

Does Corporate Governance Matter for Politically Connected Firms? — Evidence from the Regime Change in Malaysia *

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Abstract

We examine the role that corporate governance plays in moderating the association between political connections and firm value when an unexpected but peaceful shift in political power takes place. Using the 2018 general election in Malaysia as our event, we find that the stock market reacts positively (negatively) to politically connected firms (PCFs) that are connected to the winning (losing) coalition. Further investigation reveals that market reactions take into account the corporate governance of these connected firms. Our results highlight the importance of corporate governance across PCFs as a hedge when such connections can be detrimental to firm value.

Keywords: Political Connections, Corporate Governance, Institutional Ownership, Political Affiliations, Regime Change

JEL codes: G32, G34, D72

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I. Introduction

Unexpected political events can have a significant impact on the value of politically connected firms (PCFs). One such impact is that firms connected to the politicians or political parties that win an election may receive a premium in their market value (Johnson and Mitton, 2003; Bunkanwanicha and Wiwattanakantang, 2009; Goldman *et al.*, 2009; Cooper *et al.*, 2010; Wagner *et al.*, 2018). The increase in market value can be attributed to the potential for such firms to obtain future income through commercial privileges (i.e. contracts, tax incentives, monopoly licenses, lower costs of financing, and subsidies) granted by the elected government. The positive association between favourable political events and the value of PCFs is consistent with the crony capitalism and political patronage theories (Shefter, 1977; Shleifer and Vishny, 1993, 1994).

On the other hand, firms connected to politicians or political parties that experience a fall from power, or parties that lose their majority position in legislature, experience a decline in their market value (Johnson and Mitton, 2003; Siegel, 2007; Dang and So, 2018; Dang *et al.*, 2018). The decline in the market value can be attributed to negative market sentiment over the ousting of the regime and the absence of future government favouritism (Siegel, 2007; Dang and So, 2018; Dang *et al.*, 2018). Moreover, the adverse impact of political connections on firm value can occur when the political benefactor is gravely ill (Fisman, 2001), experiences a sudden fall from power (Leuz and Oberholzer-Gee, 2006), or is the subject of violent political struggles that lead to a fall from power (Acemoglu *et al.*, 2018; Dang and So, 2018; Dang *et al.*, 2018).

Previous studies have used unexpected changes in the political landscape to determine the association between political connections and firm value (Leuz and Oberholzer-Gee, 2006; Goldman *et al.*, 2009; Cooper *et al.*, 2010; Acemoglu *et al.*, 2018; Dang and So, 2018; Dang *et al.*, 2018; Wagner *et al.*, 2018). The findings of these studies suggest that the expectation of future income derived from firms' political connections determines the association between political connections and firm value. A positive expectation regarding future income would lead to a positive association between political connections and firm value, while a negative expectation would lead to a negative association. However, past studies have not considered the role of corporate governance vis-à-vis the ways in which political connections affect firm value during an unexpected political event.

The outcome of the 2018 general election in Malaysia was an unexpected and peaceful shift in political power. While the incumbent Barisan Nasional coalition (the National Front and, later, Barisan Nasional; hereinafter "BN") had won every election and governed Malaysia since 1957, it lost unexpectedly to the Pakatan Harapan (Alliance of Hope; hereinafter "PH") coalition in the 2018 general election. BN's loss came as a surprise, as the consensus prior to election day was a majority win for BN (Chua, 2018; The Edge Financial Daily, 2018; Toh, 2018a, b). Using this unexpected outcome of Malaysia's 2018 general

election as our event of interest, our paper asks two questions. First, do market reactions take into account the potential future income gains or losses among PCFs? Previous studies show that firms connected to politicians or political parties that win power experience an increase in their market value (Johnson and Mitton, 2003; Bunkanwanicha and Wiwattanakantang, 2009; Goldman *et al.*, 2009; Cooper *et al.*, 2010; Wagner *et al.*, 2018), while firms connected to politicians and parties that experience a fall from power experience a decline in their market value (Johnson and Mitton, 2003; Siegel, 2007; Dang and So, 2018; Dang *et al.*, 2018).

Second, our paper aims to answer the question of what role, if any, corporate governance plays with respect to the association between political connections and firm value during an unexpected political event. We classify corporate governance monitors into two groups: internal and external monitors. Internal monitors include board and audit committee independence, while external monitors include the performance of audits by a Big 4 accounting and audit firm and the presence of institutional investors within PCFs. Given the fiduciary duties of corporate directors and members of audit committees (Bliss *et al.*, 2011; Majid and Arjunan, 2020), board independence (Andreou *et al.*, 2016) can play an effective monitoring role in PCFs. As for external monitors, Guedhami *et al.* (2014) suggest that the controlling shareholders of PCFs prefer to engage the services of a Big 4 audit firm to ensure transparency in corporate dealings. To maintain their reputation and minimise legal risks, Big 4 audit firms are more likely to provide high-quality audit services in firms with severe agency problems, particularly in PCFs (Tee *et al.*, 2017). Shleifer and Vishny (1986) suggest that institutional investors can perform a monitoring role to minimise agency problems. Recent evidence suggests that institutional investors intensify their monitoring efforts in firms such as PCFs with severe agency problems (Tee, 2018). Furthermore, geographical proximity theory argues that domestic institutional investors perform better in monitoring roles than foreign institutional investors do (Ayers *et al.*, 2011; Chhaochharia *et al.*, 2012). This is because domestic institutional investors have a competitive advantage over their foreign counterparts due to their familiarity with the local language, culture, and business networks (Ferreira and Matos, 2008; Aggarwal *et al.*, 2011).

Fung *et al.* (2015) find that PCFs connected to incumbent politicians or political parties for more than 10 years tend to be commercially self-sustaining, with stronger corporate governance. PCFs with these characteristics experience only a minor decrease in their market value when their political patrons lose their power. Chaney *et al.* (2011) suggest that political connectedness suppresses financial transparency and therefore reduces firm value. When political benefactors unexpectedly lose their power, the strong corporate governance within PCFs alleviates the negative association between political connections and the value of PCFs. Alternatively, when political benefactors gain power, good corporate governance promotes higher valuations (Chaney *et al.*, 2011; Fung *et al.*, 2015). Given the above, and considering the unexpected result of Malaysia's 2018 general election, we propose that sound corporate

governance could moderate the value of firms connected to BN and PH. It is noteworthy that, unlike violent public protests that forcibly changed the political landscape in Indonesia (Leuz and Oberholzer-Gee, 2006) and Egypt (Acemoglu *et al.*, 2018; Dang and So, 2018; Dang *et al.*, 2018), the transition of power after the 2018 general election in Malaysia was peaceful. This allowed investors in the Malaysian stock market to assess the value of good corporate governance in PCFs.

We adopt Faccio's (2006) general definitions to compile a list of PCFs in Malaysia. A firm is identified as politically connected if at least one of its executive directors (i.e. the CEO or a chairperson) or controlling shareholders (with at least 10% voting rights) have family or business ties with Malaysia's top politicians. Two political affiliations existed prior to the general election in 2018: the incumbent (governing) BN coalition and the newly formed PH coalition⁴ (see section 2.3 for details). We consider a firm as a BN- or PH-connected firm if its executive directors and/or controlling shareholders are connected to top politicians affiliated with BN or PH. Section 3.4 provides a detailed description of the identification of BN- and PH-connected firms. Out of the 734 firms listed on Bursa Malaysia (the Kuala Lumpur Stock Exchange), 100 are politically connected. We further identify these 100 PCFs as BN-connected firms ($n = 63$) and PH-connected firms ($n = 37$). A list of PCFs and their political affiliation is provided in Appendix B.

We conduct an event study analysis surrounding the 2018 general election in Malaysia with an event date ($t = 0$) of 10 May 2018, the day that the PH coalition was proclaimed the winner. The $t+1$ date of the event was 14 May 2018, as the PH coalition announced 10 and 11 May (Thursday and Friday) as public holidays. We use daily returns data from 9 May 2017 to 30 April 2018 to estimate the market model-based expected returns. We find that the cumulative abnormal returns (CARs) of the PCFs are consistently lower than those of the non-PCFs. A detailed analysis shows that firms connected to BN experience negative CARs, while firms connected to PH show positive and significant CARs.

Next, we test whether or not market reactions take into account the efficacy of corporate governance in PCFs. We find that board and audit committee independence fail to attenuate the negative market reactions to BN-connected firms. The negative market reaction is attenuated if BN-connected firms engage Big 4 auditors. On the other hand, the association between PH-connected firms and the positive market reaction is strengthened by greater board and audit committee independence and the engagement of Big 4 auditors by such firms.

We also find that the presence of institutional investors in PCFs moderates the association between BN- and PH-connected firms and market reactions. Institutional investors mitigate the negative market reactions experienced by BN-connected firms, while simultaneously enhancing positive market reactions to PH-connected firms. This suggests that

⁴ In 2015, the former Malaysian Prime Minister (PM), Mahathir Mohamad, formed the PH coalition with several parties—namely, *Parti Keadilan Rakyat* (PKR), the Democratic Action Party (DAP), *Amanah*, and *Parti Pribumi Bersatu Malaysia* (PPBM)—to contest against the BN coalition in the 2018 general election.

institutional investors play an effective monitoring role when they have equity ownership in either BN- or PH-connected firms. However, after considering the location of institutional investors, we find that domestic institutional investors alleviate the negative market reactions to BN-connected firms while enhancing the positive market reactions to PH-connected firms. In contrast, the presence of foreign institutional investors significantly lowers market returns for BN-connected firms.

We perform additional tests to examine the moderating role of corporate governance on the association between political connections and firm value. First, we examine the possibility that future income, potentially gained or lost by PCFs, plays a significant role in moderating the positive association between political connections and the value of PH-connected firms. Given the absence of economic policies that favour PH-connected firms from the PH government, we observe the post-election performance of PCFs in our sample (i.e. the one- and two-year changes in their ROA and ROE). We find that PCFs perform poorly compared to non-connected firms. Moreover, PH-connected firms do not perform better than BN-connected firms. Our findings offer corroborative evidence that future income channels may not be present in our sample. However, we do not dismiss the possibility that future income considerations may play a role in moderating the positive association between political connections and the value of PH-connected firms. More comprehensive tests, which are beyond the scope of this paper, are needed to pursue this line of inquiry.

Next, we investigate whether or not PCFs display stronger corporate governance. We find that PCFs have stronger corporate governance, as shown by their earnings quality. The stronger corporate governance of PCFs moderates the association between political connections and firm value. Finally, we examine whether or not our findings regarding BN-connected firms are driven by another firm characteristic: size. The results of a matched sample analysis reveal that this is not the case.

Our paper contributes to the extant literature in three ways. First, using an unexpected but peaceful shift in political power in Malaysia in 2018, we find that corporate governance plays a significant role in moderating the impact of political connections on firm value. Some PCFs do benefit from strong corporate governance amid unexpected major changes in political power. For example, the presence of institutional investors and the use of Big 4 audit firms attenuate negative market reactions toward firms that are connected to BN (the losing coalition), while all corporate governance variables (i.e. board and audit committee independence, the use of Big 4 auditors, and the presence of institutional investors) significantly magnify positive market reactions toward firms connected to PH (the winning coalition). More importantly, our results are free from other confounding factors related to political instability, which would arise when public protests initiate a shift in power (Leuz and Oberholzer-Gee, 2006; Dang and So, 2018; Dang *et al.*, 2018).

Second, we provide evidence of the important role of corporate governance in PCFs in a

more extreme situation than the one examined by Fung *et al.* (2015), who selected the 2008 Malaysian election as the event under study. Although the BN coalition lost its supermajority in Malaysia's parliament, it still managed to hold on to power. As such, Fung *et al.*'s (2015) study is only able to focus on adverse market reactions among BN-connected firms, and on how such reactions may be attenuated by board independence. In contrast, the results of our study highlight that the stock market considers corporate governance when valuing politically connected firms amid an unexpected major change in political power.

Finally, we suggest that PCFs benefit from having strong corporate governance as a hedge when such connections can be detrimental to firm value (Leuz and Oberholzer-Gee, 2006; Dang and So, 2018). Firms that are more susceptible to a loss of favour are insulated from negative market reactions by their corporate governance practices. Our study complements the results of Lin *et al.* (2016) in regard to the governance role that institutional investors play in moderating the impact of political connections on firm value. Our findings provide supporting evidence to Fung *et al.* (2015) in regard to the role that corporate governance plays in enhancing the value of PCFs.

The rest of this paper is organised as follows. In Section II, we discuss the related literature on political connections and corporate governance. In Section III, we discuss the data and methodology. Section IV presents the descriptive statistics and empirical results. We conclude our findings in Section V.

II. Literature Review and Institutional Background

2.1 Political Connections and Firm Value

The crony capitalism (Shleifer and Vishny, 1993, 1994) and political patronage theories (Shefter, 1977) posit that a firm's value can be enhanced through close ties with top politicians or ruling elites. These connected firms can extract vast commercial and non-commercial privileges from the government. Commercial privileges include lucrative government contracts and subsidies (Johnson and Mitton, 2003; Leuz and Oberholzer-Gee, 2006), tariff protection (Wagner *et al.*, 2018), preferential access to financing (Bliss and Gul, 2012), and equity (Boubakri *et al.*, 2012) and monopoly licenses (Bunkanwanicha and Wiwattanakantang, 2009). Non-commercial privileges include political protection from legal prosecution (Yu and Yu, 2011; Piotroski *et al.*, 2015; Kim and Zhang, 2016), and lax regulatory oversight (Houston *et al.*, 2014; Tee, 2018).

Firms connected to the winning political party in an election experience an increase in their market value due to the expected implementation of economic policies favourable to them by their political benefactors (Goldman *et al.*, 2009; Cooper *et al.*, 2010). In contrast, firms connected to incumbent politicians or parties that lose political power experience a substantial reduction in their value due to the curtailment of their rent-seeking activities. For instance, Leuz and Oberholzer-Gee (2006) show that firms connected to the Suharto regime

had their commercial privileges eliminated and were forced to seek external financing after the fall of President Suharto. Meanwhile, Fisman (2001) documents the lower valuations of firms closely connected to President Suharto as his health deteriorated. In fact, recent studies find that the adverse effect is compounded if changes in the political landscape are unexpected and chaotic, such as those that occurred in Egypt in 2011 (Acemoglu *et al.*, 2018; Dang and So, 2018; Dang *et al.*, 2018).

2.2 Political Connections and Corporate Governance

The extant literature provides two research streams to explain the relationship between corporate governance and PCFs. First, the internal governance monitors of PCFs (i.e. board and audit committee independence) are reported to be rigorous, given the severe agency problems in PCFs. Bliss *et al.* (2011) show that the audit committees of PCFs are more independent and tend to appoint Big 4 audit firms. Board independence drives high quality financial reporting by PCFs, while the appointment of Big 4 audit firms ensures high quality audits. In addition, controlling shareholders seek to increase the number of independent directors on the boards and audit committees of PCFs (Andreou *et al.*, 2016; Habib *et al.*, 2018).

Second, prior studies suggest that PCFs initiate measures to improve external governance by appointing Big 4 audit firms. The controlling shareholders of PCFs engage the services of Big 4 audit firms to assure other shareholders that the firm will be transparent in its corporate dealings and financial reporting (Guedhami *et al.*, 2014). In addition, institutional investors play a pivotal monitoring role in alleviating agency problems between managers and shareholders (Shleifer and Vishny, 1986). Institutional investors' expertise, networks, and economies of scale (Cronqvist and Fahlenbrach, 2009) facilitate monitoring and reduce the ability of top managers or controlling shareholders to engage in rent-seeking behaviour (Becker *et al.*, 2011) and over-investment (Gugler *et al.*, 2008). On the other hand, institutional investors induce greater CEO pay performance sensitivity (Hartzell and Starks, 2003), lower corporate investment, corporate cash holdings and CEO pay, as well as greater dividend payouts (Becker *et al.*, 2011).

In terms of the geographic origin of institutional investors, domestic institutional investors are better informed and have a comparative advantage in terms of influencing firms in governance matters, including earnings management (Ayers *et al.*, 2011; Kim *et al.*, 2016; Liu *et al.*, 2018). Foreign institutional investors, on the other hand, possess greater investment skills, are free from local political pressure (Ferreira and Matos, 2008; Liu *et al.*, 2018), and are more likely to improve firm governance (Gillan and Starks, 2003).

2.3 Political Connections in Malaysia

The origins of crony capitalism in Malaysia can be traced back to the introduction of the New Economic Policy (NEP) by the Malaysian government in 1970. The NEP was an

affirmative economic and social policy aiming to redistribute wealth among the different ethnic groups in Malaysia (Gomez and Jomo, 1999; Tee, 2018). However, its implementation required the active participation of the government in the economy and capital markets. This facilitated the establishment of an intricate system of political patronage, whereby top politicians from the incumbent BN government granted business concessions to connected businesses in exchange for political donations, bribes, and economic support (Gomez and Jomo, 1999; Gomez *et al.*, 2017; Tee, 2018; Phan *et al.*, 2020). By doing so, BN politicians solidified and perpetuated their grip on power in Malaysia (Gomez *et al.*, 2017; Phan *et al.*, 2020). Crony capitalism was particularly pronounced from 1981 to 2003, during the tenure of Prime Minister (PM) Mahathir Mohamad, as his government embarked on a policy of privatising government services.

Consequently, a political struggle occurred between the major political factions within UMNO during the 1997-1998 Asian currency crisis (Gomez and Jomo, 1999). Johnson and Mitton (2003) show that, in the initial staged of the currency crisis, firms connected to Anwar Ibrahim, who was Deputy Prime Minister (DPM) and the Minister of Finance at the time, reported higher firm valuations than firms linked to PM Mahathir Mohamad. At the same time, firms connected to Anwar Ibrahim were charged lower audit fees than firms connected to Mahathir Mohamad (Gul, 2006). However, following the implementation of capital controls in 1998, firms connected to Mahathir Mohamad received higher valuations and lower audit fees. Prior to that, Mahathir, as the PM, had sacked Anwar Ibrahim as the DPM and Minister of Finance, signalling to the market that the former had won the political struggle against the latter. In addition, capital markets perceived the implementation of capital controls as an effort by the Malaysian government to assist firms connected to Mahathir Mohamad and his political supporters (Johnson and Mitton, 2003).

2.4 Malaysia's 2018 General Election

After serving for 22 years from 1981 to 2003, Mahathir Mohamad stepped down and was succeeded by Abdullah Badawi. The following year, Abdullah Badawi led BN to a historic victory, winning 90% of contested parliamentary seats in the 2004 general election. However, Abdullah Badawi's administration failed to institute measures to improve the country's economy and the promised political reforms. As a result, BN suffered huge losses to opposition parties in the subsequent 2008 general election. Although BN remained the governing party, it lost five states and its supermajority in parliament for the first time since 1969. This prompted Mahathir Mohamad to instigate efforts within UMNO to remove Abdullah Badawi.

Although Mahathir had retired from politics, he remained an influential leader in UMNO. In 2009, he played an instrumental role in Abdullah Badawi's resignation and the election of Mahathir's hand-picked successor, Najib Razak. Mahathir's relationship with PM Najib Razak began to sour, however, in 2015, due to evidence linking the PM with the 1Malaysia

Development Berhad (1MDB) \$10 billion financial scandal. In 2016, the US Department of Justice filed a lawsuit in US court to recover laundered money from 1MDB. Mahathir Mohamad demanded Najib Razak's resignation as PM and tried to topple him through UMNO. When Mahathir failed, he quit UMNO and formed a new political party, *Parti Pribumi Bersatu Malaysia* (PPBM), to contest in the 2018 general election. To increase his chance of winning the election against the incumbent BN government of Najib Razak, Mahathir Mohamad formed an opposition coalition known as *Pakatan Harapan* (PH), which included other opposition parties, such as *Parti Keadilan Rakyat* (PKR), the Democratic Action Party (DAP), and *Amanah*, alongside PPBM.

Despite allegations of massive corruption and the introduction of the unpopular goods and services tax (GST), Najib Razak's BN coalition was favoured to win the 2018 general election (Chua, 2018; The Edge Financial Daily, 2018; Toh, 2018a, b). Meanwhile, the PH coalition focused its campaign on the issue of the 1MDB corruption scandal and the repeal of the GST. On 9 May 2018, PH unexpectedly defeated BN by obtaining a 12-seat majority in Parliament. The PH victory was a shock to the stock market, as BN had ruled Malaysia before the country's independence from the British in 1957. As an immediate market reaction, firms connected to PH's top leaders, including Mahathir Mohamad, Muhyiddin Yassin, and Lim Guan Eng, recorded spectacular appreciations in stock prices, while firms connected to BN's top politicians, such as Najib Razak and Zahid Hamidi, experienced huge losses.

III. Data and Methodology

3.1 Data

The sample for this study consists of 734 firms listed on Bursa Malaysia (the Kuala Lumpur Stock Exchange). Approximately 14% of these firms are politically connected ($n = 100$). We analyse the 100 PCFs and classify them as either BN-affiliated firms ($n = 63$) or PH-affiliated firms ($n = 37$). We collect daily stock prices and records of the market index, the FTSE Bursa Malaysia Emas Index, for these firms from Datastream. The firms' financial data are obtained from Compustat. Data related to political connections and corporate governance are hand-collected from the annual reports and websites of the firms under study.

3.2 Event Study

As indicated previously, the event of interest in this study is the 2018 Malaysian general election, which was held on 9 May 2018. Our event date (t_0) includes three calendar days consisting of the election day and the two-day holiday after the election. The stock exchange reopened on 14 May 2018 and we consider this day as $t + 1$ in our analysis. We estimate normal returns using a market model, with the beta estimated using returns data from 9 May 2017 to 30 April 2018. We use the FTSE Bursa Malaysia Emas Index as a proxy for market returns. We identify a list of events that occurred after 9 May 2018 and expect varying impacts

on the stock market based on a firm's political connection or affiliation (details are provided in Appendix A). We calculate the cumulative abnormal returns (CARs) for each firm for different event windows surrounding the general election, from day $t - 5$ to day $t + 14$.

3.3 Research Design

To examine whether or not market reaction considers political connections, we estimate the following regression:

$$CAR_{i,t} = \alpha_0 + \alpha_1 PCF_{i,t-1} + \alpha_k \sum_k Control_{i,t-1}^k + \alpha_j \sum_j Industry_j + e_{i,t}, \quad (1)$$

where $CAR_{i,t}$ represents the cumulative abnormal returns of firm i calculated for several event windows surrounding the general election, and $PCF_{i,t-1}$ is an indicator for political connections for firm i one year prior to the election year. The variable takes the value of unity if a firm is politically connected, and zero otherwise.

In the subsequent analysis, we replace the PCF indicator with BN affiliation or PH affiliation, and obtain the following equation:

$$CAR_{i,t} = \alpha_0 + \alpha_1 BN \text{ or } PH_{i,t-1} + \alpha_k \sum_k Control_{i,t-1}^k + \alpha_j \sum_j Industry_j + e_{i,t}, \quad (2)$$

where BN and PH are dummy variables that take the value of unity if a firm is connected to BN or PH in the year leading to the election, and zero otherwise. $Control_{i,t-1}$ denotes a set of control variables. We control for industry-level differences by including dummy indicators based on the two-digit SIC industry index. Following Dang *et al.* (2018), we estimate the regression specified in Equation 1 using the generalised least squares (GLS) method, to avoid downward bias regarding the standard errors of the coefficient estimates due to event-date clustering. We winsorise the top and bottom 1% of the distribution of all continuous variables to reduce the influence of extreme outliers.

3.4 Political Connections

We compile a list of Malaysian PCFs by adopting Faccio's (2006) general definition. A firm is identified as politically connected if at least one of its executive directors (i.e. the CEO or a chairperson) or controlling shareholders have family or business ties with top politicians in Malaysia. A firm is identified as PCF if it is determined to be aligned with top politicians in either BN or PH. In the case of BN, we consider former PM Najib Razak, former DPM Zahid Hamidi, and former cabinet ministers as top politicians. On the other hand, only key leaders from the constituent parties in the PH coalition are considered top PH politicians. These include Mahathir Mohamad, Muhyiddin Yassin, and Mukhriz Mahathir from PPBM, Anwar Ibrahim from *Parti Keadilan Rakyat* (PKR), Lim Guan Eng from the Democratic Action Party (DAP), and Mohamad Sabu from *Amanah*. We review the Directors' Profiles and the Substantial Shareholders sections of firms' 2017 annual reports to identify the

executive directors (chairperson and CEO) and controlling shareholders of each firm, respectively. We then check the political connections of the executive directors and the controlling shareholders against the top politicians identified earlier using news articles from *The Edge Malaysia*, a leading financial newspaper in Malaysia. The list of PCFs, along with their BN and PH affiliations, is provided in Appendix B.

3.5 Control Variables

A set of firm characteristic control variables is included following prior literature examining CARs in studies of similar events (Fung *et al.*, 2015; Dang *et al.*, 2018). Firm size is represented by the log of the firm's prior year market capitalisation ($MCAP_{T-1}$), while leverage (LEV_{T-1}) is calculated by dividing total debt by total assets. Firm growth is represented by the previous year's market-to-book value (MB_{T-1}). Operating performance is measured by the return on assets (ROA_{T-1}). We also include firm age ($FirmAge_{T-1}$) to control for the effects of age on our results. The definitions of all variables used in this study are summarised in Appendix C.

IV. Empirical Results

4.1 Descriptive Statistics

Table 1 presents the results from the univariate tests of the CARs and compares the CARs of PCFs ($n = 100$) against those of non-PCFs ($n = 634$), the CARs of BN-connected firms ($n = 63$) against those of non-BN-connected firms ($n = 671$), and the CARs of PH-connected firms ($n = 37$) against those of non-PH-connected firms ($n = 697$) over the different windows surrounding the general election.

Despite the uncertainty that a general election may generate, the market has a positive view of the results of the 2018 general election. Table 1 shows that the CARs for PCFs and non-PCFs are positive and significant about one week before the election day (-5, -1), with PH-connected firms recording CARs of 3.3% and BN-connected firms experiencing negative and significant CARs (-0.73%) two days prior to the election day. Given its magnitude, this negative result for BN-connected firms may suggest that the market is reacting to the uncertainty surrounding a general election. Overall, the findings suggest that the market did not expect PH to win Malaysia's 2018 general election.

After the outcome of the general election is known, non-PCFs are better off than PCFs. During the same period, the CARs of BN-connected firms are negative and significant, while the corresponding CARs of PH-connected firms are positive and significant. The negative and significant CARs of BN-connected firms for various event periods starting from $t+1$ are significantly different from the CARs of PH-connected firms. When comparing these results against those of non-PCFs, we find that the CARs of BN-connected firms are significantly lower than the CARs of non-PCFs. There seem to be no significant differences between the

Table 1 Descriptive Statistics and the Results of Univariate Tests of the Market Reaction to Election Results — Univariate tests of the difference in cumulative abnormal returns

This table presents the univariate tests of difference in cumulative abnormal returns (CARs, in %). The sample covers firm-year observations with non-missing values for all control variables for the fiscal year 2017. T-values are based on two-tailed tests, while * and ** indicate statistical significance at the 5% and 1% levels, respectively. Definitions of all variables are provided in Appendix C.

Event Windows	PCFs (n = 100)		Non-PCFs (n = 634)		PCFs-Non PCFs		BN (n = 63)		PH (n = 37)		BN-PH		BN-Non-PCFs		PH-Non-PCFs	
	Mean	T-stats	Mean	T-stats	Mean	T-stats	Mean	T-stats	Mean	T-stats	Mean	T-stats	Mean	T-stats	Mean	T-stats
<i>[-5, -1]</i>	1.625*	0.29	1.467**	0.158	-0.195	-0.52	0.610	3.307**	-2.697	-2.41*	-0.857	-1.31	1.840	1.84		
<i>[-3, -1]</i>	0.402	-0.52	0.597**	-0.195	-0.283	-0.75	-0.102	1.238	-1.340	-1.69	-0.699	-2.05*	0.641	0.97		
<i>[-2, -1]</i>	-0.044	-0.75	0.239	-0.283	-0.770	-3.70**	-0.725*	1.084	-1.809	-2.41*	-0.964	-2.46*	0.845	1.43		
<i>[-1, +1]</i>	-2.024	-3.70**	3.746**	-5.770	-5.775	-3.46**	-9.093**	9.509**	-18.601	-6.85**	-12.839	-9.04**	5.762	2.44*		
<i>[-1, +2]</i>	-1.824	-3.15**	3.951**	-5.775	-6.047	-3.15**	-9.156**	10.140**	-19.296	-6.95**	-13.107	-8.13**	6.189	2.51*		
<i>[-1, +4]</i>	-2.059	-4.37**	3.988**	-6.047	-8.802	-4.37**	-9.229**	9.639**	-18.868	-5.55**	-13.217	-6.36**	5.651	2.01		
<i>[-1, +6]</i>	-4.743*	-4.12**	4.059**	-8.802	-8.700	-4.12**	-12.490**	8.100**	-20.590	-5.83**	-16.549	-7.43**	4.041	1.46		
<i>[-1, +9]</i>	-2.505	-4.05**	6.195**	-8.700	-8.529	-4.05**	-10.678**	11.043**	-21.721	-5.89**	-16.873	-7.36**	4.848	1.63		
<i>[-1, +11]</i>	-2.390	-3.62**	6.139**	-8.529	-8.315	-3.62**	-9.930**	10.110**	-20.040	-5.36**	-16.069	-6.78**	3.971	1.34		
<i>[-1, +14]</i>	-1.641	-3.62**	6.674**	-8.315	-8.315	-3.62**	-9.390**	11.205**	-20.595	-4.97**	-16.064	-6.41**	4.531	1.29		

positive CARs that PH-connected firms and non-PCFs experience, except for two short observation windows— $(-1, +1)$ and $(-1, +2)$ —where the CARs of PH-connected firms are significantly greater than the CARs of non-PCFs. Overall, the results of our univariate analysis show a positive relationship between political connections and firm value for PH-connected firms, and the opposite for BN-connected firms.

Table 2

Panel A: Descriptive Statistics and Univariate Tests of Politically Connected Firms (PCFs) and Non-politically Connected Firms (non-PCFs)

This table presents descriptive statistics and univariate tests of control variables for the subsamples of politically connected firms (PCFs) and non-politically connected firms (non-PCFs) included in the main regression analyses. The sample covers firm-year observations with non-missing values for all control variables for the fiscal year 2018. T-values are based on two-tailed tests, while * and ** indicate statistical significance at the 5% and 1% levels, respectively. Definitions of all variables are provided in Appendix C.

Variables	PCFs (N = 100)		Non-PCFs (N = 634)		PCFs–Non-PCFs
	Mean	S.D.	Mean	S.D.	Mean
<u>Control Variables</u>					
<i>MCAP_{T-1}</i>	7.207	1.985	5.506	1.483	1.701**
<i>LEV_{T-1}</i>	0.264	0.161	0.181	0.163	0.083**
<i>MB_{T-1}</i>	3.220	9.840	1.340	2.050	1.880
<i>ROA_{T-1}</i>	0.017	0.108	0.019	0.123	-0.002
<i>FIRMAGE_{T-1}</i>	35.158	22.736	27.439	17.178	7.719**
<i>INDDIR_{T-1}</i>	52.423	12.426	51.363	13.255	1.060
<i>AUDITCOM_{T-1}</i>	88.820	13.572	88.024	15.109	0.796
<i>AUDITOR_{T-1}</i>	0.847	0.362	0.500	0.500	0.347**
<i>II_{T-1}</i>	27.361	31.847	9.577	14.788	17.784**
<i>IIDOM_{T-1}</i>	22.424	28.332	6.919	11.984	15.505**
<i>IIFOR_{T-1}</i>	4.936	7.274	2.658	5.954	2.278*

Panel B: Descriptive Statistics and the Results of Univariate Tests of BN-affiliated Firms, PH-affiliated Firms, and Non-PCFs

This table presents descriptive statistics and the results of univariate tests of control variables for the subsamples of BN-affiliated firms, PH-affiliated firms, and non-politically connected firms (non-PCFs) included in the main regression analyses. The sample covers firm-year observations with non-missing values for all control variables for the fiscal year 2018. T-values are based on two-tailed tests, while * and ** indicate statistical significance at the 5% and 1% levels, respectively. Definitions of all variables are provided in Appendix C.

Control Variables	BN (N = 63)		PH (N = 37)		Non-PCFs (N = 634)		BN–PH	BN–Non-PCFs	PH–Non-PCFs
	Mean	Std Dev	Mean	Std Dev	Mean	Std Dev	Mean	Mean	Mean
<i>MCAP_{T-1}</i>	7.239	2.097	7.154	1.810	5.506	1.483	0.085	1.733**	1.648**
<i>LEV_{T-1}</i>	0.269	0.163	0.257	0.159	0.181	0.163	0.012	0.088**	0.076**
<i>MB_{T-1}</i>	1.700	2.130	5.740	15.600	1.340	2.050	-4.040	0.360	4.400
<i>ROA_{T-1}</i>	0.012	0.109	0.024	0.108	0.019	0.123	-0.012	-0.007	0.005
<i>FIRMAGE_{T-1}</i>	35.667	21.935	34.316	24.286	27.439	17.178	1.351	8.228**	6.877
<i>INDDIR_{T-1}</i>	50.848	11.562	55.209	13.612	51.363	13.255	-4.361	-0.515	3.846
<i>AUDITCOM_{T-1}</i>	86.833	13.593	92.333	13.055	88.024	15.109	-5.500	-1.191	4.309
<i>AUDITOR_{T-1}</i>	0.848	0.363	0.846	0.368	0.500	0.500	0.002	0.348**	0.346**
<i>II_{T-1}</i>	36.705	34.798	10.829	15.994	9.577	14.788	25.876**	27.128**	1.252
<i>IIDOM_{T-1}</i>	30.299	31.286	8.493	14.209	6.919	11.984	21.806**	23.380**	1.574
<i>IIFOR_{T-1}</i>	6.406	8.346	2.336	3.729	2.658	5.954	4.070**	3.748**	-0.322

Table 2 presents the mean values of the firm characteristic control variables and corporate governance variables of our sample firms, which are categorised as PCFs and non-PCFs.

Panel A shows that the PCFs ($n = 100$) are significantly larger in size (in terms of market capitalisation), more leveraged, and older than the non-PCFs ($n = 634$). We also find that, while PCFs do not differ significantly from non-PCFs in terms of their internal monitors (i.e. the percentage of independent directors on both their boards of directors and audit committees), PCFs are better governed externally. This is because 85% of PCFs are audited by a Big 4 audit firm, compared to half of non-PCFs. Moreover, PCFs are owned by a higher percentage of institutional investors, both domestic and foreign, than non-PCFs.

Looking at Panel B, BN-connected firms are not significantly different from PH-connected firms in regard to almost all their characteristics, except for the presence of institutional investors, where BN-connected firms have a significantly greater presence of institutional investors. In addition, we find that BN- and PH-connected firms are larger and older, with greater debt, and are more likely to be audited by a Big 4 audit firm than non-PCFs. There is no statistically significant variation in terms of firm age for PH-connected firms and non-PCFs.

4.2 Regression Results

So far, the results of our univariate analysis suggest that the market reacts differently to PCFs and non-PCFs. In addition, market reaction seems to favour firms that are connected to the winner of the election (PH). Our regression analysis aims to investigate different market reactions while considering the different firm characteristics of PCFs and non-PCFs, as well as BN-connected and PH-connected firms.

4.2.1 Political connections and CARs

Table 3 reports the results of estimating the cross-sectional regressions depicted in Equation 1. Table 3 shows market reactions measured by CARs; these are calculated at various time intervals ranging from $(-1,1)$ to $(-1,14)$. We include both short and long intervals to consider delayed market reactions. In addition, we align the selection of time intervals to coincide with several important events that occurred after the PH government came to power (the details are listed in Appendix 2). Panel A of Table 3 shows that PCFs suffer negative CARs for all time intervals. This finding indicates that the market reacts negatively to all forms of political connections, confirming the earlier findings of our univariate analysis.

The effects of the control variables are significant and their signs are as expected. The cross-sectional variations of *MCAP* have a negative and significant relationship with CARs across all intervals. This signifies that large firms are affected by adverse market reactions, consistent with the findings of Dang *et al.* (2018). As for the other control variables, *MB*, *ROA*, and *AGE* have a positive relationship with CARs across all intervals, suggesting that firms

with greater stability and growth prospects are affected by positive market reactions across all intervals. However, the positive and significant coefficients for *LEV* may capture the greater leverage of PCFs in Malaysia. As presented in both panels of Table 2, PCFs have greater leverage, and this is true for firms connected to either BN or PH.

Table 3 Market Reaction to the Outcome of the 2018 Election

This table shows the market reaction to the announcement of the 2018 election outcome. Panel A shows the general market reaction toward politically connected firms. Panel B shows the market reaction to firms that are connected to the incumbent regime (BN) and the winning coalition (PH). The regressions include 10 industry dummy variables. We report the generalised least square (GLS) standard errors in parentheses to take into account the heteroskedastic errors in the cross-sectional regressions. * and ** indicate statistical significance at the 5% and 1% levels, respectively. All variables are defined in Appendix C.

Panel A: CAR and PCF

	(1) CAR (-1,1)	(2) CAR (-1,2)	(3) CAR (-1,4)	(4) CAR (-1,6)	(5) CAR (-1,9)	(6) CAR (-1,11)	(7) CAR (-1,14)
<i>PCF</i>	-6.3723** (0.0745)	-6.7658** (0.1717)	-6.9616** (0.1753)	-9.7211** (0.1849)	-9.4507** (0.3153)	-8.9131** (0.2717)	-8.5546** (0.1940)
<i>MCAP_{T-1}</i>	-0.0274 (0.0191)	-0.1129** (0.0210)	-0.0492 (0.0458)	-0.0020 (0.0343)	-0.1355** (0.0300)	-0.2723** (0.0396)	-0.4846** (0.0296)
<i>LEV_{T-1}</i>	2.2314** (0.2418)	3.4864** (0.1537)	3.4090** (0.2631)	4.7328** (0.2705)	4.4356** (0.2561)	3.3668** (0.3015)	4.9578** (0.1876)
<i>MB_{T-1}</i>	0.2300* (0.1078)	0.4402** (0.0573)	0.6338** (0.1341)	0.6186** (0.1432)	0.6721** (0.0875)	0.4413** (0.1050)	0.5893** (0.0897)
<i>ROA_{T-1}</i>	0.8871* (0.3534)	1.6857** (0.5428)	6.8290** (0.7089)	9.6318** (0.6467)	4.5339** (0.5666)	4.2164** (0.5293)	6.8680** (0.7772)
<i>FIRMAGE_{T-1}</i>	0.0126** (0.0028)	0.0344** (0.0013)	0.0533** (0.0029)	0.0309** (0.0035)	0.0159** (0.0032)	0.0250** (0.0024)	0.0168** (0.0025)
<i>N</i>	587	602	616	623	623	625	627
<i>Pseudo R²</i>	0.0812	0.0799	0.0831	0.1249	0.1001	0.0984	0.0840

Panel B: CAR and Political Connections to BN and PH

	(1) CAR (-1,1)	(2) CAR (-1,2)	(3) CAR (-1,4)	(4) CAR (-1,6)	(5) CAR (-1,9)	(6) CAR (-1,11)	(7) CAR (-1,14)
<i>BN</i>	-12.1331** (0.3325)	-12.5542** (0.2883)	-12.5892** (0.1932)	-16.0495** (0.1150)	-16.9468** (0.3337)	-14.5920** (0.1411)	-14.9844** (0.2058)
<i>PH</i>	4.9626** (0.1349)	3.8446** (0.4229)	3.5935** (0.1150)	2.0421** (0.2986)	2.7079** (0.4657)	3.3194** (0.2125)	3.1791** (0.3447)
<i>MCAP_{T-1}</i>	-0.0267 (0.0242)	-0.0954** (0.0113)	0.0149 (0.0297)	-0.0322 (0.0261)	-0.0868** (0.0286)	-0.3266** (0.0335)	-0.4596** (0.0200)
<i>LEV_{T-1}</i>	2.7318** (0.1748)	3.6477** (0.1410)	3.3522** (0.2436)	4.9022** (0.2048)	4.4756** (0.1798)	3.8498** (0.2382)	4.9494** (0.1876)
<i>MB_{T-1}</i>	-1.3619** (0.1439)	-0.9938** (0.0624)	-1.0893** (0.1639)	-0.9310** (0.1455)	-1.0302** (0.1319)	-0.9626** (0.1219)	-0.9605** (0.1223)
<i>ROA_{T-1}</i>	2.1389** (0.2658)	1.5989** (0.2463)	7.9838** (0.3734)	10.4371** (0.6303)	5.9242** (0.5586)	5.7480** (0.5664)	7.2665** (0.4485)
<i>FIRMAGE_{T-1}</i>	0.0278** (0.0030)	0.0393** (0.0007)	0.0576** (0.0028)	0.0440** (0.0020)	0.0282** (0.0028)	0.0310** (0.0021)	0.0196** (0.0030)
<i>N</i>	587	602	616	623	623	625	627
<i>Pseudo R²</i>	0.1861	0.1701	0.1394	0.1820	0.1626	0.1455	0.1221

Given the different types of political affiliations among PCFs, we estimate Equation 2 by replacing *PCF* in Equation 1 with two dummy indicators, *BN* and *PH*, to reflect the affiliations of the connected firms. Panel B of Table 3 shows that affiliation with the old regime (BN) leads to a negative market reaction throughout the various intervals of CARs, while affiliation with the winning regime (PH) leads to a positive market reaction. These findings are highly significant at the 1% level. Overall, our results show that, when a government loses its political influence, firm value may diminish (Fisman, 2001) and a political connection with the old regime could become a liability (Dang and So, 2018; Dang *et al.*, 2018). The positive relationship observed between political connections and firm value for firms that are connected to the winning party is consistent with the findings of Goldman *et al.* (2009) and Lin *et al.* (2016). The estimated coefficients for the control variables in Panel B have similar signs and significance to those in Panel A, except for the estimated coefficients for *MB*, which are negative and significant. This finding indicates that firms with high growth prospects receive negative market reactions when the models consider the different political affiliations (BN and PH). This finding could be attributed to the uncertain nature of firms' growth prospects after the election, once the greater *MB* of PH-connected firms is accounted for. Panel B of Table 2 shows that the *MB* for PH-connected firms is greater than that for BN-connected firms, although the difference is not statistically significant, due to the great variation of *MB* figures across PH-connected firms.

4.2.2 Political connections and corporate governance

We modify Equation 1 to examine the role of various corporate governance variables in explaining the market reaction surrounding the 2018 general election. The equation takes the following form:

$$CAR_{i,t} = \alpha_0 + \alpha_1 BN \text{ or } PH_{i,t-1} + \alpha_2 (BN \text{ or } PH_{i,t-1} \times \sum_l CGOV_{i,t-1}^l) + \alpha_l \sum_l CGOV_{i,t-1}^l + \alpha_k \sum_k Control_{i,t-1}^k + \alpha_j \sum_j Industry_j + e_{i,t}, \quad (3)$$

where $CGOV_{i,t-1}$ denotes corporate governance variables that consist of the percentage of independent directors on the firm's board of directors (*INDDIR*), the percentage of independent directors on the firm's audit committee (*AUDITCOM*), and whether or not the firm is audited by one of the Big 4 audit firms (*AUDITOR*). As earlier studies find that institutional investors can exert good governance through ownership (Shleifer and Vishny, 1986; Hartzell and Starks, 2003; Gugler *et al.*, 2008; Becker *et al.*, 2011), we include institutional ownership at the end of 2017 as a governance variable. We use the ownership of institutional investors as a whole (*II*), as well as that of domestic institutional investors (*IDOM*) and foreign institutional investors (*IFOR*). We estimate the regression independently for all the corporate governance variables and include the interaction term of these governance variables with *PH* and *BN* dummy indicators to ascertain whether or not corporate governance plays a role in explaining market reaction to the connected firms. We include market reaction

as the dependent variable at short (-1,1) and long (-1,14) intervals, as the stock market may need time to digest how corporate governance will affect the contribution of political connections to the value of connected firms. Table 4 reports the results.

Table 4 Political Connections and Firm Governance

This table shows the influence of the firm governance of the politically connected companies on the market reaction, captured at the different intervals. CAR(-1,1) captures the short-interval market reaction, while CAR(-1,14) captures a relatively longer interval in the market reaction. The regressions include 10 industry dummy variables. We report the generalised least square (GLS) standard errors in parentheses to take into account the heteroskedastic errors in the cross-sectional regressions. * and ** indicate statistical significance at the 5% and 1% levels, respectively. Appendix C contains definitions of the variables.

	(1)	(2)	(3)	(4)	(5)	(6)
	CAR(-1,1)	CAR(-1,1)	CAR(-1,1)	CAR(-1,14)	CAR(-1,14)	CAR(-1,14)
<i>BN</i>	-10.5654** (1.2272)	-11.8216** (1.7798)	-15.5849** (0.2256)	-9.1817** (0.5915)	-15.2326** (0.7401)	-15.6349** (1.1990)
<i>PH</i>	3.2160** (1.1652)	3.5276** (1.1837)	-0.6633* (0.2998)	1.5475** (0.5689)	1.5100** (0.0768)	-3.0206 (1.9469)
<i>INDDIR</i>	0.0072** (0.0014)			-0.0010 (0.0014)		
<i>BN x INDDIR</i>	-0.0081 (0.0257)			-0.1260** (0.0087)		
<i>PH x INDDIR</i>	0.0389 (0.0222)			0.0496* (0.0228)		
<i>AUDITCOM</i>		0.0042** (0.0007)			0.0016* (0.0008)	
<i>BN x AUDITCOM</i>		0.0188 (0.0203)			0.0070 (0.0095)	
<i>PH x AUDITCOM</i>		0.0232 (0.0137)			0.0407** (0.0091)	
<i>AUDITOR</i>			-0.4632** (0.0701)			0.1404* (0.0662)
<i>BN x AUDITOR</i>			6.5046** (0.5865)			2.9131* (1.2405)
<i>PH x AUDITOR</i>			9.5248** (0.4005)			12.6238** (1.9616)
Control Variables	Included	Included	Included	Included	Included	Included
<i>N</i>	593	593	593	633	633	633
<i>Pseudo R</i> ²	0.1830	0.1851	0.1980	0.1207	0.1187	0.1280

Focusing on the interaction term between the governance variables and connections to BN or PH, Column 4 of Table 4 shows that the interaction variable *INDDIR x BN* is negative and significant (at the 1% level), while the interaction variable *INDDIR x PH* is positive and significant (at the 5% level). These findings indicate that the presence of independent directors worsens the negative CARs of BN-connected firms while strengthening positive market reaction toward PH-connected firms. Continuing with Column 5 of Table 4, the interaction

terms of *AUDITCOM* and *PH* are positive and significant at the 1% level, but insignificant and positive for the interaction terms of *AUDITCOM* and *BN*. These findings suggest that PH-connected firms experience an enhancement in their value due to corporate governance, in terms of the percentage of independent directors on boards and audit committees. However, the greater presence of independent directors on the boards of directors and audit committees cannot alleviate adverse market reactions for BN-connected firms. The appointment of independent directors can decrease value, especially when appointments have a political motive. For example, a politician without the appropriate skillsets can be appointed as an independent director in a politically connected firm for political reasons (Agrawal and Knoeber, 1996).

The results in Columns 3 and 6 show that the interaction variable of *AUDITOR* and political connections to BN and PH are both significantly positive. These findings suggest that the use of Big 4 audit firms moderates the ways in which political connections affect the value of connected firms. The appointment of a Big 4 audit firm attenuates the negative market reaction that BN-connected firms experience, while PH-connected firms experience a positive impact on firm value from the appointment. However, the contribution of *AUDITOR* to firm value is greater for PH-connected firms than for BN-connected firms, as shown by the magnitude of the estimated coefficients of the interaction terms (Column 6) of 12.62 and 2.91, respectively. Looking at Column 6 of Table 4, BN-connected firms that appoint a Big 4 audit firm experience a drop of 12.72% in their market value, while BN-connected firms that do not appoint a Big 4 audit firm suffer a 15.63% decline in market value.

To investigate the corporate governance role that institutional ownership may play in PCFs, we estimate Equation 3 and present the results in Table 5. Columns 1 and 4 of Table 5 show that the interaction variables between BN and institutional investors (*BN x II*) are positive and significant at the 1% level across short- and long-interval CARs. Similarly, the interaction variables between PH and II (*PH x II*) are positive and significant, particularly for CARs (-1,14), at the 5% level (Column 4). These findings suggest that the stock market perceives the presence of institutional investors in the connected firms as a positive influence, as such investors would enhance corporate governance among PCFs (Shleifer and Vishny, 1986; Hartzell and Starks, 2003; Gugler *et al.*, 2008; Becker *et al.*, 2011). In examining the origins of institutional investors, we find that the stock market reacts differently to the presence of domestic and foreign institutional investors in PCFs. Columns 2 and 5 of Table 5 show that the interaction variables *BN x IIDOM* and *PH x IIDOM* are positive and significant. On the other hand, Columns 3 and 6 of Table 5 show that the interaction variables *BN x IIFOR* are negative and significant, while the interaction variables *PH x IIFOR* are insignificant. These findings indicate that the stock market views the presence of domestic institutional investors in BN- and PH-connected firms positively, but displays negative reactions to the presence of foreign institutions in BN-connected firms.

Table 5 Political Connections and Institutional Ownership

This table shows the influence of stronger monitoring from institutional investors on the market reaction. CAR(-1,1) captures the short-interval market reaction, while CAR(-1,14) captures a relatively longer interval market reaction. The regressions include 10 industry dummy variables. We report the generalised least square (GLS) standard errors in parentheses to take into account the heteroskedastic errors in the cross-sectional regressions. * and ** indicate statistical significance at the 5% and 1% levels, respectively. All variables are defined in Appendix C.

	(1)	(2)	(3)	(4)	(5)	(6)
	CAR(-1,1)	CAR(-1,1)	CAR(-1,1)	CAR(-1,14)	CAR(-1,14)	CAR(-1,14)
BN	-13.2407** (0.4510)	-13.5313** (0.0782)	-11.2090** (0.3710)	-15.1174** (0.1349)	-15.6542** (0.3131)	-11.5991** (0.4568)
PH	4.6160** (0.2746)	4.7545** (0.2051)	5.4124** (0.4966)	1.5661** (0.5229)	1.8289** (0.4137)	3.4399** (0.3556)
II	-0.0130** (0.0016)			-0.0295** (0.0050)		
BN x II	0.0454** (0.0110)			0.0303** (0.0114)		
PH x II	0.0613 (0.0383)			0.2106* (0.0835)		
IIDOM		-0.0158** (0.0020)			-0.0245** (0.0061)	
BN x IIDOM		0.0583** (0.0026)			0.1019** (0.0237)	
PH x IIDOM		0.0698* (0.0305)			0.2799** (0.0893)	
IIFOR			-0.0233** (0.0060)			-0.0930** (0.0049)
BN x IIFOR			-0.1771** (0.0423)			-0.6539** (0.0744)
PH x IIFOR			-0.0983 (0.1360)			-0.1811 (0.3064)
ASSET_{T-1}	-0.0467 (0.0248)	-0.0885** (0.0291)	0.0671* (0.0276)	-0.4762** (0.0326)	-0.5840** (0.0487)	-0.1411** (0.0523)
LEV_{T-1}	2.8897** (0.1406)	2.8004** (0.1666)	2.2503** (0.1580)	5.4322** (0.4193)	5.6411** (0.4331)	3.9401** (0.4215)
MB_{T-1}	-136.2108** (14.2609)	-131.3457** (14.5343)	-129.6926** (13.5691)	-89.4982** (7.3875)	-89.5046** (5.6326)	-118.3023** (5.6475)
ROA_{T-1}	2.5788** (0.1971)	2.4843** (0.1744)	1.3933** (0.3903)	6.2105** (0.3214)	6.8508** (0.5199)	6.1096** (0.5778)
FIRMAGE_{T-1}	0.0304** (0.0027)	0.0305** (0.0030)	0.0281** (0.0015)	0.0216** (0.0032)	0.0192** (0.0029)	0.0249** (0.0035)
N	593	593	593	633	633	633
Pseudo R²	0.1847	0.1858	0.1863	0.1374	0.1384	0.1420

Our findings on the positive contribution of domestic institutional investors to the improvement of the corporate governance of PCFs align well with the literature. Domestic institutional investors are more likely to attend shareholder meetings and initiate shareholder proposals (Chhaochharia *et al.*, 2012). As a result, domestic institutional investors can

influence management by deterring opportunistic financial reporting (Ayers *et al.*, 2011; Kim *et al.*, 2016; Liu *et al.*, 2018), lowering the cost of debt (Tee, 2018), improving corporate governance, and encouraging value-increasing acquisition activities (Gaspar and Massa, 2007; Chhaochharia *et al.*, 2012).

Government linked investment companies (GLICs) dominate domestic institutional investor ownership in Malaysia (Gomez *et al.*, 2017); these companies were under the control of the BN government prior to the 2018 general election. The ownership interest of these BN-affiliated investment companies may have been politically motivated, however; considering the performance that these companies needed to deliver, they would have exerted their best efforts to improve the governance and performance of the BN-connected firms in which they had invested. Moreover, given the PH coalition's opposition status prior to the 2018 general election, domestic institutional investors may have opted to invest in PH-connected firms based on the ability of those firms to deliver sustainable performance and their good corporate governance. As we cannot identify the motivation behind domestic institutional investors' investments in PCFs, we cannot examine why the stock market perceives domestic institutional ownership as a positive contributing factor to the corporate governance of PCFs. Thus, we leave this question to future research.

We find that the negative market reaction toward BN-connected firms is exacerbated by the high level of foreign institutional investor ownership of such firms. The stock market may perceive foreign institutional investors as not performing much of a corporate governance role through their ownership. The stock market may perceive foreign institutional investors as portfolio investors (Ng *et al.*, 2016) that may dispose of their holdings in BN-connected firms when these firms are deemed to be too risky. The market perception of foreign investors as portfolio investors fits with the absence of a market reaction toward PH-connected firms with high levels foreign institutional ownership. Foreign investors may be in a position in which they are waiting to examine the costs and benefits of holding PH-connected firms in their portfolio, given that the PH coalition is now in power.

So far, we find that corporate governance attenuates the negative market reaction toward firms connected to BN, the losing coalition. This suggests that corporate governance moderates the impact of political connections on firm value. In the case of firms connected to PH, the winning coalition, we find that corporate governance amplifies the positive market reaction, indicating that the market perceives PH-connected firms to have better corporate governance than BN-connected firms. Our finding that good governance intensifies the positive market reaction toward PH-connected firms may overlook the possibility that such a reaction could be attributed to the greater future income potential of PH-connected firms. We review this possibility in the following section on additional tests and also examine the earnings quality of BN- and PH-connected firms. We end the additional tests section with an examination of selection bias, which may influence our results.

4.3 Additional Tests

4.3.1 The role of future income and governance

While earlier studies have identified favourable economic policies for PCFs (Johnson and Mitton, 2003; Lin *et al.*, 2016; Wagner *et al.*, 2018), the winning PH coalition does not have specific economic policies that would favour PH-connected firms. Our attempt to investigate the future income argument relies on political connections in Malaysia that are driven primarily by personal ties. We conjecture that the future income argument emanates from firms' performance metrics; namely, the return on assets (ROA) and the return on equity (ROE). Table 6 presents the results of estimating cross-sectional regressions with a one-year change (from 2017 to 2018) and a two-year (from 2017 to 2019) change in ROA and ROE across all firms in our sample.

Table 6 Firm Performance after the Election

This table examines the future income arguments. The dependent variables are the change in ROA and ROE over one and two years. The one-year period covers 2017 to 2018, while the two-year period covers 2017 to 2019. We report the generalised least square (GLS) standard errors in parentheses to take into account the heteroskedastic errors in the cross-sectional regressions. * and ** indicate statistical significance at the 5% and 1% levels, respectively. Appendix C contains definitions of the variables.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	One-year change in ROA	One-year change in ROE	Two-year change in ROA	Two-year change in ROE	One-year change in ROA	One-year change in ROE	Two-year change in ROA	Two-year change in ROE
PCF	-0.2397** (0.0114)	-0.8632** (0.0261)	-0.1253** (0.0242)	-1.2114** (0.0508)				
BN					-0.0190 (0.0302)	-0.8702** (0.0374)	-0.1349** (0.0256)	-0.6009** (0.0242)
PH					-0.4967** (0.0386)	-0.7840** (0.0711)	-0.0952 (0.0903)	-2.1630** (0.1799)
MCAP	0.1392** (0.0037)	0.1785** (0.0031)	0.5409** (0.0044)	0.6439** (0.0095)	0.1391** (0.0035)	0.1766** (0.0032)	0.5441** (0.0038)	0.6591** (0.0077)
LEV	0.9284** (0.0387)	-0.4229** (0.0215)	-1.0380** (0.0490)	-0.2633** (0.0591)	0.8841** (0.0443)	-0.4256** (0.0074)	-1.0375** (0.0512)	-0.2652** (0.0586)
MB	0.0792** (0.0114)	0.0372* (0.0160)	-0.1745** (0.0046)	-0.0919** (0.0142)	0.0953** (0.0106)	0.0303 (0.0178)	-0.1815** (0.0119)	0.0064 (0.0246)
FIRMAGE	0.0042** (0.0003)	0.0002 (0.0003)	-0.0092** (0.0005)	-0.0032** (0.0005)	0.0043** (0.0003)	0.0003 (0.0002)	-0.0092** (0.0005)	-0.0034** (0.0003)
<i>N</i>	615	616	619	620	615	616	619	620
<i>Pseudo R</i> ²	0.0081	0.0196	0.0394	0.0311	0.0088	0.0197	0.0394	0.0338

The results in Table 6 indicate that PCFs under the PH regime do not perform as well as their non-connected counterparts, as demonstrated by the negative and significant coefficients for PCFs. Similarly, positive and significant coefficients for BN and PH are absent from the results, suggesting that firms connected to BN and PH do not perform better than non-

connected firms. While these findings offer less support for the future income argument, we do not dismiss the possibility that the potential to earn future income may play a significant role in explaining the positive market reaction across PH-connected firms. We leave this line of enquiry for future research to investigate.

4.3.2 Earnings quality

PCFs are susceptible to concealing politically-motivated expropriation activities to siphon off corporate resources and deprive minority shareholders of returns (Fan and Wong, 2002; Guedhami *et al.*, 2014; Habib *et al.*, 2017). One way in which PCFs can conceal information about underlying firm performance is by manipulating financial statements (Guedhami *et al.*, 2014; Habib *et al.*, 2017). We conjecture that strong corporate governance will lead PCFs to report truthful earnings. To examine the earnings quality of the PCFs, we regress the proxies for earnings quality against a set of control variables. Following Chaney *et al.* (2011), the regression equation is as follows:

$$EARNQ_{i,t} = \alpha_0 + \alpha_1 PCF_{i,t-1} + \alpha_k \sum_k Control_{i,t-1}^k + \alpha_j \sum_j Industry_j + e_{i,t}, \quad (4)$$

where *EARNQ* refers to earnings quality, which is estimated using three years of data from 2015 to 2017. We estimate two earnings quality measures: *R_JONES* and *R_MJONES*. The former is a discretionary accruals measure that follows the Jones (1991) model, while the latter is a modified version of the Jones model (Dechow *et al.*, 1995). The greater the value of discretionary accruals, the higher the likelihood that the firm is engaging in earnings management, which lowers the quality of earnings reported by the firm. In the untabulated results, we find that the average *R_JONES* and *R_MJONES* for PCFs are -0.0067 and -0.0077, respectively. As for the non-connected firms, the average *R_JONES* and *R_MJONES* are 0.0001 and 0.0010, respectively. However, the *R_JONES* and *R_MJONES* values for PCFs are not significantly different from those of the non-connected firms. When considering the political affiliation of connected firms (either BN or PH), we find that PH-connected firms possess better earnings quality than non-connected firms. The earnings quality of PH-connected firms is statistically smaller than that of non-connected firms. The earnings quality of BN-connected firms is not statistically different from that reported by non-connected firms. It is noteworthy that the average *R_JONES* and *R_MJONES* values of BN-connected firms are not statistically different from zero, which signifies a low probability that BN-connected firms are engaging in earnings management. Finally, the earnings quality of BN- and PH-connected firms is not significantly different.

We estimate Equation 4 to determine how likely PCFs are to manage their earnings. We then examine whether or not BN- and PH-connected firms engage in earnings manipulation by replacing *PCF* in Equation 4 with *BN* and *PH*, which represent the political affiliations of the PCFs. Table 7 reports the results.

Table 7 Political Connections and Earnings Quality

This table estimates the relationship between PCFs and the political affiliations, and earnings accrual, respectively. The dependent variables are the four proxies for earnings quality, obtained by estimating discretionary accruals using the Jones (1991) and modified Jones (Dechow *et al.*, 1995) models. The sample covers firm-year observations with non-missing values for all variables from 2015 until 2017. The panel data regressions include year and industry fixed effects, and we report robust standard errors in parentheses. * and ** indicate statistical significance at the 5% and 1% levels, respectively. All variables are defined in Appendix C.

	(1)	(2)	(3)	(4)
	<i>R</i> <i>JONES</i>	<i>R</i> <i>MJONES</i>	<i>R</i> <i>JONES</i>	<i>R</i> <i>MJONES</i>
<i>PCF</i>	-0.0153*	-0.0183*		
	(0.0076)	(0.0078)		
<i>BN</i>			-0.0062	-0.0086
			(0.0092)	(0.0095)
<i>PH</i>			-0.0290*	-0.0323**
			(0.0114)	(0.0116)
<i>ASSET</i>_{<i>T-1</i>}	0.0047*	0.0051**	0.0047*	0.0051**
	(0.0019)	(0.0019)	(0.0019)	(0.0019)
<i>LEV</i>_{<i>T-1</i>}	-0.0259	-0.0246	-0.0262	-0.0247
	(0.0158)	(0.0166)	(0.0158)	(0.0166)
<i>ROE</i>_{<i>T-1</i>}	0.0325**	0.0369**	0.0330**	0.0375**
	(0.0052)	(0.0053)	(0.0052)	(0.0053)
<i>Year fixed effect</i>	Yes	Yes	Yes	Yes
<i>Industry fixed effect</i>	Yes	Yes	Yes	Yes
<i>N</i>	1,876	1,866	1,876	1,866
adj. <i>R</i> ²	0.0229	0.0298	0.0237	0.0306

Models 1 and 2 of Table 7 report the results of the examination of the earnings quality of PCFs. We find that *PCF* is negatively associated with all proxies for earnings quality, indicating better earnings quality among PCFs. These findings seem to be inconsistent with those of Chaney *et al.* (2011), which suggest that PCFs can afford to disclose lower quality accounting information due to less market pressure arising from political connections to improve the quality of their financial reporting. However, the PCFs in our sample seem to have long connections to their political patrons, which result in stronger corporate governance (Fung *et al.*, 2015).

Further investigation reveals that the negative association between *PCF* and earnings quality is driven by PH-connected firms. Models 3 and 4 of Table 7 show that the negative association between earnings quality and PH-connected firms is significant and negative, signifying the better quality of accounting information reported by PH-connected firms. Models 3 and 4 of Table 7 report an insignificant association between BN-connected firms and all proxies for earnings quality. It is noteworthy that the insignificant association between BN-connected firms and earnings accruals can be interpreted as exhibiting a low likelihood that BN-connected firms manipulate their earnings. Overall, the results described in this section show that PCFs have stronger corporate governance. This can be observed through

the better earnings quality that the PCFs report. The strong corporate governance of the PCFs moderates the association between political connections and firm value.

4.3.3 Matched samples for BN-connected firms

Selection bias may influence our results, as firm characteristics could drive the negative abnormal returns that BN-connected firms experience. Panel A of Table 1 shows that connected firms are significantly larger than non-connected firms. Connected firms may experience negative abnormal returns because of their size, instead of because of their political connections. Even though our results show a divergence in abnormal returns for BN- and PH-connected firms, we test the likelihood that firm size drives our findings across BN-connected firms by conducting a principal score matching analysis. We do this by matching a BN-connected firm with a non-connected firm, based on their size, and implement a near neighbour match with no replacement. We then replicate our main analyses in Panel B of Table 3 using the matched sample for BN-connected firms. The results in Table 8 show that the matched BN-connected firms and PH-connected firms experience greater positive CARs in the period surrounding the 2018 election. These findings show that firm size does not drive our results and that political connections are the driver of negative CARs that we document across BN-connected firms.

Table 8 Event Study Results Using a Matched Sample

This table re-examines the results in Table 3 using a matched sample for BN-connected firms. We match BN-connected firms based on size and implement a near neighbour match with no replacement. We report the generalised least squares (GLS) standard errors in parentheses to take into account the heteroskedastic errors and the cross-sectional regressions. * and ** indicate statistical significance at the 5% and 1% levels, respectively. Appendix C contains definitions of the variables.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	CAR(-1,1)	CAR(-1,2)	CAR(-1,4)	CAR(-1,6)	CAR(-1,9)	CAR(-1,11)	CAR(-1,14)
Matched-BN	2.1933** (0.1348)	1.6892** (0.1031)	1.2617** (0.1849)	1.9858** (0.1178)	3.5600** (0.2161)	2.3106** (0.2433)	3.7671** (0.2693)
PH	6.7470** (0.4367)	6.9517** (0.1910)	5.5634** (0.1888)	5.2626** (0.4694)	6.2034** (0.1187)	6.0801** (0.2860)	5.9334** (0.3446)
MCAP_{T-1}	-0.7144** (0.0081)	-0.8130** (0.0171)	-0.6081** (0.0341)	-0.8692** (0.0314)	-1.0426** (0.0241)	-1.0666** (0.0244)	-1.2964** (0.0512)
LEV_{T-1}	0.3815* (0.1770)	1.6342** (0.1896)	0.5119 (0.3899)	2.4281** (0.2594)	1.7732** (0.3256)	1.1723** (0.3083)	2.8285** (0.3615)
MB_{T-1}	-1.2218** (0.0848)	-0.9468** (0.0887)	-0.7303** (0.1155)	-1.0053** (0.1115)	-1.0885** (0.1118)	-1.1127** (0.1423)	-1.2862** (0.1766)
ROA_{T-1}	4.0582** (0.2305)	3.7530** (0.4026)	8.7386** (0.6250)	15.7777** (0.8268)	10.3769** (0.3654)	9.6571** (0.6048)	12.7134** (0.6938)
FIRMAGE_{T-1}	-0.0015 (0.0018)	0.0142** (0.0014)	0.0362** (0.0025)	0.0151** (0.0022)	0.0043* (0.0020)	0.0149** (0.0015)	0.0023 (0.0029)
<i>N</i>	579	594	609	616	616	618	620
adj. <i>R</i> ²	0.0660	0.0574	0.0546	0.0764	0.0614	0.0725	0.0676

V. Conclusion

Using a rare political event, that of an unexpected election resulting in the loss of an incumbent political regime in Malaysia, which is followed by a peaceful shift in power to a new regime, we investigate whether or not corporate governance moderates the ways in which political connections affect the value of PCFs. Our findings suggest that future income considerations determine the association between political connections and firm value. After the announcement of the election outcome, we find that the market reacted negatively to firms connected to the ousted (BN) regime, but positively to firms connected to the winning (PH) coalition. Further investigation reveals that market reactions take into account the corporate governance of these connected firms. We find evidence that corporate governance mitigates adverse market reactions to BN-connected firms, since hiring a Big 4 audit firm and the presence of domestic institutional investors in a firm seem to attenuate negative market reactions. On the other hand, the stock market reacts positively to the corporate governance practices among PH-connected firms (i.e. the presence of independent directors on board and audit committees, the appointment of a Big 4 audit firm, and the presence of domestic institutional investors).

The significant role that corporate governance plays in moderating the association between political connections and the value of PH-connected firms could be driven by future income considerations. As there is no clear way to identify future benefits that PH-connected firms may receive from the government, we investigate the future income consideration by observing the one- and two-year performance of all companies in our sample. We find that PH-connected firms do not perform better than BN-connected firms or non-PCFs. Our findings offer corroborative evidence that the future income channel may not be present. However, given the absence of direct evidence of a future income consideration, we do not dismiss the possibility that, besides corporate governance, the future income channel may play a role in moderating the positive association between political connections and the value of PH-connected firms. Next, we investigate whether or not PCFs display stronger corporate governance, as suggested by their earnings quality. We find that PCFs have stronger corporate governance, as indicated by the better earnings quality among PH-connected firms. Finally, the results of the matched sample analysis reveal that our findings are not driven by firm size.

Overall, our findings show that market performance during a power shift is influenced by political affiliations, which in turn are moderated by corporate governance. Our results highlight the importance of corporate governance across PCFs as a hedge when such connections can be detrimental to firm value (Leuz and Oberholzer-Gee, 2006; Dang and So, 2018). Firms that are more susceptible to a loss of favour exhibit insulation from negative market reactions through their corporate governance practices. Our study complements the results of Lin *et al.* (2016) regarding the governance role that institutional investors play in moderating the impact of political connections on firm value. Our findings further provide

supporting evidence to Fung *et al.* (2015) regarding the role that corporate governance plays in enhancing the value of PCFs. The shift in the political map after an election may reflect changes in a firm's ability to derive benefits from political connections (Kim *et al.*, 2012), as well as changes in their corporate governance practices.

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Appendix A

List of Subsequent Significant Events

<u>Event Day</u>	<u>Event Date</u>	<u>Event</u>
0	9 May 2018 (Wednesday)	Malaysia's 14 th general election polling day.
0	10 May 2018 (Thursday)	Mahathir Mohamad sworn in as Malaysia's seventh Prime Minister (New Straits Times, 2018a).
0	12 May 2018 (Saturday)	Members of the Council of Elders and some of the new cabinet ministers are announced (New Straits Times, 2018c). Najib Razak resigns as Chairman of UMNO and BN.
+1	14 May 2018 (Monday)	Bursa Malaysia reopens.
+4	17 May 2018 (Thursday)	The raid commences on 16 May 2018 and continues at Najib Razak's residence (New Straits Times, 2018b).
+6	21 May 2018 (Monday)	The new cabinet of the new government is sworn in.
+7	22 May 2018 (Tuesday)	Najib Razak is questioned by the Malaysia Anti-Corruption Commission (MACC) for about four and a half hours.
+8	23 May 2018 (Wednesday)	The new Finance Minister, Lim Guan Eng, confirms that the country's debt exceeds RM1 trillion.
+9	24 May 2018 (Thursday)	It is confirmed that 1MDB is unable to pay its debts due by 30 May 2018. Najib Razak attends the second day of MACC questioning.
+11	28 May 2018 (Monday)	According to the Finance Minister, Najib Razak must be held responsible for the 1MDB scandal (The Edge Markets, 2018a).
+12	30 May 2018 (Wednesday)	Mega projects, such as the High Speed Rail (The Star, 2018a) and MRT3 rail transit projects (The Star, 2018b), are cancelled by the new government.
+14	1 June 2018 (Friday)	The new government will review mega projects in accordance with the contracts (The Edge Markets, 2018b).

Appendix B

List of Politically Connected Firms and Their Affiliations

Firms affiliated with Barisan Nasional (BN)	Firms affiliated with Pakatan Harapan (PH)
AHMAD ZAKI RESOURCES BHD	7-ELEVEN MALAYSIA HOLDINGS
AIRASIA GROUP BERHAD	ADVANCE SYNERGY BHD
AIRASIA X BERHAD	ASTRO MALAYSIA HOLDINGS BHD
ANCOM BHD	BERJAYA FOOD BHD
AXIATA GROUP BHD	BERJAYA ASSETS BHD
BOUSTEAD HEAVY INDS CORP	BERJAYA CORP BHD
BOUSTEAD HOLDINGS BHD	BERJAYA LAND BHD
BOUSTEAD PLANTATIONS BERHAD	BERJAYA MEDIA BHD
CAHYA MATA SARAWAK BHD	BERJAYA SPORTS TOTO BHD
CHEMICAL CO OF MALAYSIA BHD	BERMAZ AUTO BHD
DATASONIC GROUP BERHAD	COUNTRY HEIGHTS HLDGS BHD
DESTINI BHD	DIGI.COM BHD
ECONPILE HLDGS BHD	DRB-HICOM BHD
EDARAN BHD	EDEN INC BERHAD
EKOVEST BHD	EWEIN BHD
FELDA GLOBAL VENTURES HOLD	EXCEL FORCE MSC BHD
GABUNGAN AQRS BERHAD	GUOCOLAND (MALAYSIA) BHD
GAMUDA BHD	HONG LEONG INDUSTRIES BHD
GEORGE KENT (MALAYSIA) BHD	KUMPULAN POWERNET BHD
IJM CORP BHD	MALAYAN FLOUR MILLS BHD
ISKANDAR WATERFRONT CITY BHD	MALAYAN UTD INDS BHD
JOHAN HLDGS BHD	MALAYSIAN BULK CARRIERS BHD
KNUSFORD BHD	MALAYSIAN PACIFIC INDUS BHD
KUB MALAYSIA BHD	MAXIS BHD
KUMPULAN JETSON	MMC CORPORATION BHD
LINGKARAN TRANS KOTA HLDGS	PETRON MALAYSIA REFINING
LION FOREST INDUSTRIES	PPB GROUP BHD
LION INDUSTRIES CORP BHD	SAPURA ENERGY BHD
MALAYSIA AIRPORTS HLDGS BHD	SAPURA INDUSTRIAL BHD
MALAYSIAN RESOURCES CORP	SAPURA RESOURCES BHD
MALTON BHD	SHANGRI-LA HOTELS (MALAYSIA)
MEDIA PRIMA BHD	SUNWAY BHD
MISC BERHAD	SUNWAY CONSTRUCTION GROUP
MTD ACPI ENGINEERING BHD	SUNWAY REIT
MY EG SERVICES BHD	TASEK CORP BHD
NAIM HLDGS BERHAD	THRIVEN GLOBAL BHD
NYLEX (MALAYSIA) GROUP	TROPICANA CORP BHD
PETRA ENERGY BHD	

PETRONAS CHEMICALS GROUP
PETRONAS DAGANGAN
PETRONAS GAS
PHARMANIAGA BHD
PINEHILL PACIFIC BHD
POS MALAYSIA BERHAD
PRESTARIANG BERHAD
PROTASCO BERHAD
SARAWAK CABLE BHD
SARAWAK CONS IND BERHAD
SARAWAK OIL PALMS BHD
SARAWAK PLANTATION
SIME DARBY BHD
STAR MEDIA GROUP BHD
TELEKOM MALAYSIA BHD
TENAGA NASIONAL BHD
TH PLANTATIONS BERHAD
TIME DOTCOM BHD
UEM EDGENTA BHD
UEM SUNRISE BHD
UMW HOLDINGS BHD
UTUSAN MELAYU (MALAY) BHD
WCT HOLDINGS BHD
YTL CORP BHD
YTL POWER INTERNATIONAL BHD

Appendix C

Definitions of Variables

Dependent Variables

CAR is the cumulative abnormal returns calculated for the different windows centred around the Malaysia 14th general election results held on 8 March 2018 (day zero).

R_JONES is the discretionary accruals estimated by applying the Jones (1991) model.

R_MJONES is the discretionary accruals estimated by applying the modified Jones model (Dechow *et al.*, 1995).

Test Variables: Political Connections Measures

PCF is an indicator variable that equals one when the firm is identified as a politically connected firm, and zero otherwise.

BN is an indicator variable that equals one when the firm is affiliated with Barisan Nasional, and zero otherwise.

PH is an indicator variable that equals one when the firm is affiliated with Pakatan Harapan, and zero otherwise.

Control Variables

MCAP is the natural log of market capitalisation at the end of the fiscal year.

LEV is the book value of total liabilities divided by total assets at the end of the fiscal year.

MB is the ratio of the market value of equity to the book value of equity measured at the end of the fiscal year.

ROA is the ratio of income before extraordinary items to total assets at the end of the fiscal year.

FIRMAGE is the firm's age from the firm's incorporation to the end of the fiscal year.

INDDIR is the percentage of independent directors on the board of directors.

AUDITCOM is the percentage of independent directors on the audit committee.

AUDITOR is one of the Big 4 auditing firms (PWC, Ernst & Young, KPMG, or Deloitte).

II is the percentage of shares held by institutional investors.

IIDOM is the percentage of shares held by domestic institutional ownership.

IIFOR is the percentage of shares held by foreign institutional ownership.
