



UNIVERSITY  
OF WOLLONGONG  
AUSTRALIA

University of Wollongong  
Research Online

---

Faculty of Business - Papers

Faculty of Business

---

2013

# Political connections, founder-managers, and their impact on tunneling in China's listed firms

Liangbo Ma

*University of Wollongong*, [lm649@uowmail.edu.au](mailto:lm649@uowmail.edu.au)

Shiguang Ma

*University of Wollongong*, [shiguang@uow.edu.au](mailto:shiguang@uow.edu.au)

Gary Tian

*University of Wollongong*, [gtian@uow.edu.au](mailto:gtian@uow.edu.au)

---

## Publication Details

Ma, L., Ma, S. & Tian, G. (2013). Political connections, founder-managers, and their impact on tunneling in China's listed firms. *Pacific-Basin Finance Journal*, 24 312-339.

Research Online is the open access institutional repository for the University of Wollongong. For further information contact the UOW Library: [research-pubs@uow.edu.au](mailto:research-pubs@uow.edu.au)

---

# Political connections, founder-managers, and their impact on tunneling in China's listed firms

## **Abstract**

We investigate the impact of manager political connection and founder status on tunneling in China's listed firms from 2004 to 2010. By classifying the political connections into three dimensions with two categories of controlling ownerships, we find that overall manager political connection is negatively related to tunneling in private firms but positively related to tunneling in SOEs. The CPC/CPPCC-type connection is likely to protect firms from tunneling, while the official-type connection facilitates tunneling from firms. The impact of these two types of political connection on tunneling is stronger at the central level than the local level. A chairman's political connection has significantly greater influence on tunneling than a CEO's connection. We also find that firms with founder-managers have a stronger resistance to tunneling than those with non-founder-managers, which is still observed in firms with politically connected founder-managers. Our results show that the incentives of various managers towards tunneling depend on their motivation for establishing relevant political connections.

## **Keywords**

era2015

## **Disciplines**

Business

## **Publication Details**

Ma, L., Ma, S. & Tian, G. (2013). Political connections, founder-managers, and their impact on tunneling in China's listed firms. *Pacific-Basin Finance Journal*, 24 312-339.

# **Political connections, founder-managers, and their impact on tunneling in China's listed firms**

Liangbo Ma<sup>a</sup>, Shiguang Ma<sup>a\*</sup>, Gary Tian<sup>a</sup>

<sup>a</sup> *School of Accounting and Finance, University of Wollongong, Australia 2522*

---

We would like to thank the participants at the Asian Finance Association (AsianFA) 2012 International Conference in Taipei and the 2012 China International Conference in Finance in Chongqing for their helpful comments. We are grateful to the anonymous referees' constructive comments and suggestions. We appreciate Professor Ghon Rhee (the editor) for his advice and support. We also acknowledge the financial support from the Faculty Research Grant, Faculty of Commerce, University of Wollongong.

\* Corresponding author. Northfields Avenue, Wollongong, New South Wales 2522, Australia; E-mail address: [shiguang\\_ma@uow.edu.au](mailto:shiguang_ma@uow.edu.au); Tel: +61 2 4221 3312; Fax: +61 2 4221 4297.

# **Political connections, founder-managers, and their impact on tunneling in China's listed firms**

## **Abstract:**

We investigate the impact of manager political connection and founder status on tunneling in China's listed firms from 2004 to 2010. By classifying the political connections into three dimensions with two categories of controlling ownerships, we find that overall manager political connection is negatively related to tunneling in private firms but positively related to tunneling in SOEs. The CPC/PPCC-type connection is likely to protect firms from tunneling, while the official-type connection facilitates tunneling from firms. The impact of these two types of political connection on tunneling is stronger at the central level than the local level. A chairman's political connection has significantly greater influence on tunneling than a CEO's connection. We also find that firms with founder-managers have a stronger resistance to tunneling than those with non-founder-managers, which is still observed in firms with politically connected founder-managers. Our results show that the incentives of various managers towards tunneling depend on their motivation for establishing relevant political connections.

JEL classification: G32; G34

Keywords: Tunneling; Political connection; Founder-manager; Chairman; CEO

## **1. Introduction**

When larger shareholders or other insiders such as managers have the capability of controlling the firms they may have an incentive to extract private benefits as well. The practice of expropriating value from a firm is commonly referred to as “tunneling” (Johnson et al., 2000) or “self-dealing” (Djankov et al., 2008). Friedman et al. (2003) find that tunneling by entrepreneurs who control the firms is prevalent in countries with a weak legal system. The Chinese market has been criticized for its generally ineffective institutional system, weak investor protection, and lack of internal monitoring and external discipline mechanism. Tunneling behavior has frequently been detected in China’s publicly listed firms.

Some studies have tried to identify the specific factors, in addition to the common regulatory environment, that determine tunneling in China’s publicly listed firms. Li et al. (2004) document that concentrated ownership exacerbates the expropriation of assets by block shareholders. Chen et al. (2005) indicate that the state as the controlling shareholder facilitates tunneling. Tang et al. (2004) concede that institutional ownership is favorable for tunneling, while Gao and Kling (2008) argue that having the state and institution as principal shareholders is not necessary to facilitate tunneling. Jang et al. (2010) show that institutional investors avoid investing in firms that experience severe tunneling and this problem is much greater in non-state owned firms.

It is obvious that the existing literature on tunneling in China’s listed firms provides inconsistent evidence. In this research, we do not intend to duplicate any of the evidence to align with some viewpoints because we conjecture that there is a ‘hand’ behind the factors identified by the abovementioned studies, which is the ultimate determinant of the tunneling behavior in China’s listed firms. This ‘hand’ is the powerful ‘Guan Xi’ (relationship) in China – political connection. Political connection and its impact on firms’ performance in various ways has been found in many countries (Friedman et al., 2003; Faccio et al., 2006),

but it is more profound in China because political connection in China represents a complicated framework with three dimensions and permeates various enterprises.

First, political connection in China can be categorized into two types. One is an official-type political connection where a firm's manager is a current or former government official or military officer. The other is a CPC/ CPPCC-type political connection where a firm's manager is a current or former member of the Chinese People's Congress (CPC) or the Chinese People's Political Consultative Conference (CPPCC). Second, political connection in China is attributed to two levels of administrative hierarchy. One is that a firm's manager holds or held a political position in local (provincial or regional) government organizations. The other is that a firm's manager holds or held a political position in central (national) government organizations. Finally, firm manager in China is a brief concept that in reality can be either a chief executive officer (CEO) or chairman of the board who plays different roles in the firm. Thus, a firm can be politically connected by either its CEO or chairman, or both. These differently politically connected managers represent a diverse form of interests of shareholders, government organizations, and themselves and thus should have various incentives for tunneling.

If a manager is the establisher of the firm, the manager is entitled to be a founder manager and the firm is entitled to be a founder firm. The founder manager may be a block shareholder of the firm or an expert in the production, marketing, and management of the firm. Literature shows that founder managers and non-founder managers have different incentives in a firm's decision making (Anderson and Reeb, 2003; Anderson et al., 2009; Li and Srinivasan, 2011). It is expected that when founder managers are politically connected their incentives may have changed.

In this paper we investigate the function of the 'hand' – political connection – in firm's tunneling behavior. The novelty of this research is that we are the first to classify

political connections in China's publically listed firms into three dimensions: official-type and CPC/PPCC-type, local level and central level, CEO's connection and chairman's connection. Accordingly, we fill a gap by analyzing the motivation of managers with different political connections towards tunneling, intertwined with firms' ownership and managers' founder status.

We show that both political connection and founder status determines tunneling behavior and their impact varies in private firms and SOEs (state owned enterprises). Specifically, we find evidence that overall, manager's political connection reduces tunneling in private firms, whereas it facilitates tunneling in SOEs. There is less tunneling in both private firms and SOEs with founder-managers than in firms with non-founder-managers, but the tunneling between founder-manager firms and non-founder-manager firms is significantly greater in private firms than in SOEs. When founder managers are politically connected they can still resist tunneling to some extent.

We find that for private firms, CPC/PPCC-type political connection significantly reduces firm tunneling, while official-type political connection has a positive but insignificant impact on tunneling. On the contrary, official-type political connection in SOEs significantly increases tunneling, while CPC/PPCC-type political connection has a negative but insignificant impact on tunneling. These results are consistent with the nature of these two types of political connections.

Finally, we show that a chairman's political connection has greater influences on tunneling than a CEO's political connection, in both private firms and SOEs. Political connections at the central level affect tunneling more than at the local level, for both official-type and CPC/PPCC-type political connections. These findings are also in line with our hypothetical analyses.

This study contributes to the literature in three ways. First, numerous studies show that managerial attributes affect firm risk-taking, investment policy, capital structure, and other corporate governance practices (May, 1995; Adams et al., 2005; Fahlenbrach, 2009; Faccio, 2010). We show that managerial attributes such as political connection and founder status, can also have a significant impact on tunneling, so this study adds to the existing literature by identifying a new channel through which managerial attributes affect firm valuation and performance.

Second, most existing studies of the Chinese market treat all political connections equally (Fan et al., 2007, Peng et al., 2011; Wu et al., 2012). We not only find evidence that political connection affects firm tunneling, we also show that the impact of political connection between types of political connection (official- or CPC/PPCC-type), hierarchy levels (local or central) and managers' positions (CEOs or chairmen) changes significantly. In our study we take the private or state controlling ownership as a firm's background, so to this extent, our study is also related to Wu et al. (2010), who find that the impact of political connection on firm performance, government subsidiary, and policy burden varies depending on the type of firm ownership. Third, this study contributes to the literature on founder-managers in relation to political connections. The behavior of founder-managers and their impact on firm performance and valuation is attracting a great deal of academic interest (Anderson and Reeb, 2003; Adams et al., 2005; Villalonga and Amit, 2006; Anderson et al., 2009; Fahlenbrach, 2009). The Chinese stock market is still in its early stage of development and the number of listed firms is growing fast, which suggests there may be a higher percentage of firms with founder-managers than in Western markets,<sup>1</sup> and yet there are only

---

<sup>1</sup> Founders are managers in more than 21% of our sample firms, with a percentage of 33% for private firms and 15% for SOEs, respectively. The overall percentage of firms with founder-manager almost doubles that in the US, where only about 11% of firms have founder-managers.



a few studies that directly examine the impact of founder-managers in the Chinese market (e.g., Wang and Wang 2011; Zhang et al., 2011). These two papers examine the relationship between founders and venture-capital performance, and the relationship between a CEO's founder status and turnover. We examine the impact of founder-managers from a different perspective, including political connection, which gives a better understanding of the impact of founder-managers in China and provides an important complement to the literature that still largely focuses on Western markets.

The remainder of this paper proceeds as follows. Section 2 provides a review of existing literature. Section 3 presents the institutional background in China and lays out our hypotheses. Section 4 describes the samples and data. Section 5 reports our empirical results. Section 6 carries out robustness tests and Section 7 concludes our paper.

## **2. Literature review**

### *2.1. Impact of ownership structure and firm characteristics on tunneling*

A large number of studies examine the relationship between the structure of firm ownership and the nature and severity of tunneling by controlling shareholders. Berkman et al. (2009) and Jiang et al. (2010) find that the incidence of tunneling through loan guarantees and related lending is greater in private firms than in SOEs. Both Chen et al. (2009) and Cheung et al. (2010) find that firms controlled by the central government are more likely to be propped up, while firms controlled by local governments are more likely to be tunneled. La Porta et al. (1999), Claessens et al. (2000), and Faccio and Lang (2002) provide empirical evidence that firms belonging to business groups and being controlled by the ultimate owner through a chain of companies are more likely to be tunneled. The ultimate controlling shareholder exerts control over lower-level firms in the chain without necessarily having a majority of cash flow rights, which separates control rights from cash flow rights. This gives

the controlling shareholder a strong incentive to extract private benefits and expropriate minority shareholders.

Researchers also examine other factors that may affect tunneling behavior. Cheung et al. (2006), Gao and Kling (2008), and Jiang et al. (2010) all find that tunneling is more severe in small firms relative to large firms. Gao and Kling (2008) find that the proportion of independent (outsider) directors is negatively associated with the severity of tunneling. Both Gao and Kling (2008) and Jiang et al. (2010) find that auditors do play a monitoring role with respect to reducing firm tunneling, but the latter point out that non-clean auditor opinions alone are not enough to deter tunneling. Finally, Jiang et al. (2010) find that good performance (ROA) in the previous year significantly reduce tunneling in the current year, whereas Cheung et al. (2006) show that the market-to-book ratio in the previous year is not negatively related to the likelihood of connected transactions; rather, it is positively associated with certain types of connected transactions that are of a tunneling nature.

## *2.2 Impact of political connection on firm performance and valuation*

The literature finds both positive and negative impact of political connection on firm behavior, performance, and valuation. On the positive side, Leuz and Oberholzer-Gee (2006) find that politically connected firms have preferential access to loans from state owned banks. Li et al. (2006) find that politically connected firms gain favorable regulatory and legal treatment, while Boubakri et al. (2012) find that politically connected firms enjoy lower costs of equity capital than their non-connected peers because investors consider them to be less risky. Finally, Faccio et al. (2006) find that politically connected firms are significantly more likely to be bailed out by governments.

On the negative side, Cheung et al. (2005) find that political connection worsens the expropriation of minority shareholders by controlling shareholders and is detrimental to the

firm, while Fan et al. (2007) find there are more bureaucrats and fewer professionals on the boards of politically connected firms in China. Consequently, these firms underperform their non-connected peers in both the short term and long term. Faccio (2010) finds similar evidence using cross-country data.

### *2.3 Impact of founder-managers on firm behavior and performance*

Research on the impact of founder and founder-managers generates extant literature with mixed empirical evidence. On one hand Anderson and Reeb (2003) and Villalonga and Amit (2006) find that firms with founder-managers have a higher market valuation and better performance than firms without founder-managers, while Fahlenbrach (2009) finds that firms with founder-CEOs invest more on R&D, have higher capital expenditure, and make more focused M&As, and Li and Srinivasan (2011) find that CEO pay-performance sensitivity is higher and the level of pay is lower when there is a founder-director on the board.

On the other hand Johnson et al. (1985) find that stock markets react positively when a company founder suddenly dies, suggesting that founder control has a negative effect. Leone and Liu (2008) find that compared to non-founder-CEOs, founder-CEOs are significantly less likely to be fired following an accounting irregularity, which indicates they are probably entrenched. Anderson et al. (2009) find that firms with both founders and heirs are significantly more opaque than firms with diffuse shareholders and founders and heirs tend to exploit this opacity to expropriate minority shareholders.

Firms with founder-managers account for about 11% of the largest public firms in the US (Anderson and Reeb, 2003) whereas firms with founder-managers make up more than 21% of all our sample firms (or 33% for private firms and 15% for SOEs). Yet the impact of founder-managers in the Chinese market attracts little academic interest. As one of few exceptions, Pi and Lowe (2010) study the patterns of CEO turnovers from 1997 to 2006 and

discover that being a founder makes a CEO less likely to be replaced involuntarily. Wang and Wang (2011) find that the performance of a cross-border venture capital firm is strongly related to the founder's departure. These authors argue that the departure of the founder is an indication of the firm's transition to a modern corporation.

In summary, the literature on the Chinese market examines tunneling, political connection, and founder managers from various perspectives but in an isolated manner. This study differs from existing studies in that we integrate these three lines of research and investigate how manager's political connection and founder status can influence tunneling.

### **3. Institutional background and hypotheses**

#### *3.1. Institutional background of the Chinese markets*

The Chinese stock market offers a natural setting for studying the tunneling activities of controlling shareholders for the following reasons. First, Chinese firms are commonly dominated by controlling shareholders with highly concentrated ownership. In a bid to recapitalize the ailing SOE sector, the Chinese government initiated the share issue privatization (SIP) reform with public share ownership in the early 1990s. In the preparation of IPOs, most selected SOEs went through a partial restructuring process where part of the assets and businesses of SOEs (often the best performing units) were either carved out or spun off to become publicly listed firms. The parent companies retained the majority of shares in the listed firms and also served as the controlling shareholders. Our data shows that the ultimate largest shareholder of a median SOE holds 40.87% of ownership. Deng et al. (2006) argue that such a parent-subsidary structure provides controlling shareholders with strong incentives and the capabilities of engaging in tunneling activities. In recent years an increasing number of privately controlled firms are listed on the market. Private firms have a relatively less concentrated ownership structure than SOE firms, but the largest shareholder,

on average, still has 32.60% of all control rights, which is above the 30% criterion set by the CSRC in determining effective control.<sup>2</sup>

Second, the corporate governance system in China is still incomplete because China lacks a well-developed legal and investor protection system, which means minority shareholders have few channels through which to take action against controlling shareholders when their rights are jeopardized (McNeil, 2002; Allen et al., 2005). Although the China Securities Regulatory Committee (CSRC) is the official regulator of the stock markets in China, it lacks investigative and prosecuting power and sufficient resources to effectively enforce its own rules. External discipline is also weak in China. For example, takeovers and other forms of competition for corporate control (e.g., proxy contest) are far from common. The news media, which plays a significant role in improving corporate governance in Western markets (e.g., Miller 2006; Dyck et al., 2010), is ineffective in China due to tight government control of the news media sector.

Third, China is a politically dominated country where the Communist Party is the sole ruling party and other parties assist the Communist Party in improving its governance. Nominally, the Chinese People's Congress (CPC) is the legislative institution and the Chinese People's Political Consultative Conference (CPPCC) is the advisory body and the government is in charge of routine decision making and governance. In reality, the government retains the highest power while the other two organizations perform assisting roles. A prominent politician may hold a position in the government and/or have contemporary membership of the CPC or CPPCC. The national system of administrative control is a pyramid structure where, under the administrative control of the central government, there are 31 provinces and municipalities (excluding Hong Kong, Taiwan and

---

<sup>2</sup> "Notice about Issuing 'Guides to Constitutions of Listed Companies'", CSRC, December 16, 1997 (in Chinese, title is translated by the authors).

Macao). A province controls a number of regions and a region administrates a number of counties, but the government and the CPC and CPPCC are embedded in each of these administrative hierarchies. Members of any of the three political at all levels enjoy special rights and personal benefits, either explicitly or implicitly.

To summarize this up, in transiting itself from a highly centralized planned economy to a modern market-oriented economy, China has been unable to synchronize other necessary and complementary reforms such as property rights, investor protection, and corporate laws. The concentrate ownership and salient institutional environment makes the Chinese stock market conducive to frequent and severe tunneling by large shareholders. Managers with different political connections represent diversiform interests of shareholders and government organizations, and thus may impel or prevent tunneling in firms.

### *3.2. Hypothesis development*

#### *3.2.1. Manager's political connections and firm tunneling*

The majority of publically listed SOEs in China were mainly transformed from large state-owned enterprises that carved out or span off their profitable businesses and assets and restructured them into independent legal entities for listing. Thus, publicly listed SOEs have two notable features; one is that they have parent corporations, and the other is that the government retains the largest ownership stakes.

These parent corporations were reorganized with the remaining assets and labor resources in the original state owned enterprises after the publicly listed SOEs were carved out. Normally, the listed SOEs were affiliated to their parent corporations in both ownership and management teams' nomination, at least for a certain period after the SOEs were listed, but the assets and labor resources are of a lower quality than those in the listed SOEs because the high quality resources were allocated to the listed SOEs so they could qualify for listing

and market competition. The parent corporations did not always receive fair compensation for carving out high quality resources in the period before the SOEs were listed, thus, they expected to receive valuable feedback from the listed SOEs in the future, and so felt that such action was reasonable.

The government retains the largest ownership stakes in the publicly listed SOEs, either directly or via their parent corporations, and holds the ultimate decision making rights in those firms<sup>3</sup>. These newly listed SOEs often assume the legacies of a planned economy because their primary goal is social stability and sustainable government power rather than maximizing shareholder value. To fulfill these goals, listed SOEs may be required to transfer some assets and resources to support the government's social and economic policies.

To ensure the listed SOEs follow the requirements of both government and their parent corporations, both governments and parent corporations have strong incentives to appoint politically connected managers to run the listed SOEs, and these managers, being more concerned about their political future,<sup>4</sup> are often willing to collude with government controlling shareholders and their parent corporations and engage in tunneling activities. Thus, we propose that:

***H1a:*** Overall for SOEs, manager political connection is positively related to the severity of firm tunneling.

In contrast with SOEs, most private firms were listed because of their overall qualifications, with only a few being carved out from existing enterprises. Several listed private firms were formerly listed SOEs who relinquished their controlling stakes to private

---

<sup>3</sup> Of course in some cases, the government may choose to relinquish their stakes by selling it to private entities, resulting in "private control transfer". However, as Chen et al. (2008) find, there were only 62 such private control transfers during 1996 and 2000.

<sup>4</sup> In a year 2000 survey cited by Chang and Wong (2004), Communist Party Committees and governments have remained involvement in all major corporate decisions in listed SOEs, particularly personnel decisions.

entities, which means the parent-subsidary structure is not as common here, and the associated incentive for the parent corporation to tunnel is less severe in listed private firms .

Despite the fact that the private sector has been the main engine of China's economic growth over the past two decades, private firms are still being discriminated and disadvantaged in many areas. Governments, either central or local, still maintain considerable control over the allocation of resources such as land, energy, and awarding of government projects and procurements, etc. Bank loans, a primary source of external financing, flow disproportionately to SOEs despite their poor performance (Cull and Xu, 2000). Private firms often face many administrative obstacles in trying to obtain licenses and enter certain industries. Furthermore, private firms are frequently discriminated against when it comes to the enforcement of contracts with governments or SOEs.

To overcome this imperfect market mechanism and disadvantage in resource allocation, private entrepreneurs have strong motivation to enter politics or to establish political connections (Li et al., 2006). Unlike listed SOEs who must put up with various social burdens imposed by the government, private firms strive to obtain benefits through political connections, but do not need to bear the social burden, and as a rule, the government does not intervene in the operations of private firms through the political channel. Thus, we expect that:

***H1b***: Overall for private firms, manager political connection is negatively related to the severity of firm tunneling.

### *3.2.2. Different types and levels of political connections and firm tunneling*

Managers' political connections in China can be categorized into two broad types: Official-types and CPC/PPCC-type, with each being at either the local level or central level.



These two types of political connections are of very different natures and consequently have different impacts on firm behavior, including tunneling activities.

Official-type political connection is where a firm's managers are/were government or military officers. The government (including military) officers take charge of routine decision making and governance, such as resource allocations, fiscal grants, license issuance, industry restructure, monetary policy, municipal projects, and so forth. Although overall private firms' political connection is hypothesized to be negatively related to tunneling in our H1b, their official-type connected managers may have rent seeking motivations. While they directly bring many benefits to the firms such as industry access and bank loans through their political network with government authorities, they often require some rewards, so it may prove costly for firms to maintain these connections.

Similarly, official-type politically connected managers in SOEs may pursue personal rents for the benefits they bring into the firms and cost the firms' wealth to build their personal relationships. However, it is more important whether the government intends to expropriate the SOEs whenever it is necessary to achieve their social goals. Official-type connected managers in SOEs usually keep their administrative position ranking in line with the size and importance of the firm's business and their political future depends largely on how well they carry out the policies and instructions of the relevant local or central governments, the controlling shareholders of publicly listed SOEs.

Furthermore, the higher the level of official-type political connections, the greater the benefits these connections may bring to the firm, but in return, the larger rents required, and consequently more possible expropriation. Thus,

**H2a:** For both private firms and SOEs, manager's official-type political connection is positively related to tunneling. This positive relationship is stronger when the political connection is at the central level than at the local level.

CPC/ CPPCC-type political connection is where a firm's managers are/were members of the Chinese People's Congress (CPC) or the Chinese People's Political Consultative Conference (CPPCC). In contrast with government officers, members of the CPC and CPPCC have two characteristics; first, many of them are not members of the communist party, particularly in the CPPCC, second, many of them have expertise in science, technology, industry, and business management. Although some of them are former veterans of government officers, they, except for a few who hold contemporary positions in government agencies, actually do not participate in routine and specific decision making as government officers do, and therefore managers connected to CPC/ CPPCC are less likely to bring direct benefits to the firms so they have no bargaining power for personal rents and are unable to make effective commitments to the government.

Instead, because the CPC and CPPCC are legislative and advisory bodies, managers with connections to them are, to some extent, capable of preventing firms from adverse events such as unfair treatment from related parties in legal disputes, market shares, access to resources, and asset transactions. They are also able to raise unfair treatments in the CPC and CPPCC that the government should deal with, which also protects these firms from tunneling.

To show participation in governance from multiple parties, diverse nationalities and all classes of people, members of the CPC and CPPCC are positioned high in the political hierarchy. They are entitled to the same remuneration and welfare as government officers in the equivalent hierarchy, plus political privileges such as being immune from custody. Members of the CPC/ CPPCC are expected to demonstrate integrity and impartiality as evidence that the government is being monitored effectively and because they enjoy social and personal benefits, competition for the limited membership of the CPC or CPPCC can be fierce. In fact, *ceteris paribus*, members who are guilty of misconduct may lose their reputation and further nomination.

To maintain their position and retain a good image, a manager who is a member of the CPC/PPCC is less likely to expropriate the firm's assets. Furthermore, relative to CPC/PPCC members at the local level, those at the central level attract greater scrutiny, either from the market, the media, or from within the organizations. Consequently, those at the central level have even stronger incentives not to engage in wrongdoing such as tunneling. Thus,

**H2b:** For both private firms and SOEs, manager's CPC/PPCC-type political connection is negatively related to tunneling. This negative relationship is stronger when the political connection is at the central level than at the local level.

### *3.2.3. Founder-managers and firm tunneling*

Founder-managers are those who were either founders or main executives when a firm was first incorporated or spun-off for public listing. They were quite experienced with the firms' establishment, IPO process, and operations as publicly listed firms. Founder-managers at public SOEs were normally appointed by the state to lead these newly listed firms. In some cases they were instructed by governments to set up new businesses to solve the legacies of long term underperformance of SOEs and other social issues such as high unemployment and pressure on the government's fiscal budget. To encourage these managers to run the firms appropriately, governments often granted them a certain amount of equity ownership. Our data shows that in SOEs, the average equity ownership is 0.35% for founder-managers and 0.07% for non-founder-managers, with the difference significant at the 1% level. The performance of these firms has been linked to the reputation of founder-managers, including their career concerns and personal benefits.

Most of the listed private firms in China were originally family firms established by private entrepreneurs who were most likely to be the largest equity owner.<sup>5</sup> The founders often assume the position of chairman, CEO, or both, and still hold a large ownership stake, even after the firms were publicly listed. Because founder-managers of private firms invest most of their wealth into the firms, they have a stronger motivation in their firms' long term survival and continuous development, and are extremely desirous of passing profitable firms and sustainable assets to their descendants.

Founder managers in both SOEs and private firms are most likely to be more painstaking than non-founder-managers, indeed the relation between personal benefits and firm performance is also stronger for founder-managers than non-founder-managers. Founder-managers usually regard the firms as their life success and thus try hard to avoid having the firms fail. This motivates them to take a longer term approach (Fahlenbrach, 2009) and restrain the firms from tunneling.

Founder-managers can also be politically connected, but as we point out above, founder-managers often have high monetary interests which are closely linked to firm performance. The motivation for a sole founder-manager not to tunnel is stronger than the motivation to tunnel, whereas a sole politically connected manager may not be so motivated because of the interest and efforts of trade-off, i.e., the interest obtained from one unit effort is larger from a founder's perspective than from a politically connected manager's perspective, and even if a politically connected manager engages in tunneling activities, his incentive to tunnel is likely to be reduced if he is also a founder-manager. Thus,

---

<sup>5</sup> We find that, in our sample firms, the ownership of the largest shareholder (which is often the founder) is 28.49% for founder-manager firms and 21.19% for non-founder-manager firms. The difference is significant at the 1% level.

**H3:** For both private firms and SOEs, firms with founder-managers have less tunneling than firms without founder-managers, regardless of whether the managers are politically connected or not.

#### *3.2.4. Different impact of the Chairman's and COE's political connection on tunneling*

So far in this paper we have made no distinction between either the chairman's or the CEO's political connections with respect to their impact on tunneling, and while such a distinction may be irrelevant for firms in Western countries where the chairman is usually not involved in the day-to-day running of the firm (except for executive chairmen), the situation in Chinese firms is quite different. Existing literature on the Chinese stock market has different opinions as to who the top executive in a Chinese firm actually is; for example, Fan et al. (2007) regard the CEO as the top executive, whereas Firth et al. (2006) consider the chairman to be the top executive because they argue that the chairman is often involved in day-to-day decision making in Chinese firms. Meanwhile Kato and Long (2006) also consider the Chairman to be the top executive insofar that the chairman is paid a salary by the firm. Furthermore, existing literature pays almost no attention to the possible different impact that a chairman and CEO has on firm behavior.<sup>6</sup>

In China, the chairman is the legal representative of a firm and in most cases is appointed by the controlling shareholder. Given the highly concentrated ownership structure, the chairman is more likely to be powerful and exert enormous influence on the daily operations of the firm. Kato and Long (2006) argue that even when the chairman and the CEO are both responsible for daily operations of the firm, the chairman is likely to be more

---

<sup>6</sup> One notable exception is Wu et al. (2012). These authors find that politically connected CEOs play a more important role than politically connected chairmen in the operations in local SEOs, and politically connected chairmen have greater influence than connected COEs in obtaining government subsidies in private firms. But other than these, there is no distinct difference between chairmen and CEOs on firm value, government subsidies and policy burden.

powerful than the CEO. The relative power of the chairman and the CEO can be proven by the following two facts; first, founders in private firms, who are often the controlling shareholders, are more likely to take the position of chairman rather than CEO,<sup>7</sup> second, it is widely regarded as a promotion in SOEs when the CEO is appointed to become the chairman, and a demotion if the chairman loses his chairmanship and becomes the CEO of the firm. Thus, we expect that,

**H4:** For both private firms and SOEs, the chairman's political connection is more influential than the CEO's political connection on tunneling behavior.

## **4. Sample and data**

### *4.1. Sample selection and data source*

Our initial sample consists of all non-financial A-share issuing firms listed on either the Shanghai Stock Exchange or the Shenzhen Stock Exchange between 2004 and 2010. We chose 2004 as the starting year because membership of the Chinese Communist Party was not officially open to private entrepreneurs until late 2002, when the 16<sup>th</sup> National Congress of the Communist Party amended its Party Constitution (Xinhua News Agency Nov. 18 2002). The Chinese Communist Party was officially opened to private entrepreneurs to provide more opportunity for private entrepreneurs to be selected as government officers. This also signaled that the CPC and CPPCC would accept more private entrepreneurs as members. The procedure from submission of application to official assessment and ratification normally takes a couple of years, although it may vary among different applicants.

In our sample we exclude firms where the ultimate largest shareholder is a foreign entity, and also firms cross-listed overseas (including Hong Kong) because foreign

---

<sup>7</sup> We find that, of the 1130 private firms with founder-managers, 1108 founders take the position of the chairman and 502 founders take the position of the CEO, with some founders taking both positions.

accounting rules may affect the treatment of “other receivables” and some other accounting items used in this study.<sup>8</sup> We then delete the observations of the first year of listing because Chinese firms commonly engage in pre-IPO earnings management that results in unusually high levels of various forms of related party transactions and fund transfers in the first year of listing. After eliminating observation sets with missing data, our final sample consists of 1591 firms and 9499 firm-year observation sets, which is larger than those in most previous studies on tunneling in the Chinese stock markets.

We obtain our accounting and financial data from the China Stock Market and Accounting Research (CSMAR) database, which is one of the most widely used databases for research on the Chinese stock markets. We hand collect the information on manager political connection by checking the “Directors and Senior Executives’ Profile” in annual reports. However, annual reports rarely mention whether or not a manager is a founder, so we search the internet through Google, Baidu, and Wikipedia. We consider a manager to be a founder-manager if any one of those sources explicitly mentions so and no other source indicates otherwise.

## *4.2. Measurement of variables*

### *4.2.1. Tunneling*

Three approaches have generally been used to measure tunneling in China: related party transactions (Cheung et al., 2006), loan guarantees to related parties (Berkman et al., 2009), and fund occupations (i.e., inter-corporate loans in Jiang et al., 2010). We do not use the first two measurements because: (1) the issuance of any new loan guarantee was banned by the CSRC in June 2000; and (2) the approach used by Cheung et al. (2006) requires an a

---

<sup>8</sup> Our sample includes firms that also issue B-shares (in addition to A-shares), since these firms must abide Chinese laws. We, however, exclude B-shares in this study.

priori subjective judgment on whether a certain RPT is beneficial, expropriating, or neutral to the listed firm. The limitation of such a subjective judgment is evident. For example, Cheung et al. (2006) consider all asset sales by a listed firm to related parties to be expropriating; but it's obvious that the nature of such transactions depends on whether the prices paid are above, below, or the same as in arms-length deals. Therefore, we follow Jiang et al. (2010) and use fund occupation by controlling shareholders as a proxy for tunneling, which is the ratio of the total amount of "other receivables" in the balance sheet to total assets.

"Other receivables" is an accounting item that includes receivables that are not part of ordinary business transactions. These receivables are essentially interest free loans made by listed firms to other parties where a large proportion of these funds are occupied for a long period of time, and in many cases are never paid back to the listed firms (Jiang et al., 2010). The advantage of this measurement is that, unlike the approach used by Cheung et al. (2006), it is relatively easy to tell who the beneficiary of this particular form of tunneling is. In addition, fund occupation through the "other receivables" account by controlling shareholders and their affiliates is such a widespread tunneling practice in China that the CSRC has issued several rules or decrees aimed specifically at tackling this issue. However, this practice remains prevalent because the rules are not enforced. For our sample firms the balance of "other receivables", on average, accounted for 6.00% of total assets (or 138 million RMB) in a private firm and 3.90% of total assets (or 227 million RMB) in a state-owned enterprise (SOE), which represents a heavy cost to the listed firms. Moreover these figures are almost certainly underestimated since many of the affiliates cannot easily be identified with controlling shareholders.

#### *4.2.2. Manager political connection*

Faccio (2006) defines a firm to be politically connected if one of the firm's large shareholders or top officers is a member of parliament, a minister, or the head of state, or



closely related to a top official. However, in the Chinese situation Chen et al. (2011), Fan et al. (2007) and others extend Faccio (2006)'s original definition by considering China's specific circumstances and define a Chinese firm to be politically connected if a manager is a current or former (1) government official; (2) military officer; (3) member of the Chinese People's Congress (CPC); and (4) member of the Chinese People's Political Consultative Conference (CPPCC). Therefore we follow Chen et al. (2011) definition to identify politically connected managers. To examine the impact of these types of political connections on firm's tunneling behavior we categorize managers' political connections into two broad types, namely official-type connection (if a manager has the above (1) or (2) connection), and CPC/PPCC-type connection (if a manager has the above (3) or (4) connection). To test the impact of political connections at different levels, we further classify all political connections into central level connections and local level connections (province or lower). Thus, we now have up to six different types of manager political connections in our formal tests.

#### *4.2.3. Founder-manager*

To remain consistent with Anderson and Reeb (2003) and Adams et al. (2005), we consider a manager to be a founder-manager if she/he was a founder or a main executive when the firm was first incorporated, or when it was spun-off.

#### *4.2.4. Control variables*

To control for other factors that may affect tunneling, we include the following control variables in our regressions: a dummy variable indicating that the firm has completed the non-tradable share reform (*Reform*), the difference between the controlling shareholder's control rights and cash flow rights (*Wedge*), equity ownership by managers (*Mg shares*), the size of the firm (*Firm size*), return on assets (*ROA*), leverage (*Leverage*), sales growth (*Growth*), and percentage of independent directors (*Independence*). The theoretical and

empirical evidence for the impact of these variables on tunneling is relatively well known so we only provide a brief discussion.

Before the non-tradable share (NTS) reform started in the middle of 2005, a high proportion of listed firms' outstanding shares were mainly held by blockholders, including controlling shareholders, and were not tradable in the stock exchanges. Thus, controlling shareholders were not too concerned about negative market reactions to their tunneling behavior, but after NTS reform the controlling shareholders would have less incentive to tunnel listed firms because they must now balance their private benefits from tunneling with any loss from negative market reactions. Therefore, we expect a negative impact of *Reform* on tunneling. Controlling shareholders have more incentive to extract private benefits from the firm if there is a divergence between their control rights and cash flow rights, while managers with a large equity ownership are more concerned about firm performance and therefore are less likely to engage in tunneling, *ceteris paribus*. Large firms are subjected to more public scrutiny and are more likely to be located in developed areas with stronger institutional development. Thus, we expect a negative association between firm size and tunneling. Tunneling is expected to have an adverse impact on firm performance, so controlling shareholders must consider the trade-off between private benefits from tunneling and returns from future growth. The potential cost of tunneling for controlling shareholders is higher for firms with higher ROA and sales growth so we expect that the impact of both ROA and sales growth on tunneling would be negative. While we expect a negative association between board independence and tunneling, the relationship between leverage and tunneling is not as clear cut as it may appear. Friedman et al. (2003) argue that debt represents a commitment by controlling shareholders to prop up the firm when a moderately adverse shock occurs, but high leverage may lead controlling shareholders to abandon or loot the firm in the case of a serious shock. The primary source of debt financing in China is bank loans

and state owned banks are the dominant players in the banking sector. A high leverage could indicate government support (through state owned banks), making a firm less concerned about negative market reactions to tunneling.

We also include industry and year dummy variables in all the regression analyses. Industry dummy variables are based on the one-digit industry codes published by the China Securities Regulatory Commission (CSRC), which classifies all listed firms into 13 broad industries (12 industries if the financial service industry is excluded). Detailed descriptions of main variables used in this paper are reported in Table 1. To minimize the influence of extreme values, all continuous variables are winsorized at the 1% and 99% level.

< Insert Table 1 about here >

#### *4.3. Descriptive statistics*

Panel A in Table 2 reports the distribution of firms with political connections and firms with founder-managers by year, for private firms and for SOEs, respectively. The data shows that a total of 9499 firms (or firm-year observations) consists of 3416 (or 35.96%) firms where a private entity is the ultimate largest shareholder, and 6083 (or 64.04%) firms where the state or a government agency is the ultimate largest shareholder. The proportion of private firms in our sample is higher than in many previous studies (e.g., Chen et al., 2009; Peng et al., 2011), probably because our sample covers a more recent period and private firms accounted for a larger proportion of all newly listed firms during this period.

<Insert Table 2 about here >

Across the whole sample period, about 36.50% of private firms and 35.23% of SOEs are politically connected. On a year-by-year basis the percentage of politically connected firms is relatively stable; this is why we are unable to test how changes in political connections affect firm tunneling activities.

Regarding the percentage of firms with founder-managers, it is higher in private firms (33.08%) than in SOEs (14.68%). Also, the percentage of founder-manager firms is much higher than in the US (about 11%, see Anderson and Reeb, 2003 and Adams et al., 2005). This significant difference clearly reflects the fact that the Chinese stock markets are in their early stage of development. The data also shows that the percentage of private firms with founder-managers is rising steadily while the percentage of SOEs with founder-manager is declining. There are two possible explanations for this, the increasing number of newly listed private firms (which often have a founder-manager) and/or the promotion or retirement of founder-managers in SOEs.

Panel B in Table 2 presents the descriptive statistics of tunneling measured by “other receivables”, a proxy for fund occupation by controlling shareholders. The data shows that almost all sample firms report “other receivables” in their balance sheets, with the balance representing 6.00% of total assets (or 138 million RMB) for privately controlled firms and 3.90% of total assets (or 227 million RMB) for SOEs. These occupied funds are charged very low interest, even zero, and in many cases they are never paid back, which could have significant adverse economic consequences for the listed firms (Jiang et al., 2010).

Panel B also reveals three clear patterns. First, on average, private firms report more tunneling than SOEs, either on an aggregated base or on a year-by-year base. Second, during our sample period, the severity of tunneling is on the decline, suggesting that enhancement in laws and regulations have had some effects in reducing tunneling. Nonetheless, at the end of 2010, “other receivables” still represents 2.50% of total assets in private firms and 1.90% in SOEs. Third, the difference in tunneling between private firms and SOEs has also narrowed. For example, at the end of 2004, “other receivables” represented 11.20% of total assets for private firms and 6.50% for local SOEs, with a difference of 4.70%. At the end of 2010 this

difference narrows to 0.60%, which may suggest that relevant laws and regulations have had a larger effect on private firms than on SOEs.

Table 3 provides descriptive statistics that are broken down by manager political connection and founder status. Private firms without politically connected managers report tunneling that represents 7.00% of total assets, which is significantly higher than the 4.10% reported by those private firms with connected managers. In contrast, SOEs with politically connected managers report significantly more tunneling than those SOEs without connected managers (4.40% vs. 3.70%, significant at the 1% level). Private firms without founder-managers report tunneling that represents 7.40% of total assets, which almost triples the reported tunneling (2.50%) for those with founder-managers. SOEs with founder-managers also report significantly less tunneling than those without founder-managers, but the difference is smaller than in private firms. The above statistics provide initial evidences that coincide with our hypotheses 1a, 1b and 3.

<Insert Table 3 about here>

A manager is more likely to be politically connected if they are a founder-manager, which can be observed in both private firms and SOEs. For both private firms and SOEs, the divergence between the controlling shareholder's control rights and cash flow rights is smaller if a firm has a politically connected or founder-manager. These firms are also significantly larger. Firms with founder-managers have significantly lower leverage than those without, which may imply they take less risk. What is also notable is that private firms with politically connected managers have a leverage ratio of 0.52, which is only slightly higher than half the leverage ratio for those without connected managers. This is certainly worth further investigation. There is no significant difference in performance (either ROA or sales growth) between firms with/without politically connected managers or founder-managers. One exception is that SOEs with founder-managers have marginally higher ROA

than SOEs without founder-managers, which may imply that the former are more concerned about firm performance than the latter. Finally, private firms with founder-managers have a significantly higher percentage of independent directors, which indicates that the internal corporate governance in these firms is better.

To summarize, firms with and without politically connected managers or founder-managers differ significantly in their tunneling behavior. They also differ significantly in size and capital structure. We next formally examine how these factors affect firm tunneling behavior.

## 5. Multivariate results

### 5.1. Impact of political connection on tunneling

Table 4 arranges the results of OLS regressions of tunneling on manager political connection. We run two sets of regressions, one for private firms, reported in columns (1) to (4), and the other for SOEs, reported in columns (5) to (8). In each of the regressions, the dependent variable is *Tunneling* measured by the ratio of “other receivables” to total assets. We use four specifications for each set of regressions. First, we only control *Reform* in columns (1) and (5), without considering other control variables. We then add control for *wedge* – the divergence between controlling shareholders’ control rights and cash flow rights, as well as year and industry effects, in columns (2) and (6). We further include manager equity ownership and firm leverage in columns (3) and (7). Existing literature indicates there is a strong association between firm tunneling and these three factors. Finally, we include more other control variables in columns (4) and (8). The *p*-values reported in parentheses are based on standard errors adjusted for heteroskedasticity using White (1980).

< Insert Table 4 about here >

Throughout columns (1) to (4), the coefficient of *Political connection* is negative and significant at least at the 5% level. The results indicate that private firms with politically connected managers have significantly less tunneling than those without connected managers, which confirms the univariate results reported in Table 3. In contrast, the coefficient of *Political connection* in columns (5) to (8) is positive and significant at the 1% level, which indicates that SOEs with politically connected managers have significantly more tunneling than those SOEs without connected managers. These results are also consistent with the univariate results in Table 3.

Overall, the results in Table 4 confirm *H1a* and *H1b*. That is, manager political connection is negatively related to firm tunneling in private firms, but is positively related to tunneling in SOEs. Private firms seek political connections to protect themselves from disadvantage in the competition for resources while they have less responsibility to fulfill social goals. Manager political connection in SOEs is a tool for their parent corporations to obtain feedback and for the government to fulfill social goals.

The coefficients of control variables are generally in line with our expectations. Tunneling by controlling shareholders has been significantly reduced since the completion of NTS reform, indicating a better alignment between controlling shareholders and minority shareholders after the NTS reform. Large firms (*Firm size*), better performing (ROA), high growth (*Growth*) and manager equity ownership (Mg shares) have less tunneling. However, firm leverage (*Leverage*) is positively and significantly related to tunneling. This result contradicts the prediction by Friedman et al. (2003), who argue that debt may act as a commitment by controlling shareholders to prop up the firms when needed. Consistent with some existing studies (Claessens et al., 2000; Faccio and Lang 2002), we find a strong positive link between controlling shareholder's excess control rights and tunneling.

## 5.2. Impact of the type and level of political connection on tunneling

Earlier in Section 3.2.2, we classify political connection into official-type and CPC/PPCC-type, at either local or central hierarchy. Actually, a firm's political connection can be both official-type and CPC/PPCC-type (Dual-type), because a CEO may be official-type connected and a chairman may be CPC/PPCC-type connected in a firm, or vice versa. Those managers with various political connections have different incentive for tunneling. The regression results are reported in Table 5, and as in Table 4, we run a set of regressions for private firms and SOEs, respectively.

< Insert Table 5 about here >

We first analyze the results for private firms. Column (1) contains only private firms with managers who have official-type political connection and private firms without politically connected managers. The coefficient of either *Local official PC* or *Central official PC* is positive but insignificant, which indicates that official-type political connection has no significant impact on tunneling in private firms. Column (2) contains only private firms with managers who have CPC/PPCC-type political connection and private firms without politically connected managers. Both of the coefficients of *Local CPC/PPCC* and *Central CPC/PPCC* are negative and significant, which indicates that this type of political connection significantly reduces firm tunneling. The coefficient of *Central CPC/PPCC* is much larger than *Local CPC/PPCC* (-0.012 vs. -0.006), which suggests that the higher the level of CPC/PPCC-type connections, the greater the impact it has in reducing firm tunneling. Column (3) contains only private firms with Dual-type political connections and private firms without political connected managers. Both of the coefficients of *Local dual PC* and *Central dual PC* are insignificant. This is not surprising since official-type and CPC/PPCC-type connections have an opposite impact on tunneling and offset each other. However, both of these two coefficients are negative, the same sign as those of *Local*



*CPC/PPCC* and *Central CPC/PPCC*, which suggests that in private firms, *CPC/PPCC*-type political connections have a greater impact on tunneling than official-type political connections. This can be confirmed by the results in Table 4, where overall manager political connection has a significantly negative impact on tunneling in private firms. Column (4) contains all the private firms. The sign and significance of the coefficient of each of these six types of political connections generally confirms those in columns (1) to (3), with the exception of *Central dual PC*, which becomes significant in the full sub-sample regression.

The firm samples in columns (5) to (8) are defined the same as columns (1) to (4), with the exception of state ownership. As for SOEs, the results in columns (5) to (8) show that manager official-type political connection significantly increases tunneling, and this positive impact is significantly greater if the connection is at the central level than at the local level (0.024 vs. 0.009 in column (5) and 0.023 vs. 0.008 in column (8), all significant at the 1% level). The coefficient of *Central CPC/PPCC* is -0.004 and is significant at the 5% level, which indicates that manager *CPC/PPCC*-type political connection at the central level significantly reduces tunneling at SOEs, while *CPC/PPCC*-type political connection at the local level has a negative but insignificant impact on tunneling in SOEs.

Overall, the regression results in Table 5 partially confirm **H2a** and **H2b**. Manager official-type political connection has a positive impact on tunneling, but this positive impact is significant only in SOEs. Manager *CPC/PPCC*-type political connection has a negative impact on tunneling, but this negative impact is more significant in private firms than in SOEs. With both types of political connections, those at the central level are more influential than those at the local level, with respect to their impact on firm tunneling. Managers with official-type political connection have an incentive to seek rent because they can bring benefit to the firms. They also expect political promotion by satisfying governmental requirements. Managers with *CPC/PPCC*-type political connection cannot bring direct

benefits to the firms, but they have the incentive and ability to protect the firm from adverse events such as tunneling. The incentive for managers with a central level of connection is higher than for managers with local levels of connection.

### *5.3. Impact of founder-manager and the interactive impact between political connection and founder-manager on tunneling*

Based on our earlier analysis in Section 3.2.3, we examine the effect of founder-managers and the interactive effect of founder-managers with political connection on firm tunneling. Table 6 reports the results of regression of tunneling on firm founder status and its intertwining with either official-type, CPC/PPCC-type, or Dual-type political connection. The sample of firms in each column in Table 6 is defined the same as equivalent columns in Table 5, as shown by the title of each column.

< Insert Table 6 about here >

On the left side, regarding private firms, the coefficients of the stand-alone variables of *Official PC*, *CPC/PPCC*, and *Dual PC* are consistent with those in Table 5, that is, only CPC/PPCC-type political connection has a significantly negative impact on tunneling. In every column the coefficient of *Founder* is negative and significant at the 1% level, which confirms our expectation that private firms with founder-managers have significantly less tunneling than those without. The coefficients of the interactions between the type of political connection and founder-manager are all negative. These results indicate that when a firm has a politically connected manager who is also a founder, there is less tunneling than in those firms with politically connected but non-founder managers, regardless of the type of political connection. However, of these three interactions, only the coefficient of *CPC/PPCC\*Founder* is significant. The results in columns (4) and (5) of all private firms are consistent with those in columns (1) to (3), and support our expectation that the

CPC/PPCC-type of political connection is the main driver of the overall impact of political connection on tunneling in private firms.

On the right side, regarding SOEs, the coefficient of *Founder* is negative and significant at the 5% level in every column, which indicates that SOEs with a founder-manager have significantly less tunneling than those without. The coefficients of the stand-alone variables of *Official PC*, *CPC/PPCC*, and *Dual PC* also confirm the results in Table 5. The coefficients of all three interactions between the type of political connection and founder-manager are negative, but only *Official PC\*Founder* is insignificant, which indicates that founder-managers do not significantly reduce tunneling in those SOEs that have official-type political connection, because official-type political connection leads to significant tunneling in SOEs. Of particular interest is the interaction term *Dual PC\*Founder*. The coefficient of the stand-alone variable *Dual PC* is positive and significant, thus the negative and significant coefficient of *Dual PC\*Founder* suggests that founder-managers have a strong reductive impact on tunneling in SOEs.

Table 7 reports the results of regression of tunneling on manager's founder status and its intertwining with either local level or central level political connection. Columns (1) to (3) report the regression results for private firms and columns (4) to (6) report the results for SOEs.

<Insert Table 7 about here>

The coefficient of *Central PC* is negative and significant in columns (1) to (3), but the coefficient of *Local PC* is insignificant. In columns (4) to (6), although all the coefficients of *Central PC* and *Local PC* are positive and significant at the 1% level, the former are about double the magnitude for the latter. These results confirm the results in Table 5 where manager political connections at the central level have a greater impact on tunneling than connections at the local level. For both private firms and SOEs, the coefficient of the stand-

alone variable *Founder* and the coefficient of the interaction term *Central PC\*Founder* are negative and significant, while the coefficient of *Local PC\*Founder* is insignificant. These results indicate that the negative relation between founder-manager and tunneling is stronger in firms with centrally connected managers than in firms with locally connected managers only.

Thus, the results in Tables 6 and 7 confirm **H3** that, for both private firms and SOEs, those firms with founder-managers have significantly less tunneling than those without. The negative effects of founder-managers on tunneling are also observed in politically connected firms. Founder managers have a special incentive to maintain the firm's long term development and survival. The tradeoff between interest and effort is greater from a founder manager's perspective than from a politically connected manager's perspective.

#### 5.4. Difference between the chairman's and the CEO's political connection on tunneling

We hypothesize in Section 3.3.4 that the chairman's political connection is more influential on firm tunneling than the CEO's political connection, and in this section we formally test this hypothesis. The results for private firms are reported in columns (1) to (3) and the results for SOEs are reported in columns (4) to (6) of Table 8.

<Insert Table 8 about here>

The sample in Column (1) contains private firms where the chairman is politically connected (regardless of the type of connection) and private firms without political connection. The sample in Column (2) contains private firms where the CEO is politically connected and private firms without political connection. In 735 of our 3416 private firms the chairman and CEO is the same person. Thus, as general practice, we introduce a new control variable *Duality* which is a dummy variable that takes the value of 1 if the chairman and the CEO is the same person. The coefficient of *Chair PC* in column (1) is negative and

significant at the 5% level. The coefficient of *CEO PC* in column (2) is positive but insignificant. The results in column (3), which contains all private firms, are consistent with those in columns (1) and (2). Recall the results in Table 4 where the chairman's and CEO's political connections are aggregated into a single variable *Political connection*; the coefficient of *Political connection* in column (4) in Table 4 is negative and significant. Thus, we can conclude that for private firms, the overall impact of manager political connection on tunneling is negative and almost certainly driven by the chairman's political connection because the CEO's political connection has an opposite (although insignificant) impact.

The samples in columns (4) to (6) are similarly designed as those in columns (1) to (3) respectively, except that private firms are replaced by SOEs. The coefficient of *Chair PC* in column (4) and (6) is positive and significant at the 1% level, but the coefficient of *CEO PC* is negative but insignificant. In Table 4 the coefficient of *Political connection* is positive and significant for SOEs, so for SOEs, the overall impact of manager political connection on tunneling is also almost certainly driven by the chairman's political connection. Thus, the results in Table 8 support *H4* that, for private firms and SOEs, the chairman's political connection is more influential than the CEO's political connection, with respect to their impacts on firm tunneling. In the Chinese context, chairmen are not only (the representatives) controlling shareholders, they are also involved in routine decision making, so the chairmen, not CEOs, are the top executives and wield the most power.

## **6. Robustness checks**

The preceding analyses provide evidence on the relation between manager political connection and firm tunneling. There is a potential endogeneity problem particularly for firms with severe tunneling, because they are more likely to appoint politically connected managers to mitigate the adverse impact of tunneling on firm performance and stock market

reactions. In this section, we address the potential endogeneity concern and then test the sensitivity of our results with alternative model specifications.

### *6.1. Endogeneity of political connection*

One general practice used to solve the endogeneity problem is the instrumental variable (IV) approach. An appropriate IV needs to satisfy two conditions. First, the IV needs to be exogenous in the main regressions, and second the IV must be correlated to the endogenous variable, conditional on other covariates. We use three IVs in this study; the first IV is the registered unemployment rate (*Unemployment*) in the province where a firm is headquartered, the second IV is the natural logarithm of GDP per capita (*Log GDP*) in the province where a firm is headquartered, and the third IV is the ratio of total domestic deposits in financial institutions to total GDP (*Savings ratio*) in the province where a firm is headquartered. These IVs are obtained directly from the website of the National Bureau of Statistics of China (NBSC) or calculated based on the data from the NBSC. All these three IVs are related to the availability of capital, in that it is easier for a firm to obtain external financing if it is located in regions with a lower unemployment rate, higher GDP per capita, and a higher savings to GDP ratio. Thus, firms in these regions have fewer incentives to establish political connection. Furthermore, governments (the controlling shareholders of SOEs) in these regions have less political and social pressure (e.g., redundant workers and social unrest) to intervene into the operations of SOEs by appointing politically connected managers. We, however, do not expect these three IVs to have a significant impact on firm tunneling.<sup>9</sup> Thus, all these three IVs satisfy the two conditions for an appropriate IV.

---

<sup>9</sup> In unreported results, we run regressions of firm tunneling on these three IVs. After controlling for other factors, none of these three IVs has significant impact on tunneling, either in private firms or in SOEs.

We use the regressions in Table 6 as examples for this robustness test and the results are arranged in Table 9. The two-stage least squares (2SLS) model is applied. In the first stage, we run *probit* regressions of manager political connection type on these three IVs. All the control variables used in the main regressions in Table 6 are also included in the first stage. In the second stage the predicted values from the first stage are used as the key independent variable, as well as other control variables. In Table 9, columns (1) to (3) and columns (5) to (7) report the results of the first stage for private firms and SOEs, respectively. Columns (4) and (8) report the results of the second stage for private firms and SOEs, respectively.

<Insert Table 9 about here>

In columns (1) to (3), the dependent variables are dummies of *Official PC*, *CPC/PPCC*, and *Dual PC*. It can be seen from the negative and significant coefficients, that *Unemployment*, *Log GDP*, and *Savings ratio* impact the probability of a firm establishing political connection, which satisfies the IV selection criteria. In column (4), the dependent variable is *Tunneling* and the key independent variables, namely *Official PC*, *CPC/PPCC*, and *Dual PC*, are the predicted values (labeled “instrumented”) from the first stage regressions. If we compare the results in column (4) with the corresponding results in column (5) in Table 6, it is obvious that the coefficients are of the same sign but are either larger or more significant than those in Table 6. For example, the coefficient of *CPC/PPCC* in column (4) in Table 9 is -0.172, while the coefficient of *CPC/PPCC* in column (5) in Table 6 is -0.014. A similar comparison can be made between the SOEs in Table 6 and the SOEs in Table 9. Thus, the results from the 2SLS regressions confirm the results in Table 6.

We argue that political connection has different impacts in private firms and SOEs. Therefore, the potential endogeneity problems could be also different in these two types of firms. Specifically, for private firms, managers establish *CPC/PPCC*-type connection if

their firms perform well, indicating these firms have less severe tunneling. While for SOEs, governments appoint politically connected managers to mitigate adverse impact of tunneling on firm performance and stock market reactions. We therefore use the propensity score matching (PSM) approach to address such endogeneity concern.<sup>10</sup> In untabulated results, the impacts of Official PC, CPC/PPCC, and Dual PC are largely consistent with those reported in Table 5. Manager CPC/PPCC-type connection (central and local combined) has a negative and significant impact on tunneling in private firms (coef. = -0.009,  $p = 0.042$ ) and manager official-type connection (central and local combined) has a positive and significant impact on tunneling in SOEs (coef. = 0.014,  $p = 0.000$ ).

## 6.2. Alternative regression specifications

In our main analyses the divergence (*Wedge*) between the controlling shareholder's control rights and cash flow rights is a continuous variable measured by the difference. As a robustness test, we replace this continuous variable with a dummy variable that takes the value of 1 if a divergence exists and zero otherwise. Our main results remain unchanged with this alternative definition. Literature finds that institutional development is an important factor that affects controlling shareholders' tunneling behavior, so to control for the variations in institutional development in different regions, we add a dummy variable for each province where a firm is headquartered. Again, our main results remain qualitatively unchanged.

## 7. Conclusions

To fill a gap in the literature, we investigate whether and how managers' political connection status and founder status affect firm tunneling behaviour, using a sample of 9499

---

<sup>10</sup> We thank the anonymous referee for suggesting this.



firm-year observations of publicly listed firms over the period of 2004–2010. We find that both manager political connection and founder status have a significant impact on firm's tunneling behavior. For private firms overall manager political connection is negatively related to firm tunneling. This negative relation is almost entirely driven by manager's CPC/PPCC-type political connection, and this negative relation is stronger for political connections at the central level than at the local levels. In contrast, for SOEs, overall manager political connection is positively related to firm tunneling. This positive relation is almost entirely driven by manager's official-type connection, and this positive relation is greater for political connections at the central level than at the local levels.

These results indicate that manager political connection in private firms is more likely to compete for resources and protect firms from adverse events. Manager political connection in SOEs is more likely to be formed to fulfill the social goals of governments. Official-type connected managers may have a rent seeking incentive, while CPC/PPCC-type connected managers are better able to prevent firms from tunneling. The motivation and capabilities are more powerful if the political connection is at the central level.

We also find that for both private firms and SOEs, firms with founder-managers have more resistance to tunneling than those without because founder-managers have higher monetary interests than non-founder-managers, and the interest and effort required for a tradeoff is greater from a founder-manager's perspective than from a politically connected manager's perspective. Therefore, if a politically connected manager is also a founder, the possibility of tunneling due to political connection, if it exists, is also reduced. The incentive for a politically connected founder-manager to tunnel is weaker than a politically connected non-founder-manager.

Finally, we test the impact of the chairman's and the CEO's political connection on firm tunneling. We generate evidence that the chairman's political connection has a

significantly greater impact on tunneling than the CEO's political connection. Thus our results support the notion that the chairman, rather than the CEO, is the top executive in Chinese firms. This finding may have important implications for research regarding the behavior of top executives in the Chinese context.

## References

- Adams, R., Almeida, H., Ferreira, D., 2005. Powerful CEOs and their impact on corporate performance. *Review of Financial Studies* 18, 1403–1432.
- Allen, F., Qian, J., Qian, M., 2005. Law, finance, and economic growth in China. *Journal of Financial Economics* 77, 57–116.
- Anderson, R., Duru, A., Reeb, D., 2009. Founders, heirs, and corporate opacity in the United States. *Journal of Financial Economics* 92, 205-222.
- Anderson, R., Reeb, D., 2003. Founding-family ownership and firm performance: Evidence from the S&P 500. *Journal of Finance* 58, 1301–1328.
- Berkman, H., Cole, R., Fu, L., 2009. Expropriation through loan guarantees to related parties: Evidence from China. *Journal of Banking and Finance* 33, 141-156.
- Boubakri, N., Guedhami, O., Mishra, D., Saffar, W., 2012. Political connections and the cost of equity capital. *Journal of Corporate Finance* 18, 541-559.
- Chang, E., Wong, S., 2004. Political control and performance in China's listed firms. *Journal of Comparative Economics* 32, 617-636.
- Chen, D.H., Chen, X.Y., Wan, H.L., 2005. Regulation and non-pecuniary compensation in Chinese SOEs. *Economic Research* 39/2, 92–101.
- Chen, G., Firth, M., Xin, Y., Xu, L., 2008. Control transfers, privatization, and corporate performance: Efficiency gains in China's listed companies. *Journal of Financial and Quantitative Analysis* 43, 161-190.
- Chen, G., Firth, M., Xu, L., 2009. Does the type of ownership control matter? Evidence from China's listed companies. *Journal of Banking and Finance* 33(1), 171–181.
- Chen, J. P., Li, Z., Su, X., Sun, Z., 2011. Rent-seeking incentives, corporate political connections, and the control structure of private firms: Chinese evidence. *Journal of Corporate Finance* 12 229-243.

- Cheung, Y., Jing, L., Rau, P., Stouraitis, A., 2005. Guanxi, political connections and expropriation: The dark side of state ownership in Chinese listed firms. Unpublished working paper. City University of Hong Kong.
- Cheung, Y., Rau, P., Stouraitis, A., 2006. Tunneling, propping and expropriation: Evidence from connected party transactions in Hong Kong. *Journal of Financial Economics*, 82, 343–386.
- Cheung, Y., Rau, P., Stouraitis, A., 2010. Helping hands or grabbing hand? Central vs. local government shareholders in Chinese listed firms. *Review of finance* 14, 669-694.
- Claessens, S., Djankov, S., Lang, L., 2000. The separation of ownership and control in East Asian corporations. *Journal of Financial Economics* 58, 81-112.
- Cull R., Xu, L., 2000. Bureaucrats, state banks, and the efficiency of credit allocation: The experience of Chinese state-owned enterprises. *Journal of Comparative Economics* 28, 1-31.
- Deng, J., Gan, J., He, J., 2006. Privatization, large shareholders' incentive to expropriate, and firm performance. Unpublished working paper. HKUST, Hong Kong.
- Djankov, S., La Porta, R., Lopez-de-Silanes, F., Shleifer, A., 2008. The Law and Economics of Self-Dealing. *Journal of Financial Economics* 88, 430–465.
- Dyck, A., Morse, A., Zingales, L., 2010. Who blows whistle on corporate fraud? *Journal of Finance* 65, 2213-2253.
- Faccio, M. 2006. Politically connected firms. *American Economic Review*. 96, 369–386.
- Faccio, M., 2010. Differences between politically connected and non-connected firms: A cross country analysis. *Financial Management* 39, 905-928.
- Faccio, M., Lang, L., 2002. The ultimate ownership of Western European corporations. *Journal of Financial Economics* 65, 365–395.

- Faccio, M., Masulis, R., McConnell J., 2006. Political connections and corporate bailouts. *Journal of Finance*, 61(6), 2597-2635.
- Fahlenbrach, R., 2009. Founder-CEOs, investment decisions, and stock market performance. *Journal of Financial and Quantitative Analysis* 44, 439-466.
- Fan, P., Wong, T., Zhang, T., 2007. Politically-connected CEOs, corporate governance and post-IPO performance of China's partially privatized firms. *Journal of Financial Economics* 84, 330-357.
- Firth, M., Fung, P., Rui, O., 2006. Corporate performance and CEO compensation in China. *Journal of Corporate Finance* 12, 693-714.
- Friedman, E., Johnson, S., Mitton, T., 2003. Propping and tunneling. *Journal of Comparative Economics* 31, 732-750.
- Gao, L. Kling, G., 2008. Corporate governance and tunneling: Empirical evidence from China, *Pacific-Basin Finance Journal*, 16, 591 – 605.
- Gao, L., Kling, G., 2008. Corporate governance and tunneling: Empirical evidence from China. *Pacific-Basin Finance Journal* 16, 591-565.
- Jiang, G., Lee, C., Yue, H., 2010. Tunneling through inter-corporate loans: The China experience. *Journal of Financial Economics* 98, 1-20.
- Johnson, B., Magee, R., Nagarajan, N., Newman, H., 1985. An analysis of the stock price reaction to sudden executive deaths. *Journal of Accounting and Economics* 7, 151–174.
- Johnson, S., La Porta, R., Lopez-de-Silanes, F., Shleifer, A., 2000. Tunneling. *American Economic Review Papers and Proceedings* 90, 22–27.
- Kato, T., Long, C., 2006. CEO turnover, firm performance, and enterprise reform in China: Evidence from micro data. *Journal of Comparative Economics* 34, 796-817.

- La Porta, R., Lopez-de-Silanes, F., Shleifer, A., 1999. Corporate ownership around the world. *Journal of Finance* 54, 471–517.
- Leone, A., Liu, M., 2008. Accounting irregularities and executive turnover in founder-manager firms. Unpublished working paper. Accessed via <http://ssrn.com/abstract=1302420>.
- Leuz, C., Oberholzer-Gee, F., 2006. Political relationships, global financing, and corporate transparency: Evidence from Indonesia. *Journal of Financial Economics* 81, 411-439.
- Li, F., Srinivasan, S., 2011. Corporate governance when founders are directors. *Journal of Financial Economics* 102, 454-469.
- Li, H., Meng, L., Zhang, J., 2006. Why do entrepreneurs enter politics? Evidence from China. *Economic Inquiry* 44, 559-578.
- Li, Z. Q., Wang, Z. W., Sun, Z., 2004. Tunneling and ownership arrangement: empirical evidence from tunneling in Chinese listed firms. *Journal of Accounting Research* 25/12, 3–13.
- MacNeil, I., 2002. Adaptation and convergence in corporate governance: The case of Chinese listed companies. *Journal of Corporate Law Studies* 2, 289–344.
- May, D., 1995. Do managerial motives influence firm risk reduction strategies? *Journal of Finance* 50, 1291-1308.
- Miller, G., 2006. The Press as a Watchdog for Accounting Fraud. *Journal of Accounting Research* 44, 1001-1033.
- Peng, W., Wei, K., Yang, Z., 2011. Tunneling or propping: Evidence from connected transactions in China. *Journal of Corporate Finance* 17, 306-325.
- Pi, L., Lowe, J., 2010. Can a powerful CEO avoid involuntary replacement?—An empirical study from China. *Asia Pacific Journal of Management* 28, 775-805.

- Tang, Q., Luo, D., Wang, L., 2004. Major stockholder's tunnel digging and its balancing strength: empirical evidence from Chinese market. Proceedings of the Third International Symposium of Empirical Accounting.
- Villalonga, B., Amit, R., 2006. How do family ownership, control and management affect firm value? *Journal of Financial Economics* 80, 385-417.
- Wang, L., Wang, S., 2011. Cross-border venture capital performance: Evidence from China. *Pacific-Basin Finance Journal* 19, 71-97.
- White, H., 1980. A heteroskedasticity-consistent covariance matrix estimator and a direct test for heteroskedasticity. *Econometrica* 48, 817-838.
- Wu, J., Li, S., Li, Z., 2013. The contingent value of CEO political connections: A study on IPO performance in China, *Asia Pacific Journal of Management*, (forthcoming)
- Wu, W., Wu, C., Rui, O., 2010. Ownership and the value of political connections: Evidence from China. *European Financial Management* 18, 695-729.
- Zhang, L., Ji, W., Tao, J., Wang, Q., 2011. Who shall leave? How CEO preference and power affect executive turnover in Chinese listed companies. *Corporate Governance: An International Review* 19, 547-561.

Table1. Descriptions of main variables used in the analyses.

Variable	Description
Dependent variables	
Tunneling	Total amount of “other receivables” / total assets (Jiang et al., 2010)
Key independent variables	
Political connection	Dummy variable that equals 1 if either (or both) the Chairman or the CEO is a current or former government official, military officer or member of the Chinese People’s Congress (CPC) or the Chinese People’s Political Consultative Conference (CPPCC); zero otherwise
Official PC	Dummy variable that equals 1 if either (or both) the Chairman or the CEO is a current or former government official or military officer and neither of them is a member of the CPC or CPPCC; zero otherwise
CPC/CPPCC	Dummy variable that equals 1 if either (or both) the Chairman or the CEO is a current or former member of the CPC or CPPCC and neither of them is a current or former government official or military officer; zero otherwise
Dual PC	Dummy variable that equals 1 if a firm has both official-type PC and CPC/CPPCC-type PC; zero otherwise
Local PC	Dummy variable that equals 1 if a firm has only local level (provincial or lower) political connection
Central PC	Dummy variable that equals 1 if a firm has central level political connection
Chair PC	Dummy variable that equals 1 if the chairman has political connection; zero otherwise
CEO PC	Dummy variable that equals 1 if the CEO has political connection; zero otherwise
Founder	Dummy variable that equals 1 if the Chairman or the CEO is a founder or a main executive when the firm was first incorporated (including when spun-off); zero otherwise
Control variables	
Reform	Dummy variable that equals 1 if the firm has completed the non-tradable share reform at the end of the year; zero otherwise
Wedge	The difference between the ultimate largest shareholder’s control rights and cash flow rights.
Mg shares	Number of shares held by top executives / total number of shares outstanding
Firm size	Natural logarithm of total assets
ROA	Net income / total assets
Leverage	Total liabilities / total assets
Growth	(Total sales this year – total sales last year) / total sales last year
Board independence (Independence)	Number of independent directors / total number of directors
Duality	Dummy variable that equals 1 if the Chair and the CEO is the same person; zero otherwise
Instrumental variables	
Unemployment	Registered unemployment rate in the province in which a firm is headquartered
Log GDP	Natural logarithm of GDP per capita in the province in which a firm is headquartered
Savings ratio	Total domestic deposits in financial institutions / total GDP in the province in which a firm is headquartered



Table 2. Descriptive statistics of manager political connection, founder status, and overall level of tunneling.

Year	Panel A: The proportion of political connection and founder-manager firms by year						Panel B: Tunneling by year					
	Private Firms			State-owned enterprises (SOEs)			Private firms			State-owned enterprises (SOEs)		
	# of firms	Political connection (proportion)	Founder (proportion)	# of firms	Political connection (proportion)	Founder (proportion)	# of firms reporting tunneling	Mean	Median	# of firms reporting tunneling	Mean	Median
2004	339	119 (35.10%)	84 (24.78%)	842	305 (36.22%)	133 (15.80%)	339	0.112	0.047	842	0.065	0.029
2005	400	140 (35.00%)	113 (28.25%)	878	310 (35.31%)	143 (16.29%)	400	0.108	0.039	878	0.062	0.026
2006	429	152 (35.43%)	121 (28.21%)	850	296 (34.82%)	131 (15.41%)	429	0.101	0.033	850	0.055	0.020
2007	474	172 (36.29%)	141 (29.75%)	849	305 (35.92%)	130 (15.31%)	474	0.052	0.021	848	0.030	0.013
2008	538	192 (35.69%)	193 (35.87%)	884	319 (36.09%)	131 (14.82%)	536	0.036	0.015	881	0.025	0.011
2009	596	228 (38.26%)	225 (37.75%)	886	310 (34.99%)	120 (13.54%)	596	0.030	0.012	885	0.020	0.009
2010	640	244 (38.13%)	253 (39.53%)	894	298 (33.33%)	105 (11.74%)	639	0.025	0.011	894	0.019	0.008
Total	3416	1247 (36.50%)	1130 (33.08%)	6083	2143 (35.23%)	893 (14.68%)	3413	0.060	0.019	6078	0.039	0.014

This table presents the descriptive statistics of manager political connection and founder-managers for private firms and SOEs. Panel A reports sample breakdown across years. Panel B reports the overall level of tunneling across years. The definitions of *Political connection*, *Founder*, and *Tunneling* are reported in Table 1. Proportion is calculated by dividing the number of firms with political connection or founder-manager by the total number of firms in that category. For example, there are 339 private firms in 2004 of which 119 have political connections. Therefore, the proportion of political connection is  $119/339=35.10\%$ .

Table 3. Univariate analyses on mean differences for main variables.

	Private firms						State-owned enterprises (SOEs)					
	PC firms	Non-PC firms	Difference in means	Founder firms	Non-founder firms	Difference in means	PC firms	Non-PC firms	Difference in means	Founder firms	Non-founder firms	Difference in means
	(1)	(2)	(1)–(2)	(3)	(4)	(3)–(4)	(5)	(6)	(5)–(6)	(7)	(8)	(7)–(8)
Tunneling	0.041	0.070	-0.029*** (0.000)	0.025	0.074	-0.049*** (0.000)	0.044	0.037	0.007*** (0.001)	0.031	0.041	-0.010*** (0.000)
Political Connection				0.516	0.302	0.214*** (0.00)				0.456	0.335	0.121*** (0.000)
Founder	0.416	0.224	0.192*** (0.000)				0.190	0.123	0.067*** (0.000)			
Reform	0.803	0.757	0.046*** (0.001)	0.869	0.734	0.135*** (0.000)	0.706	0.712	-0.006 (0.322)	0.700	0.711	-0.011 (0.246)
Wedge	0.086	0.092	-0.006** (0.032)	0.073	0.097	-0.024*** (0.000)	0.030	0.045	-0.015*** (0.000)	0.032	0.041	-0.009*** (0.000)
Mg shares	0.034	0.027	0.007** (0.018)	0.079	0.009	0.070*** (0.000)	<0.001	0.001	-0.001*** (0.006)	0.003	0.001	0.002*** (0.000)
Total assets (billion)	3.230	1.780	1.450*** (0.000)	2.940	2.050	0.890*** (0.000)	6.830	5.260	1.570*** (0.002)	6.450	5.710	0.740* (0.076)
ROA	0.075	0.049	0.026 (0.760)	0.102	0.044	0.058 (0.263)	0.021	0.088	-0.067 (0.106)	0.095	0.059	0.036* (0.091)
Leverage	0.520	1.024	-0.504*** (0.000)	0.440	1.006	-0.566*** (0.000)	0.538	0.541	-0.003 (0.350)	0.500	0.547	-0.047*** (0.000)
Growth	0.270	0.238	0.032* (0.100)	0.255	0.247	0.008 (0.368)	0.234	0.232	0.002 (0.452)	0.228	0.233	-0.005 (0.371)
Independence	0.363	0.363	0.000 (0.568)	0.368	0.361	0.007*** (0.002)	0.353	0.353	0.000 (0.593)	0.353	0.353	0.000 (0.768)
No. of firms	1247	2169	–	1003	2413	–	2143	3940	–	893	5190	–

Variables include *Tunneling*, *Political connection*, *Founder*, and other firm characteristics. The definitions of these variables are reported in Table 1. *P*-values using the two-tailed *t*-test (Mann-Whitney-Wilcoxon test) are reported in parentheses below the differences in means. \*, \*\*, and \*\*\* indicate significance at the 10%, 5%, and 1% levels, respectively.

Table 4. Impact of manager political connection on firm tunneling behavior.

	Dependent variable: Tunneling							
	Private firms				State-owned enterprises (SOEs)			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Constant	0.141*** (0.000)	0.120*** (0.000)	0.121*** (0.000)	0.643*** (0.000)	0.072*** (0.000)	0.073*** (0.000)	0.050*** (0.000)	0.304*** (0.000)
Political connection	-0.025*** (0.000)	-0.020*** (0.000)	-0.019*** (0.000)	-0.006** (0.050)	0.007*** (0.001)	0.007*** (0.001)	0.007*** (0.001)	0.008*** (0.000)
Reform	-0.094*** (0.000)	-0.107*** (0.000)	-0.098*** (0.000)	-0.082*** (0.000)	-0.049*** (0.000)	-0.081*** (0.000)	-0.070*** (0.000)	-0.055*** (0.000)
Wedge		0.042** (0.022)	0.063*** (0.001)	0.021* (0.094)		0.036*** (0.000)	0.034*** (0.000)	0.026*** (0.006)
Mg shares			-0.084*** (0.000)	-0.100*** (0.000)			-0.004 (0.929)	-0.024 (0.538)
Firm size				-0.025*** (0.000)				-0.012*** (0.000)
ROA				-0.001*** (0.000)				-0.006*** (0.009)
Leverage			0.003** (0.049)	0.003** (0.025)			0.052*** (0.000)	0.057*** (0.000)
Growth				-0.006 (0.104)				-0.009*** (0.000)
Independence				-0.004 (0.907)				0.009 (0.598)
Year effect	No	Yes	Yes	Yes	No	Yes	Yes	Yes
Industry effect	No	Yes	Yes	Yes	No	Yes	Yes	Yes
No. of Obs.	3416	3416	3416	3416	6083	6083	6083	6083
R-squared	0.139	0.190	0.208	0.269	0.090	0.143	0.199	0.251
F-value	124.73***	19.01***	21.25***	20.27***	160.24***	27.91***	27.43***	26.77***

This table presents OLS regression results of the impacts of manager political connection on firm tunneling behavior. The dependent variable is *Tunneling* and the key independent variable is *Political connection*. Columns (1) to (4) report the results for private firms and columns (5) to (8) report the results for SOEs. The definitions of all variables are reported in Table 1. *P*-values based on standard errors corrected for heteroskedasticity using White (1980) are reported in parentheses. \*, \*\*, and \*\*\* indicate significance at the 10%, 5%, and 1% levels, respectively.

Table 5. Impact of manager political connection type and connection level on firm tunneling behavior.

	Dependent variable: Tunneling							
	Private firms				State-owned enterprises (SOEs)			
	Official PC firms vs. Non-PC firms	CPC/CPCC firms vs. Non-PC firms	Dual PC firms vs. Non-PC firms	All private firms	Official PC firms vs. Non-PC firms	CPC/CPCC firms vs. Non-PC firms	Dual PC firms vs. Non-PC firms	All SOEs
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
Constant	0.745*** (0.000)	0.617*** (0.000)	0.743*** (0.000)	0.659*** (0.000)	0.306*** (0.000)	0.288*** (0.000)	0.289*** (0.000)	0.302*** (0.000)
Local official PC	0.003 (0.643)			0.005 (0.406)	0.009*** (0.001)			0.008*** (0.001)
Central official PC	0.016 (0.380)			0.020 (0.250)	0.024*** (0.000)			0.023*** (0.000)
Local CPC/CPCC		-0.006** (0.043)		-0.008** (0.026)		-0.003 (0.511)		-0.002 (0.572)
Central CPC/CPCC		-0.012*** (0.005)		-0.011*** (0.005)		-0.004** (0.046)		-0.004* (0.057)
Local dual PC			-0.014 (0.181)	-0.013 (0.217)			0.011** (0.022)	0.010* (0.064)
Central dual PC			-0.001 (0.964)	-0.015* (0.098)			0.021** (0.011)	0.021** (0.011)
Reform	-0.083*** (0.000)	-0.083*** (0.000)	-0.082*** (0.000)	-0.046*** (0.000)	-0.058*** (0.000)	-0.048*** (0.000)	-0.052*** (0.000)	-0.055*** (0.000)
Wedge	0.056** (0.020)	0.023* (0.097)	0.032* (0.081)	0.017 (0.165)	0.024** (0.019)	0.022** (0.028)	0.024** (0.028)	0.026*** (0.006)
Mg shares	-0.119*** (0.000)	-0.098*** (0.000)	-0.112*** (0.000)	-0.104*** (0.000)	-0.042 (0.271)	-0.057** (0.023)	-0.082*** (0.001)	-0.018 (0.631)
Firm size	-0.030*** (0.000)	-0.025*** (0.000)	-0.031*** (0.000)	-0.026*** (0.000)	-0.012*** (0.000)	-0.011*** (0.000)	-0.011*** (0.000)	-0.012*** (0.000)
ROA	-0.001*** (0.000)	-0.001*** (0.000)	-0.001*** (0.000)	-0.001*** (0.000)	-0.006*** (0.007)	-0.013*** (0.001)	-0.014*** (0.000)	-0.006*** (0.009)
Leverage	0.002* (0.052)	0.002** (0.027)	0.002* (0.066)	0.003** (0.023)	0.053*** (0.000)	0.054*** (0.000)	0.052*** (0.000)	0.056*** (0.000)
Growth	-0.008** (0.047)	-0.007* (0.060)	-0.009** (0.021)	-0.008** (0.021)	-0.009*** (0.000)	-0.009*** (0.000)	-0.008*** (0.000)	-0.008*** (0.000)
Independence	-0.002 (0.961)	0.007 (0.857)	0.001 (0.977)	-0.014 (0.714)	0.019 (0.259)	0.023 (0.214)	0.028 (0.204)	0.009 (0.636)
Year effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
No. of Obs.	2450	3013	2281	3416	5394	4442	4127	6083
R-squared	0.283	0.279	0.287	0.251	0.255	0.242	0.238	0.254
F-value	18.04***	17.53***	16.22***	16.92***	23.29***	18.94***	19.10***	22.83***

This table presents OLS regression results of the impacts of different types of manager political connections on firm tunneling behavior. The dependent variable is *Tunneling* and the key independent variables are three types of political connections, namely *Official PC*, *CPC/CPCC*, and *Both PC*. Columns (1) to (4) report the results for private firms and columns (5) to (8) report

the results for SOEs. Columns (1) and (5) contain only those firms with managers who have official-type political connection and firms without connected managers. Columns (2) and (6) contain only those firms with managers who have CPC/PPCC-type political connection and firms without connected managers. Columns (3) and (7) contain only those firms with managers who have both official-type and CPC/PPCC-type political connection and firms without connected managers. Columns (4) and (8) contain all private firms and all SOEs, respectively. The definitions of all variables are reported in Table 1. *P*-values based on standard errors corrected for heteroskedasticity using White (1980) are reported in parentheses. \*, \*\*, and \*\*\* indicate significance at the 10%, 5%, and 1% levels, respectively.

Table 6. Interactive impact of manager political connection type and founder status on firm tunneling behavior.

	Dependent variable: Tunneling									
	Private firms					State-owned enterprises (SOEs)				
	Official PC vs. Non-PC	CPC/CPCC vs. Non-PC	Dual PC vs. Non-PC	All private firms	All private firms	Official PC vs. Non-PC	CPC/CPCC vs. Non-PC	Dual PC vs. Non-PC	All SOEs	All SOEs
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	
Constant	0.730*** (0.000)	0.604*** (0.000)	0.721*** (0.000)	0.625*** (0.000)	0.619*** (0.000)	0.304*** (0.000)	0.289*** (0.000)	0.288*** (0.000)	0.303*** (0.000)	0.301*** (0.000)
Political connection (PC)				-0.009** (0.038)					0.009*** (0.000)	
Official PC	<0.001 (0.953)				<0.001 (0.943)	0.011*** (0.000)				0.011*** (0.000)
CPC/CPCC		-0.013*** (0.004)			-0.014*** (0.003)		-0.002 (0.414)			-0.002 (0.541)
Dual PC			-0.012 (0.243)		-0.013 (0.192)			0.015** (0.039)		0.016** (0.029)
Founder	-0.023*** (0.000)	-0.023*** (0.000)	-0.022*** (0.000)	-0.024*** (0.000)	-0.025*** (0.000)	-0.005** (0.047)	-0.005** (0.023)	-0.005** (0.033)	-0.005** (0.042)	-0.005** (0.041)
PC * Founder				-0.016*** (0.006)					-0.002 (0.564)	
Official PC * Founder	-0.021 (0.139)				-0.021 (0.119)	<-0.001 (0.985)				<-0.001 (0.949)
CPC/CPCC*Founder		-0.021*** (0.000)			-0.021*** (0.000)		-0.008* (0.072)			-0.008* (0.097)
Dual PC * Founder			<-0.001 (0.994)		-0.001 (0.961)			-0.018* (0.058)		-0.016* (0.073)
Reform	-0.081*** (0.000)	-0.080*** (0.000)	-0.079*** (0.000)	-0.079*** (0.000)	-0.078*** (0.000)	-0.058*** (0.000)	-0.048*** (0.000)	-0.052*** (0.000)	-0.055*** (0.000)	-0.055*** (0.000)
Wedge	0.059** (0.014)	0.017 (0.375)	0.037 (0.127)	0.025 (0.171)	0.026 (0.159)	0.024** (0.020)	0.022** (0.031)	0.025** (0.019)	0.027*** (0.004)	0.026*** (0.006)
Mg shares	-0.084*** (0.000)	-0.072*** (0.000)	-0.077*** (0.000)	-0.072*** (0.000)	-0.072*** (0.000)	-0.029 (0.465)	-0.047* (0.069)	-0.068*** (0.010)	-0.009 (0.824)	-0.006 (0.868)
Firm size	-0.029*** (0.000)	-0.024*** (0.000)	-0.030*** (0.000)	-0.024*** (0.000)	-0.024*** (0.000)	-0.012*** (0.000)	-0.011*** (0.000)	-0.011*** (0.000)	-0.012*** (0.000)	-0.012*** (0.000)
ROA	-0.001*** (0.000)	-0.001*** (0.000)	-0.001*** (0.000)	-0.001*** (0.000)	-0.001*** (0.000)	-0.006*** (0.007)	-0.013*** (0.001)	-0.013*** (0.000)	-0.006*** (0.009)	-0.006*** (0.009)
Leverage	0.002* (0.052)	0.002** (0.027)	0.002* (0.063)	0.002** (0.025)	0.003** (0.024)	0.053*** (0.000)	0.054*** (0.000)	0.052*** (0.000)	0.056*** (0.000)	0.056*** (0.000)
Growth	-0.008** (0.045)	-0.007* (0.060)	-0.009** (0.019)	-0.006* (0.098)	-0.006 (0.101)	-0.009*** (0.000)	-0.009*** (0.000)	-0.008*** (0.000)	-0.009*** (0.000)	-0.009*** (0.000)
Independence	0.005 (0.908)	0.010 (0.797)	0.004 (0.932)	<0.001 (0.989)	-0.002 (0.965)	0.019 (0.276)	0.024 (0.187)	0.028 (0.185)	0.009 (0.603)	0.009 (0.628)
Year effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
No. of Obs.	2450	3013	2281	3416	3416	5394	4442	4127	6083	6083

R-squared	0.287	0.284	0.292	0.274	0.275	0.254	0.242	0.238	0.252	0.253
F-value	18.13***	17.79***	16.58***	19.98***	17.96***	22.42***	18.28***	18.29***	24.95***	22.00***

This table presents OLS regression results of the impacts of manager political connections type, founder status, and interaction between political connection type and founder status on firm tunneling behavior. The dependent variable is *Tunneling* and the key independent variables are three types of political connections (namely *Official PC*, *CPC/PPCC*, and *Dual PC*), *Founder*, and interactions between *Political connection* and *Founder*. Columns (1) to (5) report the results for private firms and columns (6) to (10) report the results for SOEs. Columns (1) and (6) contain only those firms with managers who have official-type political connection and firms without connected managers. Columns (2) and (7) contain only those firms with managers who have CPC/PPCC-type political connection and firms without connected managers. Columns (3) and (8) contain only those firms with managers who have both official-type and CPC/PPCC-type political connection and firms without connected managers. Columns (4) and (5) and columns (9) and (10) contain all private firms and all SOEs, respectively. The definitions of all variables are reported in Table 1. *P*-values based on standard errors corrected for heteroskedasticity using White (1980) are reported in parentheses. \*, \*\*, and \*\*\* indicate significance at the 10%, 5%, and 1% levels, respectively.

Table 7. Interactive impact of manager political connection level and founder status on firm tunneling behavior.

	Dependent variable: Tunneling					
	Private firms			State-owned enterprises (SOEs)		
	(1)	(2)	(3)	(4)	(5)	(6)
Constant	0.641*** (0.000)	0.640*** (0.000)	0.624*** (0.000)	0.305*** (0.000)	0.304*** (0.000)	0.304*** (0.000)
Local PC	-0.004 (0.246)	<0.001 (0.981)	-0.005 (0.281)	0.006*** (0.004)	0.007*** (0.003)	0.007*** (0.006)
Central PC	-0.009** (0.035)	-0.013** (0.032)	-0.017*** (0.003)	0.010*** (0.001)	0.014*** (0.000)	0.014*** (0.000)
Founder			-0.023*** (0.000)			-0.005** (0.043)
Local PC*Founder		0.008 (0.293)	-0.009 (0.145)		-0.006 (0.160)	-0.001 (0.799)
Central PC*Founder		-0.011** (0.015)	-0.029*** (0.000)		-0.012*** (0.009)	-0.007* (0.085)
Reform	-0.082*** (0.000)	-0.081*** (0.000)	-0.079*** (0.000)	-0.055*** (0.000)	-0.055*** (0.000)	-0.055*** (0.000)
Wedge	0.020 (0.269)	0.023 (0.213)	0.026 (0.153)	0.026*** (0.006)	0.027*** (0.005)	0.027*** (0.004)
Mg shares	-0.101*** (0.000)	-0.096*** (0.000)	-0.072*** (0.000)	-0.026 (0.492)	-0.021 (0.589)	-0.010 (0.803)
Firm size	-0.025*** (0.000)	-0.025*** (0.000)	-0.024*** (0.000)	-0.012*** (0.000)	-0.012*** (0.000)	-0.012*** (0.000)
ROA	-0.001*** (0.000)	-0.001*** (0.000)	-0.001*** (0.000)	-0.006*** (0.009)	-0.006*** (0.009)	-0.006*** (0.008)
Leverage	0.003** (0.025)	0.003** (0.024)	0.003** (0.024)	0.057*** (0.000)	0.057*** (0.000)	0.056*** (0.000)
Growth	-0.006* (0.100)	-0.006* (0.096)	-0.006* (0.095)	-0.009*** (0.000)	-0.009*** (0.000)	-0.009*** (0.000)
Independence	-0.003 (0.924)	-0.005 (0.886)	-0.002 (0.949)	0.010 (0.593)	0.009 (0.617)	0.001 (0.792)
Year effect	Yes	Yes	Yes	Yes	Yes	Yes
Industry effect	Yes	Yes	Yes	Yes	Yes	Yes
No. of Obs.	3416	3416	3416	6083	6083	6083
R-squared	0.269	0.270	0.274	0.251	0.251	0.252
F-value	19.51***	18.41***	18.63***	25.86***	24.16***	23.39***

This table presents OLS regression results of the impacts of manager political connections level, founder status, and interaction between political connection level and founder status on firm tunneling behavior. The dependent variable is *Tunneling* and the key independent variables are two levels of political connections (namely *Local PC* and *Central PC*), *Founder*, and interactions between *Political connection* and *Founder*. Columns (1) to (3) report the results for private firms and columns (4) to (6) report the results for SOEs. Columns (1) and (4) test the stand-alone impacts of *Political connection level* on tunneling. Columns (2) and (5) include the interaction terms between *Political connection level* and *Founder*. Columns (3) and (6) also include the stand-alone *Founder* variable. The definitions of all variables are reported in Table 1. *P*-values based on standard errors corrected for heteroskedasticity using White (1980) are reported in parentheses. \*, \*\*, and \*\*\* indicate significance at the 10%, 5%, and 1% levels, respectively.



Table 8. Different impact of the chairman's political connection and the CEO's political connection on firm tunneling behavior.

	Dependent variable: Tunneling					
	Private firms			State-owned enterprises (SOEs)		
	Chair PC firms vs. Non-PC firms	CEO PC firms vs. Non-PC firms	All private firms	Chair PC firms vs. Non-PC firms	CEO PC firms vs. Non-PC firms	All SOEs
(1)	(2)	(3)	(4)	(5)	(6)	
Constant	0.630*** (0.000)	0.701*** (0.000)	0.642*** (0.000)	0.295*** (0.000)	0.280*** (0.000)	0.300*** (0.000)
Chair PC	-0.008** (0.015)		-0.007** (0.038)	0.008*** (0.000)		0.009*** (0.000)
CEO PC		0.006 (0.155)	0.002 (0.707)		-0.002 (0.422)	-0.004 (0.141)
Duality	-0.005 (0.250)	-0.005 (0.272)	-0.005 (0.257)	0.006* (0.091)	0.009** (0.014)	0.007* (0.063)
Reform	-0.080*** (0.000)	-0.080*** (0.000)	-0.082*** (0.000)	-0.056*** (0.000)	-0.053*** (0.000)	-0.055*** (0.000)
Wedge	0.021 (0.253)	0.028 (0.215)	0.021 (0.241)	0.028*** (0.004)	0.023** (0.023)	0.026*** (0.006)
Mg shares	-0.096*** (0.000)	-0.090*** (0.000)	-0.094*** (0.000)	-0.077*** (0.002)	-0.052 (0.189)	-0.033 (0.409)
Firm size	-0.025*** (0.000)	-0.028*** (0.000)	-0.025*** (0.000)	-0.012*** (0.000)	-0.011*** (0.000)	-0.012*** (0.000)
ROA	-0.001*** (0.000)	-0.001*** (0.000)	-0.001*** (0.000)	-0.006*** (0.009)	0.006*** (0.002)	-0.006*** (0.009)
Leverage	0.002** (0.025)	0.002** (0.037)	0.003** (0.025)	0.056*** (0.000)	0.046*** (0.000)	0.056*** (0.000)
Growth	-0.006 (0.112)	-0.006 (0.136)	-0.006 (0.103)	-0.008*** (0.000)	-0.009*** (0.000)	-0.009*** (0.000)
Independence	0.001 (0.985)	0.009 (0.824)	-0.001 (0.975)	0.009 (0.611)	0.002 (0.917)	0.008 (0.690)
Year effect	Yes	Yes	Yes	Yes	Yes	Yes
Industry effect	Yes	Yes	Yes	Yes	Yes	Yes
No. of Obs.	3282	2721	3416	5867	4776	6083
R-squared	0.267	0.281	0.270	0.252	0.240	0.252
F-value	18.54***	18.56***	18.92***	24.91***	20.86***	24.86***

This table presents OLS regression results of the different impacts of the Chairman's political connection and the CEO's political connection on firm tunneling behavior. The dependent variable is *Tunneling* and the key independent variables are *Chair PC* and *CEO PC*. *Chair PC* is a dummy variable that equals 1 if the chairman has political connection. *CEO PC* is a dummy variable that equals 1 if the CEO has political connection. The definitions of all other variables are reported in Table 1. Columns (1) to (3) report the results for private firms and columns (4) to (6) report the results for SOEs. *P*-values based on standard errors corrected for heteroskedasticity using White (1980) are reported in parentheses. \*, \*\*, and \*\*\* indicate significance at the 10%, 5%, and 1% levels, respectively.

Table 9. 2SLS instrumental variable (IV) analyses of impact of manager political connection type, founder status, and their interaction on firm tunneling behavior.

	Private firms				State-owned enterprises (SOEs)			
	1st stage Dependent variables			2nd stage	1st stage Dependent variables			2nd stage
	Official PC	CPC/CPCC	Dual PC	Tunneling	Official PC	CPC/CPCC	Dual PC	Tunneling
(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
Constant	-0.390 (0.690)	-5.445*** (0.000)	-4.204*** (0.000)	0.727*** (0.000)	-4.059*** (0.000)	0.729 (0.279)	-2.743*** (0.000)	0.302*** (0.000)
Official PC (Instrumented)				0.046* (0.064)				0.108*** (0.000)
CPC/CPCC (Instrumented)				-0.172*** (0.006)				-0.004 (0.870)
Dual PC (Instrumented)				-0.131** (0.038)				0.107** (0.042)
Founder				-0.096*** (0.000)				-0.039*** (0.009)
Official PC * Founder (Instrumented)				-0.290*** (0.006)				0.023** (0.035)
CPC/CPCC * Founder (Instrumented)				-0.244*** (0.000)				-0.051* (0.063)
Dual PC * Founder (Instrumented)				-0.321* (0.068)				0.158** (0.048)
Unemployment	0.238*** (0.000)	-0.232*** (0.000)	-0.085 (0.182)		0.110*** (0.000)	-0.190*** (0.000)	0.085** (0.045)	-0.055*** (0.000)
Log GDP	-0.326*** (0.000)	-0.133** (0.021)	-0.221** (0.014)		0.173*** (0.000)	-0.201*** (0.000)	-0.174*** (0.007)	
Savings ratio	0.779*** (0.001)	-0.132 (0.468)	0.138*** (0.002)		0.186 (0.121)	-0.439*** (0.007)	0.170 (0.423)	
Reform	-0.131 (0.235)	0.261*** (0.003)	-0.039 (0.774)	-0.076*** (0.000)	-0.011 (0.852)	0.016 (0.842)	0.017 (0.877)	
Wedge	0.091 (0.809)	1.052*** (0.000)	0.983** (0.046)	0.013 (0.509)	1.711*** (0.000)	0.208 (0.511)	1.542*** (0.005)	0.027*** (0.006)
Mg shares	-1.568* (0.071)	0.929*** (0.001)	1.080 (0.141)	-0.118*** (0.000)	-9.940** (0.049)	2.107 (0.112)	-19.132*** (0.001)	-0.023 (0.696)
Firm size	0.025 (0.432)	0.342*** (0.000)	0.203*** (0.000)	-0.029*** (0.000)	0.042** (0.012)	0.052** (0.017)	0.129*** (0.000)	-0.012*** (0.000)
ROA	-0.006 (0.813)	-0.034 (0.522)	0.022** (0.036)	-0.001*** (0.000)	-0.042 (0.174)	0.022 (0.405)	0.002 (0.821)	-0.006*** (0.009)
Leverage	-0.077** (0.029)	-0.153 (0.145)	-0.180** (0.041)	0.002** (0.043)	-0.021 (0.698)	-0.025 (0.776)	-0.036 (0.690)	0.056*** (0.000)
Growth	-0.002 (0.971)	0.003 (0.936)	0.023 (0.599)	-0.005 (0.106)	-0.015 (0.631)	<-0.001 (0.997)	-0.015 (0.797)	-0.008*** (0.000)
Independence	0.175 (0.761)	0.591 (0.215)	-1.714* (0.071)	-0.037 (0.336)	0.682* (0.058)	-0.787 (0.104)	-1.656** (0.031)	0.006 (0.761)
Year effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
No. of Obs.	3416	3416	3416	3416	6083	6083	6083	6083
Wald Chi2	100.08***	320.98***	47.43***		183.22***	38.74***	80.31***	
Pseudo R squared	0.054	0.094	0.051		0.030	0.015	0.031	
Log pseudo likelihood	-926.600	-1733.162	-477.534		-3244.636	-1706.715	-809.206	
R-squared				0.286				0.253
F-value				19.37***				22.31***

This table presents the results of two-stage least squares (2SLS) instrumental variable (IV) regressions of the impacts of manager political connection type, founder status, and their interaction on firm tunneling behavior. Columns (1) to (4) report the results for private firms and columns (5) to (8) report the results for SOEs. Columns (1) to (3) and columns (5) to (7) report the results of the first stage, in which probit regressions are used. The dependent variables in the first-stage regressions are three types of political connections, namely *Official PC*, *CPC/CPCC*, and *Dual PC*. Columns (4) and (8) report the results of the second stage, in which OLS regressions are used. The dependent variable in the second-stage regressions is *Tunneling*. We use three instrumental variables (IVs) in the first stage. These IVs are Unemployment, Log GDP, and Savings ratio. The definitions of these three IVs and of all other variables are reported in Table 1. *P*-values based on standard errors corrected for heteroskedasticity using White (1980) are reported in parentheses. \*, \*\*, and \*\*\* indicate significance at the 10%, 5%, and 1% levels, respectively.