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Disclosure of corporate information and political connections: a study of Chinese firms

Voluntary disclosure provides useful information about a firm's market and financial state, along with its plans and outlook for the future. However, firms do not always fully disclose their private information. Research by Jean Chen, Xinsheng Cheng, Stephen Gong, and Youchao Tan investigated the link between the level of voluntary disclosure and companies' political connectedness.* The authors examined this linkage through comparing companies connected to the 2006 Shanghai Pension Corruption Scandal against comparable non-connected firms.

Because disclosures can end up revealing a company's political ties and open the door to public scrutiny, firms with greater political connections face potentially high costs if they disclose information. The benefits from disclosure are low compared to what they could derive from their political connections. The study findings showed that companies connected to politicians implicated in the corruption scandal disclosed far less information than non-connected companies in the pre-scandal period.

After the corruption scandal had come to light, there was no longer a political relationship for firms to protect. Hence, the associated costs of disclosure went down and the costs of perceived opacity went up in the aftermath of the high-profile scandal. The study results show that connected firms increased their disclosure, while the control group of non-connected firms maintained similar levels of disclosure compared to pre-scandal levels. In addition, the size of the increase in disclosure was moderated by the extent of the company's pre-scandal dependence on political connectedness and the severity of the negative publicity sustained.

The researchers argue that the increase in disclosure was not merely a public relations ploy: post-scandal disclosures included important company information not asked for by market regulators.

The enduring lesson from this research is that firms make their disclosure decisions by weighing up the associated costs. Political connections increase the cost of disclosure; thus, politically connected firms disclose less information.

*Full study results are available in an article authored by Jean Chen, Xinsheng Cheng, Stephen Gong, and Youchao Tan: "Implications of Political Patronage and Political Costs for Corporate Disclosure: Evidence from the Shanghai Pension Corruption Scandal", Journal of Accounting, Auditing & Finance, Vol. 32(1): 92-122. (2017).