (0.01)	0 (0.01)	0 (0.01)
dlocal	0.11 (0.1)	0.09 (0.11)	0.03 (0.13)
plocal	0.07 (0.14)	0.09 (0.13)	-0.48* (0.21)
International auditor	0.03 (0.16)	0.03 (0.16)	-0.08 (0.26)
JV auditor	-0.46* (0.2)	-0.45* (0.2)	0 (0)
H	-0.1 (0.27)	-0.09 (0.26)	-0.08 (0.34)
ratio	0 (0)	0 (0)	-0.08 (0.08)
roa1	-0.04 (0.34)	-0.03 (0.34)	0.08 (0.06)
debtratio1	-0.08 (0.08)	-0.08 (0.08)	-0.03 (0.13)
size1	0.06 (0.06)	0.07 (0.06)	-0.01 (0.02)
regulate	-0.03 (0.12)	-0.03 (0.13)	-0.03 (0.11)
age	-0.02 (0.01)	-0.02 (0.01)	0.2 (0.26)
st1	-0.04 (0.1)	-0.03 (0.1)	0.36*** (0.08)
negative	0.18 (0.26)	0.18 (0.25)	0 (0)
lag2	0.35*** (0.08)	0.35*** (0.08)	0.05*** (0.01)
priorrst	0 (0)	0 (0)	-1.96 (1.21)
priorselfrst	0.05*** (0.01)	0.05*** (0.01)	0.05** (0.02)
_cons	-1.71 (1.23)	-1.63 (1.18)	0.01** (0)

Note: *** Significant at .001 level; ** significant at .01 level; * significant at .05 level; + significant at .1 level.

APPENDIX 1 FACTOR ANALYSIS: MEASURE OF SYMBOLISM OF RESTRUCTURING

As firms often conduct a series of restructurings, I look at one-year restructuring packages to define the symbolism index. I choose several items and conduct factor analysis on the characteristics proposed in section 1.3.3. The items include:

Item 1: the ratio of business restructuring without a refocusing.

To calculate the ratio, I read the original announcement of the restructuring plan. I code the restructuring as a refocusing if the firm stated it was concentrating on its core activities in the restructuring. In the announcement, the refocusing was addressed by all means such as:

(1) Enhancing an existing product line to concentrate on core activities. For example, on May 8, 2005, Nanjing Zhongbei bought 100% of the equity of Jingong Industry held by Nanjing Gas and Oil. Thus, Nanjing Zhongbei was able to expand its core business and increase its market share of taxi operations in Nanjing;

(2) Introducing a new product line or entering a new industry as the new core activity. For example, Zhejiang Yingte swapped its assets relating to the textile industry for the equity of Zhejiang Yingte Medicine Ltd. held by Zhejiang Hualong. Thus, its main business transitioned from traditional textiles to pharmaceuticals (Dec. 30, 2001);

(3) Exiting an existing industry to concentrate on core activities. For example, on July 23, 2003, Zhongyuan Huanbao sold its 90% equity stake in Guangdong Danbaoli Yeast Co., Ltd. to Ersha Industrial Co., Ltd. Through the restructuring, the company exited the biological industry and concentrated on its existing abrasives and grinder business.

I code the restructuring as not involving a refocusing if the firm did not mention the above types of information at all, but mentioned that the firm would increase cash flow through the restructuring by selling idle or peripheral assets to help the firm out of financial distress, discharge a debt or resolve a bad debt problem to improve its capital structure, or to resolve the problem of an ultimate controller embezzling firm assets. I then sum up all the restructurings with a refocusing statement and obtain a count variable. The refocusing ratio is calculated as:

$$\text{Non-refocusing ratio} = 1 - \frac{\text{Number of business restructurings with refocusing statement}}{\text{Number of business restructurings}}$$

Item 2: the ratio of ownership restructuring without a control transfer.

I identify the identity of the ultimate controllers before and after the ownership restructuring. If they are the same entity, I code the restructuring as one without a control transfer. If they are different entities, I code the restructuring as one with a control transfer. The ratio is calculated as:

$$\text{Non-control transfer ratio} = 1 - \frac{\text{Number of ownership restructurings with control transfer}}{\text{Number of ownership restructurings}}$$

Item 3: the ratio of business restructurings conducted between related parties

I code a business restructuring as one conducted between related parties if the transaction partner is a previous shareholder, an affiliate, a subsidiary or a TMT member (including directors, supervisors or managers) of the firm. The ratio is calculated as:

$$\text{Related business restructuring ratio} = \frac{\text{Number of business restructurings conducted between related parties}}{\text{Number of business restructurings}}$$

Item 4: the ratio of ownership restructurings conducted between related parties

I code an ownership restructuring as one conducted between related parties if the buyer is a previous shareholder, an affiliate, a subsidiary or a TMT member (including directors, supervisors or managers) of the firm.

Related ownership restructuring ratio

$$= \frac{\text{Number of ownership restructurings conducted between related parties}}{\text{Number of ownership restructurings}}$$

Item 5: the ratio of business restructurings announced between October and December.

I examine the timing of the business restructurings and identify those conducted between October and December. The ratio is thus calculated as:

Ratio of business restructuring in Quarter 4

$$= \frac{\text{Number of business restructurings conducted in the 4th quater of the year}}{\text{Number of business restructurings}}$$

Item 6: the ratio of ownership restructurings announced between October and December.

I examine the timing of the ownership restructurings and identify those conducted between October and December. The ratio is thus calculated as:

Ratio of ownership restructuring in quarter 4

$$= \frac{\text{Number of ownership restructurings conducted in the 4th quater of the year}}{\text{Number of ownership restructurings}}$$

Item 7: the value of the business restructuring.

I summate the value of all the business restructurings in a year and divide it by the total assets of the firm.

$$\text{business restructuring value} = \frac{\text{business restructuring value}}{\text{total asset}}$$

Factor analysis is conducted using these items. The items "related ownership restructuring ratio" and "value of restructuring" are dropped as they are loaded into two factors. Two factors are finally obtained and presented in Table a. Factor 1 is the symbolism of ownership restructuring (Cronbach's alpha = 0.472). Factor 2 is the symbolism of business restructuring (Cronbach's alpha = 0.405). As the Cronbach's alpha values are low, I cannot simply summate the items to represent each factor. Thus the factor scores are used as the symbolism indices.

Table a Factor Analysis: Measuring Symbolism of Restructuring Plan

	Symbolism of ownership restructuring	Symbolism of business restructuring
Ratio of ownership restructurings without a control transfer	0.81	-0.09
Ratio of ownership restructurings announced between October and December	0.80	0.13
Ratio of business restructurings without refocusing	-0.04	0.65
Ratio of related business restructurings	0.03	-0.62
Number of business restructurings announced between October and December	0.11	0.57

Note: KMO measure: .505

Bartlett's test of sphericity: .000

The two factors are combined as the index of procedural symbolism. This shows whether the restructuring procedure addresses efficiency aspects. The indices are continuous variables. The higher the indices, the more symbolic the restructuring. The lower the indices, the more substantial the restructuring.

APPENDIX 2 CATEGORIZATION OF LAWS, REGULATIONS AND RULES

To measure the quality of provincial legislation, I examined the number of laws, regulations and rules that are established by the Provincial government and thus are effective throughout the whole province. Following Acemoglu and Johnson (2005), I classify laws into two types based on the objectives of regulation. Contracting laws refer to the laws, regulations and rules regulating the contracting behavior of business actors; property right laws refer to the laws, regulations and rules that regulate government behavior, restricting the government from expropriating private resources.

I consulted a Chinese legal counsel about the categorization based on the categories provided by China Law Info Database developed by Chinalawinfo Co., Ltd.. Contracting laws include laws on trading, competition, real estate, private enterprise, business administration, contracting, quality and technology supervision, protection of the environment, finance and foreign exchange, accounting and auditing, advertisement, pricing, labor, logistics, bill, stock and bonds, company, foreign investment, intelligent property, lease and future, and arbitration. Property rights laws include laws on elections, government intervention, legislation, judiciary, fiscal and administrative reconsidering, planning and statistics, public, taxation and urban construction.

To double check the categorization, I further examined the topic of the afore-mentioned laws, rules and regulations themselves, using key words to identify the objective of the regulation. Terms such as "local government", "officials", "legislation", "enforcement", "election", "judiciary", "fiscal", "administrative", "planning", "public", "taxation" or "urban construction" in titles suggests that the law or regulation has been established to regulate government behavior. Otherwise, it is established to regulate business or individual behavior.

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