Corporate Political Contributions and Stock Returns *

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Abstract

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We examine whether firms are rewarded in terms of increases in shareholder wealth for their involvement in the U.S. political system. We develop a new and comprehensive database of firm-level contributions to U.S. political campaigns from 1979 to 2004. We construct variables that measure the extent of firm support for candidates. Strikingly, we find that these measures are positively and significantly correlated with the cross-section of future returns. The effect is strongest for firms that support a greater number of candidates which hold office in the same state that the firm is based. In addition, there are stronger effects for firms whose contributions are slanted toward Democratic candidates and House candidates.

Despite a spate of recent events concerning lobbyists and other special interest groups and their alleged undue influence on elected officials[1], the U.S. political system is viewed by many as a relatively fair and impartial form of government, especially when compared to other governments (Kaufmann, Kraay, and Mastruzzi (2003)). However, in the US, 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)), but 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. For example, Ansolabehere, de Figueiredo, and Snyder (2003) survey 36 studies on the political efficacy of interest group contributions to politicians and find that contributions have apparently relatively little effect on voting outcomes.

Corporate contributions may not help the donating firms on average to influence voting outcomes, but there is evidence that the funds raised by candidates help them win elections. Snyder (1990) documents a positive relationship between the amount of contributions coming from special interest groups and the probability of a legislator winning an election.[2] In addition, Grier and Munger (1991), Romer and Snyder (1994) and Ansolabehere and Snyder (1999) show that influential legislators (i.e., party leaders, committee chairs, and members of powerful committees) raise substantially more funds than other legislators. So, contributions appear to increase the welfare of the candidates, but do contributions increase the welfare of the corporate contributors?

In this paper, we address this important question by studying shareholder wealth effects for firms that make contributions to political candidates. We test for evidence of pervasive cross-sectional return effects related to firm political contributions. Using data from the U.S. Federal Election Commission (FEC), we create a new and comprehensive database on publicly traded firms' political action committee (PAC) contributions to political campaigns in the U.S. from 1979 to 2004. After merging the FEC contributions data with CRSP/Compustat data, we have approximately 770,000 contributions made by 1522 firms over the past twenty five years or so – thus, we have a remarkably rich dataset to test for systematic contribution/return effects arising from publicly traded firms' involvement in the U.S. political process.

We develop a simple measure to capture the effects of firms' participation in the political contribution process and to take advantage of the comprehensive nature of the FEC data. We view each firm as supporting a portfolio of candidates and simply sum up over a rolling multiyear

[1] Many examples of past and present political controversies can be found at The Center for Responsive Politics web page at http://www.crp.org/.
[2] Stratmann (2005) provides a survey of the related literature.

window the number of candidates that each firm supports. We find that the average firm participating in the political donation process contributes to 73 candidates over any five year period, 53 of which go on to win their elections. There is substantial variability across firms in the number of supported candidates, with a standard deviation of approximately 96 candidates. Our sample captures over 70 percent of the total dollar volume of all corporate contributions and represents on average 60 percent of the market-value-weighted capitalization of all publicly traded firms in the U.S. Our decision to study contribution effects in the U.S. is largely influenced by the robustness of the FEC data and by the observation that the U.S. is relatively low on the global scale of corrupt governments, the later point likely biasing us against rejecting the null hypothesis that firm political contributions have no effect on firm value.

To test for pervasive wealth effects arising from firms participating in the political contribution process, we perform cross-sectional regressions of returns on the lagged number of supported candidates and other control variables. Strikingly, we find that the number of supported candidates has a statistically significant positive relation with the cross-section of future returns for firms which contribute to candidates. In fact, within our sample, the effect of firm contributions is more important than many of the established predictors of the cross-section of returns (more important than book-to-market (BM) and capitalization (SIZE)) and is about as important as a momentum variable.

Given that the firms in our sample support an average of about 50 elected politicians, it is likely that accurately uncovering the sources of the documented positive wealth benefits is no easy task; firm/candidate relationships may be complex, and in all likelihood the FEC contribution records may not capture all aspects of the candidate/firm relationship (such as "soft" money contributions or other types of private support). To begin to understand the sources of the contribution effect, we examine variations on our basic measure of total supported candidates. These robustness measures augment the number-of-supported-candidates measure with other important dimensions of firms' ability to affect the political process (Ansolabehere, de Figueiredo, and Snyder, 2003). These modified measures capture the total strength of the relationships between candidates and the contributing firm (as measured by the length of the firm-candidate relationship and by the dollar amount of contributions), the ability of the candidates to help the firm (as measured by the home state of the firm and the candidate), and the power of the candidates (as measured by politician seniority and committee rankings). We find that our results are robust to these alternative contribution definitions: The average coefficients on these measures from cross-sectional regressions are positive and statistically significant. We document especially strong effects for a measure related to the ability of the candidate to help the donating

firm; the t-statistic on the coefficient of "ability" is over 3 (which is large, given the typically lower t-statistics for our sample's large capitalized stocks relative to smaller capitalized stocks in cross-sectional regressions of returns on firm characteristics), and is the most important factor in predicting the cross-section (more important than BM, size, and momentum) for the firms in our sample. Thus, the contribution effect appears to increase for firms that have longer relationships with candidates, support more home candidates, and support more powerful candidates.

To further understand the sources of the contribution effect, we split our sample along political party lines. The FEC data show that Republican candidates typically receive higher total dollar contributions than do Democrats and that Republican candidates' contributions come from a larger number of supporting firms than do Democrat candidates' contributions. However, despite the fact that Republicans receive more contributions than Democrats, we find that the contributions effect is stronger for firm contributions to Democratic candidates, although contributions to Republican candidates also result in statistically significant increases in firm returns. We also break the contributions data up into House and Senate categories. We find that the effect is strongest for firm support aimed towards House candidates, although contributions to both branches of government result in positive economic effects for the contributing firms. Our finding of greater effects for firms supporting House candidates may be related to the constitutional provision that revenue and appropriations bills must originate in the House. Thus, firms may find that it is more expedient to support House members, where potential firm welfare increasing actions may be more suitably created.

To measure whether political contributions affect future abnormal returns, we form annually rebalanced contribution-weighted portfolios. We find that firm contributions result in abnormal returns. For example, a portfolio of firms weighted by the number of supported candidates has a statistically significant Fama-French-Carhart four-factor model abnormal monthly return of 21 basis points (or about 2.5 percent per year). These results are robust to the alternative contribution measures and robust to controls for the House or Senate candidates and Democratic or Republican candidates.

Taken as a whole, we believe that our new evidence of political contribution return effects is quite startling given the apparent transparency of the U.S. political system relative to other countries, and the fact that our results uncover systematic cross-sectional effects. Given the fact that the FEC data we use to construct our measures of political connectedness are composed of publicly available "hard-money" contributions, and thus presumably subject to watchdog actions of the press concerning the monitoring of and minimization of inappropriate legislation to donating firms, it is interesting to consider the process of exactly how firm contributions result in

increases in shareholder wealth. Potential ways in which politician sponsored legislation may benefit firms include (but are not limited to) favorable tax treatment and or credits, the awarding of government contracts, the imposing of tariffs or other penalties on competitors, and implementing favorable regulatory requirements. Given that our study involves literally hundreds of thousands of individual contributions, it is not practical to trace through all the possible legislation that may affect firm returns. Instead, we perform analysis to uncover direct effects of political contributions on changes to firm fundamental performance. We perform cross-sectional regressions of changes in year-to-year return-on-equity (ROE) on lagged values of the number of supported candidates and other contribution measures. We find that changes in ROE are related to the number of supported candidates and other measures of contributions. Also, consistent with theory from the political science literature, we find greater contribution effects for industries with a smaller number of firms, more heavily concentrated sales, and a higher percentage of unionized employees.[3]

Of course, our paper is not the first to document advantages to firms from being connected to politicians; there is an important and growing literature on the welfare benefits to firms which exhibit a degree of connectedness to politicians. These studies examine connectedness arising from 1) explicit relationships between firms and politicians (e.g., the politician is a member of the firm's board of directors) and 2) a firm's contributions of money to a politician's coffers.

Connectedness arising from explicit relationships appears to be important for firm welfare. Faccio (2006) examines stock price reactions to the announcement of two potentially connectedness increasing events; one, that a firm's officer or a large shareholder enters politics and two, that a politician joins a firm's board. Her sample consists of 157 announcements across 35 countries. She documents an over two percent increase in firm value at the announcement that an officer or large shareholder enters politics but she does not find an increase in firm value when a politician joins a firm's board. In addition, she finds that the announcement effect is greater in countries with higher levels of corruption. Faccio and Parsley (2006) document an approximate two percent decline in the market value of firms connected to legislators for a sample of 123 legislators who unexpectedly die. Fisman (2001) examines Indonesian firms that are connected to the Suharto family and shows that these companies decrease in value following announcements of declining health of President Suharto. Faccio, Masulis, and McConnell (2006) find that the

[3] We also examine contribution effects as a function of how much product an industry sells to the government. In related work, Karpoff, Lee, and Vendrzyk (1999) find that abnormal stock returns following press reports of fraud investigations are less negative for U.S. defense contractors that obtain a larger percentage of their revenue from government contracts.

likelihood of government bailouts of financially distressed firms increases for firms that have a top company officer or large shareholder in an important government position.[4]

Connectedness arising from firm contributions to politicians also appears to be important for firm welfare. Roberts (1990) finds a decrease in firm wealth at the time of death of U.S. senator Henry Jackson, for firms that made contributions to his campaign. Jayachandran (2006) analyzes the announcement effects of Senator Jim Jeffords decision to leave the Republican Party in 2001, a decision that transferred the control of the Senate from Republicans to Democrats. He finds that the decision resulted in an almost one percent decline in the market value of firms contributing to Republicans and an increase in market value for firms supporting Democratic candidates. Goldman, Rocholl, and So (2006) find that individual firms connected to the U.S. Republican Party increased in value after the Republican win in the 2000 Presidential elections. Knight (2006) and Shon (2006) show that industries that stand to benefit (lose) from a Republican win increase (decrease) in value following an increase in the probability of a Republican win in the 2000. Ansolabehere, Snyder, Ueda (2004) study return effects to firms that either did or did not give soft money donations around five important events in the approval of the Bi-Partisan Campaign Reform Act (BCRA). They find no noticeable return differences across donor and non-donor firms for the five events surrounding the BCRA. Claessens, Feijen, and Laeven (2006) find that Brazilian firms which provide larger contributions relative to other firms in the 1998 campaign for incumbent federal deputies experienced higher stock returns following the election.

Overall, the existing research on the value to the firm of political connections is intriguing; there appear to be positive shareholder wealth effects to being connected and the value of being connected is greater in more corrupt countries. However, the results may be difficult to generalize because they are usually obtained with relatively small samples and because they are based on isolated events.

In contrast, in this paper, the FEC data enables us to construct firm-specific year-by-year connectedness measures, allowing us to perform cross-sectional asset pricing tests over the full sample, something which has not been possible with previous event-based measures of political connectedness. In summary, our results are important because they provide new findings which show: 1) pervasive contribution/return effects for many firms over many years, 2) that the effects are strongest for firms which concentrate their contributions on House members, Democratic

[4] See also Leuz and Oberholzer-Gee (2006) who study the role of political connections and their implications for firms' financing and long-run financial performance in Indonesia and Fisman, Fisman, Galef, and Khurana (2006) who examine the value to firms of having personal ties to U.S. Vice-President Dick Cheney.

candidates, and candidates in the same state as the firm, and 3) the contribution effect arises from increases in firm profitability and is stronger within industries which may be more likely to benefit from political connections. Although one can never rule out for sure that our documented positive relation between the number-of-supported candidates and future returns may be due to the contributing firms being better firms *per se*, we believe it is unlikely that there exists an undiscovered firm characteristic that just happens to be correlated with firm political contributions over the 25 or so years of our study. Further, the nature of our tests (cross-sectional return regressions where we control for known determinants of the cross-section), the variation within our results (consistent with theory, the effect is stronger for firms where we would expect it to be stronger) and the causal link between contributions and increases in firm profitability, strongly suggest that the effect is real – firm political contributions affect future returns.

Perhaps future work will address whether our results are due to elected officials maximizing general public welfare or whether it suggests an unfair exchange of dollars for policy, resulting in wealth transfers from those firms without access to those firms with access, or subsidies from taxpayers to contributing firms. Regardless of the sources of the effect, our results suggest that some firms obtain greater access and benefits than other firms as a result of participating in the U.S. political system.

The remainder of the paper is organized as follows. In Section I we describe the data used in our analysis and detail the construction of the firm political contribution measures. In Section II we present results which document the effects of political contributions on future returns. In Section III we explore the sources of the contribution effect. Section IV concludes.

I. Data Sources and Variable Construction

A. Contribution data

Our data on corporate contributions is from the Federal Election Commission (FEC) detailed committee and candidate summary contribution files for the period 1979 – 2004.[5] We merge the FEC data with CRSP/Compustat data and build a comprehensive database of firm contributions, monthly returns, and annual firm accounting characteristics from 1984 to 2005. We first describe the FEC data, detail the construction of contribution variables designed to capture return effects, and then describe the full merged FEC/CRSP/Compustat dataset.

[5] The summary file provides data on how much total money each candidate received from different interest groups, what the total cost of the election was, and other related information. The detailed file provides contribution-by-contribution data for each candidate. It records every single contribution made by all special interest groups (corporations for our purposes), the date of the contribution, and the amount.

We obtain FEC data on total campaign financing raised by each candidate's (re)election campaign. The contribution data are all "hard-money" contributions meaning that they are made to specific candidates and the contributions are limited to $10,000 per candidate per election cycle ($5,000 contributed during a primary election and $5,000 contributed during a general election).[6] See appendix A for details on the limits of contributions and other aspects of campaign finance law. The FEC database identifies seven distinct groups that contribute to candidates' campaigns: (i) individuals, (ii) labor organizations, (iii) corporations, (iv) trade, membership, and health organizations, (v) party committees, (vi) non-party committees, and (vii) corporations without capital stock. We obtain data on total funds received by each candidate from each of these groups. The FEC detailed committee contribution file consists of 2,794,790 contributions made by all special interest groups to all candidates running for the President, the Senate, and the House of Representatives. We limit our sample to all contributions made by corporations through their corporate political action committees (1,064,830 observations). After further deleting private firms, subsidiaries of foreign firms and firms with no data on CRSP, we are left with 819,815 contributions made by 1,930 unique firms. Thus, not all publicly traded firms have PACs - we find that on average only 9.49 percent of firms listed on the combined CRSP/Compustat database participate in the contribution process and these firms tend to be very large firms (e.g., the average capitalization of contributing firms in 2004 places them at the top 8 percent of NYSE market cap).

We obtain data on the identity of the contributing firm, the date and the amount of contribution, and the identity of the receiving candidate. For each receiving candidate, we also use the FEC data on the sought after public office, the state and the district for which the candidate is running, the candidate's party affiliation, and the election outcome. For all elected officials, we obtain data on their committee assignments and their party rankings on each serving committee. This data is from Charles Stewart's Congressional Data Page.[7] Figure 1 reports the giving totals per the seven groups (aggregated across all candidates for each two-year election cycle). Panel A reports the results for the House races.[8] Panel B reports the results for the Senate races.[9]

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[6] This is in contrast to "soft-money" contributions which are non-candidate specific contributions from individuals and special interest groups used on voter registration expenses, "get out the vote" campaigns, "party building," issue advertising, and other administrative expenses. The Bipartisan Campaign Reform Act of 2002 banned soft money contributions.

[7] We thank Charles Stewart III for generously providing this data on his website http://web.mit.edu/17.251/www/data_page.html.

[8] In these figures, we concentrate on House and Senate contributions. This is because firms contribute only insignificantly to Presidential races. For example, according to the Center for Responsive Politics, George W. Bush received over $367 million in total campaign financing in his 2004 reelection bid for the White

Individuals constitute the largest group of contributors, contributing between 60 and 80 percent of total campaign financing for the Senate races and between 40 and 60 percent of total campaign financing for the House races. This totals over $3.8 billion during the 26-year period. It is worth pointing out that individual contributions are spread over many individuals who contribute in small amounts. According to recent survey evidence (Burns et al (2001)), 10 percent of the American population (or 21 million individuals) contributed to various elections in the 2000 election cycle. Ansolabehere et al (2003) use this data to estimate that the average individual contribution is a trivial $115.

Corporate contributions constitute a notably lower fraction of candidates' total campaign financing. We document below, however, that because these contributions come from significantly fewer firms (relative to individual contributions), their dollar amounts are much larger than those of individuals. The results in figure 1 indicate that, as mentioned above, individual contributions are the largest source of campaign financing. For Republicans, for both House and Senate candidates, contributions from corporations are the second largest source. For Democrats, for both the House and Senate, corporate contributions fall about third in importance, near labor and trade associations totals. On average, corporate contributions comprise 12 percent (10 percent) of total campaign financing for Republican (Democrat) candidates running for the House and nine percent (five percent) for Republican (Democrat) candidates running for the Senate.

Figure 2 provides a detailed look at the distribution of corporate contributions as a percentage of total campaign financing. For a significant number of candidates running for office, corporate contributions constitute less than five percent of total campaign financing. More interestingly, there is significant heterogeneity in how much financing comes from corporations across different candidates. The ratio of corporate contributions to total money raised ranges from zero percent to 90.59 percent (53.87 percent) for Republicans (Democrats) running for the House and from zero percent to 39.20 percent (28.46 percent) for Republicans (Democrats) running for the Senate. One implication of the percentages reported above is that corporate contributions on average represent only a small fraction of candidates' campaign financing and, therefore, are unlikely to buy candidates' attention. However, if firms are making large

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House. A lion share of this capital ($272 million or 74 percent) came from individuals. Only $2.9 million (or less than one percent) came from all special interest groups, which include firms in our sample. John Kerry's totals look even more striking. He received over $326 million in total campaign financing, with merely $141,918 coming from special interest groups. This pattern in sources of Presidential campaign contributions is consistent over our sample. Nonetheless, in our later analysis, we include all contributions; Senate, House and Presidential.

[9] For every two-year election cycle, one-third of all senators are up for reelection. Thus, figure 1 reports the average giving totals for 1/3 of the Senate candidates every two years.

contributions relative to other contributors, they are much more likely to be noticed even though these contributions represent only a small percentage of total money raised. Table I analyzes the size and frequency of corporate contributions.

Panel A of table I reports that the per firm average contribution totals (across all candidates) $64,694 during any two-year election cycle. This amount is spread over an average of 56 contributions. This total amount varies significantly between the minimum contribution total of only $29 to the maximum contribution total of $2.7 million. Democrats receive on average $30,758 from each firm, while Republicans receive $43,126. Thus, corporate contributions are much larger than individual contributions and, therefore, are much more likely to be noticed by the receiving candidates.

In panel B, a typical firm supports 31 candidates per election cycle, 16 Democrats and 20 Republicans. This number also varies substantially from one supported candidate per election cycle to 564 supported candidates per election cycle. We find no evidence that firms that support fewer candidates give less money per candidate. For example, firms that support only a single candidate give on average $1,837 dollars (standard deviation = $2,131), while firms that support 10, 20, and 30 candidates give on average $1,703 (standard deviation = $2,148), and $1,747 (standard deviation = $1,963) and $1,540 (standard deviation = $1,870) per candidate respectively. It appears therefore, that the total amount of giving per firm is determined by the number of candidates that the firm chooses to support, not by the amount that each candidate receives, which appears fairly constant across candidates. The results in table I also indicate that firms on average are not constrained by the FEC contribution limits. Firms contribute just over $2,000 per candidate per election cycle ($64,694 / 31 candidates = $2,086.90), well under the $10,000 contribution limit imposed by the FEC. Similar evidence is reported in Ansolabehere et al (2003).[10]

B. Contribution Indexes

We use the FEC data to create a number of measures designed to capture potential effects on firm welfare from participating in the contribution process. We construct our initial measure based upon implications from the above results that not all firms participate in the contribution process, the average contribution per candidate is about the same regardless of how many candidates a firm supports, the participating firms are very large, and the FEC contribution limits

[10] It is unlikely that firms contribute below contribution limits because they receive little money from individuals allowed to contribute to their PACs. Ansolabehere et al (2003) report that corporate PACs can double the amount they contribute to political candidates by legally shifting their overhead expenses to the sponsoring firms. Instead, corporate PACs choose to pay for overhead and other administrative expenses from the funds raised from corporate officers and employees.

are not on average binding. Those findings are consistent with the idea that to successfully compete in the market for possible political favors, it may require more than simply donating $10,000 in hard-money contributions to a candidate – that is, it may require soft money-like contributions, or other forms of non-money favors, which are not publicly disclosed, and which only larger firms can afford.[11] Thus, a potential way to capture the benefits to firms from participating in the political process is to keep track of the total number of candidates that a firm supports, with the idea that, much like a venture capital portfolio of many start-ups, a few of the supported candidates will "payoff big" and result in increases in firm shareholder wealth.

Thus, our initial measure is simply the sum of supported candidates (House, Senate, and Presidential) over a rolling multiyear window. At the end of October of each year, we compute the total number of supported candidates over the previous five years for each firm in our sample. We use an October cutoff point to match up the timing of political contributions to the timing of elections, which take place on the Tuesday following the first Monday in November every even year. The "political index" (PI) for the number of supported candidates for firm *i* in year *t* is:

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

where $Cand_{jt,t-5}$ is an indicator variable equal to one if the firm has contributed money to candidate *j* over the years *t-5* and *t*. The FEC contribution data is from January of 1979 to December of 2004. Since we require 5 years of data to compute equation 1, the number-of-supported-candidates index is computed once a year, from October of 1984 to October of 2004.

We create variations on our basic measure of number of supported candidates. These robustness measures are designed to scale equation 1 with other important contribution dimensions related to the strength of the relationship between a candidate and the contributing firm, the ability of a candidate to help the firm, and the power of a candidate. Numerous papers from the political science literature suggest that these dimensions are important in the firm/candidate relationship.

[11] Anecdotal examples of firms helping politicians include: 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 Ivins (2006)) reports that President Bush took 14 free rides on Enron corporate jets during the 2000 Presidential campaign; *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.

Concerning the strength of the relationship, Kroszner and Stratmann (1998) show that to maximize contributions, legislators tend to build relationships with PACs by participating on specialized committees and catering to PACs interests. Thus, long-term relationships between politicians and PACs are an important source of value to politicians. Stratmann (1998) documents that highly reputable politicians are more likely to receive contributions prior to critical votes, while less reputable politicians are more likely to receive contributions after critical votes. Thus, politicians that have strong relationships with special interest groups (and therefore are considered more trustworthy) are valued (and rewarded) differently by special interest groups than other politicians. Regarding the ability of the politician to help the contributing firm, Krozner and Stratmann (1998) document that firms decrease their contributions to politicians who are expected to retire soon or change their affiliation from the committee that has jurisdiction over the firm's operations to the committee with no such jurisdictions. This suggests that firms adjust their contributions to politicians as the expected ability of these politicians to help the firm changes. Finally, pertaining to the power of the candidate, Grier and Munger (1991), Romer and Snyder (1994) and Ansolabehere and Snyder (1999) document that elected officials who are committee chairs or who serve on powerful committees raise substantially more than other members.

Thus, using the aforementioned papers as a guide, we construct three political indexes designed to capture strength, ability, and power features of the firm/candidate relationship. We construct the strength of the relationships between candidates and the contributing firm as follows. Each candidate supported by a firm and currently in office as of October of year *t*, gets assigned an indicator variable of one. We then multiply the indicator variable by the number of months that the firm has maintained an uninterrupted relationship with the candidate. We consider uninterrupted relationships as those relationships in which the firm did not miss any past reelection cycles of the candidate. We then scale that number by the ratio of total House or Senate votes the candidate's party has relative to the total votes of the opposing party (for either the House or the Senate). Thus, the PI strength measure for firm *i* in year *t* is:

$$PI_{it}^{strength} = \sum_{j=1}^{J} Cand_{jt,t-5} \times I_{jt} \times \frac{NCV_{jt}}{NOV_{jt}} \times rellength_{jt,t-5} \qquad (2)$$

where $Cand_{jt,t-5}$ is an indicator variable equal to one if the firm has contributed money to candidate *j* over the years *t-5* and *t*, I_{jt} is an indicator variable equal to one if candidate *j* is in office at time *t* and zero otherwise, NCV_{jt} is the number of votes that candidate *j*'s party holds in

office at time t, NOC_{jt} is the number of votes that candidate j's opposing party holds in office at time t, and $rellength_{jt}$ is the number of months that firm i has maintained an uninterrupted[12] relationship with candidate j until time t. The ratio $\frac{NCV_{jt}}{NOV_{jt}}$ captures the candidate's party strength relative to the opposition party.[13]

The second variation is designed to capture the ability of the candidates to help a firm. In this measure, we only include candidates that hold office in the same state in which the firm is headquartered. We obtain firm headquarter data from Compustat. The PI ability measure for firm i in year t is:

$$PI_{it}^{ability} = \sum_{j=1}^{J} HomeCandidate_{jt,t-5} \times I_{jt} \times \frac{NCV_{jt}}{NOV_{jt}} \tag{3}$$

where $HomeCand_{jt}$ is an indicator variable if candidate j is running for office from the state where firm i is headquartered and zero otherwise, and the rest of the variables are as defined above.

The last variation is designed to measure the power of the candidates. In this measure, we weight the candidate by the sum of the candidate's committee rankings. The PI power measure for firm i in year t is:

$$PI_{it}^{power} = \sum_{j=1}^{J} Cand_{jt,t-5} \times I_{jt} \times \frac{NCV_{jt}}{NOV_{jt}} \times \left[\sum_{m=1}^{M} \frac{Committeerank_{mt}}{Mediancommitteerank_{mt}} \right]_j \tag{4}$$

where *Committee rank*$_m$ is the reciprocal of candidate j's rank on committee m (where rank =1 for the most important member, rank = 2, for the next important, and so on), *Median committee rank*$_m$ is the median number of members on a given committee m for which candidate j's is a member, and the rest of the variables are as defined above.

We merge the firms' political indexes (and other data from FEC) with data from CRSP and Compustat to create a merged database from November of 1984 to October of 2005. We

[12] To be defined as an uninterrupted relationship between a firm and a House candidate, the firm must contribute at least twice to the same candidate within consecutive two-year windows (i.e., the length of a House position). To be defined as an uninterrupted relationship between a firm and a Senate candidate, the firm must contribute at least twice within consecutive 6-year windows.

[13] This ratio captures the possibility that a given candidate will be less effective if his/her party is not in control (in which case, this ratio will be less than one). For example, consider the Speaker of the House or the Majority Leader in the Senate. They are elected from the party that has the majority in the respective Chamber. These individuals are vested with the power to introduce (or refuse to introduce) a particular legislation to the floor. Thus, even the most powerful politician in the minority party is ineffective at influencing a piece of legislation if the Speaker/Majority Leader refuse to discuss it on the floor.

manually match firm names from CRSP with the names of sponsoring corporations reported by the FEC. In cases involving firm name changes, we examine corporate SEC filings to find the appropriate matching name. In cases involving wholly-owned subsidiaries of other firms, we identify the ultimate parent firm from the SEC filings. We require that a firm have nonmissing price and volume on CRSP in October of year *t* and have non-missing total assets in year *t* on Compustat. To mitigate backfilling biases, a firm must be listed on Compustat for two years before it is included in the data set (Fama and French, 1993). These requirements further reduce our sample from 819,815 contributions made by 1,930 unique firms to 769,044 contributions made by 1,522 unique firms. We merge the end-of-October contribution measures with firm monthly returns from November of year *t* to October of year *t+1*. As control variables in many of our tests, we use market value scaled accounting ratios, such as book-to-market (BM), and firm capitalization (SIZE). To construct the ratios, we use accounting information from fiscal year end *t-1* from Compustat and capitalization from December of year *t-1*. For firm capitalization alone, we use the market value of the firm's equity from CRSP at the end of June of year *t*. When our tests include lagged return measures (for example, six-month lagged returns) we estimate a holding period return from the beginning of January of year *t* to the end of June of year *t*. In keeping with the convention in most cross-sectional asset pricing papers, BM, firm capitalization and lagged return measures are updated annually, at the end of June each year.[14] Political indexes are updated annually, at the end of October each year. We examine numerous robustness tests, including variations to the political index October rebalancing convention, modifications of the political indexes (including scaling the measures by the dollar amount of contributions and combining together the measures to capture higher order interactions of support, strength, ability, and power), and winsorizing the political indexes at the 1 percent and 99 percent distribution points.

Table II reports summary statistics on the four political indexes. Our final merged sample captures 71.08 percent of the total dollar volume of all corporate contributions reported by the FEC. We find that contributing firms on average support 72.48 candidates (standard deviation of 95.89) over any given five-year period.[15] Of these 72 candidates, 53.24 win their race (not reported in the table). The median number of supported candidates is 31. The minimum number of supported candidates is one (460 firms in our sample support a single candidate over some five year window), and the maximum is 818 (AT&T Corp in 1984). The

[14] Our results are unchanged using BM, capitalization, and six-month returns updated in October of year *t*.
[15] We also calculate the standard deviation of the time series of each firm's number of supported candidates; the average (median) standard deviation of the number of supported candidates is 22.26 (11.63).

average (standard deviation) of the strength index, equation 2, is 1,690.98 candidate-months (3,394), for the ability index, equation 3, it is 6.86 home candidates (7.27), and for the power index, equation 4, it is 256.18 candidate committee rank units (337.39). Figure 3 plots the time series variation in the four political indexes. There is not a high degree of variation in the mean of each of the four indexes over time, (with the exception of a run-up in the strength index in the first decade of the sample). However, there is a large cross-sectional standard deviation in the contribution indexes over time – thus the issue of contributions being potentially related to the cross-section of future stock returns is strongly motivated given the large across-firm dispersion in the contribution indexes.

In Table III we report formation period (that is, for the year prior to and including October of year *t*) summary statistics for various firm characteristics of contributing and non-contributing firms. We report both the time-series average of yearly cross-sectional median values and also report the average of yearly cross-sectional averages for capitalization (SIZE). The non-contributing firms are all firms in CRSP/Compustat that meet the above sample formation screens but do not appear on the FEC database. Appendix B provides exact formulas for the non-political index variables used in our tests. In Panel A, contributing firms are much larger than non-contributing firms; the time-series average of the yearly median capitalization of contributors is $1.5B versus $72M for the non-contributing firms (the time-series average of the yearly mean capitalization is $6.1B for contributors and $483M for non-contributors). In a typical year, our sample firms number 691.61 firms which constitute 9.49 percent of all publicly traded firms and represent 59.55 percent of the total market capitalization. We find that the average capitalization of contributing firms, computed relative to annually ranked NYSE breakpoints, places the contributing firms consistently in the top 13 percent of capitalization. Thus, firms participating in the political process are very large firms. In fact, we find that the percentage of firms making contributions increases dramatically as we move from the smallest to the largest decile of annually ranked NYSE breakpoint capitalization (these numbers are not reported in the table); the percentage of firms making contributions is 1.82% for the smallest decile, 24.17% for decile five, and 90.54% for the largest decile. Also, contributing firms tend to have experienced slightly worse stock price performance (in terms of lagged 36-month returns), are more profitable than non-contributing firms, and are more levered. The last observation is consistent with Faccio, Masulis, and McConnell (2006) who find that government bailed out politically-connected firms have significantly higher leverage ratios than their non-connected matching peers. In Table III, panel B, we report characteristics of the contributing firms based on annual decile sorts of the number of supported candidates (equation 1) measure. Some very

interesting patterns emerge. First, the firms that support more candidates are much larger firms than the firms that support fewer candidates: The average capitalization of the firms in the top decile of number of supported candidates is $23.7B, with the firm size decreasing almost monotonically to $1.2B for the firms in decile one of supported candidates. The top decile contribution firms also have lower 36-month returns, but are more profitable (as judged by PROFIT and ROE) than the firms in the lowest decile. If there are in fact extra costs (above and beyond the nominal costs of hard-money contributions) to effectively participating in the contribution process, then it appears that the high contributing firms, with their much larger firm size and higher profitability may be more able to incur these expenses than the low contributing firms.

II. Results

A. Cross-sectional Regressions

We perform Fama and MacBeth (1973) cross-sectional regressions of monthly returns on the lagged political contribution indexes and other firm characteristics.[16] We seek to determine if firms' contributions to candidates result in an increase in future shareholder wealth. In the regressions we include a set of control variables which have been shown to be important predictors of the cross-section (book-to-market equity (BM), capitalization (SIZE), and six month lagged returns (BHRET6) - Fama and French (1992), and Jegadeesh and Titman (1993)). The contribution measures are standardized to have unit variance in order to facilitate comparisons across the indexes. We take the natural log of all the right hand side variables except BHRET6. The standard errors from the regressions are adjusted for autocorrelation in the beta estimates.[17] We first discuss results for the full sample of contributing firms, and then break the sample up along Democratic/Republican and House/Senate splits.

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[16] An implicit assumption of our analysis is that there may exist future increases in firm market value as a result of political contributions which is not reflected in immediate changes to firm value when the contributions are made public.

[17] The resulting parameter estimates are time series averages of monthly regression coefficient estimates. The statistical significance is ascertained by using the standard errors of the time series averages of the regression parameters. Since the existence of autocorrelation in the parameter estimates would bias the statistical significance, we adjust the standard errors of the average slopes to control for autocorrelation. The autocorrelation adjustment is made by adjusting the standard errors for first-order autocorrelation by multiplying the standard errors of the average parameters by $\sqrt{\frac{(1+\rho)}{(1-\rho)}}$ where ρ is the first-order autocorrelation in monthly parameter estimates. The t-statistics in Tables 3 and 4 reflect this first-order autocorrelation correction. Similar adjustments are done in Lakonishok and Lee (2001), Fama and French (2002), Chakravarty, Gulen, and Mayhew (2004) and others.

The regression in row one of Table IV shows that the total number of supported candidates ($\ln(PI_{it}^{candidates})$) helps to explain the cross-section of future returns for firms participating in the political process.[18] The results show that firms which support a greater number of candidates experience a greater increase in future returns; the t-statistic on the coefficient of the total number of supported candidates is 2.07. It is worth noting again that the contributing firms are very large capitalized firms, thus, the t-statistic of slightly over 2 is relatively strong for the coefficient on a firm characteristic from a cross-sectional return regression on this group of stocks. For example, neither the coefficient on ln(BM) nor ln(SIZE) is significant in the regression. Remarkably, the coefficient on the contribution measure is almost as statistically significant as the coefficient on lagged 6 month returns (t-statistic = 2.35).

The regressions in rows two through four examine the robustness of our basic total-candidates measure to other potential ways of defining firm participation in the political contribution process. As might be expected because of their multiplicative construction, the other contribution indexes (equations 2 through 4) are highly correlated with the total candidates measure (correlations range from 0.47 to 0.97). Thus, in rows two through four of the Table IV, we estimate monthly return regressions using each political index in a separate regression, to rule out bias in the index coefficients from the high degree of correlation across the indexes (later when we split contributions up along party and chamber dimensions, we create orthogonalized indexes to help facilitate comparisons across the indexes, but in this section we are more interested in the robustness of the equation 1 basic contribution measure). The coefficients on the three alternative measures, strength of the relationship (row 2), ability of the candidate (row 3), and power of the candidate (row 4) all obtain statistically significant positive t-statistics (2.45, 3.12, and 1.95, respectively). The ability index, which is designed to measure the ability of the candidate to help the firm, is particularly important, obtaining a t-statistic of even greater significance than the momentum variable.

The average coefficient on the number of supported candidates from the cross-sectional regressions provides us with a sense of the economic effects of contributions. A one standard deviation change in the number of supported candidates predicts about an eleven basis point per month (1.32 percent per year) increase in returns. We find similar results with the other contribution measures; a one standard deviation increase for the strength, ability, and power measures result in monthly average return increases of between 10 to 11 basis points. These results suggest, for example, that a firm could increase its annual returns by approximately 1.2

[18] Our sample includes 689 firms at the beginning of the sample period (1984) and 656 firms at the end of the sample period (2004).

percent by supporting an extra seven home-state candidates. For comparison, in specification 1 of Table IV, a one standard deviation increase in the BM, SIZE, and 6-month lagged returns predicts a 3, -15, and 19 basis points per month change in returns, respectively (specifications 2-4 yield similar economic effects).

Next, we split our sample along political party lines and along House and Senate chambers. The FEC data show that Republican candidates typically receive higher total dollar contributions than do Democrats and that Republican candidates' contributions come from a larger number of supporting firms that do Democrat candidates' contributions, so one might hypothesize that the contribution effect should be greater for Republican contributing firms.[19] In addition, there are constitutional provisions which state that all revenue raising legislation and appropriations bills must originate in the House. Thus, firms may find that it is more expedient to support House members, where potential firm welfare increasing actions may be more readily created. For the Democrat/Republican split, we recomputed each political index by multiplying candidate variables by a party indicator variable: For each Democrat (Republican) candidate, the party indicator variable equals one if the candidate is affiliated with a Democratic (Republican) party and zero otherwise. For the House/Senate split, we recomputed each political index by multiplying candidate variables by a chamber indicator variable: For each candidate in the House (Senate), the chamber indicator variable equals to one if the candidate is affiliated with a House (Senate) and zero otherwise.

There is a high degree of correlation across the indexes when we split on party or chamber, since many firms support candidates in both parties and houses. For example, most firms contribute to both Republican and Democrat candidates – we have only 29 (104) firms in the sample that only contribute to Democrats (Republicans). As a result of firms supporting both types of candidates, the correlations among equations 1 through 4 scaled by the Republican and Democrat dummies range from 0.44 to 0.80. Thus, there may be multicollinearity problems in interpreting the coefficients from models that include indexes of both parties or chambers in the same model. To address this issue, we estimate two stage regressions. In the first stage we regress each respective Democrat index (equations 1 through 4) on the respective Republican index and create a Democrat residual series using the errors from the regression. In the second stage, we regress monthly firm returns against the Republican index and the residual Democrat index. We do the same orthogonalization procedure for the House/Senate indexes.

Table V regressions report the Democrat/Republicans in Panel A and the House/Senate in Panel B. The information in the residual contributions to Democrats index results in a greater

[19] We find that the average firm supports 39 percent Democrat candidates and 61 percent Republican candidates over any five-year period.

effect on future stock prices than do contributions to Republicans. For Democratic candidates, the t-statistics on the coefficients of the four residual political indexes range from 3.01 for the total-number-of-supported-candidates measure up to 4.77 for the strength-of-the-candidate measure. In contrast, for Senate candidates, the t-statistics on the coefficients of the four political indexes, while always displaying positive economic effects, are less statistically positive, ranging from 1.40 to 2.34.[20] The Table V Panel B regressions show that contributions to House candidates result in a greater effect on future stock prices than do contributions to Senate candidates. For House candidates, the t-statistics on the coefficients of the four residual political indexes range from 2.99 the total-number-of-supported-candidates measure to 3.88 the strength-of-the-candidate measure. In contrast, for Republican candidates, the t-statistics on the coefficients of the four political indexes, while displaying positive economic effects, are not statistically significant, ranging from 1.33 to 1.68. Finally, we create residual indexes in a reverse manner (that is, create a Republican residual and a Senate residual) and find that the Democrat and House effects remain stronger than the Republican and Senate effects.

We examine if the differences in the contribution effect across parties is due in part to which party is in control. A convenient "natural experiment" to test for party control is to examine contribution effects before and after the 1994 elections in which Republicans strongly won control of both the House and Senate. We divide our sample into pre and post 1994. We find no consistent differences on the coefficients of the number of candidates, strength and power indexes, but we do find a large effect for the ability of the candidate to help index (equation 3). For that index, the t-statistic on the index coefficient is 1.06 from the pre-1994 period and 3.17 in the post 1994 period. To further investigate, we construct a number-of-Democrat-supported-candidates version of equation 3 and a number-of-Republican-supported-candidates version of equation 3 and estimate regressions in both the pre and post 1994 period. The results indicate that the return effect is stronger during the post-1994 period for both the Democratic and Republican versions of equation 3. The t-statistic on the Democratic (Republican) index coefficient is 0.93 (0.66) during the pre-1994 period and 3.31 (2.49) during the post-1994 period. Thus, there is no clear evidence that only Republican leaning firms benefited from making candidate contributions during the post-1994 Republican-controlled era.

Our result of no consistent differences in contribution effects between Republican and Democratic leaning firms across periods of Democratic and Republican control is consistent with the Grossman and Helpman (1994) argument that firms lobby incumbent politicians who already hold public office irrespective of those politicians' election platforms. The Grossman and

[20] In related work, Santa-Clara and Valkanov (2003) document that common stocks earn higher returns when a Democrat is President than when a Republican is President.

Helpman model builds on the Stigler (1971) theory of economic regulation that views political contributions not as a means to affect the election outcome per se, but as a means to purchase political support from the candidate already in office.

We perform a number of robustness tests. First, to mitigate the potential effects of possible microstructure biases emanating from the use of CRSP monthly closing prices, we use geometrically compounded annual returns (instead of the typical monthly returns) as the dependent variable in the cross-sectional regressions. We find that our results are robust; the t-statistics on the coefficients from the four contribution indexes range from 2.07 for the ability of the candidate measure up to 2.8 for the power of the candidate measure.

Second, we examine variations to the October rebalancing convention: We recompute the political indexes at the end of June of year *t*, and line up the index values with returns from July of year *t* to June of year *t+1*. We also recompute the political indexes at the end of December of year *t*, and line up the index values with returns from January of year t+1 to December of year t+1. Our results are robust to variations in the rebalancing convention; t-statistics on the coefficients from the four contribution indexes range from 1.72 for the power index up to 2.93 for the ability index for the June – July convention and range from 1.57 for the power index up to 2.47 for the ability index for the January – December convention.

Third, we examine modifications of the political indexes by scaling the measures by the dollar amount of contributions and combining together the measures to capture higher order interactions of strength, ability, and power. We estimate a regression for each of the four political indexes by scaling each index by the total amount of contributions over the previous five years. The t-statistics on the contribution-scaled index coefficients are 1.49 for equation 1, 1.87 for equation 2, 2.31 for equation 3, and 1.43 for equation 4. The economic effects (the average increase in monthly returns from a one standard deviation change in the index) are slightly less or about the same as the non-contribution-scaled indexes, suggesting that it is the number of supported candidates, more than the dollar value of the contributions that matter. We also estimate regressions using indexes constructed from cross-products of the strength, ability and power indexes. The information in these new indexes does not seem to especially help or hurt the results; the t-statistic on the coefficient for (strength x ability) is 2.35, for (strength x power) it is 2.18, and for (ability x power) it is 3.14.

To explore whether our documented hard-money-based contribution effects are driven by non-candidate specific soft money contributions, we estimate regressions of the four PI indexes from 2002 to 2005, a period over which soft-money contributions from corporations were banned. If soft-money contributions are a significant source of the contributions effect, we would

expect to see less of an effect after 2002. We find that the coefficients on the four indexes are actually larger in the post 2002 period than in the previous periods (but as expected, due to the short time series, are less statistically significant), consistent with the observations that 1) the shareholder wealth benefits from participating in the political process prior to 2002 were not due solely to non-candidate specific soft-money contributions, and 2) that the contribution effect remains strong in the most recent years of our sample.

Finally, to examine the effects of outliers in the contributions data on the regression results, we winsorize the political indexes at the 1 percent and 99 percent distribution points. The results are relatively unchanged; the t-statistics on the coefficients of the four PIs range from 1.98 for equation 4 to 3.13 for equation 3 (without winsorizing, t-statistics range from 1.95 for equation 4 to 3.12 for equation 3).

B. Political Contribution Portfolios

In this section, we analyze whether firm political contributions affect future abnormal returns. We form portfolios by weighting each firm by its relative value of a given political contribution index. Thus, firms that have a larger value of a given PI index are given a larger weight in a portfolio. Compared to forming quintile or decile sorted portfolios (two common methods), this methodology is simpler, and results in a single portfolio which includes all securities in our sample. The portfolios are rebalanced once a year, at the end of October. The weight given to stock *i* in the portfolio from November of year *t* to October of year *t+1* is:

$$w_{it}^{p} = \frac{PI_{it}^{p}}{\sum_{i=1}^{N} PI_{it}^{p}} \tag{5}$$

where p equals the portfolio for a particular political index (equations 1 through 4), and PI_{it}^{p} is the political index value for firm *i* (where *i*= 1, 2,… N) in October of year *t*. After forming the portfolios, we obtain a time series of monthly returns to each portfolio from November of 1984 to October of 2005. We regress the time series of portfolio returns in excess of the risk free rate on the four factors from the Fama-French-Carhart model and report the intercept (i.e., the alpha) in Table VI.

We find that the political contribution portfolios earn positive abnormal returns and that the evidence of abnormal returns is robust to the four political indexes, the party of the candidate, and the chamber of the candidate. For example, a portfolio formed by weighting firms by the total number of supported candidates earns abnormal returns of 21 basis points per month (t-statistic = 2.82). Across the other three contribution measures and across the

Democrat/Republican and House/Senate splits, the portfolios consistently earn positive abnormal returns, with average monthly returns ranging from 16 basis points (t-statistic = 2.08) for the Senate/strength-of-the-relationship portfolio up to a high of 24 basis points (t-statistic = 3.41) for the Democrats/ability-of-the-candidate-to-help portfolio.

Overall, the results thus far, using both regressions and portfolios, clearly support a story of positive firm welfare effects from participating in the political contribution process: As firms increase the total number of supported candidates, their future raw and abnormal returns increase. The effect seems to be the strongest for firms that support a greater number of candidates which hold office in the same state that the firm is based. In addition, there are stronger effects for firms whose contributions are slanted toward Democratic candidates and House candidates.

The apparent firm wealth effects from participating in the contribution process are large. For example, we estimate the nominal annual return-on-investment for the portfolio weighted by the total-number-of-supported-candidates to be a ridiculously high 654,836 percent.[21] We are not the first to document such a high rate of return; Tullock (1972), Ansolabehere, de Figueiredo, and Snyder (2003) and others have noted that the rate of return earned on hard-money contributions appears to be astronomically high. Our results translate to an average one-year increase in abnormal shareholder wealth summed over all firms of $106.3 billion, or about $154 million per year per firm. One obvious interpretation of such a high rate of return is that we are not using the true participation costs in our computations. As we have mentioned, there may be other substantial hidden costs, above and beyond hard-money contributions, that are required to generate firm wealth effects. Although we do not know exactly how politicians increase firm welfare, one might reasonably assume that if a firm is in fact "helped" by contributing to a portfolio of politicians, then these benefits should be reflected in terms of increases in firm fundamental performance, such as increases in profitability.[22] Thus in the next section, we analyze links between contributions, increases in firm profitability, and other firm characteristics.

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[21] The monthly abnormal return for the portfolio formed from weighting firms by their total number of supported candidate is 21 basis points, the average firm capitalization of contributing firms is $6.1B, and the average total contribution amount per year is $23,471. Thus, a back-of-the-hand estimation of the implied annual rate of return is ([0.21 basis points x 12 months x $6.1B]/$23,471)-1 = 654,836 percent. Similarly, the average annual increase in abnormal shareholder wealth is 21 basis points x 12 months x $6.1B = $153.7M.

[22] Anecdotal examples of politicians helping firms include: *The Salt Lake Tribune* (see Abrams (2006)) reports that the House recently changed its rules to make it harder for lawmakers to anonymously insert special "earmark" funding requests (narrowly tailored spending that helps a specific company in their district) into bills. Prior to these changes, politicians were able to insert special earmarks into spending bills relatively unnoticed; *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

III. What drives the relation between contributions and returns?

A. Changes in Fundamental Performance

In Table VII we estimate yearly cross-sectional regressions of changes in earnings (ROE(t+1) – ROE(t)), where ROE is equal to the earnings before extraordinary items scaled by the book value of equity, on lagged values of the contribution indexes, and standard control variables for forecasting future earnings (lagged Tobin's Q, lagged firm capitalization, and lagged changes in ROE). ROE(t) is from December of year *t,* the contribution index is from October of year *t*, and capitalization and Q are from June of year t, and changes in ROE is constructed as ROE(t-1) – ROE(t-2). As in the previous return regressions, the political indexes are standardized to have unit variance, we take the natural log of capitalization and Q, and the standard errors from the regressions are adjusted for autocorrelation in the beta estimates. If corporate political contributions increase future firm profitability, then we would expect to see positive and significant coefficients on the PI indexes.

Remarkably, we find a positive and significant relationship between the contributions and future profitability. Although we can't say exactly how (on a firm-by-firm basis) contributions increase firms' bottom lines, they appear to, and in a very significant manner: The coefficients on the four measures of contributions are all positive and statistically significant, with t-statistics ranging from 2.18 for the power-of-the-candidate index up to 4.05 for the strength index. Thus, it appears that the contribution effect is due in part to real changes in firm performance. The coefficients on Q and SIZE are positive and negative, respectively, and significant in all of the specifications, and the coefficients on lagged changes in ROE are always negative, but only marginally significant. We also estimate the ROE regressions for the contributions indexes split up by party and by chamber. For both Republicans and Democrats, changes in ROE are positively and statistically significantly related to the contribution indexes, although there is a slightly stronger effect for Democrats and for House candidates. Our finding that firm operating performance (or profitability) is positively and significantly related to political contributions is consistent with results in Faccio and Parsley (2006). They report that firms connected to local politicians experience a significant decline in sales growth upon the sudden death of the connected politician.

We can use the ROE results to estimate the present-value of firms participating in the contribution process. Using the coefficient on the number-of-supported-candidates regression, we

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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.

find that a one standard deviation change in the index translates to an approximate 0.36 percent annual increase in ROE. Treating the increase in ROE as a perpetuity and assuming an average discount rate of 10 percent, implies a 3.60 percent increase in firm value for a one standard deviation increase in the number of supported candidates.

B. Industry Effects

The above results suggest that firm contributions result in real changes to future firm profitability. In this section, we analyze if industry characteristics of the contributing firms help us to further understand the sources of the effect. Andres (1985) and Masters and Keim (1985) argue that firm participation rates in the political process vary systematically with industry characteristics. In particular, industries with a smaller number of firms, highly concentrated sales, more unionized industries, industries selling more of their product to the government, and more regulated industries are more likely to participate in politics.[23] In this section, we analyze if the aforementioned types of industries are more likely to benefit in terms of increases in shareholder wealth than other industries from their participation in the political process.

To get a preliminary understanding of the link between industries and contributions, in Figure 4 we plot the total number of supported candidates per firm per industry. The industry groups are defined using the Fama-French 49 industries. This figure shows that defense, smoke, aircraft, drugs, automobiles, and oil tend to contribute to the largest number of candidates and industries such as real estate, apparel, and precious metals tend to support the fewest number of candidates. These trends are fairly consistent across House (Panel A) and Senate (panel B) candidates.

We more formally analyze the relationship between the political giving effects and industry characteristics in Figure 5. Using SIC codes from Compustat, we annually sort firms in our sample into the Fama-French 49 industries. Within each industry, we perform cross-sectional regressions of monthly firm returns from November of 1984 to October of 2005 on book-to-market, capitalization, six-month returns and the total-number-of-supported-candidates index (equation 1). We take the natural log of all variables except six-month returns. Next, the resulting time-series average beta loadings on the political index for each of the 49 industries are regressed on the industry variables. The industry variables are: *Number of firms* is the average

[23] An increase in the number of firms in an industry may have a negative impact on participation rates because of an increased incentive to free-ride on other firms' contribution efforts. An increase in industry concentration may have a positive impact on participation rates because of an increased awareness of the industry by politicians. Finally, an increase in labor unions in an industry may have a positive impact on participation rates because of an increased firm incentive to lobby for pro-business (which may take a form of anti-labor) regulations.

annual number of firms in an industry from Compustat; *Herfindahl index* is the average annual Herfindahl index of industry concentration computed with firm net sales figures from Compustat; *Percent industry employees unionized* is the average annual percent of industry employees belonging to labor unions from Hirsch and Macpherson (2003); *Percent industry output purchased by government* is the average annual percent of total industry output purchased by the federal and state governments from the U.S Economic Census; *Total industry contribution* is the total amount of political contributions coming from an industry from the FEC data; and *Average number of supported candidates* is the average number of candidates supported per firm for a given industry from the FEC data.

In Figure 5 we report scatter diagrams of the industry beta loading on the PI and the industry variables as well as the output of the regressions. Consistent with theory from the political science literature, we find stronger political contribution effects for industries with a smaller number of firms (t-statistic = -2.41), more heavily concentrated sales (t-statistic = 2.12), and a higher percentage of unionized employees (t-statistic = 2.41). The coefficient on total number of supported candidates is marginally significant (t-statistic = 1.83), and the coefficient on total industry contribution is insignificant, consistent with the individual firm results. Also, industry output purchased by the government is not significant, suggesting that contribution return effects come from sources other than direct government purchases (e.g., favorable tax treatment, the imposing of tariffs or other penalties on competitors, favorable regulatory requirements). These results shed some light on the apparent mystery of why there is not a greater firm participation rate in campaign contributions (Ansolabehere, de Figueiredo, and Snyder (2003)). It appears that firms in certain types of industries choose to participate because they directly benefit more than firms in other industries where the potential welfare gains from political contributions are not as easily attainable.

IV. Conclusions

Ansolabehere, de Figueiredo, and Snyder (2003) argue that political contributions should not be viewed as investment in the political process but merely as a form of consumption good. Their argument is built around the apparent paradox of campaign financing – if political contributions are investment in the political process, the rate of return earned on that investment appears astronomically high (Tullock (1972)).[24] If we assume that the value of the hard-money contributions we use in this paper are the true costs for firms to play in the political process, then

[24] For example, according to AFS, all defense contracting firms and all individuals associated with those firms gave approximately $10.6 million in campaign contributions in 1998 and $13.2 million in 2000. In turn, the U.S. government spent approximately $134 billion on all defense contracts in 2000.

our results directly confirm the apparent off-the-scales high rate of return for firms participating in the political contribution process. Of course, another story is that the true costs for firms to participate in the political process are greater than the costs of hard-money contributions, and potentially include other off-the-books contributions or non-money favors, for which only large firms can afford to pay.[25] Or perhaps politicians find it most beneficial to grant favors to large firms because those are the firms that generate the largest amount of tax revenues and jobs. For example, Bertrand et al (2004) find that firms managed by connected CEOs in France create more jobs in politically more contested areas, and that this is especially so around election years.

In this paper, we capture the effectiveness of firm participation in the political process with a unique portfolio approach of how many candidates a firm supports. Using this measure, we document large and pervasive cross-sectional return effects; the more candidates a firm supports, the higher are its next year's raw and abnormal returns. We find that the increase in returns appears to be due in part to increases in a firm's future operating performance. Thus, our results imply that firms participate in the political system not from the standpoint of consuming a patriotic consumption good, as suggested in Ansolabehere, de Figueiredo, and Snyder (2003), but rather from the standpoint of creating positive net present value investments. Regardless, our results suggest that not all firms benefit the same from the political process, and if the goal of the FEC and other governing bodies is equal and fair access to government, then more work is needed in the area of firm/candidate transparency.

[25] For example, Cheung, Jing, Rau, and Stouraitis, Aris (2006) argue that governments can obtain resources from firms in the forms of bribes and other payoffs.

Appendix A: Campaign Finance Law

This appendix provides a brief historical overview of campaign finance laws in the United States. While these laws are rather extensive, we focus primarily on provisions dealing with disclosure requirements and contribution and spending limits by candidates and political parties.

A.1 The Federal Election Campaign Act of 1971

As early as 1905, President Theodore Roosevelt, recognizing the need for regulating the financing of federal election campaigns, called for a ban on corporate contributions for political purposes. As a result, the U.S. Congress has passed several statutes between 1907 and 1971 that collectively were designed to limit the disproportionate influence of wealthy individuals and special interest groups on the outcome of federal elections. For example, in the Act of August 19, 1911, Congress banned all corporate contributions to political parties and imposed disclosure requirements on political contributions and expenditures. Over the next half-century, the ban was extended to other organizations including labor unions and trade associations. However, these rules were not comprehensive enough and were rarely strictly enforced (Ansolabehere, de Figueiredo, and Snyder (2003)).

The Federal Election Campaign Act (FECA), passed by Congress in 1971, was the first comprehensive set of rules governing public funding of federal elections. It also provided for a detailed set of disclosure requirements for candidates and political parties. Congress amended the Act in 1974 following the Watergate scandal setting strict limits on contributions by individuals, political parties and special interest groups. The 1974 amendment also created an independent agency, the Federal Election Commission (FEC), to enforce the campaign finance law.

According to FECA, candidates seeking a federal office may create their own candidate campaign committees. National parties may create party committees. Both types of committees must be registered with the FEC and report to the FEC all contributions in excess of $200 made to them by individuals and special interest groups. Special interest groups may include corporations, labor unions, trade organizations and other interest groups.

For the purposes of transparency, special interest groups must create (and register with the FEC) their own political action committees (PACs) and make contributions to national parties or candidates only through these committees. The sponsoring interest groups are not allowed to contribute to their own PACs but may cover PACs' start-up, administrative and fundraising expenses. PACs may solicit contributions only from individuals associated with the sponsoring

organization. In the case of corporate PACs, only individuals directly employed by the firm may contribute to the firm's PAC, with most of contributions coming from the firm's top managers.

FECA established strict limits on contributions by individuals and special interest groups (which include corporations) to candidates, party committees and PACs. For each two-year election cycle, PACs have been allowed to contribute up to $5,000 to a candidate per election ($10,000 total, with $5,000 contributed during a primary election and $5,000 contributed during a general election). Individuals have been allowed to contribute up to $2,000 to a candidate ($1,000 during a primary and $1,000 during a general election), up to $5,000 to any special interest PAC and up to $20,000 to a party committee. Finally, FECA imposed a $25,000 limit on the total amount of political contributions made by individuals. No limit was set on the total number of candidates which special interest PACs may support.

Despite the existing contribution limits, individuals and special interest groups could contribute unlimited amounts during elections by using two important exceptions. First, individuals and interest groups were allowed to spend unlimited amounts in "independent expenditures" in support of or against political candidates. To qualify as "independent expenditures", these expenditures could not be coordinated with candidate or party campaigns. Second, individuals and interest groups could contribute unlimited amounts to political parties in "soft-money" contributions. These contributions, established under the 1979 amendment to FECA, were intended to be used on voter registration expenses and on "get out the vote" campaigns. Quickly, however, the parties began to use soft money for party building and other administrative expenses. Perhaps more controversially, political parties began using soft money on issue advertising, which amounted to supporting or criticizing particular candidates running for office.

A.2. The Bipartisan Campaign Reform Act of 2002

By many accounts, FECA has not been very successful in limiting the role of wealthy individuals and special interest groups in the election outcomes. The use of "independent expenditures" and soft money by the wealthy has allowed them to advance their agenda in federal elections. In early 2002, in part influenced by the spectacular collapse of Enron (a major political contributor in federal elections), Congress passed the Bipartisan Campaign Reform Act (BCRA), which significantly altered the campaign finance system in the US.

Two of the most important changes introduced by the Act are the ban on all soft money contributions and the increase in contribution limits. The limit on contributions from individuals directly to political candidates was doubled from $2,000 per election cycle to $4,000 per election

cycle. The individual contribution limit to party committees was increased from $20,000 to $25,000 per election cycle, and the contribution limit to state or local PACs was increased from $5,000 to $10,000 (there was no change in the individual contribution limit to other special interest PACs). Finally, the limit on total individual contributions was increased from $25,000 to $95,000 per election cycle. Contribution limits from special interest PACs to candidates and political parties were not changed.

BCRA also limited the use independent expenditures for issue advertising. Under the new issue advertising restrictions, special interest groups cannot pay for any advertisement that identifies a federal candidate within 30 days of a primary election or within 60 days of a general election. Any advertisement that does identify a federal candidate within those time periods must be paid for with regulated "hard-money" contributions or with contributions coming directly from individuals.

Appendix B

The variables used in the paper are listed below (with Compustat data items in parenthesis).

Market value (SIZE) is the price per share times shares outstanding at the end of June of calendar year *t*.

Book-to-market equity (BM), for the fiscal year ending in calendar year *t*, is as defined in Davis, Fama, and French (2000) where book equity (BE) is the stockholders book equity (data60), plus balance sheet deferred taxes and investment tax credit (data35), minus book value of preferred stock (in the following order: data56 or data10 or data130) and ME is the price times shares outstanding at the end of December of calendar year *t*.

ASSETS is total assets (data6)

ROE is income before extraordinary items (data18) scaled by total common equity (data60)

Leverage is the sum of long-term debt and debt in current liabilities, scaled by total assets [data9 + data34)/data6]

BHRET6 is the six-month buy-and-hold return over January (t) to June (t) $[(1+r_1) \times ... \times (1+r_6)-1]$ where r_i is the return in month i

BHRET36 is the 3-year buy-and-hold return over July (t-3) to June (t) $[(1+r_1) \times ... \times (1+r_{36}) -1]$ where r_i is the return in month i

Cash Flow (CF), as used in Titman, Wei, and Xie (2004). It is defined as Cash Flow =(Operating income before depreciation - interest expenses - taxes - preferred dividends - common dividends)/total assets [data13-(data15+data16+data19+data21)]/data6

Tobin's Q market value in fiscal year t measured as price times number of shares outstanding at the end of fiscal year t (data199*data25) divided by book equity (BE) in fiscal year t.

EMPLOYEES is the number of employees in millions (data 29)

PROFIT is operating income before depreciation scaled by lagged total assets (data13/data6)

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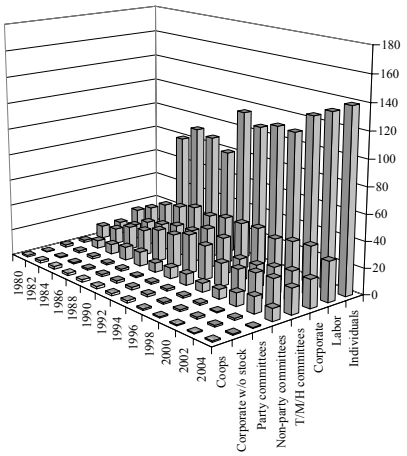
Figure 1
Sources of Election Funds, 01/1979 – 12/2004

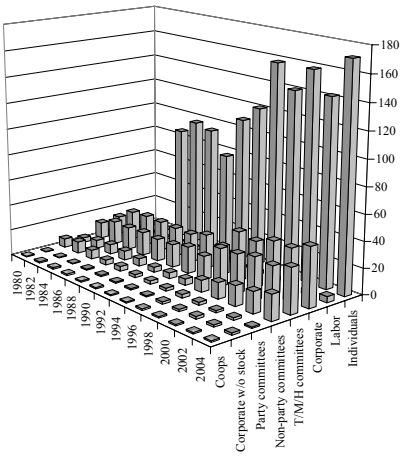
The data is from the Federal Election Commission (FEC) summary files on political contributions to House and Senate elections for the period 1979 – 2004. Panel A presents summary data for the House of Representatives elections. Panel B presents summary data for the Senate elections. Contributions are reported for different classes of contributors. Coops are organizations that define themselves as cooperatives. Corporate w/o stock are corporations without capital stock. Party committees are national party committees. Non-party committees are committees that are not directly affiliated with any parties but that have not reported any connected organization. T/M/H committees are organizations affiliated with trade associations, membership organizations, or organizations in the health field. Corporate are private and public corporations. Labor are organizations connected with labor entities. Individuals are individual contributors. All figures are in millions of 12/2004 dollars.

Panel A: Contributions to House of Representatives candidates, in millions of dollars

Contributions to Democrats

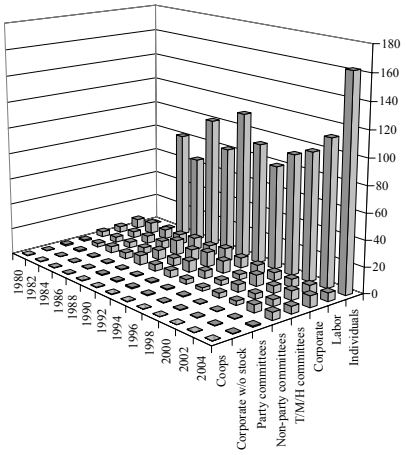


Contributions to Republicans



Panel B: Contributions to Senate candidates, in millions of dollars

Contributions to Democrats



Contributions to Republicans

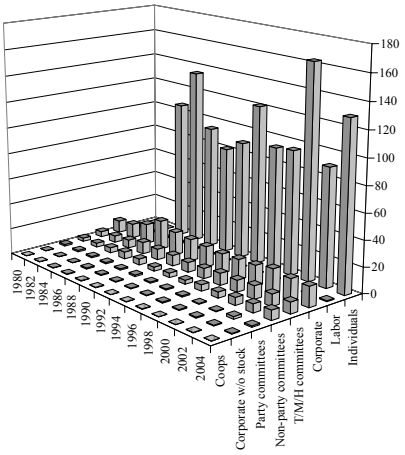
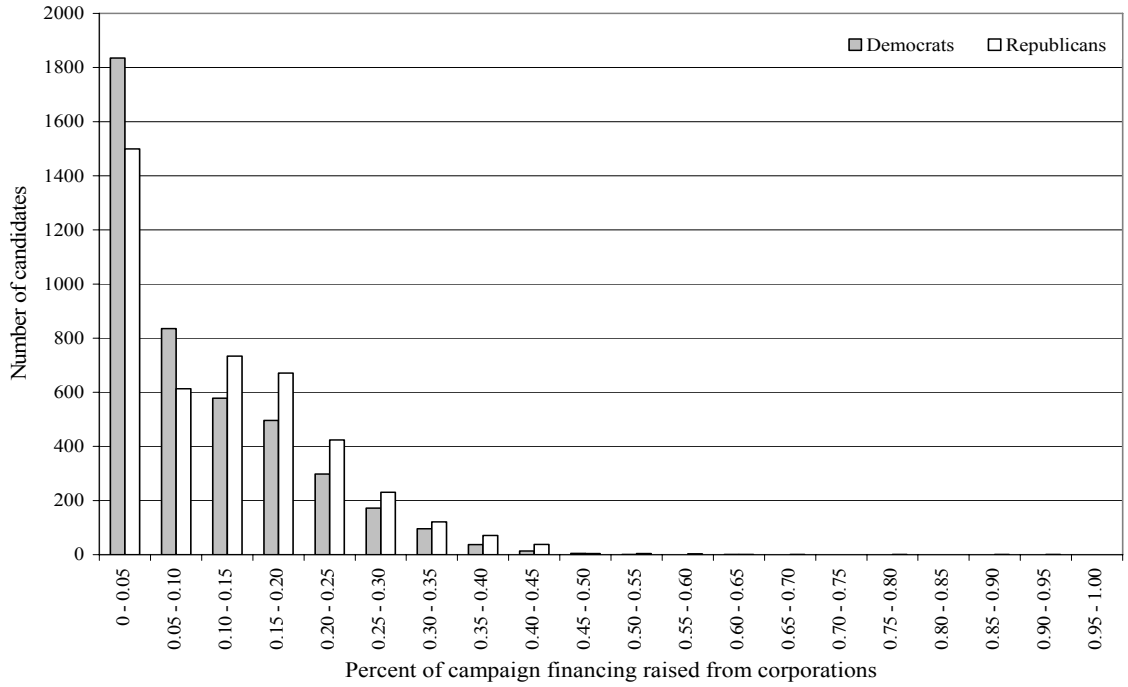


Figure 2
Corporate Contributions as a Percentage of Candidates' Total Campaign Financing, 01/1979 – 12/2004

The data is from the FEC summary files on political contributions to House and Senate elections for the period 1979 – 2004. Panel A is a frequency diagram of corporate contributions as a percentage of total campaign financing for candidates running for the House of Representatives. Panel B is a frequency diagram of corporate contributions as a percentage of total campaign financing for candidates running for the Senate.

Panel A: House of Representative candidates



Panel B: Senate candidates

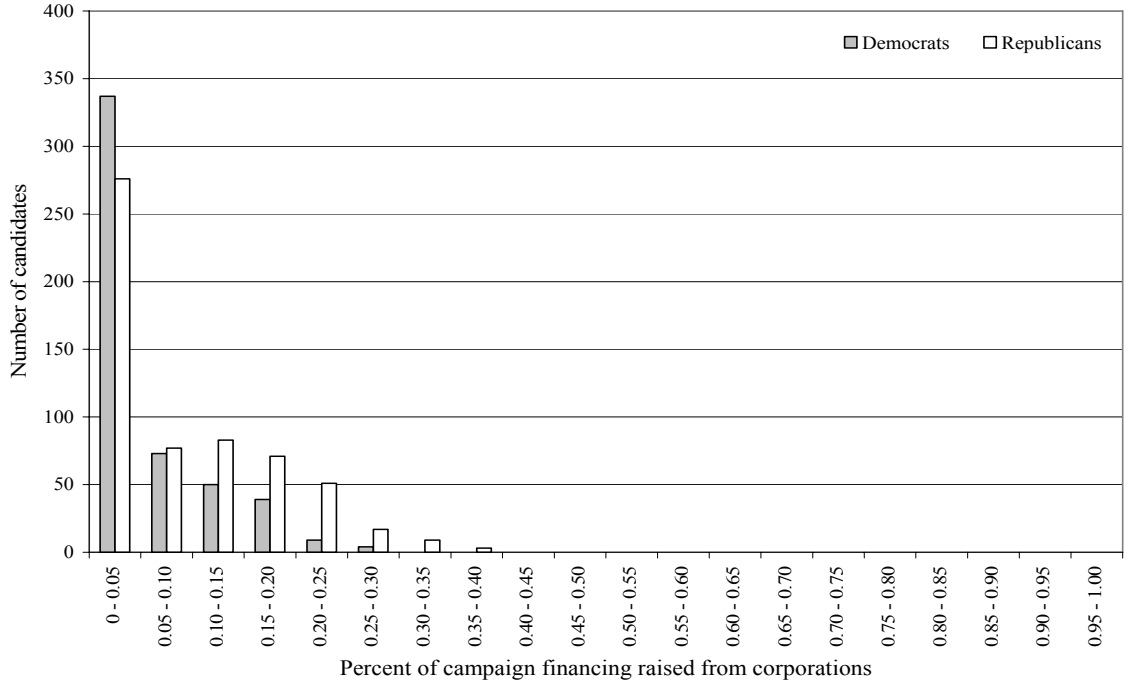
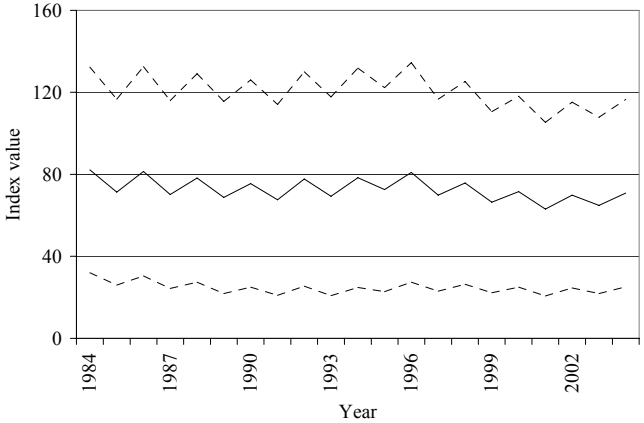


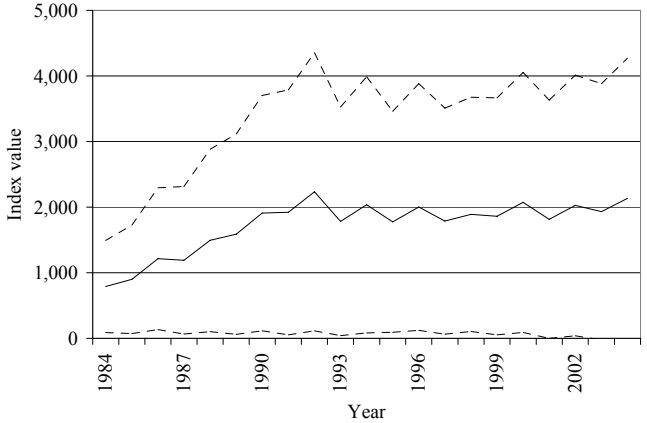
Figure 3
Time-series Variation in Political Indices, 10/1984 – 10/2004

The data is from the FEC detailed files on political contributions to House, Senate and Presidential elections for the period 1979 – 2004. We exclude all non-corporate contributions, contributions from private firms and subsidiaries of foreign firms, as well as contributions from firms for which there is no return data on CRSP. The sample includes 819,815 contributions made by 1,930 unique firms. Individual contributions are combined into four different political indexes (PIs). Panel A is the number of supported candidates, Panel B is the strength of the relationships between candidates and the contributing firm, Panel C is the ability of the candidates to help the firm, and Panel D is the power of the candidates. The solid line in each panel is the yearly mean value of the PI index. The upper and lower dashed lines are one-standard-deviation bounds around the mean.

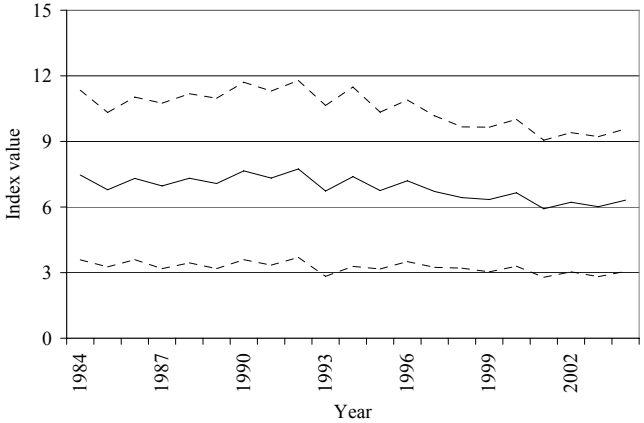
Panel A: $PI^{candidates}$



Panel B: $PI^{strength}$



Panel C: $PI^{ability}$



Panel D: PI^{power}

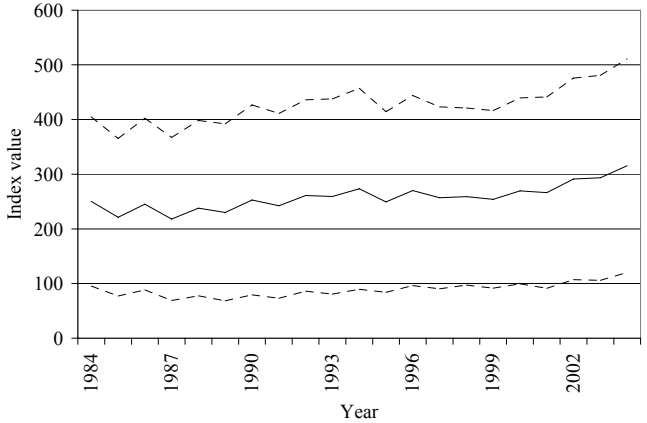
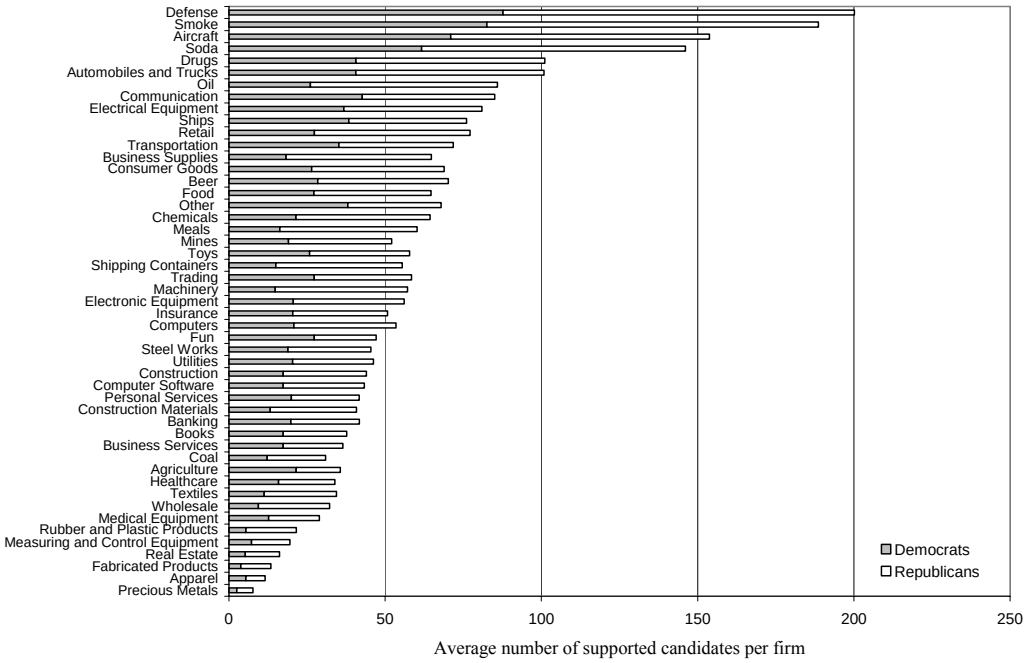


Figure 4
Industry Contribution Analysis, 01/1979 – 12/2004

The data is from the FEC detailed files on political contributions to House and Senate elections for the period 1979 – 2004. We exclude all non-corporate contributions, contributions from private firms and subsidiaries of foreign firms, as well as contributions from firms for which there is for which there is no return data on CRSP. The sample includes 819,815 contributions made by 1,930 unique firms. Panel A is the average number of supported House candidates per firm reported separately for each Fama-French 49 industry. Panel B is the average number of supported Senate candidates per firm reported separately for each Fama-French 49 industry.

Panel A: The average number of supported candidates running for the House of Representatives



Panel B: The average number of supported candidates running for the Senate

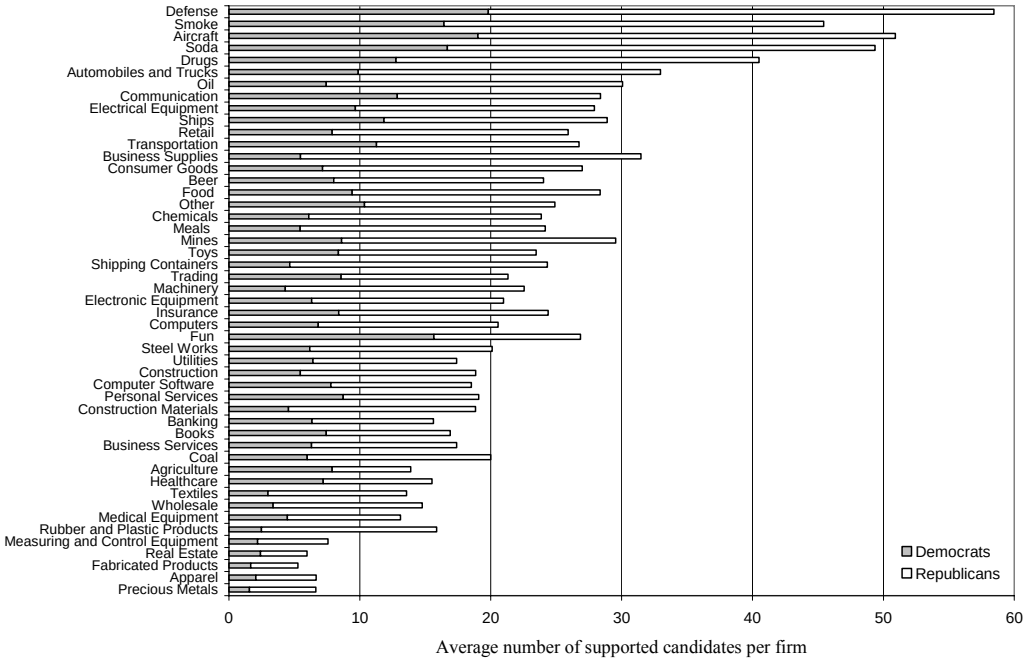


Figure 5
Industry Analysis, 11/1984 – 10/2005

All firms making political contributions are first sorted into Fama-French 49 industries. Monthly cross-sectional return regressions are performed each month from November 1984 to October 2005 within each industry using Ln(BM), Ln(SIZE), BHRET6, and Ln($PI_{it}^{candidates}$) as the independent variables. Finally, the time-series average beta loadings on $PI_{it}^{candidates}$ for each industry are regressed on industry variables. The resulting regression lines, coefficients, and t-statistics on the coefficients are reported in separate figures. *Number of firms* is the average annual number of firms in an industry. *Herfindahl index* is the average annual Herfindahl index of industry concentration computed with firm sales figures. *Percent industry employees unionized* is the average annual percent of industry employees who belong to labor unions. *Percent industry output purchased by government* is the average annual percent of total industry output purchased by the federal and state governments. *Total industry contribution* is the total amount of political contributions coming from each industry. *Average number of supported candidates per firm* is the average number of candidates that each firm in an industry supports.

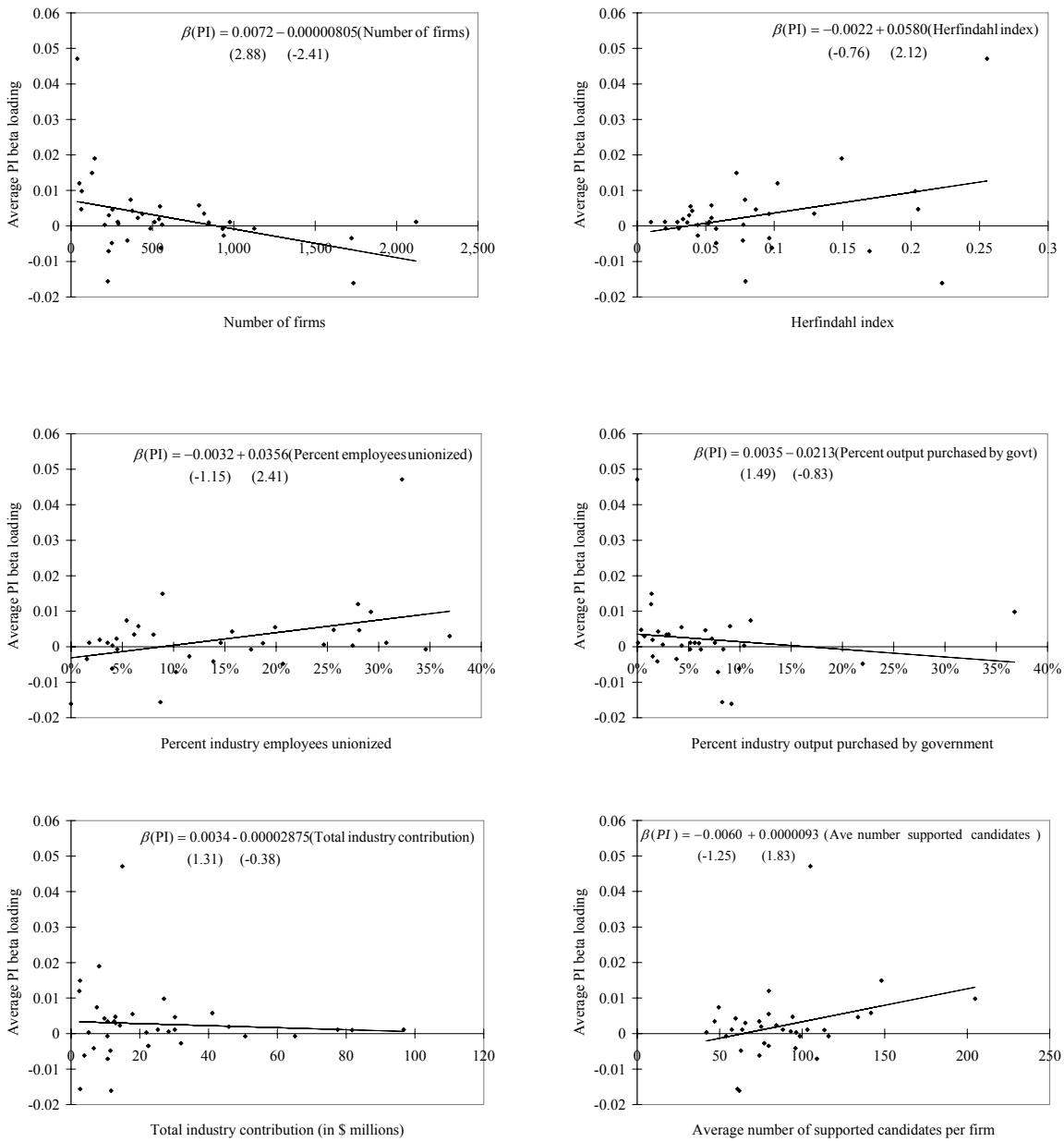


Table I
Firm Contribution Characteristics, 01/1979 – 12/2004

The data is from the FEC detailed files on political contributions to House, Senate and Presidential elections for the period 1979 – 2004. We exclude all non-corporate contributions, contributions from private firms and subsidiaries of foreign firms, as well as contributions from firms for which there is no return data on CRSP. The sample includes 819,815 contributions made by 1,930 unique firms. The table reports firm contribution characteristics per firm, per election cycle. All figures in panel A are in 12/2004 dollars.

Variable	Mean	Min	25th Per	Median	75th Per	Max
Panel A: Dollar amount of firm contributions per election cycle						
Total contributions	$64,694	29	3,606	15,657	60,668	2,713,367
Candidates						
Democrats	30,758	33	2,347	8,352	29,530	1,439,031
Republicans	43,126	29	3,037	11,327	41,431	1,614,756
Races						
House	50,176	41	3,556	14,110	48,920	2,195,978
Senate	26,258	19	2,708	8,854	28,058	658,160
Presidential	5,660	11	1,365	3,661	6,801	84,530
Panel B: Number of firm contributions per election cycle						
Number of contributions	56	1	3	15	57	1,930
Number of candidates	31	1	2	10	38	564
Candidates						
Democrats	16	1	2	6	19	338
Republicans	20	1	2	7	25	245
Races						
House	29	1	3	11	36	505
Senate	8	1	2	4	12	64
Presidential	2	1	1	1	2	9

Table II
Political Indexes Descriptive Statistics, 10/1984 – 10/2004

The data is from the FEC detailed files on political contributions to House, Senate and Presidential elections for the period 1979 – 2004. We exclude all non-corporate contributions, contributions from private firms and subsidiaries of foreign firms, as well as contributions from firms for which there is for which there is no return data on CRSP. The sample includes 819,815 contributions made by 1,930 unique firms. Individual contributions are combined into four different political indexes (PIs):

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

$$PI_{it}^{strength} = \sum_{j=1}^{J} Cand_{jt,t-5} \times I_{jt} \times \frac{NCV_{jt}}{NOV_{jt}} \times rellength_{jt,t-5} \tag{2}$$

$$PI_{it}^{ability} = \sum_{j=1}^{J} HomeCandidate_{jt,t-5} \times I_{jt} \times \frac{NCV_{jt}}{NOV_{jt}} \tag{3}$$

$$PI_{it}^{power} = \sum_{j=1}^{J} Cand_{jt,t-5} \times I_{jt} \times \frac{NCV_{jt}}{NOV_{jt}} \times \left[\sum_{m=1}^{M} \frac{Committeerank_{mt}}{Mediancommitteerank_{mt}} \right]_j \tag{4}$$

Panel A presents the descriptive statistics for each political index. Panel B presents correlation coefficients across four political indexes. $PI_{it}^{candidates}$ is the number of supported candidates, $PI_{it}^{strength}$ is the strength of the relationships between candidates and the contributing firm, $PI_{it}^{ability}$ is the ability of the candidates to help the firm, and PI_{it}^{power} is the power of the candidates. See equations 1 – 4 in the text for construction details of the indexes. The descriptive statistics and the correlations are computed using full sample pooled data. The *p*-values in Panel B test the null hypothesis that the correlations are equal to zero.

Panel A: Descriptive statistics

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

Panel B: Correlations

	$PI^{candidates}$	$PI^{strength}$	$PI^{ability}$	PI^{power}
$PI^{candidates}$	1			
$PI^{strength}$	0.8710 (< 0.001)	1		
$PI^{ability}$	0.5385 (< 0.001)	0.4700 (< 0.001)	1	
PI^{power}	0.9676 (< 0.001)	0.8896 (< 0.001)	0.5441 (< 0.001)	1

Table III
Characteristics of Contributing and Non-Contributing Firms, 01/1984 – 12/2004

The sample of contributing firms is from the FEC detailed files for the period 1979 – 2004. We exclude all non-corporate contributions, contributions from private firms and subsidiaries of foreign firms, as well as contributions from firms for which there is insufficient data on CRSP/Compustat. The final merged sample includes 769,044 contributions made by 1,522 unique firms. Monthly returns from November 1984 to October 2005 are merged with the total number of supported candidates from October of year *t* and accounting variables from June of year *t*. ASSETS is Compustat data item6, total assets, in millions of $, from the fiscal year ending in calendar year *t*-1. Capitalization (SIZE), in millions of $, is calculated using the price and the number of shares outstanding at the end of June of year *t*. EMP is the number of employees in millions (data 29). All accounting variables (book-to-market ratio (BM), Leverage, return on equity (ROE), cash flow (CF), profitability (PROFIT) are calculated using Compustat data in the fiscal year ending in calendar year *t*-1. BHRET36 is the 36-month buy and hold return over July(t-3) to June(t). The numbers in each cell are time series averages of yearly cross-sectional medians, with the exception of average capitalization (SIZE-AVG), in millions of $, which is the time series average of yearly cross-sectional mean capitalization. Number of firms is the average number of firms per year for the non-contributors and contributors. Number of supported candidates is the average number of supported candidates per firm over a 5 rolling year window (see equation 1 in the text). Panel A reports characteristics of contributing and non-contributing firms. Panel B reports characteristics of the contributing firms based on annual decile sorts of the number of supported candidates (equation 1) measure. All numbers, with the exception of ASSETS, SIZE, and SIZE-AVG, are in decimal form, e.g. 0.01 is 1 percent. Details on the construction of these variables are provided in the appendix.

	BHRET36	BHRET6	ASSETS	SIZE	SIZE-AVG	BM	LEVERAGE	CF	EMP	PROFIT	ROE	Number of Supported Candidates	Number of firms
Panel A: Comparison of non-contributing and contributing firms													
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	
Panel B: Comparison of contributing firms partitioned by the number of supported candidates index													
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	

Table IV
Fama-MacBeth Return Regressions for Firms Participating in the Political Process, 11/1984 – 10/2005

The sample of contributing firms is from the FEC detailed files for the period 1979 – 2004. We exclude all non-corporate contributions, contributions from private firms and subsidiaries of foreign firms, as well as contributions from firms for which there is insufficient data on CRSP/Compustat. The sample includes 769,044 contributions made by 1,522 unique firms. These contributions are combined into four separate political indexes (PIs) according to equations 1 – 4 in the text. $PI_{it}^{candidates}$ is the number of supported candidates, $PI_{it}^{strength}$ is the strength of the relationships between candidates and the contributing firm, $PI_{it}^{ability}$ is the ability of the candidates to help the firm, and PI_{it}^{power} is the power of the candidates. Monthly returns from November 1984 to October 2005 are regressed on the natural logarithm of each lagged political index and the natural logarithm of lagged book-to-market ratio (ln(BM)), the natural logarithm of the lagged firm's market value of equity (ln(SIZE)) and lagged 6-month buy-and-hold returns (BHRET6). Ln(BM), ln(SIZE), and BHRET6 are computed as of June of each year and updated in July. Political indexes are computed as of October of each year and are updated in November. Beta estimates are time series averages of betas obtained from monthly cross sectional regressions. The t-statistics are adjusted for autocorrelation in the beta estimates and are reported in parenthesis.

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

Table V
Fama-MacBeth Return Regressions for Democrat/Republican and House/Senate Political Indexes, 11/1984 – 10/2005

The sample of contributing firms is from the FEC detailed files for the period 1979 – 2004. We exclude all non-corporate contributions, contributions from private firms and subsidiaries of foreign firms, as well as contributions from firms for which there is insufficient data on CRSP/Compustat. The sample includes 769,044 contributions made by 1,522 unique firms. These contributions are combined into four separate Democrat (Republican) political indexes (PIs) by modifying equations 1 – 4 with an indicator variable equal to one if the candidate is affiliated with the Democratic (Republican) Party and zero otherwise. Similarly, contributions are combined into separate House (Senate) PIs by modifying equation 1 – 4 with an indicator variable equal to one if the candidate is affiliated with the House (Senate) and zero otherwise. In panel A, monthly returns from November 1984 to October 2005 are regressed on lagged ln(BM), ln(SIZE), BHRET6, Ln(PI_{Demres}) and Ln(PI_{Rep}). Ln(BM), ln(SIZE) and BHRET6 are as defined in table IV. Ln(PI_{Demres}) is the natural logarithm of the residual Democrat PI obtained from regressing each Democrat PI in equations 1 – 4 on the respective Republican PI. Ln(PI_{Rep}) is the Republican PI. In panel B, monthly returns from November 1984 to October 2005 are regressed on ln(BM), ln(SIZE), BHRET6, Ln($PI_{Houseres}$) and Ln(PI_{Senate}). Ln(BM), ln(SIZE) and BHRET6 are as defined in table IV. Ln($PI_{Houseres}$) is the natural logarithm of the residual House PI obtained from regressing each House PI in equations 1 – 4 on the respective Senate PI. Ln(PI_{Senate}) is the Republican PI. Beta estimates are time series averages of betas obtained from monthly cross sectional regressions. The t-statistics are adjusted for autocorrelation in the beta estimates and are reported in parenthesis.

Panel A: Regressions for Democrat / Republican Political Indexes

Intercept	Ln(BM)	Ln(SIZE)	BHRET6	Ln($PI^{candidates}_{Demres}$)	Ln($PI^{candidates}_{Rep}$)	Ln($PI^{strength}_{Demres}$)	Ln($PI^{strength}_{Rep}$)	Ln($PI^{ability}_{Demres}$)	Ln($PI^{ability}_{Rep}$)	Ln (PI^{power}_{Demres})	Ln (PI^{power}_{Rep})
0.0134	0.0004	-0.0009	0.0076	0.0009	0.0009						
(3.99)	(0.39)	(-1.60)	(2.35)	(3.01)	(1.76)						
0.0134	0.0004	-0.0009	0.0075			0.0011	0.0008				
(4.01)	(0.37)	(-1.73)	(2.30)			(4.77)	(1.79)				
0.0133	0.0004	-0.0008	0.0076					0.0010	0.0007		
(3.98)	(0.35)	(-1.73)	(2.32)					(3.20)	(2.34)		
0.0133	0.0005	-0.0008	0.0075							0.0009	0.0007
(3.98)	(0.46)	(-1.46)	(2.31)							(3.54)	(1.40)

Panel B: Regressions for House / Senate Political Indexes

Intercept	Ln(BM)	Ln(SIZE)	BHRET6	Ln($PI^{candidates}_{Houseres}$)	Ln($PI^{candidates}_{Senate}$)	Ln($PI^{strength}_{Houseres}$)	Ln($PI^{strength}_{Senate}$)	Ln($PI^{ability}_{Houseres}$)	Ln($PI^{ability}_{Senate}$)	Ln ($PI^{power}_{Houseres}$)	Ln (PI^{power}_{Senate})
0.0133	0.0004	-0.0010	0.0076	0.0010	0.0009						
(3.97)	(0.37)	(-1.67)	(2.36)	(2.99)	(1.67)						
0.0133	0.0004	-0.0008	0.0077			0.0010	0.0007				
(3.97)	(0.36)	(-1.66)	(2.37)			(3.88)	(1.68)				
0.0133	0.0004	-0.0008	0.0077					0.0010	0.0004		
(4.00)	(0.40)	(-1.67)	(2.34)					(3.52)	(1.33)		
0.0133	0.0005	-0.0008	0.0077							0.0010	0.0007
(3.97)	(0.46)	(-1.52)	(2.37)							(3.69)	(1.35)

Table VI
Monthly Abnormal Returns for Firms Participating in the Political Process, 11/1984 – 10/2005

The sample of contributing firms is from the FEC detailed files for the period 1979 – 2004. We exclude all non-corporate contributions, contributions from private firms and subsidiaries of foreign firms, as well as contributions from firms for which there is insufficient data on CRSP/Compustat. The sample includes 769,044 contributions made by 1,522 unique firms. These contributions are combined into four separate political indexes (PIs) according to equations 1 – 4 in table II and the text. We form portfolios of contributing firms by weighting each firm by its relative value of a given lagged political contribution index. The portfolios are rebalanced once a year, at the end of October. The weight given to stock *i* in the portfolio from November of year *t* to October of year *t+1* is:

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

where p equals the portfolio for a particular political index (equations 1 – 4 in table II and the text), and PI_{it}^{p} is the political index value for firm *i* (where *i*= 1, 2,… N) in October of year *t*. We form a time series of monthly returns to each portfolio from November 1984 to October 2005. We regress the time series of portfolio returns in excess of the risk free rate on the four factors from the Fama-French-Carhart model and report the intercept (i.e., the alpha) for each portfolio. Returns are in decimal form, i.e., 0.01 is one percent. T-statistics are in parenthesis.

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

Table VII
Fama-MacBeth ROE Regressions for Firms Participating in the Political Process, 12/ 1984 – 12/2005

Annual changes in ROE (ROE(t+1) – ROE(t)) from December 1984 to December 2005 are regressed on the natural logarithm of each lagged political index and the natural logarithm of lagged Tobin's Q (ln(Q)), the natural logarithm of the firm's lagged market value of equity (ln(SIZE)) and lagged annual changes in ROE (ΔROE). ROE(t) is from December of year *t,* the contribution index is from October of year *t*, capitalization and Q are from June of year *t*, and ΔROE is constructed as ROE(t-1) – ROE(t-2). The sample of contributing firms is from the FEC detailed files for the period 1979 – 2004. We exclude all non-corporate contributions, contributions from private firms and subsidiaries of foreign firms, as well as contributions from firms for which there is insufficient data on CRSP/Compustat. The sample includes 769,044 contributions made by 1,522 unique firms. These contributions are combined into four separate political indexes (PIs) according to equations 1 – 4 in table II and the text. $PI_{it}^{candidates}$ is the number of supported candidates, $PI_{it}^{strength}$ is the strength of the relationships between candidates and the contributing firm, $PI_{it}^{ability}$ is the ability of the candidates to help the firm, and PI_{it}^{power} is the power of the candidates. Beta estimates are time series average of cross sectional regression betas obtained from monthly cross sectional regressions. The t-statistics are adjusted for autocorrelation in the beta estimates and are reported in parenthesis.

Intercept	Ln(Q)	Ln(SIZE)	Δ ROE	Ln($PI^{candidates}$)	Ln($PI^{strength}$)	Ln($PI^{ability}$)	Ln (PI^{power})
0.0123	0.0273	-0.0042	-0.0394	0.0036			
(1.44)	(3.50)	(-3.55)	(-1.76)	(2.42)			
0.0155	0.0282	-0.0047	-0.0392		0.0053		
(1.92)	(3.62)	(-4.26)	(-1.76)		(4.05)		
0.0086	0.0277	-0.0036	-0.0384			0.0035	
(0.97)	(3.64)	(-3.13)	(-1.71)			(2.29)	
0.0103	0.0272	-0.0039	-0.0396				0.0031
(1.30)	(3.50)	(-3.60)	(-1.76)				(2.18)