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**POLITICAL CONNECTIONS AND COST OF DEBT:
EVIDENCE FROM CHINA**



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UUM
Universiti Utara Malaysia

**MASTER OF SCIENCE (INTERNATIONAL ACCOUNTING)
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**POLITICAL CONNECTIONS AND COST OF DEBT: EVIDENCE
FROM CHINA**



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**Thesis Submitted to
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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

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.

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**Pan Ying
May, 2017**

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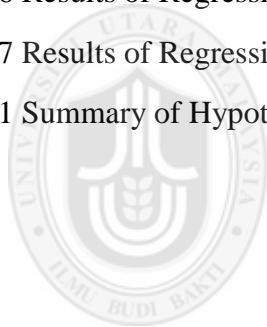
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LIST OF ABBREVIATIONS

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.

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