

POLICY UNCERTAINTY, POLITICAL CONNECTION
AND M&A: EVIDENCE FROM CHINA

Qizhi Tao

Professor of School of Finance, Southwestern University of Finance and

Economics

Chengdu, China

Email: taoqizhi@swufe.edu.cn

Post Code:611130

Wan Zhang (corresponding author)

PhD Student of School of Finance, Southwestern University of Finance

and Economics

Chengdu, China

Email: 710634270@qq.com

Post Code:611130

POLICY UNCERTAINTY, POLITICAL CONNECTION AND M&A: EVIDENCE FROM CHINA

Abstract

The Sino-US trade war shows that the policy uncertainty has huge impact on the economy. It is important to figure out how policy uncertainty affect corporate behavior and how to deal with the possible negative effect from policy uncertainty. This study examines the relationship among policy uncertainty, political connection and firms' M&A. Using 4,317 M&As deals of 2015 listed acquiring firms from China between 2008 and 2017, we find that policy uncertainty would has negative impact on the likelihood of firms' M&As, which is consistent with the real option theory. Furthermore, we find new evidence for the help hand of political connection by proving political connection could help firms mitigate the negative impact from policy uncertainty on M&As. Moreover, non-SOEs are less negatively affected by the policy uncertainty than SOEs. We also find the buffering effect of political connection is stronger for firms with more government support and in regions/provinces with low degree of marketization.

Keyword: Policy uncertainty; Political connection; M&A

JEL classifications: G28; G32; G34

1.Introduction

The policy uncertainty could have huge influence on economic environment and corporate firms' behavior. Recently, according to a research report released by the Federal Reserve, by the beginning of 2020, because of the policy uncertainty caused by Sino-US Trade War, the United States will lose billions of dollars in output, and the world will lose as much as \$850 billion. And some foreign companies in China feel the unpredictability of the current business environment and they withdraw from China.

The impact of policy uncertainty on economic environment and corporate firms' behavior has attracted much attention in recent years. Economic policy uncertainty means that economic entities cannot accurately predict whether, when and how the government changes its current economic policies (Gulen & Ion, 2016). Research has shown that policy uncertainty has negative effect on the economy. Pastor and Veronesi (2013) find that increase in policy uncertainty led to a risk premium and stocks' high volatility. Prior literature has found that, during periods of high policy uncertainty , firms intend to suppress corporate investment (Julio & Yook, 2012 ; Gulen & Ion, 2012), reduce to initiate dividends (Tao et al, 2015), and firms with higher exposure to policy uncertainty would pay higher loan spread (Francis et al,2014). Except the above-mentioned corporate behaviors, there is another important corporate activity——merger and acquisition, that deserves further relative study.

Currently, research regarding M&A and policy uncertainty is rare. There are two papers examine the relationship between policy uncertainty and M&A activities: Nguyen and Phan (2017) and Bonaime, Gulen and Ion (2018). Both find that policy

uncertainty has negative impact on the likelihood of firm acquisitiveness in United States. From the real option perspective, firms are more likely to delay irreversible investments until some of the uncertainty is resolved (Bernake,1983; Dixit and Pindyck, 1994). In contrast to previous study, in this article, we not only prove the negative effect of policy effect on M&As in China, but more importantly to find out firm, as microeconomic entity, how to partly mitigate the macro negative influence from economic policy uncertainty.

Many studies argue that political connections play the role of a helping hand to a firm. Ferris, Houston and Javakhadze(2016) find that firms with political connections are more inclined to acquire targets , and Liu,Wang and Zhang(2013) also demonstrate that enterprise with political connections have greater probability of engaging in M&A activities. They argue that political connected firms have information advantage in M&A because they have easier access policy-making information, thus can more readily complete the M&A activity. If a firm could receive some information of policy alteration, it may partially resist the negative consequences of uncertainty.

Given the negative consequence of policy uncertainty, we wonder if it is possible that political connected firms could partially offset the harmful effect by gaining relevant information about policy alteration through their executives' connection with government agency. The previous literature always using two methods to examine the effect of political connection on firms' behaviors. Firstly, comparing the firm's behaviors by dividing the firms into political connected subgroup and non-political connected subgroup or using the binary variable to measure the political connection of

a firm (Fan et al, 2007;Faccio, 2006;); secondly, the percentage of the political executives of the all executives (Chen et al,2011). In contrast with them, we use a political connection index by considering the level and strength of the connections associated with firms' executives. And we find new evidence for the helping hand of political connection by figuring out political connection could help firms to alleviate the negative effect from policy uncertainty.

In this study, we examine the relationship among policy uncertainty, political connection and firms' M&A. There are two questions need to figure out: first, whether the negative relationship between policy uncertainty and M&A activities still holds in China, an important emerging market; second, whether the political connection of a firm can partly act as a "umbrella" in the face of policy uncertainty. Research have proved the negative effect from policy uncertainty on firms' likelihood to engage in M&As in American. But there is no research to find how to mitigate the macro negative effect. Thus, we capture the political connection degree of a firm as a essential factor, because a firm can use the political connection of executive to obtain some information about the policy. In addition to the above two main issues, we also consider about the impact of firm's heterogeneity on this research.

To solve the first question, we use a measure of China's policy uncertainty based upon the China economic policy uncertainty (EPU) index constructed by Baker, Bloom and Davis (2016) to examine the relation between policy uncertainty and M&A activities from 2008 to 2017, including 60,686 firm-quarterly observations. Specially, we model the likelihood of a firm makes at least one M&A announcement in quarter t

as a function policy uncertainty as well as firm-level controls. Our empirical results report a significant and negative relation between policy uncertainty and the likelihood of M&As.

After proving the negative effect of policy uncertainty on M&A, we need to examine if the political connection can help firms to mitigate the negative effect. So we turn to figure out the second question, we structure our tests as logistic models, capturing the likelihood of making at least one M&A announcement in quarter t as a function of policy uncertainty, political connection, an interaction term between policy uncertainty and political connection, and firm-level controls. And the results consistent with our expectation that political connections can partially alleviate the negative effect of policy uncertainty on mergers and acquisitions.

We turn next to examine how the mitigating effect of political connection would change when it comes to the heterogeneity of firms. Specifically, we find the buffering effect of political connection when faced with policy uncertainty is stronger in firms that are non-state-owned, gain more subsidy from government and locate in more marketized provinces/regions.

The previous examinations are all about the likelihood of M&A, and there is other important question of M&A to study. Finally, we investigate the relationship among the effect of policy uncertainty, the regulating effect of political connection and the performance of M&As, we adopt the firm's CARs to measure the M&As' performance. As present in the empirical results, the policy uncertainty has significantly negative effect on firms' abnormal return, and the political connection still has the

buffer function.

The contributions of this study are as follows: First, this paper discovers a key factor, political connections, that can influence the extent to which policy uncertainty affects mergers and acquisitions. Research on policy uncertainty and M&A, are focus on finding out how and why the policy uncertainty affects the M&A activities. Bhagwat et al (2016) investigate the relationship between market uncertainty and M&A activities, but our study adopt the Baker index based on newspaper coverage to better measure the policy uncertainty. Nguyen et al (2017) and Bonaime et al (2018) both use the Baker index in US to prove the negative relationship between the policy uncertainty and M&A, but neglect to explore the characteristics of firm itself could influence the effect of policy uncertainty on M&A. We fill this gap by adding the measurement of firms' political connection, which can partially offset the negative impact of policy uncertainty on firms' M&As. Moreover, we investigate how the mitigating effect of political connection would change from three aspects of heterogeneity of firms.

Second, we find new evidence to support the help hand theory of political connection. The previous studies hold mix views about the influence of political connection on firms' behaviors. On the one hand, some studies hold the view that political connections play as a "help hand", which can directly or indirectly bring a lot of advantages for firms (Liu, Wang and Zhang,2013; Ferris, Houston and Javakhadze, 2016; Wellman,2016). On the other hand, some literature argue that political connection could be a grabbing hand, in which government officials extract resources from a firm (Shleifer and Vishny,2002; Stulz,2005; Caprio et al, 2013). In our study, we prove the

buffering effect of political connections, as a strong proof for “the help hand” hypothesis.

The rest of the article is organized as follows: In Section 2, we present the theoretical analysis. In Section 3, we propose our hypotheses. In Section 4, we describe the data we use. Section 5 reports the empirical results and Section 6 provides some concluding remarks.

2. Literature Review

In this section, we will discuss three strands of the literature: policy uncertainty, political connection and M&As.

2.1 Policy uncertainty

Many researches find the impact of economic policy uncertainty on the economy is negative. Bloom (2009) use the VAR model estimate the impact of uncertainty shocks on US industrial output, and the empirical results show that uncertainty impacts reduce about 1% of US industrial output. Baker et al. (2016) construct a policy-related uncertainty index and show that the increase in US policy uncertainty from 2006 to 2011 led to a 2% decrease in GDP. Gilchrist et al. (2010) establish an empirical model to find that the impact of uncertainty adversely affects output. In addition to the impact on the macro economy, policy uncertainty also has a negative influence on micro firms. Jorion (1990) find that macroeconomic uncertainty and macroeconomic volatility have a significant negative impact on US multinational corporate earnings. Pastor and Veronesi (2013) find that increase in policy uncertainty led to a risk premium and stocks’

high volatility. Many researches empirically prove policy uncertainty has the negative effect on corporate investments by holding the real options theory. They emphasize that if investment projects are (even partially) irreversible, uncertainty can increase firms' incentives to delay investment until some of the uncertainty resolves (Bernanke 1983 ; Rodrik 1991; Dixit and Pindyck 1994). Using the BBD(Baker, Bloom, and Davis ,2013) index as the proxy for policy uncertainty, Gulen and Ion (2016) find a strong negative relationship between firm-level capital investment and policy uncertainty, and the dampening effect of policy uncertainty on capital expenditures is stronger for firms that have a higher degree of investment irreversibility. Julio and Yook (2012) also show that firms are more likely to reduce capital expenditure during the gubernational election years when policy uncertainty is high. And Jens (2017) find that policy uncertainty cause a decline in US corporate investment and companies would delay equity and debt financing.

Overall, this body of literature suggests that policy uncertainty could have negative effect on the macro and micro economy. And we realize that they ignore to find potential factors to help firms to mitigate the policy uncertainty

2.2 Political connection

Political connection plays a critical role in many economic activities. There are two opposing hypotheses to define the role of political connection: the helping hand and the grabbing hand. From the help hand perspective, Faccio et al. (2006) find that companies with political connections have a greater chance of receiving government

bailouts or policy support than those without political connections. And Claessens et al. (2008) find that companies with political connection are more able to obtain loans from banks. Furthermore, a firm can use political connections to yield other benefits, including more favorable tax rates, higher corporate value, and the approval and promotion of initial public offerings (Fan Rui, and Zhao 2006; Liu et al., 2013; Piotroski and Zhang, 2014). Except the above-mentioned corporate behaviors, Ferris, Houston and Javakhadze (2016) find that firms with political connections are more inclined to acquire targets, and Liu, Wang and Zhang (2013) also demonstrate that enterprise with political connections have greater probability of engaging in M&A activities. In contrast, some literature argue that political connection could be a grabbing hand. Shleifer and Vishny (1994) find that political connections encourage firms to make suboptimal decisions, employing more employees and pay them higher wages, which could destroy firm value. And prior researches provide evidence that some politicians extract firm assets via the connection with firm (Stulz,2005; Caprio et al, 2013)

Taking together, previous studies have mixed answers for the role of political connection. We seek new evidence to support the help hand hypothesis of political connection.

2.3 The external environment and mergers and acquisitions

M&A is one of the most important resource allocation behaviors of firms. When it comes to M&A, firms will not only consider the operation of the firms themselves, but also should consider the external economic environment and relative policy. However,

the view on the relationship of external environment and M&As are mixed. Harford (2005) find that economic, regulatory and technical shocks stimulate the wave of mergers and acquisitions when capital markets are generally liquid. Garfinkel and Hankins (2010) provide the empirical evidence that when macroeconomic uncertainty is high, mergers and acquisitions can be a tool of risk management for firms. And Duchin and Schmidt (2013) find that merger waves may bring firms poorer quality of analysts' forecasts, greater uncertainty, and weaker CEO turnover-performance sensitivity. Therefore, merger waves may lead to worse mergers because of agency-driven behavior and managerial herding. But other literature argue that external uncertainty will have a negative impact on M&As. Bhagwat et al. (2016) use the VIX index of the US market to explore the impact of market uncertainty on M&A. They find that the higher the VIX index, the lower of the likelihood of mergers and acquisitions and the amount of M&A expenditures. Nguyen and Phan (2017) and Bonaime, Gulen and Ion (2018) also find that policy uncertainty has negative impact on the likelihood of firm acquisitiveness in United States. In our study, we show the negative relationship between the uncertainty of external environment and M&A in China.

3. Hypotheses Development

In our study, we want to figure out how the policy uncertainty affects M&As. Given the opinions of the existing studies, there is one mainstream theory—the real options theory—explaining that why economic policy uncertainty could affect M&A activities. Real options theory suggests that firms are inclined to delay an investment

project when policy uncertainty is high. And many researches find policy uncertainty indeed have the negative effect on corporate investments (Gulen and Ion, 2016; Chen et al, 2014). As one of the most important forms of corporate investments, we expect that M&A activities should also be negatively affected by policy uncertainty. Therefore, we state our first hypothesis as follows:

H1: The policy uncertainty has negative effect on the likelihood of Mergers and acquisitions

If our first hypothesis is valid, we can answer the first question. Then we turn next to the second question if it is possible that political connected firms could partially resist the harmful effect.

Many studies argue that political connections play the role of a helping hand to a firm. A firm can use political connections to yield many benefits, including government assistance in face of difficulties, easier access to loans, more favorable tax rates, higher corporate value, and the approval and promotion of initial public offerings (Faccio, 2006; Fan Rui, and Zhao 2006; Liu et al., 2013; Piotroski and Zhang, 2014). Except the above-mentioned corporate behaviors, Ferris, Houston and Javakhadze(2016) find that firms with political connections are more inclined to acquire targets , and Liu, Wang and Zhang(2013) also demonstrate that enterprise with political connections have greater probability of engaging in M&A activities. They explain the reason why political connections firms have advantage in M&A is the information advantage. Since the implementation of mergers and acquisitions depends on the formulation of relative policies, a firm having easier access to policy-making information can more readily

complete the M&A activity.

As mentioned above, the economic policy uncertainty means that economic entities cannot accurately predict whether, when and how the government changes its current economic policies (Gulen & Ion, 2016). In other words, if a firm could receive some information of policy alteration, it can partially resist the negative consequences of uncertainty. Wellman (2016) argues that there is less information asymmetry between politically connected firms and policy-makers, and provides empirical evidence that the negative effect of policy uncertainty on investment is (partially) mitigated by a firm's superior access to political information via political connections.

When referring to measure the political connections, many researches focus on the political background of a firm's boards of directors or management teams. The appointment of former or current regulators or politicians for companies executives, can not only help firms avoid adverse influence from regulatory policy changes due to the relative knowledge possessed by those individuals (Ferris, Houston and Javakhadze, 2016), but also assist firms to build a good network with current regulators or politicians who can offer some insider information about relevant policies (Xin and Pearce, 1996). Thus, we propose the second hypothesis as follows:

H2: The political connected firms can alleviate the negative effect of economic policy uncertainty on M&A activities.

Furthermore, we also want to figure out if the firms with heterogenous characteristics would respond differently in the face of policy uncertainty, and the buffering effect of political connection.

First, we consider the effect of firm ownership on the relation between the policy uncertainty and the likelihood of M&As. The relationship is not unambiguously clear. On the one hand, Wang et al. (2014) document that state-owned firms tend to make their behavior in accordance with policies because of the close relationship between them and the government, which means SOEs are inclined to respond positively to policy. And Morck et al. (2013) find that state bank lending is significantly more responsive to monetary policy. These evidences imply that SOEs may be affected more by economic policy uncertainty. On the other hand, the main goal of non-SOEs is maximizing shareholder wealth, however, SOEs have more responsibility to achieve additional objectives such as generating tax revenues, providing employment opportunities and maintaining social stabilization (North 1990; Olson 1993). Therefore, when firms face the policy uncertainty, SOEs are more likely to stay mellow as they need to undertake much more social responsibility than non-SOEs. Therefore, SOEs may be less affected by the policy uncertainty than non-SOEs. In line with the above two views, we propose the following hypothesis:

H3a: The relationship between policy uncertainty and the likelihood of M&As is stronger for the SOEs than non-SOEs.

H3b: The relationship between policy uncertainty and the likelihood of M&As is weaker for the SOEs than non-SOEs.

Second, our next hypothesis about the firms' heterogeneity is to figure out if the buffering effect of political connection on policy uncertainty will vary with the degree of government support to firm. Previous research present evidence that political

connection could help firms to obtain more government subsidies (Tao et al, 2017 ; Wu et al, 2011), and thus firms can get more cash or opportunities to increase their value or protect themselves from dilemma. When firms are faced with the policy uncertainty, the government support is vital for them as the policy is formulated by the government. With this argument, we expect to find the firm with higher government support could strengthen the protective effects of political connection from the policy uncertainty. Therefore, we state our fourth hypothesis as follows:

H4: Firms with high government support can obtain more protective effect of political connection from the policy uncertainty.

Third, the degree of regional marketization measures the relationship between the government and the market. In the regions/provinces with less marketization, the government officials have the greater power to determine the resource allocation, which means political connections can play a more important role for firms. The existing researches show that the lower the degree of marketization in the country or region where the enterprise is located, the stronger the government regulation, the less robust the legal and financial system and the more serious the tax burden, which strong the motivation for firms to establish political connections (Chen et al. 2011; Li et al. 2010; Faccio, 2006). Therefore, our fifth hypothesis is postulated as follows:

H5: Firms in less marketized regions/provinces can obtain more protective effect of political connection from the policy uncertainty.

4.Data

The policy uncertainty data are sourced from Baker, Bloom and Davis(2016), and the merger and acquisition data are found from the Thomson Eikons database, and other data are obtained from the China Securities Market Accounting Research database (CSMAR) and Wind database including macro-level data, firm-level accounting data, the political background information of the company's executives, market data and firms' stock return data. We initially select all acquirer firms listed on the Shanghai and Shenzhen Stock Exchanges during the period from 2008 to 2017. We construct politically relevant data based on the political background of executives, and CSMAR database just updates the data to 2017. We remove financial and utility firms because they are strongly regulated by the government, and only include deals with a value of at least 1 million dollars following the literature (Bonaime et al,2018; Nguyen et al,2017). Finally, after removing the missing data, we obtain 4,317 M&A deals and 60,686 observations of 2015 firms. And except the binary variables, all data are winsorized to minimize the influence of outliers.

4.1 Measuring policy uncertainty

We use the EPU index for China developed by Baker, Bloom and Davis(2016) to proxy for policy uncertainty. Figure.1 shows the trend of China's monthly economic policy uncertainty index during the sample period. As the figure presents, the uncertainty of China's policy uncertainty has risen sharply in 2008, mostly due to the outbreak of the financial crisis. In addition, since the negative effect of "Four trillion"

investment plan released by central government began to emerge, the policy uncertainty went up quickly around 2011. And after the stock market crash in late 2015, the uncertainty index climbed again. In general, our country's economic policy uncertainty increased significantly after the financial crisis of 2008, consistent with the conclusion of Pastor and Veronesi (2013).

For our research purpose, we need to convert monthly data into quarterly data. Thus, we construct the policy uncertainty variable as the natural logarithm of average of the EPU index for China.

4.2 Measuring political connection

There are various of indicators proxy for political connections, and most of them use the political background of a firm's executives as a yardstick (Fan et al, 2007; Faccio, 2006; Chen et al, 2011). In this study, following the prior literature, we develop our measurement. Firstly, a member of a company's executives, including board of directors, board of supervisors and senior management, who satisfy any one of the following two criteria is defined as a politically connected executive: (1) having work experience in central or local government departments; (2) a current or former member of the People's Congress or the People's Political Consultative Conference. Secondly, follow the similar method in the article written by Tao and Sun in 2017, we track their highest political ranks in each year and assign a numerical score from 0 to 11 based on their ranks. In particular, according to the civil servant law of People's Republic of China revised at the seventh session of the standing committee of the 13th National People's Congress in December 2018, we assign 0 for no political connection, 1 for

administrative clerk, 2 for township level deputy, 3 for township level, ..., 8 for provincial and ministerial level, 9 for provincial and ministerial level, 10 for national level deputy and 11 for national level. And the overall degree of political connection for a firm is the sum of all the scores of executives. Finally, we transform the political connection index using a natural logarithm as follows: $Ln(Index) = Ln(1 + Index)$.

4.3 M&A data and other variables

Follow the prior research (Bonaime et al,2018; Nguyen et al,2017), our mergers and acquisitions data exclude the financial and utility firm's deals and transactions with a value below \$1 million. If a firm is in continuous acquisition in the short term, we only choose the first acquisition in the estimation window. And we gather a host of data to construct our control variables, including firm-level data and industry data. The detailed description of these data is provided in the Appendix 1. To proxy for the likelihood of M&A, we generate the M&A dummy which takes a value of 1 if a firm makes at least one M&A announcement in a given quarter, and 0 otherwise. After merging the M&A dummy and control variables, we obtain the final sample with 60,686 firm-year observations.

Table 1 presents the descriptive statistics of variables. Panel A shows the continuous variables of full sample, which consists of 60,686 firm-year observations of 2040 unique firms. Panel B presents the summary of M&A Dummy variable. Panel C describes summary statistics of 4,317 merger and acquisition deals and all deals valued at 65.5160 million on average. Panel D describes the cumulative abnormal return of acquirers calculated based on the event window (-3,3) and (-5,5), and we use the

estimation window (-130, -30).

[Insert Table 1 here]

Table 2 reports correlation coefficients among relevant variables. We can see from the table that all the correlation coefficients are relatively small.

[Insert Table 2 here]

5. Empirical analysis and results

5.1 M&A activities, policy uncertainty and political connection

We begin our empirical analysis by observing and comparing the trend of the frequency of M&A deals and the trend of the economic policy uncertainty varying with time. To measure the frequency of M&A deals, we use the total M&A deal number and value in every month during the period from 2007 to 2017. From Figure 2 and Figure 3, we can see that both the total monthly deal number and deal value grow fast during the period when policy uncertainty was low, and declined sharply when policy uncertainty is high. Thus, we are expecting to find there could be a negative relationship between M&A activity and policy uncertainty.

[Insert Figure 2 and Figure 3 here]

Our first hypothesis states that the policy uncertainty has negative effect on the likelihood of mergers and acquisitions, which to figure out the first problem we propose. To test Hypothesis 1, we use the following logit model to investigate the relationship between policy uncertainty and the firms' M&A activities:

$$\begin{aligned}
M \& A - Dummy_{i,t} = \alpha + \beta_1 Policy\ Uncertainty_{i,t} + \beta_2 \Delta GDP_{t-1} + \beta_3 Size_{i,t-1} + \beta_4 Growth_{i,t-1} \\
& + \beta_5 Past\ return_{i,t} + \beta_6 Market\ to\ Book\ ratio_{i,t-1} + \beta_7 Leverage_{i,t-1} \quad (1) \\
& + \beta_8 Cash\ Flow_{i,t-1} + \beta_9 Firm\ Age_{i,t-1} + \beta_{10} ROA_{i,t-1} + \varepsilon_{it}
\end{aligned}$$

The dependent variable is *M&A – Dummy*, an indicator that equals 1 if firm *i* participate in M&A in quarter *t*, and 0 otherwise. *Policy Uncertainty* is measured as the natural logarithm of the weighted average of the EPU index. Based on our hypothesis, we expect the coefficient (β_1) of *Policy Uncertainty* to be negative. To capture the effects of general macroeconomic conditions, we include the quarterly change in GDP, ΔGDP measured as the percentage change in real GDP. Finally, following the M&A literature, we control for firm characteristics that have power in explaining the likelihood of M&A activity, including *Size*, *Past return*, *Market to Book ratio*, *Leverage*, *Cash Flow*, *Firm Age*, *ROA*, *Growth*. To control for industry trends, we include industry fixed effects in the regressions.

In Table 3, the column (1) and (2) presents the result of test on hypothesis 1. In column (1) and (2), we conduct an empirical analysis with full samples, reporting that the coefficient of *Policy Uncertainty* is negative (-0.2536; -0.2643) and statistically significant at the 1% level regardless of controlling industry effect. The marginal effects associated with the policy uncertainty coefficient in the full sample (column 1) suggest that a one standard deviation increase in the *Policy Uncertainty* index is associated with a 2.65% decrease in M&A likelihood. This result uniformly supports the hypothesis that high policy uncertainty is associated with a lower likelihood of participating in M&A, and also consistent with prior research where policy uncertainty has a negative impact on mergers and acquisitions (Bonaime, Gulen and Ion, 2018;

Nguyen and Phan,2017).

The next empirical analysis is designed to figure out if political connection has the regulation effect. To test Hypothesis 2, on the basis of the regression equation (1), we add the *Political Connection* variable and the interaction between policy uncertainty and political connection:

$$\begin{aligned}
 M \& A - Dummy_{i,t} = \alpha + \beta_1 Policy\ Uncertainty_{i,t} + \beta_2 Political\ Connection_{i,t} \\
 & + \beta_3 (Policy\ Uncertainty \times Political\ Connection)_{i,t} + \beta_4 \Delta GDP_{t-1} \quad (2) \\
 & + \beta_5 Size_{i,t-1} + \beta_6 Growth_{i,t-1} + \beta_7 Past\ return_{i,t} + \beta_8 Market\ to\ Book\ ratio_{i,t-1} \\
 & + \beta_9 Leverage_{i,t-1} + \beta_{10} Cash\ Flow_{i,t-1} + \beta_{11} Firm\ Age_{i,t-1} + \beta_{12} ROA_{i,t-1} + \varepsilon_{it}
 \end{aligned}$$

The coefficient (β_3) on the interaction of *Policy Uncertainty* and *Political Connection* is designed to capture the differential effect of policy uncertainty on firm's M&A activities with varying degree of political connection. Given our assumptions and inferences, we expect the coefficient (β_3) to be positive.

In Table 3, the column (3) and (4) reporting the regression results based on equation (2), provides empirical evidence consistent with political connections partially offsetting the negative effect of policy uncertainty on mergers and acquisitions. We test our hypothesis 2 with full sample, then we find that the coefficient on the interaction of *Policy Uncertainty* and *Political Connection* is positive and significant. The results suggest that the effect of policy uncertainty on M&A is weaker (less negative) if the firm has stronger political connection. Secondly, we divide all the samples into state-owned samples and non-state-owned ones, and implement the regression with the two subsamples separately.

[Insert Table 3 here]

5.2 The heterogeneity of firm, policy uncertainty and political connection

Then we want to figure out if the firms with heterogenous characteristics would respond differently in the face of policy uncertainty, and the buffering effect of political connection. First, to test hypothesis 3 (a) and (b), we examine the relationship between policy uncertainty and M&A among the subsample of state-owned enterprises and non-state-owned enterprises. We define a firm as a SOE if its ultimate controlling shareholder is a state government. The effect of state ownership could have important implication on the relation between policy uncertainty and M&A activities, mostly due to the different objectives between SOEs and non-SOEs. On the one hand, the main goal of non-SOEs is maximizing shareholder wealth, therefore, when firms face the policy uncertainty, non-SOEs are less likely to affect by the alternation of policy because they are inclined to follow their own strategic plan. On the other hand, SOEs have more responsibility to achieve additional objectives such as generating tax revenues, providing employment opportunities and maintaining social stabilization (North 1990; Olson 1993). They are more like to stay mellow when face with policy uncertainty, which imply policy uncertainty could have more significant negative effect on non-SOEs. The Table 4 presents the empirical results to support the Hypothesis 3 (a). It can be seen from column (1) and (3) that the negative effect of policy uncertainty still holds significantly on both state-owned firms and non-state-owned firms, but the coefficient of policy uncertainty for SOEs is more negative than non-SOEs. The result implies that non-SOEs are less adversely affected by policy uncertainty, the result is consistent with what we speculate. With regarding to this interesting and new finding, we take a step further to seek for the buffering effect from political connection. The

result reported in column (4), demonstrates that political connection can palliate the impact of policy uncertainty on non-state-owned enterprises since the coefficient on interaction term still be significantly positive. However, the state-owned firms' regression results in column (2) show no significant mitigation from political connection on policy uncertainty.

[Insert Table 4 here]

Secondly, another critical factor that deserves further research is the degree of government support to firms. If a firm with higher support of government, it is more likely to get the help from political connection and thus decrease the loss caused by policy uncertainty. In addition, the government who formulate the policy, would incline to construct stable and good environment for healthy development of enterprises or industries that they strongly support. In view of this, to test hypothesis 4, we divide the full sample into two groups by the degree of government support to firms. To proxy the degree of government support, we use the government subsidy data provided in firms' financial reports. Then we divide the full sample into high and low government subsidies groups based on the median level, and run the equation (1) and (2) of these two groups respectively. If the result is consistent with our hypothesis, the coefficient (β_3) on the interaction of *Policy Uncertainty* and *Political Connection* of firms with high government subsidies could be significant and positive.

Table 6 displays the result that the high subsidy of government group has a positive and significant coefficient on the interaction term while the low subsidy of government group shows no significant mitigating effect of political connection.

Overall, the result indeed confirms that firms with high government support can obtain more protective effect of political connection from the policy uncertainty.

[Insert Table 5 here]

Finally, we examine how the mitigating effect of political connection would change when it comes to the degree of marketization. Since economic development and the degree of marketization seem to be uneven across regions in China, it would be interesting to see firms in regions with various degree of marketization respond differently to the policy uncertainty. To capture the degree of marketization, we use the marketization index constructed by Fan et al.(2016) in their “NERI Index of marketization of China’s provinces” . To test hypothesis 5, we divide the full sample into high marketization group and low marketization group. If a firm is in a region/province with the marketization index above the median level, the firm falls into the high marketization group; otherwise, it belongs to the low marketization group. Then, we run our baseline regressions equation (1) and (2) separately for these two groups. As shown in the Table 6, it can be seen from the column (1) and (3) that both the policy uncertainty continues to be negatively related to the likelihood of participating M&A activities. Moreover, consistent with our expectation, the empirical evidence in column (4) shows that the coefficient on the interaction of *Policy Uncertainty* and *Political Connection* is positive and significant when the firms in a region/province with low degree of marketization. On the contrary, the result from column (2) shows no benefits of political connection in the high degree of marketization sample. The results demonstrate that firms in a region/province with low degree of

marketization can obtain more protective effect from political connection.

[Insert Table 5 here]

5.3 The performance of M&As, policy uncertainty and political connection

Except for the likelihood of taking part in mergers and acquisitions, it is also essential to gauge the effect of policy uncertainty and the regulating effect of political connection on the performance of M&As. We run OLS regression in which the dependent variable is the firm's 3-day and 5-days CARs centered on the M&A announcement day. Table 7 show how policy uncertainty and political connection affects cumulative abnormal return (column (1) and column (3)). The empirical results show that the policy uncertainty has significantly negative effect on firms' abnormal return. Moreover, we find that political connection still has the buffer function, cause the coefficient on the interaction between policy uncertainty and political connection continues to be significantly positive (column 4).

[Insert Table 7 here]

6. Conclusion

Previous study has provided much evidence to prove the policy uncertainty could harm firms in many ways (Gulen & Ion, 2016; Julio & Yook, 2012; Tao et al,2015; Bonaime, Gulen and Ion, 2018; Nguyen and Phan,2017). In this study, based on the 606,86 observations, we have shown that policy uncertainty indeed has negative effect on mergers and acquisitions from the evidence of China listed firms' M&A activities. Moreover, in contrast to the previous study investigating the relationship between

policy uncertainty and M&A (Bonaime, Gulen and Ion, 2018; Nguyen and Phan,2017), we find political connection could help firms alleviate the negative effect of economic policy uncertainty. And this finding is a new evidence for the helping hand hypothesis of the role of political connection, Furthermore, we aware that the heterogeneity of firms can be an important factor to influence the effect of policy uncertainty and political connection, thus we investigate further research. Specifically, non-SOEs are less negatively affected by the policy uncertainty and they could obtain more help from political connection. Then we find that firms with high subsidy from government to policy uncertainty can get more help from the political connection, and firms in regions/provinces with low degree of marketization can obtain more protective effect of political connection from the policy uncertainty. Finally, we find that the policy uncertainty has significantly negative effect on M&As' performance and political connection still has the buffer function. Our study not only figure out the policy uncertainty how to influence M&A, but also find firm can mitigate the negative effect from policy uncertainty via political connection.

References

- Baker,S; N.Bloom; and S.Davis. Measuring Economic Policy Uncertainty. *Quarterly Journal of Economics*, 131(2016), 1593-1636
- Bernanke B S. Irreversibility, Uncertainty, and Cyclical Investment. *Quarterly Journal of Economics*, 1983, 98(1):85-106.
- Bhagwat V , Dam R A , Harford J . The Real Effects of Uncertainty on Merger Activity. *Review of Financial Studies*, 2016, 29(11):3000-3034.
- Bloom N. The Impact of Uncertainty Shocks. *Econometrica*, 2009, 77(3):623–685.
- Bonaime A, Gulen H, Ion M. Does Policy Uncertainty Affect Mergers and Acquisitions? *Journal of Financial Economics*, 2018. 129(3):531-558
- Duchin R , Schmidt B . Riding the merger wave: Uncertainty, reduced monitoring, and bad acquisitions. *Journal of Financial Economics*, 2013, 107(1).
- Fan, J.P.H., Wong, T.J., Zhang, T., 2007. Politically Connected CEOs, Corporate Governance and Post-IPO Performance of China's Newly Partially Privatized Firms. *Journal of Financial Economics*.84(2), 330–357
- Faccio M. Politically Connected Firms. *American Economic Review*, 2006, 96(1):369-386.
- Chen C J P, Li Z, Su X, et al. Rent-seeking incentives, corporate political connections, and the control structure of private firms: Chinese evidence. *Journal of Corporate Finance*, 2011, 17(2):229-243.
- Dixit, A. K., and R. S. Pindyck. 1994. *Investment under uncertainty*. Princeton: Princeton UP. pp. 135-212
- Fama E F , French K R . Common risk factors in the returns on stocks and bonds. *Journal of Financial Economics*, 1993, 33(1):3-56.
- Ferris S P, Houston R, Javakhadze D. Friends in the right places: The effect of political connections on corporate merger activity. *Journal of Corporate Finance*, 2016, 41:81-102.
- Firth M , Fung P M Y , Rui O M . Ownership, two-tier board structure, and the informativeness of earnings: Evidence from China. *Journal of Accounting and Public Policy*, 2007, 26(4):0-496.

Francis B B, Hasan I, Zhu Y. Policy uncertainty and bank loan contracting. *Journal of Empirical Finance*, 2014, 29:281-286.

Garfinkel J A, Hankins K W. The role of risk management in mergers and merger waves. *Journal of Financial Economics*, 2010, 101(3):515-532.

Gilchrist S , Sim J W , Egon Zakrajsek. Uncertainty, Financial Frictions, and Investment Dynamics. *SSRN Electronic Journal*, 2010.

Gulen H, Ion M. Policy Uncertainty and Corporate Investment. *Ssrn Electronic Journal*, 2016, 29(3).

Harford J . What drives merger waves? *Journal of Financial Economics*, 2005, 77(3):529-560.

Julio B, Yook Y. Policy uncertainty and Corporate Investment Cycles. *Journal of Finance*, 2012, 67(1):45-83.

Jens C. Political uncertainty and investment: causal evidence from U.S. gubernatorial elections. *Journal of Financial Economics*, 2017, 124: page. 563-579.

Jorion P . The Exchange Rate Exposure of US Multinationals. *The Journal of Business*, 1990, 63:331-345.

Lambrecht B M, Myers S C. A Theory of Takeovers and Disinvestment. *Journal of Finance*, 2007, 62(2):809-845.

Liu N, Wang L, Zhang M. Corporate Ownership, Political Connections and M&A: Empirical Evidence from China. *Asian Economic Papers*, 2013, 12(3):41-57.

Luo J , Luo J , Wang X , et al. Political Connections and Stock Price Crash Risk. *Contemporary Accounting Review*, 2014.

Li H , Meng L , Zhang J . Why Do Entrepreneurs Enter Politics? Evidence from China. *Social Science Electronic Publishing*, 2010, 44(3):559-578.

Nguyen N H, Phan H V. Policy Uncertainty and Mergers and Acquisitions. *Journal of Financial & Quantitative Analysis*, 2017, 52(2):613-644.

North D C. Institutions, Institutional Change and Economic Performance: Institutions. *Journal of Economic Behavior & Organization*, 1990, 18(1):142-144.

Mancur O. Dictatorship, Democracy, and Development. *American Political Science Review*, 1993, 87.

Morck R , Yavuz M D , Yeung B . State-controlled Banks and the Effectiveness of Monetary Policy. *General Information*, 2013, 51(3):1-15.

Olson M . Dictatorship, Democracy, and Development. *The American Political Science Review*, 1993, 87(3):567-576.

Pastor, L., Veronesi, P., 2013. Policy uncertainty and risk premia. *Journal of Financial Economics*. 110 (3), 520–545.

Piotroski J D, Zhang T. Politicians and the IPO decision: The impact of impending political promotions on IPO activity in China. *Journal of Financial Economics*, 2014, 111(1):111-136.

Rodrik D. Policy Uncertainty and Private Investment in Developing Countries. *Journal of Development Economics* 36:229–42.

Tao Q , Sun Y , Zhu Y. Political Connections and Government Subsidies: Evidence from Financially Distressed Firms in China. *Emerging Markets Finance and Trade*, 2017, 53(1).

Tao H, Fei W, Jin Y, et al. Political risk and dividend policy: Evidence from international political crises. *Journal of International Business Studies*, 2015, 46(5):574-595.

Wei L, Lihong W. Do political connections affect stock price crash risk? Firm-level evidence from China. *Review of Quantitative Finance & Accounting*, 2016, 48(3):1-34.

Wang Y , Chen C R , Huang Y S . Economic policy uncertainty and corporate investment: Evidence from China. *Pacific-Basin Finance Journal*, 2014, 26:227-243.

Wellman L A. Mitigating policy uncertainty. *Review of Accounting Studies*, 2016, 22(1):1-34.

Wu J , Liu Cheng M . The impact of managerial political connections and quality on government subsidies. *Chinese Management Studies*, 2011, 5(2):207-226.

Xin K R, Pearce J L. Guanxi: Connections as substitutes for formal institutional support. *Academy of Management Journal*, 1996, 39(6):1641-1658.

Table 1. Summary statistics

This table describes the summary statistics of our data. Panel A presents descriptive statistics of the continuous variables of full sample. And Panel B presents the summary of M&A Dummy variable, which takes a value of 1 if a firm makes at least one M&A announcement in a given quarter, and 0 otherwise. The detailed definitions for variables are provided in Appendix.1. Panel C describes summary statistics on merger and acquisition announcements reported in the Securities Data Corporation (SDC) database between 2008 and 2017. Panel D describes the cumulative abnormal return of acquirers in event window (-3,3) and (-5,5), both use the estimation window (-130,-30).

Panel A. Full Sample						
Variable	N	Mean	P25	Median	P75	Std.Dev.
<i>Policy Uncertainty</i>	60,686	5.1865	4.7105	5.1185	5.6216	0.5355
<i>Political Connection</i>	60,686	2.1659	1.6094	2.4849	3.0445	1.1960
<i>ΔGDP</i>	60,686	0.3393	0.3957	0.5525	1.1114	0.6890
<i>Size</i>	60,686	20.1174	19.2128	19.9662	20.8457	1.2706
<i>Growth</i>	60,686	0.1720	-0.1445	0.0373	0.2575	0.7774
<i>Past return</i>	60,686	0.0110	-0.1318	-0.0035	0.1430	0.2420
<i>Market to Book ratio</i>	60,686	0.8878	0.3547	0.6017	1.0741	0.8627
<i>Leverage</i>	60,686	0.4529	0.2798	0.4508	0.6181	0.2213
<i>Cash Flow</i>	60,686	0.0133	-0.0213	0.0099	0.0466	0.0666
<i>Firm Age</i>	60,686	7.9652	7.4599	8.1789	8.6278	0.8128
<i>ROA</i>	60,686	0.0241	0.0049	0.0176	0.0395	0.0361

Panel B. Dummy variables			
	Dummy variable=1	Dummy variable=0	Total numbers
<i>M & A_Dummy</i>	4,317(7.11%)	56,369 (92.89%)	60,686

Panel C. Merger and acquisition summary statistics			
	Number of deals	Average deal size (in \$millions)	Median deal size (in \$millions)
Public acquirer and public target	50	100.1313	48.2185
Public acquirer and non-public target	4,267	65.1104	11.9939
All deals	4,317	65.5160	12.0846

Panel C. Cumulative abnormal return						
Variable	N	Mean	P25	Median	P75	t
<i>CAR(-3,+3)</i>	4,317	-0.0493	-0.0813	-0.0440	-0.0129	-51.15***
<i>CAR(-5,+5)</i>	4,317	-0.0782	-0.1200	-0.0706	-0.0287	-60.42***

Table 2. Correlation for the major variables

This table reports a correlation for the main independent and control variables. The correlation shown below is for our sample of 2040 firms with 60,686 firm-quarter observations. The corresponding p-values are reported in parentheses. * stand for statistical significance based on two-sided tests at the 5% level in this table

	1	2	3	4	5	6	7	8	9	10	11
1 <i>Policy Uncertainty</i>	1.0000										
2 <i>Political Connection</i>	-0.1929*	1.0000									
3 ΔGDP	0.2005*	0.0015	1.0000								
4 <i>Size</i>	0.1235*	0.1465*	0.0069	1.0000							
5 <i>Growth</i>	0.0476*	-0.0116*	0.2182*	0.0028	1.0000						
6 <i>Past return</i>	-0.1065*	-0.0229*	-0.1197*	-0.0205*	-0.0014	1.0000					
7 <i>Market to Book ratio</i>	-0.0298*	0.1438*	0.0244*	0.6269*	0.0165*	-0.1163*	1.0000				
8 <i>Leverage</i>	-0.0538*	0.0923*	0.0037	0.4121*	0.0475*	-0.0151*	0.5416*	1.0000			
9 <i>Cash Flow</i>	0.0032	0.0245*	0.0905*	0.0491*	0.0085*	0.0446*	-0.0449*	-0.0769*	1.0000		
10 <i>Firm Age</i>	0.0794*	-0.0132*	-0.0012	0.3237*	0.0300*	0.0094*	0.2615*	0.4149*	0.0385*	1.0000	
11 <i>ROA</i>	0.0388*	0.0208*	0.1648*	0.0115*	0.0652*	0.0130*	-0.2236*	-0.3530*	0.3594*	-0.1733*	1.0000

Table 3. Policy uncertainty and M&A activities

This table reports the M&A panel logit fixed effect regression results. The dependent variable is M&A Dummy, which takes a value of 1 if a firm makes at least one M&A announcement in a given quarter, and 0 otherwise. The independent variables are defined in the Appendix.1. We use the following equation to run the regression:

$$M \& A_Dummy_{i,t} = \alpha + \beta_1 Policy\ Uncertainty_t + \beta_2 Political\ Connection_{it} + \beta_3 (Policy\ Uncertainty \times Policy\ Connection)_{it} + \beta Control_{i-1} + \varepsilon_{it}$$

Z-statistics are reported in parentheses. *,**,*** indicate statistical significance at the 10%,5%,1% levels, respectively.

Variable	Dependent Variable: <i>M & A _ Dummy</i>			
	Full Sample			
	(1)	(2)	(3)	(4)
<i>Policy Uncertainty</i>	-0.2847*** (-4.6024)	-0.2909*** (-4.6570)	-0.3738*** (-4.6288)	-0.3799*** (-4.6529)
<i>Political Connection</i>			-0.2229* (-1.8020)	-0.2206* (-1.7817)
<i>Policy Uncertainty</i> × <i>Policy Connection</i>			0.0424* (1.7861)	0.0423* (1.7818)
ΔGDP	0.0736*** (2.6572)	-0.7680 (-0.2980)	0.0732*** (2.6452)	-0.5470 (-0.2126)
<i>Size</i>	0.0987*** (6.2680)	0.0886*** (5.5798)	0.1006*** (6.2794)	0.0898*** (5.5611)
<i>Growth</i>	-0.0219 (-0.9364)	0.0105 (0.4577)	-0.0217 (-0.9279)	0.0107 (0.4675)
<i>Past return</i>	0.2088*** (2.8816)	0.2677*** (3.6923)	0.2076*** (2.8662)	0.2661*** (3.6714)
<i>Market to Book ratio</i>	-0.0474* (-1.7539)	-0.0396 (-1.4630)	-0.0490* (-1.8126)	-0.0408 (-1.5086)
<i>Leverage</i>	-0.2790*** (-3.2441)	-0.2221** (-2.5730)	-0.2781*** (-3.2347)	-0.2209** (-2.5607)
<i>Cash Flow</i>	-0.5014** (-2.0312)	-0.1238 (-0.4864)	-0.5016** (-2.0311)	-0.1234 (-0.4847)
<i>Firm Age</i>	-0.2289*** (-12.3003)	-0.2294*** (-12.3845)	-0.2292*** (-12.2963)	-0.2296*** (-12.3731)
<i>ROA</i>	1.3491*** (2.7971)	1.8808*** (3.6813)	1.3463*** (2.7898)	1.8846*** (3.6853)
Constant	-0.9952** (-2.1890)	-0.6919 (-0.5828)	-0.5571 (-1.0630)	-0.3425 (-0.2827)
Pseudo R ²	0.0089	0.0110	0.0090	0.0111
Industry fixed effects	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes
Quarter fixed effects	No	Yes	No	Yes
Cluster by firm	Yes	Yes	Yes	Yes
No of obs.	60,686	60,686	60,686	60,686

Table 4. Ownership, political connection, policy uncertainty and M&A activities

This table reports the M&A panel logit fixed effect regression results. The dependent variable is M&A Dummy, which takes a value of 1 if a firm makes at least one M&A announcement in a given quarter, and 0 otherwise. The independent variables are defined in the Appendix.1. We use the following equation to run the regression:

$$M \& A_Dummy_{i,t} = \alpha + \beta_1 Policy\ Uncertainty_i + \beta_2 Political\ Connection_{it} + \beta_3 (Policy\ Uncertainty \times Policy\ Connection)_{it} + \beta Control_{t-1} + \varepsilon_{it}$$

Z-statistics are reported in parentheses. *, **, *** indicate statistical significance at the 10%, 5%, 1% levels, respectively.

Variable	Dependent Variable: <i>M & A _ Dummy</i>			
	SOE		Non-SOE	
	(1)	(2)	(3)	(4)
<i>Policy Uncertainty</i>	-0.3329*** (-3.3987)	-0.4339*** (-3.0160)	-0.2684*** (-3.3295)	-0.3697*** (-3.6785)
<i>Political Connection</i>		-0.2108 (-0.9870)		-0.2682* (-1.7142)
<i>Policy Uncertainty × Policy Connection</i>		0.0427 (1.0245)		0.0521* (1.7495)
<i>ΔGDP</i>	-2.6076 (-0.6209)	-2.4221 (-0.5774)	0.4835 (0.1480)	0.7404 (0.2270)
<i>Size</i>	0.1018*** (4.4099)	0.1005*** (4.2572)	0.1137*** (4.8825)	0.1138*** (4.8357)
<i>Growth</i>	0.0252 (0.6788)	0.0253 (0.6807)	-0.0012 (-0.0405)	-0.0008 (-0.0287)
<i>Past return</i>	0.1656 (1.3232)	0.1649 (1.3175)	0.3119*** (3.5031)	0.3093*** (3.4776)
<i>Market to Book ratio</i>	-0.0012 (-0.0338)	-0.0010 (-0.0288)	-0.1135*** (-2.6261)	-0.1160*** (-2.6849)
<i>Leverage</i>	-0.0632 (-0.4368)	-0.0637 (-0.4400)	-0.2998*** (-2.7006)	-0.2959*** (-2.6673)
<i>Cash Flow</i>	-0.1244 (-0.2816)	-0.1272 (-0.2877)	-0.2337 (-0.7636)	-0.2315 (-0.7546)
<i>Firm Age</i>	-0.1497*** (-3.7920)	-0.1476*** (-3.7206)	-0.2252*** (-9.1135)	-0.2248*** (-9.0845)
<i>ROA</i>	2.5235*** (3.0347)	2.5204*** (3.0294)	1.5851** (2.3963)	1.6051** (2.4226)
Constant	-0.7881 (-0.4022)	-0.3614 (-0.1785)	-1.5938 (-1.0637)	-1.1859 (-0.7788)
Pseudo R ²	0.0130	0.0131	0.0117	0.0118
Industry fixed effects	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes
Quarter fixed effects	Yes	Yes	Yes	Yes
Cluster by firm	Yes	Yes	Yes	Yes
No of obs.	26,336	26,336	34,350	34,350

Table 5. Subsidy of government, Political connection, policy uncertainty and M&A activities

This table reports the M&A panel logit fixed effect regression results. The dependent variable is M&A Dummy, which takes a value of 1 if a firm makes at least one M&A announcement in a given quarter, and 0 otherwise. The independent variables are defined in the Appendix.1.

We use the following equation to run the regression:

$$M \& A_Dummy_{i,t} = \alpha + \beta_1 Policy\ Uncertainty_{i,t} + \beta_2 Political\ Connection_{i,t} + \beta_3 (Policy\ Uncertainty \times Policy\ Connection)_{i,t} + \beta Control_{t-1} + \varepsilon_{it}$$

Z-statistics are reported in parentheses. *, **, *** indicate statistical significance at the 10%, 5%, 1% levels, respectively.

Dependent Variable: <i>M & A _ Dummy</i>				
Variable	High Subsidy of Government		Low Subsidy of Government	
	(1)	(2)	(3)	(4)
<i>Policy Uncertainty</i>	-0.3214*** (-3.7243)	-0.4719*** (-4.0176)	-0.2527*** (-2.8051)	-0.3091*** (-2.7166)
<i>Political Connection</i>		-0.3431* (-1.9543)		-0.1564 (-0.8842)
<i>Policy Uncertainty × Policy Connection</i>		0.0672** (1.9760)		0.0287 (0.8550)
<i>ΔGDP</i>	0.3284 (0.0883)	0.6580 (0.1774)	-1.3724 (-0.3832)	-1.2259 (-0.3424)
<i>Size</i>	0.0944*** (4.6190)	0.0945*** (4.5579)	0.0339 (1.0999)	0.0360 (1.1635)
<i>Growth</i>	0.0178 (0.4437)	0.0183 (0.4554)	0.0066 (0.2349)	0.0066 (0.2361)
<i>Past return</i>	0.3362*** (3.1666)	0.3339*** (3.1469)	0.2172** (2.1642)	0.2160** (2.1520)
<i>Market to Book ratio</i>	-0.0366 (-1.1804)	-0.0377 (-1.2163)	-0.0061 (-0.1111)	-0.0072 (-0.1312)
<i>Leverage</i>	-0.5121*** (-4.0393)	-0.5099*** (-4.0207)	-0.0586 (-0.4923)	-0.0582 (-0.4901)
<i>Cash Flow</i>	-0.1596 (-0.4299)	-0.1602 (-0.4313)	-0.0839 (-0.2419)	-0.0846 (-0.2437)
<i>Firm Age</i>	-0.1127*** (-3.9363)	-0.1121*** (-3.9139)	-0.3161*** (-12.6077)	-0.3165*** (-12.6093)
<i>ROA</i>	1.4245* (1.9489)	1.4308* (1.9545)	2.2743*** (3.1337)	2.2747*** (3.1323)
Constant	-1.6596 (-0.9684)	-1.0377 (-0.5920)	0.7821 (0.4674)	0.9972 (0.5860)
Pseudo R ²	0.0109	0.0111	0.0153	0.0154
Industry fixed effects	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes
Quarter fixed effects	Yes	Yes	Yes	Yes
Cluster by firm	Yes	Yes	Yes	Yes
No of obs.	30,466	30,466	30,220	30,220

Table 6. The degree of marketization, Political connection, and M&A activities

This table reports the M&A panel logit fixed effect regression results. The dependent variable is M&A Dummy, which takes a value of 1 if a firm makes at least one M&A announcement in a given quarter, and 0 otherwise. The independent variables are defined in the Appendix.1.

We use the following equation to run the regression:

$$M \& A_Dummy_{i,t} = \alpha + \beta_1 Policy\ Uncertainty_t + \beta_2 Political\ Connection_{it} + \beta_3 (Policy\ Uncertainty \times Political\ Connection)_{it} + \beta Control_{t-1} + \varepsilon_{it}$$

Z-statistics are reported in parentheses. *, **, *** indicate statistical significance at the 10%, 5%, 1% levels, respectively.

Dependent Variable: <i>M & A_Dummy</i>				
Variable	High Marketization		Low Marketization	
	(1)	(2)	(3)	(4)
<i>Policy Uncertainty</i>	-0.1990** (-2.3419)	-0.2566** (-2.3752)	-0.3937*** (-4.2648)	-0.5586*** (-4.4510)
<i>Political Connection</i>		-0.1644 (-1.0023)		-0.3638* (-1.9146)
<i>Policy Uncertainty × Political Connection</i>		0.0286 (0.9196)		0.0748** (2.0294)
<i>ΔGDP</i>	0.5844 (0.1676)	0.7513 (0.2159)	-2.7899 (-0.7236)	-2.4772 (-0.6436)
<i>Size</i>	0.0880*** (3.8826)	0.0922*** (4.0184)	0.1098*** (4.6105)	0.1059*** (4.3583)
<i>Growth</i>	0.0070 (0.1980)	0.0071 (0.1985)	0.0122 (0.4049)	0.0132 (0.4385)
<i>Past return</i>	0.3538*** (3.4120)	0.3531*** (3.4048)	0.1826* (1.7922)	0.1810* (1.7777)
<i>Market to Book ratio</i>	-0.0745 (-1.6158)	-0.0755 (-1.6375)	-0.0245 (-0.7228)	-0.0250 (-0.7356)
<i>Leverage</i>	-0.1275 (-0.9917)	-0.1280 (-0.9951)	-0.3423*** (-2.8205)	-0.3393*** (-2.7999)
<i>Cash Flow</i>	0.0744 (0.1993)	0.0723 (0.1933)	-0.4337 (-1.2474)	-0.4333 (-1.2439)
<i>Firm Age</i>	-0.2689*** (-10.6610)	-0.2694*** (-10.6963)	-0.1730*** (-6.0828)	-0.1705*** (-5.9337)
<i>ROA</i>	2.2624*** (3.1378)	2.2417*** (3.1047)	1.4493** (1.9764)	1.4735** (2.0070)
Constant	-1.5546 (-0.9738)	-1.3570 (-0.8332)	-0.0228 (-0.0127)	0.6844 (0.3736)
Pseudo R ²	0.0134	0.0135	0.0127	0.0130
Industry fixed effects	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes
Quarter fixed effects	Yes	Yes	Yes	Yes
Cluster by firm	Yes	Yes	Yes	Yes
No of obs.	30,359	30,359	30,327	30,327

Table 7. Policy uncertainty, Political connection and Cumulative abnormal return

This table reports the CAR OLS regression results. The dependent variable is the firm 3-day and 5-days CARs centered on the M&A announcement day. The independent variables are defined in the Appendix.1. We use the following equation to run the regression:

$$CAR_{i,t} = \alpha + \beta_1 Policy\ Uncertainty_t + \beta_2 Political\ Connection_{it} + \beta_3 (Policy\ Uncertainty \times Policy\ Connection)_{it} + \beta Control_{t-1} + \varepsilon_{it}$$

T-statistics are reported in parentheses. *, **, *** indicate statistical significance at the 10%, 5%, 1% levels, respectively.

Variable	Dependent Variable: <i>CAR</i>			
	<i>CAR</i> (-3, +3)		<i>CAR</i> (-5, +5)	
	(1)	(2)	(3)	(4)
<i>Policy Uncertainty</i>	-0.0110*** (-3.0569)	-0.0178*** (-3.8587)	-0.0153*** (-3.2955)	-0.0230*** (-3.7454)
<i>Political Connection</i>		-0.0162** (-2.4936)		-0.0176** (-2.0181)
<i>Policy Uncertainty</i> × <i>Policy Connection</i>		0.0032*** (2.5907)		0.0036** (2.1719)
ΔGDP	-0.7545*** (-5.5807)	-0.7431*** (-5.4679)	-1.2434*** (-6.8389)	-1.2325*** (-6.7359)
<i>Size</i>	-0.0019* (-1.8051)	-0.0020* (-1.8155)	-0.0045*** (-3.3433)	-0.0048*** (-3.3974)
<i>Growth</i>	-0.0003 (-0.2414)	-0.0003 (-0.2358)	-0.0007 (-0.4939)	-0.0007 (-0.4847)
<i>Past return</i>	0.0161*** (3.6024)	0.0158*** (3.5380)	0.0277*** (4.7291)	0.0273*** (4.6647)
<i>Market to Book ratio</i>	0.0042*** (2.6227)	0.0042*** (2.6018)	0.0064*** (3.2389)	0.0064*** (3.2269)
<i>Leverage</i>	0.0051 (0.9409)	0.0053 (0.9757)	0.0126* (1.7625)	0.0129* (1.8054)
<i>Cash Flow</i>	0.0026 (0.1802)	0.0031 (0.2117)	0.0159 (0.8260)	0.0166 (0.8598)
<i>Firm Age</i>	0.0037*** (3.1833)	0.0037*** (3.2113)	0.0046*** (3.0329)	0.0047*** (3.0781)
<i>ROA</i>	0.0493 (1.4568)	0.0508 (1.4980)	0.0592 (1.3933)	0.0618 (1.4515)
Constant	0.2855*** (4.4951)	0.3155*** (4.8925)	0.4993*** (5.8906)	0.5355*** (6.1759)
Adj R ²	0.1221	0.1229	0.1691	0.1698
	15.2468	14.7197	21.3772	20.5541
Industry fixed effects	Yes	Yes	Yes	Yes
Year fixed effects	Yes	Yes	Yes	Yes
Quarter fixed effects	Yes	Yes	Yes	Yes
Cluster by firm	Yes	Yes	Yes	Yes
No of obs.	4,317	4,317	4,317	4,317

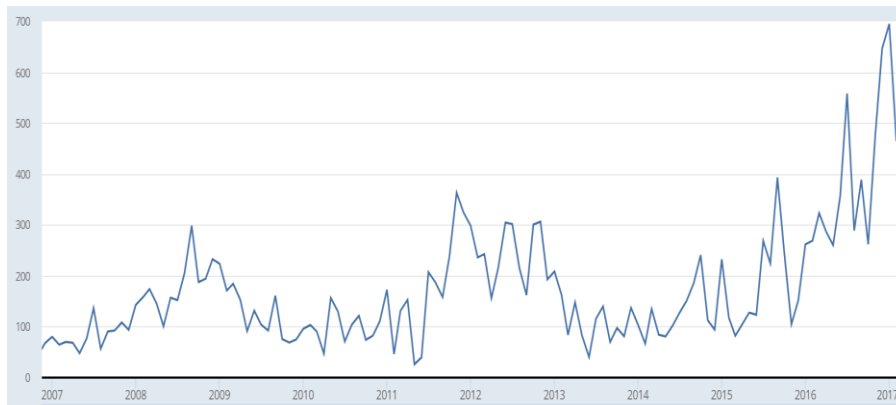


Figure1.Monthly Policy Uncertainty Index
 Source:<http://www.policyuncertainty.com/index.html>

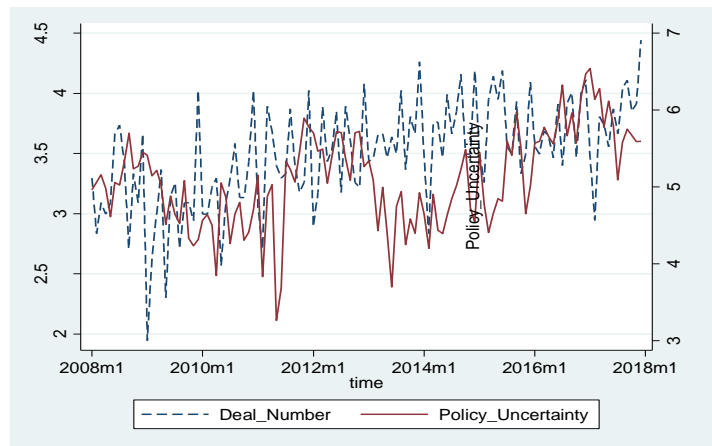


Figure2.The M&A Deal Number and Economic Policy Uncertainty

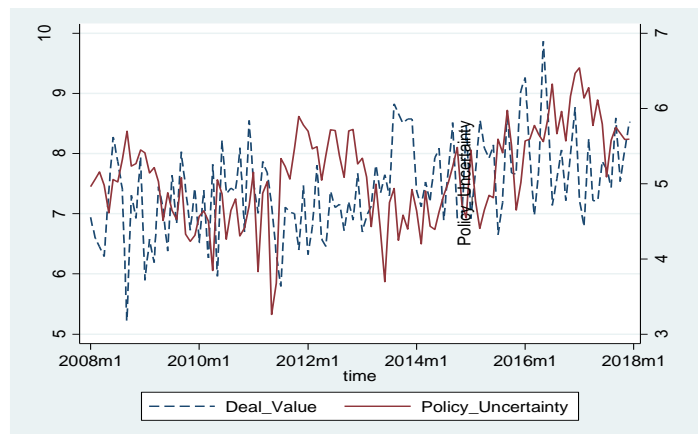


Figure3.The M&A Deal Value and Economic Policy Uncertainty

Note: The M&A deal number is the natural logarithm of 1 plus total M&A deal numbers of all firms every month, and the M&A deal value is the natural logarithm of 1 plus total M&A deal value (in million dollars) of all firms every month. The policy uncertainty is the natural logarithm of monthly economic policy uncertainty index developed by Baker, Bloom and Davis (2016).

Appendix.1: Variable Definitions

Variable	Definitions	Data source
<i>M & A_Dummy</i>	An indicator that equals 1 if a firm makes an M&A announcement in a given quarter, and 0 otherwise	SDC
<i>M & A deal number</i>	The natural logarithm of 1 plus the firm's total annual M&A deal number	SDC
<i>M & A deal value</i> (\$)	The natural logarithm of 1 plus the firm's total annual M&A deal value	SDC
<i>Policy Uncertainty</i>	The natural logarithm of the weighted average of the EPU index	http://www.policyuncertainty.com/index.html
<i>Political Connection</i>	The percentage of political members on the total firm's executives	CSMAR
ΔGDP (%)	The percentage change in real GDP	CSMAR
<i>Size</i> (\$)	The natural logarithm of the book value of assets	CSMAR
<i>Growth</i> (%)	The rate of change of main business income	CSMAR
<i>Past return</i>	The average returns during the 12-month period ending preceding the firm's fiscal quarter	CSMAR
<i>Market to Book ratio</i> (%)	The ratio of stock market value to the book value of total assets	CSMAR
<i>Leverage</i> (%)	The ratio of total debt to total assets	CSMAR
<i>Cash Flow</i> (%)	The ratio of cash flow produced by company operational activities to total assets	CSMAR
<i>Firm Age</i>	The natural logarithm of days between the current day and the IPO day	CSMAR
<i>ROA</i> (%)	The ratio of return on assets	CSMAR
<i>CAR</i> (-3, +3)	The cumulative abnormal stock return over the window (-3, +3) centered on the M&A announcement day	CSMAR
<i>CAR</i> (-5, +5)	The cumulative abnormal stock return over the event window (-5, +5) centered on the M&A announcement day	CSMAR