# Partisan Investment Cycles

by

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ABSTRACT

This paper studies the relation between alignment in partisan affiliation between a firm's management team and the president and corporate investment. Survey evidence suggest that households have higher expectations of economic growth when their preferred party controls the presidency. I therefore investigate whether finance professionals, specifically corporate managers, are subject to the same partisan-based optimism and make investment decisions not based on fundamentals. Consistent with the behavior displayed by the general public, I find that managers invest more and become more optimistic about their companies' prospects when their preferred party is in power. Using insider trades, I am able to separate optimism from alternative explanations such as industry sorting of partisan managers, political connections, etc. This optimism-driven increase in investment is associated with lower profitability and stock returns. Overall, managers' partisan beliefs produce heterogeneous expectations about future cash flows and distort investment decisions.

DEDICATION

*To Shannon Broderick, the person I want to spend the rest of my life with. Without your support and encouragement I wouldn't be where I am today. Let's travel the world together, with our little Teddy.*

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Chapter 1

# INTRODUCTION

The widening gap between the views of Republicans and Democrats has been one of the most defining trends in the American public in the past two decades. Party identification has been found to be a more significant predictor of Americans' political values than any other demographic or social attribute, including race, religion, and education Westwood *et al.* (2018). The sharp contrast between partisan views is particularly stark in the electorate's optimism about future economic growth. Survey evidence from the Pew Research Center shows that individuals become more optimistic when the president from their political party assumes power. One example of this relationship can be found surrounding the election of President Donald J. Trump. Shortly after the 2016 election the Pew Research Center conducted a poll that found that only 14% (46%) of Republicans (Democrats) rated the economy as good or excellent. The following October they conducted another poll and found that 74% (37%) Republicans (Democrats) rated the economy as good or excellent. Even Ben Bernanke, in a 2017 interview with the New York Times, remarked that "There is this kind of partisan coloring, it is really striking, the election result completely reversed people's views of the state of the economy."

Given the potentially large implications of a sudden shift in economic optimism in a sizable number of individuals, a growing body of research has focused on how political differences between households can affect their portfolio allocation and consumption decisions during different partisan cycles.[1] In terms of corporate outcomes,

[1]Examples include Makridis (2019), McGrath *et al.* (2017), and Meeuwis *et al.* (2018), among others.

prior research has primarily focused on how political cycles affect firms through connections from lobbying and PAC contributions, industry sensitivity to government spending, and political uncertainty stemming from national elections. So far, the literature has largely been quiet regarding how partisanship can affect corporate investment during different partisan cycles.

I attempt to fill this gap by exploring whether managers' economic, and by extensions earnings, expectations can be affected by the interaction between their political affiliations and those of the presidents'. The case can certainly be made that top level executives are less likely to exhibit this partisan behavior due to reversibility issues and the pecuniary cost of poor investment decisions, but some anecdotal evidence and the findings from the behavioral consistency literature do offer support for this idea. In an another interview with the New York Times David Congdon, the CEO of Old Dominion Freight Line, said that "Trump's got a hard road ahead of him, but I think he's off to a decent start, I'm personally optimistic about the economy for the rest of the year and I think we will see an uptick in terms of freight deliveries, we have picked up our hiring." There are also studies in this area that have shown that individuals tend to behave consistently across multiple domains such as professional and personal, e.g. Hutton *et al.* (2015) find that managers who are more politically conservative have more conservative corporate policies, Cronqvist *et al.* (2012) find that managers make similar home and firm leverage choices, and Chyz (2013) finds that executives with personal aggressive tax behavior use tax sheltering schemes at their firms. Therefore, one could plausibly anticipate that highly partisan managers would exhibit this behavior, which has been shown to occur in the general public, to their forward looking assessments of the economy.

Motivated by survey evidence and the findings from prior studies, I hypothesize that firms with higher partisan alignment with the president will have a more positive

view of that president's current or future performance, or economic policies, and would subsequently invest more than a firm with similar financial characteristics. Two complimentary channels, partisan perceptual screening and in-group favoritism, allow for this behavior. The idea of in-group favoritism was first developed by Tajfel *et al.* (1979) and posits that individuals identify with a group based on perceived similarities, that is, individuals tend to prefer others who are in the same group than those outside of it. This has been shown to reduce firm value as boards are less likely to monitor CEOs who belong to the same political party (Lee *et al.*, 2014). In terms of optimism, managers who have similar partisan preferences as the president may overestimate that president's ability to improve business conditions. A more indirect channel could be that in-group favoritism may cause individuals to form ideological echo chambers where managers may live near, work for, and associate with, individuals of the same political party, or seek partisan news sources that agree with their viewpoints. This partisan aggregation can reduce ones exposure to diverse opinions and result in decision making based on politically biased information.

The other complementary channel, partisan perceptual screening, was first introduced by Campbell *et al.* (1980) who state that when individuals interpret information, they tend to see what is favorable to their political orientation. So when interpreting information, individuals either find evidence to support their preconceived opinions, reject evidence that disagrees with it (i.e. confirmation bias), or they interpret information in a way that conforms to their political beliefs. For example, a Republican manager who believes that tax cuts will boost economic growth will look for information or interpret existing information in a way that conforms to their existing belief, in order to reduce cognitive dissonance. This can result in two managers with different partisan affiliations to react differently to the same economic information. This has been shown to affect mutual fund managers who had a differ-

ent interpretation on the efficacy the Federal Reserves policies based on their political affiliation (Moszoro, 2020).

To test my hypothesis, I use the political homophily index (PHI), developed by Lee *et al.* (2014), to measure the degree of partisan alignment between firms and the president. To construct this measure I first identify each manager's partisan affiliation using the dollar amounts of political contributions made by that individual to the Republican and Democratic Parties. I use an individuals full donation history from 1979 to 2016 and measure their partisan leaning as the difference between funds given to the Republican Party and the Democratic Party divided by their total contributions, named *Rep*, which ranges from negative to positive one.[2] Then, I calculate a firm's political orientation by taking the equal-weighted average of *Rep* for its' top five managers, named $Rep_{Top5}$, and then take the normalized absolute value between $Rep_{Top5}$ and the president (as is for *Rep*, 1 = Republican and -1 = Democrat).[3] $PHI_{Top5}$ ranges from zero (least) similarity to one (most) similarity between a firm and the president.

For 2,644 publicly traded U.S. corporations from the Execucomp database for years 1992 to 2016, I find that a one standard deviation increase in partisan similarity with the president results in an increase in investment of 2.1% relative to the sample average. This result is statistically significant at the 1% level and is robust to controlling for firm-level financial variables, different proxies for political connections, and for omitted variables through the use of fixed effects.

To better understand the underlying channels driving the results I employ a suite of tests whose aim is to establish whether the observed behavior is due to a behavioral

[2]I validate this measure by comparing a sub sample of executives' publicly stated political affiliations, gathered from voter records, to their estimated affiliation and confirm that personal political contributions are a suitable proxy. See appendix A for more details.

[3]The top five managers are assumed to have the most power to affect investment decisions

explanation, i.e. partisan-based optimism, or due to other reasons such as managers self-selection into certain industries or states based on partisan affiliation, or changes in political connections.

To test whether this relation is behavioral in nature, i.e. individuals become more optimistic when their preferred party is in power, I first isolate variation that is driven by elections, management turnover, and changes in presidential approval ratings. If changes in the party of the presidency are the only driving factor then one could argue that this relation is largely driven by unobserved and time-varying firm specific characteristics. I show that changes from all three sources have an effect on corporate investment decisions conditional on managers' partisan similarity to the president. I also show that partisan investment behavior is not symmetric as Republican managers react more to partisan cycles than do Democrats, when compared to non-donors, providing support for the behavioral hypothesis as managers from both political parties should equally value political connections.

To cleanly test the expectations hypothesis, I compare the opportunistic trades made by executives who support different parties but work at the same firm at the same time. By exploiting variation in executives' party affiliations, this approach accounts for confounding factors and alternative channels as executives will have the same access to information and should therefore make the same decisions absent partisan influences on their decision making. I find that individuals who align with the president are 69% less likely to sell their companies' shares during the president's first term. Focusing on option grant exercise behavior and narrowing the insider trading test to the years immediately surrounding elections yields similar results and shows that individuals' expectations regarding their firms' growth are conditional on their partisan similarity to the president. I also find complementary evidence that partisan similar firms are more likely to issue optimistic annual earnings guidance

and are less likely to meet these expectations.

To see whether my results are largely driven by partisan-based clustering I exclude industries that were identified by prior studies to be sensitive to government spending, as well as industries that are the most partisan according to my data. I also exclude the most partisan states to account for geographic clustering.[4] To ensure that my results are not driven by partisan connection seeking, I exclude firms who have lobbied at least once in the sample period and firms who list the government as a major customer. To ensure that my measure of partisan affiliation is not actually a measure of direct political connections, I estimate the partisan affiliation of managers using only contributions to political party committees (not candidates) and to the president as well as estimate their affiliation using the election cycle average of contributions to ensure my results are not driven by large single contributions. After running these test I find that my remain largely unchanged.

Finally, I examine how investment decisions due to partisan-based optimism affect performance outcomes. To determine whether these decisions are based on rational expectations of future growth, I interact partisan similarity to the president with the firms' level of investment. On the one hand, if firms do not exercise all of their growth options partisan investment can be value improving. On the other hand, over investment can result in decreased profitability. My results are more consistent with the value-destroying hypothesis. I find that firms with investment levels equal to the sample mean experience a 1.7% and 5% decrease in stock returns and a 0.5% and 0.6% decrease in operating profits in the subsequent one and two years following these investment decisions.

The main contribution of this study is to provide novel evidence that managers

[4]In unreported test I also control for time-varying changes in investment based on a firm's industry, state, city, fiscal-year end, and industry and state combined.

with different partisan affiliations display different levels of optimism, resulting in economically large distortions in firms' investment policies and negative performance outcomes. Given that partisanship prevails in this group of sophisticated financial professionals and in a labor market setting where there are large pecuniary cost to bad decision making, it would be interesting to explore what effect good governance and optimal compensation can have to help mitigate this behavior.

The rest of this paper is organized as follows. Chapter 2 discusses literature and motivates the link between partisanship and corporate investment. Chapter 3 outlines the data used. Chapter 4 outlines the empirical approach and presents results on the relationship between partisanship and investment, Chapter 5 examines the channels between partisanship and investment, Chapter 6 discusses performance outcomes, and Chapter 7 concludes.

Chapter 2

# RELATED LITERATURE

My study lies on the intersection of the literature on partisanship and its effects on economic agents, and political economy. With respect to the former strand of literature, I focus on a group of sophisticated individuals whose decisions are economically large and harder to reverse. With respect to the latter, I take into account how the federal government can affect firm decisions solely based on which political party is in control.

The literature on the effects that partisanship can have on economic agents is fairly new. This literature can be broken up into partisanship and its effects on economic optimism in regards to households, and partisanship and its effects on finance professionals. With regard to the household literature, one of the earliest papers on the topic, by Gerber and Huber (2009), observes that consumption changes following an election are conditional on whether the election was won by the respondent's preferred political party. Other subsequent papers have found similar results. Benhabib and Spiegel (2019) find a positive relation between partisan driven sentiment and state-level GDP growth, Makridis (2019) using individual-level data from Gallup finds that conservatives increased consumption of non-durable goods around the 2016 presidential election, and Gillitzer *et al.* (2016) find a positive relation between election driven sentiment and vehicle purchases.[1] In terms of asset allocation, Addoum and Kumar (2016) show that the industry-level portfolio composition of investors changes when the party in power changes, likely driven by investors' perceptions of which industry

[1]There are also studies that show that while partisan-driven optimism may exist, they do not lead to changes in consumption (McGrath *et al.*, 2017; Mian *et al.*, 2018)

are more likely to be favored by Republican and Democratic presidents. Bonaparte *et al.* (2017) find that households, when the party of the president aligns with their own, are more likely to allocate more capital to riskier investments. A similar paper by Meeuwis *et al.* (2018) show that individuals living in Republican regions increased their share of equity and the market beta of their portfolios after the November 2016 election. Finally, Cookson *et al.* (2020) show that the optimism of Republican users on the social platform StockTwits remains unchanged during the Covid-19 pandemic while other users become more pessimistic.

With regard to the literature on partisanship and finance professionals, Moszoro (2020) finds that for the period 2004-2014 Democrat and Republican hedge fund managers had no differences in performance, but in 2008 managers had different interpretations of central bank policy depending on their political preferences and Democrats performed better than Republicans from December 2008 to September 2009. Kempf and Tsoutsoura (2018) find that the economic optimism of more sophisticated individuals (i.e. credit ratings analysts) depends on who controls the Executive branch. Wintoki and Xi (2019) find that Republican mutual fund managers are more likely to invest in firms that have the same partisan preferences. And finally, Lee *et al.* (2014) show that there are poorer governance and performance outcomes when the CEO belongs to same political party as the average board member. I add to this literature being the first to show that partisanship among corporate executives can affect economically significant real investment decisions as executives become more optimistic about future economic growth when they belong to the same party as the president.

My study also adds to the literature on how the federal government can affect firm performance and investment decisions. Prior studies have found that political connections can lead the distortions in investment efficiency (Duchin and Sosyura,

2012) but can be seen as valuable by shareholders (Faccio, 2006). In terms of political cycles, Belo *et al.* (2013) find that certain industries are sensitive to government spending and during Democratic presidencies, which tend to expand federal spending, have higher cash flows and be traded to make abnormal profits. When nearing the end of a political cycle Julio and Yook (2012) find that election uncertainty can temporarily suppress corporate investment as firms wait until election outcomes are realized and parties set their political agenda. I add to this literature by providing evidence that the the dynamics between the partisan affiliation of the current regime and of managers can directly affect corporate investment policies and result in decreased profitability. This breaks from the literature which currently focuses on the tangible channels of political economy, i.e. the effect of policies on corporate behavior, and not intangible ones, i.e. the party that is enacting these policies.

Related papers include the following. Schwartz (2019) finds an association between the political affiliation of a CEO's birth county and overconfidence, conditional on the the state of the economy and the party of president during their upbringing. This hypothesis is that managers who grew up in "blue" counties when the president is a Democrat will associate that party with stronger economic growth. Using a sub sample of CEOs he finds no relation between political contributions and investment. And finally, Knill *et al.* (2019) finds that partisan media slant, induced by the introduction Fox News to firms' headquarter locations, can affect managers' investment decisions depending on their political party. Specifically, they find that Fox News caused Republican firms to investment more than Democratic ones, but do not test the ex-post operating outcomes that result from these decisions. My paper complements these findings by showing that managers' political beliefs can affect investment decisions for a large sample of firms over different political regimes. My measure does not rely on geography and has been shown to be an accurate proxy of partisan affili-

ation. Additionally, using insider trades I am able to provide concrete evidence that managers from different political parties, but within the same firm, exhibit different levels of optimism when their preferred party is in power, which is a novel finding.

# Chapter 3

# DATA AND SAMPLE

## 3.1 Sample Construction

My sample consists of financial data from the Compustat Fundamentals Annual file and managerial data from Execucomp for years 1992 to 2016. I use executives' full names listed on Execucomp to identify their political contributions and insider trades. Additionally, I focus my analysis on the top five managers to get a more accurate estimate of the political affiliation of firms' top decision makers. To control for changes in investment due to regulation, which may systematically vary based on the political party in control, I exclude all utility (SIC Codes 4900-4999) and financial (SIC codes 6000-6999) firms as well as all firms categorized as public service, international affairs, or non-operating establishments (SIC 9000+). Finally, following Peters and Taylor (2017) I discard firms with missing or non-positive book value of assets or less than $5 million in physical capital to exclude small firms which may have more volatile accounting data and skewed investment patterns. This results in a sample of 33,706 firm-years corresponding to 2,644 unique firms.

## 3.2 Political Contributions

I use executives' personal campaign contributions over the period 1979 to 2016 from the Harvard disambiguated FEC campaign contribution database to identify managers' political affiliations.[1] This data set contains the same individual contributions to all campaign committees (national, candidate, etc) as the FEC's bulk data

[1] https://dataverse.harvard.edu/dataset.xhtml?persistentId=doi:10.7910/DVN/BQN6XE

set, with the addition of assigned identities which is similar to the extensively used disambiguated inventor database. Using this data is advantageous as once you correctly identify the contribution of an executive, you have access to that individuals' other contributions that were identified using the disambiguation software. This allows for greater coverage of each individuals' total contribution history and helps to overcome, but not fully, the issue of only being able to identify the contributions of an individual who worked as an executive within the sample period.[2]

Once an individual's total contribution exceeds the FEC's disclosure limits for a particular year (1975-1988: $500, 1989-Present: $200) each campaign committee must disclose the donor's name, address (excluding street), occupation, as well as the contribution amount and date. While I can observe contributions to both Political Action Committees (PACs) and individual committees (i.e. candidate, party, etc.), only the latter is useful for identifying partisan affiliations. This is due to the fact that PACs donate to multiple parties in any given election cycle (Cooper *et al.*, 2010), making them a noisy measure.

To create my contributions sample, I first take the committee master file from the FEC bulk data set and match it to the Harvard disambiguated data set using committee ID. The FEC committee file has identifying information for each campaign committee including its name, type, and party identification. There are many committees that identify with a party that is neither Democrat nor Republican (e.g. Federalist, Freedom Party, Labor Party), I manually research these parties and categorize them as Democrat or Republican based on their standing within the political spectrum (e.g., Green Party = Democrat).[3] I then match the resulting file to Execu-

[2]I cannot observe contributions when an individual is either unemployed or not an executive of a firm in the Execucomp database.

[3]Results are robust to only using contributions to either the Democratic or Republican Party.

comp using a custom algorithm that allows for more accurate matching and greater coverage.[4] After verifying the accuracy of the matches, my final sample consists of 564,556 individual contributions for 13,783 unique executives resulting in 101,521 executive contribution years covering approximately 75% of Execucomp firms.

### 3.3 Measuring Political Affiliation

I follow the approach used by Lee *et al.* (2014) by constructing a firm-level political orientation measure using the average orientation of that firm's management team in a given year. First, I measure each manager's individual political orientation, called *Rep*, and define it as the difference between the inflation adjusted dollar (adjusted to 2016 dollars) amount of contributions to the Republican Party and the Democratic Party divided by total contributions to both parties:

$$Rep_i = \frac{R_i - D_i}{R_i + D_i}, \tag{3.1}$$

which ranges from -1 (Democrat) to 1 (Republican). Following the prior literature (Hong and Kostovetsky, 2012; Hutton *et al.*, 2015; Lee *et al.*, 2014; Wintoki and Xi, 2019), I use an individual's total contribution history to estimate their political orientation. This is done to minimize measurement errors as contributions over several years are more likely to reflect an individual's true orientation, even if they sometimes contribute to the opposite party. For each executive, *Rep* remains constant throughout the sample with the assumption that an individual's political stance is stable in adulthood and is determined in their formative years (Green *et al.*, 2004). It is important to note that using political contributions to proxy for partisan affiliation causes at least some measurement error, as some individuals might make donations

[4]See the appendix for a more detailed explanation of the matching algorithm

based on personal or professional relationships with candidates rather than party affiliation. To show the robustness, I compare my measure to managers' self-declared political affiliations using state voter records and achieve an accuracy of 80%.[5]

Next, I measure a firm's political orientation ($Rep_{Top5}$) as the equal-weighted average of the top five managers' *Rep* for each year, using the sum of their salary and bonus to determine their ranking.[6] I focus on the top five managers because Graham *et al.* (2015), using an survey of 1,000 CEOs, finds that corporate investment is one of the most delegated capital allocation decisions. With that being said, including other important executives will yield a better connection between partisanship and investment.[7]

Because disclosure limits are relatively low, especially for these high wealth individuals, I assume that non-contributing executives are as partisan as those who contribute equally to both parties and set their *Rep* equal to 0. The main benefit of including non-donors is that it allows for a less noisy measure of a firm's political orientation, e.g. if one out of five managers for a specific firm only donated $1,000 (in total between 1979 and 2016) to the Republican Party, that firm would be seen as highly Republican (equal to 1) while its true orientation may be more moderate (closer to 0). Additionally, another benefit of including non-donors is that for firm-years where no executives have donated, the inclusion of these observations allows me to estimate the fixed effects and coefficients on control variables more precisely.[8]

[5]Later I also show that my results are robust to only using donations given to the president and party committees which are more likely to reveal partisan affiliation.

[6]Results do not change significantly if I use a value-weighted measure based on salary and bonuses (*EXECRANKANN*).

[7]Consistent with their findings, I find in unreported test that the partisan similarity among executives is a stronger predictor of investment then the partisan similarity of the CEO, although both are statistically significant.

[8]My results hold if I exclude non-donors from my sample.

My main variable of interest is the Political Homophily Index, first developed by Lee *et al.* (2014), but augmented to measure the normalized inverse Euclidean distance between the affiliation of a firm's top five managers and the president:

$$PHI_{Top5} = 1 - \frac{|Rep_{Top5} - Rep_{Pres}|}{2}, \tag{3.2}$$

where $Rep_{Top5}$ = [0,1] and $Rep_{Pres}$ = [-1,1}, -1(1) is a Democratic (Republican) president. $PHI_{Top5}$ is a measure of partisan similarity between a firm's management team and the president and take any value between 0 (least similar) and 1 (most similar). Because managers' partisan affiliations are fixed throughout the sample period, variation in this measure is solely driven by both managerial turnover and changes in the party of the presidency.

Figure 1 presents a timeline of political control for the Executive and Legislative Branches. For twelve years of the sample period there is a trifecta government, where one party controls the executive and legislative branches, and for the remaining sample period control of the legislative chambers is relatively stable over time.

Table 1 presents the level of industry and state grouping by Republican firms. While there is significant separation between the least and most Republican industries and states, they represent a very small fraction of the firms in my sample. This helps ease concerns that my results could be driven by Republican managers aggregating into firms in certain industries or states that can be systematically affected by which party is in power. Table 2 presents the summary statistics for this sample. These statistics show that the majority of management teams lean Republican, which is consistent with prior studies.

### 3.4 Insider Trading and Options Exercise Data

I use data from Table 1 of the Thomson Reuters insider transaction database, which consists of all transactions filed on Form 4 of the U.S. Securities and Exchange Commission. For years 1986 to 2016 I follow the prior literature (Cohen *et al.*, 2012), and focus on open market purchases and sales which can be identified by transaction codes "P" and "S". When an insider makes multiple trades in the same stock in the same month I aggregate the total number of shares traded to monthly level. I then merge the data with CRSP using NCUSIP, and scale the total number of shares traded by an executive by that month's shares outstanding.

I then follow the method employed by Cohen *et al.* (2012) to identify opportunistic trades. This is done because routine trades are more likely to reflect personal liquidity and diversification motives or be the result of routine events like the issuance of stock grants, and are less likely to be signals of managers' expectations of their firms' future cash flows. Following their main identification method, I identify an insider as a "routine" trader once they have traded in the same month for three consecutive years, whereas every other insider who does not display predictable behavior is labeled as "opportunistic". After removing all routine insider-trade observations I aggregate all insider trade information to the executive-year level and merge it with Execucomp based on firms' CUSIPs and executives' first and last names. To be included in the sample, an executive must make at least one opportunistic insider trade during the sample period.[9]

To capture the level of trading done by an executive I create a variable called *Shares*, which is equal net number of scaled shares purchased minus shares sold per

[9]The executives merged with insider trades are the same individuals used in my main analysis, i.e. top five managers who do not work for utility or financial companies.

year. To better understand whether managers are trading in different directions I use a variable *Sale*, which is an indicator variable that takes the value of 1 if an executive sold shares in year t and 0 otherwise, and *Purchase*, which is an indicator variable that takes the value of 1 if an executive purchased shares in year t and 0 otherwise. I also control for an executive's total compensation using Execucomp item TDC1, *Total Comp*, and for an executive's tenure at their firm, *Tenure*.

After excluding routine insider trades I am left with 504,958 insider transactions, which aggregate to 49,773 executive-year observations with at least one trade. I have data on 29,408 executive insiders trading across 2,727 unique firms. Table 1 describes the resulting sample. During the sample period 32% of all executive-years contain a insider sale and 8% an insider purchase. Out of the non-missing observation, 18% of executive-years consist of only purchases, 80% consists of only sales, and 2% consists of both sales and purchases.[10] The fact that most trades by executives are sales may be due to the rise in stock-based compensation. Also, for most of the executive years there are no trades, which is a direct result of screening for opportunistic trades only.

In addition to insider trades I also utilize options data provided by Execucomp. I only include a firm's top five executives, for each year, who have had an unexercised but exercisable stock option package at least once in the sample period. To capture an insider's options exercising behavior, I create a variable called *Exercised*, which is an indicator equal to one if an executive has exercised a stock option in year t and 0 otherwise. I also create two additional variables to measure how many options are exercised, *Exercised (N)*, and the value of options exercised, *Exercised ($)*. Table 1 shows that similar to insider trading behavior, executives only exercise options in approximately 36% of executive-years. To control for outliers I winsorize the top and bottom 1% of all non-indicator insider trading and stock options variables.

[10]Results are unchanged when excluding these 2% of transactions.

### 3.5 Financial and Other Variables

Over the past few decades U.S. companies have moved from manufacturing to more high-tech entities and as a result rely less on physical capital such as property, plant and equipment and more on intangible capital (Kahle and Stulz, 2017). To account for this change in the relative importance of these two forms of investment and to allow for substitution between them, I follow Peters and Taylor (2017) and define total investment (*Total Inv*) as the sum of capital expenditures (*capx*), research & development (*xrd*) expenditures, and 30% of selling, general, and administrative (*xsga*) expenditures. While SG&A is not a perfect measure for investment in intangible capital, Eisfeldt and Papanikolaou (2013) find that a large part of this item consists of expenses related to labor and IT (white collar wages, training, consulting, and IT expenses) and is therefore a good proxy for intangible investment.[11] The remaining 70% of SG&A is treated as operating cost that support the current periods profits.

In addition to *Total Inv* I use the following financial variables constructed from the Compustat: profitability (*Profit*) which is the firms operating profits before depreciation and amortization plus R&D and 30% SG&A, total book leverage (*Leverage*), the natural logarithm of the book value of a firm's total capital (*Size*), Tobin's ($Q$) which is computed as the market value of outstanding equity plus book value of debt minus the firm's current assets, cash and short-term investments (*Cash*), and cash flow (*Cash Flow*) which is equal to income before extraordinary items plus depreciation and the effective cost of intangible investment.[12] All financial variables are

[11] It is important to note that Peters and Taylor (2017) find that Compustat adds R&D to SG&A in certain circumstances, therefore, to avoid double counting R&D expenses I follow their methodology and remove it when possible. A more in-depth explanation of their logic can be found in their Appendix B.

[12] The effective cost of intangible investment is calculated as (1-marginal tax rate) times intangible

scaled by the firm's book value of total capital, i.e. the replacement cost of gross property, plant, and equipment, plus the replacement cost of intangible capital. To control for outliers I winsorize all firm financial regression variables at the 1% level. My summary statistics for *Total Inv*, *Cash Flow*, and $Q$ are similar to those reported in Peters and Taylor (2017) but differ slightly due to different sample periods.

To study M&A announcement returns and completion rates, I rely on the Thomson Securities Data Company (SDC) merger database to identify all takeover attempts for the firms in my sample. I create a sample of 3,103 mergers and acquisitions of majority interest of U.S. private and public targets during the sample period (SDC Form of the Deal: A (Acquisition), M (Merger), AM (Acquisition of Majority Interest)). I exclude all mergers with a deal size less than $100 million. My main outcome variables are cumulative abnormal returns, defined as the sum of the differences between the acquiring firm's daily stock returns and the CRSP value-weighted market returns around the announcement of the proposed transaction with windows of (-1,7) and (-5,5), and whether the acquisition was abandoned, *Abandon*. I control for deal characteristics by using the following control variables to account for whether the target is publicly traded, *Public Target*, has the same two-digit, *Similar Industry*, and the size of the deal, *Log(Deal Size)*.

For political control variables I use lobbying data from the Center for Responsible Politics (CRP) to identify firms that lobby in the prior and current year, *Lobbying*. I also use the partisan composition of a state's federal Senate and House of Representatives from the Biographical Directory of the United States Congress to control for how similar a state's congressional members are to the party in power, $PHI_{State}$. And I FEC contributions data to control for the total donations given by firm's employees,

investment. When available, I use the non-parametric marginal tax rates from Blouin *et al.* (2010), if missing the marginal tax rate is assumed to be 24% which is the sample average.

to the party in power, in the prior election cycle, *Contributions*.

To determine which firms are sensitive to government spending I use the high sensitivity industries determined by Belo *et al.* (2013) who use Input-Output tables, these industries include oil and gas extraction and defense firms, among others.[13] Additionally, it could be the case that in certain firms in non-sensitive industries could have the government as a major customer. To control for this I use the S&P Business Description, Compustat variable *BUSDESC*, which is a textual description of a company's business operations, and identify firms that have the government as a customer.[14] The Appendix provides a comprehensive description of variable definitions.

[13]See the appendix for the list of SIC codes.

[14]I look for the keywords agencies, government, governmental, army, navy, air force, marines, combat systems, reconnaissance, military, defense, homeland security, guidance, and department of, to identify local, state, and federal governments as major customers.

Chapter 4

# PARTISAN INVESTMENT

This section presents the empirical findings related to changes in corporate investment for Democrat and Republican firms during different partisan presidential cycles. I begin with a multivariate regression controlling for firm characteristics and for different proxies of political connections. I exploit variation in the degree of partisan similarity between firms and the president over different partisan cycles, and show the robustness of my results. I also address alternative explanations and explore the potential channels, behavioral and non-behavioral, that could produce the observed relation. Finally, I examine the value implications of these investment decisions.

## 4.1 Partisan Affiliation and Corporate Investment

To determine the effect partisan similarity between firms and the president can have on investment, I run the following augmented version of the standard investment-$Q$ specification to evaluate changes in investment during different partisan presidential cycles, conditional on firms' partisan similarity the president, that cannot be explained by the standard explanatory variables:

$$Total\ Inv_{ft} = \beta_0 + \beta_1 PHI_{Top5ft} + \beta_2 Rep_{Top5ft} + Q_{ft-1} + CashFlow_{ft} + \alpha_f + \alpha_t + \epsilon_f \tag{4.1}$$

where $f$ indexes firms and $t$ indexes years. The dependent variable, *Total Inv,* is defined as capital expenditures, SG&A, and R&D expenditures scaled by beginning-of-year total capital, as defined by Peters and Taylor (2017). The explanatory variable of interest, *PHI*, is a measure of similarity between the partisan affiliation of a

firm's top five managers and president. The coefficient on the similarity measure is designed to capture changes in the conditional investment rate that are driven by changes in the the presidency as well changes in a firm's executive team, controlling for firm investment opportunities and cash flows. I attempt to properly benchmark the conditional mean investment rate for a firm by controlling for time-varying firm characteristics, *Cash Flow*, and growth opportunities, $Q$. Firm and year fixed effects are included in the specification and standard errors are clustered by firm throughout the paper. Following both Julio and Yook (2012) and Peters and Taylor (2017), I also use the investment-$Q$ framework as the baseline specification as it has a solid theoretical foundation as well as good empirical support relative to other investment regression models (Eberly *et al.*, 2008). As discussed in the robustness section, the main results are robust to various alternative specifications as well as to different measures of investment and proxies for partisan similarity.

Table 3 reports the results for my baseline specification. The first column reports the regression of investment on *PHI* alone. The following column reports the regression of investment on a firm's unconditional partisan affiliation. In line with Hutton *et al.* (2015) I find a weak negative relation between Republican managers and corporate investment policies. As a result I control for partisan affiliation for the remainder of the paper. When including both partisan similarity and affiliation in the same specification, party affiliation becomes a much weaker predictor of investment, supportive of the idea that dynamics between affiliations is more important. In the remaining columns I add controls for firms' investment opportunities and cash flows and find that investment is positively related to both, and is negatively related to how Republican a firm's managers are.

In column (6), which represents my baseline specification throughout the rest of the paper, I include the following controls for the effect that time-varying political

connections can have on a firm's investment policies, which can result from additional procurement contacts, favorable regulation, etc. *Contributions* is defined as the natural log of one plus a firm's total employee contributions given to the winning party in the prior election cycle. *Lobbying* is constructed from the CRP database and is an indicator variable that is equal to one if a firm lobbies in both the prior and current year. Finally, I follow Kim *et al.* (2012) who show that firms in states whose majority of federal legislative members belong to the same party as the president outperform those whose representatives do not and include, $PHI_{State}$, which is equal to the fraction of a state's federal Senators plus the fraction of a state's federal House of Representatives who belong to the same party as the president.

Consistent with the hypothesis that partisan similarity to the president is positively related to investment, *PHI* in column (6) increases the conditional mean investment rate in a economically and statistically significant way. These estimates show that investment increases by 0.0037 with a one standard deviation in partisan similarity. In terms of magnitudes, this coefficient translates into a economically significant 1.9% increase in corporate investment, relative to the sample average. The results from this baseline specification are consistent with the hypothesis that managers become more opportunistic when their preferred party controls the White House.

Having shown that partisan similarity is associated with changes in total investment, in Table D.2 I deepen the analysis by exploring which components of *Total Inv* vary with changes in partisan similarity. I find that not only do firms hire more employees, with an increase in their employment growth of 4.9%, but they also spend more per employee with intangibles per employee increasing by 3.4%. Looking at the components of *Total Inv*, I find increases of 1.2% in SG&A, 0.8% in CapEx, and 2.8% in R&D. The fact that intangible investments are more sensitive to partisan affiliation than tangible ones is particularly interesting as investments in intangible and human

capital are activities widely considered to be riskier than most other investments, such as in fixed assets and business acquisitions. That riskiness is a major reason why U.S. GAAP mandates that R&D should be expensed (except for software development costs — SFAS 86) despite the obvious expectation of future benefits from this activity. Managers also consider innovation investments, and R&D in particular, to significantly enhance the firm's risk, a 2012 Conference Board CEO survey reports that executives consider innovation management as one of the top five aspects of corporate risk management (Mitchell and Rebecca, 2012).[1]

### 4.2 Robustness

In this section, I perform several robustness checks. I start by examining the changes in the importance of partisan similarity changing it from a contemporaneous to lagged variable. While the different start dates of a firm's executives does indeed add noise to the estimation of a management team's partisan similarity, Execucomp lists an executive when they work at their current firm for more than half of fiscal year t. When looking at investment decisions the year after a firm's estimated similarity, in column (1) of Table 4, the level of investment is lower, which can be the result of election and post-election years, but is still significant both economically and statistically. Despite evidence that individuals' partisan preferences are stable in adulthood and that most managers contribute consistently to one party, it could be the case that individuals' partisan affiliations change later in their adult lives. In column (2) of Table 4 I address whether the partisan consistency assumption is necessary for this

[1]Some studies also consider R&D expenditures as risky investments compared to capital expenditures; for example, Coles *et al.* (2006) examine whether risk induced by executive compensation is associated with more R&D expenditures. Also, Kothari *et al.* (2002) report that R&D is substantially riskier than capital expenditures.

study by defining an individuals' partisan affiliation as the five-year rolling average of their political contributions. As you can see, the relation with investment is largely unaffected by changes to this assumption.

The third column of Table 4 reports the results with the lagged dependent variable on right-hand side of the regression equation. Eberly *et al.* (2008) note that lagged investment has been found to be correlated with contemporary investment. With that being said, there may be concern that autocorrelation in *Total Inv* may contribute to the results found in this paper. I find that the main finding is robust to the inclusion of lagged investment rates. In column (4), I construct a random political similarity measure to address the concern that there may be some underlying time trend in the data that is not captured by the year dummy variables or that political similarity is simply not important. For each firm-year observation I assign each firm a random political similarity measure from a normal distribution so that the mean and standard deviation are equal to the sample statistics for the variable $PHI_{Top5}$. The coefficient for this random variable is close to zero and insignificant, suggesting that the changes in investment are indeed driven by partisan similarity and not due to underlying time trends in the data. Finally, in the fifth column I include additional control variables such as lagged *Size*, *Leverage*, *Cash*, and state-level GDP growth, $GDP_{State}$, and find that the main result does not change. For additional robustness, which can be found in Table D.3 in the appendix, I rerun my baseline specification using alternative proxies for investment including. [2] My results are quantitatively similar and statistically significant across all different measures of investment.

[2]In unreported test I include different fixed effects to account for state, industry, city, fiscal year end, and other time-varying shocks to *Total Inv*. I also double cluster the standard errors by firm and year, firm and president, etc., with results remaining quantitatively similar.

# Chapter 5

# INVESTMENT CHANNELS

## 5.1 Partisan Based Optimism

Having shown the relation between political similarity and investment is robust, I now explore the potential explanations for this finding. The main channel that can be driving this relation, and the main focus of this paper, is that managers become more optimistic when their preferred party is in power, whether due to in-group favoritism or partisan-perceptual screening, and subsequently invest more. In order to show that the observed findings are behavioral in nature, it will first be useful to establish which sources of variation in *PHI*, are associated with changes in *Total Inv*. If the relation between *PHI* and *Total Inv* is solely driven by changes in the party of presidency, as the result of national elections, then my results could be the result of time-varying omitted variables and not behavioral. Likewise, it will also be beneficial to see if the relation between *PHI* and *Total Inv* is symmetric between Republicans and Democrats as it would either imply that one group is more partisan than the other or that one group is more likely to be affected by changes in the presidency. Because it is unlikely that one group is affected differently by changes in the presidency, as political connections should be seen as valuable by both groups of managers, any asymmetric effects would tend to lend support for managerial optimism based on different levels of partisanship.

### *5.1.1 Sources of Variation*

To observe whether the relation between *PHI* and *Total Inv* is the result of omitted variable bias (OMB), and therefore not captured by firm fixed effects, I determine which sources of variation are driving my results. To do this I rerun my baseline specification from Table 3 and use different fixed effects to isolate changes due to elections and to managerial turnover. I also study to what extent changes in presidential approval ratings can affect investment because even though this is not a source of variation in this paper, this channel would provide some evidence of a behavioral explanation.

Table 5 reports the results from this analysis. In the first column I use firm, year, and party fixed effects to determine how changes in partisan similarity due to national elections affects management teams, holding their partisan affiliation constant. In this setting there is only identification when management teams experience no turnover between managers with different affiliations but experience a change in *PHI* due to a national election. Consistent with both the OMB and behavioral explanation, I find that management teams invest more then their candidate is president. In column (2) of Table 5 I use firm x president and year fixed effects to study the changes in investment due to changes in management teams within each president's tenure. With this specification there is only identification when partisan similarity changes due to management changes between executives with different affiliations. Interestingly, this effect is isolated to the president's first term, likely a result of increasing uncertainty surrounding the next election outcome. In this setting, I find evidence with the behavioral channel of investment. In column (3) of Table 5 I use firm x president, year, and party fixed effects to see how changes in presidential approval, while holding the team's party and the president fixed, affect investment. *Rep Approval* is the average

yearly presidential approval rating surveyed by Republicans and identification comes from changes in the presidents approval by Republicans. I only include Republican approval ratings because Democrats have the opposite view of the president. As you can see, the more favorably a Republican management team views the president, assuming their views mirror the general public's, the more they invest. Results from this table show that the relation between partisan similarity and investment is not solely driven by changes in the presidency, which eases concerns of omitted variable bias, but are also driven by changes in management teams and changes in presidential approval.

### *5.1.2 Partisan Asymmetry*

Next, to see whether this relation is symmetric among Democrats and Republicans, I use the same baseline specification as Table 3 but augment to compare Republican and Democrat run firms to non-donor firms. In column (1) of Table 6, *% Republican* is equal to a $Party_{Top5}$ but re-scaled to be between 0 and 1 where 0 means the average executive donates equally to both parties and 1 means the average executive donates only to the Republican Party. *% Democrat* is similar to *% Republican* but in the opposite direction. These results show that Republican firms increase investment by 1.8% during Republican presidencies but decrease by 1.6% during Democratic ones, whereas Democrat firms show no statistically different behavior when compared to non-donor firms. To show this result in a different way I run the same baseline analysis as in column (6) of Table 3 but with partition the sample based on firms' partisan affiliations. I first compare Republican firms with non-donor firms, and then Democrat firms with non-donor firms. These results also corroborate the intuition in column (1) that there is a partisan asymmetry between Republican and Democrat managers. This difference in behavior would imply that

either Republican firms establish more political connections, or are more reliant on political connections, or Republican managers are more partisan and as a result will become more or less optimistic depending on the party in power when compared to Democrats and Independents. While both could be true, it seems more likely given that Republicans have been shown to be more partisan that the relation between *PHI* and *Total Inv* is stronger for Republican firms because they are more partisan than Democrat firms.

### *5.1.3 Individual Level Evidence*

Even though the above results show that changes in investment are due to variation in *PHI* that is driven by managerial turnover and that the observed partisanship is mainly driven by Republican managers, determining whether partisan related heterogeneous beliefs is driving the observed changes in investment is still empirically challenging. This is mainly due to the fact I cannot tie investment outcomes to these individuals, and that manager selection is endogenous even if its timing is exogenous (i.e. mandatory retirement, death, etc.). Hiring more Republican managers during a Republican presidency could introduce unobserved political connections to the party in power, and vice versa.

**Opportunistic Trades and Options Exercising**

To overcome these challenges and to provide evidence that partisan bias can change an individual's level of optimism based on the party of the president, I exploit executives' opportunistic insider trading decisions and compare them to other executives, with different political affiliations, within the same firm and year. This setting provides the perfect environment to test whether the PHI-investment relation is due to a behavioral channel, i.e. increased optimism due to partisan similarity, because man-

agers will make trading decisions that they believe will maximize their own wealth thereby revealing their level of optimism regarding their own firms' business outlook. For example, if a Republican becomes president, for the non-behavioral channel to be true one would not expect Republican managers to systemically exhibit different trading behavior when compared to non-donor or Democrat managers after an election outcome because they should all have the same ex-ante expectations regarding their firms future performance, given the same information set.

My identification strategy tests whether managers within the same firm exhibit different levels of optimism, conditional on their partisan similarity to the president, by regressing insider trades by executive $i$ in firm $f$ in year $t$ on firm x year fixed effects and individual executive fixed effects. Additionally, I cluster standard errors at both the executive and firm level. I also allow for differential behavior during later stages of each presidency, as individuals may want to purchase their companies shares in the beginning of the presidency and either hold their positions and/or sell in the president's second term to realize gains before a potential regime change. This is done by running the following regression:

$$Trade_{ift} = \beta_0 + \beta_1 PHI_{it} + \beta_2 PHIxTerm2_{it} + Controls_{it} + \alpha_{ft} + \alpha_i + \epsilon_{if} \tag{5.1}$$

*PHI* in this analysis is a discrete variable equal to 0 or 1 for executives depending on their partisan affiliation and the party in power (1 = similar) and 0.5 for managers who are non-donors, and *PHI x Term2* is equal to a manager's *PHI* in the second term of each presidency.[1] As in my main analysis in subsection 4.1, I include non-donors to estimate the fixed effects and coefficients on control variables more precisely. I also include controls for total compensation and tenure since Democrat (Republican) managers in mainly Republican (Democrat) controlled firms could have both lower

[1]This analysis is unaffected by changing *PHI* for non-donors to 0 due to executive fixed effects.

pay and shorter tenures which could systematically affect their trading decisions.

Due to the long time horizon, the inclusion of executive-years with no trades, and the fact that not all managers regularly make opportunistic insider trades, I include individual executive fixed effects in my regression. As a result, the coefficient on *PHI* will be identified only based on Republican and Democratic managers whose partisan similarity measure *PHI* switches from 0 to 1. By including firm x year fixed effects I am essentially comparing managers who are employed by the same firm and at the same point in time. This means that results from this analysis are less prone to endogeneity issues or omitted variable bias. In terms of expected outcomes, if the relation between *PHI* and *Total Inv* is to some extent due to increased optimism stemming from partisan bias, then one would expect managers who belong to the same political party as the president to be more likely to purchase their own companies shares, or be less likely to sell them. This behavior should be more pronounced in the beginning of each president's term as there is a longer time horizon before there is uncertainty regarding who will control the White House.

Results from this analysis are reported in Table 7. For every variable besides *Purchase*, a clear relation emerges. During the first term of a presidency, executives who belong to the same party as the president are less likely to sell their shares when compared to non-donor executives and those of the opposite party within the same company. In columns (1-2) of Table 7, the positive coefficient for *Shares* of 0.007 implies that managers belonging to the same party as the president hold 20% more shares in their company when compared to the sample average. To get a better idea of this behavior, i.e. to see if managers trade in different directions, I look at indicators for sales and purchases. In columns (3-4), when looking at these indicator variables, it seems that affiliated executives sell less shares than other executives within the same company when a president is first elected, a decrease in the probability of selling of

69% relative to sample average. In columns (5-6) this relation is not significant which is most likely due to the lower frequency of insider purchases in the sample. Taken together, these results indicate that executives who belong to the same party as the president have higher expectations of their firms' performance and are more likely to hold onto their shares. When looking at results during the president's second term, executives' optimism seems to decrease due to increasing uncertainty of the next election outcome and subsequently behave similarly to managers with different partisan affiliations. This is evident by the joint p-value being statistically insignificant for all specifications.

I also provide complimentary evidence, using the same identification strategy as the previous table, by showing that executives also exhibit optimistic behavior when it comes to exercising stock options. If executives are optimistic, in regards to prevailing and future economic conditions induced by their partisan similarity to the president, they would be less likely than executives from the opposite party to exercise their stock options in the president's first term as they would expect their options will be more in-the-money (ITM) as time progresses. This relationship would naturally reverse in the second term because these same executives will have to exercise their options before they expire and because there will be more uncertainty regarding the next election outcome. To test for this hypothesis I control for executives' total compensation and tenure, exploit within firm-year differences in executives partisan affiliations to the president, and control for executive time-invariant characteristics. My outcome variables measure whether an executive exercised options in a particular year, *Exercised*, the number of options they exercised, *Exercised (N)*, and the value of options exercised, *Exercised ($)*. Results from this analysis are reported in Table 8. Consistent with the managers being less likely to exercise stock options in the first term of their preferred presidents tenure due the expectation that their options

will be more ITM in the future, column (2) shows that executives are 4% less likely to exercise their options when they belong to same party as the president. These partisan similar individuals then exhibit exercise behavior in their presidents second term that is similar to other executives. This same relationship holds when replacing the binary *Exercised* variable with the number (columns (3-4)) or value (column (5-6)) of options exercised.

**Opportunistic Trades - Election Setting**

So far there is evidence that partisan similarity to the president changes an individual's level of optimism, as evident by changes in their trading and option exercising behavior. To provide an even cleaner test of insider trading results I conduct an event study around all of the elections in my sample. Focusing on the years around elections minimizes the noise that is introduced when analyzing infrequent actions over a long time series. To do this, I restrict the sample to one year before and after each election (including election years) and to executives who I can identify as either Democrat or Republican (excluding non-donors). Due to the shorter time series and the fact that not all executives trade on a consistent basis, I exclude all executive years where there are no trades, omit executive fixed effects, and run following regression:

$$Trade_{ift} = \beta_0 + \beta_1 WinningParty_{it} + \beta_2 Rep_{it} + Controls_{it} + \alpha_{ft} + \epsilon_{if} \tag{5.2}$$

*WinningParty* in this analysis is an indicator variable equal to 0 for years t-1 and t, and is equal to 1 or 0 depending on an executives similarity to the president in year t+1. *Rep* is an indicator equal to 1 if an executive is Republican and 0 if a Democrat. By excluding missing executive-year observations I am only comparing purchases and sales by executives which provides a cleaner test of changes in optimism because I am now comparing actions between individuals instead of an action compared to

action/no action as in Table 7.

The results from this analysis, found in Table 9, show that prior to elections Republican and Democrat managers do not display any significantly different trading behavior, which is evidence that managers are waiting for uncertainty to clear and that this is a clean test environment. Looking at the results for *WinningParty*, after a manager's preferred party wins the presidency there is a significant increase in their level of optimism and as a result they hold on to more shares of their companies' stock relative to other managers. In terms of economic magnitudes, when a managers party wins the election, their position within the firm increases by 38%. To see whether this is a result of managers buying or selling in different quantities, or the result of managers trading in different directions, I use the variable *Sale*. Results from column (4) show the outcome in column (1) is both a result of managers purchasing more or selling less when all managers trade in the same direction, as well as a result of managers being less likely to sell (i.e. more likely to purchase) their companies' shares.

In Table 10, I run the same analysis as in Table 9 and find similar results when focusing on the 2001 presidential election. This is the closest election in my sample, with George W. Bush winning the election by winning in Florida by 537 votes (or by a margin of 0.009%), but it was also the closest election in the history of the US Electoral College and was also the first ever election decided by the US Supreme Court. The variable *Rep x Rep President* is equal to one the year after George W. Bush wins the election, as you can see the year after election Republican managers hold more shares in their firms (columns (1-2), which is driven by less selling and more purchases (columns (3-4)).

While showing that managers within the same firm exhibit different levels of optimism depending on their political party is consistent with irrational expectations of future performance, it would be useful to assess whether these opportunistic trades

carry credible information or result in long-term insider profits. Following a similar methodology as Cohen *et al.* (2012), who look at the next month's stock returns to assess the informational content of opportunistic insider trades, I look at the next year's returns after insiders purchase or sell shares in their own firm, unconditional transactions, and then assess whether the information content is reduced by partisan similarity. I follow the specification in Table 9 with the exception of including non-trading years. As you can

## 5.2 Partisan Clustering

Having shown the relation between political similarity and investment rates are driven by managerial optimism, I explore whether the observed effect can be explained by other factors as well. One explanation could be that managers may on average choose to work in industries based on their partisan preferences, for example, Republican managers may be more likely to choose to work for companies in the defense or oil and gas industries. So extending the results of Hong and Kostovetsky (2012), who show that Democrats and Republican fund managers have different industry preferences, to managers employment choices. These same industries could be more likely to receive government support by presidents with similar partisan preferences. For example, Republican managers may be more likely to select into the defense industry and this industry may be more favored by a Republican president when choosing the allocation of government resources. This same relationship could also apply to partisan states, where individuals live and work in states based on partisan affiliation, e.g. Republicans in Texas, and these states may be favored by a partisan similar president.

In either case, this effect should be captured by controlling for investment opportunities and cash flows but it is well established that the different proxies of $Q$ are

noisy approximations and therefore may not fully account for this.[2] To check if such mismeasurement is driving my results, I rerun my baseline regression equation on different subsamples. In column (1) of Table 11 I exclude the industries identified by Belo *et al.* (2013) to be sensitive to government spending.[3] In the second column I label industries as partisan if they are on of the top ten most Republican or Democratic industries based on firms' partisan affiliations, for the whole sample period. Finally, in the third column I do the same exclusion for states based on the average affiliation of firms within them. Across all sample restrictions the relation between $PHI_{Top5}$ and investment is is even more economically and statistically significant than my baseline result. Compared to the full sample, only 12% of firms are in partisan industries or in partisan states.

### 5.3 Partisan Connection Seeking

So far my results have relied on the assumption that political contributions are a reliable proxy for an individual's political affiliation. Despite evidence from the political science literature that this may be the case, two key alternative explanations for the positive relation between $PHI_{Top5}$ and *Total Inv* are that personal political contributions, instead being an indicator of one's partisan affiliation, are actually an attempt to establish political connections, or individuals prefer to establish connections with congressional members who share the same partisan preferences. In either case this would imply that my findings could be the result of gains and losses of political connections linked to the party in power, rather than from changes in optimism. While there is evidence that strategic political contributions can be beneficial to firm

[2]As discussed in the robustness section, my results hold with the inclusion of state-year and industry-year fixed effects, which should account for this.

[3]This industries were identified using IO tables from 2001. See Appendix D for details.

value (Cooper *et al.*, 2010), this seems unlikely to explain my findings due to the following reasons. First, approximately 50% of executives in my sample donate to only one party and 68% of the executives in my sample contribute more than 80% of their funds to one party. This would imply that managers are revealing their preferred party or are only building connections with one party, which ex ante is not optimal, instead of strategically donating to both parties. Second, the median total contributions over the whole sample period for executives is approximately $6,000 (mean is $37k). This amount is trivial when compared to the total contributions given by firms' PACs and compared to the amount of money spent on lobbying.[4]

To test for these alternative explanations I repeat my baseline specification in column (6) of Table 3 but with different estimations of *PHI* and omit firms for who government contracts are important. First, Ovtchinnikov and Pantaleoni (2012) find that individuals make contributions that strategically target politicians with power to affect their economic well-being. More specifically, individuals in congressional districts with greater industry clustering choose to support politicians with jurisdiction over the industry and are associated with improvements in operating performance of firms in industry clusters. Even with the sample restrictions done in the prior subsection, the use of city-year time fixed effects done for robustness, and optimality argument for contributing to both parties, in column (1) of Table 12 I calculate individual's partisan affiliations by excluding their contributions to specific candidates (other than the president), and include all donations to party committees which pool

[4]Ansolabehere *et al.* (2003) suggest that political contributions are commonly used to express one's political orientation and ideology rather than to establish political connections. They find that the political contribution limits are not reached in most cases, and, on average, top corporate executives contribute less than 0.05% of their annual compensation. Recent research in political science also supports the view that campaign contributions are unlikely to facilitate political connections. Those connections are instead formed mainly through direct lobbying activities (Milyo *et al.*, 2000).

funds and distribute them to politically important congressional races.[5] This restriction on personal contributions addresses both the concern that they are used to establish connections but also the concern that individuals may contribute to candidates based on pre-existing relations, i.e. a neighbor or close friend for local races, which as a result adds noise to estimation of their partisan affiliation.

My baseline *PHI* variable is calculated using an individual's total dollar amount donated over the entire sample period to both parties. Therefore, a large opportunistic donation to the Republican Party in a single election cycle for instance, would categorize that individual as a Republican even if they donated to only the Democratic party in every other election cycle, perhaps revealing their true affiliation. In column (2) of Table 12 I test this idea by measuring each manager's *PHI* as the equal-weighted average of every election-cycle specific *PHI*. This alternative measure is less likely to be affected by large opportunistic donations made in a single election cycle and therefore is less subject to concerns related to the timing of strategic donations.

Another way to control for the connections explanation would be to only include executives who donate 80% more to a single party in the analysis as they are likely to be Partisan Republicans or Democrats and not individuals who strategically contribute to both parties. While its true that firms could seek connections with individuals who only belong to their party, evidence from prior studies suggest that most firm PACs, which dwarf personal contributions in terms of dollar amounts, donate more equally to both parties. Therefore, I re-estimate $PHI_{Top5}$ by making $Party_{Top5}$ equal to 1 for firms whose managers donated 80% to only the Republican Party over the sample period and vice versa. The result in column (3) indicates that for firm's

[5]It is very unlikely that political parties notify each candidate of the companies that contributed to the party's campaign. Additionally, contributions by executives could be given to unrelated candidates from a different states.

who are polarized a change in presidency results in a 7% change in investment. Because the relation is only identified by polarized firms, results are similar if I exclude non-polarized ones.

Finally, in the last two columns I exclude firms for which political connections would be beneficial. If the relation between partisan similarity and investment exist in these samples then it seems unlikely political connections or partisan connection seeking are driving my results. In column (4) of Table 12 I use lobbying data to exclude all firms identified by the Center for Responsible Politics (CRP) to have lobbied at least once during the sample period. In column (5), I use S&P Business descriptions, which provides a description of each firms core business and customers, to exclude all firms who have the government listed as a customer. In both of these subsamples the results are nearly identical to the baseline specification. Overall, the results from this table suggest that political connections are unlikely to be a case for concern.

# Chapter 6

# PERFORMANCE OUTCOMES

## 6.1 Firm Value and Operating Performance

After presenting evidence that changes in investment during different partisan cycles can be attributed to individuals becoming more optimistic when their preferred party is in power, I determine whether these optimism-based investment decisions are optimal or are distortions in investment efficiency. If firms invest more because managers believe economic conditions will improve due to their partisan-based optimism, this would imply that their investment decisions are not the result of fundamentals-based expectations. If true, partisan similarity should be negatively associated with future performance as managers could be more likely to accept lower NPV projects, after exhausting better growth opportunities, that they otherwise wouldn't accept. To test this hypothesis, I run the following specification:

$$Performance_{ft} = \beta_0 + \beta_1 PHI_{Top5ft} + \beta_2 Rep_{Top5ft} + Controls_{ft} + \alpha_f + \alpha_t + \epsilon_f \quad (6.1)$$

where $f$ indexes firms and $t$ indexes years. I test for both contemporaneous stock price and operating performance as well as perform additional specifications with one and two year ahead performance measures to account for the delay in realized gains or losses that would occur with long-term investments (i.e R&D and SG&A). To analyze valuation effects I use annual returns calculated using fiscal year end stock prices. Following the extant literature, I include control variables for political connections, size, cash, total investment, leverage, and profitability. For operating performance, I use operating profits as the LHS variable and include control variables for political

connections, size, cash, total investment, and leverage. For both specifications I cluster standard errors at the firm level and include both firm and year fixed effects. Due to the well documented evidence that firms in government related industries and firms with the government as a principal customer both experience increased stock price performance and cash flows, especially when there is increased government spending which typical occurs under Democratic presidents, I remove them from this analysis.

The results from this analysis can be found in Table 13. In terms of valuation effects, columns (1-3) clearly show that when holding partisan similarity constant, there is a negative relation between investment and stock returns in the years following the initial investment decisions, this can be attributed to the time lag between investments and their subsequent realized returns. Because I exclude government related firms, as defined by industry and customers, the positive relation between *PHI* and contemporaneous returns is most likely due to shareholder expectations that firms with partisan similar managers could be better positioned in terms of regulatory outcomes or other favorable treatment. This observed relation could also be a result of partisan similar investors buying firms who invest more because they also have biased expectations of future economic growth. For columns (2) and (3) in terms of economic outcomes, when holding investment equal to the sample average, a one standard deviation increase in political similarity is associated with decrease in stock returns of 1.7% and 5% compared to the sample average. Columns (4-6) report the operating outcomes due to increased investment. Consistent with valuation results there exist a negative relation between investment and profitability conditional on a firms' partisan similarity. For columns (5) and (6), when holding investment equal to the sample average, a one standard deviation increase in political similarity is associated with a decrease in operating profits of 0.5% and 0.6% compared to the

sample average. It is important to note that this result is not purely mechanical as I capitalize investments in both R&D and SG&A so that they do not affect operating profits.[1]

### 6.2 M&A Announcement Returns

Finally, after showing that *Total Inv* is negatively associated with financial and operating performance for partisan similar firms, I explore whether there is also a negative association with large single investment decisions. Takeovers are not only one of the most important capital allocation decisions a firm can make, but they are also a good empirical setting because they are publicly observable investment decisions whose quality can be determined using market reactions to their announcement.

If partisan managers have higher expectations of economic growth they make taking on lower NPV projects. These poorer investment decisions could be reflected in the quality of their takeovers. To test this hypothesis, I run the following specification:

$$Y_{ft} = \beta_0 + \beta_1 PHI_{Top5ft} + \beta_2 Rep_{Top5ft} + Controls_{ft-1} + \alpha_i + \alpha_t + \epsilon_f \tag{6.2}$$

where $i$ indexes industries and $t$ indexes years. The dependent variable is the cumulative abnormal return CAR measured over the windows (-1,+7) or (-5,+5). I include control variables for political connections, for firm specific characteristics including size, cash, leverage, investment opportunities, and for deal characteristics including the whether the target is a publicly traded firm, in the same industry, and the natural log of the deal value. I cluster standard errors at the firm level and include both industry and year fixed effects. Table 14 reports the results from this analysis. In columns (1) and (3) I regress CARs on my main explanatory variable and firm

[1]Both sets of results are quantitatively similar with the inclusion of industry x year fixed effects to account for time-varying industry effects.

characteristics, in the remaining columns I include deal specific controls. Across all specifications there is no statistical relationship between *PHI* and deal quality.

The absence of a result can be due to several reasons. Unlike the performance results from the previous table, takeover attempts occur at lower frequencies, this can reduce the preciseness of my analysis as most firms will not announce an acquisition over different presidencies which prevent me from controlling for firm specific time-invariant omitted variables. Additionally, these decisions due to their size and complexity, public disclosure, may receive more scrutiny than decisions that are incrementally made throughout the year, such as hiring decisions or R&D spending, which can reduce the effects of partisan optimism. Finally, it could also be that stock returns surrounding the announcement can not be completely attributed to expectations regarding the effect of the takeover on the bidder's profitability (Fuller *et al.*, 2002).

Overall, these results provide support for the value-destroying hypothesis as forward looking measures of performance are negatively associated with partisan similarity for firms with higher levels of investment. Additionally, while takeover attempts by partisan similar firms are not associated with negative CARs on average, for potential reasons discussed earlier, these firms are less likely to abandon acquisitions that the market determines are value reducing.

# Chapter 7

# CONCLUSION

I study how similarities in the political affiliation between managers and the president affect firm's investment decisions and their subsequent valuation and performance. Using a sample of 2,644 firms for years 1992 to 2016, I find that firms whose managers' partisan preferences align with the president increase total investment more than less similar ones. I show that this relation is not driven by partisan clustering into certain industries or states, or by changes in political connections. After isolating changes in partisan similarity that are solely due to management turnover and exploiting individuals' insider trading decisions, I show that managers who belong to the same party as the president are more optimistic in regards to their firms future performance. As a result of these non-fundamental based expectations, I find that higher investment is associated with lower valuations and operating performance for firms who are more politically aligned with the party in power.

Overall, my results indicate that managers can have heterogeneous expectations in regards to future business conditions based on the party in power and their partisan affiliations. Investment decisions based on this partisan optimism do not appear to be associated with any tangible benefits. In fact, investments made by partisan similar firms are negatively associated with different measures of performance and these firms are less likely to abandon value-reducing takeover attempts.

These findings are important for a few reasons. First, this behavior can be insidious as it is not clear whether shareholders are aware of the effects partisan bias can have on economic agents. Second, compensation contracts should drive individuals to make optimal decisions, but if managers believe their decisions are maximizing

shareholder value even though they are driven by partisan beliefs, then additional corporate fixes should be warranted. It would be beneficial for directors and institutional shareholders to design governance mechanisms that control for this behavior, such as adding political affiliation to the list of diversity initiatives for executives.

Table 1: Summary Statistics

This table presents summary statistics for the main variables in my regression models. The sample consists of 2,644 firms (excluding utility and financial firms, and firms with less than $5 million in physical capital from 1992-2016. Detailed definitions for all variables can be found in Appendix B. All financial variables are constructed using Compustat and are winsorized at the 1% level at both tails.

| | N | Mean | Std. Dev. | 25th Pct | Median | 75th Pct |
|---|---|---|---|---|---|---|
| **Panel A: Political Variables** | | | | | | |
| $Rep_{Top5}$ | 35,318 | 0.12 | 0.30 | 0.00 | 0.03 | 0.27 |
| $PHI_{Top5}$ | 35,318 | 0.48 | 0.16 | 0.40 | 0.50 | 0.58 |
| $PHI_{State}$ | 35,227 | 0.52 | 0.28 | 0.25 | 0.52 | 0.78 |
| *Contributions* | 35,318 | 0.12 | 0.69 | -0.09 | 0.00 | 0.67 |
| *Lobbying* | 35,318 | 0.18 | 0.38 | 0.00 | 0.00 | 0.00 |
| **Panel B: Other Variables** | | | | | | |
| *Total Inv.* | 34,981 | 0.19 | 0.15 | 0.02 | 0.09 | 0.14 |
| *Q* | 32,911 | 1.51 | 2.08 | 0.47 | 0.87 | 1.66 |
| *Size* | 35,192 | 7.17 | 1.61 | 6.02 | 7.04 | 8.20 |
| *Cash* | 34,959 | 0.22 | 0.36 | 0.03 | 0.09 | 0.25 |
| *Leverage* | 34,981 | 0.28 | 0.35 | 0.05 | 0.20 | 0.37 |
| *Cash Flow* | 34,981 | 0.16 | 0.16 | 0.09 | 0.14 | 0.21 |
| *Profit* | 34,923 | 0.25 | 0.21 | 0.14 | 0.21 | 0.31 |
| *Ret* | 34,040 | 0.12 | 0.56 | -0.20 | 0.05 | 0.32 |
| *Dividend* | 35,416 | 0.48 | 0.50 | 0.00 | 0.00 | 1.00 |
| *Shares* | 128,209 | -0.03 | 0.11 | -0.01 | 0.00 | 0.00 |
| *Sale* | 128,209 | 0.32 | 0.47 | 0.00 | 0.00 | 1.00 |
| *Purchase* | 128,209 | 0.08 | 0.27 | 0.00 | 0.00 | 0.00 |
| *Log(Total Comp)* | 121,952 | 7.16 | 1.03 | 6.40 | 7.09 | 7.84 |
| *Tenure* | 128,209 | 3.75 | 3.87 | 1.00 | 3.00 | 5.00 |
| *Exercise Options* | 170,311 | 0.36 | 0.48 | 0.00 | 0.00 | 1.00 |
| *Exercised (N)* | 161,638 | 1.37 | 1.95 | 0.00 | 0.00 | 3.04 |
| *Exercised ($)* | 143,684 | 2.43 | 3.39 | 0.00 | 0.00 | 5.75 |
| *Greater Than Analyst* | 7,871 | 0.39 | 0.49 | 0.00 | 1.00 | 1.00 |
| *Miss Guidance* | 10,637 | 0.54 | 0.50 | 0.00 | 1.00 | 1.00 |
| *CAR(-1,+7)* | 2,916 | -0.00 | 0.08 | -0.04 | 0.00 | 0.04 |
| *CAR(-5,+5)* | 2,951 | 0.00 | 0.09 | -0.04 | 0.00 | 0.05 |
| *Abandon* | 3,103 | 0.08 | 0.27 | 0.00 | 0.00 | 0.00 |
| *Public Target* | 3,103 | 0.48 | 0.50 | 0.00 | 1.00 | 1.00 |
| *Same Industry* | 3,103 | 0.60 | 0.49 | 0.00 | 1.00 | 1.00 |
| *Log(Deal Size)* | 2,170 | 6.35 | 1.30 | 5.30 | 6.04 | 7.21 |

Table 2: Political Aggregation by Industry and State

This table sorts states and industries by how Republican the firms within them are. $\text{Rep}_{Ind}$ and $\text{Rep}_{State}$ are the average $\text{Rep}_{Top5i}$ for each firm, which is aggregated to the industry or state level and standardized to be between 0 and 1.

Panel A: Industries

| | # of Firms | Industry (sic2) | $\text{Rep}_{Ind}$ |
|---|---|---|---|
| Lowest | 3 | 83: Social & Child Services | 0.447 |
| | 13 | 78: Services - Motion Picture and Video | 0.461 |
| | 15 | 47: Transportation Services | 0.477 |
| | 11 | 31: Leather & and Footwear | 0.481 |
| | 7 | 17: Construction & Electrical Work | 0.491 |
| Highest | 8 | 12: Bituminous Coal & Lignite Mining | 0.635 |
| | 19 | 24: Lumber, Sawmills, Prefab Builds, & Mobile Homes | 0.642 |
| | 5 | 21: Tobacco and Cigarettes | 0.650 |
| | 29 | 29: Asphalt, Roofing, Petroleum Products | 0.685 |
| | 11 | 40: Railroads & Line-Haul Operating | 0.688 |

Panel B: States

| | # of Firms | State | $\text{Rep}_{State}$ |
|---|---|---|---|
| Lowest | 2 | Hawaii | 0.382 |
| | 5 | District of Columbia | 0.445 |
| | 13 | New Hampshire | 0.487 |
| | 170 | New York | 0.487 |
| | 8 | Rhode Island | 0.487 |
| Highest | 8 | Mississippi | 0.658 |
| | 5 | New Mexico | 0.669 |
| | 11 | Idaho | 0.683 |
| | 9 | Nebraska | 0.692 |
| | 2 | North Dakota | 0.739 |

Table 3: Investment and Partisan Similarity

This table represents the baseline specification. The dependent variable, *Total Inv*, is the sum of CapEx, SG&A, and R&D scaled by total capital. The main explanatory variable, *PHI*, is the partisan similarity between a firm's management team and the president. *Party* is the average party affiliation of a firm's managers. Financial controls, $Q_{t-1}$ and *Cash Flow*, are from the extant literature and are lagged by one year. *Lobbying* is an indicator variable equal to one if a firm lobbies in the prior and current year, $PHI_{State}$ measures the partisan similarity between a state's congressional members and the president, and *Contributions* is the log of the total employee contributions to the winning party in the prior election cycle. The sample consist of firms with over $5 million in physical capital and excludes financial and utility firms. See Appendix A for variable definitions. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | (1) | (2) | (3) | (4) | (5) | (6) |
|---|---|---|---|---|---|---|
| $PHI_{Top5}$ | 0.022*** | | 0.021*** | 0.023*** | 0.021*** | 0.023*** |
| | (0.006) | | (0.005) | (0.004) | (0.004) | (0.004) |
| $Party_{Top5}$ | | -0.012* | -0.009 | -0.006 | -0.006 | -0.005 |
| | | (0.007) | (0.007) | (0.005) | (0.005) | (0.005) |
| $Q$ | | | | 0.037*** | 0.034*** | 0.034*** |
| | | | | (0.001) | (0.001) | (0.001) |
| *Cash Flow* | | | | | 0.063*** | 0.062*** |
| | | | | | (0.016) | (0.016) |
| *Lobbying* | | | | | | 0.008*** |
| | | | | | | (0.003) |
| *Contributions* | | | | | | -0.001*** |
| | | | | | | (0.000) |
| $PHI_{State}$ | | | | | | 0.008*** |
| | | | | | | (0.003) |
| Observations | 34,953 | 34,953 | 34,953 | 33,793 | 33,706 | 33,706 |
| Adjusted $R^2$ | 0.563 | 0.563 | 0.563 | 0.699 | 0.700 | 0.701 |
| Fixed Effects | Firm | Firm | Firm | Firm | Firm | Firm |
| | Year | Year | Year | Year | Year | Year |

Table 4: Alternative Specifications

This table shows robustness to different specifications. The dependent variable, *Total Inv*, is the sum of CapEx, SG&A, and R&D scaled by total capital. The main explanatory variable, *PHI*, is the partisan similarity between a firm's management team and the president. *Party* is the average party affiliation of a firm's managers. *Rolling Average* is the *PHI* calculated using a five year rolling window of political contributions. *Lagged Investment* is the main dependent variable lagged by one year. *Random Similarity* is a placebo partisan similarity measure drawn from a normal distribution with the same mean and standard deviation as the sample *PHI*. Full controls are included from column (6) of Table 3. *Lagged PHI* is the baselined explanatory variable lagged by one year. Controls in column (5) include, in addition to existing ones, size, leverage, cash and state-level GDP growth. The sample consist of firms with over $5 million in physical capital and excludes financial and utility firms. See Appendix A for variable definitions. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | (1) Lagged $PHI_{Top5}$ | (2) Rolling Average | (3) Lagged Investment | (4) Random Similarity | (5) Additional Controls |
|---|---|---|---|---|---|
| $PHI_{Top5}$ | 0.015*** | 0.019*** | 0.014*** | 0.003 | 0.017*** |
| | (0.004) | (0.005) | (0.003) | (0.003) | (0.004) |
| Observations | 31,781 | 33,706 | 33,706 | 33,643 | 33,635 |
| Adjusted $R^2$ | 0.702 | 0.700 | 0.700 | 0.759 | 0.751 |
| Fixed Effects | Firm | Firm | Firm | Firm | Firm |
| | Year | Year | Year | Year | Year |

Table 5: Types of Variation

This table explores the different sources of variation. The dependent variable, *Total Inv*, is the sum of CapEx, SG&A, and R&D scaled by total capital. The main explanatory variable, *PHI*, is the partisan similarity between a firm's management team and the president. *Party* is the average party affiliation of a firm's managers. Column headings represent to source of variation in *PHI*. *Rep Approval* is the mean approval rating of the president by Republicans for year t. Full controls are included from column (6) of Table 3. The sample consist of firms with over $5 million in physical capital and excludes financial and utility firms. See Appendix A for variable definitions. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | (1) Elections | (2) Turnover | (3) Approval |
|---|---|---|---|
| $PHI_{Top5}$ | 0.014** | 0.018** | |
| | (0.005) | (0.009) | |
| $PHI_{Top5}$ *x Term 2* | | -0.012 | |
| | | (0.007) | |
| $Party_{Top5}$ *x Rep Approval* | | | 0.029* |
| | | | (0.018) |
| Observations | 30,588 | 32,476 | 29,288 |
| Adjusted $R^2$ | 0.791 | 0.817 | 0.779 |
| Fixed Effects | Firm | Firm-Pres | Firm-Pres |
| | Year | Year | Year |
| | $Party_{Top5}$ | | $Party_{Top5}$ |

Table 6: Partisan Asymmetry

This test for the existence of partisan asymmetry. The dependent variable, *Total Inv*, is the sum of CapEx, SG&A, and R&D scaled by total capital. The main explanatory variables for column (1) are *% Republican*, the percent of excess dollars donated to the Republican Party, and *% Democrat*, is percent of excess dollars donated to the Democratic Party. The main explanatory variable for columns (1) and (2), *PHI*, is the partisan similarity between a firm's management team and the president. In terms of subsamples, column (1) is the full sample of firms with over $5 million in physical capital and excludes financial and utility firms, whereas columns (2) and (3) exclude all left-leaning firms and all right-leaning firms, respectively. Full controls are included from column (6) of Table 3. See Appendix A for variable definitions. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | (1) Full Sample | (2) Non-Donors & RL | (3) Non-Donors & LL |
|---|---|---|---|
| *% Rep* | 0.015** | | |
| | (0.006) | | |
| *% Rep x Dem Pres* | -0.028*** | | |
| | (0.005) | | |
| *% Dem* | 0.015 | | |
| | (0.012) | | |
| *% Demo x Dem Pres* | 0.009 | | |
| | (0.012) | | |
| $PHI_{Top5}$ | | 0.026*** | -0.001 |
| | | (0.005) | (0.013) |
| $Rep_{Top5}$ | | 0.005 | -0.021* |
| | | (0.006) | (0.013) |
| Observations | 33,706 | 26,134 | 16,046 |
| Adjusted $R^2$ | 0.724 | 0.698 | 0.756 |
| Fixed Effects | Firm | Firm | Firm |
| | Year | Year | Year |

Table 7: Evidence From Insider Trades

This table reports insider trading results. The dependent variables are *Shares*, the net number of shares purchased (+) and sold (-) scaled by the number of shares outstanding, *Sale*, an indicator variable equal to 1 if there was a sale made in year t and 0 otherwise, and *Purchase*, an indicator variable equal to 1 if there was a purchase made in year t and 0 otherwise. The main explanatory variables are *PHI*, the partisan similarity between a firm's management team and the president, and *PHI x Term2*, the partisan similarity in the president's second term. *Log(Total Comp)* is the log of an executive's total compensation and *Tenure* is the employee's length of employment at their current firm. For readability the estimates for *Shares* are multiplied by 100. The sample excludes financial and utility firms. See Appendix A for variable definitions. Standard errors are clustered by firm and executive, and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | Shares | | Sale | | Purchase | |
|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| *PHI* | 0.007*** | 0.007*** | -0.028*** | -0.028** | -0.002 | -0.000 |
| | (0.003) | (0.003) | (0.010) | (0.010)) | (0.005) | (0.004) |
| *PHI x Term 2* | -0.007** | -0.007** | 0.037*** | 0.038** | -0.000 | -0.001 |
| | (0.003) | (0.003) | (0.014) | (0.014) | (0.006) | (0.006) |
| *Log(Total Comp)* | | 0.031** | | -0.021*** | | 0.011*** |
| | | (0.001) | | (0.005) | | (0.003) |
| *Tenure* | | -0.010*** | | 0.139*** | | -0.022*** |
| | | (0.002) | | (0.008) | | (0.004) |
| Observations | 123,220 | 116,109 | 123,220 | 116,109 | 123,220 | 116,109 |
| Adjusted $R^2$ | 0.312 | 0.319 | 0.374 | 0.384 | 0.367 | 0.375 |
| Fixed Effects | Firm-Year | Firm-Year | Firm-Year | Firm-Year | Firm-Year | Firm-Year |
| | Executive | Executive | Executive | Executive | Executive | Executive |
| Test: PHI + PHI x Term 2 = 0 | | | | | | |
| F-stat | 0.00 | 0.01 | 0.79 | 0.93 | 0.21 | 0.09 |
| p-value | 0.968 | 0.912 | 0.374 | 0.336 | 0.649 | 0.768 |

Table 8: Evidence From Options Behavior

This table reports options exercising results. The dependent variables are *Exercised* is an indicator equal to 1 if the executive exercises options in year t and 0 otherwise, *Exercised (N)*, the log of the number of options exercised in year t, and *Exercised ($)*, the log of the total value of options exercised in year t. The main explanatory variables are *PHI*, the partisan similarity between a firm's management team and the president, and *PHI x Term2*, the partisan similarity in the president's second term. *Log(Total Comp)* is the log of an executive's total compensation and *Tenure* is the employee's length of employment at their current firm. The sample excludes financial and utility firms. See Appendix A for variable definitions. Standard errors are clustered by firm and executive, and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | Exercised | | Exercised (N) | | Exercised ($) | |
|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| *PHI* | -0.014* | -0.015* | -0.045 | -0.048 | -0.086 | -0.091* |
| | (0.008) | (0.008) | (0.032) | (0.033) | (0.054) | (0.054) |
| *PHI x Term 2* | 0.022** | 0.023** | 0.086* | 0.083* | 0.139* | 0.136* |
| | (0.010) | (0.010) | (0.044) | (0.044) | (0.073) | (0.073) |
| *Log(Total Comp)* | | 0.0400*** | | -0.062*** | | -0.106*** |
| | | (0.004) | | (0.017) | | (0.0271) |
| *Tenure* | | 0.027*** | | 0.152*** | | 0.222*** |
| | | (0.002) | | (0.008) | | (0.014) |
| Observations | 165,679 | 165,594 | 155,962 | 155,895 | 155,954 | 155,887 |
| Adjusted $R^2$ | 0.466 | 0.469 | 0.516 | 0.519 | 0.529 | 0.531 |
| Fixed Effects | Firm-Year | Firm-Year | Firm-Year | Firm-Year | Firm-Year | Firm-Year |
| | Executive | Executive | Executive | Executive | Executive | Executive |
| Test: PHI + PHI x Term 2 = 0 | | | | | | |
| F-stat | 1.85 | 1.71 | 2.80 | 2.45 | 2.31 | 2.06 |
| p-value | 0.174 | 0.191 | 0.095 | 0.118 | 0.129 | 0.152 |

Table 9: Evidence From Insider Trades - All Elections

This table reports insider trading results around presidential elections where the event period is t-1 to t+1. The dependent variables are *Shares*, the net number of shares purchased (+) and sold (-) scaled by the number of shares outstanding, and *Sale*, an indicator variable equal to 1 if there was a sale made in year t and 0 otherwise. The main explanatory variables are *Rep*, an indicator for whether a manager is a Republican, and *Winning Party*, which is equal to the *PHI* between an executive and the president in the year after an election. *Log(Total Comp)* is the log of an executive's total compensation and *Tenure* is the employee's length of employment at their current firm. For readability the estimates for *Shares* are multiplied by 100. The sample excludes financial and utility firms. See Appendix A for variable definitions. Standard errors are clustered by firm and executive, and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | Shares | | Sale | |
|---|---|---|---|---|
| | (1) | (2) | (3) | (4) |
| *Winning Party* | 0.033*** | 0.031** | -0.048** | -0.051** |
| | (0.013) | (0.013) | (0.023) | (0.024) |
| *Rep* | 0.003 | 0.005 | -0.003 | -0.004 |
| | (0.004) | (0.004) | (0.007) | (0.007) |
| *Log(Total Comp)* | | -0.026*** | | -0.058*** |
| | | (0.006) | | (0.009) |
| *Tenure* | | -0.027*** | | 0.053*** |
| | | (0.004) | | (0.011) |
| Observations | 4,047 | 3,957 | 4,047 | 3,957 |
| Adjusted $R^2$ | 0.369 | 0.397 | 0.622 | 0.627 |
| Fixed Effects | Firm-Year | Firm-Year | Firm-Year | Firm-Year |

Table 10: Evidence From Insider Trades - 2001 Election

This table reports insider trading results around the 2001 presidential election where the event period is t-1 to t+1. The dependent variables are *Shares*, the net number of shares purchased (+) and sold (-) scaled by the number of shares outstanding, and *Sale*, an indicator variable equal to 1 if there was a sale made in year t and 0 otherwise. The main explanatory variables are *Rep*, an indicator for whether a manager is a Republican, and *Rep x Rep President*, which takes the value of *Rep* in year$_{t+1}$. *Log(Total Comp)* is the log of an executive's total compensation and *Tenure* is the employee's length of employment at their current firm. For readability the estimates for *Shares* are multiplied by 100. The sample excludes financial and utility firms. See Appendix A for variable definitions. Standard errors are clustered by firm and executive, and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | Shares | | Sale | |
|---|---|---|---|---|
| | (1) | (2) | (3) | (4) |
| *Rep* | -0.009 | -0.008 | 0.009 | 0.009 |
| | (0.014) | (0.013) | (0.033) | (0.034) |
| *Rep x Rep President* | 0.052** | 0.052** | -0.107** | -0.114** |
| | (0.023) | (0.024) | (0.049) | (0.051) |
| *Log(Total Comp)* | | -0.011 | | -0.053*** |
| | | (0.009) | | (0.015) |
| *Tenure* | | -0.026*** | | 0.069*** |
| | | (0.006) | | (0.019) |
| Observations | 1,558 | 1,509 | 1,558 | 1,509 |
| Adjusted $R^2$ | 0.393 | 0.402 | 0.622 | 0.598 |
| Fixed Effects | Firm-Year | Firm-Year | Firm-Year | Firm-Year |
| Test: Rep + Rep x Rep Pres = 0 | | | | |
| F-stat | 4.40 | 4.18 | 5.86 | 6.42 |
| p-value | 0.037 | 0.042 | 0.016 | 0.012 |

Table 11: Partisan Clustering

This table test for the influence of partisan clustering. The dependent variable, *Total Inv*, is the sum of CapEx, SG&A, and R&D scaled by total capital. The main explanatory variable, *PHI*, is the partisan similarity between a firm's management team and the president. Column headings represent different subsamples where *Sensitive Ind. Omitted* excludes industries which are sensitive to government spending, *Partisan Ind. Omitted* excludes the top 10 most Republican and Democrat industries, and *Partisan States Omitted* excludes the top 10 most Republican and Democrat states. Full controls are included from column (6) of Table 3. The sample consist of firms with over $5 million in physical capital and excludes financial and utility firms. See Appendix A for variable definitions and see Appendix D for the list of government-related industries. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | (1) Sensitive Ind. Omitted | (2) Partisan Ind. Omitted | (3) Partisan States Omitted |
|---|---|---|---|
| $PHI_{Top5}$ | 0.024*** | 0.025*** | 0.024*** |
| | (0.005) | (0.005) | (0.005) |
| Observations | 30,734 | 25,976 | 26,083 |
| Adjusted $R^2$ | 0.710 | 0.710 | 0.711 |
| Fixed Effects | Firm | Firm | Firm |
| | Year | Year | Year |

Table 12: Partisan Connection Seeking

This table test for the influence of political connections. The dependent variable, *Total Inv*, is the sum of CapEx, SG&A, and R&D scaled by total capital. The main explanatory variable, *PHI*, is the partisan similarity between a firm's management team and the president. Columns (1-3) represent different measurements of *PHI*, where *Parties and Presidents* uses only contributions to party committees and the president to estimate partisan similarity, *Election Cycle Average* is the mean of all election cycle *PHIs*, and *Polarizers* uses only executives who have donated at least 80% of their total contributions to one party to estimate a discrete version of *PHI* and *Party*, with all other executives equal to zero. Columns (4-5) represent different subsamples where *Lobbying Firms Omitted* excludes firms who have lobbied at least once during the sample period and *Govt. Customer Omitted* excludes all firms who have the federal government as a major customer. Full controls are included from column (6) of Table 3. The sample consist of firms with over $5 million in physical capital and excludes financial and utility firms. See Appendix A for variable definitions. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | (1) Parties & Presidents | (2) Election Cycle Average | (3) Polarizers | (4) Lobbying Firms Omitted | (5) Govt. Customer Omitted |
|---|---|---|---|---|---|
| $PHI_{Top5}$ | 0.025*** | 0.023*** | 0.014*** | 0.021*** | 0.022*** |
| | (0.003) | (0.002) | (0.004) | (0.008) | (0.004) |
| Observations | 31,781 | 33,706 | 33,706 | 16,583 | 32,109 |
| Adjusted $R^2$ | 0.700 | 0.706 | 0.700 | 0.712 | 0.701 |
| Fixed Effects | Firm | Firm | Firm | Firm | Firm |
| | Year | Year | Year | Year | Year |

Table 13: Valuation and Operating Performance

The main dependent variables are annual stock returns (*Ret*) and profitability, (*Profit*). The main explanatory variable, *PHI*, is the partisan similarity between a firm's management team and the president. *Party* is the average party affiliation of a firm's managers. All control variables are contemporaneous. The sample consist of firms with over $5 million in physical capital and excludes financial and utility firms as well as firms in industries that sensitive to government firms or have the government as a major customer. See Appendix A for variable definitions and Appendix D for government related industries. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | (1) $Ret_t$ | (2) $Ret_{t+1}$ | (3) $Ret_{t+2}$ | (4) $Profit_t$ | (5) $Profit_{t+1}$ | (6) $Profit_{t+2}$ |
|---|---|---|---|---|---|---|
| $PHI_{Top5}$ | 0.086** | 0.074** | 0.040 | 0.018 | 0.024* | 0.028** |
| | (0.036) | (0.033) | (0.034) | (0.014) | (0.013) | (0.012) |
| $PHI_{Top5}$ *x Total Inv* | -0.111 | -0.456*** | -0.409** | -0.142 | -0.168* | -0.198** |
| | (0.187) | (0.160) | (0.179) | (0.099) | (0.086) | (0.078) |
| $Party_{Top5}$ | 0.002 | -0.010 | -0.017 | 0.023*** | 0.021** | 0.018** |
| | (0.018) | (0.018) | (0.017) | (0.008) | (0.008) | (0.008) |
| *Lobbying* | -0.015 | 0.023** | 0.022** | 0.011** | 0.017*** | 0.017*** |
| | (0.011) | (0.011) | (0.011) | (0.005) | (0.005) | (0.005) |
| *Contributions* | -0.002 | -0.000 | -0.000 | 0.001 | 0.000 | 0.000 |
| | (0.001) | (0.001) | (0.001) | (0.000) | (0.000) | (0.000) |
| $PHI_{State}$ | 0.045*** | 0.027** | 0.000 | 0.011** | 0.012*** | 0.005 |
| | (0.013) | (0.012) | (0.012) | (0.005) | (0.004) | (0.004) |
| *Size* | -0.160*** | -0.202*** | -0.103*** | -0.024*** | -0.088*** | -0.096*** |
| | (0.009) | (0.009) | (0.007) | (0.005) | (0.005) | (0.005) |
| *Total Inv* | -0.702*** | 0.037 | 0.225** | 0.746*** | 0.325*** | 0.202*** |
| | (0.106) | (0.098) | (0.104) | (0.051) | (0.044) | (0.039) |
| *Leverage* | -0.004 | 0.047*** | 0.037** | 0.055*** | -0.001 | 0.006 |
| | (0.017) | (0.016) | (0.018) | (0.009) | (0.008) | (0.007) |
| *Cash* | 0.076*** | -0.159*** | -0.095*** | 0.099*** | 0.071*** | 0.009 |
| | (0.022) | (0.019) | (0.019) | (0.013) | (0.011) | (0.011) |
| *Profit* | 0.392*** | -0.442*** | -0.323*** | | | |
| | (0.036) | (0.039) | (0.038) | | | |
| Observations | 29,524 | 28,991 | 27,895 | 30,496 | 29,374 | 27,295 |
| Adjusted $R^2$ | 0.125 | 0.142 | 0.117 | 0.711 | 0.655 | 0.637 |
| Fixed Effects | Firm | Firm | Firm | Firm | Firm | Firm |
| | Year | Year | Year | Year | Year | Year |

Table 14: M&A Announcement Returns

The main dependent variables are the probability of initiating a takeover in year t or t+1 and M&A announcement CARs measured over different windows. The main explanatory variable, *PHI*, is the partisan similarity between a firm's management team and the president. *Party* is the average party affiliation of a firm's managers. Political controls are contemporaneous and firm controls are lagged. The sample consist of proposed M&As with a deal value greater than $100 million, firms with over $5 million in physical capital and excludes financial and utility firms. See Appendix A for variable definitions. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | Pr(Takeover) | CAR (-1,+7) | | CAR (-5,+5) | |
|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) |
| $PHI_{Top5}$ | -0.031 | 0.001 | -0.003 | -0.005 | -0.005 |
| | (0.019) | (0.011) | (0.013) | (0.011) | (0.014) |
| $Party_{Top5}$ | 0.016 | 0.009* | 0.015** | 0.009 | 0.017** |
| | (0.019) | (0.005) | (0.006) | (0.006) | (0.007) |
| *Contributions* | 0.000 | 0.002* | 0.001 | 0.001 | -0.000 |
| | (0.001) | (0.001) | (0.001) | (0.001) | (0.001) |
| *Lobbying* | -0.002 | -0.002 | -0.001 | -0.001 | 0.004 |
| | (0.011) | (0.005) | (0.006) | (0.005) | (0.006) |
| $PHI_{State}$ | 0.003 | 0.008 | 0.006 | 0.008 | 0.010 |
| | (0.011) | (0.006) | (0.008) | (0.007) | (0.008) |
| *Size* | -0.028*** | -0.004*** | -0.001 | -0.005*** | -0.003 |
| | (0.007) | (0.001) | (0.002) | (0.001) | (0.002) |
| *Cash* | 0.000 | -0.000 | -0.001 | 0.000 | -0.001 |
| | (0.000) | (0.001) | (0.004) | (0.000) | (0.002) |
| *Leverage* | -0.000*** | -0.002 | -0.003 | -0.002 | -0.004 |
| | (0.000) | (0.002) | (0.004) | (0.002) | (0.003) |
| *Cash Flow* | 0.031*** | 0.002 | 0.006 | -0.002 | 0.001 |
| | (0.012) | (0.006) | (0.006) | (0.002) | (0.007) |
| *Q* | 0.002*** | 0.000 | 0.000 | -0.000 | 0.000 |
| | (0.001) | (0.000) | (0.000) | (0.000) | (0.000) |
| *Public Target* | | | -0.020*** | | -0.024*** |
| | | | (0.005) | | (0.005) |
| *Log(Deal Size)* | | | -0.007*** | | -0.004** |
| | | | (0.002) | | (0.002) |
| *Similar Industry* | | | 0.009** | | 0.005 |
| | | | (0.004) | | (0.004) |
| Observations | 33,898 | 2,871 | 1,997 | 2,887 | 2,011 |
| Adjusted $R^2$ | 0.293 | 0.018 | 0.050 | 0.021 | 0.045 |
| Fixed Effects | Firm | Industry | Industry | Industry | Industry |
| | Year | Year | Year | Year | Year |

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# APPENDIX A

# VARIABLE DESCRIPTIONS

***Rep*:** Measured at the executive level, equal to the ratio of net contributions to the republican party divided by total contributions to both parties, where 1 equals Republican and -1 equals Democrat, Rep=$\frac{Rep_i - Dem_i}{Rep_i + Dem_i}$

***Rep*$_{Top5}$:** Equal to the equal-weighted average of a firm's top five managers', ranked by salary, individual *Rep*'s for each firm year.

**Political Homophiliy Index (*PHI*$_{Top5}$):** Equal to half the absolute value between the political affiliation of a firm's top five managers and the president. PHI= 1 - $\frac{|Rep + Rep_{Pres}|}{2}$, where Rep = [0,1] and Rep$_{Pres}$ = {-1,1}, where -1 (1) is a Democratic (Republican) president.

***Contributions*:** Equal to the natural log of total firm contributions, given in the prior election cycle, to the winning party.

***Lobbying*:** Indicator equal to 1 if the firm lobbied in both the current and prior year.

***PHI*$_{State}$:** $(\frac{1}{2}) * Senators + (\frac{1}{2}) * Representatives$, where *Senators* is the fraction of a state's two senators who belong to the same party as the president and *Representatives* is the fraction of a state's House of Representatives who belong to the same party as the president.

***Size*:** Natural logarithm of total capital, i.e. the sum of the book value of property, plant, and equipment (ppegt) plus the replacement cost of intangible capital (see Section 3.2 of Peters and Taylor (2017) for its computation).

***Total Inv*:** Sum of annual capital expenditures (Compustat item *capx*), research and design expenditures (Compustat item *xrd*), and 30% of selling, general, and administrative expenses (Compustat item *xsga*) scaled by beginning-of-year total capital. Missing components are set to 0. When identifiable, R&D expenditures are removed from SG&A to avoid double counting.

***Q*:** Market value of equity (Compustat items *prcc_f* x *csho*), plus the book value of debt (compustat items *dltt* + *dlc*), minus current assets (compustat item *act*) (at + prcc_f x csho - ceq - txditc) scaled by total capital.

***Ret*:** Fiscal-year annual return (compustat item $(\frac{prcc\_f_t}{prcc\_f_{t-1}} - 1)$)

***Profit*:** Sum of operating income before depreciation (Compustat item *oibdp*), 30% of selling, general, and administrative expenses (Compustat item *xsga*) and research and design expenditures (Compustat item *xrd*) beginning-of-year total capital.

***Cash Flow*:** Income before extraordinary items and depreciation (compustat items *ib* + *dp*) plus the after-tax cost of the intangible investment ((1-$m$) x (0.3 x SG&A)+ R&D)) scaled by beginning-of-year total capital, where $m$ is the firm's marginal tax rate from Blouin, Core, and Guay (2010). When missing $m$ is equal to the sample average of 24%.

***Cash*:** Cash holdings (Compustat item *che*) scaled by beginning-of-year total capital.

***Leverage*:** Book value of long-term and current debt (compustat items *dltt* + *dlc*) scaled by beginning-of-year total capital.

***Dividend*:** Indicator equal to 1 if the firm issued a dividend during the fiscal year.

***Shares*:** Annual net number of monthly shares purchased (+) and sold (-) scaled by that month's average number of shares outstanding.

***Sale*:** Indicator equal to 1 if an executive makes an opportunistic sale.

***Purchase*:** Indicator equal to 1 if an executive makes an opportunistic purchase.

***Exercised*:** Indicator equal to 1 if an executive exercises stock options.

***Exercised ($)*:** Natural logarithm of the total value of exercise stock options (Execucomp item *opt_exer_val*)

***Exercised (N)*:** Natural logarithm of the number of exercise stock options (Execucomp item *opt_exer_num*)

***Log(Total Comp)*:** Natural logarithm of a manager's total compensation (Execucomp item *tdc1*).

***Tenure*:** Manager's tenure at their firm.

***Greater Than Analyst*:** Indicator equal to 1 if the firm's beginning-of-year annual guidance is greater than the average analyst forecast.

***Miss Guidance*:** Indicator equal to 1 if the firm's beginning-of-year annual guidance is greater than their realized earnings.

***Abandon*:** Indicator equal to 1 if the acquirer withdraws from a takeover attempt and equal to 0 if it is completed..

***Public Target*:** Indicator equal to 1 if the target is a publicly traded firm.

***Similar Industry*:** Indicator equal to 1 if the acquirer and target belong to the same industry, defined by two-digit SIC code.

***Log(Deal Size)*:** Natural logarithm of a the M&A deal value.

# APPENDIX B

# MATCHING PROCEDURE

Matching individual contributions data from the FEC to Execucomp executives presents one main challenge. When an individual contributes more the predetermined non-disclosure limit, the committee who receives the funds must report the individual's name, occupation, and employer (among other things), but the spelling for an employer does not have to match the firm's legal name. For example, in the FEC contributions data AAR Corp has the spellings A.A.R. Corporation, A.A.R. L.L.C., AAR Inc., AAR, etc. This means that when using traditional fuzzy matching techniques, you may miss many potential matches.

I therefore pre-process the text by removing punctuation, extra whitespace, numbers, common words and abbreviations with little value (corporation, corp, inc, etc.), as well as occupation positions that are present in the the employer column (CEO, etc.) when parsed. Using the processed text, I match on the first word in the name sequence to get a list of possible matches, I then run a Ratcliff-Obershelp algorithm which finds the longest contiguous matching sub-sequence that contains no "junk" elements. The same idea is then applied recursively to the pieces of the sequences to the left and to the right of the matching sub-sequence. This does not yield minimal edit sequences, but does tend to yield matches that "look right" to people. I keep matches with a similarity greater than 75%.

After matching the FEC file to Execucomp using company names, I then use the same procedure with the addition of removing credential abbreviations (CPA, PhD, MBA, etc.). Similar to the previous matching procedure, I first match observations by last name (nicknames and abbreviated first names) and then apply the same Ratcliff-Obershelp algorithm and inspect matches with a similarity greater than 80%. This results in 76,423 exact company-executive name matches and 101k executive-contribution-years for 13,697 executives.

# APPENDIX C

# PARTISAN AFFILIATION MEASURE VALIDATION

To validate my FEC contributions based political affiliation measure I compare an executives' inferred affiliations with their publicly available ones. I obtain individuals' voter registrations through FOIA request with 28 states, six counties in Texas, five cities in Massachusetts, and the District of Columbia, which contain over 160 million registered voters or 60% of all eligible voters, and match them to executives. These voter registration records contain identifying information such as the voter's name, residential and mailing address, date of birth or birth year, party affiliation, and for some states their voting history. For states where party affiliation is not disclosed I assign an individual to a party if they vote for that party in a primary election 100% of the time.

Matching individual voter records to executives is problematic due to the lack on mutual identifiers. I match on the full first and last name, middle initial, and allow for a two year difference between the date of birth on the voter records and the estimated date of birth provided by Execucomp. To ensure the highest degree of accuracy I only keep matches where there is one unique match between both data sources. To build a measure of partisanship I focus on CEOs who reside in Ohio, Florida, Illinois, or California because these states have a long voting history time series. This results in a sample of 1,518 CEOs. To build the partisanship measure I find the percent of available general primaries and general elections that the executive participated in during their tenure in the state. I take that voting participation percentage and multiply that by their party affiliation (i.e. +1 for Republicans and -1 for Democrats) to create a measure between -1 (Partisan Democrat) and 1 (Partisan Republican)

Table C.1 Panel A presents the average composition of donations to each party based on individual donors' registered parties. Overall, personal political contributions match well with the average individual's contributions. Republicans personally contribute significantly more to committees that align with their party, with approxi-

mately 79%, than democrats with 63%. Independents on the other hand donate fairly evenly to both parties with only 55% going to Republican committees and 44% going to Democratic committees. Panel B presents the same contribution percentages using the partisanship measure. It seems that individuals who are more politically active do not necessary contribute more to their party when compared to less active ones. If this result holds with a larger sample of CEOs this would imply that other measures of partisanship should be used other than voter participation. Panel C presents the univariate regressions testing the relationship between individuals' contribution patterns and their registered party. Consistent with political contributions being an accurate proxy of ones partisan affiliation, there is a strong relationship between an individuals party identification and donation history. In column 1, the percent of donations to the Republican Party is statistically associated with an individual's party identification. In columns 2 and 3 I determine whether individuals who have no donation history are more likely to identify with a particular party. I find that individuals who have no contribution history are 7% less likely, when compared to the sample average, to be Republican and only 2% more likely, when compared to the sample average, to be an independent, even though this result is not statistically significant. These results are consistent with the assumptions used to calculate $REP_{Top5}$, namely that non-contributors are seen as less partisan. In terms of accuracy, when assigning an individual to a party (either Democratic or Republican), based on their net donations to that party, I achieve an accuracy of approximately 80%.

In Table C.1 I rerun my baseline analysis with the voter registration data to see how my results hold up. After the exclusion of utility and financial firms, I am left with a sample of 1,130 CEOs. In column (1) I use my partisan similarity measure of the top five managers and in column (3) I use the partisan similarity of the CEO for the full sample period using voter records. I find a significant economic and statistical

relationship between partisan similarity and investment. In columns (2) and (3) rerun the baseline specification after excluding years where I cannot match a CEO to their voter registration. With this restriction the baseline results are either severely weakened or disappear entirely. In Column (5) I use voter registrations to determine CEOs partisan affiliation and similarity, and in column (6) I use my partisanship measure. There are several potential reasons for these null results. First, Graham *et al.* (2015) find that corporate investment decisions are one of the most delegated firm policies by CEOs. That could explain that even with the sample restrictions by top five partisan similarity measure (column (2)) is still significant although the CEO one is no longer significant (column (4)). Another reason, especially when using voter registrations is that I have an incomplete sample of CEOs. With only 6,405 firm-year observations that would equate to approximately two observations per firm. With a sample of 1,130 CEOs the average would be approximately 7 years. Without data on multiple CEO observations per firm, I may not have enough variation during presidencies or enough CEO observations that overlap with elections to have proper identification with the use of firm fixed effects. A longer time-series should alleviate this issue. Other issues include a mismatching of CEOs or political affiliation not being correlated with managers true leanings (e.g. registered independent but leans Republican), which can cause a high degree of measurement error in such a small sample. Finding an appropriate measure of partisanship is key to addressing this problem.

Table C.1: Measure Validation - Voter Registrations

Panel A reports the average percent of contributions to each party based on executives' stated party affiliations gathered from voter records. Panel B reports the univariate regressions results where the main dependent variable is an individual's stated party affiliation and main independent variable is either the percent of contributions to the Republican party, *% to Republicans*, or and indicator variable equal to one if an individual is not found the FEC contributions database, *No Contributions*.

Panel A: Donation Percentages

| Registered Party | To Republicans | To Democrats | To Independents |
|---|---|---|---|
| Democrat | 36% | 63% | 1% |
| Independent | 55% | 44% | 1% |
| Republican | 79% | 19% | 2% |

Panel B: Donation Percentages - Partisanship

| Registered Party | To Republicans | To Democrats | To Independents |
|---|---|---|---|
| Partisan Dem | 36% | 62% | 1% |
| Democrat | 36% | 63% | 1% |
| Independent | 55% | 44% | 1% |
| Republican | 80% | 18% | 1% |
| Partisan Rep | 76% | 22% | 3% |

Panel C: Predicting Party

| | (1) Republican | (2) Republican | (3) Independent |
|---|---|---|---|
| *% to Republicans* | 0.59*** | | |
| | (0.041) | | |
| *No Contributions* | | -0.072** | 0.022 |
| | | (0.025) | (0.021) |
| Observations | 868 | 1,518 | 1,518 |
| Adjusted $R^2$ | 0.189 | 0.005 | 0.000 |

Table C.2: Measure Validation - Investment

This table represents the baseline specification. The dependent variable, *Total Inv*, is the sum of CapEx, SG&A, and R&D scaled by total capital. The main explanatory variable, *PHI*, is the partisan similarity between a firm's management team and the president. *Party* is the average party affiliation of a firm's managers. These measures are calculated in columns (1-4) using political contributions, registered party in column (3), and registered party along with voting history in column (4). The restricted sample is all firm years where a CEO is matched with voter records. Full controls are included from column (6) of Table 3. The sample consist of firms with over $5 million in physical capital and excludes financial and utility firms. See Appendix A for variable definitions and see Appendix D for the list of government-related industries. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | Political Contributions | | | | Voter Registration | |
|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| $PHI_{Top5}$ | 0.023*** | 0.017* | | | | |
| | (0.004) | (0.009) | | | | |
| $Party_{Top5}$ | (-0.005) | -0.003 | | | | |
| | (0.005) | (0.009) | | | | |
| $PHI_{CEO}$ | | | 0.006*** | -0.003 | -0.004 | -0.007 |
| | | | (0.002) | (0.006) | (0.004) | (0.006) |
| $Party_{CEO}$ | | | -0.003 | -0.002 | -0.007 | -0.005 |
| | | | (0.002) | (0.007) | (0.004) | (0.006) |
| Restricted Sample | | ✓ | | ✓ | ✓ | ✓ |
| Observations | 33,706 | 6,405 | 31,250 | 6,405 | 6,405 | 6,405 |
| Adjusted $R^2$ | 0.701 | 0.765 | 0.737 | 0.769 | 0.769 | 0.769 |
| Fixed Effects | Firm | Firm | Firm | Firm | Firm | Firm |
| | Year | Year | Year | Year | Year | Year |

# APPENDIX D

# ADDITIONAL TABLES

Table D.1: Industries Sensitive to Government Spending

This table reports industries that have been identified by both Agrawal and Knoeber (2001) and Belo, Gala and Li (2013) to have a high sensitivity to government spending.

| SIC Codes | Industry Description |
|---|---|
| 1311, 1381, 1382, 1389 | Oil and gas extraction |
| 2621 | Paper mills |
| 2711 | Newspaper publishers |
| 3480 | Ammunition, ordnance and accessories |
| 3720, 3721, 3724, 3728 | Aircraft and aircraft parts |
| 3730 | Ship building and repairing |
| 3760 | Guided missiles, space vehicles and parts |
| 3790 | Tanks and tank components |
| 4812, 4813 | Radio and television broadcasting |
| 8731 | Scientific research and development services |

Table D.2: Components of Total Investment

This table presents the components of *Total Inv.* The dependent variable, $\Delta$ *Emp*, is the percent change in total employment. *Intan/Emp* is equal to the sum of R&D and SG&A scaled by total capital. The main explanatory variable, *PHI*, is the partisan similarity between a firm's management team and the president. Full controls are included from column (6) of Table 3. The sample consist of firms with over $5 million in physical capital and excludes financial and utility firms. See Appendix A for variable definitions and see Appendix D for the list of government-related industries. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | (1) $\Delta$ Emp | (2) Intan/Emp | (3) SG&A | (4) CapEx | (5) R&D |
|---|---|---|---|---|---|
| $PHI_{Top5}$ | 0.037*** | 0.045*** | 0.006*** | 0.007** | 0.007*** |
| | (0.009) | (0.013) | (0.002) | (0.003) | (0.002) |
| Observations | 33,369 | 33,487 | 33,706 | 33,706 | 33,706 |
| Adjusted $R^2$ | 0.239 | 0.724 | 0.811 | 0.602 | 0.830 |
| Fixed Effects | Firm | Firm | Firm | Firm | Firm |
| | Year | Year | Year | Year | Year |

Table D.3: Alternative Proxies for Investment

This table presents alternative proxies for *Total Inv*. The dependent variables are the change in total book assets, total capital, PP&E, and CapEx, as well as CapEx scaled by tangible capital. The main explanatory variable, *PHI*, is the partisan similarity between a firm's management team and the president. Full controls are included from column (6) of Table 3. The sample consist of firms with over $5 million in physical capital and excludes financial and utility firms. See Appendix A for variable definitions and see Appendix D for the list of government-related industries. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | (1) $\Delta$ AT | (2) $\Delta$ Capital | (3) $\Delta$ PPE | (4) $\Delta$ CapEx | (5) $\text{CapEx}_{PPE}$ |
|---|---|---|---|---|---|
| $PHI_{Top5}$ | 0.059*** | 0.038*** | 0.049*** | 0.085*** | 0.022** |
| | (0.013) | (0.011) | (0.014) | (0.025) | (0.009) |
| Observations | 33,706 | 33,690 | 33,701 | 33,467 | 33,704 |
| Adjusted $R^2$ | 0.220 | 0.325 | 0.272 | 0.109 | 0.509 |
| Fixed Effects | Firm | Firm | Firm | Firm | Firm |
| | Year | Year | Year | Year | Year |

Table D.4: Long Run Effects

The main explanatory variable is the *PHI* between a firm's management team and the president. Full controls are from column 6 of Table 3. The sample consist of firms with over $5 million in physical capital and excludes financial and utility firms. See Appendix B for variable definitions and government related industries. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | (1) *Total Inv* | (2) *Tobin's Q* | (3) *Stock Return* | (4) *Profit* |
|---|---|---|---|---|
| $PHI_{Top5}$ *x Year 1* | 0.035*** | -0.329** | 0.230*** | 0.032** |
| | (0.010) | (0.132) | (0.069) | (0.014) |
| $PHI_{Top5}$ *x Year 2* | 0.045*** | -0.016 | 0.088* | 0.026* |
| | (0.009) | (0.123) | (0.048) | (0.014) |
| $PHI_{Top5}$ *x Year 3* | 0.025*** | -0.117 | -0.109* | -0.006 |
| | (0.009) | (0.121) | (0.056) | (0.013) |
| $PHI_{Top5}$ *x Year 4* | 0.034*** | -0.283** | 0.001 | -0.031** |
| | (0.008) | (0.117) | (0.049) | (0.013) |
| $PHI_{Top5}$ *x Year 5* | 0.032*** | -0.192 | 0.063 | -0.029** |
| | (0.008) | (0.128) | (0.050) | (0.013) |
| $PHI_{Top5}$ *x Year 6* | 0.019** | -0.219* | 0.078 | -0.022* |
| | (0.008) | (0.131) | (0.048) | (0.013) |
| $PHI_{Top5}$ *x Year 7* | 0.017* | 0.453*** | 0.245*** | -0.008 |
| | (0.009) | (0.156) | (0.059) | (0.014) |
| $PHI_{Top5}$ *x Year 8* | 0.002 | 0.305* | 0.023 | -0.001 |
| | (0.009) | (0.159) | (0.053) | (0.016) |
| Observations | 29,554 | 30,044 | 29,528 | 30,496 |
| Adjusted $R^2$ | 0.711 | 0.680 | 0.125 | 0.711 |
| Fixed Effects | Firm | Firm | Firm | Firm |
| | Year | Year | Year | Year |

Table D.5: Management Forecast

The main explanatory variable is the political similarity (*PHI*) between a firm's management team and the president. *Issue* is an indicator variable equal to 1 if the firm issues an earning guidance during the fiscal year. *Great Than Analyst* is an indicator equal to 1 if the beginning of fiscal year annual earnings forecast is greater than the average analyst forecast. *Miss Guidance* is an indicator equal to 1 if a firm falls short of its annual earnings guidance. The sample consist of firms with over $5 million in physical capital and excludes financial and utility firms. See Appendix B for variable definitions and government related industries. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | (1) *Issue* | (2) Greater Than Analyst | (3) Miss Guidance | (4) Range |
|---|---|---|---|---|
| $PHI_{Top5}$ | 0.004 | 0.107** | 0.064* | 0.001 |
| | (0.03) | (0.050) | (0.036) | (0.026) |
| $Rep_{Top5}$ | -0.001 | -0.013 | -0.028 | 0.033 |
| | (0.026) | (0.048) | (0.037) | (0.036) |
| *Contributions* | 0.003** | 0.001 | 0.003 | -0.003 |
| | (0.001) | (0.003) | (0.002) | (0.003) |
| *Lobbying* | 0.021 | 0.0297 | -0.001 | -0.007 |
| | (0.013) | (0.026) | (0.021) | (0.008) |
| $PHI_{State}$ | -0.013 | -0.021 | -0.035 | -0.020* |
| | (0.015) | (0.027) | (0.024) | (0.011) |
| *Size* | 0.067*** | -0.055** | 0.229*** | -0.023 |
| | (0.009) | (0.0250) | (0.0173) | (0.015) |
| *Q* | (0.003) | -0.001 | 0.010* | -0.008* |
| | (0.003) | (0.009) | (0.006) | (0.005) |
| *Total Inv* | (-0.014) | -0.206 | 0.297*** | 0.196*** |
| | (0.033) | (0.152) | (0.086) | (0.073) |
| *Profit* | (0.262)*** | 0.072 | 0.098 | -0.237*** |
| | (0.029) | (0.105) | (0.066) | (0.054) |
| *Leverage* | (-0.019) | 0.033 | -0.004 | -0.000 |
| | (0.016) | (0.041) | (0.030) | (0.021) |
| *Cash* | (-0.017) | 0.044 | -0.031 | -0.009 |
| | (0.014) | (0.049) | (0.031) | (0.049) |
| Observations | 29,508 | 6,849 | 9,268 | 7,847 |
| Adjusted $R^2$ | 0.501 | 0.063 | 0.290 | 0.062 |
| Fixed Effects | Firm | Firm | Firm | Firm |
| | Year | Year | Year | Year |

Table D.6: Cash and Leverage Decisions

The main explanatory variable is the *PHI* between a firm's management team and the president. The sample consist of firms with over $5 million in physical capital and excludes financial and utility firms. See Appendix B for variable definitions and government related industries. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% level, respectively.

| | Leverage | | | Cash | | |
|---|---|---|---|---|---|---|
| | (1) | (2) | (3) | (4) | (5) | (6) |
| $PHI_{Top5}$ | 0.047*** | 0.042*** | 0.039*** | -0.031** | -0.019* | -0.020* |
| | (0.018) | (0.014) | (0.015) | (0.013) | (0.011) | (0.012) |
| $Party_{Top5}$ | 0.007 | -0.010 | -0.012 | -0.061*** | -0.022** | -0.020* |
| | (0.016) | (0.016) | (0.016) | (0.011) | (0.011) | (0.012) |
| $PHI_{State}$ | -0.037*** | -0.022** | -0.017** | 0.009 | -0.011 | -0.004 |
| | (0.010) | (0.009) | (0.009) | (0.008) | (0.008) | (0.008) |
| *Lobbying* | 0.004 | -0.020** | -0.024*** | 0.023*** | 0.011 | 0.012* |
| | (0.011) | (0.009) | (0.008) | (0.008) | (0.007) | (0.007) |
| *Contributions* | -0.003*** | -0.001 | -0.001* | -0.000 | -0.000 | 0.000 |
| | (0.001) | (0.001) | (0.001) | (0.001) | (0.001) | (0.001) |
| *Q* | -0.019*** | -0.021*** | -0.021*** | 0.069*** | 0.054*** | 0.051*** |
| | (0.004) | (0.002) | (0.003) | (0.004) | (0.003) | (0.003) |
| *Total Inv* | 0.092* | 0.424*** | 0.462*** | 0.918*** | 0.653*** | 0.636*** |
| | (0.054) | (0.045) | (0.046) | (0.043) | (0.048) | (0.049) |
| *Profit* | 0.339*** | 0.285*** | 0.274*** | -0.043 | 0.074* | 0.148*** |
| | (0.047) | (0.043) | (0.048) | (0.035) | (0.040) | (0.039) |
| *Dividend* | -0.057*** | -0.017* | -0.017* | -0.021*** | 0.016** | 0.019*** |
| | (0.009) | (0.008) | (0.009) | (0.007) | (0.007) | (0.008) |
| *Size* | 0.038*** | 0.066*** | 0.071*** | -0.026*** | -0.064*** | -0.069*** |
| | (0.004) | (0.009) | (0.009) | (0.003) | (0.007) | (0.008) |
| *Cash* | 0.029 | 0.057*** | 0.065*** | | | |
| | (0.024) | (0.022) | (0.022) | | | |
| *Leverage* | | | | 0.019 | 0.043*** | 0.049*** |
| | | | | (0.016) | (0.017) | (0.017) |
| Observations | 30,077 | 30,040 | 30,001 | 30,077 | 30,040 | 30,001 |
| Adjusted $R^2$ | 0.288 | 0.639 | 0.646 | 0.538 | 0.736 | 0.740 |
| Fixed Effects | Industry | Firm | Firm | Industry | Firm | Firm |
| | Year | Year | Ind x Year | Year | Year | Ind x Year |