

## Corporate Political Contributions: Investment or Agency?

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## Corporate Political Contributions: Investment or Agency?

**Abstract:** We examine corporate contributions to political candidates for federal offices in the United States from 1991 to 2004. We find that firms that donate have operating characteristics consistent with the existence of a free cash flow problem. Further, donations are negatively correlated with future excess returns. An increase in donations of \$10,000 is associated with a reduction in annual excess returns of 9.6 basis points. We find that worse corporate governance is associated with larger donations. However, even after controlling for corporate governance, we find that donations are associated with worse excess returns. Firms that make donations engage in more acquisitions and donating firms' acquisitions have significantly lower cumulative abnormal announcement returns than firms that do not make donations. When we try to isolate instances in which donations may lead to better returns, we find only limited support for the hypothesis that political donations represent an investment in political capital. Taken together, our results suggest that political donations are more symptomatic of agency problems within the firm.

## Introduction

Why do companies make donations to political parties and to candidates for political office? Companies do not have political preferences per se. They may, however, have an economic interest in various legislative actions, regulatory decisions, or other political outcomes. Thus, one reason why companies may donate is to influence the political process in ways that improve firm performance. An alternative reason why companies may donate is that, while companies do not have political preferences, their managers do. In this view, political donations need not be associated with firm performance and, in fact, may damage firm returns as they represent a form of perquisites consumption for the firm's managers. This form of perquisites consumption is often not transparent or visible to shareholders, and can indicate wider agency problems at the firm.

While these two possibilities for why firms donate are not mutually exclusive, they do have very different implications for the firm and its shareholders. Under the first view, donations are an investment in political capital that should, in expectation, generate positive returns for the firm. Under the second view, donations are symptomatic of an agency problem that should lower returns for the firm. We examine which of these views more accurately characterizes political contributions in the United States.

In order to do so, we use comprehensive data on corporate political contributions from the Center for Responsive Politics. Our data span the years 1991 to 2004 and include the four main types of political contributions: political action committee (PAC) donations, soft-money donations, donations by individuals affiliated with a company, and donations to 527 Committees. We thus have a complete picture of donations by firms to candidates for federal offices and the national parties. Notably, of the universe of publicly-traded firms, only 14% or 1,829 firms donate during our sample period.<sup>1</sup>

We find that the firms that donate generally have operating characteristics consistent with the firms' facing a free cash flow problem—they are large, stable firms that have more free cash flow and yet engage in less R&D and investment spending. Second, we find that donations are negatively correlated with future excess returns. An increase in

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<sup>1</sup> Donations by individuals affiliated with a company are discretionary for the individual. If we exclude all individual donations, then the number of firms with donations drops to 1,767.

donations (excluding individual contributions) of \$10,000 is associated with a reduction in excess returns of 9.6 basis points in the following year. Similar to Yermack's (2006) result for CEO personal use of corporate aircraft, this reduction in shareholder value far outstrips the dollar value of the donations. Moreover, Liu and Yermack (2007) argue that behavior such as home purchases, which are seemingly irrelevant to corporate performance, can serve as signals of whether an executive is committed to the firm or entrenched. This suggests that political donations may be a useful window into the presence of wider agency problems within firms. Further, to address endogeneity concerns, we instrument for donations and find similar negative associations between donations and returns. We also examine if large donations lead to better returns. We find some support for this, but only for the very largest donors representing one quarter of one percent of our sample of donating firm-year observations.

Third, we find that better corporate governance (smaller boards, CEOs who are not also chairman of their board, less abnormal CEO compensation, larger block ownership) is associated with smaller donations. However, even after we control for corporate governance, we continue to find a negative association between donations and excess returns. Thus, while better governance may attenuate donations, the negative association between donations and excess returns is not wholly attributable to an omitted governance effect. Fourth, we find that firms that make political donations engage in more acquisitions than do non-donating firms. Further, donating firms' acquisitions have significantly lower cumulative abnormal announcement returns than do non-donating firms' acquisitions.

Fifth, we try to isolate instances in which donations may lead to better returns. For example, firms that donate might have shown even worse returns without the donations. Such firms might experience or anticipate negative shocks and donate to try to offset the shock. If donations do not fully mitigate the shocks, then we would observe a negative correlation between donations and excess returns. To address this, we control for industry shocks, firm-specific shocks, and shocks tied to firm investment, as well as considering different possible timing for when such shocks might occur. We also consider a political risk insurance explanation, in which firms that donate are ex ante purchasing insurance, which ex post they did not use. In addition, we examine a

subsample of companies in industries that receive government contracts since for these companies donations are more likely to be an investment in political capital. In none of these instances do we find evidence of the hypothesized positive association between donations and returns.

We also examine whether donations to the winning party in an election lead to higher event-study returns. We find positive one-day abnormal returns to donating to the winning party in Presidential election years. This is consistent with the prior literature and has been viewed as supporting the investment hypothesis. However, we do not find positive one-day abnormal returns for donating to winners in Congressional elections. For longer-horizon returns, we find no evidence of a positive effect of donating to winners in either Presidential or Congressional elections. Importantly, we find that donating to either winners or losers is associated with worse returns than not donating at all. This provides us with a direct test of the two hypotheses, and our findings are consistent with the agency hypothesis but hard to reconcile with the investment hypothesis.

We also consider the possibility that politicians may do favors for firms and then firms may donate to politicians. If so, any positive effect of the political favors on firm returns may occur prior to the donations. To address this possibility, we examine returns for firms that start donating in the year that there is a shift in political control. Our rationale is that firms that start donating to the winning party in a year that political control changes are unlikely to be donating in response to past favors. By definition, the winning party in a year in which control shifts cannot have been in power before, and therefore would not have been in a good position to provide political favors. Firms starting to donate to the party that then wins power are more likely to be seeking future political favors. In this case, we still find a strong negative association between firm returns and starting to donate to a party that wins political control. Thus, our results cannot simply be driven by firms choosing to donate after political favors are bestowed.

Overall, we find only limited support for the hypothesis that political donations represent an investment in political capital. Taken together, our results suggest that political donations are reflective of an agency problem. Given the magnitude of the

destruction of shareholder value that we document, it is more plausibly the case that corporate political contributions are symptomatic of wider agency problems in the firm.

The existing literature—which we review in the next section—has largely focused on short-term event studies that examine whether corporate political connections or donations are valuable. While this approach can detect changes in firm value that can be accurately attributed to certain events (e.g., elections or the severance of connections), it does not measure potential offsetting costs. To the extent that the literature has examined the costs of political donations, it has done so in the context of rent-seeking by politicians. In contrast, we test two competing hypotheses—donations as reflective of an agency problem between managers and shareholders versus donations as an investment in political capital. In order to do so, our approach differs along two dimensions.

First, we use the direct monetary amount of donations, which allows us to test the two competing hypotheses, since donations can either be the monetary investment or a measure of perquisites consumption. Second, we study long-horizon returns, which help us to formally distinguish between the agency hypothesis and the investment hypothesis. Our focus on stock returns is appropriate given that corporate political contributions are not disclosed in a transparent or timely fashion to shareholders, and are therefore likely to be capitalized into stock prices only slowly over time. In addition, we provide more precise support for the agency hypothesis by examining the determinants of donations and by controlling for endogeneity of the donation decision. Specifically, long-horizon returns are negatively associated with donations, and donations are associated with weak corporate governance characteristics.

While the view that corporate political contributions are not in shareholders' interests may be surprising (at least to us), it is apparently not surprising to shareholder activists. According to a survey conducted by the Center for Political Accountability, “73% [of surveyed shareholders] agreed that corporate political spending is often undertaken to advance the private political interests of corporate executives rather than the company's interest.”<sup>2</sup> The surveyed shareholders strongly support enhanced disclosure of corporate contributions. According to the *Financial Times*, “investors argue that public disclosure and board oversight is essential to ensure that executives do not use corporate money to

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<sup>2</sup> See [www.politicalaccountability.net](http://www.politicalaccountability.net).

help political allies or channel funds to politicians whose agendas contravene company policies.”<sup>3</sup> Our results support the proposition that lack of transparency allows contributions to function as a form of private benefits for managers in the United States.<sup>4</sup>

The remainder of this paper is organized as follows. The next section reviews the relevant literature and discusses our experimental design. Section 2 describes our data on political contributions. Section 3 presents results on the characteristics of companies that choose to donate. Section 4 examines the association between firm returns and donations while correcting for the endogeneity of the donation decision. Section 5 examines the hypothesis that donations are symptomatic of an agency problem while Section 6 examines the hypothesis that donations represent an investment in political capital. Section 7 concludes.

## 1. Literature Review and Experimental Design

This paper contributes to a growing literature that looks at the intersection of politics and finance. The strand of this research that is most directly related to our work examines the effect of political contributions on various firm outcomes. Several recent working papers present event studies examining the effect of the 2000 U.S. Presidential elections on companies aligned with Republicans or Democrats, including Knight (2006), Goldman, Rocholl, and So (2006), Shon (2006), and Jayachandran (2006). In general, these papers find that good (bad) news for Republicans is associated with a positive (negative) stock price reaction for Republican-leaning firms and a negative (positive) stock price reaction for Democratic-leaning firms. Hood and Nofsinger (2006) use a similar strategy and find similar results for the 2004 Presidential election. These papers necessarily focus on short-run returns, small samples, and isolated events, in contrast to our study.<sup>5</sup> Roberts (1990) and Cooper, Gulen, and Ovtchinnikov (2006) find evidence

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<sup>3</sup> See Francesco Guerrera, “Investors want facts on political donations,” *Financial Times*, April 1, 2007.

<sup>4</sup> We do not take a stance on the optimal level of transparency with regard to corporate political contributions—see Hermalin and Weisbach (2007).

<sup>5</sup> For studies examining the effect of corporate political donations on voting outcomes see Snyder (1990), Grier and Munger (1991), Romer and Snyder (1994), Ansolabehere and Snyder (1999), and Stratmann (2005). Ang and Boyer (2006) study the gains and losses to special interest groups during the nationalization and privatization of Conrail. Kroszner and Stratmann (1998) develop and test a model of

of a positive effect of donations on firm value. Cooper, et. al., is the paper closest in spirit to ours. We discuss their results in relation to ours in Section 4. Bombardini and Trebbi (2008) examine government expenditures on an industry relative to both contributions and votes from that industry. They do not examine stock returns.

On the other hand, several recent studies document the ineffectiveness of campaign contributions as a form of gaining influence or buying favorable policies. For example, Ansolabehere, de Figueiredo, and Snyder (2003) show that only one in four studies from the previous literature support the popular notion that contributions buy legislators' votes. They also illustrate that when one controls for unobserved constituent and legislator effects, there is little relationship between money and legislator votes. They suggest that contributors gain relatively little leverage from their donations. Ansolabehere, Snyder, and Ueda (2004) examine the excess returns of firms that give large amounts of soft money and firms that give no soft money, and changes in those excess returns around five key events in the approval of the Bipartisan Campaign Reform Act of 2002. They find no noticeable effect on the valuation of Fortune 500 firms that give large amounts of soft money relative to the firms that give no soft money.

We note that much of the prior literature uses short-term event studies to examine the effect of political contributions on firm returns. One innovation of our study is to examine long-term (one-year) stock returns instead of short-horizon stock returns. We choose to use long-term stock returns for three reasons. First, a short-run event study around an election does not allow us to detect an agency motive for donations. If political contributions are purely a private benefit for managers, then the election outcome is not informative one way or the other for shareholders. In this case, an agency motive would be entirely consistent with the results in Ansolabehere, de Figueiredo, and Snyder (2003) and Ansolabehere, Snyder, and Ueda (2004), who show no immediate benefits from contributions.

Second, firms that do not donate are generally left out in the election event studies of donations to winners and losers.<sup>6</sup> However, an examination of non-donors provides

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how competition among political pressure groups shapes the organization of Congress. For studies on corporate corruption, see Hellman, Jones, and Kaufmann (2003) and Svensson (2003).

<sup>6</sup> Although not in an election context, Ansolabehere, Snyder, and Ueda (2004) do examine donors and non-donors.

valuable information about the motives for donation. As we noted before, many companies choose not to donate, presumably because the costs of donating exceed the benefits. Understanding the determinants of corporate donations helps us distinguish whether donations are related to shareholder value creation or to management's private benefits.

Third, the short event window of election outcome announcements does not allow us to fully examine the investment value of corporate political donations. If corporate political donations are made as an investment on behalf of shareholders, then the investment value should be fully incorporated into stock prices when the investment outcomes are realized (or expected to be realized). Presumably corporate donors wish to get favorable legislative outcomes or government contracts. The probability of these favorable outcomes may increase at the time of the election, but are likely to increase much more over time as the legislative process unfolds. Therefore, we should expect that the investment value of political donation gets incorporated into stock prices over time as favorable legislation moves through committees, the House, and the Senate. Since those outcomes take a substantial amount of time to be realized, and there is still a high degree of uncertainty about those outcomes at the time of the election, long-term stock performance appears to be a better measure of the investment value of corporate political donations than the short-term stock returns following an election. Of course, there is also a cost to using long-term stock performance, in that long-term stock returns are noisier than event-horizon returns.

A second strand of the literature examines how political connections influence financial performance. We note that political connections (personal ties between politicians and corporate managers or corporations) are distinct from political donations (payments from corporations to politicians), which are the focus of this paper. Political donations do not operate in the same way and do not have the same impact as tightly established political connections that are typically examined in the literature. A good example of a political connection is former Senator William Frist and (the formerly publicly traded, now private) Hospital Corporation of America, a hospital holding company founded by Senator Frist's father and brother. While political connections represent long-term relationships, political contributions tend to be transactional and

short-term. As we show in the next section, the average amount of campaign contributions is small and limited by regulation, and thus contributions alone are unlikely to develop strong ties between the firm and a politician. Direct and strong personal connections take time to establish, while political contributions tend to vary over time and are spread across both parties and multiple candidates.

A number of studies examine corporate political connections within a country (see, e.g., Fisman (2001) for the case of Indonesia, Johnson and Mitton (2003) for the case of Malaysia, Ferguson and Voth (2004) and Niessen and Ruenzi (2007) for the case of Germany, and Agrawal and Knoeber (2001) for a sample of outside directors in the United States). Several recent papers also provide cross-country evidence of the impact of political connections on firm value (see, e.g., Faccio (2006), Faccio and Parsley (2007), and Faccio, Masulis, and McConnell (2006)). Taken together, these findings suggest that politically connected firms benefit from their connections, particularly in countries with a higher level of corruption.

Other research, however, documents that corporate political connections are costly to the firm due to rent-seeking by politicians. Morck, Stangeland, and Yeung (2000) argue that the corporate control pyramids of wealthy Canadian families give them preferential access to capital and enhanced lobbying power. However, these firms show low industry-adjusted financial performance, labor capital ratios, and R&D spending relative to other firms of the same age and size. Similar results are found by Fan and Wong (2006) in the case of China for politically-connected firms' IPOs and by Bertrand, Kramarz, Schoar, and Thesmar (2006) for politically connected firms in France. Fisman, et. al. (2006), examine the value of political connections to Vice President Richard Cheney and find that the value of such connections is zero. They argue that this implies that U.S. institutions are effective at controlling political rent-seeking.

Our results for US firms that donate to politicians are consistent with the results in these studies of political connections, but we emphasize a different mechanism. We show that political contributions are associated with and indicative of conflicts between shareholders and managers. Our focus on agency problems within firms is distinct from rent-seeking by politicians, although the two explanations may also be complementary.

## 2. Data

Corporations may give money to political parties and candidates through four different channels: as donations to Political Action Committees (PACs), as “soft money” donations, as individual donations, and as contributions to 527 groups. PACs solicit contributions from employees of a company, aggregate the funds, and then in turn make contributions to candidates and parties. The PAC is set up by the company, its operating expenses are paid by the company, and the officers of the PAC are company employees. Because the PAC is controlled by management, one can think of the funds within the PAC as resources directed by management. PAC contributions are limited to \$1,000 per election to candidates and \$20,000 per calendar year to political parties.

Soft money donations are unlimited campaign contributions to the national parties for party-building activities such as get-out-the-vote drives and non-party specific advertising. Soft money donations are made directly by the company and its officers using company funds. As of November 6, 2002, these soft money donations have been banned as a result of the Bipartisan Campaign Reform Act, but were an important means of political giving throughout all but the last election cycle of our sample period. After soft money was banned, direct contributions from corporate funds switched to 527 groups. These are tax-exempt organizations under section 527 of the Internal Revenue Code and they exist to raise money for political activities like voter mobilization efforts and issue advocacy. These groups became more important after the abandonment of soft money donations, which is apparent from Panel A of Table 1.

The final form of political contributions comes from individual donations. Individuals are asked to disclose their employer when they make contributions in excess of \$200.<sup>7</sup> Individual donations were limited to \$25,000 per year prior to the Bipartisan Campaign Reform Act and are now limited to \$95,000 per two-year cycle. Individual contributions need not necessarily reflect the preferences of either the firm’s shareholders or its managers—they make simply reflect the preferences of the individual making the contributions. In the tables that follow, we primarily report results aggregate corporate

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<sup>7</sup> The Federal Election Commission does not track individual donations that are smaller than \$200.

contributions excluding individual donations. The results are quite similar if we also include individual donations.<sup>8</sup>

Donations to political parties must be itemized and reported to the Federal Election Commission (FEC), which makes the reports public. Since corporate political donations can come directly from the corporation or from individuals associated with the corporation, accurate tracking of such donations is challenging. Fortunately, the Center for Responsive Politics (CRP) has created a comprehensive database based on FEC filings that links all four types of donations (PAC, soft money, individual, 527 groups) to the donor's affiliated organization.<sup>9</sup> Our donation data from 1991 to 2004 comes from this CRP database. These data cover donations to candidates for federal offices (Congressional and Executive) and national parties; they do not include donations to candidates for state level offices.

While CRP associates some high-profile subsidiaries with their parent company (i.e., KBR, formerly Kellogg Brown and Root, is indicated as a subsidiary of Halliburton), most subsidiaries are not indicated as such. In addition, the CRP data does not accurately reflect changes in corporate ownership due to mergers and acquisitions. This may be a potential concern since many firms are participants in the market for corporate control during our sample period, and donations may be linked to attempts to influence regulatory approval. To rectify these two drawbacks of the data, we use a variety of data sources such as LexisNexis' Corporate Affiliations, Mergent Online, Dun & Bradstreet's Million Dollar Database, Hoovers, the Securities and Exchange Commission's EDGAR database as well as internet searches and corporate web pages to identify the ultimate corporate parent company of subsidiaries and to accurately track mergers and

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<sup>8</sup> One point worth noting is that we do not examine lobbying expenditures in this paper. Lobbying may be directed at Senators and Representatives, but it is often directed at Federal agencies that may have a direct regulatory or oversight function for the lobbying firm (e.g., the Federal Communications Commission). Interestingly, the Center for Responsive Politics reports that there is little correlation between firms' lobbying expenditures and firms' political contributions, suggesting that these are distinct categories for attempting to garner influence. See <http://www.opensecrets.org/pubs/lobby00/summary.asp> for details. Further, in a recent paper Yu and Yu (2007) argue that corporate lobbying seems to delay corporate fraud detection, suggesting that managers are "buying off" regulators. Such lobbying postpones fraud detection, allowing managers to sell more shares, and arguably leading to worse outcomes for shareholders.

<sup>9</sup> PAC contributions are almost 100% categorized, soft money is more than 90% coded, and individual contributions are approximately 70% categorized in most election cycles. Individual contributions are most difficult to classify because of the large number of contributions and because the self-reported employer/occupation data is often incomplete. See <http://www.crp.org/industries/methodology.asp> for details.

acquisitions of donating companies. We aggregate donations of subsidiaries at the level of the parent company and attribute donations of acquired companies made after the acquisition was completed to the acquiring company. We exclude private companies and U.S. subsidiaries of foreign companies, which results in a final sample of 1,829 publicly traded companies that make donations. This is a small fraction of all publicly traded companies. Over our sample period, only 14.33% of all publicly traded firms donate to candidates for federal offices. Further, only 12.6% of our firm-year observations show positive donations, implying that not all firms that donate choose to do so every year.

Panel A of Table 1 displays the total donations as well as the four categories of political donations by year and shows that for our sample, PAC, soft money, individual, and 527 contributions accounted for 42.6%, 35.5%, 20.5%, and 1.5% of total donations, respectively. Throughout this study, all donations are expressed in 2004 dollars. Panel B shows donations aggregated at the industry level for Financial Trading, Telecommunication, Utilities, Banking, and Transportation, the five industries that donated the most money during our sample period (based on the Fama-French 49 industry classification). Both panels show an election year effect, that is, donation levels are higher in even years which correspond to Congressional and Presidential elections.

Later in this paper we investigate the effect of political donations in year  $t$  on future stock returns in year  $t + 1$ . If year  $t$  is an election year, we expect a portion of the future annual stock return associated with political donations in this year to be driven by the announcement effect of the election outcome. To capture this announcement return, we calculate the annual return variable as the buy-and-hold return from the first Wednesday of November until the first Monday of November the following year.<sup>10</sup> Later in the paper, we also examine the one-day announcement return associated with the election outcome. However, we focus on the annual return for most of this study because political donations occur in every year, both election and non-election, and occur throughout the course of the year. To the extent that this implies that donations build up political capital, we expect the returns to political capital to accrue over time. In addition, if donations

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<sup>10</sup> For example, we associate the 2001 (year  $t+1$ ) return (calculated from Wednesday, Nov. 8, 2000 until Monday, Nov. 5, 2001) with all political donations made from January 1, 2000 until December 31, 2000 (year  $t$ ). In election years, the vast majority of donations are made prior to the election, so the slight overlap in periods (between November 8 and December 31, 2000 in this example) is not, in practice, a problem.

result in passage of specific, favorable legislation, then we expect the returns to accrue when either the legislation passes or it becomes clear the legislation will pass, which need not coincide with elections.

The daily stock returns for our calculations are from CRSP, which we also use to calculate each company's return volatility, defined as the standard deviation of monthly stock returns during the previous 60 months. We use both the delisting information from the daily CRSP file and the SDC Platinum database to identify companies that have been involved in mergers or acquisitions as either an acquirer or as a target.

Ownership data (the fraction of shares owned by insiders, block holders, and institutions) comes from Compact Disclosure. The number of directors (board size) is calculated for all companies in our sample that are either covered by Compact Disclosure or by RiskMetrics. We construct an indicator variable that equals one if the Chief Executive Officer (CEO) is also the Chairman of the Board (CEO Chair) for all companies for which this information is available through either Compact Disclosure, RiskMetrics, or Execucomp. Based on its four-digit SIC code, we assign each company to one of the Fama-French 49 industries.<sup>11</sup> This classification is used to control for industry effects and to calculate each firm's Sales Impact, defined as company's sales scaled by the sales of all companies in the same industry, and Industry Frequency, defined as the fraction of firms in an industry that donate.

Finally, each CEO's abnormal compensation is calculated as the deviation from predicted compensation based on firm size and industry median-adjusted prior stock and accounting performance. All other firm characteristics are obtained from the CRSP/Compustat merged database. Definitions and summary statistics for these variables are in Table 2. As is clear from the summary statistics, there are important differences between donating and non-donating firms. The key difference for our purposes in Table 2, Panel B, is that the mean excess future return for donating firms is 4.0% while for non-donating firms, it is 6.5%.<sup>12</sup> We explore this difference in the rest of the paper.

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<sup>11</sup> The industry classification used is available at [http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data\\_library.html](http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html).

<sup>12</sup> Excess returns are measured relative to the four-factor model, which we describe in Section 4. Excess returns for the whole sample are positive because of equal-weighting when reporting means. Value-weighting for the entire sample yields mean excess returns of 0.

### 3. Determinants of Corporate Political Donations

#### A. Why do Firms Chose to Donate?

Firms may donate for a variety of reasons. We focus on two important ones. First, donations may represent a form of investment in political capital. In this view, firms donate because they expect the recipients of the donations (national level politicians and/or committees associated with the national political parties) to reward the contributions with favorable legislation. An example of this is Altria Group, the parent company of Phillip Morris—the largest corporate contributor in our sample—which presumably has an economic interest in discouraging increased tobacco and cigarette taxes as well as in limiting government regulation of tobacco products.

Second, donations may represent an agency problem. Corporate donations are largely unobservable to shareholders. While donations are disclosed to the government, they are not disclosed in firm financial statements, usually are not discussed in board meetings, and are generally small enough to evade shareholder scrutiny. If donations represent an agency problem, then they do not generate returns for shareholders. Instead, donations are a form of perquisites consumption for top managers. Managers may have personal preferences over candidates and parties they wish to support that are simply unrelated to the firm's activities.<sup>13</sup> Donations may grant access to politicians. While such access could be valuable for the firm, it may also simply be a way for executives to demonstrate their own power and prestige. Such donations may pave the way for executives to be appointed to high-profile cabinet positions or to high-status ambassadorships.

As an example, the Center for Responsive Politics' "the Bush administration embassy row" project lists 40 major ambassadorial picks who contributed large amounts to the Bush campaigns and the Republican Party during the 2000, 2002, and 2004 election cycles. Among the 40 large-donor ambassadors, 33 were corporate CEOs, presidents or founders, or their immediate family members (e.g., wife). In some cases, such political

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<sup>13</sup> One point worth noting is that many private companies make political donations as well. In the case of a private company, however, donations made at the discretion of the owner-manager do not constitute an agency problem because the owner's preferences and the manager's preferences are necessarily congruent (although there is still the possibility of minority shareholder expropriation).

appointments might be beneficial for the firm. In other cases, such appointments may be simply neutral or even negative for the firm, as we expect for ambassadorial appointments for CEOs.<sup>14</sup>

Even if donations represent an agency problem, it may be difficult to identify the exact nature of the agency problem. Do donations represent perquisites consumption? Or, do they signify that top executives are busy attending to political issues that are peripheral to shareholders and therefore neglecting the firm? Perhaps donations simply reflect a propensity to squander excess cash? All of these are possibilities, but are hard to disentangle. Because we cannot directly identify the source of agency problems, we look for evidence that is consistent with the presence of agency problems broadly speaking. We will then examine whether agency problems or efficient investment better describe why firms make political contributions.<sup>15</sup>

## B. Characteristics Associated with Donations

Our previous discussion makes clear that firms choose whether and how much to donate. What factors influence these decisions? In Table 3, we estimate donations as a function of a vector of firm characteristics as well as industry and year dummies. Year dummies are critical as Panel A of Table 1 shows that donations are larger in even-numbered years, which correspond to national level elections. Industry dummies are also critical as Panel B of Table 1 shows that some industries are consistently large contributors in the aggregate.

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<sup>14</sup> An interesting example of this is in Fisman, et. al., who document a negative announcement return for Halliburton when then-CEO Richard Cheney selected himself to be George W. Bush's Vice-Presidential running mate. One possibility is that the loss of a talented CEO may be costly to the firm.

<sup>15</sup> There is an analogy between corporate political contributions and corporate philanthropic donations. Brown, Helland, and Smith (2006) examine corporate philanthropic donations of Fortune 500 companies and report that agency costs play a prominent role in explaining corporate giving. Firms with higher debt ratios give less cash to charities and are less likely to establish corporate foundations, while firms with larger boards of directors give more cash and are more likely to establish foundations. The first finding is consistent with effective monitoring by creditors, while the second result is consistent with the model by Aggarwal and Nanda (2006), which predicts that larger boards are associated with a greater variety of social objectives and lower managerial incentives to increase shareholder value. In contrast, Lev, Petrovits, and Radhakrishnan (2006) find that firms with a product market incentive to have a charitable reputation use giving to enhance revenue.

As noted before, 87.4% of our firm-year observations are donations of 0. In Table 3, the first column displays the results from a probit specification where the dependent variable, Donation Dummy, takes a value of 1 if the firm donates in that year and 0 otherwise. The second column displays the results from a Tobit specification where the dependent variable is the dollar value of all donations. The third column presents results for a Tobit specification where the dependent variable is the dollar value of all donations excluding individual contributions. We include this specification because individual contributions may reflect an individual employee's preferences rather than those of the firm or management. In such situations, individual contributions will reflect noise rather than either an investment or an agency problem. All of the independent variables for these specifications are measured as of the year prior to the donating year. In general, the results across the three specifications are quite consistent.<sup>16</sup>

Firms that donate and firms that donate more tend to have lower book-to-market ratios, more free cash flow, more assets (larger size), lower stock return volatility, less R&D spending, and less investment (capital expenditure) spending.<sup>17</sup> This set of characteristics implies that firms that donate and donate more are larger, more stable, and have excess cash. Interestingly, firms that donate more do not seem to spend this cash on R&D or physical capital as they invest less in R&D and physical assets than firms that donate less.

This last finding is surprising in light of the fact that the firms that donate more have lower book-to-market ratios. If we think of the book-to-market ratio as the inverse of Tobin's Q or a proxy for growth opportunities, the firms that donate more should be investing more and yet they do not. While these results are suggestive, they are certainly not conclusive. These results could be consistent with the view that firms that donate have a free cash flow-based agency problem. On the other hand, these results could also be consistent with the view that these firms are investing in political capital rather than R&D or physical capital. Investments in political capital may lead to protection against competitors, or the awarding of contracts or subsidies from the government.

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<sup>16</sup> Throughout we use robust standard errors clustered by firm (see White (1980), Froot (1989), and Rogers (1993)).

<sup>17</sup> In these specifications, firms that donate more seem to have greater leverage as well. However, the coefficients on leverage are not robust to alternative specifications, so we do not draw conclusions with respect to leverage.

Several other characteristics stand out as well. Firms that are large relative to their industries as measured by their fraction of industry sales (sales impact) donate more. Thus, size, both in absolute terms and relative to the industry, matters for donations. Firms in industries that have a high fraction of donors tend to donate more. Because many firms are participants in the market for corporate control during our sample period, and donations may be linked to attempts to influence regulatory approval, we include both a target firm and an acquirer dummy in our specifications. Target firms are less likely to donate and donate less. Acquirers are more likely to donate and donate more.

In general, we conclude that larger, stable firms with more free cash flow and less R&D and investment spending tend to donate more. At this stage, we do not claim any causal relation between these characteristics and donations. However, these associations are sufficiently suggestive as to cause us to question whether donations are investments that generate better returns or symptomatic of agency problems. We turn to this question in the next section.

#### 4. Donations and Returns

The relation between donations and firm returns could be either positive or negative. If donations are investments, then, in general, we would expect there to be a positive reduced-form relation between donations and returns. On the other hand, if donations are symptomatic of an agency problem, then we would expect a negative reduced-form relation between donations and returns. The null hypothesis is that donations and stock returns are unrelated, either because there truly does not exist an economic relation or because markets correctly and fully anticipate both donations and their impact on stock returns. Then year  $t$  donations should have no marginal explanatory power for year  $t+1$  excess returns at all. We focus on one-year stock returns because corporate political contributions are not disclosed in a transparent or timely fashion to shareholders, and are therefore likely to be capitalized into stock prices only slowly over time.<sup>18</sup>

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<sup>18</sup> For robustness, we have also examined two-year and four-year returns.

To examine this question, we define our dependent variable, firm-level excess returns (XR), as one-year buy-and-hold returns<sup>19</sup> minus the expected return. We use the four-factor model<sup>20</sup> as our benchmark asset pricing model. We define the expected return for firm  $i$  as:

$$E(R_{it}) = r_{ft} + \beta_{1i}Market_t + \beta_{2i}SMB_t + \beta_{3i}HML_t + \beta_{4i}MOM_t$$

where  $r_{ft}$  is the risk-free rate. The coefficients on the factors are estimated separately for each firm based on the prior sixty months of returns and factors.<sup>21</sup> The excess return is then:

$$XR_{it+1} = R_{it+1} - E(R_{it+1}).$$

Next we regress excess returns on donations. The general form of our specification is:

$$XR_{it+1} = \alpha + \beta_1 Donation_{it} + \beta_2 (YearDummies) + \varepsilon_{it+1}.$$

The first column of Panel A of Table 4 contains results from an OLS specification of returns on total donations. Following Petersen (2007), we include year dummies and cluster the standard errors at the firm level. We find that the coefficient on donations is negative and significant for the four factor model. As noted earlier, total donations include individual contributions, which may reflect an individual employee's preferences, rather than those of the firm's shareholders or management. To address this concern, in Columns 2, we repeat the specification from Column 1, but use donations excluding individual contributions as the independent variable of interest. Throughout the rest of the paper, we focus on donations excluding individual contributions. We find a negative

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<sup>19</sup> As described in Section 2, we calculate the annual return variable as the buy-and-hold return from the first Wednesday of November until the first Monday of November the following year to capture potential announcement returns associated with election outcomes.

<sup>20</sup> Following Carhart (1997), we use the three Fama-French factors—Market (market returns minus the risk-free rate), SMB, HML—and momentum, MOM. The four factors and the risk-free rate are obtained from Ken French's webpage at <http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/>

<sup>21</sup> For robustness, we also estimated firm-specific factor loadings using the 52 prior weeks of returns for the Fama/French model. The results are unaffected.

and significant coefficient of -0.096 on donations excluding individual contributions.<sup>22</sup> The coefficient of -0.096 in the four factor model implies that an incremental firm donation of \$10,000 would be associated with a negative 9.6 basis point excess return. This is not trivial. The median donating firm has a market value of equity of \$1.8 billion. The 9.6 basis point loss translates into a dollar loss of \$1.73 million associated with the \$10,000 donation.<sup>23</sup>

The above result clearly suggests that more is lost than the simple dollar value of the donation. Instead, we view donations as providing us with a window into firm value destruction, similar to the result in Yermack (2006), who finds large negative returns associated with CEO use of corporate aircraft, and to the result in Liu and Yermack (2007), who find poor firm performance following large real estate purchases by CEOs. We more formally link value destruction to agency problems later in the paper. While the dollar loss is certainly surprising, it may also explain why 86% of publicly-traded firms do not donate — donations are associated with bad outcomes for shareholders.

As noted in the previous section, the decision of whether and how much to donate is clearly endogenous. Our first specification does not take account of this potential endogeneity. Because most firms choose not to donate, our first concern is to address a firm's propensity to donate. Using the method of Li and Prabhala (2008), we estimate the following two-stage Heckman selection model for Panel A (the analogous second stage equation is used in Panel B):

$$D_{it}^* = \gamma Z_{it-1} + u_{it}; \quad D_{it} = 1 \text{ if } D_{it}^* > 0, \text{ and } D_{it} = 0 \text{ if } D_{it}^* \leq 0.$$

$$XR_{it+1} = \alpha + \beta_1 D_{it} + \beta_2 \lambda_i + \beta_3 (\text{YearDummies}) + \varepsilon_{it+1}.$$

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<sup>22</sup> One concern with this result is that it may be driven by specific years or only a small number of years. To address this concern, we perform cross-sectional regressions year-by-year and then use the Fama-Macbeth procedure to find time-series average coefficients and standard errors. As suggested by Petersen (2007), the results (not reported) are consistent with the results reported in the first two columns of Table 4.

<sup>23</sup> In further robustness tests (unreported), we examine donations cumulated over two years and cumulative excess returns over the subsequent two years (i.e., a Congressional election cycle). The results are virtually identical. We also examine donations cumulated over four years and cumulative excess returns over the subsequent four years (i.e., a Presidential election cycle). The negative coefficients on donations are similar in magnitude, but the sharp reduction in observations renders the results statistically insignificant.

The first equation is the probit selection equation.  $Z$  is a set of variables that are correlated with a firm's propensity to donate—in this case, all of the variables used in Model 1 of Table 3.  $\lambda$  is the inverse Mills ratio computed from the selection equation. The second equation is the return regression including the donation dummy. The results of this specification are in the third column of Table 4. Correcting for a firm's propensity to donate (or, alternatively, the private information that leads the firm to donate), in Panel A we estimate a negative and significant coefficient on the donation dummy of -0.113.

While the probit-selection specification addresses a firm's propensity to donate, it does not take into account the information contained in how much a firm chooses to donate (and thus may overstate the effect of donations on returns). Following Li and Prabhala (2008), we estimate the following two-stage Heckman-style Tobit selection model displayed in the third column of Panel A:

$$D_{it}^* = \gamma Z_{it-1} + u_{it}; \quad D_{it} = D_{it}^* \text{ if } D_{it}^* > 0, \text{ and } D_{it} = 0 \text{ if } D_{it}^* \leq 0.$$

$$XR_{it+1} = \alpha + \beta_1 D_{it} + \beta_2 \lambda_i + \beta_3 (\text{YearDummies}) + \varepsilon_{it+1}.$$

The first equation is the Tobit selection equation where  $Z$  is a set of variables that are correlated with the amount a firm donates ( $D_{it}^*$ ). In this case,  $Z$  is all of the variables used in Model 3 of Table 3. As we noted in Table 1B, there is a clear industry component to donations, so our selection equation includes industry fixed effects.  $\lambda$  is the inverse Mills ratio computed from the selection equation. The second equation is the return regression including the amount of donations. The results from the second equation are in the fourth column of Panel A of Table 4. Correcting for the information in how much the firm chooses to donate, we estimate a negative and significant coefficient on donations of -0.081.

As a further robustness check, we consider an alternative asset pricing model for our definition of excess returns. Daniel, Grinblatt, Titman, and Wermers (1997) [DGTW] form 125 benchmark portfolios based on market capitalization, book-to-market,

and prior year stock return characteristics. We define excess returns for each firm  $i$  as the difference between raw returns and the DGTW benchmark portfolio return<sup>24</sup>:

$$XR_{it+1} = R_{it+1} - R_{pt+1}.$$

The results for the OLS and selection models using DGTW excess returns are in the fifth through seventh columns of Panel A of Table 4. The results are similar, although the coefficients are somewhat smaller in magnitude and less significant. Thus, we do not take a stand on whether factors or characteristics are relevant for asset pricing and simply note that our results are robust to the choice of asset pricing model.

In Panel B of Table 4, we consider other specifications to further demonstrate the robustness of our results. First, we consider a specification for excess returns using the Fama-French three factor model, rather than the four factor model. The results in the first column of Panel B of Table 4 are similar to the previous results in the second column of Panel A.<sup>25</sup> Second, we can restrict donations to those donations that come solely from corporate funds. If we restrict donations to soft money and donations to 527 committees, then using the four factor model for excess returns we find a negative and significant coefficient on donations in the second column of Panel B of Table 4. Thus, whether we include or exclude PAC contributions does not affect our result.

One possible objection is that donations matter for returns only for specific industries, such as regulated industries. We address this in two ways. First, we add industry fixed effects to the OLS specification using the four factor model for excess returns in the third column of Panel B of Table 4. Our results are unaffected. Second, if donations matter for returns only for industries with a high level of aggregate donations, then industry fixed effects may be insufficient to isolate an effect of donations on returns. The fourth

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<sup>24</sup> The DGTW benchmarks are available via <http://www.smith.umd.edu/faculty/rwermers/ftpsite/Dgtw/coverpage.htm>.

<sup>25</sup> In unreported robustness tests, we have replicated all of our results in the subsequent tables using the three factor model to generate excess returns. The results are quite similar to those reported.

column restricts our sample to the five largest donating industries and the results are again similar.<sup>26</sup>

Another possibility is that the returns to donations show nonlinear or non-monotonic effects. In particular, large donations may yield positive returns while small donations do not. Such an effect would be consistent with the fact that Altria (formerly Phillip Morris) is the largest donor in our sample, presumably seeking to forestall adverse tobacco legislation.<sup>27</sup> To examine this possibility, we consider two nonlinear specifications in columns 5 and 6.

The fifth column reports results from an OLS specification of excess returns based on the four-factor model that includes both donations excluding individual contributions and a squared term for donations. The coefficient on donations, -0.148, is negative and significant, while the coefficient on donations squared, 0.039, is positive and insignificant, possibly suggesting a U-shaped relation between donations and returns. The inflection point occurs at donations of \$1.897 million, so that only companies donating more than \$1.897 million in a single year begin to see an increase in returns for their marginal dollar donated. In our sample, there are only 26 such firm-year observations out of 10,448, or 0.25%. These results suggest that donations could be a positive investment for only the very largest donors in our sample.

The sixth column reports results from a spline specification, where we estimate coefficients on two segments—donations below the median value of donations in the sample, and donations above the median value of donations in the sample.<sup>28</sup> We find a negative, significant, and large in magnitude coefficient on the segment below the median value of donations. Above the median value of donations, the coefficient is negative and insignificant. These results suggest that smaller donations, in particular, are associated with lower returns.

Our results thus far suggest a negative relation between donations and excess returns. However, this relation need not be causal and, clearly, donations may be endogenous. To

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<sup>26</sup> In unreported results, we have similarly included industry fixed effects and restricted our sample to the five largest donating industries for the selection specification, as well as the IV specification below. In all cases, the results are similar to those reported here.

<sup>27</sup> It is also worth noting that Altria generates large free cash flows, so we would not entirely discount an agency motivation for donations in this case either.

<sup>28</sup> We have experimented with numerous other spline specifications, from more segments to choosing different breakpoints. The overall results are consistent across specifications

ascertain causality, we instrument for the firm's level of donations. The specification in the seventh column of Panel B of Table 4 is:

$$Donation_{it} = \delta_1 X_{it-1} + v_{it};$$

$$XR_{it+1} = \alpha + \beta_1 \hat{Don}_{it} + \beta_2 (YearDummies) + \varepsilon_{it+1},$$

where  $\hat{Don}_{it} = \hat{\delta}_1 X_{it-1}$ . The first stage regression is used to predict the level of donations. The instrument  $X$  in the first stage regression is a firm's political donations excluding individual contributions for the year 1992. The dependent variable is the firm's political donations excluding individual contributions where the dependent variable is measured from 1996 to 2004. In effect we are using lagged donations as our instrument, but the lag length increases from four years for 1996 contributions to twelve years for 2004 contributions. The second stage regression is the excess return regression, where donations are measured in the year prior to the excess returns. The donation instrument is measured at least four years prior to the donation year, and so is measured at least five years prior to the excess returns. Contributions from at least five years prior are unlikely to be correlated with current excess returns except through what they tell us about a firm's propensity to donate. Statistically, the instrument  $X$  is uncorrelated with the error term in the excess return regressions, but is correlated with current donations. Thus, we have plausible exogenous variation related to donations but unrelated to future excess returns. The seventh column restricts the excess return regression to those firms that have non-missing excess returns in 1996 to 2004. We find that the coefficient estimate for expected (instrumented) donations is -0.071 and is statistically significant. These results imply that exogenous variation in donations is associated with negative excess returns.

In a recent paper, Cooper, Gulen, and Ovtchinnikov (2009) examine firm-level PAC contributions to U.S. political campaigns from 1979 to 2004 and report that the number of politicians to which a firm donates is positively correlated with future stock returns.

Aside from differences in data,<sup>29</sup> there are three important differences between our paper and theirs. Their primary variable is how many different candidates a firm has supported over the previous five years, not the dollar value of donations. We focus on the dollar value a firm has given in the aggregate. If contributions are an investment as Cooper, et. al., suggest, then the dollar value of contributions seems to be the more appropriate measure of investing in political capital.

Second, Cooper, et. al., treat the choice to donate as exogenous by performing their primary tests only on firms that contribute. This ignores the fact that 86% of the firms choose not to donate, and further ignores why they chose not to donate. In our specifications, we explore what countervailing factors might matter when it comes to political giving. As a result, we find that including firms that do not donate is critical for understanding both the costs and benefits of contributions.

The third difference between their paper and ours is how they specify their asset pricing tests. In their primary return specifications, they use three lagged firm-specific characteristics— $\ln(\text{book-to-market})$ ,  $\ln(\text{market value of equity})$ , and 12-month buy-and-hold returns—that correspond to the DGTW benchmark portfolios we use in the fifth through seventh columns of Panel A of Table 4. While our focus is not on the best way to perform asset pricing tests, we note that this difference in specification partially explains the differences in results, as our results using the DGTW benchmark portfolios are somewhat weaker than our results using the four-factor model. Nevertheless, our results are robust to the characteristic-based asset pricing approach used in Cooper, et. al.

Our specifications in Table 4, coupled with the results from the previous section, are certainly suggestive that donations are symptomatic of an agency problem. Larger firms with more free cash flow and less R&D and investment spending donate more. Firms that donate have lower excess returns. Further, the more a firm donates, the lower the excess returns. These results seem less consistent with donations-as-a-positive-NPV-investment-in-political-capital hypothesis and more consistent with the donations-

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<sup>29</sup> There are several differences between their data and ours. First, they have a longer time series (1979 to 2004) than we do (1991 to 2004). Second, their data is disaggregated in the sense that they have data on donations to individual candidates. In our data, we know how much a firm contributed, but not to whom. Third, their data are restricted to political contributions from firm's political action committees (PAC contributions or so-called hard money donations). Our data contains not only PAC contributions, but also soft money donations, donations by individuals affiliated with a company, and donations to 527 Committees. Over our sample period, PAC donations comprise only 43% of all political giving.

reflecting-an-agency-problem hypothesis. However, the evidence thus far is indirect. In the next section, we turn to more direct tests of the agency hypothesis.

## 5. Donations and Agency Problems

### A. Corporate Governance

In order to examine whether donations could be reflective of agency problems, we ask whether mechanisms thought to constrain or exacerbate agency problems influence donations and, subsequently, excess returns. Our perspective thus far is that firms with agency problems could see them manifested as having excess free cash flow leading to high levels of donations. The agency problems then lead to poor future excess returns. The donations are not the cause of the agency problems but are symptomatic of them.

Various corporate governance variables have been shown to exacerbate or mitigate agency problems. For example, Yermack (1996) argues that firms with large boards of directors seem to be ineffective in constraining agency problems. Thus we include board size as a measure of board effectiveness. Morck, Shleifer, and Vishny (1989) argue that CEOs who are also chairman of the board are entrenched and therefore better able to engage or indulge in agency behavior. We include a dummy variable if the CEO is also chairman of the board. High abnormal CEO compensation (defined as compensation minus predicted compensation based on firm size and industry median adjusted prior stock and accounting performance) is thought to be a contemporaneous indicator of agency problems (see, e.g., Hartzell, Ofek, and Yermack (2004) and Bebchuk and Fried (2004)).<sup>30</sup> In addition, three ownership variables are thought to potentially constrain agency behavior. Greater insider ownership provides direct incentives for managers not to engage in agency behavior (Aggarwal and Samwick (2006)). Greater block ownership and institutional ownership are thought to limit agency behavior as block owners and institutional owners are more likely to be effective monitors (Holderness (2003)).

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<sup>30</sup> Gordon, Hafer, and Landa (2007) find that executives with higher pay-performance sensitivities tend to donate more. What is unclear in their study is whether high pay-performance sensitivities reflect incentive alignment or rent extraction. Our focus on abnormal compensation is meant to isolate rent extraction.

To see whether these mechanisms influence donations, we augment our donation specification from Table 3 with each of the agency-controlling or agency-associated mechanisms. The results are in Panel A of Table 5. The dependent variable is the dollar value of donations excluding individual contributions. Each column adds one of the agency-controlling mechanisms to the original set of covariates  $Z$ . The last column includes all mechanisms simultaneously. Because each mechanism comes from a different data source, we have differing numbers of observations across the columns and also relative to Table 3.

The results are consistent with the agency hypothesis. Larger boards are associated with larger donations. Firms in which the CEO is also the chairman of the board have larger donations. Higher abnormal CEO compensation is associated with larger donations. Firms in which there is greater insider ownership have smaller donations in Column 4, although this relation is insignificant in Column 7. Firms in which there is large block ownership have smaller donations. Contrary to the agency hypothesis, there is a positive relation between institutional ownership and donations in Column 6, but this relation disappears in Column 7, which includes all agency variables at once. Thus, to the extent that these corporate governance variables either exacerbate or control agency problems, they also seem to have the same effect on donations.

It is also worth examining what impact these variables have on the relation between donations and returns. One possibility is that while donations may be reflective of an agency problem, this effect is entirely subsumed by corporate governance, so that corporate governance variables are omitted factors in the return-donation regressions. In Panel B of Table 5, we modify the OLS and selection specifications from Panel A of Table 4. We add the six corporate governance variables (board size, CEO Chair, insider ownership, block ownership, institutional ownership, and abnormal compensation) to the excess return regression (for the selection specification, this is the second stage regression).

In all three specifications, the coefficient on the level of donations excluding individual contributions is negative and significant (-0.041, -0.141, -0.057 respectively). Due to the inclusion of the governance variables, the number of observations is greatly reduced relative to the return specifications in Panel A of Table 4. If we run the

specifications in Columns 2 through 4 in Panel A of Table 4 on the same reduced sample of observations, the coefficients on donations are -0.102, -0.174, and -0.096 respectively. This implies that part of the negative donation-return relation can be attributed to the effects of corporate governance variables constraining or exacerbating agency problems. However, controlling for governance matters, but does not fully explain the negative relation between donations and returns. There are two potential interpretations of this. First, there are aspects of agency that are not captured by our governance variables, and so agency problems that result in donations go beyond the ability of governance to control. Second, once we control for aspects of governance (which ameliorate or exacerbate agency problems) in our specifications, the remaining negative donation-return relation is driven by something other than agency, such as the investment hypothesis. We return to this possibility in Section 6.

For now, we note that the two findings in this section—the positive correlation between governance variables that exacerbate agency problems and donations and the negative correlation between governance variables that control agency problems and donations, coupled with the reduction in the magnitude of the coefficient on donations in return-donation regressions that include governance variables—are supportive of the agency hypothesis.

## B. Mergers and Acquisitions

Next we examine the effect of corporate political contributions on mergers and acquisitions. Mergers and acquisitions are thought to be especially fraught with agency problems (see, e.g., Gompers, Ishii, and Metrick (2003)). Table 2 shows that donating firms are unconditionally more likely to be both acquirers and targets than are non-donating firms. In particular, donating firms are almost twice as likely to be acquirers as are non-donating firms. Further, Table 3 shows a strong positive association between donations and whether a firm is an acquirer after controlling for many other firm characteristics.<sup>31</sup> Such an association is consistent with both donations and acquisitions being manifestations of agency problems. For example, firms with excess free cash flow

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<sup>31</sup> Controlling for other firm characteristics, targets are less likely to donate.

may be willing to engage in both wasteful political donations and acquisitions. While this association is suggestive, we further explore the link between donations and acquisitions to shed light on whether donations are indicative of an agency problem.

In order to do so, we ask whether acquisitions following political contributions are more likely to be bad for shareholders. We examine cumulative abnormal returns (CAR) around acquisition announcements for donating acquirers versus non-donating acquirers. Table 6, Panel A presents a univariate comparison. The CAR from one day before to one day after announcement is significantly smaller for donating acquirers than for non-donating acquirers.

Panel B presents two regression specifications to control for other factors that influence acquisition announcement returns. The first specification controls for deal characteristics, while the second specification also controls for acquirer characteristics. In both specifications, the CAR is significantly lower for acquirers that made a donation in the year of or the year prior to the acquisition announcement. In Column 2, a donating acquirer's CAR is 88.5 basis points lower than a non-donating acquirer's, controlling for firm and deal characteristics. Thus it appears that donating firms make worse acquisitions than do non-donating firms, consistent with the agency explanation.

## 6. Donations as an Investment

### A. Is donating to the winner of the election an investment?

Much of the previous research that has examined the relation between political donations and stock returns has relied on event studies. For example, Knight (2006), Goldman, Rocholl, and So (2006), Shon (2006), and Jayachandran (2006) examine the effect of the 2000 U.S. Presidential election on companies aligned with either party and find that good (bad) news for Republicans is associated with a positive (negative) stock price reaction for Republican-leaning firms and a negative (positive) stock price reaction for Democratic-leaning firms. The evidence in those papers suggests an alternative explanation — donating to the winning party (good news) shows up as positive returns while donating to the losing party represents a bad bet, one that is penalized with negative

returns. In this case, the negative returns we document may simply be an outgrowth of losing political bets made over the period we study. Had firms bet on political winners, then they would have enjoyed positive returns on their investments in political capital.

To explore this possibility, we separate years into three categories — years with a Presidential election (i.e., years evenly divisible by four), years with a Congressional election only (i.e., years evenly divisible by two but not by four), and non-election years (i.e., odd-numbered years). For the two categories of election years, we define a dummy variable “Win” as follows. In a Presidential election year, if donations by a firm to the party that wins the presidency exceed 50% of total donations, then  $Win = 1$  for that firm, and 0 otherwise. In a Congressional election year, if donations by a firm to the party that wins net seats (i.e., the party’s total seats in Congress increase) exceed 50% of total donations, then  $Win = 1$  for that firm, and 0 otherwise. Here donations are donations excluding individual contributions.  $Win$  is not defined for non-election years.<sup>32</sup>

In Panel A of Table 7 we report several specifications to examine the possibility that what matters for donations as investments is donating to the winning party. In Columns 1, 3, and 5, we regress excess returns on the dollar value of donations excluding individual contributions for Presidential election years, Congressional election years, and non-election years, respectively. The relation between donations and excess returns is negative in all three cases, although marginally significant (at the 10% level) for Presidential election years. These results are consistent with our results from Table 4.

In Columns 2 and 4, we add an interaction between donations and  $Win$  for Presidential election years and Congressional election years.<sup>33</sup> The investment hypothesis predicts that the effect of donations should be insignificant, while the

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<sup>32</sup> Four remarks are in order. We have also examined results for election cycles—we combine non-election year donations with the following election year donations to create two-year election cycle donations. The results are similar to the results we report below. Second, we have used several alternate definitions of  $Win$  — the fraction donated to the winning party has to exceed thresholds of 60% and 70% in order for  $Win = 1$ . The results again are similar to those reported below, but the number of observations shrinks markedly. Third, one might question the use of net gain of seats in Congressional elections in that what matters is which party is in control, not whether the margin increases or decreases. Conversely, one might argue that what matters for stock returns is not the net gain of seats but how the parties fared relative to expectations. Both of these issues will reduce the power of our tests, but since neither political party consistently dominates elections during our sample, there is no obvious bias a priori. Fourth, as an additional robustness check, we have also used a dummy variable for whether a firm donates, rather than the amount of donations, in all of our specifications. All of the results are similar to those reported below.

<sup>33</sup> More precisely,  $Win$  is a conditioning variable, since  $Win$  is not defined for firms that do not donate.

interaction of donations and Win should be positive and significant. For Presidential elections, the coefficient on donations is negative and marginally significant, and the coefficient on the interaction is positive and insignificant and smaller in absolute value than the coefficient on donations. For congressional elections, the coefficient on the interaction is positive but insignificant and small in magnitude, while the coefficient on donations is negative, large in magnitude, and significant. Donating leads to large negative returns, while donating to the winning party does not offset the negative returns to donating. Thus, for one-year excess returns there is no support for the hypothesis that donating to the winning party leads to better returns. Importantly, it is worth reiterating that the agency hypothesis predicts that the coefficient on donations should be negative in these specifications, and that the coefficient on the interaction terms should be insignificant.

As an additional robustness test, we replicate the results from the event study literature mentioned before. In Panel B of Table 7, we examine cumulative abnormal returns from one day before to one day after Presidential and Congressional elections. Consistent with the event study literature that focuses on Presidential elections, we find in Columns 1 and 2 that donations are positively associated with one-day returns in Presidential elections, and that this effect comes entirely from donating to winners. Conversely, for Congressional elections, donations are negatively associated with one-day returns. This negative association is primarily driven by donations to the losing party, where donations to the winning party partially, but not fully, offset the negative coefficient on donations. We can therefore reconcile our results with those in the event study literature—examining only Presidential elections provides an incomplete picture of the relation between donations and returns. For one-day returns, there are positive returns from donations to the winning party in Presidential elections, but there are negative returns from donations in Congressional elections, especially from donations to the losing party.

In total, these results for one-year and one-day returns suggest that donating to the winning party in a Presidential election year has transient positive effects. This transient positive effect does not persist to the one-year horizon. Further, to the extent that donating to the winning party in Congressional elections has a partial offset to the

negative effect of donations, this effect is also transient. At the one-year horizon, the positive effects of donations to winners in Congressional elections entirely disappear. Other than for one-day returns when donating to winners in Presidential elections, the primary effect of donations on returns is negative; suggesting that in most cases, not donating dominates donating, even if donating to the winning party.

Two other points are worth mentioning. First, while much of the literature has focused on the event study approach, it is not clear why this should be preferable to examining longer horizon returns. As noted above, the positive effects from our event study are transitory in nature. If donating to winners really does represent an investment, we would expect that the positive effects would be persistent. Moreover, it is not clear that choosing winners is the correct interpretation of donations as an investment. There are many instances in our data of firms donating to both parties and even donating to both candidates in the same race. If donations represent political risk insurance, donating to both parties or candidates would seem to be optimal.

Second, firms making donations do tend to display an incumbency bias, and incumbents are expected to win in the vast majority of cases. Thus, the news that an incumbent has won is unlikely to be a surprise. Instead, donations, if they are an investment, are likely to be an investment over time, with returns that show up periodically as firms see favorable legislation or earmarks passed. In short, focusing exclusively on the event of an election is likely to give an incomplete assessment of the value of donations. Of course, there is also a cost to using long-term stock performance, in that long-term stock returns are noisier than event-horizon returns. Nonetheless, the long-horizon approach seems preferable, and yet does not show evidence supporting the donations as investments story.

#### B. Would returns be worse without donations?

While the evidence thus far is consistent with the agency hypothesis, it may be the case that for some firms donations do represent a positive net present value investment. Because we do not observe the state of the world in which donating firms do not donate, we cannot tell if the relation between donations and returns is causal. If the firms had not

donated, it is possible that their returns would have been even worse. For example, we know that the firms that donate are large, stable, and have more free cash flow. This may indicate that they are in mature or declining industries or that the firms themselves are in idiosyncratic decline. Such decline could be even worse were it not for the donations.

We note that we have controlled for industry-level variation in Table 4. However, those specifications leave unaddressed the possibility that firms foresee poor firm- or industry-level returns and donate to offset the poor returns. In order for this hypothesis to be valid, whatever causes the poor stock returns should not be known by the market (at least initially—otherwise, the cause of the poor returns would be priced). Here the donation represents a response that partially offsets the negative effects of whatever the managers observe privately, which we will call a productivity shock. When managers observe the shock, they donate with the expectation that the politicians' responses to the donations will mitigate the effects of the shock on the firm's returns. If mitigation is not complete, then we should expect to see a negative correlation between returns (once the shock or its effects are publicly revealed) and donations. Further, as econometricians, we do not know when the productivity shock occurs because it is private information. The shock could occur contemporaneously with the donations or the donations could even happen in anticipation of a future shock. We consider both possibilities in turn.

Suppose first that a productivity shock shows up in firm or industry characteristics when it occurs and shows up in returns a period later. Our previous tests were based on firm characteristics measured two years prior to returns because we wanted to measure the impact of characteristics ( $t-1$ ) on donations ( $t$ ) and the impact of donations ( $t$ ) on returns ( $t+1$ ). A productivity shock between  $t-1$  and  $t$  would not be captured in firm characteristics in our specifications in Tables 3 and 4, and could generate the negative correlation between donations and returns. We address this possibility in Table 8.

We use excess returns based on the four-factor model as our dependent variable. We regress excess returns on donations and changes in firm and industry characteristics measured from time  $t-1$  to time  $t$ . To be explicit, excess returns are measured at time  $t+1$  and donations and changes in firm and industry characteristics are measured one year prior. If donations are a positive response to a shock captured in changes in firm and

industry characteristics at time  $t$ , then controlling for the characteristics should result in a positive coefficient on donations. Figure 1 depicts this graphically.

We start by adding changes in industry characteristics (industry sales growth and the change in the fraction of the firms in an industry that donate) in the first column of Table 8. In this specification we include industry fixed effects. We find a negative and significant coefficient of -0.093 on donations excluding individual contributions in the excess return specification. This coefficient is similar in magnitude to the coefficient on donations (-0.096) from the second column of Table 4, Panel A. This suggests that controlling for industry-specific factors such as industry decline does not eliminate or reverse the negative association between donations and returns.<sup>34</sup>

Next the second column of Table 8 includes changes in firm-specific characteristics measured from time  $t-1$  to time  $t$ . If the productivity shock is captured by changes in firm characteristics, then the negative coefficient on donations should be reversed or at least reduced. The set of firm characteristics includes natural candidates to reflect shocks: return on assets, change in the book-to-market ratio, sales growth, change in free cash flow, change in leverage, change in return volatility, and prior excess returns. Again, we find that the coefficient on donations is negative, significant, and of the same magnitude as in our prior specifications.

As another test, we consider the possibility that, if donations are an investment, then perhaps they are used to offset shocks to other forms of investment between time  $t-1$  and time  $t$ . We consider changes in R&D, changes in investments in physical capital, and acquisitions (the target and acquirer dummies are for acquisitions at time  $t$ ). The results in the third column of Table 8 are consistent with our previous results — the coefficient on donations is negative and significant and similar in size. In the fourth column, we combine changes in industry characteristics, firm-specific characteristics, and other forms of investment, all measured between time  $t-1$  and time  $t$ . The coefficient on donations is still negative, significant, and similar in magnitude.

Another possibility is that donations are meant to offset future productivity shocks. To be specific, suppose that management anticipates a productivity shock between time  $t$

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<sup>34</sup> In unreported regressions, we use the interaction of industry and year dummies to proxy for time-varying industry effects and the results are similar.

and time  $t+1$  and so donates at time  $t$ . The productivity shock shows up in firm characteristics and returns at time  $t+1$  when the shock happens. To address this, in the fifth column of Table 8, we regress excess returns at time  $t+1$  on donations measured at time  $t$  and changes in industry and firm characteristics measured from time  $t$  to time  $t+1$ . We drop the return characteristic so that we do not regress excess returns on contemporaneous returns. Again, we find a negative and significant coefficient on donations in the excess return specification, and the coefficient is similar in magnitude.

While these results cast doubt on the hypothesis that donations are a positive NPV investment, they do not fully refute it. First, it is possible that the productivity shock occurs even farther in the future than when we measure returns (for example, at time  $t+2$ ). In order for such a story to work, managers would have to anticipate the shock two years or more ( $t$ ) before the market observes the shock ( $t+2$  or later). This seems unlikely to happen consistently across a broad cross-section of firms. Second, it is possible that the firm characteristics we use do not capture the productivity shock. We have included a fairly exhaustive set of standard characteristics, but there may still be an omitted characteristic. Offsetting both of these concerns is that our instrumental variables specification from Table 4, Panel B, using donations from at least four years prior as the instrument, still finds a negative effect of donations on returns.

Another possibility is that donations represent a form of political risk insurance. The risk of firm-specific catastrophes or expropriation, (modeled, for example, by Shiller (1981) and Voth (2002)), may lead some companies to donate in order to reduce the probability of adverse events. While insuring against political risks may have *ex ante* benefited shareholders, it is possible that no major political shock occurred during our 14-year sample period, so that politically-uninsured firms *ex post* performed unexpectedly well. The underperformance of donating firms could then simply indicate that their political insurance premiums expired worthless during our sample period, while stock prices of politically-uninsured firms rose because they neither paid political insurance premiums nor suffered an adverse event.

This risk insurance explanation does not seem very plausible, however. To start with, our sample period includes two NBER-dated recessions, various international financial crises, the collapse of the dot-com and technology bubble, as well as major governance

and accounting scandals such as Enron, WorldCom, and Global Crossing, and various industry-specific shocks. If corporate political donations are best understood as an insurance premium against political risk, we would expect some evidence of return to shareholders during our sample period. Even within the top five donating industries, including banking, financial trading, and utilities that have undergone deregulation during our sample period, donors have lower excess returns than non-donors (see also Table 11). In addition, the insurance explanation implies that the 14% of publicly traded firms who donated to politicians acted in the shareholders' interest despite having worse governance characteristics, while the remaining firms failed to protect their shareholders from political risks despite the surprisingly low cost of insurance and despite having better governance characteristics.

While we do not directly observe possible productivity shocks or the need to pay for political insurance, we do not directly observe possible agency problems either. But, in the agency results, conventional variables that constrain or exacerbate agency problems have the expected impact on donations and returns. In contrast, we have not found evidence to support the notion that firms partially offset productivity shocks by investing in political capital.

### C. Are donations a reward to politicians for past political favors?

Our tests thus far assume that firms first donate and then politicians respond with either favors for firms or for managers. The operating assumption is that favors for firms should be reflected in stock returns. Another possibility is that politicians do favors for firms, and as a result, the firms then donate to the politicians. To the extent that firm returns increase as a result of favors, we would miss the returns that occur prior to the donations. A backward-looking approach to donations, where favors and returns occur prior to donations, would not be captured in our previous specifications. While Table 3 shows that excess returns in the year prior to the donation are lower for donors versus non-donors, this does not fully resolve the issue. While we cannot identify past political favors to firms, we can examine this issue indirectly by focusing on a set of firms for which it is quite unlikely that donations are a reward for past political favors.

We examine the set of firms that initiate donations concurrent with or immediately subsequent to a change in political control. To see the rationale for this test, consider the 1994 House and Senate elections. In that election, the Republican Party gained control of both the House and Senate. Now consider donors who started donating in 1994 or 1995, and gave the majority of their contributions to Republican candidates. Prior to 1994, the Republicans were not in power, so these contributions are unlikely to be a reward for past political favors. Conversely, after 1994, the Republicans are well-positioned to provide favors on a going forward basis. Are the returns for the firms that initiate donations to the winning party when control changes positive (returns to investment) or negative (no returns to investment)?

We examine five specific events that correspond to all changes of control at the Federal level during our sample. First, as described above, we examine firms that initiate donations in 1994 or 1995 and give the majority of their donations to the Republican candidates for House and Senate elections. This corresponds to the Republicans winning majority Congressional control in 1994. Second, we examine firms that initiate donations in 2001 and give the majority of their donations to the Democratic candidates in Senate elections. This corresponds to the switch of Senator James Jeffords from the Republican Party to Independent, who then voted for Democratic Party control of the Senate. Third, we examine firms that initiate donations in 2002 or 2003 and give the majority of their donations to the Republican candidates for Senate elections. This corresponds to the Republicans winning majority Senate control in 2002. Fourth, we examine firms that initiate donations in 1992 or 1993 and give the majority of their donations to the Democratic candidates for President (Bill Clinton and all of his Democratic primary opponents). This corresponds to President Clinton winning the presidency in 1992. Fifth, we examine firms that initiate donations in 2000 or 2001 and give the majority of their donations to the Republican candidates for President (George W. Bush and all of his Republican primary opponents). This corresponds to President Bush winning the presidency in 2000. We assign a treatment dummy equal to one for all firm-year observations that meet the above criteria. Here donations are donations excluding individual contributions.

Table 9, Panel A, provides summary statistics for the treatment group and several other groups. Mean excess annual returns relative to the four factor model for the treatment group are -7 basis points, and there are 214 firm-year observations that meet the criteria above. We also report mean excess returns for firms that initiated donations in the treatment years, but gave the majority of their donations to the other political party. In addition, we have mean excess returns for firms that had previously donated and mean excess returns to non-donors. In all cases, the excess returns are for the year following the donation. Excess returns for first-time donors to a party that wins control are lower than excess returns for first-time donors to the losing party, which in turn are lower than excess returns to existing donors. Excess returns to all categories of donors are lower than excess returns for non-donors. These results are exactly the opposite of what we would expect if donations were an investment in political capital.

Table 9, Panel B, demonstrates these results in a regression. The negative and significant coefficient on the treatment dummy in Column 1 shows that excess returns are lower for firms that initiate donations to the party that wins control. For these firms, it is implausible that their donations are in response to past political favors, since the party to which they donate was not in power. When we add the dollar amount of donations excluding individual contributions in Column 2, we find—consistent with our previous results—that donations are negatively associated with future excess returns. In addition, excess returns are still lower for firms that initiate donations to the party that wins control, suggesting that these donations are unlikely to be an investment in political capital. In light of our agency results before, it is more plausible that political donations are seeking favors for managers rather than firms.

#### D. Donations and government contracts

As another test, we examine the relation between donations and industries that rely heavily on government contracts. We hypothesize that, for firms in industries in which government purchases are responsible for a large fraction of firm revenues, political donations are more likely to be an investment in political capital, as in Agrawal and

Knoeber (2001). We expect that returns should be positively associated with donations specifically in those instances in which the industry is dependent upon the government.

In order to test this hypothesis, we gather data on the percentage of sales to federal, state, and local governments for 1,172 industry groups from the 2002 Economic Census.<sup>35</sup> We assign to each company in our sample the company's industry level of sales to the government. In effect, we are assigning an industry fixed effect to the firms in our sample, albeit at a very high level of disaggregation with 1,172 industry classifications. We regress one-year excess returns on donations excluding individual contributions, industry sales to the government, and the interaction of donations and industry sales to the government. The hypothesis is that the coefficient on the interaction of donations and industry sales should be positive. In other words, in industries in which government contracts matter to firm revenues, the returns to donating are positive. For donations, we report results for both a dummy variable if the firm donates as well as the dollar amount a firm donates.

The results are in Table 10. Columns 1 and 3 report results from a baseline regression of excess returns on donations and sales to the government. Consistent with our prior results, the relation between donations and returns is negative. Firms in industries that derive a higher fraction of total revenues from sales to government have higher excess returns. In Columns 2 and 4, we add the interaction of donations with industry sales to the government. In neither case is the coefficient on the interaction term positive. Indeed, when we use the dollar amount of donations in Column 4, the coefficient on the interaction term is negative and significant. These results suggest that firms in industries with a large fraction of sales to the government do not earn higher returns from donating.

#### E. Industry Heterogeneity

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<sup>35</sup> Technically, the 2002 Economic Census provides PSGOV, the percentage of sales to federal, state, and local government bodies, for 1,172 NAICS industry groups. For each company in our sample we assign PSGOV based on the company's NAICS. If the census data does not provide PSGOV for the company's eight-digit NAICS, we assign PSGOV based on the next higher, non-missing NAICS industry classification.

As a final set of tests, we examine the relation between donations and returns industry-by-industry. Our results thus far suggest that the donation-return relation is on average negative, which almost certainly masks industry variation. In Table 11, we regress excess returns on donations and year dummies for each of the 49 Fama-French industries. We then order the industries by the smallest to largest coefficient on donations. We note three results in particular. First, while there is substantial heterogeneity, there is also a strikingly consistent pattern of negative relations between donations and excess returns. 37 out of the 49 industries show a negative relation between donations and returns, and only 12 industries show a positive relation between donations and returns. Second, of the 37 industries with negative coefficients, 15 are statistically significant. In none of the industries with positive coefficients are the coefficients statistically significant. Third, of the five industries with the largest dollar donations, telecommunication, banking, and utilities show a negative and significant relation between donations and excess returns, while financial trading and transportation show a negative and insignificant relation. While we certainly observe some heterogeneity, these results tend to reinforce our earlier conclusions about the negative donation-return relation at the industry level.

## 7. Conclusion

Are corporate political contributions investments in political capital or are they symptomatic of agency problems in firms? Our results suggest that corporate political contributions in the United States are more reflective of agency problems. We find that firms that donate more generally have operating characteristics consistent with a free cash flow problem—they are large and stable and have higher free cash flow but also have lower R&D and investment spending. We also find that donations are negatively correlated with future excess returns. An increase in donations of \$10,000 is associated with a reduction in excess returns of 9.6 basis points.

Worse corporate governance is associated with larger donations. Worse governance characteristics explain part but not all of the negative return-donation relation. Further, firms that make political contributions are more likely to engage in acquisitions than

firms that do not make contributions. In addition, donating firms engage in worse acquisitions than firms that do not donate, as measured by cumulative abnormal announcement returns.

When we try to isolate instances in which donations may lead to better returns, we find only a small amount of support for the hypothesis that political donations represent an investment in political capital. Specifically, we find positive one-day returns associated with donations to the winning party in Presidential elections. This effect is transient and evaporates over time. We also find that returns to donations are positive for the very largest donors in our sample. To put this in context, this is true for one quarter of one percent of our donating firm-year observations.

Our results suggest that political donations are symptomatic of an agency problem. In addition, our results suggest that smaller donations, in particular, are associated with value destruction for shareholders. Smaller values of donations are unlikely to influence legislation but may grant access for managers to favored politicians. Even though the dollar value of the donation is small, and therefore cannot account for the loss of value to shareholders, managers willing to squander small sums on political giving are likely to squander larger sums elsewhere. Further, it is precisely smaller levels of donations for which it is easier to hide that donations are being organized at the corporate level.

Our findings are consistent with the fact that shareholders are taking an increased interest in political contributions. For example, proxy proposals requiring disclosure of political donations and lobbying expenses and establishing guidelines for such donations are increasingly popular with shareholders.<sup>36</sup> As previously noted, shareholder surveys suggest that shareholders believe corporate political contributions are made in the private interests of executives and not in the company's interest. Our findings may shed light on why 86% of the publicly traded firms in the United States make no political contributions at all during our entire sample period — shareholders are unlikely to benefit from such contributions. While severe agency problems are likely to exist at some firms, it is unlikely that they exist at the majority of firms. Thus, we view political contributions as a window into firms with potentially severe agency problems.

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<sup>36</sup> See Kary, Tiffany, "Shareholders Favor More Disclosure," *Wall Street Journal*, October 4, 2006.

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**Table 1: Summary Statistics of Corporate Political Donations****Panel A: Corporate Political Donations: 1991 – 2004**

This panel shows the dollar value of corporate political donations (in millions) at the federal level for the entire sample period and for each sample year. The donation data is obtained from the Center for Responsive Politics. “PAC Donations” are corporate donations to political action committees, and are also called hard money donations. “Soft Money Donations” are corporate contributions made outside the federal contribution limits to the national parties or outside interest groups. “Individual Money Donations” are limited, regulated contributions made by an individual affiliated with a corporation to a candidate’s campaign committee, a PAC, or a political party. “Donations to 527 Committees” are corporate donations to tax-exempt groups organized under section 527 of the Internal Revenue Code to raise money for political activities including voter mobilization efforts, issue advocacy, etc. All the donations are expressed in 2004 dollars.

	# of Obs.	Total Donations	PAC Donations	Soft Money Donations	Individual Money Donations	Donations to 527 Committees
Total	12105	1421.234	604.935	504.953	290.721	20.630
Mean	12105	0.117	0.050	0.042	0.024	0.002
Median	12105	0.028	0.009	0.000	0.004	0.000
1991	708	44.126	26.952	8.588	8.587	0.000
1992	818	82.470	45.542	20.641	16.286	0.000
1993	758	43.054	25.565	10.300	7.182	0.000
1994	888	75.961	44.388	18.286	13.287	0.000
1995	880	71.489	29.928	27.772	13.739	0.000
1996	1205	133.100	49.496	64.363	19.241	0.000
1997	875	72.027	31.591	29.101	11.330	0.000
1998	934	114.400	48.300	49.813	16.285	0.000
1999	880	105.484	36.367	42.700	26.415	0.000
2000	1011	192.141	53.470	104.470	34.199	0.000
2001	867	106.214	38.801	53.483	13.894	0.000
2002	863	152.574	57.818	75.434	19.275	.0525
2003	780	88.148	49.196	0.000	34.855	4.096
2004	818	140.103	67.519	0.000	56.103	16.481

**Panel B: Top Five Donating Industries**

This panel reports the top five industries by national level political donations. The industries are defined according to the Fama-French 49 industry classification. The top five industries are defined according to the total dollar value of industry political donations (in millions) from 1991 through 2004.

Year	Financial Trading	Tele- communication	Utilities	Banking	Transportation
1991-2004	226.361	110.288	99.905	80.637	76.365
1991	8.178	2.229	2.765	1.830	2.217
1992	15.754	3.899	4.596	3.160	3.154
1993	7.734	2.869	2.977	1.336	2.301
1994	12.892	5.176	4.709	2.228	3.321
1995	11.551	6.468	4.532	2.467	3.668
1996	22.379	9.418	8.265	4.707	7.604
1997	13.959	4.953	5.504	3.125	3.368
1998	20.492	8.450	7.986	5.686	6.101
1999	18.841	9.294	8.341	4.969	7.390
2000	28.277	17.357	14.081	10.312	10.248
2001	12.834	9.643	8.991	9.302	7.287
2002	18.824	16.276	12.766	11.455	8.388
2003	15.863	5.830	7.019	5.359	4.992
2004	18.783	8.426	7.372	14.701	6.325

**Table 2: Summary Statistics of Firm Characteristics****Panel A: Variable Definitions**

<b>Variable</b>	<b>Definition</b>
Excess Return	Annual buy-and-hold excess return relative to four-factor model
Book/Market	Book value of equity divided by market value of equity
ROA	Operating income after depreciation divided by total assets
Sales Growth	Two year average sales growth
Free CF	Free cash flow (Lehn and Poulsen, 1989) divided by total assets
Leverage	Long-term debt divided by total assets
R&D	R&D expenditure divided by total assets
Investment	Net investing cash flow divided by total assets
Sales Impact	Firm sales divided by total industry sales
Return Volatility	Standard deviation of monthly returns over the previous 60 months
Assets	Total assets
Target	=1 if the company is acquired in the year, =0 otherwise
Acquirer	=1 if the company is an acquirer in the year, =0 otherwise
Industry Frequency	Fraction of firms in an industry that donate in a year
Insider Own	Natural log of insider equity ownership
Block Own	Natural log of total ownership of shareholders who own at least 5% of the firm
Institutional Own	Natural log of total ownership of institutional shareholders
Abnormal Compensation	The residual from regressing CEO total compensation (TDC1 in ExecuComp) on prior year total sales and industry median adjusted sales growth and return
Industry Sales Growth	Industry median sales growth

**Panel B: Summary Statistics**

This panel reports means of firm characteristics for the donating sample and the non-donating sample. Except “Excess Return (t+1),” all variables are measured as of the year prior to donations. Excess Return (t+1) is measured as of the year after donations. z statistics for the Wilcoxon tests that compare the two samples are reported. \*\* indicates significance at the 1% level.

<b>Variables</b>	<b>Donating</b>		<b>Non-donating</b>		<b>Wilcoxon Z</b>
	<b>Sample</b>	<b># of Obs.</b>	<b>Sample</b>	<b># of Obs.</b>	
Excess Return (t+1)	0.040	11576	0.065	71453	-10.177**
Excess Return (t-1)	0.052	11118	0.078	64763	-12.884**
Book/Market	0.581	11797	0.698	72211	-15.05**
ROA	0.077	11890	0.003	72155	40.61**
Sales Growth	0.153	11644	0.226	66374	-10.79**
Free CF	0.081	9963	0.003	57571	26.34**
Leverage	0.222	11847	0.156	73109	48.20**
R&D	0.016	11702	0.042	72932	-19.12**
Investment	0.095	10696	0.095	64579	8.89**
Sales Impact	0.025	11952	0.003	72868	122.54**
Return Volatility	0.110	12053	0.159	82299	-52.32**
Assets	14146	11990	732.39	74128	134.94**
Target	0.192	12107	0.134	84166	16.94**
Acquirer	0.403	12107	0.221	84166	43.62**
Insider Own	0.107	9048	0.207	52891	-49.38**
Block Own	0.282	9065	0.357	52968	-21.55**
Institutional Own	0.500	9067	0.284	52802	70.10**
Abnormal					
Compensation	1.373	8082	-0.860	12903	27.82**
Industry Frequency	0.192	12107	0.117	84166	68.87**

**Table 3: Characteristics of Donating Firms**

The table presents Probit and Tobit regression results of corporate political donations on firm characteristics. “Donation Dummy” equals 1 if a firm donates in that year and 0 otherwise. “Donation” is the dollar value of donations (in millions). All the independent variables are measured as of the year prior to the donating year. Robust standard errors clustered by firm are reported in brackets. \*\* and \* indicate significance at 1% and 5% levels, respectively.

	Probit Total Donation	Tobit Total Donation	Tobit Excluding Individual Donation
Book/Market	-0.238** [0.034]	-0.071** [0.009]	-0.066** [0.009]
ROA	-0.200 [0.289]	0.006 [0.083]	0.001 [0.082]
Sales Growth	-0.046 [0.034]	-0.005 [0.011]	-0.006 [0.010]
Free CF	0.964** [0.271]	0.189* [0.075]	0.160* [0.075]
Leverage	0.784** [0.095]	0.150** [0.023]	0.136** [0.023]
R&D	-0.779* [0.395]	-0.191* [0.095]	-0.218* [0.097]
Investment	-0.203* [0.084]	-0.051* [0.021]	-0.058** [0.021]
Sales Impact	6.890** [1.555]	1.896** [0.243]	1.758** [0.229]
Excess Return (t-1)	0.003 [0.013]	0.004 [0.005]	0.003 [0.005]
Return Volatility	-4.591** [0.398]	-1.475** [0.139]	-1.465** [0.139]
Assets	0.069** [0.012]	0.003** [0.0004]	0.002** [0.0004]
Target	-0.058 [0.032]	-0.018** [0.007]	-0.018* [0.007]
Acquirer	0.304** [0.030]	0.072** [0.009]	0.064** [0.008]
Ind. Donation Frequency	3.202** [0.353]	0.579** [0.091]	0.536** [0.091]
Constant	-0.942** [0.236]	-0.124* [0.051]	-0.152** [0.046]
Industry & Year Dummies	Included	Included	Included
Observations	47274	47274	47274
Log pseudo-likelihood	-15964	-9605	-8571

**Table 4: Relation between Donations and Future Excess Returns**

**Panel A**

In models (1)-(4) the dependent variable is a firm’s 12-month buy-and-hold excess return using the four-factor model from November 1 to the following October 31. “Market,” “SMB,” “HML” are the three Fama-French factors, and “MOM” is the momentum factor. For each firm, factor loadings are estimated using the monthly returns and factors during the prior 60 months. The estimated factor loadings along with the risk-free rate are used to compute expected monthly returns for the 12-month period. The excess return is the raw return minus the expected return. In models (5)-(7), the dependent variable, excess return, is a firm’s one-year buy-and-hold return minus the corresponding DGTW benchmark portfolio return (Daniel, Grinblatt, Titman, and Wermers, 1997). Monthly excess returns are cumulated over the 12-month period. Robust standard errors clustered by firm are reported in brackets. \*\*, \*, and + indicate significance at 1%, 5%, and 10% levels, respectively.

OLS Model:

$$XR_{t+1} = \alpha + \beta_1 Donation_t + \beta_2 (YearDummies) + \varepsilon_{t+1}$$

Selection-Probit Model:

Selection equation:  $D_t^* = \gamma Z_{t-1} + u_t$ ;  $D_t = 1$  if  $D_t^* > 0$ , and  $D_t = 0$  if  $D_t^* \leq 0$ .

$$XR_{t+1} = \alpha + \beta_1 D_t + \beta_2 \lambda + \beta_3 (YearDummies) + \varepsilon_{t+1}$$

Z is a set of variables that are correlated with a firm’s propensity to donate. In our specification, Z includes all the variables in Model (1) of Table 3.  $\lambda$  is the inverse Mills ratio computed from the selection equation.

Selection-Tobit Model:

Selection equation:  $D_t^* = \gamma Z_{t-1} + u_t$ ;  $D_t = D_t^*$  if  $D_t^* > 0$ , and  $D_t = 0$  if  $D_t^* \leq 0$ .

$$XR_{t+1} = \alpha + \beta_1 D_t + \beta_2 \lambda + \beta_3 (YearDummies) + \varepsilon_{t+1}$$

Z is the same as in the Selection-Probit model.  $\lambda$  is the inverse Mills ratio computed from the selection equation.

	Four Factor Excess Return				DGTW Excess Return		
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
	OLS	OLS	Selection Probit	Selection Tobit	OLS	Selection Probit	Selection Tobit
Total Donation	-0.070** [0.018]						
Donation (excl. individual donation)		-0.096** [0.020]		-0.081** [0.021]	-0.025+ [0.014]		-0.045* [0.019]
Donation Dummy (excl. individual donation)			-0.113** [0.018]			-0.037** [0.011]	
$\lambda$			0.065** [0.017]	0.008 [0.009]		0.023** [0.007]	0.007 [0.006]
Constant	0.055** [0.010]	0.055** [0.010]	0.045** [0.013]	0.029* [0.012]	0.055** [0.012]	0.038** [0.013]	0.027* [0.013]
Year Dummies	Included	Included	Included	Included	Included	Included	Included
Observations	83029	83029	44325	44325	60149	38801	38801
Adjusted R-squared	0.01	0.01	0.01	0.01	0.002	0.01	0.01

### Panel B

The dependent variable, excess return, is computed based on the four-factor model, except for Model (1) below. “Donation” (in millions) is a company’s annual political contribution excluding individual contributions. Robust standard errors clustered by firm are reported in brackets. \*\* and \* indicate significance at 1% and 5% levels, respectively.

Model (1) is the OLS model but with excess returns computed using the Fama-French three factor model.

Model (2) is the OLS model but with donations restricted to soft money donations and donations to 527 committees.

Model (3) is the OLS model with industry fixed effects in the excess return regression.

Model (4) is the OLS model, but the excess return regression is restricted to firms in the top five donating industries (financial trading, telecommunication, utilities, banking and transportation).

Model (5) is the specifications are:

$$XR_{t+1} = \alpha + \beta_1 Donation_t + \beta_2 Donation_t^2 + \beta_3 (YearDummies) + \varepsilon_{t+1}$$

Model (6) is a spline regression above and below the median level of donations.

Model (7) is an Instrumental Variable specification:

$$Donation_t = \delta_1 X_{t-1} + v_t;$$

$$ExpDonation_t = \hat{\delta}_1 X_{t-1}.$$

$X$  is a set of variables that are correlated with donation but not directly correlated with future excess returns. In this specification,  $X$  is a firm’s political donations (excluding individual contributions) in 1992. The instrumented donation, ExpDonation, is computed for years between 1996 and 2004. The excess returns are restricted to the time period between 1997 and 2005.

$$XR_{t+1} = \alpha + \beta_1 ExpDonation_t + \beta_2 (YearDummies) + \varepsilon_{t+1}$$

	(1) OLS (3 factor model)	(2) OLS (soft money donations)	(3) OLS (industry dummies)	(4) OLS (top 5 donating industries only)	(5) OLS	(6) OLS (donating sample only)	(7) IV
Donation	-0.084** [0.020]	-0.136** [0.030]	-0.090** [0.022]	-0.094** [0.020]	-0.148** [0.033]		
(Donation) <sup>2</sup>					0.039 [0.025]		
Donation (0 < Donation < Median)						-1.291** [0.426]	
Donation (Donation ≥ Median)						-0.023 [0.021]	
ExpDonation							-0.071** [0.025]
Constant	0.035** [0.010]	0.055** [0.010]	0.019 [0.050]	0.122** [0.016]	0.056** [0.010]	0.127** [0.019]	0.028** [0.010]
Year Dummies	Included	Included	Included	Included	Included	Included	Included
Industry Dummies			Included				
Observations	83029	83029	83029	25510	83029	11576	26844
Adjusted R-squared	0.01	0.01	0.01	0.01	0.01	0.01	0.01

**Table 5: Corporate Governance and Corporate Political Donations****Panel A: Governance Characteristics and Donations**

This table reports Tobit regressions of donations (in millions, excluding individual donations) on governance characteristics and control variables. Robust standard errors clustered by firm are reported in brackets. \*\* and \* indicate significance at 1% and 5% levels, respectively. All regressions include industry and year dummies.

	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Board Size	0.036** [0.003]						0.034** [0.004]
CEO Chair		0.056** [0.010]					0.056** [0.014]
Abnormal Compensation			0.335** [0.106]				0.294** [0.100]
Insider Own				-0.230** [0.031]			-0.066 [0.045]
Block Own					-0.143** [0.020]		-0.103** [0.032]
Institutional Own						0.215** [0.021]	-0.010 [0.032]
Book/Market	-0.067** [0.013]	-0.079** [0.012]	-0.036* [0.014]	-0.069** [0.011]	-0.066** [0.010]	-0.056** [0.010]	-0.034* [0.017]
ROA	0.123 [0.114]	0.109 [0.106]	-0.066 [0.148]	0.124 [0.095]	0.102 [0.094]	0.097 [0.098]	-0.094 [0.180]
Sales Growth	0.007 [0.011]	0.011 [0.013]	-0.008 [0.020]	0.000 [0.010]	-0.005 [0.010]	-0.011 [0.011]	-0.000 [0.019]
Free CF	-0.018 [0.101]	-0.014 [0.098]	-0.059 [0.137]	-0.024 [0.083]	-0.007 [0.083]	-0.065 [0.084]	-0.046 [0.169]
Leverage	0.134** [0.031]	0.154** [0.028]	0.141** [0.037]	0.167** [0.026]	0.182** [0.026]	0.156** [0.026]	0.128** [0.048]
R&D	-0.290* [0.126]	-0.270* [0.118]	-0.314* [0.160]	-0.261* [0.108]	-0.222* [0.105]	-0.272* [0.110]	-0.325 [0.206]
Investment	-0.038 [0.029]	-0.072** [0.027]	-0.089** [0.033]	-0.063** [0.023]	-0.064** [0.023]	-0.087** [0.024]	-0.034 [0.045]
Sales Impact	1.415** [0.192]	1.763** [0.233]	1.439** [0.218]	1.559** [0.208]	1.567** [0.207]	1.554** [0.209]	1.067** [0.169]
Excess Return (t-1)	0.006 [0.007]	0.009 [0.007]	0.012 [0.010]	0.005 [0.006]	0.006 [0.006]	0.008 [0.006]	0.015 [0.012]
Return Volatility	-0.979** [0.137]	-1.573** [0.161]	-1.629** [0.186]	-1.336** [0.139]	-1.419** [0.143]	-1.224** [0.144]	-0.995** [0.189]
Assets	0.001** [0.0003]	0.002** [0.0004]	0.002** [0.0004]	0.002** [0.0004]	0.002** [0.0004]	0.002** [0.0004]	0.001** [0.0003]
Target	-0.028** [0.009]	-0.032** [0.009]	-0.016 [0.009]	-0.017* [0.007]	-0.013 [0.007]	-0.019** [0.007]	-0.029* [0.012]
Acquirer	0.069** [0.011]	0.059** [0.009]	0.032** [0.010]	0.067** [0.009]	0.068** [0.009]	0.062** [0.009]	0.037** [0.013]
Ind. Donation Frequency	0.682** [0.115]	0.556** [0.104]	0.576** [0.123]	0.545** [0.092]	0.520** [0.092]	0.544** [0.093]	0.649** [0.128]
Constant	-0.602** [0.077]	-0.200** [0.061]	-0.074 [0.066]	-0.128* [0.051]	-0.088 [0.052]	-0.291** [0.057]	-0.520** [0.089]
Observations	23335	28002	15861	35175	35208	35159	8963
Log pseudo-likelihood	-4031	-5928	-4249	-6023	-6080	-5942	-2242

### Panel B

The dependent variable in all regressions is the excess return based on the four-factor model. “Donation” (in millions) is a company’s annual political contribution excluding individual contributions. Robust standard errors clustered by firm are reported in brackets. \*\* and \* indicate significance at 1% and 5% levels, respectively.

OLS Model:

$$XR_{t+1} = \alpha + \beta_1 \text{Donation}_t + \beta_2 (\text{Governance}) + \beta_3 (\text{YearDummies}) + \varepsilon_{t+1}$$

Selection-Probit Model:

Selection equation:  $D_t^* = \gamma Z_{t-1} + u_t$ ;  $D_t = 1$  if  $D_t^* > 0$ , and  $D_t = 0$  if  $D_t^* \leq 0$ .

$$XR_{t+1} = \alpha + \beta_1 D_t + \beta_2 \lambda + \beta_3 (\text{YearDummies}) + \varepsilon_{t+1}$$

Z is a set of variables that are correlated with a firm’s propensity to donate. In our specification, Z includes all the variables in Model (1) of Table 3.  $\lambda$  is the inverse Mills ratio computed from the selection equation.

Selection-Tobit Model:

Selection equation:  $D_t^* = \gamma Z_{t-1} + u_t$ ;  $D_t = D_t^*$  if  $D_t^* > 0$ , and  $D_t = 0$  if  $D_t^* \leq 0$ .

$$XR_{t+1} = \alpha + \beta_1 D_t + \beta_2 \lambda + \beta_3 (\text{Governance}) + \beta_4 (\text{YearDummies}) + \varepsilon_{t+1}$$

Z is the same as in the Selection-Probit model.  $\lambda$  is the inverse Mills ratio computed from the selection equation.

	(1) OLS	(2) Selection Probit	(3) Selection Tobit
Donation	-0.041* [0.021]		-0.057* [0.026]
Donation Dummy		-0.141** [0.034]	
$\lambda$		0.082** [0.020]	0.003 [0.008]
Board Size	-0.016** [0.002]	-0.009** [0.003]	-0.015** [0.003]
CEO Chair	0.019 [0.013]	0.025 [0.016]	0.016 [0.015]
Abnormal Compensation	-0.042 [0.062]	0.021 [0.059]	-0.021 [0.063]
Insider Own	-0.003 [0.054]	-0.038 [0.065]	-0.032 [0.065]
Block Own	0.023 [0.031]	-0.023 [0.037]	0.004 [0.035]
Institutional Own	-0.216** [0.038]	-0.214** [0.044]	-0.228** [0.045]
Constant	0.280** [0.044]	0.281** [0.053]	0.297** [0.054]
Year Dummies	Included	Included	Included
Observations	11626	8937	8937
R-squared	0.02	0.03	0.03

**Table 6: Donations and Acquirer Returns**

This table reports univariate comparisons and multivariate analysis of acquisition announcement returns for donating and non-donating firms. Panel A reports the mean, median and number of observations for acquirer and acquisition characteristics of donating and non-donating firms, and the Wilcoxon z statistics for the differences of the two samples. Panel B reports OLS regressions of acquisition announcement returns (in percent), CAR [-1,+1], on a donation dummy that equals one if the firm donated money to politicians in the year of, or the year before, the acquisition announcement. “Tobin’s Q” is market value of assets divided by book value of assets. “Deal Size” is the ratio of deal value over the acquirer’s market capitalization averaged across the transactions by the same acquirer in a year. Observations with Deal Size less than 1% are excluded. “Public Target” is the fraction of transactions in a year in which the target is a publicly traded company. “% of Stock” is the fraction of transaction value paid with stock averaged across transactions by the same acquirer in a year. Robust standard errors are reported in brackets. \*\* and \* indicate significance at 1% and 5% levels, respectively.

**Panel A: Univariate Comparison**

	Donating Sample			Non-Donating Sample			Wilcoxon Z
	Mean	Median	N	Mean	Median	N	
CAR [-1,+1] (%)	0.012	-0.025	1852	1.544	0.567	8854	-6.75**
Assets (billion)	18.466	3.473	1821	9.723	2.185	8098	27.90**
Tobin's Q	1.715	1.316	1761	2.094	1.485	7810	-7.63**
Cash/Asset	0.099	0.046	1820	0.186	0.080	8067	-14.11**
Deal Size	0.187	0.072	1852	0.286	0.115	8854	-12.48**
Public Target	0.355	0	1852	0.166	0	8854	20.33**
% of Stock	0.443	0.363	1492	0.448	0.390	7034	-1.174

**Panel B: Multivariate Analysis**

	(1)	(2)
Donation Dummy	-0.963** [0.186]	-0.885** [0.185]
Deal Size	0.422 <sup>+</sup> [0.247]	0.671 <sup>+</sup> [0.370]
Public Target	-3.279** [0.249]	-3.371** [0.253]
% of Stock	-0.718* [0.279]	-0.418 [0.290]
Tobin’s Q		-0.430** [0.096]
Cash Ratio		1.026 [0.879]
Assets		-0.001* [0.0005]
Constant	2.364** [0.146]	2.937** [0.224]
Observations	8526	7555
Adjusted R-squared	0.03	0.04

**Table 7: Returns to Donation: Variation across Elections**

Panel A has future one-year excess returns computed based on the four-factor model: the three Fama-French factors and the momentum factor. Panel B has cumulative abnormal returns where “CAR [-1, +1]” is the market-adjusted election announcement return from day 1 to day 2 after election day. “Donation” is the dollar amount of donation (in millions, excluding individual donations). “Win” is a dummy variable that equals one if a firm donates more than 50% to the winning party, and zero otherwise. For a congressional election, the winning party is defined as the party that gains seats in the congress (the Senate and the House). Robust standard errors clustered by firm are reported in brackets. \*\*, \*, and + indicate significance at 1%, 5%, and 10% levels, respectively.

<b>Panel A</b>					
	<b>Future Excess Return</b>				
	Presidential		Congressional		No Election
Donation	-0.059 <sup>+</sup> [0.031]	-0.078 <sup>+</sup> [0.044]	-0.174** [0.027]	-0.176** [0.047]	-0.077** [0.028]
Donation × Win		0.035 [0.047]		0.004 [0.050]	
Constant	0.031** [0.007]	0.031** [0.007]	0.147** [0.013]	0.147** [0.013]	0.023** [0.006]
Year Dummies	Included	Included	Included	Included	Included
Observations	23016	23016	18308	18308	41705
R-squared	0.01	0.01	0.01	0.01	0.01

<b>Panel B</b>				
	<b>Election Announcement CAR[-1, +1]</b>			
	Presidential		Congressional	
Donation	0.011** [0.003]	0.001 [0.003]	-0.005 [0.003]	-0.009** [0.003]
Donation × Win		0.018** [0.004]		0.007 [0.005]
Constant	-0.003** [0.000]	-0.003** [0.000]	0.006** [0.001]	0.006** [0.001]
Observations	24215	24215	19344	19344
R-squared	0.01	0.01	0.01	0.01

**Table 8: Are Corporate Political Donations a Response to Negative Shocks?**

This table reports regressions of a firm's excess return computed based on the four-factor model on donations and changes in firm characteristics that can reflect potential negative productivity or regulatory shocks to the firm. In all models, "Excess Return" is measured at year t+1 and "Donation" is measured at year t. In Models (1) – (4), all the changes in firm and industry characteristics are measured at year t. In Model (5), all the changes in firm characteristics are measured at year t+1. "Donation" is the dollar value of donation (in millions, excluding individual donations) at year t. Robust standard errors clustered by firm are reported in brackets. \*\* and \* indicate significance at 1% and 5% levels, respectively. Industry dummies are included in regression (1). Year dummies are included in all regressions.

	(1)	(2)	(3)	(4)	(5)
Donation	-0.093** [0.024]	-0.076** [0.023]	-0.118** [0.024]	-0.085** [0.023]	-0.097** [0.026]
Ind. Sales Growth	-0.539** [0.109]			-0.535** [0.102]	-0.151 [0.110]
Δ(Industry Frequency)	0.089 [0.088]			-0.038 [0.104]	-0.321** [0.100]
Δ(Book/Market)		-0.030 [0.046]		-0.018 [0.053]	-0.479** [0.017]
ROA		-0.072 [0.063]		0.041 [0.080]	0.562** [0.044]
Sales Growth		-0.067** [0.025]		-0.095** [0.024]	0.132** [0.017]
Δ(Free CF)		0.400** [0.058]		0.411** [0.058]	0.749** [0.111]
Δ(Leverage)		-0.090 [0.066]		-0.073 [0.089]	-0.416** [0.062]
Δ(Return Vol.)		1.038 [0.572]		0.982 [0.576]	1.998** [0.417]
Prior Excess Return		0.059 [0.079]		0.070 [0.092]	
Δ(R&D)			0.208 [0.159]	0.683** [0.214]	-0.173 [0.273]
Δ(Investment)			0.003 [0.028]	-0.026 [0.055]	0.359** [0.034]
Target			-0.021 [0.012]		-0.017 [0.013]
Acquirer			0.031** [0.011]		0.054** [0.010]
Constant	0.041 [0.032]	0.025* [0.011]	0.030* [0.012]	0.133** [0.044]	-0.121** [0.035]
Observations	76723	44751	56485	41690	38851
R-squared	0.01	0.02	0.01	0.03	0.13

**Table 9: Are Donations a Response to Past Political Favors?**

The “Treatment Dummy” is an indicator that equals one if a firm initiates political contributions and gives more than 50% of its contributions to the political party that enters power in that year. The “Treatment” dummy equals one

- 1) If a firm initiated political contributions and gave more than 50% of its contributions to the Republican candidates in the House election or Senate election in years 1994 and 1995;
- 2) If a firm initiated political contributions and gave more than 50% of its contributions to the Democratic candidates in the Senate election in year 2001 (James Jeffords switched from Republican to Independent but voting with the Democrats in 2001);
- 3) If a firm initiated political contributions and gave more than 50% of its contributions to the Republican candidates in the Senate election in years 2002 and 2003;
- 4) If a firm initiated political contributions and gave more than 50% of its contributions to the Democratic presidential candidates in years 1992 and 1993;
- 5) If a firm initiated political contributions and gave more than 50% of its contributions to the Republican presidential candidates in years 2000 and 2001.

**Panel A: Summary Statistics**

	Mean Excess Return	# of Observations
Treatment group	-0.007	214
Donation initiators not in the treatment group	0.011	369
Non-initiating Donors	0.034	9436
Non-donors	0.065	73007

**Panel B: Regression Results**

The dependent variable in each regression is the future excess return. “Donation” is the dollar amount of donations (in millions). Robust standard errors clustered by firm are reported in brackets. \*\* and \* indicate significance at 1% and 5% levels, respectively.

	(1)	(2)
Treatment Dummy	-0.106** [0.041]	-0.104* [0.041]
Donation		-0.095** [0.020]
Constant	0.055** [0.010]	0.055** [0.010]
Year Dummies	Included	Included
Observations	83029	83029
R-squared	0.01	0.01

**Table 10: Government Contracts and Returns to Donations**

The dependent variable is one-year excess returns based on the four factor model. Data on the fraction of industry sales to the government (“Sales to Government”) are taken from the 2002 Economic Census. “Donation” is either the dollar amount of donations or a dummy variable for whether the firm donates at all. Robust standard errors clustered by firm are reported in brackets. \*\*, \*, and + indicate significance at 1%, 5%, and 10% levels, respectively.

	(1)	(2)	(3)	(4)
Donation (dummy)	-0.061** [0.013]	-0.048** [0.015]		
Donation (amount)			-0.285** [0.076]	-0.166* [0.080]
Sales to Government	0.138+ [0.075]	0.162+ [0.083]	0.153* [0.076]	0.167* [0.078]
Donation × Sales to Government		-0.231 [0.156]		-2.918** [1.125]
Constant	0.029 [0.021]	0.027 [0.021]	0.020 [0.020]	0.019 [0.020]
Year Dummies	Included	Included	Included	Included
Observations	12396	12396	12396	12396
R-squared	0.01	0.01	0.01	0.01

**Table 11: Donation Effect by Industry**

The dependent variable is a firm's 12-month buy-and-hold excess return using the four-factor model from November 1 to the following October 31. Robust standard errors clustered by firm are reported in brackets. \*\*, \*, and + indicate significance at 1%, 5%, and 10% levels, respectively. Each row (corresponding to the industries listed in the first column) reports the coefficient from the OLS specification:

$$XR_{t+1} = \alpha + \beta_1 \text{Donation}_t + \beta_2 (\text{YearDummies}) + \varepsilon_{t+1}$$

Fama/French Industry Classification	Donation Coefficient	Standard Error	Observations
Fabricated Products	-1.194**	0.293	238
Precious Metals	-1.069**	0.380	426
Textiles	-0.693*	0.279	400
Personal Services	-0.653 <sup>+</sup>	0.366	785
Electronic Equipment	-0.463*	0.193	3403
Apparel	-0.391*	0.190	841
Almost Nothing	-0.383*	0.188	690
Wholesale	-0.374**	0.125	3249
Construction	-0.341**	0.119	834
Pharmaceutical Products	-0.212*	0.087	3099
Communication	-0.201*	0.106	1669
Banking	-0.151**	0.045	6185
Computers	-0.116**	0.044	2179
Food Products	-0.098**	0.037	1034
Utilities	-0.095 <sup>+</sup>	0.055	2137
Real Estate	-0.986	0.814	834
Measuring and Control Equipment	-0.822	1.010	1403
Rubber and Plastic Products	-0.655	1.060	592
Printing and Publishing	-0.578	0.534	743
Non-Metallic and Industrial Metal Mining	-0.506	0.738	283
Machinery	-0.295	0.230	2254
Steel Works Etc	-0.263	0.386	953
Medical Equipment	-0.257	0.271	2181
Aircraft	-0.187	0.116	290
Entertainment	-0.186	0.160	1033
Tobacco Products	-0.166	0.113	74
Candy & Soda	-0.134	0.089	162
Shipping Containers	-0.071	0.805	254
Automobiles and Trucks	-0.068	0.092	859
Chemicals	-0.063	0.102	1162
Retail	-0.056	0.126	3509
Petroleum and Natural Gas	-0.053	0.050	2865
Healthcare	-0.049	0.272	1633
Business Services	-0.039	0.220	3924
Trading	-0.031	0.022	13981
Transportation	-0.016	0.058	1538
Electrical Equipment	-0.011	0.163	2153
Beer & Liquor	0.004	0.050	226

Insurance	0.033	0.078	2148
Consumer Goods	0.056	0.116	1410
Computer Software	0.066	0.177	4324
Construction Materials	0.108	0.215	1460
Defense	0.118	0.079	123
Restaraunts, Hotels, Motels	0.126	0.082	1694
Shipbuilding, Railroad Equipment	0.127	0.141	113
Recreation	0.130	0.446	651
Business Supplies	0.296	0.333	710
Coal	1.127	1.424	114
Agriculture	1.412	2.464	207

Figure 1  
Donations as an Investment

