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POLITICAL CONNECTIONS AND COST OF DEBT: EVIDENCE FROM CHINA

BY

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(International Accounting)
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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


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

May, 2017
# CONTENT

PERMISSION TO USE........................................................................................................i
ABSTRACT.....................................................................................................................ii
ABSTRAK ....................................................................................................................... iii
ACKNOWLEDGEMENT ..................................................................................................... iv
CONTENT .......................................................................................................................... v

LIST OF TABLES .............................................................................................................. viii
LIST OF FIGURES ........................................................................................................... ix
LIST OF APPENDIX .......................................................................................................... x
LIST OF ABBREVIATIONS ............................................................................................... xi

CHAPTER ONE ................................................................................................................ 1

INTRODUCTION ............................................................................................................ 1
1.1 Background of Study ............................................................................................... 1
1.2 Problem Statement ................................................................................................. 4
1.3 Research Questions ................................................................................................. 6
1.4 Research Objectives ............................................................................................... 6
1.5 Significance of Study .............................................................................................. 7
1.6 Scope of Study ......................................................................................................... 8
1.7 Organization of Study ............................................................................................. 9
1.8 Chapter Summary .................................................................................................... 9

CHAPTER TWO .............................................................................................................. 10

LITERATURE REVIEW .................................................................................................. 10
2.1 Introduction ............................................................................................................. 10
2.2 Political Connections ............................................................................................ 10
  2.2.1 Concept of Political Connections .................................................................... 10
  2.2.2 Influence Factors of Political Connections ..................................................... 12
  2.2.3 Political Connections and Corporate Governance ........................................ 14
2.3 Cost of Debt ............................................................................................................ 16
2.4 Political Connections and Cost of Debt ................................................................. 19
2.5 Critical Analysis of the Related Studies ................................................................ 19
<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>2.6 Underpinning Theory</td>
<td>21</td>
</tr>
<tr>
<td>2.6.1 Rent-seeking Theory</td>
<td>21</td>
</tr>
<tr>
<td>2.7 Chapter Summary</td>
<td>22</td>
</tr>
<tr>
<td>CHAPTER THREE</td>
<td>23</td>
</tr>
<tr>
<td>RESEARCH METHODOLOGY</td>
<td>23</td>
</tr>
<tr>
<td>3.1 Introduction</td>
<td>23</td>
</tr>
<tr>
<td>3.2 Research Framework</td>
<td>23</td>
</tr>
<tr>
<td>3.3 Hypotheses Development</td>
<td>24</td>
</tr>
<tr>
<td>3.4 Research Approach/Design</td>
<td>28</td>
</tr>
<tr>
<td>3.5 Sampling</td>
<td>28</td>
</tr>
<tr>
<td>3.6 Data Collection Procedures</td>
<td>30</td>
</tr>
<tr>
<td>3.7 Measurement of the variables</td>
<td>31</td>
</tr>
<tr>
<td>3.7.1 Dependent Variable</td>
<td>32</td>
</tr>
<tr>
<td>3.7.2 Hypotheses Variables</td>
<td>32</td>
</tr>
<tr>
<td>3.7.3 Control Variables</td>
<td>35</td>
</tr>
<tr>
<td>3.8 Research Variables</td>
<td>39</td>
</tr>
<tr>
<td>3.9 Data Analysis</td>
<td>40</td>
</tr>
<tr>
<td>3.9.1 Descriptive Analysis</td>
<td>40</td>
</tr>
<tr>
<td>3.9.2 Normality Assumption</td>
<td>40</td>
</tr>
<tr>
<td>3.9.3 Heteroscedasticity Test</td>
<td>41</td>
</tr>
<tr>
<td>3.9.4 Multicollinearity Test</td>
<td>41</td>
</tr>
<tr>
<td>3.9.5 Multiple Linear Regression Test</td>
<td>42</td>
</tr>
<tr>
<td>3.10 Chapter Summary</td>
<td>42</td>
</tr>
<tr>
<td>CHAPTER FOUR</td>
<td>43</td>
</tr>
<tr>
<td>ANALYSIS AND FINDINGS</td>
<td>43</td>
</tr>
<tr>
<td>4.1 Introduction</td>
<td>43</td>
</tr>
<tr>
<td>4.2 Descriptive Statistics</td>
<td>43</td>
</tr>
<tr>
<td>4.3 Diagnostic Tests</td>
<td>46</td>
</tr>
<tr>
<td>4.3.1 Normality Assumption</td>
<td>46</td>
</tr>
<tr>
<td>4.3.2 Heteroskedasticity Test</td>
<td>48</td>
</tr>
<tr>
<td>4.3.3 Multicollinearity and Correlation</td>
<td>49</td>
</tr>
<tr>
<td>4.4 Regression Test</td>
<td>53</td>
</tr>
<tr>
<td>4.5 Further Tests</td>
<td>54</td>
</tr>
</tbody>
</table>
4.6 Discussions ............................................................................................................. 57
4.7 Chapter Summary ................................................................................................. 59

CHAPTER FIVE ............................................................................................................ 61

CONCLUSIONS AND RECOMMENDATIONS ......................................................... 61

5.1 Introduction ........................................................................................................... 61
5.2 Summary of Study ............................................................................................... 61
5.3 Contributions of Study ......................................................................................... 62
5.4 Limitation of Study .............................................................................................. 64
5.5 Recommendation for Future Studies ................................................................. 65

REFERENCES ............................................................................................................ 66

APPENDIX .................................................................................................................. 72
LIST OF TABLES

<table>
<thead>
<tr>
<th>Table</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Table 3.1 Summary of Sample</td>
<td>30</td>
</tr>
<tr>
<td>Table 3.2 Value of Political Connection</td>
<td>34</td>
</tr>
<tr>
<td>Table 3.3 Description of Dependent and Independent variables</td>
<td>38</td>
</tr>
<tr>
<td>Table 4.1 Summary of Descriptive Statistic</td>
<td>44</td>
</tr>
<tr>
<td>Table 4.2 Test for Model Specification and Heteroscedasticity</td>
<td>49</td>
</tr>
<tr>
<td>Table 4.3 Summary of Pearson Correlation Matrix</td>
<td>51</td>
</tr>
<tr>
<td>Table 4.4 Results of the VIF Test</td>
<td>52</td>
</tr>
<tr>
<td>Table 4.5 Result of Regression Test: Cost of Debt model</td>
<td>53</td>
</tr>
<tr>
<td>Table 4.6 Results of Regression Model of IV as PCVALUE</td>
<td>55</td>
</tr>
<tr>
<td>Table 4.7 Results of Regression Model of IV as PCON</td>
<td>56</td>
</tr>
<tr>
<td>Table 5.1 Summary of Hypothesis Testing Results</td>
<td>61</td>
</tr>
</tbody>
</table>
**LIST OF FIGURES**

<table>
<thead>
<tr>
<th>Figure</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Figure 3.1 Theoretical Framework</td>
<td>24</td>
</tr>
<tr>
<td>Figure 4.1 Kernel Density Estimate</td>
<td>47</td>
</tr>
</tbody>
</table>
# LIST OF APPENDIX

<table>
<thead>
<tr>
<th>Appendix</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>A1: Appendix: Stock Code and Political Connections date collection</td>
<td>72</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Full Form</td>
</tr>
<tr>
<td>--------------</td>
<td>---------------------------------------------------------------------------</td>
</tr>
<tr>
<td>AUDITOR</td>
<td>Big 4</td>
</tr>
<tr>
<td>BOD</td>
<td>Board of Director</td>
</tr>
<tr>
<td>CEO</td>
<td>Chief Executive Officer</td>
</tr>
<tr>
<td>CF</td>
<td>Cash-Flow</td>
</tr>
<tr>
<td>CPPCC</td>
<td>Chinese People's Political Consultative Conference</td>
</tr>
<tr>
<td>CR</td>
<td>Current Ratio</td>
</tr>
<tr>
<td>CSMAR</td>
<td>China Stock Market Accounting Research</td>
</tr>
<tr>
<td>CSRC</td>
<td>China Securities Regulatory Commission</td>
</tr>
<tr>
<td>GROWTH</td>
<td>Sales Growth</td>
</tr>
<tr>
<td>IR</td>
<td>Cost of Debt</td>
</tr>
<tr>
<td>LEV</td>
<td>Leverage</td>
</tr>
<tr>
<td>LISAGE</td>
<td>Number of Years since Listed</td>
</tr>
<tr>
<td>LOSS</td>
<td>Firms Report Loss</td>
</tr>
<tr>
<td>NPC</td>
<td>National People’s Congress</td>
</tr>
<tr>
<td>PCON</td>
<td>Political Connections firms</td>
</tr>
<tr>
<td>PCVALUE</td>
<td>Value of Political Connections</td>
</tr>
<tr>
<td>PPE</td>
<td>Plant and Equipment</td>
</tr>
<tr>
<td>SIZE</td>
<td>Firm Size</td>
</tr>
<tr>
<td>SOE</td>
<td>State-owned Enterprises</td>
</tr>
<tr>
<td>SSE</td>
<td>Shanghai Stock Exchange</td>
</tr>
</tbody>
</table>
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 contents of the thesis is for internal user 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.

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