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Value of Politically Connected Independent Directors: Evidence from the Anti-Corruption Campaign in China

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Keywords: Political connections, Independent directors, Political risk, Firm value

JEL Classifications: G14, G3

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1. Introduction

Political connections are widely considered as valuable resources to firms, especially in emerging markets. For example, politically connected firms can have more access to financing, preferential regulatory treatment, and lower tax rate that increase firm value. However, political connections may also destroy firm value because connected firms can have worse corporate governance and lower operating efficiency. Moreover, they may also have higher political risk and thus higher required rate of return from investors. Therefore, studies have shown evidence supporting both the "helping hand theory" and "grabbing hand theory" of political connections. Although the literature is large, most of them focus on connections from blockholders and executives instead of independent directors, possibly because most connections are built by top insiders. However, it was prevalent for Chinese firms to appoint politicians as independent directors to build political connections. Appointing politically connected independent director (PCID) may help firms to build connections and thus increase firm value, but it can also distort the original role that independent directors should play and thus destroy firm value. Therefore, this study tries to extend existing research by focusing on PCIDs and shed more light on the overall effect of political connections.

In early 2013, the Chinese government started a massive anti-corruption campaign after President Xi Jinping came to power. During this campaign, a new regulation known as Regulation No.18 was issued by the Organization Department of the Communist Party of China (CPC) Central Committee on October 19, 2013. The new regulation prohibits all levels of government officials, who are currently in an official position or retried within 3 years, from taking any part-time position in firms and getting any kind of payment from firms. Many government officials had to resign from firms because of the regulation. Independent director is the largest group affected by this regulation given the prevalence of Chinese firms offering these positions to officials. Since officials are not required to resign immediately, we witnessed a wave of resignation of PCIDs in the following two years. Using this regulation as a shock, I examine the effect of losing PCIDs on Chinese listed firms in this study.

One would expect firms with PCIDs decrease in firm value after the release of Regulation No.18, because they may lose various benefits from political connections, which leads to worse operating performance or less future cash flows (cash flow explanation). However, since PCIDs do not necessarily resign right after the release of the regulation, firms with PCIDs may have higher political risk than other firms before their PCIDs actually leave, which leads to higher discount rate by investors and thus decrease in firm value (political risk explanation). To explore these two explanations, I further test the value effect when firms announce the actual resignation of their PCIDs. If the cash flow explanation holds, firm value should not change around announcement of PCID resignation since the loss of political connection is already expected by the market when Regulation No.18 is released. Moreover, firms should have worse operating performance after losing PCIDs. On the contrary, if the political risk explanation holds, firms should gain in firm value around PCID resignation because of lower political risk after announcing the actual leave of PCIDs.

In order to identify PCIDs, I first collect the resignation reports of all resigning independent directors during the period of January 2013 to May 2017. Then I use the most popular definition of political official in the literature to identify PCID: directors who are current or former (1) government officials, (2) leaders of the People's Congress, or (3) leaders of the People's Consultative Conference. My final sample includes 418 treated firms that have PCID resignations and 418 controlled firms matched with the treatment group using propensity score matching. The sample period is from 2011 to 2016. I have three event dates (year) in this study. The first one is the issuance date of Regulation No.18 and the second one is the announcement date of PCID resignation, which is different across firms. Since the resignation of an independent director cannot take effect if the fraction of independent directors is less than one third until the firm appoints a new director, the third one is the actual leaving date (year) of the resigning PCID.

This study has three main findings. First, the treatment group has significantly negative cumulative abnormal return (CAR) around release of Regulation No.18, especially in the

longer event windows. This is consistent with the first hypothesis that firms with PCIDs decrease in firm value because of the new regulation. Second, treated firms have large and significantly positive CAR around announcement of PCID resignations, providing support to the political risk explanation. However, the cross-sectional regression on CAR shows that the value effect is only significant for non-SOEs but not for SOEs. Third, using a difference-in-difference regression model, I find that firm's operating performance does not change after their PCIDs resign. This suggests that political connections built by PCIDs may not be so valuable for firm performance in China and casts doubt on the "helping hand" theory of political connections. On the contrary, political risk decreases significantly after PCIDs resign, providing further support to the political risk explanation. The subsample analysis shows that while non-SOEs decrease significantly in firm risk, SOEs' firm risk does not change. This is also consistent with results from CAR analysis. One possible explanation for the different results is that SOEs have more other political connections than non-SOEs because of their special relationship with the government. Even their PCIDs leave, they still have other connections and thus the same political risk.

This study is related to three strands of literature. First, many studies have investigated the effect of political connections on firms. On the one hand, some studies find that political connected firms have easier access to debt financing (Khwaja and Mian, 2005; Sapienza, 2004) and equity financing (Claessens, Feijen, and Laeven, 2008), preferential regulatory treatment (Faccio, 2006; Johnson and Mitton, 2003), and lower tax rates (Faccio, 2010). Therefore, political connections improve firm performance and firm value (Fisman, 2001; Goldman, Rocholl, and So, 2008). On the other hand, some studies also show that connected firms are associated with worse corporate governance (Cao, Pan, Qian, and Tian, 2017; Fan, Wong, and Zhang, 2007; Wang, 2015). The recent study of Akcigit, Baslandze, and Lotti (2018) find that although politically connected firms have a higher rate of survival, as well as growth in employment and revenue, they are much less likely to innovate and have lower productivity. Several studies also find that while political connections are valuable to

firms, the rent-seeking behavior distorts the allocation of economic resources and therefore brings about costs to the society overall (Claessens et al., 2008; Khwaja and Mian, 2005). In general, evidence on the overall effect of political connections is still mixing. While the literature is large, all of them focus on connections from blockholders and executives instead of independent directors with very few exceptions (e.g. Wang, 2015). My study extends existing literature by testing the effect of independent directors, who may play different roles from the top insiders. Moreover, by exploiting an exogenous shock, I show that political connections can destroy firm value because connected firms may have higher political risk and thus higher required rate of return from investors. Therefore, my study provides more evidence on the effect of political connections and cast doubt on the "helping hand" theory. I also show that the effect of losing PCIDs is different for SOEs and non-SOEs, suggesting that the effect of political connections in contingent on firm's ownership structure.

Second, recent studies have investigated the effect of political risk on asset prices. The theoretical work of Pástor and Veronesi (2013) predicts that political uncertainty commands a risk premium whose magnitude is larger in weaker economic conditions. The recent empirical studies also find evidence consistent with this prediction. For example, using the Economic Policy Uncertainty (EPU) index constructed by Baker, Bloom, and Davis (2016), Brogaard and Detzel (2015) find that EPU positively forecasts log excess market returns. However, as argued in Liu, Shu, and Wei (2017), most existing studies are unable to rule out the issue of endogeneity and isolate political uncertainty from economic uncertainty. To address this issue, Liu et al. (2017) use the Bo scandal in China as an exogenous shock and finds that firms connected with Bo suffer decrease in firm value after the scandal. This study also exploits a clean exogenous shock and provide strong support for the existence of priced political risk in China. Consistent with Liu et al. (2017), I find that firm value decreases around release of the regulation when political risk increases. Moreover, different from them, I also find that stock price increases when political risk decreases around the actual resignation of PCIDs.

Third, this study also relates to the increasing literature on China's anti-corruption cam-

paign. For example, Ding, Fang, Lin, and Shi (2017) use the inspection of provincial government as the event to examine the consequences of corruption on firms. Similarly, Lin, Morck, Yeung, and Zhao (2016) and Griffin, Liu, and Shu (2018) also examine consequences of the anti-corruption campaign on firms. Different from them, I use Regulation No.18, a specific regulation during the campaign, to test the value effect of political connections. Although Liu, Lin, and Wu (2018) also use Regulation No.18 to test the value effect of political connections, they only focus on the value effect around release of the regulation and do not explore the potential mechanisms. While they argue firms have negative CAR around release of Regulation No.18 because they are expected to lose benefits from political connections, my results suggest that the negative CAR is because of higher political risk. The recent work of Hu, Karim, Lin, and Tan (2019) also investigate the value effect of PCID resignations, but they only provide very limited results on the CAR analysis and their sample size is much smaller. Moreover, while they mainly focus on the change of debt financing, government subsidy, and corporate governance after the loss of PCIDs, they do not consider the change of political risk, which is my focus in this study.

The rest of this paper is organized as follows. Section 2 introduces Chinese institutional background and develops my hypotheses. Section 3 describes the data and variables. Section 4 presents empirical results and Section 5 concludes.

2. Institutional Background and Hypotheses

First introduced in 1990 with only eight firms listed, China's stock market has become the second largest in the world by 2012. 3052 companies are listed in Shanghai Stock Exchange (SSE) and Shenzhen Stock Exchange (SZSE) with market capitalization of about 50 trillion CNY (7.4 trillion USD) as of 2016.[1] However, corporate governance in Chinese listed firms has always been a looming issue because many firms are controlled by the government and legal structures of most firms are complicated. In order to improve corporate governance,

[1]Source: The Annual Report of the CSRC.

on August 16, 2001, China Securities Regulatory Commission (CSRC) issued the *Guideline for the Establishment of the Independent Director System in Listed Firms* (Guideline). The Guideline requires that all firms listed on Chinese stock exchanges should have at least one third of board members as independent directors by June 30, 2003. As in Clarke (2006), the independent director system in China was meant to be a "legal transplant" from the U.S. corporate governance law and practice, but the definition of "independence" is even stricter. A director affiliated with or representing a non-insider block holder who holds more than 1% of shares outstanding is not considered independent in China, while the common ownership threshold for insider classification is 10% in the United States (Jiang, Wan, and Zhao, 2015).

Although the definition of independence is stricter, monitoring from independent directors can be weak in China. One of the reasons is that many of them are government officials instead of industry experts. Studies have shown that although PCID may bring valuable political resources to firms, it may also distort the original role that independent directors should play in firm's governance. Some Chinese SOEs appoint politicians as independent directors in order to occupy more board seats and achieve political and social objectives (Wang, 2015). For non-SOEs, building good relationship with the government is even more important as the government has large control over resources and Chinese culture values interpersonal connections in business (or *Guanxi* in Chinese). Appointing PCIDs is an easy way to build such a relationship with the government. As a result, appointing PCID was prevalent in Chinese listed firms.

However, this situation has changed from 2013. In early 2013, Chinese government started a massive anti-corruption campaign after President Xi Jinping came to power. During this campaign, the Organization Department of the CPC Central Committee issued a new regulation known as Regulation No.18 on October 19, 2013.[2] This regulation prohibits all levels of government officials, who are currently in an official position or retried within 3 years,

[2]See Organization Department of the CPC Central Committee, *Guanyu jinyibu guifan dangzheng lingdao ganbu zai qiye jianzhi (renzhi) wenti de yijian (Guidance on the Regulation of Party and Government Leaders Taking Office in Companies)*, issued on October 19, 2013. The original document is available on http://hdtz.buct.edu.cn/docs/20141103161920781696.pdf.

from taking any part-time position in firms and getting any kind of payment from firms. One feature of the new regulation is that it applies to all officials: officials of local and central government, leaders of the CPC, leaders of People's Congress or People's Consultative Conference, leaders of main SOEs, and leaders of main public universities and hospitals. Independent director is the largest group affected by this regulation. Most PCIDs resigned after the release of this regulation. However, since this regulation gives some time for government officials to resign in order to maintain the normal operation of boards, we witnessed a wave of independent director resignations over the next two years. According to the Guideline of CSRC, all listed firms must have at least one third board members as independent. Therefore, the resignation of an independent director cannot take effect if the fraction of independent directors is less than one third until the firm appoints a new director in a shareholder meeting. Some PCID stayed in the board after announcing resignation until they are replaced.

Regulation No.18 is an exogenous shock to the market because it is difficult to anticipate the release of such a regulation. Even though firms could anticipate that their political connections could be affected by the anti-corruption campaign, it is unlikely for them to know to what extent officials would be regulated or the exact time of a new regulation. Moreover, this regulation applies to officials who resigned or retired from the government within 3 years, which means officials could not choose to leave the government and stay in firms. Therefore, some firms unexpectedly lost political connections, especially some privately controlled firms.

One would expect firms with PCIDs decrease in firm value after release of Regulation No.18 for two possible reasons. First, previous studies find that connected firms have higher firm value because political connections can bring various benefits, especially in China where government has large control over resources. After the release of the new regulation, some firms are expected to lose such valuable connections when PCIDs resign. Second, since Regulation No.18 gives some time for government officials to resign in order to maintain the nor-

mal operation of boards, most PCIDs resign during 2014 to 2015. Therefore, firms may have higher political risk before the actual leave of PCIDs, especially during the anti-corruption campaign when connected firms are more likely to be investigated by the government (e.g., Griffin et al., 2018). In sum, I postulate the following:

Hypothesis 1: Firms with PCIDs decrease in firm value following the release of Regulation No.18.

To further explore the two potential reasons, I test the value effect when firms announce the actual resignation of their PCIDs. If the first explanation holds, firm value should not change around announcement of PCID resignation since the loss of political connection is already expected by the market when Regulation No.18 is released. Moreover, firms should have worse operating performance as a result of losing political connections. This is summarized as the cash flow explanation. However, if the second explanation holds, firm value should increase around announcement of PCID resignation, because firms have lower political risk after announcing the actual leave of PCIDs and complying with the regulation. This is summarized as the political risk explanation. In sum, I postulate the following alternative hypotheses for the two explanations, respectively:

Hypothesis 2a: Firm value does not change around the announcement of PCID resignation.

Hypothesis 2b: Firms have worse operating performance after replacing PCIDs.

Hypothesis 3a: Firms value increases around the announcement of PCID resignation.

Hypothesis 3b: Firms have lower risk after replacing PCIDs.

3. Data and Variables

3.1. Data Sources and Identification Strategy

In order to identify resigning PCIDs, I first collect the resignation reports of all resigning independent directors during the period of January 2013 to May 2017 from the official website

of SSE (www.sse.com.cn) and SZSE (www.szse.cn). CSRC requires listed firms to make public announcements for all major issues, including independent director resignations. A resignation report normally states which director resigns, why the director resigns and when the resignation is effective. Based on the resignation reports, I identify 2342 independent directors resigning from 1477 firms, in which 2217 independent directors from 1433 firms resign after the release of Regulation No.18. Then I use the most popular definition of political official in the literature to identify PCID: directors who are current or former (1) government officials, (2) leaders of the People's Congress, or (3) leaders of the People's Consultative Conference (Chen, Li, Su, and Sun, 2011; Fan et al., 2007; Li, Meng, Wang, and Zhou, 2008). I do not include leaders of main SOEs, public universities and hospitals although they are also affected by the new regulation, as their political connections can be limited and firms appoint them mainly for their industry or academic expertise. Using this method, I identify 741 PCIDs resigning from 562 firms. Then I exclude financial firms and firms whose PCIDs resign after December 2016. Since I use 2010 as the matching year for propensity score matching, I also exclude firms listed after 2010. Finally, I am left with 418 firms that comprise my treatment group. The sample period is from 2011 to 2016 for the empirical analysis. The firm-level data are from CSMAR database maintained by GTA Information Technology Company Ltd. The background information of independent directors are collected from firm's annual reports. Finally, I collect release dates of 55 regulatory documents of CSRC issued during 2011 to 2016 from the official website (www.csrc.gov.cn) to construct the policy risk measure.

Figure 1 plots the number of independent director resignations during January 2013 to May 2017. The solid line shows that the total number of independent director resignations increase dramatically after the release of Regulation No.18 and goes back to normal level from the beginning of 2016. At the end of 2014 and 2015, there are two peaks when more than 200 independent directors resign within a month. This is probably because they tend to resign in the end of the financial year in order to take full compensation. The dashed line

shows that the first resignation of PCID takes place in January 2014 and the last one in June 2016. The distribution of PCID resignations shows the same pattern as that of independent director resignation. Figure 2 plots the actual leaving dates of the resigning PCIDs following the release of Regulation No.18. The first effective resignation takes place in January 2014. Since many Chinese listed firms hold their annual shareholder meetings in April and May, we witness three peaks of effective PCID resignation around May 2014, 2015, and 2016.

I have three event dates (year) in this study. The first one is the release date of Regulation No.18. Since the regulation is issued on Saturday, I use the following Monday (October 21, 2013) as the event date. The second one is the announcement date of PCID resignation, which is different across firms. I use this event date to examine the value effect of PCID resignation. Third, since some of the resignations cannot take effect if the fraction of independent director is less than one third until a new director is appointed in a shareholder meeting, I use the effective date of the resignation as the actual leaving date of the PCID. Since listed firms are also required to make public announcements after each shareholder meeting, it is possible to identify the appointing date of the new director or the actual leaving date of the resigning director. I use this event date (year) to test the change of operating performance and firm risk. For firms that have more than one independent director resignation, I use the date when the firm loses its first PCID as the event date.

3.2. Variables

I calculate cumulative abnormal return (CAR) around the event dates to measure the value effect of Regulation No.18 and PCID resignation. Following the literature, I use return on equity (ROE) and cash flow from operation (CFO) to measure firm's operating performance. I also use operating profit to total assets (OPOA) and total cash flow (CF) in the robustness tests. As shown in previous studies, it is difficult to measure firm's political risk and isolate political risk from firm's overall risk. Therefore, following Liu et al. (2017), I use stock return volatility to measure firm risk. If firm's political risk change, the overall

risk measured by volatility should also change. Volatility is defined as the annual standard deviation of daily stock return multiplied by 100. I also construct a political sensitivity measure is the spirit of Liu et al. (2017). Specifically, I calculate the firm's CAR from market model over the three-day window around announcements of the new regulatory documents issued by CSRC each year. Then I sum the absolute value of these CAR in the year and use it to proxy firm's political sensitivity. A full listed of variable definitions can be found in Appendix A.

3.3. Propensity Score Matching

In order to use difference-in-difference (DID) regression in empirical analysis, firms in the treatment and control group need to be comparable before release of the new regulation. Therefore, I implement propensity score matching as a resampling technique. Since the regression analysis uses data from 2011 to 2016, I use 2010 as the matching year to make the treatment and control groups comparable throughout the pre-event period. I first estimate the following cross-sectional logit regression in 2010 for all non-financial listed firms in China to estimate an ex-ante probability of being treated, i.e., the propensity score:

$$\begin{aligned} PCID_i = \alpha + \beta_1 Size_i + \beta_2 Leverage_i + \beta_3 B/M_i + \beta_4 Growth_i \\ + \beta_5 Top1_i + \beta_6 Independence_i + \beta_7 Board\ size_i + \epsilon_i, \end{aligned} \tag{1}$$

where $PCID_i$ is a dummy variable which is equal to 1 if firm i is in the treatment group and 0 otherwise. The regression results are reported in Table B1 of Appendix B. Then for each treated firm, I use one-to-one matching without replacement to identify a controlled firm with the closest propensity score as well as the same industry and ownership structure (SOE or non-SOE). The propensity score density of the treatment group and control group is plotted in Figure B1 of Appendix B. It shows that the two groups have similar propensity score distributions, suggesting that they have similar ex-ante probability of being treated. Table B2 reports summary statistics of firm characteristics for the matched sample, which

includes 418 treated firms and 418 controlled firms. I compare firm characteristics of the two groups in all three pre-event years. It shows that the treatment and control groups are not significantly different in firm characteristics, suggesting the propensity score matching succeeds in finding comparable controlled firms.

4. Empirical Results

4.1. Summary Statistics

Table 1 reports summary statistics of variables used in this study. In Panel A, the sample includes all non-financial listed firms in China from 2011 to 2016. All variables are winsorized at 1%-99% except dummy variables. $PCID$ has a mean of 0.204, which means that 20.4% A-share firms have PCIDs resignation after the release of Regulation No.18. *Policy sensitivity* has a mean of 4.95%, suggesting that policy and regulation of CSRC has a large impact on market performance. The average board independence is 0.374, which is consistent with the regulation in China that at least one third board members should be independent. The statistics of other variables are comparable with other recent studies (e.g., Liu et al., 2017). Panel B shows the summary statistics of the matched sample used in the empirical analysis. Firm characteristics of the matched sample are similar to those of the full sample except the matched sample has more SOEs.

4.2. Value Effect

4.2.1. Market Reaction to Release of Regulation No.18

To investigate the value effect of Regulation No.18, I perform an event study to test the stock market reaction to the release of the regulation. To obtain CAR, I first estimate the following regression for stock i:

$$R_{i,t} = \beta_i R_{m,t} + \epsilon_{i,t} \tag{2}$$

where $R_{i,t}$ and $R_{m,t}$ are the excess return of stock i and market excess return on day t. The estimation window is 280 days to 90 days before the release of Regulation No.18. The estimated coefficients $\hat{\beta}_i$ is used to construct the abnormal return as $AR_{i,\tau} = R_{i,\tau} - \hat{\beta}_i R_{m,\tau}$, where $R_{i,\tau}$ and $R_{m,\tau}$ are realized returns of stock i and market return on day τ. τ is equal to 0 on the event day (October 21, 2013). CAR is calculated as $\sum_{\tau=-1}^{T} AR_{i,\tau}$, where T is equal to 1, 5, 10, 15, and 20 for different windows. Since many Chinese listed firms have a large fraction of non-tradable shares, I use float value weighted market return when calculating CAR. I also use total value weighted market return for robustness tests.

Table 2 reports CAR of treated firms around release of Regulation No.18. The first column shows the results of full sample. Generally, treated firms have negative CAR in all five windows, although they are not significant in the short event windows. The CAR is -0.04% in the 3-day window and -0.543% in the 7-day window without significance. In the 12-day window, the negative CAR is very large in magnitude (-2.006%) and significant at 1% level. While it decreases to -1.729% and -0.933% in the 11-day and 22-day window, it is still significant. The non-significant CAR in short event windows is possibly because of inefficient information transmission. As in Liu et al. (2018), the new regulation was initially sent to certain government agencies and institutions concerned through the internal administrative system, which may have caused a delay in the dissemination of the message across the market. The next two columns show results for the SOEs and non-SOEs subsamples. Non-SOEs seems to be more affected by the new regulation than SOEs as evident by the slightly larger CAR. The CAR estimated using total value weighted market return are reported in Table IA1 and similar with the main results, although they are smaller in magnitude.

Next, to further build the causal effect of Regulation No.18 on firm value, I estimate the following cross-sectional regression:

$$CAR_i = \alpha + \beta_1 PCID_i + Controls + \omega_j + \epsilon_i, \tag{3}$$

where CAR_i is the CAR of firm i, and $PCID$ is a dummy variable which is equal to 1 if

the firm is in the treatment group and 0 otherwise. I control for firm size, leverage ratio, book-to-market ratio, growth rate, ROE, ownership of the largest shareholder, idiosyncratic risk, and SOE status in the regression. I also include ω_j to control for industry fixed effect. Moreover, in order to avoid correlations in the error term due to unobserved heterogeneity, I adjust standard errors by clustering observations at industry level throughout the paper. The sample includes 418 treated firms and 418 controlled firms matched with the treatment group.

The regression results are reported in Table 3. It shows that coefficients on the main interest variable, $PCID$, are all significantly negative. The coefficient is -0.342% in the 3-day window. It further decreases to -1.047%, -1.267%, and -1.437% in the 7-day, 12-day, and 17-day window, respectively. Although the coefficient is smaller in magnitude in the longest window, it is still significant at 1% level. The results suggest that the treated firms have significant lower CAR than controlled firms and thus the release of Regulation of No.18 has negative effect on firm value of treated firms. Regression results of CAR estimated using total value weighted market return are reported in Table IA2 of Internet Appendix. The results show similar pattern as those in Table 3. Therefore, the CAR analysis provides evidence supporting Hypothesis 1.

4.2.2. Market Reaction to PCID Resignation

Although treated firms have negative CAR around the release of Regulation No.18, the underlying mechanism is not clear. To test Hypothesis 2a and 3a, I calculate CAR of treated firms around the announcement of PCID resignation. I use the same method to estimate CAR as in previous subsection, except that the event date is the announcement date of PCID resignation, which is different across treated firms. Table 4 shows that firms have large and significantly positive CAR around the announcements of PCID resignations. Overall, the treatment group has a 1.3% CAR in the 3-day window and the CAR further increases to 2.782% in the 7-day window and 3.681% in the 12-day window, after which it decreases to

3.579% in the 17-day window and 3.025% in the 22-day window. The last two columns show that both SOEs and non-SOEs have positive CAR, but their magnitudes are different. Non-SOEs have much larger CAR than SOEs in all windows, especially in the longer windows, suggesting that non-SOEs may be more affected by PCID resignation. The results are similar if I use total value weighted market return as shown in Panel A of Table IA3. I also use market-adjusted return and Fama-French three factor model to estimate CAR for robustness tests. The results are reported in Table IA3 and still consistent with the main results.

Next, to further address the causal effect of PCID resignation on firm value, I run regression model (3) on CAR around PCID resignation. The results are reported in Panel A of Table 5. $PCID$ has significantly positive coefficient in all windows, suggesting that treated firms have higher CAR around announcements of PCID resignations than controlled firms after controlling for other firm characteristics. The coefficient on $PCID$ is 0.519 in the 3-day window and further increases to 1.086 and 2.413 in the 7-day and 12-day window. Although the coefficients decrease in longer windows, they are still significant and economically large. The results using different methods to calculate CAR are reported in Table IA4 and are almost identical with those in Table 5. To conclude, Table 4 and 5 suggest that treated firms increase in firm value when their PCIDs resign, providing support for the political risk explanation. The results are also consistent with those in Ding et al. (2017). However, they mainly investigate the overall market reaction to the anti-corruption campaign, while I focus on the lose of political connections from PCIDs in this study.

As shown in Table 4, CAR of SOEs and non-SOEs are different in magnitude. To further explore whether the value effect is contingent on ownership structure, I estimate the cross-sectional regression for SOEs and non-SOEs, separately. The results are reported in Panel B of Table 5. The first five columns show that although SOEs still have positive coefficients on $PCID$, they are not significant. On the contrary, the coefficients in non-SOEs subsample are significant and even larger in magnitude than those in the full sample. For example, the coefficients are 2.413 and 2.013 in the 12-day and 17-day window for the full sample, while

they are 4.554 and 4.009 for the non-SOEs subsample. Therefore, the positive value effect around PCID resignations are mainly driven by non-SOEs. One possible explanation is that non-SOEs decrease more in political risk than SOEs after their PCID resign. I will further explore this issue in the next subsection. My results are also consistent with Liu et al. (2018) who find that market reaction to the release of Regulation No.18 is significant for non-SOEs but not significant for SOEs. Results in the robustness tests are shown in Table IA5 and still consistent.

4.3. Operating Performance and Firm Risk

The previous subsection shows that treated firms have positive CAR around PCID resignation, suggesting that the political risk explanation may dominant the cash flow explanation. To further explore the two mechanisms, I perform a DID analysis on firm's operating performance and firm risk. DID methodology is ideally suited for establishing casual claims in a quasi-experimental setting. It eliminates the bias that comes from changes other than the regulation that could have affected the treatment group (Vig, 2013). The regression model is specified as follows:

$$y_{it} = \alpha + \beta_1 PCID_i + \beta_2 PCID_i \times Post_t + Controls_{t-1} + \omega_j + \gamma_t + \epsilon_{it}, \tag{4}$$

where $PCID_i$ is defined as above and $Post_t$ is a dummy variable which is equal to 1 after the PCID physically leaves the board. ω_j and γ_t are industry and year fixed effect. The regression model does not have the dummy variable $Post_t$ like a typical DID regression model since it has year fixed effect that overlaps with $Post_t$. The interaction dummy variable, $PCID_i \times Post_t$ is the main interest variable that reflects the change of treated firms after the event compared to controlled firms.

Table 6 reports regression results of operating performance. In Panel A, I use ROE to measure operating performance. The first column shows that ROE of the treatment group

does not change significantly after losing PCIDs compared to controlled firms. Column (2) and (3) further show that operating performance of both SOEs and non-SOEs is not affected by PCID resignation. In Panel B, I use CFO to measure operating performance. Similar to results in Panel A, the coefficients on $PCID \times Post$ are not significant in all three columns. I also use OPOA and CF as alternative measures of operating performance. The results are reported in Table IA6 of Internet Appendix and consistent with the main results. Therefore, firms do not have worse operating performance after losing political connections from PCID, providing consistent evidence with the CAR analysis that the cash flow explanation does not hold. Therefore, my results suggest that political connections built by PCIDs may not be so valuable for firm performance in China and cast doubt on the "helping hand" theory of political connections.

The regression results of firm risk is reported in Table 7. As shown in column (1) for the full sample, the coefficient of $PCID \times Post$ is negative but not significant. However, column (2) and (3) show different results for SOEs and non-SOEs. While the coefficient is not significant for SOEs, it is significantly negative for non-SOEs, suggesting that stock return volatility of non-SOEs in the treatment group decrease significantly after losing PCIDs. In Panel B, the results are similar when using political sensitivity as the dependent variable. Non-SOEs decrease significantly in political sensitivity while SOEs' political sensitivity does not change. One possible explanation is that SOEs have more other sources of political connections than non-SOEs because of their special relation with the government. Even their PCIDs leave, they still have other connections and thus similar political risk. On the contrary, PCIDs may be a main source of political connection for some non-SOEs. Therefore, their risk decreases significantly after losing this connection. The results are also consistent with the CAR around PCID resignation where I find the non-SOEs have more significant CAR than SOEs. Since non-SOEs have lower firm risk after losing PCIDs, they gain in firm value when their PCIDs resign. Therefore, Table 7 provides supporting evidence for Hypothesis 3b, suggesting that political risk explanation dominates the cash flow explanation. Although

political connections may bring various benefits to firms in China as shown in previous studies, they also increase firm's political risk, especially during the anti-corruption campaign, which cast doubt on the "helping hand" theory. Moreover, the results also provide novel evidence that political risk is priced by investors in China. To conclude, the previous two subsections suggest that while treated firms lose in firm value after the release of Regulation No.18 because of higher political risk, they gain in firm value after their PCIDs resign because of lower political risk.

5. Conclusions

On October 19, 2013, the CPC Central Committee issued a new regulation known as Regulation No.18, which leads to a wave of PCID resignation in the following two years. Using this regulation as a quasi-natural experiment, I investigate the effects of losing PCIDs on Chinese listed firms. There are three main findings in this study. First, firms have significantly negative CAR around the release of the new regulation. Further analysis suggests that the decrease in firm value is probably because of increase in political risk. Second, firms have large and significantly positive CAR around resignation announcement of PCIDs, because their political risk decreases after replacing PCIDs and complying with the new regulation. The positive CAR is more prominent for non-SOEs than SOEs as SOEs may have more other connections with the government and thus their political risk does not change significantly. Third, using DID methodology, I show that firms' operating performance does not change after replacing PCIDs. Consistent with the CAR analysis, political risk of non-SOEs decreases significantly, while SOEs' political risk does not change. The previous three findings cast doubt on the "helping hand" theory of political connections. Although connections may bring benefits to firms and increase firm value, it can also increase firm risk and thus decrease firm value, especially during the anti-corruption campaign. The results also suggest that political risk is priced by investors in China.

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Appendix A. Variable Definitions

Variable	Definition
PCID	A dummy variable which is equal to 1 if the firm is in the treatment group and 0 otherwise. The firm is in the treatment group if it has politically connected independent directors (PCID) resignation to comply with Regulation No.18 and 0 otherwise.
Post	A dummy variable which is equal to 1 after the resignation of politically connected independent director takes effect and 0 otherwise.
ROE	The ratio of net profit to book value of equity.
CFO	The ratio of cash flows from operation to total assets.
OPOA	The ratio of operating profit to total assets.
CF	The ratio of total cash flows to total assets.
Volatility (%)	Stock price volatility, which is calculated as the standard deviation of daily stock return, multiplied by 100.
Political sensitivity (%)	The sum of absolute cumulative abnormal return over the three-day window around announcements of the new regulatory documents issued by China Securities Regulatory Commission (CSRC) estimated using market model.
Size	The natural logarithm of total assets.
Leverage	The ratio of total liabilities to total assets.
Tangibility	The ratio of tangible assets to total assets.
ROA	The ratio of net profit to total assets.
B/M	The ratio of book value of equity to market value of equity.
Growth	The one-year lagged growth rate of net sales.
Top1	The ratio of shares held by the largest shareholder to total shares outstanding.
Age	The natural logarithm of firm age.
Independence	Board independence, which is defined as the ratio of the number of independent director to the total number of board member.
Board size	The natural logarithm of number of board members.
Beta	The beta obtained from market model.
Ivol (%)	Idiosyncratic volatility, which is defined as the standard deviation of daily stock return residuals from market model, multiplied by 100.
SOE	A dummy variable which is equal to 1 if the firm is a state owned enterprise and 0 otherwise.

Appendix B. Propensity Score Matching

Table B1: Logit Regression Results

This table reports regression results of propensity score matching using the following logit regression model: $PCID_i = \alpha + \beta_1 Size_i + \beta_2 Leverage_i + \beta_3 B/M_i + \beta_4 Growth_i + \beta_5 Top1_i + \beta_6 Independence_i + \beta_7 Board\ size_i + \epsilon_i$, where $PCID_i$ is a dummy variable which is equal to 1 if the firm is in the treatment group and 0 otherwise. The firm is in the treatment group if it has politically connected independent directors resignation to comply with Regulation No.18. The matching year is 2010. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

Size	0.137**
	(0.054)
Leverage	-0.174
	(0.197)
B/M	-0.207
	(0.204)
Growth	0.002
	(0.002)
Top1	0.002
	(0.004)
Independence	2.222**
	(0.993)
Board size	0.115***
	(0.033)
Constant	-5.407***
	(1.236)
Observations	1920
Pseudo R^2	0.012

Table B2: Summary Statistics after Matching

This table reports summary statistics of variables used in this study for the matched sample during the pre-event period. A firm is treated if it has politically connected independent directors resignation to comply with Regulation No.18. For each treated firm, I use one-to-one propensity score matching without replacement to find a controlled firm in the same industry and with the same SOE status in 2010. I report summary statistics for 2011, 2012, and 2013 separately. I also report difference between the treatment and control group and perform t-test on the difference. All variables are winsorized at 1% to 99% except dummy variables. All variables are defined in Appendix A. ***, **, and * represent statistical significance at the 1%, 5%, and 10%, respectively. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

	2011			2012			2013		
	Treatment	Control	Difference	Treatment	Control	Difference	Treatment	Control	Difference
ROE	0.087	0.073	0.015**	0.066	0.046	0.020**	0.048	0.034	0.014
CFO	0.033	0.033	0.000	0.047	0.045	0.003	0.040	0.037	0.003
OPOA	0.051	0.041	0.009**	0.038	0.031	0.007*	0.034	0.026	0.008
CF	0.625	0.604	0.020	0.594	0.599	-0.004	0.580	0.584	-0.004
Volatility (%)	2.480	2.497	-0.017	2.439	2.482	-0.043	2.558	2.628	0.070*
Political sensitivity (%)	5.238	5.269	-0.031	3.787	3.901	-0.114	4.510	4.571	-0.061
Size	22.005	21.801	0.204	22.159	21.919	0.239***	22.285	22.042	0.243***
Leverage	0.463	0.458	0.005	0.471	0.458	0.013	0.474	0.471	0.003
Tangibility	0.952	0.954	-0.002	0.947	0.950	-0.003	0.947	0.948	-0.001
ROA	0.047	0.041	0.006	0.037	0.034	0.003	0.032	0.027	0.005
B/M	0.485	0.482	0.003	0.537	0.528	0.009	0.541	0.529	0.012
Growth	0.420	0.261	0.160**	0.165	0.176	-0.011	0.149	0.162	-0.013
Top1	0.372	0.373	-0.001	0.371	0.376	-0.005	0.368	0.368	0.000
Age	2.490	2.479	0.011	2.580	2.570	0.010	2.661	2.651	0.009
Independence	0.373	0.369	0.003	0.372	0.371	0.001	0.372	0.374	-0.002
Board size	2.204	2.197	0.007	2.207	2.198	0.009	2.204	2.191	0.013
Beta	1.187	1.185	0.003	1.241	1.241	0.000	1.087	1.088	-0.001
Ivol (%)	1.957	1.982	-0.026	1.876	1.935	-0.059	2.156	2.231	-0.075*
SOE	0.555	0.560	-0.005	0.565	0.560	0.005	0.567	0.562	0.005
N	418	418		418	418		418	418	

Figure B1: Propensity Score Density

This figure plots the density of propensity scores from the propensity score matching for the treatment and control group. The solid line plots propensity score density of the treatment group and the dashed line plots propensity score density of the control group. A firm is treated if it has politically connected independent directors resignation to comply with Regulation No.18. For each treated firm, I use one-to-one propensity score matching without replacement to find a controlled firm in the same industry and with the same SOE status in 2010. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

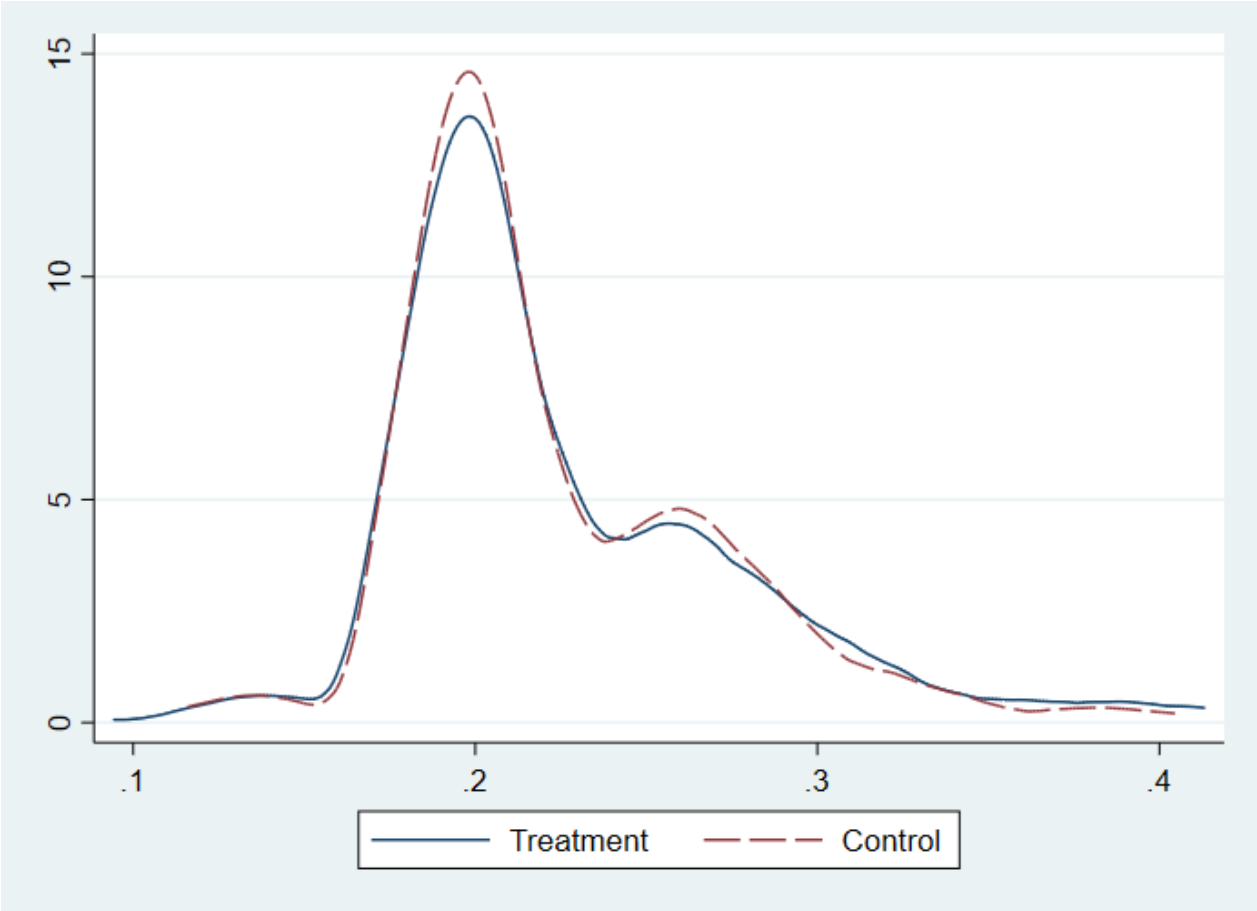


Table 1: Summary Statistics

This table reports summary statistics of variables used in this study. The sample in Panel A includes all non-financial A-share firms in China from 2011 to 2016. The sample in Panel B is a matched sample including treated firms and controlled firms. A firm is treated if it has politically connected independent directors resignation to comply with Regulation No.18. For each treated firm, I use one-to-one propensity score matching without replacement to find a controlled firm in the same industry and with the same SOE status in 2010.All variables are winsorized at 1% to 99% except dummy variables. All variables are defined in Appendix A. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

Panel A: all listed firms Variable	Mean	S.D.	p25	p50	p75
PCID	0.204	0.403	0.000	0.000	0.000
ROE	0.063	0.121	0.028	0.068	0.112
CFO	0.039	0.074	0.000	0.040	0.083
OPOA	0.040	0.063	0.011	0.038	0.072
CF	0.555	0.471	0.253	0.429	0.695
Volatility (%)	3.241	1.318	2.375	2.848	3.697
Political sensitivity (%)	4.946	2.018	3.652	4.579	5.740
Size	21.957	1.295	21.027	21.795	22.695
Leverage	0.431	0.222	0.250	0.418	0.600
Tangibility	0.953	0.052	0.941	0.966	0.984
ROA	0.039	0.055	0.013	0.036	0.066
B/M	0.394	0.270	0.199	0.336	0.515
Growth	0.204	0.608	-0.040	0.098	0.263
Top1	0.354	0.152	0.233	0.333	0.458
Age	2.642	0.431	2.398	2.708	2.944
Independence	0.374	0.053	0.333	0.333	0.429
Board size	2.143	0.198	1.946	2.197	2.197
Beta	0.975	0.589	0.631	1.063	1.367
Ivol (%)	2.579	1.217	1.840	2.289	2.947
SOE	0.433	0.496	0.000	0.000	1.000
N	15530				

Table 1 Continued

Panel B: matched sample Variable	Mean	S.D.	p25	p50	p75
PCID	0.500	0.500	0.000	0.500	1.000
ROE	0.051	0.145	0.022	0.062	0.108
CFO	0.042	0.072	0.003	0.041	0.085
OPOA	0.033	0.064	0.006	0.031	0.065
CF	0.560	0.479	0.248	0.434	0.698
Volatility (%)	2.949	0.963	2.285	2.702	3.338
Political sensitivity (%)	4.681	1.587	3.566	4.474	5.539
Size	22.233	1.331	21.313	22.073	22.994
Leverage	0.464	0.218	0.287	0.469	0.632
Tangibility	0.950	0.059	0.939	0.966	0.984
ROA	0.032	0.057	0.009	0.030	0.059
B/M	0.442	0.300	0.232	0.370	0.573
Growth	0.185	0.607	-0.054	0.080	0.243
Top1	0.359	0.153	0.239	0.333	0.471
Age	2.684	0.408	2.485	2.773	2.996
Independence	0.373	0.054	0.333	0.355	0.400
Board size	2.182	0.205	2.079	2.197	2.197
Beta	1.147	0.237	0.989	1.165	1.312
Ivol (%)	2.287	0.749	1.758	2.163	2.706
SOE	0.554	0.497	0.000	1.000	1.000
N	5016				

Table 2: Market Reaction to Release of Regulation No.18

This table reports cumulative abnormal return (CAR) of treated firms around the release of Regulation No.18 on October 19, 2013. A firm is treated it has politically connected independent directors resignation to comply with Regulation No.18. I use market model to obtain abnormal return: $R_{i,t} = \beta_i R_{m,t} + \epsilon_{i,t}$, where $R_{i,t}$ and $R_{m,t}$ are the excess return of stock i and market excess return on day t. The estimation window is 280 days to 90 days before the release of Regulation No.18. The estimated coefficients $\hat{\beta}_i$ is used to construct the abnormal return as $AR_{i,\tau} = R_{i,\tau} - \hat{\beta}_i R_{m,\tau}$, where $R_{i,\tau}$ and $R_{m,\tau}$ are realized excess returns of stock i and market on day τ. CAR is calculated as $\sum_{\tau=-1}^{T} AR_{i,\tau}$, where T is equal to 1, 5, 10, 15, and 20 for different event windows. I use float value weighted market return when estimating CAR. Standard errors are reported in parentheses. ***, **, and * represent statistical significance at the 1%, 5%, and 10%, respectively. All returns and standard errors are in %. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

	Full sample	SOEs subsample	Non-SOEs subsample
(-1, +1)	-0.040	-0.235	0.397
	(0.172)	(0.213)	(0.282)
(-1, +5)	-0.543	-0.167	-0.832**
	(0.331)	(0.582)	(0.377)
(-1, +10)	-2.006***	-1.898***	-2.674***
	(0.371)	(0.493)	(0.778)
(-1, +15)	-1.729***	-1.605***	-2.199***
	(0.414)	(0.573)	(0.798)
(-1, +20)	-0.933*	-0.944	-0.920
	(0.495)	(0.607)	(0.821)
N	418	230	188

Table 3: Cross-sectional Regression of CAR around Release of Regulation No.18

This table reports results of the cross-sectional regression of cumulative abnormal returns (CAR) around release of Regulation No.18 using the following model: $CAR_i = \alpha + \beta_1 PCID_i + Controls + \omega_j + \epsilon_i$, where CAR_i is the CAR of firm i, $PCID_i$ is a dummy variable which is equal to 1 if the firm is in the treatment group and 0 otherwise, and ω_j is industry fixed effect. The firm is in the treatment group if it has politically connected independent directors resignation to comply with Regulation No.18. I use market model to obtain abnormal return: $R_{i,t} = \beta_i R_{m,t} + \epsilon_{i,t}$, where $R_{i,t}$ and $R_{m,t}$ are the excess return of stock i and float value weighted market excess return on day t. The estimation window is 280 days to 90 days before the release of Regulation No.18. The estimated coefficients $\hat{\beta}_i$ is used to construct the abnormal return as $AR_{i,\tau} = Ret_{i,\tau} - \hat{\beta}_i R_{m,\tau}$, where $R_{i,\tau}$ and $R_{m,\tau}$ are realized excess returns of stock i and market on day τ. CAR is calculated as $\sum_{\tau=-1}^{T} AR_{i,\tau}$, where T is equal to 1, 5, 10, 15, and 20 for different event windows. The sample includes 418 treated firms and 418 controlled firms matched with the treatment group. All variables are winsorized at 1% to 99% except dummy variables. All variables are defined in Appendix A. Standard errors are clustered at the industry level and reported in parentheses. ***, **, and * represent statistical significance at the 1% level, 5% level, and 10% level, respectively. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

	(-1,+1)	(-1,+5)	(-1,+10)	(-1,+15)	(-1,+20)
PCID	-0.342**	-1.047**	-1.267*	-1.437**	-0.989***
	(0.140)	(0.442)	(0.660)	(0.551)	(0.306)
Size	0.143***	-0.238	-0.026	0.045	0.067
	(0.046)	(0.283)	(0.268)	(0.366)	(0.470)
Leverage	-0.568	-1.207	-0.359	-2.870	-5.636***
	(0.353)	(1.449)	(1.637)	(1.960)	(1.434)
B/M	-0.290	-0.007	-0.423	-1.780*	-4.007***
	(0.181)	(0.692)	(0.673)	(0.862)	(1.248)
Growth	-0.099	-0.298	-0.245	0.018	-0.049
	(0.108)	(0.396)	(0.711)	(0.548)	(0.421)
ROE	0.764	1.842	1.184	1.382	2.933
	(0.757)	(1.084)	(3.531)	(4.569)	(3.468)
Top1	-0.386	0.857	3.250**	1.943	3.152
	(0.821)	(1.294)	(1.324)	(1.204)	(1.841)
Ivol	1.236***	-0.638	-0.193	0.384	3.663***
	(0.187)	(0.450)	(0.838)	(0.777)	(0.606)
SOE	-0.347	-0.571	0.384	-0.246	-0.009
	(0.201)	(0.357)	(0.479)	(0.888)	(0.770)
Constant	-5.150***	10.122	4.011	6.556	-0.615
	(1.202)	(6.071)	(5.562)	(7.794)	(9.782)
N	836	836	836	836	836
Adj. R^2	0.139	0.050	0.041	0.037	0.115

Table 4: Market Reaction to PCID Resignations

This table reports cumulative abnormal return (CAR) of treated firms around the announcement of politically connected independent directors (PCID) resignation. A firm is treated if it has PCID resignation to comply with Regulation No.18. I use market model to obtain abnormal return: $R_{i,t} = \beta_i R_{m,t} + \epsilon_{i,t}$, where $R_{i,t}$ and $R_{m,t}$ are the excess return of stock i and market excess return on day t. The estimation window is 280 days to 90 days before the release of Regulation No.18. The estimated coefficients $\hat{\beta}_i$ is used to construct the abnormal return as $AR_{i,\tau} = R_{i,\tau} - \hat{\beta}_i R_{m,\tau}$, where $R_{i,\tau}$ and $R_{m,\tau}$ are realized excess returns of stock i and market on day τ. CAR is calculated as $\sum_{\tau=-1}^{T} AR_{i,\tau}$, where T is equal to 1, 5, 10, 15, and 20 for different event windows. I use float value weighted market return when estimating CAR. Standard errors are reported in parentheses. ***, **, and * represent statistical significance at the 1%, 5%, and 10%, respectively. All returns and standard errors are in %. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

	Full sample	SOEs subsample	Non-SOEs subsample
(-1, +1)	1.300***	1.168***	1.462**
	(0.341)	(0.394)	(0.586)
(-1, +5)	2.782***	1.979***	3.764***
	(0.650)	(0.725)	(1.140)
(-1, +10)	3.681***	2.240***	5.445***
	(0.860)	(0.832)	(1.612)
(-1, +15)	3.579***	2.095**	5.394***
	(0.983)	(0.888)	(1.892)
(-1, +20)	3.025***	1.800*	4.524**
	(1.071)	(1.009)	(2.035)
N	418	230	188

Table 5: Cross-sectional Regression of CAR around PCID Resignation

This table reports results of the cross-sectional regression of cumulative abnormal returns (CAR) around resignation of politically connected independent director (PCID) using the following model: $CAR_i = \alpha + \beta_1 PCID_i + Controls + \omega_j + \epsilon_i$, where CAR_i is the CAR of firm i, $PCID_i$ is a dummy variable which is equal to 1 if the firm is in the treatment group and 0 otherwise, and ω_j is industry fixed effect. The firm is in the treatment group if it has PCID resignation to comply with Regulation No.18. I use market model to obtain abnormal return: $R_{i,t} = \beta_i R_{m,t} + \epsilon_{i,t}$, where $R_{i,t}$ and $R_{m,t}$ are the excess return of stock i and float value weighted market excess return on day t. The estimation window is 280 days to 90 days before the release of Regulation No.18. The estimated coefficients $\hat{\beta}_i$ is used to construct the abnormal return as $AR_{i,\tau} = Ret_{i,\tau} - \hat{\beta}_i R_{m,\tau}$, where $R_{i,\tau}$ and $R_{m,\tau}$ are realized excess returns of stock i and market on day τ. CAR is calculated as $\sum_{\tau=-1}^{T} AR_{i,\tau}$, where T is equal to 1, 5, 10, 15, and 20 for different event windows. In Panel A, the sample includes 418 treated firms and 418 controlled firms matched with the treatment group. In Panel B, I report the subsample results for SOEs and non-SOEs. All variables are winsorized at 1% to 99% except dummy variables. All variables are defined in Appendix A. Standard errors are clustered at the industry level and reported in parentheses. ***, **, and * represent statistical significance at the 1% level, 5% level, and 10% level, respectively. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

Panel A: full sample	(-1,+1)	(-1,+5)	(-1,+10)	(-1,+15)	(-1,+20)
PCID	0.519*	1.086*	2.413***	2.013***	1.352**
	(0.262)	(0.567)	(0.450)	(0.463)	(0.513)
Size	-0.195	-0.444	-0.627	-0.383	0.273
	(0.351)	(0.539)	(0.538)	(0.549)	(0.653)
Leverage	-0.190	0.609	2.070	1.479	0.491
	(0.806)	(1.583)	(1.790)	(2.197)	(2.499)
B/M	-2.032*	-2.142	-1.515	-3.354*	-4.308**
	(1.065)	(1.487)	(1.791)	(1.668)	(1.916)
Growth	0.293	0.074	0.150	-0.336	-0.542
	(0.220)	(0.368)	(0.518)	(0.568)	(0.727)
ROE	0.135*	0.491***	0.767***	0.908***	0.877***
	(0.076)	(0.165)	(0.208)	(0.190)	(0.249)
Top1	1.366	2.616	0.842	2.318	0.515
	(2.446)	(5.472)	(5.720)	(5.853)	(6.816)
Ivol	-0.014***	-0.036***	-0.069***	-0.107***	-0.063***
	(0.004)	(0.011)	(0.016)	(0.016)	(0.016)
SOE	0.352	-0.753	-1.159	-1.308	-1.635
	(0.504)	(0.857)	(1.075)	(1.369)	(1.410)
Constant	4.305	10.092	12.729	6.999	-6.208
	(6.839)	(9.872)	(9.691)	(10.028)	(11.951)
N	836	836	836	836	836
Adj. R^2	0.026	0.030	0.035	0.035	0.028

Table 5 Continued

Panel B: subsamples by ownership structure										
	SOEs subsample					non-SOEs subsample				
	(-1,+1)	(-1,+5)	(-1,+10)	(-1,+15)	(-1,+20)	(-1,+1)	(-1,+5)	(-1,+10)	(-1,+15)	(-1,+20)
PCID	0.445	0.750	1.186	0.929	0.912	0.707*	2.025**	4.554***	4.009***	2.529*
	(0.587)	(1.307)	(1.089)	(1.015)	(0.883)	(0.379)	(0.778)	(0.993)	(1.058)	(1.420)
Size	-0.375	-0.427	-0.600	-0.540	0.178	-0.102	-1.008	-1.710	-1.220	-0.847
	(0.398)	(0.541)	(0.742)	(0.510)	(0.627)	(0.775)	(1.301)	(1.049)	(0.810)	(0.823)
Leverage	-0.604	-1.424	-0.820	-1.582	-2.366	0.475	3.439	6.075**	6.381**	4.636
	(0.874)	(1.806)	(2.030)	(2.024)	(2.395)	(2.111)	(2.845)	(2.570)	(2.162)	(3.581)
B/M	-0.615	0.011	0.948	0.608	0.378	-2.993*	-3.015	-1.080	-4.566	-6.008
	(1.181)	(1.740)	(2.056)	(2.111)	(2.492)	(1.685)	(2.366)	(2.801)	(3.210)	(4.070)
Growth	0.223	-0.541	0.276	-0.603	-1.747*	0.347	0.200	0.049	-0.271	-0.032
	(0.162)	(0.579)	(0.887)	(0.774)	(0.811)	(0.279)	(0.398)	(0.674)	(0.758)	(0.757)
ROE	0.617	3.310	7.585	6.165	4.434	0.127	0.524*	0.789***	0.960***	0.953***
	(2.012)	(5.155)	(8.491)	(7.806)	(6.977)	(0.131)	(0.255)	(0.194)	(0.100)	(0.126)
Top1	1.712	2.011	0.956	6.405*	4.246	2.143	6.478	6.563	3.391	2.947
	(1.551)	(3.313)	(3.085)	(3.238)	(3.283)	(3.570)	(6.826)	(5.960)	(8.002)	(10.601)
Ivol	0.682***	1.663***	1.815**	2.281***	2.676***	-0.024***	-0.055***	-0.086***	-0.135***	-0.091***
	(0.170)	(0.424)	(0.810)	(0.689)	(0.718)	(0.005)	(0.008)	(0.011)	(0.012)	(0.011)
Constant	6.944	6.531	8.495	2.945	-14.683	1.702	19.090	31.237	22.523	17.215
	(8.350)	(11.056)	(14.433)	(9.993)	(12.358)	(15.045)	(24.793)	(19.633)	(15.591)	(15.653)
N	460	460	460	460	460	376	376	376	376	376
Adj. R^2	0.052	0.059	0.073	0.066	0.059	0.045	0.052	0.067	0.077	0.073

Table 6: Loss of PCID and Operating Performance

This table reports change of firm's operating performance after politically connected independent director (PCID) resignation using the following regression model: $y_{it} = \alpha + \beta_1 PCID_i + \beta_2 PCID_i \times Post_t + Controls_{t-1} + \omega_j + \gamma_t + \epsilon_{it}$, where $PCID_i$ is a dummy variable which is equal to 1 if the firm is in the treatment group and 0 otherwise, $Post_t$ is a dummy variable which is equal to 1 after the PCID resignation takes effect and 0 otherwise, ω_j and γ_t are industry and year fixed effect. The firm is in the treatment group if it has PCID resignation to comply with Regulation No.18. Operating performance is measured using ROE in Panel A and cash flow from operations (CFO) in Panel B. ROE is defined as the ratio of net profit to book value of equity and CFO is defined as the ratio of cash flows from operations to total assets. The sample includes 418 treated firms and 418 controlled firms matched with the treatment group. I report results for the full sample, SOEs subsample, and non-SOEs subsample. All variables are winsorized at 1% to 99% except dummy variables. All variables are defined in Appendix A. Standard errors are clustered at the industry level and reported in parentheses. ***, **, and * represent statistical significance at the 1% level, 5% level, and 10% level, respectively. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

Panel A: ROE

	(1) Full sample	(2) SOEs subsample	(3) Non-SOEs subsample
$PCID$	0.009	0.017*	0.003
	(0.006)	(0.009)	(0.006)
$PCID \times Post$	-0.000	-0.006	0.004
	(0.004)	(0.006)	(0.008)
Size	0.032***	0.035***	0.032***
	(0.005)	(0.005)	(0.006)
Tangibility	-0.165***	-0.227***	-0.103***
	(0.023)	(0.030)	(0.023)
Leverage	-0.001	-0.035	0.112
	(0.028)	(0.033)	(0.086)
B/M	-0.114***	-0.097***	-0.157***
	(0.021)	(0.027)	(0.015)
Growth	0.014***	0.022***	0.004
	(0.003)	(0.006)	(0.003)
Top1	0.020**	-0.025	0.077**
	(0.008)	(0.019)	(0.028)
Age	0.010*	0.015*	0.000
	(0.005)	(0.007)	(0.007)
Independence	0.006	-0.027	0.064
	(0.038)	(0.052)	(0.053)
Board size	-0.004	-0.008	0.031
	(0.016)	(0.023)	(0.018)
SOE	-0.026***		
	(0.006)		
Constant	-0.573***	-0.593***	-0.768***
	(0.076)	(0.091)	(0.079)
N	4,871	2,747	2,124
Adj. R^2	0.089	0.096	0.100

Table 6 Continued

Panel B: cash flow from operations (CFO)			
	(1) Full sample	(2) SOEs subsample	(3) Non-SOEs subsample
$PCID$	0.001	0.001	0.001
	(0.002)	(0.003)	(0.004)
$PCID \times Post$	0.002	0.004	0.001
	(0.003)	(0.005)	(0.003)
Size	0.008***	0.008***	0.009***
	(0.001)	(0.002)	(0.003)
Tangibility	-0.024***	-0.022	-0.034**
	(0.008)	(0.014)	(0.012)
ROA	-0.040*	-0.013	-0.145***
	(0.021)	(0.016)	(0.023)
Leverage	0.255***	0.220***	0.268***
	(0.041)	(0.038)	(0.066)
B/M	-0.013	-0.013	-0.011
	(0.010)	(0.008)	(0.026)
Growth	-0.009***	-0.010***	-0.007**
	(0.003)	(0.003)	(0.003)
Top1	0.033***	0.020*	0.058***
	(0.007)	(0.010)	(0.016)
Age	0.004*	0.008	0.001
	(0.002)	(0.005)	(0.002)
Independence	-0.002	0.002	-0.017
	(0.029)	(0.032)	(0.023)
Board size	0.008	0.012	0.002
	(0.007)	(0.011)	(0.008)
SOE	-0.001		
	(0.002)		
Constant	-0.121***	-0.156***	-0.022
	(0.041)	(0.036)	(0.036)
N	4,871	2,747	2,124
Adj. R^2	0.118	0.109	0.138

Table 7: Loss of PCID and Firm Risk

This table reports change of firm risk after politically connected independent director (PCID) resignation using the following DID regression model: $y_{it} = \alpha + \beta_1 PCID_i + \beta_2 PCID_i \times Post_t + Controls_{t-1} + \omega_j + \gamma_t + \epsilon_{it}$, where $PCID_i$ is a dummy variable which is equal to 1 if the firm is in the treatment group and 0 otherwise, $Post_t$ is a dummy variable which is equal to 1 after the PCID resignation takes effect and 0 otherwise, ω_j and γ_t are industry and year fixed effect. The firm is in the treatment group if it has PCID resignation to comply with Regulation No.18. In Panel A, the dependent variable is stock return volatility (volatility), which is defined as the standard deviation of daily stock return, multiplied by 100. The sample includes 418 treated firms and 418 controlled firms matched with the treatment group. I report results for the full sample, SOEs subsample, and non-SOEs subsample. In Panel B, the dependent variable is political sensitivity, which is defined as the absolute cumulative abnormal return over the three-day window around announcements of the new regulatory documents issued by China Securities Regulatory Commission (CSRC) estimated using market model. All variables are winsorized at 1% to 99% except dummy variables. All variables are defined in Appendix A. Standard errors are clustered at the industry level and reported in parentheses. ***, **, and * represent statistical significance at the 1% level, 5% level, and 10% level, respectively. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

Table 7 Continued

Panel A: stock price volatility	(1) Full sample	(2) SOEs subsample	(3) Non-SOEs subsample
$PCID$	-0.002	0.001	0.012
	(0.011)	(0.010)	(0.026)
$PCID \times Post$	-0.022	-0.010	-0.054***
	(0.014)	(0.019)	(0.016)
Size	-0.137***	-0.130***	-0.136***
	(0.007)	(0.009)	(0.019)
Leverage	0.223***	0.334***	0.064
	(0.039)	(0.042)	(0.041)
Tangibility	-0.018	0.011	0.230
	(0.089)	(0.121)	(0.333)
ROA	-0.611***	-0.579***	-0.768**
	(0.155)	(0.178)	(0.272)
B/M	0.069**	0.050	0.083
	(0.028)	(0.038)	(0.077)
Growth	0.067**	0.034	0.084**
	(0.025)	(0.021)	(0.029)
Top1	0.081**	0.026	0.187*
	(0.028)	(0.042)	(0.094)
Age	-0.052***	-0.037	-0.060***
	(0.015)	(0.031)	(0.011)
Independence	-0.264**	-0.323**	-0.328
	(0.117)	(0.148)	(0.191)
Board size	-0.068**	-0.055	-0.131***
	(0.029)	(0.049)	(0.035)
Beta	0.377***	0.372***	0.340***
	(0.029)	(0.051)	(0.022)
Ivol	0.217***	0.250***	0.190***
	(0.016)	(0.020)	(0.013)
SOE	-0.010		
	(0.016)		
Constant	4.769***	4.500***	4.750***
	(0.243)	(0.293)	(0.297)
N	4,867	2,745	2,122
Adj. R^2	0.741	0.754	0.720

Table 7 Continued

Panel B: political sensitivity	(1) Full sample	(2) SOEs subsample	(3) Non-SOEs subsample
$PCID$	-0.028	0.018	-0.027
	(0.023)	(0.045)	(0.046)
$PCID \times Post$	-0.114	-0.058	-0.190***
	(0.072)	(0.122)	(0.054)
Size	-0.158***	-0.151***	-0.183***
	(0.018)	(0.030)	(0.035)
Leverage	0.383***	0.309**	0.386***
	(0.107)	(0.138)	(0.126)
Tangibility	0.268	0.419	0.113
	(0.345)	(0.314)	(1.055)
ROA	-2.168***	-2.456***	-1.773**
	(0.383)	(0.486)	(0.698)
B/M	-0.188**	-0.125*	-0.333*
	(0.066)	(0.061)	(0.160)
Growth	0.168**	0.190**	0.106*
	(0.060)	(0.064)	(0.050)
Top1	-0.007	-0.101	0.217
	(0.130)	(0.214)	(0.144)
Age	-0.256***	-0.362***	-0.191***
	(0.052)	(0.076)	(0.047)
Independence	-0.137	-0.329	-0.749
	(0.413)	(0.443)	(0.635)
Board size	-0.172	-0.019	-0.471*
	(0.107)	(0.136)	(0.233)
Beta	0.177***	0.186**	0.145
	(0.051)	(0.069)	(0.086)
Ivol	0.305***	0.333***	0.262***
	(0.035)	(0.052)	(0.025)
SOE	-0.182***		
	(0.041)		
Constant	8.602***	8.405***	9.688***
	(0.720)	(1.071)	(0.741)
N	4,862	2,743	2,119
Adj. R^2	0.286	0.267	0.304

Figure 1: Resigning Dates of Independent Directors and PCIDs

This figure plots the number of independent director resignation and politically connected independent director (PCID) resignation every month during January 2013 to May 2017. The solid line plots the total number of independent director resignation and the dashed line plots the number of PCIDs resignation. Data source: website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

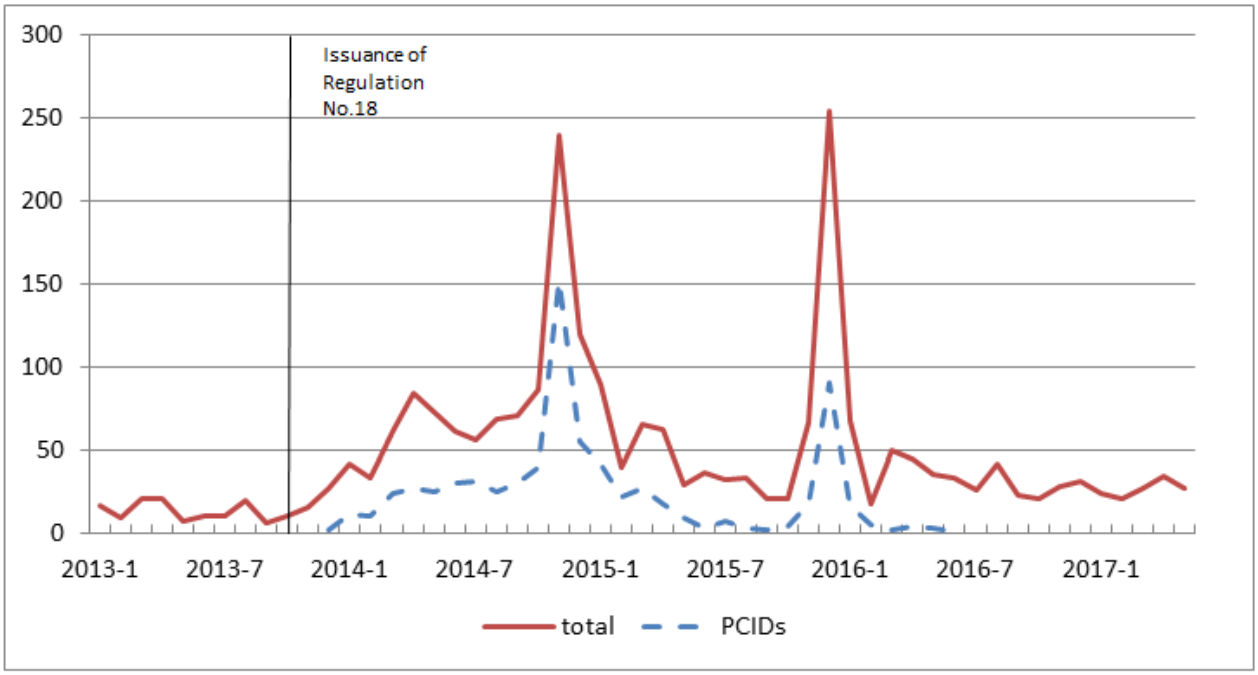
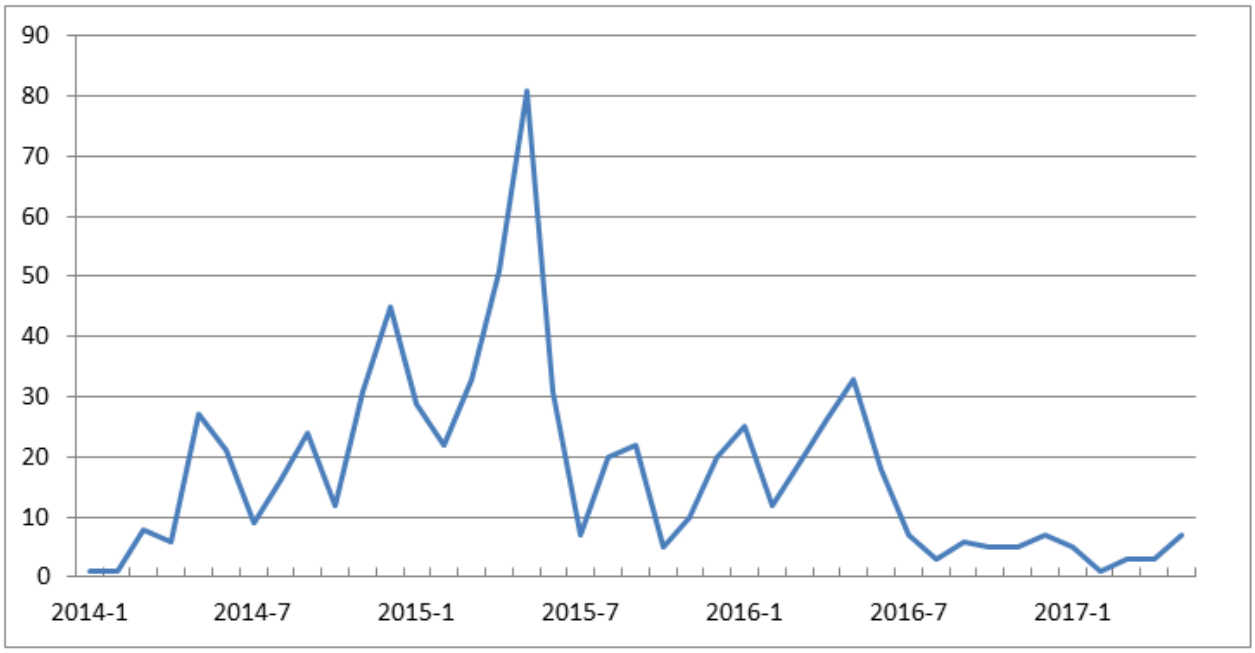


Figure 2: Leaving Dates of Resigning PCIDs

This figure plots the actual leaving dates of resigning politically connected independent directors (PCIDs) after the release of Regulation No.18. Data source: website of Shanghai Stock Exchange and Shenzhen Stock Exchange.



Internet Appendix

Value of Politically Connected Independent Directors: Evidence from the Anti-Corruption Campaign in China

August 15, 2019

Table IA1: Robustness test of CAR around Release of Regulation No.18

This table reports cumulative abnormal return (CAR) of treated firms around the release of Regulation No.18 on October 19, 2013. A firm is treated it has politically connected independent directors resignation to comply with Regulation No.18. I use market model to obtain abnormal return: $R_{i,t} = \beta_i R_{m,t} + \epsilon_{i,t}$, where $R_{i,t}$ and $R_{m,t}$ are the excess return of stock i and market excess return on day t. The estimation window is 280 days to 90 days before the release of Regulation No.18. The estimated coefficients $\hat{\beta}_i$ is used to construct the abnormal return as $AR_{i,\tau} = R_{i,\tau} - \hat{\beta}_i R_{m,\tau}$, where $R_{i,\tau}$ and $R_{m,\tau}$ are realized excess returns of stock i and market on day τ. CAR is calculated as $\sum_{\tau=-1}^{T} AR_{i,\tau}$, where T is equal to 1, 5, 10, 15, and 20 for different event windows. I use total value weighted market return when estimating CAR. Standard errors are reported in parentheses. ***, **, and * represent statistical significance at the 1%, 5%, and 10%, respectively. All returns and standard errors are in %. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

	Full sample	SOEs subsample	Non-SOEs subsample
(-1, +1)	-0.195	-0.475**	0.169
	(0.173)	(0.214)	(0.282)
(-1, +5)	-0.587*	-0.206	-0.879**
	(0.331)	(0.582)	(0.377)
(-1, +10)	-1.893***	-1.553***	-2.335***
	(0.438)	(0.494)	(0.777)
(-1, +15)	-1.546***	-1.285**	-1.885**
	(0.474)	(0.574)	(0.797)
(-1, +20)	-0.870*	-0.878	-0.859
	(0.495)	(0.608)	(0.821)
N	418	230	188

Table IA2: Robustness test of Cross-sectional Regression of CAR around Release of Regulation No.18

This table reports results of the cross-sectional regression of cumulative abnormal returns (CAR) around release of Regulation No.18 using the following model: $CAR_i = \alpha + \beta_1 PCID_i + Controls + \omega_j + \epsilon_i$, where CAR_i is the CAR of firm i, $PCID_i$ is a dummy variable which is equal to 1 if the firm is in the treatment group and 0 otherwise, and ω_j is industry fixed effect. The firm is in the treatment group if it has politically connected independent directors (PCID) resignation to comply with Regulation No.18. I use market model to obtain abnormal return: $R_{i,t} = \beta_i R_{m,t} + \epsilon_{i,t}$, where $R_{i,t}$ and $R_{m,t}$ are the excess return of stock i and total value weighted market excess return on day t. The estimation window is 280 days to 90 days before the release of Regulation No.18. The estimated coefficients $\hat{\beta}_i$ is used to construct the abnormal return as $AR_{i,\tau} = Ret_{i,\tau} - \hat{\beta}_i R_{m,\tau}$, where $R_{i,\tau}$ and $R_{m,\tau}$ are realized excess returns of stock i and market on day τ. CAR is calculated as $\sum_{\tau=-1}^{T} AR_{i,\tau}$, where T is equal to 1, 5, 10, 15, and 20 for different event windows. The sample includes 418 treated firms and 418 controlled firms matched with the treatment group. All variables are winsorized at 1% to 99% except dummy variables. All variables are defined in Appendix A. Standard errors are clustered at the industry level and reported in parentheses. ***, **, and * represent statistical significance at the 1% level, 5% level, and 10% level, respectively. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

	(-1,+1)	(-1,+5)	(-1,+10)	(-1,+15)	(-1,+20)
PCID	-0.420	-1.043**	-1.262*	-1.444**	-1.000***
	(0.243)	(0.442)	(0.661)	(0.553)	(0.305)
Size	-0.120	-0.241	-0.021	0.042	0.053
	(0.107)	(0.283)	(0.267)	(0.367)	(0.472)
Leverage	-0.243	-1.263	-0.375	-2.906	-5.537***
	(0.746)	(1.445)	(1.627)	(1.963)	(1.434)
B/M	0.268	-0.030	-0.417	-1.817*	-4.082***
	(0.225)	(0.694)	(0.669)	(0.866)	(1.272)
Growth	-0.286	-0.287	-0.232	0.029	-0.050
	(0.172)	(0.392)	(0.706)	(0.547)	(0.426)
ROE	-0.203	1.894	1.266	1.468	3.060
	(1.236)	(1.087)	(3.522)	(4.574)	(3.490)
Top1	0.136	0.835	3.244**	1.944	3.190*
	(0.710)	(1.295)	(1.311)	(1.203)	(1.801)
Ivol	1.645***	-0.569	-0.192	0.415	3.628***
	(0.193)	(0.455)	(0.832)	(0.777)	(0.610)
SOE	-0.472	-0.600	0.376	-0.273	-0.021
	(0.398)	(0.359)	(0.478)	(0.893)	(0.777)
Constant	-0.319	10.150	4.084	6.519	-0.793
	(2.105)	(6.090)	(5.546)	(7.807)	(9.815)
N	836	836	836	836	836
Adj. R^2	0.083	0.050	0.041	0.038	0.116

Table IA3: Robustness test of CAR around PCID Resignation

This table reports cumulative abnormal return (CAR) of treated firms around the announcement of politically connected independent director (PCID) resignation using different models to estimate abnormal return. A firm is treated if it has PCID resignation to comply with Regulation No.18. In Panel A, I use market model to obtain abnormal return: $R_{i,t} = \beta_i R_{m,t} + \epsilon_{i,t}$, where $R_{i,t}$ and $R_{m,t}$ are the excess return of stock i and total value weighted market excess return on day t. The estimation window is 280 days to 90 days before the release of Regulation No.18. The estimated coefficients $\hat{\beta}_i$ is used to construct the abnormal return as $AR_{i,\tau} = R_{i,\tau} - \hat{\beta}_i R_{m,\tau}$, where $R_{i,\tau}$ and $R_{m,\tau}$ are realized excess returns of stock i and market on day τ. CAR is calculated as $\sum_{\tau=-1}^{T} AR_{i,\tau}$, where T is equal to 1, 5, 10, 15, and 20 for different event windows. In Panel B and C, the abnormal return is estimated using market-adjusted return: $AR_{i,\tau} = R_{i,\tau} - R_{m,\tau}$. I use float value weighted market return and total value weighted market return in Panel B and Panel C, respectively. In Panel D and E, I estimate the Fama-French three factor model to obtain abnormal return: $R_{i,t} = \beta_{1,i} R_{m,t} + \beta_{2,i} SMB_t + \beta_{3,i} HML_t + \epsilon_{i,t}$, where $R_{i,t}$, $R_{m,t}$, SMB_t, and HML_t are excess return of stock i, market risk premium, size premium, and value premium on day t, respectively. The estimated coefficients $\hat{\beta_{1,i}}$, $\hat{\beta_{2,i}}$, and $\hat{\beta_{3,i}}$ are used to construct the abnormal return as $AR_{i,\tau} = R_{i,\tau} - (\hat{\beta_{1,i}} R_{m,\tau} + \hat{\beta_{2,i}} SMB_\tau + \hat{\beta_{3,i}} HML_\tau)$, where $R_{i,\tau}$, $R_{m,\tau}$, SMB_τ, and HML_τ are realized excess returns of stock i, realized market risk premium, size premium, and value premium on day τ, respectively. I use float value weighted market return and total value weighted risk premium in Panel D and Panel E, respectively. Standard errors are reported in parentheses. ***, **, and * represent statistical significance at the 1%, 5%, and 10%, respectively. All returns and standard errors are in %. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

Panel A: market model with total value weighted market return			
	Full sample	SOEs subsample	Non-SOEs subsample
(-1, +1)	1.325***	1.187***	1.494**
	(0.338)	(0.390)	(0.581)
(-1, +5)	2.783***	1.991***	3.752***
	(0.644)	(0.719)	(1.129)
(-1, +10)	3.668***	2.254***	5.397***
	(0.851)	(0.824)	(1.596)
(-1, +15)	3.581***	2.127**	5.36***
	(0.974)	(0.876)	(1.877)
(-1, +20)	3.094***	1.944*	4.502**
	(1.055)	(0.992)	(2.006)
N	418	230	188

Panel B: market adjusted return with float value weighted market return			
	Full sample	SOEs subsample	Non-SOEs subsample
(-1, +1)	1.329***	1.178***	1.514***
	(0.335)	(0.388)	(0.575)
(-1, +5)	2.844***	2.039***	3.828***
	(0.641)	(0.708)	(1.130)
(-1, +10)	3.749***	2.273***	5.555***
	(0.853)	(0.821)	(1.601)
(-1, +15)	3.790***	2.165**	5.777***
	(0.975)	(0.887)	(1.869)
(-1, +20)	3.252***	1.756*	5.083**
	(1.055)	(0.976)	(2.014)
N	418	230	188

Table IA3 Continued

Panel C: market adjusted return with total value weighted market return			
	Full sample	SOEs subsample	Non-SOEs subsample
(-1, +1)	1.350***	1.189***	1.546***
	(0.332)	(0.385)	(0.571)
(-1, +5)	2.849***	2.041***	3.837***
	(0.636)	(0.702)	(1.120)
(-1, +10)	3.744***	2.271***	5.547***
	(0.844)	(0.812)	(1.584)
(-1, +15)	3.805***	2.176**	5.797***
	(0.965)	(0.874)	(1.852)
(-1, +20)	3.332***	1.859*	5.134**
	(1.039)	(0.959)	(1.986)
N	418	230	188

Panel D: Fama-French three factor model with float value weighted risk premium			
	Full sample	SOEs subsample	Non-SOEs subsample
(-1, +1)	1.287***	1.047***	1.581**
	(0.372)	(0.391)	(0.675)
(-1, +5)	2.053***	1.387*	2.867*
	(0.787)	(0.709)	(1.519)
(-1, +10)	2.626**	1.583*	3.902*
	(1.068)	(0.808)	(2.160)
(-1, +15)	2.788***	0.951	5.036**
	(1.014)	(0.853)	(1.991)
(-1, +20)	2.373**	1.054	3.987*
	(1.066)	(0.951)	(2.063)
N	418	230	188

Panel E: Fama-French three factor model with total value weighted risk premium			
	Full sample	SOEs subsample	Non-SOEs subsample
(-1, +1)	1.357***	1.111***	1.658***
	(0.354)	(0.389)	(0.626)
(-1, +5)	2.166***	1.453**	3.038**
	(0.725)	(0.703)	(1.362)
(-1, +10)	2.772***	1.609**	4.195**
	(0.953)	(0.801)	(1.876)
(-1, +15)	2.921***	1.012	5.256***
	(0.987)	(0.853)	(1.921)
(-1, +20)	2.525**	1.105	4.261**
	(1.033)	(0.957)	(1.971)
N	418	230	188

Table IA4: Robustness test of Cross-sectional Regression of CAR around PCID Resignation

This table reports results of the cross-sectional regression of cumulative abnormal returns (CAR) around resignation of politically connected independent directors (PCID) estimated from different models using the following model: $CAR_i = \alpha + \beta_1 PCID_i i + Controls + \omega_j + \epsilon_i$, where CAR_i is the CAR of firm i, $PCID_i$ is a dummy variable which is equal to 1 if the firm is in the treatment group and 0 otherwise, and ω_j is industry fixed effect. The firm is in the treatment group it has PCID resignation to comply with Regulation No.18. The sample includes 418 treated firms and 418 controlled firms matched with the treatment group. In Panel A, I use market model to obtain abnormal return: $R_{i,t} = \beta_i R_{m,t} + \epsilon_{i,t}$, where $R_{i,t}$ and $R_{m,t}$ are the excess return of stock i and total value weighted market excess return on day t. The estimation window is 280 days to 90 days before the release of Regulation No.18. The estimated coefficients $\hat{\beta}_i$ is used to construct the abnormal return as $AR_{i,\tau} = Ret_{i,\tau} - \hat{\beta}_i R_{m,\tau}$, where $R_{i,\tau}$ and $R_{m,\tau}$ are realized excess returns of stock i and market on day τ. CAR is calculated as $\sum_{\tau=-1}^{T} AR_{i,\tau}$, where T is equal to 1, 5, 10, 15, and 20 for different event windows. In Panel B and C, the abnormal return is estimated using market-adjusted return: $AR_{i,\tau} = R_{i,\tau} - R_{m,\tau}$. CAR is calculated as the same as in Panel A. I use float value weighted market return and total value weighted market return in Panel B and Panel C, respectively. In Panel D and E, I estimate the Fama-French three factor model to obtain abnormal return: $R_{i,t} = \beta_{1,i} R_{m,t} + \beta_{2,i} SMB_t + \beta_{3,i} HML_t + \epsilon_{i,t}$, where $R_{i,t}$, $R_{m,t}$, SMB_t, and HML_t are the excess return of stock i, market risk premium, size premium, and value premium on day t, respectively. The estimated coefficients $\hat{\beta_{1,i}}$, $\hat{\beta_{2,i}}$, and $\hat{\beta_{3,i}}$ are used to construct the abnormal return as $AR_{i,\tau} = R_{i,\tau} - (\hat{\beta_{1,i}} R_{m,\tau} + \hat{\beta_{2,i}} SMB_\tau + \hat{\beta_{3,i}} HML_\tau)$, where $R_{i,\tau}$, $R_{m,\tau}$, SMB_τ, and HML_τ are realized excess returns of stock i, realized market risk premium, size premium, and value premium on day τ, respectively. I use float value weighted market return and total value weighted risk premium in Panel D and Panel E, respectively. All variables are winsorized at 1% to 99% except dummy variables. All variables are defined in Appendix A. Standard errors are clustered at the industry level and reported in parentheses. ***, **, and * represent statistical significance at the 1% level, 5% level, and 10% level, respectively. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

Table IA4 Continued

Panel A: market model with total value weighted market return					
	(-1,+1)	(-1,+5)	(-1,+10)	(-1,+15)	(-1,+20)
PCID	0.515*	1.047*	2.371***	1.971***	1.330**
	(0.265)	(0.562)	(0.456)	(0.463)	(0.488)
Size	-0.196	-0.439	-0.629	-0.394	0.211
	(0.347)	(0.532)	(0.527)	(0.533)	(0.637)
Leverage	-0.238	0.652	2.067	1.595	0.802
	(0.791)	(1.590)	(1.805)	(2.212)	(2.461)
B/M	-1.912*	-1.858	-1.135	-2.926*	-3.676*
	(1.041)	(1.451)	(1.765)	(1.585)	(1.799)
Growth	0.301	0.083	0.155	-0.321	-0.523
	(0.203)	(0.344)	(0.485)	(0.533)	(0.688)
ROE	0.127	0.469**	0.739***	0.876***	0.841***
	(0.077)	(0.164)	(0.207)	(0.189)	(0.248)
Top1	1.200	2.359	0.727	2.221	0.516
	(2.410)	(5.352)	(5.589)	(5.683)	(6.545)
Ivol	-0.014***	-0.036***	-0.069***	-0.105***	-0.063***
	(0.004)	(0.010)	(0.015)	(0.014)	(0.015)
SOE	0.344	-0.754	-1.150	-1.302	-1.551
	(0.487)	(0.842)	(1.066)	(1.361)	(1.390)
Constant	4.201	10.008	12.891	7.573	-4.855
	(6.784)	(9.757)	(9.517)	(9.765)	(11.697)
N	836	836	836	836	836
Adj. R^2	0.025	0.029	0.033	0.034	0.027

Panel B: market adjusted return with float value weighted market return					
	(-1,+1)	(-1,+5)	(-1,+10)	(-1,+15)	(-1,+20)
PCID	0.524*	1.065*	2.317***	1.972***	1.322**
	(0.272)	(0.513)	(0.432)	(0.486)	(0.523)
Size	-0.195	-0.449	-0.675	-0.510	0.105
	(0.358)	(0.573)	(0.600)	(0.616)	(0.714)
Leverage	-0.223	0.379	1.928	1.650	0.691
	(0.817)	(1.636)	(1.763)	(2.103)	(2.328)
B/M	-2.100*	-2.281	-1.404	-2.877*	-3.947**
	(1.089)	(1.515)	(1.783)	(1.483)	(1.646)
Growth	0.328	0.112	0.208	-0.284	-0.501
	(0.224)	(0.343)	(0.477)	(0.525)	(0.702)
ROE	0.130	0.466**	0.747***	0.892***	0.877***
	(0.075)	(0.163)	(0.211)	(0.197)	(0.264)
Top1	1.152	2.242	0.324	1.632	-0.184
	(2.272)	(5.366)	(5.683)	(5.727)	(6.769)
Ivol	-0.019***	-0.038***	-0.063***	-0.081***	-0.043***
	(0.003)	(0.010)	(0.014)	(0.013)	(0.013)
SOE	0.403	-0.417	-0.741	-0.962	-1.496
	(0.480)	(0.855)	(1.059)	(1.372)	(1.388)
Constant	4.485	10.479	13.896	9.656	-2.686
	(6.947)	(10.455)	(10.678)	(11.084)	(12.921)
N	836	836	836	836	836
Adj. R^2	0.027	0.031	0.036	0.037	0.031

Table IA4 Continued

Panel C: market adjusted return with total value weighted market return					
	(-1,+1)	(-1,+5)	(-1,+10)	(-1,+15)	(-1,+20)
PCID	0.519*	1.037*	2.288***	1.949***	1.315**
	(0.273)	(0.508)	(0.434)	(0.485)	(0.504)
Size	-0.199	-0.452	-0.694	-0.531	0.045
	(0.354)	(0.564)	(0.587)	(0.598)	(0.700)
Leverage	-0.290	0.383	1.901	1.696	0.895
	(0.800)	(1.638)	(1.773)	(2.115)	(2.313)
B/M	-1.976*	-1.997	-1.004	-2.454	-3.362**
	(1.062)	(1.473)	(1.742)	(1.417)	(1.564)
Growth	0.338	0.120	0.204	-0.272	-0.485
	(0.210)	(0.321)	(0.443)	(0.487)	(0.657)
ROE	0.124	0.448**	0.725***	0.868***	0.848***
	(0.075)	(0.162)	(0.210)	(0.197)	(0.263)
Top1	1.005	1.999	0.230	1.555	-0.205
	(2.241)	(5.252)	(5.550)	(5.554)	(6.527)
Ivol	-0.018***	-0.038***	-0.061***	-0.077***	-0.042***
	(0.003)	(0.009)	(0.013)	(0.012)	(0.012)
SOE	0.386	-0.449	-0.774	-1.016	-1.501
	(0.467)	(0.842)	(1.059)	(1.377)	(1.394)
Constant	4.461	10.602	14.453	10.464	-1.238
	(6.869)	(10.304)	(10.448)	(10.786)	(12.681)
N	836	836	836	836	836
Adj. R^2	0.027	0.030	0.035	0.036	0.031

Panel D: Fama-French three factor model with float value weighted market return					
	(-1,+1)	(-1,+5)	(-1,+10)	(-1,+15)	(-1,+20)
PCID	0.433*	0.273	0.958	1.186**	0.491
	(0.235)	(0.581)	(0.845)	(0.459)	(0.518)
Size	-0.148	-0.426	-0.555	-0.822*	-0.606
	(0.327)	(0.537)	(0.542)	(0.454)	(0.571)
Leverage	-0.816	-0.366	-0.174	1.992	1.643
	(1.207)	(3.055)	(3.660)	(2.829)	(2.915)
B/M	-1.311	0.417	2.489	2.157	2.966
	(1.118)	(1.637)	(1.807)	(1.818)	(2.047)
Growth	0.353***	0.185	0.264	-0.092	-0.324
	(0.099)	(0.180)	(0.247)	(0.378)	(0.413)
ROE	0.015	0.192	0.360*	0.454**	0.320
	(0.084)	(0.167)	(0.191)	(0.162)	(0.235)
Top1	0.039	-0.569	-2.713	1.698	1.721
	(3.027)	(6.424)	(6.902)	(5.074)	(5.601)
IVol	-0.014**	-0.040**	-0.065**	-0.090***	-0.061***
	(0.006)	(0.017)	(0.023)	(0.014)	(0.015)
SOE	0.222	-0.506	-0.671	-2.141	-1.993
	(0.690)	(1.535)	(1.878)	(1.544)	(1.528)
Constant	2.629	10.346	13.770	18.928**	13.718
	(6.381)	(9.364)	(9.283)	(8.491)	(10.580)
N	836	836	836	836	836
Adj. R^2	0.020	0.018	0.019	0.029	0.023

Table IA4 Continued

Panel E: Fama-French three factor model with total value weighted market return					
	(-1,+1)	(-1,+5)	(-1,+10)	(-1,+15)	(-1,+20)
PCID	0.499**	0.390	1.208*	1.395**	0.714**
	(0.215)	(0.505)	(0.654)	(0.502)	(0.327)
Size	-0.157	-0.444	-0.625	-0.880*	-0.677
	(0.320)	(0.515)	(0.506)	(0.442)	(0.547)
Leverage	-0.806	-0.082	0.399	2.595	2.442
	(1.058)	(2.677)	(2.995)	(2.399)	(2.351)
B/M	-1.343	0.338	2.206	1.860	2.671
	(1.046)	(1.525)	(1.726)	(1.713)	(1.893)
Growth	0.342***	0.164	0.212	-0.132	-0.386
	(0.093)	(0.174)	(0.231)	(0.400)	(0.478)
ROE	0.014	0.200	0.376*	0.475**	0.329
	(0.083)	(0.162)	(0.187)	(0.162)	(0.234)
Top1	0.235	0.064	-1.412	2.836	2.995
	(2.819)	(5.924)	(6.057)	(4.418)	(4.787)
Ivol	-0.015***	-0.039**	-0.063***	-0.085***	-0.060***
	(0.005)	(0.015)	(0.019)	(0.011)	(0.011)
SOE	0.195	-0.640	-0.907	-2.304	-2.247
	(0.620)	(1.350)	(1.559)	(1.402)	(1.412)
Constant	2.718	10.409	14.610	19.500**	14.492
	(6.274)	(9.069)	(8.845)	(8.396)	(10.356)
N	836	836	836	836	836
Adj. R^2	0.021	0.020	0.022	0.034	0.027

Table IA5: Robustness Test of Cross-sectional Regression of CAR around PCID Resignation by Ownership Structure

This table reports results of the cross-sectional regression of cumulative abnormal returns (CAR) around resignation of politically connected independent directors by ownership structure using the following model: $CAR_i = \alpha + \beta_1 PCID_i + Controls + \omega_j + \epsilon_i$, where CAR_i is the CAR of firm i, $PCID_i$ is a dummy variable which is equal to 1 if the firm is in the treatment group and 0 otherwise, and ω_j is industry fixed effect. The firm is in the treatment group if it has PCID resignation to comply with Regulation No.18. I use market model to obtain abnormal return: $R_{i,t} = \beta_i R_{m,t} + \epsilon_{i,t}$, where $R_{i,t}$ and $R_{m,t}$ are the excess return of stock i and total value weighted market excess return on day t. The estimation window is 280 days to 90 days before the release of Regulation No.18. The estimated coefficients $\hat{\beta}_i$ is used to construct the abnormal return as $AR_{i,\tau} = R_{i,\tau} - \hat{\beta}_i R_{m,\tau}$, where $R_{i,\tau}$ and $R_{m,\tau}$ are realized excess returns of stock i and market on day τ. CAR is calculated as $\sum_{\tau=-1}^{T} AR_{i,\tau}$, where T is equal to 1, 5, 10, 15, and 20 for different event windows. The SOEs sample includes 230 treated firms and 230 controlled firms matched with the treatment group. The non-SOEs sample includes 188 treated firms and 188 controlled firms. All variables are winsorized at 1% to 99% except dummy variables. All variables are defined in Appendix A. Standard errors are clustered at the industry level and reported in parentheses. ***, **, and * represent statistical significance at the 1% level, 5% level, and 10% level, respectively. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

	SOEs subsample					non-SOEs subsample				
	(-1,+1)	(-1,+5)	(-1,+10)	(-1,+15)	(-1,+20)	(-1,+1)	(-1,+5)	(-1,+10)	(-1,+15)	(-1,+20)
PCID	0.432	0.683	1.120	0.832	0.840	0.716*	2.023**	4.541***	4.038***	2.561*
	(0.592)	(1.315)	(1.096)	(1.025)	(0.907)	(0.376)	(0.763)	(0.986)	(1.045)	(1.394)
Size	-0.365	-0.394	-0.566	-0.514	0.145	-0.118	-1.040	-1.747	-1.286	-0.935
	(0.399)	(0.537)	(0.736)	(0.515)	(0.627)	(0.764)	(1.279)	(1.018)	(0.764)	(0.769)
Leverage	-0.701	-1.439	-0.853	-1.510	-2.011	0.523	3.626	6.188**	6.694***	4.991
	(0.888)	(1.848)	(2.061)	(2.052)	(2.431)	(2.036)	(2.775)	(2.509)	(2.152)	(3.505)
B/M	-0.585	0.099	1.002	0.679	0.586	-2.811	-2.613	-0.480	-3.922	-5.102
	(1.170)	(1.674)	(1.957)	(2.028)	(2.341)	(1.687)	(2.347)	(2.752)	(3.142)	(3.967)
Growth	0.242	-0.524	0.279	-0.530	-1.630*	0.342	0.194	0.034	-0.296	-0.065
	(0.160)	(0.563)	(0.860)	(0.754)	(0.782)	(0.269)	(0.385)	(0.648)	(0.742)	(0.746)
ROE	0.705	3.350	7.578	6.188	4.391	0.120	0.506*	0.765***	0.936***	0.921***
	(2.013)	(5.168)	(8.495)	(7.877)	(7.089)	(0.131)	(0.254)	(0.191)	(0.096)	(0.126)
Top1	1.528	1.739	0.891	6.376*	4.379	2.001	6.217	6.268	3.128	2.636
	(1.528)	(3.186)	(2.962)	(3.094)	(3.158)	(3.512)	(6.732)	(5.937)	(7.833)	(10.195)
Ivol	0.649***	1.599***	1.708*	2.156***	2.526***	-0.023***	-0.054***	-0.084***	-0.132***	-0.090***
	(0.170)	(0.413)	(0.786)	(0.664)	(0.689)	(0.005)	(0.008)	(0.010)	(0.012)	(0.010)
Constant	6.651	6.032	8.336	3.222	-13.566	1.961	19.744	31.996	24.100	19.256
	(8.368)	(10.959)	(14.330)	(10.136)	(12.388)	(14.871)	(24.380)	(19.009)	(14.713)	(14.619)
N	460	460	460	460	460	376	376	376	376	376
Adj. R^2	0.050	0.057	0.072	0.065	0.058	0.044	0.051	0.065	0.074	0.070

Table IA6: Robustness test of Operating Performance

This table reports change of firm's operating performance after politically connected independent director (PCID) resignation using the following regression model: $y_{it} = \alpha + \beta_1 PCID_i + \beta_2 PCID_i \times Post_t + Controls_{t-1} + \omega_j + \gamma_t + \epsilon_{it}$, where $PCID_i$ is a dummy variable which is equal to 1 if the firm is in the treatment group and 0 otherwise, $Post_t$ is a dummy variable which is equal to 1 after the PCID resignation takes effect and 0 otherwise, ω_j and γ_t are industry and year fixed effect. The firm is in the treatment group if it has PCIDs resignation to comply with Regulation No.18. Operating performance is measured using operating profits (OPOA) in Panel A and total cash flow (CF) in Panel B. OPOA is defined as the ratio of operating profit to total assets and CF is defined as the ratio of total cash flows to total assets. The sample includes 418 treated firms and 418 controlled firms matched with the treatment group. I report results for the full sample, SOEs subsample, and non-SOEs subsample. All variables are winsorized at 1% to 99% except dummy variables. All variables are defined in Appendix A. Standard errors are clustered at the industry level and reported in parentheses. ***, **, and * represent statistical significance at the 1% level, 5% level, and 10% level, respectively. Data source: CSMAR and website of Shanghai Stock Exchange and Shenzhen Stock Exchange.

Panel A: operating profits (OPOA)			
	(1)	(2)	(3)
	Full sample	SOEs subsample	Non-SOEs subsample
$PCID$	0.005	0.010**	-0.003
	(0.004)	(0.004)	(0.004)
$PCID \times Post$	-0.001	-0.002	0.001
	(0.002)	(0.003)	(0.003)
Size	0.020***	0.019***	0.024***
	(0.003)	(0.003)	(0.002)
Tangibility	-0.151***	-0.159***	-0.147***
	(0.009)	(0.013)	(0.007)
Leverage	0.006	-0.019	0.043
	(0.015)	(0.016)	(0.028)
B/M	-0.061***	-0.049***	-0.095***
	(0.008)	(0.008)	(0.006)
Growth	0.010***	0.013**	0.006**
	(0.003)	(0.005)	(0.002)
Top1	0.015***	-0.003	0.044***
	(0.005)	(0.011)	(0.009)
Age	0.005*	0.008*	0.002
	(0.003)	(0.004)	(0.003)
Independence	0.005	-0.005	0.024
	(0.026)	(0.027)	(0.028)
Board size	0.007	0.000	0.026***
	(0.005)	(0.009)	(0.008)
SOE	-0.013***		
	(0.003)		
Constant	-0.380***	-0.339***	-0.528***
	(0.049)	(0.047)	(0.034)
N	4,871	2,747	2,124
Adj. R^2	0.259	0.272	0.272

Table IA5 Continued

Panel B: total cash flow (CF)	(1) Full sample	(2) SOEs subsample	(3) Non-SOEs subsample
$PCID$	-0.015	-0.022	-0.009
	(0.015)	(0.028)	(0.025)
$PCID \times Post$	0.020	0.003	0.032
	(0.018)	(0.024)	(0.022)
Size	0.026	0.052**	0.013
	(0.017)	(0.024)	(0.018)
Tangibility	0.386***	0.251**	0.482***
	(0.054)	(0.094)	(0.069)
ROA	0.405***	0.398***	0.157
	(0.085)	(0.129)	(0.130)
Leverage	1.001***	1.004***	0.806**
	(0.216)	(0.219)	(0.374)
B/M	-0.155***	-0.180***	-0.136
	(0.043)	(0.031)	(0.127)
Growth	0.024	0.052	0.007
	(0.016)	(0.035)	(0.005)
Top1	0.254	0.174	0.416***
	(0.170)	(0.194)	(0.129)
Age	0.021	0.049	-0.017
	(0.040)	(0.091)	(0.028)
Independence	-0.210	-0.154	-0.375**
	(0.238)	(0.330)	(0.138)
Board size	-0.071	-0.051	-0.105***
	(0.048)	(0.071)	(0.019)
SOE	0.078***		
	(0.016)		
Constant	-0.517	-0.985*	0.080
	(0.368)	(0.513)	(0.428)
N	4,871	2,747	2,124
Adj. R^2	0.241	0.256	0.226

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