

A Study on the Impact of Top Management Team Political Connection on Diversification

Taking the Listed Companies in Hubei Province as Samples

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Abstract—Taking listed companies in Hubei Province as an example, this paper empirically studies the influence of political connection of top management team on diversification of listed companies. The results show that the political connection of top management team has significant influence on the diversification of enterprises, among which the degree of diversification of politically related enterprises is higher than that of non-politically related enterprises. Moreover, the influence of local political affiliation on diversification of listed companies is stronger than that of central political affiliation.

Keywords—political connection; diversified management; listed companies

I. INTRODUCTION

In the thousands of years of Chinese history, "relationship" culture exists widely as an implicit contract. As a typical form of "relationship", political connection is a typical phenomenon in the process of economic development in China. Moreover, the political connection also exists widely in the world (Faccio, 2006), which makes the political connection not only become an inevitable important practical economic issue, but also become the key theoretical problem of economics and management [1].

Our country is in a special period of economic transformation, from the highly-centralized central planning management system to the market economy system. Although since the reform and opening-up, many reforms of organizational forms and institutions have been carried out in our enterprises, which has greatly improved the management autonomy of enterprises, and rendered market economy the leading role [2]. However, the above-mentioned reforms remain more at the economic level than at the administrative level. Due to the immaturity of various systems, the government's control over the market is still strong. At the same time, China's market-oriented reforms still rely on the path of the planned economy system. Marketization inevitably bears the residual brand of the planned economy, and the government's influence on Enterprises continues. As a result, the real separation of government and enterprise has not been achieved, and political connections still exist widely in China's economic society. How to straighten out the relationship between government and enterprises and transform

government functions into service-oriented government has become the key to success of the reform.

As an important nature of an enterprise, political connection also has a significant impact on business performance. Compared with other enterprises that have no political connection, an enterprise whose executives have political connections can not only avoid the possibility of encroachment, but also provide enterprises with more favorable loans, more favorable policy guidance, privileges, low tax rates and other scarce resources [3]. For Chinese enterprises, diversified resource is a kind of scarce resource. Not every enterprise can enter other industries at will. Serious market segmentation, property right discrimination and industry barriers are the important factors that restrict the diversification of enterprises. In this case, political connections may help companies gain more diversified resources. This paper selects the behavior characteristics of diversified operation and analyzes the influence of political connection on business operation behavior and its economic consequences.

II. LITERATURE REVIEW

The study on the influence of enterprise political connection on enterprise value mainly revolves around two questions: the first is whether the enterprise political connection has a significant impact on enterprise value, and the second is what kind of mechanism the political connection impacts the enterprise value. For the first question: Faccio (2006) selected 20202 companies from 42 countries as samples to study political connection. The results show that the influence of political connection on enterprise value exists on a global scale. Most researchers believe that enterprise political connections add value to the enterprise. Bunkanwanicha (2008) conducted a research on Thai firms and found that once the owner of the firm wins the election of senior officials, the firm's market value rises sharply. Ferguson and Voth (2008) studied the relationship value between German manufacturing and Nazi movements in 1933. As for the second question, a large number of studies show that the influence of political connection on enterprise value is the result of a combination of mechanisms.

Academic research on diversified operation has never stopped. Most scholars mainly discuss the motivation and value effect of enterprise diversification [4]. In the aspect of the motivation of diversification, Montgomery (1994) put forward three theoretical perspectives: agency theory, market forces theory and resource-based theory. The literature on American enterprises mainly analyzes the motivation of enterprise diversification from the perspective of principal-agent theory, which holds that diversification comes from the self-interest of enterprise managers [5]. Different from the principal-agent theory of diversification in developed countries especially in the United States, many literatures emphasize the influence of institutional environment on the motivation of diversification in developing countries and emerging markets. Khanna and Pelepu believe that, unlike developed countries such as the United States, there are perfect market systems and legal systems [6]. Many emerging market countries lack developed external capital, labor force and intermediate product markets, and the surplus resources of enterprises are difficult to circulate smoothly in the market. In this case, enterprises can form enterprises by forming diversified business groups. The internal factor market replaces the external market failure. Zhu Hongbo (2017) found that political connections significantly impacted the non-related diversified operation of mining enterprises.

In general, enterprise political connection has been studied in China for only about a decade. The theoretical basis is relatively weak, and there is little research on the impact of political connection on the diversified operation of enterprises [7]. The selected samples are generally listed companies or private enterprises, and there is no specific research on regional enterprises in Hubei Province. Moreover, the definition of political connections used to be limited to the executive individuals such as the chairman and the general manager, ignoring that some senior executives, as members of the top management team (including the chairman, the director, the independent director and the general manager), also play a role in the diversified operation strategy of the enterprise with political connections. From the perspective of the senior team, this paper uses the ratio of senior executives with political connections to the sum of senior executives of the enterprise as an indicator to comprehensively measure the enterprise political connections. Taking the listed companies in Hubei province as samples, this paper really studies whether the political connections have an impact on the diversified operation strategy.

III. THEORETICAL ANALYSIS AND RESEARCH HYPOTHESES

As can be seen from previous research literature, Top management team can participate and discuss politics as personal representatives in formal occasions such as people's congresses and political associations at all levels, maintain good communication with the government, reflect and express their ideas to the government, and keep in contact with government officials at all levels to establish and maintain good relations [8]. In addition, the government's intervention in economic activities such as resource allocation and enterprise management is still relatively huge [9]. The scarcity of resources and government regulation may restrict the diversification strategy of enterprises [10]. If the executive

team has political connections, thus getting the "protective umbrella" of government, the acquaintance with the operational rules of the government, better understanding of the policy trends of the government and more effective "communication" with the government officials, enterprises will be able to better protect their property rights, have easier access to finance, enjoy preferential tax policy, and gain other benefits [11]. All benefits mentioned above are essential resources for enterprises to make diversified operation decisions. Moreover, members of the executive team rely on their particular social status and influence in governmental agencies to accumulate "interpersonal connections" and maintain a large amount of social capital during their tenure as government officials. This kind of social capital also increases the opportunity of diversified operation in the business environment where both the market rules and the "relationship" rules play an important role. Based on the analysis above, the first hypothesis of this paper is proposed:

Hypothesis one: It is more advantageous for the enterprise to carry out the diversified operation with the political connection of the senior executive team. The higher the degree of political connection is, the more significant the influence on the degree of diversified operation.

Most listed companies are more or less restricted by local governments when they enter some key industries to conduct diversified operation [12]. Therefore, apart from a few enterprises that need central government approval to enter certain industries, most of the business activities of local listed companies are managed by local governments [13]. Therefore, the influence of local government on the diversified operation activities of listed companies is greater than that of central government. Moreover, the favorable conditions of land use approval, tax preference, bank loans with favorable conditions relevant with diversified operation activities are mainly related to local governments. Therefore, a second hypothesis is proposed:

Hypothesis two: the influence of executive team with local government political connection is more significant than that with central government political connection on enterprise diversification, and the local government political management can give full play to the advantages of political resources and provide more favorable conditions for the diversified operation of enterprises.

IV. RESEARCH DESIGN

A. Data Source

The data of this paper are selected from the Hubei Province Company Listed on Stock Exchange from 2011 to 2017 as samples. After removing the sample of unknown disclosure of market closure, data, and political connection of the chairman of the company, a total of 402 sample data of listed companies are obtained. Other control variables such as diversified operation index and profitability come from CSMAR database.

B. Model Construction

In view of the influence of political connection on the diversified operation of listed companies in hypothesis one, Model 1 is established to test.

$$\text{Model 1: } HHI = \alpha + \beta_1 PCrate + \beta_2 Size + \beta_3 Lev + \beta_4 Growth + \beta_5 Top1 + \beta_6 Top1 * Top1 + \beta_7 Year + \epsilon \quad (1)$$

In view of the influence of political connection under different government background on the diversified operation, the following models are established to test.

$$\text{Model 2: } HHI = \alpha + \beta_1 Cen + \beta_2 Size + \beta_3 Lev + \beta_4 Growth + \beta_5 Top1 + \beta_6 Top1 * Top1 + \beta_7 Year + \epsilon \quad (2)$$

$$\text{Model 3: } HHI = \alpha + \beta_1 Loc + \beta_2 Size + \beta_3 Lev + \beta_4 Growth + \beta_5 Top1 + \beta_6 Top1 * Top1 + \beta_7 Year + \epsilon \quad (3)$$

$$\text{Model 4: } HHI = \alpha + \beta_1 Pol + \beta_2 Pol_Cen_Loc + \beta_3 Size + \beta_4 Lev + \beta_5 Growth + \beta_6 Top1 + \beta_7 Top1 * Top1 + \beta_8 Year + \epsilon \quad (4)$$

未找到引用源。

TABLE I. DETAILED VARIABLE DESCRIPTION TABLE

Symbol	Definition and Calculation Method
HHI	$HHI = 1 - \sum_{i=1}^n P_i^2$ <p>Where n is the number of cross-industry units of the company, P_i is the sales or assets of each business units in the total sales or assets of the enterprise.</p>
PCrate	Number of senior executives with political connection / total number of senior executives
Pol	The value of senior executive team with political connection is 1, or the value is 0
Cen	The value of senior executive team with central government political connection is 1, or the value is 0
Loc	The value of senior executive team with local government political connection is 1, or the value is 0
Pol_Cen_Loc	The value of senior executive team with only local government political connection but no central government political connection is 1; the value of senior executive team with central government political connection but no local government political connection is -1; the value of other cases is 0
Size	Logarithmic value of the total assets of the company
LEV	Total liabilities / total assets
ROA	After-tax profits / owners' equity
Top1	Share proportion of the largest shareholder
Top1 * Top1	The quadratic component of the share proportion of the largest shareholder

V. EMPIRICAL RESULTS ANALYSIS

A. Descriptive Statistics

Through descriptive statistics of dependent variables, it can be found that the average value of HHI index of listed companies in Hubei Province is 0.4861, the maximum value is 0.8442, and the minimum value is 0.0529, which indicates that the diversification is quite common among listed companies in Hubei Province. According to the descriptive statistics of the independent variables related to the political connection of senior executives, there are 39.29% enterprises with political connections(Pol) in the executive team of listed companies in Hubei Province. The average value of the proportion of the number of senior executives with political connections in the total number of executives in the executive team(PCrate) is 0.036. Among them, the enterprises whose executive team has local government political connection are in the majority, the sample number of accounts for 28.06% of the total, while only 14.96% of the sample enterprises have central government political connection.

TABLE II. DESCRIPTIVE STATISTICS OF INDEPENDENT VARIABLES, DEPENDENT VARIABLES, AND OTHER CONTROL VARIABLES

		Average value	Median	Standard Deviation	Maximum Value	Minimum Value
Dependent Variables	HHI	0.4861	0.4472	0.2487	0.8442	0.0529
	PCrate	0.036	0	0.2203	0.33	0
	Pol	0.3929	0	0.3814	1	0
Independent Variables	Cen	0.1134	0	0.4117	1	0
	Loc	0.2806	0	0.3162	1	0
	Pol_Cen_Loc	0.1496	0	0.297	1	-1
	Size	12.7891	10.852	1.5354	16.0815	9.2745
Control Variables	LEV	0.6436	0.4877	0.4951	0.6128	0.2586
	ROA	0.0411	0.0388	0.1253	0.9301	-0.0982
	Top1	0.3374	0.2976	0.1375	0.8147	0.0518
	Top1 * Top1	0.0013	0.0886	0.0011	0.6637	0.0021

This paper then groups all sample enterprises according to whether the executive team has political association or not, and divides them into political connection group and non-political connection group for descriptive statistics and comparative analysis. From Table II, it can be seen that the average value of the enterprises with political connection(HHI) is 0.5277, which is larger than the average value of the group without political connection (0.4274). The average value of the return on asset(ROA) of the group with political connection is 0.0799, which is greater than that of the group without political connection(0.0782). Moreover, the logarithmic average value of the enterprises size of group with political connection is 13.6981, which is greater than that without political connection of 10.0295. According to the grouping and comparing the descriptive statistics of the

sample enterprises, the degree of diversification and performance of the enterprises that executive team has the political connection is better than that of the enterprises that executive team has no political connection.

TABLE III. GROUPING DESCRIPTIVE STATISTICS OF INDEPENDENT VARIABLES AND OTHER CONTROL VARIABLES

	Group with no political connection				Group with political connection			
	Maximum value	Minimum value	Average value	Standard deviation	Maximum value	Minimum value	Average value	Standard deviation
HHI	0.7333	0.0529	0.4274	0.328	0.8442	0.0624	0.5277	0.2714
ROA	0.3448	0.2873	0.0782	0.1794	0.4424	0.5209	0.0799	0.0513
Size	15.3605	9.2745	10.0295	0.7440	16.0815	10.8315	13.6981	0.9731
LEV	0.9938	0.0003	0.4592	1.9220	0.9733	0.0116	0.39431	2.7299
Top1	0.8147	0.0621	0.3274	0.1592	0.7928	0.0518	0.3584	0.2331
Top1* Top1	0.6637	0.0021	0.0012	0.6281	0.3928	0.0059	0.0019	0.7497

B. An Analysis of the Influence of the Political Connection of Top Management Team on the Diversified Operation of Enterprises

From the regression results of the four models in Table III, the correlation coefficient of the ratio of the number of executives with political connection to the total number of executives (Pcrate) in the executive team in Model 1 is greater than 0 and could be significant in the level of 10% (Model 1: $\beta = 0.0585$, $p < 0.1$), which indicates that the more executives with political connection are, the more diversified the enterprise is. To a certain extent, it also shows that the degree of diversified operation of the listed enterprises whose top management team has political connection in Hubei Province is significantly higher than that of the enterprises whose executive team has no political connection. That is to say, the research hypothesis 1 put forward in this paper holds true: The diversification degree of the listed companies in Hubei Province is positively impacted by the political connection of the top management team [14].

According to the regression results of Model 2 and Model 3, the correlation coefficient of independent variable local government political connection (Loc) is 0.4261 and the correlation coefficient of central government political connection (Cen) is 0.7457, though greater than 0, but the significant level is not high. All of them could not pass the significance test (Model 2: $\beta = 0.7457$, $p > 0.1$; Model 3: $\beta = 0.4261$, $p > 0.1$).

However, according to the regression result of Model 4, the coefficient of Pol_Cen_Loc is significantly positive (Model 4: $\beta = 0.6224$, $p < 0.05$), which indicates that the contribution of local government political connection of executive team to enterprise diversification is significantly greater than that of central government political connection. That is to say, the research hypothesis 2 proposed in this paper holds true, which shows that the operation of local enterprises is more influenced by the local government.

In terms of the influence of control variables on enterprise performance, the estimated value of the company size coefficient is significantly positive at the confidence level of 1%. This result supports the research conclusion of relevant scholars, that is, the larger the scale, the higher the degree of diversification of listed companies [15]. On the one hand, it is the scale effect. On the other hand, it is because that the larger the size of the enterprise is, the greater the influence and reputation of entrepreneurs and other executives, and consequently, they have more opportunities to participate in political affairs, and use the benefits of political connections to obtain the resources that diversified operation needs. However, the correlation between business performance and the political connection of executive team is not high, and none of the four models can pass the significance test. In addition, the negative and positive correlation between the share proportion of the largest shareholder Top1 and its quadratic component and the business performance show that the influence of the share proportion of the largest shareholder on the small and medium-sized board listed companies is nonlinear.

TABLE IV. THE INFLUENCE OF POLITICAL CONNECTION OF EXECUTIVE TEAM ON DIVERSIFIED OPERATION

	Model 1	Model 2	Model 3	Model 4
PCrate	0.0585* -0.0633			
Cen		0.7457 (0.1639)		
Loc			0.4261 (0.2182)	
Pol_Cen_Loc				0.6224** (0.0399)
Size	0.0533*** -0.0029	0.0627*** -0.0016	0.0849** -0.0037	0.0693** -0.0049
ROA	0.0111 0.614	0.0105 0.729	0.012 0.5913	0.0329 0.4115
Top1	-0.012* 0.0965	-0.0118 0.1034	-0.0127* 0.0784	-0.0126* 0.0793
Top1* Top1	0.0001 -0.1344	0.0001 -0.1343	0.0001 -0.1486	0.0001 -0.1337
SampleSize	402	402	402	402
R-Square	0.5232	0.5687	0.4581	0.5351
Fixed effects	Year	Year	Year	Year

^a Note: The intercept is omitted. The value of the coefficient value in the right bracket is p, *, **, *** represents significant levels of 10%, 5% and 1% respectively.

VI. CONCLUSION

Synthesize all of the researches above, the political connection of executive team has a significant positive impact on the degree of diversified operation of the enterprise. As the legal system and balance of rights system is not perfect in China, the government still controls the scarce resources that most diversified operation needs. Compared with enterprises that the executive team has no political connection, the enterprise that executive team has political connection can obtain exclusive rights, concessions, loans, preferential interest rates and other scarce resources at less cost, thus promoting the diversified operation of enterprises. In terms of political connections at different levels, after considering the degree of the local government intervention in the market, the local government political connection is more valuable than the central government political connection, and can improve the degree of diversified operation of enterprises. The relationship network in regional authorities is easier to build than its counterpart in central authorities. Also, the rent-seeking deals are easier to strike. Therefore, it's easier for the local political connections of executive team to provide favorable conditions for diversified operation.

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