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Abstract

Property rules of China's partial share issue privatization have created rent-seeking incentives for politicians that may hurt the performance and corporate governance of newly listed state enterprises. The study reports that 28% of the CEOs in the sample of 617 firms are ex- or current government bureaucrats. The three-year post-IPO stock returns of the full sample underperform the market by 23%. Much of the underperformance is attributable to the firms run by politically-connected CEOs: the underperformance of firms with politically-connected CEOs exceeds those without politically-connected CEOs by 37%. Firms with politically-connected CEOs are more likely to appoint other bureaucrats to the management teams and boards of directors, while they appoint fewer directors with relevant professional background or prior business experience, nor any representative of minority shareholders. The presence of politically-connected CEOs is related to the unemployment and fiscal conditions of the firms' regions while unrelated to most firm characteristics. Overall, the results indicate that the appointment of politically-connected CEOs does not enhance firm efficiency but rather fulfill political goals of politicians.

Politically-connected CEOs, Corporate Governance and Post-IPO Performance of China's Newly Partially Privatized Firms

1. Introduction

Empirical studies on share issue privatization have almost unanimously documented performance improvement of newly privatized firms across countries.[1] China is a notable exception. Performance change subsequent to China's share issue privatization is at best mixed, according to Sun and Tong (2003). Figure 1 of this paper also shows that the average cumulative market adjusted return (CAR) of newly listed firms in China not only failed to increase but deteriorated by almost 23% over the three years subsequent to their initial public offerings (IPOs).[2] Why the difference? This study takes a stab into the issue by examining institutional constraints that influence the control and governance structures of newly listed companies in China, and their implications on privatization performance.

China's economic reform in the 1990s features a large-scale partial privatization of state enterprises and the creation of stock markets. This involves the IPOs of a minority portion of state shares to the private sector, while the majority shares of the newly listed companies are ultimately owned by various layers of governmental agencies and state enterprises. The newly listed firms face two important institutional constraints: (1)

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[1] See Megginson and Netter (2001) for a comprehensive survey of the literature.

[2] This post-IPO decline in performance is not restricted only to IPOs to domestic investors. Using a sample of Chinese newly listed firms that issued shares to foreign investors (B- and H-shares), Aharony et al. (2000) document that accounting performance significantly decline over the three years after the IPO.

government-controlled shares and assets are prohibited to be sold to the public[3], and (2) government maintains the ultimate decision right on the appointment of chief executive officers (CEOs).

It is not difficult to forecast the impact of these institutional constraints on the incentives of the controlling owners (governments) and managers of these newly listed companies. The non-transferability of the state owned shares and assets create thorny incentive problems for both the government (politicians, to be more specific) and the firm management, and it has great implications on corporate governance and firm efficiency.[4] The government and politicians cannot benefit from any efficiency improvement of the firm by freely selling off some of the state ownership. They may instead collect rents directly from the firm. An incentive scheme that ties a politician's (or CEO's) income and promotion to firm performance is unlikely to be effective because total firm value is hard to measure when most of its shares are non-transferable. Rather, the wealth of the politician depends on a set of macroeconomic and political factors. Firm efficiency is but one and perhaps less important performance measure. By contrast, it is important for the politician to improve the employment rate, and the fiscal conditions of the region, building relationships through trading favors with colleagues and superiors, and so on. Achieving these objectives may increase the politician's incomes and promotion opportunities, but it can dissipate the

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[3] Government-owned shares can occasionally be transferred in blocks between state-owned firms. However, these shares are strictly prohibited from being freely traded in the secondary markets.

[4] Alchian (1965) and Karpoff and Rice (1988) provide analyses on the effects of non-transferable property rights on organization and incentive.

2

efficiency and value of the enterprise. Moreover, if we cannot assume that the politician is always benevolent, a corrupted politician can further bring down firm efficiency as he/she strips away firm value not for social welfare enhancement but personal gains – a grabbing hand view (Shleifer and Vishny, 1994; 1998)

Given the politicians' cost and reward functions resulting from the non-transferability of state shares, CEO appointments open up opportunities for politicians to exert *direct* influence on the listed companies to fulfill their political and personal goals. Figure 3 (5) plots the mean (median) CARs of two groups of newly listed companies in China distinguished by whether their CEOs are politically connected (current or ex-government bureaucrats). The mean (median) CAR of the group of firms run by politically-connected CEOs exhibits a steep decline of 50% (60%) over the three years subsequent to IPOs, while the mean (median) CAR of the second group of firms exhibits a much smaller drop at 13% (40%) over the same duration. Together with Figure 1 and 2, the overall decline in stock performance of the newly privatized firms seems to be attributable to the set of firms that are subject to more direct intervention by politicians.

To better understand the performance and governance problems of China's partial privatization, this study (1) performs additional analyses on the connections between firm performance and CEOs' political ties, (2) examines the structures of the management teams and boards of directors and how these structures are related to CEOs' political connections, and (3) investigates how political objectives of politicians measured by micro- and macro-economic factors influence the appointment of politically-connected CEOs.

Based on our detailed database tracking CEOs and directors of 617 companies that went public in China during 1993 through 2000, we report that almost 28 percent of the companies' CEOs are politically connected – they are current or ex-government bureaucrats. Controlling for other factors that influence firm performance, we still find that the post-IPO long-term stock returns of a firm is significantly worse when its CEO is politically connected. Consistently, accounting performance of a firm run by a politically-connected CEO deteriorates more than an otherwise similar firm. The analysis of board structures reveals a lack of governance function – almost no director represents public stock investors. It also clearly shows that having a politically-connected CEO jeopardizes professionalism. When a CEO is politically connected, the board is more political but less professional: the board has more politically-connected directors (in addition to the CEO) but fewer directors with professional backgrounds. The directors are on average older in age, less educated, and less likely to be women. Finally, a listed company's CEO is more likely to be politically-connected when the company belongs to a region with larger fiscal deficit and higher unemployment. By contrast, few other firm-level factors explain the presence of the politically-connected CEO. Taken together, these findings suggest that substantial resources of listed state-controlled companies in China are diverted by politicians for social objectives, even though these objectives are often inconsistent with firm value maximization. The high involvement of politicians and the low participation of professionals in management and directorship, and the value discounts of the firms therefore should not be surprising results of China's share issue privatization.

This paper can be related to several strands of literature. First, our evidence supports recent research that the grabbing hand model can describe government behavior and its involvement in business activities of publicly listed firms (Shleifer and Vishny, 1998; Hellman et al., 2000). Our results are also consistent with the public choice literature emphasizing rent seeking, extraction, and protection as primary motives of government intervention (Stigler, 1971; Peltzman, 1976; McChesney, 1987, 1997; De Soto, 1990; Spiller, 1990; Shleifer and Vishny, 1998). Second, our findings are complementary with recent U.S. evidence on the role of political directors. Agrawal and Knoeber (2001) document that directors with experience in politics serve an advisory role in firms that need to deal with the government. Helland and Sykuta (2000) find a rent-seeking role of political directors in the public utilities industry; such role was weakened after the industry was deregulated. Hadlock, Lee, and Parrino (forthcoming) document that CEOs of gas and electric utility firms tend to be older, have less prestigious education background, and are more likely to have a legal background than those of unregulated firms. Faccio (2002) reports cross-country evidence that firms use their political connections to extract resources from the state. Third, and more generally, our empirical results demonstrate that the conflict between economic and political objectives of politicians poses a credible challenge to market and enterprise reforms in transition economies. Our findings are consistent with Shen and Park (2001) who argue that decentralization in financial institutions in China has led to problems involving local governments intervening bank loan decisions for private benefits. In Russia, the failure of the

5

central government to effectively curtail the agency problem of local governments and firms has been attributed as a major reason why its reform failed (Blanchard and Shleifer, 2000).

In addition to adding evidence to the literature, our study reveals that institutional constraints and public governance fundamentally affect firm governance and performance. To market reformers, our findings suggest that the non-transferability of state shares and the politicians' power of intervening firms and markets are important considerations for both improving corporate governance and the functioning of product and capital markets in China.

The remainder of the paper proceeds as follows. Section 2 discusses the institutional background and develops the hypotheses. Section 3 presents empirical results. In section 4, we conclude the paper.

2. Institutional background and hypotheses

In this section, we discuss the institutional background of China's share issue privatization and develop a few hypotheses regarding the effects of government intervention on the performance and governance of newly privatized firms.

2.1. Background

During the 1980's economic reform, the Chinese government launched a program that decentralized management decision rights of stated owned enterprises (SOEs) from the central government down to the local firm level. The decentralization was motivated by the central government's desire of promoting markets and gradually replacing its central planning function. In the 1990's, the government allowed SOEs to be partially privatized by issuing a

minority portion of shares to individual investors, who can trade their shares freely in newly developed stock markets, set up in Shenzhen and Shanghai in 1990 and 1991 respectively. For ideology reasons, this partial privatization process is officially called *corporatization* and it prohibits the government from selling its controlling stake in the firms. This ownership restriction also aims to ensure government control of these newly privatized firms and reduce agency problems between the government and the management of the listed firms.

In association with corporatization in the 1990's, the central government further decentralized its power by specifying the exact decision rights passed to the SOE level, involving a total of 14 rights mainly related to usage of retained funds and operating decisions (Qian, 1995). While giving the SOE management mainly operating decision rights, the government has kept two key control rights. First, the government has ultimate decision right concerning all disposal of assets and mergers and acquisitions of these listed firms. Second, the government makes the final decision about the appointment of CEOs.[5]

2.2. Hypotheses

As discussed in the introduction, the non-transferability of the state assets and shares and the government intervention of CEO election have great implications on the valuation and governance of the newly listed companies. Under these property rights assignments, even a benevolent government (a government that maximizes social welfare) can have the incentive

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[5] Such retention of power, especially in the appointment of key officials in an SOE, is consistent with arguments by Blanchard and Shleifer (2000) that in transition economies, the competitive benefits of decentralization requires political centralization. In transition economies where weak institutions fail to support private ownership and property rights, a strong government can play a role in fostering growth.

of using its intervention power to collect rents from the companies at the expense of their

operating efficiency. The extraction of corporate wealth is further exacerbated when

corrupted politicians are involved. Therefore, the property rules of China's share issue

privatization are expected to result in the government's grabbing hand behavior described in

Shleifer and Vishny (1998):

> *"The key problem of state firms is government interference in their*
> *activities to direct them to pursue political rather than economic goals,*
> *such as excess employment. As a consequence, the design of*
> *privatization must focus on restricting the possible future influence of*
> *the state on privatized firms, through subsidies, regulations, or even*
> *minority ownership." pp. 10-11.*

Such view of government also falls into the public choice tradition that rent creation,

extraction, and protection are the primary motives of government intervention (Stigler, 1971;

Peltzman, 1976; McChesney, 1987; De Soto, 1990).

We now develop a few hypotheses pertaining to the causes and effects of CEOs'

political ties with government.

2.2.1. Effects on firm performance

We assume that a more intervening government is more likely to endorse a politician's

appointment as the CEO of a listed company. A first test of whether the politically-connected

CEO and his/her affiliated government pursue objectives at the expense of corporate

efficiency is how the appointment is associated with subsequent firm performance. If the

grabbing hand model describes the behavior of Chinese government and politicians, the

appointment of the politically-connected CEO is expected to be associated with poor

valuation in terms of stock returns and accounting performance subsequent to the IPO, all else equal.

2.2.2. Effects on board structures

The structures of boards of directors reveal information about the quality of management and the degree of check and balance in place on managerial decisions. The degrees of professionalism and monitoring required by a firm are likely determined by the institutional environment to which the firm adapts (Hermalin and Weisbach, 2001). In the context of China, we argue that the property rules of China's share issue privatization likely result in boards strongly influenced by politicians while exhibiting weak governance function and low professionalism. Specifically, we expect that firms appointing politically-connected CEOs are associated with more (non-CEO) directors with political ties and fewer directors with business experience or professional background, compared with other firms whose CEOs are without such political ties. This is true for two reasons. First, the boards need more allied politicians to reinforce the politically-connected CEO's objectives. Second, professionals are likely obstacles against resource diversion away from firms.

2.2.3. Why are CEOs politically connected?

We have argued that the property rules of China's share issue privatization result in politicians' incentives of diverting corporate resources for social/political objectives. As such, the appointment of politically-connected CEOs of newly listed companies should be linked to these objectives. We therefore examine a few macro conditions of China's different regions which likely enter politicians' reward formulas – regional wealth level and growth

(gross domestic product (GDP) and GDP growth), fiscal conditions, the unemployment rate, and the degree of private sector market development in the region. We expect that the appointment of politically-connected CEOs is related to some of these government's objectives. Specifically, we expect that CEOs are more likely to be politically connected in regions with more serious macro-economic problems, as governments of these regions have more urgent demand for mitigating these problems using corporate resources.

3. Empirical results

3.1. The sample

We manually collect board data from the IPO prospectus of listed A-share companies in the Shanghai Stock Exchange and the Shenzhen Stock Exchange from 1993 to 2000[6]. From the "Introduction of the Board of Directors, Supervisors and Senior Managers (IDSSM)" section of the prospectus, we obtain a brief biography of each director. Sometimes, we search other sections of the prospectus to ascertain the background of the directors. For instance, we examine the sections such as "History of Listed Company", "Background of Founding Investors" or "Background of Large Shareholders" to analyze whether the companies that the directors worked for or are currently working for are affiliated with the listed company. For some companies that went public prior to 1997, the information disclosed in the prospectus is insufficient due to low disclosure standards and weak

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[6] During the sample period, A-shares are traded by domestic investors, in comparison with other classes of shares such as B- or H-shares that are traded by foreign investors. Starting in 2001, domestic investors are allowed to trade B-shares.

enforcement, a typical problem for an emerging market such as China. From the Shenzhen Genius Information Technology Company database, we are able to obtain the IPO-year financial and ownership data for most of the companies. Also, we obtain China's regional economic data from China Economic Information Network Data Co., Ltd. (CEInet Co. for short).

The final sample consists of 617 companies. It represents 61 percent of the total number of IPO firms in China during the same period. Table 1 provides a description of the sample. From Panel A of the table, the IPO firms in our sample are unevenly distributed across the sample period, ranging from 128 and 169 firms in 1996 and 1997 to 11 and 18 firms in 1995 and 2000. The sample distribution largely reflects the overall IPO pattern in China: the IPO market was hot in 1996 and 1997 and cold in 1995.[7] In the year 2000, the sample is small relative to the population because most of the data for that year was not yet available to us. The sample coverage improves over time, from about 47 percent of the population in 1993 to 85 percent in 1999. This pattern reflects improved public disclosure of company information over time.

Panel B of the table breaks down the sample by industry sector. Of the sample firms, 36 firms are in the natural resources sector, 386 in the manufacturing sector, 94 in the services and trade sector, 45 in the public utilities sector, 13 in the finance and real estate sector, and 43 are classified as conglomerate as they operate in multiple sectors. Across the sectors, the

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[7] The overheating economy and high inflation during the early 1990s resulted in central government's policies to restrict the money supply, which caused the IPO market to collapse in 1995.

sample displays similar degrees of coverage. It represents about 60 percent of total IPO firms in each of the sectors, with an exception of the finance and real estate sectors (35 percent).

Panel C of the table reports that about 28% of the sample firms appoint politically-connected CEOs – current or ex-government bureaucrats. This suggests that the government maintains direct influence in a significant portion of firm through appointing political-connected CEOs.

3.2. Politically-connected CEOs and firm performance

We employ both stock return and accounting measures of firm performance in our analyses. Stock performance of a firm is measured as the one-, two-, and three-year cumulative market-adjusted compound stock returns (CAR) since the firm went public.[8] Monthly stock returns are used in the calculation of CAR. The accounting performance is measured as the one- and two-year change in return on equity (ROE) subsequent to the IPO. Table 2 reports the mean and median values of these performance measures. Consistent with Figure 1 and 2, the sharp drop in stock returns occur in the third year after the IPO, suggesting that it takes the market three years to recognize the problems of these newly listed firms. The stock returns of firms with politically-connected CEOs are statistically significantly lower than those without politically-connected CEOs in each of the three years, indicating that the market is able to distinguish the two groups of firms starting in the first year after the IPO. However, the stock return gap between the two groups is growing each year, as shown by both mean and median CAR in Table 2 as well Figure 4 and 6.

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[8] We start to compute CAR one month after the IPO date.

Table 2 also reports the mean and median values of the accounting performance measures for sub-samples distinguished by whether the CEO is politically connected, as well as test statistics for differences in the mean and median values between the sub-samples. The total sample of firms manages to maintain the ROE one year after the IPO. However, it starts to decline in year two with a mean (median) change in ROE of -6.45% (-2.59%). Between the two sub-samples, the difference in mean change in ROE is statistically significant in both one and two years after IPO, which corroborate the stock returns results. The difference in median change in ROE is statistically significant only in the second year after the IPO. The difference in median change in ROE in the first year after the IPO is not statistically significant probably because median ROE in either sub-sample is quite close to zero.

Table 3 presents the results of ordinary least squared (OLS) regressions that analyze the effects of politically-connected CEOs on post-IPO stock return performance. The dependent variables are one-, two-, and three-year CARs subsequent to the IPO.[9] The independent variables are the dummy variable for politically-connected CEO, the market to book equity ratio, the debt to sales ratio, log of total assets, and the regulated industry dummy. With these dependent and independent variables, we run two sets of regressions using two different control variables for ownership. We first use the largest owner's ownership percentage to control for the largest shareholder's ownership effect on performance. The second variable is the state asset bureau dummy variable which reflects government's degree

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[9] The number of observations drops to 599 and 517 two and three years after the IPO, respectively, because stock return data for more recent IPO firms are yet to be available.

of influence in the firm. Government intervention would be more direct if a state asset bureau directly controls the firm. Alternatively, when the immediate largest shareholder is the listed firm's parent state enterprise, this added layer is likely to mitigate government's direct influence (Shirley and Walsh, 2001).[10] All the variable definitions are presented in Appendix 1.

Consistent with the univariate results reported in Table 2, the multivariate regression results show that firms with politically-connected CEOs bear a more statistically significant stock performance decline after IPOs. Results from the two sets of regressions show that firms with politically-connected CEOs underperform those without politically-connected CEOs by 11% one year after the IPO, 15% to 16% two years after the IPO and 35% to 37% three years after the IPO.[11] The magnitudes of CAR differences between these two sub-samples are similar to the univariate results even after controlling for firm specific factors that may affect post-IPO stock return performance. In addition, the post-IPO stock performance is related to a few firm variables: it is better for firms with higher market-to-book equity ratio, firms in regulated industries, and smaller firms.

Table 4 presents the results of OLS regressions using firm's one- and two-year accounting performance changes as dependent variables. The independent variables are the same as in the stock performance regressions. In column (1) and (2) we find firms with politically-connected CEOs bear a significant ROE reduction in the first year after IPO. From

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[10] The parent state enterprise is ultimately controlled by a state asset bureau.

[11] To check whether the results are affected by outliers, we winsorize the three years of CARs at the top and the bottom five percent. The results (not reported) are qualitatively the same.

column (3) and (4), the two-year accounting performance change is insignificantly related to whether the CEO is politically connected. The difference in change in ROE one year and two years after IPO is roughly one percent in the multivariate regressions, which is similar to the results in Table 2. For firms with politically-connected CEOs, the significantly more negative change in ROE one year after the IPO could be due to earnings reversal resulting from earnings manipulation during the year of the IPO. To check whether the political connection of CEOs facilitate more earnings management, we regress the level of non-core earnings over total equity (non-core ROE) at the IPO year on the same set of independent variables in the regressions of Table 4.[12] The results (not reported) show that politically-connected CEO is statistically significantly associated with more non-core ROE, which suggests that he/she engage in more earnings management. However, when we use the change in non-core ROE one year after the IPO as dependent variable in the same regression, the coefficient of politically-connected CEO is not statistically significantly different from zero. This suggests that the larger decline in change in ROE one year after the IPO in Table 4 (column 1 and 2) is not driven by a reversal in non-core ROE that results from earnings manipulation during the year of the IPO.

In Table 4, three control variables also show statistically significant results. Accounting performance is poorer among larger and highly levered firms, but higher among firms in regulated industries. Evidences from Table 4 do not support that ownership structure

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[12] Prior research such as Chen and Yuan (forthcoming) documents that Chinese listed firms typically use non-core earnings to manage earnings.

has direct and linear effect on firm's accounting performance. This is somewhat inconsistent with Sun and Tong's (2003) finding.[13] Our stock performance results also suggest that post-IPO stock decline is not statistically significantly associated with firm's ownership variables (Table 3). One explanation for the insignificant results is that the government maintains effective control of most listed firms because sales of government shares are prohibited. Thus in our sample, variation in ownership levels or whether or not listed firms are controlled by state asset bureaus may not substantially affect government's effective control level, and therefore fails to capture the variance of politicians' rent-seeking incentives. However, whether or not firms appoint politically-connected CEOs may reflect politicians' incentives and their level influence in the firms.

In summary, our regression results show that subsequent to their IPOs, firms with politically-connected CEOs generally have poorer stock return and accounting performance than their counterparts. The evidence lends support to our earlier predictions.

3.3. Characteristics of Chinese Corporate Boards

We construct a few variables to capture the governance function and the degree of professionalism of the sample firms' boards of directors. Table 5 reports the total sample mean and median values of the board variables in columns one and five, the definitions of which are detailed in Appendix 1.[14] The mean statistics reveal the following characteristics of a typical board in China. The board has nine directors. Excluding the CEO, 2.41 (32.5%)

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[13] We have also used state or legal person share ownership percentage of the largest shareholder and the results are statistically insignificant.

[14] Pearson correlations coefficients of pairs of variables used in this study are reported in Appendix 2.

additional directors are current or ex-government bureaucrats (politicians), of which 1.35 (18.21%) are connected with local governments. The board has 3.18 (33.88%) directors that are also managers of the company.[15]

The board has 3.17 (34.45%) directors that are professionals. Of these professional directors, 1.69 (18.14%) directors are currently or were previously employed in other unaffiliated companies in the same business sector or the same administrative region. The number is rather small relative to those of more developed economies such as the U.S.[16] The small number of directors with outside relevant business experience reflects the underdevelopment of the market for managerial professionals. Consistently, it also reflects that the typical company tends to recruit managerial talent internally, either within the company or within the same business group. There is also a lack of legal, accounting, and finance professionals on the board: only about 0.24 (2.48%) directors are accountants, lawyers, or either currently or were previously working in financial institutions or securities intermediaries. By contrast, there is a surprisingly large number, 1.25 (13.82%), of directors with academic background, consistent with the scarcity of professionals and lack of managerial labor market in Chinese businesses.

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[15] A significant portion of the executive management team (including non-board members) also has political ties. Excluding the CEO, an average of 1.15 (27.1%) top managers are politically connected and 0.33 (11.6%) is connected with the local government.

[16] U.S. corporate boards are typically dominated by outside directors. See, for example, Hermalin and Weisbach (1988) and Yermack (1996). The outside directors are often thought as monitors of management (Fama and Jensen, 1983). They are usually decision makers in other organizations with expertise in capital markets, corporate law, or relevant technology who provide a support function to the inside manager directors in dealing with specialized decision problems. See also Klein (1998) for the various roles of outside directors.

The average education level of the directors is between junior college and college degrees. The average age of the directors is 47. This generation of directors' education level is modest because various political movements such as the Cultural Revolution disrupted their formal education. Lastly, 0.47 directors are female, accounting for about five percent of the board membership. Compared to the Fortune 1000 companies in the U.S., China has a higher proportion of female directors possibly because almost all women join the workforce under the socialist regime.[17] As reported in Appendix 2, Panel A, woman directorship is negatively correlated with politician CEO and politician directors, while positively correlated with directors possessing business experience from unaffiliated firms and directors with legal, accounting, or finance expertise. These gender statistics suggest that women are more likely appointed on the board for their specialized expertise than for managerial or political roles. Consistently, Agrawal and Knoeber (2001) do not find woman directors play a political role in the U.S.

Not reported in the table, during our sample period, there is almost no director representing minority shareholders, might they be institutional or individual investors. The lack of directors representing minority shareholders' interest is in stark contrast with the large percentages of directors affiliated with the largest shareholder (which is also not reported here) and governments.

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[17] Farrell and Hersch (2001) document that the percentage of women on the board of Fortune 1000 firms is less than 2% from 1990-1999.

In summary, the basic statistics reveal that CEOs and directors that are politicians, especially those affiliated with local governments, accounts for a large portion of Chinese corporate boards. This reflects that through decentralization, local governments have been given control rights of listed enterprises. The strong presence of local politicians on the boards indicates that local governments have exerted strong influence over corporate policies. By contrast, there is generally a lack of legal, accounting, and finance professionals and business experience from unaffiliated enterprises on the boards, suggesting a lack of professionalism. There is almost no director representing minority shareholders, indicating that their interests may not be well protected. There is a large fraction of directors with academic background, which perhaps manifests the scarcity of professionals in the Chinese business community.

3.4. Politically-connected CEOs and board structures

Table 5 also reports the mean and median values of board variables for the sub-samples distinguished by whether the CEO is politically connected. For firms with politically-connected CEOs, a mean (median) of 47.81% (50%) of directors are politically connected while firms without politically-connected CEOs only have a mean (median) of 26.61% (25%) of politically-connected directors. The differences in mean and median are about 21% and 25%, which are statistically significant. However, most of the differences are driven by local government connections. The differences in mean and median of directors that are politically-

connected to local governments amount to about 20% and 23%, respectively.[18] These results together support our hypothesis that firms appointing politically-connected CEOs are associated with more directors with political ties. The univariate results also indicate that CEOs' political connection is associated with fewer directors with business experience or professional background or professional qualifications in accounting, law or finance. Compared with the other sub-sample, firms with politically-connected CEOs also have significantly smaller percentages of academics and women serving as directors, and the average age of directors is significantly older. However, the directors' average education level is higher for firms with politically-connected CEOs than those without politically-connected CEOs.

We next perform a set of Poisson regressions to examine how board structures are affected by the appointment of politically-connected CEOs. Similar to the firm performance regressions in Table 3 and 4, we use two sets of regressions with different control for ownership, which are separately reported in Table 6, Panels A and B. The dependent variables in these regressions, in order, are the number of directors (excluding the CEO) that are politically connected, the number of directors (excluding the CEO) that have local government connections, the number of directors that are managers, directors that are professionals (and broken down into directors that have accounting, law, or finance

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[18] The mean and median of politically-connected managers in the executive management team show similar patterns. Firms with politically-connected CEOs have significantly more politically-connected managers than firms without politically-connected CEOs. Also, most of the difference is driven by managers' local government connections.

background, directors with unaffiliated business experience, and directors with academic background), director age, directors that are women, and director education level. The independent variables in each of the regressions are politician CEO, board size, ownership percentage by the largest shareholder for regressions in Panel A and largest owner as state asset bureau for regressions in Panel B, ROE, market-to-book equity ratio, leverage, log of total assets, and the regulated industry dummy.

Panel A of Table 6 reports the regression results, which are mostly consistent with the univariate results in Table 5. In columns 1 and 2, directors are more likely to be politically connected when CEOs have political ties to the government.[19] By contrast, results in columns 4 through 10 consistently show that boards are less professional when CEOs are politically connected. The results show that when a CEO is a politician, fewer directors have prior professional, business, or academic experience, directors are on average older in age, lower in education level, and less likely to be women. Perhaps the CEO desires to bring in more politicians to reinforce his agenda, while professionals are obstacles against fulfilling the CEO's goals. One exception is that the CEO's political connection is not significantly associated with directors with non-affiliated business experience (column 6).

Consistent with our earlier results that firms' ownership structures are not associated with stock return and accounting performance, ownership by the largest shareholder does not have significant explanatory power to board structure. Firm size is generally unrelated to the

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[19] Using the same multivariate regressions, we also find (not reported) that there are more politically-connected managers in the executive team when CEOs have political ties with the government.

board characteristics except that it is positively related to the number of directors who are academics, the average age of directors and the average education level of firms. The insignificant relation between firm size and professional directorship is inconsistent with the U.S. evidence that the demand for professionals is larger for more complex organization (Klein, 1998). This evidence suggests that organizational complexity is unlikely a primary factor determining the appointment of professionals in China. The leverage variable is positively related to the politician directors and directors who are academics. Conceivably, the demand for outside business expertise is lower for lower growth firms. High growth firms appoint more professionals, more directors with finance background, more directors with academic background, and fewer politically-connected director-managers.

In panel B of table 6, we substitute ownership by the largest shareholder with the state ownership dummy. The results are generally similar with those in Panel A.

3.5. Determinants of CEOs' political ties

We perform Logit regressions to identify factors that influence the election of politically-connected CEOs. The dependent variable is a dummy variable equal to one if the CEO is a current or ex-government bureaucrat, or else zero. The independent variables are a few regional macroeconomic variables including GDP growth, fiscal deficits, unemployment rate, private sector market development, and a few firm- and industry-level variables including ownership percentage by the largest shareholder, the state ownership dummy, the dummy of regulated industries, ROE, market-to-book equity, leverage, and log of total assets. Year dummies are controlled in all the regressions but not reported.

Table 7 reports the regression results. In column 1, fiscal deficits and unemployment rate are significantly positively related to politician CEO. It indicates that when local governments are facing the challenge from fiscal deficits and high unemployment rates, they have incentives to appoint politically-connected CEOs. Column 2 shows that the appointment of politician CEOs is negatively related to state ownership. When the state asset bureau is the largest shareholder, the firm is less likely to have a politically-connected CEO. Similarly, we find that firms controlled by state asset bureau have significantly fewer managers with political connections (not reported). One explanation for these results is that, compared with firms not directly owned by state asset bureau, the closer relationship between the bureau and the listed firm allows politicians to use different means of intervention other than appointments of politically-connected CEOs and other top managers.

Across the two columns of Table 7, a CEO is more likely to be a politician when the firm's ROE at the IPO year is lower. This may suggest that firms with lower earnings performance may need more political connections such as appointing politically-connected CEOs to facilitate IPOs. This corroborates earlier evidence that CEOs' political connections are associated with more positive earnings management, reflected in higher non-core ROE, in the IPO years. Otherwise, none of the firm-level factors (market-to-book ratio, leverage, and firm size) is important in the choice of politically connected CEOs.

4. Conclusion

We have documented a significant presence of politically connected CEOs in publicly listed companies in China. Their presence is related to regional macroeconomic conditions, i.e., unemployment and government fiscal deficit, but unrelated to most firm characteristics. Politically connected CEOs bring in political allies to their companies, as their boards of directors are populated with politicians. By contrast, these boards show low degrees of professionalism, as fewer directors have relevant professional background or prior business experience. The accounting and stock return performance of the firms run by politically-connected CEOs is poor relative to their less political counterparts. The overall evidence is consistent with the grabbing hand argument that politicians extract resources from listed SOEs under their control to fulfill personal or political goals that are not consistent with firm value maximization.

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Figure 1:Cumulative Market-Adjusted Compound Stock Return
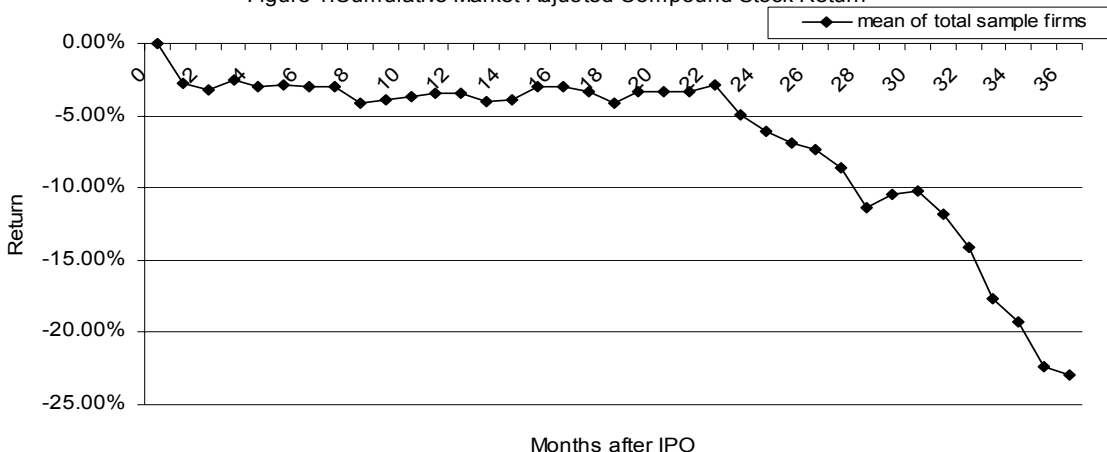
Figure 2: Cumulative Market-Adjusted Compound Stock Return
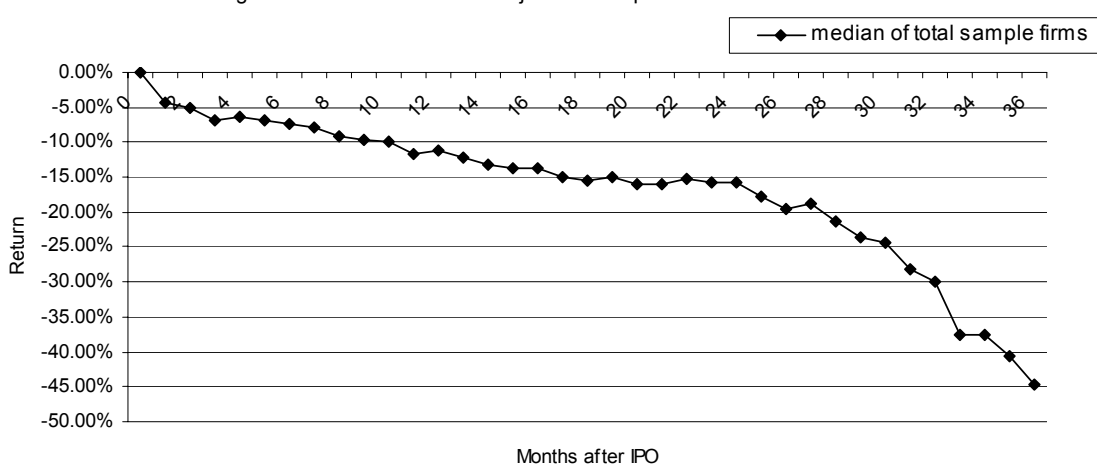
Figure 3: Cumulative Market-Adjusted Compound Stock Return

28
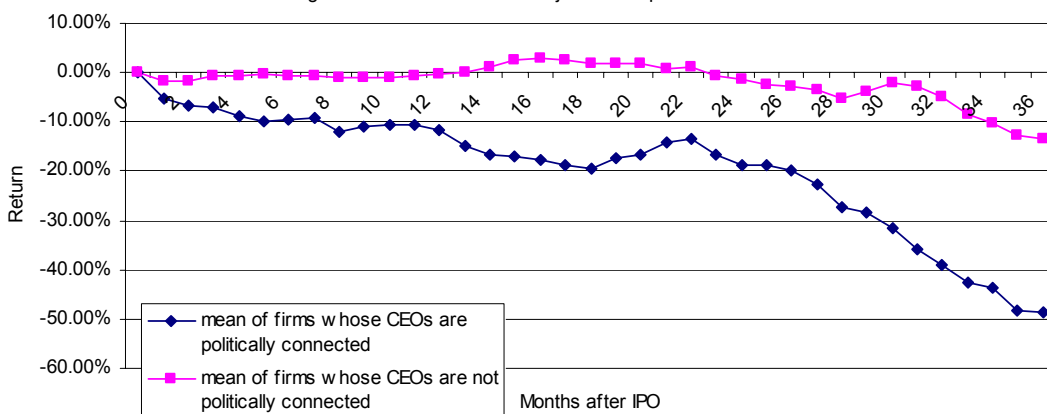
Figure 4: Cumulative Market-Adjusted Compound Stock Return
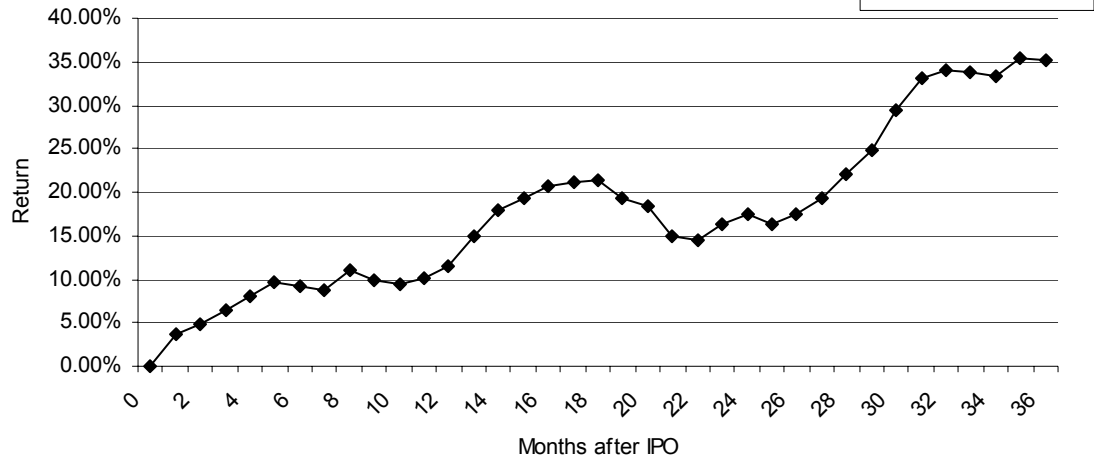
Figure 5: Cumulative Market-Adjusted Compound Stock Return
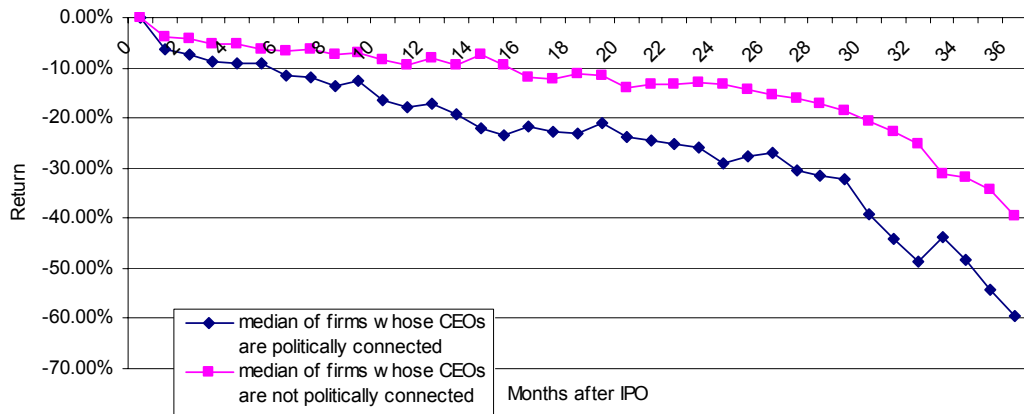
Figure 6: Cumulative Market-Adjusted Compound Stock Return
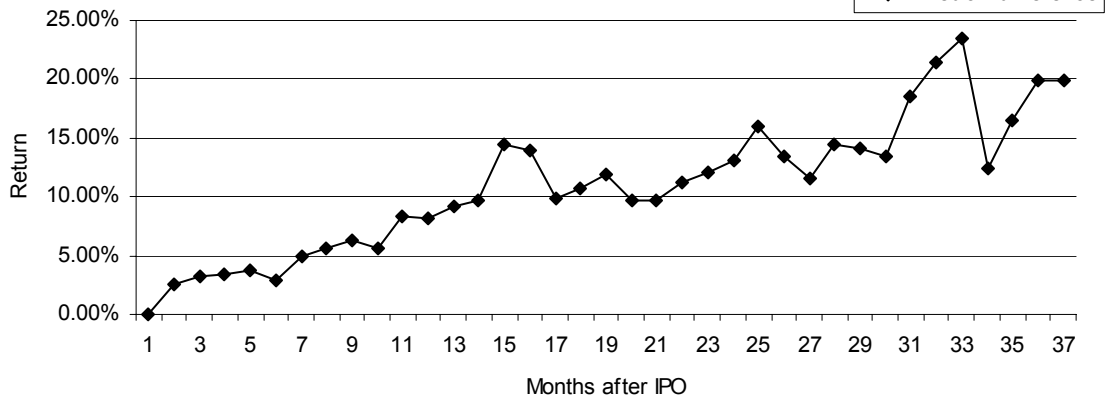
Table 1

The Distribution of IPO Firms by Year , Industry and CEO's political connection

	Sample of IPO firms		Total population	Sample firms as a % of population
	Number	Percentage		
Panel A: by year				
1993	58	9.40%	123	47.15%
1994	63	10.21%	110	57.27%
1995	11	1.78%	24	45.83%
1996	128	20.75%	203	63.05%
1997	169	27.39%	206	82.04%
1998	88	14.26%	105	83.81%
1999	82	13.29%	97	84.54%
2000	18	2.92%	136	13.24%
Panel B: by industry				
Natural resources	36	5.83%	56	64.29%
Manufacturing	386	62.56%	609	63.38%
Services and trade	94	15.24%	149	63.09%
Public utilities	45	7.29%	82	54.88%
Finance & real estate	13	2.11%	37	35.14%
Conglomerate	43	6.97%	71	60.56%
Panel C: by CEO's political connection				
Firm whose CEO is politically-connected	173	28.04%		
Firm whose CEO is not politically-connected	444	71.96%		
Total	617		1004	61.45%

Table 2
Comparison of accounting and stock performance by CEOs' political connection
This table compares the mean and median accounting and stock return performances between firms with and without politically-connected CEOs. Appendix 1 describes the variables of this table in detail. *** indicates significant at 1% (two-tailed); ** indicates significant at 5% (two-tailed); * indicates significant at 10% (two-tailed).

	Mean			
	Total sample	CEO is politically connected	CEO is not politically connected	T-statistic for difference in mean
Change in ROE one year after IPO	0.13%	-0.50%	0.82%	-2.79***
Change in ROE two year after IPO	-6.45%	-3.50%	-2.30%	-2.04**
Cumulative market-adjusted compounded stock returns one year after IPO	-3.62%	-11.80%	-0.27%	-2.81***
Cumulative market-adjusted compounded stock returns two year after IPO	-6.30%	-18.91%	-1.35%	-2.74***
Cumulative market-adjusted compounded stock returns three year after IPO	-23.03%	-48.53%	-13.34%	-3.19***

	Median			
	Total sample	CEO is politically connected	CEO is not politically connected	Z-statistic for difference in median
Change in ROE one year after IPO	0.03%	-0.05%	0.14%	-0.95
Change in ROE two year after IPO	-2.59%	-3.70%	-2.36%	-1.91***
Cumulative market-adjusted compounded stock returns one year after IPO	-11.25%	-17.30%	-8.17%	-3.46***
Cumulative market-adjusted compounded stock returns two year after IPO	-15.65%	-29.15%	-13.24%	-2.43***
Cumulative market-adjusted compounded stock returns three year after IPO	-45.23%	-59.37%	-39.47%	-2.92***

Table 3
Politically-connected CEOs and stock performance

This table presents the results of OLS regressions using stock return performance as dependent variables. Appendix 1 describes the variables of this table in detail. T-statistics are in parentheses. *** indicates significant at 1% (two-tailed); ** indicates significant at 5% (two-tailed); * indicates significant at 10% (two-tailed).

Independent Variables	Cumulative market-adjusted compounded stock returns one year after IPO		Cumulative market-adjusted compounded stock returns two year after IPO		Cumulative market-adjusted compounded stock returns three year after IPO	
Intercept	0.78	0.74	3.61***	3.80***	4.36***	4.84***
	(1.41)	(1.33)	(4.26)	(4.48)	(2.75)	(3.05)
CEO is politically-connected	-0.11**	-0.11**	-0.15**	-0.16**	-0.35***	-0.37***
	(-2.58)	(-2.56)	(-2.38)	(-2.45)	(-2.79)	(-2.93)
Largest owner's ownership percentage	0.00		-0.00		-0.00	
	(0.38)		(-0.30)		(-0.04)	
Largest owner is the State Asset Bureau		0.00		-0.07		-0.22
		(0.04)		(-0.90)		(-1.57)
Market-to-book value of equity	0.04***	0.04***	0.03	0.03	0.08**	0.08*
	(2.65)	(2.67)	(1.34)	(1.19)	(2.00)	(1.81)
Leverage	0.00	-0.00	-0.02	-0.02	-0.10	-0.09
	(0.03)	(-0.03)	(-0.61)	(-0.53)	(-1.43)	(-1.35)
Total assets	-0.05*	-0.04*	-0.18***	-0.19***	-0.23***	-0.25***
	(-1.75)	(-1.68)	(-4.38)	(-4.73)	(-2.96)	(-3.33)
Regulated Industries	0.20***	0.20***	0.27***	0.27***	0.36**	0.36**
	(3.65)	(3.63)	(3.21)	(3.24)	(2.19)	(2.19)
N	617	617	599	599	517	517
Adjusted R-sq	0.05	0.05	0.10	0.10	0.07	0.07

Table 4
Politically-connected CEOs and Accounting Performance

This table presents the results of OLS regressions using accounting performance as dependent variables. Appendix 1 describes the variables of this table in detail. T-statistics are in parentheses. *** indicates significant at 1% (two-tailed); ** indicates significant at 5% (two-tailed); * indicates significant at 10% (two-tailed).

	Change in ROE one year after IPO		Change in ROE two year after IPO	
Independent Variables				
Intercept	0.11**	0.10*	0.14*	0.14*
	(2.05)	(1.92)	(1.86)	(1.88)
CEO is politically-connected	-0.01**	-0.01**	-0.01	-0.01
	(-2.15)	(-2.15)	(-1.06)	(-1.10)
Largest owner's ownership percentage	0.00		0.00	
	(0.89)		(0.55)	
Largest owner is the State Asset Bureau		-0.00		-0.00
		(-0.15)		(-0.59)
Market-to-book value of equity	0.00	0.00	0.00	0.00
	(1.19)	(1.24)	(0.03)	(0.01)
Leverage	-0.01***	-0.01***	-0.00	-0.00
	(-2.86)	(-3.01)	(-1.49)	(-1.56)
Total assets	-0.01**	-0.00**	-0.01**	-0.01**
	(-2.21)	(-2.04)	(-2.24)	(-2.25)
Regulated Industries	0.02***	0.02***	0.02***	0.02***
	(4.02)	(3.96)	(2.99)	(2.96)
N	617	617	598	598
Adjusted R-sq	0.42	0.42	0.29	0.29

Table 5
Comparison of board characteristic by CEOs' political connection
This table compares the mean and median board characteristics between firms with and without politically-connected CEOs. Appendix 1 describes the variables of this table in detail. *** indicates significant at 1% (two-tailed); ** indicates significant at 5% (two-tailed); * indicates significant at 10% (two-tailed).

Panel A: Board Characteristics in Number

	Mean				Median			
	Total sample	CEO is politically connected	CEO is not politically connected	T-statistic for difference in mean	Total sample	CEO is politically connected	CEO is not politically connected	Z-statistic for difference in median
Number of politically-connected directors	2.41	3.47	1.99	8.52***	2.00	3.00	2.00	7.06***
Number of directors connected with local governments	1.35	2.50	0.91	9.74***	1.00	2.00	0.00	8.25***
Number of manager directors	3.18	3.07	3.22	1.01	3.00	3.00	3.00	1.53
Number of directors with professional background	3.17	2.34	3.49	-5.85***	3.00	2.00	3.00	-5.53***
Number of directors with accounting, law, or finance professions	0.24	0.05	0.31	-5.95***	0.00	0.00	0.00	-3.80***
Number of directors with non-affiliated business experience	1.69	1.53	1.73	-1.67*	2.00	1.00	2.00	-2.40***
Director education level	1.61	1.73	1.65	2.54**	1.63	1.78	1.63	3.27***
Number of directors in academics	1.25	0.76	1.45	-5.76***	1.00	1.00	1.00	-1.41
Director Age	47.01	47.61	46.79	4.05***	46.94	47.64	46.60	3.34***
Number of woman director	0.47	0.30	0.54	-4.39***	0.00	0.00	0.00	-2.93***

Table 5, continued

Panel B: Board Characteristics in Percentage

	Mean				Median			
	Total sample	CEO is politically connected	CEO is not politically connected	T-statistic for difference in mean	Total sample	CEO is politically connected	CEO is not politically connected	Z-statistic for difference in median
Percentage of politically-connected directors	32.50%	47.81%	26.61%	9.56***	30.77%	50.00%	25.00%	7.81***
Percentage of directors connected with local governments	18.21%	32.83%	12.59%	9.10***	11.11%	30.77%	7.14%	7.57***
Percentage of manager directors	33.88%	33.16%	34.15%	0.74	33.33%	33.33%	30.00%	1.65*
Percentage of directors with professional background	34.45%	24.94%	38.10%	-6.72***	27.27%	22.22%	30.00%	-5.01***
Percentage of directors with accounting, law, or finance professions	2.48%	0.43%	3.27%	-6.10***	0.00%	0.00%	0.00%	-3.80***
Percentage of directors with non-affiliated business experience	18.14%	16.46%	18.79%	-1.82*	16.67%	13.33%	18.18%	-1.65*I
Percentage of directors in academics	13.82%	8.05%	16.04%	-6.03***	9.09%	6.67%	9.09%	-0.32
Percentage of woman director	5.00%	3.26%	5.66%	-4.13***	0.00%	0.00%	0.00%	-2.92***

Table 6
Politically-connected CEOs and Board Structure

This table presents the results of Poisson regressions. The variables are defined in Appendix 1. Chi-square statistics are in parentheses. *** indicates significant at 1% (two-tailed); ** indicates significant at 5% (two-tailed); * indicates significant at 10% (two-tailed).

Panel A

Independent Variables	Number of politically-connected directors	Number of directors connected with local governments	Number of manager directors	Number of directors with professional background	Number of directors with accounting, law, or finance professions	Number of directors with non-affiliated business experience	Number of directors in academics	Director Age	Number of woman director	Director education level
Intercept	-0.10	-0.71	-0.03	-0.11	0.51	0.98	-3.64***	4.98***	0.80	0.99***
	(0.02)	(0.46)	0.01	(0.03)	(0.05)	(1.08)	(12.77)	(7483.95)	(0.20)	(10.33)
CEO is politically-connected	0.58***	1.05***	-0.03	-0.37***	-1.77***	-0.09	-0.63***	0.02***	-0.48***	0.04*
	(112.19)	(217.11)	(0.33)	(42.16)	(23.40)	(1.48)	(42.27)	(23.19)	(9.63)	(2.77)
Board size	0.10***	0.10***	0.12***	0.10***	0.11***	0.11***	0.08***	0.10***	0.11***	0.10***
	(108.73)	(56.98)	(220.24)	(152.79)	(14.81)	(105.00)	(36.46)	(19287.1)	(29.46)	(659.17)
Largest owner's ownership percentage	-0.00	-0.00	0.00	-0.00	-0.01*	-0.00	0.00	0.00**	0.00	0.00
	(0.22)	(0.00)	(0.30)	(0.79)	(3.70)	(1.50)	(0.64)	(4.47)	(0.18)	(0.36)
ROE	-0.17	0.54	-0.45	-0.67	-3.38*	-0.69	-0.21	-0.10**	1.11	0.02
	(0.08)	(0.47)	(0.79)	(1.83)	(3.47)	(0.95)	(0.08)	(5.30)	(0.82)	(0.01)
Market-to-book value of equity	-0.03	-0.01	-0.02	0.05***	0.10**	0.03	0.07***	-0.00	0.02	0.00
	(1.82)	(0.22)	(0.93)	(12.83)	(5.06)	(1.79)	(9.34)	(0.15)	(0.38)	(0.33)
Leverage	0.06*	0.07	-0.01	0.04	0.02	-0.01	0.09**	0.00	0.01	0.01
	(3.71)	(2.26)	(0.18)	(1.91)	(0.05)	(0.09)	(5.41)	(2.57)	(0.01)	(0.27)
Total assets	-0.01	-0.03	0.01	0.01	-0.12	-0.07	0.14***	0.01***	-0.12	0.04**
	(0.05)	(0.26)	(0.03)	(0.18)	(1.09)	(2.42)	(7.97)	(9.87)	(2.09)	(5.97)
Regulated industries	0.03	-0.00	-0.12*	-0.03	0.14	-0.11	0.04	-0.01***	-0.05	-0.05
	(0.22)	(0.00)	(3.36)	(0.20)	(0.37)	(1.41)	(0.19)	(6.93)	(0.07)	(2.26)
N	617	617	617	617	617	617	617	617	617	617

Panel B

Independent Variables	Number of politically-connected directors	Number of directors connected with local governments	Number of manager directors	Number of directors with professional background	Number of directors with accounting, law, or finance professions	Number of directors with non-affiliated business experience	Number of directors in academics	Director Age	Number of woman director	Director education level
Intercept	0.18	-0.51	-0.12	0.18	1.89	1.44	-3.94***	5.01***	0.78	0.98***
	(0.06)	(0.23)	(0.03)	(0.07)	(0.65)	(2.33)	(15.16)	(7492.10)	(0.19)	(9.98)
CEO is politically-connected	0.57***	1.05***	-0.03	-0.38***	-1.83***	-0.10	-0.62***	0.02***	-0.49***	0.04*
	(108.70)	(213.72)	(0.30)	(43.66)	(25.07)	(1.83)	(41.19)	(22.21)	(9.68)	(2.71)
Board size	0.10***	0.10***	0.12***	0.10***	0.13***	0.12***	0.08***	0.10***	0.11***	0.10***
	(111.04)	(57.71)	(218.90)	(158.37)	(21.07)	(110.06)	(35.24)	(19409.10)	(29.35)	(659.15)
Largest owner is the State Asset Bureau	-0.10	-0.09	0.01	-0.10	-0.78***	-0.14	0.07	-0.00	-0.05	-0.01
	(1.87)	(0.75)	(0.04)	(2.60)	(10.20)	(2.61)	(0.56)	(0.29)	(0.12)	(0.10)
ROE	-0.18	0.57	-0.42	-0.74	-4.34**	-0.79	-0.13	-0.11**	1.16	0.03
	(0.10)	(0.52)	(0.70)	(2.22)	(4.94)	(1.23)	(0.03)	(6.36)	(0.90)	(0.02)
Market-to-book value of equity	-0.03	-0.02	-0.02	0.05***	0.08*	0.02	0.07***	-0.00	0.02	0.00
	(2.29)	(0.32)	(0.82)	(11.20)	(3.12)	(1.18)	(10.47)	(0.33)	(0.36)	(0.32)
Leverage	0.07**	0.07	-0.02	0.04	0.05	-0.00	0.09**	0.00*	0.00	0.01
	(4.48)	(2.50)	(0.26)	(2.45)	(0.30)	(0.01)	(4.90)	(3.77)	(0.00)	(0.21)
Total assets	-0.02	-0.03	0.01	-0.00	-0.21*	-0.10**	0.16***	0.01**	-0.12	0.04***
	(0.41)	(0.49)	(0.13)	(0.01)	(3.66)	(4.87)	(10.97)	(6.33)	(2.01)	(6.74)
Regulated industries	0.04	-0.00	-0.13	-0.02	0.20	-0.10	0.03	-0.01**	-0.05	-0.05
	(0.23)	(0.00)	(3.46)	(0.13)	(0.81)	(1.27)	(0.12)	(6.33)	(0.08)	(2.37)
N	617	617	617	617	617	617	617	617	617	617

Table 7
Why are CEOs politically connected?

This table presents the results of Logistic regressions using politically-connected CEO as the dependent variable. T-statistics are in parentheses. *** indicates significant at 1% (two-tailed); ** indicates significant at 5% (two-tailed); * indicates significant at 10% (two-tailed).

Independent Variables		
Intercept	-7.85	-7.35
	(1.52)	(1.31)
Regional GDP growth rate	0.011	0.01
	(0.05)	(0.07)
Regional fiscal deficits	0.19**	0.19**
	(3.91)	(3.83)
Regional unemployment rate	2.69*	2.59*
	(3.53)	(3.26)
Regional private sector market development	0.17	0.12
	(0.32)	(0.17)
Largest owner's ownership percentage	0.00	
	(0.52)	
Largest owner is the State Asset Bureau		-0.60**
		(4.59)
Regulated Industries	0.38	0.37
	2.18	(2.00)
ROE	-6.78***	-6.61***
	(8.29)	(7.99)
Market-to-book value of equity	0.08	0.06
	(1.24)	(0.74)
Leverage	-0.14	-0.14
	(1.11)	(1.08)
Total assets	0.20	0.182
	(2.28)	(1.90)
N	617	617
Pseudo R-sq	0.05	0.05

Appendix 1
The Variables

This appendix table describes the variables collected for the 617 Chinese listed firms included in our study. The first column presents the variable names. The second column describes the variables. All the board data are collected manually from the IPO prospectus of listed companies. The financial data are obtained from the Shenzhen Genius Information Technology Company database. The regional data are obtained from China Economics database.

Variables on board characteristics	
CEO is politically-connected	Dummy variable to measure whether there is politically-connected CEOs in the firm, 1 if CEO was or is a current or ex-government bureaucrat, and 0 otherwise. Government includes central, local and other governments.
Board size	The total number of directors on the board during the IPO
Number of politically-connected directors	The number of directors who used to work or are currently working for the government, including central government, local governments and other governments.
Number of directors connected with local governments	The number of directors (excluding CEO) who used to work or are working for government agencies of local administrative region where the listed firm is located, including government agencies at the provincial level and below. The level of autonomous regions and municipalities directly under the central government are considered equivalent to the provincial level.
Number of manager directors	The number of director managers. Director managers are managers who serve as directors of the firm during the IPO.
Number of directors with accounting, law, or finance professions	The number of directors (excluding CEO) as consultants or finance professionals. Directors as consultants or finance professionals are those who used to work or are currently working for financial institutions or intermediaries, or who are accountants, lawyers, or auditors.
Number of directors with non-affiliated business experience	The number of directors with business experience from unaffiliated firms. These are directors who used to work or are currently working for any unaffiliated firms. The largest shareholder, parent firm of the largest shareholder, other large shareholders, pre-existing firm prior to the IPO, and subsidiaries of the listed firm are considered as affiliated firms.
Number of directors in academics	The number of academician directors. Academician directors are those who used to work or are currently working for universities or research institutions.
Number of directors with professional background	The number of directors who have business experience from unaffiliated firms, or who are experts or academics. The definitions for unaffiliated firms, experts and academics are presented above.
Director education level	The average education level of the directors on the board during the IPO. In this paper, we classify the education level as follows: If below junior college, the value is 0; if junior college, the value is 1; if graduated with bachelor degrees, the value is 2; if graduated with master degrees the value is 3; and if graduated with doctorate degrees, the value is 4.
Director Age	The average age of directors on the board when IPO.
Number of woman director	The number of female directors as percentage of board size.
Variables on ownership and financial information	
Largest owner's ownership percentage	The percentage of shares held by the largest shareholder of the listed firm at the end of the IPO year.
Largest owner is the state asset bureau	Dummy variable. 1 if firm's largest shareholder is state asset management bureau; 0 otherwise.
ROE	Return on equity in the IPO year.

Market-to-book value of equity	Year-end stock price over book value of equity.
Total assets	The logarithm of assets at the end of IPO year.
Leverage	IPO-year-end debt divided by assets.
Change in ROE one year after IPO	Return on equity one year after the IPO minus return on equity in the IPO year
Change in ROE two year after IPO	Return on equity two years after the IPO minus return on equity one year after IPO
Cumulative market-adjusted compounded stock returns one year after IPO	Market-adjusted monthly stock return continuously compounded over the twelve-month period after the IPO
Cumulative market-adjusted compounded stock returns two year after IPO	Market-adjusted monthly stock return continuously compounded over the twenty-four-month period after the IPO
Cumulative market-adjusted compounded stock returns three year after IPO	Market-adjusted monthly stock return continuously compounded over the thirty-six-month period after the IPO

Variables on industries

Natural resources	SIC code = 0100, 0200, 0700, 0800, 0900, 1000, 1200, 1300, 1400, 2900, or 4600.
Service and trade	SIC code = 4700, 5000, 5100, 5300, 5400, 5800, 7000, 7200, 7300, or 7900.
Public utilities	SIC code = 4000, 4100, 4200, 4300, 4400, 4500, 4800, or 4900.
Finance and real estate	SIC code = 6000, 6100, 6200, 6300, 6400, 6500, or 6700.
Conglomerate	SIC code = 9900.
Regulated industries	Dummy variable. 1 if the firm's industry belongs to natural resources, or public utilities or finance; and 0 otherwise.

Variables on regional development

Regional GDP growth rate	Yearly regional average GDP growth rate in and before firm's IPO year
Regional fiscal deficits	Log(fiscal deficits) if yearly average regional fiscal deficits in and before IPO year > 0; and 0 if yearly average regional fiscal deficits in and before IPO year = 0; and, –Log(the absolute value of fiscal deficits) if yearly average regional fiscal deficits in and before IPO year < 0
Regional unemployment rate	The yearly average of non-working population over total population in a region in and before IPO year
Regional private sector market development	Yearly average ratio of private sector in regional GDP in and before firm's IPO year

Appendix 2
Pearson Correlation Coefficients

All variables are defined in Appendix 1.

Panel A

	Board size	Number of politically-connected directors	Number of directors connected with local governments	Number of manager directors	Number of directors with professional background	Number of directors with accounting, law, or finance professions	Number of directors with non-affiliated business experience	Director education level	Number of directors in academics	Director Age	Number of woman director
CEO is politically-connected	-0.0124 (0.7578)	0.3402 (<.0001)	0.4309 (<.0001)	-0.0326 (0.4186)	-0.1991 (<.0001)	-0.1624 (<.0001)	-0.0693 (0.0854)	0.0624 (0.1217)	-0.1712 (<.0001)	0.1521 (0.0001)	-0.1450 (0.0003)
Board size	1.0000	0.3197 (<.0001)	0.2021 (<.0001)	0.5634 (<.0001)	0.3614 (<.0001)	0.1143 (0.0045)	0.3797 (<.0001)	-0.0107 (0.7915)	0.1764 (<.0001)	-0.0394 (0.329)	0.2175 (<.0001)
Number of politically-connected directors		1.0000	0.7062 (<.0001)	0.0806 (0.0454)	-0.1095 (0.0065)	-0.2740 (<.0001)	0.1016 (0.0115)	0.0309 (0.4438)	-0.1322 (0.001)	0.2780 (<.0001)	-0.1454 (0.0003)
Number of directors connected with local governments			1.0000	0.0085 (0.8335)	-0.2004 (<.0001)	-0.1841 (<.0001)	-0.0099 (0.8058)	-0.1076 (0.0075)	-0.2132 (<.0001)	0.1393 (0.0005)	-0.0161 (0.6894)
Number of manager directors				1.0000	-0.0809 (0.0445)	-0.1663 (<.0001)	0.0531 (0.1876)	-0.0821 (0.0416)	-0.0947 (0.0187)	0.0367 (0.3626)	-0.0202 (0.6174)
Number of directors with professional background					1.0000	0.4530 (<.0001)	0.7110 (<.0001)	0.3519 (<.0001)	0.7122 (<.0001)	-0.0132 (0.7434)	0.2025 (<.0001)
Number of directors with accounting, law, or finance professions						1.0000	0.3381 (<.0001)	-0.2626 (<.0001)	-0.0261 (0.5184)	-0.3088 (<.0001)	0.3071 (<.0001)
Number of directors with non-affiliated business experience							1.0000	0.0308 (0.4448)	0.0895 (0.0262)	-0.0774 (0.0548)	0.1855 (<.0001)
Director education level								1.0000	0.6106 (<.0001)	0.3629 (<.0001)	-0.1153 (0.0041)
Number of directors in academics									1.0000	0.1747 (<.0001)	0.0189 (0.6395)
Director Age										1.0000	-0.2711 (<.0001)
Number of woman director											1.0000

Panel B

	Largest owner's ownership percentage	Largest owner is the State Asset Bureau	ROE	Market-to-book value of equity	Leverage	Total assets	Regional GDP growth rate	Regional fiscal deficits	Regional unemployment rate	Regional private sector market development
CEO is politically-connected	0.0303 (0.4522)	-0.1126 (0.0051)	-0.0300 (0.4567)	-0.0134 (0.7400)	-0.0170 (0.6730)	0.0640 (0.1125)	-0.0658 (0.1025)	0.1008 (0.0122)	0.0733 (0.0675)	-0.0015 (0.9713)
Largest owner's ownership percentage	1.0000	-0.1325 (0.001)	0.1433 (0.0004)	-0.0532 (0.1867)	-0.1282 (0.0014)	0.2572 (<.0001)	-0.0312 (0.4393)	-0.0616 (0.1264)	-0.0492 (0.2199)	0.0367 (0.3630)
Largest owner is the State Asset Bureau		1.0000	-0.0863 (0.0321)	-0.0411 (0.3086)	0.0463 (0.2504)	-0.1937 (<.0001)	0.1382 (0.0006)	-0.0795 (0.0484)	-0.0093 (0.8175)	-0.0936 (0.0201)
ROE			1.0000	0.1282 (0.0014)	-0.1790 (<.0001)	-0.0089 (0.8258)	0.0727 (0.0713)	0.0076 (0.8512)	-0.0954 (0.0174)	0.0390 (0.3336)
Market-to-book value of equity				1.0000	-0.1162 (0.0039)	-0.4185 (<.0001)	-0.0089 (0.8258)	0.0164 (0.6847)	-0.0622 (0.1223)	-0.0084 (0.8356)
Leverage					1.0000	0.1528 (0.0001)	-0.1073 (0.0077)	-0.0494 (0.2201)	0.0709 (0.0783)	-0.0590 (0.1432)
Total assets						1.0000	-0.1960 (<.0001)	0.0997 (0.0132)	0.0821 (0.0408)	0.1488 (0.0002)
Regional GDP growth rate							1.0000	-0.3346 (<.0001)	-0.3540 (<.0001)	0.1325 (0.001)
Regional fiscal deficits								1.0000	0.0614 (0.1257)	-0.0235 (<.0001)
Regional unemployment rate									1.0000	-0.2623 (<.0001)
Regional private sector market development										1.0000

Panel C

	Change in ROE one year after IPO	Change in ROE two year after IPO	Cumulative market-adjusted compounded stock returns one year after IPO	Cumulative market-adjusted compounded stocks return two years after IPO	Cumulative market-adjusted compounded stock returns three years after IPO
CEO is politically-connected	-0.0597	-0.0031	-0.1011	-0.1045	-0.1197
	(0.1389)	(0.9395)	(0.0120)	(0.0105)	(0.0064)
Change in ROE one year after IPO	1.0000	0.2736	0.2451	0.3203	0.2476
		(<.0001)	(<.0001)	(<.0001)	(<.0001)
Change in ROE two year after IPO		1.0000	-0.0087	0.0371	0.1006
			(0.8323)	(0.3647)	(0.0223)
Cumulative market-adjusted compounded stock returns one year after IPO			1.0000	0.6878	0.4819
				(<.0001)	(<.0001)
Cumulative market-adjusted compounded stock returns two years after IPO				1.0000	0.7163
					(<.0001)
Cumulative market-adjusted compounded stock returns three years after IPO					1.0000