

POLITICAL CONNECTIONS OF NEWLY PRIVATIZED FIRMS

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ABSTRACT

We investigate the extent of political connections in newly privatized firms. Using a sample of 245 privatized firms headquartered in 27 developing and 14 developed countries over the period 1980 to 2002, we find that 87 firms have a politician or an ex-politician on their board of directors. Politically-connected firms are generally incorporated in major cities, are highly leveraged, and operate in regulated sectors. The likelihood of observing political connections in these firms is positively related to government residual ownership, and negatively related to foreign ownership. Political fractionalization and tenure, as well as judicial independence are also key explanatory variables. Finally, politically-connected firms exhibit a poor accounting performance compared to their non-connected counterparts.

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1. Introduction

Privatization programs launched in developed and developing countries over the last two decades have transformed the structure of corporate ownership around the world. A large bulk of assets, previously under government control, ownership and management, has been transferred to the private sector. However, anecdotal evidence suggests that, whether the firms are fully or partially privatized, the government often resorts to indirect means to maintain the control on these firms, particularly through political connection – i.e, appointing politicians or bureaucrats in key positions within the firms. The French privatization experience provides an interesting illustration of this phenomenon. Most privatizations, aimed to favour popular capitalism, were implemented via initial public offerings to avoid the possibility that a controlling owner (shareholder) would emerge. Simultaneously, the government was appointing loyal bureaucrats, linked to the government, as the chief executive officers of these newly privatized firms, making them the principal decisions makers there in. Furthermore, a network of cross shareholdings and cross directorships (the “noyaux durs” or hard cores) were set up between privatized manufacturing firms, banks, and insurance companies to protect these firms from possible takeover threats (Bertrand et al., 2006).

In this paper, we provide a worldwide description of political connections in newly privatized firms, a crucial aspect of postprivatization corporate governance. We focus on the particular case of newly privatized firms because, in the spirit of privatization, we would expect governments to reduce their interference in the firms' policies.¹ Indeed, the switch from government to private ownership is intended to eliminate the political objectives of state-owned firms (considered in the literature as the main reason

¹ We refer to privatized firms as *newly* privatized firms because we are running an event study analysis around the date of privatization.

for state-owned enterprises' inefficiency), and to induce a change towards profit maximization by new private owners.² If newly privatized firms do not become completely independent from government influence (i.e., state ownership/control and management are not completely relinquished), then firms will likely face conflicting objectives: political benefits of control by bureaucrats and politicians on the one hand, and private benefits of control by new private owners on the other. Hence, we expect that politically-connected privatized firms will reduce the expected benefits of the reform (i.e., change in incentives, increased monitoring of management, improved performance, etc.).

These observations raise the following questions: how pervasive are political ties in the privatization context? In which countries and in which firms are we more likely to observe political connections? How do political ties affect performance? Where do politically-connected firms stand performance-wise in comparison to their non-connected newly privatized counterparts?

To determine the presence of political connections in newly privatized firms, we examine the composition of their respective board of directors and supervisory board (when they exist) after privatization, and we trace the political background of these directors. Our results are as follows: we find that 35.51% of our sample (87 out of 245) firms are politically-connected after privatization - have a politician or an ex-politician on their boards. We show that the residual government ownership (and the presence of foreign investors) is positively (negatively) related to the likelihood of observing politically-connected boards in newly privatized firms. We also bring to light some common characteristics of politically-connected firms. For instance, they are located in major cities, are highly-leveraged firms, and operate in strategic sectors. Further, we show that political ties are related to political and judicial

² The reader can refer to recent studies on the performance of privatized firms such as Gupta (2005) for partially privatized firms in India, Boubakri et al. (2005a, b), D'Souza et al. (2005), among others for multinational studies, and to excellent reviews of the overall literature on privatization by Megginson and Netter (2001) and by Djankov and Murrell (2002) in the specific case of transition economies.

variables. For example, a government that faces higher political fractionalization, and that has been in office for only few years, is more likely to have politicians on the boards of privatized firms. In addition, political connections seem to be more prevalent in countries with a lower judicial independence. When we assess the impact of political ties on performance, we find that politically-connected firms exhibit a poor accounting performance compared to their non-connected counterparts. These results are robust to endogeneity issues, and to the use of an alternative measure for political connections that is, the percentage of members of the board of directors that are politically-connected.

Our paper contributes to the recent empirical literature on the politics of privatization. Dinç and Gupta (2007), for example, focus on the impact of political competition and patronage on privatization decisions in India. They find that the government, concerned with political goals, is reluctant to privatize firms located in regions where the ruling party faces political competition. They also show that politicians in charge of government-owned enterprises do not privatize those firms that are located in their home state. Our study complements this evidence by providing additional support for the hypothesis that privatization is indeed related to political variables.

Our paper also adds to the literature on corporate governance, and more specifically on postprivatization corporate governance. For example, using a multinational sample of 209 privatized firms, Boubakri et al. (2005a) show that the average government stake decreases substantially after privatization, and that most governments generally relinquish control over time (after a few years). Investigating whether newly privatized firms are politically-connected through their boards despite ownership divestiture by the state helps us to understand the incentive structure and objectives of the newly privatized firms.

A recent study by Fan et al. (2007) finds indeed that Chinese newly privatized firms whose CEOs are ex- or current government bureaucrats are associated with poorer accounting and stock price performance. However, as the authors themselves acknowledge it, their evidence is specific to a single

country and could depend on the country's particular conditions. Our study seeks to provide more general insights on the determinants and impact of political ties in newly privatized firms around the world by using a multinational sample of 245 firms privatized in 27 developing countries and 14 industrialized countries. In doing so, we shall be able to assess whether environmental, judicial and political variables that vary across countries have an impact on the likelihood of observing political ties in newly privatized firms.

The remainder of the paper is organized as follows: section 2 reviews the literature and develops our hypotheses. Section 3 defines and describes the phenomenon of political connection. Section 4 presents the respective samples of newly privatized and politically-connected firms. Section 5 investigates the determinants of political connection while section 6 links political connection to performance. The last section summarizes our findings and discusses some policy implications.

2. Literature and hypotheses

The economic theory of privatization advances two main arguments to explain the lack of efficiency of state-owned enterprises (SOEs).

(1) *The political view* of SOEs posits that the high political interference in the decision-making process of these firms distorts the objectives defined for managers (Shleifer and Vishny, 1994). In the words of Boycko et al. (1993, page 143) "Public enterprises are inefficient because their inefficiency serves the goals of politicians." Indeed, the goals pursued by the politically-oriented selected managers are not necessarily in line with profit or value maximization. Their objectives are rather to maximize employment and wages; promote regional development by locating production in politically desirable rather than economically attractive districts; ensure national security; provide low-prices goods and services; and

produce unnecessary goods.³ These objectives generally aim at ensuring success in elections, and a long tenure in power.

Shleifer and Vishny (1998) state that the “grabbing hand” of governments on the former SOEs must be minimized for privatization to succeed. Specifically, they argue that the design of privatization should restrict the future influence that the state exerts on privatized firms through subsidies, regulations, and minority ownership. Privatization is thus effective if it controls political discretion, or put differently, if it draws a line between politicians and firms, and drives a wedge between politicians and managers. As a result, privatization should depoliticize firms and lead to their restructuring. For this to happen, privatization must involve two changes: (1) the turnover of control from spending politicians to managers (whereby the power of bureaucracy to protect its control rights diminishes), and (2) a reduction of the government cash flow ownership that is compensated by an increase of control ownership in the hands of outside shareholders.

Under the reasonable assumption that it is difficult for incumbent managers/politicians to abandon the policies that they previously employed in SOEs, Barberis et al. (1996) argue that appointing new skilled managers and directors, more suitable to the postprivatization environment, is the easiest and the most effective way to break the old corporate governance.

In a nutshell, if privatization is defined as the transfer of ownership and control, and a switch of objectives from political/social to value maximization driven, it should also imply distancing from political influence and political objectives. Hence, the first testable hypothesis, for partially and fully privatized firms alike:

H1: Privatization is accompanied by a removal of political connections in newly privatized firms (NPFs).

³ This is particularly true for SOEs in strategic sectors. We discuss the implication of this issue on our results later in the text.

If H1 is rejected, we can conclude, as sustained by Shleifer and Vishny (1998), that governments maintain a grip on the firms through an additional control device (political connection), subjecting them to government interference and political discretion.⁴

(2) The *managerial view* of SOEs posits that the managers of these firms are not adequately monitored, hence leading to poor incentive structures and a high discretion in decision making (Vickers and Yarrow, 1988, 1991). Laffont and Tirole (1993) also sustain that SOEs are inefficient because their managers are not adequately monitored as there is no individual owner with the necessary incentives to do this. Furthermore, SOEs are not subjected to the scrutiny of stock markets which could help judge the managers' actions and thus a potential explanation for their inefficiency.

Political connections help the government and affiliated politicians to extract *political benefits* at the expense of wealth maximization for the benefit of other stakeholders in the firm. Our conjecture is echoed by arguments in Cuervo and Villalonga (2000) that the replacement of pre-privatization managers is called for in order to allow internal changes in the governance of NPFs. To the extent that these managers might have the wrong entrepreneurial skills, namely being better at dealing with politicians rather than effectively facing competitive market conditions, postprivatization performance improvements may not be achieved. Barberis et al. (1996) make a case for this conjecture. They specifically state that management skills (rather than political acceptability) become the main requirements for privatization to work. In this sense, managerial skills are a potential channel of transmission by which political connections can distort firm behavior. The example of Thai airways is insightful in this context: after its privatization in 1992, most corporate decisions were taken by the military governing the board and the management team of the company. An analyst with Wall Street

⁴ Note that political connections are considered as an indirect means of control, as opposed to direct control exerted by the government through residual ownership. Hence, political connections and government residual ownership are not necessarily substitutes to each other. We can observe political connection in both fully and partially privatized firms. We thank the referee for this note.

Finance and Securities in Bangkok states that “Thai is too much like a state enterprise” – where decisions are slowly made by people who may not fully understand how to run a commercial operation.⁵

Performance may also be negatively affected, in light of the political view arguments discussed above, because political connections do not help to materially change the objectives pursued by the firm (especially in strategic sectors that provide subsidized services). For instance, politically-connected firms will be more reluctant to initiate employee lay-offs in order to decrease operating costs, because such a decision would be politically costly.

In light of this discussion, we can draw an additional hypothesis about the impact of political connections on firm performance: if the government retains control rights, or if boards are politically-connected, privatization will not create the necessary managerial incentives to maximize the shareholders’ wealth and improve overall firm performance.⁶ Since we cannot directly test the impact of managers’ skills and discipline on the firm’s performance, as a specific channel of influence, we formulate a more general hypothesis as follows:

H2: *If NPFs are politically-connected, we expect them to perform more poorly than non-connected firms.*

⁵ The link, <http://www.asiaweek.com/asiaweek/96/0830/biz1.html>, gives more details of the privatization of Thai Airways, describes the Thai environment during the mid-1990s, and shows the involvement of the military in the governance of the airline company.

⁶ Another potential argument reverses the causality: indeed, poorly performing firms may be more likely to retain or seek political connections. Since we cannot exclude this possibility, it introduces a potential endogeneity problem, which we try to tackle in our empirical analysis, later in the text. We thank the referee for bringing up this issue.

3. Political connections of privatized firms

3.1. Definition of political connections

We consider that a company is politically-connected if at least one member of its board of directors⁷ (BOD) or its supervisory board is or was a politician, that is, a member of parliament, a minister or any other top appointed-bureaucrat. We track politicians on the board of NPFs over a period of three years after the privatization date.

The definition of political connection in this paper takes into account the standard definitions used in the literature. For example, according to Faccio (2006), a firm is politically-connected if at least one of the firm's largest shareholders or one of its top officers is a member of parliament, a minister, a head of state or closely related to a top official. Fan et al. (2007) define a Chinese firm as being politically-connected if the CEO is a current or former officer of the central government, local government, or the military. Bertrand et al. (2006) consider a firm as politically-connected in France if its CEO attended elite schools ("Grandes Écoles": École Nationale d'Administration and École Polytechnique) and was employed as a civil servant or had a government position. Ferguson and Voth (2007) consider firms to be politically-connected if the executives and supervisory board members were close to the ruling party in the early 1930s in Germany. Our definition of political connection covers *current* and *former* politicians based on the argument that politicians are able to extract rents even when they are not directly in power. Recent single-country studies suggest that this is indeed the case. For example, Khwaja and Mian (2005) bring to light the role of ex-politicians in providing government bank loans to politically-connected Pakistani firms. Likewise, Agrawal and Knoeber (2001) show that politically-experienced directors (i.e., with prior employment in government or a political party) are more prevalent in U.S. manufacturing firms for which politics (through, for example, government purchases, trade policy, and environmental regulation) might

⁷ In general, the chairman of the board is also the CEO. Thus, we also include the CEO to identify the political connections.

affect their performance. Generally, the largest shareholders of privatized firms also sit on the BOD. Hence, our definition also takes into account the largest shareholders to identify cases of political connection as in Faccio (2006).

Based on this definition, we are able to identify 87 politically-connected firms out of our sample of 245 NPFs. They therefore account for 35.51% of our sample.

3.2. Examples of political connections in NPFs

This section describes the involvement of politicians in some of the NPFs from our sample. Note that these cases come from developing and industrialized countries from around the globe.

In Europe and Central Asia, specifically in France, we note that Jean-Dominique Comelli, Chairman of the BOD and CEO of “*Seita*,” a tobacco manufacturer that was privatized in 1995 by the Balladur government, was previously the chief of staff of Pierre Bérégovoy, the Prime Minister of the socialist government under François Mitterrand from 1992 to 1993. In Turkey, the Republican People's Party (CHP) owns 28% of the shares of “*Isbank*,” which was privatized in 1998. The BOD of “*Isbank*” includes four politicians from the CHP. Interestingly, a local newspaper article reports that these four bureaucrats sitting on the Isbank board of governors did nothing to prevent irregularly disbursed loans to an influential businessman, potentially contributing to the weak profitability of this bank.⁸

In Latin America, we find evidence of many political appointments in NPFs. In Chile, for example, high military officers dominate the BOD of the telecommunication company “*Entel*,” privatized in 1986. Jorge Cauas Lama, an ex-minister, also appears as a director. In Brazil, we find that Djalma Bastos de Moraes, the chairman of the BOD and CEO of “*CEMIG*,” an energy company privatized in 1997, was a state minister of communications a few years before.

⁸ For a description of the Isbank experience, see: <http://www.turkpulse.com/economy3.htm>.

In Africa, we note that, in Nigeria, higher bureaucrats from the Ministry of Justice are appointed directors of “*The United Nigeria Life Insurance Company PLC*,” which was privatized in 1989. Likewise, influential politicians from the All Nigeria People Party are appointed members of the BOD of “*Unipetrol*,” a leading petroleum company which was privatized in 1991.⁹

In East Asia, “*Thai Airways*,” privatized in 1992, appoints Siripong Thongyai, a commander in chief of the Royal Thai Air Force in 1993-1994, as Vice-Chairman of the BOD. Other directors are top bureaucrats in different Thai ministries.¹⁰ This appointment stems from the influence of the army in government decision-making over this period.

In the Arab world, we can cite the example of Saleh Rusheidat and Suleiman Hafez, the two successive Chairmen of the BOD of “*Arab Potash Company*” (privatized in 1997) who have acted as ministers in several Jordanian governments. The same BOD also includes a current Jordanian minister, an ex-minister, and top bureaucrats from different ministries.

These examples show that political connections of NPFs are not geographically clustered. They also bring to light the fact that, although the literature has widely documented that privatization in developing countries (DCs) has a dynamic of its own compared to the experience of industrialized countries (ICs), political connections in the context of privatization are a common feature in most countries, regardless of their level of development. The extent to which this is true and the conditions in which political ties occur in NPFs are questions that we intend to address further in the paper. We shall first, however, provide a detailed description of our sample.

⁹ See also Beck et al. (2005) for a discussion of the presence of many politicians and ex-military officials on the managing boards of newly privatized banks in Nigeria.

¹⁰ Several studies focus on political connections in Thailand. Bunkanwanicha and Wiwattanakantang (2008) examine the market valuation of political connections, following the appointment of the Thai Prime Minister Thaksin Shinawatra in 2001. Charumilind et al. (2006) study connected lending in Thailand before the financial crisis.

4. Data and descriptive statistics

4.1. The sample

We obtain the list of privatized firms from several sources such as the *World Bank* privatization database for DCs, the *Privatization Barometer* for OECD countries, and Megginson's (2003) list of privatized firms in developed and developing countries. For every privatized firm, we collect ownership structure from several data sources including annual reports, Asian, Brazilian, and Mexican Company Handbooks, the Guide to Asian Companies, and Kompass Egypt Financial Year Book. We draw financial information from the firms' financial statements, their web sites, and from databases such as *Moody's International*, *Mergent Online*, *Worldscope Disclosure*, and *Bankscope*. Using these sources, we gather financial data and ownership structure of 273 privatized firms.¹¹ For every privatized firm, we collect data on BOD members, using the sources mentioned above. For some firms, especially Scandinavian and Germanic firms, we also have the composition of the supervisory board which manages the firm with the BOD.¹² We lose 28 firms for which we cannot trace information about BOD composition. Many companies in our sample describe the experience profile of their directors in their annual reports or in their prospectus. For some companies, we compile the name of the members of the BOD and we search for their background data from other sources like *Lexis-Nexis*, *Who's Who*, *Forbes*, *Fortune*, company, government, and parliament websites, and the Internet. In addition, we crosschecked our sample of privatized firms with Faccio's (2006) list of politically-connected firms around the world.

We are finally able to collect data on boards and board members for 245 firms privatized in 14 ICs and 27 DCs, over the period 1980 to 2002. We follow the usual practice of excluding firms from the ex-

¹¹ We generally lose observations because of unavailable data on firm ownership structure in developing countries, or because companies privatized in the 1980s no longer have these data.

¹² Members of the supervisory board are elected during the annual shareholders' general meeting. The supervisory board elects the chairman/chairwoman and the members of the BOD.

communist countries for two reasons. First, the process of privatization in these countries takes place in a context of major institutional and political changes. Thus, the traditional law system in these countries is based on the Soviet law which has undergone many changes during the transition period (La Porta et al., 2000). Second, these countries have generally conducted mass privatizations which involve the distribution of vouchers to the population for free or a nominal fee.

Table 1 provides some descriptive statistics on the 245 firms used in the study. The 245 firms are located in different geographical regions as categorized by the *World Bank*. For example, 28.57% come from Africa and the Middle East, 20.41% from East and South Asia and the Pacific, 22.04% from Latin America and the Caribbean, and 28.98% from Europe and Central Asia. This geographical diversification is important because it involves countries with different development levels and legal, political, and institutional environments. As reported in Table 1, 85.71% of the privatization transactions occurred between 1990 and 2002, as compared to 14.29% in the 1980s. These figures are largely driven by recent large-scale privatizations, especially in DCs.¹³ A total of 70.20% of our privatized firms are headquartered in major cities (the two biggest cities in the country), and 29.80% are located in other cities.¹⁴ Our sample includes 74.30% of firms privatized through share issue privatizations (SIPs), while 25.70% were privatized through private sales, including privatization through auctions. Furthermore, our sample is also

¹³ In terms of percentages, the figures discussed in this text about our sample are close to those of the *World Bank* list of privatized firms. For example, the *World Bank* reports that 30.48% of the firms are from Africa and the Middle East, 17.08% from East and South Asia and the Pacific, 42.35% from Latin America, and 10.09% from Europe and Central Asia. 20.52% of the firms are from the financial sector, and 15.97% are utilities. We also note that 80% of the privatization transactions occurred in the nineties. Additionally, our sample of privatized firms from industrialized countries is largely drawn from Megginson's (2003) appendix and the *Privatization Barometer* database, which, to our knowledge, offer the most comprehensive record of privatization in these countries.

¹⁴ We consider the firm's headquarter as its location.

diversified across industries with 21.22% in the financial sector, 12.24% in the energy sector, and 10.20% in telecommunications. Taken together, these strategic sectors comprise half of our sample firms.

Insert Table 1 about here

4.2. The phenomenon of political connections

Table 2 provides descriptive statistics on the subsample of 87 NPFs that are politically-connected.¹⁵ Of the 61 firms operating in ICs, 26 are politically-connected (i.e., 42.62%), while 61 of the 184 firms operating in DCs, (i.e., 33.15%) are politically-connected. Most of the sample of politically-connected firms is located in East and South Asia and Europe. Only 12.64% of our sample of politically-connected firms is in Africa and Middle East countries. A likely explanation for this lack of political connections in NPFs from this region is that firms privatized in these countries were mostly small in size. Of the 30 firms operating in the energy sector, 18 are politically-connected (i.e., 60%). As previously noted, the presence of politicians on the BOD of such firms is most likely explained by the importance of strategic sectors and their relative impact on the country's whole economy: for instance, the presence of politicians on the boards of petroleum companies ensures a relative stabilization of the market, and a quick reaction in times of crisis. Furthermore, strategic sectors are traditionally state monopolies (especially utilities) and the transfer to private ownership requires new regulations and extensive supervision. Thus, the appointment of politicians as directors keeps the firm politically-close and may serve as a supervisory (monitoring) mechanism. Indeed, as noted by Laffont and Tirole (1993), unlike the case of unregulated firms, managers of private regulated firms must respond to two masters, the regulators and the shareholders, whose divergence of opinion could be a source of inefficiency. Additionally, strategic firms are often used as political means to guarantee employment (hence popular support), as these firms usually

¹⁵ 42 NPFs are connected through the CEO/chairman or chairman, and the 45 remaining ones are connected through directors. 25 NPFs are connected through a minister, and 62 NPFs are connected through members of parliament or bureaucrats.

hire overcapacity, and employ thousands of employees.¹⁶ In our sample, 81.61% of politically-connected firms are located in major cities where politicians are more likely to extract political support (votes), and almost one thirds of NPFs privatized through SIPs are run by politicians.

Insert Table 2 about here

Overall, these descriptive statistics suggest that politically-connected privatized firms are very common, in developed and developing countries alike, whatever the time period, although political connections seem more prevalent in strategic industries, in firms located in major cities and for SIPs. We thus do not seem to find support for hypothesis H1 that privatization is accompanied by a removal of political connections. This result echoes a remark made by Bortolotti and Siniscalco (2004, p 89) that “The sale of a majority holding is not itself a sufficient condition to avoid government interference in privatized companies”.

5. The determinants of the political connections of NPFs

5.1. Ownership structure and characteristics of politically-connected NPFs

To examine the postprivatization ownership structure of firms run by connected boards, we calculate the average ownership fraction for the three years following the privatization date for five groups of investors: the government, local institutions, foreign investors, employees, and individuals.

Table 3 reports the postprivatization ownership structure of the entire sample, the politically-connected firms, and their non-connected counterparts. The average government-retained-ownership stake (over the three years following privatization) for politically-connected firms is 45.27% compared to

¹⁶ Privatization in infrastructure industries, like energy and financial sectors, is a very sensitive issue and requires a strong political commitment by privatizing governments, particularly for those sectors that were required to provide subsidized services before privatization. For social welfare and stability issues, layoffs and significant decreases in costs are not immediately feasible and thus the depolitization of the firms’ control and decision making is less likely.

24.86% for their non-connected counterparts.¹⁷ This difference is statistically significant (at the 1% level). Thus, on average, governments retain control through significant ownership shares and political ties. In other words, government ownership divestiture is not accompanied by the elimination of political connections. In contrast, the average foreign investors' ownership stake for politically-connected firms is 9.05%, while it amounts to 19.37% for the non-connected firms. This difference is also significant at the 1% level. The firm employees are involved in the ownership structure of politically-connected NPFs at 5.14%, compared to 6.60% in non-connected NPFs. The difference in medians is statistically significant at the 5% level. As for the other two groups of investors (local institutions and individuals), the average stakes are almost identical between sub-samples, and the difference is not statistically significant. Overall, these results show that governments (foreigner investors) keep an important (small) stake in politically-connected firms, compared to their non-connected counterparts.¹⁸

Insert Table 3 about here

Table 4 compares the following characteristics of politically-connected firms and their non-connected counterparts:

Firm size: We measure firm size by the natural logarithm of total sales upon privatization and find that firms run by connected boards are larger than non-connected firms (13.07 for politically-connected

¹⁷ These numbers reflect direct state ownership. For a subsample of 81 NPFs for which we are able to collect ultimate state ownership as defined by La Porta et al. (1999), Claessens et al. (2000), and Faccio and Lang (2002), we find that the ultimate state ownership for politically-connected NPFs is 53.51% compared to 31.35% for their non-connected counterpart. This difference is statistically significant at the 1% level. The direct state ownership for the same subsample of firms is 46.04% for politically-connected NPFs and 23.73% for their non-connected counterparts. Although direct ownership understates ultimate ownership, it shows that the government-held stake in politically-connected firms is significantly larger than that held in non-connected ones, whatever the measure of ownership. Since the direct ownership sample is larger, we use direct ownership in the rest of this paper.

¹⁸ We re-examine this evidence later in the text.

firms compared to 12.39 for non-connected firms). This difference is statistically significant (at the 5% level). Our results for a cross-country sample of privatized firms confirm the findings of Agrawal and Knoeber (2001) who show that politically-experienced directors are more prevalent in large U.S. firms. For a multinational sample of publicly-traded firms, Faccio (2006) also finds that political connections are more common among larger firms.

Board size: Politically-connected firms have also larger boards than non-connected firms. The median number of directors on the BOD for politically-connected firms is 11 compared to 9 for the unconnected ones. This difference is statistically significant at the 1% level.

Leverage: The preprivatization mean (median) leverage of politically-connected firms measured by the ratio of total debt to total assets (DTA) is 52.9% (48.1%) compared to 38.4% (37.8%) for non-connected firms. The difference is statistically significant (at the 1% level).¹⁹ In the same vein, Khwaja and Mian (2005) find that private politically-connected firms in Pakistan exercise their political influence to obtain preferential access to credit from government banks.

Employment: Politically-connected firms hire more employees than non-connected ones. The mean (median) number of employees for politically-connected firms is 35,976 (9,193) compared to 9,623 (3,692) for unconnected firms. We also find that the mean (median) percentage change in employment for politically-connected firms is 11.54 (4.04) compared to 1.06 (-4.66) for their non-connected counterparts. These results are consistent with Shleifer and Vishny's (1994) arguments that politicians generally want the firms to overemploy since they derive political benefits from excess employment.

¹⁹ Privatization programs in most of our countries are secondary share offerings. Given that the proceeds of these offerings go to the government and the equity and asset bases of NPFs do not change, we could use either the pre-privatization or the post-privatization mean (median) of the DTA ratio. Table 4 reports the pre-privatization leverage ratio, also used in our regression analysis. However, we also consider the leverage of privatized firms for the three years following privatization. The results, unreported here but available from the authors, show that politically-connected firms are more leveraged than their non-connected counterparts.

Insert Table 4 about here

5.2. *The Political and judicial environment and political connections*

Because of the political goals pursued by the government, the likelihood to observe political connections should be related to political variables. Few existing studies suggest for example that the decision of privatization is politically determined (i.e., Dinc and Gupta, 2007; Jones et al., 1999).

We first consider the government tenure and use the number of years that the chief executive has been in office. Measures of this variable come from the “Database of Political Institutions,” (the *World Bank*). The privatization literature suggests that political factors affect the timing of privatization (Bortolotti and Pinotti, 2007). The appointment of politicians to the board of privatized firms can be used by the government in the initial years to limit the potential actions of the divested firm, such as layoffs and setting higher prices. This interference consolidates the government’s position. However, we can also expect the opposite relation: a government that has been in office for many years can resort to political appointments to reward friends and politicians close to the party.

We also consider the impact of political competition using government fractionalization as a proxy which represents the probability that two deputies picked at random from among the government parties will be of different parties. Measures of this variable come from the “Database of Political Institutions,” (the *World Bank*). Dinç and Gupta (2007) find that governments in India are reluctant to privatize firms located in regions where the ruling party faces more political competition from parties in opposition. We expect that even if the government privatizes firms when it faces a higher fractionalization, it will appoint friends and politically-connected directors to interfere in the firms’ decisions and to prevent drastic decisions that can lead to falls in government popularity.

Finally, we proxy for the extent of judicial independence in the country using the index of tenure of administrative court judges built by La Porta et al. (2004).²⁰ Judicial independence becomes relevant in private disputes and when the litigants (e.g., BOD members) are politically-connected. In addition, judges are both less susceptible to political pressure and less likely to have been selected by the government currently in office when they have life-long tenure (La Porta et al., 2004). Thus, we expect governments to appoint allies as BOD members because they are less likely to be pursued in case of fraud in lower judicial independence countries.

5.3. Methodology and Control variables

We perform logit regressions to identify the determinants of political connections. The dependent variable is a dummy variable that is equal to one if the BOD or the supervisory board is politically-connected and zero otherwise. The independent variables, discussed below, include the political and judicial independence variables discussed above, and control variables related to the macro-environment of the country, to the firm and to the privatization process.

5.3.1. Definition of variables

a. Environment variables

We use the following environment variables appearing in the previous literature that are likely to affect the political connection decision: economic development, bureaucracy, and corruption. As a proxy for economic development, we use the natural log of per capita GDP. We expect to have less political connections in developed countries. These countries have press freedom and transparent systems that can detect the political appointments on the board of privatized firms. In this regard, Mauro (1995) finds that economic growth and the political environment are related.

²⁰ This variable measures the tenure of the highest ranked judges ruling on administrative cases. The variable takes three possible values: 2 - if tenure is lifelong, 1 - if tenure is more than six years but not lifelong, 0 - if tenure is less than six years.

As a proxy for bureaucracy, we use the number of procedures that a start-up has to comply with in order to obtain a legal status (Djankov et al., 2002). The number of procedures in the sample ranges from 2 in Australia to 17 in Colombia. A large number of start-up procedures will constitute a barrier to entry and will protect existing firms against competition. Many privatized firms are either monopolistic or quasi-monopolistic firms, and appreciate these barriers to entry. Political connections can help to protect a firm against competition. Thus, we expect political connections to be more prevalent in countries with higher barriers to entry.

As a proxy for corruption, we use the International Country Risk Guide (ICRG) assessment of the corruption in government. Faccio (2006) finds that connections in publicly-traded firms are particularly common in countries that are perceived as being highly corrupt. We assess this relation for our sample of privatized firms.

b. Firm-specific variables

We use the following firm-specific variables: size, sector, location, and leverage. The size is the natural logarithm of total sales at the time of privatization, and the sector is an indicator variable that takes the value of 1 if the firm is from a regulated sector (utilities, telecommunication and petroleum), and 0 otherwise. Shleifer and Vishny (1994) model the interest of politicians in controlling large and influent firms to get political benefits, like excess employment and lower prices. Thus, we expect that large, regulated firms, and those located in major cities are more likely to have politicians on their boards. For instance, Bertrand et al (2006) find that politically-connected firms are under-represented among manufacturing firms. Roberts (1990), Agrawal and Knoeber (2001), and Bertrand et al. (2006) support the strong localized effects of political connections.

Specific-country studies like Johnson and Mitton (2003) in Malaysia, Cull and Xu (2005) in China and Khwaja and Mian (2005) in Pakistan, and cross-country studies like Faccio et al. (2006), and Faccio (2007) show that private politically-connected firms have higher leverage ratios than their non-connected

counterparts. In the specific context of privatization, leverage is also a potential determinant of political connections, as politicians are more likely to be appointed in highly indebted privatized firms to keep them from defaulting. We control for this variable to assess this relation in the context of a multinational sample of privatized firms.

c. Privatization variables

We use the following three privatization variables: residual government ownership, fraction held by foreigners, and privatization method. The larger the residual stake of the government, the more likely the privatized firm is expected to be politically-connected. If the government keeps a significant stake after privatization, it will have the power to appoint friends as directors. For instance, Bertrand et al. (2006) find that politically-connected CEOs are more likely to head previously SOEs. We expect that NPFs are less likely to be politically-connected when foreign investors are involved in the ownership structure. To the extent that foreign investors closely monitor managers' actions and are more concerned with profitability than with political goals (Dyck, 2001), they are less likely to accept the political discretion of bureaucrats.

We also expect firms privatized through private sales to be less likely to be politically-connected since, as shown by Boubakri et al. (2005a), this type of privatization engenders a concentrated ownership by private investors who are more concerned with profitability than with political goals.

5.3.2. Regression results

The dependent variable is a dummy variable that is equal to one if the BOD or the supervisory board has a politically-experienced director, and zero otherwise. We regress this variable on four groups of independent variables as defined earlier, namely (1) judicial and political variables, (2) environment variables, (3) firm-specific variables, and (4) privatization variables. Table 5 defines the variables used in these regressions and their sources. We present three different specifications which allow us to separately include variables that are highly correlated (e.g. economic development and corruption, years in office

and government fractionalization). We assess multicollinearity in the retained regression models using Belsley et al.'s (1980) condition index as a criterion. We retain specifications for which the condition index is below the threshold level of thirty. Finally, the standard errors are corrected for heteroskedasticity and clustering of observations at the country level.

Insert Table 5 about here

Table 6 reports the results of the multivariate regression analysis. A striking general inference that can be made is that variables related to political and judicial variables significantly explain the presence of politicians on the boards of NPFs. For instance, in all three specifications, we observe a negative and significant association between the likelihood of political connections and the index of judicial independence. This result suggests that political appointments in NPFs are more prevalent in countries with weaker judicial independence.

A government that faces a higher fractionalization, and that has been in office for only a few years is also more likely to keep/appoint politicians on the boards of NPFs. These actions minimize frictions among veto players, and favor voting support. The findings of all the specifications confirm these conjectures with regard to government fractionalization, and to the number of years in office.

However, the macro economic and legal environments do not have a significant explanatory power when it comes to predicting such phenomenon. Contrary to Faccio's (2006) findings for publicly-traded firms, we do not find that corruption is a determinant of political connections for privatized firms.²¹ Bureaucracy is negatively but insignificantly (at the conventional levels) associated with political connection in specifications (i) and (ii).

²¹ We assess the robustness of this result by using other proxies of corruption such as the Kaufmann et al. (2006) series, or *Transparency International*. Our inferences remain unchanged with respect to corruption. We choose to report the results with the ICRG indicator of the risk of corruption since it has the longest time series, and enables us to use observations that date back to the eighties.

As for firm-specific variables, the results suggest that privatized firms located in major cities and operating in regulated sectors are more likely to be politically-connected. Indeed, these firms generally hire thousands of employees. As argued in Shleifer and Vishny (1994), politicians are reluctant to relinquish control of these firms and thus appoint “friends” on their boards to get political benefits, with rent-seeking from these firms being higher. We also find that firms with a higher leverage before privatization are more likely to be politically-connected.

With respect to privatization variables, specifications (i) and (ii) show that the residual stake of the government increases the likelihood of political connections. As can be seen from Table 6, the coefficient associated with the residual stake of the government in NPFs is positive and highly significant. In contrast, the percentage held by foreign investors in all the specifications exhibits a negative and significant coefficient.

Insert Table 6 about here

5.4. Robustness tests

We perform a number of robustness tests for the different models of the determinants of political connections. The results, unreported here for the sake of space, are available from the authors upon request.

5.4.1. An alternative definition of political connections

The results reported above could be specific to the choice of our political connection measure. Indeed, the strength of the government influence could vary with the number of politically-connected members on the BOD. We could expect/argue that the influence of a single politically-connected member could be less decisive than that of several connected directors. Thus, we consider an alternative measure of political connection that could capture this effect: the percentage of politically-connected directors. For each board, we identify politically-experienced directors, and we compute their percentage with respect to all board members. Table 7 displays the results of a tobit analysis using the percentage of

politicians on the BOD of NPFs. Overall, the results do not change. Most importantly, the coefficients associated with the government residual ownership are positive and highly significant in the specifications (i.e., (i) and (ii)). Foreign ownership also yields negative and significant coefficients.

Insert Table 7 about here

5.4.2. Panel sample

The results presented in Table 6 use cross-sectional data. In this section, we exploit the panel data on ownership during the three years following privatization (the period for which we consider our definition of political connections) to assess the robustness of our findings.²² Table 8 displays the results of a panel logit analysis using industry fixed-effects and controlling for the year dummies. We do not document major changes in our results when using panel data. Specifically, we find that state ownership and foreign ownership are respectively positively and negatively related to political connections.

Insert Table 8 about here

5.4.3. Political connections and privatization of strategic industries

Our sample of newly privatized firms includes a large number of firms from strategic industries such as financial, mining, steel, telecommunications, transportation, utilities, oil, and military-related production as in Manzetti (1994) and Megginson et al. (2004), among others. Due to their strategic nature of social-service providers, the privatization of these industries has a different dynamic. These industries, in developed and developing countries alike, are generally under state monopoly, and involve political and institutional issues that hardly concern manufacturing or competitive industries. Strategic industries compared to non strategic industries, particularly in developing countries, tend to be partially privatized, and very often remain under state control since they are considered as “crown jewels”. Additionally, foreign ownership in these industries is often limited to avoid raising the population’s opposition to the

²² We thank the referee for suggesting this test.

process. This raises the possibility of a joint determination between these two explanatory variables in the context of strategic industries.

In our sample, we find indeed that the percentage of state (foreign) ownership in strategic sectors is 37.43% (10.61%) compared to 26.63% (21.20%) in the other sectors. In the subsample of politically-connected firms, foreign investors own 7.98% on average in strategic industries compared to 9.89% on average in the other sectors. These figures suggest that foreign owners typically hold a lower participation in strategic sectors, whether the privatized firms are politically connected or not.²³

5.4.4. Alternative proxies for political and environment variables

To ensure that our results are not specific to the choice of our proxies, we employ alternative measures of government competition. We specifically use the Herfindahl index of legislature,²⁴ and total fractionalization²⁵ rather than government fractionalization (the *World Bank's* Database of Political Institutions). The results are qualitatively similar and confirm that governments that face higher fractionalization are more likely to keep/appoint politicians on the boards of NPFs.

We also use the ICRG bureaucracy assessment as a proxy of bureaucracy rather than the number of procedures for a business start-up (Djankov et al., 2002). We find in specifications (i) and (ii) that the coefficient is consistently negative and insignificant as previously documented.

Finally, we control for other measures of institutional and macro-economic environments (environment variables). For instance, introducing the level of unemployment in the country (the World

²³ In order to mitigate the fact that the two types of ownership, state and foreign, could be jointly determined, we re-estimate, in unreported results, the logit models in table 6 (specifications i and ii) of political connection likelihood in which enter separately, the state and foreign ownership. Our results continue to confirm that state (foreign) ownership is significantly positively (negatively) related to political connections. We thank the referee for raising this issue.

²⁴ The sum of the squared seat shares of all parties in the legislature.

²⁵ The probability that two deputies picked at random from the legislature will be of different parties.

Development Indicators) yields an insignificant coefficient. Other environment variables such as the ICRG assessment of a country's law and order, and the ICRG assessment of a country's level of democracy are not significant determinants of political connections either.

Overall, our results show that the political and judicial variables, as well as firm-specific and privatization characteristics, are key determinants of political connections. The institutional and macro-economic variables, however, have no explanatory power. Our results are robust to the choice of political and environment proxies, and to an alternative measure of political connection.

6. Political connections and performance

In this section, we examine the impact of the presence of politically-experienced directors on the performance of NPFs.

6.1. Performance measurement

In the context of China, Fan et al. (2007) find that newly partially privatized firms with former or current government bureaucrats as CEOs underperform non politically-connected firms. In this section, we seek to generalize their results in a sample of cross-country privatized firms that allows for heterogeneous political institutions and economic conditions. Fan et al. (2007) use changes in return on sales (ROS), sales growth, and earnings growth as proxies for accounting performance. For the sake of comparison, we use the same dependent variables as Fan et al. (2007), although we also consider two additional profitability measures in our summary statistics namely, return on assets (ROA) and return on equity (ROE). Focusing on ROS in the main analysis is more appropriate because it is based on two flow measures (net income and sales) that are less sensitive to inflation and accounting conventions, in contrast to the two other profitability ratios (ROA, ROE) that involve flow and stock measures (net income, total assets, common equity) (Megginson et al., 1994). We compute the profitability measures for a period of 7 years (3 years prior to privatization and 3 years postprivatization) or at least for a period of

5 years (2 years prior to privatization and 2 years postprivatization). We then compute the means before and after privatization for each profitability ratio.

The sales (earnings) growth variable is the growth rate of sales (earnings) from the average annual sales (earnings) of the three years prior to privatization to that of the three years that follow privatization. The privatization date is the date on which the government divests, for the first time, a certain amount of shares or capital.

We expect political connections to hinder (to be negatively related to) postprivatization performance improvements since there is no switch towards profitability maximization, or change in the incentive structure of the firms that accompany ownership divestiture by the state. Consequently, compared to non-connected counterparts who seek to maximize profits, connected firms are more likely to continue to pursue political goals which often conflict with value maximization. Thus they should exhibit a lower performance (Hypothesis H2).

6.2. Univariate results

Table 9 reports the mean and median performance changes for the entire sample of NPFs which we split into two groups of firms: firms whose BOD or supervisory board is politically-connected, and those where BOD is politically-independent. Profitability changes for politically-connected firms are significantly lower than for non-connected firms (at the 1% level for ROS, and at the 5% level for ROE and ROA). The mean (median) ROS, ROA, and ROE changes for firms run by connected BODs are respectively 1.82% (0.85%), 0.85% (0.26%), and -1.56% (1.38%) compared to 6.36% (3.57%), 2.43% (1.27%), and 4.86% (5.36%) for their non-connected counterparts. For growth measures, we find that the means and medians of sales growth and earnings growth are also higher for non-connected firms than for

their connected counterparts.²⁶ The difference is statistically significant at conventional levels only for sales growth. Overall, the results support the findings of Fan et al. (2007) for Chinese newly partially privatized firms and Faccio (2007) for a multinational sample of publicly-traded companies: politically-connected firms exhibit a lower accounting performance than do non-connected ones.

Insert Table 9 about here

6.3. Multivariate regression analysis

We next perform a multivariate regression analysis to identify the effect of political connection on firm performance. We regress changes in ROS, sales growth, and earnings growth on three groups of independent variables, namely (1) macro-economic variables, (2) corporate governance variables, and (3) control variables. Table 10 defines these variables.

We use the following independent variables related to the macro-economic environment and thus control for the country effects: the real GDP growth and the change in the size of the trade sector (the sum of imports and exports over GDP) during the privatization window (-3,-1 and +1,+3). The use of real GDP growth allows us to control for the impact of economic growth on the post-privatization performance of NPFs. The size of the trade sector is a proxy for an economy's openness to trade.

We consider the following corporate governance variables: (i) PC which measures political connections is a dummy variable that takes the value of 1 if politically-connected directors are involved in the management of the privatized firm, and 0 otherwise. As discussed earlier, the involvement of politically-connected directors in NPFs can distract these firms from profitability objectives to pursue political goals which might in turn affect their operating performance. (ii) %Gvt which is the average fraction held by the government during the window (+1,+3).

²⁶ We do not find a significant performance difference between firms that are connected through (1) a minister rather than a member of parliament or bureaucrat or (2) through a CEO/chairman or chairman of the BOD rather than a member of the BOD.

We also consider the natural logarithm of total sales upon privatization as a measure of firm size. Aussenegg and Jelic (2007) and Villalonga (2000) argue that larger firms may show more resistance to changes which can lead to less substantial post-privatization performance improvements. We also include industry dummies.

Insert Table 10 about here

Table 11 displays the results for performance changes and politically-connected boards. In accordance with our expectations, we generally find that performance is negatively related to political connections. Specifically, the changes in profitability (ROS) and sales growth are lower for politically-connected firms. These relations are statistically significant at the 10% level and 5% level, respectively, and are consistent with Shleifer and Vishny' (1998) claim that privatization is successful if it draws a line between politicians and firms. Our results are also consistent with Fan et al.'s (2007) evidence that Chinese newly partially privatized firms with politically-connected CEOs experience a poor operating performance.

One potential explanation for the lower performance of politically-connected firms might be traced back to the higher level of employment of politically-connected firms compared to that of their non-connected counterparts. Indeed, in Table 4, we found that politically-connected firms increase the median number of employees by 4.04% compared to a decrease of 4.66% for their non-connected counterparts. This evidence seems to point to the fact that connected firms may underperform because of their higher wage bills, as sustained by Bertrand et al. (2006). In addition, for a subsample of 123 firms for which we were able to calculate the change of their sales efficiency (real sales per employee) before and after privatization, we find that politically-connected firms exhibit a lower efficiency change compared to their non-connected counterparts and this difference is statistically significant at the 5 % level.

Further, the changes in profitability and sales growth are significantly (at the 1% level and 10% level, respectively) and positively related to real GDP growth. Trade openness also plays a significant role in explaining sales growth and earnings growth, suggesting that the higher competition that characterizes more open economies provides NPFs with more growth opportunities.

Insert Table 11 about here

6.4. Robustness checks

6.4.1. Endogeneity of political connections

One potential concern for this regression is that the dummy variable political connections may not be exogenous. Specifically, some unobserved determinants of firm performance may also explain political connections, leading OLS estimates to be biased and inconsistent. We address this issue by using instrumental variables estimations. We use the firm's location as an instrument of political connections. Our choice of this instrument is motivated by previous studies providing evidence on the influence of the firm's location on political connections (Agrawal and Knoeber, 2001; Bertrand et al., 2006).²⁷ In the first-stage regression, we predict, with logit regression, political connections (IPC) using the firm's location (dummy variable that is equal to one if the firm is located in the two biggest cities in the country) as well as the other independent variables. The first-stage fitted values for political connections (IPC) are then used in the second-stage OLS regressions.

Table 12 displays the results for the first- and the second-stage regressions. In the first-stage, the results show that firm's location is a good predictor of political connections. In the second-stage, and in accordance with our expectations, we generally find that performance is negatively related to the instrumented value of political connections. Specifically, the changes in profitability (ROS) and sales growth are lower for politically-connected firms. These relations are statistically significant at the 1% level and 10% level, respectively. Hence, our results suggest that politically-connected firms exhibit a poorer

²⁷ The same arguments are used by Chaney et al. (2008) when instrumenting political connections.

accounting performance compared to their non-connected peers, after taking into consideration the endogeneity issue in the political connection by using the firm's location as an instrument.

Insert Table 12 about here

6.4.2. An alternative definition of political connections

To ensure that our results are not specific to the political-connection measure chosen here, we rerun our regressions using the percentage of politically-connected members on the BOD instead of the dummy variable of political connection. Table 13 displays the results and shows that the percentage of politically-connected members of the BOD is negatively-associated with performance measures and suggests that the existence and strength of political connections are value destroying. As previously documented in Panels A and B of Tables 11 and 12, this relation is statistically significant for ROS changes and sales growth.

Insert Table 13 about here

6.4.3. Other robustness tests

We also perform other diagnostic checks for our accounting performance regressions. The results, unreported here for the sake of space, are available from the authors upon request.

In an attempt to determine whether the negative impact of PC on performance is worse when the government retains a larger stake, we interact PC with the direct ownership stake of the government and find support for our conjecture in the sales growth model. The coefficient of the interaction variable is negative for both ROS changes and earnings growth, but is not significant.

In addition to changes in ROS, we also regress changes in ROA and in ROE on our independent variables. The results show that the regression coefficient of the measure of political connection in the ROA (ROE) change model is negative and significant at the 5% (10%) level.

In summary, the regression results confirm our predictions (H2) and the univariate results, and suggest that the continued political interference inhibits firms from achieving the expected performance improvements after divestiture.

7. Conclusion and policy implications

In this paper, we investigate the extent of political connections in newly privatized firms around the world. Using a sample of 245 privatized firms headquartered in 27 developing countries and 14 industrialized countries over the period 1980 to 2002, we find that 87 firms have a politician or an ex-politician on their board of directors or supervisory board. We also show that political connection of newly privatized firms is a worldwide phenomenon, common to different sectors and privatization methods.

Next, we examine the ownership structure and the characteristics of politically-connected newly privatized firms. We find that the larger (smaller) the residual government (foreign) ownership, the more likely it is that the board is politically tied. This result holds for strategic as well as non strategic industries. Our multivariate analysis of the determinants of political connections shows that political and judicial conditions influence political appointments in newly privatized firms. For example, a government that faces higher political fractionalization and has held office for only a few years is more likely to appoint politicians on the boards of privatized firms. Furthermore, we find that political connection is more prevalent in countries with lower judicial independence. Other firm-specific variables affect the likelihood of political connection. For instance, leveraged firms, operating in regulated sectors and located in major cities are more likely to be politically-connected. Privatization characteristics such as the residual government stake and foreign ownership respectively have a positive and negative effect on the likelihood that newly privatized firms are politically-connected. Macro-economic or institutional environments do not seem to determine the likelihood of political connections. Our results are robust to

the use of an alternative measure of political connections, namely the percentage of politically-connected members on the board of directors.

Finally, we examine the impact of the political connection of board directors on the accounting performance of newly privatized firms. To do so, we consider three accounting performance measures: change in return on sales, sales growth, and earnings growth. Bearing in mind the fact that our sample characteristics may drive our results, and even though we do not provide direct evidence on the way political connections affect firm performance, we find that politically-connected privatized firms underperform their non-connected counterparts. A major implication of these results is that if governments retain control over privatized firms through political appointments, privatization is more likely to be slower in delivering its promises.

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Table 1

Description of the sample of newly privatized firms

| Distribution of privatizations | | | | | |
|--------------------------------|---------|------------|--|--------|------------|
| Year | By year | | By industry | | |
| | Number | Percentage | Industry | Number | Percentage |
| 1980 | 1 | 0.41 | Financial | 52 | 21.22 |
| 1983 | 1 | 0.41 | Utilities | 24 | 9.80 |
| 1984 | 1 | 0.41 | Telecommunication | 25 | 10.20 |
| 1985 | 4 | 1.63 | Energy | 30 | 12.24 |
| 1986 | 3 | 1.22 | Other industries | 114 | 46.53 |
| 1987 | 2 | 0.82 | Total | 245 | 100 |
| 1988 | 1 | 0.41 | By location | | |
| 1989 | 22 | 8.98 | Category | Number | Percentage |
| 1990 | 11 | 4.49 | Major cities | 172 | 70.20 |
| 1991 | 19 | 7.76 | Other cities | 73 | 29.80 |
| 1992 | 20 | 8.16 | Total | 245 | 100 |
| 1993 | 11 | 4.49 | By region * | | |
| 1994 | 16 | 6.53 | Region (countries) | Number | Percentage |
| 1995 | 19 | 7.76 | Africa and the Middle East (5) | 70 | 28.57 |
| 1996 | 29 | 11.84 | East and South Asia and the Pacific (12) | 50 | 20.41 |
| 1997 | 32 | 13.06 | Latin America and the Caribbean (9) | 54 | 22.04 |
| 1998 | 17 | 6.94 | Europe and Central Asia (15) | 71 | 28.98 |
| 1999 | 19 | 7.76 | Total (41) | 245 | 100 |
| 2000 | 10 | 4.08 | By development level | | |
| 2001 | 4 | 1.63 | Category (countries) | Number | Percentage |
| 2002 | 3 | 1.22 | Industrialized countries (14) | 61 | 24.90 |
| Total | 245 | 100 | Developing countries (27) | 184 | 75.10 |
| | | | Total (41) | 245 | 100 |
| | | | By privatization method | | |
| | | | Method | Number | Percentage |
| | | | Share issue privatization (SIP) | 159 | 74.30 |
| | | | Private sale (PS) | 55 | 25.70 |
| | | | Total | 214 | 100 |

This table provides descriptive statistics for the sample of 245 privatized firms used in this study. We report the **distribution** of privatizations in the countries included in the sample by year, industry, location, region, development level, and type of offering.

* World Bank country group classification.

Table 2

Description of the sample of politically-connected firms

| Distribution of political connections | | | | | |
|---------------------------------------|---------|------------|--|--------|------------|
| Year | By year | | By industry | | |
| | Number | Percentage | Industry | Number | Percentage |
| 1980 | 0 | 0.00 | Financial | 17 | 19.54 |
| 1983 | 1 | 1.15 | Utilities | 8 | 9.20 |
| 1984 | 0 | 0.00 | Telecommunication | 11 | 12.64 |
| 1985 | 2 | 2.30 | Energy | 18 | 20.69 |
| 1986 | 2 | 2.30 | Other industries | 33 | 37.93 |
| 1987 | 0 | 0.00 | Total | 87 | 100 |
| 1988 | 1 | 1.15 | By location | | |
| 1989 | 6 | 6.90 | Category | Number | Percentage |
| 1990 | 5 | 5.75 | Major cities | 71 | 81.61 |
| 1991 | 7 | 8.05 | Other cities | 16 | 18.39 |
| 1992 | 8 | 9.20 | Total | 87 | 100 |
| 1993 | 6 | 6.90 | By region * | | |
| 1994 | 6 | 6.90 | Region (countries) | Number | Percentage |
| 1995 | 6 | 6.90 | Africa and the Middle East (5) | 11 | 12.64 |
| 1996 | 6 | 6.90 | East and South Asia and the Pacific (12) | 28 | 32.18 |
| 1997 | 10 | 11.49 | Latin America and the Caribbean (9) | 16 | 18.39 |
| 1998 | 5 | 5.75 | Europe and Central Asia (15) | 32 | 36.78 |
| 1999 | 8 | 9.20 | Total (41) | 87 | 100 |
| 2000 | 3 | 3.45 | By development level | | |
| 2001 | 2 | 2.30 | Category (countries) | Number | Percentage |
| 2002 | 3 | 3.45 | Industrialized countries (14) | 26 | 29.89 |
| Total | 87 | 100 | Developing countries (27) | 61 | 70.11 |
| | | | Total (41) | 87 | 100 |
| | | | By privatization method | | |
| | | | Method | Number | Percentage |
| | | | Share issue privatization (SIP) | 54 | 73.97 |
| | | | Private sale (PS) | 19 | 26.03 |
| | | | Total | 73 | 100 |

This table provides descriptive statistics for the subsample of 87 politically-connected firms. We report the distribution of politically-connected firms in the sample by year, industry, location, region, development level, and type of offering.

* World Bank country group classification.

Table 3

Summary of the ownership structure for the sample of privatized firms: 1980-2002^a

| Type of investors | N | Mean (Median) Total Sample | Mean (Median) PC board | Mean (Median) NC board | T-statistics for difference in means | Z-statistics for difference in medians |
|--------------------|-----|----------------------------------|------------------------------|------------------------------|---|--|
| Government | 213 | 31.95 (30.00) | 45.27 (52.94) | 24.86 (17.60) | -5.29*** | -4.91*** |
| Local institutions | 172 | 24.65 (18.24) | 23.01 (14.25) | 25.46 (18.70) | 0.59 | 0.06 |
| Foreign investors | 195 | 15.82 (6.63) | 9.05 (3.42) | 19.37 (10.86) | 3.52*** | 2.89*** |
| Employees | 156 | 6.16 (3.30) | 5.14 (0.80) | 6.60 (4.32) | 0.80 | 2.36** |
| Individuals | 170 | 18.35 (13.06) | 16.17 (11.26) | 19.42 (13.76) | 1.12 | 0.79 |

This table presents the univariate results for the complete sample of privatized firms, for both the politically-connected (PC) boards and non-connected (NC) boards over the period 1980-2002. The measures of ownership structure are the average percentage of ownership during the three years after privatization for the government, the local institutions, the foreign investors, the employees, and the individuals. For each type of investor, it provides the average mean and median ownership percentage for the three years after privatization. Columns 6 and 7 provide the *T*-statistic for the difference in means and the Wilcoxon *Z*-statistic for the difference in medians, respectively.

^a Significance at the 1% and 5% level is noted by *** and **, respectively.

Table 4**Summary of the firm size, BOD size, leverage, number of employees, and employment change for the sample of privatized firms: 1980-2002^a**

| Variable | N | Mean (Median) Total Sample | Mean (Median) PC board | Mean (Median) NC board | T-statistics for difference in means | Z-statistics for difference in medians |
|---------------------|-----|----------------------------------|------------------------------|------------------------------|---|--|
| Firm size | 245 | 12.63 (12.72) | 13.07 (13.25) | 12.39 (12.28) | -2.14** | -2.43** |
| BOD size | 245 | 10.64 (10) | 11.74 (11) | 10.03 (9) | -2.94*** | -2.99*** |
| Leverage | 228 | 43.8 (39.9) | 52.9 (48.1) | 38.4 (37.8) | -2.89*** | -2.73*** |
| Number of employees | 159 | 18,739 (4,335) | 35,976 (9,193) | 9,623 (3,692) | -3.85*** | -2.65*** |
| Employment change | 159 | 4.69 (-2.14) | 11.54 (4.04) | 1.06 (-4.66) | -0.97 | -2.52** |

This table presents the univariate results for the sample of privatized firms, for both politically-connected (PC) boards and non-connected (NC) boards over the period 1980-2002. Firm size is the natural logarithm of total sales at the time of privatization. BOD size is measured by the number of directors on the BOD. Leverage is measured by the average total debt to assets for the three years prior to privatization. Number of employees corresponds to the average number of employees for the three years before privatization. Employment change is measured by the percentage of change in the number of employees after privatization. Columns 6 and 7 provide the *T*-statistic for the difference in means and the Wilcoxon *Z*-statistic for the difference in medians, respectively.

^a Significance at the 1% and 5% level is noted by *** and **, respectively.

Table 5**Summary of the variables**

| Variable | Definition | Sources |
|--|--|------------------------------------|
| <u>Judicial and political variables</u> | | |
| JudI | Index of judicial independence | La Porta et al. (2004) |
| GovF | The government fractionalization | Database of Political Institutions |
| Yoff | The years that the chief executive has been in office | Database of Political Institutions |
| <u>Environment variables</u> | | |
| LGDP | The natural log of GDP per capita | World Development Indicators |
| Burr | The number of bureaucratic procedures for a start-up | Djankov et al. (2002) |
| Corr | The ICRG assessment of a country's corruption | International Country Risk Guide |
| <u>Firm variables</u> | | |
| Size | The natural logarithm of total sales upon privatization. | Authors' calculations |
| Ind | Indicator variable that takes the value of 1 if the firm is from regulated sectors and 0 otherwise | Authors' calculations |
| Loc | Indicator variable that takes the value of 1 if the firm is located in major cities and 0 otherwise | Authors' calculations |
| Lev | The ratio of total debt to total assets during the window (-3,-1) | Authors' calculations |
| <u>Privatization variables</u> | | |
| %Gvt | The average fraction held by the government during the window (+1,+3) | Authors' calculations |
| %For | The average fraction held by foreign investors during the window (+1,+3) | Authors' calculations |
| SIP | Indicator variable that takes the value of 1 if the privatization occurs through SIP and 0 otherwise | Authors' calculations |

This table describes the variables used in the regression analysis to investigate the determinants of political connection.

Table 6

Political connections in newly privatized firms: logit regressions ^a

| | Judicial and political variables | | | | Environment variables | | | Firm variables | | | | Privatization variables | | | N | Pseudo R ² |
|-------|----------------------------------|---------------------|--------------------|---------------------|-----------------------|-------------------|------------------|------------------|--------------------|---------------------|--------------------|-------------------------|----------------------|------------------|-----|-----------------------|
| | Constant | JudI | GovF | Yoff | LGDP | Burr | Corr | Size | Ind | Loc | Lev | %Gvt | %For | SIP | | |
| (i) | -1.829 (0.576) | -1.074** (0.014) | 1.978** (0.022) | | 0.067 (0.754) | -0.042 (0.668) | | | 1.452** (0.028) | 1.412** (0.019) | 1.470** (0.014) | 2.632*** (0.003) | -5.212*** (0.000) | | 154 | 0.32 |
| (ii) | 0.819 (0.737) | -0.860* (0.077) | | -0.092** (0.026) | -0.139 (0.408) | -0.082 (0.329) | | | 1.494** (0.020) | 1.520*** (0.003) | 1.602** (0.012) | 2.867*** (0.000) | -3.469*** (0.007) | | 178 | 0.30 |
| (iii) | -2.241 (0.184) | -0.840** (0.012) | 2.308** (0.019) | | | | 0.054 (0.790) | 0.046 (0.729) | 1.406** (0.020) | 1.619*** (0.007) | 1.075** (0.020) | | -6.274*** (0.000) | 0.395 (0.567) | 142 | 0.28 |

This table presents the logit results of the determinants of politically-connected boards of 245 newly privatized firms over the period 1980-2002. The dependent variable is a dummy variable equal to one if the board is politically-connected. The independent variables are related to judicial, political, environment, firm, and privatization characteristics. They are described as follows: JudI is an index of judicial independence; GovF represent government fractionalization; Yoff is the years that the chief executive has been in office; LGDP is the natural log of GDP per capita; Burr is the number of bureaucratic procedures for a start-up; Corr is the ICRG assessment of a country's corruption; Size is the natural logarithm of total sales upon privatization; Ind is an indicator variable that takes the value of 1 if the firm is from regulated sectors; Loc is an indicator variable that takes the value of 1 if the firm is located in major cities; Lev is the ratio of the total debt to assets during the window (-3,-1); %Gvt is the average fraction held by the government during the window (+1,+3); %For is the average fraction held by foreign investors during the window (+1,+3); SIP is an indicator variable that takes the value of 1 if the privatization occurs through a SIP. The *p*-values, adjusted for heteroskedasticity and clustering at the country level, are reported in parentheses.

^a Significance at the 1%, 5%, and 10% level is noted by ***, **, and *, respectively.

Table 7

Political connections in newly privatized firms: tobit regressions ^a

| | Judicial and political variables | | | Environment variables | | | Firm variables | | | | Privatization variables | | | | Adj- R ² | |
|-------|----------------------------------|---------------------|---------------------|-----------------------|-------------------|-------------------|------------------|------------------|---------------------|---------------------|-------------------------|---------------------|----------------------|------------------|------------------------|------|
| | Constant | JudI | GovF | Yoff | LGDP | Burr | Corr | Size | Ind | Loc | Lev | %Gvt | %For | SIP | N | |
| (i) | -0.181 (0.525) | -0.094** (0.033) | 0.300*** (0.002) | | 0.002 (0.879) | -0.006 (0.460) | | | 0.148** (0.016) | 0.171*** (0.001) | 0.094*** (0.008) | 0.272*** (0.007) | -0.591*** (0.003) | | 154 | 0.52 |
| (ii) | 0.049 (0.832) | -0.057 (0.275) | | -0.012** (0.017) | -0.010 (0.473) | -0.011 (0.261) | | | 0.150** (0.018) | 0.188*** (0.000) | 0.075* (0.080) | 0.301*** (0.000) | -0.365** (0.031) | | 178 | 0.46 |
| (iii) | -0.391*** (0.009) | -0.069** (0.029) | 0.353*** (0.003) | | 0.007 (0.488) | | 0.014 (0.638) | 0.007 (0.488) | 0.180*** (0.002) | 0.226*** (0.000) | 0.089*** (0.001) | | -0.835*** (0.002) | 0.024 (0.749) | 142 | 0.43 |

This table presents the tobit results of the determinants of politically-connected boards of 245 newly privatized firms over the period 1980-2002. The dependent variable is the percentage of directors that are politically-connected. The independent variables are related to judicial, political, environment, firm, and privatization characteristics. They are described as follows: JudI is an index of judicial independence; GovF represent government fractionalization; Yoff is the years that the chief executive has been in office; LGDP is the natural log of GDP per capita; Burr is the number of bureaucratic procedures for a start-up; Corr is the ICRG assessment of a country's corruption; Size is the natural logarithm of total sales upon privatization; Ind is an indicator variable that takes the value of 1 if the firm is from regulated sectors; Loc is an indicator variable that takes the value of 1 if the firm is located in major cities; Lev is the ratio of the total debt to assets during the window (-3,-1); %Gvt is the average fraction held by the government during the window (+1,+3); %For is the average fraction held by foreign investors during the window (+1,+3); SIP is an indicator variable that takes the value of 1 if the privatization occurs through a SIP. The *p*-values, adjusted for heteroskedasticity and clustering at the country level, are reported in parentheses.

^a Significance at the 1%, 5%, and 10% level is noted by ***, **, and *, respectively.

Table 8

Political connections in newly privatized firms: Panel regressions ^a

| | Judicial and political variables | | | | Environment variables | | | Firm variables | | | Privatization variables | | | Year | N | R ² |
|-------|----------------------------------|----------------------|---------------------|----------------------|-----------------------|-------------------|-------------------|--------------------|---------------------|---------------------|-------------------------|----------------------|------------------|---------|-----|----------------|
| | Constant | JudI | GovF | Yoff | LGDP | Burr | Corr | Size | Loc | Lev | %Gvt | %For | SIP | Dummies | | |
| (i) | 7.419*** (0.007) | -1.924*** (0.000) | 3.570*** (0.000) | | -0.742 (0.546) | -0.142 (0.236) | | | 1.270*** (0.000) | 1.012* (0.064) | 1.674*** (0.001) | -3.982*** (0.000) | | YES | 448 | 0.34 |
| (ii) | 4.710** (0.011) | -1.146*** (0.000) | | -0.065*** (0.003) | -0.515 (0.378) | -0.100 (0.167) | | | 1.317*** (0.000) | 1.317*** (0.005) | 1.916*** (0.000) | -2.145*** (0.003) | | YES | 523 | 0.33 |
| (iii) | -2.641** (0.012) | -0.727*** (0.002) | 2.812*** (0.000) | | | | -0.115 (0.371) | 0.136** (0.049) | 1.374*** (0.000) | 0.148 (0.791) | | -4.154*** (0.000) | 0.324 (0.331) | YES | 417 | 0.32 |

This table presents results from an industry fixed effects panel logit regression of the determinants of politically-connected boards of 245 newly privatized firms over the period 1980-2002. The dependent variable is a dummy variable equal to one if the board is politically-connected over the three years following privatization. The independent variables are related to judicial, political, environment, firm, and privatization characteristics. They are described as follows: JudI is an index of judicial independence; GovF represent government fractionalization; Yoff is the years that the chief executive has been in office; LGDP is the natural log of GDP per capita; Burr is the number of bureaucratic procedures for a start-up; Corr is the ICRG assessment of a country's corruption; Size is the natural logarithm of total sales; Loc is an indicator variable that takes the value of 1 if the firm is located in major cities; Lev is the ratio of the total debt to assets; %Gvt is the fraction held by the government; %For is the fraction held by foreign investors; SIP is an indicator variable that takes the value of 1 if the privatization occurs through a SIP. The *p*-values, adjusted for heteroskedasticity, are reported in parentheses.

^a Significance at the 1%, 5%, and 10% level is noted by ***, **, and *, respectively.

Table 9
Summary of performance results for the sample of privatized firms: 1980-2002^a

| Variable | N | Mean change (Median change) Total sample | Mean change (Median change) PC Board | Mean change (Median change) NC Board | T-statistics for difference in mean changes | Z-statistics for difference in median changes |
|------------------------|-----|--|--|--|---|---|
| Return on sales (ROS) | 233 | 4.76 (2.26) | 1.82 (0.85) | 6.36 (3.57) | 2.51*** | 2.89*** |
| Return on assets (ROA) | 233 | 1.87 (1.05) | 0.85 (0.26) | 2.43 (1.27) | 1.97** | 2.58*** |
| Return on equity (ROE) | 233 | 2.57 (3.60) | -1.56 (1.38) | 4.86 (5.36) | 1.91** | 2.28** |
| Sales growth | 236 | 109.3 (61.5) | 58.8 (55.2) | 137.2 (71.8) | 2.68*** | 1.83* |
| Earnings growth | 233 | 132.1 (73.3) | 128.2 (51.4) | 134.1 (92.3) | 0.10 | 0.37 |

This table presents the univariate results for the complete sample of privatized firms, for both the politically-connected (PC) boards and non-connected (NC) boards over the period 1980-2002. The measures of operating performance are return on sales (ROS), return on assets (ROA), return on equity (ROE), sales growth, and earnings growth. The mean and the median change in percentage for the three-year period before and after privatization are provided for ROS, ROA, and ROE. The sales (earnings) growth is the growth rate of sales (earnings) from the average annual sales (earnings) of the three years before the privatization year to that of the three years after the privatization year. Columns 6 and 7 provide the *T*-statistic for the difference in means and the Wilcoxon *Z*-statistic for the difference in medians, respectively.

^a Significance at the 1%, 5%, and 10% level is noted by ***, **, and *, respectively.

Table 10**Summary of the variables**

| Variable | Definition | Sources |
|--|--|------------------------------|
| <u>Operating performance</u> | | |
| DROS | Change in return on sales during the privatization window (-3,-1 versus +1, +3) | Authors' calculations |
| Sales growth | Sales growth is the growth rate of sales from the average annual sales of the three years before the privatization year to that of the three years after the privatization year | Authors' calculations |
| Earnings growth | Earnings growth is the growth rate of earnings from the average annual earnings of the three years before the privatization year to that of the three years after the privatization year | Authors' calculations |
| <u>Macro-economic environment</u> | | |
| Δ GDP | Percentage growth in real GDP over the privatization window (-3,-1 versus +1, +3) | World Development Indicators |
| Δ Trade | Change of the sum of exports and imports over GDP during the privatization window (-3,-1 versus +1, +3) | World Development Indicators |
| <u>Corporate governance</u> | | |
| PC | Indicator variable that takes the value of 1 if the firm is politically-connected and 0 otherwise | Authors' calculations |
| %Gvt | The average fraction held by the government during the window (+1,+3) | Authors' calculations |
| <u>Control variables</u> | | |
| Size | The natural logarithm of total sales upon privatization | Authors' calculations |
| Industry dummies | Dummy variables for each industry | Authors' calculations |

This table describes the variables used in the regression analysis of the link between the post-privatization performance changes and political connections.

Table 11

Performance changes of newly privatized firms and politically-connected boards ^a

| Constant | Macro-economic environment | | Corporate governance | | Control | | Adj-R ² | N |
|--------------------------------------|----------------------------|----------|----------------------|---------|---------|------------------|--------------------|-----|
| | ΔGDP | ΔTrade | PC | %Gvt | Size | Industry dummies | | |
| ----- Panel A. DROS ----- | | | | | | | | |
| 0.232*** | 0.005*** | -0.060 | -0.032* | 0.004 | 0.010** | YES | 0.14 | 218 |
| (0.002) | (0.001) | (0.149) | (0.096) | (0.782) | (0.020) | | | |
| ----- Panel B. Sales growth ----- | | | | | | | | |
| 0.596 | 0.041* | 1.506** | -0.709** | -0.146 | -0.075 | YES | 0.14 | 221 |
| (0.595) | (0.057) | (0.021) | (0.017) | (0.494) | (0.265) | | | |
| ----- Panel C. Earnings growth ----- | | | | | | | | |
| 2.346 | 0.086 | 4.973*** | 0.020 | 0.643 | 0.136 | YES | 0.13 | 218 |
| (0.297) | (0.370) | (0.000) | (0.973) | (0.123) | (0.323) | | | |

This table presents the results from regressions conducted to determine the sources of performance changes of privatized firms over the period 1980-2002. The dependent variables in the three panels are change in return on sales (DROS), sales growth and earnings growth, respectively. The change in ROS is computed by subtracting the three-year- pre-privatization average from the three-year-post-privatization average. The sales (earnings) growth is the growth rate of sales (earnings) from the average annual sales (earnings) of the three years before the privatization year to that of the three years after the privatization year. The independent variables are related to the macro-economic environment and corporate governance. They are described as follows: ΔGDP is the real GDP growth during the privatization window (-3,-1 and +1,+3); ΔTrade is the change in the sum of exports and imports over GDP during the privatization window (-3,-1 and +1,+3); PC is an indicator variable that takes the value of 1 if the firm is politically-connected; %Gvt is the average fraction held by the government during the window (+1,+3); Control variables include Size and industry dummies: Size is the natural logarithm of total sales upon privatization. The *p*-values, adjusted for heteroskedasticity and clustering at the country level, are reported in parentheses.

^a Significance at the 1%, 5%, and 10% level is noted by ***, **, and *, respectively.

Table 12

Performance changes of newly privatized firms and politically-connected boards^a

| Constant | Macro-economic environment | | Corporate governance | | | Control | | Adj-R ² | N |
|---------------------------------|----------------------------|----------|----------------------|-----------|----------|----------|------------------|--------------------|-----|
| | ΔGDP | ΔTrade | Location | IPC | %Gvt | Size | Industry dummies | | |
| First-Stage | | | | | | | | | |
| -3.911* | -0.014 | 0.607 | 0.917** | | -0.538** | 0.177** | Yes | 0.10 | 230 |
| (0.069) | (0.532) | (0.549) | (0.024) | | (0.043) | (0.047) | | | |
| Second-Stage | | | | | | | | | |
| Panel A. DROS | | | | | | | | | |
| -0.321** | 0.020*** | 0.127 | | -0.652*** | -0.048 | 0.032*** | Yes | 0.27 | 218 |
| (0.030) | (0.000) | (0.128) | | (0.003) | (0.211) | (0.009) | | | |
| Panel B. Sales growth | | | | | | | | | |
| -0.046 | 0.033 | 1.881*** | | -3.360* | -0.501 | 0.034 | Yes | 0.10 | 221 |
| (0.969) | (0.136) | (0.008) | | (0.057) | (0.112) | (0.728) | | | |
| Panel C. Earnings growth | | | | | | | | | |
| 2.596 | 0.084 | 5.099*** | | 0.939 | 0.770 | 0.095 | Yes | 0.13 | 218 |
| (0.286) | (0.378) | (0.000) | | (0.787) | (0.221) | (0.640) | | | |

This table presents the results from regressions conducted to determine the sources of performance changes of privatized firms over the period 1980-2002. The dependent variables in the first stage is the dummy variable PC and in the three panels are change in return on sales (DROS), sales growth, and earnings growth, respectively. PC is indicator variable that takes the value of 1 if the firm is politically-connected and 0 otherwise. The change in ROS is computed by subtracting the three-year- pre-privatization average from the three-year-post-privatization average. The sales (earnings) growth is the growth rate of sales (earnings) from the average annual sales (earnings) of the three years before the privatization year to that of the three years after the privatization year. The independent variables are related to the macro-economic environment and corporate governance. They are described as follows: ΔGDP is the real GDP growth during the privatization window (-3,-1 and +1,+3); ΔTrade is the change in the sum of exports and imports over GDP during the privatization window (-3,-1 and +1,+3); Location is an indicator variable that takes the value of 1 if the firm is located in major cities and 0 otherwise. IPC is the predicted value of PC estimated in the first stage; %Gvt is the average fraction held by the government during the window (+1,+3); Control variables include Size and industry dummies: Size is the natural logarithm of total sales upon privatization. The *p*-values, adjusted for heteroskedasticity and clustering at the country level, are reported in parentheses.

^a Significance at the 1%, 5%, and 10% level is noted by ***, **, and *, respectively.

Table 13

Performance changes of newly privatized firms and the percentage of politically-connected members on the board ^a

| Constant | Macro-economic environment | | Corporate governance | | Control | | Adj-R ² | N |
|---------------------------------|----------------------------|----------------|----------------------|----------|---------|------------------|--------------------|-----|
| | Δ GDP | Δ Trade | %PCD | %Gvt | Size | Industry dummies | | |
| Panel A. DROS | | | | | | | | |
| 0.240*** | 0.005*** | -0.063 | -0.073* | 0.004 | -0.011 | YES | 0.13 | 218 |
| (0.008) | (0.000) | (0.121) | (0.079) | (0.791) | (0.135) | | | |
| Panel B. Sales growth | | | | | | | | |
| 0.313 | 0.025** | 1.576*** | -3.012** | -0.276 | -0.056 | YES | 0.10 | 221 |
| (0.841) | (0.013) | (0.004) | (0.011) | (0.401) | (0.630) | | | |
| Panel C. Earnings growth | | | | | | | | |
| 1.291 | 0.021 | 2.230*** | 1.124 | -1.208** | -0.065 | YES | 0.12 | 218 |
| (0.500) | (0.855) | (0.002) | (0.503) | (0.029) | (0.686) | | | |

This table presents the results from regressions conducted to determine the sources of performance changes of privatized firms over the period 1980-2002. The dependent variables in the three panels are change in return on sales (DROS), sales growth and earnings growth, respectively. The change in ROS is computed by subtracting the three-year- pre-privatization average from the three-year-post-privatization average. The sales (earnings) growth is the growth rate of sales (earnings) from the average annual sales (earnings) of the three years before the privatization year to that of the three years after the privatization year. The independent variables are related to the macro-economic environment and corporate governance. They are described as follows: Δ GDP is the real GDP growth during the privatization window (-3,-1 and +1,+3); Δ Trade is the change in the sum of exports and imports over GDP during the privatization window (-3,-1 and +1,+3); %PCD is the percentage of directors that are politically-connected; %Gvt is the average fraction held by the government during the window (+1,+3); Control variables include Size and industry dummies: Size is the natural logarithm of total sales upon privatization. The *p*-values, adjusted for heteroskedasticity and clustering at the country level, are reported in parentheses.

^a Significance at the 1%, 5%, and 10% level is noted by ***, **, and *, respectively.