

POLITICALLY CONNECTED FIRMS: A REVIEW*

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ABSTRACT

The issue of politically connected firms has recently become one of the hot topics in management and financial studies. The aim of this review is to present the theories used in this topic and assesses the empirical studies. To do so first, we present the definition of politically connected firms. Subsequently, the paper introduces the theoretical approaches, namely; the resource dependence theory and the theory of privatization that aim to explain the reasons of political connection. Furthermore, the paper reviews existing empirical studies discussing the impacts of political connection on several issues: namely, impact of political connection on firm performance, impact of political connection on accessing bank credit, impact of political connection on accessing preferential treatments and finally impact of political connection on employment.

Keywords: Politically Connected Firms, Resource Dependence Theory, Theory of Privatization, Accounting Performance.

POLİTİK BAĞLANTILI FİRMALAR: DEĞERLENDİRME

ÖZET

Politik bağlantılı firmalar konusu son dönemlerde yönetim ve finans alanlarının en gözde çalışma konularından birisi haline geldi. Bu değerlendirmenin amacı, bu konuyla ilgili teorileri sunmak ve ampirik çalışmaları değerlendirmektir. Bu amaç doğrultusunda ilk olarak, politik bağlantılı firmanın tanımı yapılmıştır. Akabinde, politik bağlantının gerekçelerini açıklamaya yönelik olan teoriler; kaynak bağımlılığı teorisi ve özelleştirme teorisini ele almıştır. Sonrasında, makale politik bağlantıların çeşitli konular üzerine etkilerini şöyleki; politik bağlantının firma performansı üzerine etkisi, politik bağlantının banka kredilerine ulaşmada etkisi, politik bağlantının ayrıcalıklı uygulamalara ulaşmada etkisi ve son olarak politik bağlantının istihdama etkisi, var olan ampirik çalışmalar bağlamında tartışarak incelenmektedir.

Anahtar Kelimeler: Politik Bağlantılı Firmalar, Kaynak Bağımlılığı Teorisi, Özelleştirme Teorisi, Muhasebe Performansı.

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1. Introduction

Recently a growing body of literature has noticed that there is a specific relation between politicians and private firms. It has been acknowledged that some private companies attempt to establish connections with politicians. This connection mainly occurs through a board of directors. More specifically, especially former or sometimes even incumbent politicians have been appointed as members of the board of directors (sometimes even as CEO or chairman) of the private companies. In this respect, a company is considered as politically connected if at least one of the board of directors, CEO or chairman of a company is/was a politician. What is meant by a politician is, in general, an individual who is/was a member of parliament, in their national assembly.

In recent years, it has been noted that political connections exist both in developing and developed countries and it is quite widespread around the world. In a cross-country analysis Faccio (2006) demonstrates that politically connected companies exist in 35 countries out of 42, in their sample, in 2001. In addition, studies have revealed that the number of politically connected companies has increased recently. Using data on U.S.-listed companies, Kang & Zhang (2017) show that 31.5% of their sample firms had politically connected directors in 1990; this number considerably increased and reached 54.5% in 2007. Similarly, *USA Today* reports an escalation in political connectedness throughout Fortune 1000 companies, which went up from 39% in 1992 to 55% in 2000 (Houston et al., 2014).

Studies analyzing the consequences of the political connection have mainly focused on the benefits to the private companies. Indeed, a growing body of literature indicates that companies with a close connection to politically connected individuals receive certain benefits that may not be available for them otherwise. As it is argued, political connections may enable the connected companies to access preferential bank loans (Saeed et al., 2014; Charumilind et al., 2006). In addition, the political connection may play a crucial role in the allocation of government procurement contracts (Goldman et al., 2013). Furthermore, the political connection may provide insurance against external shock (Jackowicz et al., 2014). In relation to this, the political connection may enable connected companies to receive government aids at a time of financial distress (Blau et al., 2013; Faccio et al., 2006).

Looking at the other side of the coin, although there have been very limited number of studies, in the literature it has also been acknowledged that not only do the private companies seek benefits from the politicians, but in some cases politicians may pursue the benefits from the connected companies (Bertrand et al., 2007). In fact, benefits to the politicians are mainly linked with a story of buying a vote. In that respect, politicians may use the connected companies as a tool to transfer the resources from the connected companies to their supporters especially at the time of elections, to enhance their re-election chances. In relation to this, for instance, politically connected companies may have different employment decisions than their non-connected counterparts (Faccio & Hsu, 2017; Bertrand et al., 2007).

The aim of this paper is to review the consequences of political connection and to assess the impact of political connection on connected companies. In doing so, the paper presents the existing theoretical and empirical studies undertaken worldwide with the objective of reviewing the differences between politically connected companies and their non-politically

connected counterparts. In more detail, this paper is organized as follows: Section 2 discusses the definition of the politically connected company. Section 3 presents the underpinning theories used in the literature (resource dependence theory and the theory of privatization). Section 4 covers the reviews of the empirical studies of political connection. Furthermore, the review of political connection is divided into four subsections including the impact of political connection on performance, accessing the bank credit, accessing preferential treatments (government contracts, government subsidies and lower tax rates), and lastly on employment. Lastly, section 5 concludes the paper.

2. Definition of Political Connection

In the literature, the definition of a politically connected company is well established. It is widely accepted that a company can be connected to the politicians through two different channels; the top officers and ownership. In relation to the connection through the top officers, it is argued that if CEO, chairman or at least a board member of a company is a politician, then the company can be considered as politically connected. In relation to the connection through ownership, it is asserted that if at least 10% of the share of a company is controlled (directly or indirectly¹) by a politician then the company can be considered as politically connected (Faccio, 2006).

Perhaps the most important issue here is that who is considered as a politician. It is important to stress that there is an agreement among the empirical studies that an incumbent or former Members of Parliament, ministers and the head of the state are considered as politicians. Although the definition of a politician is generally fixed and the same across countries, a few numbers of studies may vary in terms of whether they include political actors other than members of parliaments, ministers and the head of the state. In more detail, these empirical studies may include other political actors that the author think to play a role (e.g. military) or include indirect channels through which politicians may influence firm behavior (or vice versa) (e.g. personnel relationships such as friendships or family links).

In an ill-functioning democratic country, in addition to the members of parliament, there might be other important political actors, such as officers of armed forces. Therefore, firms that are managed by an incumbent or retired high ranked military officer can also be considered as politically connected firm. China might be considered as a good example in this regard. Studies show that, in China, a company is considered as politically connected if one of the top officers of a company is an incumbent or retired high ranked military officer (Wu et al., 2012; Wu et al., 2010).

Even though there have been empirical studies which are taken “close relationship with politicians” into account when defining a company as politically connected, it is very limited in numbers (Saeed et al., 2015; Asquer & Calderoni, 2011). According to their studies, a company is also considered as politically connected if one of the top officers or major shareholders of the company is a close friend or a relative of the member of parliaments, ministers or the head of state. Nevertheless, as it is pointed out by Asquer & Calderoni (2011) differences between

¹ For detailed discussion about direct and indirect control of ownership see Bortolotti & Faccio, (2009) and Faccio & Lang, (2002).

direct and indirect connection to politicians needs to be acknowledged. According to them being connected to a politician is a direct connection, whereas being connected to the relatives of a politician is an indirect connection. In the literature, since it is difficult, if not impossible, to define a close relationship objectively, the great majority of existing empirical studies neglect indirect connection to the politicians, and focus on direct connection to them (Disli et al., 2013; Goldman et al., 2013; Goldman et al., 2009; Baum et al., 2008).

Furthermore, the majority of the empirical studies demonstrate that the issue of data availability also plays a role in determining whether a company is politically connected or not. Because of not having full information about the top officers of the companies, some studies specifically focus on political connection through only a CEO or a chairman, therefore even neglect the connection through board of directors (Disli et al., 2013; Wu et al., 2010; Bertrand et al., 2007). In addition, it is also worth mentioning that in some countries, companies that are not listed in the stock exchange do not have to disclose their ownership data (Ozcan & Gunduz, 2015). Thereby, the great number of the existing empirical studies have neglected political connection through ownership.

3. Theories Used in the Literature

Although there are several empirical studies that are lack of theoretical perspectives while discussing the differences between a politically connected company and non-politically connected company, the rest, in general, use two different theories (resource dependence theory and theory of privatization) to explain the connection between a politician and a private firm. These two theories are quite different from each other by nature. While the resource dependence theory is used to explain the benefits flow from a politician to a connected company, the theory of privatization is used to explain the benefits flow from a connected company to a politician.

3.1. Resource Dependence Theory

In the literature, resource dependence theory is mainly used to explain the benefits to the politically connected companies (Hillman, 2005). Resource dependence theory aims to explain how an organization reduce their environmental interdependence and uncertainty. Pfeffer & Salancik (1978) argue that external resources are essential to surviving in an uncertain environment. They further contend that an organization might minimize their environmental dependence through five channels including, mergers and vertical integration, joint ventures and other inter-organizational relationships, a board of directors, political action and executive succession. As it is pointed out by Pfeffer & Salancik (1978) board of directors of a company can play a crucial role to minimize environmental dependence and uncertainty. They further contend that board directors bring several benefits to the company including preferential access to key resources, access to channels of information between the firm and environmental contingencies, and information in the form of advice and counsel. In addition, it is also asserted that “resource-rich” directors, in this case, an incumbent or former politician, might enable the connected company specially to reach valuable resources such as access to credit particularly from state-owned banks (Hillman, 2005; Boyd, 1990). It might be argued that a political board direct is likely to play a crucial role in preferential access to a key resource. A firm with political board director might have a competitive advantage of accessing a key resource, such as receiving government procurement contract or receiving bank credit, especially from state-

owned banks. Thereby, from a resource dependence point of view having a board director who is/was a politician may bring competitive advantage to the connected company to reach valuable resources into the market.

3.2. The Theory of Privatization

In the literature, empirical studies take the theory of privatization into consideration while explaining the benefits that flow from a connected firm to a politician. The theory of privatization, as proposed by Boycko et al., (1996), assumes that state-owned companies are inefficient as they address the objectives of a politician rather than maximizing efficiency. Shleifer & Vishny (1994) further argue that it is not necessarily only state-owned companies which are inefficient, but also private companies that are under the influence of politicians especially if they address the objectives of a politician rather than focusing on the maximization of shareholder profits. The main objective of a politician is to remain in power. Hence, they particularly use the state-owned companies as an instrument to deliver their social and political objectives. In addition, politically connected companies might be used as an instrument in order to achieve objectives of a politician (Bertrand et al., 2007).

Employment is one of the key objectives of politicians because they care about votes of citizens whose jobs might be in danger (Boycko et al., 1996). In this way, workers who move from unemployment to employment, are more likely to vote positively for the incumbent governing politician. In other words, of course, it is not only state-owned companies which can experience excess employment, but also private companies as well. Shleifer & Vishny (1994) argue that a politician can persuade the manager of a private company to employ an extra worker through the provision of subsidies. Most of the time a politician makes a transfer from the Treasury to the private firm to persuade them to increase the number of employees, especially at the time of an election.

4. Consequences of Political Connection

The issue of political connection is a double-edged sword. In principle, the objective of a company to establish a connection with a politician is to receive an economic benefit or favorable treatment to continue the firm's economic success. Indeed, scholars from various disciplines including economics and management have noted that firms which have close relationships with politicians seem to gain a variety of economic benefits in return (Infante & Piazza, 2014; Goldman et al., 2013; Braggion & Moore, 2013; Faccio & Parsley, 2009; Fisman 2001). However, it has also been argued that political connection may have a detrimental impact on the performance of connected firms (Fan et al., 2007). This can be because firms which are under the influence of a politician may pursue the objectives of that politician rather than maximizing the value to shareholders. Connected firms might have excess employment which consequently deteriorates the performance. Generally speaking, it might be argued that a private company might establish a political connection only if the marginal benefits of political connection exceed the marginal costs. Another way of saying is that there might be an exchange of favor story between a politician and a private firm. A private firm might divert its resources to the public in a way that might turn back in the form of votes to the politicians. In return, a politician might enable the connected company to access low cost of financing especially from state-owned banks, or the politician might eliminate certain bureaucratic obstacles for the connected companies.

In principle, political connections may benefit both; private firms and politicians. In substance, political connections are likely to provide a range of different benefits to the connected firms, including preferential access to credit especially from state-owned banks, allocation of government contracts, relaxed regulatory oversight of the company in question, tax exemption, and government bailouts of financially distressed firms (Faccio & Parsley, 2009). The benefits that a connected company may have is generally explained by the resource dependence theory. The benefits that politicians may extract from the connected companies can be the actions of the connected companies that may be returned in the form of a vote to the politician which is explained by the theory of privatization. In more detail, connected company may employ more people, or connected banks might transfer their resources to the companies that are more likely to create a job for the supporter of the political party (Bertrand et al., 2007; Boycko et al., 1996; Shleifer & Vishny, 1994).

Regarding the empirical studies concentrating on the performance differences between politically connected and non-connected companies, while some of them explain why a connected company has a better (worse) performance than their non-connected counterparts, others do not. In addition, there are some studies analyze only the benefits to the connected company or to the politician without taking the impact of this difference on performance into consideration.

4.1. Impact of Political Connection on Performance

Existing empirical studies examining whether politically connected companies have a better performance than their non-connected counterparts are mainly divided into two sub-categories. The first group of empirical studies mainly focuses on accounting performance and in general return on assets (ROA) and/or return on equity (ROE) have been used as a proxy for performance measurement. The second group of studies largely concentrate on stock performance measurements.

The question of whether political connectedness has a positive or negative impact on the performance of the connected firm is one of the most discussed issues in economic and management circles. Looking at the existing empirical studies, one can see that political connection has both positive and negative impacts on the performance of connected companies. Taking the former studies into consideration, scholars argue that there are many reasons which may explain why politically connected companies might perform better than their non-connected counterparts. First and perhaps most importantly, as might be associated with resource dependence theory, a political board director is likely to enable the connected company to reach certain key resources such as easier access to bank credit, which can be translated into better performance (Boubakri et al., 2012a; Faccio, 2006; Li et al., 2008). Secondly, for reputational reasons, politicians may be concerned about choosing the best-performing companies to work for (Niessen & Reunzi, 2010). In other words, rather than politically connected companies performing better, politicians prefer to work for the private companies which already have a better performance. On the contrary, empirical studies observing negative relations between political connection and company performance argue that politically connected boards lack managerial incentives to maximize shareholders' wealth and improve overall company performance (Carretta et al., 2012; Faccio, 2010; Boubakri et al., 2008; Fan et al., 2007). Moreover, as might be linked with

the theory of privatization politically connected companies may pursue social and political objectives rather than pursuing the maximization of shareholders' wealth and thereby this may have a detrimental impact on the performance of a connected company (Menozzi et al., 2012; Bertrand et al., 2007).

4.1.1. Positive Impact on Accounting Performance

A positive relation between political connection and company performance has been observed in cross-country (Boubakri et al., 2012b) and country-specific studies including developed countries such as Germany (Niessen & Ruenzi, 2010) and developing countries such as China (Ding et al., 2014; Li et al., 2008) and Nigeria (Aburime, 2009).

Collecting cross-country data from both developed and developing countries, Boubakri et al. (2012a) examine whether political connection affects accounting performance and financing decisions of connected companies over the period 1989 and 2003. Using change in the ROA as a proxy for performance measurement, Boubakri et al. (2012a) find that connected companies increase their performance after the establishment of a political connection. Furthermore, they show that political connection enables the connected companies to gain access to credit more easily which eventually leads to better accounting performance.

In a single country study of Germany, Niessen & Ruenzi (2010) examine whether politically connected companies differ from their non-connected counterparts, in 2006. As in many other studies, they find that in terms of total assets, politically connected companies are larger and less risky but surprisingly have a lower market valuation compared to their non-connected counterparts. Using ROE and return on investment (ROI) in level as a proxy for performance measurement, they find that the performance of politically connected companies is better than their non-connected counterparts.

In a related study, using a nationwide survey of private firms in China, Li et al. (2008) examine the impact of affiliation with the ruling Communist Party on the performance of private companies. Similar to the findings of Boubakri et al. (2012a), party membership enables connected companies to obtain loans from state-owned banks or other state institutions. Using ROA in level as a proxy for performance measurement, they find that party affiliation has a positive impact on the performance of connected private companies.

In a single country study of Nigeria, Aburime (2009) examined whether a political connection has any impact on the profitability of banks during the period 1999 – 2007. Using ROA in level as a proxy for the performance measurement, he finds that political connection has a positive impact on the performance of connected banks. However, it is worth noting that Aburime's results were not statistically significant at the conventional level.

4.1.2. Negative Impact on Accounting Performance

On the other hand, existing empirical studies have also observed that political connection may have a detrimental impact on the performance of a connected company including both cross-country (Chaney et al., 2011; Faccio, 2010; Boubakri et al., 2008) and country-specific analysis (Jackowicz et al., 2014; You & Du, 2012; Carretta et al., 2012; Menozzi et al., 2012).

In her seminal paper, collecting data from 47 countries including both developed and developing countries, Faccio (2010) examines whether differences between politically connected and non-connected companies are common across countries. Her findings reveal that when considering an accounting base, politically connected companies underperform compared to their non-connected counterparts. Moreover, Faccio (2010) documents that a negative relationship between the political connection and firm performance becomes more pronounced when political links are stronger.

Using cross-country data including both developed and developing countries, Boubakri et al. (2008) investigate the extent of political connection in newly privatized companies. Firstly, they find that politically connected companies are highly leveraged and operate in regulated sectors. Unsurprisingly, they also show that the likelihood of observing political connection is positively associated with government residual ownership and negatively associated with foreign ownership. Using change in return on sale as a proxy for performance measurement they find that political connection has a negative impact on the performance of connected companies.

In a single country study of Italy, Menozzi et al. (2012) examine whether there was a correlation between board composition and employment and performance, using a hand-collected dataset of 114 Italian public utilities (gas, electric and water), during the period between 1994 and 2004. They found that local public companies that are connected with politicians through the board of directors have higher levels of employment. In addition, using change in ROI and ROE as a proxy for performance measurement, they find that political connection has a detrimental impact on the performance of the connected company. In other words, the higher the number of the politicians on the board, the lower the performance of the connected company.

Jackowicz et al. (2014) argue that companies may connect with politicians not as a means to obtain preferential access to resources but as a form of insurance against external shocks. In a single country study of Poland, they examine the impact of political connection on the operational performance of non-financial firms during the period 2001-2011. Using a level of income from sales as a proxy for performance measurement, they find that political connection has a negative effect on the performance of connected companies. Moreover, they find that the negative impact becomes more pronounced when a politically connected company employs more than one politician on the board of director.

4.1.3. Impact on Stock Performance

Empirical studies that focus on the comparison of the stock value of politically connected and politically non-connected companies also find that having a close tie with politicians seems to have a positive impact on the value of private firms (Perez et al., 2014; Do et al., 2013; Braggion & Moore, 2013; Bunkanwanicha & Wiwattanakantang, 2009; Goldman et al., 2009; Claessens et al., 2008; Faccio, 2006; Faccio & Parsley, 2009; Fisman, 2001). For example, in her seminal paper, *Politically Connected Firms*, Faccio (2006) finds that there is a significant increase in the value of a company when those involved in the business enter politics. Moreover, her findings indicate that this significant increase becomes more pronounced whenever a businessperson is elected as a prime minister rather than as a member of the parliament.

Empirical studies approaching the issue from a different perspective have analyzed the impact of electoral results on the performance of connected companies. Such studies have concentrated on whether the value of the company that is connected with the winning (losing) political party has been affected by the electoral result find that indeed the value of the company that is connected with the winning political party significantly increases after the election. Collecting data of Standard & Poor's 500 listed companies in the US, Goldman et al., (2009) examine whether being connected to the winning (losing) political party has any impact on the value of a company. They find that in the 2000 presidential election, private companies that have a board director from the Republican Party exhibited a positive and significant cumulative abnormal return due to the Republican candidate, George Walker Bush, being elected as the 43rd President of the US. Moreover, they find that companies that were connected with the Democrats (the losing political party) had a negative cumulative abnormal return in the same period.

In a similar vein, Do et al. (2013) examine whether political connection affects the value of a company in the US. Rather than focusing on presidential elections as Goldman et al. (2009), they focus on gubernatorial elections, during the period 1999-2010, in the US. They find that private companies connected to the winning political party increase in value by approximately 1.36% after an election. Furthermore, they also show that there is a positive correlation between political connection and investment. Specifically, companies connected to the winning political parties invest significantly more than the companies connected to the losing political parties. Furthermore, companies connected to the winning political parties hold more cash, have a better-operating performance and enjoy a better long-term stock performance.

The study of Braggion & Moore (2013) show that political connection also existed and had a positive impact on the value of a firm even more than a century ago. Analyzing 467 British companies between 1895 and 1904, they examine the impact of political connection on the value of the firm in Great Britain. They found that the share prices of new technology companies were affected positively when the political party they are affiliated with won the parliamentary election. Specifically, they show that the share price of the politically connected company increased approximately 2.5% when the political party that they are affiliated with wins the parliamentary election.

In the case of an external shock, the value of the politically connected companies may also be affected. In his seminal paper, Fisman (2001) examines whether the value of the Indonesian companies that were affiliated with President Suharto of Indonesia were affected when the health condition of the President deteriorated. Fisman (2001) finds that those firms which were politically affiliated, on average, lost more value than the unaffiliated counter partners, during the time when Suharto's health condition was deteriorating. Thus, this indicates that politically connected firms are more sensitive to external shocks compared to their non-connected counterparts.

In a related study, considering a company as politically connected if the firm has made financial contributions to the Nazi party and/or a member of the Nazi party served on the supervisory board, Ferguson & Voth (2008) examine whether a performance of connected companies differs from that of non-connected companies. Their findings show that politically

connected firms had a better performance, measured in terms of share price performance; specifically, they outperformed the non-connected firms by 5–10%.

Considering the above findings, we conclude that although some of the existing empirical studies provide supporting evidence for the idea that political connections have a positive impact on connected company and stock performance of a company is positively associated with political connection, there are also empirical studies providing support for the idea that political connections have a detrimental impact on a connected company. Hence, it is not wrong to say that the body of existing empirical evidence is inconclusive for the impact of political connections on the performance of a connected company.

Table 1: The Review of the Impact of Political Connection on Performance

Author(s)	Measure of Performance	Country	Definition of Political Connection
Jackowicz et al., (2014)	Return on Sales	Poland	A company is considered as politically connected if at least one of the supervisory and management board members is a politician
Braggion & Moore (2013)	ROA, ROE, the Growth Rate of Assets	United Kingdom	A company is considered as politically connected if at least one of the board of directors is/was a member of the parliament
Liang et al., (2013)	ROA, ROE, Pre-provision profitability ratio,	China	A company is considered as politically connected if at least one of the board of directors is currently serving or formerly served in the government or military
Menozzi et al., (2012)	Δ ROE, Δ ROI	Italy	A firm is considered as politically connected if at least one of the board of directors of a company is holding / held a seat in the parliament or in the municipal, or regional government If a board director's relation with political party is well known
Boubakri et al., (2012a)	Δ ROA, Δ debt-to-assets	Cross-country (12 developed and 11 developing countries)	A company is considered as politically connected 1) if at least one of its top officers (CEO, president, vice-president, chairman or secretary) is a member of parliament, 2) if at least 10% of shares of a company is directly or indirectly controlled by a politician

Table 1 continue

Faccio (2010)	ROA, Market-to-book (ratio of market value of equity + the book value of debt, divided by the sum of book value of equity plus book value of debt)	Cross-country (47 countries)	A company is considered as politically connected 1) if at least one of its top officers (CEO, president, vice-president, chairman or secretary) is a member of parliament, 2) if at least 10% of shares of a company is directly or indirectly controlled by a politician
Niessen & Ruenzi (2010)	ROE, ROI, Tobin's Q	Germany	A company is considered as politically connected if at least one of the board of directors is a member of parliament
Aburime (2009)	ROA, Ratio of before tax profits to total assets	Nigeria	A company is considered as politically connected if ex-board director of a company held a position as the president, vice president, senators, speaker of the House of Representatives, deputy speaker of the House of Representatives, honourable ministers and state governors.
Goldman et al., (2009)	Cumulative Abnormal Return	USA	A company is defined as politically connected if one of its board member at any time in his or her past held a position such as senator, member of the House of Representatives, or member of the administration, or has been a director of an organization such as the Central Intelligence Agency
Boubakri et al., (2008)	ROA, ROE Δ in Return on Sale,	Cross-country (14 developed and 27 developed countries)	A company is considered as politically-connected if at least one member of its board of directors or its supervisory board is or was a politician, that is, a member of parliament, a minister or any other top appointed-bureaucrat
Ferguson & Voth (2008)	Stock Price	Germany	A company is considered as politically connected if business leaders or firms contributed financially to the Nazis or to Hitler or Goring or provide political support for the Nazis.
Fisman (2001)	Return on price od security	Indonesia	For political connectedness, Suharto Dependency Index (1995) is used.

4.2. Impact of Political Connection on Accessing the Bank Credit

Resource Dependence Theory is likely to infer that, one of the main objectives of a company of establishing a political connection is to receive economic benefits such as preferential access to credit. Looking at the empirical studies, preferential access to credit takes various forms including paying a lower interest rate (Houston et al., 2014; Infante & Piazza, 2014), and receiving long-term credit (Hasan et al., 2014; Malesky & Taussing, 2009; Charumilind et al., 2006; Johnson & Mitton, 2003).

Using hand-collected data of Standard and Poor's 500 companies over the period 2003 and 2008, Houston et al. (2014) investigate whether the political connections of listed firms in the US have any impact on the cost and terms of loan contracts. Firstly, using the natural logarithm of the loan spread for a single loan facility as a dependent variable, they find that the cost of bank loans is significantly lower for politically connected companies in the US. In other words, their results show that politically connected companies pay lower interest rates in comparison to their non-connected counterparts. Moreover, they also find that the degree of political connection also influences the cost of borrowing. They show that the stronger the political connection is the lower the cost of borrowing for the politically connected companies in the US. Houston et al. (2014) also examine whether the cost of borrowing of politically connected companies differs from that of their non-politically connected counterparts at the time of financial crises. They show that politically connected companies paid a lower borrowing cost than their non-connected peers, during the 2007-2008 crisis period in the US. It is important to highlight that if the cost of borrowing for the connected companies is lower than their non-connected companies, the performance of the banks that make loans to the politically connected companies might be negatively affected. In their analysis, Houston et al. (2014) approach the issue from a politically connected company point of view and not investigate whether making a loan to the connected company has any impact on the performance of banks.

In a related study, Infante & Piazza (2014) investigate whether politically connected firms enjoy preferential treatment in Italy. Using interest rate applied on overdrafts as a dependent variable, they find that politically connected firms in Italy, pay lower interest rates than their non-connected counterparts. Furthermore, politically connected firms pay even lower interest rates when they borrow from politically connected banks, in Italy. Similarly, in a survey analysis, Hersch et al. (1997) examine the impact of political connection on receiving a bank loan in Hungary. They also document that politically connected private companies obtained bank loans more easily than did other firms.

Preferential access to credit is more prevalently observed in election years. Collecting data from Taiwanese private companies, Chen et al. (2014) investigate whether the political connection has any impact on access to bank loans. Firstly, they show that the percentage of non-secured loans is higher for politically connected firms than from their non-connected counterparts. Secondly, they show that politically connected firms pay lower interest rates in Taiwan. Moreover, politically connected companies access cheaper loan rates, especially from the state-owned banks. It is worth noting that the favors regarding interest rates from state-owned banks increase especially during presidential election years. Thirdly, they also show that being connected with the incumbent governing party differs from being connected to the

opposition political parties. They show that private companies connected to the incumbent governing parties enjoy lower interest rates in their loans than their non-connected counterparts.

It is argued that it is difficult for private firms to access bank leverage in developing countries due to heavy government regulations (Charumilind et al., 2006). In such an environment, close relationships with politicians may enable the connected company to overcome problems relating to an ill-functioning market. In such markets, the political connection might be an important mechanism to influence the lending behavior of a bank. Thereby, the political connection itself becomes an important tool to access bank credit in some countries such as China (Li et al., 2008) and Vietnam (Malesky & Taussig, 2009).

In this regard, Li et al. (2008) examine whether affiliation with the ruling Communist Party brings any benefit to the connected firms. They find that in comparison to their non-connected counterparts, politically connected companies are more likely to get a loan from state-owned banks or other state institutions, in China. In a related study, in Vietnam, Malesky & Taussig (2009) confirm the earlier findings. In a bivariate analysis, Malesky & Taussig (2009) show that even though companies have similar characteristics including size, profitability and background information, politically connected companies are more likely to receive bank loans in Vietnam. Furthermore, they also show that the previous performance of a company is not taken into consideration, but their political connection is to receive a loan from the banks.

In a similar vein, Firth et al. (2009) examine whether the political connection has any impact on the allocation of loans to the private sector. They find that political connections play a role in gaining access to state-owned bank finance in China.

The political connection may also enable a connected company to access long term-loans, especially from state-owned banks. Yeh et al. (2013) examine whether politically connected companies enjoy preferential bank loans in Taiwan during the period 1998-2000. They find that companies connected to the incumbent ruling political party are more likely to access three-year or beyond non-collateral loans from state owned-banks compared to their non-connected counterparts.

Similarly, using data from Stock Exchange of Thailand, Charumilind et al. (2006) examine whether political connection plays a role in accessing long-term bank loan in Thailand one year before the Asian crisis in 1996. Indeed, they find that political connection plays a significant role in accessing long-term bank loans in Thailand. Additionally, Charumilind et al. (2006) demonstrate that politically connected companies had greater access to long-term debt than their non-connected counterparts. Moreover, they also observed that politically connected companies needed less collateral.

Using listed Pakistani companies over the period 2002-2010, Saeed et al. (2014) examine the impact of political connection on corporate financial decisions. They find a positive and significant association between long-term debt and political connections. This finding suggests that politically connected companies have a greater access to long term-debt than their non-connected counterparts. Moreover, they also show that positive effects of political connections are seen to be stronger for large firms and those affiliated with the business group.

Similar results have also been found in Poland. Collecting data from listed companies in Poland, between 2001 and 2011, Hasan et al. (2014) examine whether politically connected Polish firms have greater access to bank loans compared to their non-connected counterparts. Using the share of long-term liabilities in total liabilities as a proxy for an access to long-term bank financing they find that private companies employing persons with political experience have greater access to bank loans in Poland during the period between 2001 and 2011.

To summarize, empirical analysis from developed countries including Italy and the US and developing countries including China, Thailand and Pakistan, show that politically connected companies have preferential treatment to access bank loans. Preferential treatments may be in different forms including being charged a lower interest rate, having long-term access to bank loans, or providing less collateral.

Table 2: The Review of the Impact of Political Connection on Accessing Bank Credit

Author(s)	Measure of Accessing Bank Credit	Country	Definition of Political Connection
Houston et al., (2014)	Loan Spread,	USA	A company is considered as politically connected if at least one board member and/or director either holds or held an important government or political position.
Infante & Piazza (2014)	Interest Rates on Overdrafts	Italy	A company is considered as politically connected if either a board member or a top executive of it is, at the same time, a member of the listed political bodies.
Chen et al., (2014)	Loan rate (Spread - Loan spread over the risk-free rate-)	Taiwan	A company is considered as politically connected if top managers (COE or chairman) of a company have ever publicly supported a political party in media, or if top managers have ever become the central committee member of a political party.
Li et al., (2008)	Initial loan from banks, Initial loan from government institution	China	A company is considered as politically connected if an entrepreneur has become a party member or s/he formerly served as a manager in state-owned enterprises or township and village enterprises, or s/he formerly served as a government cadre, or s/he is a member of the People’s Congress at any level, before the establishment of the company.
Saeed et al., (2014)	Leverage (the ratio of the book value of a firm’s total debt -short and long terms- to total assets)	Pakistan	A company is considered as politically connected if a firm has a politician on its board of directors, and a politician is defined as any individual who stood in the national or provincial election, held in 2002 and 2008.

4.3. Impact of Political Connection on Accessing Preferential Treatments (Government Contracts, Government Subsidies and Lower Tax Rates)

As it is inferred by Resource Dependence Theory, a political connection may facilitate firms in terms of accessing critical resources. Allocation of government contracts and whether politically connected companies have easier access to these types of contracts has been an empirical question in economics and management studies. In general, existing empirical studies, show that politically connected companies have preferential treatment in receiving valuable government procurement contracts. To shed lights on this issue, Goldman et al. (2013) analyze whether a political connection has any impact on the allocation of government procurement contracts, in the US. Focusing on the change in control of both the House and Senate following the 1994 election, they find that publicly traded companies with boards connected to the winning (losing) political party had a significant and large increase (decrease) in government procurement contracts after the election. It is also worth noting that their results remain robust after controlling for company and industry characteristics suggesting that their results are not driven by these factors.

In a similar vein, existing empirical studies show that politically connected companies are more likely to get government subsidies than their non-connected counterparts at the time of financial distress (Zhang et al., 2014; Blau et al., 2013; Duchin & Sosyura, 2012; Wu et al., 2012; Faccio et al., 2006). In a cross-country analysis Faccio et al. (2006) examine the likelihood of government bailouts of 450 politically connected firms from 35 countries during 1997-2002. They find that even though companies have similar characteristics including size and industry; companies that are affiliated with politicians are more likely to be bailed out than their non-connected counterparts at the time of financial distress. They also find that politically connected companies are more likely to get financial assistance when a home country receives international financial assistance including from the International Monetary Fund (IMF) and the World Bank.

Country-specific studies of both developed and developing countries also confirm earlier findings and provide empirical evidence that politically connected companies are more likely to receive government subsidies compared to their non-connected counterparts. Focusing on the Capital Purchase Programme, in the US, Duchin & Sosyura (2012) examine the relationship between politically connected companies and their access to government capital, in the 2007 financial crisis. They find that there is a positive correlation between a firm's political connections and its access to government capital. In detail, they find that the likelihood of application approval of politically connected financial institutions is higher than their non-connected peers. In other words, political connection plays a crucial role in accessing the government subsidies even in the US. Using the same data set, Blau et al. (2013) also investigate whether political connection plays a role in accessing financial support from the US government. First of all, they find that firms with political connections had a 29% higher chance of receiving support than their non-connected firms. Furthermore, they show that politically connected firms received a greater amount of financial support and received the financial support earlier than firms that are non-politically connected.

In a similar vein, an empirical study from China, Wu et al. (2012) examine whether being connected with a politician has any impact on the likelihood of accessing government subsidies. The authors find that private companies with a politically connected manager received more government subsidies than their non-connected counterparts over the period 1999-2006.

Additionally, one of the preferential treatments that a politically connected company can potentially achieve is paying a lower tax rate compared to their non-connected counterparts (Kim & Zhang, 2015; Faccio, 2010; Adhikar et al., 2006). Indeed, studies varying from cross-country and developing country analyses provide empirical support that politically connected companies enjoy paying lower tax rates. To shed light on this issue, collecting firm data from 47 countries, Faccio (2010) examines whether politically connected companies differ from that of their non-connected counterparts. She finds that private companies that are connected with politicians only through ownership pay a lower tax rate than their non-connected counterparts. In a country-specific analysis, in Malaysia, Adhikari et al. (2006) examine whether there is a link between the effective tax rate and political connection over a ten-year period. Their findings show that firms with political connections pay tax at significantly lower effective rates than other firms, suggesting that political connections are an important determinant of effective tax rates in Malaysia.

4.4. Impact of Political Connection on Employment

As it has been argued by many scholars prior to privatization, most state-owned enterprises tend to be overstaffed (Boubakri & Cosset, 1998). Although some scholars argue that privatization does not necessarily mean a decline in employment (Megginson & Netter, 2001; Megginson et al., 1994), other findings document a sharp decline in employment after privatization (Boubakri & Cosset, 1998). Changing ownership from state-to-private also decreases the influence of a politician on a company. Private companies free from the politicians' influence can pursue profit maximization, rather than the objectives of politicians. However, private companies that are managed by a politician, or private companies that appoint a politician as a member of the board of directors, might be open to the interference of that politician. Because of addressing the objective of a politician, they might also exhibit excess employment.

In the literature of politically connected companies, although, the great majority of existing empirical studies have examined whether connected companies receive any benefits from having close relationships with politicians, there have been a few empirical papers investigating whether politically connected private companies address the objectives of politicians (Faccio & Hsu, 2017; Menozzi et al., 2012; Wu et al., 2010; Bertrand et al., 2007).

In a single country study of Italy, Menozzi et al. (2012) analyze the effects of board composition on the behavior of 114 local public utilities; namely gas, electricity and water, during the period between 1994 and 2004. Indeed, they find empirical support for the idea that those firms that are under the influence of a politician are likely to pursue the objectives of that politician. In more detail, they show that employment levels of politically connected companies are higher than those that are not connected to politicians. Similarly, Wu et al. (2010) examine the impact of political connection on the behavior of Chinese firms. Their results indicate that

politically connected state-owned companies employ more surplus labor compared to those non-connected counterparts. Furthermore, they argue that politically connected companies are quite prevalent in less-developed regions. Their findings show that local governments use subsidies to help politically connected state-owned companies to improve local employment levels.

It is worth mentioning that the focus of these papers was only to compare the employment level of politically connected companies with others. Hence, they do not focus on the impact of the electoral cycle on employment.

In the literature, there have been a few empirical studies that examine the impact of the electoral cycle on employment decisions of politically connected companies. One of the major papers in this area is written by Bertrand et al. (2007) who examine whether benefits flow from a connected company to a politician. Based on a firm-level dataset from 1987 to 2002 from France they analyze whether firms headed by politically connected CEOs alter their business decisions to grant election favors to politicians. In more detail, they focus on the hiring and firing decisions of companies. They find that companies that are managed by politically connected CEOs are likely to employ more people and maybe more interestingly lay-off fewer people in comparison to their un-connected counterparts, especially in municipal election years. Furthermore, they find a higher rate of plant creation and a lower rate of plant destruction for firms managed by politically connected CEOs, especially during municipal election years. More importantly, their findings reveal that politically connected companies are likely to create more jobs and more new plants and they are less likely to destroy existing plants in politically unstable cities, especially in municipal election years. Their results remain robust after controlling for several firm characteristics such as size.

In a related study, Faccio & Hsu (2017) examine the employment consequences of a buyout by politically connected private equity firms, during the period 1980-2008, in the US. Their findings show that politically connected private equity companies boost employment at their target companies during the five years after the buyout. Furthermore, their results show that politically connected private equity companies increase employment especially at the time of presidential election years in order to help the incumbent political party to win the presidential elections. More importantly, these findings become more pronounced in states with high corruption.

To summarize, although a great majority of existing empirical studies analyze whether political connection often results in an economic advantage for connected companies, there have been a few empirical studies examining whether politicians seek support from their connected companies especially at the time of election years to increase their re-election chance. Limited existing empirical studies indicate that connected companies are likely to pursue the objectives of politicians. In more detail, those companies that are under the influence of a politician are more likely to employ more workers compared to their non-connected counterparts, especially at the time of municipal or presidential election years.

5. Conclusion

Over the last decade, the political connection has been observed in many countries including developed and developing world. The issue of political connection has captured the attention of many scholars from different disciplines including, economic, finance, management and administration. Consequences of political connections have become one of the hot topics in these areas. From a theoretical point of view, in principle, both a private company and a politician is likely to receive benefit from this connection. Looking at the existing empirical studies, it might be argued that although there is a limited number of studies examining benefits to the politicians, the majority of them concentrate on benefits to the connected firm. Benefits to the firm might be in the form of reaching valuable resources, such as government procurement contract, accessing easier bank credit, and accessing preferential treatments. These privileges are likely to enable the connected company to perform better than their non-connected counterparts. Benefits to the politicians might be to receive the support of connected company especially at the time of election years, to increase their re-election change. Empirical findings show that the benefits to the politician are likely to deteriorate the performance of connected company compared to their non-connected counterparts.

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