

# Expropriation of minority shareholders in politically connected firms\*

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## Abstract

The conflict of interest between controlling and minority shareholders is an important issue in firms with concentrated ownership. We document that expropriation behavior by controlling shareholders through tunneling or self-dealing is far more severe in politically connected firms than in nonpolitically connected firms. This severity results more from the formers' lower concern with capital market punishment than from the possibility that such firms tend to establish political connections for protection. Consistent with the view that a firm's financing condition influences its corporate governance, we show that such severe expropriation occurs only in firms whose political connection helps them secure bank loan access.

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## 1. Introduction

The agency problems arising from a firm's ownership structure have received enormous academic attention (Berle and Means 1932, Jensen and Meckling 1976). However, whereas literature in the field focuses traditionally on the conflict of interest between the manager and a group of diffused equity holders in U.S. firms, recent international evidence shows that outside the U.S., ownership is actually highly concentrated (Claessens, Djankov, Fan, and Lang 2000, Faccio and Lang 2002) and the central theme in corporate governance is the conflict between controlling and minority shareholders. Most particularly, controlling shareholders have the incentive to expropriate minority shareholders, and so the market, in response, evaluates the ownership concentration negatively (Lemmon and Lins 2003).

The specific practices of expropriation vary depending on each country's legal and regulatory rules on such behavior, and anecdotal evidence illustrates a variety of practices (Johnson, La Porta, Lopez-de-Silanes, and Shleifer 2000). Systematic evidence of specific forms, however, is documented for Hong Kong and Chinese firms, in which controlling shareholders engage widely in self-dealing through related party transactions (Cheung, Rau, and Stouraitis, 2006, Peng, Wei, and Yang 2010) and tunneling through intercorporate loans (Jiang, Lee and Yue 2010). In fact, the Chinese stock market is highly conducive to tunneling and self-dealing behavior because of the widespread dominance of controlling shareholders and the weak legal and regulatory protections for minority shareholders.<sup>1</sup> Such an environment in one specific country provides an ideal platform for investigating the factors beyond the legal and regulatory rules that influence the incentive of controlling shareholders to expropriate minority shareholders.

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<sup>1</sup> Because, as Johnson et al. (2000) show, tunneling and self-dealing typically occur within legal boundaries, the recent disclosure requirements implemented in China on related party transactions may discourage certain controlling shareholders. It does not, however, alleviate the problem. Nor does the reform that allows the state ownership of listed firms to be tradable change the essential feature of the widespread dominance of controlling shareholders. Therefore, despite these new developments on the Chinese stock market, the environment remains conducive to tunneling and self-dealing.

The purpose of this paper is to investigate the effect of political connections on tunneling and self-dealing behaviors. We take advantage of China's institutional environment, which provides fertile soil for tunneling and self-dealing, and in the light of recent disclosure rules on these activities. To distinguish the political connection effect from state ownership, we examine only listed firms that are ultimately owned by private individuals or entities. We find that political connections, particularly those that secure financing sources for the company, have incrementally greater explanatory power beyond firm characteristics and governance measures for tunneling and self-dealing behavior.

Political connections can potentially influence controlling shareholders' incentive to expropriate minority shareholders in the following ways. First, insiders want to seize the benefits that their connections bring to the firms to at least cover the cost of building such connections and possibly more (Morck, Stangeland, and Yeung 2004). Second, politically connected firms face fewer disciplinary constraints from regulatory rules (Berkman, Cole, and Fu 2010). Alternatively, controlling shareholders with a higher tendency for tunneling may be more likely to seek protection from political ties.

Neither these advantages nor the endogenous decision of political ties, however, shield the connected firms from capital market punishment (Lemmon and Lins 2003, Berkman, Cole, and Fu 2010). Hence, the ability to secure capital to fund future investment opportunities without bearing the increased cost of equity financing from expropriation is crucial. One of the most important alternatives to equity financing, particularly in countries with underdeveloped corporate bond markets, is the bank loan.

Political connections help firms to access resources like bank financing both in terms of access and of cost (Khwaja and Mian 2005, Li, Meng, Wang, and Zhou 2008). However, political interference in bank loan allocation makes loan decisions insensitive to firm governance

and risks. Furthermore, priority in accessing bank loans reduces firms' reliance on equity financing, which prevents the equity market from effectively pricing the cost of new capital based on firm condition. Consequently, firms with capital secured through political connections can afford not to care about market punishment. Indeed, our findings indicate that expropriation of minority shareholders can deteriorate to a major extent in such firms because of bank inefficiency and political intervention.

In a general setting, any social network or relationship that can provide firms with secured capital both in terms of amount and cost has the same effect as the political connections addressed here. However, it is much more difficult to document the social network and differentiate its ability to secure capital versus other benefits in a populous society like China. Political connections, on the other hand, are salient and, because the economy is tightly controlled by a ruling party and political intervention in bank loan allocation is widely practiced by both the central and local governments, it makes an ideal measure.

According to our empirical analyses, expropriation is more severe in politically connected firms or firms that are heavily financed by banks, a relation driven particularly by firms that are both connected and heavily bank financed, for which the interactive effect completely eliminates the stand-alone effect of political connection or bank loan. Our results also indicate that bank loan access is positively associated with political connection. All these patterns are more apparent in regions in which bank decisions are less market driven, which also implies that inefficiency in bank financing is the culprit. Finally, firms that are engaging in expropriation of minority shareholders, especially those that are politically connected, significantly underperform other firms, implying that controlling shareholders in these firms steal more than political ties can bring in. These findings are consistent with our argument that political connection can worsen the expropriation of minority shareholders. The fact that firms

without any political connections that access bank loans stay away from expropriation implies that punishment from banks would still be possible through loan pricing, if loan officers' decisions remain unaffected by political ties.

We can derive two important and general lessons from the above observations. First, the financing market can serve as a corporate governance mechanism; that is, the agency problem becomes worse when the capital market cannot effectively penalize moral hazard problems (e.g., when financing resources are allocated based on connections rather than on a firm's financial strength). Second, although political connections can overcome resource constraints or ensure favorable regulatory conditions and investment opportunities, they are not always value adding; that is, they may as equally destroy firm value by making expropriation less costly to block holders, especially in countries with underdeveloped institutions.

Our paper especially echoes the work of Chaney, Faccio, and Parsley (2009), who show that the quality of accounting information from politically connected firms is poorer than that from nonconnected firms because their connections give them advantages in the debt market, meaning that the capital market is less likely to punish them for low standards. Our work is also closely related, however, to Durnev and Kim (2005), who show that the three firm attributes, investment opportunities, financing, and ownership structure, influence corporate governance. Indeed, our analysis provides empirical evidence that corporate governance deteriorates because of the influence political connection has on financing channels.

The rest of the paper proceeds as follows. In section 2, we formulate hypotheses on specific empirical relations based on our argument and explain the methodology used to test these hypotheses. In sections 3, 4, and 5, respectively, we introduce the data, report the empirical results, and discuss robustness. Section 6 concludes the paper.

## 2. Hypotheses and Methodology

### A. Controlling shareholders' decision

In deciding whether or not to steal, controlling shareholders face a tradeoff between short-run benefits and reputation loss in the long run. Nonetheless, the price of the reputation loss depends on the firm's future investment opportunities and the resources it has available to fund these projects. Thus, controlling shareholders are less likely to expropriate minority shareholders if such behavior will make a large impact on the firm's future costs of capital.

Access to financing and its cost is a major concern in any investment opportunity of any firms, but it is especially important for the private sector in China, which is disadvantaged in the allocation of resources. Investors on the equity market, aware of controlling shareholders' reputation for expropriation, require larger discounts if they are to provide a firm with financing, making the company's future seasoned equity offerings more costly. Banks, on the other hand, care mostly about the firm's making good on loans and less about expropriation unless it leads to firm bankruptcy. Nonetheless, bank financing may still be denied or highly priced if the expropriation is severe. It is much easier, however, for firms to influence the decisions of a bank loan officer than those of a group of dispersed investors on the equity market. One channel to influencing such bank decisions is to build political connections.

Therefore, when firm access to bank financing and its cost are guaranteed by certain type of political connections in place, controlling shareholders are minimally concerned with long-run punishment from the capital market and hence have higher incentives to expropriate. Without such connections, however, they are cautious about the firm's reputation on the capital market and are thus less likely to expropriate.

## B. Hypotheses

This rationale underlying controlling shareholders' decisions implies that the preferential treatment in accessing bank loans brought by political connection can encourage the expropriation of minority shareholders because it shields firms from punishment by external financing markets. To support this argument, we first establish the evidence that political connection is one way of obtaining such preferential treatment and, in turn, it encourages expropriation:

Not all political connections are the same, however: whereas some bring financing advantages, others may bring investment opportunities only. Most important, we want to show that only those connections that influence bank financing can influence the incentive to expropriate:

Furthermore, the efficiency of banking decision should matter, because using political relations to interfere with bank lending is more likely to occur and be successful in regions in which the banking industry is less developed; that is, bank lending is less market driven.

Finally, the implications of political connection and expropriation for firm performance, however, are neither simple nor direct. First, although political connection can bring in various benefits that should improve firm performance, it may also lead to profits being tunneled outside the firm. Moreover, the more profitable the firm, the more the controlling shareholders can expropriate. Hence, the net effect between political connection and firm performance is unclear. All else being equal in terms of profitability and political connection, the marginal effect that expropriation has on performance should be negative. This negative relation should also be more profound in politically connected firms because it encourages controlling shareholder to steal even more:

### C. Variable measurements

Consistent with Fan, Wong, and Zhang (2007) and Faccio (2006), we define a firm as politically connected if its CEO or any one of its controlling shareholders or board members is currently or was formerly a government official. In the tests for robustness, we also differentiate between whether the position held is (was) at the central or local government level. Both because of the nature of China's political system and data availability, it was infeasible to adopt the measures used in some other previous studies, such as contributions during electoral campaigns (e.g., Roberts 1990, Kroszner and Stratmann 1998), historical friendships with top politicians (e.g., Fisman, 2001, Johnson and Mitton 2003), and corruption cases (Hellman et al., 2003; Svensson, 2003).

We measure the expropriation of minority shareholders based on two variables: the fund occupation by controlling shareholders, which Jiang, Lee, and Yue (2010) call "intercorporate loans," and the benefit transferred in transactions with controlling shareholders or firms related through controlling shareholders (e.g., business groups), which Cheung, Rau, and Strouraitis (2006) term "related party transactions." Fund occupation, a primary tool by which controlling shareholders tunnel resources, is so widespread in China that the Chinese Security Regulatory Committee (CSRC) has issued repeated warnings on it and has made its disclosure mandatory. Because of weak regulatory enforcement, however, the practice has not abated. We therefore measure fund occupation by the account receivables of controlling shareholders reported in annual reports. In addition, however, because these numbers are quite likely to have been manipulated or underreported, we also include the financial statement item "other account receivables," which are receivables in excess of trading accounts and advanced payments and mostly comprise the actual funds occupied by the controlling shareholders. This latter measurement is also used in Jiang et al. (2010).



Transactions between the firm and its controlling shareholder constitute another tunneling tool, although related-party transactions above RMB 3 million must be reported to the exchange and announced publicly within two working days after the contract date. Given the difficulty of benchmarking the fair price of these transactions, we use the abnormal market returns at announcement to measure the benefits transferred through the transaction. We also categorize the transactions by type and define a dummy variable that equals one if the transaction is a priori likely to result in expropriation of the listed firm's minority shareholders (Cheung et al. 2006). Such transactions include the listed company's acquisition of assets from related parties or sales of assets or equity stake to related parties, the purchase and sale of goods and services, and direct cash payments or loan guarantees from the listed firm to related parties. For transactions whose rationale is strategic or that are likely to benefit the listed firms, this variable takes a value of zero. Such transactions include the listed company's cash receipts; transactions between the listed firm and its subsidiaries; takeover offers in which the connected party is another publicly listed or foreign company; and/or the formation of joint ventures, the acquisition of joint venture stakes from the remaining partners, and the sale of joint venture stakes to the remaining partners.

We measure access to bank loans as the ratio of total bank loans to total firm assets. In China, the location of bank branches is designed to minimize overlap and competition within the same institution by making it parallel with the territorial structure of the government system and by discouraging branches from lending beyond their own area. Hence, the bank industry with which a firm deals is region specific.

To measure regional development heterogeneity of the banking industry, we borrow indices formulated by the World Bank, China's National Economic Research Institute (NERI), and the China Reform Foundation (CRF). The World Bank index (our index 4), applied in a 2004 climate survey of 12,400 firms in 120 Chinese cities (World Bank 2006), is based on the

ratio of loans made to small domestic private firms and whether an informal payment to the loan officer was expected. The NERI and CRF formulated three indices at the province level: an index of banking industry competitiveness in each province using the ratio of nonstate-owned banks' deposits to total deposits in the banking industry (index 1); an index of bank loan competition in each province based on the ratio of loans made to non-SOEs to total loans<sup>2</sup> (index 2); and an index of banking competitiveness that incorporates the deposits and loan completions from indexes 1 and 2 (index 3).

Because what these indices together actually measure is the degree to which the banking industry in each region is market driven, we use all four to capture the heterogeneity of banking development in China. However, even though the original values of the indices are positive, with higher values meaning better development, we multiply these positive values by a negative value to make the results more easily interpretable. Thus, a higher (less negative) number means a less developed banking industry. Finally, we use perceived property rights protection, also taken from the World Bank survey, to proxy legal enforcement.

The measures of firm corporate governance and managerial incentives include the divergence between the ultimate controlling shareholders' cash flow rights and their control rights, board independence, managerial ownership, institutional investor ownership, and a dummy variable that equals one if the ultimate controlling shareholder is private at the time of the firm's IPO, zero otherwise. This latter captures the cases in which firms listed with the state as controlling shareholders were later privatized (while still listed) through block transfer of ownership to private entities or individuals. We also control for auditor quality using a dummy variable that equals one if one of the four largest international auditing companies audits the firms' financials, zero otherwise. We also control for firm characteristics, including size (log

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<sup>2</sup> These non-SOE loans include agricultural loans, township enterprise loans, private enterprise loans, and foreign enterprise loans.

(assets)), age ( $\log(\text{Age})$ ), leverage (total liability over total assets), tangibility (fixed assets over total assets), and the growth rate of sales. Finally, we measure firm performance using return on assets, return on equity, and EBITA over assets. All these variable definitions are listed in table A1.

#### **D. Analytical approach**

In the empirical analysis, to provide evidence that expropriation of minority shareholders is more severe in politically connected firms, we explain expropriation using firms' political connections together with firm characteristics and corporate governance. We measure expropriations using fund occupation and market responses to related party transactions. Our governance variables include the divergence between controlling shareholders' cash flow rights and their control rights, board independence, managerial ownership, institutional investor ownership, and auditor quality. Firm characteristics include size, age, leverage, tangibility, and sales growth as defined above. Because we run the regressions on pooled panel data, we also control for firm fixed effects and cluster all the estimated standard errors at the firm level.

To support the argument that the relation between expropriation and political connection results from the latter's influence in firm financing, we conduct our analysis based on the following aspects. First, to show that political connection can help firms to access bank loans, we explain bank loan access and loan amounts using political ties and firm characteristics. It would admittedly have been better to show that there is actually no subsequent loan reduction following the tunneling or self-dealing activities by comparing the loan amount and contracts before and after expropriation events. However, because the firms' fund occupations are observed yearly and related party transactions are quite frequent – once every two years on average and a maximum of three times a year for some firms – defining a clear pre- versus post- period is

infeasible. We can therefore only gain insights by examining the overall trend of bank loans to these firms.

Second, to show that the relation between expropriation and political connection exists only when the political connection can bring secure bank funding (i.e., political connections with other benefit types do not encourage controlling shareholder expropriation of minority shareholders because of firm concern that its capital market reputation may drive up future financing costs), we implement two approaches. First, we differentiate the political types directly, although unfortunately, we can only find direct evidence of a firms' political connection with a bank for a very small subsample. Hence, although the values on the expropriation measures for this subsample are high, the statistical inference is inefficient because of sample size. We therefore resort to an interaction variable between bank loan and political connection, which we add into the baseline regressions. If a political connection does indeed encourage expropriation only when it helps a firm to secure funding, the coefficient on this interaction term should be significant, causing the stand-alone coefficients on political connection and bank loan to lose their significance.

Third, because the less market driven the banking, the more the flexibilities and the higher the likelihood that political ties will play a role in financing, we expect the relation between political connection and expropriation to be stronger when the banking industry is less efficient. To test this assumption, we introduce the four banking indices into the regression and interact them with political connection and bank loans. If the results of these analyses are consistent with our hypotheses, we can confirm that in the presence of political connection, the relation between political ties and controlling shareholder expropriation of minority shareholders is induced by inefficient loan allocations.

To address the possible endogeneity issue that firms characterized by a high tendency to expropriate minority shareholders establish political connections to seek protection, we conduct a two-stage robustness test that controls for the likelihood of a firm establishing political connections. In the first stage, we analyze the probability that the firm will establish political ties using a logit model in which the explanatory variables include firm characteristics and governance variables. We also include board size in the first stage instruments because, although there is little consistent relation between firm behavior or performance and board size in Chinese firms, it is common practice for these firms to connect themselves politically by offering board membership. In the second stage, we expand the earlier regressions by including the predicted likelihood, measured by Heckman's  $\lambda$ .

Because, conditional on profitability, stealing by controlling shareholders reduces firms' accounting performance, what is interesting is to examine whether controlling shareholders steal even more when they are politically connected. To do so, we regress firm accounting performance on political connection, expropriation measures, the interactions between these measures, profitability, firm characteristics, and governance measures. The sign of the coefficients on the interaction term indicates whether controlling shareholders are stealing more than political connections are bringing in.

### **3. Data**

#### **A. Sample and data sources**

The sample firms are Chinese listed firms whose ultimate controlling shareholders are private entities or individuals. Such identification became possible after the Chinese Security Regulatory Committee (CSRC) began in 2001 to require all listed companies to disclose their detailed ownership information, including the structure of pyramids in that year. The sample

thus excludes financial firms and firms with the state as the ultimate controlling owner. In addition, because including dual listings would introduce the complication of different legal treatments for tunneling and self-dealing, we limit our sample to firms that are listed in the domestic market only. Finally, we include CEO and board member experience as reported in the firm prospectus, and the financials and governance data available in Chinese Security Market Research (CSMAR) through Wharton Research Database(WRDS).The final sample includes 592 firms and 2,031 firm\* year panel observations from 2002 to 2007.

The information on political connection must be manually collected from company prospectuses, and, because the CSMAR records are incomplete, the related party transaction data must also be hand collected from the Chinese Security Regulatory Committee (CSRC) archives, which contain a total of 572 related party transactions for the sample firms during the sample period. Finally, we obtain the four banking development indices from World Bank (2006) and Fan, Wang, and Zhu (2007).

## **B. Summary Statistics**

Table 1 presents the distribution of the sample firms by year, industry, and geography. The number of firms entering the sample increases over time not because of new listings, but because of the availability of information on their ownership pyramids. About 85% of these firms are politically connected. Over half are in the manufacturing sector, followed by conglomerates, technology, and retailing/wholesale, a ranking that is quite representative of firms in China. Firms that are in the mining, transportation, and media sectors are 100% politically connected, reflecting the fact that in China, these industries rely heavily on government regulatory support. The construction industry contains the lowest percentage of politically connected firms at 75%. Provinces that each host over 5% of the sample include Zhejiang, Guangdong, Jiangsu, Shanghai, Sichuan, and Shandong, with Zhejiang accounting for the highest percentage of sample firms,

about 13%. Such geographic distribution is also representative because these provinces have the largest regional economies in China.

[Insert table 1 here]

Table 2 summarizes the main analytical variables and the differences between politically connected and nonconnected firms. The average ratio of bank loan to total assets is 27% for politically connected firms and 26% for nonconnected companies. This difference is significant at the 1% level. The values for fund occupation, other account receivables, and negative market response to related party transactions are all higher for the politically connected firms but those for performance are lower. These differences do not emerge as significant, however, in the univariate tests. Table 2 also clearly shows that the politically connected firms are more frequently located in regions in which the banking industry is less developed and the property rights score is low. Such prevalence of and regional preference for political connection in private firms is consistent with Faccio's (2006a) finding that political connections are particularly common in countries with higher levels of corruption or fewer limitations on official behavior. Other characteristics of politically connected firms are lower cash rights of the controlling owner, higher divergence from ownership, and lower managerial ownership – all indications of a more severe agency problem. Finally, politically connected firms tend to be significantly larger and have a higher tangibility ratio, implying that they are less concerned about being expropriated by the government.

[Insert table 2]

#### **4. Empirical Results**

The empirical results not only show a positive relation between political connection and the expropriation of minority shareholders, they also indicate that political connection leads to

preferential treatment in bank financing. Moreover, although both political connection and bank loan are positively associated with expropriation of minority shareholders, such relations disappear once the interaction term between the two is introduced into the regression. This finding implies that neither political connection without bank loan nor bank loan access without political connection is associated with expropriation. We also find that all the above relations are stronger in regions in which the banking industry is less market driven. Finally, we show that firms in which expropriation is present underperform other firms, and even more so if they are politically connected. These results support our argument that political connection influences firms' financing choices, which in turn facilitates expropriation and hurts the returns to minority shareholders. These observations are detailed below.

#### **A. Political connection and expropriation of minority shareholders**

The regression results given in table 3 clearly illustrate the relation between political connection and expropriation of minority shareholders as measured by other account receivables over total assets. As previously mentioned, other account receivables (i.e., receivables other than those for trading accounts, receivable notes, and prepayments) is the most convincing measure of fund occupation by controlling shareholders because the fund occupations disclosed to regulatory authorities are largely manipulated and underreported (Jiang et al. 2009). The explanatory variables in this regression are political connection and its interactions with bank development indices, bank loans, firm characteristics and governance measures, and firm fixed effects. Because the regressions are run with pooled panel data, the estimated standard errors are clustered at the firm level (as in all the pooled regressions reported hereafter).

As table 3 shows, expropriation is positively and significantly associated with political connection. The dummy variable for being connected has a coefficient between 1.7% and 4.7%, implying that the fund occupation ratio is marginally twice as high in politically connected firms



as in nonconnected firms because the sample mean of fund occupation is just slightly above 2%. This relation is even stronger in regions in which the bank industry is less market driven. A decrease of one on the bank development index score produces a 0.5% increase in the fund occupation ratio for the politically connected firms.<sup>3</sup> In addition, expropriation is higher in firms with more bank loans: a 1% increase in bank loan ratio increases the expropriation ratio by 0.1% at a 1% significance level. The results also show that expropriation is more severe in regions with weaker property rights; in firms that were privately owned at the time of the IPO; and in firms that are smaller, have less managerial ownership, or show lower sales growth.

[Insert table 3 here]

Table 4 outlines the results on political connection's association with market response to announcements of related party transactions. The dependent variable here is the 11 day cumulative abnormal returns adjusted by the market returns,  $CAR[-5,+5]$ . As the market benchmark, we use stock index returns on the Shanghai exchange. Because there is no accurate measure of exactly how much economic benefit is transferred through these transactions, we use the market response as a proxy: a negative market response to a related party transaction announcement indicates tunneling that hurts the interests of minority shareholders. The explanatory variables for this regression are political connection and its interactions with the bank development indices, bank loans, firm characteristics and governance measures, and firm fixed effects.

We find that related party transactions seemingly destroy more firm value, measured by negative abnormal returns, when the firms are politically connected, small, or located in regions with a less market-driven banking industry or weaker property rights. However, the market

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<sup>3</sup> As noted earlier, we multiply the index values by a negative value to facilitate interpretation.

response results in less negative returns if the firm has a larger ratio of bank loan to total assets. This finding is not surprising given that bank loan access alone adds value to firms. Market response is also positively associated with the quality of the firm's accounting information, measured by a dummy that equals one if the firm is audited by one of the four largest auditing firms in the world. Even when we conduct robustness tests using abnormal returns over different event windows – for example,  $CAR[-10,+10]$ ,  $CAR[-2,+2]$ , and  $CAR[-1,+1]$  – these results remain the same.

[Insert table 4 here]

Overall, the evidence in tables 3 and 4 indicates a positive relation between political connection and the expropriation of minority shareholders. This relation is stronger for firms located in regions with a less market-driven banking industry, indicating that the factor of influence is the change in firms' financing conditions. We provide further support for this argument in the next section.

### **B. Political connection, bank financing, and expropriation**

We attribute the positive relation between political connection and expropriation to changes in the firm's financial condition because of a specific type of benefit brought in by political connection – preferential treatment in bank loan access. We confirm this assumption with tests along the three dimensions discussed below.

First, we show that political connection can bring firms preferential treatment in bank financing. Table 5 illustrates the relation between the ratio of bank loan to assets and political connection when firm characteristics and the likelihood of bank loan access are controlled for. To exclude the banking relationship inherited from state ownership, this regression limits the sample to firms that were privately owned at the time of their IPO, which excludes firms whose

controlling private ownership came into being through the block transfer of state shares following IPOs. We find that the ratio of bank loan to assets is 26% higher in politically connected firms than in nonconnected firms and the coefficients are significant at the 1% level. The bank loan ratio is also higher in larger firms and in firms with a higher tangibility ratio. We also find that the likelihood of a firm having bank loan access is positively associated with political connection (see table 5 for our sigma estimation). This finding is consistent with reports in the literature that political connection helps firms obtain bank loans in terms of not only access (Khwaja and Mian 2005; Li et al. 2008) but also amount.

[Insert table 5 here]

In table 6 and table 7, we analyze the expropriation of minority shareholders in the context of bank financing influenced by political connection. In table 6, the dependent variable is fund occupation by controlling shareholders, and in table 7, it is the announcement effects of related party transactions. The explanatory variables include political connection, firm bank loans, bank development indices, the interaction term between political connection and bank loans, firm characteristics and governance, and firm fixed effects. The estimated standard errors are clustered at the firm level.

As expected, in both tables, the coefficients on the interaction term between political connection and bank loan are positive and significant, but the stand-alone coefficients on political connection or bank loan lose their significance. That is, tunneling through intercorporate loans is severe in politically connected firms only if the firm is heavily bank financed at the time. The results for related party transactions also suggest more value-destroying tunneling in firms that are both politically connected and heavily bank financed than in other firms, including nonconnected firms and a subset of politically connected firms that are not heavily financed by

banks. These results confirm that political connection encourages expropriation of minority shareholders only when it alters firms' financing conditions by helping them secure bank loans.

Finally, both tables 6 and table 7 show that the tendency for political connection to help firms obtain bank financing and the severe expropriation in politically connected firms with heavy bank financing are both stronger in regions with a less market-driven banking industry, undoubtedly because political connection can successfully influence bank loan decisions in these areas. Overall, the empirical evidence on the above three dimensions is consistent with our argument that political connection can weaken a firm's corporate governance when it helps the firm secure financing through bank loans.

[Insert tables 6 & 7 here]

### **C. Political connection, expropriation, and firm performance**

[Insert table 8 here]

Table 8 lists the results for the regression on firm performance, in which the dependent variables are EBITA, ROE, and ROA.. The explanatory variables include political connection, measures of the expropriation of minority shareholders, and the interactions between these two. The regression also controls for firm characteristics and governance. As table 8 shows, there is no clear relation between political connection and firm performance, although firm performance is reduced, not surprisingly, by the expropriation of minority shareholders. Specifically, a 1% increase in fund occupation by controlling shareholders results in an up to 1.4% decrease in EBITA, a 0.61% decrease in ROE, and a 0.58% decrease in ROA. Such performance reduction is especially pronounced when the expropriation or tunneling occurs in the presence of political connection. Likewise, a 1% increase in fund occupation in politically connected firms lowers EBITA -4.57% compared to fund occupation in nonconnected firms. This finding provides

evidence that the controlling shareholders in politically connected firms tend to extract rent much more aggressively than those in nonconnected firms do.

## **5. Robustness**

### **A. Selection bias and reverse causality**

The previously mentioned argument that controlling shareholders who expropriate minority shareholders seek political connections for protection suggests a positive relation between political connection and the expropriation of minority shareholders. However, the evidence reported in section 4 indicates that expropriation is not necessarily larger in all politically connected firms. That is, politically connected firms that do not use their connections to secure bank loan access do not have larger expropriation than nonconnected firms. Therefore, the selection bias argument does not fit the empirical results.

We also investigate the timing of connection establishment, finding that most of the political connections were established before the firms launched IPOs, when there was no conflict of interest between controlling and minority shareholders. Only 10% of the political connections in the sample were established post IPO. We also observed that firm ownership structure, as it relates to expropriation concerns like cash flow rights and their divergence from control rights, is not associated with political connection. Therefore, reverse causality does not align with the empirical evidence either.

### **B. Local versus central government**

Many scholars studying the Chinese economy believe that local government officials are more likely than central government officials to use their political powers for rent seeking. Our sample allows differentiation between political connections with central government and those with local government at a provincial level or below. We find that both types of political

connections influence expropriation, but the effect is stronger for connections with local government than for those with the central government.

### **C. Median regression and other control variables**

Because we are working with panel data, we also run median regressions for robustness. These results turn out to be stronger than those from the pooled ordinary least square regressions reported earlier. The interaction term between political connection and bank development index 3, particularly, becomes significant in the median regressions but is not significant in the pooled regression with standard errors clustered.

We also check robustness by including other variables that may affect controlling shareholders' incentive to expropriate; specifically, the percentage of shares owned by the state (although the state is never the controlling shareholder in our sample), a dummy that measures whether the controlling owner is the CEO or a family member, and the exact percentage of shares owned by the controlling shareholders. These variables have no significant impact on expropriation and do not affect the earlier results.

## **6. Conclusion**

This paper provides evidence that the influence of political connections on a firm's financing positions impairs its corporate governance. When the political connection is one that guarantees firms bank loan access, controlling shareholders are less concerned about reputation loss in capital markets that could lead to an increase in the firm's cost of capital on the equity market. Hence, they are more likely to expropriate minority shareholders.

The empirical analysis also identifies a positive relation between political connection and the expropriation of minority shareholders, a relation driven mainly by the type of political connection that can help firms secure bank loans. This relation is stronger in regions with a less market-driven banking industry because in these areas, intervention by political connections in

financing is more likely to be successful. Finally, firms whose controlling shareholders expropriate minority shareholders, especially those with political connections, underperform other firms.

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## Appendix

**Table A1: Definition of Variables**

Variables	Description
<i>Panel A: Variables on political connections, bank loans, expropriations and firm performance</i>	
Political connection	A dummy variable that equals one if there is at least one board member or the CEO of the firm is a current or former government official, zero otherwise.
Bank loan	A ratio of bank loans to total assets.
Funds occupation	Three separate variables: (1). The ratio of receivables by controlling shareholders and insiders to total assets. The former is taken from the firms' annual reports. (2) A dummy variable that equals one if the firm reported nonzero receivables by controlling shareholders or insiders, zero otherwise. (3) Account receivables other than those through trading accounts, notes, and prepayment over total assets, with the actual funds occupied by controlling shareholders as the main component.
Related party transactions	Two separate variables: (1) Market reactions to the announcement of related party transactions – 11 day [-5,+5] abnormal returns adjusted by market; (2). A dummy variable that equals one if the transaction are likely to hurt the listed firm, zero otherwise.
ROE	The ratio of net income to over equity.
ROA	The ratio of net income to total assets.
EBITA	The ratio of earnings before extraordinary items plus interests and tax to total assets.
<i>Panel B: Variable on institutional factors cross region</i>	
Banking development index 1	An index of banking competitiveness based on the ratio of nonstate-owned banks' deposits to total bank deposits in the province. We use the average of the 2003 to 2005 indexes in our analyses. Source: Fan , Wang et al. (2007).
Banking development index 2	An index of banking competitiveness based on the ratio of bank loans to nonstate business like agricultural loans, township enterprise loans, private enterprise loans, and foreign enterprise loans to all bank loans in the province. Source: Fan, Wang et al. (2007).
Banking development index 3	An index of banking competitiveness that incorporates the deposits and loan completions from indexes 1 and 2. Source: Fan, Wang et al. (2007).
Banking development index 4	An index of banking liberalization based on the portion of small private domestic firms that have access to bank financing by region. Source: World Bank (2006).
Property rights	An index of property rights protection. Source: Fan, Wang et al. (2007).
<i>Panel C: Variables on firm characteristics</i>	
Private at IPO	A dummy variable that equals one if the firm was ultimately owned by individuals at the time of IPO, zero otherwise.
Cash flow rights	The cash flow rights of the controlling shareholders.
Divergence	The divergence between the controlling shareholders' cash flow rights and their control rights.
Board independence	The percentage of board members that are outsiders.
Managerial ownership	The percentage of shares held by the CEO
Institution Investors	The percentage of shares held by institutional investors.
Audit	A dummy variable that equals one if the firm's financial reports are audited by any one of the largest four auditing firms.
Firm size	The logarithm of the total assets.
Leverage	The ratio of total liabilities to total assets.
Tangibility	The ratio of fixed assets to total assets.
Sales growth	The firm's total sales growth.

**Table 1: Sample Distributions**

This table reports the distribution of the sample firms by their political connections, year, industry, and region. The sample includes all firms that were ultimately privately owned from 2003 to 2007. A firm is defined as politically connected if at least one board member or the CEO is currently or was formerly a government official.

<b>Panel A: Sample Distribution by Year</b>						
Years	2003	2004	2005	2006	2007	<b>Total</b>
Total number of firms	275	366	389	453	548	2,031
Politically connected firms	237	316	335	386	443	1,717
Percentage of connected firms (%)	86.18	86.34	86.12	85.21	80.84	84.54

  

<b>Panel B: Sample Distribution by Industry</b>			
Industries	Total	Politically connected	Percentage of politically connected firms (%)
Agriculture, forestry and fishing (A)	49	42	85.71
Mining (B)	7	7	100.00
Manufacturing (C)	1,262	1,049	83.12
Electricity, gas and water production and supply (D)	19	15	78.95
Construction (E)	32	24	75.00
Transportation and storage (F)	25	25	100.00
Information technology (G)	169	137	81.07
Retail and wholesale trade (H)	113	99	87.61
Real estate (J)	93	77	82.80
Services (K)	37	36	97.30
Media (L)	10	10	100.00
Conglomerates (M)	215	196	91.16
<b>Total</b>	<b>2,031</b>	<b>1,717</b>	<b>84.54</b>

  

<b>Panel C: Sample Distribution by Region</b>			
Region	Total	Politically connected	Percentage of politically connected firms (%)
Zhejiang	274	215	78.47
Guangdong	265	220	83.02
Jiangsu	196	175	89.29
Shanghai	160	128	80.00
Sichuan	114	97	85.09
Shandong	103	96	93.20
Others	919	786	85.53
<b>Total</b>	<b>2,031</b>	<b>1,717</b>	<b>84.54</b>

**Table 2: Summary statistics**

This table summarizes the observations on the main analytical variables and identifies the differences in these variables between politically connected and nonconnected firms.

	Politically connected		Politically nonconnected		Difference
	Mean	Median	Mean	Mean	t-test
<i>Panel A: Firm characteristics</i>					
Firm size <u>(scale?)</u>	20.89	20.87	20.74	20.64	2.58***
Leverage ratio	0.56	0.53	0.53	0.46	1.17
Tangibility ratio	0.32	0.30	0.29	0.27	2.38**
Sales growth	0.47	0.15	0.79	0.14	-1.63
Private at IPO time	0.58	1.00	0.62	1.00	-1.02
Bank loan	27.02	25.94	23.95	21.69	2.74***
<i>Panel B: Firm governance measures</i>					
Cash flow rights	21.20	19.17	22.99	21.90	-2.04**
Divergence of cash flow and control rights	9.90	8.67	8.65	8.01	2.26**
Board independence	0.36	0.33	0.36	0.33	-0.39
CEO ownership	1.23	0.00	2.31	0.00	-3.14***
Institutional ownership	2.54	0.03	2.69	0.03	-0.42
Auditor	0.04	0.00	0.04	0.00	-0.35
<i>Panel C: Firm performance</i>					
ROE	3.20	5.45	5.52	5.97	-0.31
ROA	-0.63	1.98	0.81	2.19	-1.21
EBITA	2.00	4.27	3.20	4.40	-1.04
<i>Panel D: Expropriation measures</i>					
Funds occupied	2.73	0.00	2.02	0.00	0.76
Other account receivables	6.18	2.40	5.57	2.19	1.01
Market response to RP transactions [-5, +5]	1.09	0.74	1.98	0.50	-0.72
<i>Panel E: Cross-regional institutional factors</i>					
Property rights	6.18	5.35	6.77	6.62	-3.44***
Bank development index 1	-7.85	-8.46	-8.38	-9.06	3.74***
Bank development index 2	-6.95	-7.36	-7.42	-8.50	2.58***
Bank development index 3	-8.75	-8.94	-9.33	-10.15	4.00***
Bank development index 4	-0.39	-0.43	-0.39	-0.44	0.13

**Table 3: Political connection and fund occupation by controlling shareholders.**

This table presents the regression results for the effects of political connection on fund occupation by controlling shareholders. The dependent variable is measured by other account receivables (receivables other than those on trading accounts, receivable notes, and prepayments) over total assets. Standard errors are clustered by firm and reported in parentheses. \*\*\*, \*\*, and \* denote significance at the 10%, 5%, and 1% levels, respectively.

Y= Fund occupation by controlling shareholders				
	(1)	(2)	(3)	(4)
Political connections	4.717** [1.895]	3.683** [1.562]	1.234 [1.849]	1.728* [0.893]
Political connections *	0.552*** [0.204]			
Bank development index 1				
Political connections *		0.476*** [0.180]		
Bank development index 2				
Political connections *			0.118 [0.188]	
Bank development index 3				
Political connections *				4.855*** [1.468]
Bank development index 4				
Bank loan	0.108*** [0.024]	0.103*** [0.023]	0.110*** [0.024]	0.115*** [0.031]
Property rights	0.061 [0.162]	0.080 [0.153]	-0.202 [0.153]	-0.366*** [0.140]
Private at IPO	-1.521** [0.666]	-1.627** [0.662]	-1.575** [0.670]	-1.307* [0.758]
CEO ownership	-0.122*** [0.030]	-0.125*** [0.030]	-0.122*** [0.030]	-0.129*** [0.035]
Institutional ownership	-0.087*** [0.028]	-0.094*** [0.028]	-0.084*** [0.027]	-0.092** [0.037]
Auditor	-0.277 [1.065]	-0.395 [1.108]	-0.225 [1.052]	0.193 [1.453]
Size	-2.240*** [0.452]	-2.196*** [0.433]	-2.310*** [0.457]	-2.090*** [0.524]
Sales growth	-0.102** [0.042]	-0.104** [0.042]	-0.100** [0.042]	-0.085* [0.044]
Constant	48.444*** [9.140]	47.746*** [8.594]	51.466*** [9.468]	48.176*** [10.258]
Other governance variables	Yes	Yes	Yes	Yes
Firm fixed effects	Yes	Yes	Yes	Yes
Observations	1,853	1,853	1,853	1,338
R-squared	0.199	0.202	0.193	0.211

**Table 4: Political connection and the market response to related party transactions.**

This table presents the regression results for the effects of political connection on the abnormal returns at announcement of related party transactions between the firms and their controlling shareholders from 2004 to 2007. The dependent variable is the [-5, +5] day cumulative abnormal returns adjusted by the market (Shanghai integrative index returns). Standard errors are clustered by firm and reported in parentheses. \*\*\*, \*\*, and \* denote significance at the 10%, 5%, and 1% levels, respectively.

Y: Market reaction to related party transactions, CAR[-5,5]				
	(1)	(2)	(3)	(4)
Political connections	-11.799*** [3.009]	-5.856*** [2.006]	-8.272*** [2.840]	-1.542 [2.288]
Political connections *	-1.411***			
Bank development index 1	[0.335]			
Political connections *		-0.738***		
Bank development index 2		[0.213]		
Political connections *			-0.888***	
Bank development index 3			[0.288]	
Political connections *				-1.952
Bank development index 4				[4.298]
Type of transactions	-0.248 [1.446]	-0.036 [1.447]	-0.258 [1.489]	0.271 [1.630]
Bank loan	0.017*** [0.004]	0.016*** [0.004]	0.015*** [0.004]	0.013** [0.005]
Property rights	-0.806*** [0.273]	-0.511** [0.241]	-0.394 [0.246]	-0.035 [0.246]
Private at IPO time	-1.968* [1.040]	-1.752* [1.050]	-2.117** [1.072]	-2.256* [1.338]
CEO ownership	0.029 [0.249]	0.006 [0.255]	0.064 [0.249]	0.033 [0.337]
Institutional ownership	0.158 [0.097]	0.151 [0.099]	0.140 [0.107]	0.190 [0.133]
Auditor	2.348* [1.360]	2.534* [1.374]	2.258 [1.476]	2.219 [1.710]
Firm size	-1.382** [0.692]	-1.397** [0.697]	-1.320* [0.705]	-2.183** [0.994]
Sales growth	0.002 [0.001]	0.001 [0.001]	0.002 [0.001]	-0.001 [0.001]
Constant	33.805** [14.726]	30.752** [14.867]	31.018** [15.002]	45.952** [20.723]
Other governance variables	Yes	Yes	Yes	Yes
Firm fixed effects	Yes	Yes	Yes	Yes
Observations	522	522	522	379
R-squared	0.090	0.078	0.078	0.082

**Table 5: Political connections and bank loans**

This table analyzes the influence of political connection on bank loan access. The dependent variable is bank loans over total assets. The explanatory variables include political connection, bank development index, and firm characteristics. The sample is limited to firms that are private at the time of IPO. Significance is based on robust standard errors (reported in parentheses) clustered by firm. \*\*\*, \*\*, and \* denote significance at the 10%, 5%, and 1% levels, respectively.

Y= bank loan/total assets					
	(1)	(2)	(3)	(4)	(5)
Political connections	4.435** [1.969]	26.164*** [9.073]	19.660*** [6.856]	17.951** [8.308]	9.176** [4.442]
Political connections *		2.461*** [0.925]			
Bank development index 1					
Political connections *			1.960**		
Bank development index 2			[0.760]		
Political connections *				1.343*	
Bank development index 3				[0.799]	
Political connections *					12.656*
Bank development index 4					[7.498]
Bank development index 1	0.365 [0.444]	-1.750** [0.832]			
Bank development index 2			-1.178* [0.674]		
Bank development index 3				-1.207* [0.727]	
Bank development index 4					-12.745* [6.980]
Firm size	3.313*** [1.179]	3.212*** [1.170]	3.273*** [1.156]	3.230*** [1.191]	1.152 [1.399]
Tangibility	18.765*** [5.824]	19.011*** [5.779]	18.697*** [5.792]	19.155*** [5.830]	16.943** [7.467]
EBITA	-0.244* [0.125]	-0.246* [0.126]	-0.245** [0.124]	-0.248* [0.127]	-0.183 [0.111]
Sales growth	-0.083 [0.167]	-0.070 [0.168]	-0.072 [0.163]	-0.086 [0.169]	-0.144 [0.166]
Constant	-49.177* [25.499]	-65.296** [25.905]	-59.787** [25.138]	-62.430** [26.168]	-0.597 [29.916]
Observations	1,198	1,198	1,198	1,198	829
R2	0.028	0.029	0.030	0.028	0.030

**Table 6: Political connections, bank loan, and expropriation of minority shareholders measured by fund occupation.**

This table explains fund occupation of controlling shareholders by financing channel. The dependent variable is other account receivables, the receivables other those from trading accounts, receivable notes, and prepayments. The explanatory variables include political connection and bank development and their interactions with firm bank loans. Firm characteristics and governance are also controlled for. Standard errors are clustered by firm and reported in parentheses. \*\*\*, \*\*, and \* denote significance at the 10%, 5%, and 1% levels, respectively.

Y= Fund occupation by controlling shareholders				
	(2)	(3)	(4)	(5)
Political connections	-0.634 [1.263]	-0.729 [1.258]	-0.809 [1.265]	-0.968 [1.488]
Bank loan	0.055 [0.057]	0.053 [0.057]	0.059 [0.056]	0.061 [0.067]
Political connection *Bank loan	0.180** [0.086]	0.124* [0.074]	0.136 [0.089]	0.111 [0.075]
Political connection *Bank loan * * bank development index 1	0.018*** [0.007]			
Political connection *Bank loan * * bank development index 2		0.012** [0.005]		
Political connection *Bank loan * * bank development index 3			0.011 [0.008]	
Political connection *Bank loan * * bank development index 4				0.219*** [0.051]
Property rights	-0.064 [0.156]	-0.100 [0.151]	-0.219 [0.159]	-0.385** [0.154]
CEO ownership	-0.108*** [0.032]	-0.108*** [0.032]	-0.104*** [0.032]	-0.122*** [0.037]
Institutional ownership	-0.082*** [0.030]	-0.087*** [0.030]	-0.073** [0.031]	-0.085** [0.040]
Auditor	-0.025 [0.817]	-0.295 [0.829]	0.200 [0.838]	0.552 [0.866]
Firm size	-2.081*** [0.461]	-2.028*** [0.445]	-2.215*** [0.485]	-2.158*** [0.604]
Sales growth	0.011 [0.042]	0.006 [0.042]	0.014 [0.042]	-0.001 [0.041]
Constant	45.147*** [9.552]	44.219*** [9.149]	48.949*** [10.223]	50.217*** [12.280]
Other governance variables	Yes	Yes	Yes	Yes
Firm fixed effects	Yes	Yes	Yes	Yes
Observations	1,092	1,092	1,092	753
R-squared	0.258	0.257	0.250	0.281



**Table 7: Political connection, bank loan, and expropriation of minority shareholders measured by market reaction to related party transactions.**

This table explains fund occupation of controlling shareholders by financing channel. The dependent variable is announcement effect of related party transactions. The explanatory variables include political connection and bank development and their interactions with firm bank loans. Standard errors are clustered by firm and reported in parentheses. \*\*\*, \*\*, and \* denote significance at the 10%, 5%, and 1% levels, respectively.

	(1)	(2)	(3)	(4)
Y: Market reaction to related party transactions, CAR[-5,5]				
Political connections	0.837 [2.926]	1.038 [2.910]	1.212 [3.132]	1.733 [4.576]
Bank loan	0.086 [0.094]	0.084 [0.094]	0.067 [0.102]	0.022 [0.169]
Political connection *Bank loan	-0.272** [0.109]	-0.131 [0.097]	-0.285* [0.169]	-0.141 [0.176]
Political connection *Bank loan * * bank development index 1	-0.032*** [0.011]			
Political connection *Bank loan * * bank development index 2		-0.013** [0.006]		
Political connection *Bank loan * * bank development index 3			-0.027* [0.016]	
Political connection *Bank loan * * bank development index 4				-0.300** [0.123]
Type of transaction	-1.155 [1.326]	-1.116 [1.311]	-1.026 [1.311]	-0.256 [1.610]
CEO ownership	0.008 [0.252]	-0.045 [0.265]	-0.042 [0.248]	1.008* [0.562]
Institutional ownership	-0.056 [0.200]	-0.100 [0.215]	-0.124 [0.198]	0.039 [0.222]
Audit	5.354** [2.233]	5.553** [2.533]	5.130** [2.355]	-1.217 [2.987]
Size	-2.004** [0.822]	-1.796** [0.862]	-1.695** [0.800]	-2.087* [1.176]
Sales growth	0.000 [0.038]	-0.006 [0.036]	0.008 [0.038]	-0.035 [0.037]
Constant	43.329** [17.056]	38.056** [17.918]	38.186** [16.464]	45.253* [24.782]
Other governance variables	Yes	Yes	Yes	Yes
Firm fixed effects	Yes	Yes	Yes	Yes
Observations	198	198	198	142
R-squared	0.146	0.130	0.137	0.155

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**Table 8: Political connections and firm performance**

This table presents the regression results for the effects of political connection on firm performance. The dependent variables are EBITA, ROE, and ROA. The explanatory variables include political connection, measures of expropriation of minority shareholders, and the interactions between the two. Firm characteristics and governance are also controlled for. Standard errors are clustered by firm and reported in parentheses. \*\*\*, \*\*, and \* denote significance at the 10%, 5%, and 1% levels, respectively.

	EBITA			ROE			ROA		
	(1)	(2)	(3)	(1)	(2)	(3)	(1)	(2)	(3)
Political connection	-1.70 [4.30]	-1.90 [4.11]	-0.22 [4.03]	-0.76 [0.78]	-0.71 [0.67]	-0.51 [0.60]	-0.66 [0.71]	-0.62 [0.62]	-0.29 [0.63]
Other account receivables	-0.80** [0.34]			-0.21*** [0.08]			-0.26*** [0.07]		
Funds occupied		-1.46*** [0.33]	-1.30*** [0.35]		-0.61*** [0.18]	-0.66*** [0.13]		-0.58*** [0.19]	-0.50*** [0.15]
Political connection *Funds occupied			-4.57** [2.15]			-0.53 [0.80]			-0.82 [0.77]
Cash flow rights	0.13** [0.05]	0.12** [0.05]	0.13** [0.05]	0.04* [0.02]	0.03 [0.02]	0.03 [0.02]	0.03 [0.02]	0.05 [0.03]	0.02 [0.02]
CEO ownership	0.11 [0.07]	0.14* [0.08]	0.14* [0.08]	0.12*** [0.04]	0.11*** [0.03]	0.11*** [0.03]	0.13*** [0.04]	0.12*** [0.03]	0.12*** [0.03]
Institutional ownership	0.50*** [0.09]	0.51*** [0.09]	0.49*** [0.09]	0.25*** [0.03]	0.25*** [0.03]	0.25*** [0.02]	0.30*** [0.03]	0.31*** [0.03]	0.30*** [0.03]
Firm size	4.39** [1.83]	5.22** [2.16]	5.26** [2.15]	2.00*** [0.56]	1.71*** [0.45]	1.72*** [0.45]	1.80*** [0.53]	1.56*** [0.42]	1.57*** [0.42]
Leverage	-34.49*** [12.98]	-38.00** [15.29]	-37.25** [15.29]	-16.57*** [3.99]	-12.86*** [1.756]	-12.84*** [1.74]	-14.27*** [3.77]	-10.72*** [1.61]	-10.69*** [1.59]
Growth of sales	0.35** [0.16]	0.36** [0.17]	0.35** [0.16]	0.19*** [0.06]	0.18*** [0.06]	0.17*** [0.06]	0.20*** [0.07]	0.19*** [0.06]	0.18*** [0.06]
Constant	-76.76** [35.43]	-94.50** [42.26]	-95.48* [42.04]	-32.37*** [11.13]	-27.12*** [9.62]	-27.32*** [9.69]	-28.09*** [10.69]	-23.76** [9.27]	-24.08** [9.34]
Other governance variables	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Firm fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	1,769	1,769	1,769	1,853	1,853	1,853	1,853	1,853	1,853
R-squared	0.093	0.104	0.106	0.303	0.409	0.409	0.269	0.375	0.375

