Research briefing

Leverhulme Centre
for Research on Globalisation and Economic Policy

Politics and generosity in China

Political Affiliation and Trade Credit Extension by Chinese Firms

By Simona Mateut and Alessandra Guariglia

A study published by GEP has shed new light on how political affiliations help shape the behaviour of private firms in China's state-dominated business arena.

The research examined data for tens of thousands of companies to investigate whether political ties influence how firms use their financial resources.

It found those with strong links to government not only enjoy better access to funding but are also more likely to extend trade credit to their business partners.

The finding offers what is thought to be the first evidence of how the link between political affiliation and trade credit has helped fuel China's economic rise.

Research basis

The research drew on data from annual accounting reports filed with China's National Bureau of Statistics by over 70,000 firms during the period from 2000 to 2007.

The companies in the sample operated in all 31 provinces or province-equivalent municipal cites, and each had annual sales of more than five million yuan.

Key information contained in the data included ownership type, product characteristics and degree of political affiliation – specifically, high, medium or none.

Observations with negative sales and negative total assets were dropped from the sample, as were firms with fewer than five consecutive observations.

The final panel contained more than 420,000 firm-year observations for over 72,000 companies.

Comments and implications

Co-author Dr Simona Mateut, a Lecturer in Industrial Economics at Nottingham University Business School, believes the research offers a fresh insight into how China's private firms survive and compete.

She said: "Previous studies have suggested trade credit hasn't been a significant factor in the rapid growth of China's private sector.

"This is perhaps surprising, as it should play a prominent role in an emerging economy in which private firms receive limited support from the banking system.

"The story that comes out of our research is that private companies in China use political affiliation to gain access to external funding in a state-dominated market.

"They then redistribute that funding to their business partners through trade credit – effectively reducing the inefficiencies of state-owned banks' lending policies."

Key findings

- Political affiliations help shape the behaviour of private firms in China's state-dominated business arena.
- In general, those with strong links to government not only enjoy better access to funding but are also more likely to extend trade credit to their business partners.
- Companies with links to the highest levels of government – central or provincial – are most likely to extend trade credit.
- Firms with links to more localised forms of government are less likely to do so, while those with no political affiliation are the least likely of all.
- The extension of trade credit deserves consideration when explaining the growth of China's private sector and the country's economy in general.

The Chinese banking sector's attitude to loans has long been criticised for favouring state-owned enterprises (SOEs) and discriminating against private firms.

Until 1998 state-owned commercial banks could lend only to SOEs, and even now they still consider private businesses riskier than their public-owned counterparts.

But establishing ties with local, provincial or central government offers a valuable method of increasing the chance of securing external funding, says the study.

This in turn leads to a trickle-down effect as politically affiliated firms "redistribute" bank loans by extending credit to the companies with which they do business.

Dr Mateut added: "We found access to funding is influenced by a various factors, including capital ownership, industry characteristics and political connections.

"Firms that enjoy better access – for example, state-owned enterprises – extend more trade credit, so alleviating their business partners' financial constraints.

"Crucially, however, once we control for affiliation with government, the differences between how firms owned by different agents extend trade credit disappears.

"In particular, because they have the same sort of favourable credit conditions, private firms with strong political connections behave similarly to SOEs."

The study found companies with links to the highest levels of government – central or provincial – most likely to extend trade credit to their business partners.

Firms with links to more localised forms of government were discovered to be less likely to do so, while those with no political affiliation were the least likely of all.

Dr Mateut said the study added to the overall understanding of how private firms are able to endure in an "underdeveloped market dominated by the state".

She said: "Overall, our findings suggest political affiliation may reduce the imbalances in resource allocation arising from discrimination by state-owned banks.

"They also suggest the extension of trade credit deserves consideration when explaining the growth of China's private sector and the Chinese economy in general."

Globalisation and Economic Policy Centre (GEP)

Based at the University of Nottingham in the UK and primarily funded by grants from the Leverhulme Trust, GEP is the major centre in Europe studying the impacts of globalisation and economic policy.

In January 2008 it opened GEP in Malaysia at the University of Nottingham's purpose-built Semenyih campus, 30km from Kuala Lumpur. In November 2008 it launched GEP in China at the University of Nottingham, Ningbo, China.

GEP is keen to promote its research work and is committed to communicating its expertise. Its academics have advised the Treasury, the OECD, the World Bank and the WTO.

www.nottingham.ac.uk/gep

Research co-authors

Dr Simona Mateut is a Lecturer in Industrial Economics at Nottingham University Business School. Her research interests include macroeconomics, applied microeconometrics, credit market imperfections, monetary policy transmission, household indebtedness and migration.

Alessandra Guariglia is a Professor of Financial Economics at Durham University and a GEP External Research Fellow. Her research interests include the links between macroeconomic activity and finance, the economics of transition in China and Eastern Europe and the determinants of household saving and consumption decisions.

For more information, contact:

Sue Berry, GEP
Telephone: +44 (0) 115 951 5469
Email: sue.berry@nottingham.ac.uk