Political connections, media monitoring and long-term loans

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A B S T R A C T
We analyze data on Chinese non-state-listed firms and find that it is easier for firms with political connections to obtain long-term loans with extended debt maturities than it is for firms without political connections. Our investigation indicates that this phenomenon is significantly less common with increased media monitoring. Houston et al. (2011) find strong evidence that the state ownership of media is associated with higher levels of bank corruption in China, but our study shows that, to a certain extent, media monitoring can curb corruption.

C

Some researchers have found that non-state-owned firms with political connections can secure preferential access to financing and tax breaks (e.g. Johnson and Mitton, 2003; Claessens et al., 2008; Li et al., 2008; Luo and Zhen, 2008; Wang and Wang, 2013; Yu and Pan, 2008). Yet there are also disadvantages to firms setting up political connections. Some empirical studies have shown that political connections may improve or reduce firm value and performance (Liu et al., 2010). For example, Fisman (2001), Johnson and Mitton (2003), and Faccio and Parsley (2009) find that political connections can improve firm performance and value. However, other studies come to the opposite conclusion, such as Fan et al. (2007), who find that the accounting and market performance of firms with political connections are significantly lower than those of other firms after initial public offerings (IPOs), due to a lack of managerial capabilities. Thus, further study is clearly needed to determine why these empirical results diverge and to identify the internal mechanisms of political connections that affect firms.

F

There are at least two theories that can explain the existence and mechanisms of political connections. First, reputation theory emphasizes the importance of relationships, using a reputation enhancement argument that suggests that the political connections of firm executives serve as an alternative channel for establishing firm reputation when quality disclosure is absent (Sun et al., 2005; Yu and Pan, 2008). Second, rent-seeking theory also explains political connections by arguing that firms use them to engage in activities that influence the government's approval decisions and government officials then show partiality to firms whose executives promise these officials personal favors. In other words, the approval decision process is influenced by officials desire to seek rents (e.g., Fan et al., 2007). Which theory more effectively explains the existence and mechanisms of political connections in the Chinese stock market? In this study, we attempt to answer this question from a media monitoring perspective.

B

Due to ideological factors and compared with state-owned firms, non-state-owned firms face unfair market conditions, also known as "tilted playing field" problems. The constraints on non-state-owned firm development mainly include legal obstacles, government intervention or administration and financing difficulties (Bai et al., 2003). Another problem for non-state-owned listed firms is related to stock market development. The Chinese stock market is a burgeoning traditional planned economy and socialist market economic system pursuing state-owned enterprise (SOE) reform. The central and local governments have rapidly recognized the stock market's potential to facilitate SOE reform. In the early 1990s, the stock market's SOE reform burden was the result of the SOEs general inefficiency, which led to the stock-issuing system and the complication of SOE reforms. This indicates that SOEs inevitably dominate the Chinese stock market. Although non-SOEs can list through mergers and acquisitions (M&A) and management buyout (MBO) markets, SOEs still dominate the stock market because the M&A and MBO markets are largely controlled by governments and SOEs. Thus, the majority of Chinese listed firms are ultimately under government control (Liu et al., 2003). Hence, non-state-owned listed firms naturally face tilted playing field problems such as those listed below.

E

First, there are several legal and administrative barriers for non-state-owned listed firms. According to Chen et al. (2008), the proportion of non-state-owned listed firms is less than 20% in high-barrier industries such as automotive, marine and road and rail transportation—far below the proportion of SOEs. The proportion of non-state-owned listed firms in moderate- and low-barrier industries is about 30–50% and/or exceeds that of SOEs, respectively. These results reflect the ubiquity of barriers, such as legal and administrative, for non-state-owned listed firms in high-barrier industries.

A

Second, non-state-owned listed firms in China are developing serious financing difficulties in that they are unable to gain adequate external financing in the stock market or from the banking system, the latter of which exhibits credit discrimination. Banks, especially those that are state-owned, prefer to provide loans to SOEs rather than to non-state-owned listed firms. In the past 10 years, while non-state-owned firms contribution to Chinese GDP exceeded 70%, they obtained less than 20% of the bank loans (Lu and Yao, 2004). On the stock market, in the early 1990s, non-state-owned firms could not easily achieve listing directly through IPOs due to the stock market's burden in serving the SOE reform. Given the reform, some non-state-owned firms had to initially list through the takeover market or buy shell resources from SOEs, but the quality of such resources was typically low because SOEs and governments preferred not to sell high-quality shell resources (Wang et al., 2001). These details explain why non-state-owned listed firms profitability is generally not as good as that of SOEs, despite the former's superior system design, corporate government and ownership structure. Gaining a low-quality shell does not solve non-state-owned listed firms financing problems, and neither does equity refinancing, according to Chen et al. (2008), due to low benefits and government intervention.

D

Given non-state-owned listed firms tilted playing field problems, they should use the following measures to avoid constraints. First, they should seek political connections to avoid the negative effects of laws and governmental regulations (Fan et al., 2007). Second, they should solve their financing difficulties through political connections and the leakage effect to seek informal financial support (Lu and Yao, 2004; Yu and Pan, 2008).

IN GROUPS, ANSWER THESE QUESTIONS:

1. Who are the authors of this article? Where and when was it published? What are the key words?

2. What is the purpose of this study?

3. What are the theories explaining the existence of political connections? Describe them in your own words.

4. What should companies do in order to avoid problems with financing?

5. Write an APA reference for this article.

MULTIPLE CHOICE AND OPEN-ENDED QUESTIONS (10 questions, 2 points each)

1. According to the study of Fan et al. (2007), why is the performance of companies with connections lower?
    a) They have chosen the wrong connections.
    b) Their managers are not very good.
    c) They do not get enough funding.
    d) Their advertising is ineffective.
2. What is the meaning of the phrase 'officials then show partiality to firms' in the second paragraph?
    a) Officials hate these companies.
    b) Officials close these companies down.
    c) Officials support these companies.
    d) Officials take over these companies.
3. What are some of the difficulties that non-state-owned companies face?
    a) problems with laws and money
    b) problems with dissatisfied employees
    c) problems with a low number of customers
    d) problems with production of goods
4. Which one of these is included among the high-barrier industries?
    a) mobile phone production
    b) car production
    c) food production
    d) clothes production
5. Who are banks more likely to provide with loans?
    a) companies with political connections
    b) companies without political connections
    c) both equally
    d) neither
6. **In your own words**, explain how the mechanism of political connections works.

7. **In your own words**, explain the expression 'tilted playing field'.

8. **In your own words**, explain the problems faced by companies without connections.

9. **In your own words**, explain what companies without connections should do.

10. **In your own words**, describe how this article may be useful.