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Communist party committee direct control and the market value of corporate cash holdings

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ABSTRACT

We study the impact of having a communist party committee (CPC) member directly involved in the management of a firm on the market value of cash. Our findings suggest that the CPC member can enhance the market value of cash only when he or she is a director of the board. When the CPC members are supervisors of a supervisory board or senior management, they have no effect.

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1. Introduction

The impact of politics on economic activities is well-documented. Previous studies generally suggest that when a firm's executives are politically connected, the firm's value increases (e.g., Faccio, 2006; Faccio et al., 2006; Fisman, 2001; Bunkanwanicha and Wiwattanakantang, 2009; Tang et al., 2016). The literature primarily examines how politics *indirectly* affects a firm's performance. For instance, government officials can help a firm to receive government subsidies, low cost bank loans, favorable decisions in lawsuits, approval of initial public offerings, family firm success, and other benefits (Firth et al., 2011; Piotroski and Zhang, 2014; Xu et al., 2015). In the extant literature, government officials did not engage in the *direct* management of a firm.

In communist countries, each state-owned firm (SOE) has a communist party committee (CPC) to promote political ideology and labor harmony. On certain occasions, members of the CPC are involved with the management of the SOE by serving as directors of the board, supervisors of the supervisory board, or as senior executives of the management team. With the exceptions of Chang and Wong (2004) and Li and Chan (2016), little is known on the impact of such CPC *direct* control on an SOE's performance.

Specifically, Chang and Wong (2004) report that a CPC control adversely affects accounting performance, but reduces the agency problem of an SOE. Li and Chan (2016) document that CPC control in terms of being a director, not supervisor or executive, can help to reduce an SOE's stock price crash risk. It is unclear how such control affects other important

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Table 1

Sample distribution. Panels A and B of this table present the sample distribution by industry and by year.

Panel A: Sample distribution by industry		
Industry	N	%
Agriculture	208	1.97
Mining	371	3.52
Manufacturing	5999	56.84
Electricity, gas, and water	694	6.58
Building and construction	274	2.60
Commerce	779	7.38
Transportation and logistics	701	6.64
Accommodation and restaurants	70	0.66
Information technology	278	2.63
Real estate	570	5.40
Leasing and commercial services	143	1.35
Environment and public facilities management	98	0.93
Culture, sports and entertainment	99	0.94
Conglomerates	270	2.56
Total	10,554	100.00
Panel B: Sample distribution by year		
Year	N	%
2004	869	8.23
2005	886	8.39
2006	836	7.92
2007	830	7.86
2008	877	8.31
2009	900	8.53
2010	907	8.59
2011	928	8.79
2012	950	9.00
2013	962	9.12
2014	925	8.76
2015	684	6.48
Total	10,554	100.00

performance attributes of an SOE. We fill this gap by studying the impact of a CPC control on the market value of corporate cash holdings.

Cash provides liquidity to a firm and is an important element in managing a firm. The trade-off theory of cash in Opler et al. (1999) suggests that holding cash can benefit a firm by providing liquidity, but also incurs opportunity costs due to low return of holding cash. Hence, in weighing the benefits and costs, we pay attention to the market value of the cash holdings. If a firm's cash contributes to a better firm performance, the market value of cash is positive and vice versa. The extant literature on cash holdings and market value of the cash holdings focuses on the western countries (such as the U.S.), the reasons behind firms holding cash, and the impact of finance factors on cash holdings (e.g., Bates et al., 2009; Dittmar et al., 2003; Dittmar and Mahrt-Smith, 2007; D' Mello et al., 2008). Few studies examine the impact of politics via a government's direct impact in a firm as directors, supervisors, or senior managers. We study the impact of a CPC control on the market value of cash holdings by using a sample of Chinese state-owned firms.

Our findings suggest that when members of a CPC are directors of the board for an SOE, the market value of cash is higher than an SOE without such CPC control. There are no such effects when members of a CPC are supervisors of supervisory board or senior managers of the SOE. We complement the findings in Chang and Wong (2004) and Li and Chan (2016) that CPC direct control is good for an SOE in the context of enhancing the market value of cash holdings.

2. Data and methods

2.1. Data

We collect stock price and CPC control information among state-owned enterprises (SOEs) from the China Stock Market and Accounting Research database. The CPC control information is for the period 2004 to 2015. Our sample comprises 10,554 firm-years.

The frequency distribution of the sample is presented in Panels A and B of Table 1. By industry, manufacturing firms make up 57% of the sample. In terms of year, the samples are evenly distributed across all years.

Table 2

Summary statistics. This table presents the summary statistics of the sample. Definitions are present in the Appendix.

Variable	N	Mean	Std. dev.	Min	Median	Max
$r_{i,t} - R_{i,t}^B$	10,554	0.004	0.796	-1.983	-0.142	7.344
ΔC_t	10,554	0.023	0.179	-3.314	0.006	11.610
PARTY	10,554	0.087	0.281	0.000	0.000	1.000
PARTY_DIR	10,554	0.066	0.248	0.000	0.000	1.000
PARTY_SUP	10,554	0.022	0.147	0.000	0.000	1.000
PARTY_MAN	10,554	0.032	0.177	0.000	0.000	1.000
ΔE_t	10,554	0.006	0.083	-1.077	0.003	1.423
ΔNA_t	10,554	0.150	0.572	-2.293	0.062	23.610
ΔI_t	10,554	0.002	0.017	-0.445	0.000	0.505
ΔD_t	10,554	0.001	0.014	-0.129	0.000	0.341
C_{t-1}	10,554	0.168	0.181	0.000	0.118	3.864
NF_t	10,554	0.031	0.191	-1.483	-0.002	5.228
L_t	10,554	0.531	0.267	0.008	0.533	8.612
CONTROLTYPE	10,554	0.716	0.451	0.000	1.000	1.000
GROUP	10,554	0.616	0.486	0.000	1.000	1.000
PM	10,554	0.394	0.517	0.000	0.000	3.000
DUAL	10,554	0.090	0.287	0.000	0.000	1.000
EXCESSPAY	8754	-0.055	0.627	-3.954	-0.058	2.904
WEDGE	10,032	1.251	0.652	1.000	1.000	13.220
BIG4	10,554	0.090	0.286	0.000	0.000	1.000
HK	10,554	0.051	0.220	0.000	0.000	1.000
HHI	10,554	0.067	0.108	0.009	0.025	0.850

2.2. Methods

We modify the model in Faulkender and Wang (2006) to conduct our examination as follows:

$$(r_{i,t} - R_{i,t}^B) = \beta_0 + \beta_1 \frac{\Delta C_{i,t}}{M_{i,t-1}} + \beta_2 \text{PARTY_DIR}_{i,t} + \beta_3 \text{PARTY_DIR}_{i,t} * \frac{\Delta C_{i,t}}{M_{i,t-1}} + \beta_4 \frac{\Delta E_{i,t}}{M_{i,t-1}} + \beta_5 \frac{\Delta NA_{i,t}}{M_{i,t-1}} + \beta_6 \frac{\Delta I_{i,t}}{M_{i,t-1}} + \beta_7 \frac{\Delta D_{i,t}}{M_{i,t-1}} + \beta_8 \frac{C_{i,t-1}}{M_{i,t-1}} + \beta_9 \frac{NF_{i,t}}{M_{i,t-1}} + \beta_{10} L_{i,t} + \beta_{11} \frac{C_{i,t-1}}{M_{i,t-1}} * \frac{\Delta C_{i,t}}{M_{i,t-1}} + \beta_{12} L_{i,t} * \frac{\Delta C_{i,t}}{M_{i,t-1}} + \varepsilon_{i,t} \quad (1)$$

where the dependent variable is the excess stock return, $(r_{i,t} - R_{i,t}^B)$, with $r_{i,t}$ the stock return for firm i during fiscal year t , and $R_{i,t}^B$ is stock i 's benchmark return in year t . We add *PARTY_DIR* (a dummy variable with a value of 1 if a member of CPC is a director) and its interaction term with $\Delta C_{i,t}/M_{i,t-1}$ in Eq. (1) to capture the impact of a CPC member serving a director on the market value of cash. The variable $\Delta C_{i,t}$ is a proxy for the change of firm i 's cash holdings during fiscal year t . To disentangle the possible impact of a CPC member in different roles in the firm, we also replace *PARTY_DIR* by *PARTY_SUP* or *PARTY_MAN* (dummy variables with a value of 1 if there is at least one CPC member as a supervisor of the supervisory board or a senior executive of the management) in Eq. (1).

Following Faulkender and Wang (2006), we use a set of control variables in Eq. (1), where the symbol Δ indicates changes in a variable from year $t-1$ to t . These control variables are a firm's profitability using earnings before interest and extraordinary items ($E_{i,t}$), changes in the firm's investment policy using total assets net of cash ($NA_{i,t}$), interest expenses ($I_{i,t}$), total dividends ($D_{i,t}$), market leverage at the end of fiscal year t ($L_{i,t}$), the firm's net financing during fiscal year t ($NF_{i,t}$), and lagged cash holdings ($C_{i,t-1}$). To prevent large firms from dominating the results, we deflate the firm-specific factors (except leverage) by the one-year lagged market value of equity ($M_{i,t-1}$). Because stock return is the spread $M_{i,t} - M_{i,t-1}$ divided by $M_{i,t-1}$, standardization enables us to interpret the estimated coefficients as the dollar change in value for a one dollar change in the corresponding independent variable.

Additionally, following Faulkender and Wang (2006), we add the interaction terms $(C_{i,t-1}/M_{i,t-1}) \times (\Delta C_{i,t}/M_{i,t-1})$ and $L_{i,t} \times (\Delta C_{i,t}/M_{i,t-1})$. We are interested in sign and magnitude of β_3 . If β_3 is positive (negative), the market value of the extra cash accrued to shareholders will be higher (lower) when a CPC member is a director, a supervisor, or a senior executive of the SOE. We provide detailed definitions of all variables in the Appendix.

3. Results and discussion

3.1. Summary statistics and base results

We report the summary statistics in Table 2. Among the samples, the mean of *PARTY* is 0.087, suggesting there are approximately 8.7% of SOEs having members of their CPCs as directors, supervisors, or senior managers. The means of *PARTY_DIR*, *PARTY_SUP*, and *PARTY_MAN* are 0.066, 0.022, and 0.032, respectively, indicating 6.6%, 2.2%, and 3.2% of the SOEs

Table 3

Communist party direct control and the value of corporate cash holdings. This table presents the results for the impact of communist party control on the market value of cash holdings. Definitions are present in the Appendix. *, **, and *** indicate significant at the 10%, 5%, or 1%, respectively.

	(1) $r_{i,t} - R_{i,t}^B$	(2) $r_{i,t} - R_{i,t}^B$	(3) $r_{i,t} - R_{i,t}^B$
ΔC_t	0.680*** (2.65)	0.693*** (2.67)	0.699*** (2.68)
<i>PARTY_DIR</i>	-0.065*** (-3.41)		
<i>PARTY_DIR</i> * ΔC_t	0.636** (1.97)		
<i>PARTY_SUP</i>		-0.098*** (-3.00)	
<i>PARTY_SUP</i> * ΔC_t		0.635 (1.33)	
<i>PARTY_MAN</i>			-0.061** (-2.17)
<i>PARTY_MAN</i> * ΔC_t			0.506 (1.04)
ΔE_t	0.785*** (6.54)	0.785*** (6.54)	0.789*** (6.54)
ΔNA_t	0.109*** (4.13)	0.106*** (4.02)	0.107*** (4.04)
ΔI_t	-0.954** (-1.96)	-0.922* (-1.90)	-0.931* (-1.91)
ΔD_t	2.242*** (3.60)	2.276*** (3.64)	2.255*** (3.62)
C_{t-1}	0.723*** (10.31)	0.727*** (10.33)	0.726*** (10.33)
NF_t	0.025 (0.42)	0.027 (0.45)	0.025 (0.43)
L_t	-0.328*** (-8.05)	-0.328*** (-8.05)	-0.329*** (-8.06)
C_{t-1} * ΔC_t	0.090 (0.60)	0.085 (0.57)	0.085 (0.57)
L_t * ΔC_t	0.680*** (2.65)	0.693*** (2.67)	0.699*** (2.68)
<i>INDUSTRY</i>	YES	YES	YES
<i>YEAR</i>	YES	YES	YES
<i>CONSTANT</i>	-0.233*** (-5.60)	-0.235*** (-5.65)	-0.236*** (-5.68)
<i>N</i>	10,554	10,554	10,554
<i>R</i> ²	0.580	0.580	0.579

have at least one member of their CPCs as a director, a supervisor, or a senior manager. Overall, the CPC members of SOEs show some involvement in running their SOEs.

We present the results for Eq. (1) in columns (1) to (3) of Table 3. Three interesting results emerge. First, the coefficients of ΔC_t are positive and significant at the 1% level in all three columns; indicating that just holding cash alone contributes to the market value of the SOE. This is consistent with the cash management literature (Faulkender and Wang, 2006). Second, the coefficients of *PARTY_DIR*, *PARTY_SUP*, and *PARTY_MAN* are all negative and significant at the 1% or 5% level; suggesting that a CPC member being involved in the direct management of the SOE hurts an SOE's stock return. This result is consistent with the findings in Chang and Wong (2004). Third, for our key focus, the interaction variables (*PARTY_DIR** ΔC_t , *PARTY_SUP** ΔC_t , and *PARTY_MAN** ΔC_t), we only find that the coefficient of *PARTY_DIR** ΔC_t is positive and significant at the 5% level in column (1). The other two interaction variables are not significant in columns (2) and (3). This is interesting in the sense that only when a CPC member serves as a director can the SOE enhance its stock return via the source of cash management. That is, a CPC member makes a positive contribution to an SOE when he or she plays a monitoring role as a director of the board. It is not useful when a CPC member serves as a supervisor or as a senior manager, which is consistent with the literature on the ineffectiveness of supervisory board in China (e.g., Ding et al., 2010) and serious agency problem among Chinese SOEs (e.g., Chang and Wong, 2004). In addition, the coefficients of control variables, if significant, carry the expected signs. For instance, the coefficients of ΔE_t , ΔNA_t , ΔD_t , C_{t-1} , and L_t * ΔC_t are consistently positive and significant at the 1% level across all three columns, showing that an SOE's change of earnings, change of total assets, change of dividends, lagged cash holdings, and the interaction between leverage and change of cash holdings all positively related to an SOE's excess stock return. In contrast, the coefficient of ΔI_t (a change of interest expense) and L_t (leverage) are negative

Table 4

Robustness Test: Alternative measures of cash holdings. This table presents the results of using alternative definitions of cash holdings. $C2$ is the cash plus marketable securities. Definitions are present in the Appendix. *, **, and *** indicate significant at the 10%, 5%, or 1%, respectively.

	(1)	(2)	(3)
	$r_{i,t} - R_{i,t}^B$	$r_{i,t} - R_{i,t}^B$	$r_{i,t} - R_{i,t}^B$
$\Delta C2_t$	0.663*** (2.63)	0.677*** (2.65)	0.683*** (2.66)
$PARTY_DIR$	-0.065*** (-3.41)		
$PARTY_DIR * \Delta C2_t$	0.657** (2.07)		
$PARTY_SUP$		-0.098*** (-2.97)	
$PARTY_SUP * \Delta C2_t$		0.652 (1.43)	
$PARTY_MAN$			-0.061** (-2.19)
$PARTY_MAN * \Delta C2_t$			0.534 (1.10)
ΔE_t	0.783*** (6.60)	0.783*** (6.61)	0.787*** (6.62)
ΔNA_t	0.120*** (4.42)	0.118*** (4.33)	0.119*** (4.35)
ΔI_t	-1.051** (-2.13)	-1.021** (-2.07)	-1.031** (-2.09)
ΔD_t	2.229*** (3.57)	2.264*** (3.62)	2.242*** (3.59)
$C2_{t-1}$	0.719*** (10.45)	0.722*** (10.47)	0.720*** (10.47)
NF_t	0.026 (0.47)	0.029 (0.51)	0.027 (0.49)
L_t	-0.326*** (-8.05)	-0.327*** (-8.05)	-0.328*** (-8.06)
$C2_{t-1} * \Delta C2_t$	0.113 (0.77)	0.110 (0.74)	0.110 (0.75)
$L_t * \Delta C2_t$	-0.650** (-1.98)	-0.656** (-1.96)	-0.664** (-1.98)
<i>INDUSTRY</i>	YES	YES	YES
<i>YEAR</i>	YES	YES	YES
<i>CONSTANT</i>	-0.238*** (-5.72)	-0.240*** (-5.76)	-0.242*** (-5.79)
<i>N</i>	10,554	10,554	10,554
<i>R</i> ²	0.580	0.580	0.580

and significant at the 1%, 5%, or 10% level. In other words, when an SOE experiences an increase in interest expense and leverage, the excess stock return drops.

3.2. Robust analysis

3.2.1. Alternative definitions of cash holdings

There is more than one way to define cash holdings. For robustness, we use cash plus marketable securities ($\Delta C2$) to define cash holdings. The results for Eq. (1) are presented in Table 4. The general findings are qualitatively similar to those in Table 3. In other words, our findings in Table 3 are robust to alternative definitions of cash holdings.

3.2.2. Endogeneity mitigation

It is possible that an SOE's excess stock return and CPC member involvement are endogenously determined. When a firm experiences poor stock performance, it leads to a higher probability of CPC direct control of the firm. To mitigate the endogeneity, we use two approaches. To conserve space, we confine to the discussions when the CPC member is a director because Tables 3 and 4 show that only when a CPC member is a director, she can contribute to a better market value of cash holdings.

The first approach is to use the Heckman two-stage analysis. In the first stage of the selection equation, we use a set of instrumental variables to predict the $PARTY_DIR$. The variables are (a) whether the firm's controlling shareholder belongs to a State-owned Assets Supervision and Administration Commission (*CONTROLTYPE*), (b) whether the SOE's largest shareholder belongs to a business group (*GROUP*), (c) whether the CEO is a member of the China Communist Party (*PM*), and (d) if the CEO and chairman of the board are the same individual (*DUAL*).

Table 5

Endogeneity mitigation: Heckman two-stage analysis. This table presents the results of using Heckman two-stage analysis. Column (1) is the selection equation while column (2) is the correction of potential endogeneity. Definitions are present in the Appendix. *, **, and *** indicate significant at the 10%, 5%, or 1%, respectively.

	(1) <i>PARTY_DIR</i>	(2) $r_{i,t} - R_{i,t}^B$
<i>CONTROLTYPE</i>	0.295*** (5.94)	
<i>GROUP</i>	-0.233*** (-5.73)	
<i>PM</i>	0.288*** (7.76)	
<i>DUAL</i>	-0.499*** (-5.58)	
C_t	-0.640 (-1.12)	0.661** (2.57)
<i>PARTY_DIR</i>		-0.062*** (-3.23)
<i>PARTY_DIR</i> * ΔC_t		0.640** (1.98)
ΔE_t	-0.013 (-0.05)	0.784*** (6.54)
ΔNA_t	-0.143* (-1.83)	0.105*** (3.98)
ΔI_t	-1.899 (-1.41)	-1.004** (-2.06)
ΔD_t	1.601 (1.02)	2.290*** (3.67)
C_{t-1}	-0.365*** (-2.66)	0.713*** (10.08)
NF_t	0.225 (1.50)	0.030 (0.52)
L_t	0.228*** (3.65)	-0.321*** (-7.75)
C_{t-1} * ΔC_t	0.116 (0.34)	0.095 (0.63)
L_t * ΔC_t	0.717 (0.86)	-0.579* (-1.65)
<i>LAMBDA</i>		0.033 (1.42)
<i>INDUSTRY</i>	YES	YES
<i>YEAR</i>	YES	YES
<i>CONSTANT</i>	-1.934*** (-11.36)	-0.306*** (-4.55)
<i>N</i>	10,554	10,554
<i>Pseudo R</i> ²	0.059	
<i>R</i> ²		0.581

The results are presented in column (1) of Table 5. We find that the coefficients of *CONTROLTYPE*, *GROUP*, *PM*, and *DUAL* are significant in explaining the probability for an SOE to appoint a CPC member as a direct of the board. In the second stage, we use the inverse Mills ratios (*LAMBDA*) generated from the selection equations in the second-step model to control for the potential sample selection bias. The results are presented in the column (2) of Table 5. The coefficient of *PARTY_DIR** ΔC_t carries the same signs and significance level as those in Table 3. Most importantly, the endogeneity indicating variable, *LAMBDA*, is not significant; suggesting endogeneity is not a big concern.

The second approach to mitigate endogeneity between excess stock return and CPC member control is a propensity score matching (PSM). We use a probit model that is the same as the selection equations of Table 5 to conduct the PSM. There are 1392 matched samples. The results in column (2) of Table 6 are qualitatively similar to those in Table 3. Overall, our findings in Table 3 are not due to endogeneity.

3.3. Moderating effect of corporate governance

To examine the moderating effect of corporate governance on the impact of CPC control on the market value of cash, we partition the samples into sub-samples based on various corporate governance criteria. The criteria are (a) ownership wedge, (b) excess compensation level of the SOE, (c) auditor quality, (d) listing in Hong Kong, and (e) product market competition.

Table 6

Endogeneity mitigation: Propensity score matching (PSM). This table presents the results of using PSM. Column (1) is the matching of firms using the probit model that is the same as the selection equations of Table 5. Column (2) shows the findings of matched samples. Definitions are present in the Appendix. *, **, and *** indicate significant at the 10%, 5%, or 1%, respectively.

	(1) <i>PARTY_DIR</i>	(2) $r_{i,t} - R_{i,t}^B$
<i>CONTROLTYPE</i>	0.295*** (5.94)	
<i>GROUP</i>	-0.233*** (-5.73)	
<i>PM</i>	0.288*** (7.76)	
<i>DUAL</i>	-0.499*** (-5.58)	
ΔC_t	-0.640 (-1.12)	1.169 (1.43)
<i>PARTY_DIR</i>		-0.053** (-2.03)
<i>PARTY_DIR</i> * ΔC_t		0.756** (2.06)
ΔE_t	-0.013 (-0.05)	0.806*** (2.94)
ΔNA_t	-0.143* (-1.83)	0.075 (0.82)
ΔI_t	-1.899 (-1.41)	-0.155 (-0.27)
ΔD_t	1.601 (1.02)	2.530* (1.92)
C_{t-1}	-0.365*** (-2.66)	1.033*** (7.58)
NF_t	0.225 (1.50)	0.088 (0.61)
L_t	0.228*** (3.65)	-0.412*** (-6.31)
C_{t-1} * ΔC_t	0.116 (0.34)	-0.625 (-0.86)
L_t * ΔC_t	0.717 (0.86)	-1.260 (-1.30)
<i>INDUSTRY</i>	YES	YES
<i>YEAR</i>	YES	YES
<i>CONSTANT</i>	-1.934*** (-11.36)	-0.208** (-2.40)
<i>N</i>	10,554	1392
<i>Pseudo R²</i>	0.059	
<i>R²</i>		0.598

Ownership wedge is the ultimate owners' control rights divided by their cash flow rights in a firm. When an ownership wedge is large, the controlling shareholder has a greater incentive to expropriate minority shareholders (e.g., Claessens et al., 2000; Lin et al., 2011). We define a (1, 0) variable, *WEDGE*, with the value of 1 for an SOE having ownership wedge above the median level. If *WEDGE* = 0, then the SOE, at the margin, has a strong corporate governance.

For excess compensation, we follow Firth et al. (2006) and Core et al. (2008) to examine the model:

$$\begin{aligned} \text{LOG}(\text{PAY}_{i,t}) = & \beta_0 + \beta_1 \text{SIZE}_{i,t} + \beta_2 \text{ROA}_{i,t} + \beta_3 \text{ROA}_{i,t-1} \\ & + \beta_4 \text{LOG}(\text{AREAWAGE}_{i,t}) + \beta_5 \text{MIDDLE}_{i,t} + \beta_6 \text{WEST}_{i,t} + \varepsilon_{i,t} \end{aligned} \quad (2)$$

where *LOG(PAY)* is the natural logarithm of total cash compensation, *PAY* is the average cash compensation of the three highest paid executives, *SIZE* is the natural logarithm of total assets, *ROA* is income before extraordinary items divided by total assets, *AREAWAGE* is the natural logarithm of wage per capita of the region in which the firm is located, and *MIDDLE* equals 1 if the SOE is in the midland of China and is zero otherwise. *WEST* equals 1 if the firm is located in the western part of China and is zero otherwise. *EXCESSPAY* is the residual from Eq. (2). When *EXCESSPAY* > 0, we consider the firm has poor corporate governance.

With reference to auditor quality, we consider that a firm has strong corporate governance if it is audited by a Big 4 international accounting firm (Gul et al., 2010, 2011). To capture the impact, we use a dummy variable, *BIG4*, that takes the value of one if the firm is audited by a Big 4 international accounting firm in China and zero otherwise, to proxy for external corporate governance.

Many Chinese firms can elect to cross-list their stocks on the Hong Kong Stock Exchange (HKSE). The monitoring of HKSE is better than that of China. Thus, firms listed in Hong Kong, on average, have better corporate governance.

Last, we consider an SOE's product market competition level. If an SOE faces a low product market competition, it is under less external constituent scrutiny. Thus, the corporate governance is weak. We construct a product market competition index (*HHI*) using the ratio of the SOE own sales to the sum of squared market shares for all firms in the same industry. If *HHI* of an SOE is above its median, the external corporate governance is weak.

Overall, we consider an SOE has a poor corporate governance when it has a high ownership wedge, having a positive excess compensation, does not have a "big 4" auditor, does not list shares in Hong Kong, or product market competition is low.

The results are presented in Panels A to E of Table 7. For brevity, we only report on the key coefficients. The findings in Table 2 show that the impact of CPC control is the strongest when members of CPCs serve as a director. Thus, we focus on the impact of *PARTY_DIR* under different corporate governance environment.

In Panel A, we find that the coefficient of $PARTY_DIR * \Delta C_t$ is positive and significant at the 5% level for a high ownership wedge sub-sample, while the same coefficient is not significant for the low ownership wedge sub-sample. For Panel B, the coefficient of $PARTY_DIR * \Delta C_t$ is positive and significant at the 5% level for the sub-sample with excess pay greater than zero. For the BIG4 auditor in Panel C, we document that only the coefficient of $PARTY_DIR * \Delta C_t$ is positive and significant at the 10% level among the SOEs not using a Big 4 auditor. In Panel D, we report the coefficient of $PARTY_DIR * \Delta C_t$ is positive only for the SOEs not cross listing in Hong Kong. Similarly, in Panel E, the coefficient of $PARTY_DIR * \Delta C_t$ is positive only for the sub-samples with low product market competition (a high *HHI*).

Therefore, consistently across all five panels, we only find the coefficient of $PARTY_DIR * \Delta C_t$ be positive and significant when the corporate governance is weak (in column (1) of Panels A and B; and in columns (2) of Panels C to E). The findings

Table 7

Internal and external governance, communist party control, and market value of cash holdings. Table 7 presents the results for SOEs with serious agency problem vs. less serious agency problems. When a SOE has a large ownership wedge (above median), excess compensation is positive ($EXCESSPAY > 0$), does not have a big four auditor ($BIG4 = 0$), does not list in Hong Kong ($HK = 0$), or product market competition is low (*HHI* above median), we consider its corporate governance is weak. For brevity, we do not report the efficient of control variables. *, **, and *** indicate significant at the 10%, 5%, or 1%, respectively.

Panel A: Ownership wedge		
	High (1) $r_{i,t} - R_{i,t}^B$	Low (2) $r_{i,t} - R_{i,t}^B$
ΔC_t	0.782* (1.78)	1.304*** (4.49)
<i>PARTY_DIR</i>	-0.005 (-0.15)	-0.082*** (-3.50)
$PARTY_DIR * \Delta C_t$	1.053** (2.35)	0.260 (0.68)
CONTROL VARIABLES	YES	YES
INDUSTRY	YES	YES
YEAR	YES	YES
CONSTANT	-0.003 (-0.01)	-0.253*** (-5.76)
N	3205	6827
R ²	0.572	0.592
Panel B: Excess compensation		
	EXCESSPAY > 0 (1) $r_{i,t} - R_{i,t}^B$	EXCESSPAY < 0 (2) $r_{i,t} - R_{i,t}^B$
ΔC_t	1.166** (2.39)	0.326 (1.28)
<i>PARTY_DIR</i>	-0.061* (-1.90)	-0.060** (-2.16)
$PARTY_DIR * \Delta C_t$	0.789** (2.06)	-0.057 (-0.15)
CONTROL VARIABLES	YES	YES
INDUSTRY	YES	YES
YEAR	YES	YES
CONSTANT	-0.491*** (-3.96)	-0.059 (-1.03)
N	4058	4696
R ²	0.595	0.613

(continued on next page)

Table 7 (continued)

Panel C: BIG4 auditor		
	BIG4 = 1 (1)	BIG4 = 0 (2)
	$r_{i,t} - R_{i,t}^B$	$r_{i,t} - R_{i,t}^B$
ΔC_t	0.421** (2.03)	1.058*** (3.34)
PARTY_DIR	-0.136** (-2.16)	-0.058*** (-2.93)
PARTY_DIR * ΔC_t	-0.243 (-0.34)	0.541* (1.67)
CONTROL VARIABLES	YES	YES
INDUSTRY	YES	YES
YEAR	YES	YES
CONSTANT	-0.298*** (-4.38)	-0.227*** (-5.34)
N	951	9603
R ²	0.596	0.585
Panel D: Hong Kong cross-listing		
	HK = 1 (1)	HK = 0 (2)
	$r_{i,t} - R_{i,t}^B$	$r_{i,t} - R_{i,t}^B$
ΔC_t	2.425** (2.52)	0.664*** (2.63)
PARTY_DIR	-0.003 (-0.04)	-0.065*** (-3.33)
PARTY_DIR * ΔC_t	-0.838 (-1.03)	0.673** (2.08)
CONTROL VARIABLES	YES	YES
INDUSTRY	YES	YES
YEAR	YES	YES
CONSTANT	-0.345*** (-3.48)	-0.228*** (-5.43)
N	536	10,018
R ²	0.608	0.582
Panel E: Product market competition		
	High (1)	Low (2)
	$r_{i,t} - R_{i,t}^B$	$r_{i,t} - R_{i,t}^B$
ΔC_t	0.402 (1.62)	0.740* (1.81)
PARTY_DIR	-0.084*** (-2.92)	-0.057** (-2.23)
PARTY_DIR * ΔC_t	0.471 (0.92)	0.716* (1.70)
CONTROL VARIABLES	YES	YES
INDUSTRY	YES	YES
YEAR	YES	YES
CONSTANT	-0.153*** (-3.66)	-0.247*** (-5.17)
N	5151	5403
R ²	0.607	0.557

in Table 7 suggests that when a CPC member serves as a director, the individual can raise the corporate governance level to make the market value of cash better when the SOE has poor corporate governance. Once an SOE has good corporate governance in place, the impact of involving a CPC member is minimal. This finding is consistent with Li and Chan (2016) in which they document that only when a CPC member is a director can she help to reduce the crash risk of an SOE.

4. Summary

We study the impact of having a CPC member directly involved in the management of an SOE on the market value of cash. Our findings suggest that the CPC member can enhance the market value of cash only when he or she is a director of the board. When the CPC members are supervisors of supervisory board or senior managers, they have no effect. We show that by being a director, the CPC member can add value to the SOE through an increase in the market value of cash. Our additional findings of stronger results observed when CPC members are directors of SOEs corroborate our base results.

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Appendix. Variable definitions

$r_{i,t} - R_{i,t}^B$	Excess stock return equals the stock returns of firm i in the year t minus its benchmark return at year t . We use the 25 Fama and French portfolios formed on size and book-to-market (B/M) as our benchmark portfolios. The portfolio return is a value-weighted return based on market capitalization within each of the 25 portfolios. For each year, we group every firm into one of 25 size and B/M portfolios based on the intersection between the size and B/M independent sorts.
C	Cash
C2	cash plus marketable securities
PARTY	Carries a value of 1 if any members of the CPC are also directors, supervisors, or senior executives, zero otherwise.
PARTY_DIR	Carries a value of 1 if any members of the CPC are also directors, zero otherwise.
PARTY_SUP	Carries a value of 1 if any members of the CPC are also supervisors, zero otherwise.
PARTY_MAN	Carries a value of 1 if any members of the CPC are also senior managers, zero otherwise.
E	Earnings before extraordinary items plus interest, deferred tax credits, and investment tax credits.
NA	Total assets minus cash holdings.
I	Interest expense.
D	The total common dividend paid by the company.
NF	The company's net financing, measured as the total equity issuance minus repurchases plus debt issuance minus debt redemption.
L	Total liabilities to total assets.
ΔX_t	X_t is compact notation for the 1-year change, $X_t - X_{t-1}$.
M	Market value, which takes the market value of the company's stock in the closing days.
CONTROLTYPE	Dummy variable that equals 1 if the firm's control shareholder belongs to a State-owned Assets Supervision and Administration Commission, zero otherwise.
GROUP	Dummy variable that equals 1 if the SOE's largest shareholder belongs to a business group, zero otherwise.
PM	Carries a value of 1 if CEO is member of the Communist Party, zero otherwise.
DUAL	Takes the value 1 if the CEO also holds the position of chair of the board, zero otherwise.
EXCESSPAY	Excess compensation, we define the residuals from estimating the following model based on Firth et al. (2006) and Core et al. (2008) as excess compensation. The model is as follows: $LOG(PAY_{i,t}) = \beta_0 + \beta_1 SIZE_{i,t} + \beta_2 ROA_{i,t} + \beta_3 ROA_{i,t-1} + \beta_4 LOG(AREAWAGE_{i,t}) + \beta_5 MIDDLE_{i,t} + \beta_6 WEST_{i,t} + \varepsilon_{i,t}$, where $LOG(PAY)$ is natural logarithm of total cash compensation, PAY is average cash compensation of the three highest paid executives, $SIZE$ is natural logarithm of total assets, ROA is income before extraordinary items divided by total assets, $AREAWAGE$ is the natural logarithm of wage per capita of the region in which the SOE is located, $MIDDLE$ equals 1 if the SOE located in the midland of China, zero otherwise. $WEST$ equals 1 if the SOE located in the west part of China, zero otherwise.
BIG4	Dummy variable that equals 1 if the SOE employs a Big Four auditor, 0 otherwise.
WEDGE	Control rights/cash flow rights.
HK	A dummy variable that equals 1 if the SOE is cross-listed in the Hong Kong stock exchange and 0 otherwise.
HHI	Product market competition, Sum of squared market shares for all firms in the same industry. The market share of a firm is the ratio of firm sales to industry sales.

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