

The Resource Effect of Political Connections

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Abstract: With the transformation and social structure of relationship-oriented in China, political connections widely exist in various. Each year many businesses spent huge amounts of time and money on establishing political connections. Taking GEM Listing Corporations as samples, This paper studied what kind of resources the political connection brought to the enterprise. The result found that political connections and debt financing have a significant positive correlation, and government subsidies have a significant negative correlation, and tax preferences have a significant negative correlation.

Introduction

The government builds the market order by formulating various economic policies and control measures, provides a lot of behavioral norms for business activities. The survival and development of enterprises need to be supported by many external scarce resources, such as tangible financial capital and intangible policy resources. Essentially the same as other behaviors of enterprises, the establishment of political connection in enterprises aims to maximize the benefits, hoping to obtain the resources available through this relational capital to influence governmental behavior.

The empirical evidence also shows that enterprises with political background can enjoy low financing costs^[1,2] and high rate of liability, it is more likely to receive assistance from local governments in financial difficulties^[3], easier access to long-term loans^[4]. Companies can also use their political resources to help the company get out of trouble^[5], compared with the non-political connection enterprises. In addition to direct access to bank loans and access to capital markets and other financing advantages, companies with political connections can also get a variety of preferential policies, such as tax preferences and more government subsidies, getting various resources at a price below the market, more competitive in the market^[6], having the preferential qualifications access to market^[7]. Political connections can mitigate the policy risks to protect enterprise income, and reduce the possible infringement suffered.

Literature Review and Research Hypothesis

Political Connection and Financing

Political connection has informative effect. External financing is an important factor affecting the development of enterprises. Political connection as a signal of enterprise business efficiency can reduce the business risks of private enterprises, avoid credit discrimination and pass the image of good prospect and social reputation to the public. Equivalent to an invisible government guarantees, political connection smoothes the degree of information asymmetry between capital supply and demand^[7], playing an important role in debt contracts with more favorable loan conditions and lower loan interest rates available^[8]. Accordingly, we put forward the hypothesis 1.

Hypothesis 1: Enterprise with political connection has a significant positive correlation with

debt financing

Political Connection and Government Subsidy

Government financial subsidy is part of political and economic policy of the government in order to achieve a specific purpose. The communication between politically connected enterprises and government departments is more effective, more likely to obtain identification and approval of financial subsidies of the relevant government departments in the tournament for local government financial subsidies. Since there existed information asymmetry in the government's decision to provide subsidies to enterprises, such as enterprise production technology, product market, development potential, profit ability, employment opportunities created and potential tax capacity etc, political connection may be a kind of signal display mechanism with good development prospect and social reputation, may be considered to have good prospects for development and social contributions^[9]. Political connection enhance the ability of enterprises to obtain resources, improve the profitability of the enterprises in the future, help enterprises get more government subsidies when they fall into financial difficulties. Accordingly, we put forward the hypothesis 2.

Hypothesis 2: Enterprise with political connection has a significant positive correlation with government subsidies.

Political Connection and Tax Preference

Tax burden affects the enterprise value and development space. The level of the tax burden of enterprises not only relates to provisions of the tax system and policy, but also relates to the degree of implementation of the policy^[10]. Political connection may have important impact on the tax burden of enterprises. The higher the administrative level of the actual controller or senior executives of the political-connect enterprises is, the more likely to obtain the identification and approval of preferential tax policy. The empirical evidence shows that tax rate of political connection enterprises is lower than those non-connected. Accordingly, we put forward the hypothesis 3.

Hypothesis 3: Enterprise with political connection has a significant positive correlation tax preferences

Research Design

Sample and Data

The sample of this paper is the GEM Listing Corporation of 2010—2012, after deleting missing data a total of 356 samples were obtained. The data comes from the CCER database. The corporate executives of political connected enterprises mainly are whether deputies, CPPCC members of theirs had worked in government departments.

Description of Research Variables

The variables and their calculation methods are shown in Table 1.

Table 1 Variable symbols and calculation method

	Variable	Symbol	Calculation Methods
Dependent Variable	<i>Debt financing</i>	Debt	Liabilities / Total assets
	<i>Government subsidies</i>	Subsidy	Government subsidies / Total assets
	<i>Tax preferences</i>	TaxCredit	Actual income tax rate, net profit / total profit
Independent Variable	<i>Political connection</i>	Politic	Dummy variables, 1 for a politically connected enterprise, 0 for non political connection
Control Variable	<i>R&D intensity</i>	R&D	R&D expenditure / Total revenue
	<i>Innovation performance</i>	Patent	Number of patents approved in the current period
	<i>The proportion of the largest shareholder</i>	Shareholder	The shares holding by first major shareholders / the total number of shares.
	<i>Corporate size</i>	Size	The logarithm of total assets
	<i>Profitability</i>	ROA	Net profit / total assets
	<i>Location</i>	Location	Virtual variables, 1 is enterprises in the eastern region, 0 is the central and Western Regions
	<i>Growth</i>	Q	Tobin's Q, company market value / book value

Research Model

In order to test the hypothesis 1, 2, 3, we constructed the model (1), (2), (3) to test.

$$\text{Debt} = \alpha + \beta_1 \text{Politic} + \beta_2 \text{R\&D} + \beta_3 \text{Patent} + \beta_4 \text{Shareholder} + \beta_5 \text{Size} + \beta_6 \text{Roa} + \beta_7 \text{Location} + \beta_8 \text{Q} + \varepsilon \quad (1)$$

$$\text{Subsidy} = \alpha + \beta_1 \text{Politic} + \beta_2 \text{R\&D} + \beta_3 \text{Patent} + \beta_4 \text{Shareholder} + \beta_5 \text{Size} + \beta_6 \text{Roa} + \beta_7 \text{Location} + \beta_8 \text{Q} + \varepsilon \quad (2)$$

$$\text{TaxCredit} = \alpha + \beta_1 \text{Politic} + \beta_2 \text{R\&D} + \beta_3 \text{Patent} + \beta_4 \text{Shareholder} + \beta_5 \text{Size} + \beta_6 \text{Roa} + \beta_7 \text{Location} + \beta_8 \text{Q} + \varepsilon \quad (3)$$

Regression Result

Descriptive Statistics Analysis

Table 2 shows the descriptive statistics of the main variables. In 2010-2012, most of the GEM companies are non state-owned companies, at the same time, more than half of the enterprises have political connections. The maximum value of government subsidies is 0.0949, the minimum value is 0, and the mean value is 0.0093. It shows that the government subsidy of listing Corporation in China is still at a low level. The maximum value of the tax preference is 0.3307, mean value is 0.1433 which shows China's tax preference is relatively high. The maximum value of debt financing is 74.69%, the minimum value is 1.26%, and the mean value is 18.01% indicating that the level of corporate debt financing is relatively high.

Table 2 Descriptive Statistical Analysis

	Average value	Mid value	Maximum value	Minimum value	Standard deviation
Government Subsidies	0.0093	0.0062	0.0949	0	0.0111
Tax Preferences	0.1433	0.1441	0.3307	0	0.0485
Debt Financing	0.1801	0.1369	0.7469	0.0126	0.137
Political Connection	0.47	0	1	0	0.4996
R&D Intensity	0.0718	0.0464	0.9839	0.0008	0.0908
Innovation Performance	11.2997	6	115	0	16.2334
Proportion of the Largest Shareholder	0.3502	0.3332	0.855	0.0066	0.1317
Corporate Size	19.6589	19.5705	22.3576	18.0036	0.6858
Profitability	0.0761	0.0651	0.469	-0.0008	0.049
Location	0.772	1	1	0	0.42
Growth	1.5155	1.4579	3.7156	0.0774	0.4983

Regression Analysis

From the regression coefficient of Table 3, the political connection and the debt financing are

positively related significantly which verifies the hypothesis 1. The political connection and government subsidies are negatively related insignificantly, the result is inconsistent with the hypothesis 2. The political connection and the tax preference are negatively related significantly which is inconsistent with the hypothesis 3.

Table 3 Regression analysis

	Debt Financing	Government Subsidies	Tax Preferences
Constant	-0.8308*** (0.0001)	0.0512*** (0.0005)	-0.0259 (0.6866)
Political connection	0.0290** (0.0205)	-0.0009 (0.3308)	-0.0069* (0.0787)
R&D intensity	-0.1261* (0.0737)	0.0151*** (0.0026)	-0.1066*** (0.0000)
R&D performance	0.0001 (0.8525)	0.0001*** (0.0002)	0.0000 (0.8102)
Proportion of the largest shareholder	0.1746*** (0.0003)	-0.0042 (0.2167)	0.0309** (0.0383)
Corporate size	0.0542*** (0.0000)	-0.0025*** (0.0006)	0.0082** (0.0107)
Profitability	0.2038* (0.0993)	0.1237*** (0.0000)	-0.0279*** (0.4707)
Location	-0.0279* (0.0734)	-0.0010 (0.3841)	-0.0007 (0.8849)
Growth	-0.0751*** (0.0000)	-0.0013 (0.1453)	0.0039 (0.3160)
Adjusted R ²	0.2263	0.4179	0.1043
F statistic	14.7855***	34.7459***	6.4891***
The value of D-W	1.4588	1.7766	1.7971

Note: ***, **, * indicate significance at the level of 1%, 5% and 10%, P value of the corresponding coefficients is in the bracket.

Conclusions

This study analyzed the resource effect of the political connection. The results showed that political connection has a significant positive correlation with debt financing, an insignificant negative correlation with government subsidies, and a significant negative correlation with tax preferences.

Therefore, the political connection does not necessarily bring the enterprise resource facility, may also bring a negative effect on the enterprise. The enterprises should focus on the development of core competitive advantage instead of taking opportunity by seeking rent.

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