

POLITICALLY CONNECTED FIRMS: AN INTERNATIONAL EVENT STUDY*

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ABSTRACT

We investigate the impact that the political connections of publicly traded firms have on their performance and risk-taking. Using a long-term event study covering a sample of 234 politically connected firms headquartered in 12 developed and 11 developing countries, we find that firms increase their performance and risk-taking after the establishment of a political connection. We also find that the political connection is more valuable for firms with closer ties to political power. Overall, our study confirms that politically connected firms gain easier access to credit and reap benefits in terms of performance from their ties with politicians.

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1. Introduction

Anecdotal evidence indicates that politically connected firms in different countries around the world benefit from their relationships with politicians. In Indonesia, relatives of ex-President Suharto, especially his sons, enjoyed easy access to cut-rate credit and import licenses. For instance, the conglomerate *Bimantara Citra*, managed by Suharto's son Bambang Trihatmodjo, was given *carte blanche* to import various commodities for milk production while competitors were granted restricted licenses (Mobarak and Purbasari, 2006). In Malaysia, investors interpreted the imposition of capital controls following the 1997 Asian financial crisis as preferential treatment for firms that were politically linked to Prime Minister Mahathir. During the same mandate of Prime Minister Mahathir, other government figures (Daim Zainuddin and Anwar Ibrahim) provided preferential treatment to many corporations (Johnson and Mitton, 2003).

This evidence is empirically supported by recent studies showing that the political connection phenomenon is prevalent in both developed and developing countries. Indeed, an international study by Faccio et al. (2006) finds that politically connected firms are more likely to be bailed out when faced with financial distress as compared to their non-connected peers. In Indonesia, Fisman (2001) finds a correlation between reports on Suharto's state of health and the value of the firms connected to his regime. There is also substantial evidence of political connections in developed countries, for instance: Agrawal and Knoeber (2001) show that U.S. firms with strong political interests will appoint directors whose political background will equip them to deal with government bureaucrats. In his study on financial firms, Sapienza (2004) shows that, in Italy, state-owned banks serve as a mechanism to supply political patronage.

In this paper, we revisit the consequences of political connections in a new framework, by conducting a worldwide event study to analyze how the political connections of publicly traded firms affect their accounting performance and their corporate risk-taking. Our paper also considers several aspects of corporate risk-taking, including those associated with financial leverage, liquidity risk, and debt maturity structures. We focus on these specific aspects because they are the most likely to change in response to political connections. The literature on the effect of political connections on firm value is mixed: *On the one hand*, the preferential treatment

conceded to connected firms gives them comparative advantages that should reflect favourably on their accounting performance. Indeed, politicians on the board of directors of corporations can use their influence to obtain preferential treatment from banks (especially government-owned banks), such as easier access to long-term debt with lower interest rates (Khwaja and Mian, 2005). If efficiently allocated, this soft budget constraint, could give politically connected firms a comparative advantage over their competitors. *On the other hand*, political interference in the management of the firms and the weak managerial skills of politicians could be harmful to the firm's performance (Fan et al., 2007). Bertrand et al. (2007) find that in French firms managed by politically connected CEOs profits tend to decline as the fraction of their employment located in politically contested areas increases, due to higher wage bills. These firms also display higher rates of job and plant creation and a lower rate of plant closings, especially in election years.

The event study framework is well suited to examine the consequences of political connections, as it allows us to determine more precisely the direct impact of such connections on the firm's accounting performance and risk-taking during the three years following their establishment. Furthermore, an event study starting at the inception of the connection is far more appropriate for this kind of investigation than a cross-sectional analysis, since the date of the event (i.e. the establishment of the connection) and the length of the connection (very likely to affect its efficiency) will both vary across firms. Hence, an event-study approach can be used to isolate the impact of the establishment of the political connection on the firm's performance and risk-taking.

Our paper contributes to the recent empirical literature on the political economy of governance which often yields conflicting conclusions concerning the impact of political connections on value performance. For instance, in their study following the 2001 appointment of the Thai Prime Minister Thaksin Shinawatra (a big business owner), Bunkanwanicha and Wiwattanakantang (2008) bring to light the market valuation of political connections and show that the value of politically connected firms can increase more than two-fold in only two years. Yet, Bertrand et al. (2007) find instead that French firms with politically connected CEOs exhibit a poorer accounting and stock market performance than do their non-connected counterparts.

While these single country studies are informative, an international cross-country event study, using a similar definition of political connection, should provide us with further insights into the impact of political connections on performance and risk-taking, particularly because cross-country differences in rules, institutions, and enforcement mechanisms are bound to make

the results of single-country studies difficult to generalize. Analyzing the relation between political connection and the firm's performance and risk-taking ratios throws light on the importance of considering political ties with the government when studying these aspects. Using matching firms allows us to strengthen our comparative analysis by contrasting firms with similar characteristics and environments. We also add to the literature on agency theory. Managers who feel sheltered from career concerns by government links might be tempted to engage in riskier projects.

We conduct a three-year event study based on a multinational sample of 234 politically connected firms around the date of the establishment of the political connection, that is the date of a politician's appointment to the board of directors or the date on which a shareholder (or a director) enters politics. Over a longer seven-year period, we compare various performance and risk-taking strategies used in connected firms to those used in a matching sample of non-connected firms. We find that politically connected firms increase their performance and risk-taking after the establishment of political connections. We also find that the political connection is more valuable for firms with closer ties. We ensure that our results are robust to different definitions of political ties; to the problem of endogeneity; to the exclusion of financial firms; and, finally, to the introduction of different corporate governance measures.

The rest of the paper proceeds as follows. Section 2 reviews the literature and develops our hypotheses. Section 3 outlines our sample. Section 4 defines the variables and presents the univariate results, while section 5 covers the empirical evidence. The last section summarizes our findings and discusses some policy implications.

2. Literature and Hypotheses

The literature on the interdependence between politics and business is abundant. Shleifer and Vishny (1994) state that politicians try to influence firms through subsidies and firms try to influence politicians through bribes. On the one hand, entrepreneurs run for political office in order to be in a position to play on the weaknesses of the institutional environment and to extract private benefits from their political power (Bartels and Brady, 2003). Indeed, in many countries, heads of State are well known entrepreneurs and rich businessmen. On the other hand, corporations are also interested in appointing politicians to their board of directors since they know the political scene and have friends in key positions in the government, who could be valuable to these firms (Agrawal and Knoeber, 2001). Government

contracts and preferential treatment are more easily negotiated when politicians are dealing with each other. Politically connected firms could also reward incumbents by supporting their reelection. Bertrand et al. (2007) find that firms managed by connected CEOs in France create more jobs in hotly contested districts at election time.

Mobarak and Purbasari (2006) show that firms politically connected to President Suharto are more likely to be granted import licenses than non-connected ones. These firms are ten times more profitable and export-oriented than non-connected firms. Political connections are even more valuable in protected industries. Ferguson and Voth (2008) study how the stock market returns of firms supporting the Nazi party fared between 1932 and 1933 in Germany. They find that after the party's accession to power, these firms outperformed the market by five to ten percent. Bunkanwanicha and Wiwattanakantang (2008) find that, in Thailand, the market valuation of big business firms increases when their owners enter politics.

However, other studies do not support these findings. For instance, Faccio (2007) finds that, in spite of the advantages they obtain, politically connected firms show a poorer accounting performance than non-connected ones. In France, Bertrand et al. (2007) find that politically connected firms show lower profits due to higher wage bills. Their analysis reveals a negative correlation between a firm's performance and its CEO's connections with political leaders. Fan et al. (2007) in China and Boubakri et al. (2008) in an international sample find that newly privatized politically connected firms under-perform their non-connected counterparts. Politically connected banks (especially government-controlled banks) increase their lending in election years (Dinc, 2005) and charge lower interest rates (Sapienza, 2004), which could have negative effects on their performance.

In light of this discussion suggesting that the benefits of political connections could be offset by their cost, we can draw up the following key testable hypothesis:

H1: Political connections do not improve performance.

If H1 is rejected, we can conclude that the benefits (costs) of political connections are greater than their costs (benefits), and that this type of connection improves (weakens) the performance of firms.

To our knowledge, with the exception of Bunkanwanicha and Wiwattanakantang's (2008) study on politically connected Thai firms, studies generally document the higher use of

debt by politically connected firms. For instance, Cull and Xu (2005) in China, Johnson and Mitton (2003) in Malaysia, and Khwaja and Mian (2005) in Pakistan confirm this point.

In the same vein, Leuz and Oberholzer-Gee (2006) examine the financing strategies of politically connected firms in Indonesia during the Suharto Presidency and find that since such politically connected firms have easier access to loans, they are less likely to have publicly traded foreign securities. Faccio et al. (2006) reveal that politically connected firms faced with financial distress are more likely to be bailed out compared to their non-connected counterparts. They conclude that lenders factor into their lending decisions the likelihood that borrowers will be bailed out when they encounter financial distress. Sapienza (2004) finds that the firms located in depressed areas in Italy are charged lower interest rates. But this policy is affected by election results and depends on the political affiliation of the banks' directors.

Hence, politicians wield their influence, relationship networks, and power to obtain returns from banks, especially government-owned banks, seeing to it that bank officers are rewarded in consequence by promotions and strategic appointments. Politically connected firms enjoy soft budget constraints, carry a heavier debt load, and chalk up greater default rates than their non-connected counterparts. They are also more likely to receive government assistance in case of crises. Consequently, we formulate H2 as follows:

H2: Politically connected firms are riskier than their non-connected counterparts.

3. Data

3.1. Definition of Political Connection

A company is defined as politically connected if at least one of its largest shareholders (anyone controlling more than 10% of voting rights, directly or indirectly) or top officers (CEO, president, vice-president, chairman or secretary) is: (i) a member of parliament, (ii) a king, president or minister, or (iii) closely related to politicians or a political party as of 2003.

We also consider close relationships to be indirect political connections, as when heads of State or their relatives also serve as top officers of a company or hold large blocks of its shares. Close relationships also include top officers who are known to be close friends with a king, a president, a minister or a member of parliament, as described in several journals (e.g., *The Economist*, *Forbes* and *Fortune*).

3.2. Data Sources

The names of top officers of companies are drawn from Worldscope, Extel, company Web sites, and Lexis-Nexis. Major shareholders are identified from different sources such as Claessens et al. (2000); Faccio and Lang (2002); stock exchanges; and the Web sites of supervisory authorities; Worldscope; and Extel. Information about close relationships are drawn from various studies: Agrawal and Knoeber (2001) for the U.S.A; Backman (1999) for Asia; Gomez and Jomo (1997) and Johnson and Mitton (2003) for Malaysia; and Fisman (2001) for Indonesia – as well as different journals such as *The Economist*, *Forbes*, and *Fortune*.

3.3. Sample of Politically connected Firms

Our initial sample of politically connected firms comes from Faccio (2006). It contains 245 observations for which she was able to pinpoint the date of political appointment or election or entrance into politics. These observations involve 217 firms. The year of a politician's appointment to the board of a firm or of a shareholder's or director's entrance into politics is considered as time zero in our event study. For 173 of the 217 firms in the sample, we have been able to collect financial information for the window -3 to +3 years. We have updated this sample with connections from 2002 and 2003, allowing us to add another 61 politically connected firms.

Table 1 describes the distribution of the firms in the sample by country, by definition, by industry – as classified by Campbell (1996), by year, and by position (of the person involved). Our sample is dominated by British companies (79 firms) which represent 33.76% of our sample, followed by Japanese firms (27 firms, 11.54%), and Malaysian firms (22 firms, 9.40%). Out of the 541 politically connected firms in his study, Faccio (2006) finds 154 connections in the UK (28.47%); 32 in Japan (5.91%); and 88 in Malaysia (16.27%). Furthermore, 146 connections involve members of parliament whereas the others involve close ties with government officials or heads of State. Politically connected firms are spread across industries, with 19.66% in the financial sector, 15.38% in consumer durables, and 10.68% in services. Finally, a total of 65 firms are connected through ownership and 169 through top officers.

Insert Table 1 about here

3.4. Matching Procedure

We used the same procedure as Faccio et al. (2006) to identify a matching non-connected firm for each of our politically connected firms. A potential match was defined as any company

from the same country, with the same 2-digit SIC code as the connected firm, which did not have political connections. From the set of potential matches, we chose the one whose equity market capitalization came closest to that of the connected firm at the end of the year preceding the establishment of the connection, provided its equity market capitalization fell within +/- 40% of the connected firm's market capitalization (168 companies were matched). If no matching company was found, the industry classification was broadened to Campbell's (1996) industry classification measure, and the procedure was repeated (46 more companies were matched). If no matching company satisfied these criteria, we used Campbell's industry classification to select the firm from any country whose market capitalization came closest to that of the connected company (a further 20 companies were matched). Matching was done without duplication, so a matching firm could be used only once.

4. Variables and Univariate Analysis

4.1. Dependent Variables

ΔROA : We use the change in the return on assets (ΔROA) as our proxy for a change in firm performance during the three years surrounding the establishment of the political connection (i.e. during the first three years of the political connection as compared to that in the three years before the connection was made). Shleifer and Vishny (1994) model the costs of the relation between firms and politicians. The politicians will provide favours to the firms in exchange for political benefits that could turn into votes (e.g., over employment, localization of some activities in politically desirable cities). On the one hand, connected firms may outperform non-connected firms owing to the benefits they derive from their connections (for example, generous government contracts). On the other hand, one cannot exclude the possibility that connected firms may fail to perform as well as their non-connected peers precisely because they are run by managers who have been selected by politicians on the basis of their connections and not their managerial skills (Fan et al., 2007).

ΔDTA : We use the change in the debt-to-assets ratio (ΔDTA) during the three years surrounding the beginning of the political connection to gauge the impact of political connections on firm leverage.¹ Recent studies find that politically connected firms are more

¹ Anecdotal evidence suggests that politically connected firms enjoy soft budget constraints. For instance, Tommy, President Suharto's son, recommended by his father, asked the central bank of Indonesia for US\$600 million to finance the activities of BPPC (Backman, 1999). In Germany, Leo Kirch an entrepreneur close to Bavaria's ruling party, the Christian Social Union, has been supported for several decades by Bayerische Landesbank, which is half-owned by the Bavarian State.

leveraged than their non-connected counterparts. Khwaja and Mian (2005) find that, between 1996 and 2002, politically connected firms in Pakistan borrowed 45 percent more and had 50 percent higher default rates than non-connected firms. Such preferential treatment occurs exclusively in government banks (private banks provide no political favours). Their political benefits increase with the strength of the firm's politician and whether he or his party is in power. Empirical studies thus support the anecdotal evidence that politically connected firms have easier access to credit, especially from state-owned banks. Accordingly, we predict that politically connected firms will tend to increase their leverage more than their non-connected counterparts.

Δ *CURRENT*: We use the change in the ratio of current assets (cash, inventory, other working capital, and trade receivables) over current liabilities (short-term debt and trade payables) during the three years surrounding the beginning of the political connection to examine the impact of such connections on the liquidity structure of these firms. This ratio captures the magnitude of the assets that the company can quickly transform into cash as compared to its short-term debt. This ratio can be especially important if the company has relatively large amounts of short-term debt. The combination of high debt service payments and the inability to cash in assets quickly could cause financial distress (Claessens et al., 2001). Since politically connected firms are often bailed out by the government when they face financial distress (Faccio et al., 2006), and because of the preferential treatment they receive from state-owned banks (Khwaja and Mian, 2005), they are more likely to maintain a lower current ratio than their non-connected counterparts. Further, the higher leverage of politically connected firms and the use of long-term debt to finance their activities could increase this ratio, owing to a decrease in short-term debt and, consequently, current liabilities. In the same vein, in Thailand, Charumilind et al. (2006) find that firms connected to banks and politicians need less collateral (i.e., fixed assets) to gain access to credit than those without such connections. This evidence suggests that politically connected firms have a higher current ratio.

Δ *MATURITY*: Recent empirical studies suggest that politically connected firms have easier access to credit. However, to the best of our knowledge, no study examines whether this easier access is to long-term debt or other types of debt. We use the change in the ratio of long-term debt over short-term debt during the three years surrounding the connection to assess the impact of political connections on debt maturity. Analyzing this ratio is important since Faccio et al. (2006) find that politically connected firms are more likely to be bailed out by the government when they face a financial crisis. Thus, politically connected firms are more likely

to contract long-term debt, knowing that they will eventually be bailed out in the event of downturns. Hence, we expect that any change in the maturity ratio will be positively associated with political connections.

4.2. Univariate Analysis

Table 2 reports measures of a central tendency toward changes in performance and corporate risk measured by ΔROA , ΔDTA , $\Delta CURRENT$, and $\Delta MATURITY$ for the three years surrounding the establishment of a political connection, for both politically connected firms and their non-connected counterparts. The results indicate that politically connected firms show significant increases in their performance, leverage, current ratio, and debt maturity after the establishment of political ties. The results also indicate that politically connected firms will, on average, increase their performance by 125.7% as compared to 66.5% for their non-connected peers. This difference is statistically significant at the 1% level. These initial findings suggest that politically connected firms benefit from their connections with the government and outperform their non-connected counterparts.

Turning to the impact of political connections on the firm's risk, we observe several significant relations. First, consistent with extensive prior research, we report a positive and statistically significant increase in the firm's leverage. Indeed, politically connected firms increase their *DTA* by 152% after the establishment of their political connection as compared to a relatively meager 18.4% increase on the part of non-connected firms. This difference is statistically significant at the 1% level. Second, we find that, after the establishment of their political connection, politically connected firms average a 4.6% increase in their current ratio as compared to an average 12% decrease by their non-connected counterparts during the same period. Finally, we find that politically connected firms increase their debt maturity ratio as measured by long-term debt over short-term debt. The mean (median) change in debt maturity is 31.9% (18.7%) for the subsample of politically connected firms compared to -37.2% (-21.2%) for the non-connected subsample. More relevant to our purposes, the findings strongly suggest that politically connected firms have easier access to long-term debt.

Although these univariate tests provide preliminary support for our hypotheses, they only document binary relations without controlling for other potential determinants. In the next section, we extend our analysis by more rigorously examining whether the evidence on these predictions will persist in a multivariate framework.

Insert Table 2 about here

4.3. Control Variables

Before reporting our regression results, we outline a number of firm and country characteristics that we use as controls in our multivariate analysis. In identifying and specifying the set of control variables, we refer to prior studies that showed them to be associated with performance and risk-taking at the firm or at the country level (Claessens et al., 2001; Dermirgüç-Kunt and Maksimovic, 1999; Fan et al., 2006; John et al., 2008).

We control for a set of firm characteristics that exist upon establishment of the political connection. The accounting data are taken from Worldscope. First, the firm's size (*SIZE*) is measured as the natural log of the company's market capitalization in US dollars to control for the effects of size on financing patterns. We also control for the availability of collateral (*COLLATERAL*) which may influence the firm's access to long-term financing (Guedes and Opler, 1996). Collateral is equal to the sum of net inventory and of gross plant, property, and equipment (*PPE*) relative to total assets. Similarly, (*OPERINC*) is defined as the ratio of operating income over total assets and is used to control for the profitability of the particular firm. We expect more profitable firms with higher cash flows to use less debt and more internal financing. Two potential explanations for this expectation appear in the literature. The first links it to the wish to avoid the personal taxes associated with distributions (Auerbach, 1979). The second links it to the asymmetric information problems associated with issuing equity that is considered costly (Myers and Majluf, 1984). Hence, profitable firms are unlikely to prefer debt financing. Further, we supplement these variables with an industry classification, since financing patterns can be expected to depend on the type of activity to be financed, including factors such as the volatility of the underlying income stream, the degree of informational asymmetries in the management of the particular type of business, etc. Like Campbell (1996) we classify our firms into 12 industry categories, and we control for industry-fixed effects.

Finally, we control for a set of country-level variables that exist upon establishment of the political connection. *CR* is an index of country creditor rights taken from Djankov et al. (2007). This index captures the extent to which creditors can control the bankruptcy process, an important issue in our study since politically connected firms are more likely to be bailed out by the government when they face financial distress (Faccio et al., 2006). Creditor rights indices range from zero for countries like France and Philippines to four for other countries like Singapore and United Kingdom. *ASR* is an index measuring the quality of accounting

disclosure standards. High accounting disclosure standards lead to better investor protection and make it harder to divert resources (John et al., 2008). Higher accounting disclosure requirements could also lessen any propensity politically connected directors may have to tunnel or take on riskier projects. The variable is retrieved from La Porta et al. (1998). We supplement the accounting disclosure standards with the International Country Risk Guide's (ICRG) assessment of the country's rule of law (*RL*) an indicator of the effectiveness of regulatory enforcement. Dermirgüç-Kunt and Maksimovic (1999) find that firms contract longer-term debt in countries whose legal systems merit a higher *RL* score. Third, we include the ICRG assessment of country corruption (*CORRUPTION*) to gauge the impact of the level of corruption on the firm's performance and risk-taking. Fan et al. (2006) find that firms in more corrupt countries have a harder time raising equity capital there. Their results also show that a lower level of corruption encourages the use of long-term debt financing. Finally, we control for standard exogenous variables used in international studies, such as the country's level of development as measured by the log of GDP per Capita (*LGDP*). Nevertheless, to control for the country-fixed effects, we supplement these variables with a set of dummy variables for each country represented in our sample.

5. Regression Analysis

5.1. The Model

In this section, following Faccio's (2006) approach, we report the results of a multivariate regression analysis of the impact of political connection as well as firm and country characteristics on changes in performance and risk-taking in politically connected firms and their matching non-connected firms over the six years surrounding the establishment of the political connection (three years before vis-à-vis three years after). We adjust the standard errors for both heteroskedasticity in the error term and clustering of observation at the country level. Specifically, we estimate the following model (subscripts suppressed for notational convenience):

$$\Delta \text{ INDICATOR} = \alpha + \gamma_1 \text{ POLITICAL} + \gamma_2 \text{ FIRM CONTROL} + \gamma_3 \text{ COUNTRY CONTROL} + \sum_{K=1}^{K-1} \text{IND}_K + \sum_{C=1}^{C-1} \text{CNT}_C + \eta \quad (1)$$

where $\Delta \text{ INDICATOR}$ refers to the changes in the performance ($\Delta \text{ ROA}$), financial leverage ($\Delta \text{ DTA}$), current ratio ($\Delta \text{ CURRENT}$), and debt maturity ratio ($\Delta \text{ MATURITY}$) indicators discussed above during the three years surrounding the establishment of the political connection. *POLITICAL* is our variable of interest. It is a dummy variable that is equal to one if

the firm is politically connected. *FIRM CONTROL* refers to a set of firm-level control variables (*SIZE*, *COLLATERAL*, and *OPERINC*). *COUNTRY CONTROL* refers to a set of institutional variables (*CR*, *CORRUPTION*, and *RL*), disclosure standards (*ASR*), and development level (*LGDP*). *IND* is a set of dummy variables controlling for *K* industry groups and *CNT* is a set of dummy variables controlling for *C* countries. η is an error term.

Our focus is on the coefficient γ_1 , which measures the sensitivity of performance and risk-taking to whether or not firms are politically connected.

5.2. Main Evidence

Table 3 reports the results of regressing change in performance and risk-taking on firm characteristics and country characteristics. All models include industry and country-fixed effects which, for the sake of brevity, are not reported. All models also exhibit significant explanatory power (adjusted- R^2 ranges from 10.6% to 36.9%).

In the “change of *ROA*” model (ΔROA), we find that political connections are instrumental in explaining the change in *ROA*. More specifically, the coefficient for *POLITICAL* is positive and statistically significant at the 5% level, implying that politically connected firms outperform their non-connected counterparts after the establishment of the connections. We find that the change in performance is positively related to the country’s rule of law and to firm size. We also find that the change in *ROA* is negatively related to the index of accounting disclosure standards (*ASR*).

In the “change of *DTA*” model (ΔDTA), we find that the coefficient for *POLITICAL* loads positive at the 1% level, suggesting that, after establishing their political connection, politically connected firms increase their leverage more than their matching non-connected firms. This finding is consistent with recent empirical studies on the soft budget constraints of politically connected firms (e.g., Cull and Xu, 2005 in China). We also find that, consistent with the findings of Claessens et al. (2001), the coefficient for creditor rights is negatively related to the change in leverage.

Turning to the “change of current ratio” model ($\Delta CURRENT$), the results show that the coefficient for *POLITICAL* is positively and significantly related to $\Delta CURRENT$ at the 1% level. We also find that *CR* and *ASR* load negative at the 1% level and 5% level, respectively. This finding is consistent with the study of Claessens et al. (2001). Stronger creditor rights and protection for minority investors are associated with lower firm risk characteristics.

Finally, in the “change of debt maturity” model ($\Delta MATURITY$), we focus on the impact of political connections on the term of the debts contracted. We find that the coefficient for *POLITICAL* loads positive at the 10% level, suggesting that politically connected firms increase the amount of their long-term debt over their short-term debt during the first three years of the political connection more than do their matching non-connected firms. This finding supports the anecdotal evidence that politically connected firms have easier access to long-term debt. The fact that creditor rights fail to explain the change in debt maturity structure has been noted elsewhere in the literature (Dermirgüç-Kunt and Maksimovic, 1999).

Overall, our findings suggest that political connection is associated with significant gains in performance and with increased risk-taking in terms of financial leverage, liquidity, and debt structure. We also document a significant negative impact of creditor rights on risk-taking, consistent with the findings of Claessens et al. (2001). Finally, we fail to find any significant association between level of *CORRUPTION* and *OPERINC* and changes in performance and risk-taking.

Insert Table 3 about here

The results presented above do not take into account the classification of political connections into specific types. Previous studies (e.g. Khwaja and Mian, 2005) document that the strength of the connection will affect its benefits. Connections through close relationships, government, and ownership are more valuable to firms than connections through a member of parliament and directorship. In the next section, we divide our sample of connected firms into different types of connections (government (*GOV*), member of parliament (*MP*) or close relationship (*CLOSE*)/ directorship (*DIRECTORSHIP*) or ownership (*OWNERSHIP*) and we re-estimate the equations in Table 3.

5.3. Other Evidence

Table 4 reproduces the regressions of Table 3 by dividing the political connections into their specific types, as defined in section 3.1 (government, member of parliament or close relationship/directorship or ownership). First, in the ΔROA models, we find that the coefficients of *OWNERSHIP* and *DIRECTORSHIP* remain positive and significantly associated with the change in performance after the establishment of the political connection. We also find that the coefficients of *GOV*, *MP*, and *CLOSE* are positively associated with the change in performance. The coefficients of *CLOSE* and *GOV* are higher than *MP*, which is consistent with the previous studies.

Second, in the Δ *DTA* models, we find that firms politically connected through *OWNERSHIP* and *GOV* exhibit positive and significant coefficients compared to the other types of connections. The coefficients of the other types of connection remain positive (except for *CLOSE*) and consistent with the results in Table 3. Indeed, this finding was expected since there is extensive evidence showing the easier access to debt for firms owned by several heads of State or their relatives (e.g. Suharto in Indonesia, Mahathir in Malaysia, Shinawatra in Thailand, and Berlusconi in Italy).

Third, in the Δ *CURRENT* models, the results show that only the connections through *DIRECTORSHIP* and *CLOSE* are positively and significantly related to the change in the current ratio. The other coefficients remain positive. The results from these regressions suggest that, in contrast with the previous ratio changes, the current-ratio change does not seem to be related to the strength of the political connection

Finally, in the Δ *MATURITY* models, we find that, whatever the type of connection, the coefficients are positive, as shown in Table 3. We also find that the coefficients of *OWNERSHIP*, *MP*, and *CLOSE* are positively significant at the 5% level for the first two, and at the 10% level for the last one. Except for the lack of significance of *GOV*, the results are as expected and show that the extensive use of long-term debt compared to short-term debt is more prevalent in politically connected firms with strong types of connection than in those with weaker ones.

Altogether, the results from this classification of politically connected firms into specific types support the findings of section 5.2, and provide evidence that the stronger the connections, the deeper their effects in terms of performance change and risk-taking for politically connected firms.

Insert Table 4 about here

5.4. Robustness Checks

We perform sensitivity tests to ensure the robustness of our results, some of which are reported in Table 5. The unreported results are available from the authors upon request.

5.4.1. Exclusion of Individual Countries

To tackle the concern that our results might be driven by a specific country, we recursively repeat our estimations, omitting a single country with each iteration. The coefficients of *POLITICAL* for the different measures remain statistically significant at the conventional level and with a similar sign as those reported in Table 3, in all the regressions in

the ΔROA model, in 22 out of 23 regressions in the ΔDTA model (except for the United Kingdom), in all the regressions in the $\Delta CURRENT$ model, and finally in 21 out of 23 regressions in the $\Delta MATURITY$ model (except for Italy and the United Kingdom).

5.4.2. Endogeneity

One potential concern for the regressions in Table 3 is that the dummy variable *POLITICAL* may not be exogenous. Specifically, some unobserved determinants of firm performance and risk-taking may also explain political connections, leading OLS estimates to be biased and inconsistent. We address this issue here by using an instrumental variable estimation procedure. We use the firm's location as an instrumental variable for political connection. Previous studies providing evidence on the influence of the firm's location on political connection motivate the choice of this instrumental variable (Agrawal and Knoeber, 2001; Bertrand et al., 2007; Roberts, 1990). In the first stage regression, we use a probit regression to predict political connections (*I_POLITICAL*), based on the firm's location (*CITY*)—a dummy variable that is equal to one if the firm is located in the two biggest cities in the country—as well as the other independent variables. The first-stage fitted values for political connections (*I_POLITICAL*) are then used in the second-stage regressions.

We report the results in the Models 1 column of Table 5. In the first stage, the results show that the location of the firm's headquarters (*CITY*) is a good predictor of political connections. Moreover, in each of the second-stage regressions, the instrumented value of connections (*I_POLITICAL*) is statistically significant as well. Hence, politically connected firms exhibit higher profitability and risk-taking compared to their matching non-connected counterparts.

5.4.3. Other Measures of Firms' Performance and Risk-Taking

As a robustness check, we use different measures to estimate the impact of political connections on firms' performance and risk-taking, in Table 5 Models 2. Specifically, we estimate performance by any change in return on equity (ΔROE) rather than ΔROA . The results show that the coefficient for *POLITICAL* remains positively and significantly related to the change of performance. We also regress the $\Delta LDTE$ (the change in the ratio of long-term debt to equity during the three years surrounding the establishment of the political connection) in place of the ΔDTA and the results remain qualitatively the same. *POLITICAL* is positive and statistically significant at the 1% level. When we replace $\Delta CURRENT$ by $\Delta QUICK$ (the change in the quick ratio, measured by current assets (net of inventory) over total assets, during the

three years surrounding the establishment of the political connection), the results show that the new liquidity ratio remains positively and significantly associated with political connection. Finally, instead of $\Delta MATURITY$, we use the ratio of working capital over short-term debt ($\Delta WORKST$). The results show that the coefficient for *POLITICAL* remains positive but becomes insignificant. Taken together, Table 5 Models 2 reveal that performance and risk-taking are affected by political connections whatever the measures applied.

5.4.4. Exclusion of Financial Firms

In our regressions, we control for industry effects using Campbell (1996) classifications. Yet, financial firms are expected to have higher leverage ratios compared to non-financial firms, a possibility which may drive the results. To mitigate this concern, in Models 3 of Table 5, we report results using only non-financial firms (i.e. we exclude firms with SIC 6000-6999). Our main results remain unaffected, i.e. political connection continues to be positively associated with $\Delta MATURITY$ and significantly and positively associated with ΔROA , ΔDTA , and $\Delta CURRENT$ models.

5.4.5. Inclusion of Other Measures of Corporate Governance

The valuable effects of political connection on the firm's performance and risk-taking could be mitigated if the firms are followed by analysts or have outstanding American deposit receipts (ADRs). For instance, being under the scrutiny of analysts and foreign investors could discourage politically connected firms from extracting benefits from their political ties. Indeed, Leuz and Oberholzer-Gee (2006) find that politically connected firms in Indonesia are less likely to have publicly traded foreign securities and are more likely to increase their foreign financing when the government patron falls from power. In Models 4 of Table 5, we introduce a dummy variable (*ADRS*) that is equal to one if the firm has outstanding ADRs, and zero otherwise. In Models 5, we introduce a dummy variable (*ANALYST*) that is equal to one if the firm is followed by analysts, and zero otherwise. Supporting our prior evidence on the link between political connections and the firm's performance and risk-taking, we find a significant and expected sign for the *POLITICAL* coefficient in Models 4 and 5. The introduction of these two variables does not affect our results. Finally, in Model 6 of Table 5, we introduce an extra-legal measure of corporate governance, *NEWSPAPER*, from Dyck and Zingales (2004): a proxy for press freedom in the country, which could disclose and restrain the cases of political connections and hence their rent-seeking activities. The introduction of this measure does not affect our results

significantly. Profitability and risk-taking still remain higher for connected firms as compared to their matching non-connected counterparts.

In a nutshell, the results from these sensitivity tests reinforce our basic inferences on the substantial effect of political connection on firms' performance and risk-taking.

Insert Table 5 about here

6. Conclusion

In this paper, we rely on a unique data set of 234 politically connected firms from 23 countries to extend recent evidence on the benefits firms draw from their political ties. Our analysis focuses on whether political connections increase firms' performance and lead them to take more risks to finance their activities. Prior evidence implies that political connection is valuable to firms. However, other studies document that the impact of political connections on performance is negative. The use of a new approach to study the impact of political connections, namely an international event study over the three years surrounding the establishment of the political connection, allows us to disentangle both effects and is well suited to examine these issues.

We expect to observe an increase in leverage ratios and debt maturities after the political connection has been established. Indeed, due to their ties with politicians and government bureaucrats, politically connected firms could have easier access to long-term debt, especially from state-owned banks. The risk of having a higher leverage ratio is counterbalanced by the evidence that they are usually bailed out by the government when they encounter financial distress. In contrast, the impact of political connections on performance and liquidity could go in both directions. Politically connected firms could obtain important government contracts and hence increase their performance. In return, the government will want to obtain political benefits by recommending over-employment to win the votes of the employees and their relatives.

We report evidence that politically connected firms increase their performance after the establishment of the political connection. We also document an increase in their financial leverage, their use of long-term debt, and their liquidity ratio during the first three years of the political connection vis-à-vis the three years before the connection. Another interesting result is brought to light in our study. We generally find that the impact of the political connection is greater for stronger ties.

Our paper contributes to the recent cross-country evidence on how politics and firms are closely and mutually related (Brown and Dinc, 2005; Claessens et al., 2008; Sapienza, 2004). We also add to the literature on the agency theory. Managers could engage in riskier projects without worrying about career concerns, owing to their link with the government. Finally, analyzing the relation between political connections and firms' performance and risk-taking ratios highlights the importance of considering the political ties between firms and governments when studying these different measures.

TABLE A1*Firm and Country Specific Control Variables*

Panel A. Dependent Variables		
ΔROA	Change in ROA during the political connection window (-1;-3 VS +1:+3)	Worldscope
ΔDTA	Change in DTA during the political connection window (-1;-3 VS +1:+3)	Worldscope
$\Delta CURRENT$	Change in current assets/current liabilities ratio during the political connection window (-1;-3 VS +1:+3)	Worldscope
$\Delta MATURITY$	Change in long-term debt/short-term debt during the political connection window (-1;-3 VS +1:+3)	Worldscope
Panel B. Firm-Specific Variables		
<i>POLITICAL</i>	A dummy variable that is equal to one if the firm is politically connected	Faccio (2006) Updated
<i>GOV</i>	A dummy variable that is equal to one if the firm is politically connected through a member of the government	Faccio (2006) Updated
<i>MP</i>	A dummy variable that is equal to one if the firm is politically connected through a member of parliament	Faccio (2006) Updated
<i>CLOSE</i>	A dummy variable that is equal to one if the firm is politically connected through a close relationship	Faccio (2006) Updated
<i>DIRECTORSHIP</i>	A dummy Variable that is equal to one if the firm is politically connected through directorship	Faccio (2006) Updated
<i>OWNERSHIP</i>	A dummy variable that is equal to one if the firm is politically connected through ownership	Faccio (2006) Updated
<i>SIZE</i>	Natural Log of Total Market capitalization, US Dollars	Worldscope
<i>COLLATERAL</i>	(Inventory + Gross PPE)/Total Assets	Worldscope
<i>OPERINC</i>	Operating Income/Total Assets	Worldscope
<i>ANALYSTS</i>	A dummy variable that is equal to one if the firm is followed by an analyst	I/B/E/S
<i>ADRS</i>	A dummy variable that is equal to one if the firm has an ADR	Bank of New York, City Bank, and JP Morgan
Panel C. Country-Specific Variables		
<i>CORRUPTION</i>	The International Country Risk Guide (ICRG) assessment of a country's corruption.	ICRG
<i>RL</i>	Rule of Law is the assessment of the law and order tradition of the country	ICRG
<i>CR</i>	An index reflecting creditor rights. It is formed by adding 1 when (1) the country imposes restrictions , such as creditors consent or minimum dividends to file for reorganization; (2) secured creditors are able to gain possession of their security once the reorganization petition has been approved (no automatic stay); (3) secured creditors are ranked first in the distribution of the proceeds that result from the disposition of the assets of a bankrupt firm; and (4) the debtor does not retain the administration of <i>his</i> property pending the resolution of the reorganization. The index ranges from zero to four.	Djankov et al. (2007)

<i>ASR</i>	Index that is created by “examining and rating companies’ 1990 annual report on their inclusion or omission of 90 items. These items fall into seven categories (general information, income statements, balance sheets, fund flow statement, accounting disclosure standards, stock data, and special items). A minimum of three companies in each country were studied.” Approximately 70% of the companies screened are industrials, while the remaining 30% represent financials.	La Porta et al. (1998)
<i>LGDP</i>	The natural log of GDP per capita	World Development Indicators
<i>NEWSPAPER</i>	Circulation of daily newspapers divided by population	Dyck and Zingales (2004)

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TABLE 1

Description of the Sample of Politically Connected Firms

Distribution of political connections					
By country			By industry		
Country	Number	Percentage	Industry	Number	Percentage
Australia	2	0.85	Basic industries	20	8.55
Belgium	1	0.43	Capital goods	10	4.27
Canada	4	1.71	Consumer durables	36	15.38
Chile	2	0.85	Construction	20	8.55
Finland	2	0.85	Finance/real estate	46	19.66
France	12	5.13	Food/tobacco	17	7.26
Germany	4	1.71	Leisure	11	4.70
Indonesia	12	5.13	Petroleum	4	1.71
Italy	13	5.56	Services	25	10.68
Japan	27	11.54	Textiles/trade	12	5.13
Malaysia	22	9.40	Transportation	13	5.56
Mexico	4	1.71	Utilities	20	8.55
Philippines	4	1.71	Total	234	100
Portugal	2	0.85	By year		
Russian Federation	2	0.85	Year	Number	Percentage
Singapore	10	4.27	1989	1	0.43
Sweden	4	1.71	1990	1	0.43
Switzerland	5	2.14	1991	14	5.98
South Korea	6	2.56	1992	15	6.41
Thailand	13	5.56	1993	6	2.56
Taiwan	2	0.85	1994	3	1.28
United Kingdom	79	33.76	1995	9	3.85
USA	2	0.85	1996	11	4.70
Total	234	100	1997	22	9.40
By definition			1998	20	8.55
Definition	Number	Percentage	1999	22	9.40
Member of parliament	146	62.39	2000	24	10.26
Close relationship	26	11.11	2001	25	10.68
Government	62	26.50	2002	26	11.11
Total	234	100	2003	35	14.96
By position			Total	234	100
Position	Number	Percentage			
Ownership	65	27.78			
Directorship	169	72.22			
Total	234	100			

Notes: This table provides some descriptive statistics for the sample of 234 politically connected firms used in this study. We report the distribution of political connections included in the sample by country, definition, industry, year, and by position.

TABLE 2
Univariate Tests by Political Connections

	Means		<i>T</i> - Statistics	Medians		<i>Z</i> - Statistics
	Politically Connected (A)	Non- Connected (B)		Politically Connected (C)	Non- Connected (D)	
Δ ROA	1.257	0.665	-2.583***	0.889	0.729	-2.347**
Δ DTA	1.520	0.184	-2.436***	0.636	-0.206	-2.374**
Δ CURRENT	0.046	-0.120	-2.007**	0.008	-0.026	-1.011
Δ MATURITY	0.319	-0.372	-2.990***	0.187	-0.212	-3.572***

Notes: This table reports measures of central tendency for all dependent variables for the politically connected firms and non-connected subsamples. The full sample includes 234 firms from 23 countries. The superscripts asterisks ***, **, and * denote statistical significance at the 1%, 5%, and 10% levels, respectively. The definitions and data sources for the variables are outlined in Table A1.

TABLE 3*Political Connections and Corporate Performance and Risk*

<i>Dependant Variable</i>	Δ ROA	Δ DTA	Δ CURRENT	Δ MATURITY
CONSTANT	4.448 (0.426)	-8.192 (0.791)	-11.669*** (0.002)	0.696 (0.982)
POLITICAL	0.539** (0.016)	2.358*** (0.009)	0.143*** (0.003)	2.938* (0.075)
COLLATERAL	0.418 (0.196)	-2.878 (0.137)	0.268 (0.195)	-0.383 (0.830)
OPERINC	0.029 (0.976)	-4.952 (0.291)	0.563 (0.509)	3.565 (0.315)
SIZE	0.087* (0.064)	0.141 (0.692)	0.012 (0.681)	0.036 (0.843)
CORRUPTION	-0.157 (0.568)	1.291 (0.206)	0.109 (0.291)	1.657 (0.195)
RL	0.996** (0.010)	3.140** (0.034)	-0.221* (0.083)	0.542 (0.319)
CR	0.134 (0.331)	-1.487** (0.011)	-0.439*** (0.000)	-2.176 (0.399)
ASR	-0.096*** (0.000)	0.161* (0.081)	-0.024** (0.027)	-0.310 (0.349)
LGDP	-0.635 (0.394)	-3.369 (0.411)	1.521*** (0.004)	1.659 (0.733)
Industry Effect	YES	YES	YES	YES
Country Effect	YES	YES	YES	YES
AdjRSQ	0.106	0.160	0.159	0.369
Sample Size	356	371	348	227

Notes: This table reports regression results of firms' corporate performance and risk on a variable representing political connections, and all others are control variables. Political connections data are drawn from Faccio (2006) and updated. Appendix A.1 reports detailed definitions and data sources for all variables. Beneath each coefficient is the *p-value* robust and clustered at the country level. The superscript asterisks ***, **, * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

TABLE 4

Type of Political Connections and Corporate Performance and Risk

<i>Dependent Variable</i>	Δ ROA	Δ DTA	Δ CURRENT	Δ MATURITY	Δ ROA	Δ DTA	Δ CURRENT	Δ MATURITY
CONSTANT	4.470 (0.426)	-4.397 (0.842)	-11.539*** (0.003)	0.628 (0.984)	4.412 (0.428)	6.416 (0.798)	-11.450*** (0.003)	10.659 (0.711)
GOV					0.557*** (0.008)	5.804*** (0.006)	0.124 (0.407)	6.659 (0.160)
MP					0.500* (0.091)	1.425 (0.188)	0.122 (0.129)	1.839** (0.019)
CLOSE					0.773* (0.078)	-0.228 (0.904)	0.365*** (0.002)	2.063* (0.092)
OWNERSHIP	0.516* (0.050)	8.244*** (0.000)	0.106 (0.471)	3.181** (0.036)				
DIRECTORSHIP	0.546** (0.030)	0.407 (0.684)	0.158** (0.030)	2.863 (0.108)				
COLLATERAL	0.419 (0.195)	-3.089** (0.034)	0.267 (0.199)	-0.375 (0.832)	0.419 (0.215)	-3.241* (0.073)	0.287 (0.166)	-0.169 (0.922)
OPERINC	0.028 (0.976)	-5.328 (0.183)	0.566 (0.516)	3.468 (0.350)	0.049 (0.961)	-5.747 (0.185)	0.565 (0.522)	2.459 (0.306)
SIZE	0.087* (0.073)	0.255 (0.409)	0.011 (0.728)	0.033 (0.865)	0.086* (0.080)	0.223 (0.485)	0.013 (0.688)	-0.016 (0.916)
CORRUPTION	-0.155 (0.574)	0.651 (0.455)	0.114 (0.281)	1.688 (0.183)	-0.162 (0.559)	0.948 (0.295)	0.100 (0.333)	2.034 (0.174)
RL	0.995** (0.010)	1.734 (0.131)	-0.220* (0.086)	0.531 (0.299)	0.992** (0.011)	2.047 (0.103)	-0.230* (0.068)	0.578 (0.313)
CR	0.134 (0.332)	2.443*** (0.000)	-0.437*** (0.000)	-2.165 (0.407)	0.139 (0.317)	2.814*** (0.000)	-0.431*** (0.000)	-1.250 (0.523)
ASR	-0.096*** (0.000)	-0.222* (0.079)	-0.024** (0.026)	-0.311 (0.347)	-0.097*** (0.000)	-0.262** (0.012)	-0.023** (0.036)	-0.268 (0.358)
LGDP	-0.639 (0.392)	-1.263 (0.705)	1.504*** (0.005)	1.662 (0.732)	-0.623 (0.398)	-2.619 (0.455)	1.495*** (0.006)	-0.042 (0.992)
Industry Effect	YES	YES	YES	YES	YES	YES	YES	YES
Country Effect	YES	YES	YES	YES	YES	YES	YES	YES
AdjRSQ	0.106	0.203	0.159	0.369	0.107	0.177	0.163	0.400
Sample Size	356	371	348	227	356	371	348	227

Notes: This table reports regression results of firm's corporate performance and risk on variables representing the type of political connections, and all others are control variables. Political connections data are drawn from Faccio (2006) and updated. Appendix A.1 reports detailed definitions and data sources for all variables. Beneath each coefficient is the *p-value* robust and clustered at the country level. The superscript asterisks ***, **, * denote statistical significance at the 1%, 5%, and 10% levels, respectively.

Table 5
Robustness Tests

<i>Dependant variable</i>	<i>1st stage</i>	Models 1				Models 2				Models 3			
	<i>POLI-TICAL</i>	Δ ROA	Δ DTA	Δ CURRENT	Δ MATURITY	Δ ROE	Δ LDTE	Δ QUICK	Δ WORKST	Δ ROA	Δ DTA	Δ CURRENT	Δ MATURITY
CONSTANT	-30.908*** (0.000)	3.912 (0.455)	-9.349 (0.783)	-11.949*** (0.002)	0.313 (0.992)	-5.298 (0.655)	5.333 (0.847)	-9.071*** (0.001)	-52.967 (0.630)	3.822 (0.584)	34.395 (0.315)	-9.796* (0.065)	0.581 (0.989)
POLITICAL						0.734*** (0.004)	0.817* (0.072)	0.222* (0.082)	-1.798 (0.222)	0.582** (0.016)	2.328** (0.022)	0.128*** (0.009)	2.721 (0.130)
CITY	19.313*** (0.000)												
I_POLITICAL		0.561** (0.024)	2.779*** (0.003)	0.117** (0.021)	3.040* (0.096)								
COLLATERAL	0.136 (0.819)	0.435 (0.183)	-2.813 (0.150)	0.268 (0.193)	-0.508 (0.779)	0.570 (0.270)	-0.130 (0.935)	0.961** (0.019)	3.296 (0.212)	0.450 (0.290)	-3.840 (0.089)	0.285 (0.174)	1.141 (0.579)
OPERINC	2.403*** (0.001)	-0.038 (0.968)	-5.401 (0.242)	0.557 (0.512)	3.349 (0.349)	-0.815 (0.486)	-2.823 (0.447)	0.773 (0.304)	4.423 (0.485)	0.030 (0.975)	-5.029 (0.264)	0.561 (0.505)	3.370 (0.334)
SIZE	-0.175** (0.034)	0.092* (0.057)	0.211 (0.536)	0.013 (0.667)	0.024 (0.890)	-0.061 (0.400)	-0.019 (0.908)	0.016 (0.591)	-0.092 (0.483)	0.086* (0.087)	0.007 (0.984)	0.016 (0.563)	0.090 (0.657)
CORRUPTION	0.137 (0.764)	-0.168 (0.535)	1.075 (0.278)	0.100 (0.347)	1.651 (0.196)	1.045** (0.012)	-0.851 (0.361)	0.138 (0.118)	1.112 (0.368)	-0.090 (0.762)	0.487 (0.676)	0.074 (0.451)	1.621 (0.228)
RL	1.912 (0.486)	0.941** (0.020)	3.277** (0.042)	-0.208 (0.108)	-0.442 (0.690)	0.267 (0.593)	1.201 (0.170)	-0.061 (0.609)	-1.544 (0.406)	0.948** (0.021)	4.235*** (0.004)	-0.161 (0.238)	0.573 (0.382)
CR	6.867** (0.015)	0.895** (0.010)	4.034*** (0.003)	0.002 (0.983)	-0.778 (0.606)	0.442 (0.133)	-0.825** (0.017)	-0.377*** (0.000)	-2.232 (0.703)	0.129 (0.394)	-0.887 (0.167)	-0.424*** (0.000)	-1.922 (0.555)
ASR	-0.478*** (0.000)	-0.089*** (0.000)	0.172* (0.052)	-0.024** (0.022)	-0.150 (0.553)	-0.067** (0.011)	0.176** (0.018)	-0.017*** (0.005)	-0.231 (0.646)	-0.098*** (0.000)	0.267** (0.049)	-0.020 (0.160)	-0.283 (0.470)
LGDP	3.266 (0.286)	-0.670 (0.348)	-4.016 (0.373)	1.497*** (0.005)	1.254 (0.790)	0.251 (0.876)	-1.910 (0.608)	1.026*** (0.007)	7.862 (0.644)	-0.551 (0.543)	-8.898* (0.071)	1.258* (0.082)	1.264 (0.848)
Industry Effect	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Country Effect	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
AdjRSQ	0.563	0.104	0.154	0.151	0.208	0.122	0.208	0.109	0.253	0.106	0.170	0.134	0.372
Sample Size	395	356	371	348	227	347	340	351	266	320	334	342	208

Table 5 (continued)
Robustness Tests

<i>Dependant variable</i>	Models 4				Models 5				Models 6			
	Δ ROA	Δ DTA	Δ CURRENT	Δ MATURITY	Δ ROA	Δ DTA	Δ CURRENT	Δ MATURITY	Δ ROA	Δ DTA	Δ CURRENT	Δ MATURITY
CONSTANT	4.197 (0.491)	-7.142 (0.837)	-11.511*** (0.003)	1.494 (0.962)	3.646 (0.518)	-5.323 (0.867)	-12.494*** (0.003)	1.376 (0.965)	2.476 (0.680)	10.634 (0.756)	-14.782*** (0.002)	-5.041 (0.865)
POLITICAL	0.545** (0.017)	2.340** (0.011)	0.139*** (0.004)	2.859* (0.078)	0.512** (0.024)	2.409*** (0.009)	0.134*** (0.004)	2.849* (0.065)	0.544** (0.016)	2.505*** (0.006)	0.135*** (0.003)	2.932* (0.078)
COLLATERAL	0.437 (0.207)	-2.918 (0.177)	0.261 (0.236)	-0.273 (0.873)	0.431 (0.180)	-2.882 (0.130)	0.274 (0.181)	-0.377 (0.837)	0.429 (0.189)	-2.952 (0.134)	0.289 (0.176)	-0.413 (0.818)
OPERINC	-0.030 (0.972)	-4.859 (0.317)	0.591 (0.514)	2.953 (0.423)	0.054 (0.955)	-4.946 (0.304)	0.575 (0.488)	3.442 (0.308)	-0.005 (0.996)	-5.434 (0.262)	0.580 (0.507)	3.585 (0.316)
SIZE	0.105 (0.126)	0.100 (0.863)	0.003 (0.945)	0.217 (0.429)	0.182* (0.087)	-0.066 (0.889)	0.047 (0.350)	-0.199 (0.447)	0.092* (0.058)	0.199 (0.568)	0.012 (0.696)	0.033 (0.857)
CORRUPTION	-0.157 (0.567)	1.286 (0.211)	0.108 (0.289)	1.651 (0.192)	-0.146 (0.598)	1.247 (0.224)	0.122 (0.234)	1.585 (0.200)	-0.159 (0.602)	1.131 (0.274)	0.127 (0.256)	1.660 (0.194)
RL	1.018*** (0.006)	3.106** (0.039)	-0.229* (0.080)	0.621 (0.245)	1.059*** (0.007)	3.054** (0.039)	-0.215* (0.084)	0.567 (0.289)	1.054*** (0.009)	-1.279 (0.525)	-0.161 (0.197)	8.007*** (0.001)
CR	0.163 (0.255)	-1.549** (0.018)	-0.454*** (0.000)	-2.098 (0.409)	0.117 (0.398)	-1.433** (0.016)	-0.452*** (0.000)	-2.485 (0.411)	0.673*** (0.000)	-0.440 (0.807)	0.416*** (0.002)	-5.025*** (0.000)
ASR	-0.098*** (0.000)	0.164 (0.116)	1.522*** (0.003)	-0.315 (0.344)	-0.094*** (0.000)	0.156 (0.103)	1.558*** (0.004)	2.120 (0.700)	-0.059*** (0.001)	0.259 (0.148)	0.029*** (0.000)	-1.228*** (0.000)
LGDP	-0.646 (0.385)	-3.406 (0.421)	-0.024** (0.038)	1.293 (0.784)	-0.728 (0.352)	-3.318 (0.427)	-0.024** (0.023)	-0.345 (0.358)	-0.647 (0.391)	-3.626 (0.393)	1.547*** (0.005)	1.670 (0.731)
ADRS	-0.132 (0.727)	0.316 (0.894)	0.070 (0.663)	-1.258 (0.125)								
ANALYSTS					-0.483 (0.202)	1.050 (0.402)	-0.179 (0.221)	1.195 (0.505)				
NEWSPAPER									-0.393*** (0.003)	1.123* (0.070)	-0.601*** (0.000)	2.225** (0.026)
Industry Effect	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Country Effect	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
AdjRSQ	0.106	0.160	0.160	0.371	0.109	0.160	0.163	0.370	0.106	0.158	0.161	0.368
Sample Size	356	371	348	227	356	371	348	227	351	366	343	223

Notes: This table reports regression results of firm's corporate performance and risk on a variable representing political connections, and all others are control variables. Political connections data are drawn from Faccio (2006) and updated. Appendix A.1 reports detailed definitions and data sources for all variables. Beneath each coefficient is the *p-value* robust and clustered at the country level. The superscript asterisks ***, **, * denote statistical significance at the 1%, 5%, and 10% levels, respectively.