

Crony Capitalism and Stock Returns during an Election

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ABSTRACT

Crony capitalism is prevalent throughout Asia, particularly in Thailand, where certain businesses rely heavily on their relationships with politicians. The general election in 2019 was the first since the coup d'état in 2014 marking the return of democratically elected politicians to positions of power. Companies that relied on crony capitalism were expected to experience positive abnormal returns during the election period. To assess the relationship between crony capitalism and stock returns, this paper studied the 2019 Thai general election as 'the event', with a data set covering SET100 companies. Results indicated that stocks of companies operating in sectors subject to crony capitalism had higher positive abnormal returns than those operating in other sectors. Investors should, therefore, exercise caution in dealings with stocks of companies subject to crony capitalism because these may show higher volatility during elections.

Keywords: Cronyism; Event study; Thai; Thailand.

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1. INTRODUCTION

Crony capitalism is widespread in Asia, especially in Thailand, where certain companies rely on their political connections. Paitoonpong (2001) argued that the 1997 Thai financial crisis was caused by crony capitalism, while Kim and Im (2001) suggested that collusive rather than collaborative networking led to this event. Over two decades later, Thailand continues to be plagued by crony capitalism.

Sitthipongpanich (2004) highlighted the existence as well as the utilization of political connections by Thai businesspeople. Thaksin Shinawatra amassed his wealth as a result of connections that enabled him to sell technological products and increase his stake in the telecommunications industry using government concessions (Baker and Phongpaichit, 1998). Cronyism gives certain companies benefits to outperform their rivals.

Companies employing crony capitalism have higher values, stock prices, and consequently stock returns to outperform their competitors. Fisman (2001) revealed that Indonesian businesses with connections to President Suharto outperformed others in terms of stock returns, while Syaraswati and Setiany (2022) suggested that political ties in Indonesia influenced business decisions. In the same vein, Johnson and Mitton (2003) found that Malaysian businesses with links to Prime Minister Mahathir had higher stock returns, while Acemoglu *et al.* (2013) discovered that US financial firms with relations to

Timothy Geithner, a former central banker who served as the 75th Secretary of the Treasury of the United States under President Barack Obama, also benefitted from higher stock returns.

Some industries are notorious for relying heavily on political connections and greatly benefit from crony capitalism, with Sonsuphap (2011) asserting that crony capitalism was pervasive in construction concessions, telecommunications, and commercial banking. When calculating the crony-capitalism index, The Economist magazine also included the aforementioned industries as rent-seeking industries. Koziuk et al. (2018) also utilized industries identified by the crony-capitalism index as rent-seeking.

The general election in 2019 was the first since the coup d'état in 2014, and this was considered as 'an event' when politicians reclaimed power, with the return of crony capitalism. Companies in industries plagued by crony capitalism are thus expected to see higher stock returns during the election period than others.

To assess the relationship between crony capitalism and stock returns, this study collected and analyzed stock return data during the period of Thai general election in 2019. This study used the 2019 Thai general election as the 'event of interest'. Results revealed that stocks of companies in industries infiltrated by crony capitalism had higher positive abnormal returns than stocks in other industries, implying that these companies benefitted from crony capitalism.

The remainder of this article is structured as follows. The next section explains the data and method used. The third section reports the results, whereas the final section concludes.

2. DATA COLLECTION METHODOLOGY

Data provided by the Stock Exchange of Thailand were obtained from SETSMART to study the relationship between crony capitalism and stock returns. The dataset covered SET100 companies during the 2019 Thai general election. SETSMART also provided information on market indices and company characteristics. Similar to Susan *et al.* (2022) and Almagribi *et al.* (2023), size, return on equity, and debt-to-equity ratio for Thai SET100 companies are also obtained as control variables in a regression analysis using values from the last quarter of 2018.

Stock returns were used to study the general election in 2019 as 'the event'. The general election was held on Sunday, March 24, with the following trading day, March 25, used as the event date. The estimation window was assumed to extend from 270 trading days before the event date to 20 trading days before the event date, beginning one year before and ending one month before the event date.

Using a single-index model, stock returns showed regressed market indices as

$$R_{it} = \alpha_i + \beta_i RM_t + u_{it},$$

where i and t are company and time indices, respectively. R is the stock return, RM is the market return, and u is the residual, where α and β are the coefficients to be estimated. After estimating the coefficients, abnormal returns can be computed as

$$AR_{it} = R_{it} - (\alpha_i + \beta_i RM_t),$$

where AR is an abnormal return. The cumulative abnormal return was computed over an event window as

$$CAR_i(0, T) = \sum_{t=0}^T AR_{it}$$

where $CAR(0, T)$ is the cumulative abnormal return from the event date to T days after the event date. During the 2019 Thai general election, the cumulative abnormal return of a company with crony capitalism was expected to be higher than others, allowing benefits from political connections for easier reestablishment under a new government.

To assess whether a company with crony capitalism had a higher cumulative abnormal return than other companies, the cumulative abnormal return was regressed on a variable indicating crony capitalism and other control variables as

$$CAR_i(0, T) = \delta_0 + \delta_1 Crony_i + \delta_2 \ln Size_i + \delta_3 ROE_i + \delta_4 D2E_i + v_i$$

where *Crony* is a dummy variable indicating whether the company operates in an industry characterized by crony capitalism, *lnSize* is the logarithm of the total assets of a company, *ROE* is the return on equity, *D2E* is the debt-to-equity ratio, and *v* is the residual. As one of the coefficients to be estimated, δ_1 is expected to be positive because a company with crony capitalism is expected to have greater cumulative abnormal returns than other companies.

To elucidate the industries characterized by crony capitalism, a dummy variable was introduced indicating crony capitalism subject to variation. *Crony1* defines companies in the construction services industry as being characterized by crony capitalism. The construction services industry is notorious for relying heavily on political connections and bribery to win government contracts. For instance, STEC was awarded contracts to construct the new parliament building and monorail structures.

Sonsuphap (2011) suggested that crony capitalism thrives in construction concessions, telecommunications, and commercial banking. These industries were also included in The Economist's crony-capitalism index. Political connections should benefit the telecommunications industry. ADVANC, DTAC, and TRUE all relied on government concessions to operate their cellular services using specific spectrum. *Crony2* additionally identified crony capitalism in the information and communication technology industry, while *Crony3* further defined the banking industry. As suggested by Moon and Schoenherr (2022), heavily regulated banking industries could benefit from political connections. Descriptions of each variable are offered in Table 1, with summary statistics in Table 2.

Table 1 Descriptions of the variables

Variable	Description
$CAR(0, T)$	The cumulative abnormal return from the event date to T days after the event date. The event date was March 25, 2019.
<i>Crony1</i>	A dummy variable indicating whether the company operated in an industry characterized by crony capitalism. For a company in the construction services industry, the value was one; otherwise, it was zero.
<i>Crony2</i>	A dummy variable indicating whether the company operated in an industry characterized by crony capitalism. If a company was in the construction services or information and communication technology industries, the value was one; otherwise, it was zero.

<i>Crony3</i>	A dummy variable indicating whether the company operated in an industry characterized by crony capitalism. If a company was in the construction services, information and communication technology, or banking industries, the value was one; otherwise, it was zero.
<i>lnSize</i>	The logarithm of the total assets of a company covering the last quarter of 2018.
<i>ROE</i>	The return on equity of a company covering the last quarter of 2018.
<i>D2E</i>	The debt-to-equity ratio of a company covering the last quarter of 2018.

Table 2 Summary statistics

Variable	Mean	Min	Max	Standard deviation	Observation
<i>CAR(0,0)</i>	0.001833	-0.03106	0.046052	0.011644	100
<i>CAR(0,1)</i>	0.000769	-0.03092	0.044432	0.013203	100
<i>CAR(0,3)</i>	0.00193	-0.04493	0.067135	0.019025	100
<i>CAR(0,5)</i>	0.004811	-0.04412	0.061169	0.02524	100
<i>Crony1</i>	0.02	0	1	0.140705	100
<i>Crony2</i>	0.06	0	1	0.238683	100
<i>Crony3</i>	0.14	0	1	0.348735	100
<i>lnSize</i>	18.07663	14.38995	21.88245	1.534789	100
<i>ROE</i>	15.2104	-44.51	64.78	12.68113	100
<i>D2E</i>	1.9559	0.16	12.14	2.126496	100

Results in Table 2 show that average cumulative abnormal returns were positive, with 2% of companies in the construction services industry, 4% in the information and communication technology industry, and 8% in the banking industry.

3. RESULTS

Regression results of cumulative abnormal returns on cronyism are shown in Tables 3 – 5. The dependent variables in columns (1) – (4) are *CAR(0,0)*, *CAR(0,1)*, *CAR(0,3)*, and *CAR(0,5)*, respectively with *lnSize*, *ROE*, and *D2E* included in all columns. Table 3 employs *Crony1*, while Tables 4 and 5 employ *Crony2* and *Crony3*, respectively.

Table 3 Cumulative abnormal returns and cronyism—*Crony1*

	(1) <i>CAR(0,0)</i>	(2) <i>CAR(0,1)</i>	(3) <i>CAR(0,3)</i>	(4) <i>CAR(0,5)</i>
<i>Crony1</i>	0.028*** (0.008)	0.020* (0.009)	0.030* (0.013)	0.017 (0.018)
<i>lnSize</i>	-0.001 (0.001)	-0.001 (0.001)	-0.002 (0.001)	-0.003 (0.002)
<i>ROE</i>	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)
<i>D2E</i>	-0.000 (0.001)	-0.000 (0.001)	-0.001 (0.001)	-0.001 (0.001)
Constant	0.021 (0.016)	0.020 (0.019)	0.048 (0.026)	0.066 (0.035)
Observations	100	100	100	100

R^2	0.135	0.066	0.101	0.079
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Note: Standard errors are enclosed in parentheses. *, **, and *** indicate 10%, 5%, and 1% significance.

Results in Table 3 showed that *Crony1* was positive and significant in the first three columns, with $CAR(0,0)$, $CAR(0,1)$, and $CAR(0,3)$ as the corresponding dependent variables indicating that the construction services industry experienced a greater increase in abnormal returns during the election than other industries. Thus, political connections through cronyism were important and valuable in the construction services industry. This could be due to the result of the construction services industry's reliance on government contracts for infrastructure projects such as roads and rails. There were numerous planned subway and elevated train projects in Thailand. The new government could be of tremendous benefit to these construction companies.

Table 4 Cumulative abnormal returns and cronyism—*Crony2*

	(1) $CAR(0,0)$	(2) $CAR(0,1)$	(3) $CAR(0,3)$	(4) $CAR(0,5)$
<i>Crony2</i>	0.006 (0.005)	0.007 (0.006)	0.018** (0.008)	0.017 (0.010)
<i>lnSize</i>	-0.001 (0.001)	-0.001 (0.001)	-0.003 (0.001)	-0.003 (0.002)
<i>ROE</i>	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)
<i>D2E</i>	-0.000 (0.001)	-0.000 (0.001)	-0.001 (0.001)	-0.002 (0.001)
Constant	0.025 (0.017)	0.024 (0.019)	0.055* (0.026)	0.071* (0.035)
Observations	100	100	100	100
R^2	0.038	0.033	0.105	0.094

Note: Standard errors are enclosed in parentheses. *, **, and *** indicate 10%, 5%, and 1% significance.

In Table 4, *Crony2* was positive and significant in the third column, with $CAR(0,3)$ as the dependent variable, indicating that the information and communication technology industry showed a higher increase in abnormal returns during the election than other industries. Results suggested that both the construction services and the information and communication technology industries benefitted from cronyism.

Table 5 Cumulative abnormal returns and cronyism—*Crony3*

	(1) $CAR(0,0)$	(2) $CAR(0,1)$	(3) $CAR(0,3)$	(4) $CAR(0,5)$
<i>Crony3</i>	0.006 (0.005)	0.006 (0.005)	0.012 (0.007)	0.003 (0.010)
<i>lnSize</i>	-0.002 (0.001)	-0.002 (0.001)	-0.003* (0.002)	-0.003 (0.002)
<i>ROE</i>	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)	-0.000 (0.000)
<i>D2E</i>	-0.001	-0.001	-0.002	-0.002

	(0.001)	(0.001)	(0.001)	(0.002)
Constant	0.031	0.030	0.066**	0.072
	(0.017)	(0.020)	(0.028)	(0.037)
Observations	100	100	100	100
R^2	0.039	0.032	0.080	0.071

Note: Standard errors are enclosed in parentheses. *, **, and *** indicate 10%, 5%, and 1% significance.

Results in Table 5 showed that *Crony3* was positive but not significant in all columns, indicating that companies in the three industries had abnormal returns, comparable to companies in other industries. Cronyism did not benefit the banking industry, rendering the coefficient insignificant.

Crony1 was significantly more frequent than *Crony2* and *Crony3* because the construction services industry benefitted the most from cronyism. This result was consistent with the reputation of the construction services industry as heavily relying on political connections and bribery to secure government contracts.

4. CONCLUSIONS

This study assessed the relationship between crony capitalism and stock returns using data collected from SET100 companies during the 2019 Thai general election as “the event”. This event was chosen as the point when democratically elected politicians reclaimed power, benefitting companies that relied on crony capitalism.

Results showed that stocks of companies operating in sectors subject to crony capitalism had higher positive abnormal returns than stocks of companies operating in other sectors. Specifically, companies in the construction services and information and communication technology industries experienced greater abnormal returns than those operating in other industries. Findings implied that crony capitalism was more prevalent in these two industries, particularly construction services. Therefore, investors should exercise caution in dealings with stocks of companies subject to crony capitalism because these may show higher volatility during election periods. For example, STEC rose sharply during the 2019 election and then fluctuated following the election due to political uncertainty. Prior elections, such as the 2011 election, also witnessed fluctuations in STEC and similar stocks.

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