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ORIGINAL PAPER

Local party committee and labor cost asymmetry

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Abstract
Chinese state-owned enterprises (SOEs) operate under seemingly incompatible logics of economic and noneconomic objectives and thus within a setting of institutional complexity. This complexity manifests in the coexistence of the modern enterprise system and a firm-level Local Party Committee (LPC). LPCs check proposals from a political standpoint before executives decide on economic feasibility. We provide evidence that SOEs with more LPC participation exhibit greater labor stickiness, and this association is more pronounced after the enactment of the Labor Contract Law in 2008, when LPCs became more focused on noneconomic objectives. Additional analyses reveal that regional differences in market-based institutional quality moderate the association between LPC participation and labor cost asymmetry. Our results are relevant for emerging market investors who attempt to incorporate cost asymmetry into their profitability forecasts and for other stakeholders who strive to understand and anticipate the impact of the complex Chinese institutional setting on cost behavior.

Keywords Institutional complexity · Cost asymmetry · LPC participation · Determinants of cost asymmetry

1 Introduction

The objective of Chinese state-owned enterprises (SOEs) is to maximize social welfare as defined by their majority shareholder, the party-state. Social welfare encompasses the economic objective of increasing shareholder wealth and noneconomic objectives, such as employment (Jin et al., 2022). Consequently, SOEs exhibit characteristics of corporate governance ("modern enterprise system") and political governance. This "twin governance structure" and the seemingly incompatible logics of economic and noneconomic objectives create institutional complexity (Greenwood

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et al., 2011). In this study, we focus on one key element of political governance, the Party Committee (hereafter, LPC), at the firm level[1] and its relationship with SOEs' asymmetric cost behavior. The question of whether SOEs with more LPC participation in corporate governance exhibit different degrees of cost asymmetry is pertinent because when activity levels decline, one expects to observe the strongest intervention of political governance in cost reduction decisions. On the basis of institutional theory and through the lens of institutional logic, we also examine the dynamic aspect of the relationship between LPC participation in corporate governance and cost asymmetry, that is, how this relationship has evolved over time and how it varies cross-sectionally with differences in market-based institutional quality. Thus, investigating the role of the LPC in determining cost asymmetry fills the research gap related to the influence of institutional infrastructure on cost asymmetry (Günther et al., 2014; Hinings et al., 2017).

The LPC within an SOE participates in decision making through two mechanisms. First, the LPC engages in discussions from a political standpoint and exerts its veto right over important corporate decisions before proposals enter the decision-making process of the board of directors ("ex ante procedure"). Second, LPC members can directly occupy director or supervisor positions (Jin et al., 2022: 2, 4). Similarly, party members on the board of directors, the board of supervisors, and the top management team can serve on the LPC. This is known as the "two-way entry and cross-appointment" mechanism. Third, for "three-important and one-large" decisions,[2] a group discussion system in which the LPC, the board of directors, and the management team jointly discuss and determine such decisions is adopted. LPC participation differs conceptually from the previously investigated phenomenon of political control and political connections. While the LPC involves internal company members, political connections involve external politicians such as government officials, military officers, and members of political bodies (Chang & Wong, 2004; Li & Chan, 2016; Li et al., 2017, 2020b; Wang et al., 2023). Since LPC members are firm insiders selected on the basis of their political ideology (Li et al., 2020b), they balance maximizing economic value and social stability in SOEs' *internal* strategic business processes, whereas political connections are informal ties to the state and represent *external* networks.

We base our analyses on Chinese listed SOEs from a sample spanning the 2004–2019 period. Article 19 of the General Principles of the "*Gongsi Fa*" (Company Law of the People's Republic of China) establishes the legitimacy of the

[1] To distinguish the firm-level party committee from committees at other levels, we refer to Jin et al. (2022) and call the firm-level Communist Party Committee an LPC. Nevertheless, an LPC is the same as in Li and Chan (2016), Li et al., (2017, 2020b), which called the Communist Party Committee an LPC.

[2] "Three-important and one-large decisions" indicates decisions concerning "important issues", the appointment and removal of "important personnel", investments in "important projects", and the allocation of "substantial financial resources". See the original policy document at the website https://www.gov.cn/jrzg/2010-07/15/content_1655395.htm.

LPC for every company.[3] However, existing policies and documents related to the implementation of the law suggest that LPC participation in corporate governance predominantly targets SOEs.[4] We apply an extended version of the Anderson et al. (2003) model, and our analyses provide three important insights. First, LPC participation in corporate governance is associated with higher sticky labor cost behavior. Second, the association between LPC participation and cost asymmetry depends on the LPC's main objective and varies over time. We show that the positive relationship between LPC participation in corporate governance and sticky cost behavior is significant in the later subperiod after the enforcement of the Labor Contract Law in 2008, when the Party-state became more focused on noneconomic objectives. Third, LPC participation in corporate governance is associated with greater sticky cost behavior when firms are in regions where market-based institutions are well developed.

By employing elements from the theories of cost stickiness, institutional theory, agency theory, and the upper-echelon perspective, we empirically investigate the dynamic associations between direct LPC participation in corporate governance and labor asymmetry in the context of institutional complexity. We extend the literature that considers elements of institutional infrastructure and competing institutional logics (economic vs. noneconomic objectives) as important determinants of cost asymmetry (Nagasawa, 2018). LPC members carry and shift institutional logics within SOEs, resulting in variations in the level of cost stickiness over time. However, LPC-induced cost stickiness may also be linked to agency costs introduced by the political objective of LPC participation. In summary, we build on institutional theory, agency theory, and upper-echelon theory and incorporate them with the theory of cost asymmetry to investigate the association between LPC participation and labor cost stickiness. Methodologically, we follow the approach delineated by Loy and Hartlieb (2018) and Nagasawa (2018) and analyze how cost behavior changes over time. In essence, our study explores the time-sensitive and context-specific associations between LPC involvement and labor cost stickiness. Our results show that this association is consistent with the setting of a political agenda.

In addition, we also contribute to the literature by extending the traditional research on political control beyond the narrow focus of the control exerted by

[3] Article 19: In accordance with the provisions of the Constitution of the Communist Party of China, an organization of the Communist Party of China is established in the company to carry out party activities. The company should provide necessary conditions for the party organization's activities. See the whole document at http://www.npc.gov.cn/wxzl/gongbao/2014-03/21/content_1867695.htm.

[4] In 2013, the Organization Department of the Chinese Communist Party and the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) issued the *"Opinions on the Central Enterprise Party Committees Giving Full Play to the Political Core Role under the Modern Enterprise System"*. Based on this document, in accordance with the new situation and new problems of SOEs' party-building work, the central government has formulated and issued a new document, "*Several Opinions"*, and has put forward a series of targeted and highly guiding measures and requirements. In October 2016, the *National State-owned Enterprise Party Building Work Conference* was held in Beijing. In January 2020, the Central Committee of the Communist Party of China issued the *"Regulations on the work of grassroots local party committees of the Communist Party of China in State-owned Enterprises (for trial implementation)"*. In July 2021, the SASAC launched an SOEs' party-building work conference.

local governments or line ministries through political connections (external politicians are appointed as the key insiders of firms—board chairs or CEOs) and state shareholders (Chang & Wong, 2004; Faccio et al., 2006; Gu et al., 2020). Unlike interventions by the state or the government, which are external entities, LPC members are internal to the company, distinguishing our study from past research (Gu et al., 2020; Lee et al., 2020; Prabowo et al., 2018). Upper-echelon theory posits that the specific political background of management leads to distinct behaviors, and our research elucidates the influence of management's political ideology, such as having a seat on the LPC, on cost stickiness, which fills one of the gaps identified by Ibrahim et al. (2022). In addition, we contribute to the understanding of the effects of political uncertainty on corporate cost behaviors in a one-party system. Lee et al. (2020) capture political uncertainty through events arising from potential shifts in national leadership, excluding one-party systems, such as China. We delve deeper into the time-varying priority set by the one-party system, the Communist Party in China, and its influence on the labor cost adjustments of SOEs. Consequently, our findings provide valuable insights applicable to other one-party systems worldwide, e.g., North Korea, Vietnam, and Cuba.

Our study offers valuable insights into the corporate–political ecosystem in China. China has become the world's second largest economy and has numerous corporations with global influence. For a comprehensive understanding of international business dynamics, China's corporate governance cannot be overlooked (Jiang & Kim, 2020). As Rebérioux (2002: 131) stated, "the diversity of corporate governance models is valuable, and is rooted in societal characteristics that, together, shape the competitiveness of different models." Although the phenomenon of the ruling party's (the Chinese Communist Party, hereafter the CCP) direct control through LPC participation in corporate governance is a unique feature of China, this setting provides the opportunity to investigate the dynamic tension between shareholder and stakeholder wealth maximization. Moreover, the influence of CCP ideological work on the private sector and foreign companies in China has recently gained prominence (Livingston, 2021). Owing to the fragmented understanding of the Chinese corporate and political ecosystems, concerns are raised by liberal market economies and foreign investors regarding potential CCP intervention. Our findings hold significance for emerging market investors seeking to incorporate cost asymmetry into their profitability forecasts and for other stakeholders who aim to comprehend and anticipate the impact of LPC participation on their firms.

The remainder of this paper is structured as follows. In Sect. 2, we discuss the prior literature. In Sect. 3, we discuss the institutional background and develop hypotheses. Section 4 describes the methodology and sample selection. We present the results and discuss additional analyses in Sects. 5 and 6. Section 7 concludes our study.

2 Prior literature

2.1 Adjustment cost, managerial expectations, the agency problem, and stakeholder orientation

Cost stickiness is a phenomenon where costs increase more than they decrease for an equivalent change in activity (Anderson et al., 2003). Previous research has extensively explored the determinants of cost stickiness (Berg et al., 2024; Brüggen & Zehnder, 2014; Calleja et al., 2006; Costa et al., 2021; Günther et al., 2014; Nagasawa, 2018).

Adjustment cost theory suggests that once managers have committed resources according to their expectations on future activity levels, scaling back is difficult without incurring substantial adjustment costs (Anderson et al., 2003). Managers consider these costs when making resource commitment decisions, resulting in a lesser reduction in costs when activity decreases than when activity increases, thereby leading to cost stickiness. Efficient cost management and working capital management can aid managers in adjusting their operating cost and thus reduce cost stickiness (Berg et al., 2024). Firms that face financial constraints have been shown to reduce slack resources and cost stickiness (Costa et al., 2021).

Agency theory and psychological perspectives emphasize that managers play a crucial role in adjusting costs. From the agency theory perspective, cost stickiness occurs because of managers' self-serving and empire-building behaviors (Brüggen & Zehnder, 2014). For example, they retain unutilized resources for their self-interest, preventing firms from efficiently allocating their resources (Chen et al., 2012). Government and political officials can also use firms to meet their political objectives and increase stickiness (Gu et al., 2020; Prabowo et al., 2018). Effective political institutions impose greater constraints on government power and reduce government officials' opportunities for rent-seeking, resulting in less cost stickiness (Kuo & Lee, 2023). Additionally, from a psychological perspective, managers' differing perceptions of the market situation are among the determinants of cost stickiness. When managers are optimistic about future market conditions, they may be hesitant to reduce costs or implement only minimal cuts in response to declining sales, thereby retaining excess capacity and contributing to cost stickiness (Banker & Chen, 2006; Chen et al., 2019, 2022).

Stakeholder-oriented firms incur higher adjustment costs than shareholder-oriented firms do when sales decline, leading to greater cost stickiness (Li & Lu, 2022; Xin et al., 2021). This occurs because stakeholder theory posits that firms act in a socially responsible manner by considering the interests of all stakeholders, investing in corporate social responsibility (CSR), and committing to long-term relationships with stakeholders such as employees (Habib & Hasan, 2019). These commitments are not easily adjusted or reduced during periods of declining sales.

2.2 The importance of the national institutional context and cost stickiness research in the Chinese market

Legislation and the national institutional context also affect adjustment costs and thus influence cost stickiness. Using a global sample, Banker et al. (2013) find that

employment protection legislation raises labor adjustment costs, which is in turn associated with greater cost stickiness. Calleja et al. (2006) find that the common-law systems of corporate governance of the United States and the United Kingdom, which emphasize shareholder maximization, are associated with lower cost stickiness than are the systems of corporate governance of France and Germany, which emphasize social democracy and codetermination.

China, with its blend of state-led capitalism and rapid economic growth, features a distinct corporate governance system shaped by both government policies and market dynamics. Scholars have identified several determinants of cost stickiness in Chinese listed firms, including product market competition (Li & Luo, 2021), access to capital markets (Cheng et al., 2018), minimal wage policy enforcement (Jiang et al., 2016), Confucian culture (Pan et al., 2024), internal labor market practices (Xu et al., 2023), political connections (Gu et al., 2020), intellectual capital efficiency (Yang & Chen, 2024), and political turnover (Pan et al., 2022).

2.3 Cost stickiness research on state-level law in the United States

Prior research in the United States has demonstrated that features of labor contract law are correlated with cost asymmetry. For example, Golden et al. (2020) show that skilled labor is associated with greater cost stickiness, and this correlation is moderated by the enactment of wrongful discharge laws at the state level. Similarly, Kim et al. (2020) show that the implementation of wrongful discharge laws, which they consider a natural experiment, leads to greater cost stickiness. Baloria (2024) uses intertemporal and state-level variation in employment protection legislation to gauge the impact of labor adjustment costs on cost asymmetry. While our study focuses on the Chinese market, it contributes to this stream of research by adopting the view that cost stickiness is a dynamic phenomenon that varies over time and within a country, depending on differences in the institutional setting.

2.4 Positioning of this study in the literature

We extend the literature by examining management's political ideology (having a seat in the LPC) as a determinant of cost stickiness. Unlike state or government intervention, LPC members are internal to the corporation, which distinguishes our study from past research (Gu et al., 2020; Lee et al., 2020; Prabowo et al., 2018). Upper-echelon theory posits that the specific political background of management leads to distinct behaviors, and we elucidate the influence of management characteristics, such as political ideology, on cost stickiness. Our study shares similarities with prior studies (Gu et al., 2020; Lee et al., 2020; Prabowo et al., 2018) in exploring how political uncertainty and state intervention impact management resource adjustment decisions. However, the LPC is conceptually different from the state intervention and political connections examined in Gu et al. (2020) and Prabowo et al. (2018). Furthermore, we extend Lee et al. (2020) by shedding light on the influence of political uncertainty on cost stickiness within a one-party jurisdiction.

In addition, we extend the literature that considers elements of institutional infrastructure and competing institutional logics (economic vs. noneconomic objectives) as important determinants of cost asymmetry (Nagasawa, 2018). LPC members carry and shift institutional logics within SOEs, resulting in variations in the level of cost stickiness over time. LPC-induced cost stickiness may also be linked to agency costs introduced by the political role of LPC participation. Methodologically, we follow the approach delineated by Loy and Hartlieb (2018) and Nagasawa (2018) and analyze how cost behavior changes over time. In essence, our study explores the time-sensitive and context-specific associations between LPC involvement and labor cost stickiness. Our results support the hypothesis that the effects of the institutional logic introduced by the LPC on SOEs' cost behavior are time dependent and consistent with political agenda setting.

3 Institutional background and hypotheses development

3.1 LPC participation in the field of SOEs and institutional complexity

Actors in the economy and politics can try to enhance social welfare through both economic and noneconomic logic, e.g., social and political stability. When the economic and noneconomic objectives of SOEs are in harmony, no compromises need to be made (Lankoski & Smith, 2018). However, conflicts between the two objectives arise in various corporate activities, particularly when short-term outcomes are considered. For example, maintaining excessive employment levels (keeping employees when corporate activities decline) contributes to social stability but hampers economic efficiency. In summary, SOEs in China operate in a complex institutional environment, that is, one with antagonism in organizational arrangements caused by conflicting institutional logics (Durand & Jourdan, 2012; McPherson & Sauder, 2013).

The modern enterprise system in China was established in 1993 as a two-tier board system (the board of directors and the board of supervisors), similar to the German corporate governance system.[5] To protect the rights of minority shareholders and inspired by the shareholder models of the United States and the United Kingdom, China revised its *Company Law* and adopted the independent director system in 2005. Since 2006, the modern enterprise system in China has represented a fusion and transformation of the German and Anglo-American structures. In our analysis, we adopt the approach of Greenwood and Suddaby (2006: 28) and conceptualize SOEs as organizational fields in which LPCs claim to reconcile the coexistence of various institutional logics in the political, social, and economic domains with the ultimate logic of maximizing social welfare (Jin et al., 2022: 2).

The presence of the LPC within SOEs is a distinguishing feature of the Chinese corporate system. The *Dangzhang* (Chinese Communist Party Constitution), the *Gongsi Fa* (Company Law), and other legal documents legitimize the involvement

[5] The *"Company Law"* promulgated in 1993 stipulates that the company shall set up a board of directors and a board of supervisors at the general meeting of shareholders, forming a two-tier governance model.

of the LPC in corporate governance. LPC members can directly participate in decision-making processes in three ways. First, the LPC engages in discussions from a political standpoint and exerts veto rights over important corporate decisions before proposals reach the board of directors ("Ex-Ante Procedure").[6] However, competing logics are still prevalent in decision-making, as the board of directors determines economic feasibility and shareholder value. Second, LPC members can also serve as directors or supervisors or on the top management team and thus participate directly in corporate decision making (Jin et al., 2022: 2, 4). Similarly, eligible members on the board of directors, board of supervisors, and top management team can serve on the LPC. This is known as the "two-way entry and cross-appointment" mechanism. Third, for "three important and one large" decisions, a group discussion system is adopted in which the LPC, the board of directors, and the management team jointly discuss and determine such decisions. More specifically, the LPC in SOEs is involved in developing firms' long-term strategies, implementing the Party-state's policies and ideology, and supervising insider behavior. When making important decisions concerning employees' vital interests, LPCs should actively consider their opinions and assume a representative role during group discussions with the board of directors and other top management members.

To visualize the positioning of LPCs in the corporate governance of SOEs, we reprint in Fig. 1 those parts of Figure 2 in Jin et al., (2022: 8) that are relevant to our research. The highest level of the CCP is the Central Committee (CCCPC). Under the leadership of the CCP, the CCCPC established the State Council and the State-owned Assets Supervision and Administration Commission (SASAC) to oversee SOEs. Corporate governance involves various actors, including the general modern enterprise system consisting of the board of directors, board of supervisors, and management team, as well as LPC participation.

3.2 LPC participation versus political connection

Direct political control through LPC representation at the board or senior executive level is conceptually different from the political connections at the center of the study of Gu et al. (2020). LPC members are not necessarily current or former government officials, military officers, delegates of the People's Congress, or members of the Chinese People's Political Consultative Conference. Instead, they are firm insiders selected on the basis of their political ideology (Li et al., 2020b). Thus, they are supposed to trade off maximizing economic value and social stability, whereas political connections are more or less informal ties to the state and represent *external* networks. These networks might be a gateway for government intervention (the Party-state influences managerial behavior) but might also enable politically connected managers to secure advantages for their firms (managers influence the Party-state's impact on their firm) (Faccio, 2006; Goldman et al., 2013; Gu et al.,

[6] This unique decision-making process is called *"Dangweihui Qianzhi Taolun"* (Prediscussion of LPC). Refer to Article 15 of Chapter 4 of *"Regulations on the Work of grassroots local party committees of the Communist Party of China in State-owned Enterprises (for Trial Implementation)"*, http://www.gov.cn/zhengce/2020-01/05/content_5466687.htm.

2020). Political connections and LPC participation in corporate governance also differ in their empirical prevalence. Gu et al. (2020) use a sample of SOEs that spans 1999–2011 and report a prevalence of political connections of 41.92%, whereas Li et al. (2017) use a sample of SOEs that spans the period 2004–2015 and report a prevalence of LPC participation in corporate governance of only 8.7%.

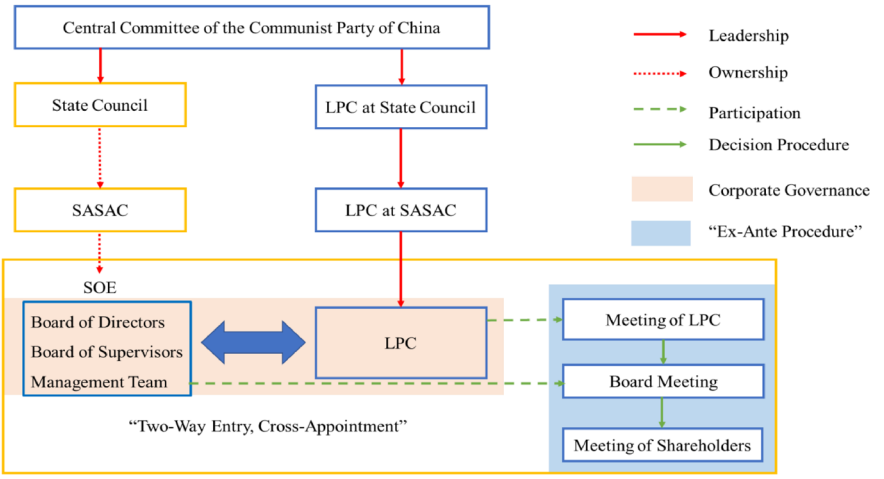
3.3 Institutional complexity and labor cost asymmetry

SOEs represent the economic and political basis of the Party-state, which implies that they contribute to social welfare through shareholder returns, employment, and other services provided to the public. The complexity of China's corporate governance goes beyond the combination of the American–Anglo independent director system and the German supervisory board system. It is deeply rooted in the country's societal and institutional characteristics, balancing economic development (shareholder wealth maximization) and employment stability (social democracies). In this setting of institutional complexity, i.e., economic vs. noneconomic logics, reducing labor expenditures during periods of revenue decline compromises noneconomic objectives. Therefore, we assume that LPC participation in corporate governance is related to cost asymmetry conditional on the time-varying focus of the party-state on either economic or noneconomic objectives. Nagasawa (2018) describes a similar phenomenon in Japan, where cost asymmetry varies between local public and commercial enterprises. LPC participation in corporate governance and cost asymmetry fit Nagasawa's (2018: 241) framework, which was reprinted and extended in Fig. 2.

Asymmetric cost behavior theory posits that costs exhibit asymmetry when their response to an equivalent change in activity is uneven due to deliberate managerial decisions to adjust resources (Anderson et al., 2003). We explain the motivations behind managers' labor cost adjustment decisions from a stakeholder theory perspective. Employees represent one of the most vital stakeholders within a firm. Employee well-being and overall corporate social considerations can be significant determinants of cost stickiness (Günther et al., 2014; Habib & Hasan, 2019). We argue that LPC participation in corporate governance will advance the party-state's efforts toward social stability (noneconomic logic) within firms' operations, particularly by fostering employment[7] and bolstering employee welfare.

Employment plays a fundamental role in maintaining social and overall economic stability (Bai et al., 2000). Li and Yamada (2015) state that the Chinese government keeps control of SOEs, mainly due to employment considerations. In the absence of a well-functioning social security system in China, the Party-state considers SOEs as a means to offer various benefits and services, including retirement pensions, housing, healthcare, and educational expenses for employees' children (Cheng & Ng, 2023). Chinese SOEs are operated under a multitask approach, where the party-state prioritizes job security and employee welfare over economic efficiency (shareholder maximization) to ensure secure and stable employment for its citizens (Bai et al., 2006), particularly during periods of economic hardship, and to keep

[7] The *"Several Opinions of the State Council on Doing a Good Job in Promoting Employment at Present and in the Future"* (Guo Fa [2018] No. 39) emphasizes the importance of stabilizing employment.



This figure is a modified version of Figure 2 in Jin et al. (2022: 8) and shows the political governance of Chinese SOEs. The highest level of the Communist Party of China is the Central Committee (CCCPC). The CCCPC, under the Party's leadership, established the State Council and the State-owned Assets Supervision and Administration Commission (SASAC) to oversee SOEs. Corporate governance involves various actors, including the general modern enterprise system consisting of the board of directors, board of supervisors, and management team, as well as LPC participation. The LPC engages in decision making through the "two-way entry, cross-appointment" system and the "ex ante procedure". Additionally, decisions regarding "three important and one large" matters require the involvement of both structures—the LPC and the board.

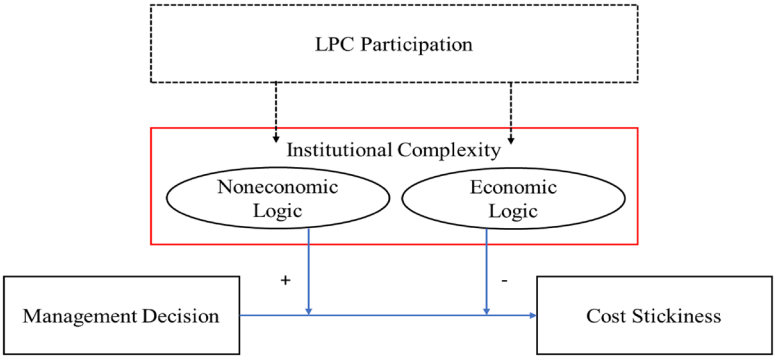
Fig. 1 Framework of political governance in Chinese SOEs. This figure is a modified version of Fig. 2 in Jin et al., (2022: 8) and shows the political governance of Chinese SOEs. The highest level of the Communist Party of China is the Central Committee (CCCPC). The CCCPC, under the Party's leadership, established the State Council and the State-owned Assets Supervision and Administration Commission (SASAC) to oversee SOEs. Corporate governance involves various actors, including the general modern enterprise system consisting of the board of directors, board of supervisors, and management team, as well as LPC participation. The LPC engages in decision making through the "two-way entry, cross-appointment" system and the "ex ante procedure". Additionally, decisions regarding "three important and one large" matters require the involvement of both structures—the LPC and the board

more workers (Cheng & Ng, 2023). Thus, managers on the boards of LPC are likely to intervene in labor resource adjustments by retaining employees even when sales decrease, and we expect that there is a positive relationship between LPC participation in corporate governance and cost asymmetry.

In addition to Party-state initiatives on social stability and safety, the LPC also serves as an employee representative within a firm. Employees can communicate their opinions and expectations to LPC members, who are then obligated to advocate for the rights and benefits of employees.[8] The desire for stable employment and worry-free income is deeply rooted in Chinese culture and traditions,[9] and employees can communicate these desires to management through LPC members. Further arguments that support this hypothesis are the Party-state's intention to increase

[8] Supra note 7, Article 15, point 5.

[9] The expressions "*Tie Fanwan*" (a secure job), *"Daguo Fan"* (egalitarian distribution; the personal salary should be disconnected from the operating performance of the firm), and *"Zhengshi Zhigong"* (permanent staff) are popular among the Chinese, clearly reflecting the yearning and expectation of the majority of the Chinese to obtain a stable and secure salary income.



The party-state agenda is characterized by its multilevel and dynamic nature, encompassing objectives such as low unemployment and economic development. This figure is a modified version of Figure 5 in Nagasawa (2018: 241).

Fig. 2 The mechanism of LPC participation in corporate governance on cost stickiness. The party-state agenda is characterized by its multilevel and dynamic nature, encompassing objectives such as low unemployment and economic development. This figure is a modified version of Fig. 5 in Nagasawa (2018: 241)

SOE size.[10] Thus, maintaining a stable scale of SOEs when activity levels decrease is presumably an important goal of LPC members. Furthermore, LPC members might provide confidence to managers regarding the state's plans and policies for future economic development (Dong et al., 2016).[11] Finally, LPC participation can increase cost stickiness through the corporate social responsibility channel. Existing legislation requires LPC members to consider corporate social responsibility when exercising their influence on SOEs.[12] Xu et al. (2019) show that LPC participation pushes Chinese firms to engage more in CSR, whereas Habib and Hasan (2019) show that for U.S. firms, CSR is associated with greater cost stickiness. We acknowledge that CSR (e.g., labor rights protection) is one of many paths through which LPC participation increases cost stickiness.

A different view of LPC participation would stipulate that political intervention through this channel could increase agency costs (Wang et al., 2022) or prioritize political interests and harm minority shareholders (Jiang & Kim, 2020), ultimately contributing to increased cost stickiness. Regardless of whether LPC participation results in increased agency costs or protects employee benefits during periods of

[10] Xi Jinping clearly pointed out in the 2016 *National SOEs Reform Symposium* that SOEs must become larger and stronger and increase the value of state-owned assets. Furthermore, the *"Proposal of the CCLPC on Formulating the Fourteenth Five-Year Plan for National Economic and Social Development and the Long-term Goals for 2035"* promotes this idea.

[11] To test whether LPC provide confidence to managers and intervenes in labor adjustment decision, we conducted a cross-section test based on economic and policy uncertainty. We employ the economic policy uncertainty index (publicly available at www.PolicyUncertainty.com) and find that firms with LPC participation are associated with higher labor cost stickiness when economic policy is more uncertain. Our findings indicate that firms with LPC participation bolster managers' confidence and are associated with a greater labor cost stickiness during periods of heightened economic policy uncertainty. The results are tabulated in Table OA 12.

[12] Article 15 in *"Regulations on the Work of grassroots local party committees of the Communist Party of China in State-owned Enterprises (for Trial Implementation)"*.

sales decline, it is linked to greater labor cost stickiness. Based on this discussion, we formulate the following hypothesis.

H1 LPC participation is associated with greater labor cost stickiness.

Our second research hypothesis addresses the question of whether the LPC's agenda and thus the association between LPC participation in corporate governance and cost asymmetry changes over time. Political–social stability (noneconomic logic) and profitability (economic logic) have always been dual goals of Chinese SOEs (Jin et al., 2022). Although these dual goals are sometimes aligned (promotion of industrial and economic development), they can at times contradict each other. LPCs aim to reconcile seemingly competing institutional logics by emphasizing different objectives at different times.

China's economy has maintained continuous and rapid growth since its *Open Door Policy* was adopted in 1978. Despite the great success of China's overall economic reforms, the performance of SOEs was not optimal during the 1990s, when these enterprises failed to be profitable and drain government resources. In the 2000s, the Party-state reformed SOEs for the primary objective of increasing their efficiency and building a modern enterprise system (Jin et al., 2022: 4). That is, SOE reform was intended to solve the unprofitability problem, but its root cause was the retention of superfluous workers (Lee, 2000). The Party-state faced difficult layoff situations at SOEs during the conflict between economic/market reform and the state's social responsibilities. Since economic development and market reform represented economic logic and were prioritized at that time, SOEs' layoff policy was put on the political and economic agenda in 1998.[13] Even though SOEs' layoff policy was initially supposed to be completed between 1998 and 2000, it lasted until 2008.[14] Therefore, we argue that before 2008, the firm-level LPC was likely to adopt a layoff policy to enhance SOE profitability, which was in line with the policies suggested by the Party-state at that time.

To transform from a planned economy to a market economy, China built a legal system and related regulatory mechanisms to support SOE market reform. The *Company Law* and *Securities Law* were established in 2006, and many other administrative regulations and regulatory documents were established before 2008.[15] Since January 2008, the "*Implementing Regulations of the PRC Labor Contract Law*"

[13] The layoff policy for SOEs was well documented in the doctrine "*Opinions on the Reform and Development of SOEs in 1998*" published by the State Council. See http://www.reformdata.org/1998/0516/6055.shtml.

[14] The "*Opinions on Further Doing a Good Job in the Policy-based Bankruptcy of SOEs*" (issued in 2006, see http://www.gov.cn/gongbao/content/2006/content_219946.htm) clearly stated that the period for implementing the policy-based bankruptcy of SOEs was extended to 2008. In 2008, *Wen Jiabao*, Premier of the State Council, delivered the *Report on the Work of the Government* on the 11th National People's Congress and announced that the problem of workers being laid off from SOEs was basically solved.

[15] *Opinions on Promoting the Reform, Opening-up and Steady Growth of Capital Market*s (2004); *Regulations on Listed Companies' Information Disclosure* (2007); *Rules on Listed Companies' Shareholders' Meetings* (2006); *Regulations on the Takeover of Listed Companies* (2006); *Trading Rules of the Shanghai Stock Exchange* (2006), *Trading Rules of the Shenzhen Stock Exchange* (2006); etc.

has been promulgated to take effect, which reflects the Party-state's commitment to further protect employee rights. The Party-state delegated this responsibility to the grassroots of the party organization via the firm-level LPC. Therefore, we hypothesize that the firm-level LPC gravitated more toward noneconomic logic after 2008, resulting in greater cost stickiness after the implementation of market reforms:

H2 LPC participation is associated with greater labor cost stickiness after 2008.

China has unbalanced regional economic development and different levels of regional market-based institutional quality, i.e., marketization (Fan et al., 2011). The global market economies of the 1980s and 1990s saw the 'new economy' arising as the result of the shareholder value movement. By the mid-1990s, many established U.S. corporations had restructured significantly to stay competitive, focusing on maximizing shareholder value (Lazonick, 2003; Lazonick & O'Sullivan, 2000). As market-based institutions emphasize shareholder maximization, they lead to less cost stickiness than do firms in nonmarket-based institutional environments (Calleja et al., 2006). As a consequence, we argue that in the Chinese market, if LPC members fulfill their mission to balance the goals of the party-state and the firm, they are likely to push for greater labor cost stickiness in regions where market-based institutions are strong and for less cost stickiness in regions where market-based institutions are weak. We posit that in areas with a strong marketization environment, firms may be incentivized to streamline redundant resources when sales decrease, and LPC participation serves as an effective mechanism to counter market forces that typically compel firms to reduce labor costs more significantly during sales downturns. In sum, we expect a stronger (weaker) association of LPC direct control with cost stickiness in regions with stronger (weaker) market-based institutions:

H3 The association between LPC participation and labor cost stickiness is stronger (weaker) in regions with stronger (weaker) market-based institutions.

4 Methodology and sample

4.1 Identification of LPC participation in corporate governance

We obtain data on management characteristics from the CSMAR database. CSMAR offers the "Top Management Profile" dataset, which contains management's "Current Positions" and "Resumes" data. Instead of exclusively relying on the incomplete "Current Positions" data directly offered by the CSMAR, we base the construction of LPC-related variables on the "Resumes" data and manually add related LPC positions to the "Current Positions" data. We use curriculum vitae data from the database and manually check whether managers currently hold positions at the LPC at the firm level. Referring to Li and Chan (2016), Li et al. (2017), and Li et al. (2020b), we employ four proxies to capture LPC participation. *PARTY* is a general indicator that takes a value of 1 if any member of the firm-level LPC serves as a

director, supervisor, or senior executive. In contrast, *PAR_DIRD*, *PAR_SUPD*, and *PAR_EXED* specifically capture whether any member of the LPC serves as a director, supervisor, or senior executive, respectively. Thus, these three variables capture LPC participation in corporate governance at different corporate governance layers. We set *PARTY*, *PAR_DIRD*, *PAR_SUPD*, and *PAR_EXED* to zero if LPC participation is absent. Furthermore, we define several additional dummies, *PCEO*, *PCHAIR*, and *PAR_KEY*, which indicate whether a person holds leadership positions on both the LPC team and top management. Specifically, *PCEO* and *PCHAIR* take a value of 1 if the LPC secretary or vice-secretary is also the CEO or the chairperson, respectively. Table OA 1 in Online Appendix A provides detailed descriptions of all the variables. In robustness tests, we use the ratio variables *PAR_TOT*, *PAR_DIR*, *PAR_SUP*, and *PAR_EXE* as substitutes for the dummy variables and show that the results remain qualitatively unchanged.

To test our research hypotheses, we extend the empirical model from the prior literature (Anderson et al., 2003; Chen et al., 2012) as follows:

$$\begin{aligned}\log(\Delta LC)_{i,t} = {} & b_0 + b_1\log(\Delta REV)_{i,t} + b_2 D_{i,t} + b_3 D_{i,t}\log(\Delta REV)_{i,t} \\ & + \Sigma b_k DET_{i,t} + \Sigma b_m DET_{i,t}\log(\Delta REV)_{i,t} + \Sigma b_n DET_{i,t} D_{i,t}\log(\Delta REV)_{i,t} \\ & + \lambda_1 PAR_{i,t} + \lambda_2 PAR_{i,t}\log(\Delta REV)_{i,t} + \lambda_3 PAR_{i,t} D_{i,t}\log(\Delta REV)_{i,t} \\ & + \mu_t + \gamma_i + \varepsilon_{i,t}\end{aligned} \tag{1}$$

where ΔLC is the change in labor costs. We measure the dependent variable of Model (1) with labor costs rather than broader cost categories such as operating costs.[16] Chinese companies do not provide direct information on labor expenses. As described in Li et al. (2020a), we approximate labor costs by summing the "cash paid for and on behalf of employees" stated in the cash flow statement and adjustments in "wages payable" from the balance sheet.[17] ΔREV is the change in revenue. D is a dummy variable equal to 1 when revenue decreases and 0 otherwise. *DET* is a placeholder for various determinants of cost stickiness identified in the previous literature (Anderson et al., 2003; Banker & Byzalov, 2014). Specifically, we include asset intensity, *AINT*, employee intensity, *EINT*, leverage, *LEV*, and successive sales decrease (*SUC*). Furthermore, we control for region-level variables. *GDP* is the regional percentage growth in real gross domestic product (GDP), and *UNEM* is the regional unemployment rate. These data are from the National Bureau of Statistics of China.[18] To control for the firms' internal governance and managerial opportunism, we add free cash flow intensity, *FCFINT*, board size, *BDSIZE*, and

[16] Our argument focuses on the noneconomic logic of SOEs, specifically employment welfare. Therefore, we use labor costs instead of other cost categories. We examine our results using operating costs, and the findings remain qualitatively unchanged.

[17] We do not rely on "cash paid for and on behalf of employees", which is used in Gu et al. (2020), as a proxy for labor cost because a company's actual labor cost is reflected in not only the cash already paid to employees but also the salaries that should be paid but have not yet been paid. Our results remain qualitatively unchanged when using the other proxy. In addition, we exclude the management salary from our primary labor cost proxy. The results are shown in the Table OA 6 in Online Appendix B.

[18] Addressing the disparities and diversity among different regions in China, we follow Gu et al. (2020) to utilize regional GDP and unemployment rate data rather than relying on national data.

shareholder dispersion, *SHA_DIS*, in Model (1) (Chen et al., 2012; Xue & Hong, 2016). In China, ownership is significantly more concentrated than it is in the USA and numerous other developed economies. Unlike the traditional vertical agency issues found in Western corporate governance, China faces a predominant horizontal agency conflict between controlling and minority shareholders due to its concentrated ownership structure. Thus, we employ the ratio of the shares held by the largest 2 to 5 shareholders to those held by the largest shareholder to measure shareholder dispersion. The placeholder *PAR* represents the four different LPC participation proxies that we use in this study. μ represents year effects, and γ represents firm fixed effects. Our main coefficient of interest is λ_3. A significantly negative estimate of this coefficient indicates that LPC participation has a positive (increasing) association with cost stickiness.

We use the whole sample to examine H1. To examine H2, we split our sample into two subsamples, one comprising all observations up until 2007 and the other comprising all observations from 2008 onward. To study H3, we split the full sample into two subsamples based on the median value of the marketization index (NERI index), which captures institutional quality (Fan et al., 2011; Gu et al., 2020).

4.2 Sample selection

Although "*Gongsi Fa*" (the Company Law of the People's Republic of China) establishes the legitimacy of party organizations in every company, existing policies and documents relating to the implementation of the law suggest that LPC participation predominantly targets SOEs. Therefore, our sample comprises all listed SOEs in China between 2004 and 2019. We begin our analysis in 2004, as CSMAR did not provide the resumes of top management until 2004.[19]

We obtain accounting data from the CSMAR database and regional marketization data from the WIND database. Table 1 summarizes the detailed sample construction processes, which we complement with Table OA 2 in Online Appendix A, which shows the distribution of sample observations across years. We first discard non-SOEs and firms in the financial industry from the income statement data assembled under the CSMAR database. The sample spans from 2004 to 2019 and comprises 15,315 observations. In alignment with prior literature (Anderson et al., 2003; Chen et al., 2012; Golden et al., 2020; Jin et al., 2022), we exclude 809 firm-year observations that have missing or negative *LC* or *REV* values for years t, t − 1, or t − 2. We also remove 28 firm-year observations where *LC* is greater than *REV*. To eliminate the extreme revenue changes that may be caused by acquisitions and mergers, we follow the literature (Banker et al., 2013; Jin et al., 2022; Lee et al., 2020) and eliminate observations where revenue increases more than 50% or decreases more than 33% in the current or prior year. In addition, we exclude observations under

[19] The related data on LPC appointments in "Current Positions" are not available comprehensively until 2003. Thus, Li et al., (2017, 2020b) employed the sample from 2003. However, we are not just employing the "Current Positions" data directly offered by CSMAR in the "Top Management Profile" dataset. We base our variable definitions on the "Resumes" and manually add related LPC positions to the "Current Positions" and "Resumes" data.

special treatment and 264 observations with missing values for other control variables. Finally, referring to the literature (Banker et al., 2013; Jin & Wu, 2021), we eliminate 1% of the outliers of log(Δ*LC*), log(Δ*REV*), *AINT* and *EINT*. The final sample comprises 9,616 observations. Some analyses are based on fewer observations depending on the specific variables we use in the empirical estimations.

5 Results and discussion

5.1 Descriptive statistics

Table 2 provides descriptive statistics. The mean value of *D* indicates that 27.2% of the observations experience a decrease in sales. The mean value of the variable *PARTY* is 0.739, which implies that 73.9% of the firm-year observations in our sample exhibit LPC participation at one or more of the three governance levels. The mean values of the LPC participation variables at the board of directors (*PAR_DIRD*), supervisory board (*PAR_SUPD*), and senior executives (*PAR_EXED*) levels are 0.625, 0.414, and 0.406, respectively. These values are considerably greater than the mean values of the corresponding variables in Li et al., (2017, 2020b) since we not only employ politically related information on top management positions provided by the CSMAR but also manually add LPC positions from top management resumes.[20] In our sample, 21.8% of CEOs are also LPC secretaries/vice secretaries (*PCEO*) and 47.5% of chairs also have a leading position on the firm-level LPC team (*PCHAIR*). On average, GDP growth is 12.4%. The descriptive statistics of changes in labor costs (Δ*LC*), changes in operating sales (Δ*REV*), asset intensity (*AINT*), employee intensity (*EINT*), and other variables are in line with those in the previous literature based on Chinese samples (Gu et al., 2020; Li et al., 2020c).

5.2 The association between LPC participation in corporate governance and labor cost asymmetry

Table 3 presents the results for the association between LPC participation in corporate governance and labor cost asymmetry. We control for year and firm fixed effects and report standard errors clustered at the firm level for all the analyses. The coefficient on $D \times \log(\Delta REV)$ in the first column is significantly negative (−0.2276), indicating that the average labor costs of SOEs are sticky. More specifically, labor costs increase 0.41 per 1% increase in revenues but decrease only 0.18 per 1% decrease in sales revenues (0.4081–0.2276 = 0.1805). The point estimates of the coefficients on the three-way interaction terms, $PARTY \times D \times \log(\Delta REV)$, $PAR\_DIRD \times D \times \log(\Delta REV)$, $PAR\_SUPD \times D \times \log(\Delta REV)$, and

[20] The "*Top Management Profile*" in CSMAR offers information on management's current positions and their resumes. We notice that "Current Positions" data are not complete and manually add LPC positions from resumes. If we only employ the LPC positions in the "Current Positions" data directly provided by CSMAR, the mean value of *PARTY* is 0.1115 and the standard deviation is 0.3147, which are similar to the corresponding statistics reported in Li et al., (2017, 2020b).

PAR_EXED×*D*×log(Δ*REV*), in Columns 2 through 5 are consistently negative except for the coefficient on LPC participation at the executive level, which lacks statistical significance. We credit these outcomes to the presence of the Chinese two-tier board system, indicating a significantly greater influence exerted by the board of directors and the supervisory board. Combining LPC participation at all three levels into a single multivariate regression shows a statistically significant result at the supervisory board level. Jiang and Kim (2020: 743) reported that "the supervisory board must have at least three members and must include representatives of shareholders, but at least one-third of the supervisors must be employees." Hence, when any member of the supervisory board also holds a position in an LPC, their capacity to influence managerial decisions regarding labor cost behavior is likely to be more robust. This enables them to prioritize employee rights, leading to a significant increase in labor cost stickiness. In summary, the results in Table 3 support H1. Our results show no evidence of a relationship between *GDP*/*EINT* and labor cost stickiness, which is consistent with prior results for Chinese SOEs (Gu et al., 2020; Li et al., 2020c). Notably, we observe a positive but statistically insignificant coefficient of *AINT*. We attribute this to the fact that we focus on labor costs in SOEs, and our findings are consistent with the literature (Gu et al., 2020: 4711; Prabowo et al., 2018: 784). The coefficient of *SHA_DIS* on cost stickiness is negatively significant, which aligns with the findings of Xue and Hong (2016). Controlling shareholders might support minority shareholders during periods of financial distress to prevent their companies from failing (Jiang & Kim, 2020). High ownership concentration can indicate concentrated management authority, facilitating effective managerial cost control methods (Xue & Hong, 2016). Consequently, when the ratio of the shares held by the second to fifth largest shareholders to those held by the largest shareholder is elevated, these benefits diminish, leading to a greater association with cost stickiness.

5.3 Variation in LPC participation and labor cost asymmetry over time

To examine whether the relationship between LPC participation and cost stickiness varies over time, we partition the sample from years up to and including 2007 and observations from 2008 onward. The results for H2 are presented in Table 4. The coefficients on the three-way interaction terms of interest are consistently negative and significant in the post-2008 subsample, except for *PAR_EXED*×*D*×log(Δ*REV*). These results indicate that LPC participation is associated with greater cost stickiness after 2008, whereas participation at the executive level is less effective. In contrast, for the earlier period until 2007, the point estimates of the coefficients on the three-way interaction terms of interest, *PARTY*×*D*×log(Δ*REV*), *PAR_DIRD*×*D*×log(Δ*REV*), *PAR_SUPD*×*D*×log(Δ*REV*), and *PAR_EXED*×*D*×log(Δ*REV*), are consistently positive. We employ seemingly unrelated regression estimations to assess differences in the three-way interactions of interest. The differences in the coefficients prove significant for LPC participation and involvement at the supervisory level, which partly supports H2.

Table 1 Sample construction process

Initial data for income statement in CSMAR for 2004–2019 (excluding financial industry and nonSOEs)	15,315
Less (1): Observations with missing or negative data on concurrent and previous year *REV* or *LC*	−793
Less (2): Abnormal *LC*: observations which *LC* are more than *REV*	−28
Less (3): Abnormal *REV*: observations which revenue increases more than 50% or decrease more than 33% in the current or prior year	−3486
Less (4): Observations under special treatment	−347
Less (5): Missing values on concurrent and previous year in other control variables	−264
Less (6): 1% outliers of log change of *REV*, *LC*, *AINT* and *EINT*	−781
Final sample for analyses	9616

This table presents the sample construction process. Our initial sample is Chinese listed SOEs. We first discard nonSOEs and firms in the financial industry from the income statement data assembled in the CSMAR database. The sample spans from 2004 to 2019 and comprises 15,315 observations. Following the literature (Anderson et al., 2003; Chen et al., 2012; Golden et al., 2020; Jin et al., 2022), we exclude 793 firm-year observations that have missing or negative *LC* or *REV* values for years t, t − 1, and t − 2. We also remove firm-year observations in which *LC* is more than *REV* or observations in which revenue increases more than 50% or decreases more than 33% in the current or prior year. The regional GDP growth and regional unemployment rate data are from the National Bureau of Statistics of China. We exclude observations under special treatment. In addition, we delete 264 observations with missing values for other control variables. Finally, we eliminate 1% of the outliers of log (ΔLC), log (ΔREV), *AINT* and *EINT*. The final sample has 9616 observations

In our hypothesis development, we suggest that sticky labor costs could be linked to agency problems and corruption resulting from political control, represented here by LPC participation. However, we contend that our findings are less likely to be attributed to the detrimental effects of political control. This is because the association between LPC participation and cost stickiness does not remain constant over time. If labor cost stickiness were genuinely a result of the increasing agency costs associated with political intervention, we would constantly observe LPC participation correlating with greater stickiness. We delve deeper into this alternative explanation related to the agency problem in our robustness tests.

To further investigate how the relationship between LPC participation and cost asymmetry evolves over time, we estimate Model (1) on a rolling 3-year basis. Figure 3 shows the evolution of the coefficients on $PARTY \times D \times \log(\Delta REV)$ over time, while the last year of each rolling regression is depicted on the x-axis. LPC participation tends to be associated with lower cost stickiness (positive point estimates of coefficients) until 2007 but higher cost stickiness (negative point estimates of coefficients) thereafter. Thus, the results in Fig. 3 are consistent with H2.

We conjecture that firm-level LPC members' objectives vary over time since they prioritized economic logic (profitability) rather than noneconomic logic (keeping unemployment low) during the earlier period, which was dominated by SOE market reform. This changed thereafter when the LPC members began prioritizing social stability. To formally test this conjecture, we run a time series regression of the LPC-cost stickiness coefficient on the variable *OBJ*, which captures the LPC's balance between economic goals and social stability. The *Report on the Work*

Table 2 Descriptive statistics

Variable	N	Mean	SD	Min	P50	Max
log(Δ*LC*)	9616	0.111	0.151	−0.404	0.101	0.702
D	9616	0.272	0.445	0.000	0.000	1.000
log(Δ*REV*)	9616	0.077	0.149	−0.339	0.084	0.386
PARTY	9616	0.739	0.439	0.000	1.000	1.000
PAR_DIRD	9616	0.625	0.484	0.000	1.000	1.000
PAR_SUPD	9616	0.414	0.493	0.000	0.000	1.000
PAR_EXED	9616	0.406	0.491	0.000	0.000	1.000
PCEO	9616	0.218	0.413	0.000	0.000	1.000
PCHAIR	9616	0.475	0.499	0.000	0.000	1.000
PAR_KEY	9616	0.510	0.500	0.000	1.000	1.000
PAR_TOT	9616	0.110	0.110	0.000	0.083	0.786
PAR_DIR	9616	0.138	0.145	0.000	0.111	0.667
PAR_SUP	9616	0.128	0.178	0.000	0.000	1.000
PAR_EXE	9616	0.112	0.185	0.000	0.000	1.000
GDP	9616	12.397	5.482	−3.95	10.897	29.809
AINT	9616	0.560	0.640	−0.951	0.522	2.384
EINT	9616	−13.777	0.894	−16.707	−13.714	−11.714
SUC	9616	0.254	0.435	0.000	0.000	1.000
FCFINT	9616	0.010	0.089	−0.902	0.017	1.350
LEV	9616	−0.794	0.496	−4.811	−0.680	0.160
UNEM	9616	0.411	8.019	−52.381	0.242	63.077
BDSIZE	9616	2.224	0.210	0.000	2.197	2.890
SHA_DIS	9616	0.483	0.494	0.003	0.300	3.695

Log(Δ*LC*) represents the natural logarithm of the change in labor costs. *LC* equals the amount of "cash paid for and on behalf of employees" reported in the cash flow statement plus changes in "wages payable" in the balance sheet (Li et al., 2020b). The variables are defined in Table 2. See Table OA 1 for the detailed variable definitions. *D* equals 1 if revenue has decreased relative to the prior period. Log(Δ*REV*) is the natural logarithm of the change in revenue. *PARTY* indicates whether any LPC member serves as a director, supervisory board member, or senior executive. *PAR_DIR, PAR_SUP* and *PAR_EXE* take a value of 1 if any member of the LPC also serves as a director, supervisor, or senior executive, respectively. *PCEO* and *PCHAIR* take a value of 1 if the LPC secretary or vice-secretary is also the CEO or the chairperson, respectively. *PAR_KEY* takes a value of 1 if *PCEO* or *PCHAIR* has a value of 1. *PAR_TOT* is defined as the ratio of the sum of all LPC members acting as directors, supervisors, or senior executives to the sum of all directors, supervisors, and senior executives. *PAR_DIR*, *PAR_SUP* and *PAR_EXE* are the ratios of the number of party committee members acting as directors, supervisors, or senior executives to the total number of directors, supervisors, or senior executives, respectively. The *GDP* is the regional percentage growth in the real gross domestic product. To address the disparities and diversity among different regions in China (Gu et al., 2020), we utilize regional GDP data rather than relying on national GDP data. *AINT* represents asset intensity, which is the natural logarithm of the ratio of total assets to revenues. *EINT* is the natural logarithm of the ratio of the number of employees to revenues. *SUC* equals 1 if revenue decreased during the prior period relative to the period before that. *FCFINT* is the ratio of free cash flow to total assets—since some firms have negative free cash flows, we do not apply the logarithmic transformation. *LEV* is the natural logarithm of the ratio of total liabilities to total assets. *UNEM* is the regional unemployment rate. *BDSIZE* is the natural logarithm of board size. Shareholder dispersion (*SHA_DIS*) equals the shareholding percentage of the 2nd–5th largest shareholders/ shareholding percentage of the largest shareholder

Table 3 LPC participation and labor cost asymmetry

	(1) log (Δ*LC*)	(2) log (Δ*LC*)	(3) log (Δ*LC*)	(4) log (Δ*LC*)	(5) log (Δ*LC*)	(6) log (Δ*LC*)
log(Δ*REV*)	0.4081***	1.8666***	1.9125***	1.8859***	1.9472***	1.8738***
	(0.0231)	(0.4154)	(0.4160)	(0.4130)	(0.4150)	(0.4145)
D	0.0058	0.0051	0.0051	0.0053	0.0053	0.0053
	(0.0056)	(0.0057)	(0.0057)	(0.0057)	(0.0057)	(0.0057)
D×log(Δ*REV*)	−0.2276***	−1.4623	−1.5493*	−1.4933*	−1.6142*	−1.4712*
	(0.0441)	(0.8951)	(0.8973)	(0.8873)	(0.8906)	(0.8928)
PARTY×*D*×log(Δ*REV*)		−0.1857*				
		(0.0991)				
PAR_DIRD×*D*×log(Δ*REV*)			−0.2006**			−0.1448
			(0.0840)			(0.0923)
PAR_SUPD×*D*×log(Δ*REV*)				−0.2168***		−0.1752**
				(0.0800)		(0.0823)
PAR_EXED×*D*×log(Δ*REV*)					−0.1110	−0.0152
					(0.0771)	(0.0836)
GDP×*D*×log(Δ*REV*)		−0.0040	−0.0043	−0.0037	−0.0034	−0.0049
		(0.0089)	(0.0090)	(0.0089)	(0.0089)	(0.0090)
AINT×*D*×log(Δ*REV*)		0.0668	0.0681	0.0572	0.0701	0.0547
		(0.0711)	(0.0715)	(0.0714)	(0.0712)	(0.0720)
EINT×*D*×log(Δ*REV*)		−0.0561	−0.0586	−0.0550	−0.0620	−0.0559
		(0.0497)	(0.0501)	(0.0495)	(0.0496)	(0.0498)
SUC×*D*×log(Δ*REV*)		0.0741	0.0789	0.0768	0.0752	0.0814
		(0.0891)	(0.0891)	(0.0894)	(0.0894)	(0.0891)
LEV×*D*×log(Δ*REV*)		−0.0373	−0.0359	−0.0369	−0.0408	−0.0309
		(0.0801)	(0.0802)	(0.0798)	(0.0803)	(0.0801)
FCFINT×*D*×log(Δ*REV*)		−0.3369	−0.3229	−0.3309	−0.3231	−0.3272
		(0.4175)	(0.4184)	(0.4179)	(0.4185)	(0.4188)
BDSIZE×*D*×log(Δ*REV*)		0.3117	0.3315*	0.3139	0.2927	0.3440*
		(0.1956)	(0.1959)	(0.1963)	(0.1958)	(0.1965)
UNEM×*D*×log(Δ*REV*)		−0.0065	−0.0066	−0.0064	−0.0066	−0.0064
		(0.0061)	(0.0061)	(0.0061)	(0.0061)	(0.0061)
SHA_DIS×*D*×log(Δ*REV*)		−0.2588***	−0.2650***	−0.2656***	−0.2465***	−0.2774***
		(0.0826)	(0.0830)	(0.0833)	(0.0830)	(0.0832)
CONSTANT	0.0526***	−0.0645	−0.0744	−0.0744	−0.0791	−0.0678
	(0.0094)	(0.0889)	(0.0896)	(0.0892)	(0.0895)	(0.0893)
Remaining constitutive terms	N/A	YES	YES	YES	YES	YES
Firm & Year fixed effects	YES	YES	YES	YES	YES	YES
N	9616	9616	9616	9616	9616	9616
Adj. R^2	0.1505	0.1663	0.1660	0.1664	0.1656	0.1665

Robust standard errors clustered at the firm level are displayed in parentheses

Asterisks indicate significance at the 10% (*), 5% (**) and 1% (***) levels. The variables are defined in Table 2. See Table OA 1 for the detailed variable definitions

Table 4 LPC participation and labor cost asymmetry (split by pre- and post-2008)

	(1) Post 2008 log (Δ*LC*)	(2) Pre 2008 log (Δ*LC*)	(3) Post 2008 log (Δ*LC*)	(4) Pre 2008 log (Δ*LC*)	(5) Post 2008 log (Δ*LC*)	(6) Pre 2008 log (Δ*LC*)	(7) Post 2008 log (Δ*LC*)	(8) Pre 2008 log (Δ*LC*)	(9) Post 2008 log (Δ*LC*)	(10) Pre 2008 log (Δ*LC*)	(11) Post 2008 log (Δ*LC*)	(12) Pre 2008 log (Δ*LC*)
log(Δ*REV*)	0.3889***	0.4828***	2.2704***	1.3233	2.3204***	1.3083	2.2789***	1.4995	2.3514***	1.4310	2.2669***	1.3429
	(0.0248)	(0.0638)	(0.4505)	(1.2953)	(0.4494)	(1.2765)	(0.4504)	(1.2786)	(0.4511)	(1.2729)	(0.4494)	(1.2853)
D	0.0083	0.0063	0.0069	0.0060	0.0069	0.0056	0.0072	0.0020	0.0071	0.0050	0.0070	0.0049
	(0.0056)	(0.0254)	(0.0056)	(0.0269)	(0.0057)	(0.0268)	(0.0056)	(0.0263)	(0.0057)	(0.0270)	(0.0057)	(0.0265)
D×log(Δ*REV*)	−0.1890***	−0.4915**	−1.8207*	−3.0670	−1.9358**	−2.9961	−1.8770**	−3.5573	−1.9869**	−3.2053	−1.8442**	−3.4232
	(0.0451)	(0.2098)	(0.9423)	(3.5251)	(0.9415)	(3.4485)	(0.9349)	(3.5316)	(0.9361)	(3.6534)	(0.9367)	(3.3218)
PARTY×*D*×log(Δ*REV*)			−0.2352**	0.3687								
			(0.1043)	(0.4054)								
PAR_DIRD×*D*×log(Δ*REV*)					−0.2211**	0.2898					−0.1525	0.2789
					(0.0872)	(0.3825)					(0.0935)	(0.3866)
PAR_SUPD×*D*×log(Δ*REV*)							−0.2908***	0.3899			−0.2521***	0.3184
							(0.0832)	(0.3947)			(0.0848)	(0.3799)
PAR_EXED×*D*×log(Δ*REV*)									−0.1053	0.0665	0.0076	−0.1337
									(0.0799)	(0.4031)	(0.0861)	(0.4224)
CONSTANT	0.0910***	0.0297**	0.0744***	0.0259	0.0715***	0.0315	0.0700***	0.0228	0.0685***	0.0285	0.0732***	0.0294
	(0.0086)	(0.0144)	(0.0120)	(0.0388)	(0.0119)	(0.0383)	(0.0118)	(0.0376)	(0.0119)	(0.0378)	(0.0119)	(0.0382)
Control variables	NO	NO	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Remaining constitutive terms	N/A	N/A	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Firm and year fixed effects	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
χ^2 (*p* value for testing whether λ_3 is equal)			0.1393	0.1871								
N	7695	1921	7695	1921	7695	1921	7695	1921	7695	1921	7695	1921

Table 4 (continued)

	(1) Post 2008 log (Δ*LC*)	(2) Pre 2008 log (Δ*LC*)	(3) Post 2008 log (Δ*LC*)	(4) Pre 2008 log (Δ*LC*)	(5) Post 2008 log (Δ*LC*)	(6) Pre 2008 log (Δ*LC*)	(7) Post 2008 log (Δ*LC*)	(8) Pre 2008 log (Δ*LC*)	(9) Post 2008 log (Δ*LC*)	(10) Pre 2008 log (Δ*LC*)	(11) Post 2008 log (Δ*LC*)	(12) Pre 2008 log (Δ*LC*)
Adj. R^2	0.1490	0.1084	0.1680	0.1163	0.1678	0.1174	0.1683	0.1152	0.1673	0.1140	0.1689	0.1172

The post-2008 period covers the period 2008–2019. The pre-2008 period covers the period 2004–2007. Robust standard errors clustered at the firm level are displayed in parentheses

Asterisks indicate significance at the 10% (*), 5% (**) and 1% (***) levels. The variables are defined in Table 2. See Table OA 1 for detailed variable definitions

of the Government, which is an official document of the Chinese "*Zhengfu Gongzuo Baogao*",[21] contains a paragraph on SOE market-oriented reform and another on employment issues.[22] We count the number of words in these two paragraphs and calculate the natural logarithm of their ratio, *OBJ*.[23] *OBJ* is negatively correlated with time and has a positive mean value (more words related to market-oriented reform than to employment issues) of 0.33 for 2004–2007. *OBJ* is negative (more words related to employment issues than to market-oriented reform) for the first time in 2008 (−0.23). Table 5 shows that LPC participation is associated with lower cost asymmetry when *OBJ* is higher, i.e., during the earlier years in our sample, when the LPC's mandate gravitated more (less) toward market-oriented reform (employment issue).

5.4 Cross-sectional variations in market-based institutional quality

We use the marketization index (NERI index) to capture differences in regional institutional quality (Fan et al., 2011; Gu et al., 2020) and investigate whether it moderates the relationship between LPC participation and cost stickiness. The NERI covers a range of 0–10, with lower values indicating lower marketization. We use the index's cross-sectional median values to separate our sample into strong and weak market-based institutions and repeat the analyses on the two subsamples.

Table 6 shows the results. When firms are in regions with strong market-based institutions, the coefficients on $PARTY \times D \times \log(\Delta REV)$, $PAR\_DIRD \times D \times \log(\Delta REV)$ and $PAR\_SUPD \times D \times \log(\Delta REV)$ are negative and significant; the coefficient on $PAR\_EXED \times D \times \log(\Delta REV)$ is negative but not significant. These results indicate that LPC participation is associated with increased cost stickiness in regions with strong market-based institutions. We interpret this as LPC

[21] The premier of the State Council delivers annually the *Report on the Work of the Government* at the National People's Congress. The report always contains two main parts. One part is a review of the work of the past year, and the other part is a general plan and major tasks for the current year. The specific content of the major tasks in the report changes annually based on the current government development focus. Nonetheless, economic development, environmental protection, improvements in people's well-being, reform, and opening up are present constantly. We compare the length of the paragraph on SOE market reform assembled in the "reform" part with the paragraph discussing employment in the "improvement of people's well-being" task.

[22] The original report is in Chinese. We translate some key messages in the 2017 report for a better understanding: "We will deepen the reform of SOEs and state capital. We should develop a corporate governance structure (represented by a legal person) that is under effective check and a flexible and efficient market-based operating system, with a view to increasing core competitiveness and making resource allocation more effective…" (a paragraph on deepening the reform of SOEs). "We will improve employment policy, strengthen employment training, and increase support for flexible employment and new forms of employment. This year, 7.95 million students will graduate from college, the highest number on record. We need to effectively implement initiatives to promote their employment, guide them in starting businesses, and encourage them to work at the community level, providing our college graduates with multiple channels to find jobs or start their own businesses…" (a paragraph related to the employment issue).

[23] We derive this proxy to capture the variation in the Party-state's agenda over time. The positive value of *OBJ* means that the Party-state emphasizes more the economic efficiency of SOEs, while the negative value suggests that their main orientation is the social mandate.

participation serving as an effective mechanism to counter market forces that typically compel firms to reduce labor costs more during sales downturns.

When firms are in regions with weak market-based institutions, the coefficients on $PARTY \times D \times \log(\Delta REV)$, $PAR\_DIRD \times D \times \log(\Delta REV)$, $PAR\_SUPD \times D \times \log(\Delta REV)$, and $PAR\_EXED \times D \times \log(\Delta REV)$ are not significant. We find no evidence that LPC participation is associated with cost asymmetry in regions with weak market-based institutions. These results are consistent with **H3** and suggest that LPC participation does not require SOEs to adopt significantly more political and social stability if firms operate under conditions of low market pressure.[24]

Our results are conceptually and fundamentally different from those reported in Gu et al. (2020), who show that political connections (current or former government official, a military officer, a delegate of the People's Congress, or a member of the Chinese People's Political Consultative Conference) lead to smaller (greater) cost stickiness when market institutions are strong (weak). Thus, the results in Gu et al. (2020) imply that marketization restricts the impact of political connections on cost stickiness. When market-based institutions are strong, politically connected managers face more resistance when trying to increase cost stickiness than do those in regions with weak market-based institutions. However, LPC participation is an internal governance system, and LPC members, e.g., board members, originate from the inside of a firm. Hence, we posit that marketization does not curtail the influence of internal corporate governance but rather affects firms' cost behavior on a broader scale. Firms located in areas characterized by strong marketization are compelled to increase their economic efficiency, and LPC participation counteracts those forces of the market that call for labor cost reductions when sales decrease.

6 Additional tests and robustness

6.1 Controlling for political connections

We add political connection as a control variable to differentiate the impact of LPC participation on cost stickiness from the impact of political connections. We use political connection data from the Chinese Research Data Services Platform (CNRDS), which is available until 2017. Thus, the sample period for this analysis is 2004–2017. Table OA 4 in Online Appendix B shows the correlation coefficient between the LPC participation proxy and political connections. The correlation coefficient between *PARTY* and political connections (*PC_FIRM*) is 0.029, which indicates that LPC participation is different from political connections. The correlation coefficient between *PAR_GU* and *PC_FIRM* is 0.060, which indicates that LPC participation at the CEO or chair level is not identical to having a politically connected CEO or chair. Table OA 5 shows that even when controlling for political connections, the results are consistent with our previous findings.

[24] We do not observe significant cost stickiness in weak marketization regions but find significant differences between the relevant coefficients on LPC participation overall and at the director level. This finding provides partial support for H3.

6.2 LPC participation, managerial opportunism, and labor cost stickiness

We hypothesize that LPCs manage a tradeoff between noneconomic logic and economic logic, which impacts labor cost behavior. Alternatively, cost stickiness may be influenced by managerial opportunism and agency problems, which are associated with political control (Jiang & Kim, 2020; Wang et al., 2022). Therefore, in our baseline regression Model (1), we follow the approach of Chen et al. (2012) and account for managerial opportunism by incorporating free cash flow, *FCFINT*, as a proxy for empire-building incentives. Moreover, the presence of better governance and internal controls might deter managerial opportunism (Chen et al., 2012). Consequently, we include board size, *BSIZE*, i.e., the logarithm of the total number of board members, and shareholder concentration, *SHA_DIS*, i.e., the ratio of the shareholding percentage of the 2nd–5th largest shareholders to the shareholding percentage of the largest shareholder, in our baseline model. To further address that our results are potentially influenced by agency problems, we employ another labor cost proxy in which management compensation is excluded from labor costs. *LC_EM* corresponds to our primary labor cost proxy minus management compensation.[25] The results presented in Table OA 6 are qualitatively similar to our main findings.

In addition, we enhance our analysis by adding a comprehensive corporate governance proxy to our control variables. Strong corporate governance is known to limit agency problems and decrease cost stickiness (Chen et al., 2012). We use principal component analysis (PCA) to derive a comprehensive proxy for corporate governance. The PCA is based on variables such as the concentration of company equity, board size, proportion of independent directors to the board size, proportion of executive shareholdings, proportion of institutional investors, and whether the chairperson and CEO are the same person. The results indicate that strong corporate governance is associated with less cost stickiness. When controlling for this variable, our results remain qualitatively unchanged. The results are shown in Column (8) of Table OA 6.

6.3 LPC participation, employee protection, and labor cost stickiness

Our main argument is that LPC participation pushes firms toward the noneconomic logic and results in greater labor cost stickiness. To analyze whether the correlation between LPC and labor cost stickiness prevails after controlling for social responsibility, we include an additional control variable, *EMP_PRO*, and reexamine our main regressions. *EMP_PRO* is a dummy variable that captures a firm's employee rights protection activities and equals one if a firm discloses its employee rights protection scheme according to data retrieved from the CSMAR. The data are available from the year 2006 onward. The results are shown in Table OA 7. In Column (1),

[25] We also test executive compensation and find that the relevant coefficients are not significant (t value is −0.37). Thus, we find that LPC is significantly associated with higher labor cost stickiness, but not with executive cost stickiness. The results are tabulated in Table OA 6 Column (7).

our results remain qualitatively unchanged when we control for firm-level employee protection activities. In Column (2), we use average employee compensation (*AVE_LC*) as a proxy for average labor cost and explore the impact of LPCs on employee welfare during sales declines. Our findings reveal a link between LPC participation and increased average labor cost stickiness. This finding supports our argument that LPC drives firms to prioritize noneconomic factors, enhancing employee benefits and social obligations. Introducing *EMP_PRO* as a control variable in Column (3) does not alter our results.

6.4 Corporate social responsibility and regional social capital

Habib and Hasan (2019) and Hartlieb et al. (2020) provide evidence that CSR and social capital are determinants of cost stickiness. Therefore, we conduct two additional cross-sectional analyses on the basis of CSR and region of social capital. We use CSR scores (the Hexun index) for Chinese listed firms. Since the score is only available from 2010 onward, the sample decreases accordingly. We find that firms with LPC are significantly associated with greater labor cost stickiness in the higher CSR score group (the coefficient is −0.3530) but not significantly in the lower score group (the coefficient is −0.0825). The results are shown in Columns (1) and (2) in Table OA 8.

To investigate the impact of regional social capital, we split the sample into eastern, western, and central China. This is because "overall, the provinces in eastern China have higher stocks of social capital, and provinces in central China have lower stocks than those in western China do" (Pan & He, 2010: 444). We find that firms with LPC exhibit significant labor stickiness in the high social capital area (the coefficient is −0.3232). The results are shown in Columns (3) and (4) in Table OA 8.

6.5 Different types of labor costs

Furthermore, we delve into different types of labor costs. As a starting point, we divide the total number of employees into staff that benefit from higher education and others. We identify an employee as highly educated when he or she has a master's or Ph.D. degree, whereas the category "others" includes employees with a bachelor's degree or lower than a bachelor's degree. We find that LPC is associated with lower stickiness in the lower educated group (the coefficient is 0.3343), but there are no significant results for the higher education subsample. The results are tabulated in Columns (4) and (5) in Table OA 8. We then divide the total number of employees into technical positions and others. The employee position data are from the CSMAR. We find that LPC is significantly associated with greater stickiness of technical employees (the coefficient is −0.4471). Our findings suggest that LPCs are more likely to keep technical people when sales decrease, which supports the notion that LPCs influence the resource adjustment decisions for technical employees. The results are tabulated in Table OA 8 Columns (7) and (8).

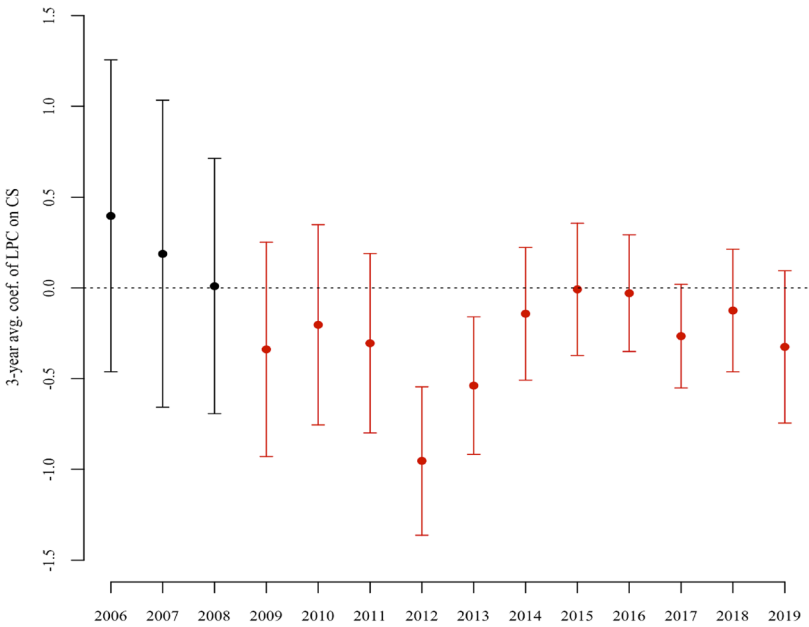


Fig. 3 LPC's role in cost asymmetry over time. This graph illustrates the 3-year average coefficients depicting the relationship between LPCs and labor cost asymmetry over time. Notably, the coefficients shift from positive to negative after 2008, suggesting a transition in LPC behavior from a decrease in cost stickiness to an increase in cost stickiness

6.6 Different LPC participation proxies

We use different proxies for LPC participation to test the robustness of our main findings. Referring to Jin et al. (2022), we define *PAR_TOT* as the ratio of the sum of all LPC members acting as directors, supervisors, or senior executives to the sum of all directors, supervisors, and senior executives. Consequently, *PAR_TOT* gauges the general influence of LPC participation on firm activities. Furthermore, we define *PAR_DIR*, *PAR_SUP*, and *PAR_EXE* as the ratios of the number of party committee members acting as directors, supervisors, or senior executives to the total number of directors, supervisors, or senior executives, respectively. Hence, these variables capture LPC participation at different layers of corporate governance. We set *PAR_TOT*, *PAR_DIR*, *PAR_SUP*, and *PAR_EXE* to zero if LPC participation is absent. We use these four ratio measures as alternative proxies for LPC participation. The results provided in Table OA 9 and Table OA 10 are consistent with our main results.

Previous studies, such as Fan et al. (2007) and Gu et al. (2020), have examined the effect of political control through the lens of CEO/chair appointments. Following this notion, we measure LPC participation via four alternative indicators (*PCEO*, *PCHAIR*, *PAR_KEY*, and *PAR_GU*). *PCEO* and *PCHAIR* take a value of 1 when the

Table 5 LPC objectives for time series variations

	(1)
	CS_PAR
OBJ	0.2929*
	(0.1528)
GDP_NATION	−0.0130
	(0.0211)
UNEM_NATION	−0.2259
	(0.6313)
CONSTANT	1.0162
	(2.4793)
N	16
Adj. R^2	0.0753

This table shows the impact of the variations in LPC objectives on cost asymmetry

Asterisks indicate significance at the 10% (*), 5% (**) and 1% (***) levels. The *OBJ* captures the LPC's balance between SOEs' economic goals and social stability. We count the number of words discussing SOE market reform and employment issues in the annual *Government Report* and calculate the natural logarithm of their ratio. *OBJ* equals log (words_num_market/words_num_employment). In contrast to the main analysis, the GDP growth and unemployment rate data are at the national level. See Table OA 1 for detailed variable definitions

CEO or chair acts as the LPC secretary (or deputy secretary). *PAR_KEY* equals 1 if the CEO or chair of the board serves as an LPC secretary (or deputy secretary). Like the political connection proxy used by Gu et al. (2020), we derive an indicator, *PAR_GU*, which takes a value of 1 if the CEO or chair holds any position in the firm-level LPC. Table OA 11 presents the regression results. The coefficients on $PCEO \times D \times \log(\Delta REV)$, $PCHAIR \times D \times \log(\Delta REV)$, $PAR\_KEY \times D \times \log(\Delta REV)$, and $PAR\_GU \times D \times \log(\Delta REV)$ are negative and statistically significant in the post-2008 subsample but positive in the earlier period subsample. These results are in line with our previous findings.

7 Conclusion

We find that LPC participation is associated with greater labor cost asymmetry in Chinese listed SOEs. The association between LPC participation and cost asymmetry depends on the LPC's main objective and varies over time. Before the implementation of the Labor Contract Law in 2008, there is no significant evidence of cost asymmetry; however, following the law's introduction, when the Party-state became more focused on noneconomic objectives, LPC participation is associated with greater labor cost stickiness. The relationship between LPC participation and cost asymmetry is stronger for SOEs in regions with stronger market-based institutions. Market-based institutions prioritize shareholder maximization, compelling

Table 6 Cross-sectional variations in market-based institutional quality

	(1) Strong log (Δ*LC*)	(2) Weak log (Δ*LC*)	(3) Strong log (Δ*LC*)	(4) Weak log (Δ*LC*)	(5) Strong log (Δ*LC*)	(6) Weak log (Δ*LC*)	(7) Strong log (Δ*LC*)	(8) Weak log (Δ*LC*)	(9) Strong log (Δ*LC*)	(10) Weak log (Δ*LC*)	(11) Strong log (Δ*LC*)	(12) Weak log (Δ*LC*)
log(Δ*REV*)	0.3704***	0.4281***	2.1847***	1.7872***	2.2333***	1.7993***	2.1749***	1.7792***	2.2738***	1.8232***	2.1728***	1.8006***
	(0.0338)	(0.0324)	(0.6107)	(0.5772)	(0.6170)	(0.5784)	(0.6081)	(0.5786)	(0.6168)	(0.5794)	(0.6138)	(0.5795)
D	−0.0010	0.0101	−0.0016	0.0098	−0.0012	0.0092	−0.0016	0.0099	−0.0015	0.0100	−0.0014	0.0095
	(0.0079)	(0.0078)	(0.0079)	(0.0081)	(0.0080)	(0.0081)	(0.0079)	(0.0081)	(0.0079)	(0.0081)	(0.0080)	(0.0081)
D×log(Δ*REV*)	−0.2095***	−0.2406***	−1.8765	−1.0771	−1.9804	−1.0579	−1.9729	−1.0725	−2.0720	−1.1012	−1.9168	−1.0787
	(0.0660)	(0.0618)	(1.3255)	(1.3343)	(1.3373)	(1.3394)	(1.2962)	(1.3525)	(1.3305)	(1.3555)	(1.3376)	(1.3420)
PARTY×*D*×log(Δ*REV*)			−0.3366**	0.0213								
			(0.1316)	(0.1586)								
PAR_DIRD×*D*×log(Δ*REV*)					−0.3952***	0.0255					−0.3614***	0.0748
					(0.1145)	(0.1255)					(0.1291)	(0.1333)
PAR_SUPD×*D*×log(Δ*REV*)							−0.3246***	−0.0946			−0.2497**	−0.0998
							(0.1185)	(0.1141)			(0.1246)	(0.1146)
PAR_EXED×*D*×log(Δ*REV*)									−0.1328	−0.0425	0.0832	−0.0539
									(0.1156)	(0.1088)	(0.1281)	(0.1118)
CONSTANT	0.0541***	0.0561***	−0.0490	−0.0838	−0.0525	−0.0894	−0.0584	−0.0935	−0.0659	−0.0987	−0.0427	−0.0924
	(0.0124)	(0.0142)	(0.1241)	(0.1318)	(0.1250)	(0.1331)	(0.1242)	(0.1339)	(0.1257)	(0.1334)	(0.1250)	(0.1331)
Control variables	NO	NO	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Remaining constitutive terms	N/A	N/A	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Firm and year fixed effects	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
χ^2 (*p* value for testing whether λ_3 is equal)			0.0796*	0.0121**								
N	4853	4763	4853	4763	4853	4763	4853	4763	4,853	4,763	4,853	4,763
Adj. R^2	0.1193	0.1849	0.1340	0.2022	0.1350	0.2017	0.1343	0.2012	0.1327	0.2011	0.1355	0.2013

This table shows the cross-sectional variations in market-based institutional quality

Asterisks indicate significance at the 10% (*), 5% (**) and 1% (***) levels. The variables are defined in Table 2. See Table OA 1 for the detailed variable definitions

company management to make decisions in the interest of shareholders, resulting in less cost stickiness than firms in nonmarket-based institutional environments do (Calleja et al., 2006). LPC participation serves as a mechanism for countering market forces that typically compel firms to reduce labor costs more significantly during sales downturns. These results complement prior academic research on the impact of institutional constraints on cost asymmetry (Gu et al., 2020; Nagasawa, 2018; Prabowo et al., 2018). Understanding these important determinants of cost asymmetry is important for investors and analysts. Costa and Habib (2023) highlight the value relevance of cost stickiness. Moreover, prior research has shown that cost asymmetry is an important but thus far insufficiently considered ingredient in the earnings forecasting process (Ciftci et al., 2016; Kaspereit & Lopatta, 2019). Future research could be directed toward the questions of whether an enhanced understanding of institutional constraints on cost behavior can serve as a significant input to cost forecasting and ultimately earnings forecasting models.

This study focuses on examining the association between LPC participation and labor cost stickiness, which introduces a limitation related to causality. Our estimates of cost stickiness are based on average coefficients from the ABJ model, which does not allow us to establish a causal relationship between LPC participation and cost stickiness—a limitation inherent to this design and acknowledged in the literature (e.g., Hartlieb et al., (2020: 13)). While tempting, we refrain from arguing that the introduction of the Labor Contract Law in 2008 represents an exogenous event, as political agenda setting is likely to depend on past realizations of and future expectations for the national economy.[26] Thus, future research on how to establish causality in studies that explore the determinants of cost asymmetry is needed.[27]

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[26] We focus on how the implementation of this law moderates the correlation between LPC representation and cost stickiness at the firm-level, thus analyzing this setting might have the merit of alleviating endogeneity to some limited extent. However, we remain cautious.

[27] Ballas et al. (2022) try to establish causality by means of using the firm-year measure of Weiss (2010) and econometric tools such as Granger-causality tests and the difference-in-difference design. Based on our own experience with the empirical properties of the Weiss measure, particularly the restrictions it puts on sample selection, we are skeptical whether it should be used for that purpose (Kaspereit and Lopatta, 2019). Comprehensive overview articles such as Günther et al. (2014), Ibrahim et al. (2022), and Naoum et al. (2023) do not discuss the issue of association versus causality, which indicates that this issue has not yet been sufficiently addressed in the underlying primary research articles.

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