THREE ESSAYS ON
CORPORATE-POLITICAL RELATIONSHIPS

A Dissertation
presented to
the Faculty of the Graduate School
at the University of Missouri-Columbia

In Partial Fulfillment
of the Requirements for the Degree
Doctor of Philosophy

by
ANNA ABDULMANOVA
Dr. Stephen Ferris, Dissertation Supervisor
MAY 2018

The undersigned, appointed by the dean of the Graduate School, have examined the dissertation entitled

THREE ESSAYS ON
CORPORATE-POLITICAL RELATIONSHIPS

presented by Anna Abdulmanova, a candidate for the degree of doctor of philosophy, and hereby certify that, in their opinion, it is worthy of acceptance.

Professor Stephen Ferris

Professor John Howe

Professor Karen Schnatterly

Professor Adam Yore

Professor Matteo Arena

ACKNOWLEDGEMENTS

I thank my advisor Dr. Stephen Ferris and the members of my dissertation committee Dr. John Howe, Dr. Karen Schnatterly, Dr. Adam Yore, and Dr. Matteo Arena. I appreciate helpful comments and suggestions from Pratik Kothari and participants of seminars at the University of Missouri, University of Denver, and University of Wisconsin Milwaukee. I also thank National Archive of Criminal Justice Data and Institute for social research at University of Michigan for providing the data on civil litigation.

TABLE OF CONTENTS

ACKNOWLEDGEMENTS	ii
LIST OF TABLES	v
ABSTRACT.....	vii
Chapter	
1. INTRODUCTION	1
2. A THEORY OF CORPORATE-POLITICAL RELATIONSHIPS.....	4
Human relationships	4
Business relationships	6
Corporate costs and benefits.....	9
Politicians’ costs and benefits	19
Mutual decision to establish political relationship	24
The empirical evidence regarding political connections	29
3. POLITICAL CONNECTIONS AS AN ELEMENT OF LITIGATION	
DEFENSE	34
Introduction	34
Motivations for political connections and their mechanics	39
Hypotheses development.....	42
Data and sample	52
Main results	58
Robustness tests.....	80
Conclusion.....	83
4. THE EFFECT OF TARGET’S POLITICAL CONNECTIONS ON MERGERS AND ACQUISITIONS	107

Introduction	107
Value of political connections to targets and acquirers.....	111
Target’s political connections and the acquisition process	113
Acquirer’s environment and the acquisition process.....	118
Data construction and sample.....	125
Main results	129
Summary and discussion	138
5. THE EFFECT OF POLITICAL WEDGE ON CORPORATE DECISIONS, PERFORMANCE, AND VALUE	156
Introduction	156
Difference in political orientation and its effect on a firm	159
Data and sample construction.....	163
Empirical results.....	167
Robustness tests.....	177
Conclusion and implication for further research	180
APPENDIX	
1. PROPENSITY SCORE MATCHING	199
REFERENCES	202
VITA.....	214

LIST OF TABLES

Table	Page
1. Sample Descriptive Statistics	85
2. Lawsuits Distribution	86
3. Summary of Political Contributions.....	88
4. Political Connections and Anticipation of Litigation.....	90
5. Political Contributions Made During Litigation	92
6. Benefits of Political Connections in Litigation	93
7. Benefits of State Contributions in Litigation	95
8. Limitations of Political Connections in Litigation	96
9. Complex Litigation	98
10. Government Entity as a Plaintiff.....	100
11. Litigation in the State of Head Quarters.....	102
12. Self-Selection in Political Contributions.....	104
13. Selection Bias	106
14. Mergers and Acquisitions Summary	142
15. Targets and Acquirers Characteristics.....	145
16. Deals Summary	147
17. Acquirers' Type and Deal Completion	149
18. Acquirers' Type and Deal Characteristics	151
19. Acquirers' Type and Target Premium.....	152
20. Acquirers' Country Characteristics and Target Premium	154
21. Descriptive Statistics of Firms and CEOs	183

22. Statistical summary of Political Variables	184
23. Distributions of Political Variables	185
24. Political Wedge and Allocation of Resources	186
25. Political Wedge and Quality of Acquisitions	188
26. Political Wedge and Firm Performance	190
27. Political Wedge and Firm Value	191
28. Size of Political Wedge and Firm Performance	194
29. Firm and CEO Political Spending	195
30. Effect of Regulatory Changes on Political Wedge.....	197
31. Comparison of Target and Control Firms	201

ABSTRACT

This study examines the effect of corporate-political relationships on corporate decision making, performance, and value. In the first essay, presented in Chapter 3, I examine whether defendant firms use their political connections as an element of litigation defense. I document that lawsuit filing encourages firms to make contributions during litigation. I also report that cases of politically connected firms are resolved quicker and are more likely to get dismissed or transferred to another court. I find, however, that firms do not receive any benefits from their political connections during the trial stage. Thus, verdict and monetary penalties are not affected by firms' political contributions.

In the second essay, presented in Chapter 4, I examine the effect of target's political connections on the process of mergers and acquisitions. I find that foreign acquirers are more likely to complete acquisitions of politically connected targets than domestic firms. I document that foreign acquirers are also more likely to choose tender offers and pay in cash than domestic acquirers. Additionally, I demonstrate that acquirers from countries where corporate-political relationships are common pay higher premiums for politically connected targets.

In the third essay, presented in Chapter 5, I examine the effect of the difference in political orientation between a firm and a CEO on corporate decisions, firm performance, and value. I find that firms with a difference in political orientation deviate from the industry practices of resource management. I also document a negative effect of a difference in political orientation on firm performance and value, which increases with the size of this difference. Finally, I report that changes in political regulations do not change the effect of a difference in political orientation.

CHAPTER I. INTRODUCTION

A firms' relationships with politicians have received a lot of attention from researchers in many academic disciplines. Thus, the motivation to establish connections with politicians and the consequences of such relationships are examined by political science (Stratmann, 1992; Ansolabehere, De Figueiredo, and Snyder, 2003; Stratmann, 2005; Ang and Jia, 2014), economics (Besley, 2004; Vidal, Draca, and Fons-Rosen, 2012), and management (Hillman, 2005; Sun, Mellahi, and Wright, 2012; Sun, Hu, and Hillman, 2016).

The finance literature raises an important question on the effect of political connections on firms' operations, decision making, and value. Existing studies demonstrate that political relationships do not represent a simple exchange of favors between firms and politicians; they have a strong impact on the firm and its shareholders. Politically connected firms save time and money on transactions with the government in form of lower effective tax rates and faster turnaround times (Adhikari, Derashid, and Zhang, 2006; Wu et al., 2012; Correia, 2014). Firms connected with politicians also receive access to additional resources and information while enjoying a lower cost of capital (Khwaja and Mian, 2005; Faccio, Masulis, and McConnell, 2006; Boubakri et al., 2012; Marin, Akin, and Peydro, 2016; Bradley, Pantzalis, and Yuan, 2016). Most importantly, the benefits from an association with politicians increase the value of connected firms and result in better accounting and market performance (Cooper, Gulen, and Ovtchinnikov, 2010; Amore and Bennedsen, 2013).

In this dissertation, I continue the research on how a firm's relationships with politicians affect its decision making. To understand the motivation of firms and politicians

to establish a connection, I develop a cost-benefit model of corporate-political connections. I model the connection between firms and politicians as a typical business relationship, where both parties establish contact with a goal to receive benefits. Before firms decide to approach a politician, they compare the costs and benefits associated with the potential relationship. Potential benefits from an established connection with politicians can be divided into following groups: reduction of transaction costs, greater access to resources and private information, and reduction of potential competition. The firm's potential costs consist of cash costs and non-cash costs, such as opportunity costs of management time, reduced reputational capital, and internal inefficiencies arising from firms' over-investment in political projects.

Politicians also conduct their own cost-benefit analysis, when they evaluate potential costs and benefits of establishing the connection with a particular firm. The greatest benefits to politicians include financial support of campaigns, access to resources and information, as well as future employment by the connected firms. The biggest cost of the relationship to politicians is the reputational effect from being associated with connected firms. The relationship between firms and politicians is only established if the benefits exceed costs for both parties.

I test the implications and predictions of my model of corporate-political relationships, presented in Chapter 2, in three essays. In the first essay, I examine how firms use their political connections as a litigation defense. As suggested by the model, after comparing the costs to establish a relationship with a politician to the damages anticipated by the defendant firms from litigation, they decide to approach politicians for help with the defense of a lawsuit. To satisfy their side of an implicit contract between

firms and politicians, defendant firms make contributions to their campaigns in exchange for reduced litigation costs and preserved reputation. In the essay, I empirically test the behavior of firms anticipating litigation and the benefits they receive from their political connections after a lawsuit is filed.

My second essay examines the effect of political connections on the process of mergers and acquisitions. Before acquiring a politically connected target, bidders conduct a cost-benefit analysis. However, the structure of the costs and benefits from such transactions might be different for foreign and domestic acquirers. Foreign firms experience larger costs while establishing relationships with politicians. Thus, existing political connections of targets are more valuable to them. I test how the structure of costs and benefits for different types of acquirers affects the process and the outcome of the acquisitions. I also examine the benefits connected targets receive from these transactions.

The third essay examines the effect of a difference in political orientation between a firm and a CEO on corporate decisions, performance, and value. Difference in political orientation could represent a disagreement in views, core beliefs, and preferences of directors and a CEO. Its presence could lead to a poor communication, collaboration, and inability to focus on interests of a firm and its shareholders. Consequently, this disagreement within a firm might impact the quality of corporate decisions and should be reflected in firm performance and value. I empirically test the effect of this difference on firm's resource management and acquisition returns, followed by accounting and market performance. I also examine how changes in regulations of corporate political contributions affect a difference in political orientation and its effect on a firm.

CHAPTER II. A THEORY OF CORPORATE-POLITICAL RELATIONSHIPS

1. Human relationships

1.1 Relationships in Finance

Human relationships are extensively examined by numerous social sciences. In finance, network theory, agency theory, and behavioral finance examine personal relationships within and between firms and their effect on firm's value. Social network theory defines relationships as social connections. In this framework, financial agents, such as directors, managers and even firms themselves are connected to other agents and represent parts of a social network. Such networks are formed through education, the past or current employment or other activities, and can become important channels of information for their members (Fracassi, 2016). Engelberg, Gao, and Parsons (2012) examine personal connections between firms and banks and establish that connected firms receive lower rates. In general, they conclude that social ties lead to either exchange of valuable information or better monitoring. At the same time, social ties of directors and managers could be signals of weaker corporate governance. Fracassi and Tate (2012) study personal connections between CEOs and directors, using their education, employment, and club membership information. They find that powerful CEOs are more likely to hire directors that are connected to them. Most importantly, they show that social ties between CEOs and directors weaken the board's monitoring and lead to lower firm valuation. Similarly, Hwang and Kim (2009) study social connections of board members and conclude that socially independent boards have lower compensation and higher pay-performance sensitivity.

Another way of examining relationships is with agency theory. Jensen and Meckling (1976) first discuss the agency costs to the shareholders that arise from the separation of ownership and management in the corporate organizational form. Directors are representatives of the shareholders, and managers are expected to make decisions to maximize shareholders value. However, the relationship between managers, directors, and shareholder in practice is quite complex. In the absence of strong monitoring from the board and contractual protection of shareholders' rights, managers can make value destroying corporate decisions. Other agency conflicts within the firm include relationships between shareholders and debtholders (Childs, Mauer, and Ott, 2005; Kalay and Lemmon, 2008), minority and majority shareholders (Cronqvist and Nilsson, 2003; Villalonga et al., 2015), and non-investor stakeholders (Cornell and Shapiro, 1987; Hill and Jones, 1992).

The behavioral finance literature examines the irrationality of the relationships between multiple financial agents (Barberis and Thaler, 2003). For example, behavioral studies document a strong familiarity bias in investors' behavior, when they develop strong ties to certain firms and disregard rational principles of portfolio theory (Huberman, 2001). Additionally, principles of behavioral finance have been widely used in the development of successful financial adviser-client relationships (Brown and Brown, 2008).

1.2 Definition and Types of Human Relationships

Human relationships are generally defined as series of interactions between people (Heider, 2013). Relationships, however, are different from single and random interactions because they represent repeated behavior of parties familiar with each other (Hinde, 1996). Additionally, relationships have such distinctive features as purpose and expectation of future interactions (Rogers and Millar, 1988).

An individual is involved in numerous types of relationships throughout life, such as parental, romantic, peer and business relationships. All relationships possess certain characteristics in common (e.g., continuity, interdependence, communication), but the motivation to establish a relationship makes them different from each other. For example, passion, commitment, and intimacy define romantic relationships (Connolly et al., 1999), while support, empathy, and respect are features of a peer relationship. In this study, I focus on business relationships, characterized as an economic exchange of interested parties.

2. Business relationships

2.1 Definition

Business relationships represent one type of human relationships and can be defined as the mutual interaction of committed parties with a purpose of beneficial transactions (Snehota and Hakasson, 1995). Like other types of relationships, business relationships can be described using important features, such as initial attraction, trust, and commitment. Business relationships start when multiple parties are attracted to each other. Psychological studies show that people feel attraction to others because of similarity of attitudes and values (Byrne, 1971). When applied to business, the attraction happens when one party realizes the importance of the other party for the transaction.

2.2 Features of Business Relationships

A business relationship is built on trust and commitment. Trust can be described as a confidence in another partner (Morgan and Hunt, 1994) when the trusting party believes the partner to be reliable and honest. Anderson and Narus (1990) describe trust in a business relationship when one party is willing to believe that actions of the other party will lead to

a positive expected outcome. Trust of each other positively affects parties' commitment (Achrol, 1991). When one partner believes that another partner will do whatever is necessary to conclude a transaction, the trusting partner will commit and invest in the project (Naude and Buttle, 2000).

Business relationships differ from other types of human relationships because of the presence of profits. The goal of a successful business interaction is to create value, measured as the profits that both parties enjoy from the transaction. Naude and Buttle (2000) and Palmatier, Dant, and Grewal (2007) identify profits as one of the most important factors contributing to the quality of a business relationship.

There are three common types of relationships that exist in business: relationships between firms and their customers, firms, and partners, and relationships within firms. Relationships between firms and their customers represent a foundation of firms' business. Without established connections with the customers, firms would cease to exist. Firms' value depends on customer loyalty, which in turn is positively related to customer satisfaction and quality of service.

Interfirm connections are also called dyadic relationships and are examined in network theory. They typically include connections with suppliers, rivals, and other business partners. The relationship between firms and politicians is another kind of a business relationship, in which politician plays a role of a business partner. A political-business relationship has many of the typical features of a business relationship, such as trust, commitment and most importantly profits. This kind of a business relationship can only be established if both parties expect a positive result from these series of transactions.

Intra-firm relationships include interactions between managers and shareholders, managers and employees and other stakeholders. According to Jensen and Meckling (1976), most intrafirm relationships can be well maintained by effective contracting. However, relationships between managers and shareholders are quite complicated. To align the interests of executives and shareholders managers should have an incentive to increase firm value. Relationships with stakeholders are often neglected by literature. However, Jiao (2010) argues that stakeholders' wealth represents an intangible factor that positively affects firm value, measured as Tobin's Q.

2.3 Cost-Benefit Analysis

Before a committed relationship can be established, parties go through a pre-relationship stage (Ford, 1980), when they evaluate potential business partners and outcomes of the relationship. One of the tools commonly used to estimate the value of the potential relationship is a cost-benefit analysis. This approach directly compares the costs and benefits associated with a given project (Dreze and Stern, 1987; Rothenberg, 1969). This decision making procedure helps to decide whether to invest in a particular project or make a rational choice between multiple available projects. The analysis includes estimating costs and benefits separately, comparing them and selecting a project with maximum economic efficiency (Marglin, 1968).

Cost-benefit analysis is built on the assumption of resource scarcity, and the agent is expected to make the most efficient allocation of available resources to generate the best outcome (Rothenberg, 1969). Another important assumption defining the analysis is agent's ability to predict consequences (Dreze and Stern, 1987). Without this ability, an agent won't be able to estimate and compare the benefits of available projects, which makes

the analysis incomplete. Finally, it's important for the agent to understand the rationality of the choice when the choice between projects shouldn't be random or be affected by agent's preferences (Rothenberg, 1969).

The cost-benefit approach can be applied to any analysis involving the allocation of resources in social sciences. In healthcare science, Williams (1974) applies this approach to the selection of the treatment method and Bartlett (1995) compares costs and benefits of patients' education. In economics, this approach is often used to estimate costs and benefits of proposed regulations or public policies. Thus, Posner and Weyl (2013) apply cost-benefit analysis to calculate the efficiency in financial markets following Dodd-Frank Reform act, and De Grauwe (2016) compares the costs and benefits of a monetary union. The existing literature in finance shows the application of the cost-benefit approach to shareholder activism (Gantchev, 2013), board friendliness in mergers and acquisitions (Schmidt, 2015) and securities markets regulation (Mulherin, 2007).

Relationships between firms and politicians can be modeled as a typical business relationship, where both parties establish contact with a goal to extract benefits. In this study, I use a cost-benefit analysis to examine the decision to establish a relationship between firms and politicians. I follow the standard procedure to separately analyze costs and benefits for firms and politicians and model a condition under which both parties decide to establish a relationship. I finalize this analysis with a model presented in section 5.1.

3. Corporate costs and benefits

Before firms decide to approach a politician, they compare the costs and benefits of the potential relationship. This allows them to calculate a net present value from

investing time and resources in a political connection. Existing economic, political science and finance literature has identified multiple sources of costs and benefits for connected firms. Potential benefits from an established connection with regulators could be divided into following groups: reduction of transaction costs, greater access to resources and private information, and elimination of industrial competition. Firms' potential costs consist of cash monetary costs, the opportunity cost of managerial time and other non-cash costs from the association with politicians.

3.1 Corporate Benefits

3.1.1 Reduction of transaction costs

Effective reduction of transaction costs implies that firms can save time or money when dealing with government regulations. Ties to local or national politicians help to create advantages for connected firms, giving them a competitive advantage over non-connected peers. Politicians allow connected firms to "bend" or avoid public policy regulations, and connected firms pay lower effective tax rates (Adhikari, Derashid, and Zhang, 2006) and are more likely to receive tax benefits (Wu et al., 2012) and import licenses (Mobarak and Purbasari, 2006). If politicians act in favor of connected firms, transaction time is significantly reduced. For example, connected firms enjoy shorter judicial hearings and receive government contracts and relief funds faster than non-connected firms (Blau, Brough, and Thomas, 2013; Brogaard, Denes, and Duchin, 2015). Additionally, knowledgeable and connected politicians can offer firms guidance through bureaucratic processes, which decreases firms' transaction costs of going through the process themselves and increases a probability of receiving government support. Another way for politicians to preserve firms' money is to reduce monetary penalties, such as fines

directly induced by the government or litigation settlements, charged by federal judges (Correia, 2014).

Connected firms can improve their access to regulators and use existing connections to establish new ones. It helps firms to acquire new channels of influence, save more on transaction costs and consequently achieve an even greater advantage over industry peers. Additionally, in the presence of weak government institutions, state failure or high corruption existing political connections help to overcome bureaucratic burdens and even offer a protection from political exploitation by other parties (Chen et al., 2011).

3.1.2 Greater access to resources

When it comes to access to the resources, it's well established that politically connected firms have greater access to capital markets, especially in the presence of weaker government institutions. Khwaja and Mian (2005) study the banking sector in Pakistan between 1996 and 2002 and find that government banks treat politically connected firms differently. Despite having 50% higher default rates, connected firms are allowed to borrow more frequently than non-connected firms. Charumilind, Kali, and Wiwattanakantang (2006) document that prior to the Asian crisis of 1997 politically connected Thai firms receive better access to a long-term bank credit with less collateral. Similar evidence of politically connected firms gaining access to more capital is documented by Claessens, Feijen, and Laeven (2008). They find that Brazilian banks, which contributed to deputy campaigns in 1998 and 2002 elections, significantly increase leverage after elections.

Politically connected firms also enjoy cheaper capital either directly through politicians' connections to financial institutions or indirectly through lower cost of capital.

The prevailing view is that political connections are beneficial to the firms through different favors, which is ultimately reflected in firms' cash flows. Holding everything else constant, cash flows of politically connected firms are expected to be more stable, especially in downturns, compared to cash flows of non-connected peers. Consequently, financial institutions consider politically connected firms to be less risky, which in turn decreases their cost of capital (Boubakri et al., 2012). In support of this theory Infante and Piazza (2014) study Italian credit markets and document that locally connected firms enjoy lower interest rates in more corrupted geographical areas. Similarly, Bradley, Pantzalis, and Yuan (2016) find that politically connected firms have lower yields. Boubakri et al. (2012) study cost of equity in 541 firms in 35 countries and document that politically connected firms are considered to be less risky than their non-connected peers and consequently have a lower cost of equity. Additionally, politicians can use their connections to regulators and institutional investors to effect an IPO process of connected firms, which results in higher offering prices and lower underpricing (Francis, Hasan, and Sun, 2009), as well as increased bargaining power with lead underwriters (Gounopoulos et al., 2017).

Firms can receive access to government resources in forms of capital bailouts or relief programs, such as TARP, when they are connected to politicians responsible for allocation of government resources. Faccio, Masulis, and McConnell (2006) show the international connected firms are more likely to receive financial support from the government, despite worse performance than the peers following the bailout. Duchin and Sosyura (2012) and Blau, Brough, and Thomas (2013) study the allocations of the Troubled

Asset Relief Program in 2008 and conclude that politically connected firms and banks, in particular, are more likely to receive TARP funds and actually receive larger support.

Another way for firms to receive access to government resources is through the procurement of government contracts. Government contracts could be very valuable to firms due to regular and well-paid services provided to the government. Review of the submitted bids and negotiation of the contracts are usually carried out by authorized government officials, who could have ties to firms applying for contracts. Existing literature confirms that politically connected firms benefit from the procurement of government spending. Firms connected to authorized officials either through campaign contributions or personal ties to firms' directors are more likely to receive government contracts (Goldman, Rocholl, and So, 2013; Brogaard, Denes, and Duchin, 2015; Ferris and Houston, 2016). Additionally, connected firms receive larger contracts with better contract terms and looser oversight from the government (Brogaard, Denes, and Duchin 2015; Ferris and Houston, 2016).

3.1.3 Access to insider information

Politicians have access to a lot of information that can be valuable to firms. Congressional members and professional lobbyists use confidential information for personal gain either directly or in exchanging favors with their corporate sponsors. Connected firms are known to successfully trade on such private information acquired through political sources. Prior to 2012 trading on political knowledge was considered unethical, but not surprising because it did not violate insider trading laws (Jerke, 2010). Marin, Akin, and Peydro (2016) analyze trading by corporate insiders on TARP related information. They find that insiders of politically connected banks received positive

abnormal returns around TARP announcement. Gao and Huang (2016) show that hedge funds receiving information from professional lobbyists outperformed non-connected funds by 53-96 basis points. However, the enactment of the Stop Trading on Congressional Knowledge (STOCK) Act imposed liability on both politicians and tippees. Gao and Huang (2016) analyze hedge fund returns before and after the enactment of the act and find that new regulation significantly reduces the incentive to trade on insider political information.

Trading on political insider information is not limited only to the United States. Bourveau, Coulomb, and Sangnier (2016) present evidence on illegal insider trading in France. They document that directors of publicly traded firms financially or personally connected to the elected president realize positive abnormal returns.

3.1.4 Reduction of competition

Reduction of competition is the most advantageous benefit of political connections. Firms specifically develop corporate political strategies to influence policy makers and hinder the competition in the industry. Campaign contributions and particularly lobbying expenses are widely used by firms to influence industrial legislation and achieve competitive advantages (Antia, Kim, and Pantzalis, 2013). McWilliams, Van Fleet, and Cory (2002) discuss one of the oldest ways to hinder competition – through restricting rivals’ access to resources, raising their costs and driving them out of the market. One of the first examples of political strategy restrictions described in the literature happened in 1833 in Great Britain (Marvel, 1977). The passage of Lord Althorp’s Factory Act, which controlled child labor, benefited large urban textile manufacturers and injured smaller rural manufacturers which relied more on cheap labor than modern technology. Similarly, domestic firms often use their political influence to affect foreign trade policies through

ties to Congress and Trade Administration, which consequently decreases the number of foreign competitors in the markets (Schuler, 1996).

3.2 Corporate Costs

3.2.1 Cash costs

One of the largest costs associated with political connections is a cash dollar cost, which includes monetary contributions to political campaigns and salaries paid to former politicians when they're employed by corporate firms. Ways to make corporate political contributions are heavily regulated by the Federal Election Campaign Act. Firms themselves can't directly support politicians, however, they can donate up to \$5,000 a year to each political action campaign (PAC) which in turn contributes to politicians. Firm management can individually make small contributions to personal and committee campaigns. Additionally, firms are allowed to spend significantly larger amounts on lobbying. Firms can engage in direct lobbying, which represents their attempts to influence legislation through direct communication with officials, as well as grassroots lobbying via communication with general public and requests to express their views to the legislators.

Firms choose how to contribute to politicians' campaigns depending on the goal of the relationship. If firms' purpose is to simply establish a connection with a politician or receive a one-time favor, firms might consider making a targeted one-time contribution. However, it's important to understand that a single donation will not buy politician's vote or establish a long-term trusted relationship with a regulator. One-time contributions are most effective when a politician is currently in the office and has access to resources requested by his corporate donor. Unlike one-time contributions, periodic payments are used to establish and maintain long-term relationships. However, sometimes it takes

multiple contributions to start receiving a benefit. If a firm supports a political runner-up during the election cycle, it has to wait for the politician to get elected and acquainted with available resources before it can expect any favor in return for financial support. Snyder (1992) confirms that actual political donations in the U.S. are very persistent, and firms are likely to contribute to the same candidate over several election cycles. He argues that payment persistence indicates firms are viewing political connections as implicit long-term contracts.

Political contributions are often considered to be a profitable investment. Tullock (1972) first notes that benefits to corporate sponsors of political campaigns are much larger than their campaign contributions, known as Tullock's puzzle. Since then a distribution of corporate donations and benefits remains unchanged, and recent evidence is still consistent with the puzzle. For example, Ansolabehere, De Figueiredo, and Snyder (2003) calculate that in 2000 defense contracting firms and individuals associated with those firms contribute approximately \$13.2 million to candidates and parties and receive \$134 billion in return in form of procurement contracts. Similarly, Chen, Gunny, and Ramanna (2014) document that connected firms lobbying for the Jobs Act receive \$32.4 million in tax breaks for \$1 million of lobbying expenses.

However, political investments are associated with great uncertainty and have a higher discount rate than traditional investment projects. A lower present value of political investments can be explained by the fact that politicians can't simply spend all of their time in the office benefiting their corporate sponsors due to the risk of reelection. Ansolabehere, De Figueiredo, and Snyder (2003) support the hypothesis that politicians do not always vote in favor of their sponsors. They study the relationship between politicians' votes and

corporate contributions to their campaigns. They find that, in addition to corporate contributions, legislators' votes primarily depend on their personal beliefs and preferences of their individual voters.

If a firm finds politician's services valuable, its management considers making the relationship official through an employment of former politicians as consultants, directors or executives. In the case of a formal relationship firms' cash costs consist of salaries paid to former politicians rather than political contributions to their campaigns. Paying salaries to former politicians helps firms to maximize possible benefits from the established relationship and to avoid a free-rider problem arising from firms' efforts to affect industrial legislation as a whole. At the same time existence of a formal contractual relationship between firms and politicians eliminates negative reputational effects to both parties when the typical informal relationship becomes known to the public. However, not all firms choose to employ former politicians. Firms in more regulated industries, such as banking and utilities, have a higher demand for their knowledge and connections than firms in other industries (Agrawal and Knoeber, 2001; Hillman, 2005; Goldman, Rocholl, and So, 2009).

3.2.2 Non-cash costs

In addition to the cash costs of political connections, firms incur numerous non-cash costs arising from their political activity and association with politicians. Firms with strong ties to politicians may experience reputational spillovers from political scandals. Such spillovers may result in a reputation loss in form of lower market value, lower sales, higher contracting costs and worsened relationships with stakeholders. Firm's exposure to the scandal depends on the scandal severity and firm's relatedness to scandal participants,

measured by firm's donations to disgraced politicians (Yu and Lester, 2008; Mohammed and Crane, 2015).

Sometimes political connections lead to internal inefficiencies within the firm. If firms with politically-oriented managers overinvest in political projects, it leads to inefficient allocation of resources, agency problems and suboptimal shareholders' value (Boubakri, Cosset, and Saffar, 2008). Existing literature identifies multiple problems arising from political rent-seeking. Boubakri, Cosset, and Saffar (2008) and Fan, Wong, and Zhang (2007) document that newly privatized politically connected firms exhibit a short and long-term underperformance following the IPO. Politically connected firms have lower productivity, sales growth, earnings growth and return on sales than their non-connected peers. Additionally, Coates and John (2012) show that politically active firms have larger managerial agency costs and lower firm value.

The decision to donate to political campaigns is a joint decision made by firms' board of directors and the management, based on their mutual understanding of what's good for the firm (Clawson, Neustadtl, and Weller, 1998). Development of corporate political strategy takes a lot of directors' and managers' time, which is costly and could be spent on other investment projects. First, firm executives need to evaluate firm's position in the industry and identify benefits they would like to achieve from relationships with politicians. Second, it takes time to recruit politicians with the right resources and maintain the relationship long enough to extract a positive present value from a political investment. Kaufmann and Wei (1999) identify management time spent in negotiations with politicians as one of the rent-seeking burdens arising from political connections. More specifically, they show that firms bribing politicians spend more time in negotiations than other firms.

3.3 Firm's Decision to Establish Political Relationship

After firm's management carefully evaluates and compares possible benefits and costs of the business relationship with a politician, it can make a rational decision whether to establish the relationship or not. According to the cost-benefit approach, a firm would only be interested in contacting politicians if potential benefits from connections outweigh the costs.

4. Politicians' costs and benefits

When a firm makes a rational decision to establish a political relationship, it approaches politicians first. After being contacted by the firm, politicians conduct their own cost-benefit analysis, when they evaluate potential costs and benefits of establishing the connection with a particular firm. Main benefits to politicians include financial support of campaigns, access to resources and information, as well as future employment at connected firms. The biggest cost of the relationship to politicians is the reputational effect from being associated with connected firms.

4.1 Benefits to Politicians

4.1.1 Financial support

Financial support of campaigns is very important to politicians because it increases their chances of being reelected. Existing literature shows a strong positive relation between donations during election cycles and a probability of winning political races (Mann, 2003). However, the relation is nonlinear, and each additional dollar spent on an election has a diminishing return.

Politicians can receive financial support from firms in multiple ways: through PAC contributions, lobbying expenses to support individual legislation, individual contributions of managers and directors and donations to charities associated with politicians. Lake (2015) examines PAC contributions and lobbying expenses between 1999 and 2012. He shows that overall expenses for House elections are increasing, and more firms are engaged in political activity. Hill et al. (2013) reach similar conclusions with lobbying expenses in their sample. They find that between 1999 and 2011 propensity to engage in lobbying increased from 11% to 28%. Average lobbying expenses more than doubled from \$100,000 to \$334,000. Firm executives are also politically active, and their donations don't have to match contributions of their firms. Fremeth, Richter, and Schaufele (2013) study political contributions by CEOs of S&P 500 firms between 1991 and 2008. They find that 87% of CEOs have made at least one donation and contributions of active CEOs are much higher than contributions of the general public (\$12,282 vs. \$115).

4.1.2 Greater access to resources

Active politicians can extract private benefits while being in office. They may provide useful services and information to corporate donors in exchange for access to more capital and other resources, increasing their personal wealth. Fisman, Schulz, and Vig (2016) provide evidence consistent with the hypothesis of private benefits and show that Indian winning political candidates acquire personal net wealth 3%-5% faster than their unsuccessful runner-ups following the election. Tahoun and Vasvari (2016) first document that members of financial committees in the Senate and the House establish personal ties with financial institutions through their committee appointments. Politicians report higher levels of personal leverage compared to members of other committees, 32% lower

maturities and lower interest rates of politicians' liabilities. The chapter confirms existing anecdotal evidence of politicians receiving preferential treatment from certain financial institutions, particularly including lower mortgage rates and faster loan processing.

4.1.3 Access to insider information

Politicians work with a lot of information when in office. They can easily convert relevant information into portfolio returns either by directly trading on the information or by sharing the information with connected firms and investing into their stock. Direct trading on information doesn't require a politician to have a connection with the firm. For example, a member of the Defense Committee can directly invest in stocks of receivers of large procurement contracts. Indirect trading happens when a politician receives capital gains from investing in stocks of connected firms. If a politician does a favor to the connected firm and its stock is going to appreciate as the result of a favor, politician's positive returns from investing into firm's stock can be considered a compensation for the favor. Additionally, having a politician as one of the investors in the firm might be a positive signal to other investors about firm's prospects (Tahoun, 2014).

Existing literature documents that politicians heavily invest in firms they've established a connection, and generate higher returns only from connected investments (Eggers and Hainmueller, 2014). Stephan, Walther, and Wellman (2016) also provide evidence that politicians actively trade on tips from connected brokerage houses, because trades of politicians connected to these brokerage firms are more profitable than trades of other politicians.

4.1.4 Future employment

After leaving the office former politicians and White House staff can be employed as consultants, directors or even executives by corporate firms. Appointments of politically connected directors are quite common in large firms. Goldman, Rocholl, and So (2009) document that at the time of the 2000 presidential election 153 firms out of S&P 500 have connected directors on their boards. Similarly, Goldman, Rocholl, and So (2013) show that in 1994 boards of 330 firms in their sample have 253 nominations of connected directors.

Demand for former politicians as advisors is easily explained. They have established connections to current politicians in the office and have inside knowledge of bureaucratic procedures and regulations, which can be beneficial to firms, especially in heavily regulated industries. Research on politically connected boards shows that former politicians as directors create value for firms and their shareholders. Firms with politically connected directors exhibit better market and accounting performance (Hillman, 2005; Goldman, Rocholl, and So, 2009; Goldman, Rocholl, and So, 2013) than non-connected firms. Similarly, employment of former politicians can also serve as a positive signal to firm's rivals and shareholders that the firm might receive an advantage and outperform non-connected peers.

4.2 Politicians' Costs

4.2.1 Adverse reputational effects

The largest cost incurred by politicians from the relationship with firms is the decline in their political reputation. Politicians do their best to preserve their reputation, which is similar to corporate brands for firms (Pettersson and Karlstrom, 2011). The longer is the politician's tenure in the office, the more fragile his reputation becomes. In a case of multiple elections a politician's reputation is represented by his actions when in office.

During future election cycles, voters take reputation into consideration and may even punish the politician for not being consistent with past decisions (Aragones, Postlewaite, and Palfrey, 2007). Reputation concerns can even affect incumbent politicians' decision making when legislators exhibit perverse policy persistence (Garri, 2008). To preserve their reputation with voters they continue past policies when changes are needed.

Multiple adverse effects arise from either corporate or political scandal involving politicians or firms. Politicians connected to firms engaged in fraud or other corporate scandals experience a negative reputational spillover from their association with exposed firms . At the same time relationship between politicians and firms can become public, and politicians might face corruption charges . Politicians involved in any scandal experience negative effects to their reputation and face a greater risk of future reelection. Specifically, politicians with tainted reputation lose the support of their voters and receive fewer campaign contributions. Welch and Hibbing (1997) study corruption scandals among federal politicians between 1982 and 1990. They document that only 72% of incumbent politicians involved in scandals decide to secure reelection and 25% of them are defeated due to 9%-10% decrease in votes. Jacobson and Dimock (1994) examine the scandal of House members in 1992 and find that it leads to a larger number of retirements and defeats in both primary and general elections. Similarly, politicians exiled from committees and losing their power over the policy-making process experience a decrease in business interest and campaign contributions (Powell and Grimmer, 2016), while challengers of disgraced politicians receive more funds (Jacobson and Dimock, 1994; Powell and Grimmer, 2016).

4.2.2 Reduced discretion

When politicians accept contributions from their corporate sponsors, they implicitly agree to benefit the firms through voting and allocation of resources in their favor. Such behavior affects politicians' independence and reduces their discretion. If voters realize that decisions of politicians in the office deviate from their election promises, it can negatively affect politicians' future. Despite reduced discretion and reelection risk, politicians continue to accept corporate donations. Stratmann (1995; 2002) compares campaign contributions and congressional voting behavior and finds consistent evidence that roll call votes of legislators are influenced by interests of particular business groups. Similarly, de Figueiredo and Edwards (2007) find a strong effect of political contributions on regulatory outcomes.

4.3 Politician's Decision to Establish Political Relationship

After being approached by firms interested in establishing a relationship, politicians conduct an explicit comparison of the associated costs and benefits. They are willing to invest time and resources into the relationship if its benefits outweigh the costs. That is, if a politician receives benefits in excess of the associated costs, a relationship is likely to be established.

5. Mutual decision to establish political relationship

As any other type of a relationship, the business relationship between politicians and firms has to be mutual. Both parties need to compare cost and benefits to make a decision whether to establish the relationship or not. Therefore, benefits for both politicians and firms have to outweigh their costs for a relationship to exist.

5.1 A Model of Political Connection Establishment

Corporate agent in assessing whether to undertake an investment in a business relationship with a politician will conduct a cost-benefit analysis of the costs and benefits associated with the potential investment.

5.2 The Corporate Agent's Decision to Establish A Connection

Benefits to the corporate agent consist of both fixed and variable components. Fixed benefits are the initial access to a politician. The firm is introduced to the politician, expresses its expectations for the relationship and describes what it can offer. However, these fixed benefits are unlikely to significantly advantage the corporate agent because they are limited in scope and quickly decay over time. Variable benefits include access to additional resources or information provided by the politician. They vary with the size and consistency of an agent's contributions (Fisman, 2001; Goldman, Rocholl, and So, 2009). Corporate agents continue to receive these benefits as long as they maintain their support of the politician. The agent's benefits vary with their level of contributions to the politician. The larger is the financial support, the more important is the favor expected by the corporate agent in return. Therefore, I model the benefits to a corporate agent, B_c , as:

$$B_c = \alpha + \beta \cdot \text{Contributions}, \quad (1)$$

where: α =fixed component of benefits,

β =sensitivity of benefits to contributions made by a corporate agent.

But fixed benefits quickly become insignificant since a politician is unwilling to favor the corporate agent without continuous financial support. Thus, $\alpha \approx 0$ and B_c simplifies to:

$$B_c = \beta \cdot \text{Contributions} \quad (2)$$

To gain these benefits the corporate agent must incur costs. The agent's total costs to establish a political connection also consist of fixed and variable elements. The fixed costs consist mainly of time and money spent by the corporate agent to obtain the initial contact with the politician. The variable costs to the corporate agent are both cash and non-cash in nature. Cash variable costs are the financial support of politician's campaigns in form of lobbying expenses, contributions to PACs and donations of the agent's directors and executives (Cooper, Gulen, and Ovtchinnikov, 2010; Ovtchinnikov and Pantaleoni, 2012; Bradley, Pantzalis, and Yuan, 2016). Non-cash variable costs include management's time spent on establishing and maintaining the relationship, possible reputational losses from the association with a politician, and internal inefficiencies within the corporate agent due to the connection. Both cash and non-cash variable costs are functions of agent's contributions. Time spent on maintaining the relationship and agent's potential losses from the involvement with the politician increase with the size of agent's donations. Thus, total variable costs are determined by the contributions amounts. Therefore, I model the corporate agent's costs as follows:

$$C_c = \gamma + \delta \cdot \text{Contributions}, \quad (3)$$

where: γ =fixed costs,

δ =sensitivity of agent's costs to contributions.

Fixed costs incurred by the agent to establish an initial contact with the politician are not prime drivers of the decision to maintain the relationship. Thus, I exclude them and C_c simplifies to:

$$C_c = \delta \cdot \text{Contributions} \quad (4)$$

A rational corporate agent is willing to establish a political connection as long as benefits exceed costs:

$$B_c > C_c \quad (5)$$

Substituting for (2) and (4), I obtain the first condition necessary for the corporate agent to establish a political connection:

$$\beta \cdot \text{Contributions} > \delta \cdot \text{Contributions} \quad (6)$$

5.3 The Politician's Decision to Establish A Connection

Similar to the benefits enjoyed by a corporate agent, the politician's benefits can be decomposed into fixed and variable elements. The fixed element is the initial connection to the corporate agent's directors or executives. Initial contact provides the politician with a potential corporate financial contributor or an important source of information. If the political agent wants to pursue the relationship with the firm in the future, he already knows who to approach and what the corporate sponsor has to offer. Variable benefits to politicians include financial support of their political campaigns, additional access to resources and information, and possible future employment with the corporate agent. The variable benefits enjoyed by a politician are a function of agent's variable costs. Therefore, I model politician's benefits as follows:

$$B_p = \varepsilon + \lambda \cdot C_{vc}, \quad (7)$$

where: ε =fixed benefits,

λ =sensitivity of politician's benefits to the corporate agent's variable costs.

However, fixed benefits to politicians are close to zero because the initial connection to the corporate agent is of only limited value to politicians. The real value occurs with an ongoing relationship. Thus, B_p simplifies to:

$$B_p = \lambda \cdot C_{vc} \quad (8)$$

Politician's costs, C_p , are variable and include adverse reputational effects from the association with corporate agents and consequences of the reduced discretion. When a politician acts in favor of the corporate agent and not of his voters, it affects his political reputation through lower voters' support, smaller campaign contributions and increased risk of reelection. At the same time, politician's costs vary with the size of the corporate agent's contributions. The negative impact on the politician's reputation and discretion increases with the size of the financial support from the corporate agent. Therefore, I model politician's costs as follows:

$$C_p = \eta \cdot \text{Contributions}, \quad (9)$$

where η =sensitivity of politician's costs to the corporate agent's contributions.

For a politician to agree to establish a political relationship with a corporate agent politician's benefits have to exceed politician's costs:

$$B_p > C_p \quad (10)$$

Substituting for B_p , C_p and C_{vc} , I obtain politician's condition to establish a political connection:

$$\lambda \cdot \delta \cdot \text{Contributions} > \eta \cdot \text{Contributions} \quad (11)$$

5.4 Establishing The Connection

For the relationship to occur, the benefits of both parties have to outweigh the costs. Therefore the joint condition for the relationship is as follows:

$$\begin{cases} \beta \cdot \text{Contributions} > \delta \cdot \text{Contributions} \\ \lambda \cdot \delta \cdot \text{Contributions} > \eta \cdot \text{Contributions} \end{cases} \quad (12)$$

At the same time, corporate agent's costs and politician's benefits are closely related. I substitute $C_c = \delta \cdot B_p$ into equation (12) and arrive at the joint condition to establish a connection:

$$\begin{cases} \beta \cdot \text{Contributions} > \delta \cdot B_p \\ \lambda \cdot \delta \cdot \text{Contributions} > \eta \cdot \text{Contributions} \end{cases} \quad (13)$$

6. The empirical evidence regarding political connections

The existence of numerous relationships between firms and politicians supports the validity of the model, discussed in Section 5. The existing literature documents that political connections are wide spread. Faccio (2006) shows that they exist in 35 out of 47 countries in her sample and represent 8% of world's stock market capitalization. Therefore I can conclude that for many politicians and firms all over the world benefits from the connections outweigh their costs, and parties successfully engage in profitable business relationships.

6.1 Domestic and International Research

The existing literature studies political connections both internationally and in the U.S. Relationships between politicians and firms are clearly more frequent in countries with higher corruption, weaker development of government institutions, law enforcement, and investor protection. Benefits from the relationship for both parties in such countries are significantly larger than costs because the risk of the relationship becoming public and its negative consequences are low. At the same time firms might be especially interested

in establishing political connections to protect themselves from further rent-seeking by the government. Thus a large strain of literature examines international political connections in countries, such as Indonesia (Fisman, 2001), Malaysia (Johnson and Mitton, 2003), Pakistan (Khwaja and Mian, 2005), France (Bertrand et al., 2007) and Brazil (Claessens, Feijen, and Laeven, 2008).

Multiple studies focus on political connections in China. The existence of state owned firms and government's direct involvement in business make it a perfect laboratory to study business relationships between government and firms. Fan, Wong, and Zhang (2007) document that Chinese firms are controlled by the government from the start of their operations. They examine 790 newly privatized firms and find that 27% of them have a former or current politician as a CEO. Firms run by politicians are also more likely to appoint bureaucrats to the board of directors. Chen, Li, and Su (2011) confirm that politicians want to control firm operations directly through concentrated ownership and appointments as executives or directors. They conclude that such ownership and management structure allows politicians to extract all benefits arising from the connection.

Domestic research studies political connections in the U.S. Despite lower corruption and strong institutes relationships between politicians and firms are very common. Thus, Faccio (2006) estimates that 5% of the U.S. firms have a personal connection to politicians and government officials, and 11% of firms contribute to political campaigns (Aggarwal, Meschke, and Wang, 2012). In the U.S. firms are allowed to support parties, candidates and their legislations through PAC contributions and lobbying. Therefore, unlike in countries where corporations can't participate in elections, a lot of

connections between politicians and firms are established indirectly through financial support.

6.2 Types of Formed Connections

Firms establish connections with politicians indirectly through financial support of their campaigns, through personal connections or direct employment of former politicians. A large strain of literature studies the amounts contributed to election campaigns through political action committees (Cooper, Gulen, and Ovtchinnikov, 2010; Duchin and Sosyura, 2012; Bradley, Pantzalis, and Yuan, 2016), donations of individuals affiliated with a company (Ovtchinnikov and Pantaleoni, 2012), soft money (Aggarwal, Meschke, and Wang, 2012) and lobbying expenses associated with supporting politicians' legislation activity (Tripathi, Ansolabehere, and Snyder, 2002; Hill et al., 2013; Adelino and Dinc, 2014; Bradley, Pantzalis, and Yuan, 2016). Most of the analysis is done on U.S. companies due to public availability of the data from the Federal Election Commission. Multiple studies show that different types of financial support are related to each other and jointly represent firms' corporate political strategies. Firms spend more on lobbying than on PAC or soft money contributions (Milyo, Primo, and Groseclose, 2000). But at the same time, lobbying and PAC contributions are quite correlated and are considered to be complements (Tripathi, Ansolabehere, and Snyder, 2002; Hill et al., 2013).

Firms frequently establish personal relationships with politicians. Multiple studies examine personal, educational or professional networks between firms' executives or directors and government officials. For example, Faccio, Masulis, and McConnell (2006) define firms as politically connected if a relative of a highly ranked politician is a top officer or a large shareholder of the firm. Fisman et al. (2012) use network theory to establish

personal ties between corporate boards and Vice-president Richard Cheney. Amore and Bennedsen (2013) study family relationships between directors and CEOs of Danish firms and politicians at local municipalities.

However, the most formal and legitimate way for firms to establish direct relationships with politicians is to officially employ them as consultants, lobbyists, directors or executives. Bertrand et al. (2007) examine the behavior of French public firms managed by former government officials. Cingano and Pinotti (2013) study 1,200 Italian manufacturing firms which employ over 11,000 of politicians from local municipalities. Goldman, Rocholl, and So (2013) examine S&P500 firms with former politicians on boards.

6.3 Effect of Formed Connections

Political connections are very important because they affect firms' value. Existing literature presents the evidence of them being both value creating and value destroying for the connected firms. Goldman, Rocholl, and So (2009) study effect of political connections established through the appointment of former politicians as directors. They analyze stock responses to 2000 presidential elections and document that firms connected to the winning party increase in value. Cooper, Gulen, and Ovtchinnikov (2010) use comprehensive data on political contributions to calculate the number of politicians supported by publicly traded firms. They find a strong positive relation between the number of supported politicians and firms' future earnings. Amore and Bennedsen (2013) study connections of Danish firms to local municipalities and show that connected firms outperform their non-connected peers, especially in industries closely working with local government.

However, the effect of political connections is not uniform all over the world. Thus, Faccio (2006) documents no change in stock prices of connected firms in 47 countries when politicians are appointed as directors. Similarly, Boubakri, Cosset, and Saffar (2008) conduct an international study of the effect of political connections in newly privatized firms. They document that connected firms underperform compared to non-connected firms.

6.4 Conclusion

Numerous evidence presented in section 6 confirms implications of the model of the relationships between firms and politicians. Firms and politicians willingly establish and maintain mutually beneficial relationships, when their benefits outweigh the costs for both sides. Existing literature also shows that political connections matter. Politicians help their corporate sponsors to receive an advantage over their competitors, which results in an improved firms' value. Therefore, I conclude that the model is valid and further test it in different corporate settings in the essays.

CHAPTER III. POLITICAL CONNECTIONS AS AN ELEMENT OF LITIGATION DEFENSE

1. Introduction

The existing literature mainly views firms' political connections as investment projects creating value for their shareholders. Previous studies document multiple benefits received by firms from their ties to politicians. Politically connected firms have lower transaction costs (Yang, 2013), receive tax benefits (Adhikari, Derashid, and Zhang, 2006) and have access to government resources such as contracts and relief funds (Faccio, Masulis, and McConnell, 2006; Blau, Brough, and Thomas, 2013; Brogaard, Denes, and Duchin, 2015). Firms with connections to politicians are also perceived to be less risky by partners and investors (Claessens, Feijen, and Laeven, 2008; Boubakri et al., 2012).

Fewer lawsuits filed against the connected firms and favorable verdicts represent common benefits from political connections in corporate litigation. Correia (2014) studies SEC initiated lawsuits and concludes that politically connected firms face fewer cases and lower penalties. Firth, Rui, and Wu (2011) identify a bias towards politically connected and state owned firms in the judicial system of China. They find that politically connected firms have higher returns around the filing and verdict announcements and enjoy favorable outcomes of appeals.

This essay examines how defendant firms use their political connections as a litigation defense mechanism. Using a large sample of civil lawsuits between 1998 and 2014, I study what benefits defendant firms receive from their relationships with politicians during litigation. First, I establish that firms, anticipating litigation, use their connections with politicians and approach them for help with litigation defense. I find that firms with

high litigation risk are 8.6%-13.5% more likely to make political contributions and donate larger amounts. Additionally, my evidence suggests that lawsuit filing motivates defendant firms to approach politicians and contribute to their campaigns during litigation to directly affect the outcome. Thus, I report that sued firms spend \$3,628 per day more on lobbying during litigation than their peers not involved in litigation and \$11,107 per day more in comparison with their historical contributions.

Consistent with the existing literature on the benefits of political connections, I document that defendant firms receive benefits from their connections. These benefits include shorter lawsuit resolution, less negative cumulative abnormal returns to lawsuit filing and verdict and a higher likelihood of lawsuits being terminated or moved prior to the court hearing. A one standard deviation increase in political contributions decreases litigation time by 88 days and increases cumulative abnormal returns to filing (verdict) announcements by 0.39% (0.48%). A similar increase in contributions increases the odds of a case dismissal by 14.4% and the odds of a case transfer to another court by 9.6%. The odds of a lawsuit being settled out of court decrease by 20.3% with a one standard deviation increase in political contributions of the defendant firms.

Defendant firms, however, do not receive any benefits when the case is actually presented in front of a judge or a jury in a federal district court. I document that political contributions of defendant firms do not influence a lawsuit verdict. Thus, political contributions are not associated with a case being terminated in favor of a plaintiff or a defendant. Similarly, the assignment of monetary penalties and their size are not affected by firms' connections to politicians. Therefore, I conclude that the networks of connected politicians do not provide defendant firms with direct access to federal district court judges

and do not affect their decision making. Thus, political connections do not provide defendant firms with all benefits predicted by the hypotheses.

I further explore other limitations of political connections in litigation. I find that political connections are less effective in complex litigation, which is typically associated with multiple plaintiffs, a high quality of evidence, and increased media scrutiny. In these cases, such as class action lawsuits, the power of political connections gets diluted. Concerns about the disclosure of relationships with firms mitigate politicians' willingness to help their client with a lawsuit defense. I observe similar results in lawsuits filed by government entities. Consistent with existing literature, I document that government lawsuits put increased pressure on defendant firms and encourage them to seek political help. However, concerns about their political careers affect politicians' decision to help firms during government litigation.

Evidence presented in this study contributes to the literature on the value of political connections to connected firms. More specifically, it contributes to the debate on the rate of return on political contributions. The existing literature documents mixed findings on how profitable political investments are. Alexander, Mazza, and Scholz (2009) find that for every \$1 spent on lobbying, firms receive an astounding 22,000% return. However, Ansolabehere, De Figueiredo, and Snyder (2003), De Figueiredo and Silverman (2006), and Chen, Gunny, and Ramanna (2014) argue that not all previous studies are able to model political investments accurately and report much smaller returns on corporate political contributions. Empirical results in this study show that political connections of defendant firms do not provide them with all the benefits possible in litigation. This causes the NPV of political projects in litigation to be smaller than hypothesized. These findings are

consistent with Ansolabehere, De Figueiredo, and Snyder (2003) and confirm that politicians do not act solely in the interest of the firms donating to their campaigns due to career concerns. However, a smaller than expected rate of return on political contributions in litigation does not prevent firms from further political donations. It suggests that firms expect a higher rate of return from other political projects, such as industry lobbying and access to additional resources and information from their relationships with politicians.

The remainder of the study is organized as follows. Section 2 discusses the motivation of firms and politicians to establish political connections as well as the mechanism of how politicians can help defendant firms. Section 3 presents the hypotheses. Section 4 describes the data, sample and presents descriptive statistics. Section 5 presents the main empirical results, while the robustness tests are discussed in section 6. A brief conclusion and implications of the study are presented in section 7.

2. Motivations for political connections and their mechanics

2.1 Motivation to Establish Political Connections

Political connections between politicians and firms represent implicit contracts where both parties must benefit each other for the relationship to exist (Snyder, 1992). Before entering into a political relationship, both firms and politicians compare the associated costs and benefits. If both parties expect the benefits to outweigh the associated costs, the relationship is established. For the relationship to continue, both sides must honor the contract. This essentially means that firms support the politicians' campaigns while politicians provide various benefits to their corporate sponsors.

2.1.1. Firms' motivation to establish political connections

Firms are interested in establishing relationships with politicians because they can receive multiple advantages from such associations. Political connections help firms to save time and money when dealing with regulations. Connected firms receive tax benefits (Wu et al., 2012) and gain access to import licenses (Mobarak and Purbasari, 2006). They are more likely to receive government contracts and other relief funds, as well as save time on these transactions (Blau, Brough, and Thomas, 2013; Brogaard, Denes, and Duchin, 2015). Through their connections to politicians, firms can reduce competition in the industry through legislation and changes to foreign trade policies (Schuler, 1996; Antia, Kim, and Pantzalis, 2013). Close ties to politicians provide connected firms with insider information which allows them to trade and realize positive abnormal returns (Gao and Huang, 2016). Preferential treatment by the government and other benefits received by connected firms result in more stable cash flows than those of non-connected peers. Firms connected to politicians are perceived by investors and financial intermediaries as less risky than non-connected firms. Therefore, connected firms can obtain greater access to capital markets and enjoy a lower cost of capital (Boubakri et al., 2012; Bradley, Pantzalis, and Yuan, 2016).

2.1.2 Politicians' motivation to establish political connections

Politicians' motivation to establish and maintain relationships with firms can be explained by career, reputation, and individual financial concerns. Firms provide politicians with financial support in the form of individual contributions, PAC contributions, and lobbying. Political contributions have a strong effect on the probability of reelection and continuing political careers (Mann, 2003). Additionally, strong relationships with firms can provide future employment opportunities for politicians after

they leave the office. Former politicians are often hired by connected firms as consultants, lobbyists, directors or executives (Hillman, 2005; Goldman, Rocholl, and So, 2013). Finally, politicians can receive useful information from the connected firms which might increase their personal wealth (Eggers and Hainmueller, 2014).

2.2 The Mechanics of Political Connections

In this section, I examine the network of connections developed by politicians while in office and the channels of influence they use to assist their corporate sponsors.

2.2.1 The politician's network

Politicians develop their strongest ties to other politicians and government officials that belong to the same political party. Such inter-party relationships are built on similar political views and a mutual belief in the goals and prospects of the party. Politicians from the same party spend a lot of time interacting with each other during the national committee events, congressional party meetings, and party fundraising campaigns.

Politicians continuously acquire new connections throughout their tenure on various committees and sub-committees. There are 20 standing committees in the U.S. House of Representatives and 16 committees in the U.S. Senate, as well as 4 joint congressional committees¹. Traditionally the main duties of Congressional members include lawmaking, oversight of the executive agencies, and representation/service to their constituents. During the legislative hearings committee members meet and establish contact with government officials, members of relevant executive agencies and regulators as well as public and interest groups. Members of the congressional committee and full Congress have a right to

¹ <https://www.congress.gov/committees>

request oversight hearings to follow up on the enactment of the law or a resolution. During these hearings members of Congress question regulators and government officials on how efficiently the new legislation is being implemented. Additionally, Congressional members partake in investigative hearings, where government or public officials report to them on the various matters. Finally, Congressmen hold confirmation hearings, where they review nominations to key government or judicial positions. Therefore, throughout their daily activity, members of Congress establish connections to various members of the government and various agencies.

Politicians are also connected to various industry groups through their legislative initiatives. Industry groups are organizations which represent multiple businesses in the same industry. Members of such groups combine their resources to lobby politicians to promote their combined interests. Being a member of an industry group provides firms with greater access to politicians and a higher likelihood of receiving preferential treatment.

While in the office, politicians meet and interact with varied staff. Both Senate and House members work with personal staff and employees assigned to each committee they serve on. In addition, through their lawmaking and oversight activities, politicians have ties to lobbyists, current White House staff, and former government members currently working in the private sector.

Congressional members develop connections to many political agents and potential sponsors during their election campaigns. Despite being federal office-holders, senators and representatives are elected by voters in their home states and local congressional districts. To increase the likelihood of a successful election, politicians need to acquire voter support. They can either directly visit different groups of constituents or approach

local politicians and interest groups for official endorsements.

2.2.2 The politician's channels of influence

Politicians can provide firms with important information. Politicians can inform their corporate sponsors about new legislative initiatives or upcoming changes to existing bills and regulations. Information disclosure prior to the official release provides firms with more time to adjust corporate policies or gain an advantage relative to competitors. When a politician is aware of the firm's desire to influence legislation already being discussed by the committee, he can inform the connected firm of the upcoming hearing and encourage attendance. Additionally, politicians can give firms useful tips on different procedures, policies, or contacts regarding legislation of interest.

Politicians can introduce firms to other politicians or relevant interest groups². When connected firms want to increase their influence in the same industry, politicians introduce them to other members of the committees they serve on. When firms want to acquire connections in different industries, however, introductions to members of other committees will help them to establish the appropriate contact. Similarly, politicians can introduce firms to government officials, regulators, and members of the executive agencies they consult with and supervise on a regular basis. Politicians work closely with lobbyists and can introduce them to firms, seeking new political connections. Finally, firms benefit from politicians' introductions to industry groups or other corporate sponsors with similar political goals.

Politicians benefit their corporate sponsors through legislation. Politicians can create

² <https://sunlightfoundation.com/2006/02/06/ralph-reed-introduced-enron-to-abramoff/>

new legislation or tailor existing bills and resolutions to the needs of the connected firms. New legislation can often directly affect the performance of corporate sponsors (Hart and Ahuja, 1996; Fredriksson, 2001).

Politicians can assist connected firms through direct action. Direct involvement of the politician occurs when the politician is directly in charge of the issue. Politicians treat connected firms differently by waiving necessary paperwork or fees, granting exceptions, or extending deadlines. At the same time, instead of directly advancing connected firms, politicians can initiate an investigation of firms' competitors or otherwise damage their public reputation. Politicians can also indirectly support their connected firms. Indirect involvement includes connected politicians approaching other political agents and persuading them to benefit the firms or by otherwise pressuring them.

3. Hypotheses development

In this section, I describe how established relationships with politicians help connected firms in defending against corporate litigation. I argue that political influence is used by connected firms as part of their litigation defense. I then explain how political connections help firms both prior and during litigation.

3.1 Litigation Environment

3.1.1 Lawsuit anticipation

Future litigation can be anticipated by firms based on their industry membership, certain financial characteristics or product/market circumstances. Existing literature documents that firms in biotechnology, technology, regulated industries, and retail generally incur higher litigation risks (Francis, Philbrick, and Schipper, 1994; Johnson,

Kasznik, and Nelson, 2000; Field, Lowry, and Shu, 2005). Kim and Skinner (2012) extend this line of research and show that litigation rates are higher in certain industry clusters which change over time. Similarly, Gande and Lewis (2009) show that the number of previous lawsuits in the industry is an important factor of firms' litigation risk.

Previous studies show that certain types of firms have higher litigation risks. Larger profitable firms with high return volatility and stock turnover are more likely to get sued (Johnson, Kasznik, and Nelson, 2000; Gande and Lewis, 2009). Corporate governance quality, CEO power, and insider trading are also known as factors influencing litigation risk (Johnson, Kasznik, and Nelson, 2000). The relation between these firm characteristics and the propensity to get sued is well known to managers. Thus, firms exposed to these factors should anticipate litigation. Additionally, firms experience "reasonable anticipation" of litigation, when the management believes that a firm might be facing a lawsuit. Such anticipation typically arises when a firm receives letters, complaints, and demands from a potential plaintiff prior to a lawsuit filing. However, anticipation might also come from the management being aware of certain corporate practices or events and worried regarding their discovery.

If litigation can be anticipated, then firms wish to mitigate litigation risk. Political connections represent a defense mechanism that firms anticipating litigation can use. When firms assess their probability of being sued, they also estimate the damages associated with litigation. They will then evaluate the need for establishing political connections as part of their defense against the litigation. Firms establish connections with politicians and maintain existing relationships to receive benefits in exchange for contributions to politicians' campaigns. Thus, firm's political contributions can be used to measure the

strength of its relationships with connected politicians. Therefore, I expect a positive relation between propensity of litigation and political contributions and hypothesize:

H1: Firms with greater litigation risks are more likely to make political contributions.

3.1.2 Political connections established during litigation

Firms facing litigation have an incentive to use political connections as a defense strategy to minimize the large monetary and reputational damages associated with a lawsuit. In anticipation of these damages, firms' management considers seeking politicians' assistance. Thus, lawsuit filing encourages defendant firms to contribute to politicians' campaigns and legislative initiatives during the litigation to receive direct help with the defense of a lawsuit filed against the firm. Therefore, I hypothesize the following:

H2a: Firms involved in litigation are more likely to contribute than firms not involved in litigation.

A firm's concern about damages from litigation encourages it to seek the help of connected politicians. Assistance provided by connected firms varies with the size of their contributions (Fisman, 2001; Goldman, Rocholl, and So, 2009). Thus, defendant firms involved in litigation are more likely to increase their level of contributions to receive politicians' assistance with the defense of a lawsuit. Therefore, I hypothesize:

H2b: Political contributions made during litigation are larger than firms' historical contributions.

3.2 Benefits from Political Connections in Litigation

3.2.1 Litigation costs

The total costs incurred by defendant firms during litigation can be divided into

cash and non-cash expenses. Cash costs include direct monetary losses experienced by the firms, such as legal expenses and monetary penalties charged by the judge. Non-cash expenses represent the decrease in firms' value, measured by the cumulative abnormal returns to lawsuit announcements and the change in firm value.

Defendant firms are interested in a quicker lawsuit resolution to mitigate cash and non-cash losses associated with the litigation. Legal expenses represent a large part of the firm's total expenses. A survey by Fullbright and Jaworski LLP reports that in 2013 mean and median litigation costs amount to \$11.6 million and \$1.2 million, respectively³. Legal costs vary with the time spent on lawsuit preparation and legal support during the trial. Thus, a shorter time to verdict reduces the firm's cash expenses from litigation. Additionally, a firm's non-cash expenses increase with the length of the trial. Longer lawsuit resolution leads to a greater exposure to investors and others of the firm's wrongdoing. Thus, a firm's reputation and value losses vary with the duration of the lawsuit.

The career concerns of politicians, discussed in Section 2.2, create incentives for them to help defend the lawsuit and thus reduce the time and money firms must spend on litigation. Politicians can directly approach or introduce a firm to other political agents to convince the plaintiff to quickly resolve the lawsuit and settle. Similarly, politicians can use their networks to influence the judge and terminate the lawsuit quicker. Additionally, by reaching out to the appropriate judicial bodies or committees, politicians can facilitate getting the lawsuit dismissed. Finally, politicians, their staff, and other political agents can present evidence in favor of the defendant. Convincing evidence might weaken the position

³ http://www.nortonrosefulbright.com/files/20150514-2015-litigation-trends-survey_v24-128746.pdf

of the plaintiff and lead to a quicker favorable resolution of the lawsuit. Because politicians can assist firms in decreasing litigation time, I hypothesize:

H3a: The time to verdict for a politically connected firm is shorter than that for a non-connected firm.

Monetary penalties charged by the judge are the largest explicit expense incurred by a defendant firms. The monetary compensation awarded to plaintiffs varies with the severity of the violation committed by the defendant firm and litigation time. Karpoff, Lee, and Martin (2008) examine firms targeted by the SEC between 1978 and 2002 and document that the average monetary fees equal \$23.5 million. McTier and Wald (2011) document gross (net) settlements in securities class actions of \$58.4 million (\$103.5 million). Sometimes penalties assigned to the defendant firms include legal expenses suffered by the plaintiffs. For example, in a case of class actions, the cumulative compensation paid to the class members, includes legal fees, which usually amount to 20-30% of the total compensation (Alexander, 2000; Eisenberg and Miller, 2003).

Firms can mitigate the monetary penalties through introductions to other political agents or lawyers who can influence the judge. Politicians can also use their connections to federal district courts and the judicial bodies to negotiate the final penalties charged to the firm. It might be possible to substitute non-monetary alternatives, such as changes to corporate policies, for expensive monetary fees. Additionally, politicians can use their oversight and investigative powers to question the fairness of the assigned penalties. Finally, politicians can assist the firm in showing the large negative impact of the penalties to the firm, its employees, and the public. Monetary penalties assigned by the court typically vary with the severity of the offense. Thus, to properly estimate the effect of

political connections on the monetary penalties I control for the violation committed by a defendant firm. Because political connections can help to decrease the monetary penalties charged to the firms, I hypothesize:

H3b: Politically connected firms are charged smaller monetary penalties than non-connected firms.

Though explicit monetary expenses from litigation can be quite large, Karpoff, Lee, and Martin (2008) estimate the implicit reputational costs to be 7.5 times the explicit costs. They additionally calculate that reputational losses represent 88% of the total losses incurred by firms engaged in financial misrepresentation.

The decrease in a firm's value comes from the investors' overreaction to the bad news about the litigation (Romano, 1991). As the news of the lawsuit spreads, the firm's investors assess the probability of an unfavorable verdict and potential damages from litigation. Such calculation often leads to investors exiting their positions and selling the firm's stocks. Information about corporate support for politicians is publicly available. Investors have access to the list of politicians supported by a firm and the amounts of their political donations⁴. Since the overall view of political connections is that they create value for a firm's shareholders⁵, investors expect politicians to help the firm to defend against the lawsuit and achieve a more favorable verdict. The expectations from political connections lead to a less negative investor reaction to news of the litigation and ultimately less negative cumulative abnormal returns to lawsuit filing and verdict. Therefore, I hypothesize:

⁴ <https://www.opensecrets.org/>; <https://www.followthemoney.org/>

⁵ Goldman, Rocholl, and So (2009); Cooper, Gulen, and Ovtchinnikov (2010)

H3c: The market's reaction to a lawsuit's filing and its verdict announcement is less negative for politically connected firms.

3.2.2 Litigation verdict

The firm's value loss and damage to the firm's reputation are larger, however, when the firm is found guilty by the court. The formal indictment of the defendant firm leads to more negative abnormal returns, increased risk to operations, larger transaction costs, and a reduced interest from investors. Hutton, Peterson, and Smith (2014) thoroughly examine the consequences of litigation to firms. They find that the reduction in sales, return on assets, and institutional ownership is statistically significant when firms are found guilty or decide to settle to avoid a formal verdict.

Considering the importance of an unfavorable verdict to a firm's operations and politicians' incentives to assist the firm, I expect politicians to support the defense of the lawsuit. Politicians can provide support in multiple ways. First, they can introduce the firm to local politicians or powerful law firms with connections that can help influence the verdict. Politicians' connections, however, can be used to indirectly influence a verdict. They can use multiple resources to offer direct evidence or relevant precedents, to help mitigate the firm's guilt. Testimonies from regulators or government officials can also be presented during litigation. To increase the chances of a favorable lawsuit resolution, politicians might imply negative consequences for the plaintiff's party if the connected firms are found guilty. Therefore, I hypothesize⁶:

H3d: Politically connected firms are found guilty less frequently than non-connected firms.

⁶ Verdict can be affected by the severity of a violation committed by the defendant firm. I control for the violation to isolate the effect of political connections on litigation verdict.

3.3 Limitations of Political Connections

3.3.1 Case complexity and political connections

Lawsuit complexity might limit the power of political connections in corporate litigation. I refer to class action lawsuits as complex litigation because of their features, such as plaintiff numerosity, complicated certification process, and wide media coverage. Such lawsuits typically involve multiple plaintiffs who suffer similar damages from the actions or products of the defendant firms. The number of plaintiffs in such lawsuits varies from ten to multiple millions (Koku, 2006). It's more complicated for politicians to assist connected firms in such cases because there are too many parties to approach. A large number of lawsuit participants dilutes political influence. Thus, political assistance might be less effective in complex litigation.

In addition to involving a whole class of plaintiffs, complex complaints must be certified before they receive the status of a class action lawsuit. The certification process is complicated and requires the complaint to meet multiple criteria. If a complaint hasn't been dismissed at the certification stage, it is likely to have strong evidence against the defendant firm and might be resolved in favor of the plaintiffs or settled⁷. Thus, politicians, regulators, and other experts will have difficulty providing strong evidence in favor of the defendant firm and thereby affecting the litigation. During the trial of complex lawsuits, plaintiff's councils must present abundant evidence against the defendant firm. In addition to simply claiming the defendant's wrongdoing, the plaintiffs need to provide the dates of the alleged violation and present a detailed calculation of their total damages. Such

⁷ NERA report of the recent trends in securities class actions shows that dismissal rate historically varies from 32% to 54% (http://www.nera.com/content/dam/nera/publications/2016/2015_Securities_Trends_Report_NERA.pdf)

complex trials tend to last longer and challenge the politician's ability to support the defendant firm.

Complex lawsuits also have greater media coverage, which scrutinizes politicians to a greater degree. Wider exposure of the case to the public affects all the participants of the lawsuit. Judges are concerned about their reputation and will want to exercise increased discretion. Plaintiffs will be less interested in dismissing the lawsuit or settling out of court to maximize the monetary penalties to the defendant firms. Politicians themselves will be concerned about the disclosure of their relationship with the defendant firm and are more likely to refrain from assisting with the lawsuit's defense. Thus, media exposure reduces politicians' ability to influence the litigation process.

In complex lawsuits offense of the defendant firm can cause serious injury to a whole class of plaintiffs, such as firm's shareholders, employees or customers. Thus, judges are more likely to create a precedent and strictly penalize the defendant. An unfavorable verdict or large monetary penalties assigned in complex cases can positively affect the judge's reputation, but significantly decrease the firm's value. In such cases, politicians will be unable to assist the firm with its defense. Therefore, I hypothesize that political connections are less effective in the case of complex litigation:

H4a: Political connections are less effective in complex litigation.

3.3.2 Plaintiff identity and political connections

In the case of corporate litigation, plaintiff identity is an important determinant of the lawsuit's ultimate outcome, firms' monetary penalties, and reputational damages. Government lawsuits are by far the most damaging to the firm's value and reputation.

Correia (2014) argues that government entities efficiently use their resources. They are only going to prosecute firms if they have sufficient evidence and expect a positive outcome. Therefore, there is a strong relationship between the filing of government lawsuits and verdicts in favor of the plaintiff. Results presented in Haslem (2005) support this argument.

The effect of government lawsuits stretches beyond negative cumulative abnormal returns and monetary penalties. Bhagat, Bizhak, and Coles (1998) argue that the settlement behavior of the government is different from that of other plaintiffs. For example, a government might be unwilling to settle to avoid creating a legal precedent. Government lawsuits are often accompanied by wide media coverage, which in turn increases the reputational loss suffered by the defendant firm. Additionally, government employees access to more resources than other plaintiffs.

Plaintiff identity can limit the extent to which a connected politician is willing to assist with the lawsuit. Before assisting a connected firm, a politician considers the possible negative effects to his reputation from the corporate involvement. Politicians are less likely to assist with a lawsuit when a firm is accused of wrongdoing by a government agency. Therefore, I hypothesize the following:

H4b: Political connections are less effective when the plaintiff is the government or a government agency.

3.3.3 Proximity of political connections to the court

The geographical distance between political connections and district courts is another factor impacting the politician's ability to help connected firm and assist with the lawsuit.

Geographical distance measures the ability of politicians connected to the defendant firm to reach out to the judges of federal district courts. If a firm is facing litigation in the federal district court of New York, political connections within the state of New York are more likely to benefit it.

A firm's motivation to establish political connections within a certain state clearly depends on how much revenue is generated by the firm in that state. They have significant incentives to connect to politicians in their headquarters state. Most firms establish close ties with local politicians and donate to their federal or state campaigns. Consequently, when a firm is sued in the state of its headquarters, it has more connections to use to affect the litigation than when it's sued elsewhere. Therefore, I hypothesize the following:

H4c: Political connections have a greater effect on a lawsuit when litigation occurs in the state of the firm's headquarters.

4. Data and sample

4.1 Data

My litigation sample consists of civil lawsuits filed and terminated in federal district courts. I use the Integrated Database maintained by the Federal Judicial Center⁸. The database provides information about each civil lawsuit, such as filing and termination dates, nature of the lawsuit, the identities of plaintiffs and defendants, as well as the verdict and penalties appointed by the court.

The Integrated Database goes back to lawsuits terminated in 1970, but data on political contributions and lobbying expenses begin in 1990. Therefore, I start with civil

⁸ <https://www.icpsr.umich.edu/icpsrweb/ICPSR/series/72>

lawsuits terminated between 1990 and 2014. After I filter the database for publicly traded defendants and identify them in Compustat, the sample decreases to 248,666 lawsuits. I use I/B/E/S to obtain analyst coverage, ISS (former Risk Metrics) for corporate governance controls⁹, and the 13F database for institutional ownership of the defendant firms. Corporate governance and institutional ownership information are available starting 1998, which reduces the number of observations in my sample. My final sample consists of 116,662 individual lawsuits terminated in federal district courts between 1998 and 2014.

I obtain the information on defendant firms' lobbying expenses and political contributions to federal election campaigns from the Federal Election Committee database. While data on lobbying expenses is available quarterly, each contribution to a federal election is recorded and dated as a separate transaction. It allows me to more precisely identify contributions made before and during a lawsuit than if contributions data was provided annually.

Information on political contributions to state elections comes from the FollowTheMoney website¹⁰. This website provides information on the political contributions made to support candidates across the entire range of state political offices. All political contributions are recorded and reported separately for each calendar year.

4.2 Control Variables

I use multiple firm characteristics as control variables in the regression analysis. Consistent with the deep pockets hypotheses (Harper and Adams, 1996; Amoah and Makkawi, 2013) firm size and leverage are good estimates of firm's financial resources

⁹ I use the data from Coles, Daniel, and Naveen (2014) to link ISS to Compustat

¹⁰ <https://www.followthemoney.org/>

and consequently what monetary penalties firms can bear. Harper and Adams (1996) assume that larger firms with less debt have more resources to cover litigation damages and therefore should experience more negative announcement day market response and larger monetary penalties. Similarly, the profitability of a defendant firm implies the firm's financial resources. At the same time, however, a firm's profitability can become a reason for shareholder initiated lawsuits. I use the log of the market value of equity and the book-to-market ratio as proxies for firm size. The debt-to-equity ratio represents the degree of leverage used by the defendant firm, and the return on assets is a proxy for the firm's profitability.

A firm's corporate governance and institutional ownership represent mechanisms which are expected to align the incentives of managers and shareholders. Consequently, they can be expected to decrease the number of lawsuits against the firm. To control for the efficiency of the relationship between the board and shareholders, I use the number of directors, the percent of independent directors and an indicator variable which equals one when a CEO is also a board chairman. I use the percent of the firm's stock owned by institutional investors as a proxy for external corporate governance.

Analyst coverage is an important control in litigation. A large number of analysts following the firm results in an increased scrutiny of firm's policies and operations. Such scrutiny can reduce firm's ability to engage in a wrongdoing or lead to a faster discovery of a violation and subsequent lawsuit filing. At the same time, if a firm is already engaged in a lawsuit, greater analyst coverage can increase media and investor attention concerning the litigation and exacerbate reputational damages associated with the lawsuit.

The lawsuit specific controls used in my regressions include indicator variables for

the most frequent types of lawsuits in the sample (i.e., personal injury and product liability) as well as civil rights violations. I also use the number of days until lawsuit resolution to control for the complexity of the lawsuit and the severity of the violation against the defendant firm.

4.3 Firms Characteristics

Table 1 presents the financial and accounting characteristics of the firms in my sample. An average defendant firm is a large, profitable firm with substantial analyst coverage and high institutional ownership. The average market capitalization in the sample equals \$1.8 billion, an average book-to-market ratio to 0.54, and a mean return on assets and equity equal to 15.0% and 13.4%, respectively. On average, firms in the sample have a capital structure with 57.8% debt. The average firm in the sample is followed by 13 analysts and has 10 directors, with 71.5% of them being independent. At the same time, in 74.6% of the sample firms, the CEO is also appointed as a board chairman. Individual firms in the sample can be sued multiple times in federal district courts. Among the 1,490 individual firms in my sample, only 297 are sued once. The mean (median) number of lawsuits per each firm is 15 (2).

4.4 Lawsuits Distribution

Panel A of Table 2 presents a time-series distribution of lawsuits in the sample by plaintiff type. Because of the availability of political contributions and controls data, the lawsuit filings start in 1998. A large number or 46.8% of filed lawsuits occurs between 2004 and 2006, which is mainly explained by weak corporate governance and institutional ownership controls in the 1990s and early 2000s.

The sample combines civil lawsuits filed against the defendant firms by individuals, other firms, government entities and groups of individuals (class action members). The majority (96.7%) of the lawsuits between 1998 and 2014 are filed by individuals or other firms. I document that class action lawsuits, or lawsuits filed on behalf of a whole class of individual members, represent 1.9% of all lawsuits. The proportion of class actions increases towards the end of the sample period and reaches 5.6% of the total sample in 2014. Lawsuits filed by various government entities represent 1.3% of the sample. The percent of government lawsuits peaks at 6.3% of all civil lawsuits filed in federal district courts in 1999.

Panel B of Table 2 presents a distribution of the defendant firm's industry. I use a 2-digit SIC code to identify the industry of the defendant firm. More than half, or 57.9%, of lawsuits in the sample are filed against firms engaged in manufacturing, followed by retail (17.7%) and then the financial sector (11.5%) industries. Distribution of class actions and government lawsuits by industry is different. The largest percentage of class actions, 5.1%, occurs for firms engaged in services, followed by 3.1% in transportation and 3.0% in wholesale. The largest percent of government lawsuits happens among agricultural firms (20.0%), followed by wholesale (2.5%) and public administration (2.2%).

The sample distribution by lawsuit type and plaintiff is presented in Panel C of Table 2. Following Haslem, Hutton, and Smith (2017), I divide all lawsuits in the sample into 10 groups. Personal injury and product liability lawsuits represent 40.4% of the sample. Civil rights violations represent another 15.3%. Environmental and securities lawsuits are the least frequent types of complaints (0.2% and 0.7% respectively). The distribution of lawsuit types by class action and government lawsuits, however, is the

opposite. Class action and government complaints represent a large share of infrequent lawsuits types. Thus, class actions represent 38.6% of all securities lawsuits, primarily filed by firm shareholders. Similarly, lawsuits filed by government entities represent 43.4% of all environmental lawsuits.

4.5 Distribution of Political Contributions

Summary statistics of political contributions used as the main independent variables in this chapter are presented in Panel A of Table 3. Lobbying expenses represent how much defendant firms spend on influencing various legislative initiatives over 1, 2 and 3 years prior to lawsuit filing. Federal contributions are corporate donations to federal elections over 1, 2 and 3 years prior to a lawsuit filing. Similarly, state contributions represent the financial support of local candidates in various elections in the state of litigation during 1, 2 and 3 years prior to lawsuit filing.

I document that more firms are engaged in lobbying than in donating to federal and state elections. On average, 41.5% of sample firms support certain legislation, compared to 32.9% (13.7%) of firms making federal (state) contributions. A small number of firms donating to local state elections can be explained by a requirement that the contribution has to be made in the state of litigation to provide contributing firms with a valuable connection. The magnitude of political contributions also varies by type. Lobbying expenses in the year preceding the lawsuit filing are much larger than federal and state donations. Average lobbying expenses equal \$5.1 million compared to an average annual federal contribution of \$329,986 and an average state contribution of \$17,507.

Contribution patterns by industry are presented in Panel B of Table 3. Similarly to Table 2, I use a 2-digit SIC code to define the industry for a defendant firm. I find that the

largest percentage of firms engaged in lobbying and making other political contributions is in transportation. Over 61.5% of the firms in this industry spend on lobbying initiatives, 56.0% of firms contribute to federal elections, and 24.8% of firms donate to local campaigns in the state of litigation.

The average size of political contributions also varies by industry, with chi-square p-values close to zero. On average, public administration firms incur the largest lobbying expenses (mean of \$34.7 million) and make the largest donations to federal campaigns (mean of \$1.1 million). This result appears quite plausible as these firms rely on close business relationships with the government. However, transportation firms make the largest donations to state elections with a mean contribution of \$49,752.

5. Main results

5.1 Litigation Environment

In this section, I examine how firms use political connections as a litigation defense mechanism.

5.1.1 Anticipation of litigation

Consistent with hypothesis H1, I examine whether firms anticipating future litigation use political connections to mitigate the risk of damages associated with these lawsuits. The anticipation of short-term and reputational losses from litigation creates an incentive for firms to seek the help of connected politicians. Thus, I argue that firms, which are aware of existing litigation risks, are going to connect with politicians and assist in financing their legislative initiatives or election campaigns. To establish a positive relation between a firm's litigation risk and their political contributions, I perform a two-stage

analysis. First, I follow Kim and Skinner (2012) to construct an out-of-sample model of litigation risk¹¹. For all firms in Compustat and CRSP between 1998 and 2014¹², I estimate the following first stage model:

$$\begin{aligned} Sued = & \beta_0 + \beta_1 * FPS + \beta_2 * Ln Assets + \beta_3 * Sales Growth + \beta_4 * Return + \beta_5 * \\ & Return Skewness + \beta_6 * Return StDev + \beta_7 * Turnover + \varepsilon, \end{aligned} \quad (1)$$

where FPS=1 if a firm operates in one of the highly litigious industries as defined by Francis, Philbrick, and Schipper (1994).

Then I use the predicted dependent variable from the first stage, or fitted litigation risk, as one of the explanatory variables in the second stage, where I regress lobbying expenses and contributions to federal elections against a set of controls:

$$\begin{aligned} Contribution = & \beta_0 + \beta_1 * Litigation Risk + \beta_2 * Leverage + \beta_3 * ROA + \beta_4 * BM + \\ & \beta_5 * Analysts + YearFE + \varepsilon \end{aligned} \quad (2)$$

The results of the first stage regression are presented in column 1 of Panel A of Table 4. My sample consists of 118,608 firm-year observations, and the model has an explanatory power of 38.9%. Consistent with the historical distribution of lawsuits by industry, I find that firms in biotech, electronics, and retail industries are more likely to get sued. I also document that larger firms with slower growth have higher litigation risk, which is consistent with the deep pocket hypothesis. This hypothesis argues that larger and mature firms are less vulnerable to litigation damages and can “afford” to be sued more often than smaller, less profitable firms. I find that only the standard deviation of stock returns is the

¹¹ The model was originally designed to calculate the risk of securities class action lawsuits. However, I find the explanatory variables to be relevant for any type of civil litigation.

¹² My litigation sample includes civil lawsuits filed between 1998 and 2014.

only share price characteristic that is statistically and economically significant. A one standard deviation increase in stock volatility raises litigation risk by 1.6%. The coefficient of stock turnover is negatively related to litigation risk. Thus, frequently traded firms are less likely to get sued.

Columns 2 through 5 summarize the regression results from the second stage¹³. Consistent with hypothesis H1, I find that litigation risk is positively related to a firm's propensity to make political contributions and their size. A one standard deviation increase in litigation risk increases a firm's propensity to lobby and to make contributions to federal elections by 8.6% and 13.5%, respectively. Similarly, greater litigation risk leads to firms spending \$439,247 and \$63,674 more on lobbying and federal elections. Additionally, I find that analyst coverage is positively related to the propensity to make contributions and their size. Thus, I conclude that firms anticipating damages associated with litigation seek the assistance of connected politicians and contribute larger amounts to various political campaigns.

As a robustness test, I examine whether firms previously engaged in civil litigation seek the help of connected politicians. I hypothesize that sued firms understand the monetary and reputational losses associated with litigation and are interested in mitigating future damages. Thus, such firms are more likely to seek the help of connected politicians and contribute to their campaigns. Consistent with this argument, I expect to find a positive relation between a firm's previous litigation experience and political contributions. I rerun the second stage regression from Panel A and substitute litigation risk for variables describing a firm's experience with litigation. I include a dummy variable, which equals

¹³ Sample consists of 86,811 firm-year observations with non-missing fitted litigation risk and controls.

one if a firm has been sued before, and the number of lawsuits previously filed against the firm.

The regression results of this test are presented in Panel B of Table 4. As expected, previous litigation experience encourages firms to seek political help to mitigation damages associated with future lawsuits¹⁴. I document that firms are more likely to lobby (14.1%) and contribute to federal election campaigns (14.9%) if they have been sued in federal district court before. Similarly, average lobbying expenses and election contributions increase by \$766,804 and \$54,507 for previously sued firms. Consistent with the anticipation hypothesis, I also find that the number of past lawsuits is positively related to a firm's political contributions. The additional lawsuit filed against the firm in the past increases the propensity to donate by about 6.0%. Average lobbying and contribution size increases by \$458,414 and \$36,424 for each previously filed lawsuit. Further, I find that larger, less profitable firms with more analyst coverage exhibit a greater propensity to both donate and to make larger contributions. Overall, the evidence presented in Table 4 strongly indicates that firms, which are concerned with damages associated with litigation, seek politicians who can help them with future lawsuits. Firms with high litigation risk as well as previously sued firms are more likely to contribute to political campaigns and make larger donations in exchange for political help with litigation.

5.1.2 Political contributions made during litigation

Despite lawsuit anticipation and preventive measures taken by firms, lawsuit filing creates an incentive for defendant firms to seek the help of connected politicians. In section

¹⁴ Results are also robust to the inclusion of corporate governance controls to the model.

3.2.1 I describe cash and non-cash litigation costs in detail. To summarize, litigation is associated with large legal expenses, firm value loss and long-term reputational damages, regardless of lawsuit outcome (Alexander, 2000; Karpoff, Lee, and Martin, 2008). Therefore, defendant firms are interested in decreasing litigation costs and consider approaching politicians for assistance. Since relationships between firms and politicians are time-sensitive, firms are likely to contribute to political campaigns after the lawsuit is filed to better influence its process and outcome. Thus, I argue that sued firms are more likely to contribute during the litigation than non-sued firms. Additionally, I expect that the size of contributions made during litigation is larger than historical contributions made prior to the lawsuit.

Panel A of Table 5 presents a statistical summary of lobbying expenses and contributions to federal election campaigns made by sample firms during the lawsuit hearing. On average, firms in the sample spend \$5.5 million on lobbying and \$322,132 on contributions to various federal elections.

Panel B of Table 5 summarizes time-adjusted political contributions. To test whether sued firms contribute more during litigation than firms not simultaneously involved in litigation, I construct a matched sample using propensity score matching. The matching procedure and the comparison of sued firms and their matches are presented in the Appendix. Lobbying expenses and contributions to federal elections for sued and matched firms have to be adjusted for the length of litigation. Thus, I divide the cumulative contributions donated during the litigation by the number of calendar days between lawsuit filing and verdict. As expected, I find that sued firms contribute more during litigation than their matched peers. On average, sued firms spend \$21,829 a day on lobbying expenses,

compared to \$5,991 spent by firms not involved in litigation. Similarly, sued firms contribute almost 82.7% more per calendar day than their matched peers (\$824 vs. \$451 per day).

To test whether lawsuit filing encourages sued firms to contribute more than before the filing, I compare daily political contributions made during the litigation to daily historical contributions in Panel B of Table 5. I find that sued firms spent 103.4% more on lobbying during litigation than before the lawsuit is filed (i.e., average daily expenses of \$21,829 vs. \$10,730). However, average daily contributions to federal election campaigns made during litigation are \$49 or 5.6% smaller than adjusted historical donations (\$824 vs. \$873 per day).

To test hypotheses H2a and H2b in a multivariate setting, I perform the following difference-in-difference estimation:

$$\begin{aligned} \text{Contribution} = & \beta_0 + \beta_1 * \text{Sued} + \beta_2 * \text{During} + \beta_3 * \text{Sued} * \text{During} + \beta_i * \\ & \text{Controls} + \varepsilon, \end{aligned} \tag{3}$$

where *Sued* equals one if a firm is sued between 1998 and 2014 and 0 for matched firms, *During* equals one if the contribution is made during litigation and 0 if it is made prior to lawsuit filing, *Sued*During* represents the interaction of the *Sued* and *During* dummy variables. A set of controls includes the independent variables used in Panel C of Table 4. My main variable of interest is the interaction term, which should be positive if lawsuit filing affects the size of contributions made during litigation.

The regression results are summarized in Panel C of Table 5¹⁵. Column 1 presents

¹⁵ Results are also robust to the inclusion of corporate governance controls to the model.

the results for the lobbying expense specification. The *Sued* coefficient is positive and highly significant. I find that in general, sued firms spend \$3,628 more per day on lobbying than firms not engaged in litigation. The coefficient of *During* is positive, but only marginally significant. This dummy variable establishes a time trend in lobbying expenses for both sued and matched firms and shows that, on average, all firms contribute \$2,883 more per day during the litigation. The interaction term is positive and both economically and statistically significant. This confirms H2a and H2b. These results show that sued firms donate \$11,107 more per day during litigation, compared to the daily expenses of their matched peers and their own historical contribution. However, the results of contributions to federal election campaigns, presented in column 2, are insignificant. None of the coefficients of interest have an impact on a firm's federal election contributions made during litigation. Therefore, I conclude that only lobbying expenses capture a firm's efforts to seek political help with litigation and contribute more to their campaigns after the filing of a lawsuit.

Overall results presented in Tables 4 and 5 indicate that firms seek the help of connected politicians with civil litigation. More specifically, firms with high litigation risks and firms with previous litigation experience anticipate future litigation and approach politicians for help. Thus, I document that such firms are more likely to make contributions and actually contribute larger amounts to political campaigns. Additionally, I find that lawsuit filing creates concerns for the management and encourages firms to use their political connections to reduce cash and reputational damages associated with litigation. Empirical results show that sued firms make larger contributions during litigation than they make before lawsuits filing, as well as in comparison to their non-sued peers. These results

also have important implications for the literature on the costs and benefits associated with political connections. If firms actively use their relationships with politicians to mitigate losses associated with litigation, as rational agents, they must expect some benefits in exchange for monetary support of connected politicians.

5.2 Benefits to Connected Firms in Litigation

After documenting that firms seek the help of connected politicians when they get sued, I examine and report what kind of benefits firms actually receive from their political connections in civil litigation. Hypotheses H3a-H3d, presented in section 3.3, argue that firms with well-established political connections should receive politicians' help with litigation. Connected firms are expected to incur smaller cash and non-cash losses from litigation. More specifically, they should experience shorter litigation time, less negative returns to lawsuit announcements, smaller monetary penalties, and favorable verdicts. However, I do not find that politically connected firms receive all benefits in litigation, as hypothesized.

5.2.1 Main benefits

Panel A of Table 6 presents the statistical summary of key benefits actually received by politically connected firms in civil litigation, such as time to verdict, returns to filing and verdict announcements and verdict types. Time to verdict is a proxy for the length of a lawsuit and represents the number of calendar days between the lawsuit filing and its official resolution. On average, it takes almost one year or 336 calendar days to terminate a lawsuit in the sample. Certain lawsuits do not qualify as valid complaints and get dismissed immediately with the time to verdict of 0 days. The longest case in the sample takes 4,459 days or over 12 years to get resolved.

The cumulative abnormal returns (CARs) to lawsuit filing and verdict announcements represent firm value loss from litigation. At lawsuit filing, investors review the available information and then assess the probability of an unfavorable verdict and the total costs associated with litigation. Pritchard and Ferris (2001) and Gande and Lewis (2009) find significant negative returns of -3.47% and -4.66% around the time of filing. Verdict announcements, however, are not associated with a comparable magnitude of loss. Karpoff, Lee, and Martin (2008) and Gande and Lewis (2009) document that returns to filing are more negative than returns to verdict announcements. Consistent with the existing literature, the average returns to filing in the sample are negative and statistically significant. They vary from -0.09% on the day of lawsuit filing to -0.02% for 5 days surrounding the event. The average cumulative abnormal returns to verdict, however, are positive and significant. They range from 0.00% on the actual day of the announcement to 0.27% for the (-2, +2) window. The summary of verdict types shows that 31.3% of lawsuits in the sample are dismissed, 40.3% are settled, and 14.8% of cases are transferred to other courts. Only 13.5% of the cases receive a judgment when a party at fault is actually determined.

The distribution of litigation benefits by the median size of political contributions is presented in Panel B of Table 6. I hypothesize that firms spending more on lobbying and making larger contributions to federal elections receive larger benefits. Regarding the time to verdict, I expect that cases of politically connected firms are resolved quicker. Consistent with hypothesis H3a, I document that the time to verdict for firms making larger donations to federal elections or spending more on lobbying is 59.3% shorter than the time to verdict for firms contributing less. Thus, cases of firms making larger than median political

contributions last 172 days shorter than cases of firms spending less on political donations.

Consistent with hypothesis H3b, firms contributing more than median amounts to federal elections and lobbying initiatives experience less negative cumulative abnormal returns. The average filing CARs of politically active firms are positive and statistically significant. Firms spending less than median amounts on federal elections and lobbying experience have negative cumulative abnormal returns. Similarly, verdict CARs of firms making larger political contributions are more positive than of firms making smaller than median donations.

Lobbying expenses and contributions to federal election campaigns have different effects depending on the type of lawsuit resolution. Larger lobbying expenses are associated with a greater percentage of dismissed cases, more cases transferred to other courts, and a smaller probability of judgment. If a defendant firm spends more than a median amount on lobbying, its case is 4.4% more likely to get dismissed, 10.6% less likely to get settled, and 6.2% less likely to be heard by a judge or a jury than a case of a firm with smaller lobbying expenditures.

Contributions to federal election campaigns, however, are positively related to the probability of a lawsuit being settled or heard in front of a judge or a jury. Overall, this univariate comparison confirms that larger political contributions are associated with greater benefits for connected firms.

To test whether political contributions have a positive effect on litigation benefits in a multivariate setting, I estimate the following regressions:

$$Benefit = \alpha + \beta_1 \ln PoliticalContributions + \beta_i Controls + YearFE + IndustryFE \quad (4)$$

The dependent variable is different across all specifications. In model 1 the dependent variable is time to verdict, in model 2 the dependent variable equals filing cumulative abnormal returns, and in model 3 the dependent variable is verdict CARs. Probabilities of a lawsuit being dismissed, settled or transferred represent the dependent variable in specifications 4 through 6. Control variables in all specifications include a firm's market capitalization, book-to-market ratio, debt-to-equity ratio, return on assets, analyst coverage, number of directors on a board, a dummy variable for a CEO being a chairman of a board, percent of independent directors, percent of common stocks owned by institutional investors, a dummy variable for personal injury and product liability lawsuits, a dummy variable for civil rights lawsuits, and time to verdict.

My regression results are presented in Panel C of Table 6. Consistent with hypothesis H3a, I find that politically connected defendant firms receive help from connected politicians and experience a shorter time for lawsuit resolution. A one standard deviation increase in federal contributions made prior to the lawsuit filing decreases the time to verdict by 88 days or 26.3% of the average resolution time. Additionally, I document that lawsuits of larger and more profitable firms last longer. Thus, a one standard deviation increase in the firm's market capitalization increases the times to verdict by 8.6 days. The same increase in the firm's return on assets increases the length of the lawsuit by 38 days. Corporate governance measures and a firm's institutional ownership increase the transparency of information about the lawsuit available to the public and reduce the time it takes to achieve a lawsuit resolution. Similarly, each additional analyst following the defendant firm reduces the length of the case by 6.9 days.

Consistent with the prediction of hypothesis H3b, I find that political contributions

are associated with more positive cumulative returns to lawsuit filing and verdict. Thus, a one standard deviation increase in contributions to federal elections leads to a 0.39% increase in average returns on the filing day. As expected, the effect of political connections is weaker in the verdict announcement regression. A standard deviation increase in lobbying expenses increases cumulative abnormal returns by 0.48%. Thus, I conclude that investors positively value political connections acquired by defendant firms. Market participants expect firms to extract value from these connections when it comes to corporate litigation. They anticipate politicians to help defendant firms with the lawsuit defense. Therefore, filing and verdict announcement returns of politically connected firms are less negative than the returns of their non-connected peers.

The probability of a favorable verdict is also greater for politically connected firms, consistent with hypothesis H3d. I document that the amount firms spend on lobbying are positively related to the probability of case dismissal and transfer, but negatively related to the probability of settlement. With a one standard deviation increase in lobbying expenses, the odds of case dismissal increase by 14.4%. The same increase in lobbying expenses increases the odds of a case being transferred to another court by 9.6%. The odds of a case settlement are 20.3% lower for a one standard deviation increase in lobbying expenses. Thus, I conclude that politically connected firms are more likely to receive a favorable disposition until a case reaches the judge.

5.2.2 Robustness test with state political contributions

Traditionally, the finance literature defines a firm's political connections as its ties to federal politicians (Cooper, Gulen, and Ovtchinnikov, 2010; Duchin and Sosyura, 2012; Hill et al., 2013; Adelino and Dinc, 2014). It ignores firm's relationships with state political

agents. I believe, however, that importance of state connections is overlooked. A firm's relationships with local politicians can provide them with a direct access to judges. Judges of federal district courts are well connected to the members of the U.S. Congress¹⁶, but also have close ties to politicians within the state of their appointment.

Future district judges build their careers for decades in the state of their appointment and establish connections with local politicians, such as governors, members of the state Senate and House, before being appointed to federal district courts. Even though they are protected from political pressure by their tenure, federal judges remain involved members of their communities. They might be asked to endorse or participate in the election campaign of the same party politician within the state. Additionally, state politicians have a direct link to federal judges through their home representatives and senators. Also before federal judges receive tenure, they are typically appointed to their first state position by the state's governor or legislature. Multiple studies document that federal judges develop strong ties to politicians who first appoint them and adjust their decision making to reflect the political affiliation of those politicians (Sunstein, Schklade, and Ellman, 2004; Shepherd, 2009). Therefore, I hypothesize that state connections provide connected firms a direct and effective way to reduce litigation damages and achieve a favorable lawsuit resolution.

I reestimate the tests on benefits received by connected firms in litigation using the firm's contributions to election campaigns in the state of litigation. Panel A of Table 7 presents the distribution of verdict cumulative abnormal returns and lawsuit resolution by

¹⁶ Qualified nominees to the federal judicial positions are often recommended to the President by Senators or members of the House. Approval of the nomination is also determined by members of the Senate Judiciary Committee and the full Senate.

the amount of state contributions. I find that comparable to Table 6, state contributions are positively related to benefits expected by connected firms in litigation. More specifically, cases of defendant firms making state contributions are more likely to get dismissed or settled. They are less likely to reach the verdict stage in front of a judge or a jury.

My regression results are presented in Panel B of Table 7. I find that state contributions have an effect on the verdict announcement returns and lawsuit resolution comparable to that of federal election contributions. I document a positive relation between state contributions and benefits received by the firms in litigation. A one standard deviation increase in contributions to election campaigns in the state of litigation results in more positive abnormal returns to the verdict announcement. A similar increase in state contributions is associated with a 13.1% higher odds of a case being dismissed and a 3.6% reduction in the likelihood of being heard in front of a judge or a jury.

Overall, these results presented in Tables 6 and 7 supports the hypothesis that politically connected firms can decrease their losses from litigation. I document that larger political contributions are associated with a shorter time to verdict, less negative returns to lawsuit announcements, and a greater probability of cases being terminated before they reach the judge.

5.3 Limitations of Political Connections in Litigation

In this section, I examine the effect of political connections on a verdict, a probability of monetary penalties assigned by the court and their magnitude. Additionally, I discuss the benefits provided by a firm's political connections in complex litigation and lawsuits filed by government agencies. Finally, I examine the value created by a firm's relationships with politicians in the home state litigation.

5.3.1 Verdict and monetary penalties

When a civil lawsuit gets dismissed or settled, the evidence of both parties is not presented in court. The case is officially terminated without establishing the guilt of the defendant firm. Such lawsuit resolutions are beneficial to defendant firms because they decrease the length of the trial and reduce the cash and reputational costs associated with a lawsuit. If the case is not terminated at this stage and moves to "judgment", it means that either the judge or the jury must decide the verdict and assign monetary or other penalties to the defendant.

Panel A of Table 8 presents the distribution of judgment verdicts and litigation penalties. About 14% of my sample lawsuits reach the judgment stage, and almost half of them are terminated in favor of the defendant. Only 12.8% cases are decided in favor of the plaintiff. In 39.6% cases, neither or both parties are found guilty. In 23.8% cases, there is a decision on monetary or another form of penalty for the defendant firm when it is found to be guilty. In most cases, however, no monetary penalties are assigned. Only 3.7% of judgments include some form of a penalty for the guilty party. Panel A also presents the statistics on the monetary compensation requested by the plaintiffs and assigned by the court. The monetary penalty is requested in over 16,000 cases. Only in 8.9% of these cases, a monetary compensation is awarded. On average, plaintiffs receive 1.8 times larger amounts than they demand in the lawsuits - \$1.5 million vs. \$1.4 million.

Panel B of Table 8 presents the distribution of the key judgment verdicts and monetary penalties by the median size of lobbying expenses and political contributions. For both measures of political connections, the univariate analysis shows that larger contributions are associated with a lower probability of the verdict in favor of both plaintiff

and defendant. This univariate statistic suggests that connections with politicians are unable to affect the decision making of federal judges. At the same time, I document that the probability of a monetary penalty and its magnitude are positively related to the size of lobbying expenses and contributions to federal elections made by the defendant firms.

To test whether political contributions have a positive effect on the verdict and monetary penalties in a multivariate setting, I estimate the following regression:

$$Benefit = \alpha + \beta_1 \ln PoliticalContributions + \beta_i Controls + YearFE + IndustryFE \quad (5)$$

The dependent variable is different across the models. In the first specification, the dependent variable equals a verdict in favor of the plaintiff. In the second model, the verdict in favor of the defendant represents the dependent variable. The probability of monetary penalties and their magnitude represent the dependent variables in specifications 3 and 4.

The results of this regression analysis are presented in Panel C of Table 8. I find that the defendant firm's contributions to campaigns of connected politicians have no effect on the probability of the verdict or monetary penalties. Despite large networks and the resources of politicians connected to defendant firms, they cannot help with the defense of a lawsuit once it enters into judgment stage and evidence is presented in front of a judge or a jury. I do not find any evidence that politicians can affect the decision making of federal judges. Hence, I conclude that judges at federal district courts act independently.

5.3.2 Lawsuit complexity

Complex lawsuits, such as class actions, are usually associated with larger damages to the defendant firms. Longer trials increase legal expenses incurred by defendant firms. Greater exposure to the media exacerbates the reputational losses associated with such

lawsuits. Thus, the procedural complexity of these lawsuits and larger losses associated with them create a greater incentive for firms to seek political assistance. Hypothesis H4a, however, argues that political connections are less effective in complex litigation. Complex lawsuits involve numerous plaintiffs, who are combined into a separate class. Thus, a large number of plaintiffs dilutes the power of political connections. Additionally, class action litigation is often closely followed by the media and the public, resulting in a greater scrutiny of the process with increased disclosure of the relationship between politician and the firm. Thus, the advantage of political connections when most needed, might not be available in class action lawsuits.

Panel A of Table 9 presents the univariate comparison of key litigation variables by lawsuit complexity. I compare class action lawsuits, which consist of securities and other class actions, to other lawsuits in the sample. I document that due to procedural complexity, class actions take 255 days longer to resolve than other lawsuits. Class actions plaintiffs are also more likely to take the case to trial. Thus, class actions are 5.8% less likely to get dismissed, 18.6% less likely to get settled out of court, and 17.4% more likely to receive a judgment. Additionally, the size of monetary compensation to the members of the plaintiff class is larger than the penalties in other lawsuits - \$72,157 vs. \$16,933. Comparison between the two main types of class actions shows that securities lawsuits filed by a firm's shareholders create larger damages for the defendant firms than other types of class actions. Securities class actions take 367 days longer to get resolved than other class action lawsuits. A firm sued by its shareholders experiences more negative cumulative returns to filing and is awarded greater monetary penalties than a defendant in other types of class actions.

To test the effect of political connections on securities class actions, I run the following regression:

$$\begin{aligned} \text{Benefit} = & \alpha + \beta_1 \text{LnPoliticalContributions} + \beta_2 \text{LnPoliticalContributions} * \text{ClassAction} + \\ & \beta_3 \text{ClassAction} + \beta_i \text{Controls} + \text{YearFE} + \text{IndustryFE}, \end{aligned} \quad (6)$$

where *ClassAction* equals one when a lawsuit is a class action, *LnPoliticalContributions*ClassAction* is the interaction of political contributions with the *ClassAction* indicator variable.

Regression results are presented in Panel B of Table 9¹⁷. Consistent with the existing literature (Koku, 2006; Gande and Lewis, 2009), I find that class action lawsuits put more pressure on defendant firms. Complex lawsuits have a longer time to verdict by 383 days and greater odds of an unfavorable lawsuit resolution for the defendant firms. Thus, settlement odds are 20.3% lower and direct judgment odds are 20.8% higher than for other types of lawsuits. The main variable of interest in this regression is the interaction of the political contributions made to federal election campaigns with the class action indicator variable. I find that political connections are less effective in securities class actions than in other types of lawsuits. I document that out of 9 model specifications, the interaction variable is economically and statistically significant only in the time to verdict and probability of judgment models. In class actions, a one standard deviation increase in the firm's contributions to federal election campaigns reduces time to verdict by 166 days. A similar increase in political contributions decreases the odds of a direct judgment in front of a judge or a jury by 13.2%. Therefore, I conclude that politicians are less likely to help

¹⁷ For brevity, Table 9 presents the results for federal campaign contributions only. Results for the firm's lobbying expenses are the same.

connected firms with the defense of a class action lawsuits.

5.3.2 Government as a plaintiff

The existing literature documents that the process and resolution of lawsuits filed by government entities are different from those of lawsuits filed by other types of plaintiffs. Government bodies have unlimited resources and mainly file lawsuits against defendant firms when they have sufficient evidence to win the case (Correia, 2014). Thus, lawsuits filed by the government are more likely to resolve in favor of the plaintiff and generate large damages for the guilty firms (Haslem, 2005). At first glance, it seems that political contributions to members of the Congress should provide defendant firms with more help during litigation with the government. Congressional members develop a network of connections when in office and interact with numerous government officials. Media exposure, the large resources of the plaintiff, and the government's desire to create a precedent make it more costly for the politician to help the firm.

Panel A of Table 10 presents the distributions of litigation variables by plaintiff type. Consistent with the existing literature, I find that government lawsuits are resolved 55 days quicker. These lawsuits are 7.0% less likely to get dismissed, 25.6% less likely to get settled, and 46.2% more likely to receive a judgment. Additionally, judges assign larger monetary penalties in lawsuits filed by government entities (\$313,869 vs. \$14,034). Empirical evidence suggests that government lawsuits are filed when the plaintiff has collected strong evidence of a defendant's guilt. This affects lawsuit resolution and monetary compensation in the government's favor.

To determine the effect of political connections on government lawsuits, I estimate the following regression:

$$Benefit = \alpha + \beta_1 LnPoliticalContributions + \beta_2 LnPoliticalContributions * Government + \beta_3 Government + \beta_i Controls + YearFE + IndustryFE, \quad (7)$$

where *Government* equals one when a government entity is a plaintiff.

Panel B of Table 10 presents the regression results¹⁸. Consistent with previous studies (Bhagat, Bizjak, and Coles, 1998; Haslem, 2005), government as a plaintiff strongly affects the time to verdict, lawsuit resolution, and monetary compensation. Lawsuits filed by government entities are 152 days shorter than lawsuits filed by other plaintiffs. Government lawsuits have 4.4% lower odds of being dismissed, 19.1% lower odds of being settled, and 50.0% higher odds of being heard in front of a judge or a jury. Such pattern of the lawsuit resolution indicates that government entities want defendant firms to be found guilty and are interested in setting precedents. Similarly, government lawsuits have a 37.3% greater odds of receiving monetary compensation. The size of the penalty is, on average, \$224,100 larger than compensation determined in other lawsuits.

The interaction of political contributions made to federal election campaigns with the government indicator variable shows how effective political connections are in government litigation. The results in Panel C indicate that consistent with hypothesis H4b, political connections are not effective when the government is a plaintiff. None of 9 model specifications presented in the table are economically or statistically significant. I interpret these results as follows. I believe that politicians' reputational concerns and the reelection risk affect their willingness to help connected firms with a defense of government lawsuits.

5.3.3 Litigation in the state of headquarters

¹⁸ For brevity, Table 10 presents the results for federal campaign contributions only. Results for the firm's lobbying expenses are the same.

The geographical distance between the connections of defendant firms and court location plays an important role in how effective political connections are in civil litigation. Political connections are most effective when the firm is sued in the state where it is headquartered. I will refer to this as the firm's "home state". Over time, firms develop strong social connections within their headquarters state and are likely to contribute to political campaigns of state politicians. Thus, defendant firms have more politicians to approach for help when they are sued in the state of headquarters than elsewhere.

Panel A of Table 11 presents the comparison of litigation variables for headquarters lawsuits and those filed elsewhere. If a federal district court is located in the home state of the defendant firm, I define the case as a headquarters (HQ) lawsuit. I document that HQ lawsuits on average last 562 days longer. Cumulative abnormal returns to filing and verdict announcements of HQ lawsuits are less negative. When it comes to lawsuit resolution, HQ lawsuits are 14.2% more likely to get dismissed and 16.2% less likely to get settled.

To test the effect of political connections in HQ litigation, I estimate the following regressions:

$$\begin{aligned} \textit{Benefit} = & \alpha + \beta_1 \textit{LnPoliticalContributions} + \beta_2 \textit{LnPoliticalContributions} * \\ & \textit{Ln_Years} + \beta_3 \textit{Ln_Years} + \beta_i \textit{Controls} + \textit{YearFE} + \textit{IndustryFE}, \end{aligned} \quad (8)$$

where *Ln_Year* equals a natural log of the number of years a firm has been located in the state¹⁹. The longer a firm has been in a certain state, the larger social and political network it has developed over the years. I set the interaction of political contributions with the number of years in the same state as a proxy for the quality of a firm's connections to

¹⁹ I use Compustat State variable to identify the state of HQ of defendant firms in the sample.

home state politicians.

Regression results are presented in Panel B of Table 11. I restrict the sample to include only HQ lawsuits, causing the subsample to decrease to 9,670 observations. I find that the number of years a firm has worked in the state is related to an unfavorable verdict for defendant firms and larger monetary penalties. A one standard deviation increase in the number of years spent in HQ state decreases the odds of a lawsuit being dismissed by 4.0%. The odds of both settlement and judgment increase by 2.6% with a one standard deviation increase in a firm's political contributions. Monetary penalties determined by the court increase by \$16,000 thousand with a one standard deviation increase in the state tenure.

Lobbying expenditures and contributions to federal election campaigns are not as effective in the state of HQ as predicted by hypothesis H4c. The coefficients for federal contributions are economically and statistically significant but do not have the desired sign. An increase in federal contributions is negatively related to the probability of a case dismissal and positively related to the probability of settlement and judgment. Lobbying expenditures results are more consistent with my expectation. Thus, a one standard deviation increase in the lobbying expenditures of defendant firms increases the odds of dismissal by 31.9% and decreases the odds of settlement by 21.1%.

The interaction of political contributions with the number of years a firm operates in the state, however, produces the best results. I document that a one standard deviation increase in the interaction term decreases the probability of settlement by 7.5%. A similar change decreases the monetary penalty assigned by the court by \$41,107. Overall, these results suggest that political connections alone do not help defendant firms with litigation in their home state. Only the interaction of political contributions with the firm's tenure in

the state of litigation affects the lawsuit outcome. If the number of years in the HQ state is considered to represent the consistency of political contributions over the years, then only well-maintained relationships with state politicians help firms with lawsuit defense.

6. Robustness tests

6.1 Self-Selection

The decision to establish political connections with politicians and donate to their campaigns is clearly endogenous. I address this self-selection bias by implementing a Heckman treatment effect. I use *Senator_Office* indicator variable and a set of previously mentioned controls to instrument the choice to make campaign contributions and to spend on lobbying in the first stage of a probit regression. *Senator_Office* variable equals one if a senator's local office is located in the same city as the defendant firm. The instrumental variable is highly correlated with the choice to establish political connections but does not affect litigation related dependent variables. If a firm is located close to the office of a senator, it is more likely to establish and maintain the relationship with the politician. However, such convenient location does not directly induce or affect corporate litigation.

I estimate the following first stage regression for federal contributions and lobbying expenditures separately:

$$P(\text{Contribution} = 1) = \alpha + \beta_1 \text{Senator Office} + \beta_i \text{Controls} + FE \quad (9)$$

Panel A of Table 12 presents the results from the first stage probit regression. Overall, the first stage regression explains a lot of variation in a firm's decision to establish political connections. Thus, the r-square of the first (second) model equals 35.6% (19.4%). As hypothesized, *Senator_Office* coefficients are positive and statistically significant at the

1% level in both specifications. Overall, large firms with a higher leverage and lower book-to-market ratio are more likely to spend on lobbying or to make federal contributions. Interestingly, better corporate governance is negatively related to the probability of making political contributions.

I calculate the inverse mills ratios (IMR) from the first stage and use them in the second stage OLS regression with the same controls. OLS regression results are presented in Panel B of Table 12. The main variables of interest in this model are *Federal_Choice* and *Lobby_Choice* indicator variables from the first stage. I find that the regression results are similar to those presented in section 5. Thus, lawsuits of firms spending on lobbying are 445 days shorter than those of firms not engaged in lobbying. Similarly, firms making contributions experience 0.33% more positive cumulative abnormal returns to filing announcement returns. When it comes to the types of lawsuit resolution, I confirm that political connections provide benefits to defendant firms until the case reaches the judge or the jury. Thus, I document that a firm's decision to lobby decreases the odds of a case being settled by 41.4%. Similarly, a firm's lobbying activity decreases the odds of a direct judgment by 23.8%. Additionally, cases of lobbying defendant firms have 106.5% higher odds of being transferred. However, when it comes to the probability of assigned monetary penalties and their amounts, political contributions have no effect on the decisions made by judges at federal district courts.

6.2 Selection Bias

The litigation sample used in this study includes only firms which are formally accused of wrongdoing. A potential selection bias exists because often potential plaintiffs never file lawsuits against firms engaged in unlawful practices. At the same time, plaintiffs

file frivolous lawsuits against innocent firms. To address this concern I perform a two-stage Heckman model to test the severity of selection bias and examine its effect on my main results. In the first stage, I estimate the litigation risk for Compustat firms between 1998 and 2014, using the method of Kim and Skinner (2012)²⁰. Table 13 presents the results of a second stage OLS and probit regressions. Consistent with the main results presented in section 5, I confirm that the political connections of a defendant firm reduce the time to verdict and are positively related to the market response to a lawsuit filing announcement. Similarly to the main results, I document that a greater spending on lobbying decreases the odds of lawsuits being settled and increases the odds of cases being transferred to another court. I also confirm that political connections do not create benefits for a defendant firm when a lawsuit is presented to a judge or a jury. Thus, the log of contributions to federal elections is positively related to the probability of a monetary penalty but does not have any significance for explaining the size of monetary penalties assigned by the court.

The magnitude and the sign of the rho coefficient address the severity and the direction of a selection bias. Small values of the rho coefficient in models 4, 7 and 8 indicate the presence of a bias in the regressions of the direct judgment, probability, and size of monetary penalties. However, the results corrected for a possible selection bias are similar to the main results presented in Tables 6, 7 and 8.

6.3 Severity of Offense

The severity of a violation committed by a defendant firm affects the process and

²⁰ The first stage procedure is discussed in detail in section 5.1.1.

outcome of litigation. Due to a lack of details about the lawsuit, I use the lawsuit's nature to control for the severity of the offense committed by a firm. I include indicator variables for the most common lawsuit types in my sample. However, such model specifications do not control for the unobserved effects of a lawsuit type. In untabulated regression results, I cluster standard errors by a lawsuit type and find the results to be unchanged. Additionally, I interact the political contributions variables with the indicator variables for various lawsuit types and do not find them to be statistically or economically significant.

7. Conclusion

This essay examines how firms use their connections to politicians as an element in their litigation defense. Consistent with an implicit contract between politicians and firms, firms approach their political connections to mitigate losses from anticipated or actual litigation. Additionally, sued firms have an increased incentive to use established relationships with politicians as litigation defense by contributing to their campaign during litigation.

Politicians, however, are not always helpful with litigation defense, and the benefits received by connected firms are smaller than expected. I document that political contributions of defendant firms are positively related to filing and verdict announcement returns as well as the probability of a lawsuit being dismissed or settled. When a lawsuit is heard in front of a judge or a jury, however, political connections do not affect the final verdict or the penalties assigned by the court. Additionally, I determine that political connections are less effective as litigation defense in complex litigation or lawsuits filed by government agencies.

These results have important implications for the theory of corporate-political relationships. Existing literature treats the relationship between a firm and politicians as an implicit contract with associated costs and benefits. Thus, firms decide to contribute to politicians' campaigns in exchange for certain benefits expected from politicians. The evidence presented in this essay suggests that firms make contributions to political campaigns and approach politicians for help with litigation, but do not receive all of the benefits expected from such relationship. Therefore, I conclude that the NPV of political projects in litigation is smaller than hypothesized or presented by existing literature. If firms, aware of a small NPV of litigation projects, continue to support campaigns of connected politicians, it could also indicate that firms expect to receive a higher NPV from political projects elsewhere. Thus, connected firms could incur lower transaction costs and receive greater access to insider information and resources, such as larger government contracts with better terms (Brogaard, Denes, and Duchin, 2015; Ferris and Houston, 2016; Gao and Huang, 2016). Additionally, these results contribute to the debate on the independence of tenured judges. Clearly, the evidence presented in the chapter confirms that federal district judges act independently, and their decisions are not affected by defendants' political connections.

Table 1: Sample Descriptive Statistics

This table presents characteristics of firms in the sample. *MarketCap* is firms' market capitalization in millions. *Book-to-market* is the ratio of book equity to market equity. *Debt-to-Assets* is calculated as the ratio of firms' total liabilities to total assets. *Debt-to-Equity* is calculated as the ratio of total liabilities to market equity. *ROA* is calculated as the ratio of net income to total assets. *ROE* is calculated as the ratio of net income to market equity. *Analyst_Coverage* represents the number of analysts covering the firm. *Num_Directors* equals the number of directors on board. *CEO_Chairman* is the indicator variable, which equals 1 if the CEO is also the chairman of the board. *Board_Independence* is calculated as the ratio of the number of independent directors to the total number of directors on board. *Instit_Ownership* is calculated as the ratio of the number of shares owned by institutional investors to the total number of shares outstanding. *Lawsuits_Per_Year* equals the number of times each firm gets sued per calendar year. Financial ratios are calculated one quarter before lawsuit filing. Corporate governance, number of analysts, and institutional ownership controls are calculated in the year preceding the filing. Variables are winsorized at 1%.

	N	25th Pct	Mean	Median	75th Pctl	StDev
MarketCap (mil.)	7,875	535	1,833	1,949	6,509	5
Book-to-Market	7,800	0.27	0.54	0.44	0.71	0.36
Debt-to-Assets	7,887	0.43	0.58	0.58	0.71	0.20
Debt-to-Equity	7,887	0.74	2.65	1.35	2.45	4.02
ROA (%)	7,873	8.9%	15.0%	14.2%	20.3%	8.6%
ROE (%)	7,789	6.7%	13.4%	13.0%	20.2%	16.8%
Analyst Coverage	7,893	7	13	12	18	8
Num Directors	7,893	8	10	10	12	3
CEO Chairman (%)	7,893	0.0%	74.6%	100.0%	100.0%	43.5%
Board Independence (%)	7,893	62.5%	71.5%	75.0%	84.6%	16.0%
Instit Ownership (%)	7,893	61.6%	73.8%	76.1%	87.6%	20.8%
Lawsuits Per Year		1	15	2	6	212

Table 2: Lawsuits Distribution

This table presents distributions of the lawsuits in the sample. Panel A provides a distribution by filing year. Panel B provides the distribution by industry. Panel C provides a lawsuit distribution by lawsuit type. *% of Class Actions* equals the percentage of lawsuits which are classified as class actions. *% of Government Lawsuits* equals the percentage of lawsuits filed by the U.S. government. *% of Other Lawsuits* equals the percentage of lawsuits filed by individuals or firms.

Panel A: Lawsuit Distribution by Filing Year

Year	Total	% Total	% of Class Actions	% of Government Lawsuits	% of Other Lawsuits
1998	5,633	4.8%	0.3%	2.6%	97.1%
1999	3,530	3.0%	0.6%	6.3%	93.1%
2000	3,488	3.0%	1.7%	5.2%	93.1%
2001	4,575	3.9%	2.8%	2.8%	94.5%
2002	5,240	4.5%	3.4%	1.6%	94.9%
2003	6,430	5.5%	3.1%	1.3%	95.6%
2004	18,031	15.5%	1.4%	0.5%	98.1%
2005	14,862	12.7%	1.6%	0.7%	97.7%
2006	21,656	18.6%	0.9%	0.5%	98.6%
2007	9,633	8.3%	2.2%	0.9%	96.9%
2008	5,000	4.3%	2.0%	1.3%	96.6%
2009	4,556	3.9%	2.5%	1.4%	96.1%
2010	928	0.8%	2.5%	1.6%	95.9%
2011	3,940	3.4%	3.9%	2.1%	94.0%
2012	4,070	3.5%	2.9%	1.2%	95.9%
2013	3,399	2.9%	4.3%	1.0%	94.7%
2014	1,691	1.4%	5.6%	0.8%	93.7%
Total	116,662	100.0%	1.9%	1.3%	96.7%

Panel B: Lawsuit Distribution by Industry

Industry	SIC Code	Total	% Total	% of Class Actions	% of Government Lawsuits	% of Other Lawsuits
Agriculture	0-9	5	0.0%	0.0%	20.0%	80.0%
Construction	15-17	293	0.3%	0.3%	1.7%	98.0%
Finance	60-67	13,473	11.5%	2.8%	0.5%	96.7%
Manufacturing	20-39	67,504	57.9%	1.4%	1.5%	97.1%
Mining	10-14	1,877	1.6%	0.5%	0.6%	98.8%
Public Administration	91-99	830	0.7%	1.6%	2.2%	96.3%
Retail Trade	52-59	20,667	17.7%	2.0%	1.1%	96.9%
Services	70-89	4,262	3.7%	5.1%	2.1%	92.8%
Transportation	40-49	7,019	6.0%	3.1%	1.3%	95.5%
Wholesale Trade	50-51	732	0.6%	3.0%	2.5%	94.5%
Total		116,662	100.0%	2,252	1,543	112,867

Panel C: Lawsuit Distribution by Type

Lawsuit Type	Total	% Total	% of Class Actions	% of Government Lawsuits	% of Other Lawsuits
Antitrust	963	0.8%	17.4%	3.1%	79.4%
Civil Rights	17,801	15.3%	0.9%	1.8%	97.3%
Environmental	256	0.2%	1.2%	43.4%	55.5%
Intellectual Property	3,741	3.2%	0.5%	0.1%	99.4%
Labor	3,038	2.6%	8.9%	0.6%	90.5%
Personal Injury Only	13,865	11.9%	0.5%	0.0%	99.5%
Product Liability Only	3,307	2.8%	2.0%	0.1%	97.9%
Injury and Product Liability	47,163	40.4%	0.5%	0.0%	99.5%
Securities	858	0.7%	38.6%	6.6%	54.8%
Other	25,670	22.0%	3.6%	3.9%	92.5%
Total	116,622	100.0%	2,252	1,543	112,827

Table 3: Summary of Political Contributions

This table presents the summary of political contributions. Panel A presents the summary statistics of various political contributions. *Lobbying* refers to firms' lobbying expenses, *Federal* refers to contributions to federal election campaigns. *State* variable shows contributions to local elections made in the states of litigation. *Lag of 1 year* represents contributions made during the year preceding the filing of a lawsuit. *Lag of 2 years* represents contributions made over two years preceding the filing. *Lag of 3 years* represents contributions made over three years preceding the filing. Panel B presents the industry distribution of political contributions made during one year preceding the filing. Amounts of political contributions are in thousands of the U.S. dollars.

Panel A: Political Contributions Statistics

	# of Contributing Firms	% of Total Firms	25th Pct	Mean	Median	75th Pctl	StDev
Lobbying_1	619	41.5%	20	5,103	3,154	7,561	8,219
Lobbying_2	596	40.0%	0	9,854	5,760	16,024	15,319
Lobbying_3	548	36.8%	0	14,218	8,260	23,650	22,357
PAC_1	490	32.9%	2	330	201	340	476
PAC_2	496	33.3%	11	624	373	609	883
PAC_3	499	33.5%	19	875	477	880	1,260
State_1	204	13.7%	0	18	0	4	283
State_2	224	15.0%	0	32	3	23	357
State_3	228	15.3%	0	43	5	24	409

Panel B: Distribution of Political Contributions by Industry

Industry	SIC Code	% Contributing Firms			Mean Contribution		
		Lobbying	Federal	State	Lobbying	Federal	State
Agriculture	0-9	0.0%	0.0%	0.0%	0	0	0
Construction	15-17	47.4%	26.3%	15.8%	188	46	0
Finance	60-67	41.2%	44.6%	24.9%	1,516	206	12
Manufacturing	20-39	45.7%	33.0%	10.2%	6,340	289	18
Mining	10-14	33.3%	31.4%	9.8%	147	50	2
Public Administration	91-99	40.0%	20.0%	20.0%	34,660	1,087	26
Retail Trade	52-59	27.4%	21.0%	15.3%	2,636	494	11
Services	70-89	35.4%	24.0%	9.8%	2,250	126	7
Transportation	40-49	61.0%	56.0%	24.8%	7,513	618	50
Wholesale Trade	50-51	19.2%	13.5%	5.8%	609	33	2
Total		41.5%	32.9%	13.7%	5,103	330	18
Chi-Square p-value					<0.001***	<0.001***	<0.001***

Table 4: Political Connections and Anticipation of Litigation

This table presents the regression of political contributions on litigation risk and past litigation experience. Panel A presents a two-stage analysis of litigation risk. Results of a first stage regression are presented in column 1, second stage results are in columns 2-5. Panel B presents the results from regressing political contributions on past litigation variables. *FPS* equals one if firm operates in a highly litigious industry following Francis et al. (1994). *Ln_Assets* equals a natural log of firm total assets. *Sales_Growth* is calculated as an annual change in total revenue. *Adj_Return* is a 12-mo market adjusted return. *Return_Skewness* is the skewness of a 12-mo return. *Return_Stdev* is the standard deviation of a 12-month return. *Turnover* equals trading volume accumulated over 12 months scaled by shares outstanding. *Litigation_Risk* is the predicted dependent variables from a first-stage regression. Controls include *Debt-to-Equity*, *ROA*, *Book-to-market* and *Analyst_Coverage*. *Sued_Before* equals one if a firm has been sued before in federal district courts between 1998 and 2014. *Prev_Lawsuits* equals the number of lawsuits previously filed against the firm in federal district courts between 1998 and 2014. Variables are calculated at the end of a calendar year preceding the lawsuit filing. Political contributions are in thousands of U.S. dollars. ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels, respectively. T-statistics are reported in parentheses.

<i>Panel A: Political Contributions and Litigation Risk</i>					
	(1)	(2)	(3)	(4)	(5)
	Sued=1	PAC=1	Lobby=1	PAC Amt	Lobby Amt
Intercept	-0.4895*** (-8.01)	-0.0229 (-0.77)	0.0272 (0.90)	-32.8011* (-1.83)	-285.0540** (-2.38)
FPS	0.0683*** (10.35)				
Ln_Assets	0.0909*** (8.24)				
Sales_Growth	-0.0006*** (-6.70)				
Adj_Return	-0.0009 (-1.20)				
Return_Skewness	0.0067 (1.02)				
Return_Stdev	0.6405*** (4.08)				
Turnover	-0.0021*** (-2.82)				
Litigation_Risk		0.5987*** (8.39)	0.3805*** (4.95)	282.3187*** (3.59)	1947.5410*** (2.89)
Controls		Yes	Yes	Yes	Yes
Fixed Effects		Year	Year	Year	Year
Cluster	Firm	Firm	Firm	Firm	Firm
N	118,608	86,811	86,811	86,811	86,811
Adj R-sq	0.389	0.267	0.189	0.089	0.028

Panel B: Political Contributions and Past Litigation

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	PAC=1	PAC=1	Lobby=1	Lobby=1	PAC Amt	PAC Amt	Lobby Amt	Lobby Amt
Intercept	-0.1053 (-1.58)	-0.1101* (-1.74)	-0.0849 (-1.22)	-0.0888 (-1.30)	59.1036 (0.68)	61.3931 (0.79)	1850.1639 (0.88)	1867.2122 (0.94)
Sued_Before	0.1485*** (7.37)		0.1409*** (6.86)		54.5067*** (6.13)		766.8044*** (4.78)	
Prev_Lawsuits		0.0601*** (9.49)		0.0594*** (9.99)		36.4242*** (6.48)		458.4142*** (6.34)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FF	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FF	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm	Firm	Firm	Firm	Firm
N	78,824	78,824	78,824	78,824	78,824	78,824	78,824	78,824
Adj R-sq	0.242	0.253	0.228	0.236	0.084	0.120	0.019	0.026

Table 5: Political Contributions Made During Litigation

This table presents the analysis of political contributions made during litigation. Panel A presents the statistical summary of lobbying expenses and contributions to federal elections. Panel B presents the comparison of time-adjusted political contributions. Panel C presents the difference-in-difference regression of political contributions on indicator variables and their interaction. *Sued* equals one if a firm has been sued before in federal district courts. *During* equals one if a contribution is made during the litigation. *Sued*During* is the interaction of *Sued* and *During* indicator variables. Controls include *Ln_MarketCap*, *Debt-to-Equity*, *ROA*, *Analyst_Coverage* and *Num_Directors*. Political contributions are in thousands of U.S. dollars. ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels, respectively. T-statistics are reported in parentheses.

Panel A: Summary of Political Contributions Made During Litigation

	N	25th Pct	Mean	Median	75th Pctl	StDev
Lobbying	116,030	0	5,534	380	4,160	16,001
Federal	116,030	0	322	11	291	755

Panel B: Comparison of Time Adjusted Political Contributions

	Sued Firms	Non-Sued Firms	t-stat	During Litigation	Prior to Litigation	t-stat
Lobbying	21,829	5,991	40.39***	21,829	10,730	29.10***
Federal	824	451	64.50***	824	873	-7.84***

Panel C: Lawsuit Filing and Contributions Made During Litigation

	(1)	(2)
	Lobby Amt	Federal Amt
Intercept	39.9264 (1.59)	-0.0071 (0.00)
Sued	3.6278*** (2.61)	0.2235 (0.56)
During	2.8826* (1.70)	-0.1978 (-0.49)
Sued*During	11.1072*** (2.64)	0.3522 (0.97)
Controls	Yes	Yes
Year FF	Yes	Yes
Industry FF	Yes	Yes
Cluster	Firm	Firm
N	366,673	366,673
Adj R-sq	0.038	0.129

Table 6: Benefits of Political Connections in Litigation

This table presents the analysis of main benefits received by defendant firms from political connections. Panel A presents the statistical summary of the benefits. Panel B presents comparison of the benefits by the size of political contributions. Panel C presents the results of regressing litigation benefits on political contributions. *Time to Verdict* equals the number of days between lawsuit filing and verdict. *Filing CAR* equals the cumulative abnormal return around the filing event. *Verdict CAR* equals the cumulative abnormal return around the verdict. *Dismissed* equals one if a lawsuit is dismissed. *Settled* equals one if a lawsuit is settled. *Case Transferred* equals one if a case is transferred to another court. *Judgement* equals one if a case moves to a judgement stage and is heard in front of a judge or a jury. Control variables include *Ln_MarketCap*, *Book-to-Market*, *Debt-to-Equity*, *ROA*, *Analyst_Coverage*, *Num_Directors*, *CEO_Chairman*, *Board_Independence*, *Instit_Ownership*, *Injury_Liability*, *Civil_Rights* and *Verdict_Time*. Control variables are winsorized at 1%. ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels, respectively. T-statistics are reported in parentheses.

Panel A: Summary of Litigation Variables

	N	25th Pct	Mean	Median	75th Pctl	StDev	t-stat
<i>Length of Litigation</i>							
Time to Verdict	116,662	43	336	183	435	474	
<i>Lawsuit Announcements</i>							
Filing (-2,2)	115,288	-1.67%	-0.02%	0.07%	1.83%	4.19%	-1.42
Filing (-1,1)	115,284	-1.28%	-0.07%	0.02%	1.15%	3.35%	-7.21***
Filing (0)	115,279	-0.70%	-0.09%	-0.05%	0.58%	2.04%	-14.86***
Verdict (-2,2)	114,114	-1.49%	0.27%	0.19%	1.93%	3.95%	22.82***
Verdict (-1,1)	114,106	-1.22%	0.12%	0.14%	1.24%	3.10%	12.83***
Verdict (0)	114,097	-0.63%	0.00%	-0.01%	0.67%	1.77%	-0.19
<i>Lawsuit Resolution</i>							
Dismissed	36,561		31.3%				
Settled	46,997		40.3%				
Case Transferred	17,319		14.8%				
Judgement	15,785		13.5%				

Panel B: Comparison of Litigation Variables by Political Contributions

	Federal Contributions			Lobbying Expenses		
	Below Median	Above Median	t-stat	Below Median	Above Median	t-stat
Time to Verdict	423	251	-63.13***	423	249	-63.86***
Filing CAR	-0.20%	0.06%	13.41***	-0.18%	0.03%	10.61***
Verdict CAR	0.09%	0.15%	3.34***	0.26%	-0.02%	-14.82***
Dismissed	32.7%	29.8%	-11.08***	28.3%	34.2%	21.65***
Settled	35.1%	45.3%	35.50***	45.8%	34.7%	-39.02***
Dismissed/Settled	67.9%	75.0%	27.06***	74.1%	68.9%	-19.95***
Case Transferred	15.8%	14.3%	-7.00***	7.9%	22.1%	69.65***
Judgement	16.3%	10.7%	-28.42***	18.0%	9.0%	-45.41***

Panel C: Litigation Variables and Political Contributions

	(1)	(2)	(3)	(4)	(5)	(6)
	Time to Verdict	Filing CAR	Verdict CAR	Dismissed	Settled	Case Transferred
Intercept	-204.0999 (-1.40)	0.0136** (2.57)	0.0090 (1.10)	0.5222*** (4.84)	0.2604** (2.26)	0.1753 (1.32)
Ln_Federal	-6.7991** (-2.37)	0.0003*** (2.96)				
Ln_Lobby			0.0003** (2.31)	0.0090** (2.17)	-0.0127** (-2.03)	0.0060*** (3.01)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year and Industry FF	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm	Firm	Firm
N	115,915	114,171	109,368	110,393	110,393	110,393
Adj R-sq	0.302	0.039	0.043	0.120	0.132	0.103

Table 7: Benefits of State Contributions in Litigation

This table presents the analysis of main benefits received by defendant firms from state political connections. Panel A presents the comparison of the benefits by the size of state political contributions. Panel C presents the results of regressing litigation benefits on state political contributions. *Verdict CAR* equals the cumulative abnormal return around the verdict. *Dismissed* equals one if a lawsuit is dismissed. *Settled* equals one if a lawsuit is settled. *Case Transferred* equals one if a case is transferred to another court. *Judgement* equals one if a case moves to a judgement stage and is heard in front of a judge or a jury. Control variables include *Ln_MarketCap*, *Book-to-Market*, *Debt-to-Equity*, *ROA*, *Analyst_Coverage*, *Num_Directors*, *CEO_Chairman*, *Board_Independence*, *Instit_Ownership*, *Injury_Liability*, *Civil_Rights* and *Verdict_Time*. Control variables are winsorized at 1%. ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels, respectively. T-statistics are reported in parentheses.

Panel A: Comparison of Litigation Variables by State Political Contributions

	State Contributions		t-stat
	Below Median	Above Median	
Verdict CAR	0.29%	0.22%	10.83***
Dismissed	27.06%	36.40%	34.39***
Settled	34.51%	46.48%	41.94***
Case Transferred	20.94%	0.08%	-63.32***
Judgement	17.49%	8.85%	-44.58***

Panel B: Litigation Variables and State Political Contributions

	(1)	(2)	(3)	(4)
	Verdict CAR	Dismissed	Settled	Judgement
Intercept	0.0092 (1.10)	0.5576*** (5.05)	0.3116*** (2.92)	0.0202 (0.31)
Ln_State	0.0002* (1.83)	0.0104*** (3.62)	0.0127 (1.49)	-0.0029*** (-3.36)
Controls	Yes	Yes	Yes	Yes
Year FF	Yes	Yes	Yes	Yes
Industry FF	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
N	110,394	111,296	111,296	111,296
Adj R-sq	0.042	0.117	0.125	0.070

Table 8: Limitations of Political Connections in Litigation

This table presents the analysis of main benefits not received by defendant firms from political connections. Panel A presents the statistical summary of the benefits. Panel B presents comparison of the benefits by the size of political contributions. Panel C presents the results of regressing litigation benefits on political contributions. *Plaintiff Wins* equals one if a plaintiff wins the case. *Defendant Wins* equals one if a defendant wins the case. *Monetary Penalty* equals one if a monetary penalty is assigned by court. *Monetary Penalty Amt* equals the size of a monetary penalty in thousands of U.S. dollars. Control variables include *Ln_MarketCap*, *Book-to-Market*, *Debt-to-Equity*, *ROA*, *Analyst_Coverage*, *Num_Directors*, *CEO_Chairman*, *Board_Independence*, *Instit_Ownership*, *Injury_Liability*, *Civil_Rights* and *Verdict_Time*. Control variables are winsorized at 1%. ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels, respectively. T-statistics are reported in parentheses.

Panel A: Summary of Key Dependent Variables

	N	25th Pct	Mean	Median	75th Pctl	StDev
<i>Judgement</i>						
In favor of plaintiff	2,026		12.8%			
In favor of defendant	7,512		47.6%			
Other	6,247		39.6%			
<i>Litigation Penalties</i>						
No Monetary Award	26,463		93.0%			
Monetary Award Only	918		3.2%			
Monetary and Other Award	413		1.5%			
<i>Monetary Penalties</i>						
Amount Demanded	16,061	75.0	1,369.5	100.0	750.0	2,898.4
Amount Received	1,434	6.0	1,470.0	40.0	434.0	3,167.1
Received/Demanded	16,061	0.0	1.8	0.0	0.0	46.8

Panel B: Comparison of Litigation Variables by Political Contributions

	Federal Contributions			Lobbying Expenses		
	Below Median	Above Median	t-stat	Below Median	Above Median	t-stat
In favor of plaintiff	18.3%	7.2%	-19.67***	18.3%	7.4%	-19.24***
In favor of defendant	57.1%	37.9%	-18.16***	74.6%	20.4%	-51.77***
Monetary Penalty	6.3%	2.6%	-15.61***	5.8%	3.1%	-11.18***
Monetary Penalty Amt	93.2	44.8	-5.49***	100.6	33.3	-7.85***

Panel C: Litigation Variables and Political Contributions

	(1)	(2)	(3)	(4)
	Plaintiff Wins	Defendant Wins	Monetary Penalty	Monetary Penalty Amt
Intercept	0.0665*** (3.86)	-0.0578 (-1.29)	0.0352*** (2.58)	50.3581* (1.70)
Ln_Federal	0.0010 (1.21)	0.0008 (1.06)		
Ln_Lobby			-0.0001 (-0.21)	-0.1659 (-0.39)
Controls	Yes	Yes	Yes	Yes
Year FF	Yes	Yes	Yes	Yes
Industry FF	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm
N	110,368	110,368	110,393	110,393
Adj R-sq	0.033	0.069	0.027	0.003

Table 9: Complex Litigation

This table presents the analysis of main benefits from political connections in complex litigation. Panel A presents a comparison of complex litigation and other types of lawsuits. Panel B presents the results of regressing litigation benefits on federal contributions, class action indicator variable and their interaction. *Time to Verdict* equals the number of days between lawsuit filing and verdict. *Filing CAR* equals the cumulative abnormal return around the filing event. *Verdict CAR* equals the cumulative abnormal return around the verdict. *Dismissed* equals one if a lawsuit is dismissed. *Settled* equals one if a lawsuit is settled. *Judgement* equals one if a case moves to a judgement stage and is heard in front of a judge or a jury. *Plaintiff Wins* equals one if a plaintiff wins the case. *Defendant Wins* equals one if a defendant wins the case. *Monetary Penalty* equals one if a monetary penalty is assigned by the court. *Monetary Penalty Amt* equals the size of a monetary penalty in thousands of U.S. dollars. Control variables include *Ln_MarketCap*, *Book-to-Market*, *Debt-to-Equity*, *ROA*, *Analyst_Coverage*, *Num_Directors*, *CEO_Chairman*, *Board_Independence*, *Instit_Ownership*, *Injury_Liability*, *Civil_Rights* and *Verdict_Time*. Control variables are winsorized at 1%. ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels, respectively. T-statistics are reported in parentheses.

Panel A: Comparison of Litigation Variables by Litigation Complexity

	Class Action Lawsuits	Securities CA	Other CA	Other Lawsuits	t-stat
Time to Verdict	586	899	532	331	19.75***
Filing CAR	-0.14%	-0.84%	-0.02%	-0.01%	0.97
Verdict CAR	0.19%	0.28%	0.17%	0.27%	0.83
Dismissed	25.62%	32.33%	24.47%	31.39%	-6.20***
Settled	21.98%	13.60%	23.43%	40.61%	-21.05***
Judgement	30.46%	48.04%	27.43%	13.10%	17.80***
Monetary Penalty	0.62%	0.00%	0.73%	0.78%	0.97
Monetary Penalty Amt	72.2	103.5	66.7	16.9	3.58***

Panel B: Complex Litigation and Political Contributions

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Time to Verdict	Filing CAR	Verdict CAR	Dismissed	Settled	Judgement	Monetary Penalties	Monetary Penalty Amt
Intercept	-223.2640 (-1.57)	0.0136** (2.57)	0.0102 (1.13)	0.5016*** (4.32)	0.2809** (2.32)	0.0561 (0.81)	0.0430*** (3.38)	56.8643* (1.86)
Ln_Federal	-6.1929** (-2.05)	0.0003*** (2.92)	0.0001 (0.57)	-0.0016 (-0.73)	0.0007 (0.22)	0.0017 (1.32)	0.0006 (1.00)	0.5353 (1.18)
Ln_Federal*Class_Action	-12.7444** (-2.06)	-0.0001 (-0.20)	-0.0001 (-0.37)	-0.0007 (-0.17)	0.0046 (1.17)	-0.0109** (-2.07)	-0.0002 (-0.25)	3.3658 (1.52)
Class_Action	382.5341*** (5.66)	0.0002 (0.06)	-0.0005 (-0.14)	-0.0037 (-0.06)	-0.2267*** (-4.19)	0.1891*** (2.65)	0.0040 (0.47)	1.0818 (0.06)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FF	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FF	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm	Firm	Firm	Firm	Firm
N	115,675	114,171	109,317	110,204	110,204	110,204	110,204	110,204
Adj R-sq	0.310	0.039	0.041	0.111	0.116	0.071	0.028	0.003

Table 10: Government as a Plaintiff

This table presents the analysis of main benefits from political connections in lawsuits filed by government entities. Panel A presents a comparison of government lawsuits and lawsuits filed by other plaintiffs. Panel B presents the results of regressing litigation benefits on federal contributions, class action indicator variable and their interaction. *Time to Verdict* equals the number of days between lawsuit filing and verdict. *Filing CAR* equals the cumulative abnormal return around the filing event. *Verdict CAR* equals the cumulative abnormal return around the verdict. *Dismissed* equals one if a lawsuit is dismissed. *Settled* equals one if a lawsuit is settled. *Judgement* equals one if a case moves to a judgement stage and is heard in front of a judge or a jury. *Plaintiff Wins* equals one if a plaintiff wins the case. *Defendant Wins* equals one if a defendant wins the case. *Monetary Penalty* equals one if a monetary penalty is assigned by the court. *Monetary Penalty Amt* equals the size of a monetary penalty in thousands of U.S. dollars. Control variables include *Ln_MarketCap*, *Book-to-Market*, *Debt-to-Equity*, *ROA*, *Analyst_Coverage*, *Num_Directors*, *CEO_Chairman*, *Board_Independence*, *Instit_Ownership*, *Injury_Liability*, *Civil_Rights* and *Verdict_Time*. Control variables are winsorized at 1%. ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels, respectively. T-statistics are reported in parentheses.

Panel A: Comparison of Litigation Variables by Plaintiff

	Government	Other Plaintiffs	t-stat
Time to Verdict	282	337	-5.39***
Filing CAR	-0.11%	-0.02%	-0.70
Verdict CAR	0.02%	0.27%	-1.86*
Dismissed	24.37%	31.37%	-6.36***
Settled	15.04%	40.59%	-27.72***
Judgement	59.04%	12.83%	36.79***
Monetary Penalty	22.29%	0.49%	20.56***
Monetary Penalty Amt	313.9	14.0	7.39***

Panel B: Government as a Plaintiff and Political Contributions

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Time to Verdict	Filing CAR	Verdict CAR	Dismissed	Settled	Judgement	Monetary Penalties	Monetary Penalty Amt
Intercept	-196.6142 (-1.34)	0.0137*** (2.59)	0.0097 (1.08)	0.5033*** (4.34)	0.2809** (2.34)	0.0437 (0.66)	0.0260*** (2.89)	44.5605 (1.51)
Ln_Federal	-6.9174** (-2.39)	0.0003*** (2.95)	0.0001 (0.63)	-0.0015 (-0.68)		0.0011 (0.98)	0.0003** (1.98)	0.1060 (0.28)
Ln_Federal*Government	9.4378 (1.58)	0.0000 (-0.08)	-0.0006** (-2.35)	-0.0020 (-0.79)	0.0009 (0.32)	-0.0012 (-0.22)	-0.0017 (-0.22)	8.7855 (1.11)
Government	-151.9607*** (-3.69)	-0.0014 (-0.55)	0.0040 (1.52)	-0.0450* (-1.83)	-0.2120*** (-7.07)	0.4057*** (15.57)	0.3169*** (10.05)	224.1000*** (4.00)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FF	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FF	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm	Firm	Firm	Firm	Firm
N	115,675	114,171	109,344	110,231	110,231	110,231	110,231	110,231
Adj R-sq	0.303	0.039	0.042	0.111	0.116	0.086	0.132	0.011

Table 11: Litigation in the State of Head Quarters

This table presents the analysis of main benefits from political connections in HQ lawsuits. Panel A presents a comparison of HQ lawsuits and lawsuits filed in other states. Panel B presents the results of regressing litigation benefits on political contributions, log of the number of years firm has worked in HQ state and their interaction. *Time to Verdict* equals the number of days between lawsuit filing and verdict. *Filing CAR* equals the cumulative abnormal return around the filing event. *Verdict CAR* equals the cumulative abnormal return around the verdict. *Dismissed* equals one if a lawsuit is dismissed. *Settled* equals one if a lawsuit is settled. *Judgement* equals one if a case moves to a judgement stage and is heard in front of a judge or a jury. *Plaintiff Wins* equals one if a plaintiff wins the case. *Defendant Wins* equals one if a defendant wins the case. *Monetary Penalty* equals one if a monetary penalty is assigned by the court. *Monetary Penalty Amt* equals the size of a monetary penalty in thousands of U.S. dollars. *Ln_Years* is a natural log of the number of years a firm has worked in state of HQ. Control variables include *Ln_MarketCap*, *Book-to-Market*, *Debt-to-Equity*, *ROA*, *Analyst_Coverage*, *Num_Directors*, *CEO_Chairman*, *Board_Independence*, *Instit_Ownership*, *Injury_Liability*, *Civil_Rights* and *Verdict_Time*. Control variables are winsorized at 1%. ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels, respectively. T-statistics are reported in parentheses.

Panel A: Comparison of Litigation Variables by Litigation Location

	HQ State	Other States	t-stat
Time to Verdict	845	283	60.06***
Filing CAR	0.18%	-0.04%	4.21***
Verdict CAR	1.26%	0.17%	20.68***
Dismissed	44.12%	29.95%	28.63***
Settled	25.61%	41.77%	-36.40***
Judgement	19.21%	12.84%	16.32***
Monetary Penalty	0.48%	0.81%	-4.58***
Monetary Penalty	22.1	17.6	1.05

Panel B: Litigation in State of Head Quarters and Political Contributions

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Dismissed	Dismissed	Settled	Settled	Judgement	Judgement	Monetary Penalty Amt	Monetary Penalty Amt
Intercept	0.4665*** (4.88)	0.3473*** (3.85)	0.3769*** (4.11)	0.4768*** (5.59)	-0.1994*** (-2.64)	-0.1748** (-2.49)	19.5043 (0.36)	-13.3148 (-0.25)
Ln_Federal	-0.0206*** (-3.31)		0.0103* (1.79)		0.0159*** (2.90)		3.0472 (0.73)	
Ln_Federal*Ln_Years	0.0054*** (3.07)		-0.0036** (-2.18)		-0.0044*** (-2.82)		-0.4760 (-0.38)	
Ln_Lobby		0.0213*** (3.99)		-0.0147*** (-3.09)		0.0041 (0.90)		5.9628* (1.88)
Ln_Lobby*Ln_Years		-0.0034** (-2.34)		0.0014 (1.09)		-0.0026** (-2.07)		-1.6646** (-1.99)
Ln_Years	-0.0721*** (-4.42)	-0.0337** (-2.38)	0.0453*** (3.01)	0.0224* (1.67)	0.0455*** (3.27)	0.0370*** (2.91)	21.1728* (1.93)	28.1137** (2.56)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FF	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FF	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Firm	Firm	Firm	Firm	Firm	Firm	Firm	Firm
N	9,666	9,670	9,666	9,670	9,666	9,670	9,666	9,670
Adj R-sq	0.298	0.305	0.100	0.112	0.127	0.130	0.008	0.008

Table 12: Self-Selection in Political Contributions

This table presents the Heckman correction for a self-selection in political contributions. Panel A presents a first stage probit regression. Panel B presents the results of a second stage regression. *Senator_Office* equals one if firm's headquarters is located in the same city as a senator's office. *Time to Verdict* equals the number of days between lawsuit filing and verdict. *Filing CAR* equals the cumulative abnormal return around the filing event. *Verdict CAR* equals the cumulative abnormal return around the verdict. *Settled* equals one if a lawsuit is settled. *Judgement* equals one if a case moves to the judgement stage and is heard in front of a judge or a jury. *Monetary Penalty* equals one if a monetary penalty is assigned by the court. *Monetary Penalty Amt* equals the size of the monetary penalty in thousands of U.S. dollars. Control variables include *Ln_MarketCap*, *Book-to-Market*, *Debt-to-Equity*, *ROA*, *Analyst_Coverage*, *Num_Directors*, *CEO_Chairman*, *Board_Independence*, *Instit_Ownership*, *Injury_Liability*, *Civil_Rights* and *Verdict_Time*. Control variables are winsorized at 1%. ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels, respectively. T-statistics are reported in parentheses.

Panel A: First Stage

	(1)	(2)
	Federal=1	Lobby=1
Senator_Office	0.4329*** (36.84)	0.4087*** (39.59)
Controls	Yes	Yes
Year FF	Yes	Yes
Industry FF	Yes	Yes
N	110,036	110,036
Adj R-sq	0.356	0.194

Panel B: Second Stage

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Time to Verdict	Filing CAR	Verdict CAR	Settled	Judgement	Case Transferred	Monetary Penalties	Monetary Penalty Amt
Intercept	-1009.4630*** (-4.73)	0.0229** (2.56)	0.0088 (1.18)	1.0844 (1.39)	-1.5624*** (-2.74)	-3.4158** (-2.45)	-2.2493*** (-4.19)	52.0728 (1.43)
Federal_Choice		0.0033*** (2.89)	-0.0033** (-2.23)				0.1280 (0.82)	4.3875 (0.79)
Lobby_Choice	-444.7953*** (-10.16)			-0.5342* (-1.85)	-0.2716*** (-4.05)	0.7249*** (5.89)		
IMR	159.6516** (2.57)	-0.0030 (-1.17)	-0.0044** (-2.12)	-0.5767** (-2.35)	-0.0437 (-0.34)	0.6749** (2.01)	0.1445 (1.17)	-5.2611 (-0.67)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FF	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FF	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cluster	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	109,753	113,958	108,864	110,036	110,036	110,036	110,036	109,753
Adj R-sq	0.593	0.040	0.029	0.102	0.091	0.120	0.173	0.003

Table 13: Selection Bias

This table presents the Heckman correction for a selection bias. *Time to Verdict* equals the number of days between lawsuit filing and verdict. *Filing CAR* equals the cumulative abnormal return around the filing event. *Verdict CAR* equals the cumulative abnormal return around the verdict. *Settled* equals one if a lawsuit is settled. *Judgement* equals one if a case moves to the judgement stage and is heard in front of a judge or a jury. *Monetary Penalty* equals one if a monetary penalty is assigned by the court. *Monetary Penalty Amt* equals the size of the monetary penalty in thousands of U.S. dollars. Control variables include *Ln_MarketCap*, *Book-to-Market*, *Debt-to-Equity*, *ROA*, *Analyst_Coverage*, *Num_Directors*, *CEO_Chairman*, *Board_Independence*, *Instit_Ownership*, *Injury_Liability*, *Civil_Rights* and *Verdict_Time*. Control variables are winsorized at 1%. ***, ** and * indicate statistical significance at the 1%, 5% and 10% levels, respectively. Z-statistics are reported in parentheses.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Time to Verdict	Filing CAR	Verdict CAR	Settled	Judgement	Case Transferred	Monetary Penalties	Monetary Penalty Amt
Intercept	-438.1354*** (-14.29)	-3.9900*** (-160.68)	0.0018 (0.78)	-0.3105*** (-3.13)	-1.8381*** (-15.11)	-1.4997*** (-11.34)	-1.6363*** (-5.62)	16.0920 (0.55)
Ln_Federal	-6.7039*** (-23.62)	0.0003*** (10.22)	-0.0002*** (-10.25)				0.0136*** (5.03)	0.3693 (1.35)
Ln_Lobby				-0.0378*** (-60.92)	-0.0185*** (-23.62)	0.0480*** (57.81)		
IMR	73.3871*** (11.08)	-0.0059*** (-8.87)	-0.0027 (-5.58)					8.9561 (1.47)
Rho	0.1845	-0.1487	-0.0915					0.0242
Prob>chi2				0.00	0.06	0.00	0.97	
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FF	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FF	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	114,505	113,047	108,849	109,743	110,036	110,036	110,036	109,718

CHAPTER IV. THE EFFECT OF TARGET'S POLITICAL CONNECTIONS ON MERGERS AND ACQUISITIONS

1. Introduction

Political relationships between firms and politicians represent a corporate investment. Before a firm decides to establish a political connections, management estimates the return from such an investment and compares them to the associated costs. As with any other corporate decision, a firm has an incentive to invest in political connections only when the benefits of this connection exceed its costs.

The existing finance literature identifies numerous benefits received by connected firms from their political relations. Politically connected firms experience lower transaction costs and fewer frictions when dealing with the government in the form of lower effective tax rates (Adhikari, Derashid, and Zhang, 2006), greater tax benefits (Wu et al., 2012), and shorter transaction time (Correia, 2014). Connected firms also enjoy greater access to capital markets and a lower cost of capital (Khwaja and Mian, 2005; Charumilind, Kali, and Wiwattanakantang, 2006; Boubakri et al., 2012; Infante and Piazza, 2014). Connected firms are also more likely to receive financial subsidies from the government or government contracts (Faccio, Masulis, and McConnell, 2006; Duchin and Sosyura, 2012; Goldman, Rocholl, and So, 2013; Ferris and Houston, 2016). Finally, connected firms can use their political relations to affect market competition through industrial legislation (Antia, Kim, and Pantzalis, 2013).

Political relationships can provide the firm with other important benefits during a merger. Existing relationships create value for a firm's shareholders and, at the same time, represent a desirable asset for potential acquirers. A target firm's political relationships

provide it with leverage to negotiate with an acquirer and generate higher returns for its shareholders. At the same time, a target firm can use its connections with government entities to help protect itself against a hostile transaction²¹.

In this essay I examine how targets' political connections affect the process and outcome of mergers and acquisitions. I specifically examine politically connected domestic targets acquired by foreign and domestic firms. I argue that foreign and domestic acquirers have different demands for the political connections established by target firms. The large costs of establishing political relationships and the greater benefits from using targets' connections might motivate foreign acquirers to pay higher premiums for such targets. Additionally, institutional environment and culturally based attitudes towards corporate-political relationships in an acquirer's home country affect its demand for political connections and its ability to generate higher returns from these connections.

A greater demand for politically connected targets by foreign acquirers might also affect the process and outcome of M&A activity. Foreign acquirers are more interested in completing acquisitions of politically connected targets. Thus, they are more likely to choose the structure of a deal to increase the probability of a successful bid. I expect that foreign acquirers are more likely to choose tender offers over mergers and pay in cash than domestic firms. Consequently, along with a higher premium they are willing to pay for a connected target, their bids are less likely to be challenged by other competitive bidders.

I also examine the political environment in acquirers' home countries and its effect on acquirers' demand for politically connected targets. I expect that acquirers from

²¹ <http://knowledge.wharton.upenn.edu/article/hostile-takeovers-russian-style/>

countries where political connections are needed more for business success pursue politically connected targets with greater intensity. Therefore, I argue that acquirers from countries with more rigid political systems, higher levels of corruption, lower levels of institutional development, and corporate sponsorship of elections have a higher demand for targets' political connections and are willing to pay higher premiums.

The evidence presented in this essay suggests that acquirers having experience in corporate-political relationships are more likely to complete the transactions, negotiate with targets, and pay higher premiums. The amount of acquirers' resources, or firm size and profitability, are positively related to the probability of establishing corporate-political relationships. In turn these firms are more likely to have the experience and skills needed to successfully exploit a target's connections. Consistent with this argument, I document that larger and profitable foreign acquirers are more likely to complete acquisitions of connected targets than domestic firms. The odds of a deal completion are 1.89 and 9.53 times higher for acquirers with above median total assets and return on assets, respectively.

These results are also consistent with the implications of a cost-benefit analysis conducted by potential acquirers prior to the acquisition of connected firms. I discover that profitable acquirers and firms with higher leverage, which might be able to generate greater returns from targets' political connections, are willing to pay higher premiums. On the contrary, larger foreign acquirers, which incur lower costs of establishing their own connections, might not see targets' connections as valuable and pay lower premiums.

I also obtain results which support the hypothesis that foreign acquirers have a greater demand for political connections and thus complete more transactions than domestic firms. I further establish that foreign acquirers choose to engage in tender offers rather than

mergers and are more likely to pay in cash, resulting in fewer competitive bids. The existing literature shows that these transaction characteristics have a significant positive relation with the probability of a deal completion and are treated as an indicator of acquirers' demand for the targets (Betton, Eckbo, and Thorburn, 2008; Offenberger and Pirinsky, 2015).

I further discover that, consistent with the learning hypothesis, acquirers from certain countries have a greater demand for political connections and are willing to pay higher premiums. More specifically, I find a strong positive relation between corporatism and corruption in an acquirer's home country and the premium they pay for politically connected targets. A one standard deviation increase in corporatism or corruption is associated with an increase in target premium by about 5.5%. The level of institutional development, however, is inversely related to target premiums²². Acquirers from countries with weaker institutions are willing to pay more for access to existing political connections. Finally, I provide evidence that acquirers from countries not permitting corporate contributions are unaccustomed to making political contributions and do not view targets' political connections as valuable. I document a 16.3% decrease in target premium in acquisitions attempted by acquirers from countries with corporate sponsorship bans.

The remainder of the essay is organized as follows. Section 2 discusses the value of political connections to targets and acquirers. Sections 3 and 4 presents the hypotheses. Section 5 describes the data and presents the descriptive statistics of the sample. Main empirical results are presented in section 6. The discussion of the results and future research implications are presented in section 7.

²² I use institutional indices reported by the World Bank. The data includes indices of the corruption control, government effectiveness, political stability, administrative quality, rule of law, and voice and accountability.

2. Value of political connections to targets and acquirers

2.1 Acquirers and Political Connections

Before bidding on a politically connected target, a potential acquirer, interested in receiving the benefits from its political relationships, conducts a cost-benefit analysis similar to the one described in Chapter 2. More specifically, a firm compares the costs of acquiring a connected target to the costs of establishing political connections directly.

The cost of acquiring connections through an acquisition typically includes a higher premium to compensate a target firm for the resources it has already spent on establishing and maintaining relationships with politicians. In this case, the acquirer purchases a connected target and immediately enjoys the benefits from already established political connections. The cost of establishing new connections with politicians consists of the cash expenses to support political campaigns and time the management spends on approaching the politicians and maintaining the relationship (Kaufmann and Wei, 1999). It is also important to understand that the benefits might not be available immediately after the firm establishes connections with politicians. It might take time and periodic contributions to start receiving benefits expected from the relationship (Snyder, 1992). If the cost of acquiring a politically connected target is lower than the cost of buying a non-connected competitor and establishing new relationships with politicians, a potential acquirer chooses to buy a connected firm.

2.2 Value of Political Connections to Foreign and Domestic Acquirers

The cost-benefit analysis conducted by domestic acquirers is different from the analysis of foreign firms. Regulations of corporate contributions and an acquirers'

experience with political connections in their home countries affect their decision to establish connections in the United States. Thus, foreign acquirers receive greater benefits and incur higher costs from establishing relationships with the U.S. politicians, compared to domestic firms.

Foreign firms might obtain greater benefits from political connections with the U.S. politicians than domestic firms. The political, legal, and institutional environment in their home countries might help foreign firms to obtain the experience and skills necessary to successfully manage relationships with politicians (Faccio, 2006). Therefore, such qualities may allow them to more efficiently use political connections in the U.S. and extract greater benefits from such relationships as compared to domestic firms.

Foreign firms, however, might spend more resources to establish and maintain relationships with politicians in the U.S. than domestic firms. Unlike domestic firms, foreign firms are prohibited from directly contributing to the election campaigns. However, they can use contributions of their domestic subsidiaries to represent their political interests. American divisions of foreign firms are allowed to form a political action committee (PAC) and contribute on behalf of their domestic employees²³. Thus, the domestic subsidiary plays an important role in establishing and managing the relationships with politicians on the behalf of the foreign parent company.

Foreign firms can also hire lobbyists to meet politicians and establish the relationships on their behalf. However, foreign clients of lobbyist firms are required to be disclosed and registered with the U.S. government by the Foreign Agents Registration Act.

²³ <https://www.opensecrets.org/pacs/foreign.php>, <http://www.wnyc.org/story/181667-explainer-can-foreign-companies-make-political-donations/>

Strict regulations and career concerns can affect the willingness of lobbyists to represent the interests of foreign firms and, in effect, increase the cost of their services. Furthermore, politicians themselves might be less interested in establishing connections with foreign firms. Overall, an increased disclosure and scrutiny of the public might increase the costs incurred by foreign firms to establish relationships with politicians and even reduce the rate of return from such political investments.

The different costs and benefits from political connections for foreign and domestic acquirers have important implications for acquisitions of politically connected targets. Higher costs to establish and maintain connections to politicians create additional incentives for foreign firms to acquire politically connected targets instead of establishing political relationships directly. Similarly, greater benefits obtained by foreign firms from a target's political connections positively affect their demand for connected targets.

3. Target's political connections and the acquisition process

3.1 Deal Characteristics

3.1.1 Probability of completion

A deal completion is an important indicator of the negotiation process between potential acquirers and targets. After the firms sign the initial contract and publicly announce an acquisition, they enter the negotiations and discuss how to achieve the synergies from the transaction. A deal completion is not simply a function of an acquirer's demand for the target, it is affected by many factors, including public status, payment method, industry complementarity, target's takeover defenses, difference in culture, and previous acquisition experience (Haleblian, Kim, and Rajagopalan, 2006; Betton, Eckbo,

and Thorburn, 2008; Ahern, Daminelli, and Fracassi, 2015; Lim and Lee, 2016).

I argue that the cost-benefit analysis, described in detail in section 2, creates greater incentives for foreign acquirers to complete the acquisition of a politically connected target than for domestic firms. Because of the regulations, foreign acquirers might be more likely to establish connections with politicians through acquisitions. A demand for a target's political connections is greater for foreign acquirers than for domestic firms, who can establish their own connections to politicians more easily. Thus, to obtain the benefits from a target's relationships with politicians, foreign acquirers are more interested in completing the deal than domestic firms. Thus, I hypothesize:

H1a: Percent of completed acquisitions of politically connected targets is larger for foreign than for domestic acquirers.

3.1.2 Deal structure

The existing literature documents that the structure of an acquisition impacts its process and outcome. A tender offer, unlike a merger, allows a bidder to directly approach target's shareholders with an offer. Such transactions are completed faster than mergers and do not require an approval of a target's management (Betton, Eckbo, and Thorburn, 2008). At the same time, a requirement to publicly disclose a bid increases target premium paid in tender offers (Schwert, 1996; Officer, 2003). Thus, a tender offer acquisition is more likely to be completed than a merger.

Offenberg and Pirinsky (2015) argue that a competitive environment affects an acquisition method. They document that an acquirer will always choose a tender offer in the presence of a competition for a target because of a faster completion. Additionally,

higher expected synergies from an acquisition are positively related to a bidder's choice of a tender offer (Offenberg, Straska, and Waller, 2014).

A similar logic of choosing an acquisition method could be applied to an acquisition of a politically connected target. Target's political connections represent a valuable to asset to potential acquirers. Thus, these connections are positively related to the level of competition for a target. Since the costs of establish political connections are higher for foreign acquirers than for domestic firms, they are more likely to compete for a connected target and, consequently, structure an acquisition as a tender offer. Additionally, due to the experience with political connections in their home countries, foreign acquirers have the skills necessary to generate higher returns from political relationships. They estimate a greater synergy from an acquisition of a connected target than domestic acquirers. Overall, I expect the cost-benefit analysis of foreign acquirers to have an effect on their choice of an acquisition method. Thus, I hypothesize:

H1b: Foreign acquirers are more likely to structure an acquisition of a politically connected target as a tender offer than domestic acquirers.

3.1.3 Method of payment

An acquirer's demand for a target affects its choice of a payment method. If an acquirer is interested in a fast completion of a deal, it is more likely to choose a cash-only method of payment. This relation is even stronger in tender offers due to registration statement requirements (Martin, 1996). Additionally, a level of competition for a target creates an incentive for an acquirer to deter competition and choose a cash payment method (Berkovitch and Narayanan, 1990).

I expect that a high demand from foreign acquirers for a politically connected target might impact their choice of a payment method. Since foreign firms are more interested in completing an acquisition of a connected target, I hypothesize the following:

H1c: Foreign acquirers are more likely to pay in cash for politically connected targets than domestic acquirers.

3.1.4 Number of competitive bids

A high demand for a politically connected target creates an incentive for foreign acquirers to deter competitive bids. Thus, they are likely to structure a deal to increase the probability of a successful completion. More specifically, foreign acquirers are more likely to choose a tender offer over a merger, pay in cash, and offer higher target premiums. Overall, these deal options are associated with a higher probability of a bid success and lower competition from other bidders (Betton, Eckbo, and Thorburn, 2008). Thus, I hypothesize the following:

H1d: Foreign acquirers are less likely to receive competitive bids for politically connected targets than domestic acquirers.

3.2 Target Premium

3.2.1 The size of the premium

A target premium represents the gains of a target's shareholders from the transaction and is measured as the difference between the actual value of the target and what the acquirer is willing to pay for it. On average, a takeover premium is estimated between 45% and 50% (Eckbo, 2009). The size of a premium depends on the bidding process and varies with an acquirer's expectation of the demand for the target, probability

of a deal completion, and potential synergies from the acquisition.

To formulate a bid, an acquirer thoroughly examines and prices the synergies from a target's political connections. Because of a limited opportunity to establish their own political connections in the U.S., foreign acquirers perceive a target's political connections to be more valuable, compared to domestic acquirers. Thus, foreign acquirers have a higher demand for politically connected targets than domestic firms. At the same time, skills to effectively manage political connections, acquired by foreign firms in their home countries, increase future benefits from a target's political relationships and overall synergies from the acquisition. Therefore, foreign acquirers can generate higher returns from the acquisition of politically connected targets than domestic firms. Thus, I expect that foreign firms are willing to pay a higher premium for greater benefits from a target's political connections and hypothesize the following:

H2a: Foreign acquirers pay a higher premium for politically connected targets than domestic acquirers.

3.2.2 Target premium in regulated industries

Political connections are especially important to firms operating in regulated industries. Regulatory and supervisory policies and legislation have a strong impact of a firm's operations and performance (Santos, 2001; Delis, Molyneux, and Pasiouras, 2011). Intuitively, a greater dependence on the government creates greater incentives for regulated firms to establish connections with politicians and government officials (Yoffie, 1988; Hillman and Hitt, 1999; Hillman, 2005). Firms can use their political relationships to monitor changes and even affect industrial legislation to obtain an advantage over its competitors.

Target firms with existing connections to politicians controlling the regulated industries are even more important to potential acquirers. Even if the buyer already has relationships with the right politicians, acquiring a connected target only increases the synergies from the transaction. By using a target's connections, the regulated acquirer can achieve even greater benefits from its relationships with politicians, such as a greater access to resources and information and more control over the industrial legislation. Therefore, the marginal value of an additional political connection in regulated industries is higher than its value in other sectors. Thus, I expect that regulated acquirers are willing to pay a higher premium to gain access to a target's political connections. I hypothesize the following:

H2b: Acquirers in the regulated industries pay a higher premium for politically connected targets than acquirers in other industries.

4. Acquirer's environment and the acquisition process

4.1 Organizational Learning and Political Connections

The organizational learning represents a constant learning process and examines how a firm adapts to new experiences (Haleblian, Kim, and Rahagopalan, 2006; Argote and Miron-Spektor, 2011). The process typically consists of three stages: knowledge and routine creation, retention, and transfer. The learning process is very unique to each firm, and, thus, can be viewed as a firm's competitive advantage over its peers (Jimenez-Jimenez and Sanz-Valle, 2011).

A firm's experience is an important factor of its organizational learning process. Levitt and March (1988) argue that the behavior of a firm is determined by a set of routines,

which represent rules, procedures, and strategies used to operate a firm. A firm's experience shapes these routines and affects the creating of knowledge and innovation in a firm. Also an existing experience is positively related to a probability of repeating a routine. Thus, if a firm feels comfortable making a corporate decision, it's likely it will do it again, regardless of the past outcomes associated with a decision (Amburgey, Kelly, and Barnett, 1993; Halebian, Kim, and Rahagopalan, 2006).

The learning process usually occurs within a certain context, which affects a firm's experience and a process of knowledge accumulation (Glynn, Lant, and Milliken, 1994; Argote, 2011). Such context could be internal and external. The internal context is determined by the processes, structure, culture, and other factors within the firm. The environmental, or external, context represents all possible factors outside the firm and their interaction (Argote and Miron-Spektor, 2011).

The organizational learning theory can be applied to finance research and help to examine how firms use their hands-on business experience to develop different knowledge and skills. Specifically, a firm's experience with political connections and its skills to generate returns from such relationships can shape its opinion on the value of political connections and affect its ability to establish and maintain relationships with politicians. I extend the learning theory argument further and contend that firms do not necessary need to establish their own connections to understand the costs and benefits associated with them. Thus, such learning can occur within a certain context, such as a national culture and norms related to the relationships between firms and politicians.

Similarly to their effect on the trade, investments, and acquisitions (Alm, Sanchez, and Dejuan, 1995; Guiso, Sapienza, and Zingales, 2009; Ahern, Daminelli, and Fracassi,

2015), national political values and norms affect firms' relationships with politicians. During daily operations, firms and their managers adopt the views on corporate-political relationships developed in their home countries. Thus, a firm operating in a country where political connections are considered a business necessity is more likely to find connections valuable and actually establish them than a firm from a country with a negative view of such connections. Moreover, the national norms on political connections define a firm's experience, which in turn creates knowledge and skills necessary to successfully establish and maintain relationships with politicians.

In the context of mergers and acquisitions, a firm's national values and norms on political connections can directly affect its decision to acquire a politically connected target. Managers who learn about the value of political connections from the experience in their home countries might be able to more efficiently establish and manage relationships with the U.S. politicians. Moreover, the rate of return on political investments might be higher for foreign acquirers who develop the necessary skills in their home countries. Thus, a firm's knowledge of political connections increases its demand for a politically connected target and the price a firm is willing to pay for access to domestic politicians.

4.2 Corruption

Certain country characteristics affect a firm's experience with political connections. A manager's knowledge of the costs and benefits arising from connections with politicians and skills needed to manage them vary with the leniency of national political norms. If political connections are frequent and are not publicly disapproved, it is reasonable to expect that many firms will try to establish relationships with politicians to obtain certain benefits.

The national level of corruption directly affects a firm's skills and ability to establish connections with politicians. Existing literature shows that firms operating in geographical areas with high corruption levels frequently establish relationships with politicians and obtain numerous benefits from such connections (Faccio, 2010; Infante and Piazza, 2014). Additionally, firms from countries with higher corruption see relationships with politicians as a necessary way to conduct business (Wank, 2002; Granovetter, 2007). Thus, the national norms and a greater exposure to political connections increase the knowledge and skills acquired by firms operating in countries with high levels of corruption. Consistent with the organizational learning theory, frequent experience affects the actions of a firm and, in this setting, its choice to establish political connections.

The national level of corruption and a firm's political experience also affect its acquisitions of politically connected targets. A firm's experience with political connections determines its ability to efficiently use them, mitigate the uncertainty, and increase the rate of return from political investments. Consequently, a firm's demand for a politically connected target varies with its experience with political projects, as measured by the national level of corruption in its home country. At the same time, a firm's demand for a domestic firm with political connections is reflected in its persistence to acquire the target. I expect that firms with necessary skills of political connections, developed in countries with a high level of corruption, are more likely to negotiate with the target firm in order to complete the transaction than firms operating in better corruption environments.

Consistent with the learning theory, firms operating in countries with a higher level of corruption are more familiar with the benefits from political connections and are able to generate higher returns from political investments. Thus, I conclude that a target's political

connections are more valuable to such firms than to other acquirers. Therefore, I hypothesize the following:

H3a: Acquirers from countries with a higher level of corruption pay higher premiums for politically connected targets than acquirers from countries with a lower corruption.

4.3 Institutions

A weak law enforcement, a lower quality of bureaucracy, and the overall ineffectiveness of the government provide both the politicians and firms with an opportunity to collude and pursue personal interests. Melgar, Rossi, and Smith (2010) also argue that a “culture of distrust” towards government institutions can affect the public perception of political connections. The existing finance literature empirically reaffirms the relation between the strength of government institutions and the development of political connections. Li et al. (2008) study political connections in China and find that relationships with the government play a more important role in regions with weaker market institutions and legal protection. Similarly, Dinc (2005) studies the lending behavior of government-owned banks. He documents that connected banks acquire more leverage than private banks and that the main effect comes from countries with weaker developed institutions.

Consistent with the organizational learning, a firm’s experience and knowledge about political connections increase with the frequency of political connections and their acceptance in its home country. Political connections are more common in countries with weaker government institutions (Dinc, 2005; Li et al., 2008), and, thus, firms operating in such environment are more likely to acquire the skills to manage such connections.

Similarly, firms from countries with weak institutions value political connections and have a higher demand for politically connected targets. Consistent with the organizational learning, I argue that acquirers, which obtain skills to effectively use political connections in countries with weaker institutions, realize the value of a target's political connections and are willing to pay a higher premium to receive their benefits. Therefore, I hypothesize the following:

H3b: Acquirers from countries with weak institutions pay higher premiums for politically connected targets than acquirers from countries with stronger institutions.

4.4. Political Corporatism

The degree of centralization of a political power can be used to describe a country's level of corporatism. Countries with a high level of corporatism exhibit a limited political competition, small number of interest groups participating in political processes, and a strong involvement of the government in the regulation of firms (Murtha and Lenway, 1994). Pluralistic countries, on the contrary, allow many interest groups to participate in the political process and approve a decentralized regulation of firms (Schmitter, 1977). A list of corporatistic countries includes Brazil, Argentina, and Japan, while United States, United Kingdom, and Canada are traditionally considered to have a high level of political pluralism (Murtha and Lenway, 1994).

A corporatism impacts the number of relationships between firms and politicians established in the country. The lack of political competition and the government's authoritarianism encourage firms to establish connections with politicians. At the same time, the hierarchy and the conservatism of political processes affect a firm's decision to maintain these relationships over time. Consistent with this argument, Hillman (2003)

documents a positive relation between the corporatism and a firm's political connections.

A positive relation between a country's level of corporatism and a firm's decision to establish political connections suggests that firms from corporatistic countries acquire greater political skills. The size of a target premium is often related to the acquirer's expectation of transaction synergies. Since acquirers from corporatistic countries might generate greater benefits from political connections of target firms, they are willing to pay a higher premium for targets' connections. Thus, I hypothesize:

H3c: Acquirers from corporatistic countries pay higher premiums for politically connected targets than acquirers from pluralistic countries.

4.5 Regulation of Corporate Political Contributions

Regulations of the corporate sponsorship of elections vary internationally²⁴. Often countries choose to prohibit corporate contributions to politicians to preserve the fairness of the political process and to encourage the transparency of political activities. Thus, Canada, France, and Mexico prohibit corporate donations to political parties and individual candidates. At the same time, corporate sponsorship of election campaigns is allowed in the United Kingdom, Germany, and Italy.

If a country allows firms to publicly establish and maintain relationships with politicians through a financial support of their campaigns, more firms are going to develop these connections. Direct corporate contributions represent the simplest and the most effective way to connect with politicians, compared to the direct employment of politicians or executives with political connections (Faccio, 2006; Fisman et al., 2012). Corporate

²⁴ Data on the regulation of election campaigns in 180 countries is available at <http://www.idea.int>.

contributions are easy to make, and their amounts are essentially unlimited and might be tax deductible. Additionally, politicians appreciate financial support of their campaigns, and, thus, firms making the contributions are more likely to receive their attention.

The learning theory suggests that the regulation of corporate contributions affects a firm's choice to establish political connections in the future. Business experience in such countries promotes a firm's knowledge and skills necessary to effectively manage its political connections. Thus, such firms have a higher demand for political connections because they might generate greater benefits from such relationships. An acquirer's skill to effectively manage political connections increases the potential benefits from the acquisition. Consequently, acquirers are willing to incur higher acquisition costs to enjoy greater benefits from a target's political connections in the future. Therefore, I hypothesize the following:

H3d: Acquirers from countries allowing corporate contributions pay higher premiums for politically connected targets than acquirers from countries prohibiting corporate contributions.

5. Data construction and sample

5.1 Data

I use a sample of mergers and acquisitions of publicly traded domestic targets pursued by publicly traded domestic and foreign acquirers. I obtain deal characteristics, such as announcement and completion dates, completion status, transaction value, a form of payment, and attitude of the deal, from the SDC database. Financial information about targets and acquirers is drawn from the CRSP, Compustat North America, Compustat

Global, and DataStream databases.

I use target firms' historical contributions to federal election campaigns and lobbying expenses as my primary measure of political connections. Data on targets' political donations come from the Federal Election Commission and OpenSecrets databases^{25, 26}. Records of all election contributions made by domestic firms begin in 1990, while quarterly lobbying expenses are reported since 1998.

To test the learning hypothesis, I obtain country-level indices of corruption and institutional development from the DataStream and the WorldBank databases. The International Institute for Democracy and Electoral Assistance²⁷ provides the information about election laws internationally, allowing me to identify countries with bans on corporate sponsorship of elections. To identify the level of a corporatism of acquirers' countries, I use the data from Murtha and Lenway (1994) and Siaroff (1999).

Given the data availability for corporate political contributions, I begin by identifying domestic mergers and acquisitions between public firms over the 1990-2016 sample period. I focus on politically connected targets only. I define a target as being politically connected if a firm contributes to federal election campaigns or lobbies during one, three, and five years prior to a deal announcement²⁸. After applying these filters and matching with the appropriate databases, I obtain a final sample of 866 transactions.

²⁵ www.fec.gov/data

²⁶ www.opensecrets.org

²⁷ www.idea.int/

²⁸ I have used other definitions of political connections, such as political spending adjusted by total assets, individual contributions of targets' managers, and percent of sales to the U.S. government. The results remain comparable, so I choose to use a political indicator variable to select the final sample of politically connected targets.

5.2 Distribution of Mergers and Acquisitions by Year, Country, and Industry

The distributions of my sample mergers and acquisitions are presented in Table 14. Panel A presents the distribution of transactions by the announcement year and reports the number of deals announced each calendar year, as well as the percentage of the total deal number. The greatest annual number of mergers and acquisitions is 65 (7.51%) and occurs in 1999. The smallest number of transactions is 11 (1.27%) which happens in 1990.

The sample distribution by acquirers' country is presented in Panel B of Table 14. The majority of acquirers (80.6%) are domestic. Acquirers from the United Kingdom announce 23 acquisitions (2.66%), followed by acquirers from Canada (20 acquisitions; 2.31%), Germany (18 acquisitions; 2.08%), and France (17 acquisitions; 1.96%). Overall, the final sample includes acquirers from 28 countries.

Distribution by targets' industry is reported in Panel C of Table 14²⁹. Almost half, or 41.80% of targets, are engaged in manufacturing, followed by transportation and communications (16.74%), services (15.70%), and finance (13.51%).

5.3 Targets' and Acquirers' Characteristics

Table 15 summarizes the characteristics of targets and acquirers from the final sample. As presented in Panel A of Table 15, an average target firm has total assets of \$17.5 billion, return on assets of 8.15%, and a book-to-market ratio of 0.67. The average target firm's leverage is 63.7%. Also, 30.25% of the target firms operate in government regulated industries, such as transportation, utilities, and financial services. Approximately 81% of targets make political contributions one year prior to a deal announcement. On

²⁹ I use targets' 2-digit SIC code to define their main industry.

average, they spend \$45,255 on federal election campaigns and \$482,004 on lobbying. The majority of target firms consistently donate to political campaigns. Thus, 97.92% of targets make political contributions within five years of deal announcements. Their cumulative spending on federal elections is \$204,070, while that for lobbying is \$3.14 million.

Panel B of Table 15 presents a summary of acquirers' characteristics and a comparison for between and foreign firms. An average acquirer in the sample has total assets of \$58.8 billion, return on assets of 11.06%, and a debt-to-assets ratio of 0.64. Foreign acquirers are significantly larger and more profitable than my sample domestic firms³⁰. The mean total assets of foreign firms equal \$116.3 billion compared to \$45.0 billion for domestic acquirers. Similarly, the average return on assets of foreign firms of 11.84% is more than double that of 4.56% for domestic firms. Additionally, only 25.6% of foreign acquirers operate in heavily regulated industries compared to almost 37% of domestic firms.

5.4 Deal Characteristics

Table 16 presents the main characteristics of mergers and acquisitions included in the sample. The statistical summary reported in Panel A of Table 16 shows that the average transaction is \$6.3 billion, with a target premium of 38.30%. Prior to a deal announcement, 11.20% of bidders already own shares in the target firm. The average toehold in the sample is quite small and equals 3.25%. Over 81% of announced transactions are completed, and negotiations take, on average, 148 days. On average, there is only one competitive bidder per transaction, who offers two bids. The prevailing attitude of deals is friendly, with only

³⁰ The differences in total assets, return on assets, and percent of firms in regulated industries for foreign and domestic acquirers are statistically significant.

5.20% of transactions being hostile. 17.32% of deals are structured as tender offers, and 40.30% of them are paid in cash. Only a small portion of target firms, 11.89%, has antitakeover defenses in place.

Panel B contains a statistical summary and comparison of bids provided by foreign and domestic acquirers. Foreign acquirers are more likely to own targets' shares prior to an announcement and to complete acquisitions of politically connected targets. Also, transactions of foreign acquirers are less likely to be challenged by competing firms. Additionally, foreign firms choose fewer targets with antitakeover defenses and are more likely to pay in cash than domestic acquirers.

6. Main results

6.1 Deal Completion

In section 3 I hypothesize that foreign acquirers have a higher demand for politically connected targets, which should be captured by a higher completion rate for foreign firms. The univariate results, presented in Table 16, are consistent with the expectation. Therefore, following hypotheses H1a, I examine the relation between the acquirers' type and the probability of a deal completion in a multivariate setting. I estimate the following regression:

$$P(\text{completed} = 1) = \beta_0 + \beta_1 * \text{Foreign} + \beta_i * \text{Controls} + \varepsilon, \quad (1)$$

where Foreign=1 if an acquirer is a foreign firm, and 0 otherwise.

The regression results are presented in Table 17. Column 1 summarizes the results of a logistic regression of the probability of completion on acquirers' type, using the full sample. Overall, I fail to show a significant relation between an acquirers' type and the

probability of completion. The regression coefficient of the Foreign variable is positive, but statistically insignificant. Additionally, I find that hostile acquisitions of large targets are less likely to be completed. Also, acquirers' size is positively related to the probability of a deal completion.

However, foreign acquirers with certain characteristics might have a greater appreciation for targets' political connections than other foreign firms. Consequently, they are able to complete more acquisitions of politically connected firms. I hypothesize that firms' direct experience with political relations is positively related to their interest in politically connected targets and willingness to complete the deal. The existing political science and finance literature shows that larger and profitable firms are, on average, more likely to establish relationships with politicians (Faccio, 2010). Therefore, to examine whether these foreign acquirers are more interested in politically connected targets than other firms, I interact the Foreign variable with size and profitability indicator variables. Size indicator variable equals one if an acquirer's total assets are greater than the median assets in the sample, and zero otherwise. Similarly, profitability indicator variable equals one if a firm's return on assets exceeds the median ROA.

Columns 2 and 3 present the regression results for the size and profitability interactions. Consistent with my expectation, I find that larger foreign acquirers are more likely to complete acquisitions of politically connected targets than domestic and smaller foreign acquirers. The odds of a deal completion are 1.89 times higher for foreign acquirers with larger total assets. Similarly, the regression results presented in column 3 show that profitable foreign acquirers are also more likely to complete acquisitions of politically connected targets. Their odds of a deal completion are 9.53 times greater for profitable

foreign firms than the odds of domestic firms.

Overall, I interpret these results the following way. Consistent with the hypothesis H1a, I find that certain foreign acquirers have a higher demand for politically connected targets. These larger and more profitable foreign firms are better able to understand the immediate value of targets' political connections, possibly due to their own political relations. In addition to their greater demand for connected targets, these acquirers have more resources to negotiate.

6.2 Deal Characteristics

In section 3 I argue that foreign acquirers have a higher demand for politically connected targets than domestic acquirers due to their home experience with politicians. Thus, foreign acquirers are more interested in completing acquisitions of politically connected firms. Consequently, they might approach the transaction to maximize the probability of a successful acquisition and to decrease the number of competitive bids. A tender offer structure and a cash only payment method are traditionally associated with a higher probability of a successful bid (Betton, Eckbo, and Thorburn, 2008; Offenberg and Pirinsky, 2015). Thus, I expect that foreign acquirers' are more likely to choose tender offers and pay in cash, which might consequently result in fewer competitive bids for their offers.

To test the relation between an acquirers' type and deal characteristics I estimate the following regression:

$$Characteristic = \beta_0 + \beta_1 * Foreign + \beta_i * Controls + \varepsilon, \quad (2)$$

where Characteristic represents indicator variables for a tender offer, cash-only payment,

and probability of a competitive bid in different model specifications.

The regression results are presented in Table 18. Column 1 presents the results of the tender offer regression. Consistent with hypothesis H1b, I find a positive relation between the acquirers' type and the deal structure. This result suggests that the odds of foreign acquirers choosing a tender offer approach are 1.66 times greater than those of domestic firms. The results of the payment method regression are presented in column 2. Again, consistent with my hypothesis, I document a significantly positive relation between foreign acquirers and a cash-only payment. The results show that the odds of foreign acquirers paying in cash are 1.62 times higher than those of domestic firms. Finally, the regression results for the probability of a competitive bid are presented in column 3. The Foreign regression coefficient is significantly negative, suggesting the acquisitions of foreign acquirers are less likely to be challenged by other competing bidders. More specifically, the odds of an acquisition by a domestic acquirer being challenged are 71.2% higher than those of foreign acquirers.

The empirical results presented in Table 18 suggest that foreign acquirers' demand for politically-connected targets motivates them to structure transactions to increase the probability of deal completion. Foreign acquirers are more likely to choose the approach and the payment method to accommodate the interests of targets' shareholders, which results in fewer competitive bids. Together with the deal completion results presented in Table 17, these findings provide substantial evidence that foreign acquirers assign a greater value to targets' political connections.

6.3 Target Premium

After documenting that foreign acquirers are more interested in completing

acquisitions of politically connected firms than domestic acquirers, I test whether foreign firms are willing to pay more for targets' political relations. I estimate the following regressions:

$$Premium = \beta_0 + \beta_1 * Foreign + \beta_i * Controls + \varepsilon, \quad (3)$$

$$Premium = \beta_0 + \beta_1 * Foreign + \beta_2 * Foreign * Regulated Acquirer + \beta_i * Controls + \varepsilon, \quad (4)$$

where Foreign=1 if an acquirer is a foreign firm, and 0 otherwise, Regulated Acquirer =1 if an acquirer operates in transportation, utilities, or financial services³¹, and Premium equals the percent change in a target's stock price from 4 weeks to 1 day prior to a deal announcement.

The main regression results are presented in Table 19. Contrary to hypothesis H2a, I do not observe a significant relation between an acquirers' type and target premium. The regression coefficient of the main independent variable Foreign is statistically insignificant in the first model specification (column 1). In the second specification, I retest the model for regulated acquirers. According to hypothesis H2b, I expect that targets' political connections are more valuable to acquirers in heavily regulated industries. The main independent variable in this model is the interaction of Foreign and Regulated Acquirer indicators. Contrary to hypothesis H2b, the interaction coefficient is negative insignificant. The presented evidence suggests that regulated foreign acquirers might view their own political network as adequate or, perhaps, plan to reach out to politicians and regulators in a different way.

³¹ Acquirer's 1-digit SIC code of 4 or 6.

It is possible for acquirers with specific financial characteristics to value targets' political connections in a different way. A firm's decision to purchase a politically connected target and the premium it is willing to pay for the connections depend on the costs and benefits associated with the acquisition. For example, the costs of establishing political connections are smaller for larger acquirers, but the benefits from political relations are quite similar to those of smaller firms. Thus, I expect that larger acquirers are willing to pay a smaller premium for access to targets' political connections compared to smaller firms. Similarly, the existing literature documents that distressed firms are more likely to assign greater value to political connections than firms with less leverage (Faccio, Masulis, and McConnell, 2006; Faccio, 2010). Therefore, I argue that the costs of establishing connections are larger for distressed firms, and they are willing to pay higher premium than financially healthy acquirers. Finally, the expected benefits from a target's political connections need to be large for a profitable firm to invest in a political rather than a real project. Thus, I expect that profitable acquirers anticipate greater benefits from the acquisitions of politically connected targets. Thus, they are willing to pay higher premiums for access to these political resources.

I reestimate the main regression (3) using interactions with the size, profitability, and debt variables. In these model specifications I use actual total assets, return on assets, and debt-to-assets ratio instead of the above median indicators to calculate their interactions with the Foreign indicator variable. The regression results are presented in columns 3 through 5. Consistent with the logic presented above, I find that larger foreign acquirers pay lower premiums for politically connected targets. A 10% increase in a firm's total assets is associated with a 43.86% decrease in the target premium. I also discover that more

profitable foreign acquirers assign a greater value to expected benefits from targets' political connections than domestic firms and are willing to pay higher premiums. A one standard deviation increase in acquirers' return on assets is associated with a 17.44% increase in the target premium. Finally, the debt interaction coefficient is significantly positive, suggesting that targets' political connections could seem more valuable to distressed foreign acquirers than to domestic firms. A one standard deviation increase in their debt-to-assets ratio is associated with a 4.93% higher premium.

Overall, the results reported in Table 19 are consistent with the hypotheses presented in section 3. I observe that the target premium foreign acquirers are willing to pay for politically connected targets depends on their estimates of the costs and benefits associated with the acquisition. Even though I do not find a uniform positive relation between an acquirers' type and target premium, I find that more profitable and distressed foreign acquirers pay higher premiums for access to a target's existing political relations. At the same time, larger foreign acquirers and firms operating in regulated industries might rely on their own political networks and pay lower premiums for connected targets.

6.4 Acquirers' Country Characteristics and Target Premium

In section 4, I discuss how an acquirers' environment might affect the process and outcome of mergers and acquisitions. Overall, I argue that the attitude towards political connections in acquirers' home countries might shape their demand and ability to successfully use political relationships. Consequently, an acquirer's political experience and skills can affect their demand for politically connected targets, empirically measured by the probability of deal completion and target premium. I hypothesize that bidders from countries where establishing connections with politicians is common are more likely to

complete acquisitions of connected targets and might pay higher premiums for their connections. To proxy for a country's attitude towards corporate-political relationships, I use the following measures: corruption index, measures of institutional development, corporatism index, and ban of corporate sponsorship of elections.

I use the corruption perception index (CPI) provided by the Transparency International to measure the level of corruption in acquirers' home countries. CPI ranges between 0 for corrupt countries and 10 for countries with low levels of corruption. To make the interpretation of the results more intuitive, I reverse the CPI for more (less) corrupt countries to have a higher (lower) CPI. Since my hypothesis is that acquirers from more corrupt countries value political connections to a greater extent, I expect a positive relation between the corruption index and the target premium.

The World Bank provides the information on the development of institutions for 214 countries. The voice and accountability index estimates the citizens' freedoms and their ability to participate in selection the government. The political stability index measure the likelihood of the disruption of political stability within the country. Government effectiveness index estimates the quality of the government policies and services, while the regulatory quality index measures whether the government is able to create effective regulations. The rule of law index measures citizens' confidence in law enforcement and their willingness to abide by regulations. Finally, control of corruption estimates the government's ability to prevent and fight corruption. Each index ranges between -2.50 and 2.50, with lower values indicating a higher quality of national institutions.

The corporatism index assesses the level of political competition within the country. It ranges between 0 (politically pluralistic countries) and 5 (corporatistic

countries). Higher index values indicate lower political competition, fewer participants in the political system, and a more rigid political system overall. I argue that firms operating in corporatistic countries are more familiar with corporate-political relations and are able to generate greater benefits from these relations.

Regulations of corporate sponsorships represent an important determinant of the corporate-political relationships because they legally determine how firms and politicians can interact. In countries where the corporate financial support of candidates is prohibited, firms cannot establish the most direct monetary channel to politicians. Thus, firms might be unable to develop the skills and knowledge necessary to successfully use political connections in other countries. Consequently, when it comes to an acquisition of a politically connected target, I expect a negative relation between regulatory limits on corporate sponsorship and the target premium paid by acquirers from these countries.

Panel A of Table 20 presents a statistical summary of empirical measures, used to characterize acquirers' home countries. On average, acquirers in my sample operate in countries with rigid political systems and a corruption index of 7.5 out of 10.0. Additionally, corporate sponsorships of elections is banned in 87.38% of countries. The average cumulative ranking of institutions, provided by the World Bank, equals 8.13 points out of a maximum of 15.

Panel B of Table 20 summarizes the regression results of a target premium on country characteristics. The coefficients of most independent variables are statistically significant. I find a positive relation between the level of corporatism and the target premium acquirers pay for politically connected targets. Thus, acquirers from countries with fixed political systems and few political participants are willing to pay higher

premiums for access to targets' political connections. A one standard deviation increase in national corporatism increases a target premium by 5.03%. Consistent with expectations, I find a strong negative relation between an election sponsorship ban and a target premium. An election sponsorship ban is associated with a target premium decrease of 16.28%. Acquirers operating in countries where the financial support of elections is not allowed, lack the experience and skills necessary to successfully use targets' political connections. Moreover, acquirers from such countries might not value targets' connections. Additionally, I find a positive relation between the corruption index and the target premium. A one standard deviation increase in corruption is associated with a 5.21% increase in the target premium. Finally, I find that, on average, weaker levels of institutional development measured by corruption control, government effectiveness, administrative quality, rule of law, and voice and accountability, are also positively related to the target premium.

Overall, I observe that the institutional environment in acquirers' home countries affects their attitude towards political relations and their demand for politically connected targets. Acquirers from countries with greater levels of corruption, weaker institutions, and more rigid political systems seem more accustomed to corporate-political relationships and are more likely to use them in corporate decision-making. Consequently, firms from these countries develop knowledge and skills on how best use political relationships. Therefore, they are more interested in acquiring politically connected firms and are willing to pay higher premiums for them.

7. Summary and discussion

7.1 Conclusion

This essay examines the demand for politically connected targets from foreign and domestic acquirers. Consistent with the argument that foreign acquirers might extract greater benefits from politically connected targets, they should have a greater demand for such firms and, thus, be willing to pay a higher premium for them. I find that foreign acquirers familiar with political relations or expecting to generate greater returns from acquisitions of connected targets are more interested in completing the transactions. I observe that larger and more profitable foreign acquirers, traditionally engaged in corporate-political relationships, are more likely to complete the acquisitions of connected targets than domestic firms. I also determine that foreign acquirers choose to approach transactions to increase the probability of completing the deal. More specifically, foreign acquirers are more likely to attempt a tender offer and pay in cash than domestic acquirers, which results in fewer competitive bids.

Additionally, I examine whether an acquirer's home country environment affects its demand for politically connected targets and the premium it is willing to pay for the target. I find that acquirers from countries with high levels of corruption, weaker institutional development, and fewer political agents pay higher premiums for politically connected targets. This result is consistent with the argument that acquirers with political experience anticipate exploiting the target's political relations to generate corporate wealth.

7.2 Implications for Future Research

These results have important implications for the theory of corporate-political relationships. They help to estimate the demand for political connections from different acquirers and to understand whether firms are willing to pay for access to relationships with politicians. Additionally, my results provide insights into how country characteristics

help firms to value political connections during the acquisition process.

I believe that there is further work to be done for the study of politically connected targets. First, because of the different cost-benefit analysis conducted by foreign acquirers, it might be interesting to compare their demand for connected and non-connected targets. Such setup allows to further examine how the size of targets' political contributions might affect firms' probability of completion, target premium, and other deal characteristics.

Also, acquisition attempts by foreign firms are usually more carefully examined by the FCC and the Department of justice. Furthermore, certain acquisitions of politically connected targets or firms closely working with the government might be subject to a special review. The regulations and the procedure of the review process might affect the type of acquirers interested in politically connected targets. In turn, it could influence the overall level of interest for the target and the premium acquirers are willing to pay for it.

It might be interesting to examine corporate political strategy after acquisitions are completed. If a merged firm continues to maintain political relationships previously established by the target, it might indicate that the acquirer also finds targets' relationships with politicians quite useful and hopes to extract benefits from these relationships. On the contrary, if a target's political activity is suspended following the acquisition, it might indicate that the acquirer does not see political relations as value enhancing and might even view political contributions as a consequence of a free cash flow problem within the firm.

Finally, a further analysis of how acquirers use targets' political connections after the completion is needed. Acquisitions of targets with established political connections provide acquirers with immediate competitive advantages over non-connected rival firms. Such transactions help acquirers to save the resources on establishing their own political

relations and allow them to immediately exploit the connections to generate greater benefits. These benefits in the form of government contracts, lower tax rates, and lower cost of capital could be used to measure the long-term return from acquisitions of politically connected targets.

Table 14: Mergers and Acquisitions Summary

This table presents the distributions of mergers and acquisitions in the sample. Panel A presents the distribution by the announcement year. Panel B presents the distribution by acquirer's country. Panel C presents the distribution by target's industry.

Panel A: Distribution by Year

Year	N	% Total
1990	11	1.27
1991	15	1.73
1992	21	2.42
1993	12	1.39
1994	21	2.42
1995	32	3.7
1996	24	2.77
1997	37	4.27
1998	34	3.93
1999	65	7.51
2000	50	5.77
2001	30	3.46
2002	15	1.73
2003	18	2.08
2004	23	2.66
2005	44	5.08
2006	42	4.85
2007	41	4.73
2008	38	4.39
2009	30	3.46
2010	35	4.04
2011	33	3.81
2012	41	4.73
2013	25	2.89
2014	37	4.27
2015	47	5.43
2016	45	5.2
Total	866	100.00

Panel B: Distribution by Acquirer's Country

Country	N	% Total
United States	698	80.6
United Kingdom	23	2.66
Canada	20	2.31
Germany	18	2.08
France	17	1.96
Switzerland	16	1.85
Japan	15	1.73
Netherlands	10	1.15
Spain	10	1.15
Australia	5	0.58
South Korea	5	0.58
Bermuda	3	0.35
Finland	3	0.35
India	3	0.35
Mexico	3	0.35
Ireland	2	0.23
Israel	2	0.23
Sweden	2	0.23
Taiwan	2	0.23
Argentina	1	0.12
Austria	1	0.12
Belgium	1	0.12
China	1	0.12
Denmark	1	0.12
Hong Kong	1	0.12
Malaysia	1	0.12
Puerto Rico	1	0.12
Singapore	1	0.12
Total	866	100.00

Panel C: Distribution by Target's Industry

Industry	SIC	N	% Total
Agriculture, Forestry, Fishing	01-09	40	4.62
Mining	10-14	32	3.70
Construction	15-17	1	0.12
Manufacturing	20-39	362	41.80
Transportation, Communications, Utilities	40-49	145	16.74
Wholesale Trade	50-51	7	0.81
Retail Trade	52-59	25	2.89
Finance, Insurance, Real Estate	60-67	117	13.51
Services	70-89	136	15.70
Public Administration	91-99	1	0.12
Total		866	100.00

Table 15: Targets and Acquirers Characteristics

This table summarizes targets' and acquirers' characteristics. Panel A presents targets' summary statistics. Panel B presents acquirers' summary statistics and their comparison for foreign and domestic acquirers. Total Assets represents firms' total assets. ROA is calculated as a ratio of net income to total assets. Debt-to-Assets is calculated as a ratio of total debt to total assets. BM is calculated as a ratio of book equity to market equity. Gov Industries equals the percentage of firms in regulated industries. Political 1Yr equals the percentage of firms with political spending one year before deal announcement. PAC 1Yr equals the amount firms contribute to PACs one year before deal announcement. Lobby 1Yr equals the amount firms spend on lobbying one year before deal announcement. Political 3Yr equals the percentage of firms with political spending three years before deal announcement. PAC 3Yr equals the amount firms contribute to PACs three years before deal announcement. Lobby 3Yr equals the amount firms spend on lobbying three years before deal announcement. Political 5Yr equals the percentage of firms with political spending five years before deal announcement. PAC 5Yr equals the amount firms contribute to PACs five years before deal announcement. Lobby 5Yr equals the amount firms spend on lobbying five years before deal announcement. Mean (median) values are presented in Panel B.

Panel A: Targets Summary

	N	25th Pctl	Mean	Median	75th Pctl	StDev
Total Assets (mil.)	866	656	17,545	2,258	8,768	101,474
ROA (%)	866	3.18%	8.15%	9.92%	15.40%	17.49%
Debt-to-Assets (number)	866	0.46	0.64	0.65	0.82	0.26
BM (number)	830	0.31	0.67	0.54	0.82	0.61
Regulated Industry (%)	866		30.25%			
Political 1Yr (%)	866		81.41%			
PAC 1Yr (\$)	866	0	45,144	2,000	29,750	120,903
Lobby 1Yr (\$)	866	0	482,004	0	230,000	1,356,190
Political 3Yr (%)	866		92.96%			
PAC 3Yr (\$)	866	0	135,152	12,800	110,860	354,098
Lobby 3Yr (\$)	866	0	2,436,834	86,250	595,000	34,254,264
Political 5Yr (%)	866		97.92%			
PAC 5Yr (\$)	866	0	204,070	19,738	155,000	555,617
Lobby 5Yr (\$)	866	0	3,140,203	140,000	880,000	34,710,569

Panel B: Acquirers Summary

	All	Domestic	Foreign	Domestic-Foreign	t-stat (Domestic-Foreign)
Total Assets (Mil.)	58,832 (10,672)	45,002 (8,837)	116,293 (27,640)	-71,291	-2.73***
ROA (%)	11.06% (11.54%)	11.84% (12.18%)	4.56% (7.96%)	7.28%	5.32***
Debt-to-Assets (number)	0.64 (0.63)	0.63 (0.80)	0.65 (0.65)	-0.02	-0.22
Regulated Industry (%)	34.99% (0.00%)	36.96% (0.00%)	25.60% (0.00%)	11.36%	3.03***
N	866	698	168		

Table 16: Deals Summary

This table summarizes deal characteristics. Panel A presents deals' statistical summary. Panel B presents deals distribution by foreign and domestic acquirers. Transaction Value represents the amount paid by acquirers. Target Premium is calculated as the change in targets' stock price from one month prior to deal announcement to one day prior to deal announcement. Toehold indicator equals one when acquirer owns target's stock prior to a deal. Toehold equals the percentage of target's shares owned by acquirer prior to a deal. Competed equals the percentage of all deals being completed. Time to Completion equals the number of days between deal announcement and completion. Bidders equals the number of firms bidding on a target. Considerations equals number of offers received by a target. Challenged equals the percentage of deals receiving competing offers. Hostile equals the percentage of hostile deals. Tender equals the percentage of deals structured as tender offers. Cash Only equals the percentage of deals with cash only payment method. Targets with Antitakeover Defense equals the percentage of deals with targets using antitakeover defenses. Same Industry equals the percentage of deals with acquirer and target operating in the same 3-digit SIC industry. Regulated Targets equals the percentage of deals with targets in regulated industries. Mean variables are presented in Panel B.

Panel A: Deals Summary

	N	25th Pctl	Mean	Median	75th Pctl	StDev
Transaction Value (mil.)	866	453	6,337	1,859	6,214	12,738
Target Premium (%)	769	17.50%	38.30%	32.70%	50.58%	45.00%
Toehold (indicator)	866	0.00	11.20%	0.00	0.00	0.32
Toehold (%)	861	0.00%	3.25%	0.00%	0.00%	12.65%
Competed (%)	866	100.00%	81.29%	100.00%	100.00%	39.02%
Time to Completion (days)	704	71	148	126	195	120
Bidders (number)	866	1.00	1.14	1.00	1.00	0.44
Considerations (number)	866	1.00	2.09	2.00	2.00	1.38
Challenged (%)	861	0.00%	11.85%	0.00%	0.00%	32.33%
Hostile (%)	866	0.00%	5.20%	0.00%	0.00%	22.21%
Tender (%)	866	0.00%	17.32%	0.00%	0.00%	37.86%
Cash Only (%)	866	0.00%	40.30%	0.00%	100.00%	49.08%
Targets with Antitakeover Defense (%)	866	0.00%	11.89%	0.00%	0.00%	32.39%
Same Industry (%)	866	0.00%	36.61%	0.00%	100.00%	48.20%
Regulated Targets (%)	866	0.00%	30.25%	0.00%	100.00%	45.96%

Panel B: Deals Distribution by Acquirers' Type

	Domestic	Foreign	Domestic- Foreign	t-stat (Domestic- Foreign)
Transaction Value (mil.)	6,574	5,350	1,224	1.37
Target Premium (%)	37.08%	43.58%	-6.51%	-1.26
Toehold (indicator)	9.89%	16.67%	-6.78%	-2.19**
Toehold (%)	2.61%	5.92%	-3.32%	-2.45**
Competed (%)	79.80%	87.50%	-7.70%	-2.59**
Time to Completion (days)	152	136	16	1.46
Bidders (number)	1.16	1.07	0.09	3.39***
Considerations (number)	2.10	2.01	0.09	0.77
Challenged (%)	12.99%	7.14%	5.8%	2.47**
Hostile (%)	5.59%	3.57%	2.0%	1.20
Tender (%)	15.47%	25.00%	-9.5%	-2.63***
Cash Only (%)	36.39%	56.55%	-20.2%	-4.84***
Targets with Antitakeover Defense (%)	13.75%	4.17%	9.6%	4.74***
Same Industry (%)	38.40%	29.17%	9.2%	2.32**
Regulated Targets (%)	31.38%	25.60%	5.8%	1.46
N	698	168		

Table 17: Acquirers' Type and Deal Completion

This table presents the results of logistic regressions. The dependent variable in these regressions is the completion indicator variable, which equals one if a deal is completed and zero otherwise. Foreign indicator variable equals one if an acquiring firm is foreign and zero otherwise. Size Interaction is the interaction of Foreign indicator with an acquirer's size indicator, which equals one if an acquirer's total assets are above median. Profitability Interaction is the interaction of Foreign indicator with an acquirer's profitability indicator, which equals one if an acquirer's return on assets is above median. Toehold equals the percentage of target's shares owned by acquirer prior to a deal. Cash Only indicator equals one if a deal's payment method is cash only and zero otherwise. Hostile indicator equals one if a deal is hostile and zero otherwise. Tender Offer indicator equals one if a deal is a tender offer and zero otherwise. Challenged indicator equals one if there is a competitive bid and zero otherwise. Log (Target TA) equals a natural log of a target's total assets. Target ROA is calculated as a ratio of net income to total assets. Antitakeover Defense indicator equals one if a target has antitakeover defenses and zero otherwise. Log (Acq TA) equals a natural log of an acquirer's total assets. Same Industry indicator equals one if a target and an acquirer operate in the same 3-digit SIC code. Chi-square statistics and t-statistics are presented in parentheses. ***, **, * indicate statistical significance at 1%, 5%, and 10% levels, respectively.

	(1) Completed=1	(2) Completed=1	(3) Completed=1
Intercept	-1.4688 (1.51)	-0.2407 (0.04)	-1.5237 (1.65)
Foreign	0.2754 (0.81)		
Size Interaction		0.6366* (3.02)	
Profitability Interaction			2.2545* (3.42)
Toehold	-0.0101 (1.25)	-0.0086 (0.92)	-0.0102 (1.29)
Cash Only	-0.0522 (0.04)	0.0975 (0.17)	-0.1117 (0.20)
Hostile	-2.4359*** (33.31)	-2.4009*** (33.12)	-2.5354*** (34.51)
Tender Offer	1.0416*** (7.93)	1.0125*** (7.87)	1.0094*** (7.43)
Challenged	-2.2248*** (61.85)	-2.1773*** (60.68)	-2.3037*** (63.48)
Log (Target TA)	-0.1858** (4.66)	0.0147 (0.05)	-0.1808** (4.36)
Target ROA	1.1972* (2.98)	0.8457 (1.69)	1.3024* (3.54)
Antitakeover Defense	-0.2968 (0.74)	-0.0996 (0.09)	-0.3132 (0.81)
Log (Acq TA)	0.3267*** (18.13)		0.3383*** (19.56)
Same Industry	-0.0830 (0.14)	-0.0898 (0.17)	-0.0359 (0.03)
Year FE	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
N	861	862	856
Adj R-sq	20.2%	17.9%	20.4%

Table 18: Acquirers' Type and Deal Characteristics

This table presents the results of logistic regressions. The dependent variables in these regressions are tender offer, cash only, and competitive bid indicators. Foreign indicator variable equals one if an acquiring firm is foreign and zero otherwise. Toehold equals the percentage of target's shares owned by acquirer prior to a deal. Cash Only indicator equals one if a deal's payment method is cash only and zero otherwise. Hostile indicator equals one if a deal is hostile and zero otherwise. Tender Offer indicator equals one if a deal is a tender offer and zero otherwise. Challenged indicator equals one if a deal is challenged by another bidder and zero otherwise. Log (Target TA) equals a natural log of a target's total assets. Target ROA is calculated as a ratio of net income to total assets. Antitakeover Defense indicator equals one if a target has antitakeover defenses and zero otherwise. Log (Acq TA) equals a natural log of an acquirer's total assets. Same Industry indicator equals one if a target and an acquirer operate in the same 3-digit SIC code. Chi-square statistics are presented in parentheses. ***, **, * indicate statistical significance at 1%, 5%, and 10% levels, respectively.

	(1) Tender Offer=1	(2) Cash Only=1	(3) Challenged=1
Intercept	-1.8702 (1.87)	0.5876 (0.24)	-4.2410*** (12.87)
Foreign	0.5062* (3.42)	0.4848** (5.06)	-1.2431** (5.28)
Toehold	0.0177** (5.07)	0.0115* (2.85)	-0.0053 (0.68)
Cash Only	1.7841*** (47.61)		-0.0274 (0.02)
Hostile	1.7503*** (15.30)	0.1902 (0.21)	0.3000 (0.47)
Tender Offer		1.8008*** (49.42)	0.2141 (0.80)
Challenged	1.0162*** (8.47)	-0.1035 (0.14)	
Log (Target TA)	-0.3934*** (19.34)	-0.2740*** (18.43)	0.3784*** (33.79)
Target ROA	1.2782** (4.21)	0.5866 (1.34)	-0.0484 (0.01)
Antitakeover Defense	0.7846* (3.83)	-0.8081** (5.96)	-0.3105 (1.29)
Log (Acq TA)	0.1018 (1.84)	0.2651*** (20.88)	0.0426 (0.58)
Same Industry	0.0131 (0.00)	-0.02364 (1.72)	0.1163 (0.46)
Year FE	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes
N	861	861	861
Adj R-sq	26.1%	27.1%	21.9%

Table 19: Acquirers' Type and Target Premium

This table presents the results of an OLS regression of a target premium on a foreign indicator. The dependent variable in these regressions is target premium. Foreign indicator variable equals one if an acquiring firm is foreign and zero otherwise. Foreign*Regulated Acquirer represents the interaction of Foreign and Regulated Acquirer variables. Size Interaction is the interaction of Foreign indicator and acquirer's total assets. Profitability Interaction is the interaction of Foreign indicator and acquirer's return on assets. Debt Interaction is the interaction of Foreign indicator and acquirer's debt-to-equity. Toehold equals the percentage of target's shares owned by acquirer prior to a deal. Cash Only indicator equals one if a deal's payment method is cash only and zero otherwise. Hostile indicator equals one if a deal is hostile and zero otherwise. Tender Offer indicator equals one if a deal is a tender offer and zero otherwise. Challenged indicator equals one if a deal is challenged by another bidder and zero otherwise. Log (Target TA) equals a natural log of a target's total assets. Target ROA is calculated as a ratio of net income to total assets. Antitakeover Defense indicator equals one if a target has antitakeover defenses and zero otherwise. Log (Acq TA) equals a natural log of an acquirer's total assets. Same Industry indicator equals one if a target and an acquirer operate in the same 3-digit SIC code. Regulated Acquirer indicator equals one if an acquirer operates in a regulated industry and zero otherwise. Coefficient of Size Interaction is multiplied by 1,000. T-statistics are presented in parentheses. ***, **, * indicate statistical significance at 1%, 5%, and 10% levels, respectively.

	(1)	(2)	(3)	(4)	(5)
	Target Premium	Target Premium	Target Premium	Target Premium	Target Premium
Intercept	33.3748* (1.71)	32.1982 (1.63)	25.2175 (1.19)	34.3921* (1.78)	35.6249* (1.82)
Foreign	6.7226 (0.72)	30.2247 (1.53)	8.6466 (0.92)	-1.9729 (-0.13)	2.0880 (0.22)
Foreign*Regulated Acquirer		-7.0673 (-0.69)			
Size Interaction			-0.0250** (-2.08)		
Profitability Interaction				99.7237* (1.82)	
Debt Interaction					18.9627** (1.98)
Toehold	-0.0061 (-0.05)	-0.0070 (-0.06)	0.0015 (0.01)	-0.0833 (-0.57)	-0.0021 (-0.02)
Cash Only	6.1883* (1.66)	5.9952 (1.61)	5.5774 (1.50)	2.2795 (0.59)	5.8078 (1.56)
Hostile	3.4339 (0.50)	3.0206 (0.43)	3.5239 (0.51)	-0.4316 (-0.06)	4.1610 (0.60)
Tender Offer	12.6553*** (2.81)	12.7654*** (2.82)	12.3423*** (2.75)	13.5307*** (2.89)	12.1407*** (2.70)
Challenged	16.9207*** (3.33)	16.8159*** (3.31)	16.8371*** (3.32)	16.5815*** (3.18)	16.9010*** (3.32)
Log (Target TA)	-4.5316*** (-3.71)	-4.4763*** (-3.66)	-4.6002*** (-3.77)	-3.9015*** (-3.01)	-4.4378*** (-3.62)
Target ROA	-40.9418*** (-3.93)	-41.3795*** (-3.97)	-41.9756*** (-4.04)	-53.4576*** (-4.66)	-41.0559*** (-3.95)
Antitakeover Defense	6.9162 (1.37)	6.9761 (1.38)	6.7038 (1.33)	7.9361 (1.56)	6.4748 (1.28)
Log (Acq TA)	1.2087 (1.07)	1.4234 (1.25)	2.2974 (1.41)	1.3154 (1.13)	1.2228 (1.09)
Same Industry	2.4649 (0.73)	2.4251 (0.72)	2.5498 (0.76)	4.3902 (1.26)	3.0744 (0.91)
Regulated Acquirer		-4.8457 (-0.84)			
Year, Industry, Country FE	Yes	Yes	Yes	Yes	Yes
N	759	759	759	653	759
Adj R-sq	19.7%	19.7%	20.0%	25.6%	20.0%

Table 20: Acquirers' Country Characteristics and Target Premium

This table presents the analysis of acquirers' country characteristics and target premiums. Panel A presents the statistical summary of acquirers' country characteristics. Panel B presents the results of OLS regressions of target premium on acquirers' country characteristics. Corporatism Rank represents the level of corporatism in a country, which ranges from 0 to 5. Candidate Sponsorship Ban (%) equals the percentage of acquirers' countries with a ban on corporate sponsorship of political elections. Candidate Ban indicator equals one if a country has a corporate sponsorship ban and zero otherwise. CPI represents the corruption index and ranges between 0 and 10. Corruption Control equals the level of a national control of corruption. Government Effectiveness equals the level of a national government effectiveness. Political Stability represents the likelihood that the government will be destabilized or overthrown. Administrative Quality defines the quality of bureaucracy. Rule of Law equals the level of confidence in law enforcement. Voice and Accountability equals the level of freedom of expression, association, and media. Corruption Control, Government Effectiveness, Political Stability, Administrative Quality, Rule of Law, and Voice and Accountability variables range between -2.50 and 2.50. Control variables include Toehold, Cash Only, Hostile, Tender Offer, Log (Target TA), Target ROA, Antitakeover Defense, Log (Acq TA), Same Industry, Inflation, Exchange Rate. T-statistics are presented in parentheses. ***, **, * indicate statistical significance at 1%, 5%, and 10% levels, respectively.

Panel A: Acquirers' Country Characteristics

	N	Min	25th Pctl	Mean	Median	75th Pctl	Max	StDev
Corporatism Rank	731	0.00	2.00	1.89	2.00	2.00	5.00	0.69
Candidate Sponsorship Ban (%)	729	0.00	100.00	87.38	100.00	100.00	100.00	33.23
CPI	685	2.80	7.30	7.51	7.50	7.66	9.80	0.75
Corruption Control	663	-0.51	1.38	1.55	1.57	1.70	2.45	0.34
Government Effectiveness	663	-0.17	1.52	1.62	1.61	1.76	2.23	0.26
Political Stability	663	-1.34	0.44	0.65	0.64	0.94	1.59	0.43
Administrative Quality	663	-0.55	1.45	1.51	1.59	1.67	2.05	0.28
Rule of Law	664	-0.73	1.55	1.56	1.61	1.63	2.00	0.25
Voice and Accountability	664	-0.56	1.11	1.24	1.31	1.34	1.70	0.19

Panel B: Acquirers' Country Characteristics and Target Premium

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
	Target Premium	Target Premium	Target Premium	Target Premium	Target Premium	Target Premium	Target Premium	Target Premium	Target Premium
Intercept	31.3036 (1.22)	44.5399* (1.72)	-8.4075 (-0.20)	-2.3860 (-0.09)	4.5857 (0.16)	27.8554 (1.06)	2.2193 (0.08)	8.9117 (0.30)	-12.6100 (-0.38)
Corporatism Rank	5.0264*** (2.67)								
Candidate Ban		-16.2803*** (-2.86)							
CPI			5.2095* (1.78)						
Corruption Control				111.5967*** (3.44)					
Government Effectiveness					87.4140** (2.05)				
Political Stability						18.2908 (1.44)			
Administrative Quality							92.8159*** (2.61)		
Rule of Law								72.2765 (1.57)	
Voice and Accountability									37.7261** (2.08)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	589	588	521	503	503	503	503	503	503
Adj R-sq	18.6%	18.8%	19.3%	21.2%	19.9%	19.5%	20.3%	19.6%	19.9%

CHAPTER V. THE EFFECT OF POLITICAL WEDGE ON CORPORATE DECISIONS, PERFORMANCE, AND VALUE

1. Introduction

It is well known that many firms engage in political activities and financially support political campaigns and legislative initiatives. The existing literature shows that in exchange firms receive multiple benefits from their relationships with politicians in the form of government contract, subsidies, and greater access to capital markets (Khwaja and Mian, 2005; Adhikari, Derashid, and Zhang, 2006; Faccio, 2006; Faccio, Masulis, and McConnell, 2006). Firm managers, as individuals, can also donate to candidates or parties of their own choice, regardless of the political strategy of their firm. The existing literature demonstrates that often CEOs engage in politics to preserve their own interests and to improve their economic well-being and career perspectives (Aslan and Grienstein, 2012; Ovtchinnikov and Panteleoni, 2012). At the same time, corporate and individual contributions can represent something more than a political investment project. I believe that a thorough examination of beliefs and values represented by a political orientation could help to understand the environment and dynamics within a firm.

This essay examines the effect of a difference in political orientation between a firm and its CEO on corporate decision-making, performance, and value. Since a difference in political orientation could indicate a difference in views, values, beliefs, and preferences of directors and a CEO, such disagreement might have a deteriorating effect on a firm and its shareholders. Due to a lack of a proper communication, collaboration, and trust within a firm, a difference in political orientation could negatively impact the quality of corporate decisions and, consequently, firm performance and value.

I empirically measure a difference in political orientation as a political wedge, which calculates the difference between firm's and CEO's net contributions to the Republicans. I primarily use a political wedge indicator throughout the essay as a main independent variable. I alternatively use, however, a size of a political wedge and its direction to check the robustness of main results.

The evidence presented in this essay suggests a negative effect of a difference in political orientation on firm's corporate decisions, performance, and value. First, I examine the relation between a political wedge and firm's resource management practices. I document that firms with a political wedge spend more resources than their industry peers. Thus, I find that they underinvest in cash and overinvest in capital expenditures. Such larger spending, however, does not always indicate an inefficient use of firm's resources. I observe that the intensity of capital expenditures of firms with a political wedge is 0.56% higher than of firms without a wedge. At the same time, however, even though these firms make R&D investments similar to those of industry peers, their efficiency of R&D spending is lower by 0.46% (9.2% of the sample average).

Further I examine whether firms with a political wedge are more likely to make value destroying acquisitions. Contrary to the hypothesis of a deteriorating effect of a difference in views and values on corporate decisions, I do not find a relation between a political wedge and short-term acquisition returns. I document, however, that three year buy-and-hold acquisitions returns of firms with a political wedge are 13.1% higher.

I also examine the relation between a political wedge and firm performance. I document that firms with a political wedge underperform, as measured by both accounting and market returns. The negative effect of a political wedge on performance also becomes

stronger with its size. I find that a one standard deviation in a wedge decreases firm's return on equity and earnings per share by 1.6% and \$0.45, respectively. A similar increase in the size of a wedge is associated with a 5.0% decrease in firm stock returns.

The presented evidence also suggests a similar effect of a political wedge on firm value. Since the negative effect of a wedge on firm performance is known to firm's investors, I expect it to also be reflected in firm valuation. I find that the presence of a political wedge decreases Tobin's Q and market-to-book ratio by 23.3% and 8.6%, respectively.

Main results presented in this essay are robust to multiple alternative specifications of a political wedge. I also calculate the wedge as a ratio of net Republican contributions in the attempt to capture the effect of the contribution size. I find that the size of contributions made by a firm and its CEO does not provide any additional information to understanding the effect of a difference in political orientation on a firm. Additionally, I examine the direction of a wedge. If a CEO made a larger (smaller) percent of contributions to the Republicans than a firm, I call it a CEO (Firm) wedge. I document that directional wedge indicators have a similar effect on firm's decisions, performance, and value as compared to a main wedge variable.

Finally, I examine the effect of changes in regulations of corporate political contributions on a political wedge. Citizens United court ruling has led to an increase in political spending by corporations and labor unions. After 2010 firms are allowed to make unlimited contributions and the ones made to Super PACs do not have to be disclosed. I document that a probability and size of a political wedge in my sample decrease after the

regulations. I find, however, that the effect of a wedge on firm's resource management, performance, and value remains similar.

The remainder of this essay is organized as follows. Section 2 discusses the difference in political orientation and presents main hypotheses. Section 3 describes the data collection process and the descriptive statistics of the sample. Main empirical results are presented in section 4. The discussion of the results and future research implications are presented in section 5.

2. Difference in political orientation and its effect on a firm

2.1 Difference in Political Orientation

The existing literature documents a close link between personal characteristics, political ideology, and behavior. Feldman (1988) argues that political attitude and orientation are consistent with certain core beliefs and values, while Goren (2005) suggests that political views even represent individual's beliefs and opinions about a variety of social issues. This relationship goes both ways. By examining individuals' political orientation, we can infer a lot about their basic values, traits, personal preferences, and attitudes, and the other way around. Caprara et al. (2006) examine values and traits of voters of two major coalitions in the Italian national election of 2001. They document strong differences in individual characteristics of the two voter groups with different political orientation. Similarly, Jost, Nosek, and Gosling (2008) examine implicit and explicit preferences of conservators and liberals and report important personality and lifestyle differences.

Since political orientation could serve as a proxy of personality and opinions, a difference in political views between individuals could indicate a disagreement in their basic core values, views, and preferences. Similarly, a difference in political orientation in a corporate setting might arise if its CEO and a firm, which is represented by a board of directors, hold different political views³². Such difference in corporate political orientation could indicate a disagreement in values, views, and preferences between a CEO and a firm.

This difference in core beliefs and values between a manager and a firm could have a deteriorating effect on a work environment, interfirm relationships, firm operations, and consequently its performance. Such disagreement might negatively affect the environment and work ethics of key employees, causing a power struggle within a firm (Mintzberg, 1989; Hackman, 2002). The presence of interpersonal conflicts might lead to a distraction from work responsibilities. Moreover, firm agents, such as a CEO or directors, might choose to affect their decision-making to advantage their personal interests instead of those of firm's shareholders.

Such disagreement might also result in a lack of communication and coordination within a firm (Bunderson and Sutcliffe, 2002). In return, it could negatively affect corporate decision-making and interests of shareholders. Additionally, a lack of trust

³² The process of decision making for a political investment is the same as for real projects. Political spending is regulated by the same laws, rules, and interests as other business decisions (Bebchuk and Jackson Jr., 2010). Since political spending represents a corporate investment decision, it can become a tool used by managers to pursue personal interests. Managers might use their power to dominate the board's decision on political spending and convince directors to contribute to politicians CEOs personally support. The board discusses potential benefits to the firm from supporting politicians suggested by the manager, proposes the alternative strategy, and votes to finalize the set of candidates and parties to support (Clawson, Neustadtl, and Weller, 1998; Burris, 2001; Bebchuk and Jackson Jr., 2010). As any other business decision political strategy is intended to benefit the firm and to serve solely the interests of its shareholders. The duty of the board is to preserve the interests of the firm and mitigate the effect of agency costs on a firm's political spending.

between a CEO and a board of directors could increase the information asymmetry between them and shareholders and affect a firm's corporate governance. If a board does not agree or trust a CEO, it could result in excessive monitoring and, consequently, a diminishing power and role of a manager within a firm. At the same time, if a CEO does not trust a board of directors, he is more likely to make decisions to increase personal gains.

Additionally, a disagreement in views and values between a CEO and a firm could affect a formulation of corporate visions and goals. A decision of a firm's future requires a collaboration between a board and a CEO, as well as their mutual understanding of shareholders' interests. If a firm and a CEO have different views and values, it could be more difficult for them to decide on where a firm should be in the future and what corporate decisions are necessary to achieve these goals.

Also a lack of agreement and collaboration within a firm could affect its decision-making process. First, parties with different views are more likely to compromise rather than agree on a corporate decision with the best outcome for a firm. Their inability to agree with each other can be reflected in making suboptimal decisions or only a partial implementation of corporate plans. Second, a lack of collaboration could also affect the time it takes for a CEO and a board to make a decision. As a result, some corporate decisions could be delayed or even cancelled.

2.2 Corporate Decisions

Such difference in values, views, and preferences, represented by a difference in political orientation between a firm and a CEO, could affect its corporate decision-making. A board-CEO disagreement about a firm's future and their inability to collaborate might

affect the approval of corporate decisions and their implementation. Additionally, directors or a CEO could pursue personal gains instead of interests of firm's shareholders.

A poor quality of corporate decisions affected by a difference in political orientation could be captured by firm's resource management and allocation policies. A firm could make suboptimal decisions and over (under) invest in cash, innovations, and other expansion projects. As a result of a bad resource management, the investment efficiency of its resource spending will be lower. Consequently, to produce \$1 of sales a firm needs to invest more resources than a firm without a difference in political orientation. Therefore, I hypothesize:

H1: The investment efficiency of firms with a difference in political orientation is lower than of firms without such a difference.

The effect of a difference in political orientation on corporate decision-making could also be measured by the quality of acquisitions attempted by a firm. Since a firm and its CEO might not be able to agree on investment projects maximizing shareholders' wealth, it is more likely for a firm to undertake value destroying acquisitions instead. I expect a difference in political orientation to have a negative effect on acquisition returns and hypothesize the following:

H2: The acquisition returns of firms with a difference in political orientation are lower than of firms without a difference.

2.3 Firm Performance

A difference in political orientation and following bad corporate decision-making have an effect of firm's accounting and market performance. Suboptimal allocation of

resources, inefficient spending, and value destroying acquisitions are reflected in financial statements and reported to firm's investors. In turn, investors negatively react to a poor accounting performance which is reflected in a firm's stock price. Overall, I expect a negative relation between a difference in political orientation and firm's performance. Thus, I hypothesize:

H3: Firms with a difference in political orientation exhibit lower accounting and market performance than firms without a difference.

2.4 Firm Value

Firm value represents an investors' assessment of firm's long-term performance and opportunities available to a firm. Bad corporate decisions caused by a difference in political orientation are reflected in poor firm performance and are noticed by investors. Consequently, poor market performance of a firm's stock suggests a lower firm valuation. Therefore, I hypothesize the following:

H4: Firms with a difference in political orientation have a lower market value than firms without a difference.

3. Data and Sample Construction

3.1 Data

Due to the availability of the political contributions data, I start my sample construction with Compustat firms between 1990 and 2016. Then I merge the sample with the Execucomp database to obtain the information about firms' CEOs. Information about corporate and individual political contributions of chief executive officers comes from the Federal Election Commission. Finally, I use I/B/E/S for analyst coverage, ISS for corporate

governance data, and 13F database for institutional ownership. My final sample consists of 18,225 firm-year observations.

3.2 Firms' Characteristics

Panel A of Table 21 presents the statistical summary of my sample firms. I find that an average firm has total assets of \$11.2 billion, a market capitalization of \$2.7 billion, and a book-to-market ratio of 0.61. Almost 30% of sample firms pay dividends to their shareholders. Sample firms are profitable, with the average ROA of 13.4% and a ROE of 9.6%. Additionally, firms in the sample have a mean leverage of 56% debt. An average sample firm is covered by 10 analysts and has an institutional ownership of 68.2%. Firms in my sample have an average board size of 10, with about 7 of them independent.

3.3 CEOs' Characteristics

Panel B of Table 21 presents a summary of the CEOs' characteristics. An average chief executive officer in my sample is 56 years old and receives a mean total compensation of \$4.83 million, of which salary represents almost 30%. The average stock and options awards in the sample equal \$2.15 million and \$1.00 million, respectively. Additionally, 69.3% of CEOs also serve as their chairman of the board.

3.4 Summary of Political Contributions

The statistical summary of political contributions and the main political variables is presented in Table 22. The distribution of political contributions made by the sample firms is presented in Panel A. On average, sample firms make total annual contributions of \$37,025, which include targeted donations to individual candidates (\$20,735), donations to political parties (\$15,282), and other small contributions (\$1,635). On average, sample

firms make larger donations to support Republican candidates and parties than Democratic (\$20,422 v. \$11,618, respectively). The statistical distribution of the individual political contributions of firms' executive officers is presented in Panel B of Table 22. Overall personal contributions are smaller than corporate donations made by sample firms. On average, CEOs make total annual contributions of \$4,581. Unlike the sample firms, CEOs donate more to political parties rather than to individual candidates. On average, they contribute \$2,357 to the Republican and \$1,026 to the Democratic parties and candidates.

I empirically measure the difference in political orientation between the firm and the CEO in multiple ways. First, I calculate the political wedge as the difference in net contributions to the Republicans between the firm and its CEO^{33,34}:

$$Wedge = \left| \left(\frac{Republican_{CEO} - Democratic_{CEO}}{Total\ Contributions_{CEO}} \right) - \left(\frac{Republican_{Firm} - Democratic_{Firm}}{Total\ Contributions_{Firm}} \right) \right|, \quad (1)$$

which ranges between 0 and 1. I also create an indicator variable Wedge Dummy, which equals 1 if the political wedge is greater than 0. Finally, I create the indicator variables Firm_Zero and CEO_Zero to capture whether only the firm or the CEO make political contributions, but not both.

The statistical summary of political difference measures is presented in Panel C of Table 22. On average, the difference in political orientation between sample firms and their CEOs is 16.5% for my sample firms. The average size of the wedge dummy equals 0.52. Additionally, 29.5% of firms do not make political donations, while their CEOs make

³³ The percent of contributions to Republicans and Democrats are compliments and sum up to 100%. Calculating the wedge using either distribution of contributions generates the same results.

³⁴ I also calculate the wedge using the gross contributions to Republicans, instead of the net contributions. I reestimate main regressions using the alternative wedge and find similar results.

contributions. Only in 8.6% of sample firms do CEOs fail to make contributions when their firms do so.

The correlation and autocorrelation coefficients of the difference measures are presented in Panel D of Table 22. I observe that the Wedge Dummy is negatively correlated with the Firm_Zero and CEO_Zero indicators. I also report that indicator variables are more consistent over time than the wedge variable. The autocorrelation coefficient of the Wedge Dummy equals 0.71, while the coefficient for the Wedge equals 0.21. I conclude that the presence of the difference in political orientation within the firm is stable, while the size of the difference has substantial annual variation. Because of the high time-series variation in the Wedge variable, I use the Wedge Dummy as the main independent variable throughout this essay³⁵. The other indicator variables Firm_Zero and CEO_Zero are also quite stable over time, with the autocorrelation coefficients of 0.58 and 0.60, respectively.

3.5 Distribution of Political Differences

The distributions of the political difference measures are presented in Table 23. An industry statistical summary is presented in Panel A³⁶. I find the largest number of firms with political differences in transportation (26.4%), public administration (17.6%), and financial services (17.1%). Though the wholesale trade industry has the smallest number of firms with political difference (8.1%), it has the greatest wedge of 0.65. The smallest wedge, 0.35, occurs with public administration firms. I also observe the greatest number of politically inactive firms whose CEOs make political contributions in the construction

³⁵ I reestimate the main results using the Wedge variable and present them in section 4.5.

³⁶ I use the 2-digit SIC code to define the industry.

industry (39.2%). 17.0% of public administration firms make political contributions, while their CEOs chose not to donate.

The distribution of political difference measures by corporate governance is presented in Panel B of Table 23. First, I compare the variables for firms with dual CEO/chairman appointments and those without. I find that the first group of firms is more likely to have the difference in political orientation between the firm and manager. The difference in the size of the wedge between the two groups, however, is statistically insignificant. I also compare the wedge variables for firms with different board size and outside appointments. I observe that firms with larger and busier boards are more likely to have a difference in political orientation within the firm. The size of the wedge in these groups, however, is smaller. This evidence is consistent with the argument that larger and more experienced boards are more likely to view political spending as an investment outlay and contribute to political activity.

4. Empirical results

4.1 Presence of the Political Wedge and Allocation of Resources

Panel A of Table 24 presents the statistical summary of the variables measuring how firms allocate available resources. The cash ratio is calculated as the industry adjusted ratio of cash and marketable securities to firms' total assets. Similarly, capital expenditures and research and development ratio represent the industry-adjusted ratios of capital expenditures and R&D expenditures to total assets³⁷. If the industry-adjusted ratios are above (below) zero, it implies that the firm overinvests (underinvests) in cash, capital

³⁷ I follow D'Mello and Miranda (2010) in the calculation of industry-adjusted ratios.

expenditures, or research and development compared to their peers³⁸. The average adjusted cash ratio equals 9.3%, suggesting that firms in the sample overinvest in cash. The mean industry-adjusted capital expenditures and R&D ratios are also positive and equal 0.8% and 1.3%, respectively. Capital expenditures and R&D intensity represent how effectively firms use their resources and are calculated as the ratios of expenditures or R&D to sales (Straska and Waller, 2010; Hovakimian and Li, 2011). The mean intensity of capital expenditures and research and development equals to 5.0% each.

The comparison of the resource allocation measures by the Wedge Dummy is presented in Panel B of Table 24. Consistent with hypothesis 1, I expect that firms with the difference in political orientation deviate from industry practices when allocating resources. Similarly, when it comes to the use of resources, I hypothesize these firms exhibit a lower intensity of capital expenditures and R&D spending. The results presented in Panel B suggest that firms with a difference in political orientation underinvest in cash, capital expenditures, and research and development compared to their industry peers. Additionally, I document that these firms exhibit a higher intensity of capital expenditures and a lower intensity of R&D spending.

To examine the relation between the difference in political orientation within the firm and its use of resources, I estimate the following regression³⁹:

$$Ratio = \alpha + \beta_1 * Wedge\ Dummy + \beta_i * Controls + \beta_j * Fixed\ Effects + \varepsilon \quad (2)$$

³⁸ I use 4-digit SIC codes to identify industry peers.

³⁹ Existing literature documents an effect of a CEO gender on corporate decision making. Faccio, Marchica, and Mura (2016) find that firms managed by female CEOs have lower leverage and less volatile earnings. They link this risk aversion to a less efficient allocation of capital. I include CEO gender as a control variable in an untabulated set of results. I find the results to be similar to the results presented in this essay.

The dependent variable is different across specifications. My results are presented in Panel C of Table 24. First, I examine the association between the political wedge and the firm's resource management practices. Models 1 through 6 present the results of regressing the industry adjusted ratios on the Wedge Dummy. I find that firms with a difference in political orientation underinvest in cash and overinvest in capital expenditures. Thus, the presence of the wedge decreases the industry adjusted cash ratio by 2.71% and increases the adjusted capex ratio by 0.4%. Consistent with these results, I also find that firms with a political wedge exhibit 6.3% lower odds of overinvesting in cash and 1.18 times greater odds of overinvesting in capex, relatively to their peers. I fail to find, however, a significant relation between the political wedge and a firm's research and development spending.

Further I also examine how effectively firms use their resources. More specifically, I use capex and R&D intensity ratios to examine how much the firms spend to produce one dollar of revenues. Consistent with the argument presented in hypotheses 1, I expect the presence of the wedge to be negatively related to capital intensity. The regression results, presented in columns 7 and 8, suggest that the difference in political orientation within the firm is positively related to the intensity of capital expenditures and negatively related to the efficiency of R&D spending. The presence of the wedge within the firm is associated with a 0.56% increase in the capex efficiency and a 0.46% decrease in R&D intensity.

Overall, I conclude that firms with a difference in political orientation overinvest in capital expenditures compared to their peers and manage them quite efficiently. Additionally, I observe that such firms do not deviate from the industry practices of R&D spending, but experience negative R&D intensity. Finally, firms with a political wedge underinvest in cash, relative to other firms in their industries.

4.2 Presence of the Political Wedge and Quality of Acquisitions

I use cumulative abnormal returns around the acquisition announcement as a measure of the short-term acquisition return and buy and hold returns as the measure of the long-term return⁴⁰. The distribution of short and long-term acquisition returns is presented in Panel A of Table 25. Overall firms in the sample experience positive returns due to the acquisition announcements. I observe that, on average, sample firms earn 0.5% cumulative abnormal return over the 5 days around the filing. Similarly, cumulative abnormal returns 3 days around the deal announcement and on the announcement day equal 0.4% and 0.2%, respectively. Average buy-and-hold returns of sample firms are also positive. The two (three) year long-term returns equal 5.6% (8.5%).

The comparison of acquisition returns by the Wedge Dummy is presented in Panel B of Table 25. The results suggest that firms with a difference in political orientation experience more negative short-term cumulative abnormal returns but more positive long-term returns. The differences in returns for the two groups of firms, however, are statistically insignificant.

In this section I use short-term and long-term acquisition returns as another example of corporate decisions to further study the relation between the political wedge and corporate activity. I estimate the following regression:

$$Return = \alpha + \beta_1 * Wedge\ Dummy + \beta_i * Controls + \beta_j * Fixed\ Effects + \varepsilon \quad (3)$$

⁴⁰ If a firm had another acquisition attempt during the two or three years after the first transaction, I exclude it from the sample.

The results of an OLS regression of the cumulative abnormal returns to the acquisitions announcements on the Wedge Dummy are presented in column 1 of Panel C. I do not find a significant relation between the wedge and short-term announcement returns. Column 2 summarizes the results of the 3-year buy-and-hold returns regression. The regression coefficient of the Wedge Dummy equals 0.1309 and is statistically significant. The results suggest a positive relation between the presence of the political wedge and the long-term performance of acquisitions. Thus, the long-term acquisition returns of firms with a difference in political orientation are 13.09% higher than those of firms without such a difference.

4.3 Presence of the Political Wedge and Firm Performance

The statistical summary of firm performance measures is presented in Panel A of Table 26. I use the return on assets, return on equity, and earnings per share to measure firms' accounting performance⁴¹. The firm's annual stock returns, market adjusted returns, CAPM adjusted returns, and Fama-French three factor adjusted returns represent its market performance. I determine that, on average, sample firms exhibit positive accounting performance. The mean return on assets and return on equity equal 13.4% and 9.6%, respectively. The average earnings per share equal \$1.94. The market performance of sample firms is mixed. Average gross and market-adjusted returns are positive (i.e., 16.2% and 6.6%), while CAPM and Fama-French adjusted returns are negative (i.e., -3.4% and -2.6%).

⁴¹ I use earnings per share excluding extraordinary events as the main measure of earnings per share. I alternatively use earnings per share including extraordinary events and document similar results.

The comparison of firms' performance measures by the Wedge Dummy is presented in Panel B of Table 26. Consistent with the hypothesis 3, I expect the firms with a difference in political orientation to exhibit worse accounting and market performance than their peers. The results presented in the panel show that firms with a wedge experience better accounting performance than other firms. The gross and market returns of these firms, however, are more negative than those of firms without a wedge. The differences in earnings per share, CAPM adjusted, and Fama-French adjusted returns for the two groups of firms are statistically insignificant.

According to hypothesis 3, I expect a negative relation between the political wedge and firm performance. The arguments presented in section 2.3 suggest that the difference in political orientation negatively affects corporate decisions, which should be reflected in a firm's performance. Therefore, I estimate the following regression:

$$Performance = \alpha + \beta_1 * Wedge\ Dummy + \beta_i * Controls + \beta_j * Fixed\ Effects + \varepsilon \quad (4)$$

The regression results are contained in Panel C of Table 26. Columns 1 through 3 present the results of return on assets, return on equity, and earnings per share regression models. The empirical evidence suggests an expected negative relation between the Wedge Dummy and return on equity. Thus, the return on equity of firms with a difference in political orientation is 0.39% lower than of firms without a wedge. I fail to, however, obtain a link between the wedge and other measures of accounting performance such as return on assets or earnings per share. Columns 4 through 7 present the results for the measures of market performance. Consistent with hypothesis 3, I document that gross and market adjusted stock returns of firms with a political wedge are 1.36% and 1.34% lower than those of firms without a wedge.

Overall, I conclude that firms with a difference in political orientation exhibit lower accounting performance as measured by the return on equity and lower market performance in the form of gross and market-adjusted stock returns.

4.4 Presence of the Political Wedge and Firm Value

Panel A of Table 27 presents the statistical summary of Tobin's Q and the market-to-book ratio. Both of these variables measure the firm value. The average q and market-to-book ratio in the sample equal 3.58 and 2.94, respectively. The comparison of these measures between firms with and without a political wedge is presented in Panel B. Consistent with the argument in hypothesis 4, I discover that both Tobin's Q and the market-to-book of firms with a political wedge are significantly lower than those of firms without a wedge.

To examine the relation between a political wedge and firm value, I estimate the following regression:

$$Firm\ Value = \alpha + \beta_1 * Wedge\ Dummy + \beta_i * Controls + \beta_j * Fixed\ Effects + \varepsilon \quad (5)$$

Hypothesis 4 argues that the negative effect of the political wedge on the quality of corporate decisions can be assessed by firm value. I hypothesize that firms with a difference in political orientation have lower value than firms without such a difference. The empirical results for the Tobin's Q and market-to-book ratio regressions are presented in Panel C of Table 27. Consistent with the argument presented in section 2.4, I observe a strong negative relation between the Wedge Dummy and the measures of firm value. I discover that Tobin's Q and the market-to-book ratio of firms with a political wedge are lower by 0.84 and 0.25 than of firms without a wedge. Overall, I conclude that the suboptimal use of

resources by firms with a difference in political orientation is ultimately reflected in lower firm value.

4.5 Size of the Wedge and Firm Performance

So far I have used the Wedge Dummy as the main measure of the difference in political orientation within the firm. In this section I examine whether the size of the wedge has an effect on corporate decisions, firm performance, and company value. I hypothesize that with a larger wedge, the greater is the difference in views, values, and culture between the firm and the CEO. Therefore, the distorting effect of the difference in political orientation on the corporate activity, performance, and value should increase with the size of the wedge.

I reestimate regressions 2 through 5 using the Wedge variable instead of the Wedge Dummy. While I document that the size of the wedge is not associated with the return on the investment of capital expenditures and R&D, I observe a strong negative relation between the wedge size and firm performance. The regression results for different measures of firm performance are presented in Table 28. The presented evidence is overall similar to the results for the Wedge Dummy, documented in Table 26. The regression coefficient for the Wedge independent variable is both statistically and economically significant in 6 out of 7 model specifications. When it comes to accounting performance, a one standard deviation increase in the wedge is associated with a 1.6% decrease in the return on equity and a \$0.45 decrease in earnings per share. A similar increase in the size of the wedge is associated with a 5.0% decrease in annual gross stock return and a 5.5% decrease in the market-adjusted return.

4.6 Political Contributions of Firms and CEOs

In section 3.4 I introduce other indicator variables. Firm_Zero equals 1 if the manager makes personal political contributions but the firm chooses not to. Contrary to that, CEO_Zero indicator variable equals 1 when the firm makes political contributions, but its CEO chooses not to make any donations. These variables also capture the difference in political orientation within the firm. Instead of the direction of the contributions, they measure the political activity of firms and their managers.

I reestimate regressions 2 through 5 using these dummy variables. The regression results are presented in Table 29. Panel A documents the results for the firm's investment in capital expenditures and R&D and the acquisition returns. I find that both Firm_Zero and CEO_Zero variables lack a significant relation with the intensity of capital expenditures made by the firm. When it comes to the efficiency of research and development spending, I observe a strong negative relation in both models. Thus, a manager's political activity is associated with a 0.27% increase in R&D intensity, while a firm's contributions are associated with a 0.38% decline in the efficiency of R&D spending.

Similar to the results presented in Table 25, I fail to document the effect of political activity on the short-term acquisition returns. The Firm_Zero and CEO_Zero regression coefficients, however, are statistically and economically significant in the buy-and-hold returns regressions. My evidence suggests that the manager's decision to make political contributions when the firm does not is associated with a 10.8% decrease in 3-year buy-and-hold acquisitions returns. I further find that a firm's sole decision to make political donations is associated with a 14.5% increase in a 3-year buy-and-hold acquisition return.

The regressions results for the firm performance and value models are presented in Panel B of Table 29. These results suggest that politically inactive firms whose managers choose to make political contributions exhibit better accounting and market performance as well as greater firm value. Firms making political contributions whose CEOs choose not to make individual donations consistently, however, exhibit poor accounting performance and lower firm value.

In this section I introduce a set of indicator variables that measure the difference in political activity within the firm. The results presented in Table 29 suggest that politically active firms with inactive managers make poor corporate decisions, which are reflected in poor performance and lower firm value. At the same time, politically active CEOs are able to achieve greater performance and value. I believe, however, a further analysis of these findings is needed to understand the factors influencing both the firm and the CEO decisions to make political contributions and their ability to generate returns from these political investments.

4.7 Contribution Amounts and Firm Performance

The political wedge introduced in section 3.4 and discussed in section 4.5 captures the difference in political contributions made by firms and managers but ignores their amounts. The existing literature presents a strong positive relation between the size of contributions, behavior of politicians, and benefits received by connected firms (Ovtchinnikov and Pantaleoni, 2012; Bradley, Pantzalis, and Yuan, 2016; Minnick and Noga, 2017; Gounopoulos et al., 2017). Thus, I introduce another measure of the political wedge, calculated as the ratio of net contributions to the Republicans:

$$Wedge = \frac{(Republican_{CEO} - Democratic_{CEO})}{(Republican_{Firm} - Democratic_{Firm})} \quad (6)$$

The size of the ratio indicates the difference in the size of the contributions made by firms and the CEOs. If the wedge is less (greater) than 1, it suggests that the net Republican contributions of managers are smaller (greater) than those made by the firm. The sign of the wedge indicates the difference in political orientation between the firm and the managers.

I reestimate the main regressions 2 through 5 using this measure of the political wedge. In the untabulated results I find that the relation between the size of contributions and firm's corporate decision making, performance, and value is statistically insignificant. These results suggest that the difference in political orientation does not necessary increase with the size of political contributions. Once it is present within the firm, it has a stable effect on firm's operations, performance, and value.

5. Robustness tests

5.1 Direction of the Wedge

To better understand the effect of the political wedge on the firm, I split the Wedge Dummy into two variables. CEO Dummy captures the effect of a more conservative manager, who contributes larger percentages to the Republican Party and candidates than the firm. This indicator variable equals 1 when the political wedge presented in section 3.4 has a positive sign. Similarly, the Firm Dummy captures the more conservative firm effect and equals 1 when the political wedge is negative.

I reestimate the main regressions using the CEO and Firm indicator variables, instead of the Wedge Dummy. The untabulated regression results are similar to the results

presented in Tables 24, 25, and 26. I document that either wedge indicator is associated with the underinvestment in cash, overinvestment in capital expenditures, and lower return of the R&D investment. Additionally, the presence of the CEO or Firm wedge is negatively related to the firm accounting and market performance, as well as firm value. Thus, I conclude that the direction of the wedge does not provide additional evidence to the main results.

5.2 Changes in the Regulation of Political Contributions

The Supreme Court's decision in the Citizens United case has had a strong impact on corporate political activity. Since 2010 corporations and labor unions are allowed to incur unlimited independent expenses to support election campaigns. Additionally, the lift of the contribution limits was followed by a SpeechNOW court decision which contributed to the growing number of Super PACs. These changes to the regulations of the election campaigns have received a mixed feedback from the media, scholars, and regulators. Without a doubt, the relaxation of the contribution limits is related to the growing resources used in election campaigns and the increase in the number of Super PACs contributing to recent elections⁴². According to the study conducted by the Center for Responsive Politics, the Super PAC spending of \$1.1 billion during the 2016 presidential election campaign is almost doubled compared to \$609 million spent in 2012. The study also mentions a higher concentration of contributions coming from the top donors. Hansen, Rocca, and Ortiz (2015) also document the change in campaign contributions before and after the Citizens

⁴² <https://www.opensecrets.org/news/2017/01/citizens-united-7-years-later/>

United case. They argue that a 594% increase in the expenditures between the 2008 and the 2012 presidential elections is the result of the regulatory changes in contribution limits.

I use these changes as an exogenous shock to the corporate political activity of firms in my sample. I hypothesize that the ability of corporations to incur unlimited political expenses has an impact on the number of firms making political contributions and the presence of the political wedge within the firm. The statistical comparison of the key political measures before and after 2011 is presented in the Panel A of Table 30. I document a strong effect of the regulatory changes on the presence of the political wedge, size of the wedge, as well as firms' and managers' propensity to make political contributions. The probability of a wedge within the firm after 2011 is lower by 7.2%, and the size of the wedge decreases from 0.53 to 0.45. Additionally, only 19.1% of firms choose not to make political contributions when their managers are politically active, compared to 33.4% prior to 2011. Similarly, I document that after 2011 managers of 5.5% firms choose not to contribute while their firms continue to make political donations, compared to 9.8% of firms prior to the regulatory changes.

I use the difference-in-difference approach to capture the effect of the regulatory changes on firms' operations, performance, and value. I reestimate the main regressions 2 through 5 using the following model:

$$Ratio = \alpha + \beta_1 * Wedge Dummy + \beta_2 * After2011 + \beta_3 * Interaction + \varepsilon \quad (7)$$

where the Interaction represents the interaction of the Wedge Dummy with the After2011 indicator variable.

The regression results are presented in Panel B of Table 30. I find that in most specifications the Interaction coefficients are statistically insignificant, except for the stock returns regression models. Comparing the effect of a political wedge on stock returns before and after 2011, however, I document a stronger negative effect of a wedge on firm's returns after the change in regulations. Overall, I interpret these results in the following way. The change in regulations of political contributions has led to an increase of the financial support of election campaigns. Coates and John (2012) document that the increase happens within the firms who have been politically active before the Citizens United decision. Thus, traditionally politically active firms are contributing larger amounts using different channels. Prior to 2011 firms are more selective with corporate political spending and might have invested into a small number of political projects. After 2011 corporations are able to invest in a variety of the political projects, followed by a decrease in the probability and the size of the political wedge. The effect of a political wedge on a firm's operations, performance, and firm value, however, remains similar. Thus, I conclude that the change in regulations of corporate political contributions does not influence the effect of a political wedge on a firm's investment efficiency and firm value. Its effect on stock performance, however, is more negative after 2011.

6. Conclusion and implications for further research

This essay examines the effect of a political wedge on firm's operating decisions, performance, and value. More specifically, I find that a difference in political orientation between the firm and its CEO is associated with the deviation from the industry practices of resource management. I document that firms with a political wedge are more likely to underinvest in cash and overinvest in capital expenditures compared to their industry peers.

Additionally, I observe that a political wedge is associated with a lower investment efficiency of research and development spending. I document, however, that the difference in political orientation does not have a negative effect on the quality of acquisitions made by the firms. Thus, I observe a positive relation between a political wedge and the long-term buy-and-hold returns following the acquisition. I further examine the relation between a political wedge and firm performance and value. I find that firms with a difference in political orientation underperform, and its negative effect on performance and value increases with the size of a wedge. I conduct a series of robustness tests and report that the direction of the wedge or the amounts of contributions made by the firm and its CEO do not impact the main results. Finally, I document that while the size of the wedge decreases after the regulatory changes made in 2010, its effect on firm's corporate decisions, performance, and value remains similar.

The evidence presented in this essay suggests a relation between a difference in political orientation within the firm and its investment efficiency, performance, and value. A thorough examination of the effect of a political wedge, however, is needed. It's important to further isolate the effect of a wedge from the other factors which could be related to a firm's decision making, performance, and value. For example, a political orientation and other characteristics of a board could be affecting a firm's political activity, a political wedge, and its effect on the firm. Similarly, it is possible that firms with certain characteristics choose a particular political strategy, which could affect a construction of a wedge. Thus, a self-selection bias could affect the main results presented in this essay.

In this essay I examine the effect of the exogenous change in regulations on a political wedge. Additionally, I plan to study the behavior of a wedge in the presence of

endogenous changes within a firm. I believe that a dismissal or a hiring of a new CEO could affect a political wedge and its impact on a firm's operations, performance, and value. Also such analysis might help to understand whether the board is aware of a difference in political orientation and its effect on the firm. Finally, some firms choose to introduce corporate political governance in addition to standard corporate governance practices. I believe that such introduction of a mandatory disclosure of political spending to the shareholders might impact the corporate political activity and, consequently, a political wedge.

Table 21: Descriptive Statistics of Firms and CEOs

This table presents firms' and CEOs' characteristics. Panel A reports statistical summary of sample firms. Panel B presents summary statistics of sample firms' CEOs. Total Assets represents firms total assets in millions. Log Market Cap is the natural log of firms' market capitalization. Tobin's Q is calculated as a ratio of market value of equity and book value of debt to firms' total assets. Dividend Payout represents a percent of total firms which pay dividends. Book-to-market is calculated as a ratio of book equity to market equity. ROA is a ratio of net income to total assets. ROE is a ratio of net income to total equity. Debt-to-assets is a ratio of total debt to total assets. Analysts represents a number of analysts following sample firms. Institutional Ownership is a percent of total shares owned by institutional investors. Directors equals a number of firms' directors. Board Independence is a percent of independent directors on a board. Board Assignments represents cumulative number of outside appointments held by directors. Board Tenure is a cumulative tenure of firms' directors. CEO Age defines age of CEOs. CEO Chairman represents a percent of CEOs who also serve as board chairman. Salary represents CEOs' salary in millions. Bonus equals CEOs' bonus in millions. Stock Awards represents a cumulative value of stocks vested to CEOs in millions. Option Awards represents a value of options vested to CEOs in millions. Total Compensation represents cumulative compensation of CEOs in millions. Pct Salary represents a ratio of CEOs' salary to total compensation.

Panel A: Firms Summary

	N	25th Pctl	Mean	Median	75th Pctl	StDev
Total Assets (Mil.)	38,912	600	11,169	1,946	7,057	31,516
Log Market Cap	38,316	6.67	7.91	7.95	9.24	1.90
Tobin's Q	38,302	1.19	3.58	1.96	3.75	4.67
Dividend Payout (%)	30,123	0.0%	29.8%	11.1%	37.6%	57.4%
Book-to-market	33,665	0.30	0.61	0.50	0.78	0.44
ROA (%)	34,156	7.2%	13.4%	12.8%	19.0%	10.9%
ROE (%)	33,581	4.9%	9.6%	11.1%	18.2%	23.3%
Debt-to-assets	34,182	0.40	0.56	0.57	0.72	0.23
Analysts	38,967	4	10	8	14	8
Institutional Ownership (%)	30,498	54.0%	68.2%	71.4%	85.1%	24.1%
Directors	20,943	8	10	9	11	3
Board Independence (%)	20,943	61.5%	71.0%	75.0%	84.6%	16.4%
Board Assignments	18,809	3	8	7	12	7
Board Tenure	18,805	6	9	8	11	4

Panel B: CEOs Summary

	N	25th Pctl	Mean	Median	75th Pctl	StDev
CEO Age	37,546	51	56	56	61	7
CEO Chairman (%)	20,943	0.0%	69.3%	100.0%	100.0%	46.1%
Salary (Mil.)	38,967	0.45	0.70	0.65	0.92	0.35
Bonus (Mil.)	38,967	0.00	0.44	0.02	0.50	0.87
Stock Awards (Mil.)	19,296	0.10	2.15	1.11	2.99	2.87
Option Awards (Mil.)	19,296	0.00	1.00	0.19	1.25	1.79
Total Compensation (Mil.)	38,732	1.29	4.83	2.83	6.06	5.65
Pct Salary (%)	38,732	12.9%	29.6%	22.5%	39.8%	23.1%

Table 22: Statistical Summary of Political Variables

This table presents a statistical summary of political variables. Panel A presents a summary of firms' political contributions. Panel B presents a summary of CEOs' political contributions. Panel C presents a summary of variables measuring difference in political orientation. Panel D presents correlations of variables measuring difference in political orientation. Wedge Dummy is an indicator variable which equals one when there is a political wedge within a firm. Wedge is calculated as an absolute value of a difference in ratios of net contributions to Republicans between a firm and a CEO. Firm/CEO (0,1) is an indicator variable which equals one when a firm does not make political contributions but its CEO does. Firm/CEO (1,0) is an indicator variable which equals one when a firm makes political contributions but its CEO does not.

Panel A: Summary of Firms' Political Contributions

	N	25th Pctl	Mean	Median	75th Pctl	StDev
Total Contributions	38,967	0	37,025	0	25	135,179
Candidate Contributions	38,967	0	20,735	0	0	71,787
Party Contributions	38,967	0	15,282	0	0	62,511
Contributions to Republicans	38,967	0	20,422	0	0	74,226
Contributions to Democrats	38,967	0	11,618	0	0	44,132
Other Contributions	38,967	0	1,635	0	0	6,667

Panel B: Summary of CEO's Political Contributions

	N	25th Pctl	Mean	Median	75th Pctl	StDev
Total Contributions	38,967	0	4,581	0	3,000	12,815
Candidate Contributions	38,967	0	1,723	0	1,500	4,137
Party Contributions	38,967	0	2,681	0	750	9,137
Contributions to Republicans	38,967	0	2,357	0	1,000	8,174
Contributions to Democrats	38,967	0	1,026	0	0	3,955
Other Contributions	38,967	0	702	0	0	1,838

Panel C: Summary of Differences in Political Orientation

	N	25th Pctl	Mean	Median	75th Pctl	StDev
Wedge Dummy	38,967	0.0%	16.5%	0.0%	0.0%	37.2%
Wedge	6,444	0.18	0.52	0.41	0.76	0.44
Firm/CEO (0,1)	38,967	0.0%	29.5%	0.0%	100.0%	45.6%
Firm/CEO (1,0)	38,967	0.0%	8.6%	0.0%	0.0%	28.0%

Panel D: Correlations of Differences in Political Orientation

	Wedge Dummy	Wedge	Firm/CEO (0,1)	Firm/CEO (1,0)
Wedge Dummy				
Wedge				
Firm/CEO (0,1)	-28.8%			
Firm/CEO (1,0)	-13.7%		-19.8%	
Autocorrelation Coefficient	0.7060	0.2096	0.5821	0.6037

Table 23: Distributions of Political Variables

This table presents distributions of variables measuring difference in political orientation. Panel A presents a distribution by industry measured by 2-digit SIC code. Panel B presents a distribution by corporate governance. Wedge Dummy is an indicator variable which equals one when there is a political wedge within a firm. Wedge is calculated as an absolute value of a difference in ratios of net contributions to Republicans between a firm and a CEO. Firm/CEO (0,1) is an indicator variable which equals one when a firm does not make political contributions but its CEO does. Firm/CEO (1,0) is an indicator variable which equals one when a firm makes political contributions but its CEO does not.

Panel A: Distribution of Political Differences by Industry

	Mining	Construction	Manufacturing	Transportation	Wholesale	Retail	Finance	Services	Public Administration
Wedge Dummy	15.5%	16.2%	15.7%	26.4%	8.1%	14.6%	17.1%	12.4%	17.6%
Wedge	0.47	0.62	0.50	0.48	0.65	0.54	0.52	0.61	0.35
Firm/CEO (0,1)	24.6%	39.2%	26.7%	33.2%	34.8%	31.3%	33.4%	28.6%	27.7%
Firm/CEO (1,0)	13.1%	8.5%	7.9%	11.4%	6.6%	7.6%	8.4%	6.9%	17.0%

Panel B: Distribution of Political Differences by Corporate Governance

	CEO/Chairman			Board Size			Board Appointments		
	Yes	No	t-test	Above Median	Below Median	t-test	Above Median	Below Median	t-test
Wedge Dummy	25.1%	15.6%	16.38***	31.4%	11.4%	40.19***	32.0%	12.0%	37.60***
Wedge	0.51	0.50	0.74	0.49	0.54	-5.04***	0.49	0.54	-3.94***
Firm/CEO (0,1)	31.9%	29.8%	3.16***	29.0%	29.6%	-1.21	26.6%	30.3%	-6.91***
Firm/CEO (1,0)	12.1%	8.8%	7.31***	15.2%	6.3%	23.05***	15.5%	6.6%	21.68***

Table 24: Political Wedge and Allocation of Resources

This table presents the analysis of resource allocation. Panel A presents the statistical summary of variables measuring resource management of sample firms. Panel B presents their comparison by Wedge Dummy variable. Panel C presents the results of regressing resource management variables on Wedge Dummy. Cash Ratio represents an industry adjusted ratio of cash and equivalent market securities to total assets. Capx Ratio represents an industry adjusted ratio of capital expenditures to total assets. R&D Ratio represents an industry adjusted ratio of R&D expenditures to total assets. Capx Intensity is calculated as a ratio of capital expenditures to total sales. R&D Intensity is calculated as a ratio of R&D expenditures to total sales. Wedge Dummy is an indicator variable which equals one when there is a political wedge within a firm. Definitions of control variables are presented in Table 1. Control variables include industry and year fixed effects. Control variables are winsorized at 1%. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively. T-statistics are reported in parentheses.

Panel A: Summary of Resource Management Variables

	N	25th Pctl	Mean	Median	75th Pctl	StDev
Cash Ratio	38,900	-2.6%	9.3%	0.0%	6.1%	39.8%
Capx Ratio	37,620	-0.9%	0.8%	0.0%	1.3%	4.4%
R&D Ratio	20,423	-0.7%	1.3%	0.0%	1.0%	7.3%
Capx Intensity	37,620	1.5%	5.0%	3.6%	6.7%	5.2%
R&D Intensity	20,423	0.2%	5.0%	2.3%	7.2%	6.9%

Panel B: Comparison of Resource Management Variables by Wedge Dummy

	Wedge Dummy		t-stat (Above-Below)
	Above Median	Below Median	
Cash Ratio	2.2%	10.7%	-22.71***
Capx Ratio	0.7%	0.8%	-1.55
R&D Ratio	0.1%	1.6%	-14.70***
Capx Intensity	5.4%	5.0%	5.82***
R&D Intensity	3.5%	5.3%	-17.67***

Panel C: Wedge Dummy and Resource Management

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Cash Ratio	Cash Over	Capx Ratio	Capx Over	R&D Ratio	R&D Over	Capx Intensity	R&D Intensity
Intercept	0.5014*** (16.47)	0.8346*** (15.71)	0.0324*** (7.51)	-0.1325 (0.38)	0.0510*** (7.70)	0.7599** (5.36)	0.0459*** (11.36)	0.1196*** (19.28)
Wedge Dummy	-0.0271*** (-4.84)	-0.0659* (2.93)	0.0037*** (4.61)	0.1645*** (17.17)	-0.0005 (-0.42)	0.0675 (1.19)	0.0056*** (7.50)	-0.0046*** (-3.87)
Log Market Cap	0.0097*** (4.06)	0.0275* (2.77)	-0.0019*** (-5.58)	-0.0542*** (10.26)	-0.0003 (-0.66)	-0.0815*** (10.05)	-0.0018*** (-5.54)	0.0034*** (6.91)
Payout Ratio	0.0033 (0.78)	0.0588** (4.09)	-0.0021*** (-3.46)	-0.0418 (2.06)	0.0001 (0.05)	-0.0257 (0.29)	-0.0008 (-1.44)	-0.0035*** (-3.80)
Book-to-market	-0.0990*** (-13.74)	-0.3206*** (40.87)	-0.0006 (-0.58)	-0.1100** (4.75)	-0.0109*** (-5.90)	-0.0515 (0.30)	0.0045*** (4.69)	-0.0244*** (-14.05)
ROA	-0.2730*** (-8.53)	1.2293*** (29.74)	0.0994*** (22.00)	4.7230*** (367.84)	-0.0178*** (-2.64)	1.3481*** (16.20)	0.1543*** (36.47)	-0.0558*** (-8.81)
Debt-to-assets	-0.4778*** (-35.23)	-1.4301*** (226.20)	-0.0113*** (-5.90)	-0.4191*** (19.09)	-0.0263*** (-9.58)	-0.0458 (0.12)	-0.0035** (-1.98)	-0.0746*** (-29.05)
Analysts	-0.0007 (-1.56)	-0.0243*** (55.31)	0.0004*** (6.32)	0.0060* (3.24)	0.0003*** (2.66)	0.0174*** (11.81)	0.0004*** (5.89)	0.0004*** (4.27)
Directors	-0.0107*** (-11.85)	0.0000 (0.00)	-0.0005*** (-3.92)	0.0248*** (13.78)	-0.0011*** (-5.18)	0.0085 (0.63)	-0.0005*** (-3.85)	-0.0027*** (-13.17)
Board Independence	0.0224 (1.39)	0.1065 (0.91)	-0.0085*** (-3.70)	0.0716 (0.39)	0.0075** (2.09)	0.0530 (0.09)	-0.0104*** (-4.84)	0.0165*** (4.93)
CEO Age	-0.0013*** (-4.03)	-0.0019 (0.71)	-0.0002*** (-5.35)	-0.0025 (1.18)	-0.0002*** (-3.49)	0.0018 (0.27)	-0.0002*** (-5.09)	-0.0005*** (-7.82)
CEO Chairman	0.0034 (0.65)	0.0019 (0.00)	0.0007 (1.00)	0.0414 (1.26)	-0.0047*** (-4.21)	0.0018 (0.00)	0.0014** (2.00)	-0.0061*** (-5.85)
Pct_Salary	-0.0330*** (-2.61)	-0.3736*** (18.32)	0.0050*** (2.81)	0.0130 (0.02)	-0.0075*** (-2.66)	-0.3189** (4.99)	0.0065*** (3.87)	0.0004 (0.14)
N	18,285	18,000	17,613	17,613	9,071	9,071	17,613	9,071
Adj R-sq	11.0%	3.4%	6.3%	4.1%	3.2%	14.8%	42.2%	31.5%

Table 25: Political Wedge and Quality of Acquisitions

This table presents the analysis of acquisition returns. Panel A presents the statistical summary of acquisition returns. Panel B presents their comparison by Wedge Dummy variable. Panel C presents the results of regressing resource acquisition returns on Wedge Dummy. CAR (-2,2) represents acquirers' cumulative abnormal returns calculated over 5 days around the acquisition announcement. CAR (-1,1) represents acquirers' cumulative abnormal returns calculated over 3 days around the acquisition announcement. CAR (0) represents acquirers' cumulative abnormal returns on the day of the acquisition announcement. BHAR 2Yr represents buy-and-hold returns calculated over 2 years after the acquisition announcement. BHAR 3Yr represents buy-and-hold returns calculated over 3 years after the acquisition announcement. Wedge Dummy is an indicator variable which equals one when there is a political wedge within a firm. Definitions of control variables are presented in Table 1. Control variables are winsorized at 1%. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively. T-statistics are reported in parentheses.

Panel A: Summary of Acquisition Returns

	N	25th Pctl	Mean	Median	75th Pctl	StDev	t-stat
CAR (-2,2)	10,684	-2.3%	0.5%	0.3%	3.3%	5.9%	9.43
CAR (-1,1)	10,688	-1.9%	0.4%	0.2%	2.7%	5.1%	8.51
CAR (0)	10,691	-1.1%	0.2%	0.0%	1.4%	3.1%	5.97
BHAR 2Yr	3,238	-36.9%	5.6%	-1.1%	37.5%	70.9%	4.51***
BHAR 3Yr	2,378	-47.8%	8.5%	-2.2%	47.7%	96.3%	4.32***

Panel B: Comparison of Acquisition Returns by Wedge Dummy

	Wedge Dummy		t-stat (Above-Below)
	Above Median	Below Median	
CAR (-2,2)	0.4%	0.6%	-0.94
CAR (-1,1)	0.4%	0.4%	-0.38
CAR (0)	0.2%	0.2%	-0.11
BHAR 2Yr	5.6%	5.6%	0.00
BHAR 3Yr	11.6%	7.7%	0.83

Panel C: Wedge Dummy and Acquisition Returns

	(1) CAR (-2,2)	(2) BHAR 3Yr
Intercept	0.0077 (0.61)	-0.0697 (-0.20)
Wedge Dummy	0.0009 (0.48)	0.1309** (2.36)
Log Market Cap	0.0007 (0.84)	-0.0278 (-1.18)
Payout Ratio	-0.0027** (-2.00)	0.0019 (0.04)
Book-to-market	-0.0064** (-2.21)	0.0153 (0.19)
ROA	0.0196* (1.74)	0.3577 (1.07)
Debt-to-assets	0.0072 (1.42)	-0.1315 (-0.88)
Analysts	-0.0005*** (-3.07)	0.0006 (0.13)
Directors	-0.0002 (-1.07)	-0.0125 (-1.49)
Board Independence	-0.0032 (-0.57)	0.3881** (2.33)
CEO Age	0.0001 (0.61)	0.0026 (0.76)
CEO Chairman	-0.0018 (-0.91)	-0.0719 (-1.33)
Pct_Salary	0.0002 (0.03)	0.0017 (0.01)
Friendly	0.0037 (0.65)	0.0220 (0.21)
Same Industry	-0.0010 (-0.60)	0.0527 (1.11)
Year FE	Yes	Yes
Industry FE	Yes	Yes
N	5,341	1,397
Adj R-sq	0.6%	8.8%

Table 26: Political Wedge and Firm Performance

This table presents the analysis of firm performance. Panel A presents the statistical summary of performance measures. Panel B presents their comparison by Wedge Dummy variable. Panel C presents the results of regressing firm performance on Wedge Dummy. ROA is calculated as a ratio of net income to total assets. ROE is calculated as a ratio of net income to total equity. EPS represents basic earnings per share excluding extraordinary events. Return represents annual gross stock return. Return Market represents annual stock return adjusted for market performance. Return CAPM represents CAPM adjusted annual return. Return FF3 represents three factors adjusted annual return. Wedge Dummy is an indicator variable which equals one when there is a political wedge within a firm. Definitions of control variables are presented in Table 1. Control variables are winsorized at 1%. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively. T-statistics are reported in parentheses.

Panel A: Summary of

	N	25th Pctl	Mean	Median	75th Pctl	StDev
ROA	34,156	7.2%	13.4%	12.8%	19.0%	10.9%
ROE	33,581	4.9%	9.6%	11.1%	18.2%	23.3%
EPS	38,628	0.41	1.94	1.34	2.43	194.83
Return	36,993	-4.7%	16.2%	16.1%	36.9%	40.3%
Return Market	36,993	-13.7%	6.6%	5.2%	25.5%	38.0%
Return CAPM	36,987	-22.5%	-3.4%	-3.6%	14.7%	35.6%
Return FF3	36,987	-20.2%	-2.6%	-2.6%	13.9%	32.3%

Panel B: Comparison by Difference in Political Orientation

	Wedge Dummy		t-stat (Above- Below)
	Above Median	Below Median	
ROA	13.6%	13.4%	1.80*
ROE	12.5%	8.9%	12.16***
EPS1	2.22	1.89	0.26
Return	14.9%	16.4%	-2.98***
Return Market	5.8%	6.7%	-2.01**
Return CAPM	-3.0%	-3.4%	0.96
Return FF3	-2.3%	-2.7%	0.88

Panel C: Wedge Dummy and Firm Performance

	(1)	(2)	(3)	(4)	(5)	(6)
	ROA	ROE	EPS	Return	Market Return	CAPM Return
Intercept	0.2353*** (31.26)	-0.1639*** (-14.87)	-3.9949*** (-12.76)	0.0719** (2.10)	-0.0330 (-0.97)	-0.2354*** (-7.06)
Wedge Dummy	-0.0016 (-1.24)	-0.0039** (-2.09)	-0.0605 (-1.15)	-0.0136** (-2.37)	-0.0134** (-2.33)	-0.0072 (-1.28)
Log Market Cap	0.0073*** (13.31)	0.0047*** (5.96)	0.3934*** (17.53)	0.0372*** (15.16)	0.0376*** (15.33)	0.0306*** (12.79)
Payout Ratio	-0.0072*** (-7.40)	-0.0231*** (-16.66)	-0.5851*** (-14.85)	-0.0253*** (-5.85)	-0.0252*** (-5.85)	-0.0160*** (-3.82)
Book-to-market	-0.0938*** (-61.91)	-0.0692*** (-29.07)	-0.1896*** (-2.81)	-0.2302*** (-31.18)	-0.2299*** (-31.17)	-0.1796*** (-24.96)
ROA		0.9849*** (93.17)	6.5005*** (21.67)	-0.0894*** (-2.74)	-0.0900*** (-2.75)	-0.0682** (-2.14)
Debt-to-assets	-0.1059*** (-34.93)	0.2613*** (58.26)	1.2071*** (9.51)	-0.0249* (-1.80)	-0.0251* (-1.81)	0.0539*** (3.99)
Analysts	-0.0004*** (-3.78)	-0.0007*** (-4.77)	-0.0442*** (-9.99)	-0.0093*** (-19.16)	-0.0093*** (-19.31)	-0.0088*** (-18.67)
Directors	-0.0018*** (-8.56)	0.0008*** (2.60)	0.0811*** (9.56)	-0.0042*** (-4.59)	-0.0043*** (-4.59)	-0.0008 (-0.85)
Board Independence	-0.0159*** (-4.29)	0.0123** (2.33)	0.8385*** (5.57)	-0.0195 (-1.18)	-0.0202 (-1.23)	0.0106 (0.66)
CEO Age	0.0001 (1.17)	0.0002** (2.13)	0.0099*** (3.21)	0.0001 (0.27)	0.0001 (0.22)	0.0003 (1.05)
CEO Chairman	-0.0025** (-2.02)	-0.0032* (-1.85)	0.1737*** (3.54)	-0.0124** (-2.31)	-0.0121** (-2.26)	-0.0096* (-1.85)
Pct_Salary	0.0035 (1.20)	-0.0037 (-0.89)	0.0190 (0.16)	-0.0443*** (-3.44)	-0.0434*** (-3.37)	-0.0366*** (-2.92)
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
N	18,289	18,271	18,288	18,126	18,126	18,126
Adj R-sq	43.7%	51.7%	13.9%	24.9%	20.0%	15.8%

Table 27: Political Wedge and Firm Value

This table presents the analysis of firm value. Panel A presents the statistical summary of firm value measures. Panel B presents their comparison by Wedge Dummy variable. Panel C presents the results of regressing firm value on Wedge Dummy. Tobin's Q is calculated as a ratio of market value of equity and book value of debt to total assets. Market-to-book is calculated as a ratio of market equity to book equity. Wedge Dummy is an indicator variable which equals one when there is a political wedge within a firm. Definitions of control variables are presented in Table 1. Control variables are winsorized at 1%. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively. T-statistics are reported in parentheses.

Panel A: Summary of Firm Value Measures

	N	25th Pctl	Mean	Median	75th Pctl	StDev
Tobin's Q	38,302	1.19	3.58	1.96	3.75	4.67
Market-to-book	33,665	1.27	2.94	1.99	3.30	3.15

Panel B: Comparison by Difference in Political Orientation

	Wedge Dummy		t-stat (Above- Below)
	Above Median	Below Median	
Tobin's Q	2.92	3.71	-14.77***
Market-to-book	2.80	2.97	-4.18***

Panel C: Wedge Dummy and Firm Value

	(1) Tobin's Q	(2) Market-to-book
Intercept	2.0703*** (5.33)	1.2020*** (5.11)
Wedge Dummy	-0.8354*** (-12.84)	-0.2534*** (-6.43)
Log Market Cap	1.1093*** (39.83)	0.2263*** (13.41)
Payout Ratio	-0.1126** (-2.30)	0.1996*** (6.74)
Book-to-market	-1.4206*** (-16.94)	-2.8657*** (-56.45)
ROA	11.4714*** (30.81)	11.7618*** (52.16)
Debt-to-assets	-5.7439*** (-36.45)	3.5756*** (37.47)
Analysts	-0.0113** (-2.05)	0.0095*** (2.86)
Directors	-0.2705*** (-25.70)	-0.0722*** (-11.33)
Board Independence	0.3567* (1.91)	-0.2070* (-1.83)
CEO Age	-0.0610*** (-15.97)	-0.0172*** (-7.42)
CEO Chairman	-0.2149*** (-3.53)	-0.0968*** (-2.62)
Pct_Salary	1.1057*** (7.53)	0.3859*** (4.34)
Year FE	Yes	Yes
Industry FE	Yes	Yes
N	18,289	18,289
Adj R-sq	44.3%	48.7%

Table 28: Size of Political Wedge and Firm Performance

This table presents the results of regressing firm performance on Wedge. ROA is calculated as a ratio of net income to total assets. ROE is calculated as a ratio of net income to total equity. EPS represents basic earnings per share excluding extraordinary events. Return represents annual gross stock return. Return Market represents annual stock return adjusted for market performance. Return CAPM represents CAPM adjusted annual return. Wedge is calculated as an absolute value of a difference in ratios of net contributions to Republicans between a firm and a CEO. Definitions of control variables are presented in Table 1. Control variables are winsorized at 1%. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively. T-statistics are reported in parentheses.

	(1)	(2)	(3)	(4)	(5)	(6)
	ROA	ROE	EPS	Return	Market Return	CAPM Return
Intercept	0.2393*** (15.83)	-0.2199*** (-8.16)	-5.8898*** (-8.91)	0.1154 (1.58)	0.0099 (0.14)	-0.1886*** (-2.66)
Wedge	-0.0011 (-0.51)	-0.0070* (-1.83)	-0.2000** (-2.15)	-0.0222** (-2.18)	-0.0240** (-2.35)	-0.0225** (-2.26)
Log Market Cap	0.0035*** (3.28)	0.0028 (1.55)	0.4203*** (9.40)	0.0335*** (6.79)	0.0342*** (6.92)	0.0284*** (5.91)
Payout Ratio	-0.0096*** (-5.13)	-0.0270*** (-8.33)	-0.6614*** (-8.33)	-0.0292*** (-3.36)	-0.0299*** (-3.44)	-0.0218*** (-2.58)
Book-to-market	-0.0746*** (-27.25)	-0.0776*** (-15.06)	-0.3677*** (-2.91)	-0.1857*** (-13.37)	-0.1877*** (-13.48)	-0.1387*** (-10.26)
ROA		1.0619*** (39.32)	6.2230*** (9.39)	-0.0157 (-0.22)	-0.0176 (-0.24)	-0.0814 (-1.15)
Debt-to-assets	-0.1222*** (-19.77)	0.3188*** (28.37)	1.2739*** (4.64)	0.0023 (0.08)	0.0033 (0.11)	0.0683** (2.33)
Analysts	0.0004** (2.07)	-0.0005 (-1.43)	-0.0519*** (-6.34)	-0.0067*** (-7.44)	-0.0068*** (-7.52)	-0.0071*** (-8.11)
Directors	-0.0027*** (-7.23)	0.0004 (0.60)	0.0614*** (3.81)	-0.0084*** (-4.75)	-0.0087*** (-4.88)	-0.0029* (-1.68)
Board Independence	-0.0141* (-1.95)	0.0203 (1.62)	1.9825*** (6.44)	0.0168 (0.49)	0.0165 (0.48)	0.0326 (0.98)
CEO Age	0.0007*** (4.23)	0.0005* (1.76)	0.0272*** (4.08)	-0.0003 (-0.46)	-0.0003 (-0.45)	0.0003 (0.43)
CEO Chairman	-0.0055** (-2.24)	-0.0009 (-0.21)	0.2389** (2.28)	-0.0037 (-0.32)	-0.0025 (-0.21)	-0.0042 (-0.37)
Pct_Salary	-0.0078 (-1.16)	-0.0111 (-0.95)	-0.3495 (-1.23)	-0.0531* (-1.69)	-0.0509 (-1.62)	-0.0421 (-1.38)
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
N	4,150	4,144	4,150	4,094	4,094	4,094
Adj R-sq	46.4%	48.4%	16.3%	26.2%	19.4%	14.5%

Table 29: Firm and CEO Political Spending

This table presents the analysis of political spending of firms and CEOs. Panel A presents the results of regressing resource management variables and acquisition returns on firm and CEO spending. Panel B presents the results of regressing firm performance and value measures on firm and CEO spending. Capx Intensity is calculated as a ratio of capital expenditures to total sales. R&D Intensity is calculated as a ratio of R&D expenditures to total sales. CAR (-2,2) represents acquirers' cumulative abnormal returns calculated over 5 days around the acquisition announcement. BHAR 3Yr represents buy-and-hold returns calculated over 3 years after the acquisition announcement. ROA is calculated as a ratio of net income to total assets. Return represents annual gross stock return. Firm/CEO (0,1) is an indicator variable which equals one when a firm does not make political contributions but its CEO does. Firm/CEO (1,0) is an indicator variable which equals one when a firm makes political contributions but its CEO does not. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively. T-statistics are reported in parentheses.

Panel A: Political Spending, Resource Management, and Acquisition Returns

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Capx Intensity	Capx Intensity	R&D Intensity	R&D Intensity	CAR (-2,2)	CAR (-2,2)	BHAR 3Yr	BHAR 3Yr
Intercept	0.0428*** (10.62)	0.0423*** (10.52)	0.1232*** (19.97)	0.1216*** (19.69)	0.0060 (0.48)	0.0058 (0.46)	-0.0440 (-0.13)	-0.0715 (-0.21)
Firm/CEO (0,1)	-0.0010 (-1.58)		-0.0027*** (-2.75)		0.0013 (0.73)		-0.1078** (-2.15)	
Firm/CEO (1,0)		-0.0005 (-0.58)		-0.0038** (-2.51)		-0.0029 (-1.20)		0.1448** (2.05)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	17,613	17,613	9,071	9,071	5,341	5,341	1,397	1,397
Adj R-sq	42.1%	42.1%	31.4%	31.4%	0.6%	0.6%	8.8%	8.7%

Panel B: Political Spending, Firm Performance, and Firm Value

	(1) ROA	(2) ROA	(3) Return	(4) Return	(5) Tobin's Q	(6) Tobin's Q
Intercept	0.2349*** (31.35)	0.2358*** (31.48)	0.0772** (2.26)	0.0795** (2.34)	0.3059*** (5.47)	2.5304*** (6.52)
Firm/CEO (0,1)	0.0038*** (3.44)		0.0087* (1.77)		1.0742*** (38.65)	
Firm/CEO (1,0)		-0.0042** (-2.56)		-0.0029 (-0.40)		-0.3423*** (-4.14)
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
N	18,289	18,289	18,126	18,126	18,289	18,289
Adj R-sq	43.8%	43.7%	24.9%	24.9%	43.9%	43.8%

Table 30: Effect of Regulatory Changes on Political Wedge

This table presents the analysis of regulatory changes on political wedge. Panel A presents the comparison of measures of difference in political orientation before and after 2011. Panel B presents the results of regressing resource management variables, acquisition returns, firm performance and value measures on Wedge Dummy, After2011 indicator, and their interaction. Capx Intensity is calculated as a ratio of capital expenditures to total sales. R&D Intensity is calculated as a ratio of R&D expenditures to total sales. CAR (-2,2) represents acquirers' cumulative abnormal returns calculated over 5 days around the acquisition announcement. BHAR 3Yr represents buy-and-hold returns calculated over 3 years after the acquisition announcement. ROA is calculated as a ratio of net income to total assets. Return represents annual gross stock return. Tobin's Q is calculated as a ratio of market value of equity and book value of debt to total assets. Wedge Dummy is an indicator variable which equals one when there is a political wedge within a firm. ***, **, and * indicate statistical significance at the 1%, 5%, and 10% levels, respectively. T-statistics are reported in parentheses.

Panel A: Comparison of Political Wedge Before and After 2011

	2011		t-stat (After-Before)
	Before	After	
Wedge Dummy	18.5%	11.3%	-18.68***
Wedge	0.53	0.45	-6.28***
Firm/CEO (0,1)	33.4%	19.1%	-30.19***
Firm/CEO (1,0)	9.8%	5.5%	-15.01***

Panel B: Effect of Political Wedge After 2011

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	Capx Intensity	R&D Intensity	CAR (-2,2)	BHAR 3Yr	ROA	Return	Tobin's Q
Intercept	0.0399*** (9.13)	0.0774*** (11.68)	0.0061 (0.46)	0.1550 (0.41)	0.2527*** (34.14)	0.2619*** (7.75)	2.6260*** (6.84)
Wedge Dummy	0.0054*** (6.41)	-0.0037*** (-2.88)	0.0003 (0.16)	0.1070* (1.77)	-0.0019 (-1.33)	-0.0203*** (-3.18)	-0.8444*** (-11.65)
After 2011	0.0110*** (6.10)	-0.0032 (-1.17)	0.0068 (1.35)	-0.0645 (-0.51)	- (-5.54)	-0.1924*** (-13.74)	-0.5589*** (-3.51)
Interaction	0.0010 (0.60)	-0.0005 (-0.19)	0.0054 (0.95)	0.1658 (1.18)	0.0015 (0.49)	0.0310** (2.38)	0.0418 (0.28)
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	17,613	9,071	5,341	1,397	18,289	18,126	18,289
Adj R-sq	42.3%	34.1%	0.6%	8.9%	43.7%	24.9%	44.3%

APPENDIX

1. Propensity score matching

I use propensity score matching to construct a sample of control non-sued firms. In this setting propensity score represents a predicted probability of firm being sued in the next year. I estimate the probability using the following regression for each year in my sample:

$$P = \text{LnMarketCap} + \text{BM} + \text{Leverage} + \text{ROA} + \text{Analysts} + \text{Industry}, \quad (1)$$

where *LnMarketCap* represents the natural log of the market value of equity, *BM* is the ratio of book equity to market equity, *Leverage* is calculated as debt-to-equity, *ROA* is calculated as the ratio of net income to total assets, *Analysts* represents the number of analysts following a firm, *Industry* is an indicator variable for a 2-digit SIC code. I select non-sued firms with the closest propensity score with the replacement option to form a group of control firms.

Table 31 presents a comparison of target firms in the sample and matched control firms one year before litigation events. Target and control firms have similar market capitalization (\$6.8 billion vs. \$7.2 billion with a t-stat of -1.66), book-to-market ratios of 0.58 vs 0.57 with a t-stat of 0.50, debt-to-equity ratios of 2.60 compared to 2.97 with a t-stat of 1.63, and analyst coverage of 13 analysts for both categories of firms with a t-stat of -1.34. Target firms are, however, slightly less profitable than control firms. Average return on assets for target and control firms is 15.0% and 15.7% with a t-stat of -2.62. Additionally, there is a statistically significant difference in the number of directors on the

boards of target and control firms. Even though on average both groups of firms have 10 directors, the t-stat of 2.79 is positive and significant.

Table 31: Comparison of Target and Control Firms

	Target Firms (n=7,697)		Control Firms (n=7,697)		t-stat
	Mean	Median	Mean	Median	
Ln_MarketCap	8.83	8.93	8.88	8.97	-1.66*
Book-to-Market	0.58	0.46	0.57	0.42	0.50
Debt-to-Equity	2.60	1.38	2.97	1.22	1.63
ROA	15.0%	14.2%	15.7%	14.3%	-2.62***
Analyst_Coverage	13	12	13	12	-1.34
Num_Directors	10	10	10	10	2.79***

REFERENCES

- Achrol, R.S., 1991. Evolution of the marketing organization: new forms for turbulent environments. *Journal of Marketing*, pp.77-93.
- Adelino, M. and Dinc, I.S., 2014. Corporate distress and lobbying: Evidence from the Stimulus Act. *Journal of Financial Economics*, 114(2), pp.256-272.
- Adhikari, A., Derashid, C. and Zhang, H., 2006. Public policy, political connections, and effective tax rates: Longitudinal evidence from Malaysia. *Journal of Accounting and Public Policy*, 25(5), pp.574-595.
- Aggarwal, R.K., Meschke, F. and Wang, T.Y., 2012. Corporate political donations: investment or agency?. *Business and Politics*, 14(1), pp.1-38.
- Agrawal, A. and Knoeber, C.R., 2001. Do some outside directors play a political role?. *The Journal of Law and Economics*, 44(1), pp.179-198.
- Ahern, K.R., Daminelli, D. and Fracassi, C., 2015. Lost in translation? The effect of cultural values on mergers around the world. *Journal of Financial Economics*, 117(1), pp.165-189.
- Alexander, J.C., 2000, July. An Introduction to Class Action Procedure in the United States. In Conference: Debates over Group Litigation in Comparative Perspective (Switzerland, Geneva).
- Alexander, R., Mazza, S.W. and Scholz, S., 2009. Measuring rates of return on lobbying expenditures: An empirical case study of tax breaks for multinational corporations. *Journal of Law and Politics*, 25, p.401.
- Alm, J., Sanchez, I. and De Juan, A., 1995. Economic and noneconomic factors in tax compliance. *Kyklos*, 48(1), pp.1-18.
- Amburgey, T., Kelly, D., and Barnett, W., 1993. Resetting the clock: The dynamics of organizational change. *Administrative Science Quarterly*, 38, pp.51-73.
- Amoah, N.Y. and Makkawi, B., 2013. Determinants of Investor Reaction to Announcement of SEC 10B-5 Lawsuit.
- Amore, M.D. and Bennedsen, M., 2013. The value of local political connections in a low-corruption environment. *Journal of Financial Economics*, 110(2), pp.387-402.
- Anderson, J.C. and Narus, J.A., 1990. A model of distributor firm and manufacturer firm working partnerships. *Journal of Marketing*, pp.42-58.
- Ang, Y.Y. and Jia, N., 2014. Perverse complementarity: Political connections and the use of courts among private firms in China. *The Journal of Politics*, 76(2), pp.318-332.
- Ansola-behere, S., De Figueiredo, J.M. and Snyder, J.M., 2003. Why is there so little money in US politics?. *The Journal of Economic Perspectives*, 17(1), pp.105-130.

- Antia, M., Kim, I. and Pantzalis, C., 2013. Political geography and corporate political strategy. *Journal of Corporate Finance*, 22, pp.361-374.
- Aragonès, E., Postlewaite, A. and Palfrey, T., 2007. Political reputations and campaign promises. *Journal of the European Economic Association*, 5(4), pp.846-884.
- Argote, L., 2011. Organizational learning research: Past, present and future. *Management Learning*, 42(4), pp.439-446.
- Argote, L. and Miron-Spektor, E., 2011. Organizational learning: From experience to knowledge. *Organization Science*, 22(5), pp.1123-1137.
- Barberis, N. and Thaler, R., 2003. A survey of behavioral finance. *Handbook of the Economics of Finance*, 1, pp.1053-1128.
- Bartlett, E.E., 1995. Cost-benefit analysis of patient education. *Patient Education and Counseling*, 26(1), pp.87-91.
- Bebchuk, L.A. and Jackson, R.J., 2010. Corporate Political Speech: Who Decides?. *Harvard Law Review*, 124(1), pp.83-117.
- Berkovitch, E., and Narayanan, M., 1990. Competition and the medium of exchange in takeovers. *Review of Financial Studies*, 3(2), pp.153-174.
- Bertrand, M., Kramarz, F., Schoar, A. and Thesmar, D., 2007. Politicians, firms and the political business cycle: Evidence from France. *Unpublished working paper, University of Chicago*.
- Besley, T., 2004. Paying politicians: theory and evidence. *Journal of the European Economic Association*, 2(2-3), pp.193-215.
- Betton, S., Eckbo, B.E. and Thorburn, K.S., 2008. Corporate takeovers. *Handbook of corporate finance: Empirical corporate finance*, 2, pp.291-430.
- Bhagat, S., Bizjak, J. and Coles, J.L., 1998. The shareholder wealth implications of corporate lawsuits. *Financial Management*, pp.5-27.
- Blau, B.M., Brough, T.J. and Thomas, D.W., 2013. Corporate lobbying, political connections, and the bailout of banks. *Journal of Banking & Finance*, 37(8), pp.3007-3017.
- Boubakri, N., Cosset, J.C. and Saffar, W., 2008. Political connections of newly privatized firms. *Journal of Corporate Finance*, 14(5), pp.654-673.
- Boubakri, N., Guedhami, O., Mishra, D. and Saffar, W., 2012. Political connections and the cost of equity capital. *Journal of Corporate Finance*, 18(3), pp.541-559.
- Bourveau, T., Coulomb, R. and Sangnier, M., 2016. Political connections and insider trading.
- Bradley, D., Pantzalis, C. and Yuan, X., 2016. Policy risk, corporate political strategies, and the cost of debt. *Journal of Corporate Finance*, 40, pp.254-275.

- Brogaard, J., Denes, M. and Duchin, R., 2015. Political connections, incentives and innovation: Evidence from contract-level data. Unpublished working paper.
- Brown, D. and Brown, Z.E., 2008. The relationship between investor attachment style and financial advisor loyalty. *Journal of Behavioral Finance*, 9(4), pp.232-239.
- Bunderson, J.S. and Sutcliffe, K.M., 2002. Comparing alternative conceptualizations of functional diversity in management teams: Process and performance effects. *Academy of Management Journal*, 45(5), pp.875-893.
- Burris, V., 2001. The two faces of capital: Corporations and individual capitalists as political actors. *American Sociological Review*, pp.361-381.
- Byrne, D.E., 1971. *The attraction paradigm*, 11.
- Caprara, G.V., Schwartz, S., Capanna, C., Vecchione, M. and Barbaranelli, C., 2006. Personality and politics: Values, traits, and political choice. *Political Psychology*, 27(1), pp.1-28.
- Charumilind, C., Kali, R. and Wiwattanakantang, Y., 2006. Connected lending: Thailand before the financial crisis. *The Journal of Business*, 79(1), pp.181-218.
- Chen, H., Gunny, K. and Ramanna, K., 2014. Return on political investment in the American Jobs Creation Act of 2004.
- Chen, C.J., Li, Z., Su, X. and Sun, Z., 2011. Rent-seeking incentives, corporate political connections, and the control structure of private firms: Chinese evidence. *Journal of Corporate Finance*, 17(2), pp.229-243.
- Childs, P.D., Mauer, D.C. and Ott, S.H., 2005. Interactions of corporate financing and investment decisions: The effects of agency conflicts. *Journal of Financial Economics*, 76(3), pp.667-690.
- Cingano, F. and Pinotti, P., 2013. Politicians at work: The private returns and social costs of political connections. *Journal of the European Economic Association*, 11(2), pp.433-465.
- Claessens, S., Feijen, E. and Laeven, L., 2008. Political connections and preferential access to finance: The role of campaign contributions. *Journal of Financial Economics*, 88(3), pp.554-580.
- Clawson, D., Neustadt, A. and Weller, M., 1998. Dollars and votes: How business campaign contributions subvert democracy. Temple University Press.
- Coates, I.V. and John, C., 2012. Corporate politics, governance, and value before and after Citizens United. *Journal of Empirical Legal Studies*, 9(4), pp.657-696.
- Coles, J.L., Daniel, N.D. and Naveen, L., 2014. Co-opted boards. *The Review of Financial Studies*, 27(6), pp.1751-1796.

- Connolly, J., Craig, W., Goldberg, A. and Pepler, D., 1999. Conceptions of cross-sex friendships and romantic relationships in early adolescence. *Journal of Youth and Adolescence*, 28(4), pp.481-494.
- Cooper, M.J., Gulen, H. and Ovtchinnikov, A.V., 2010. Corporate political contributions and stock returns. *The Journal of Finance*, 65(2), pp.687-724.
- Cornell, B. and Shapiro, A.C., 1987. Corporate stakeholders and corporate finance. *Financial Management*, pp.5-14.
- Correia, M.M., 2014. Political connections and SEC enforcement. *Journal of Accounting and Economics*, 57(2), pp.241-262.
- Cronqvist, H. and Nilsson, M., 2003. Agency costs of controlling minority shareholders. *Journal of Financial and Quantitative analysis*, 38(4), pp.695-719.
- D'Mello, R. and Miranda, M., 2010. Long-term debt and overinvestment agency problem. *Journal of Banking & Finance*, 34(2), pp.324-335.
- De Figueiredo, R.J. and Edwards, G., 2007. Does private money buy public policy? Campaign contributions and regulatory outcomes in telecommunications. *Journal of Economics & Management Strategy*, 16(3), pp.547-576.
- De Figueiredo, J.M. and Silverman, B.S., 2006. Academic earmarks and the returns to lobbying. *The Journal of Law and Economics*, 49(2), pp.597-625.
- De Grauwe, P., 2018. *Economics of monetary union*. Oxford university press.
- Delis, M.D., Molyneux, P. and Pasiouras, F., 2011. Regulations and productivity growth in banking: Evidence from transition economies. *Journal of Money, Credit and Banking*, 43(4), pp.735-764.
- Dinç, I.S., 2005. Politicians and banks: Political influences on government-owned banks in emerging markets. *Journal of Financial Economics*, 77(2), pp.453-479.
- Drèze, J. and Stern, N., 1987. The theory of cost-benefit analysis. *Handbook of public economics* 2.
- Duchin, R. and Sosyura, D., 2012. The politics of government investment. *Journal of Financial Economics*, 106(1), pp.24-48.
- Eckbo, B.E., 2009. Bidding strategies and takeover premiums: A review. *Journal of Corporate Finance*, 15(1), pp.149-178.
- Eggers, A.C. and Hainmueller, J., 2014. Political capital: Corporate connections and stock investments in the US Congress, 2004-2008.
- Eisenberg, T. and Miller, G.P., 2004. Attorney fees in class action settlements: An empirical study. *Journal of Empirical Legal Studies*, 1(1), pp.27-78.

- Elvik, R., 1995. Explaining the distribution of State funds for national road investments between counties in Norway: Engineering standards or vote trading?. *Public Choice*, 85(3), pp.371-388.
- Engelberg, J., Gao, P. and Parsons, C.A., 2012. Friends with money. *Journal of Financial Economics*, 103(1), pp.169-188.
- Faccio, M., 2006. Politically connected firms. *The American Economic Review*, 96(1), pp.369-386.
- Faccio, M., 2010. Differences between politically connected and nonconnected firms: A cross-country analysis. *Financial Management*, 39(3), pp.905-928.
- Faccio, M., Masulis, R.W. and McConnell, J., 2006. Political connections and corporate bailouts. *The Journal of Finance*, 61(6), pp.2597-2635.
- Fan, J.P., Wong, T.J. and Zhang, T., 2007. Politically connected CEOs, corporate governance, and Post-IPO performance of China's newly partially privatized firms. *Journal of Financial Economics*, 84(2), pp.330-357.
- Feldman, S., 1988. Structure and consistency in public opinion: The role of core beliefs and values. *American Journal of Political Science*, pp.416-440.
- Ferris, S.P. and Houston, R., 2016. It's a Sweetheart of a Deal: Political Connections and Federal Contracting.
- Field, L., Lowry, M. and Shu, S., 2005. Does disclosure deter or trigger litigation?. *Journal of Accounting and Economics*, 39(3), pp.487-507.
- Firth, M., Rui, O.M. and Wu, W., 2011. The effects of political connections and state ownership on corporate litigation in China. *The Journal of Law and Economics*, 54(3), pp.573-607.
- Fisman, R., 2001. Estimating the value of political connections. *The American Economic Review*, 91(4), pp.1095-1102.
- Fisman, D., Fisman, R.J., Galef, J., Khurana, R. and Wang, Y., 2012. Estimating the value of connections to Vice-President Cheney. *The BE Journal of Economic Analysis & Policy*, 12(3).
- Fisman, R., Schulz, F. and Vig, V., 2016. Financial disclosure and political selection: Evidence from India.
- Ford, D., 1980. The development of buyer-seller relationships in industrial markets. *European Journal of Marketing*, 14(5/6), pp.339-353.
- Fracassi, C., 2016. Corporate finance policies and social networks. *Management Science*, 63(8), pp.2420-2438.
- Fracassi, C. and Tate, G., 2012. External networking and internal firm governance. *The Journal of Finance*, 67(1), pp.153-194.

- Francis, B.B., Hasan, I. and Sun, X., 2009. Political connections and the process of going public: Evidence from China. *Journal of International Money and Finance*, 28(4), pp.696-719.
- Francis, J., Philbrick, D. and Schipper, K., 1994. Shareholder litigation and corporate disclosures. *Journal of Accounting Research*, pp.137-164.
- Fredriksson, P.G., 2001. How pollution taxes may increase pollution and reduce net revenues. *Public Choice*, 107(1), pp.65-85.
- Fremeth, A., Richter, B.K. and Schaufele, B., 2016. Motivations for corporate political activity. *Strategy Beyond Markets*, pp. 161-191.
- Gande, A. and Lewis, C.M., 2009. Shareholder-initiated class action lawsuits: Shareholder wealth effects and industry spillovers. *Journal of Financial and Quantitative Analysis*, 44(4), pp.823-850.
- Gantchev, N., 2013. The costs of shareholder activism: Evidence from a sequential decision model. *Journal of Financial Economics*, 107(3), pp.610-631.
- Gao, M. and Huang, J., 2016. Capitalizing on Capitol Hill: Informed trading by hedge fund managers. *Journal of Financial Economics*, 121(3), pp.521-545.
- Garri, I., 2008. *Politician's Reputation and Policy (Un) persistence*. Università Cattolica del Sacro Cuore, Dipartimenti e Istituti di Scienze Economiche.
- Glynn, M., Lant, T., and Milliken, F., 1994. Mapping Learning Processes in Organizations: A Multi-level Framework Linking Learning and Organizing. *Advances in Managerial Cognition and Organizational Information Processing*, 5, pp.43-83.
- Goldman, E., Rocholl, J. and So, J., 2009. Do politically connected boards affect firm value?. *The Review of Financial Studies*, 22(6), pp.2331-2360.
- Goldman, E., Rocholl, J. and So, J., 2013. Politically connected boards of directors and the allocation of procurement contracts. *Review of Finance*, 17(5), pp.1617-1648.
- Goren, P., 2005. Party identification and core political values. *American Journal of Political Science*, 49(4), pp.881-896.
- Gounopoulos, D., Kallias, A., Kallias, K. and Tzeremes, P.G., 2017. Political money contributions of US IPOs. *Journal of Corporate Finance*, 43, pp.19-38.
- Granovetter, M., 2007. The social construction of corruption. *On capitalism*, 15.
- Guiso, L., Sapienza, P. and Zingales, L., 2009. Cultural biases in economic exchange?. *The Quarterly Journal of Economics*, 124(3), pp.1095-1131.
- Hackman, J.R., 2002. Leading teams: Setting the stage for great performances.
- Haleblian, J.J., Kim, J.Y.J. and Rajagopalan, N., 2006. The influence of acquisition experience and performance on acquisition behavior: Evidence from the US commercial banking industry. *Academy of Management Journal*, 49(2), pp.357-370.

- Hansen, W.L., Rocca, M.S. and Ortiz, B.L., 2015. The effects of Citizens United on corporate spending in the 2012 presidential election. *The Journal of Politics*, 77(2), pp.535-545.
- Harper, R.K. and Adams, S.C., 1996. CERCLA and deep pockets: Market response to the Superfund program. *Contemporary Economic Policy*, 14(1), pp.107-115.
- Hart, S.L. and Ahuja, G., 1996. Does it pay to be green? An empirical examination of the relationship between emission reduction and firm performance. *Business Strategy and the Environment*, 5(1), pp.30-37.
- Haslem, B., 2005. Managerial opportunism during corporate litigation. *The Journal of Finance*, 60(4), pp.2013-2041.
- Haslem, B., Hutton, I. and Smith, A.H., 2017. How much do corporate defendants really lose? A new verdict on the reputation loss induced by corporate litigation. *Financial Management*, 46(2), pp.323-358.
- Heider, F., 2013. *The psychology of interpersonal relations*. Psychology Press.
- Hill, C.W. and Jones, T.M., 1992. Stakeholder-agency theory. *Journal of Management Studies*, 29(2), pp.131-154.
- Hill, M.D., Kelly, G.W., Lockhart, G.B. and Ness, R.A., 2013. Determinants and effects of corporate lobbying. *Financial Management*, 42(4), pp.931-957.
- Hillman, A.J., 2003. Determinants of political strategies in US multinationals. *Business & Society*, 42(4), pp.455-484.
- Hillman, A.J., 2005. Politicians on the board of directors: Do connections affect the bottom line?. *Journal of Management*, 31(3), pp.464-481.
- Hillman, A.J. and Hitt, M.A., 1999. Corporate political strategy formulation: A model of approach, participation, and strategy decisions. *Academy of Management Review*, 24(4), pp.825-842.
- Hinde, R.A., 1996. Describing relationships. *The diversity of human relationships*, pp.7-35.
- Hovakimian, A. and Li, G., 2011. In search of conclusive evidence: How to test for adjustment to target capital structure. *Journal of Corporate Finance*, 17(1), pp.33-44.
- Huberman, G., 2001. Familiarity breeds investment. *Review of Financial Studies*, 14(3), pp.659-680.
- Hutton, I., Peterson, D.R. and Smith, A.H., 2014. The effect of securities litigation on external financing. *Journal of Corporate Finance*, 27, pp.231-250.
- Hwang, B.H. and Kim, S., 2009. It pays to have friends. *Journal of Financial Economics*, 93(1), pp.138-158.

- Infante, L. and Piazza, M., 2014. Political connections and preferential lending at local level: Some evidence from the Italian credit market. *Journal of Corporate Finance*, 29, pp.246-262.
- Jacobson, G.C. and Dimock, M.A., 1994. Checking out: The effects of bank overdrafts on the 1992 house elections. *American Journal of Political Science*, pp.601-624.
- Jerke, B.W., 2010. Cashing in on Capitol Hill: Insider trading and the use of political intelligence for profit. *University of Pennsylvania Law Review*, pp.1451-1521.
- Jensen, M.C. and Meckling, W.H., 1976. Theory of the firm: Managerial behavior, agency costs and ownership structure. *Journal of Financial Economics*, 3(4), pp.305-360.
- Jiao, Y., 2010. Stakeholder welfare and firm value. *Journal of Banking & Finance*, 34(10), pp.2549-2561.
- Jiménez-Jiménez, D. and Sanz-Valle, R., 2011. Innovation, organizational learning, and performance. *Journal of Business Research*, 64(4), pp.408-417.
- Johnson, S. and Mitton, T., 2003. Cronyism and capital controls: evidence from Malaysia. *Journal of Financial Economics*, 67(2), pp.351-382.
- Johnson, M.F., Kasznik, R. and Nelson, K.K., 2000. Shareholder wealth effects of the private securities litigation reform act of 1995. *Review of Accounting Studies*, 5(3), pp.217-233.
- Jost, J.T., Nosek, B.A. and Gosling, S.D., 2008. Ideology: Its resurgence in social, personality, and political psychology. *Perspectives on Psychological Science*, 3(2), pp.126-136.
- Kalay, A. and Lemmon, M., 2008. Payout Policy, Handbook of Corporate Finance: Empirical Corporate Finance, 2.
- Karpoff, J.M., Lee, D.S. and Martin, G.S., 2008. The cost to firms of cooking the books. *Journal of Financial and Quantitative Analysis*, 43(3), pp.581-611.
- Kaufmann, D. and Wei, S.J., 1999. Does grease money speed up the wheels of commerce?.
- Khwaja, A.I. and Mian, A., 2005. Do lenders favor politically connected firms? Rent provision in an emerging financial market. *The Quarterly Journal of Economics*, 120(4), pp.1371-1411.
- Kim, I. and Skinner, D.J., 2012. Measuring securities litigation risk. *Journal of Accounting and Economics*, 53(1), pp.290-310.
- Koku, P.S., 2006. An analysis and the effects of class-action lawsuits. *Journal of Business Research*, 59(4), pp.508-515.
- Lake, J., 2015. Revisiting the link between PAC contributions and lobbying expenditures. *European Journal of Political Economy*, 37, pp.86-101.

- Levitt, B. and March, J.G., 1988. Organizational learning. *Annual Review of Sociology*, 14(1), pp.319-338.
- Lim, M.H. and Lee, J.H., 2016. The effects of industry relatedness and takeover motives on cross-border acquisition completion. *Journal of Business Research*, 69(11), pp.4787-4792.
- Mann, T.E., 2003. Linking knowledge and action: Political science and campaign finance reform. *Perspectives on Politics*, 1(1), pp.69-83.
- Marglin, S.A., 1968. The Discount Rate in Public Investment Evaluation.
- Marin, J.M., Akin, O. and Peydró, J.L., 2016. Anticipating the financial crisis: Evidence from insider trading in banks.
- Martin, K., 1996. The method of payment in corporate acquisitions, investment opportunities, and management ownership. *The Journal of Finance*, 51(4), pp.1227-1246.
- Marvel, H.P., 1977. Factory Regulation: A Reinterpretation of Early English Experience. *The Journal of Law and Economics*, 20(2), pp.379-402.
- McTier, B.C. and Wald, J.K., 2011. The causes and consequences of securities class action litigation. *Journal of Corporate Finance*, 17(3), pp.649-665.
- McWilliams, A., Van Fleet, D.D. and Cory, K.D., 2002. Raising rivals' costs through political strategy: An extension of resource-based theory. *Journal of Management Studies*, 39(5), pp.707-724.
- Melgar, N., Rossi, M. and Smith, T.W., 2010. The perception of corruption. *International Journal of Public Opinion Research*, 22(1), pp.120-131.
- Millar, F.E. and Rogers, L.E., 1988. Power dynamics in marital relationships. *Perspectives on Marital Interaction*, pp.78-97.
- Milyo, J., Primo, D. and Groseclose, T., 2000. Corporate PAC campaign contributions in perspective. *Business and Politics*, 2(1), pp.75-88.
- Minnick, K. and Noga, T., 2017. The influence of firm and industry political spending on tax management among S&P 500 firms. *Journal of Corporate Finance*, 44, pp.233-254.
- Mintzberg, H., 1989. The structuring of organizations. *Readings in Strategic Management*, pp. 322-352.
- Mobarak, A.M. and Purbasari, D.P., 2006. Corrupt protection for sale to firms: evidence from Indonesia. Unpublished working paper, University of Colorado at Boulder.
- Mohammad, S. and Crane, A., 2015. Theorizing Reputational Spillovers.
- Morgan, R.M. and Hunt, S.D., 1994. The commitment-trust theory of relationship marketing. *Journal of Marketing*, pp.20-38.
- Mulherin, J.H., 2007. Measuring the costs and benefits of regulation: Conceptual issues in securities markets. *Journal of Corporate Finance*, 13(2-3), pp.421-437.

- Murtha, T.P. and Lenway, S.A., 1994. Country capabilities and the strategic state: How national political institutions affect multinational corporations' strategies. *Strategic Management Journal*, 15(S2), pp.113-129.
- Naudé, P. and Buttle, F., 2000. Assessing relationship quality. *Industrial Marketing Management*, 29(4), pp.351-361.
- Offenberg, D. and Pirinsky, C., 2015. How do acquirers choose between mergers and tender offers?. *Journal of Financial Economics*, 116(2), pp.331-348.
- Offenberg, D., Straska, M. and Waller, H.G., 2014. Who gains from buying bad bidders?. *Journal of Financial and Quantitative Analysis*, 49(2), pp.513-540.
- Officer, M.S., 2003. Termination fees in mergers and acquisitions. *Journal of Financial Economics*, 69(3), pp.431-467.
- Ovtchinnikov, A.V. and Pantaleoni, E., 2012. Individual political contributions and firm performance. *Journal of Financial Economics*, 105(2), pp.367-392.
- Palmatier, R.W., Dant, R.P. and Grewal, D., 2007. A comparative longitudinal analysis of theoretical perspectives of interorganizational relationship performance. *Journal of Marketing*, 71(4), pp.172-194.
- Pettersson, D. and Karlström, P., 2011. Reputation as a product: Politicians in Social Media.
- Powell, E.N. and Grimmer, J., 2016. Money in exile: campaign contributions and committee access. *The Journal of Politics*, 78(4), pp.974-988.
- Posner, E. and Weyl, E.G., 2013. Benefit-cost analysis for financial regulation. *The American Economic Review*, 103(3), pp.393-97.
- Pritchard, A.C. and Ferris, S.P., 2001. Stock price reactions to securities fraud class actions under the private securities litigation reform act.
- Romano, R., 1991. The shareholder suit: litigation without foundation?. *Journal of Law, Economics, & Organization*, 7(1), pp.55-87.
- Rothenberg, J., 1969. Cost-benefit analysis: A methodological exposition.
- Santos, J.A., 2001. Bank capital regulation in contemporary banking theory: A review of the literature. *Financial Markets, Institutions & Instruments*, 10(2), pp.41-84.
- Schmidt, B., 2015. Costs and benefits of friendly boards during mergers and acquisitions. *Journal of Financial Economics*, 117(2), pp.424-447.
- Schmitter, P.C., 1977. Modes of interest intermediation and models of societal change in Western Europe. *Comparative Political Studies*, 10(1), pp.7-38.
- Schuler, D.A., 1996. Corporate political strategy and foreign competition: The case of the steel industry. *Academy of Management Journal*, 39(3), pp.720-737.

- Schwert, G.W., 1996. Markup pricing in mergers and acquisitions. *Journal of Financial Economics*, 41(2), pp.153-192.
- Shepherd, J.M., 2009. The influence of retention politics on judges' voting. *The Journal of Legal Studies*, 38(1), pp.169-206.
- Siaroff, A., 1999. Corporatism in 24 industrial democracies: Meaning and measurement. *European Journal of Political Research*, 36(2), pp.175-205.
- Snehota, I. and Hakansson, H., 1995. *Developing relationships in business networks*. London: Routledge.
- Snyder Jr, J.M., 1992. Long-term investing in politicians; or, give early, give often. *The Journal of Law and Economics*, 35(1), pp.15-43.
- Stephan, A.P., Walther, B.R. and Wellman, L.A., Maintaining Access to Political Information: Evidence on the Exchange of Information Between Brokerage Houses and Politicians.
- Stráska, M. and Waller, G., 2010. Do antitakeover provisions harm shareholders?. *Journal of Corporate Finance*, 16(4), pp.487-497.
- Stratmann, T., 1992. The effects of logrolling on congressional voting. *The American Economic Review*, pp.1162-1176.
- Stratmann, T., 2005. Some talk: Money in politics. A (partial) review of the literature. In *Policy Challenges and Political Responses* (pp. 135-156). Springer, Boston, MA.
- Sun, P., Hu, H.W. and Hillman, A.J., 2016. The dark side of board political capital: Enabling blockholder rent appropriation. *Academy of Management Journal*, 59(5), pp.1801-1822.
- Sun, P., Mellahi, K. and Wright, M., 2012. The contingent value of corporate political ties. *The Academy of Management Perspectives*, 26(3), pp.68-82.
- Sunstein, C.R., Schkade, D. and Ellman, L.M., 2004. Ideological voting on federal courts of appeals: A preliminary investigation. *Virginia Law Review*, pp.301-354.
- Tahoun, A., 2014. The role of stock ownership by US members of Congress on the market for political favors. *Journal of Financial Economics*, 111(1), pp.86-110.
- Tahoun, A. and Vasvari, F.P., 2016. Political lending.
- Tripathi, M., Ansolabehere, S. and Snyder, J.M., 2002. Are PAC contributions and lobbying linked? New evidence from the 1995 Lobby Disclosure Act. *Business and Politics*, 4(2), pp.131-155.
- Tullock, G., 1972. The purchase of politicians. *Western Economic Journal*, 10(3), pp.354-55.
- Vidal, J., Draca, M. and Fons-Rosen, C., 2012. Revolving door lobbyists. *The American Economic Review*, 102(7), pp.3731-48.

- Villalonga, B., Amit, R., Trujillo, M.A. and Guzmán, A., 2015. Governance of family firms. *Annual Review of Financial Economics*, 7, pp.635-654.
- Wank, D., 2002. Business-state clientelism in China: Decline or evolution. *Social connections in China: Institutions, culture, and the changing nature of guanxi*, 21, p.97.
- Welch, S. and Hibbing, J.R., 1997. The effects of charges of corruption on voting behavior in congressional elections, 1982-1990. *The Journal of Politics*, 59(1), pp.226-239.
- Williams, A., 1974. The cost-benefit approach. *British Medical Bulletin*, 30(3), pp.252-256.
- Wu, W., Wu, C., Zhou, C. and Wu, J., 2012. Political connections, tax benefits and firm performance: Evidence from China. *Journal of Accounting and Public policy*, 31(3), pp.277-300.
- Yang, Z., 2013. Do political connections add value to audit firms? Evidence from IPO audits in China. *Contemporary Accounting Research*, 30(3), pp.891-921.
- Yoffie, D. 1988. How an industry builds political advantage. *Harvard Business Review*, 38, pp.80-89.
- Yu, T. and Lester, R.H., 2008. Moving beyond firm boundaries: A social network perspective on reputation spillover. *Corporate Reputation Review*, 11(1), pp.94-108.

VITA

Anna Abdulmanova completed her undergraduate degree in economics in 2007. She received her graduate degree in finance in 2009 and worked as a financial analyst prior to joining the finance doctoral program at the University of Missouri.