

CORPORATE, SOCIAL, POLITICAL CONNECTIONS AND CORPORATE GOVERNANCE: A REVIEW

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Abstract

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Considering the important role of connections in corporate governance quality, this review paper has investigated the effectiveness of corporate, social, and political connections on corporate governance practices. In general, the findings of this research show that networking activities in various forms positively and negatively affect corporate governance practices. As far as corporate connections are concerned, there is no consensus on the relationship between interlocked boards and firm performance. Moreover, interlocking boards are positively associated with the propagation of some governance malpractices such as earnings manipulation and options backdating. Regarding social connections, the evidence provides contradictory results regarding the effects of social ties on CEO compensation and firm performance. Finally, as for political connections, the findings related to the impact of political connections on corporate decisions and firm value are mixed. Furthermore, politically connected firms pay lower taxes; have more access to credit markets; and enjoy governmental contracts. Additionally, in some cases, political ties are positively associated with corrupt activities.

Keywords: Connections, Interlocked Boards, Political Connection, Interlocking Directorates, Corporate Governance, Board Networks

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1. INTRODUCTION

We live in a small world where every two random persons could be connected to each other by a short chain of separate individuals or short social distances (Kogut, 2012; Milgram, 1967). This number gets a lot smaller in the corporate elite world in which the CEOs, directors, and corporate elite often know each other, work together, and share common organizational ideas and information (Bertoni & Randone, 2006; Conyon & Muldoon, 2006; Mills, 2012; Sankar, Asokan, & Kumar, 2015; Sankowska & Siudak, 2016; Sinani, Stafsudd, Thomsen, Edling, &

Randøy, 2008). A firm's networking activities may be formed based on corporate, social (Davis, 1996), and/or political connections (Faccio, 2006). In the U.S., board networks are mainly associated with social connections like the relationship between friends. In contrast, in Japan they are often linked to corporate needs and connections such as banking or customer-supplier relationships (Davis, 1996).

Corporate connections matter in corporate governance. In a broad sense, corporate connection is defined as a network of firms connected through business relationships by which they can have better access to knowledge, capital, information, and trust

(Cordova-Espinoza, 2018). Apart from directors' level of knowledge, experiences, and skills, corporations like individuals need corporate connections as social capital to earn more success (Connelly & Van Slyke, 2012). Interlocking directorates play an important role in disseminating information (Hao, Hu, Liu, & Yao, 2014) and make a network through which common values and norms can spread (Koenig & Gogel, 1981). Corporate connections facilitate the exchange of financial practices and experiences between interlocked directors (Cordova-Espinoza, 2018). Moreover, interlocking directorates are the conduits of organizational knowledge and experience exchange (Shropshire, 2010). Taking the literature into account, we find that corporate connections facilitate information transfer via interlocked boards and contribute to higher firm performance followed by an increase in formation asymmetry and reduced agency costs. In contrast, busy directors serving multiple boards impair board monitoring activities and as a result, negatively affect corporate investment decisions. Consequently, there is no consensus on the relationship between interlocked boards and firm performance. Moreover, board networks play a considerable role in propagating some corporate malpractices such as options backdating and earnings manipulation.

Social connections and corporate governance are inextricably linked to each other. The corporate elite usually has common schools and professional trainings. They may go to the same clubs and sit on the same boards. They usually share membership in organizations or charities and have other backgrounds in common. These mutual acquaintanceships form an informal social network in which directors and CEOs can gain access to superior communications and make investment decisions through an information exchange that is indispensable for leaders (Mills, 2012). The social network of the corporate elite exists in all countries and can affect businesses as a source of competitive advantage (Davis, Yoo, & Baker, 2003; Nguyen, 2012; Xin & Pearce, 1996). The findings of this research provide contradictory results regarding the effects of social connections on CEO compensation and firm performance with respect to corporate investment and M&As decision-making quality. However, some literature exists in support of the negative impact of social networking on board independence and monitoring quality. It also provides some evidence regarding the association of corruption with social connections.

Political connections made by corporations are another type of network that influences corporate governance quality. According to Faccio (2006), a company is politically connected if at least one of its large shareholders, holding 10% of voting shares, or one of its top executives has engaged in politics, serves, or has served as a head of state, parliament member, or minister. A company is also considered as politically connected if it has relationships with foreign politicians or has a friendship with top politicians and political parties (Faccio, 2006). The connection between firms and politicians exists in numerous forms. Firms may make friendship ties with politicians. They may invite them to serve as board members in the companies and finally, they may support an individual politician or a political party with campaign financing. Business and politics

are closely tight to each other and political connections are widespread in the world (Faccio, 2006). Bertrand, Kramarz, Schoar, and Thesmar (2007) documented that more than 50% of the assets in the French stock markets are managed and traded by the CEOs who previously served as government employees. Furthermore, in a corporate governance context, top executives try to make political connections in order to increase firm performance and create value for the shareholders (Tang, Lin, Peng, Du, & Chan, 2016). Political connection facilitates a firm's access to more resources (Zhu, 2016), and is an important determinant of stock price volatility (Datta & Ganguli, 2014). Agrawal and Knoeber (2001) discussed that in corporations with higher trading levels with governments, political connections are considerably linked to firm performance and therefore, such companies often have directors with political experience and background on their boards. Claessens, Feijen, and Laeven (2008) found that political connections serve as a channel through which contributing firms can have access to bank financing. Moreover, politically connected firms support the re-election of politicians and in return, enjoy governmental contracts and privileged opportunities (Boubakri, Cosset, & Saffar, 2012). This paper provides evidence that politically connected firms take advantage of paying lower taxes, receiving more loans, and obtaining governmental contracts. On the other hand, political connections are more likely to be exposed to corrupt activities mainly related to political and economic rents. However, the literature shows inconsistent results about the impact of political connections on corporate decisions and firm value. Moreover, the impacts of political ties on earnings management and voluntary disclosure quality are mixed.

Do networking activities in any form, including corporate, social, and political, affect corporate governance quality? To address this research question, the current paper reviews the impact of corporate, social, and political connections on corporate governance practices from different aspects based on the literature. The findings of this review paper provide the executives and the board directors with useful information in making effective connections. In other words, the results of this research can inform the corporate decision-makers of the advantages and disadvantages of engaging in networks so that they can have a better understanding of the types of connections and the associated conditions that best suit their firms and can create wealth for their shareholders.

The rest of the paper is structured as follows. Section 2 concentrates on corporate connections and their advantages and disadvantages for the firms. In Section 3, we review the findings related to social connections and their positive and negative impacts on the firms. Section 4 discusses the impact of political connections on companies. Finally, the conclusion is presented in Section 5.

2. CORPORATE CONNECTIONS

Based on empirical research, we define corporate connection as a network of directors that are linked to each other via serving on multiple boards and form interlocking boards. It also refers to informal and friendly relationships between the directors

and top executives at the firm level. Equity or interlocking directorates and ownership networks are two types of corporate connections (Cordova-Espinoza, 2018). However, our focus is on interlocking directorates that is a form of a corporate connection made by a vast and diverse network of shared directors who serve on the boards of other firms and build board interlocks (Barzuza & Curtis, 2014; Connelly & Van Slyke, 2012). Since 1914, board interlocks have been an interesting research topic in different fields including social networks, general management, sociology, and corporate governance. To date, this phenomenon has evolved during four distinct periods: the emerging debate, the earliest modern, the modern, and the post-modern eras.

The emerging debate era is distinguished by the studies that explain the reasons for the formation of interlocking directorates, as well as their legal restrictions (Caiazza & Simoni, 2019). Accordingly, numerous models and theories were presented to discuss why such ties take place. Management control, finance control, and reciprocity models discuss that firms build interlocking boards for the purpose of affecting shareholders' votes; taking possession of debtor firms; and developing mutual corporation relations, respectively. Moreover, based on legitimacy, social cohesion, and collusion models, firms tend to form interlocking directorates in order to legitimize their entity to investors and shareholders; to strengthen their power within more influential (Romano & Favino, 2013) and similar social groups (homophily) (Cordova-Espinoza, 2018; Heemskerk & Struijs, 2012); and to obtain illegal competitive advantage in the market (Cordova-Espinoza, 2018; Romano & Favino, 2013), respectively. In the earliest modern era, the concentration of the studies was more on the separation between the organizational and individual perspectives of interlocking directorates related to resource dependency and class hegemony theories, respectively (Caiazza & Simoni, 2019). According to resource dependency theory (Pfeffer & Salancik, 1978), firms make corporate ties to obtain the resources they need to reduce the uncertainty risks related to the external environment. They also use these ties to control the entrusted sources. As a result, interlocking boards function as a cooptative, coordinative, and controlling mechanism (Caiazza & Simoni, 2019; Romano & Favino, 2013). However, class hegemony theory (Useem, 1979) states that interlocking directorates provide the directors with a common culture and objectives, giving rise to more coordination in achieving their social, political, and economic interests (Caiazza & Simoni, 2019), as well as obtaining personal profits and more control power (Romano & Favino, 2013) through occupying influential positions (Caiazza & Simoni, 2019). The modern era's focus is on the role of interlocked boards in spreading experience and knowledge among firms, and in sharing similar behaviors when making strategic decisions (Caiazza & Simoni, 2019). The analysis of the impact of such behaviors on firm performance together with the influence of interlocking boards on directors' reputation, skill levels, and compensation was the subject of interest for many scholars (Romano & Favino, 2013). During the post-modern era, board interlocks were discussed in relation to the corporate

governance systems, putting more emphasis on socio-cognitive and institutional models that take into consideration both social influences and decision makers' interests in appointing interlocked directors (Caiazza & Simoni, 2019). Moreover, the role of interlocked boards in connection with competitor firms, market concentration, and competition was a research topic (Caiazza & Simoni, 2019; Romano & Favino, 2013).

In addition to collusion, cooptation and monitoring, legitimacy, directors' self-interests, and social cohesion, the literature also indicates some other motivating factors that contribute to the formation of interlocking directorates including the firm size, management control, financial interlocks, local interest groups, competition, access to credit sources (Cordova-Espinoza, 2018; Dixon, 1914), industrial purposes (Dixon, 1914), reputation (Cordova-Espinoza, 2018; Heemskerk & Struijs, 2012), and business development (Dixon, 1914).

In this section, we concentrate on corporate connections and their effects on corporate governance quality and firm performance. Corporate connections play an important role in affecting firm performance and developing governance practices (Barzuza & Curtis, 2014). They also have considerable impacts on corporate governance quality in different fields such as executive compensation and takeover strategies (Davis, 1996). Basically, the impacts of corporate connections on firms are considerable from two aspects. First, they function as control and management mechanisms. In doing so, they affect the board's monitoring level and consequently, the quality of corporate financial decision-making. Second, they have an influence on a firm's financial performance (Cordova-Espinoza, 2018). Board networks leverage social interactions and decrease information asymmetry. In addition, interlocked boards make effective connections with customers and suppliers and therefore, provide a competitive advantage for companies in making corporate decisions. They are also sources of support and information exchange for the firms and provide them with investment requirements such as capital and information (Larcker, So, & Wang, 2013). The evidence shows that about one-quarter of large companies have their directors on two boards in other companies (Connelly & Van Slyke, 2012). This type of connection, as a corporate control and coordination mechanism (Colli & Colpan, 2016), is of much importance in corporate governance decision-making, especially from the aspect of having access to more information sources to help the managers better evaluate and choose investment opportunities (Barzuza & Curtis, 2014; Connelly & Van Slyke, 2012).

Board connectivity influences governance quality from both positive and negative aspects (Balasubramanian, Barua, Bhagavatula, & George, 2011; Barzuza & Curtis, 2014; Connelly & Van Slyke, 2012; Larcker et al., 2013). On the one hand, the presence of interlocking directorates in a firm sends a positive message to its investors and shareholders that the firm has a high reputation with potential strategic growth opportunities, leading to higher firm value. On the other hand, connected boards observe the actions and behavior of other firms' directors, especially in relation to decision-making processes and the consequent failures and successes (Connelly & Van Slyke, 2012).

Therefore, they affect and are affected by each other; tend to have similar board and governance characteristics; and adopt similar norms, values, and behaviors (Bouwman, 2011; Connelly & Van Slyke, 2012). As a result, bad governance practices or unethical issues existing in a board can be imitated by other directors and be propagated via interlocked boards (Connelly & Van Slyke, 2012).

Corporate connections between firms can positively affect corporate governance practices. First, board interlocks are the channels for information diffusion (Barzuza & Curtis, 2014; Davis, 1996; Haunschild & Beckman, 1998; Hao et al., 2014; Omer, Shelley, & Tice, 2020). Accordingly, well-connected directors have access to rich and various sources of information related to regulatory changes, market trends, and business innovations in the industry (Larcker et al., 2013; Omer, Shelley, & Tice, 2014). Interlocking directorates are associated with higher levels of short-selling trading (Cheng, Felix, & Zhao, 2019). They also affect positively corporate innovation (Chang & Wu, 2020) in terms of patenting and R&D (Helmets, Patnam, & Rau, 2017). Srinivasan, Wuyts, and Mallapragada (2018) found that board interlocks as a source of market intelligence, contribute to introducing innovative products. Likewise, Mazzola, Perrone, and Kamuriwo (2016) showed that interlocked boards are positively associated with the effectiveness of inter-firm relationships on a firm's new product development. The exchange of information between interlocked boards increases directors' knowledge and experiences and results in higher firm value (Omer et al., 2014). However, interlocking directorates considerably affect corporate governance even in environments that are rich informationally (Barzuza & Curtis, 2014). The quality of information seeking through establishing social networks depends on some factors, such as being informed of what other parties know; valuing their knowledge; and having timely access to information and knowledge sources at a low cost (Borgatti & Cross, 2003). As such, the number of board interlocks and their strength (longstanding ties) are two important factors that can help firms benefit more in obtaining information efficiently (Connelly & Van Slyke, 2012). Second, interlocking directorates considerably and positively influence corporate governance quality in various fields such as monitoring, disclosure quality, firm performance, investment decisions, and board characteristics (Barzuza & Curtis, 2014; Fich & White, 2005; Larcker et al., 2013; Martin, Gozubuyuk, & Becerra, 2015; Peng, Mutlu, Sauerwald, Au, & Wang, 2015; Singh & Schonlau, 2009). Corporate networks act as informal governance mechanisms and increase investor protection (Stafsudd, 2009), and positively affect firm performance (Afzali & Kettunen, 2019; Wong & Hooy, 2018; Yeo, Pochet, & Alcouffe, 2003), especially in private firms, through reducing transaction costs. They are also related to higher employee productivity and lower cash holdings (Afzali & Kettunen, 2019). Barzuza and Curtis (2014) concluded that interlocking boards increase monitoring quality and performance of outside directors through providing them with useful information. Handschumacher, Behrmann, Ceschinski, and Sassen (2019) demonstrated that board interlocks are positively connected to management pay and monitoring effectiveness

measured by pay-for-performance sensitivity. Fich and White (2005) argued that reciprocal interlocking networks in which two companies have board members on each other's boards, positively affect firm value and CEO incumbency. Moreover, interlocked boards act as information channels to share corporate disclosure policies (Cai, Dhaliwal, Kim, & Pan, 2014). Connected board members can assure other members of the correctness of governance practices based on what they have previously observed and experienced in other firms. They have more experience in analyzing financial reports and statements (Barzuza & Curtis, 2014). Furthermore, firms with connected boards earn stronger improvements in return on assets (ROA) (Pombo & Gutierrez, 2011; Singh & Delios, 2017), and higher stock returns in the future. They have more tendency in following growth opportunities in both domestic and international markets (Singh & Delios, 2017) and generate economic benefits that are not immediately captured by their stock prices (Larcker et al., 2013). The findings of Singh and Schonlau (2009) showed that interlocked directors show better performance when choosing the targets as well as payment methods during the process of making mergers and acquisitions (M&As). They also make successful M&As with abnormal post-M&As returns and more growth in ROA (Singh and Schonlau, 2009). Finally, in cases where corporate practices are required to change by law, e.g., the introduction of the poison pill as a takeover defense strategy, board interlocks play a considerable role in spreading the legal changes (Barzuza & Curtis, 2014). A poison pill is a takeover defense mechanism that increases the cost of acquiring a firm by a hostile acquirer. The pill is issued to shareholders as a dividend and allows them to buy the firm's shares at a discounted rate where the firm becomes a takeover target without the board approval. As such, interlocking networks provide a social structure through which poison pill adoption spreads (Davis, 1991).

Conversely, some studies have discussed how board networks negatively affect governance practices (Armstrong & Larcker, 2009; Barzuza & Curtis, 2014; Bizjak, Lemmon, & Whitby, 2009; Chauvin & Shenoy, 2001; Chiu, Teoh, & Tian, 2013; Falato, Kadyrzhanova, & Lel, 2014). The findings of Drago, Millo, Ricciuti, and Santella (2015) and Devos, Prevost, and Puthenpurackal (2009) showed that interlocking directorates negatively affect firm performance, and shareholders consider it as a sign of weak governance, ineffective monitoring, and entrenched directorship. First, interlocking directorates propagate bad governance practices. Interlocked directors are more likely to be in accordance with the decisions made in other firms such as those related to options backdating and earnings management (Barzuza & Curtis, 2014; Snyder, Priem, & Levitas, 2009). Bizjak et al. (2009) discussed that board interlocks play a considerable role in spreading options backdating by observing the stock prices in the past to choose the dates with the lowest exercise prices for grant option awards. Armstrong and Larcker (2009) found that directors engaged in backdating firms considerably make backdating decisions. Although backdating is not illegal if disclosed properly, firms usually keep this practice a secret from the public (Barzuza & Curtis, 2014; Bizjak et al., 2009). Chauvin and Shenoy (2001)

concluded that executives manipulate the timing of information transfer to the market during a 10-day period before the grant date of their stock options. They also make voluntary opportunistic disclosures by postponing good news and diffusing bad news when they get close to stock option awards (Aboody & Kasznik, 2000). By doing so, they profit from stock price fluctuations before and after the grant date, respectively (Chauvin & Shenoy, 2001; Lie, 2005). Chiu et al. (2013) documented that earnings manipulation is more probable where board interlocks exist. Second, although multiple directorships can provide the firms with competitive advantages through integrating information sources with corporate decision-making, they may cause distraction because busy directors with too many tasks will not be able to concentrate well on their duties and assignments (Connelly & Van Slyke, 2012) including monitoring activities effectively, and this reduces the effectiveness of their experience obtained through serving on multiple boards (Barzuza & Curtis, 2014; Falato et al., 2014). Busy outside directors who sit on three or more boards negatively affect firm performance, and firms will earn positive abnormal returns when busy directors abandon the boards (Falato et al., 2014; Fich & Shivdasani, 2012). Hashim and Rahman (2011) found that although interlocked directors improve a firm's earnings quality, busy directors on multiple boards negatively affect it. However, Omer et al. (2014) argued that in case of having multiple directorates, the benefits of obtaining information including higher monitoring quality, better decision-making, and higher firm value outweigh the associated costs namely, the time spent on multiple boards for the purpose of receiving and analyzing accurate and relevant information. Accordingly, the higher the firms are connected, the greater will be the firm value on average (Omer et al., 2014). Third, interlocked boards give rise to the power imbalance problem when only one or a few numbers of connected directors have access to information sources. The concentration of power in the hands of few individuals increases board's dependence on them and the problem becomes more serious when appointed individuals or the CEOs have other managerial positions (Connelly & Van Slyke, 2012). Finally, interlocking directorates is a concern issue that has its roots in many evils (Brandeis, 2009) and gives rise to governance malpractices (Barzuza & Curtis, 2014; Davis, 1991). It suppresses competition in competitive environments and spreads disloyalty among the firms. As a result, it destroys incentives and results in inefficiency (Brandeis, 2009). Simoni and Caiazza (2012) concluded that although interlocking boards function as a cooperation mechanism between interlocked firms, they will work as a competition mechanism if the same directors serve simultaneously on the board of two competing firms. As a result, some laws and regulations have decreased the number of interlocks, and firms try to limit outside directors on their boards to avoid board interconnectedness and any related potential bad and risky governance practices (Barzuza & Curtis, 2014).

Concerning the impact of interlocking directorates on firm performance, there is no consensus on the relationship between interlocked boards and firm performance (Smith & Sarabi, 2021),

and interlocked boards negatively and positively affect firm performance depending on some other factors such as CEO ownership, firm's relative resources, ownership concentration, and power imbalance (Zona, Gomez-Mejia, & Withers, 2018). Regarding the effects of CEO pay on corporate governance practices in the presence of interlocking directorates, the evidence shows mixed results as well. Well-connected directors earn higher compensation (Hallock, 1997; Horton, Millo, & Serafeim, 2012) and increase firm value (Horton et al., 2012). They also tend to award their CEOs higher compensation (Barnea & Guedj, 2007). In contrast, Fich and White (2003) demonstrated that reciprocal boards are associated with CEO overpayment, low monitoring quality, and poor governance practices. In other words, CEOs in such firms act to the detriment of shareholders since they pursue their self-interest and increase agency costs. Devos et al. (2009) discussed that CEOs in firms with interlocked directors receive higher compensation with lower pay-performance sensitivity. Moreover, Handschumacher et al. (2019) argued that although higher pay-for-performance sensitivity indicates more effective monitoring, management overpayment reflects the negative impact of interlocked boards on corporate governance.

Finally, there are some factors that can help firms improve board interlock efficiency. First, directors should try to connect themselves to the networks of other firms where they serve as board members. By doing so, they close the structural holes that exist in many social networks and fortify their connection with second-order interlocks beside their intra-interlock links. They also increase the chance of having access to new and timely information, knowledge, opinions, and ideas. In addition, filling the structural gaps enables the firms to take advantage of information arbitrage and leveraging. Second, directors' characteristics in board interlocks are important factors in improving board receptivity and the quality of corporate decision-making. Directors' experience, knowledge, and status, as well as their presence in relevant committees, affect the quality of obtaining, analyzing, and spreading information, ideas, and innovations through board networks (Connelly & Van Slyke, 2012). Finally, Omer et al. (2020) hold that the presence of connected audit committees within interlocked boards reduces the negative effects of multiple directorships on corporate governance practices. They discussed that although interlocked boards reduce the quality of financial reporting in the firms that manipulate earnings, interlocking audit committees within the boards increase financial reporting quality through strengthening the monitoring role of boards in connection with financial statement processes. Table 1 shows the findings of the research regarding corporate connections and their impacts on corporate governance and firm performance based on four research focus: 1) corporate connections as a cooptative, coordinative, and controlling mechanism (organizational perspective based on resource dependency theory), 2) corporate connections and directors' social, political and economic interests as well as individual expertise and compensation (individual perspective based on class hegemony

theory), 3) behavioral aspect of corporate connections, 4) corporate connections and market, innovation, and competition.

In sum, the effects of corporate connections on corporate governance quality and firm performance are both positive and negative. From positive perspectives, board networks provide the firms with information sources in various fields, such as regulatory changes, competition strategies, corporate disclosure policies, market trends, and investor protection. Using these information channels directors and CEOs can reduce information asymmetry; increase monitoring quality; make better investment decisions, and increase firm value.

Moreover, interlocking directorates help directors increase their knowledge and experience through information exchange. From negative perspectives, interlocked boards are too busy to do their monitoring activities effectively. Moreover, they are associated with higher CEO compensation and lower pay-performance sensitivity. They also function as a means of spreading corporate malpractices such as earnings management and options backdating. Therefore, from shareholders' viewpoint, interlocking directorates can be interpreted as a sign of weak governance quality, inefficient monitoring, and entrenched directorship that fosters directors' self-interest.

Table 1. Summary of the findings related to corporate connections and their effects on corporate governance (CG) and firm performance (FP)

<i>Research focus</i>	<i>Authors</i>	<i>Findings</i>	<i>Impact on CG quality and/or FP</i>
Corporate connections as a cooptative, coordinative, and controlling mechanism (organizational perspective based on resource dependency theory)	Larcker et al. (2013); Omer et al. (2014); Cai et al. (2014); Barzuza and Curtis (2014); Connelly and Van Slyke (2012); Stafsudd (2009); Afzali and Kettunen (2019); Yeo et al. (2003); Wong and Hooy (2018); Handschumacher et al. (2019); Pombo and Gutierrez (2011)	Board networks are sources of information exchange for firms in different fields, such as regulatory changes, corporate disclosure policies, market trends, and business innovations. They also reduce information asymmetry; increase investor protection; reduce transaction costs, and help managers make better investment decisions. Interlocking boards increase monitoring quality, management pay, and firm performance.	Positive
	Barzuza and Curtis (2014); Falato et al. (2014); Fich and Shivdasani (2012); Hashim and Rahman (2011); Drago et al. (2015); Devos et al. (2009)	Interlocked boards are so busy that cannot do their monitoring activities effectively. Therefore, Shareholders consider them as a sign of weak governance and ineffective monitoring.	Negative
Corporate connections and directors' social, political and economic interests, as well as individual expertise and compensation (individual perspective based on class hegemony theory)	Hallock (1997); Horton et al. (2012); Omer et al. (2014); Barzuza and Curtis (2014)	Well-connected directors earn higher compensation. Interlocked boards increase directors' knowledge and experience through the exchange of information. Connected board members have more experience in analyzing financial reports and statements and can assure other members of the correctness of governance practices.	Positive
	Devos et al. (2009); Fich and White (2003); Handschumacher et al. (2019)	Management overpayment reflects the negative impact of interlocked boards on corporate governance. Moreover, CEOs in firms with interlocked directors receive higher compensation with lower pay-performance sensitivity.	Negative
Corporate connections (behavioral aspect)	Connelly and Van Slyke (2012); Bouwman (2011)	Connected boards show similar board and governance characteristics.	Positive/negative
	Barzuza and Curtis (2014); Snyder et al. (2009); Bizjak et al. (2009); Armstrong and Larcker (2009); Chauvin and Shenoy (2001); Lie (2005); Aboody and Kasznik (2000); Chiu et al. (2013)	Interlocking directorates propagate bad governance practices such as those related to earnings management and options backdating when it is not disclosed properly.	Negative
Corporate connections (market, innovation, and competition)	Chang and Wu (2020); Helmers et al. (2017); Srinivasan et al. (2018); Mazzola et al. (2016); Larcker et al. (2013)	Board interlocks as sources of market intelligence, positively affect corporate innovation and new product development. They create competitive advantages and generate economic benefits through making effective connections with customers and suppliers.	Positive
	Singh and Delios (2017)	Firms with connected boards have more tendency in following growth opportunities in both domestic and international markets.	Positive

3. SOCIAL CONNECTIONS

As the literature implies, we consider the social connection as a set of social ties and activities that form a base for potential familiarity between business and corporate directors, entrepreneurs, and executive managers in the future. These connections may be established through participation in social clubs, training courses, or any other social events, as well as old friendships from school, university, or educational institutions. Social network theory discusses how individuals make

relationships with each other in the networks to exchange resources and particularly information (Omer et al., 2020). Social networks act as the conduits for exchanging information and beliefs (McMillan & Woodruff, 1999; Shue, 2013; Uzzi, 1999), and affect corporate governance practices. Davis (1996) concluded that directors are recruited based on friendship or board-level acquaintances. Accordingly, social network of managers is an important determinant of making corporate financial decisions (Fracassi, 2017). As such, having good knowledge about executive social interactions

is essential for understanding how CEOs make corporate decisions (Shue, 2013).

Social connections are positively associated with corporate governance from different aspects, such as CEO compensation, firm performance, and corporate investment and M&As decisions (Cohen, Frazzini, & Malloy, 2008; Davis, 1996; Hochberg, Ljungqvist, & Lu, 2007; Shue, 2013). Socially connected firms make similar investment decisions and show higher economic performance (Fracassi, 2017). Shue (2013) conducted research on Harvard Business School MBA students and documented that social interactions are significantly associated with corporate decision-making and policies. In their research, MBA students of the same year were randomly allocated into different sections and formed two groups of class peers (graduates from different sections) and section peers (graduates from the same section and with stronger social interactions). The findings showed that peer effects strongly affect CEO compensation and acquisitions policies. Moreover, section peers show significantly more similar characteristics than class peers with respect to CEO compensation and acquisitions strategies. Finally, peers play an important role in making career decisions when choosing firms, industries, and geographical places (Shue, 2013). Cohen et al. (2008) analyzed information transfer in security markets through social networks. They used the connections between mutual fund managers and corporate board members via shared educational institutions as a proxy for the social network. They found that portfolio managers place larger bets on firms to which they are connected through their network and perform significantly better on these holdings in comparison to their non-connected holdings. These results suggested that social networks are an important mechanism for information transfer to asset prices. Hochberg et al. (2007) investigated the venture capital firms that were connected through a network of syndicated portfolio company investments. Similarly, they concluded that well-networked venture capital firms enjoy significantly higher fund performance measured by the proportion of successful portfolio investments. Moreover, it is more probable that the portfolio of well-connected venture capital companies survives for further financing. Regarding the positive impact of social connections on corporate investment and the quality of M&As decisions, evidence shows that social ties between target and acquirer companies enhance information flow and lead to better decision-making (Cohen et al., 2008; Hochberg et al., 2007) since they reduce the costs of gathering information and provide a means of efficient information exchange (Ishii & Xuan, 2014). Moreover, Gaspar and Massa (2011) argued that in conglomerate organizations, segments whose managers are well-connected to the CEOs due to their common education and training background, have higher investment levels because they have more bargaining power versus the CEOs. They also allocate resources more efficiently and increase firm value.

Despite all the advantages of social networks, especially in relation to their role in information exchange between connected firms, they are considered as a threat to corporate governance as well. First, social networks can negatively affect investment decisions and firm performance. Concerning the negative effects of social connections on corporate investment and M&As

decisions, Ishii and Xuan (2014) demonstrated that the intensified trust resulting from high social ties between acquirer and target firms lead to both lower due diligence standards during the M&As process and overestimation of synergistic gains. It also makes firms more inclined to overlook better opportunities that may exist outside the network (Ishii & Xuan, 2014). In addition, at the firm-level social ties between the directors and the CEOs in the acquirer firms reduce the monitoring role of the board members and impair their willingness to discipline the CEOs (Adams & Ferreira, 2007) that will result in making value-destroying M&As (Fracassi & Tate, 2012). Fracassi and Tate (2012) concluded that powerful CEOs hire directors that are more socially connected with them. Consequently, such a network-based recruiting system reduces monitoring quality and destroys firm value as a result of making unsuccessful M&As decisions. However, Kuhnen (2009) discussed that reciprocal hiring based on social ties does not necessarily decrease firm value. They conducted research on the mutual fund industry and concluded that fund directors and investment advisory firms prefer reciprocal hiring based on their business relationships and interactions in the past. Nevertheless, this hiring mechanism has no significant impact on investors' wealth. Kramarz and Thesmar (2013) found that firms managed by politically connected civil servants are less profitable. However, they appoint directors from the same network to stay more in power after showing weak performance. They also manipulate a firm's labor demand to contribute to incumbents' political campaign in the future. Nguyen (2012) studied the social ties between the CEOs and the board members within the companies based on their educational background to analyze their impact on the effectiveness of board monitoring. Their results showed that in places where the directors and CEOs are affiliated with the same social networks, CEOs are provided with double protection, meaning that they are less likely to be fired for poor performance, and are more likely to find a new and good job after a forced departure. In a different study, using the social ties between the CEOs and directors as a proxy for board independence, Schmidt (2015) argued that board independence does not always work in the interests of the shareholders because the CEOs do not intend to provide the independent directors with inside information when the board's monitoring role is dominant. Consequently, in situations where monitoring needs are high, social connections between the CEOs and directors do not work efficiently, and monitoring boards may reduce firm value. However, in cases where advisory needs are high, social ties between the CEOs and board members are positively associated with returns on bidder announcements, and friendly boards make better M&As decisions (Schmidt, 2015). Second, social networks within the firms are positively correlated to higher pay while less efficient compensation for well-connected directors and CEOs. Although higher CEO pay will lead to better firm performance in some cases, some evidence considers it as one of the negative factors associated with socially connected firms. Hwang and Kim (2009) showed that social director-CEO connection within a firm gives rise to CEO overpayment and reduces the firm's operating performance through impairing directors' independence and reducing their

monitoring quality. Table 2 provides information about the findings of the research conducted on social corporations and their effects on corporate governance and firm performance based on the research focus of social connections, compensation, firm performance, and corporate investment.

In sum, social connections are significantly associated with corporate decision-making and therefore, they can positively and negatively affect governance quality and firm performance. Social networks can improve the quality of corporate

investment decisions and increase firm value through information transfer. Conversely, social ties between CEOs and directors may result in impairing the board's independence and reducing directors' monitoring quality. This occurs when directors and executives are recruited based on a network-based system that provides them with protection against poor performance and is often associated with overpayment. Consequently, lack of efficient monitoring together with increased equity agency costs will destroy firm value.

Table 2. Summary of the literature regarding social connections and their relationship with corporate governance (CG) and firm performance (FP)

<i>Research focus</i>	<i>Authors</i>	<i>Findings</i>	<i>Impact on CG quality and/or FP</i>
Social connections (compensation, firm performance, and corporate investment)	Fracassi (2017); Shue (2013)	Socially connected firms make similar investment decisions and show higher economic performance. They are associated with corporate decision-making and policies.	Positive
	Cohen et al. (2008)	Social networks are an important mechanism for information transfer to asset prices, and portfolio managers place larger bets on firms to which they are connected through their network.	Positive
	Cohen et al. (2008); Hochberg et al. (2007); Ishii and Xuan (2014)	Social ties between target and acquirer companies enhance information flow and lead to better decision-making since they reduce the costs of gathering information and provide a means of efficient information exchange.	Positive
	Ishii and Xuan (2014)	Intensified trust resulting from high social ties between acquirer and target firms lead to both lower due diligence standards during the M&As process and overestimation of synergistic gains.	Negative
	Fracassi and Tate (2012); Adams and Ferreira (2007); Hwang and Kim (2009); Nguyen (2012)	Social director-CEO connection and a network-based recruiting system give rise to CEO overpayment; impair directors' independence; reduce monitoring quality and results in making unsuccessful investment decisions. Social ties between the CEOs and directors provide the CEOs with double protection against dismissal.	Negative

4. POLITICAL CONNECTIONS

Based on the literature, we define political connections as a subset of social connections that are limited to the social ties made between the corporate elite and individual politicians or political parties. Businessmen are interested in politics to improve their businesses and in exchange, politicians are interested in business to secure their political power. There is a positive relationship between a firm's political contribution and its future abnormal returns (Cooper, Gulen, & Ovtchinnikov, 2010). Firms support politicians through informational, monetary, and voting channels, and in return, winning politicians serve as the firm's advocate to achieve its business goals (Szakonyi, 2018). Shleifer and Vishny (1994) discussed that politicians offer subsidies and pay bribes to manager-controlled firms to encourage them to follow political objectives. Bertrand et al. (2007) investigated whether politically connected CEOs make employment decisions with the aim of keeping political incumbents in power. To this end, taking political business cycles into account, they discussed that publicly traded firms managed by politically connected CEOs adjust their employment as well as their plant creation or destruction decisions in a way that they help the incumbent politicians with their re-election bid. They also showed that both employment growth and the rate of plant creation increase within politically connected firms during the election years. In another study, Claessens et al. (2008) found that firms contribute to political campaigns in hopes of

receiving firm-specific favors in the future. As such, campaign contributions to political candidates are positively associated with higher stock returns at times where election events are about to end. This positive effect will be more significant if the supported candidates win the election.

Numerous studies have investigated the positive effects of political ties on corporate governance practices from different aspects including firm performance, tax benefits, corporate innovation, risk exposure level, and easier access to the credit market and governmental support. They conclude that on average, the benefits of having political connections outweigh its costs, and therefore, the net effect of political connections on firm value is positive (Boubakri, Guedhami, Mishra, & Saffar, 2012; Ferguson & Voth, 2008; Fisman, 2001; Mobarak & Purbasari, 2006; Ramalho, 2004). However, the impacts of political ties on earnings management and voluntary disclosure quality are mixed (Amara & Khelif, 2020). Politically connected firms outperform non-connected firms (Rusmin, Evans, & Hossain, 2012) with respect to firm performance (Boubakri, Cosset, & Saffar, 2012; Wong & Hooy, 2018), profitability (Szakonyi, 2018), and firm value (Cingano & Pinotti, 2013; Tang et al., 2016). Goldman, Rocholl, and So (2009) provided evidence that politically connected board members, on average, add to the value of U.S. firms. Faccio (2006) investigated how firm value is influenced when large shareholders and officers enter political activities or when politicians join corporate boards. Faccio's (2006) findings showed that business

activists positively and significantly affect firm value when entering politics. Moreover, the positive shock on stock prices is higher when a businessperson is elected to serve as a prime minister, or when a large shareholder becomes a politician. Similarly, Bunkanwanicha and Wiwattanakantang (2009) demonstrated that in Thailand, the market valuation of large companies increases after their owners enter politics. Regarding the relationship between political ties and corporate decision-making, political connection significantly and positively affects M&As performance in private companies (Zhong, 2016). However, in a recent study, Al'Alam and Firmansyah (2019) documented that political connection does not affect firm's investment efficiency.

Faccio (2007) concluded that politically connected firms have easier access to credit markets (higher leverage); profit more from tax discounts (pay lower tax); and have higher market shares. In the same vein, Boubakri, Cosset, and Saffar (2012) and Faccio, Masulis, and McConnell (2006) documented that politically connected firms in comparison with non-connected firms have higher debt levels; receive more government support; and show higher firm performance. Wang, Yao, and Kang (2019) found that political connections measured by corporate visits of government officials result in higher firm performance and abnormal stock returns because such field trips to firms are interpreted as governmental support by the investors (Wang et al., 2019). In addition, politically connected firms are more likely to be bailed out by the government through facilitating debt financing that increases their leverage ratio and improves their performance when encountering financial distress (Boubakri, Cosset, & Saffar, 2012; He, Xu, & McIver, 2019). Boubakri, Guedhami, et al. (2012) demonstrated that politically connected firms are less risky since investors demand a lower cost of capital for these firms rather than non-connected ones. By contrast, Al-Hadi, Al-Yahyaee, Hussain, and Taylor (2018) discussed that politically connected firms are more exposed to market risk, however; higher corporate governance quality increases a firm's transparency and as a result, reduces market risk disclosure related to connected firms.

In addition, politically connected firms show more tax aggressive behavior by using strategies that minimize tax liability (Wahab, Ariff, Marzuki, & Sanusi, 2017). A review of studies conducted on non-U.S. firms shows that politically connected firms pay lower tax (Amara & Khlif, 2020). Political connections also matter for corporate innovation, meaning that they give rise to innovative activities in companies with innovative entrepreneurs (Cheng, Cheng, & Zhuang, 2019) and with lower governmental support (Su, Xiao, & Yu, 2019). They also contribute to firm's fixed asset investment through tax benefits and governmental subsidies (Cheng, Cheng, & Zhuang, 2019).

Notwithstanding the positive outcomes of political relations with corporate governance, the literature shows some evidence in support of the negative aspects of political connections with regards to firm performance, investment decisions, corporate disclosure quality, and corruption issues. First, some studies have affirmed that politically connected firms show weaker accounting and financial performance (Chancharat, Detthamrong, & Chancharat, 2019; Osazuwa, Ahmad, & Che-Adam, 2016) in terms of ROA (Bliss & Gul, 2012; Ling, Zhou, Liang, Song, & Zeng, 2016), return on equity (ROE),

and market valuation in comparison to non-connected companies (Boubakri, Cosset, & Saffar, 2008; Faccio, 2007; Fan, Wong, & Zhang, 2007). However, based on Yeh, Shu, and Chiu (2013), higher debt ratios in politically connected firms may result in both higher and lower abnormal returns. Faccio et al. (2006) concluded that firm performance is lower in politically connected bailed-out firms in comparison to other firms in the same industry. Bertrand et al. (2007) documented that politically connected firms show lower profits due to paying higher salaries. These firms make inefficient investment decisions, especially about making M&As that are often considered as the most consequential investing decisions of senior managers (Jensen & Ruback, 1983). Moreover, politically connected firms have preferential access to bank financing (Claessens et al., 2008; Khwaja & Mian, 2005). Therefore, they are highly leveraged with respect to long-term debt and hold high cash amounts (Alabass, Harjan, Teng, & Shah, 2019; Bliss & Gul, 2012; Ling et al., 2016). This will increase firm's overinvestment risk (Ling et al., 2016) and can be detrimental to firms because not only it gives rise to debt agency problems, but also managers of the firms with large cash flows and unused borrowing credit are more likely to make unprofitable investment and M&As decisions that will destroy firm value (Jensen, 1986). Furthermore, political connections are associated with weak corporate governance practices (Shen, Lin, & Wang, 2015), and politically connected firms show lower financial reporting quality in comparison to non-politically connected firms (Alabass et al., 2019). Second, corruption favors unfairly politically connected firms (dela Rama, 2012). As such, political connections are more likely linked to corruption and political connection premium is larger in places with high corruption levels (Cingano & Pinotti, 2013). Shleifer and Vishny (1994) discussed that politician-controlled firms are associated with lower efficiency and higher corruption. According to Fisman (2001), as far as perceived corruption is concerned as an acceptable proxy for political rents, political connections matter for many large economies in the world. Faccio (2007) found that politically connected firms show higher performance in countries with higher corruption levels. Faccio (2006) argued that political connections are more common in countries with high levels of corruption and more restrictions on foreign investments like Russia. These connections are less common where political conflicts of interest are highly regulated (Faccio, 2006). Moreover, the stronger are the political ties to firms and the more they are linked to higher corrupt countries, the greater will be the difference between politically connected and non-connected firms (Faccio, 2007). Khlif and Amara (2019) concluded that politically connected firms, especially in more corrupt countries, show tax aggressive behavior to avoid tax payment. In fact, political connection and corruption level have complementary effects on increasing a firm's tax aggressive behavior (Khlif & Amara, 2019). On the other hand, the corruption level negatively affects corporate governance quality. Faizabad, Refakar, and Champagne (2021) studied the quality of both internal and external corporate governance practices in the oil and gas exporting developing countries and concluded that inefficient internal governance mechanisms in developing countries, that are associated with higher corruption levels in comparison with developed countries, are mainly related to low transparency levels, and weak

disclosure quality. Moreover, external governance mechanisms in these countries strongly and negatively affect the quality of internal governance practices. These mechanisms that were common in all the studied countries include weak legal systems, inefficient law enforcement infrastructures, and low protection levels for investors and shareholders. Moreover, although developing countries have tried to improve the quality of internal governance mechanisms during the recent years in response to the competitive environment, recent innovations in the financial markets, and the requirements of the international regulators, they are still in the initial steps of improvement process comparing to developed countries. As such, political connections significantly affect M&As activities depending on the institutional environment including the strength of legal systems and corruption level. In other words, politically connected bidders in comparison to their non-connected counterparts show higher post-M&As performance in more corrupt countries with poor legal systems. In contrast, they experience lower post-M&As performance in less corrupt countries with improved legal systems (Brockman, Rui, & Zou, 2013).

In contrast, Wang et al. (2019) discussed that political connection benefits, such as lower information asymmetry, higher corporate investment levels, greater debt ratios, and higher corporate governance quality cannot be attributed to political corruption. As a result, lack of political corruption improves political connection effectiveness (Wang et al., 2019). For example, in Singapore, where the corruption level is low, politically connected

directors, especially in the industries that operate under strict government regulations, significantly contribute to firm value (Ang, Ding, & Thong, 2013). Table 3 summarizes the literature regarding the effects of political connections on corporate governance and firm performance based on three research focus: 1) political connections, firm performance, and corporate governance practices, 2) political connections, corporate innovation, tax benefits, government support, risk exposure, investment decisions, and access to the credit market, 3) political connections and corruption.

In sum, although both politicians and business activists take advantage of making mutual political connections in many cases, political ties can negatively affect firm performance in some situations. In other words, politically connected firms usually receive government support and have easy access to financial sources that enable them to show higher performance under financial distress in comparison with non-connected firms. Moreover, they may pay lower tax and outperform non-connected firms in countries with high corruption levels. However, they show weak governance quality when they are highly leveraged and are at risk of exposure to overinvestment as well as a high salary payment. Similarly, they are associated with low efficiency in less corrupt environments with strong legal systems, especially that they have lower financial reporting quality in comparison to non-politically connected firms.

Table 3. Summary of the studies related to political connections and their impacts on corporate governance (CG) and firm performance (FP)

<i>Research focus</i>	<i>Authors</i>	<i>Findings</i>	<i>Impact on CG quality and/or FP</i>
Political connections, firm performance, and corporate governance practices	Rusmin et al. (2012); Szakonyi (2018); Cingano and Pinotti (2013); Boubakri, Cosset, and Saffar (2012); Tang et al. (2016); Wong and Hooy (2018); Boubakri, Guedhami, et al. (2012); Ferguson and Voth (2008); Fisman (2001); Mobarak and Purbasari (2006); Ramalho (2003)	Politically connected firms outperform non-connected firms with respect to firm performance, profitability, and firm value. On average, the benefits of having political connections outweigh its costs.	Positive
	Chancharat et al. (2019); Osazuwa et al. (2016); Bliss and Gul (2012); Ling et al. (2016); Boubakri et al. (2008); Faccio (2007); Fan et al. (2007); Shen et al. (2015); Alabass et al. (2019)	Politically connected firms show weaker accounting and financial performance in terms of ROA, ROE, and market valuation in comparison to non-politically connected companies. They are associated with weak corporate governance practices and show lower financial reporting quality.	Negative
Political connections, corporate innovation, tax benefits, government support, risk exposure, investment decisions, and access to the credit market	Faccio (2007); Boubakri, Cosset, and Saffar (2012); Faccio et al. (2006); Wahab et al. (2017); Amara and Khlif (2020); Cheng, Cheng, and Zhuang (2019); Su et al. (2019)	Politically connected firms have higher debt levels; receive more government support, and have higher market shares in comparison with non-connected firms. They pay lower tax and give rise to innovative activities in companies with innovative entrepreneurs and with lower governmental support.	Positive
	Bertrand et al. (2007); Claessens et al. (2008); Khwaja and Mian (2005); Alabass et al. (2019); Bliss and Gul (2012); Ling et al. (2016)	Politically connected firms are highly leveraged, pay higher salaries, and make inefficient investment decisions. This will increase both overinvestment risk and high debt agency problems.	Negative
Political connections and corruption	Faccio (2007); Faccio (2006)	Politically connected firms show higher performance in countries with higher corruption levels.	Positive
	Shleifer and Vishny (1994)	Politician-controlled firms are associated with lower efficiency and higher corruption.	Negative
	Brockman et al. (2013)	Political connections significantly affect M&As activities depending on the institutional environment including the strength of legal systems and corruption level.	Positive/negative

5. CONCLUSION

Networking activities are essential for corporations to survive in today's rapidly changing business environments. In other words, communicative networks provide the firms with channels through which they can exchange for the required corporate resources and information in contact with the external environment. For this purpose, firms construct their networks through making corporate, social, and political connections so that they can better stabilize their position in highly risky and competitive situations. Moreover, firms obtain a competitive advantage through acquiring information and other required resources. Therefore, considering the importance of connections in corporate governance, this paper has made a concise review of the literature of networking activities and corporate governance to demonstrate to what extent corporate, social, and political connections are influential to corporations, and how they affect firms' corporate governance quality.

In general, the findings of this research show that network activities in any of its forms positively and negatively affect corporate governance practices. As far as corporate connections are concerned, evidence shows that interlocked boards increase firm performance because of having access to information sources that reduce agency costs, assist them with making more efficient corporate decisions, and provide more accurate and reliable financial reports. On the other hand, serving multiple boards make interlocked directors so busy that they will not be able to accomplish their monitoring activities. This will increase the risk of accepting unprofitable projects that may destroy firm value. As such, there is no consensus on the relationship between interlocked boards and firm performance. Moreover, interlocking boards are positively associated with the propagation of some bad corporate practices including earnings manipulation and options backdating. Regarding social connections, the literature review reveals that the effects of such networks on CEO compensation and firm performance, specifically about investment and M&As decisions are not consistent.

Nevertheless, there is some evidence about the negative impacts of social networking on board independence and monitoring quality that may result in making unsuccessful M&As. Moreover, in some cases, social connections are linked to corrupt practices. Finally, as for political connections, the findings related to the impact of political connections on corporate decisions and firm value are contradictory. Furthermore, the impacts of political ties on earnings management and voluntary disclosure quality are mixed. However, according to the literature, politically connected firms pay lower tax; have more access to credit markets; and enjoy governmental contracts. Additionally, there is much evidence in support of the connection between political ties and corrupt activities, especially those related to economic and political rents.

Regarding the research limitations and taking into consideration the contradictory results about the effects of corruption and overcompensation on firm performance, there are no criteria to determine to what extent interlocked directors' overcompensation can be considered as a good corporate governance practice, and at what level it will negatively affect corporate governance quality. The same limitation exists about the impact of the corruption originated from to the connections on firm performance where the gained benefits due to the political or social connections are defined in the context of corruption. These limitations can be regarded as potential research topics for future studies. Furthermore, more research is required to delve into the independence level of interlocked boards and its influence on corporate decision-making. This issue should be discussed from two perspectives, i.e., in relation to the firms whom they represent versus in connection with the linked firms that they sit on their boards as outsider directors. In addition, political connections may differently affect corporations in developed and developing countries where corporate governance standards and quality, as well as capital market laws and regulations, are not the same. This topic together with the ownership network as another type of corporate connection can be considered for future research as well.

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