Journal of Corporate Finance 41 (2016) 179–200

Contents lists available at ScienceDirect

Journal of Corporate Finance

journal homepage: www.elsevier.com/locate/jcorpfin

Managerial professional connections versus political connections: Evidence from firms' access to informal financing resources☆

Qigui Liu [a], Jinbo Luo [b], Gary Gang Tian [c,*]

[a] School of Management, Zhejiang University, Xihu District, Hangzhou, Zhejiang, 310058, China
[b] School of Accounting, Jiangxi University of Finance and Economics, China
[c] Department of Applied Finance and Actuarial Studies, Macquarie University, 2109, Australia

ARTICLE INFO

Article history:
Received 6 April 2016
Received in revised form 12 September 2016
Accepted 13 September 2016
Available online 16 September 2016

JEL classifications:
G32
G34

Keywords:
Trade credit
Managerial professional connections
Political connections
Informal financing

ABSTRACT

This study investigates how managerial professional connections, through executives' membership of an industry association, play a role in helping firms obtain trade credit, while political connections do not. We document that firms whose managers have professional connections receive more trade credit, especially in firms that are not controlled by the state (non-SOEs), which have limited access to formal financial resources. The business environment, for example, low social trust and high product market competition, also strengthen the positive relationship between managers' professional connections and firms' access to trade credit. We further provide evidence that directors' professional connections also bring firms more trade credit and that firms with professional connections make more use of financing component of trade credit and abnormal trade credit. Our results are robust to a series of robustness and endogeneity tests. Overall, we argue that managerial professional connections, other than political connections, help firms, especially those with limited access to formal financing, to obtain informal financing resources.

1. Introduction

One central element of corporate finance is firms' access to financial resources. As a major channel of informal financing for firms, trade credit has been widely documented to play an important role around the world (Rajan and Zingales, 1995; Kohler et al., 2000; Guariglia and Mateut, 2006), and it is even more important in emerging markets like China, where the formal

☆ We are grateful for the valuable comments received from Nuttawat Visaltanachoti, Nick Nguyen and participants of the seminar organized by Massey University Albany campus on 8 May 2015 and Southwestern University of Finance and Economics on 1 July 2016; and comments received from the participants from the IFABS 2016 Barcelona Conference, "Risk in Financial Markets and Institutions: New challenges, New solutions" Universitat Autònoma de Barcelona (UAB), Casa Convalescència, Barcelona, June 1–3, 2016 and Asian Finance Association 2016 Annual Meeting, Bangkok, June 26–28, 2016. All errors are our own.

* Corresponding author.
E-mail addresses: qigui@zju.edu.cn (Q. Liu), gaintheend@163.com (J. Luo), gary.tian@mq.edu.au (G.G. Tian).

http://dx.doi.org/10.1016/j.jcorpfin.2016.09.003
0929-1199/

financing market, such as the corporate bond market and the banking system, is not well developed, with the consequence that firms get limited access to formal financing channels (Ge and Qiu, 2007). Numerous existing studies have provided reasons/arguments why firms receive or grant trade credit,[1] and related empirical studies mainly link trade credit to other financial statement variables or characteristics of firms to find evidence to either support or reject those arguments.[2]

An increasing body of recent literature has begun to focus on how informal contracts and institutions, such as political connections and professional connections through business clubs, mitigate credit market frictions and facilitate firms' access to formal financial resources, such as bank loans and the equity market (Agrawal and Knoeber, 2001; Khwaja and Mian, 2005; Adhikari et al., 2006; Faccio, 2006; Faccio et al., 2006; Claessens et al., 2008; Le and Nguyen, 2009; Liu et al., 2013; Engelberg et al., 2012; Haselmann et al., 2013). It has been documented that asymmetric information and moral hazard problems are the major impediments to financial contracting because they create inefficiencies in the allocation of credit and raise the cost of providing credit (Haselmann et al., 2013). These frictions have a stronger influence on the supply of trade credit than on formal financing, such as bank loans, because suppliers take more risk in granting trade credit, as they neither charge any interest nor require any collateral or deposit (Wu et al., 2014).

However, one unexplored question is whether and how the supply of trade credit is influenced by informal contracts of managers, such as their social and political networks through business clubs and political connections. In this paper, we attempt to shed light on this question by linking managerial personal professional and political connections to firms' access to informal financial resources – trade credit. In order to do so, we identify an important type of managerial professional connection that has never been studied before, i.e., managers who have working experience, or currently work, as an executive member of an industry association. We expect that by being an executive member of an industry association, such professional connections help firms' top executives to establish a good professional reputation and thus signal that any corporate decisions and repayment commitments made by those connected executives are reliable and trustworthy, and this kind of reputation and trust helps firms to reduce the credit risk faced by firms which offer credit. Professional connections seem to be more relevant to firms' access to trade credit for the following reasons: First, unlike formal financing, informal financing is always reputation and relationship-based (Ayyagari et al., 2010), which means that it can be greatly influenced by firms' social capital, such as managerial social connections. In addition, like business clubs in western countries,[3] industry associations in China play an important social role, such as communication and collaboration between companies within the industry and with other related industries, which means that they enable the members, especially executive members, given that the duties of industry associations are conducted by the executive members, to build close social connections and managerial ties with other members. Such social connections and managerial ties have been identified as an important form of social capital for firms (Peng and Luo, 2000; Park and Luo, 2001; Luk et al., 2008; Haselmann et al., 2013) as they help executive members of associations to establish a better reputation and interpersonal trust with managers within the industry and related industries, such as upstream and downstream industries, which is vital to the supply of trade credit (Guiso et al., 2004; Wu et al., 2014). Furthermore, Wu et al. (2014) document that better regional social trust encourages firms to use trade credit. Thus we expect that interpersonal trust within an industry also plays an important role in helping firms to obtain external financial resources, and the role is more important for accessing trade credit than other forms of financial resources, given that trade credit is usually obtained from suppliers, who are usually from the same industry, or from upstream industries.

Political connections, on the other hand, have been widely documented to bring various benefits to firms in accessing formal financial resources, such as bank loans and equity issuing, through rent seeking from government regulations or government lobbying (Berkman et al., 2010; Chen et al., 2011; Liu et al., 2013). However, they may be less important for firms' access to trade credit because government's intervention into financing resources mainly focuses on the formal financing market rather than the trade credit market, which is to say, government is less likely to have a direct influence on individual firms' decisions on whether to provide trade credit and how much to provide. Therefore, in this paper we hypothesize that managerial professional connections through industry associations, rather than political connections, help firms to access trade credit, and we provide comprehensive evidence to support our hypothesis by investigating the effect of managerial professional and political connections on the trade credit of Chinese listed firms.

China is an ideal setting for our study for the following reasons: First of all, trade credit is more important in emerging markets such as China, where the formal financing markets, such as bank lending and the bonds market, are both poorly developed. And thus informal financing, such as trade credit, plays an even more important role in China than in the developed markets. Nevertheless, the Chinese economy is also characterized by a weak legal system that provides weak protection for creditors[4]

[1] They are based on information asymmetries (Smith, 1987; Biais and Gollier, 1997), discrimination arguments (Brennan et al., 1988), monitoring advantages (Jain, 2001; Mateut et al., 2006), insurance (Cunat, 2007), product quality (Lee and Stove, 1993; Long et al., 1993), bankruptcy (Frank and Maksimovic, 2005; Wilner, 2000), opportunistic behaviour (Burkart and Ellingsen, 2004), externalities (Daripa and Nilsen, 2005) and trade-off between inventories and trade credit (Bougheas et al., 2009).

[2] See, for example, Mian and Smith (1992), Rajan and Zingales (1995), Petersen and Rajan (1997), Ng et al. (1999), Demirguc-Kunt and Maksimovic (2002), Alphonse et al. (2003), Fisman and Love (2003), Giannetti (2003), Preve (2003), Burkart et al. (2005), Cunningham (2004), Atanasova and Wilson (2004), Love et al. (2005), Guariglia and Mateut (2006), and Cull et al. (2009).

[3] Haselmann et al. (2013) document that such business clubs help firms to obtain bank loans, as banks lend primarily to firms within the same business club.

[4] Although the legal system within China does not differ much from region to region, its implementation does. For example, according to the Supreme Court's judicial interpretation, the right of jurisdiction over all listed companies as defendants in a civil action belongs to the regional People's Intermediate Court. In this situation, the implementation of the legal system depends on whether the region has a well-developed free market with less government intervention in the economy. In regions that do not have a well-developed free market economy, listed companies are more likely to influence the local judicial department (the regional People's Intermediate Court) through networks or relationships, which dominate the Chinese economy. For example, Shanghai is considered to better implement the legal system than Tibet, due to the former's freer market and better developed economy.