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Political connections and operational performance of non-financial firms: New evidence from Poland



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ABSTRACT

This study analyses the impact of political connections on the operational performance of non-financial firms in Poland. Using a data set covering the 2001–2011 period, we find that political connections lower firm profitability, as measured on the level of income from sales. The negative impact is the strongest when a firm possesses multiple connections, has politically connected members on its supervisory board, or employs ex-politicians with central government experience. Therefore, our findings do not support claims based on resource dependence theory. The Polish market's specificity is most likely related to the instability of the political scene.

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1. Introduction

Anecdotal evidence suggests that ties between politics and business are strong in Central Europe.¹ Surprisingly, to the best of our knowledge, little research has analysed the consequences of non-financial firms hiring ex-politicians in this region. The literature on this issue uses mainly data from China, other Asian economies, the United States, and developed European countries. The findings for these markets, however relevant, are not directly applicable to Central European economies, which are unique for three reasons. First, Central European economies underwent deep market-oriented transformation in the 1990s (Kołodko, 2009), which included extensive privatisation programmes (Megginson, 2005; Claessens and Djankov, 2002). Second, several Central European countries joined the European Union in 2004 or 2007, thoroughly modernised their institutions during the accession process, and attempted to integrate their financial systems with the leading European economies (Pungulescu, 2013). Third, the political scene in Central Europe was much less stable during 1990s and 2000s than that in, for example, China, the United States, or western European countries.

In this study, we assess the impact of political connections on the operational performance of non-financial firms. We choose operational performance as the main subject of our research because it summarises the influence of political factors through different channels. Thus, establishing the net impact of political connections on operational performance helps us to answer more fundamental questions, such as why firms invest in political connections and whether political connections create an uneven playing field. Our empirical evidence is based on data from the Polish market. However, we believe that our results have wider appeal. We believe that our results are applicable to the other Central European countries that have joined the EU and, to some extent, to non-European emerging markets that are characterised, similar to Poland, by the co-existence of a democratic political system and moderate political instability.

Political connections may affect firms' performance through several channels. The net impact of political factors is theoretically ambiguous. On the one hand, the literature suggests that political connections increase the risk of diverting a firm's resources to political goals (Bertrand et al., 2009) and that they weaken the control functions of the board (You and Du, 2012). On the other hand, political connections may, as suggested by Pfeffer and Salancik's (1978) resource dependence theory, facilitate access to bank financing (Faccio, 2006, 2010; Boubakri et al., 2012a; Chen et al., 2014), lower the cost of equity (Boubakri et al., 2012b), and improve firms' chance of obtaining government contracts (Goldman et al., 2013; Tahoun, 2014) or subsidies (Wu and Cheng, 2011). Therefore, in our opinion, the issue of the relative performance of politically connected companies constitutes suitable material for empirical research, especially in the case of Central European countries, which differ from both developed and non-European emerging economies.

To assess the effect of political connections on operational performance, we gathered a new and hand-collected data set. This data set includes financial information on 316 non-financial companies that were listed on Warsaw Stock Exchange for the 2001–2011 period, the names of supervisory and management board members, and detailed information on their political past. During the sample period, 105 listed non-financial firms in Poland (33.2% of the sample) were politically connected.

Our empirical evidence does not support predictions based on resource dependence theory. Regardless of the method that was used, we found almost no evidence that hiring ex-politicians facilitated access to valuable resources and increased the operational performance of Polish non-financial firms. Therefore, the improved operational results apparently did not constitute a rationale underlying the creation of political connections—at least if we assume that firms do not repeatedly overvalue political ties. Some of our

¹ In Poland, for which we have an extensive database on political connections, three prime ministers and seven finance ministers from the post-Communist era became members of the supervisory or management boards of listed firms between 2001 and 2011. Politically connected firms are also present in other Central European economies. For example, in 2008, *Mlada Fronta Dnes*—the Czech daily newspaper—published a list of high and low ranking politicians who were also members of companies' boards (BBC Monitoring European, 2008). This list included the former Deputy Prime Minister and Minister of Finance for the 1992–1997 period, who subsequently was the chairman or vice chairman of the boards of leading Czech insurance, petrol, and airline companies. The former Hungarian Finance Minister (1998–2000) and Governor of the central bank (2001–2007) was also the chairman of the supervisory board of an insurance company as well as a member of the board of directors for an oil and gas group. The former Slovak Minister of Economy (1992–1993 and 1998–1999) became, from 2000 onwards, the chairman of the board of directors for an investing company that manages and administrates a group of industrial companies in this country. The former Romanian Economic Domain Minister (2005–2006) and Minister of Finance (2008–2009) held high positions in investment and banking firms. The former Bulgarian Minister of Finance (1995–1997) since 2000 has held several top managerial jobs in commercial and investment banks.

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