THE CHARACTERISTICS OF POLITICALLY CONNECTED FIRMS

Mara Faccio
Vanderbilt University
Owen Graduate School of Management
401 21st Avenue South
Nashville, TN 37203
e-mail: mara.faccio@owen.vanderbilt.edu

* Some of the results in this paper were previously circulated with the title "Politically-Connected Firms: Can They Squeeze the State?" I thank Massimo Belcredi, Bernardo Bortolotti, Lorenzo Caprio, Tom Cosimano, Serdar Dinç, Simeon Djankov, Ray Fisman, Mariassunta Giannetti, Richard Green, Tom Gresik, E. Han Kim, Meziane Lasfer, Ron Masulis, Paolo Mauro, John McConnell, Todd Mitton, Randall Morck, David Parsley, Susan Rose-Ackerman, Paul Schultz, Andrei Shleifer, and David Stolin for their helpful comments, and Suzanne Bellezza for editorial help. I also benefited from comments from workshop participants at Indiana University, Stockholm School of Economics, Università Cattolica (Milan), Università di Lugano, University of Michigan, University of Notre Dame, Syracuse University, Vanderbilt University, the IMF, the AFA meeting, and the METU International Conference in Economics in Ankara.

THE CHARACTERISTICS OF POLITICALLY CONNECTED FIRMS

Evidence from firms in 47 countries shows that companies with political connections have higher leverage, lower tax rates, and larger market share than non-connected firms. In spite of these advantages, connected firms underperform non-connected companies on an accounting basis. Differences between connected and unconnected firms are greater when political links are stronger, and when connected firms operate in countries with higher levels of corruption.

I. Introduction

Despite the negative effect of corruption on aggregate growth, recent research has shown that political connections may be beneficial to specific firms. Many anecdotes in the press identify possible sources of advantage for politically connected firms. For example, preferential access to credit was a source of great advantage to President Suharto of Indonesia and his family. In the aftermath of the Asian financial crisis, one of the IMF conditions for loans to Indonesia was that Suharto sign an agreement that companies controlled by his family would give up government concessions, government contracts, licenses, monopolies, and tax breaks that protected them from competition.[1] The value of the Suharto family's preferential access to credit was enormous. In fact, when the Indonesian Bank Restructuring Agency published the names of Indonesia's main corporate borrowers, two of the top five on the list were Suharto's children: "Second on the list, with 3.5 trillion rupiah in loans, is Timor Putra Nasional, the auto firm controlled by Tommy Suharto. Number five, with 2.9 trillion rupiah in debt, is a petrochemical company owned by the timber tycoon Prajogo Pangestu and Suharto's second son, Bambang Trihatmodjo."[2]

Despite a large number of such anecdotes in the press, academic studies of the specific sources of value associated with political connections have considered only a few mechanisms through which the advantage from political connections is realized, such as: preferential access to credit (Chiu and Joh, 2004, Cull and Xu, 2005, Dinç, 2005, Johnson and Mitton, 2003, and Khwaja and Mian, 2005), regulatory protection (Kroszner and Stratmann, 1998), and government aid to financially troubled firms (Faccio, Masulis and

[1] Rosenthal, A. M., "What Suharto Knew," The New York Times, 10 March 1998. Pura, Raphael, "Rising Resentment: Scrutiny of Suharto Wealth Is Intensifying in Jakarta," The Asian Wall Street Journal, 1 June 1998.

[2] Arnold, Wayne, "Indonesia's repo man: Eko Budianto has ordered corporate cronies from the Suharto regime to pay back the billions they owe Indonesian banks or he'll seize their assets, even if it means enlisting the army to help him," The New York Times, 31 July 1999.

McConnell, 2006). Additionally, most of these studies look at individual countries[3] and at dissimilar types of connections, making cross-country comparison virtually impossible.

The purpose of this paper is to analyze the characteristics of connected firms across a large number of countries. I focus on firm characteristics that are likely to reflect three sources of benefits: preferential access to credit, tax discounts and market power. I have two main questions. First, are benefits from these sources common across many countries and connection types, or are they specific to a few countries and connection types? Second, are these benefits greater in countries characterized by high levels of corruption?

To address these questions, I use a new database, constructed in Faccio (2006), that includes several thousand firms in 47 countries. A company is defined as politically connected if at least one of its large shareholders (anyone controlling at least 10 percent of voting shares) or one of its top executives (CEO, president, vice-president, or secretary) is a king, president or minister in the government, has a close relationship with a politician or is a member of parliament. A close relationship involves a politician who has a less direct association with the firm or the government; it may be with i) a friend who is a politician, ii) a former king, president or prime minister, iii) an executive who resigned recently and is currently a politician, iv) a foreign politician, or v) a contact from a well known association with a political party (Gomez and Jomo, 1997; and Johnson and Mitton, 2003).

I find that connected firms have higher leverage (a proxy for preferential access to credit), have lower tax rates (a proxy for tax discounts), and have greater market share (a proxy for market power). However, in spite of these advantages, connected firms have poorer accounting performance than non-connected firms. These differences are greater when the partners in the connection have more power. For example, differences are greater when companies are connected through owners rather than directors. Similarly, they are greater

[3] The lone exception is Faccio, Masulis and McConnell (2006).

when the connection is with a king, president or a minister, rather than with a member of parliament. In addition, I find that the financial characteristics of connected firms differ more from those of their non-connected peers in countries characterized by high levels of corruption. Results are robust to the exclusion of individual countries and firms with characteristics that might distort results, to the influence of outliers, and to tests for reverse causality.

These results indicate that practitioners are often justified in claiming that the allocation of public resources is distorted by political favoritism; these distortions are common in both emerging and developed countries. However, the magnitude of this phenomenon is much larger in more corrupt nations. This last result is consistent with Faccio (2006) who, for a large sample of connections across developed and emerging markets, documents that firm value increases when an entrepreneur is elected to a top political position, especially in highly corrupt countries. Overall, the influence of corruption indicates that caution is called for when using evidence from an individual country to make inferences about the prevalence or value of benefits associated with political ties.

This work complements the developing literature on the net effect of political connections on firm value. The empirical evidence in this literature has generally shown that, on average, the benefits exceed the costs. For example, Fisman's (2001) study of firms having connections with Indonesian President Suharto shows that rumors of the decline in Suharto's health had a statistically significant negative effect on the prices of these companies. Studies by Roberts (1990) and Goldman, Rocholl and So (2006) provide evidence that on average, the connections created by campaign contributions add value to US firms.[4] Ramalho (2003) and Feguson and Voth (2006) provide similar evidence for firms related to

[4] However, Fisman, Fisman, Galef, and Khurana (2006) report that the value of companies closely connected to Vice President Cheney is not affected by major political or health news involving the Vice President.

Brazilian President Collor de Mello and for German firms affiliated with the Nazi party during its rise to power, respectively.

The rest of the paper is organized as follows. In section II, I define political connections. Section III presents evidence on the characteristics of connected firms. Section IV discusses cross-country evidence. Section V provides a number of robustness tests. Section VI addresses the potential problem of reverse causality. Finally, Section VII concludes the paper.

II. Definition of political connections.

Data on political ties come from Faccio (2006), who analyzes political connections across 47 countries. A company is defined as politically connected if at least one major owner (anyone directly or indirectly controlling at least 10% of voting rights) or one of its top executives (e.g., CEO, president, etc) is a king, president or government minister, is a member of parliament or has a close relationship with a politician or political party.

The close relationships are somewhat more informal connections. They may be with i) a friend who has a government position, ii) a former head of state or prime minister,[5] iii) a director who resigned recently and is currently a politician (in 1997), iv) a foreign politician, or v) a contact from a well-known association with a political party (Gomez and Jomo, 1997; and Johnson and Mitton, 2003). These connections must involve the politician personally.

To establish the presence of connections, the names of members of parliament and top government officials are identified using the *Chiefs of State* directory (CIA, 2001) and the official website of each country's government and parliament. Names of top company executives are taken from Worldscope, Extel, company websites, and Lexis-Nexis. Major shareholders are identified from Claessens, Djankov, and Lang (2000), Faccio and Lang (2002), the web sites of stock exchanges or their supervisory authorities, Worldscope, and

[5] See from http://www2.owen.vanderbilt.edu/marafaccio/AppendixA.doc for data sources.

Extel. *The Economist*, *Forbes* and *Fortune* are the sources of information for well-known friendships between top executives and politicians. Additionally, studies by Agrawal and Knoeber (2001), Backman (1999), Gomez and Jomo (1997), Johnson and Mitton (2003), and Fisman (2001) are used to identify close relationships of the types listed above.

The dataset constructed in Faccio (2006) identifies 541 companies with political connections in 47 countries. To be included in the sample, financial information for these companies must be available in Worldscope for 1997. This criterion reduces the sample to 458 connected firms, and 15,733 non-connected peers. Table I shows that 256 connections (56%) involve top executives, while 202 (44%) involve major owners. In the majority of cases, connections are with members of parliament (262), and fewer are due to close relationships (130) and connections with heads of state or ministers (66).

[Table I goes about here]

Table II shows the distribution of connections across countries. The full list of connections is available at: http://www.aeaweb.org/articles/issue_detail.php?journal=AER&volume=96&issue=1&issue_date=March%202006.

[Table II goes about here]

III. The characteristics of politically connected firms

The characteristics of connected firms that are of interest are (i) preferential access to credit, (ii) tax discounts, (iii) market power, (iv) accounting performance and (v) stock market performance. Before proceeding with the analysis, it is important to point out that at least three factors work against finding statistical significance. First, if preferential access to credit and tax discounts are benefits, they may accrue mostly to unlisted firms connected with politicians. Since financial data are not widely available for unlisted firms, I cannot test this hypothesis. Second, benefits may be granted to the entire industry, rather than to specific

firms. For example, tax discounts are sometimes granted to industries with high barriers to entry. Stigler (1971) discusses several such cases in the U.S. Third, since many connected firms may operate as monopolies or quasi-monopolies, their industry-adjusted financial ratios will be exactly the same as those of their "peers."

A. Variable definitions and descriptive statistics for connected and non-connected firms

(i) *Leverage* is a proxy for access to credit. *Leverage* is defined as the ratio of long-term debt (excluding the current portion of long-term debt, pensions, deferred taxes, and minority interest) to total capital × 100. Total capital represents the total investment in the company. It is the sum of common equity, preferred stock, minority interests, long-term debt, non-equity reserves, and the deferred tax liability in untaxed reserves.

(ii) *Tax rate* is a proxy for tax discounts. It is computed as (Income Taxes / Pretax Income) x 100. Companies with negative earnings and companies that display a tax rate above 100 percent are excluded.

(iii) *Market share* is a proxy for market power. Government protection may take the form of a monopoly, a concession or license, or a large government contract. Large firms may find connections more valuable, and therefore they may be more likely to establish them. *Market share* is a firm's market capitalization as a proportion of the total market capitalization of all firms in the same country and two-digit SIC industry. I use market capitalization instead of sales because the sample includes financial companies. However, results are similar when I exclude financial companies and use sales instead of market capitalization. In the regressions for *market share*, I do not control for country and industry effects because the variable is defined at the country and industry levels,.

(iv) *Return on equity* (*ROE*) is an accounting measure of firm performance. It is computed as: [(net income before preferred dividends – preferred dividend requirement) / last year's common equity] × 100.

(v) *Market-to-book* is a measure of performance in the stock market. It is computed as: (market value of ordinary equity + market value of preferred equity + book value of debt) / (book value of equity + book value of debt).

Several other characteristics may influence the relation between political connections and the five variables of interest. They will be controlled for in the regression tests. *Mkcap* (Market capitalization) is a proxy for firm size. It is computed as market price as of year end × common shares outstanding. *State* represents the voting stake held by the central and local government. *State* is calculated by identifying the weakest link in each control chain linking the corporation to the controlling shareholder, then summing the percentage control rights across these links. Government ownership is identified using Extel, Worldscope, Claessens *et al.* (2000), Faccio and Lang (2002), and the 2000 "Fortune 500 Global List." *Privatized* is a dummy that equals 1 if the company is a privatized firm, and is 0 otherwise. Lists of privatized firms are obtained from SDC Platinum; Bortolotti, Fantini and Siniscalco (2001), Dewenter and Malatesta (1997), and Megginson, Nash, and Van Randenborgh (1994); data from these sources are updated with data provided, most kindly, by Bill Megginson. *Dually listed* is a dummy that equals 1 if the company is listed on at least two stock markets, and is 0 otherwise. Dual listings are identified from Worldscope.

Table III provides univariate statistics for the subsamples of connected firms and their non-connected peers. It shows that the *leverage* of connected firms is significantly higher than that of non-connected peers (28.14% vs. 24.19%). Connected firms also enjoy significantly lower *tax rates* (29.67% vs. 32.7%) and have larger *market shares* (18.04% vs. 9.48%). The *ROE* and *market-to-book* ratios for the connected and non-connected sub

samples are not statistically different. However, connected firms are substantially larger (market value of equity is three times as large, on average), a larger proportion of their equity is government owned, and they are more likely to be former state-owned enterprises.

[Table III goes about here]

B. The Effects of a Firm Being Connected and of Different Connection Types

To analyze the effects of political connections, I first compare all the connected firms with all the non-connected firms (Table IV, Panel A). Then connected firms are divided into sub samples in order to make comparisons between connection types. The first of these comparisons is between firms having connections through the two firm positions: i) major owners and ii) executives (Panel B).

The final comparison is among firms having connections with politicians in each of the three political categories: i) the king, president or a minister; ii) close relationships and iii) members of parliament (Panel C).

An alternative approach would be to look at changes in *leverage* ratios (*tax rates, market share*) from before to after the date on which the connection was established. However, the precise date can be identified for only a small proportion of firms. Unless otherwise specified, all regressions control for the company's listing status, government control (recently privatized, or state-controlled), as well as size (market capitalization), country, and industry as defined by Campbell (1996).[6]

[Table IV goes about here]

[6] Industries are defined as follows: petroleum (SIC 13, 29), consumer durables (SIC 25, 30, 36-37, 50, 55, 57), basic industry (SIC 10, 12, 14, 24, 26, 28, 33), food and tobacco (SIC 1-2, 9, 20-21, 54), construction (SIC 15-17, 32, 52), capital goods (SIC 34-35, 38), transportation (SIC 40-42, 44-45, 47), utilities (SIC 46, 48-49), textiles and trade (SIC 22-23, 31, 51, 53, 56, 59), services (SIC 72-73, 75-76, 80, 82, 87, 89), leisure (SIC 27, 58, 70, 78-79), and financial companies (SIC 60-69).

B.1. Leverage

Panel A shows that connected firms have significantly higher *leverage* than non-connected ones. Furthermore, *leverage* is higher when connections are stronger. The excess leverage is higher for firms connected through a major owner, rather than through a top executive (Panel B). Second, *leverage* is higher for firms connected with a close relationship (coeff. = 8.29), or with a king, president, or minister (coeff. = 3.99), and *leverage* is lower for those connected with a member of parliament (coeff. = 1.28) (Panel C). Results are robust to the exclusion of financial companies.

While connections facilitate access to debt financing, they do not necessarily result in lower interest rates. For the whole sample, the average interest rate on debt (interest paid/total debt) is only marginally lower for connected firms (difference = -0.07 percent, not reported in a table). For companies connected with a king, president or minister, however, the average interest rate is lower by 1.14 percent (p = .05), which supports the argument that connections with more influential politicians are worth more.

B.2. Tax rate.

The results shown in Table IV indicate that connected firms tend to enjoy low *tax rates*. However, the rates are significantly lower only for companies that have a stronger connection partner on the firm side: that is, a connection through a major owner. Surprisingly, connections with the king, president, or a minister are associated with insignificantly higher tax rates.

One problem in analyzing tax rates is that tax breaks may be granted to the entire industry, rather than to one connected firm, which would lead to insignificant differences across firms. To assess this possibility, I rerun all simulations eliminating industry dummies (results not reported for space reasons). Results are essentially unchanged after the exclusion of industry dummies. A second limitation is that, while my tax variable captures tax breaks in

the form of special deductions, it does not reflect tax savings that occur when connected companies are allowed to under-report income.

B.3. Market share.

The *market share* variable has a particularly strong relation with political connections. Connected firms enjoy significantly higher market shares. *Market share* is notably higher when the connection is through the owner (coeff. = 11.60) rather than through a director (coeff. = 1.89). Similarly, the *market share* is higher when the connection is with a close relationship (coeff. = 13.95), than when it is with the king, president or a minister (coeff. = 8.02). The *market share* is only marginally higher (coeff. = 2.09) when connections are with a member of parliament. These results confirm the univariate test evidence that connections with more powerful partners have greater excess differences than those with less powerful partners.

B.4. Accounting performance and market valuation.

Connected firms might have better performance than non-conneccted firms. It may be that connected firms report better performance because of the benefits associated with connections. Or it may be that better performing firms establish connections to maintain their power and performance. On the other hand, it might be that connected firms perform poorly. First, they might have performed poorly ex ante and established political connections in order to obtain relief from some of their problems. Second, firms owned or managed by politicians may be poor performers because the politicians select managers on the basis of connections, regardless of whether the managers have the skills needed to run a successful company. Third, the cost of maintaining a political connection may be greater than the benefits derived from the connection (see Fisman, 2001; Johnson and Mitton, 2002). Several studies consider the costs of political connections. De Soto (1989) argues that in Peru, bribes replace the taxes

that connected companies do not pay. Shleifer and Vishny (1994) argue that while politicians may be willing to provide subsidies to private firms, they expect the firms to pay them back by acting to support their political agendas, which involves a cost to the firms.[7]

Results indicate that connected firms are poor performers. The *ROE* of connected firms is significantly lower ($p < .01$) than that of non-connected firms, and their market-to-book ratio is lower by 0.48 (difference only marginally significant). All subgroups of connected firms exhibit significantly lower *ROE*s than their non-connected peers. Companies connected through the weakest connection partners (executives, MPs) have the lowest market valuations. My interpretation of the *ROE* results is that the poor accounting performance of connected firms likely reflects ex-ante underperformance. In other words, although political connections on average add value to the connected firms (see Faccio, 2006), the added value is not enough to offset prior underperformance.

IV. Cross country evidence

A. Country-level results.

One of the important contributions of this study is that the data permits an analysis of whether the benefits of political connections vary by country. For example, the effect of connections through MPs and comparable officials, might differ in the UK and US because of their political systems are not the same. In the British system, a member of Parliament has no individual power because voting occurs by party, while members of the U.S. Congress vote

[7] To test for the possible level of over employment by connected firms, I compute the ratio of the number of employees to total assets. I regress this ratio against the proxies for connections used above and various control factors. In no case is there a significant difference between the employment levels of connected and non–connected firms (results not reported to save space). The difference is generally very small in economic terms (the coefficient of the connection dummy is –0.001), far from being statistically significant, and generally has the wrong sign, i.e., connected firms employ fewer people. The data do not allow examination of other interesting costs such as the remuneration of politicians who are board members or payments to politicians, both legal (i.e., campaign contributions) and illegal.

independently on many issues. Because there are just a handful of connected firms in many countries, I focus on countries (i) that have a large number of connected firms, (ii) that have a large proportion of politically connected listed firms, or (iii) in which a large proportion of the country's market capitalization is owned by connected firms. The countries that meet at least one of these criteria are: Indonesia, Italy, Japan, Malaysia, Russia, Thailand, and the U.K. Ireland is not included because it has only two connected firms.

The results of the country level analysis are shown in Table V. In all countries except Italy, connected firms have higher *leverage*. *Leverage* is significantly higher for connected firms in Malaysia, Russia, and Thailand. In Italy, *leverage* is not only lower, but is significantly so. In all seven countries, connected firms have lower *tax rates*, but rates are significantly lower only in Russia, where the tax discount of connected firms is an amazing 73.27 percentage points. Connected firms have a larger *market share* in five of the seven countries. This advantage is statistically significant and economically large for the Russian sample. Connected firms have lower *ROE*s in all countries; the difference is significant in Russia and Thailand. Finally, connected firms have a significantly lower *market-to-book ratio* in the U.K.; although they have higher *market-to-book ratios* in Japan, Malaysia, and Russia, these results are not significant.

[Table V goes about here]

B. The effect of corruption in a country

To test whether connections are more important in countries with higher levels of corruption, I analyze a number of interactions between connections and corruption. Table VI shows that differences between connected and non-connected firms are greater in highly corrupt systems.

As proxy for corruption, I use the average of four indexes used elsewhere as measures of perceived corruption: the Business International index, the International Country Risk index,

the Kaufmann, Kraay and Zoido-Lobatón index (http://www.worldbank.org/wbi/governance/datasets.html#dataset), and Transparency International index (www.transparency.org). Corruption indexes are rescaled from 0 to 10, so that lower scores correspond to lower levels of corruption. The Business International's (Economist Intelligence Unit) index assesses the "degree to which business transactions involve corruption and questionable payments". This assessment is compiled based upon questionnaires filled in by BI's network of correspondents and analysts based in the countries covered, and reflect their perception of corruption. The International Country Risk's assessment of the corruption in government indicates whether "high government officials are likely to demand special payments" and "illegal payments are generally expected throughout lower levels of government" in the form of "bribes connected with import and export licenses, exchange controls, tax assessment, policy protection, or loans." The Kaufmann *et al.* corruption index is defined as the exercise of public power for private gains, and measures various aspects, ranging from the frequency of "additional payments to get things done" to the effects of corruption on the business environment. "The indicator reflects the statistical compilation of perceptions of the quality of governance of a large number of survey respondents in industrial and developing countries, as well as non-governmental organizations, commercial risk rating agencies, and think-tanks during 1997 and 1998". Finally, Transparency International measures the "degree to which corruption is perceived to exist among public officials and politicians. It is a composite index, drawing on 14 different polls and surveys from seven independent institutions, carried out among business people and country analysts, including surveys of residents, both local and expatriate." Corruption represents "the abuse of public office for private gain."

[Table VI goes about here]

For example, in the *leverage* regression for connected firms versus unconnected firms (Panel A), the variable representing the interaction between connection and corruption has a coefficient of 2.04 ($p < .01$). This implies that in the country with the lowest corruption index, connected firms have, on average, 2.17 percentage points more leverage than non-connected firms compared to 11.35 percentage points more in the country with the highest corruption index. The tax rates of connected firms are lower in more corrupt countries, but not significantly lower. Further, the market share of connected firms increases significantly with corruption (coefficient = 2.58, p-value < 0.01).

Interestingly, while the accounting performance of connected firms deteriorates significantly with the level of corruption in the country, their market-to-book ratios do not change. This combination of results may indicate that in countries with more corruption, connected firms are relatively inefficient, but the market expects that the advantages associated with connections will allow them to compensate for weak management.

Table VI also confirms that the type and strength of connections matters. A connection through an owner, rather than through a director, has a greater marginal effect on *leverage*, *tax rate*, *market share* and *ROE* in more corrupt countries. A connection with the king, the president, or a minister has a greater marginal effect on *leverage* and *tax rate* as corruption increases, while a connection through a close relationship has a greater marginal effect on *market share* and *ROE* as corruption increases.

[Table VI goes about here]

V. Robustness tests.

I perform a number of tests to assess the robustness of my results. First, firms are divided by the corruption level of the country; firms in countries with a corruption measure greater than the sample median (Table VII, Panel A), and firms in countries with a corruption measure less than or equal to the median (Panel B). The *leverage* premium for connected

firms is significant only in the more corrupt countries. The *market share* premium is significant in both more and less corrupt countries. As before, *tax rate* is not significant for either group. For both samples, the *ROE* of connected firms is significantly worse. This poorer accounting performance results in below-market valuations for firms in less corrupt countries, but has no effect on market valuations in more corrupt countries.

[Table VII goes about here]

Since Fisman (2001) and Johnson and Mitton (2003) have already documented substantial effects associated with connections in Malaysia and Indonesia, these countries are excluded from the tests reported in Table VII, Panel C. The basic results are unchanged after excluding these two countries, with one exception. In the full sample, the market-to-book of connected firms is lower, but not significantly lower, than that of non-connected firms, but when Malaysia and Indonesia are excluded, it is significantly lower. The exclusion of the US and UK, which have the largest numbers of firms, does not change the results.

The tests reported in Panel D exclude financial firms (SIC 6000-6999) because they have ratios that differ from non-financial firms. Those reported in Panel E exclude government-controlled and privatized firms, which may have objectives be other than maximizing shareholder value and which may have unusual ratios. And finally, in Panel F, the data is truncated at the 5^{th} and 95^{th} percentiles to test for the effect of outliers. The results shown in these panels show that none of these factors (financial firms, government control (present or past), and outliers) has an effect on results.

VI. Is there a reverse causality problem?

A. Anecdotal evidence.

Anecdotal evidence suggests that connected firms enjoy easier access to debt financing from state-controlled banks, even though their situation does not justify additional credit. For example, in 1982, a Malaysian company, Baktimu Sdn Bhd, which was owned by Daim

Zainuddin (former Malay Deputy Prime Minister and close friend of Prime Minister Mahathir), acquired a 33 percent stake in Sime UEP, for RM 75m cash. "Part of the loan for the acquisition, amounting to RM 40m, was obtained from the Singapore branch of the Union Bank of Switzerland; the loan was approved by the Union Bank only after the government-owned Bank Bimiputra issued a guarantee on Bakrimu's behalf as security for the credit" (Asian Wall Street Journal, Aug. 24, 1984; Gomez and Jomo, 1997, pp. 54-55). Pinault SA (France) provides another example. In 1986, François Pinault, the controlling shareholder of Pinault SA obtained a FF250 million (US$40 million) grant from the government. By 1997, Crédit Lyonnais' credits and investments in Pinault had reached a value of FF12 billion (US$2.14 billion) (Calvi and Meurice, 1999; Gay and Monnot, 1999). Similarly, Italian Prime Minister Silvio Berlusconi was accused of financing his television empire through the "large helping hand [of] public-sector banks, which provided bigger loans than Fininvest's creditworthiness seemed to merit" (The Economist, 2001a).

Anecdotal evidence also suggests that politically connected firms receive preferential tax treatment. In 1996, Russian President Boris Yeltsin signed a decree giving tax breaks and other aid potentially worth more than US$1 billion to Norilsk Nickel, one of the country's richest and most influential industrial giants. Norilsk was controlled by Uneximbank, and the president of Uneximbank, Vladimir Potanin, was shortly thereafter appointed deputy prime minister (The Moscow Times, 1996). Similarly, when Pinault SA obtained its 1996 cash grant from the French government, it was also given a tax exemption of FF250 million (Gay and Monnot, 1999).

Anecdotes about politically connected firms having protections that give them market power are legion. For example, Backman (1999, pp. 266-268) says that "money from the [Suharto] family's start-up capital came from having themselves granted import monopolies. One of the earliest such monopolies was an exclusive license for the import of raw materials

for plastic, granted in 1984." Similarly, Malay crony capitalists are described as "private sector businessmen who benefit enormously from close relations" with government leaders by obtaining "not only protection from foreign competition, but also concessions, licenses, monopoly rights, and government subsidies" (Yoshihara, 1988, pp. 3-4, 71). This practice was so widespread that by 1995 almost 20 percent of the Malay ruling party's division chairmen were millionaire businessmen (Gomez and Jomo, 1997, p. 26). In the Philippines, connected firms could easily obtain licenses by paying a 10 percent fee (Hutchcroft, 1998, p.73).

B. Formal tests.

The anecdotal evidence reported above supports the view that higher leverage, lower tax rates and greater market share, are all advantages associated with political connections. However, the relation between *market share* (*leverage and tax rates*) and political connections is potentially endogenous: the owner or manager of a large and important firm in the country may simply have more opportunity to enter politics. I use two methodologies to control for reverse causality.

First, I attempt to control for this source of reverse causality by dividing the firms into those that have political partners with longer and shorter tenures in politics. The rationale for doing this is that political partners with longer tenure presumably have connections that have lasted longer; if higher leverage (lower tax rates, larger market share) are for the benefits associated with political connections, then they should cumulate as the duration of the connection increases. For this purpose I use the following two variables: *Connected with seasoned politician* is a dummy that equals one if the political partner had at least a ten year

tenure in politics in 1997;[8] *Connected with unseasoned politician* is a dummy that equals one if the politician took office after 1987.

Results in Table VIII show that companies connected with a seasoned politician display significantly lower *tax rates* than their peers, while firms connected to an unseasoned politician do not. Second, firms connected with a seasoned politician enjoy higher *market share* (coeff. = 9.29) compared to firms connected with an unseasoned politician (coeff. = 5.25). However, a connection with an unseasoned politician (rather than with a seasoned politician) is associated with insignificantly higher *leverage* (coeff. = 4.34 vs. 4.21). Overall, these results are consistent with the idea that benefits accumulate as the duration of political connections increases.

[Table VIII goes about here]

Second, I test the direction of causality using a two-stage regression approach. I re-run all regressions using this approach.[9] In the first stage, I regress each connection's political tenure dummy against firm size (log of the lagged value of market capitalization or log of the lagged value of total assets); lagged accounting performance (*ROE*); and country and industry dummies. Then in the second stage, I use the predicted values of each connection as the regressor, and re-run the previous regressions. All second-stage results have signs and significance levels that are consistent with the results discussed earlier.

VII. Conclusion.

This paper evaluates the benefits derived from political connections by individual firms. The study analyzes the sources of benefit from political connections, whether these sources of these advantages involve a variety of connection types, and whether they are

[8] Each politician's date of initial appointment is determined from sources listed in http://www2.owen.vanderbilt.edu/marafaccio/AppendixA.doc, Panel G. When I cannot identify the initial year of appointment, I classify the firm as being connected with an unseasoned politician.

common across many countries. A connection type is defined by the positions of the people who form the connection, one from the firm and one in politics, such as a firm owner and a country president. The focus of the study is on three sources of advantage from political connections: preferential access to credit, tax discounts, and market power.

Results indicate that politically connected companies are different from non-connected firms. On average, connected companies have preferential access to credit (higher leverage), they enjoy tax discounts (lower tax rates) and they are protected from market competition (greater market share). On the other hand, connected firms do not perform as well as their peers, as measured both by their accounting performance (lower *ROE*) and by their market performance (*market-to-book* ratios are comparable or lower). These results are generally consistent across countries. The evidence of preferential access to credit confirms results reported in previous studies. For example, Kwaja and Mian (2004) show that in Pakistan, politically connected firms enjoy greater access to debt financing and, although they exhibit significantly higher default rates, they pay higher interest rates than their non-connected peers.[10] However, to the best of my knowledge, this is the first study to document systematically that tax discounts and market power are also sources of political benefits.

I also show that differences between connected and non-connected firms are greater when the two partners making up the connection have more power; that is, they are greater when the partner in the firm is an owner, rather than a director, and when the partner in politics is a king, president or minister, rather than a member of parliament. The differences are also greater when the firm operates in a country with a higher level of corruption. This last result complements Faccio's (2006) finding that the net benefits of political connections are larger in more corrupt countries. Thus, the evidence indicates that the three sources of

[9] Results are available from the author upon request.

[10] Empirical evidence of politically connected firms having higher leverage is also reported in Chiu and Joh (2004), Cull and Xu (2005), and Johnson and Mitton (2003).

benefit analyzed in this study occur across a large number of countries and many political connection types, although the power of the connection partners and the level of corruption in the firm's country influence the size of those benefits.

References.

Agrawal, Anup, and Charles R. Knoeber, 2001, "Do some outside directors play a political role?" *Journal of Law and Economics*, 44: 179-198.

Backman, Michael, 1999, "*Asian eclipse: Exposing the dark side of business in Asia,"* Wiley: Singapore.

Bortolotti, Bernardo, Marcella Fantini, and Domenico Siniscalco, 2001, "Privatization: Politics, institutions and financial markets," *Emerging Markets Review*, 2: 109-137.

Campbell, John, 1996, "Understanding risk and return," *Journal of Political Economy*, 104: 298-345.

Chiu, Ming Ming, and Sung Wook Joh, 2004, "Loans to distressed firms: Political connections, related lending, business group affiliations, and bank governance," Chinese University of Hong Kong working paper.

Claessens, Stijn, Simeon Djankov, and Larry H. P. Lang, 2000, "The separation of ownership and control in East Asian corporations," *Journal of Financial Economics,* 58: 81-112.

Cull, Robert, and Lixin Colin Xu, 2005, "Institutions, ownership and finance: The determinants of profit reinvestment among Chinese firms," *Journal of Financial Economics,* 77: 117-146.

De Soto, Hernando, 1989, *"The other path: The invisible revolution in the third worlds'*, Harper and Row Publishers, New York.

Dewenter, Kathryn L., and Paul H. Malatesta, 1997, "Public offerings of state-owned and privately-owned enterprises: An international comparison," *Journal of Finance*, 52: 1659-1679.

Dinç, I. Serdar, 2004, "Politicians and banks: political influences on government-owned banks in emerging countries," *Journal of Financial Economics*, 77: 453-479.

Faccio, Mara, 2006, "Politically connected firms," *American Economic Review*, 96: 369-386.

Faccio, Mara, and Larry H. P. Lang, 2002, "The ultimate ownership of western European corporations," *Journal of Financial Economics*, 65: 365-395.

Faccio, Mara, Ronald W. Masulis, and John J. McConnell, 2006, "Political connections and corporate bailouts," *Journal of Finance,* forthcoming.

Ferguson, Thomas, and Hans-Joachim Voth, 2006, "Betting on Hitler – The value of poltical connections in Nazi Germany," Universitat Pompeu Fabra working paper.

Fisman, David, Raymond Fisman, Julia Galef, and Rakesh Khurana, 2006, "Estimating the value of connections to Vice-President Cheney," Columbia University working paper.

Fisman, Raymond, 2001, "Estimating the value of political connections," *American Economic Review*, 91: 1095-1102.

Goldman, Eitan, Jörg Rocholl, and Jongil So, 2006, "Does political connectedness affect firm value?" University of North Carolina at Chapel Hill working paper.

Gomez, Edmund Terence, and K.S. Jomo, 1997, *"Malaysia's political economy: Politics, patronage and profits,"* Cambridge University Press: Cambridge.

Johnson, Simon, and Todd Mitton, 2003, "Cronyism and capital controls: Evidence from Malaysia," *Journal of Financial Economics*, 67: 351-382.

Khwaja, Asim Ijaz, and Atif Mian, 2005, "Do lenders favor politically connected firms? Rent-seeking in an emerging financial market," *Quarterly Journal of Economics*, 120: 1371-1411.

Kroszner, Randall S., and Thomas Stratmann, 1998, "Interest group competition and the organization of congress: Theory and evidence from financial services' Political Action Committees," *American Economic Review*, 88: 1163-1188.

Megginson, William L., Robert C. Nash, and Matthias Van Randenborgh, 1994, "The financial and operating performance of newly privatized firms: An international empirical analysis," *Journal of Finance*, 49: 403-452.

Ramalho, Rita, 2003, "The effects of anti-corruption campaign: Evidence from the 1992 presidential impeachment in Brazil," M.I.T. working paper.

Roberts, Brian E., 1990, "A dead senator tells no lies: Seniority and the distribution of federal benefits," *American Journal of Political Science*, 34: 31-58.

Shleifer, Andrei, and Robert W. Vishny, 1994, "Politicians and firms," *Quarterly Journal of Economics*, 109: 995-1025.

Stigler, George, 1971, "The theory of economic regulation," *Bell Journal of Economics and Management Science*, 2: 3-21.

The New York Times, 1998, "*The Suharto billions - A special report; For Asian nation's first family, financial empire is in peril*," January 16.

White, Halbert, 1980, "A heteroskedasticity-consistent covariance matrix estimator and a direct test for heteroskedasticity," *Econometrica*, 48: 817-838.

Table I. Classification of Connections by Type.

Connections with MPs represent cases in which a large shareholder (≥10% of voting shares) or top executive of the company sits in a national parliament. *Connections with ministers* represent cases in which a large shareholder (≥10% of voting shares) or top executive holds a high government office, or is king or president of the country. *Closely related firms* involve connections with i) a friend who has a government position, ii) a former head of state or prime minister, iii) a director who resigned recently and is currently a politician (in 1997), iv) a foreign politician, or v) a contact from a well-known association with a political party. *Connections through owner* represent cases in which a major shareholder (≥10% of voting shares) sits in a national parliament, holds office in the government, is the head of state, or is closely related to a top politician or political party. *Connections through top director* represent cases in which a company's top executive sits in a national parliament, holds office in the government, is the head of state, or is closely related to a top politician or political party.

	Connections with MPs	Connections with ministers	Closely related firms	Total	*(%)*
Connections through owner	35	49	118	202	*44.10*
Connections through top director	227	17	12	256	*55.90*
Total	262	66	130	458	
(%)	*57.21*	*14.41*	*28.38*		

Table II. Distribution of Firms with Political Connections by Country.

No. of firms with available data is the number of firms with financial data available in Worldscope. *No. of connected firms* is the number of firms with a major owner or top executive who sits on a national parliament, is a member of the government, is king or president of the country, or is closely related to a top politician or political party.

Country	No. of firms with available data	No. of connected firms	Country	No. of firms with available data	No. of connected firms
Argentina	34	0	Mexico	68	7
Australia	257	2	Netherlands	179	1
Austria	87	1	New Zealand	47	0
Belgium	104	5	Norway	113	0
Brazil	127	0	Peru	24	0
Canada	438	6	Philippines	100	5
Chile	71	2	Poland	32	0
Colombia	32	0	Portugal	60	3
Czech Rep.	58	0	Russian Fed.	11	4
Denmark	172	7	Singapore	215	16
Finland	91	2	South Africa	188	0
France	519	19	South Korea	271	7
Germany	507	10	Spain	138	1
Greece	90	1	Sri Lanka	18	0
Hong Kong	381	7	Sweden	172	3
Hungary	26	1	Switzerland	180	4
India	257	8	Taiwan	237	7
Indonesia	116	27	Thailand	204	32
Ireland	52	2	Turkey	78	1
Israel	47	2	U.K.	1,417	119
Italy	178	21	U.S.A.	6,007	13
Japan	2,322	30	Venezuela	17	0
Luxembourg	23	1	Zimbabwe	8	0
Malaysia	418	81			
			All countries	16,191	458

Table III: Descriptive statistics

Connected companies have a major shareholder (≥10% of voting shares) or top executive who is king or president of the country, a minister, a member of parliament, or is closely related to a top politician/political party. *Leverage* is defined as long-term debt (excluding the current portion of long-term debt, pensions, deferred taxes, and minority interest) over total capital × 100. Total capital represents the total investment in the company: the sum of common equity, preferred stock, minority interests, long-term debt, non-equity reserves, and deferred tax liability in untaxed reserves. *Tax* is income taxes over pretax income × 100. *Market share* is firm's market capitalization over the total market capitalization of all firms in the same country and two-digit SIC industry (%). *ROE* is computed as [(Net income before preferred dividends – preferred dividend requirement) / last year's common equity] × 100. *Market-to-book* is the ratio of the market values of ordinary and preferred equity plus the book value of debt, to the sum of book value of equity and book value of debt. *Mkcap* is the company's market capitalization, defined as market price as of year end × common shares outstanding (in millions of US$). *State* represents the voting stake held by the central and local government. It is calculated by identifying the weakest link in each control chain linking the corporation to the controlling shareholder, then summing the percentage control rights across these links. *Privatized* is a dummy that equals 1 if the company is a privatized firm, and is 0 otherwise. *Dually listed* is a dummy that equals 1 if the company is listed on at least two stock markets, and is 0 otherwise.

	Connected		Non-connected			Kruskal-	Test of
	Mean	Median	Mean	Median	T-test	Wallis test	proportion
Leverage	28.14	22.67	24.19	18.62	0.00	0.00	
Tax	29.67	30.00	32.70	34.43	0.00	0.00	
Market share	18.04	5.26	9.48	0.61	0.00	0.00	
ROE	6.29	8.78	6.87	8.63	0.78	0.50	
Market-to-book	2.09	1.29	2.77	1.46	0.66	0.00	
Mkcap ($M)	3,634.65	309.41	1,265.04	166.85	0.00	0.00	
State (%)	1.79	0.00	0.88	0.00	0.00	0.04	
Privatized (%)	4.37		1.33				0.00
Dually listed (%)	21.40		20.78				0.75

Table IV: Characteristics of Connected Firms.

Each panel shows results for the comparison of a different set of connection types, and each column shows results for a set of regressions that include one variable of interest. All regressions control for whether the firm has recently been privatized, is state-controlled, or is dually listed, as well as for firm size (ln{*mkcap*}). Leverage, Tax, ROE, and Stock return regressions include country and industry dummies. The industry categories are taken from Campbell (1996). Coefficients for control variables are not reported to save space. *Leverage* is defined as long-term debt (excluding the current portion of long-term debt, pensions, deferred taxes, and minority interest) over total capital × 100. Total capital represents the total investment in the company: the sum of common equity, preferred stock, minority interests, long-term debt, non-equity reserves, and deferred tax liability in untaxed reserves. *Tax* is income taxes over pretax income × 100. *Market share* is firm's market capitalization over the total market capitalization of all firms in the same country and two-digit SIC industry (%). *ROE* is computed as [(Net income before preferred dividends – preferred dividend requirement) / last year's common equity] × 100. *Market-to-book* is the ratio of the market values of ordinary and preferred equity plus the book value of debt, to the sum of book value of equity and book value of debt. *Connected* is a dummy that equals 1 if the a company's major shareholder (≥10% of voting shares) or top executive is king or president of the country, minister, member of parliament, or is closely related to a top politician/political party. *Connected through the owner* is a dummy that equals 1 if a major owner sits in a national parliament, holds office in the government, is the head of state, or is closely related to a top politician/political party, and is 0 otherwise. *Connected through a director* is a dummy that equals 1 if a company's top executive sits in a national parliament, holds office in the government, is the head of state, or is closely related to a top politician/political party, and 0 is otherwise. *Connected with king, president or minister* is a dummy that equals 1 if a controlling shareholder or top executive of the company holds a government office, or is king/president of the country, and is 0 otherwise. *Connected with MP* is a dummy that equals 1 if a controlling shareholder or top director of the company sits in a national parliament, and is 0 otherwise. *Close relationships* is a dummy that equals 1 if a controlling shareholder or top executive of a company is closely related to at least one top politician, and is 0 otherwise. Close relationships include: (i) friendship, (ii) former heads of state or prime ministers (and their relatives), (iii) directorships covered by current politicians in 1997, who recently left the firm, (iv) connections with foreign politicians, and (v) well-known cases of relationships with political parties. Standard errors (reported in parentheses below the coefficients) are computed using Huber/White correction for heteroskedasticity (see White, 1980). [a], [b], [c] indicates that the value is significantly different from zero at the .01, .05, and .10 levels respectively.

	Leverage	Tax	Market share	ROE	Market-to-book
Panel A: General results					
Connected	3.51 [a]	–0.73	6.30 [a]	–5.38 [a]	–0.48 [c]
	(1.29)	(0.88)	(1.21)	(1.47)	(0.29)
Panel B: Director vs. shareholder connection					
Connected through the owner	4.27 [b]	–2.60 [c]	11.60 [a]	–5.76 [b]	–0.11
	(1.95)	(1.47)	(1.95)	(2.43)	(0.34)
Connected through a director	2.08	0.33	1.89	–3.76 [b]	–0.66 [c]
	(1.62)	(1.02)	(1.44)	(1.72)	(0.34)
Panel C: Connections with members of parliament vs. connections with ministers					
Connected with king, president, or minister	3.99	0.83	8.02 [b]	–6.96 [c]	0.36
	(3.83)	(2.54)	(3.18)	(4.18)	(0.61)
Connected with MP	1.28	–1.01	2.09	–3.58 [b]	–0.75 [b]
	(1.62)	(1.01)	(1.39)	(1.73)	(0.36)
Close relationships	8.29 [a]	–0.75	13.95 [a]	–8.78 [a]	–0.30
	(2.31)	(2.05)	(2.63)	(3.05)	(0.39)

Table IV: Characteristics of Connected Firms (Cont'd).

	Leverage	Tax	Market share	ROE	Market-to-book
	Memo items				
N. Obs. Panels A–C	16,138	12,304	16,147	16,190	16,143
Country dummies	Yes	Yes	No	Yes	Yes
Industry dummies	Yes	Yes	No	Yes	Yes
Estimation technique	Tobit	Tobit	Tobit	OLS	OLS

Table V: Country - Level Regressions.

Horizontal lines separate regressions for the various countries, and each column shows results for a set of regressions that include one variable of interest. All regressions control for whether the firm has recently been privatized, whether it is state-controlled or dually listed, and for firm size (ln{mkcap}). All regressions except those for market share also control for whether the firm is in the financial industry (SIC between 6000 and 6999). Coefficients for these control variables are not reported save space. All regressions include an intercept. *Leverage* is defined as long-term debt (excluding the current portion of long-term debt, pensions, deferred taxes, and minority interest) over total capital × 100. Total capital represents the total investment in the company: the sum of common equity, preferred stock, minority interests, long-term debt, non-equity reserves, and deferred tax liability in untaxed reserves. *Tax* is income taxes over pretax income × 100. *Market share* is firm's market capitalization over the total market capitalization of all firms in the same country and two-digit SIC industry (%). *ROE* is computed as [(Net income before preferred dividends – preferred dividend requirement) / last year's common equity] × 100. *Market-to-book* is the ratio of the market values of ordinary and preferred equity plus the book value of debt, to the sum of book value of equity and book value of debt. *Connected* is a dummy that equals 1 if the a company's major shareholder (≥10% of voting shares) or top executive is king or president of the country, minister, member of parliament, or is closely related to a top politician/political party. Standard errors (reported in parentheses below the coefficients) are computed using Huber/White correction for heteroskedasticity (see White, 1980). [a], [b], [c] indicates that the value is significantly different from zero at the .01, .05, and .10 levels respectively.

	Leverage	Tax	Market share	ROE	Market-to-book
			Indonesia		
Connected	4.26	–1.56	–5.21	–10.32	–0.18
	(6.08)	(6.49)	(7.28)	(7.10)	(0.14)
R^2 adj.; N. Obs.	0.07; 116	<0; 66	<0; 106	0.07; 115	0.28; 116
			Italy		
Connected	–11.15 [b]	–3.99	3.89	–1.54	–0.52
	(5.47)	(3.52)	(5.55)	(2.61)	(0.43)
R^2 adj.; N. Obs.	0.23: 178	<0; 149	0.04; 178	0.18; 173	0.16; 178
			Japan		
Connected	0.59	–4.08	2.18	–0.02	0.24
	(4.78)	(2.62)	(1.65)	(2.54)	(0.15)
R^2 adj.; N. Obs.	0.02; 2,322	0.01; 1,786	0.16; 2,322	0.03; 2,314	0.10; 2,322
			Malaysia		
Connected	12.31 [a]	–0.79	1.52	–3.80	0.19
	(2.92)	(2.55)	(3.31)	(4.52)	(0.77)
R^2 adj.; N. Obs.	0.05; 418	0.06; 300	0.07; 418	0.01; 391	0.04; 418
			Russia		
Connected	9.79 [a]	–73.27 [b]	88.32 [a]	–7.48 [c]	0.61
	(2.26)	(31.26)	(30.92)	(2.21)	(1.18)
R^2 adj.; N. Obs.	0.47; 11	0.19; 8	0.08; 11	0.58; 6	0.24; 11
			Thailand		
Connected	20.44 [a]	–3.40	–9.20 [b]	–24.65 [a]	–0.06
	(7.53)	(5.38)	(4.39)	(8.83)	(0.24)
R^2 adj.; N. Obs.	0.07; 204	<0; 119	0.27; 204	0.02; 204	0.03; 204
			U.K.		
Connected	3.55	–1.48	2.35	–5.28	–0.70 [b]
	(2.37)	(1.16)	(1.74)	(4.28)	(0.34)
R^2 adj.; N. Obs.	0.05; 1,417	0.04; 1,200	0.15; 1,416	0.03; 1,367	0.04; 1,417
Estim. technique	Tobit	Tobit	Tobit	OLS	OLS

Table VI: The Effect of Corruption Level in a Country: Interaction of Corruption and Connection Types.

Each panel shows results for the comparison of a different set of connection types, and each column shows results for a set of regressions that include one variable of interest. All regressions control for whether the firm is politically connected, has recently been privatized, is state-controlled, dually listed, as well as for firm size (ln{*mkcap*}). Leverage, Tax, ROE, and Stock return regressions include country and industry dummies. Industry is defined according to Campbell (1996). Coefficients for these control variables are not reported to save space. *Leverage* is defined as long-term debt (excluding the current portion of long-term debt, pensions, deferred taxes, and minority interest) over total capital × 100. Total capital represents the total investment in the company: the sum of common equity, preferred stock, minority interests, long-term debt, non-equity reserves, and deferred tax liability in untaxed reserves. *Tax* is income taxes over pretax income × 100. *Market share* is firm's market capitalization over the total market capitalization of all firms in the same country and two-digit SIC industry (%). *ROE* is computed as [(Net income before preferred dividends – preferred dividend requirement) / last year's common equity] × 100. *Market-to-book* is the ratio of the market values of ordinary and preferred equity plus the book value of debt, to the sum of book value of equity and book value of debt. *Connected* is a dummy that equals 1 if the a company's major shareholder (≥10% of voting shares) or top executive is king or president of the country, minister, member of parliament, or is closely related to a top politician/political party. *Ave. Corruption* is the average of four indexes used elsewhere as measures of perceived corruption: the Business International index, the International Country Risk index, the Kaufmann, Kraay and Zoido-Lobatón index (http://www.worldbank.org/wbi/governance/datasets.html#dataset), and Transparency International index (www.transparency.org). Corruption indexes are rescaled from 0 to 10, so that lower scores correspond to lower levels of corruption. *Connected through the owner* is a dummy that equals 1 if a major owner sits in a national parliament, holds office in the government, is the head of state, or is closely related to a top politician/political party, and is 0 otherwise. *Connected through a director* is a dummy that equals 1 if a company's top executive sits in a national parliament, holds office in the government, is the head of state, or is closely related to a top politician/political party, and 0 is otherwise. *Connected with king, president or minister* is a dummy that equals 1 if a controlling shareholder or top executive of the company holds a government office, or is king/president of the country, and is 0 otherwise. *Connected with MP* is a dummy that equals 1 if a controlling shareholder or top director of the company sits in a national parliament, and is 0 otherwise. *Close relationships* is a dummy that equals 1 if a controlling shareholder or top executive of a company is closely related to at least one top politician, and is 0 otherwise. Close relationships include: (i) friendship, (ii) former heads of state or prime ministers (and their relatives), (iii) directorships covered by current politicians in 1997, who recently left the firm, (iv) connections with foreign politicians, and (v) well-known cases of relationships with political parties. Standard errors (reported in parentheses below the coefficients) are computed using Huber/White correction for heteroskedasticity (see White, 1980). [a], [b], [c] indicates that the value is significantly different from zero at the .01, .05, and .10 levels respectively.

	Leverage	Tax	Market share	ROE	Market-to-book
Panel A: General results					
Connected	–4.36 [b]	–1.37	–1.46	5.54 [b]	–0.05
	(2.14)	(1.44)	(2.03)	(2.37)	(0.55)
Connected × Ave. Corruption	2.04 [a]	–0.45	2.58 [a]	–2.99 [a]	–0.36
	(0.66)	(0.52)	(0.61)	(0.77)	(0.37)
Panel B: Director vs. shareholder connection					
Connected through the owner	–13.46 [a]	–0.34	1.22	10.87 [b]	0.19
	(4.00)	(3.18)	(4.38)	(4.73)	(0.77)
Connected through a director	–0.85	–2.55	–1.71	2.59	–0.08
	(2.63)	(1.72)	(2.43)	(2.83)	(0.52)
Connected through the owner × Ave. Corruption	3.54 [a]	–0.80	2.33 [b]	–3.90 [a]	–0.36
	(0.96)	(0.81)	(0.98)	(1.15)	(0.35)
Connected through a director × Ave. Corruption	0.95	0.52	1.85 [c]	–1.57	–0.35
	(1.15)	(0.86)	(0.98)	(1.13)	(0.33)

Table VI: Differences Across Countries (Cont'd).

	Leverage	Tax	Market share	ROE	Market-to-book
Panel C: Connections with members of parliament vs. connections with ministers					
Connected with king, president, or minister	–16.72 [b]	1.98	–0.80	2.19	0.98
	(7.95)	(5.17)	(7.12)	(6.31)	(1.31)
Connected with MP	–1.37	–2.32	–1.24	5.22 [c]	–0.09
	(2.81)	(1.76)	(2.30)	(2.96)	(0.57)
Close relationships	–7.95	–0.18	4.65	5.52	0.06
	(5.06)	(4.62)	(6.82)	(6.38)	(0.90)
Connected with king, president, or minister × Ave. Corruption	4.24 [a]	–1.38	1.94	–2.52	–0.48
	(1.56)	(1.07)	(1.48)	(1.68)	(0.42)
Connected with MP × Ave. Corruption	0.89	0.03	1.71 [c]	–2.54 [b]	–0.40
	(1.29)	(0.90)	(0.90)	(1.17)	(0.37)
Close relationships × Ave. Corruption	2.78 [b]	–0.63	2.13	–3.10 [b]	–0.39
	(1.23)	(1.18)	(1.47)	(1.39)	(0.36)
Memo items					
N. Obs. Panels A–C	16,138	12,304	16,147	16,190	16,143
Country dummies	Yes	Yes	No	Yes	Yes
Industry dummies	Yes	Yes	No	Yes	Yes
Estimation technique	Tobit	Tobit	Tobit	OLS	OLS

Table VII: Robustness Tests.

Panels report regressions that test for the influence of a particular group within the sample, and each column shows results for a set of regressions that include one variable of interest. Generally, all regressions control for whether the firm is politically connected, has recently been privatized, is state-controlled, dually listed, as well as for firm size (ln{*mkcap*}). However, the regressions in Panel E do not control for whether the firm has recently been privatized or is state-controlled. The regressions for *Leverage*, *Tax*, *ROE*, and *Market-to-book* include country and industry dummies. Industry is defined according to Campbell (1996). Coefficients for these control variables are not reported to save space. *Leverage* is defined as long-term debt (excluding the current portion of long-term debt, pensions, deferred taxes, and minority interest) over total capital × 100. Total capital represents the total investment in the company: the sum of common equity, preferred stock, minority interests, long-term debt, non-equity reserves, and deferred tax liability in untaxed reserves. *Tax* is income taxes over pretax income × 100. *Market share* is firm's market capitalization over the total market capitalization of all firms in the same country and two-digit SIC industry (%). *ROE* is computed as [(Net income before preferred dividends – preferred dividend requirement) / last year's common equity] × 100. *Market-to-book* is the ratio of the market values of ordinary and preferred equity plus the book value of debt, to the sum of book value of equity and book value of debt. *Connected* is a dummy that equals 1 if the a company's major shareholder (≥10% of voting shares) or top executive is king or president of the country, minister, member of parliament, or is closely related to a top politician/political party. Standard errors (reported in parentheses below the coefficients) are computed using Huber/White correction for heteroskedasticity (see White, 1980). [a], [b], [c] indicates that the value is significantly different from zero at the .01, .05, and .10 levels respectively.

	Leverage	Tax	Market share	ROE	Market-to-book
Panel A: Countries with corruption above the sample median					
Connected	5.35 [a]	–2.37	3.90 [b]	–5.25 [b]	–0.67
	(1.89)	(1.50)	(1.78)	(2.09)	(0.63)
R^2 adj.; N. Obs.	NA; 5,241	NA; 3,927	0.03; 5,244	0.21; 5,084	0.02; 5,242
Panel B: Countries with corruption equal or below the sample median					
Connected	1.69	0.68	5.22 [a]	–5.14 [b]	–0.47 [b]
	(1.72)	(1.00)	(1.64)	(2.12)	(0.20)
R^2 adj.; N. Obs.	NA; 10,897	NA; 8,377	0.02; 10,903	0.06; 10,310	<0; 10,901
Panel C: All countries except Malaysia and Indonesia					
Connected	2.73 [c]	–0.11	5.11 [a]	–5.19 [a]	–0.64 [b]
	(1.46)	(0.92)	(1.34)	(1.56)	(0.30)
R^2 adj.; N. Obs.	NA; 15,604	NA; 11,938	0.01; 15,613	0.07; 14,888	0.01; 15,609
Panel D: All industries except financial services (SIC: 6000-6999)					
Connected	2.69 [b]	–1.25	8.02 [a]	–4.74 [a]	–0.55
	(1.37)	(1.03)	(1.57)	(1.79)	(0.43)
R^2 adj.; N. Obs.	NA; 12,887	NA; 9,548	0.02; 12,893	0.08; 12,280	0.03; 12,891
Panel E: All companies except government-controlled and privatized firms					
Connected	3.49 [a]	–0.41	6.12 [a]	–5.41 [a]	–0.57
	(1.36)	(0.93)	(1.24)	(1.61)	(0.35)
R^2 adj.; N. Obs.	NA; 15,395	NA; 11,692	<0; 15,404	0.07; 14,658	0.02; 15,400
Panel F: Dependent variable truncated at the 5th and 95th percentiles					
Connected	1.84 [c]	–0.08	4.73 [a]	–1.35 [b]	–0.06
	(1.11)	(0.69)	(0.70)	(0.68)	(0.04)
R^2 adj.; N. Obs.	NA; 13,288	NA; 11,272	0.05; 14,572	0.18; 13,852	0.27; 14,501
Country dummies	Yes	Yes	No	Yes	Yes
Industry dummies	Yes	Yes	No	Yes	Yes
Estim. technique	Tobit	Tobit	Tobit	OLS	OLS

Table VIII: Connections with Politicians having Longer and Shorter Tenure in Politics

All regressions control for whether the firm is politically connected, has recently been privatized, is state-controlled, dually listed, as well as for firm size (ln{*mkcap*}). *Leverage*, and *Tax* regressions include country and industry dummies. Industry is defined according to Campbell (1996). Coefficients for control variables are not reported to save space. *Leverage* is defined as long-term debt (excluding the current portion of long-term debt, pensions, deferred taxes, and minority interest) over total capital × 100. Total capital represents the total investment in the company: the sum of common equity, preferred stock, minority interests, long-term debt, non-equity reserves, and deferred tax liability in untaxed reserves. *Tax* is income taxes over pretax income × 100. *Market share* is firm's market capitalization over the total market capitalization of all firms in the same country and two-digit SIC industry (%). *Connected* is a dummy that equals 1 if the a company's major shareholder (≥10% of voting shares) or top executive is king or president of the country, minister, member of parliament, or is closely related to a top politician/political party. Standard errors (reported in parentheses below the coefficients) are computed using Huber/White correction for heteroskedasticity (see White, 1980). [a], [b], [c] indicates that the value is significantly different from zero at the .01, .05, and .10 levels respectively.

	Leverage	Tax	Market share
Connected with seasoned politician	4.21 [b]	–2.96 [c]	9.29 [a]
	(2.08)	(1.69)	(2.14)
Connected with unseasoned politician	4.34 [b]	1.11	5.25 [a]
	(2.00)	(1.18)	(1.85)
Memo items			
N. Obs.	16,138	12,304	16,147
Country dummies	Yes	Yes	No
Industry dummies	Yes	Yes	No
Estimation technique	Tobit	Tobit	Tobit