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Political connections of executives and directors: Relevant facts to understand the impact of politicians on firm valuation

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ABSTRACT

This paper examines the effect of political connections on firm valuation across large, listed corporations in emerging markets in the Americas. The study analyzes the impact of a higher number of politically connected individuals, their role as officers or directors, and the impact of tenure on firm market value. Our estimations show the positive impact of being a politically connected firm. Moreover, the strongly positive impact of politically connected directors is different from the weaker effect of politically connected officers. The intensity of politically connected directors positively impacts on firm valuation. There is a moderating role of tenure, that implies the positive beginning impact of politically connected directors on firm value decreases over time.

1. Introduction

Corporate executive officers and directors are responsible for making the most significant decisions that shape firms' outcomes. Their effectiveness in fulfilling their duties and responsibilities is often linked to their ability to achieve the goals for which they are accountable. Over the last three decades, corporate governance literature has extensively explored the relationship between board structure, directors' attributes, and their impact on firm value and performance.

The structure of a board of directors is typically characterized by its key attributes: size, the professional and demographic profiles of its members, their independence from management, the number of committees, and director compensation. Empirical studies have analyzed these attributes to evaluate mechanisms that mitigate agency costs among stakeholders, provide resources to enhance firms' market and non-market strategies, and foster firm value and performance.

Positive outcomes have been documented when a board is led by an independent director or includes a representative proportion of independent directors (Choi et al., 2007; Duchin et al., 2008). However, mixed results have been observed regarding the effectiveness of board monitoring, agency costs, and firm value in cases where directors serve on multiple boards ("busy directors") (Andres et al., 2013; Fich & Shivdasani, 2006) or when senior executives reciprocally sit on each other's boards ("interlocked boards"), particularly in the context of business groups (Pombo & Gutiérrez, 2011; Santos et al., 2012).

The representation of specific constituencies—such as bankers, financial experts, politically connected individuals, and employees—on boards has been a prominent research topic over the past two decades. These appointments are typically nonrandom and often serve strategic purposes. For example, (Miwa & Ramseyer, 2005) found that in Japan, firms appoint financial experts and banking industry representatives based on their levels of indebtedness. Similarly, (Burak Güner et al., 2008) reported that in the U.S., the appointment of bankers to boards is associated with increased external borrowing and reduced firm investment-cash flow sensitivity. However, this does not necessarily indicate that debt resources are being directed toward fostering firm investment opportunities, which may conflict with shareholders' interests.

An important area of study in corporate governance involves politically connected directors. Research in this field assesses the costs and benefits for firms of appointing politically connected individuals, influenced by market imperfections and the institutional settings of countries. Faccio's (2006) seminal work, based on data from 47 countries, finds that the demand for political connections is higher in environments with weak legal protections, restrictions on international capital flows, high trade barriers, and distorted corporate tax schemes that provide preferential benefits to certain industries. According to her data, politically connected firms are particularly prevalent in large

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emerging markets such as Russia, South Korea, Indonesia, Thailand, and Malaysia. A common characteristic of these markets is the strong presence of the state in the economy. For example, by 1997, the market capitalization of politically connected firms represented 87 % in Russia, 42 % in Thailand, and 23 % in Indonesia. In China, (Liu et al., 2021) report that politically connected private firms constituted 25 % of all listed firms by 2017.

We extend Faccio's (2006) core questions to Latin America's major financial markets, examining: i) whether politically connected firms are prevalent over time in these markets, and ii) how the heterogeneity of politically connected individuals, whether through top executives or board directors, and the intensity of firms' connectedness affect firm value ex post. The concept of connectedness intensity is borrowed from the lobbying literature, where firms with higher lobbying expenditures than the industry average have a higher probability of securing public grants (Unsal, 2020).

Politically connected firms remain as an understudied topic in Latin America from a corporate finance perspective. This region offers a unique economic and institutional context that highlights the importance of understanding the costs and benefits of political connections through the appointment of politically connected individuals to company boards or top management. From the 1950s to the 1990s, economic development in the region followed an inward substitution industrialization model. This included the establishment of domestic development banks and industrial finance corporations to provide targeted credit under favorable conditions, promoting manufacturing industrialization and agro-industrial projects. Additional policies included tariff protection, tax exemptions, fixed exchange rate regimes, and restrictions on international capital outflows. Since the 1990s, the region has shifted towards economic openness and export diversification policies. Governments reduced tariffs and promoted competition across previously protected industries, including the domestic financial sector. However, development banks retained their strategic role in financing the private sector.

Brazil serves as a notable example. Leading companies were founded or supported financially by BNDES (Brazilian Development Bank) during their growth phases. For instance, **Embraer** (1969), a globally recognized aerospace company, was established with government backing, including early support from BNDES to develop its initial aircraft models and expand production; **Braskem** (2002), Latin America's largest petrochemical company, was formed with significant financial support from BNDES; **JBS** (1953), a multinational meat processing company, used BNDES funding to finance aggressive expansion, including the acquisition of several international competitors from 2007 onward, becoming one of the largest food companies globally.[1]

The contribution of this study to the field of emerging markets finance is threefold. First, this is the first comprehensive study focusing on politically connected directors and executives in Latin America, incorporating a panel-specific dataset of 370 listed firms spanning 10 years. This dataset covers the six largest equity markets in the region, providing a representative sample for emerging markets. On average, our dataset shows that politically connected firms account for 35 % of the total sample, illustrating that political ties are a common attribute among corporations in the region.

Previous studies on politically connected firms in Latin America are scarce and limited. Notable exceptions include Arantes et al. (2024) for Brazil and Batta et al. (2014) for Venezuela. For other emerging markets, most research has relied on single-country datasets or focused on contexts characterized by dictatorial governments or extreme corruption, such as Malaysia (Hoang et al., 2022; Tee, 2018, 2019), Indonesia (Fu et al., 2017; Leuz & Oberholzer-Gee, 2006), and China (Li et al., 2015; Liu et al., 2021; Mo & Jiang, 2020; Zhang et al., 2014).

Second, we introduce two novel metrics to measure the intensity of political ties and assess their effects on firm value. Borrowing concepts from the corporate lobbying literature, we define board intensity as the ratio of politically connected directors to the total board size and the tenure of these directors within company boards. A higher proportion of politically connected directors or longer tenures reflects a greater degree of political connectedness. The concept of political intensity ties offers a novel contribution, distinguishing this study from previous research on politically connected firms from a corporate finance perspective.

Third, our empirical strategy incorporates a corporate governance quality index, which synthesizes qualitative information on core governance provisions. These provisions include the composition of board committees with outside directors, executive performance compensation schemes, CEO/COB role separation, and the proportion of independent directors. By including this index, we mitigate potential omitted variable bias in the firm value regressions, capturing the overall effects of firm-specific best practices in addition to political ties.

Representative studies on political ties and firm performance often overlook the intensity dimension of political connections and fail to comprehensively control for corporate governance provisions (Chaney et al., 2011; Niessen & Ruenzi, 2010; Shin et al., 2018; Wong & Hooy, 2018).

This study examines the determinants of firm value, focusing on firm political connections, corporate structure, corporate governance, institutional context, and firm-specific financial variables. The measurements of political connections include both binary and continuous variables, which are assessed based on the presence of politically connected individuals (hereafter, PCI), their roles as directors (PCDs) or officers (PCOs), the intensity (proportion) of PCDs on the board, and the tenure of PCDs.

Information about political connections was meticulously hand-collected from the biographies of current and former top executives and directors. The baseline estimates of firm value are derived from dynamic panel data (DPD) regression models, employing the Arellano/Bover and Blundell/Bond specifications and the generalized method of moments (GMM) estimator. This approach effectively controls for endogeneity bias by incorporating dynamic lags of potentially endogenous explanatory variables on the right-hand side of the regression equation.

The study provides the following key findings: i) a positive impact of political connections on firm value in emerging markets, particularly through the presence of politically connected directors; ii) a positive effect of the intensity of politically connected directors on boards; and iii) the moderating role of the tenure of politically connected directors, indicating that these effects are more pronounced in the short term.

The remainder of this article is organized as follows: Section 2 presents the analytical framework and develops the working hypotheses. Section 3 discusses the dataset and the methodology for the baseline regression estimates. Section 4 provides the study's results and discussion. Section 5 concludes.

2. Theoretical framework and hypotheses

2.1. The emerging Americas (Latin America) institutional context

Latin America offers a unique setting to evaluate the effect of political connections on businesses, serving as a representative case study of emerging markets. Key aspects that make Latin American countries particularly interesting include: i) the institutional context, ii) political systems, iii) economic and market development, and iv) corruption.

[1] To provide perspective on the role of financial development institutions in the region, by the end of 2023, **BNDES (Brazilian Development Bank)** had an outstanding loan portfolio of approximately **USD 94 billion**, based on exchange rates and recent disclosures. In comparison, the **Inter-American Development Bank (IDB)**, the primary multilateral financial institution for the region, reported outstanding loans totaling around **USD 100 billion**. The most representative acquisition by JBS was the purchase of Swift & Company, a major U.S.-based meat processing firm, for $1.4 billion in 2007.

Regarding the political system, there are notable similarities among countries in the region. Key characteristics include a civil law legal system, presidential systems, weak political parties, and fragmented parliaments. The civil law structure is based on written codes and laws, which define rights and duties (La Porta et al., 1998). Presidential systems grant significant power to the president (executive branch), although the president must negotiate with the parliament to pass laws. Historically, it has been rare for Latin American presidents to have direct parliamentary majorities (Jiménez Badillo, 2007) because the executive and legislative elections are separate, and political parties are generally weak. Law approvals typically require negotiations between the executive and legislative branches before a law is passed.

Additionally, the fragmentation of parliaments gives considerable power to individual parliamentarians, unlike the limited role they play in parliamentary systems (e.g., in Europe). Consequently, political parties and parliaments have limited influence, which is often determined by their relationships with the executive branch. In this environment, firms benefit from establishing connections with government officials and parliamentarians to secure favorable positions in laws, public policies, and access to public procurement, a feature common across most Latin American countries. Unlike in parliamentary systems, in presidential systems political party affiliation is not as significant for individuals (Cooper et al., 2010). The key factor is the role of the individual within the branches of public power.

In terms of capital market development, Latin America lags behind regions like the United States, Western Europe, or Asia/Pacific. However, market capitalization represents around 50 % of GDP across the region, and public companies have a substantial impact on the economy as shown in Fig. 1.

Regarding corruption, five out of the six countries in our dataset (except Chile) rank below the average corruption level according to Transparency International (average score of 43 in 2021). The average score for the six countries in the sample during 2019–2021 is 41.8/100. The highest corruption index in the sample is observed in Mexico, while Chile shows the lowest level. Studies from countries with higher levels of corruption have shown a positive effect of political connections on firms' financial outcomes (Leuz & Oberholzer-Gee, 2006).

2.2. Hypotheses development

Corporate finance studies have defined a politically connected firm (PCF, henceforth) as one that has at least one political tie through a top executive officer, director, or major shareholder (Chaney et al., 2011; Faccio, 2006, 2010). This definition also includes firms that have contributed funds to political campaigns (Cooper et al., 2010). To be considered a politically connected individual (PCI, henceforth), a person must hold a significant political position in the executive or legislative branches, such as (but not limited to) heads of state, prime ministers, government ministers, or members of the national parliament (Faccio, 2006). This classification also extends to their close relatives (Goldman et al., 2009). Firms may actively seek political ties for various reasons, including direct and indirect benefits through laws or government decisions. These benefits can take the form of tax advantages, preferential bailout conditions, easier access to credit, lower interest rates, and favorable contracts.

In this context, we develop our working hypotheses based on three strands of literature in corporate finance and economics that are related but not necessarily intertwined. The first strand, referred to here as the corporate finance view, examines the causes and effects of politically connected firms, building on and extending the work of (Faccio, 2006). Her study addresses two core questions: what are the common characteristics of countries with politically connected firms, and whether these connections enhance firm value. Her findings indicate that politically connected firms are more likely to exist in highly corrupt environments. Moreover, these connections generate significant stock returns when a large shareholder or top executive enters politics. A similar effect is observed when a politician or high-profile technocrat is appointed to a firm's board.

These characteristics are evident in the Latin American context, as illustrated by examples from our dataset. The family of former Chilean president Sebastián Piñera (R.I.P.) controlled LATAM Airlines Group until 2014, when he was elected president. Another example is Julio Ponce Lerou, the son-in-law of former dictator Augusto Pinochet and a prominent Chilean businessman with substantial involvement in the mining sector. He served as the chairman of Sociedad Química y Minera (SQM) from 1987 to 2015. In our dataset, Ponce Lerou appears as a busy director, holding multiple board positions simultaneously, predominantly within mining companies.

Representative studies following Faccio's (2006) framework test differences in key financial variables, as well as the operational and market performance of politically connected versus non-connected firms. Key variables under analysis include leverage and valuation (Faccio, 2010), differences in the cost of debt (Chkir et al., 2020; Li & Wang, 2016), firm payout policies (López-Iturriaga & Santana Martín, 2019), and corporate overinvestment in sectors such as banking (Chahal & Ahmad, 2020) and energy (Yu et al., 2020). Other studies explore the characteristics of politically connected directors. For instance, (Shin et al., 2018) examine the appointment of outside politically connected

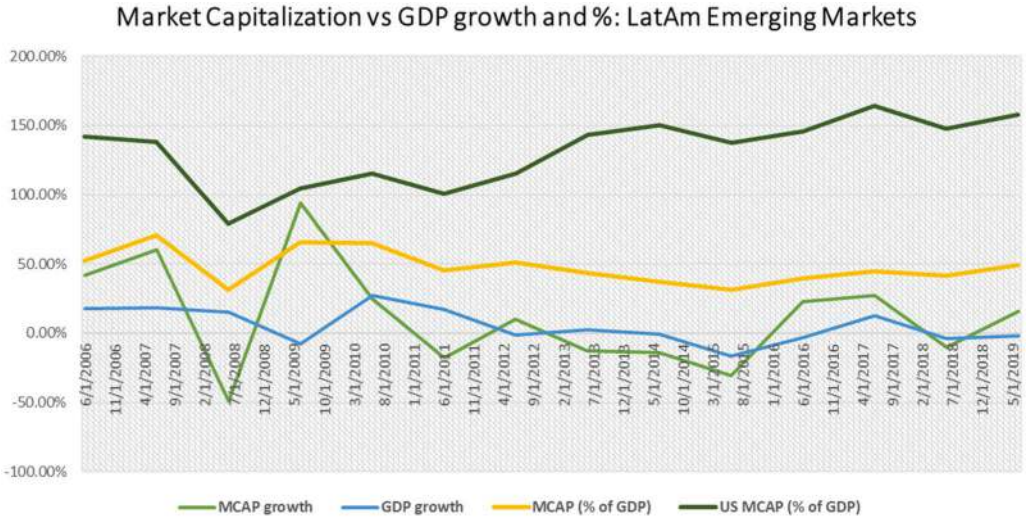

Fig. 1. Market Capitalization vs. GDP growth and percentage in LatAm vs US. Source: World Bank economic indicators.

directors in Korea, finding that firms with a higher number of such directors exhibit better operating performance and lower risk, but also weaker monitoring capabilities.

Overall, the findings of these studies suggest that firms with politically connected individuals on their boards or among their executives tend to experience enhanced firm value. One mechanism is that political ties provide firms with competitive advantages, including easier access to financing, preferential treatment in government contracts, and regulatory flexibility. Politically connected firms thus enjoy a buffer against market risks, which can make them more attractive to investors despite potential inefficiencies. For instance, (Goldman et al., 2009) find that a portfolio of companies classified as having a Republican-leaning board significantly outperforms a portfolio of companies classified as having a Democratic-leaning board within S&P 500 firms following elections. Similarly, Faccio (2010) observes that connected firms across a sample of 47 countries exhibit strong market power, which offsets accounting underperformance measured by return on assets. Additionally, (Liu et al., 2021) find that in China, political connections provide firms with access to reliable political information, mitigating policy uncertainty risks.

Political ties may also foster firms' R&D efficiency. While evidence suggests that firms with former politicians on their boards invest less in R&D than their counterparts, their presence is positively associated with an increase in patent applications (Díaz-Díaz et al., 2022).

Studies on board diversity in corporate finance introduce the dimension of directors' social and professional ties, which strengthen the board members' monitoring and advisory roles in reducing agency costs and enhancing internal corporate governance mechanisms. These attributes, combined with directors' human capital (e.g., educational qualifications) and reputation, collectively define a firm's overall board capital. This, in turn, contributes to the development of more diverse and professional boards within organizations. Research on board capital has demonstrated a positive impact of its components on firm value (Pombo & De La Hoz, 2021) and board effectiveness (Sanchez-Famoso et al., 2020). The concept of social capital encompasses ties to entities, personal relationships, and status or prestige (Johnson et al., 2013).

Institutional economic theory posits that firms have both economic and political opportunities (North, 1990). In robust institutional contexts, firms typically prioritize economic opportunities. However, in weaker institutional environments, such as those prevalent in Latin America, political opportunities become more appealing. In these settings, firms often deploy non-market strategies, including corporate political activity, to influence or manage political entities for their benefit (Lux et al., 2011).

The corporate governance literature classifies countries by legal origins into three civil law traditions (French, German, and Scandinavian) and one common law tradition (English) (La Porta et al., 1998, 2008). This body of work emphasizes that common law regimes provide stronger investor protections, fostering corporate value and promoting the development and deepening of capital markets.

Our data sample consists of six major Latin American countries that follow French civil law systems. To analyze these countries, we adopted the categorization proposed by Fainshmidt et al. (2018), which integrates various dimensions—state, financial markets, human capital, social capital, and corporate governance institutions—providing valuable insights. This classification differentiates between regulatory, developmental, predatory, and welfare states, as well as institutional systems such as family-led and state-led, effectively capturing the institutional diversity of the region. Fainshmidt's institutional classification has been widely applied in recent corporate governance studies to account for country-specific institutional systems within emerging markets. Notable examples include (Almarayeh et al., 2024), who examined earnings management and board effectiveness in MENA markets; Hearn et al. (2024), who investigated the relationship between business group ownership and the adoption of Anglo-American shareholder value governance codes by constituent firms in African markets; and Mertzanis et al. (2024), who analyzed the impact of sustainable investment conditions on firm performance in Middle Eastern and North African markets.

Within this framework, Brazil and Argentina exhibit greater centralized state dominance, while Chile and Mexico are characterized by stronger regulatory institutions. Furthermore, family-led institutional systems are predominant in Brazil, Colombia, Mexico, and Peru. This categorization provides a solid foundation for understanding country-level variations in political connectedness across the region.

Consequently, based on the conceptual framework and empirical findings discussed above, we propose the following hypothesis:

H1: *The presence of political connections generates a firm value premium, evidenced by a positive marginal effect on firms' Tobin's Q ratios in markets where the institutional context enhances political opportunities, as is the case of Americas emerging markets.*

Informational lobbying theory explores how interest groups and firms provide valuable information to policymakers in exchange for favorable regulatory or policy outcomes. This theory posits that lobbying activities primarily serve as a channel for transferring information from firms to regulators, particularly in complex or specialized industries.

Early contributions to this theory, such as those by Grossman and Helpman (1994), highlight that lobbying is not solely about exerting influence but also about informing policymakers who often lack complete knowledge of industry-specific issues. Their model suggests that policymakers are more likely to adopt positions favorable to lobbyists when those positions are supported by credible information, especially in contexts of informational asymmetry.

Ellis and Groll (2020) extend this work by proposing a signaling lobbying model, arguing that informational lobbying is most influential in environments where regulators face high demands but limited resources. In such settings, regulators become more receptive to external information, particularly when corporations seek subsidies or public grants. Empirical evidence further supports this claim, showing a positive association between lobbying activities and the receipt of grants, especially when firms provide detailed insights into the technical aspects of their projects or industries (Unsal, 2020).

Empirical studies on the relationship between corporate lobbying and firm value show mixed results, particularly among U.S.-listed firms. [2] Directors, in their stewardship roles of counseling and advising management, provide valuable resources through their networks, which align with the company's strategy in response to market and institutional changes (Hillman et al., 2000; Hillman & Dalziel, 2003).

Lobbying expenditures enhance firms' growth opportunities by influencing changes in market and product regulations. Under this view, some studies report a positive return on lobbying. For instance, Kang (2016) reports average returns of 136 % on lobbying expenditures for energy companies. Ernst et al. (2014) find significant tax benefits for lobbying firms, noting a reduction of approximately 1.5 % in corporate tax rates associated with a 1 % increase in lobbying expenditures from the prior year. Similarly, Chen et al. (2015) report that portfolios of firms with the highest lobbying intensities significantly outperform their benchmarks by 5.5 % in excess returns over three years. Girard et al. (2023) estimate a positive elasticity of 6 % between lobbying spending intensity and firms' Tobin's Q. However, this relationship is non-linear; relative lobbying expenditures are positively associated with firm performance when a firm's relative lobbying intensity is between 4.5 and 15 times the industry average.

Aligned with the informational view of lobbying and the observed relationships between firm value and corporate political spending, we propose the following hypothesis:

[2] Data on corporate lobbying expenditures is subject to mandatory disclosure under the Lobbying Disclosure Act of 1995, which requires lobbyists to report this information to the U.S. Senate.

H2: *Higher intensity of political connections, as indicated by the number and tenure of politically connected directors, has a positive marginal effect on firm market value measured through the Tobin's Q.*

This hypothesis underscores the importance of the intensity of political connectedness in our context, characterized by the number and tenure of politically connected directors (PCDs). Firms with a greater number of PCDs or longer PCD tenures are expected to leverage these deeper connections to achieve improved financial outcomes".

The next section describes the dataset's characteristics, the variable definitions included in the baseline empirical specification, and their relationship with studies in the corporate governance literature, with an emphasis on emerging markets.

3. Data and methodology

3.1. Database description

The database for this study includes firms from six emerging market countries in the Americas: Argentina, Brazil, Chile, Colombia, Mexico, and Peru. It covers 372 firms over the period 2010–2019. Data sources include LSEG Workspace and hand-collected information on officers' and directors' biographies, focusing on education and expertise. Firms in the banking and healthcare sectors were excluded due to their distinct regulatory environments.

Previous studies have adopted various approaches to measure political connections. For example, Fisman (2001) and Leuz and Oberholzer-Gee (2006) use social network closeness to examine its impact on debt performance or stock prices. Other studies measure connections through campaign contributions (Cooper et al., 2010), political roles such as prime minister (Faccio, 2006), or shareholder ties (Tahoun, 2014). In Germany, Niessen and Ruenzi (2010) used monetary compensation to politicians, while in China, Li et al. (2015) analyzed state ownership as a unique form of connection. A politically connected director dummy was employed in an industry-specific study by Agrawal and Knoeber (2001).

This study defines politically connected individuals (PCIs) as those who currently or formerly held roles such as parliamentarian, minister, or head of state or government, at national or regional levels. It also includes individuals linked to state entities like the military or central banks (Cooper et al., 2010; Faccio, 2006, 2010).

In the firm context, we differentiate between politically connected directors (PCDs) and officers (PCOs) using dummy variables. These are assigned a value of one if the firm has at least one PCI serving as a director or officer, respectively, and zero otherwise.

We also measure tenure and intensity of PCI involvement. Tenure refers to the average number of years PCDs have served as directors, while intensity represents the percentage of PCDs relative to the total number of directors in a firm-year observation.

The dependent variable is Tobin's Q, which represents the market valuation of a firm. A higher Tobin's Q indicates greater expectations of the firm's future cash flows, growth opportunities, and asset value. The independent regressors set includes three groups of variables: i) political connections variables, as explained above; ii) financial and other firm-level controls, including a corporate governance index; and iii) institutional context variables.

Among financial and firm-level controls, we follow prior literature on corporate governance and firm value. Variables include board size (Dávila-Velásquez & Lagos-Cortés, 2020; Issarawornrawanich, 2015), attributes of corporate governance quality, firm experience as the number of years public, asset turnover, leverage, firm size as log of total assets (Ararat et al., 2017; Black et al., 2017; Black & Kim, 2012), and control contestability (Jara et al., 2019; Maury & Pajuste, 2005; Tahoun, 2014).

We group information on corporate governance practices into an index comprising the following provisions: i) CEO/COB separation, ii) corporate governance committee, iii) nominations committee, iv) audit committee, v) compensation committee, vi) a policy ensuring adequate board experience, vii) the presence of at least one independent director, and viii) a performance-oriented executive compensation policy. Each provision is represented by a dummy variable equal to one if implemented and zero otherwise. This index reflects the overall quality of corporate governance and follows established methodologies in the literature (Ararat et al., 2017; Black et al., 2017; Gompers et al., 2003; Spencer Stuart, 2018a, 2018b).

Institutional context variables are included to account for differences across countries in the sample and to enhance robustness in the estimations. GDP per capita is incorporated as an economic indicator (Doidge et al., 2007) to control for country characteristics. Following Fainshmidt's (2018) classification, dummy variables capture direct state dominance and institutional context variety. For countries classified as Regulatory, the dummy variable *Regulatory* equals one, while a separate dummy, *Family Led*, equals one for countries predominantly characterized by family-led contexts.

We also include the World Bank Governance Indices (WBGI) as additional country-specific institutional variables. These indices account for country-level differences in various governance conditions. They are advantageous for estimations due to their continuous nature and annual updates. Our models incorporate regulatory quality, political stability, and government effectiveness indices. The WBGIs have been widely used as country-level institutional controls in corporate finance studies, particularly for emerging markets and Latin America (Alvarez et al., 2018; Pombo et al., 2024).

Full specifications for variable calculations, expected relationships, and supporting literature are detailed in Table A1 in Appendix A.

3.2. Model specification

We address the potential endogeneity in the firm-value (Tobin's Q) baseline regressions by using the two-step difference generalized method of moments (GMM). Following the literature, we consider an auto-regressive model that accounts for all the controls and industry fixed effects (Bover & Arellano, 1997). Also, the specifications consider the lagged dependent variable as endogenous (Hauk & Wacziarg, 2009). The method includes also as instruments the set of strictly exogenous, endogenous, and predetermined variables both contemporary and lagged (Blundell et al., 2001; Bover & Arellano, 1997). This estimator has been extensively used in financial economics research, and interest in this methodology has recently increased (Abu Afifa et al., 2024; Areneke et al., 2022; Girard et al., 2023; Khandelwal et al., 2020; Orazalin & Mahmood, 2021)

The choice of the internal instruments must fulfill the relevance and the exclusion (or moment) conditions. To evaluate the quality of our instrumentation we retrieve the two GMM standard tests. While the Sargan test estimates the joint validity of the instruments (Arellano, 2002), the Arellano−Bond test for AR2 evaluates the second order auto-correlation of residuals.[3]

The system-GMM models we use follow the next specification:

$$y_{it} = \sum_{j=1}^{p} \alpha_j y_{i,t-j} + x_{it}\beta_m + w_{it}\beta_n + v_i + \varepsilon_{it}, \ \textit{where } i = 1, 2, \ldots, N \textit{ and } t = 1, \ldots, T \tag{1}$$

Where α_j are p parameters to be estimated; x_{it} is a $1 \times k_m$ vector of strictly exogenous covariates; β_1 is a $k_m \times 1$ vector of m parameters to be estimated; w_{it} is a $1 \times k_n$ vector of predetermined and endogenous covariates; β_2 is a $k_n \times 1$ vector of n parameters to be estimated; v_i are

[3] System-GMM estimator is widely used in financial economics and corporate governance studies Some recent papers in corporate finance with GMM system estimates are found in Abu Afifa et al. (2024), Areneke and Tunyi (2022), Girard et al. (2023), Khandelwal et al. (2020), Orazalin and Mahmood (2021).

the panel level effects which may be correlated with the covariates; ε_{it} are i.i.d. over the whole sample with variance σ_{ε}^2.

4. Econometric results

4.1. Descriptive statistics analysis

Table 1 provides a summary of the descriptive statistics for the research variables, with several noteworthy observations. First, politically connected firms (PCFs) constitute 35 % of the sample. Additionally, 31 % of firms have at least one politically connected director (PCD), while only 12 % have at least one politically connected officer (PCO). Second, the average proportion of PCDs on boards is 9 %, equivalent to approximately one PCD on an average board of ten members. However, there are cases with extreme structures where the entire board is composed of PCDs. The mean (median) board size is 11 (9) directors, aligning with findings from other studies on board composition in Latin America (Pombo & De La Hoz, 2021).

Third, the adoption of corporate governance measures in Latin American firms remains low. The analysis of widely accepted provisions reveals that the most implemented measure is the audit committee, present in 75 % of firms, often because it is mandatory. However, other governance practices fail to reach an adoption level of 50 %.

Regarding the institutional context, there are two distinct types of variables: the World Bank indicators and Fainshmidt's classification indicators. The World Bank indicators reveal a low level of political stability in the region, with a negative mean of −0.21. Moreover, the rule of law shows a mean of 0.11, which is lower than that of government effectiveness. These indicators account for the differences among countries in the sample. The regulatory category applies to 72 % of firm-year observations, while the family-led variety is observed in 61 % of the sample.

Table 1
Descriptive statistics of variables in the total sample.

	Mean	StD	Min	perc 50	Max	N
Tobin's Q	1.15	0.93	0.06	0.89	5.70	2653
Political connections variables						
Politically Connected Firm (PCF)	0.35	0.48	0.00	0.00	1.00	2653
Politically Connected Director Dummy (PCD)	0.31	0.46	0.00	0.00	1.00	2653
Politically Connected Officer Dummy (PCO)	0.12	0.32	0.00	0.00	1.00	2653
Intensity PC into the Board	0.09	0.18	0.00	0.00	1.00	2653
PCD's Tenure (LN)	0.53	0.94	0.00	0.00	4.13	2653
Financial and other firm-level controls						
Age (Incorporation, LN)	2.84	0.80	0.40	3.03	4.17	2565
Herfindahl differences	0.17	0.21	0.00	0.07	0.99	1712
Corporate Governance Index	1.34	0.48	0.00	1.39	2.20	1390
Board Size (LN)	2.41	0.33	1.61	2.30	3.22	1390
Firm's Size	6.93	2.03	1.38	7.12	11.20	2653
Assets Turnover	0.65	0.45	0.00	0.59	2.41	2322
Leverage (D/A)	0.25	0.17	0.00	0.25	0.70	2653
Institutional context variables						
GDP per capita (LN)	9.30	0.29	8.56	9.33	9.66	2653
Country Rule of Law	0.11	0.75	−0.87	−0.20	1.35	2161
Country Political Stability	−0.21	0.48	−1.40	−0.26	0.45	2161
Country Government Effectiveness	0.24	0.55	−0.50	−0.03	1.18	2161
Regulatory category	0.72	0.45	0.00	1.00	1.00	2653
Family Led variety	0.61	0.49	0.00	1.00	1.00	2653
Corporate Governance Provisions						
Corporate governance committee	0.23	0.42	0.00	0.00	1.00	1072
Nominations committee	0.17	0.38	0.00	0.00	1.00	1072
Audit committee	0.75	0.43	0.00	1.00	1.00	1072
Compensation committee	0.38	0.49	0.00	0.00	1.00	1072
Director selection linked to experience	0.23	0.42	0.00	0.00	1.00	1072
CEO/COB Separation	0.29	0.46	0.00	0.00	1.00	1072
Executive compensation linked to performance	0.48	0.50	0.00	0.00	1.00	1072

Notes: i.) The table shows the summary of statistics of variables included in the baseline econometric specifications. **ii.)** The number of non-missing values varies across the database due to the lack of information. Variable definitions are in Table A1 in the appendix.

Table 2 presents the mean values for the full set of variables, broken down by country and political connection classification. This composition reflects the market size of each country. The most represented countries are Chile and Brazil, while Colombia has the smallest subsample. Politically connected firms (PCFs) are fewer than non-politically connected firms (NPCFs) in every country except Brazil, where PCFs constitute approximately 60 % of the sample. Colombia has the second-highest proportion of PCFs (43 %), whereas Chile exhibits the lowest ratio of PCFs (20 %).

Across the countries in the sample, PCFs generally display higher average levels of corporate governance quality, size, efficiency, and leverage. Conversely, they tend to have smaller boards of directors and, in practice, show no significant differences from NPCFs in terms of control contestability (Herfindahl differences) or age. As shown in Table A2 in Appendix A, the mean differences between PCFs and NPCFs are statistically significant in terms of the dependent variable (Tobin's Q), corporate governance quality, firm size, and leverage.

Some relevant aspects of corporate governance quality provide insights into firms' decisions regarding the selection of board directors and officers. The two most widely adopted corporate governance provisions are: (i) independent directors, implemented by 91 % of firms, and (ii) the audit committee, adopted by 75 % of firms. In contrast, the least implemented recommendations are the nominations committee (17 %), the corporate governance committee (23 %), and policies linking director selection to experience (23 %). Both of these latter provisions are directly related to the selection of directors and officers.

The nominations committee, in particular, is responsible for overseeing the assessment process for filling new directorships and CEO positions. The low level of adoption of these practices may indicate a lack of formality in assessing candidates' profiles, lower quality in the selection of directors and officers, or the absence of explicit policies governing these processes. Full descriptive statistics for corporate governance measures are presented in Table 1.

The correlations presented in Tables A3[1] and A3[2] in Appendix A reveal several key insights. First, Tobin's Q exhibits significant correlations with certain financial variables, such as asset turnover (positively) and firm age (negatively). These findings suggest that the market rewards strong operational performance while placing a lower premium on older firms. Second, political connection variables—including politically connected firms (PCFs), politically connected directors (PCDs), and the tenure of PCDs—show positive correlations with both Tobin's Q and the Corporate Governance Quality Index. This indicates that political connections may enhance internal corporate governance mechanisms, which the market perceives favorably. Third, firm size is positively correlated with corporate governance quality, suggesting that larger firms are more likely to adopt higher-quality governance practices. Moreover, firm market value exhibits strong correlations with institutional context indices, such as rule of law, political stability, and government effectiveness, as well as with the regulatory state dummy. Additionally, Tobin's Q is positively correlated with the family-led economic variety, highlighting the market's favorable perception of this governance structure.

4.2. Baseline regressions

Table 3 presents the core results of the system GMM regressions for Eq. (1). The results of the base empirical model include two different specifications: (i) DPD with all regressors specified as predetermined,

Table 2
Frequency and mean of variables by country and type of politically connected firms.

	N	Perc.	Tobin's Q	PCF	PC Director	PC Officer	Intensity PCD	PCDs' Tenure	Age (Incorp)	Herfindahl differences	Corporate Governance Index	Board Size (LN)	Firm's Size	Assets Turnover	Leverage (D/A)
Firms by Country and type of connections															
Argentina															
Non PCF	101	0.04	0.87	0.00	0.00	0.00	0.00	0.00	2.63	0.30	1.03	2.55	5.74	0.93	0.23
PCF	44	0.02	1.91	1.00	0.91	0.25	0.25	1.37	2.84	0.20	1.57	2.57	7.93	0.77	0.23
Total	**145**	**0.05**	**1.18**	**0.30**	**0.28**	**0.08**	**0.08**	**0.42**	**2.69**	**0.25**	**1.20**	**2.56**	**6.40**	**0.88**	**0.23**
Brazil															
Non PCF	248	0.09	1.45	0.00	0.00	0.00	0.00	0.00	2.35	0.19	1.23	2.24	7.01	0.58	0.28
PCF	348	0.13	1.32	1.00	0.91	0.38	0.27	1.43	2.65	0.11	1.49	2.38	8.34	0.71	0.31
Total	**596**	**0.22**	**1.37**	**0.58**	**0.53**	**0.22**	**0.16**	**0.84**	**2.52**	**0.14**	**1.41**	**2.34**	**7.79**	**0.66**	**0.30**
Chile															
Non PCF	684	0.26	0.96	0.00	0.00	0.00	0.00	0.00	3.02	0.18	1.01	2.23	5.61	0.56	0.22
PCF	201	0.08	1.01	1.00	1.00	0.16	0.32	1.72	3.19	0.18	1.20	2.29	7.95	0.58	0.27
Total	**885**	**0.33**	**0.98**	**0.23**	**0.23**	**0.04**	**0.07**	**0.39**	**3.06**	**0.18**	**1.12**	**2.27**	**6.14**	**0.57**	**0.23**
Colombia															
Non PCF	20	0.01	0.60	0.00	0.00	0.00	0.00	0.00	3.54	0.29	2.05	2.09	7.65	0.33	0.16
PCF	30	0.01	1.25	1.00	0.97	0.57	0.51	1.53	3.06	0.35	1.97	2.18	9.34	0.51	0.25
Total	**50**	**0.02**	**0.99**	**0.60**	**0.58**	**0.34**	**0.31**	**0.92**	**3.25**	**0.33**	**1.99**	**2.16**	**8.66**	**0.44**	**0.21**
Mexico															
Non PCF	397	0.15	1.35	0.00	0.00	0.00	0.00	0.00	2.81	0.12	1.54	2.66	7.93	0.75	0.24
PCF	159	0.06	1.55	1.00	0.77	0.31	0.14	1.28	2.56	0.17	1.54	2.62	8.31	0.66	0.29
Total	**556**	**0.21**	**1.41**	**0.29**	**0.22**	**0.09**	**0.04**	**0.37**	**2.74**	**0.13**	**1.54**	**2.65**	**8.04**	**0.73**	**0.25**
Peru															
Non PCF	272	0.10	0.81	0.00	0.00	0.00	0.00	0.00	2.96	0.17	0.89	2.03	5.48	0.74	0.20
PCF	149	0.06	1.04	1.00	0.79	0.44	0.25	1.65	2.93	0.19	1.10	2.29	6.69	0.50	0.21
Total	**421**	**0.16**	**0.90**	**0.35**	**0.28**	**0.16**	**0.09**	**0.58**	**2.95**	**0.18**	**1.05**	**2.23**	**5.91**	**0.65**	**0.21**
Total															
Non PCF	1722	0.65	1.09	0.00	0.00	0.00	0.00	0.00	2.84	0.17	1.28	2.43	6.36	0.66	0.23
PCF	931	0.35	1.27	1.00	0.89	0.33	0.26	1.50	2.82	0.16	1.40	2.39	8.00	0.64	0.28
Total	**2653**	**1.00**	**1.15**	**0.35**	**0.31**	**0.12**	**0.09**	**0.53**	**2.84**	**0.17**	**1.34**	**2.41**	**6.93**	**0.65**	**0.25**

Notes: i.) This table displays the mean, the frequency distribution, and the median values of all variables included in the empirical model by country and type of politically connected firm; PCF stands for political connected. Variable definitions are in Table A1 in the appendix.

Table 3
System GMM panel regressions.

Dependent variable, y=Tobin's Q $_{it}$	(1a) Predetermined	(1b) Endogenous	(2a) Predetermined	(2b) Endogenous	(3a) Predetermined	(3b) Endogenous
Political connections variables						
Politically Connected Firm$_{it}$	0.226***	0.233***				
	(0.062)	(0.071)				
Intensity PC into the Board$_{it}$			0.347**	0.294*		
			(0.148)	(0.161)		
Politically Connected Officer$_{it}$					0.129*	-0.017
					(0.070)	(0.080)
Politically Connected Director$_{it}$					0.156**	0.190***
					(0.064)	(0.072)
Financial and other firm-level controls						
Age (Incorporation)$_{it}$	0.086**	0.120***	0.093**	0.127***	0.043	0.088**
	(0.040)	(0.043)	(0.043)	(0.045)	(0.038)	(0.042)
Herfindahl differences$_{it}$	0.256	-0.075	0.443**	-0.038	0.381**	-0.028
	(0.180)	(0.209)	(0.175)	(0.199)	(0.172)	(0.201)
Corporate Governance Index$_{it}$	0.281***	-0.146	0.325***	-0.090	0.186**	-0.069
	(0.083)	(0.096)	(0.081)	(0.094)	(0.079)	(0.091)
Board Size (LN)$_{it}$	-0.160	-0.071	-0.173*	-0.168	-0.114	-0.057
	(0.106)	(0.119)	(0.104)	(0.120)	(0.103)	(0.118)
Firm's Size$_{it}$	-0.041	-0.073*	-0.031	-0.067	0.015	-0.016
	(0.038)	(0.041)	(0.039)	(0.041)	(0.036)	(0.038)
Assets Turnover$_{it}$	0.631***	0.298***	0.589***	0.297***	0.574***	0.283***
	(0.086)	(0.091)	(0.084)	(0.091)	(0.082)	(0.089)
Leverage (D/A)$_{it}$	-0.178	-0.294*	-0.072	-0.298*	-0.086	-0.155
	(0.167)	(0.166)	(0.170)	(0.169)	(0.162)	(0.164)
Institutional context variables						
GDP per capita (Ln)$_{jt}$	-0.150	0.049	-0.078	0.029	-0.145	0.021
	(0.117)	(0.121)	(0.115)	(0.118)	(0.116)	(0.121)
Country Rule of Law$_{jt}$	0.064	-0.203*	0.010	-0.210**	-0.018	-0.235**
	(0.097)	(0.108)	(0.095)	(0.105)	(0.096)	(0.108)
Country Political Stability$_{jt}$	-0.295***	-0.216**	-0.317***	-0.223***	-0.316***	-0.162*
	(0.084)	(0.086)	(0.084)	(0.084)	(0.083)	(0.086)
Country Government Effectiveness$_{jt}$	0.260**	0.468***	0.244**	0.463***	0.307***	0.409***
	(0.102)	(0.103)	(0.099)	(0.100)	(0.101)	(0.105)
Regulatory category$_{j}$	-0.277***	-0.293***	-0.260***	-0.232***	-0.280***	-0.287***
	(0.083)	(0.081)	(0.082)	(0.081)	(0.080)	(0.081)
Family Led variety$_{j}$	0.531***	0.626***	0.433***	0.569***	0.458***	0.359**
	(0.125)	(0.143)	(0.122)	(0.140)	(0.122)	(0.141)
Tobin's Q$_{i,t-1}$	0.582***	0.570***	0.569***	0.551***	0.582***	0.601***
	(0.025)	(0.027)	(0.026)	(0.027)	(0.025)	(0.027)
Number of observations	914	914	914	914	914	914
Number of groups	145	145	145	145	145	145
χ^2	11162.170	10552.038	11312.523	10725.956	11241.607	10222.783
Sum of squared differenced residuals	170.084	165.697	166.600	161.428	169.662	172.183
Sargan statistic	787.970	647.424	794.354	646.873	843.472	693.478
Estimate of $(\sigma_\varepsilon)^2$	0.115	0.112	0.113	0.110	0.115	0.117
arm1	-4.913	-5.219	-4.906	-5.111	-4.928	-5.272
arm2	0.001	-0.086	-0.006	-0.078	-0.069	-0.028

Notes: i.) Standard errors in parenthesis. **ii.)** Significance stars: * p < 0.10, ** p<0.05, ***p<0.01. **iii)** All estimations were performed through system gmm data panel estimator. **iv.)** Models 1a, 2a and 3a assume independent regressor as predetermined, on the other hand, models 1b, 2b and 3b assume independent regressors as endogenous. **v.)** All models incorporate industry and institutional context effects as shown in each case.

and (ii) DPD with all regressors specified as endogenous.

There are three baseline regressions: (i) using the PCF dummy, (ii) using the intensity of politically connected directors (PCDs) on the board, and (iii) using the officer and director dummies. The following sections analyze the main results of the estimated models. The results indicate that PCFs outperform their NPCF peers across different specifications. Firms with politically connected individuals enjoy a market premium of approximately 22–23 % over their peers, as demonstrated in models 1a and 1b. Furthermore, increasing the participation of PCDs on the board results in a market premium of approximately 3–3.8 % for each additional director, as shown in models 2a and 2b. This corresponds to an 11 % increase in the intensity proportion for each additional PCD.

The primary effect on firm value is driven by the presence of PCDs rather than politically connected officers (PCOs). As shown in models 3a and 3b, the positive coefficient is robust across specifications only in the case of PCDs. For PCOs, the positive effect is weakly significant and does not persist when the variable is treated as endogenous.

These findings confirm and extend previous evidence from single-country studies (Batta et al., 2014; Faccio, 2006, 2010; Leuz & Oberholzer-Gee, 2006).

The regression coefficients vary according to the specifications of the political connection variables. For the dummy variable, the coefficient remains stable at approximately 0.23 across both predetermined and endogenous specifications. This indicates a 23 % market value premium, on average, for politically connected firms (PCFs) over their non-politically connected peers (NPCFs).

In terms of intensity, the regression coefficients range from 0.29 to 0.35, reflecting the presence of politically connected directors (PCDs) on the board. As one director typically represents about 11 % of board size, the premium associated with an additional PCD is approximately 3–4 %. Previous studies have primarily focused on the number of political campaign contributions by firms, rather than the impact of increasing politically connected individuals on market performance (Cooper et al., 2010).

When analyzing the roles of politically connected individuals, the

results differ slightly in magnitude. Firms with at least one PCD consistently exhibit a market value premium of 16 %. Conversely, the effect of politically connected officers (PCOs) is weakly positive but not robust to changes in model specifications. These findings support Hypothesis 1 and align with research on board relational capital and firm performance. For example, firm market value has been shown to correlate positively with directors' managerial, entrepreneurial, or public sector experience (Pombo et al., 2021). Additionally, directors' relational capital attributes help explain institutional ownership patterns in listed firms across Latin America (Pombo & De la Hoz, 2021).

Other relevant control variables offer additional insights. Firm age and operational efficiency demonstrate consistent positive effects on market value across different model specifications. However, the corporate governance index does not exhibit a consistent relationship with firm value; it is only positive and significant when considered as predetermined.

Institutional context variables also reveal important relationships. For instance, the "family-led" variety of capitalism shows a strongly positive and significant relationship across specifications, contributing a value premium of approximately 50 % to Tobin's Q levels. In contrast, the "regulatory" state model has a strongly negative effect of about −0.28. This negative effect may offset the positive influence of the family-led model in countries classified under both categories, such as Brazil, Colombia, Mexico, and Peru.

Two of the three World Bank indicators have strong effects on firm value. Political stability shows a significant negative effect, while government effectiveness positively impacts market value. The rule of law indicator does not exhibit a significant relationship.

Table 4
System GMM panel regressions with additional PC variables.

Dependent variable, y = Tobin's Q_{it}					
	PCDs Tenure		**Interactions with Corporate Governance Index**		
	(1)	(2)	(3)	(4)	(5)
Politically Connected $Firm_{it}$		0.315***			
		(0.109)			
PCD's $Tenure_{it}$	0.300***	0.177**			
	(0.075)	(0.076)			
Squared PCD's $Tenure_{it}$	−0.080***	−0.028			
	(0.026)	(0.028)			
PCD's Tenure x PCF_{it}		−0.170***			
		(0.064)			
PCF x Corporate Governance Ind_{it}			0.155***		
			(0.042)		
Intensity x Corporate Governance Ind_{it}				0.196**	
				(0.095)	
PCD's Tenure x Corporate Governance Ind_{it}					0.110***
					(0.024)
Financial and other firm-level controls					
Age (Incorporation)$_{it}$	0.102***	0.042	0.044	0.087**	0.102**
	(0.039)	(0.037)	(0.041)	(0.042)	(0.042)
Herfindahl $differences_{it}$	0.361**	0.165	0.315*	0.445**	0.382**
	(0.167)	(0.164)	(0.181)	(0.174)	(0.174)
Corporate Governance $Index_{it}$	0.279***	0.146*	0.195**	0.293***	0.108
	(0.076)	(0.076)	(0.090)	(0.085)	(0.091)
Board Size (LN)$_{it}$	−0.124	−0.129	−0.165	−0.155	−0.029
	(0.100)	(0.098)	(0.107)	(0.105)	(0.106)
Firm's $Size_{it}$	−0.065*	−0.045	0.008	−0.011	−0.069*
	(0.036)	(0.034)	(0.039)	(0.039)	(0.037)
$Assets\_Turnover_{it}$	0.648***	0.432***	0.578***	0.618***	0.758***
	(0.082)	(0.079)	(0.085)	(0.084)	(0.087)
Leverage (D/A)$_{it}$	0.074	0.073	−0.167	−0.061	−0.052
	(0.161)	(0.155)	(0.169)	(0.172)	(0.168)
Institutional context variables					
GDP per capita (Ln) $_{jt}$	−0.024	−0.159	−0.143	−0.074	−0.065
	(0.115)	(0.119)	(0.119)	(0.116)	(0.116)
Country Rule of Law_{jt}	0.039	0.103	0.001	−0.001	0.012
	(0.093)	(0.094)	(0.100)	(0.097)	(0.096)
Country Political $Stability_{jt}$	−0.299***	−0.256***	−0.264***	−0.322***	−0.330***
	(0.082)	(0.085)	(0.085)	(0.083)	(0.083)
Country Government $Effectiveness_{jt}$	0.255***	0.242**	0.281***	0.236**	0.230**
	(0.097)	(0.101)	(0.103)	(0.099)	(0.100)
Regulatory $category_{j}$	−0.288***	−0.242***	−0.306***	−0.279***	−0.275***
	(0.079)	(0.081)	(0.087)	(0.085)	(0.084)
Family Led $variety_{j}$	0.395***	0.422***	0.525***	0.465***	0.558***
	(0.120)	(0.121)	(0.126)	(0.122)	(0.125)
Tobin's $Q_{i,t-1}$	0.568***	0.616***	0.586***	0.571***	0.573***
	(0.025)	(0.025)	(0.025)	(0.025)	(0.026)
Number of observations	914	891	914	914	914
Number of groups	145	144	145	145	145
χ^2	11629.162	10802.728	10988.532	11304.697	11423.965
Sum of squared differenced residuals	163.760	171.923	172.862	167.233	166.402
Sargan statistic	840.853	923.533	761.807	781.199	779.868
Estimate of $(\sigma\_\varepsilon)^2$	0.111	0.120	0.117	0.113	0.113

Notes: i.) Significance stars *** p < .01, ** p < .05, * p < .1. **ii.)** Models 1 and 2 incorporate tenure of politically connected directors PCDs jointly with other political connection variables to estimate the effects and interactions of tenure. **iii.)** Models 3, 4 and 5 incorporate interactions of the main political connections' variables with corporate governance quality index.

Regarding the firm-specific controls such as leverage, firm size, and board size, have negative marginal effects. This suggests that politically connected boards, as well as large and incumbent firms, exhibit diminishing returns to scale. One explanation is that large firms face fewer growth opportunities, as highlighted in corporate governance literature. This body of research suggests that a firm's free cash flow often derives from intangible assets—such as reputation, branding, and know-how—rather than increased investment in fixed assets, which may boost market-to-book ratios but also risk fund diversion and tunneling by controlling shareholders (Siegel & Choudhury, 2012).

Finally, operating performance, measured by asset turnover, shows a strongly positive effect. This result aligns with expectations, as improved operational efficiency signals better expected earnings and future asset valuations, enhancing investor confidence.

All regression equations incorporate industry fixed-effects dummies to account for sector-specific variations.

Table 4 extends the empirical analysis by incorporating additional variables related to political connections into the baseline system GMM regressions. These variables go beyond the initial estimations by including the tenure of politically connected directors (PCDs) in both linear and squared terms, as well as interactions with the corporate governance quality index.

Regressions in columns 1 and 2 introduce the linear and squared terms of PCDs' tenure and the interaction between politically connected firms (PCFs) and PCDs' tenure. The results suggest a moderating effect of PCDs' tenure on firm value. The negative and significant coefficient of squared tenure indicates that the relationship between tenure and firm value forms a concave function over time.

For a firm with an average PCD tenure of three years, the linear effect on market value is 0.42. However, when the squared effect is accounted for, the total effect decreases to 0.26. When considering only marginal effects, the linear coefficient yields $\frac{dy}{dx} = 0.30$, while both linear and squared coefficients combined yield $\frac{dy}{dx} = 0.08$ at a three-year mean tenure. As average tenure increases to four years, the effect diminishes to 0.04, and by the sixth year, the marginal effect turns negative (-0.01). This indicates that the positive impact of PCDs on firm value persists for approximately 5.5 years.

These findings suggest that the benefits of newly appointed PCDs are more pronounced in the short term. For instance, a PCD may secure a favorable public project contract for the firm upon appointment, but such advantages are unlikely to be recurrent. These results support Hypothesis 2, highlighting a positive short-term effect of PCD tenure that diminishes in the long term. The moderation effect of tenure has significant implications: the novelty of PCDs on the board may initially provide better access to resources due to external political dynamics.

The regression estimates also reveal the moderating effects of political connections when corporate governance quality is considered in explaining firms' market value. The interaction between the PCF dummy and corporate governance quality shows a positive effect of approximately 0.16. This indicates that when corporate governance quality is high, PCFs enjoy an additional market value premium. Similarly, interactions between corporate governance quality and both the intensity of PCDs and PCDs' tenure yield consistent results.

For intensity, the positive and significant coefficient of 0.20 indicates that having more PCDs on the board, combined with high corporate governance standards, enhances firm value. When PCDs' tenure interacts with corporate governance quality, the average positive effect on firm value is 0.11.

The implications of these findings align with previous studies on the relationship between human capital and corporate governance (Johnson et al., 2013; Klesner, 2007; Pombo et al., 2022; Sanchez-Famoso et al., 2020). Specifically, the results demonstrate that political connections, as an attribute of directors or officers, contribute positively to firm value when combined with high-quality corporate governance.

4.3. Additional endogeneity checks

This section presents an analysis of additional checks addressing potential endogeneity biases in the relationship between political ties and firm performance. While the baseline system GMM models control for endogeneity, we also conducted treatment-control regressions to test the consistency of our results.

First, we performed a treatment-effect estimation using the nearest neighbor (NN) algorithm. This algorithm evaluates the treatment effect on the outcome variable—Tobin's Q in this case—using a weighted function of the same covariates included in the main regression models. Treatments in NN models are binary variables that allow for estimating an average treatment effect (ATE). Here, the PCF dummy is used as the treatment variable to examine the impact of a firm being politically connected (PCF = 1). Additionally, to account for the intensity of political connections, we created a separate dummy variable equal to 1 when the number of politically connected directors (PCDs) exceeds one for a given firm-year observation and 0 otherwise.

Columns 1 and 2 of Table 5 estimate the ATE of PCF versus non-PCF firms using one and two nearest neighbors, respectively. The ATE is positive and significant in both cases, indicating that politically connected firms (PCFs) enjoy a firm value premium of 0.13–0.15 compared to non-PCFs.

Columns 3 and 4 present the ATE for models where the intensity of political connections exceeds one politically connected director. The mean ATE coefficients show a significant impact on firm value, with effects ranging from 0.22 to 0.29—higher than those observed for the PCF treatment (0.13–0.15).

These findings suggest that the intensity of political ties is positively associated with greater firm value. Using the nearest neighbor treatment-effects approach, we show that under similar conditions, political connections increase firm value. Moreover, when firms have more than one politically connected director, the effect is amplified. All results are significant at the 1 % level.

The second method we employed for treatment regression is the inverse probability weighted regression adjustment (IPWRA), as introduced by Cattaneo (2010); and, Cattaneo et al. (2013). This method weights observations by the inverse of a nonparametric estimate of the propensity score, rather than the true propensity score, to produce efficient estimates of average treatment effects (Hirano et al., 2000).

As shown in Table 6 we estimated regression equations using Tobin's Q as the outcome variable, incorporating independent regressors and treatment variables through either the PCF dummy (Eq. 1) or the

Table 5
Nearest neighbor treatment effects.

Outcome: Tobin's Q				
	(1)	**(2)**	**(3)**	**(4)**
	PCF, 1 NN	**PCF, 2 NN**	**Intensity, 1 NN**	**Intensity, 2 NN**
	Politically Connected Firm (1 vs 0)		**Intensity greater than one (1 vs 0)**	
After Treatment Effect (ATE)	**0.146*****	**0.131*****	**0.289*****	**0.221*****
Robust standard error	(0.049)	(0.042)	(0.056)	(0.047)
z value	2.968	3.150	5.159	4.677
P > |z|	0.003	0.002	0.000	0.000
95 % confidence interval	[0.050 0.242]	[0.049 0.212]	[0.179 0.399]	[0.128 0.313]
N	914	914	914	914
k levels	2	2	2	2
k nneighbors	1	2	1	2

Notes: i.) After treatment effects on the Tobin's Q as the outcome variable. ii.) Significance stars *** $p < 0.01$, ** $p < 0.05$, * $p < 0.10$

Table 6
Estimations of treatment effects through Inverse Probability Weighted Regression Adjustment.

Outcome variable: Tobin's Q			
	(1) PCF, Full sample	(2) Intensity > 1, Full sample	(3) Intensity > 1 & PCF = 1
	PCF (1 vs 0)	Intensity > 1 (1 vs 0)	Intensity > 1 (1 vs 0)
Coefficient	0.119**	0.248***	0.2201**
Robust standard error	(.0548)	(.0673)	(.0941)
z value	2.17	3.68	2.34
P > |z|	0.0298	0.0002	0.0194
N	914	914	480
control	0	0	0
k_eq	5	5	5
k_levels	2	2	2
n0	377	644	210
n1	537	270	270
treated	1	1	1

Notes: i.) Models 1 and 2 were estimated in the full sample, model 3 only considers Politically Connected Firms. **ii.)** significance stars *** $p < .01$, ** $p < .05$, * $p < .1$.

intensity measure (for values greater than one, Equations 2 and 3). Eq. 1 and 2 were estimated using the full sample, while Equation 3 focused exclusively on politically connected firms.

The results reveal that after applying the treatment—whether by identifying a firm as politically connected (PCF) or as having more than one politically connected director (intensity > 1)—firm value increases significantly. Specifically, in Eq. 1, Tobin's Q increases by 12 % for firms identified as politically connected. In Equation 2, for the full sample with intensity measures greater than one, firm value increases by 25 %. Equation 3, based on the subsample of PCFs, examines the effect of being politically connected through more than one politically connected director (PCD) versus cases where the firm has only one PCD or politically connected owner (PCO). These results confirm a positive and significant market premium of 22 % for firms that are "more" politically connected compared to those with lower levels of political connections. All results are statistically significant at the 1 % level.

5. Conclusions

This study analyzed the effect of political connected directorates on firms' market value in the context of the six large Latin American capital markets. The study incorporated the institutional dimension and firm year corporate governance index. Regression estimates controls for firms' firm ownership, size and financial attributes. The empirical model on firm's Tobin's Q follows a dynamic panel data specification and GMM estimates, that control for endogeneity bias by dynamically adjusting lags of the independent variables as instruments in level and difference equations. Results are robust to two additional endogeneity and causality tests following treatment-effect estimation using the nearest neighbor (NN) algorithm and treatment regression following the inverse probability weighted regression adjustment (Cattaneo, 2010; Cattaneo, et al., 2013).

We state two hypotheses to extend previous evidence to a multi-country emerging markets environment. Both hypotheses are related to the effect of PCF condition through directors or officers, the intensity of PCDs on the board, and the effect of PCDs' tenure. The main and complementary findings confirm the positive effect of politically connected individuals on firm valuation and the intensity of PCD in the board of directors. However, effects are higher in the short term than in the long run, so tenure has a moderating role in the political connections' effects.

The first hypothesis concerning with the expected positive impact of PCF on performance was confirmed, and its coefficient remains positive and significant across different specifications of the model. This implies the presence of politically connected individuals is positive for the market participants in the studied context. Deeping into the role of politically connected individuals, we studied the effect of each role: officers and directors. There is a stronger positive effect of PCDs on performance than does not hold in the case of PCOs. So, the political connection through directors is beneficial, and not so in the case of officers. The role of directors is more related to interlocks, social capital, and external linkages to powerful entities and people. Due to the Latin American context, PCDs are a valuable resource for firms. In the case of executive officers, they are expected to be technically qualified, so their political connections are not valuable for firms.

The second hypothesis on the intensity of PCDs in the board, their results indicate a strongly positive impact. This variable represents an effort to improve political connections measurement. So, if the PCF dummy captures the benefits of being politically connected, the intensity is a continuous variable that shows a firm is more or less politically connected i.e. Firm A has an intensity of 22 % implying two PCDs in the median board, Firm B has 11 %, implying one PCD. The presence of more PCDs is positive for firms. Moreover, we analyze the effects of tenure of PCDs that proxies in another way the intensity or "amount" or "quality" of connection. Tenure as another continuous proxy of political connections has a strong positive effect. However, squared tenure has a moderating role implying effects decrease across time. Moreover, the interaction between political connection and tenure has a negative coefficient, confirming this moderating relationship PCDs have a stronger positive effect in the short run, but it is not sustainable in the long term. So, integrating marginal effects of tenure, they plot a concave function, so they tend to decrease over time.

The results have several managerial implications for real-sector companies, particularly in the context of emerging markets in general and Latin America in particular. First, political connections through directors provide resource-based value, especially in contexts characterized by explicit market risks and instability in economic policies. These directors can help moderate firm uncertainty and facilitate the implementation of long-term strategies.

Second, politically connected directors may ease access to direct public financing for export-import firms through development banks in the region. These financial institutions often offer special credit lines for private sector infrastructure financing, support for industrial productivity and innovation, SME financing to promote entrepreneurship and job creation, sustainability and social impact projects, and export promotion. In Latin America, prominent development banks include: **BNDES** in Brazil, founded in 1952, the former promotion bank **PROEXPO** in Colombia, established in 1967 (now integrated into Bancoldex), and **CORFO** in Chile, founded in 1939. Third, politically connected directors can play a key role in enabling firms to advocate—either directly or indirectly through producers' associations—for government actions, such as the implementation of trade covenants to counter foreign trade dumping. Fourth, firms may benefit from politically connected directors in securing approvals for patented products and expediting industrial protections for their branding, new designs, products, processes, and services.

Overall, the study highlights the positive role of political ties—a prime example of a non-market strategy—which can generate favorable effects on firms' market capitalization. The economic and institutional context also influences firm valuation, particularly in countries where family ownership is predominant and the state exerts significant influence on the economy and financial markets.

Declaration of Competing Interest

The authors whose names are listed immediately below certify that they have NO affiliations with or involvement in any organization or entity with any financial interest (such as honoraria; educational grants; participation in speakers' bureaus; membership, employment,

consultancies, stock ownership, or other equity interest; and expert testimony or patent-licensing arrangements), or non-financial interest (such as personal or professional relationships, affiliations, knowledge or beliefs) in the subject matter or materials discussed in this manuscript.

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Appendix A

Table A1
Variable definitions

Variable	Estimation	Expected sign	References
Tobin's Q	$Tobin's\ Q_{it} = \frac{Debt_{it} + Market\ Value\ of\ Equity_{it}}{Total\ Assets_{it}}$	Dependent	
Political connections variables			
Politically Connected Firm (Dummy)	$PC_{it} = 1 \Rightarrow$ *Firm i has at least one PC Officer or Director as of year t*	Positive	(Hoang et al., 2022; Pérez et al., 2015)
Politically Connected Officer (Dummy)	$PCO_{it} = 1 \Rightarrow$ *Firm i has at least one PC Officer as of year t*		
Politically Connected Director (Dummy)	$PCD_{it} = 1 \Rightarrow$ *Firm i has at least one PC Director as of year t*		(Tahoun, 2014)
Intensity of PCD into the Board	$Intensity\ PC\ Board_{it} = \frac{Count\ of\ PCD_{it}}{Board\ Size_{it}}$	Positive	Authors own construction
PCD Tenure	$PCD\ Tenure_{it} = Ln\left(1 + \frac{1}{n}\sum_{j=1}^{n} Tenure\ of\ PCDs_{it}\right)$		(Pérez et al., 2015)
Financial and other firm-level controls			
Board size	$BS_{it} = Ln(1 + Count\ of\ \ Directors_{it})$	Negative (n. s.)	(Agrawal & Knoeber, 2001; Dávila-Velásquez & Lagos-Cortés, 2020; Issarawornrawanich, 2015; Pombo et al., 2022)
Index of Corporate Governance Quality	$Corp.Gov.Qual_{it} = Ln\ (1 + CEO.COB.Sep_{.it} + Corp.Gov.Comm_{.it} + Nom.Comm_{.it} + Audit\ Comm_{.it} + Comp.Comm_{.it} + Policy.Board.Link.to\ Exper_{.it} + Ind.Direc_{.it} + Policy\ Exec.Comp.Link.to.Perf_{.it})$	Positive	(Ararat et al., 2017; Black et al., 2017; Black & Kim, 2012; Black et al., 2014, 2015)
Age of firm (years public)	$Age\ of\ firm_{it} = Ln(1 + Years\ of\ incorporation_{it})$	Negative (n. s.)	(Ararat et al., 2017; Black & Kim, 2012; Black et al., 2015)
Total Revenue to Total Assets	$TR\ to\ TA_{it} = \frac{Total\ Revenue_{it}}{Total\ Assets_{it}}$	Positive	(Ararat et al., 2017)
Leverage	$Leverage_{it} = \frac{Total\ Debt_{it}}{Total\ Assets_{it}}$		(Ararat et al., 2017; Black & Kim, 2012; Black et al., 2014, 2015)
Size	$Firm\ size_{it} = Ln(1 + Total\ Assets_{it})$	Positive/ Negative	(Ararat et al., 2017; Black & Kim, 2012; Black et al., 2014; 2015; Pérez et al., 2015; Jara et al., 2019; Maury & Pajuste, 2005; Pombo et al., 2022; Tahoun, 2014)
Herfindahl Differences (First three)	$HD_{it} = (Sh1_{it} - Sh2_{it})^2 + (Sh2_{it} - Sh3_{it})^2 + (Sh3_{it} - Sh4_{it})^2$	Negative	(Jara et al., 2019; Maury & Pajuste, 2005; Tahoun, 2014)
Institutional context variables			
GDP per capita	$Ln\ GDP_{jt} = Ln(1 + GDP\ Per\ Capita_{jt})$	Positive	(Doidge et al., 2007)
Worldbank indicators	Regulatory quality (RL), Political stability (PV), Government Effectiveness (GE). Indicators from World Bank.	Positive	
Regulatory category	$RC_i = 1 \Rightarrow$ *Firm i headquarters are located in a Regulatory country, and* 0 *otherwise*	Control	(Abu Afifa et al., 2024; Fainshmidt et al., 2018; Hearn et al., 2024; Mertzanis et al., 2024)
Family Led Variety	$FL_i = 1 \Rightarrow$ *Firm i headquarters are located in a Family Led country, and* 0 *otherwise*	Control	(Abu Afifa et al., 2024; Fainshmidt et al., 2018; Hearn et al., 2024; Mertzanis et al., 2024)

Table A2
T-Test of mean differences (Politically Connected vs. Non-Politically Connected firms)

	Tobin's Q (1)	Herfindahl Diff (2)	Corporate Governance Index (3)	Board size (4)	Firm Size (5)	Assets Turnover (6)	Leverage (7)
Sample size n_1 (Non Politically Connected)	1722	1024	623	623	1722	1482	1722
Sample size n_2 (Politically Connected)	931	688	767	767	931	840	931
Degrees of freedom	2651	1710	1388	1388	2651	2320	2651
Confidence level	95	95	95	95	95	95	95
x_1 mean for population 1	1.09	0.171	1.275	2.433	6.358	0.657	0.228
x_2 mean for population 2	1.273	0.162	1.397	2.388	7.998	0.635	0.276
Two-sided p-value	**0.**	0.417	**0.**	0.012	**0.**	0.265	**0.**
Lower one-sided p-value	0.	0.792	0.	0.994	0.	0.867	0.
Upper one-sided p-value	1.	0.208	1.	0.006	1.	0.133	1.
Combined std. dev.	0.932	0.212	0.478	0.335	2.026	0.449	0.165
Standard deviation for first variable	0.895	0.224	0.449	0.367	1.971	0.451	0.171
Standard deviation for second variable	0.986	0.194	0.494	0.305	1.663	0.446	0.15
Std. error	0.038	0.01	0.026	0.018	0.076	0.019	0.007
t statistic	−4.859	0.812	−4.769	2.515	−21.579	1.115	−7.205

Notes: i.) Firms are divided into non-politically connected (NPC=n1) and politically connected (PC=n2). **ii.)** Tests of mean differences are estimated for the variables in columns 1–7.

Table A3
Pearson's correlation matrix of variables in the models (Part 1/2)

		[1]	[2]	[3]	[4]	[5]	[6]	[7]	[8]	[9]	[10]
[1]	**Tobin's Q**	1.000	0.094	0.099	−0.024	0.007	0.090	0.005	−0.133	−0.150	−0.109
[2]	**Politically connected firm**	0.094	1.000	0.914	0.495	0.708	0.766	−0.098	−0.134	−0.115	−0.202
[3]	**PC Director**	0.099	0.914	1.000	0.275	0.774	0.837	−0.047	−0.079	−0.062	−0.152
[4]	**PC Officer**	−0.024	0.495	0.275	1.000	0.370	0.240	−0.135	−0.139	−0.134	−0.188
[5]	**Intensity of PCD/Board**	0.007	0.708	0.774	0.370	1.000	0.661	−0.048	−0.031	−0.028	−0.104
[6]	**PCD's Tenure**	0.090	0.766	0.837	0.240	0.661	1.000	−0.071	−0.078	−0.059	−0.136
[7]	**Log GDP per capita**	0.005	−0.098	−0.047	−0.135	−0.048	−0.071	1.000	0.761	0.732	0.765
[8]	**Country Rule of Law**	−0.133	−0.134	−0.079	−0.139	−0.031	−0.078	0.761	1.000	0.852	0.921
[9]	**Country Political Stability**	−0.150	−0.115	−0.062	−0.134	−0.028	−0.059	0.732	0.852	1.000	0.753
[10]	**Country Government Effectiveness**	−0.109	−0.202	−0.152	−0.188	−0.104	−0.136	0.765	0.921	0.753	1.000
[11]	**Regulatory type of state**	−0.121	−0.232	−0.227	−0.150	−0.179	−0.151	−0.070	0.284	0.072	0.500
[12]	**Family led variety**	0.128	0.189	0.133	0.184	0.085	0.114	−0.733	−0.848	−0.862	−0.864
[13]	**Age (years public)**	−0.107	−0.013	−0.004	0.003	0.017	0.092	0.028	0.167	0.141	0.182
[14]	**Herfindahl differences**	−0.083	−0.020	−0.015	0.013	0.026	−0.006	0.028	0.055	0.074	0.059
[15]	**Corporate governance index**	0.190	0.127	0.169	0.063	0.103	0.174	−0.052	−0.203	−0.312	−0.150
[16]	**Board size**	0.002	−0.067	−0.098	0.046	−0.111	−0.113	0.067	−0.246	−0.178	−0.053
[17]	**Firm's size**	0.059	0.387	0.340	0.246	0.338	0.281	−0.037	−0.261	−0.313	−0.247
[18]	**Assets turnover**	0.162	−0.023	−0.009	−0.066	−0.063	0.014	−0.028	−0.132	−0.074	−0.092
[19]	**Leverage**	−0.031	0.139	0.124	0.079	0.074	0.128	0.026	−0.065	−0.061	−0.102

Table A3
Pearson's correlation matrix of variables in the models (Part 2/2)

		[11]	[12]	[13]	**[14]**	**[15]**	**[16]**	**[17]**	**[18]**	**[19]**
[1]	**Tobin's Q**	−0.121	0.128	−0.107	−0.083	0.190	0.002	0.059	0.162	−0.031
[2]	**Politically connected firm**	−0.232	0.189	−0.013	−0.020	0.127	−0.067	0.387	−0.023	0.139
[3]	**PC Director**	−0.227	0.133	−0.004	−0.015	0.169	−0.098	0.340	−0.009	0.124
[4]	**PC Officer**	−0.150	0.184	0.003	0.013	0.063	0.046	0.246	−0.066	0.079
[5]	**Intensity of PCD/Board**	−0.179	0.085	0.017	0.026	0.103	−0.111	0.338	−0.063	0.074
[6]	**PCD's Tenure**	−0.151	0.114	0.092	−0.006	0.174	−0.113	0.281	0.014	0.128
[7]	**Log GDP per capita**	−0.070	−0.733	0.028	0.028	−0.052	0.067	−0.037	−0.028	0.026
[8]	**Country Rule of Law**	0.284	−0.848	0.167	0.055	−0.203	−0.246	−0.261	−0.132	−0.065
[9]	**Country Political Stability**	0.072	−0.862	0.141	0.074	−0.312	−0.178	−0.313	−0.074	−0.061
[10]	**Country Government Effectiveness**	0.500	−0.864	0.182	0.059	−0.150	−0.053	−0.247	−0.092	−0.102
[11]	**Regulatory type of state**	1.000	−0.246	0.221	0.026	−0.026	0.045	−0.179	−0.070	−0.144
[12]	**Family led variety**	−0.246	1.000	−0.170	−0.095	0.260	0.088	0.298	0.068	0.084
[13]	**Age (years public)**	0.221	−0.170	1.000	0.021	−0.021	0.054	−0.015	−0.003	−0.048
[14]	**Herfindahl differences**	0.026	−0.095	0.021	1.000	−0.123	−0.123	−0.043	0.006	−0.160
[15]	**Corporate governance index**	−0.026	0.260	−0.021	−0.123	1.000	0.233	0.335	0.026	0.086
[16]	**Board size**	0.045	0.088	0.054	−0.123	0.233	1.000	0.227	0.076	0.017
[17]	**Firm's size**	−0.179	0.298	−0.015	−0.043	0.335	0.227	1.000	0.016	0.360
[18]	**Assets turnover**	−0.070	0.068	−0.003	0.006	0.026	0.076	0.016	1.000	0.021
[19]	**Leverage**	−0.144	0.084	−0.048	−0.160	0.086	0.017	0.360	0.021	1.000

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