A Work Project, presented as part of the requirements for the Award of a Master Degree in Finance from Nova School of Business and Economics and Fundação Getulio Vargas – Escola de Economia da Universidade de São Paulo

Political Connections and Firm Performance: Evidence from Brazil

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A Project carried out on the International Masters in Finance Brazil-Europe program, under the supervision of:

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Carcavelos, 4th of January 2019

Abstract

This paper studies the influence of politically connected Board of Directors on Brazilian firms' future performance. We control for the drivers of firm performance on the Brazilian market, the influence of a political related Board of Director's member on future firm performance and the differences of this influence between outperforming and underperforming companies. Using a sample of 49 ibovespa companies' Board of Directors from 2010 to 2015 we conclude that politically connected members of the Board have a positive influence on the one-year-ahead firm performance. We also conclude that this influence is stronger in companies that underperform the industry.

Keywords: Political Connections; Firm Performance; Board of Directors; Corporate Governance

Acknowledgments

I would like to thank my parents for making this possible. For providing me everything I needed and for giving me the chance of making my own choices in such an easy way. To my sister for all the advices that I pretend I didn't care but helped me so many times.

To my supervisors Professor Antonio Nogueira Leite and Professor Joelson Sampaio for the team work and availability throughout the completion of this work.

To Rita, for the support given every day, for making me focus even when everything is going wrong and for taking my issues as hers and helping me unconditionally.

To my friends Duarte Carrasquinho, Francisco Espenica, Francisco Godinho and Pedro Teixeira for the support, the company and for being there always. To Ricardo, Margarida, Guilherme, Ricardo, Diogo and Tomas for their friendship and dedication.

To Afonso and Filipe for sharing this chapter of my life with me, and for their friendship in such an important time.

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1. - Introduction

The impact of political connections on the firm performance and the market value is present on a large body of literature. According to the resource dependence theory developed by Pfeffer and Salancik (1978), political connections can help firms to obtain key resources, cope with various external uncertainties, and thereby increase firm value. Consistent with this, Boubakri, Cosset and Saffar (2012) find that firms increase their performance and indebtedness after the establishment of a political connection. The authors also find that the political connection is more strongly associated with changes in leverage and operating performance for firms with closer ties to political power.

The positive relationship between board's political connections and the firm performance can be explained by several reasons. According to Lashitew (2014), the strength of political connections, measured by the amount of time the firm's senior managers spend with government officials, has a significant positive effect on credit access. The effect of political connections is higher in countries where the banking sector is more concentrated and has higher net interest margin. In addition, according to the work of Boubakri, Cosset and Saffar (2012), politically connected firms gain easier access to credit and reap benefits in terms of performance from their ties with politicians. Moreover, Lu (2011) finds that Political Connections lead to increase of trade expansion. Political connections affect trade expansion by overcoming insecure property rights institutions and inefficient contracting institutions. Plus, Kim and Zhang (2016) find that Politically connected firms are more tax aggressive than non-connected firms because of their lower expected cost of tax enforcement, better information regarding tax law and enforcement changes, lower capital market pressure for transparency, and greater risk-taking tendencies induced by political connections. Another reason may be related with corporate bailouts, since according to Faccio, Masulis and McConnel (2006) politically connected firms are significantly more likely to be bailed out than similar non-connected firms are. Additionally, politically connected firms are disproportionately more likely to be bailed

out when the International Monetary Fund or the World Bank provides financial assistance to the firm's home government. Further, among bailed-out firms, those that are politically connected exhibit significantly worse financial performance than their nonconnected peers do at the time of and following bailout. This evidence suggests that, at least in some countries, political connections influence the allocation of capital through the mechanism of financial assistance when connected companies confront economic distress. Finally, Houston, Jiang, Lin and Ma (2014) find that the cost of bank loans is significantly lower for companies that have board members with political ties. The authors consider two possible explanations for these findings: a Borrower Channel in which lenders charge lower rates because they recognize that connections enhance the borrower's credit worthiness and a Bank Channel in which banks assign greater value to connected loans to enhance their own relationships with key politicians. Political connections reduce the likelihood of a capital expenditure restriction or liquidity requirement commanded by banks at the origination of the loan. Political connections increase the value of the U.S. companies and reduce monitoring costs and credit risk faced by banks, which, in turn, reduces the borrowers' cost of debt.

The geographic location of the firms also represents an important factor in this relationship. Consistent with this, Du and Girma (2010) find that there is robust evidence that political affiliation enhances firm's survival and growth prospects. However, interestingly politically neutral start-ups enjoy faster productivity improvements conditional on survival. In addition, the benefits of political connections are largely confined to firms associated with local or top level governments, and they are more pronounced in capital-intensive industries. We conclude that the close association between the state and a segment of the business community is leading to sub-optimal resource allocation in the economy by interfering with the process of market selection.

The geographic importance of the relationship opens a gap in the literature, as the relationship has mostly been studied for Asian countries, with, of course, some exceptions.

Niessen and Ruenzi (2009) find that in Germany Politically connected firms are larger, less risky and have lower market valuations than unconnected firms. They also have fewer growth opportunities, but slightly better accounting performance. On the stock market, connected firms significantly outperformed unconnected firms in 2006.

In this work, we try to fill this gap by studying the influence of politically connected boards on the future performance of Brazilian companies. We took Brazil has the ideal setting to perform this study for the following reasons: First, political connections are a common situation in the board of important companies. This is due to the fact that several own-state companies are among the top performers of the country and for that reason may be selected as a good setting for the country market index. Second, and according to Gokhberg, Kuznetsova and Zaytseva (2012), Brazil is among the biggest, fastest growing emerging markets, giving the perfect setting for companies to have a consolidated increase in their performance through the years.

With our study, we were able to understand how the Brazilian companies' performance is influenced by a political connected Board of Directors. Most of the results were consistent with our expectations. Brazilian companies' future performance is positively influenced by a political connected Board of Directors (BoD). Moreover, the companies that outperform the market industry have their future performance less influenced by a political connected BoD. The opposite effect may be verified in the companies that underperform the market industry.

2. - Related Research and Hypothesis Development

According to Nee (1992) and McMillan (1997) in transition economies, the government control a wide range of financial and regulatory resources either through its power of planning or through its full control over the state-owned enterprises. It is usual that companies in these economies use political resources to avoid so called government extorsion such as arbitrary fees and charges and to beneficiate from it. The benefits to the companies include, according to You

and Du (2012), Boubakri, Guedhami, Mishra and Saffar (2010), Claessens (2008) Faccio (2010) Francis, Hasan and Sun (2009), Mobarak and Pur-basari (2006), Chen, Firth, Gao and Rui (2006) access to loans from state owned banks, more favorable tax treatment, more flexible budget constraints, more relaxed market entry regulation, greater change of government bailout in case of default and so on. As a consequence of the benefits it is expected that the motivation of having political connected boards to increase.

The work done by You and Du (2012) was the main reference for the realization of our study. The authors used a large sample of listed firms in China and find that politically connected CEOs are less likely to be fired and that sensitivity of forced turnover to firm performance is weaker for connected CEOs than for their non-connected peers. There is a suggestion that CEOs in transition economies tend to use their political resources for their own good. The work "Are Political Connections a Blessing or a Curse? Evidence from CEO turnover in China" also finds significant positive relationship between political connections and future firm performance only when firm profitability is below the industry median.

In transition economies, the uncertainty in the policy making and the weak institutional characteristics bring substantial transaction costs for the firms, according to the study of Williamson (1991). You and Du (2012), find that they create and strengthen the incentives to develop informal institutions including government-business relationships to comply with the current rules and enhance the efficiency of formal institutions. Consequently, business organizations tend to engage in political behaviors to internalize these costs and influence the policy process in ways favorable to them. This implies the additional value of political ties for firms in transaction countries. Consistent with this view, Faccio (2006) finds that benefits obtained from political connections are especially noticeable in countries with high levels of corruption and weak legal system. According to Lorenzon (2017) Brazil's judiciary still has palpable problems, particularly its excessive cost and a bloated workload. In addition, judges enjoy certain prerogatives that are frequently abused. In addition, Brazil takes part in one of the

biggest corruption scandals in history. In the last three years, hundreds of businesspeople and politicians have been investigated and prosecuted for taking part in a massive bribery scheme involving state-owned companies. In line with what was said before that we propose the following hypothesis:

Hypothesis 1. In the Brazilian market, future firm performance is positively related to political connections of the members of the Board of Directors of the companies.

Finally we examine whether the influence of political connections on future firm performance varies with a firm's operational performance. In order to do that, we divided the sample of firms in two categories: Firms that have 2015 ROA above the same year industry median, and firms that have ROA below the industry median. In other words, we divided the sample into, respectively, companies that outperform the industry and companies that underperform the industry. You and Du (2012) state that it is expected for an underperforming company's Board to face greater pressure from shareholders. Therefore greater efforts will be done in order to improve firm performance. This might mean that benefits from political connections will be used more often when a firm is underperforming. At the same time, and consistent with this, Jiaxing You and Guqian Du (2012) state that the government tends to help underperforming connected firms through the provision of fiscal subsidies and/or low cost loans. Moreover, and as it was said before, when confronting economic distress, politically connected firms are more likely to be bailed out than their non-connected peers (Faccio, Masulis and McConnell, 2006). We test this prediction in the following hypothesis:

Hypothesis 2. The positive relationship between future firm performance and political connections is stronger when current return on assets is below the industry median rather than above it.

3. - Research Design

3.1. - Research Context

As a transitional economy, Brazil provides an ideal setting for our study. Ramalho (2007) shows that politically connected firms in Brazil lost value during the impeachment of then-president Collor in 1992, which means that there is a strong influence of the government on the economy. In addition, a significant percentage of the listed firms in Brazil are either state-owned or have strong political connections.

The six-year period considered for this study coincides with the end of a decade in which, according to Weisbrot, Johnston and Lefebvre (2014) the Brazilian economy has gone through a significant transformation. It was a period when poverty and extreme poverty decreased significantly and the main contributor was an increasing economic growth with the government as the propellant.

Despite the control over economy may be done in the wrong way, that does not make Brazil a worst setting for our study since, according to Faccio (2006) the benefits obtained from political connections are especially noticeable in countries with high levels of corruption and weak legal system.

3.2. - Sample Construction and Data Sources

The sample used to performed our study contains all the companies that make up the market index (ibovespa) of the Brazilian Stock Market over the period 2010-2015. Data related with the members of the Board of Directors of each company through the years was collected from 'Formulario de Referencia' obtained on 'Comissão de Valores Mobiliários' website as part of the public reports. On the other hand, data related to the financial information was collected through the Bloomberg terminal.

Ibovespa is composed by 64 companies. Our sample is made by only 49 of those due to some missing public information about financial information of companies and the fact that some companies were listed in the stock market after or during the study period.

In this study, we assumed Board of Directors as all the members, executive and non-executive, plus the members of the Supervisory Board. The members of the Board of Directors were analyzed in order to understand the real involvement with the company and divided into executive/non-executive, independent/non-independent, members of the Supervisory Board or not, and political connected or not. When the companies had an audit committee composed by some of the directors instead of a Supervisory Board, none of the directors was included as a member of the Supervisory Board because it was of the interest of the study to analyze the members of the Supervisory Board as an independent board.

Using this sample, information was collected in order to understand the board size and the number of: executive members, independent members, Supervisory Board members, politically connected members, executive members that are political connected, independent members that are political connected and Supervisory Board members that are political connected.

Related with the financials we collected information about total assets, total liabilities, enterprise value, EBITDA, short-term debt, long-term debt, total debt to EBITDA, revenues and Return on Assets. The resulting sample comprises 294 firm-year observations of 49 companies over a six-year period.

3.3. - Definition of Political Connections

According to Goldman, Rocholl and So (2009) it is necessary to identify and define a proper measurement of political connections first when analyzing the impact of such connections. There are different approaches to this definition in the literature. Faccio (2006) considers parliament members, ministers, state principals, and anyone closely related to senior

officials as the source of political connections. Measurements from economies in transition may be different such as the definition of Shin, Hyun, Oh and Yang (2017) that states that independent directors are classified politically connected if they hold or have held a position as a judge, prosecutor, government official, member of congress, journalist, or social activist. The authors define political connections as having the ability to access key constituents surrounding a firm. There is also the partly affiliation (Republicans vs Democrats) as a key measurement factor as stated by Goldman et al (2009).

Thus, and considering the reality in Brazil, we define as political connection any position on a government branch, any relation with a political party and any social position that may have influence on the government decisions.

3.4. - Regression Model

To test the effect of politically connected members of Brazilian companies' BoD on the future firm performance, we estimate the following regression model:

$$Performance_{t+1} = f(politically\ connected\ members_t, control\ variables_t)$$

Future firm performance is measured by the one-year-ahead return on assets (ROA). Firm performance may be measured in several ways. Accounting rates of return, specifically return on assets, are still one of the most used performing measures, according to RC Anderson and DM Reeb (2003). Moreover, in line with You and Du (2012), we take a one-year lag to better understand the influence of a Board of Directors in a full year. By following previous research, we include several controlling variables that may influence firm performance. We separate the controlling variables into corporate governance related and financial related.

In the first group, we include the number of political connected members of the Board of Directors, the number of executive members that are politically connected and the number

of the supervisory board members that are politically connected. As for the second group, we include firm size, total liabilities, enterprise value, EBITDA value and total debt to EBITDA ratio. Table 1 provides the description and measurement of the aforementioned control variables.

Variable	Description
FIRM SIZE	the Logarithm of total assets at the beginning of the fiscal year.
TOTAL_LIABILITIES	Total amount of liabilities at the beginning of the fiscal year.
ENTERPRISE_VALUE	Enterprise value of the company measured at the beginning of the fiscal year.
EBITDA	Value o of the company EBITDA at the beginning of the fiscal year.
TOTAL_DEBT_TO_EBITDA	Total debt measured as part of the total EBITDA value at the beginning of the fiscal year.
PC_MEMBERS	Number of Board of Director's members that are politically connected at the beginning of the fiscal year.
PC_AND_EXECUTIVE	Number of Board of Director's executive members that are politically connected at the beginning of the fiscal year.
PC_AND_CF	Number of Supervisory Board's members that are politically connected at the beginning of the fiscal year.

Table 1

To test hypothesis 2, we separate the sample into two sub-samples: underperforming and outperforming companies. The division of the sample was based on the current firm return on assets, being underperforming all the companies that have current return on assets below the industry median and outperforming the companies with current return on assets above the industry median. We separately estimate the coefficients for the full, outperforming and underperforming samples to test our hypothesis.

3.5. - Descriptive Statistics

Table 2 provides the descriptive statistics for the key variables in our regression model. In our sample, the average of ROA is 4,8167 and the average of political connected members of the Board of Directors is approximately 3. In addition, the average of the Board of Directors' politically connected executive members is close to 0,5, meaning that most of the members with political ties assume a more independent position in the council. Finally, the average of the Supervisory Board's politically connected members is approximately 0,8. Taking in consideration the size of the Supervisory Boards in Brazilian companies, we can conclude that there is a considerably large percentage of members with political relations.

	ROA_T_1	FIRM _SIZE	TOTAL _LIABILITIES	ENTERPRISE _VALUE	EBITDA	TOTAL_DEBT _TO_EBITDA	PC_MEMBERS	PC_AND _EXECUTIVE	PC_AND _CF
Mean	4,816696	4,288268	24387,20	37162,91	3939,439	3,602275	3,057823	0,523810	0,833333
Median	4,516142	4,285757	9440,212	17350,01	1647,712	2,861972	1,000000	0,000000	0,000000
Maximum	40,92135	5,954308	642205,0	496303,5	61729,00	42,24248	18,00000	6,000000	7,000000
Minimum	-13,50063	3,028863	218,6380	1564,686	-13215,33	0,000000	0,000000	0,000000	0,000000
Std. Dev.	5,884119	0,504205	61532,52	73304,05	8919,832	4,508341	4,341253	1,193460	1,621984
Skewness	1,098756	0,601966	6,605824	4,156729	4,728774	5,877543	1,882904	2,513836	2,385752
Kurtosis	9,124916	3,946264	54,15265	20,74270	27,92446	45,47309	5,421409	8,895794	8,227217
Jarque-Bera	518,7097	28,72463	34191,48	4702,982	8705,757	23791,28	245,5456	735,4640	613,6152
Probability	0,000000	0,000001	0,000000	0,000000	0,000000	0,000000	0,000000	0,000000	0,000000
Sum	1416,109	1260,751	7169837	10925897	1158195	1059,069	899,0000	154,0000	245,0000
Sum Sq. Dev.	10144,50	74,48715	0,000000	0,000000	0,000000	5955,264	5522,017	417,3333	770,8333
Observations	294	294	294	294	294	294	294	294	294

Table 2

Table 3 reports the correlation coefficients among the key variables used in our regression model. Focusing on our special interests, we can see that PC_MEMBERS variable is negatively correlated with the performance measure ROA_T_1, showing that politically connected members will increase in response to poor performance.

	ROA_T_1	FIRM _SIZE	TOTAL _LIABILITIES	ENTERPRISE _VALUE	EBITDA	TOTAL_DEBT _TO_EBITDA	PC_MEMBERS	PC_AND _EXECUTIVE	PC_AND _CF
ROA_T_1	1,000000	-0,309446	-0,221422	0,004834	-0,006603	-0,361876	-0,042934	-0,010661	-0,14017
FIRM _SIZE	-0,309446	1,000000	0,655348	0,679847	0,597634	0,171121	0,33439	0,108126	0,457181
TOTAL _LIABILITIES	-0,221422	0,655348	1,000000	0,832653	0,610846	0,367241	0,256982	0,082082	0,514363
ENTERPRISE_VALUE	0,004834	0,679847	0,832653	1,000000	0,844494	0,157744	0,182218	0,006042	0,408957
EBITDA	-0,006603	0,597634	0,610846	0,844494	1,000000	-0,022966	0,187597	0,025353	0,206683
TOTAL_DEBT _TO_EBITDA	-0,361876	0,171121	0,367241	0,157744	-0,022966	1,000000	0,056978	-0,035956	0,206683
PC_MEMBERS	-0,042934	0,33439	0,256982	0,182218	0,187597	0,056978	1,000000	0,845876	0,818089
PC_AND _EXECUTIVE	-0,010661	0,108126	0,082082	0,006042	0,025353	-0,035956	0,845876	1,000000	0,588289
PC_AND _CF	-0,14017	0,457181	0,514363	0,408957	0,206683	0,206683	0,818089	0,588289	1,000000

Table 3

4. - Empirical Results and Analysis

4.1. - The Effect of Political Connections on Future Firm Performance

The following Equations show the empirical results of the Ordinary Least Squares (OLS) regressions with one-year-ahead ROA as dependent variable. The PC_MEMBERS is the variable for the politically connected members of the Board of Directors. In the regressions, we include Political Connection variables and a series of control variables as explanatory variables.

Equation 1 shows that the coefficient on Political Connections is significantly positive ($t = 3,4861$; $p = 0,0006$). This result suggests that an increase in the number of politically connected members on the Board of Directors of Brazilian companies will significantly improve future firm performance, which is consistent with Hypothesis 1.

The number of executive Board members with political connections is also important as an explanatory variable of the future firm performance ($t = -2,1722$; $p < 0,05$). However, the influence of the variable on firm performance is verified in the opposite direction. The same

happens with the variable that controls for the number of Supervisory Board members with political connections (t = -1,9885; p <0,05).

These results may indicate a stronger influence of the independent members of the Board of Directors (*latu sensu*) on the Brazilian companies' future firm performance. In other words, members that do not have a function other that of a non-executive counselor, have a positive influence on future firm performance when politically related. On the other hand, executive members and Supervisory Board members with political ties have a negative impact on the future firm performance of the companies.

Dependent Variable: ROA_T_1
Method: Panel Least Squares
Date: 11/03/18 Time: 18:06
Sample: 2010 2015
Periods included: 6
Cross-sections included: 49
Total panel (balanced) observations: 294

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	30.81700	3.293727	9.356271	0.0000
FIRM_SIZE	-6.256791	0.808704	-7.736810	0.0000
TOTAL_LIABILITIES	-4.54E-05	9.81E-06	-4.623474	0.0000
ENTERPRISE_VALUE	8.81E-05	1.07E-05	8.212701	0.0000
EBITDA	-0.000231	6.23E-05	-3.703760	0.0003
TOTAL_DEBT_TO_EBIT	-0.353483	0.069968	-5.052100	0.0000
PC_MEMBERS	0.650610	0.186629	3.486113	0.0006
PC_AND_EXECUTIVE	-1.035283	0.476596	-2.172243	0.0307
PC_AND_CF	-0.723346	0.363791	-1.988354	0.0477

R-squared	0.386149	Mean dependent var	4.816696
Adjusted R-squared	0.368918	S.D. dependent var	5.884119
S.E. of regression	4.674384	Akaike info criterion	5.952206
Sum squared resid	6227.212	Schwarz criterion	6.064968
Log likelihood	-865.9743	Hannan-Quinn criter.	5.997364
F-statistic	22.41024	Durbin-Watson stat	0.658876
Prob(F-statistic)	0.000000		

Equation 1

More than study the possible impact of the political connections of the BoD's Members on the firm performance, we want to study the possible variation of this effect across different samples. More precisely, what is the difference in the impact on outperforming and underperforming companies. When the sample splits according to the median of ROA, the effects of politically connected members on firm performance change.

Equation 2 shows the results referring to the sub-sample of the companies which the current year ROA is above the industry median, meaning the companies that outperform the industry. This regression shows that the coefficient on the performance impact of the politically connected non-executive Directors is less significant than it was for the complete sample of Brazilian companies ($t = 2,1743$; $0,05 > p > 0,0006$). Once again, it is very important to analyze the behavior of the variables that control for the executive members of the BoD and the members of the Supervisory Board. The influence on firm performance of these samples is different for the sub-sample of the outperforming companies. PC_AND_EXECUTIVE have a more significant influence in this sub-sample ($t = -2,2926$; $p < 0,0307$) while PC_AND_CF loses importance on the behavior of the dependent variable ($t = -1,3415$; $p > 0,1$).

Dependent Variable: ROA_T_1
Method: Panel Least Squares
Date: 11/18/18 Time: 18:37
Sample: 2010 2015
Periods included: 6
Cross-sections included: 22
Total panel (balanced) observations: 132

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	20.52711	8.696163	2.360479	0.0198
FIRM_SIZE	-3.000102	2.367556	-1.267173	0.2075
TOTAL_LIABILITIES	-0.000430	0.000199	-2.163990	0.0324
ENTERPRISE_VALUE	-6.78E-06	4.19E-05	-0.161948	0.8716
EBITDA	0.001461	0.000643	2.271669	0.0248
TOTAL_DEBT_TO_EBIT	-0.342199	0.131003	-2.612146	0.0101
PC_MEMBERS	0.698539	0.321273	2.174288	0.0316
PC_AND_EXECUTIVE	-1.686318	0.735536	-2.292639	0.0236
PC_AND_CF	-0.920701	0.686279	-1.341583	0.1822

R-squared	0.352275	Mean dependent var	7.230548
Adjusted R-squared	0.310146	S.D. dependent var	6.094722
S.E. of regression	5.062119	Akaike info criterion	6.147194
Sum squared resid	3151.881	Schwarz criterion	6.343748
Log likelihood	-396.7148	Hannan-Quinn criter.	6.227064
F-statistic	8.361920	Durbin-Watson stat	0.626622
Prob(F-statistic)	0.000000		

Equation 2

Equation 3 shows the results referring to the sub-sample of the companies which current year ROA is below the industry median, meaning companies that underperform the industry. The regression shows that the coefficient on politically connected non-executive Directors is

significantly positive (t = 1,9773; p < 0,0006), meaning that is even more significant than it was for the all sample.

The sub-sample of the underperforming companies shows the opposite influence of the variables controlling for the executive members and the members of the supervisory board, when compared with the sub-sample of the outperforming companies. In the last regression, PC_AND_EXECUTIVE is no longer a statistically significant variable (t = -1,3417 ; p > 0,1) and PC_AND_CF is a more statistically significant variable than it was for the all sample (t = -3,2363; p < 0,0477).

Dependent Variable: ROA_T_1
Method: Panel Least Squares
Date: 11/18/18 Time: 18:41
Sample: 2010 2015
Periods included: 6
Cross-sections included: 28
Total panel (balanced) observations: 168

Variable	Coefficient	Std. Error	t-Statistic	Prob.
C	24.19841	4.270721	5.666120	0.0000
FIRM_SIZE	-5.082863	1.013471	-5.015300	0.0000
TOTAL_LIABILITIES	-3.47E-05	1.40E-05	-2.484798	0.0140
ENTERPRISE_VALUE	7.45E-05	1.75E-05	4.256745	0.0000
EBITDA	-0.000184	7.32E-05	-2.514408	0.0129
TOTAL_DEBT_TO_EBIT	-0.276313	0.075261	-3.671409	0.0003
PC_MEMBERS	0.860380	0.221984	3.875858	0.0002
PC_AND_EXECUTIVE	-0.851950	0.634971	-1.341715	0.1816
PC_AND_CF	-1.355496	0.418834	-3.236360	0.0015

R-squared	0.353493	Mean dependent var	2.658565
Adjusted R-squared	0.320965	S.D. dependent var	4.982597
S.E. of regression	4.105839	Akaike info criterion	5.714780
Sum squared resid	2680.409	Schwarz criterion	5.882136
Log likelihood	-471.0416	Hannan-Quinn criter.	5.782701
F-statistic	10.86714	Durbin-Watson stat	0.948605
Prob(F-statistic)	0.000000		

Equation 3

The previous results indicate that the relationship between politically connected members and future firm performance is mainly driven by the underperforming companies of the sample, which is consistent with Hypothesis 2. This indicates that the number of politically connected members of a BoD is particularly important, and has particular effect on future firm

performance when firms are in financial distress or simply underperforming vis a vis the industry.

The results also showed an interesting relationship between the influence of the politically connected executive and non-executive members with the future firm performance. Politically connected executive directors have a stronger influence on the performance of Brazilian companies that outperform the industry and an insignificant influence on the companies that underperform the industry.

These results may indicate a difference on the type of political relations that each company requires depending on the financial situation of the firm. There is also a separation of the way the different functions of the BoD use their political relationships, and the difference may be seen on the type of firm that might need each type of influence.

An outperforming firm will probably have lower levels of growth and an increasing need of better and stable control, while an underperforming firm will have higher growth rates and needs for independent control and decisions that control the growth of the company, which is in accordance with the results of regressions 2 and 3.

5. - Robustness Tests

The literature suggests other firm performance measures than return on assets. One of the most used is Tobin's q ratio which a financial market-based measure. According to Bharadwaj, Bharadwaj and Konsynski (1999), a forward-looking measure like Tobin's q ratio is better able to capture the firm performance.

To examine the robustness of our results to the return on assets as definition of firm performance, we use Tobin's q as an alternative firm performance measure. Using Tobin's q, we thus re-estimate the regressions in equations 1, 2 and 3 to evaluate the influence of political connections on the firm performance and the influence on the performance of the outperforming and underperforming companies.

The results show that the coefficient on Political Connections is significantly related with the future performance of the companies, which means that the robustness test is in accordance with the first hypothesis that is tested in our study.

Moreover, the equations used to study the differences between outperforming and underperforming companies show a significant relationship between the future firm performance and the political connections of non-executive directors of underperforming companies and a less significant relationship for the outperforming companies. The robustness test is also in accordance with the second hypothesis tested in our study.

As a conclusion, a change in the performance measure still guarantees the same results for our study. Since the robustness test results are qualitatively similar to those of the main specifications we can argue that que the equations used in our study produce robust and significant results.

6. - Limitations and suggestions for further research

The access to data for corporate governance matter is still an issue. There is no database available to collect this sort of information, which makes the search for data a slow and rudimentary process. Since all the corporate governance variables were manually created, using a larger sample to pursue more significant results would make the process even slower and risky, because collecting data by hand exposes the final product to human mistakes, that it wouldn't be exposed if a reliable data base exited.

The first limitation is connected to the second since, the difficulties felt on the data collection were reflected on the sample size. A study of a determined variable on an industry dimension would probably require a larger sample. A sample that was really representative of the Brazilian market. Using a larger sample would probably reveal better the importance of the politically connected members on the future performance of the firms but more importantly the difference between the outperforming and the underperforming companies.

The third limitation relies with financial information that is provided by the Brazilian companies. Approximately fifteen companies were withdraw from the sample due to missing financial information. Once again, this limitation is connected with the previous, since it is another issue connected with data collection.

Finally, a stronger set of robustness tests would make us able to take more significant conclusion from the results. To test for other definitions of political connections would be a good way to test the robustness of the definition that we used in our study. In addition, to test for other firm performance measures would also turn the variable that we use as definition of firm performance a more robust variable.

For further research, it would be interesting to perform a deeper study about the influence of political connections on the future firm performance in Brazil. To be able to perform the regressions with a larger sample might allow the introduction of new control variables and allow for a better understanding of the influence. Moreover, it would be interesting to focus the study on the different influences that the different functions inside the Board of Directors may have on the companies depending on their financial situation.

Another interesting suggestion would be to perform a comparison between the influence of political related board members in a developed economy and the Brazilian economy. Would also be interesting to compare the influence between the Brazilian companies and the companies of a country with lower government influence on the market.

Finally, to extend the study to other influences of political connections would be important for the literature. To study, for instance, the influence of political connections of the members on their turnover and understand how does the career path of a politically related member is driven would be an interesting work to perform. However, a project like this might require a larger team and a different set of tools to collect this type of information.

7. - Conclusion

Although the effects of political connections are part of the literature, the studies of the influence of it on the firm performance do not abound for the Brazilian market. Moreover, the importance of corporate governance on the Brazilian firm is still very small part of the literature. We explore this gap in the literature with this work. The influence that the political connected members of the Brazilian companies' Board of Directors have on the future performance of those companies, reflecting the quality of corporate governance.

We argue that Brazilian firms with politically connected members of the Board of Directors have better performance in following fiscal year. The reasoning behind this argument is the benefits that solid political relationships may bring to firms in costs, tax benefits and negotiations. In addition, under certain operating situations, BoD's members may face different pressures and have different motivations to use their resources, which will influence the relationship between political connections and firm performance.

To test our hypothesis, we use a sample of Brazilian listed companies that compose the market index (ibovespa), and manually collected data about the members of the Board of Director of each company, by analyzing the Curriculum Vitae of each member. We found a positive relationship between politically connected members and the one-year-ahead firm performance. We also find that the positive influence of political relationships is stronger in companies that underperform the industry, which means that companies facing a financial distress or are underperforming vis a vis the industry are more likely to improve their performance in the following year if the members of their Board of Directors have strong political connections. Moreover, we find that executive members with political connections may have a stronger influence on companies that outperform the industry while members with no other function in the company rather than being a counselor may have a stronger influence on the companies that underperform the industry.

Our findings may have implications on the needs of a deeper study of the complexity of corporate governance of Brazilian companies. Plus, our findings may have, despites its limitations, cross-sectional policy implications for other transition economies. First, because our findings show that political connections may be used as a way to improve firm performance, mostly in companies in a fragile financial situation. And on the other hand, these political relations may be associated to some conflict of interests and lead to some prejudicial decisions for the firms. For this reason it is crucial to reinforce the importance of internal corporate governance mechanisms to constrain the power derived from political relationships.

8. - References

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