POLITICAL CONNECTIONS, CORRUPTION AND ACCESS TO CREDIT IN VIETNAMESE SMES

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Abstract - The observation of firms' political connections (PCs) and corruption has raised the question of their benefits to firms' operation, especially on accessing to the financial resources. Firms with stronger political connections or informal payment willingness may get easier in approaching to formal bank loans. By using different types of PCs and bribe, the study shows that while PCs can help SMEs in getting formal bank loans, bribe does not have any effect on firms' access to credit. The PCs can be known as the social capital, which helps the firm in accessing the resources. The paper gives a better understanding about the characteristics of SMEs in an emerging market and a network-oriented country like Vietnam.

Key words - Political connections; corruption; bribe; access to credit; SMEs; Vietnam

JEL classification: G32, G38, O16, O53.

1. Introduction

Small and medium enterprises (SMEs) play an important role[1] in economic development of emerging countries like Vietnam. However, existing studies find that SMEs in emerge market including Vietnam are facing many difficulties in access to credit [1]; [2]. This phenomenon can be explained by [3] using information asymmetries theory. Financial institutions do not have sufficient information about SMEs' project and their payment ability as well as their creditworthiness. Moreover, formal financial institution not willing to invest in collecting this type of information due to the small loan amount and the fixed cost nature of collecting information [4]. Therefore, the model of "relationship lending" is usually used by bank in granting loan for SMEs [5]. In this model, banks rely on "soft information" gathered by the loan officer through continuous, personalized, direct contacts with SMEs, their owners and managers, and the local community in which they operate [6]. By the relationship lending, banks may generate additional value by learning about the borrowers through their relationship with the borrowers and providing the decisions. In this case, political connection or bribes likely helps SMEs access to credit, especially in in developing and transition economies where absent well-developed formal institutions.

Empirically, many authors show that political connections have a strong positive effect on credit access of firms in developing countries [7]; [8]; [9]; [10]; [11]; [12]. Some authors explain that political connection may help enterprise access to additional social resource used in case of repayment problems [13]; [14] that reduce risks in collection loan for financial institutions. Moreover, having political connections is often associated with political power, which can be used to negotiate with formal financial institutions officers to overcome credit obstacles [14]. In Vietnam, [15] finds that firms whose owner is a member of Communist Party decrease the likelihood of being credit-constrained. However, the measurement of political connection does not include the case that the owner has connections with politicians. Thus, the aim of our study is to close this gap by using different measurement for variables.

Regarding corruption, international studies suggest that it affects firms' access to credit both positively and negatively. On one hand, bribery helps firms in both developed and developing countries access to credit [16]; [17]. More interestingly, [17] show that bribery is more of help than performance for firms in attempting to obtain larger loans in a high corruption country like China. On another hand, corruption increases credit constraint of firms [18]; [19]; [20]. Paying bribes increase loan cost [1] that make small businesses in high corruption countries more likely refrain from applying for loans due to fear of rejection [19]. Besides, financial institutions will be more restricted to grant credit for SMEs because high corruption indicates weak legal environment for protecting creditors and enforcing contracts that make financial institution find it's hard to control borrow risk for SME's loan. In Vietnam, corruption is also a major economic concern as it inhibits economic growth [21]. However, to the best of our knowledge, studies about impact of corruption on credit access in Vietnam are still limited. Therefore, we conduct this study to examine this relationship in Vietnam.

In this paper, we focus on SMEs only by using the data from surveys carried out in collaboration between the Institute of Labour Studies and Social Affairs (ILSSA) in the Ministry of Labour, Invalids and Social Affairs (MOLISA) and Department of Economics, University of Copenhagen with funding from DAN- IDA in 2015. Two logit models are used separately to analyse the impact of political connection and corruption on SMEs' access to credit from formal financial institution. The regression results show that firms whose owners have/had positions in village, commune, district, province cadre or he/she has membership of the Communist Party or firms with bigger

[1] According to Vietnam Business Annual Report of VCCI in 2016, SMEs account for major share (97%) of enterprises in Vietnam. This sector also provides jobs for a large number of workers, and contributing significantly to national income. Particularly, it contributes over 40% of the GDP, accounts for 31% of the government budget revenue and roughly 30% of the total export turnover and creates over 70% of employment.

political connections may have lower probability to face with difficulty in accessing to credit. Nevertheless, informal payment or bribe does not have any effect on accessing to credit in Vietnam. This study differs from existing studies in several important ways. First, while prior studies only include firms whose owners have been members of political party, we added the case that the owner has connections with at least one politician. Second, we examine the impact of corruption form perspective of SMEs on their credit access while the studies about this problem have not been carried out in Vietnam.

2. Literature review and hypotheses development

2.1. Political connection and access to credit

"Corporate political connections could be defined as a special relationship between a firm and those who hold political powers in the place where firm operate" [22]. These connections range from organizational-level ties such as state ownership and personal-level linkages focusing on managerial political ties [23]. The former is known as ascribed political connection that helps firm certainly gain political resources from the government such as low-cost loans from state-owned banks [24]. The latter is called as acquired political connection that is created or developed via managerial-based political ties. Popular managerial-based political tie identified in many prior study is the case that firm's owner or director is a member or a former member of political organizations [25]; [7]; [13]; [26]; [10]; [27]; [28]; [29]; [15]; [12]. Acquired political connection can also be formed by informal ties of top officers through close relationship with political parties [25], pure chance personal encounters [7], campaign contributions [30] or regularly meetings with government or public officials dealing with regulatory issues [31]. Generally, firms with acquired political connection always need to seek or maintain their ties. Therefore, top officers can use firm's resources for rent-seeking that increases the cost of firm [32]. However, acquired political connection also helps firm in access to finance from formal financial institution because politicians could pressure local bankers into offering better terms to politically connected firms and work within their institutional environment to reduce favored firms' risk premium [26]. Empirically, a large number of prior studies show that political connections can help firms in obtaining bank credit. International evidences show that politically connected firms have much more debt [25]. Also, [31] analyses World Bank's Enterprises Survey (WBES) dataset focusing on SMEs and indicated that political connections have a strong positive effect on credit access. Similar results are found in emerge markets such as Malaysia [10]; [7], China [13]; [9]; [11]; [12], Indonesia [19]. Regarding developed countries, [26] points out that political influence improves firms' access to finance beyond domestic (bank) debt markets in Italy. Likewise, [29] proves that the cost of bank loans is significantly lower for companies that have board members with political ties in the US. These results are much more relevant in developing countries.

Vietnam is a transition country with "weak legal institutions, a large and growing state-dominated bank sector and rapidly expanding entrepreneurship" [33]. Therefore, firms usually rely on informal networks for doing business [34]. In credit market for SMEs, it is more likely that connection helps SMEs access to finance because bank usually use the model "relationship lending" to grant loan for SMEs [5]. [33] find that Vietnamese private firms with political connections are significantly more likely to receive bank financing. Political ties in this study are identified in third cases related to Vietnam Communist Party, government official or military officer and state-owned enterprises. Focusing on the case that firm's owner is (or becomes) a member of the Communist Party of Vietnam, [15] found similar result that political connection decreases the likelihood of being credit-constrained of Vietnamese SMEs. Although these studies do not cover all forms of political connections such as informal connection with politicians, the results are relevant to other prior studies in foreign countries.

Motivated by the results from the above literature stream that having political connections help SMEs in access to credit and the context of network-oriented and transitional country like Vietnam, we formulate our first hypothesis as follows:

H1: Politically connected SMEs less constrained in credit markets in Vietnam

2.2. Corruption and access to credit

"Corruption is the abuse of entrusted public power for private gain" [35]. More specifically, corrupt practices involve "offering, giving, receiving, or soliciting" anything of value to get thing done in purchasing process or in contract execution that relates to public officers. According to this definition, it is understandable that corruption is still exists, especially in emerging markets where absent a strong institutional environment and lack transparency in administrative as well as legal frameworks [36]. SMEs in these countries are more probably to be forced to engage in bribery than large enterprises to cope with unfavourable business environments [8]. In credit market, formal financial institutions impose a lot of rigorous conditions on SMEs as a result of information asymmetry. These obstacles encourage SMEs to use informal payments like bribes as grease to gain access to credit. Empirically, [16] analyse the contemporaneous corruption and governance indices from a dataset for a sample of 69 countries over the world and find that corruption is has a positive effect on the economic activities in countries where the institutional framework is weak. In China where financial sector is beset by corruption, [17] also prove that bribery greases the wheels of finance that helps private firms be allocated more credit.

However, another literature strand argues that corruption has negative impact on credit accessibility of SMEs [18]; [19]; [20]. [18] demonstrate that paying bribes increase credit constraint of SMEs in South Asia. In transition countries, [20] also report that access to bank credit is tighter for firms that engage more frequently in bribery. These results can be explained by looking at the demand-side and the supply-side. On the demand-side argument, paying bribes increase loan cost that constitutes a big obstacle in access to credit of SMEs [1]. Besides, the level of corruption effects on the behaviour of small firms in credit market [19]. [19] prove that small businesses in high corruption countries more likely refrain from applying for loans due to fear of rejection. On the supply-side argument, high corruption indicates weak legal environment that protect creditors and enforce contracts. Consequently, financial institutions will find it difficult to control borrower risk and recover the loan in the event of default [37]; [18]. Therefore, financial institutions will be more restricted to grant credit for SMEs.

In Vietnam, corruption is still considered widespread throughout the country and Vietnam still lags behind other Asian countries in terms of control of corruption and most governance indicators [38]. Vietnam is ranked 96th amongst 180 countries in the 2015 Global Corruption Report [2](where the country with the highest corruption level is ranked at 180). Prior studies find that corruption is sand in the wheel of economics. For instances, many others demonstrate that corruption has a negative impact on the growth of Vietnamese firms [39]; [40]; [41] and private sector investment, employment as well as per capita income at the provincial level in Vietnam [42]. Similarly, the survey of 79 firms in Vietnam conducted by [43] suggests that corruption is perceived as the most impactful business obstacle for their operation. [43] also indicate that corruption affects medium-sized enterprises are more likely to pay unofficial charge than other enterprises. In the credit market, we found the only one study conducted by [2] indicated that household businesses have to make 'grease payments' to get a loan, mainly from banks. Combining two strands of prior researches in foreign countries and the impact of corruption on business environment of Vietnam, in this study, we conjecture that corruption increase SMEs' level of credit constraint. Hence, we formulate our second hypothesis as follows:

H2: Corruption is negatively associated with credit access of SMEs in Vietnam.

3. Methodology

3.1. Models and variable measure

In order to figure out the influence of political connections and corruption in SMEs on the difficulty in accessing to credit, equations (1) and (2) are built. The first equation is used to test the impact of political connections on the difficulty in accessing to credit, and equation (2) is for testing the effect of corruption on the difficulty in accessing to credit.

$$(1)\ DIFF_i = \beta_0 + \beta_1{*}POLCON_i + \beta_2{*}CONTROLS_i + e_i$$

$$(2)\ DIFF_i = \beta_0 + \beta_1{*}CORRUP_i + \beta_2{*}\ CONTROLS_i + e_i$$

Difficulty in accessing to credit is measured as a binary variable on whether the firm faces with any difficulty to get a bank loan. It equals one if the firm thinks it is difficult to get a formal loan from financial institutions and zero otherwise. POLCON is measured by using four proxies: POLCON1 is a binary variable, which is one if the owner of the firm has/had a position in village, commune, district, province cadre since we think the owner is easier to get connections with politicians if they are/were working in those positions. POLCON2 is also a binary variable, which equals one if the owner of the firm is a war veteran; POLCON3 equals one if the owner of the firm has membership of Communist Party; and POLCON4 is the number of politicians the owner has connections with. For the CORRUP, we measure it by a binary variable, which is one if the firm needs to pay any bribe.

We include owner age (OAGE), owner gender (OGENDER), firm age (FAGE), firm size (FSIZE), owner education (EDU) and innovation (INNO) as the control variables in this study. OAGE is the age of the owner of the household business [44]; OGENDER is a binary variable, which equals one if the owner is male and zero if the owner is female. Besides that, larger or older firms can be more experienced in dealing with financial need, which influences their credit choices. Table 1 shows the variable definitions in detail.

Table 1. *Variable Definition*

Var. name	Definition
DIFF	1 if the firm thinks it is difficult to get a formal loan from financial institutions, 0 otherwise.
POLCON1	1 if the owner of the firm has/had a position in village, commune, district, province cadre, 0 otherwise.
POLCON2	1 if the owner of the firm is a war veteran, 0 otherwise.
POLCON3	1 if the owner of the firm has membership of Communist Party, 0 otherwise.
POLCON4	The number of politicians the owner has connections with.
BRIBE	one if the firm needs to pay any bribe, 0 otherwise.
OAGE	The age of the firm's owner.
OGENDER	The gender of the firm's owner. 1 for male, 0 for female.
FAGE	The age of firm.
LABOR	The number of employees of the firm.
FSIZE	The logarithm of the total asset.
EDU	1 if the owner has college/university degree, 0 otherwise.
INNO	1 if the firm has introduced new technology or a new product and zero otherwise.

3.2. Data

We use the data from surveys carried out in collaboration between the Institute of Labour Studies and Social Affairs (ILSSA) in the Ministry of Labour, Invalids and Social Affairs (MOLISA) and Department of Economics, University of Copenhagen with funding from DAN- IDA in 2011, 2013, 2015. We focus on SMEs only since we think political connections play important roles in doing business in those enterprises. The sample includes 3,277 observations. Those enterprises are located at 9 provinces: Hanoi, Ho Chi Minh City, Haiphong, Khanhhoa, Lamdong, Longan, Nghean, Phutho and Quangnam.

[2] According to the Transparency International (2021), Vietnam scored 39 in the Corruption Perceptions Index (CPI), which ranges between 100 (highly clean) and 0 (highly corrupt)

Table 2. *Descriptive Statistics*

	Mean	Std. Dev.	Min	Max
DIFF	0.0712	0.257	0	1
POLCON1	0.0264	0.160	0	1
POLCON2	0.0284	0.166	0	1
POLCON3	0.0813	0.273	0	1
POLCON4	1.834	1.739	0	6
BRIBE	0.7161	0.451	0	1
FSIZE	9064.857	10969.21	480	41120
OAGE	42.855	11.100	26	63
OGENDER	0.4984	0.50025	0	1
FAGE	12.659	5.227	4	24
EDU	0.4628	0.4988	0	1
INNO	0.2370	0.4254	0	1

We also use the pearson correlation coefficients to test for the possibility of serious multi-collinearity, the result shows that there is no multi-collinearity in the models.

4. Regression results

The Table 3 presents the regression results by using logit model. In the model (1), we put all proxies of political connections into one model; the coefficient of POLCON1, POLCON2, POLCON4 are negatively significant. This is consistent with the expectation that with political connections, we may avoid the difficulty in getting formal bank loans. In order to figure out the impacts of different types of political connections, we put each of proxies of political connection into models (2), (3), (4), (5). According the results in those models, the coefficients of POLCON1, POLCON2 and POLCON4 are negatively significant. The negative coefficient of POLCON1 and POLCON2 indicate that the firms have lower probability to face with the difficulty if the owners have/had positions in village, commune, district, province cadre or he/she has membership of Communist Party; while the negative coefficient of POLCON4 shows that firm with bigger political connections may have lower probability to face with difficulty in accessing to credit.

The model (6) shows the regression result on the effect of corruption on the difficulty in accessing to credit. The result shows that the coefficient of BRIBE is insignificant. This indicates that informal payment or bribe does not have any effect on accessing to credit.

Table 3. *Regression Results*

	(1)		(2)		(3)		(4)		(5)		(6)	
	Coef.	T	Coef.	t	Coef.	t	Coef.	t	Coef.	t	Coef.	t
POLCON1	-0.064***	-3.24	-0.069***	-4.03								
POLCON2	-0.070***	-3.22			-0.081***	-3.99						
POLCON3	0.005	0.15					-0.015	-0.44				
POLCON4	-0.013**	-2.43							-0.013**	-2.42		
BRIBE											0.037	1.57
FSIZE	0.016*	1.89	0.013	1.59	0.012	1.46	0.013	1.56	0.016*	1.94	0.011	1.36
OAGE	-0.001	-0.45	-0.001	-0.67	-0.001	-0.58	-0.001	-0.60	-0.001	-0.72	-0.001	-0.75
OGENDER	-0.011	-0.45	-0.011	-0.44	-0.009	-0.39	-0.011	-0.47	-0.013	-0.53	-0.013	-0.53
FAGE	0.001	0.60	0.001	0.51	0.001	0.46	0.001	0.47	0.001	0.57	0.001	0.50
EDU	-0.034	-1.49	-0.036*	-1.66	-0.037*	0.088	-0.037*	-1.65	-0.035	-1.63	-0.038*	-1.75
INNO	0.016	0.63	0.016	0.62	0.019	0.73	0.017	0.67	0.017	0.66	0.019	0.72
Indus. dum.	*Y*		*Y*		*Y*		*Y*		*Y*		*Y*	
Year dum.	*Y*		*Y*		*Y*		*Y*		*Y*		*Y*	
Obs.	3.277		3.277		3.277		3.277		3.277		3.277	
Pseudo R^2	0.0332		0.0229		0.0240		0.0209		0.0282		0.0241	

5. Conclusion

The regression results reveal that firms with political connections may have lower probability to face with difficulty to get formal loans. The owners of the firms get easier to connect with politicians if they had/have positions in village, commune, district, province cadre or he/she is a war veteran; hence, their political connections may help the firms in getting formal loans from banks and other financial institutions. Besides, the paper also figures out that the more politicians the owners connect with, the stronger support they can get from them. It is interesting in the results that the membership of Communist Party does not have any effect on access to credit of SMEs. Another interesting result shown in the paper is that bribe does not influence on access to credit of the firms. It can be explained that bribe may be also a constraint when firms try to get formal loans from banks and other financial institutions.

Overall, the study gives a better understanding about the characteristics of SMEs in an emerging market and a network-oriented country like Vietnam. Accordingly, firms, especially SMEs are facing with many difficulties in accessing to credit (credit constraint), government, financial institutions and other social associations should better support SMEs because they bring many benefits and value to the whole society.

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