

External sources of political connections: Financial advisors and Chinese acquisitions

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Abstract

This study considers the effects of an external form of political connection, namely, politically connected financial advisors, on the value creation of Chinese acquiring firms over the period 2004–2014. Using data consisting of 1,623 Chinese mergers and acquisitions (M&As) deals, we show that politically connected financial advisors create significantly higher market value for acquiring firms, after controlling for firms' own political connections and reputation. Further analysis indicates that the appointment of political advisers can improve an acquiring firm's long-term industry-adjusted operating performance and help acquirers reduce bid premiums. We show that private firms and stock-pay acquisitions are more likely to appoint politically connected financial advisors in M&A transactions, whereas our findings remain unchanged after controlling for endogeneities.

KEYWORDS

acquisition performance, financial advisors, mergers and acquisitions, political connection, value creation

1 | INTRODUCTION

Political connections may benefit a firm in terms of low-cost financing, preferential tax treatment, more government subsidies, and superior access to regulated industry (Feng, Johansson, & Zhang, 2015). On the other hand, there are potential costs to the firm's own political connections, such as higher volatility, high beta, poor corporate governance, and lower levels of equity-based compensation (Kostovetsky, 2015; Shen, Lin, & Wang, 2015). These somewhat opposing elements explain why some empirical studies find that political connections generate value for shareholders (Brockman, Rui, & Zou, 2013; Civilize, Wongchoti, & Young, 2015; Conyon, He, & Zhou, 2015), whereas others fail to find any positive effect in this regard (Faccio, 2010; Mitchell & Joseph, 2010; Peng & Luo, 2000).

To solve this “double-edged sword” problem engendered by political connections, this research considers

another form of political connection, namely, the external political connections that are associated with firms. We investigate acquirers' decisions to appoint politically connected financial advisors (*PC advisors*) in Chinese mergers and acquisitions (M&As) and how such advisors influence value creation. The focus on the role of politically connected financial advisors in Chinese M&As is motivated by the following reasons. First, Chinese M&As are subject to strict government control, and the success of an acquisition depends crucially on the approval of Chinese regulators, as an M&A's plan has to be approved by the M&As committee of the Chinese Securities Regulatory Committee (CSRC; hereafter “the committee”). The committee focuses on the legal and accounting information disclosure of each submitted M&A application, and it approves the application on the basis of economic, consumer protection and national interests. Therefore, setting up a potential connection with government regulators will obviously be helpful in

the approval process. Several researchers echo this point and emphasize the “helping hand” approach of government–business relationships in shaping business strategy and performance in China (Che & Qian, 1998).

Second, the role of external advisors is vital and common practice for companies conducting acquisitions in advanced market economies, but it is a relatively new and unexplored phenomenon in China. Financial advisors have the expertise to help firms select appropriate acquisition targets, carry out due diligence, and negotiate favourable terms on behalf of acquiring firms. In addition, financial advisors in China also help firms liaise with government regulators, in order to speed up the acquisition process. In a highly regulated financial market, the ability to communicate effectively with government regulators is another key determinant to be considered by companies when selecting advisors. Against this backdrop, it is important to shed light on the effects of financial advisors on M&As, which are important corporate events and yet an under-researched topic, to facilitate managerial decision-making in emerging countries.

Third, as one of the most important corporate investment decisions, M&As can have a significant effect on the wealth of shareholders. For example, some authors (Bi & Gregory, 2011; Shleifer & Vishny, 2003) have examined the U.S. and U.K. markets and generally found that M&As destroy shareholder value in both the short and the long terms. On the other hand, Boateng and Bi (2014) and Bi and Wang (2018) found that M&As generate value for Chinese shareholders. Using acquisitions as an empirical setting enables us to examine directly the value-creation role of politically connected financial advisors.

This study examines the Chinese market for the following reasons. First, the Chinese government is known for its active involvement in firms' business operations, through both ownership and market regulation (Du, Boateng, & Newton, 2016). In the capital market, government regulators create rules to regulate financing and acquisition activities, and thus, firms that fall into the category of “supported industries” find it easier to access external financing and conduct acquisitions in regulated industries. In this environment, building up political connections through either recruiting a politically connected managerial team or seeking external-related sources that help firms achieve desired business objectives is crucial. Second, a remarkable feature of the Chinese stock market is its poor levels of available information (Piotroski & Zhang, 2014), due to inadequate disclosure and governance standards; in this environment, the information-conveying role of financial advisors in takeover deals becomes very important.

Using 1,623 acquisition deals over the period 2004 to 2014, we found that politically connected financial advisors create significantly higher market value for acquiring firms after controlling for the firm's political connections and advisors' reputations. The value-creation role of politically connected financial advisors is more pronounced for small acquirers and those with a high Tobin's Q. Furthermore, in terms of the source of value creation, we find that appointing this type of financial advisor for the transaction can improve an acquiring firm's long-term, industry-adjusted operating performance and help reduce the bid premium. In addition, our empirical studies also show that private firms that are potentially less likely to have strong political connections with various government regulators, and in complex deals such as stock-pay acquisitions, are more likely to appoint politically connected financial advisors for the transaction, in order to take advantage of the positive role they play. Our results remain the same after taking the following three-pronged approach to addressing endogeneity in our empirical investigations: the year and industry fixed effect, to address the omitted variable problem, Heckman (1979), to control for “self-selection bias,” and propensity score matching (PSM), to address sample selection bias based on observable firm characteristics.

Our study contributes in several ways to the ongoing debate on the impact of political connections on shareholder wealth. First, instead of considering a firm's political connections, which are prone to the aforementioned potential “double-edged sword” problem, we examine an external source of political connection, namely, the decision to appoint a politically connected financial advisor. Existing empirical studies find mixed evidence regarding the role of the firm's political connections, with some of the literature (Cull, Li, Sun, & Xu, 2015; Feng et al., 2015) supporting the notion that they generate higher value for firms, because of the easier access to capital, the lower cost of financing, and preferential tax treatment. Nonetheless, other empirical studies have found a negative effect in this regard on a firm's value creation, due to higher volatility, high leverage, and poor corporate governance (Kostovetsky, 2015; Shen et al., 2015). Therefore, we consider the acquirer's decision to appoint a politically connected financial advisor, as well as its subsequent impact on value creation. Such an empirical setting enables us to focus on the role of political connections without the contamination effect of other firm characteristics.

Second, we contribute to the M&A literature regarding the key determinants of acquisition performance, as M&A-related decisions are the most important of all corporate decisions, and associated transactions have a significant impact on shareholder value. In the Chinese

financial market, the government has both the opportunity and the motivation to exert considerable influence on a firm's investment decisions (Brockman et al., 2013). Thus, Chinese M&A samples provide us with an ideal testing ground on which to examine the role of political connections in this complex corporate transaction. After controlling for the common factors that have been examined in the current literature, for example, size, leverage, and Tobin's Q (Huang, Jiang, Lie, & Yang, 2014; Phalippou, Xu, & Zhao, 2014), we additionally collect data on the acquirer's political connections and external advisors' political connections, to examine whether these networks play a more important role in a highly regulated financial market.

Third, we expand the current financial intermediary literature to consider the social network effect, namely, financial intermediaries' political influences. The question of whether financial advisors, especially quality financial advisors, add value to the transaction is still subject to much debate; for example, Rau (2000), Francis, Hasan, and Sun (2014), and Ismail (2010) suggest that they are indeed valuable to firms, due to their superior expertise in the M&As market, whereas others (Bowers & Miller, 1990; Michel, Shaked, & Lee, 1991; Rau, 2000) measure quality based on either the prestige of the name or market share. Unfortunately, however, they fail to find any link between advisor quality and acquirer returns, because an advisory fee is paid only if the acquisition is completed and the fees are not contingent on whether the transaction creates value for the acquirer (Sibilkov & McConnell, 2014). Our research provides additional evidence regarding the role played by financial advisors in acquisition transactions by focusing on their political connections.

The rest of the paper is organized as follows. Section 2 presents the literature review and institutional background. Section 3 discusses data and our variables, and Section 4 presents empirical evidence on the impact of politically connected financial advisors on acquisition performance. Finally, Section 5 reports the robustness test, and Section 6 concludes.

2 | LITERATURE REVIEW AND INSTITUTIONAL BACKGROUND

2.1 | Literature review of political connections

Our paper is related to several strands of the political connection literature. First, some empirical studies support the notion that political connections generate value for shareholders. For example, Civilize et al. (2015) used hand-collected data from 1985 to 2008 and found that

politically connected firms enjoyed higher realized returns than nonpolitically connected firms, especially in competitive and regulated industries. Examining "star-CEOs" in Chinese listed firms, Conyon et al. (2015) found that these strong politically connected companies have much higher announcement returns and higher CEO compensation and these premiums are largely driven by the political connections of these "star-CEOs." In cross-border M&A research fields, Brockman et al. (2013) used M&A samples from 22 countries and found that politically connected acquirers have more than 15% higher abnormal returns than unconnected firms, and these abnormal returns are much higher in weak legal systems or in highly corrupt countries.

A number of other studies have also investigated the reasons for the value creation of political connectedness. For example, Cull et al. (2015) demonstrated that political connections can reduce financial constraints and make it easier to acquire financing from state-owned banks. More specifically, Feng et al. (2015) identified four ways through which political connections in China can add value: better access to debt financing, preferential tax treatment, more government subsidies, and superior access to a regulated industry. Boubakri, Guedhami, Mishra, and Saffar (2012) used data from 1997 to 2001 to show that political connections can significantly reduce a firm's cost of equity, and thus, politically connected firms are considered to be lower risk than their nonconnected counterparts. In addition to an increase in performance, political connections can also increase the number of successful initial public offerings (IPOs; Li & Zhou, 2015) and are less likely involved in US Securities and Exchange Commission (SEC) enforcement actions (Correia, 2014), thus supporting, along with all of the above evidence, the benefits of political connection.

On the other hand, there are potential costs involved in political connections. Faccio (2010) used 16,191 firms across 47 countries to show that these companies have much lower operating performance and lower market valuations because of their higher leverage compared with matching firms. Mitchell and Joseph (2010) also demonstrated empirically that politically connected firms do not perform well, and they also suffer more during crisis periods. Peng and Luo (2000) again documented that ties to political officers do not add value to firms in China.

Empirical studies have also documented reasons why political connections might destroy an organization's value. For example, Kostovetsky (2015) examined how they affect risk exposure, finding that politically connected firms had higher leverage, high volatility, and high beta. Shen et al. (2015) established that these businesses are more likely to demonstrate poor governance

practices, thus destroying firm value in the long run, whereas Yu (2010) also provided empirical evidence to show that CEOs in these companies have a lower level of equity-based compensation, which in turn has negative consequences for aligning interests between top management and shareholders.

2.2 | Financial advisors and sources of value gain

The key role of financial advisors in M&As is to process and evaluate information in the market and then to provide technical and tactical assistance to merger rivals throughout the takeover process (Chang, Shekhar, Tam, & Yao, 2016). Early theoretical studies by Beatty and Ritter (1986) demonstrated that financial advisors are able to collect information and—as mediators—resolve the information asymmetry issue in transactions. The latest empirical studies also support the information role of financial advisors; for example, Graham, Walter, Yawson, and Zhang (2017) find that those with target industry experience can help acquiring firms to identify and evaluate the potential synergies of target firms. Furthermore, experience also enables financial advisors to establish extensive networks of connections in a particular industry, thereby giving these advisors a competitive advantage in extracting information in the takeover process. Their empirical studies support the above hypotheses and find that financial advisors with extensive industry experience have higher cumulative abnormal returns (CARs) and lower premiums. Song, Wei, and Zhou (2013) document that “boutique advisors” generate value in complex deals, because of their skill and expertise, and they also help acquirers achieve more favourable deal outcomes, such as lower premiums. In addition, Francis et al. (2014) propose a “certification” role of financial advisors in cross-border M&A deals, in that they establish that financial advisors with target-country deal experience improve shareholder value by picking up suitable targets and generating higher operating performance. All of the above studies support the “information advantage” argument of financial advisors who can improve the screening of target candidates and make better deals.

2.3 | Regulated M&A market in China

Different from developed capital markets, the Chinese financial market is still heavily regulated by the government and/or market regulators (i.e., CSRC). For example, in the IPO market, the government still controls the numbers of organizations that can be listed each year, and a new issuing firm's PE ratio has to be under a certain limit set by CSRC. In the Seasoned equity offering (SEO) market,

CSRC periodically issues guidance regarding which industry will be supported. Similarly, in the M&A market, the government plays a crucial role in how listed firms conduct an acquisition, as the success thereof depends crucially on the approval of Chinese regulators. Takeover transactions in China need to be approved by an M&A committee of the CSRC, which will consider all the documents submitted and make their final decision based on current accounting and legal regulations in the Chinese capital market. The key criterion in this decision process is to protect shareholder value. Therefore, understanding the latest takeover regulations and responding properly to enquiries from regulators are particularly important to ensuring successful approval by the committee.

3 | DATA AND VARIABLES

In this section, we discuss our sample, the main variables, and sample characteristics. We also present a univariate test, in order to compare deal characteristics grouped by politically connected acquisitions versus nonpolitically connected acquisitions.

3.1 | Sample construction

Our sample of 1,623 Chinese domestic M&As deals are selected from the GTA Corporate Restructure and Acquisition database from 2004 to 2014. We use the following criteria to select our final M&As sample: (a) transaction type would include mergers, tender offers, and acquisitions of assets; (b) acquirers would be domestic Chinese listed companies; (c) the deal value would be at least 1% of the acquirers' total assets; (d) related-party transactions and financial and utility sectors would be excluded, due to different financial reporting methods; (e) we exclude observations with multiple deals announced for the same firm over the 1-year period to reduce the contamination effect; and (f) firm-level financial and accounting data would be selected from the CSMAR database.

Table 1 presents a sample industry distribution for the 1,623 acquisition observations. Our samples cover all major CSRC industries, excluding financial and utilities firms. The manufacturing industry has the highest number of deals (61.18%), followed by the real estate industry (9%) and the IT industry (8.69%). Acquisitions in the IT industry increased dramatically due to the importance of IT technology for various sectors. Our sample industry distribution is very similar to that reported by Deng, Kang, and Low (2013) in the U.S. market, where 57.19% of U.S. acquirers operate in the manufacturing sector. Table 1 also presents the industry distribution for the 340 politically connected advisor samples, and the

TABLE 1 Sample distribution by CSRC industry classification

CSRC industry classification	All samples		Politically connected advisors samples	
	N	%	N	%
Manufacturing	993	61.18	220	64.71
Real estate	146	9.00	10	2.94
IT	141	8.69	61	17.94
Wholesale and retail trade	92	5.67	5	1.47
Mining	60	3.70	10	2.94
Transportation, storage	39	2.40	3	0.88
Leasing and other business service	25	1.54	6	1.76
Agriculture, forestry, livestock farming, fishery	24	1.48	4	1.18
Other communication and cultural industries	24	1.48	4	1.18
Construction	22	1.36	7	2.06
Professional, scientific research service	19	1.17	2	0.59
Public facilities service	18	1.11	6	1.76
Catering and hotels	9	0.55	2	0.59
Comprehensive	8	0.49	0	0.00
Hygiene, health care, nursing service, and other social services	3	0.18	0	0.00
Total	1,623	100.00	340	100.00

Note. This table reports our sample distribution by acquirer industry. Our sample consists of 1,623 M&A deals from GTA M&A databases. Our industry classification follows Chinese Securities Regulatory Committee (CSRC) industry code.

manufacturing industry still has the highest number of deals (64.71%). The number of politically connected advisors deals in the IT industry increased dramatically to 17.94%.

3.2 | Measure of key variables

Our main variable of interest is a dummy variable equal to 1, if acquirers appointed a politically connected financial advisor in the transaction; otherwise, the dummy equals 0. In the Chinese M&A market, securities companies play the role of financial advisors for each transaction, and so we define a politically connected financial advisor if at least one of the top management team members of a specific securities company has political connections. Following existing empirical studies (Civilize et al., 2015; Feng et al., 2015; Liu, Tang, & Tian, 2013), our

definition of a political connection is that a top management team member of a securities company is a current or a former member of the People's Congress (including a member of the People's Political Consultative Conference) or is a former government official. The CVs of each top management team member were hand-collected from company annual reports and websites. As shown in Tables 1 and 2, around 21% of our acquirers appoint politically connected financial advisors in the transaction.

To determine whether appointing PC advisors can improve shareholder value through acquisition, we examine whether acquisition deals with them affect capital market responses to the announcement of deals, measured by CARs over various event windows. We apply a standard event study methodology based on a standard market model benchmark, with market returns provided by the Shanghai Composite Index. Specifically, the market model calculates the abnormal return AR_{it} for firm i on day t as

$$AR_{it} = R_{it} - (\alpha_i + \beta_i R_{mt}), \quad (1)$$

where R_{it} is returns for firm i on day t and α_i and β_i are firm-specific regression parameters estimated over the 250-day period, in this case event day -310 to event day -61 . We focus on various event windows, and the event day is designated as the announcement date of the acquisition deal.

An alternative method for calculating CAR involves using a market-adjusted model over a market model, due to the illiquidity bias (Dimson, 1979; Dimson & Marsh, 1983) of the estimation of market model parameters in China. In our market-adjusted model, a market return is the return earned on the market index (Shanghai Composite Index/Shenzhen Component Index) for the firm's market, as indicated on the CSMAR database. For brevity, we only report results based on the market model, but CAR results using the market-adjusted model still hold in all of our regression analyses.

3.3 | Sample statistics

Table 2 presents summary statistics on key acquiring firm characteristics. Detailed definitions of the variables are given in Appendix A. All continuous variables are winsorized at their first and 99th percentiles, to reduce the influence of outliers. Our results show that the acquiring firms' CARs over three different observation periods, and the mean CARs for acquiring firms, are within 1.5% to 3.3%, and the median CARs for acquiring firms are in the range 0.4% to 1.6%. The short-term abnormal return reported in this paper is in line with the results in Yang, Guariglia, and Guo (2017), who find that

TABLE 2 Sample variable summary statistics

Variable	<i>N</i>	<i>M</i>	<i>SD</i>	<i>P25</i>	<i>P50</i>	<i>P75</i>
Cumulative abnormal return from market model						
$CAR_{mkt}(-1,1)$	1,549	0.017	0.075	-0.025	0.008	0.050
$CAR_{mkt}(-2,2)$	1,555	0.018	0.096	-0.034	0.006	0.057
$CAR_{mkt}(-5,5)$	1,573	0.015	0.134	-0.051	0.004	0.069
Cumulative abnormal return adjusted by market return						
$CAR_{mktadj}(-1,1)$	1,409	0.022	0.072	-0.021	0.011	0.053
$CAR_{mktadj}(-2,2)$	1,416	0.026	0.092	-0.026	0.010	0.062
$CAR_{mktadj}(-5,5)$	1,443	0.033	0.122	-0.036	0.016	0.081
Acquirer and deal characteristics						
<i>Size</i> (in billions)	1,623	5.632	6.452	2.122	3.637	6.561
<i>Leverage</i>	1,623	0.363	0.224	0.173	0.338	0.520
<i>Cash holdings</i>	1,620	0.207	0.180	0.076	0.152	0.292
<i>Tobin's Q</i>	1,547	1.970	1.116	1.290	1.590	2.187
<i>BM</i>	1,547	0.612	0.216	0.457	0.629	0.775
<i>Run-up</i>	1,538	0.100	0.532	-0.198	0.001	0.293
<i>ROA</i>	1,589	0.014	0.056	-0.012	0.012	0.040
<i>ROE</i>	1,589	0.020	0.093	-0.020	0.015	0.057
<i>Pre-holdings</i> (%)	1,467	13.481	25.564	0.000	0.000	4.030
<i>Post-holdings</i> (%)	1,471	71.046	29.494	51.000	75.821	100.000
<i>Relative size</i>	1,623	0.112	0.232	0.020	0.038	0.097
<i>All-cash</i> (0/1)	1,623	0.860	0.348	1.000	1.000	1.000
<i>Managerial holdings</i>	1,590	0.143	0.214	0.000	0.000	0.300
<i>CEO duality</i> (0/1)	1,511	0.310	0.463	0.000	0.000	1.000
<i>Independent directors</i>	1,583	0.367	0.050	0.333	0.333	0.400
<i>Shareholding concentration</i> (%)	1,590	49.927	15.209	38.960	51.021	61.581
<i>Z index</i>	1,590	10.122	20.175	1.667	3.625	8.248
<i>PC advisor</i> (0/1)	1,623	0.209	0.407	0.000	0.000	0.000
<i>PC acquirer</i> (0/1)	1,623	0.474	0.499	0.000	0.000	1.000

Note. This table reports the number, mean, standard deviations, 25th percentile, median, and 75th percentile of acquirer and deal characteristics. See Appendix A for the detailed definition of variables.

Chinese acquirers have significantly positive CARs in the range 1.85% to 2.16% over three to five event-day periods from 1998 to 2015. Our CARs are also quantitatively similar to a more recent paper by Bi and Wang (2018), who use two models to calculate CARs and find that Chinese acquirers' CARs range from 2.7% to 4.7% over three to 11 event-day periods.

The significantly positive returns of these Chinese acquirers are due mainly to the fact that takeovers are likely to improve acquiring firms' long-term profitability and enhance their competitive advantage. In addition, Chi, Sun, and Young (2011) argue that the low M&A competition in China is another reason for these observed positive CARs in China.

The median market capitalization of acquirers is 3.64 billion yuan, and the median leverage ratio for acquiring firms is 0.338. Our sample's acquirers also have a mean cash holding of 20.7%, which supports Boateng and Bi (2014)'s argument that most Chinese acquiring firms are cash-rich. In this sample, the acquirers' median Tobin's Q ratio is 1.59, book-to-market ratio of 0.629, and price run-up (measured by a pre-event 12-month buy and hold abnormal return (BHAR)) of 0.1%. In terms of operating performance measurement, our sample's acquiring firms have higher industry median-adjusted return on assets (ROA) and return on equity (ROE), which are, respectively, 1.2% and 1.5% higher than the industry median value. Our acquirers' Tobin's Q ratio is similar to that

TABLE 3 Univariate tests

Variables	Non-PC adv	PC adv	Diff	<i>p</i> value
Cumulative abnormal return from market model				
$CAR_{mkt}(-1,1)$	0.012	0.066	-0.054	0.000
$CAR_{mkt}(-2,2)$	0.012	0.078	-0.066	0.000
$CAR_{mkt}(-5,5)$	0.011	0.084	-0.073	0.000
Cumulative abnormal return adjusted by market return				
$CAR_{mktadj}(-1,1)$	0.014	0.069	-0.055	0.000
$CAR_{mktadj}(-2,2)$	0.017	0.082	-0.065	0.000
$CAR_{mktadj}(-5,5)$	0.027	0.096	-0.069	0.000
Acquirer and deal characteristics				
<i>Size</i> (in billions)	5.700	4.500	1.200	0.001
<i>Leverage</i>	0.348	0.279	0.070	0.000
<i>Cash holdings</i>	0.213	0.248	-0.034	0.005
<i>Tobin's Q</i>	2.005	2.158	-0.153	0.096
<i>BM</i>	0.612	0.566	0.046	0.007
<i>Run-up</i>	0.124	0.191	-0.067	0.068
<i>ROA</i>	0.014	0.016	-0.002	0.542
<i>ROE</i>	0.018	0.020	-0.002	0.789
<i>Pre-holdings (%)</i>	15.325	7.775	7.549	0.000
<i>Post-holdings (%)</i>	72.343	80.137	-7.795	0.000
<i>Relative size</i>	0.086	0.283	-0.197	0.000
<i>All-cash (0/1)</i>	0.908	0.469	0.439	0.000
<i>Managerial holdings</i>	0.172	0.261	-0.088	0.000
<i>CEO duality (0/1)</i>	0.362	0.381	-0.020	0.583
<i>Independent directors</i>	0.371	0.375	-0.004	0.257
<i>Shareholding concentration (%)</i>	49.921	50.069	-0.148	0.893
<i>Z index</i>	10.055	5.632	4.423	0.001
<i>PC acquirer (0/1)</i>	0.485	0.489	-0.004	0.923

Note. This table reports acquirer and deal characteristics for PC advisor sample and the non-PC advisor sample, respectively. See Appendix A for the detailed definition of variables.

reported by Schmidt (2015) and Yang et al. (2017), but it has a higher leverage ratio than U.S. acquirers. Regarding the proxies for corporate governance, 14.3% of our acquirers have managerial holdings, and 36.7% of board members are independent directors, whereas the controlling shareholders of our sample's acquirers hold more than 49% of outstanding shares, which indicates a very concentrated ownership structure in Chinese capital markets.

3.4 | Univariate test

Table 3 presents a univariate test of key acquiring firm characteristics through the presence of PC advisors in

M&A deals. We observe that firms in the two subgroups have different firm characteristics. Table 3 demonstrates that acquiring firms with PC advisors have a greater relative size, higher price run-up, and a higher Tobin's Q ratio and are less likely to pay in cash than firms without PC advisors. Moreover, there is no significant statistical difference in terms of managerial holdings and pre-event operating performance. In addition, average market reactions around announcements (CARs) are positive for both subsamples, whereas the PC advisors subsample experiences significantly higher short-term market reactions than the non-PC advisors subsample. Collectively, these univariate results suggest that markets react positively to those acquirers who appoint PC advisors in the transaction.

4 | EMPIRICAL ANALYSIS

4.1 | Announcement effect

If appointing PC advisors can create value for the acquisition deal compared with a non-PC advisor deal, we expect such firms to make better acquisitions and experience higher market reactions in relation to these events. In the following section, we examine whether PC advisors generate better acquisition deals, by presenting estimates from multivariate regressions, using $CAR(-1/1)$ as the dependent variables and the dummy variables of PC advisors as a key independent variable. Our regressions of acquisition returns control for acquirers' political connections, the determinants of acquirers announcement returns shown in previous studies (Huang et al., 2014; Phalippou et al., 2014). Specifically, *ROA* measures accounting performance (Harford, 1999), and *pre-event price run-up* measures stock price performance. We also include *cash holding*, to control for the agency cost of free cash flow (Jensen, 1986), and *book-to-market ratio*, to control for investment opportunities (Officer, 2003). Other firm and deal characteristics include firm size, leverage, Tobin's Q ratio (growth opportunity), and method of payment. In addition to including common control variables in the M&A literature, we also include corporate governance variables available for the Chinese market in our regressions, including *CEO duality*, *managerial holding*, *independent directors*, *share concentration ratio*, and *Z index* (Boateng & Bi, 2014). Our regressions also control for industry and yearly fixed effects. We use the following multivariate regression:

$$CAR_{(-1,1),i} = \beta_0 + \beta_1 PCadv_i + \gamma_1 DealControl_i + \gamma_2 CGControl_i + \varepsilon_i \quad (2)$$

where the dependent variable $CAR_{(-1,1),i}$ is the announcement CAR calculated from the market model during the

(−1,1) event window for firm i . Our main variable of interest is $PCadv_i$, a dummy variable that equals 1, if a deal is advised by a politically connected financial advisor, and 0 otherwise.

The results are reported in Table 4. Column 1 presents estimates of the *politically connected advisors* coefficient, without any control variables. The coefficient is 0.041 and significantly positive at the 1% level. The result suggests that the average CARs for acquiring firms that appoint PC advisors is 4.1% higher than the average CARs for acquiring firms that do not appoint PC advisors. Column 2 presents estimates after controlling for the acquirer's political connections and the determinants of acquirer announcement returns in previous studies. These control variables include acquirer *size*, the *leverage* ratio, the acquirer's *cash holding* prior to the event, the acquirer's *Tobin's Q* ratio, the *book-to-market ratio*, the *percentage share held after the transaction*, and the

acquirer's *pre-event performance*. We find that the coefficient estimates for PC advisors are reduced to 0.019, but they remain positive and significant at the 1% level. Thus, even after controlling for various firm- and deal-specific characteristics, acquisitions with PC advisors create higher returns than those deals that do not appoint PC advisors. In column 3, we repeat the regression analysis seen in column 2 and include additional corporate governance variables in the Chinese market, including the *percentage of managerial holdings*, *CEO duality*, and the *percentage of independent directors* (Boateng & Bi, 2014); our primary explanatory variable of interest, namely, the *PC advisors* dummy, is still positively and significantly associated with the acquirers' announcement returns. Table 4 provides strong evidence supporting the notion that a politically connected advisor creates value for shareholders, even controlling for the acquirer's own political connections.

TABLE 4 PC advisor and value creation

Dep. var = $CAR(-1/1)$	(1)	(2)	(3)
<i>PC advisor</i> (0/1)	0.041*** (0.000)	0.019*** (0.004)	0.019*** (0.005)
<i>PC acquirer</i> (0/1)		−0.001 (0.872)	−0.001 (0.766)
<i>Size</i>		−0.012*** (0.000)	−0.013*** (0.000)
<i>Leverage</i>		−0.014 (0.251)	−0.009 (0.489)
<i>Cash holding</i>		−0.032* (0.056)	−0.028 (0.103)
<i>Tobin's Q</i>		−0.003 (0.289)	−0.003 (0.312)
<i>BM</i>		−0.029* (0.097)	−0.033* (0.070)
<i>Run-up</i>		−0.001 (0.875)	−0.002 (0.728)
<i>ROA</i>		−0.023 (0.314)	−0.019 (0.399)
<i>Pre-holdings</i>		−0.007 (0.345)	−0.007 (0.391)
<i>Post-holdings</i>		0.005 (0.469)	0.005 (0.523)
<i>Relative size</i>		0.020** (0.041)	0.018* (0.077)
<i>All-cash</i>		−0.042*** (0.000)	−0.044*** (0.000)
<i>Managerial holdings</i>			−0.004 (0.715)
<i>CEO duality</i>			−0.002 (0.682)
<i>Independent directors</i>			−0.013 (0.727)
<i>Shareholding concentration (%)</i>			0.030** (0.024)
<i>Z index</i>			−0.000 (0.344)
Intercepts	−0.003 (0.855)	0.243*** (0.000)	0.265*** (0.000)
<i>N</i>	1549	1268	1206
R^2	0.081	0.129	0.130
Year dummy	Y	Y	Y
Industry dummy	Y	Y	Y

Note. This table presents results from the regression of acquirer CARs on the *politically connected advisor* dummy and other acquirer- and deal-specific characteristics for a sample of China M&As. The dependent variable is acquirer $CAR(-1,1)$. Variables are defined in Appendix A. All regressions control for year and industry fixed effects. The p values reported in parentheses are based on standard errors adjusted for heteroscedasticity and clustered at the firm level.

*Statistical significance at the 10% levels. **Statistical significance at the 5% level. ***Statistical significance at the 1% level.

Announcement CARs are also significantly related to certain firm- and deal-specific characteristics. Consistent with previous findings, such as those presented by Faccio, McConnell, and Stolin (2006), there is a significant negative relationship between acquirer CARs and acquirer size. Our regressions also support Yang et al. (2017), in that cash-payment acquisitions in China reduce shareholder value (significantly negative CARs). In our sample, acquirer CARs are also negatively related to the book-to-market ratio and positively related to the relative size of deals.

4.2 | When are PC advisors most valuable?

The results in Table 4 suggest that PC advisors do indeed add value for shareholders, and we expect that these value-creation effects of political connections are more important for firms that are small and potentially have more growth opportunities, in which case appointing politically connected advisors will create much higher market abnormal returns for small size acquirers and high Q ratio firms.

To examine the above hypotheses, we perform the CARs regressions as in Equation (2) by interacting the *PC advisors* dummy with the *small acquirer* dummy and *high Tobin's Q* dummy. The dep. variable in Table 5 is the acquirer's CAR(-1/1), and all other control variables are the same as those used in Table 4. The estimated coefficient for *PC advisors* remains significantly positive. More importantly, as shown in columns 1 and 2 of Table 5, the significantly positive coefficient on the interaction term *PC advisors * Small acquirer* suggests that the value-creation effect of PC advisors is more pronounced for smaller acquirers who are young and less likely to have strong connections with government or market regulators. Columns 3 and 4 of Table 5 suggest that the value-creation effect of PC advisors is also significant for acquirers with higher growth opportunities, as the interaction term *PC advisors * High Tobin's Q* is significantly positive at the 5% level. Our results do not change when we include both the *small acquirer* dummy and the *high Tobin's Q* dummy in the same regression, as shown in columns 5 and 6 of Table 5. Taken together, the results in Table 5 indicate that the value-creation effects of appointing PC advisors are highly valued for small- and high-growth opportunities acquirers.

4.3 | The source of value gain

In the following section, we explore potential sources of the value gains associated with acquisitions, to identify the mechanisms through which politically connected financial advisors add value for acquirers'

shareholders. In particular, we hypothesize that they can help acquirers select the "right" target, generating greater synergy and thereby enhancing post-event operating performance.

$$OP_i = \beta_0 + \beta_1 PCadv_i + \gamma_1 DealControl_i + \gamma_2 CGControl_i + \varepsilon_i \quad (3)$$

The dependent variables are *ROE* and *ROA* in the 12 months following the acquisition, defined as the difference between raw data and the industry median value. All regressions control for the acquiring firm's characteristics and deal characteristics, as defined in Appendix A.

Coefficients for the *PC advisors* dummy in columns (1) and (3) of Table 6 are all statistically significant at the 5% level, suggesting that, on average, the appointment of PC advisors can improve industry-adjusted operating performance over the post-acquisition 12-month period, possibly because they can help select suitable targets with higher potential synergy. Furthermore, we control for additional corporate governance variables in the regression, and the results in columns (2) and (4) of Table 6 show that the coefficients for PC advisors remain significant positive at the 5% level, thereby indicating that appointing PC advisors can generate superior operating performance for acquirers compared with their industry peers.

We further hypothesize that a politically connected financial advisor can help acquirers negotiate better deal terms through their influence with local government, especially for private acquirers, thereby reducing the bid premium in the transaction.

$$Premium_i = \beta_0 + \beta_1 PCadv_i + \gamma_1 DealControl_i + \gamma_2 CGControl_i + \varepsilon_i \quad (4)$$

The dependent variable is *bid premium*, defined as the offer price divided by the target book value. All regressions control for the acquiring firm's characteristics and deal characteristics, as defined in Appendix A.

Coefficients for the *PC advisors* dummy in columns (3) and (4) of Table 7 are not statistically significant after controlling for deal- and firm-level characteristics, suggesting that PC advisors from a standalone point of view do not have a strong influence on the bid premium. However, the interaction term *PC advisors * Private acquirer* is significantly negative at the 5% level, and it remains so after we include additional deal- and firm-level control variables, thereby indicating that appointing PC advisors can reduce bid premiums for the private acquirers.

TABLE 5 PC advisor, small acquirer, and high Q acquirer

Dep. var. = $CAR(-1/1)$	(1)	(2)	(3)	(4)	(5)	(6)
<i>PC advisor</i> (0/1)	0.030*** (0.000)	0.005 (0.577)	0.028*** (0.000)	0.006 (0.473)	0.010 (0.371)	-0.015 (0.223)
<i>Small acquirer</i>	0.014*** (0.001)	0.000 (0.949)			0.012*** (0.004)	-0.001 (0.835)
<i>PC advisor</i> × <i>Small acquirer</i>	0.020* (0.075)	0.027** (0.025)			0.029** (0.013)	0.034*** (0.007)
<i>High Tobin's Q firm</i>			0.003 (0.488)	-0.001 (0.941)	0.004 (0.310)	-0.003 (0.727)
<i>PC advisor</i> × <i>High Q firm</i>			0.019 (0.101)	0.025** (0.046)	0.024** (0.039)	0.032** (0.012)
Acquirer controls	N	Y	N	Y	N	Y
Deal controls	N	Y	N	Y	N	Y
Fixed effects	Year, industry	Year, industry	Year, industry	Year, industry	Year, industry	Year, industry
Observations	1,549	1,206	1,489	1,206	1,489	1,206
Adjusted R ²	0.095	0.135	0.063	0.134	0.081	0.141

Note. This table presents results from the regression of acquirer CARs on the *PC advisor* dummy, its interaction with small acquirer, high Q firm, and other acquirer- and deal-specific characteristics. The dependent variable is acquirer $CAR(-1/1)$. Variables are defined in Appendix A. All regressions control for year and industry fixed effects. The *p* values reported in parentheses are based on standard errors adjusted for heteroscedasticity and clustered at the firm level.

*Statistical significance at the 10% levels. **Statistical significance at the 5% level. ***Statistical significance at the 1% level.

4.4 | The likelihood of appointing a PC advisor

If appointing politically connected financial advisors creates value for shareholders of acquiring firms, do firms recognize this gain and rationally choose to appoint them? In this section, we investigate further the determinants of acquiring firms' decisions on appointing PC advisors. We perform the following logit regression:

$$Prob(PCAdv)_i = \beta_0 + \gamma_1 FControl_i + \gamma_2 DControl_i + \varepsilon_i, \quad (5)$$

where the dependent variable $Prob(PCAdv)$ is a dummy variable that equals 1 if the acquiring firm appoints a PC advisor, and 0 otherwise. We include various firm and deal characteristics as the explanatory variables.

Table 8 presents the results. Our main variables of interest are the *private acquirers* dummy and the *stock-pay* dummy. State-owned firms in China are naturally linked to either centre-level or local-level government, and thus, they already have the potential benefits of political connections. However, private acquirers are less likely to have this advantage, and we therefore hypothesize that they are more likely to appoint PC advisors for transactions. Although stock payment acquisitions require the issuing of new shares before making the stock payment, and issuing additional new shares is highly regulated by government, additional political connections obviously benefit firms' new issue activities. We again hypothesize that acquirers are more likely to appoint politically connected advisors in stock payment acquisitions. The results are presented in Table 8 and confirm these two predictions. Column 1 shows that the coefficient on the *private acquirers* dummy is significantly positive at the 5% level, suggesting that private acquirers are more likely to appoint PC advisors. Column 2 illustrates that the coefficient on the *stock payment* dummy is also significantly positive at the 1% level, suggesting that acquirers are more likely to appoint PC advisors in stock payment acquisitions. Taken together, the results in Table 8 indicate that private acquirers in complex transactions are more likely to recruit external PC advisors.

5 | ROBUSTNESS CHECK

5.1 | Identification concerns

In this section, we address concerns about endogeneity and take the following three-pronged approach to address this issue in our empirical investigations: year and industry fixed effect, to address the omitted variable problem,

TABLE 6 PC advisor and operating performance

Dep. var. = <i>post-event operating performance</i>	(1)	(2)	(3)	(4)
	ROA	ROA	ROE	ROE
<i>PC advisor</i> (0/1)	0.007** (0.018)	0.007** (0.027)	0.012*** (0.005)	0.012*** (0.005)
<i>PC acquirers</i> (0/1)	-0.004* (0.075)	-0.004* (0.098)	-0.006 (0.170)	-0.005 (0.197)
<i>Size</i>	0.019*** (0.000)	0.018*** (0.000)	0.037*** (0.000)	0.034*** (0.000)
<i>Leverage</i>	-0.021** (0.013)	-0.017* (0.052)	0.014 (0.446)	0.017 (0.370)
<i>Cash holding</i>	0.041*** (0.000)	0.036*** (0.000)	0.029** (0.044)	0.022 (0.122)
<i>Tobin's Q</i>	0.001 (0.692)	0.002 (0.481)	0.003 (0.434)	0.005 (0.216)
<i>BM</i>	-0.046*** (0.001)	-0.052*** (0.000)	-0.039* (0.098)	-0.043* (0.067)
<i>Run-up</i>	0.000 (0.831)	-0.001 (0.578)	0.003 (0.444)	0.000 (0.899)
<i>ROA</i>	0.036 (0.287)	0.032 (0.264)	0.200*** (0.000)	0.190*** (0.000)
<i>Pre-holdings</i>	0.001 (0.814)	0.001 (0.810)	0.010 (0.248)	0.009 (0.283)
<i>Post-holdings</i>	0.001 (0.821)	-0.000 (0.929)	0.002 (0.769)	0.001 (0.910)
<i>Relative size</i>	0.004 (0.552)	0.001 (0.885)	-0.008 (0.452)	-0.013 (0.202)
<i>All-cash</i>	0.007* (0.075)	0.005 (0.168)	0.005 (0.488)	0.002 (0.704)
<i>Managerial holdings</i>		0.012** (0.024)		0.010 (0.181)
<i>CEO duality</i>		-0.006** (0.018)		-0.009** (0.048)
<i>Independent directors</i>		-0.012 (0.679)		-0.001 (0.985)
<i>Shareholding concentration (%)</i>		0.050*** (0.000)		0.076*** (0.000)
<i>Z index</i>		-0.000* (0.090)		-0.000 (0.305)
Intercepts	-0.265*** (0.000)	-0.261*** (0.000)	-0.550*** (0.000)	-0.550*** (0.000)
<i>N</i>	1313	1249	1313	1249
<i>R</i> ²	0.249	0.275	0.263	0.281
<i>Year dummy</i>	Y	Y	Y	Y
<i>Industry dummy</i>	Y	Y	Y	Y

Note. This table presents results from the regression of post-event operating performance on the *PC advisor* dummy and other acquirer- and deal-specific characteristics. The dependent variable is post-event industry median-adjusted 1-year ROE and ROA. Variables are defined in Appendix A. The *p* values reported in parentheses are based on standard errors adjusted for heteroscedasticity and clustered at the firm level.

*Statistical significance at the 10% levels. **Statistical significance at the 5% level. ***Statistical significance at the 1% level.

Heckman (1979), to control for “self-selection bias,” and PSM, to address sample selection bias based on observable firm characteristics.

First of all, the decision to appoint a politically connected financial advisor could be an endogenous decision and related to other firm characteristics that may influence M&A announcement returns. This possibility may also lead to omitted variable bias. Following Fich, Trana, and Walklinga (2013)'s suggestions, we correct omitted variable bias by including year and industry fixed effects in each of our multivariate tests, because industry and/or time trends could affect the incidence of M&As and the decision to appoint a PC advisor. As shown in Tables 4 and 5, all of our key variables of interest are significant at the 1% level.

Second, we consider the endogeneity of bidder–advisor matching that arises from the advisor's choice being

correlated with certain unobserved firm- or deal-specific characteristics, as PC advisors may be preferred by a specific type of acquirer, in which case traditional ordinary least squares estimates are therefore potentially biased. To address this concern, we follow Golubov, Petmezas, and Travlos (2012) and Heckman (1979)'s methods to control for this potential “self-selection bias.” Heckman (1979) argued that self-selection bias is similar in nature to a specification error (omitted variable bias) and proposed a two-stage procedure to control for it. We implement this procedure, whereby the first-stage equation models the choice between a PC advisor and a non-PC advisor and the second-stage equation corrects for selection bias.¹ Following Li and Prabhala (2007), this

¹Refer Golubov et al. (2012) for theoretical arguments and a practical application of this methodology.

TABLE 7 Politically connected advisor and bid premium

Dep. var. = <i>bid premium</i>	(1)	(2)	(3)	(4)
PC advisor (0/1)	0.654*** (0.005)	0.754*** (0.003)	0.333 (0.160)	0.372 (0.143)
<i>PC advisor</i> × <i>Private acquirer</i>	−0.515** (0.027)	−0.652** (0.012)	−0.415* (0.076)	−0.465* (0.070)
<i>Private acquirer</i>		0.154 (0.107)		0.070 (0.504)
<i>PC acquirers</i>			−0.107 (0.115)	−0.106 (0.118)
<i>Size</i>			0.203*** (0.000)	0.209*** (0.000)
<i>Leverage</i>			−0.171 (0.337)	−0.168 (0.347)
<i>Cash holding</i>			0.027 (0.919)	0.031 (0.904)
<i>Tobin's Q</i>			−0.107** (0.011)	−0.105** (0.013)
<i>BM</i>			−0.441* (0.092)	−0.424 (0.101)
<i>Run-up</i>			0.028 (0.547)	0.030 (0.519)
<i>ROA</i>			−0.302 (0.204)	−0.288 (0.230)
<i>Pre-holdings</i>			−0.187 (0.308)	−0.185 (0.312)
<i>Post-holdings</i>			0.080 (0.558)	0.079 (0.557)
<i>Relative size</i>			0.295*** (0.002)	0.292*** (0.003)
<i>All-cash</i>			−0.254** (0.015)	−0.251** (0.017)
<i>Managerial holdings</i>			0.327 (0.106)	0.300 (0.131)
<i>CEO duality</i>			0.011 (0.886)	0.000 (0.996)
<i>Independent directors</i>			−0.001 (0.999)	0.041 (0.956)
<i>Shareholding concentration (%)</i>			0.116 (0.605)	0.101 (0.660)
<i>Z index</i>			−0.003** (0.046)	−0.003* (0.066)
Intercepts	0.677** (0.024)	0.626** (0.039)	−1.040 (0.287)	−1.182 (0.235)
<i>N</i>	861	861	713	713
<i>R</i> ²	0.077	0.080	0.139	0.138
Year dummy	Y	Y	Y	Y
Industry dummy	Y	Y	Y	Y

Note. This table presents results from the regression of bid premium on the *PC advisor* dummy and other acquirer- and deal-specific characteristics. The dependent variable is acquirer *bid premium*. Variables are defined in Appendix A. The *p* values reported in parentheses are based on standard errors adjusted for heteroscedasticity and clustered at the firm level.

*Statistical significance at the 10% levels. **Statistical significance at the 5% level. ***Statistical significance at the 1% level.

instrumental variable should have an influence on the choice of PC advisor, but not on the outcome of the acquisitions deal. In the spirit of Fang (2005) and Golubov et al. (2012), we construct the variable “*scope*” to serve as such an identification restriction. “*scope*” measures the extent to which the acquirers used the services of a PC advisor in a past IPO process. The *scope* variable takes the value of 1 if the acquirer employed a PC advisor in the IPO process, and 0 otherwise.

Table 9 presents the results of this analysis. The *scope* variable is a highly significant (at the 1% level) determinant of the choice between a PC advisor and a non-PC advisor in the acquisition process, which means the extent to which the acquirers used the services of a PC advisor in the previous IPO process is positively related to the decision to appoint one again. The probability of

choosing a PC advisor is also positively related to the acquirers' cash holding and percentage of managerial holdings. The choice, though, is negatively related to the acquirers' leverage, as well as pre-event run-up. In addition, the higher relative size of the deal is also more likely to result in appointing a PC advisor for the transaction. The pseudo-*R*² in the first-stage indicates that the model explains up to 24.8% of the choice between a PC advisor and a non-PC advisor.

From the first-stage equation, we construct the inverse Mills ratio that we add as an additional regressor to the second-stage equation. As shown in Table 9, this selection term is insignificant at conventional levels, indicating that the coefficient estimates in our baseline regressions (Table 4) are reliable. In other words, unobserved characteristics that affect the likelihood of hiring

TABLE 8 Probability of hiring PC advisors

Dep. var. = <i>Prob(hiring politically connected advisors)</i>	(1)	(2)	(3)
<i>Private acquirer</i>	0.567** (0.037)		0.648** (0.021)
<i>Stock pay</i>		1.881*** (0.000)	1.911*** (0.000)
<i>PC acquirer (0/1)</i>	0.118 (0.464)	0.095 (0.560)	0.170 (0.302)
<i>Size</i>	-0.045 (0.719)	-0.079 (0.524)	-0.009 (0.945)
<i>Leverage</i>	-1.427*** (0.009)	-1.760*** (0.001)	-1.711*** (0.002)
<i>Cash holding</i>	-0.188 (0.748)	0.106 (0.855)	-0.061 (0.918)
<i>Tobin's Q</i>	-0.321* (0.062)	-0.338** (0.043)	-0.341** (0.047)
<i>BM</i>	-0.751 (0.391)	-0.976 (0.254)	-0.796 (0.362)
<i>Run-up</i>	-0.309* (0.056)	-0.282* (0.081)	-0.290* (0.074)
<i>ROA</i>	0.154 (0.896)	0.411 (0.736)	0.242 (0.843)
<i>Pre-holdings</i>	-1.231*** (0.002)	-1.380*** (0.001)	-1.404*** (0.001)
<i>Post-holdings</i>	0.341 (0.255)	0.284 (0.342)	0.313 (0.301)
<i>Relative size</i>	2.034*** (0.000)	1.753*** (0.000)	1.733*** (0.000)
<i>Managerial holdings</i>	1.008*** (0.009)	0.985** (0.010)	0.932** (0.018)
<i>CEO duality</i>	0.149 (0.387)	0.218 (0.202)	0.195 (0.264)
<i>Independent directors</i>	-1.325 (0.417)	-0.316 (0.846)	-0.714 (0.664)
<i>Shareholding concentration (%)</i>	-0.661 (0.249)	-0.604 (0.290)	-0.726 (0.212)
<i>Z index</i>	-0.005 (0.353)	-0.006 (0.285)	-0.004 (0.482)
Intercepts	-12.443 (0.975)	-14.626 (0.990)	-15.394 (0.990)
<i>N</i>	1,219	1,231	1,219
Adjusted R^2	0.203	0.219	0.223
Fixed effects	Year, industry	Year, industry	Year, industry

Note. This table presents results from the logit regression of the decision appointing PC advisor on acquirer- and deal-specific characteristics. The dependent variable is a dummy variable that equals 1 if the acquiring firm appoint PC advisor and 0 otherwise. Variables are defined in Appendix A. The p values are reported in parentheses.

*Statistical significance at the 10% levels. **Statistical significance at the 5% level. ***Statistical significance at the 1% level.

a PC advisor do not have a significant effect on M&A outcomes. Thus, we can conclude that the use of a PC advisor is associated with higher announcement returns.

Our third approach to addressing the endogeneity issue is to use the PSM method, which can correct for sample selection bias due to observable differences between the treatment and the control groups (Dehejia & Wahba, 2002). We compare the mean CARs of a portfolio consisting of deals where the PC advisor is used with control groups without using a PC advisor. We follow the procedure outlined in Jha and Cox (2015), and the control deal is identified using the PSM process. We first build a propensity score model using a logit model that estimates the usage of a PC advisor in the acquisition, with the dependent variable equal to 1 if the PC advisor is present, and 0 otherwise. For each of the observations in the treated and control groups, we calculate the propensity score using the above logit model. We use the following firm-level variable to construct the following propensity

scores: *firm size*, *leverage*, *cash holding*, *Tobin's Q ratio*, *book-to-market ratio*, *price run-up*, *pre-event operating performance*, and *Z index*. Then, for each observation from the treated sample, we find the nearest neighbour, the observation from the control group for which the absolute value of the difference in propensity scores is the minimum, from the control group.

The selection model estimation is reported in panel A of Table 10. Acquirers with higher leverage and higher cash holdings are more likely to appoint a PC advisor in the transaction; however, the Z index significantly reduces the likelihood of doing so. In panel B of Table 10, we report the mean difference of CARs between the treatment and control samples. Same as results reported in Table 3, our treatment samples have an average CAR of 6.1–7.1%, over three different event windows, whereas the control samples' CARs are in the range 0.6–0.8% over the same event windows, and the differences between these two groups are test significant. The results

TABLE 9 Addressing endogeneity: Heckman's two-stage procedure for acquirer CARs

Variables	Selection	Outcome
Scope	0.835*** (0.000)	
Size	-0.019 (0.801)	-0.009*** (0.001)
Leverage	-0.864** (0.011)	-0.010 (0.413)
Cash holdings	0.981*** (0.007)	-0.016 (0.289)
Tobin's Q	-0.091 (0.366)	-0.000 (0.890)
BM	0.113 (0.825)	-0.010 (0.560)
Run-up	-0.229* (0.058)	-0.007** (0.010)
ROA	-0.173 (0.861)	-0.024 (0.172)
Pre-holdings	-0.464* (0.079)	-0.008 (0.298)
Post-holdings	-0.169 (0.401)	0.009 (0.218)
Managerial holdings	0.819*** (0.001)	-0.002 (0.831)
CEO duality	0.095 (0.419)	-0.005 (0.255)
Independent directors	-0.580 (0.609)	-0.053 (0.168)
Share concentration ratio	-0.489 (0.195)	0.015 (0.219)
Z index	-0.003 (0.288)	-0.000 (0.118)
Relative size	0.651*** (0.002)	0.006 (0.437)
All-cash	-1.382*** (0.000)	-0.031*** (0.010)
Inverse Mills ratio		0.003 (0.610)
Intercept	0.610 (0.653)	0.208*** (0.000)
Observations	1,083	1,083
Pseudo R ² (adj R ²)	0.249	0.024

Note. This table presents results of the Heckman's two-stage procedure for acquirer CARs during M&A announcements. The first column reports the first-stage selection equation estimated by a Probit regression, where the dependent variable is 1 if the acquiring firm hires a PC advisor and 0 otherwise. The second column reports the second-stage regression, where the dependent variable is acquirer CAR and the inverse Mills ratio adjusted for potential self-selection bias. Variables are defined in Appendix A. The *scope* variable equals 1 if the acquirers used the services of a PC advisor in a past IPO process and 0 otherwise. The *p* values reported in parentheses are based on standard errors adjusted for heteroscedasticity and clustered at the firm level.

*Statistical significance at the 10% levels. **Statistical significance at the 5% level. ***Statistical significance at the 1% level.

from the PSM method therefore confirm those generated from our univariate analysis in Table 3 and multiple regression analysis in Table 4. Overall, these findings find higher acquirer abnormal returns when a PC advisor is used in an acquisition.

5.2 | Alternative measurement of CARs

Another concern in calculating the abnormal returns used in our regression analysis is model specification bias, because the Chinese domestic market is less liquid compared with Western markets. To solve this problem, we use an alternative market-adjusted model and

TABLE 10 Addressing endogeneity—propensity score matching

Panel A: Predicting the likelihood of appointing politically connected advisor				
Variables	Coefficients		<i>p</i> value	
Size (in billions)	-0.130		0.195	
Leverage	-1.605		0.000	
Cash holdings	1.516		0.001	
Tobin's Q	-0.077		0.494	
BM	-0.987		0.125	
Run-up	-0.056		0.638	
ROA	-1.007		0.241	
Post-holdings (%)	0.815		0.001	
Z index	-0.011		0.043	
Intercepts	1.048		0.530	
Pseudo R ²		0.067		
N		1,318		
Panel B: CARs difference between treatment and control groups				
	(Control)	(Treatment)	Diff	<i>p</i> value
CAR _{mkt} (-1,1)	0.006	0.061	-0.055	0.000
CAR _{mkt} (-2,2)	0.008	0.070	-0.063	0.000
CAR _{mkt} (-5,5)	0.006	0.071	-0.065	0.000

Note. This table presents results from the propensity score matching approach. We build propensity score matching process using a logit model that estimates the usage of PC advisor in the acquisition, with dependent variable equal to 1 if a PC advisor is present and 0 otherwise. CAR_{mkt} is the cumulative abnormal return based on market model.

Fama–French 3 factor model to calculate CARs. Using alternative models and a different event window, we re-run our baseline regression in Table 4. The dependent variable in column 1 of Table 11 is CAR(-2/2). Column 2 reports the results, using a market-adjusted model with deal-level and corporate governance controlling variables, and fixed effects are also controlled by year and industry dummies. In addition, column 3 shows the results, using CARs from the Fama–French 3 factor model as a dependent variable. The coefficients for the *PC advisors* dummy all remain significant and positive at the 5% level, thereby indicating that PC advisors do indeed create value for acquirers' shareholders, even if we use different model and event periods.

5.3 | Advisor's political connections and reputation

One more concern in interpreting our results is that an advisor's reputation may also play a role in acquisition

TABLE 11 Alternative event window and models

	(1) Alternative window	(2) Market-adjusted model	(3) FF3F model
Dep. var. = CAR	CAR(-2/2)	CAR(-1/1)	CAR(-1/1)
<i>PC advisor</i> (0/1)	0.018** (0.029)	0.021*** (0.003)	0.021*** (0.002)
<i>PC acquirers</i> (0/1)	0.001 (0.828)	0.000 (0.956)	0.002 (0.649)
<i>Size</i>	-0.022*** (0.000)	-0.013*** (0.000)	-0.012*** (0.000)
<i>Leverage</i>	-0.016 (0.353)	-0.001 (0.967)	-0.007 (0.574)
<i>Cash holding</i>	-0.035* (0.094)	-0.014 (0.441)	-0.016 (0.329)
<i>Tobin's Q</i>	-0.005 (0.250)	-0.005 (0.141)	-0.006** (0.049)
<i>BM</i>	-0.046** (0.042)	-0.042** (0.020)	-0.046** (0.011)
<i>Run-up</i>	-0.001 (0.846)	0.003 (0.221)	-0.002 (0.615)
<i>ROA</i>	-0.012 (0.614)	-0.008 (0.699)	-0.021 (0.285)
<i>Pre-holdings</i>	-0.005 (0.612)	-0.006 (0.444)	-0.004 (0.558)
<i>Post-holdings</i>	0.005 (0.564)	0.003 (0.646)	0.005 (0.466)
<i>Relative size</i>	0.030** (0.036)	0.016 (0.102)	0.020** (0.045)
<i>All-cash</i>	-0.058*** (0.000)	-0.037*** (0.000)	-0.048*** (0.000)
<i>Managerial holdings</i>	-0.009 (0.551)	0.005 (0.688)	-0.009 (0.453)
<i>CEO duality</i>	-0.001 (0.856)	-0.000 (0.978)	0.001 (0.823)
<i>Independent directors</i>	-0.027 (0.620)	-0.033 (0.392)	-0.006 (0.881)
<i>Shareholding concentration (%)</i>	0.027* (0.094)	0.033** (0.014)	0.027** (0.035)
<i>Z index</i>	-0.000 (0.338)	-0.000 (0.262)	-0.000* (0.081)
Intercepts	0.406*** (0.000)	0.268*** (0.000)	0.263*** (0.000)
<i>N</i>	1210	1092	1208
<i>R</i> ²	0.148	0.127	0.158
Year dummy	Y	Y	Y
Industry dummy	Y	Y	Y

Note. This table presents results from the regression of acquirer CARs on the *politically connected advisors* dummy and other acquirer- and deal-specific characteristics for a sample of China M&As. The dependent variable is acquirer CAR(-1,1) and CAR(-2/2). Variables are defined in Appendix A. All regressions control for year and industry fixed effects. The *p* values reported in parentheses are based on standard errors adjusted for heteroscedasticity and clustered at the firm level.

*Statistical significance at the 10% levels. **Statistical significance at the 5% level. ***Statistical significance at the 1% level.

performance, and superior performance driven by PC advisors simply comes from the advisor's reputation in this field. For example, Rau (2000) finds that acquirers advised by first-tier investment banks earn higher abnormal returns, whereas Francis et al. (2014) document that advisors' certification roles and experience in target countries are particularly valuable to firms. This empirical evidence is in line with the argument promulgated by Ismail (2010), in that a quality advisor, due to superior expertise in the M&As market, has the ability to find better targets and create greater operational and financial synergies for shareholders.

To solve this concern, we additionally control advisors' reputations (top-tier advisor) in our regression

model, in which we define top-tier advisors as those who are ranked in the top 30% in China in terms of market shares,² or in the top 30% in terms of numbers of deals executed. We re-run our baseline regression in Table 4 with two proxies of an advisor's reputation, and the results are presented in Table 12. The coefficients for the *PC advisors* dummy all remain significant and positive at the 5% level, thereby indicating that political connections play more important roles beside the reputations of financial advisors in Chinese acquisition deals.

²Data were collected from the WIND database and are available from 2012.

TABLE 12 Advisor's reputation and advisor's political connection

Dep. var. = $CAR(-1/1)$	(1)	(2)
<i>PC advisor</i> (0/1)	0.022** (0.025)	0.022** (0.048)
Advisor's reputation by no. of deals	0.004 (0.756)	
Advisor's reputation by market shares		0.004 (0.746)
<i>PC acquirers</i> (0/1)	0.003 (0.567)	0.003 (0.564)
Acquirer controls	Y	Y
Deal controls	Y	Y
Fixed effects	Year, industry	Year, industry
<i>N</i>	733	733
Adjusted R^2	0.154	0.154

Note. This table presents results from the regression of acquirer CARs on the *PC advisors* dummy, advisors' reputation, and other acquirer- and deal-specific characteristics for a sample of China M&As. The dependent variable is acquirer $CAR(-1,1)$ based on market model. Variables are defined in Appendix A. All regressions control for year and industry fixed effects. The *p* values reported in parentheses are based on standard errors adjusted for heteroscedasticity and clustered at the firm level.

*Statistical significance at the 10% levels. **Statistical significance at the 5% level. ***Statistical significance at the 1% level.

6 | CONCLUSION

This study provides an empirical analysis of the relationship between appointing politically connected financial advisors and acquisitions in China. We find that they create significantly higher market value for acquiring firms after controlling for the firm's own political connections, the advisor's reputation, and by addressing endogeneity in our empirical investigation. The value-creation role of politically connected financial advisors is more pronounced for small acquirers and acquirers with high Tobin's Q. Furthermore, we find that appointing them as part of the transaction can improve an acquiring firm's long-term, industry-adjusted operating performance and help reduce bid premiums. Finally, we show that private acquirers and stock payment deals are more likely to appoint PC advisors in the transaction. Collectively, this paper contributes to our understanding of political connections in acquisition transactions. The practical implications of this paper appear self-evident to the managerial teams of companies who may be considering acquiring firms. Moreover, the results, indicating that financial advisors play an important information role in the takeover process, suggest that managerial competence is not the only factor influencing M&A value creation. In emerging countries such as China, where capital markets are not well developed and information asymmetry

appears high, the appointment of financial advisors with political connections is particularly valuable and leads to value creation for acquiring firms.

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APPENDIX A

VARIABLE DEFINITIONS

Variables	Definitions
$CAR_{mktadj}(-1,1)$	Cumulative abnormal return adjusted by the market return during the event window (-1,1).
$CAR_{mktadj}(-2,2)$	Cumulative abnormal return adjusted by the market return during the event window (-2,2).
$CAR_{mktadj}(-5,5)$	Cumulative abnormal return adjusted by the market return during the event window (-5,5).
$CAR_{mkt}(-1,1)$	Cumulative abnormal return calculated from the market model during the event window (-1,1).
$CAR_{mkt}(-2,2)$	Cumulative abnormal return calculated from the market model during the event window (-2,2).
$CAR_{mkt}(-5,5)$	Cumulative abnormal return calculated from the market model during the event window (-5,5).
Size (in billions)	Acquire market capitalization (in billions) at year end prior to acquisition announcements.
Leverage	Acquirer leverage ratio, defined as total liability scaled by total assets, at year end prior to acquisition announcements.
Cash holdings	Acquirer cash-to-total assets ratio at year end prior to acquisition announcements.
Tobin's Q	Acquirer Tobin's Q at year end prior to acquisition announcements.
BM	Acquirer book-to-market equity ratio at year end prior to acquisition announcements.
Run-up	Acquirer 12-month buy and hold abnormal return prior to acquisition announcements.
ROA	Acquirer industry-adjusted return to asset prior to acquisition announcements.
ROE	Acquirer industry-adjusted return to equity prior to acquisition announcements.
Pre-holdings	Percentage shares of target firm held by acquirers before acquisitions.
Post-holdings	Percentage shares of target firm held by acquirer after acquisitions.
Relative size	Deal transaction value scaled by acquirer total assets prior to acquisition announcements.
All-cash	A dummy variable that equals 1 when payment is 100% cash and 0 otherwise.
Managerial holdings	Percentage shares held by managerial team of acquirers prior to acquisition announcements.
CEO duality	A dummy variable that equals 1 if CEO and Chairman are the same person and 0 otherwise.
Independent directors	Percentage of independent directors on the board of directors.
Controlling shareholding concentration	Percentage shares hold by controlling shareholders.
Z index	Shares held by the largest shareholder divided by shares held by the second largest shareholder.
Politically connected advisor (PC advisor)	A board member or CEO is a former government official, or a current or former member of the Provincial People's Congress, or a current or former member of the People's Political Consultative Conference.
Politically connected acquirer (PC acquirer)	A board member or CEO is a former government official, or a current or former member of the Provincial People's Congress, or a current or former member of the People's Political Consultative Conference.
Advisor's reputation (top-tier advisor)	A dummy variable that equals 1 if the financial advisor is ranked as the top 30% of financial advisors based on the value of deals (number of deals) reported in WIND database.
Scope	A dummy variable equals 1 if the acquirers used the services of a PC-advisor in a past IPO process and 0 otherwise.