

Democratic Governance, Kinship Networks, and Entrepreneurial Development

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Democratic Governance, Kinship Networks, and Entrepreneurial Development: Evidence from Rural China

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Abstract

Existing entrepreneurship literature has focused on formal regulatory institutions but has rarely examined effects on entrepreneurship of formal political institutions, particularly that of democracy. This study explores the role of democracy in entrepreneurial development, as well as how democracy moderates the role of kinship networks, in a developing or emerging economy setting. Integrating new institutional economic theory with social network theory, this study examines the rate of rural entrepreneurship in China by arguing that stronger local democratic governance facilitates entrepreneurial development and negatively moderates the role of kinship networks in entrepreneurial development. In particular, while kinship networks have a positive effect on entrepreneurial development when democratic governance is weak, their effect turns negative when it is strong. We use a national sample of villages from China for our empirical test. Results from both Ordinary Least Squares and an instrumental variable approach provide strong support for our hypotheses. The research contributions and implications are discussed.

Keywords

democratic governance, kinship networks, entrepreneurial development, political institutions, China

Existing entrepreneurship literature has emphasized interactions between formal institutions—particularly, formal regulatory institutions¹—and entrepreneurship in recent decades (see, e.g., reviews by Bradley & Klein, 2016; Bruton et al., 2010; Jennings et al., 2013; Minniti & Levesque, 2008; Su et al., 2016). Following North (1990) and Baumol (1990), this body of research has suggested that formal regulatory institutions—

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particularly, effective legal rules (e.g., Acemoglu & Johnson, 2005; De Soto, 2000; Johnson et al., 2002), as well as a developed market system (Gwartney & Lawson, 2002; Zhou, 2014, 2018) and economic freedom (e.g., Bradley & Klein, 2016; Minniti, 2008; Minniti & Levesque, 2008; Sobel, 2008)—are essential for genuine entrepreneurial activities in both the developed and developing worlds. However, while the existing literature has studied extensively the significance of formal regulatory institutions in entrepreneurship, it has rarely examined the effect on entrepreneurship of formal political institutions, particularly, democratic ones (Audretsch & Moog, 2022; but see Farè et al., 2023 for exception). As Audretsch and Moog (2022, p. 385) put it, while democracy and entrepreneurship may be inextricably linked, “the links to democracy have not been a focal point of research in the field of entrepreneurship.”

This study aims to explore the role of democracy in entrepreneurial development, as well as how democracy moderates the role of kinship networks, particularly, in a developing or emerging economy setting by integrating new institutional economic theory on democracy with social network theory related to kinship networks. Our first purpose is to explore the role of democracy in entrepreneurial development in a developing or emerging economy. Recently, Farè et al. (2023) have examined the effect of democracy on entrepreneurship using country-level data of 23 OECD countries. Given their focus on developed economies, however, they have emphasized two mechanisms through which democracy fosters entrepreneurship: *knowledge creation and diffusion* and *institutional trust*. Our study complements their analysis by focusing on the developing or emerging economy setting, and, thus, also different mechanisms. Following recent new institutional economic view (e.g., Acemoglu & Robinson, 2012, 2016; Acemoglu et al., 2005, 2019), we believe that democratic institutions can play a significant role in entrepreneurial development, particularly, in a developing or emerging economy, which typically has weak formal regulatory institutions (Batjargal et al., 2013; Webb et al., 2020; Zhou, 2013, 2017), because such institutions can facilitate formal regulatory institutions that support entrepreneurship.

Recent studies suggest that kinship networks, a specific type of social networks pervasive in rural villages in most of the developing world, can facilitate social norms that protect private property rights and help entrepreneurs to access resources, and, thus, playing a significant role in entrepreneurial development across developing and emerging economies (Khayesi et al., 2014; Peng, 2004, 2005; Stewart, 2003; Verver & Koning, 2018; C. Zhang, 2020). However, it has long been noted that kinship networks have a number of dark sides that can hinder entrepreneurial development, for example, demands for conforming to the norm of sharing without reckoning and barring non-kin from access to resources and opportunities crucial for entrepreneurship (Stewart, 2003; Stewart & Hitt, 2010; Portes, 1998). Given such dark sides, and given that democracy can substitute for the roles of kinship networks, it can be argued that the net effect of kinship networks may decline and may even be negative under stronger democracy. Therefore, for another purpose, this study will examine whether and how variations in democratic governance influence the net effect of kinship networks on entrepreneurial development in a developing or emerging economy.

We set the study in the context of reform-era rural China. As the World’s largest emerging economy with a dynamic entrepreneurial sector (Lardy, 2014), China offers several important advantages for this study. First, while China remains an authoritarian state today, rural villages have experienced waves of democratization since 1980 and village committees in almost all villages were elected by all adult villagers by the early 2000s (Tsai, 2007a; Wang & Yao, 2007; Wong et al., 2017). Second, there have been large variations in

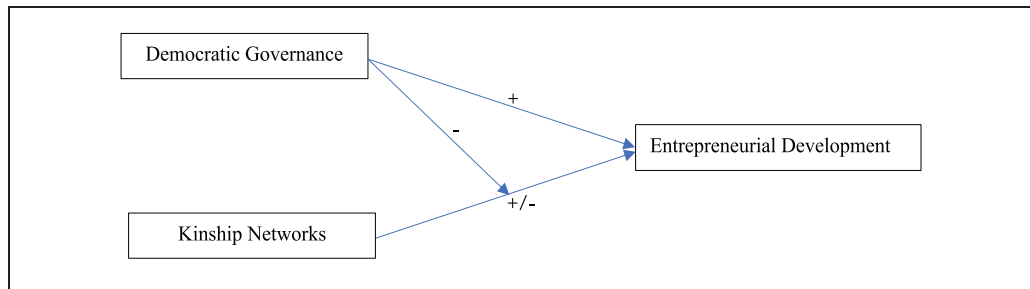


Figure 1. Democratic governance, kinship networks, and entrepreneurial development.

village-level democratic governance because of the flawed national law on village elections (Oi & Rozelle, 2000; Wong et al., 2017; X. Zhang et al., 2004) and varying degrees of intervention in village elections and governance from Party institutions and higher level governments (Tsai, 2007a; Wang & Yao, 2007). Third, as in many other developing or emerging economies, kinship networks have been found to play a significant role in China's recent entrepreneurial development (Peng, 2004, 2005; C. Zhang, 2020). Fourth, Chinese villages face the same political and economic institutions and are subject to similar social, political and economic shocks at provincial and national levels, making them better groups for comparison to each other than countries in cross-national studies.

We argue, first, that stronger local democratic governance can protect private property rights and provide quality public goods/services and economic resources, thus facilitating entrepreneurial development in rural villages. Second, we argue that democratic governance has a negative moderating effect on the role of kinship networks in entrepreneurial development because it not only substitutes for some of the roles of kinship networks (e.g., property rights protection and provision of some economic resources) but can also provide other types of benefits (e.g., providing public goods/services) to entrepreneurs that kinship networks cannot. In addition, we argue that, while kinship networks have a positive effect on entrepreneurial development when democratic governance is weak because their benefits for entrepreneurs are higher than their costs, their effect turns negative when democratic governance is strong, with lower benefits than costs. Figure 1 presents the paper's theoretical model. To test these arguments, we use a national sample of villages from the 2012 China Laborforce Dynamic Survey. To tackle the endogeneity problem, we use an instrumental variable approach with a two-stage least squares (2SLS) regression, in addition to the Ordinary Least Squares (OLS) regression. Results from both the OLS and 2SLS provide strong support to our hypotheses.

This paper makes two new theoretical contributions to the existing literature. First, it contributes to the literature on the relationship between institutions and entrepreneurship by proposing and empirically examining not only the main effect on entrepreneurship of democracy in a developing or emerging economy setting but also the moderating effects of democracy on the relationship between kinship networks and entrepreneurial development, thus expanding the explanatory power of democracy as a formal institution beyond its main effect on entrepreneurship. Second, for the kinship networks literature, while the previous empirical literature suggests that kinship networks still facilitate entrepreneurial development in the contemporary world, this study demonstrates that the net effect of kinship networks is lower under stronger democratic governance, and can be even negative under sufficiently strong democratic governance. These findings help establish new

boundary conditions for the role of kinship networks in entrepreneurial development. Besides, it makes an empirical contribution to the literature on China's entrepreneurship development. Given China's authoritarian regime, existing literature has emphasized the role of informal normative institutions or formal regulatory institutions in China's entrepreneurial development. This study suggests that the introduction of village-level democratization may also be one of the reasons to understanding China's rural entrepreneurial development.

Theory and Hypotheses

Democracy, Regulatory Institutions, and Entrepreneurship

Democracy means that a government affords voice and accountability to citizens on a regular basis (Keefer, 2004). Empirically, three indicators are often used for identifying whether a government has democratic governance: *free elections* (i.e., whether there are fair and free competitive elections), *participation* (i.e., whether political decisions of elected officials are transparent and constrained by citizens), and *responsiveness* (i.e., whether elected officials are responsive to the aggregated demands of citizens) (e.g., Acemoglu et al., 2019; Gulzar & Pasquale, 2017; Keefer, 2004; Papaioannou & Siourounis, 2008; X. Zhang et al., 2004).

There has been a long-lasting debate on the relationship between democracy and economic growth in both political science and economics (e.g., Acemoglu & Robinson, 2012; Acemoglu et al., 2019; Glaeser et al., 2004; Huntington, 1968; North, 1990; for recent reviews, see, e.g., Acemoglu et al., 2014; Doucouliagos & Ulubasoglu, 2008; Papaioannou & Siourounis, 2008). One camp emphasizes the inefficiencies of democratic institutions. Some researchers in this camp, such as Huntington (1968), argue that democratic institutions are vulnerable to popular demands at the expense of profitable investment. Others, particularly, public choice theorists, suggest that democratic governments are often surrounded by rent-seekers for directly unproductive profit-seeking behaviors (Buchanan & Tullock, 1962). Given such negative effects, researchers in this camp believe that authoritarian regimes with strong states may outperform democracies in economic growth because the former can partially avoid both of the above problems by neglecting populist demands and enforcing developmentalist policies with insulation from powerful interest groups (Barro, 1996; see, also, Doucouliagos & Ulubasoglu, 2008, for meta-analysis).

Another camp argues for the positive contributions of democracy to economic growth. Earlier scholars in this camp believe that modern democracy with universal suffrage can solve the credible commitment problem of the government (Olson, 1993) and gather and transmit information more efficiently (Sen, 1999). Following North's (1990) new institutional economic approach, recent researchers argue with evidence that modern democracy is the fundamental cause for the emergence of a set of inclusive regulatory institutions conducive to economic growth, for example, secure private property and a level playing field for all economic actors (e.g., Acemoglu & Robinson, 2012, 2016; Acemoglu et al., 2005, 2014, 2019). Given that such inclusive regulatory institutions are conducive not only to general economic growth but also to entrepreneurship, according to existing entrepreneurship literature, as noted above, it is believed here that democracy can facilitate entrepreneurship, particularly, in developing and emerging economies where formal regulatory institutions are generally weak.

Democratic Governance and Entrepreneurial Development in Rural China

To examine the notion of a positive effect of democracy on entrepreneurship in a developing or emerging economy, we take advantage of the empirical setting of the concurrent development of village-level democratic governance and entrepreneurship in reform-era rural China. Although China remains an authoritarian state today, it has introduced waves of democratization in all rural villages since 1980 (O'Brien & Li, 2000; Wang & Yao, 2007; Y. Xu & Yao, 2015). After China initiated rural reforms to redistribute village lands to farmers in the late 1970s, the production brigade—a form of village government under the People's Commune during the Mao era—fell apart. To address the social disorder resulting from the fall of the production brigade, villagers in a village in Guangxi province elected their own leaders by popular votes in 1980. This democratic experiment was soon supported by Mr. Peng Zhen—the then vice chairman of the National People's Congress (NPC)—who promoted village democratic elections in order to put village cadres under the supervision of villagers and to stabilize Chinese Communist Party (CCP) rule in rural areas. Therefore, China's 1982 Constitution introduced a new article on village committee (VC), which was defined as a self-governing body and should be elected by villagers. In 1987, the NPC passed the Organic Law of the Village Committees (OLVC) and introduced local elections to China's villages (Oi & Rozelle, 2000). The formal version of the OLVC was finally passed by the NPC in 1998 and, since then, village elections have spread quickly, so that village committees in almost all villages were elected by all adult villagers with democratic procedures by the early 2000s (Tsai, 2007a; Wang & Yao, 2007; Y. Xu & Yao, 2015).

However, local governance has continued to vary across villages with different degrees of democracy since then primarily because of both the OLVC and China's overall authoritarian institutional environment. First, while the OLVC requires the candidates for a VC to be nominated by all villagers (popular nomination or *haixuan*), it has provided limited details for either candidate nomination procedures or village electoral systems (Wong et al., 2017).² Thus, in practice, county and township governments have continued to maintain considerable influence over village elections by intervening in candidate nominations and determining who will be elected at least by the early 2010s (Oi & Rozelle, 2000; Wong et al., 2017; Y. Xu & Yao, 2015). As a result, villagers' voice for candidate nominations—the key element of *free elections*—varies across different villages largely because villages can adopt—and have adopted—different ways for candidate nomination, for example, popular nomination, nomination by villager representatives, and appointment by higher level township or county governments (Wang & Yao, 2007).

Second, although villages in China have been granted self-governing status since 1982, the CCP, as well as higher level governments, can intrude not only in village elections but other aspects of village governance because China is still a one-party authoritarian state. In particular, the village government in China is formally composed of not only the elected village committee but the unelected village Party branch (Tsai, 2007a); and the OLVC stipulates that the VC works under the leadership of the village Party branch committee (Wang & Yao, 2007). To reconcile conflicts between the two committees, the Chinese government has encouraged village officials to hold concurrent positions in both organizations, and, thus, higher level Party institutions potentially have a direct influence on not only the village Party branch but also the elected VC (Tsai, 2007a). As a result, while both *participation* and *responsiveness* increased dramatically across Chinese villages in the 2000s and early 2010s, they still varied widely across villages (Luo et al., 2010; Oi & Rozelle, 2000; Tsai, 2007a; Wang & Yao, 2007; Wong et al., 2017; Y. Xu & Yao, 2015; X. Zhang et al., 2004).

Following the new institutional economic view discussed above, it is argued here that those villages with higher degrees of democratic governance should have higher levels of private entrepreneurship. This is because democratic governance can facilitate a regulatory environment that provides secure private property, quality public goods and services, and economic resources to entrepreneurs.

Secure Private Property. New institutional economic theory suggests two mechanisms through which democracy facilitates secure property rights (Acemoglu et al., 2005). First, democracy limits rents that power holders can extract from the rest of society and places checks on those who hold political power, thus making bureaucratic expropriation less possible. Second, it allows political power to be held in the hands of a relatively broad group, thus facilitating the emergence of inclusive regulatory institutions (e.g., protection of private property rights). In China, the idea of respecting private property rights has taken time to sink in because of both a long period with a command economy (Peng, 2005) and a re-emphasis on the state-owned sector (“state advances and private retreats”) in the past two decades (Lardy, 2014; Zhou, 2018). Consistent with new institutional economic theory, however, empirical research suggests that introducing democratic governance into China’s villages has pressed the VC to abolish some insensible methods for collecting state taxes, levies and fees (Wang & Yao, 2007), and can significantly reduce levies and fees that villages have charged local farmers and enterprises (X. Zhang et al., 2004). There is also evidence showing that elected village leaders are very supportive to village businesses by protecting them from encroachment by local officials and citizens in order to raise more funds for public goods/services, and thus, to be re-elected (Luo et al., 2010; Wang & Yao, 2007).

Quality Public Goods and Services. According to the new institutional economic literature, compared to non-democratic governments, elected democratic governments are more responsive to the demands of the people and invest more in broad-based public goods (Acemoglu & Robinson, 2016, 2019; Doucouliagos & Ulubasoglu, 2008). In rural China, while public goods/services are generally underproduced, village elections have greatly increased provision of public goods and improved the quality of public services for local people (Luo et al., 2010; Tsai, 2002, 2007a; Wang & Yao, 2007; Wong et al., 2017; X. Zhang et al., 2004). One particularly important public good is village roads, including both those within villages and those between the village and the external world (e.g., a road connecting the village with a national highway), which are crucial for both villagers and village enterprises. While higher level governments sometimes provide part of the funding, villages are usually fully or at least partly responsible for road projects (Wang & Yao, 2007). Prior research suggests that, in villages with free and fair elections and effective political participation and monitoring by villagers, villagers and village enterprises are more willing to contribute money to public projects such as road building (Tsai, 2002, 2007a), and village leaders spend more on public projects such as building higher quality village roads (Luo et al., 2010; Wang & Yao, 2007; Wong et al., 2017; X. Zhang et al., 2004).

Economic Resources. The new institutional economic literature suggests that elected leaders are generally more supportive to businesses by providing not only secure property rights but also a level playing field for all businesses in order to facilitate economic growth (Acemoglu et al., 2005, 2014, 2019). In rural China, it is noted that there exists unlevel

playing field between village-owned and privately-owned firms and, thus, economic resources such as land, factory buildings/storefronts, and capital are particularly scarce for private entrepreneurial firms (Peng, 2004, 2005; C. Zhang, 2020; Zhou, 2013, 2017). Yet, evidence suggests that, in villages with free elections VCs often invest village funds in new factory buildings or storefronts and then rent these out to private businesses, which usually have difficulties in constructing such buildings or storefronts themselves because of both lack of resources and lengthy bureaucratic procedures (Tsai, 2002; 2007a). In addition, quite many VCs have even provided capital to private businesses, although such fundings are sometimes channelled to pet projects and pork barrels for village leaders (Wang & Yao, 2007).

Given that democratic governance can facilitate secure private property and provide quality public goods/services and economic resources to entrepreneurs as reasoned above, we have the following hypothesis:

Hypothesis 1. Villages with higher degrees of democratic governance would have higher levels of private entrepreneurship.

Democratic Governance and the Role of Kinship Networks

In explaining the development of rural entrepreneurship under an overall less business-friendly national regulatory environment in a developing or emerging economy such as China, the existing literature focuses on the role of kinship networks, which have been and are still a prominent feature of village life in both China (e.g., Peng, 2004, 2005; C. Zhang, 2020) and many developing countries (e.g., Khayesi et al., 2014; Stewart, 2003; Stewart & Hitt, 2010; Verver & Koning, 2018). A kinship network, sometimes called a lineage network or clan, means a network of genealogical relationships based on demonstrated descent from a common ancestor (Watson, 1982). According to this literature, given the strong solidarity, reciprocity, and enforceable trust between kin, kinship networks can bring the following social capital benefits to entrepreneurs.

First, they can facilitate access to economic resources (e.g., capital) for startup firms (Khayesi et al., 2014; Stewart, 2003; Stewart & Hitt, 2010; Verver & Koning, 2018). This is particularly so in China, which has long emphasized mutual assistance among *guanxi* relations, especially, kinship relations due to the Confucian culture, which has been preserved today (Burt and Batjargal, 2019; C. Chen et al., 2013; Peng, 2004, 2005). It is noted that Chinese entrepreneurs rely heavily on kin, as well as friends, for pooling capital, recruiting labor, and collecting business information in both pre-modern and contemporary China (Z. Chen et al., 2022; Peng, 2004, 2005). Second, in countries such as China with ineffective property rights law, kinship networks can provide informal protection of property rights by sheltering entrepreneurs from both predatory government officials and the grabbing hands of local governments because intrinsic kin solidarity enables the kinship network to organize collective sanction to keep the latter at bay (Peng, 2004, 2005; C. Zhang, 2020; T. Zhang & Zhao, 2014). Third, there is also evidence that, in villages wherein formal democratic institutions of accountability are weak and the collective action problem is severe as in some parts of China, kinship networks can make village leaders subject to unofficial rules and norms that establish and enforce their public obligations (Tsai, 2007a, 2007b), and can also help village leaders overcome the collective action problem of financing public goods (Y. Xu & Yao, 2015), thus facilitating provision of public goods/services, which can benefit entrepreneurs.

However, despite the above benefits, kinship networks have dark sides for entrepreneurs. One most noted dark side is demands for conforming to the norm of “sharing without reckoning” (Portes, 1998; see, also, Khayesi et al., 2014; Stewart, 2003). Under this norm, entrepreneurs are expected to maximize the overall welfare of the whole clan by supporting the common causes of the clan and the extended families; and failing to do so could cause entrepreneurs to lose reputation, social status and legitimacy within and even beyond the kinship networks (Khayesi et al., 2014; Stewart, 2003). Contemporary rural China is no exception as the Confucian tradition emphasizes clans as prominent welfare organizations (Li, 2018; Peng, 2004, 2005). As a result, entrepreneurs in rural China are expected to contribute significantly to costly lineage projects such as maintaining the lineage hall and lineage genealogy, provide for the financial expenses of the lineage and local events (Tsai, 2007b; C. Zhang, 2020; T. Zhang & Zhao, 2014), hire kin in their own firms (Oi, 1999; Y. Xu & Yao, 2015), and provide financial support to poor relations (Li, 2018).

This norm can create at least two negative consequences for entrepreneurs. First, by diverting resources from entrepreneurial investment to supporting the common causes of the clan and the extending family, it may prevent the success of entrepreneurial initiatives (Portes, 1998). Second, this norm leads to nepotism in the firm. When entrepreneurs hire kin in their own firms, the link between performance and rewards may be breached and it may be difficult to dismiss those kin who are incompetent (Oi, 1999; Stewart, 2003; Y. Xu & Yao, 2015). Given such consequences, some entrepreneurs, particularly those who are young and more independent-minded, may leave their villages, along with their enterprises (Li, 2018; Portes, 1998).

In addition, the same kin solidarity that brings benefits to kinship members can also bar non-kin from access. As with other closed networks such as ethnic groups (Portes, 1998), social capital benefits can only be extended to members within kinship networks (Stewart, 2003; Stewart & Hitt, 2010). In rural China, clans are found to provide economic resources and informal protection of property rights to entrepreneurs from the same clan only (Peng, 2004, 2005; T. Zhang & Zhao, 2014). Even for public goods/services, it is found that clans tend to contribute only to those public goods or services that directly benefit themselves only, particularly in villages with multiple clans (Tsai, 2007b). Such exclusion of non-kin from access can hinder entrepreneurs who either come from outside a village or do not belong to the large clans in the same village from business founding in the village.

Given both the benefits and dark sides, it is argued here that the effect on entrepreneurship of kinship networks could be inconclusive, depending on the formal institutional environment, particularly, democratic governance. If democratic governance is weak in the village and, thus, private property rights are not secure, public goods/services are underdeveloped, and there is a shortage of public supply of economic resources, kinship networks may facilitate entrepreneurial development because their benefits are substantial for entrepreneurs, who can, therefore, endure their dark sides. Indeed, this positive effect of kinship networks is supported by existing research, which has used data from an earlier period of China’s economic reforms when the overall regulatory environment was weak (e.g., Peng, 2004, 2005; C. Zhang, 2020).

However, the effect of kinship networks may be lower in villages where democratic governance is stronger. This is because stronger democratic governance can substitute for most of the key roles played by kinship networks, although kinship networks may continue to provide some benefits, particularly access to economic resources such as capital, to entrepreneurs (Stewart, 2003; Stewart & Hitt, 2010). Compared to kinship networks, democratic governance can protect private property rights more effectively, supply public goods and

services not selectively but universally for all entrepreneurs and villagers, and may even provide some key economic resources that cannot be provided by kinship networks, for example, land and factory buildings/storefronts, as seen in China.

It is argued, further, that the net effect of kinship networks may even turn negative in villages where democratic governance is sufficiently strong for two reasons. First, most of the key benefits of kinship networks—except for access to a few economic resources, particularly, capital—would have disappeared under sufficiently strong democratic governance because infringement of private property rights will not be an issue, public goods and services will be provided universally, and key resources such as land and even capital will be at least partially available. Second, the dark sides of kinship networks, particular, the norm of “sharing without reckoning” will not vanish easily because informal norms are impervious to deliberate designing and take time to change (North, 1990). Indeed, it has been noted that the norm of “sharing without reckoning” has continued to be effective in many rural areas in contemporary developing and emerging economies (Portes, 1998; Stewart, 2003), including China (Li, 2018). As a result, the negative consequences or costs of this norm as mentioned previously would continue to exist under strong democratic governance. Based on both reasons, it can be argued that kinship networks may bring less benefits than costs, and, thus, their net effect on entrepreneurial development may be negative under sufficiently strong democratic governance.

Given the reasoning above, we hypothesize the following:

Hypothesis 2.1. Democratic governance will have a negative moderating effect on the role of kinship networks in entrepreneurial development. That is, while kinship networks have a positive effect on entrepreneurial development under weak democratic governance, their effect will be lower under stronger democratic governance.

Hypothesis 2.2. When democratic governance becomes sufficiently strong, the effect of kinship networks will turn from positive to negative.

Data and Methods

Data and Sample

The empirical test uses a national sample of villages from the China Laborforce Dynamic Survey (CLDS) conducted in 2012 when local governance still varied widely across villages with different degrees of democracy. The 2012 CLDS was designed and administered by the Social Science Survey Center of Sun Yat-sen University in China. The survey aimed to understand the job-related information of all working adults in 29 provinces—all Chinese provinces except Tibet and Qinghai—and includes both an urban sample and a rural sample. We use only the rural sample, given our interest in understanding rural entrepreneurship. In addition, for the rural sample, we use only the village level data, not the individual level data, because the latter includes very few entrepreneurs—averaging less than one per village, making meaningful statistical analysis impossible, while the village level survey reports all detailed information on the level of entrepreneurship in a village, as well as other key variables for this study. It is noted that previous studies on China’s rural entrepreneurship have also used village level data only (e.g., Peng, 2004, 2005).

Using a stratified sampling method, the rural sample includes a national sample of 174 administrative villages from the 29 provinces. Since at least as early as 1998, an administrative village has been defined as a self-governing rural organization governed by an elected VC and typically includes both (1) several natural villages, which are tight-knit

communities formed in early historical periods and are often lineage-based, and (2) several village groups, which were formed for administrative purposes and previously called small production brigades under Mao's people's commune system and still carry some administrative functions under the leadership of the VC (Dang, 2008; Tsai, 2007a; Wang & Yao, 2007). The sampling of administrative villages in the survey involved three stages (Cai, 2013). In the first, a pre-specified number of counties were selected in each of the 29 provinces with more counties being selected from provinces with a larger population. In the second stage, a pre-specified number of rural towns were selected in each county based on economic development levels. Finally, a pre-specified number of administrative villages were selected in each town, again, based on economic development levels. After the sample was collected, questions were asked face-to-face with VC members who have detailed knowledge about the village, as well as villager representatives, to collect detailed information.

Dependent and Independent Variables

Following Peng (2004, 2005), *number of private enterprises*—the dependent variable—is the number of rural private enterprises by the end of 2011. This measure includes both domestic private enterprises (*siying qiye*) founded by villagers and private enterprises that were founded by overseas Chinese who had lineage roots in the village and were identified as Hong Kong-Macau-Taiwan firms in the CLDS. Our field research in multiple provinces suggests that rural private enterprises in China's villages are mostly small and medium enterprises (SMEs) owned by individuals who are from a single household or multiple households in the village. However, some rural private enterprises, particularly in southern China, are founded by overseas Chinese—mostly from Hong Kong, Macau, and Taiwan—who have their lineage roots in the village (Fan, 2006).

Democratic governance is the independent variable in Hypothesis 1, as well as the moderating variable in Hypotheses 2.1 and 2.2. We use the average of three widely-adopted indicators as mentioned previously for measuring this variable: *free elections*, *participation*, and *responsiveness*. In terms of *free elections*, villages in the CLDS varied in having four forms of candidate nomination in the 2000s and early 2010s: popular nomination, self-nomination or nomination by villager representatives, appointment by the village Party branch, and appointment by higher level governments. According to Wang and Yao (2007), popular nomination is the most free and open form, followed by self-nominating or nomination by villager representatives, and then appointment by the village Party branch, with appointment by higher level governments being the most closed and least free form. To be consistent with the 5-point scale used in the other indicators, therefore, popular nomination is coded 5, self-nomination or nomination by villager representatives 4, appointment by the village Party branch 2, and appointment by higher level governments 1, with higher numbers indicating more open and free elections.

Participation refers to whether political decisions of elected officials are transparent and constrained by citizens (Keefer, 2004; X. Zhang et al., 2004). Using a 5-point scale, the CLDS asked two questions to measure the degree of villagers' participation in village governance in the 2000s and early 2010s: the frequency with which the VC released information on village finance to all villagers for discussions and suggestions, and the frequency with which the VC released information on village affairs to all villagers for discussions and suggestions. We code rarely released 1, once a year 2, once a quarter 3, once a month

4, and two or more times a month 5 for both measures, so that a larger number indicates higher participation by villagers in village decisions.

Responsiveness refers to whether elected officials are responsive to the aggregated demands of citizens (Keefer, 2004; Wang & Yao, 2007). It can be measured with two ways (Bovaird & Loffler, 2003). Existing research on China's village governance measures it using the quantity and/or quality of public goods/services provided by the VC (e.g., Wang & Yao, 2007; Wong et al., 2017; X. Zhang et al., 2004). Such information, however, is not fully available in the CLDS, which asked about only the three largest expenses but not all public goods and services in each village. Another method is to measure the success of government responsiveness in terms of quality of life changes in the village, rather than quantity and quality of activities, themselves (Bovaird & Loffler, 2003). In terms of quality of life changes brought about by public goods/services provided by a VC in our case, previous research suggests that a VC's provision of more and higher quality public goods/services leads to more harmonious and trusting relationships between the VC and villagers (Luo et al., 2010; Wang & Yao, 2007; Wong et al., 2017; X. Zhang et al., 2004). Therefore, we measure responsiveness with the relationship between VC and villagers, which was asked in the CLDS using a 5-point scale ranging from very strained/untrusting to very harmonious/trusting. We code very strained/untrusting 1 and very harmonious/trusting 5 with higher number indicating a more harmonious/trusting relationship. Additional tests suggest that this measure has a highly positive correlation with public expenses in public goods such as improving village schools and village roads. By taking averages of the measures of the three indicators, we get *democratic governance*, which ranges from 2 to 4.75.

Following Peng (2004, 2005, 2010), we use three measures to indicate the strength of *kinship networks*—the independent variable in hypotheses 2.1 and 2.2. *Percentage of largest lineage group* is the proportion of households that belong to the largest lineage group in a village. Many villages, however, have multiple lineage groups, which may be all powerful. Therefore, *percentage of top three lineage groups* is the proportion of households that belong to the three largest lineage groups in the village. On average, 45% of households belongs to the largest lineage group and 71% the top three groups. Finally, the kinship homogeneity index is constructed as $H = \sum P_i^2$, where P_i stands for the proportion of households belonging to the i th lineage group. The CLDS collects information for up to three lineage groups because most villages have less than four large lineage groups. If all households in a village belong to a single lineage, then, $H = 1$; if the households are equally divided among three lineages, then $H = 0.33^2 + 0.33^2 + 0.33^2 = 0.33$; if there are no clans, then $H = \sum (1/T^2)$, where T stands for the total number of households (Peng, 2010). Therefore, high H indicates dominance by a single lineage, low H the absence of lineage groups, and medium H a coexistence of multiple lineages. As such, this index may be a more comprehensive measure than the other two. It has a mean of 0.32 with a standard deviation of 0.28.

In accordance with the existing literature (Podsakoff et al., 2003), this study has adopted several measures to mitigate common method variance (CMV) biases. First, as seen above, different levels of measurement were used for the dependent variable and independent variables to reduce CMV biases. Second, the measurements of the dependent and independent variables came from different modules of the questionnaire. Third, this study has introduced a complicated theoretical model with moderating effects, which helps reduce CMV biases, as “respondents are unlikely to be guided by a cognitive map that includes difficult-to-visualize interaction and non-linear effects” (Chang et al., 2010, p. 179).

Control Variables

Following existing literature, we control for the following variables. *Distance from city* is measured as the distance between the village and the nearest city. Previous studies suggest that this variable has a negative effect on rural entrepreneurial development because proximity to cities is related to entrepreneurial opportunities and resources (Peng, 2004, 2005). *Collective revenue* is measured as the total revenue a village received from its village-owned collective enterprises. This variable controls the size of the collective economy in the village, which may have a positive effect on private entrepreneurial development because of synergies between collective and private enterprises. It also has a positive correlation with democratic governance because villagers are more likely to participate in elections and monitor the VC since stakes are high in villages with higher collective income (Oi & Rozelle, 2000; Wang & Yao, 2007). *Land-labor ratio* is measured as the total amount of farmland divided by the total labor force. It is an inverse measure of a village's surplus labor. Given that more surplus labor may have a positive effect on entrepreneurship, a higher land-labor ratio may be negatively correlated with entrepreneurial development (Peng, 2004, 2005). For the above three variables, their logarithmic form is used for their skewed distribution.

Number of labor force is the number of all laborers between 15 and 64 years old who are registered residents in the village. This variable may have a positive effect on rural entrepreneurship (Peng, 2005) and may also be negatively correlated with democratic governance because it may make public decisions more difficult (Wang & Yao, 2007). To facilitate interpretation, we divide this variable by 1000. *Average education*, which is created from the individual level survey, is the average years of schooling for the surveyed adult labor force in the village. It measures a village's human capital stock, which is found to have a positive effect on regional entrepreneurship (Peng, 2004; Zhou, 2018) and may also be positively correlated with democratic governance in a village (Acemoglu et al., 2014). We also control for whether the topography of the village is *flatland*, *hilly land*, or *mountainous land*. Anecdotal evidence suggests that villagers living in mountainous areas rather than flat and hilly areas, in general, not only are more constrained in terms of entrepreneurial opportunities because of less access to market information and economic resources but have less demand for democracy (Yu & Xu, 2004).

Following Peng (2005), and given our relatively small sample size and, thus, less degrees of freedom, we do not control for all 29 province fixed effects in the regressions but control for *Eastern region* (i.e., nine provinces located in Eastern China), *Central region* (i.e., twelve provinces located in Central China), and *Western region* (i.e., eight provinces located in Western China). These three regions have different levels of economic, legal, market, and infrastructure development, which can affect both entrepreneurship and democratic governance in rural areas (C. Xu, 2011). Finally, *percentage of ethnic minorities* is the proportion of households that belong to ethnic minorities—that is, not Han Chinese, the dominant ethnic group in China—in the village. Villages with higher percentages of ethnic minorities are generally located in poor regions within each province/county and thus have fewer entrepreneurial opportunities. Also, although kinship networks are important for virtually all ethnic groups, lineage culture is relatively weaker among some ethnic minority groups than among Han Chinese (Peng, 2005; C. Zhang, 2020). It should be noted that, following existing studies on rural entrepreneurial development in Chinese villages (e.g., Peng, 2004, 2005), we control for only largely exogenous variables but avoid including endogenous variables such as local economic development level in the village, which are partly results of entrepreneurial development. To include such endogenous variables would be what Angrist and Pischke (2008, p. 64) refer to as “bad control,” although

additional tests suggest that including such variables would not affect our results reported below.

Model Specification

We first adopt OLS to test our hypotheses, as done in existing research (e.g., Peng, 2004, 2005). As a second step, we employ an instrumental approach using the two-stage least squares (2SLS) regression to verify the robustness of our OLS results. Our dependent variable—*number of private enterprises*—is a count variable with a mean of 11.67 and a large standard deviation of 42.17. Long (1997) suggested that, for a count variable with a relatively large mean and standard deviation, as in this case, the log-linear model provides results similar to the Negative Binomial model, which is a standard estimation strategy when the dependent variable is an overly-dispersed count one. Therefore, we report OLS results based on the log-linear model with the Negative Binomial model used for robustness tests. A general representation of the OLS models that we estimate is shown in the following equation:

$$\ln Y_i = \alpha_1 + \gamma'_1 D_i + \theta'_1 K_i + \beta'_1 X_i + \epsilon_{1i} \quad (1)$$

for $i = 1, \dots, n$ villages. In the above equation, $\ln Y_i$ is the logarithmic form of the number of private enterprises (a small positive number was used to replace zero for logarithmic transformation); α_1 is the intercept; γ'_1 is the effect of democratic governance, because D_i denotes democratic governance; θ'_1 is the effect of kinship networks, because K_i denotes a measure of kinship networks; β'_1 is a vector of all other village-level effects, because X_i is a vector of control variables; and ϵ_{1i} is the random error term.

However, given the cross-sectional data, the endogeneity issue is a clear threat to the validity of the OLS results from Equation 1. First, democratic governance is less observable and is measured with indices, thus giving rise to the potential problem of measurement errors. Second, some unmeasured but relevant control variables may have been omitted from the regressions. Third, while our measures for kinship networks are relatively stable over the reform period and, thus, affected little by entrepreneurial development (Peng, 2004, 2005), there may be a simultaneous relationship between democratic governance and the number of private enterprises (Barro, 1996; Doucouliagos & Ulubasoglu, 2008; Wang & Yao, 2007).

Given that democratic governance (D_i) is potentially endogenous, therefore, we also test the hypotheses by employing an instrumental variable approach using 2SLS (Angrist and Pischke, 2008; see, also, Acemoglu et al., 2001, 2014). The second stage of the 2SLS regression is the same as in Equation 1. The first stage regresses D_i on a set of instruments, as shown below:

$$D_i = \alpha_2 + \gamma'_2 C_i + \theta'_2 K_i + \beta'_2 X_i + \epsilon_{2i} \quad (2)$$

for $i = 1, \dots, n$ villages. In Equation 2, D_i denotes democratic governance; γ'_2 is a vector of the effects of instruments, because C_i is a vector of instruments. All other notations are similar to Equation 1.

We use three instruments for D_i . The first is *total area* of the village. While regional area size is usually considered to have no effect on economic development (Alesina & Spolaore, 2005), previous research suggests that a larger village area size may reduce a VC's accountability because of higher probability of elite capture of land resources in such a village

(Hoff & Stiglitz, 2004; Wang & Yao, 2007). The other two instruments are *number of natural villages* and *number of village groups*. Above, we have mentioned that a typical administrative village includes both (1) several natural villages, which are tight-knit communities and often kinship-based, and (2) several village groups formed for administrative purposes and still carrying some administrative functions. While the number of both natural villages and village groups should have no direct effect on entrepreneurial development after controlling for kinship networks and village labor force size, it has been found that representation in village councils has been apportioned to natural villages and village groups (Tsai, 2007a). Since a VC should report to a village assembly (VA), which includes several village councils according to the OLVC (Wang & Yao, 2007; Wong et al., 2017), the number of both natural villages and village groups should have an effect on village governance, although the relationships between the two numbers on the one hand and democratic governance on the other are yet to be determined empirically.

Regression Results

Table 1 presents descriptive statistics and pairwise correlations among study variables. It is noted that *number of private enterprises* has a mean of 11.67 with a standard deviation of 42.17. This variable ranges from 0 to 300 with sixty percent of the sample villages being reported to have no private enterprises. Further analysis suggests that, compared to those with at least one private enterprises, villages without private enterprises have significantly weaker democratic governance, stronger kinship networks, higher land-labor ratio, and lower levels of labor force and education; they are also located more distant from cities and more likely in Central or Western mountainous regions with higher percentage of ethnic minorities. Such results are consistent with our hypothesis that there exists positive association between democratic governance and entrepreneurship, as well as with the existing research (e.g., Peng, 2004, 2005). For correlations among all covariates, no extremely large correlation coefficients are detected. Additional tests suggest that no significant evidence of multicollinearity is found, as the largest VIF (1.64) is smaller than 10 and the mean of all VIFs (1.31) is not considerably larger than 1 (Chatterjee & Hadi, 2006).

OLS Results

Table 2 presents OLS results based on Equation 1 for testing Hypothesis 1, which argues that villages with higher degrees of democratic governance will have higher levels of private entrepreneurship. The three models have the same specifications except that each uses a different measure of kinship networks. It is shown that the coefficients of all three measures of kinship networks are not statistically significant and even negative, suggesting that the *average* effect of kinship networks is, indeed, inconclusive, possibly because kinship networks have both benefits and dark sides as noted above. Yet, the coefficient of *democratic governance* is positive and statistically significant in all three models, suggesting that a higher degree of democratic governance is positively associated with entrepreneurial development in a village. Substantively, a one unit increase in democratic governance can increase the number of private enterprises by 74.4 % ($e^{.556} - 1$). This large effect results from both the large dispersion of *number of private enterprises* (0 to 300) and the small range of *democratic governance* (2 to 4.75). To see the effect more clearly, controlling for all other variables, a village with a democratic governance index of 4.75 (the maximum in the data)

Table 1. Descriptive Statistics and Pairwise Correlation Matrix.

Variables	Mean	SD	N	1	2	3	4	5	6	7
1. No. of private enterprises	11.67	42.17	172	1.00	—	—	—	—	—	—
2. Democratic governance	3.83	0.47	173	.07	1.00	—	—	—	—	—
3. Kinship homogeneity index	0.32	0.28	161	-.02	-.05	1.00	—	—	—	—
4. % of largest lineage group	0.45	0.26	162	.02	-.03	.98	1.00	—	—	—
5. % of top three lineage groups	0.71	0.25	162	-.01	-.04	.82	.85	1.00	—	—
6. Distance from city (km)	24.94	20.82	173	-.17	-.03	.03	.07	.01	1.00	—
7. Collective revenue (10,000)	130.42	762.54	174	.08	-.02	-.12	-.12	-.16	-.06	1.00
8. Land-labor ratio (mu)	1.39	1.59	170	-.15	.03	.02	.03	.15	.09	-.10
9. No. of labor force (1,000)	1.66	1.55	165	.23	.05	-.22	-.20	-.20	-.14	-.01
10. Average education	8.39	0.72	174	.29	.03	-.13	-.14	-.22	-.20	.26
11. Hilly land ^a	0.24	0.43	173	.03	-.01	.06	.04	.06	.02	-.08
12. Mountainous land ^a	0.25	0.44	173	-.13	-.08	-.06	-.04	-.03	.35	.01
13. Western region ^b	0.31	0.46	174	-.12	.03	-.11	-.10	-.06	.15	-.10
14. Central region ^b	0.28	0.45	174	-.07	-.14	-.05	-.03	.08	.02	.03
15. % of ethnic minorities	0.14	0.31	173	-.11	.10	-.11	-.10	-.00	.14	-.06
16. Total area (km ²)	12.55	63.23	160	-.03	-.10	.06	.08	.08	.05	-.02
17. No. of natural villages	5.32	5.69	170	-.02	-.05	-.21	-.20	-.15	.24	.00
18. No. of village groups	10.59	7.92	168	.09	.13	-.24	-.23	-.23	-.02	-.08
Variables	8	9	10	11	12	13	14	15	16	17
8. Land-labor ratio (mu)	1.00	—	—	—	—	—	—	—	—	—
9. No. of labor force (1,000)	-.19	1.00	—	—	—	—	—	—	—	—
10. Average education	-.16	-.01	1.00	—	—	—	—	—	—	—
11. Hilly land ^a	-.04	.16	-.19	1.00	—	—	—	—	—	—
12. Mountainous land ^a	-.02	-.10	-.12	-.33	1.00	—	—	—	—	—
13. Western region ^b	.02	-.03	-.12	-.06	.33	1.00	—	—	—	—
14. Central region ^b	.24	-.13	-.18	-.05	.02	-.41	1.00	—	—	—
15. % of ethnic minorities	-.01	-.04	-.24	-.11	.38	.47	-.12	1.00	—	—
16. Total area (km ²)	.27	-.04	.07	-.04	-.00	-.03	.13	-.02	1.00	—
17. No. of natural villages	.06	.14	-.17	.21	.03	.02	.12	-.02	-.04	1.00
18. No. of village groups	-.08	.39	-.08	.12	.02	-.09	.10	-.13	-.07	.48

Note. Correlations with an absolute value exceeding .20 are significant at $p = .01$, correlations exceeding .15 are significant at $p = .05$, and correlations exceeding .13 are significant at $p = .1$.

^aThe reference category is flat land.

^bThe reference category is eastern region.

Table 2. OLS Estimates for the Effect of Democratic Governance on Entrepreneurial Development.

Variables	Log (No. of private enterprises)	Log (No. of private enterprises)	Log (No. of private enterprises)
Kinship homogeneity index	-0.220 (0.304)	—	—
% of largest lineage group	—	-0.005 (0.344)	—
% of top three lineage groups	—	—	-0.116 (0.372)
Democratic governance	0.553* (0.284)	0.556* (0.281)	0.556* (0.283)
Distance from city (logged)	-0.073 (0.139)	-0.076 (0.142)	-0.075 (0.141)
Collective revenue (logged)	0.005 (0.007)	0.005 (0.008)	0.005 (0.008)
Land-labor ratio (logged)	-0.053 (0.045)	-0.051 (0.044)	-0.051 (0.044)
No. of labor force	0.232*** (0.090)	0.242*** (0.091)	0.238*** (0.088)
Average education	0.685*** (0.239)	0.701*** (0.244)	0.694*** (0.247)
Hilly land ^a	0.073 (0.305)	0.068 (0.303)	0.070 (0.304)
Mountainous land ^a	-0.211 (0.363)	-0.209 (0.368)	-0.212 (0.363)
Western region ^b	-0.227 (0.334)	-0.203 (0.332)	-0.208 (0.332)
Central region ^b	-0.643* (0.369)	-0.610 (0.367)	-0.613 (0.364)
% of ethnic minorities	-0.292 (0.291)	-0.271 (0.301)	-0.272 (0.301)
Constant	-7.203*** (1.733)	-7.445*** (1.760)	-7.296*** (1.835)
Observations	152	152	152
R-squared	0.296	0.295	0.295

Note. Robust standard errors adjusted for clusters in provinces in parentheses.

^aThe reference category is flat land.

^bThe reference category is eastern region.

*** $p < .01$. ** $p < .05$. * $p < .1$.

would have 2.046 times more private enterprises than one with the index of 2 (the minimum in the data). Thus, Hypothesis 1 is strongly supported.

Table 3 reports results for testing hypotheses 2.1 and 2.2 by adding an interaction between *democratic governance* and a measure of kinship networks into each of the models in Table 2. Hypothesis 2.1 argues that, while kinship networks have a positive effect on entrepreneurial development under weak democratic governance, their effect will be lower under stronger democratic governance. Hypothesis 2.2 argues further that the effect of kinship networks will turn from positive to negative where democratic governance is sufficiently strong. This table shows that, while the coefficient of each measure of kinship networks (i.e., its effect when *democratic governance* = 0) is significantly positive, that of the interaction variable is negative and statistically significant in all models, suggesting that the effect of kinship networks indeed declines with higher level of democratic governance. Further calculation based on the results from Table 3 suggests that, in Model 1, *kinship homogeneity index* would have a declining positive effect on $\ln(\text{number of private enterprises})$ when *democratic governance* increases to 3.647 ($= 5.685/1.559$), but the effect turns negative and declines further after *democratic governance* is above 3.647. The pattern is the same for the other two measures of kinship networks. In Model 2, the effect of *percentage of largest lineage group* changes from positive to negative when *democratic governance* is above 3.794 ($= 6.837/1.802$). In Model 3, the effect of *percentage of top three lineage groups* changes from positive to negative when *democratic governance* is above 3.752 ($= 7.534/2.008$). Such results provide strong support for both hypotheses 2.1 and 2.2.

To see the pattern more clearly, we have calculated the net effect of each measure of kinship networks on $\ln(\text{number of private enterprises})$ at two levels of *democratic governance*:

Table 3. OLS Estimates for the Moderating Effect of Democratic Governance.

Variables	Log (No. of private enterprises)	Log (No. of private enterprises)	Log (No. of private enterprises)
Kinship homogeneity index	5.685*** (1.880)		
×Democratic governance	−1.559*** (0.461)		
% of largest lineage group		6.837** (2.466)	
×Democratic governance		−1.802*** (0.604)	
% of top three lineage groups			7.534** (3.416)
×Democratic governance			−2.008** (0.852)
Democratic governance	1.084*** (0.336)	1.388*** (0.403)	1.949*** (0.685)
Distance from city (logged)	−0.064 (0.139)	−0.070 (0.139)	−0.062 (0.134)
Collective revenue (logged)	0.008 (0.007)	0.008 (0.007)	0.007 (0.007)
Land-labor ratio (logged)	−0.054 (0.045)	−0.054 (0.044)	−0.056 (0.045)
No. of labor force	0.244** (0.088)	0.257*** (0.088)	0.247*** (0.085)
Average education	0.667** (0.246)	0.679** (0.251)	0.692** (0.254)
Hilly land ^a	0.055 (0.288)	0.042 (0.284)	−0.014 (0.303)
Mountainous land ^a	−0.276 (0.369)	−0.283 (0.372)	−0.310 (0.369)
Western region ^b	−0.194 (0.324)	−0.170 (0.321)	−0.158 (0.329)
Central region ^b	−0.563 (0.369)	−0.528 (0.372)	−0.556 (0.373)
% of ethnic minorities	−0.239 (0.280)	−0.185 (0.288)	−0.152 (0.301)
Constant	−9.097*** (1.903)	−10.444*** (2.240)	−12.602*** (3.252)
Observations	152	152	152
R-squared	0.311	0.314	0.316

Note. Robust standard errors adjusted for clusters in provinces in parentheses.

^aThe reference category is flat land.

^bThe reference category is eastern region.

*** $p < .01$, ** $p < .05$, * $p < .1$.

3.362 (one standard deviation below the mean, which is below the above three thresholds) and 4.296 (one standard deviation above the mean, which is above the three thresholds), with all control variables set at their mean values. Results are shown in Figures 2 to 4. Consistent with hypotheses 2.1 and 2.2, these figures show clearly a positive effect of each measure of kinship networks on $\ln(\text{number of private enterprises})$ when *democratic governance* equals 3.362, but a negative effect of each measure when *democratic governance* equals 4.296.

To see whether our results reported above are affected by model misspecification, we conducted a number of robustness tests. For one test, we added provincial random effects into Equation 1 to check whether provincial characteristics bias the results. For the second test, we used the random-effects Negative Binomial model with the number of private enterprises as the dependent variable. In addition, we conducted robustness tests by adding a measure of economic development level, which is endogenous to entrepreneurial development as mentioned previously, into Equation 1. The results, which still provide strong support to the hypotheses, are reported and discussed in the Online Appendices.

Results From 2SLS Regression

Our most important robustness test, however, is to use the 2SLS to resolve the endogeneity problem. Table 4 presents 2SLS estimates based on both Equation 1 and Equation 2 for

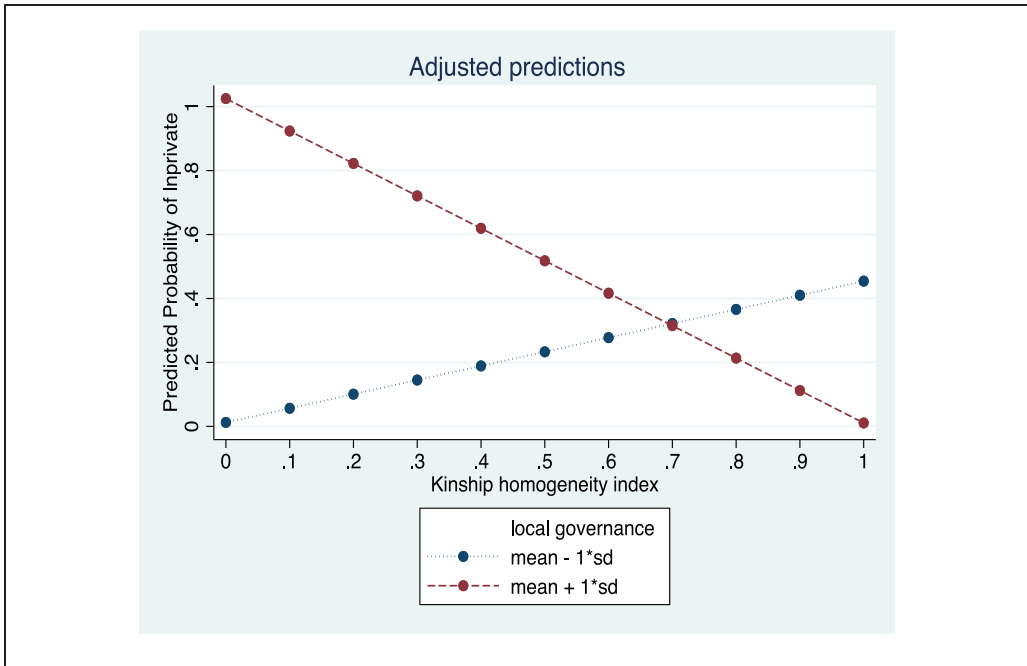


Figure 2. Effect of kinship homogeneity index on ln (No. of private enterprises), OLS estimates.

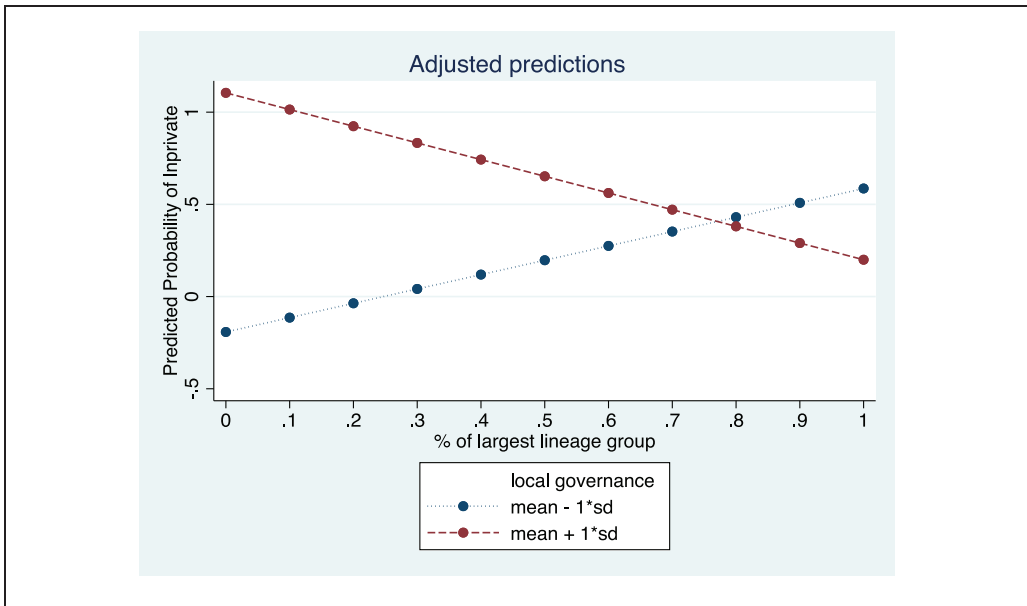


Figure 3. Effect of % of largest lineage group on ln (No. of private enterprises), OLS estimates.

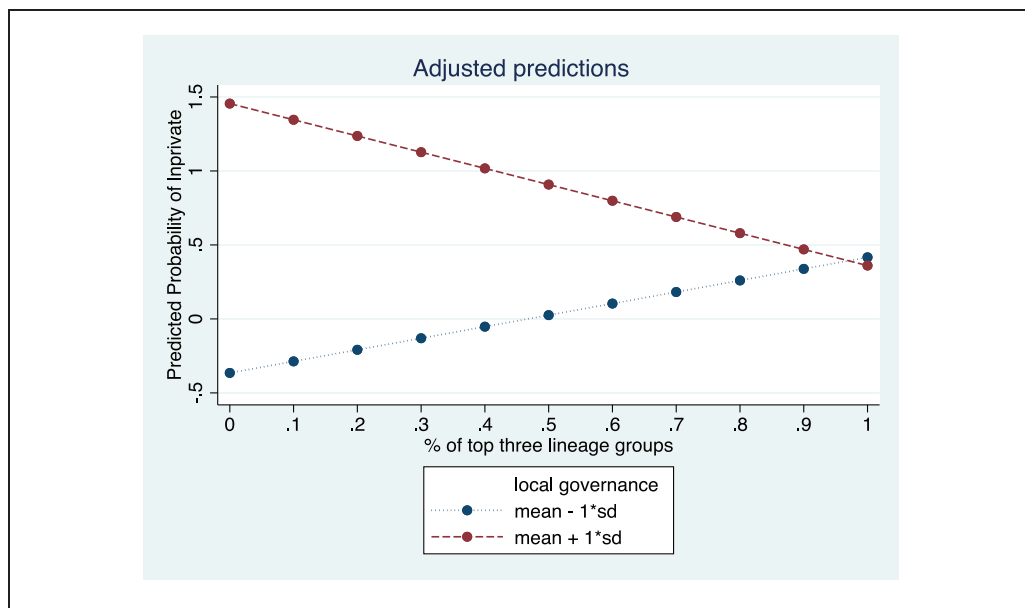


Figure 4. Effect of % of top three lineage groups on $\ln(\text{No. of private enterprises})$, OLS estimates.

testing Hypothesis 1. Panel B of Table 4 reports first stage results. Results from this Panel provide evidence that our instrumental variables are strong. All three instruments have statistically significant effects on *democratic governance* and the F-statistic for the three excluded instruments is approximately 11, which is larger than 10—the threshold for strong exogenous instruments (Acemoglu et al., 2014; Angrist & Pischke, 2008). As expected (Hoff & Stiglitz, 2004; Wang & Yao, 2007), *total area* of the village has a negative effect on *democratic governance*. *Number of natural villages* has a negative effect on *democratic governance*, possibly because natural villages, which are close-knit communities often in conflict with each other, tend to fight each other for capturing local power. *Number of village groups* has a positive effect on *democratic governance*. This may be because leaders from village groups, who represent villagers in their groups and can participate in VC decision-making, tend to favor local democracy.

Results from Panel A of Table 4 reports 2SLS estimates of the coefficients of interest. First, to further confirm the validity of the instruments used, it is seen that (1) all three equations in Table 4 are identified (i.e., the excluded instruments are correlated with democratic governance), as shown by the small p -values ($< .05$) of the under-identification test (i.e., the Kleibergen and Paap test); (2) the instruments are valid (i.e., uncorrelated with the error term), as shown by the large p -values ($> .1$) of the overidentification test (Acemoglu et al., 2014). Second, as in Table 2, the coefficients of all three measures of kinship networks are not statistically significant, and the coefficient of *democratic governance* is positive and statistically significant and approximately three times larger than that in Table 2 in all three models. The larger 2SLS estimates may suggest that there exists attenuation bias in the OLS estimates because of measurement error in democratic governance, in addition to biases created by reverse causality and omitted variables (Acemoglu et al., 2001). Therefore, the 2SLS results provide strong support for Hypothesis 1, as well.

Table 4. 2SLS Estimates for the Effect of Democratic Governance on Entrepreneurial Development.

Panel A. Second-stage regression			
Dependent variable: Log (No. of private enterprises)			
Kinship homogeneity index	-0.098 (0.342)		
% of largest lineage group		0.113 (0.401)	
% of top three lineage groups			-0.062 (0.392)
Democratic governance	1.669* (0.870)	1.708* (0.887)	1.679* (0.875)
Distance from city (logged)	0.004 (0.142)	0.002 (0.143)	0.003 (0.142)
Collective revenue (logged)	0.004 (0.009)	0.004 (0.009)	0.004 (0.009)
Land-labor ratio (logged)	-0.088 (0.054)	-0.086 (0.053)	-0.087* (0.052)
No. of labor force	0.225*** (0.081)	0.233*** (0.082)	0.227*** (0.079)
Average education	0.654*** (0.233)	0.667*** (0.236)	0.657*** (0.238)
Hilly land ^a	0.097 (0.303)	0.098 (0.297)	0.097 (0.302)
Mountainous land ^a	-0.233 (0.342)	-0.232 (0.346)	-0.234 (0.343)
Western region ^b	-0.016 (0.341)	0.010 (0.339)	-0.006 (0.344)
Central region ^b	-0.535 (0.382)	-0.504 (0.384)	-0.522 (0.381)
% of ethnic minorities	-0.617* (0.323)	-0.603* (0.331)	-0.610* (0.324)
Constant	-11.507*** (4.085)	-11.868*** (4.197)	-11.565*** (4.183)
Observations	140	140	140
Centered R-squared	0.222	0.216	0.220
Kleibergen & Paap (2006) test (<i>p</i> value)	0.022	0.022	0.023
Overidentification test (<i>p</i> value)	0.925	0.878	0.915
Panel B. First-stage regression			
Dependent variable: Democratic governance			
Total area	-0.001*** (0.000)	-0.001*** (0.000)	-0.001*** (0.000)
No. of natural villages	-0.013*** (0.005)	-0.013** (0.005)	-0.013** (0.005)
No. of villager groups	0.018*** (0.005)	0.018*** (0.005)	0.019*** (0.005)
Kinship homogeneity index	0.020 (0.107)		
% of largest lineage group		0.038 (0.122)	
% of top three lineage groups			0.103 (0.119)
Distance from city (logged)	-0.027 (0.037)	-0.028 (0.038)	-0.028 (0.119)
Collective revenue (logged)	0.002 (0.003)	0.002 (0.003)	0.002 (0.003)
Land-labor ratio (logged)	0.023** (0.010)	0.024** (0.010)	0.023** (0.009)
No. of labor force	-0.013 (0.022)	-0.013 (0.022)	-0.012 (0.022)
Average education	0.012 (0.042)	0.013 (0.043)	0.018 (0.043)
Hilly land ^a	-0.066 (0.072)	-0.065 (0.073)	-0.069 (0.073)
Mountainous land ^a	-0.136 (0.099)	-0.136 (0.099)	-0.136 (0.101)
Western region ^b	-0.027 (0.083)	-0.026 (0.083)	-0.023 (0.086)
Central region ^b	-0.102 (0.103)	-0.101 (0.102)	-0.102 (0.098)
% of ethnic minorities	0.125 (0.215)	0.126 (0.214)	0.124 (0.209)
Constant	3.802*** (0.436)	3.784*** (0.447)	3.680 (0.472)
F-statistic excluded instruments	11.47	10.92	11.57
Observations	140	140	140
Centered R-squared	0.139	0.139	0.141

Note. Robust standard errors adjusted for clusters in provinces in parentheses.

^aThe reference category is flat land.

^bThe reference category is eastern region.

****p* < .01, ***p* < .05, **p* < .1.

Table 5 presents 2SLS estimates for testing hypotheses 2.1 and 2.2 based on both Equation 1 and Equation 2. As in Table 4, Panel B of Table 5 reports first stage results and Panel A of Table 5 reports 2SLS estimates of the coefficients of interest. For each of the three equations in Panel A, there are two corresponding equations in Panel B because there are two endogenous variables: *democratic governance* and its interaction with a measure of kinship networks. Following Jeffrey Wooldridge's suggestion,³ therefore, we use the three instrumental variables and their interactions with a measure of kinship networks as instruments for both endogenous variables. Overall, results from Panel B suggest our instrumental variables are strong because most of the F-statistics for the excluded instruments are larger than 10.

Panel A of Table 5 provides strong evidence in support of both hypotheses 2.1 and 2.2. This Panel further confirms the validity of the instruments used, as shown by the small p -values ($< .05$) of the Kleibergen and Paap test and the large p -values ($> .1$) of the overidentification test. Also, the coefficients of *democratic governance*, each measure of kinship networks and the interaction terms, are all approximately three times larger than those in Table 3 in all three models. As in Table 3, Panel A of Table 5 shows that, while the coefficient of each measure of kinship networks is significantly positive, that of the interaction between democratic governance and kinship networks is negative and statistically significant in all models. In addition, Further calculation based on the results from Panel A of Table 5 suggests that, in Model 1, *kinship homogeneity index* would have a declining positive effect on $\ln(\text{number of private enterprises})$ when *democratic governance* increases to 3.761 ($= 17.645/4.692$), but the effect turns negative and declines further after *democratic governance* is above 3.761. In Model 2, the effect of *percentage of largest lineage group* changes from positive to negative when *democratic governance* is above 3.814 ($= 19.244/5.045$). In Model 3, the effect of *percentage of top three lineage groups* changes from positive to negative when *democratic governance* is above 3.786 ($= 25.057/6.618$). These results provide clear support for hypotheses 2.1 and 2.2, as well.

Based on the 2SLS results from Table 5, we calculated the net effect of each measure of kinship networks on $\ln(\text{number of private enterprises})$ at two levels of *democratic governance*: 3.362 (one standard deviation below the mean, which is below the above three thresholds) and 4.296 (one standard deviation above the mean, which is above the three thresholds), with all control variables set at their mean values. Results are shown in Figures 5 to 7, which have the same pattern as in Figures 2 to 4, thus supporting hypotheses 2.1 and 2.2.

Discussion

To the existing literature on the relationship between institutions and entrepreneurship, this study is among the first to research the effect of democracy—a formal political institution—on entrepreneurial development. Different from Farè et al. (2023), who have recently examined the effect of democracy on entrepreneurship in developed economies, our study focuses on the developing or emerging economy setting, and, thus, also different mechanisms. Following recent new institutional economic view on democracy, we argue that stronger local democratic governance can promote entrepreneurial development in rural villages in a developing or emerging economy through facilitating a regulatory environment that provides secure private property, quality public goods and services, and economic resources for entrepreneurs.

Table 5. 2SLS Estimates for the Moderating Effect of Democratic Governance.

Panel A. Second-stage regression						
Dependent variable: Log (No. of private enterprises)						
Kinship homogeneity index	17.645* (9.753)					
×Democratic governance	-4.692* (2.550)					
% of largest lineage group		19.244* (10.902)				
×Democratic governance		-5.045* (2.855)				
% of top three lineage groups			25.057*** (8.748)			
×Democratic governance			-6.618*** (2.278)			
Democratic governance	3.284** (1.325)	4.032** (1.695)	6.343*** (2.040)			
All other control variables	added	added	added			
Constant	-17.183*** (5.378)	-20.142*** (6.417)	-29.318*** (8.661)			
Observations	140	140	140			
Centered R-squared	0.164	0.166	0.110			
Kleibergen & Paap (2006) test (p value)	0.031	0.038	0.126			
Overidentification test (p value)	0.725	0.758	0.612			
Panel B. First-stage regression						
Dependent variables:	Democratic governance	Interaction term ^a	Democratic governance	Interaction term ^b	Democratic governance	Interaction term ^c
Total area	0.007 (0.007)	0.003 (0.002)	0.009 (0.009)	0.005 (0.003)	0.008 (0.017)	0.007 (0.011)
×Kinship homogeneity index	-0.014 (0.012)	-0.006* (0.004)				
×% of largest lineage group			-0.014 (0.013)	-0.007 (0.005)		
×% of top three lineage groups					-0.009 (0.018)	-0.009 (0.011)
No. of natural villages	-0.014* (0.008)	0.001 (0.004)	-0.017 (0.011)	0.001 (0.007)	-0.014 (0.014)	0.007 (0.009)
×Kinship homogeneity index	0.008 (0.026)	-0.009 (0.017)				
×% of largest lineage group			0.011 (0.025)	-0.009 (0.019)		
×% of top three lineage groups					0.000 (0.019)	-0.023 (0.015)
No. of villager groups	0.014 (0.010)	-0.005 (0.003)	0.015 (0.012)	-0.007 (0.006)	0.029* (0.016)	-0.003 (0.011)
×Kinship homogeneity index	0.017 (0.028)	0.037** (0.015)				
×% of largest lineage group			0.008 (0.024)	0.034** (0.016)		
×% of top three lineage groups					-0.015 (0.024)	0.020 (0.018)
Kinship homogeneity index	-0.056 (0.215)	3.548*** (0.138)				
% of largest lineage group			0.015 (0.229)	3.582*** (0.154)		
% of top three lineage groups					0.331 (0.239)	3.831*** (0.157)
All other control variables	added	added	added	added	added	added
Constant	3.758*** (0.446)	0.041 (0.195)	3.754*** (0.468)	0.093 (0.238)	3.494*** (0.492)	-0.165 (0.331)
F-statistic excluded instruments	4.28	17.55	9.22	20.72	18.89	16.63
Observations	140	140	140	140	140	140
Centered R-squared	0.152	0.968	0.149	0.950	0.148	0.906

Note: Robust standard errors adjusted for clusters in provinces in parentheses.

^aInteraction term: Democratic governance × Kinship homogeneity index.

^bInteraction term: Democratic governance × % of largest lineage group.

^cInteraction term: Democratic governance × % of top three lineage groups.

*** $p < .01$, ** $p < .05$, * $p < .1$.

In addition to researching the main effect on entrepreneurship of democracy, we also suggest, with evidence, that democracy has a negative moderating effect on the role of kinship networks in entrepreneurial development in a developing or emerging economy. In particular, we find that the effect of kinship networks will turn negative when democratic governance is sufficiently strong. Such research on the moderating effects of democracy expands the explanatory power of democracy as a formal institution beyond its main effect on entrepreneurship.

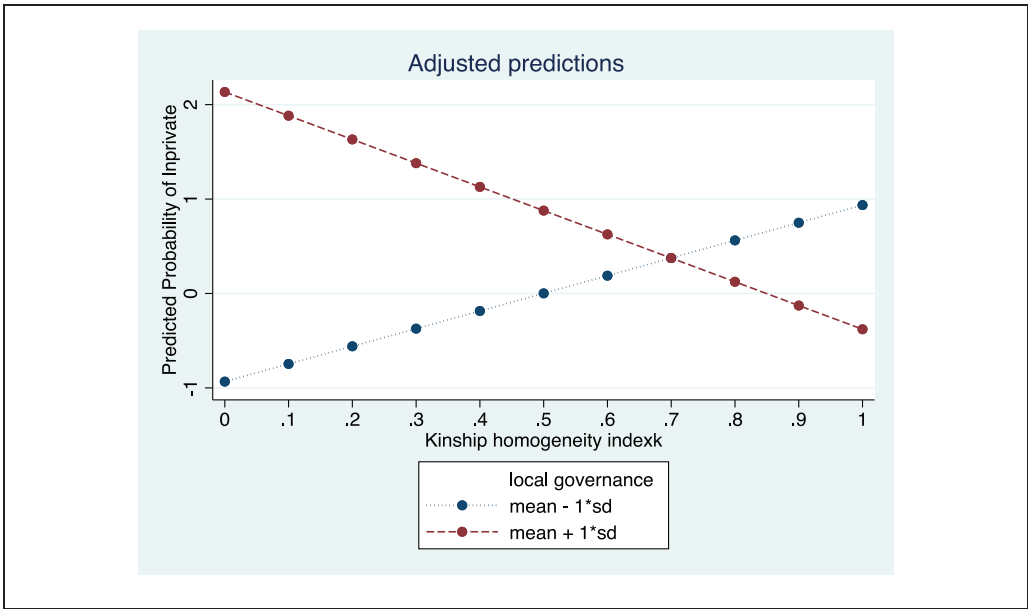


Figure 5. Effect of kinship homogeneity index on ln (No. of private enterprises), 2SLS estimates.

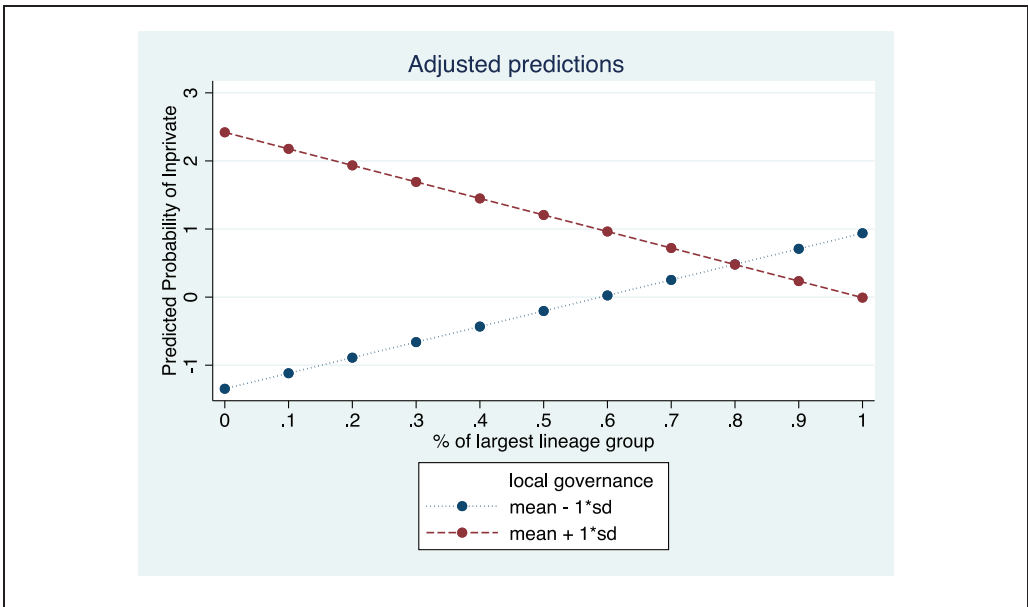


Figure 6. Effect of % of largest lineage group on ln (No. of private enterprises), 2SLS estimates.

This study has also made a new theoretical contribution to the kinship networks literature. Earlier classical scholars such as Weber (1951) considered kinship/lineage networks one of the reasons that capitalist organizations such as entrepreneurial firms failed to

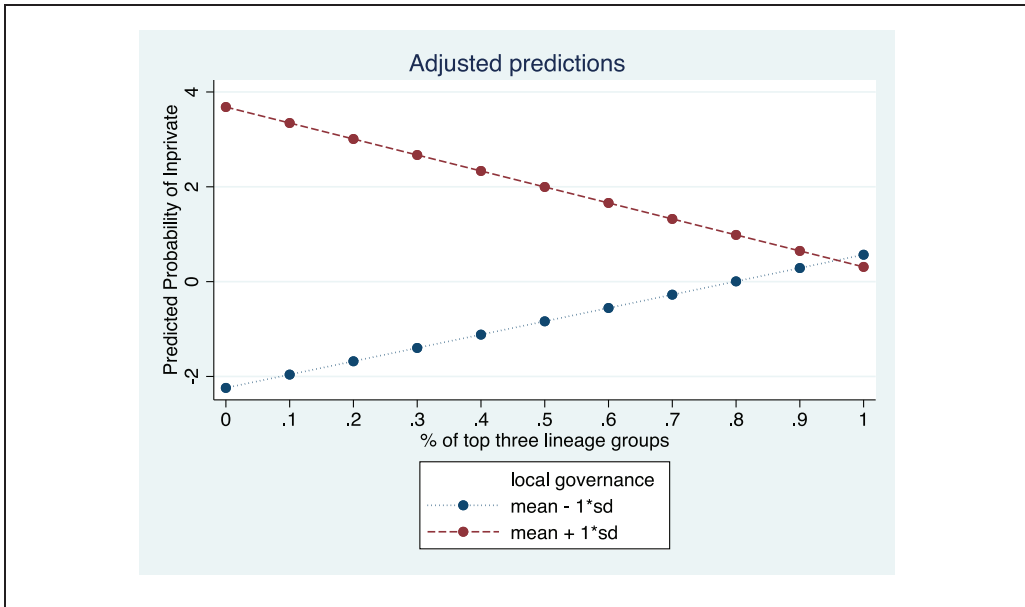


Figure 7. Effect of % of top three lineage groups on $\ln(\text{No. of private enterprises})$, 2SLS estimates.

develop in pre-modern non-Western economies, particularly China. Recent studies, however, have attributed entrepreneurial development in modern developing and emerging economies partly to kinship networks (Khayesi et al., 2014; Peng, 2004, 2005; Verver & Koning, 2018; C. Zhang, 2020). Arguably, both classical and recent studies have touched part of the truth because kinship networks are a double-edged sword, with both benefits and dark sides for entrepreneurs (Portes, 1998; Stewart, 2003; Stewart & Hitt, 2010). Therefore, to fully understand the effect of kinship networks, it is key to identify contextual boundary conditions.

This study suggests that local democratic governance serves as one such condition. We argue that the benefits of kinship networks as discussed in the existing literature, that is, helping to provide access to economic resources and property rights protection and, sometimes, facilitating provision of public goods/services, can all be partially or fully provided by democratic governance. On the other hand, the dark sides of kinship networks, particularly, the norm of “sharing without reckoning” will take time to change even under strong democratic governance. Therefore, while kinship networks can facilitate entrepreneurial development when democratic governance is weak because of positive net benefits (i.e., benefits minus costs) they can bring to entrepreneurs, their effect will decline under stronger democratic governance. Such effect will even turn negative under sufficiently strong democratic governance when the benefits of kinship networks fall below their dark sides. These arguments are supported by our empirical results.

This study may also inform the empirical literature on the puzzle of China’s rapid entrepreneurship development in rural areas (Lardy, 2014). The existing literature has emphasized the role of informal normative institutions such as kinship networks (e.g., Peng, 2004, 2005; C. Zhang, 2020) or formal regulatory institutions (e.g., Zhou, 2014, 2018) in China’s rural entrepreneurship development. Yet, entrepreneurship will be restricted and even unproductive if formal institutions are less conducive (Baumol, 1990); and formal regulatory

institutions will be not inclusive and sustainable if there are no political institutions that are accountable to all citizens (Acemoglu and Robinson, 2016). Based on the new institutional economic theory, this study provides a possible new explanation for China's rural entrepreneurial success. It suggests that the introduction of village-level democratization and democratic governance has facilitated inclusive regulatory institutions and may, thus, be one of the reasons to understanding China's rapid development in rural entrepreneurship.

This paper has several limitations that may suggest future directions of research. First, it has tested effects of democratic governance but has not empirically examined the mechanisms that generate these effects, although we have discussed these mechanisms when deriving the hypotheses. More data, particularly at firm/individual levels, are required for examining these mechanisms. Future research may acquire such data to test the mechanisms.

Second, constrained by data availability, we have analyzed the effect of democratic governance on entrepreneurial development, as well as its moderating effect on the role of kinship networks, based on cross-sectional data. This approach is fine for testing our hypotheses. However, this approach does not allow us to discern the magnitude of change in our key variables across different years and, thus, to find out the extent to which village-level democratization has played a role in facilitated entrepreneurial development in China. For that purpose, a longitudinal research design is needed.

Given that our data are from 2012, one may also wonder how village-level democratic governance has evolved and affected entrepreneurial development since then. It is noted that the authority, autonomy, and scope of elected village governments has progressively eroded in the past decade because county governments, possibly ordered by the central government, have implemented intrusive managerial practices that have increased vertical control over village governments (Martinez-Bravo et al., 2022). This democratic erosion, together with the shrinking role of private firms since around 2013 (Lardy, 2019), suggests that there may be positive correlation between the two, given the findings of this study. Future research may collect recent data to test this correlation.

Third, this study's findings are based on data from China. It is well known that China has a long tradition of clan culture in rural areas (Peng, 2004, 2005; Weber, 1951) and an authoritarian political system beyond the village level (Oi & Rozelle, 2000; Tsai, 2007a; Wang & Yao, 2007). Critics may emphasize that China's unique cultural and political contexts may influence the effect of democratic governance on both entrepreneurial development and the role of kinship networks in entrepreneurship. However, it can be argued that the strong clan culture and the authoritarian system in China may underestimate rather than overestimate the effect of democratic governance. Future research can use data from other developing or emerging economies, which have either a similar political system as China (e.g., Vietnam) or a mature democratic system (e.g., India), to see whether our results in this study still hold or have underestimated the effect of democratic institutions.

Conclusion

Existing entrepreneurship literature has focused on formal regulatory institutions but rarely examined the effect on entrepreneurship of formal political institutions, particularly that of democracy. Based on the experience of village-level democratization in China and following both new institutional economic view and the kinship networks literature, this study explores the role of democracy in entrepreneurial development, as well as how democracy moderates the role of kinship networks in a developing or emerging economy.

We have used a national sample of villages for empirical testing. Our results from both OLS and 2SLS suggest that stronger local democratic governance facilitates entrepreneurial development in rural villages and negatively moderates the role of kinship networks in entrepreneurial development. In particular, while kinship networks have a positive effect on entrepreneurial development when democratic governance is weak, their effect turns negative when it is strong.

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Supplemental Material

Supplemental material for this article is available online.

Notes

1. Regulatory institutions stem primarily from government legislation, as well as industrial agreements and standards (Scott, 2007; Bruton et al., 2010). These institutions determine the structure of property rights and the presence and perfection of markets (Acemoglu et al., 2005; Acemoglu & Robinson, 2012, 2016).
2. The OLVC states only that the VC comprises three to seven members, depending on the size of the village, who should be elected by local villagers once every three years, and should report to a village assembly (VA) of all adult villagers (Wang & Yao, 2007; Wong et al., 2017).
3. <https://www.statalist.org/forums/forum/general-stata-discussion/general/1533191-iv-regression-with-interaction-terms-and-2-instruments>

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