

Corporate political contributions and stock returns

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[Main question]

- Do firms benefit (in some measurable way) by their involvement in the US political system?

Summary of the Political Science Research

- Firms that contribute money to politicians appear to enjoy more frequent and better-quality access to politicians
 - Kroszner and Stratmann (1998), Langbein and Lotwis (1990), Durden et al (1991), Stratmann (1991), Stratmann (1995, 1998)

- Funds raised by candidates help them win elections.
 - Snyder (1990)

- *However*, contributing firms and firms with other types of political connectedness do not appear to change the outcome of votes on issues critical to connected firms.
 - Ansolabehere, de Figueiredo, and Snyder (2003)

- So, firms do not measurably benefit, but instead participate in the political system from the standpoint of consuming a “patriotic consumption good.”
 - Ansolabehere, de Figueiredo, and Snyder (2003)

[Anecdotal examples of firms helping politicians]

“It is not who votes that counts, it is who counts the votes.”

Joseph Stalin, 1923

...According to papers filed with the IRS on July 15 (2002), nearly \$14 million magically poured into the Bush/Cheney Florida recount effort - four times the amount raised by the Gore/Lieberman camp.

...From the Center for Responsive Politics: "Eighteen months after the election, we find that the (Bush) administration literally flew into office on the Enron corporate jet," said Jennifer Palmieri, press secretary for the Democratic National Committee.

More examples of firms helping politicians

- The *New York Times* (see McIntire (2006)) reports that large insurance companies in New York State skirted around legal contribution limits to candidates by routing contributions through dozens of obscure subsidiaries.
- *The Salt Lake Tribune* (see Drinkard (2006)) reports that FedEx, U.S. Tobacco, Union Pacific, the Texas plaintiff's law firm of Baron & Budd, Burlington Northern Santa Fe, R.J. Reynolds, and Barr Laboratories are among those companies that most frequently fly members of Congress around the country on their company jets, upon request of the politician.
- *The Wall Street Journal* (see Mullins (2007)) reports on the increased practice of "bundling," which effectively allows a firm to donate much more to a candidate than the legal PAC contribution limits.

Anecdotal examples of politicians helping firms

- *The Washington Post* (see Abrams (2006)) reports that House members routinely insert special “earmark” funding requests (narrowly tailored spending that helps a specific company in their district) into bills.
- *The Salt Lake Tribune* (2006) reports that former congressman Randy Cunningham pressured staff members of the House Intelligence Committee into steering more than \$70 million in classified federal business to favored military contractors.
- *The New York Times* (see Barta (2006)) reports two senators from coal producing states introduced a bill to offer loan guarantees and tax incentives for U.S coal-to-liquid plants.
- Historically, Benmelech and Moskowitz (2006) discuss that Senate initiated usury laws were used by the “elite” to control entry, hamper competition, and lower their cost of capital.
- And many more examples...

[What we do]

- We examine whether firms are rewarded in terms of increased shareholder wealth for their involvement in the U.S. political system.
- To answer this question, we develop a new and comprehensive database of firm-level “connectedness” to politicians.
- We find that the firm connectedness variables are positively correlated with the cross-section of future stock returns.

[Data]

- What do we use for our firm-to-politician connectedness measures?

The possible paths of firm-politician “connectedness”

Firm

Hard money contributions

Firm PAC

Employee contributions

Other firm PACs

Other PACs

Other forms of support:

Soft money contributions

527 Organizations

Independent expenditures

“Non-money favors”; legal and illegal

Illegal contributions

Firm lobbyists

Industry lobbyists

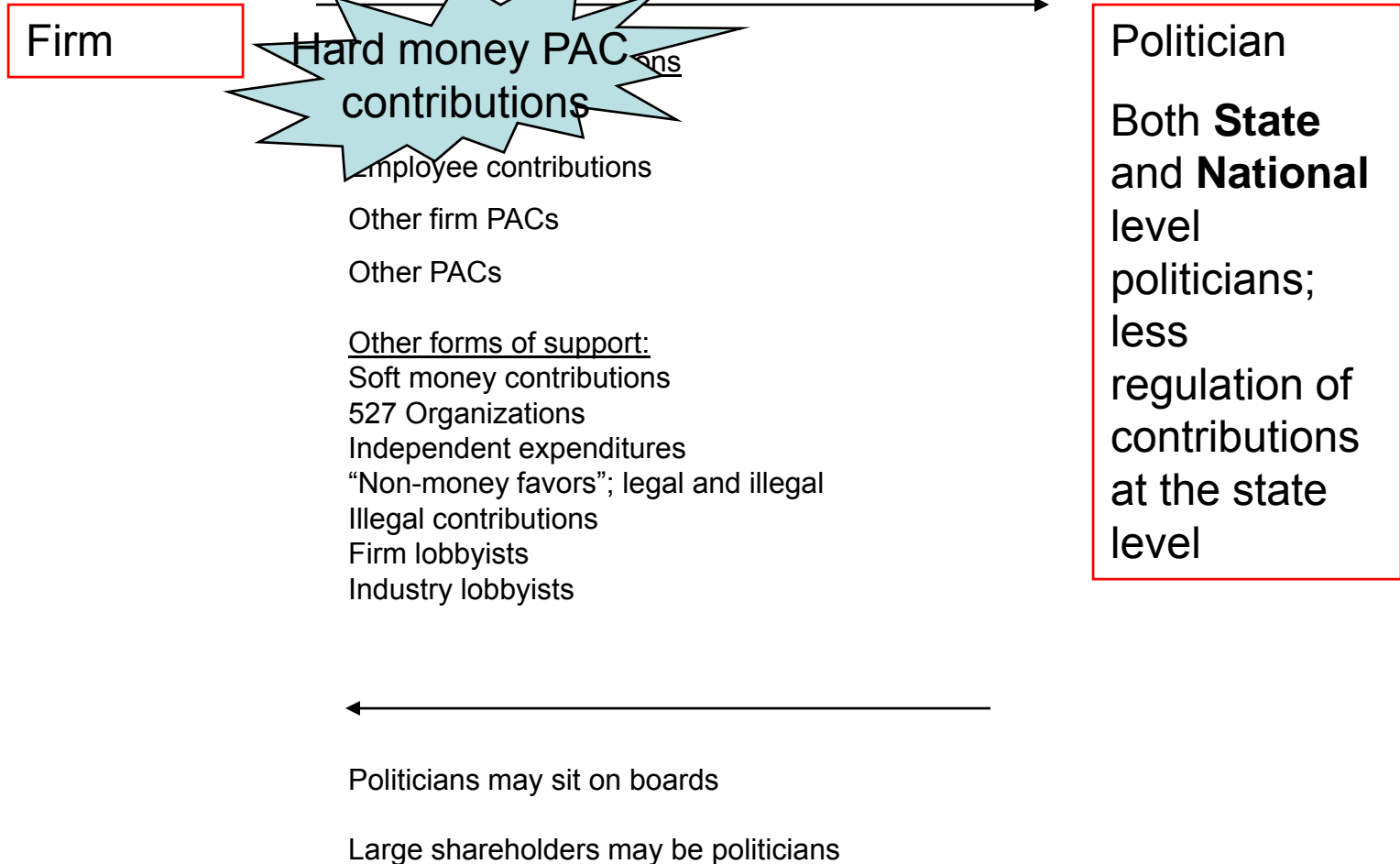
Politician

Both **State**
and **National**
level
politicians;
less
regulation of
contributions
at the state
level

←
Politicians may sit on boards

Large shareholders may be politicians

Firm-politician “connectedness”



Data

- We use an extensive dataset on hard-money contributions from the U.S. Federal Election Commission (FEC).
 - Contains all hard money contributions over \$200
 - 13 election cycles over 1979 – 2004 period
 - Presidential, Senate and House races

- We intersection the FEC data with the CRSP/COMPUSTAT databases
 - We manually map the PAC identity to firms in CRSP/COMPUSTAT
 - 770,000 contributions by 1522 public firms' PACs from 1979-2004

Rodney Smith of SBC Communications on the value of hard money contributions

"We always prefer to give the money directly to the guy, or the woman, that you're going to support. You like to walk in, you like to give them the check, you like to look in their eye and say 'I'm here to help you.' You always do."

[Some background on contributions]

- How systematic and wide-spread is corporate involvement in the political process?

Figure 1 Panel A

Contributions to House Democrats

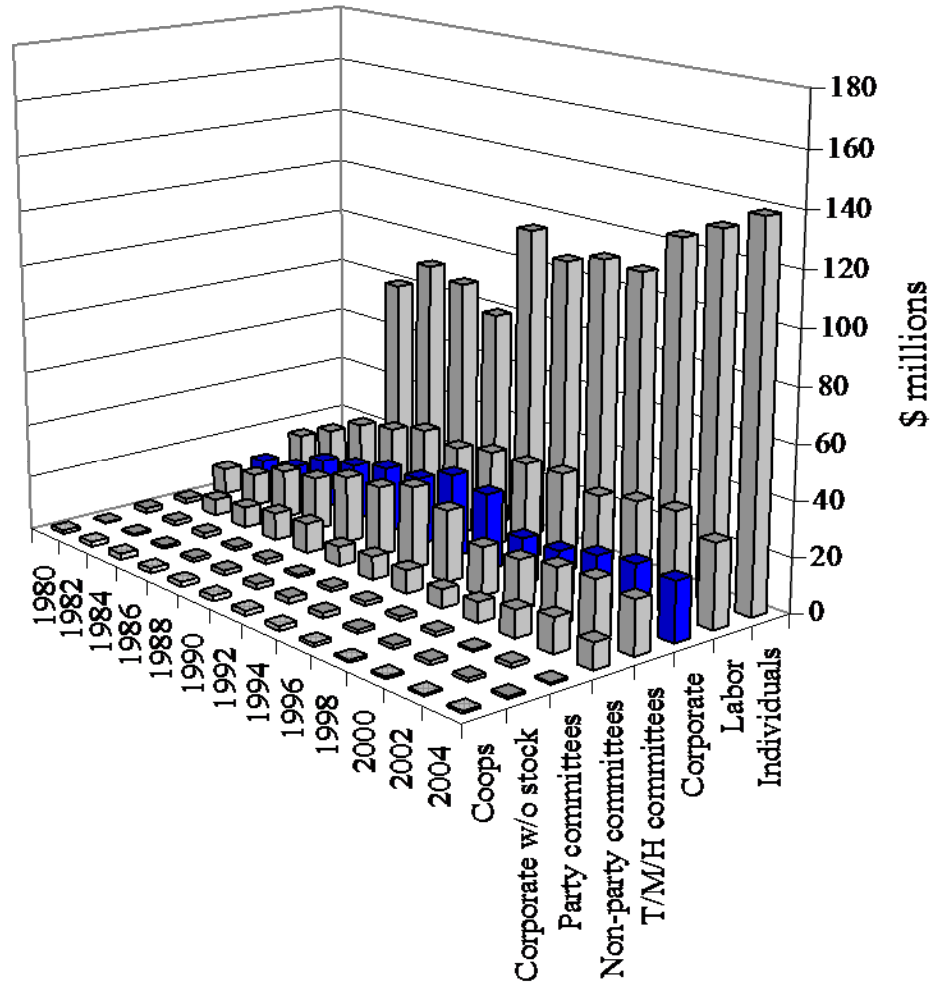


Figure 1 Panel A

Contributions to House Republicans

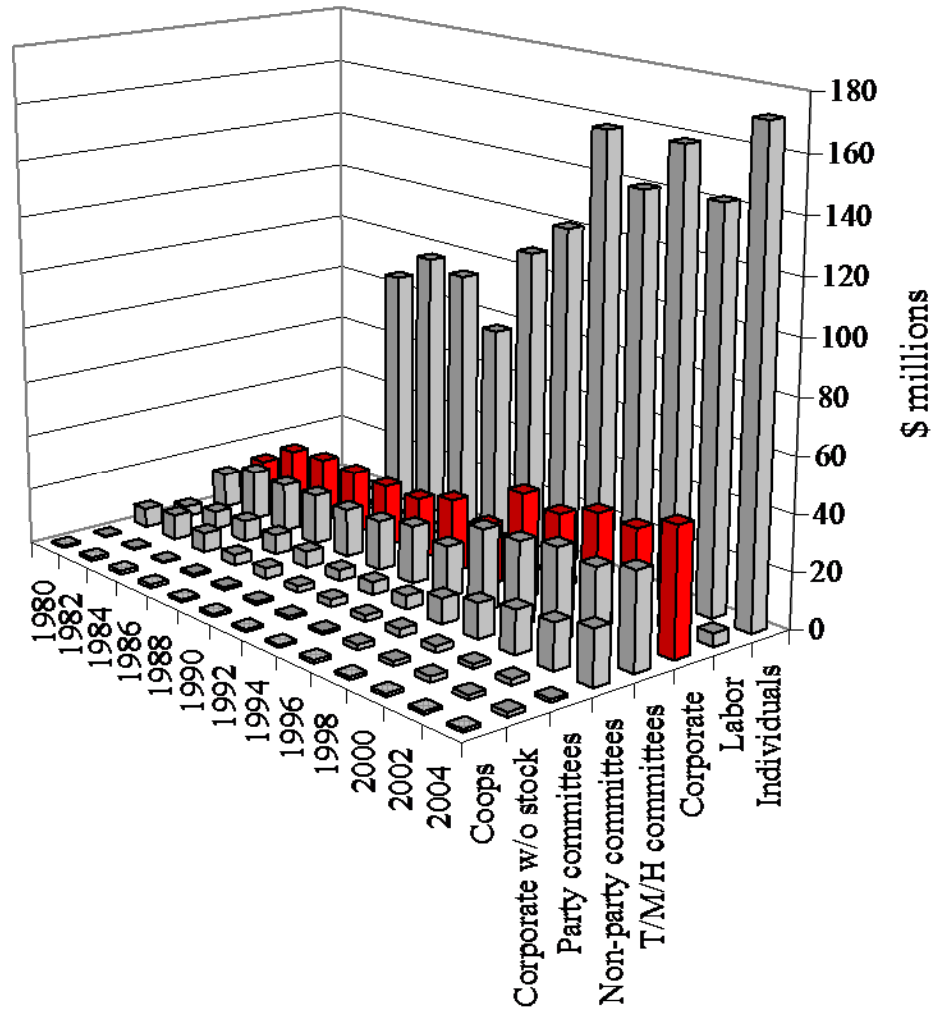


Figure 1 Panel B

Contributions to Senate Democrats

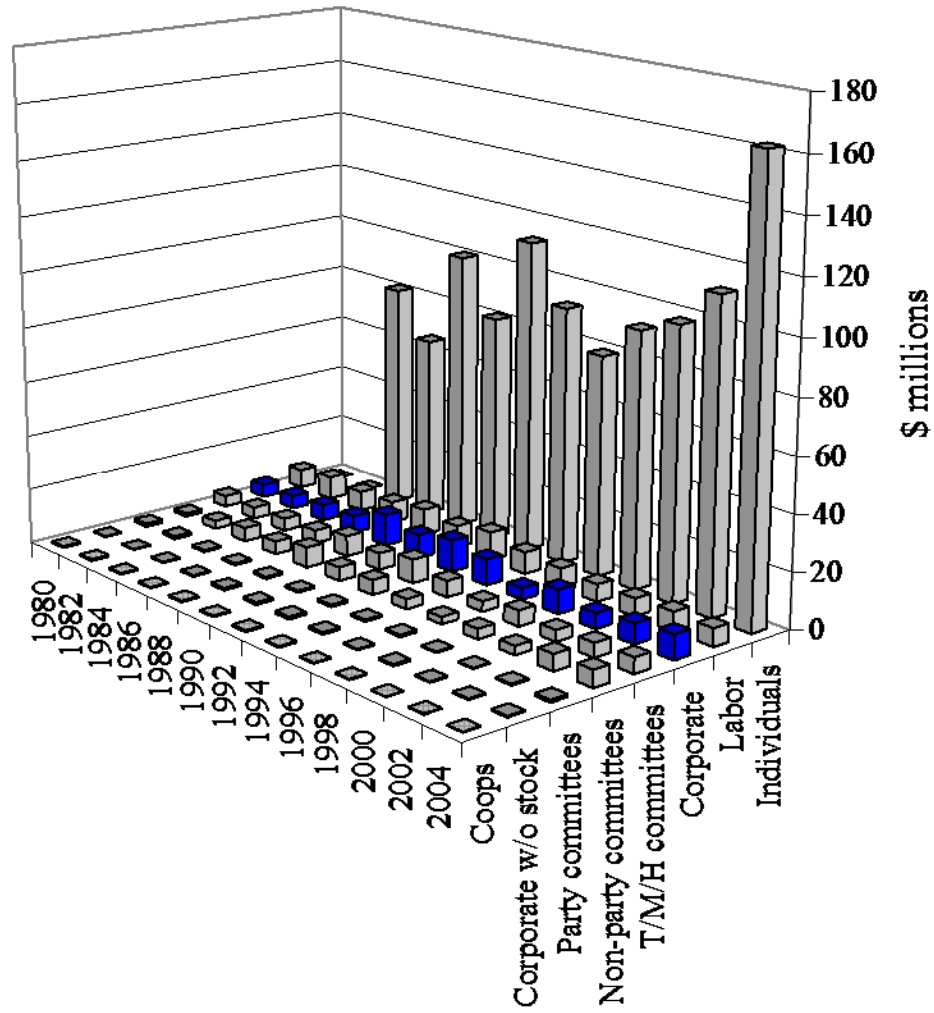


Figure 1 Panel B

Contributions to Senate Republicans

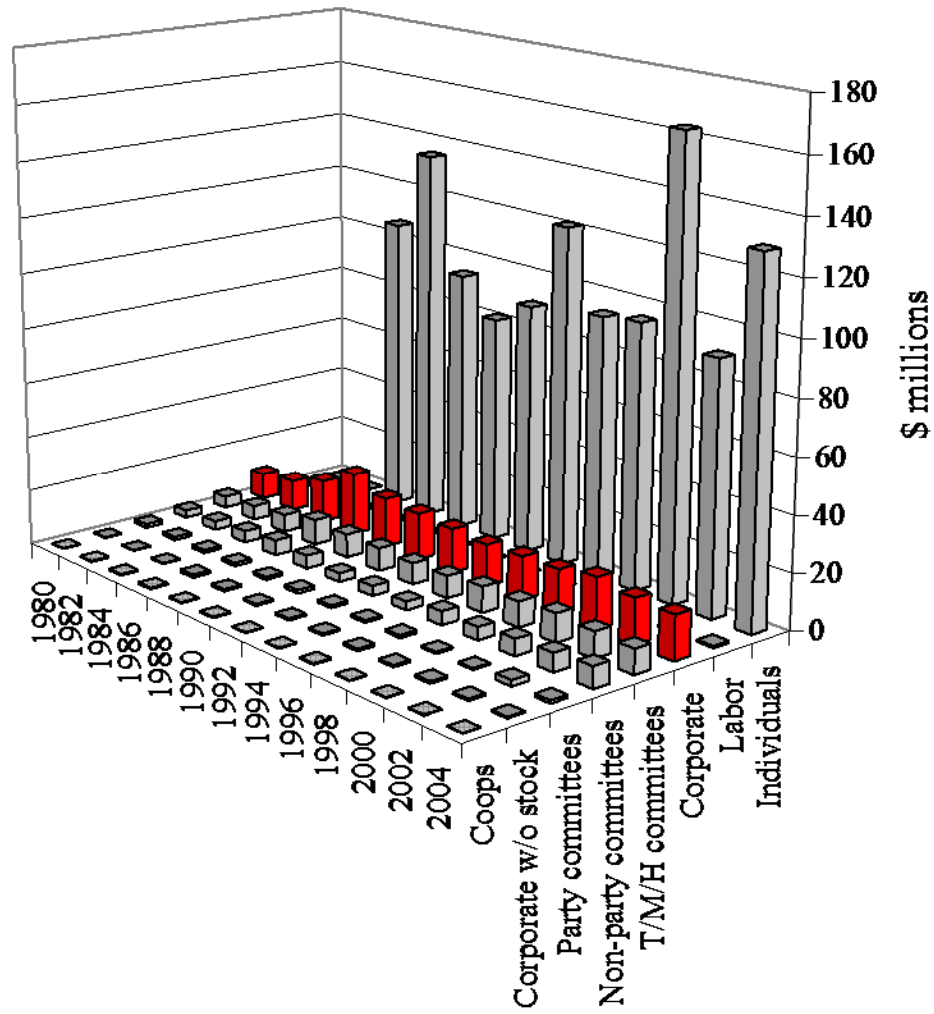


Figure 2 Panel A

Corporate Contributions as a Percentage of House Candidates' Total Campaign Financing

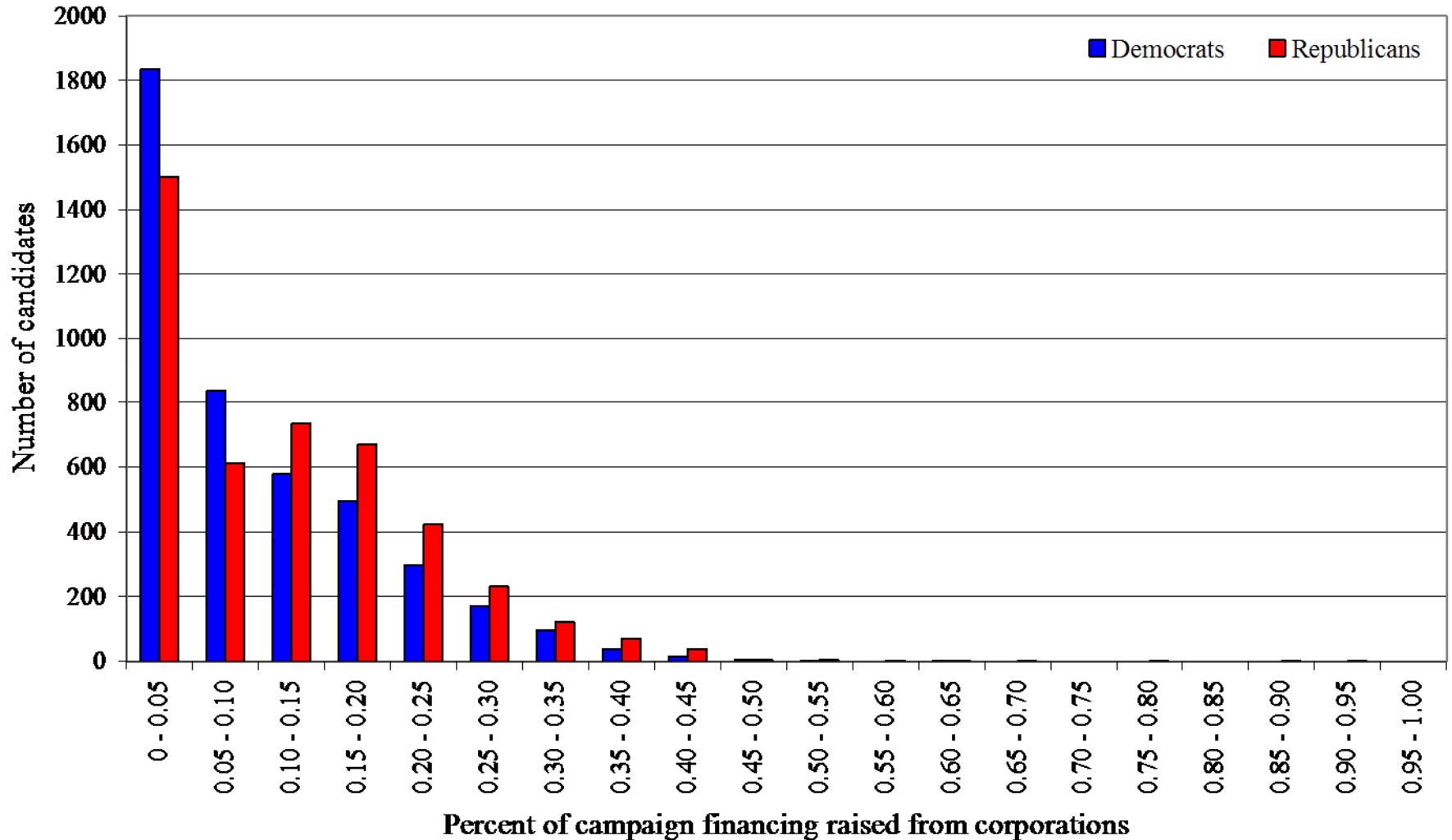
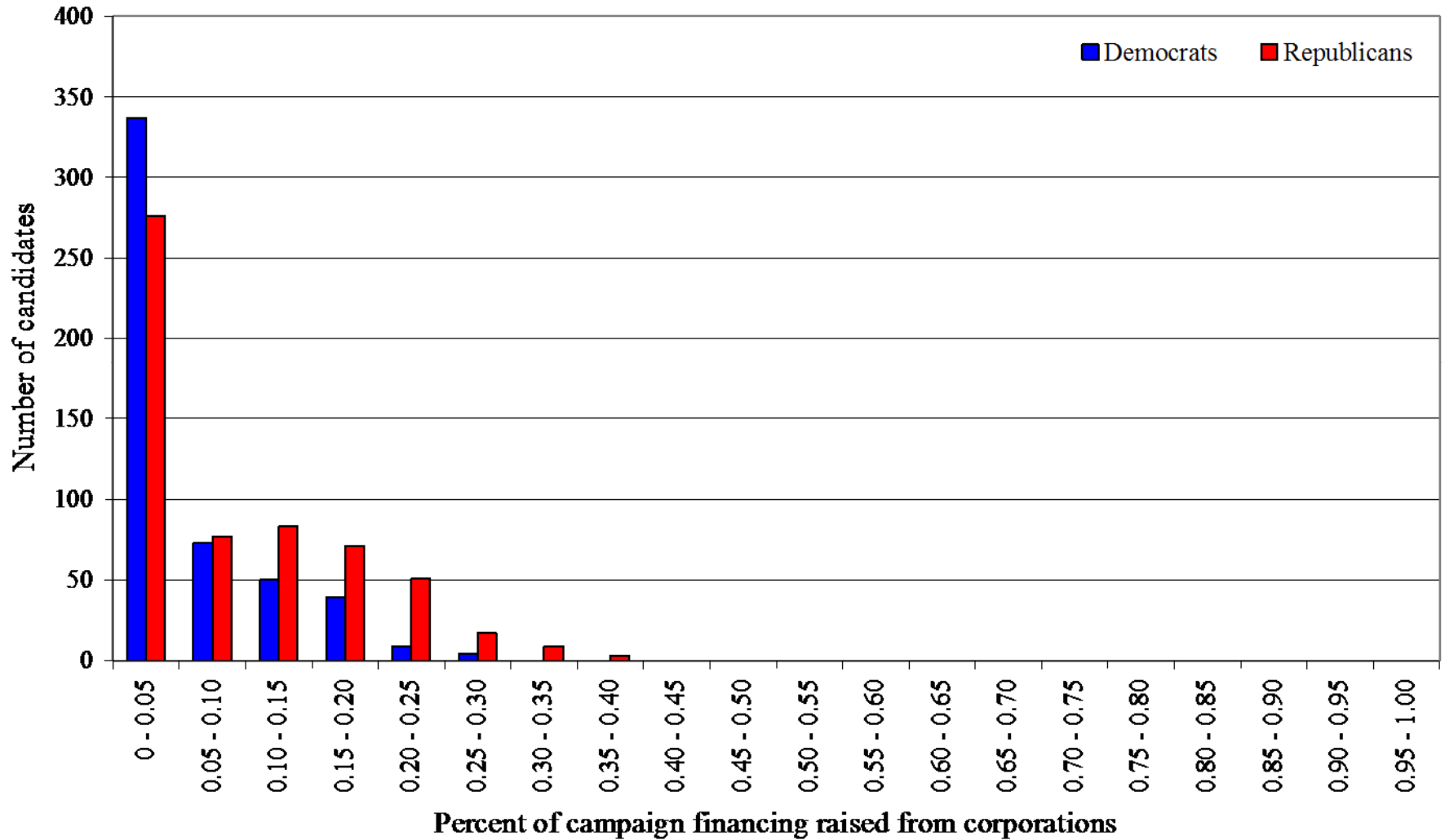


Figure 2 Panel B

Corporate Contributions as a Percentage of Senate Candidates' Total Campaign Financing



Contribution patterns

- Individuals constitute the largest group of contributors; the average contribution is about \$115.
- Corporate contributions constitute a lower fraction of candidates' total campaign financing; but their dollar amounts are much larger than those of individuals; the average corporate PAC contribution is about \$2000.
- Significant heterogeneity across candidates in the ratio of corporate contributions to total contributions
- Firms give on average 56 contributions to 31 candidates over a two-year period.
- Greater amount of contributions to Republicans and House members
- Contributing firms are few and large
- $(\text{Amount of contributions}) / (\# \text{ of candidates})$ about constant
- Contribution limits not binding

Contributions Data

■ Variables

- contribution
 - date
 - amount
 - contributing PAC identity (we manually map this to CRSP/COMPUSTAT)
 - candidate
 - sought after office
 - state and district
 - party affiliation
 - election outcome
 - committee assignments and rankings

[We create four political contribution indexes]

- Number of supported candidates index

$$PI_{it}^{candidates} = \sum_{j=1}^J Cand_{jt,t-5}$$

Political contribution indexes

- Strength index
 - Kroszner and Stratmann (1998)
 - specialized committees facilitate long-term relationships with politicians and repeat interactions
 - Stratmann (1998)
 - timing of contributions is related to politician's reputation

$$PI_{it}^{strength} = \sum_{j=1}^J Cand_{jt,t-5} \times I_{jt} \times \frac{NCV_{jt}}{NOV_{jt}} \times relength_{jt,t-5}$$

Political contribution indexes

■ Ability index

- Kroszner and Stratmann (1998)
 - firms decrease contributions to retiring politicians or politicians who change jurisdiction
- Faccio and Parsley (2006)
 - politicians favor “local” enterprises

$$PI_{it}^{ability} = \sum_{j=1}^J HomeCandidate_{jt,t-5} \times I_{jt} \times \frac{NCV_{jt}}{NOV_{jt}}$$

Political contribution indexes

- Power index
 - Grier and Munger (1991), Romer and Snyder (1994), Ansolabehere and Snyder (1999)
 - powerful politicians raise more money and appear to have the ability to more easily create earmark funding

$$PI_{it}^{power} = \sum_{j=1}^J Cand_{jt,t-5} \times I_{jt} \times \frac{NCV_{jt}}{NOV_{jt}} \times \left[\sum_{m=1}^M \frac{Committee\ rank_{mt}}{Median\ committee\ rank_{mt}} \right]_j$$

Descriptive statistics

Table II
Political Indexes Descriptive Statistics

Political index	Units	Mean	St Dev	Min	25 th Per	Median	75 th Per	Maximum
<i>PI</i> candidates	candidates	72.48	95.89	1	10	31	98	818
<i>PI</i> strength	candidate-months	1,690.98	3,394.43	0	64.62	373.70	1,614.12	49,816.64
<i>PI</i> ability	home candidates	6.86	7.27	0	1.46	4.93	9.73	60.17
<i>PI</i> power	candidate-committee rank	256.18	337.39	0	33.09	111.00	351.79	2,619.88

Descriptive statistics

- Sample firms (Table III)
 - relative to non-contributors, contributors are
 - larger
 - worse stock price performers
 - more profitable
 - more levered
 - patterns generally true within contributing firms as well

Table III
Characteristics of Contributing and Non-Contributing Firms

	BHRET36	BHRET6	ASSETS	SIZE	SIZE- AVG	BM	LEVERAGE	CF	EMP	PROFIT	ROE	Number of Supported Candidates	Number of firms
<i>Panel A: Comparison of non-contributing and contributing firms</i>													
Non-contributors	30.28%	8.82%	107	72	483	0.6662	0.1506	0.0562	0.64	10.93%	8.34%	N/A	4,076.74
All contributors	26.33%	8.67%	3,088	1,552	6,122	0.7319	0.2553	0.0603	9.39	12.77%	13.19%	42.91	691.61
t-test (difference)	-1.88	-0.04	14.65	8.54	5.53	1.26	14.82	1.94	45.87	4.49	13.32	N/A	
<i>Panel B: Comparison of contributing firms partitioned by the number of supported candidates index</i>													
Low Number of Supported Candidates	32.27%	7.93%	787	354	1,175	0.7168	0.2455	0.0661	2.60	12.78%	12.64%	2.27	
Decile 2	30.83%	9.87%	1,025	424	1,149	0.7435	0.2700	0.0568	2.83	11.61%	12.37%	6.23	
Decile 3	27.87%	8.58%	1,349	563	1,130	0.8172	0.2675	0.0587	3.11	11.85%	12.75%	11.00	
Decile 4	25.18%	8.56%	1,579	678	1,350	0.8103	0.2845	0.0541	3.75	11.86%	12.91%	17.16	
Decile 5	24.06%	8.83%	1,563	888	1,938	0.7643	0.2620	0.0549	5.21	11.77%	12.68%	25.77	
Decile 6	25.97%	8.24%	2,227	1,192	2,387	0.7564	0.2787	0.0558	7.29	12.17%	12.59%	39.41	
Decile 7	28.56%	8.52%	2,925	1,885	4,032	0.6833	0.2427	0.0639	11.51	13.70%	13.43%	62.02	
Decile 8	24.93%	8.75%	4,866	2,874	5,696	0.6825	0.2481	0.0640	16.60	13.53%	13.42%	98.45	
Decile 9	25.44%	7.83%	8,204	4,925	9,403	0.7014	0.2556	0.0632	25.39	13.47%	13.40%	158.00	
High Number of Supported Candidates	26.04%	9.15%	17,329	11,790	23,773	0.6431	0.2278	0.0653	54.88	14.11%	15.05%	286.05	
t-test (high – low)	-2.14	0.38	7.89	6.30	5.21	-1.23	-1.59	-0.27	32.22	2.37	4.82	62.33	

Descriptive statistics

- Predicting which firms contribute
 - Probit model with all firms
 - Firms are more likely to contribute as:
 - size increases
 - leverage increases
 - market share increases
 - geographic concentration increases
 - regulation increases
 - government purchases increase
 - cash-flow decreases

Cross-sectional regressions

- FM (1973) monthly regressions of firm returns on
 - variable of interest
 - Ln(political contribution indexes (PIs))
 - controls
 - Ln(BM) - book-to-market ratio
 - Ln(SIZE) - market cap
 - BHRET6 - 6-month buy-and-hold raw return
 - all RHS variables are lagged
 - timing
 - PIs updated at the end of October
 - as convention, other controls updated at the end of June
 - SE adjusted for autocorrelation in beta estimates

Cross-sectional regression results

- Political contribution indexes help explain the cross-section of future returns (Table IV)

Political index	Beta
$PI^{candidates}$	0.0011 (2.07)
$PI^{strength}$	0.0011 (2.45)
$PI^{ability}$	0.0010 (3.12)
PI^{power}	0.0010 (1.95)

Table IV
Fama-MacBeth Return Regressions for Firms Participating in the Political Process

Specification	Intercept	Ln(BM)	Ln(SIZE)	BHRET6	Ln($PF^{candidate}$)	Ln($PF^{strength}$)	Ln($PF^{ability}$)	Ln(PF^{power})
1	0.0134 (3.99)	0.0005 (0.44)	-0.0009 (-1.57)	0.0076 (2.35)	0.0011 (2.07)			
2	0.0133 (4.00)	0.0004 (0.39)	-0.0008 (-1.72)	0.0077 (2.35)		0.0011 (2.45)		
3	0.0134 (4.01)	0.0004 (0.41)	-0.0007 (-1.62)	0.0077 (2.33)			0.0010 (3.12)	
4	0.0133 (3.98)	0.0005 (0.48)	-0.0008 (-1.51)	0.0076 (2.33)				0.0010 (1.95)

Results for Democrats and Republicans

- Effects are positive for both parties but appear stronger for Democrats

Political index	Beta
$PI_{Demres}^{candidates}$	0.0009 (3.01)
$PI_{Demres}^{strength}$	0.0011 (4.77)
$PI_{Demres}^{ability}$	0.0010 (3.20)
PI_{Demres}^{power}	0.0009 (3.54)

Results for Democrats and Republicans

- Effects are positive for both parties but appear stronger for Democrats

Political index	Beta
$PI_{Rep}^{candidates}$	0.0009 (1.76)
$PI_{Rep}^{strength}$	0.0008 (1.79)
$PI_{Rep}^{ability}$	0.0007 (2.34)
PI_{Rep}^{power}	0.0007 (1.40)

Skip Roberts of Service Employees Int

"Business always covers its bets, and that makes sense. If anything I thought labor didn't do enough of what business did, that we needed to be cultivating and working with Republican members a lot more. They're human beings. The worst they can tell you is no, get the hell out of my office."

Results for House and Senate

- Effects are positive for both Chambers but appear stronger for House

Political index	Beta
$PI_{Senate}^{candidates}$	0.0009 (1.67)
$PI_{Senate}^{strength}$	0.0007 (1.68)
$PI_{Senate}^{ability}$	0.0004 (1.33)
PI_{Senate}^{power}	0.0007 (1.35)

Results for House and Senate

- Effects are positive for both Chambers but appear stronger for House

Political index	Beta
$PI_{Houses}^{candidates}$	0.0010 (2.99)
$PI_{Houses}^{strength}$	0.0010 (3.88)
$PI_{Houses}^{ability}$	0.0010 (3.52)
PI_{Houses}^{power}	0.0010 (3.69)

Other tests

- Periods of Democrat / Republican control and other subperiods
 - no consistent differences
- Abnormal return FM regressions
 - results robust
- Timing convention changes
 - results robust
- Winsorizing data
 - results robust
- Peterson standard errors
 - results robust

Other tests

- Rescale PIs by giving amounts
 - positive effect of giving on returns
 - t-statistics range from 1.43 (power) to 2.31 (ability)
 - Statistical and economic significance slightly lower

- Cross-products of strength, power, and ability
 - t-statistic (strength x power) = 2.18
 - t-statistic (strength x ability) = 2.35
 - t-statistic (ability x power) = 3.14

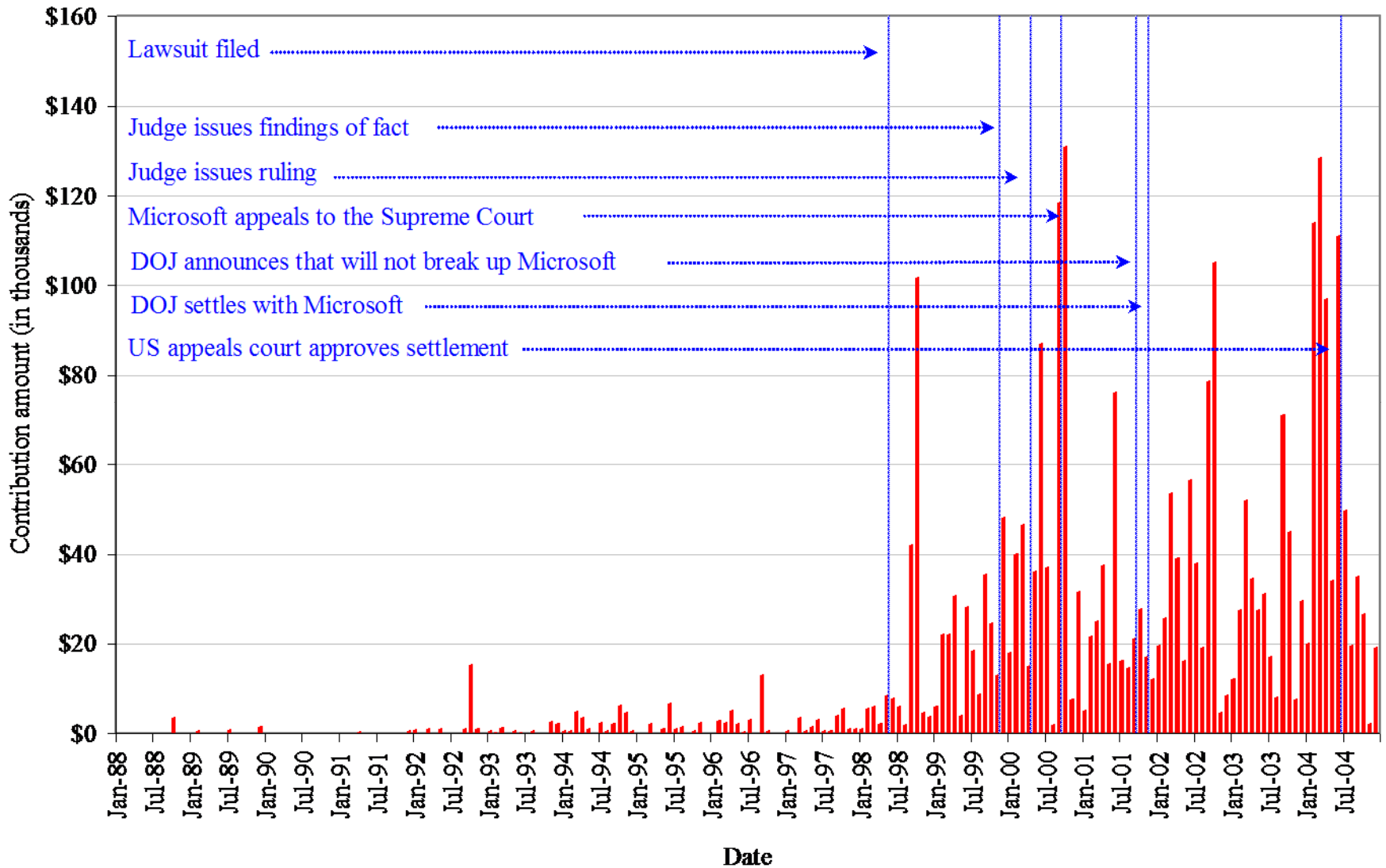
Are contributing firms just better firms?

- The political science literature tends to look at the effects of political connectedness on voting outcomes.
 - Thus, there is a cause-and-effect link:
 - contributions→legislation→favorable outcomes for a firm

- In contrast, our study looks at the effects of political connectedness on shareholder wealth for contributing firms.
 - Thus, no direct cause-and-effect link
 - New project: time series examination of contributions/legislation/returns: Microsoft example

- To address potential sample selection and endogeneity problems, we estimate 2-stage Heckman and IV models
 - Results hold up well to the inclusion of the IMR and predicted contributions in second stage regressions

Microsoft Antitrust Case Timeline



Abnormal returns for contribution portfolios

- Contribution-weighted portfolios

$$w_{it}^P = \frac{PI_{it}^P}{\sum_{i=1}^N PI_{it}^P}$$

- FFC 4-factor alpha
 - positive and significant alpha (ranges from 16 BP to 24BP)
 - implied increase in shareholder value – \$154 million / firm

Table VI
Monthly Abnormal Returns for Firms Participating in the Political Process

Portfolio	FF 4-factor alpha			
	<i>PI candidates</i>	<i>PI strength</i>	<i>PI ability</i>	<i>PI power</i>
	weighted	weighted	weighted	weighted
All candidates portfolio	0.0021 (2.82)	0.0017 (2.32)	0.0022 (3.18)	0.0021 (2.86)
Democrat portfolio	0.0021 (2.97)	0.0018 (2.55)	0.0024 (3.41)	0.0022 (3.01)
Republican portfolio	0.0020 (2.67)	0.0017 (2.16)	0.0021 (2.94)	0.0021 (2.76)
House portfolio	0.0021 (2.84)	0.0018 (2.39)	0.0022 (3.16)	0.0021 (2.86)
Senate portfolio	0.0020 (2.71)	0.0016 (2.08)	0.0023 (3.09)	0.0021 (2.84)

Quintile contribution sorted portfolios

Portfolio	R_i	$R_i - R_{BM}$	Dependent variable: $(R_i - R_f)$		Dependent variable: $(R_i - R_{BM})$	
			4-factor alpha	3-factor alpha	4-factor alpha	3-factor alpha
<i>Panel A: Portfolios formed on $PI^{candidates}$ quintile rankings</i>						
Quintile 1	0.0123 (4.35)	0.0004 (0.33)	0.0009 (1.04)	-0.0009 (-0.93)	-0.0008 (-0.95)	-0.0006 (-0.69)
Quintile 2	0.0138 (5.12)	0.0011 (0.97)	0.0021 (2.48)	0.0009 (1.02)	0.0001 (0.19)	0.0008 (1.10)
Quintile 3	0.0139 (5.30)	0.0014 (1.22)	0.0017 (2.04)	0.0006 (0.72)	-0.0002 (-0.22)	0.0006 (0.84)
Quintile 4	0.0151 (5.38)	0.0025 (2.53)	0.0025 (2.62)	0.0016 (1.61)	0.0009 (1.17)	0.0016 (2.07)
Quintile 5	0.0178 (6.09)	0.0052 (4.87)	0.0057 (4.94)	0.0043 (3.54)	0.0043 (4.50)	0.0045 (4.89)

Contributions and fundamentals

- FM annual regressions of Δ ROE on
 - variable of interest
 - $\text{Ln}(\text{PIs})$
 - controls
 - $\text{Ln}(\text{Q})$ - market-to-book ratio
 - $\text{Ln}(\text{SIZE})$ - market cap
 - Δ ROE
 - SE adjusted for autocorrelation in beta estimates
 - timing
 - PIs updated at the end of October
 - as convention, other controls updated at the end of June

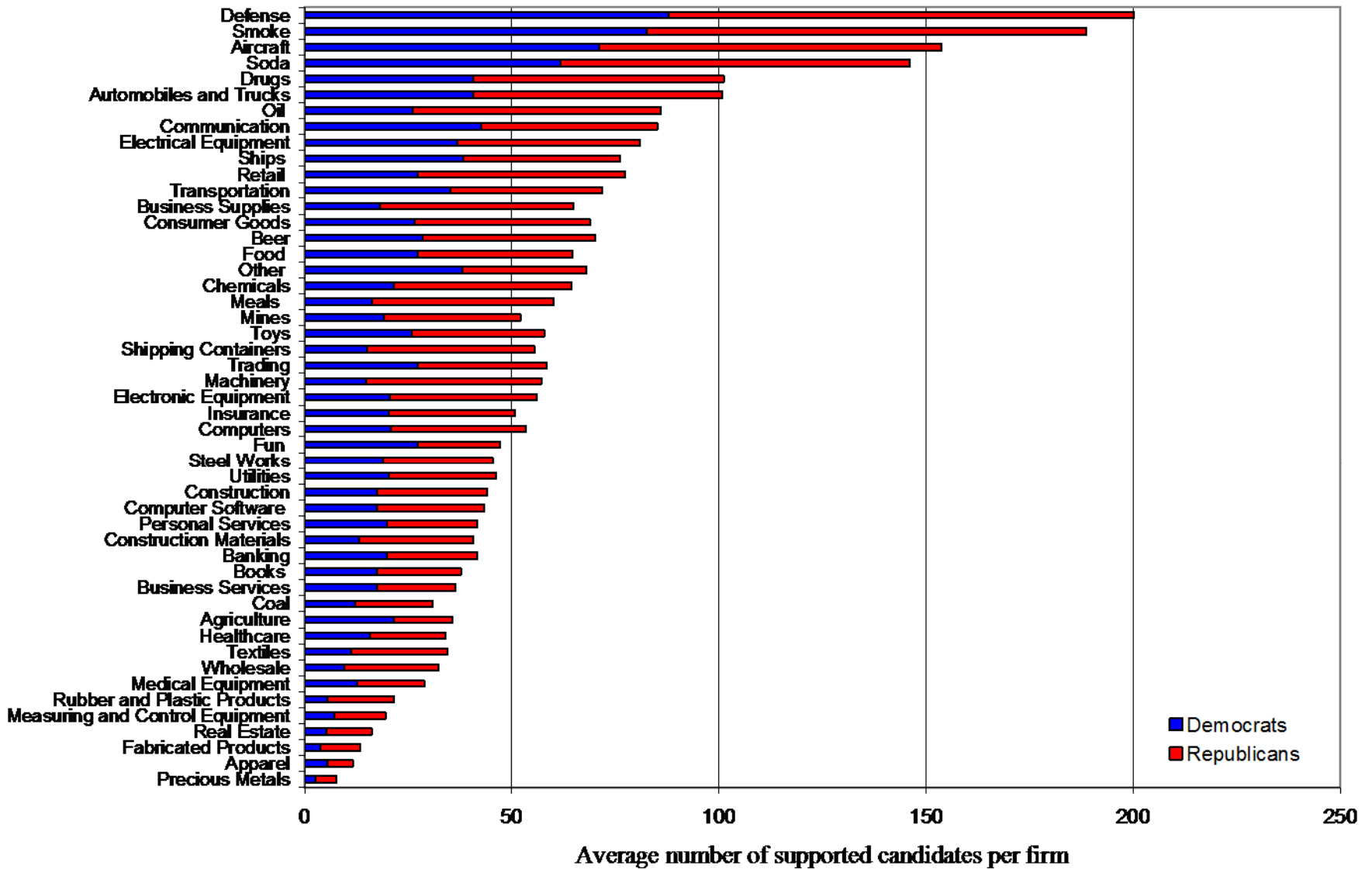
ROE regression results

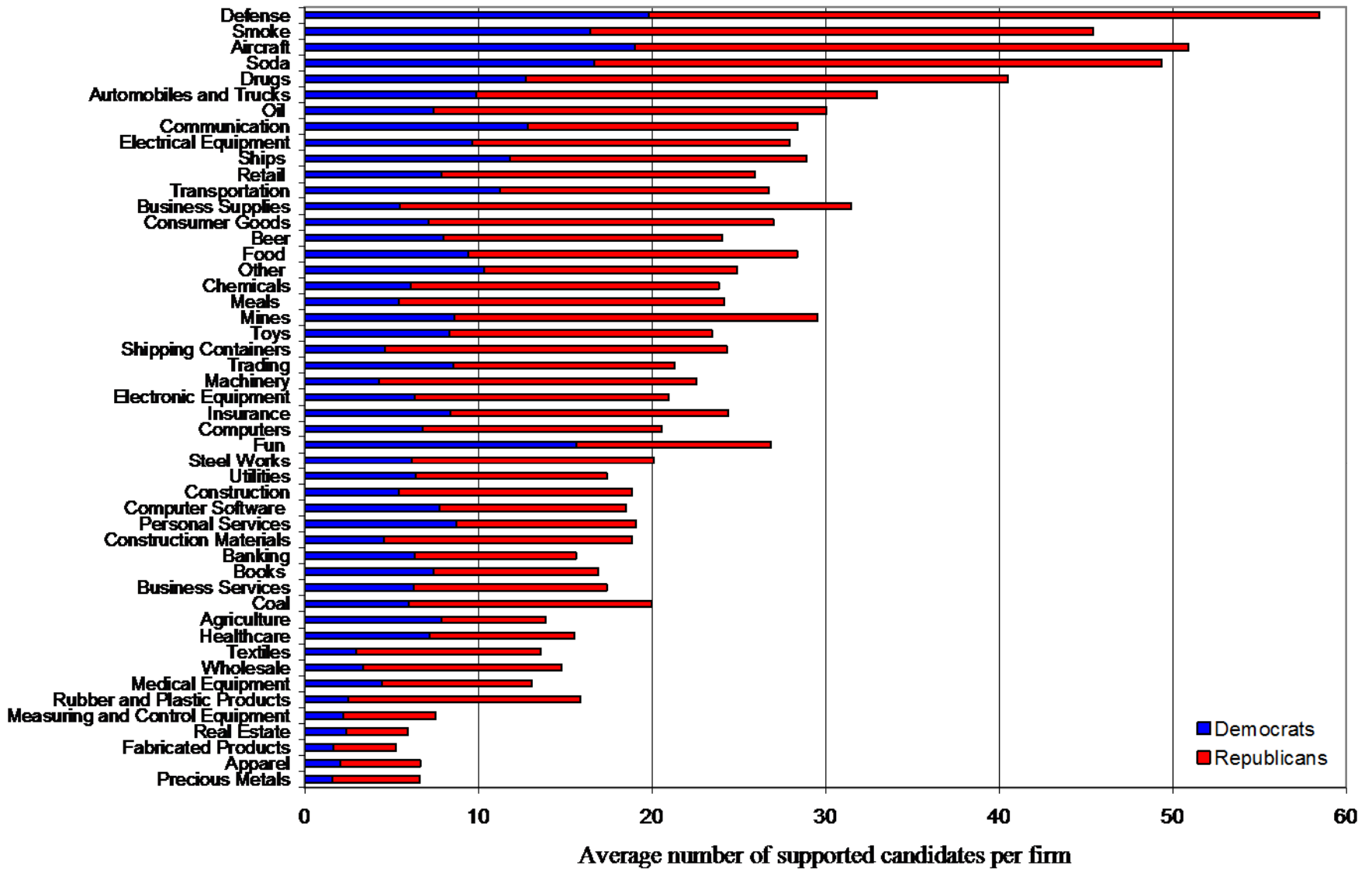
- PIs are positively and significantly related to future performance changes

Political index	Beta
<i>PI</i> ^{candidates}	0.0036 (2.42)
<i>PI</i> ^{strength}	0.0053 (4.05)
<i>PI</i> ^{ability}	0.0035 (2.29)
<i>PI</i> ^{power}	0.0031 (2.18)

Industry analysis

- Degree of participation varies considerably across industries





Industry analysis

- Andres (1985) and Masters and Keim (1985)
 - participation effects and industry characteristics
 - predictions:
 - As number of firms ↓ effect should ↑
 - As industry concentration ↑ effect should ↑
 - As degree of employee unionization ↑ effect should ↑
 - As sales to the government ↑ effect should ↑
 - As industry regulation ↑ effect should ↑

Industry analysis

- Results from industry level regressions of average PI loading on industry characteristics
 - As number of firms ↓ effect should ↑
 - t-statistic = -2.41
 - As industry concentration ↑ effect should ↑
 - t-statistic = 2.12
 - As degree of employee unionization ↑ effect should ↑
 - t-statistic = 2.41
 - As sales to the government ↑ effect should ↑
 - t-statistic = -0.83
 - As industry regulation ↑ effect should ↑
 - t-statistic = -0.74

Conclusions

- Positive value of political connections
 - Faccio (2006), Faccio and Parsley (2006), Faccio, Masulis, and McConnell (2006), Fisman (2001), Goldman, Rocholl, and So (2006), Jayachandran (2006), Roberts (1990)
- No value of political connections
 - Fisman, Fisman, Galef, and Khurana (2006)
 - Ansolabehere, Snyder, Ueda (2004)

Conclusions

- We find:
 - Firm political contributions *appear* to cause long-run cross-sectional shareholder wealth effects.
 - But maybe contributing firms are just better firms?
 - However, the contributions also affect firm fundamentals, and the value of contributions varies across
 - Political parties
 - Congress chambers
 - Industries
- Thus, we may have documented more than a chance correlation between contributions and returns.
- If you believe our results, then it suggests that firms do not contribute in order to consume “patriotic consumption goods” but rather to increase firm value.
- Future research: uncovering potential links among contributions/legislation/returns