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Political connections of Russian corporations: Blessing or curse?

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ABSTRACT

This paper provides comprehensive empirical evidence on political connections of Russian corporations based on a sample of companies for the period 2011–2015 (divided into subsamples before and after the events in Ukraine). Based on a unique database, the study (1) evaluates how common political connections are for Russian corporate environment, and (2) investigates the impact of political connections on firm value through an event study. The research shows that 27% of Russian corporations from the sample had the top officials of Russia as directors, and 43% of corporations were found to be politically connected on the basis of either state ownership or directorship. Political connections are unevenly distributed among industries, and regulated industries are more heavily politicized. Aviation, oil & gas, and banking were the most politically connected sectors of the Russian economy. The event study showed that political connections have a value-destructive total effect which is statistically significant and robust. Generally, the stock market responds to announcements of political connections with a drop in share prices by 1.34% on average within 5 trading days. Different groups of stakeholders exert different impacts on firm value. The most negative influence on firm value is that of politically connected owners. The stock market reacts to acquisitions of shares by politically connected owners with a drop in stock prices by 1.82% within 5 trading days, and with a drop in stock prices by 4.3% when the politically connected owners were individuals. The negative value effect of political connections strengthened after the events in Ukraine.

Introduction

The fact that firms seek to establish political connections to extract economic rent was first noticed by Kruger (Krueger, 1974). Later, this idea received multiple empirical confirmations all over the globe, indicating that politicians are frequently present among the top officers and owners of large corporations. The problem of political connections has grown into a separate direction of research after Faccio showed with an example of 41 countries that 3% of the world's traded corporations representing around 8% of the world's stock market capitalization have owners and top officers who held the highest official posts in the past or present (Faccio, 2006).

Political connections are not, however, equally common across different countries. Studies show that political connections are more pronounced in economies with underdeveloped market mechanisms, a high degree of state intervention, and high rates of corruption (Faccio, 2006; Gehlbach et al., 2010; Tu et al., 2013, etc.). Recent literature provides conflicting evidence concerning the impact of political connections on firm value. While examples of some economies show that political connections foster value creation (Civilize et al., 2015; Dang et al., 2018; Shi and Cheng, 2016, etc.), others show that political connections are value destructive (Fan et al., 2007; Gray et al., 2016; Wong and Hooy, 2018 etc.) and can even be an existential threat for a corporation (Sun et al., 2011a).

As shown below, Russia represents a unique natural laboratory to investigate the problem of political connections, providing perfect institutional conditions. Still, there is little comprehensive research on political connections in Russia. Empirical studies have not been able to provide comprehensive answers to the following questions:

(1) How common are political connections in the Russian corporate environment?
(2) How do political connections affect performance of Russian corporations?

This paper tries to answer these questions by means of:

- delivering descriptive statistics on political connections based on a sample of corporations;
- conducting an event study to reveal the impact of political connections on firm value as a synthetic indicator of corporate efficiency.

A sample of companies that covers the period 2011–2015 shows that political connections in Russia are widely distributed:

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27% of the corporations had the top officials of Russia as directors, and 43% of corporations were politically connected on the basis of either state ownership or directorship. Political connections exert a value-destructive effect on Russian corporations, and the announcements of political connections cause a statistically significant drop in stock prices by 1.34% within 5 trading days, and by 4.33% within 5 trading days on average for political connections through individual owners. The negative effect of political connections substantially strengthened after the events in Ukraine.

The paper is organized as follows:

- Section 1 provides the theoretical and institutional background, and shows that little is known about the role of political connections in the Russian economy;
- Section 2 explains the approach to detecting and quantifying political connections;
- Section 3 describes the sample;
- Section 4 provides descriptive statistics on the political connections of Russian corporations;
- Section 5 explores the value effects of political connections;
- the discussion section suggests possible interpretations of the findings.

1. Theoretical background

1.1. Literature review

The theory of rent-seeking (Krueger, 1974) suggests that in a transitional economy corporations can use political connections as a substitute for the market mechanism (Civilize et al., 2015), helping them get bailed out in case of emergency (Lee et al., 2018) and avoid bankruptcy (Halford and Li, 2019; Han and Zhang, 2018), get access to debt funding (He et al., 2019; Wang et al., 2019a) and stock funding (Li and Zhou, 2015), obtain preferred regimes of debt funding (Bliss et al., 2018) and taxation (Wu et al., 2012a), receive government contracts (Goldman et al., 2013), enter foreign markets (Wang et al., 2019b), foster innovation activities (Cheng et al., 2019), and enjoy other privileges. The resource-based view (Barney, 1991) says that firms can utilize political connections for a strategic competitive advantage (see Sun et al., 2011b) which results in the value-adding effect of political connections.

However, political connections entail political and social burdens (Wu et al., 2012b), which represent certain types of opportunity costs incurred by corporations due to making economically inefficient alternative choices influenced by politicization.

Political costs include direct donations to political parties and campaigns (Da Silva et al., 2018; Lee et al., 2018) or extra premiums paid to politically connected directors (Banerji et al., 2018), the costs of opportunistic behaviour when politicians use corporate funds to strengthen their political capital (Dang et al., 2018; Schweizer et al., 2019), the opportunity costs associated with the pressure to adopt strategies consistent with the political goals of the government and politicians to the detriment of corporate interests (Okhmatovskiy, 2010), or attracting top officers with weaker managerial qualifications (Fan et al., 2007), as well as other opportunity costs.

Social costs of political connections are incurred when politicization compels companies to forward their resources to accomplishing social interests like reducing unemployment (Liu et al., 2019) and supporting schools and nurseries (Wu et al., 2012a), spending funds for charity (Yang and Tang, 2018), or the inefficient provision of goods and services caused by fostering domestic sales but not exports to satisfy social demands (Cingano and Pinotti, 2013), especially during periods of economic crisis (Johnson and Mitton, 2003). All this leads to the value-destructive effect of political connections.

Thus, political connections represent a double-edged sword; their total value effect depends on how effectively the economic rents extracted from the competitive advantages of politicization offset opportunity costs stemming from political connections (Han and Zhang, 2018; Zhang and Truong, 2019). In this regard, the literature reveals some regularities determined by the social, political, and economic environment (Banerji et al., 2018; Faccio, 2006; Qin and Zhang, 2019). Recent studies suggest that political connections tend to show a greater positive effect in institutional environments with less developed market mechanisms (Wu et al., 2018), weaker corporate governance (Newton and Uysal, 2019), and higher rates of corruption (Faccio, 2006). The greater the degree of state intervention into the economy, the greater the strength of the political connections in this economy (Banerji et al., 2018).

From this perspective, Russia is a natural laboratory for studying the problem of political connections, being an economy that combines feeble market development (Rochlitz, 2014) and a weak legislative and judicial framework (Gans-Morse, 2012) with high government intervention (Chernykh, 2008).

Russia has a range of its own specificities concerning the problem of political connections. Traditionally, international studies presume implicitly that incentives to establish political connections are from the corporations, while Russia has deep institutional roots of controlling the economy and establishing political connections on the state's own initiative (Frye and Iwasaki, 2011; Trifonov, 2018; Yakovlev et al., 2014). This implies that political connections in Russia represent a simultaneous and bilateral process: while corporations seek to establish political connections in order to get competitive advantages, the state simultaneously seeks to nationalize the most successful corporations and control them (Trifonov, 2018). The government and the corporate environment affect each other simultaneously while establishing political connections, introducing the econometric problems of **endogeneity**, **simultaneity** and **reverse causality** when talking about the impact of political connections on firm value. Consequently, special research methods should be used.

Although Russia represents an ideal institutional environment for studying the problem of political connections, little is known about the role of corporate political connections in the Russian economy. Faccio showed Russia to be one of the most politicized economies with politically connected firms representing 86.75% of the market capitalization, and the share of firms connected to ministers and members of parliament amounting to 12% (Faccio, 2006). Even so, her sample was limited to only 25 large Russian companies. After Faccio, no comprehensive attempts have been made to evaluate how widespread are political connections in Russia. The few works attempting to evaluate the total value effect of corporate political connections in Russia either did not account for possible reverse casual effects of political connections and their simultaneous nature, or took into consideration narrow groups of stakeholders which are not able to reflect the overall picture (see Berkowitz et al., 2014; Klarin and Ray, 2019; Lamberova and Sonin, 2018; Okhmatovskiy, 2010, etc.). This study tries to fill this research gap.

1.2. Institutional framework: How Russian corporations are governed

From the corporate point of view, political connections are mainly established on the basis of corporate governance mechanisms. This is, therefore, crucial to understand the key principles governing Russian corporations. Russian corporate legislation is based on continental European legal traditions that imply a two-tier model of board of directors. Accordingly, Russian corporations have 3 main corporate governance bodies:

(1) **General Assembly of Shareholders** is the highest body of a Russian corporation. According to the legislation, meetings of general assemblies must be held at least once a year. Key responsibilities of general assemblies are electing boards of directors, approving annual reports and annual financial statements, and making any decisions on incorporation, reorganization, or liquidation.
(2) **The Supervisory Board,** alternatively referred to as **the Board of Directors** in the legislation, is the corporate body of oversight and control. Supervisory boards are meant to ensure that the rights of shareholders are upheld. Although the particular functions are specified in the company's charter, they are typically developing corporate strategies, controlling executives, ensuring the efficiency of their work, and taking necessary measures to uphold the rights of shareholders. Supervisory boards should have at least 5 members.
(3) **The Executive body**, which can take the form of either a single CEO, a single CEO together with an executive board, or an outside person or company taking on the functions of daily management. Depending on what is specified in the company's charter, executives can be elected by either the general assembly of shareholders or the board of directors. Executives are typically in charge of day-to-day managerial decisions. However, the company's charter can empower executives with functions of tactics or strategy. The legislation does not set any limits in regard of the size of executive bodies.

This research approaches the problem of political connections from the perspective of corporate governance and stakeholder theory (Freeman, 1984). This requires members of all the 3 main corporate governance bodies to be examined in order to obtain full and comprehensive insights into how Russian companies are governed in terms of political connections.

According to the legislation, Russian companies can be owned by individuals as well as by legal entities, including other companies, non-commercial organizations, and government bodies. A corporation can have several types of owners simultaneously. Dramatic changes happened in Russian corporate governance in the 2000s in terms of ownership structure. Avoiding controlling the economy and playing the role of a minority shareholder in the 1990s (Grosman et al., 2016), the Russian government strengthened its role in the economy in the early 2000s. The government took control of the economy by nationalizing large and strategically important enterprises (Chernykh, 2008; Yakovlev et al., 2014), using property rights as a familiar institutional mechanism of state control well-known since Soviet times (Trifonov, 2018). As a result, the state sector has increased up to 70% of the Russian economy by the year 2017 (Editorial, 2017). The government uses its shareholder rights not just within the traditional shareholder objectives, but also as an instrument of indirect state control over the economy (Gans-Morse, 2012; Yakovlev, 2014).

This paper, therefore, considers state ownership as a source of political connections itself, sharing the approach of (Liu et al., 2018; Wang et al., 2019a and others). In other words, this study treats state ownership and directorship as alternative channels through which corporations can receive the competitive advantages of politicization while paying the social and political costs of these political connections. At that, state ownership is treated in this paper as a formal tool for corporate control, while political connections through directorship are considered as an informal corporate control tool.

2. Political connections: Identification and quantification

This research relies on the methodology of (Faccio, 2006), quantifying political connections with a binary variable that takes the value 1 if a corporation has at least 1 politically connected person among its (a) supervisors, (b) executives and (c) owners, or if the state directly or indirectly holds a stake of at least 25% in this company (a blocking stake), and the value 0 otherwise. People were identified as politically connected if they have held a government post in past or present, or if they are in kinship with such a person. I focus on the following posts:

- ministers,
- members of both chambers of parliament,
- chiefs of the office of president,
- advisors to the president,
- heads of federal executive branches (namely, federal services and federal agencies).

For comparability with other studies, separate subsamples were built, adopting the exact methodology of these studies in terms of political connections.

The political connections were revealed in 2 steps. First, I analysed yearly and quarterly corporate reports disclosed publicly.[1] The reports reveal political connections by disclosing a list of executive and non-executive directors, describing their work experience over at least the past 5 years. Second, I mapped the names and years of birth of directors with the list of the top officials of Russia, collected manually from open sources, and covering around 5,000 persons from 1991 to 2015.[2] The matches were treated as political connections. A person was recognized politically connected in case if political connections were revealed at any step of the check-up.

The legislation requires Russian corporations to announce important events officially and publicly[2]. The types of events I focused on (specifically, appointments of directors, and large acquisitions of shares) are those announced. I found out about corporate reshuffles, changes in shareholder makeup, and exactly when these happened using official corporate announcements.

3. Sample

The sample embraces all Russian companies traded on the Moscow Stock Exchange 2011–2015 with a share turnover of at least 80 trading days a year and sufficient disclosure quality. These are 204 companies (64 state-owned enterprises, and 140 private companies) representing around 1% of all open joint-stock companies in Russia.[3] The sample seems narrow until we take into consideration the role these companies play in the Russian economy.

The economy of Russia is noted for its extreme concentration. This means that Russia has a small range of large companies yielding the lion's share of national wealth, while smaller companies do not make the economy virtually playing a minor role. From this perspective, corporations from the sample are the flagships of the Russian economy, representing around a quarter of it. The aggregated sales revenues for 2014 correspond to 25.7%

[1] Requirements for corporate disclosure in Russia are specified in Federal Law No 39-ФЗ "On Stock Market" by 22.04.1996, and in Provision of the Central Bank of Russia No 454-П "On disclosure of information by issuers of securities" by 30.12.2014.

[2] The timeframe is this wide as within my research I treat political connections as an intangible asset that might have been accumulating over a long period of time.

[3] Calculations based on the data of Interfax (http://www.spark-interfax.ru/ru/statistics - January 9, 2020).

Table 1
Sample statistic on channels of politicization.

Figure	Political connections		
	Via state ownership	Via directorship	Total (via either ownership or directorship)
Number of politically connected firms	64	56	**88**
% of politically connected firms	31.37	27.45	**43.13**

Table 2
Sample statistic on political connections through directorship.

Company	SOEs	POEs	Overall
Number of firms	64	140	**204**
Firms with politically connected directors	32	24	**56**
% of firms with politically connected directors	50.0	17.1	**27.5**
Number of politically connected directors	103	34	**137**
Politically connected directors per firm (average)	1.6	0.2	**0.7**
Max number of politically connected directors	11	3	**11**
Share of politically connected directors	9.5	2.1	**5.1**
Max share of politically connected directors	44.0	23.1	**44.0**

of GDP, and around 20% of the total sale revenues of all Russian firms. The aggregated book value is related to the national GDP as 88.8%[4]. The sample represented 92.9% of the stock market capitalization as of 2014.[5] Gazprom, a single company from the sample, yielded 8.57% of the national budget's incomes in 2014, while in 2008 this was 10.69%.[6]

The timeframe includes the events in Ukraine, so that the sample can be divided into subperiods before and after the Ukrainian crisis. My interest towards the events in Ukraine in light of this research is owing this was associated with both politics and economics, involving direct economic sanctions against Russian companies and politicians against a background of the increasing role of political factors in Russian society.

4. Descriptive statistics

Faccio argues that 12% of Russian corporations from her sample were connected to a minister or a member of parliament in 1996–1999. This is the highest figure among the 41 countries she analysed. According to her conclusions, connected firms in Russia represent 86.75% of the market capitalization (Faccio, 2006). Although Faccio does not disclose the exact list of companies analysed, I attempted making up a subsample similar to hers to evaluate the dynamics of politicization.[7]

Following the methodology of (Faccio, 2006), I found that 57.14% of corporations from the subsample were connected to Russian ministers or members of parliament in 2015. Specifically, 7.1% of the directors (39 persons) were not just politicians but top officials affiliated with the 3 main constitutional organs of state authority. Broadening the range of political posts under consideration up to heads of federal executive branches, heads of the office of the president, and advisors to the president, results in doubling the number of politically connected directors to 70 persons or 12.8% of directors. The politically connected firms from this subsample represent 59.38% of the stock market capitalization.

The rates of political connectedness could have increased after the change of political regime from President Yeltsin to President Putin in 1999, a comparison of my results with those of (Faccio, 2006) suggests. Although the share of politically connected firms in terms of stock market capitalization has moderately decreased due to the development of the stock market, their share in the overall number of firms is almost 5 times as high. This could reflect how state influence has increased in Russia since the early 2000s, what was discussed previously in the paper.

The evaluations of political connectedness based on the subsample similar to (Faccio, 2006) can be complemented with those based on a larger sample. My main sample includes 204 companies, 88 of which are found to be politically connected through ownership or directorship (43.13% of all companies in the sample), and 56 companies having at least 1 top politician on the board as of 2015 (Table 1).

Russian state-owned enterprises (SOEs) and privately-owned enterprises (POEs) should be considered separately from the perspective of political connections. The Chow test shows that the subsamples of SOEs and POEs are statistically heterogeneous, meaning they can potentially be subordinated to different trends in terms of political connections.[8] A one-way ANOVA test yields the same result, showing a statistically significant difference in mean degrees of political connectedness between the subsamples of SOEs and POEs at a confidence interval of 99%.[9]

State ownership is associated with a higher degree of political connectedness. Table 2 shows that SOEs have more politically connected directors in comparison with POEs, numerically and proportionally (politically connected directors represent around 9.5% of all corporate directors in SOEs, against 2.1% in POEs). This could have 2 possible explanations. From the perspective of corporate governance, this seems natural as the state could exercise its shareholder rights, appointing its representatives to corporate bodies as a majority owner. However, there are alternative explanations suggested by the theory of rent-seeking (Krueger, 1974)

[4] Calculations based on official statistics and official financial statements of the companies.

[5] Calculations based on the data provided by the Moscow Stock Exchange (https://www.moex.com/s26 - February 17, 2020).

[6] Calculations based on official statistics and financial statements of Gazprom in accordance with the IFRS (https://www.gazprom.ru/f/posts/21/499896/gazprom-ifrs-12m-2012-ru.pdf - January 9, 2020).

[7] Faccio's subsample for Russia includes 25 companies available in the 1996 - 1999 *DataStream and Bloomberg* databases. I used the same sources to find 29 companies available in the databases as for the period 2011–2015.

[8] To test the statistical homogeneity of my sample, I regressed the indicators of political connections (a binary variable for politically connectedness though directorship, another binary variable for political connectedness through either directorship or ownership, number of politically connected directors, and share of politically connected directors) on board size. Board size was chosen for this, being an indicator tightly correlated with all the indicators of political connections (values of the pairwise coefficients of correlation range from 0.37 to 0.57 with the p-value 0.01 each). Studying residual sums of squares through the Chow Test indicates that the differences between the subsamples are significant (the F-test statistics equals to 11.69 with the p-value 0.01 and 2 degrees of freedom in a sample of 204 observations).

[9] The same model as in the Chow test was used in the one-way ANOVA.

Table 3
Sample statistic on corporate roles of politically connected directors.

Figure	Politically connected directors at SOEs		Politically connected directors at POEs	
	Non-executives	Executives	Non-executives	Executives
Number of seats	82	21	28	6
% in the total amount of politically connected directors	79.6	20.4	82.4	17.6
% in the total amount of all directors	7,6	1,9	1.7	0,4
% in the size of relevant corporate body	12,6	4,8	2.5	1.2

Table 4
Industrial patterns of political connections: politically connected firms among industries.[11,12]

Industry	No firms	No of politically connected firms					% of politically connected firms					% of politically connected directors				
		2011	2012	2013	2014	2015	2011	2012	2013	2014	2015	2011	2012	2013	2014	2015
Aviation	5	5	5	5	5	5	100.0	100.0	100.0	100.0	100.0	15.5	15.9	15.9	16.8	19.0
Banking & Insurance	10	4	5	6	5	7	40.0	50.0	60.0	50.0	70.0	12.2	13.8	13.8	12.2	15.5
Commutation	8	4	4	4	4	4	50.0	50.0	50.0	50.0	50.0	0.0	3.2	3.2	4.0	3.0
Construction	5	3	3	3	4	4	60.0	60.0	60.0	80.0	80.0	1.4	2.7	2.7	5.4	4.9
Electric Power	53	33	32	31	31	31	62.3	60.4	58.5	58.5	58.5	2.3	3.1	3.1	3.7	3.6
Food	5	1	1	1	2	2	20.0	20.0	20.0	40.0	40.0	1.8	1.9	1.9	3.7	3.7
High Tech	5	2	2	3	3	3	40.0	40.0	60.0	60.0	60.0	2.3	2.3	2.3	3.4	2.2
Investment	8	1	1	1	1	1	12.5	12.5	12.5	12.5	12.5	0.0	0.0	0.0	0.0	0.0
Manufacturing (other)	16	4	4	4	4	4	25.0	25.0	25.0	25.0	25.0	1.4	1.4	1.4	1.4	2.0
Medicine & Pharmacy	5	1	1	1	1	1	20.0	20.0	20.0	20.0	20.0	0.0	0.0	0.0	0.0	0.0
Mechanical Engineering	15	8	8	8	7	7	53.3	53.3	53.3	46.7	46.7	5.0	5.5	5.5	5.1	4.5
Metallurgy	12	4	4	4	4	3	33.3	33.3	33.3	33.3	25.0	4.1	4.2	4.2	3.2	3.2
Mining: other	9	3	2	2	2	1	33.3	22.2	22.2	22.2	11.1	5.6	5.4	5.4	3.6	1.8
Mining: precious metals and stones	5	2	2	3	2	2	40.0	40.0	60.0	40.0	40.0	4.0	7.4	7.4	4.4	4.5
Oil, Oil Derivatives & Gas	14	8	8	8	8	8	57.1	57.1	57.1	57.1	57.1	5.6	5.6	5.6	6.1	9.0
Trade	4	0	0	0	0	0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Transport	4	3	2	1	1	1	75.0	50.0	25.0	25.0	25.0	4.3	2.1	2.1	0.0	1.9
Other (Miscellaneous)	5	1	1	1	1	1	20.0	20.0	20.0	20.0	20.0	4.3	6.1	6.1	7.0	7.0
Total	**188**	**87**	**85**	**86**	**85**	**85**	**46.3**	**45.2**	**45.7**	**45.2**	**45.2**	**4.1**	**4.7**	**4.7**	**4.8**	**5.2**

and the resource-based view (Barney, 1991). Competing with state ownership as with an alternative channel of connections to the state in SOEs, politically connected directors lose their status as unique managerial resources there. As a result, political connections through directorships become less valuable in SOEs in terms of the capacity to extract economic rent. SOEs could therefore try to offset this inefficiency by raising the number of politically connected directors.

Politically connected directors can have limited opportunities to extract economic rent from their political connections, taking into consideration their functions in the companies. Regardless of the forms of ownership, around 80% of politically connected directors in the general sample are non-executive. Involved in control and supervision, they are supposed to have limited influence on day-to-day management. Conversely, politically connected executives could have more opportunities to affect economic rents, having power over day-to-day managerial decisions. However, the share of executives is only about 20% of politically connected directors (see Table 3).

The degree of political connectedness could have substantially increased since 2011. This is based on a separate subsample that covers the set of companies continuously traded on the stock market throughout the full 5-year period of analysis.[10] The subsample shows that the number of politically connected directors increased by almost a quarter by 2016 in keeping with a corresponding increase in their share from 4.1% to 5.2% over the 5 years. Remarkably, a sharp increase in the number of politically connected directors on board happened by 2013 growing into a steady trend afterwards.

Political connectedness differs by industry (Table 4). Taking the percentage of politically connected directors as the measure, the most politically connected industries are aviation, banking & insurance and oil & gas. The shares of politically connected directors in those industries are higher than the average rate of 5.2%.

Regulated sectors[13] of the Russian economy show a higher degree of political connectedness. The example of Thailand suggests that restricted industries tend to be more politically connected, and political connections are of greater importance when the government has considerable power over resource allocation, regulatory changes, and access to restricted markets (Civilize et al., 2015). Under such circumstances, political connections acquire crucial importance, helping corporations to affect not just

[10] Naturally, the set of companies presented on the stock market in 2011 differs from that for the year 2015. To eliminate this effect, I made a subsample which includes companies continuously presented on the stock market throughout all the years analysed in the sample. The subsample covers 188 firms like that.

[11] To find out the dynamics of politicization over the period of 2011 – 2015, eliminating the effect of changes in the set of companies, the previous subsample was used.

[12] I use my own industry classification based on an analysis of sectoral homogeneity of political connections. The Aviation industry brings together aircraft firms and air transportation. Electric Power includes both power supply companies and power distribution companies. The High Tech industry concerns companies focusing on software, microelectronics, and device engineering. The Oil & Gas industry encompasses a broad range of companies associated with production, processing and distribution of hydrocarbon fuel. Manufacturing covers a broad specter of production enterprises that were not included in other groups. Broadcast companies, an agricultural producer and a hotel & event hall company make up the Miscellaneous group.

[13] By regulated (restricted) industries, I mean those in which government exerts substantial power over resource allocation using the regulation.

resource allocation but also the institutional environment. The subsample supports this too, showing a statistically significant correlation between the binary variable indicating company's political connectedness, and the binary variable that indicates belonging to a strategically important industry of Russia.[14] The pairwise coefficient of correlation is 0.189 (p-value 0.01).

The firm's age does not affect political connections in Russia, in contrast to the examples of Thailand, Indonesia and the U.S., which show that older companies tend to be more politically connected (Civilize et al., 2015; Leuz and Oberholzer-Gee, 2006; Unsal et al., 2016). The coefficient of pairwise correlation between firm age[15] and the indicators of political connections is statistically insignificant. This is possibly because most of Russia's biggest companies were established at roughly the same time during the period of liberalization (1991–1996): the modal firm age is 22 years in the main sample.

Politically connected companies in Russia do not gravitate to the capital regions, although the study (Chaney et al., 2011) has revealed this dependence across 19 countries. However, an exception is the subsample of SOEs, which shows a statistically significant negative coefficient of pairwise correlation of −0.228 (p-value 0.1) between the distance of company's headquarters[16] from Moscow in kilometres, and a binary variable indicating the presence of politically connected directors. Still, neither the subsample of POEs nor the main sample responds to this in a statistically significant way. This is possibly because the most politically connected companies in the sample are limited in their spatial location, being tied to either sites of natural resources extraction (oil & gas industry, mining of all types) or outlet markets (energy supply, construction, transport).

5. Value of political connections

5.1. Event study methodology

As a semblance of a natural experiment, the method of event study avoids the econometric problems of endogeneity, reverse causality and simultaneity discussed previously.

Finance theory suggests that capital markets encapsulate all available information about firms in stock prices (Fama, 1970). Given this basic premise, event studies help to find out how certain events affect a firm's prospects by quantifying the impact of the event on the firm's stock price. The event study holds the following basic assumption:

A1: *If political connections are important enough for Russian corporations, they affect the value of Russian corporations substantially, resulting in a statistically significant positive stock market reaction if political connections create value, and a statistically significant negative stock market reaction otherwise.*

Following (Faccio, 2006), I adopt the market-adjusted model based on the MOEX Russia Index (MICEX) with a 245-day estimation window to calculate abnormal returns as described in (Brown and Warner, 1985). The following types of events are considered: appointments to supervisory boards, appointments to executive bodies, acquiring shares by an individual, acquiring shares by a state body, acquiring shares by a state corporation, acquiring shares by an SOE.[17] The event date is defined as the day of the official public announcement about corporate reshuffles or the purchase of shares. I use 3 event windows of different lengths, specifically a 3-day window (days -1 to 1 around the announcement), a 4-day window (days -2 to 1 around the announcement) and a 5-day window (days -2 to 2 around the announcement). To evaluate the statistical significance of my results, both parametric and non-parametric methods are used. For a parametric testing of significance, I apply the Cross-Sectional Test as described in (Brown and Warner, 1985). I use the Sign Test (Cowan, 1992) and the Wilcoxon Rank Test (Wilcoxon, 1945) as the non-parametric tests, following the methodology of the respective works.

The dataset includes 1739 events in 204 corporations, of which 374 events in 81 corporations featured top Russian officials. The latter were divided into subsamples based on criteria including timeframes, corporate governance bodies, forms of ownership, and types of events.

An axiom of event study methodology, the efficient market hypothesis states that stock prices should reflect all the available information. The efficient market hypothesis and its validity for emerging markets is a fertile topic of debate due to conflicting witnesses in this regard, and the sample- and timeframe-dependent nature of market efficiency on developing capital markets (Majumder, 2012). This study focuses on the Moscow Stock Exchange which has showed increased efficiency over the last decade (Godlewski et al., 2011; Majumder, 2012). I also attempted to enhance market efficiency within the sample in 2 ways. First, I eliminated companies with a share turnover of less than 80 trading days per year, which is a direct manifestation of market inefficiency. Second, I introduced the 3-day asymmetric event window (days -2 to 1 around announcement) to account for information leakage prior to official announcements known to happen in emerging stock markets (Godlewski et al., 2011). However, I consider the limited efficiency of the Russian stock market in comparison to developed capital markets as a limitation of this study.

5.2. Event study results

The event study gives strong evidence that political connections exert an overall value-destructive effect on Russian corporations which is statistically significant (Table 5). In general, public announcements of political connections result in a statistically significant drop in stock prices by 1.34% on average within 5 trading days (p-value 0.01). The strength of market reaction roughly coincides with the result of Faccio (Faccio, 2006), but the direction of market reaction is negative.[18]

The strength of market reactions differs across groups of stakeholders. The most negative response is to politically connected owners resulting in an average drop in stock prices by 1.83% (p-value 0.01) within 5 trading days. This can be explained from the perspective of corporate governance, given that owners are endowed with the largest corporate power among all types of stakeholders, and play the key role in Russian corporate governance (Dolgopyatova, 2007). Moreover, if the politically connected owner is an individual, the stock price declines by 4.33%

[14] To define strategically important industries, I used Federal Law No 57-ФЗ "Procedures for Making Foreign Investments in Companies of Strategic Importance for Ensuring the Country's Defense and State Security" by 29.04.2008. The law specifies the list of criteria of strategically important companies and industries. The criteria are met by the following industries from my list: aviation, mining (precious metals and stones), mining (other), oil & gas industry, energy supply, telecommunications, and mechanical engineering. The government significantly affects resource allocation in strategically important industries.

[15] Using the term of firm's age, I refer to a difference between the date of incorporation and the day of December 31, 2015, expressed in full years.

[16] Referring to location of headquarters, I imply the address of official registration. According to Federal Law No 208-ФЗ "On Joint-Stock Companies" by 26.12.1995, the company's address of official registration corresponds to the seat of a permanent executive body.

[17] According to the legislation, state corporation is a special legal form of non-commercial organizations. This paper, therefore, distinguishes between state corporations and SOEs.

[18] Based on a sample of 41 countries with different political, economic and legal status, Faccio found that announcements of political connections result in a statistically significant increase in stock prices by 1.43% (Faccio, 2006).

Table 5
Stock market reaction to political connections.

Figure	N events	Market reaction, %			Significance (test statistics)[a]								
					Cross-sectional test (Brown and Warner, 1985)			Sign test (Giaccotto and Sfiridis, 1996)			Wilcoxon test (Wilcoxon, 1945)		
		CAAR (−1; 1)	CAAR (−2; 1)	CAAR (−2; 2)	CAAR (−1; 1)	CAAR (−2; 1)	CAAR (−2; 2)	CAAR (−1; 1)	CAAR (−2; 1)	CAAR (−2; 2)	CAAR (−1; 1)	CAAR (−2; 1)	CAAR (−2; 2)
Overall													
Grand total	374	**−0.620**	**−0.926**	**−1.340**	−1,437	−2,820***	−3,114***	4,171***	5,322***	5,226***	−2,308**	−2,955***	−3,238***
Directors (executives + non-executives)	309	**−0.554**	**−0.819**	**−1.236**	−1,856**	−2,535**	−2,041**	0,967	2,560**	2,674***	−1,071	−1,696**	−2,137**
Executive directors	44	**−0.651**	**−1.116**	**−1.771**	−1,746**	−2,468**	−3,415***	0,603	1,508	2,111**	−0,586	−1,089	−1,989**
Non-executive directors	266	**−0.542**	**−0.777**	**−1.157**	−1,587	−2,112**	−1,656**	0,858	2,207**	2,085**	−0,861	−1,351	−1,500
Owners	65	**−0.934**	**−1.431**	**−1.832**	−2,000**	−2,514**	−2,993***	3,101***	2,605**	3,101***	−1,345	−1,580	−1,867**
Types of owners													
State bodies	14	**−0.522**	**−1.647**	**−1.264**	−0,796	−2,024**	−1,605	2,138**	2,138**	1,604	−0,644	−0,954	−0,644
State corporations	11	**0.497**	**1.028**	**−0.658**	0,374	0,809	−0,409	0,302	0,302	0,905	0,660	0,786	0,031
SOEs	29	**−1.139**	**−1.613**	**−1.603**	−1,844**	−2,133**	−2,027**	2,043**	1,671	1,671	−1,040	−1,024	−0,826
Individuals	11	**−2.347**	**−3.138**	**−4.334**	−1,618	−1,602	−2,065**	1,508	1,508	2,111**	−0,786	−0,849	−1,226
SOEs													
Total	216	**−0.745**	**−0.965**	**−1.421**	−2,387**	−3,247***	−2,618***	2,172**	3,413***	3,723***	−1,716**	−2,298**	−2,834***
Directors (executives + non-executives)	171	**−0.797**	**−1.041**	**−1.565**	−1,856**	−2,535**	−2,041**	0,967	2,560**	2,674***	−1,071	−1,696**	−2,137**
Executive directors	21	**−1.035**	**−1.826**	**−1.796**	−1,746**	−2,468**	−3,415***	0,603	1,508	2,111**	−0,586	−1,089	−1,989**
Non-executive directors	150	**−0.764**	**−0.931**	**−1.533**	−1,587	−2,112**	−1,656**	0,858	2,207**	2,085**	−0,861	−1,351	−1,500
Owners	45	**−0.545**	**−0.676**	**−0.871**	−2,000**	−2,514**	−2,993***	3,101***	2,605**	3,101***	−1,345	−1,580	−1,867**
POEs													
Total	158	**−0.450**	**−0.873**	**−1.229**	−2,387**	−3,247***	−2,618***	2,172**	3,413***	3,723***	−1,716**	−2,298**	−2,834***
Directors (executives + non-executives)	138	**−0.253**	**−0.545**	**−0.828**	−1,856**	−2,535**	−2,041**	0,967	2,560**	2,674***	−1,071	−1,696**	−2,137**
Executive directors	23	**−0.300**	**−0.467**	**−1.748**	−1,746**	−2,468**	−3,415***	0,603	1,508	2,111**	−0,586	−1,089	−1,989**
Non-executive directors	116	**−0.254**	**−0.579**	**−0.670**	−1,587	−2,112**	−1,656**	0,858	2,207**	2,085**	−0,861	−1,351	−1,500
Owners	20	**−1.807**	**−3.131**	**−3.995**	−2,000**	−2,514**	−2,993***	3,101***	2,605**	3,101***	−1,345	−1,580	−1,867**
Before 2014													
Total	205	**−0.084**	**−0.214**	**−0.464**	−0,377	−0,880	−1,761**	0,070	1,187	1,327	−0,176	−0,244	−1,041
Directors (executives + non-executives)	177	**0.026**	**−0.114**	**−0.414**	0,116	−0,474	−1,569	0,676	0,977	1,278	0,255	−0,028	−1,064
Executive directors	26	**−0.873**	**−1.036**	**−1.859**	−1,729**	−1,676	−2,971***	0,392	1,177	1,961**	−0,404	−0,512	−1,625
Non-executive directors	152	**0.170**	**0.027**	**−0.187**	0,690	0,103	−0,660	0,811	0,649	0,649	0,555	0,271	−0,472
Owners	28	**−0.778**	**−0.841**	**−0.784**	−1,027	−0,932	−0,806	1,890**	0,756	0,378	−0,547	−0,274	0,032
Since 2014													
Total	169	**−1.271**	**−1.790**	**−2.402**	−2,524**	−3,250***	−2,223**	3,154***	3,769***	4,077***	−2,224**	−2,961***	−2,933***
Directors (executives + non-executives)	132	**−1.332**	**−1.765**	**−2.339**	−2,137**	−2,613**	−1,711**	2,263**	2,785***	2,611**	−1,763**	−2,311**	−1,905**
Executive directors	18	**−0.330**	**−1.231**	**−1.644**	−0,615	−1,894**	−1,852**	0,471	0,943	0,943	−0,108	−0,785	−0,908
Non-executive directors	114	**−1.491**	**−1.849**	**−2.449**	−2,083**	−2,386**	−1,553	2,248**	2,622***	2,435**	−1,760**	−2,064**	−1,630
Owners	37	**−1.052**	**−1.878**	**−2.626**	−1,796**	−2,599**	−3,457***	2,466**	2,795***	3,781***	−1,099	−1,685	−2,379**

[a]** - Significant within a 99% confidence interval.
** - Significant within a 95% confidence interval.
*** - Significant within a 90% confidence interval.

on average (p-value 0.05) within 5 trading days. The same happens when a SOE acquires a stake in a Russian company: the stock market responds with an above-average decrease in stock prices by 1.60% (p-value 0.05) within 3 trading days.

SOEs were more sensitive to political connections, showing a 1.42% decline in stock prices after announcements of political connections (p-value 0.01) against a stock price decline by 1.26% for POEs (p-value 0.01). This could be because the financial market expects SOEs to bear larger social and political costs of political connections. However, SOEs are more stable when new politically connected shareholders appear (in keeping with a weaker stock price drop by 0.87% with the p-value 0.01, against a 4.00% drop with the p-value 0.01 for POEs). This seems natural given that the government already controls a blocking stake in SOEs. As a consequence, SOEs are more sensitive to political connections through directorship; appointments of politically connected directors cause a decline in stock prices which is 2 times stronger for SOEs (1.57% with the p-value 0.05) in comparison to POEs (0.83% with the p-value 0.05). In total, the results suggest that state ownership moderates the value effect of political connections in a negative way.

Politically connected executive directors have a stronger influence on firm value than politically connected non-executives (board members), as the market reaction shows. While the announcements of political connections through the former cause a drop in stock prices by 1.77% on average within 5 trading days (p-value 0.01), news about political connections through the latter lead to a milder decline in stock prices by 1.16% on average within 5 trading days (p-value 0.05). From the perspective of corporate governance, this occurs because executives have broader opportunities to affect firm value directly making day-to-day managerial decisions, while non-executives are supposed to play the role of passive supervisors.

The results suggest that political factors were less important before the events in Ukraine. The strength of the market reaction has got almost 5 times as high after 2014; stock prices drop by 2.40% on average within 5 trading days (p-value 0.05), while this had been just 0.46% on average within 5 trading days (p-value 0.05) before 2014. This is also larger than the average stock market response over the whole 5-year period.

Political connections were significant prior to 2014. To test this, I built a new subsample extending the range of politically connected posts to governors of Russian regions, members of regional parliaments, top officers of branches of federal authorities, rectors of federal universities, and top officers of state corporations. This sufficiently enhanced the significance, showing that in 2014 the stock market reacted to politically connected people who had held those posts with a statistically significant drop in stock prices by 0.69% within 5 trading days (p-value 0.05 from the parametric test versus p-value 0.01 got from both non-parametric tests).

The stock market encapsulates all available information about the Russian corporations in stock prices to evaluate the impact of political connections on corporate prospects as negative, treating political connections through any type of affiliations deleterious for corporate development.

5.3. Robustness test

To check the robustness of the results, a control group was tested. The control subsample embraced events of appointment to boards of directors and executive bodies featuring politically unconnected directors. By political unconnectedness, this study means a lack of formal or informal channels of contact with the authorities. Specifically, I focused on those directors who had never been ministers in federal, regional or local governments, members of federal, regional and local parliaments, governors of Russian regions, rectors of state universities, top officers of state corporations, advisors to president, federal ministers or members of parliament, and had never held senior posts at federal executive authorities. 909 events like this were found.

The stock market showed a statistically insignificant reaction to appointments of directors after eliminating political connections. The Russian companies experience a statistically insignificant drop in CAR of 0.21% on average (p-value 0.5) after the announcement of politically unconnected directors. The statistical insignificance is confirmed through both parametric and non-parametric tests. This means that the previous results are robust.

6. Conclusion

This paper identifies how widespread political connections are in Russia, and what impact they exert on firm value, using a sample of Russian companies which covers the period 2011–2015.

A sharp increase of politicization occurred in Russia since 1999. As a consequence, 43% of Russian companies were found to be politically connected through ownership or directorship as of 2015. Politically connected companies are unevenly distributed across industries; regulated industries are more heavily politicized. Aviation, oil & gas and banking are the most politically connected sectors of the Russian economy. The differences between SOEs and POEs in terms of political connections have been found significant. The degree of political connectedness of the Russian corporations does not depend on how old the corporation is, nor how distant its headquarters are from the capital (despite the opposite finding in this regard for many other economies).

The results of the study show that political connections destroy the value of Russian companies. Announcements of political connections lead to a statistically significant decline in stock prices by 1.34% within 5 trading days on average. The stock market considers politically connected owners as the most detrimental group of stakeholders in terms of firm valuation, showing a statistically significant drop in stock prices by 1.82% within 5 trading days, and a decline in stock prices by 4.33% within 5 trading days when the politically connected shareholder was an individual. SOEs are more negatively affected by political connections compared to POEs. Political connections across different groups of shareholders show different strengths of impact in SOEs and POEs. The effect of political connections on firm value of Russian corporations increased substantially after 2014. The robustness of the results was confirmed through tests on a control group showing that the stock market does not show any statistically significant reaction after eliminating political connections.

7. Discussion

There are conflicting conclusions concerning the impact of political connections on firm value in the literature. The total effect of political connections varies depending on the stakeholders under consideration, forms of ownership, the current political environment and other factors. This paper investigates the influence of political connections on the value of Russian corporations given the econometric problems of endogeneity, simultaneity and reverse causality. Strong and statistically significant evidence of the value-destructive nature of corporate political connections in Russia was found, giving rise to 2 important questions.

First, why do political connections exert a negative value effect in Russia rather than positive, given that Russia provides an ideal institutional environment for this? The opposite result might have been expected in Russia given the examples of other

developing economies with underdeveloped price mechanisms, weak legal frameworks, and significant government intervention. Emerging and transitioning economies like China (Shi and Cheng, 2016; Tian et al., 2019; Wu et al., 2012a and others), Thailand (Civilize et al., 2015), Indonesia (Wati et al., 2019), Brazil (Claessens et al., 2008), Egypt (Dang et al., 2018), Korea (Chung et al., 2019) and other countries tend to demonstrate a positive total effect of political connections on firm value.

Second, why was the market reaction quite modest in Russia? The study (Banerji et al., 2018) explains that political connections are stronger in countries with greater state intervention, and more valuable in countries with a greater concentration of state ownership. According to the report of the Federal Antimonopoly Service of Russia, the state sector represents up to 70% of the Russian economy (Editorial, 2017). This paper shows that 43% of corporations from my sample are politically connected through ownership or directorship.

Considering the total effect of political connections as a form of balance suggests that the economic rents extracted by the Russian companies from political connections do not effectively offset the political and social costs of these connections.

This means that either the rents are too low, or the burdens are too high. In both cases, this could imply that political connections in Russia are not used effectively as an economic asset. Traditionally, international studies presume implicitly that corporations strive to establish political connections in order to get competitive advantages. However, in Russia political connectedness represents a bilateral process in which firms seek to establish political connections in order to get competitive advantages, while the government seeks to control the largest and most profitable companies. Although both processes play out simultaneously in Russia and affect each other, the results show that the head vector is that of the government rather than that of corporations. Establishing political connections, the government could focus on controlling the economy instead of rendering companies with extra rents through political connections. Subsequently, the enormous potential of political connections in Russia might not be operationalized enough economically. Low economic rents from political connections overlap with high political costs, and the clearest example is the direct economic sanctions against Russian companies and their directors during the Crimea Crisis. The stock market encapsulates this information to evaluate corporate prospects under the influence of political connections in a negative way.

The limited efficiency of the Russian stock market could be a factor that scaled down market reactions: while staying the same in terms of the direction of influence, the real magnitude of the impact could be higher than revealed.

Talking about possible ways of neutralizing negative effects of political connections, this is reasonable to refer to the example of South Korea which demonstrates that political connections showed a positive total effect on firm value only after political and economic liberalization (Chung et al., 2019). It is also relevant to mention the renowned Decree 18 issued in China to ban in-office government officials from taking up positions in corporations and prohibit retired government officials from exerting political influence to benefit connected firms (Hu et al., 2020; Liu et al., 2018).

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