



BALTIC JOURNAL OF LAW & POLITICS

A Journal of Vytautas Magnus University
VOLUME 15, NUMBER 2 (2022)
ISSN 2029-0454



Cite: *Baltic Journal of Law & Politics* 15:2 (2022): 650-667
DOI: 10.2478/bjlp-2022-001040

THE INFLUENCE OF POLITICAL CONNECTIONS AND OWNERSHIP ON FIRM PERFORMANCE IN PAKISTAN

Muhammad Saif ul Islam

Email: saifyislamhcc@gmail.com

School of Economics, Finance and Banking, Universiti Utara Malaysia

Woei-Chyuan Wong

Email: wwchyuan@uum.edu.my

Economic and Financial Policy Institute (ECOFI), School of Economics, Finance and Banking, Universiti Utara Malaysia, 06010 Sintok, Malaysia

Mohd Yushairi bin Mat Yusoff

Email: mohdyushairi@uum.edu.my

School of Economics, Finance and Banking, Universiti Utara Malaysia

Received: July 28, 2022; reviews: 2; accepted: October 30, 2022.

Abstract

This paper examines the effect of political connections and ownership structure on Pakistani firms' performance during the period 2010 to 2019. Consistent with the prediction of agency theory, political connection variable is negative and significantly associated with firm performance as measured by ROE, ROA, and Tobin's Q. We find evidence of the negative (positive) impact of family ownership (institutional and foreign ownership) on Tobin's Q. Further tests reveal that foreign ownership strengthens the positive association between political connections and firm performance. A plausible explanation to this finding is that firms with high foreign ownership are more able to meet international norms of good governance and corporate practices, which mitigate the potential agency issues arise from political connections. Lastly, we find 2018 general election to exacerbate the negative impact of political connection on Tobin's Q. Policymakers in Pakistan ought to implement stricter regulatory measures to limit the possible conflict of interest in politically connected firms.

Keywords

Political connections, ownership structures, firm performance, election years, Pakistan

Introduction

There is an ongoing academic debate on politicians' interference in commercial business activities (Harymawan & Nowland, 2016; Wang et al., 2017).

Previous studies have shown that agency costs tend to be high in state-owned and politically connected firms (Wang et al., 2017; Shleifer & Vishny, 1994). This line of the literature suggests that government used their political influence and connections to control firms' operational decisions (Harymawan & Nowland, 2016; Wang et al., 2017). For example, the government can through politically connected individuals exert pressure on firms to provide employment benefits and favors to political supporters that deviate from firms' profit maximization objective (Roe, 2003; Wang et al., 2017). They may also extract wealth from connected firms in the form of welfare expenditures, donations, campaign contributions, and bribes (Claessens et al., 2008). Supporting the value-destroying of political connections, previous studies showed that politically linked companies suffer from a variety of issues including weak performance (Rusmin et al., 2012), low earnings quality (Hashmi et al., 2018), corruption & operational inefficiencies (Siddiq, 2007) and lack of investor protection (Faccio, 2006, 2010).

On other side, resource dependence theory is used to explain the positive effects of political connections on the performance of an organization. This theory postulates that firms require power in order to exert influence over external resources and to obtain favorable legal and corporate conditions. Likewise, corporations are required to engage in the political sphere in order to create and promote healthy relations with elected officials. These ties may include contributions to campaigns, friendships, family, and social networking (Blau et al., 2013). Additionally, businesses may appoint retired or incumbent high-ranking officials, senior military and political leaders to their boards of directors to reap the benefits of their ties (Chen et al., 2014). This incentivizes companies to form connections with politicians or elected officials (Hillman et al., 2009). These political links will help reduce a range of uncertainties for the business emanating from legal enforcement to government policies (Hillman, 2005). The links would also improve the chances of a business's survival in response to external shocks, fluctuations, and transaction costs (Deegan, 2013; Hillman, 2005). Politically connected companies would also benefited from larger access to bank loans, higher market value, and lower taxation (Faccio, 2010; Khwaja & Mian, 2005; Faccio et al., 2006).

Pakistan provides a unique setting for exploring the effect of political ties on performance of firm. Pakistan is ranked as one of the most corrupt countries around the world as per Transparency International's "Corruption Perception index" in 2020 (124/180). Seven political regimes were dissolved over the past 30 years¹, amid claims of political malpractices and corruption. Pakistan also ranks poorly in World Governance Indicators (WGI) in 2020 scoring low in Control of Corruption (22.11 %), Absence of Violence & Political Stability (5.19 %), Effectiveness of Government (31.73 %), Rule of Law (25.48 %), Regulatory Quality (24.03 %), and Voice and

¹ There were 7 general elections in Pakistan over 30 years held in years 1990,1993,1997,2002, 2008,2013 and 2018. Syed Pervaiz Musharraf who was the military dictator imposed the martial law in 1999 and he resigned on august 18, 2008. Furthermore, in Pakistan democratic elections were 1990,1993,1997,2008,2013 and 2018.

Accountability (23.19 %). After independence in 1947, politicians have profoundly influenced the businesses in Pakistan. Well known businessmen such as Yusuf Haroon, Ahmed Dawood, Abdul Razak Dawood, and Anwar Saifullah all had held main positions in the government and political parties². Furthermore, business tycoons also control the leadership of the current leading political parties. Politicians with ties to corporate groups utilize their positions in government to defend their economic interests. For example, Saeed et al. (2019) argued that a well-known newspaper of Pakistan, The News, documented how, between 2002 and 2007, National Bank of Pakistan and United Bank Limited made a Rs. 120 million loan to the President of the "Pakistan Muslim League Quaid e Azam" (PML-Q) (President of PML-Q is the founder of Chaudhary group) against their mills on favourable conditions, which was later written off (Aklilu & MAKALELA, 2020).

In addition, there are substantial studies in the USA, Canada, and European continental countries on the ownership structure as a mechanism of corporate governance (Alhababsah, 2019). In many developing economies such as Pakistan, the legal framework does not provide sufficient protection for investors in concentrated firms. Despite having clear laws, the enforcement is weak in Pakistan. For example, weak enforcement of the law of bankruptcy encourages owners (especially those who have strong ties or connections) to deliberately default on bank loans to avoid giving back the money to the lenders (Khwaja & Mian, 2005). The country has been trapped in a vicious cycle of bad governance, sustainability, and economic issues since its independence (Hashmi et al., 2018; Siddiqa, 2007). The prevailing literature discusses a number of governance challenges faced by Pakistan that include fragile governance reforms which favor the concentrated family organization rather than safeguard minority shareholders (Rustam et al., 2019). Family-dominated boards are less capable of protecting the rights of minority shareholders and risk losing competitiveness as other non-family-dominated boards grow more professionally. Several existing studies have reported the negative effect of concentrated/blockholder ownership on firm value (Wang & Sahiler, 2015) and companies performance (Wang & Sahiler, 2015). Previous research indicates that agency issues due to concentrated/blockholder ownership have not been extensively investigated. Korkmaz et al. (2017) argued that most studies in the literature make the implicit assumption that blockholders are a homogeneous group and analyze the impact of their existence alone. However, blockholders are heterogeneous in nature, and only a few studies acknowledge their heterogeneity. Furthermore, ownership

² Yusuf Haroon was a founding member of the Dawn newspaper, Chief Minister of Sindh (March 1969 – September 1969), Ahmad Dawood is the founder of Dawood Hercules Corporation, Advisor to Pakistan's former president Field Marshall Ayub Khan on trade and industry affairs, Abdul Razzak Dawood is the founder of Descon group and current Federal Minister of commerce, PTI , 2 Anwar Saifullah is industrialist and Federal Minister of Environment and Urban Affairs, Muslim League (1991 – 18 July 1993). Nawaz Sharif, the owner of Ittefaq Foundries, is the president of the PML-N, while Chauhadry Shujaat Hussain, the owner of Chauhadry Group is the president of the PML-Q.

patterns differ in developing nations like Pakistan (highly concentrated), where the conflict of interests is likely to be between minority and majority shareholders rather than managers and stockholders as in the United Kingdom and America. Previous research has not examined the influence of the different types of ownership structure such as institutional ownership, foreign ownership, and family ownership in the Pakistani setting (Alnabulsi & Salameh, 2021; Asha & Makalela, 2020).

In addition, political instability has been an invariable phenomenon in Pakistan. Except for governments supported by military dictators, most previous elected governments were not able to complete their tenure. The military rulers had either dismissed or replaced these democratically elected governments on the grounds of inefficiency, wrongdoing, nepotism, and corruption. It was for the first time in 2013 that the Pakistan People's Party (PPP) government, established after the 2008 general election manage to complete its five-year term followed by Pakistan Muslim League Nawaz (PMLN) and Pakistan Tehreek e Insaaf (PTI). Moreover, at the time of writing, no political party is able to rule for two consecutive terms. Political instability could be one of the reasons leading to a drop in Pakistan's gross domestic product growth in 2019 from 5.8% to 1.0% in 2018 after the 2018 general election.

In this paper, we attempt to contribute to the literature in the following ways. First, this paper aims to investigate the influence of political connections on firms performance measured by Tobin's Q, ROE, and ROA. We chose to focus on Pakistan due to the prevalence and strong influence of politicians on businesses in this country. As to be discussed in the result section, 76.8% of the listed firms in Pakistan are politically linked companies. Secondly, this study investigates whether ownership structure moderates the effect of political connections on performance of firm in Pakistan. Thirdly, we investigate the moderating effect of the 2013 and 2018 election years on the relation between political connections and performance of firm. To our best knowledge, this test has not been investigated in the literature.

Research Hypothesis Development

Political Connections and Firm Performance

Under the agency theory paradigm, political interference could cause serious agency issues to connected firms (Faccio, 2010; Siddiq, 2007; Wang et al., 2017). This is because connected firms may suffer from pressures by politicians that distract firms from their underlying goal of maximizing the wealth of shareholders (Hashmi, 2018; Roe, 2003). As a result, the following hypothesis is proposed:

H1: Politically connected firms exhibit significantly lower firm performance than non-connected firms.

On the other hand, under the resource dependence theory, connections are value enhancing. Previous studies have reported that political connections offer precious resources for companies in terms of favorable relationship-based contracts and greater access to external finance (Houston et al., 2014; Claessens et al.,

2008), which in turn improve the firms' performance. As a result, the following hypothesis is proposed:

H2: Politically connected firms exhibit significantly higher firm performance than non-connected firms.

Ownership Structure and Firm Performance

As in the connection variables, the influence of ownership structure on performance of firm can go in both directions. One strand of the literature indicates that conflict of interest between owners and managers can be mitigated through the presence of institutional and foreign investors. Institutional ownership plays a vital role by voting on important decisions that serve the firm well by abstaining firms from making decisions that are detrimental to the minority shareholders. Because of their superior managerial abilities and vast resources, institutional investors (as major shareholders) eliminate information asymmetries, reduce agency problems, and maximize shareholder value. Furthermore, by exercising their ownership rights, these institutional investors can exert pressure on managers to enhance corporate governance (Lin & Fu, 2017; Shleifer & Vishny, 1986). On the other hand, it is more likely that corporations with foreign investors will adhere to global standards of good governance and corporate practices, have more diverse holdings, and have improved monitoring capacities (Jackson & Strange, 2008) which in turn reduces the asymmetries through enhanced information level. As a result, the following hypothesis is proposed:

H3: There is a positive relationship between institutional and foreign ownership and firm performance.

The literature has shown have that family ownership and control exacerbate agency costs as family owners derive personal benefits by abusing their dominant position at the minority shareholders' expense (Wang & Sahiler, 2015). Furthermore, family owners are regularly invited to engage in the organization's strategy-making process (Eddleston & Kellermanns, 2007) and the employment of employees based on family ties rather than their qualifications and experience (Kellermanns & Eddleston, 2004). Therefore, the management and governance authorities of such companies are inefficient, as well as marked by a less professional attitude (Martinez et al., 2007). As a result, the following hypothesis is proposed:

H4: There is a negative relationship between family ownership and firm performance.

Furthermore, the impact of political connection on performance of firm could be moderated by individual firms' ownership structure. For instance, the presence of foreign and institutional investors may mitigate the agency issues arises from connections discussed above. In addition, family ownership may further exacerbate the negative impact of connections on firm value. We, therefore, examine the interactive effects of ownership on the relation between political connections and performance of firm. The positive value of the ownership-connection interaction

terms will support resource dependence theory. The negative value of ownership-connection interaction terms on the other hand will support agency theory. As a result, the following hypothesis is proposed:

H5: Ownership structure moderates the relation between political connections and firm performance.

Effects of General Elections

The above discussion on political connections in Pakistan demonstrates that the boards of Pakistani firms are closely associated to political positions rather than professional positions. It is reasonable to believe that during the election period, conflict of interest would intensify in connecting firms making them more probable that be exploited by connected parties (e.g., use of company resources to fund election campaigns). As a result, the following hypothesis is proposed:

H6: The association between political connections and firm performance is significantly different between election years than non-election years.

Research design

Sample and data sources

The sample for this paper consists of non-financial firms listed on the Pakistan Stock Exchange during the period 2010 to 2019. Financial sector is excluded due to its different regulatory framework as compared with other non-financial firms. All the firm-level financial variables used in this paper are collected from Datastream. The final sample comprises 257 firms covering 24 business sectors as shown in Table 1 below. Textile, allied industries & sugar, chemical, and cement sectors constitute of 49% of total firms in our study.

The political associations of the senior management staff and directors in a listed firm are hand collected from individual firms' audited annual reports and Pakistan's National Assembly (NAP) and Election Commission of Pakistan (ECP) websites³. These websites give the complete list of contested candidates for the provincial and national constituencies since 1970. We then matched with the names of the board of directors and senior management staff as shown in the annual reports with this name list to determine directors and senior management staff that are connected to political parties. We further complement our checking by identifying directors and senior management staff whom is a state's current or former president, prime minister, cabinet minister, high ranked government official, or parliament member as reported in the annual report's director and senior management profile section. This definition is similar to those used Faccio (2006), Hashmi et al. (2018) and Wong & Hooy (2018) to determine political connection persons.

³ <https://na.gov.pk/en/index.php> (NAP website), <https://www.ecp.gov.pk/> (ECP website).

Table 1: Distribution of final sample by Sector

Sector	Number of Companies	Obv.	Percent
Textile	61	589	23.77
Allied Industries & Sugar	26	246	9.92
Chemical	21	210	8.47
Cement	17	170	6.86
Automobile	16	160	6.46
Personal Care Products & Food	11	110	4.44
Power Generation & Distribution	11	103	4.15
Oil & Gas Companies	10	96	3.87
Engineering	10	96	3.87
Miscellaneous	9	86	3.47
Technology & Communication	10	82	3.31
Pharmaceuticals-	8	76	3.07
Glass & Ceramics	7	70	2.82
Rayon & Synthetic	7	68	2.74
Paper & Board	6	60	2.42
Fertilizer	7	59	2.38
Electrical-Goods & Cable	5	50	2.02
Refinery	4	40	1.61
Transport	4	38	1.53
Leather & Tanneries	2	20	0.81
Tobacco	2	20	0.81
Jute	1	10	0.40
Vanaspati	1	10	0.40
Woolen	1	10	0.40
Total	257	2479	100.00

Variables and Measurements

The dependent variables for this paper are Tobin's Q, ROE and ROA. Political connections and ownership variables are the key explanatory variables. ROA is measured as the net income divided by total assets. ROE is measured as the net income divided by total equity. Tobin's Q is measured as the ratio of the market value of equity plus the book value of debt divided by the book value of assets. These ratios have been widely used in previous studies as proxies for firm performance (see, for example, Aldhamari et al., 2020; Mohamed et al., 2014; Eissa & Eliwa, 2021; Maaloul et al., 2018).

Political connection⁴ is a dummy variable equal to one for connected firms and 0 for non-connected firms (Hashmi et al., 2018; Momon et al., 2021). In order to measure the effect of political uncertainty during the election years, we create two dummies for the years 2013 and 2018. Dum13 (Dum18) is a dummy variable that is equal to 1 for year is 2013 (2018) and zero otherwise. Ownership structure is measured using three ownership variables that include institutional ownership, family ownership, and foreign ownership. Institutional ownership is measured as percentage of shares owned by institutional investors divided by the total number of outstanding shares. Family ownership is measured as percentage of shares owned by family members divided by the total number of outstanding shares. Foreign ownership is similarly defined as percentage of shares owned by foreign investors divided by the total number of outstanding shares (see, for instance, Anderrson et al., 2012; Azhar et al., 2019; Chen et al., 2017; Hicheeon et al., 2008; Lei & Chen, 2019; Shahzaad et al., 2019).

Firm age, leverage, and firm size are used as the control variables. These firm level characteristics have used by the previous studies on the determinants of firm performance (for instnace, Chen et al., 2011; Shahzad et al., 2019). We measured the leverage by dividing total debt by total assets. Firm age is measured as the natural log of the number of years when the company is formed and firm size is measured as natural log of total assets.

Empirical Regression Equations

To investigate the effect of political connections (PC) and ownership structures on firm performance, this study conducts a panel fixed effects regression analysis on the following equation:

$$\text{FirmPerformance}_{it} = \beta_0_{it} + \beta_1 PC_{it} + \beta_2 \text{Ownership}_{it} + \beta_3 \text{Control variables}_{it} + \mu_{it} \quad (1)$$

where, i indicates the firm and t indicate the year. Firm performance is obtained from three different measures, i.e., ROA, ROE and Tobin's Q. The positive value of the coefficient of PC will support resource dependence theory while the negative will support agency theory. Ownership structure consists of a family, foreign and institutional ownership variables. The control variables include leverage, firm size, and firm age.

Equation (2) is the expanded model used to test the moderation impact of ownership structure on the association between political connections and firm performance.

$$\text{FirmPerformance}_{it} = \beta_0_{it} + \beta_1 PC_{it} + \beta_2 PC_{it} * \text{Ownership} + \beta_3 \text{Ownership} + \text{Control variables}_{it} + \mu_{it} \quad (2)$$

⁴ The political association can be established either directly or indirectly. Direct relations are established through politicians' formal business relationships in the company. For instance, a company establishes a political link when a politician formally enters or becomes a director, a business partner, and a key shareholder/owner in the company. Indirect political ties on the other hand grow informally through friendships between the top management and politicians. In addition, Indirect political ties can also emerge, among other factors, from company donations or contributions in the campaign of a political party at election time.

The key variables of interest for this equation are the ownership-connection interaction-terms (PC*Ownership). Findings from these interaction terms will allow us to know whether ownership variables strengthen or weaken the impact of connection variables on firm performance.

The final stage of our empirical strategy is to investigate the moderating impact of election years on the association between political connections and firm performance using equation (3) below:

$$FirmPerformance_{it} = \beta_0_{it} + \beta_1 PC_{it} + \beta_2 PC_{it} * 2013 Election + \beta_3 PC_{it} * 2018 Election + \beta_5 2013 Election + \beta_5 2018 Election + \beta_5 Ownership \text{ as in (1) + Control variables} + \mu_{it} \text{ (3)}$$

The general elections in Pakistan were officially held in 2013 and 2018. Therefore, 2013 Election and 2018 Election is a dummy variable that is equal to 1 if the year is 2013 and 2018 respectively and zero otherwise. We expect the PC*Election-year interaction terms to be negative and significant supporting of hypothesis that agency costs due to political connection are exacerbated during the election years.

Empirical results and Discussion

Descriptive results

Table 2 displays the descriptive statistics for all the variables in the regression models. The mean value of the ROA and ROE are 4.80% and 11.93% respectively. The average value of Tobin's Q is 1.08 implying that share prices are fairly priced against their book value. ROA and ROE averaged 4.8% and 11.9% respectively. 76.8 % of firms are politically connected. This is high compared to 48% in Malaysia (Wong & Hooy, 2018), 60% in China (Wang et al., 2018) but lower than the Indonesia where is 89% firms are politically connected (Sakti et al., 2020).

The mean value of institutional, foreign, and family ownership are 9.36%, 5.13% and 24.49% respectively. These values are low as compared to other Asian countries as reported in the literature. For example, family and foreign ownership in China are 35% and 8.17% respectively as per Chen et al., (2017) and Mai & Hamid (2021). Family ownership is 38% as per Ng et al (2015)'s study in Malaysia and institutional ownership is 22.55% in china as per Lin & Fu (2017). The mean value of firm age is 36.24. Further, the mean value of firm size is 13.69 billion Rs. Finally, mean value of leverage is 58.7% which shows that most of the Pakistani firms are highly leveraged on average.

The Pearson correlation matrix reported in table 3 suggests that multicollinearity is not a serious problem. Similarly, variance inflation factor (VIF) values for all regression models of lesser than two further reinforce the fact that there is no serious issue of multicollinearity in this study.

Table 2: Descriptive Statistics

Variable	Mean	Std. Dev.	Min	Max
ROA	4.802	6.415	-5.221	15.831
ROE	11.934	13.672	-11.221	34.248
Tobin's Q	1.083	0.435	0.609	2.022
Political Connections	0.768	0.422	0	1
FamilyOwnership	24.485	27.333	0	98.8
InstitutionalOwnership	9.362	10.32	0	98.81
ForeignOwnership	5.131	14.252	0	89.23
Firm Age	36.239	16.927	2	106
Firm Size (Rs in Billion)	13.693	16.608	0.906	52.099
Leverage	0.587	0.291	0.004	3.146

Table 3: Correlation Matrix

	1	2	3	4	5	6	7	8	9	10
ROA (1)	1									
Tobin's Q (2)	.337**	1								
ROE (3)	-0.015	0.027	1							
Political Connections (4)	0.03	.129**	0.001	1						
Family Ownership (5)	-.133**	-.220**	0.003	-.201**	1					
Institutional Ownership (6)	.075**	-.044*	0.029	.105**	-.246**	1				
Foreign Ownership (7)	.205**	.207**	-0.003	.117**	-.212**	0.011	1			
FirmAge(8)	-0.013	.048*	0.006	.077**	-0.011	.076**	.053**	1		
FirmSize(9)	.155**	.110**	-0.012	.214**	-.313**	.147**	.157**	-0.01	1	
Leverage(10)	-.483**	.192**	.066**	0.038	.057**	-0.031	-.129**	-0.023	0.013	1

Note: ** $p < 0.05$

Regression Analysis

Table 4 shows the estimations result for the effect of political connections and ownership structure on performance of firm using a two-way fixed effect estimator⁵. The findings in columns (1) to (3) display that political connections have a negative and significant effect on a firm performance at the 1% level across all three performance indicators. This indicates that political connections destroy firm's values where political involvement distract managers from their underlying goal of

⁵ The Hausman specification test was performed to examine whether the fixed or random effect estimator is appropriate for our panel dataset. The test results suggest that the fixed effect estimator is appropriate for this research.

maximizing the wealth of shareholders as predicted by agency theory. These results are consistent with previous papers such as Pang & Wang, (2021), Wang et al. (2017) and Shleifer & Vishny (1994) that found political connections to be adversely connected to performance of firm.

Turning to the ownership variables, family ownership has a negative and significant effect on ROE and Tobin's Q which support the argument that family owners tend to abuse their dominant position at the cost of minority shareholders (Wang & Sahiler, 2015). The coefficient for institutional ownership on the other hand is positive and significantly positive related to ROE supporting the monitoring roles of institutional investors in alleviating agency issues in a company. Similarly, foreign ownership is positive and significantly associated to firm performance measured by Tobin's Q and ROA. Combine with the findings from institutional investors, these findings suggest the important roles of external capital providers in strengthening firms' corporate governance practices (Gillan & Starks, 2003), hence, improve firms' performance.

Findings for the control variables show that the firm age has a positive effect on firms' operating performance (ROA and ROE) suggesting older firms tend to perform better possible due to their longer track record (reputation) and better access to capital than their younger counterparts. In addition, Leverage have a significant negative effect on firms' operating performance, but exert a positive impact on Tobin's Q. Furthermore, Firm size is negative and significantly related to operating performance, but exert no impact on firms' valuation measured by Tobin's Q.

Table 4: Effect of political connections, ownership structure on firm performance

Model	1	2	3
Technique	(Fixed Effect)	(Fixed Effect)	(Fixed Effect)
VARIABLES	ROA	ROE	Tobin's Q
PC	-12.29*** (0.356)	-27.43*** (8.492)	-0.323*** (0.0208)
FamilyOwnership	-0.00301 (0.0169)	-0.0947*** (0.0272)	-0.00210** (0.000860)
InstitutionalOwnership	0.0239 (0.0240)	0.0748* (0.0447)	-0.000374 (0.00143)
ForeignOwnership	0.0575** (0.0269)	0.0727 (0.0562)	0.00595*** (0.00209)
Firm Age	9.510*** (3.186)	25.15*** (6.775)	-0.0676 (0.257)
Firm Size	-5.106*** (1.493)	-5.191*** (1.880)	-0.101 (0.0724)
Leverage	-9.581*** (1.379)	-6.664*** (1.658)	0.476*** (0.0592)
Constant	55.35*** (14.61)	53.67** (21.91)	1.992** (0.832)
Observations	2,479	2,479	2,479
R-squared	0.142	0.046	0.270
Year effects	Yes	Yes	Yes
Firm effects	Yes	Yes	Yes
Wald chi2	4962.83	6.67	1121.31

Note: "Standard errors in parenthesis that are robust, *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

In this section, we examine the moderating effect of ownership structure on the relation between political connections and performance of firm. The regression results are reported in table 5. Columns 1-2 show that the coefficients of political connections remain negative and strongly significant under the expanded regression model. Except for the foreign ownership-PC interaction term which is positive and significant at 10 percent level, none of the interaction terms is statistically different from zero. This implies that foreign ownership weakens the agency issues due to political connections supporting the positive monitoring roles played by this group of investors. The insignificance of most the interaction variables implies that ownership structure generally plays a minimal role in mitigating or exacerbating the agency issues associated with political connections.

Table 5: Moderating effect of ownership structure on firm performance

Model	1	2	3
Technique	(Fixed Effect)	(Fixed Effect)	(Fixed Effect)
VARIABLES	ROA	ROE	Tobin's Q
PC	-12.32*** (0.378)	-27.51*** (8.500)	-0.332*** (0.0213)
FamilyOwnership	-0.0230 (0.0310)	-0.139*** (0.0465)	-0.00369** (0.00172)
InstitutionalOwnership	0.0113 (0.0573)	0.0379 (0.118)	-0.00374 (0.00351)
ForeignOwnership	0.0197 (0.0459)	0.0266 (0.172)	-0.000560 (0.00319)
PC* FamilyOwnership	0.0303 (0.0368)	0.0676 (0.0573)	0.00239 (0.00201)
PC* InstitutionalOwnership	0.0160 (0.0620)	0.0450 (0.126)	0.00410 (0.00385)
PC* ForeignOwnership	0.0434 (0.0536)	0.0544 (0.182)	0.00749* (0.00392)
Firm Age	9.520*** (3.176)	25.22*** (6.782)	-0.0687 (0.257)
Firm Size	-5.133*** (1.500)	-5.231*** (1.884)	-0.103 (0.0729)
Leverage	-9.601*** (1.372)	-6.717*** (1.662)	0.472*** (0.0601)
Constant	55.62*** (14.69)	54.03** (21.94)	2.016** (0.833)
Observations	2,479	2,479	2,479
R-squared	0.143	0.047	0.273
Year effects	Yes	Yes	Yes
Firm effects	Yes	Yes	Yes
Wald chi2	1051.83	5.69	175.24

Note: "Standard errors in parenthesis that are robust, *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$ "

Table 6 displays the estimations result for the moderating effect of election years on the association between political connections and performance of firm. The elections could intensify the agency costs of connection as corporate resources could have been used by connected parties to fund election campaigns during the election years. We find evidence supporting this hypothesis in Tobin's Q' equation where the interaction term 2018 Elections*PC is negatively significant at the 10% level. This suggests that agency issues of political connections were intensified during the 2018 election year. We however do not observe a similar phenomenon in the election year 2013 where the 2013 Elections*PC interaction term is not significant. The insignificance of political connection variable in Column 3 suggests that agency issues reported in our base results in Table 5 are driven by the election year in 2018.

Table 6: 2013 and 2018 elections effect on political connections and firm performance

Model	1	2	3
Technique	(Fixed Effect)	(Fixed Effect)	(Fixed Effect)
VARIABLES	ROA	ROE	Tobin's Q
PC	-6.967* (3.558)	-17.31** (7.228)	-0.128 (0.118)
2013 Elections * PC	-0.492 (0.606)	-1.193 (1.506)	0.0243 (0.0264)
2018 Elections * PC	-0.900 (0.588)	-0.0274 (1.635)	-0.0884** (0.0396)
FamilyOwnership	-0.00302 (0.0170)	-0.0949** (0.0384)	-0.00209** (0.000845)
InstitutionalOwnership	0.0241 (0.0241)	0.0745 (0.0620)	-0.000335 (0.00143)
ForeignOwnership	0.0575** (0.0269)	0.0719 (0.0720)	0.00598*** (0.00211)
Firm Age	9.611*** (3.180)	25.47*** (8.449)	-0.0689 (0.258)
Firm Size	-5.082*** (1.492)	-5.189 (3.273)	-0.0992 (0.0727)
Leverage	-9.630*** (1.372)	-6.756** (2.688)	0.473*** (0.0594)
Constant	50.88*** (14.62)	45.41 (34.06)	1.824** (0.828)
Observations	2,479	2,479	2,479
R-squared	0.141	0.045	0.271
Year effects	Yes	Yes	Yes
Firm effects	Yes	Yes	Yes
Prob > F	10.07***	4.32***	23.58***

Note: "Standard errors in parenthesis that are robust, *** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$ "

Conclusion and Recommendations

The literature suggests that political connections should be examined since there exists a debate as to whether connections will destroy or enhance firm performance. We discover that political connections are prevalence across listed companies in Pakistan where 76.8% of our sample firms are political connected firms. Faccio (2006) argues that poor governance systems, ineffective legal frameworks, and high levels of corruption all contribute to a fertile climate that fosters the emergence of political connections. Using the firm fixed effect estimation technique, we find that political connections exert negative and significant effects on firm performance which supports the agency theory arguments. Furthermore, the outcomes show that family-ownership tends to destroy performance of firm (ROE and Tobin's Q) while institutional and foreign ownership are found to enhance firm performance.

In addition, we have also examined the moderating effect of ownership structure and election years on our base results. We find foreign ownership to reduce the agency issues caused by political connections. Specifically, the coefficient for the foreign ownership-political connections is positive and significant in the Tobin's Q equation. Consistent with our expectations, we find election year in 2018 to exacerbate the agency issues of political connections as compared to other non-election years. The coefficient for the Election year-political connections interaction term is negative and significantly in Tobin's Q equation. We, however, do not find 2013 election year-political connection interaction term to be significant in any of the performance equation.

The findings of this paper suggest political connections are harmful to firm performance. It is important for the policymakers to articulate more efficacious laws to restraint conflict of interest arise from political connection. For example, it is essential for management to prevent rent-seeking dealings and to make dealings that are efficient. Policymakers must have to form solid monitoring procedures, particularly for low-performing politically connected firms, in order to protect the interests of minority-shareholders. In addition, policymakers can make a minimum shareholding spread requirement for public listed companies like in Malaysia (25% of the company's shares must be held by the public). Hence, the outcomes of this study help regulators to have a better understanding of the fundamental issues due to political instability and heavy corruption in Pakistan, and their effects at the organizational level. Our results further suggest that foreign and institutional ownership matters. They tend to increase firm performance and help alleviate agency issues due to political connections (foreign ownership). The Pakistani government should therefore stir up the participation of this class of investors in the capital market. While we consider our findings to be generalized to several other developing countries with comparable socio-economic conditions with Pakistan, we leave that empirical task to future research.

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