Communist party committee direct control and the market value of corporate cash holdings

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Abstract

We study the impact of having a communist party committee (CPC) member directly involved in the management of a firm on the market value of cash. Our findings suggest that the CPC member can enhance the market value of cash only when he or she is a director of the board. When the CPC members are supervisors of a supervisory board or senior management, they have no effect.

Keywords: Communist party control
Cash

1. Introduction

The impact of politics on economic activities is well-documented. Previous studies generally suggest that when a firm’s executives are politically connected, the firm’s value increases (e.g., Faccio, 2006; Faccio et al., 2006; Fisman, 2001; Bunkanwanicha and Wiwattanakantang, 2009; Tang et al., 2016). The literature primarily examines how politics indirectly affects a firm’s performance. For instance, government officials can help a firm to receive government subsidies, low cost bank loans, favorable decisions in lawsuits, approval of initial public offerings, family firm success, and other benefits (Firth et al., 2011; Piotroski and Zhang, 2014; Xu et al., 2015). In the extant literature, government officials did not engage in the direct management of a firm.

In communist countries, each state-owned firm (SOE) has a communist party committee (CPC) to promote political ideology and labor harmony. On certain occasions, members of the CPC are involved with the management of the SOE by serving as directors of the board, supervisors of the supervisory board, or as senior executives of the management team. With the exceptions of Chang and Wong (2004) and Li and Chan (2016), little is known on the impact of such CPC direct control on an SOE’s performance.

Specifically, Chang and Wong (2004) report that a CPC control adversely affects accounting performance, but reduces the agency problem of an SOE. Li and Chan (2016) document that CPC control in terms of being a director, not supervisor or executive, can help to reduce an SOE’s stock price crash risk. It is unclear how such control affects other important...
performance attributes of an SOE. We fill this gap by studying the impact of a CPC control on the market value of corporate cash holdings.

Cash provides liquidity to a firm and is an important element in managing a firm. The trade-off theory of cash in Opler et al. (1999) suggests that holding cash can benefit a firm by providing liquidity, but also incurs opportunity costs due to low return of holding cash. Hence, in weighing the benefits and costs, we pay attention to the market value of the cash holdings. If a firm’s cash contributes to a better firm performance, the market value of cash is positive and vice versa. The extant literature on cash holdings and market value of the cash holdings focuses on the western countries (such as the U.S.), the reasons behind firms holding cash, and the impact of finance factors on cash holdings (e.g., Bates et al., 2009; Dittmar et al., 2003; Dittmar and Mahrt-Smith, 2007; D’ Mello et al., 2008). Few studies examine the impact of politics via a government’s direct impact in a firm as directors, supervisors, or senior managers. We study the impact of a CPC control on the market value of cash holdings by using a sample of Chinese state-owned firms.

Our findings suggest that when members of a CPC are directors of the board for an SOE, the market value of cash is higher than an SOE without such CPC control. There are no such effects when members of a CPC are supervisors of supervisory board or senior managers of the SOE. We complement the findings in Chang and Wong (2004) and Li and Chan (2016) that CPC direct control is good for an SOE in the context of enhancing the market value of cash holdings.

2. Data and methods

2.1. Data

We collect stock price and CPC control information among state-owned enterprises (SOEs) from the China Stock Market and Accounting Research database. The CPC control information is for the period 2004 to 2015. Our sample comprises 10,554 firm-years.

The frequency distribution of the sample is presented in Panels A and B of Table 1. By industry, manufacturing firms make up 57% of the sample. In terms of year, the samples are evenly distributed across all years.

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