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POLITICALLY CONNECTED BOARDS AND FIRM PERFORMANCE: THE CASE OF VIETNAM

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ABSTRACT

The paper examines the influence of Politically Connected Boards on Firm Performance in Vietnamese economy. Using the ordinary least square, fixed effect model, random effect model, and the comparison between the groups using sample T-test technique to examine the impact of political connections on the firm value. The findings reveal that firms with political ties exhibit reduced productivity, as evidenced by lower total factor productivity scores. Moreover, political connections hinder profitability, particularly for firms with modest earnings. Despite enjoying higher market value, politically connected firms suffer from decreased performance due to inefficiency and ineffectiveness. These results have important implications for investors, listed firms, and policymakers on the effects of political favoritism in transitional economies.

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1. Introduction

Political problems have always been the most intriguing topic of people's concern, especially in developed economies or emerging countries. Accordingly, a variety of studies have been conducted to figure out the trend of political favoritism and its impacts on many aspects of the economy. It is a popular belief that firms can reap a handsome profit by having a politically connected board or a good relationship with the government. The benefits range from knowing future economic policies in advance to enjoying preferential treatments such as lower tax rates, beneficial regulations, and **more effortless** ability to access capital (Agrawal & Knoeber, 2001).

Despite the popularity of corporate political connections in many countries, it appears to be, in contrast, a negative indicator for a frontier market like Vietnam due to the high level of corruption (Vietnam ranked 104/180 countries and territories in the Corruption Perception Index 2020). Moreover, it is mentioned an incomplete information disclosure and no relevant information about corporate operations, financial performance, and governance practices in Vietnam. Then, this becomes the investor's explanation for why the stock market of Vietnam cannot be qualified as an emerging market for many years, even though it has met the requirements of Morgan Stanley Capital International (MSCI) in terms of market size, market capitalization, and the number of billion-dollar companies. In addition, a politically connected board is considered to have no managerial incentives to maximize shareholder wealth and improve firm performance (Chen et al., 2020). A certain company's CEO or board members are often implied as having rent-seeking advantages when being connected to politicians publicly or confidentially. This also posts a belief in unfair competition among entrepreneurs, in which conglomerates gain more economic favors and try to acquire small or private-owned enterprises through "under-the-table" behaviors. For instance, firms may attempt to pay hidden costs to develop connections with the State, giving the firms advantageous treatments.

The connection between political favoritism and corporate performance in an emerging economy like Vietnam has attracted increasing scholarly attention in recent years. Such similar research papers have teased out a variety of findings in developed countries such as the United States, the United Kingdom, Italy, Germany, etc. However, the published literature on whether political connection affects the performance of firms in transitional countries (such as Vietnam) is sparse and not clear. Meanwhile, much of the empirical work on the effects of political connection in Vietnam has been focused on the firm value (Ha & Frömmel, 2020) or assessed the impacts within a specific sector (Binh, 2013). But these findings were mainly the impacts on a firm's access to finance, investment opportunity, management, or stock price, with a sample of firms in emerging or developed markets. Unlike these markets, a frontier market such as Vietnam has very few pieces of research regarding political connections, with most of the studies focusing on trading strategies and conventional characteristics of boards of directors. Therefore, the study on the effect of political connections on the performance and managerial problems of Vietnamese firms is essential.

2. Literature review

The theory of behavioral finance (Fromlet, 2001) has been proven to be true in the last decades, which means that the **investors' rationale** is not always logical and can hardly be explained by mathematical formulas and equations. In reality, psychology and emotion take control of every investment decision,

which is the unexplained and unpredictable portion of the market (Scheinkman & Xiong, 2003). Accompanied by the general belief that political connections help firms generate more profit and gain more market power, many investors, especially in developing and highly corrupt countries, have given credence to firms with politically connected boards.

Many studies on the connection between politics and corporate performance have received much attention in developed markets due to the topic's attraction and informative outcomes. These research papers cover a wide range of data samples located in many countries with different levels of market development and across many industries. The scholars, for the most part, choose an objective perspective to evaluate this sensitive relationship. Accordingly, a variety of studies have been conducted to figure out the trend of political favoritism and its impacts on the performance of firms. Ferguson and Voth (2008) concludes that German firms having an intimate relationship with the Nazis gain better profit than unconnected ones, which is unique research in the literature with minimal data during the war. Some companies having ties with Nazi Germany are still operating nowadays and have become the world's leading manufacturers, such as Mercedes-Benz, Siemens, Hugo Boss, etc.

Goldman et al. (2009) show that in America, the nomination of a politically connected board member can be a positive signal, which helps increase the stock price. Wong (2010) concluded that political connections improve firm performance measured by return on equity and market-to-book ratio, which is unlikely due to invisible factors such as firms' inherent ability. He defined a politically connected firm as one having stakeholders concurrently holding a seat on the Election Committee, a constitutional body that elects the city's chief executive. This study was conducted using the data of companies listed on the Hong Kong Stock Exchange during the handover of Hong Kong to mainland China. Going deeper into the economic behaviors of firms, Chen et al. (2020) explored an unconventional phenomenon of firm performance. That is the firm's decision to relocate its headquarters to the political centers, particularly, the largest cities of mainland China. The results are rather surprising as political favoritism does help improve firm profitability, but sustainable development diverges after the relocation to different cities in China. Firms moving to Beijing (the capital of China) benefit from higher profits but have a worse quality of productivity and innovation. In contrast, firms relocating to Shanghai or Shenzhen (vibrant cities) not only earn more profit but also improve their productivity and have an increasing number of patents as well as higher research and development (R&D) expenses. The answer to this difference is the tendency to seek political favors when firms decide to move to Beijing, where the firms' top managers can easily connect with government agents. This explains why these firms can generate higher-earning but, in fact, thanks to rent-seeking activities rather than being superior to their competitors in terms of technology or business strategies. Khwaja et al. (2004) demonstrated that politically connected firms were apportioned more loans by state-owned banks, their study exploited the data of 2209 firm-year observations of the Pakistani market. Covering a variety of companies in forty-two countries, Faccio (2006) showed that political connections give firms preferential access to valuable resources, which indirectly becomes a unique competitive advantage rather than a unique strategy. Binh Dao (2013) conducted her research in the banking sector with a sample of 32 banks in Vietnam throughout 2008 to 2011. In this paper, a positive relationship between political connection and bank performance is

found, and banks without political favoritism underperformed politically connected ones, which is explained by more security and less default risk.

However, the negative consequences of firm performance and politically connected board are also found. Fisman (2001) investigated the reaction on the firms connected to former Indonesian dictator Suharto, which is indicated to go worse at the time of any announcement or rumor about his health. Taking the sample of Malaysian companies during the Asian Financial Crisis 1997, Johnson and Mitton (2003) found that politically connected Malaysian firms reported poor financial statements because the economic crisis caused the government to cut its expenditure and reduce its ability to provide subsidies. Fan et al. (2007) showed that entrepreneurs with politically connected CEOs operated less effectively than those with normal CEOs. Using the Chinese National Twin Registry, D. Li et al. (2007) found that the economic benefits of Communist Party membership disappear whenever their power or family background ended. More globally, the study of Aguilera et al. (2021) aggregates results from 193 primary studies on SOEs situated in 131 countries, revealing that there is a small negative impact of state ownership or the existence of political connection on firm financial performance; however, there also exists a significant heterogeneity among countries in terms of the magnitude and direction of this effect. In addition, this paper demonstrates strong evidence that the current political ideology, along with the extant political institutions in a country, can considerably affect both the willingness and the ability of state owners to pursue economic and social goals. Nguyen et al. (2018) concluded that government financial support has no impact on firm profitability by using panel data covering the period of 2009-2015 and exploiting the ordinary least square method. But when trying the fixed-effect quantile approach, the result illustrated that the government's bailouts were helpful to firms with high profits but hurt the firm's ability to earn profit. However, in terms of the manufacturing sector, Nguyen et al. (2020) explored that there is a negative relationship between political connection and firm value (Tobin's Q as a proxy). The results also implied a significant impact of political connections on the ongoing business of state-controlled firms and stimulated the adverse effect of agency-related problems in these firms. On the contrary, non-state-controlled firms seemed to be non-vulnerable to these unfavorable effects. Also, regarding the firm value, Ha and Frömmel (2020) contributed to the literature by analyzing 1,365 Vietnamese listed firm-year observations from 2010 to 2014. They found that firms with political connections have lower firm value than those without any. **In particularly**, firms with acquired politically connected board members (normally obtained) reach better firm value than those with ascribed ones (assigned by the government). Acquired politically connected board members can contribute positively to the company's performance if they hold a majority of the shares.

In general, the literature on the effect of political connections on many aspects of firms has been diverse. These findings mainly focused on the impacts on a firm's access to finance, investment opportunity, management, or stock price, with a sample of firms. The literature on the influence of political connections in entrepreneurship extensively examines various facets such as access to finance, investment opportunities, management, and stock prices. However, it is important to note that most of these studies have primarily focused on firms operating in emerging or developed markets. Vietnam has very few pieces of research regarding political connection, with most of the studies only demonstrated the findings using merely a small sample size within a specific

industry or sector. This leaves a significant research gap in understanding the specific impact of political relationships within the Vietnamese context.

3. Methodology and data

3.1. Research design and hypothesis development

This study exploits quantitative methods to examine the impacts of political connections on firm performance. The research is implemented through a four-step process: (1) Scrape and tidy the data; (2) Build the criteria for the definition of a politically connected board of directors; (3) Based on the econometric models, determine the effect of political connection on firm performance; (4) Analyze and interpret the results deriving from the models.

The data used in the study are financial ratios, firm fundamentals, and profiles of board members obtained via Bloomberg, Vietstock, and FinnPro. The data is processed and filtered to build the sample. Then using the ordinary least square, fixed effect model, random effect model, and the comparison between the groups using sample T-test technique (in R studio), the study tests the impact of political connection on firm performance based on three hypotheses. The results from the models are then observed and interpreted to answer the three questions of the research.

Table 1. A summary of research questions and hypotheses

Research question	Research hypothesis
Is there any relationship between politically connected boards of directors and firm profitability?	H_1: Political connections (PC) negatively affect firm profitability.
Does a politically connected board of directors affect a firm's productivity level?	H_2: Political connections (PC) negatively affect firm productivity.
Is there any relationship between politically connected boards of directors and firm value?	H_3: Political connections (PC) negatively affect firm value.

3.2. Research Model

Since the effect of political connections occur in long-term period to corporate performance along with other firm's time-invariant characteristics, the baseline model for answering each research hypothesis is developed based on the following specification:

$$Y_{i,t} = \alpha_0 + \beta^{*}PC + \gamma_1{}^{*}X_{i,t} + \delta_i + \varphi_t + \varepsilon_{i,t}$$

Where: *$Y_{i,t}$ stands for a variety of measures of firm performance: productivity index (TFP), profitability and firm value, respectively. α_0 is the intercept, PC is the dummy variable indicating a firm with political connections (β is the coefficient). γ_i denotes the series of control variables. δ_i is the firm fixed effect, which are unchangeable description of firm (e.g., ICB industry). φ_t is the time fixed effect, which are the year dummy variables controlling for economic shocks. $\varepsilon_{i,t}$ is the error term of the equation.*

In this research, the definition of political connections is closest to the modern one by Faccio (2006) and Chen et al. (2020). A politically connected board of a company is determined if there is at least one of the firm's top officers (CEO, chairman of the board, president, vice president, or secretary) is a former official in the local or central government.

As for calculating the total factor productivity as a measure of firm productivity and management quality, this study employs

the Cobb-Douglas production function to examine the Solow residual, which is the portion of intangible inputs in manufacturing such as technology innovation, and efficiency. By the well-known method of Schoar (2002), the total output, labor capital, and material inputs of firms are attributed to proxies of total revenues, number of employees, firm size (total assets),) and cash paid to suppliers, respectively. These are the crucial independent variables for measuring firm productivity.

The original research model of this study regarding firm profitability is per the baseline model of Nguyen et al. (2020) on the determinants of corporate performance. This research is selected due to its ability to solve the contraries in previous research papers regarding firm profitability (e.g. merely access profitability through external forces and insufficient quantity of variables) and to emphasize on the impact of internal elements on firm profitability across divergent industries. The factors discussed here are firm size, liquidity, solvency, financial leverage, and capital adequacy. These components have turned out to be the standard determinants of firm profitability in modern finance. Besides, the main measures of firm profitability are still ROA, ROE (which are the two main profitability indicators of this research) and ROS ratio. Moreover, TobinQ is calculated by market value divided by the book value of total assets (total asset value of the firm) which is similar to the research of Hejazi et al. (2016).

Concerning firm value, the original research model is based on the one utilized by Ha et al. (2018). This model is popularly chosen because it overcame the hindrance of precedent studies regarding firm value such as the evaluation of a specific industry or inappropriate predictors such as the inconsistency with international findings, the absence of a firm's liquidity, capital structure, and firm size. These are the underlying theories to scrutinize the impact of political connections on firm performance and firm value in Vietnam (*see Appendix 1 and Appendix 2 online*).

Firm size is revealed **to influence firm profitability significantly** (Nguyen et al., 2020). Financial leverage negatively affect firm profitability (Nguyen et al., 2020) due to high interest expenses and periodic debt payments. Besides the above-mentioned typical factors, other crucial internal impacts are agency costs of firms (Jiang et al., 2015; Giannetti et al., 2015). These measurements are documented by the proxy of the percentage of shares owned by the largest shareholders (block) and free cash flow held by firms (measured by the ratio of free cash flow divided by total assets, Chen et al., 2020). In addition, the **stock price volatility** is added to the equation to control for market-related factors and infrequent events. Regarding the equation to assess the impact of political connection on firm value, firm growth rate, board size, duality, and concentrated ownership are conventionally decisive factors affecting firm value (Ha & Frömmel, 2020). In addition, the level of independence of board directors, the average age of board members, and profitability are also delineated to positively act on firm size (Ang et al., 2013).

3.3. Statistical Hypothesis Testing

H_1: Political connections (PC) negatively affect firm productivity.

Model 1: $TFP_{i,t} = \alpha_0 + \beta_1 * PCs + \gamma_1 * FSIZE + \gamma_2 * LEV + \gamma_3 * BLOCK + \gamma_4 * VOLAT + \gamma_5 * FCF + \delta_i + \varphi_t + \varepsilon_{i,t}$

In Model 1, if $\boldsymbol{\beta_1}$ is negative and statistically significant, the first hypothesis will be accepted. Chen et al. (2020) has demonstrated that firm having a politically connected board can be rendered vulnerable to the presence of agency problem such as bureaucracy, fraud and inefficiency in management.

H_2: Political connections (PC) negatively affect firm profitability.

Model 2: $PROFIT_{i,t} = \alpha_0 + \beta_1 * PCs + \gamma_1 * FSIZE + \gamma_2 * LEV + \gamma_3 * BLOCK + \gamma_4 * VOLAT + \gamma_5 * FCF + \delta_i + \varphi_t + \varepsilon_{i,t}$

H_3: Political connections (PC) negatively affect firm value.

Model 3: $FV_{i,t} = \alpha_0 + \beta_1 * PCs + \gamma_1 * GROWTH + \gamma_2 * LEV + \gamma_3 * FSIZE + \gamma_4 * BSIZE + \gamma_5 * DUAL + \gamma_6 * CO + \gamma_7 * IND + \gamma_8 * DIRAGE + \gamma_9 * ROA + \delta_i + \varphi_t + \varepsilon_{i,t}$

If $\boldsymbol{\beta_1}$ is negative and statistically significant, the third hypothesis will be accepted. Ang et al. (2013) reveals that political connections contribute very little to firm value using Singaporean data sample. But in contrast, a recent study by Ha & Frömmel suggests that firms with political connections have a lower value than firms without any. The summarizes all of the variables' reference and the expected effect in the three hypotheses (*see Appendix 3 online*).

3.4. Data Sources

This study utilizes a dataset comprising all non-financial companies listed on the Ho Chi Minh City Stock Exchange (HoSE) and Hanoi Stock Exchange (HNX), Vietnam's two largest stock exchanges. Data from various providers, including Bloomberg API and Vietstock, covers fundamental indicators and financial statements. All data on board members are collected from the FinnPro database and public information, encompassing details like full name, date of birth, education, career path, and shareholdings. The dataset spans January 2009 to March 2020, excluding the 2008 economic crisis and the COVID-19 recession, involving 737 listed firms and 5,769 observations.

3.5. Data Processing

For data processing, a meticulous approach is taken. The initial step involves scraping necessary data, and to fit models (as shown in Table 2). Financial firms, as classified by ICB, are excluded, while real estate firms are retained due to their alignment with manufacturing firms' reporting standards. Extreme values exceeding 1% within the sample are omitted in regression data to minimize bias.

Table 2. Calculation of the number of observations

		Profitability equation	Firm value equation
The initial number of observations in the data sample		5,462	7,220
Less	Observations of financial firms (except real estate firms)	927	400
	Observations of missing data	586	893
	Outliers	142	51
Final observations		4,207	5,876

After the data processing is completed, the data sample is an unbalanced panel of data pending the next step in the research. The summarizes the ICB industry and the number of firms within each industry in the data sample (*see Appendix 4 online*).

3.6. Data Analysis Techniques

The data sample for regression is unbalanced panel data. The conventional method of checking and summarizing the data is descriptive statistics. Each variable's characteristics are observed through a couple of mathematic measures (e.g., mean, median, standard deviation, maximum value, minimum value, skewness, and kurtosis). In addition, a summary of statistics of qualitative variables for political connectedness is also provided for the sake of deeper and detailed analysis. About the phenomenon of collinearity, a Pearson correlation matrix of variables is calculated to scrutinize the relationship between variables. **The extent of statistical significance accompanies the descriptive statistics and the correlation matrix.** The next step is to apply the regression models (by choosing among Pooled OLS, Fixed Effects Model – FEM, Random Effects Model – REM) to enumerate the research results.

4. Results and discussions

In this part, the results of the analysis of the data will be illustrated. The primary step is the review of the descriptive statistics and the inspection of the correlation matrix. Before interpreting the outcomes from regression equations, a couple of statistical tests are conducted to examine the characteristics of models. And finally, the results from the OLS, FEM, REM and quantile regression approach are interpreted and discussed along with the repetition of findings from previous papers.

4.1. Descriptive Statistics

This study assesses the impact of political connection on firm performance based on two aspects of a firm, the firm's ability to generate profitability and the firm's value. Thus, the descriptive statistic tables and correlation matrix of variables within each specific model are separated and observed *(see Appendix 5 and Appendix 6 online)*.

4.2. Correlation Matrix

Using the Pearson method in calculating the correlation between the variables of interest in each model, this study finds no considerable correlation among variables (with the absolute value of correlations lower than 0.7, as indicated in the theoretical literature). Therefore, the presence of multicollinearity in the regression models can be rejected in both models for firm profitability and firm value. As seen in Appendix 8 online, there is also no significant correlation between variables, a piece of evidence denying the likelihood of multicollinearity. Though the identification of multicollinearity is not observed through the correlation matrix, multiple tests are used to detect abnormal phenomena rendering the models invalid.

4.3. Empirical results

In this section, the diagnostic tests have confirmed the presence of autocorrelation and heteroscedasticity within the models of the study, thus, to be accurate, the regression models are transformed to the robust covariance matrix, which helps to address the models' errors. The results in regression tables are partially similar to those of the original fixed-effects models, though they are altered by the results from the method of the robust covariance matrix (Sandwich estimators). But as expected, the impact of political connection on firm profitability and firm value is found to **be maintained** after the transformation.

On the other hand, the analysis of the impact of political connections on firm performance will not be sufficient at the preliminary level, for an explicit approach, the effect might vary across the distribution of the data sample. Therefore, the quantile regression method is

applied to better exhibit the phenomenon with a different aspect and resist the influence of outlying observations. Quantile regression is also semi-parametric because it removes the assumptions about the traditional distribution of the error process. The models under the quantile regression are also exploited in the robustness test.

In elaborating the effect of political connection on firm profitability and firm value, as a rule of thumb, the quantile regression is implemented based on six groups, which is equivalent to six percentiles within the sample (10%, 25%, 50%, 75%, and 90%) for optimal subsampling. In general, the regression results from fixed-effects models illustrated using robust covariance matrix-sandwich estimator give credit to explain the relationship between political connections and firm performance. Meanwhile, the results from quantile treatment regression (from the third to seventh column in the table depict the impact of political connectedness within each sub-sample data. For instance, the coefficient in the sub sample of smaller than 10% (tau equals 0.1) will be the magnitude of the effect of political connection on firm performance in that subsample *(see Appendix 9 online)*.

The empirical results regarding the impact of political connections on firm performance in Vietnam are presented and analyzed by the determination of each hypothesis. The conclusion of the hypothesis regarding firm productivity, firm productivity, and firm value are illustrated, respectively.

Hypothesis H_1: Political connections (PC) negatively affect firm productivity (accept H_1).

The total factor productivity, which is a common and modern method of measuring a firm's productivity, is negatively affected by the presence of political connection. In all of the models, political connectedness is found to hurt a firm's TFP. The negative relationship between political connection and firm productivity is observed through the whole sample using the results from the pooled OLS model. In addition, the score of TFP is reduced by the presence of political connections in firms with low and medium TFP, which is equivalent to productivity below the median. From the reasons mentioned above, the first hypothesis is accepted as there is cogent evidence of the detrimental impact of the political relationship on firm productivity. In summary, political connectedness is found to raise the likelihood of agency problems and reduce management quality in firms with a score of productivity below the median.

Hypothesis H_2: Political connections (PC) negatively affect firm profitability (accept H_2).

In terms of profitability models with ROA as a response variable, the baseline models are the fixed-effects models, which are selected through the diagnostic tests *(see Appendix 10 online)*. As expected, the presence of political connectedness in a firm renders the firm's ability to generate income. But the results deliver an astonishing aspect, in particular, politically connected boards have a significantly negative impact on the firm profitability in Vietnam. Profitability (proxied by return on assets - ROA) plummets around 0.6% if a firm is detected to have a political connection. The negative effects expand the group of firms with medium profit (around the median of profitability), especially politically connected firms with total annual profit belonging to the group 75th percentile.

Hypothesis H_3: Political connections (PC) negatively affect firm value (reject H_3).

As opposed to the null hypothesis, the results from the fixed-effect models imply an astonishing positive relationship between firm value (measured by market-to-book value) and the existence of political favoritism in a firm. Although the results from regression *(see appendix 11 online)* exhibit a significantly positive

relationship between political connectedness and a firm's market-to-book ratio, the positive impact of political connection is revealed to be only significant in the subsample of 10th, 25th, and 50th percentiles with the magnitude of 1.1%, 3.4%, and 5.0%, respectively. According to the fixed-effects model (controlled by the robust covariance matrix), firms having a politically connected board are found to have an increase in corporate value by 1.3%.

The first upshots confirm the phenomenon of interest to be true: political connection does negatively affect firm performance in terms of firm productivity and firm profitability, but positively influence firm value. The depiction of this phenomenon will be continuously conducted using the robustness test to reinforce the accuracy of the results. Afterward, the study will elaborate on thoughtful analysis of the phenomenon using an independent sample T-test and unpaired two-sample Wilcoxon test to figure out the intensity of effect within each sector.

4.3.1. Discussions

The first is politically connected boards and firm productivity

The empirical results from the models also point out that firm productivity often plummets in firms with political connections, similar to Ding (2016) and Chen et al. (2020). A lower productivity score is witnessed in a firm if this firm demonstrates low R&D expenditure, and a lack of innovation and efficiency (Chen et al., 2020). Thus, leading managers of politically connected firms seem to have lower management quality and more remarkable agency problems due to low productivity (Ding, 2016).

The second is politically connected boards and firm profitability

There is a broad consensus of the relationship between firms with political connections and firm profitability. Still, there is also divergence among previous findings regarding the magnitude and the direction. The differences are attributed to geography, characteristics of the market, and the nation's political status (Faccio, 2006). Therefore, this study discovers that firm profitability is negatively influenced by the presence of political connections in firms in emerging markets, particularly the Vietnamese market. This result is identical to the other findings pointing out that political connectedness deteriorates profit in developing markets (Fisman, 2001; Johnson and Mitton, 2003; Chen et al., 2020). Besides, this study also digs deeper into finding the impact of political connections on firm profitability within each group of firms by using quantile treatment. Firms with small and middle levels of profitability per year (below the sample's median) seem to be rendered more severe with an intensely negative impact from political connectedness. A similar research paper conducted by Nguyen et al. (2018) regarding government support and firm profitability also indicates that small and medium-sized firms are subjected to adverse effects deriving from affiliations with the authorities. The combination of upshots reinforces the argument that smaller firms with political connections cannot handle the business appropriately, though receiving many benefits. Given the political favoritism inside these firms, they fail to expand profitability effectively and sustainably. According to Jain (2024), smaller firms in developing economies often develop less cost-effective strategies, and weak operational capabilities. These may also result in bureaucratic problems and a weak monitor system inside PC firms. Thus, top managers in smaller firms rife with political connections attempt not to maximize profitability for the firm's investors but to personal benefits and power.

The third is politically connected boards and firm value

Firm value is a benchmark for measuring a firm's economic position. The statistical results

show that solid value is positively affected by political connections in Vietnam, a transitional economy. Thus, this result provides a robust depiction in combination with previous studies in developed countries, such as Faccio (2006) and Ang (2013), given the intensity of the impact may differ across countries, economies, and the level of political connectedness, PC firms are frequently benefited from the higher value in emerging markets. Hence, this result can imply that analysts and investors respond positively to politically connected personnel in any firm by evaluating the firm higher. On the other hand, perhaps more importantly, the higher firm value might seemingly signal rent-seeking behaviors of politically-connected managers, such as stock price manipulation, overestimated revenue projections, or implausible strategies (Shleifer & Vishny, 1994). And, of course, this is not a long-term and sustainable intrinsic value of a company, as the value does not originate from firm productivity and operational capabilities.

4.3.2. Robustness Test

Firm profitability and firm value can be measured by a variety of indicators under different aspects. Thus, a reinforcement from changing the dependent variables in the models will confirm the existence of the phenomenon. Firm profitability (measured by return on equity – ROE) is adversely influenced by political connection, especially in firms with profitability lie around the median *(see appendix 12 online)*. In general, the outcomes of the effect of political connection on firm profitability in terms of ROE and ROA are still unchanged.

4.3.3. Comparison of financial indicators between non-PC firms and PC firms

In this part, the study will analyze the impact of political connections on firm performance within each ICB sector using common financial measurements. The purpose is to determine the intensity of political connection in many sectors, especially in heavily regulated sectors, which are often strictly controlled by SOEs and politically connected firms. This analysis also acts as robustness to the conclusion drawn from the models and helps explain the cause of the phenomenon. The first and second columns are the type of financial measurements and financial ratios belonging to each type *(see appendix 14 online)*.

This study conducts the independent sample T-test between financial ratios of PC and non-PC firms, accompanied by the unpaired two-sample Wilcoxon test. The third column displays the percentage of sectors with the satisfied significance level (smaller than 10%). The significance level is taken from the unpaired two-samples Wilcoxon test. Hence, the level of accuracy of each financial ratio is measured by the percentage of significant sectors in the sample. The fourth and fifth columns *(see Appendix 12 online)* illustrate the proportion of negative/positive mean difference (average value of non-PC firms minus the average value of PC firms).

First, in terms of valuation ratios, the P/E and EV/EBITDA of non-PC firms tend to be lower than PC firms (as the percentage of negative mean difference equals 90.4% and 78.2%) while the amount of dividend paid from PC firms is smaller than that non-PC firms. This can be interpreted as political favoritism of most of the investors when selecting a stock, or the investors are willing to pay a higher price even the future return is uncertain. This argument can be more convincing by the higher profitability acquired by non-PC firms compared to PC firms (profitability ratios). As around 60% to 70% of PC firms have lower ROE, ROCE, and ROA than firms without political connectedness. Non-PC firms, in general, have a better ability to generate cash (with higher cash and quick ratio than PC firms), but also have higher days of sales outstanding and days

of inventory on hand, which might derive from the fact that these firms have less bargaining power and fewer opportunities to sign large-scale contracts. Besides, non-PC firms also have fewer days of payables.

In terms of leverage ratios, non-PC firms have less tendency to lend capital or increase financial leverage. On average, PC firms tend to have poorer cost management than non-PC firms (as general and administrative expenses of PC firms are mostly larger than non-PC firms), while PC firms have to pay fewer interest expenses, which infers that PC firms may be favored by better loan policy. Concerning long-term assets structure, PC firms explicitly have less intangible fixed assets than non-PC firms, which can be represented by trademarks, copyright, and goodwill. This implies that non-PC firms have greater innovations, intellectual properties, and especially productivity than PC firms.

In summary, PC firms are found to have a higher value than non-PC firms, though, in terms of profitability, liquidity, efficiency, cost management, and productivity, non-PC firms are superior to their counterparts with PC. This delivers a robust conclusion that political connections have substantially affected firm performance, in particular, firm profitability and management quality are negatively affected by the appearance of political connections, meanwhile, only firm value (market value) are positively influenced by the political connection.

5. Conclusions and recommendations

The implications of political connections on firm performance are multifaceted and significant. For firm productivity, firms with political connections are detrimentally affected by the lower score of total factor productivity. For firm profitability, political connections adversely affect the firm's ability to gain profit. Especially, the presence of a politically connected board in firms with small and middle levels of profitability per year (below the median of the sample) indeed reduces firm profitability. For firm value, this study finds that firms with political connections have higher market value than firms without any connections. However, this study demonstrates that political connections, in return, negatively affect firm performance, which is attributed to inefficiency and ineffectiveness. These findings underscore the complex dynamics between political connections and firm performance. While political connections may initially provide certain benefits such as higher market value, they can ultimately hinder productivity, profitability, and overall firm performance due to inherent inefficiencies and ineffectiveness.

Some recommendations for investors, *firstly*, the investors should be fully aware of the whole operation, the structure of boards of directors and crucially measure the firm's ability to generate profit in the future before making any investment decision. *Secondly*, the investors should circumvent the overconfidence bias or emotional bias with the belief that political connections play a key role in determining which firm is profitable. The investment decision should be based on fundamental analysis and thoughtful analysis and understanding of the company. *Thirdly*, as observed, small and medium-sized firms are the firms considerably affected by the adverse sides of political favoritism, investors, with long-term goals and low-risk strategy, should temporarily avoid these stocks.

Some recommendations for Listed Firms, *firstly*, firms with political favoritism should build a strict management system and have the responsibility of publicizing internal information to shareholders. Increasing the number of independent board members could be a solution for firms to improve transparency. *Secondly*, the nomination of a board member should be based on expertise

and assessed fairly through experience and knowledge. Gaining profit through rent-seeking activities might not be a long-term strategy, informal costs should be replaced by expenditure on innovations, research, and development to maintain sustainable growth. *Thirdly*, small and medium-sized firms should concentrate on investing in training as well as sustainable development to grow steadily. Besides, improvement in monitoring and management should be made to restrict fraudulent behaviors in firms. In the modern world, competitive advantage can derive from a combination of various strategies to tackle the problem of gaining market share.

Some recommendations for policymakers, *firstly*, the government should enhance its capacity to monitor the firm's operation, prevent rent-seeking activities on the market, and most importantly, reduce the level of corruption and bureaucratic behaviors among the authorities to fulfil the investors with a sense of security and integrity. *Secondly*, the nomination of any politically connected board member should be put under control by the authority and shareholders with a shining example from China, especially with state-owned firms. The announcement of the new board member should be accompanied by a detailed framework with an explanation in terms of experience, expertise and knowledge. *Thirdly*, small and medium-sized firms should be given equal opportunities and preferential treatment to grow efficiently. This group of enterprises are the most vulnerable firms in the economy but contribute remarkably to the transitional economy (Harvie, 2005) such as Vietnam. In addition, this also delivers the implications for the authority in building a strong institutional setting as well as strong corporate governance regulations in not only small firms but also all firms in the economy.

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