Political Turnover, Ownership, and Corporate Investment

Authors
Xiaping Cao†, Brandon Julio‡, Tiecheng Leng† and Sili Zhou§
†Sun Yat-sen University, ‡University of Oregon §Singapore Management University

Discussant
Subrata Sarkar , IGIDR

7th Emerging Market Finance Conference
(In collaboration with Vanderbilt Law School)
Mumbai, INDIA, December 14-17, 2016

What this paper does

- Examines the impact of political influence and ownership on corporate investment by exploiting the tournament-style promotion of provincial leaders in China

- Argues that the tournament-style promotion creates incentives for political leaders to exert influence on investment decisions of SOEs in their province to increase their career success

- Uses data on 113 provincial turnovers over a fourteen period of 1998-2012 to test the above hypothesis

What the paper finds

- The paper finds, that following a political turnover:
  - ✓ investment in SOEs increases by 6%, while
  - ✓ investment in private firms declines, and
  - ✓ the increase in investment in SOEs is not in harmony with growth opportunities as measured by Tobin's Q
- The paper concludes that political turnover and ownership lead to inefficient corporate investments thereby affecting real outcomes
- Overall:
  - ✓ very interesting paper, well motivated, well written and rigorously done
  - ✓ controls for the usual "econometric suspects" of unobserved effects, measurement errors, and selection bias
  - ✓ intuitive results which contribute to political economy literature

Measuring the change in SOE investment following political turnover

- Regression controls for unobserved time effects and firm effects.
- However, time effects can differ across industries as macro policies and factors do not affect all industries in the same way
- → May be good to have some time x industry effects for correct measurment

Some observations on Tobin's Q

- Tobin's Q = (Market Value of Equity + Market Value of Debt)/(Replacement cost of assets)
  - ✓ Difficult to get market value of debt
  - ✓ We routinely substitute market value by book value
  - ✓ But in most instances Tobin's Q is used a measure of performance
  - ✓ Here Tobin's Q is being used to identify inefficiency and hence market value is important
- Average Q versus Marginal Q
  - ✓ For investment what is important is marginal Q and not average Q
  - ✓ Average Q is more of performance measure while marginal Q is investment driver.
- Issue of endogeniety:
  - ✓ Marginal Q will affect investment → investment will change → marginal Q will change

Identifying inefficiency

- Crowding out of private investment by itself is not sufficient to prove that the corresponding SOE investment is inefficient, though it very well could be. Some “direct proof” may strengthen the argument.
  - ✓ How about taking the difference in the investment rates of SOE and private firms and then examining how this difference changes (i) following political turnover and (ii) if this effect is more pronounced for high growth industries

- Why not analyse the accounting and market performance of the SOEs, private firms, and their difference following political turnovers after the elapse of say, two years.
  - ✓ Changes in performance ought to be visible as politicians are promoted based on economic performance which is more observable rather than inefficient investment which may not bear any fruit.

- If only inefficient investments are made with no corresponding changes in economic performance, then one must give an explanation as to how such activities are sustainable in the long run and why the leadership, which presumably has a longer career than an individual politician, is unable to identify this problem

- Enjoyed reading the paper and hope to see it being published