# Measuring the Relationship between Political Connections and Managerial Ability and their Implications on Financial Constraints in Egyptian Listed Companies

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# Abstract

The objective of this research is to examine the impact of political connections on managerial ability and financial constraints and the impact of the managerial ability on financial constraints. Moreover the indirect effect of political connections on financial constraints by mediating managerial ability of firms listed on the Egyptian Stock Exchange. For the four-year study period from 2020 to 2023, a sample of 59 companies registered on the Egyptian Stock Exchange EGX was employed. The study hypotheses are tested using multiple regression models, the

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Ordinary Least Squares OLS regression analysis. The findings showed that, first, the political connections positively and significantly affect the managerial ability for firms listed on the Egyptian Stock Exchange. Second, the managerial ability has a negative and significant impact on financial constraints. Third, the political connections have negatively and significantly direct effect on financial constraints. Fourth, there is a negative and significant indirect effect of political connections on financial constraints when the managerial ability mediates the relationship. The scientific addition to the research appears in the attempt to contribute to the cognitive construction of one of the topics that has received great attention in the global business environment, Which is the issue of the impact of political connections on the managerial ability and financial constraints with the aim of enhancing that management with good political connections obtains appropriate environment to maintain firm's value stability. This research is also a continuation of research related to financial markets and improving the financial performance of firms, and thus all firms in emerging financial markets can benefit from its results helping management to have strategic resources and funds when needed at any time.

**Keywords**: The political connections, managerial ability, financial constraints.

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## **1. Introduction**

Accounting, financing, and economic literature give more attention to financial constraints, recently Financial constrains have become the focus of interest of accounting and finance scholars, in order to provide scientific answers to the keys of financial constraints genesis. Also search and analyze the characteristics of firms that are responsible for the different levels of financial constrains among them, which ultimately support the firms stability in the capital markets and maximize its market share(Hanlon et al., 2022; Agyei-Boapeah et al., 2024).

The arising of firms' financial constraints is due to several reasons; first, the unrealistic borrowing addressed in the theory of investment (Modigliani & Miller, 1958) regarding the capital markets' idealization, what can enable firms to obtain the necessary funds from external financing sources when they need it, but practically, capital markets especially in the emerging economies suffer from obstacles; as presence of transaction costs, and stock trading illiquidity, so financial constraints may arise (Opler et al., 1999). Second, financial constraints may arise because of the information asymmetry power which leads to opportunistic behavior of management, thus, it increase imbalance transaction in capital markets, and then creates more agency costs represented in adverse selection (Akerlof. 1978). Third, financial constraints may arise owing to the small size of the firm and its low profitability, the low credit rating of the firm's bonds. Finally the inability to pay cash dividends of profits (Ponikvar et al., 2013; Shen& Lin, 2016; Edward et al., 2016; Zhang, 2022).

Kaplan & Zingales (1997) show that a firm is defined as financially constrained if it faces a wedge between the internal and external costs of finance, a problem caused by market friction. In addition, Chang et al. (2017) view that financially constrained firms have limited access to the capital markets, and then the difficulty of accessing external financing sources, which makes these firms suffer from the high cost of external financing compared to non- financially constrained firms. Financial constrains has become a topic of interest to scholars and financial analysts, as it may limit the firm's ability to attract profitable investment opportunities, which affects the stability and continuity of firms in the capital markets, which push firms to take procedures that ensure increase internal funding sources to finance the investments or firms withdrawal from the capital markets. On the other hand, financial constraints can open the way for earnings management practices, in order to facilitate obtaining external financing, as some firms may change their behavior in preparing financial reports in order to achieve the good expectations of financial analysts (Carvalho & Kalatzis, 2018).

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In the same context, the issue of financial constraints is more evident in developing economies (e.g. Egypt) than developed countries, due to immature legal systems, weak investors protection, and increasing government intervention (Tan& Zhu, 2022).Managerial ability (MA) is one of the ways that can mitigate financial constraints by reducing the information asymmetry gap, reducing agency problems, and improving firms' profitability, this is what will be studied in more analysis in the next section.

According to recent studies, the managerial ability of executives firm mangers is a major determinant of firm success and its performance's sustainability currently, especially after the business environment has become characterized by quick towards internationalization and diversification movement (Kamali, 2017; Said&Srour, 2024). Firms that have capable managers can attract external financing institutions and access the financial markets more easily, which in turn affects the financial policies of the firm. The managerial ability (managers' characteristics) includes: knowledge, talent, reputation, skills, and personal experience that enable managers to use available resources efficiently, and transfer theminto revenue, which contributes to the creation of firm value (Berglund et al., 2019; al., 2021).Therefore, Ma et al.. 2019: InamBhutta et Kamali(2017) indicated that the managerial ability is one of the most important intangible assets that the firm possesses and

enhances its competitiveness in the market. Mangers with high ability have a broad knowledge and understanding of their business nature of the firm and what associated with it of economic changes is, so they can spread the real value with more credibility to external parties, which reduces the problem of information asymmetry that is facing financial markets (Puwanenthiren et al., 2019).

There is no doubt that this matter will leave a positive impact on financing institutions confidence to give firms the necessary loans to perform their activities. Hessian (2018) also explained that managerial ability refers to the ability to maximize the firm's value through the effective use of the limited available resources. Managers with high ability have full knowledge and awareness of the firm's business environment and industry trends, and the ability to apply accounting standards with flexibility, thus their effective operational decisions maximize the firm's value compared to mangers with less ability. The upper- echelon perspective also showed that managerial ability is known by some managerial characteristics such as knowledge, experience, and management style that partially affect business outcomes (Huang & Sun, 2017; Saiyed et al., 2023).

Despite the importance of managerial ability in understanding and interpreting the impact of managerial contributions in mitigation financial constraints, and thus

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improving the firm's performance and rationalizing their investment decisions, the managerial ability can weaken the firm's information environment through opaque financial disclosures (Kalyta &Magnan, 2008; Bebchuk & Fried, 2004).In other words, managers with high ability can use their skills in carrying out earning management activities, store bad news, and increase the information asymmetry gap, thus achieving their personal interests and maximizing their compensation and incentives until a crucial moment when the bad news flows all at once to capital market, which leads to building a greater financial constraint barrier, which minimizes the firm ability to get into high growth investments, further more firms' collapse.

Therefore, it can be said that the managerial ability is a double-edged sword. On one hand, the managerial ability can work to improve the informational environment, and spread credible information to investors in the capital markets, thus, it reduces the problem of information asymmetry and agency problems, finally that reflected on the reduction of financial constraints. On the other hand, managerial ability can contribute to opening up a field for management's opportunistic behavior that works to block bad news, negative information, and data manipulation, thus expanded the information asymmetry gap between the internal parties and the capital markets, and consequently more earnings management practices, which imposes more financial constraints on firms.

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One indicator that can reduce an undesirable form of managerial ability is political connections. Political connections can reduce management's opportunistic behavior and information asymmetry gap, thus mitigation financial constraints. Since the political connections one of the important strategic resources that act as a defense gate against the opportunistic behavior of management, and thus lessen the market friction and financial constraints, in order to ensure the firms stability in the future. Political connections represent the key to shape the economic environment and employing market mechanisms, as it is one of the most important institutional characteristics prevailing in all (Wahab 2017; al.. Tee et al.. countries et 2021; Preuss&Königsgruber, 2021).

Wrona & Sinzig (2018) described it as non-market strategy the structure of the shape operating utilized to firm's environment and generate significant returns to the firm. Politically connected firms have special and exclusive business relationships with state-owned enterprises, and have prefer entail access to meaningful government contracts (Gomez & Jomo, 1999). This may help to improve the managerial ability and utilize to add value to the firm. The concept of political connections has attracted the attention of many scholars (Rajwani & Liedong, 2015;Boso et al., 2017; Habib et al., 2017a, 2017b; Dai& Ngo, 2021) which has turned the attention of accounting and finance scholars in Arab countries to political connections

concept, and attempt to rationalize political connections, because its impact on the Arab countries economies (e.g. The control of the cousin of the Syrian leader over more than 60% of the Syrian economy). Amara & khlif (2020) showed that Political effect on connections have strong decision-making of stakeholders, including managers (e.g. discretionary accruals, voluntary disclosure, tax avoidance and auditor choice) especially in developing economies (Boubakri et al., 2008), where there is a low legal enforcement and ineffective marketsupporting institutions (Bliss & Gul, 2012a, 2012b)Which it may reflected positively or negatively on the managerial ability in the Arab countries.

Political connections can take several forms. Carboni (2017) referred to two main forms of political connection: The first form is explicit political connections; which refer to the presence of at least a member of Parliament, a politician, or a minister, and government's concentration ownership within board of directors, audit committee, or in a firm's ownership structure(Boubakri et al., 2008). In another way Faccio et al. (2006) shows that the firm is politically connected if at least one of the firm's largest shareholders or a director is a minister, a Member of Parliament, or chief of the country. The other form is implicit political connections; Refers to connections through family ties, friendships, social networks, or firm's contributions in the election campaigns of politicians indirectly by supporting

political candidates in presidential elections during elections periods. So it can pressure on government officials to reach certain purposes (Kim et al., 2012).

Thus, political connections can be defined as one of the intangible assets of the firm that is acquired based on noncontractual relations in a way that achieves maximum insurance and benefits to the firm. It should be noted that political connections include many benefits; first, Political connections can put pressure on state-affiliated financing institutions to obtain loans with the lowest interest and the lowest cost of capital, due to the role of political connections in improving the firms' creditworthiness (Choi, 2014; Houston et al., 2014; Kalbuana et al., 2022). Second, political connections enable firms to improve their reputation and send signals to the market about the firm's strength and its ability to face default debt risks (Du, 2011; Eissa &Eliwa, 2021). Third, these connections also encourage the management to apply more tax planning practices, and push it to be more risky in order to add value to the firm (Kim & Zhang, 2016). This means the positive role of political connections in improving the efficiency of managerial ability. No one can deny that political connections may include defects, there may be collusion between one of political connections 'parties and the management, which leads to more earnings management practices. However, this paper expects that advantages can outweigh the defects in order to maintain the parties' reputation of political connections and insure its positions in the state.

PC has a direct or an indirect effect on financial constrains through MA. Regarding the direct effect, PC can ease financial constrains through putting pressure on banks and other financing institutions to obtain loans with the best facilities upon repayment, improving the firms' credit rating, in addition to easing the laws imposed by the government on un politically connected firms besides getting priority of government support during periods of financial and subsidies crises. these connections act as a safety wall Against negative events and external shocks that threat the firms 'future. However, there is an indirect association between PC and financial constrains through MA. The management's work under the support of political connections provides a good atmosphere that minimizes its opportunistic behavior, maximizes its ability to make effective operational and investment decisions, which is reflected in maximizing the firm's value, and improving its financial performance in the business environment, which is reflected in attracting financing institutions to cover the firm's investments with best terms, which means easing financial constraints imposed on firms.

#### 2. Research Contribution

The present research adds to the earlier literature in a variety of ways; this research might contribute to understanding of the effect of two important variables that are political connections (PC) and managerial ability (MA) on financial constraints by conducting the research in Egyptian context as one of the most important emerging markets. Additionally, it is important to particularly examine how PC and MA interact to affect financial constraints (FC). Therefore, the main contribution of the current research is that it is considered the first research which examines the effect of the political connections on the financial constraints through managerial ability as a mediator variable in the Egyptian stock market.

Finally, the results of the current research provide a new insight for shareholders, regulators, and policy makers in Egyptian exchange market on the importance of political connections. The political connections support capital market health, improving managerial ability which is reflected in reducing the information asymmetry gap, improving the quality of financial reporting, and finally easing financial constraints imposed on firms.

## **3. Literature Review and Hypotheses Development**

# **3.1 Political Connections and Managerial Ability**

Prior studies that examined the impact of PC on MA are divided into two groups. The first group reveals the desired link between political connections and managerial ability. Wang et al. (2017) mentioned that political connections can generate gains from the governmental institutions such as government protections in face of financial distress (Faccio et al., 2006) desired tax treatment (Faccio et al., 2006), access to strategic (key) resources (Dinc, 2005; Leuz& Oberholzer-Gee, 2006). These advantages linked to political connections will lessen a firm's needs and financial pressure with capable managers, subsequently alleviating committing fraud in general and financial reporting in particular. Also Chi et al. (2016) Documented that politically connected Chief Executive Officers (CEOs) engage in significantly lower levels of accrual-based earnings management than non-politically connected CEOs. Furthermore, Batta et al. (2014) tested the effect of political connections on accounting quality among Venezuelan industrial firms in a Latin American environment. They found that politically connected firms have higher accounting quality through lower earnings management practices than nonconnected firms. Similarly, Harymawan & Nowland (2016) revealed that political stability improves politically connected firms in Indonesia share in lower levels of earnings management. Finally, Ahmad et al. (2022) investigated the impact of political connections on the relationship between managerial ability and fraudulent financial statements, using a sample of listed firms in the Indonesia Stock Exchange during the period (2017-2019), with a total of 270 observations. The findings showed that managerial ability positively affected fraudulent financial reporting. Furthermore, the positive influence of managerial ability on the fraudulent financial statements was weaker when the firm was politically connected.

The second group revealed undesired association between political connections and managerial ability. Hashmi et al. (2018) investigated the link between political connections and earnings quality using sample more than (1600) yearly observations during the period (2009-2015). The findings documented that political connections are associated with a higher magnitude of discretionary accruals and lower earnings quality. Also, Belghitar et al. (2019) documented that political connections involved firms to increase earnings management (lower earning quality). Furthermore, Wang et al. (2017) investigated how political connections affect the relationship between managerial ability and fraudulent financial reporting using a sample of listed firms in China during the period (2007-2012). The results showed that less fraudulent financial statements with high managerial ability. They further showed that political connections limit managerial

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ability in reducing financial statement fraud and the earnings quality of politically connected firms are worse than nonpolitically connected firms. Consistently (Chaney et al., 2011) politically connected firms have high asymmetric information gaps and Firms followed to politicians increases the fraudulent financial reporting risk. (Chen et al., 2015; Gross et al., 2016) mentioned that politically connected firms will disclosure more opaque financial reports.

Hence, based on the prior literature, there is an existing argument about the critical association between political connections and the managerial ability. Therefore, the first hypothesis can be formulated as follows:

H<sub>1</sub>: There is a significant association between the political connections and the managerial ability.

## **3.2 Managerial Ability and Financial Constrains**

Prior studies that investigated the effect of MA on financial constraints are little. Therefore, the previous studies are classified according to three perspectives: The economic perspective, the firm-level determinants perspective, and the mangers' characteristics perspective.

According to economic perspective, Chong et al. (2013) showed that financing terms of firms in developing countries may be improved with bank competition, Leon (2015) accessed

to the same findings by using sample include developing and emerging countries. Moreover, Ryan et al. (2014) document that more financing constraints imposes on small and medium-sized enterprises associated with banks have more market power in European countries. Lu et al. (2022) mentioned that both the digital financial inclusion degree and the proportion of local bank branches make Chinese small and medium-sized enterprises access to financial resources easily. Finally, Chang et al. (2019) revealed that constrained firms issue more equity of high stock market valuation, on the other hand unconstrained firms provide debt issuance in response to debt market spreads.

the firm-level determinants According to perspective. Claessens et al. (2008) revealed that firms with favorable relationship with the government institutions and banks could easily obtain external financing sources to cover the investment projects requirements. Similarly, Lin et al. (2011) showed that firms with wider difference in insider control-ownership have less financial constraints. Poncet et al. (2010) using sample of Chinese firms during the period (1998-2005), found that stateowned firms are less financially constrained than private firms. Ponikvar et al. (2013) tested the impact of the financial crisis on the firms' financial constraints. The findings showed that financial health of the foreign firms worsened more compared to domestic firms, while the availability of financial resources deteriorated less for more productive firms and for exporters.

Even though firm's size had a significant impact on firm's financial constraints, crisis did not have an additional significant negative effect on firms' financial distress for all firms. Erdogan (2019) showed that firms with high performance be easier to obtain bank financing than firms with low performance. Furthermore, the small and medium-sized enterprises in the service industry are more accessing bank loans than firms in other industries.

According to the mangers' characteristics perspective, Custodio & Metzger (2014) found that Chief Executive Officers are highly financially sophisticated, and have unique skills. Thus they can gain external funds easily even during the period of tight credit conditions. Mohamed & Shehata (2017) revealed that optimistic CEOs prefer to finance R&D investment by internal funds than external funds, thereby increasing the investment-cash flow. Moreover Huang et al. (2022) tested the effect of managerial ability on financial constraints of Chinese listed firms. Findings indicated that firms with high ability can obtain funds easily. Additional analyses revealed that managerial ability helps ease financial constraints probably through decrease asymmetric information gap, minimize agency problems and enhancing firm profitability. Furthermore, they found evidence showing private companies suffer from more severe financial constraints than state- and foreign-owned firms and the effect of

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managerial ability in easing financial constraints is more addressed for private firms.

As mentioned earlier, financial constrains determinants still opaque. Therefore, the second hypothesis can be formulated as follows:

# H<sub>2</sub>: There is a significant association between the managerial ability and the financial constraints.

# **3.3 Political Connections and Financial Constrains**

Regarding the association between PC and FC, Hasan et al. (2017) mentioned that politically connected companies in Poland had simpler access to funds in the aftermath of the financial crisis in 2007. Peng et al. (2017) showed that political connections give firms in china greater access to credit, especially from state-owned banks. Similarly, Bussolo & Panizza (2019) tested the impact of political connections on financial constraints using sample of firms in Central and Eastern European countries. The findings showed that connected firms borrow more loans, since easier access to funds. Moreover, Deng et al.(2019) investigated the relationship between market frictions and political connections through determining financial constraints. The results indicated that firms in china facing big market frictions are not financially constrained, further they indicated that market frictions can significantly affect financial constraints. Poncet et al.(2010) using sample of Chinese firms during the period

(1998-2005) showed that state- owned politically connected firms are less financially constrained. Leuz & Oberholzer-Gee (2006) revealed that Indonesian firms with fewer political connections face difficult to fund its business domestically, so they go outside the country to access credit. Chen et al. (2014) found that politically connected firms have easier access to funds than non-connected firms. Chen et al. (2018) investigated the impact of political connections on financial constraints and corporate investment level using sample of Taiwan- listed firms during the period (1991-2010). The findings showed that politically connected firms. Also findings showed that financially constrained firms have political ties can increase their investment level.

Based on the previous literature, the third hypothesis can be formulated as follows:

# H<sub>3</sub>: There is a significant association between the political connections and the financial constraints.

Based on the previous results, it is assumed that the relationship between political connections and financial constraints could be indirectly affected by the inclusion of the managerial ability as a mediator variable, which will be tested in the present research. Therefore, the fourth hypothesis can be formulated as follows:

# H<sub>4</sub>: There is a significant effect of the political connections on the financial constraints through managerial ability as a mediator variable.

#### 4. Research Design

This part illustrates the sample selection process and the sources of data that were gathered, the variables used in this study, how they were measured, and the empirical models employed.

#### 4.1 Sample Selection and Data Collection

The sample of this research includes all Egyptian firms registered in the EGX 100 except all financial institutions covering a period of four years from 2020 to 2023. The sample consists of 59 firms and 236 observations. Data is collected from the annual financial available on the Arqaam website, the Misr Company website, the Mubasher Misr website, electronic companies' websites, and the Egyptian Stock Exchange website. The distribution of the sample according to the selected sectors is shown in Table (1).

		-
Description	No. of Firms	No. of Observations
Consumer Discretionary	10	40
Consumer Staples	10	40
Industrials	11	44
Materials	16	64
Real Estate	12	48
Final sample	59	236

 Table (1) Distribution of the Sample

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#### 4.2 Variables Measurement

The research includes four types of variables which are: first, dependent variable which is (FC), second, independent variable which is (PC), third the mediator variable which is (MA), fourth , the control variables which are the firm size (SIZE), the profitability ratio (ROA)firm age (AGE)and dividend payout (DIV).

#### 4.2.1 Dependent Variable

The financial constrains (FC)) is the dependent variable. According to previous literature, there are different proxies to measure FC. The current research adopts the most used one which is KZ score (Kaplan & Zingales, 1997). KZ score is measured as follows:

 $FC=KZ=\text{-}1.002(CF/\text{ TA})-39.368(DIV/\text{ TA})-1.315\ (CA/\text{ TA})+3.129\ LEV+0.283Q$ 

Where :

CF/ TA	= Cash flow to total assets ratio
DIV/ TA	= Dividends to total assets ratio
CA/ TA	= Cash liquidity ratio (Current assets - current liabilities)
LEV	= Leverage ratio (The book value of long-term debt ÷ total assets)
Q	= Market to book value ratio( Tobin's Q ratio)

According to this score, the higher the value of the score, the more financial constraints that the firm faces.

#### 4.2.2 Independent Variable

The political connections (PC) are the independent variable. Based on the previous literature, the political connections is expressed by the number of stakeholders who have own more than 5% and politically powerful in central / local government or have a relationship with former / current politicians (Johnson & Mitton, 2003; Faccio et al., 2006; Liu et al., 2012; Jackowicz et al., 2020; Tee et al., 2021).

## 4.2.3 The Mediator Variable

The managerial ability (MA) is the mediator variable. The model of Demerjian et al. (2012) will be used to measure MA. This model measures the managerial ability through two- stage process.

The first stage: using Data Envelopment Analysis Technique to measure the degree of firm efficiency within industry by comparing sales revenues with multitude revenuegeneration resources represent in seven inputs, firm efficiency stated through solving profit maximization problem.

 $Max_v \emptyset = sales / (COGS_{v1} + SG\&A_{v2} + PPE_{v3} + OpsLease_{v4} + R\&D_{v5} + GoodWill_{V6} + Other Intag_{v7} + OpsLease_{v4} + R\&D_{v5} + OpsLease_{v4} + R\&D_{v5} + OpsLease_{v4} + Op$ 

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#### Where:

Ø	= Firm efficiency
COGS	= the cost of goods sold
SG& A	= selling and administrative expenses
PPE	= net fixed assets
Op Lease	= net operating leases
R& D	= net research and development expenses
Goodwill	= Purchased goodwill
Other Intang	= other intangible assets

The firm's efficiency following to the data envelope technique take a value ranging from (1) to (0). The firm achieves a value of (1) is the most efficient, a value of (0) otherwise.

The second stage: The managerial ability score is measured by processing a regression to firm efficiency score extracted in the first stage. This score affected by both firmspecific determinants and management characteristics which is based on a set of determinants expected to hinder managerial efforts. The regression equation includes the following:

Firm efficiency= β₀+β₁ Ln(Total Assets)+β₂ Market Share + β₃ Positive Free Cash Flow + β₄ Ln(Age) + β₅ Business Segment Concentration + β₀ Foreign Currency Indicator + β₀ Year Indicator + €

The Tobit regression is used in earlier equation, since the dependent variable takes a value between zero and one, and the residual from this regression is managerial ability score.

#### 4.2.4 The Control Variables

Empirical models used in this research include some control variables that probably matter for financial constraints. Based on

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the prior literature, the control variables include Firm Size (SIZE), Firm Age (AGE), Profitability ratio (ROA), and Dividend Payout (DIV) (Huang et al. 2022; Ponikvar et al. 2013). Table (2) indicates the description of the research variables and how these variables are measured and calculated.

 Table (2) Variables Description and their Measurements

Variable	Description	Туре	Measurement
FC	Financial	Dependent	KZ Score
	Constraints	Variable	
PC	Political	Independent	Number of stakeholders who have own
	Connections	Variable	more than 5% and politically powerful
			in central / local government or have a
			relationship with former / current
			politicians
MA	Managerial Ability	Mediator Variable	Demerjian et al. (2012) Model
SIZE	Firm Size	Control Variable	The natural logarithm of lagged total
			assets
AGE	Firm Age	Control Variable	The natural logarithm of (1+ number of
			years since is foundation)
ROA	Profitability ratio	Control Variable	Dummy variable If the company
			generate return on assets take (1), and
			(0) otherwise
DIV	Dividend Payout	Control Variable	Dummy variable take(1) if firm pay the
			dividends, and (0) otherwise

#### 5. Research Models

In order to test the validity of the developed four hypotheses, ordinary least square (OLS) regression will be applied for four multiple regression models using STATA software (version 17).

# 5.1 Research Model Concerning the Effect of PC on MA

The first multiple regression model is established to test the first hypothesis that addresses the effect of the political

connections on the managerial ability. Thus the first research model is developed as follows:

$$MA_{i,t} = \beta_0 + \beta_1 PC_{i,t} + \beta_k \sum_{-1}^{k} Controls_{i,t} + \varepsilon_{i,t}$$

## Where:

 $MA_{i,t}$  = Managerial ability for firm (i) at the end of year (t).

 $PC_{i,t}$  = Political connections for firm (i) at the end of year (t).

*Controls*<sub>*i*,*t*</sub> = Size, Age, ROA, and DIV for firm (i) at the end of year (t).

 $\beta_0$  = Regression constant.

 $\beta_1: \beta_k$  = Regression coefficients for variables.

 $\varepsilon_{i,t}$  = The random error or residuals of firm (i) at the end of year (t).

## 5.2 Research Model Concerning the Effect of MA on FC

The second multiple regression model is established to test the second hypothesis that addresses the effect of the managerial ability on the financial constrains Thus, the second research hypothesis is developed as follows:

$$FC_{i,t} = \beta_0 + \beta_1 MA_{i,t} + \beta_k \sum_{n=4}^k Controls_{i,t} + \varepsilon_{i,t}$$

#### Where:

 $FC_{i,t}$  = Financial constrains for firm (i) at the end of year (t).

 $MA_{i,t}$ , Controls<sub>i,t</sub>,  $\beta_0$ ,  $\beta_1$ :  $\beta_k$ ,  $\varepsilon_{i,t}$  previously explained.

#### 5.3 Research Model Concerning the Effect of PC on FC

The third research model is established to test the third hypothesis that addresses the effect of political connections on the financial constrains. Therefore, the third model is developed as follows:

$$FC_{i,t} = \beta_0 + \beta_1 PC_{i,t} + \beta_k \sum_{n=4}^{k} Controls_{i,t} + \varepsilon_{i,t}$$

#### Where:

 $FC_{i,t}$ ,  $PC_{i,t}$ ,  $Controls_{i,t}$ ,  $\beta_0$ ,  $\beta_1: \beta_k$ ,  $\varepsilon_{i,t}$  previously explained.

#### **5.4 Research Model Concerning the Mediating Effect of MA** on the Relationship between PC and FC

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The fourth multiple regression model is established to test the fourth hypothesis that addresses the mediating effect of managerial ability on the relationship between political connections and the financial constrains. Therefore, the fourth research model is formulated as follows:

$$FC_{i,t} = \beta_0 + \beta_1 MA_{i,t} + \beta_1 PC_{i,t} + \beta_k \sum_{n=4}^{k} Controls_{i,t} + \varepsilon_{i,t}$$

#### Where:

 $FC_{i,t}$ ,  $PC_{i,t}$ ,  $MA_{i,t}$  Controls<sub>*i*,*t*</sub>,  $\beta_0$ ,  $\beta_1$ :  $\beta_k$ ,  $\varepsilon_{i,t}$  previously explained.

## 6. Data Analysis and Hypotheses Testing

This section aims to present a set of tests, which include descriptive statistical analysis, correlation analysis, multiple regression model, aggregate regression model using the ordinary least squares method (OLS), to test the hypotheses.

# 6.1 Descriptive Statistics

The negative impact of outliers or extreme values on the results of the statistical analysis are reduced by treating all continuous variables at a 1% cut-off level, which treated them at a 1% cut-off level. This part displays the descriptive analysis of the dependent, independent, and control variables. The features of the sample are described, and the validity of the normal distribution is examined, using the descriptive statistics. Table (3) presents the findings.

Variables	Mean	Std. Dev.	Min	Max					
FC	-0.261	3.117	-12.292	14.493					
MA	-0.012	0.192	-0.521	0.569					
PC	1.234	1.553	0	6					
SIZE	21.632	1.929	16.821	26.032					
AGE	3.046	0.4	1.609	3.714					
	Tabulation of ROA								
	F	req.	Percent						
0		59	25%						
1	]	177	75%						
Observations		236	100%						
Tabulation of DIV									
0		56	23.73%						
1	1	180	76.27%						
Observations	2	236	100%						

Table (3) Descriptive Statistics of Variables

The descriptive statistics for each variable utilized in the current study are shown in Table (3). The mean value of FC is (-0.261) with standard deviations of (3.117). The minimum and the maximum value are (-12.292 and 14.493) respectively. The significant variation between the Min and Max values is due to the difference among companies in terms of financial constraints. Also, most companies in the sample have a relatively low level of financial constraints as they prefer to maintain cash for any unexpected circumstances.

The mean value of MA is (-0.012) with standard deviations of (0.192) referring to the low managerial ability in the sample companies. The minimum and the maximum value are (-0.521 and 0.569) respectively, representing the difference in the determinants of managerial ability of executives' firm managers.

The mean value of PC is (1.234) with standard deviations of (0.1553). The minimum and the maximum value are (0 and 6) respectively, representing the big difference among firms in the number of shareholders with political connections.

The mean value of SIZE and AGE are (21.632, 3.046) respectively, with standard deviations of (1.929, 4) respectively. Also the minimum and the maximum value are 16.821 (1.609) and 26.032 (3.714).

Concerning ROA, the number of observations for companies with a return on assets is 177 representing 75%. While, the number of observations for companies without a return on assets is 59 representing 25%. The number of observations for companies that paid dividends is 180 representing 76.27%, while the number of observations for companies that did not pay dividends is 56 representing 23.73%.

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#### 6.2 Pearson's Correlation Test

The Pearson's correlation coefficient shows the direction and the strength of the linear association between any two variables included in the current research. Moreover, the correlation coefficients in the Pearson's correlation matrix presented in Table (4) are used to detect the multicollinearity between any two independent variables used. Anh& Leonenko (2018) stated that multicollinearity exists if the Pearson's correlation coefficient is greater than 70% between any two independent variables. Table (4) shows the Pearson's correlation coefficients indicating the strength and the direction of the linear association between any two variables used in testing the empirical models.

Variables	FC	MA	РС	SIZE	AGE	ROA	DIV
FC	1.000						
MA	-0.215***	1.000					
РС	-0.258***	0.133**	1.000				
SIZE	-0.204***	0.018	0.113*	1.000			
AGE	-0.035	0.190***	0.227***	-0.150**	1.000		
ROA	-0.317***	0.355***	0.068	0.304***	-0.084	1.000	
DIV	-0.458***	0.035	0.045	0.150**	0.047	0.253	1.00
						***	0
*** p<0.01.	** p<0.05, *	<i>p&lt;0.1</i>					

 Table (4) Pearson's Correlation Matrix

Table (4) shows that there is a negative correlation between MA and FC as the value of r is negative (-0.215) and statistically significant at 1%. This result can be explained as executives' firm  $10^{7.70}$  [lack limits]

managers with high managerial ability have the knowledge and experience to enhance access to financial resources by mitigating the impact of financial constraints and making efficient decisions to obtain the needed finance at lower cost.

There is a negative correlation between PC and FC as the value of r is negative (-0.258) and statistically significant at 1%. This result can be explained as the politically connected companies being more experienced and knowledgeable to use the loopholes to avoid any governmental decisions that might affect their performance. Therefore, the politically connected firms have easier access to funds with the best facilities.

There is a positive correlation between PC and MA as the value of r is negative (0.133) and statistically significant at 5%. This result can be explained as the politically connected companies have the ability to hire executive managers with high managerial ability to increase the firm value.

The SIZE variable is negatively correlated with FC as the value of r is negative (-0.204). This correlation is statistically significant at 1%, indicating that larger companies are better able to secure credit facilities with more favorable terms. However, there is no significant correlation between company age and financial constraints.

On the other hand, there is an insignificant correlation between AGE and FC. There is a negative correlation between ROA, DIV and FC as the value of r is negative (-0.458, -0.317) and statistically significant at 1%. This result indicated that companies achieving returns on assets and distributing dividends are better positioned to reduce financial constraints in their business environments.

Company age and return on assets are positively correlated with managerial ability, with correlation coefficients of (0.190 and 0.355), respectively. These correlations are significant at the 1% level. This result can be explained as companies with a long history and high returns on assets are more likely to attract the best managers with strong managerial ability. However, there is no significant correlation between company size or dividend distributions and managerial ability.

Company size is positively correlated with political connections, with a correlation coefficient of (0.113). This correlation is significant at the 10% level. Additionally, company age is positively correlated with political connections, with a correlation coefficient of (0.227). This correlation is significant at the 1% level. However, there is no significant correlation between return on assets or dividend distributions and political connections.

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#### **6.3 Regression Analysis and Discussion of the Findings**

Multiple regression analysis is used to test the research's hypotheses. Ordinary Least Squares (OLS) method is applied to each empirical model to assess the impact of each independent variable on the dependent variable and the effect of MA as a mediator variable on the relationship between PC and FC. The results of all the empirical models utilized are presented in this section.

#### 6.3.1The Results of Testing the First Hypothesis (H<sub>1</sub>)

To test the extent to which the managerial ability for firms listed on the Egyptian Stock Exchange as a dependent variable is affected by the political connections as an independent variable in light of the controls variables. Table No. (5) Shows the results of testing the first hypothesis.

Regression with Driscoll-Kraay standard errors Method: Pooled OLS			Num	Number of obs		
			Num	ber of groups	= 58	
Group variable (i): Pa	nel		F( 5	3)	= 130.42	
maximum lag: 3			Prob	> F	= 0.0010	
			Adj ]	R-squared	= 0.1951	
			Root	MSE	= 0.1746	
МА	Coefficient	Drisc/Kraay	Т	P>t	[95% conf.	interval]
PC	0.010	0.002	5 990	0.009	0.004	0.015
SIZE	-0.006	0.001	-5 350	0.003	-0.009	-0.002
AGE	0.097	0.010	9.540	0.002	0.065	0.130
ROA	0.183	0.014	13.090	0.001	0.138	0.227
DIV	-0.035	0.016	-2.210	0.114	-0.086	0.015
_cons	-0.300	0.043	-7.010	0.006	-0.437	-0.164
Mean dependent var		-0.010	SD dependen	t var	0.192	
Adj R-squared		0.195	Number of o	bs	228	
F-test		130.42	Prob > F		0.0010	

Table (	(5)•	The	Results	of the	First	Hype	othesis
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Akaike crit. (AIC)
\*\*\* p<.01, \*\* p<.05, \* p<.1

MA = -0.300 + 0.010 PC - 0.006 SIZE + 0.097 AGE + 0.183 ROA - 0.035 DIV

-142.836

As shown in Table (5), the model is significant and reliable, as the significance level of the F-test is less than (5%). The value of Adjusted  $R^2$  is (0.1951), indicating that the model and its included variables can explain 19.5% of the total variation in managerial ability.

Bayesian crit. (BIC)

The partial significance of the regression model can be interpreted through the regression coefficients. The regression coefficient for political connections ( $\beta_1$ ) is (0.01), significant at the 1% level. This indicates that managerial ability increases as

-122.260

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the political connections of companies increase. This may be attributed to two reasons:

- 1. Companies with higher levels of political connections attract executives with strong managerial ability to benefit from their expertise and reputation.
- 2. Politically connected companies may aim to conceal practices such as earnings management or manipulation of financial reports, requiring highly capable executives to manage these matters with credibility. This result contrasts with the findings of Wang et al. (2017) and Ahmad et al. (2022).

Regarding the impact of control variables:

- 1. There is a negative relationship between managerial ability and company size, significant at the 5% level. This suggests that as companies grow larger; their stable financial situations reduce the need for highly skilled managers since their operations are already well-established and profitable.
- 2. There is a positive relationship between managerial ability and both company age and return on assets, significant at the 1% level. This indicates that as companies age and achieve higher returns on assets, they require higher managerial ability to ensure their sustainability in the business environment.

Based on these findings, the first hypothesis stated that "There is a significant association between the political connections and the managerial ability" is accepted.

## 6.3.2 The Results of Testing the Second Hypothesis (H<sub>2</sub>)

To test the extent to which the financial constrains as a dependent variable is affected by the managerial ability as an independent variable using Model (2). Table (6) illustrates the results of testing the second hypothesis.

<b>Regression with Drisc</b>	oll-Kraay stan	dard errors	Num	ber of obs	= 227	
Method: Pooled OLS			Num	ber of groups	= 58	
Group variable (i): Panel			F( 5	, 3)	= 173.22	
maximum lag: 3			Prob	> F	= 0.0007	
0			Adj	R-squared	= 0.2801	
			Root	MSE	= 2.6934	
FC	Coefficient	Drisc/Kraay Std.err	Т	P>t	[95% conf	f. interval]
MA	-2.432	0.263	-9.240	0.003	-3.270	-1.595
SIZE	-0.153	0.025	-6.170	0.009	-0.232	-0.074
AGE	-0.099	0.103	-0.970	0.405	-0.426	0.227
ROA	-0.996	0.089	-11.230	0.002	-1.279	-0.714
DIV	-2.929	0.146	-20.080	0.000	-3.393	-2.464
_cons	6.318	0.584	10.810	0.002	4.458	8.177
		-0.232	SD dependen	ıt var	3.139	
Mean dependent var						
Adj R-squared		0.280	Number of o	bs	227	
F-test		173.22	Prob > F		0.000	
Akaike crit. (AIC)		1099.944	Bayesian crit	. (BIC)	1120.494	ŧ

Table (6)	: The	Results	of the	Second	<b>Hypothesis</b>
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FC = 6.318 - 2.432 MA - 0.153 SIZE - 0.099 AGE - 0.996 ROA - 2.929 DIV

Table (6) shows that the model is significant and reliable, as the F-test significance level is less than (5%). The value of

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Adjusted  $R^2$  is (0.280), indicating that the model and its included variables can explain 28% of the total variation in financial constraints.

The partial significance of the regression model can be interpreted through the regression coefficients. The regression coefficient for managerial ability ( $\beta_1$ ) is (-2.432), significant at the 1% level. This indicates that financial constraints decrease as the increases of managerial ability of executives. This result may be attributed to the fact that highly capable managers are efficient in financial decision-making, resource allocation, and enhancing operational efficiency, ultimately leading to a reduction in financial constraints. This finding is consistent with the study by Huang et al. (2022) but contradicts the findings of Wang et al. (2017) and Ahmad et al. (2022).

Regarding the impact of control variables, there is a negative relationship between financial constraints and each of company size, return on assets, and dividend payout, all significant at the 1% level. Larger companies, higher returns on assets, and increased dividend payouts tend to result in higher retained cash balances, which in turn, reduce financial constraints in these companies.

Based on these findings, the second hypothesis stated that "There is a significant association between the managerial ability and the financial constraints" is accepted.

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# 6.3.3 The Results of Testing the Third Hypothesis (H<sub>3</sub>)

To test the extent to which the financial constrains as a dependent variable is affected by the political connections as an independent variable using Model (3). Table (7) presents the results of testing the third hypothesis.

Table (7) The Results of the Third Hypothesis

Regression with Dris	scoll-Kraay stan	Nun	Number of obs			
Method: Pooled OLS			Nun	nber of groups	= 58	
Group variable (i): I	Panel		F( 5	5, 3)	= 753.43	
maximum lag: 3			Prol	<b>b</b> > <b>F</b>	= 0.0001	
			Adj	R-squared	= 0.3100	
			Roo	t MSE	= 2.6427	
FC	Coefficient	Drisc/Kraay Std.err	t	P>t	[95% con	f. interval]
PC	-0.451	0.067	-6.700	0.007	-0.666	-0.237
SIZE	-0.099	0.021	-4.740	0.018	-0.165	-0.032
AGE	0.073	0.116	0.630	0.572	-0.296	0.443
ROA	-1.362	0.041	-33.080	0.000	-1.493	-1.231
DIV	-2.860	0.161	-17.780	0.000	-3.371	-2.348
_cons	5.417	0.521	10.390	0.002	3.758	7.076
Mean dependent var	•	-0.235	SD depender	ıt var		3.146
Adj R-squared		0.310	Number of o	bs		226
F-test		753.43	Prob > F			0.000
Akaike crit. (AIC)		1086.534	Bayesian crit	. (BIC)	1	107.057

\*\*\* p<.01, \*\* p<.05, \* p<.1

FC = 5.417 - 0.451 PC - 0.099 SIZE + 0.073 AGE - 1.362 ROA - 2.860 DIV

As shown in Table (7), the model is significant and reliable, as the F-test significance level is less than (5%). The value of Adjusted  $R^2$  is (0.31), indicating that the model and its included variables can explain 31% of the total variation in financial constraints.

The partial significance of the regression model is evident from the regression coefficients. The regression coefficient for political connections ( $\beta_1$ ) is (-0.451), significant at the 1% level. This indicates that financial constraints decrease as political connections increase. This can be attributed to companies benefiting from their political connections, which facilitate access to financing, thereby reducing financial constraints. This aligns with the resource-based view, where political connections act as an intangible asset that enhances corporate liquidity and investment capabilities. This finding is consistent with the study by Deng et al. (2019).

Regarding the impact of control variables, there is a negative relationship between financial constraints and company size, significant at the 5% level. Larger companies tend to have lower financial constraints due to their established market presence and financial stability. As well as there is a negative relationship between financial constraints and both return on assets and dividend distributions, significant at the 1% level. Higher returns on assets and larger dividend payouts are associated with increased retained cash balances, which reduce financial constraints.

Based on these findings, the third hypothesis stated that "Political connections have a significant association with financial constraints" is accepted.

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## 6.3.4 The Results of Testing the Fourth Hypothesis (H<sub>4</sub>)

To test the extent to which financial constraints as a dependent variable, are affected by the political connections as an independent variable in the presence of managerial ability as a mediator variable using Model (4). Table (8) shows the results of testing the fourth hypothesis.

	~ /			<b>U</b> 1		
Regression with Dri	scoll-Kraay stan	dard errors	Nun	iber of obs	= 226	
Method: Pooled OLS			Nun	iber of groups	= 58	
Group variable (i): l	Panel		F( 5	5, 3)	= 183.35	
maximum lag: 3			Prol	o > F	= 0.0006	
-			Adj	R-squared	= 0.3233	
			Roo	t MSE	= 2.6230	
FC	Coefficient	Drisc/Kraay Std.err	t	P>t	[95% cont	f. interval]
MA	-2.100	0.306	-6.860	0.006	-3.073	-1.126
PC	-0.431	0.068	-6.340	0.008	-0.647	-0.214
SIZE	-0.111	0.020	-5.440	0.012	-0.176	-0.046
AGE	0.278	0.113	2.460	0.091	-0.081	0.637
ROA	-0.976	0.085	-11.480	0.001	-1.247	-0.706
DIV	-2.932	0.170	-17.230	0.000	-3.473	-2.390
_cons	4.784	0.487	9.830	0.002	3.236	6.333
Mean dependent var	r	-0.235	SD depe	endent var		3.146
Adj R-squared		0.323	Number of obs		226	
F-test		183.35	Prob > 1	F	(	0.000
Akaike crit. (AIC)		1084.114	Bayesia	n crit. (BIC)	1108.057	
*** 01 ** 07	* 1					

Table (8) The Results of the Fourth Hypothesis

\*\*\* *p*<.01, \*\* *p*<.05, \* *p*<.1

FC = 4.784 - 2.1 MA - 0.431 PC - 0.111 SIZE + 0.278 AGE - 0.976 ROA - 2.932 DIV

As shown in Table (8), the model is significant and reliable, as the F-test significance level is less than (5%). The value of Adjusted  $R^2$  is (0.323), indicating that the model and its included variables can explain 32.3% of the total variation in financial constraints through the mediation of managerial ability.

The partial significance of the regression model can be interpreted through the regression coefficients. The regression coefficient for managerial ability ( $\beta_1$ ) is (-2.10) and the regression coefficient for political connections ( $\beta_2$ ) is (-0.431), both significant at the 1% level.

These results highlight a significant reduction in financial constraints as political connections and managerial ability increase. This could be attributed to the complementary nature of these two factors. Political connections, as an intangible asset, facilitate access to highly capable executives with strong managerial skills. The integration of political connections and managerial ability significantly reduces the financial constraints, thereby improving the financial position of companies.

Regarding the impact of control variables, there is a negative relationship between financial constraints and company size, significant at the 5% level, indicating that larger companies experience fewer financial constraints. There is also a negative relationship between financial constraints and return on assets and dividend payouts, both significant at the 1% level. Companies with higher returns and larger dividends tend to retain more cash, reducing financial constraints. Lastly, there is a negative relationship between financial constraints and company age, significant at the 10% level. Older companies tend to have more stable operations and established financial structures, leading to reduced constraints.

Based on these findings, the fourth hypothesis stated that "Political connections have a significant effect on financial constraints through managerial ability as a mediator variable" is accepted. The following figure illustrates the research model.



Table (9) The Results of the Fourth Hypothesis

	Original Coefficient	Observed coefficient	Bootstrap std. err.	z	<b>P</b> >z
Indirect Effect $PC \rightarrow MA \rightarrow FC$	-0.02015808	-0.0212766	0.0141421	-1.5045	0.0662

The findings of the Baron Kenny approach for testing indirect effect through serial of multiple regression analysis (the mediating variable), as shown by the following:

1- From model (3) there is a significant direct effect of the independent variable (PC) on the dependent variable (FC).

2- From model (1) there is a significant direct effect of the independent variable (PC) on the mediating variable (MA).

3- From model (4) there is a significant direct effect of the mediating variable (MA) on the dependent variable (FC), when (PC) is included as a variable in model (4).

Thus, there is a negative indirect effect of the PC (independent) on FC (dependent) through the MA (mediator), as the indirect effect is -0.02 ( $0.0096 \times -2.0998$ ) and this can be explained as follows; PC increases MA, which has led to decrease FC.

From the previous table, new repeated results were found (Bootstrapping) where the sample was examined (5000) times, which agree with the method of analyzing the effect using Baron-Kenny, which was indirectly determined for PC on FC through MA, where the P value is less than 10%, and the value of the original sample and the Turkish coefficients that are stacked have the same error.

## 7. Conclusions

The research aimed to study and test the relationship between political connections and financial constraints, the mediating effect of managerial ability on the relationship between political connections and financial constraints, and to examine the impact of some control variables on the variables under study. Based on the theoretical and empirical studies conducted on a sample of 59 non-financial companies listed on the Egyptian Stock Exchange during the period from 2020 to 2023, with total observations of 236, the empirical study reached the following conclusions.

Political connections are one of the most important determinants for companies and all stakeholders in financial markets, as they significantly influence companies' financial performance and, consequently, their continuity in the business environment. These connections contribute to providing appropriate financing for companies under favorable conditions, thereby, playing a role in reducing the financial constraints surrounding companies.

Managerial ability is among the most vital resources for companies, contributing to the efficient allocation of corporate resources. Additionally, it improves the informational environment between management and stakeholders, thereby reducing agency problems. This ultimately alleviates financial

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constraints, attracting more viable investment opportunities for companies.

There is a significant positive relationship between political connections and managerial ability. Companies with strong political connections tend to attract executives with high managerial ability to benefit from their reputation and experience. Politically connected companies also seek to employ executives with strong managerial capabilities to reduce agency problems and information asymmetry, aiming to improve the quality of financial reporting. This supports the first hypothesis.

Managerial ability has a significant negative effect on financial constraints. Companies with highly capable executives possess the knowledge and expertise to secure resources under favorable terms, thus reducing financial constraints. These executives make well-informed decisions that ensure access to required financing at the lowest possible cost, supporting the second hypothesis.

Political connections have a significant negative effect on financial constraints. Companies benefit from political connections to facilitate access to financing, ultimately reducing their financial constraints. This supports the third hypothesis.

Political connections indirectly and significantly reduce financial constraints through managerial ability as a mediating variable. Political connections, as an intangible asset, enhance access to highly capable executives. The integration of political connections with managerial ability significantly reduces financial constraints, thereby improving the financial health of companies. This supports the fourth hypothesis.

# 8. Recommendations

Based on the theoretical findings and empirical results, the following recommendations can be proposed:

1. Companies operating in emerging markets should focus on enhancing managerial ability, which ensures the reduction of agency problems and supports their sustainability in the business environment.

2. Companies with political connections should prioritize managerial ability to ensure a healthy business environment free from opportunistic behaviors by executives and aligned with effective managerial practices. This will ultimately reduce financial constraints.

3. Researchers and relevant entities should study and analyze all determinants that improve managerial ability among executives, to mitigate the effects of financial constraints and boost viable investments for companies.

4. Stakeholders in emerging markets should consider the empirical results, as financial constraints can be minimized through the integration of political connections and managerial ability.

# 9. Research Limitations

The current research has some limitations which may limit the generalization of the results. The results obtained might differ by using different measures for the research main variables. The sample used is limited to some non-financial Egyptian listed firms from 2020 to 2023, hence the results could not be generalized to other sectors. Finally, any factors other than those included in the present research and affect the relationship between the study variables will not be considered.

# **10. Future Research**

Based on the current results, there are prospects for future research. For example, it could be consider other measures of political connections, financial constraints, and managerial ability. Further, study the impact of geopolitical crises on the managerial ability of executives. Investigate the effect of the determinants of managerial ability among executives on investor behavior. As well as, study the influence of international financial reporting standards on the relationship between managerial ability and political connections. Finally, extending the sample to include financial institutions could provide more informative results.

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