

The Trinity Effect of Corporate-Political-Banking relationship over Debt Structure: Evidence from India

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Abstract

Using a unique dataset on corporate-political connections based on campaign contributions to political parties in India for the period 2003-2016, we show that strong static (as compared to strong dynamic, weak, weak static or weak dynamic) corporate-political connections positively explain the debt structure of firms. Further, GOBs are used as a discretion to award long-term loans at lower interest rates. This highlights the possible inefficiency of GOBs in the country as the political connections alone do not explain the effect on debt structure. We also include sector-specific developments.

1. Introduction

- Corporate-Political-Banking relationship is a significant structural impediment in a country's financial development and hence economic growth.
- Though the idea has an established literature, [3] emphasized the weakness of cross-country studies as the nature of connections positively depends on the nation specific political system.
- The Economic Survey of India (2017-18) indicates an unprecedented rise in the corporate loan defaults and blamed the mid-2000s investment boom along with other factors.
- We set-up an empirical framework to study the trinity effect on Indian firms and filled the lacuna in Asian studies.
- Concerning debt structure, the study mainly focus on banking institutions as a major lender to firms in India[4].

2. Objective

1. Role of corporate-political connections in explaining the debt structure of Indian firms.
2. Different categories of these connections (weak or strong; persisting or dynamic) help explain the role of banks in providing easy loans to politically connected firms (PCFs).
3. Whether banks provide long-term credit to the firms without any cherry-picking on their political connections?
4. Corporate-Political-GOB trinity may help decipher the underlying reasons for high corporate loan defaults and the Twin-Balance Sheet (TBS) problem in the country.
5. Understanding the sector specific trinity effect. Do some sectors outperform the default as compared to others?

3. Data and Research design

Multiple Sources: Election Commission of India (campaign contributions to Political Parties i.e. BJP & INC), CMIE Prowess IQ, Thomson Reuters Datastream.

Sample & Period: S&P BSE500 firms excluding financial firms (418) from 2003 to 2016.

Variable Construction

Persisting Corporate-Political Connections: At least once the firm or any of its subsidiary contributed to a national party, not connected otherwise.

Dynamic Corporate-Political Connections: If a firm monetarily contributes to any of the national political parties in a particular year, not connected otherwise.

Strength Effect: On the lines of [1] firms contributing to a single party are weakly connected where as those contributing to multiple parties are strongly connected.

Corporate-Banking Relationship: Generate a score variable for each firm's banking relationship for each year. Figure 1 shows a higher preference of strong PCFs for GOBs.

Debt Structure: Following [2] constructs two forms of debt i.e. book & market.

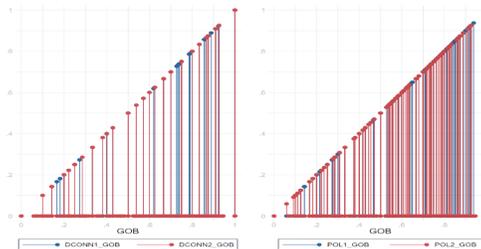


Figure 1: Interaction of Dynamic and Persisting political connections with GOBs

Empirical Strategy

$$DEBT_{it} = \gamma + \beta_0 DEBT_{it-1} + \beta_1 POL + \beta_2 Firm_Factors + \beta_3 Country_Factors + \alpha_k + \alpha_t + \varepsilon_{ijt}$$

Further includes the strength and POL-GOB relationship in the specification. Beside the OLS technique the study also uses two-step robust GMM approach as a robustness check.

4. Results & Extensions

Table 1: GMM results of debt structure with Strength and GOB channel

VARIABLES	LTD.BV	LTD.MV	LTD.BV	LTD.MV
GOB	-0.651 (1.223)	-0.294 (1.085)	-0.0447 (0.571)	-0.514 (0.802)
DCONN.ONE	0.404 (0.822)	0.339 (0.853)		
DCONN.BOTH	-1.522# (0.966)	-1.635* (0.959)		
DCONN1.GOB	-0.820 (0.958)	-0.583 (1.077)		
DCONN2.GOB	2.380* (1.365)	2.422* (1.364)		
POL.ONE			0.172 (0.617)	0.528 (0.519)
POL.BOTH			0.842 (0.550)	0.440 (0.550)
POL1.GOB			1.372 (1.143)	0.602 (0.807)
POL2.GOB			2.346** (1.010)	1.306# (0.896)

- The results remain insignificant for PoBs.

Table 2: Summarized

	LTD (BV & MV)	LTD (BV & MV)
Dynamic WPCs	INSGF	INSGF
Dynamic SPCs	Pos. SGF	Neg. SGF
Persisting WPCs	INSGF	INSGF
Persisting SPCs	Pos. SGF	INSGF
Dynamic WPC*GOB		INSGF
Dynamic SPC*GOB		Pos. SGF
Persisting WPC*GOB		INSGF
Persisting SPC*GOB		Pos. SGF

Extensions

Table 3: Competency Analysis of GOBs

VARIABLES	INT EXP	RLD	PRV BD
DCONN.ONE	0.119 (0.442)	-0.536 (0.581)	-0.884 (0.641)
DCONN.BOTH	0.511*** (0.193)	1.448*** (0.479)	0.541* (0.307)
GOB	-0.0145 (0.127)	0.501** (0.251)	-0.246 (0.190)
DCONN1.GOB	-0.500 (0.722)	1.291 (0.837)	0.488 (1.050)
DCONN2.GOB	-1.014** (0.432)	-2.207*** (0.824)	-0.659 (0.854)

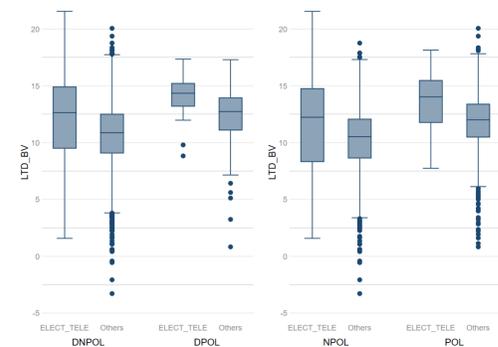


Figure 2: Electronic and Telecommunication Sector

5. Conclusion

- Only strong political connections have a significant effect with higher returns for persisting connections in comparison to dynamic ones.
- The efficiency of GOBs is significantly affected by their favoritism towards PCFs.
- Further, find a support to the inefficiency of GOBs particularly for the Electronics and Telecommunication sectors.

6. Forthcoming Research

We are developing a fraud risk mitigation mechanism. The study will discover the relationship between firms political connections and their financial reporting standards (FRS).

References

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