

# **Essays on Political Connections and Firm Value**

Jongil So

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Approved by:  
Paolo Fulghieri  
Eitan Goldman  
Jorg Rocholl  
Sergey Sanzhar  
Merih Sevilir

## **ABSTRACT**

**JOGNIL SO: Essays on Political Connections and Firm Value**  
(Under the direction of Paolo Fulghieri)

One of the interesting topics in finance is the relationship between politics and firm value. In particular, many people have analyzed whether or not political connections add value to the firm. While previous studies addressed this question in the contexts of countries with weak legal systems, I attempt to study whether political connections are also important in non corrupted countries with a well functioning strong legal system.

This thesis consists of two empirical studies on political connections and firm value. Chapter I analyzes whether politically connected boards affect firm value and then Chapter II explores the specifics of what are the benefits from political connections.

More specifically, Chapter I explores whether political connections are also important in the United States. It uses an original hand-collected data set on the political connections of board members of S&P500 companies to sort companies into those connected to the Republican Party and those connected to the Democratic Party. The analysis shows a positive abnormal stock return following the announcement of the nomination of a politically connected individual to the board. The paper also analyzes the stock price response to the 2000 Presidential Election and finds that companies connected to the Republican Party increase in value while companies connected to the Democratic Party decrease in value.

Chapter II analyzes whether political connections of public corporations in the United States affect the allocation of government procurement contracts. Using this classification, the study focuses on the change in control of both House and Senate following the 1994 midterm election and on the change in the Presidency following the 2000 election. An analysis of the change in the value of the procurement contracts awarded to these companies before and after 1994 and 2000, respectively, indicates that companies that are connected to the winning (losing) party are significantly more likely to experience an increase (decrease) in procurement contracts. In total, these findings suggest that the allocation of procurement contracts is influenced, at least in part, by political connections. Thus, this study provides one of the first pieces of evidence showing a direct avenue through which political connections add value to U.S. companies.

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## Chapter I. Do Politically Connected Boards affect Firm Value?

### 1. Introduction

In countries with a well functioning legal system, companies are not expected to receive a substantial competitive advantage or preferential treatment from their political connections. Government officials with the power to affect the economic value of public companies would risk serious legal and political costs if they chose to help companies for private reasons rather than for reasons of public merit.

While this argument should be true in general, anecdotal stories about the potential influence of political connections in the U.S. do exist. For example, a 2004 AP news wire reports that *“the Army awarded Vice President Dick Cheney's former company a contract Friday to rebuild Iraq's oil industry. Halliburton won a competitive bid to rebuild the oil industry in southern Iraq, a contract worth up to \$ 1.2 billion over two years...”* On the other side of the political spectrum, a 2000 USA Today report says that *“True powerbrokers such as Clinton confidante Vernon Jordan, who's listed on 10 boards, are considered a good fit for many boards. Jordan now is senior managing director at investment bank Lazard Freres. His wife, consultant Ann Dibble Jordan, is a director at Johnson & Johnson, Citigroup, Automatic Data Processing, three non-profit groups and, until they were acquired, Coleman and Salant.”* The article goes on to claim that this phenomenon is becoming more and more prevalent: *“Among Fortune 1,000 companies, about 55% have at least one director with public service experience, up from 39% in 1992”.*

Although the political connections of board members can be beneficial both for innocuous reasons, such as providing knowledge about how to navigate government bureaucracies, and for less innocuous ones, it is nevertheless important to explore how pervasive is the impact of these connections on the value of publicly traded U.S. companies. Thus, this paper attempts to investigate whether the

examples above merely represent isolated idiosyncratic cases in which politically connected boards may have affected value or whether they are the tip of the iceberg of a much larger widespread phenomenon.

To address this question, the paper focuses on analyzing the value impact of political connections of major U.S. companies, including all companies in the S&P500. Testing for whether political connections impact value requires addressing two basic challenges. The first challenge is to identify and define a viable measure of political connections. Given a definition of political connections, the second challenge is to find a setting that would allow one to test whether they do indeed affect company value.

To address the first challenge, the paper employs a unique definition of a company's political connections based on new hand-collected data, detailing the former political positions held by each of the board members of all companies that are in the S&P500 during the years 1996 and 2000.<sup>1</sup> Information about the political background of board members is then used to sort companies into those that are connected to the Democrats and those that are connected to the Republicans.

To address the second challenge, the paper looks at two different events. The first is the 2000 Presidential Election on November 7, 2000.<sup>2</sup> The second is the announcement of the board nomination of all of the directors that are identified as having a political connection. The hypothesis is that if political connections matter then: 1) companies with political connections to the Republican Party will increase in value upon the Republican win while companies connected to the Democratic Party will suffer a drop in value; and 2) the nomination of a politically connected director to the board will result in an increase in firm value due to the revelation that this company is able to hire from a limited supply of politically connected individuals who have the ability to generate future political benefits.<sup>3</sup>

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<sup>1</sup> There are of course other ways in which a company may get connected, e.g. through lobbyists or consultants. This implies that the number of politically connected companies identified in this study is a lower bound on the actual number of politically connected companies.

<sup>2</sup> The election results can only be a viable event if the outcome of the election is uncertain. The 2000 election provides such an event as the polls suggest a very close race up to the election date, in contrast to the elections in 1992 and 1996. This is the reason why this paper, similar to other papers in the field of political economics, focuses on the 2000 election.

<sup>3</sup> Further discussion of the theory and economic motivation behind this test is provided in Section 3.3.

The first main result of the paper is that a portfolio of S&P500 companies classified as having a Republican board significantly outperforms in the post-election period a portfolio of S&P500 companies classified as having a Democratic board. This is true regardless of whether the portfolios are formed based on equal weighting or value weighting. A company is defined as having a Republican (Democratic) board if it has at least one board member who has a former affiliation to the Republicans (Democrats) but no such member with ties to the Democrats (Republicans). The results also show that, considered separately, the Republican portfolio exhibits a positive and significant cumulative abnormal return (CAR) following the election. Conversely, the Democratic portfolio exhibits a negative CAR following the election. This last result is significant though only in the value-weighted average, which suggests that the effect of political connections is more pronounced for the larger companies in the sample.

The second main result is that a company experiences a positive and statistically significant abnormal stock return following the announcement of a board nomination of a politically connected individual. In particular, this announcement effect is stronger for a value-weighted than for an equally-weighted average. In addition, the positive announcement effect holds true both for Republican and Democratic connected directors.

In sum, these results indicate the following two points: First, a company's value goes up in anticipation of future benefits following the nomination of politically connected individuals. Second, when the connected board member's political party gains control of the presidency, the value generated by her increases while the value generated by a director connected to the opposing party decreases.

These findings also suggest a new way in which boards can increase firm value. While past studies have argued that the board can add value either by monitoring or by advising management (see for example, Adams and Ferreira, 2007), this paper shows that the board can also add value via the connections it provides with politicians.

The results in the paper are robust to a number of different specifications. For example, the election results remain strongly significant for different choices of event windows surrounding the 2000

elections, and in the cross-section after controlling for several company characteristics such as size, past returns (momentum) and book to market ratio.

The paper also specifically addresses a number of different interpretations for the results at hand and controls for them. First, it might be argued that the post-election abnormal returns are not due to the fact that companies are politically connected but rather that these abnormal returns simply mirror the political preferences of the company's industry. As an example, Republican boards may serve in companies in a particular industry that stands to benefit from a win of the Republican Party due to its specific political platform and regardless of whether or not the company itself is politically connected.

To deal with this issue, the analysis is repeated by calculating abnormal returns using industry-adjusted returns. The results remain significant, indicating that companies with politically connected boards outperform their industry in the post-election period. This suggests that political board members represent connections rather than preferences of the industry. To further illustrate this point, the paper employs a second (less direct) measure of connections based on information regarding all money donations made by companies to the two political parties prior to the 2000 election.<sup>4</sup> Using this measure, the paper finds that, unlike politically connected board members, political donations seem to represent the political preferences of the industry rather than political connections. Namely, controlling for both donations and political board affiliations, the results indicate that companies that donate more to Republicans (Democrats) do not outperform (underperform) their industry in the post-election period, but companies with a Republican (Democratic) board do.

Further industry analysis shows that companies with politically connected boards are relatively evenly distributed across the Fama-French industry groups. It is also worth noting that the industry

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<sup>4</sup> This second data set comes from the Center of Responsive Politics (CRP), which collects information provided by the Federal Election Commission.

distribution of Republican companies is statistically not different from the industry distribution of Democratic companies. This further suggests that the results are not driven by any specific industry.<sup>5</sup>

A second interpretation of the results deals with the announcement returns following the board nominations of politically connected directors. One question that arises is whether the same abnormal returns are observed when non-political directors are added to the board of the same company. It might be argued that the observed effect is due to the characteristics of the company itself or to the fact that these directors are independent rather than politically connected. To address this issue, each announcement of the board nomination of a former politician is matched with an announcement by the same company of another nomination of an independent director who is not politically connected. The results suggest that independent non-political directors do not generate a positive abnormal return. These results are consistent with Shivdasani and Yermack (1999) and Fich and Shivdasani (2006) who also show that the announcement effect of the nomination of independent directors is either insignificantly different from zero or negative. While Rosenstein and Wyatt (1990) do find a very small positive announcement effect of the order of 0.2%, this effect is much smaller than the effect found here. Furthermore, they find the effect to be significant only for small firms. This is the opposite of the findings in our paper, which suggests that the announcement effects here are due to the unique political characteristics of the sample of directors.

A final interpretation of the positive announcement returns following the board nomination could be that these abnormal returns are not due to the board members being politically connected but rather to their superb quality and expertise. The paper controls for this possibility by sorting politically connected board members into two groups; those individuals that had a political position that was functionally related to the company for which they receive their board nomination and those individuals whose political position was unrelated. If expertise was indeed the only driving force behind the positive announcement returns, then positive announcement returns should only be observed for board members

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<sup>5</sup> The industry analysis in the paper is done using the Fama-French 30 industry classification. The results remain the same when using alternative Fama-French industry specifications as well as when specifically controlling for the oil industry, the defense industry, and utilities.

with related experience. The results in the paper show that the announcement return of *related* board members is indeed higher than that for *not related* board members, but that the announcement returns for the latter group are consistently positive and significant.

In fact, after sorting the sample of former politicians into numerous sub-groups we find that there is no sub-classification that can solely explain the positive announcement returns. Rather, it seems that *any* type of political connection initiated at *any* point in time results in a positive announcement return. This suggests that there are many different ways in which political connections may help companies. Note, however, that we do not argue that all companies can benefit from political connections as it is likely that our sample of companies that have been able to attract former politicians are probably also more likely to benefit from these political connections. Nevertheless, this is consistent with our argument that connections add value.

The value from political connections may arise in many different ways. There are both direct channels as well as more subtle indirect channels. For example, government officials can influence the allocation of lucrative government contracts towards the connected company. As another example, legislators can impose tariffs on competitors (especially foreign companies) to the benefit of specific companies. In addition, they can use tax incentives to promote the prospects of one product/business area and discourage those of others. Furthermore, the government can change various regulatory requirements that may also have a substantial effect on value. Finally, government officials with ties outside the U.S. can be beneficial in opening doors abroad. Thus, former politicians with various backgrounds, either in the administration or in the legislative branch or in any other type of political position, can be valuable to a company.

This study relates to two main strands of the literature: the first studies the relation between politics and business and the second studies how board attributes and director characteristics affect the company.

The literature on the importance of political connections and on its value implications is relatively small. Fisman (2001), Faccio (2006), and Faccio and Parsley (2007) all document the impact of political

links on firm value in countries with weak legal systems. Fisman (2001) looks at companies in Indonesia that are connected to the Suharto family and shows that these companies lose value following several announcements regarding the deteriorating health of President Suharto.<sup>6</sup> Faccio (2006) studies political connections across many countries and documents that most politically connected companies are listed in countries with high levels of corruption and a weak legal system. She further shows that the value of these companies increases when their executives enter politics. However, she finds that this latter result comes from the sub-sample of companies in countries with high levels of corruption.<sup>7</sup> Faccio and Parsley (2007) shows that companies located in a politician's home town decrease in value upon the announcement of the politician's unexpected death. Finally, Faccio et al. (2006) show one direct way in which connections create value by demonstrating that politically connected firms are more likely to be bailed out by the government.

Several studies provide limited evidence that is suggestive of the existence of political biases in the U.S. For example, Roberts (1990) shows that following the death of the ranking Democrat on the Senate Armed Service Committee the value of firms located in the Senator's state decreased in value. However, he shows that this is true both for firms that made donations to the Senator as well as those that did not. Kroszner and Stratmann (1998) show that interest-group political action committees (PACs) donate more to a politician who is a member of a House Committee that is of relevance to them, but that rival PACs do not. Agrawal and Knoeber (2001) show that companies in industries with larger government dealings tend to have a larger number of political directors. Thus, their paper does not have any direct implications on whether these connections create value. Finally, in a recent study that looks at usury laws in the 19<sup>th</sup> century across different states in the U.S., Benmelech and Moskowitz (2007) find evidence that usury laws were used by incumbents with political power to limit their competitors' ability to enter the market.

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<sup>6</sup> Fisman et al. (2006) use a similar methodology to identify changes in Vice-President Cheney's health condition and test for their value impact.

<sup>7</sup> Note that Faccio's initial sample does include companies from countries with low levels of corruption such as the UK and the U.S., but she finds no value impact for those companies.

As mentioned above, this paper promotes the idea that political connections *create* value by generating future benefits to the firm. Three recent papers that use donation data stop short of making this point. These papers include Jayachandran (2006), Knight (2006), and Shon (2006). Jayachandran (2006) looks at the 2001 departure of Senator Jim Jeffords from the Republican to the Democratic Party. She shows that this event results in a decrease in value of firms donating to the Republicans. However, as she argues in the paper “*An important open question that the results do not fully resolve is whether the relationship is casual, that is, whether firms contribute to politicians whose intrinsic views match the firms’ interests or whether donations affect politicians’ behavior*” (p. 2 ).

Knight (2006) analyzes the stock return around the 2000 Presidential Election of a sample of firms that are identified by financial analysts as likely to fare well under Bush and Gore administrations. His objective is to show that policy platforms are capitalized into equity prices. While Knight (2006) also uses these firms’ donation data as a robustness check for the categorization made by the financial analysts, the thrust of his work is that firms in *industries* that stand to benefit from the Bush administration will donate more to the Bush Campaign. Thus, again, his results cannot be used to show that connections *bring about* or *cause* future financial benefits. Similarly, Shon (2006) looks only at donations at an industry level and shows that firms in industries that donate more to Republicans exhibit a positive stock price return following Bush’s win in the 2000 election.<sup>8</sup>

To summarize, all three of these papers are close to our paper in that they show that there exists a positive relation between donations to one of the two Parties and a positive stock return following an increase in power of that Party. However, to our knowledge, our paper is the first to use a direct measure of the political connections of the board of directors to show that political connections in the U.S. are viewed by the market as *creating* value.

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<sup>8</sup> Looking at campaign contributions in Brazil, Claessens et al. (2006) find that donating companies experience higher stock returns around elections. Using a different cut of donation data, Cooper et al. (2007) consider the long-run performance of donating companies in the U.S.



More specifically, unlike political contributions, which are likely to affect election outcomes and hence may represent a company's political preferences rather than its political influence, it is more difficult to argue that a company nominates a former politician to its board (on average these directors are nominated more than five years before the 2000 election) in order to increase the chance that that politician's party will win the elections. It is also more difficult to argue that the positive stock price response to the announcement of the nomination itself is a signal that the government is planning to start implementing policies that are favorable to the company.<sup>9</sup> Thus, again, the unique contribution of this paper is in showing that the impact of political connections on value is more likely to be due to the market's belief that these connections provide companies with political influence.

The second strand of the literature related to this study includes papers that explore whether or not the board of directors can add value to the company (see Hermalin and Weisbach (2003) for a recent survey of this literature). Even more closely related to this paper is the growing body of work that looks at director characteristics. For example, Kroszner and Strahan (2001) and Guner et al. (2006) focus on boards with directors that have banking experience. Ferris et al. (2003), Perry and Peyer (2005), and Fich and Shivdasani (2006) all analyze different implications of having directors with multiple board seats. Finally, Adams and Ferreira (2004) analyze boards that have female directors. In the context of these papers, this study focuses on directors with the unique characteristic of having a political background.

The rest of the paper is organized as follows. The next section describes the data used in this paper. Section 3 presents the empirical analyses and the main results of the paper. Finally, Section 4 concludes.

## **2. Data description**

The analyses in this paper utilize two types of data. The first data set consists of original data containing information regarding the political affiliation of each board member of all companies in the

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<sup>9</sup> Note, that we do not argue that board nominations of a politician are exogenous and that they are completely unanticipated by the market. Rather, we believe that the announcement simply reflects the resolution of whatever remaining uncertainty exists with respect to whether the former politician will join this board and not that of another company.

S&P500. The second data set consists of information on donations made by publicly traded companies to the Republican and Democratic Parties. Both data sets are described in more detail below. In addition to these data, the paper uses CRSP and Compustat data for the sample companies as well as CRSP data for the market indexes and Fama-French industry return data.

### ***2.1. Board data***

Board connections are derived by considering the composition of the board of directors of all S&P500 companies in the years 1996 and 2000 and analyzing the background of each board member. Section 14 of the Securities and Exchange Commission (SEC) Act requires companies to file definite proxy statements (submission type Def 14a), containing information about their board members. These filings, which are hand-collected from the EDGAR database of the SEC, contain a brief description of each board member's career background. Based on these data, it is possible to identify whether board members are connected to the Republicans, to the Democrats, or to neither. A board member is defined as being politically connected if she at any time in her past held a position such as Senator, Member of the House of Representatives, Member of the Administration, or has been a Director of an organization such as the CIA. A full list of these positions is provided in Table 1.

Politically connected board members are further sorted into two sub-groups based on whether their former political position is related to the industry sector of the company for which they become a board member. A former politician is classified as being *related* if she is nominated to a company that operates in an industry that is related to her past political duties. More specifically, a board member is classified as being *related* if she served in a committee, department, or government agency that deals with the industry in which the nominating company operates. For example, a senator who served on the Energy and Natural Resources Committee and joins the board of an oil company is classified as being related.

We use the sample of directors serving on the boards of S&P500 firms in November 2000 to analyze the stock price response of connected companies to the announcement of the results of the Presidential Election. Table 1 shows descriptive statistics for the sample of these politically connected

boards. According to the definition used in this paper, 153 of the S&P500 companies are politically connected at the time of the 2000 election. Out of these 153 companies, 78 companies have at least one board member connected to the Republicans, but no board member connected to the Democrats, while 47 companies have at least one board member connected to the Democrats, but no board member connected to the Republicans. The remaining connected companies have at least one board member connected to the Republicans and at least one board member connected to the Democrats. The vast majority of politically connected board members serve as independent directors, while only four politically connected board members have an internal appointment, mainly as CEO. The descriptive statistics in Table 1 show that, on average, connected companies tend to be larger than non-connected companies. The Table also documents that, at the time of the 2000 election, politically connected board members have served an average of 5.5 years on their boards. The board member with the longest tenure was nominated in 1981, while the board member with the shortest tenure was nominated in the election year 2000.

Note, that our sample of connected companies is relatively evenly distributed across different industries. However, consistent with the findings of Agrawal and Knoeber (2001) we find a higher number of connected companies (both republican and democrats) in regulated industries. For example, the highest share of politically connected companies and directors can be found in the Banking and Utilities industries.

When analyzing the announcement effect of the nomination of politically connected directors, we start with a sample of 254 connected board members in S&P500 companies in 1996 and 2000. For this set of directors, we perform a Lexis-Nexis press search to obtain the announcement date of a nomination of these directors to any publicly traded company. This procedure provides a total of 592 nominations, which occur in the time period between 1981 and 2005. A number of 243 nominations are eliminated as the announcement of the nomination coincides with other price-relevant events such as a dividend or an earnings announcement, a share repurchase, or an M&A activity. The final sample of 349 nominations is then analyzed. In this sample, directors serve on average on 4.46 boards (not necessarily at the same time).

The maximum number of positions for one board member in the sample amounts to 13.<sup>10</sup> Nominations are only considered if the board member already has a political career at the time of the announcement of the nomination. This restriction rules out the case of board members who are not yet politically connected at the time they are nominated.

## ***2.2. Donation data***

Donation data are provided by the Center for Responsive Politics (CRP). The CRP is a non-partisan, non-profit research organization supported by a combination of foundation grants and individual contributions. It collects information on companies' donations to the Democratic and Republican Parties. The underlying information comes from the Federal Election Commission, which publicly discloses funds raised and spent. The Federal Election Campaign Act requires candidate committees, party committees and political action committees (PACs) to file periodic reports, disclosing the amount and source of money raised and spent. For each election cycle, candidates must identify all party committees and PACs that contribute to their campaigns, all individuals who donate more than \$200, and all expenditures exceeding \$200.

The CRP classifies 80 donating industries, from agricultural services to waste management. Among these industries are labor unions and various groups that do not fall into a genuine business, including retired individuals and government employees. Donation amounts in each industry are the sum of contributions to federal candidates of \$200 or more from individuals and PACs, and contributions to political parties from PACs, soft money and individual donors.

For each election cycle, the CRP provides information on the 20 largest contributors in each of the 80 industries. The sample in this paper is constructed by using this information for the 1999 and 2000 election cycle. A company is included in the sample if it belongs to the 20 largest contributors in the 80 industries classified by the CRP, if it is publicly listed, and if the total donation exceeds \$100,000. This

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<sup>10</sup> Ann McLaughlin, Secretary of Labor between 1987 and 1989, and Frank Carlucci, Secretary of Defense between 1987 and 1989, have served on a total of 13 boards between the years 1989 and 2005.

results in a total of 315 sample companies. Table 2 provides an overview of the amounts of money that these companies donate to the Republican and the Democratic Parties. The total donations amount to \$246 million, with \$88 million going to the Democrats and \$158 million going to the Republicans. This compares to total donations of \$1,634 million recorded by the CRP. The donation share to the Republicans is higher in the sample than in the overall population, as the largest contributors to the Democrats are not publicly listed organizations (e.g. labor unions). Most of the sample companies donate to both parties, but the relative shares vary substantially. Only 18 of the 315 sample companies donate to only one of the two major parties. The sample companies donate on average \$779,985. The maximum donation made by one of the sample companies is \$5,075,311, while the minimum amounts to \$100,443.

### **3. Empirical results**

The empirical analysis consists of three parts. The first part provides univariate results on the impact of politically connected board members (and corporate donations) on companies' post-election stock returns. The second part tests for the multivariate cross-sectional impact on stock returns after controlling for a number of other potentially relevant factors. While the previous two analyses focus on the stock returns after the Election Day, the third analysis concentrates on the announcement of the nomination to the board of politically connected board members.

#### ***3.1. Univariate results***

The first part of the empirical analysis tests for the stock price reactions of politically connected companies to the 2000 Presidential Election in a univariate setup. The first piece of this analysis focuses on the original measure of politically connected board members, while the second piece of this analysis considers corporate donations.

### 3.1.1. Board connection results

Political connections are defined based on the political background of the board members in each S&P 500 company in the year 2000. Board members with the previously described former political positions may help a company build and maintain close links to the administration. The hypothesis is that if connections matter, then board members linked to Republicans should be more valuable than board members linked to Democrats, when the Republicans win the election.

Table 3 analyzes the relation between stock returns following the Election Day and several definitions of political connections of board members for all S&P500 companies. The first analysis considers only those companies in which there is at least one board member with a connection to one party and no board member with a connection to the other party. These are defined as *pure* connections. In 78 companies, board members have connections only to the Republicans, while in 47 companies board members have connections only to the Democrats. The results in Panel a) of Table 3 show that the market-adjusted post-election returns for companies with connections to the Republicans are positive and significant. This holds for both the equally-weighted and the value-weighted average. The market-adjusted post-election stock returns for companies with connections to the Democrats are insignificant in the equally-weighted average, but significantly negative in the value-weighted average. This suggests that mainly large companies with connections to the Democrats decrease in value following the election. The difference in returns between companies with connections to the Democrats and Republicans is statistically significant for all event windows and for all specifications, in both the equally-weighted and the value-weighted averages.<sup>11</sup>

The subsequent analysis focuses on those companies that are connected to the Republicans and considers the specific political positions that the connected board members held before being nominated to the companies' boards. In the second classification, the sample of Republican companies is thus

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<sup>11</sup> The results for the 28 companies in which there is at least one board member with an affiliation to the Republicans and at least one board member with an affiliation to the Democrats are inconclusive in the equally-weighted and the value-weighted averages. A more thorough analysis of this sample of mixed companies would require considering different sub-groups based on the relative importance of the Republican versus Democratic board members. However, the number of observations for these sub-samples is too small for a meaningful analysis.

divided based on whether at least one of its board member's former political positions is related to the industry sector of the company. The goal is to test whether, in addition to the pure existence of a political connection, the expertise and knowledge that the board member gained through her political position have an impact. Recall that a board member is defined as being related if she is nominated to a company that operates in the same functional area in which she served in her political career. Among the sample companies, 34 Republican companies have at least one related board member and 44 companies have no related board member.

Panel b) of Table 3 reports the results for this classification. The market-adjusted returns for both related and not related companies with connections to the Republicans are positive and significant in each event window and in both the equally-weighted and value-weighted average. This suggests that the pure existence of a political connection, regardless of the specific nature of that connection, creates value for the company. At the same time, the difference in returns between related and not related Republican companies is positive for each event window and significant for some event windows, which suggests that the specific expertise that a politically connected board member gained through her political position generates additional value.

As a third classification of board connections, companies are sorted based on the political position that a board member held before being nominated to the board. Panel c) of Table 3 shows that there are 44 companies in which at least one board member was a senator, a member of the House, or a member of the administration; while there are 23 companies in which politically connected board members held positions other than the ones stated above. The results are again significant for both groups in each event window and in both the equally-weighted and value-weighted average, while the difference in returns between the two groups fails to be significant. The results suggest that the specific political position that a board member held is not important beyond the pure existence of a political position.

In conclusion, the results in this analysis suggest that companies benefit substantially from connections to the election-winning party. Their abnormal stock returns are positive and statistically significant and they are statistically significantly higher than the returns for companies with links to the

losing party. Furthermore, political connections generate value independent of the specific nature of those connections, while specific expertise generates additional value.<sup>12</sup>

### **3.1.2. Donation results**

As mentioned before, the majority of the sample companies donate to both parties, which implies that hedging considerations are one important determinant of their donations. Nevertheless, the cross-sectional variation in the relative donations made to the two parties provides an opportunity to categorize companies as benefiting more from one party or another.

We repeat the analysis in Table 3 using donation amounts in order to classify companies into Republican and Democratic and find results similar to those in Table 3. Since our focus is on political connections of the board, we do not provide the details of this analysis in this paper. They are available upon request. Furthermore, as will be shown in the multivariate analysis, we argue that donations seem to represent industry-wide preferences rather than company-level connections.

### **3.2. Cross-sectional results**

The previous analysis compares the post-election stock returns for different portfolios of companies and provides evidence for the impact of board connections on company value by showing that companies that are connected to the Republicans experience positive and significantly higher returns than companies that are connected to the Democrats. It is important to test this relation in the cross-section and to control for other firm characteristics.

In the multivariate tests, the dependent variable is the post-election CAR for days (+1,+3) for each S&P 500 company. Each company's return is adjusted by the CRSP value-weighted market index. The control variables comprise several firm characteristics: the log of each company's market

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<sup>12</sup> As an additional event, we repeat the analysis in Jayachandran (2006) that considers the decision by Senator Jim Jeffords to leave the Republican Party in May 2001. This event resulted in a change in power in the U.S. Senate. Using the political classification of the board of directors for our sample companies, we find results that exactly mirror Jayachandran's results. In particular, we find that Republican companies experience a negative and significant decline in their stock price in the period between May 18, 2001, and May 25, 2001. We also find, as she does, that in the same period of time the stock returns for Democratic companies are not significantly different from zero. These results are available upon request.



capitalization, its book-to-market ratio, and a momentum variable, which is the company's market-adjusted return in the 3<sup>rd</sup> quarter of 2000. The variables of interest are different categorical and dummy variables that indicate whether a company is connected or donates to either of the two parties.<sup>13</sup> The results are reported in Table 4.

Model 1 tests for the impact of companies' board connections. This is measured by the variable Board Rep-Dem, which takes a value of one if a company's board is politically connected only to the Republicans, a value of minus one if a company's board is politically connected only to the Democrats and a value of zero otherwise. The results show that the coefficient is positive and significant at the 1% level. This implies that the political connection of a company's board remains a significant determinant of its post-election stock return even after controlling for other firm characteristics. The same holds true for the variable Donations Rep-Dem in Model 2, which is constructed analogously to Board Rep-Dem based on the donation data. Model 3 includes both Board Rep-Dem and Donations Rep-Dem, and both variables are again positive and significant at the 1% level.

Starting with Model 4, the estimations consider this relation in more depth by analyzing whether it is driven by either or both of the two parties. For this purpose, four more dummy variables and one interaction variable are introduced. The first of these variables takes a value of one if a company is politically connected only to the Republicans and a value of zero otherwise, whereas the second variable takes a value of one if a company is politically connected only to the Democrats and a value of zero otherwise. In analogy for the donation part, the third dummy variable takes a value of one if a company donates more to the Republicans than to the Democrats and a value of zero otherwise, whereas the fourth variable takes a value of one if a company donates more to the Democrats than to the Republicans and a value of zero otherwise. Motivated by the findings in Faccio and Parsley (2007), who show the impact of the geographic proximity of company headquarters to a politician's home town, this paper constructs an additional dummy variable that takes a value of one if the Republicans win the majority of the

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<sup>13</sup> The correlation between board connections to a party and its donations to that party is positive with a coefficient of 0.07, but fails to be significant. This implies that connections of board members and donations do not necessarily go hand in hand.

presidential votes in the state in which a company is headquartered and a value of zero otherwise. This variable is interacted with the Republican board dummy variable to test whether there is an effect for companies that are connected to the Republicans and located in a Republican state.

The results in Models 4 to 10 show that all but one of the dummy variables are significant at least at the 5% level. While companies with board connections to the Republicans experience a significantly positive abnormal post-election return (Model 4), companies with board connections to the Democrats suffer a significant drop in value (Model 6). These returns are also economically significant. Companies with board connections to the Republicans experience nearly a 3% increase in value, while companies with board connections to the Democrats experience nearly a 3% drop in value. Model 5 shows that there is no additional effect for companies with Republican board connections from having their headquarters in a Republican state. The coefficient for the interaction variable is positive, but fails to be significant. The insights from Models 4 and 6 still hold when both variables are included simultaneously (Model 7) and when the two donation dummy variables are included in Models 8 to 10. The results for the two donation dummy variables show that the coefficient for donations to the Republicans is positive and significant, while the coefficient for donations to Democrats is negative, but not significant. This might be due to the fewer number of companies donating more to the Democrats than to the Republicans and in particular the even fewer number of those companies with a clear donation tendency to the Democrats.

The results so far suggest that political connections affect company value in the post-election period. An alternative explanation for this evidence could be motivated by the findings in Knight (2006) who points out that each party follows certain policies that will have differing effects on the outlook of certain industries. As two examples, a reform of the health care system may benefit or hurt the pharmaceutical industry, while a specific foreign policy may benefit or hurt the defense industry. Thus, a company may be affected by these general policies merely due to the fact that it is in a specific industry and not due to its political connections. To address this issue, the next specification controls for the return in the industry in which the company operates.

Table 5 reports the results for the case in which the return for each company in the S&P500 index is adjusted by the equally-weighted return of its industry. The industry classification of each company is defined by the Fama-French 30 industries.<sup>14</sup> The explanatory variables are identical to those in Table 4. The results in Table 5 show that all the board connection variables of interest that are significant with market-adjusted returns are still significant with industry-adjusted returns. In particular, neither the categorical variables in Models 1 to 3 lose their significance nor do the dummy variables for board connections in Models 4, 6, and 7. In fact, the coefficients for the variables that characterize a company's board connections are significant again at least at the 5% level. In contrast, the dummy variables for donations in Models 9 and 10 become insignificant under this specification. This suggests that while the donation variable may likely represent an (endogenous) industry effect, our measure of political connections based on the board data does not. Namely, our measure of connections remains significant even after controlling for these industry effects.

In total, the results in Tables 4 and 5 provide evidence that the political connections of companies' board members have a significant impact on their post-election stock returns. This result holds even after controlling for other important firm characteristics and in particular the industry reaction to the election outcome.

### ***3.3. Nomination of politically connected board members***

An additional approach to test for the impact of politically connected board members is to analyze the abnormal returns following the announcements of their nominations. The underlying economic model is one in which there is a limited supply of individuals with political connections that are both *willing* and *able* to use their political connections for the purpose of helping the company. Therefore, there is uncertainty in the market about which of the competing companies that value these connections will be able to obtain this scarce resource. While the announcement by a company that it was able to

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<sup>14</sup> As mentioned in footnote 5, the analysis is repeated for alternative Fama-French industry specifications with no material impact on the results.

attract a politically connected individual might be somewhat anticipated by the market, the actual announcement return reflects the resolution of any remaining uncertainty that had existed with respect to which of the group of competing companies was actually able to get hold of this valuable resource of limited supply.<sup>15</sup>

Our primary objective then is to test whether political connections are valuable by analyzing the announcement return surrounding the nominations. Furthermore, it is possible to use the announcement returns to analyze the secondary question whether some connections are more valuable than others. The magnitude of the announcement return can be used as a measure of the importance of the new connection. For example, one can ask whether connections to the legislator or the administration are more important than other connections, whether a politician's connections weaken over time, or whether connections to the administration (legislator) matter more during a time when the former politician's party is in control of the administration (legislator).

For some of these secondary questions it is important to obtain more details about what drives the timing of nominations. Namely, are they mostly driven by supply (i.e., politicians join boards once they leave their political position) or are they mostly driven by demand (i.e., politicians are added to the board at a time when they are most valuable to the corporation)?

Table 6 provides descriptive statistics of the time-trend in nominations over the presidential and legislative cycles. In particular, it considers when and under which majorities nominations occur. The table illustrates several points. First, it shows that nominations are not evenly distributed over the four-year political cycle, but rather that most of them occur in a year following a presidential or a midterm election. More than a third of the observations occur in the first year of a presidential cycle and more than 63% of the nominations occur in the year following a presidential or midterm election. Thus companies tend to hire political directors at the beginning of either a presidential or a congressional cycle.<sup>16</sup> While

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<sup>15</sup> It is important to note that institutional constraints on the financial compensation of corporate boards prevent politically connected board members from capturing the entire surplus of their appointments, thereby increasing the value of the nominating company.

<sup>16</sup> We thank the referee for bringing this point to our attention.

not reported in the table, directors nominated in the first year of a presidential cycle tend to have been out of their political office for a much shorter time relative to all others.

Second, Table 6 shows that nominations of Republican (Democratic) board members are equally likely to occur under Republican and Democratic Presidents, but are much more likely to occur in times of Democratic (Republican) control of house and senate. For example, under Republican senate majority 118 out of 202 nominations are of Republican board members, representing 58% of the total. However, under Democratic senate majority 115 out of 147 nominations are of Republican board members, representing 78% of the total. Thus, a higher percent of Republicans are nominated during a period of Democratic majority.

The numbers above suggest that nominations are driven more by supply than by demand. Demand-driven nominations would imply more Republican (Democratic) nominations under Republican (Democratic) regimes, while supply-driven nominations would potentially imply the opposite because the supply of former Republicans (Democrats) is higher when Democrats (Republicans) win the majority.<sup>17</sup>

To summarize, our main hypothesis is that having a politically connected board member is valuable to a company and, hence, we expect that the company's stock price should increase when the nomination of this board member is announced. As for our secondary group of tests, they are aimed at determining whether or not some connections are more valuable than others. Alternatively, given that these politicians serve on the boards for long stretches of time, it may be the case that all connections are valuable as there are many ways in which a former politician can help a company.

The analysis in Table 7 focuses on the sample of connected board members found in S&P 500 companies in the years 1996 and 2000. As described before, these board members are nominated for a total of 349 positions in companies for which stock market data are available and for which the nominations do not coincide with other price-relevant announcements. The first row of Table 7 shows that

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<sup>17</sup> As a further illustration of this point, we see that in each of the sample years that follow a year in which the presidential power changes, i.e. 1981, 1993, and 2001, the overwhelming majority of nominated board members come from the losing party. In 1981, the year following the Republican win of the Presidential Election, 6 out of 7 nominees are affiliated with the Democrats. In 1993, the sample year with the highest number of board nominations, 33 of the 37 total nominations are of Republicans. This year follows the Republican loss of the presidency (congress and house remain Democratic). Finally, in 2001, after the Republican win in the Presidential Election, 12 out of 17 nominations are of Democrats.

the announcement effect of the nomination of politically connected board members is positive and statistically significant in the equally-weighted and in the value-weighted averages. The two-day abnormal announcement return amounts to 0.69% in the equally-weighted and to 1.20% in the value-weighted average. Furthermore, as the first sub-classification in Panel a) of Table 7 shows, returns are significantly positive for board members with connections to either the Republican or the Democratic Party in both the equally-weighted and value-weighted average. Thus, the value impact is not unique to a connection to either of the two parties.

These results are particularly noteworthy as the previous literature has shown that announcements of the nomination of independent board members are associated with returns that are indistinguishable from zero. While the significantly positive returns for our sample of independent board members who are connected to either of the two parties are indicative of the value of political connections, it is important to consider additional explanations for the results at hand. To see whether some political connections matter more than others, nominations are further categorized into several sub-groups. As will be seen below, the overall results from these sub-classifications indicate that *all* political connections seem to matter regardless of the circumstances under which they are achieved.

As the second sub-classification, we form two groups based on a nominee's specific former political career. Consistent with the classification in Table 3, a politically connected board member is classified into the first group if she was a senator, a member of the house, or a member of the administration; otherwise she is classified into the second group. The results in Panel b) of Table 7 suggest that there is no statistical difference between the announcement returns of the two groups in the equal weighted average but a statistically significant difference in the value weighted average. This suggests the possibility that former Senators and Congressmen add more value to the larger companies relative to others. Third, announcements are separated based on whether they refer to a director's 1<sup>st</sup> and 2<sup>nd</sup> or subsequent nominations. The question is whether politically connected board members are particularly valuable for the first companies whose board they join as they are less likely to have worn out their welcome in the political circles at that point. While the announcement returns are positive and

significant for both groups, the magnitude of the impact for the 1<sup>st</sup> and 2<sup>nd</sup> nomination is much greater than that for subsequent nominations in the value-weighted average. This again suggests that, for the larger companies, the director has a greater impact in the early nominations, and this impact may decrease as the director joins more companies.

Fourth, the nominations of former politicians with positions within the administration are divided based on whether or not a director's political party holds the control of the presidency at the time of the announcement. The idea is that a former politician who worked for a previous administration is more likely to be connected to the current administration given that it is of the same party. The results for this sub-classification are shown in Panel d) of the table. They indicate that former administration politicians are indeed more valuable when the current administration is from the same party.

As a flip side to this last test, nominations are sorted by whether a director is nominated at a time in which his or her party holds the majority in either the senate or the house. While the results are positive for each sub-group, they tend to be higher for nominations that occur when the *other* party holds the majority. This result would be surprising if presidency and the legislator majority were both held by the same party. However, note that during the sample period between 1981 and 2005, there are only five years in which the ruling presidential party also holds the majority of the house and senate. The results here are therefore necessarily highly negatively correlated with the results presented in Panel d) and are thus hard to interpret.

Finally, motivated by Agrawal and Knoeber (2001) we divide the sample into nominating companies in regulated and non-regulated companies. We find that the announcement returns tend to be higher in regulated relative to non-regulated industries, but the difference fails to be significant. We obtain a similar result when classifying companies based on total government shipments within the industry, again according to the measure used by Agrawal and Knoeber (2001).

One alternative explanation for our results is that the observed positive stock price reactions might not only be due to the fact that a board member is politically connected, but also to her expertise. As an example, a senator who serves in the Finance committee during her political tenure may learn about

general trends including risks and challenges in the finance industry, and this knowledge might be of highest importance to companies that operate in banking or insurance. The positive announcement effect in this case would thus be partly due to her expertise as well as to her being politically connected. While it might be hard to differentiate between expertise in a specific field and general political connection in each given case, it is still possible to distinguish between related and not related politically connected board members. Thus, in the last classification, Panel h) of Table 7 reports the results for the announcement returns for both groups of board members. The results suggest that the nomination of both related (defined as a political director who served in a committee, department, or government agency that deals with the industry in which the nominating company operates) and not related board members generates positive and significant abnormal returns. At the same time, the abnormal returns for related board members are higher than those for not related board members. This result suggests that expertise and knowledge are valuable, but that the pure existence of political connections independent of their content also generates abnormal positive returns.

As a final robustness check for these results one still needs to show that other independent directors nominated to the same companies do not generate a similar abnormal return. For this purpose, we compare the announcement returns of the nomination of politically connected board members to those of nominations of other board members in the same company at a similar point in time. The matching sample is constructed in the following way. For each announcement in a company in the original sample, we chose the closest possible announcement of the nomination of another board member in the same company who is not politically connected. Those announcements are identified by a search in LexisNexis. To ensure time consistency, the matching announcement has to occur in a maximum interval of  $[-3, 3]$  years around the day of the announcement in the original sample. This procedure yields 319 announcements in the matching sample.

The results in Panel a) of Table 8 show that the announcements in the matched sample do not result in positive stock returns. While they are not statistically different from zero in the equally-weighted average, they are even negative and significant in the value-weighted average. The lack of a positive price



reaction in the matched sample is thus consistent with the results in the previous literature. Most importantly, the returns for the original sample are significantly higher than for the matched sample, and this holds for both the equally-weighted and value-weighted average.

To guarantee the highest level of comparability of the results, in the next step announcements of CEOs and internal promotions (e.g. CFOs) are excluded from the matching sample, as these may cause different stock price reactions than those for outside board members. This procedure generates a sub-sample of 287 announcements. The results are reported in Panel b) of Table 8 and show that the announcement returns in the matched sample are still not significantly positive, albeit not significantly negative any more in the value-weighted average. Again and most importantly, the difference in returns between the original and the matched sample is positive and highly significant. Finally, 28 more observations are dropped in which multiple board members are announced on the same day. The results, shown in Panel c) of Table 8, are qualitatively the same as before.<sup>18</sup>

Overall, for all sub-classifications we find a positive abnormal return following the nomination of a politically connected board member. In particular, the results suggest that while expertise matters, the pure existence of a political connection generates positive and significant abnormal returns. This is consistent with the findings for the post-election stock returns and suggests that the results in this paper are driven by political connections independent of their specific nature.

### ***3.4. Further tests and robustness***

Apart from the empirical tests discussed above, a number of further analyses and robustness tests are performed. These tests are described below.

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<sup>18</sup> Using the announcements of politically connected directors and the matching sample of non-political directors, we run multivariate regressions in which we control for size and the book-to-market ratio as well as for the characteristics described in Table 7. The main result from this analysis is that what matters for the abnormal announcement return is whether or not you are a politician, rather than any sub-classification of the characteristics of the appointment (i.e. who is nominated, at which point in time etc.)

### **3.4.1. Choice of event window**

To test for the robustness of the event window, the analyses are repeated for different events around the election. First, the 2000 Presidential Election gave Governor Bush only a disputed and tiny lead of votes, ranging from 300 to about 1,800 throughout the period of uncertainty with a final margin of 537 votes. As a consequence, the election was finally decided only on December 13, 2000 after the Federal Court's decision to halt the manual recount of ballots in Florida and the subsequent concession by Vice President Gore. Between the election and the final decision, there are a number of exogenous events as for example court decisions that increase or decrease the probability of a Republican win. These exogenous events provide a unique laboratory in which the value of political connections can be tested. Two events deserve particular attention: First, on December 8, the Florida Supreme Court orders a state-wide recount of ballots in counties with under-votes, thereby increasing the chances for the Democrats to win the election. Second, on December 13, Mr. Gore accepts Mr. Bush as the President in a public speech, thereby resolving the uncertainty about the election outcome. The event study for politically connected board members in Table 3 is repeated for these two events. While the value-weighted portfolio of companies with pure connections to the Democrats provides a one-day positive return of 1.45% on December 8, the respective Republican portfolio provides a negative return of -1.26%. In contrast, the return for the Republican portfolio on December 13 amounts to 0.32%, while the return for the Democratic portfolio amounts to -1.63%. The differences in returns between the Democratic and the Republican portfolio on both December 8 and December 13 are statistically significant at the 1% level. In general, the correlation between the daily abnormal returns of the Democratic and the Republican portfolio in the time period between November 8 and December 20 is highly negative with a coefficient of -0.46, which is significant at the 1% level. This provides further evidence for the value impact of political connections, independent of the choice of the specific event window. Overall, the uncertainty around the 2000 Presidential Election is expected to aggravate any attempt to find evidence for the impact of political connections on stock returns. The fact that the results in this paper are substantial and

significant despite the existing uncertainty on the final election outcome, stresses even more the importance of political connections for firm value.

Second, the analyses are repeated using November 7 as the start date for the event period. This choice is motivated by the fact that even though the first election results were announced only after the end of trading on the Election Day, November 7, it is possible that the stock market already incorporates information arriving during the Election Day. The results are qualitatively the same as the results for the event period starting on November 8.

### **3.4.2. Industry clustering**

While Table 5 controls for industry effects, it is still important to consider whether there is a concentration of politically connected companies in certain industries and in particular a concentration of Republican/Democratic companies in certain industries. The analysis of the distribution of the sample companies across the Fama-French 30 industries shows that Republican/Democratic companies based on board connections are relatively evenly distributed across all of these industries. There are two exceptions to this in the Utilities industry, which has 9% of the sample companies, and Banking, Insurance, Real Estate and Trading industry, which includes 15% of the sample.<sup>19</sup> However, both industries have almost the same number of Republican firms as Democratic firms (6 republican and 8 democrats in Utilities and 10 and 9 in Banking, respectively). More formally, a chi-square test of the difference in the industry distribution between Republican and Democratic companies fails to be significant ( $p$ -value = 0.40). Thus, there appears to be no industry bias or clustering in the distribution of Republican and Democratic companies.

Finally, as mentioned before, the industry analysis is repeated for alternative Fama-French industry classifications, yielding the same results. In addition, we control for some specific industries that

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<sup>19</sup> This finding is similar to that of Agrawal and Knoeber (2001) who conduct a more elaborate test of the industry distribution of political directors.

might have larger political biases such as the oil industry, the defense industry, and utilities. Again, the results remain unchanged.

### **3.4.3. Weighing of observations**

The analysis of the announcement returns in Table 7 gives equal weight to each announcement of a nomination. This means that an individual with many board nominations will appear more often in the data set than an individual with only a few board nominations. To rule out the possibility that the announcement returns are driven by those board members with many nominations, the analysis is repeated by giving equal weight to each individual. This means that first the average announcement return is computed for each individual, and then the average is taken across individuals. The results are positive and economically and statistically significant. The average announcement return in this approach amounts to 0.78% for the two-day window around the announcement and is significant at the 1% level. Further analyses are conducted for the same sub-groups as in Table 7, and the results are qualitatively the same as before. This suggests that the significantly positive announcement returns represent a general phenomenon across politically connected board members and are not driven by a small number of individuals.

## **4. Conclusion**

This paper shows that political connections have a pervasive impact on the value of public companies even within the confine of the strong legal system in the U.S. The paper sorts companies into those that are connected to the Republican Party and those that are connected to the Democratic Party and analyzes the value of these connections by looking at two events: the 2000 Presidential Election and the nomination of politically connected directors to the board.

Using a measure of connections based on hand-collected data of the political background of all directors on the boards of S&P500 companies in the year 2000, the paper derives the following two main results: First, following the announcement of the Republican win, the return difference between

companies classified as having a Republican board and those classified as having a Democratic board is positive. Furthermore, the announcement returns are positive for the Republican portfolio and negative for the Democratic portfolio. These results remain robust after controlling for several firm characteristics as well as for industry effects.

Second, following the announcement of the board nomination of a politically connected individual, there is on average a positive and significant stock price response. This positive announcement effect is more pronounced for the larger companies in the sample but holds for Republican directors as well as for Democratic directors. It is independent of the specific nature of the political position held.

In conclusion, the evidence presented in this paper regarding the value of political connections opens a number of interesting avenues for future research. In particular, it will be interesting to explore the specific actions that create this value and their legal and political ramifications.

## Chapter II. Political Connections and the Allocation of Procurement Contracts

### 1. Introduction

A growing body of recent research finds that political connections add value to the corporation. Studies such as Roberts (1990), Fisman (2001), Faccio (2006), and Goldman, Rocholl, and So (2007) use stock market data to demonstrate that the value of politically connected companies is affected by changes in the political landscape. However, while these studies point to the value of having political connections, they remain silent about the exact source of this value.

The present study attempts to shed light on this issue by analyzing the allocation of government procurement contracts across the largest U.S. publicly traded companies. Government procurement contracts total more than 3.1 trillion dollars over the sample period between 1990 and 2004, and thus the allocation of these contracts is perhaps the most direct way in which political connections may influence company values.<sup>20</sup>

The following quote from the Wall Street Journal features an anecdotal story that highlights the general question that is analyzed in this study.

*“The tale of Bajagua's success in getting the contract involves, among other things, well-timed campaign contributions to local members of Congress and other political figures. The firm also enlisted people with crucial connections...”*

*WSJ January 29, 2007.*

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<sup>20</sup> Studies by Khwaja and Mian (2005) and Faccio, Masulis, and McConnell (2006) also study how politicians generate firm value. These studies, discussed below, look at companies in countries in which there is a high level of corruption and focus on the impact of politicians on a company's loans.

If, as suggested by the quote above, connections influence contract awards, then companies that are connected to a political party will receive more government contracts during periods in which that political party has greater control relative to periods in which that party has less control. In contrast, during the same time, companies that are connected to the opposing party will receive fewer contracts.

To provide a specific example, consider the case of two companies in the S&P500 that receive government procurement contracts during the 1990s. The two companies, Phillips Petroleum and Occidental Petroleum, are both in the Petroleum and Natural Gas industry (based on the Fama-French industry classification). Phillips Petroleum has several former Republicans on its board of directors and no former Democrats while Occidental Petroleum has several former Democrats on its board and no former Republicans (see Table 9 for a detailed description of these companies and their politically connected board members). For example, Phillips Petroleum has on its board James Edwards who was the Energy Secretary under President Reagan between 1981 and 1982. Occidental Petroleum has on its board Albert Gore who was a Tennessee Senator with the Democratic Party until 1971. For our study, Phillips Petroleum is defined as a Republican company and Occidental Petroleum as a Democratic company.

What happens then to the government contracts that these companies receive once there is a change in the political landscape? In this example, we focus on the 1994 midterm election in which control of the House and Senate changes from the Democratic to the Republican Party. As our analysis indicates, both companies experience big changes in their government contracts around this time. Phillips Petroleum's government procurement contracts increase from a total of \$120 million during the 1990 to 1993 period to a total of \$289.3 million in the period between 1995 and 1998. In contrast, Occidental Petroleum experiences a decrease in contracts from \$169.5 million during the 1990 to 1993 period to \$143.7 million in the period between 1995 and 1998. Thus, while both companies operate in the same industry and have seemingly similar characteristics, the company with a Republican (Democratic) board experiences an increase (decrease) in its government contracts following the 1994 midterm election. This anecdotal case study demonstrates what we analyze more rigorously in the remainder of the paper.

More generally, the paper focuses on a sample of all companies that are in the S&P500 in the years 1994 and 2000. The choice of 1994 and 2000 as the two focal points is based on the fact that there is a shift in political control in both the 1994 midterm election and the 2000 presidential election. The 1994 midterm election results in a shift of control in both the House and the Senate from being majority controlled by Democrats to being majority controlled by Republicans. The 2000 presidential election results in a shift of control of the presidency from Democratic to Republican. These changes imply that the influence over the allocation of procurement contracts is likely to switch from the Democrats to the Republicans.<sup>21</sup>

For each company, the study first identifies the political party to which the company is connected, as measured by the political background of the individuals on the board of directors.

The study then calculates the change in the value of each company's procurement contracts surrounding the 1994 and the 2000 election. Specifically, companies in the S&P500 in 1994 and in 2000 are classified into one of the following three categories: (1) Those that are connected to the Republicans, (2) those that are connected to the Democrats, and (3) others.<sup>22</sup> The classification of political connections is based on hand-collected data detailing the past political positions held by each of the board members of S&P500 companies in 1994 and 2000. A company is classified as being Republican (Democratic) if it has at least one director with a past political position with the Republicans (Democrats) and if the company has no other director with any past political position with the Democrats (Republicans).

Given the above classification, for each company in the 1994 sample (2000 sample) we compare the total value of procurement contracts that it receives between 1990 and 1993 (1996 and 1999) with the total value of these contracts that it receives between 1995 and 1998 (2001 and 2004). The procurement contracts that are considered include all contracts awarded to the company itself and to any of its subsidiaries.

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<sup>21</sup> See below for a more elaborate discussion of how procurement contracts are awarded.

<sup>22</sup> Others include companies without any political connection and companies with political connections to both parties.



The main findings for the 1994 sample are that companies connected to the Republicans are more likely to experience an increase in the value of their procurement contracts following the 1994 change in the political landscape. The paper also finds that companies connected to the Democrats are more likely to experience a decrease in the value of their procurement contracts following the 1994 change. These results are both economically and statistically significant and remain significant after controlling for several company characteristics such as size, book-to-market ratio, and capital expenditure.

The results for the 2000 sample are qualitatively the same as for the 1994 sample. In this case, again, companies that are connected to the Republicans are more likely to experience an increase in contracts while companies that are connected to the Democrats are more likely to experience a decrease in contracts following the 2000 presidential election. The only difference in the results here is that the decrease in contracts of the Democratic companies is not statistically significant.<sup>23</sup>

The paper addresses several interpretations of the results. First, one might ask whether companies that are defined as Republican simply have preferences that are naturally aligned with the Republican agenda and, therefore, also receive more contracts when Republicans are in power. This argument especially has merit on an industry level as Republicans tend to favor certain industries while Democrats tend to favor others (e.g. oil companies likely have a preference for the Republican agenda). Thus, it may be the case that Republican boards serve in companies that are in a particular industry that stands to benefit from a win of the Republican Party due to its specific political platform and regardless of whether or not the company itself is politically connected. To deal with this issue the analysis is repeated after controlling directly for an industry effect with industry dummies in general as well as with dummies for those specific industries in which there is a larger concentration of politically connected companies. The results remain unaffected by these controls. Furthermore, a direct test of the distribution of Democratic and Republican companies across the Fama-French 30 industries (see Figure 1 and Table 18)

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<sup>23</sup> In the empirical specification Republican companies are compared to all S&P 500 companies and Democrat companies are compared to all S&P500 companies. A simpler analysis comparing Republican companies to Democrat companies yields even stronger and more pronounced results.

suggests that the two distributions are not statistically different from each other. Thus, political board members represent connections rather than industry-level preferences.<sup>24</sup>

Second, companies that might have agendas that correlate with a given party are likely to donate to the political campaign of that party. Thus, we control for political donations and find that donations cannot explain contract awards but board affiliations remain significant. This provides further evidence that board affiliations represent connections rather than company preferences.

A third issue related to the above point is whether the results are due to the fact that Republican companies are on a different trajectory than Democratic companies. To address this issue the analysis is repeated after controlling for each company's past sales growth (as well as past growth in procurement contracts and past growth in company size). Controlling for these trends does not affect any of the results.

A more general approach that captures any possible unobserved difference in trends between Republican and Democrat companies is to conduct a placebo test whereby we use a year in which there is no political change, 1997, as the event year. If indeed Republican and Democrat companies are on different trajectories and our results do not come from the change in the political landscape then we should also find that Republican companies obtain more contracts following 1997 and Democratic companies obtain less contract following that year. However, when we repeat our tests around the 1997 event year we find that the change in contracts to Republican companies and to Democrat companies is not statistically different from each other and from other S&P500 companies. Thus, the results are due to the specific change in the political landscape.

One final observation is with respect to whether companies hire political board members right before they are about to receive government contracts. The data suggest that this is not the case. In our sample, politically connected directors are nominated on average more than 5 years before either election.<sup>26</sup>

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<sup>24</sup> The fact that board connections do not represent industry preferences has also been established in Goldman Rocholl and So (2007) who show that post election stock returns of companies connected to the winning (losing) party go up (down) above those of their industry.

<sup>26</sup> A detailed description of the time trend of board nominations for our sample is provided in Section 2.4.

The present study focuses on individual connections of the board as a form of obtaining government access. Past studies in the political science literature have argued that companies use political donations in much the same way (see literature review below). Hence, our analysis is repeated after controlling for political donations. In particular, we classify all companies based on their political donations into those that donate more to Republicans, those that donate more to Democrats, and those that do not donate. Controlling for this classification we find that whether you donate more to Republicans or to Democrats does not explain changes in contract awards but that the political classification of the board of directors still remains significant as before. This result is consistent with the findings of Ansolabehere, de Figueiredo, and Snyder (2003), Aggarwal, Meschke, and Wang (2007) and Goldman, Rocholl, and So (2007) who argue that donations do not grant companies access to political power. Furthermore, Goldman, Rocholl, and So (2007) show specifically that post election stock returns of companies that donate more to the winning (losing) party are positive (negative) but not significantly higher (lower) than their industry's returns. This suggests that companies that donate more to Republicans (Democrats) are in industries that stand to benefit from a Republican (Democrat) regime. They also find that the correlation between board affiliation to a party and donation to that party is only 6%.

Lobbying activity, of course, can also impact contract awards. However, as we do not have access to such data we cannot test for its importance. If anything this might add noise to our empirical specification and make it harder for us to obtain the above results.

In sum, the paper shows that companies that are connected to the winning party experience an increase in their contracts upon a change in control of the House and Senate or upon a change in control of the administration, while those connected to the losing party suffer a decrease in their procurement contracts following these changes. The results remain significant after controlling for the industry of the company as well as for other company characteristics. The paper thus highlights one crucial way in which political connections can have a direct influence on company value.

Note that we do not argue whether or not these findings are a result of corruption or whether they are the result of companies benefiting from natural social connections. We merely wish to point out in this paper that connections to the winning (losing) party lead to a statistical increase (decrease) in contracts.

The process by which politicians can influence the awarding of contracts to specific companies is by its nature not a transparent one. For this reason, our paper looks at both an event in which the political power changes within the legislative branch and an event in which the political power changes within the administration.

From a formal standpoint, the process of awarding government contracts begins when an agency of the federal government identifies a need for a purchase of a good or service. Each agency has a contracting officer who posts a solicitation on the Federal Business Opportunities website. Companies then submit their offers for review by agency personnel who evaluate the alternative offers and make the final decision.<sup>27</sup>

In practice, there are many ways in which connected companies can influence the design and award of contracts. For example, according to the Federal Acquisition Regulation (FAR), the government encourages bidding companies to interact with government agencies prior to the agency putting out its Request For Proposal (RFP). The purpose of this is to help the government in defining its needs. This, however, allows connected companies to help shape the RFP and thus increase the chances that they would win the contract. In addition to this, contractors can approach different Congressional Committees with requests to increase funding for goods and services that they provide. Finally, lawmakers often write letters of recommendations on behalf of contractors (albeit for the most part generic ones).<sup>28</sup> Thus, as both legislators and administration officials have some capacity to influence contract awards, the goal of this paper is to see whether or not there is empirical evidence that connected companies benefit in this dimension.

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<sup>27</sup> For more details on this process see Halchin (2006).

<sup>28</sup> See Palmer (2005).

The situation in which companies may succeed in influencing the allocation of government contracts is one example of the more general case in which an interest group may use non-market interactions to achieve certain goals (see Baron, 1999).

Political scientists have mostly focused on how political donations and lobbying activity influence the government. For example, Snyder (1990) shows both theoretically and empirically that political donations are a form of investment. In particular, he shows that politicians with a higher probability of winning receive more donations. More recent work by Ansolabehere, de Figueirido, and Snyder (2003) (see also references therein) suggest that patterns of political donations are not consistent with an investment that aims to gain a financial return but rather reflect a mechanism through which donating groups express their political preferences. Consistent with this view, Ansolabehere, Snyder, and Ueda (2004), Aggrawal, Meschke, and Wang (2007), and Goldman, Rocholl, and So (2007) all find that political donations do not benefit shareholders.<sup>29</sup> Stratmann (2005) provides a summary of the literature which relates donations to indirect measures of firm value such as the probability of passing a favorable congressional vote.

Although much research has focused on political donations, Groseclose, Milyo, and Primo (2000) argue that companies' expenditures on lobbying activities far outweigh their soft money or PAC contributions. Thus, it would seem more likely that companies attempt to influence the government via their lobbying activity rather than through their donations. Work by Wright (1990), Goldberg and Maggi (1999), de Figueiredo and Silverman (2002), and Drope and Hansen (2004), to name a few, all find evidence that is consistent with lobbying activity being a powerful tool used to influence the transfer of government resources to various industry groups.<sup>30</sup>

We add to this literature by focusing on company-level connections rather than industry-level ones. Furthermore, unlike most of the above work we explore the direct monetary reward that accrues to

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<sup>29</sup> One notable exception are Gulen, Cooper, and Ovtchinnikov (2007) who show that the number of individuals the company donates to can impact long term stock returns.

<sup>30</sup> See also the theoretical work of Grossman and Helpman (1994) that models the optimal lobbying behavior of interest groups.

the company (somewhat similar to De Figueiredo and Silverman 2002 who show this in the context of universities lobbying).

Perhaps more closely related to our work is the growing literature that demonstrates the importance of political connections for companies. As mentioned earlier, Roberts (1990), Fisman (2001), Faccio (2006), Jayachandran (2006), and Goldman, Rocholl, and So (2007) all use event studies to demonstrate that the change in the strength of the political connection of a company (either due to a company event or a market-wide political event) is followed by a corresponding change in the company's stock price.<sup>31</sup>

Establishing political connections for the purpose of receiving favorable government treatment can be viewed (in the extreme case) as one form of corruption. Several authors analyzed the theoretical causes and consequences of corruption. For example, Shleifer and Vishny (1993) show how corruption affects government resource allocation and economic development. Banerjee (1997) argues that it is optimal to define an activity as being corrupt (illegal) in cases where the government has a role in solving a market failure. Ades and Di Tella (1999) analyze the incentive to engage in corrupt activity as a function of the competitiveness of the bribing firm's market and the magnitude of the resulting industry rents. Finally, Acemoglu and Verdier (2000) demonstrate that corruption can arise as part of the second best equilibrium exactly in those markets in which the government attempts to intervene and solve socially inefficient market failures.

Most closely related to this paper are studies by Khwaja and Mian (2005) and Faccio, Masulis, and McConnell (2006) who show several direct ways in which companies benefit from having political connections.<sup>32</sup> In particular, Khwaja and Mian (2005) demonstrate that companies in Pakistan with political connections receive more loans and default on these loans at a much higher rate relative to non-

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<sup>31</sup> Fisman, Fisman, Galef, and Khurana (2007) demonstrate that this is not the case for companies that are connected to Vice President Dick Cheney. Kroszner and Stratmann (1988) provide indirect evidence that politics matter in the US by looking at the competition among interest groups and how they donate to political institutions.

<sup>32</sup> Shleifer and Vishny (1994) analyze theoretically the opposite case in which politicians use their connections to a company in order to further their political objectives while Bertrand, Kramarz, Schoar, and Thesmar (2006) show empirically that politically connected companies can help their politicians.

connected companies, suggesting that these loans are granted based on political considerations. Similarly, Faccio, Masulis, and McConnell (2006) look at a cross-country sample of bankrupt companies that are politically connected and show that these companies are much more likely to get bailed out. While our study complements the above two papers, it differs from them in two key ways. First, this study focuses on the value created by political connections in the U.S. which is a country with a strong legal system and relatively low levels of corruption. Second, our study considers a different and perhaps more direct source of political rents: government contracts.

Finally, Karpoff, Lee, and Vendrzyk (1999) provide evidence on the treatment of companies who receive government defense procurement contracts and then commit fraud in an attempt to deceive the government. They show that the penalty incurred by these companies is much less severe if the company is in the group of the top 100 government contractors. While their paper suggests that having large government contracts provides the company with preferential treatment, our paper finds that the source of the preferential treatment might be the company's board connections which result in large contracts.

The rest of the paper is organized as follow. In Section 2 we describe the data in more detail and specify the empirical methodology. In Section 3 we highlight the key findings of the paper and discuss their interpretation. Section 4 describes several robustness tests. Section 5 concludes.

## **2. Data description**

The analyses in this paper utilize two event periods and two types of data. The first event period spans the time around the 1994 midterm election, while the second event period covers the time around the 2000 presidential election. The first data set comprises information on all U.S. government procurement contracts in the sample period between 1990 and 2004. The second data set consists of original data containing information regarding the political affiliation of each board member of all companies in the S&P500 at the end of 1994 and at the end of 2000. Both data sets are described in more detail below. In addition, we hand-collect information regarding the subsidiaries of all S&P500 companies in 1994 and 2000 and obtain CRSP and COMPUSTAT data as well as Fama-French industry

classification data. Finally, the SDC Platinum database by Thompson Financial is used for checking merger and acquisition activities or divestitures by S&P500 companies in the sample period.

### ***2.1. Procurement data***

Procurement contract data on the company level are available from the Federal Procurement Data System – Next Generation (FPDS-NG).<sup>33</sup> The FPDS-NG, which is operated and maintained by Global Computer Enterprises, replaced the Federal Procurement Data Center (FPDC).<sup>34</sup> The FPDS-NG contains all procurement contracts that are awarded by the U.S. Government and that exceed an individual transaction value of \$2,500.<sup>35</sup> The largest exceptions to this reporting requirement are the U.S. Postal Service and several legislative and judicial branch organizations.<sup>36</sup> FPDS-NG reports procurement contracts for each company that is a separate legal entity, independent of the ultimate owner of that company. This means that procurement contracts for subsidiaries of companies are not aggregated on the parent company level, which aggravates the use of these data for the purpose of academic research. The exact matching procedure used in this paper is described in detail in sections 2.2. and 2.3.

Table 10 shows the aggregate value and number of procurement contracts over the sample period between 1990 and 2004. The yearly value increases substantially over the sample period from \$158 billion in 1990 to \$351 billion in 2004. In particular, it increases greatly after 2001 as a result of the increased spending following the events of September 11, 2001. Similarly, the number of procurement contracts increases from 371,514 in 1990 to 2,843,212 in 2004. The total number of procurement contracts in the sample period exceeds 11.5 million and the aggregate value is more than \$3.1 trillion.

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<sup>33</sup> A "procurement contract" is any of a number of documented legal interactions between the government and a contractor including a "contract award" (the basic terms and conditions of the contract including the goods and services to be provided), a "modification" (which may be an exercise of an option to modify the contract), or an "order" (for example an order against a government-wide contract).

<sup>34</sup> FPDC, implemented under Public Law 93-400, provides data for Congress, the Executive branch, the private sector, and the public. FPDC was a part of the U.S. General Services Administration and operated and maintained the original Federal Procurement Data System. FPDS-NG is the central repository of statistical information on federal contracting.

<sup>35</sup> The reporting threshold for individual transactions was \$25,000 before 2004.

<sup>36</sup> US Census Bureau reports total procurement amount annually in the Consolidated Federal Funds Report (CFFR) but no detailed data on the company level are available. The total procurement amount in FPDS-NG covers more than 85% of the total amount in CFFR over the sample period.



Table 10 also shows which departments award the major share of these procurement contracts. The defense department is by far the largest contractor with an average share of 65% of the awarded value, followed by the Energy Department with an average share of 10% and NASA with an average share of 5%. Note that defense-related spending is broadly defined and can include contracts with many non-defense companies such as IBM and Compaq. Other departments comprise the remaining 20% share. The figures in Table 10 suggest that the share of the Defense Department is relatively stable over time, with a maximum of 68.9% in 2004 and a minimum of 58.8% in 1993; this is the year when NASA is awarded its highest relative share in any of the sample years.

## ***2.2. Subsidiary data***

Many companies receive a substantial share of their procurement contracts through their subsidiaries. As an example, Halliburton receives aggregate procurement contracts of \$7 million in 1998, while its subsidiary KBR receives procurement contracts of \$43 million in the same year. For this reason, we collect information on all subsidiaries of S&P500 companies from Exhibit 21 (Subsidiaries of the Registrant) of their annual 10-K reports. These are available in the EDGAR database of the SEC. S&P 500 companies and their subsidiaries are then matched with the list of companies in the FPDS-NG database.<sup>37</sup> The procurement contracts of S&P500 companies and their subsidiaries are finally summed up to obtain the aggregate value of procurement contracts for each company in the S&P500 and for each year over the sample period.

## ***2.3. Resulting sample***

This procedure results in a total sample of 411 S&P500 companies that receive procurement contracts in the period between 1990 and 1998 and a total of 412 companies that receive procurement contracts in the period between 1996 and 2004. For the first event period, 17 of the 411 companies have

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<sup>37</sup> The procurement data used in this paper are based on the September 2006 status of FPDS-NG.

procurement contracts of less than one million dollars in aggregate throughout the 1990-1998 period and are therefore excluded from the sample. Furthermore, a number of companies are involved in substantial merger and acquisition activities or divestitures over the sample period. To ensure consistency and comparability of the procurement contracts of these companies over time, their procurement contracts are adjusted in the following way. First, 22 companies in the S&P500 are acquired by other companies in the S&P500 during the sample period. In this case, the procurement contracts of the target company are added to those of the acquiring company before the merger and are thus comparable to the procurement contracts of the combined entity after the merger.<sup>38</sup> Second, 45 companies in the S&P500 are acquired by non-S&P500 companies and are thus excluded from the sample. Third, over the sample period 8 S&P500 companies sell units or divisions in which the transaction value exceeds one billion dollars. To ensure the comparability of the awarded government contracts, these companies are excluded as well. The final sample for the first event period thus consists of 319 companies.

For the second event period, the same criteria are applied. Out of the 412 sample companies, 47 are excluded as they are awarded procurement contracts of less than one million dollar in the event period. Another 12 companies merge with other S&P500 companies, and thus the procurement contracts of these target companies are added to those of the acquiring companies. An additional 15 companies are further excluded; 8 companies merge with non-S&P500 companies, and 7 companies sell units or divisions with a transaction value of more than one billion dollars. After excluding these companies, the final sample results in a total of 338 companies.

#### ***2.4. Board data***

Board connections are derived by considering the composition of the board of directors at the end of 1994 and 2000 of all S&P500 companies with procurement contracts and analyzing the background of each board member. Section 14 of the Securities and Exchange Commission (SEC) Act requires

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<sup>38</sup> For these companies, the accounting variables such as sales, assets, EBITD, capital expenditure, and book-to-market ratio are adjusted in the same way.

companies to file a definite proxy statement (submission type Def 14a), containing information about their board members. These filings, which are hand-collected from the EDGAR database of the SEC, contain a brief description of each board member's career background. Based on these data, it is possible to identify whether board members are connected to the Republicans, to the Democrats, or to neither. A board member is defined as being politically connected if he or she at any time prior to 1994 and 2000, respectively, held a position such as Senator, Member of the House of Representatives, Member of the Administration, or was a Director of an organization such as the CIA, SEC, or FDA. A full list of these positions is provided in Table 11.

Panel a) of Table 11 shows the descriptive statistics for the 319 sample companies used in the analysis of the 1994 midterm election. According to the definition used in this paper, 79 of the 319 companies are connected to the Republican Party as they have at least one board member with a former political position with the Republicans, but no board member with a former position with the Democratic Party. Similarly, 36 companies are defined as being connected to the Democratic Party as they have at least one board member connected to the Democrats, but no board member connected to the Republicans. The remaining 204 companies are connected either to both parties (30 companies) or to neither (174 companies). Note that the expectation is that companies connected to both parties should not exhibit any change in contracts. This is true as long as the strength of their connection to one party is the same as the strength of their connection to the other. While a separate analysis of these companies is interesting in principle, the fact that some have strong connections to one party and weak connections to the other implies that a further classification of this group does not generate any conclusive statistical results. The descriptive statistics in Panel a) show that, on average, companies that are connected to the Republicans tend to be larger than those that are connected to the Democrats.

Panel b) of Table 11 presents the descriptive statistics for the 338 sample companies used in the analysis of the 2000 presidential election. While 54 companies are connected only to the Republicans, 35 companies are connected only to the Democrats. The remaining 249 sample companies are either connected to both parties (23 companies) or to neither (226 companies). Panel b) also confirms the

evidence from Panel a) that companies that are connected to the Republicans tend to be larger than companies that are connected to the Democrats.

As mentioned earlier the industry distribution of Republican and Democratic firms is relatively evenly distributed (see Figure 1) in both years and this suggests that there is no major concern about Republican or Democrat companies representing industry preferences that are correlated with the agenda of one of the two parties. A more formal chi-square test finds that the two distributions are not statistically different from each other (p-values of 0.9 for 1994 and 0.6 for 2000).

Finally, while not reported in the table there are only 5 companies that switch from being connected to one party in 1994 to another party in 2000. Thus, political connections seem to be long-term connections.

Table 12 provides descriptive statistics of the timing of nominations. Panel a) of Table 12 shows that former politicians are hired long before either of the events studied. On average, these directors are on the board more than five years before the elections. Panel b) of Table 12 describes the timing of nominations relative to the presidential and legislative cycles. In particular, the table shows several key points. First, most of the nominations occur in a year following a presidential or a midterm election. More than 60% of the nominations (230 out of 371) occur in the year following a presidential or midterm election. Second, while the number of nominations of Republican (Democratic) board members is nearly the same under Republican or Democratic Presidents, Republicans (Democrats) are much more likely to be nominated in times of Democratic (Republican) control of house and senate. For example, under Republican senate majority 69 out of 134 nominations are of Republican board members, representing 52% of the total. However, under Democratic senate majority 175 out of 237 nominations are of Republican board members, representing 74% of the total. Thus, a higher percent of Republicans are nominated during a period of Democratic majority.

The numbers above suggest that nominations are driven more by supply than by demand. Demand-driven nominations would imply more Republican (Democratic) nominations under Republican (Democratic) regimes, while supply-driven nominations would potentially imply the opposite because the

supply of former Republicans (Democrats) is higher when Democrats (Republicans) win the majority. Thus, it would seem that politicians do not get hired when they are most valuable (right at the beginning of their party's rule) but rather when they become available. This is consistent with a situation in which there is a limited supply of politicians who companies view as both *able* and *willing* to use their connections for the benefit of a specific company.

Table 13 reports the value of the procurement contracts for the sample companies for the two event periods. The figures in the left column of Panel a) show that S&P500 companies receive procurement contracts totaling more than \$475 billion between 1990 and 1998. This represents a substantial share of the \$1,552 billion of total procurement contracts in FPDS-NG over that period. The highest share of the contracts goes to Republican companies even though there are only 79 Republican companies as compared to 204 companies classified as others.

The column on the right hand side of the table reports average numbers. These figures suggest that the mean value of procurement contracts to Republican companies is substantially higher than that to Democratic companies, which is itself higher than that for the rest of the companies. The average value of procurement contracts for the three groups over the sample period amounts to \$3,771 million, \$882 million, and \$716 million, respectively. These figures suggest the existence of a positive correlation between the political connections of a company and the value of its government procurement contracts.

While the average value of procurement contracts in the pre-election period between 1990 and 1993 is about \$589 million, it increases to \$732 million in the post-election period between 1995 and 1998. However, there is a remarkable difference between Republican and Democratic companies. While the average Republican company experiences an increase of \$504 million in procurement contracts, the average Democratic company suffers a decrease of \$75 million. Other companies see an average increase of \$42 million.

Panel b) of Table 13 presents the statistics for the second event period between 1996 and 2004. The numbers exhibit similar patterns as in Panel a). The highest value of procurement contracts is awarded again to Republican companies. They receive on average \$3,908 million over the sample period.

While companies with Republican boards receive on average \$1,495 million worth of procurement contracts between 1996 and 1999, this number increases by 35.0% to \$2,018 million between 2001 and 2004. This growth rate is much higher than the 10.9% growth rate for Democratic companies. A seemingly surprising result can be found for the third group, which comprises the companies that are connected either to both parties or to neither. These companies experience the largest average increase of 58.1% in their procurement contracts.

A further examination of this group shows that this last figure is almost entirely due to three companies, which are connected to both parties: Boeing, Northrop Grumman, and Raytheon. They receive more than \$280 billion worth of procurement contracts between 1996 and 2004. Excluding these companies from the third group leads to a decrease in the value of procurement contracts from \$518 billion to \$236 billion and a drop in the growth rate from 58.1% to 20.7%. This last growth rate is substantially lower than the growth rate for Republican companies. The fact that a small number of companies may have a substantial impact on the overall averages is of crucial importance in the design and specification of an appropriate empirical test. This will be described in the next section.

Overall, these figures provide the first piece of evidence suggesting that political connections of companies may influence how procurement contracts are allocated.

### **3. Empirical Results**

The purpose of the empirical analysis is to determine whether the political connections of the board influence the value of procurement contracts that companies receive a) before and after the change in majority in House and Senate following the 1994 midterm election and b) before and after the change in Presidency following the 2000 presidential election. The analysis proceeds in two steps. First, we show univariate results. Second, we present multivariate analyses that control for other variables.

### 3.1. Univariate Results

The two variables of interest are the change in the value of procurement contracts a) between the four-year period before and the four-year period after the 1994 midterm election and b) between the four-year period before and the four-year period after the 2000 presidential election. To minimize the impact of outliers in a specific year and to take into account the long-term nature of public procurement contracts, the procurement contracts for each sample company are aggregated over the two four-year periods and then compared to each other. The first variable of interest, the change in the value of the sum of procurement contracts between the two periods around the 1994 midterm election, is defined as

$$\Delta = \sum_{i=1}^n \left( \sum_{t=1995}^{1998} C_{i,t} - \sum_{t=1990}^{1993} C_{i,t} \right)$$

where  $C_{i,t}$  represents the dollar value of procurement contracts for company  $i$  in year  $t$ .<sup>39</sup>

Equivalently, the second variable of interest for the two periods around the 2000 presidential election is defined as

$$\Delta = \sum_{i=1}^n \left( \sum_{t=2001}^{2004} C_{i,t} - \sum_{t=1996}^{1999} C_{i,t} \right)$$

As mentioned earlier, this variable turns out to have an uneven distribution across the sample companies with some extreme negative and positive values. As an example, the highest negative difference for the first event period is found for Perkin Elmer, which loses \$6.6 billion in government procurement contracts; the highest positive difference is found for Lockheed Martin, which gains \$29.2 billion in these contracts. More formally, we test whether the two variables of interest are normally distributed using the Shapiro-Wilk and the Shapiro-Francia test. The tests reject this null hypothesis at the 1% level for either of the sample periods. The variables exhibit significant levels of skewness and kurtosis which need to be taken into account in the design of the empirical specification. To deal with these extreme values in the univariate statistics, the sample is thus divided into five groups with the same

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<sup>39</sup> Note that the election year is not included in the calculation of the dependent variable to eliminate any potential abnormal behavior in an election year.

number of companies in each group. Companies are sorted into these five groups based on the value of  $\Delta C_i$ . For example, Group 1 comprises those companies with the lowest  $\Delta C_i$  implying that companies in this group have experienced the lowest increase or the highest decrease in the value of their contracts.

Panel a) of Table 14 shows that for the 1994 event the average difference for the companies in Group 1 is indeed negative, i.e. they receive less procurement contracts after the midterm election relative to before the election. As Panel a) further indicates, the same is true for Group 2 although here the difference is obviously less negative than that for the first group. Group 3 contains those companies that do not experience a major change in the value of their procurement contracts in the pre- and post-election period. Finally, companies in Group 4 and Group 5 receive substantially more procurement contracts after the election than before the election.

Panel a) also shows the distribution of Republican and Democratic companies across the five groups. The number of Democratic companies almost monotonically decreases from 12 in the first group to 4 in the fifth group. This suggests that Democratic companies are overrepresented among those companies that lose procurement contracts. By contrast, the highest number of Republican companies can be found in the highest group while the lowest number can be found in the second-lowest group. This suggests that Republican companies are overrepresented among those companies that receive more government procurement contracts following the election.

Panel b) of Table 14 shows the respective figures for the 2000 event period. In line with the results for the first event period, the average difference is negative for companies in Group 1 and Group 2, it becomes slightly positive for companies in Group 3, and it is substantially positive for companies in Group 4 and in particular in Group 5. While there are slightly more Democratic than Republican companies in Group 1 and Group 2, the number of Republican companies significantly outweighs the number of Democratic companies in Group 4 and Group 5. This means that Republican companies are also overrepresented among those companies that gain procurement contracts after the 2000 presidential election.



In the following section, we consider the statistical significance of these changes when controlling for other company and industry characteristics.

### 3.2. Multivariate results

The previous section documents that the change in procurement contracts before and after the 1994 (2000) midterm election (presidential election) has a non-normal distribution with some extreme negative and positive outliers. For the multivariate analysis of the impact of political connections on the value of procurement contracts, the dependent variable is thus defined as the log of the change in the sum of procurement contracts between the two periods around the 1994 midterm election:

$$\ln \Delta C_i = \begin{cases} \ln\left(\sum_{t=1995}^{1998} C_{i,t} - \sum_{t=1990}^{1993} C_{i,t}\right) & \text{if } (\ ) > 0 \\ -\ln\left[-\left(\sum_{t=1995}^{1998} C_{i,t} - \sum_{t=1990}^{1993} C_{i,t}\right)\right] & \text{if } (\ ) < 0 \end{cases}$$

The equivalent variable for the change in procurement contracts around the 2000 presidential election is defined as:

$$\ln \Delta C_i = \begin{cases} \ln\left(\sum_{t=2001}^{2004} C_{i,t} - \sum_{t=1996}^{1999} C_{i,t}\right) & \text{if } (\ ) > 0 \\ -\ln\left[-\left(\sum_{t=2001}^{2004} C_{i,t} - \sum_{t=1996}^{1999} C_{i,t}\right)\right] & \text{if } (\ ) < 0 \end{cases}$$

While this choice of the dependent variable better addresses the uneven distribution of the raw variable, it maintains its cardinality. In the robustness section, we report results for a different specification of the dependent variable. There, we use an ordered logit model in which the dependent variable is an ordinal variable that takes a value of 1 to 5 based on a company's classification into one of

the five  $\Delta C_i$  groups for the respective event period. As the robustness section will show, the results are qualitatively the same for the two dependent variables.

The independent variables of interest are two dummy variables:  $dRep$  takes a value of one if a company has at least one board member connected to the Republicans, but no board member connected to the Democrats and a value of zero otherwise;  $dDem$  takes a value of one if a company has at least one board member connected to the Democrats, but no board member connected to the Republicans and a value of zero otherwise.

In addition, the paper uses a number of control variables. The first variable is  $\ln Cap$ , which captures the log of the size of the company.<sup>40</sup> The second variable,  $BM$ , represents the company's book-to-market ratio. The Herfindahl index is included in order to take into account the intensity of competition in the industry in which the company operates. This index is calculated based on the sales of all competitors with the same 2-digit SIC code. In order to control for the investment level, the profitability, and the cost structure of the company, three accounting variables are included as further independent variables. The first accounting variable is the ratio of capital expenditure to sales, which controls for the possibility that a company that has recently invested in its facilities is expected to subsequently increase its production. The second variable is the ratio of EBITD to assets, which takes into account the possibility that a government agency may award procurement contracts to healthy companies that can be expected to survive in the long-run. The third accounting variable is the ratio of cost of goods sold to sales, which is important to consider as cost-efficient producers are more likely to be awarded with procurement contracts. Finally, to control for the possibility that Republican and Democratic are simply on different growth trajectories, we control for the growth in sales in the two-year period before the election.<sup>41</sup> More formally, we use variations of the following empirical specification:

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<sup>40</sup> In the robustness section, we control for more flexible functional forms of size.

<sup>41</sup> Alternatively, we control for the growth in firm size and in procurement contracts in the two-year period before the election. The results, which are available upon request, do not change.

$$\begin{aligned} \ln \Delta C_i = & \alpha + \beta_1(\ln Cap)_i + \beta_2(BM)_i + \beta_3(HF\_index)_i + \beta_4(CAPEX / Sales)_i + \\ & + \beta_5(EBITD / Assets)_i + \beta_6(CostGood / Sales)_i + \beta_7(SalesGrowth)_i + \\ & + \beta_8(dRep)_i + \beta_9(dDem)_i + \varepsilon_i \end{aligned}$$

where  $\ln \Delta C_i$  is the log of the change in the sum of procurement contracts between the two periods before and after the 1994 (2000) midterm (presidential) election.

Table 15 reports the results of the cross-sectional analysis for the 1994 midterm election. Model 1 and Model 2 include the Republican and Democratic dummy variable, respectively, as well as the first three control variables. The coefficient for the Republican dummy variable is positive and significant at the 1% level, while the coefficient for the Democratic dummy variable is negative and significant at the 5% level. This suggests that Republican companies are more likely to experience an increase in government contracts in the post-election period, while Democratic companies are more likely to experience a decrease in government contracts in this period. Model 3 includes both political dummy variables at the same time showing that they remain significant, although the Democratic dummy variable is now significant at the 10% level.<sup>42</sup>

Model 4 also includes the second and third accounting ratio, EBITD to assets and cost of goods sold to sales, respectively. While neither of these variables proves to be significant, the two variables of interest remain significant at their previous levels. The same holds for Model 5, which also includes the growth in sales as an additional control variable. The coefficient for this control variable is significant at the 5% level and thus suggests that companies that are on a growth trajectory before the election increase their government procurement awards after the election. The more important result for the purpose of this study is that the Republican and Democratic dummy variables remain significant even after controlling for the pre-election sales growth.

The coefficient for the Herfindahl index is positive and significant throughout the different models. This suggests that the lower is the level of competition in the industry in which a company

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<sup>42</sup> Note that these two variables are negatively correlated with a correlation coefficient of -0.2046 (p-value = 0.0002) such that the significance of the coefficients decreases.

operates the more likely the company is to gain more government contracts. Thus, it is easier for a company to gain market shares for government contracts in a less competitive industry.

In Models 6 to 8, interaction variables are included to test for the heterogeneity in the types of political connections. We concentrate here on companies with connections to the Republican Party as the winning party in the 1994 election and define three interaction variables. The first interaction variable considers companies in which the Republican board member had a political career in the defense sector; this includes all the former Republican politicians who worked for the department of defense. The second interaction variable focuses on companies in which the Republican board member was a congressman or senator. This is particularly important for the 1994 midterm election. Finally, the third interaction variable deals with companies that are headquartered in a state with a Republican majority in the 1994 senate election. The results show that none of these interaction variables proves to be significant and that the Republican dummy variable remains significant in each specification. This suggests that it is only important to have a political connection, independent of the exact nature of this political connection.

In addition to controlling for the variables described above, it is also important to rule out the possibility that Republican and Democratic companies happen to be in certain industries that benefit from an increase or suffer from a decrease in government spending. In this case, the observed pattern would not be due to a company's political affiliation, but simply due to the industry in which it operates. As discussed previously, the industry distribution of Republican companies is not statistically different from the industry distribution of Democratic companies.

To address the industry impact more rigorously, the estimations in Model 9 and Model 10 include industry controls as additional explanatory variables. In Model 9, dummy variables are included for each of the industries in the Fama-French 30-industry classification.<sup>43</sup> In Model 10, dummy variables are included for companies only in those industries in which Republican companies appear to be overrepresented in 1994 based on the Fama-French 30-industry classification shown in Figure 1: 1 (Food Products), 8 (Healthcare, Medical Equipment, Pharmaceutical Products), 19 (Petroleum and Natural Gas),

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<sup>43</sup> To be precise, 29 dummy variables are included in order to avoid redundancy.

20 (Utilities), 24 (Business Supplies and Shipping Containers), and 29 (Banking, Insurance, Real Estate, Trading). Only in these industries there are at least five companies that are connected to the Republicans. The results in Model 9 and Model 10 show that the earlier findings remain true even after controlling for an industry effect. The coefficients for the Republican and Democratic dummy variables are again significant at the 10% and 5% level, respectively. This suggests that the results for the 1994 midterm election are not driven by the change in government spending in the specific industry that happens to comprise companies with a particular political preference.

Finally, in model 11 we include controls for the political donations made by each company. Specifically, we add two dummy variables *dDonDem* and *dDonRep*. The first variable gets the value of 1 if the company donates more to Democrats than to Republicans and zero otherwise. The second variable is defined similarly. Model 11 shows that donations do not have any impact on contract awards while board affiliations remain as before.

Thus, the inclusion of control variables does not change the main statement that Republican companies are more likely to increase the value of their procurement contracts after the 1994 midterm election, while Democratic companies are more likely to lose contracts.

Table 16 reports the results for the estimation for the second event period, which captures the time before and after the 2000 presidential election. The explanatory variables are the same variables as in Table 15. The only exception is the interaction variable in Model 7, which differs from that in Model 7 in Table 15 as it takes into account Republican board members with a former career in the government, reflecting the nature of the 2000 election as a presidential election. The results suggest that Republican companies significantly increase their government procurement contracts after the election. The coefficient for the Republican dummy variable is significant for each specification, almost always at least at the 5% level. At the same time, the coefficient for the Democratic companies, while negative, fails to be statistically significant.

Using the same methodology as for the analysis in Table 15, Model 9 and Model 10 in Table 16 comprise industry controls for the event of the 2000 presidential election. In Model 9, dummy variables

are again included for each of the industries in the Fama-French 30-industry classification. In Model 10, dummy variables are again included for companies only in those industries in which Republican companies appear to be overrepresented in 2000 based on the Fama-French 30-industry-classification. As shown in Figure 1, these are the same six industries in 2000 as in 1994. Only in these six industries there are at least four companies that are connected to the Republicans in 2000. The results show that the Republican dummy variable is significant even at the 1% level in both specifications, while the Democratic dummy variable is negative, but fails to be significant. These results suggest, consistent with the results for the 1994 midterm election, that the observed effect is not driven by specific industries.

Overall, the empirical results suggest that companies that are connected to the Republican Party benefit from the Republican win in the 1994 midterm election as well as the Republican win in the 2000 presidential election. They receive more government contracts following the two respective elections. By contrast, companies connected to the Democratic Party lose government contracts after the elections. These results are robust to a number of control factors that capture both company- and industry-specific characteristics. In particular, the results are robust to industry controls and seem to be driven by political affiliations rather than changes in procurement contracts across industries.

#### **4. Further tests and robustness**

This section presents a number of robustness tests that are described in more detail below.

##### ***4.1. Choice of the dependent variable***

The dependent variable in the multivariate estimations is the log of the change in the sum of procurement contracts between the two periods before and after the 1994 (2000) midterm (presidential) election. The choice of this dependent variable addresses the issue of the existence of extreme negative and positive outliers in the raw variable, while maintaining the cardinality of the observations. An alternative estimation technique is to transfer the cardinal into an ordinal variable. For robustness, the multivariate estimations are rerun as ordered logit models where the dependent variable is now a number

between 1 and 5 depending on which of the five  $\Delta C_i$  groups the company falls in to. This ordinal classification is the same one used in the univariate tests in section 3.1. The rest of the control variables are exactly the same variables as before.

The results of this estimation, which are available upon request, are the same as before. The Republican dummy variable is positive and significant for both the 1994 and 2000 election, while the Democratic dummy variable is negative for both elections, but significant only for the 1994 election. Thus, the results are robust to a different specification of the dependent variable.

#### *4.2. Type of companies and different trajectories*

In the empirical estimations, we control for various company-specific factors to address the possibility that the observed differences in changes in procurement contracts between Republican and Democratic companies might not be due to their political connections, but rather due to the fact that these firms are different from each other and on potentially different trajectories. We perform additional tests to rule out this possibility.

First, we allow for more flexible functional forms of size. While we control for the size of the company in our estimations, it might be that only certain size groups benefit or suffer from a change in procurement contracts. Therefore, we create size quintiles (deciles) for our sample companies and include dummies for these quintiles (deciles). The results, which are available upon request, do not materially change. The sign and significance of the political dummy variables remains the same, which suggests that the results hold true also for more flexible forms of size.

Second, to address the possibility that Republican companies experience an increase in procurement contracts and Democratic companies experience a decrease in procurement contracts over the sample period irrespective of the two political events, we create an artificial placebo event that is unaffected by any election. We choose the year 1997 as the placebo event, which covers a 3-year period before and after with no change in the political landscape. If the documented results were simply due to

different trajectories for Republican and Democratic companies, the coefficients for both parties should be significant not only for the 1994 or 2000 event, but also for the 1997 placebo event. The results of the estimation for this event, are reported in Table 17. These results show that neither the coefficient for the Republican nor the one for the Democratic companies proves to be significant. Thus, it is not the time trend that generates the results but rather the specific political changes occurring in the election years.<sup>44</sup>

#### ***4.3. Different types of political connections***

There are several other ways in which a company may become politically connected, e.g. through indirect ways such as lobbyists and consultants, or through other direct ways such as donations. As mentioned in the introduction, existing studies provide at best mixed evidence on whether donations help companies in becoming politically connected. Furthermore, even if they do, Jayachandran (2006) raises the question whether donations have a causal effect on firm value or simply represent industry preferences. Consistent with the latter, Goldman, Rocholl, and So (2007) show that donations lose their explanatory power once the industry effect is taken into account. For a robustness test, we collect donation data, for the 1994 and 2000 elections, from the Center for Responsive Politics (CRP), a non-partisan research organization that collects information on corporate donations to the Republican and Democratic Party. We then construct a dummy variable that takes a value of one if a party assigns more than 50% of its donations to the Republican Party and a value of zero otherwise. This variable is included in the estimation along with the board connection variable. The results, which can be seen in model 11 of tables 15 and 16 show that the donation variables are not significant, while the board connections variables remains significant. As a further robustness test we create a continuous donation variable which records for each company the percentage amount donated to Republicans out of the total political donations made by that company. The results, available upon request, remain the same.

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<sup>44</sup> The third potential way to address the issue of different trajectories would be to consider only those companies that are Republican (Democratic) in 1994 and Democratic (Republican) in 2000. However, as mentioned before, the whole sample only comprises 5 companies that fit these criteria.



#### ***4.4. First event period***

One last point is that the period before the 1994 election comprises two different presidencies: a Republican presidency until 1992 and a Democratic Presidency after 1992. However, this setting imposes an even higher hurdle to find any evidence for the political influence on the allocation of procurement contracts. For robustness we repeat the analysis using the years 1993 and 1994 as the pre-period and the years 1995 to 1998 as the post-period. As the two periods do not have the same duration, we use as the dependent variable the log of the change in the average annual amount in contracts between the period from 1993 to 1994 and the period from 1995 to 1998. The results on the Republican and Democratic dummy variables remain as before.

### **5. Conclusion**

As government intervention in economic activity can result in a significant reallocation of resources, some companies have the incentive to become politically connected. In previous studies, these connections have been shown to result in an increase in shareholder value as measured by changes in company stock prices around political events.

This paper takes a first step in disentangling the source of this value by identifying one direct way in which political connections affect the value of the largest U.S. publicly traded companies. Based on the analysis of the individuals who serve on the board of directors of all S&P500 companies, the paper classifies these companies into those that are connected to the Democrats and those that are connected to the Republicans. The paper asks whether political connections affect the allocation of procurement contracts awarded to these companies following the 1994 midterm election in which majority control in House and Senate shifts from the Democratic to the Republican Party and following the 2000 presidential election in which the Presidency shifts from the Democratic to the Republican Party.

The main findings are that following the 1994 midterm election and the 2000 presidential election Republican companies are more likely to experience an increase in the total value of their procurement contracts while Democratic companies are more likely to experience a respective decrease. These results

remain statistically significant after controlling for company characteristics as well as for the industry in which the company operates.

The results suggest that, even within the confine of the strong legal system of the U.S., political connections have a significant impact on the allocation of government resources.

**Table 1: Board connections**

Table 1 presents descriptive statistics of the S&P 500 companies in the year 2000 sorted based on the political connections of their board members. The reported values for Market Cap, Sales, Assets, and P/E Ratio are measured as of the end of 1999. This information is (partly) missing for seven companies. A company is classified as politically connected if it has at least one board member with the following former position: President (Gerald R. Ford), Presidential (Vice-Presidential) Candidate, Senator, Member of the House of Representatives, (Assistant) Secretary, Deputy Secretary, Deputy Assistant Secretary, Under Secretary, Associate Director, Governor, Director (CIA, FEMA), Deputy Director (CIA, OMB), Commissioner (IRS, NRC, SSA, CRC, FDA, SEC), Representative to the United Nations, Ambassador, Mayor, Staff (White House, President, Presidential campaign), Chairman of the Party Caucus, Chairman or Staff of the Presidential Election campaign, and Chairman or member of the President's Committee/Council. A company is classified as Pure Rep (Pure Dem) if it has only Republican (Democratic) affiliated board members.

	Independent companies		Connected companies		Pure Rep companies		Pure Dem companies	
	Mean	Median	Mean	Median	Mean	Median	Mean	Median
Market Cap (in \$ Million)	20,894	7,246	32,028	10,201	31,270	10,693	21,621	7,784
Sales (in \$ Million)	9,014	4,534	15,308	8,640	13,931	8,520	14,267	6,103
Assets (in \$ Million)	23,545	6,140	37,137	13,077	21,747	12,079	49,792	15,149
P/E Ratio	35.6	19.8	33.0	19.6	38.1	22.2	24.5	14.9
Number of Companies	340	340	153	153	78	78	47	47
Tenure of politically connected board members (years)	NA	NA	5.48	5.5	6.07	6.5	3.32	3.5

**Table 2: Donations**

Table 2 presents descriptive statistics for the sample of donating companies. The reported values for Market Cap, Sales, Assets, and P/E Ratio are measured as of the end of 1999. Donation data are provided by the Center for Responsive Politics (CRP) and are based on information furnished by the Federal Election Commission regarding political contributions to the two parties that exceed \$200. These contributions come from Political Action Committees (PACs), soft money donors, and individuals in the 1999-2000 election cycle. For each election cycle, the CRP defines 80 industries and provides information on the 20 largest contributors in each of these industries. A company is included in the sample if it belongs to these contributors, it is publicly listed, and its total donations exceed \$100,000.

	Population	Sample companies	
<b><i>a) Donations</i></b>			
Total Donations (in \$1,000)	1,634,288	245,695	
Republicans (in \$1,000)	896,520	157,502	
in % of Total Donations	54.9	64.1	
Democrats (in \$1,000)	722,256	87,764	
in % of Total Donations	44.2	35.7	
Number of Companies		315	
<b><i>b) Company characteristics</i></b>			
		Mean	Median
Market Cap (in \$ Million)		31,478	7,671
Sales (in \$ Million)		13,516	6,288
Assets (in \$ Million)		38,038	9,375
P/E Ratio		28.5	16.5
Number of Companies		315	315

**Table 3: Post-Election CARs of S&P500 companies with board connections**

Each company in the S&P 500 index in the year 2000 is classified based on the political connection of members of its board of directors. The information about the board of directors is taken from Def 14a filings from the EDGAR database of the Securities and Exchange Commission (SEC). A company is classified as Pure Rep (Pure Dem) if it has only Republican (Democratic) affiliated board members. A company is classified as related (not related) if it has at least one (no) board member who served in a committee, department, or government agency that deals with the industry in which the nominating company operates. A company is classified as Senate/House, Administration if it has at least one board member that served as a senator, member of the House, or member of the administration; it is classified as Others if it has at least one board member that served in any other political position and no board member that served in Senate/House or Administration. All abnormal returns are adjusted by the CRSP value-weighted index. The cumulative abnormal returns (CARs) of the value-weighted portfolio are weighted by the value of each company, and the CARs of the equally-weighted portfolio are equally weighted across the companies. The estimation period is from day 300 to day 46 before the 2000 Presidential Election Day, while the test period is from 1 day until 7 days after the Election Day. All company returns and index returns are taken from the CRSP files. Unless indicated otherwise, t-values are in parentheses. Symbols \$, \* and \*\* denote statistical significance at the 10%, 5% and 1% level, respectively.

Connection type	Number of companies	Equally-weighted CAR(%)				Value-weighted CAR(%)			
		(+1,+2)	(+1,+3)	(+1,+5)	(+1,+7)	(+1,+2)	(+1,+3)	(+1,+5)	(+1,+7)
<i>a) Exclusivity of Connection</i>									
Pure Rep (A)	78	2.80 (6.16**)	4.69 (8.69**)	3.46 (4.81**)	5.31 (6.16**)	3.10 (7.00**)	4.22 (8.12**)	3.63 (4.93**)	4.94 (5.73**)
Pure Dem (B)	47	-0.41 (0.28)	0.06 (1.42)	-0.51 (0.39)	0.31 (1.45)	-3.99 (6.00**)	-4.87 (5.70**)	-5.34 (5.11**)	-4.36 (3.02**)
Difference (A-B) (t-value)		3.21 (2.56**)	4.63 (6.71**)	3.97 (2.94**)	5.00 (4.49**)	7.09 (9.34**)	9.09 (9.79**)	8.97 (7.29**)	9.30 (6.00**)
<i>b) Relatedness of Republican firm</i>									
Related (C)	34	3.54 (5.08**)	6.10 (7.33**)	5.12 (4.49**)	7.02 (5.26**)	3.49 (4.57**)	4.52 (5.04**)	6.05 (4.62**)	7.00 (4.57**)
Not related (D)	44	2.22 (3.74**)	3.60 (5.13**)	2.18 (2.46*)	4.00 (3.58**)	2.87 (5.29**)	4.04 (6.32**)	2.21 (2.78**)	3.72 (3.78**)
Difference (C-D) (t-value)		1.32 (1.47)	2.50 (2.34**)	2.94 (2.09*)	3.02 (1.77\$)	0.62 (0.69)	0.48 (0.45)	3.84 (2.66**)	3.28 (1.90\$)
<i>c) Former Career of connected board of Republican firm</i>									
Senate/House, Administration(E)	44	2.79 (4.50**)	4.41 (6.14**)	3.05 (3.23**)	5.22 (4.64**)	3.21 (5.10**)	4.52 (6.19**)	2.97 (3.14**)	5.14 (4.53**)
Others (F)	23	2.84 (3.30**)	5.30 (4.96**)	3.89 (2.73**)	5.82 (3.31**)	2.97 (3.78**)	4.79 (4.89**)	3.27 (2.44*)	5.14 (3.19**)
Difference (E-F) (t-value)		-0.05 (-0.05)	-0.89 (-0.72)	-0.84 (-0.51)	-0.60 (-0.30)	0.24 (0.23)	-0.27 (-0.22)	-0.30 (-0.19)	0.00 (0.00)

**Table 4: Cross-sectional analysis of Post-Election CARs adjusted by the market index**

The sample comprises all S&P 500 companies in the year 2000. The dependent variable is the CAR adjusted by the CRSP value-weighted market index in a period of (+1,+3) days following the 2000 Presidential Election on Nov. 7, 2000. lnCap is the log of the company's market capitalization at the end of 1999. Book to Market is the ratio of book value of equity and market value of equity at the end of 1999. Market-adjusted past return is the average market-adjusted returns for each company during the 3rd quarter of 2000. The variable Board Rep-Dem is a dummy variable that takes a value of one if a company is politically connected to the Republicans, a value of minus one if a company is politically connected to the Democrats and a value of zero otherwise. The variable Donations Rep-Dem is a dummy variable that takes a value of one if a company donates more to the Republicans than to the Democrats, a value of minus one if a company donates more to the Democrats than to the Republicans, and a value of zero otherwise. All models are adjusted for heteroskedasticity. The t-values are in parentheses. The symbols \$, \* and \*\* denote statistical significance at the 10%, 5% and 1% levels, respectively.

<b>Model</b>	<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>	<b>7</b>	<b>8</b>	<b>9</b>	<b>10</b>
Constant	3.715 (1.47)	5.649 (2.19*)	5.369 (2.15*)	3.992 (1.57)	2.588 (1.02)	3.712 (1.44)	3.840 (1.53)	6.371 (2.52*)	3.458 (1.35)	6.261 (2.37*)
lnCap	-0.361 (1.39)	-0.570 (2.15*)	-0.568 (2.21*)	-0.416 (1.59)	-0.276 (1.05)	-0.312 (1.19)	-0.381 (1.48)	-0.691 (2.60*)	-0.336 (1.26)	-0.678 (2.40*)
Book to Market	4.118 (4.11**)	3.089 (3.04**)	3.528 (3.47**)	3.898 (3.95**)	4.272 (4.20**)	3.981 (3.94**)	4.115 (4.14**)	3.324 (3.29**)	4.174 (4.18**)	3.347 (3.30**)
Market-adjusted past return	0.133 (3.15**)	0.131 (3.06**)	0.128 (3.01**)	0.128 (3.01**)	0.121 (2.77**)	0.143 (3.33**)	0.133 (3.11**)	0.125 (2.90**)	0.135 (3.14**)	0.125 (2.90**)
Board Rep-Dem	2.101 (3.68**)		1.992 (3.47**)							
Donations Rep-Dem		1.745 (3.63**)	1.626 (3.43**)							
= 1 if Republican Board				2.977 (4.51**)	2.353 (2.94**)		2.710 (4.07**)	2.443 (3.63**)	2.668 (4.02**)	2.443 (3.63**)
= 1 if Republican Board in Republican State					1.810 (1.46)					
= 1 if Democratic Board						-2.853 (2.53**)	-2.375 (2.10*)	-2.353 (2.08*)	-2.358 (2.08*)	-2.350 (2.08*)
= 1 if donates > 50% to Republicans								1.937 (3.30**)		1.908 (3.10**)
= 1 if donates > 50% to Democrats									-1.278 (1.14)	-0.243 (0.21)
R-squared	0.1200	0.1139	0.1381	0.1218	0.1210	0.1099	0.1333	0.1507	0.1349	0.1508
Number of Observations	493	493	493	493	493	493	493	493	493	493

**Table 5: Cross-sectional analysis of Post-Election CARs adjusted by Fama-French 30 industry returns**

The sample comprises all S&P 500 companies in the year 2000. Each company is sorted into one of the 30 industries according to Fama-French. The dependent variable is the CAR adjusted by the equally-weighted industry return of the Fama-French 30 industries and calculated over a period (+1,+3) days following the 2000 Presidential Election on Nov. 7, 2000. The explanatory variables are the same as in Table 4. All models are adjusted for heteroskedasticity. The t-values are in parentheses. The symbols \$, \* and \*\* denote statistical significance at the 10%, 5% and 1% levels, respectively.

Model	1	2	3	4	5	6	7	8	9	10
Constant	1.562 (0.70)	2.578 (1.14)	2.298 (1.06)	1.801 (0.80)	1.723 (0.77)	1.560 (0.69)	1.656 (0.75)	2.786 (1.26)	1.503 (0.66)	12.764 (1.20)
lnCap	-0.253 (1.10)	-0.351 (1.51)	-0.345 (1.53)	-0.296 (1.27)	-0.286 (1.23)	-0.211 (0.91)	-0.263 (1.15)	-0.401 (1.74)	-0.244 (1.04)	-0.398 (1.63)
Book to Market	1.767 (2.04*)	1.119 (1.27)	1.503 (1.72\$)	1.569 (1.80\$)	1.548 (1.78\$)	1.675 (1.92\$)	1.776 (2.05*)	1.423 (1.62)	1.800 (2.08*)	1.427 (1.62)
Market-adjusted past return	0.035 (0.96)	0.037 (0.97)	0.033 (0.89)	0.031 (0.85)	0.027 (0.74)	0.044 (1.17)	0.036 (0.98)	0.033 (0.87)	0.037 (0.99)	0.033 (0.87)
Board Rep-Dem	1.845 (3.69**)		1.786 (3.54**)							
Donations Rep-Dem		0.851 (1.99*)	0.723 (1.72\$)							
=1 if Republican Board				2.288 (3.73**)	1.507 (2.09*)		2.035 (3.28**)	1.916 (3.07**)	2.026 (3.26**)	1.916 (3.07**)
= 1 if Republican Board in Republican State					2.253 (2.04*)					
= 1 if Democratic Board						-2.617 (2.79**)	-2.259 (2.39*)	-2.249 (2.37*)	-2.252 (2.37*)	-2.248 (2.36*)
= 1 if donates > 50% to Republicans								0.964 (1.66)		0.859 (1.58)
= 1 if donates > 50% to Democrats									-0.513 (0.50)	-0.047 (0.04)
R-squared	0.0474	0.0263	0.0522	0.0426	0.0487	0.0388	0.0566	0.0613	0.0570	0.0613
Number of Observations	493	493	493	493	493	493	493	493	493	493

**Table 6: Timing of Nominations**

The table reports the number of nominations of politically connected board members in specific years. The first sorting criterion is based on the year in a presidential cycle in which a politically connected board member is nominated. 1<sup>st</sup> year refers to nominations in 1981, 1985, 1989, 1993, 1997, 2001, 2005; 2<sup>nd</sup> year refers to nominations in 1982, 1986, 1990, 1994, 1998, 2002; 3<sup>rd</sup> year refers to nominations in 1983, 1987, 1991, 1995, 1999, 2003, and 4<sup>th</sup> year refers to nominations in 1984, 1988, 1992, 1996, 2000, 2004. The second sorting criterion is whether a board member is nominated in an odd or an even year. The third sorting criterion is based on whether the incumbent President is from the Republican or Democratic Party. The fourth and fifth criteria are based on whether the Republican or Democratic Party holds the majority in the Senate and House, respectively. The calculation of the legislative year starts on Nov. 11<sup>th</sup> while the Presidential Election year starts on the day after the election.

Year	Nominations		
	Rep	Dem	Total
<b>Total</b>	<b>233</b>	<b>116</b>	<b>349</b>
<b>Year in presidential cycle</b>			
1 <sup>st</sup> year	80	47	127
2 <sup>nd</sup> year	47	19	66
3 <sup>rd</sup> year	63	30	93
4 <sup>th</sup> year	43	20	63
<b>Odd/Even Years</b>			
Odd Years	143	77	220
Even Years	90	39	129
<b>President</b>			
Republican	113	53	166
Democratic	120	63	183
<b>Senate Majority</b>			
Republican	118	84	202
Democratic	115	32	147
<b>House Majority</b>			
Republican	105	82	187
Democratic	128	34	162



**Table 7: The announcement effect of the nomination of connected board members**

The sample is based on politically connected board members in S&P 500 companies in the years 1996 and 2000. For these board members, a search in the Lexis-Nexis database yields 592 announcements of board nominations. The press reports on 243 of these announcements contain other price-relevant information such as dividend or earning announcements, share repurchases, or M&A activity. Eliminating these announcements yields a final sample of 349 announcements that are used. Companies are sub-classified by several methods: a) based on the nominated directors' party affiliation, b) directors former political position, c) the order in time of the nomination: first two times a directors is nominated versus third nomination and above, d) the nominee worked for the administration and his or her party is the same as that of the president at the nomination day, e) the nominee's party and the party with the majority in house or senate at the nomination day are the same, f) the nominating company is in the banking or utilities industries, g) the nominating company is in one of the three industries with the highest levels of government shipments as measured by Agrawal and Knoeber (2001) or in any other of their sample industries, h) the relatedness of the connection (as detailed earlier). The CARs for each of the sample portfolios are calculated in the same way as before. In parenthesis are t-values. The symbols \$, \* and \*\* denote statistical significance at the 10%, 5% and 1% levels, respectively.

Connection type	Number of Observation	Equally-weighted CAR(%): (0,+1)	Value-weighted CAR(%): (0,+1)
<b>All companies</b>	349	0.69 (3.88**)	1.20 (9.41**)
<i>a) Nominee's party</i>			
Rep nominee (A)	233	0.44 (2.21*)	0.88 (5.54**)
Dem nominee (B)	116	1.21 (3.61**)	1.40 (6.42**)
difference (A-B)		-0.77 (-3.05**)	-0.52 (-2.88**)
<i>b) Former career</i>			
Senate, House, Administration (C)	264	0.72 (3.69**)	1.43 (9.60**)
Others (D)	85	0.60 (1.37)	0.19 (1.10)
difference (C-D)		0.12 (0.29)	1.24 (5.22**)
<i>c) Nomination order in time</i>			
1st & 2nd Nomination (E)	178	0.63 (3.16**)	1.70 (10.96**)
Over 2nd Nomination (F)	171	0.76 (2.33*)	0.80 (3.30**)
difference (E-F)		-0.13 (-0.48)	0.90 (4.44**)
<i>d) Administration Board and President at nomination</i>			
Same Party (G)	81	1.00 (2.08*)	2.10 (5.42**)
Different Party (H)	96	0.62 (2.20*)	0.80 (3.13**)
difference (G-H)		0.38 (0.99)	1.30 (4.03**)
<i>e) Board party and house/senate party at nomination</i>			
Same Party (I)	175	0.51 (1.52)	0.80 (4.31**)
Different Party (J)	174	0.87 (3.94**)	1.44 (8.07**)
Difference (I-J)		-0.36 (1.26)	-0.64 (3.52**)
<i>f) Industry 1</i>			
Regulated (K)	79	0.82 (2.81**)	1.25 (3.48**)
Not Regulated (L)	270	0.66 (2.86**)	1.18 (8.72**)
difference (K-L)		0.16 (0.65)	0.07 (0.34)
<i>g) Industry 2</i>			
High Procurement (M)	48	0.70 (1.30)	1.40 (2.86**)
Low Procurement (N)	90	0.60 (2.76**)	1.24 (7.09**)
difference (M-N)		0.10 (0.32)	0.16 (0.56)
<i>h) Relatedness</i>			
Related nominee (O)	108	1.16 (3.89**)	2.28 (11.56**)
Not related nominee (P)	241	0.49 (2.09*)	0.77 (4.03**)
Difference (O-P)		0.67 (1.82\$)	1.51 (5.50**)

**Table 8: Comparison of announcement effect to matching sample**

The original sample is constructed in the same way as in Table 7 and results in 349 announcements. The matching sample is constructed by a search in LexisNexis. A matching observation is identified in the following way: For each announcement in a company in the original sample, the closest possible announcement of another board member in the same company is chosen. This has to occur in a maximum interval of [-3, 3] years around the day of the announcement in the original sample. This search yields 319 announcements in the matching sample. Panel a) reports the results for the comparison of this sample. Panel b) excludes 32 announcements of CEOs and internal promotions (e.g. CFOs). Panel c) excludes 28 more observations in which multiple board members are announced on the same day. The CARs for each of the sample portfolios are calculated in the same way as before. In parenthesis are z-values. The symbols \$, \* and \*\* denote statistical significance at the 10%, 5% and 1% levels, respectively.

	Number of Observations	Equally-weighted CAR(%) : (0,+1)	Value-weighted CAR(%) : (0,+1)
<i>a) Full sample</i>			
Original Sample (A)	319	0.76 (3.98**)	1.28 (9.63**)
Matched Sample (B)	319	0.07 -0.86	-0.37 (1.72\$)
difference (A-B)		0.69	1.65
(t-value)		(4.70**)	(9.21**)
<i>b) Excluding CEOs and promotions</i>			
Original Sample (C)	287	0.81 (4.18)***	1.38 (9.81**)
Matched Sample (D)	287	0.1 -0.71	-0.13 -0.8
difference (C-D)		0.71	1.51
(t-value)		(4.19**)	(9.93**)
<i>c) Excluding CEOs, promotions, and multiple board announcements</i>			
Original Sample (E)	259	0.83 (3.99**)	1.47 (9.98**)
Matched Sample (F)	259	-0.09 -0.33	-0.26 (1.95\$)
difference (E-F)		0.92	1.73
(t-value)		(3.77**)	(12.31**)

**Table 9: Procurement awards of two sample companies**

Table 9 shows descriptive statistics for two of our sample companies that receive procurement awards during the period surrounding the 1994 midterm election. Both companies are classified to the “petroleum and natural gas” industry based on the Fama-French 30 industry classification. The value of procurement contracts awarded by the U.S. government between 1990 and 1998 is found using information provided by FPDS-NG (Federal Procurement Data System – Next Generation). Accounting variables are from Compustat and are based on values at the end of 1994. The listed board members are those with a former political affiliation. For each board member with a former political position we provide information on his/her former position.

	Phillips Petroleum	Occidental Petroleum
Procurement (\$million): 1990~1993(A)	120.0	169.5
Procurement (\$million): 1995~1998(B)	289.3	143.7
Difference (B – A)	169.3	-25.8
Growth rate (%)	141.1	-15.2
Market Cap (\$million)	8,568.7	6,099.4
Asset (\$million)	11,436.0	17,989.0
Sales (\$million)	12,211.0	9,236.0
EBITD (\$million)	1,752.0	1,539.0
CAPEX (\$million)	1,216.0	1,103.0
Book-to-market	0.66	0.93
Connected Board member (Nomination year)	James B. Edwards (1983) Lawrence S. Eagleburger (1993) Norman R. Augustine (1989)	Albert Gore (1972) Ray R. Irani (1984)
Connected Party	Republican	Democratic

**The political career of connected board members**

Board member	Year(s) of service	Position	Connected party
James B. Edwards	1981-82	Secretary of Energy Dept.	Republican
Lawrence E. Eagleburger	1989-93	Secretary of State Dept.	Republican
Norman R. Augustine	1977	Under Secretary of Defense Dept.	Republican
Albert A. Gore	1953-71	Senator in Tennessee	Democratic
Ray R. Irani	1994	Member of President Clinton's Export Council	Democratic

**Table 10: Procurement awards in the United States between 1990 and 2004**

Table 10 presents the value and number of procurement contracts awarded by the U.S. government between 1990 and 2004. It shows the total value of procurement contracts (in \$ million), the number of contracts, and the share of the value awarded by the Defense Department, the Energy Department, and NASA. All procurement data are from FPDS-NG (Federal Procurement Data System – Next Generation).

Year	Value of Contracts (in \$ million)	Number of Contracts	Share by Department(in % of value)			
			Defense	Energy	NASA	Others
1990	158,150	371,514	66.6	13.4	6.7	13.3
1991	169,079	422,275	62.5	14.3	8.6	14.6
1992	159,277	506,592	63.4	13.0	6.2	17.4
1993	165,534	450,340	58.8	12.0	12.9	16.3
1994	170,680	459,692	63.6	12.4	5.7	18.3
1995	165,275	527,085	65.5	11.1	4.4	19.0
1996	201,876	592,985	63.5	9.4	11.2	16.0
1997	177,945	537,696	66.0	10.5	3.4	20.0
1998	183,793	537,246	64.7	10.1	4.1	21.0
1999	189,312	567,669	64.8	10.7	3.6	20.9
2000	208,208	613,655	66.5	8.3	2.8	22.3
2001	213,840	691,568	66.2	9.4	2.5	21.9
2002	281,240	902,218	67.3	8.0	2.0	22.7
2003	335,237	1,503,145	65.6	8.9	4.2	21.3
2004	351,107	2,843,212	68.9	6.1	4.4	20.7
Mean	208,704	768,459	65.3	10.0	5.2	19.5
Sum	3,130,553	11,526,892				

**Table 11: Summary statistics for the sample companies**

Panel a) of Table 11 presents descriptive statistics for the 319 S&P500 companies that obtain government procurement contracts of more than \$1 million during the 1990 to 1998 period. Panel b) presents descriptive statistics for the 338 S&P500 companies that obtain government procurement contracts of more than \$1 million during the 1996 to 2004 period. These companies are sorted based on the political connections of their board members in 1994 (panel a) and 2000 (panel b). The reported values for Market Cap, Assets, Sales, Earning before income tax and depreciation, Capital Expenditure and Book-to-Market Equity Ratio are measured as of the end of 1994 (panel a) and 2000 (panel b). A company is classified as politically connected if it has at least one board member with the following former position: President, Presidential (Vice-Presidential) Candidate, Senator, Member of the House of Representatives, Governor, Mayor, (Assistant) Secretary, Deputy Secretary, Deputy Assistant Secretary, Under Secretary, Director (CIA, FEMA), Deputy Director (CIA, OMB), Commissioner (IRS, NRC, SSA, CRC, FDA, SEC), Representative to the United Nations, Ambassador, Staff (White House, President, Presidential campaign), Chairman of the Party Caucus, Chairman or Staff of the Presidential Election campaign, and Chairman or member of the President's Committee/Council.). A company is classified as Rep (Dem) if it has only Republican (Democratic) affiliated board members.

**a) 1994 Midterm election**

Variable	Full Sample		Rep		Dem	
	Mean	Median	Mean	Median	Mean	Median
Market Cap (\$ million)	7,534	3,711	11,136	6,718	5,952	3,151
Asset (\$ million)	14,514	4,886	21,825	8,338	13,565	5,109
Sales (\$ million)	8,268	4,507	12,989	8,087	8,191	4,854
EBITD (\$ million)	1,420	623	2,096	1,193	1,186	493
CAPEX (\$ million)	553	220	835	356	491	294
Book-to-market	0.57	0.51	0.57	0.47	0.55	0.55
No. of companies	319		79		36	

**b) 2000 Presidential election**

Variable	Full Sample		Rep		Dem	
	Mean	Median	Mean	Median	Mean	Median
Market Cap (\$ million)	29,882	8,925	41,189	12,532	23,384	10,013
Asset (\$ million)	32,984	10,077	25,333	12,372	73,934	18,142
Sales (\$ million)	14,663	7,156	18,285	10,070	19,965	9,260
EBITD (\$ million)	3,024	1,298	3,555	2,047	4,321	1,841
CAPEX (\$ million)	1,073	332	1,152	584	1,558	659
Book-to-market	0.49	0.38	0.40	0.30	0.65	0.54
No. of companies	338		54		35	

**Table 12: Tenure and timing of nomination of political boards**

Panel a) of Table 12 reports the mean, median, and maximum period of time (in years) between the nomination of a politically connected board member and the 1994 midterm election and the 2000 presidential election, respectively. Panel b) presents the number of nominations of politically connected board members in specific years. The first sorting criterion is based on the year in a presidential cycle in which a politically connected board member is nominated. 1<sup>st</sup> year refers to nominations in the next year after a presidential election (e.g. 1981, 1985, 1989); 2<sup>nd</sup> year refers to nominations in the second year after a presidential election (e.g. 1982, 1986, 1990); 3<sup>rd</sup> year refers to nominations in the third year after a presidential election (e.g. 1983, 1987, 1991), and 4<sup>th</sup> year refers to nominations in the fourth year after a presidential election (e.g. 1984, 1988, 1992). The second sorting criterion is based on whether a board member is nominated in an odd or an even year. The third sorting criterion is based on whether the incumbent President is from the Republican or Democratic Party. The fourth and fifth criteria are based on whether the Republican or Democratic Party holds the majority in the Senate and House, respectively. In election years, the calculation of the year starts on the day after the election; in non-election years it starts on Nov. 11<sup>th</sup>.

**a) Tenure of connected boards before the 1994 election and the 2000 election**

		1994 Election			2000 Election			All
		Rep	Dem	Total	Rep	Dem	Total	
Number of nominations of connected board members		152	71	223	91	57	148	371
Tenure	Mean	5.23	7.22	5.86	5.77	5.03	5.49	5.71
	Median	3	6	4	5	3	4	4
	Max	20	22	22	14	23	23	23

**b) Nomination timing of connected boards**

Nomination	Rep	Dem	Total
Total	244	127	371
<i>Year in presidential cycle</i>			
1 <sup>st</sup> year	105	43	148
2 <sup>nd</sup> year	55	24	79
3 <sup>rd</sup> year	50	32	82
4 <sup>th</sup> year	34	28	62
<i>Odd/Even Years</i>			
Odd Years	155	75	230
Even Years	89	52	141
<i>President</i>			
Republican	109	58	167
Democratic	135	69	204
<i>Senate Majority</i>			
Republican	69	65	134
Democratic	175	62	237
<i>House Majority</i>			
Republican	46	42	88
Democratic	198	85	283

**Table 13: Value of procurement contracts for sample companies**

Panel a) of Table 13 summarizes the value of procurement contracts (in \$million) for the sample of 319 S&P500 companies between 1990 and 1998. Panel b) summarizes the value of procurement contracts (in \$million) for the sample of 338 S&P500 companies between 1996 and 2004. A company is classified as Rep (Dem) if it has only Republican (Democratic) affiliated board members. Based on the political connections of their board members, the sample companies are sorted into three groups: Republican, Democratic, and Others. The left columns report the sum of the procurement contracts for all companies, while the right columns report the average of the procurement contracts.

**a) 1994 Midterm election**

Year	Sum of procurement contracts (\$ million)				Mean of procurement contracts (\$ million)			
	Full Sample	Rep	Dem	Others	Full Sample	Rep	Dem	Others
1990~1998	475,632	297,913	31,749	145,970	1,491	3,771	882	716
1990~1993 (A)	187,829	113,127	15,314	59,387	589	1,432	425	291
1995~1998 (B)	233,594	152,954	12,611	68,029	732	1,936	350	333
Difference (B-A)	45,765	39,826	-2,703	8,641	143	504	-75	42
Growth rate (%)	24.4	35.2	-17.6	14.6	24.4	35.2	-17.6	14.6
No. of companies	319	79	36	204	319	79	36	204

**b) 2000 Presidential election**

Year	Sum of procurement contracts (\$ million)				Mean of procurement contracts (\$ million)			
	Full Sample	Rep	Dem	Others	Full Sample	Rep	Dem	Others
1996~2004	755,883	211,037	27,132	517,713	2,236	3,908	775	2,079
1996~1999 (A)	270,013	80,725	10,876	178,412	799	1,495	311	717
2001~2004 (B)	403,164	108,995	12,057	282,112	1,193	2,018	344	1,133
Difference (B-A)	133,151	28,270	1,181	103,700	394	524	34	416
Growth rate (%)	49.3	35.0	10.9	58.1	49.3	35.0	10.9	58.1
No. of companies	338	54	35	249	338	54	35	249

**Table 14: Summary statistics for the sample companies by categories**

The 319 sample companies in panel a) are classified into one of five groups based on the difference in the amount of procurement contracts that they receive in the four-year period before 1994 and the four-year period after 1994. The 338 sample companies in panel b) are classified into one of five groups based on the difference in the amount of procurement contracts that they receive in the four-year period before 2000 and the four-year period after 2000. Each of the five groups comprises the same number of companies (with the exception of group 1 in the 1994 sample and groups 1, 2 in the 2000 sample), with group 1 comprising the companies with the lowest dollar difference and group 5 comprising the companies with the highest dollar difference in procurement contracts across the two time periods.

**a) 1994 Midterm election**

Group	Number of companies				Mean of difference amount (\$1,000)			
	Rep	Dem	Others	Sum	Rep	Dem	Others	Total
1	15	12	36	63	-210,320	-649,105	-135,099	-250,915
2	7	9	48	64	-8,556	-7,543	-8,026	-8,016
3	14	4	46	64	809	641	363	478
4	21	7	36	64	13,414	23,757	14,263	15,023
5	22	4	38	64	1,943,093	1,246,390	351,570	954,583
Full sample	79	36	204	319	504,131	-75,076	42,358	143,463

**b) 2000 Presidential election**

Group	Number of companies				Mean of difference amount(\$1,000)			
	Rep	Dem	Others	Sum	Rep	Dem	Others	Total
1	8	11	48	67	-61,217	-316,145	-302,384	-275,847
2	4	7	56	67	-2,848	-3,680	-2,492	-2,637
3	9	7	52	68	2,223	2,765	2,791	2,713
4	20	3	45	68	22,228	46,554	25,228	25,286
5	13	7	48	68	2,177,392	646,535	2,439,035	2,204,493
Full Sample	54	35	249	338	523,510	33,754	416,466	393,938



**Table 15: Cross-section analysis for the change in procurement contracts of 1994 sample**

The sample consists of 319 companies in the S&P 500 in the year 1994. The dependent variable is the log of the absolute value of the change in the sum of procurement contracts between 1990-1993 and 1995-1998; this variable is multiplied by 1 if the change is positive and -1 if it is negative. lnCap is the log of the company's market capitalization. BM is the ratio of the book value and market value of equity. Hf\_index is the Herfindahl index, which is based on the sales amount in the 2-digit SIC industry of the company. CAPEX/Sales is the ratio of capital expenditure to sales. EBITD/Assets is the ratio of earnings before income tax and depreciation to assets. CostGood/Sales is the ratio of cost of goods sold to sales. All control variables are from COMPUSTAT and are measured at the end of 1994. dRep is a dummy variable that takes a value of one if a company is politically connected to the Republicans and zero otherwise. dDem is defined similarly. SalesGrowth is the growth rate in sales between 1990-1991 and 1992-1993. dDefense is a dummy variable that takes a value of one if a company has political board members with a defense career. dCongress is a dummy variable that takes a value of one if a company has political board members with a former career in congress. dHeadquarter is a dummy variable that takes a value of one if the board is connected to the party that wins the 1994 senate election in the company's headquarter state. FF30 industry includes dummy variables for each industry according to the Fama-French 30-industry classification. Six industries is a dummy variables that takes a value of 1 if a company operates in food, health, oil, utility, finance, or business supplies according to the Fama-French 30-industry classification and a value of zero otherwise. dDonRep is dummy variable that takes the value of one if a company donates more to Republicans than to Democrats in the 1994 elections, and dDonDem is defined similarly. All models are adjusted for heteroskedasticity. The t-values are in parentheses. The symbols \$, \* and \*\* denote statistical significance at the 10%, 5% and 1% levels, respectively.

Model	1	2	3	4	5	6	7	8	9	10	11
lnCap	0.005 [0.01]	0.274 [0.74]	0.043 [0.11]	0.093 [0.24]	0.018 [0.04]	0.007 [0.02]	0.048 [0.12]	-0.004 [0.01]	-0.458 [1.08]	-0.062 [0.16]	0.222 [0.50]
BM	1.092 [0.94]	1.125 [0.97]	1.086 [0.95]	0.829 [0.72]	0.875 [0.75]	0.971 [0.78]	0.915 [0.74]	0.926 [0.76]	1.123 [1.07]	0.987 [0.74]	0.807 [0.66]
Hf_index	0.206** [3.70]	0.205** [3.52]	0.205** [3.60]	0.209** [3.66]	0.209** [3.67]	0.209** [3.74]	0.211** [3.79]	0.203** [3.62]	0.216** [3.02]	0.211** [3.57]	0.212** [3.71]
Capex/Sales	0.136* [2.38]	0.135* [2.32]	0.133* [2.29]	0.142* [2.42]	0.141* [2.40]	0.149* [2.56]	0.137* [2.30]	0.144* [2.45]	0.069 [1.08]	0.144* [2.40]	0.146* [2.46]
EBITD/Assets				-0.045 [0.75]	-0.058 [0.99]	-0.036 [0.59]	-0.031 [0.50]	-0.022 [0.35]			-0.049 [0.81]
CostGood/Sales				-0.004 [0.18]	-0.008 [0.33]	-0.004 [0.17]	-0.003 [0.14]	-0.001 [0.03]			-0.002 [0.08]
dRep	2.933** [3.15]		2.599** [2.72]	2.539** [2.63]	2.664** [2.76]	2.500* [2.46]	2.684* [2.55]	3.842** [3.33]	2.912** [3.07]	2.429* [2.49]	2.601** [2.70]
dDem		-2.824* [2.40]	-2.092\$ [1.73]	-2.240\$ [1.82]	-2.207\$ [1.81]				-2.305\$ [1.72]	-2.183\$ [1.73]	-2.256\$ [1.82]
SalesGrowth					0.878* [2.24]						
dRep*dDefense						2.091 [1.05]					
dRep*dCongress							0.987 [0.56]				
dRep*dHeadquarter								-2.061 [1.29]			
FF 30 industry									yes		
Six industries										yes	
dDonRep											-0.690 [0.57]
dDonDem											-0.760 [0.52]
Constant	-2.942 [0.89]	-4.117 [1.26]	-2.904 [0.88]	-2.290 [0.57]	-1.488 [0.37]	-2.205 [0.55]	-2.557 [0.63]	-2.441 [0.61]	2.857 [0.66]	-2.224 [0.65]	-3.287 [0.75]
Observations	319	319	319	319	319	319	319	319	319	319	319
R-squared	0.07	0.06	0.08	0.08	0.09	0.08	0.07	0.08	0.19	0.09	0.08

**Table 16: Cross-section analysis for the change in procurement contracts of 2000 sample**

The sample consists of 338 companies in the S&P 500 in the year 2000. The dependent variable is the log of the absolute value of the change in the sum of procurement contracts between 1996-1999 and 2001-2004; this figure is multiplied by 1 if the change is positive and multiplied by -1 if it is negative. InCap is the log of the company's market capitalization. BM is the ratio of book to market value of equity. Hf\_index is the Herfindahl index, which is based on the sales amount in the 2-digit SIC industry of the company. CAPEX/Sales is the ratio of capital expenditure to sales. EBITD/Assets is the ratio of earnings before income tax and depreciation to assets. CostGood/Sales is the ratio of cost of goods sold to sales. All control variables are from COMPUSTAT and are measured at the end of 2000. dRep is a dummy variable that takes a value of one if a company is politically connected only to the Republicans and a value of zero otherwise. dDem is a dummy variable that takes a value of one if a company is politically connected only to the Democrats and a value of zero otherwise. SalesGrowth is the growth rate in sales between 1996-1997 and 1998-1999. dDefense is a dummy variable that takes a value of one if a company has political board members with a defense career. dGovernment is a dummy variable that takes a value of one if a company has political board members with a former career in the government. dHeadquarter is a dummy variable that takes a value of one if the board member is connected to the party that wins the majority in the company's headquarter state in the 2000 election. FF30 industry includes dummy variables for each industry according to the Fama-French 30-industry classification. Six industries is a dummy variable that takes a value of 1 if a company operates in food, health, oil, utility, finance, or business supplies according to the Fama-French 30-industry classification and a value of zero otherwise. dDonRep is dummy variable that takes the value of one if a company donates more to Republicans than to Democrats in the 2000 elections, and dDonDem is defined similarly. All models are adjusted for heteroskedasticity. The t-values are in parentheses. The symbols \$, \* and \*\* denote statistical significance at the 10%, 5% and 1% levels, respectively.

Model	1	2	3	4	5	6	7	8	9	10	11
InCap	-0.238 [0.76]	-0.129 [0.41]	-0.223 [0.71]	-0.264 [0.82]	-0.278 [0.87]	-0.282 [0.88]	-0.275 [0.85]	-0.274 [0.85]	-0.208 [0.57]	-0.287 [0.89]	-0.319 [0.84]
BM	-4.122** [4.45]	-4.042** [4.32]	-4.046** [4.34]	-4.061** [3.91]	-3.894** [3.79]	-4.100** [3.96]	-4.096** [3.95]	-4.092** [3.94]	-3.320** [2.94]	-3.426** [3.51]	-4.215** [3.88]
Hf_index	0.002 [0.03]	0.000 [0.00]	0.000 [0.00]	0.013 [0.17]	0.008 [0.11]	0.015 [0.20]	0.016 [0.22]	0.016 [0.21]	-0.019 [0.18]	-0.018 [0.23]	0.006 [0.09]
Capex/Sales	-0.096* [2.33]	-0.102* [2.39]	-0.095* [2.27]	-0.101* [2.39]	-0.117** [2.78]	-0.102* [2.46]	-0.102* [2.46]	-0.104* [2.51]	-0.062 [1.41]	-0.078\$ [1.80]	-0.100* [2.35]
EBITD/Assets				-0.033 [0.67]	-0.017 [0.33]	-0.031 [0.63]	-0.031 [0.62]	-0.033 [0.66]			-0.028 [0.55]
CostGood/Sales				-0.017 [0.84]	-0.011 [0.53]	-0.018 [0.88]	-0.018 [0.88]	-0.019 [0.93]			-0.016 [0.75]
dRep	2.454* [2.59]		2.380* [2.49]	2.474* [2.57]	2.458* [2.54]	2.472* [2.48]	2.418\$ [1.66]	2.001\$ [1.70]	2.890** [2.81]	2.653** [2.63]	2.364* [2.43]
dDem		-1.037 [0.78]	-0.629 [0.47]	-0.626 [0.46]	-0.582 [0.43]				-0.670 [0.46]	-0.272 [0.20]	-0.704 [0.52]
SalesGrowth					0.763\$ [1.89]						
dRep*dDefense						0.706 [0.27]					
dRep*dGovernment							0.196 [0.11]				
dRep*dHeadquarter								1.474 [0.87]			
FF 30 industry									yes		
Six industries										yes	
dDon_rep											0.315 [0.32]
dDon_dem											2.229 [1.25]
Constant	6.320* [2.08]	5.827\$ [1.91]	6.223* [2.05]	8.132* [2.16]	7.415* [1.97]	8.275* [2.19]	8.193* [2.17]	8.298* [2.20]	5.299 [1.11]	6.590* [2.12]	8.389\$ [1.97]
Observations	338	338	338	338	338	338	338	338	338	338	338
R-squared	0.09	0.08	0.09	0.10	0.10	0.10	0.10	0.10	0.17	0.11	0.10

**Table 17: Placebo event year test for the change in procurement contracts of 1997 sample**

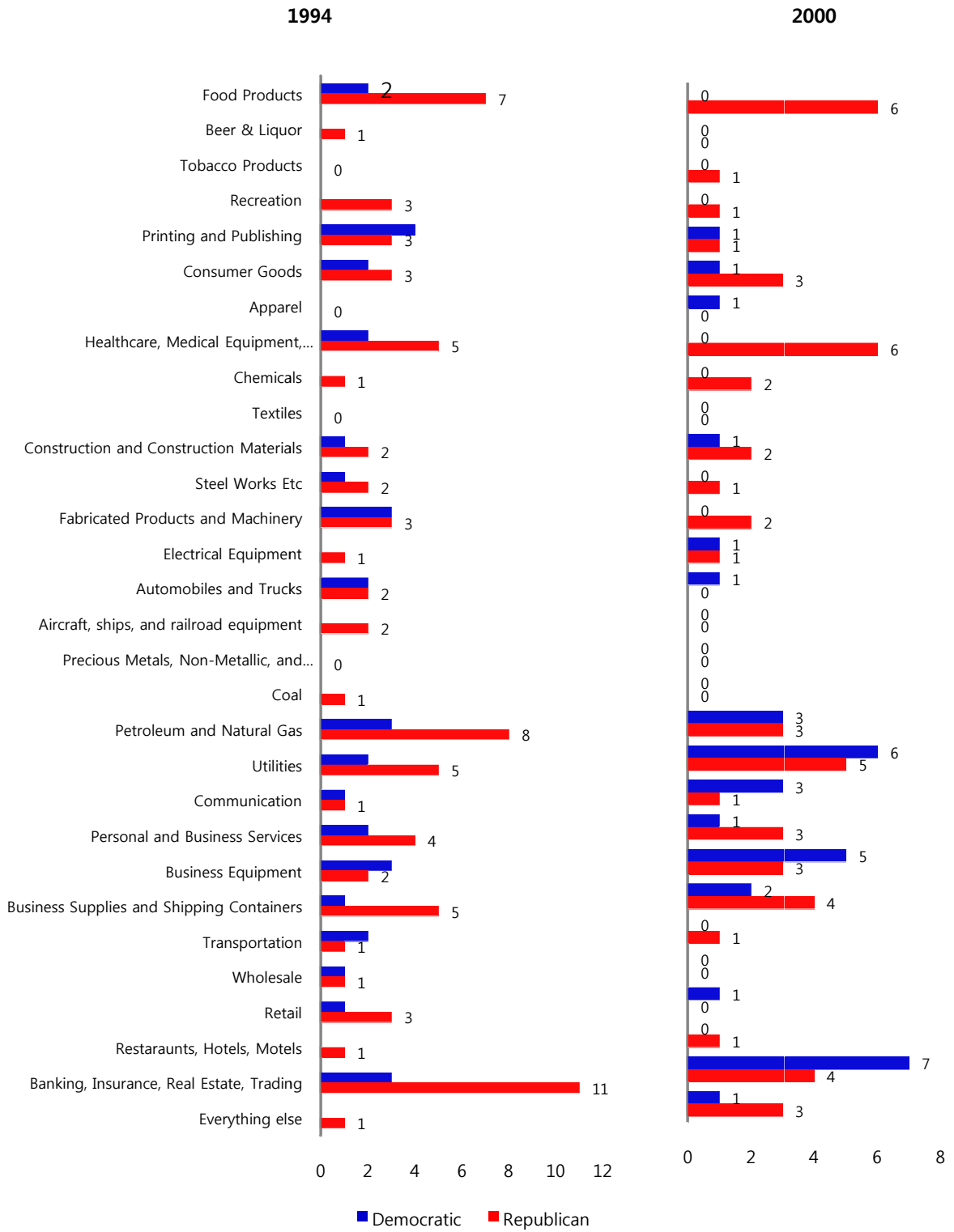
The sample consists of 345 companies in the S&P 500 in the year 1996. The dependent variable is the log of the absolute value of the change in the sum of procurement contracts between 1995-1997 and 1998-2000; this figure is multiplied by 1 if the change is positive and multiplied by -1 if the change is negative.  $\ln\text{Cap}$  is the log of the company's market capitalization.  $\text{BM}$  is the ratio of the book value of equity to the market value of equity.  $\text{Hf\_index}$  is the Herfindahl index, which is based on the sales amount in the 2-digit SIC industry in which a company operates.  $\text{CAPEX/Sales}$  is the ratio of capital expenditure to sales.  $\text{EBITD/Assets}$  is the ratio of earnings before income tax and depreciation to assets.  $\text{CostGood/Sales}$  is the ratio of cost of goods sold to sales. All control variables are from COMPUSTAT and are measured at the end of 1997.  $\text{dRep}$  is a dummy variable that takes a value of one if a company is politically connected only to the Republicans and a value of zero otherwise.  $\text{dDem}$  is a dummy variable that takes a value of one if a company is politically connected only to the Democrats and a value of zero otherwise.  $\text{SalesGrowth}$  is the growth rate in sales between 1994-1995 and 1996-1997.  $\text{FF30 industry}$  includes dummy variables for each industry according to the Fama-French 30-industry classification.  $\text{Six industries}$  is a dummy variables that takes a value of 1 if a company operates in food, health, oil, utility, finance, or business supplies according to the Fama-French 30-industry classification and a value of zero otherwise. All models are adjusted for heteroskedasticity. The t-values are in parentheses. The symbols \$, \* and \*\* denote statistical significance at the 10%, 5% and 1% levels, respectively.

Model	1	2	3	4	5
$\ln\text{Cap}$	0.936** [2.83]	0.961** [2.93]	0.930** [2.80]	0.763* [2.22]	1.047** [2.67]
$\text{BM}$	-1.104 [0.69]	-0.974 [0.63]	-1.095 [0.68]	-1.017 [0.63]	-2.569 [1.26]
$\text{Hf\_index}$	0.007 [0.13]	0.007 [0.12]	0.008 [0.14]	0.002 [0.03]	0.022 [0.34]
$\text{Capex/Sales}$	-0.088\$ [1.75]	-0.088\$ [1.76]	-0.088\$ [1.74]	-0.089\$ [1.82]	-0.108 [1.48]
$\text{EBITD/Assets}$	0.000 [0.00]	0.000 [0.01]	0.001 [0.02]	-0.003 [0.06]	
$\text{CostGood/Sales}$	-0.002 [0.09]	0.000 [0.00]	-0.002 [0.07]	0.001 [0.05]	
$\text{dRep}$	0.627 [0.67]		0.663 [0.70]	0.726 [0.76]	1.014 [1.01]
$\text{dDem}$		0.267 [0.20]	0.409 [0.30]	0.613 [0.46]	0.200 [0.14]
$\text{SalesGrowth}$				2.605* [2.00]	
$\text{FF 30 industry}$					yes
Constant	-7.330\$ [1.90]	-7.622* [1.99]	-7.376\$ [1.91]	-6.623\$ [1.70]	-11.143** [2.61]
Observations	345	345	345	345	345
R-squared	0.05	0.04	0.05	0.06	0.11

**Table 18: Distribution of sample companies across the Fama-French 30 industries**

FF 30 Industries	1994				2000			
	Rep	Dem	Others	Sum	Rep	Dem	Others	Sum
Food Products	7	2	7	16	6		8	14
Beer & Liquor	1			1			3	3
Tobacco Products			2	2	1			1
Recreation	3		2	5	1		1	2
Printing and Publishing	3	4	5	12	1	1	7	9
Consumer Goods	3	2	9	14	3	1	8	12
Apparel			5	5		1	1	2
Healthcare, Medical Equipment, Pharmaceutical Products	5	2	12	19	6		20	26
Chemicals	1		7	8	2		7	9
Textiles			1	1			2	2
Construction and Construction Materials	1	2	12	15	2	1	8	11
Steel Works Etc	2	1	4	7	1		6	7
Fabricated Products and Machinery	3	3	11	17	2		9	11
Electrical Equipment	1		2	3	1	1	3	5
Automobiles and Trucks	2	2	8	12		1	9	10
Aircraft, ships, and railroad equipment	2		3	5			7	7
Precious Metals, Non-Metallic, and Industrial Metal Mining			2	2			1	1
Coal	1		1	2				
Petroleum and Natural Gas	8	3	9	20	3	3	9	15
Utilities	5	2	20	27	5	6	18	29
Communication	1	1	4	6	1	3	8	12
Personal and Business Services	4	2	8	14	3	1	21	25
Business Equipment	2	3	19	24	3	5	36	44
Business Supplies and Shipping Containers	5	1	7	13	4	2	7	13
Transportation	1	2	5	8	1		5	6
Wholesale	1	1	4	6			6	6
Retail	3	1	6	10		1	14	15
Restaraunts, Hotels, Motels	1		4	5	1		1	2
Banking, Insurance, Real Estate, Trading	11	3	20	34	4	7	22	33
Everything Else	1		5	6	3	1	2	6
<b>Total</b>	<b>78</b>	<b>37</b>	<b>204</b>	<b>319</b>	<b>54</b>	<b>35</b>	<b>249</b>	<b>338</b>

**Figure 1: Distribution of politically connected companies across the Fama-French 30 industries**



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