An Empirical Study on the Impacts of Political Connection on the Relationship between Managerial Discretion and Perquisite Consumption

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ABSTRACT

This paper selects several listed companies in Shanghai and Shenzhen Stock Exchange during 2008 to 2013 as research subjects, the results suggest that in the Stated-owned enterprises (hereinafter referred to as SOE), the political connections would strengthen the impact of managerial discretion on perquisite consumption. In the private enterprises, the political connections of government officials would enhance such influence while connections of representatives would not make a difference. Furthermore, there exists a positive relationship between managerial discretion and perquisite consumption, reinforced by the political connections.

Keywords: Perquisite Consumption, Political Connections, Managerial Discretion

INTRODUCTION

The entertainment expenses in the 2013 and 2014 annual reports published by listed SOE were less than former years. However, several media see this reduction as the result of perquisite consumption being more difficult to detect. The main income sources of senior executives are not just the salaries, bonuses and dividends, but also the implicit incomes. For example, perquisite consumption of those senior executives can help them shift their expense smoothly. Donghua Chen (2005) is one of the earliest scholars researching in this area. He argues that the senior executives are most likely to gain personal profits from office allowances and travel expenses, and might turn these benefits into their own hidden incomes.

Without doubt, excessive perquisite consumption would cause a major waste of social resources, hurt a company's performance and raise operational risks. Furthermore, those consumptions have high concealment and could escape from public supervision. So, which factors might influence the perquisite consumption and what could be done to set a restriction of these kinds of excessive consumption? These are two important questions for scholars as well as managers. Many scholars try to use the principal-agent theory and managerial power perspective to solve those problems. However, they neglect the realistic background of companies in China and the fact that many problems of corporate management would change along with several certain factors.

Combining corporate institution and behavior analysis is the general trend in international academic circles at present. This paper explains the mechanism of perquisite consumption on the basis of individual needs and motivation. The results are as follows:

➢ The rise of perquisite consumption is because of the pursuit of money and power. This kind of motivated behavior was caused by the lack of a formal corporate and the unfulfilled individual needs.

➢ Regulations and range of power in a company decide whether a senior executive has the possibility to abuse his power, which influence the form and extent of the in perquisite consumption.

The informal institution theory regards the mechanism of informal institution affecting senior executives' perquisite consumption is that the institution may generate impacts on those managers' perquisite consumption by affecting their judgments on expected outcomes, which are influenced by some conscious factors such as ethics and traditions.

Youlin Shu (2011) conducts that there is a hidden connection between the perquisite consumption of senior managers and their power. The more power they have, the more money they spend. In the theory of managerial discretion, informal institution may have a great influence on the possibility and extent of the choices executives make about perquisite consumption due to its unique attributes. It is clear that managers would consider their career achievements, potential risks and political treatments before they decide the level of their perquisite consumption (Meckling W. H., 1976). It is obvious that political connections may affect managers' self-interest behaviors and perquisite consumption.

To sum up, the academic value of this paper can be illustrated by the following two points. First, considering the unique macro-background of China in this transitional period of economy this paper divides political connections into two different types, which are political connections of representatives and of government officials, according to their extent and analyzes the impacts they make on perquisite consumption. Second, according to the formal institution theory, the combination of managerial discretion and political connections makes perquisite consumption possible. This paper studies the way managerial discretion impact perquisite consumption considering manager discretion as a variable and discusses how political connections make an influence on the relationship between managerial discretion and perquisite consumption by using hierarchical multiple regression.

LITERATURE REVIEW AND HYPOTHESES

State Owned Enterprises

Huning Wang (2008) conducts that political connections, an informal institution, would affect manager's subjective needs. Rent-seeking activities of different kinds of power might have direct influences on how the self-interest activities are done. As for SOE, there are some serious agent problems. For instance, the obedience of individuals to their families and communities, which is a very important part of Chinese culture, allows social relationships to allocate resources. Furthermore, political connections, an informal institution, are more likely to make negative influences due to its long closed state.

Particularly, in SOE, the political lock-in effect and weakened corporate management directly affect the perquisite consumption of senior executives. This point can be specifically demonstrated by the followings. First, the culture of so called "Supreme Leader" in political connections gives birth to the self-interest activities of senior managers in SOE. Second, official standard thoughts in political connections provide tacit approvals to this kind of consumption. Third, political connections offer diversified noneconomic objectives, which force managers in SOE tend to actualize perquisite consumption. When categorizing political connections, the author finds out that the political connections of most SOE are from government officials and only a few SOE have connections from representatives. Government officials could bring tremendous resources to SOE because of their

relationship with the government. Thus, it would cost corporate fewer efforts to establish a relationship with the government. Hence, there is no need to categorize the type of political connection of SOE.

Accordingly, this paper hypothesizes that H1 represents that political connections would reinforce the impact of managerial discretion in SOE on perquisite consumption.

Private Enterprises

Xingqiang Du (2010) categorizes the political connections in private enterprises into two sub categories, which is representatives and government officials. In those private enterprises with political connections of government officials, executive managers are mostly former officials or retired officials.

Xiaohui Lu (2006) argues that these managers may bring strong political interference into the companies, which are similar to the political connections in SOE. The explanation for this phenomenon is that the Chinese law system clearly forbids current government officials having any involvement with private enterprises. The political connections of government officials usually come from former or retired officials. They are hired because they might build a special bridge between companies and the government using their irreplaceable social connections with current officials. Thus, they are allowed to abuse their power to pursuit personal interests. The establishment of these political connections would reinforce the perquisite consumption. Therefore, this paper selects these private companies as samples. This paper regards that perquisite consumption in companies with political connections of government officials might be more likely to be a self-interest activity.

In view of the above, this paper assumes that H2 represents that political connections government officials would strengthen the influence of managerial discretion in private enterprises on perquisite consumption.

In private companies with political connections of representatives, major shareholders usually take charge. Thus, managers would not have too many chances to abuse their power. Those companies would initiate the political connection to strive for more opportunities. Therefore, this type of political connection might not affect executives' self-interest activities.

Based on this, this paper hypothesize that H3 suggests that political connection of representatives would not remarkably influence the relationship between managerial discretion and their perquisite consumption.

STUDY DESIGN

Samples Selection and Data Sources

This paper selects several listed companies in Shanghai and Shenzhen Stock Exchange during 2008 to 2013 as research subjects and tests the impacts of political connections on the relationship between managerial discretion and perquisite consumption through building multiple regression models.

In order to remove the effects of abnormal values, this paper eliminates the following abnormal samples:

➤ Financial companies.

➤ Companies that have special treatment.

➤ Companies that cannot provide enough data.

➤ Abnormal values after data standardization.

Eventually, there are 1686 observed values in all, among which 221observed values come from the year of 2008, 282 come from 2009, 290 from 2010, 297 from 2011, 308 from 2012 and 288 from 2013. All data in this paper are obtained from CSMAR Solution while the author collects the information about political connection.

Variable Definition

Explained Variable

In this paper, managers' perquisite consumption equals to general expenses minus the amortization of intangible assets, inventory falling price reserves and the emolument of director, senior executives and board of supervision, using Tongying Liang's method for reference.

Explaining variable

This paper regards a company owns political connections if its chairman or general manager has political connections. The author uses Excel to analyze whether there are words like "chairman of the union" "division chief" and "deputy to the People's Congress" in those manager's profiles and then categorizes these political connections into representatives type and government officials type.

Political connections of government officials (hereinafter referred to as GOVCONNECT)

Yue Pan (2009) values the political influence of executives based on their former position in the administration. Xingqiang Du (2010) divides the political connection into 9 levels according to managers' current or former administrative level.

Using these as reference, this paper classifies political connections of government officials into the following five ranks. Those with or under vice section chief rank have the valuation of 1. Those with section chief rank have the valuation of 2. Those with section rank have the valuation of 3. Those with department rank have the valuation of 4. Those above vice ministries rank have the valuation of 5.

Political connections of representatives (hereinafter referred to as REPCONNECT)

Xuyang Hu (2011) gives representatives different valuations on the basis of their level and considers the square value as indicators of the extent of political connection. Using these as reference, this paper classifies political connections of representatives into the following three ranks. Current or former deputy to the township People's Congress has the valuation of 1. Current or former deputy to the county or municipal People's Congress and member of municipal CPPCC has the valuation of 2. Current of former deputy to the provincial or national People's Congress and member of municipal or national CPPCC has the valuation of 3.

Other Controlled Variable

This paper selects total assets turnover (hereinafter referred to as Totassrat), top ten share proportion of shareholders (hereinafter referred to as Topten), growth rate of operating revenue (hereinafter referred to as Ppeincmgrrt), debt to assets ratio (hereinafter referred to as Dbastrt) and return on assets (hereinafter referred to as ROA) as controlled variables because they might affect the extent of managers' perquisite consumption.

Empirical Models

This paper uses hierarchical multiple regression to study the relationship between perquisite consumption and the interaction terms of managerial discretion and political connections.

First, the author adds the variable of managerial discretion (hereinafter referred to as power) and other controlled variable including Totassrat, Topten, Ppeincmgrrt, Dbastrt and ROA, which generates model (1).

Second, the author adds the variable of political connections into model (1), which leads to model (2).

Third, the author adds the interaction terms of political connection and managerial discretion into model (2) and gets model (3).

$$TobinQ = \alpha_0 + \alpha_1 * power + \sum_{i=1}^{n} \gamma_i * control_i + \varepsilon \qquad (1)$$

$$TobinQ = \alpha_0 + \alpha_1 * power + \alpha_2 * POLCNNECT + \sum_{i=1}^{n} \gamma_i * control_i + \varepsilon \qquad (2)$$

$$TobinQ = \alpha_0 + \alpha_1 * power + \alpha_2 * POLCNNECT + \alpha_3 * POLNNECT * power + \sum_{i=1}^{n} \gamma_i * control_i + \varepsilon \qquad (3)$$

Among the formulas above, α_0 is a constant, α and γ are regression coefficients, "control" represents controlled variable, ε is random error. POLCONNECT, GOVCONNECT and REPCONNECT should be inserted into the model respectively for different hypothesis tests.

RESULTS AND ANALYSIS

Correlation Analyses

Table 1 suggests that the results are consistent with H1, H2 and H4, which proves that generally senior executives in SOE could try for a higher level of perquisite consumption by abusing their powers. The results also prove that in SOE and private companies with political connection of government officials, managers are capable to seek perquisite consumption. Furthermore, political connections could reinforce the extent of such consumption in SOE.

Table1. *Pearson correlation test of major variables in the whole samples*

	Perk				
	Whole Samples	SOE	Private Enterprises		
			Whole samples	Representatives type	Government officials type
POLCONNECT	0.127*** 0.000	0.088*** 0.006	\	\	\
power	0.088*** 0.000	0.100*** 0.002	\	0.082* 0.067	0.182** 0.017
POLconnect *power*	0.108*** 0.000	0.074** 0.021	\	\	\
REPCONNECT *power*	0.133*** 0.000	\	0.175*** 0.001	\	\
GOVCONNECT *power*	0.073*** 0.004	0.114*** 0.000	\	\	\

Note: *** , ** and * represent that the results are significant at 1%, 5% and 10% respectively and numbers in the brackets are t values, similarly hereinafter.*

However, the test results are not consistent with H3, which suggests that political connection of representatives would not remarkably influence the relationship between managerial discretion and their perquisite consumption. Nonetheless, the test results suggest that there exists a certain relationship between perquisite consumption and the interaction of political connections of representatives and managerial discretion. In hence, H3 should be further examined.

Regression Results and Analysis

Table2. *Hierarchical multiple regression results of the influence of political connections in SOE on managerial discretion and perquisite consumption*

Perk			
Standardized regression coefficient	SOE		
	Model (1) (First layer)	Model (2) (Second layer)	Model (3) (Third layer)
power	0.239*** (7.234)	0.249*** (7.689)	0.191*** (4.734)
POLCONNECT	\	0.094*** (3.215)	0.098*** (3.368)
POLCONNECT * power	\	\	0.086** (2.189)
Totassrat	0.110*** (3.455)	0.109*** (3.517)	0.098*** (3.198)
Topten	0.338*** (11.479)	0.339*** (11.478)	0.341*** (11.689)
Opeincmgrrt	-0.034 (-1.158)	-0.038*** (-1.213)	-0.038 (-1.289)
Dbastrt	0.064* (1.718)	0.061* (1.687)	0.067* (1.843)
ROA	0.114*** (3.612)	0.109*** (1.698)	0.109*** (3.456)
R^2	0.239	0.246	0.251
F	34.579	50.924	28.523
Sig.F	0.000	0.000	0.000

Table 2 demonstrates that models in this paper have a relatively strong explanatory ability. The R^2 value increases after adding the value of political connection and the interactive variable of political connections and discretion. This phenomenon indicates that political connections in SOE would have obvious effects on perquisite consumption. Meanwhile, the regression coefficients of interaction terms are significant positive, which implicates that political connections would enhance the positive relationship between managerial discretion and perquisite consumption and then validates H1. Therefore, perquisite consumption of managers in SOE would have a dramatic growth along with the reinforcement of political connections.

Table3. *Hierarchical Multiple Regression Results Of the Influence Of Political Connections Government Officials On Managerial Discretion And Perquisite Consumption*

Perk			
Standardized regression coefficient	Private Enterprises		
	Model (1) (First layer)	Model (2) (Second layer)	Model (3) (Third layer)
power	0.063** (2.415)	0.077*** (2.987)	0.015 (0.411)
POLCONNECT	\	0.198*** (5.121)	0.124*** (5.305)

POLCONNECT * power	\	\	0.098***
			(2.934)
Totassrat	0.165	0.152***	0.137***
	(5.983)	(5.774)	(5.147)
Topten	0.239	0.239***	0.246***
	(9.874)	(10.025)	(10.267)
Opeincmgrrt	-0.062	-0.064***	-0.064***
	(-2.582)	(-2.716)	(-2.732)
Dbastrt	0.198	0.192***	0.195***
	(7.657)	(7.423)	(7.543)
ROA	0.153	0.152***	0.152***
	(6.035)	(5.998)	(5.996)
R^2	0.165	0.179	0.183
F	28.503	35.112	55.214
Sig.F	0.000	0.000	0.000

Table 3 implies that models in this paper have a relatively strong explanatory ability. This ability embraces a gradual increase after adding political connections of government officials and the interaction terms of political connections of government officials and managerial discretion. Besides, this kind of political connections could enhance the positive relationship between discretion and perquisite consumption, which validates H2. This shows that executives would pursue noneconomic objectives owing to the political connections of government officials, which leads to a huge rise of perquisite consumption.

As for those private companies with political connection of representatives, this paper assumes that there is no obvious correlation. For this reason, this paper directly implement regression analysis of the third layer of the model. The results can be found in table 4.

Table4. *Hierarchical multiple regression results*

Model (3)		R	R^2	adjusted R^2	SEE	
		0.407	0.166	0.161	1.233	
Model (3)		quadratic sum	dF	mean square	F	Sig
	regression	452.944	9	50.325	33.129	0
	residual	2293.912	1510	1.519		
	total	2746.856	1519			
Perk						
		unstandardized coefficients		standard coefficient	t	Sig
		B	standard error			
Constant		14.887	0.156		88.19	0.000
Power		0.008	0.017	0.013	0.448	
REPCONNECT		0.019	0.083	0.006	0.227	0.823
REPCONNECT*power		0.114	0.037	0.083	3.175	0.003
Totassrat		0.329	0.069	0.134	5.116	0.000
Topten		2.243	0.217	0.024	10.418	0.000
Opeincmgrrt		0.000	0.000	-0.059	-2.476	0.016
Dbastrt		0.013	0.003	0.176	5.987	0.000
ROA		12.987	2.182	0.154	-2.827	0.000

Robustness Tests

In order to test the reliability of the test results, the author chooses "average amount of perquisite consumption (logarithm)" as the substitute variable of perquisite consumption, reanalyzing all the models mentioned above and has essentially the same results. Considering the length of this paper, robustness tests will not be discussed.

CONCLUSION

This paper selects listed companies in China as research subjects, studying the relationship between managerial discretion and perquisite consumption and tests the impact of political connection on this relationship. The test results are as following.

There is a positive relationship between perquisite consumption and the interaction terms of discretion and political connections are SOE. In other words, the extent of perquisite consumption in SOE might witness a growth after the establishment of political connections. Between those political connections, the political connections of government officials would also reinforce the perquisite consumption in private companies, which validates the hypothesis in this paper. To the contrary, this phenomenon would not occur in private companies with political connections of representatives. This proves that power has limited influence on perquisite consumption, which more often to be a type of rent-seeking activity, in these corporate.

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