Political Connection Heterogeneity and Firm Value

A Discussion

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The Big Picture

- In the past decades, emerging markets have grown swiftly with the rise of several giant economies, such as China and India.
- There are many differences in *institutions* between emerging markets and developed countries, which shape the differences in corporate finance and governance decisions.

Government Quality

- Heavy government involvement in business.
- An important behavior distortion under low government quality is *bribery and political connection building*.

  e.g. Managers may bribe or build connections with bureaucrats to get loans from state banks. As a consequence, firms in more corrupt countries tend to have more debt in their capital structures relative to equity.

State Ownership

- By definition, the shares and assets of state owned firms (SOEs) cannot be transferred freely.
- State ownership is typically associated with low productivity.
  - lack of ownership incentives.
  - politicians interfering SOEs to transfer wealth
    e.g. bureaucrats may use their ownership position to interfere SOEs to support the economy

This Paper

Clear definitions of political connections (PCs)

- ascribed PCs: equity-based political ties
- acquired PCs: managerial-based political ties

The interaction effect of acquired PCs with ownership concentration

- Firms with concentrated ownership may able to handle the agency costs brought by PCs.

This Paper

Do political connections (PCs) improve firm values?

- No. PCs in most cases lower firm values.
- Firms suffer from ascribed PC's and acquired PC's except ... firms with *sufficient ownership concentration* can benefit from acquired PC's

Comments

- Robust checks on definitions of PCs.
    - Ascribed PCs, robust checks of state-owned shares
    - Acquired PCs is somehow arbitrary, could be better if robust checks on each of the three criteria are added.
- State ownership may have a broader influence than ascribed PCs.
    - State ownership can affect corporate governance and finance in various ways
    - No direct evidence on which part is 'political'
- Heterogeneous effects of PCs?
    - In general, the effect is negative
    - with more concentrated ownership, the negative effect is less, but still not positively significant(?).

Comments

- Separately control for `ownership concentration`?
  - In regressions with interaction with `ownership concentration`, the variable itself is not controlled.
- Panel features of the data
  - Is there any difference between the cross-sectional regression and the panel regression?
  - Is there any change over time by comparing cross-sectional regressions?
  - Can you make use of the panel features, the within-firm variation? Perhaps hard.
- On causal inference
  - It is correlation, not a causal relationship.

Self-selection and equilibrium effects

- Consider the following game played by a high productivity firm H and low productivity firm L.
- Without government interventions, the profits are

$$\pi_H = 80, \pi_L = 10.$$

- If one of the firm pursues political connections, then the firm will gain 10, while the other one will lose 20
- If both firms seek political supports, then they need to bid on favorable interventions

$$\pi_H = \pi_L = 0.$$

		H	
		PCs	No PCs
L	PCs	$(\underline{0}, 0)$	$(\underline{20}, \underline{60})$
	No PCs	$(-10, \underline{90})$	$(10, 80)$