

## IN AN EXPLORATORY RESEARCH ON CORPORATE EXPENDITURE ON NETWORKING WITH GOVERNMENT OFFICIALS CHINA

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### ABSTRACT

*Building a networking with government officials is one of Chinese firm's political strategies. Different from those political connections which are identified by state-owned ownership or political background of CEOs, the connection built through socializing with officials is few documented in literatures. This paper exploringly constructs a proxy variable to quantify corporate political networking strategy by reliably measuring corporate expenditure on networking with officials. We examine how changes of local political environment affect corporate expenditure in this regard. Empirical results show that when local political environment has changed, firms in these regions will increase expenditure on political networking. Compared with the SOEs, non-SOEs act more aggressively in respond to the local political environment changing. In addition, the concentration of listed firms located in one region would weaken the impact of local political environment changing on corporate political networking expenditure, which could be explained from the perspective of political resource supply restriction. This paper also finds a positive relation between firm value and corporate expenditure on political networking no matter the political environment changed or not, which indicates corporate political networking expenditure could be another perspective to quantify corporate political connection.*

**Keywords:** *political connection, expenditure on political networking, political environment change*

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### INTRODUCTION

The valuation of political connection for corporates has been widely discussed around the world (Fisman, 2001; Faccio, 2006; Faccio et al., 2006; Niessen and Ruenzi, 2010). In the absence of a generally accepted definition of corporate political connection, the identifications and measurements of political connection are varied in literatures. The most commonly used identifications of Chinese corporate political connection are state-owned ownership and politic-related career of CEO or board members (Chen et al., 2011). Even though these kind of explicit identifications of corporate political connection have been used widespread, it is meaningful to examine other reliable identifications of corporate political connection corresponding to other important corporate political strategies (Kim et al., 2012).

Building networking with government officials is one of commonly used corporate political strategies in China which is rooted in Chinese cultural norms and relationship-based regime. In order to build or maintain a connection with politicians or government officials, the corporates have incentive to socialize with officials via various social methods (Zhang and Zhang, 2005; Jin and Yuan, 2011 (in Chinese)). Luo and Ying (2012, in Chinese) use a special affair of officials' inspection/visit into a corporate as a proxy of corporate political connection and they find a systematically positive impact of officials' inspection/visit affair on corporate performance. However, official's public inspection/visit could not comprehensively represent corporate political connection or political networking. Zhang and Zhang (2005, in Chinese) surveyed hundreds of Chinese entrepreneurs and found the corporates generally socialize with government officials via inviting officials inspecting/visiting corporates, sponsoring the officials travelling abroad, giving gifts, etc. Even though we can not directly observe all these political social behaviors, especially those private ones, we can indirectly quantify corporate political networking strategies through rationally measuring the networking expenditure with government officials. We construct a proxy variable to measure corporate expenditure on networking with government officials. Because Chinese firms are not mandatorily required to disclose the political expenditure individually, we need to distinguish the political networking expenditure from firms' public disclosed expenses. Zhang and Zhang (2005, in Chinese) and Cai et al. (2011) provide survey and empirical evidences for us to construct a reliable measurement for corporate political networking expenditure.

Chinese corporates commonly use the following accounting categories, such as "entertainment expense (Ye Wu Zhao Dai Fei Yong in Chinese)", "travel expense (Chai Lv Fei Yong in Chinese)", "social expense (Jiao Ji Ying Chou Fei Yong in Chinese)" and so on, to reimburse expenditures on networking with government officials (Washington Post, Aug-22 2005; Bodrock, 2005; Zhang and Zhang, 2005, in Chinese; Cai et al., 2011). Even though above expenses are not directly entitled as political networking expenditure, Cai et al. (2011) find that the entertainment and travel costs overall have a significantly value-added effect to firms, which suggests somehow this kind of expenses has a connotative meaning of political networking expenditure.

Leuz and Oberholzer-Gee(2006)found that when the political regime changed in Indonesia(i.e. Suharto's resignation),the corporates once closely connected to Suharto systematically changed their financing strategy from domestic financing to global financing. This result implies that the disappearance of corporate political connection would lead to a change of corporate financing strategy, corresponding to a change of political environment. However, there is few literature investigating the impact of political environment change for Chinese firms where the political connection is believed to be a valuable resource for corporates. In this paper, we examine the impact of political environment change on Chinese corporate expenditure on networking with officials and we find that the local corporates increase the expenditure on political networking when local political environment changed. In this study, we use the turnover of city-level mayor or secretary of municipal Party committee as a proxy variable of local political environment change. As the top officials of municipal region, the turnover of mayor or secretary of municipal Party committee could lead to a significant change of local political environment.

We further analyze the impact of corporate political networking expenditure on local political environment changing from political-connection demand perspective and political resource supply perspective, respectively. From demand perspective, the corporates with stronger incentive to build political networking would invest more on networking with government officials. Followed literatures, non state-owned enterprises (hereafter non-SOEs) have more incentive to obtain political connection (Luo and Zhen, 2008(in Chinese); Wu, Wu, Rui, 2010; Guo and Du, 2011(in Chinese)), consistently we find non-SOEs act more aggressively in respond to the local political environment changing.

Few literatures discussed corporate political strategy from political resource supply perspective. To fill the gap, we use the concentration of public-listed firms located in one municipal region as a proxy variable of local political resource supply restriction under the assumption that fewer firms located in one municipal region would lead to more political resource allocated to firms from local government. Essentially, the opportunity of socializing with officials is a kind of limited political resource which is valuable to corporates. For instance, corporate's social opportunity with officials is restricted by the officials' limited social hours .Therefore, the corporate expenditure on networking with government officials is influenced by political social opportunity supply. Consistent with our expectation, the increase of corporate political networking expenditure when facing political environment change is significantly weakened with the increase of the number of public-listed firms located in one municipal region.

As an exploring empirical research on Chinese corporate political networking strategy, we need to reliably quantify corporate political networking strategy at the first step. According to the evidences of Cai et al. (2011) and Zhang and Zhang (2005), we are motivated to quantify corporate political networking strategy via measuring the corresponding expenditure. We pick up the most commonly used accounting categories to reimburse corporate political networking expenditure, i.e. travel expense<sup>1</sup> (Chai Lv Fei Yong in Chinese), entertainment expense (Ye Wu Zhao Dai Fei Yong in Chinese), oversea training expense (Chu Guo Pei Xun Fei Yong in Chinese), meeting expense (Hui Yi Fei Yong in Chinese), social expense (Jiao Ji Ying Chou Fei Yong in Chinese) and clerical expense (Ban Gong Fei Yong in Chinese). In this paper, we propose the sum amount of these six expenses as a measure of political networking expenditure for Chinese firms. As a part of management expense (Guan Li Fei Yong in Chinese), these six detailed accounting items are used to cover networking expenditures (including expense of eating, drinking, gifts, karaoke, travelling and sports club membership, etc.)(Cai et al, 2011; Zhang and Zhang, 2005(in Chinese); Washington Post,Aug-22 2005).All these expense items are measured with little error because each reimbursement item in this category needs a receipt and all these expenses are standard expenditure items publicly reported in accounting books of Chinese firms<sup>2</sup>, it is not subject to the biases associated with subjective survey data.

Our paper has the following three contributions. Firstly, building networking with officials functions as a common and important corporate political strategy, however, it was few mentioned in previous empirical studies which may be mainly attributed to the difficulty in quantifying corporate political networking strategy .This paper exploringly constructs a reliable variable of firm-level expenditure on networking with political officials under the assumption that the firms relying heavy upon the political networking strategy would spend more on networking with officials. Secondly, previous literatures few discussed the impact of local political environment changing on corporate behavior in China, we try to fill this gap by examining the impact of political environment changing on firm-level political networking expenditure. Thirdly, previous literatures mostly discuss the variance of corporate political strategy from the demand perspective of corporate political tie. Few literatures discussed corporate political strategy from the supply perspective of political resource. To fill this gap, we use the number of local public-listed firms as a proxy of local political resource supply restriction and find that the impact of local political environment changing on corporate political networking expenditure is weakened with the increase of the number of public-listed firms located in one municipal region.

The rest paper is structured as follows. Section II discusses the related literatures and hypotheses. Section III describes the sample selection and variable definition. Section IV provides the research design and empirical results. Section VI concludes.

## LITERATURES AND HYPOTHESES

Corporate political connection plays an important role around the world(Fisman, 2001; Faccio, 2006 ; Faccio, Masulis, and McConnell, 2006;Niessen and Ruenzi, 2010). Political connection could bring financing preference to well-connected

<sup>1</sup> For example, many hotels operate boutiques for expensive gifts, and those gifts can be invoiced as room charges, which would be classified as traveling costs(Cai et al.,2011).

<sup>2</sup> The detailed disclosure of management expense are not mandatory, nearly 40% of the public listed firms disclose the detailed components of management expense.

firms(Faccio et al.2006; Chaney et al.2011;Yu and Pan,2008(in Chinese);Zhang et al.2010(in Chinese);Lian et al.2011(in Chinese)).It also brings government subsidy to connected firms(Faccio et al.2006;Goldman et al.2008;Chen,2003(in Chinese);Luo and Tang,2009(in Chinese);Wu et al,2010;Guo and Du,2011(in Chinese)). In addition, political tie leads to a lower effective tax rate for politically connected firms(Adhikari et al.2006; Wu et al,2009(in Chinese)).Particularly, political connection which is valuable for Chinese firms could lead the firms easily into regulated industries(Hu,2006(in Chinese);Hu and Shi,2008(in Chinese);Luo and Liu,2009(in Chinese)).

In U.S. researches, it has been documented that U.S. firms adopt a variety of political strategies, such as adding politicians to their board of directors (Goldman, Rocholl, and So, 2008 ,2009), making significant political campaign contributions (Cooper, Gulen, and Ovtchinnikov, 2010, among others),or incurring significant lobbying expenditures(Hill, Kelly, and Van Ness, 2009 , among others). Lobbying seems not to maturely exist in China; however, Chinese corporates could lobby for preference via their private political networking. Building a social networking with government officials is valuable for corporates and corporates would socialize with officials via various social methods. Zhang and Zhang(2005,in Chinese)surveyed hundreds of entrepreneurs in Wenzhou City and Suzhou Province and they found corporates generally socialize with officials via inviting them inspecting corporates, sponsoring them travelling abroad, giving gifts to officials ,etc. According to the evidences of Cai et al(2011)and Zhang and Zhang(2005, in Chinese),we pick up the six most reliable accounting categories to be used to reimburse political networking expenditure, i.e. travel expense(Chai Lv Fei Yong in Chinese),entertainment expense(Ye Wu Zhao Dai Fei Yong in Chinese),oversea training expense(Chu Guo Pei Xun Fei Yong in Chinese),meeting expense(Hui Yi Fei Yong in Chinese),social expense(Jiao Ji Ying Chou Fei Yong in Chinese) and clerical expense(Ban Gonf Fei Yong in Chinese) (Washington Post, Aug-22 2005;Bodrock,2005; Zhang and Zhang,2005,in Chinese; Cai et al.,2011). In this paper, we propose the sum amount of these expenses as a measure of political networking expenditure for Chinese firms.

Few literatures investigated the impact of political environment change on corporate strategy in China. Building networking with political officials as a kind of corporate political strategy, we propose corporate expenditure on networking with officials will increase when local political environment changed. The following policy risk argument and political connection argument provide support to our view.

The change of local political environment brings policy uncertainty and administration uncertainty to local corporates (Guthrie, 1997;Zhang and Zhang,2005,in Chinese).Those uncertainties would bring unpredictable risk to corporate operation. When the local political environment changed, corporates could know well about the administration procedure of government agencies via networking with new-appointed officials; the corporates' requestes would be easily accepted by government via well socializing with new-appointed officials, thereby the policy risk faced by local corporates could be reduced. Political connection is an effective access for corporates to obtain more useful resources in China which is in a relationship-based developing stage. Local government as the top administration agency of municipal region, the government officials have the influenced power to allocate the local resources. From the political connection perspective, the local corporates have incentive to build political connection via networking with new appointed officials. Based on above analysis, we propose that the corporates would aggressively socialize with officials when the local political environment changed correspondingly an increase of political networking expenditure is shown. Our main hypothesis is as follows.

**H1: When local political environment changed, the local corporates' expenditure on political networking increase.**

The corporates with few natural political connection would have more incentive to socialize with new appointed officials. Compared to SOEs, the non-SOEs have more incentive to establish political connection via networking with officials in order to obtain resource allocation preference (Luo and Zhen, 2008(in Chinese); Wu,Wu and Rui,2010;Guo and Du,2011,(in Chinese)). Therefore, we propose the non-SOEs would socialize with officials more aggressively compared to SOEs when the local political environment changed. Based on above analysis, we provide the following hypothesis.

**H2: Compared to SOEs, non-SOEs' expenditure on networking with officials act more aggressively to local political environment change.**

Few literatures discussed the influence of political resource supply restriction .In our case, the opportunity of socializing with government officials is a kind of limited political resource (For instance, political social opportunity is restricted by limited social hours provided by officials ).Not all the corporates have opportunity to get access to officials ,especially when the concentration of corporates located in one city is high. It implies that the corporate expenditure on networking with government officials is influenced by the concentration of corporates located in one municipal region. Based on above analysis, when the concentration of corporates located in one municipal region is high, the impact of corporate political networking expenditure on local political environment change would be systematically weakened. Our third hypothesis is as follows.

**H3: With the increase of corporate number located in one municipal region, the impact of corporate political networking expenditure on local political environment change would be weakened.**

**SAMPLE SELECTION AND VARIABLE DEFINITION**

**Data and Sample**

Our sample consists of firms with listed A-Shares on either the Shenzhen or the Shanghai Stock Exchanges between 2006 and 2010. Corporate expenditure on networking with government officials is hand-collected from the footnotes of firms' public

annual reports. Followed literatures, we pick up the six most reliable accounting categories to be used to reimburse political networking expenditure, i.e. travel expense(Chai Lv Fei Yong in Chinese),entertainment expense(Ye Wu Zhao Dai Fei Yong in Chinese),oversea training expense(Chu Guo Pei Xun Fei Yong in Chinese),meeting expense(Hui Yi Fei Yong in Chinese),social expense(Jiao Ji Ying Chou Fei Yong in Chinese) and clerical expense(Ban Gong Fei Yong in Chinese). In this paper, we use the sum amount of these six expenses as a measure of political networking expenditure. We exclude from the sample firms that are financial corporates or do not disclose any item of these expenses. As a result, our sample consists of 3199 firm-year observations between 2006 and 2010.

City-level top official turnover data is hand-collected from announcements on the local government (i.e. city-level government) websites. The accounting and corporate governance data is obtained from the China Stock Market and Accounting Research (CSMAR) database.

[Insert Table 1 here]

Panel A of Table 1 summarizes the distribution of the 3199 observations by calendar year. It shows nearly 40 percent of non-financial listed companies have disclosed one or more pre-mentioned expenses in each sample year, in other words, our sample covers 40 percent of non-financial listed firms. Panel B of Table 1 reports the top officials turnover (TOT) events during the sample period .It shows that city-level top officials (i.e. mayor or secretary of municipal Party committee) turnover events are evenly distributed across sample years. Each year, there are about 35 percent sample companies experienced the replacements of top government officials. This proportion is very close to the percentage in overall non-financial A share listed companies, namely 36%, which implies that our sample do not have significant selection bias.

[Insert Table 2 here]

Table 2 summarizes the distribution of top official turnover (TOT) events by city. It shows that cities covered by sample companies are nearly 70% of overall cities covered by non-financial listed companies. Although our sample is limited by insufficient data disclosure, a very large percentage of cities are contained in the sample. In addition, the proportion of cities experienced top official turnover (TOT) is 0.36 in our sample, which is very close to the ratio in overall non-financial listed firms, namely 0.37. This suggests our sample do not have significant sample selection bias.

### Variable Definition

The variable definitions are illustrated in Table 3. The two variables in our interest are political networking expenditure (i.e. *Social1*, *Social2*, *Social3*) and local political environment change (i.e. *Turnover*).

We use the sum amount of pre-mentioned expenses (i.e. entertainment expense, travel expense, etc.) as the measure of corporate political networking expenditure. These kinds of expenses also contain firms' normal operating expense and managers rent seeking (Chen, 2005; Chen et al.2010). In order to diminish the measurement noise, we control the factors which affect manager's rent seeking in the main regressions, i.e. board size, manager's monetary compensation and shareholding, etc.; we also control the factors which may affect firms' normal operation expenses i.e.: firm size, firm's performance, leverage and state-owned ownership, etc.

Followed previous literatures, we predict the regional development level have impact on firm operating expense and manager rent seeking. We construct a direct variable of city development level. If the company located in Beijing, Shanghai, Guangzhou or Shenzhen where are the most developed cities in China, we set the *CityLevel* variable equal to 2; If the company located in other provincial capital cities or sub-provincial cities (included municipalities with independent planning status) where are mid-developed cities in China, *CityLevel* variable equals to 1; otherwise, the *CityLevel* variable is valued zero.

[Insert Table 3 here]

## RESEARCH DESIGN AND EMPIRICAL RESULTS

### Univariate Analysis

Table 4 shows the mean level of corporate political networking expenditure under the different status of local political environment. T-test shows a significant increase in the expenditure when the local political environment changed.

[Insert Table 4 here]

Table 5 reports the correlations of variables included in our regressions. It shows that the corporate political networking expenditure is significantly positive related to firm size, regional development level, ownership percentage of largest shareholder and monetary compensation of executives . In our interest, there reports a positive relation (not significant here) between corporate political networking expenditure and local top officials turnover, which means corporates increased the expenditure on networking with officials when the local political environment changed. In order to test our hypothesis, we construct the following multivariate analysis.

[Insert Table 5 here]

Table 6 Panel A,B shows the descriptive statistic of continuous variables and discrete variables in regressions ,respectively. The proportion of SOEs in the sample is about 60%, the mean and max value of largest shareholding percentage is 36% and 83.74%, respectively, which are consistent with previous literatures.

[Insert Table 6 here]

### Results From Multivariate Analysis

In order to test whether corporate would increase the expenditure on political networking when the local political environment changed, we construct the following pooled OLS regression:

$$\begin{aligned} Social1 = & \alpha_1 TurnOver + \alpha_2 SOE + \alpha_3 Concentration + \alpha_4 MgerHolding \\ & + \alpha_5 BoardSize + \alpha_6 LnComp + \alpha_7 Size + \alpha_8 ROA + \alpha_9 MB \\ & + \alpha_{10} Leverage + \alpha_{11} FirmAge + \alpha_{12} CityLevel + Industry + Year + \alpha_0 + \varepsilon \end{aligned} \quad (Model 1)$$

where *Social1* is the natural logarithm of political networking expenditure of firm *i* in year *t*; *TurnOver* is a dummy variable that takes the value of 1 if there is a top official turnover in year *t-1* in the region where firm *i* located, and 0 otherwise. Other control variables are defined in Table 3. We expect a positive  $\alpha_1$  in model 1.

We test the hypothesis 2 in the subgroups of SOEs and non-SOEs. A pooled OLS regression, as Models 2, is used:

$$\begin{aligned} Social1 = & \beta_1 TurnOver + \beta_2 Concentration + \beta_3 MgerHolding + \beta_4 BoardSize \\ & + \beta_5 LnComp + \beta_6 Size + \beta_7 ROA + \beta_8 MB + \beta_9 Leverage + \beta_{10} FirmAge \\ & + \beta_{11} CityLevel + Industry + Year + \beta_0 + \varepsilon \end{aligned} \quad (Model 2)$$

where all variables are defined in Table 3. We predict coefficient  $\beta_1$  is more aggressive in the sub group of non-SOEs relatively to SOEs.

[Insert Table 7 here]

Table 7 presents the results of Model 1 and 2. First, the result in line 1 shows that corporate political networking expenditure increases when local political environment changed, which supports H1. Second, the result in line 2 shows that the corporate political expenditure significantly increases when local political environment changing in the subgroup of non-SOEs. But in subgroup of SOEs, above result disappears (line 3). Thus H2 is supported. In addition, coefficients of the control variables show that firms with following characteristics tend to spend more on political networking, *ceteris paribus*: large firms, good performed firms (i.e., higher ROA), firms with high managerial compensation, firms located in developed cities.

In order to test the impact of concentration of listed firms in one region on corporate political networking strategy, especially when local political environment changes, we construct the following regression:

$$\begin{aligned} Social 1 = & \gamma_1 TurnOver + \gamma_2 NUM + \gamma_3 TurnOver * NUM + \gamma_4 SOE \\ & + \gamma_5 Concentration + \gamma_6 MgerHoldin g + \gamma_7 BoardSize + \gamma_8 LnComp \\ & + \gamma_9 Size + \gamma_{10} ROA + \gamma_{11} MB + \gamma_{12} Leverage + \gamma_{13} FirmAge + \gamma_{14} CityLevel \\ & + Industry + Year + \gamma_0 + \varepsilon \end{aligned} \quad (Model 3)$$

where *Social1* is the natural logarithm of political networking expenditure of firm *i* in year *t*; *TurnOver* is a dummy variable that takes the value of 1 if there is a top official turnover in year *t-1* in the region where firm *i* located, and 0 otherwise. Followed Tan et al (2010) and Tan et al (2011), we use the number of listed firms located in one city (i.e. *NUM\_1, NUM\_2, NUM\_3*) to measure the concentration of listed companies in one region. We also include an interaction of *TurnOver* and *NUM*. Other control variables are defined in Table 3.

Table 8 reports coefficients from estimations of Model 3; these estimations reveal several findings. Firstly, evidence from line 1 to line 3 show a significant increase of corporate political networking expenditure when local political environment changes, which keep supporting H1. Secondly, the coefficients of the interaction variables of *Turnover* and *NUM* are all significantly negative, which provides support to political resources supply argument. The opportunity of socializing with government officials is a kind of limited political resource, especially when local political environment is changing. If there are more competitors hunting for the political networking opportunity in one city, the impact of corporate political networking expenditure on local political environment changing will be systematically weakened, which provides evidence to H3. Thirdly, the coefficients of *NUM\_1, NUM\_2* and *NUM\_3* are all significantly positive, which can be explained by political connection demand argument. Followed Tan et al. (2010), firms with weaker political connection if concentration of listed firms in one city is higher. The result could be explained by that the firms with weak political connection have more incentive to socialize with

government officials. Above results imply that the political resource supply restriction functions aggressive when political environment changing (i.e. there is a big information asymmetric between officials and corporates).

[Insert Table 8 here]

### Robustness Tests

Earlier in this paper, we use the original sum amount of relative expenses as the measure of corporate political networking expenditure. In this section, we will use the following method to further diminish the measurement error in dependent variable. First, we calculate the mean value for the sum amount of the six expenses by “industry-city-year”. And then, we deduct the calculated mean from the original data and the residual value is so called excessive expenditure which can be a proxy of excessive political networking expenditure. We choose the positive ones to be our sample data as a robust test. The result is reported in line 1 of Table 9. Consistent with the result in main test(H1), the change of local political environment has a positive impact on corporate excessive expenditure on political networking(Social2).

As mentioned in section III, 60 percent of non-financial listed firms do not disclose the expense items relative to corporate political networking expenditure in annual report; the data limitation may potentially affect our results. We use pair-matching method to estimate the corporate political networking expenditures for undisclosed firms. We match the companies by “industry-city-year” and we re-test the main regression (Model 1) using a large sample consisting of original data and matched data. The result is reported in line 2 of Table 9. Consistent with the result in main test (H1), we also find a positive impact of local political environment change on corporate political networking expenditure (Social3).

[Insert Table 9 here]

### Additional Test

What is the economic consequence of political networking as a corporate political strategy? We test the relationship between corporate political networking expenditure and firm value. Based on existing literatures, we propose that firms’ political networking expenditure is positively related to firm value, regardless of local political environment changes. We choose Tobin’s Q to proxy firm value and the results are reported in Table 10. Consistent with our expectation, a positive relation between corporate political networking expenditure and firm value is shown, which implies corporates could build political connection via networking with government officials and it is valuable to firms.

[Insert Tables 10 here]

## CONCLUSIONS AND DISCUSSIONS

In this study, we document that building a networking with government officials is a common and important political strategy for Chinese firms. Several interesting findings emerge from our analysis. First, we document that when the local political environment is changed, local corporate’s expenditure on political networking increases significantly. Second, we further find such increases are more aggressive for non-SOEs, where political connections are demanded aggressively. Third, we show that the reaction of local corporates political networking expenditure to local environment change is influenced by local political resource supply restriction. Additionally, we find the corporates which spend more on political networking, no matter the local political environment changed or not, would have a higher firm value. One important implication of our results is somehow the corporate expenditure on networking with government officials could function as a proxy variable of corporate political connection.

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**Table 1 Sample distribution**

Panel A : sample selection			
Year	(1) Number of overall non-financial listed firms	(2) Number of sample firms	(3) Percentage =(2)/(1)
2006	1408	477	0.34
2007	1520	500	0.33
2008	1575	732	0.46
2009	1678	763	0.45
2010	1903	727	0.38
Total	8084	3199	0.40

Panel B: top officials turnover(TOT) events: by firm-year

Year	Overall non-financial listed firms			Sample		
	(1) Number	(2) Number of firms experienced TOT	(3) Percentage =(2)/(1)	(4) Number	(5) Number of firms experienced TOT	(6) Percentage =(4)/(3)
2006	1408	561	0.40	477	191	0.40
2007	1520	528	0.35	500	174	0.35
2008	1575	551	0.35	732	268	0.37
2009	1678	586	0.35	763	228	0.30
2010	1903	674	0.35	727	253	0.35
Total	8084	2900	0.36	3199	1114	0.35

**Table 2 Top official turnover(TOT) events: by city**

Year	(1) Number of cities covered by overall non-financial listed firms	(2) Number of cities covered by sample firms	(3) Percentage =(2)/(1)	(4) Number of cities where top officials are replaced among(1)	(5) Number of cities where top officials are replaced among(2)	(6) Percentage= (4)/(1)	(7) Percentage = (5)/(2)
2006	281	170	0.60	152	88	0.54	0.52
2007	283	174	0.61	82	51	0.29	0.29
2008	286	208	0.73	140	100	0.49	0.48
2009	288	210	0.73	64	43	0.22	0.20
2010	296	214	0.72	90	70	0.30	0.33

Total	1434	976	0.68	528	352	0.37	0.36
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**Table 3 Variable Definitions**

<b>Dependent Variables</b>	
<i>Social_1</i>	Natural log of the sum amount of the six expenses. <sup>3</sup>
<i>Social_2</i>	Natural log of the sum amount of the six expenses after mean adjustment.
<i>Social_3</i>	Natural log of the sum amount of the six expenses after pair matching.
<b>Experiment Variables</b>	
<i>Turnover</i>	Turnover dummy= 1 if top officials of a city-level region where firm i located replaced in year t-1, and = 0 otherwise.
<i>NUM_1</i>	NUM_1=10 if number of listed firms in one city is above top 10%; NUM_1=9 if number of listed firms in one city is between top 10% to top 20%, etc. NUM_1 =1 if number of listed firms in one city is below bottom 10%.
<i>NUM_2</i>	NUM_2=5 if number of listed firms in one city is above top 20%; NUM_2=4 if number of listed firms in one city is between top 20% to top 40%, etc. NUM_2=1 if number of listed firms in one city is below bottom 20%.
<i>NUM_3</i>	NUM_3=4 if number of listed firms in one city is above top 25%; NUM_3=3 if number of listed firms in one city is between top 25% to top 50%, etc. NUM_3 =1 if number of listed firms in one city is below bottom 25%.
<i>Turnover*SOE</i>	Interaction of Turnover and SOE
<i>Turnover* NUM_1</i>	Interaction of Turnover and NUM_1
<i>Turnover* NUM_2</i>	Interaction of Turnover and NUM_2
<i>Turnover* NUM_3</i>	Interaction of Turnover and NUM_3
<b>Control Variables</b>	
<i>Size</i>	Natural log of total assets.
<i>SOE</i>	Stated-owned enterprise dummy, = 1 if the firm is a state-owned enterprise, and = 0 otherwise.
<i>Concentration</i>	The shareholding percentage of largest shareholder.
<i>ROA</i>	Return on Assets, which equals Net income dividing by average total assets.
<i>Leverage</i>	= Total liabilities / total assets.
<i>MB</i>	Market-to-Book, = market value of equity/ book value of equity.
<i>MgerHolding</i>	Manager share holding percentage, = manager share holding/liquid shares
<i>BoardSize</i>	Number of directors in the board.
<i>LnComp</i>	Natural log form of top management's top3 compensation.
<i>CityLevel</i>	CityLevel=2 if the company located in Beijing, Shanghai, Guangzhou and Shenzhen; CityLevel =1 if the company located in other provincial capital cities and sub-provincial cities;CityLevel =0 if otherwise
<i>Firmage</i>	Age of the firm.
<i>Industry</i>	13 industry dummies, =1 if observation belongs to the industry, =0 if otherwise.
<i>Year</i>	5 year dummies, =1 if observation belongs to the year, =0 if otherwise.

**Table 4 T-test of political networking expenditure across government official turnover and non-turnover groups**

	(1) <i>TurnOver</i> =1		(2) <i>TurnOver</i> =0		(3) = (1)-(2)	
	N	mean	N	mean	t-statistics	
Political networking expenditure	1083	27,500,000	2116	24,700,000	1.6753	**

Notes:

\*\* denotes that the political networking expenditure in the turnover group are significantly different from the non-turnover group in the two-tailed *t*-tests at the 0.05 level.

<sup>3</sup> Travel expense, entertainment expense, oversea training expense, meeting expense, social expense and clerical expense.