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# POLITICAL CONNECTIONS and FIRM PERFORMANCE: EVIDENCE FROM VIETNAMESE SMES

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The current paper investigates the role of political connections in firm performance under various conditions of market competition and institutions in Vietnam. By employing a three-year panel-data survey from 500 small and medium-sized enterprises and a fixed-effects model controlled for unobserved invariants, estimation results show that political connections with servants positively affect the performance of their firms when firm and industry effects and endogeneity of political connections are controlled. We also find that the positive impacts of political connections on firm performance vary with market competition, as in the case of Vietnam. We further find that political connections are significantly negative to firm performance in the conditions of weak market institutions in the case of Vietnam (the first stage of the institutional political connection hypothesis). In addition, there are no different institutional effects on firm performance between stages of the institution. Policies related to institutional development and corporate governance are recommended to foster firm performance and positive side-effects of political connections.

### 1. INTRODUCTION

There are many studies on the importance of political connections on firm performance in developing countries, especially in countries in transition. In developing countries, market and state failures are found to stipulate firms who are more likely to establish political connections Pang & Wang (2020). In socialist countries in transition, in addition to market and state failures (Boso et al., 2016; Pett et al., 2019), ideological discrimination also prevents private firms, especially SMEs, from accessing productive and financial resources, bear extra heavy fees or costs (Guriev, 2004; Johnson et al., 2000; McMillan & Woodruff, 2002).

Several empirical studies have examined the impact of political connections on firm performance, in which political connections can be classified into four groups: (1) Board members as former politicians, military, and government officers, (2) firm owners as Communist Party members, (3) firm's owners having connections with political officers, and (4) tycoon holding public office.

Prior studies (Bunkanwanicha & Wiwattanakantang, 2009; Fan et al., 2007; H. Li et al., 2008; Ling et al., 2016; Su & Fung, 2013) have found mixed results on the effect of political connections on firm performance. We believe the effects can be positive or negative, depending on the proxies used for the political connections and the various sectoral, institutional, and political contexts of firm operations. For example, Bunkanwanicha & Wiwattanakantang (2009) find that political connections gained by holding public office

(such as the House of Representatives) are associated with firm performance. However, the measurement of political connections (Bunkanwanicha & Wiwattanakantang, 2009) is not directly linked to the “real” political connections and is somewhat related to the concept of crony capitalism. Li et al. (2008) find that political connections positively affect the performance of firms. However, the political connection measured by Communist party membership is an exceptional case of political connections (Su & Fung, 2013). A contradictory example comes from (Fan et al., 2007) without the positive effect of political connections, which depends on the political goals of firms. Ling et al. (2016) also find a negative effect of political connections.

Vietnam has transitioned from a centrally planned economy to a market economy since 1986 (Riedel & Turley, 1999). After 35 years of *Doi Moi* (renovation), Vietnam, under the socialist regime led by the Communist Party (Gillen, 2011; Thanh et al., 2020), has built market institutions, although the government deeply intervenes in the economy by using a direct allocation of resources and development orientations with state-owned enterprises.

In Vietnam, small and medium-sized enterprises (SMEs) are essential to the market economy. In 2018, Vietnam had around 593,629 SMEs in operation with a total registered capital of about 130 billion USD, about 1/3 of the total registered capital of enterprises of all kinds, a total turnover of about 5.63 quadrillions (GSO, 2020), contributing about 40% of GDP, 30% the state budget, 33% industrial output, 30% value of goods exported and nearly 60% of the work-

force (Chu, 2020). SMEs have been present in most localities, making good use of local resources.

In 2011, SMEs contacting bank officials was 4.71%, with politicians and government officials at 6.46%. SMEs with regular contact with politicians and public officials are likelier to be members of the association's provision. The primary function of the association's provision is to provide non-financial services and represent members' common interests by lobbying the government to provide public goods. Approximately 63% of SMEs received this support in 2011, and about 42% received information about new policies and related laws (CIEM et al., 2011).

Some studies highlight the role of political connections in the operation of Vietnamese firms. They indicate that political connections can help enterprises access bank credits (Brunell, 2010; Malesky & Taussig, 2009), access public services, resolve tax issues, gain contracts from the government, and have more business licenses (CIEM et al., 2015; Malesky, 2018).

In the current paper, we examine the influences of political connections on firm performance in Vietnam. In particular, we analyze the role of political connections in the conditions of weak market institutions and then investigate how the effects change when the conditions of market institutions are improved. We also investigate the heterogeneous impacts of political connections in various market competition conditions. We are among the new efforts to identify further how these effects change with various levels of political connections (in terms of the existence of political connections and ranges of political contacts). The first hypothesis here is whether political connections positively affect firm performance in the case of Vietnam. The second hypothesis here is whether the impacts of political connections on firm performance vary with the market competition in the case of Vietnam (the competition political connection hypothesis). The third hypothesis is whether political connections are significant to firm performance in the conditions of weak market institutions in the case of Vietnam (the first stage of the institutional political connection hypothesis). Furthermore, we can test whether this hypothesis holds in strong/improved market institutions (the second stage of the institutional political connection hypothesis).

We employ a dataset from the Survey on Small and Medium Scale Manufacturing Enterprises in Vietnam in 2011-2015 with 1500 observations by 500 firms. 60-70 percent of firms in our sample have at least one political connection regarding a relationship with politicians and civil servants. There are approximately two political contacts with which firms have regular connections.

Our paper contributes three-fold to the literature on development economics and the political economy of transitions. Firstly, most previous studies in socialist countries show that (1) political connections support private firms to maximize profit (H. Li et al., 2008), (2) political connections secure returns from property rights (Hellman et al., 2003), and thus ensure superior firm performance. Our paper finds that political connections are significant to firm performance in the conditions of weak market institutions,

as in the case of Vietnam (the performance hypothesis) and under the pressure of market competition (the competition hypothesis). Furthermore, our results hold strong/improved market institutions (the institution hypothesis). Last but not least, the institutional effects of political connections change following (1) weak/intense levels of political connections, (2) specific types of political connections such as (a) the existence of connections with local government officers, central government officers, and (b) the number of political contractors.

The remainder of this paper is as follows. In Section 2, we propose hypotheses. Section 3 presents data and methods, while Section 4 presents empirical results. Conclusions are in Section 5.

## 2. HYPOTHESIS DEVELOPMENT

### 2.1. Performance hypothesis

In developing countries in transition, there is supportive evidence that political connection enhances the performance of private firms. Several empirical studies support the positive effect of the political connection hypothesis on firm performance.

First, political connections measured by board members (such as former politicians and government officers) have been studied (Agrawal & Knoeber, 2001; Boubakri et al., 2012; Chancharat et al., 2019; Do et al., 2015; Fan et al., 2007; Hung et al., 2017; G. Li & Zhou, 2015; X. Li & Jin, 2021; Pang & Wang, 2020; Sharma et al., 2020; Sun & Zou, 2021; Wu et al., 2012) or by the military (S. Ding et al., 2014; Fan et al., 2007). A positive effect has been indicated by (Do et al., 2015), who find that politically connected list firms may receive significantly more state procurement contracts and investments. Chancharat et al. (2019) also find a positive impact of political affiliation on businesses through favorable legal conditions for access to bank loans, debt, and intense marketing competition. In addition, Boubakri et al. (2012) stress access to bank credits. Political connections can help to reduce administrative procedures when establishing a business (Zhou, 2013).

In contradiction, some studies show the adverse impact of political connections on firm performance. For example, Pang & Wang (2020) find that the effect of political connections on the firm value is significantly negative after controlling for the costs involved in rent-seeking activities. In addition, Jackowicz et al. (2014) find that political connections, as measured as connections with the supervisory board or employing ex-politicians with central government experience, negatively impact income level from sales in Poland. Besides, Saeed et al. (2016) show a negative relationship between political connections and firm performance in Pakistan. Moreover, political connections reduce stock prices (Fan et al., 2007), appoint government officials rather than those with appropriate expertise on the board of directors (Chancharat et al., 2019), and decrease returns on assets (Ling et al., 2016). Malesky & Taussig (2009) even find that political connections do not lead to better performance.

Second, as another approach, political connections among the party members also contribute to firm performance (H. Li et al., 2008; Malesky & Taussig, 2009; Su & Fung, 2013). According to Li et al. (2008) and Su & Fung (2013), political connections have a positive effect on the firm performance through several channels, for example, access to resources such as bank credits, a firm's profitability (H. Li et al., 2008), or more cash holdings, longer-term loans, lower financial fees, more sales and lower selling costs (Su & Fung, 2013). Malesky & Taussig (2009) suggest that political connections are ineffective for investors to access credit sources, making the connected firms less profitable.

Third, political connections can also be seen from the perspective of political networks with servants, such as officers working in the communist party and state agencies (Brown & Huang, 2020; Du & Girma, 2010; Johnson & Mitton, 2003; Sakti, 2020; Shen & Lin, 2016). Accordingly, political connections can help increase access to public services, quickly receiving many contracts from the government and obtaining government-sponsored finances (Brown & Huang, 2020), or offering credit (Du & Girma, 2010), reducing financial difficulties and increasing investment (Shen & Lin, 2016). However, Johnson & Mitton (2003) find a negative impact of political connections increasing a firm's debt-asset ratio. Moreover, political connections in terms of political networks with state-owned banks ease firms in attaining loans or low-interest rates (Chen et al., 2014; Khwaja & Mian, 2005; H. Li et al., 2008), such as special preferential financing from the government when the investment is complex (Faccio et al., 2006; Lazarini et al., 2015).

Fourth, from the perspective that political connections measured by firm's owners as tycoons (Bunkanwanicha & Wiwattanakantang, 2009; Ovtchinnikov & Pantaleoni, 2012), or the political interventions from Party Committees (Bunkanwanicha & Wiwattanakantang, 2009; Guo et al., 2019) reveal that connected firms receive the benefit of cutting taxes and licensing fees, state contracts, and reducing barriers to market entry. Guo et al. (2019) have found evidence that political affiliation harms corporate performance when focusing more on political or social goals.

A recent study by Wong & Hooy (2018) with comprehensive measures of political connections, namely, government-linked companies, boards of directors, businessmen, and family members, found that not every type of political connection has the same effect on firm performance in Malaysia.

In this paper, we propose the following hypothesis.

Hypothesis 1: *Vietnamese SMEs with political connections will have higher economic performance than those without political connections, other things being equal.*

## 2.2. Competition-political connections hypothesis

So far, empirical research lacks evidence of how political connections affect firm performance when market competitions vary. A recent exception comes from (Pang & Wang,

2020), indicating that political connections may be more favorable for heavily-regulated industries such as utilities, tobacco, and the military. This also recalls a study by Agrawal & Knoeber (2001), and Bunkanwanicha & Wiwattanakantang (2009) that shows that firms with political connections are protected from market competition. Sakti (2020) shows that the firm's performance differs between different industries in the context of companies with political connections. In addition, political connections positively affect improvements in the operating performance of firms in industry clusters, especially underperforming companies, companies in financial trouble, and contributions in recent elections (Ovtchinnikov & Pantaleoni, 2012).

In this paper, we propose the following hypothesis.

Hypothesis 2: *Vietnamese SMEs with political connections under the pressure of competition will have higher performance than the firms without political connections, other things being equal.*

## 2.3. Institution-political connections hypotheses

How do political connections induce firm performance with weak institutions? What happens when institutions improve? (Carney et al., 2020; Djankov et al., 2008; Pang & Wang, 2020; Porta et al., 1998; Sheng et al., 2011). Institutional factors such as legal environments and shareholder protection mechanisms are essential in determining political connections.

Carney et al. (2020) find that a director or manager's position as minister or parliamentarian would significantly improve outcomes in countries with weak institutional development. Pang & Wang (2020) show that firms in countries with poorer legal environments or shareholder protection mechanisms are more likely to form political connections, adversely affecting performances and firm value.

Li et al. (2008) find that Party membership is more important to firm performance in regions with weaker market institutions and weaker legal protection. Similarly, Malesky & Taussig (2009) suggest that under weak legal institutions, connections may be a reasonable way for firms with party members, government, or state ownership to access credits since banks tend to rely on guaranteed loans by public officers. However, banks may see a firm with personal relationships with government officials as riskier than an average private firm.

Bunkanwanicha & Wiwattanakantang (2009) argue that the positive effects of political connections and weak institutions could not stop the leaders from engaging in rent-seeking activities.

In this paper, we propose the following hypothesis.

Hypothesis 3: *Vietnamese SMEs with political connections under good institutions will perform better than those without political connections; things are equal.*

### 3. DATA AND METHODS

#### 3.1. Data

Our first source of datasets comes from the Survey on Small and Medium Scale Manufacturing Enterprises in Vietnam, providing characteristics of the business environment every two years in the period 2011-2015, presided over by UNU-WIDER, associated with the Institute of Labour Science and Social Affairs (ILSSA) of the Ministry of Labour, Invalids and Social Affairs (MOLISA), the Department of Economics (DoE) of the University of Copenhagen, and the Central Institute of Economic Management (CIEM). Ten provinces and cities are sampled in the survey, including Ha Noi (code 1), Ho Chi Minh City (code 79), Hai Phong (code 31), ex-Ha Tay (code 28), Long An (code 80), Phu Tho (code 25), Quang Nam (code 49), Nghe An (code 40), Khanh Hoa (code 56), and Lam Dong (code 68). The dataset is only for 2011-2015 and is unique in its information on political connections.

Regarding political connections, the questionnaire has the following questions: (1) Having a relationship with politicians and civil servants (Answer: Yes/No); (2) If "Yes," answers: (2) approximately, with how many people do you currently (presently) have regular contact with? (3) Of these contacts, whom do you consider the most important? (4) How many times in (2010, 2012, and 2014) did your contacts assist in issues related to the operation of your firm? From these answers, we construct various indicators of political connections, namely: (1) Existence of political connections (Yes/No), (2) wideness level of political connections (numbers), (3) intensity level of political connections (how important), and (4) frequency of political connections (frequency). Unfortunately, from the information from the data, only indicators (1) and (2) are statistically suitable for the analysis.

The questionnaire has the following questions about competition: "Do you face competition in your field of activity?" (Answer: Yes/No). Moreover, "If yes, how hard was the competition?" (Answers: a) From state enterprises, b) From other non-state formal enterprises, c) From other non-state informal (unregistered) enterprises, d) From legal imports/foreign competition, e) From smuggling, and f) From other sources. Code: Severe (1), Moderate (2), Insignificant (3), No competition (4).

Our second data was extracted from the Provincial Competitiveness Indicator (PCI) survey collected by the Vietnam Chamber of Commerce and Industry (VCCI) and the United States Agency for International Development (USAID) in 2011-2015. From 2011 to 2013, PCI was calculated as an index of 9 component indices, namely: (1) The cost of entering the market is low; (2) Easy land access and stable land use; (3) The business environment is transparent and business information public; (4) low unofficial fees; (5) time of inspection, testing, and implementation of regulations, administrative procedures quickly; (6) Provincial leaders are dynamic and creative in solving problems for businesses; (7) Highly developed and high-quality business support services; (8) Good labor training policy; and (9) Fair and effective dispute resolution procedures. From 2013 to

2015, PCI was calculated as an index of 10 component indices. In addition to the nine indicators, as shown above, the PCI index has been added to the Equal Competitive Environment Index. The change in methodology has a negligible impact on the rankings of all localities.

PCI ranges from 0 to 100. In this paper, PCI in 2015 is classified into six groups, namely: (1) low PCI (low-institution group): PCI is worth less than 54; (2) relatively low PCI: PCI from 54 to less than 56; (3) medium PCI (medium-institution group): PCI from 56 to less than 57; (4) Rather PCI (good-institution group): PCI from 57 to less than 60; (5) Good PCI: PCI from 60 to less than 62; (6) Very good PCI (high-institution group): PCI from 62 to 100.

PCI measured at the province level is matched with SMEs by using the information on the locations of firms collected in the SME survey.

#### 3.2. Model specification

We use a regression model widely used in the literature to examine the relationship between performance and political connections (Faccio et al., 2006; Fan et al., 2007; Su & Fung, 2013; Wu et al., 2012). The empirical model is specified as follows:

$$y_{it} = \alpha_0 + \alpha_1 k_{it} + \alpha_2 l_{it} + \alpha_3 PC_{it} + \alpha_4 AGE_{it} + \alpha_5 YEAR_t + u_{it} \quad (1)$$

where  $Y_{it}$  represents the output of firm  $i$  in period  $t$ ;  $K_{it}$  and  $L_{it}$  are capital and labor inputs, respectively.  $PC$  is a variable representing the political connection, either by range or frequency and  $AGE$  is the number of years in operation.  $YEAR$  is a vector of dummy variables capturing annual time effects,  $\alpha$ 's denoting parameters, and  $u_{it}$  the error term.

In terms of our conceptual framework, Eq. (1) permits us to test the core hypothesis about the effect of the political connections on the output of the firms:  $H_1$ : Firms with political connections, ceteris paribus, exhibit higher output;  $H_2$ : Firms with more political connections, ceteris paribus, exhibit higher output. We also estimate the output effects of the political connections in various levels of market competition ( $H_3$ ). In order to examine the performance effects of the political connections in various levels of institutions ( $H_4$ ), we estimate the empirical model separately for institutional levels: (1) rather good-institution group and (2) good-institution group.

#### Dependent variable

In this paper, outcome variables are value-added, which most scholars have used (Pang & Wang, 2020; Sakti, 2020). In our empirical analysis, value-added is calculated as sales less the cost of goods, materials, and services from the balance sheet and income statements. The average SME reported 4 billion VND of value-added in 2011-2015 (See [Table 1](#)).

#### Political connection

The current paper defines political connections as the relationship between firms, politicians, or servants working in the political system. Owing to the unique dataset, po-

**Table 1. Statistical Description, 2011-2015**

Variable	2011 (Obs. = 500)		2013 (Obs. = 500)		2015 (Obs. = 500)	
	Mean	Std. Dev.	Mean	Std. Dev.	Mean	Std. Dev.
Value added (Million VND)	4.4010	16.4706	3.9520	9.5711	4.8549	1.5640
Existence of political connections (Yes=1)	.686	.465	.82	.385	.716	.451
Range level of political connections (Number of contacts)	1.84	2.67	2.238	2.777	2.074	2.465
Capital (total assets) (Million VND)	14.5801	34.4391	13.1835	22.007	15.34	1.41
Labor (total laborers)	42.672	57.70	38.89	86.07	38.37	60.57
Age of firm (years of operation)	9.132	5.385	11.53	6.178	13.53	6.18
Leverage ratio	.099	.111	.1004	.119	.0002	.0004

Source: Authors' estimation

political connections in the current paper take alternative forms: (1) existence of political connections (Yes/No), and (2) range level of political connections (numbers of people regularly contacted).

We define a firm as having a political connection if the firm occupies a relationship with politicians or servants currently working in the political system. The proxy variable of political connection is suggested by Faccio et al. (2006), Xu et al. (2016), Zhou (2013), Brown & Huang (2020), Lin et al. (2015), and Du & Girma (2010). From this definition, we construct the range level of political connections as the firm's number of politically resource persons. Moreover, the repetition level of political connections is noted as the frequency that the political resource persons support the firm in issues related to the firm operation.

Examining political connections in the study period (Table 1), we find that political connections are around 70-80%. We also find that the average number of political contacts is around two in the study period, and the number of meetings is around six times.

### Controlling variables

We control several firms, industry, and provincial-level factors that impact firm performance. The descriptive statistics are presented in Table 1. We follow Sheng et al. (2011) and Malesky & Taussig (2009) to identify firm-level controlling variables at the firm level. They include the size of the firm (measured by both capital and labor in the natural logarithm), age of the firm (years of operation) (the standard relationship lending hypothesis) (Malesky & Taussig, 2009; Sheng et al., 2011). In addition, political connections are associated with firms with a lower leverage ratio (Pang & Wang, 2020).

### Market competition

At the industry level, as pointed out by Pang & Wang (2020) and Agrawal & Knoeber (2001), the value of political connections may be differentiated by specific industries, and firms may seek these ties in more profitable industries and are affected by industrial attributes such as structural uncertainty, regulatory stringency, and competitive pres-

sure (Lux et al., 2011). Firm performance is also limited by competition from other firms. To measure this, we use several competition indicators reported by the respondents (Table 2).

### Institutions

Moreover, political connections are quite often connected to institutional imperfections. For instance, in transitional economies, which are often characterized by weak market-supporting institutions and vital government interventions, private firms might have more significant incentives to build political connections to reduce institutional risks (H. Li et al., 2006; Park & Luo, 2001; Xin & Pearce, 1996).

Legal institutions play essential roles at the province level in determining political connections, including legal environments (Pang & Wang, 2020). In this paper, based on the sample, we categorize the sample into five groups, namely: (1) low PCI (low-institution group): PCI is worth less than 54, (2) relatively low PCI: PCI from 54 to less than 56; (3) medium PCI (medium-institution group): PCI from 56 to less than 57; (4) Rather PCI (good-institution group): PCI from 57 to less than 60; and (5) Good PCI: PCI from 60 to less than 62 (Table 3).

### 3.3. Estimation strategy

One concern is the endogeneity of political connections. Previous studies indicate that firms' choice to be involved in political connections is determined by several groups of characteristics such as (1) entrepreneurial characteristics, (2) firm characteristics (H. Li et al., 2006; Liu & Zhang, 2021; Lux et al., 2011; Park & Luo, 2001; Xin & Pearce, 1996). Details are in Table 4.

Variables on entrepreneurial characteristics include whether the respondent is the owner, ethnicity, gender, age, the highest general educational level completed of the owner, previous primary work status, social positions (former village, commune, district, province cadre, war veteran), and the membership of the Vietnamese Communist Party. Moreover, to better identify entrepreneurship on firms' political connections, we add a variable that captures

**Table 2. Competition Assessment by Respondent, 2011-2015**

Variable	2011 (Obs. = 500)		2013 (Obs. = 500)		2015 (Obs. = 500)	
	Mean	Std. Dev.	Mean	Std. Dev.	Mean	Std. Dev.
Competition in your field of activity? (Yes=1)	.938	.2414	.912	.2836	.914	.2806
<i>How stiff is the competition?</i>						
from state enterprises (Severe=1)	.064	.245	.102	.303	.1	.3003
from state enterprises (Moderate=1)	.378	.4854	.362	.4811	.336	.4728
from other non-state formal enterprises (Severe=1)	.306	.4613	.35	.4774	.302	.4596
from other non-state formal enterprises (Moderate=1)	.47	.4996	.416	.4934	.446	.4976
from other non-state informal enterprises (Severe=1)	0	0	.002	.0447	0	0
from other non-state informal enterprises (Moderate=1)	.306	.4613	.25	.4334	.238	.4263
from legal imports/foreign competition (Severe=1)	.108	.3107	.132	.3388	.106	.3081
from legal imports/foreign competition (Moderate=1)	.222	.416	.216	.4119	.23	.4213
from smuggling (Severe=1)	.102	.303	.106	.3081	.082	.2746
from smuggling (Moderate=1)	.138	.3452	.154	.3613	.162	.3688

Source: Authors' estimation

**Table 3. Institution Changes (PCI), 2011-2015**

Variable	Obs.	2011		2013		2015	
		Mean	Std. Dev.	Mean	Std. Dev.	Mean	Std. Dev.
PCI	500	59.77	3.17	58.97	2.02	59.91	1.24
By province							
Ha Noi (code 1)	280	58.28		57.67		59	
Phu Tho (code 25)	45	60.31		53.91		58.37	
Ex-Ha Tay (code 28)	107	58.28		57.67		59	
Hai Phong (code 31)	156	57.07		59.76		58.65	
Nghe An (code 40)	135	55.46		55.83		58.47	
Quang Nam (code 49)	66	63.4		58.76		61.06	
Khanh Hoa (code 56)	57	59.11		57.49		58.69	
Lam Dong (code 68)	45	51.75		57.22		59.04	
Ho Chi Minh City (code 79)	531	61.93		61.19		61.36	
Long An (code 80)	78	67.12		59.36		60.86	

Source: Authors' estimation

entrepreneurship experience: a dummy variable that equals one if the entrepreneur owns any other enterprise before establishing or owning the present enterprise. Variables on firm characteristics include the firm's year of starting a business. In addition, we employ the information on whether the firm is located in an Industrial park/zone (IZ), High-Tech park/zone (HTZ), or Export processing park/zone (EPZ). Furthermore, to control for the possible impact of a firm's internationalization strategy on its pursuit of political connections (H. Ding et al., 2018), we include a dummy variable indicating whether the firm engages in export activities.

Although the three waves of survey data were designed and implemented by the same survey organization, we in-

clude survey dummies by year to control for possible variations in survey executions. The survey dummies also essentially function as year dummies capturing macroeconomic trends. Robust standard error, clustered at the industry-province level, deals with the possible heteroskedasticity problem in Eq. (1).

## 4. EMPIRICAL RESULTS

### 4.1. Statistical description

[Table 5](#) presents the descriptive statistics of our sample's firm-level variables of all firm-year observations.

[Table 6](#) compares the means of each variable for politically connected firms and non-connected firms. We find connected firms show significantly different firm charac-

**Table 4. Statistical Description of Entrepreneurship Characteristics, 2011-2015**

Variable	2011 (Obs. = 500)		2013 (Obs. = 500)		2015 (Obs. = 500)	
	Mean	Std. Dev.	Mean	Std. Dev.	Mean	Std. Dev.
Position of respondent: owner (Yes=1)	.502	.501	.462	.499	.422	.494
Gender of respondent (Male=1)	.53	.500	.474	.500	.448	.498
Age of respondent	3.71	.266	3.73	.319	3.73	.276
Firm located in the industrial zone (Yes=1)	.138	.345	.126	.332	.12	.325
Year of starting the current firm	2001	5.39	2001	6.18	2001	6.18
Owner as the former employee in state-owner enterprise (Yes=1)	.008	.09	0	0	0	0
<i>The highest general educational level completed by the respondent</i>						
Finished primary (Yes=1)	.016	.126	.008	.089	.006	.077
Finished lower secondary (Yes=1)	.058	.234	.026	.1593	.028	.165
Finished upper secondary (Yes=1)	.926	.262	.966	.181	.966	.181
<i>Previous main work status</i>						
Wage employee in state enterprise (Yes=1)	.24	.428	.242	.429	.214	.411
Wage employee in non-state enterprise (Yes=1)	.34	.474	.374	.484	.376	.485
Self-employed in manufacturing construction (Yes=1)	.07	.255	.072	.259	.07	.255
Self-employed in trade/services (Yes=1)	.198	.399	.166	.373	.154	.361
Own or collective farm (Yes=1)	.016	.126	.016	.126	.018	.133
Respondent as former cadre (Yes=1)	.024	.153	.024	.153	.028	.165
Respondent and war veteran (Yes=1)	.05	.218	.036	.187	.024	.153
Member of the Communist Party (Yes=1)	.106	.308	.114	.318	.086	.281
Respondent owned a firm before (Yes=1)	.024	.153	.02	.140	.012	.109
The firm involved in exporting (Yes=1)	.16	.367	.162	.369	.214	.411

Source: Authors' estimation

**Table 5. Summary Statistics of the Total Sample, 2011-2015**

Variable (N=1500)	Mean	Std. Dev.
Value-added, ln	14.2	1.95
Capital, ln	15.52	1.33
Labour, ln	3.05	1.07
Age of firm (years of operation), ln	2.31	.506
Age of firm (years of operation), ln, squared	5.58	2.31
Existence of political connections (Yes = 1)	.74	.438
No political contacts	.272	.445
Political contact =1	.205	.404
Political contacts =2	.265	.442
Political contacts from 3 and above	.258	.438
Exporting (Yes = 1)	.179	.383
Innovation (Yes = 1)	.117	.322
Leverage ratio	.067	.105
Liquidity ratio	.204	.239

Source: Authors' estimation

teristics from non-connected firms in value-added, capital, labor, ages, exporting activities, innovation, leverage, and liquidity. On average, connected firms are significantly larger and older than non-connected firms, but their innovation is lower. Moreover, connected firms have higher leverage and higher liquidity than non-connected firms.

[Table 7](#) compares the means of each variable for groups of political contacts by firms. We find that firms with one political contact or more show a significantly different firm characteristic from firms without any contact. On average, connected firms are significantly larger, older, and more or less exporting than non-connected firms, but their innovation is lower. Moreover, connected firms have higher leverage and higher liquidity than non-connected firms.

## 4.2. Empirical results

### 4.2.1. Existence of political connections

This section investigates the effect of political connections on the firms' performance. In [Table 8](#), we examine the effect of having political connections on the firms' value-added. The estimated coefficients in column (1) are for the existence of political connections (Yes/No), columns (2) and (3) for political connections under competition pressure, and columns (4) and (5) for political connections under various types of institutions.

**Table 6. Comparison of Politically Connected and Non-connected Firms, 2011-2015**

Variable	Connected (Obs.: 1,111)		Non-connected (Obs.: 389)	
	Mean	Std. Dev.	Mean	Std. Dev.
Value added, ln	14.26	1.85	13.94	2.19
Capital, ln	15.57	1.32	15.36	1.36
Labour, ln	3.102	1.07	2.92	1.07
Age of firm (years of operation), ln	2.33	.510	2.25	.487
Age of firm (years of operation), ln, squared	5.69	2.36	5.29	2.15
Exporting (Yes = 1)	.185	.389	.160	.367
Innovation (Yes = 1)	.113	.316	.131	.338
Leverage ratio	.068	.108	.062	.096
Liquidity ratio	.213	.241	.179	.231

Source: Authors' estimation

**Table 7. Comparison of Politically Connected Firms by Ranges of Connections, 2011-2015**

Variable	No political contacts (Obs.: 408)		Political contact =1 (Obs.: 307)		Political contacts =2 (Obs.: 398)		Political contacts from 3 and above (Obs.: 387)	
	Mean	Std. Dev.	Mean	Std. Dev.	Mean	Std. Dev.	Mean	Std. Dev.
Value added, ln	13.96	2.15	14.11	1.85	14.26	1.88	14.45	1.83
Capital, ln	15.38	1.36	15.40	1.34	15.58	1.32	15.69	1.30
Labour, ln	2.92	1.07	2.95	1.03	3.10	1.04	3.24	1.12
Age of firm (years of operation), ln	2.25	.484	2.31	.507	2.32	.509	2.350	.520
Age of firm (years of operation), ln, squared	5.32	2.14	5.61	2.26	5.63	2.36	5.79	2.46
Exporting (Yes = 1)	.167	.373	.182	.387	.166	.372	.202	.402
Innovation (Yes = 1)	.127	.334	.104	.306	.116	.320	.119	.324
Leverage ratio	.063	.096	.062	.098	.060	.091	.080	.129
Liquidity ratio	.185	.233	.186	.224	.208	.241	.232	.250

Source: Authors' estimation

Several tests are done related to the endogeneity of political connections. The Sargan-Hansen test, the Hansen J test, is a test of over-identifying restrictions. The joint null hypothesis is that the instruments are valid, i.e., uncorrelated with the error term, and that the excluded instruments are correctly excluded from the estimated equation. The Hansen J statistics for Model 1 is 9.36 (the p-value of 0.90), for Model 2 is 10.24 (the p-value of 0.90), for Model 3 is 24.29 (the p-value of 0.80), for Model 4 is 9.89 (the p-value of 0.91), and for Model 5 is 27.28 (the p-value of 0.82). They all do not reject the null hypothesis that these instruments are exogenous as a group.

The under-identification test is an LM test of whether the equation is identified, i.e., the excluded instruments are relevant, which correlates with the endogenous regressors. Results in Table 8 show that the LM test statistic for under-identification for Model 1 is 26.96 (the p-value of 0.06), for Model 2 is 27.05 (the p-value of 0.08), for Model 3 is 36.61 (the p-value of 0.26), for Model 4 is 27.66 (the p-value of 0.07), and for Model 5 is 42.78 (the p-value of 0.20), indicating that we can reject the null hypothesis in models (1),

(2) (4), implying that excluded instruments are not correlated with the endogenous regressors, but not with models (3) and (5), meaning that weak identification may exist.

We begin by estimating our benchmark performance equation with firm characteristics, year dummies, and political connections measured by the existence of political connections. The regression results in column (1) show that political connections positively affect firm performance as measured by the existence of political connections. By using value-added as the dependent variable, the effect here can be considered the net effects obtained from benefits and costs endured by political connections to the firms. When the value added by political connections exceeds the costs incurred, a significantly positive relationship between the political connections and the performance measure will be observed; otherwise, a significantly negative relation will be attained. The estimated coefficient on political connections is .52 and significant at the 1% level.

Next, we estimate the effect of the existence of political connections under competition conditions in column (2). We find that firms with political connections have better



**Table 8. Regression Results: the Existence of Political Connections, 2011-2015**

VARIABLES	(1)	(2)	(3)	(4)	(5)
	Value-added	Value-added with competition	Value-added with competition, interactions	Value-added with institution	Value-added with institution interactions
Existence of political connections (Yes=1)	0.518*** (0.192)	0.522*** (0.192)	0.534*** (0.178)	0.519*** (0.191)	0.489*** (0.165)
Existence of political connections (Yes=1) * Moderate competition from other non-state informal enterprises (Yes=1)			-0.689** (0.283)		
Capital, ln	0.0634*** (0.0244)	0.0647*** (0.0244)	0.0586** (0.0242)	0.0643*** (0.0244)	0.0656*** (0.0242)
Labor, ln	0.384*** (0.0374)	0.383*** (0.0375)	0.415*** (0.0368)	0.385*** (0.0380)	0.384*** (0.0367)
Age of firm (years of operation), ln	0.195 (0.225)	0.198 (0.224)	0.116 (0.212)	0.166 (0.224)	0.307 (0.242)
Age of firm (years of operation), ln, squared	-0.143* (0.0757)	-0.142* (0.0753)	-0.129* (0.0708)	-0.135* (0.0749)	-0.161** (0.0792)
Year 2013 (Yes=1)	0.0817* (0.0465)	0.0767* (0.0463)	0.118*** (0.0436)	0.0927* (0.0485)	0.0932** (0.0428)
Year 2015 (Yes=1)	0.341*** (0.0678)	0.335*** (0.0676)	0.358*** (0.0666)	0.337*** (0.0684)	0.326*** (0.0683)
Moderate competition from other non-state informal enterprises (Yes=1)		-0.0504 (0.0367)	0.459** (0.204)	-0.0459 (0.0365)	-0.0635* (0.0367)
Relatively low PCI: PCI from 54 to less than 56				-0.269* (0.150)	0.606** (0.304)
Medium PCI (medium-institution group): PCI from 56 to less than 57				-0.195 (0.126)	
Rather-good PCI (good-institution group): PCI from 57 to less than 60				-0.0560 (0.130)	
Good PCI: PCI from 60 to less than 62				-0.0892 (0.145)	
Existence of political connections (Yes=1) * relatively low PCI (PCI from 54 to less than 56)					-0.818** (0.366)
Observations	1,500	1,500	1,500	1,500	1,500
R-squared	0.050	0.049	0.096	0.058	0.088
Number of firms	500	500	500	500	500
Hansen J statistic	9.363	10.24	24.29	9.891	27.28
p-value of Hansen statistic	0.898	0.893	0.798	0.908	0.821
F statistic	28.30	25.11	23.81	17.14	21.17
LM test statistic for under-identification (Anderson or Kleibergen-Paap)	26.96	27.05	36.61	27.66	42.78
p-value of under-identification LM statistic	0.0587	0.0781	0.263	0.0675	0.203
F statistic for weak identification (Cragg- Donald or Kleibergen-Paap)	2.062	1.951	1.442	1.928	1.415
LM statistic for instrument redundancy	20.52	20.59	69.66	21.08	54.45
p-value of LM statistic for instrument redundancy	0.115	0.151	0.235	0.175	0.678
Centered R-squared	0.0499	0.0489	0.0964	0.0580	0.0877

Note: Robust standard errors in parentheses; \*\*\* p<0.01, \*\* p<0.05, \* p<0.1. Source: Authors' estimation

operating performance. After controlling for the year and industry fixed effects, the estimated coefficient on political connections is 0.52 and significant at the 1% level. The interactions between political connections and moderate competition from other non-state informal enterprises with minus sign and significance at the 5% level in column (3) indicate that we do not find evidence that political connec-

tions are more pronounced on firm performance in highly competitive industries.

In columns (4) and (5), we want to examine whether an excellent province-level legal environment could help prevent politicians' rent-seeking, thus improving the firm performance. We hypothesize that it will be more difficult for politicians to do rent-seeking in provincial locals with a

better legal system. Therefore, the political connections in a good institution should perform less than those in a relatively good institution.

We find that in column (4), the estimated coefficients on institutions are all minus and only significant with the category “Relatively low PCI (PCI from 54 to less than 56)”. This indicates that firms working in a “Relatively low PCI (PCI from 54 to less than 56)” do not prove their performance compared with other types of institutions. In column (5), the interaction’s political connections with relatively low institutions are minus and significant at the 5% level after controlling for the year and industry-fixed effects. In economic terms, the results suggest that after controlling all the other variables, the operating performance of politically connected firms in even relatively low institutions has been significantly degraded. Estimation results do not support the hypothesis that the political connections in a better institution should have a lower performance.

#### 4.2.2. Groups of political contacts

In [Table 9](#), we examine the effect of political connections in terms of the groups of political contacts on the firms’ value-added. The estimated coefficients in column (1) are for a benchmark of political contacts, columns (2) and (3) are for political contacts under competition pressure, and columns (4) and (5) are for political contacts under some types of institutions. As in [Table 8](#), relevant tests are also conducted, and we cannot reject the null hypothesis that these instruments are exogenous as a group. On top of that, we cannot reject the null hypothesis in all models, meaning that weak identification may exist.

In column (1), we find that the estimated coefficients on political contacts are significant, with the number of political contacts equal to 2. At the same time, other alternatives are proved to be the same (No difference among alternatives such as “no political contact,” “one political contact,” and “political contacts from three and above”). The estimated coefficient on “two political contacts” is 0.58, significant at 1%.

Next, we estimate the effect of the existence of political contacts under competition conditions in column (2). We find that heavy competition may hamper the firm performance, but this is not significant. Considering the competition in column (3), the estimated coefficients on having two political contacts are minus and significant at the 1% level after controlling for the year and industry fixed effects. Again, the results indicate that we do not find evidence that political contacts are more pronounced on firm performance in moderately competitive industries than in the case of the existence of political connections.

We find that in column (4), under various types of institutions, the estimated coefficients on institutions are all minus and only significant with the category “Relatively low PCI (PCI from 54 to less than 56)”. The result indicates that an improved institutional environment does not benefit firm performance. In column (5), the political connections associated with relatively low institutions are significant at the 10% and 5% levels for one and two political contacts, respectively, after controlling for the year and in-

dustry-fixed effects. The finding does not support the view that political connections explore firms and seek rents from firms.

#### 4.2.3. Number of political contacts

[Table 10](#) examines the effect of political connections in terms of the number of political contacts on firms’ value-added. Similar steps and tests were conducted, as in [Tables 8](#) and [9](#). Results in [Table 10](#) again confirm the performance effects of political contacts in general and in various competitive and institutional conditions, as in the case of political connections.

## 5. CONCLUSIONS AND IMPLICATION

In this paper, we examine how political connections affect SMEs’ performance. Using firm-level panel data on SMEs in Vietnam, we measure SMEs’ political connectedness by two indicators: political connections and the range of political contacts. We show that the existence of political connections and the ranges of political contacts leads to the higher value-added performance of the firm, *ceteris paribus*. We also examine the impacts of political connections on firm performance, which vary with market competition in Vietnam. We go further by analyzing whether the political connections are significant to firm performance in the conditions of weak market institutions (the first stage of the institutional political connection hypothesis) in the case of Vietnam and whether this holds in the conditions of solid/improved market institutions (the second stage of institutional political connection hypothesis).

Our results confirm the positive effect of the prevalent form of political corruption on firm performance in many emerging market economies. It also opens up the vital issue of market regulation and institutional changes for easing business. We do not find evidence that political connections affect firm performance in highly competitive industries. In addition, estimation results do not support the hypothesis that the political connections in a better institution should have less performance. Indeed, the results suggest that after controlling all the other variables, the operating performance of politically connected firms in relatively low institutions has been significantly degraded.

This study holds important implications for the literature on development in transitional developing countries, corporate governance in general, and politics and business ethics. The importance of institutional development for contributing to countries’ political, social, and economic well-being is attained. Negative side-effects of political connections can be compensated by building an excellent institutional environment where servants are pioneers and supportive of firms. Firms can strengthen their political connection as a component of corporate political responsibility.

Future research could further investigate the dynamics behind the interactions between political connections, firms’ development, and competition. The institutional transition toward more efficient, well-working laws and

**Table 9. Regression Results: Groups of the Political Contacts, 2011-2015**

VARIABLES	(1) Value-added	(2) Value-added with competition	(3) Value-added with competition, interactions	(4) Value-added with institution	(5) Value-added with institution interactions
Political contact =1	0.500 (0.377)	0.536 (0.380)	0.667* (0.371)	0.490 (0.382)	0.389 (0.323)
Political contacts =2	0.577*** (0.203)	0.561*** (0.208)	0.742*** (0.238)	0.570*** (0.205)	0.568*** (0.190)
Political contacts from 3 and above	0.421 (0.286)	0.490* (0.286)	0.352 (0.290)	0.441 (0.278)	0.360 (0.270)
(Political contact =1) * Moderate competition from other non-state informal enterprises (Yes=1)			-0.590 (0.474)		
(Political contacts =2) * Moderate competition from other non-state informal enterprises (Yes=1)			-1.066*** (0.398)		
(Political contacts from 3 and above) * Moderate competition from other non-state informal enterprises (Yes=1)			-0.409 (0.386)		
Capital, ln	0.0642** (0.0258)	0.0659** (0.0260)	0.0617** (0.0257)	0.0644** (0.0260)	0.0610** (0.0251)
Labor, ln	0.386*** (0.0396)	0.382*** (0.0402)	0.420*** (0.0409)	0.387*** (0.0407)	0.395*** (0.0390)
Age of firm (years of operation), ln	0.186 (0.218)	0.192 (0.223)	0.214 (0.232)	0.152 (0.220)	0.280 (0.237)
Age of firm (years of operation), ln, squared	-0.141* (0.0731)	-0.141* (0.0742)	-0.152** (0.0698)	-0.132* (0.0732)	-0.154** (0.0765)
Year 2013 (Yes=1)	0.108** (0.0489)	0.0979** (0.0493)	0.122*** (0.0466)	0.121** (0.0529)	0.146*** (0.0472)
Year 2015 (Yes=1)	0.344*** (0.0666)	0.336*** (0.0672)	0.360*** (0.0653)	0.340*** (0.0681)	0.340*** (0.0690)
Moderate competition from other non-state informal enterprises (Yes=1)		-0.0507 (0.0391)	0.460** (0.220)	-0.0438 (0.0385)	-0.0552 (0.0394)
Relatively low PCI: PCI from 54 to less than 56				-0.283* (0.164)	0.503 (0.345)
Medium PCI (medium-institution group): PCI from 56 to less than 57				-0.203 (0.125)	-0.198 (0.125)
Rather-good PCI (good-institution group): PCI from 57 to less than 60				-0.0619 (0.131)	-0.0379 (0.129)
Good PCI: PCI from 60 to less than 62				-0.0797 (0.154)	-0.0355 (0.151)
(Political contact =1) * Relatively low PCI (PCI from 54 to less than 56)					-0.984* (0.523)
(Political contacts =2) * Relatively low PCI (PCI from 54 to less than 56)					-1.083** (0.449)
(Political contacts from 3 and above) * Relatively low PCI (PCI from 54 to less than 56)					-0.792 (0.484)
Observations	1,500	1,500	1,500	1,500	1,500
R-squared	0.054	0.038	-0.009	0.063	0.098
Number of firms	500	500	500	500	500
Hansen J statistic	8.795	9.498	19.22	8.317	17.13
p-value of Hansen statistic	0.844	0.850	0.862	0.872	0.877
F statistic	23.21	20.48	15.59	15.52	13.44
LM test statistic for under-identification (Anderson or Kleibergen-Paap)	14.02	14.96	17.49	13.94	21.85

p-value of under-identification LM statistic	0.524	0.527	0.938	0.530	0.697
F statistic for weak identification (Cragg-Donald or Kleibergen-Paap)	0.877	0.886	0.663	0.866	0.957
LM statistic for instrument redundancy	51.69	52.91			
p-value of LM statistic for instrument redundancy	0.145	0.195			
centered R-squared	0.0535	0.0377	-0.00897	0.0634	0.0978

Note: Robust standard errors in parentheses; \*\*\* p<0.01, \*\* p<0.05, \* p<0.1. Source: Authors' estimation

regulations and more politically ethical forms of easing business is essential for their development.

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**Table 10. Regression Results: Numbers of the Political Contacts, 2011-2015**

VARIABLES	(1)	(2)	(3)	(4)	(5)
	Value-added	Value-added with competition	Value-added with competition, interactions	Value-added with institution	Value-added with institution interactions
Number of political contacts, ln	0.288** (0.113)	0.281** (0.112)	0.243** (0.113)	0.291** (0.114)	0.244** (0.105)
Number of political contacts (ln) * Moderate competition from other non-state informal enterprises (Yes=1)			-0.386** (0.162)		
Capital, ln	0.0549** (0.0249)	0.0578** (0.0246)	0.0653*** (0.0238)	0.0552** (0.0248)	0.0632*** (0.0241)
Labor, ln	0.399*** (0.0363)	0.398*** (0.0362)	0.422*** (0.0353)	0.397*** (0.0372)	0.398*** (0.0356)
Age of firm (years of operation), ln	0.133 (0.227)	0.134 (0.225)	0.0779 (0.213)	0.106 (0.225)	0.192 (0.232)
Age of firm (years of operation), ln, squared	-0.120 (0.0798)	-0.118 (0.0788)	-0.105 (0.0751)	-0.112 (0.0788)	-0.124 (0.0799)
Year 2013 (Yes=1)	0.106** (0.0444)	0.100** (0.0443)	0.141*** (0.0427)	0.110** (0.0474)	0.110*** (0.0424)
Year 2015 (Yes=1)	0.322*** (0.0719)	0.313*** (0.0715)	0.329*** (0.0698)	0.303*** (0.0729)	0.297*** (0.0714)
Moderate competition from other non-state informal enterprises (Yes=1)		-0.0727** (0.0369)	0.287** (0.142)	-0.0707* (0.0369)	-0.0793** (0.0372)
Relatively low PCI: PCI from 54 to less than 56				-0.338** (0.149)	0.232 (0.210)
Medium PCI (medium-institution group): PCI from 56 to less than 57				-0.200 (0.123)	
Rather-good PCI (good-institution group): PCI from 57 to less than 60				-0.0543 (0.127)	
Good PCI: PCI from 60 to less than 62				-0.143 (0.151)	
Number of political contacts (ln) * Relatively low PCI (PCI from 54 to less than 56)					-0.373* (0.224)
Observations	1,500	1,500	1,500	1,500	1,500
R-squared	0.090	0.102	0.173	0.099	0.151
Number of firms	500	500	500	500	500
Hansen J statistic	12.09	12.17	26.24	11.43	27.11
p-value of Hansen statistic	0.795	0.790	0.710	0.833	0.617
F statistic	29.56	26.56	24.83	18.01	21.84
LM test statistic for under-identification (Anderson or Kleibergen-Paap)	27.52	27.74	43.71	28.01	34.30
p-value of under-identification LM statistic	0.0697	0.0662	0.0812	0.0619	0.312
F statistic for weak identification (Cragg-Donald or Kleibergen-Paap)	2.008	2.023	1.657	1.870	1.464
LM statistic for instrument redundancy	18.22	18.48	66.93	19.46	55.34
p-value of LM statistic for instrument redundancy	0.251	0.238	0.312	0.245	0.646
centered R-squared	0.0896	0.102	0.173	0.0992	0.151

Note: Robust standard errors in parentheses; \*\*\* p<0.01, \*\* p<0.05, \* p<0.1. Source: Authors' estimation



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