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**Political Ties and Venture Capital:
Evidence from China**

A thesis presented in fulfilment of the requirement for the
degree of
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in
Finance

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“Eventually everything connects - people, ideas, objects. The quality of the connections is the key to quality per se”

–Charles Eames

ABSTRACT

This thesis investigates whether venture capital firms (VCs) benefit from political ties (PTs), and whether VCs add value to China's public equity market by constraining earnings management (EM) and improving corporate governance of their backed firms. The first essay examines whether PTs facilitate VCs' successful exits via either initial public offerings (IPOs) or merger and acquisitions (M&As). Using a sample of 2578 Chinese portfolio firms that received their initial VC funding during 2004-2010, this essay shows that PTs increases the likelihood of VCs' successful exit through mainland stock markets and M&A markets. It further shows that VCs with management-level PTs enjoy greater success than those with ownership-level PTs, whereas no significant difference between central and local government PTs on VC exits.

The second essay examines whether VCs with PTs are better able to constrain opportunistic earnings management (EM) in Chinese IPO markets. It shows that IPOs backed by VCs with ownership-level PTs are more likely to conduct opportunistic IPO-year EM, while those backed by VCs with management-level PTs are associated with lower IPO-year EM. The higher EM in IPOs backed by VCs with ownership-level PTs is mainly driven by VC lock-up sale within six months following VC lock-up expiration, while the lower EM in IPOs backed by VCs with management-level PTs is not significantly associated with VC lock-up sale. Lastly, IPOs subject to immediate exits from VCs with ownership-level PTs exhibit poorer post-issue stock performance, while

IPOs backed by VCs with management-level PTs exhibit better post-issue stock performance regardless of VC lock-up sale.

The final essay investigates how VCs influence the size and composition of corporate boards. Using hand-collected data from 924 IPO prospectuses, this essay shows that VC-backed IPOs have more independent boards in China. Furthermore, VCs with management-level PTs improve governance by using their networks to recruit specialist independent directors with industry relevant expertise. Lastly, this essay shows that IPOs with more independent boards are not necessarily associated with better performance. However, IPOs backed by VCs with management-level PTs and firms that have a larger percentage of independent directors with industry relevant expertise exhibit higher long-term stock returns.

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