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TRANSFERS OF MANAGERS AND BOARD MEMBERS TO POLITICS: IMPACT ON FIRM ACCESS TO DEBT

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Abstract. The main goal of this study is to examine how Transfers of Managers and Board members to Politics (TMBPs) impact firms' access to financing. Using a new dataset covering Central European economies during the 2014–2019 period and random–effects static panel models, we find that TMBPs worsen access to financing for concerned firms, which suggests that TMBPs constitute a loss of valuable social ties for firms and that TMBPs do not create a new form of political connections through past social networks. Moreover, according to our results, the latter seems to be short–lived.

Keywords: social ties, political connections, transfers to politics, access to debt, firm financing.

JEL Classification: G30, H80.

Introduction

The vast literature examining the impact of political connections on companies focuses almost exclusively on ex–politicians joining managerial teams or taking up posts on boards. The number of studies devoted to transfers in the opposite direction, that is, from business to politics, is extremely limited. Bunkanwanicha and Wiwattanakantang (2009) assess the microeconomic implications of business tycoons' involvement in politics, while Feng et al. (2015) verify whether entrepreneurs benefit from participating in politics. Notably, to the best of our knowledge, the literature remains silent about the consequences of managers and board members' transfers to politics (TMBPs). We attempt to fill this lacuna by investigating how political carriers of ex–managers and ex–board members affect companies.

If we assume that social ties between current managers and board members and their former colleagues are stable and long lasting, the transfers from firms to politics create an implicit form of political connections. Considering that the literature on political connections and social ties strongly suggests that both types of links facilitate access to various resources (Faccio et al., 2006; Boubakri et al., 2012; Goldman et al., 2013; Tahoun, 2014; Fogel et al., 2018), implicit political connections should also play a relevant role in shaping firm access to external capital. However, when the assumption about the solidity of social ties with ex–members of managerial teams or boards is violated, the impact of this type of political connection on loan availability is uncertain and constitutes a suitable topic for empirical investigations. Therefore, the main goal of this study is to examine how TMBPs influence firm access to debt.

In this study, we employed a new and rich dataset. This set includes information on listed companies operating in 11 Central European countries over the period 2014–2019. In total, we identified 150 firms affected by the TMBPs. Therefore, the number of TMBPs is sufficiently high to estimate econometric models and draw reliable conclusions on the relationship between these transfers and company access to debt financing. We base our statistical inferences on static panel models with random–effects.

We find that TMBPs, regardless of the dependent variable definition and sample specification, worsen access to financing for concerned firms. This empirical regularity implies that, in reality, TMBPs constitute for firms a loss of valuable social ties (possessed by ex–managers and board members) rather than a way to create an implicit form of valuable political connections. Further, our results suggest that social ties are short–lived once a

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person abandons a company. Importantly, the negative effects of TMBPs seem to be offset by the traditionally understood political connections, that is, the presence of persons with political experience within the managerial team or supervisory board.

This study contributes to the literature in three ways. First, it confirms that personal political connections, established through current directors, facilitate access to debt financing or neutralize the negative influence in this respect of other factors (Johnson & Mitton, 2003; Khwaja & Mian, 2005; Faccio et al., 2006; Claessens et al., 2008; Boubakri et al., 2012; Bussolo et al., 2022). Second, it supports the view that political connections should not be treated as a homogenous phenomenon and underscores the need to distinguish between different types of these connections in empirical investigations (Wong & Hooy, 2018). Although TMBPs can theoretically create implicit political connections, they, in reality, fail to facilitate firm access to debt financing in striking contrast to other types of political connections. Third, the study indicates that while the benefits of having social ties are palpable in many spheres (Qiao et al., 2013; Chen et al., 2018; Skousen et al., 2018; Cucculelli et al., 2019; Luu & Ngo, 2019; Togan Egrican, 2021), these benefits may critically depend on the longevity of social ties.

The remainder of this paper is organized as follows. In Section 1, we present relevant literature and substantiate our main hypothesis. Section 2 describes the data sources and the applied methodology. In Section 3, we outline our empirical results. The last section contains concluding remarks and discusses the research outcomes from a broader perspective.

1. Literature review and hypothesis development

We base the main research hypothesis on two strands of the existing literature. The first strand concerns the impact of political connections on access to financial resources. The second strand evaluates the relevance of social ties in the same context.

The vast majority of the studies conducted so far agree that political connections are highly valuable in terms of access to financial resources. Faccio et al. (2006), Faccio (2010), and Boubakri et al. (2012), using cross–country samples, find that politically connected entities report higher leverage ratios and contract long–term debt more easily. Numerous studies confirm the privileged position of politically connected firms in the loan market in a single country setting (for example, Johnson & Mitton, 2003; Khwaja & Mian, 2005; Claessens et al., 2008; Malesky & Taussing, 2009; Chow et al., 2012; Liu et al., 2012; Li & Shi, 2022). The improved access of politically connected firms to financial resources is not limited only to bank lending or issuance of debt instruments, but also encompasses access to government contracts and subsidies (Goldman et al., 2013; Tahoun, 2014; Trinh et al., 2021).

With regard to Central European countries, to the best of our knowledge, there are only two relevant studies. Hasan et al. (2017) demonstrate that politically connected firms in Poland have more long–term liabilities than other firms, particularly when political connections are established through people who only recently left politics. Bussolo et al. (2022) examine six Central and Eastern European countries (Bulgaria, Hungary, Romania, Russian Federation, Serbia, and Slovak Republic) and show that politically connected firms are less likely to face financial constraints and more leveraged than unconnected firms.

The strand of the literature tackling the issue of the importance of social ties for firms shows that they act in a similar way to political connections. Namely, these ties improve access to debt, reduce costs, and limit the number of restrictive covenants. For U.S. firms, Engelberg et al. (2012), Skousen et al. (2018), and Fogel et al. (2018) find that the presence of social ties between firms and lenders is associated with lower cost of debt, higher volumes of individual loans, and fewer contract covenants. Togan Egrican (2021) shows, using data from a market for syndicated loans, that firms socially connected to bankers via other company boards are less financially constrained. Haw et al. (2021) add that firms that share directors with bankrupt firms suffer from higher loan spreads after bankruptcy of firms with common directors due to reputational damages to common directors involved in bankruptcy–related events.

For European firms, Javakhadze et al. (2016) establish that social ties reduce a firm's dependence on internally generated cash. Cucculelli et al. (2019) state that close bank–firm ties limit the probability of experiencing credit constraints. Moreover, Liu et al. (2016) find that social ties help firms obtain trade credit. Finally, in the case of Polish firms, Jackowicz and Kozłowski (2019) document that social ties improve SMEs' access to bank financing only when these connections involve high–rank bank officials.

In the context of TMBPs, the reviewed literature suggests that those transfers should improve firm access to debt because they can potentially create a form of implicit political connection. Thus, we formulate the main hypothesis as follows:

Main hypothesis: *Transfers of Managers and Board members to Politics (TMBPs) facilitate firm access to debt financing.*

However, the reasoning behind the main hypothesis relies on one key assumption: Namely, it speculates that social ties between current directors and former directors are stable and persist in the long–term. If this assumption is violated, as we already mentioned in the introductory section, the firm cannot realize gains from implicit political connections as well as lose all benefits (discussed above) related to social ties brought by former directors currently active in politics. Consequently, if social ties dissolve shortly after directors abandon firms, it is conceivable that TMBPs may lead to the deterioration of firm access to debt financing.

2. Data and methodology

To verify our research hypothesis, we combined the data from a few sources. First, we used Thomson Reuters services to collect information on about 635 listed companies in the 2014–2019 period from 11 Central European economies: Bulgaria, Croatia, Czechia, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, and Slovenia. We gathered financial statements of the companies at the end of each financial year and detailed information on their current and former management and supervisory board members. For each company, we were able to list its management and supervisory board members, start and end dates for each position, and biographical notes that included each person's experience/past career. The sample with current and past management and supervisory board members included 18,947 people (29.8 person per firm). Second, we augmented the biographical notes from Thomson Reuters using data collected from the Internet. We then screened the list of management and supervisory board members to identify people who were politically active at any moment in time. A person was meant to be politically active if she/he served one of the following functions: head of state, Member of Parliament, member of a cabinet, deputy member of a cabinet, other government official, high–ranking official at a regulatory body, and a member of a local government authority. Thus, we were able to assign dates of political activity to the management and supervisory board members of the firms included in our sample. From our sample, 819 people (4.3%) were found to be politically active at any moment in their career, that is, before or after they held positions at firms from our sample. Third, we augment our dataset with country–specific macroeconomic indicators derived from the World Bank's World Development Indicator database.

After collecting the data, we constructed a panel sample of 3,499 firm–year observations and defined variables for our study. Before calculating all firm–level financial indicators, we divide our companies into eight industries to further deduce industry–year medians from each individual firm–year observation. This procedure allows us to directly reflect all industry–year variations in firm–level financial indicators. Our dependent variables, DEBT.GR and LT.DEBT.GR, represent a firm's access to debt or long–term debt, calculated as an inflation–adjusted yearly growth rate of total debt or inflation–adjusted yearly increase in long–term debt, divided by the asset value at the beginning of a year, respectively. Our firm–level control variables include the natural logarithm of assets in millions of EUR (FIRM.SIZE), equity–to–assets ratio (EQUITY), ratio of net income before taxes to average assets (PROFIT), total sales to assets ratio (TAT), and cash to assets ratio (CASH). The macroeconomic country–level control variables include GDP growth rate (GDP), inflation rate (INFLATION), and unemployment rate (UNEMPL).

We employed three political variables to verify our hypothesis. First, PB.POL is a binary variable that takes the value of 1 for a given firm–year observation if a firm's past board member was politically active in a given year, and 0 otherwise. Second, PB.POL.FUT is constructed as a binary variable that takes the value of 1 for a given firm–year observation if a firm's past board member became politically active after leaving the post at a company (i.e., even if this activity started after a given year), and 0 otherwise. Third, CB.POL is a binary variable that takes the value of 1 for a given firm–year observation if a firm's current board member is politically active before a given year, and 0 otherwise. Thus, PB.POL and PB.POL.FUT allow us to directly check whether TMBPs influence firm access to debt financing, while CB.POL is a traditional measure of political connections, that is, connections established through current employees with political experience, which allows us to verify whether such connections moderate the effects of TBMPs.

Table 1 presents the descriptive statistics of the sample. It shows that almost a quarter of observations relate to firms that are politically connected in a traditional manner (i.e., CB.POL equals 1 for them), while the firm–year observations for which TMBPs are identified (i.e., PB.POL equals 1) constitute 4.3% of the sample, and 4.9% firm–year observations concern situations in which a firm's past management or supervisory board members became politically active until the end of the sample period.

Table 1. Descriptive statistics

Variable name	Observ.	Firms	Mean	Std. Dev.
DEBT.GR	3,499	635	0.115	0.707
LT.DEBT.GR	3,426	624	0.014	0.104
FIRM.SIZE	3,499	635	0.215	1.744
EQUITY	3,499	635	0.005	0.210
PROFIT	3,499	635	0.004	0.106
CASH	2,033	473	0.028	0.083
TAT	3,225	592	0.197	0.801
GDP.GROWTH	3,499	635	0.040	0.011
INFLATION	3,499	635	0.009	0.015
UNEMPL	3,499	635	0.062	0.025
PB.POL	3,499	635	0.043	0.203
PB.POL.FUT	3,499	635	0.049	0.217
CB.POL	3,499	635	0.249	0.433

As our political variables are relatively stable in time for each firm, we employed our variables in random effects panel models. Equation (1) represents the general construction of the models:

$$DEP_{i,t} = f\left(FIRM.SPEC_{i,t-1}; MACRO_{i,t}; POLIT_{i,t}\right), \quad (1)$$

where $DEP_{i,t}$ represents the value of our dependent variable (DEBT.GR or LT.DEBT.GR) for company *i* in year *t*; $FIRM.SPEC_{i,t-1}$ denotes the set of firm–specific control variables (in all regressions, we employ FIRM.SIZE, EQUITY, and PROFIT, while we also add TAT and CASH in regressions applied to a subsample deprived of banks

and insurers); $MACRO_{i,t}$ includes GDP.GROWTH, INFLATION and UNEMPL, and $POLIT_{i,t}$ encompasses our political variables PB.POL, PB.POL.FUT, and CB. POLIT. Since all our firm–specific variables are positioned against industry–year medians, we do not include year and industry dummies in our models. In all regressions, we calculate the standard errors clustered at the firm–level.

3. Empirical results

Table 2 addresses our research hypothesis. In specifications 1–3, we verify the impact of all regressors on DEBT.GR, while in specifications 4–6 we regress the same set of variables against the LT.DEBT.GR. Regarding our control variables, a few coefficients are statistically significant. First, in specifications 1–3, we observe that the growth rate of total debt is negatively influenced by a firm size, and positively influenced by its past equity–to–assets ratio. In turn, in the last three specifications, we find positive coefficients for the PROFIT variable. All the above–mentioned coefficients are statistically significant at levels below 1%. Those observations are fully in line with theoretical expectations that smaller companies require more debt to develop, while companies with more sound fundamentals have generally facilitated access to debt financing (i.e., their relatively high creditworthiness is rewarded by potential creditors). It is also worth noting that many of our political variables are statistically significant in the regressions. First, in specifications 1 and 4, we observe that TMBPs work to the detriment of a firm's access to total debt or long–term debt, respectively. The coefficients are negative and statistically significant at the 5% and 1% level, respectively, and those observations allow for a rejection of our research hypothesis. Namely, they suggest that social ties between current directors and former directors who left a firm for politics are not stable. In other words, TMBPs mean for a firm a loss of valuable managers and a loss of benefits related to their social ties. The identified phenomenon is not only statistically significant but also relevant in economic terms. For example, if a firm's past management or supervisory board member holds a political position in a given year, then her/his loss by the firm could be expressed in the following manner: on average, it means a decrease of debt growth rate by 9.55 percentage points, that is, by 34% of the DEBT.GR's interquartile range in the sample.

Table 2. Board members' political activity vs. firms' access to debt (the results of the estimations for the random effects model; for brevity, we do not present a constant term; standard errors clustered at the firm–level are shown in parentheses. *, **, *** refer to significance at the 10%, 5%, and 1% levels, respectively)

	(1)	(2)	(3)
Variables:	$DEBT.GR_t$	$DEBT.GR_t$	$DEBT.GR_t$
Controls:			
$FIRM.SIZE_{t-1}$	−0.0321***	−0.0321***	−0.0343***
	(0.00920)	(0.00919)	(0.00949)
$EQUITY_{t-1}$	0.575***	0.575***	0.572***
	(0.0946)	(0.0949)	(0.0947)
$PROFIT_{t-1}$	0.197	0.194	0.194
	(0.173)	(0.173)	(0.172)
$GDP.GROWTH_t$	1.982*	1.971	1.950
	(1.203)	(1.203)	(1.204)
$INFLATION_t$	0.425	0.401	0.494
	(0.900)	(0.899)	(0.905)
$UNEMPL_t$	0.860	0.861	0.884
	(0.619)	(0.619)	(0.620)
Political connections:			
$PB.POL_t$	−0.0955**		−0.179***
	(0.0389)		(0.0621)
$PB.POL.FUT_t$		−0.0923**	
		(0.0369)	
$CB.POL_t$			0.0211
			(0.0304)
$PB.POL_t$ x $CB.POL_t$			0.134**
			(0.0658)
Observations	3,499	3,499	3,499
Firms	635	635	635
	(4)	(5)	(6)
Variables:	$LT.DEBT.GR_t$	$LT.DEBT.GR_t$	$LT.DEBT.GR_t$
Controls:			
$FIRM.SIZE_{t-1}$	−9.04e−05	−0.000185	−0.000209
	(0.00103)	(0.00103)	(0.00109)
$EQUITY_{t-1}$	−0.00470	−0.00493	−0.00453
	(0.00910)	(0.00913)	(0.00905)
$PROFIT_{t-1}$	0.0738***	0.0735***	0.0733***
	(0.0188)	(0.0188)	(0.0189)
$GDP.GROWTH_t$	0.131	0.126	0.125
	(0.191)	(0.191)	(0.191)
$INFLATION_t$	−0.116	−0.118	−0.109
	(0.140)	(0.140)	(0.141)
$UNEMPL_t$	−0.0790	−0.0771	−0.0782
	(0.107)	(0.108)	(0.108)
Political connections:			
$PB.POL_t$	−0.0171***		−0.0317***
	(0.00571)		(0.00975)
$PB.POL.FUT_t$		−0.0129**	
		(0.00518)	
$CB.POL_t$			−0.000244
			(0.00468)
$PB.POL_t$ x $CB.POL_t$			0.0241**
			(0.0119)
Observations	3,429	3,429	3,429
Firms	624	624	624

End of Table 2

If TMBPs mean for a firm a loss of valuable managers, then we should observe decreased access to debt not only for firms whose past directors hold political positions in a given year, but generally, for all firms whose past directors became politically active at any moment in time after they had left the post at the firm (i.e., including moments following a given year). Thus, even if a past director will only go to politics in the future, her/his loss by a firm always means a lost value for a firm, as even the future political activity of this person is an ex–post evidence of his/her value. Estimations outcomes in specifications 2 and 5 corroborate our findings from specifications 1 and 4. Namely, the coefficients for the PB.POL.FUT variable are negative and statistically significant at the 5% level. Once again, they allow for the rejection of our research hypothesis. Finally, in specifications 3 and 6, we simultaneously address the effects of TMBPs and the existence of traditional political connections, that is, through the employment of former politicians at a company. The estimated coefficients for our political variables and their interaction terms document the negative effect of TMBPs as well as the moderating role of political connections understood in the traditional manner. In both specifications, the coefficients for PB.POL are still negative and statistically significant at levels below 1%, while the interaction terms of PB.POL and CB.POL are positive and statistically significant at the 5% level. Thus, personal political connections established through current directors neutralize the negative influence of TMBSs. These observations support existing empirical evidence on the positive effects that can be observed when a firm employs past politicians (e.g., Johnson & Mitton, 2003; Khwaja & Mian, 2005; Faccio et al., 2006; Claessens et al., 2008; Boubakri et al., 2012; Bussolo et al., 2022).

To validate our findings, we re–run our regression models after incorporating two adjustments. First, we removed banks and insurers from the sample as one may argue that the specificity of their business and the meaning of their financial ratios strongly deviate from other firms and cannot be easily controlled for through the positioning of all financial measures against industry–year medians. Second, having removed those firms from the sample, we added two additional regressors to our models, TAT and CASH. Both of them should positively influence access to debt, as their relatively high values provide additional evidence of a firm's creditworthiness. Table 3 presents the estimated outcomes. The results for the PB.POL and PB.POL.FUT variables fully corroborate our previous findings; that is, they allow for the rejection of the research hypothesis and show that TMBPs work to the detriment of a firm's access to debt. The only difference in relation to the outcomes in Table 2 concerns the role of political connections in their traditional meaning. Namely, while the interaction term of the PB.POL and CB.POL variables are still positive in Table 3, it loses its statistical significance.

Table 3. Board members' political activity vs. firms' access to debt: exclusion of banks and insurers (the results of the estimations for the random effects model; for brevity, we do not present a constant term; standard errors clustered at the firm–level are shown in parentheses. *, **, *** refer to significance at the 10%, 5%, and 1% levels, respectively)

	(1)	(2)	(3)
Variables:	$DEBT.GR_t$	$DEBT.GR_t$	$DEBT.GR_t$
Controls:			
$FIRM.SIZE_{t-1}$	–0.0368**	–0.0366**	–0.0369**
	(0.0146)	(0.0146)	(0.0155)
$EQUITY_{t-1}$	0.563***	0.563***	0.563***
	(0.140)	(0.140)	(0.140)
$PROFIT_{t-1}$	–0.00206	–0.00383	–0.00243
	(0.283)	(0.283)	(0.282)
$CASH_{t-1}$	0.946*	0.946*	0.946*
	(0.529)	(0.529)	(0.530)
TAT_{t-1}	0.00675	0.00669	0.00691
	(0.0186)	(0.0186)	(0.0186)
$GDP.GROWTH_t$	3.268	3.262	3.243
	(2.002)	(2.002)	(2.018)
$INFLATION_t$	0.550	0.536	0.573
	(1.515)	(1.514)	(1.523)
$UNEMPL_t$	1.055	1.062	1.056
	(0.879)	(0.879)	(0.880)
Political connections:			
$PB.POL_t$	–0.0928*		–0.138*
	(0.0498)		(0.0772)
$PB.POL.FUT_t$		–0.0900*	
		(0.0475)	
$CB.POL_t$			–0.00175
			(0.0402)
$PB.POL_t$ x $CB.POL_t$			0.0722
			(0.0836)
Observations	2,024	2,024	2,024
Firms	472	472	472
	(4)	(5)	(6)
Variables:	$LT.DEBT.GR_t$	$LT.DEBT.GR_t$	$LT.DEBT.GR_t$
Controls:			
$FIRM.SIZE_{t-1}$	–0.000377	–0.000461	–0.000495
	(0.00155)	(0.00155)	(0.00169)
$EQUITY_{t-1}$	–0.0103	–0.0105	–0.0101
	(0.0143)	(0.0143)	(0.0142)
$PROFIT_{t-1}$	0.0571**	0.0570**	0.0570**
	(0.0278)	(0.0278)	(0.0277)
$CASH_{t-1}$	–0.00461	–0.00496	–0.00514
	(0.0277)	(0.0277)	(0.0271)
TAT_{t-1}	0.00421	0.00420	0.00430
	(0.00343)	(0.00343)	(0.00344)

End of Table 3

	(4)	(5)	(6)
Variables:	LT.DEBT. GR_t	LT.DEBT. GR_t	LT.DEBT. GR_t
$GDP.GROWTH_t$	0.237	0.232	0.226
	(0.260)	(0.260)	(0.260)
$INFLATION_t$	0.0145	0.0133	0.0218
	(0.200)	(0.200)	(0.201)
$UNEMPL_t$	–0.0819	–0.0792	–0.0818
	(0.141)	(0.141)	(0.141)
Political connections:			
$PB.POL_t$	–0.0175***		–0.0278**
	(0.00661)		(0.0129)
$PB.POL.FUT_t$		–0.0135**	
		(0.00670)	
$CB.POL_t$			0.000587
			(0.00630)
$PB.POL_t$ x $CB.POL_t$			0.0160
			(0.0156)
Observations	2,020	2,020	2,020
Firms	472	472	472

Discussion and concluding remarks

In this study, we verified the main hypothesis negatively. Specifically, we failed to find any support for the presumption that TMBPs create valuable implicit political connections, which in turn improve firm access to bank financing. Even more, we established that TMBPs are associated with increased difficulty in contracting debt. The identified empirical patterns suggest that TMBPs, instead of creating implicit political connections, significantly reduce firm social capital and network connectedness. As a result, concerned companies are no longer able to realize the benefits of having social ties (Engelberg et al., 2012; Fogel et al., 2018; Skousen et al., 2018; Cucculelli et al., 2019; Jackowicz & Kozłowski, 2019; Togan Egrican, 2021). Interestingly, the traditionally understood political connections, which are connections established through current employees with political experience, offset the negative effects of TMBPs. It should be noted that while consequences of TMBPs are directly studied in our paper, the conclusions concerning changes in social connections are only indirectly substantiated by our results.

When we relate our findings to the existing works on the relevance of political connections in Central European countries, we notice that our results confirm previous conclusions. Namely, the fact that traditionally understood political connections offset the negative impact of TMBPs on access to debt corresponds well with research outcomes reported by Hasan et al. (2017) for Poland and by Bussolo et al. (2022) for six countries in this region. In contrast, when we compare our findings to the literature on transfers from business to politics, important differences emerge. Bunkanwanicha and Wiwattanakantang (2009) show that firms controlled by tycoons who enter politics perform extraordinarily well. Feng et al. (2015) add that entrepreneurs' political participation has a strong, positive influence on long–term stock and operating performance. The divergence in the results reported in this paper and in the previous studies stems from the fact that we analyze transfers of managers and board members to politics, instead of transfers involving firm founders and owners who have stable and long–term ties to their firms, regardless of current political activities.

Our study also has managerial implications. Managers and board members should be aware that social ties may quickly lose value once formal ties to a firm end. Consequently, the loss of directors with extensive social networks may damage a firm via limited access to scarce physical and financial resources. The fact that we observe a statistically negative impact of TMBPs on access to debt suggests that lost social connections are difficult to rebuild.

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