An Empirical Analysis of the Influence of the Relationship between Government, Business and Villagers on Cash Holding of Enterprises from the Perspective of Financial Engineering

----From the Computer data of Chinese A-share listed companies

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Abstract. The hometown connection is one of the crucial relationships in China's relational society. Using the data of A-share listed companies, we examine how hometown connections between corporate executives and local government officials affect corporate cash holdings from the perspective of financial engineering. We find that hometown connections significantly decrease corporate cash holdings. After a variety of robustness tests, this result is still significant. We also find that hometown connections do have a significant impact on corporate cash holdings in provinces with a lower marketization index. One plausible channel for the hometown connections effect is reducing preventive motivation of corporate cash holdings.

Keywords: Financial engineering; Hometown relations; Corporate cash holdings; Government enterprise relations; Computer data

1   Introduction

In the context of traditional Chinese culture, hometown relations are an important informal system. Since ancient times, people have had special identities and feelings for people from the same birthplace or place of origin. Similar to the study of alumni relations abroad (Cohen et al, 2008) [1], many studies of hometown relations by domestic researchers have shown that hometown relations affect corporate behavior at the micro level (Dai Yiyi et al., 2016; Lu Yao and Hu Jiangyan, 2014) [2][3]. Both local government officials and enterprise executives are "social people" with high social interaction needs, eager to establish a wide range of social relations networks, and the relationship

between hometown and hometown has enhanced the communication and coordination between local government officials and enterprise executives, providing the possibility for the government and enterprises to build a new pro Qing political and business relationship, Further, the relationship between government and business will affect the financial decision-making of enterprises, but the current academic research on the relationship between government and business still needs to be deepened.

This paper studies enterprise cash holdings from the innovative perspective of "government business hometown relationship" of enterprise executives. Based on the data of A-share listed companies in Shanghai and Shenzhen stock exchanges from 2007 to 2016, this paper uses panel data regression model to empirically test the impact of government business hometown relationship on enterprise cash holdings. The results show that if there is a hometown relationship between senior executives and local government officials, the proportion of cash holdings in the enterprise decreases significantly, which is still valid after the robustness test and endogenous test. Corporate cash holdings declined significantly in the years when executives formed ties with local government officials.

2   Study design and descriptive statistics

2.1   Data sources

First, data on birthplace and place of origin. Firstly, the birthplace and native place information of executives (CEO and chairman) of all listed A-share enterprises in 2007-2016 are manually collated and extracted from the resumes of executives of listed enterprises, and the data are derived from the resumes of executives in CSMAR (China Stock Market & Accounting Research) database. Secondly, the birthplace and native place information of prefecture level municipal government officials (mayors and party secretaries) are extracted from the background information of provincial and municipal leaders.

Second, company level data. The company level data in this paper is based on the data of A-share listed companies in Shanghai and Shenzhen from 2007-2016, which is derived from the CSMAR database, and the initial samples are processed as follows: (1) all st enterprise samples are excluded; (2) Excluding the sample of financial industry companies; (3) In order to avoid the influence of extreme values, the continuous variables in the sample were winsorize at the 1% and 99% levels; (4) Delete samples with missing key variables. After the above processing, the actual samples entering the regression include 15116 samples from 2539 companies from 2007 to 2016.

2.2   Empirical model

$$Cashholding_{i,t} = \alpha + \beta_1 LaoXiang_{i,t} + \beta_2 X_{i,t-1} + Industry + Year + \varepsilon_{it} \quad (1)$$

Among them, cashholding is the cash holding level of the enterprise, and Laoxiang said whether the incumbent executives of the enterprise had a hometown relationship with the local government officials at that time. Among them, business executives refer to

the CEO and chairman of the company, while government officials refer to the mayor and the party secretary. Specifically, referring to the relevant practices studied by Lu Yao and Hu Jiangyan (2014, 2016) [3], when the birthplace of any two senior executives (CEO, chairman) and government officials (mayor, municipal Party Secretary) in the same province, the variable Laoxiang is 1, otherwise it is 0. In order to ensure the robustness of the results, this paper takes whether the birthplace of business executives and local government officials is the same province as the core explanatory variable for regression in the robustness test.

X is a set of control variables, measured by one lag period, to alleviate endogenous problems. Referring to previous studies on corporate cash holdings, this paper chooses the following variables as control variables. The control variables at the company level are: asset liability ratio (Lev), company size (Size), TobinQ (TobinQ), return on total assets (ROA), cash flow (CF), net working capital (NWC), capital expenditure (Capex), debt structure (DebtS), whether the company pays dividends (Dividend) and the shareholding ratio of the largest shareholder (Top1). In addition, it also controls the fixed effect of industry and year to control the impact of the company's industry and macroeconomic situation. The definition and measurement of variables are shown in Table 1.

In order to further explore the impact mechanism of the relationship between government and business and hometown on corporate cash holdings, and to study how the relationship between government and business and hometown affects corporate cash holdings through management's preventive motivation and agency motivation, this paper constructs models (2) and (3) for empirical test.

$$Cashholding_{i,t} = \alpha + \beta_1 LaoXiang_{i,t} + \beta_2 LaoXiang_{i,t} \times MP_{i,t} + \beta_3 MP_{i,t}$$
$$+ \beta_4 X_{i,t-1} + Industry + Year + \varepsilon_{it} \tag{2}$$

$$Cashholding_{i,t} = \alpha + \beta_1 LaoXiang_{i,t} + \beta_2 LaoXiang_{i,t} \times Manager_{i,t} + \beta_3 Manager_{i,t}$$
$$+ \beta_4 X_{i,t-1} + Industry + Year + \varepsilon_{it} \tag{3}$$

Model (2) is used to test the preventive motivation mechanism of the relationship between government, business and hometown affecting corporate cash. The relationship between government, business and hometown is different from the general relationship between government and enterprises. The relationship between hometown and hometown plays a role more through implicit channels (Chen yunsen and Cui Chenyu, 2016) [4]. The relationship between government and business does broaden the information channels of enterprises, enhance the ability of enterprises to cope with financial difficulties, and reduce the preventive motivation of enterprises. Therefore, this paper uses the way of multiplier to study the mechanism of action, introduces the multiplier of the relationship between government, business and villagers and the impact of monetary policy tightening on MP in model (1), draws lessons from the research of Rao pingui and Jiang Guohua (2013) [5], and defines the virtual variable MP in the tightening stage of monetary policy based on China's specific monetary policy and macroeconomic environment, define 2007, 2008, 2011 and 2013 as the tightening period of monetary policy, MP = 1, MP = 0 in other years, and the regression model is shown in model (2). Monetary policy tightening will increase the difficulty of enterprise financing and

the possibility of enterprise capital chain fracture, so the preventive motivation of enterprises will increase and increase their cash assets, in model (2)β_3 should be positive. If β_2 is negative, indicating that enterprises with the relationship between government and business have less cash assets during the period of monetary tightening, and the relationship between government and business has reduced the sensitivity of enterprise cash assets to the impact of monetary tightening, reflecting that the relationship between government and business has reduced the preventive motivation of enterprises.

Model (3) is used to test the agency motivation of the relationship between government, business and hometown to affect the cash holding of enterprises. Manager is the proportion of shares held by the management of the enterprise to the total shares. Agency motivation stems from the inconsistency between the interests of management and shareholders. As discussed above, the higher the agency motivation, the more enterprises tend to reduce cash holdings. Management shareholding is an important incentive way to alleviate the agency problem between management and shareholders. When management holds more shares, the interests of management and shareholders tend to be consistent, which reduces unnecessary investment and expenditure, and will increase the cash holdings of enterprises, β_3 is expected to be positive. If β_2 is positive, indicating that in enterprises with higher management shareholding and smaller agency problems, the weaker the negative impact of the relationship between government, business and hometown on enterprise cash holdings, the stronger the negative impact of the relationship between officials and hometown on enterprise cash holdings in enterprises with serious agency problems, and the executives of enterprises have made a lot of unnecessary investment and expenditure to meet the officials of hometown, It reflects that the relationship between government, business and hometown affects the cash holding of enterprises through agency motivation.

Table 1. variable definition (Source: Self drawn)

variable	symbol	Variable definition
Explained variable	Cashholding	Cash holding ratio = cash and cash equivalents / non cash assets at the end of the year 1. Cash and cash equivalents = monetary funds + trading financial assets 2. Non cash assets = total assets cash and cash equivalents
Explanatory variable	Laoxiang	If any two of the company's executives (CEO or chairman) and government officials (mayor and municipal Party Secretary) are born in the same province, the value is 1, otherwise it is 0
control variable	Lev	Asset liability ratio = Total Liabilities / total assets
	Size	Company size, natural logarithms of total assets
	Tobinq	Tobin Q = (market value of shareholders' equity of the company + book value of debt) / book value of total assets
	Roa	Return on total assets = net profit / total assets
	CF	Cash flow = net cash flow from operating activities / non cash assets
	NWC	Net working capital = (working capital cash and cash equivalents) / non cash assets

Capex	Capital expenditure = Cash / non cash assets paid for the purchase and construction of fixed assets, intangible assets and other long-term assets
Dbets	Debt structure = current liabilities / total liabilities
Divide	Whether the company pays dividends, the dividend expenditure in that year is 1, otherwise it is 0
Top1	Shareholding ratio of the largest shareholder = number of shares held by the largest shareholder / total shares

The descriptive statistics of the main variables are shown in Table 2. The proportion of cash holdings of Companies in the sample is 35.5%, with a standard deviation of 0.474, indicating that the cash holdings of different companies are very different. The average hometown relationship was 0.301, and 30.1% of the sample executives had a hometown relationship with local government officials during the sample period. The variance expansion factor (VIF) of all explanatory variables was below 10, and the average VIF was 1.43, so there was no multicollinearity problem. Table 3 shows the descriptive statistics after grouping according to whether the enterprises have the relationship between hometown and township. It can be seen that the proportion of cash holdings varies greatly between the two groups. The proportion of cash holdings of enterprises with the relationship between government and business hometown is 30.8%, while the proportion of cash holdings of enterprises without the relationship between government and business hometown is as high as 37.6%. The difference of most control variables between the two groups is not large, but the difference of Tobin Q value (TobinQ) and net working capital (NWC) between the two groups is large. The Tobin Q value and net working capital of enterprises with government business hometown relationship are low, which may indicate that the treatment of government business hometown relationship is not completely random.

Table 2. Descriptive statistics of main variables (Source: Self drawn)

Variable name	Number of samples	Average	standard deviation	minimum value	Max
Cashholding	15116	0.355	0.474	0.013	3.092
Laoxiang	15116	0.301	0.459	0	1
Lev	15116	0.427	0.216	0.045	0.989
Size	15116	21.974	1.286	19.114	28.509
Tobinq	15116	2.405	2.174	0.211	13.187
Roa	15116	0.072	0.055	-0.146	0.291
CF	15116	0.065	0.109	-0.246	0.473
NWC	15116	0.042	0.272	-0.906	0.642
Capex	15116	0.072	0.068	0	0.328
Debt	15116	0.822	0.187	0.058	1
Divide	15116	0.755	0.430	0	1
Top1	15116	0.365	0.152	0.088	0.758

Table 3. Descriptive statistics of main variable grouping (Source: Self drawn)

Variable name	Laoxiang = 1			Laoxiang = 0		
	Number of samples	Average	standard deviation	Number of samples	Average	standard deviation
Cashholding	4557	0.308	0.406	10559	0.376	0.499
Lev	4557	0.447	0.209	10559	0.419	0.219
Size	4557	22.192	1.263	10559	21.881	1.285
Tobinq	4557	2.033	1.816	10559	2.566	2.294
Roa	4557	0.074	0.056	10559	0.071	0.055
CF	4557	0.070	0.105	10559	0.063	0.111
NWC	4557	0.016	0.255	10559	0.053	0.278
Capex	4557	0.074	0.067	10559	0.071	0.068
Debt	4557	0.823	0.180	10559	0.823	0.190
Divide	4557	0.775	0.418	10559	0.747	0.435
Top1	4557	0.367	0.152	10559	0.364	0.153

3   Empirical test results and analysis

3.1   Relationship between government, business and hometown and enterprise holding

In order to test hypothesis 1, a regression analysis was performed on the whole sample, and the regression results are shown in Table 4. Table 4 (1) lists the regression results without adding other control variables, industry effects and year effects; (2) listed as the regression results of adding other control variables but not controlling industry effect and year effect; (3) is the regression results of the benchmark model in this paper. In the three regression results, the coefficient of hometown relationship is significantly negative, indicating that if there is a hometown relationship between enterprise executives and local government officials, enterprises tend to hold less cash, which verifies hypothesis 1. Specifically, column (3) shows the regression results of the benchmark model. If there is a hometown relationship between business executives and local government officials, the cash holding level of enterprises is 3.7% lower than that of enterprises without a hometown relationship between government and business, which is significant at the level of 1%. The hometown relationship between business executives and local officials has improved the possibility of full communication and coordination between the two, helped enterprises establish a good relationship between government and enterprises, and reduced the proportion of cash held by enterprises.

Table 4. Relationship between government, business and hometown and cash holdings of enterprises (Source: Self drawn)

Explained variable	Cashholding		
	(1)	(2)	(3)
Laoxiang	-0.068* * *	-0.037* * *	-0.037* * *
	(0.014)	(0.011)	(0.010)
Lev		-0.461* * *	-0.596* * *
		(0.042)	(0.047)
Size		-0.016* * *	-0.003
		(0.005)	(0.005)
Tobinq		0.009* *	0.013* *
		(0.004)	(0.004)
Roa		-0.222*	-0.336* * *
		(0.123)	(0.109)
CF		0.955* * *	0.953* * *
		(0.079)	(0.072)
NWC		-0.092* *	-0.175* * *
		(0.044)	(0.050)
Capex		-0.025	-0.113
		(0.076)	(0.075)
Debt		0.230* * *	0.105* * *
		(0.025)	(0.028)
Divide		0.023* * *	0.023* * *
		(0.009)	(0.009)
Top1		0.017	0.047
		(0.035)	(0.033)
_Cons	0.376* * *	0.580* * *	0.460* * *
	(0.009)	(0.124)	(0.128)
Industry effect	no	no	yes
Year effect	no	no	yes
N	15116	11861	11861
AdjR2	0.003	0.237	0.311

Note: *, * * and * * indicate significant at 10%, 5% and 1% levels, respectively. The standard error (SE) adjusted by company level cluster is in brackets.

3.2   Robustness test and endogenous test

3.2.1. Robustness check.
In order to ensure the reliability of the conclusion, this paper also makes the following robustness tests: (1) change the measurement method of the relationship between

government and business, refer to the practice of Hu Jun et al. (2017) [6], and take whether business executives and local government officials have the same hometown Province as the measurement of the relationship between villagers. Define variable Laoxiang_N is the relationship between government, business and hometown, which replaces the variable Laoxiang into the model (1) for regression. The results are shown in column (1) of table 5. After replacing the core explanatory variable, the estimated coefficient is -0.035, and the significance, value, standard error and main regression results of the coefficient are basically unchanged. (2) Control the provincial effect. Laoxiang relationship is a social relationship generated by individuals based on birthplace identity, which may show different intensities of Laoxiang identity in different provinces. Some areas traditionally pay more attention to maintaining Laoxiang relationship, so we consider controlling the provincial effect in the main regression model (1), and the results are shown in column (2) of table 5. (3) To change the measurement of corporate cash holdings, refer to Bates et al. (2009) to define the variable cashholding_A is the cash holding level of the enterprise, which is cash and cash equivalents / total assets at the end of the year. Replace the original explanatory variable into the main model (1) regression, and the result is column (3) of table 5. (4) After deleting the samples of companies registered in Beijing, Shanghai, Tianjin and Chongqing in four prefecture level cities, the results are shown in column (4) of table 5. The above robustness test results show that the main research conclusions have not changed substantially.

Table 5. robustness test results (Source: Self drawn)

Explained variable	Cashholding (1)	Cashholding (2)	Cashhold-ing_A (3)	Cashholding (4)
Laoxiang		-0.027* *	-0.014* * *	-0.032* * *
		(0.009)	(0.004)	(0.010)
Laoxiang_N	-0.035* * *			
	(0.010)			
control variable	yes	yes	yes	yes
Industry effect	yes	yes	yes	yes
time effect	yes	yes	yes	yes
Provincial effect	no	yes	no	no
N	11861	11861	11861	9060
AdjR2	0.303	0.307	0.339	0.313

Note: *, * * and * * indicate significant at 10%, 5% and 1% levels, respectively. The standard error (SE) adjusted by company level cluster is in brackets.

3.2.2. Endogenous test.

The main sources of endogenous problems are reverse causality, missing variables and measurement errors. In this study, the reverse causality problem is not serious: the variable of government business hometown relationship is determined at birth, which is an exogenous variable. Enterprise cash holdings are the financial decisions of the

company in operation. In this study, reverse causality means that reducing cash holdings will enable enterprise executives and local officials to establish a hometown relationship. Such a causal path obviously does not exist.

However, there may be a selection bias in this study, that is, the treatment is not random. In this study, some enterprises may expect to reduce cash holdings by establishing the relationship between government and business, so they take the initiative to hire managers who can establish the relationship between government and business as executives. This paper uses propensity score matching method (PSM) to solve this problem. With cashholding as the dependent variable and the control variable as the matching variable, logit regression was used, and the closest neighbor method was selected by the propensity score. 1:1 put back matching was carried out between the two groups, and finally the matched samples were used for regression. 4457 samples were obtained in the treatment group and 3464 samples in the control group, totaling 7921 samples. Table 6 reports the average causal effect (ATT) of the treatment group and the descriptive statistics and T test of the matching variables in the treatment group and the control group. There is basically no significant difference in the matching variables between the two groups. The average causal effect (ATT) of the treatment group is -0.047, which is significant at the significance level of 1%, indicating that after matching, The proportion of cash held by enterprises with government business hometown relations is still significantly smaller than that of enterprises without government business hometown relations, with an average cash holding ratio of 4.7% lower. Table 6 reports the results of regression using samples matched by PSM. the meaning of control variables is consistent with that of the main model. Column (1) (2) (3) of table 7 shows the results of PSM. regression with no control variables and two-way fixed effects, only control variables and both control variables and two-way fixed effects in turn. The regression results are basically consistent with those of the main model in Table 4, indicating that after overcoming the selective bias, the relationship between government, business and hometown still has a significant negative impact on the cash holding level of enterprises.

Table 6. trend test of PSA samples (Source: Self drawn)

variable	Mean		T-test
	Treated	Untreated	Meandiff
Cashholding			
(ATT)	0.308	0.356	-0.047* * *
Lev	0.447	0.447	0.000
Size	22.192	22.192	0.000
Tobinq	2.033	2.033	0.000
Roa	0.074	0.074	0.000
CF	0.070	0.069	0.001
NWC	0.016	0.010	0.006
Capex	0.074	0.074	0.000
Debts	0.823	0.820	0.003
Divend	0.775	0.780	-0.005
Top1	0.367	0.365	0.002

Note: *, * * and * * indicate significant at 10%, 5% and 1% levels, respectively.

Table 7. Relationship between government, business and hometown and cash holding of enterprises (Source: Self drawn)

Explained variable	Cashholding		
	(1)	(2)	(3)
Laoxiang	-0.048* * *	-0.037* * *	-0.037* * *
	(0.016)	(0.012)	(0.012)
Lev		-0.425* * *	-0.602* * *
		(0.056)	(0.064)
Size		-0.016* * *	-0.006
		(0.006)	(0.005)
Tobinq		0.014* *	0.013* *
		(0.003)	(0.006)
Roa		-0.263* *	-0.263*
		(0.104)	(0.145)
CF		0.980* * *	0.917* * *
		(0.096)	(0.085)
NWC		-0.153* *	-0.250* * *
		(0.056)	(0.066)
Capex		-0.025* * *	-0.097
		(0.094)	(0.092)
Debts		0.216* * *	0.073* *
		(0.030)	(0.032)
Divide		0.024* *	0.020
		(0.012)	(0.009)
Top1		0.025	0.055
		(0.036)	(0.038)
_Cons	0.356* * *	0.577* * *	0.545* * *
	(0.011)	(0.139)	(0.142)
Industry effect	no	no	yes
Year effect	no	no	yes
N	7921	6334	6334
AdjR2	0.003	0.254	0.333

Note: *, * * and * * indicate significant at 10%, 5% and 1% levels, respectively. The standard error (SE) adjusted by company level cluster is in brackets.

During the sample period, there are moments of "establishment" and "fracture" in the hometown relationship between some enterprise executives and officials. If the hometown relationship between government and business has a causal impact on the cash holding level of enterprises, the impact of these two relatively exogenous events will affect the cash holding behavior of enterprises. This paper uses did method to identify the impact of these two events on the level of cash holdings of enterprises, and constructs the establishment index and fracture index of the relationship between government, business and hometown, establish×Treat and break×Treat. The meaning of

treat is that at any time during the sample period, if senior executives have the relation-ship between government and business, treat is 1, otherwise it is 0. For the measurement of the relationship establishment variable establishment, the establishment is assigned to 1, otherwise it is 0. Taking the establishment of the relationship between government and business, as an example, the did regression model is as follows, among which λ_i is the individual fixed effect, v_t is the time fixed effect, and we mainly focus on the coef-ficient β Size and significance, the value of the coefficient β represents the impact of the event of "establishment" of the relationship between government and business and hometown on the cash holding level of enterprises.

$$Cashholding_{i,t} = \alpha + \beta Establish \times Treat + \lambda_i + v_t + \varepsilon_{it} \qquad (4)$$

The regression results are shown in Table 8. Establish×The coefficient of treat is -0.040, which is significant at the 5% confidence level, indicating that the level of cash holdings of enterprises has decreased by 4.0% in the current period when senior exec-utives and local officials have established a hometown relationship, which is in line with our hypothesis. Break×Although the coefficient of treat is positive, it is not signif-icant, and the rupture of the relationship between government and business has not caused enterprises to substantially increase their cash assets. This may be because the relationship between government and business and hometown has established a good relationship between government and enterprise for enterprises, and helps enterprises to build a wide range of social and commercial networks. These benefits have a certain degree of sustainability. The rupture of the relationship between government and busi-ness will not make enterprises lose these networks immediately, Therefore, the level of corporate cash holdings is not sensitive to the "rupture" of the relationship.

Table 8. did regression results of the establishment and fracture of the relationship between government, business and villagers (Source: Self drawn)

Explained variable	Cashholding	
	(1)	(2)
Establish×Treat	-0.040* *	
	(0.012)	
Break×Treat		0.020
		(0.017)
_Cons	0.353* * *	0.352* * *
	(0.000)	(0.000)
Individual effect	yes	yes
time effect	yes	yes
N	14887	14887
AdjR2	0.512	0.512

Note: *, * * and * * indicate significant at 10%, 5% and 1% levels, respectively. The standard error (SE) adjusted by company level cluster is in brackets.

4   Conclusion

Starting from the informal institutional perspective of the relationship between government and business, this paper uses the data of A-share listed companies in China from 2007 to 2016 as a sample to study the impact of the relationship between government and business on the proportion of cash holdings and its mechanism. This paper finds that when there is a hometown relationship between business executives and local government officials, the proportion of cash held by enterprises is significantly smaller than that of enterprises without a hometown relationship between government and business.

This paper confirms some positive effects of the relationship between government and business in corporate governance, but this paper is not to encourage business executives to "find fellow townspeople" and "climb the relationship" among local government officials, but to dialectically view the role of the relationship in enterprises. This paper finds that the relationship between government and business has reduced the cash holdings of enterprises and has a positive effect on corporate governance, which is helpful for local governments to think about how to further construct a new relationship between government and business with "pro" and "Qing" as the core, build a service oriented government, and create a relatively equal and stable environment for all micro subjects participating in the market economy. A good competitive development environment has important practical significance; At the same time, this paper also finds that in areas with high degree of marketization, the impact of the relationship between government, business and villagers on corporate cash holdings is not significant, which suggests that our informal system may be a supplement to the formal system. With the continuous improvement of the degree of marketization, the impact of informal system on the economy will gradually fade. Therefore, we should adhere to promoting market-oriented reform and improving the market-oriented allocation mechanism of resources.

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