



## The Impact of Governmental Ownership, Political Connections, and Related-Party Transactions on External Financing and Investment<sup>1</sup>

Zinat Babaei-Parkohi<sup>2</sup>, Seyed Kazem Ebrahimi<sup>3</sup>, Mohammad Amri-Asrami<sup>4</sup>

Received: 2022/07/16

Accepted: 2023/04/17

### INTRODUCTION

The existing literature provides conflicting predictions and evidence regarding the relationship between government ownership, political connections, and related-party transactions on external financing and investment in emerging markets. This study relies on the institutional theory to explore the relation between political and economic institutions in the Iranian capital market and examines the impact of governmental ownership, political connections, and related-party transactions on external financing and investment of companies listed on the Tehran Stock Exchange. Consequently, two key questions were addressed: (a) how are government ownership, political connections, and related-party transactions related to external financing? And (b) how are government ownership, political connections, and dealings with related parties related to the company's investment? The study utilized government ownership, political relations, and related-party transactions as independent variables, while

1. DOI: 10.22051/JFM.2023.41063.2712

2. M.Sc. Department of Accounting, Semnan University, Semnan, Iran. Email: zinat.babaei@yahoo.com.

3 Associate Professor, Department of Accounting, Faculty of Economics, Management and Administrative Sciences, Semnan University, Semnan, Iran. (Corresponding Author). Email:kebrahimi@semnan.ac.ir.

4 Assistant Professor, Department of Accounting, Faculty of Economics, Management and Administrative Sciences, Semnan University, Semnan, Iran. Email: m.amriasrami@semnan.ac.ir

external financing and investment in tangible fixed assets served as the dependent variables.

### **HYPOTHESES**

To examine the relationship between government ownership, political connections, and related-party transactions on external financing and investment, the following hypotheses are presented:

1. There is a negative relationship between government ownership and external financing.
2. There is a negative relationship between political connections and external financing.
3. There is a positive relationship between related-party transactions and external financing.
4. There is a positive relationship between government ownership and investment.
5. There is a positive relationship between political connections and investment.
6. There is a positive relationship between related-party transactions and investment.

### **METHOD**

The research method employed in this study is descriptive-correlational with an applied approach. The data collection method utilized in the theoretical foundations section was the library method, while in the hypotheses testing section, it relied on the analysis of firms' financial statements.

The sampling process was conducted using the systematic elimination method, adhering to the sample selection criteria of companies listed on the Tehran Stock Exchange. As a result, a sample of 102 companies was selected for the period of 2014-2020.

To test the research hypotheses, a multiple regression model with fixed effects was employed.

### **THE RESEARCH VARIABLES ARE AS FOLLOWS**

#### **THE DEPENDENT VARIABLES:**

**External Financing (EF):** The total cash received from the issuance of shares, an increase in borrowing and long-term loans and facilities.

**Investment:** Cash paid for the purchase of tangible fixed assets.

#### **INDEPENDENT VARIABLES:**

**Government Ownership (GO):** The total percentage of shares held by governmental companies and organizations.

**Political connections (PCON):** The following two criteria are used to measure it:



- (1) The ratio of long-term debt to total debt
- (2) The ratio of government-connected board members to all board members

Companies whose value of both criteria is higher than the middle are considered as companies with political connections and one is assigned to them, otherwise they will be zero.

**related-party transactions (RPT):** Represents the transactions between the parent company and its subsidiaries, which is divided by the sum of assets.

#### **CONTROL VARIABLES:**

**Company Size (Size):** Equal to the natural logarithm of all assets.

**Return on Assets (ROA):** Equal to net income divided by total assets.

**Financial Leverage (LEV):** Equal to total liabilities divided by total assets.

**Company Age (AGE):** Equal to the natural logarithm of the company since its inception in TSE.

**Cash flow (CFO):** Equivalent to the ratio of operating cash flow to total assets at the beginning of the period.

**Growth (Growth):** Equal to the amount of changes in the company's sales compared to last year.

#### **RESULTS**

The results indicate that government ownership and political connections exhibit a negative and significant relationship with external financing. Conversely, related-party transactions demonstrate a positive and significant relationship with external financing. However, no significant relationship was found between government ownership, political connections, related-party transactions, and investment.

#### **CONCLUSION AND DISCUSSION**

Government ownership often takes a long-term perspective and provides support to companies in terms of cash flow. Many government-owned companies rely on government budgets and financial resources rather than external financing. Corporate political connections, on the other hand, can serve various purposes beyond attracting external sources of supply. These relationships may have different objectives.

Related-party transactions can be utilized to optimally allocate internal resources, reduce transaction costs, and improve asset returns among group companies. Government ownership functions as a tool to achieve government goals, and as the economic and investment policies change, so does its role. Political connections can potentially distort or induce related-party transactions, and the behavior of the company's investment can confirm the theory of conflict of interest and opportunistic behavior, where company resources are acquired through related-party transactions.

Existing theories present two attitudes towards dealing with affiliates: opportunistic behavior (conflict of interest theory) and efficient behavior (efficient transaction hypothesis). The presence or absence of these behaviors is influenced by corporate governance, investor protection laws, and the overall business environment of countries. The conflict-of-interest theory suggests that such transactions are used to gain personal benefits for managers, resulting in harm to the company and shareholders. In contrast, the efficient transaction hypothesis considers related-party transactions as part of the business unit's demand and as a means to ensure managerial efficiency within the company. This perspective does not view trading with related parties as inherently harmful and may even deem it beneficial to shareholders.

Government owners can potentially improve the company's financial performance due to their influence in the government and access to financial resources. The extent of government involvement in corporate affairs and the level of its share ownership are influential factors in the frequency of transactions with related parties.

**Keywords:** Governmental Ownership, Political Connections, Related Party Transaction, External Financing, Investment.

**JEL Classification:** D25, H82, L14.

#### COPYRIGHTS



This license allows others to download the works and share them with others as long as they credit them, but they can't change them in any way or use them commercially.

