

# The Impact of Political Connections on Corporate Development: A Literature Review

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**Keywords:** Political connection; enterprise development; Influence Mechanism

**Abstract:** In recent years, the study of the influence of political associations on the development of enterprises has gradually become a hot issue. By combing the relevant literatures of political connection and enterprise development, this paper summarizes the relationship between political connections and enterprise development on the basis of summarizing the relationship and finally put forward policy recommendations.

## 1. Introduction

With the continuous improvement of Chinese market economy, the growth of enterprises is accompanied by fierce competition. Under the pressure of competition, the government's support for enterprises is crucial. The company will do its utmost to establish a relationship between government and enterprises and maintain this bond, so as to maximize the competitive advantage and bring benefits. At the same time, in the initial stage of enterprise development, it is important to rely on the protection of relevant government departments or key personnel with influence to the maximum extent, and achieve the purpose of avoiding institutional risks. After the company grows and develops, its own value is realized and social responsibility is assumed. The purpose can be gradually completed. Therefore, the development of enterprises depends on political connections, and this model will also affect the multi-faceted behaviors such as financing, diversified investment and fulfilling social responsibility in the process of enterprise development; rationally combing the influence of political connections on the development of enterprises, and analyzing the development of enterprises Path and behavioral characteristics. On the basis of summarizing the relationship between political connection and enterprise development, this paper defines the political connection by combing the research results of Chinese and foreign scholars, analyzes its influencing factors and the favorable and unfavorable influence of political connection on enterprise development, and give related suggestion.

## 2. Definition and influence mechanism of political connections

From the perspective of the definition of political connections, Foreign scholars often use case enumeration. For example, political connections are defined as whether the CEO of a Western company has served or is currently in the government sector, or whether the company has made a donation to a candidate for a political campaign. Therefore, whether an executive is employed in a government department or whether a company makes a donation to a candidate is a factor that affects the relationship between government and enterprises <sup>[1]</sup>. However, due to the existence of different political systems in China, it is necessary to combine Chinese special national conditions when defining the political connection of enterprises. Based on the general definition of domestic research, in addition to state-owned enterprises, if the enterprise is established by a government official, or the management of the company is served by some retired government officials, this belong to the category of corporate political relations <sup>[2]</sup>. In summary, corporate political relations are mainly defined as the implicit relationship between corporate executives and political power owners, as shown by the fact that some positions in government departments have been held by senior

management and major shareholders, or that enterprises have conducted charitable charities.

### **3. The impact mechanism of political relations on enterprise development**

The existence of political connections has increased the efficiency of economic resource allocation. The study found that bank credit support is more easily obtained by companies with politically relevant backgrounds, which can obtain more long-term loans with less collateral and receive twice as much bank loans as other companies. The financing cost of the enterprise will be greatly reduced, which will eventually lead to a reduction in the financial risk of the enterprise. In addition, companies with politically relevant backgrounds are more likely to receive financing and government assistance, and banks have a greater tendency to prioritize credit funds to politically connected companies. In addition, politically-linked companies can obtain higher initial offering prices, while underwriting lower discounted prices and fixed costs. Finally, companies with a politically relevant background are more likely to receive external funding support. Therefore, companies have more capital to invest, and can reduce the excessive dependence on the owner's capital and financing costs. Besides, the existence of political connections reduces the degree of corporate resource constraints. Political power affects the allocation of economic resources to a large extent, and this phenomenon is more prominent in transition countries and developing countries where the legal system is not perfect<sup>[3]</sup>. For example, the government has established a bridge between talents training programs in universities and enterprises, so that technical talent resources can be rationally allocated to enterprises. In the allocation of government science and technology innovation resources, more innovative resources and preferential policies are more easily obtained by enterprises with political advantages. At the same time, the government's information on technological innovation policies is also easily known by politically connected companies. Therefore, enterprises make timely adjustments based on the government's innovation policy orientation, and increase incentives to obtain more government resources. Even in countries with a well-established legal system, political connections can greatly affect the allocation of government resources. For example, after every election in the United States, with the change of the ruling party, companies that participated in the campaign support can often obtain a large number of quality orders. At the same time, as a kind of invisible system, corporate political connection can make up for the shortcomings of the law on the infringement of property rights and other aspects, and obtain more institutional resources. In addition, politically connected operators may rely on their personal connections and social resources to obtain more tax breaks and refunds, which will reduce the actual tax burden of enterprises.

However, Political connections will ultimately harm the interests of the company in long-term. Because corporate political connections are vulnerable to more government intervention and assume more policy burdens, such companies often consider and cater to the will of the government, but only focus on the short-term production capacity of enterprises, and consume limited resources of enterprises. In addition, corporate political connections will lead to the prevalence of various rent-seeking behaviors, and even lead to more complex rent-seeking chains, rent-seeking networks and rent-seeking circles, causing distortions in corporate investment behavior and leading to corporate executives ignoring trade-offs. The associated benefits and costs are not conducive to maximize the interests of shareholders, and ultimately the value of the company is impaired. In addition, the original fairness and resource allocation effectiveness in the market will be broken by political connections. Under the support of the government, some enterprises have rapidly developed into industry leaders, but some enterprises have not developed successfully. Finally, the relationship between government and enterprises will distort the efficiency of resource allocation. For example, some high-tech enterprises do not meet the standards of supporting policies, but they enjoy various preferential policies, which ultimately lead to mismatching of resources. Also, Political connections tend to make companies ignore the importance of technological innovation. Because of the mutual substitution effect between political connection and market competition, the competitive pressure of enterprises with political background is greatly reduced, which makes the enterprise less dynamic on the road of innovation and intensifies the extensive development. It is estimated that this negative effect on corporate innovation will continue until the third year after the company has obtained political

connections, and ultimately will not help improve the quality of economic growth. Also, politically affiliated companies are more likely to lead to excessive investment behavior<sup>[4]</sup>. When internal cash flow is sufficient, companies tend to invest in a variety of projects, which will increase the company's excessive investment. This shows that when a company has a political relationship, it is more likely to lead to over-investment in free cash flow because of the convenience.

#### 4. Summary

From the perspective of enterprises, when establishing political connections, we must first consider their internal characteristics and external environment, optimize their own political relevance strategies, and make reasonable choices in different competitive strategies. Secondly, it is necessary to standardize and improve the internal governance system, strictly abide by relevant national laws and regulations, closely cooperate with government policies, rationally plan the development of the company according to the system, and reduce the adverse effects caused by government intervention. Finally, companies need to weigh the benefits and costs of political connections to the company, focus on the long-term interests of the company, scientifically make decisions on technological innovation, and effectively improve their business performance.

From the government's point of view, the first task is to improve the relevant systems and reduce the unnecessary burden of government intervention on politically connected enterprises. First, it is important to properly handle the relationship between the government and the market, so that the market plays a decisive role in resource allocation. Second, the government needs to further improve relevant policies, reduce the rent-seeking space of corporate political connections, and improve the transparency and fairness of policy implementation. Third, the government needs to strengthen the main position of enterprises in technological innovation, stimulate the innovation vitality of enterprises and strengthen the supervision of the technological innovation process of enterprises.

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