

DOI: <https://doi.org/10.30525/978-9934-26-296-8-7>

**THE INFLUENCE OF POLITICAL CONNECTIONS
ON THE INTERNATIONAL INVESTMENT ACTIVITIES
OF CHINESE COMPANIES UNDER DEPENDENCE
ON EXTERNAL FINANCING**

The specific institutional environment dictates the fact that enterprises with political connections are more likely to receive favorable conditions from the government and state-owned banks. Research shows that the government-business nexus is widespread throughout the world and is particularly important for enterprises in transition economies, mainly because of their weak institutional environment. H. Li et al. [11] argue that a poorly functioning market economy and a weak legal system are the main reasons why political connections are valuable for businesses in transition economies. Also A. Khwaja and A. Mian [2], C. Bai et al. [3] found a positive connection between the company's proximity to the authorities and the favorable conditions that the company receives from state banks.

We will analyze whether political connections matter more for the enterprise's implementation of outward foreign direct investment (OFDI) when the enterprise's dependence on external financing is stronger. It is difficult to determine the actual dependence of the enterprise on external financing. Even if data were available on the number of rejections that each enterprise receives when applying for a loan, these data would probably be distorted, due to the influence of political connections and the quality of the institutional environment. This statement is especially true for developing countries with weak financial markets. In such countries, dependence on external financing is more likely to be internally determined by specific institutional characteristics, rather than by industry-specific technological characteristics, as in developed countries (e.g., the USA). In China, the number of actual bank loans received by enterprises already reflects the benefits of political connections, and therefore cannot be a measure of real financing needs. Accordingly, it is necessary to identify mechanisms that will allow measuring dependence on external financing.

As R. Rajan and J. Zingales discovered [4], in a perfect capital market, the supply of external financing, according to the assumptions, is perfectly elastic, so the enterprise's dependence on external financing reflects the enterprise's need for capital. According to the mentioned study, the amount

of initial investment, periods of cash flow, and the need for further investments differ, depending on the industry in which the enterprise operates, that is, they are determined by technological characteristics specific to a certain industry.

In our study, we used the calculations of Rajan and Zingales and used them as a conditional indicator of the real needs of Chinese enterprises in external financing. We then used a discrete survival model using complementary double-log regression.

$$p_{it} = 1 - \exp [- \exp (\alpha_1 + \beta_1 TPF_{it} + \beta_2 politicalconnection_{it} + \beta_3 firmkl_{it} + \beta_4 age_{it} + \beta_5 edu_{it} + \beta_6 financing)]$$

The results of the analysis are presented in table 1.

These results prove that the indicator of the interaction effect of political connections and dependence on external financing has the expected positive sign, regardless of the way political connections are measured. The interaction effect is significant at the 1% level when political connections are measured by the percentage of directors with political experience, and at the 5% level for the other three measures, but not significant for the other options. The positive and significant coefficient of the interaction effect indicator proves that the influence of political connections on the probability of a firm's transformation into a multinational enterprise (MNE) is greater for companies with a high dependence on external financing.

For example, when political connections are measured as the sum of the number of directors with political experience, for a company with an average value of dependence on external financing (which is equal to 0.415), an additional director with political connections on the board increases the probability of conversion to a new MNE by 36.3 %. For firms with a high dependence on external financing (which is 0.77), an additional director with political connections increases the chance of first OFDI by 72%, *ceteris paribus*. Accordingly, if political connections are measured as the weighted sum of the number of directors with political connections, then for the average level of dependence, the growth of a director by one level in the political hierarchy increases the chance of making the first OFDI by 17.2%, and with a strong dependence on external financing, this indicator is 31%.

It is worth noting that the influence of political connections on the probability of OFDI is minimal when the firm's dependence on external financing is zero, regardless of the way political connections are measured. For example, for political connections measured by the number of directors with political experience, if dependence on external financing is zero, then an additional director with political connections increases the probability of the first OFDI by only 4%. This result shows that when the company has significant financial resources to make its investments, political connections are no longer so important. Accordingly, this result confirms the thesis about the financial channel through which political connections affect OFDI.

Table 1

Political connections and dependence on external funding

Event: transformation into a new MNE	Expected sign	1 (amount)		2 (weighted amount)		3 (percentage)		4 (weighted percentage)		5 (dummy variable)	
		coef.	SE	coef	SE	coef	SE	coef	SE	coef	SE
log TPF	+	0.53***	0.14	0.52***	0.14	0.53***	0.14	0.53***	0.15	0.52***	0.14
indicator of political connections	+	0.04	0.15	0.03	0.07	0.01	0.03	0.01	0.02	-0.31	0.43
the interaction of political connections and the need for external financing	+	0.65**	0.29	0.31**	0.14	0.08***	0.06	0.04	0.03	1.71***	0.76
average level of education	+	0.72**	0.34	0.73**	0.34	0.72**	0.34	0.73**	0.34	0.72**	0.34
average age	+	-0.008	0.05	-0.01	0.05	-0.002	0.05	-0.006	0.05	0.01	0.05
log capital-labor ratio	+/-	-0.05	0.25	-0.04	0.25	-0.03	0.24	-0.03	0.24	0.01	0.22
industry fixed effect		Yes		Yes		Yes		Yes		Yes	
location fixed effects		Yes		Yes		Yes		Yes		Yes	
Number of observations		1915		1915		1915		1915		1915	
Log pseudolikelihood		-327.13		-326.01		-328.9		-328.12		-328.2	

Note: ***, ** and * represent significance level at 1%, 5% and 10% respectively

In general, our analysis proved that the influence of political connections on the probability of conversion to a new MNE is greater in the case of limited liquidity, which arises both from the underdevelopment of the financial market in China and from the specific financial needs of the enterprise for a certain industry.

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