The Politics of Corporate Investment: Evidence from Political Turnovers and IPO Proceeds*

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Abstract

This paper studies corporate investment as a novel channel of political activity by startups. Using project-level data on changes in firms' investments of IPO proceeds around turnovers of local Chinese politicians, we find that IPO firms initiate new projects and modify existing projects to cater to incoming politicians. Subsequently, they obtain better access to bank credit and government subsidies, while the access of their mature industry peers declines, particularly when investment irreversibility is high. Overall, we provide novel evidence that startups repurpose their uncommitted investments to build political capital at the expense of mature firms whose investment is irreversible.

Keywords: Political connections, Government, Investment, China

JEL Classification: D80, G18, E22, D72

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1. Introduction

Firms utilize various strategies to build political connections to influence policy decisions, gain access to information, and shape regulations that can impact their business operations and bottom line. A number of studies show that these strategies include campaign contributions to politicians (Cooper, Gulen, and Ovtchinnikov (2010) and Akey (2015)), lobbying (Borisov, Goldman, and Gupta (2016)), and hiring former government officials to work at the firm or serve on its board (Goldman, Rocholl, and So (2009)). In this paper, we investigate a new channel through which firms cultivate political connections – the reallocation of corporate investment towards projects aligned with the interests of politicians and policy makers.

Corporate investment can be an important channel of firms' political activity for several reasons. First, other channels such as campaign contributions are typically limited in size. Consequently, their effectiveness in building political connections can be limited compared to corporate investment that tends to be considerably larger. Second, direct forms of corporate political activity are typically regulated and heavily monitored by investors and activists. Corporate investment is less subject to these limitations. Third, corporate investment is among the most important decisions that firms make, shaping firms' business and operating environments. It can therefore have important implications for firms' political capital, operations, and value, as well as for overall economic conditions.

We use novel data on firms' investments of IPO proceeds in China to answer three main questions. First, how do political considerations affect corporate investment and capital budgeting policies of startups? Second, what are the implications for the allocation of external financing and government subsidies across young and mature firms in an industry? Third, what are the real effects on firms and local economies? Despite the importance of these questions, it is difficult to

provide evidence on the causal effect of politics on corporate investments and capital budgeting. Detailed investment decisions are typically unobservable. Additionally, variation in the political setting is non-random and likely correlated with contemporaneous economic trends that simultaneously affect corporate investment policies.

We address these identification challenges by exploiting a unique setting in China, which allows us to observe firms' detailed investments of their IPO proceeds, starting with the initial IPO application and through all subsequent modifications. The empirical approach identifies project-by-project changes in the stated use of IPO proceeds throughout the IPO filing process, which takes two years, on average. We focus on changes around turnovers of local Chinese politicians due to deaths, term limits, and mandatory retirements. The analyses exploit project-level data on changes in investments of IPO proceeds, including project replacements, cancellations, and changes in the implementation, location, and progress of existing projects. We also use the detailed explanations accompanying investment changes, which must be disclosed within two days of the board meeting in which they are decided. Lastly, the analyses exploit firm-level data on government subsidies, which are mostly unavailable in other countries.

To investigate the relation between politics and corporate investment, we obtain data from several sources. First, we retrieve project-level data on initial investments of IPO proceeds and all subsequent investment changes from *Tonghuashun*, a major financial service company in China. Second, we retrieve the full text of each investment change announcement and use textual analysis to parse the reasons that firms provide for the changes. Third, we hand-collect data on turnovers of provincial governors. Lastly, we obtain IPO filing dates from China's Securities Regulatory Commission (CSRC) and financial data from China Stock Market & Accounting Research

(CSMAR) and the WIND database, including bank loans and government subsidies. Using these data, we compile a novel dataset in which the unit of analysis is a province-firm-project triplet.[1]

In the first set of analyses, we investigate the effect of turnovers of provincial governors on changes in investment policies of startup firms headquartered in the province. We find that political turnovers are positively related to the likelihood of investment changes. Following the turnover of local politicians, the likelihood of investment changes increases by 10.8 percentage points. These estimates are statistically significant at conventional levels and also hold after controlling for macroeconomic conditions, IPO characteristics, project-level attributes such as purpose and size, and firm-level attributes such as size, sales growth, and corporate governance.

We provide several analyses to address concerns about confounding factors and selection effects. First, we consider the possibility that exogenous political turnovers are accompanied by heightened political or economic policy uncertainty. Prior research has shown that political uncertainty leads to declines in corporate investment (Julio and Yook (2012) and Jens (2017)). However, startups in our sample do not reduce their total investment amounts. Instead, they reallocate their IPO proceeds across existing and new projects, suggesting that the estimates do not capture investment reductions driven by political uncertainty. Nevertheless, we attempt to control for the effects of political uncertainty by constructing a province-level index of economic policy uncertainty (EPU) based on the frequency of newspaper coverage following the method of Baker et al. (2016) and Yu et al. (2021). We find similar results after including this EPU index in the baseline analyses.

We examine dynamic treatment effects and find no evidence that firms change their investments if the turnover of provincial governors happens before initiating the IPO application

[1] As such, our dataset is different from a typical project-firm-year panel dataset, and consequently precludes estimating standard panel regressions. See Appendix C for a detailed description of the project-level data structure.

or after the IPO process is completed. We also show that the turnovers are not associated with a wide array of local economic indicators or governor attributes. Additionally, we examine neighboring provinces and find that exogenous turnovers of governors do not generate similar investment changes. Finally, we show that the effects are mainly driven by firms that have stronger incentives to cater to the newly appointed governors as proxied by government ownership.

To provide context, we compare the magnitude of changes in corporate investment to other forms of firms' political activity and find that it is considerably bigger. For example, the average size of political contributions reported by Cooper, Gulen, and Ovtchinnikov (2010) is 0.003% of book assets, compared to an average ratio of investment changes to book assets of 1.5% or 1.0% when evaluated at the firm or project level, respectively. If other forms of political activity, such as campaign contributions, are correlated with changes in corporate investment, which are often unobservable in other settings, our findings can help explain how seemingly trivial magnitudes of political activity have large effects on firms' performance and value.

Next, we investigate the potential implications for government policies. These analyses are motivated by theories of corporate political activity (e.g., Stigler (1971), Peltzman (1976), McChesney (1987), De Soto (1990), Spiller (1990), and Shleifer and Vishny (1994)) and by prior empirical research that studies direct channels of corporate political connections such as campaign contributions, lobbying, and board appointments. This line of research finds that firms with political connections are more likely to be bailed out during crises (Faccio, Masulis, and McConnell (2006) and Duchin and Sosyura (2012)) and have better access to government contracts and bank credit (Dinç (2005), Goldman, Rocholl, and So (2013), Houston et al. (2014), and Brogaard, Denes, and Duchin (2021)).

We find that changes in corporate investment following the turnover of provincial governors lead to better access to bank loans. The ratio of bank loans to the book value and market value of assets increases by 7.0 and 4.1 percentage points, respectively, following firms' investment changes around political turnovers. Similarly, we find an average increase of 2.3 percentage points in the propensity of obtaining annual government subsidies. Collectively, these findings suggest that corporate investment serves as an important channel through which young and growing firms build political connections. These connections provide firms with better access to credit and government subsidies.

What are the allocational effects across startup firms and their mature industry peers? Startups might be well-positioned to adjust their investment policies to cater to incoming politicians and build political capital because they have not yet invested their IPO proceeds. In contrast, more mature firms face considerably higher investment adjustment costs because they had already invested their capital. This hypothesis predicts that political turnovers will tip the balance of resource allocation towards younger IPO firms at the expense of more mature firms.

To test this hypothesis, we examine the reallocation of bank credit and government subsidies to mature peer firms, defined as firms that have been listed for a minimum of four years and operate in the same province and industry as the IPO firms. We find that when IPO firms adjust their investment policies following political turnovers, the access of their mature peers to bank credit and government subsidies significantly declines. The regression estimates point to a significant decline of 1.9 percentage points in bank credit and 2.7 percentage points in the likelihood of obtaining government subsidies.

To provide further evidence on the role of investment irreversibility and adjustment costs in the reallocation of resources across startup and mature firms, we exploit firm-level heterogeneity

in investment irreversibility. Following Gulen and Ion (2015), we measure firm-by-firm investment irreversibility based on the capital intensity ratio, defined as net property, plant, and equipment (PP&E) divided by total book assets. We find that the decline in mature peer firms' access to bank credit and government subsidies is monotonically increasing in their investment irreversibility. An inter-tercile increase in investment irreversibility corresponds to a ten-fold decline in bank credit and a 1.7-fold decline in access to government subsidies. Combined, these results suggest that lower investment adjustment costs allow startup firms to accumulate political capital by adjusting their investment policies during periods of political change.

We also study the implications for managers' careers and local economic conditions. We find that investment changes following exogenous political turnovers are positively associated with the likelihood of CEOs and board chairmen of IPO firms being elected as members of the People's Congress (PC) or the Committee of Chinese People's Political Consultative Conference (CPPCC). These findings suggest that executive at IPO firms also have personal incentives to cater to incoming politicians by repurposing the use of their firms' IPO proceeds.

In the final set of analyses, we evaluate the real effects on local economic conditions. On the one hand, connected IPO firms perform better and can generate increases in local production, employment, and tax revenues, leading to stronger fiscal balances. On the other hand, connected firms receive preferential treatment at the expense of incumbents, including higher subsidies and promotions of connected managers, which might stifle productivity and lower tax revenues, leading to weaker fiscal balances. We find that following political turnovers, provinces experience a significant increase in fiscal deficits in provinces with higher changes in firms' investments. The effects are economically nontrivial and statistically significant: fiscal deficits rise by more than three percentage points following turnover in such provinces. These estimates provide suggestive evidence that turnover of local politicians and the ensuing changes in IPO firms' investments and

consequently in the allocation of government resources across young and mature firms have adverse economic effects.

The paper is related to a growing literature that studies the interactions between firms and politicians. Prior research has mostly focused on direct channels through which mature, publicly listed firms build political connections, including campaign contributions (Cooper, Gulen, and Ovtchinnikov (2010)), lobbying (Chen, Parsley, and Yang (2015) and Borisov, Goldman, and Gupta (2016)), and board appointments (Goldman, Rocholl, and So (2009, 2013)). This paper extends the existing literature in two ways. First, it studies the political activities of young startup firms rather than those of mature firms. By focusing on IPOs, we can trace the origins of corporate political connections to firms' initial public listings. Second, it puts forth a new channel, corporate investment, through which firms can build political connections, which has not been studied before. In particular, firms can allocate resources to projects that serve the interests of politicians or cater to their political agendas. Since startup firms face lower investment adjustment costs compared to mature firms whose investments had already been made, they can be better situated to adjust their investment policies to accumulate political capital. This related to prior plant-level evidence on government bank lending around elections in Brazil (Carvalho (2014)).

Second, the results provide new evidence on the catering of firms to stakeholders. Prior studies focus on listed firms' catering to shareholders through investment and dividend policies (Baker and Wurgler (2004), Li and Lie (2006), and Polk and Sapienza (2009)). We show that young IPO firms adjust investments to cater to the government, an important stakeholder in emerging markets. While prior studies find that catering leads to worse performance, we find that catering to the government can also have positive effects.

Third, we put forth a new link, unexplored in the literature, between corporate investment and political activity, augmenting prior studies of political connections (Fisman (2001), Faccio (2006)

and Faccio and Parsley (2009)). In particular, we document evidence of how newly listed firms accumulate political capital. Our paper also complements a recent study by Bertrand, Bombardini, Fisman, and Trebbi (2020), which shows that firms use charitable giving to accumulate political influence.

2. Institutional Background, Data Description, and Empirical Design

2.1 IPOs

The central government in China heavily regulates IPOs, possibly due to weaknesses in the legal system and the underdevelopment of Chinese financial markets (Chen and Yuan (2004), Behrer, Glaeser, Ponzetto, and Shleifer (2021)). In particular, the China Securities Regulatory Commission (CSRC) limits the number of IPOs each year and oversees the performance of firms that intend to go public. The CSRC also supervises the IPO application process, which takes, on average, approximately two years from application to approval. Panel A of Figure 1 describes the IPO application, review, and approval process.

As part of the application process, firms must report in the prospectus the set of investment projects that they intend to finance using the proceeds from the IPO. In particular, the CSRC requires firms to detail the amount of IPO proceeds, describe the usage of the funds across different projects, and provide a feasibility report for each project to avoid being rejected by the CSRC.[2] To ensure the proper and efficient use of the proceeds after listing, the CSRC also requires firms to report all changes in intended investments within two days of their approval by the board of directors. In the analyses, we exploit the detailed and timely disclosure of the use of IPO proceeds to identify whether and why firms change their investment policies.

[2] Over the years, the CSRC has rejected many IPO applications due to improper use of IPO proceeds. For example, the CSRC rejected the IPO application of China Southern Airlines Group Culture Media due to "suspicious use of IPO proceeds." It also rejected the application of Jilin Kelong Building Energy Saving because "the applicant does not clearly state the intended use of the IPO proceeds." More details (in Chinese) can be found here: http://www.sohu.com/a/128626600_355066.

To construct our sample, we start with the 1,307 IPO firms that listed on the Shanghai or Shenzhen stock exchanges from 2004 to 2014.[3] We exclude observations with missing IPO filing dates, missing corporate governance, or financial variables. We also exclude all financial firms and all IPO cases around endogenous turnovers of provincial governors. After applying these filters, the final sample includes 842 firms and 2,269 IPO projects from 2004 to 2014. We note that the number of observations varies across the analyses, depending on the specification and data availability.

2.2 Changes in Investment

Table B.1 of Appendix B provides the distribution of the different types of investment changes. These include prominent changes such as project cancellation, replacement, or investment amount, as well as other adjustments including location and methodological changes. The analyses focus on the most prominent cases where the company replaces the project, cancels the project, or alters the investment amount since these capture substantial deviations from the stated investment plan in the prospectus.

To identify the role of politics in investment changes, we investigate the reasons that accompany their announcement. We use textual analysis to gauge and categorize the reasons and focus the analyses on investment changes induced by government policy. In particular, we identify policy-induced investment changes by reading the filings related to each investment change. We categorize the change as government-related if the filing mentions specific words such as "government," "policy," or "urban plan."

Based on the above classification, we define investment changes for a particular project,

[3] The IPO application date, which we retrieve from the CSRC IPO Sponsor Credit Regulation System, is not available before 2004. The CSRC proposed to remove the mandatory disclosure of the intended use of IPO proceeds in 2015 and therefore, the disclosure after that is likely to be voluntary in nature. To mitigate concerns about selection, we end our sample period in 2014.

Investment change (t to t+2), as an indicator variable that equals one if a company changes a project investment plan due to government policy for the IPO proceeds in years t, t+1 or t+2, where t is the year of the IPO listing.

2.3 Exogenous Turnovers

Estimating the causal effect of political turnovers on changes in firms' investment policies is challenging. First, changes in investment policies can drive political turnovers and not the other way around. Prior studies have shown that firms increase investment or employment to support political candidates (e.g., Carvalho (2014), Bertrand et al. (2018), Li et al. (2020)). Second, political turnovers and changes in investment policies can be driven by correlated omitted variables such as changes in economic conditions.

To address these challenges, our identification strategy focuses on exogenous gubernatorial turnovers, defined as sudden deaths, term limits or mandatory retirements of the incumbent governors. The identifying assumption is that local economic conditions or other correlated state variables remain unchanged in the short window surrounding the exogenous turnovers of provincial governors.

More specifically, we retrieve the reasons associated with each gubernatorial turnover and classify turnovers as exogenous if they satisfy one of the following criteria. First, we define turnover due to the sudden death of the incumbent provincial governor as exogenous. Second, we use term limits since incumbent provincial governors serve in office for 10 years. According to regulation on the selection and appointment of political leaders in China, provincial governors have a term of five years and can only be reappointed once. Hence, by the end of their 10th year in office, governors must be re-appointed to a different position. Last, we include mandatory retirements, which occur if an incumbent provincial governor reaches the age of 65 during her tenure or the age of 64 when her five-year term ends. According to regulation, government leaders

must retire when they turn 65 and cannot be appointed to governors if they turn 64. We define the variable *Exogenous political turnover* as an indicator variable equaling one if an exogenous turnover of a provincial governor occurs between the IPO filing date and the IPO listing date, and zero otherwise.

We focus on political turnovers at the provincial level rather than at the prefecture level because provincial governors play a critical role in local economic policy. In particular, provincial governors enjoy considerable autonomy in developing the local economy (Xu (2011)). Consequently, they are evaluated based on the success of their economic policies and thus have an incentive to influence or change these policies in order to differentiate themselves and improve their relative performance evaluation (Xu (2011)). In contrast, mayors at the prefecture level do not enjoy the same level of autonomy in economic policy.[4] In untabulated analyses, we hand-collect data on turnovers of prefecture mayors and find that they are not associated with changes in investments of IPO proceeds.

To identify changes in investment policies, the empirical design focuses on exogenous political turnovers that occur between the IPO filing date and the IPO listing date and considers investment changes in the two years that follow the IPO listing date. Scenario 1 in Panel B of Figure 1 shows this timeline. We exclude turnovers that occur after the listing date (Scenario 2 in Panel B of Figure 1) because they occur too late to trigger investment changes. Similarly, we exclude turnovers that occur before the filing date (Scenario 3 in Panel B of Figure 1) because they will already be reflected in the firm's original investment plan when it files for an IPO. Lastly, we focus on post-listing investment changes because firms do not submit changes prior to their listing to avoid regulatory scrutiny and disqualification by the CSRC. Our approach measures investment changes submitted following turnovers relative to the original plan.

[4] See article 66 in the following Chinese legislation: https://www.cecc.gov/resources/legal-provisions/legislation-law-chinese-and-english-text.

Panel A of Table 1 provides summary statistics for the variables used in our analysis. 10.0% of the sample projects experience a change in their investment plan. Exogenous gubernatorial turnovers were involved in 14.5% of the sample projects. 9.1% (9.7%) of the IPO projects involved State-owned Enterprises by local (central) government (LSOE(CSOE)). Panel B shows the number of IPO projects and investment changes by industry. The industries with the most IPO projects are *Manufacturing* (1462) and *Information transmission, software and information technology services* (288).

2.4 Empirical Design

In the first set of analyses, we test the relation between exogenous political turnovers and firms' investments of IPO proceeds by estimating the following model:[5]

$$Investment\ change\ (\ t\ to\ t+2) = \alpha_j + \alpha_t + \beta \cdot Exogenous\ political\ turnover + \Gamma \cdot Controls_{t-1} + \varepsilon, \quad (1)$$

where *Investment change (t to t+2)* is an indicator variable that equals one if the company changes a project's investment plan due to government policy in years *t*, *t+1* or *t+2* and where *t* is the year of the IPO listing, and zero otherwise. *Controls* include the following variables: project purpose (*R&D project, Marketing project*) and size (*Oversubscription, percentage*), *Industry policy*, *GDP per capita*, *Shares owned by the largest shareholders, Firm size*, *Leverage*, *Sales growth*, and *Firm age*.[6] In addition, we control for provincial economic policy uncertainty index (*EPU index*). α_j and α_t denote industry and year fixed effects, respectively. All variables except *GDP per capital*

[5] We use a Linear Probability Model (LPM) rather than a Logit Model due to the inclusion of fixed effects in the specification (Greene 2004). We obtain similar results if we use a Logit Model.

[6] We include the indicator variable of *Industry policy* to mitigate concerns about the possible confounding effects of quinquennial industrial policy plan releases, where the policy plan is released between the firm's IPO filing date and the listing date, and the firm operates in an industry affected by the new policy plan. Results are qualitatively similar if we exclude such cases.

are winsorized at the 1% level in each tail. Variable definitions are provided in Appendix A. All the control variables are measured as of the year prior to the IPO.

In the second set of analyses, we test the relation between politically driven changes in investment policies and firms' access to credit and government subsidies. For each of these dependent variables *Y* (*Access to credit, Prob(Government subsidies>0)*), we estimate the following regression model:

$$Y = \alpha_j + \alpha_t + \beta_1 \cdot \textit{Investment change} + \beta_2 \cdot \textit{Investment change} \times \textit{Exogenous political turnover} + \beta_3 \cdot \textit{Exogenous political turnover} + \Gamma \cdot Controls_{t-1} + \varepsilon. \quad (2)$$

Access to credit is measured by the ratio of bank loans to either total book assets or the sum of total book debt and the market value of equity. *Prob(Government subsidies>0)* is an indicator variable that equals one if the company receives government subsidies. *Access to credit*, and *Prob(Government subsidies>0)* are measured in the year following the investment changes. The interaction term, *Investment change* × *Exogenous political turnover*, captures the impact of investment change on firms' access to government-controlled resources following exogenous political turnover.

The control variables differ across the regression models. For *Access to credit*, we control for the variables known to affect access to bank loans (e.g., Bae et al. (2011), Fan et al. (2012), Simintzi et al. (2015)), including *GDP per capita*, *GDP growth, Financialization, Shares owned by largest shareholders*, *Shares owned by institutional investors*, *Firm size*, *Asset tangibility*, *Inventory/assets*, *Return on assets*, *Market-to-book*, *State-owned* and *Firm age*. For *Government subsidies*, we follow Faccio et al. (2006) and add the variable of *Number of employees* to the previous specification. As before, all variables except *GDP per capita* and *GDP growth* are winsorized at the 1% level in each tail, and are defined in Appendix A.

To contrast the access to resources for both newly listed firms and their mature peers, we report the evidence for both sets of firms in a parallel manner, with the investment change variable replaced by indicating new firms' investment change in the peer group analysis.

3. The Effect of Politics on Corporate Investment

This section studies how political connections affect corporate investment. Section 3.1 provides the baseline findings and related robustness. Section 3.2 show heterogeneity in the results.

3.1 Baseline Evidence

Table 2 presents estimates of the impact of exogenous turnovers of provincial governors on firms' investment policies. The dependent variable is the likelihood of *Investment change(t to t+2)*. Columns 1 and 2 of Panel A show that the effects around exogenous political turnovers are significant both statistically and economically regardless of controlling for covariates, including EPU index in column 3. Exogenous political turnovers positively impact the probability investment changes, as indicated by the positive and significant coefficients on *Exogenous political turnover*. The effects are economically large. For example, the estimates in column 1 suggest that following exogenous turnovers, the likelihood of investment changes increases by 10.6 percentage points, or by 35.3% relative to the standard deviation.[7] Collectively, the findings suggest that exogenous political turnovers play a role in firms' investment policies by triggering changes in the set of projects that firms plan to fund using the proceeds from their IPOs.

We investigate the dynamic treatment effects in Panel B. Columns 1 and 2 study firms'

[7] We report the economic significance by comparing the estimates to the sample standard deviation throughout the paper. Mitton (2022) shows that scaling by the standard deviation overcomes potential issues with using the sample mean.

investment changes in the four-year window surrounding exogenous political turnovers. This panel reveals two important results. First, the effect of exogenous political turnovers on investment changes remains economically similar and statistically significant for firms going through the IPO application process around the exogenous turnover of provincial governors. Second, we do not observe any impact on investment changes for firms that were listed before such turnovers or for firms that filed for an IPO after them even in column 3 where EPU index is included as a control. These findings are consistent with the parallel trends assumption and mitigate concerns about reverse causality or omitted variables, a scenario where investment or economic changes lead to political turnovers.

Next, we investigate whether exogenous turnovers of provincial governors are associated with local economic indicators or personal attributes of the incumbent governors. The identifying assumption is that exogenous turnovers, which result from deaths, term limits and mandatory retirements of the incumbent governors, are unrelated to local economic conditions or personal traits of the incumbent governors that can be correlated with changes in the investment policies of local firms. We include the following provincial economic indicators: GDP per capita, GDP growth, and local inflation rate. It also considers several attributes of the incumbent governor, including her connections to the central government, ethnicity, and education. In Panel A of Table 3, we do not find a significant association between exogenous political turnovers and any of these variables. This is consistent with our identifying assumption and provides evidence suggesting that our measures of exogenous turnovers are unrelated to local conditions or gubernatorial attributes that might be driving the changes in firms' investment policies.

We also examine a placebo test in which we investigate the impact of exogenous political turnovers in neighboring provinces on investment changes. We construct an indicator variable

Pseudo political turnover that equals one if an exogenous political turnover takes place in a neighboring province between the IPO filing date and the IPO listing date, and zero otherwise. In Panel B of Table 3, we show that neighboring political turnovers do not have a positive effect on changes in firms' investment policies. In particular, the coefficients on *Pseudo political turnover* are consistently negative and are statistically insignificant across both columns. Together, these findings suggest that the effects of exogenous political turnovers on investment changes documented in Table 2 are less likely to be spurious or mechanical.

3.2 Heterogeneity

We posit that state-owned enterprises (SOEs) have weaker incentives to cater to the incoming provincial governors. First, SOEs typically enjoy implicit and explicit government guarantees, and therefore already enjoy preferential access to government resources, including bank loans and government subsidies (e.g., Firth et al. (2009), Huang et al. (2020)). Second, the managers of SOEs are political appointments. As such, they are already politically connected and do not need to cater to local government officials. Importantly, we distinguish between Centrally Owned SOEs (CSOEs) and Locally Owned SOEs (LSOEs) because LSOEs are more dependent on local government officials, and their managers therefore may still find it beneficial to cater to local politicians. Indeed, prior research shows that provincial governors exercise caution in selecting managers for LSOEs (Xu (2011)) and LSOEs cater to local politicians following political turnovers (Chen et al. (2021)). As such, CSOEs have the weakest incentives to change their investment plans to build connections with local politicians.

To test this hypothesis, we define the variable *CSOE (LSOE)* to equal one if the firm is an CSOE (LSOE). In columns 1 and 2 of Panel C of Table 3, we augment the previous regression

model with the interaction term *Exogenous political turnover* × *CSOE/LSOE*, which captures the incremental impact of exogenous political turnovers on the investment policies of central (local) state-owned firms.

The results in columns 1 and 2 of Panel A of Table 4 suggest that firms with central (local) state ownership are less (more) likely to change their investment plan in response to exogeneous political turnover. Across both columns, the coefficient on the interaction term *Exogenous political turnover* × *CSOE/LSOE* is statistically different from zero at conventional levels.

4. Government Resources

4.1 Access to Government Resources

In this section, we investigate the quid-pro-quo for the investment changes undertaken by local firms around the turnovers of provincial governors. We focus on two potential benefits that provincial governors can extend to local firms and that generate value in emerging markets: access to credit and government subsidies.

Columns 1 and 2 of Table 4 provides estimates from regressing access to credit on politically driven changes in investment policies by IPO firms. Access to credit is measured as the ratio of bank loans to either the book value of assets or the market value of assets (i.e., the sum of total book debt and the market value of equity) in levels (columns 1 and 2). The main variable of interest is the interaction term *Investment change* × *Exogenous political turnover,* which captures the effect of changes in investment policies around exogenous political turnovers on a firm's access to credit.

The estimates in columns 1 and 2 of Table 4 suggest that investment changes following exogenous political turnovers are associated with better access to credit. For example, in columns 1-2, the ratio of bank loans to the total value of book assets or the market value of assets increases

by 7.0% or 4.1%, respectively, following investment changes due to government policies. These estimates are statistically significant at conventional levels and are economically meaningful: they reflect an increase of 56.0% in bank loans scaled by total book assets and an increase of 62.8% in bank loans scaled by the market value of assets, compared to the standard deviation. In contrast, when we examine the access to bank credit for mature firms in columns 1 and 2 of Table 5, we find that such set of firms experience a deterioration in access to bank credit, with a decrease of 1.9% and 0.9% in columns 1 and 2, respectively.

In column 3 of Table 4 we provide estimates from regressing the propensity of obtaining government subsidies on changes in investment policies around exogenous turnovers of provincial governors. The dependent variable in the regression is an indicator variable that equals one if firms receive government subsidies. As shown in column 3, the coefficient on the interaction term *Investment change* × *Exogenous political turnover* is positive and statistically significant, suggesting that the propensity of obtaining government subsidies is higher for firms that change their investment policies following exogenous political turnovers. Furthermore, the economic magnitudes are large, suggesting that on average, the probability of obtaining government subsidies increases by 2.3 percentage points when the firm changes its investment policy following a political turnover.

On the contrary, peer firms that are mature are less likely to obtain government subsidies as shown by the significantly negative coefficient on the interaction term *Peer investment change* × *Exogenous political turnover* in column 3 of Table 5.

Taken together, the evidence from Tables 4 and 5 suggest the potential resource reallocation upon the politically driven investment changes by newly listed firms. In the next section, we examine if investment irreversibility contributes to the disadvantaged access to resources by mature peer firms.

4.2 Investment Irreversibility

We now focus on the frictions that prevent peer firms from catching up with newly-listed firms in making politically-driven investment changes. We contend that mature firms face greater frictions in altering investments that are already undertaken relative to younger firms that are just setting a larger share of their investment policy. We measure investment irreversibility using capital intensity ratio (net PPE scaled by book value of total asset) following Gulen and Ion (2015). We then examine the peer firms' access to resources across three groups of high, medium and low investment irreversibility.

In columns 1 to 3 of Table 6, we examine if peer firms' access to credit varies with their level of investment irreversibility. The results show that firms with low investment irreversibility experience little decrease in access to credit, while firms with high investment irreversibility suffer the most in access to credit. Moreover, test in the differences of coefficient between high and low groups show that the difference is statistically significant at conventional level. The results are similar in columns 4-6 where we use bank loans scaled by market value of assets as the access to credit measure. In columns 7-9, we examine the impact of investment irreversibility on peer firms' access to government subsidies. Consistent with access to credit, we find that firms in the high investment irreversibility group suffers the most in obtaining government subsidies compared to those in low investment irreversibility group, although the difference between the two groups are not statistically significant.

4.3 Career Implications

In this set of analyses, we investigate the implications of politically driven investment changes for the careers of top executives. We focus on top managers' political promotions to elected members of the *People's Congress* (PC) and the *Committee of Chinese People's Political Consultative*

Conference (CPPCC) one year after investment changes.

In columns 1 and 2 of Table 7, we report separate estimates for the CEO and the chair, respectively. Column 3 examines political promotions of either the CEO or the chair of the board. We obtain similar results across the three columns. Based on column 3, for example, investment changes following exogenous political turnovers increase the likelihood of the CEO and the Chairman to be elected as members of the PC/CPPCC by 20.0 percentage points, or by 41.1% compared to the standard deviation. Collectively, these results indicate that managers that adjust their firms' investment policies to cater to newly appointed provincial governors are more likely to be promoted.

5. Real Effects

The evidence thus far indicates that corporate investment is a conduit through which firms build connections to incoming local politicians. These connections benefit firms and their executives in several ways. Politically connected firms gain better access to bank credit and higher government subsidies, which lead to higher values and better performance. Their managers are more likely to be promoted to elected members of political organizations.

A natural question that arises is whether these effects have real economic consequences for the affected provinces. On the one hand, connected firms perform better and might increase local production, employment, and tax revenues, leading to stronger fiscal balances. Conversely, connected firms receive preferential treatment, including higher government subsidies, lower effective tax rates, and promotions of connected managers, which might stifle productivity and lead to lower tax revenues. Under this scenario, fiscal balances would be weaker. Hence, the economic net effect of investment reallocations around exogenous turnovers of provincial governors is unclear ex-ante.

To investigate the real economic consequences of exogenous political turnovers, we

examine the fiscal budgets of provincial governments. Table 8 explores the effects of exogenous political turnovers on provincial fiscal deficits, defined as the difference between ordinary budget expenditures and ordinary budget revenues, scaled by ordinary budget expenditures. Moreover, the effect is more pronounced in provinces with higher changes in the use of IPO proceeds. This translates to a percentage increase of 14.0% relative to the standard deviation. We obtain similar results when we or measure exogenous turnovers over the period t-3 to t-1 (column 2).[8] Taken together, these estimates provide suggestive evidence that exogenous political turnovers and the ensuing changes in firm and government policies have adverse local economic consequences.

A possible interpretation of these findings is that the entering provincial governors utilize fiscal deficits and other policy tools (e.g., debt financing in Ru (2018)) to minimize the adverse economic effects of their policy agendas. In particular, by increasing the fiscal deficit, new governors can delay the adverse economic consequences of their policies until they are no longer in office and hence avoid reputational or career damage. Consistent with this interpretation, Ru (2018) shows that incoming provincial governors raise long-term debt immediately after taking office to increase GDP growth, which is an important performance measure for promotion (e.g., Li and Zhou (2005).

6. Conclusion

Based on unique disclosure requirements in Chinese IPOs, which require firms to report the allocation of their IPO proceeds to investment projects, we examine the politics of corporate investments surrounding exogenous political turnovers. We find that firms make significant changes in their investment policies around exogenous turnovers of provincial governors.

In return for changing their investment policies, IPO firms obtain better access to credit

[8] In unreported tests, we obtain similar results if we measure exogenous political turnovers over the periods t-2 to t or t-2 to t-1. Our inference remains unchanged if we use an indicator variable to measure investment change at province level.

and more likely receive government subsidies, in contrast to their mature peers' deteriorating access to resources. Furthermore, top managers at firms that adjust their investment policies around exogenous political turnovers are more likely to be elected to a political office.

While firms obtain considerable benefits by adjusting their investment policies, the affected provinces suffer adverse real economic consequences. Our estimates suggest that following exogenous gubernatorial turnovers, provincial fiscal deficits increase.

Overall, this paper provides novel evidence that firms' investment policies serve as an important channel through which entrepreneurial firms and top executives accumulate political capital, which yields better access to government resources and improved career prospects, with adverse local economic consequences.

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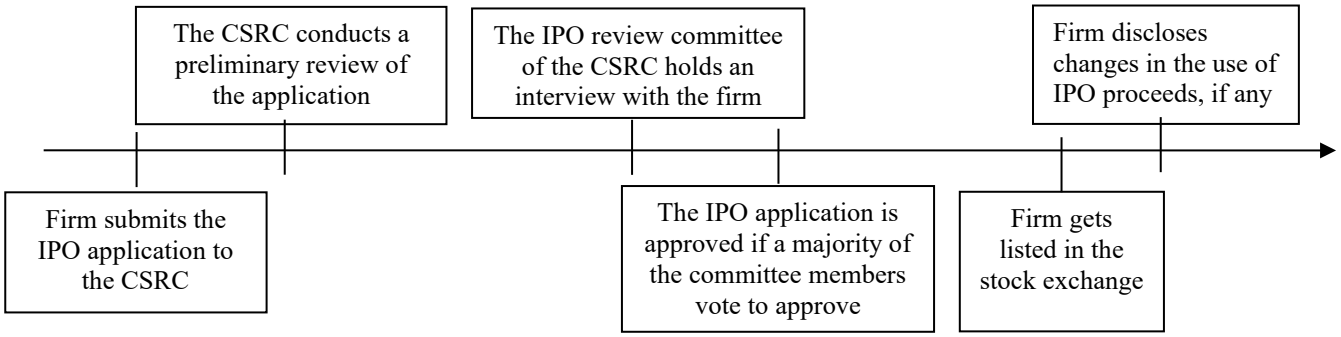
Figure 1: The IPO Process in China and the Timeline of the Events

Panel A: The Process of IPO Application, Review and Approval



Panel B: Timeline

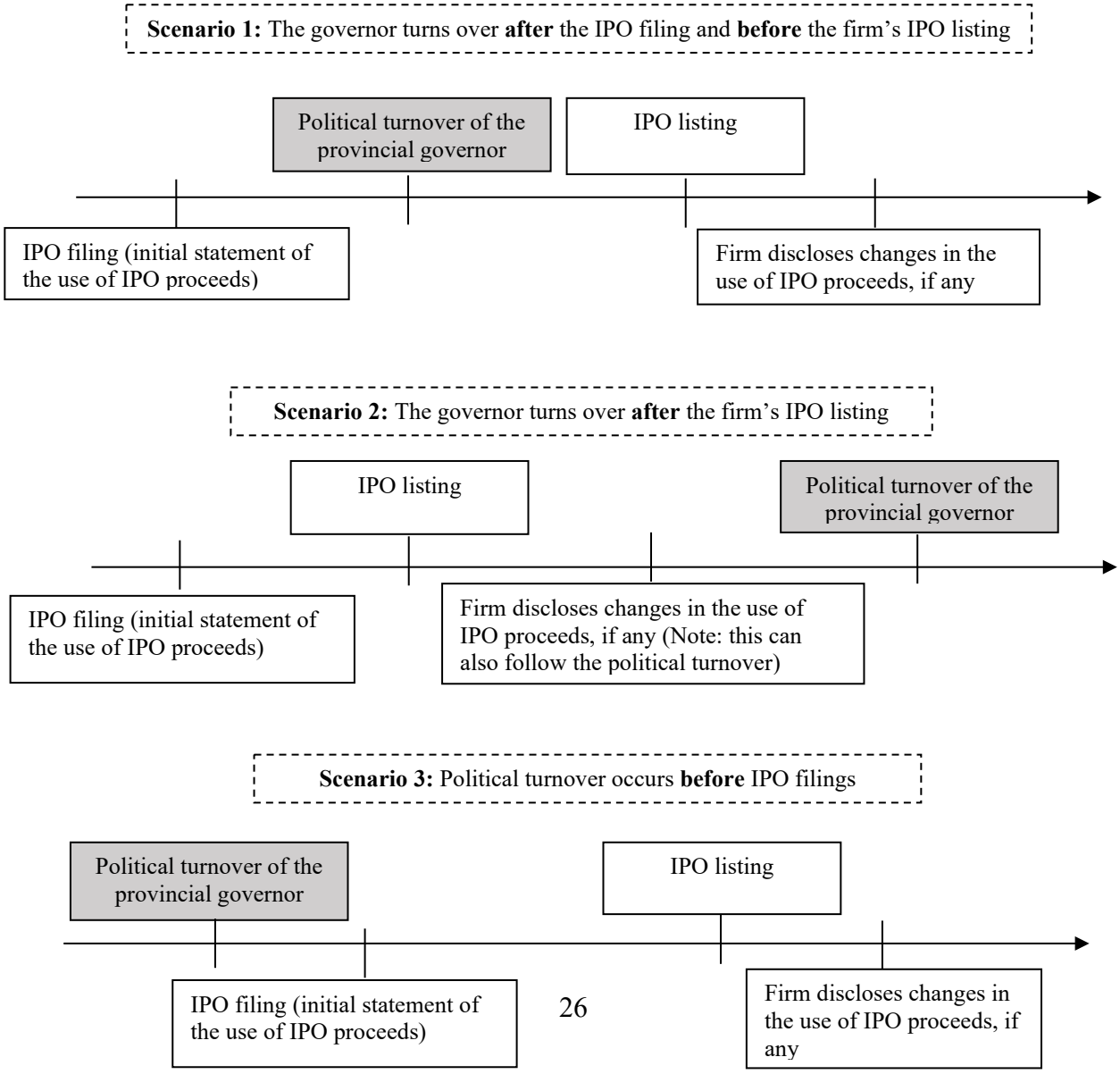


Table 1
Descriptive Statistics

Panel A provides summary statistics for the variables used in the analyses. *Investment change (t to t+2)* is an indicator variable that equals one if the company changes its investment plan due to government policy in years t, t+1 or t+2, where t is the year of the IPO listing, and zero otherwise. Panel B describes the distribution of the number of IPOs and investment changes by industry, where industries are defined according to the CSRC industry classification in 2001. Appendix A provides all variable definitions.

Panel A: Summary Statistics

Variable	min	p25	p50	mean	p75	max	sd	N
Investment change (t to t+2)	0	0	0	0.100	0	1	0.300	2,269
Exogeneous political turnover	0	0	0	0.145	0	1	0.353	2,269
State-owned	0	0	0	0.188	0	1	0.391	2,269
LSOE	0	0	0	0.091	0	1	0.288	2,269
CSOE	0	0	0	0.097	0	1	0.295	2,269
R&D project	0	0	0	0.353	1	1	0.478	2,269
Marketing project	0	0	0	0.348	1	1	0.476	2,269
Oversubscription, percentage	0	0	0	0.083	0	1	0.276	2,269
GDP per capita (RMB)	-0.366	-0.001	0.000	0.312	0.042	5.107	0.836	2,269
GDP per capita	3,603	26,133	42,214	44,074	58,833	100,105	21,693.430	2,269
GDP growth	8.190	10.171	10.651	10.544	10.982	11.514	0.597	2,269
Shares owned by largest shareholders	7.700	9.700	12.200	11.724	13.800	17.400	2.284	2,269
Board size (in persons)	11.887	36.000	51.000	53.009	66.827	98.570	21.061	2,269
Board size	5.000	8.000	9.000	8.816	9.000	17.000	1.613	2,269
Big four auditors	1.609	2.079	2.197	2.160	2.197	2.833	0.187	2,269
Firm size (millions, RMB)	0.000	0.000	0.000	0.077	0.000	1.000	0.266	2,269
Firm size	83.444	295.772	499.896	6621.273	1051.349	815143.500	40254.880	2,269
Leverage	18.498	19.505	20.030	20.356	20.773	24.693	1.307	2,269
Sales Growth	0.095	0.366	0.481	0.482	0.599	0.850	0.168	2,269
Firm age (in years)	-0.225	0.130	0.243	0.299	0.406	1.490	0.275	2,269
Firm age	0.000	4.000	8.000	8.321	12.000	29.000	5.061	2,269

Panel B: The Distribution of IPO projects and Investment Changes by Industry

Industry	Number of IPO projects	Number of investment changes
Agriculture, forestry, animal husbandry and fishery	27	8
Mining	59	4
Manufacturing	1,462	139
Electric power, heat, gas and water production and supply	60	10
Construction	87	17
Wholesale and retail	55	6
Transport, storage and postal service	49	5
Accommodation and catering	9	3
Information transmission, software and information technology services	288	18
Real estate	22	1
Leasing and commercial service	56	7
Scientific research and technical service	25	3
Water conservancy, environment and public facility management	22	1
Education	9	2
Health and social work	17	1
Culture, sports and entertainment	22	2
Total	2,269	227

Table 2
The Effect of Political Connections on Corporate Investment

This table examines the impact of exogenous turnovers of provincial governors on changes in the use of IPO proceeds. Panel A reports baseline analyses and Panel B reports dynamic effects. In both panels, the dependent variable is *Investment change (t to t+2)*, which is an indicator variable that equals one if the company changes its investment plan due to government policy in years t, t+1 or t+2, where t is the year of the IPO listing, and zero otherwise. In Panel A, *Exogenous political turnover* is an indicator variable that equals one if the governor turns over between the IPO filing date and the IPO listing date due to exogenous reasons, which include deaths, term limits, and mandatory retirements, and zero otherwise. In Panel B, *Exogenous political turnover-1(-2)* is an indicator variable that equals one if a firm files for an IPO one (two) years after an exogenous political turnover, and zero otherwise. *Exogenous political turnover+1(+2)* is an indicator variable that equals one if a firm is listed one (two) years before an exogenous political turnover, and zero otherwise. Appendix A provides all variable definitions. Robust standard errors, adjusted for heteroskedasticity and clustered at the province level, are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% level, respectively, using a two-tailed test.

Panel A: Baseline Analysis

Dependent Variable	*Investment change (t to t+2)*		
	(1)	(2)	(3)
Exogenous political turnover	0.106**	0.108***	0.119***
	[0.040]	[0.038]	[0.034]
Industry policy		-0.085***	-0.084***
		[0.026]	[0.026]
R&D project		-0.019	-0.020
		[0.015]	[0.016]
Marketing project		0.001	0.007
		[0.024]	[0.024]
Oversubscription, percentage		-0.008	-0.009
		[0.008]	[0.008]
GDP per capita		-0.049*	-0.055**
		[0.025]	[0.024]
Shares owned by largest shareholders		-0.000	-0.000
		[0.000]	[0.000]
Firm size		0.012	0.011
		[0.010]	[0.010]
Leverage		-0.046	-0.022
		[0.069]	[0.064]
Sales Growth		0.026	0.018
		[0.049]	[0.051]
Firm age		-0.012	-0.014
		[0.015]	[0.016]
EPU index			-0.001
			[0.000]
Year	Yes	Yes	Yes
Industry	Yes	Yes	Yes
Observations	2,269	2,269	2,213
Adjusted R^2	0.023	0.031	0.037

Panel B: Dynamics

Dependent Variable	*Investment change (t to t+2)*		
	(1)	(2)	(3)
Exogenous political turnover-2	-0.020	-0.041	-0.040
	[0.043]	[0.048]	[0.046]
Exogenous political turnover-1	0.101	0.091	0.077
	[0.065]	[0.059]	[0.063]
Exogenous political turnover	0.101**	0.106**	0.122***
	[0.044]	[0.043]	[0.043]
Exogenous political turnover+1	-0.028	-0.020	0.001
	[0.025]	[0.025]	[0.027]
Exogenous political turnover+2	-0.035	-0.022	-0.013
	[0.024]	[0.023]	[0.025]
Industry policy		-0.089***	-0.087***
		[0.025]	[0.025]
R&D project		-0.020	-0.021
		[0.015]	[0.015]
Marketing project		0.000	0.006
		[0.024]	[0.023]
Oversubscription, percentage		-0.007	-0.008
		[0.008]	[0.008]
GDP per capita		-0.038	-0.046**
		[0.023]	[0.021]
Shares owned by largest shareholders		-0.000	-0.000
		[0.000]	[0.000]
Firm size		0.008	0.008
		[0.008]	[0.008]
Leverage		-0.035	-0.015
		[0.062]	[0.060]
Sales Growth		0.028	0.020
		[0.049]	[0.050]
Firm age		-0.010	-0.012
		[0.015]	[0.016]
EPU index			-0.001
			[0.001]
Year	Yes	Yes	Yes
Industry	Yes	Yes	Yes
Observations	2269	2269	2213
Adjusted R^2	0.029	0.035	0.039

Table 3
Robustness and Extensions

This table reports robustness check and extended analysis. Panel A studies the determinants of exogenous political turnovers of provincial governors. The dependent variable is an indicator variable that equals one if the governor turns over due to exogenous reasons, which include deaths, term limits, and mandatory retirements, and zero otherwise. Panel B provides estimates from placebo tests based on political turnovers in neighboring provinces. The dependent variable is *Investment change (t to t+2)*, which is an indicator variable that equals one if the company changes its investment plan due to government policy in years t, t+1 or t+2, where t is the year of the IPO listing, and zero otherwise. *Pseudo political turnover* is an indicator variable that equals one if an exogenous political turnover takes place between the IPO filing date and the IPO listing date in a neighboring province, and zero otherwise. Panels C investigates the effects of firm ownership. *CSOE* is an indicator variable that equals one if the firm is state-owned by the central government, and zero otherwise. *LSOE* is an indicator variable that equals one if the firm is state-owned by the local government, and zero otherwise. Appendix A provides all variable definitions. Robust standard errors, adjusted for heteroskedasticity and clustered at the province level, are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% level, respectively, using a two-tailed test.

Panel A: Determinants of Exogenous Turnovers of Provincial Governors

Dependent Variable	*Exogenous turnovers of provincial governors (t+1)*		
	(1)	(2)	(3)
GDP per capita	0.001		0.001
	[0.013]		[0.014]
GDP growth	-0.007		-0.008
	[0.005]		[0.005]
Inflation	-0.003		-0.003
	[0.007]		[0.007]
Central connection		-0.008	-0.008
		[0.019]	[0.020]
Han ethnicity		0.021	0.019
		[0.019]	[0.018]
Education		-0.013	-0.031
		[0.040]	[0.037]
Year	Yes	Yes	Yes
Observations	465	465	465
Adjusted R^2	-0.001	-0.004	-0.006

Panel B: Placebo Tests – Political Turnovers in Neighboring Provinces

Dependent Variable	*Investment change (t to t+2)*	
	(1)	(2)
Pseudo political turnover	-0.027	-0.027
	[0.020]	[0.021]
Industry policy		-0.082***
		[0.025]
R&D project		-0.017
		[0.015]
Marketing project		0.003
		[0.026]
Oversubscription, percentage		-0.008
		[0.007]
GDP per capita		-0.054*
		[0.027]
Shares owned by largest shareholders		-0.000
		[0.000]
Firm size		0.012
		[0.011]
Leverage		-0.059
		[0.077]
Sales Growth		0.024
		[0.049]
Firm age		-0.006
		[0.016]
Year	Yes	Yes
Industry	Yes	Yes
Observations	2,269	2,269
Adjusted R^2	0.015	0.022

Panel C: State Ownership

Dependent Variable	*Investment change (t to t+2)*	
	(1)	(2)
Exogenous political turnover	0.080**	0.085**
	[0.034]	[0.034]
Exogenous political turnover×CSOE	-0.208*	-0.221*
	[0.114]	[0.130]
Exogenous political turnover×LSOE	0.177*	0.163*
	[0.099]	[0.091]
CSOE	-0.003	-0.013
	[0.037]	[0.044]
LSOE	0.006	-0.004
	[0.025]	[0.026]
Industry policy		-0.083***
		[0.025]
R&D project		-0.019
		[0.015]
Marketing project		-0.003
		[0.025]
Oversubscription, percentage		-0.008
		[0.008]
GDP per capita		-0.045*
		[0.024]
Shares owned by largest shareholders		-0.000
		[0.000]
Firm size		0.012
		[0.012]
Leverage		-0.042
		[0.069]
Sales Growth		0.026
		[0.049]
Firm age		-0.015
		[0.014]
Year	Yes	Yes
Industry	Yes	Yes
Observations	2,269	2,269
Adjusted R^2	0.026	0.033

Table 4
Firm-Level Consequences

This table examines the effect of the change in the use of IPO proceeds around exogenous political turnovers on newly listed firms' access to resources. Columns (1)-(2) examine the effect of the change in the use of IPO proceeds around exogenous political turnovers on firms' access to credit. *Bank loans/book assets* is the ratio of bank loans to the book value of assets in year t+1, where t is the year of investment change. *Bank loans/market value of assets* is the ratio of bank loans to the sum of the book value of debt and the market value of equity in year t+1, where t is the year of investment change. Column (3) examines the effect of the change in the use of IPO proceeds around exogenous political turnovers on firms' access to government subsidies. The dependent variable is *Prob(Government subsidies>0)*, which is an indicator variable that equals one if the company receives government subsidies in year t+1, where t is the year of investment change, and zero otherwise. In both panels, *Investment change* is an indicator variable that equals one if the company changes its investment plan due to government policy in a given year, and zero otherwise. *Exogenous political turnover* is an indicator variable that equals one if the governor turns over between the IPO filing date and the IPO listing date due to exogenous reasons, which include deaths, term limits, and mandatory retirements, and zero otherwise. Appendix A provides all variable definitions. The columns alternate with respect to year and industry fixed effects. Robust standard errors, adjusted for heteroskedasticity and clustered at the province level, are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% level, respectively, using a two-tailed test.

Dependent Variable	*Bank loans/ book assets*	*Bank loans/ market value of assets*	*Prob(Government subsidies>0)*
	(1)	(2)	(3)
Exogenous political turnover	-0.008	-0.002	0.008
	[0.009]	[0.005]	[0.006]
Investment change	-0.016	-0.008	-0.017*
	[0.011]	[0.007]	[0.010]
Investment change × Exogenous political turnover	0.070***	0.041***	0.023*
	[0.021]	[0.012]	[0.013]
Year	Yes	Yes	Yes
Industry	Yes	Yes	Yes
Controls	Yes	Yes	Yes
Observations	1,151	1,122	1,163
Adjusted R^2	0.354	0.362	0.801

Table 5
Peer Firms' Access to Resources

This table examines the effect of the change in the use of IPO proceeds around exogenous political turnovers on peer firms' (listed for at least 4 years) access to resources. Columns (1)-(2) examine the effect of the change in the use of IPO proceeds around exogenous political turnovers on firms' access to credit. *Bank loans/book assets* is the ratio of bank loans to the book value of assets in year t+1, where t is the year of investment change. *Bank loans/market value of assets* is the ratio of bank loans to the sum of the book value of debt and the market value of equity in year t+1, where t is the year of investment change. Column (3) examines the effect of the change in the use of IPO proceeds around exogenous political turnovers on firms' access to government subsidies. The dependent variable is *Prob(Government subsidies>0)*, which is an indicator variable that equals one if the company receives government subsidies in year t+1, where t is the year of investment change, and zero otherwise. In both panels, *Peer investment change* is an indicator variable that equals one if the newly listed firm changes its investment plan due to government policy in a given year, and zero otherwise. *Exogenous political turnover* is an indicator variable that equals one if the governor turns over between the IPO filing date and the IPO listing date due to exogenous reasons, which include deaths, term limits, and mandatory retirements, and zero otherwise. Appendix A provides all variable definitions. The columns alternate with respect to year and industry fixed effects. Robust standard errors, adjusted for heteroskedasticity and clustered at the province level, are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% level, respectively, using a two-tailed test.

Dependent Variable	*Bank loans/book assets*	*Bank loans/market value of assets*	*Prob(Government subsidies>0)*
	(1)	(2)	(3)
Exogenous political turnover	0.008	0.000	0.034***
	[0.006]	[0.002]	[0.012]
Peer investment change	-0.002	-0.001	0.019***
	[0.005]	[0.002]	[0.007]
*Peer investment change*Exogenous political turnover*	-0.019**	-0.009**	-0.027**
	[0.007]	[0.003]	[0.010]
Year	Yes	Yes	Yes
Industry	Yes	Yes	Yes
Controls	Yes	Yes	Yes
Observations	7,514	7,269	7,539
Adjusted R^2	0.253	0.364	0.571

Table 6
Investment Irreversibility and Peer Firms' Access to Resources

This table examines the effect of investment irreversibility on peer firms' (listed for at least 4 years) access to resources around exogenous political turnovers. Columns (1)-(6)examine the effect of investment irreversibility on firms' access to credit. *Bank loans/book assets* is the ratio of bank loans to the book value of assets in year t+1, where t is the year of investment change. *Bank loans/market value of assets* is the ratio of bank loans to the sum of the book value of debt and the market value of equity in year t+1, where t is the year of investment change. Columns (7)-(9) examine the effect of investment irreversibility on firms' access to government subsidies. The dependent variable is *Prob(Government subsidies>0)*, which is an indicator variable that equals one if the company receives government subsidies in year t+1, where t is the year of investment change, and zero otherwise. Investment irreversibility is defined as firm-level net PPE scaled by total assets. The firm-level measure is then ranked annually in the same industry to assign firms into high, medium and low investment irreversibility groups, respectively. In both panels, *Peer investment change* is an indicator variable that equals one if the newly listed firm changes its investment plan due to government policy in a given year, and zero otherwise. *Exogenous political turnover* is an indicator variable that equals one if the governor turns over between the IPO filing date and the IPO listing date due to exogenous reasons, which include deaths, term limits, and mandatory retirements, and zero otherwise. Appendix A provides all variable definitions. The columns alternate with respect to year and industry fixed effects. Robust standard errors, adjusted for heteroskedasticity and clustered at the province level, are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% level, respectively, using a two-tailed test.

Dependent Variable	Investment irreversibility								
	Bank loans/book assets			*Bank loans/market value of assets*			*Prob(Government subsidies>0)*		
	Low	Medium	High	Low	Medium	High	Low	Medium	High
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Exogenous political turnover	0.001	-0.001	0.002	-0.006	0.001	-0.001	0.014	0.041	0.035***
	[0.013]	[0.015]	[0.011]	[0.006]	[0.007]	[0.005]	[0.021]	[0.025]	[0.010]
Peer investment change	0.004	-0.019*	0.000	0.000	-0.009	-0.001	0.007	0.012	0.015*
	[0.010]	[0.011]	[0.007]	[0.004]	[0.005]	[0.003]	[0.015]	[0.010]	[0.008]
Peer investment change × Exogenous political turnover	-0.003	-0.018	-0.030***	0.002	-0.012*	-0.013**	-0.021	-0.021	-0.036***
	[0.018]	[0.015]	[0.011]	[0.007]	[0.006]	[0.006]	[0.020]	[0.026]	[0.010]
Difference in the coefficient of Peer investment change × Exogenous political turnover (high minus low)		-0.027 (p-value=0.10)			-0.011 (p-value=0.03)			-0.010 (p-value=0.16)	
Year	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	2084	1641	2766	2012	1583	2674	2,090	1,643	2,772
Adjusted R^2	0.197	0.234	0.208	0.266	0.340	0.327	0.543	0.580	0.621

Table 7
Managerial Careers

This table examines the career outcomes of managers that adjust their firms' investment policy following the exogenous turnover of the provincial governors. The dependent variable is *Political promotion*, defined as an indicator variable that equals one if the CEO/Chairman of the Board is elected for the *People's Congress* (PC) or the *Committee of Chinese People's Political Consultative Conference* (CPPCC) in year t+1, where t is the year of investment change, and zero otherwise. *Investment change* is an indicator variable that equals one if the company changes its investment plan due to government policy in a given year, and zero otherwise. *Exogenous political turnover* is an indicator variable that equals one if the governor turns over between the IPO filing date and the IPO listing date due to exogenous reasons, which include deaths, term limits, and mandatory retirements, and zero otherwise. Appendix A provides all variable definitions. The regressions include year and industry fixed effects. Robust standard errors, adjusted for heteroskedasticity and clustered at the province level, are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% level, respectively, using a two-tailed test.

Dependent Variable	*Political promotion*		
	Chairman	CEO	CEO/Chairman
	(1)	(2)	(3)
Exogenous political turnover	-0.087	-0.040	-0.092*
	[0.054]	[0.070]	[0.053]
Investment change	0.032	0.039	0.054
	[0.037]	[0.032]	[0.053]
Investment change × Exogenous political turnover	0.260***	0.239***	0.200***
	[0.086]	[0.078]	[0.060]
Year	Yes	Yes	Yes
Industry	Yes	Yes	Yes
Controls	Yes	Yes	Yes
Observations	1,164	1,021	1,021
Adjusted R^2	0.048	0.047	0.056

Table 8
Local Economic Consequences

This table examines the impact of exogenous political turnovers on provincial fiscal deficits from 2003 to 2015. The dependent variable is *Deficit ratio (t+1),* defined as the difference between the provincial ordinary budget expenditure and ordinary budget revenue, scaled by ordinary budget expenditure. *Exogenous political turnover (t-2 to t-1)* is an indicator variable that equals one if there was an exogenous governor turnover between year t-2 and year t-1, and zero otherwise. *Exogenous political turnover (t-3 to t-1)* is an indicator variable that equals one if there was an exogenous governor turnover between year t-3 and year t-1, and zero otherwise. *Provincial investment change* is an indicator variable that equals one if the ratio of firms that change the use of IPO proceeds in a province in year t is in the annual top tercile, and zero otherwise. Appendix A provides all variable definitions. The regressions include year and province fixed effects. Robust standard errors, adjusted for heteroskedasticity and clustered at the province level, are reported in parentheses. ***, **, and * denote statistical significance at the 1%, 5%, and 10% level, respectively, using a two-tailed test.

Dependent Variable	*Deficit ratio (t+1)*	
	(1)	(2)
Provincial investment change	-0.006	-0.007
	[0.004]	[0.004]
Exogenous political turnover(t-2 to t-1)	-0.001	
	[0.007]	
*Provincial investment change*Exogenous political turnover(t-2 to t-1)*	0.031***	
	[0.010]	
Exogenous political turnover(t-3 to t-1)		0.005
		[0.006]
*Provincial investment change*Exogenous political turnover(t-3 to t-1)*		0.028***
		[0.009]
Year	Yes	Yes
Province	Yes	Yes
Controls	Yes	Yes
Observations	182	182
Adjusted R^2	0.987	0.987

Appendix A: Variable Definitions

This appendix provides detailed definitions and data sources for all the variables included in the analyses.

Variables	Definition	Source
	Investment changes and governors' turnovers	
Exogenous political turnover	An indicator variable that equals one if the provincial governor turns over between the IPO filing date and the IPO listing date due to exogenous reasons, which include deaths, term limits, and mandatory retirements, and zero otherwise.	Hand-collected
Investment change	An indicator variable that equals one if the company changes its investment plan due to government policy, and zero otherwise. It is measured at project level.	Hand-collected
Pseudo political turnover	An indicator variable that equals one if an exogenous political turnover takes place between the IPO filing date and the IPO listing date in a neighboring province, and zero otherwise.	Hand-collected
	Governors	
Central connection	An indicator variable that equals one if the governor has working experience or holds a joint-appointment in the central government, and zero otherwise.	Hand-collected
Education	An indicator variable that equals one if the governor holds a bachelor's degree or higher, and zero otherwise.	Hand-collected
Han ethnicity	An indicator variable that equals one if the governor is Han Chinese, and zero otherwise.	Hand-collected
	Firm managers	
Political promotion	An indicator variable that equals one if the manager (Chairman of the Board, or CEO) is elected to the *People's Congress* (PC) or the *Committee of Chinese People's Political Consultative Conference* (CPPCC) in year t+1, where t is the year of investment change, and zero otherwise.	CSMAR
	Firms	
Asset tangibility	The ratio of net property, plant, and equipment to the book value of assets.	CSMAR
Bank loans/book assets	The ratio of bank loans to the book value of assets in year t+1, where t is the year of the investment change.	CSMAR
Bank loans/market value of assets	The ratio of bank loans to the sum of book debt and the market value of equity in year t+1, where t is the year of the investment change.	CSMAR
Big four auditors	An indicator variable that equals one if a firm is audited by a joint venture of one of the big four accounting firms and a domestic accounting firm, and zero otherwise.	CSMAR
Board size	The natural logarithm of the number of directors.	CSMAR
Cash holdings	The ratio of cash to book assets.	CSMAR
CSOE	An indicator variable that equals one if the firm is state-owned by the central government, and zero otherwise.	CSMAR
Firm age	The natural logarithm of one plus the number of years since the firm was incorporated.	CSMAR
Firm size	The natural logarithm of total book assets.	CSMAR
Firm leverage	The ratio of total liabilities to total book assets.	CSMAR
Industry policy	An indicator variable that equals one if the new industry policy is implemented at either provincial or central government level between the IPO filing date and the IPO listing date, and the firm operates in an industry affected by the policy plan.	Hand-collected
Inventory/assets	The ratio of inventory to book assets.	CSMAR
IPO proceeds	The natural logarithm of the proceeds raised in the IPO.	Tonghuashun
LSOE	An indicator variable that equals one if the firm is state-owned by the local government, and zero otherwise.	CSMAR
Market-to-book	The market value of equity divided by the book value of equity.	CSMAR
Marketing project	An indicator variable that equals one if the project is funded for marketing, and zero otherwise.	Hand-collected
Number of employees	The natural logarithm of the number of firm employees.	CSMAR
Oversubscription, percentage	The percentage of oversubscription, defined as the difference between actual fund raised and planned fund raised, scaled by planned fund raised.	Tonghuashun
Prob(Government subsidies>0)	An indicator variable that equals one if the company receives government subsidies in year t+1, where t is the year of investment change, and zero otherwise.	CSMAR

R&D project	An indicator variable that equals one if the project is funded for R&D, and zero otherwise.	Hand-collected
Return on assets	Earnings before interest and taxes divided by total assets.	CSMAR
Shares owned by institutional investors	The percentage of shares held by institutional investors.	WIND
Shares owned by largest shareholders	The percentage of shares held by the largest shareowner.	WIND
State-owned	An indicator variable that equals one if the firm is state-owned by the government, and zero otherwise.	CSMAR
Regional and macroeconomic conditions		
Deficit ratio	The difference between provincial ordinary budget expenditures and ordinary budget revenues, scaled by ordinary budget expenditures in year t+1.	CSMAR
EPU index	The economic uncertainty index at provincial level across China following the methodology in Baker et al. (2016).	Yu et al. (2021)
Provincial investment change	An indicator variable that equals one if the ratio of firms that change the use of IPO proceeds in a province in year t is in the annual top tercile, and zero otherwise.	Hand-collected
Financialization	The proportion of bank financing to small and medium enterprises as of total bank loans in the province.	World Bank (2006)
Fixed asset investment/ GDP	The percentage of fixed asset investments as of total provincial GDP.	CSMAR
GDP growth	The growth in provincial GDP (in percentage points).	CSMAR
GDP per capita	The natural logarithm of provincial GDP per capita.	CSMAR
Inflation	The local inflation rate (in percentage points) in the province.	CSMAR
Population growth	The population growth rate (in percentage points) in the province.	CSMAR
Secondary sector/GDP	The percentage of output from secondary sectors as of total provincial GDP.	CSMAR
Tertiary sector/GDP	The percentage of output from tertiary sectors as of total provincial GDP.	CSMAR
Urbanization ratio	The ratio of urban population to total population in the province.	Hand-collected

Appendix B: Changes in the Use of IPO Proceeds

This Appendix describes the types of changes in the use of IPO proceeds and provides examples. Note that a firm's investment change can include several types of investment changes, which are not mutually exclusive.

Table B.1: Types of Changes

	Project-level
Sample	*2,274*
Number of Investment Changes	*1,476*
Including:	
Project Replacement	*501*
Project Cancellation	*128*
Investment Amount	*335*
Implementation Entity	*72*
Implementation Location	*432*
Implementation Methods	*195*
Implementation Progress	*547*
Others	*150*

Examples

Project Replacement (Italics are added by the authors)
"*This project was approved by Shenzhen Development and Reform Bureau in May 2008* for construction. This project is an expansion project of building materials production base in South China. After the listing of the Company in stock exchange in December 2009, the Company started to implement the project. However, due to the fact that the basic construction conditions such as municipal roads and hydropower facilities attached to the project have not reached the construction requirements and *the exogenous factors such as the change of government planning*, the project failed to be implemented as scheduled. Owing to the significant adverse changes in the macroeconomic condition of the shipping compartment business, the existing production capacity of the Company can basically meet the demand of the shipping compartment market. The implementation of the project, if continued, would have failed to achieve the original objectives. Therefore, in order to avoid overcapacity and improve the efficiency of raised funds, the company intends to terminate the project.
Part of the raised proceeds that were used will be made up by the company's own funds. After that, 98 million RMB will be changed to 'the Production Project of Jiangsu Changshu Huadong Box-type Integrated Housing' for the implementation of the second phase of the project; the remaining 52 million RMB will be changed to 'the construction projects of Xi'an Yazhi integrated housing production base.'"

Change Due to Government Policy
"Since the company went public, it has continuously strengthened the research and development of new products. For example, the colour ultrasound and POCT product projects have undertaken smooth progress. Therefore, the company has received strong support in terms of special funds from the government. Due to the timeliness of government funds, the company plans that the central expansion project will give priority to government project funds, while streamlining the "R&D centre expansion project" and reducing the corresponding investment amount to save some money. To improve the efficiency of the use of IPO proceeds, the savings will be allocated to the new project "Pingshan Project". *The "Eleventh Five-Year Plan" of the pharmaceutical industry by Shenzhen government pointed out that the development of medical device products is one of the five major areas of the pharmaceutical industry's key development.* The government strives to build Shenzhen into an internationally renowned medical device production and export base. The project is located in the National Bio-industry Base of Pingshan New District, which belongs to the medical device industry. In line with the planning of the industrial distribution of the country and Shenzhen, it is conducive to the formation of a rational layout of regional industries."

Appendix C: Project-Level Data Structure

In 1998, the China Securities Regulatory Commission (CSRC) mandated that the IPO prospectus provide detailed disclosure of the allocation of IPO funds across individual projects. The detailed disclosure of capital allocation across projects in Chinese IPOs differs from the disclosure mandates in the U.S. In the U.S., firms have discretion on if and how to disclose their use of the IPO proceeds. Not surprisingly, Leone et al. (2007) shows that there is a considerable variation in the level of details that firms disclose in their IPO prospectus. Moreover, firms in the U.S. report the general purpose of their proceeds' usage, including working capital, debt repayment and R&D, but do not disclose the allocation of the proceeds across individual projects as Chinese firms are required to do.[9]

The disclosure in China includes each project's name, the total amount of investment in each project and its breakdown into categories (e.g., labour costs, machinery, etc.), the prospects and feasibility of the project, the board's views on the project, the implementation entity, and the duration of the project. Firms are required to disclose this information when they submit the IPO application to the CSRC. After the IPO application is approved, firms that change their investment or implementation plans for a given project are required to disclose the change within two days of when the decision is made by the board of directors.

The following table illustrates the project-level data that we use and shows how we identified project-level investment changes. The table is taken from the announcement made by the board of directors of Transfar, a listed company that operates in the Petroleum, Chemistry, Rubber, and Plastic industry in China. The company provides a feasibility report for four projects in its IPO prospectus (as indicated by the column of "Intended"). After the firm was listed, it kept three of the four projects unchanged (as indicated by the column of "Actual"), while replacing one project with a new one (project No. 4). Our sample includes four observations that correspond to this company, with the variable *Investment changes (t to t+2)* taking the value of zero for projects No. 1-3, and the value of one for project No.4. As such, our data structure comprises province-firm-project level observations rather than a typical panel structure (e.g., firm-year or project-firm-year observations). This, in turn, affects the design of our empirical analyses and precludes standard panel regressions.

Investment projects			**Total investment of IPO proceeds** (In millions RMB)		**Variable**
No.	Intended (based on IPO prospectus, IPO date is June 15, 2004)	Actual (based on the announcement on October 24, 2006)	Intended investment amount in IPO prospectus	Investment amount after investment change is made	*Investment changes (t to t+2)*
1	Project with an annual output of 20,000 tons of fabric coating agent	Same as intended	49.96	49.96	0
2	Technical transformation project of fabric finishing agent with an annual output of 22,000 tons	Same as intended	42.07	42.07	0
3	Annual output of 20,000 tons of dyeing auxiliaries' technical transformation	Same as intended	47.21	47.21	0
4	Project with an annual output of 7,000 tons of pre-spinning chemical fibre oiling agent	Technical transformation project of fabric finishing agent with an annual output of 20,000 tons	49.97	49.69	1

Source: https://bit.ly/3Diq2r9 (Company: Transfar, Stock code:002010, Industry: Petroleum, chemistry, rubber, and plastic)

[9] For example, Facebook (now Meta) stated the use of its IPO proceeds in its IPO prospectus as follows: "The principal purposes of our initial public offering are to create a public market for our Class A common stock and thereby enable future access to the public equity markets by us and our employees, obtain additional capital, and facilitate an orderly distribution of shares for the selling stockholders. We intend to use the net proceeds to us from our initial public offering for working capital and other general corporate purposes; however, we do not currently have any specific uses of the net proceeds planned. We may use a portion of the net proceeds to us to satisfy a portion of the anticipated tax withholding and remittance obligations related to the initial settlement of our outstanding RSUs, which will become due approximately six months following the completion of our initial public offering. Additionally, we may use a portion of the proceeds to us for acquisitions of complementary businesses, technologies, or other assets. However, we have no commitments with respect to any such acquisitions or investments at this time." For more details, see its Form S-1, which is available at: https://www.sec.gov/Archives/edgar/data/1326801/000119312512034517/d287954ds1.htm#toc287954_4