

【特集・論文】

# Rent Seeking and Political Connections of China's Family-Controlled Listed Companies\*

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## 1. Introduction

Rent seeking is the economic gains obtained from others to a resourceful firm without reciprocating any benefits back to society through wealth creation. The largest resource comes from the government in China. Can the firms benefit through political connections in China?

Faccio (2006) find that political connection can increase the value of the firm. Khwaja and Mian (2005) and Leuz and Oberholzer (2005) point out that firms with political connections can obtain preferential financing. Faccio (2006) and Adhikari et al. (2006) show that a good relationship with government can bring tax relief to the firm. Faccio et al. (2006) find that political connections are associated with government supports.

However, Shleifer and Vishny (1998) and Faccio et al. (2006) argue that political connection may damage firm value. Fan et al (2007) find that political connections destruct corporate values in China, evidenced by lower three-year post-IPO stock returns and by poorer growth of three-year post-IPO earnings. Bai et al. (2006) and Chen et al. (2011) argue that political connections serves for

investor protections in China. It demands a further study to understand whether and how political connections can bring governmental benefits to the connected firms.

In this paper, we examine the data of the family-controlled firms listed on the Shanghai or Shenzhen Stock Exchanges. We find that political connections of family-controlled firms significantly bring about better long term performance after listing and that political connections are associated with easier access to bank loans, longer term loans, higher tax rebates, and more government subsidies in family-controlled firms.

This paper makes the following contributions to the literature. First, we provide the concrete empirical evidences of rent seeking by the family-controlled firms in China, if they are well politically connected. Second, our paper

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enriches the literature of political connections (e.g. Faccio, 2006 and Faccio et al., 2006). Third, our findings of government benefits develop Allen et al. (2005), Bai et al. (2006), Li et al. (2006), and Chen et al. (2011).

The rest of this paper is organized as follows. Section 2 reviews the literature and develops the research hypotheses. Section 3 defines the sample, variables, and empirical models employed. Section 4 empirically examines and discusses the relationship between political connections and rent seeking as well as stock returns. Section 5 concludes.

## 2. Rent seeking and political connections

Political connections are a growing stream of literature in finance and economics. Faccio (2006) finds that share prices significantly rise up in a company if setting up political connections, but Faccio et al. (2006) and Boubakri et al. (2008) argue that politically connected firms financially perform worse than their non-connected peers.

In the study of political connections in China, Fan et al. (2007) show that the accounting and stock performance of firms run by politically connected CEOs are worse than their unconnected counterparts in the newly privatized firms. However, Allen et al. (2005) and Bai et al. (2006) argue that being connected to the government can bring about investor protections. Li et al. (2008) argue that the memberships of communist party for the senior executives take the positive influences on the performance of private firms. Chen et al. (2011) suggest that political connections can rise up the value of private firms.

In this paper, we argue that political connections bring about rent seeking and increase corporate value in the connected family-controlled firms with its weaker legal

environment, such as China. The rents may come from better lending conditions, since most banks are controlled by the government in China (Tian and Estrin, 2007). Leuz and Oberholzer (2005) and Khwaja and Mian (2005) argue that politically connected firms are easier to achieve bank loans. Li et al. (2008) show that the Communist-Party membership of private entrepreneurs helps to obtain loans from the banks. Chan et al. (2012) argue that there are no financing constraints in the politically-connected firms with the supports from the government. Given the problem of credit rationing in an emerging market, it implies that the Chinese connected firms can have more loans from the state-controlled banks, especially the long-term loans.

Hypothesis 1: Political connections can increase the leverage ratios.

The rents shall also include less tax payments. Faccio (2006) finds that politically connected firms enjoy lower taxes than non-connected ones. Examining the public listed companies in Malaysia, Adhikari et al. (2006) suggest that tax-rate of politically-connected firms is lower. Wu et al. (2012) also find that private firms with politically connected managers enjoy tax benefits in China. We therefore have the hypothesis 2.

Hypothesis 2: Political connections help to reduce tax burdens.

The rents shall also include the government subsidies. Faccio et al. (2006) suggest that the politically connected firms can get more financial aides from the government than non-connected firms. The hypothesis 3 is as the following.

Hypothesis 3: Political connections are positively associated with the government subsidies.

If the above is true, the connected firms can

gain the benefits from the government. That is, rent seeking raises up corporate values at the cost of the social welfare. We therefore have the hypothesis 4.

Hypothesis 4: Political connections bring about higher long-term stock returns.

### 3. Sample, variables, and models

#### 3.1. Sample

We study the share price data and financial data from January 2009 to December 2011 for the firms in China's stock market. That is, our sample includes the firms listed onto Shanghai or Shenzhen Stock Exchanges in the year of 2008. Our sample only retains the firms whose ultimate controlling owners are the individuals or families.<sup>1</sup>

Our database includes the financial data, market data, the data of ultimate controlling owners and the data of political connections of all board members. Annual financial data and monthly market microstructure data are taken from CSMAR database and WIND database, respectively. We manually collected the data of ultimate controlling owners and the political connections of board members from the IPO prospectus released in 2008.

If these board chairmen served in the central government, local governments or military or they are former or current members of NPC (National People's Congress) or of CPPCC (Chinese People's Political Consultative Conference), we take them as being politically connected. As a result, our final sample consists of 57 companies and there are 21 firms with political connections. If

taking the general managers into account, there are 45.1% firms to be politically connected. If taking the non-independent directors into account, there are 60.2% firms having political connections.

#### 3.2. Variables

In the family-controlled firms in China, the boss takes to the role of the board president instead of the general manager and the boss tends to make the decision with its large sizes of shares. Actually, the board president tends to get involved in the day-to-day operations and management of the firm, as the representative of the legal person. Therefore, it is in need to examine whether the political backgrounds of board chairmen take influence on corporate behaviors. The dummy variables of political connections are measured by whether the board president is politically connected. Besides it, our paper also examines the impact of political connections with the data of the general managers and the directors of board in the robustness tests.

Following Khwaja and Mian (2005), Adhikari et al. (2006), Faccio et al. (2006), and Fan et al. (2008), we examine the data of loan sizes, loan maturity, effective tax rates, and government subsidies for three years after public listing. We follow the simple measures to examine

As a proxy of real tax burden of the firm, the variables of real effective tax rates capture tax preference, tax base preference, and tax mount preference. Shevlin (1987) suggests several methods to calculate the real effective tax rate and we correspondingly work out the variables of TAX1, TAX2 and TAX3 and the definitions of the variables are given in table 1. The variables of government subsidies are adjusted by firm income and total assets, respectively. To reduce the industrial effect, we adjust the

1 For the purpose of comparison with Fan et al. (2007), these firms in the financial industry are involved to perform empirical analyses. However, the results of this paper hold when these firms are taken out from our sample.

Table 1. Definitions of variables

Variable name	Variable definition
POL	Political dummy equals 1 if the president has working experiences serving government or military, or is a former or current member of NPC or CPPCC, and 0 otherwise.
Leverage	Financial leverage ratio. The current Year debt-to-asset ratio of a firm.
Stashare	The percentage of state shareholding.
Lnasset	Natural log of total assets.
Market_Book	Market-to-equity ratio measured as market value over book value in IPO Year end.
Regulated	Regulatory industry dummy. Regulated equals 1 if the firm is in heavily sector (natural resources, public utilities, or finance and real estate), and 0 otherwise.
Total_Loan	Total_Loan is measured as the long term bank loan plus short term loan divided by total assets.
Loan_Term	Loan_Term is calculated by long term bank loan over total assets.
TAX <sub>i</sub>	Real effective tax-rate, $i=1, 2, 3$ . TAX1 is calculated as income tax expense less deferred income tax expense, and divided by EBIT. TAX2 is defined as income tax expense divided by adjusted pre-tax accounting income. TAX3 is measured as income tax expense minus deferred income tax expense, and divided by adjusted pre-tax accounting income. We calculate adjusted pre-tax accounting income as pre-tax income minus the difference between deferred income tax expense and applicable tax-rate.
Subsidy <sub>i</sub>	Government subsidy, $i=1, 2, 3, 4$ . Subsidy1 and Subsidy3 are calculated by government subsidy divided by total income and total asset, respectively. Subsidy2 and subsidy4 are calculated by government subsidy minus added-value tax divided by total income and total asset, respectively.
BHAR <sub>i</sub>	The $i$ months buy-and-hold abnormal stock return from 2nd month after IPO, adjusted by equally weighted return of Shanghai and Shenzhen stock Exchange, $i=12, 24, 36$ .

above measures with the corresponding industry median value.

Following Fan et al. (2007) and Chen et al. (2011), we measure share performance with the abnormal market-adjusted buy-and-hold returns (BHAR) of 12-month, 24-month and 36-month after being listed into the stock markets. The CAR and BHAR are adjusted by the equally weighted indices of Shanghai and Shenzhen Stock Exchanges in all our analysis. If the adjustment changes to the value weighted indices, all our results remain almost the same. Table 2 presents the definitions of

variables.

The choice of control variables follows Fan et al. (2007) to use the following variables, including *Loan\_Term* (financial leverage), *State-share* (the percentage of state share), *Lnasset* (the natural log of total assets), *Market\_Book* (the market-to-book ratio) and *Regulated* (industry dummy variable).

### 3.3. Models

The relationship between the rents and political connections are examined by the following model:

$$Rent_i = \alpha_0 + \beta_1 POL + B * Controls + \varepsilon \quad (1)$$

The *Rent* are approximated by the variables of leverages, tax rates and subsidies. *POL* is the abbreviation of political connections. The control variables are shown in the following tables.

We further examine the relationship between stock returns and political connections with the following model:

$$\begin{aligned} BHAR_i = & \alpha_0 + \beta_1 POL + \beta_2 Leverage \\ & + \beta_3 Stateshare + \beta_4 Lnasset \\ & + \beta_5 Market\_Book \\ & + \beta_6 Regulated + \varepsilon \end{aligned} \quad (2)$$

where *BHAR<sub>i</sub>* (*i*=12, 24, 36) represents the 12, 24, and 36-month buy and hold abnormal equally weighted adjusted returns<sup>2</sup>, respectively.

#### 4. Regression results

In this section, we empirically examine and discuss the relationship between the rents and political connections. We find that political connections can bring about lending facilitates, reduce tax burdens, result in government subsidies and therefore increase the stock returns after public listing.

We use model (1) to test the relationship between political connection and bank loan, effective tax-rate, and government subsidy in family-controlled firms. The regression results are reported in the following tables, where the robust OLS estimation methods are used.

Table 2 report the regression results of political connection on bank loans. Column 1 displays that political connections have a positive impact on total loans at 10% level, which indicates political connection is conduc-

Table 2. Lending facilities and political connections

	Total_Loan	Loan_Term
POL	0.014* (1.67)	0.007** (1.75)
Leverage	-0.014*** (-6.88)	-0.003** (-2.41)
Stateshare	0.205*** (6.09)	0.042*** (2.91)
Lnasset	-0.000 (-0.02)	0.000 (0.02)
Market_Book	-0.006*** (-3.43)	-0.001 (-1.19)
Regulated	0.014 (0.70)	0.135*** (5.10)
Intercept	0.260* (1.77)	0.009 (0.13)
adj. R2	0.249	0.377

Note: The dependent variables in this table are the total bank loan *Total Loan*, the loan term *Loan Term*, real effective tax-rate *TAX1-TAX3*, and government subsidy *subsidy1-subsidy4*. The independent variables are a dummy variable *POL* equal to 1 if the president is politically connected (zero otherwise), financial Leverage ratio *Leverage*, the percentage ownership of government *Stateshare*, the natural log of total assets *Lnasset*, the Market to book equity ratio *Market\_Book*, and a dummy variable *Regulated* equal to one if the firm is in a heavily regulated sector (natural resources, public utilities, or finance and real estate). The robust ordinary least square method is used in this table. Robust t-statistics are provided in parentheses. \*\*\*, \*\*, \* denote significant at the 1%, 5%, and 10% levels, respectively.

tive to help private listed firms obtain more bank loans. Column 2 shows that political connection is positively relative to loan maturity which is consistent with Fan et al. (2008). Columns 1 and 2 suggest that political connections can alleviate financing constraints of family-controlled firms. It supports Khwaja and Mian (2005) that political connections can bring not only more loans but also longer

<sup>2</sup> The conclusion of this paper holds when CARs are scaled by value weighted market return of Shanghai and Shenzhen stock exchanges.

Table 3. Tax rebates and political connections

	TAX1	TAX2	TAX3
POL	-0.036** (-2.40)	-0.033* (-1.77)	-0.027** (-1.99)
Leverage	-0.003 (-0.36)	-0.003 (0.62)	-0.004 (-1.31)
Stateshare	-0.076 (-1.39)	-0.045 (-0.66)	-0.057 (-1.23)
Lnasset	0.009 (0.54)	-0.003 (-0.12)	-0.021* (-1.68)
Market_Book	-0.001 (-0.76)	-0.000 (-0.01)	-0.004 (-1.08)
Regulated	0.152 (1.54)	0.046 (0.41)	-0.232** (-2.34)
Intercept	0.139 (0.43)	0.314 (0.85)	0.776** (2.54)
adj. R2	0.418	0.178	0.212

Note: The dependent variables in this table are the real effective tax-rate *TAX1-TAX3*. The independent variables are a dummy variable *POL* equal to 1 if the president is politically connected (zero otherwise), financial Leverage ratio *Leverage*, the percentage ownership of government *Stateshare*, the natural log of total assets *Lnasset*, the Market to book equity ratio *Market\_Book*, and a dummy variable *Regulated* equal to one if the firm is in a heavily regulated sector (natural resources, public utilities, or finance and real estate). The robust ordinary least square method is used in this table. Robust t-statistics are provided in parentheses. \*\*\*, \*\*, \* denote significant at the 1%, 5%, and 10% levels, respectively. Robust t-statistics are provided in parentheses. \*\*\*, \*\*, \* denote significant at the 1%, 5%, and 10% levels, respectively.

maturities of these loans. To some extent, family-controlled companies gain better access to the government-controlled banks in China. Political ties between the government and the family-controlled firms may help the firm to obtain bank loans and ease the financing constraints.

Table 3 reports the regression results of political connection on real effective tax-rate. It can be seen that political connection has a significantly negative impact on tax-rate, which implies that political connection reduces the real effective tax-rate of private firms. This result is consistent with Faccio (2006), Adhikari et al. (2006), and Wu et al. (2012). Political connections help to reduce the tax

burdens.

Table 4 report the regression results of political connection on government subsidies. As can be seen, political connections have a significant and positive effect on government subsidies. Indeed, our results are rather consistent with Johnson and Mitton (2003) and Faccio et al. (2006) and political connections can help the private firms obtain more government subsidies.

Overall, political connections help to get more bank loans, longer loan maturity, lower effective tax-rate, and more government subsidies in the family-controlled firms. If so, can political connections increase corporate values?

Table 4. Government subsidies and political connections

	Subsidy1	Subsidy2	Subsidy3	Subsidy4
POL	0.147*** (3.24)	0.091*** (2.63)	0.076** (2.42)	0.059** (2.40)
Leverage	-0.007 (-0.91)	-0.004 (-0.68)	-0.007* (-1.87)	-0.005 (-1.32)
Stateshare	0.123 (0.55)	-0.086 (-0.51)	0.035 (0.25)	-0.107 (-0.89)
Lnasset	-0.044 (-1.08)	-0.033 (-1.04)	-0.030 (-1.19)	-0.023 (-0.95)
Market_Book	0.022** (2.08)	0.020*** (2.74)	0.018 (0.91)	0.016** (2.47)
Regulated	0.053 (0.19)	0.258 (0.89)	-0.056 (-0.26)	0.214 (1.05)
Intercept	0.778 (0.87)	0.256 (0.39)	0.767 (1.28)	0.176 (0.35)
adj. R2	0.187	0.228	0.163	0.227

Note: The dependent variables in this table are the government subsidies *subsidy1-subsidy4*. The independent variables are a dummy variable *POL* equal to 1 if the president is politically connected (zero otherwise), financial Leverage ratio *Leverage*, the percentage ownership of government *Stateshare*, the natural log of total assets *Lnasset*, the Market to book equity ratio *Market\_Book*, and a dummy variable *Regulated* equal to one if the firm is in a heavily regulated sector (natural resources, public utilities, or finance and real estate). The robust ordinary least square method is used in this table. Robust t-statistics are provided in parentheses. \*\*\*, \*\*, \* denote significant at the 1%, 5%, and 10% levels, respectively. Robust t-statistics are provided in parentheses. \*\*\*, \*\*, \* denote significant at the 1%, 5%, and 10% levels, respectively.

Table 5 reports the 12-month, 24-month and 36-month BHARs of listed firms after IPO. The results display that political connection has significantly positive effects on BHAR24 and BHAR36. It shows that political connections can significantly enhance the value of the firm. With a different dataset, Fan et al. (2007), however, find that the coefficients of the CEO's political connection are significantly negative. The dataset of Fan et al. (2007) are mainly newly partially privatized firms listed onto the stock exchanges. However, we found that political connections have significantly positive effects on corporate value in the family-controlled firms. The coefficients of political connection gradually increase from 0.109 to

0.482, which suggests that positive effects of political connection become larger with longer periods on the stock market and consequently getting more established. Hypothesis 4 is well supported. Consistent with the literature (e.g., Fisman, 2001; Faccio, 2006; Chen et al, 2011), political connections can improve corporate value.

## 5. Conclusion

Examining the firms listed onto Shanghai or Shenzhen Stock Exchanges, this paper investigates the relationship between rent taking and political connections. We find that political connections in the family controlled firms are associated with the governmental benefits,

Table 5. Stock returns and political connections

	BHAR12	BHAR24	BHAR36
POL	0.109** (2.13)	0.379*** (2.97)	0.482** (2.22)
Leverage	0.024** (2.19)	0.028* (1.79)	0.066** (2.21)
Stateshare	-0.919* (-1.98)	-0.466 (-1.17)	-1.269* (-1.91)
Lnasset	0.017 (0.19)	0.028 (0.27)	0.072 (0.38)
Market_Book	-0.028 (-1.38)	-0.006 (-0.2)	0.032 (0.77)
Regulated	0.172 (1.21)	0.172 (1.19)	0.612 (1.47)
Intercept	-0.585 (-0.37)	-0.839 (-0.48)	-2.712 (-0.57)
adj. R2	0.030	0.034	0.029

Note: The dependent variables reported in this table are the 12-, 24-, 36-month buy-and-hold returns (BHARs) adjusted by equally-weighted market return from the second month after the IPO month. Monthly returns are used to calculate the BHARs measures. The independent variables are a dummy variable POL equal to 1 if the president is politically connected (zero otherwise), financial Leverage ratio Leverage, the percentage ownership of government Stateshare, the natural log of total assets Lnasset, the Market to book equity ratio Market\_Book, and a dummy variable Regulated equal to one if the firm is in a heavily regulated sector (natural resources, public utilities, or finance and real estate). The regressions adopt ordinary least square methods. Robust t-statistics are provided in parentheses. \*\*\*, \*\*, \* denote significant at the 1%, 5%, and 10% levels, respectively.

including the better access to bank loans, lower tax effect rates and higher government subsidies. The rents taken from the government can bring up the corporate value at the cost of the social welfare.

In a transition economy, like China, where the legal enforcement is weak and the government intervention is heavy, political connections have different influences on the value of government-controlled and family-controlled firms. With the recent dataset and a more comprehensive approach, our paper develops Fan et al. (2007). We find that the value enhancement of the “helping hand” of the government is larger than the value reduction of the “grabbing hand” in family-

controlled firms, when these firms can successfully build up political connections.

Our results also mean that, the higher value of family firms may come from rent taking instead of corporate efficiency under the poor institutions of legal enforcement in China. The stock market in China may not be able to help much on the efficient resource allocation, as political connections twist the market functions. The relationship between the government and the firms remains a key problem in China even after its partial privatization or with its new family-owned business, since there is still a long way to go for China to improve its legal environments.



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Can political connections bring about government benefits? Investigating the firms publicly listed on the Chinese stock, we find that political connections in family-controlled firms are associated with better accesses to bank loans, less tax payments and more government subsidies. We further find that political connections can result in higher stock returns in the Chinese family-controlled firms. We argue that political connections bring about rents for the family-controlled firms under poor institutional environment, which increases corporate value at the cost of social welfares.