

# The Impact of Political Connection on Enterprise Value: Empirical Evidence from China's Anti-Corruption Reform

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**Abstract.** To some extent, anti-corruption has destroyed the original political connection of enterprises, deprived enterprises of rent-seeking interests such as financing convenience and preferential access to investment projects, and will damage the value of political affiliated enterprises in the short term. Based on the realistic background of the "Eight Provisions" issued by the Central Committee of China, this paper uses the event study method to study the impact of political connections on the value of enterprises. The study finds that the market reaction of anti-corruption reform is significantly positive; compared with the politically related listed companies, the positive market reaction of the non-politically related listed companies is greater. This shows that anti-corruption is "good news" for listed companies and is conducive to the promotion of corporate value, especially for those without political affiliation.

**Keywords:** Political Connection; Corporate Value; Anti-Corruption.

## 1. Introduction

The political connection exists widely in all countries of the world (Faccio, 2006). The connection between enterprises and governments (i.e. political connection) has always been an important topic of concern to all sectors of society. The concept of political connection was first proposed by Fisman (2001) when he studied the relationship between Indonesian enterprises and the Suharto family. However, there is no consensus on the definition of political connection in academic circles. Generally speaking, when the general manager or chairman of a company is a current or former government official, we think that the company has political connections.

As for the relationship between political affiliation and corporate value, early studies have found that politically affiliated companies enhance corporate value by obtaining more bank credit (Boubakri et al., 2012; Chen et al., 2014) and tax incentives (Faccio, 2006). More and more recent studies have found that political connections may also have some negative effects on corporate value. For example, companies with political connections perform worse than those without political connections, lack effective capital allocation (Faccio et al., 2006). Moreover, political resources have a curse effect, which will hinder enterprise innovation (Yuan Jianguo et al., 2015), thus not conducive to the improvement of enterprise value.

In China's special political and economic environment, the political background is a valuable resource (Fisman, 2001). However, in the process of an economic boom, China breeds a lot of corruption. In 2012, China launched a far-reaching anti-corruption reform marked by the promulgation of the Eight Provisions. In this context, anti-corruption will inevitably hinder enterprises' pursuit of political links, and even lead to the loss of political links. In the long run, the anti-corruption reform has promoted the rational allocation of market-oriented administrative resources and attacked the political links established by rent-seeking in the past (Ying Qianwei, 2016), which has a significant positive effect on the value of enterprises. In view of this, this paper will use the event study method to examine the reaction of A-share market to anti-corruption reform, and compare the stock price changes of politically-related enterprises and non-politically-related enterprises before and after the introduction of the "Eight Provisions", so as to reveal the intrinsic relationship between political connection and enterprise value.

## 2. Research Methods and Data Sources

### 2.1 Research Methods

This paper mainly uses the event study method to examine the impact of the "Eight Provisions" of the Central Committee on the market value of listed companies and focuses on the differences between the impact of the "Eight Provisions" on the value of politically related enterprises and non-politically related enterprises. Specifically, first of all, on December 4, 2012, the "Eight Provisions" were officially promulgated, requiring the rectification of the unhealthy atmosphere among Party members and cadres and strict thrift. Therefore, this paper regards December 4, 2012, as the event day. Secondly, the event windows selected in this paper are  $[0, +1]$ ,  $[-1, +1]$  and  $[-2, +2]$ . Finally, in the CAPM model, the estimated window is set to 200 days.

### 2.2 Data Selection and Sources

In this paper, all listed companies in Shanghai and Shenzhen Stock Exchanges in 2012 are taken as samples, excluding major announcements, ST listed companies and financial and Insurance Listed Companies in the window period of research events, and finally 2210 listed companies are obtained. Among them, the procedure of selecting political association data is to select keywords from the resumes of chairman and CEO. If the resumes of current chairman or CEO contain "government", "people's congress", "CPPCC", "provincial / municipal / county / district / town committee", "political association" is defined as 1, otherwise 0. The stock price data and political correlation data of listed companies used in this paper are all from the CSMAR database.

## 3. Empirical Results

Table 1 shows the short-term impact of the introduction of the "Eight Regulations" on the accumulated excess earnings (CAR) of listed companies. According to Table 1, it can be found that after the issuance of the eight regulations, the share prices of sample listed companies have increased significantly in the time windows of  $[0, +1]$ ,  $[-1, +1]$ ,  $[-2, +2]$ . This shows that the issuance of the eight regulations has a positive impact on the market value of sample enterprises. Further research finds that the CAR means of politically related companies and non-politically related companies is positive and significant, but the increase of the share price of politically related companies is significantly lower than that of non-politically related companies (the CAR mean of politically related companies and non-politically related companies is significantly different at 1% level). This shows that the impact of anti-corruption reform on the market value of politically related and non-politically related enterprises is different.

Table 1. Market reaction to anti-corruption reform

	N	CAR $[0, +1]$	CAR $[-1, +1]$	CAR $[-2, +2]$
All companies	2210	0.0119*** (6.2614)	0.0168*** (7.0208)	0.0071*** (3.9846)
Political connections (a)	498	0.0084*** (3.5147)	0.0067** (2.1825)	0.0011** (2.3312)
No political connection (b)	1712	0.0162*** (6.4365)	0.0279*** (11.5177)	0.0131*** (3.9918)
Difference (a-b)	2210	-0.0078*** (-4.2630)	-0.0212*** (-5.6231)	-0.012*** (-3.1569)

Note: \*, \*\* and \*\*\* are significant at the level of 10%, 5%, 1% respectively, bracketed as t value.

## 4. Conclusions and Policy Suggestions

This paper studies the impact of anti-corruption reform on the market value of listed companies by using the "Eight Provisions" issued by the Central Committee of China. The study finds that, on the whole, anti-corruption has a positive impact on the market value of listed companies. However, anti-corruption has different effects on the market value of politically-affiliated enterprises and non-politically-affiliated enterprises: the positive impact of anti-corruption on the market value of non-politically-affiliated enterprises is significantly greater; while the market value of listed companies with politically-affiliated enterprises increases very slightly. This shows that anti-corruption may inhibit the motivation of rent-seeking and lead to the loss of existing political linkages, which may lead to the market value of those politically related enterprises not increasing very significantly, that is, anti-corruption reduces the "lubrication" role of political linkages.

Based on the above conclusions, this paper puts forward two policy recommendations. First, as soon as the eight regulations were issued, they were established as the first official policy in anti-corruption activities, demonstrating the central government's determination to fight corruption. According to the positive role of anti-corruption in the promotion of enterprise value shown by the research institute, we believe that the government should continue to deepen anti-corruption reform, curb corruption, and create a more honest and clean market environment for the growth of enterprises. Secondly, after the issuance of the eight regulations, there are different market reactions of politically related and non-politically related enterprises. It can be seen that although the political connection can provide some conveniences for enterprises such as credit and tax, it cannot promote the long-term stable development of enterprises. To this end, the government should pay attention to ensuring fair and orderly market, strengthen the implementation of innovation policies, so as to help enterprises grow steadily.

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