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Political connections and stock price crash risk

The role of intermediary information disclosure

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Political connections and stock price crash risk

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Abstract

Purpose – The purpose of this paper is to research the impact of firms' political connections on the stock price crash risk.

Design/methodology/approach – Empirical methodology is used in this study.

Findings – Using a large sample of Chinese firms for the period 2008-2013, the authors find that corporate political connections can reduce the stock price crash risk. When managers are still in politics or firms are in high financial transparency of local governments, the relationship between political connections and the stock price crash risk is weakened. In addition, the authors' research shows that the corporate political connections influence the stock price crash risk by affecting the speed of confirmation of bad news.

Research limitations/implications – The findings in this study suggest that political connections will affect corporate disclosure.

Practical implications – These results can help senior executives and investors make better decisions to prevent the stock price crash risk.

Originality/value – This paper empirically analyzes the impact of different types of political connections on the stock price crash risk for the first time.

Keywords Political connections, Accounting conservatism, Fiscal transparency, The stock price crash risk

Paper type Research paper

1. Introduction

China is a typical *guanxi*-based (i.e. social networks) society. Political connections are arguably the most valuable among all the social relationships. Empirical evidence shows that firms enjoy political connections when the president or chairman of a firm is either a former or a current government official. As an important type of informal institutional arrangements, political ties are widespread in China's current transitional economic system in China[1]. Corporate behaviors shaped by political connections through senior executives are appealing to academics. In this study, we investigate the economic consequence of political connections. Specifically, we study the impact of political connections on the stock price crash risk.

Firms have incentives to appoint executives with political backgrounds as Chairman or CEO to enhance the firm's competitive advantage. Existing research shows the positive economic consequence of political connections. For example, Jou *et al.* (2017) find that political connections can help companies obtain external financing from the banks. Yu *et al.* (2012) and Li and Xie (2014) find that the political background of executives background helps strengthen the resource-seeking ability of private enterprises. Recent behavioral corporate finance literature links political connections to increased tax benefits (Wu *et al.*, 2009), more mergers and acquisitions (Li *et al.*, 2009), greater convenience in bond issuance (Du, 2011), stronger competitive advantages (Faccio, 2006), and enterprise value (Chen, Kim and Yao, 2017; Chen, Li, Luo and Zhang, 2017; Chen, Ghouli and Guedhami *et al.* 2017). Thus, Zhang and Fang (2013) argue that companies are willing to disclose information to maintain the benefits of such political connections. Most of the existing



studies focus on the impact of political connections on firm operations. To the extent that business operations are finally priced into stock prices, we investigate one important dimension of stock price – the risk of future stock price crash.

Stock price crashes and jumps negatively affect the stability of capital markets. Analytical theories show that stock price crash risk is rooted in information disclosure. If a firm's manager withholds and accumulates negative information for an extended period, the firm's share price will be severely overvalued. When the accumulated negative information reaches a tipping point, it will be suddenly released to the stock market, all at once, resulting in a stock price crash (Jin and Myers, 2006). Xu *et al.* (2014) and Kothari *et al.* (2009) find evidence consistent with the motivation of managers to hoard bad news due to maintaining the level of excess welfare or seeking a promotion. In addition, prior studies find that firms with directors' and officers' liability insurance (Yuan *et al.*, 2016), takeover protections (Bhargava *et al.*, 2016), and high social trust (Cao *et al.*, 2016; Li *et al.*, 2017) are associated with lower stock price crash risk. Focusing on the individual characteristics of corporate executives, Callen and Fang (2015) find that firms with CEOs with religious beliefs are associated with lower stock price crash risk. In our study, we investigate the impact of another dimension of the individual characteristics of corporate executives, i.e. the political connections. We answer the following questions. How does the political connections affect the stock price crash risk? What is the underlying mechanism? We believe that the answers to these questions are not only appealing to academics but are also important to capital market practitioners.

Using a large sample of Chinese-listed firms for the period 2008-2013, we provide strong and robust evidence that corporate political connections are negatively associated with firm-specific stock price crash risk. This finding is consistent with the following view: political connections help companies to ease financing constraints and reduce bad news hoarding activities. Moreover, we show that the negative relation between political connection and stock price crash risk is attenuated either when firms' senior executives remain in politics or when companies are in high financial transparency of local governments. In investigating the channels through which political connections affect stock crash risk, we found that political connections can increase the rate at which companies react to bad news, thereby curbing the stock price crash risk.

The contributions of this paper are mainly as follows: first, under the typical background of social relations in China, it is very important to study the political connections constructed by senior political background. However, the link between political connections and stock price crash risk is not yet clear. To fill this void, this paper studies mechanisms. Second, this paper considers the impact of fiscal transparency on political connections. Most domestic and foreign scholars study the political relations between enterprises. However, this type of government intervention distorts the efficiency of allocation of social public resources, such as government procurement and financial subsidies, to a certain extent, and the public can supervise the level of government public administration through the disclosure of financial information of local governments. Third, the stock price crash risk that is a recent topic attracting academic attention. The conclusion of this paper provides empirical evidence for the cause of stock price crash, that is, the stock price crash risk stems from the hiding of negative news by firms. The improved disclosure can significantly prevent stock price crash risk.

The remainder of this paper is organized as follows. Section 2 discusses the prior literature and Section 3 develops our hypotheses. We describe the research design in Section 4. We provide empirical results in Sections 5-7, and our conclusions are found in Section 8.

2. Literature review

2.1 Political connections

Under the institutional background of China, "relationship" has become the most pervasive informal institutional arrangements. Du *et al.* (2012) argue that political

relations have become the most valuable business relationship. However, Faccio (2006) shows that political connotations are totally different from the government corruption because it is legal in law. Due to the large differences in the political and economic systems in different countries, the definition of the concept of “political connection” also varies from country to country. Claessens *et al.* (2008) pointed out that the US-listed firms rely on political contributions to members of parliament. Bertrand *et al.* (2007) argue that political connections in France may result from the fact that the CEO of a company has served in the government and graduated from an elite school. Wong (2010) argues that in Hong Kong, if a company’s shareholders or directors are members of the election committee, the company is politically connected. Consistent with the prediction of Pan *et al.* (2008), Wu *et al.* (2008) show that the political affiliation of the chairman helps companies establish close political connections.

It is a relatively common phenomenon for a company to establish a connection with the government. Relevant literature shows that it is common for companies in both developed and developing countries to have political connections (Gray *et al.*, 2016). Political connections bring major financial advantages to an enterprise. Jou *et al.* (2017) show that the political connection enhances the enterprise’s credit superiority and improves the security of the financial return. Infante and Piazza (2010), in a study of Italian firms, also find that political connections can help firms obtain loans from banks at lower interest rates. Pan *et al.* (2008) argue that it is easier for private enterprises to obtain loans from banks when they establish political connections. Luo and Zhen (2008) show that political connections can help enterprises alleviate the financing constraints by investing in the sensitivity of cash flow. Consistent with the prediction of Hu (2006), Bai *et al.* (2005) also conclude the same conclusion that political connections increase corporate credit capacity.

Wu *et al.* (2008) argue that political connections, in addition to alleviating financing constraints, can help firms to obtain tax advantages, especially in provinces with a heavy tax burden. Wu *et al.* (2016) show that political connections may reduce enforcement actions against corporate fraud. Min *et al.* (2016), who take the environmental pollution charge (environmental tax) levied by China as an example, found that political affiliated enterprises pay less environmental tax. Pan *et al.* (2009) take China ST enterprises as a sample and find that enterprises with political connections are more likely to receive government subsidies after they fall into financial difficulties. In addition, the politically-associated enterprises are more likely to gain industry competitive industrial advantage (Faccio, 2006), and enterprises tend to “hide profits” against earnings management in order to avoid industry regulation (Du *et al.*, 2012). Consistent with Zhang and Fang (2013), Lin *et al.* (2015) argue that enterprises tend to strengthen information disclosure to stabilize the politically-associated revenue.

Luo *et al.* (2016) provide empirical evidence that political connections are significantly and negatively related to the stock price crash risk. More specifically, government officials political connections are significantly negatively associated with the stock price crash risk. In addition, Wei and Wang (2016), taking the 2003-2012 China IPO as an example, argue that the local government-appointed executive intensifies the stock price crash risk and that employing central government officials as executives can significantly inhibit the future stock price crash risk. However, Zhang *et al.* (2017) find that the chaotic political relationship during this period exacerbated not only the bad news hoarding behavior of managers but also the risk of stock price collapse. From this, we can see that there is no clear conclusion to be drawn about the relationship between political connections and stock price crash risk and that the existing literature analyzes the relationship between political connection and stock price crash risk without deeply analyzing the underlying mechanism of action. In this paper, we try to answer these questions.

2.2 The stock price crash risk

Jin and Myers (2006) argue that bad news hoarding is the root cause of the stock price crash risk. If a manager withholds and accumulates negative information for an extended period, the firm's share price will be severely overvalued. When the accumulated negative information reaches a tipping point, it will be suddenly released to the stock market, all at once, resulting in the stock price crash. Recent behavioral corporate finance literature reveals bad news hoarding behaviors of CEO in order to maintaining excess welfare (Xu *et al.*, 2014). Kim *et al.* (2016) find that firms with overconfident CEOs have higher a higher stock price crash risk than do firms with non-overconfident CEOs. Li and Liu (2012) argue that female executives have a stronger sense of morality and display less opportunistic behavior, which can significantly reduce the stock price crash risk. Wang *et al.* (2015) provide empirical evidence that major shareholders influence the stock price crash risk through "supervision effect." Ye *et al.* (2015) show that good internal information disclosure can significantly reduce the stock price crash risk. Pan *et al.* (2011) find that the securities analysts' participation in the market is conducive to reducing information asymmetry and suppressing the stock price crash risk. However, Xu *et al.* (2012, 2013) point out that analyst optimism bias significantly affects the stock price crash risk and that herd behavior by institutional investors raises the future stock price crash risk. In addition, Yuan *et al.* (2016) argue that the purchasing of director liability insurance can effectively suppress the stock price crash risk. Piotroski *et al.* (2015) research the stock price crash risk from the perspective the Chinese National People's Congress (NPC) and find that convening the NPC can significantly suppress the stock price crash risk. Cao *et al.* (2016) point out that social trust can restrain the stock price crash risk, which is because social trust is an alternative to other formal supervision mechanisms and can inhibit management behavior.

To sum up, the stock price crash risk stems from management's hoarding of negative news, which eventually reaches the critical threshold and is released to the market, resulting in a sustained plunge in the stock price.

3. Hypotheses development

Corporate finance has always been the mainstream area of financial research and also an important realistic problem faced by enterprises. Political connections bring natural advantages in terms of financing, and non-politically-related enterprises are more likely to be trapped in financing constraints (Luo and Zhen, 2008). Jiang (2009) find that investors as creditors are very concerned about the profitability of enterprises. They take profitability as the main basis of their judgment of to the enterprise financing cost. To protect their own interests, creditors usually add some restrictive clauses in the debt contract. Rao and Hu (2005) conduct a questionnaire survey on the use of accounting information in bank credit. They argue that bank credit personnel pay more attention to the balance sheet, income statement, the cash flow statement, notes to the financial ratios and the vast majority of the accounting information. Zhou (2015) shows that the higher the degree of earnings management, the lower the long-term financing costs. Therefore, the managers are motivated to whitewash financial statements to achieve the financing requirements. This behavior increases the degree of information asymmetry of the enterprise. Wu and Yu (2013) confirm this point that the quality of accounting information of politically-related enterprises is significantly higher than is that of non-politically-related enterprises. Further researches argue that managers have an inherent preference to disclose good news and postpone the disclosure of bad news in information disclosure. Huang (2013) argue that the negative news from enterprises has seriously damaged the performance of enterprises in some areas, such as raising the cost of financing. Non-politically-related enterprises have more incentives to hide negative information in order to obtaining financing at a lower cost.

The accumulation of negative news and its eventual release into the market leads to a stock price crash risk.

In addition, Watts and Zimmerman (1986) argue that listed firms tend toward negative earnings management because they enter the monopolistic sector through political connections and worry about government regulation after making excess profits. Du *et al.* (2012) also show that politically-related enterprises prefer to follow the negative earnings management to avoid regulation. Zhang and Fang (2013) point out that firms with political connections are more motivated to disclose information than firms without political connections, and will be more likely to voluntarily disclose internal control assurance reports. Pan *et al.* (2008) conclude the conclusion that political connections can alleviate the information asymmetry between enterprises and financial institutions. Based on the above analysis, non-politically-related enterprises have the incentive to hide negative information to ease the financing constraints. This behavior increases the degree of information asymmetry between stakeholders and enterprises. At the same time, politically-related enterprises will increase information disclosure to stabilize the political affluence. To a certain extent, reducing information asymmetry will reduce the stock price crash risk. Based on this discussion, the first hypothesis is formulated as follows:

H1. There is a negative correlation between the political connection and the stock price crash risk.

Du *et al.* (2012) argue that, if the chairman or CEO becomes a member of the National People's Congress or a member of the Chinese People's Political Consultative Conference, the listed firms often draw the attention of voters by setting a good image. Under such circumstances, management will have the option of concealing the negative news of the enterprise so as to avoid negative news affecting their political career. Therefore, when the senior executive has a current background is current, executives will pay more attention to their own political promotion than to the performance of the company. Through increasing closeness to the government when they are promoted politically, businesses can obtain more tax benefits and government subsidies, etc., thereby bringing more economic benefits to the business. Managers have both the motivation and the will to hide negative corporate news temporarily. This will increase the degree of information asymmetry and lead to the stock price crash risk. Based on this discussion, the second hypothesis is formulated as follows:

H2. When the managers are still working in government, the relationship between the political connections and the stock price crash risk is weakened.

Corporate political connections can ease financing constraints, allow enterprises to gain competitive advantage in the market, and have a positive impact in raising the corporate value of the enterprise. However, the political advantages brought by the political connection stem from the distortion of public demand (Cingano and Pinotti, 2009). For the governance effect of local government, its influence is undoubtedly negative. In the case of China, Chen (2006) find that political connections distort market resources, disrupt market operations and breed corruption among government officials. Yu *et al.* (2010) further argue that government fiscal expenditure based on political connections is inefficient. Such distorted allocations of resources seriously damage social interests. It is necessary for the public and stakeholders to supervise the work of the government through disclosure of the financial information of local governments. However, the level of disclosure of financial information by local governments is different. The public understands government policies and guidelines. Pan *et al.* (2016) show that higher financial transparency helps the public to get an accurate understanding of the financial status and benefits of activities, strengthens social supervision over local governments, and reduces

the degree of asymmetry of information in the study of the fiscal transparency and the credit rating of city bonds. From the above analysis, it can be found that the government expenditure in the regions with higher fiscal transparency is more reasonable and the allocation of public resources is more efficient. Firms cannot obtain excess returns from the government's favor through the political connections experienced by the executives. All kinds of inhibition of risk cannot be implemented. Based on this analysis, the third hypothesis is formulated as follows:

- H3.* When the firms are in the area of higher financial transparency, the relationship between the political connections and the stock price crash risk is weakened.

4. Research design

4.1 Data source

The sample for our main analysis is based on listed firms between 2008 and 2013. Following Kim *et al.* (2016) and Cao *et al.* (2016), we conduct screening: because of the particularity of ST and *ST enterprises, this paper excludes such companies; the number of listed companies in the financial sector is relatively small and the accounting treatment differs greatly from other industries; to ensure the reliability of the calculation of the stock price crash risk index, we exclude samples with an annual trading volume of less than 30 excluding the companies with the missing financial data. After screening, 8,004 observation values were finally obtained, to eliminate the influence of extreme values, and to carry out the extreme value adjustment (Winsorize) on the 1 and 99 percent of the continuous variables. The executive (chairman and general manager) has a political experience from the personality traits of the CSMAR database, and manually retrieve the comparison. The rest of the financial data comes from the Wind database and the national Thai security database (CSMAR).

4.2 Variable definitions

4.2.1 The stock price crash risk. Following Hutton *et al.* (2009) and Kim *et al.* (2016), there are two measures of stock price crash risk as the dependent variable of regression analysis. The specific algorithm is as follows.

First, we estimate the firm-specific weekly returns for each firm and year because we are interested in firm-specific return crashes. We use the weekly earnings data of stock i to make the following regression:

$$R_{i,t} = \alpha_i + \beta_1 R_{m,t-2} + \beta_2 R_{m,t-1} + \beta_3 R_{m,t} + \beta_4 R_{m,t+1} + \beta_5 R_{m,t+2} + \varepsilon_{i,t} \quad (1)$$

In model (1), $R_{i,t}$ is the return rate of the stock of company i in the t week. $R_{m,t}$ is the weighted average return rate of the market in week. $\varepsilon_{i,t}$ means that the return of a stock cannot be explained by the volatility of market return. We defined $W_{i,t} = \ln(1 + \varepsilon_{i,t})$ as the weekly rate of return for the company.

Our first measure of crash risk is calculated as the negative skewness of firm-specific weekly returns (*NCSKEW*). The calculation method is shown in formula (2):

$$NCSKEW_{i,t} = - \left[n(n-1)^{3/2} \sum W_{i,t}^3 \right] / \left[(n-1)(n-2) \left(\sum W_{i,t}^2 \right)^{3/2} \right] \quad (2)$$

Our second measure is the asymmetric volatility of negative vs positive returns (*DUVOL*). For each firm j over a fiscal year t , we separate all the weeks with firm-specific

weekly returns below the annual mean (“down” weeks) from those with firm-specific returns above the annual mean (“up” weeks) and calculate the standard deviation for each of these subsamples separately. The calculation method is shown in formula (3):

$$DUVOL_{i,t} = \log \left\{ \left[(n_u - 1) \sum_{DOWN} W_{i,t}^2 \right] / \left[(n_d - 1) \sum_{UP} W_{i,t}^2 \right] \right\} \quad (3)$$

Political connections and stock price crash risk

4.2.2 Political connections. According to the CSMAR classification, we define the managers who have served in the following organizations. CPC central committee; President of the People’s Republic of China; The state council of the People’s Republic of China; NPC; Chinese people’s political consultative conference; National Party Congress; Local people’s governments at various levels; The organization department (including the central government agencies, state council institutions, and local agencies); Democratic parties; Social group; Colleges and universities; and The local committee of the communist party of China, as having a political connection, setting the virtual variable Political as equal to 1; otherwise it is 0.

4.2.3 Fiscal transparency. The financial transparency data are from the report “Fiscal transparency in China”, by Tsinghua University of Finance and public policy research center. When the data are specifically adopted, they are based on the score of the second part of the budget and the performance of the report in 2013 and 2014. The municipal government budget and budget implementation of 2013 and 2014 including the content of the public finances, government-managed funds, state-owned capital operation and the social security fund. We score each item and get the transparency index for each municipal government. The index is used to reflect the openness of the municipal government’s financial information.

The remaining variables are defined in Table I.

Variable	Definition
$NCSKEW_{t+1}$	Negative skewness of firm-specific weekly returns in year $t+1$
$DUVOL_{t+1}$	Down-to-up volatility of firm-specific weekly returns in year $t+1$
<i>Political</i>	= 1, if Chairman or CEO has the government background = 0, otherwise
<i>Ftscore</i>	Financial transparency
<i>Overturn</i>	= the average turnover rate for stock i in year t -the average turnover rate for stock i in year $t-1$
<i>Sigma</i>	The standard deviation of firm-specific weekly returns in t
<i>Ret</i>	The arithmetic average of firm-specific weekly returns in year t
<i>Mb</i>	The market value of equity divided by the book value of equity in year t
<i>Size</i>	The log of the market value of equity in year t
<i>Lev</i>	The total long-term debt divided by total assets
<i>Roa</i>	Income before extraordinary items divided by lagged total assets
<i>Nature</i>	= 1, if the firm is state-owned = 0, otherwise
<i>Absacc</i>	Fixed the absolute value of the residuals of the Jones model
<i>Indu</i>	Industry fixed effects
<i>Year</i>	Year fixed effects

Table I.
Variable definition

4.3 Research model

To formally test our prediction that the political connection is negatively related to the stock price crash risk, we use the general regression specification:

$$\begin{aligned} NCSKEW_{t+1}(DUVOL_{t+1}) = & \alpha_0 + \alpha_1 Political_t + \alpha_2 Overturn_t + \alpha_3 Sigma_t + \alpha_4 Retweek_t \\ & + \alpha_5 Size_t + \alpha_6 Mb_t + \alpha_7 Lev_t + \alpha_8 Roa_t + \alpha_9 Nature \\ & + \alpha_{10} Absacc_t + Year + Indu + \varepsilon \end{aligned} \quad (4)$$

4.4 Descriptive statistics

Table II presents summary statistics for the sample. The mean value of *NCSKEW* (*DUVOL*) is -0.172 (-0.203), which is consistent with the prediction of Wang *et al.* (2015) and Cao *et al.* (2015). The median value of *NCSKEW* (*DUVOL*) is 0.688 (0.700), which indicates that there are significant differences between the two indicators in the sample companies. The mean value of the political connection is 0.343, which indicates that 34.3 percent of the enterprises are politically-related.

Table III presents the correlation analysis. The Pearson correlation coefficient between the *NCSKEW* (*DUVOL*) and the political connection is -0.027 , and the coefficient between *NCSKEW* and *DUVOL* is 0.958. In addition, there are no high correlations between the control variables.

5. Results

5.1 The result of the relationship between enterprise political connection and stock price crash risk

Table IV presents the test result of the *H1*. We find that the political connection coefficient is -0.0334 and that it is significant at the 1 percent level in regression (1), in which we only control industry and year fixed effects. This indicates that the political connection is negatively related to the stock price crash risk. After adding a series of control variables, we find that the political connection coefficient is -0.0457 , which is still significant at the 1 percent level in regression (2). When we add the control variable of *Absacc*, the relationship between the political connection and stock price crash risk is almost the same. This is consistent with *H1*.

Variables	<i>n</i>	Mean	SD	P50	Min.	Max.
<i>Ncskew</i>	8,004	-0.172	0.688	-0.149	-2.162	1.476
<i>Duwo</i>	8,004	-0.203	0.700	-0.208	-1.923	1.450
<i>Political</i>	8,004	0.343	0.475	0	0	1
<i>Cpolitical</i>	8,004	1.813	0.390	2	1	2
<i>Ftscore</i>	8,004	35.96	29.03	31	0	85.91
<i>Overturn</i>	8,004	-0.0884	0.302	-0.0338	-0.997	0.780
<i>Sigma</i>	8,004	0.0596	0.0176	0.0568	0.0286	0.115
<i>Retweek</i>	8,004	0.00162	0.00959	0.000854	-0.0192	0.0291
<i>Size</i>	8,004	21.88	1.255	21.69	19.27	25.77
<i>Mb</i>	8,004	0.986	0.926	0.687	0.116	5.301
<i>Lev</i>	8,004	0.445	0.222	0.449	0.0398	0.946
<i>Roa</i>	8,004	0.0820	0.111	0.0804	-0.483	0.406
<i>Nature</i>	8,004	0.472	0.499	0	0	1
<i>Absacc</i>	8,004	0.190	0.278	0.103	0.00150	1.943

Table II.
Summary statistics

	<i>Nskew</i>	<i>Duval</i>	<i>Political</i>	<i>Overturm</i>	<i>Sigma</i>	<i>Retweek</i>	<i>Size</i>	<i>Mb</i>	<i>Lev</i>	<i>Roa</i>	<i>Absacc</i>
<i>Nskew</i>	1										
<i>Duval</i>	0.958***	1									
<i>Political</i>	-0.027**	-0.078***	1								
<i>Overturm</i>	-0.088***	-0.108***	-0.0150	1							
<i>Sigma</i>	-0.072***	-0.079***	-0.040***	-0.025**	1						
<i>Retweek</i>	-0.098***	-0.096***	-0.00800	0.222***	-0.236***	1					
<i>Size</i>	-0.106***	-0.107***	0.038***	0.021*	-0.098***	-0.170***	1				
<i>Mb</i>	-0.133***	-0.107***	0.00700	0.042***	-0.305***	-0.044***	0.633***	1			
<i>Lev</i>	-0.072***	-0.071***	-0.044***	0.026**	0.00300	-0.044***	0.453***	0.549***	1		
<i>Roa</i>	0.019*	0.0120	0.025**	-0.035***	-0.056***	0.117***	0.177***	-0.111***	-0.115***	1	
<i>Absacc</i>	0.0160	0.00900	-0.037***	-0.023**	0.062***	0.053***	0.069***	-0.0140	0.138***	0.135***	1

Notes: This table presents the Pearson correlation coefficients at the lower triangular part. *, **, ***, Significant at the 10, 5 and 1 percent levels, respectively

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Table III.
Correlation matrix

Table IV.
H1

	(1)	(2)	(3)	(4)	(5)	(6)
	$Nc skew_{t+1}$	$Nc skew_{t+1}$	$Nc skew_{t+1}$	$Duol_{t+1}$	$Duol_{t+1}$	$Duol_{t+1}$
<i>Political</i>	-0.0334** (-2.11)	-0.0457*** (-2.91)	-0.0457*** (-2.91)	-0.0308* (-1.90)	-0.0414*** (-2.58)	-0.0415*** (-2.59)
<i>Overtum</i>	-0.0492* (-1.89)	-0.0492* (-1.89)	-0.0492* (-1.89)		-0.0558** (-2.10)	-0.0558** (-2.10)
<i>Sigma</i>	-7.677*** (-12.73)	-7.677*** (-12.73)	-7.677*** (-12.72)		-7.983*** (-12.95)	-7.979*** (-12.94)
<i>Retweek</i>	-1.839 (-1.45)	-1.839 (-1.45)	-1.837 (-1.45)		-1.778 (-1.37)	-1.762 (-1.36)
<i>Size</i>	-0.0141 (-1.62)	-0.0141 (-1.62)	-0.0141 (-1.62)		-0.0211** (-2.37)	-0.0210** (-2.36)
<i>Mb</i>	-0.0799*** (-6.37)	-0.0799*** (-6.37)	-0.0800*** (-6.36)		-0.0617*** (-4.81)	-0.0618*** (-4.81)
<i>Lev</i>	0.0478 (1.09)	0.0478 (1.09)	0.0480 (1.08)		0.0229 (0.51)	0.0243 (0.53)
<i>Roa</i>	-0.0281 (-0.38)	-0.0281 (-0.38)	-0.0279 (-0.38)		-0.0605 (-0.80)	-0.0586 (-0.77)
<i>Nature</i>	-0.0809*** (-4.79)	-0.0809*** (-4.79)	-0.0809*** (-4.79)		-0.0691*** (-4.01)	-0.0691*** (-4.01)
<i>Absacc</i>	-0.0668 (-1.03)	0.987*** (4.81)	-0.000712 (-0.03)		-0.0691*** (-4.01)	-0.0691*** (-4.01)
<i>_cons</i>		0.987*** (4.80)	0.987*** (4.80)		0.973*** (4.63)	0.971*** (4.63)
<i>Year</i>	Yes	Yes	Yes	Yes	Yes	Yes
<i>Indu</i>	Yes	Yes	Yes	Yes	Yes	Yes
<i>n</i>	8,004	8,004	8,004	8,004	8,004	8,004
<i>Adj. R²</i>	0.0645	0.0965	0.0964	0.0590	0.0897	0.0896
<i>F</i>	22.24	26.15	25.40	20.30	24.19	23.50

Notes: This table presents the regression results. *, **, ***, Significant at the 10, 5 and 1 percent levels, respectively

5.2 The test of the relationship between current and former management

We estimate the model by the group of current and former. The regression (1) and (2) in Table V presents the relationship between executive's current political connection and the stock price crash risk. We find that the political connection coefficient is -0.0629 , which is only significant at the 10 percent level. When the index is replaced with *Duvol*, there is no significant relationship between the political connection and the stock price crash risk. The regression (3) and (4) in Table V presents that the relationship between executive's former political connection and the stock price crash risk. We find that the political connection coefficient is significant at the 1 percent level which is consistent with *H2*.

5.3 The test of financial transparency

According to the annual financial transparency index, the sample is divided into two groups: low level and high level. Table VI presents the test result of *H3*. The regressions (1) and (2) in Table VI shows that the relationship between the political connection and the stock price crash risk is significant at 5 percent level when the financial transparency is lower. This indicates that the political connection of lower financial transparency helps enterprises to obtain government public resource allocation. However, there is no significant relationship between political connection and the stock price crash risk when the financial transparency is higher. This result is consistent with *H3*.

6. Further analysis: the influence of political connection on the stock price crash risk

As mentioned above, political connections can significantly inhibit the stock price crash risk. The political background of either a Chairman or a CEO can help firms obtain tax incentives, resources from the government, and competitive industrial advantage. As a result, enterprises do not need to hide negative news to alleviate financing constraints, but should be more willing to strengthen information disclosure to maintain stable politically-associated revenue. At the same time, the enterprise may strengthen the disclosure of bad news to avoid government regulation and maintain access to government subsidies. Via such a path, the enterprise can reduce the degree of information asymmetry and, thus,

	(1) Current <i>Ncskew</i> _{<i>t</i>+1}	(2) <i>Duvol</i> _{<i>t</i>+1}	(3) Former <i>Ncskew</i> _{<i>t</i>+1}	(4) <i>Duvol</i> _{<i>t</i>+1}
<i>Political</i>	-0.0629* (-1.75)	-0.0438 (-1.19)	-0.0542*** (-2.99)	-0.0524*** (-2.83)
<i>Overturn</i>	-0.208*** (-3.34)	-0.219*** (-3.45)	-0.0153 (-0.53)	-0.0210 (-0.72)
<i>Sigma</i>	-10.30*** (-7.27)	-11.47*** (-7.93)	-7.154*** (-10.70)	-7.248*** (-10.61)
<i>Retweek</i>	-0.192 (-0.06)	0.888 (0.29)	-2.111 (-1.50)	-2.278 (-1.59)
<i>Size</i>	0.0155 (0.76)	0.0136 (0.65)	-0.0218** (-2.25)	-0.0299*** (-3.02)
<i>Mb</i>	-0.0848*** (-2.62)	-0.0751** (-2.27)	-0.0763*** (-5.56)	-0.0563*** (-4.01)
<i>Lev</i>	0.115 (1.03)	0.0930 (0.82)	0.0382 (0.78)	0.0120 (0.24)
<i>Roa</i>	-0.299 (-1.58)	-0.356* (-1.84)	0.0270 (0.33)	0.0000924 (0.00)
<i>Nature</i>	-0.152*** (-3.57)	-0.141*** (-3.25)	-0.0649*** (-3.50)	-0.0523*** (-2.76)
<i>Absacc</i>	-0.0108 (-0.17)	-0.0133 (-0.20)	-0.000668 (-0.02)	-0.00665 (-0.21)
<i>_cons</i>	0.779 (1.56)	0.696 (1.37)	1.075*** (4.73)	1.072*** (4.61)
<i>Year</i>	Yes	Yes	Yes	Yes
<i>Indu</i>	Yes	Yes	Yes	Yes
<i>n</i>	8,004	8,004	8,004	8,004
<i>Adj. R²</i>	0.1173	0.1217	0.0929	0.0841
<i>F</i>	7.01	7.27	20.03	18.07

Notes: This table presents the regression results. *, **, *** Significant at the 10, 5 and 1 percent levels, respectively

Table V.
H2

	(1) Lower financial transparency <i>Ncskew</i> _{<i>t</i>+1}	(2) <i>Duvol</i> _{<i>t</i>+1}	(3) Higher financial transparency <i>Ncskew</i> _{<i>t</i>+1}	(4) <i>Duvol</i> _{<i>t</i>+1}
<i>Political</i>	-0.0657*** (-2.89)	-0.0601*** (-2.60)	-0.0265 (-1.21)	-0.0236 (-1.05)
<i>Overturn</i>	-0.0792** (-2.10)	-0.0836** (-2.18)	-0.0235 (-0.65)	-0.0321 (-0.87)
<i>Sigma</i>	-7.655*** (-8.63)	-7.759*** (-8.60)	-7.583*** (-9.10)	-8.068*** (-9.43)
<i>Retweek</i>	-2.050 (-1.11)	-2.344 (-1.25)	-1.940 (-1.10)	-1.570 (-0.87)
<i>Size</i>	-0.0772*** (-4.24)	-0.0574*** (-3.11)	-0.0779*** (-4.43)	-0.0610*** (-3.38)
<i>Mb</i>	-0.0129 (-1.02)	-0.0220* (-1.72)	-0.0172 (-1.43)	-0.0232* (-1.88)
<i>Lev</i>	0.0677 (1.01)	0.0286 (0.42)	0.0286 (0.43)	0.0169 (0.25)
<i>Roa</i>	0.0407 (0.16)	-0.0497 (-0.19)	0.0890 (0.36)	0.0591 (0.24)
<i>Nature</i>	-0.0756*** (-3.10)	-0.0645*** (-2.61)	-0.0870*** (-3.70)	-0.0736*** (-3.05)
<i>Absacc</i>	0.0227 (0.57)	0.0149 (0.37)	-0.0254 (-0.65)	-0.0301 (-0.75)
<i>_cons</i>	0.884*** (2.97)	0.921*** (3.04)	1.099*** (3.93)	1.061*** (3.69)
<i>Year</i>	Yes	Yes	Yes	Yes
<i>Indu</i>	Yes	Yes	Yes	Yes
<i>n</i>	3,955	3,955	4,049	4,049
<i>Adj. R²</i>	12.62	11.48	13.66	12.64
<i>F</i>	0.0932	0.0849	0.0987	0.0915

Table VI.
H3

Notes: This table presents the regression results. *, **, ***Significant at the 10, 5 and 1 percent levels, respectively

reduce the stock price crash risk. This paper further examines whether such paths exist in Chinese listed firms.

The stock price crash risk stems from managers' bad news hoarding. The executives' experience in politics strengthens the company's information disclosure. This will reduce the stock price crash risk. Based on this, this paper constructs the following model to test whether the firm's reaction rate to bad news is the intermediary mechanism that influences the stock price crash risk:

$$\begin{aligned}
 NCSKEW_{t+1}(DUVOL_{t+1}) = & \alpha_0 + \alpha_1 Political_t + \alpha_2 Overturn_t + \alpha_3 Sigma_t + \alpha_4 Retweek_t \\
 & + \alpha_5 Size_t + \alpha_6 Mb_t + \alpha_7 Lev_t + \alpha_8 Roa_t + \alpha_9 Nature_t \\
 & + \alpha_{10} Absacc_t + Year + Indu + \varepsilon
 \end{aligned} \quad (5)$$

$$\begin{aligned}
 C-SCORE_t = & \alpha_0 + \alpha_1 Political_t + \alpha_2 Overturn_t + \alpha_3 Sigma_t + \alpha_4 Retweek_t \\
 & + \alpha_5 Size_t + \alpha_6 Mb_t + \alpha_7 Lev_t + \alpha_8 Roa_t + \alpha_9 Nature_t \\
 & + \alpha_{10} Absacc_t + Year + Indu + \varepsilon
 \end{aligned} \quad (6)$$

$$\begin{aligned}
 NCSKEW_{t+1}(DUVOL_{t+1}) = & \alpha_0 + \alpha_1 Political_t + \alpha_2 Cscore_t + \alpha_3 Overturn_t + \alpha_4 Sigma_t \\
 & + \alpha_5 Retweek_t + \alpha_6 Size_t + \alpha_7 Mb_t + \alpha_8 Lev_t + \alpha_9 Roa_t \\
 & + \alpha_{10} Nature_t + \alpha_{11} Absacc_t + Year + Indu + \varepsilon
 \end{aligned} \quad (7)$$

Model (5) tests the relationship between the political connection and the stock price crash risk. Model (6) tests the influence of political connection of bad news reflect speed (i.e. accounting conservatism). Controlling accounting conservatism, model (7) tests the relationship between the political connection and the stock price crash risk. Following Wen *et al.* (2004), we start model (7) to test weather the political connection has a significant influence on accounting conservatism. We think political connections through part of the bad news reflect speed affect the stock price crash risk if the coefficient

of Cscore is significant and the coefficient of Political is declined in the model (7). Following Khan and Watts (2009), we estimate accounting conservatism. The measure of accounting conservatism is as follows:

$$EPS_{i,t}/P_{i,t-1} = \beta_0 + \beta_1 D_{i,t} + \beta_2 R_{i,t} + \beta_3 D_{i,t} \times R_{i,t} + \zeta \quad (8)$$

$EPS_{i,t}$ is the basic earnings for stock i in year t ; $P_{i,t-1}$ is the price of the stock for stock i in year $t-1$; $R_{i,t}$ is excess return for stock i in year t ; $D = 1$ if $R_{i,t} < 0$, $D = 0$ if $R_{i,t} \geq 0$:

$$G - Score = \beta_2 = \mu_0 + \mu_1 Size + \mu_2 MB + \mu_3 Lev \quad (9)$$

$$C - Score = \beta_3 = \lambda_0 + \lambda_1 Size + \lambda_2 MB + \lambda_3 Lev \quad (10)$$

Models (9) and (10) are brought into model (8):

$$\begin{aligned} EPS_i/P_i = & \beta_0 + \beta_1 D_i + R_i (\mu_0 + \mu_1 Size + \mu_2 MB + \mu_3 Lev) \\ & + D_i \times R_i (\lambda_0 + \lambda_1 Size + \lambda_2 MB + \lambda_3 Lev) \\ & + (\delta_1 Size + \delta_2 MB + \delta_3 Lev + \delta_4 D_i \times Size + \delta_5 D_i \times MB + \delta_6 D_i \times Lev) + \varepsilon \quad (11) \end{aligned}$$

Table IV presents the test result of the intermediate mechanism test. Corresponding to our prediction, the speed of the enterprise's reaction to bad news may become a part of the intermediary variable that influences the stock price crash risk. This means that political connection influences the stock price crash risk through the company's rate of confirmation of bad news (Table VII).

7. Robustness tests

7.1 Propensity score matching

In order to testing the endogenous problems brought by the selection of samples, PSM is used to match politically-related enterprises and non-politically-related enterprises. Figure 1 represents the matching. We re-estimate the model and the results are corresponding with our prediction (Table VIII).

	(1) <i>Ncskew</i> _{<i>t</i>+1}	(2) <i>Duvol</i> _{<i>t</i>+1}	(3) <i>Cscore</i>	(4) <i>Ncskew</i> _{<i>t</i>+1}	(5) <i>Duvol</i> _{<i>t</i>+1}
<i>Political</i>	-0.0457*** (-2.91)	-0.0415*** (-2.59)	0.00270*** (2.84)	-0.0339*** (-2.80)	-0.0319** (-2.49)
<i>Cscore</i>				-0.671*** (-3.63)	-0.609*** (-3.22)
<i>Overturn</i>	-0.0492* (-1.89)	-0.0558** (-2.10)	0.00348** (2.21)	-0.0469* (-1.80)	-0.0537** (-2.02)
<i>Sigma</i>	-7.677*** (-12.72)	-7.979*** (-12.94)	-0.0503 (-1.38)	-7.711*** (-12.79)	-8.010*** (-13.00)
<i>Retweek</i>	-1.837 (-1.45)	-1.762 (-1.36)	-1.281*** (-16.68)	-2.696** (-2.09)	-2.542* (-1.93)
<i>Size</i>	-0.0141 (-1.62)	-0.0210** (-2.36)	0.00172*** (3.26)	-0.0129 (-1.49)	-0.0200** (-2.25)
<i>Mb</i>	-0.0800*** (-6.36)	-0.0618*** (-4.81)	0.0260*** (34.19)	-0.0625*** (-4.65)	-0.0459*** (-3.34)
<i>Lev</i>	0.0480 (1.08)	0.0243 (0.53)	-0.0129*** (-4.79)	0.0393 (0.88)	0.0165 (0.36)
<i>Roa</i>	-0.0279 (-0.38)	-0.0586 (-0.77)	-0.0115** (-2.55)	-0.0356 (-0.48)	-0.0655 (-0.87)
<i>Nature</i>	-0.0809*** (-4.79)	-0.0691*** (-4.01)	-0.000605 (-0.59)	-0.0813*** (-4.82)	-0.0695*** (-4.03)
<i>Absacc</i>	-0.000712 (-0.03)	-0.00647 (-0.23)	-0.00440*** (-2.62)	-0.00366 (-0.13)	-0.00915 (-0.32)
<i>_cons</i>	0.987*** (4.80)	0.971*** (4.63)	-0.0122 (-0.98)	0.979*** (4.77)	0.964*** (4.59)
<i>Year</i>	Yes	Yes	Yes	Yes	Yes
<i>Indu</i>	Yes	Yes	Yes	Yes	Yes
<i>n</i>	8,004	8,004	8,004	8,004	8,004
<i>Adj. R²</i>	0.0964	0.0896	0.3840	0.0978	0.0907
<i>F</i>	25.40	23.50	143.52	25.10	23.16

Notes: This table presents the regression results. *, **, *** Significant at the 10, 5 and 1 percent levels, respectively

Political
connections
and stock price
crash risk

Table VII.
Intermediate
mechanism test

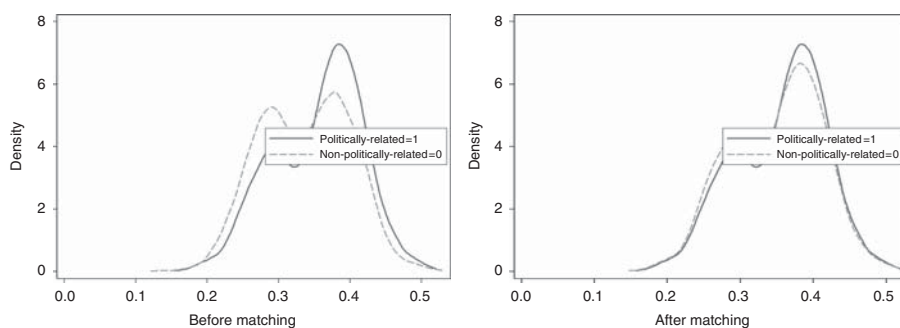


Figure 1.
Matching

	(1) $Ncskew_{t+1}$	(2) $Dwolv_{t+1}$
<i>Political</i>	-0.0459** (-2.25)	-0.0419** (-2.04)
<i>Overturn</i>	-0.00336 (-0.10)	-0.0120 (-0.34)
<i>Retweek</i>	-4.817*** (-2.75)	-5.086*** (-2.88)
<i>Sigma</i>	-8.019*** (-9.80)	-8.278*** (-10.04)
<i>Absacc</i>	-0.00362 (-0.09)	-0.0147 (-0.36)
<i>Roa</i>	-0.147 (-0.59)	-0.235 (-0.94)
<i>Size</i>	-0.0161 (-1.41)	-0.0171 (-1.48)
<i>Mb</i>	0.0247*** (4.82)	0.0232*** (4.49)
<i>Lev</i>	-0.168** (-2.52)	-0.191*** (-2.85)
<i>Nature</i>	-0.0696*** (-2.95)	-0.0503** (-2.11)
<i>_cons</i>	1.114*** (4.05)	0.956*** (3.45)
<i>Year</i>	Yes	Yes
<i>Indu</i>	Yes	Yes
<i>n</i>	4,689	4,689
<i>F</i>	15.54	14.46
<i>R²_a</i>	0.0979	0.0913

Table VIII.
Propensity score
matching

Notes: This table presents the regression results. *, **, ***Significant at the 10, 5 and 1 percent levels, respectively

7.2 Index sensitivity

In this paper, we study the local government fiscal transparency on political connection and the influence of the stock price crash risk; to some extent investigating the influence of the degree of government intervention to the market. Thus, we use data of the relationship between the government and the market in the process of marketization of China's eight years report instead of fiscal transparency in the robustness test. The conclusion remains the same.

7.3 Longer prediction window

Following Wang *et al.* (2015), we will expand the forecast window to two years to overcome the endogenous effects of political connections and stock price crash risk. The conclusion remains the same.

7.4 Further control the influence of corporate governance characteristics

In this paper, we study the influence of political connections on stock price crash risk. Corporate governance characteristics have an important effect on management behavior choice.

To alleviate omitted variables caused by endogenous problems, this paper adds a series of control variables, such as the Number of management (Number), the three management compensation (Pay), the board size (Board size), and equity balance degree (Zedx). The conclusion remains the same.

7.5 Modified heteroscedasticity

In order to controlling the influence of heteroscedasticity, the cluster is further used in the robustness test to correct heteroscedasticity, and the conclusion was basically unchanged.

8. Conclusion

Using a large sample of Chinese firms for the period 2008-2013, we provide strong and robust evidence that corporate political connections are negatively associated with firm-specific stock price crash risk. This finding is consistent with the following view: political connections help companies to ease financing constraints and reduce bad news hoarding activities. Moreover, we show that the negative relationship between political connections and stock price crash risk is weaker either when firm's senior executives are still in politics or companies are in high financial transparency of local governments. In our analysis of the impact mechanism, we find that political connections can increase the rate at which firms react to bad news, thereby curbing the risk of a share price crash.

This paper has important theoretical and practical significance. In theory, this paper first examines the political connections from the perspective of the stock price crash risk. Political connection as a typical way of informal institutional arrangement against the background of the transition of China's economic system transition is widespread, and research into political associations is of great significance. This research has not only enriched the literature on political connections but also deepened the understanding of stock price crash risk. On the practical significance, the stock price crash risk serious damage to the capital market development. This paper provides a new approach for stakeholders and regulators to predict the stock price crash risk through strengthening the supervision of enterprises' bad news. At the same time, this paper argues that executives' personal experiences have an effect on their information disclosure behavior, so it is necessary to identify information disclosure report.

Note

1. There are rich anecdotal evidences for corporate executives with political backgrounds. For example, the Chairman of Hong Xing (Stock ID: 600307), Chen Chunming, served as mayor of Jiuquan city in Gansu province.

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