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Political connections, media monitoring and long-term loans[☆]

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ABSTRACT

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.

1. Introduction

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

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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.

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. Based on the extant research, we investigate how media monitoring affects the relationship between political connections and long-term loans. We anticipate that firms with political connections can more easily obtain long-term loans with extended debt maturities. On the surface, the phenomenon can be explained by both theories, so determining which is more significant requires deeper study. If the reputation theory is more significant, then we would expect the relationship between political connections and long-term loans to be reinforced by improved media monitoring, because firms' reputations can be strengthened by media exposure. If the rent-seeking theory is more significant, we expect the relationship to be reduced by improved media monitoring because most rent-seeking behavior is unlawful and irrational, and thus the role of political connections should be weakened by media exposure.

Using data for Chinese non-state-owned listed firms from 2006 to 2012, we find that firms with political connections have easier access to long-term loans with extended debt maturities. This result suggests that political connections facilitate firms' financing. We also find that the relationship between political connections and long-term loans is significantly reduced with improved media monitoring. Overall, our findings support the rent-seeking theory.

This study contributes to the literature in several ways. First, previous studies have not distinguished between these two theories, such that research based on one cannot exclude the other. This study differentiates between these two theories and analyzes which is better suited to the Chinese stock market. Second, the role of the media in China is highly suspect due to a higher degree of government intervention. Houston et al. (2011) note a strong correlation between state-funded media and banking corruption. According to their study, it is difficult for the Chinese media to play a role in suppressing corruption, but we observe that it can play an important role in inhibiting rent-seeking, which can be explained by the market-oriented media reform of recent years. Our empirical evidence therefore provides some support for the role of the media in China, which subsequent studies can further investigate.

2. Institutional background, theoretical analysis and hypothesis development

2.1. Institutional background

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