POLITICAL CONNECTIONS AND COST OF DEBT: EVIDENCE FROM CHINA

PAN YING

MASTER OF SCIENCE (INTERNATIONAL ACCOUNTING)
UNIVERSITI UTARA MALAYSIA
MAY 2017

POLITICAL CONNECTIONS AND COST OF DEBT: EVIDENCE FROM CHINA

BY

PAN YING

Thesis Submitted to
Othman Yeop Abdullah Graduate School of Business,
Universiti Utara Malaysia,
In Partial Fulfillment of the Requirement for the Master of Sciences (International Accounting)

Pusat Pengajian Perakaunan
Tunku Puteri Intan Safinaz
TUNKU PUTERI INTAN SAFINAZ SCHOOL OF ACCOUNTANCY
Universiti Utara Malaysia

PERAKUAN KERJA KERTAS PENYELIDIKAN
(Certification of Research Paper)

Saya, mengaku bertandatangan, memperakukan bahawa
(I, the undersigned, certified that)
PAN YING (819668)

Calon untuk Ijazah Sarjana
(Candidate for the degree of)
MASTER OF SCIENCE (INTERNATIONAL ACCOUNTING)

telah mengemukakan kertas penyelidikan yang bertajuk
(has presented his/her research paper of the following title)

POLITICAL CONNECTIONS AND COST OF DEBT: EVIDENCE FROM CHINA

Seperti yang tercatat di muka surat tajuk dan kulit kertas penyelidikan
(as it appears on the title page and front cover of the research paper)

Bahawa kertas penyelidikan tersebut boleh diterima dari segi bentuk serta kandungan dan meliputi bidang ilmu dengan memuaskan.
(that the research paper acceptable in the form and content and that a satisfactory knowledge of the field is covered by the research paper).

Nama Penyelia : **DR. ROHAMI BIN SHAFIE**
(Name of Supervisor)

Tandatangan :
(Signature)

Tarikh : 13/6/2017
(Date)

PERMISSION TO USE

In presenting this dissertation/project paper in partial fulfillment of the requirements for a Post-Graduate degree from the University Utara Malaysia (UUM), I agree that the Library of this university may make it freely available for inspection. I further agree that permission for copying this dissertation/project paper in any manner, in whole or in part, for scholarly purposes may be granted by my supervisor(s) or in their absence, by the Dean of Othman Yeop Abdullah Graduate School of Business where I did my dissertation/project paper. It is understood that any copying or publication or use of this dissertation/project paper parts of it for financial gain shall not be allowed without my written permission. It is also understood that due recognition shall be given to me and to the UUM in any scholarly use which may be made of any material in my dissertation/project paper.

Request for permission to copy or to make other use of materials in this dissertation/project paper in whole or in part should be addressed to:

Dean of Othman Yeop Abdullah Graduate School of Business
Universiti Utara Malaysia
06010 UUM Sintok
Kedah Darul Aman

ABSTRACT

With the development of the Chinese economic market and Chinese economic transactions, firms are full of enthusiasm about building relationships with government officials. Under such a background, political connections are becoming important issues. Seeking good political ties, as attested by many empirical studies, proved that political connections have relationships with the firm's tax, donation, capital structure and so on. However, the objective of this study was to examine the relationship between political connections and the cost of debt, which is crucial for firms to develop because the main financial institutions are controlled by the government in China.

In this study, the political connections issue revolved around the cost of debt in 100 Chinese firms which were listed in the Shenzhen stock exchange in 2015. In addition, this study extended previous studies through an empirical study to examine the relationships between political connections and the cost of debt in China. A very interesting and new part in the research was introducing a new measurement of political connections. Besides using Faccio, Lang, and Young's (2001) dummy variable as the measurement, this study also tested the political connections from the Chinese national hierarchy positions. After using this new measurement, the result became more accurate and appropriate to Chinese social conditions.

The result of this study shows that political connections and the cost of debt in China are significant and negative, which means in current China, firms are eager to request the government to be their patron. Therefore, the Chief Executive Officer (CEO) or the board of directors (BOD) are willing to wear two hats—one is to carry the burden in the firm, and the is holding a position with political attributes. Moreover, this study enriches previous studies and makes contributions to this field. As the data and the duration are small, there are limitations to this study which provide a direction for future study.

Keywords: Political connections, cost of debt, value of political connections, China.

ABSTRAK

Pasaran ekonomi dan transaksi ekonomi China yang berkembang telah mendorong hasrat firma bagimembina hubungan rasmi dengan kerajaan.. Berdasarkan hal ini, hubungan politik menjadi satu isu yang amat penting.. Banyak kajian empirikal membuktikan pentingnya dalam membina hubungan politik yang kukuh. Oleh itu, ini membuktikan bahawa rangkaian politik mempunyai hubungan dengan cukai firma, derma, struktur modal syarikat dan sebagainya. Walau bagaimanapun, objektif kajian ini adalah untuk menyiasat korelasi di antara hubungan politik dan kos debit. Hal ini amat penting bagi firma membangun kerana institusi kewangan utama dikawal oleh kerajaan di China.

Dalam kajian ini, isu hubungan politik yang berkaitan dengan kos debit di 100 buah syarikat China yang tersenarai di bursa saham Shenzhen pada tahun 2015 telah diteliti. Apatah lagi, kajian ini merupakan lanjutan daripada kajian lepas. Menerusi kajian empirikal maka adalah perlu untuk meneroka kolerasi antara hubungan politik dengan kos debit di China. Perkara menarik dan baharu dalam penyelidikan ini adalah memperkenalkan satu pengukuran baharu dalam hubungan politik. Selain itu, kajian ini menerapkan pemboleh ubah semu yang dikemukakan oleh Faccio *et al.* (2001) sebagai ukuran. Kajian ini menguji hubungan politik daripada hierarki kedudukan kebangsaan China. Setelah penggunaan pengukuran baharu, maka hasil keputusan tersebut menjadi lebih tepat dan sesuai dengan keadaan sosial China.

Dapatan hasil kajian ini menunjukkan hubungan politik dan kos debit di China adalah penting dan berhubung negatif. Ini bermakna dalam situasi semasa di China, syarikat berhasrat menjadikan kerajaan sebagai penaung mereka. Oleh itu, Ketua Pegawai Eksekutif (CEO) atau lembaga pengarah syarikat sanggup mengalas lebih daripada satu tugas apabila mengambil beban dalam firma itu dan juga mempunyai kedudukan dalam politik. Tambahan lagi, kajian ini memperkayakan lagi kajian lepas dan memberi nafas yang baharu dalam bidang ini. Namun, disebabkan sampel data dan tempoh masa yang agak kecil, maka batasan kajian kekal muncul di dalam kajian ini dan memberi laluan bagi penambahbaikkan kajian pada masa depan.

Kata kunci: Hubungan Politik, Kos Hutang, Nilai Hubungan Politik, China.

ACKNOWLEDGEMENT

I would like to convey my appreciation to everyone who provided me with exceptional support, encouragement and wisdom in completing this thesis. First and foremost, I am deeply grateful to my supervisor in the person of Dr. Rohami Bin Shafie for his thorough supervision, encouragement, and willingness to support me throughout this study. I would also like to express my sincere gratitude for his enthusiasm and guidance. The completion of this study has been possible with his guidance. I owe a great deal of gratitude to University Utara Malaysia for giving me the opportunity to pursue my higher education and to accomplish my purpose of getting this degree, as well as to the whole Malaysia.

On a more personal level, I want to thank my family for their unconditional love, understanding and support. My father and mother raised me to believe that I could achieve anything I set my mind to. My brother, Pan Cheng have been an endless source of great joy, love and assistance. I want to thank them all for their interest and assurance that the journey does have an end at times when it seems like no end was insight.

Many thanks go to my wonderful friends for their consistent support, encouragement, and real friendship that I needed in UUM and who were there for me all the time.

Finally, I wish to dedicate this study to my family as they are always being my strongest supporters. I am indebted to all my family members for their love and appreciation throughout my study.

Thank You All Very Much

Pan Ying
May, 2017

CONTENT

LIST OF TABLES

Table **Page**

LIST OF FIGURES

Figure **Page**

LIST OF APPENDIX

Appendix **Page**

LIST OF ABBREVIATIONS

AUDITOR	Big 4
BOD	Board of Director
CEO	Chief Executive Officer
CF	Cash-Flow
CPPCC	Chinese People's Political Consultative Conference
CR	Current Ratio
CSMAR	China Stock Market Accounting Research
CSRC	China Securities Regulatory Commission
GROWTH	Sales Growth
IR	Cost of Debt
LEV	Leverage
LISAGE	Number of Years since Listed
LOSS	Firms Report Loss
NPC	National People's Congress
PCON	Political Connections firms
PCVALUE	Value of Political Connections
PPE	Plant and Equipment
SIZE	Firm Size
SOE	State-owned Enterprises
SSE	Shanghai Stock Exchange

CHAPTER ONE

INTRODUCTION

1.1 Background of Study

According to Krueger (1974) that firms were willing to spend time and money on dealing with government officials in order to boost their markets which in turn to promote the economy of the country. In addition, it was discovered that they asserted this kind of behavior could increase economic benefits. At time goes on, the world concerned economic growth through lower cost of debt. Thus, the relationship between firms and government had gradually become an attracting issue among researchers all over the world, especially in China.

China has four unique features which make it so different compare to other countries in terms of government-firms relationship. The said relationship includes accelerated economic growth as compared to other emerging economies, where they obviously see China as a paradox case of “law–finance–growth”. This is because, even though the Chinese financial system is not well established, yet its economy is growing faster than other countries. Thus, Allen, Qian, and Qian (2005) established that there must be existed selective institutional activities and governing mechanisms to fund economic growth, which includes reputation and relationships.

The second feature is the issue of culture which is also known as *Guanxi* culture (Cheung, Jing, Rau, & Stouraitis, 2005). Under this type of culture, the Chinese special background of *Guanxi* culture is seen as relation-based society which is kind of an informal mechanism also refer to as political connections where firms obtain various assistances (Tam, 2016). Increasingly, an evidence supported that, Chinese firms had relationship with government and that could make business unhindered. Thereby, making the firms to get favor from banks (Lu, Yang,& Luo, 2014). Similarly, firms were easy to get government procurement contracts under political ties (Montinola, Qian, & Weingast, 2016) and once the firm encountered financial crisis, government usually had political intervention to give a hand (Chen, Sun, Tang, & Wu, 2011).

The third issue is, since 1978, China proceed to economic transition from planned economy to market economy gradually (Howell, 1993). Until now, the economic revolution did not completed yet (Chao, 2015). Based on the political condition, Chinese government was strong while the market was weak by comparison. Therefore, government, through the macro-control, adjust market failure as well as the effect of the market on resources allocation in order to keep economic sustainable growth such as tax privilege and administrative approval, which had a huge influence on economic development (Chow, 2015). At the same time, government as an "invisible hand" maintained and interfere on market order by formulating national laws and regulations (Shleifer, 1997). Hence, in this context, how to deal with

government becomes a strategic question for every firm while it has profound impact on the firm's financial and investment decisions. In many studies, the external economic system usually belongs to the important influence factor of firm’s cost of debt.

Another issue is the differences that exist as compared to other countries on multiparty system during elections whereby China is a one-party system. Thus, the relationship between firms and government remained stable (Montinola *et al*., 2016). In addition, it made the cost for rent-seeking relatively low (Yang, Lian, & Liu, 2012). Moreover, the biggest Chinese four commercial banks belong to the government. Therefore, banks tend to be based on "relationship" cushion to determine whether could provide loans and even provided loans in different rates (Yang *et al*., 2014). The issues raised above provide an insight from the research background which could lead to the research on this topic.

In addition, cost of debt is crucial for firms’ sustainable growth especially in China. The reason for that is because of the major commercial banks in China are SOEs. Under such background, banks and financial institutions have the main rights to provide debts to firms. Therefore, banks prefer to lend money to the firm who has good reputation or big size. In some studies, scholars shown that small size firms and non-SOEs are get higher debt ratio when they borrow money from banks (Li, Wang, & Zhou, 2008). It means that the firm spend more expense in cash financing Thus

their cash-flow and firm sustainable develop are getting limitation (Lu, Zhu, &Zhang, 2012). However, to study this issue and provide suggestions, cost of debt is chosen to connect with political connections.

1.2 Problem Statement

Many studies argued that the more the firms have a political connection, the easier for the firms to obtained loan since the Chinese government control the major banks and financial institutions in China. Therefore, the government is closely to the institutions made it difficult for those firms that has no relationship with the Chinese government to obtain more debt (Cheung, Jing, Rau, & Stouraitis, 2005; Pittman & Fortin, 2004).

However, many firms are concerned not only on how to obtain the debt but considered the cost of the debt as important issue first. It is also argued that those firms with a political connection tend to have low cost of debt this is due to the intervention of the government through the connection (Adhikari, Derashid, & Zhang, 2006). Therefore, this study tends to find the relationship between the cost of debt and political connection among Chinese firms. This is because as earlier stated, Chinese government play an important role on debt decision making since the government control the major banks hence, any firm that has a connection with the government, tend not only to obtain debt but can have lower cost of debt as a result

of the government intervention (Montinola *et al*., 2016).

As the study reviewed many literatures, it was found the need to address the following major gaps. for example, of the established gaps is, most of the literatures focused on firm inner structure, while having rare studies from the cost of debt perspective in China. Therefore, this study concentrates on cost of debt to fill in the established gap. Furthermore, with the advancement of the Chinese economic transformation, the environment for political connections studies is changeable. Due to this circumstances that varies, it is very meaningful to be concern with the latest study in different transition period in China. Therefore, the study considered 2015. This is because, is the year in which Chinese government completed an old plan and embarked on a new plan which is also known as deeper revolution. Meanwhile, in terms of measurement of political connections, many studies or majority while attributing to Chinese special political system, they used dummy as a measurement. Whereas, it is assumed that the common dummy variable of political connections cannot describe the relationship comprehensively. Thus, this study introduces new measurement and it is used to overcome the weaknesses of other studies where by a value is given for different level of government positions and connections.

Base on the above argument, therefore, this study aims to address the gaps that were established. To address the said gaps, consequently, the study determines the relationship that exist between political connections and firms' cost of debt as an

influential factor. Moreover, taking considerations of the Chinese system and in combination of Chinese with special political system, the study develops the measurement for the Chinese political connections. Unlike other studies, this study considers two measurements for political connections. One of the measurement is dummy and the other measurement is the value of political connections.

Therefore, going by the problems and the observation raised. the study raised two questions and two objectives.

1.3 Research Questions

Based on the China political control, political connections are a common phenomenon appearing in emerging economic market. Cost of debt is crucial factor of a firm's development. This study attempts to establish the link between political connections and cost of debt. Thus, research questions of the study are:

1. What is the relationship between political connections value and cost of debt in China?
2. What is the relationship between political connections firms and cost of debt in China?

1.4 Research Objectives

The key objective of this research is to inspect the relationship between political

connections and cost of debt in China by two different measurements. The followings are the specific objectives of the study:

1. To examine the relationship between political connections value and cost of debt in China.
2. To examine the relationship between political connections firms and cost of debt in China.

1.5 Significance of Study

Political connections as an important represent as informal mechanisms have effect on financial institutions' credit-resources allocation decisions. Especially under the background of China's special hierarchy system. It is with social system differences, thus, it cannot simply analysis by Faccio (2005) research result. Therefore, this study supports the proxy of political connections in order to obtain a more accurate and strong result. At the same time, a large number of studies have shown that political connections can assist firms to get more loans, improve the firm performance. However, most studies stay on the debt amounts, and there is no research directly discuss about the cost of debt and political connections. Hence, significance of this study is mainly manifested in the following two aspects:

1. **Theoretical implications**: Similar with other studies, this study introduces rent-seeking theory which is mainly to discuss the political ties and firm finance, which enrich the firms' political connections related literatures. This study used

the said theory to investigates cost of debt through interest rate and examine influence of political association in Chinese typical institution system environment. By empirical test provides empirical evidence for firms cost of debt and political connections affection directly.

2. **Practical implications**: This study measures political connections by social institution of China. From firm level inspect the influence of political connections on firms financing policy. Provides certain experiences for firms to make appropriate finance decisions. Thus, firms could keep their cost expenses at a low level relatively. Moreover, the study makes contribution to improve the current situation of corporate finance in China.

1.6 Scope of Study

The study emphasizes on political connections and cost of debt in China. For this purpose, the study considered top 100 firms listed in Shanghai stock exchange by market capital in 2015 (Isshaq, Bokpin, & Amoah, 2012). The study shows the relationship between firms and government, as well as the impact of political ties working on cost of debt. Furthermore, the study measures cost of debt through the accounting variable which is interest rate (Bliss & Gul, 2012).

1.7 Organization of Study

This study is separated to five chapters. The first chapter introduces introduction, while chapter two, reviews the previous literature on political connections and cost of debt. Chapter three explains the methodology of this study. Chapter four discusses the results and chapter five delivers conclusion of this study.

1.8 Chapter Summary

This chapter demonstrates an over review of the study by highlighting background of conduct the research, problem statement, research questions and research objectives, significance of this study and later the scope of the study. Besides, this chapter describes the organization of the study.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

This part provides a review of previous literatures on political connections and cost of debt. It provides insight into the following issues: political connections in China, political connections influence and concept of political connections. This chapter also provides reviews on theoretical foundation and determinants derived from the theories that may influence on political connections and cost of debt.

2.2 Political Connections

Existing studies on developing and developed countries are very rich, also from different angles. Results from scholars are diversification.

2.2.1 Concept of Political Connections

Many articles to defined political connections. Some researchers named “political connections” as “political relationship” or “political ties”, some Chinese scholars also named it as “Guanxi” (Bian & Zhang, 2014;Tam, 2016). Based on different expression, people measured political connections by different ways.

Currently, the most common measurement in this research field to the definition political connections is proposed by Faccio, Masulis, and Mcconnell (2006), which

was standpoint from “background” and discuss whether firm was political connected or not. If there was at least one large shareholder (any person who controls at lowest 10% of the votes) or the senior management (including the chairman, CEO, president and secretary of the board) in the firm currently or former served in a government agency or parliament (Faccio *et al*., 2006; Agrawal, & Knoeber, 2001), majority scholars defined political connections as this. In their empirical model, they used dummy variable if firms were political connections equal 1, otherwise 0 (Bliss & Gul, 2012; Claessens & Laeven, 2008).

This proxy was the earliest political association studies of hierarchy. It means researchers start to seek the boundary effect of political power. The impact of political connections firms also was different. Thus, the economic consequences were diversity. Conception for political connections was focus on whether shareholder, CEO or BOD had a position in government or military (Claessens & Laeven, 2008; Fan, Wong, & Zhang, 2007; Qian & Strahan, 2007). This conception is comprehensive relatively. But within the Chinese strict structure, the definition is lean to the government official which is not enough to get consider the relationship comprehensively.

Certainly, there are also some different ways to define political connections. Such as used the percentage of political connections director which is account in the whole BOD (Boubakri, Cosset, & Saffar, 2008). In addition, there were studies that

combine political connections and political donations, use donation as a proxy variable (Claessens, Feijen, & Laeven, 2008; Jayachandran, 2006). The advantage of using donation as a conception was quite objective, because the amount and time of donation is clear described in annual report. Moreover, government ownership usually as a result of political intervention to measure political connections. This definition often appeared in the study of state-owned enterprise (SOE) (Adhikari, Derashid, & Zhang, 2006).

Meanwhile, due to the different political structure and political background of world countries. Scholars from different countries also use inconsistent methods to measure political relations. Park and Luo (2001) used questionnaire to investigated. Charumilind, Kali and Wiwattanakantang's (2006) study based on whether firms' CEO or BOD have financial bank working background, because in Thailand the debt represents bank loan. Members of the BOD had to participate in provincial or national elections (Mian&Khwaja, 2005). Fisman (2001) studied the stock price fluctuation of the firm who had close relationship with the former Indonesian presidents Suharto during the dying rumor. The result shown that the rumor more serious the stock price decreases faster.

2.2.2 Influence Factors of Political Connections

At present, political connections has become a common phenomenon in various

countries. Thus, to examine the reason causes the phenomenon can help us understand political connections better. Some studies shown that the larger the size of firms, the easier established political relationship with the government (Faccio *et al*., 2006; Hellman, Jones, & Kaufmann, 2000). Further speaking, the longer establishment of firms, the greater likelihood of having political connections (Li, Meng, & Zhang, 2006). The results of Boubakri *et al*. (2008) and Faccio *et al*. (2006) indicated that the higher degree of indebtedness, the firm was significantly positively related to the government. Johnson and Mitton (2003) chosen Malaysian firms as sample studied the changes in the share price of firms who had political connections around the 1997 Asian financial crisis. They found that before the capital controls, firms with political link had lower rate of return than those without political connections. Meanwhile, those firms return on equity was better also.

Study in Pakistan, firms had relationship with government easy to get loan and the amount of borrowing was 45% higher than other firms. For the interest rate part, political connected firms could get at least 50% privilege (Mian & Khwaja, 2005). In addition, Bunkanwanicha and Wiwattanakantang (2009) based on the largest 2,000 firms in Thailand, found that government franchise dependence and wealth levels were positively related to business owners' participation in politics. Helland and Sykuta (2004) considered that BOD with political background determined by regulatory environment, political background director was increase with the strict regulatory environment, conversely, it will decrease. Claessens *et al*.(2008) studied

the relationship between contribution of electoral activities and corporate finance priorities during 1998-2002 in German firms. The result shown that firm who did more contribute when the person was elected as preside, the ROA was higher.

Research in China, the appearance of political connected CEO was related to the unemployment rate and financial position in the certain extent. More specifically, listed age, education, and management experience are positive to political connections (Guan, Richard, Tang, & Lau, 2009). Fan *et al*. (2007) tested 790 state-owned private listed firms in China, found that around one third of the CEOs of the sample firm were former or current government officials. Results shown that firm performance were lower to 37%, comparing with the CEO without political connections. Francis, Hasan, Sun, and Zhou (2009) noticed that firms with political connections could achieve better returns in the IPO process, such as quotes, underpricing and fixed costs.

2.2.3 Political Connections and Corporate Governance

From corporate behavior standpoint: Studies of political connections on corporate governance had positive and negative consequences. As said before, government power could be a grabbing hand, but also could be the hands of support (Boubakri, Guedhami, Mishra, & Saffar, 2010). For firms with political relevance, government might for some purpose to implement intervention in the business, distorted the firm's business objectives and governance mechanisms, sacrificed corporate value

(Bolton, Rosenthal & Howard, 2017). The relationship between the government and firms could help itself get a favorable regulatory environment and tax conditions. Reducing the frictional between firms and regulatory authorities to get financing convenience (Sapienza, 2004).

Equally, firms had more cooperation with the government, such as government procurement, exports products while it means the more government background of directors in their firm (Agrawal& Knoeber, 2001). Dinç (2005) examined the impact of campaign activities on bank lending in 36 countries from 1994 to 2000, it shown that state-owned bank loans were 11% more than private banks in the year of election. From this side, government officials used state-owned banks to provide their supporters loan convenience. Charumilind *et al.* (2006) selected 270 non-financial listed firms in 1996 as sample to study found that firms with relationships with politicians and banks received more long-term loans. Boubakri *et al*. (2008) in transnational research found that average asset-liability ratio of political connections was 52.9% ,14.5% higher than those without political connections. In contrast, Bliss and Gul (2012) selected the top 500 listed firms in Malaysia from 2001 to 2004 as sample. The study shown that corporate political relations lead to higher asset-liability ratios, but because of the higher risk of political affiliates, loans required higher interest rates.

For the firm's governance: Srinidh, Zhang, and Zhang (2011) found that China's

political connections firms are unlikely to hire high-quality auditors. This made the firm failing to confirm losses in a timely manner, with more maneuverable accruals, indicating that political connections firm usually had lower transparency. On the contrary, Guedhami *et al*. (2012) found that politically connected firms were more inclined to hire "Big 4" to audit their firm. Evidences from Malaysia, independence of audit committee was affected by political relations; auditors believed that the political connections firm have higher risk in CEO Duality. After the Asian financial crisis, audit fees of political connections firms were increased. But after the Malaysia capital control started, the cost decreased(Bliss, Gul, & Majid, 2011). The former result was trigger by the risk of false statements from political connections firm's financial statements, the latter one was caused by the government's political support for political connections firms during implementation of capital control. Adhikari *et al*. (2006) provided evidence of lower actual tax rates for political connections in Malaysian and Chinese markets, respectively. In China, political relations could improve the survival chance and future growth prospects of a firm (Du & Girma, 2010).

2.3 Cost of Debt

The research from the perspective of corporate governance study the factors influencing the cost of debt. The level of corporate governance was called as the

primary factor affecting the cost of corporate debt by scholars. This was because of good corporate governance not only protects creditors' return on capital, but also mitigates conflicts between creditors and business managers, thereby, reducing corporate debt financing costs (Shleifer & Vishny, 2002). Most of the results shown that firm size, fixed asset ratio, profitability were significantly negatively correlated with corporate debt costs, and corporate debt levels were significantly positively correlated with debt levels (Fazzari, Hubbard, Petersen, Blinder, & Poterba, 1988). Firm cost of debt changed with the size of BOD. Become a bigger size of BOD, independence of the board increase and the better the independence of the audit committee, the lower the cost of the firm's debt (Anderson, Mansi, & Reeb, 2004).

Ellul, Guntay, and Lel (2007) examined the impact of family business on corporate debt agency costs under different investment protection environments. Francisco andJavier (2006) noticed that the higher the level of voluntary disclosure, the lower the cost of debt. Hollis and Ryan (2004) argued that capital costs were positively correlated with the number of large shareholders and are negatively related to the independence and shareholdings of the board. The quality of BOD also had an element effect on cost of debt. BOD with higher quality easy to have lower interest rates. Thus, corporate governance was an important factor affecting the firm cost of debt (Fields, Fraser, & Subrahmanyam, 2012). In those study Chaney, Faccio, and Parsley (2011) found that the quality of accounting information disclosure can improve credit ratings and reduce credit spreads. Firm's accounting quality effect on

the firm's loan rate, transaction costs and loan requirements which include shorter debt maturity and better profitability guarantee requirements (Bharath, Sunder, & Sunder, 2008).

There are many studies on the issue of agency costs between the ultimate controller and creditors. For example Boubakri, Guedhami, Mishra and Saffar (2012) used 19 countries in East Asia and Western Europe, it shows that cash-flow, the separation of two rights and family control are significantly positively correlated with bond costs and are significantly negatively correlated with bond ratings. Xu, Xu, and Yuan (2013) found that cash flow and the separation of two rights were significantly positively correlated with debt costs, which should be emphasized that the relationship was more significant in family control as well as CEO control family firms. Aslan and Kumar (2009) use syndicate loans data study the moral hazard caused by controlling shareholders (especially family control) was significantly positively related with loan prices. However, Some scholars had also examined the correlation between corporate governance and debt costs based on empirical analysis and found that the higher the corporate governance level connected with firm, the lower cost of debt (Takasaki, 2014).

2.4 Political Connections and Cost of Debt

In terms of political relevance and cost of debt. The impact of political connections on debt costs was mainly reflected in the loan interest rate (Sapienza, 2004), the term of the loan (Fan, Rui, & Zhao, 2008) and the requirements of loan (Mian & Khwaja, 2005). In addition, political connections were a direct and strong guarantee for the financial institutions that involving borrowing firm has strong solvency. Furthermore, the government's special preferential policies could provide implicit guarantees for the financing of politically related firms (Faccio, 2005) , which reduced its debt costs.

Fisman (2001) shown that firms associated with the government are often able to obtain bank loans at a lower cost. Johnson and Mitton (2003) argued that political relationship had effect on loan amounts. It helped firms to obtain long-term loans. but study in Thailand, the impact of political relations on the plenty of loans was not obvious (Bunkanwanicha & Wiwattanakantang, 2009).

2.5 Critical Analysis of the Related Studies

Research on the influencing factors of listed firms' debt cost. Scholars around world had accumulated a lot of fruits. Studies were varieties, some of them from institution angle, some of them from firm's structure and some of them from accounting

information. But the existing literatures about listed firms cost of debt study were just focus on single dimension and lack of the empirical study of cost of debt. Therefore, this study focuses on the relationship between political connections and cost of debt. Putting these influencing factors into one model framework for empirical test. Further enriches the research literatures on the debt financing of listed firms.

Firm political connections were extensive in the world, especially in emerging or transitional economies. Previous studies argued that political connections of affirm belong to an alternative informal system for the purpose of gaining interest. In addition, firms were keen to establish a good relationship with the government because government holds the distribution rights of competitive resource that had a fatal impact on their business survival and development.

However, it is not difficult to understand differences in the results of literatures on political connections and corporate performance. On account of the different costs incurred by different regions of enterprises as well as different market. China is a country in which political power has traditionally been concentrated, with most decision-making authority vested in the hands of the central government. Centralization of government power proved to be a major obstacle in the early stages of the economic reform process, during which there was a heavy reliance on local government initiatives (Chen, Li, Su, & Sun, 2011). Although the central

government still refuses to relinquish its control of political aspects such as the media, the military, religion, and the appointment of government personnel, economic decision-making rights have become greatly decentralized as a result of the reform process. In addition, position within government has different power strength because of the down to up system of government. Thus, the result of political connection is variable and worthwhile to detect.

In general, the current scholars are unanimous in favor of political association has a strong resource effect, the most obvious one is about get bank loan. However, these studies only focus on and study the effect of the amount of loans associated with politics, and do not further analyze the debt ratio and the impact of corporate political relations on the cost of debt.

2.6 Underpinning Theory

2.6.1 Rent-seeking Theory

The roots of rent-seeking theory could be traced back to Tullock (1967). Bertrand *et al*. (2006) suggest that political connection may be a rent-seeking behavior by the entrepreneurs. Zhang (2009) highlighted that individual rent seeker and government rent seeker were monitor each other, Thus became two sides—demander and supplier. People who involved in regulation manufacturing hope monopoly and officials who implement the principle as well as control the rare sources also

expected to get return from demander side.

Rent-seeking was an activity to help firms obtain the dealership as well as get the lower tax rate or exchange rate privilege which provided by government. All those operate assistance firms gained substantial profits (Krueger, 1974). The evidence of rent-seeking from many countries. This kind of activity especially in a country who was during a transition period or abundant in a country which had a dramatically change of the economic structure (Chen *et al*., 2011).

However, some economists had noticed that market failures were always appear and rent-seeking behavior was hard to be overcome by market itself. But both government and market were playing different roles in social resources distribution (Minggui, Yafu, & Hongbo, 2010). Due to influence of government on resources distribution. The condition of rent-seeking was setting up whilst promote by authority. When government constitute intervene, control and impose an effective supervision on market. Rent-seeking are inevitable. Thus, for seeking such relationship, firms even spend higher costs to create political connections. Therefore, rent-seeking is an important and basic theory for this research.

2.7 Chapter Summary

This chapter describes the literature review about political connections and cost of

debt. It provides detailed discussion about previous literature on dependent and independent variables. Moreover, it discusses about how political connections measurements and cost of debt into the same framework which is supported by the underpinning theory.

CHAPTER THREE

RESEARCH METHODOLOGY

3.1 Introduction

A statistical knowledge, research methodology was that through data collection and data analyses to support the study in an effective way (Kothari, 2001). In this chapter, initially, the study gives a vivid portrayal of the study framework. Next, hypotheses development for the study are discussed and explained here. Subsequently, sample and data collection methods disclosure in 3.4 which states clearly how the sample selected from total population. Section 3.7 and 3.8 depict measurements of variables involving this research. After that, data analysis techniques are introduced and emphasized.

3.2 Research Framework

This study attempts to examine the relationship between political connections and cost of debt in China by two measurements which is political connections value and

political connections firms. Both of the variables are testing in later chapter of the study. Next figure demonstrates research model with all variables of this study.

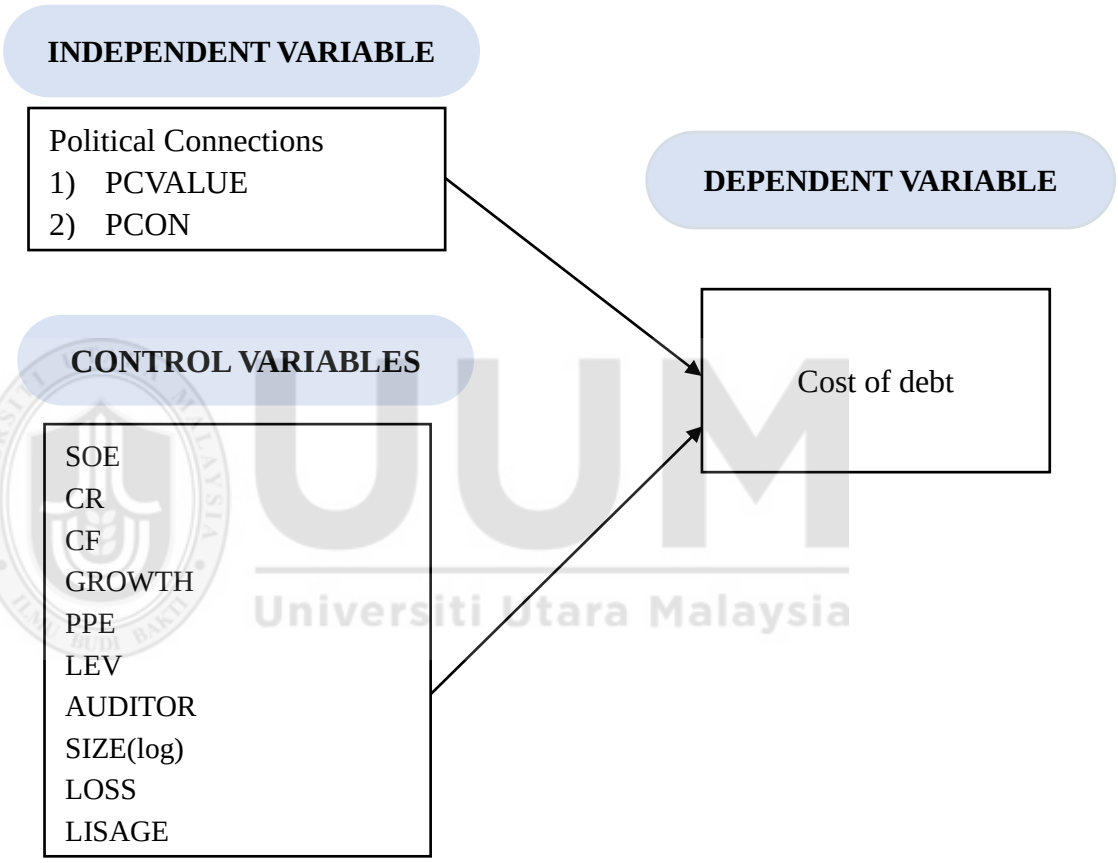

Figure 3.1
Theoretical Framework

3.3 Hypotheses Development

This section provides the reason to develop hypothesis between political connections and cost of debt by two-dimension measurements of political connections. One from the research which study in China calls political connections value (PCVALUE). The

other one is the most popular measurement in the world which is a dummy variable. To study political connections, for distinguish political connections within this study it be named as political connections firms (PCON).

Majority scholars prefer that political connections were beneficial to firm sustainable development. This kind of phenomenal not only appears in China. Even Singapore, a country that government system and institution environment was comparably transparent, also had such situation which was in the national intervention industry, firms who got relationship with government official in most cases get privilege than other firms (Wahab, Zain, & James, 2011). Likewise, similar result were proven in Malaysia that firms who own political ties had significant and positive correlation with leverage (Fraser, 2006).

According to Bliss and Gul (2012), politically Firms had higher level leverage and negative equity. Politically firms were more likely to disclosure a loss in annual report and CEO duality perceived high risk inner a firm. It was from the perspective of corporate governance to discuss financial respect. In German, well-connected entities drift towards bigger size and lowers risk. They got better resources and credit grading during the firm operation. Hence, firms were eager to invest in delegate to gain value for business (Niessen & Ruenzi, 2009). Firm debt cost varied with the size

of BOD. Usually, the larger size and stronger independence of board, the better independence of the audit committee, then, the lower cost of the firm's debt (Anderson *et al*., 2004).

Social environment also a vital element effecting political climate and cost of debt. Prior empirical studies reported that firms undertake a greater amount of debt during pre-crisis. Further, in the early days of the Asia financial crisis, stock price of political connected firms was getting lower cause citizens believe that the connected firms were inefficient (Johnson *et al*, 2003). Moreover, Fisman (2001) use "Suharto dependence index" which provided by a consulting firm named "The Castle Group" to measure political connections. "Suharto dependence index" includes 25 largest firms in Indonesia. Thereinto, 79 firms listed on Jakarta stock exchange which constituted as research sample. The author noticed firm value and debt in Indonesia footing on Suharto's health and regime during the six time of "sickness rumor". Therefore, political connections was differ from country to country, as well as, cost of debt was floating.

Political connection not only provides benefits to private enterprises, it also brings costs to them in terms of corruption and rent-seeking behavior. Bertrand *et al*. (2006) suggest that political connection may be a rent-seeking behavior by the entrepreneurs. They offer two possible reasons. First, the incumbent politicians facilitate enterprises.

If these politicians were reelected, they will continue to give favors to the enterprises. Second, close personal relationship or political ideology will directly imposed political pressure to hire more employees who are closely aligned with the entrepreneurs. In Chinese specialist Guanxi-oriented society, political connections enhanced the ability and opportunity for firms, helped them to obtain the necessary resources through implicit-market approach (Cheung *et al*., 2005; Tam, 2016). There were certain studies mentioned that political ties with government did good to firms, especially reduce business risk, decrease the degree of information asymmetry and increase the amount of credit granting (Yu & Pan, 2008).

Deserve to be mentioned in this study, the most interesting part of the study is going to test two dimensions of political connections in order to improve the result stronger. Thereby, in the light of above research's rich fruits, either from financial or corporate governance standpoint, the study perceived that the relationship between cost of debt and political connections is negative and significant in China. To be detail, show in following hypothesizes.

Hypothesis 1: Political connections value is negative and significant relationship with cost of debt.

Hypothesis 2: Political connections firms are negative and significant relationship with cost of debt.

3.4 Research Approach/Design

Research design is a matter of cardinal significance which penetrate the study from stem to stern. The issue of this study is to discover a relationship between political connections and debt cost of non-financial firms in China Shenzhen stock exchange. Besides, research approach through secondary data analysis which is gathering from the China Stock Market, China Center for Economic Research (CCER) and Accounting Research (CSMAR) database which is arranged by China Securities Regulatory Commission (CSRC). At last, measurements of variables and analysis technique are described.

3.5 Sampling

To investigate the study hypothesizes empirically. The study chose top 100 listed corporations ranked by market value at 31 December 2014 which was on Shenzhen Stock Exchanges main board (Isshaq *et al*., 2012). The selection method was an imitation of Bliss and Gul (2012)

Usually, large firms regard undertook more opportunities and resources from certain industry (Aerts, Cormier, & Magnan, 2006). Besides, most of the citizens firmly believed that larger firms participate in more social activities and have strong influence on society. It made the firm have to disclosure more information for transparent (Hackston & Milne, 1996).

Compare with Shanghai Stock Exchange (SSE). The two exchanges belongs in different category. SZSE are relatively variety but most firms in SSE are large state-owned firms. In addition, SZSE are requiring listed firms' information disclosure and provide mark to them. Thus, even the disclosure is voluntary, firms want through a well completable and transparent disclosure, no matter financial information or non-financial information, to attract investors. Thus, the information and firms listed in SZSE are good quality than SSE. Therefore, in this study SZSE are being chose (Demirer & Kutan, 2006; Fu, & Liu, 2012; Su, 2010; Xiaowen, 2012).

Moreover, all data relevant-part such as CEO and BOD political background and firm cost of debt related financial information (current ratio, cash flow, firm size et.) from CSMAR (Listed Firms Financial Statements Database, Financial Indicators Analysis Database, Financial Reports Audit Opinion Database and Dynamic Database of Executives in Chinese Listed Firms) except interest expenses. Interests expense are collected from CCER.

3.6 Data Collection Procedures

Secondary data is used in this paper conduct a cross-sectional study. For this purpose, the collected data of all variables are from CSMAR and CCER based on SZSE main board. In 2015 December, the number of listed firms in SZSE main board were 478. The data collection procedures as follow:

1) Remove 11 financial and insurance firms;
2) Remove 25 Special Treatment(ST), *Special Treatment(ST) firms;
3) Remove 38 firms without complete data.

Financial and insurance firms are the range of special industry. Industry as them, has huge cash flow and different information disclosure requirement which will impact on result. Secondary, ST and *ST firms are the firm who has limited stock liquidity and because of the abnormal finances condition or "delisting risk warning" given special treatment (Xiaowen, 2012). Complete data means CEO or BOD information and financial information are fully disclosure. In order to avoid empirical result impact by lack of senior management political background information, the study determined to remove the part of the sample.

After all those select principles, it is remaining 404 listed firms. Then ranking firms by market value at 31 December 2014. At the end, top 100 firms are chosen to carry on the study. Among those firms the number political connected firms are different which is observe in EXCEL.

Table 3.1
Summary of Sample

NUMBER	PC Firms	Non-PC Firms	Total	PROPOTION of PC Firms
PCVALUE	72	28	100	72%
PCON	69	31	100	69%

3.7 Measurement of the variables

This section present measurements of all variables: dependent variable, independent variable and control variables. The detail information clarifying in the following paragraphs. The model of this study are the improvement of Bliss and Gul (2012) and modification some variables which studied in prior literature possibly effect on cost of debt in China.

$$IR_i = \beta_0 + \beta_1 PCVALUE_i + \beta_2 PCON_i + \beta_3 SOE_i + \beta_4 CR_i + \beta_5 AUDITOR_i + \beta_6 PPE_1 + \beta_7 LISAGE_i + \beta_8 LEV_i + \beta_9 CF_1 + \beta_{10} SIZE_i + \beta_{11} GROWTH_i + \beta_{12} LOSS_i + \varepsilon_i$$

Where;

IR = Cost of debt

PCVALUE = CEO or BOD have political background are given mark for value

PCON =Firms are political connected code 1 otherwise 0

SOE = Firms are controlled by central government

CR =Current ratio

AUDITOR = Firms are audited by a big audit firm code 1 otherwise 0

PPE = Plant and equipment

LISAGE =The number of years since listed

LEV =Leverage

CF =Cash-flow

SIZE(LOG) =Firm size logarithm of total assets

GROWTH =Sales growth

LOSS =Firms are report loss code 1 otherwise 0

β_0 = Constant

β_1 **to** β_{12} =Coefficient of the independent variables

ε = Error term

$_I$ =Sign of cross sectional data

3.7.1 Dependent Variable

Dependent variable of this study is cost of debt (IR). After review previous studies, measurement was the ratio of a firm's interest expenses to its long and short term debt at the year 2015 (Martin & Riccardo, 2016). The data of interest expenses collect from CCER database firm income statement. The short-term and long-term liability come from the CSMARS database firm balance sheet. Overall, IR is a very popular measurement to test cost of debt.

3.7.2 Hypotheses Variables

This section is clarified the two measurements of independent variable, which is the most interesting part of this study. First of all, the study considers Chinese complexes political system and institution select another proxy to provide value of political

connections of each level. Similar with Fisman (2001) given 1 to 5 as score to mark Indonesian President Suharto case creative “Suharto dependence index”. According to Yang and Zhang (2015), the study mark firm political connections strength from 0 to 3. The background of CEO and BOD are classified to two types. One is CEO or BOD currently or was attend the Chinese People’s Political Consultative Conference (CPPCC) or the National People’s Congress (NPC).

The Chinese People's Political Consultative Conference, shortened as, *Renmin Zhkngxie,* i.e. "People's PCC"; or just, *Zhengxie,* i.e. "The PCC"), abbreviated CPPCC, is a political advisory body in the People's Republic of China. The organization consists of delegates from a range of political parties and organizations, as well as independent members, in China. The proportion of representation of the various parties is determined by established convention, negotiated between the parties (Obrien, 2008).

The political system of China is characterized by the system of people's congresses. According to the Constitution of People's Republic of China, all power of the state belongs to the people, and the Chinese People's Congress, including the National People's Congress (NPC) and local people's congresses at all levels, is the organ through which the people exercise their state power.

The NPC is the highest organ of state power in China, and local people's congresses

are the local organ of state power in their respective administrative areas (Dowdle,1997). Other organs, such as governments, courts and procrastinates, are elected by people's congresses at the corresponding levels, and they are responsible to and supervised by people's congresses at the corresponding levels.

The other one is CEO or BOD currently or was take position as a government official. The value score and country institution are described in the following table.

Table 3.2
Value of Political Connections

Serve Hierarchy	Conference hierarchy	Value of Political Connections
At central or provincial level	At central level	3
Below provincial level	At provincial level	2
Civil social organization	Below provincial level	1
None	None	0

CPPCC, Chinese People's Political Consultative Conference.
NPC, National People's Congress.
Source: The political connections information comes from the CSMAR database and was arranged by the author. Score adopted form Yang and Zhang (2015).

According to Chinese economic transaction situation and previous empirical studies, this study mentions the hierarchies of serve in government and attend conference to four level. When the firm CEO or BOD former or currently take position in government at central or provincial level, it is valued as 3. Same score gives to the crews at central level attend or was a member of NPC or CPPCC. Next, if a firm has

CEO or BOD who is working or at present undertake duty below provincial level as well as participate the important committee at provincial level, the value of hierarchy is 2. Thirdly, the study assigns the CEO and chairperson have experience of NPC or CPPCC or the person in an interest related civil social organization own a job title is value 1. Zero is scored for CEO or BOD doesn't have political background. When a firm has more than one person enjoy political background, the study chooses the max value as consider standard to make sure the result accuracy.

The second measurement the study use is the highest usage percentage and numbers in the field of experimental study about political connections. Extract from Faccio (2001) and Faccio (2007), it defined firms political-connected by CEO and BOD had or have government position or a member of parliament. the measure method is dummy variable which is if the firm is political connected equal 1 otherwise is 0 (Fan *et al*., 2007; Khwaja, Ijaz & Mian, 2008; Yu & Pan, 2008). Besides, the reason for choosing CEO and BOD rather than other managers is on account of Lin's study. He supported that a firm's high social status managers comparatively are easier to exploit ties from government. Thus, the aspiration and capacity of utilize social relations for corporation are growing strong.

3.7.3 Control Variables

This study employs several control variables. They are SOE, CR, AUDITOR, PPE,

LISAGE, LEV, CF, SZIE, GROWTH and LOSS as control variable.

SOE is firms which controlled by central government. In comparison to other types of firms, SOE are supposed to have a "natural blood" with government. In the transitional period, firms which have relationship with government are likely to get debt from national bank, which is very conducive to firm develop (Deng, Tian, Li, & Abrar, 2012)

CR is a proxy to measure cost of debt by liability. Firms are deemed to fulfil their obligation easily because of higher current ratio. Thus, the firm can get lower rate of debt. Furthermore, current ratio has significant and negative correlation with cost of debt (Bliss & Gul, 2012).

AUDITOR states whether a firm audited by big 4 audit firms. In many studies, big four representative auditor quality. Reports reported by famous and large size audit firm have high reliability and reference value for institutions make decision to give loans. Thus, political connected firms are preferring audited by big4 then than other firms (Boubakri *et al*., 2012)

PPEis plant and equipment, which present the assets structure of firm. Studies show that PPE influence on bank loans because it can provide a security between debtors and firms. Therefore, it can have relationship with IR (Bliss & Gul, 2012)

LISAGE is the number of years since firm listed. Previous studies show that a firm listed age has relationship with capital structure and is negative insignificant relationship with debt ratio. Firms earlier to stay in the stock market have the lower information asymmetries, which is easy to get financial debt (Amri &Ani, 2015).

LEV is the ratio of total liability and total assets. Petersen and Rajian (1994) argued that firm had positive correlation with firms' interests rate. Bliss and Gul (2012) discuss the relationship between leverage and political connections. They found there was a positive correlation exist. The high leverage to some extent representative the firm were easier to break the treaty, so the creditor's requirement of risk premium was high, lead to the cost of debt increasing (Pittman & Fortin, 2004).

CF on the contrary with current ratio, when current flow is decline and slow. The firm are considered as do not have enough ability to burden default risk. Correspondingly, lenders boost ratio of debt as well as decrease amount of debt (Bliss & Gul, 2012).

SIZE is common variable appears in this area researches but the result is ambiguous. Firm size usually uses the natural logarithm of total assets to measure. The logarithm result is higher, the firm size is bigger, which is proportional. Similar as listed age, if the firm has big size and long establish history. The firm may have good records and

are facility to get loans (Grant, 2016).

GROWTH shows a firm's grow up ability. It is significant with a firm's debt and business value. Growth of a firm is better and fast; the value of the firm is bigger (Faccio & Parsley, 2009). Also, firm debt is closely bound up to the firm investment opportunities, firm debt usually grows when earnings are far great than investment (Drobetz & Fix, 2003).

LOSS is a dummy variable using in this study. It tests by whether a firm reported a loss in the last fiscal year. If the firm has a loss in the last fiscal year, the institution believes that this firm do not have financial ability to repay the loan. Hence, this phenomenon causes the ratio of debt raises, lenders even reject the borrower requirements (Bliss *et al*., 2011).

3.8 Research Variables

Table 3.3
Description of Dependent and Independent variables

Variables	Measurement	Prediction
PCVALUE	1) CEO or BOD currently or was attend NPC or CPPCC at central or provincial level and as a government official at central level are valued 3. 2) CEO or BOD currently or was attend NPC or CPPCC at provincial level and as a government official below provincial level are valued 2. 3) CEO or BOD currently or was attend NPC or CPPCC below provincial level or a member of an important social organization equal 1 4) None is value 0	Negative
PCON	Dummy variable, If CEO or BOD have political background are equal 1 otherwise 0	Negative
SOE	Dummy variable, if firms are controlled by central government equal 1 otherwise 0	Negative
CR	current assets / current liabilities	Positive
AUDITOR	Firms are audited by a big4 audit firms code 1 otherwise 0	Negative
PPE	Gross property, plant and equipment /total assets	Negative
LISAGE	Number of years since firm listed	Negative
LEV	(long-term debt short-term debt)/ total assets	Positive
CF	Cash flow /total assets	Negative
SIZE	Log (total assets)	Negative
GROWTH	Sale revenues growth 2015 / sale revenues growth 2014	Negative
LOSS	Dummy variable, if the firm reported a loss in the last fiscal year equal 1 otherwise 0	Positive

3.9 Data Analysis

The analysis technique adopt in this study is STATA version 13.0 and EViews9.0 which is cover following steps. Descriptive statistics, normality assumption, heteroscedasticity test, multicollinearity test and ordinary Least Squares test.

3.9.1 Descriptive Analysis

Descriptive analysis is the initial step to illustrate plenary data about sample. So as to interpreting data information clearly and enable to help us understand samples. (Genser, Cooper, Yazdanbakhsh, Barreto, & Rodrigues, 2007). The descriptive context includes sample's basic feather demonstration which shows the minimum, maximum, standard deviation and mean for each variable in this study.

3.9.2 Normality Assumption

Normality is described as the shape of the distribution of data for specific quantitative data variable and its normal distribution. It is a basic assumption in multivariate analysis that follows the premise that a significant deviation from normality will result in an invalid statistical outcome (Hair, Black, Babin, Anderson, &Tatham, 2006). According to Tabachnick and Fidell (2007) the distribution shape could be observed on a graph. The residual distributions according to standardized normal probability plots that were sensitive to non-normality in the middle data

range were noted. For the purpose of this study, the Kernel Density Estimator are used.

3.9.3 Heteroscedasticity Test

The test for heteroscedasticity of a group of variances is needed in the cross-sectional data analysis because the study is one year data. There are many heteroscedasticity tests available, namely, Goldfeld-Quandt Test, Spearman's Rank Correlation, Glejser Test, Park Test, White Heteroscedasticity Test and the Breush-Pagan Goldfrey Test.

Consequently Gujarati (2009) pointed out that there was no answer for the best and most powerful test to diagnose the problem. In the data analysis using EViews statistical software, a modified Breusch-Pagan-Godfrey test for group wise heteroscedasticity in the residuals could measure heterogeneity from the significance of the chi-square value (Greene, 2003).

3.9.4 Multicollinearity Test

Data analysis is capable of reducing the multicollinearity problem (Baltagi, Bratberg, & Holmås, 2005). Multicollinearity checking is a common diagnostic test to ensure that none of the independent variables are highly correlated, which can result in massive variance bias. The high correlation between two (2) independent variables would result in a huge bias in variance, thus, causing the estimations to be unreliable (Baltagi *et al*., 2005). The Variance Inflation Factor (VIF) is an example of the test

that is common to examine such a problem. It treats one (1) of the independent variables as dependent variables and the remaining independent variables as independent variables.

3.9.5 Multiple Linear Regression Analysis

This study employs cross sectional data analyses in order to examine the association between the political connections and cost of debt as well as other control variables, such as CF, CR, LEV and so on.

3.10 Chapter Summary

This chapter underline research methodology, hypothesizes developed and sample collection process. Moreover, clarification of the theoretical framework and hypotheses formulation. Finally, the section explains the analysis technique applying in the study which used to examine relationship between examine relationship between dependent and independent variables.

CHAPTER FOUR

ANALYSIS AND FINDINGS

4.1 Introduction

This chapter reveals the findings' analysis of this study based on hypotheses. The sample data analysis by STATA 13.0and EViews 9.0which include descriptive statistics, normality, heteroscedasticity, autocorrelation, multicollinearity test and ordinary Least Squares test (Carneiro, 2006). After these tests, this chapter continue represent a further test by separate political connections variables. Last section discusses the main finding of multivariate analysis.

4.2 Descriptive Statistics

Descriptive analysis provides more descriptive information and enables to understand and interpret the data better. It gives a brief information describe about the sample aim that can urge simple and better elucidation of data (Genser, Cooper, Yazdanbakhsh, Barreto, &Rodrigues, 2007). It is crucial to keep a study integrity because it is a provision approach that assistance to express and support analytical cognition of each variable. In the following procedures, the descriptive statistics for the dependent and independent variables have been exhibits.

Table 4.1
Summary of Descriptive Statistic (N=100)

Variables	Mean	Std. Dev.	Minimum	Maximum
IR	.063	.055	.004	.342
PCVALUE	1.510	1.68	0	3
PCON	.690	.465	0	1
SOE	.560	.499	0	1
CR	1.595	1.198	.169	9.790
AUDITOR	.220	.416	0	1
PPE	.224	.204	.001	.804
LISAGE	20.700	3.976	13	35
LEV	.552	.195	.980	.899
CF	.0427	.071	-.128	.274
SIZE	10.097	.503	9.026	11.252
GROWTH	.189	.825	-.593	5.540
LOSS	.050	.219	0	1

IR=Cost of Debt, PCVALUE= Political Connections value, PCON= Political Connections Firm, SOE= State-owned Firm, AUDITOR= Big 4, CR= Current ratio, PPE= Plant and Equipment, LISAGE= Number of Years since Listed, LEV= Leverage, CF= Cash-flow, SIZE= Firm Size, GROWTH=Sales Growth, LOSS= Firms report Loss.

Table 4.1 above reports the results for descriptive statistics for each variable composed of research model. The total sample number of firms listed in SZSX 2015 which this study observed is 100.

IR is dependent variable. The mean value of interest rate is.0627, it states that most of Chinese firms are avoid a high-level debt ratio and standard deviation is .055 which means the corporate capital structure is different between firms. But the minimum and maximum number are from.004 to .342. It shows cost of debt among those firms are tremendous discrepancy. Thus, the reason leads this economic phenomenon is worthwhile for scholars to research.

PCVALUE is the score which given to the different political connections level. PCON is whether the firm is political connected. The mark of PCVALUE is from 0 to 3 and average is 1.510 around half. Besides, the two variables standard deviation1.168,.465. This study arrives at that most of Chinese firms are seek an effective relationship with government and the strength of political ties are high.

Another measurement of political connections is PCON. It is a dummy variable use 0 and 1 to describe. The mean of PCON is .690 which signifies among the sample most of the firms have the relationship with government.

To discuss control variables, the mean value of indicator variable SOE is more than 50% and standard deviation is .499 which infer that the number of SOE in the sample is median. It is conformed to Chinese national conditions that SOE are natural blood of political. Growth's average value is .189, which signifies that in China the growth opportunities are stable with political connections. Size is natural

logarithm of total assets. The mean is 10.097. It is declared that Chinese firms have large size and firms scale are greater differences, the standard deviation is.502. The mean and median for leverage is.552 and .195 respectively; it means that on average, Chinese firms use more than 50% as leverage to operate their project. AUDITOR and LOSS in the table both are dummy variable valued by 0 and 1. The mean and standard deviation for these two variables are very lower, which is .220, .050 and .416, .219 separately. It shows that the top 100 firms listed in SZSX prefer to use other auditor than big4 and most of the firms did not reported a loss.

4.3 Diagnostic Tests

Research diagnostics are proceeded to support the results of study and prove the variables are validity. It through regression analysis namely normality assumption, heteroscedasticity test, multicollinearity test and ordinary Least Squares test to verify the model (Gujarati& Porter, 2003; Anderson, & Tatham, 2006). The following tests below are carried out in this study.

4.3.1 Normality Assumption

Normality refers to the distribution of the data and whether the shape of the data is normally distributed. There are several ways to check the normality of the data. It can be checked using several tests, such as Shapiro-Francia, Shapiro-Wilk and Kamagorov Smiron tests by obtaining the values of skewness and kurtosis or by using residual graphs, such as normal probability plots, quartiles of a normal

distribution plot and histograms. Skewness and kurtosis values were checked for each variable. The method this study used to test the model was kernel density estimate (KDE), which was a way to show normality by graph. KDE is an efficient way that selecting population from the sample to encompasses smoothing of the data as well as holding the general structure and tested by a computer synthetic method (Scott & Thompson, 2006).

Figure 4.1

Kernel Density Estimate

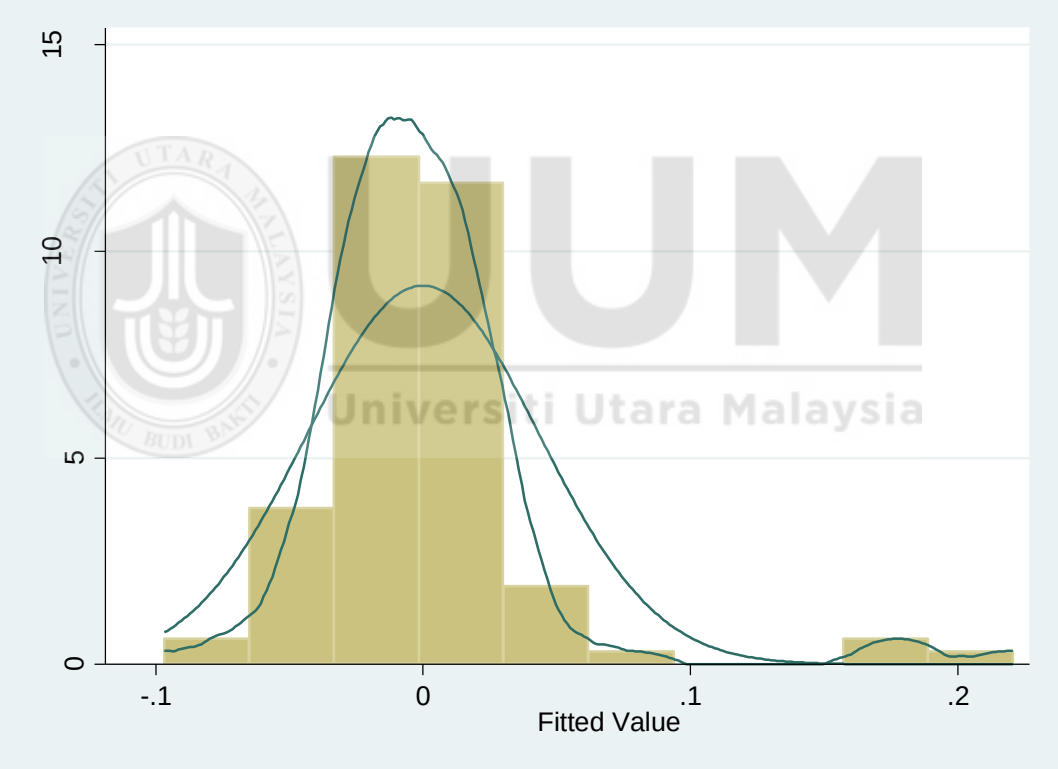

Figure 4.1 illustrate that data collected for the current study follow normal shape. Due to all the bars in the graph has a bell shape on the KDE are close to a normal curve. Thus, Figure 4.1 indicates that normality assumptions are not violated in the current study.

4.3.2 Heteroskedasticity Test

Heteroscedasticity considers as a common violation in multivariate regression to guarantee the estimates of the regression parameters have good statistical properties. It is referring to the unstable condition that the value around independent variable are dispersion. If the heteroscedasticity problem occurs in the study, the regression coefficients may be underrated. In the same time, the insignificant proxy become significant statistically (Hair *et al*., 2010). Heteroscedasticity is the problem that arises when the variance of the errors is not independently and identically distributed over the examined observations.

Many tests can be used for identifying the heteroscedasticity question, such as the white's General Heteroscedasticity Test, Spearman's Rank Correlation Test, Park Test, Goldfeld-Quandt Test, Glejser Test and Breusch-Pagan-Godfrey Test. This study has utilized Breusch-Pagan-Godfery/Cook-Weisberg Test in order to check for the existence of homoscedasticity among the error terms (Gujarati, 2009)

It is disputed about ignore the heteroscedasticity problem can cause in inefficient coefficient estimations and biased standard errors (Baltagi, 2008). Therefore, this study applies the Breusch-Pagan-Godfrey test for group-wise heteroscedasticity to test the error term in the examined models.

Table 4.2

Test for Model Specification and Heteroscedasticity

Heteroskedasticity Test: Breusch-Pagan-Godfrey			
F-statistic	1.5113	**Prob. F(11,88)**	0.1416
Obs*R-squared	15.8901	**Prob. Chi-Square (11)**	0.1453

The above Breusch-Pagan-Goffrey test shows that the prob of F greater than 0.1which indicates heteroscedasticity not existed.

4.3.3 Multicollinearity and Correlation

Multicollinearity is the test to examine the correlation between independent variables which could inflate the regression result. The problem is standard that if the correlation between variables is more than 0.9, recently it can be said that more than 0.8 will cause the multicollinearity problem (Hair *et al*.;2006; Tabachnick, & Fidell, 2006). Unreliable and unstable regression coefficient can be caused by high multicollinearity. One of the common ways to check for multicollinearity is the Pearson and Spearman Correlations. Table 4.3 shows Pearson correlation matrix where the highest correlation between variables.

Moreover, it is argued that the correlation matrix is not enough to detect multicollinearity and it is important to perform the variance inflation factor (VIF) test to ensure no collinearity between variables (Naser, Al-Khatib, & Karbhar, 2002). VIF is an indicator of the influence of the estimated coefficient because of

collinearity. The rule of thumb states that a VIF value that is more than 10 would have a multicollinearity problem (Hair *et al.*, 2006). As can be seen from Table 4.4, none of the VIF scores is more than 10, which indicates that there is no evidence of serious multicollinearity problem.

TABLE 4.3

SUMMARY OF PEARSON CORRELATION MATRIX

VARIABLES	IR	PCVALUE	PCON	SOE	CR	AUDITOR	PPE	AGE	LEV	CF	SIZE(log)	GROWTH	LOSS
IR	1.0000												
PCVALUE	-0.4764***	1.0000											
PCON	-0.4707***	0.7222***	1.0000										
SOE	-0.0869	-0.1311	-0.0714	1.0000									
CR	0.1306	-0.0550	-0.1239	-0.2268**	1.0000								
AUDITOR	-0.0893	0.1201	0.0428	0.0817	-0.0132	1.0000							
PPE	0.0224	0.0768	0.1964*	0.3266***	-0.3798***	0.2178**	1.0000						
LISAGE	-0.0736	0.0746	0.0694	-0.2658***	0.1478	0.0342	-0.1235	1.0000					
LEV	-0.0743	0.0224	-0.0252	-0.0522	-0.4452***	-0.1012	-0.1914*	-0.0403	1.0000				
CF	-0.0896	0.1911*	0.1595	0.0103	-0.1397	0.1796*	0.4051***	-0.1854*	-0.2576***	1.0000			
SIZE(log)	-0.2627***	0.2480*	0.1606	0.1504	-0.2540**	0.1878*	0.0822	-0.0640	0.4994***	0.0801	1.0000		
GROWTH	0.2612*	-0.1426	-0.2607***	-0.2647***	0.1109	-0.0549	-0.0549	-0.1179	-0.0242	0.0081	-0.1285	1.0000	
LOSS	0.0355	0.0178	0.1538	0.1109	-0.1714*	-0.0111	0.1556	-0.1334	0.1532	-0.0503	0.0007	-0.1111	1.0000

Where *p<0.1, **p<0.05, ***p<0.01 indicates significances at 10%, 5% and 1% respectively (2-tailed).

IR=Cost of debt, PCVALUE= Political connections value, PCON= Political connections Firm, SOE= State-owned Enterprises, AUDITOR= Big 4, CR= Current ratio, PPE= Plant and equipment, LISAGE= Number of years since listed, LEV= Leverage, CF= Cash-flow, SIZE= Firm size, GROWTH=Sales growth, LOSS= Firms report loss.

Table 4.4

Results of the VIF Test

Variables	VIF
PCVALUE	2.33
PCON	2.46
LEV	2.47
CR	1.86
PPE	1.80
CF	1.48
SOE	1.44
LISAGE	1.18
SIZE(log)	1.76
LOSS	1.15
AUDITOR	1.15
GROWTH	1.2
Mean VIF	1.69

Table 4.3 explains the result of Pearson Correlation test. Firstly, the most obvious relevant relations are PCVALUE and IR, the coefficient is -0.4764. Obvious part the study present that if the coefficient is more than 0.8. the research can predicate that there is a problem of collinear between variables. Moreover, the correlation coefficients of the variables in the model are far less than this number. Thus, it determines that there is no multiple collinearity between the variables initially. In addition, table 4.4 further tests support the result by VIF. The result of VIF is 1.69 which is fulfil the standard.

4.4 Regression Test

To achieve the objectives of this study, regression model is created. The following regression model tests the direct influence of PCVALUE and PCON on cost of debt with control for SOE, CR, AUDITOR, PPE, LEV, CF, GROWTH, LOSS. and LISAGE.

Table 4.5
Result of Regression Test: Cost of Debt model

VARIABLES	Coef.	Std. Err	T	P>|t|
PCVALUE	-.0109*	.0060	-1.79	0.076
PCON	-.0331**	.0157	-2.11	0.038
SOE	-.0176	.0112	-1.57	0.120
CR	.0060	.0053	1.14	0.256
AUDITOR	-.0047	.0120	-0.40	0.692
PPE	.0653**	.0305	2.14	0.036
LISAGE	-.0012	.0012	1.00	0.318
LEV	.0143	.0376	0.38	0.703
CF	-.0484	.0796	-0.61	0.544
SIZE(log)	-.0134	.0123	-1.09	0.277
GROWTH	.0086	.0061	1.40	0.166
LOSS	.0190	.0228	0.83	0.407
CONS	.2453	.1163	2.11	0.038
F-Statistic	4.130			
Prob F-Statistic				0.0000
R-Square	0.3632			
Adj R-square	0.2754			

Where *p<0.1, **p<0.05, ***p<0.01 indicates significances at 10%, 5% and 1% respectively (2-tailed). IR=Cost of debt, PCVALUE= Political connections value, PCON= Political connections Firm, SOE= State-owned Enterprises, AUDITOR= Big 4, CR= Current ratio, PPE= Plant and equipment, LISAGE= Number of years since listed, LEV= Leverage, CF= Cash-flow, SIZE= Firm

size, GROWTH=Sales growth, LOSS= Firms report loss.

Result shows that PCVALUE and IR are significance at 0.1 and have negative relationship with IR. Another measurement for political connections are PCON which have same relationship with IR, the coefficients is -.0331 and 0.038. Thus, the hypothesis of the study is confirmed.

Relationship supported by control variable, the result showing in the table that PPE is significant with interest rate at 5%. But other control variables are not significate with cost of debt. The adjust R square is 0.2779, it means the research in a normal complete level. From those analysis, this study can get that political connections are effected on debt ratio. As well as PPE has positive relationship with cost of debt, which can help interest rate decrease and beneficial to firms at this period of China.

4.5 Further Tests

For further tests, this study separate independent variables to test PCVALUE and PCON by regression model. Separate the two measurements to conduct the study in order to examine the result viability.

First test is around political connections value and the second one is about political connections firms. Either of the variable are represent political connections which already proved in previous study. Results showing below.

Table 4.6
Results of Regression Model of IV as PCVALUE

VARIABLES	Coef.	Std. Err	T	P>|t|
PCVALUE	-.0199***	.0044	-4.46	0.000
SOE	-.0151	.0113	-1.33	0.187
CR	.0070	.0053	1.30	0.196
AUDITOR	-.0018	.0121	-0.15	0.881
PPE	.0565*	.0308	1.83	0.071
LISAGE	-.0015	.0012	-1.16	0.249
LEV	.0225	.0382	0.59	0.556
CF	-.0434	.0811	-0.54	0.593
SIZE(log)	-.0143	.0125	-1.14	0.257
GROWTH	.0116*	.0061	1.90	0.061
LOSS	.0103	.0229	0.45	0.653
CONS	.2428	.1185	2.05	0.044
F-Statistic	3.95			
Prob F-Statistic				0.0001
R-Square	0.3306			
Adj R-square	0.2470			

Where *p<0.1, **p<0.05, ***p<0.01 indicates significances at 10%, 5% and 1% respectively (2-tailed).IR=Cost of debt, PCVALUE= Political connections value, PCON= Political connections Firm, SOE= State-owned Enterprises, AUDITOR= Big 4, CR= Current ratio, PPE= Plant and equipment, LISAGE= Number of years since listed, LEV= Leverage, CF= Cash-flow, SIZE= Firm size, GROWTH=Sales growth, LOSS= Firms report loss.

Table 4.7
Results of Regression Model of IV as PCON

VARIABLES	Coef.	Std. Err	T	P>|t|
PCON	-.0528***	.0114	-4.62	0.000
SOE	-.0161	.0113	-1.43	0.157
CR	.0058	.0053	1.08	0.282
AUDITOR	-.0069	.0120	-0.58	0.565
PPE	.0706**	.0308	2.29	0.024
LISAGE	-.0013	.0012	-1.01	0.316
LEVERAGE	.0140	.0381	0.37	0.713
CASHFLOW	-.0647	.0800	-0.81	0.421
SIZElog	-.0169	.0123	-1.37	0.173
GROWTH	.0081	.0062	1.31	0.194
LOSS	.0225	.0230	0.98	0.331
CONS	.2780	.1163	2.39	0.019
F-Statistic	4.11			
Prob F-Statistic				0.0001
R-Square	0.3396			
Adj R-square	0.2571			

Where *p<0.1, **p<0.05, ***p<0.01 indicates significances at 10%, 5% and 1% respectively (2-tailed).IR=Cost of debt, PCVALUE= Political connections value, PCON= Political connections Firm, SOE= State-owned Enterprises, AUDITOR= Big 4, CR= Current ratio, PPE= Plant and equipment, LISAGE= Number of years since listed, LEV= Leverage, CF= Cash-flow, SIZE= Firm size, GROWTH=Sales growth, LOSS= Firms report loss.

The two tests show that the model result is living. Table 4.6 supports that PCVALUE as an independent variable, and the model still exists. The coefficient of PCVALUE is-.0199, p value is 0.000 The result presents that PCVALUE and cost of debt are very significant and negative, which in the line with test in previous section. Table 4.7 using PCON as a variable to prove the result exists. The number of PCON is -.0528 and it is significant at 0.01.

4.6 Discussions

According to the Table 4.5, the result of regression test shows that PCVALUE and PCON have clear negative effect on cost of debt. It answers the research questions that political connections value has negative and significant relationship with cost of debt and political connections firms have negative and significant relationship with cost of debt in China. The two different measurements are all support hypotheses by the regression test result which is PCVLUE coefficient is -.0109 and PCON is -.0331.

Different with the results found of by Bliss and Gul(2012). They found that Malaysia firms had positive and significant relationship with cost of debt which is opposite to this study. Whilst the LISAGE, SIZE, CR and PPE were negative correlation with dependent variable. AUDITOR, LOSS and LEV were positive correlation. In this study, the result of political connections line with predicted, negative and significant.

Control variables of this study, SOE, AUDITOR, LISAGE, CF and SIZE are negative relationship with dependent variable IR, but not significant at two-tail. However, among those control variables SOE and GROWTH are significant with IR at 0.1 at one-tail which is 0.06 and 0.088. Only PPE is positive (0.653164) and significant with IR at two-tail. The adjusted $R^2$of this study is higher than Bliss and Gul (2012)'s study which is 27.79%

.

The reason of this phenomenon are varieties. Firstly, at present China is trying to revolute from highly centralized planned economic system to transitional system. In the transition period, due to lack of effective supervision and restraint mechanisms, the market order is not standardized which lead to rent-seeking behavior is difficult to contain and even the environment more intensified. Also, the market still unstable and majority resources are controlled by government.

Secondly, government as an invisible hand intervenes in resources allocation in order to adjust and regulate market grow healthily. Consisting with rent-seeking theory—on one hand, if a firm could use the way of rent-seeking to get resources by lower cost, the firm prefers to ask for rent-seeking behavior. In the meantime, through rent-seeking with government, firms will gain better social capital and widen their social network. On the other hand, government also take the "rent" with pleasure.

Thus, the reciprocal relationship is set up between the two sides. Further, the most of large bank and finical institution are join stock by government, some of them even SOE. Therefore, the negative and significant relationship from this research is apparent.

4.7 Chapter Summary

This chapter discusses and provides detail analysis of results for objectives of the study. This chapter carries out the diagnostic tests: normality, heteroscedasticity and multicollinearity test. In addition, using regression test shows the connections between variables in the model. Also, further tests are lined out. Finally, discussions of the results. Thus, the following chapter is conclusions and recommendations for future research.

CHAPTER FIVE

CONCLUSIONS AND RECOMMENDATIONS

5.1 Introduction

The first section of this chapter presents discussion and conclusion of the study. Contributions of the study in the second section. Limitations of the study are discussed in the third section and the suggestions for the future research is highlighted in the last section.

5.2 Summary of Study

The study investigates 100 largest non-financial firms that are chosen from China Shenzhen stock exchange main board for the year 2015. The key objective of this study is to investigate whether there is a relationship between political connections and cost of debt as well as how the political connections effect cost of debt. For the purpose, this study uses two measurements to support political connections which is political connections value and political connections firms. With ten control variables which include, SOE, firm listed age, leverage, auditor, current ratio, cash-flow, plant and equipment, firm size and loss all composed in the regression to boost the model of the study. In view of the results obtained the study indicates that political connections are negatively and significantly associated with interest rate. Which means that, the higher the political connections the lower the interest rate. Hereby,

opining that the provisions of political connections are very popular and strong in the Chinese economic market. Therefore, firms are seeking political ties vivid in order to help corporates decline the debt ratio Thus promote firm financial situation.

Table 5.1
Summary of the Hypothesis testing results

HYPOTHESIS	HYPOTHESIS STATEMENT	FINDINGS
H_1	Political connections value is negative and significant relationship with cost of debt.	Negative & Significant
H_2	Political connections firms are negative and significant relationship with cost of debt.	Negative & Significant

In summary, Table 5.1showed thatH1 and H2 are negative and significant. Based on this, it can be concluded that the objectives of the study are achieved and the results are robust because the consistent results are obtained whether hypothesis variables are analyzed individually or grouped together.

5.3 Contributions of Study

Currently, political connections become a major area of concern among researchers around world. However, the measurement of political connections still primitive. This could be attributed to the Chinese special political and social background. Moreover, the study uses the measurement of Faccio (2007) as well as Yang and Zhang (2015) which is seen as a new measurement that constituted political connections using four level.

The study portions the hierarchy of serve in government and attend conference to

four level. When the firm CEO or BOD former or currently take position in government at central or provincial level, the study values it as three level. Same score is given to the crews at central level attend or was a member of NPC or CPPCC. Next, if a firm has CEO or BOD who worked or at present undertake duty below provincial level as well as participate the important committee at provincial level, the value of hierarchy is two level. Thirdly, this study assigns the CEO and chairpersons have experience of NPC or CPPCC or the person in an interest related civil social organization own a job title are value one. Zero is scored for CEO or BOD does not have political background.

This is a new measurement for testing political connections especial in a country who has political hierarchy. The method could assist scholars examine and study political connections in a new way.

For investor, what they should concern is that political connections are a high-risk relationship. This kind of relationship deepens on social structure, institution condition and election in China. In addition, it could be effect by different firms' inner economic situation, such as PPE, CR, CF and so on. Therefore, considering all these elements could help investors to make a wise investment decision which is fatal and necessary for every investor.

This study also gives a warn to national government. Political connections maybe

good for some firms to do business. It is always having chance for business to rent-seeking. But for a nation, it is easy to consider that officials losing control of social resources. In another word, it is deemed that government power is slashing. Thus, to create a fair competitive market environment become hard and important.

Last but not least, government of China combine firms with the environmental community could control the officials and civil servant. This could be done by changing the political office holders' positions which could eradicate corruptions. Thus, the political power which leading by hierarchy different is becoming more attractive and workable. This study is a product of social trend. Therefore, the result brings many enlightenments.

5.4 Limitation of Study

The proxy of political connections is flexible. Although this study conducted a level value to measure the political value and strength. The hierarchy of Chinese government and national structure is more complex and difficult. Hence, the value of political connections may have boundedness. Reason of time and resources limitation, this study does not measure the other dimension from the position level.

The CEO and BOD background data this study collect from CSMAR. It is just the information during a certain period. Therefore, the result only represents the study in

2015. This study does not verify dynamic impact of institutional change or economic evolution on political relations.

5.5 Recommendation for Future Studies

This study reviews previous literatures to lay the foundation for the new measurement: political connections value. Studying on social structure to measure political connections in an index way instead of dummy variable. But this study still uses political dummy variable to abundant the study as well as provide a compare object. Thus, this study can get an accuracy empirical result. Most of the studies about political connections are focused on firm performance. The dependent variable used in this study is cost of debt which is measured by interest rate.

In addition, this study uses a theory framework—rent-seeking theory. The theory reveals causal chain of behavior pattern and the profit situation of the executive who has political association with firms. The recommend more empirical studies in order to solve the contradiction in the current research

In a nutshell, in any political connections' study, researchers need to broaden the scope Thus the picture of the problem will be clear. In the same vein, consider the social structure, market structure and whether the country is developing or developed country. The study can also be extended to other countries as the problem is not only

to China but global. Other study can also add more theories in addition to rent-seeking relationship between government and business. Therefore, scholars need to examine political ties on the relationship between the political connections and the cost of debt.

REFERENCES

Adhikari, A., Derashid, C., & Zhang, H. (2006). Public policy, political connections, and effective tax rates: Longitudinal evidence from Malaysia. *Journal of Accounting and Public policy*, *25*(5), 574-595.

Aerts, W., Cormier, D., & Magnan, M. (2006). Intra-industry imitation in corporate environmental reporting: An international perspective. *Journal of Accounting and public Policy*, *25*(3), 299-331.

Al Amri, M., & Al Ani, M. (2015). The determinants of capital structure: an empirical study of Omani listed industrial companies. *Verslas: teorija ir praktika*, (2), 159-167.

Allen, F., Qian, J., & Qian, M. (2005). Law, finance, and economic growth in China. *Journal of Financial Economics*, *77*(1), 57–116.

Anderson, R. C., Mansi, S. A., & Reeb, D. M. (2004). Board characteristics, accounting report integrity, and the cost of debt. *Journal of Accounting and Economics*, *37*(3), 315–342

Aslan, H., & Kumar, P. (2009). Controlling shareholders and the agency cost of debt: Evidence from syndicated loans. In *EFA 2009 Bergen Meeting*.

Bharath, S. T., Sunder, J., & Sunder, S. V. (2008). Accounting quality and debt contracting. *The Accounting Review*, *83*(1), 1–28

Bian, Y., & Zhang, L. (2014). *Contemporary Perspectives on Organizational Social Networks Corporate Social Capital in Chinese Guanxi Culture*. *the Sociology of Organizations Vanina J. Torló* (Vol. 40). Emerald Group Publishing Limited.

Bliss, M. A., & Gul, F. A. (2012). Political connection and cost of debt: Some

Malaysian evidence. *Journal of Banking and Finance*, *36*(5), 1520–1527.

Bliss, M. A., Gul, F. A., & Majid, A. (2011). Do political connections affect the role of independent audit committees and CEO Duality? Some evidence from Malaysian audit pricing. *Journal of Contemporary Accounting and Economics*, *7*(2), 82–98.

Bolton, P., & Rosenthal, H. (2002). Political intervention in debt contracts. *Journal of Political Economy*, 110(5), 1103-1134.

Boubakri, N., Cosset, J.-C., & Saffar, W. (2008). Political connections of newly privatized firms. *Journal of Corporate Finance*, *14*(5), 654–673.

Boubakri, N., Guedhami, O., Mishra, D., & Saffar, W. (2012). Political connections and the cost of equity capital. *Journal of Corporate Finance*, 18(3), 541-559.

Boubakri, N., Guedhami, O., Mishra, D., & Saffar, W. (2012). Political connections and the cost of equity capital. *Journal of Corporate Finance*, *18*(3), 541–559.

Bunkanwanicha, P., & Wiwattanakantang, Y. (2009). Big business owners in politics. *Review of Financial Studies*, *22*(6), 2133–2168.

Chaney, P. K., Faccio, M., & Parsley, D. (2011). The quality of accounting information in politically connected firms. *Journal of Accounting and Economics*, *51*(1–2), 58–76.

Chao, Y. (2015). Party Capacity in the Party-State Mode——A Simple Theoretical Explanation of China's Economic Transition. *Journal of Inner Mongolia University (Philosophy and Social Sciences)*, *2*, 11.

Charumilind, C., Kali, R., & Wiwattanakantang, Y. (2006). Connected Lending: Thailand before the Financial Crisis*. *The Journal of Business*, *79*(1), 181–218.

Chen, C. J. P., Li, Z., Su, X., & Sun, Z. (2011). Rent-seeking incentives, corporate political connections, and the control structure of private firms: Chinese evidence. *Journal of Corporate Finance*, *17*(2), 229–243.

Chen, S., Sun, Z., Tang, S., & Wu, D. (2011). Government intervention and investment efficiency: Evidence from China. *Journal of Corporate Finance*, *17*(2), 259–271.

Cheung, S. Y.-L., Jing, L., Rau, P. R., & Stouraitis, A. (2005). Guanxi, Political Connections, and Expropriation: The Dark Side of State Ownership in Chinese

Listed Companies. *SSRN Electronic Journal*, (February 2016).

Chow, G. C. (2015). *China's economic transformation*. John Wiley & Sons.

Claessens, S., Feijen, E., & Laeven, L. (2008). Political connections and preferential access to finance: The role of campaign contributions. *Journal of Financial Economics*, *88*(3), 554–580.

Demirer, R., & Kutan, A. M. (2006). Does herding behavior exist in Chinese stock markets? *Journal of International Financial Markets, Institutions and Money*, *16*(2), 123–142.

Dinç, I. S. (2005). Politicians and banks: Political influences on government-owned banks in emerging markets. *Journal of Financial Economics*, *77*(2), 453–479.

Dowdle, M. W. (1997). The constitutional development and operations of the National People's Congress. Colum. J. Asian L., 11, 1.

Du, J., & Girma, S. (2010). Red capitalists: Political connections and firm performance in China. *Kyklos*, *63*(4), 530–545.

Khwaja, A. I., & Mian, A. (2005). Do lenders favor politically connected firms? Rent provision in an emerging financial market. *The Quarterly Journal of Economics*, 120(4), 1371-1411.

Ellul, A., Guntay, L., & Lel, U. (2007). *External governance and debt agency costs of family firms.* Board of Governors of the Federal Reserve System.

Faccio, M., Lang, L.H.P., Young, L., 2001. Dividend and expropriation. AmericanEconomic Review (91), 54–78.

Faccio, M., 2010. Differences between politically connected and nonconnected firms:firms: a cross-country analysis. J. Financ.Manag. 39, 905–927

Faccio, B. M. a R. a F. (2005). Politically Connected Firms. *The American Economic Review*, *96*(1999), 369–386.

Faccio, M. (2007). The characteristics of politically connected firms., 1–34.

Faccio, M., Masulis, R. W., & Mcconnell, J. J. (2006). Political connections and corporate bailouts. *Journal of Finance*, *61*(6), 2597–2635.

Faccio, M., & Parsley, D. C. (2009). Sudden Deaths: Taking Stock of Geographic

Ties. *Journal of Financial and Quantitative Analysis*, *44*(3), 683.

Faccio, M., Masulis, R. W., & McConnell, J. (2006). Political connections and corporate bailouts. *The Journal of Finance*, 61(6), 2597-2635.

Fan, J. P. H., Rui, O. M., & Zhao, M. (2008). Public governance and corporate finance: Evidence from corruption cases. *Journal of Comparative Economics*, *36*(3), 343–364.

Fan, J. P. H., Wong, T. J., & Zhang, T. (2007a). Politically connected CEOs, corporate governance, and Post-IPO performance of China's newly partially privatized firms. *Journal of Financial Economics*, *84*(2), 330–357.

Fan, J. P. H., Wong, T. J., & Zhang, T. (2007b). Politically connected CEOs, corporate governance, and Post-IPO performance of China's newly partially privatized firms. *Journal of Financial Economics*, *84*(2), 330–357.

Fazzari, S. M., Hubbard, R. G., Petersen, B. C., Blinder, A. S., & Poterba, J. M. (2016). Linked references are available on JSTOR for this article : Federal Reserve Bank of Chicago Financing Constraints and Corporate Investment, *1988*(1), 141–206.

Fields, L. P., Fraser, D. R., & Subrahmanyam, A. (2012). Board quality and the cost of debt capital: The case of bank loans. *Journal of Banking & Finance*, *36*(5), 1536–1547.

Fisman, B. R. (2016). American Economic Association Estimating the Value of Political Connections. *The American Economic Review* , Vol . 91 , No . 4 (Sep ., 2001), pp . 1095-1102.

Fisman, R. (2001). Estimating the value of political connections. *The American economic review*, 91(4), 1095-1102.

Francis, B. B., Hasan, I., Sun, X., & Zhou, M. (2009).Institutional Factors and the Process of Going Public : Evidence from Institutional Factors and the Process of Going Public : Evidence from China. (Vol. 28)

Fraser, D. R. (2006). Capital structure and political patronage : The case of Malaysia, *30*, 1291–1308.

Fu, G., Fu, W., & Liu, D. (2012). Empirical study on financial risk factors : Capital structure , operation ability , profitability , and solvency —— evidence from listed companies in China, *3*(5), 173–178.

Grant, D. (2016). Business analysis techniques in business reengineering. *Business Process Management Journal*, *22*(1), 75–88.

Guan, J. C., Richard, C. M., Tang, E. P. Y., & Lau, A. K. W. (2009). Innovation strategy and performance during economic transition: Evidences in Beijing, China. *Research Policy*, *38*(5), 802–812.

Hackston, D., & Milne, M. (1996). Some determinants of social and environmental disclosures in New Zealand companies. *Accounting, Auditing & Accountability* , *9*(1), 77–108.

Hellman, J., Jones, G., & Kaufmann, D. (2000). Seize the State, Seize the Day: An Empirical Analysis of State Capture and Corruption in Transition Economies. *World Bank Policy Research Working Paper*, (2444), 1–41.

Hollis, a, & Ryan, L. F. (2004). Corporate Governance and the Cost of Equity Capital, (October), 49.

Howell, J. (1993). *China opens its doors: the politics of economic transition*. Harvester Wheatsheaf Boulder, CO.

Isshaq, Z., Bokpin, G. A., & Amoah, B. (2012). Efficiency and Risk-Taking Behaviour of Ghanaian Banks. *Journal of Manufacturing Technology Management*, *20*(5), 53–74.

Jayachandran, S. (2006). The jeffords effect. *The Journal of Law and Economics*, *49*(2), 397–425.

Johnson, S., & Mitton, T. (2003). Cronyism and capital controls: evidence from Malaysia. *Journal of Financial Economics*, *67*(2), 351–382.

Journal, S. M. (1998). Strategic Management Journal. *Strategic Management Journal*, *1100*(June 1997), 1079–1100.

Khwaja, Ijaz, A., & Mian, A. (2008). Tracing the Impact of Bank Liquidity Shocks : Evidence from an Emerging Market. *American Economic Review*, *98*(4), 1413–1442.

Krueger, A. O. (1974a). The Political Economy of Rent-Seeking Society. *The American Economic Review*, *64*(3), 291–303.

Krueger, A. O. (1974b). The Political Economy of the Rent Seeking Society. *The American Economic Review*, *64*(3), 291–303

Li, H., Meng, L., & Zhang, J. (2006). Why do entrepreneurs enter politics? Evidence from China. *Economic Inquiry*, *44*(3), 559–578.

Li, H., Meng, L., Wang, Q., & Zhou, L. A. (2008). Political connections, financing and firm performance: Evidence from Chinese private firms. *Journal of development economics*, 87(2), 283-299.

Lu, Z., Zhu, J., & Zhang, W. (2012). Bank discrimination, holding bank ownership, and economic consequences: Evidence from China. *Journal of Banking & Finance*, 36(2), 341-354.

Martin Belvisi , Riccardo Pianeti, G. U. (2016). Article information : *Dynamic Factor Models*, *35*, 317–360.

Montinola, G., Qian, Y., & Weingast, B. R. (2016). FEDERALISM , CHINESE STYLE The Political Basis for Economic Success in China economic, *48*(1), 50–81.

Niessen, A., & Ruenzi, S. (2009). Political Connectedness and Firm Performance -Evidence from Germany, (7), 1–42.

O'brien, K. J. (2008). Reform without liberalization: China's National People's Congress and the politics of institutional change. *Cambridge University Press.*

Pittman, J. A., & Fortin, S. (2004). Auditor choice and the cost of debt capital for newly public firms. *Journal of Accounting and Economics*, *37*(1), 113–136.

Qian, J., & Strahan, P. E. (2007). How laws and institutions shape financial contracts: The case of bank loans. *The Journal of Finance*, *62*(6), 2803–2834.

Sapienza, P. (2004). The effects of government ownership on bank lending. *Journal of Financial Economics*, *72*(2), 357–384.

Shleifer, A., & Vishny, R. W. (2002). *The grabbing hand: Government pathologies and their cures*. Harvard University Press.

Srinidh, B., Zhang, H., & Zhang, T. (2011). Transparency in politically connected firms: Evidence from private sector firms in China. In *City University of Hong Kong Working Paper*

Su, L. D. (2010). Ownership Structure, Corporate Diversification and Capital Structure. *Management Decision*, *48*(2), 25.

Takasaki, Y. (2014). How Is Disaster Aid Allocated Within Poor Communities? Risk Sharing And Social Hierarchy. *Journal of International Development*, *26*(8), 1097–1114.

Tam, S. (2016). From understanding business guanxi to practising it: A golden rule for mncs in China. *Journal of Chinese Human Resources Management*, *7*(1), 39–44.

The, S., April, N., & State, N. C. (2016). Do Some Outside Directors, *44*(1), 179–198

Wahab, E. A. A., Zain, M. M., & James, K. (2011). Audit fees in Malaysia: Does corporate governance matter? *Asian Academy of Management Journal of Accounting and Finance*, *7*(1), 1–27.

Xiaowen, S. (2012). Corporate Characteristics and Internal Control Information Disclosure- Evidence from Annual Reports in 2009 of Listed Companies in Shenzhen Stock Exchange. *Physics Procedia*, *25*, 630–635.

Xu, N., Xu, X., & Yuan, Q. (2013). Political connections, financing friction, and corporate investment: Evidence from Chinese listed family firms. *European Financial Management*, *19*(4), 675–702.

Yang, D., Lu, Z., & Luo, D. (2014). Political connections, media monitoring and long-term loans. *China Journal of Accounting Research*, *7*(3), 165–177.

Yang, J., Lian, J., & Liu, X. (2012). Political connections, bank loans and firm value. *Nankai Business Review International*, *3*(4), 376–397.

Yang, L., & Zhang, J. (2015). Political Connections, Government Intervention and Acquirer Performance in Cross-border Mergers and Acquisitions: An Empirical Analysis Based on Chinese Acquirers. *World Economy*, *38*(10), 1505–1525.

Yu, M., & Pan, H. (2008). The relationship between politics, institutional environments and private enterprises' access to bank loans. *Management World*, *8*, 9–21.

APPENDIX

A1: Appendix: Stock Code and Political Connections date collection

SN	STOCK CODE	FIRM NAME	PCVALUE	PCON
1	000008	CHINA HIGH-SPEED RAILWAY TECHNOLOGY CO., LTD.	0	0
2	000009	CHINA BAOAN GROUP CO., LTD.	3	1
3	000012	CSG HOLDING CO., LTD.	1	1
4	000018	SINO GREAT WALL CO., LTD.	0	1
5	000021	SHENZHEN KAIFA TECHNOLOGY CO., LTD	3	1
6	000027	SHENZHEN ENERGY GROUP CO., LTD.	2	1
7	000031	COFCO PROPERTY (GROUP) CO., LTD.	2	1
8	000039	CHINA INTERNATIONAL MARINE CONTAINERS (GROUP) CO., LTD	1	0
9	000046	OCEANWIDE HOLDINGS CO., LTD.	0	1
10	000050	TIANMA MICROELECTRONICS CO., LTD	2	1
11	000060	SHENZHEN ZHONGJIN LINGNAN NONFEMET CO., LTD	2	1
12	000061	SHENZHEN AGRICULTURAL PRODUCTS CO., LTD	2	1
13	000062	SHENZHEN HUAQIANG INDUSTRY CO., LTD	2	1
14	000063	ZTE CORPORATION	2	1

SN	STOCK CODE	FIRM NAME	PCVALUE	PCON
15	000069	SHENZHEN OVERSEAS CHINESE TOWN CO., LTD	3	1
16	000078	SHENZHEN NEPTUNUS BIOENGINEERING CO., LTD	0	0
17	000100	TCL CORPORATION	3	1
18	000150	YIHUA HEALTHCARE CO., LTD.	1	0
19	000156	WASU MEDIA HOLDING CO., LTD	2	1
20	000158	SHIJIAZHUANG CHANGSHAN TEXTILE CO., LTD	0	0
21	000333	MIDEA GROUP CO., LTD.	3	1
22	000338	WEICHAI POWER CO., LTD.	2	1
23	000402	FINANCIAL STREET HOLDINGS CO., LTD.	0	0
24	000410	SHENYANG MACHINE TOOL CO., LTD	2	1
25	000413	DONGXU OPTOELECTRONIC TECHNOLOGY CO., LTD.	3	1
26	000415	BOHAI CAPITAL HOLDING CO., LTD	3	1
27	000423	DONG-E-E-JIAO CO., LTD.	0	0
28	000425	XCMG CONSTRUCTION MACHINERY CO., LTD.	1	1
29	000428	HUATIAN HOTEL GROUP CO., LTD.	0	1
30	000516	XI"AN INTERNATIONAL MEDICAL INVESTMENT COMPANY LIMITED	3	1
31	000519	NORTH INDUSTRIES GROUP RED ARROW CO., LTD	2	1

SN	STOCK CODE	FIRM NAME	PCVALUE	PCON
32	000538	YUNNAN BAIYAO GROUP CO., LTD.	1	1
33	000539	GUANGDONG ELECTRIC POWER DEVELOPMENT CO., LTD	2	1
34	000540	ZHONGTIAN URBAN DEVELOPMENT GROUP COMPANY LIMITED	2	1
35	000547	ADDSINO CO.，LTD	1	1
36	000554	SINOPEC SHANDONG TAISHAN PETROLEUM CO., LTD.	0	1
37	000558	LANDER SPORTS DEVELOPMENT CO., LTD	1	0
38	000559	WANXIANG QIANCHAO CO., LTD	3	1
39	000566	HAINAN HAIYAO CO., LTD	0	1
40	000581	WEIFU HIGH-TECHNOLOGY GROUP CO., LTD.	3	1
41	000582	BEIBU GULF PORT CO., LTD.	1	1
42	000587	JINZHOU CIHANG GROUP CO., LTD	2	1
43	000592	ZHONGFU STRAITS (PINGTAN) DEVELOPMENT COMPANY LIMITED	0	0
44	000598	CHENGDU XINGRONG ENVIRONMENT CO., LTD.	2	1
45	000600	JOINTO ENERGY INVESTMENT CO., LTD.	2	1
46	000620	HEBEI MACROLINK CULTURALTAINMENT DEVELOPMENT CO., LTD.	3	1
47	000623	JILIN AODONG PHARMACEUTICAL	2	1

		GROUP CO., LTD.		
SN	**STOCK CODE**	**FIRM NAME**	**PCVALUE**	**PCON**
48	000625	CHONGQING CHANGAN AUTOMOBILE COMPANY LIMITED	3	1
49	000628	CHENGDU HI-TECH DEVELOPMENT GR0UP CO., LTD	0	1
50	000651	GREE ELECTRIC APPLIANCES, INC.OF ZHUHAI CO., LTD	0	0
51	000652	TIANJIN TEDA CO., LTD.	0	0
52	000656	JINKE PROPERTY GROUP CO., LTD	3	1
53	000671	YANGO GROUP CO., LTD	0	0
54	000687	HUAXUN FANGZHOU CO., LTD	1	1
55	000709	HESTEEL COMPANY LIMITED	1	1
56	000718	SUNING UNIVERSAL CO., LTD.	2	1
57	000723	SHANXI MEIJIN ENERGY CO.，LTD	0	0
58	000725	BOE TECHNOLOGY GROUP CO., LTD	3	1
59	000727	NANJING HUADONG ELECTRONICS INFORMATION & TECHNOLOGY CO., LTD	1	1
60	000729	BEIJING YANJING BREWERY CO., LTD	2	1
61	000732	THAIHOT GROUP CO., LTD	3	1
62	000738	AVIC AERO-ENGINE CONTROLS CO., LTD.	0	0
63	000758	CHINA NONFERROUS METAL INDUSTRY"S FOREIGN ENGINEERING &	1	0

		CONSTRUCTION CO., LTD.		
SN	**STOCK CODE**	**FIRM NAME**	**PCVALUE**	**PCON**
64	000768	AVIC AIRCRAFT CO., LTD.	1	0
65	000778	XINXING DUCTILE IRON PIPES CO., LTD	0	0
66	000786	BEIJING NEW BUILDING MATERIALS PUBLIC LIMITED COMPANY	0	0
67	000792	QINGHAI SALT LAKE INDUSTRY CO., LTD.	3	1
68	000800	FAW CAR CO., LTD	3	1
69	000801	SICHUAN JIUZHOU ELECTRONIC CO., LTD	1	0
70	000806	GALAXY BIOMEDICAL INVESTMENT CO., LTD.	2	1
71	000807	YUNNAN ALUMINIUM CO., LTD	2	1
72	000825	SHANXI TAIGANG STAINLESS STEEL CO.LTD	1	1
73	000826	TUS-SOUND ENVIRONMENTAL RESOURCES CO., LTD.	0	1
74	000839	CITIC GUOAN INFORMATION INDUSTRY CO., LTD	0	0
75	000861	GUANGDONG HIGHSUN GROUP CO., LTD.	3	1
76	000869	YANTAI CHANGYU PIONEER WINE COMPANY LIMITED	0	1
77	000878	YUNNAN COPPER CO., LTD.	0	1
78	000883	HUBEI ENERGY GROUP CO., LTD	3	1
79	000887	ANHUI ZHONGDING SEALING PARTS CO., LTD	2	1
80	000895	HENAN SHUANGHUI INVESTMENT &	3	1

		DEVELOPMENT CO., LTD		
SN	**STOCK CODE**	**FIRM NAME**	**PCVALUE**	**PCON**
81	000897	TIANJIN JINBIN DEVELOPMENT CO., LTD	1	1
82	000899	JIANGXI GANNENG CO., LTD	2	1
83	000917	HUNAN TV&BROADCAST INTERMEDIARY CO., LTD.	2	1
84	000935	SICHUAN SHUANGMA CEMENT CO.LTD	0	0
85	000937	JIZHONG ENERGY RESOURCES CO., LTD.	3	1
86	000938	UNISPLENDOUR CORPORATION LIMITED	0	0
87	000939	KAIDI ECOLOGICAL AND ENVIRONMENTAL TECHNOLOGY CO., LTD	3	1
88	000951	SINOTRUK JINAN TRUCK CO., LTD.	1	0
89	000959	BEIJING SHOUGANG CO., LTD	0	1
90	000960	YUNNAN TIN CO., LTD.	1	0
91	000961	JIANGSU ZHONGNAN CONSTRUCTION GROUP CO., LTD	0	0
92	000963	HUADONG MEDICINE CO., LTD	3	1
93	000977	INSPUR ELECTRONIC INFORMATION INDUSTRY CO., LTD	0	0
94	000979	ZHONGHONG HOLDING CO., LTD.	3	1
95	000983	SHANXI XISHAN COAL AND ELECTRICITY POWER CO., LTD	0	0
96	000988	HUAGONG TECH COMPANY LIMITED	0	0

97	000997	YUAN LONGPING HIGH-TECH AGRICULTURE CO., LTD	2	1

SN	STOCK CODE	FIRM NAME	PCVALUE	PCON
98	000998	CHINA RESOURCES SANJIU MEDICAL & PHARMACEUTICAL CO., LTD.	0	0
99	001696	HENAN YUNENG HOLDINGS CO., LTD	3	1
100	001896	HENAN YUNENG HOLDINGS CO., LTD	1	1