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Estimating the Effects of State-Business Collusion on Enterprise Expenditure

Shan Yue Jin

Gachon University
jsyrena0923@gachon.ac.kr

Abstract

This study evaluated the effects of the state-business collusion on enterprise expenditure. The results of this study showed that the state-business collusion increased unproductive expenditure items and decreased research and development. Moreover, it was concluded that the state-business collusion would negatively affect the growth of an enterprise.

Keywords: *Chinese private enterprises, state-business collusion, capital costs, unproductive expenditure, research and development costs, and growth*

1. Introduction

A corrupt relationship between political and business circles is a universal phenomenon in the world. The "political resources", which are obtained from the corrupt relationship, provide special favors such as capital finance, market entry, intellectual property protection, and government tax privileges. Faccio et al. (2004) evaluated companies in 47 countries around the world to find that most controlling shareholders and CEO of these companies had corrupt relationships with the congress or the government. [1]

Over the past decade, the number of private enterprises in China has increased by 65% and private enterprises are the critical part of the Chinese economy in terms of the government's public revenue, job opportunities, technological innovation, import, and export [8]. However, it is also true that China's small and medium-sized enterprises (SMEs) have developed slowly because they have had difficulties in entering the market, innovating technologies, and receiving financial support from the government [10].

China is in the transition from a planned economy to a market economy and it has a 'half-planned and half-market' economic system [12]. The central government plays a leading role in the macroeconomic control and industrial development, and the local government has the right to distribute the resources and to review the business qualification. If politics is viewed as a type of resources, the supply of the Chinese market does not meet the demand of private enterprises. As a result, the enterprise tries to make a connection with the government, a supplier, through diverse routes and ways. Chinese private entrepreneurs try very hard to have political statuses, such as a representative of China's National People's Congress (Congress representative) or a member of Chinese People's Political Consultative Conference (Political Conference member). Moreover, they believe that it is important to make visible or invisible political connections with the government [5].

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However, many people still have negative opinions on whether the political connection between political and business circles ultimately grows companies and increases the long-term value of them. Some researchers argue that the political connection distorts the distribution of social resources, leads to a unfair market competition, increases political costs, aggravates the social burdens, and decreases efficiency [2] [4] [13] [11].

Therefore, it would be important to study the effects of the political connection on the corporate growth in China's current political situation, in both theoretical and practical aspects. Some previous studies have suggested that the corrupt relationship between political and business circles in China negatively affects corporate performance and growth. However, there have been only a few studies evaluating how the political connection practically influences corporate performance and growth (e.g., path). This study will probably be the first study evaluating the effects of the political connection on corporate growth in terms of capital cost, which is the core element of corporate finance.

2. Preliminary research and hypotheses

In the process of pursuing a political rent seeking, the results of the "entertainment' behaviors and the actions for maintaining the political connection (e.g., communication with government officials, bribery to government officials, public donation under the political pressure, and conference entertainment) decrease corporate efficiency and increase the unproductive expenditure* of enterprises [1]. The theory of rent seeking clearly shows that maintaining the political connection requires costs and incurs huge expenditure on society and enterprises [5]. Therefore, from this perspective**, Hypothesis 1 was developed as follows.

Hypothesis 1: Enterprises maintaining a political connection has higher unproductive expenditure than other enterprises not maintaining it.

Chinese private enterprises have clearer property rights than state-owned enterprises and they are responsible for their own profit and loss. Consequently, the efficiency of private enterprises is higher than that of state-owned enterprises. However, the political connection increases the dependency of private enterprises on the government under the name of "favoritism and protection" and decreases the motivation for innovation. As a result, it makes enterprises decrease or neglect the needs of research and development [9] [7]. Therefore, Hypothesis 2 was developed as follows.

Hypothesis 2: Enterprises maintaining a political connection has lower research and development cost than other enterprises not maintaining it.

From the perspective of financial performance, increased unproductive expenditure decreases financial performance and hinders growth. The increase of unproductive expenditure reduces the profit of an enterprise because unproductive expenditure is often treated as sales cost, management cost, or other charges [3].

Hypothesis 3: Enterprises maintaining a political connection has a lower growth rate than other enterprises not maintaining it due to higher unproductive expenditure.

The innovation theory for corporate growth argues that an enterprise must innovate progressively or extraordinarily to maintain a competitive advantage and growth for a long time [7]. Therefore, enterprises maintaining a political connection would decrease research and development costs and have low growth.

Hypothesis 4: Enterprises maintaining a political connection has a lower growth rate than other enterprises not maintaining it due to lower research and development costs.

3. Research methods and results

3.1 Research methods

This study targeted private enterprises listed on the Shanghai Stock Exchange and the Shenzhen Stock Exchange from 2007 to 2015. However, enterprises, which did not reveal the type of business and financial statements, were excluded from this study. As a result, this study could collect 8,856 of firm-year panel data for 1,107 private enterprises. Relevant financial metrics were extracted from CSMAR, which is China's governance structure database.

Measuring variables related to a political connection is the most challenging part to examine the political connection related topics. It is because the "actual effects" of a company's political connection can be only revealed from a long-term follow-up survey of the company. In reality, however, enterprises ostracize this type of studies because they are reluctant to disclose these "political effects". Therefore, previous studies have been evaluating these effects by using collectible and publicly disclosed corporate political background data. Especially, the virtual variable method is the most frequently used method [7]. The virtual variable method is also used in this study.

Table1. Definition of variables

Variable		Definition	Estimation Method
Poldum		State-Business Collusion	Dummy variable; If a chief director, CEO, or an audit chairperson was a Congress representative or a Political Conference member or is a Congress representative or a Political Conference member, Poldum is equal to 1, otherwise it is 0. It is a dummy variable.
Growth (Grow)	Q	Enterprise Value	(Number of Outstanding Stock * Close Price of Outstanding Stock at the End of Term + Number of Untradable Stock * End of Term Asset per Stock + Debt) /End of Term Asset
Innovation Ability (Inno)	Exp	Unproductive Expenditure	(Sales Cost + Management Cost + Other Cost) /Business Profit
	RD	Research and Development Cost	Research and Development Cost/Business Profit
Control Variable	Size	Business Scale	Natural log of total assets
	Age	Business History	History from foundation to current
	Lev	Debt Ratio	Debt/Total Assets
	YDUM	Year Dummy	
	IDUM	Industry Dummy	

3.2 Results

Table 2. showed the descriptive statistics of all variables. Table 3 shows the results of a regression analysis regarding the effects of a corrupt relationship between the political circle and private enterprises on capital costs and growth. These results Table 3 revealed that the results of this analysis accepted our hypotheses. In other words, an enterprise maintaining state-business collusion had higher unproductive expenditure and lower research and development costs than sound enterprises. At the same time, it was found that an enterprise maintaining state-business collusion had a lower growth rate due to higher unproductive expenditure and lower research and development costs than sound enterprises.

Table2. Descriptive statistics (N=8,856)

Variable	Mean	Median	St.d	Min	Max
Q	0.937	0.486	0.587	0.069	1.981
Exp	0.117	0.096	0.079	0.006	0.610
RD	0.011	0.006	0.017	0.000	0.216
Pol	0.052	0.000	0.223	0.000	1.000
size	21.431	21.287	0.973	19.232	25.255
age	21.299	20.000	6.184	8.000	68.000
Debt	0.330	0.316	0.192	0.008	0.854

Table3. Results of a regression analysis

Variable	Exd	RD	Tobin's Q	
	Model 1	Model 2	Model 3	Model 4
Constant	0.2152*** (3.32)	-0.0564*** (-4.11)	1.3070*** (9.65)	1.1388*** (9.47)
Pol	0.0585*** (5.24)	-0.0166* (-1.70)	0.5056 (1.38)	0.2580 (1.02)
Exd			-0.8877*** (-5.15)	
RD				0.5200*** (4.16)
Pol*Exd			-0.2655*** (-3.14)	
Pol*RD				-0.6274** (-2.32)
Size	-0.0085*** (-3.02)	0.0227*** (3.79)	0.3748*** (7.32)	0.3664*** (7.13)
Age	0.0023*** (6.28)	-0.0128* (-1.63)	-0.0092 (-1.34)	-0.0011 (-0.16)
Debt	-0.0301** (-2.15)	0.0045 (1.50)	-0.6728*** (-6.63)	-0.7235*** (-6.83)
Year & Industry dummy	Yes	Yes	Yes	Yes
No.of Obs.	1,164	1,164	1,164	1,164
Adj. R^2	0.11	0.09	0.28	0.27

4. Conclusion

This study examines the effects of the state-business collusion, which is commonly found in Chinese enterprises, on the growth of enterprises. The importance of this study is that it is the first study, which identifies the path of the effects, in the aspect of corporate financings such as capital costs and research and development costs.

The results of a regression analysis showed that the state-business collusion increased unproductive expenditure, decreased research and development costs, and lowered the growth of an enterprise.

This study is an example showing the disadvantages of the state-business collusion between the Chinese government and Chinese private enterprises. Although the state-business collusion provides favors in terms of capital finance, market entry, and government tax privileges, it will ultimately decrease the growth of an enterprise. Therefore, the results of this study imply that there is a limit in advancing an enterprise by depending on the state-business collusion.

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Author

Shan Yue Jin
Gachon University
Assistant Professor