

Impact of ownership types and political connection on private equity placement

Empirical evidence from China

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Abstract

Purpose – In China, private equity placement (PEP) has become the most important equity refinancing method because most listed firms issue new stocks in this method. However, previous literature has not paid much attention to the impact of political connections on PEP. In this paper, the authors aim to focus on the effect of ultimate ownership types and political connections on approval, approval time, approval results and proceeds of PEP. Besides that the authors also explore the influence of different types and levels of political connections on PEP.

Design/methodology/approach – This study investigates the impact of ultimate ownership and political connections of private firms on the approval of PEPs. The authors obtain a final sample of 1,651 private placement events of Chinese-listed firms. To test the hypothesis that the authors developed in this paper, the authors use empirical models from the existing literature about political connections and corporate finance. They establish multiple linear regressions to test Hypothesis 1 and 3 and introduce a logit model to test Hypothesis 2.

Findings – First, this study documents that state-owned firms have significant advantages over private firms in approval procedure. Second, political connections seem to help private firms obtain approval of placements from China Securities Regulatory Commission. Third, political connections through government officers are not useful for firms to obtain refinance resources, whereas the connections of being members of Chinese People's Political Consultative Conference and People's Congress are the two valuable types of political connections to help private firms obtain approval.

Originality/value – This paper has three main contributions to the previous literature. The first contribution is to provide an evidence for the relation between political connections and PEP approval procedures. The second contribution is to provide a comparison between government officer's connection and social title's connection. The third contribution of this paper is to reveal the influence of non-disclosed political connection on PEP approval. All the three contributions are important for understanding the relation between political connections and firm refinancial policy.

Keywords Political connection, Informal mechanisms, Private enterprises, Private equity placement

Paper type Research paper



1. Introduction

Prior literature studies show that financial resources are essential for the development of firms. Studies based on the transitional markets of western Europe suggest that with the

increasing scale of investment, external finance plays a more important role in the further development of private firms (Johnson *et al.*, 2002). In China, the reinvestment ratio would increase dramatically when private companies have more access to external financial resources (Wang *et al.*, 2004). Nevertheless, private firms in China are subject to various constraints, such as market participating permission, property right protection and so on.

The main reason for these constraints is the transitional economy in China. In this economy, China's government has not established a systematic institution. Without a well-designed policy to protect private firms, governments distribute the finite resources based on the need of state-owned firms. The exact way includes limiting private firms to get enough access to capital market or lending less money from state-owned banks to private firms. In fact, private companies in China have not received enough legal protection and they have been discouraging for many years. Despite the fact that the legal system has become much more advanced than before, private sectors still get much less assistance from government.

According to rent-seeking theory, when the relevant policy is not good enough and the governments control resources strictly, private firms are more likely to seek more useful and more stable non-formal access. That is, establishing political connections with government to get protection. Therefore, many entrepreneurs are titled as different levels of representative of National People's Congress (NPC) or members of Chinese People's Political Consultative Conference (CPPCC) because they obtain connections with government through these titles (Tian and Deng, 2007). Prior literature show that to overcome the limitation of institution, firms in countries with less developed institutions are more likely to seek political connections (Bartels and Brady, 2003).

In fact, political connection can bring various benefits to firms, such as more loans from state-owned banks (Sapienza, 2004; Khwaja and Main, 2005; Houston *et al.*, 2014), more priority of government purchase orders (Agrawal and Knoeber, 2001; Tahoun, 2014), more political protections (Chaney *et al.*, 2011; Sanford, 2005; Maria, 2014) and more access to new policy (Wu *et al.*, 2008). Yu *et al.* found that politically connected firms can obtain more loans than non-connected firms (Yu and Pan, 2008). Luo *et al.* show that political connection relieve the financial constraints of private firms (Luo and Zhen, 2008). Johnson and Mitton (2003) and Leuz and Oberholzer-Gee (2006) found the similar results based on some other transition economies.

In China, private equity placement (PEP) has become the most important equity refinancing method because most listed firms issue new stocks in this method. However, previous literature has not paid much attention to the impact of political connections on PEP. In this paper, we focus on the effect of ultimate ownership types and political connections on approval, approval time, approval results and proceeds of PEP. Besides that, we also explore the influence of different types and levels of political connections on PEP. Our analyses provide three contributions to the existing literature on political connections. The first contribution is to provide an evidence for the relation between political connections and PEP approval procedures. We show that politically connected firms enjoy a high approval rate of PEP than non-connected private firms and state-owned companies have a higher chance to get approval than non-connected private firms. Besides that, we also show that a higher level of political connection has more influence on PEP approval, which indicate that proprietary nature and political connection effect PEP approval procedure.

The second contribution is to provide a comparison between government officer's connection and social title's connection. We show that social title's connection which is built by private entrepreneur actively has more significant effect on PEP approval results than officer's connection. The third contribution of this paper is to reveal the influence of non-

disclosed political connection on PEP approval. We find that more than 30 per cent private firms did not disclose their political connections and the non-disclosed connection can improve the approval rate of private firms. Therefore, future research on political connections should take these non-disclosed connections into account.

The remainder of the paper is organized as follow. Section 1 reviews relevant literature and develops hypothesis. Section 2 outlines our research design and discusses the results of our main empirical tests in Section 3. Section 4 provides additional analyses. Section 5 is conclusion.

2. Literature review and hypothesis development

2.1 Government intervention and political connection

Based on the current research, corporate political connection is related to the extent of government intervention to the market. China's capital market adopted an approval system for public offering and the core of this system is that government allocates the resources by its power. This creates a resource shortage market, which means owning these market shares corresponds to having some kind of privileges and firms, who need resources, will attempt to get these privileges (Tullock, 1980). Therefore, building connection with governments becomes an important channel for getting scarce resource; besides, it can be viewed as remedy for deficiency of the formal institution. Informal institutions play a more important role in promoting the operation of capital markets and social economy when formal institutions operate with low efficiency or deficiencies (Lin, 1994). The widespread political connection of Chinese private enterprise can be seen as pursuing informal institutional guarantee in transitional economy of China.

There is widespread interest and concern over the impacts of corporate political connections (Deng *et al.*, 2014). Since Krueger (1974) argued political rent extraction role in macro economy, scholars started to pay attention to the value of political connections. Shleifer and Vishny (1994) discuss the relationship between politicians and firms and find that politicians can benefit from the firms, whereas the firms profit from the connections with them; they also find that the firm value will increase only when the benefit exceeds the political cost. Fisman (2001) find that Indonesia-listed companies, which have a high correlation with President Suharto, suffer more serious losses when the president's health deteriorated. Jian Li *et al.* (2012) also find both central and domestic political connections can significantly increase the firms' value in China.

Further, some literature studies show that the political connections can produce more direct benefits to the firm. Faccio *et al.* (2006), based on a study of 35 countries, show that politically connected firms can get government bailouts when they face bankruptcy. Houston *et al.* (2014) find that the cost of bank loans decrease when the firms have political connections and they suggest that political connections increase firms' value and decrease credit risk of banks. Tahoun (2014) conclude that the firms which have stronger ownership–donation relationship can get more orders from the government. However, Chaney *et al.* (2011) find that the financing cost of politically connected firms do not decrease dramatically although their accounting information quality is worse. Gordon *et al.* (Sanford, 2005) report that large political donation significantly reduces the administration supervision of firms. Maria (2014) analyzes the impact of political connections on securities and exchange commissions (SEC's) administrative penalties and finds that firms having political connections with the government are less likely to receive punishment and the amount of penalty, even if they get punished, will be lower than those who do not have political connections.

2.2 Political connections and private equity placement

In the Chinese capital market, PEP has become one of the most important ways of financing. The same as approval system of issuing new shares, private placement is strictly monitored by government, which means firms need to get approved by China Securities Regulatory Commission. But to date, few studies have focused on the effects of political connections on private placement, which give us an opportunity to examine their relation by learning from other research on the political connections and other financing methods. For instance, [Johnson and Mitton \(2003\)](#) find that the politically connected firms can obtain bank loans more easily in Malaysia. [Leuz and Oberholzer-Gee \(2006\)](#) also find the same fact in Indonesia and the firms who have political connections do not need to get financing support from overseas.

Similar conclusions have been found based on the research of Chinese companies. [Luo and Zhen \(2008\)](#) show that political connections can bring private firms financing facilities and this is more pronounced in area with lower level of financial development. Based on the research on Top 100 private firms in Zhejiang province, [Hu \(2006\)](#) find that political connections can transfer quality signals for private entrepreneurs to enter the financial industry, thus providing financing facilities and conditions for the development of private firms. Moreover, [Pan and Xia \(2008\)](#) find that political can bring long term bank loans, especially in the areas where finance is undeveloped. [Yu and Wang \(2012\)](#) examine the information and resources' effects on political connections and they find that resources' effects are the key to relieve the financing difficulties of private firms, that is, political connections improve the ability of private firms to obtain resources. From the above discussion, we can conclude that corporate political connections are helpful in obtaining financial resources. Therefore, it is possible to shorten the approval time of private placement to improve approval passing rate, which lead to the following hypothesizes:

- H1.* Corporate political connection is negatively associated with approval time of PEP.
- H2.* Corporate political connection is positively associated with approval passing rate.

Early research indicated that the size of equity refinancing of politically connected firms is higher ([Wu Shuiting, 2010](#)); as the owner of private firms, it is necessary for majority of shareholders to consider utilization efficiency of capital when private placement is put forward. Aimless increase of the amount of financing is bound to reduce the performance after issuing and it will have a negative impact on corporate reputation and investor confidence, consequently affecting the interests of majority shareholders. Meanwhile, Chinese capital market has been facing great financial pressure in recent years; listed companies are continuously grabbing money, which makes investors complain incessantly. The "blood drawing" behavior of firms indirectly led to the suspension of new shares issued by regulatory authorities and to introduce a series of reforms to boost investor confidence. Political-connected private firms may not have advantages over other non-connected ones in financing amount. Compared with private firms, the agency problems of state-owned enterprises are even worse; the incentive level of executives to the enterprise operating efficiency and operating performance is not as large as majority shareholders of private enterprises. As a result, state-owned enterprises are more likely to carry out large-scale equity financing, which leads to following hypothesizes:

- H3a.* Corporate political connection is not significantly associated with the proceeds of PEP.
- H3b.* State-owned nature is positively associated with PEP.

3. Research design

3.1 Sample selection and data sources

Chinese capital market allowed listed companies to refinance by private placement since 2006, so research sample of this paper is 2,236 private placement events of A-share listed companies between 2006 and 2013. The data of refinancing application come from Wind database and financial data comes from CSMAR database; political connection data come from the political connection database of Chinese private-listed companies established by us. Finally, we obtain a final sample of 1,651 private placement events having results after filtrating. There are 926 observations of approval time and 627 financing scale observations in the sample. The specific process of sample selection is shown in [Table I](#):

3.2 Definitions of variables and empirical models

3.2.1 *Research models.* The empirical models of this paper are mainly from the existing literature about political connections and corporate finance. We establish multiple linear regression Models (1) and (3), which refer to the method used by Yu, to test *H1* and *H3*, whereas we establish logit model to test *H2* and the models are as follow:

$$\text{Time}_{i,t} = \alpha_0 + \alpha_1 \times \text{Political}_{i,t} + \alpha_2 \times \text{Private}_{i,t} + \beta \times \text{Control} + \varepsilon_{i,t} \quad (1)$$

$$\text{Approval}_{i,t} = \alpha_0 + \alpha_1 \times \text{Political}_{i,t} + \alpha_2 \times \text{Private}_{i,t} + \beta \times \text{Control} + \varepsilon_{i,t} \quad (2)$$

$$\text{Proceeds}_{i,t} = \alpha_0 + \alpha_1 \times \text{Political}_{i,t} + \alpha_2 \times \text{Private}_{i,t} + \beta \times \text{Control} + \varepsilon_{i,t} \quad (3)$$

The three dependent variables are $\text{Time}_{i,t}$ which indicates the approval time of refinancing application, $\text{Approval}_{i,t}$ which indicates the approval results of refinancing application and $\text{Proceeds}_{i,t}$ indicates refinancing amount of application. The independent variable $\text{Political}_{i,t}$ indicates the corporate political connections and the other variable $\text{Private}_{i,t}$ indicates the ownership property of enterprises and Control represents other explanatory variables.

3.3 Measure of variables

3.3.1 *Political connection variable.* The main measurements of political connections in current research include the dominant shareholder or executives are member of congress and they have a close relationship with prime minister or political parties; all these are politically connected (Faccio, 2006). Hung *et al.* (2012) define Chinese politically connected firms as the chairman of board or CEO have or is now serving at all levels of government or military. Moreover, Tian *et al.* (2008) think the main channels of obtaining political connections of private firms are participating in political and social activities by businessmen. Luo and Zhen (2008) use the definition of whether ultimate controllers are NPC

Table I.
Process of sample selection

| Selection process | Residual sample |
|---|-----------------|
| Private placement events during 2006-2013 (Wind database) | 2,236 |
| Remove observations of approval without results | 2,070 |
| Remove observations of firms in financial industry | 1,839 |
| Remove observations without control variables | 1,833 |
| Remove observations without issuing shares proportion | 1,651 |

member, CPPCC member or has worked in government departments. [Deng \(2011\)](#) use the similar political connection measures with [Tian and Deng \(2007\)](#), [Luo and Zhen \(2008\)](#). At last, [Li et al. \(2012\)](#) used the method of encoding and adding score to measure the scale of political connections of chairman of board.

Based on the previous research reviews, this paper mainly refers to the measurement method of [Luo and Zhen \(2008\)](#) and [Deng \(2011\)](#). We manually collect political-connected information and create our own database. According to the directors' controllers and executives' CVs in the annual reports, we identify their political-connected information one by one depends on whether they are serving or have served as National People's Congress (NPC) members, People's Political Consultative Conference (CPPCC) members and officials. On the basis of this method, there are 31.6 per cent of private listed companies in the sample which are politically connected and this is close to the statistical results of existing research.

In addition, we found that some executives' political background is not disclosed in the annual reports when we collected the information of executives. Therefore, to explore this kind of implicit political connections, we re-search on the internet in accordance with the key words, such as the name of executives, the name of company and year. Finally, we get 56.1 per cent of private listed companies which have political connections, which indicate that, in our sample, almost 25 per cent of private listed companies did not disclose the political background of their executives in their annual reports. We will analyze whether the impact of this "hidden" political connections is different from the disclosed ones.

Due to the clear level definition of NPC and CPPCC, we divide them into four levels: the central, province, municipal and county. The classification is designed to examine whether connection with higher level has more impact. However, because the level of political connections of government officials is hard to define, department, positions and titles are difficult to divide into obvious categories. So we introduce the dummy variable officer to indicate whether firm has political connection with the government officials.

The political connections of private listed firms can be completely measured by the above methods. We introduce an indicator variable PC to represent corporate political connections; it equals to 1 if the chairman of board, controlling shareholder and CEO, has the political connections mentioned before and 0 otherwise. Accordingly, an indicator variable PC_Report equals to 1 if a listed firm discloses political connections of its executives and 0 otherwise.

3.3.2 Control variables. We also control following factors that previous research finds to influence private placement of listed firms: Size, Financial leverage, ROA, Proportion of the largest shareholders and book-to-market ratio. Besides, we also include the industry and year dummy variables to control for the industry and year fixed effects. All variables and definitions are shown in [Table II](#):

4. Empirical results and analysis

4.1 Descriptive statistics

[Table III](#) shows the descriptive statistics and we winsorize all the continuous variables at 1 per cent (99 per cent) level to mitigate the concern of outliers. Among our samples, 995 (60.3 per cent) firms are state owned enterprise (SOEs). When dividing the samples into politically connected and non-politically connected, according to the disclosed information, we find that 31.6 per cent of the private enterprises are politically connected, which is consistent with extant studies. When we divide samples using more detailed information, we find that 56.1 per cent of the private enterprises are politically connected, showing that implicitly politically connected private enterprises account for a quarter of our sample. However, pass rate of politically connected group is higher than non-politically connected

Table II.
Definition of
variables

| Variables | Definition |
|------------------------------|--|
| <i>Dependent variables</i> | |
| <i>Time</i> | The nature logarithm of days between the date of first announcement of PEP and the date of getting approval results |
| <i>Approval Proceed_A</i> | Equals to one if the approval of private placement gets through and zero otherwise |
| <i>Proceed_Ln</i> | The ratio of private placement amount to total assets, which used to measure scale of private placement |
| <i>Independent variables</i> | |
| <i>Private</i> | Equals to one if the firm is privately controlled listed companies and zero otherwise |
| <i>PC</i> | Equals to one if there are political connections in the year of private placement and zero otherwise |
| <i>PC_Report</i> | Equals to one if the annual report discloses political connections of executives in the year of private placement and zero otherwise |
| <i>PC_Inv</i> | Equals to one if annual report does not disclose but exist political connections in the year of private placement and zero otherwise |
| <i>Central</i> | Equals to one if political connections are central level and zero otherwise |
| <i>Province</i> | Equals to one if political connections are provincial level and zero otherwise |
| <i>City</i> | Equals to one if political connections are municipal level and zero otherwise |
| <i>County</i> | Equals to one if political connections are county level and zero otherwise |
| <i>Member</i> | Equals to one if political connections are NPC, CPPCC members and zero otherwise |
| <i>Only_member</i> | Equals to one if political connections only are member type and zero otherwise |
| <i>Officer</i> | Equals to one if political connections are government officials and zero otherwise |
| <i>Only_officer</i> | Equals to one if political connections only are official type and zero otherwise |
| <i>Officer_M</i> | Equals to one if political connections are both two types and zero otherwise |
| <i>Control variables</i> | |
| <i>Size</i> | The nature logarithm of total assets at the beginning of the year of application for private placement |
| <i>Lev</i> | Total liabilities divided by total assets in year at the beginning of the year |
| <i>ROA</i> | Operating income before depreciation divided by total assets at the beginning of the year |
| <i>Big1</i> | The ratio of largest shareholder holdings to total shares at the beginning of the year |
| <i>BM</i> | Market value of equity divided by book value of equity at the beginning of the year |
| <i>Industry</i> | Industry dummy variable |
| <i>Year</i> | Year dummy variable |

group no matter from which method we divide the sample. Pass rate of SOEs is 70.5 per cent, which is much higher than non-politically connected private enterprises.

In the sample of private firms, 17 per cent are connected with officials, 46 per cent are connected with NPC & CPPCC members and 7 per cent are connected with officials and NPC & CPPCC members at the same time. Among the NPC and CPPCC member-connected firms, 13 per cent are central-level connected, 17 per cent are province-level connected, 13 per cent are municipal-level connected and 2 per cent are county-level connected. The majority of the NPC and CPPCC member connected shows that private enterprises seek political relations through NPC and CPPCC member.

4.2 Correlation analysis

Table IV listed main variables' Pearson correlation coefficients among private enterprises' sample. Parts of the independent variables are correlated significantly, but the VIF value of all the variables is less than 3, mitigating the concerns of multicollinearity. Table IV also shows that political connections are insignificantly correlated with approval of time and

| Vars | Private enterprises | | | | SOEs |
|-------------------|------------------------|---------------------------|----------------------------|---------------------------|--------------------|
| | Based on annual report | | Based on other disclosures | | |
| | Political-connected | Non-politically connected | Politically connected | Non-politically connected | |
| <i>N</i> | 207 | 449 | 368 | 288 | 995 |
| <i>N%</i> | 31.6% | 68.4% | 56.1% | 43.9% | 60.3% |
| <i>Time</i> | 4.712 (0.555) | 4.771 (0.597) | 4.753 (0.579) | 4.746 (0.589) | 4.764 (0.590) |
| <i>Approval</i> | 0.739 (0.440) | 0.619 (0.486) | 0.712 (0.453) | 0.587 (0.493) | 0.705 (0.456) |
| <i>Proceed_A</i> | 1.204 (2.622) | 2.311 (7.658) | 1.567 (4.393) | 1.371 (3.006) | 1.289 (4.625) |
| <i>Proceed_Ln</i> | 20.482 (0.903) | 20.455 (0.866) | 20.532 (0.865) | 20.363 (0.889) | 20.811 (1.022) |
| <i>Size</i> | 21.229 (1.126) | 20.945 (1.208) | 21.163 (1.168) | 20.871 (1.198) | 21.840 (1.375) |
| <i>Lev</i> | 0.581 (0.410) | 0.658 (0.600) | 0.601 (0.495) | 0.675 (0.607) | 0.610 (0.364) |
| <i>ROA</i> | 0.045 (0.085) | 0.030 (0.102) | 0.040 (0.085) | 0.028 (0.112) | 0.025 (0.080) |
| <i>Big1</i> | 34.130 (14.740) | 29.713 (13.211) | 32.600 (13.765) | 29.198 (13.757) | 38.557 (15.052) |
| <i>BM</i> | 0.651 (0.280) | 0.618 (0.311) | 0.652 (0.287) | 0.599 (0.317) | 0.746 (0.281) |

Note: Mean value of each variable is reported in the table, standard errors are in the parentheses

Table III.
Descriptive statistics

| Vars | <i>PC</i> | <i>Time</i> | <i>Approval</i> | <i>Proceed_A</i> | <i>Proceed_Ln</i> | <i>Size</i> | <i>Lev</i> | <i>ROA</i> |
|-------------------|-----------|-------------|-----------------|------------------|-------------------|-------------|------------|------------|
| <i>PC</i> | 1.000 | | | | | | | |
| <i>Time</i> | 0.006 | 1.000 | | | | | | |
| <i>Approval</i> | 0.131*** | -0.063* | 1.000 | | | | | |
| <i>Proceed_A</i> | 0.072 | -0.060 | 0.004 | 1.000 | | | | |
| <i>Proceed_Ln</i> | 0.095 | 0.020 | -0.063 | 0.202*** | 1.000 | | | |
| <i>Size</i> | 0.122*** | -0.041 | 0.077*** | -0.477*** | 0.356*** | 1.000 | | |
| <i>Lev</i> | -0.067* | -0.056* | -0.090*** | 0.460*** | 0.168*** | -0.205*** | 1.000 | |
| <i>ROA</i> | 0.062 | 0.010 | 0.075 | -0.206*** | -0.056 | 0.085*** | -0.232*** | 1.000 |

Note: ***, **, * are two tailed significance at 1%, 5% and 10% level, respectively

Table IV.
Pearson correlations

amounts but significantly positive correlated with pass rate, implying that political connection has positive effects on pass rate of seasoned equity offerings (SEOs) and support *H2b* preliminarily.

4.3 Regression analysis

4.3.1 Political connection and private equity placements approval time. Table V shows the multivariable regression testing results of *H1*. To improve the reliability of the research results, we only consider the passed observations in this part. Model A considers non-politically connected and SOE firms, Private variable is not significant ($t = -0.08$) and

| Independent variables | Dependent variable: <i>Time</i> | | |
|-------------------------|--|-------------------------------|-------------------------------|
| | <i>Private</i> = 1 <i>PC</i> = 0 <i>Private</i> = 0 Model A | <i>Private</i> = 1 Model B | <i>Private</i> = 1 Model C |
| <i>Private</i> | -0.005 (-0.08) | | |
| <i>PC</i> | | 0.003 (0.04) | |
| <i>Central Province</i> | | | 0.028 (0.27) |
| <i>City</i> | | | 0.013 (0.14) |
| <i>County</i> | | | -0.032 (-0.32) |
| <i>Size</i> | -0.049** (-2.40) | 0.009 -0.26 | 0.062 (0.27) |
| <i>Lev</i> | -0.052 (-0.83) | 0.001 (-0.01) | 0.001 (-0.01) |
| <i>ROA</i> | 0.158 (0.53) | -0.214** (-2.28) | -0.197** (-2.03) |
| <i>BM</i> | 0.173 (1.51) | -0.672 (-1.59) | -0.598 (-1.35) |
| <i>Big1</i> | 0.000 (0.07) | 0.037 (0.23) | 0.062 (0.37) |
| <i>_cons</i> | 0.000 (0.07) | -0.001 (-0.46) | 0.000 (0.06) |
| <i>Industry/Year</i> | 5.937*** (13.37) | 4.706*** (5.62) | 4.987*** (5.57) |
| <i>N</i> | Control 721 | Control 340 | Control 309 |
| <i>adj. R2</i> | 0.07 | 0.04 | 0.03 |

Table V.
Political connections
and approval time

Note: ***, **, * are two tailed significance at 1%, 5% and 10% level, respectively

Models B and C are not significant either. Model C tests whether different levels of NPC and CPPCC members have effect on approval time; thus, we omit the government official-connected observations. In one word, regression results proprietary nature and political connections do not have significant effect on SEOs' approval time and *H1* are not supported. Two possible reason may explain our results:

- (1) With the development of rapid growth of capital market and the improvement of regulations, SOE ownership and political connections cannot significantly affect SEO's approval process, which is also consistent with our interviews with managers and experts from investment banks.
- (2) Approval time is not accurately measured.

Strictly speaking, approval time measures the interval between the submission data and announcement date of approval results. Owing to the limitation of the data access, we do not have the submission date and can only use stockholder meeting's announcement date for instead.

4.3.2 *Political connection and pass rate.* Table VI shows the logit regressions of political connection and pass rate and sampling range is consistent with Table V. Observations of Model A include non-politically connected private enterprises and SOEs; *Private* is significantly negative at 1 per cent significance level ($Z = -2.98$), implying that SOEs' pass rate is significantly higher than non-politically connected private enterprises. Our results show that SOEs have financing advantages over non-politically connected private enterprises.

Model B only tests private enterprises, *PC* is significantly positive at 1 per cent significance level ($Z = 3.01$). This result shows that politically connected private enterprises' approval probability is significantly higher than non-politically connected ones, which is consistent with *H2*. Model C takes advantage of classifications of political connections

Table VI.
Political connection
and SEO approval
results

| Independent variables | Dependent variable: <i>Approval</i> | | |
|-----------------------------|-------------------------------------|--------------------|--------------------|
| | <i>Private</i> = 1 <i>PC</i> = 0 | <i>Private</i> = 1 | <i>Private</i> = 1 |
| | <i>Private</i> = 0 Model A | Model B | Model C |
| <i>Private</i> | -0.476*** (-2.98) | | |
| <i>PC</i> | | 0.549*** (3.01) | |
| <i>Central</i> | | | 0.631** (2.06) |
| <i>Province</i> | | | 0.533** (1.99) |
| <i>City</i> | | | 1.136*** (3.43) |
| <i>County</i> | | | -0.387 (-0.66) |
| <i>Size</i> | 0.147** (2.34) | 0.123 (1.22) | 0.108 (0.97) |
| <i>Lev</i> | -0.143 (-0.96) | -0.475** (-2.52) | -0.460** (-2.26) |
| <i>ROA</i> | 1.271* (1.74) | 1.509 (1.58) | 2.058** (1.98) |
| <i>BM</i> | -0.958*** (-2.90) | -1.014** (-2.24) | -1.036** (-2.07) |
| <i>Big1</i> | 0.007 (1.49) | 0.01 (1.28) | 0.011 (1.42) |
| <i>_cons</i> | -1.495 (-1.14) | -1.526 (-0.75) | -1.248 (-0.56) |
| <i>Industry/Year</i> | Control | Control | Control |
| <i>N</i> | 721 | 340 | 309 |
| <i>Pseudo R²</i> | 0.07 | 0.04 | 0.03 |

Note: ***, **, * are two tailed significance at 1%, 5% and 10% level, respectively

levels, specifically, central-level connected, province-level connected, municipal-level connected and county-level connected. We use the non-politically connected private enterprises as benchmark and find that central- and province-level connections are positively significant at the 5 per cent significance level, city-level connections are positively significant at the 1 per cent significance level, but county-level connection is insignificant. The results imply that state ownership can increase the approval probability, but for the private enterprises, only upper city-level connections can significantly increase the approval probability.

4.3.3 Political connections and SEO financing amount. Table VII shows the tests of *H3* with the financing amount scaled by total assets and natural logarithm of financing amount as dependent variables in Models A and B and Models C and D, respectively. Models A and C take advantage of whole sample to test the nature of ownership's effect on financing amount. Models B and D use private enterprises sample to test political connection's effect on private enterprises' financing amount. In Models A and C, *Private* is significantly negative at the 1 per cent level ($Z = -2.98, -2.29$), implying that SOE's financing amount is significantly higher than private enterprises, supporting *H3b*. In Models B and D, *PC* is insignificant, showing that political connection does not increase private enterprises' financing amount, supporting *H3a*.

5. Further tests

5.1 Disclosed political connection and implicit political connection

According to the descriptive statistics in Section 3.1, a quarter of private connections are not disclosed in the annual report. We analyze the difference of explicit and implicit political connections. Specifically, we divide the sample into disclosed connection, implicit connection and non-connection groups and with the last one as the benchmark to test the difference. Model A of Table VIII shows *PC_Report* is significantly positive

Table VII.
Political connection
and financing
amount

| Independent variable | Dependent variable | | | |
|---------------------------|-------------------------|--------------------------------|-------------------------|--------------------------------|
| | Proceed_A | | Proceed_Ln | |
| | Whole sample Model A | Private enterprises Model B | Whole Sample Model C | Private enterprises Model D |
| <i>Private</i> | -1.652*** (-2.98) | | -0.175** (-2.29) | |
| <i>PC</i> | | 0.956 (1.43) | | 0.184 (1.64) |
| <i>Size</i> | -2.741*** (-10.61) | -2.874*** (-7.49) | 0.283*** (7.94) | 0.211*** (3.29) |
| <i>Lev</i> | 9.116*** (12.44) | 6.786*** (7.09) | 0.346*** (3.42) | 0.207 (1.30) |
| <i>ROA</i> | 12.117*** (3.27) | 9.941** (2.05) | -0.295 (0.58) | -1.556* (1.92) |
| <i>BM</i> | -1.664 (1.25) | -1.703 (1.02) | -0.494*** (2.68) | -0.751*** (2.69) |
| <i>Big1</i> | 0.001 (0.07) | 0.008 (0.29) | 0.004 (1.44) | 0.003 (0.71) |
| <i>_cons</i> | 52.290*** (6.41) | 60.073*** (6.13) | 15.509*** (13.77) | 15.918*** (9.73) |
| <i>Industry/Year</i> | Control | Control | Control | Control |
| <i>N</i> | 627 | 261 | 627 | 261 |
| <i>adj. R²</i> | 0.42 | 0.38 | 0.22 | 0.07 |

Note: ***, **, * are two tailed significance at 1%, 5% and 10% level, respectively

Table VIII.
Different kinds of
political connections

| Independent variables | Dependent variables | | | |
|-----------------------|----------------------------|-------------------------|----------------------------|---------------------------------|
| | <i>Approval</i> Model A | <i>Times</i> Model B | <i>Approval</i> Model C | <i>Proceed/Asset</i> Model D |
| <i>PC_Report</i> | 0.732*** (3.35) | | | |
| <i>PC_Inv</i> | 0.412* (1.84) | | | |
| <i>Only_officer</i> | | 0.004 (0.04) | 0.159 (0.51) | 0.267 (1.2) |
| <i>Only_Member</i> | | 0.018 (0.26) | 0.639*** (3.08) | 0.192 (1.63) |
| <i>Officer_M</i> | | -0.121 (-0.86) | 0.729* (1.91) | -0.016 (-0.06) |
| <i>Size</i> | 0.117 (1.15) | 0.008 (0.2) | 0.109 (1.07) | 0.203*** (3.14) |
| <i>Lev</i> | -0.466** (-2.47) | -0.210** (-2.23) | -0.471** (-2.51) | 0.207 (1.29) |
| <i>ROA</i> | 1.49 (1.56) | -0.66 (-1.56) | 1.584* (1.66) | -1.509* (-1.86) |
| <i>BM</i> | -0.975** (-2.14) | 0.055 (0.34) | -0.977** (-2.14) | -0.708** (-2.49) |
| <i>Big1</i> | 0.009 (1.22) | -0.001 (-0.44) | 0.009 (1.2) | 0.004 (0.77) |
| <i>_cons</i> | -1.423 (-0.69) | 4.735*** (5.64) | -1.123 (-0.54) | 16.004*** (9.75) |
| <i>Industry/Year</i> | Control | Control | Control | Control |
| <i>N</i> | 656 | 340 | 656 | 261 |
| <i>R²</i> | 0.12 | 0.04 | 0.12 | 0.07 |

Note: ***, **, * are two tailed significance at 1%, 5% and 10% level, respectively

at 1 per cent level ($Z = 3.35$), implying that the pass rate of disclosed political connection is significantly higher than non-connected groups. *PC_Inv* is significantly positive at 10 per cent level, showing that implicit connection also makes a difference in the SEOs.

5.2 Government official political connection and National People's Congress and Chinese People's Political Consultative Conference member connection

Du Xingqiang and Guo(2009) classify political connection into two kinds: Government official political connection and NPC and CPPCC member connection. We identify official, NPC or CPPCC connected firms according to whether their directors, controllers or executives are serving or once served as National People's Congress (NPC) members,

People's Political Consultative Conference (CPPCC) members and officials. Nature and established ways are different between two kinds.

As for NPC and CPPCC member connection, private entrepreneurs seek political rents initiatively. Under this situation, private entrepreneurs make full use of this connection to make profits, such as bank loans, fiscal subsidies and simplifying the administrative examination and approval procedures.

As for government official connection, connected relations are based on current or former officials. The effects can be classified into two kinds: for one thing, private firms may initiatively seek to hire current or former officials or officials retire from the government and seek a position in the private enterprises. Under this situation, private enterprises may seek rents using this kind of connection. For another thing, government may assign an official in the private enterprise and intervene into its operations and this kind of connection is less likely to be a channel to seek rents.

All in all, government official political connection and NPC and CPPCC member connection may make a difference in the SEO process. In the Models B-D in Table VIII, we use non-connection samples as benchmark.

Model 2 are used to test the political connection classification effect on approval time. *Only_officer*, *Only_member* and *Officer_M* are all insignificant, reaffirming political connection has no effect on approval time. Model C used to test the political connection classification effect on approval result. *Only_member* and *Officer_M* are significant at 1 and 10 per cent level, respectively, but *Only_officer* is insignificant, implying that NPC and CPPCC member connection can increase the approval probability, whereas government official connection cannot. At last, *Only_officer*, *Only_member* and *Officer_M* are insignificant in Model D, reaffirming political connection has no effect on financing amount. Taking all the things mentioned above into consideration, only NPC and CPPCC member connection has significant effects on SEO process and this effect only holds in approval result.

6. Conclusions

China is still a transitional economy. Hence, market economy system is imperfect and government still reserves the right of resource allocation, especially for the strategic resource allocation and approval of the mega projects. Enterprise operations are still relying on rations, monitoring and regulations from the government. Thus, private enterprises have strong incentive to establish political connection, so that it can facilitate and lower the cost to get the scarce resources.

Political connection and financing convenience has long been regarded as a hot topic in the corporate governance and firm value area. Based on the extant studies, this study comprehensively tests political connection's effect on approval time, result and financing amount. Furthermore, this study also takes advantage of the administrative approval background and test whether ultimate ownership can make a difference in the SEO process and whether political connection can play a substitution role for the formal institution to facilitate private enterprises getting SEO resources.

We find that:

- Ceteris paribus, SOEs have inborn advantage over private firms in getting SEO resources. Specifically, SOEs have higher approval probability and more financing amount.
- NPC and CPPCC member connection can help private enterprises to get SEO resources.

- Political connection levels make a difference in the SEO process and only the higher-level connection can help private enterprises to get the scarce SEO rights.
- Implicit connection can also help private enterprises during the SEO process, which is a supplement for the prior studies that only consider the relations disclosed in the annual reports.

According to our findings in this study, SOEs have advantages over private firms in the SEO process. Political connection can play a substitution role for the inefficient formal institution and helps private enterprises to get the scarce SEO rights, easing their financing constraints. This study also shows practical significance for China's capital market development: inefficient institutions incentivize private enterprises to establish political connection, which is a net loss for the social welfare. Therefore, we suggest that the policymaker should introduce registration system for the SEO and it would reduce the imperfections in Chinese capital markets.

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