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Political Endorsement and Political Visit: New Evidence of How Governments Influence Capital Markets

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Declaration

I declare that this thesis has been composed solely by myself and that it has not been submitted, in whole or in part, in any previous application for a degree. Except where states otherwise by reference or acknowledgment, the work presented is entirely my own.

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Date: 30th Jan. 2019

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Abstract of Thesis

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Title of thesis:	Political Endorsement and Political Visit: New Evidence of How Governments Influence Capital Markets		

Governments participate in financial markets through various methods, such as issuing policies, providing subsidies or directly owning firms. This thesis examines the effects of two under-researched ways in which the government influences the market—political endorsement and political visits. Chapter 3 explores firms that are endorsed by the central government of China and finds that the government's underlying motive for endorsing firms is its social goals rather than vested interests. Political endorsement is positively associated with market reactions, especially when firms are endorsed for their achievements and advanced operation. Moreover, political endorsement has significantly positive impact on firms' operating performance, and the results are consistent after controlling for selection on observables through applying PSM methodology and controlling for selection on unobservables through applying treatment effects model with the instrumental variable technique, no matter which performance measurements are used. The positive effects are more salient for firms with weak pre-event performance, fewer connections, a greater dependence on external financing, and those located in places with better institutions. Moreover, the increase in subsidies, the reduction in cost of debts, and the improvement in investment efficiency are identified as three channels of value creation after political endorsement. In Chapter 4, another under-researched way in which government influences the market is examined —political visit. I

examine the effects of political visits by Chinese state leaders based on a sample of firms that hosted political visits from 2009 to 2016. This paper first finds that representativeness, political connections and alignment with government goals are the three basic criteria for choosing firms to visit. Moreover, the results demonstrate that the positive market reactions to political visits vary according to the political power of different administrations and different government officials. Further investigation reveals a positive association between political visits and operating performance, which is contingent on different firm and institutional characteristics and is robust after applying propensity score matching and institutional variable techniques. Moreover, the results show that political visits can be substituted as a source of legitimacy for CSR activities and increase the social attention and expectation on the firms, which reduces firms' incentive to donate while motivating their unethical behaviour in order to meet social expectations. Chapter 5 introduces the concept of passive signalling to extend existing signalling theory. Political endorsements and visits are discussed as two examples of passive signals, and the effects of passive signals are examined in an IPO setting wherein information asymmetry is a serious problem. The results show that passive signals can efficaciously influence the views of shareholders, potential institutional and private investors, regulators and partners, thus affecting every part of the IPO process, including IPO application, valuation during issuing and post-IPO performance. Specifically, the results demonstrate that firms with passive signals are associated with higher likelihood of IPO success, narrower offer price spread, lower under-pricing and better long-run performance. This chapter also provides a theoretical background for the previous two chapters about the mechanisms of endorsements and visits to influence investors' evaluation. Overall, this thesis provides evidence supporting the effectiveness of the two under-researched ways in which the government influences the market and contributes to the literature on the role of government, political economy, political connection, signalling theory, entrepreneurship and CSR.

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Political endorsement and political visits, which this thesis examines, are two under-researched ways in which the government influences the market. Political endorsement refers to supportive public statements or actions from the government about firms, and a political visit is defined in this thesis as a political device in which a political leader carries out all of the functions and symbolic representations of governing by periodically inspecting firms.

Both political endorsement and visits have positive associations with market reactions and firm operating performance, contingent on the content of the endorsement, the political power of the visiting leaders, and the different firm characteristics and levels of regional institutional development. Moreover, political endorsement and visits, as examples of passive signals which are not sent out intentionally by firms themselves, can act as a reliable cue to combat information asymmetry in the IPO market, and are significantly associated with higher likelihood of IPO success, narrower offer price spread, lower under-pricing and better post-IPO performance.

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Chapter 1 Introduction

Governments adopt different models to interact with markets, including the invisible-hand model, the helping-hand model and the grabbing-hand model (Frye & Shleifer, 1996), and researchers hold either a development view (Gerschenkron, 1962; Hawtrey, 1926a) or a political view (Kornai, 1979; Shleifer & Vishny, 1994) on the impact of governments on financial markets. Governments participate in market activities through various approaches, such as establishing political connections (e.g. Faccio, Masulis, & McConnell, 2006) and issuing laws, regulations and policies (e.g. Shleifer, 1997), as well as having direct ownership of firms (e.g.Shleifer & Vishny, 1994). This thesis explores two under-researched ways in which the government influences the market – political endorsement and political visits.

This thesis, as a whole, largely supplements literature on the role of the government by investigating political endorsement and political visits – two strategies the government uses to affect the market, which have received limited academic attention. The government penetrates the market through various methods, including directly owning enterprises (Andrianova, Demetriades, & Shortland, 2012; Shleifer & Vishny, 1994), issuing laws or policies (Krueger, 1974; Shleifer, 1997) and establishing corporate-level or individual-level political connections (Claessens, Feijen, & Laeven, 2008; Faccio et al., 2006). This thesis particularly contributes to the stream of literature that focuses on exploring the ways in which the government influences the market. Political endorsement, tested in Chapters 3, and political visits, examined in Chapter 4, are two under-researched ways in which the government

influences the market, which largely fill the existing gaps in the literature. Furthermore, following the introduction of the development view (Gerschenkron, 1962; Hawtrey, 1926b) and the political view (Kornai, 1979; Shleifer & Vishny, 1994), there has been an increasing focus in the literature on examining the role of the government in the market, within which one of the most influential works is the paper of Frye and Shleifer (1996) proposing three government-market interaction models: the invisible-hand model, the helping-hand model and the grabbing-hand model. This thesis provides supporting evidence for the helping-hand model and development view.

To better understand the government's role in the capital market, "The Role of Government in the Market: A Review" (Chapter 2) provides a detailed review, including different interaction models between government and market, different researchers' views regarding the impact of the government's market participation, and various methods the government uses to influence the market. This chapter finds that governments and capital markets are closely linked and demonstrates that political visits and political endorsement, which this thesis focuses on, are two under-researched areas.

This thesis then explores an under-researched way in which the government influences the market – political endorsement – in "Political Endorsement: Evidence from Propaganda Coverage" (Chapter 3). Political endorsement is defined as public statements or actions showing government's support for firms. This chapter finds that political endorsement is an efficient way for the government to help firms add value, both in the form of higher market reactions and better operating performance. And the results are robust after applying PSM to control selection on observables and applying treatment effects model with the instrumental variable technique to control for

selection on unobservables. Such value-added effects are more pronounced when firms are endorsed for their achievement and advanced operation, and are more salient for firms with relatively weak pre-event performance, less connections, and higher dependence on external financing, and also for those located in provinces with strong institutions, Moreover, three channels of value creations are identified in this paper: increased subsidies, reduced cost of debt, and higher investment efficiency. In addition, the results also show that the government's underlying motive for endorsing firms is its social goals rather than vested interests.

This chapter largely contributes to the literature on the role of government as the first study to investigate political endorsement – a way in which government affects the market. Moreover, Chapter 3 also extends the literature on endorsement from three perspectives. First, previous literature tests the effects of endorsement mainly in a marketing context, such as celebrity endorsements (Farrell, Karels, Montfort, & McClatchey, 2000; Khatri, 2006) and typical customer endorsements (Freiden, 1984), while this chapter introduces the concept of endorsement into finance and examines its influences on market and firm performance. Second, some literature points out that affiliation with prestigious underwriters (Carter, Dark, & Singh, 1998; Pollock, Chen, Jackson, & Hambrick, 2010; Ramirez, 1995), venture capitals (Milanov & Shepherd, 2013) and auditors (Beatty, 1989) provides similar effects to endorsement. Compared with endorsements from these financial organisations, which are based on bi-lateral cooperation, endorsement from the central government is unilaterally decided by the government, and thus is rarer and more valuable. Therefore, this chapter further contributes to this stream of literature by introducing a kind of more unilateral and more valuable endorsement that is largely ignored in previous literature. Third, this

study also supplements literature on endorsement by shifting attention to a new type of endorser—the government – while existing literature focuses on endorsers like customers (Freiden, 1984), celebrities (Farrell et al., 2000) and experts (Fireworker & Friedman, 1977).

Another largely ignored way in which governments participate in the market is political visit, which is investigated in Chapter 4 "Political Visit: State Leader Visit and Firm Performance", and is defined as a political device in which national political leaders carries out all the functions and symbolic representations of governing by periodically visiting firms. By testing a sample of firms that hosted political visits of Chinese state leaders from 2009 to 2016 and applying propensity score matching and instrumental variables to control bias, this chapter documents positive associations between political visits and firm value, both in the form of market performance and operating performance. However, the results show that the degree of the positive effects depends on the political power of visiting leaders and different administrations, as well as on various firm and institutional characteristics. Furthermore, the tests on firms' post-visit behaviour demonstrate that political visits can be substituted as a source of legitimacy, which results in a reduced need to conduct CSR. In face of the increased social attention, firms tend to engage more in disclosure. However, in order to meet increased public expectations, unethical behaviours like earnings management increase after visits. Moreover, the results of this study show that representativeness, political connections and alignment with government goals are the three basic criteria for choosing firms to visit.

The first main contribution of Chapter 4 is that it supplements the literature on the role of government, which is also a main contribution of the whole thesis and is

already discussed at the beginning of the introduction. Second, through differentiating the effects of political visits from leaders with different political powers, comparing the effects of two administrations and examining the post-visit effects on firm behaviour, this chapter particularly contributes to the paper of Li, Tsang, Luo, and Ying (2016) and Schuler, Shi, Hoskisson, and Chen (2017) which document positive effects of leaders' site visits but ignore the differences caused by different leaders and administrations, and also ignore the firms' post-visit behaviour. Third, Chapter 4 largely supplements literature on political visits by investigating how the government chooses firms to visit because no literature to date has clarified the criteria for choosing firms. The results particularly complement the interview conducted by Schuler et al. (2017) which interviewed several experts and they speculated that long-term firm-government interactions was a possible determinant of political visit. Fourth, Chapter 4 also adds value to literature on CSR by pointing out that political visits can be substituted as a source of legitimacy and demotivate firms to donate.

As a further step, based on the phenomenon of political endorsement and political visits examined in the Chapters 3 and 4, "Passive Signals and IPO market: Signalling Theory Extension" (Chapter 5) employs the concept of political endorsement and visits as two examples of passive signals to extend existing signalling theory, and this chapter also provides a theoretical background to explain why political endorsement and visits examined in previous chapters can strongly influence the market. Compared with the signals investigated in existing literature, which are intentionally sent out by firms themselves, passive signals are different in both purpose and form, making them particularly reliable cues to combat information asymmetry and enabling them to have higher signal fit, signal honesty, and signal observability. The IPO market provides a

perfect setting to test the impact of passive signals regarding its high information asymmetry. The results demonstrate that passive signals are valued by investors even under circumstances with high information asymmetry when investors carefully screen information. The results show that passive signals like political endorsement can efficaciously influence the views of shareholders, potential institutional and private investors, regulators and partners, thus affecting every part of the IPO process, including IPO application, IPO valuation during issuing and post-IPO performance. Specifically, this chapter finds that passive signals can successfully influence regulators (CSRC members), hence resulting in higher IPO pass rates. Financial intermediaries like investment bankers and institutional and individual investors also value passive signals, leading to narrower offer price spread, lower under-pricing, higher cumulative abnormal returns and higher industry-adjusted buy-and-hold returns over one to five years after IPO. Furthermore, results demonstrate that firms achieving political endorsement are less likely to change face and are able to outperform their counterparts in both the short and long term.

This chapter contributes to and extends the boundaries of signalling theory in three ways. First, this chapter introduces a new kind of signal – passive signals – which are issued in situations where firms lose control of the decision to issue signals and cannot control the signal content; this challenges the traditional signals investigated in existing literature that are intentionally sent out by firms to convey positive information, such as patent numbers (Gunther McGrath & Nerkar, 2004), board prestige (Certo, 2003) and firm names. As suggested by Janney and Folta (2003) and Connelly, Certo, Ireland, and Reutzel (2010), the intention of signalling is vital in influencing people's judgement and non-intentional signals are relatively ignored by

the literature, and Chapter 5 fills this gap by investigating passive signalling. Second, different from the commercial-led signals discussed in existing literature, whose purpose is to help firms enjoy commercial benefits such as overcoming consumer uncertainty (Lampel & Shamsie, 2000) and attracting investment (Park & Mezias, 2005), passive signals are sent out by authorities like the government, and their main purpose is encouraging industries and stimulating the economy, rather than focusing on individual firms. Therefore, Chapter 5 also supplements signalling theory literature by investigating such authority-led signals which are different from the commercial-led signals in both purposes and forms. Third, this thesis introduces the passiveness as a new criterion to enhance the efficacy of signals, which complements recent literature on determinants of signal efficacy, including signal observability, high signal costs, signal honesty and signal fit (e.g. BliegeBird et al., 2005; Connelly et al., 2010).

Moreover, Chapter 5 also adds value to literature on entrepreneurship and IPO. Strategic alliance (Gulati, 1998) and association with prestigious parties like VCs (Milanov & Shepherd, 2013), underwriters (Pollock et al., 2010) or universities (Bonardo, Paleari, & Vismara, 2011) are common strategies used by new ventures to overcome the liabilities of newness and smallness. Quantifying the effects of passive signals on new firms, this chapter suggests a new approach through which the government can help new firms overcome barriers, thus encouraging market competition and promoting innovation. Furthermore, this chapter examines the government's role in IPO from the new perspective of its market power exercised through sending out signals rather than its regulatory power during IPO screening, as tested in most IPO literature (e.g. Yang, 2013). Finally, Chapter 6 concludes the thesis.

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Chapter 2 The Role of Government: A Review

2.1 The Role of Government in The Market

Researchers like Frye and Shleifer (1996) propose three models through which the government interacts with markets and influences economic growth: the invisible-hand model, the helping-hand model and the grabbing-hand model. Under the invisible-hand model, governments with low corruption levels delegate resource allocation power to the private sector and confine themselves to providing basic public services like laws, regulations and contract enforcement. Invisible-hand governments are more common in Eastern Europe and countries that make an effort to join the European Community (Sachs, 1994).

Under the helping-hand model, governments maintain close ties with markets by taking the initiative to promote private economic activity (Frye & Shleifer, 1996). For example, pursuing industrial policies, establishing political connections with firms and treating firms unfairly are typical features of helping-hand governments. Different from invisible-hand governments, helping-hand bureaucrats have overwhelming power over the legal framework to adjudicate most disputes, leading to the limited effects of legal frameworks in these countries. However, despite the fact that corruption usually exists in helping-hand governments, the corruption is organised and the amount is limited. A representative and well-researched example of a helping-hand government is China (e.g. Walder, 1995). For example, Sun and Tong (2003) support the helping-hand role of the Chinese government during the process of share issuing privatization by examining the performance of over 600 SOEs in China.

By contrast, grabbing-hand bureaucrats are far less organised and far more corrupt, with many bureaucrats focusing only on pursuing their own political purposes (Frye & Shleifer, 1996; Shleifer & Vishny, 1993). Without a unified public-policy stance, grabbing-hand governments are not restricted by courts, and are empowered to expropriate firms by executing predatory regulations. Russia is one of the typical countries with grabbing-hand government researched in existing literature (e.g. Levin and Satarov, 2000; Shleifer, 1997). For example, Levin and Satarov (2000) point out that corruption is a social norm in Russia, resulting in government's grab of the society and the failure of economic reform.

As a further step, later literature starts to consider the government's role in the market from a dynamic perspective, and highlights that governments in reality are always a mix of invisible-hand, helping-hand and grabbing-hand models. Through investigating the effects of related party transactions between firms and their government parents, Cheung, Rau, and Stouraitis (2009) find that the related party transactions can benefit minority shareholders if the firm is controlled by the central government, or expropriate wealth from minority shareholders if the firm is controlled by local government due to the corruption of local bureaucrats, suggesting the helping-hand role of central government and grabbing-hand role of local government. Researches by Zou, Wong, Shum, Xiong, and Yan (2008) and Chen, Firth, and Xu (2009) find higher market reactions to the announcement of purchasing the liability insurance of directors for centrally controlled firms over locally controlled firms, and the higher Tobin's Q of firms controlled by the central government over those controlled by local government, and also indicate the helping role of the central government and the grabbing role of local government. Furthermore, the same

bureaucrat can switch between different models. For example, Chen, Hillman, and Gu (2001) point out that the revenue-sharing rules imposed by the central government on local government, and the interactions between local and central governments, sometimes can motivate local government to switch from helping hand to grabbing hand model.

Furthermore, some literature explores the determining factors of operating models (i.e. invisible, helping, grabbing). For example, Brown et al. (2009) demonstrate that larger bureaucracy size can lead to a helping-hand model. Larger bureaucracy size indicates increased capacity and competition among bureaucrats, leading to a better post-privatization business environment in the form of lower license application costs and reduced waiting time for the administration. As a result, governments with larger size are usually helping-hand for the privatization and market development. The work of Dalgic and Van Long (2006) complements this study by pointing out that low local tax share, shorter politician tenure length and lower local governance transparency (i.e. the ease with which extortionary activities can be hidden from central government) can motivate local governments to adopt a grabbing-hand model.

The model of the government plays a key role in determining the success of economic reform and privatization. According to Brown, Earle, and Gehlbach (2009), privatized firms after reform have incentives to maximise profits by actively restructuring the workforce, investing in new technologies or increasing R&D for new products. Government cooperation and support are prerequisites for the success of these endeavours. While a helping-hand government is capable of providing essential legal infrastructure to reduce restructuring costs, a grabbing-hand bureaucracy could

raise costs due to its weak institution, high corruption or weak rule of law. By comparing government models between Poland and Russia, Frye and Shleifer (1996) claim that the grabbing-hand government is accountable for the failure of economic transition in Russia. The later work of Shleifer (1997) upholds this view by attributing the failure of Russian economic reform to the poor performance of the government in terms of its inappropriate fiscal and electoral incentives for politicians and inefficient tenure system of politicians.

2.2 The Impact of Governments on Markets -- Development View, Social View, Political View And Agency View

Researchers hold different views on the impact of government participation in financial markets, including development view, social view, political view and agency view. The development view (Arthur Lewis, 1945; Gerschenkron, 1962; Hawtrey, 1926) highlights the government's necessary role in fulfilling the functions of institutions, especially when institutions like banks fail to support private capital markets due to public distrust, capital scarcity and fraudulent practices among debtors. For example, banks in Russia experienced a failure to direct savings to support industries due to the scarcity of capital, and finally state-owned banks allow the government to step in to fulfil the functions to support both economic and financial development (Gerschenkron, 1962). As another example, Andrianova, Demetriades, and Shortland (2008) find that state-owned banks can mobilize savings more effectively than private banks if contract enforcement is weak in the private sector. Moreover, the positive effects of government market participation are more obvious during economic downturn. For example, during the 2008 financial crisis, while

privately owned banks cut down their credit supply to a large extent, the reduction in state-owned banks was far less, in order to support the economy (Fungáčová, Herrala, & Weill, 2013).

Advocators of nationalisation, like Arthur Lewis (1945) and Myrdal (1968), provide supporting evidence for the development view. For instance, by comparing the economic growth of 128 countries, Andrianova, Demetriades, and Shortland (2012) point out that government ownership of banks is a contributing factor for the economic growth rate. Although state ownership is usually criticised for inefficiency, researches on transition economies (Bonin, Hasan, & Wachtel, 2005), developed countries like Germany (Altunbas, Evans, & Molyneux, 2001) and countries with lower income (Detragiache, 2005) find that state-owned banks have profit and cost advantages and perform more efficiently.

Another view that is similar to the development view is the social view (Atkinson & Stiglitz, 1980), which suggests that state ownership can be used to address market failures whenever its social benefits exceed the costs. Stiglitz (1993) upholds this view by underlining the government's key role in overcoming market imperfections and failures to invest in socially desirable projects, thus enhancing social welfare and contributing to economic development. For example, Stiglitz (1993) points out that government participation in the financial, particularly banking, industry is socially essential in order to form a secure financial system, overcome market failure due to information asymmetry, and support unprofitable but socially desirable projects.

In contrast, the political view (Kornai, 1979; Shleifer & Vishny, 1994) suggests that the underlying motive for government participation in the market is the personal political interests of politicians like votes, bribes and political contributions. For

example, Shleifer and Vishny (1994) state that public enterprises can lead to excess employment, excess wages and the production of goods that only meet the needs of politicians. One of the most influential works supporting the political view is the paper of La Porta, Lopez‐de‐Silanes, and Shleifer (2002), which tests the impact of state-owned banks in 92 countries and concludes that government ownership is more prevalent in less developed countries with backward financial systems, leading to both lower financial development and lower economic growth. Moreover, despite the fact that connected firms have a higher probability of default, state-owned banks still provide larger loans and favourable rates for them (Claessens, Feijen, & Laeven, 2008; Khwaja & Mian, 2005). Vins (2008) also upholds the political view and highlights a positive association between political elections and the loan amounts provided by state-owned banks, and a negative relationship between elections and the probability of closing branches, engaging in M&A and laying off staff.

Corruption accounts for a major part in political view to demonstrate the negative role of government's market participation. For example, researchers like Shleifer (1997) and Levin and Satarov (2000) point out that high corruption can distort resource allocation and leads to the failure of economic reforms. However, the paper by Shleifer (1998) points out that corrupt governments remain effective in positively influencing markets under certain circumstances, especially when institutions are weak and necessary regulation is jeopardized by corruption. Some literature then investigate corruption from a dynamic perspective and highlight a U-shaped relationship between government and market (Pagano, 2008; Petrou & Thanos, 2014). For example, Petrou and Thanos (2014) claim that capital investment first falls as corruption increases from low to moderate levels, and then increases as corruption increases from moderate to

high levels, suggesting that the government serves as a grabbing hand when corruption is low, and a helping hand when corruption is high. Under high corruption, officials tend to form "rules of the game" in order to maximise their rents, thus reducing the uncertainty of corruption and motivating firms to use bribes and buy legitimacy in order to successfully invest in these countries.

A view similar to the political view is the agency view, which admits that government market participation can solve market imperfections, while highlighting that agency costs within the government can offset the benefits. This view stresses a trade-off between the enhanced allocative efficiency supported by development and social views and the internal efficiency of state-owned firms. For example, Shleifer (1998) claims that government regulation and contracting can be used to address market imperfections and concerns, but government ownership is inefficient due to its low incentive to innovate, improve quality and reduce costs. Furthermore, the pursuit of political goals and personal interests can result in high corruption and resources transferred to supporters.

2.3 Main Influencing Mechanisms of Government

2.3.1 Types of Government Actions

According to the influential work of Stiglitz (1993), the actions governments take to influence the market can be classified into four categories, including issuing policies in terms of bankruptcy, accounting or taxes; directly participating in the capital market by providing loans; creating and regulating financial market institutions; and intervening in these institutions.

Moreover, government actions can be classified into six categories according to their objectives: stimulating economic growth, ensuring macroeconomic stability, motivating competition, enhancing resource allocation, ensuring bank solvency and providing consumer protection (Stiglitz, 1993).

With the development of the literature and the economy, researches point out more ways in which governments participate in markets, of which political connection, laws and policies, and state ownership are the three most influential. The following subsections review these three well-researched approaches in detail, and the political endorsement and political visit this thesis examines are two under-researched ways in which government influences the market.

2.3.2 Political Connection

Political connection is commonly used as a way for the government to influence the market. Political connection is a ubiquitous trend both in developed and emerging markets. For example, political connections are detected in developed countries such as the U.S. (Kim, Pantzalis, & Park, 2012) and Poland (Hasan, Jackowicz, Kowalewski, & Kozłowski, 2017), and pervasive in emerging markets such as China (Allen, Qian, & Qian, 2005; Chen, Lee, & Li, 2008; Guariglia & Mateut, 2016; He, Wan, & Zhou, 2014; Li, Poppo, & Zhou, 2008; Sun, Mellahi, & Thun, 2010), Indonesia (Leuz & Oberholzer-Gee, 2006) and Malaysia (Gul, 2006).

Political connection can be observed from various perspectives. For instance, campaign contributions (Claessens et al., 2008), political experience or identity of managers and directors (Faccio, Masulis, & McConnell, 2006; Hung, Wong, & Zhang, 2012; Li, He, Lan, & Yiu, 2012; You & Du, 2012), firm location (Hillman, 2005; Siegel,

2007) and state ownership (Chen et al., 2008; Dinç, 2005; Okhmatovskiy, 2010) are all observable and explicit ties that can be used to determine whether a firm is connected.

Furthermore, political connections can be either at an individual level or a company level. Individual-level connections consist of two broad categories: political experience and political identity. Political experience is defined as top executives' and board members' former occupation in parliaments, branches of government, state-owned banks and other regulated industries (Faccio et al., 2006; Hasan et al., 2017; You & Du, 2012). Similar measurements are employed by Li et al. (2012), Hung et al. (2012), Faccio et al. (2006) and Boubakri, Cosset, and Saffar (2008). Executives and board members are considered to possess a political identity if they are party members (Li, Meng, Wang, & Zhou, 2008), deputies to the National People's Congress or National Committee (You & Du, 2012), mayors or deputy mayors (Calomiris, Fisman, & Wang, 2010), or government or military officers (Fan, Wong, & Zhang, 2007). Additionally, some political connection is relatively indirect. For instance, if top managers have relatives with the same last name or come from the same family as serving government officers, Faccio et al. (2006) and Amore and Bennedsen (2013) deem them to be politically connected. Similarly, Siegel (2007) identifies political connection if top managers graduated from the same high school or were born in the same region as government officers. Other indirect political connection includes governmental awards, such as the "Model Worker" award (You & Du, 2012). As to company level connections, literature identifies company-level political connections by exploring whether firms pay huge campaign contributions (Claessens et al., 2008), have their headquarters in the birthplace of government officers, or are state-owned

(Faccio et al., 2006).

There has long been controversy over whether political connection is a blessing or a curse. Abundant empirical literature embraces the view that political connection is a contributing factor to performance improvement and value enhancement. Under the supporting hand of the government, connected firms demonstrate higher value and generate higher long-term returns for investors (Luo & Liu, 2009). Investors' positive views on the promising future performance of connected firms pushes up the market value. For instance, Bunkanwanicha and Wiwattanakantang (2008) point out that the market-to-book ratio increases by 242.16% after previously non-connected firms establish ties with the government, and politically connected firms also outperform counterparts with 160% higher market-to-book ratios. The significant positive correlation between political connection and superior firm performance is also proved by researchers like Hillman (2005), Calomiris et al. (2010).

These positive effects of political connection, however, are seen as biased by other research that stresses the restrictions and high costs of connection. The mutual influences between firms and government sometimes constrain firm operations and cause high costs. First, inefficiency can be caused by the unreasonable diversion of firm resources and the surrender of autonomy (Shleifer & Vishny, 2002). For example, under informal political regulations, connected firms are forced to invest in government infrastructure projects using their capital raised from IPO, and are compelled to pay dividends to release the financial problems of government (Lawrence & Crispin, 1999). Second, political officers usually pursue personal objectives at the expense of connected firms' value (Shleifer & Vishny, 1994, 2002). For instance, in order to win a campaign, political officers usually force connected firms to misallocate

capital on campaign contributions, generating economic costs of higher than 0.2% of GDP (Claessens et al., 2008). As a result, politically connected firms are characterised by higher campaign contributions and lower returns. Third, connected firms are hampered from adapting to the new competitive environment due to the heavy "liability to localness" (Perez-Batres & Eden, 2008; Uzzi, 1997). For example, after foreign banks were allowed by the government to enter the Mexican market, domestic connected firms suffered from their liability to the government and lost their competitiveness to foreign counterparts (Perez-Batres & Eden, 2008). Fourth, the political relationship is quite unstable, as it heavily depends on political fortunes, and is featured as short-term. Consequently, the short-term relationship encourages opportunistic behaviours such as earnings management (Chen et al., 2008).

Considering the inconsistent effects of political connections, some literatures shift attention to the dynamic changes of the effects of political connections and try to find the critical point at which the costs of political connection exceed the benefits. For example, Cheung et al. (2009) assert that what determines the effects of political connection is government level (central or local) rather than the proportion of shares held by the government. While investors of locally connected firms suffer losses, central government connection can benefit investors by providing more resources to improve firm performance. Based on Okhmatovskiy (2010), direct connections with the government can induce severe interference, while indirect connections through connecting with state-owned companies are beneficial. Furthermore, the effects of political connection are contingent on market competition (Li, Poppo, et al., 2008), the soundness of formal institutions (Li, Meng, et al., 2008) and macroeconomic situation (Hasan et al., 2017).

Compared with developed markets, political connection is especially pervasive and vital in emerging markets, since developing markets are characterised by the coexistence of market mechanisms and governments' redistributive mechanisms (Zhou, 2000), which motivates firms to establish government ties to get access to resources. Firms in emerging markets are left vulnerable to market changes due to a lack of effective legal systems and property rights (Allen et al., 2005; Hoskisson, Eden, Lau, & Wright, 2000). Consequently, political connections can serve as an informal support in emerging markets.

Besides sharing the common characteristics of emerging markets, the Chinese market has several unique features which attract huge attention from researchers. The first unique point lies in the non-thorough reform, indicating that the government maintains control over economic transition (Luo, 2005), which is the opposite of the situation in other transformed economies, such as Poland and the Czech Republic, which have decentralised thoroughly (Hitt, Ahlstrom, Dacin, Levitas, & Svobodina, 2004). As a result, key resources are under the control of the Chinese government, leading to the overwhelmingly advantageous role of political connection as an informal channel to obtain resources. Second, the rapid changes in the economy and legal institutions challenge the stability of the market within a transition economy, resulting in the necessity of ties to act as a buffer against the unreliability of institutional infrastructure (Xin & Pearce, 1996). The third unique characteristic of China rests with the long tradition of ties. Social ties are deemed the 'lifeblood' of business in China (Ambler, Styles, & Xiucun, 1999; Xin & Pearce, 1996), without which marketing or daily operations are hard to succeed. Fourth, some special policies encourage the prevalence of political connections in China. For example, as Fan et al.

(2007) stated, the Chinese government has the right to nominate and appoint executives for listed companies. In their sample of 790 firms from 1993 to 2001, 27% of CEOs are appointed directly by the government.

2.3.3 Law, Regulations and Policies

Law, regulations and policies are the second channel through which the government influences the financial market and economic growth. Since the pioneering paper of La Porta, Lopez‐de‐Silanes, Shleifer, and Vishny (1997) which highlights the associations among legal origin, investor protection and development of financial markets, the literature increasingly focuses on the relationships among law, finance and economic growth. By comparing the legal rules of 49 countries, La Porta et al. (1997) point out that common law countries are superior in investor protection, followed by Scandinavian and German civil laws, while French civil law countries are ranked as worst in investor protection. This paper further underlines the contributing effects of legal protection for the value and breadth of both debt and equity markets.

Later research upholds and complements La Porta et al. (1997) by pointing out that both legal systems and enforcement are contributing factors for the development of financial intermediaries like banks, and more developed financial intermediaries in turn lead to economic growth (Levine, 1998, 1999). The positive relationship between financial sector development and economic growth is verified by many researchers, including Levine and Zervos (1999) and Beck, Levine, and Loayza (2000). For example, by examining data from 80 countries, King and Levine (1993) reveal a significant positive relationship between different measures of financial development and the growth rate of real per capita GDP.

Besides laws, issuing policies and regulations is another effective way for the government to affect financial markets and economic growth. For example, through testing 46 developing countries, Aizenman and Marion (1993) conclude that economic growth is negatively correlated with the uncertainty of fiscal and monetary policies. Moreover, according to Stiglitz (1993), regulations on fraud, accounting standards, insider trading and other issues are prerequisites for a viable equity market. For instance, to ensure the thickness of the equity market, the Korean government issued a regulation to restrict firms' debt-to-equity ratio, which effectively increased the magnitude of equity issues (Stiglitz, 1993). Furthermore, the effects of restrictive trade policies like import restrictions (Krueger, 1974) and tariffs (Johnson, 1960) on the economy and financial market are widely examined in existing literature.

Moreover, the government's function of issuing laws, regulations and policies plays a key role in determining the success of economic reform. For example, researchers like Shleifer (1997) claim that during times of economic transition, governments have to take on new functions of creating legal and regulatory institutions to enhance property rights and contract enforcement, as well as dealing with banking, securities markets and patents. At the same time, regulations to constrain the power of regulators to pursue personal political goals also largely contribute to the success of economic transition.

2.3.4 State Ownership

Directly owning firms is one of the major ways in which governments participate in market activities. Consistent with the development view, state ownership can fulfil the functions of institutions and overcome market imperfections, especially during

economic downturn (Arthur Lewis, 1945; Fungáčová et al., 2013; Gerschenkron, 1962). One stream of literature highlights the profit and cost advantages of state-owned firms over private ones (Altunbas et al., 2001; Detragiache, 2005), and the positive relationship between state ownership and economic growth (Andrianova et al., 2012). Moreover, with government ownership, social benefits can be strengthened as economically unviable but socially profitable projects can be invested in (Atkinson & Stiglitz, 1980).

However, another stream of literature claims that overcoming market imperfections cannot justify the existence of state ownership, as market imperfections like monopoly can be addressed by government contracting and regulations, without resorting to government ownership (Shleifer, 1998). Instead, the choice between government ownership and private ownership depends on how different models efficiently enhance cost reduction, quality improvement and innovation (Shleifer & Vishny, 2002). Compared with private firms, state-owned companies are less efficient as they have less incentive to reduce cost, improve quality or innovate because the managers are not owners and cannot share the return (Shleifer, 1998). Researchers like Barberis, Boycko, Shleifer, and Tsukanova (1996) and Ehrlich, Gallais-Hamonno, Liu, and Lutter (1994) support this view by pointing out that privatized firms outperform government-owned firms in quality, efficiency and productivity growth. Moreover, other literature asserts that state-owned firms are characterised by poorer monitoring systems, lower investor protection and insufficient investments. For example, Vickers and Yarrow (1991) state that state-owned companies that are only partially privatized face an adverse situation where no individual investor is really interested in the active monitoring. As a result of this poor monitoring and investor protection, managers have

no motivation to take reasonable risks in order to increase firm value (John, Litov, & Yeung, 2008).

This view is criticised as biased because it is the strong incentive of private firms to reduce costs that motivates them to sacrifice non-contractible quality. For example, with a high incentive to reduce cost and increase profits, private hospitals tend to refuse to treat non-profitable patients. Similarly, it is the low motivation of government-owned firms that make them more efficient in providing non-contractible quality (Shleifer, 1998). Therefore, some people advocate state ownership of water utilities to ensure water purification, as well as advocating state car makers in order to develop environmentally friendly cars. However, researchers like Shleifer (1998) still promote private ownership by stating that this problem can be solved through competition among private companies. In face of high market competition, the demands for firms' goods and services will decrease if the firms reduce costs excessively and sacrifice non-contractible quality. As a result, market competition can motivate private firms to emphasize non-contractible quality in order to survive.

State ownership is made less efficient not only by the weak incentive of state-owned firms to reduce costs and innovate but also by the pursuit of political goals and politicians' pursuit of personal economic interests. According to Shleifer (1998), governments all over the world have a long history of channelling benefits to supporters through state-owned firms or government projects. For example, in order to win votes, governments are inclined to provide favourable prices, jobs in state-owned firms and more resources to their supporters, even though this is not economically efficient (Shleifer, 1997). Similarly, Boycko, Shleifer, and Vishny (1996) state that with an ultimate goal of winning an election, state-owned firms are unwilling

to undertake risky but profitable projects in case firm failure or distress negatively influence the government's reputation. Moreover, SOEs are not so interested in profit maximisation. Instead, solving unemployment problems and regional development become more important objectives. In addition to the government's pursuit of political goals, politicians' personal interests are also detrimental to SOE efficiency, leading to bribes and high corruption that result in resource misallocation and failed reforms (Levin and Satarov, 2000; Shleifer, 1997).

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Chapter 3 Political Endorsement: Evidence from Propaganda Coverage

Abstract

This chapter studies an under-researched way in which governments influence the market – political endorsement. I examine firms that are endorsed by the central government of China through propaganda coverage, and document positive market reactions and operating performances after controlling for selection on observables through applying PSM methodology and controlling for selection on unobservables through using treatment effects model with instrumental variable technique. The value of endorsement is more pronounced among firms with weaker pre-event performance, less political connections, higher dependence on external financing, and those located in regions with stronger market institutions. This study also identified increases in subsidy, reduction in cost of debts and improvement in investment efficiency as three channels of value creation after political endorsements.

3.1 Introduction

Endorsement is a common phenomenon worldwide. Endorsement demonstrates the formal support and approval from social actors such as celebrities, authorities, partners or governments. For example, endorsement by celebrities (Farrell, Karels, Montfort, & McClatchey, 2000; Khatri, 2006), typical customers (Freiden, 1984) and experts (Dean & Biswas, 2001; Fireworker & Friedman, 1977) are found to enhance reputation and improve sales. The share price of retailer J.Crew even increased from $9.61 to $19.23 after Michelle Obama wore a cardigan from this brand. Governments and politicians often endorse firms too. During the speech of Barack Hussein Obama on the state of education, he praised the contributions of Apple, Microsoft Verizon and Sprint to education by connecting 99% of students to high-speed internet. For another example, Evoc Group, a high-tech company, was praised by the Chinese government through its central news program about its creative improvements in computers. Political endorsement is a strategy governments use to participate in market besides other well-researched approaches like establishing political connections (e.g. Faccio, Masulis, & McConnell, 2006b) and having direct ownership of firms (e.g.Shleifer & Vishny, 1994). However, political endorsement has not yet been studied.

To fill this gap, this study aims to explore the impact of political endorsement on firm value. Political endorsement, in this paper, is defined as public statements or actions showing government support of firms. I hand collect data on political endorsement in China from the propaganda coverage from 1st January 2009 to 31st December 2011. Propaganda in China is solely controlled by the Publicity Department of the Chinese Communist Party, an organization at the deputy state rank, serving as the propaganda organ for the Party. A major outlet for propaganda is a program called

Xinwenlinabo, which reaches more than 95% of the population (Jin, 2009). As a result, positive opinions on specific firms disseminated by *Xinwenlinabo* represent the endorsement from the central government.

This paper supposes that political endorsement is positively associated with market reactions and firm performance because it implies governments' supports in three aspects: advancement, shielding and legitimacy. First, political endorsement indicates that the government regards firms as exemplars, recognises their important role in helping the government carry out policies, or plans to foster the industries these firms belong to, and hence implying that the government will advance these firms or the relevant industries in the future by providing them more resources. Rich literature on political connection demonstrates the government's ability to increase firms' access to resources through providing bank loans (Faccio, Masulis, & McConnell, 2006a), government contracts (Goldman, Rocholl, & So, 2008) and tax reductions (Bertrand, Kramarz, Schoar, & Thesmar, 2007; Faccio, 2006b; Li, Meng, Wang, & Zhou, 2008), as well as imposing tariffs on counterparts (Goldman et al., 2008). As a result, the increased resources can improve firm performance, both in the stock market and in daily operations. Second, government shielding is another potential benefit implied by political endorsement, especially for firms that fulfil public functions like providing employment. According to Schuler, Shi, Hoskisson, and Chen (2017), governments usually shield and protect firms that perform well in delivering public functions regardless of their financial performance; therefore, it can be expected that the government will shield endorsed firms, in particular those that fulfil public functions. Third, political endorsement can certify firms' cultural and moral legitimacy, because achieving government endorsement indicates these firms have political correctness or

perform well in philanthropic activities. Moreover, political endorsement also certifies firms' resource legitimacy as the government is more inclined to endorse firms that can utilise resources effectively; otherwise, the government's resource misallocations will ruin its own reputation. Therefore, this paper hypothesises that political endorsement is positively correlated with market reactions and firm performance.

The results of positive market reactions in various event windows confirm the hypothesis. The government usually specifically endorse some particular aspects of firms, so I expect that the impact of political endorsement is contingent on the contents of endorsements. I decompose endorsements into nigh specific types according to the keywords of contents: CSR, new product, R&D, profit-related, achievement, operation, co-operation, ideology and other. The definitions of each type are shown in Appendix. According to the results, endorsements of firms' achievement and advanced operation can witness significant market reactions, while reactions to endorsements of R&D are significantly negative. One explanation for the negative market reaction is that investors suspect that firms will invest more in the endorsed aspects in order to curry favour with the government or meet government's expectations after the political endorsement. Achieving political endorsement of risky aspects like R&D can give firms false motivation to excessively invest in these aspects, which could expose it to higher risks without increasing its value.

Besides cumulative abnormal return, political endorsement is also positively associated with firms' future operating performance after controlling for selection on observables through applying PSM methodology and controlling for selection on unobservables through using treatment effects model with the instrumental variable technique, no matter which performance measurements are used. Furthermore, this

chapter investigates firm and institution heterogeneity. By testing contingency factors about different firm characteristics and levels of institutional development, this study evaluates the precision of different theoretical predictions about whether firms' past performance, the existence of political connections, firms' dependence on external financing and the level of institutional development will modify the effects of political endorsement. The first contingency factor is firms' past performance. Political endorsement can add more value to firms that previously performed relatively weak through helping these firms regain reputation and key resources. The second firm trait that can influence the impact of political endorsement is the existence of political connections. The results demonstrate that firm performance are improved more for less-connected firms because endorsement from central government can help these firms to overcome the difficulties in lack of legitimacy and resources. The third firm trait is firms' dependence on external financing, and the results show that political endorsements are especially valuable for firms that heavily rely on external financing since these firms can get easier access to external funds after achieving a kind of guarantee from the central government through political endorsement. In terms of the institutional heterogeneity, results indicate that firms located in strong institution provinces can enhance performance more as the good institution can ensure that resources granted by central government can reach the target firms eventually, without being grabbed by local governments. Furthermore, this paper identify three channels of value creation after political endorsement: the increase in subsidy, decrease in financing costs, and the improvement in investment efficiency.

This paper contributes to the literature in a number of ways. First, this paper is the first to test an under-researched approach through which the government influences

the market – political endorsement. The government penetrates the market through various methods. Directly owning an enterprise (Andrianova, Demetriades, & Shortland, 2012; Shleifer & Vishny, 1994); issuing laws, regulations and policies (Krueger, 1974; Shleifer, 1997); or establishing corporate-level or individual-level political connections (Claessens, Feijen, & Laeven, 2008; Faccio et al., 2006b) are common strategies used by the government to participate in the market. As for state ownership and political connection, many researchers (e.g. Bertrand et al., 2007; Faccio, 2010; Goldman et al., 2008; Li et al., 2008) point out that state ownership and political connections increase firms' access to resources and are beneficial to firm performance, while other researchers (e.g. Perez-Batres & Eden, 2008; Shleifer & Vishny, 1994, 2002; Uzzi, 1997) highlight the inefficiency caused by the unreasonable diversion of firm resources, the surrender of autonomy, officers' pursuit of personal objectives at the expense of connected firms' value, and the high costs caused by the unstable political relationship. In terms of the impact of policies, literature on political economy demonstrates abundant evidence of how governments use policies to influence the market and the economy. For example, Aizenman and Marion (1993) focus on 46 developing countries and show that the uncertainty of policies can influence economic growth, but the direction of the sign depends on the specific region. Similarly, based on a sample of 92 countries, the study of Ramey and Ramey (1994) demonstrates that government spending-induced volatility is negatively correlated with economic growth. Such policy effects caused by a government are also supported by researchers like Bhagwati (1969) and Johnson (1960). This paper largely contributes to the literature on the ways in which governments can influence markets, because the political endorsement tested in this paper is an under-researched approach,

and no study to date has paid attention to this government strategy for affecting the market.

Second, this study complements the literature related to political impact on the market. Researchers hold either development view (Arthur Lewis, 1945; Gerschenkron, 1962; Hawtrey, 1926), social view (Atkinson & Stiglitz, 1980), agency view (Shleifer, 1998), or political view (Kornai, 1979; Shleifer & Vishny, 1994) regarding the impact of governments on the market. While the development view highlights the essential role of government to fulfil the functions of institutions and overcome market imperfections (Andrianova, Demetriades, & Shortland, 2008; Gerschenkron, 1962), the political view claims that pursing political goals or politicians' personal interests are the underlying motives for governments to participate in the market, leading to high corruption, excess employment in state-owned firms, and lower financial and economic development (La Porta, Lopez‐de‐Silanes, & Shleifer, 2002; Levin & Satarov, 2000; Shleifer & Vishny, 1994). Somewhere in the middle is the social view (similar to the development view), which upholds the government's positive role in the market as long as its social benefits exceed the costs (Atkinson & Stiglitz, 1980; Stiglitz, 1993), and the agency view (similar to the political view), which stresses the high agency costs within government which can offset all benefits, while at the same time admitting that the government can solve market imperfections (Shleifer, 1998). Another stream of literature, such as the work of Frye and Shleifer (1996), examines the role of government from another perspective by proposing helping-hand, invisible-hand and grabbing-hand interaction models between governments and markets. The results of this paper document a positive impact of political endorsement on both market reactions and firm

performance, which provides supporting evidence for the development view and helping-hand effects of government.

Third, this paper also contributes to literature on endorsement from three perspectives. First, existing literature about endorsement is mainly restricted to the field of marketing, such as celebrity endorsements (Farrell et al., 2000; Khatri, 2006), typical customer endorsements (Freiden, 1984) and expert endorsements (Fireworker & Friedman, 1977). The examination of political endorsement in this paper extends the literature by introducing the concept of endorsement into finance and examining its impact on market reactions and firm performance. Second, in finance, some literature points out that affiliation with prestigious underwriters (Carter, Dark, & Singh, 1998; Pollock, Chen, Jackson, & Hambrick, 2010; Ramirez, 1995), venture capital firms (Milanov & Shepherd, 2013), auditors (Beatty, 1989) and authoritative third parties (Bonardo, Paleari, & Vismara, 2011; Corbett, Montes-Sancho, & Kirsch, 2005; Doh, Howton, Howton, & Siegel, 2010) can bring about effects similar to endorsement. For example, affiliating with venture capital firms can increase the net proceeds of IPO (Gulati & Higgins, 2003; Megginson & Weiss, 1991; Pollock et al., 2010). In these cases, firms have some degree of freedom to choose which underwriter or venture capital to cooperate with. However, the relationship between the government and firms in political endorsement is more unilateral, which means political endorsement is determined unilaterally by the government. Compared with certification from financial organizations, central government endorsements are rarer and more valuable. Therefore, this study further contributes to this stream of literature by introducing a unilateral endorsement which has not been previously investigated. Third, extant literature covers endorsers such as celebrities, experts and cooperating

firms (Clark & Horstmann, 2003; Dean & Biswas, 2001; Pollock et al., 2010), while neglecting one of the strongest and most credible endorsers – the government, and this paper can fill this gap.

Furthermore, this study also provides practical implications for government, firms, and investors. Firstly, this paper provides policy implications by providing empirical evidence that resources can be redirected after endorsement. Through selecting firms more strategically during endorsement, officials can improve social welfare and promote economic development. For instance, choosing more environmental-friendly firms can help those firms get more social attention and thus win positive market reactions, and also help the firms to access more favourable resources. Secondly, this study has managerial implications. Although the results of this paper show that bribery and connection cannot increase the probability of endorsement, firms can maximize the impact by publicizing the endorsement once they achieved it, which is especially important for firms with relatively weak performance, less-connected, or heavily dependent on external financing. As to firms that want to pursue political endorsement in order to enhance firm performance, they can consider strengthening the aspects that the government cares more like helping government to solve employment problems. Thirdly, the empirical results of this paper offer practical implications for both domestic and international investors who are interested in investing in markets like China where the government has a helping-hand. It is sensible for investors to follow the indications from political endorsement, since they serve as important indicators of potential government support.

The remainder of the paper is organized as follows. Section Two reviews literature and develops hypotheses, and Section Three provides basic institutional background.

Samples and data are described in Section Four. In Section Five, I explored the determinants of political endorsement. Results about the impact of political endorsement on market reactions and firm performance are detailed in Sections Six and Seven respectively. Then the channels of value creation are investigated in Section Eight. Finally, a conclusion is articulated in Section Nine.

3.2 Literature Review and Hypothesis Development

Endorsement demonstrates formal support and approval from social actors such as celebrities, authorities, partners or governments. Endorsement is widely examined in marketing (Daneshvary & Schwer, 2000; Farrell et al., 2000; Fireworker & Friedman, 1977; Friedman & Friedman, 1979; Khatri, 2006). Three types of endorsement through advertising are pervasive and well examined in research: celebrity endorsement (Dean & Biswas, 2001; Farrell et al., 2000; Khatri, 2006), typical customer endorsement (Friedman & Friedman, 1979) and expert endorsement (Dean & Biswas, 2001; Fireworker & Friedman, 1977). For example, Nike's quarterly sales rose by 55% due to the market's immediate response to Tiger Woods's endorsement for Nike. And the sales of footwear and golf apparel which were endorsed by Woods doubled (Farrell et al., 2000). Marketing endorsement has various other forms in addition to advertisements mentioned above. For instance, royal warrant, a common tradition in countries with a monarch, such as the U.K., Belgium, France, Malaysia, Thailand, Spain and Sweden, is a kind of quality certificate given by a royal household. In the U.K., firms cannot obtain a royal warrant until they supply goods and services to the Queen, the Duke of Edinburgh or the Prince of Wales for over five years and the royal household are satisfied with the quality. Once firms achieve a royal

warrant, they would display the royal coat of arms on products, and this practice has been around since the 18th century, leading to improved recognition and sales. For example, the sales of Schweppes, a carbonated drinks maker, soared by 47% after the company displayed the royal warrant on its products.

Endorsement also implicitly exists in finance. Affiliation with prestigious underwriters (Carter et al., 1998; Pollock et al., 2010; Ramirez, 1995), venture capitals (Milanov & Shepherd, 2013), auditors (Beatty, 1989) and authoritative third parties (Bonardo et al., 2011; Corbett et al., 2005; Doh et al., 2010) can provide effects equivalent to endorsements, which eventually influence firm evaluation. For example, endorsement by venture capitals can make affiliated firms more credible, lower information asymmetry and increase the net proceeds of IPO (Gulati & Higgins, 2003; Megginson & Weiss, 1991; Pollock et al., 2010).

This chapter introduces a new kind of endorsement – political endorsement, which is also an under-researched way in which governments influences markets. Stiglitz (1993) points out that there are four ways in which a government can participate in the market and influence the economy: issuing policies, creating financial market institutions, regulating and intervening in these institutions, and directly participating in the capital market by providing loans. With the development of literature, more influencing mechanisms are discussed by researchers, within which issuing laws, regulations and policies (La Porta, Lopez‐de‐Silanes, Shleifer, & Vishny, 1997; Levine, 1998, 1999; Shleifer, 1997), political connection (e.g. Claessens et al., 2008; Faccio et al., 2006a) and state ownership are the three most influential approaches through which governments affect markets (e.g. Altunbas, Evans, & Molyneux, 2001; Shleifer, 1998). This chapter shifts attention to political endorsement, which is

currently under-researched.

This study hypothesises that political endorsement is positively associated with market reactions and firm performance. Political endorsement indicates the government's support in three aspects: advancement, shielding and legitimacy. In terms of advancement, political endorsement indicates that governments are inclined to advance endorsed firms or the industries they belong to by providing more resources, because being endorsed means the firms are treated as exemplars by the government, or that they play a vital role in helping the government carry out certain policies, and sometimes also indicates the firm's industry is favoured by the government. The support in resources is especially valuable when bureaucracies have high discretionary power. As suggested by Frye and Shleifer (1996), helping-hand governments tend to help some firms while killing some others, and are characterised as having close ties with firms and treating firms unfairly. As a typical example of a helping-hand government, the Chinese government has high discretionary power (Chen, Ding, & Kim, 2010; Yan & Li, 2018). Moreover, the coexistence of market mechanisms and government redistributive mechanisms (Zhou, 2000) and the non-thorough reform in China also indicate that the government maintains control over the economic transition (Luo, 2005), which stands in contrast to transformed economies, such those of Poland, Russia and the Czech Republic, which have decentralised thoroughly (Hitt, Ahlstrom, Dacin, Levitas, & Svobodina, 2004). As a result, key resources remain under government control in China, and government support becomes especially important. For example, the rich literature on political connection shows that government support can increase the accessibility of resources such as favourable regulation (Goldman et al., 2008), operation licenses (Li et al., 2008), equity capital (Hearn, 2012; Johnson &

Mitton, 2003), profitable government contracts (Goldman et al., 2008) and bailouts (Faccio et al., 2006a).

The second type of government support for endorsed firms is shielding, especially for firms that shoulder social responsibilities like providing employment. Researchers like Schuler et al. (2017) point out that governments are inclined to protect firms that deliver public functions regardless of their performance. Such socially important firms usually become targets of political endorsement. For example, on 6th June 2009, the government commended China Railway Group because it expanded recruitment for graduates, and also endorsed Hubei Yihua Chemical Industry Co., Ltd on 1st February 2009 because it provided employment opportunities for returning migrant workers. Considering the essential role of these firms in fulfilling public functions, the government is inclined to shield and protect these endorsed firms.

The third type of government support for endorsed firms lies in certifying the legitimacy of these firms. According to He and Tian (2008) and Pfeffer and Salancik (2003), legitimacy can be classified into three categories: cultural legitimacy, resource legitimacy and moral legitimacy. First, political endorsement can certify firms' cultural legitimacy, because only firms that behave in politically and culturally appropriate ways can achieve government endorsement. For example, since the 16th National Congress of the Communist Party of China, scientific development became a priority of CPC. Many firms were endorsed by the government in 2009 and 2010, such as the Aluminium Corporation of China, China Unicom, China State Shipbuilding Corporation and China Construction Bank, because they organised in-depth studies and practice of scientific development, meaning that firms who integrate CPC activities into their daily operations and perform politically correctly can achieve

government endorsement. Second, political endorsement certifies firms' resource legitimacy because the government tends to endorse firms with efficient and effective resource utilisation in order to protect its own reputation. For example, the government usually endorses efficient firms with large production potential and a promising future. On 1st August 2009, Changan Auto Co. Ltd was endorsed by the government for expanding its production capacity and increasing market needs. Third, political endorsement can also certify firms' moral legitimacy because another kind of firms that usually becomes the target of political endorsement are the firms who perform well in philanthropic activities. For example, on 10th May 2009, SOEs like China Eastern Airlines and Dongfang Electric Corporation were commended by the government for their great contributions to the recovery and reconstruction of earthquake-stricken areas. Besides SOEs, privately owned firms can also achieve political endorsement to gain moral legitimacy by engaging in philanthropic activities. For instance, on 19th August 2010, the central government certify the moral legitimacy of Oceanwide Holdings, Fosun Pharma and Shimao Group by praising their donations to the mudslide disaster areas.

Besides the government support in advancement, shielding and legitimacy, literature on endorsement also supports positive effects of political endorsement on market reactions and firm performance. The benefits of endorsement are widely documented in the marketing literature in terms of brand awareness (Daneshvary & Schwer, 2000), brain recall about products (Menon, Boone, & Rogers, 2001; Misra & Beatty, 1990; Petty, Cacioppo, & Schumann, 1983) and sales. In finance, there is some related evidence. For example, affiliating with prestigious underwriters not only increases the accessibility of external financing (Ramirez, 1995), but also provides

intangible resources such as knowledge or technologies (Quintas, Wield, & Massey, 1992). Third-party endorsements such as granting awards and rankings can facilitate the trust transfer process (Jiang, Jones, & Javie, 2008) and provide commercial-related advantages (Daneshvary & Schwer, 2000) and attractive-related benefits (Rindova, Williamson, Petkova, & Sever, 2005).

Hypothesis 1: Political endorsement is positively correlated with market reactions and firm performance.

This paper then proposes that the impact of political endorsement are contingent on the contents of endorsement. The purpose of government endorsement of firms is to improve the market or foster an industry by setting up models to motivate other firms to follow. In other words, endorsed firms have implied responsibilities to further enhance their model role on the endorsed aspects to meet the government's expectations. Therefore, firms may invest more time, effort and money into the endorsed aspects. In some cases, endorsements may give firms false incentives to excessively divert their resources to aspects with high risks (e.g. R&D), leading to higher risks and lower profits. I expect that the market would not react or would react negatively to endorsements of high-risk aspects. On the contrary, this paper assumes that the market will react positively to endorsements of low-risk value-relevant aspects such as advanced operation and achievements.

Hypothesis 2: The impact of political endorsement are contingent on the contents of endorsements.

Furthermore, this paper hypothesizes that there are firm and institutional

heterogeneities regarding the effects of political endorsement. In terms of firm heterogeneity, firms' past performance, the existence of political connections, and firms' dependence on external financing are three traits that can influence the impact of political endorsement. First, political endorsement is expected to have higher value for firms with weak financial performance prior to endorsement. Researchers like Fombrun and Shanley (1990) point out that firms' weak performance can harm their reputation, therefore government endorsement are more valuable to help such weakly performed firms to regain legitimacy and reputation, and obtain key resources to improve performance.

Second, both political connection and political endorsement indicate government support. One hypothesis is that government support has diminishing marginal effects, so the value of political endorsement for more-connected firms is not as high as for less-connected firms. Moreover, compared with firms with political connections, firms with no connection usually have less legitimacy and less support in subsidies and grants (Ahlstrom & Bruton, 2001), and political endorsement can help less connected firms to overcome these advantages, thus is more valuable for this kind of firms. The competing hypothesis is that connected firms can utilize their existing political connections to achieve material support once endorsed by the central government, which means connected firms can transform the endorsement into material resources more efficiently.

Third, firms' dependence on external financing is also a factor that can influence the impact of political endorsement. The higher dependence on external financing, the more important firms' legitimacy and reputation are. And the government support implied by political endorsement can help firms to mitigate their financial constraints.

Therefore, this study hypothesizes that political endorsement is more valuable for firms that depend heavily on external financing.

Besides firm heterogeneities, regional institutional development is also a contingency factor. Although researchers like Faccio (2006a) and Fisman (2001) state that the government's role is stronger in places with weak institutions, this does not necessarily mean that political endorsement is more beneficial for firms located in provinces with weak institutions. Political endorsement represents support from the central government, but it is the attitudes and quality of local governments that determine whether the financial and other support from the central government can eventually reach the target firms. For example, Chen, Lee, and Li (2008) state that although fiscal policy about subsidies is determined by the central government, it is up to local governments to use their discretion in determining the timing and amount of subsidies eventually granted to local firms. Moreover, the helping-hand role of the central government does not necessarily mean that local governments must play a helping role in the regional market. Cheung, Rau, and Stouraitis (2009) show that local governments have a grabbing hand while the central government has a helping hand. And the different roles of central and local governments are also proved by researchers like Chen, Firth, and Xu (2009) and Zou, Wong, Shum, Xiong, and Yan (2008). Therefore, this study hypothesises that political endorsement of firms located in provinces with better institutions are more value-added, since support from the central government can be transferred to endorsed firms without being intercepted by local governments.

Hypothesis 3: The impact of political endorsement are contingent on firm and

institutional characteristics.

3.3 Institutional Background

The Publicity Department of the Communist Party of China (PD) was initially founded in May 1924, mainly responsible for guiding public opinion, guiding central news media, making propaganda, enforcing media censorship and control, and taking charge of information dissemination systems. PD is directly controlled by the Communist Party, the sole ruling party in China. The head of PD is normally a member of the Central Politburo of the Communist Party of China, with the political rank of a sub-national leader, the second-highest civil service rank in China. Meanwhile, one of the members of the Politburo Standing Committee, holding the highest national leader ranking, oversees work on publicity and ideology. This arrangement demonstrates the importance of propaganda work in China.

One major goal of PD is to facilitate the execution of policies. For example, in order to help the government support domestic brands, PD issued a plan about 'strengthening internal and external propaganda work of Chinese brands' on 24th April 2015, which required major media outlets to highlight the high technology of domestic firms, and emphasize domestic brands' good performance in quality, innovation, firm culture, social responsibility, etc. On the same day, PD also issued a list of good domestic firms, including firms like Citic Heavy Industries Co., Ltd., and required the media to focus propaganda efforts on these firms.

Another major goal of PD is to help the Communist Party disseminate its ideology. Jinping Xi, the president of China, explicitly emphasized in 2016 that the Party's media

work should serve the Party and serve the country's overall interest, showing that the Publicity Department is the mouthpiece of the government. For example, in 2009, the 60th anniversary of China, PD carried out a series of patriotic education activities to stimulate people's patriotic enthusiasm and encourage people's patriotic actions. In another specific example, PD designed a program called "Touching China" to report outstanding personages annually. In order to cultivate people's sense of dedication to work, PD issued a notice about how to report stories of typical model workers. For example, Bin Zhang, a bus driver, is a model worker who was nominated by PD as a key figure in the program "Touching China". As required by PD, 11 central media outlets immediately broadcast stories of Bin Zhang, followed by other local media outlets. Through these programs, PD successfully directs people's values and disseminates the government's idea of expected and advocated behaviour.

PD closely controls the media in two ways. First, PD controls licenses of media outlets and issuing commands. Chief editors of China's major media outlets are required to attend PD's weekly central office meeting to receive instructions on which stories should be emphasized, downplayed or avoided (Sullivan, 2011). The instructions are as detailed as, "All websites need to use bright red colour to promote a celebratory atmosphere of the 60th anniversary of the People's Republic". Second, PD also controls the appointment of senior media personnel, such as journalists, through a national registration system. They are required by PD to participate in ideology training sessions and their loyalty to the party is assessed before their press identification passes are renewed (Ashley, 2006). For instance, several deputy chief editors of a newspaper called *Southern Weekly* were fired because they published an article criticizing the paper of Xiaoping Deng – the paramount leader of China from

1978 to 1989.

Arguably the most important outlet for PD to disseminate the will of the state is a news program called *Xinwenlianbo* by China Central Television (CCTV), the predominant state television broadcaster.[1] *Xinwenlianbo* has the privilege of being the first program to report important political activities, policy announcements, chief social and economic issues, and international news, and serves as a medium through which the government disseminates their views, wishes and ideology. All channels in China are regulated to broadcast *Xinwenlianbo* live at 7 p.m. everyday. As a result, *Xinwenlianbo* reaches more than 95% of the population and thus has extensive coverage (Jin, 2009).

PD often endorses firms through *Xinwenlianbo*. For example, in order to popularize the national policy on energy-saving and environmental protection, PD often endorses firms that perform excellently in environmental protection to set a good example for other firms. Double Star, a manufacturing company, was praised by PD in *Xinwenlianbo* in 2010 for its innovation of 800 new environmentally friendly techniques and its huge cost savings (60 million RMB) that these innovations resulted in. Therefore, commendation of firms on *Xinwenlianbo* can be deemed as strong political endorsements.

3.4 Sample and Data

The data on political endorsement is hand-collected by watching the daily 30 minutes *Xinwenlianbo* from 1st January 2009 to 31st December 2011. I record the dates

[1] Two other major state media sources are People's Daily, the official newspaper of the Party, and Xinhua, the state news agency.

and names of all firms mentioned in the program. I define a political endorsement if the program dedicates a whole slot to commend a firm. It is important to know that not all coverage is classified as endorsement. In some cases, a firm's name is mentioned in a slot in relation to other issues, and this study excludes these cases from the sample.

Besides the firm names and dates of endorsement, I record the characteristics of the endorsements, including where in the program the mention happens (*Sequence*), the number of times a firm's name is mentioned (*Times*), the length of the slot (*Length*), and whether the slot is in the main section of the program or the brief daily summary section (*Brief*). I also code the content of the endorsements into nine specific types: corporate social responsibilities (CSR), research and development (R&D), new products, profit, achievement, operation, co-operation, ideology and other. Detailed definitions of these types are shown in Appendix. Other financial data, such as return on assets and firm size, can be obtained from the China Securities Market and Accounting Research Database (CSMAR) or the RESSET database.

Table 3.1 demonstrates the descriptive statistics for the observations of political endorsement. From 1st January 2009 to 31st December 2011, I collected 278 observations of political endorsement. The small number of observations is consistent with common wisdom that political endorsements are rare and precious resources. After decomposing political endorsements into nine different categories, the distribution of the observations for each category is shown in Row 2 of Table 3.1, which reveals that government endorses firms' advanced operations, achievements, and R&D more frequently. Whether these frequently endorsed aspects are associated with more significant market reactions would be tested in the later part of this study. Because firms can be endorsed for multiple aspects within one endorsement, the total

number of observations in row (2) is higher than the total observations in row (1).

[Insert Table 3.1]

Table 3.2 shows the descriptive statistics of endorsed firms. Because firms can be endorsed for multiple times during the sample period, the total number of endorsed firms is 103. After dropping the firms lack data of GICs and the ownership types, the total observation of endorsed firms is 94 as shown in Table 3.2. Panel A and Panel B demonstrate the distribution of endorsed firms. Panel A shows that 10.64% of endorsed firms are directly controlled by the central government, while the percentage of central government-owned firms among all listed firms is just 2.67%, showing a tendency that government is more inclined to endorse connected firms. However, whether the probability difference of achieving endorsement between connected firms and other firms is significant still needs to be tested in the next section. Panel B shows the distribution of industries. Comparing Columns (2) and (4), firms in some specific industries, such as industrials and energy, are more likely to be endorsed by government.

[Insert Table 3.2]

3.5 Determinants of Political Endorsement

Table 3.2 indicates that a high percentage of endorsed firms are SOEs, but no research to date clarifies how the government chooses which firms to endorse. It is worthwhile filling this gap. Furthermore, the determining factors of political endorsement also influence the impact of endorsement on market reactions and firm operating performance. For example, if bribery is a significant reason for endorsement,

market reactions can be expected to be low, because investors take a sceptical attitude about the quality of the firms and are suspicious of whether the government will really provide material support after endorsement. Therefore, this section investigates what kinds of firms are more likely to achieve political endorsement.

Firstly, it can be expected that stated-owned and politically-connected firms are more likely to achieve political endorsements since the government has vested-interests as it is the major investor of this kind of firms. Five proxies are used to measure the political connection: whether the actual controller of the firm is central government (*CG*) or other levels of government except central government (*SOE_Other*), party intensity as measured by the ratio of party members to the total number of directors (*PartyIntensity*), whether at least one director of the firm has working experience as a government official (*PB*), political background intensity measured as the ratio of directors who has working experience as a government official to the total number of board directors (PBintensity), and the percentage of shares owned by the state (*StatesShare*). The results in Columns (1) to (5) of Table 3.3 demonstrate that most of the measurements of political connections are not significant, and the coefficients of PBintensity is even slightly negatively significant, meaning that government has no significant preference towards connected firms when it chooses firms to endorse, which is contradictory to people's take-for-granted guesses.

Secondly, another plausible determining factor of political endorsement is bribery because companies can bribe officials in return for endorsement, especially in countries with a helping-hand government where corruption does exist though its amount is limited (Frye & Shleifer, 1996). If the bribery is one of the determining factor of political endorsement, the effects of political endorsement on market and firm

performance would be negatively influenced. In columns (6) and (7), I test whether government is more likely to endorse firms located in provinces with high corruption. The higher the regional corruption level, the more likely the firms in those areas will bribe government. According to the World Bank, the ratio of provincial entertainment costs to provincial sales (*Prov_Entertain*) can be used as a proxy for the level of bribery. The results in column (6) show that political endorsement is not a thing that can be exchanged by bribery. I also manually collected data about the number of provincial corrupt officials caught during anti-corruption campaign as the second measurement of the level of provincial bribery. Results in column (7) are consistent with column (6) that bribery cannot increase the probability of endorsement. Firm-level bribery data is hard to collect since firms are reluctant to disclose such unethical information, so I follow the same measurement method as *Prov_Entertain* to calculate firm-level corruption data, *Firm_Entertain*, which equals the ratio of firms' entertainment costs of managers or hospitality fees to sales. The firm-level corruption is also not significant, as shown in Column (8) of Table 3.3. Therefore, results from Columns (6) to (8) consistently show that firms cannot bribe central government in return for endorsement, which further ensure the quality of the endorsements. And these results are also consistent with results in Columns (1) to (5) because bribery also reflects the level of political connections.

Thirdly, the government may consider political endorsement as a method to win people's support (Faccio et al., 2006a). As a result, the more employees a firm has, the more likely the government is to endorse that firm. Moreover, firms with more employees are usually more socially important in fulfilling public functions like solving employment problems. In Column (9) of Table 3.3, I test whether the logarithm

of employee number (*Lnemployees*) can significantly predict the probability of endorsement. The results show that the government is partial to firms with more employees.

Fourthly, it can be expected that the government is more likely to endorse firms with good previous performance in order to avoid hurting their reputation and creditability. I tested the past performance of endorsed firms prior to achieving political endorsement *(PastPerform)* in all models of Table 3.3, and the results indicate that the government doesn't emphasize firms' past performance when they choose firms to endorse. Then I test whether other firm features are at play, including firm size, age, leverage and number of restricted shares. Size is defined as the logarithm of market value, which is consistent with the method used by other researchers such as Hasan, Jackowicz, Kowalewski, and Kozłowski (2017). Since size is proved by a lot literature to be a significant determinant of political connection (Hasan et al., 2017), and the access of political bailouts (Faccio et al., 2006a), firm size is included in all models of Table 3.3 to predict the probability of political endorsement. Moreover, since promoting innovation is one of the focuses of the Chinese government, it can be expected that some younger and creative firms are more likely to be endorsed, therefore age is tested as another plausible determining factor of political endorsement. Furthermore, leverage (proxy for solvency) and restricted shares (proxy for power concentration) are also tested as determining factors in all models of Table 3.3 because governments will prefer to endorse firms with good financial and managerial status in order to avoid damaging their reputation. The results show that firm size and age are significant across all models, meaning that they are important determinants of political endorsement and indicating that the government prefers to endorse larger and younger

firms.

One important implication of these results is that the government's underlying motive for endorsing firms is its social goals rather than vested interests. According to the results in Table 3.3, both political connections and bribery cannot influence the endorsement decisions of the government, and the government does not even see past performance and firm leverage as important considerations. Instead, larger firms with more employees are more likely to be endorsed. This indicates that compared with firms with good past performance or with connections, the government prefers to choose firms with a greater social impact and those that have helped the government solve social problems, like employment problems. Moreover, firms that operate in line with the government's development plan and those that play a necessary role in helping government to carry out policies are also main targets of political endorsement, which can be reflected by the results that younger firms are more likely to be endorsed because of the government's plan to promote innovation. A lot of researchers like Knight and Cavusgil (2004) highlight that younger firms are more innovative because they are more flexible and less bureaucratic, while the innovation capability of long-established firms is always hindered by the substantial bureaucratization.

[Insert Table 3.3]

3.6 Political Endorsement and Market Reaction

3.6.1 Overall Market Reaction

To examine the value of political endorsement, I first use event study to examine cumulative abnormal returns (CAR). Abnormal return is calculated as the excess return

over market return. Because *Xinwenlianbo* is broadcast at 7 p.m. every night, after the stock market has closed, the day after *Xinwenlianbo*'s reporting is treated as the event date. According to Figure 3.1, the market starts to react about ten days before the event date. One reasonable explanation is that the interviews with target companies should be recorded in advance, which leads to information leakage, and being interviewed by *Xinwenlinabo* is a great honour which can attract social attentions. It is worth noting that the CAR is negative during the window [-15, -11], but the CAR at the event day is more than 2% and these positive effects persist and reaches about 3.5% in one month.

[Insert Figure 3.1]

Then this study tests the significance of cumulative abnormal returns of political endorsement over different time windows: CAR(-1,1), CAR(-2,2), CAR(-3,3), CAR(-4,4), CAR(-5,5) and CAR(-10,10) and one-month CAR. Based on Table 3.4 Row (1), political endorsements overall have significant positive relationship with market reactions, significant at the 5% or 1% levels over all windows. These results are consistent with the first hypothesis that political endorsement has positive association with market reactions.

[Insert Table 3.4]

3.6.2 Endorsement Characteristics and Market Reaction

Hypothesis two suggests minimal or even negative market reactions if a firm is endorsed for aspects that have high-risk (i.e. R&D), because endorsement may give firms false incentives to excessively divert resources into these aspects in order to meet government or social expectations, which finally leads to high risks and low profits. In contrast, this paper supposes that only endorsement of low-risk value-relevant

aspects like advanced operation and achievements are positively correlated with market reactions.

To examine whether the significant market reactions are driven by specific types of endorsement, I decompose endorsements into nine more specific types according to the keywords of contents: CSR, new product, R&D, profit-related, achievement, operation, co-operation, ideology and other. The definitions of each type are shown in Appendix. Row (2) in Table 3.4 shows that market reactions to endorsements about achievement and advanced operation are significantly positive. However, the results on R&D are not significantly negative, and I will test this further in the regression.

In order to conduct the regression on CAR, a matched sample of control companies has to be formed because the event dates of political endorsement for each firm are different. Only after identifying the matched control groups can I assign the same event dates as the endorsed firms to the corresponding matched non-endorsed firms and then the CAR are calculable for both treatment and control groups.

Propensity Score Matching (PSM) is applied to match endorsed firms with non-endorsed firms and this approach can help this study eliminate certain concerns. First, as suggested by Lennox, Francis, and Wang (2011), PSM methodology can be used to control the selection on observables by balancing out the groups being compared in terms of their covariates. Table 3.5 compares the mean differences of key variables before and after PSM. Rows marked as "U" show the mean differences between endorsed and non- endorsed firms before PSM, and rows marked as "M" demonstrate those after matching. As shown in rows marked as "U" in Table 3.5, some firm characteristics are significantly different between endorsed and non-endorsed firms. To alleviate the concern that endorsed firms are selected endogenously based on these

characteristics, PSM nearest-neighbour matching is applied. Through PSM, I formed treatment and control groups with similar predicted likelihood of political endorsement, hence these two groups are equally likely ex-ante to be endorsed by the government, though the control group in fact was not endorsed ex-post. As a result, the comparison of outcomes between treated and control groups is quasi-randomised. Second, according to researchers like Ettner (2004), PSM is especially suitable for reducing bias when the sizes of treatment and control groups are very different. Since the observation of the endorsed firms is relatively small when compared with the total number of firms, PSM is suitable to help this study reduce the bias. Third, another concern of this study is reverse causality. Firms' good performance after political endorsement may be just because the government tends to endorse firms with good performance to avoid hurting its reputation. Although the results in Table 3.3 demonstrate that past performance is not a significant determinant of political endorsement, this study will match firms according to their past performance as a further step to alleviate this concern.

[Insert Table 3.5]

Treatment and control groups are matched according to the significant determinants of political endorsement and a series of basic firm characteristics like past performance and age which I tested in the mean difference tests shown in rows marked as "U" in Table 3.5. The same firm can achieve endorsements in different years, and the financial characteristics of the same endorsed firm change every year. Therefore, panel data (firm-year) is used to match the treatment group with control group. And the non-endorsed firms will be excluded from the pool once they are matched successfully with one observation in the treatment group, meaning that one

non-endorsed firm can only be matched once. Finally, this study forms a sample of 120 observations in the treatment group with 120 observations in the control group. Rows marked as "M" of Table 3.5 suggests that most of the differences between the characteristics of treatment and control groups are not significant after PSM. Moreover, Figure 3.2 demonstrates that the standardized percentage bias of the frim characteristics narrowed significantly after propensity scoring matching, showing that the endorsed firms and matched non-endorsed firms are now more comparable.

[Insert Figure 3.2]

Based on the matched sample, Figure 3.3 demonstrates the CAR difference between endorsed and the matched non-endorsed firms. The CAR difference between these two groups is about zero or even negative during the window [-15, -11], meaning that the CAR is even higher for the non-endorsed firms before political endorsement happens. However, when political endorsements were granted and market started to react ten days before the endorsement, the CAR difference rises to more than 1.5% at the event day and this trend persists over the whole month.

[Insert Figure 3.3]

This study then tests the impact of political endorsement on CAR through regression. I firstly identify the exact pairs of treated and control firms, and then assign the event dates of the endorsement to the corresponding non-endorsed firms in the control group. Since each firm can be endorsed for multiple times within the same year, there is an expansion in the sample size (356) compared with the previous matched sample (240). Specifically, treatment and control groups are matched according to a series of key firm characteristics like past performance and age. Because most of these

matching variables are annual data which is collected from firms' annual financial statements, the endorsed firms and non-endorsed firms are matched based on firm-year panel data, forming a matched sample of 240 observations in total: 120 endorsed with 120 non-endorsed observations. However, when this study tests the impact on market reactions (CAR), the data about market reactions is available every time when the firms are endorsed even within the same year. For example, if a firm is endorsed three times within the same year, the observation number for this firm at that year in the panel data to test firms' operating performance would be one, while the observation number in the dataset to test market reactions would be three. Therefore, when this study examines the effects on market reactions, there is an expansion in the sample because each firm can be endorsed for multiple times within the same year. In the dataset to test the impact on CAR, 183 endorsed observations are matched with 183 non-endorsed observations, forming a matched sample of 366 observations, within which 5 of 366 observations lack data on market reactions, thus leading to 356 observations after excluding the 5 pairs that lack data on market reactions. The results of the regressions are shown in Table 3.6. According to Column (1), the results are consistent with those in Table 3.4 that political endorsements, as a whole, can significantly push the cumulative abnormal return up for 4.5% (P=0.034).

In Column (2), where political endorsements are divided into nine specific types according to content keywords, the results show that endorsement about firms' achievement and advanced operation have positive effects on market reactions, while contents about R&D witness negative reactions for as high as 10.8%, which is consistent with the second hypothesis of this paper. The negative market reactions of R&D endorsement are consistent with much of the literature. For example, as Cox

(2010) points out, R&D in particular causes unpredictable consequences and boosts idiosyncratic risks, since costs, time, human resources and eventual technical success are all uncertain. The riskiness of R&D is also supported by Cooper (1981), who reveals that most companies fail to recover costs and expenditures which eventually leads to huge loss and great risk. As a result, the risky nature of R&D leads to the negative reactions on R&D endorsements, since investors suspect that companies will be given false incentive by the government to take on more R&D after they are endorsed and result in higher risks. Since these firms were selected by government as exemplars for R&D, investing more in R&D to keep the trend and meet the expectations of government is inevitable. In an un-tabulated table, I use the subsamples of firms who were endorsed for R&D to test whether these firms will invest more in R&D one year after endorsement. The results show a positive association between political endorsement on R&D and firms' future R&D investments (β=0.022, P=0.023), which provides supporting evidence for the increase in risk and the negative market reactions of R&D endorsements.

[Insert Table 3.6]

3.6.3 Endorsement Forms and Market Reaction

The forms of political endorsement (e.g. length or sequence) can reflect how much importance the government attaches to that company. It can be expected that government values firms more if political endorsements are longer (*Length*), if firm names are mentioned more often (*Times*), if firms are endorsed in the non-brief section of *Xinwenlinabo* (*Brief*), and if firms are endorsed in the earlier parts of the program (*Sequence)*. As a result, the market reactions are expected to be higher if investors

think the government values the firms more. Since only the firms who achieved political endorsement have data on endorsement forms, the sample in this section is restricted to the firms with endorsement rather than the matched sample. Column (1) of Table 3.7 demonstrates that the investors think the sequence of the political endorsement is a cue to judge how much importance the government attaches to the firm. Every forward move of sequence can increase the market reactions for 0.4%. However, length, times and which sections (brief or non-brief) the endorsement appears cannot influence investors' market reactions significantly.

Although previous results in Table 3.3 demonstrate that political connection does not influence the probability of endorsement, it is still possible that connected firms will be given favourable endorsement forms once they are selected for endorsements. Therefore, from Columns (2) to (5) in Table 3.7, I test whether *Xinwenlianbo* allocates more time to the connected firm, place endorsements about the connected firm in the non-brief section or in earlier parts of the program, and mentions the names of connected firm more times in order to impress audiences. The results show that the government doesn't give favourable forms to connected firms, and Column (2) even demonstrates a negative association between central-government-ownership and the endorsement length. Therefore, government treats connected and non-connected firms fairly, both in terms of the probability of endorsement and the endorsement forms.

[Insert Table 3.7]

3.7 Political Endorsement and Firm Performance

3.7.1 Firm Performance

Besides PSM, this study will apply treatment effects model and the instrumental variable technique to further solve the endogeneity and selection problems. As discussed in the previous section, PSM can control the selection on observables and alleviate the reverse causality between political endorsements and firm performance by matching treatment and control groups according to firms' past performance and other key characteristics to form samples with similar predicted likelihood of political endorsement, and thus making the treatment and control groups equally likely ex-ante to be selected by government to endorse.

However, there is still a concern that there are unobservable omitted variables which can bias the results. For instance, although I matched firms with similar matching covariates, these firms may face different market challenges and have various growth rates that influence their probability of being endorsed and also influence their performance, which would bias the results. According to researchers like Lennox et al. (2011) and Ettner (2004), the treatment effects model can control such selection on unobservables, and the treatment effects model is especially suitable when the endogenous variable is a dummy (Cameron & Trivedi, 2010; Lennox et al., 2011), as endorsement is in this study. Specifically, I first run a probit model where the dependent variable is the endorsement dummy and include all the variables used to predict operating performance. Instrumental variable technique is used here. Whether the firm is located in the same location as the Publicity Department (*SLPD*) can be used as a valid instrumental variable because it meets the relevance condition that geographic proximity can increase firms' probability of endorsement, and also meets the exclusion condition, as no evidence shows that being located in the same province

as the Publicity Department can influence firm performance. Based on the first-stage estimations, the treatment correction can be calculated to estimate the effects of unobservable factors underlying the achievement of political endorsement, and this treatment correction will be included in the second stage as a control variable to address bias (Guo & Fraser, 2014; Heckman, 1977; Lennox et al., 2011; Schuler et al., 2017).

Column (1) of Table 3.8 shows the results for the first-stage regression. The instrumental variable *SLPD* is significantly positively associated with political endorsement (β=1.054, P<1%), and the un-tabulated marginal effects of *SLPD* is also significant under 1% level with a coefficient of 0.39, meaning that locating in the same province as the Publicity Department can significantly increase firms' probability of endorsing by 39%. Columns (2) to (4) demonstrate the results for the second stage. The dependent variables are one-year forwarded performance measurements: return on asset (*ROA*), return on sales (*ROS*) and operating margin (*OM*) respectively. Performance is forwarded one year in order to give firms enough time to take advantage of the political endorsement. The results indicate that political endorsement is positively associated with firm future performance, no matter which performance measurements are used. For example, Column (2) shows that the ROA of endorsed firms are 5.5% (P = 0.048) higher than the control group, even after matching firms according to observable characteristics like past performance and controlling for selection on unobservable factors through treatment effects model and instrumental variable technique. However, another potential concern of these results is that the statistical significance of the tests is overstated due to persistence in variables and correlation over time. Therefore, in Columns (5) to (7), performance changes are used

instead of performance level to solve the problem of persistence. The results are consistent with Columns (2) to (5) except that the impact on change in OM is not significant. The Rho in Models (2) to (7) means the correlation between the error terms of the first-step model and second-step model. A negative Rho means the positive impact of endorsement on firm performance would be biased downward if OLS is used, showing the necessity to use treatment effects model to control this bias.

[Insert Table 3.8]

3.7.2 Firm Heterogeneity

As a further step, this section explores whether endorsement differentially affects firm performance across different types of firms in a manner that is consistent with particular theories. The first contingency factor this section tests is the past performance, and this study hypothesizes that political endorsement is more valuable for weakly performed firms because it can help them regain reputation, legitimacy and key resources for development. The negative coefficient of the interaction term *Endorse* × *PastPerform* (β= - 0.198, P=0.048) shown in Column (1) of Table 3.9 supports the hypothesis.

The second firm trait that can influence the impact of political endorsement on firm performance is the existence of political connections. Since both political endorsement and connection imply government support, one hypothesis is that political support has diminishing marginal effects, meaning that the effects of political endorsement for firms already having political connections are not as large as the effects for firms without connections. Moreover, political endorsement can be particularly valuable for less connected firms to help them overcome the lack of

legitimacy. As a result, the positive impact of political endorsement on firm performance is stronger for less connected firms. However, it is also possible that firms already have connections can utilize their political network to access more material preferential resources once they achieve political endorsement from the central government. The results of columns (2) in Table 3.9 support the first possibility that political endorsement is more valuable for less-connected firms to overcome the lack in resources and legitimacy.

The third contingency factor is firms' dependence on external financing. The impact of political endorsements on firms that rely heavily on external financing are assumed to be larger since these firms can more easily access external funds after achieving a kind of guarantee from the central government through political endorsement. The coefficients of the interaction term *Endorse* × *Dependence* (β=0.055, P=0.048) shown in Column (3) means that the positive impact of political endorsement on firm performance is 5.5% higher if the firm is more dependent on external financing.

[Insert Table 3.9]

3.7.3 Institution Heterogeneity

Institutional development level, like firm characteristics, can also influence the impact of political endorsement on firm performance. Shleifer and Vishny (2002) and Hellman, Jones, and Kaufmann (2000) suggest that politicians' interventions in business activities are more severe when institutional constraints are weak. In other words, the role of the government is stronger in provinces with weak institutions. However, this does not necessarily mean that political endorsement is more beneficial for firms located in provinces with weak institutions, because support from the central

government, such as subsidies, can be grabbed by local government if its local impact is strong and the quality is low. Therefore, this paper hypothesises that a stronger regional institution can ensure support from the central government is eventually transferred to endorsed firms, so the positive association between political endorsement and firm performance is stronger for firms located in provinces with better institutions.

Based on the surveys of Fan and Wang (2011), six different measurements of regional institutional development are used: (1) the index of less government intervention (*LessGovInt*) measures the degree of convenience of administrative process; (2) the sales of non-state-owned industrial firms relative to the sales of state-owned firms, reflecting the development level of the market (*NonStateSales)*; (3) the number of employees in non-state-owned firms relative to that in state-owned firms (*NonStateEmp)*; (4) the deposits obtained by non-state-owned financial institutions to the total deposits obtained by all financial institutions (*NonStateDepo)*, reflecting the market competition in the financial industry; (5) the percentage of credits allocated to non-state firms from financial institutions (*CreditDiscrepancy)*; and (6) the protection of intellectual properties index (*IntellProtect*), which refers to the ratio of the number of patent applications to the number of technical personnel. For easier and more consistent interpretations, the institutional indices finally used in the tests in Table 3.10 are dummy variables, equal to one if the institutional development is better than the national average, and zero otherwise.

The results of Table 3.10 show that all of the interaction terms between endorsement and these six measurements of institutional development are positively significant, which supports Hypothesis 3, that political endorsement is more value-

added for firms located in provinces with better institutions. For example, the coefficients of the interaction term *Endorse* × *LessGovInt* (β=0.037, P=0.009), shown in Column (1), means the positive impact of political endorsement on firm performance is 3.7% higher for firms located in provinces with better institutions.

[Insert Table 3.10]

3.8 Channel of Value Creation

In terms of the channel of value creation, I explore whether endorsement can bring about more access to government support, and then investigate the firms' improvement in financing and investment efficiency, and finally test firms' change in policies after achieving political endorsement. According to the researchers like Hearn (2012) and Faccio et al. (2006a), companies are able to access more favourable resources after establishing a relationship with governments. Therefore, I test whether the government will give endorsed firms more support, such as subsidies and reduced effective tax rates. Results of Column (1) of Table 3.11 demonstrate that political endorsement is positively correlated with government subsidy, but Columns (2) and (3) show that there is no impact on effective tax rate.

Then this section explores the impact of political endorsement on firms' financing and investment. Column (4) shows the results about the impacts on cost of debt. The significant negative coefficient of endorse (β= - 0.002, P=0.031) indicates that the cost of debt for endorsed firms is 0.2% lower compared with non-endorsed firms. Moreover, in Column (5), the significant positive coefficient of endorse demonstrates that endorsed firms outperform their non-endorsed counterparts by 6.4% higher investment

efficiency (*ROIC*).

Furthermore, the impacts on firm policies like executive salaries are also tested. In Column (6), I test whether the salaries of top 3 managers increase after endorsements as a bonus for achieving political endorsement. The results shown in Table 3.11 does not support that managers can get higher salaries after winning political endorsement, which is contradictory to what investors usually think according to anecdotal evidence.

[Insert Table 3.11]

3.9 Conclusion

Endorsement is a pervasive phenomenon that has traditionally been studied within a marketing context. However, scant literature focuses on endorsement in financial markets. Moreover, extant literature largely ignores political endorsement as a government strategy to influence the market. To fill these gaps, this chapter examines the impact of political endorsement in financial markets. Political endorsement, in this paper, is defined as public statements or actions showing government support of firms.

The results of this paper demonstrate that firms that are larger, younger, and have more employees are more likely to achieve political endorsement, while political connections and bribery are not determining factors, which indicate that underlying motive of government to endorse firms is its social goals rather than vested-interests. Moreover, political endorsement, especially endorsements of firms' achievements and operation, is positively correlated with market reactions. However, endorsement of aspects with high risks like R&D is negatively associated with market reactions as

endorsement gives these firms false incentives to excessively divert resources into these high-risk aspects in order to meet government or social expectations. Besides endorsement contents, the endorsement forms also influence the impact of political endorsement since the forms reflect how much importance the government attaches to the firms.

Furthermore, after applying PSM methodology to control for selection on observables and treatment effects model with instrumental variable technique to control for selection on unobservables, this paper suggests the positive influences of political endorsement on firm performance, indicating that endorsed companies can participate in an exclusive club where reputation and favourable resources can be transferred from the government to firms. The value of political endorsement is higher for firms that perform weakly before the endorsement, less politically connected, depend heavily on external financing, or located in places with strong institutions. And the results also demonstrate that the channels of value creations consist in the increasing in subsidy, reduction in cost of debt, and improved investment efficiency.

This study is the first to examine political endorsement, an approach through which governments influence markets, which contributes to literature on the role of governments in capital markets. Furthermore, this study fills gaps in the literature on endorsement by introducing the concept of endorsement into finance, and focusing on a new type of endorser – the government. In addition, this study also provides practical implications for government, firms, and investors. The policy implication is that officials can improve social welfare and economy through selecting firms more strategically. The managerial implication is to publicizing the political endorsement once the firms are endorsed to maximize the market reactions. And this paper can also

provide implications for investors in markets where the government is helping-hand. Future research can try to examine whether these results of political endorsemnets can be generalized to fit other countries, especially by comparing the results among countries with invisible-hand, helping-hand and grabbing-hand governments.

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Figure 3.1 : Cumulative Abnormal Return of Political Endorsements

This figure shows the cumulative abnormal return of political endorsements from 15 days before political endorsement to one month after political endorsements.

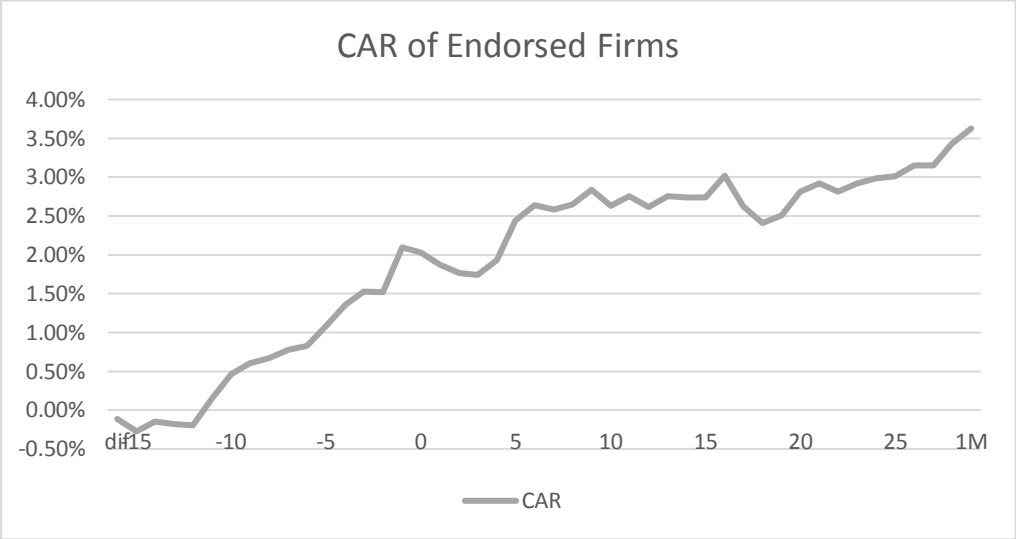

Figure 3.2 : Standardized % Bias Before and After PSM

This figures demonstrates the distribution of standardized % bias of the variables before and after propensity score matching.

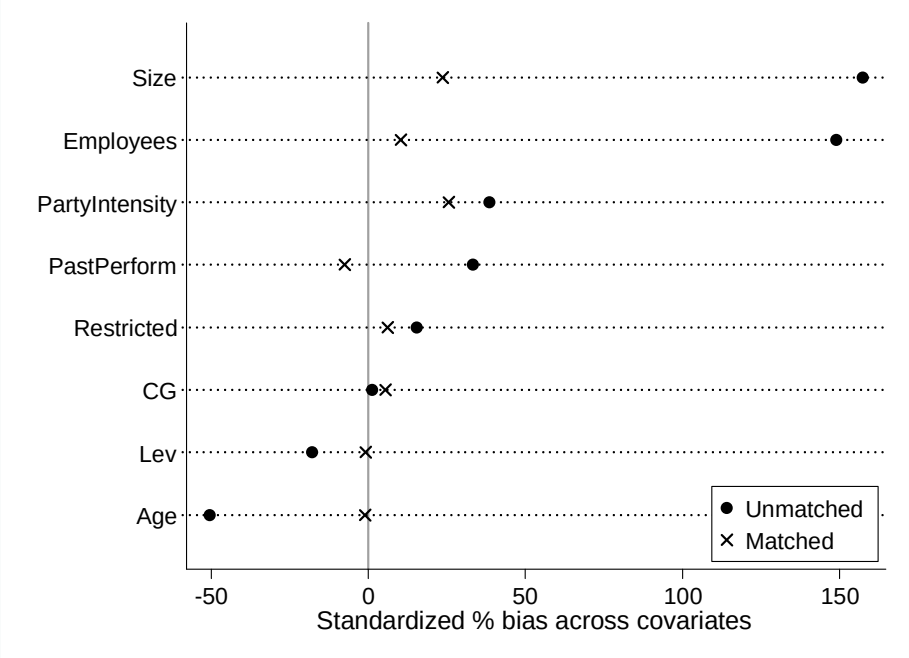

Figure 3.3 : CAR Difference Between Endorsed and Non-Endorsed Firms

This figure shows the differences in cumulative abnormal returns of endorsed and matched non-endorsed firms.

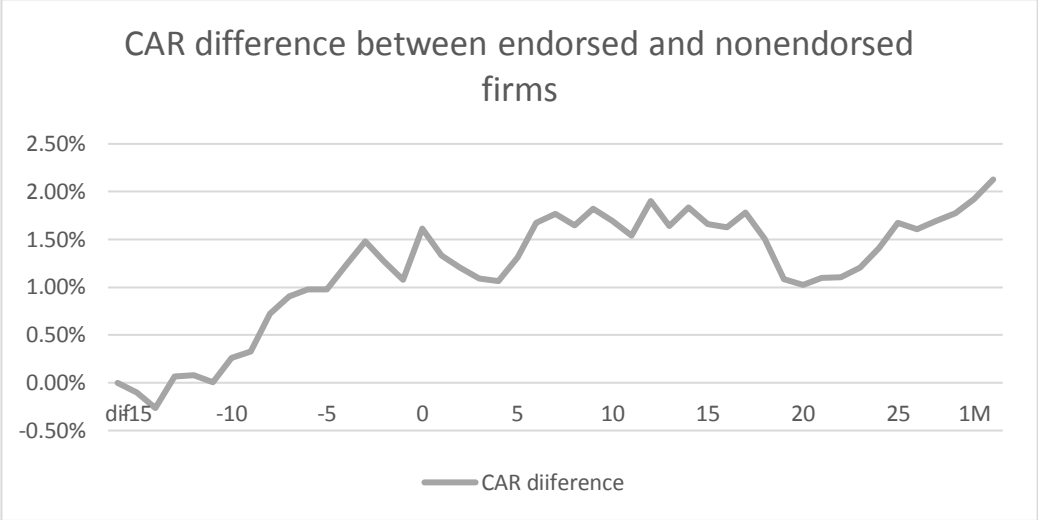

Table 3.1 : Descriptive Statistics for Political Endorsement

This table shows the observations and percentages of different political endorsement types. Row (1) treats all endorsements as a whole. In row (2), endorsements are then decomposed into nine specific aspects according to the key words of news contents: CSR, new product, R&D, profit-related, achievement, operation, co-operation, ideology and other. Firms can be endorsed for multiple aspects within one endorsement. Therefore, the total number of observations in row (2) is higher than the total observations in row (1). Definitions of all categories can be found in the Appendix.

		Observations	**Percentage%**
(1)	All Endorsement	278	
(2)	CSR	39	8.97%
	New product	31	7.13%
	R&D	57	13.10%
	Profit	37	8.51%
	Achievement	64	14.71%
	Operation	98	22.53%
	Co-operate	46	10.57%
	ideo	10	2.30%
	other	53	12.18%
	Total	435	100%

Table 3.2 : Descriptive Statistics for Endorsed Firms

This table shows the descriptive statistics of endorsed firms. **Panel A** demonstrates the number of endorsed firms that are controlled directly by central government (*CG)*, by other levels of government except CG (*SOE_Other*) and private firms (*Private*). **Panel B** shows the distribution of industries. Detailed definitions of all variables are provided in the Appendix.

	Panel A Ownership Distribution			
	Endorsed firms		**All listed firms**	
	(1)	(2)	(3)	(4)
	#	%	#	%
CG	10	10.64%	37	2.67%
SOE_Other	72	76.60%	868	62.54%
Private	12	12.77%	483	34.80%
Total	94	100%	1388	100%

Panel B Industry Distribution					
GICs	industry	**Endorsed Firms**		**All listed firms**	
		(1)	(2)	(3)	(4)
		#	%	#	%
10	Energy	8	8.51%	44	3.17%
15	Materials	8	8.51%	255	18.37%
20	Industrials	26	27.66%	306	22.05%
25	Consumer Discretionary	24	25.53%	249	17.94%
30	Consumer Staples	3	3.19%	103	7.42%
35	Health Care	3	3.19%	87	6.27%
40	Financials	10	10.64%	159	11.46%
45	Information Technology	6	6.38%	109	7.85%
50	Telecommunication	0	0.00%	3	0.22%
55	Utilities	6	6.38%	73	5.26%
Total		94	100%	1388	100%

Table 3.3 : Determinants of Political Endorsements

This table presents the results for the research question: what kind of firms is more likely to achieve political endorsement? The dependent variable *P(Endorsement)* equals 1 if the firm achieved political endorsement, and zero otherwise. *CG is a* dummy variable which equals one if the actual controller of the firm is central government. *SOE_Other* is a dummy variable which equals one if the actual controlling shareholder is other levels of government except central government. *PartyIntensity* is the ratio of party members to the total number of directors. *PB* is a dummy variable which equals one if at least one director of the firm has working experience as a government official. *PBIntensity* means the political background intensity, which equals to the ratio of directors who have working experience as a government official to the total number of board directors. *StateShare* means the percentage of shares owned by the state. *Prov_Entertain* is a provincial level data, which equals the ratio of entertainment cost to sales, reflecting the regional corruption level. *Prov_CorOfficial* refers to the number of provincial corrupt officials caught during anti-corruption campaign. *Firm_Entertain* means the ratio of the entertainment costs of managers or the hospitality fees to sales. *Employees* means the number of employees. In all models, I check some other determinants of endorsement, including past performance (*ROA_P)*, firm size (*Size*), firm age (*Age*), leverage (*Lev*), and the number of restricted shares (*Restricted*). Detailed definitions of all variables are provided in the Appendix. P-values are reported in parenthesis. ***, **, * denote significance levels at 1%, 5% and 10% respectively.

	Dependent Variable: Probability of Endorsement								
	Connection-related determinants								**Non-connection-related determinants**
	Political connection					Bribery			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
CG	-0.023								
	(0.951)								
SOE_other	0.055								
	(0.699)								
PartyIntensity		0.205							
		(0.375)							
PB			0.186						
			(0.464)						
PBintensity				-0.705*					

				(0.089)					
StatesShare					-0.075				
					(0.865)				
Prov_Entertain						-0.126			
						(0.456)			
Prov_CorOfficial							-0.004		
							(0.205)		
Firm_Entertain								-0.004	
								(0.205)	
Employees									0.572***
									(0.000)
Size	0.570***	0.568***	0.571***	0.591***	0.574***	0.574***	0.572***	0.557***	-0.022
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.112)
Age	-0.025*	-0.026*	-0.024*	-0.028*	-0.025*	-0.025*	-0.022	-0.024*	0.009
	(0.082)	(0.072)	(0.085)	(0.054)	(0.081)	(0.075)	(0.112)	(0.091)	(0.610)
Lev	0.009	0.009	0.008	0.010	0.008	0.008	0.009	0.008	0.353
	(0.592)	(0.592)	(0.616)	(0.504)	(0.598)	(0.607)	(0.610)	(0.613)	(0.702)
PastPerform	0.316	0.335	0.262	0.375	0.282	0.237	0.353	0.256	0.109
	(0.733)	(0.716)	(0.775)	(0.688)	(0.759)	(0.798)	(0.702)	(0.783)	(0.621)
Restricted	0.101	0.095	0.114	0.105	0.165	0.114	0.109	0.094	0.173
	(0.648)	(0.668)	(0.605)	(0.639)	(0.675)	(0.605)	(0.621)	(0.674)	(0.443)
Industry	Y	Y	Y	Y	Y	Y	Y	Y	Y
Constant	-14.459***	-14.413***	-14.604***	-14.755***	-14.504***	-14.336***	-14.374***	-14.065***	-14.374***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
N	2873	2873	2873	2873	2873	2873	2873	2873	2873
Pseudo R^2	0.334	0.333	0.333	0.335	0.332	0.333	0.334	0.337	0.334

Table 3.4 : Market Reactions of Different Political Endorsement Types

Row (1) presents the cumulative abnormal returns of political endorsement over different time windows. In row (2), endorsements are then decomposed into nine specific aspects according to the key words of endorsement contents: CSR, new product, R&D, profit-related, achievement, operation, co-operation, ideology and other. The detailed definitions of these endorsement categories are shown in Appendix. P-values are reported in parenthesis. ***, **, * denote significance levels at 1%, 5% and 10% respectively.

Market reactions of different political Endorsement contents								
		CAR(-1,1)	**CAR(-2,2)**	**CAR(-3,3)**	**CAR(-4,4)**	**CAR(-5,5)**	**CAR(-10,10)**	**1 month CAR**
(1)	Endorse	0.009**	0.006**	0.007**	0.008**	0.010**	0.021***	0.030***
		(0.013)	(0.039)	(0.046)	(0.036)	(0.020)	(0.001)	(0.002)
(2)	CSR	-0.005	0.002	0.009	0.007	0.000	0.015	0.036
		(0.289)	(0.818)	(0.265)	(0.476)	(0.979)	(0.514)	(0.172)
	New Product	0.013	0.026	0.026	0.031*	0.034*	0.030	0.059*
		(0.205)	(0.114)	(0.147)	(0.082)	(0.070)	(0.158)	(0.050)
	R&D	0.008	0.009	0.007	0.007	0.005	0.006	0.010
		(0.202)	(0.351)	(0.510)	(0.503)	(0.630)	(0.632)	(0.620)
	Profit	0.017**	0.026**	0.026*	0.026*	0.027**	0.030*	0.044**
		(0.040)	(0.041)	(0.051)	(0.056)	(0.047)	(0.072)	(0.041)
	Achievement	0.007	0.010	0.015	0.013	0.018*	0.027**	0.033
		(0.226)	(0.235)	(0.110)	(0.195)	(0.051)	(0.018)	(0.119)
	Operation	0.013***	0.017***	0.015***	0.019***	0.017**	0.032***	0.055***
		(0.003)	(0.001)	(0.008)	(0.006)	(0.031)	(0.007)	(0.001)
	Co-operate	0.013*	0.020*	0.022*	0.029**	0.029**	0.038**	0.064***
		(0.077)	(0.073)	(0.069)	(0.016)	(0.033)	(0.038)	(0.005)
	Ideology	-0.004	-0.003	-0.010	-0.014	-0.010	0.041	0.083
		(0.652)	(0.725)	(0.365)	(0.165)	(0.498)	(0.207)	(0.111)
	other	0.017	-0.004	-0.010**	-0.014**	-0.008	-0.002	-0.020
		(0.228)	(0.313)	(0.039)	(0.021)	(0.237)	(0.824)	(0.208)

Table 3.5 : Compare Treated and Control Groups Before and After PSM

This table compares the differences between the endorsed firms and non-endorsed firms before and after PSM. Endorsed firms are the firms that are endorsed by government through *Xinwenlianbo*. The matched non-endorsed firms are identified by applying PSM. Detailed definitions of all variables are provided in the Appendix. ***, **, * denote significance levels at 1%, 5% and 10% respectively.

Variable	Matched or Unmatched	Mean		t-test	
		Treated	Control	t	p>|t|
CG	U	0.025	0.0231	0.140	0.892
	M	0.025	0.0167	0.450	0.653
PartyIntensity	U	0.340	0.257	4.060	0
	M	0.340	0.285	2.110	0.036
Employees	U	9.557	7.421	15.86	0
	M	9.557	9.409	0.840	0.400
Size	U	24.22	21.87	19.79	0
	M	24.22	23.87	1.800	0.072
Age	U	10.07	11.98	-5.690	0
	M	10.07	10.12	-0.0800	0.936
Lev	U	1.004	1.556	-1.420	0.157
	M	1.004	1.031	-0.220	0.825
PastPerform	U	0.0519	0.0314	3.200	0.001
	M	0.0519	0.0565	-0.630	0.527
Restricted	U	0.194	0.159	1.680	0.092
	M	0.194	0.180	0.450	0.651

Table 3.6 : Market Reactions of Different Political Endorsement Types

This table explores which types of endorsement are positively associated with significant market reactions. The dependent variables of column (1) and (2) are 1-month cumulative abnormal return. Column (1) tests the market reactions of all endorsements. In column (2), political endorsements are decomposed into nine specific aspects according to the key words of endorsement contents: CSR, new product, R&D, profit-related, achievement, operation, co-operation, ideology and other. The definitions of these categories are provided in Appendix. Control variables cover commonly used influencing factors of market reactions: firm size, firm age, leverage, past performance, restricted shares, and also controls for industry effects. P-values are reported in parenthesis.*,**,*** denote the significance level at 10%, 5% and 1% respectively.

	CAR	
	(1)	(2)
Endorsement	0.045**	
	(0.034)	
CSR		0.050
		(0.118)
New Product		0.072
		(0.119)
R&D		-0.108***
		(0.001)
Achievement		0.069*
		(0.064)
Operation		0.046**
		(0.034)
Co-operate		0.043
		(0.160)
Ideology		0.082
		(0.122)
Profit		-0.042
		(0.392)
Other		-0.041
		(0.280)
CG	0.023	0.019
	(0.674)	(0.722)
PartyIntensity	-0.030	-0.026
	(0.473)	(0.532)
Employees	0.001	-0.005
	(0.922)	(0.704)
Size	-0.013	-0.008
	(0.264)	(0.448)
Age	-0.003	-0.002
	(0.270)	(0.334)
Lev	0.009	0.010*

	(0.132)	(0.071)
PastPerform	-0.084	-0.098
	(0.623)	(0.561)
Restricted	-0.022	-0.041
	(0.569)	(0.288)
Industry	Y	Y
Constant	0.338	0.288
	(0.110)	(0.156)
N	356	356
R^2	0.342	0.022

Table 3.7 : Market Reactions of Different Endorsement Forms

Column (1) of this table reveals the relationship between market reactions and different endorsement forms, where the dependent variable is the 1-month cumulative abnormal return. And the main variables of interests are the variables about endorsement forms: the length of the endorsement (*Length*); the times the same company name is mentioned (*Times*); whether the firm is endorsed in the brief section of the news program (*Brief*); and the sequence of the specific endorsement relative to the whole news program of that day (*Sequence*). Columns (2) to (5) explore whether connected firms will be given favourable forms. The dependent variables are endorsement forms, and the main variables of interests are the variables about political connections, including *CG* and *PartyIntensity*. Detailed definitions of all variables are provided in the Appendix. P-values are reported in parenthesis. ***, **, * denote significance levels at 1%, 5% and 10% respectively.

	1 month CAR	**Length**	**Times**	**Brief**	**Sequence**
	(1)	(2)	(3)	(4)	(5)
Length	-0.007				
	(0.625)				
Times	-0.001				
	(0.844)				
Sequence	-0.004*				
	(0.081)				
Brief	0.016				
	(0.628)				
CG	0.045	-0.341**	0.240	0.085	1.865
	(0.339)	(0.016)	(0.770)	(0.839)	(0.150)
PartyIntensity	-0.074	0.347	0.016	-0.592	-2.392
	(0.207)	(0.300)	(0.988)	(0.249)	(0.311)
Size	-0.022**	0.077	0.072	-0.082	-0.634*
	(0.014)	(0.156)	(0.548)	(0.245)	(0.050)
Age	-0.002	0.039*	0.162**	-0.060**	-0.324**
	(0.438)	(0.066)	(0.012)	(0.036)	(0.026)
Lev	-0.024*	0.196*	0.002	-0.199	-1.512**
	(0.087)	(0.072)	(0.994)	(0.145)	(0.024)
PastPerform	0.042	-0.465	2.937	-0.684	8.615
	(0.846)	(0.736)	(0.505)	(0.730)	(0.364)
Restricted	0.052	-0.012	-0.799	0.610	4.192**
	(0.339)	(0.977)	(0.327)	(0.192)	(0.044)
Industry	Y	Y	Y	Y	Y
Constant	0.689**	-1.993	-1.493	3.443	34.842***
	(0.012)	(0.213)	(0.671)	(0.105)	(0.000)
N	216	216	216	216	216
R^2	0.083	0.098	0.104		0.133
Pseudo R^2				0.093	

Table 3.8 : Impact of Political Endorsements on Firm Performances

This table explores the impact of political endorsement on firm performance based on matched sample. Column (1) demonstrates the first-step test of the instrumental variable: *SLPD*. *SLPD* is a dummy variable which indicates whether the firm is located in the same location as Publicity Department. The dependent variable in Column (1) is endorse dummy, which equals one if the firm is endorsed by government and zero otherwise. Column (2) to (7) are results of the second-stage tests. The dependent variables in Columns (2) to (4) are three one-year forwarded performance measurements (*ROA*, *ROS* and operating margin (*OM*)). Performance is forwarded one year in order to give firms enough time to take advantage of the political endorsement. And in column (5) to (7), dependent variables are performance changes. The main variable of interest is the endorsement dummy for Columns (2) to (7). The definitions of all variables are shown in Appendix. P-values are reported in parenthesis. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	First-Stage	Second-Stage					
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Endorse	ROA_F	ROS_F	OM_F	ΔROA	ΔROS	ΔOM
SLPD	1.054***						
	(0.000)						
Endorse		0.055**	0.133**	0.241**	0.051**	0.067*	0.090
		(0.048)	(0.036)	(0.039)	(0.047)	(0.095)	(0.133)
CG	-0.074	-0.010	0.006	0.009	0.011	0.018	0.018
	(0.900)	(0.657)	(0.902)	(0.925)	(0.582)	(0.567)	(0.709)
PartyIntensity	0.780*	-0.005	-0.000	-0.044	-0.018	-0.014	-0.030
	(0.070)	(0.778)	(0.994)	(0.559)	(0.269)	(0.586)	(0.439)
Employees	-0.085	0.008**	-0.025***	-0.045***	0.005	0.009	0.013
	(0.416)	(0.046)	(0.006)	(0.007)	(0.164)	(0.101)	(0.116)
Size	0.097	-0.010**	0.009	0.012	-0.009**	-0.018***	-0.028***
	(0.345)	(0.012)	(0.336)	(0.499)	(0.014)	(0.002)	(0.002)
Age	0.033	0.000	-0.000	-0.002	-0.000	0.000	0.000
	(0.172)	(0.740)	(0.857)	(0.625)	(0.972)	(0.708)	(0.849)
Lev	0.050	0.000	-0.000	-0.024	-0.002	-0.007	-0.019**
	(0.636)	(0.981)	(0.968)	(0.168)	(0.539)	(0.246)	(0.037)
PastPerform	0.203	0.568***	0.923***	1.180***	-0.209***	-0.268***	-0.258**
	(0.897)	(0.000)	(0.000)	(0.000)	(0.000)	(0.002)	(0.047)
Restricted	-0.001	0.000	0.023	0.050	0.003	-0.003	0.001
	(0.997)	(0.990)	(0.460)	(0.389)	(0.831)	(0.890)	(0.974)
Selection Correction		-0.032*	-0.100**	-0.185**	-0.028*	-0.039	-0.056
		(0.069)	(0.012)	(0.011)	(0.080)	(0.116)	(0.136)
Industry	Y	Y	Y	Y	Y	Y	Y
Constant	-2.279	0.171**	0.029	0.197	0.172**	0.330***	0.535***
	(0.255)	(0.027)	(0.871)	(0.543)	(0.015)	(0.003)	(0.001)
N	240	240	240	240	240	240	240
Rho		-0.647	-0.888	-0.902	-0.624	-0.561	-0.533
Pseudo R^2	0.069						

Table 3.9 : Firm Heterogeneity

This table tests whether political endorsements differentially affect firm performance across different types of firms. Dependent variable is one-year forwarded ROA (*ROA_F*). From Columns (1) to (3), different interaction terms between endorse and firm characteristics are added. (1) *PastPerfrom* means the past performance of firms, which is measured as the average ROA of past two years. (2) *SatesShare* refers to the percentage of shares owned by the state. (3) Following the method of Rajan and Zingales (1998), firm's dependence on external financing equals the capital expenditures minus cash flow from operations divided by capital expenditures. *Dependence* is a dummy variable which equals to one if the firms depend more heavily on external financing than average. The definitions of all variables are shown in Appendix. P-values are reported in parenthesis. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	Dependent Variable: ROA_F		
	(1)	(2)	(3)
Endorse × PastPerform	-0.198**		
	(0.048)		
Endorse ×StatesShare		-0.020*	
		(0.091)	
Endorse × Dependence			0.055**
			(0.048)
Endorse	0.068**	0.062**	0.055**
	(0.018)	(0.026)	(0.049)
PastPerform	0.655***	0.565***	0.568***
	(0.000)	(0.000)	(0.000)
CG	-0.010	-0.006	-0.010
	(0.663)	(0.792)	(0.657)
PartyIntensity	-0.008	-0.002	-0.005
	(0.648)	(0.911)	(0.778)
Employees	0.008**	0.008**	0.008**
	(0.043)	(0.037)	(0.046)
Size	-0.010**	-0.011***	-0.010**
	(0.012)	(0.008)	(0.012)
Age	0.000	0.000	0.000
	(0.613)	(0.754)	(0.740)
Lev	-0.000	0.000	0.000
	(0.925)	(0.917)	(0.981)
Restricted	-0.003	0.027	0.000
	(0.847)	(0.193)	(0.990)
Selection Correction	-0.033*	-0.032*	-0.032*
	(0.060)	(0.067)	(0.069)
StatesShare		-0.007	
		(0.545)	
Dependence			-0.002
			(0.889)

Industry	Y	Y	Y
Constant	0.156**	0.168**	0.160**
	(0.040)	(0.025)	(0.034)
N	240	240	240
Rho	-0.671	-0.652	-0.647

Table 3.10 : Institution Heterogeneity

This table tests whether political endorsements differentially affect firm performance across different institutional development levels. Dependent variable is one-year forwarded ROA (*ROA_F*). From Columns (1) to (6), different interaction terms between endorse and provincial institutional development indexes are added. All of these institutional indices are based on the book of Fan and Wang (2011). The institutional indices used in this paper are dummy variables, which equals to one if the institutional development is better than national average and zero otherwise. (1) The index of less government intervention (*LessGovInt*) measures the degree of convenience of administrative process. (2) *NonStateSales* means the sales of non-state-owned industrial firms relative to the sales of state-owned firms, reflecting the development level of the market. (3) *NonStateEmp* refers to the number of employees in non-state-owned firms relative to that in state-owned firms. (4) *NonStateDepo* is the ratio of the deposits obtained by non-state-owned financial institutions to the total deposits obtained by all financial institutions, reflecting the market competition in financial industry. (5) *CreditDiscrepancy* is an index for development level of the market, which refers to the percentage of credits allocated to non-state-owned firms from financial institutions. (6) the protection of intellectual properties index (*IntellProtect*) means the ratio of the number of patent applications to the number of technical personnel. The definitions of all variables are shown in Appendix. P-values are reported in parenthesis. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	Dependent Variable: ROA_F					
	(1)	(2)	(3)	(4)	(5)	(6)
Endorse × LessGovInt	0.037***					
	(0.009)					
Endorse × NonStateSales		0.020*				
		(0.081)				
Endorse × NonStateEmp			0.022*			
			(0.075)			
Endorse × nonstatebank				0.031**		
				(0.023)		
Endorse × CreditDiscrepancy					0.020*	
					(0.091)	
Endorse × IntellProtect						0.023**
						(0.039)
Endorse	0.019	0.060*	0.038	0.026	0.056*	0.031
	(0.529)	(0.067)	(0.210)	(0.389)	(0.084)	(0.285)
CG	-0.006	-0.009	-0.007	-0.010	-0.010	-0.006
	(0.779)	(0.710)	(0.742)	(0.655)	(0.689)	(0.768)
PartyIntensity	-0.008	-0.009	-0.009	-0.005	-0.008	-0.001
	(0.643)	(0.660)	(0.638)	(0.777)	(0.679)	(0.938)

Employees	0.009**	0.009**	0.008**	0.008**	0.009**	0.007*
	(0.024)	(0.046)	(0.040)	(0.030)	(0.043)	(0.057)
Size	-0.011***	-0.012**	-0.010**	-0.011***	-0.011**	-0.010***
	(0.007)	(0.011)	(0.012)	(0.007)	(0.012)	(0.010)
Age	0.000	-0.000	0.000	0.000	-0.000	0.000
	(0.828)	(0.937)	(0.753)	(0.783)	(0.984)	(0.698)
Lev	0.000	0.000	0.001	0.000	-0.000	0.001
	(0.956)	(0.997)	(0.890)	(0.917)	(0.970)	(0.895)
PastPerform	0.556***	0.573***	0.554***	0.570***	0.567***	0.576***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Restricted	0.002	-0.002	0.001	0.002	-0.003	0.001
	(0.882)	(0.882)	(0.942)	(0.871)	(0.830)	(0.912)
Selection Correction	-0.028	-0.042**	-0.031*	-0.029*	-0.040**	-0.024
	(0.106)	(0.039)	(0.081)	(0.091)	(0.047)	(0.172)
LessGovInt	-0.021**					
	(0.029)					
NonStateSales		-0.005				
		(0.542)				
NonStateEmp			-0.017*			
			(0.057)			
NonStateDepo				-0.016*		
				(0.089)		
CreditDiscrepancy					-0.006	
					(0.478)	
IntellProtect						-0.009
						(0.304)
Industry	Y	Y	Y	Y	Y	Y
Constant	0.186**	0.181**	0.171**	0.182**	0.178**	0.166**
	(0.011)	(0.028)	(0.022)	(0.014)	(0.028)	(0.019)
N	240	240	240	240	240	240
Rho	-0.590	-0.791	-0.636	-0.609	-0.764	-0.521

Table 3.11 : Channel of Value Creation

This table presents the impacts of political endorsement on the access of government supports, financing, investments and corporate policies. *Subsidy_F* refers to the logarithm of government subsidy, forwarded one year. Following Feng, Johansson, and Zhang (2015)'s method, *ETR* is defined as (tax expense-deferred tax expense)/EBIT. *ETR_F* refers to one-year forwarded ETR. *ΔETR* represents the change in tax burden, equalling the difference between the three year average annual effective tax rate before and after the political endorsements. Cost of debt (*CostofDebt_F*) is the ratio of net interest expense to sales according to Cao, Hou, and Pan (2015). Return on invested capital (*ROIC*) equals to (net income+financial expenses)/(total assets-current liabilityies+notes payable+short-term borrowings +long-term liabilities due within one year), forwarded one year. *Salary_F* means the logarithm of salaries of top 3 managers, forwarded one year. The definitions of all variables are shown in Appendix. P-values are reported in parenthesis. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	Government Support			Financing and Investment		Policy
	(1)	(2)	(3)	(4)	(5)	(6)
	Subsidy_F	ETR_F	ΔETR	CostofDebt_F	ROIC_F	Salary_F
Endorse	3.879***	0.094	-0.339	-0.002**	0.064*	0.856
	(0.009)	(0.311)	(0.743)	(0.031)	(0.077)	(0.189)
CG	-0.241	-0.015	0.546	0.000	0.003	-0.236
	(0.842)	(0.837)	(0.539)	(0.523)	(0.926)	(0.655)
PartyIntensity	-0.770	-0.111*	-0.777	0.001	-0.015	-1.341***
	(0.386)	(0.065)	(0.275)	(0.251)	(0.540)	(0.002)
Employees	0.430**	0.047***	-0.155	-0.000	0.009*	-0.020
	(0.042)	(0.000)	(0.359)	(0.484)	(0.074)	(0.829)
Size	0.489**	-0.029**	-0.073	0.000	-0.014**	0.155
	(0.024)	(0.031)	(0.670)	(0.468)	(0.011)	(0.110)
Age	-0.011	-0.002	-0.060	-0.000	0.001	0.019
	(0.822)	(0.597)	(0.102)	(0.284)	(0.527)	(0.366)
Lev	-0.081	0.011	-0.102	0.000	-0.011**	-0.063
	(0.695)	(0.396)	(0.541)	(0.347)	(0.048)	(0.519)
PastPerform	-0.438	0.588***	1.115	0.000	0.669***	3.666***
	(0.885)	(0.002)	(0.646)	(0.895)	(0.000)	(0.010)
Restricted	-0.606	0.021	-0.310	0.000	-0.000	-0.365
	(0.380)	(0.636)	(0.582)	(0.591)	(0.990)	(0.257)
Selection Correction	-2.041**	-0.067	0.452	0.001**	-0.036	-0.442
	(0.027)	(0.251)	(0.491)	(0.024)	(0.115)	(0.282)
Industry	Y	Y	Y	Y	Y	Y
Constant	0.812	0.339	5.228*	-0.001	0.263***	10.820***
	(0.838)	(0.168)	(0.086)	(0.764)	(0.009)	(0.000)
Rho	-0.860	-0.437	0.235	0.801	-0.563	-0.386
N	240	240	240	240	240	240

Appendix

Table A3.1 : Variable Definition

Endorsement-related Variables	
Endorsement	Dummy variable. If the firm is endorsed by government, equals 1, otherwise zero.
SLPD	SLPD is a dummy variable which indicates whether the firm is located in the same location as Publicity Department
Types of endorsement	
CSR	Political endorsement about firms' good performance in social responsibility like environment protection.
R&D	Political endorsement about firms' good performance in R&D
New Product	Political endorsement about firms' creation of new products.
Profit	This type of endorsement is identified by using a series of key words such as lower costs, higher profits, and huge sales.
Achievement	Government endorses firms if they have glorious history, achieve prizes for management, overcome financial crisis, win an international bid and win large market share.
Operation	This type of endorsement is identified by using a series of key words about daily operation, such as merge, financing, establishing new branches, starting or completing a new project, new service and management.
Co-operation	Co-operate with domestic or oversea companies, with governments, or with research departments.
Ideology	This type of endorsement is identified by using a series of key words such as culture, ideological education, party, and model worker.
Other	This type includes all remaining types of endorsement which cannot fit previous categories and the observations are very limited to form an independent category.
Forms of endorsement	
Sequence	The sequence of the specific piece of news which includes endorsement in the news program of that day.
Times	How many times the same company name is mentioned.
Length	The length of the piece of news which includes political endorsement.

Brief	Dummy variable. If the firm is endorsed in the brief summary of the news program, equals 1. If the firm is endorsed in normal sections, equals 0.
Institutional index	
LessGovInt	The index of less government intervention measures the degree of convenience of administrative process based on a survey conducted by Fan and Wang (2011). *LessGovInt* is a dummy variable which equals one if the government intervention within the province is lower than national average.
NonStateSales	The sales of non-state-owned industrial firms relative to the sales of state-owned firms. *NonStateSales* is a dummy variable which equals one if the index of the province is higher than national average. Resources: Fan and Wang (2011).
NonStateEmp	The number of employees in non-state-owned firms relative to that in state-owned firms. *NonStateEmp* is a dummy variable which equals one if the index of the province is higher than national average. Resources: Fan and Wang (2011).
NonStateDepo	The ratio of the deposits obtained by non-state-owned financial institutions to the total deposits obtained by all financial institutions, thus reflecting the market competition in financial industry. *NonStateDepo* is a dummy variable which equals one if the index of the province is higher than national average. Resources: Fan and Wang (2011)
CreditDiscrepancy	The percentage of credits allocated to non-state-owned firms from financial institutions. Traditionally, state-owned firms can obtain more credits while production is lower. Therefore, this index can measure the development level of the market. *CreditDiscrepancy* is a dummy variable which equals one if the index of the province is higher than national average. Resources: Fan and Wang (2011).
IntellProtect	This index measures the protection of intellectual properties according to the ratio of the number of patent applications to the number of technical personnel. *IntellProtect* is a dummy variable which equals one if the protection of intellectual property within the province is better than national average. Resources: Fan and Wang (2011).
Other variables	
CG	If actual controller is central government, equals one.
SOE_Other	If actual controller is other levels of government except central government, equals one.
Private	If actual controller is private company or individuals, equals one.
PartyIntensity	No. of party members/ Total number of directors

PBIntensity	Political background intensity. The ratio of directors who has working experience as a government official to the total number of board directors.
PB	A dummy variable which equals one if at least one director of the firm has working experience as a government official.
StateShare	Percentage of shares owned by the state.
Prov_Entertain	Province-level data. A measurement for regional political connection and corruption. Refers to the ratio of entertainment cost to sales.
Prov_CorOfficial	Province-level data. A measurement for regional political connection and corruption. Means the number of regional corrupt officials caught in anti-corruption campaign.
Firm_Entertain	Firm-level data. A measurement for firm political connection and corruption. *Firm_Entertain* is a dummy variable which equals one if firm's ratio of the entertainment costs of managers or the hospitality fees to sales is higher than average.
Dependence	According to Rajan and Zingales (1998), firm's dependence on external financing equals the capital expenditures minus cash flow from operations divided by capital expenditures. *Dependence* is a dummy variable which equals to one if the firms depend more heavily on external financing than average.
Size	Logarithm of market value, where the value of non-tradable shares are calculated by using net asset value.
Age	The age of the firm since listed.
Lev	Total equity/total liability
Employees	The logarithm of employee number
Restricted	Restricted shares. The number of shares that cannot be traded publicly during a time period according to regulation.
ROA_F	Return on asset, forwarded one year. ROA is the ratio of net income to the average of ending total assets this year and the ending total assets last year.
ΔROA	$\mathrm{ROA}_{t+1} - (\mathrm{ROA}_t + \mathrm{ROA}_{t-1})/2$
Pastperform	Past performance, $(\mathrm{ROA}_{t-1} + \mathrm{ROA}_{t-2})/2$
ROS_F	Return on sales, forwarded one year. Return on sales equals to the ratio of net income to sales
ΔROS	$\mathrm{ROS}_{t+1} - (\mathrm{ROS}_t + \mathrm{ROS}_{t-1})/2$
OM_F	Operating margin, forwarded one year. Operating Margin (OM)= EBIT/Sales
Δ OM	$\mathrm{OM}_{t+1} - (\mathrm{OM}_t + \mathrm{OM}_{t-1})/2$
ROIC_F	Return on invested capital (ROIC)= (net income+financial expenses)/(total assets-current liabilityies+notes payable+short-term borrowings +long-term liabilities due within one year), forwarded one year.
CostofDebt_F	Cost of debt is the ratio of net interest expense to sales according to Cao, Hou, and Pan (2015).
Subsidy_F	Logarithm of government subsidy, forwarded one year.

ETR_F	Effective tax rate, forwarded one year. Following Feng, Johansson, and Zhang (2015)'s method, ETR is defined as (tax expense-deferred tax expense)/EBIT.
ΔETR	Following Feng et al. (2015)'s method, ΔETR represents the change in tax burden, equaling to the difference between the three year average annual effective tax rate before and after the political endorsements.
Salary_F	Logarithm of salaries of top 3 managers.
CAR	Cumulative abnormal return over the market.

Chapter 4 Political Visit: State Leader Visit and Firm Performance

Abstract

Political visit is an under-researched way in which governments influence the capital markets. Chinese state leaders (i.e. Politburo Standing Committee Members) often visit firms during their domestic inspection tours. This study shows that representativeness, political connections and alignment with government goals are the three basic criteria for choosing firms to visit. This paper documents positive market reactions contingent on the political power of different administrations and government officials. Moreover, the results show that visits are associated with higher operating performance, which are robust after applying PSM to control selection on observables and applying treatment effects model with instrumental variable technique to control for selection on unobservables. These positive impacts are also contingent on certain firm characteristics and the levels of institutional development. Finally, this paper finds that political visit can be substituted as a source of legitimacy for CSR activities and increases the social attention for the firms, which reduces firms' incentives to donate while motivates firms' unethical behaviours in order to meet social expectations.

4.1 Introduction

Governments participate in financial markets through various methods, such as establishing regulations and policies (e.g.Johnson, 1960; Krueger, 1974), providing subsidies or directly owning firms (La Porta, Lopez‐de‐Silanes, & Shleifer, 2002). Some recent literature, such as that of Li, Tsang, Luo, and Ying (2016) and Schuler, Shi, Hoskisson, and Chen (2017), point out that site visits by political leaders are a way in which the government affects the market. For example, He and Tian (2008) regard politicians' site visits as a way to enhance government-business relationships and thus get more resources. However, research on political visits is still very limited. For example, the criteria the government uses to choose firms to visit is still unclear. And previous literature cannot differentiate the effects of political visits done by officials with different political power, nor between two administrations. Moreover, firms' actions after the visits are largely ignored by previous literature.

To fill these gaps, this paper focuses on political visits and explores the criteria for choosing firms and the impact of political visits on market and firm behaviour. Political visit, in this paper, is defined as a political device in which a high-level political leader carries out all the functions and symbolic representations of governing by periodically visiting firms. For example, in the UK, Prime Minister David Cameron visited the London Taxi Company in May 2015, which resulted in a so-called hugely exciting day for Coventry. President Obama, for another example, visited Apple Pay on 13th February 2015, described as a "big win for Apple Pay" by the CEO of Crone Consulting LLC since political visits bring about huge promotional value. Political visits are an important opportunity for the government to make key instructions to the

market. For instance, Obama visited the Detroit Auto Show in January 2016 and gave a speech expressing his government's idea on the auto industry.

To test the impact of political visit on capital market, I manually collected data on political visits of members of the Politburo Standing Committee of the Communist Party of China (PSC) in China from the Leader's Activity Database from 1st January 2009 to 31st July 2016, covering two administrations, one led by President Hu (1st January 2009 to 15th November 2012) and the other by President Xi (15th November 2012 to 31st July 2016), enabling me to examine the different effects between the two administrations. Since the reports in the database reveal the identities of the visiting leaders, I code the political power of those leaders according to their political positions, enabling this paper to differentiate the effects of political visits by officers with different political power.

Based on analysis of the data and interviews conducted by previous researchers like Schuler et al. (2017), this study first proposes that the government is more inclined to visit firms that have political connections, adhere to government goals and purposes, or are representative enough like the leading performers in their respective fields. The results show that firm-level political connection can increase the possibility of being visited, while individual-level connections have no impact. Leaders also prefer to visit firms located in less developed places, which is consistent with one of the government's goals to weaken the wealth gap and stimulate the economy in poor places, and also are more likely to visit firms with more employees which meets government's goal to maximize the social impacts of the visits and win people's support. Moreover, the results show that the government is more inclined to visit firms that have better past performance and larger size because such kinds of firms usually

play a vital part in the local economy and thus are representative.

Moreover, this paper hypothesizes that political visits are beneficial for firm, both in the form of market performance and operating performance, especially during the Xi administration due to this administration's more united structure of PSC and stronger political power. Political visits demonstrate government's promotion for the firms, and literature on political connections highlights that government support in countries with discretionary government can bring about material resources, suggesting that being visited by state leaders implies future favourable resources. For example, close relationships with government can help firms achieve bank loans (Khwaja & Mian, 2005) and generate higher long-term returns (Luo & Liu, 2009). Furthermore, the theory of private benefits of control provides a theoretical background for the positive emotional effects of political visits. Based on Yermack (2011), private benefits of control means people can utilise their position and power to obtain not only economic benefits but also intangible benefits, such as prestige and visibility. For instance, it is the public visibility and prestige Michelle Obama received from her political position as First Lady that made her influential in the fashion industry (Yermack, 2011). Similarly, in terms of political visits, visiting leaders can confer their prestige and visibility as political leaders upon visited firms, thus leading to market reactions.

The results indicate that political visits are positively correlated with market reactions over different time windows, especially when visited by Xi administration. In addition, this study finds that the higher the levels of leaders' political power, the higher market reactions. After applying PSM to alleviate endogeneity problems caused by observable factors and applying treatment effects model with instrumental variable

technique to control hidden bias, results reveal that political visits, in particular by Xi administration, are significantly and positively correlated with firms' future performance, no matter which performance measurements are used. As a further step, I take firm and institution heterogeneity into account to explore whether visits differentially affect firm performance across different types of firms and different levels of institutional development. The results show that political visits are more valuable for firms that are less-connected, weakly performed, or heavily dependent on external financing, since political leaders can confer legitimacy and prestige upon these firms. And political visit is also more valuable for firms located in places with good institutions because the higher quality of local institution can ensure the resources from central government eventually reach the target firms without being grabbed.

Finally, to fill the literature gap about the post-event resources firms obtain and firms' reactions to visits, I examine resources like loans and subsidies, and also test firms' reactions on corporate social responsibilities (CSR) and reactions on unethical behaviour like earnings management. The results find that political visit has positive impact on bank loans and government subsidies, but imposes negative impact on donation because the legitimacy provided by political visit reduce firms' need to conduct CSR. In addition, due to the increased social attention after visits, the disclosures about aspects like how firms protect investors increase. However, the decreased accountability of managers because of the increased job security and privileges brought by political connections after visits can lead to higher earnings management.

This paper contributes to the literature in a number of ways. First, this study complements the literature on the role of government. Existing literature points out

that governments can participate in markets through different approaches, such as issuing policies (Krueger, 1974), establishing political connections (e.g. Faccio, Masulis, & McConnell, 2006; You & Du, 2012)and directly owing firms (La Porta et al., 2002). This paper explores an under-researched approach through which the government can participate in the market – political visits. Different from political connection, both connected and non-connected firms can be targets of political visits. Additionally, political leaders that visit firms usually hold much higher positions than the government officials that firms generally connect with. For example, firms are usually visited by the president, though they rarely have connections with such high-level political leaders. Moreover, this paper also provides supporting evidence for the development view (Arthur Lewis, 1945; Gerschenkron, 1962; Hawtrey, 1926) of the government's positive role in the market.

Second, this paper is the first to differentiate between the effects of political visits from leaders with different political powers, compare the effects of two administrations, and identify the post-event resources and firm reactions. Existing literature about political visits or presidential travel is restricted to the impact of political visits on leaders themselves, or the impact on firm performance and market reaction, and cannot tell the difference between two administrations or the impact on firms' post-event behaviour. For example, extant literature points out that political visits can increase presidents' popularity (Brace & Hinckley, 1992; Ostrom & Simon, 1985), make power more tangible (Herbst, 2014; Mitchell, 1991) and secure the allegiance of local elites (Schatzberg, 2001). Li et al. (2016) and Schuler et al. (2017) demonstrate the impact of government leaders' site visits on market and firm performance. This paper considers political visits from a different angle, by focusing

on the impact on markets and post-event firm behaviour, and comparing the effects of different leaders and different administrations.

Third, this study largely contributes to literature on political visits by examining how the government chooses which firms to visit. No literature or material to date has clarified the criteria of how visited firms are selected. Schuler et al. (2017) conducted interviews with several experts in business-government relations and speculated that long-term interactions between firms and government may result in political visits. This paper is the first to identify the key criteria used when choosing firms. The results of this paper show that political connection is one key criterion, which is consistent with the interview results. The results complement the study of Schuler et al. (2017) by pointing out that only firm-level political connection can significantly improve the probability of political visits while individual connection is not a significant determinant.

Fourth, this paper is related to the literature on CSR. Existing literature highlights that political connection is positively correlated with corporate philanthropy activities (Li, Song, & Wu, 2015) and environmental information disclosure (Cheng, Wang, Keung, & Bai, 2017), and negatively related to management earnings forecast (Xing, Duan, & Hou, 2017). This paper complements previous literature by investigating the effects of political visits on corporate CSR and pointing out that political visits can be substituted as a source of legitimacy and demotivate firms from contributing to CSR.

This paper provides insights for government, firms and investors. First, since the results of this study demonstrate that political visits have impacts on resource allocation and can direct the ideas of the market, government can refine their selection

strategies and visit more socially meaningful firms like environmental-friendly firms to enhance social welfare. Second, considering the high value of political visit, managers can try to strengthen the aspects that are pointed out as the key determinants of political visit in this paper, thus increasing the probability of hosting PSC leaders. Third, for the investors, the results of this paper identified which kinds of visits are more valuable, thus providing investment insights.

The remainder of the paper is organised as follows. Section Two reviews literature, and hypotheses are developed in Section Three. Section Four introduces institutional background and Section Five describes the sample and data. The criteria for choosing firms to visit are explored in Section Six. Results about the impact of political visits on market reactions and firm performance are detailed in Sections Seven and Eight respectively. Section Nine analyses the post-event resources and firms' reactions. Finally, conclusions are articulated in Section Ten.

4.2 Literature Review

Site visit is a common strategy used by mutual funds and analysts to obtain information advantages and boost investment profits. Based on Liu, Dai, and Kong (2017), useful information gained from site visits can motivate mutual funds to amplify their trading volume and improve their predictive ability significantly to earn higher standardised unexpected earnings. This paper also demonstrates a significant positive relationship between predictive accuracy and the number of topics mentioned during conversations between mutual funds and firm managers. These effects are also certified by Cheng, Du, Wang, and Wang (2016), who claim that corporate site visits can improve forecast accuracy of visiting analysts, and that visits to manufacturing

firms and firms with more tangible assets and more concentrated business lines are more informative, since these kinds of firms have more observable activities and assets.

However, little research in finance recognises that site visits are also used by the government as a device to influence the market. The government influences the market using various methods. Previous literature mainly focuses on political connection (e.g. Claessens, Feijen, & Laeven, 2008; Faccio et al., 2006), government policies (e.g. Krueger, 1974) and state ownership (e.g. Shleifer, 1998). Specifically, establishing regulations and policies is one of the most straightforward ways for the government to influence the financial market. For example, the pioneering work of Krueger (1974) in political economy demonstrates that government policies like import restrictions can harm economic development, showing that establishing policies is an approach that is regularly used by the government to affect the market. Many researchers, such as Ramey and Ramey (1994), Bhagwati (1969) and Johnson (1960), also certify that government policies such as those on government spending, tariffs and quotas can influence economic growth. Directly owing firms is another approach for the government to participate in the market (La Porta et al., 2002). Compared with other approaches, direct government ownership allows governments to have overwhelming power over firms. Moreover, political connection is also a common way through which both governments in developed countries (Kim, Pantzalis, & Park, 2012) and developing economies (Gul, 2006; Leuz & Oberholzer-Gee, 2006) influence the market.

Recently, a stream of literature has begun focusing on a new kind of method used by the government to affect the market – political visits by government officials. Political visits are pervasive in both developing and developed countries. For example,

in the USA, President Obama visited corporate executives in the White House, which led to positive abnormal stock returns and helped firms win more government contracts (Brown & Huang, 2017). In the Chinese market, Schuler et al. (2017) pinpoint similar effects on firm performance after being visited by the president or premier.

However, research on political visits is still quite limited, and existing literature cannot differentiate between the effects of officials with different levels of political power, and ignore post-event firm reactions as well as the criteria used to choose which firms to visit. This study focuses on political visits to fill these gaps. Political visit, in this paper, is defined as a political device in which a high-level political leader carries out all the functions and symbolic representations of governing by periodically visiting firms.

Political visits have multiple political objectives, such as giving key instructions to the market and making governments' will manifest in person, and also lead to a series of market consequences. Based on in-depth case studies of six firms, He and Tian (2008) show that site visits by politicians can enhance firm-government relationships. Later research empirically investigates the impact on market views. For example, focusing on the political visits of the top two government officials – the president and premier – during the Hu administration, an event study conducted by Schuler et al. (2017) on 84 political visits in China demonstrates a significant positive market reaction. This paper complements this study by differentiating the effects of visits by different high-ranking government leaders, comparing the effects of the two different administrations, and investigating the impact on firm performance and post-event reactions. I propose that different government leaders and administrations provide distinct signalling and certification effects due to their respective governance

style and methods.

In addition to market reactions, Li et al. (2016) tested the effects of political visits on firm performance. By investigating visits to manufacturing firms from 2004 to 2007, Li et al. (2016) point out a positive relationship between political visits and firms' ROA and market-to-book ratio, and highlight that the effects are contingent on the severity of information asymmetry and the availability of alternative ways of reducing transaction costs. This paper can complement this paper from two perspectives. First, by focusing on visits to firms from all industries, this paper can eliminate the bias due to the sole focus on manufacturing industry. According to Cheng et al. (2016), analyst visits to manufacturing firms can provide more useful information because this kind of firms has more observable assets. Therefore, it's possible that the positive effects on firm performance are biased by the nature of the manufacturing industry, and this paper can rule out this bias by focusing on all industries. Second, firms' post-visit actions are largely ignored by previous literature. This paper complements existing literature by investigating the impacts of political visits on corporate social responsibilities and firms' unethical behaviour.

4.3 Hypothesis Development

Almost no literature or material clarifies the mechanism of how firms are chosen for political visits, but some indications can be observed from interviews of companies and experts. According to the interviews done by Schuler et al. (2017), business-government relation experts speculated that long-term and complex firm-government interactions play a role in the choice of firms. Based on interviews at three firms in Guangdong province done by Li et al. (2016), firms need to find a 'matchmaker'

between firms and officials in order to secure political visits. However, the visits investigated by Li et al. (2016) are from general government officials, not top leaders. This paper focuses on top leaders in China, and it's very difficult to influence the visit choices of leaders as high as presidents just by using a matchmaker.

Based on the collected data and the above-mentioned interviews, this paper proposes that representativeness, political connections, and alignment with government policies are the basic criteria for choosing firms to visit. First, firms must be representative enough among other firms in that city in some aspects. For example, a firm can be representative if it has larger size or if it is the leading performers in its field, because such kind of firms usually plays a vital part in the local economy or witnessed the development of that place, and thus has larger social impacts. For a specific example, CRRC Changchun Railway Vehicles Co., Ltd was visited by Premier Li in April 2015, and was visited again by President Xi in 21st July 2015. This firm became a frequent target of visit because it is representative enough in its advanced industrial upgrading and outstanding performance of the railway equipment manufacturing.

Second, as shown in the interviews conducted by Schuler et al. (2017), political connections are a factor in the choice of firms. But this is just speculation of interviewed experts, we still cannot rule out the possibility that firms can achieve political visits without connection as long as they are representative or aligned with government policies. Therefore, this paper tests whether political connection is a possible vital influencing factor in firm visiting decisions, but not a prerequisite.

Third, this study assumes that visited firms are ones that adhere to the goals, policies and ideologies promoted by the government. Since political visits are an

opportunity for the government to instruct the market, the types of visited firms will change according to the government's various purposes. For instance, during the National People's Congress and Chinese People's Political Consultative Conference, Premier Keqiang Li proposed the concept of "Internet+", demonstrating that integrating internet with traditional businesses to create more competitive new business models is now put on the top agenda to reach the national strategic level. Correspondingly, more and more internet entrepreneurs were chosen as part of the delegation to accompany the president during international political visits. For another example, encouraging innovation is an important goal of visit recently. From 5th March to 20th July 2016, president Xi visited the provinces Anhui, Heilongjiang, and Ningxia, and he emphasized the importance of innovation in all of these places. Therefore, it can be assumed that firms that are in line with the government's goals, policies and ideology are more likely to be chosen as the target of political visits.

Some government goals and purposes are temporary, like promoting "Internet +" as mentioned above, while some are long-term – these are easier to measure and test. For example, one of the government's most important long-term goals is to weaken the wealth gap; therefore, it can be supposed that the government tends to more frequently visit firms located in less developed places in order to stimulate the local economy. Another long-term goal of the government is to win people's support; therefore, this paper will test whether the government tends to visit firms with more employees in order to win people's support.

Hypothesis 1: Representativeness, political connections and alignment with government goals are the basic criteria for choosing firms to visit.

This paper hypothesizes that political visits are positively correlated with market reactions and future firm performance. Firstly, the political visit indicates government's promotion of the firms since the selected firms are representative, with connections, or align with government goals, and the literature on political connection demonstrates that government support can increase firms' access to resources, particularly in countries with a high-discretionary government like China (Chen, Ding, & Kim, 2010; Yan & Li, 2018), showing that political visits not only imply the high quality of visited firms, but also more potential resources. With an overwhelming advantage over most unconnected peers in terms of their intimate relationship with the government, connected firms can obtain more favourable treats. As Faccio et al. (2006) suggest, once firms belong to the cronies or families of current ruling political parties or leaders, these connected firms can get preferential resources, such as bailouts. Other preferential treats such as tax reductions (Bertrand, Kramarz, Schoar, & Thesmar, 2007; Faccio, 2010; Li, Meng, Wang, & Zhou, 2008), tariffs on counterparts (Goldman, Rocholl, & So, 2008) and easier access to loans (Khwaja & Mian, 2005) are common among connected firms. As a result, connected firms demonstrate higher value and generate higher long-term returns for investors (Calomiris, Fisman, & Wang, 2010; Hillman, 2005; Luo & Liu, 2009; Siegel, 2007).

Secondly, the theory about private benefits of control provides a theoretical background for the positive emotional effects of political visits. Private benefits of control means people can obtain economic gains for themselves by taking advantage of their position and power. For example, by analysing NYSE or Amex firms, Barclay and Holderness (1989) claim that block holders can trade at a premium and get private benefits by taking advantage of their voting power. According to Yermack (2011), not

only economic benefits but also intangible benefits, such as reputation, prestige and public visibility, can be obtained through people's public positions. For instance, the clothing choices of former First Lady Michelle Obama can create significant value for designers and retailers. It is the public visibility and prestige she obtained from her political position as First Lady that gives her the power to influence the market. In terms of political visits, visiting political leaders such as presidents can confer the publicity and prestige obtained from their position upon visited firms, thus leading to market reactions, which complies with the theory about private benefits of control.

Furthermore, this study proposes that political visits under different government administrations have distinct impacts on market views and firm performance due to the different governance styles and structures. The time period covered in this study (2009-2016) witnessed a major turnover in PSC personnel and position changes upon completion of a term of office in the fall of 2012, providing an excellent setting to deeply investigate the impact of visits done by PSC members by comparing the two administrations. First, the change in personnel was huge, as seven out of nine PSC members had to step down due to retirement age rules (Li, 2012), meaning that most of the PSC seats were filled by newcomers during the administration transition. These newcomers, with distinct fame and ruling styles, influence the value of political visits. Second, the number of PSC positions was reduced from nine to seven. The size reduction is vital, since the number games can determine which faction occupies the pinnacle of power and thus controls top decisions. As a result of the size reduction, PSC internal conflicts can be reduced and consensus can be reached more easily. Therefore, being visited by the more united PSC of the Xi administration implies more solid support from the central government. Third, compared with the Hu

administration, the Xi administration is more powerful and are more significantly and positively correlated with market reactions. For instance, after a key four-day meeting of top-level party officials in Beijing, the Communist Party elevated Xi Jinping to the "core" of its leadership. "The core of the Chinese Communist Party" is not just a new title but very symbolic in China and implies the power of President Xi. Moreover, after Xi launched an anti-corruption campaign, his reputation and prestige became more impressive. As a result, this paper hypothesizes that markets make more dramatic reactions to visits by President Xi's government because of its power, reputation, and more united structure of PSC.

Moreover, this paper hypothesizes that there are firm and institutional heterogeneities regarding the effects of political visits. First, the positive relationship between political visit and firm performance is more significant for firms with lower legitimacy like those privately owned, and firms with lower reputation like those with weak performance, as political visit can help these kinds of firms obtain legitimacy and regain reputation. Second, the value of political visit is expected to be greater for firms with heavy dependence on external financing since political visit can act as a guarantee from central government to attract more external funds. Third, the quality of the local government plays a vital role in determining whether the support from central government can eventually reach the visited firms rather than being grabbed by the local officials. Local government's role as a grabbing-hand is proved by a lot of researchers like Cheung, Rau, and Stouraitis (2009), so this paper hypothesizes that better regional institutional development can ensure firms obtain resources after the visits, thus leading to better operating performance.

Hypothesis 2: Political visits, especially visits by the Xi administration, are positively associated with market reactions and future firm performance, and the impacts are contingent on firm and institutional characteristics.

In addition to market reactions and firm performance, this paper hypothesizes that achieving political visit can influence firms' views on corporate social responsibilities (CSR) activities and affect firms' behaviour on disclosure and earnings management in order to meet the social expectation. Corporate social responsibility is a strategic means by which firms can establish social reputations, combat negative public views and ultimately achieve legitimacy. Legitimacy, according to Suchman (1995), is defined as the correctness, properness and desirableness of corporate actions which are aligned with social values, norms and beliefs. Researchers like Pfeffer and Salancik (2003) highlight the importance of legitimacy as a source of social support and resources. As a result, companies use CSR to improve their legitimacy, alleviate stakeholders' defiance towards controversial firms and ultimately enhance firm performance (De Roeck & Delobbe, 2012; Frynas, 2005; Yoon, Gürhan-Canli, & Schwarz, 2006). For example, after being criticized by the pressure groups in the 1995 Brent Spar and Nigeria crisis, Royal Dutch Shell engaged in CSR to mitigate criticism (Frynas, 2003). Relying on effective and sincere CSR, firms can positively affect consumer beliefs and attitudes (Becker-Olsen, Cudmore, & Hill, 2006), strengthen stakeholder-company relationships (Bhattacharya, Korschun, & Sen, 2009) and motivate employees to regard their firms as a place to share their social values rather than just a place to work (Rodrigo & Arenas, 2008).

Since political visits can confer reputation and legitimacy to visited firms, they

can be regarded as a substitute for CSR activities, which can demotivate firms to conduct CSR activities. Donation is a common CSR activity firms engage to improve legitimacy, especially for firms in controversial industries like oil companies. For example, Du and Vieira (2012) highlight that oil firms are more inclined to partner with and provide donations to non-profit organisations. In this paper, I suppose the need to donate is reduced because political visits are an alternative source of legitimacy.

On the other hand, some CSR activities are under heavy government pressure, and this paper supposes political visit is positively correlated with this kind of government-related CSR activities as an exchange for the political visits. The government's role in business ethics is controversial. Researchers like Davis (1973) emphasise that corporate social responsibility activities are voluntary, and this view is supported by business executives in the US and Europe who claim that the government's power to force firms to conduct CSR is limited (Aaronson & Reeves, 2002). By contrast, according to EuropeanCommission (2004), governments have a strong initiative to influence firms' CSR. This view is supported by researchers like Moon (2004) who highlights that the government is another driver of CSR. For example, in the face of fiscal obligations, the UK Thatcher government successfully shifted their responsibility for unemployment to firms, and expected firms to address training and work opportunity problems for the unemployed, and incorporate this as a form of CSR. This paper will further tests whether firms tend to increase their government-related CSR such as employing more staffs in exchange for visits.

Moreover, due to the increased social attention after political visits, this study assumes that firms after visits tend to engage more in disclosure. According to Cheng et al. (2017), political connection can motivate firms to disclose environmental

information more actively. Considering the fact that political visits implied a connection and the social attention increased dramatically after visits, firms' disclosure like shareholder protection, supplier protection and environment protection is expected to increase, though their real money-related donation decreased. Furthermore, this paper assumes that the decreased accountability of managers because of the increased job security and privileges brought by political connection after visits, combined with the higher expectation of the market will motivate firms to conduct more unethical behaviour like fraud and earnings management.

Hypothesis 3: Political visits demotivate firms' non-government-related CSR activities while motivate government-related CSR, disclosure, and firms' unethical behaviour.

4.4 Institutional Background

Historically, the inspection tour is a vital form of political supervision since ancient China, generally carried out by supervisory organs of the central government or even by emperors themselves. The earliest recorded patrol is from the era of Yao and Shun (about 2281 B.C.). Officials were sent by emperors Yao and Shun to carry out inspection touring every five years to observe the people's condition, and acted as a bridge between emperors and people. Besides sending officials, most emperors patrolled the country by themselves. For example, the emperor of the Qin Dynasty (221 B.C.-207 B.C.) spent more time performing inspection tours than in his palace. Many emperors of other dynasties, such as the Han Dynasty (202 B.C.-220 A.D.) and the Tang Dynasty (619 A.D.-907 A.D.) also went out to inspect frequently, among

which the inspection touring of the Qing Dynasty (1644 A.D.-1911 A.D.) is the most famous as the emperors strongly favoured inspection tours, left their footprints all over the country and claimed that visiting was more efficient than listening to officials.

The sole ruling party of China, the CPC, inherited these institutionalised practices, viewing visiting as a "weapon" to rule the Party and the country. The president of China, Jinping Xi, stressed repeatedly in a 2017 meeting of the CPC that the authority of political visiting must be ensured, and also emphasized the vital role of political visits during the symposium held in Wuhan on 23rd July, 2013, showing that the government highly values such visits. Political visits are the carrier of the government's will. The most famous example of political visiting is the southern tour conducted by Xiaoping Deng in 1992, from the capital to southern areas like Guangzhou, which aimed to show the world China's determination to achieve economic reform. In 2012, President Jinping Xi repeated Deng's southern tour as his first political visit after he took office in order to encourage further economic reform. In 2017, during President Xi's visit to Switzerland, the Swiss president asked Xi about his reflections on country governance, he highlighted the importance of political visit and said that he spent five years to travel around provinces in China, showing that visiting is still a vital approach to governing in modern China.

This study focuses on the visits by the members of the Politburo Standing Committee of the Communist Party of China (PSC). PSC functions as the most powerful part of Chinese central government, usually composed of five to nine political heavyweights. The PSC, first established in 1928 to support the daily work of the Communist Party, now aims to practice "collective leadership" and prohibit arbitrary decision-making by individual leaders. The power of PSC members mainly

lies in their simultaneous control over state and Party positions. For example, Jintao Hu took the simultaneous positions of the President of China and the general secretary of the Communist Party of China (CPC). Furthermore, PSC members' strong appointment power of high-level political personnel, and the influential regional power they accumulated in previous positions, give them enormous political power. PSC members are responsible for different functional departments, such as foreign relations and military affairs. The positions of visiting leaders can influence people's interpretations of visited firms. For example, visits by Keqiang Li, who is responsible for finance and economy, usually transmit policy information, while visits by Guoqiang He, who is responsible for party discipline, imply firms' position on party-building.

The purposes of the PSC member visit mainly consist in three types: for politics, for economic development and for society. First, as to politics, one typical example is the large-scale visits by PSC members after the Third Plenary Session of the 18th Central Committee of the CPC (TPS). The focuses of all political visiting during that time period are consistent with the *Decision* of TPS, showing that political visit is used as a way in which government spreads and promotes their new disciplines. Another example to show that the PSC members visit firms for political reasons is that firms sometimes are inspected about their performance in organising Party-related activities.

Second, another most important objective of political visits is to deliver key instructions to the market (i.e. for economic development). Economy-oriented visits usually release some important signals for policies. For example, Keqiang Li, who is mainly responsible for economic development, chose to visit two relatively more developed provinces, Shanghai and Jiangsu, as his first destinations after assuming

office, and then the Shanghai Free Trade Zone was established after his visit.

Third, improving social welfare is also an important target of political visits by PSC members. Social problems like poverty alleviation, medical care, employment, housing and food safety are main focuses of inspection during visits. For instance, during the visit of Premier Keqiang Li in Sichuan on 26th April 2016, he asked detailed questions about the employment, entrepreneurship and job training of university students. So it can be expected that firms that contribute to social welfare, such as by expanding recruitment for graduates, can increase their probability of being visited.

4.5 Sample and Data

Data on political visits is hand-collected from the Leader's Activity Database. The data is from 1st January 2009 to 31st July 2016, covering two administrations: that of President Hu (1st January 2009 to 15th November 2012) and that of President Xi (15th November 2012 to 31st July 2016).

The reports in the Leader's Activity Database reveal information about who the visiting leaders were, where they visited and what they did. I record the visit locations and the firm names. I also record leaders' names and rank them according to their political power. Other financial data, such as return on assets and firm size, can be obtained from the China Securities Market and Accounting Research Database (CSMAR), which is developed according to international standards and focuses on the Chinese market. The definitions of variables are shown in Appendix 1.

[Insert Appendix 1]

I collected data from 713 political visits by PSC members to firms from 1st

January 2009 to 31st July 2016. Figure 4.1 shows the distribution of provinces that PSC members visited. It demonstrates that almost all provinces were visited. Firms located in the eastern area have a higher probability of visit. It is worth noting that the number of visit in Tibet is zero does not mean PSC members did not visit Tibet. It means PSC members did not visit listed firms in Tibet which I can identify the stock number. Similarly, the number of visit for Taiwan is zero is because my sample only include the visits for firms listed in mainland.

Table 4.1 shows the distribution of visits by different leaders. Compared with the Xi administration, the Hu administration visited firms more frequently, with 133 and 580 visits respectively. In the Xi administration, 29 out of 133 visits (21.80%) are done by President Xi, while only 38 out of 580 visits (6.55%) are done by President Hu during his administration. The higher visit frequency of president Xi is consistent with what he highlighted repeatedly in the meeting of CPC to ensure the priority of political visit. Moreover, comparing the visits of the two presidents and the corresponding PSC members who is mainly responsible for economic development, namely president Xi versus Keqiang Li (29 versus 36), and president Hu versus Jiabao Wen (38 versus 120), the data shows that the tendency that president Xi strengthens the direct leadership in the economy is obvious.

[Insert Figure 4.1 and Table 4.1]

Panel A of Table 4.2 shows the descriptive statistics of visited firms. After dropping all observations lack data on ownership, industry codes and other dependent and control variables, the number of firms is 188, which is lower than the observations of visit because firms can be visited for multiple times. Panel A compares the distribution of the number of visited firms that are state-owned and non-state owned.

Columns (3) to (6) are based on the subsample of Xi administration and Columns (7) to (10) are based on the subsample of Hu administration. Columns (3) and (7) demonstrate the number of visited firm during Xi and Hu administrations respectively after dropping all observations lack data on ownership, industry codes and other dependent and control variables. And Columns (5) and (9) show the number of all listed firms during Xi and Hu administrations respectively after dropping all observations lack data on ownership, industry codes and other dependent and control variables. Columns (4) and (6) show that in Xi administration, 49.02% of visited firms are SOEs, while only 41.39% of all listed firms are, meaning that the government is more likely to visit SOEs. Columns (8) and (10) show similar results in Hu administration. However, compared with the Hu administration, the Xi administration visits private firms more frequently, since the percentage of visits to SOEs versus private firms is 65.69% versus 34.31% for the Hu administration and 49.02% versus 50.98% for the Xi administration. Panel B reveals the industry distribution of visited firms. Firms in industries such as energy and information technology are more likely to be visited. Moreover, the summary statistics of main variables used in this chapter are shown in Table 4.3.

[Insert Table 4.2 and Table 4.3]

4.6 How Does the Government Choose Which Firms to Visit?

Recent researches (e.g. Schuler et al., 2017) on leaders' site visits highlights the difficulty of identifying the criteria leaders use to determine which firms to visit. This paper fills this gap by investigating several possible determinants of political visits. First, this paper hypothesizes that the government is inclined to visit connected firms.

Three proxies are used to measure political connection: (1) Whether the controlling shareholders of the visited firms are the central government (*CG*) or other levels of government except central government (*SOE_other*); (2) The number of state shares (*State shares*); (3) Whether at least one director of the firm has working experience as a government official (*PB*). The dependent variable of Table 4.4 is *P(visit)*, meaning the probability of being visited, which equals one if the firm is visited by political leaders and zero otherwise. The results shown in Columns (1) to (2) of Table 4.4 demonstrate that political connection is a significant determinant of political visits. However, the results in Column (3) indicate that individual-level connection, like the political background of directors, cannot increase the probability of visit. These results can complement the paper of Schuler et al. (2017), which interviewed several business-government relations experts and speculated that interaction between government officials and firms plays a significant role in securing political visits. The results show that firm-level political connection (Columns (1) and (2)) can significantly increase the probability of political visits, while individual connection, shown in Column (3), is not a significant determinant. Compared with the results of the Chapter 3 Table 4.3 where the political connection cannot influence government's idea to endorse, this chapter shows that firm-level connection can increase the probability of visit. One plausible reason for this difference is that political visits are more costly compared with endorsement in terms of the time and financial costs in travelling, planning, and organizing security, making it to be a rarer political support. Considering the high costs of political visit, some state-owned firms who play a vital role in the economy and have higher social impacts are more likely to be visited after cost-benefit analysis.

Second, this paper hypothesizes that visited firms are firms that adhere to the

goals and ideologies promoted by the government. Since one of the long-term economic goals of the government is to weaken wealth gaps and stimulate the economy in remote areas, it can be assumed that firms located in poorer provinces are more likely to be the target of political visits. The first two geographic characteristics I test are municipality and autonomous areas. *Municipality* refers to four relatively developed cities: Beijing, Shanghai, Tianjin and Chongqing. *Autonomous* areas are places with a lot of minorities and relatively less development. These two geographic characteristics can help us investigate whether provincial development level is taken into account when leaders choose firms to visit. *Municipality* is negatively significant (β= - 0.277，P<1%), while *Autonomous* is positively significant (β=0.578，P<1%), as shown in Columns (4) and (5) respectively, meaning that the government is more inclined to visit less developed areas in order to confer credibility and attention upon those firms and regions. Moreover, the more employees one firm has, the larger the social impacts if PSC members visit the firm. Therefore, visiting firms with more employees can help government to disseminate ideas more quickly and also win more people's support, which is also consistent with the government's goal. Column (6) tested whether the logarithm of employee number (*Employee*) can significantly predict the probability of political visit, and the results support this hypothesis.

Third, another hypothesis about the determinants of political visit is the representativeness of firms. For example, firms can be representative if it has larger size because such kind of firms usually plays a vital part in the local economy or witnessed the development of that place, and thus has larger social impacts. For another example, firms can be representative if they are leading performers in their respective fields. And the effects of age are mixed. On the one hand, firms with longer

history that witnessed the development of the located city are more representative. On the other hand, one of the top goals of the government during these years is promoting innovation like the Internet+ mentioned in the previous section. As a result, firms from emerging industries that are younger are more adherent to government's goals, therefore more likely to win political visits. I tested whether firm size, age and past performance are determining factors of political visits in Models (1) to (6). The results of firm size and past performance are positively significant, which are consistent with the hypothesis that this kind of firms are more representative thus can win the political visits. The results of firm age show that younger firms are more likely to be visited. One plausible reason is that younger firms adheres to some temporary goals of the government like the promotion on innovation.

[Insert Table 4.4]

4.7 Political Visits and Market Reaction

To examine the value of political visits, I first use event study to examine cumulative abnormal return (CAR). Abnormal return is calculated as the excess return over market return. The event day is the visit day rather than the report day of the political visit. In most cases, the report date would be several days later than the actual visit date. Figure 4.2 shows that the market reactions to the Xi administration's visits are much greater, approaching 2.7% at the event day, while the CAR for visit by Hu administration is 0.3% at the event day. This provides supporting evidence for Hypothesis 2, which states that the effects of visits by the Xi administration are more significant than those of the Hu administration because the Xi administration is more politically powerful and has a more unified PSC. Another possible reason for the

significant market reactions is that the Xi administration visited firms less frequently (133 times) than the Hu administration (580 times). The market starts to react ten days before, which is caused by information leakage, since leaders' visiting plans are determined in advance and the local government is informed about the visit in advance in order to have enough time to prepare for the visit.

[Insert Figure 4.2]

In Figure 4.3, I decompose the sample according to visiting leaders' different levels of political power into three subsamples. The political power is coded according to the party positions and state positions of the PSC leaders. Detailed definitions of the ranking are provided in Appendix 2. *Top2* means the President and the Premier; *Top 3 to 5* refers to the Chairman of the Standing Committee of the National People's Congress, Chairman of the National Committee of the Chinese People's Political Consultative Conference, and the Chairman of the Central Guidance Commission for Building Spiritual Civilization. And the remaining PSC leaders are classified into the category *Others*. Results in Figure 4.3 demonstrates that higher political power is associated with higher market reactions.

[Insert Figure 4.3]

Table 4.5 shows the significance of market reactions over different time windows. Row (1) demonstrates that political visits are positively correlated with market reactions over all windows. In row (2), I categorize political visits according to administrations. The results show that the market reactions to visits by the Xi administration are more significant than for the Hu administration, which is consistent with Figure 4.2 and with Hypothesis 2. Row (3) divides the whole sample according

to leaders' different rankings of political power. Top one refers to the President. The results show that market reactions to presidents' site visits are significantly higher than those to other leaders under some windows. In Row (4) and (5) where I categorize visits into those by top two and top four, the results are all consistent that the greater the leaders' political power, the more significant the market reactions. But Row (6) shows the market reactions for visits by top five leaders are not significantly different from those by other leaders.

[Insert Table 4.5]

To further test the Hypothesis 2 that visit by PSC members of the Xi administration is more positively associated with market reactions due to its more unified PSC structure and stronger political power when compared with those by Hu administration, Table 4.6 regress the dummy variable *Xi Adm* which equals one if firms visited by the Xi administration on the CAR of different windows. And the results shown in Table 4.6 are consistent with the previous findings and support Hypothesis 2. For example, Column (1) of Table 4.6 shows that the one-week market reactions of visits by Xi administration is 3.4% (P=0.014) higher than those of Hu administration.

[Insert Table 4.6]

4.8 Political Visits and Firm Performance

4.8.1 Baseline Results

The Hypothesis 2 about the impacts of political visits on firm operating performance is tested according to the following model:

$$Performance_{t+1} = \alpha_0 + \beta_1 \text{Visit} + \sum_{k=2}^{k} \beta_k Control_k + \varepsilon$$

where performance refers to four one-year forwarded measurements of firm performance: return on asset *(ROA_F*),return on equity (*ROE_F*), return on sales (*ROS_F*) and return on invested capital (*ROIC_F*). Performance is forwarded one year in order to give firms enough time to take advantage of the political endorsement. The main variable of interest is *Visit*, a dummy variable which equals one if the firm is visited by PSC members. Based on literature, a series of variables that can influence firm operating performance are included as control variables, including variables represent political connections (*CG, PBIntensity*), firm characteristics (*Employees, Size, Age, Distance, Lev, PastPerform*), and governance quality (*BoardQuality, Duality*). The definitions of all variables are shown in Appendix.

The results in Table 4.7 demonstrates that political visit has significant positive associations with all measurements of operating performance except ROS. Columns (1), (2) and (4) demonstrate that compared with non-visited firms, visited firms outperform in ROA, ROE and ROIC by 0.9% (P=0.009), 3% (P=0.016), and 1.4% (P=0.005) respectively one year after visiting.

The results are consistent with the paper of Li et al. (2016), which highlights the positive effects of visits by officials. However, the paper of Li et al. (2016) focuses on manufacturing firms, while visits to this kind of firms are proved to be more informative by researchers like Cheng et al. (2016) since manufacturing firms have more observable assets, which could help investors make decisions. This paper complements the research of Li et al. (2016) to rule out the potential bias caused by the special nature of manufacturing firms by expanding the sample to cover firms in

all industries. The results show that the positive effects of political visits on firm performance are robust, no matter what industries are covered and no matter what performance measurements are used.

[Insert Table 4.7]

4.8.2 Robustness Test: Propensity Score Matching

One concern about the baseline results is that some observable firm characteristics can influence the probability of political visits and firm performance simultaneously. As shown in Table 4.8, some characteristics of visited firms are significantly different from those of non-visited firms, including the number of employees, size, age, leverage, past performance, distance to the capital and CEO duality. To alleviate the concern that visited firms are selected endogenously based on these characteristics, PSM nearest-neighbour matching is applied to control the selection on observables by balancing out the groups being compared in terms of their covariates (Lennox, Francis, & Wang, 2011). Through PSM, I formed treatment and control groups with a similar predicted likelihood of political visits; hence, these two groups are equally likely ex-ante to be visited by the government.

Moreover, through matching firms according to their past performance, PSM can help this study alleviate the concern of reverse causality. The baseline results suffer from the concern that firms' good performance after being visited is just because the government tends to choose well-performing firms to protect their reputation. PSM can reduce this bias through matching visited and non-visited firms with similar past performance. Furthermore, as suggested by Ettner (2004), PSM is particularly suitable for studies with very different sizes of treatment and control groups. Considering the

small amount of observations of political visits relative to the total firm-year observations for all listed firms during the sample period, PSM can help this study balance the observations.

Table 4.8 compares the mean differences of key variables before and after PSM. Rows marked as "U" show the mean differences between visited and non-visited firms before PSM, and rows marked as "M" demonstrate those after matching. The results show that the mean differences between treatment and control groups are no longer significant for all these firm characteristics, and the standardised percentage bias for all variables after PSM is lower than 10%, meaning the matching balanced the groups well. And this is also shown explicitly in Figure 4.4 that the standardised percentage bias for all variables is narrowed to a large degree.

[Insert Table 4.8 and Figure 4.4]

In Table 4.9, I use the 319 matched pairs of visited and non-visited firms to test the effects of political visits on future firm performance. The results show that visited firms can significantly outperform firms in the control group after the political visit, no matter which performance measurements are used. Specifically, visited firms outperform in ROA, ROE, ROS and ROIC by 0.9% (P=0.011), 3% (P=0.002), 1.3% (P=0.063) and 1.3% (P=0.004) respectively. These results after PSM are consistent with the baseline results and support Hypothesis 2.

[Insert Table 4.9]

4.8.3 Robustness Test: Instrumental Variables

Although PSM can control the selection on observables and alleviate the reverse causality between political endorsement and firm performance by matching treatment

and control groups according to firms' past performance and other key characteristics to form samples with a similar predicted likelihood of political visits, the limitation of PSM is that it cannot deal with hidden bias or unobservable omitted variables issues. For example, there is still a concern that some omitted factors, like the growth potential, can simultaneously influence the possibility of visits and firm performance, thus biasing the results of previous tests.

Following the method of Schuler et al. (2017) and Lennox et al. (2011), this paper applies the treatment effects model to control the selection on unobservables. Compared with 2SLS models, treatment effects model can add more structure to explicitly account for the binary nature of the endogenous regressor (Cameron & Trivedi, 2010). The first stage is a probit model, where the dependent variable is the visit dummy. To ensure the identification of the model, an instrumental variable that affects the probability of visits but does not influence firms' operating performance need to be included in the first-stage model. Then in the second stage, a treatment correction calculated based on the estimation of the first-stage model is included as a control variable to address bias caused by selection on unobservables (Guo & Fraser, 2014; Heckman, 1977; Lennox et al., 2011; Schuler et al., 2017).

The first instrument used in this paper is the percentage of PSC leaders who have life experience in the visited province (*LifeRatio*). *LifeRatio* is a valid instrumental variable because it meets the relevance condition that the leaders' experience can influence the probability of visitation, and it also meets the exclusion condition, because no evidence or theory suggests that the percentage of PSC members who have life experience in the relevant provinces can influence firm performance. Moreover, considering the fact that most people spend a long time in their birth place which is

randomly assigned, *LifeRatio* can be a good instrument because birth place is exogenous. Similarly, the second instrument variable used is the percentage of PSC leaders who have work experience in the visited province (*WorkRatio*). Different from *LifeRatio*, which takes into account PSC members' experience before working, *WorkRatio* focuses on leaders' experience after they start their political careers. The data about *LifeRatio* and *WorkRatio* are manually collected from the resumes of PSC leaders.

According to an expert related to General Office of the State Council, visiting destinations are generally determined by the General Office of the State Council or by the general office of the Central Committee of the CPC, and these two organizations allocate PSC members to different places scientifically. For example, visit destinations should be diverse rather than concentrated in order to magnify the impact across the whole country. Therefore, it can be assumed that in order to let leaders have a deep understanding of the whole country rather than just of several provinces, PSC members are more likely to be arranged to visit places where they have no life or work experience. Although there are some examples that the places PSC members visit have some relationship with the leader, these are individual cases. Because PSC members rotated across different provinces when they were relatively junior and young, it is inevitable that some visit places are the provinces that they once worked in. So it is unreasonable to assume that PSC members prefer to visit provinces they once lived or worked in just according to these individual cases. From a holistic view, the visit destinations are allocated scientifically and thus leaders are more likely to visit provinces without previous experience in order to have a better grasp of the overall situation in the whole country. The significant negative relationships between the

possibility of political visit and the life experience ratio (β= - 0.835, Marginal Effects= - 0.32, P<1%) or work experience ratio (β= - 0.780, Marginal Effects= - 0.30, P<1%) are proved in Columns (1) and (6) respectively in Table 4.10, which is consistent with the assumption.

Columns (2) to (5) and (7) to (10) demonstrate the results for the second stage. The dependent variables are ROA_F, ROE_F, ROS_F and ROIC_F. The results in Columns (2) to (5) show that political visits are positively associated with firm performance when *LifeRatio* is used as the instrumental variable, regardless of which performance measurements are used. Specifically, visited firms can outperform counterparts in ROA_F, ROE_F, ROS_F and ROIC_F by 4.4% (P=0.088), 17.4% (P=0.041), 11.3% (P=0.053) and 7.6% (P=0.036) respectively. In Columns (7) to (10), when *WorkRatio* is used as the instrumental variable, visited firms can also outperform the control group in ROE_F by 16.4% (P=0.061), ROS_F by 12.0% (P=0.098) and ROIC_F by 7.3% (P=0.05). These results support Hypothesis 2 that political visits can improve firm performance, and are consistent with previous results. The Rho in Models (2) to (5) and (7) to (9) means the correlation between the error terms between the first-stage model and second-stage model. A negative Rho means the results using OLS in Tables 7 and 9 are biased downward, and the actual positive impact of political visits on firm performance should be larger.

[Insert Table 4.10]

4.8.4 Robustness Test: Bias Due to Variable Persistence

Although this paper has already controlled for selection on observables by applying PSM methodology and controlling for selection on unobservables through

using treatment effects model with the instrumental variable technique, another potential concern of these results is that the statistical significance of the tests is overstated due to persistence in variables and correlation over time.

Table 4.11 tests the impact of political visits on the performance change as a robustness test. Performance change equals one-year forwarded performance minus the average of this year's and last year's performance. Four measurements of performance change are tested: *ΔROA, ΔROE, ΔROS and ΔROIC*. Columns (1) to (4) show the results of OLS tests, and Columns (5) to (8) demonstrate the results of tests using the instrumental variable: the percentage of PSC leaders who have life experience in the visited province (*LifeRatio*). The results are consistent with previous results, regardless of whether OLS or treatment effects models are used.

[Insert Table 4.11]

4.8.5 Visit Heterogeneity and Firm Heterogeneity

This paper further investigates visit heterogeneity and firm heterogeneity. I test whether the market reacts differently across different visits (e.g. visits by the Xi or Hu administrations) and different types of firms (e.g. firms with different past performance, with political connections or dependent on external financing).

Column (1) of Table 4.12 tests Hypothesis 2 that visits by the Xi administration are more value-adding because of its higher political power. The positive coefficient of the interaction term *Visit* × *Xi Adm* (β=0.019, P=0.013) supports the hypothesis, meaning that being visited by Xi administration is a positive moderating factor.

As for firm traits that can influence the impact of political visits, this paper supposes that firms with lower reputation or legitimacy, or that depend more heavily

on external financing, can benefit from political visits to a greater extent because such visits can help these kinds of firms regain their reputation, obtain legitimacy and access key resources, as well as acting as a guarantee from the central government to help firms easily access external funds. Therefore, the impact of political visits on firms with weak pre-event performance, fewer political connections and a greater dependence on external financing is expected to be larger.

The interaction term *Visit* × *PastPerform* (β= - 0.226, P<1%) in Column (2) and the interaction term *Visit* × *StatesShare* (β= - 0.021, P=0.021) in Column (3) support the hypothesis that firms that perform weakly or have fewer political connections can benefit more from political visits. The results in Column (4) show that the positive association between political visit and firm performance is higher (7.6%, P=0.011) when firms depend heavily on external funds.

[Insert Table 4.12]

4.8.6 Institution Heterogeneity

Besides the visit administrations and firm characteristics tested above, regional institutional development can also influence the impact of political visits on firm performance. Political visits by PSC members represent support from the central government, and the quality of the local government plays a vital role in ensuring that the support and resources eventually reach the visited firms rather than being grabbed by local officials. Researchers like Chen, Firth, and Xu (2009) and Cheung et al. (2009) highlight the different roles of central and local governments, indicating the potential conflicts of interest among different levels of government, and thus implying the possibility that support from the central government cannot reach the target firms.

Moreover, compared with central government, it is the local government that interact more frequently with local firms and influence their operations. Therefore, visits for firms located in provinces with better institutions are expected to be more valuable, since resources from the central government can eventually reach the intended targets.

Based on the surveys of Fan and Wang (2011), two indices about the levels of institutional development are used in this study. For easier and more consistent interpretations, I transformed these indices into dummy variables equal one if the institutional development of the province is better than the national average and zero otherwise: (1) extra charge besides taxes (*LessExTax*) means the ratio of extra charge besides taxes to sales, reflecting the inefficiency of market resource allocation; and (2) the protection of intellectual properties index (*IntellProtect*), which means the ratio of the number of patent applications to the number of technical personnel.

The positive coefficients of the interaction terms *Visit* × *LessExTax* (β=0.017, P=0.02), and *Visit* × *IntellProtect* (β=0.013, P=0.091) mean the positive impact of political visits for firms located in provinces with better institutional development is higher, which support the hypothesis.

[Insert Table 4.13]

4.9 Post-event Resources and Reactions of Visited Firms

4.9.1 Resources Obtained

One big gap in the previous literature on government officials' site visits is the amount of post-event resources firms can obtain. Table 4.14 tests three potential resources: government subsidy, bank loans and whether the effective tax rate declined.

Columns (1) and (3) demonstrate that firms with political visits obtain more loans (β=0.346, P=0.038) and subsidies (β=0.127, P=0.047) compared with non-visited firms, but Column (5) shows that political visits have no impact on the effective tax rate.

In Columns (2), (4) and (6), interaction terms between visits and the Xi administration dummy are included to test whether firms visited by the Xi administration obtain more resources compared with those visited by the Hu administration. Results in Column (2) show that firms visited by Xi administration obtain more bank loans (β=0.58,P=0.085). However, there is no evidence supporting that visits by the Xi administration have more significant impacts on subsidies and tax rates, as shown in Columns (4) and (6).

[Insert Table 4.14]

4.9.2 Firm Reactions

Another gap in the previous literature is that it ignores firms' reactions to visits, such as their reactions in terms of CSR and their reactions to the increased public attention and social expectation. This paper assumes that political visits can be substituted as a source of legitimacy for CSR activities, leading to firms' decreased incentive to donate. Column (1) of Table 4.15 demonstrates negative relationship between political visit and firm donations (β= - 0.591, P=0.081). On the other hand, some CSR activities are under heavy government pressure (Moon, 2004). According to See (2009), firms in China are encouraged by the government to increase CSR to meet government requirements. For example, Tian and Estrin (2008) point out that the government prevented a firm called Sinopec Shanghai Petrochemical Company from

dismissing 17,000 employees in order to satisfy the government's political interests. Thus, this paper hypothesizes that firms are expected to shoulder more social responsibilities by helping the government solve unemployment problems in exchange for political visits. However, the results in Column (2) do not support the positive relationship between political visit and employee numbers.

Moreover, facing increased social attention after political visits, in order to maintain a good image, firms tend to engage more actively in disclosure on aspects like shareholder protection and creditor protection. Column (3) of Table 4.15 demonstrates a significant positive relationship between political visit and the disclosure index (β=0.268, P=0.046). Furthermore, in face of the increased social expectation after visit, firms are assumed to conduct more window-dressing activities to meet investors' expectations. Columns (4) and (5) test the impact of political visits on earnings management and fraud. While the association between political visit and fraud is not significant, a positively significant relationship with earnings management is shown in Column (5) (β=0.134, P=0.021). In addition to meeting public expectations, another plausible reason for the increased earnings management is because the increased job security and privileges brought by political connection after visits decrease the accountability of managers.

[Insert Table 4.15]

4.10 Conclusion

Existing literature investigates how the government participates in the market through various approaches, but ignores a common strategy it uses to influence the

market – political visits. Political visit, in this paper, is defined as a political device in which a high-level political leader carries out all the functions and symbolic representations of governing by periodically visiting firms. Extant literature on political visits is quite limited, and does not explore how the government chooses which firms to visit, cannot differentiate between the effects of political visits from government officials with different political powers and between two different administrations, and also ignores the post-visit effects on firm behaviour.

To fill these gaps, political visits are investigated in detail in this study. Results show that representativeness, political connections and alignment with government goals are the three basic criteria for choosing firms to visit. Moreover, the results demonstrate that political visits are positively associated with market reactions over different time windows, especially when firms are visited by the Xi administration. And the market reactions are also positively associated with leaders' rankings of political power. Besides market reactions, visits are positively correlated with firm operating performance, and the results are robust after applying PSM to control selection on observables and applying treatment effects model with instrumental variable technique to control for selection on unobservables. And the potential bias caused by variable persistence is also ruled out. The results also demonstrate that visits from Xi administration and to firms that are less-connected, weakly performed, located in places with good institutions, and heavily dependent on external financing are more valuable. Furthermore, this paper finds that loans and subsidies are the resources firms can obtain after visits, but firms tend to donate less and engage in earnings management.

This paper complements literature on the role of government by focusing on

political visits, which are an under-researched strategy the government uses to influence the market. We also provide supporting evidence to the literature which upholds the positive role of government (Arthur Lewis, 1945; Gerschenkron, 1962; Hawtrey, 1926). Moreover, this study largely supplements the literature on government officials' site visit (Li et al., 2016; Schuler et al., 2017) by differentiating the effects of visits by leaders with different political power and from different administrations, exploring how the government chooses which firms to visit, and also pointing out the post-event effects on firms' behaviour. Different from political connection, both connected and non-connected firms can be the target of political visits, and political leaders that visit firms usually hold higher-level positions than the officials firms are normally connected with. Therefore, political visit is different from political connection and serves as a new way through which the government can influence the market. Furthermore, this paper is also related to the literature on CSR by introducing political visit as a substitute for CSR activities to achieve legitimacy.

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Figure 4.1 : Visit Frequency of Provinces

This figure demonstrates the visit frequency in each province from 1st January 2009 to 31st July 2016.

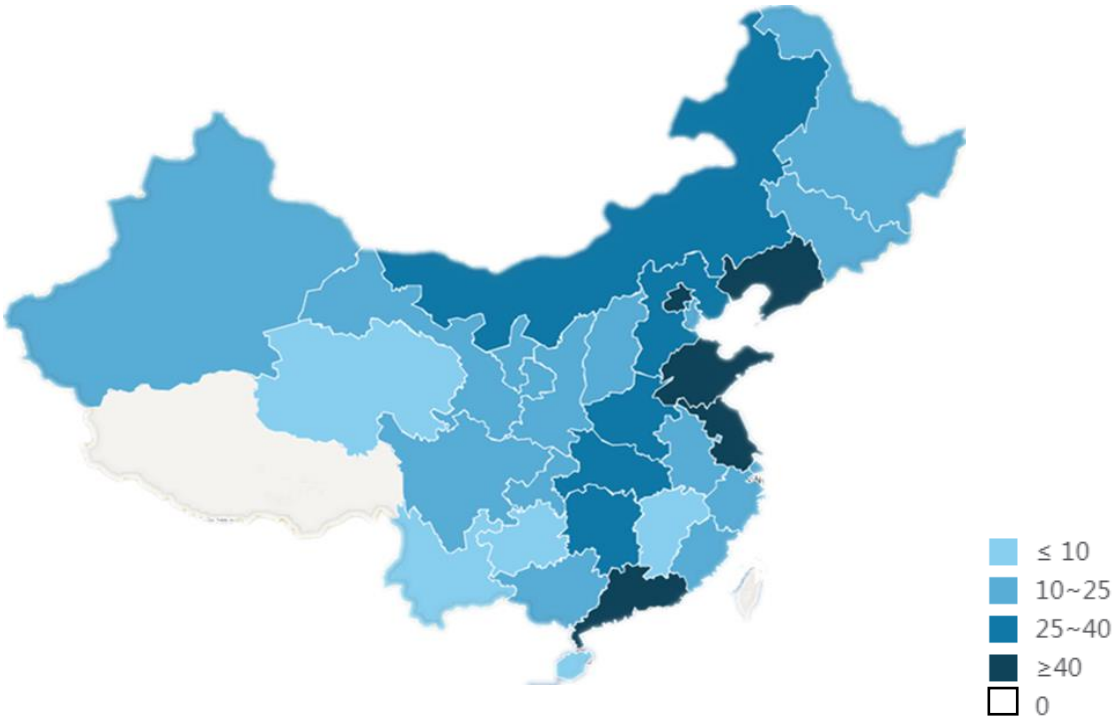

Figure 4.2 : Market Reactions of Different Administrations

This figure demonstrates the difference in market reactions of political visits by Xi and Hu administrations over one year window. The grey line refers to the cumulative abnormal returns of visits by Xi administration, and the blue line shows the cumulative abnormal returns of political visits by Hu administration.

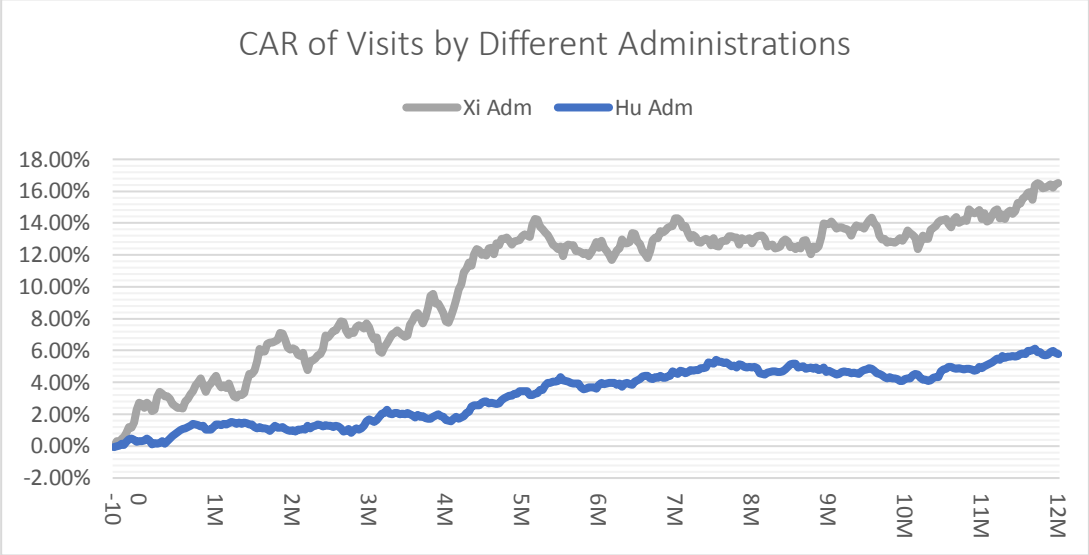

Figure 4.3 : Market Reactions of Leaders with Different Political Power

This figure demonstrates the difference in market reactions of political visits by different political leaders over one year window. The blue, grey and green lines refer to the cumulative abnormal returns of visits done by top2, top3 to 5, and top 6 to 8 political leaders respectively. I code political power according to the party positions and state positions of the PSC leaders. Detailed definitions of the rankings are shown in Appendix 2.

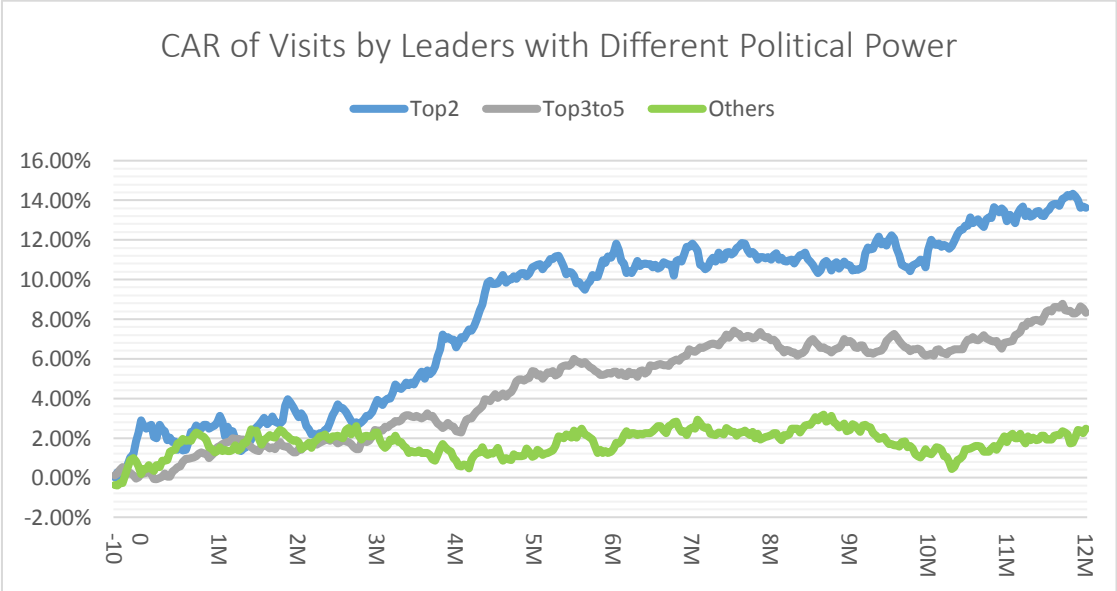

Figure 4.4 : Standardized % Bias Before and After PSM

This figure demonstrates the distribution of standardized % bias of the variables before and after propensity score matching.

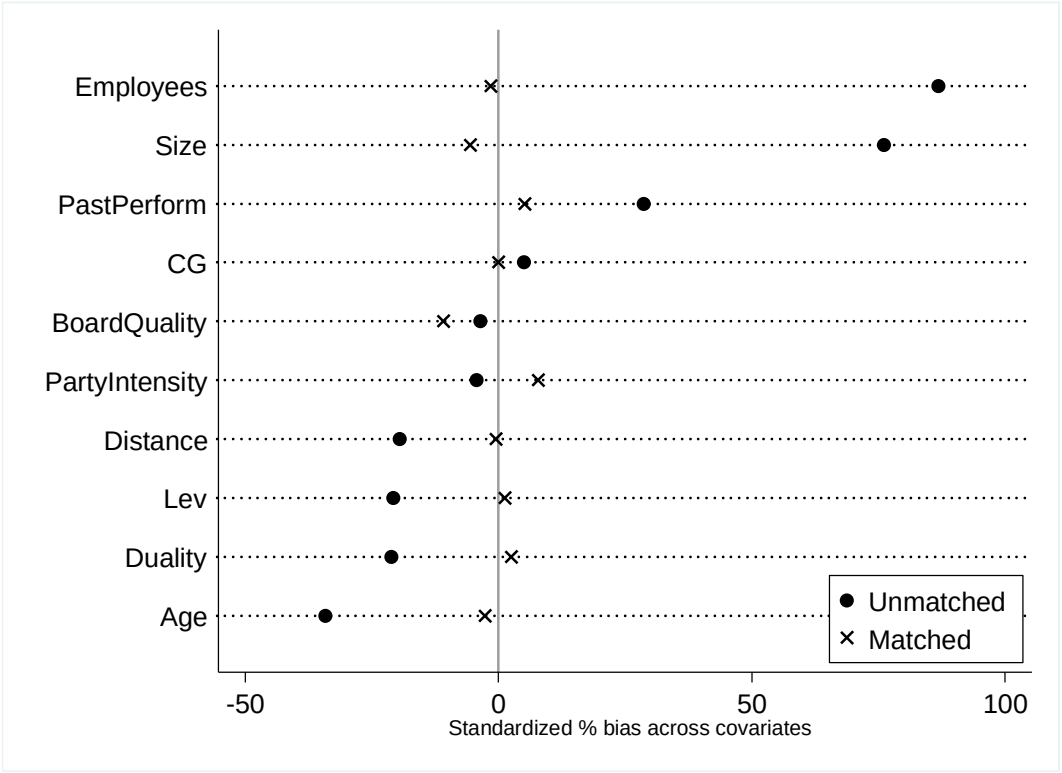

Table 4.1 : Descriptive Statistics of Visiting Leaders

This table demonstrates the distribution of leaders who visited firms during 1st January 2009 to 31st July 2016, covering two administrations: covering two administrations: that of President Hu (1st January 2009 to 15th November 2012) and that of President Xi (15th November 2012 to 31st July 2016).

Xi administration			Hu administration		
Leader names	Freq.	Percent	Leader names	Freq.	Percent
Jinping Xi	29	21.80	Jintao Hu	38	6.55
Keqiang Li	36	27.07	Jiabao Wen	120	20.69
Dejiang Zhang	9	6.77	Bangguo Wu	42	7.24
Zhengsheng Yu	17	12.78	Qinglin Jia	95	16.38
Yunshan Liu	17	12.78	Changchun Li	114	19.66
Qishan Wang	0	0	Jinping Xi	46	7.93
Gaoli Zhang	25	18.80	Keqiang Li	61	10.52
			Guoqiang He	64	11.03
Total	133	100	Total	580	100

Table 4.2 : Descriptive Statistics of Visited Firms

This table shows the descriptive statistics of visited firms. **Panel A** Columns (1) to (2) demonstrate the ownership distribution of the visited firms: state-owned firms (*SOE*) or non-state-owned firms (*Non-SOE*). In Columns (3) to (10), the whole sample is decomposed into two subsets: Xi administration and Hu administration. Columns (3) and (7) demonstrate the number of visited firm during Xi and Hu administrations respectively after dropping all observations lack data on ownership, industry codes and other dependent and control variables. And Columns (5) and (9) show the number of all listed firms during Xi and Hu administrations respectively after dropping all observations lack data on ownership, industry codes and other dependent and control variables. **Panel B** reveals the industry distribution of visited firms.

Panel A: Ownership distribution

			Xi Administration				Hu Administration			
	ALL Visited Firms		Visited Firms		All listed firms		Visited Firms		All listed firms	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
	#	%	#	%	#	%	#	%	#	%
SOE	115	61.17	25	49.02	892	41.39	90	65.69	867	59.30
Non-SOE	73	38.83	26	50.98	1,263	58.61	47	34.31	595	40.70
Total	188	100	51	100	2,155	100	137	100	1,462	100

Panel B: Industry distribution

				Xi Administration				Hu Administration			
GICs	Industry	ALL Visited Firms		Visited Firms		All listed firms		Visited Firms		All listed firms	
		(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
		#	%	#	%	#	%	#	%	#	%
10	Energy	10	5.320	4	7.840	59	2.740	6	4.380	42	2.870
15	Materials	35	18.62	5	9.800	396	18.38	30	21.90	290	19.84
20	Industrials	46	24.47	10	19.61	501	23.25	36	26.28	336	22.98
25	Consumer	29	15.43	10	19.61	363	16.84	19	13.87	265	18.13
30	Consumer Staples	9	4.790	2	3.920	142	6.590	7	5.110	104	7.110
35	Health Care	12	6.380	2	3.920	153	7.100	10	7.300	101	6.910
40	Financials	6	3.190	4	7.840	153	7.100	2	1.460	115	7.870
45	Information	32	17.02	13	25.49	309	14.34	19	13.87	137	9.370
50	Telecommunicati	1	0.530	1	1.960	8	0.370	0	0	4	0.270
55	Utilities	8	4.260	0	0	71	3.290	8	5.840	68	4.650
	Total	188	100	51	100	2,155	100	137	100	1,462	100

Table 4.3 : Summary Statistics

This table presents the summary statistics of main variables used in this chapter. The definitions of all variables are shown in Appendix.

	Full firm-year sample			Matched sample		
Variable	Obs	Mean	Std.Dev.	Obs	Mean	Std.Dev.
Visit	12116	0.026	0.160	638	0.500	0.500
ROA_F	12116	0.033	0.064	638	0.046	0.055
ROE_F	12116	0.052	0.223	638	0.085	0.151
ROS_F	12116	0.063	0.189	638	0.080	0.119
ROIC_F	12116	0.051	0.089	638	0.068	0.068
ΔROA	12116	-0.005	0.061	638	-0.009	0.047
ΔROE	12116	-0.007	0.261	638	-0.015	0.153
ΔROS	12116	-0.004	0.175	638	-0.006	0.090
ΔROIC	12116	-0.006	0.095	638	-0.009	0.065
StatesShare	12116	4.262	7.740	638	5.985	8.963
LifeRatio	12116	0.217	0.263	638	0.266	0.334
WorkRatio	12116	0.208	0.265	638	0.253	0.338
Dependence	12116	0.970	0.169	638	0.984	0.124
LessLessGovInt	12116	0.858	0.349	638	0.823	0.382
LessExTax	12116	0.617	0.486	638	0.605	0.489
IntellProtect	12116	0.548	0.498	638	0.503	0.500
CG	12116	0.021	0.142	638	0.028	0.166
PBIntensity	12116	0.164	0.126	638	0.155	0.116
Employees	12116	7.683	1.400	638	8.957	1.604
Size	12116	22.90	1.163	638	24.00	1.669
Age	12116	15.33	4.938	638	13.89	4.524
Distance	12116	6.608	2.040	638	6.005	2.643
BoardQuality	12116	0.370	0.055	638	0.372	0.061
Duality	12116	0.197	0.398	638	0.118	0.322
Lev	12116	1.976	3.949	638	1.324	1.803
PastPerform	12116	0.041	0.059	638	0.057	0.060

Table 4.4 : Determinants of Political Visit

This table presents the results for the research question: what kinds of firms are more likely to achieve political visits? The dependent variable *P(Visit)* equals 1 if the firm achieved political visit and zero otherwise. From Columns (1) to (3), I test a series of connection-related determinants of visit: (1) *CG* is a dummy variable which equals one if the actual controller of the firm is central government. *SOE_Other* is a dummy variable which equals one if the actual controller of the firm is other levels of government except CG (2) *StateShare* means the logarithm of number of shares owned by the state. (3) *PB* means the political background, a dummy variable which equals one if at least one director of the firm has working experience as a government official. From Columns (4) to (5), two geographic-related determinants are tested: (4) *Municipality* equals one if the firms are located in municipalities (Beijing, Shanghai, Tianjin and Chongqing), otherwise zero. (5) *Autonomous* equals one if the firms are located in areas classified as autonomous area by government since there are a lot of minorities. In column (6), the logarithm of employee numbers (*Employees*) is tested as a determinant of political visit. In all models, I check some other determinants of political visits, including past performance (*ROA_P)*, firm size (*Size*), firm age (*Age*), leverage (*Lev*), the quality of the board (*BoardQuality*) and CEO duality (*Duality*). Detailed definitions of all variables are provided in the Appendix. P-values are reported in parenthesis. ***, **, * denote significance levels at 1%, 5% and 10% respectively.

	Dependent Variable: P(visit)					
	Political Connection			Geographic		Employee Number
	(1)	(2)	(3)	(4)	(5)	(6)
CG	-0.022					
	(0.902)					
SOE_other	0.139**					
	(0.018)					
StateShare		0.007**				
		(0.029)				
PB			0.035			
			(0.715)			
Municipality				-0.277***		
				(0.000)		
Autonomous					0.578***	
					(0.000)	

Employees						0.148***
						(0.000)
Size	0.285***	0.285***	0.293***	0.320***	0.301***	0.173***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Age	-0.027***	-0.026***	-0.025***	-0.027***	-0.026***	-0.024***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Lev	-0.046***	-0.049***	-0.049***	-0.046***	-0.046***	-0.034**
	(0.004)	(0.002)	(0.002)	(0.004)	(0.005)	(0.034)
PastPerform	1.369***	1.360***	1.274***	1.119**	1.352***	1.386***
	(0.005)	(0.005)	(0.009)	(0.023)	(0.006)	(0.005)
BoardQuality	-0.994**	-1.002**	-1.015**	-0.995**	-0.963**	-1.016**
	(0.034)	(0.033)	(0.030)	(0.034)	(0.041)	(0.031)
Duality	-0.152**	-0.179**	-0.188**	-0.198***	-0.190**	-0.178**
	(0.047)	(0.016)	(0.012)	(0.008)	(0.012)	(0.018)
Constant	-7.923***	-7.855***	-8.028***	-8.573***	-8.268***	-6.551***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
N	12116	12116	12116	12116	12116	12116
Pseudo R^2	0.120	0.119	0.118	0.123	0.130	0.126

Table 4.5 : Market Reactions

This table shows the significance of market reactions over different time windows, starting from 7 days before the event until one week, half month, one month, one quarter, half year or one year after political visit . In Row (1), I treat all political visits as a whole. In Row (2), I divide political visits into the visits by Hu administration and the visits by Xi administration. Row (3) divides the whole sample according to leaders' different rankings of political power. Political power is coded according to the party positions and state positions of the PSC leaders. *Top1* refers to President. Row (4) compares the effects of visits by top2 leaders and other leaders. *Top2* means President and Premier. *Top4* in Row (5) refers to President, Premier, Chairman of the Standing Committee of the National People's Congress, and Chairman of the National. Committee of the Chinese People's Political Consultative Conference. *Top5* in Row (6) means the top four plus Chairman of the Central Guidance Commission for Building Spiritual Civilization. The detailed definitions of these categories are shown in Appendix Table A4.2. P-values are reported in parenthesis. ***, **, * denote significance levels at 1%, 5% and 10% respectively.

		CAR					
		(-7,1 Week)	(-7,Half Month)	(-7,1 Month)	(-7,1 Quarter)	(-7,Half Year)	(-7,1 Year)
(1)	Visit	0.009*	0.012**	0.018***	0.024**	0.050***	0.078***
		(0.053)	(0.017)	(0.007)	(0.012)	(0.000)	(0.000)
(2)	Xi administration	0.052***	0.053***	0.057***	0.071**	0.122***	0.149***
		(0.004)	(0.005)	(0.007)	(0.021)	(0.009)	(0.009)
	Hu administration	0.001	0.004	0.010	0.014	0.037***	0.067***
		(0.955)	(0.407)	(0.131)	(0.136)	(0.007)	(0.001)
	Diff	0.051***	0.049**	0.047**	0.057*	0.085*	0.0820
(3)	Top1	0.058**	0.041*	0.079**	0.074**	0.137***	0.208***
		(0.026)	(0.096)	(0.049)	(0.036)	(0.006)	(0.003)
	other	0.004	0.009*	0.012*	0.018*	0.040***	0.066***
		(0.383)	(0.069)	(0.055)	(0.061)	(0.004)	(0.001)
	Diff	0.054**	0.0320	0.067*	0.0560	0.097*	0.142**

(4)	Top2	0.036***	0.034***	0.043***	0.062***	0.116***	0.150***
		(0.003)	(0.006)	(0.009)	(0.002)	(0.000)	(0.000)
	other	-0.002	0.004	0.009	0.009	0.025*	0.053**
		(0.726)	(0.486)	(0.205)	(0.401)	(0.083)	(0.014)
	Diff	0.037***	0.031**	0.034*	0.054**	0.092***	0.097**
(5)	Top4	0.022***	0.020***	0.027***	0.036**	0.081***	0.109***
		(0.003)	(0.009)	(0.009)	(0.011)	(0.000)	(0.000)
	other	-0.005	0.004	0.008	0.010	0.017	0.047*
		(0.371)	(0.576)	(0.311)	(0.404)	(0.305)	(0.062)
	Diff	0.027***	0.016	0.019	0.026	0.063**	0.062
(6)	Top5	0.012**	0.013**	0.022***	0.027**	0.063***	0.093***
		(0.046)	(0.047)	(0.009)	(0.021)	(0.000)	(0.000)
	Other	0.003	0.012	0.010	0.016	0.021	0.046
		(0.692)	(0.187)	(0.367)	(0.310)	(0.320)	(0.145)
	Diff	0.009	0.001	0.012	0.011	0.042	0.046

Table 4.6 : Compare Market Reactions between Xi and Hu Administrations

This table compares the significance of market reactions between Xi and Hu Administrations over different time windows: from one week to one year. The main variable of interest in this table is *Xi Ad.* which equals one if the firm is visited by Xi administration. Xi administration refers to the government led by president Xi. The sample of this paper covers from 15th November 2012 to 31st July 2016. In contrast, Hu administration refers to the government led by president Hu. The sample of this paper covers from 1st January 2009 to 15th November 2012. The detailed definitions of variables are shown in Appendix. P-values are reported in parenthesis. ***, **, * denote significance levels at 1%, 5% and 10% respectively.

	CAR					
	(1)	(2)	(3)	(4)	(5)	(6)
	1 Week	Half Month	1 Month	1 Quarter	Half Year	1 Year
Xi Adm	0.034**	0.029*	0.040*	0.060**	0.073*	0.067
	(0.014)	(0.066)	(0.056)	(0.044)	(0.085)	(0.274)
CG	0.042	0.032	0.053	-0.068	-0.101	-0.007
	(0.104)	(0.276)	(0.178)	(0.225)	(0.203)	(0.947)
PBIntensity	0.032	-0.020	0.001	0.033	0.002	0.038
	(0.511)	(0.705)	(0.987)	(0.754)	(0.986)	(0.852)
Employees	-0.007	-0.008	-0.028***	-0.031**	-0.011	0.014
	(0.325)	(0.289)	(0.008)	(0.034)	(0.594)	(0.642)
Size	0.002	0.003	0.013	0.014	0.005	-0.047
	(0.795)	(0.664)	(0.229)	(0.367)	(0.810)	(0.115)
Age	-0.002*	-0.003**	-0.002	-0.004	-0.013***	-0.010*
	(0.078)	(0.026)	(0.444)	(0.129)	(0.001)	(0.097)
Distance	0.000	0.000	0.000	0.000	0.000	-0.000
	(0.515)	(0.402)	(0.485)	(0.638)	(0.296)	(0.958)
BoardQuality	0.060	0.028	-0.084	0.142	-0.214	-0.568
	(0.489)	(0.772)	(0.522)	(0.449)	(0.418)	(0.124)
Duality	0.003	0.026	0.009	-0.005	0.009	0.026
	(0.848)	(0.161)	(0.710)	(0.899)	(0.855)	(0.714)
Lev	-0.007*	-0.003	0.001	0.008	0.014	-0.001
	(0.067)	(0.472)	(0.872)	(0.311)	(0.201)	(0.930)
PastPerform	0.032	0.007	-0.102	-0.556***	-1.044***	-0.858**
	(0.738)	(0.945)	(0.476)	(0.007)	(0.000)	(0.035)
Industry	Y	Y	Y	Y	Y	Y
Constant	0.021	0.042	0.031	0.023	0.248	1.398**
	(0.873)	(0.777)	(0.874)	(0.935)	(0.533)	(0.012)
N	405	405	405	405	405	405
R^2	0.052	0.049	0.064	0.074	0.091	0.084

Table 4.7 : Impact of Political Visits on Firm Performances

This table explores the impact of political visits on firm performance. The dependent variables from Columns (1) to (4) are four one-year forwarded performance measurements: *ROA, ROE, ROS* and *ROIC*. Performance is forwarded one year in order to give firms enough time to take advantage of the political visits. The main variable of interest is the visit dummy. The definitions of all variables are shown in Appendix. P-values are reported in parenthesis. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	(1)	(2)	(3)	(4)
	ROA_F	ROE_F	ROS_F	ROIC_F
Visit	0.009***	0.030**	0.007	0.014***
	(0.009)	(0.016)	(0.486)	(0.005)
CG	-0.008*	-0.027**	-0.014	-0.006
	(0.065)	(0.049)	(0.306)	(0.255)
PBIntensity	0.008*	0.007	0.079***	0.008
	(0.087)	(0.644)	(0.000)	(0.202)
Employees	-0.005***	-0.005**	-0.016***	-0.002**
	(0.000)	(0.026)	(0.000)	(0.026)
Size	0.008***	0.014***	0.037***	0.006***
	(0.000)	(0.000)	(0.000)	(0.000)
Age	-0.001***	-0.001	-0.003***	-0.001***
	(0.000)	(0.155)	(0.000)	(0.000)
Distance	0.000	-0.000	0.000	0.000
	(0.993)	(0.857)	(0.119)	(0.993)
BoardQuality	-0.032***	-0.046	-0.090***	-0.044***
	(0.003)	(0.204)	(0.009)	(0.003)
Duality	-0.002	-0.005	-0.001	-0.005**
	(0.147)	(0.346)	(0.845)	(0.026)
Lev	0.000***	-0.001	0.002***	-0.001***
	(0.004)	(0.197)	(0.000)	(0.000)
PastPerform	0.289***	0.671***	0.510***	0.388***
	(0.000)	(0.000)	(0.000)	(0.000)
Industry	Y	Y	Y	Y
Constant	-0.102***	-0.275***	-0.683***	-0.073***
	(0.000)	(0.000)	(0.000)	(0.000)
N	12116	12116	12116	12116
R^2	0.204	0.049	0.141	0.115

Table 4.8 : Robustness of PSM

This table demonstrates how well the treatment and control groups are matched. The detailed definitions of variables are shown in Appendix. *U* refers to the unmatched sample and *M* means the matched sample.

	Unmatched or	Mean			t-test	
Variable	Matched	Treated	Control	%bias	t	p>|t|
CG	U	0.0282	0.0205	5	0.950	0.341
	M	0.0282	0.0282	0	0	1
PBIntensity	U	0.159	0.165	-4.300	-0.730	0.465
	M	0.159	0.150	7.800	1.030	0.304
Employees	U	8.946	7.648	86.90	16.51	0
	M	8.946	8.969	-1.600	-0.180	0.855
Size	U	23.96	22.87	76.10	16.66	0
	M	23.96	24.04	-5.600	-0.600	0.546
Age	U	13.83	15.37	-34.10	-5.520	0
	M	13.83	13.95	-2.600	-0.330	0.740
Distance	U	1255	1431	-19.50	-3.670	0
	M	1255	1259	-0.500	-0.0600	0.953
BoardQuality	U	0.368	0.370	-3.600	-0.660	0.509
	M	0.368	0.375	-10.90	-1.310	0.192
Duality	U	0.122	0.199	-21.10	-3.420	0.001
	M	0.122	0.113	2.600	0.370	0.713
Lev	U	1.344	1.993	-20.70	-2.900	0.004
	M	1.344	1.304	1.300	0.280	0.776
PastPerform	U	0.0583	0.0407	28.60	5.250	0
	M	0.0583	0.0551	5.200	0.670	0.502

Table 4.9 : Impact of Political Visits on Firm Performances -- PSM

This table explores the impact of political visits on firm performance based on the matched sample. The dependent variables from column (1) to (4) are four one-year forwarded performance measurements: *ROA, ROE, ROS* and *ROIC*. Performance is forwarded one year in order to give firms enough time to take advantage of the political visits. The main variable of interest is the visit dummy. The definitions of all variables are shown in Appendix. P-values are reported in parenthesis. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	(1)	(2)	(3)	(4)
	ROA_F	ROE_F	ROS_F	ROIC_F
Visit	0.009**	0.030***	0.013*	0.013***
	(0.011)	(0.002)	(0.063)	(0.004)
CG	-0.012	0.005	0.014	-0.011
	(0.328)	(0.889)	(0.559)	(0.479)
PBIntensity	0.019	0.099*	0.053	0.020
	(0.343)	(0.084)	(0.187)	(0.447)
Employees	-0.007***	-0.016**	-0.017***	-0.008**
	(0.008)	(0.026)	(0.001)	(0.013)
Size	0.008***	0.022***	0.025***	0.011***
	(0.003)	(0.005)	(0.000)	(0.002)
Age	-0.002***	-0.005***	0.001	-0.002***
	(0.003)	(0.001)	(0.418)	(0.003)
Distance	0.000	0.000	0.000	0.000*
	(0.108)	(0.854)	(0.185)	(0.094)
BoardQuality	-0.009	0.052	0.027	-0.010
	(0.807)	(0.620)	(0.713)	(0.839)
Duality	0.012*	0.021	0.033**	0.015*
	(0.060)	(0.251)	(0.011)	(0.071)
Lev	0.003**	-0.002	0.013***	-0.001
	(0.024)	(0.615)	(0.000)	(0.703)
PastPerform	0.236***	0.137	0.299***	0.202***
	(0.000)	(0.227)	(0.000)	(0.000)
Industry	Y	Y	Y	Y
Constant	-0.094*	-0.304*	-0.454***	-0.121*
	(0.068)	(0.059)	(0.000)	(0.075)
N	638	638	638	638
R^2	0.306	0.083	0.342	0.184

Table 4.10 : Impact of Political Visits on Firm Performances – Instrument Variable

This table demonstrates the robust tests about the impact of political visits on firm performances by using instrumental variables. From Columns (1) to (5), the percentage of PSC leaders who have life experience in the visited province (*LifeRatio*) is used as the instrumental variable of political visit. From Columns (6) to (10), the percentage of PSC leaders who have work experience in the visited province (*WorkRatio*) is used as the second instrumental variable to make the results more robust. Columns (1) and (6) show the results of the first step and the dependent variables are the probability of political visits. Columns (2) to (5) and (7) to (10) reveal the results of the second-stage tests. The dependent variables are four one-year forwarded performance measurements: return on asset *(ROA_F*), return on equity (*ROE_F*), return on sales (*ROS_F*), and return on invested capital (*ROIC_F*). Performance is forwarded one year in order to give firms enough time to take advantage of the political visits. The definitions of all variables are shown in Appendix. P-values are reported in parenthesis. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	IV: Leader ratio with life experience					IV: Leader ratio with work experience				
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
	Visit	ROA_F	ROE_F	ROS_F	ROIC_F	Visit	ROA_F	ROE_F	ROS1_F	ROIC_F
LifeRatio	-0.835***									
	(0.000)									
WorkRatio						-0.780***				
						(0.000)				
Visit		0.044*	0.174**	0.113*	0.076**		0.041	0.163*	0.120*	0.073*
		(0.088)	(0.041)	(0.053)	(0.036)		(0.127)	(0.061)	(0.098)	(0.050)
CG	0.222	-0.017	-0.019	0.013	-0.025	0.221	-0.016	-0.018	0.012	-0.025
	(0.497)	(0.183)	(0.636)	(0.635)	(0.147)	(0.499)	(0.183)	(0.643)	(0.725)	(0.146)
PBIntensity	1.172**	-0.017	-0.025	0.038	-0.032	1.162**	-0.015	-0.022	0.063	-0.031
	(0.021)	(0.432)	(0.712)	(0.424)	(0.269)	(0.022)	(0.465)	(0.751)	(0.266)	(0.284)
Employees	0.034	-0.003	-0.006	-0.025***	-0.002	0.031	-0.003	-0.006	-0.034***	-0.002
	(0.596)	(0.231)	(0.424)	(0.000)	(0.484)	(0.625)	(0.232)	(0.428)	(0.000)	(0.487)
Size	-0.001	0.005**	0.017**	0.029***	0.006*	-0.001	0.005**	0.016**	0.037***	0.006*
	(0.992)	(0.041)	(0.046)	(0.000)	(0.070)	(0.989)	(0.042)	(0.046)	(0.000)	(0.071)

Age	-0.012	-0.000	0.001	0.002	-0.000	-0.012	-0.001	0.001	0.003**	-0.000
	(0.307)	(0.279)	(0.696)	(0.131)	(0.586)	(0.316)	(0.265)	(0.705)	(0.030)	(0.574)
Distance	-0.000*	0.000	-0.000	0.000	0.000	-0.000	0.000	-0.000	0.000	0.000
	(0.091)	(0.327)	(0.553)	(0.391)	(0.312)	(0.126)	(0.315)	(0.556)	(0.398)	(0.303)
BoardQuality	-1.168	-0.002	0.030	0.040	0.001	-1.172	-0.003	0.026	0.057	-0.001
	(0.179)	(0.962)	(0.789)	(0.612)	(0.991)	(0.178)	(0.928)	(0.818)	(0.541)	(0.987)
Duality	0.106	0.015**	0.047**	0.031**	0.018**	0.109	0.015**	0.047**	0.038**	0.018**
	(0.511)	(0.017)	(0.019)	(0.026)	(0.040)	(0.497)	(0.015)	(0.017)	(0.020)	(0.037)
Lev	0.004	0.003**	0.001	0.016***	-0.000	0.003	0.003**	0.001	0.024***	-0.000
	(0.910)	(0.013)	(0.861)	(0.000)	(0.896)	(0.935)	(0.012)	(0.865)	(0.000)	(0.891)
PastPerform	0.117	0.348***	0.307**	0.358***	0.344***	0.134	0.349***	0.308***	0.161	0.344***
	(0.903)	(0.000)	(0.010)	(0.000)	(0.000)	(0.888)	(0.000)	(0.009)	(0.101)	(0.000)
Industry	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Constant		-0.099*	-0.406**	-0.556***	-0.129*		-0.095*	-0.394**	-0.694***	-0.125*
		(0.067)	(0.021)	(0.000)	(0.088)		(0.078)	(0.025)	(0.000)	(0.097)
Selection Correction		-0.023	-0.090*	-0.068*	-0.041*		-0.021	-0.083	-0.071	-0.039*
		(0.162)	(0.090)	(0.066)	(0.073)		(0.220)	(0.127)	(0.119)	(0.098)
N	638	638	638	638	638	638	638	638	638	638
Rho		-0.472	-0.571	-0.620	-0.604		-0.430	-0.536	-0.547	-0.580
Pseudo R^2	0.029					0.028				

Table 4.11 : Impact of Political Visits on Firm Performances – Performance Change

To solve the potential concern that the statistical significance of the previous tests is overstated due to persistence in variables and correlation over time, this table demonstrates the impact of political visits on performance changes. Performance change equals to one-year forwarded performance minus the average performances of this year and last year. Four measurements of performance change are tested: *ΔROA*, *ΔROE*, *ΔROS*, and Δ*ROIC*. Columns (1) to (4) show the results of OLS tests, and Columns (5) to (8) demonstrate the results of tests using the instrumental variable: the percentage of PSC leaders who have life experience in the visited province (*LifeRatio*). The definitions of all variables are shown in Appendix. P-values are reported in parenthesis. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	OLS				IV: Leader ratio with life experience			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	ΔROA	ΔROE	ΔROS	ΔROIC	ΔROA	ΔROE	ΔROS	ΔROIC
Visit	0.008**	0.039***	0.017***	0.009*	0.048**	0.139*	0.046	0.075**
	(0.021)	(0.001)	(0.009)	(0.054)	(0.048)	(0.091)	(0.309)	(0.034)
CG	-0.006	0.008	-0.016	0.001	-0.012	-0.009	-0.027	-0.015
	(0.582)	(0.843)	(0.466)	(0.939)	(0.293)	(0.809)	(0.206)	(0.379)
PBIntensity	0.007	0.068	-0.017	0.002	-0.018	-0.000	-0.024	-0.037
	(0.717)	(0.286)	(0.643)	(0.947)	(0.367)	(0.998)	(0.501)	(0.194)
Employees	-0.002	-0.007	0.004	-0.006*	-0.001	-0.004	0.004	-0.004
	(0.292)	(0.361)	(0.410)	(0.079)	(0.753)	(0.647)	(0.298)	(0.291)
Size	0.002	0.006	-0.002	0.003	0.002	0.004	-0.002	0.004
	(0.499)	(0.495)	(0.704)	(0.310)	(0.494)	(0.596)	(0.655)	(0.292)
Age	-0.001***	-0.001	-0.000	-0.002***	-0.001	0.001	0.000	-0.001
	(0.004)	(0.451)	(0.826)	(0.000)	(0.144)	(0.651)	(0.891)	(0.116)
Distance	0.000	-0.000	0.000	0.000	0.000	-0.000	0.000	0.000
	(0.425)	(0.711)	(0.412)	(0.519)	(0.628)	(0.420)	(0.290)	(0.973)
BoardQuality	-0.008	0.079	0.009	0.005	-0.003	0.071	0.000	0.005
	(0.795)	(0.487)	(0.895)	(0.908)	(0.934)	(0.515)	(0.996)	(0.910)
Duality	0.005	0.025	0.014	0.009	0.006	0.030	0.016	0.010

	(0.427)	(0.225)	(0.239)	(0.281)	(0.310)	(0.128)	(0.143)	(0.235)
Lev	0.000	0.003	0.000	-0.000	0.001	0.004	0.001	0.001
	(0.776)	(0.451)	(0.917)	(0.963)	(0.590)	(0.269)	(0.620)	(0.650)
PastPerform	-0.466***	-0.868***	-0.610***	-0.598***	-0.424***	-0.787***	-0.567***	-0.533***
	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)	(0.000)
Industry	Y	Y	Y	Y	Y	Y	Y	Y
Constant	0.014	-0.074	0.024	0.017	-0.034	-0.149	0.003	-0.059
	(0.769)	(0.646)	(0.796)	(0.803)	(0.497)	(0.379)	(0.973)	(0.426)
Selection Correction					-0.026*	-0.065	-0.021	-0.042*
					(0.089)	(0.204)	(0.460)	(0.058)
N	638	638	638	638	638	638	638	638
R^2	0.258	0.108	0.158	0.210				
Rho					-0.572	-0.428	-0.249	-0.639

Table 4.12 : Visit Heterogeneity and Firm Heterogeneity

This table tests whether the visits by Xi Administration are more beneficial for firms, and whether political visits differentially affect firm performance across different types of firms. Dependent variables are one-year forwarded ROA (*ROA_F*). Column (1) tests whether political visits by Xi Administration have a more positive impact on firm performance than those by Hu Administration. *Xi Adm* refers to the government led by president Xi. The sample of this paper covers from 15th November 2012 to 31st July 2016. In contrast, Hu administration refers to the government led by president Hu. The sample of this paper covers from 1st January 2009 to 15th November 2012. From Columns (2) to (4), different interaction terms between political visits and firm characteristics are included in the models. (2) *PastPerfrom* means the past performance of firms, which is measured as the average ROA of past two years. (3) *SatesShare* refers to the logarithm of number of shares owned by the state. (4) Following the method of Rajan and Zingales (1998), firm's dependence on external financing equals to the capital expenditures minus cash flow from operations divided by capital expenditures. *Dependence* is a dummy variable which equals to one if the firms depend more heavily on external financing than average. The definitions of all variables are shown in Appendix. P-values are reported in parenthesis. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	Dependent Variable: ROA_F			
	(1)	(2)	(3)	(4)
Visit × Xi Adm	0.019**			
	(0.013)			
Visit × PastPerform		-0.226***		
		(0.000)		
Visit × StatesShare			-0.021**	
			(0.021)	
Visit × Dependence				0.076**
				(0.011)
Visit	0.030	0.047*	0.045*	0.041
	(0.228)	(0.070)	(0.085)	(0.114)
CG	-0.017	-0.018	-0.016	-0.014
	(0.142)	(0.131)	(0.204)	(0.258)
PBIntensity	-0.016	-0.016	-0.014	-0.013
	(0.419)	(0.431)	(0.515)	(0.533)
Employees	-0.003	-0.003	-0.003	-0.003
	(0.262)	(0.230)	(0.203)	(0.225)
Size	0.006**	0.005**	0.005*	0.006**
	(0.020)	(0.033)	(0.058)	(0.027)
Age	-0.000	-0.001	-0.000	-0.000
	(0.750)	(0.267)	(0.286)	(0.333)
Distance	0.000	0.000	0.000	0.000
	(0.277)	(0.339)	(0.323)	(0.413)
BoardQuality	0.008	0.000	-0.008	-0.006
	(0.814)	(1.000)	(0.823)	(0.872)
Duality	0.017***	0.012*	0.015**	0.016***

	(0.005)	(0.050)	(0.014)	(0.008)
Lev	0.004***	0.003***	0.003**	0.003***
	(0.003)	(0.007)	(0.014)	(0.010)
PastPerform	0.353***	0.474***	0.356***	0.344***
	(0.000)	(0.000)	(0.000)	(0.000)
Xi Adm	-0.025***			
	(0.000)			
StatesShare			0.016**	
			(0.024)	
Dependence				-0.091***
				(0.000)
Selection Correction	-0.016	-0.022	-0.022	-0.021
	(0.307)	(0.181)	(0.184)	(0.183)
Industry	Y	Y	Y	Y
Constant	-0.120**	-0.115**	-0.095	-0.109*
	(0.030)	(0.045)	(0.100)	(0.056)
N	638	638	638	638
Rho	-0.346	-0.452	-0.450	-0.450

Table 4.13 : Institution Heterogeneity

This table tests whether political visits differentially affect firm performance across different institutional development levels. Dependent variables are one-year forwarded ROA (*ROA_F*). Columns (1) and (2) incorporate different interaction terms between visits and provincial institutional development indexes. All of these institutional indices are based on the book and surveys of Fan and Wang (2011). For easier and more consistent interpretations, the institutional indices used in this paper are transformed to dummy variables, which equals to one if the institutional development is better than national average and zero otherwise. (1) Extra charge besides taxes means the ratio of extra charge to sales, reflecting the inefficiency of market resources allocation. *LessExTax* is a dummy variable which equals to one if the extra charge in the province is lower than national average. (2) The protection of intellectual properties index means the ratio of the number of patent applications to the number of technical personnel. *IntellProtect* is a dummy variable which equals one if the protection of intellectual property within the province is better than country average. The definitions of all variables are shown in Appendix. P-values are reported in parenthesis. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	Dependent Variable: ROA_F	
	(1)	(2)
Visit × LessExTax	0.017**	
	(0.020)	
Visit × IntellProtect		0.013*
		(0.091)
Visit	0.054*	0.046*
	(0.072)	(0.100)
CG	-0.015	-0.017
	(0.242)	(0.177)
PBIntensity	-0.019	-0.018
	(0.401)	(0.400)
Employees	-0.003	-0.003
	(0.220)	(0.236)
Size	0.005*	0.005**
	(0.056)	(0.044)
Age	-0.000	-0.001
	(0.324)	(0.282)
Distance	0.000	0.000
	(0.441)	(0.336)
BoardQuality	0.001	0.000
	(0.971)	(0.998)
Duality	0.016**	0.016**
	(0.011)	(0.013)
Lev	0.003**	0.003**
	(0.020)	(0.010)
PastPerform	0.344***	0.349***
	(0.000)	(0.000)

LessExTax	-0.007	
	(0.259)	
IntellProtect		-0.006
		(0.295)
Selection Correction	-0.029	-0.023
	(0.126)	(0.180)
Industry	Y	Y
Constant	-0.105*	-0.104*
	(0.084)	(0.074)
N	638	638
Rho	-0.573	-0.477

Table 4.14 : Impact on Government Support

This table presents the impact of political visits on the access of government supports. Columns (1) and (2) test the impact of political visits on one-year forwarded logarithm of bank loans (*Lnloan_F*). Column (3) and (4) reveal the impact on the change in the government subsidy (*ΔSubsidy*). Columns (5) and (6) demonstrate the impact on one-year forwarded effective tax rate (ETR_F). Following Feng, Johansson, and Zhang (2015)'s method, *ETR* is defined as (tax expense-deferred tax expense)/EBIT. In Columns (2), (4) and (6), interaction terms between political visits and Xi administration are added to differentiate the government supports of Xi and Hu administrations. The definitions of all variables are shown in Appendix. P-values are reported in parenthesis. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	Government Support					
	(1) lnloan_F	(2) lnloan_F	(3) ΔSubsidy	(4) ΔSubsidy	(5) ETR_F	(6) ETR_F
Visit	0.346**	0.290*	0.127**	0.081	-0.275	-0.223
	(0.038)	(0.099)	(0.047)	(0.253)	(0.308)	(0.437)
Xi Adm		-0.569**		-0.049		0.571
		(0.027)		(0.618)		(0.173)
Visit × Xi Adm		0.580*		-0.112		-0.417
		(0.085)		(0.401)		(0.460)
CG	-0.719	-0.761	-0.133	-0.138	-0.116	-0.096
	(0.186)	(0.161)	(0.536)	(0.520)	(0.885)	(0.905)
PBIntensity	0.953	0.850	-0.381	-0.376	0.048	0.066
	(0.278)	(0.333)	(0.233)	(0.239)	(0.971)	(0.961)
Employees	-0.026	-0.028	0.030	0.038	-0.259	-0.269
	(0.814)	(0.801)	(0.429)	(0.325)	(0.117)	(0.105)
Size	-0.278**	-0.256**	-0.066*	-0.073*	0.319*	0.313*
	(0.016)	(0.027)	(0.096)	(0.067)	(0.062)	(0.068)
Age	-0.005	0.005	-0.017**	-0.013	-0.042	-0.052
	(0.819)	(0.821)	(0.043)	(0.130)	(0.203)	(0.125)
Distance	0.000	0.000	0.000	0.000	0.000	0.000
	(0.884)	(0.886)	(0.394)	(0.397)	(0.280)	(0.270)
BoardQuality	2.332	2.664*	-0.272	-0.161	-1.609	-1.985
	(0.138)	(0.091)	(0.629)	(0.775)	(0.491)	(0.398)
Duality	-0.212	-0.184	-0.050	-0.043	-0.101	-0.143
	(0.449)	(0.512)	(0.623)	(0.672)	(0.820)	(0.746)
Lev	-0.152***	-0.140**	-0.030	-0.026	-0.076	-0.087
	(0.009)	(0.015)	(0.163)	(0.212)	(0.402)	(0.336)
PastPerform	1.460	1.492	-0.110	-0.096	0.227	0.101
	(0.384)	(0.373)	(0.861)	(0.879)	(0.927)	(0.968)
Industry	Y	Y	Y	Y	Y	Y
Constant	6.978***	6.627***	2.727***	2.776***	-3.969	-3.856
	(0.002)	(0.003)	(0.000)	(0.000)	(0.218)	(0.231)
N	638	638	454	454	542	542
R^2	0.085	0.094	0.041	0.048	0.024	0.028

Table 4.15 : Impact on Post-event Firm Behavior

This table tests the impact of political visit on post-event firm behaviour. *Donation_F* is one-year forwarded logarithm of donation amount. *Employees_F* refers to one-year forwarded logarithm of employee number. *Disclosure_F* is a one-year forwarded disclosure index which measures firms' disclosure on ten aspects. *Fraud_F* is the number of times the firm is subject to regulatory enforcement against fraud, forwarded one year. *ΔEM* means the change in earnings management. Following Chen, Cumming, Hou, and Lee (2013), earnings management is the ratio of non-operating income relative to revenue. The definitions of all variables are shown in Appendix. P-values are reported in parenthesis. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	Post-event Firm Behaviour				
	Reaction on CSR		Reaction to increased social attention	Reaction to increased expectation	
	(1) Donation_F	(2) Employees_F	(3) Disclosure _F	(4) Fraud_F	(5) ΔEM
Visit	-0.591*	0.011	0.268**	0.010	0.134**
	(0.081)	(0.721)	(0.046)	(0.608)	(0.021)
CG	0.766	-0.095	-0.679*	0.050	-0.163
	(0.415)	(0.301)	(0.079)	(0.489)	(0.360)
PBIntensity	1.174	-0.163	-0.926	-0.139	0.065
	(0.494)	(0.271)	(0.190)	(0.238)	(0.830)
Employees	0.251	0.807***	0.100	-0.000	0.016
	(0.331)	(0.000)	(0.347)	(0.994)	(0.667)
Size	0.661**	0.150***	-0.095	-0.009	-0.051
	(0.012)	(0.000)	(0.398)	(0.591)	(0.195)
Age	-0.067	0.002	-0.029	0.005	-0.001
	(0.129)	(0.528)	(0.132)	(0.104)	(0.942)
Distance	0.000**	-0.000	0.000**	-0.000	-0.000
	(0.048)	(0.480)	(0.024)	(0.304)	(0.532)
BoardQuality	-1.903	0.215	0.637	-0.167	-0.157
	(0.539)	(0.419)	(0.632)	(0.441)	(0.774)
Duality	-0.492	-0.011	-0.031	-0.015	-0.032
	(0.392)	(0.816)	(0.898)	(0.699)	(0.746)
Lev	0.102	-0.008	0.052	-0.017*	-0.033
	(0.425)	(0.427)	(0.332)	(0.051)	(0.107)
PastPerform	4.258	0.457	-0.779	-0.232	-0.677
	(0.268)	(0.105)	(0.635)	(0.325)	(0.235)
Industry	Y	Y	Y	Y	Y
Constant	-12.808***	-1.864***	8.733***	0.669*	2.193***
	(0.009)	(0.000)	(0.000)	(0.055)	(0.004)
N	303	557	303	638	558
R^2	0.328	0.948	0.159	0.026	0.028

Appendix

Table A4.1: Variable Definition

Variables	Definitions
Visit	Dummy variable, equals one if the firm is visited by the political leaders of the Politburo Standing Committee of the Communist Party of China (PSC), and zero otherwise.
LifeRatio	The percentage of PSC leaders who have life experience in the visited province.
WorkRatio	The percentage of PSC leaders who have work experience in the visited province.
Xi Adm	Xi administration refers to the government led by president Xi. The sample of this paper covers 15th November 2012-- 31st July 2016. *Xi Adm* equals one if the firm is visited by Xi administration.
Hu Adm	Hu administration refers to the government led by president Hu. The sample of this paper covers 1st January 2009 -- 15th November 2012. *Hu Adm* equals one if the firm is visited by Hu administration.
CG	A dummy variable which equals one if the actual controller of the firm is central government.
SOE_other	A dummy variable which equals one if the actual controller of the firm is other levels of government except CG.
Private	If the actual controller of the firms are private companies or individuals, equals one.
PBIntensity	Political background intensity. The ratio of directors who has working experience as a government official to the total number of board directors.
PB	A dummy variable which equals one if at least one director of the firm has working experience as a government official.
StateShare	The logarithm of number of shares owned by the state.
Municipality	Dummy variable which equals one if the firms are located in municipalities (Beijing, Shanghai, Tianjin and Chongqing), otherwise zero.
Autonomous	Dummy variable which equals one if the firms are located in areas classified as autonomous area by government since there are a lot of minorities, and zero otherwise.
Size	Logarithm of market value, where the value of non-tradable shares are calculated by using net asset value.
Age	The age of the firm since establishment.
Lev	Leverage, equals to the ratio of total equity to total liability
Employees	The logarithm of employee number
Employee_F	The logarithm of employee number, forwarded one year.
ROA_F	Return on asset, forwarded one year. ROA is the ratio of net income to the average of ending total assets this year and the ending total assets last year.

Variables	Definitions
ΔROA	$\mathrm{ROA}_{t+1} - (\mathrm{ROA}_t + \mathrm{ROA}_{t-1})/2$
ROA_P	$Past\ Performance, (\mathrm{ROA}_{t-1} + \mathrm{ROA}_{t-2})/2$
ROS_F	Return on sales, forwarded one year. Return on sales equals to the ratio of net income to sales
ΔROS	$\mathrm{ROS}_{t+1} - (\mathrm{ROS}_t + \mathrm{ROS}_{t-1})/2$
ROE_F	Return on equity, forwarded one year. ROE is the ratio of net income to the total equity.
ΔROE	$ROE_{t+1} - (ROE_t + ROE_{t-1})/2$
ROIC_F	Return on invested capital (ROIC)= (net income+financial expenses)/(total assets-current liabilityies+notes payable+short-term borrowings +long-term liabilities due within one year), forwarded one year.
ΔROIC	$ROIC_{t+1} - (ROIC_t + ROIC_{t-1})/2$
BoardQuality	The ratio of the number of independent directors to the total number of directors.
Duality	A dummy variable, which equals one if the CEO is also the chair of the board.
Dependence	According to Rajan and Zingales (1998), firm's dependence on external financing equals to the capital expenditures minus cash flow from operations divided by capital expenditures. *Dependence* is a dummy variable which equals to one if the firms depend more heavily on external financing than average.
Distance	The logarithm of distances of firms' headquarters to the capital — Beijing.
LessExTax	Extra charge besides taxes means the ratio of extra charge to sales, reflecting the inefficiency of market resources allocation; *LessExTax* is a dummy variable which equals one if the extra charge in the province is lower than national average. Resources: Fan and Wang (2011)
IntellProtect	This index measures the protection of intellectual properties according to the ratio of the number of patent application to the number of technical personnel. *IntellProtect* is a dummy variable which equals one if the protection of intellectual property within the province is better than national average. Resources: Fan and Wang (2011).
Lnloan_F	Logarithm of bank loans, forwarded one year.
ΔSubsidy	Change in the logarithm of government subsidy between $\mathrm{Subsidy}_{t+1}$ and $\mathrm{Subsidy}_t$
ETR_F	Effective tax rate, forwarded one year. ETR is defined as (tax expense-deferred tax expense)/EBIT.
Disclosure_F	Disclosure index. Refers to the sum of 10 disclosure items: disclosure about (1) shareholder protection (2) creditor protection (3) staff protection (4) supplier protection (5) customer protection (6) environment protection (7) public relation (8) the construction and improvement of social responsibility system (9) safe production (10) the existing deficiency of company.

Variables	Definitions
Donation_F	Logarithm of donation amount, forward one year.
Fraud_F	The number of times the firm is subject to regulatory enforcement against fraud. Forwarded one year.
ΔEM	Following Chen, Cumming, Hou, and Lee (2013), earnings management is the ratio of non-operating income relative to revenue. ΔEM means the change in earnings management.

Table A4.2: PSC Members and Ranks

This table presents detailed lists of the names, ranks of political power and positions of PSC leaders. Political power is coded according to the party positions and state positions of the PSC leaders. **Panel A** shows the 17th PSC (2007-2012), and **Panel B** demonstrates 18th PSC (2012-2017).

Panel A 17th PSC (2007-2012)

RANK	NAME	PARTY POSITION	STATE POSITION
1	Jintao Hu	✧ General Secretary of the CPC Central Committee ✧ Chairman of the CPC Central Military Commission	✧ President of the People's Republic of China ✧ Chairman of the PRC Central Military Commission
2	Jiabao Wen	✧ Party secretary of the State Council of the People's Republic of China	✧ Premier of the State Council of the People's Republic of China
3	Bangguo Wu	✧ Party secretary of the Standing Committee of the National People's Congress	✧ Chairman of the Standing Committee of the National People's Congress
4	Qinglin Jia	✧ Party secretary of the National Committee of the Chinese People's Political Consultative Conference	✧ Chairman of the National Committee of the Chinese People's Political Consultative Conference
5	Changchun Li	✧ Chairman of the Central Guidance Commission for Building Spiritual Civilization	
6	Jinping Xi	✧ Top-ranked Secretary of the Central Secretariat of the CPC ✧ Vice Chairman of the CPC Central Military Commission ✧ President of the Central Party School of the CPC	✧ Vice President of the People's Republic of China ✧ Vice Chairman of the PRC Central Military Commission
7	Keqiang Li	✧ Deputy Party secretary of the State Council of the People's Republic of China	✧ First-ranked Vice Premier of the State Council of the People's Republic of China
8	Guoqiang He	✧ Secretary of the Central Commission for Discipline Inspection	
9	Yongkang Zhou	✧ Secretary of the Central Political and Legislative Committee	

Panel B 18th PSC (2012-2017)

RANK	NAME	PARTY POSITION	STATE POSITION
1	Jinping Xi	✧ General Secretary of the CPC Central Committee ✧ Chairman of the CPC Central Military Commission ✧ Leader of the Central Leading Group for Comprehensively Deepening Reforms ✧ Chairman of the National Security Commission	✧ President of the People's Republic of China ✧ Chairman of the PRC Central Military Commission
2	Keqiang Li	✧ Party secretary of the State Council of the People's Republic of China ✧ Deputy Leader of the Central Leading Group for Comprehensively Deepening Reforms ✧ Vice Chairman of the National Security Commission	✧ Premier of the State Council of the People's Republic of China
3	Dejiang Zhang	✧ Party secretary of the Standing Committee of the National People's Congress ✧ Vice Chairman of the National Security Commission	✧ Chairman of the Standing Committee of the National People's Congress
4	Zhengsheng Yu	✧ Party secretary of the National Committee of the Chinese People's Political Consultative Conference	✧ Chairman of the National Committee of the Chinese People's Political Consultative Conference
5	Yunshan Liu	✧ Top-ranked Secretary of the Central Secretariat of the CPC ✧ Chairman of the Central Guidance Commission for Building Spiritual Civilization ✧ President of the CPC Central Party School ✧ Deputy Leader of the Central Leading Group for Comprehensively Deepening Reforms	
6	Qishan Wang	✧ Secretary of the Central Commission for Discipline Inspection	
7	Gaoli Zhang	✧ Deputy Party secretary of the State Council of the People's Republic of China ✧ Deputy Leader of the Central Leading Group for Comprehensively Deepening Reforms	✧ First Vice Premier of the State Council of the People's Republic of China

Chapter 5 Passive Signals and IPO market: Signalling Theory Extension

Abstract

Signalling theory is widely used in the literature, especially in researches on IPO market. However, existing signalling literature largely ignores signals that are not intentionally sent out by firms themselves. Therefore, this paper proposes the concept of passive signalling, where firms lose control of the signalling decision and signalling contents. This paper argues that passive signals can have strong influences on people's evaluations on companies because of the higher signal honesty, signal fit, and signal observability. The IPO market provides a perfect setting to test the impact of passive signals regarding its high information asymmetry. The results show that passive signals are strong enough to influence every part of IPO process, including the IPO application process, IPO valuation during issuing and post-IPO performance.

5.1 Introduction

Information asymmetry and lacking track records can be major problems for financing and valuation, which is especially salient for small and new firms (Canovas & Solano, 2007). To address this problem, ventures intentionally send out signals to convey positive information, and researchers approach this problem from the perspective of signalling theory, focusing either on the different kinds of signallers (e.g. Coff, 2002; Ndofor & Levitas, 2004) and receivers, such as shareholders (Cohen & Dean, 2005) and VCs (Busenitz, Fiet, & Moesel, 2005), or on various kinds of signals like board composition or prestige (D'Aveni, 1990; Shivdasani, 1993) and brand name (Rao & Monroe, 1989). However, existing literature on signalling theory mainly focuses on signals sent intentionally by firms themselves, where firms have the power to decide whether to issue the signals and determine the signal content, and extant researches also focus on commercial-led signals, where the signalling relationships are established by signing commercial contracts to form mutually beneficial relationships such as those with VCs or reputable underwriters with the main purpose of boosting firms' performance. The literature largely ignores a totally different kind of signal – passive signals, where firms lose control of either the signal issuing decision or the signal content, and the authority issues signals for firms voluntarily without commercial contracts with the main purpose of stimulating the whole industry and economy rather than helping individual firms.

To fill the gap, this paper proposes the concept of 'passive signalling' to extend the boundaries of existing signalling theory. Political endorsement and visits, which refer to public statements or visits showing that governments support firms, are

examples of passive signalling. For example, Roshow Group Co., Ltd, a high-tech company, was praised for its advanced technology in processing copper raw material by the Chinese government in a government-controlled news program on 25th July 2010. With the market sentiment triggered by political endorsement, Roshow Group outperformed the market and counterparts after its IPO both in the short and long term. The 7-day and 1-year cumulative abnormal returns are as high as 11.6% and 85.5% respectively. In this paper, political endorsement and visits are deemed as examples of passive signals because it is the government rather than firms themselves send out these signals while firms are only left to accept the decisions of the government passively. Moreover, the purpose of government does not target on boosting firms' individual performance but rather on improving the whole economy.

Passive signals have several unique characteristics which distinguish them from other signals in the existing literature. A passive signal is authority-led, which is different from the commercial-led signals explored in existing literature in terms of both purpose and form. In terms of the purpose, under commercial-led signals, the relationship between the firm and other entities (e.g. celebrity endorsers, VCs or reputable underwriters) is based on signing commercial contracts to form a mutually beneficial situation, with the purpose of enhancing firms' commercial performance. By contrast, under authority-led passive signals, no contract is needed to form the relationship thus is more objective as the authoritative party, for example the government, will issue signals voluntarily with the broader purpose of stimulating the market and economy after considering the effects of the endorsement on the local economy or on specific industries rather than just on firms themselves. In terms of forms, passive signals are characterized by losing control of the signal issuing decision

and signal content. Existing literature on signalling theory mainly focuses on the actions entities intentionally take to send positive information to the public (Connelly, Certo, Ireland, & Reutzel, 2010), while largely ignoring situations where firms themselves no longer have abilities to decide whether or not to issue the signal. Under passive signalling, firms lose control of the issuing decision and the content of the signal due to the power of the authoritative party. For example, in political endorsement, it is the government that determines which firms to endorse and then issues signals by broadcasting political endorsements nationwide, while firms themselves are only left to accept the decisions passively.

These unique perspectives of passive signalling make it overwhelmingly powerful in influencing the evaluation of people on firms through several channels: serving as a particularly reliable cue to combat information asymmetry, certifying and transferring legitimacy, and indicating resources. Consequently, passive signals can effectively influence the views and valuations of shareholders, investors, regulators and partners. First, a passive signal serves as a particularly reliable cue to combat information asymmetry, as it is less likely to be manipulated by firms themselves due to its "passive" nature. Moreover, signallers issuing passive signals are as authoritative as government who have a higher reputation for honesty and fewer incentives to send false signals, and usually have professional knowledge and testing facilities to perform due diligence and dig into the deep of the firm, thus increasing signal reliability. Second, the authority of the signallers in passive signalling can transfer and certify the cultural, resource and moral legitimacy of firms, as only the firms behave culturally and politically correctly, deal with resources efficiently and perform morally well can attract authoritative entities to send passive signals for them. Third, passive signals

sent out by authoritative entities usually indicate signaller's support because of the broader purposes of the signaller. Instead of focusing on one particular firm, the signaller holds a broader purpose to stimulate the whole economy, thus indicating that the authoritative entities like government tend to provide more resources after the signalling for the firms.

This paper examines the effects of passive signals in an IPO setting, where information asymmetry is salient and signals are especially important. Information asymmetry is obvious at IPO due to firm owners' incentives to distort information and the complexity of the information as a result of the mixture of corporate culture, leadership, strategy and technology. Under high information asymmetry, investors do not believe in every signal. Instead, they screen signals and only rely on credible ones (Downes & Heinkel, 1982; Riley, 1979; Spence, 1976). Therefore, the IPO market provides a perfect setting to examine whether passive signals like political endorsement are valued by investors, and whether they are strong enough to trigger reactions in a market with high information asymmetry when investors carefully screen signals.

Although both political endorsement and visits are examples of passive signalling, this paper empirically tests the effects of political endorsement due to the small number of observations of political visits before firms' public listing. This study hypothesises that political endorsement can influence every part of IPO process, including IPO application process, valuation during issuing, and post-IPO performance. The strong effects of passive signalling in IPO market is due to its passive nature: the signal is not sent out intentionally by firms themselves, and the content of the signal is also out of firms' control, thus leading to higher *signal honesty*

and *signal fit*. And the strength of the passive signalling is also rooted from the authority of the signaller who can certify firms' cultural, moral and resource legitimacy. Moreover, the broader purposes of passive signalling indicates potential increase in accessible resources. As to IPO application, the first hypothesis is that passive signals like political endorsement can efficaciously influence the views of IPO regulators because passive signals can foster trust and legitimacy, certify firms' compliance with government IPO regulations, and indicate political relations which can increase firms' access to officials in the China Securities Regulatory Commission (CSRC), thus leading to higher IPO application success. Second, as to IPO valuation during issuing, this paper supposes that investment bankers will narrower IPO offer price spread because of the reduced risk following political endorsement as passive signals indicate more accessible potential favourable resources. Moreover, political endorsement can stimulate the demand of institutional investors, thus leading to higher price and lower under-pricing. Third, in terms of post-IPO performance, this paper hypothesizes that firms with endorsement can outperform in the long run because the signaller (i.e. the government) has both a better ability to test the firm's quality and less incentive to send false signals.

To test the effects of passive signals like political endorsement, I hand-collected data on political endorsement in China from the government-controlled daily news programme *Xinwenlianbo*, from 1st January 2009 to 31st December 2011. *Xinwenlianbo* is under the firm control of the Publicity Department of the Chinese Communist Party, and serves as a mouthpiece for the government. Therefore, the positive coverage of particular firms shown in *Xinwenlianbo* can be regarded as government endorsements. In order to test the effects on IPO, this paper only focuses

on observations where endorsement happens within one years before firms' public listing. From 2009 to 2012, 802 firms went public, 41 of which were endorsed by the government before public listing.

One possible concern of the study is selection bias. For example, it's possible that the government is more inclined to endorse firms with good internal corporate governance as these firms are safer, allowing the government to protect its own reputation. Good corporate governance, in turn, results in better IPO performance and higher valuation at IPO. Therefore, it was vital to find a group of non-endorsed firms that are similar to endorsed firms in all pre-treatment characteristics. To address observable selection bias, propensity score matching (PSM) is applied to match the treatment group with its five nearest neighbours according to a series of significant factors of IPO valuation and performance, thus forming treatment and control groups with similar likelihood to achieve endorsement.

The results show that political endorsement, as an example of passive signals, can influence regulators, partners, and institutional and individual investors, hence impacting IPO application success, IPO valuation at issuing and post-IPO performance. This paper first finds that political endorsement can influence CSRC members, as endorsed firms are 7.8% more likely to pass the IPO screening with their first attempt with every additional endorsement. Second, I test the impact on valuation at IPO and find that investment bankers set a narrower spread for endorsed firms due to the reduced risk and increased certainty about the offer price, and the first-day returns for endorsed IPOs are significantly lower, meaning less under-pricing. Third, by investigating the impact on post-IPO performance, I find that endorsed IPO firms have higher cumulative abnormal returns and industry-adjusted buy-and-hold returns over

one to five years after IPO. Furthermore, results also demonstrate that the changes in post-IPO operating performance, like return on asset, return on sales, and operating margin are more positive and significant for endorsed firms after IPO, meaning that firms with political endorsement are less likely for *face-changing* and can outperform in the market in both the short and long term.

This paper contributes to the literature on signalling theory in a number of ways. First, this study extends the boundaries of signalling theory in the literature by introducing the concept of passive signalling through investigating political endorsement. The investigated setting challenges traditional signalling theory, where signals are sent intentionally by insiders and firms can control the signal contents (e.g. BliegeBird et al., 2005; Connelly et al., 2010). Different from signals sent intentionally by firms, like board composition or prestige (D'Aveni, 1990; Shivdasani, 1993) or CEO-retained equity (Brealey, Leland, & Pyle, 1977; Carter & Van Auken, 1991), political endorsement is a signal determined and sent by the government. Due to the government's overwhelming power over firms, companies lose control of the signalling decision and contents, and such passively issued signals are largely ignored by literature. Second, this study also compliments the literature on signalling theory by introducing "authority-led signals". Commercial-led signals are the main focus of existing signalling literature, where the signalling relationship is based on commercial contracts, such as those with reputable underwriters (Carter & Manaster, 1990) and VCs (Megginson & Weiss, 1991), and the purpose is to improve firm performance. However, in authority-led signals, contracts are not the prerequisites thus are more objective, and the main purpose of authority-led signals is not just enhancing firm performance but stimulating the whole market. Third, this paper supplements

signalling literature which mentions the reliability of signals (e.g. Busenitz et al., 2005; Sanders & Carpenter, 2003). Due to the unique features of passive signals discussed in this paper, passive signals are particularly reliable and credible since they are less likely to be manipulated by firms and have higher signal honesty, signal fit and signal observability. Although some literature mentions signal reliability, few empirical studies exist. The results of this paper can indicate the strength of the impact of reliable signals and introduce the passiveness as a new criteria to judge the signal reliability.

This paper is also related to the literature on entrepreneurship. This stream of literature points out that ventures usually overcome the liability of smallness or newness through strategic alliance or associating with prestigious entities (Gulati & Higgins, 2003). For instance, affiliation with prestigious underwriters (Pollock, Chen, Jackson, & Hambrick, 2010), venture capitals (Milanov & Shepherd, 2013), auditors (Beatty, 1989) and reputable third parties like universities (Bonardo, Paleari, & Vismara, 2011) can enhance affiliated firms' reputation and bring about resources and expertise, hence increasing the survival probability of business ventures. The results provide supporting evidence that political endorsement is a new way for new ventures to increase their chance of survival. Different from the strategic alliance and association investigated in existing entrepreneurship literature, where firms have some degree of freedom to choose which underwriter or venture capital to cooperate with, political endorsement is a unilateral choice where only the government chooses which firms to endorse. Therefore, compared with strategic alliance and association, achieving government endorsement is rarer and more valuable. New ventures can try to establish long-term political connections to strive for political endorsement.

Moreover, this study contributes to IPO literature as the first to investigate the

impact of political endorsement on IPO application, valuation and performance. The government's role in the IPO market is usually restricted to their regulatory power through their political connections with firms (e.g. Yang, 2013). By contrast, political endorsement in this study is a strategy the government uses to influence the market by using its market power exercised through sending out signals, rather than regulatory power. Just through providing endorsements to guide people's views, the government succeeds in guiding efficient resource allocation in the IPO market.

The remainder of the paper is organised as follows. Section Two first reviews literature and then extends signalling theory. Section Three describes the market consequences of passive signals, and develops hypothesis. Research design is detailed in Sections Four. Results and discussions are articulated in Section Five, followed by conclusion in Section Six.

5.2 Literature Review, Theoretical Background, and Signalling Theory Extension

Literature on signalling theory covers different signals, various kinds of signallers and some factors that influence the efficacy of signals. The passive nature and other unique perspectives of political endorsement and political visits discussed below distinguish it from the signals covered in previous literature, and enable political endorsement and political visit to be influential in the market, especially in markets with high uncertainty like the IPO market.

Signalling theory demonstrates the information-identifying process of decision makers when information is asymmetrical (Spence, 1973). In a market characterised

by high information asymmetry, companies own more information than investors, hence giving firms the power to deceive investors. As a result, investors turn to signals for help (Boulding & Kirmani, 1993). Existing literature on signalling theory covers many signals, such as price (Wolinsky, 1983), warranties and guarantees (Grossman, 1981; Lutz, 1989; Spence, 1977), advertising (Milgrom & Roberts, 1986; Nelson, 1974), and brand name (Rao & Monroe, 1989).

Moreover, researchers have identified different kinds of signallers. Firms are the main signallers in finance, strategy and management studies (e.g. Coff, 2002; Karamanos, 2003; Ndofor & Levitas, 2004). For example, Park and Mezias (2005) consider 74 e-commerce firms as signallers and alliance announcements as signals, and find that multiple meanings are attached to one signal during interpretation. In some literature, especially strategy studies, individuals are tested as signallers. For instance, the studies of Miller and del Carmen Triana (2009) and Kang (2008) regard boards of directors as signallers, and directors use board diversity and interlocks to send signals to organisational stakeholders and shareholders respectively. Moreover, studies like Goranova, Alessandri, Brandes, and Dharwadkar (2007) also deem managers as signallers.

Besides signallers, researchers also investigate different types of receivers. In entrepreneurship studies, investors are the main signal receivers (Daily, Certo, & Dalton, 2005; Higgins & Gulati, 2006; Jain, Jayaraman, & Kini, 2008). For example, in Cohen and Dean (2005), IPO firms that send signals to certify the legitimacy of top management to potential investors can reduce under-pricing. Another stream of literature focuses on shareholders as signal receivers. For instance, managers usually try to send signals to shareholders to ensure that managers' own wealth is aligned with

shareholders' wealth (Eisenhardt, 1989; Sanders & Carpenter, 2003). Moreover, other stakeholders, such as VCs (Busenitz et al., 2005), customers (e.g. Basuroy, Desai, & Talukdar, 2006), competitors (Basdeo, Smith, Grimm, Rindova, & Derfus, 2006) and acquirers (Coff, 2002) are also investigated as signal receivers in previous literature.

Furthermore, recent literature discusses in depth the factors that influence the efficacy of signals. First and foremost, observability is a prerequisite of signal efficacy, which means inside actions must be observable to outsiders. Second, the costs of the signal must be high enough to prevent other unqualified firms from imitating and sending false signals (Connelly et al., 2010). Third, researchers like Connelly et al. (2010) point out that the reliability of a signal depends on signal honesty and signal fit. *Signal honesty* (Arthurs, Busenitz, Hoskisson, & Johnson, 2009), also known as signal *veracity* (Busenitz et al., 2005), refers to consistency between signals and the real quality of the firm. In other words, the extent to which firms send false signals. Firms will develop a reputation for dishonesty over time if their real actions and signals are inconsistent, and signals sent by such firms will be no longer effective. *Signal fit* refers to the correlation between the signal and underlying quality (Busenitz et al., 2005). Signal fit is different from signal honesty because the former is a feature of the signal itself, while the latter is a characteristic of the signallers. Fourth, the literature also highlights that the efficacy of signals depends on the frequency of signal issuance (Baum & Korn, 1999) and the consistency of different signals (Chung & Kalnins, 2001).

Signalling theory is the dominant theoretical explanation the literature applies to examine the IPO market (e.g. Daily & Dalton, 2001; McBain & Krause, 1989). In an IPO context, it is the information asymmetry between issuing firms and other

market participants regarding firms' future prospects that leads to the need for firms to issue signals to increase IPO success. Existing literature covers a series of signals which could reduce uncertainty and increase the probability of successful IPO, including board quality (Certo, 2003), certification (Rao, 1994) and the presence of founders (Nelson, 2003). Researchers like Carter and Manaster (1990), Bonardo et al. (2011), Bruton, Chahine, and Filatotchev (2009) and Gompers (1996) point out that affiliation with prestigious third-parties like underwriters, prestigious universities, business angels and venture capitalists can serve as strong signals that lower uncertainty over performance. In addition, prospectuses are a major channel through which IPO firms can issue signals to influence investors' evaluation of a firm (Daily et al., 2005).

However, existing signalling theory literature largely ignores passive signals, and political endorsement and political visits, as examples of passive signals, provide an invaluable setting to extend the boundaries of existing signalling theory. Passive signals have several unique features which can complement current literature on signalling theory. The first feature of a passive signal is its broader purposes. Passive signals are authority-led. Different from commercial-led signals, where the main purpose is to boost firms' commercial performance, authority-led passive signals have a wider purpose – to motivate the whole economy. Specifically, examples of commercial-led signals are the mutually beneficial relationships built by signing commercial contracts, such as those with reputable underwriters (Carter & Manaster, 1990), VCs (Megginson & Weiss, 1991) and accounting firms (Yang, 2013), and the main purpose of commercial-led signals is to enhance firms' commercial performance, such as their performance in sales or in financing. By contrast, there is no commercial

contract thus no vested interests between the firm and the authoritative entity in an authority-led signal, and the authoritative entities (e.g. the government) voluntarily issues signals based on a holistic view about the whole economy. The authoritative entity in passive signalling usually aims to improve the whole market, stimulate the local economy or strengthen political correctness, rather than just helping an individual firm. For example, specifically to political endorsement, the government endorses firms located in rural areas in order to stimulate the local economy. Therefore, compared with commercial-led signals, the purpose of authority-led passive signals is broader.

The second unique aspect of passive signals is the lost control of the signalling decision and signal content. Previous literature investigates signals sent intentionally by firms to deliberately convey positive information (Connelly et al., 2010). For example, during IPO, firms intentionally issue signals like board quality (Certo, 2003), certification (Rao, 1994), and affiliation with underwriters or venture capitals (Carter & Manaster, 1990; Gompers, 1996) to convince investors of the quality of new firms. In these cases, firms take the initiative to issue signals and convey positive information. By contrast, in passive signals, like political endorsement and political visits, it is up to authoritative entities (e.g. government) to determine whether to issue this signal, which means firms play a passive role. Such cases are ignored by previous signalling literature as existing literature relies heavily on intentional and active signals.

The unique perspectives of political endorsement discussed above distinguish political endorsement from the signals investigated in existing literature, and make it overwhelmingly powerful in influencing people's judgement. Compared with normal signals sent out intentionally by firms, political endorsement is more reliable because

it is less likely to be manipulated as firms have no control of the content of endorsement, and also cannot control whether or not they are endorsed or visited. Furthermore, under circumstances with severe information asymmetry, like the IPO market, such passively issued signals are extremely valuable because investors will only respond to reliable signals, while ignoring certain information released by owners when information transparency is poor (Downes & Heinkel, 1982; Riley, 1979; Spence, 1976).

5.3 Market Consequences and Hypothesis Development

Passive signals like political endorsement or visit are efficacious in influencing people's valuation of firms through three channels: serving as a particularly reliable cue to combat information asymmetry (mainly due to the passive nature of the signal), certifying and transferring legitimacy (because of the powerful signaller), and indicating resources (because of the broader purpose of passive signal). As a result, passive signals can influence the views of shareholders, potential institutional and private investors, related regulators and cooperated partners. This paper uses the IPO setting to test the impact of passive signals on the views of IPO regulators, underwriters, institutional investors and potential individual investors.

5.3.1 Channel One: Reliable Cue in Markets with High Information Asymmetry

When information asymmetry is high, only reliable information will catch the attention of investors (Downes & Heinkel, 1982; Riley, 1979; Spence, 1976). Passive signals are especially reliable and efficient in influencing people under high

information asymmetry and when track records are limited, because passive signals are less likely to be manipulated by firms and have higher signal honesty, signal fit and signal observability. First, since passive signals are sent out by an authoritative third party (e.g. the government) rather than firms themselves, they are less likely to be manipulated than other signals intentionally issued by firms themselves to convey positive ideas.

Second, the signaller in passive signals has higher "*signal honesty"* since they are more objective as an authoritative third party. For example, in political endorsement and visit, the high integrity of the signaller (i.e. the government) can enhance the reliability of signals. According to Connelly, Certo, Ireland, and Reutzel (2011), information reliability can be improved by the integrity of the information sender, which means whether the sender has a reputation for honesty or has the incentive to intentionally mislead investors with false information. Compared with other signallers, the authoritative entities like government has higher integrity and fewer incentives to endorse or visit bad firms for the following reasons: (1) like venture capitals or reputable managers in existing signalling literature, governments risk their own reputation if endorsed or visited firms perform badly; (2) without receiving direct compensation from firms, the government is more objective; (3) like other investors, the government would perform due diligence to ensure the quality of firms before endorsement or visit, because the government usually allocates financial resources or issues favourable policies to endorsed or visited industries or firms.

Third, passive signals are more likely to meet the "*signal fit"* criterion of signalling theory, which means signals are consistent with the real quality of the firms. Since the signallers in passive signals are authoritative entities, they usually have a

better ability to identify good firms through their professional knowledge and advanced testing facilities, thus ensuring consistency between endorsements and actual quality. Furthermore, in order to avoid risking its reputation and to ensure efficient resource allocation, the signaller will perform due diligence to investigate the private information thoroughly, hence increasing signal fit and reliability.

Fourth, high *"signal observability"* enhances the influence of passive signals. Due to the overwhelming power and authority of signallers of passive signals, the signals they send out usually attract more attention. For example, political endorsement is broadcast nationwide on the government-controlled news program *Xinwenlianbo*. Virtually all channels in China are regulated to broadcast Xinwenlianbo live at 7 p.m. everyday, which reaches more than 95% of the population and thus has extensive coverage (Jin, 2009). As a result, signals sent out by powerful authoritative entities can be easily noticed by the public.

The IPO market this paper focuses on is one with high information asymmetry and quite limited track records, where passive signals can show their effectiveness and efficiency in influencing peoples' ideas. One key characteristic of the IPO market is information asymmetry, because these firms usually lack track records. While internal owners of the firms can obtain extensive knowledge about operations or the quality of management and employees (Brealey et al., 1977), limited information is available to outsiders (e.g. Carter & Manaster, 1990; Stuart, Hoang, & Hybels, 1999). Information asymmetry is especially obvious in the IPO market for a number of reasons. First, IPO candidates usually lack track records. Second, firm owners have high incentives to distort information before it becomes publicly available (Downes & Heinkel, 1982). Third, the mixture of corporate culture, leadership, strategy and technology of each

new organisation highlights the complexity of IPO information. Fourth, material information is usually not fully disclosed, notwithstanding the legal requirement of information disclosure (Cohen & Dean, 2005). Under high information asymmetry, investors do not believe in every signal. Instead, they screen signals and only rely on credible ones (Downes & Heinkel, 1982; Riley, 1979; Spence, 1976). Therefore, it is worthwhile to testing whether passive signals are so reliable as to effectively influence people's evaluation on firms in markets with high information asymmetry like the IPO market.

5.3.2 Channel Two: Legitimacy Transfer and Certificate

Based on Berger, Berger, and Kellner (1973) and Scott (1987), institutionalisation emphasises a taken-for-granted feeling, norms and conformity. Legitimacy, as the symbol of appropriateness, taken-for-grantedness (Carroll & Hannan, 1989), social acceptance (Brown, 1997), congruence and reasonableness (Dowling & Pfeffer, 1975; Meyer & Rowan, 1977), is the essential prerequisite for firms to obtain a good reputation, access resources and survive (Pfeffer & Salancik, 1978; Rindova, Williamson, Petkova, & Sever, 2005). Therefore, one core implication from institutional theory is that legitimacy is paramount in determining firm performance (Barringer & Milkovich, 1998; Eisenhardt, 1988).

Passive signals can transfer legitimacy since the signaller in passive signals is usually overwhelmingly powerful and authoritative. Political endorsement or visits is one of the most efficient passive signals for legitimacy transfer because the signaller is the government. The legitimacy can be transferred because the passive signals can motivate investors to classify firms and another authoritative party into the same

category. According to Brewer and Feinstein (1999), Bodenhausen, Macrae, and Sherman (2016), and Fiske, Lin, and Neuberg (1999), investors tend to employ categorical thinking to simplify the evaluation process, especially when individuals cannot think deeply and accurately due to a lack of time, resources and cognitive capacity. Since new firms are characterised by few track records and high uncertainty, the most observable and reliable cues to judge newcomers are their partners, founders or endorsers. As a result, newcomers either fall into the same category as their partners or are categorised according to their founders' social capital (Milanov & Shepherd, 2013). Therefore, passive signals like political endorsement can help investors shape categorisation, and facilitate the transfer of legitimacy from authoritative entities to firms.

Besides transferring legitimacy, passive signals can also certify firms' cultural legitimacy, resource legitimacy and moral legitimacy, because signallers use certain criteria to choose firms. First, cultural legitimacy means the authoritative entity in the passive signals confirm that the firms they endorse or visit behave culturally and politically appropriate, because only the firms with political correctness and good culture can be endorsed or visited. For example, Hengrui Medicine were visited by PSC leaders on 25th April 2009, during which it were commended and encouraged for further development in Party building. Through the passive signal, government explicitly indicates the market that this firm perform politically appropriate, thus certifying its cultural legitimacy. Second, passive signals can let investors recognize firms' resource legitimacy because the authoritative entity is more inclined to endorse or visit firms that can utilize resources effectively after careful cost-benefit analysis in order to protect its own reputation. Third, through passive signals, the authoritative

entity also certified the moral legitimacy of some firms that donate to help disaster areas or expand recruitments to solve social problems.

5.3.3 Channel Three: Resources Indication

As discussed previously, the purpose of passive signal is wider when compared with other signals as the authoritative entity has a broader consideration rather on focusing on helping an individual firm. For example, the government can visit or endorse firms for politic reasons, for improving social welfare or for stimulating the economy. Congqing Chuanyi Automation, China South Locomotive, and Yuanda Holdings, for example, were visited by government in 2014 because they are in industries that need huge innovations to remain competitive and government was promoting innovation at that time. By visiting these firms, government sets these firms as models in their respective industries and motivate other firms to follow. Since the purposes of passive signal consists in a big picture which target at improving the whole economy and social welfare, it can be expected that government will promote these firms by providing more resources. And this is already proved in the previous two chapters as subsidies and loans increased. Therefore, the broader purpose of the passive signal distinguish it from other signals, and it is the wider considerations of the signaller in passive signal that indicate potential increase in resources accessibility for firms.

5.3.4 Hypothesis Development

Considering passive signal's reliability and its ability to transfer legitimacy and indicate resources, this paper supposes passive signals could influence the views of IPO regulators, leading to higher success rates. Moreover, passive signals can also

influence underwriters and institutional investors, resulting in lower under-pricing and offer price spread. Most importantly, individual investors in the market will also be influenced by passive signals thus raising the cumulative abnormal return. Detailed development of these hypotheses are provided below.

5.3.4.1 Application Success

IPO firms have to be approved by the China Securities Regulatory Commission (CSRC) before listing. The CSRC, as an institution of the State Council and with a ministry-level rank, was granted the authority to impose unified and centralised supervision and regulation of the Chinese securities market. Accounting and financial issues are closely monitored by the CSRC, and up to 20% of IPO applications were rejected. Seven CSRC members, called “the key seven people” attend each committee meeting to screen IPO candidates, and candidates have to achieve more than five votes to pass and go public.

The IPO selection process is somewhat subjective rather than strictly objective, which enables political endorsement to influence CSRC members’ decisions. According to Yang (2013), some criteria used by the CSRC to screen IPO candidates are not known publicly. Although there are some regulations to guide and standardise IPO selection, a number of criteria are soft, vague and qualitative. For instance, the rule “the amount of funds raised should be commensurate with the issuer's current business scale, financial status, technical level, and management capabilities” is qualitative and ambiguous. As a result, these vague regulations give CSRC officials great discretion and flexibility. Researchers like Yang (2013) highlight that political connections with CSRC members can increase survival probability during the IPO

screening process, showing that CSRC members have a great deal of discretion in making decisions, and that the IPO selection process is not that objective.

The first hypothesis is that firms with political endorsement or visits are more likely to pass the IPO screening process. First, from a theoretical perspective, political endorsement or visit is an effective passive signal in influencing people's valuations of firms because it has higher signal honesty, signal fit and signal observability, and passive signals are also less likely to be manipulated by firms themselves. Since passive signals are more reliable and can transfer legitimacy and indicate resources, I suppose CSRC members would be influenced by political endorsement or visits, leading to higher IPO success. Second, political endorsement or visit certifies firms' legitimacy since it indicates governments' positive ideas about firms' compliance with regulations and rules, as the government has the ability to look deep into firms' regulatory issues. Therefore, governments' endorsements or visits to firms can reduce IPO firms' regulatory and operational risks and increase their chances of success. Third, one possible resources indicated by political endorsement or visit is the connection between firm and government, though not as obvious as the connections researched in other literature, endorsed or visited firms are more likely to have access to CSRC officials, leading to stronger lobbying power. Considering that the political and lobbying influence on the IPO regulatory process in the Chinese market has been proven by previous literature (e.g. Aharony, Lee, & Wong, 2000; Hung, Wong, & Zhang, 2012), this paper supposes that achieving political endorsement or visit can increase the chance of IPO success.

Hypothesis 1: Passive signal can efficaciously influence the views of IPO

regulator, leading to higher IPO application success.

5.3.4.2 Valuation at IPO

The Chinese government has experimented with different IPO pricing mechanisms since the establishment of the stock market. The fixed-price system was first adopted by regulators from 1990 to 1995, which means the price was set according to the firm book value. Then, a controlled P/E range system was used from 1996 to 1999, with the P/E confined to about 15. From mid-1999 to 2002, to reduce government intervention and let the market determine the price, regulators adopted an auction system to let investors decide the offer price through online bidding. However, this trial ultimately led to extremely high initial returns and large later losses due to high speculation. As a result, the controlled P/E system was reused from mid-2002 to 2004, with P/E confined to 20.

With the growth of institutional investors, the commonly used book-building system was finally adopted by regulators at the beginning of 2005 (Gao, 2010) to allow the market to determine prices and reduce government intervention further. Under the book-building system, the lead underwriter first determines the price range of new shares according to the information obtained from some particular institutions and individual investors, and then repeatedly corrects the issue price according to the demand of institutional investors. The adoption of the book-building system reduced the arbitrariness of stock pricing by involving institutional and particular individual investors in the pricing process.

The book-building system enables passive signals to influence the valuation at IPO since it involves the judgement of both underwriters and institutional investors.

As to underwriters, Tinic (1988) suggests that investment bankers are very sensitive to the uncertainty of IPO firms, and they set prices according to firms' available resources and risk levels. In the face of high risk, underwriters tend to set a wider spread of offer prices in order to retain the flexibility to set a more accurate offer price later. A resource-based view (Barney, 1991; Wernerfelt, 1984) is applied by researchers like Daily et al. (2005) to investigate the influence of resources on IPO pricing. For example, Daily et al. (2005) find that resources like the skills of the top management team can encourage investment bankers to set a narrower spread and higher offer price due to the lower risks. As discussed in section 3.3, the broader purposes of passive signals indicate that the authoritative entity will provide more resources after endorse or visit, so passive signal can reduce underwriters' concern regarding firm risk and motivate underwriters to set a narrower spread. By the same token, the potential resources implied by passive signal also increase the demand of institutional investors, resulting in lower under-pricing. Therefore, this paper hypothesises that political endorsement or visit, as a passive signal which is deemed to be credible, is regarded by underwriters and institutional investors as an indication of more accessible favourable resources from the authoritative signaller, which reduces risks and motivates investment bankers to set a narrower offer price spread, and also gives institutional investors incentives to increase demand, thus leading to reduced degree of IPO under-pricing.

Hypothesis 2: Passive signals influence the evaluation of underwriters and institutional investors on firms, leading to lower spread and lower under-pricing.

5.3.4.3 Post-IPO Performance

Face-changing, which happens when the operating performance of IPO firms declines significantly and immediately after IPO, is a common phenomenon in the Chinese market (Yang, 2013). In order to pass the CSRC's IPO screening process, firms tend to use "financial packaging", within which earnings management is a significant part (Aharony et al., 2000). As a result, these firms usually turn out to perform badly and change face quickly. For example, Guangzhou Shangpin Home Collection Co., Ltd, a firm listed publicly in March 2017, was issued at a price as high as 54.35 RMB because of its high earnings 3.15 RMB per share in financial report before listing. However, it changed face quickly and its performance turn out to be bad according to its first quarterly financial report in 2017, resulting in a loss of 0.57 RMB per share. Face-changing attracts the close attention of investors, regulators and the media since it happens frequently. To solve this problem, regulators even impose penalties on firms whose earnings decline by more than 50%.

Despite repeated efforts by regulators, face-changing is still a serious problem, making it meaningful to test whether passive signals can really indicate the quality and resources of the firms thus reducing firms' probability of face changing. I conjecture that firms with passive signals are less likely to change face for several reasons. First, passive signals has higher signal fit, which means the actual quality of the firms are more likely to be consistent with what is indicated in signals because of authority's higher ability to identify good firms. Another reason for the high signal fit is that passive signal is not intentionally sent out by firms themselves but by an more objective authoritative party. Second, the signallers in passive signal has higher honesty because the authoritative entity does not receive compensations and value its

own reputation. Third, the bonding hypothesis of signalling theory implies that the reputation of government will suffer if the endorsed firms turn to perform bad, and the bonding system is especially obvious in passive signalling since the authoritative entities are more vulnerable to reputation loss. As a result, government has incentives to help the endorsed firms to get good performance in the long-term such as providing more resources like subsidies or bank loans as tested in previous two chapters. Therefore, it can be supposed that passive signals can imply more accessible future resources and are more effective in reflecting the real quality of firms, so firms with passive signals outperform other IPO firms in the long run in the stock market and are less likely to change face.

Hypothesis 3: Firms with passive signals outperform in the stock market and are less likely to change face.

5.4 Research Design

5.4.1 Data, Sample and Descriptive Statistics

Both political endorsement and visit are examples of passive signals. However, the number of observations of political visits those happen before firms' public listing is as small as nine, therefore the following empirical tests focus on political endorsement. The endorsement data covers the period from 1st January 2009 to 31st December 2011; this is the time period when the Chinese IPO market was more comparable with other global markets for several reasons. First, from 1990 to 2000, a strict quota system was imposed by the Chinese government on the IPO market, leading to limited IPO supply and high initial returns. After 2001, the quota system

was abandoned and a standard registration system was used, and firms now have the right to choose whether to go public by themselves. Therefore, the use of a registration system means that government intervention in the IPO market reduced after 2001. Second, the Chinese government has tried different IPO pricing mechanisms since 1990, including a fixed-price system, a controlled P/E range system and an auction system. With the growth of institutional investors, on January 1, 2005, the Chinese IPO market finally adopted the commonly used book-building system, under which stock price is determined by market force. The book-building system means that institutional investors first determine the IPO price and then individual investors apply for shares at this price. The book-building system made the Chinese IPO market more comparable to other international markets (Gao, 2010). Third, the floatation reform was finished in late 2006, making the Chinese market more market-oriented. The difference between tradable and non-tradable shares is one unique feature of the Chinese stock market. Non-tradable shares are usually held by the government in order to maintain state control, and the holders of non-tradable shares are the major shareholders and real decision makers. As a result, non-tradable shareholders are inclined to harm the interests of tradable shareholders. In 2004, the Chinese market started a reform to unify tradable and non-tradable shares, which was completed in late 2006. The sample period is from 1st January 2009 to 31st December 2011 when the market was compatible with other global markets, since the book-building method was used for IPO pricing during this time period, and the majority of split share structure reform was complete. Therefore, this study on China's IPO market is meaningful and comparable with studies on other markets.

I manually collect data about political endorsement by watching the

government-controlled daily news program *Xinwenlianbo*, which serves as the mouthpiece of the government. *Xinwenlianbo* is one of the most important outlets to spread the government's views and ideology, and it is broadcast daily and reaches over 95% of the population (Jin, 2009). Firm names and endorsement dates are recorded, and only the endorsements that occur within one year before firms' listing dates are retained. Since it's possible for a firm to be endorsed repeatedly, I calculate endorsement frequency (*EnF*), which is equal to the number of times a firm is endorsed. Endorsement frequency is especially important in this study since researchers like Baum and Korn (1999) point out that the frequency of signal can influence its efficacy.

IPO data is collected from China Stock Market and Accounting Research (CSMAR) and CHOICE databases. The endorsement data is from 2009 to 2011, and we focus on firms that achieve political endorsement within one year before listing, so the whole sample includes firms that went public from 2009 to 2012. As shown in Table 5.1, after dropping firms that lack data on GICS industry codes, provinces codes and year, I identify 802 firms that went public during the sample period, of which 41 achieved political endorsement before listing. Other financial and accounting data are also collected from CSMAR and CHOICE. Panel A of Table 5.1 shows the number and percentage of firms going public in different years. Years 2009 and 2010 are the years that more previously endorsed firms went public successfully, with 12 and 21 firms respectively.

Panels B and C demonstrate the distribution of IPO firms in different industry sectors and provinces. In Panel B, GICS code is used to identify industry sectors, and it shows that some industries, like industrial and financial firms, are more likely to achieve endorsement before listing. Panel C demonstrates the distribution of IPO firms

in different provinces, and shows that firms in more developed provinces are more likely to go public, especially firms in Guangdong (18.96%), Zhejiang (12.97%), Jiangsu (13.09%) and Beijing (10.97%). But more firms going public in more developed provinces does not necessarily mean firms in more developed provinces are more likely to achieve endorsement before listing. For example, only 3 out of 152 IPO firms in Guangdong achieved political endorsement before listing. While only eight firms went public in Tianjin during the sample period, three of them achieved endorsement.

[Insert Table 5.1]

5.4.2 Application Process and Success

Propensity score matching is used to match treatment and control groups before testing the impact of the political endorsement on IPO market to address selection bias by controlling for relevant observable factors. By using propensity score matching, I form treatment and control groups with similar predicted likelihood of political endorsement since PSM can balance out the groups being compared in terms of their covariates. Considering the relative small observations of listed firms that achieve endorsement before going public (41), the treatment group is matched with their five nearest neighbours in order to get substantial samples for testing. However, different from one-to-one matching, a firm can be put into the control group multiple times. In other words, a firm can be one of the five nearest neighbours for different firms in the treatment group simultaneously. Therefore, the final sample used for regression is smaller than what it is supposed to be.

Firms are matched according to a series of significant factors of IPO application,

valuation and performance, including leverage, firm size, firm age, connection with central government, previous profitability, retained equity, state shares, board quality, duality, reputation of underwriters and auditors, proceeds, and exchange effects (e.g. Bonardo et al., 2011; Carter, Dark, & Singh, 1998; Certo, Daily, & Dalton, 2001; Daily et al., 2005). Researchers like Brealey et al. (1977) and Carter and Van Auken (1991) point out that more retained equity *(RE)* indicates that the founder or CEO perceives the IPO firm as having long-term potential. State shares (*StateShares*) and the connection with central government (*CG*)is included to control the effects of political connection. Since board independence (*BoardQuality*) can indicate the existence of an effective monitoring system (Daily et al., 2005) and is negatively associated with IPO under-pricing (Certo et al., 2001), it is also included as a matching factor. In addition, CEO duality (*Duality*) is included as a proxy for the quality of corporate governance. Based on Carter et al. (1998), IPO stocks supported by a reputable underwriter can outperform in both the short and long run, so I also match firms according to underwriter reputation (*UnderRepu*) and auditor reputation (*AuditorRepu*). Moreover, to control for a systematic influence of offering size (Carter et al., 1998), I also match firms according to the logarithm of proceeds (*LnProceeds*). Treatment and control groups are also matched according to the exchange firms listed (*Exchange)* to control impact brought by the choice of listing venue. Additionally, I also match samples according to some key firm characteristics, including leverage (*Lev*), firm size (*Size*), firm age (*Age*), previous performance (*ROA*), and industries (*GICS*). Since the factors mentioned above would influence IPO application, performance and valuation, and it is also possible that these factors will influence the possibility of endorsement simultaneously, I first apply PSM to match the endorsed firms with other firms based

on these factors to form treatment and control groups with similar ex-ante likelihood to be endorsed.

Based on the matched sample, I first test the impact of political endorsement on the success probability of IPO application. IPO applications have to pass screening by the CSRC, and some criteria used by the CSRC to screen IPO candidates are too qualitative and vague (Yang, 2013),which makes the selection process subjective to some extent and gives political endorsement the opportunity to influence CSRC members' decisions. The regulatory and operational risks of IPO candidates can be reduced after political endorsement since the government has the ability and incentive to carefully investigate firms before providing endorsement to protect its own reputation, therefore a positive association between political endorsement and the probability of passing the screening can be expected. Second, political endorsement implies a connection and more accessibility to officials, resulting in stronger lobbying power and a higher probability of passing the screening. This paper use the following model to test whether political endorsement has positive impacts on success probability of IPO application:

$$\text{Prob}(\text{Single application} = 1) = \alpha + \beta_1 \text{ EnF} + \sum_{k=2}^{k} \beta_k Control_k + \varepsilon$$

where the dependent variable is the probability of passing the IPO screening and successfully going public only with one application attempt, otherwise equals zero if firms apply for multiple times. The main variable of interest is the endorsement frequency (*EnF*) which equals the number of times firms achieve political endorsement within one year before listing. To test the efficacy of passive signal, the endorsement frequency is more important than whether the firms are endorsed because

frequency of signal can influence its efficacy (Baum & Korn, 1999). Moreover, considering the fact that pre-IPO firms are relatively small and people are usually unfamiliar with and insensitive to the firm names, the more frequently firms are endorsed by the government, the more likely people change their valuation of IPO firms. Therefore, endorsement frequency is used in the regression as the main variable of interest. The control variables are the same set of variables used for PSM matching.

5.4.3 Valuation at IPO

To test Hypothesis 2 regarding the impact of political endorsement on the valuation at IPO, I regress the endorsement frequency on spread and initial return. According to researchers like Tinic (1988), investment bankers tend to set a wider spread of offer price in order to have the flexibility and time to find a more accurate offer price later if the IPO candidate is risky. If the passive signal is regarded as valuable and reliable in the eyes of underwriters, they will set a narrower spread in face of the reduced risk implied by political endorsement. Similarly, if institutional investors regard passive signals reliable, they tend to bid the stock and thus leading to less under-pricing.

The matched sample is used to test the impact of political endorsement on valuation at IPO by using the following model.

$$\text{IPO valuation } = \alpha + \beta_1 \text{EnF } + \sum_{k=2}^{k} \beta_k Control_k + \varepsilon$$

The dependent variable is IPO valuation, including IPO spread and IPO under-pricing. Spread (*Spread*) is defined as the range set by investment bankers, within which the IPO offer price will likely reside. The spread and the final offer price directly

determine the amount of funds firm owners are likely to raise. According to Yang (2013), the width of the spread can reflect the uncertainty and risk of IPO firms. If passive signals are regarded as reliable by underwriters, investment bankers will narrow the spread due to the reduced risk implied by political endorsement.

Under-pricing means the difference between the pre-market valuation set by investment bankers and the aftermarket pricing set by investors on the first day of public trading. Under-pricing is described by researchers like Tully (1999) as money left on the table by initial shareholders, because the pricing difference is wealth creation for first-day investors but is a loss for initial shareholders who sold equities to investment bankers at a price lower than the market price. Since greater under-pricing leads to greater first-day return, these two terms are interchangeable in most of the literature. Therefore, I measure under-pricing using first-day return (*FDreturn*) and first-day market-adjusted return (*FDadjreturn*), which is defined as the percentage difference between the first-day closing price and the offer price, adjusted by market return.

5.4.4 Post-IPO Performance

Researchers like Yang (2013) highlight a special phenomenon in the IPO market – face-changing. To test Hypothesis 3 regarding the impact of political endorsement on post-IPO performance, the following model is established based on the matched sample:

$$\text{Post IPO performance } = \alpha + \beta_1 \text{EnF } + \sum_{k=2}^{k} \beta_k Control_k + \varepsilon$$

where the dependent variable is firms' post-IPO performance. I first use buy-

and-hold return (*BHR*) and cumulative abnormal return (*CAR*) to measure short- and long-term market performance. Following the method of Michel (2014), BHR is calculated using weekly returns, starting from the first week of IPO and ending 1, 2, 3, 4 or 5 years after listing, or ending on the delisting date, whichever is earlier. And then BHR is adjusted for the industry BHR. I exclude firms for which I didn't find weekly returns after one month of listing. CAR is another proxy for market performance. Abnormal return is calculated as the excess return over market return.

Another aspect of post-IPO performance is firm operating performance. Like previous researchers such as Boubakri and Cosset (1998), D'souza and Megginson (1999), Megginson, Nash, and Randenborgh (1994) and Sun and Tong (2003), I use accounting figures to measure operating performance. To make the results robust, different measurements are used. First, following Fan, Wong, and Zhang (2007)'s method, this paper uses performance change which refers to the difference in performance between the two-year average after IPO and the two -year average before public listing, including change in return on asset (*ΔROA*), change in return on sales (*ΔROS*) and change in operating margin (*ΔOM*).

5.5 Results and Discussion

5.5.1 Results for Application Process and Success

Before testing Hypothesis 1 that passive signals like political endorsement can efficaciously influence the views of IPO regulators, thus having positive impact on IPO application success, the descriptive statistics on application success for endorsed firms are shown in Table 5.2. Panel A is related to firms that only submitted an

application once. It shows that 38 out of 41 endorsed firms passed the screening and successfully went public after only one application attempt. It is noteworthy that Row (2) of Table 5.2 demonstrates that 8 endorsed firms had already passed screening before achieving political endorsement, but their listing date is later than their endorsement dates. Therefore, I exclude these eight firms when I test the impact on the probability of passing the screening.

Panel B includes firms that submitted a listing application multiple times. As shown in Row (3), two firms failed to pass the screening initially, but successfully went public when they applied a second time after achieving political endorsement. Moreover, Row (4) shows that only one firm failed to pass the screening after endorsement, and this firm failed twice consecutively. After excluding the eight firms that passed the screening before endorsement, it shows that 32 out of 33 (97%) firms passed the screening successfully after endorsement, thus indicating that political endorsement can increase the success probability of IPO.

[Insert Table 5.2]

PSM is applied to control for selection on observables. The mean test in Table 5.3 shows that endorsed and non-endorsed IPO firms are significantly different in some firm characteristics. For example, IPO candidates with endorsement have larger firm size. One concern is that these observable firm characteristics will influence IPO application and the possibility of endorsement at the same time. PSM can reduce this concern by forming treatment and control groups with similar likelihood of achieving political endorsement. Table 5.4 Column (1) shows the first-step of propensity score matching. In PSM for this section, I exclude the eight firms that passed the screening before endorsement (shown in Row 2 of Table 5.2), and the two firms that were refused

before the endorsement but passed after (shown in Row 3 of Table 5.2) because it is possible that these two firms passed at their second application because they learned from the previous experience, so their pass cannot totally reflect the effects of political endorsement. Therefore, this section excludes 10 firms when I match firms to test the impact on IPO application, and the number of firms in the treatment group is 31. After one-to-five match, the total sample size is 174. As mentioned previously, in one-to-multiple matching, a firm can be one of the five nearest neighbours for different firms in the treatment group simultaneously, so the sample size is bit smaller than 6 times 31. However, an advantage of putting selected non-endorsed firms back to the pool is to ensure a better balance between the groups being compared in terms of their covariates

[Insert Table 5.3 and 5.4]

Based on the matched sample, Table 5.5 shows that firms with political endorsement are more likely to pass the IPO screening and successfully go public with only one application attempt (β=0.459, Marginal Effect=0.078, P=0.057), meaning that every additional political endorsement increases the probability of going public with only one application attempt by 7.8%. These results support the first hypothesis that political endorsement, as a passive signal, is effective in influencing CSRC regulators, thus imposing positive impact on the chance of IPO success.

[Insert Table 5.5]

5.5.2 Results for Valuation at IPO

This section tests Hypothesis 2 about the impact of political endorsement on valuation at IPO. I rematch the sample by adding the ten firms excluded in the previous

section back to the pool to expand sample. Table 5.4 Column (2) shows the first-step of propensity score matching of this section. Based on the matched sample, Table 5.6 tests the impact of political endorsement on IPO valuation. Column (1) shows that every additional endorsement can motivate investment bankers to narrower the offer price spread by 1.96 RMB (P=0.017), which supports Hypothesis 2 that political endorsement can convey reliable information to enhance information transparency and reduce firm risk, thus motivating underwriters to set a narrower spread. Column (2) tests IPO under-pricing. The results show that each additional political endorsement can reduce the first-day return by 2.1%. In Column (3), the market-adjusted first-return is tested as a robustness check, and the results are consistent with Column (2), which supports the hypothesis that political endorsement can convince underwriters and institutional investors about the quality of the firm, thus having negative impact on under-pricing.

[Insert Table 5.6]

5.5.3 Results for Aftermarket Valuation

This section tests whether endorsed firms outperform other firms in the market and are less likely to change face after IPO. The results in Table 5.7 demonstrate that political endorsement has a significant positive correlation with almost all CAR and BHR over 1 to 5 years after endorsement. For example, Columns (3) and (8) show that the 3-year CAR and BHR are 4.4% (P=0.006) and 4.5% (P=0.016) significantly higher if firms get one more endorsement before listing.

[Insert Table 5.7]

The results for face-changing are shown in Table 5.8, which provides supporting

evidence for Hypothesis 3 that politically endorsed firms are less likely to change face because the passive signal has higher signal fit and the government has higher signal honesty which ensures the quality of the endorsed firms. Results in Tables 8 demonstrate that endorsement frequency is positively associated with performance change in ROA, ROS and OM, demonstrating that endorsed firms outperform their counterparts in the market and are less likely to change face after IPO.

[Insert Table 5.8]

5.6 Conclusion

Signalling theory is well-researched in literature; however, no study has ever paid attention to "passive signals", where firms lose control of the signal issuing decision and the signal content, with a main purpose to stimulate the whole economy rather than helping individual firms. To fill these gaps, this paper introduces political endorsement and visits as a new setting to examine the effects of passive signals.

This paper proposes that passive signals are more influential in guiding the public because they have higher signal honesty, signal fit and signal observability, and are less likely to be manipulated by firms. Moreover, the authoritative signaller in passive signal can transfer and certificate cultural, resource and moral legitimacy, as well as indicate more potential accessible resources. Political visit and endorsement are two setting can be used to test the effects of passive signals. Due to the small number of observations of political visits before firms' public listing, this paper empirically focuses on political endorsement. The results find that political endorsement, as a passive signal, can influence the evaluation of IPO regulators: each

additional political endorsement a firm achieves can increase endorsed firms' success probability in the IPO market by 7.8%. Moreover, the results demonstrate that passive signals can influence institutional investors and partners like underwriters, resulting in reduced offer price spread and lower under-pricing. Furthermore, passive signals are also proved be positively associated with CAR and BHR over one to five years following IPO. Besides the contributions to signalling theory and literature on entrepreneurship, this paper also complements literature on IPO, since previous literature mainly focuses on the regulatory power of the government or on political connections, while political endorsement is a way in which the government acts as a market pusher by sending signals to guide the public without using its regulatory power. The findings of this study also have implications for policy makers regarding how to more efficiently allocate resources. Although some anecdotal evidence shows that political endorsement is a great honour for firms, no study empirically investigates the real impact, especially in the IPO market. The results show that firms with political endorsement outperform counterparts both in the short and long term, which indicates to policy makers that their political endorsements are effective in triggering dramatic reactions. As mentioned before, the purpose of political endorsement is to stimulate the whole economy; therefore, policy makers can consider more valuable criteria to select firms to provide endorsements so as to allocate resources more efficiently to the firms that deserve it.

Although different measurements of dependent variables and PSM have been used to make the results more reliable, this study still has some limitations, which future studies can try to test. First, the sample is relatively small due to the time-consuming manual data collection process. I collected 41 firms that achieved political

endorsement before listing from 2009 to 2011 by watching the daily government-controlled news program, and then matched these 41 firms with their five nearest neighbours. Future studies can try to expand the time period and sample size to test whether the results are robust. Second, I tested the effects of passive signals by using political endorsement as an example. Future research can try other forms of passive signals like political visits to see whether the effects are as strong as those of political endorsement. Additionally, future research can test the generalised effects of political endorsement in different markets.

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Table 5.1 : Descriptive Statistics for IPO and Endorsed Firms

This table shows the descriptive statistics of IPO and Endorsed firms during 2009 to 2012. The distributions of listing years, industry sectors, and provinces of IPO firms are shown in Panel A, B and C respectively. Firms are regarded as endorsed if the firm achieve political endorsement within one year before its public listing. Industry sector is coded according to the GICS code of firms.

		Shenzhen/Shanghai Exchange Total listed firms		Firms achieved Endorsements within 1 year before listing	
		N	%	N	%
Panel A: By year					
2009		99	12.34%	12	29.27%
2010		349	43.52%	21	51.22%
2011		282	35.16%	7	17.07%
2012		72	8.98%	1	2.44%
		802		41	
Panel B: By industry Sector					
10	Energy	18	2.24%	0	0.00%
15	Materials	129	16.08%	1	2.44%
20	Industrials	210	26.18%	23	56.10%
25	Consumer Discretionary	124	15.46%	6	14.63%
30	Consumer Staples	43	5.36%	0	0.00%
35	Health Care	64	7.98%	3	7.32%
40	Financials	12	1.50%	2	4.88%
45	Information Technology	190	23.69%	6	14.63%
50	Telecommunication Services	3	0.37%	0	0.00%
55	Utilities	9	1.12%	0	0.00%
		802		41	

Table 5.1 : Descriptive Statistics for IPO and Endorsed firms (Cont.)

This table shows the descriptive statistics of IPO and Endorsed firms during 2009 to 2012. The distributions of listing years, industry sectors, and provinces of IPO firms are shown in Panel A, B and C respectively. Firms are regarded as endorsed if the firm achieve political endorsement within one year before its public listing. Industry sector is coded according to the GICS code of firms.

Panel C By Province		Shenzhen/Shanghai Exchange Total listed firms		Firms achieved Endorsements within 1 year before listing	
		N	%	N	%
1	Beijing	88	10.97%	11	26.83%
2	Tianjin	8	1.00%	3	7.32%
3	Hebei	14	1.75%	2	4.88%
4	Shanxi	5	0.62%	0	0.00%
5	Neimenggu	3	0.37%	0	0.00%
6	Liaoning	14	1.75%	2	4.88%
7	Jilin	7	0.87%	1	2.44%
8	Heilongjiang	5	0.62%	1	2.44%
9	Shanghai	45	5.61%	2	4.88%
10	Jiangsu	105	13.09%	2	4.88%
11	Zhejiang	104	12.97%	4	9.76%
12	Anhui	21	2.62%	1	2.44%
13	Fujian	30	3.74%	1	2.44%
14	Jiangxi	6	0.75%	0	0.00%
15	Shandong	54	6.73%	3	7.32%
16	Henan	26	3.24%	0	0.00%
17	Hubei	19	2.37%	0	0.00%
18	Hunan	25	3.12%	2	4.88%
19	Guangdong	152	18.95%	3	7.32%
20	Guangxi	4	0.50%	0	0.00%
21	Hainan	6	0.75%	0	0.00%
22	Chongqing	9	1.12%	1	2.44%
23	Sichuan	25	3.12%	1	2.44%
24	Guizhou	3	0.37%	0	0.00%
25	Yunnan	2	0.25%	0	0.00%
26	Xizang	2	0.25%	0	0.00%
27	Shannxi	8	1.00%	1	2.44%
28	Gansu	4	0.50%	0	0.00%
29	Qinghai	2	0.25%	0	0.00%
30	Ningxia	1	0.12%	0	0.00%
31	Xinjiang	5	0.62%	0	0.00%

Table 5.2 : Descriptive Statistics for IPO Application Success

This table shows the descriptive statistics for IPO application success for endorsed firms. ***Panel A*** is related to firms only submitted application once. ***Panel B*** includes firms who submitted IPO applications for multiple times.

		# of Endorsed firms	Application No.
	Panel A:Single application		
(1)	Pass after endorsement	30	1
(2)	Passed before Endorsement, but was listed publicly after endorsement.	8	1
	Panel B: Multiple applications		
(3)	Being refused before, but passed after endorsement	2	2
(4)	Applied after endorsement, and was refused consecutively	1	2
	Total	41	

Table 5.3 : Compare Endorsed and Non-endorsed Firms

This table presents the mean differences between endorsed and non-endorsed firms, showing the different characteristics between these two groups before propensity score matching.

Variables	Non-endorsed	Endorsed	Mean Difference
Lev	0.443	0.546	-0.103**
Size	19.53	20.99	-1.463***
Age	8.848	6.732	2.117**
CG	0.008	0.098	-0.089*
ROA	0.090	0.056	0.034***
RE	0.309	0.138	0.172***
StateShare	0.021	0.139	-0.118**
BoardQuality	0.336	0.348	-0.0120
Duality	0.446	0.250	0.196***
LnProceeds	11.10	12.35	-1.250***
AuditorRepu	0.027	0.122	-0.095*
UnderRepu	0.217	0.146	0.0700

Table 5.4 : PSM

This table shows the results for propensity score matching, where the dependent variable is *Endorse*, which equals one if the firms are endorsed by government within one year before public listing, and zero otherwise. I match the treatment and control groups according to a series of significant factors of IPO application, valuation and performance, including pre-IPO leverage (*Lev*), firm size (*Size*), state shares (*StateShare*), previous profitability (*ROA*), firm age (*Age*), whether the controlling shareholder is central government (*CG*), retained equity (*RE*), board quality (*BoardQuality*), duality (*Duality*), reputation of underwriters and auditors (*UnderRepu* & *AuditorRepu*), logarithm of net proceeds (*LnProceeds*), exchange effects (*Exchange*), and industry effects (*Industry*). The definitions of all variables are shown in Appendix. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	(1) Endorse	(2) Endorse
Lev	-1.650**	-1.631**
	(0.031)	(0.031)
Size	0.267*	0.226
	(0.072)	(0.117)
Age	0.005	0.007
	(0.829)	(0.749)
CG	0.847	1.059
	(0.306)	(0.145)
ROA	-9.243***	-8.688***
	(0.000)	(0.000)
RE	-0.642	-0.630
	(0.193)	(0.194)
StateShare	0.477	0.451
	(0.441)	(0.460)
BoardQuality	2.681	2.174
	(0.152)	(0.192)
Duality	-0.095	-0.106
	(0.679)	(0.639)
LnProceeds	0.653***	0.704***
	(0.002)	(0.001)
AuditorRepu	-0.736	-0.746
	(0.308)	(0.228)
UnderRepu	-0.308	-0.327
	(0.290)	(0.251)
Industry	Y	Y
Exchange	Y	Y
Constant	-14.173***	-13.506***
	(0.000)	(0.000)
N	621	621
Pseudo R^2	0.304	0.363

Table 5.5 : Impact on IPO Application

This table tests the impact of political endorsement on the success probability of IPO. The dependent variable is the probability of passing the IPO screening and go public successfully only with one application attempt, which equals one if the IPO candidates pass the screening only with one application attempt, and zero if with multiple application attempts. The main variable of interest is *EnF*, which refers to endorsement frequency and equals the number of times firms achieve political endorsement within one year before listing. The definitions of all variables are shown in Appendix. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	(1) Pro(pass)
EnF	0.459*
	(0.057)
Lev	-0.195
	(0.844)
Size	0.040
	(0.866)
Age	-0.035
	(0.199)
ROA	-3.982
	(0.283)
RE	0.218
	(0.745)
StateShare	0.896
	(0.359)
BoardQuality	3.365
	(0.139)
Duality	-0.157
	(0.576)
LnProceeds	-0.283
	(0.421)
UnderRepu	-0.407
	(0.261)
Industry	Y
Exchange	Y
Constant	3.209
	(0.476)
N	174
R^2	0.231

Table 5.6 : Impact on Valuation at IPO

This table shows the impact of political endorsement on the valuation at IPO based on the matched sample. Offer price spread and underpricing are two aspects of IPO valuation. In column (1), the dependent variable is *Spread*, which equals the range set by investment bankers within which the IPO offering price will likely reside. The dependent variables in column (2) and (3) are two different measurements of underpricing. First-day return (*FDreturn*) and first-day market-adjusted return (*FDadjreturn*). *FDreturn* is defined as the percentage difference between the first-day closing price and the offer price, and *FDadjreturn* adjusted the first-day return by market return. The main variable of interest in this table is the endorsement frequency (*EnF*), which means the number of times firms achieve political endorsement within one year before listing. The detailed definitions of all variables are shown in Appendix. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	(1)	(2)	(3)
	Spread	FDreturn	FDadjreturn
EnF	-1.960**	-0.021*	-0.021*
	(0.017)	(0.097)	(0.081)
Lev	-7.676	-0.732***	-0.567***
	(0.439)	(0.001)	(0.003)
Size	-3.023	0.130***	0.093***
	(0.133)	(0.000)	(0.002)
Age	-0.256	-0.004	-0.004
	(0.155)	(0.352)	(0.365)
CG	12.980	0.269	0.308
	(0.229)	(0.140)	(0.116)
ROA	19.042	-1.134*	-0.883
	(0.534)	(0.054)	(0.114)
RE	4.678	-0.108	-0.104
	(0.269)	(0.287)	(0.273)
StateShare	-11.205**	0.407**	0.386**
	(0.029)	(0.012)	(0.012)
BoardQuality	-16.182	-0.309	-0.367
	(0.246)	(0.298)	(0.212)
Duality	1.289	-0.008	-0.003
	(0.516)	(0.884)	(0.946)
LnProceeds	11.016***	-0.216***	-0.188***
	(0.000)	(0.000)	(0.000)
AuditorRepu	5.046	-0.100	-0.075
	(0.612)	(0.439)	(0.545)
UnderRepu	1.312	-0.066	-0.061
	(0.630)	(0.239)	(0.242)
Industry	Y	Y	Y
Exchange	Y	Y	Y
Constant	-42.449	0.825	1.258*
	(0.304)	(0.223)	(0.062)
N	228	228	228
R^2	0.550	0.227	0.214

Table 5.7 : Impact on Post-IPO Valuation – Market Performance

This table shows the impact of political endorsement on post-IPO market performance based on matched sample. Buy-and-hold return (*BHR*) and cumulative abnormal return (*CAR*) are used to measure short- and long- term market performance. *BHR* is calculated using weekly returns, starting from the first week of IPO and ending 1,2,3,4 or 5 years after listing, or ending on the delisting date, whichever is earlier. And then BHR is adjusted for the industry BHR. I exclude firms which I didn't find weekly returns after one month of listing. *CAR* is calculated as the excess return over the market return. The main variable of interest in this table is the endorsement frequency (*EnF*), which means the number of times firms achieve political endorsement within one year before listing. The detailed definitions of all variables are shown in Appendix 1. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	CAR					BHR				
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
	1Y	2Y	3Y	4Y	5Y	1Y	2Y	3Y	4Y	5Y
EnF	0.027**	0.041***	0.044***	0.066**	0.037	0.030**	0.035***	0.045**	0.239	0.191**
	(0.016)	(0.003)	(0.006)	(0.010)	(0.447)	(0.013)	(0.002)	(0.016)	(0.139)	(0.043)
Lev	0.148	0.324	0.513*	0.427	0.699	0.177	0.508	0.726	1.289	0.941
	(0.358)	(0.169)	(0.059)	(0.178)	(0.193)	(0.274)	(0.173)	(0.132)	(0.161)	(0.197)
Size	-0.029	-0.073*	-0.125**	-0.161***	-0.049	-0.033	-0.072**	-0.105**	-0.222	-0.299*
	(0.310)	(0.057)	(0.011)	(0.008)	(0.768)	(0.245)	(0.039)	(0.036)	(0.183)	(0.079)
Age	-0.001	0.004	0.011	0.012	0.007	0.000	0.005	0.013	0.035	0.029
	(0.701)	(0.456)	(0.152)	(0.199)	(0.551)	(0.974)	(0.414)	(0.182)	(0.160)	(0.313)
CG	-0.047	-0.004	-0.016	0.127	-0.123	-0.004	-0.036	0.091	0.314	0.072
	(0.694)	(0.980)	(0.960)	(0.771)	(0.781)	(0.976)	(0.827)	(0.698)	(0.728)	(0.949)
ROA	-0.034	0.187	-0.787	-0.017	0.663	0.060	0.970	-0.365	1.014	2.379
	(0.946)	(0.807)	(0.370)	(0.987)	(0.714)	(0.903)	(0.239)	(0.725)	(0.669)	(0.489)
RE	-0.060	-0.097	-0.040	-0.069	0.749	-0.023	-0.040	-0.156	-0.945	-0.149
	(0.465)	(0.450)	(0.785)	(0.695)	(0.304)	(0.771)	(0.752)	(0.348)	(0.111)	(0.754)
StateShare	0.040	0.332***	0.298	0.288	0.456	0.135	0.378**	0.327	0.887	0.959
	(0.716)	(0.008)	(0.109)	(0.265)	(0.162)	(0.334)	(0.011)	(0.176)	(0.229)	(0.122)

BoardQuality	0.699***	0.593	1.197**	1.389**	-0.672	0.836***	0.542	0.747	1.007	3.212*
	(0.005)	(0.120)	(0.017)	(0.022)	(0.734)	(0.003)	(0.212)	(0.228)	(0.482)	(0.052)
Duality	-0.068*	-0.073	-0.107	-0.072	0.211	-0.063	-0.064	-0.081	0.142	-0.221
	(0.086)	(0.253)	(0.182)	(0.428)	(0.535)	(0.122)	(0.364)	(0.423)	(0.619)	(0.402)
LnProceeds	-0.041	-0.105**	-0.150**	-0.170**	-0.135	-0.009	-0.073	-0.143*	-0.388**	-0.519**
	(0.298)	(0.048)	(0.035)	(0.042)	(0.403)	(0.832)	(0.193)	(0.074)	(0.040)	(0.019)
AuditorRepu	0.012	0.082	0.195	0.278	0.152	-0.066	0.059	0.146	0.140	0.863*
	(0.914)	(0.580)	(0.261)	(0.242)	(0.773)	(0.584)	(0.656)	(0.379)	(0.824)	(0.087)
UnderRepu	0.077	0.171**	0.232**	0.205*	-0.112	0.057	0.080	0.160	0.199	0.365
	(0.181)	(0.041)	(0.013)	(0.081)	(0.726)	(0.379)	(0.356)	(0.180)	(0.439)	(0.241)
Industry	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Exchange	Y	Y	Y	Y	Y	Y	Y	Y	Y	Y
Constant	0.869	2.389***	3.771***	4.626***	2.274	0.514	1.765**	3.174***	7.392**	10.093***
	(0.161)	(0.003)	(0.000)	(0.000)	(0.609)	(0.448)	(0.022)	(0.007)	(0.022)	(0.002)
N	228	228	228	228	228	228	228	228	228	228
R^2	0.131	0.148	0.210	0.220	0.089	0.147	0.107	0.136	0.134	0.143

Table 5.8 : Impact on Post-IPO Valuation – Operating Performance

This table shows the impact of political endorsement on post-IPO operating performance based on matched sample. From Columns (1) to (3), dependent variables are change in return on asset (*ΔROA*), change in return on sales (*ΔROS*) and change in operating margin (*ΔOM*). 'Change' refers to the difference between the two-year average after IPO and the two -year average before public listing. ROA is the ratio of net income to the average of ending total assets in this and last years. ROS means the ratio of net income to total sales. OM equals the ratio of EBIT to sales. The main variable of interest in this table is the endorsement frequency (*EnF*), which means the number of times firms achieve political endorsement within one year before listing. The detailed definitions of all variables are shown in Appendix. *,**,*** denote the significance level at 10%, 5% and 1% respectively.

	(1)	(2)	(3)
	ΔROA	ΔROS	ΔOM
EnF	0.010***	0.033**	0.030*
	(0.010)	(0.046)	(0.081)
Lev	-0.097**	-0.326**	-0.293**
	(0.010)	(0.012)	(0.047)
Size	0.003	-0.033*	-0.039*
	(0.702)	(0.068)	(0.060)
Age	0.001	0.003	0.003
	(0.530)	(0.128)	(0.305)
CG	0.046*	0.173***	0.176**
	(0.068)	(0.005)	(0.031)
ROA	-0.166	-0.008	0.120
	(0.194)	(0.976)	(0.700)
RE	-0.004	-0.036	-0.061
	(0.828)	(0.478)	(0.281)
StateShare	-0.021	0.089	0.085
	(0.580)	(0.444)	(0.516)
BoardQuality	0.031	-0.120	-0.132
	(0.745)	(0.545)	(0.567)
Duality	-0.027***	-0.055**	-0.058**
	(0.008)	(0.032)	(0.039)
LnProceeds	0.011	0.033	0.043
	(0.257)	(0.235)	(0.183)
AuditorRepu	-0.025	0.168*	0.186*
	(0.470)	(0.086)	(0.098)
UnderRepu	-0.005	0.033	0.033
	(0.800)	(0.362)	(0.413)
Industry	Y	Y	Y
Exchange	Y	Y	Y
Constant	-0.142	0.253	0.248
	(0.377)	(0.469)	(0.527)
N	228	228	228
R^2	0.200	0.438	0.412

Appendix

Table A5.1 : Variable Definition

Main variable of interest	
Endorse	Dummy variable. If the firm is endorsed by government within one year before listing, equal 1, and otherwise zero.
EnF	Endorsement frequency. Equals the number of times a firm achieves political endorsement within one year before listing.
Dependent variables	
Pro(pass)	The probability of passing the IPO screening and go public successfully, which equals to one if the IPO candidates pass the screening only with one application attempt, and zero if with multiple application attempts.
Spread	Equals the range set by investment bankers within which the IPO offering price will likely reside.
FDreturn	First-day return is the percentage difference between the first-day closing price and the offer price.
FDadjreturn	First-day market-adjusted return is defined as the percentage difference between the first-day closing price and the offer price, and then adjusted by market return.
BHR	Buy-and-hold return. BHR is calculated using weekly returns, starting from the first week of IPO and ending 1,2,3,4 or 5 years after the listing, or ending on the delisting date, whichever is earlier. And then BHR is adjusted for market BHR to calculate BHR. I exclude firms which I didn't find weekly returns after one month of listing.
CAR	Cumulative abnormal return, which is calculated as the excess return over the market return.
ΔROA	Change in ROA. The difference between the two-year average ROA after IPO and the two-year average before public listing. ROA is the ratio of net income to the average of ending total assets in this and last years.
ΔROS	Change in ROS. The difference between the two -year average ROS after IPO and the two-year average before public listing. ROS means the ratio of net income to total sales.
ΔOM	Change in OM. The difference between the two-year average OM after IPO and the two-year average before public listing. OM equals to the ratio of EBIT to sales.
Control variables	
Lev	Leverage one year before listing, refers to the ratio of total liability to total assets.
Size	Logarithm of total sales one year before listing
ROA	Return on asset one year before listing

Age	Years since establishment.
CG	Equals one if the controlling shareholder of the firm is central government, and zero otherwise.
RE	Retained equity, means the percentage of shares executives retain post-IPO.
StateShare	The percentage of shares held by state one year before listing.
BoardQuality	Board quality, is measured as the percentage of independent directors in board.
Duality	A dummy variable, which equals one if the CEO is also the chair of the board.
LnProceeds	Logarithm of net proceeds
UnderRepu	Underwriter reputation, equals one if the leading underwriter of the IPO candidate wins the top 5 in market shares, and zero otherwise.
AuditorRepu	Auditor reputation, equals one if the IPO firm use a "Big Four" accounting firm, including Deloitte, EY, KPMG, and PWC, and zero otherwise.
Exchange	Exchange effects, to control impact brought by the choice of listing venue.
Industry	Coded according to GICS codes.

Chapter 6 Conclusion

This thesis examines the role of the government in the market and mainly contributes to existing literature on the role of government (e.g.Frye & Shleifer, 1996; Gerschenkron, 1962; Krueger, 1974; Shleifer & Vishny, 1994) by examining two under-researched ways in which governments affect financial markets. First, through testing a sample of endorsed firms in Chapter 3, results reveal that political endorsement is positively correlated with market reactions and firm performance. Moreover, the results show that political endorsement for less-connected firms and for those perform weakly are more valuable, as these firms lack reputation and legitimacy. Because of the easier access to external funds after endorsement, the value of endorsement for firms that heavily depend on external financing are more significant. Furthermore, political endorsement has greater impact on firms located in provinces with strong institutions. The results of Chapter 3 are consistent with the development view (Arthur Lewis, 1945; Gerschenkron, 1962; Hawtrey, 1926) which supports the government's positive role in the market, and also provides supporting evidence for the helping-hand model of government (Sun & Tong, 2003). Besides complementing literature on the role of government, Chapter 3 also fills the gaps in literature on endorsement, which mainly tests endorsement in the field of marketing, such as celebrity endorsements (Farrell, Karels, Montfort, & McClatchey, 2000; Khatri, 2006), typical customer endorsements (Freiden, 1984) and expert endorsements (Fireworker & Friedman, 1977). Through testing the effects of political endorsement in the securities market, this chapter extends the literature by introducing the concept of endorsement into finance and shifting attention to a new type of endorsers – the government. Moreover, this chapter supplements literature which points out the

certification effects provided by financial organisations like venture capitals (Milanov & Shepherd, 2013) or auditors (Beatty, 1989) by investigating political endorsement, which is ignored in existing literature.

Second, this thesis studies political visits in Chapter 4 based on a sample of firms who were visited by Chinese state leaders from 2009 to 2016. The results suggest that political visit is an efficient tool the government can use to help firms enhance value, both in the form of market reactions and operating performance, contingent on various firm and institutional features. Moreover, this chapter identifies the key criteria the government uses to choose which firms to visit, and differentiates the effects of visits by government leaders with different amounts of political power, and also compares different administrations, which particularly contributes to the paper of Li, Tsang, Luo, and Ying (2016) and Schuler, Shi, Hoskisson, and Chen (2017). Furthermore, the results show that firms will change their CSR behaviour after political visits from state leaders, and these results contribute to literature on CSR by pointing out that political visit can be substituted as a source of legitimacy and demotivate firms to contribute to CSR.

Finally, this thesis employs the concept of political endorsement and political visits as examples of passive signals to extend existing signalling theory in Chapter 5. By testing the effects of political endorsement under an IPO setting, this chapter finds that passive signals are still valued by investors even under circumstances with high information asymmetry when investors carefully screen information. Their passive nature distinguishes passive signals like political endorsement and visits from other signals investigated in existing literature, which enables them to serve as a reliable cue to combat information asymmetry. The results demonstrate that passive signals can

affect every aspect of IPO, including having positive impact on the success probability of the IPO application through influencing the views of regulators, narrowing IPO offer price spread and lowering initial returns through affecting the ideas of investment bankers as well as those of institutional and individual investors. Furthermore, I find that IPO firms with passive signals witness higher cumulative abnormal return and industry-adjusted buy-and-hold return, and also outperform their counterparts in the long run. This chapter largely contributes to the literature on signalling theory, as existing literature is mainly restricted to intentional signals sent out by firms themselves, like board prestige (Certo, 2003) and firm names (Lee, 2001). Furthermore, the results show that the passive nature of signals indicates higher reliability, which complements literature on determinants of signal efficacy (e.g. BliegeBird et al., 2005; Connelly, Certo, Ireland, & Reutzel, 2010). Moreover, this chapter is also closely related to literature on entrepreneurship, as the results suggest that political endorsement is a new strategy that the government and firms can use to increase the success probability of new ventures, besides strategic alliance (Gulati, 1998) and prestigious association (Milanov & Shepherd, 2013; Pollock, Chen, Jackson, & Hambrick, 2010) discussed in existing literature. Finally, this chapter also adds value to literature on IPO by re-examining the government's role in the IPO market from the perspective of a market pusher rather than a regulator (e.g. Gao, 2010).

Besides the contributions to literature discussed above, this thesis also provides practical implications for governments and companies. First, the results from Chapters 3 to 5 provide implications for government on how to affect the market and help allocate resources more efficiently. Although some anecdotal evidence shows that political endorsement and political visits are a great honour for firms, few study

empirically investigates the real impact. The results of this thesis show that political visits and political endorsement can efficiently help both listed firms and new ventures add value both in the short and long run, which means political visits and endorsement can serve as efficient tools for the government to fulfil its helping-hand function in China. One practical implication is that the government, in future, can make full use of political endorsement and visits to guide resource allocation. For example, the government can help private firms gain more resources if they want to develop the private sector by endorsing or visiting more private enterprises. Second, considering the positive impact of political endorsement and visits on market reactions and firm performance, one implication for the companies is to strengthen the aspects that are favoured by government in order to increase the probability of endorsing and visiting, and also try to publicize the political endorsement and visits once they achieved it to maximize the positive impact. Third, the results from Chapter 5, about the impact of political endorsement on the IPO market, indicate a new method new ventures can use to increase their survival probability besides the common strategies used by new ventures to overcome the liability of newness such as strategic alliance (Gulati, 1998) and association with prestigious parties like VCs (Milanov & Shepherd, 2013).

This thesis remains a fruitful area for future research. First, due to limitation in data availability, this thesis tests political endorsement and political visit in the Chinese market. As discussed in previous chapters, political endorsement and political visits exist widely in both developed and developing countries. Therefore, generalised effects in different markets can be tested in future research. Second, Chapter 5 regards political endorsement and visits as an example of a passive signal, and future research can try to find more kinds of passive signals and compare their effects with those of

political endorsement. Third, the sample size for Chapter 5, where this thesis tests the impact of endorsement on the IPO market, is relatively small, and this thesis did not empirically test the impact of political visit on IPO market because the number of observations for firms hosting political visits before listing is too limited. Future studies can try to expand the time period and sample size to test whether the results are robust. Fourth, since Chapter 4 indicates that political visits can increase firms' resources and are positively correlated with firms' future performance, executives can be benefited through political visits. Moreover, one possible reason for the positive correlation between political visit and earnings management in section 4.9.2 is because the increased job security and privileges brought by political connection after visits decrease the accountability of managers. Therefore, examining the career development of executives in visited firms can be an interesting and meaning question for future research.

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