

**The Impact of Political Connectedness on Firm Value and Corporate Policies:  
Evidence from *Citizens United***

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**Abstract**

In this study, we examine the effects of political connections on firm value and corporate policies by exploiting an exogenous Supreme Court decision (*Citizens United*) that lifted long-standing restrictions on corporate political contributions. We find a significant negative market reaction to politically connected firms surrounding the announcement of *Citizens United*. There is also a significant increase in the cash holdings of politically connected firms relative to before the event and relative to non-politically connected firms. For politically connected firms, this result is further exacerbated by poor corporate governance quality. Collectively, these findings are consistent with a positive association between agency costs and political connections.

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*“At bottom, the Court’s opinion [in Citizens United] is thus a rejection of the common sense of the American people, who have recognized a need to prevent corporations from undermining self-government since the founding, and who have fought against the distinctive corrupting potential of corporate electioneering since the days of Theodore Roosevelt. It is a strange time to repudiate that common sense. While American democracy is imperfect, few outside the majority of this Court would have thought its flaws included a dearth of corporate money in politics.”*  
– Dissenting opinion of Supreme Court Justice John Paul Stevens, Citizens United v. FEC

Do corporate political connections enhance or destroy firm value? Existing insights into political connectedness as it relates to firm value are inconclusive, likely owed at least in part to endogeneity concerns.<sup>1</sup> This paper exploits an exogenous enhancement in the impact of political connections on firm value and corporate policies that accompanied a landmark Supreme Court ruling, *Citizens United v. Federal Election Commission* (hereafter, “*Citizens United*”). In doing so, we are able to help fill a gap in the literature with regard to the value implications of corporate political connectedness.

Political connectedness may destroy shareholder value if the political connectedness of a company is driven by management’s political agenda – an agenda that diverges from that of the company’s stakeholders. Specifically, connected firms place their resources in jeopardy of being exploited by politicians (Fan, Wong, and Zhang 2007; Caprio, Faccio, and McConnell 2008), and are marred by agency conflicts (Aggarwal, Meschke, and Wang 2012; Boubakri, El Ghouli, and Saffar 2012). Under this view, *Citizens United* amplifies the value-destroying effect of

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<sup>1</sup> Notably, in response to endogeneity concerns, prominent researchers have called for more careful inspection of the relationship between corporate political activism and firm value. For example, Cooper et al. state the following: “However, do we document evidence of a causal link from firm PAC contributions to future stock prices? Answering this question in the affirmative requires resolving potential endogeneity problems with our data... Our hope is that future work... can further analyze the issue of causality and the related topic of whether the correlations between contributions and returns arise from mispricing or risk” (2010, p. 690).

political connectedness through its lifting of restrictions on corporate political contributions; thus, historically politically connected firms are likely to realize an unfavorable market reaction surrounding the *Citizens United* decision (Agency Cost Hypothesis).

A competing view states that political connectedness enhances shareholder value (e.g., Cooper, Gulen, and Ovtchinnikov 2010). Specifically, politically connected firms can derive a benefit (1) from preferential access to financing (Faccio, Masulis, and McConnell 2006; Claessens, Feijen, and Laeven 2008), (2) through less risk and an accompanying lower cost of capital (Boubakri, Guedhami, Mishra, and Saffar 2012), (3) when a politically connected individual joins the corporation's board (Goldman, Rocholl, and So 2009), or (4) when a businessperson enters politics (Faccio 2006). As *Citizens United* amplified the value implications of political connectedness, this view predicts that connected firms will enjoy a favorable market reaction surrounding the announcement of *Citizens United* (Value Enhancing Hypothesis).

To address the value implications of political connectedness, we exploit an exogenous and landmark Supreme Court ruling, *Citizens United*. Decided in January 2010, *Citizens United* lifted long-standing limits on corporate political contributions. However, the verdict was unanticipated and did not come easily, as the issue was accompanied by considerable disagreement (e.g., Bravin 2010; Barnes 2010b; Biskupic 2009). The 5-4 vote in favor of its passing further verified division amongst members of the Court.<sup>2</sup>

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<sup>2</sup> Soon after the ruling, President Barack Obama voiced vigorous criticism, declaring the decision “a green light to a new stampede of special interest money” (Barnes and Eggen 2010). The majority vote adamantly defended their belief that corporate political contributions are a form of free speech and, as such, constitutional under the First Amendment. Not surprisingly, the months following passage of *Citizens United* have been marked by controversy and turmoil, with some lawmakers and investors urgently pleading that the Supreme Court reconsider

The controversial and uncertain nature of *Citizens United* offers an ideal research setting to examine the effect of political connectedness on both firm value and corporate policies. Specifically, much of the extant, related literature relies on a simple, cross-sectional research design that is subject to endogeneity concerns. Since predicting the likely outcome of *Citizens United* was highly infeasible (e.g., Barnes 2010a; Biskupic 2009; Eggen 2010), it is difficult to argue that either investors or corporations were able to anticipate its favorable vote and proactively adjust their behaviors accordingly. The surprise nature of *Citizens United* lends to its credibility as a valid natural experimental setting.

A primary channel through which corporations become politically connected is through campaign contributions to candidates for office. We follow previous studies (Aggarwal et al. 2012; Claessens et al. 2008; Goldman et al. 2009) in basing our definition of political connectedness on corporate campaign contributions, as reported in the Center for Responsive Politics. Specifically, for companies belonging to the S&P 500, we define a firm as politically connected if its median firm-level, pre-*Citizens United* political contributions (scaled by net total assets) falls in the top quartile.

By operationalizing the political connectedness measure in the natural experiment of *Citizens United*, this paper provides novel evidence on the impact of political activism on firm value. Specifically, using a seemingly unrelated regression (SUR) specification, we find that

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the expansive and profuse provisions accompanying *Citizens United*, in addition to urging the Securities and Exchange Commission to consider adopting disclosure requirements for corporate political contributions. Notably, in June 2012, the Supreme Court refused a request to reconsider its *Citizens United* decision (Bravin 2012). As of mid-2013, the SEC was continuing to consider petitions by advocates of campaign finance reform calling for stark improvements in the disclosure of corporate political contributions (SEC 2011).

political connections destroy shareholder value. Notably, historically politically connected firms realized an abnormal price drop of  $-0.475\%$  on the date the *Citizens United* decision was announced, and a cumulative abnormal loss of  $-1.219\%$  five days after the announcement date. In contrast, historically non-politically connected firms enjoyed positive returns on announcement date in the order of  $0.240\%$ . The difference between the announcement date reactions of politically connected firms and non-politically connected firms is also highly statistically significant. In multivariate analyses that control for firm characteristics, we continue to find a negative and significant effect of political connectedness on shareholder value. Collectively, these findings support the Agency Cost Hypothesis.

Given our finding that political connections reduce firm value, we exploit differences in corporate policies as a means to further investigate whether political connectedness and agency conflicts are positively related. Since corporate policies and political connectedness are jointly determined, we use the natural experimental setting of *Citizens United* to overcome endogeneity limitations. This improvement over related, existing literature offers an opportunity to draw more sound conclusions on the relationship between corporate policies and political connectedness.

We study this relationship in the context of cash management policies. Building upon previous studies that show that greater agency conflicts are associated with higher cash holdings (e.g., Jensen 1986; Stulz 1990; Harford 1999), we compare the cash holdings of politically connected firms to their less-connected counterparts. Specifically, we utilize a difference-in-differences approach to capture differences between firms of differing political connectedness and during different periods of time (i.e., pre- versus post-*Citizens United*). After controlling for

traditional determinants of cash holdings, we find that switching from non-politically connected status to politically connected status results in an incremental increase in corporate cash holdings of almost 20% following passage of *Citizens United*. Poor corporate governance quality also exacerbates the agency problems inherent to politically connected firms. Specifically, politically connected firms with entrenched managers, busy boards of directors, and overcompensated CEOs retain even more cash relative to their well-governed counterparts in the post-*Citizens United* period. We also find that the mere entertaining of a shareholder proposal that would restrict political contributions acts as a monitoring mechanism and, by extension, reduces the cash holdings of politically connected firms. Further, our results reveal that within-firm political tension, defined as divergence in management's political preferences from those of his employees, is associated with incrementally higher cash holdings. Collectively, these findings support the existence of agency costs in politically connected firms.

We conduct several sensitivity tests to validate our findings. Specifically, our conclusions regarding the value implications of corporate political connections hold after accounting for potentially confounding events. Our findings related to the agency conflicts of politically connected firms are robust to an analysis of *excess* cash holdings. Finally, we demonstrate that our empirical findings remain intact after excluding politically exposed firms belonging to the defense, energy, and utilities industries. These robustness checks lend further support to the value-destroying effects of corporate political connections and a positive association between political connectedness and agency costs.

This paper adds to emerging literature on the value-decreasing effects of political connections on stock prices. In a study of the effects of *Citizens United*, Coates (2012) finds that political connectedness is negatively related to Tobin's Q ratio, suggesting agency problems in politically connected firms.<sup>3</sup> Using the event study methodology, we document an unfavorable (favorable) capital market reaction to *Citizens United* for politically (non-politically) connected firms. Our paper fulfills a request repeatedly stated in related literature to explore the ramifications of *Citizens United* on corporate political activism, particularly since the landmark decision is expected "to greatly increase the use of corporate funds for political donations" (Aggarwal, Meschke, and Wang 2012, p. 2). Through a study of *Citizens United* and its exogenous enhancement in the value implications of political connectedness, we are better able to provide a causal link between political connections and changes in firm value.

This paper is also related to extant literature that examines the impact of political connectedness on corporate policies. Relevant studies have shown that political connectedness is significantly and positively related to executive compensation (Aslan and Grinstein 2012), leverage (Boubakri, Cosset, and Saffar 2012; Faccio 2010; Hutton, Jiang, and Kumar 2013), and liquidity (Boubakri, El Ghouli, and Saffar 2012; Hill, Fuller, Kelly, and Washam 2013). In a cross-country study of corporate cash holdings, Boubakri, El Ghouli, and Saffar (2012) find that politically connected firms hold more cash relative to non-politically connected firms, suggestive of agency costs. In a study of political *lobbying* expenditures, Hill, Fuller, Kelly, and Washam

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<sup>3</sup> Previous studies show that Tobin's Q ratio is correlated with several other factors (e.g., growth opportunities, capital structure) which do not fully reflect shareholder value (e.g., Anderson and Reeb 2003; Hail and Leuz 2009). We offer a more direct examination of shareholder value by making use of an event study methodology.

(2013) observe an inverse relation between cash holdings and lobbying costs, thus favoring a liquidity story. Our contribution to this stream of literature is two-fold. First, while the majority of this research relies on inferences drawn from cross-sectional data, the primary focus and findings of our paper revolve around a natural experiment, thus significantly alleviating endogeneity concerns. Second, we demonstrate that the agency conflicts inherent to politically connected firms have only been amplified in the post-*Citizens United* era that is distinguished by its lack of restraints on corporate political contributions.

The remainder of the paper is organized as follows. A discussion of *Citizens United* is presented in the next section. Section II presents our hypotheses and related literature. Section III describes the sampling procedure, and our empirical analysis is offered in section IV. We conclude in section V.

## I. BACKGROUND

Historically, corporations were prohibited from actively campaigning on behalf of politicians through donations of independent expenditures, which were strictly forbidden during the period from World War II through 2010.<sup>4</sup> This ban was challenged by the nonprofit organization Citizens United through their 2008 release of a conservative-inspired documentary attacking then-senator Hillary Rodham Clinton's record and instilling doubts as to her

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<sup>4</sup> Independent expenditures are defined as funds “expressly advocating the election of or defeat of a clearly identified candidate who is not made in cooperation, consultation, or concert with, or at the request or suggestion of, a candidate, a candidate’s authorized committee, or their agents, or a political party or its agents” (11 CFR 100.16(a)). An example of an independent expenditure would be a corporation’s decision to finance television commercials endorsing the candidate of their choosing.

qualifications to be president. The Federal Election Commission restricted Citizens United on their advertisements of the movie, a limitation that Citizens United CEO David Bossie – a long-time adversary of Senator Clinton – claimed to violate his First Amendment and right to free speech (Rucker 2010). The response to Citizens United’s challenge was a landmark Supreme Court decision in January 2010, where prohibitions on certain forms of corporate political activism were rendered unconstitutional under the First Amendment.

Some aspects of the regulatory environment surrounding corporate political activism did remain unchanged following *Citizens United*. Notably, corporations are still prohibited from contributing corporate funds directly to a political candidate. Instead, corporations derive a large proportion of their political connectedness through Political Action Committee (PAC) contributions. Managers, employees, and shareholders can contribute to their company’s PAC, and subsequently the PAC will channel the said funds to a political candidate. Interestingly, corporations are permitted to use internal funds to finance the fundraising efforts of PACs. Despite these regulatory consistencies, a logical yet relatively unexplored implication of *Citizens United* is an increase in corporate political activism through all means available, and not just through channels that were previously off limits.

Election spending reached new highs following passage of *Citizens United*. The estimated \$6 billion spent on the year 2012 election represents a new record and exceeds the cost of the second most expensive election by more than \$700 million (Center for Responsive Politics 2012). While corporations have never been barred from political activism in an attempt to influence lawmakers to reform policies, passage of *Citizens United* essentially opened the

floodgates for corporations to take an active, direct, and economically meaningful role in campaigning for preferred political candidates. Moreover, given the previously-documented complementary nature of the various types of political activism, *Citizens United* stimulated corporate political involvement of all forms, even those types that were allowed to be used prior to its passage (Coates 2012).<sup>5</sup>

A distinction of this paper is its focus on *Citizens United*, a powerful and controversial decision but one whose effects are limited to the United States. That is, our focus differs from broad, cross-country studies (e.g., Boubakri, El Ghouli, and Saffar 2012) in that we focus on a specific country (the United States) and the impact of a specific exogenous shock (*Citizens United*). Restricting our focus to a single country enables us to hold important within-country factors constant, such as cultural values, political views, regulations, and government structure.

## II. HYPOTHESIS DEVELOPMENT

### A. Agency Cost Hypothesis

As illustrated next, there exist several arguments for why the political motives of managers create or further exacerbate agency conflicts and are thus associated with a reduction

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<sup>5</sup> It is important to recognize that many forms of corporate campaign activity need not be disclosed. This reality complicates studies of political connectedness, since corporations can choose to strategically disguise their political activism. For example, a firm can avoid disclosure altogether by channeling political contributions through a separate entity (i.e., a “conduit”, or “independent” organization). In the case that the independent entity subsequently contributes said funds to a political campaign, it may be required to disclose the identity of its donors. However, if the entity restricts its contributions to independent expenditures, no disclosure is required. These strategic yet unobservable channels of political activism were utilized even more in the post-*Citizens United* period. Specifically, the identities of donors who sourced more than 50 percent of the \$266.4 million contributed by outside groups in 2010 remain unknown (Public Citizen 2010). The unobservable nature of some forms of corporate political activity results in conservative estimates of political contributions and should only bias against our ability to document a link between political connectedness and corporate policies.

in firm value. The potential negative consequences in this context are perhaps best identified through the testimony of Columbia law professor John C. Coffee, Jr. before the U.S. House Subcommittee on Capital Markets, Insurance, and Government Sponsored Enterprises, who noted the following:

“...The goal, however, has to be not only to increase transparency and disclosure, but to give shareholders an effective remedy by which to challenge decisions of which they disapprove, because this is a world in which shareholder and managerial interests are not well aligned. There may be perfectly legitimate corporate contributions, but for every dollar contributed by a corporation that maximizes shareholder wealth, there are other dollars that are contributed to pursue the personal, political, or ideological agenda of senior managers, all of that is hidden... [*Citizens United*] assumes that shareholders have practical remedies by which to contest decisions of managers to make contributions. In fact, they have very few rights.” (Corporate Governance after *Citizens United* 2010)<sup>6</sup>

More recent headlines directly tied to *Citizens United* involve incidents in which top-level corporate executives use their stature to influence the political leanings and voting decisions of lower-level employees, consistent with the presence of agency problems. For example, an October 2010 *New York Daily News* article revealed that the owner of several Ohio-based McDonald's restaurants sent Republican advertisements to employees as a means to strongly encourage them to vote for GOP candidates in the mid-term election. The owner, Paul Siegfried, went so far as to threaten the employees with pay and benefit cuts should they choose to not comply (Shahid 2010). These instances of political coercion are only becoming more common in the post-*Citizens United* period, as the freedoms imparted by the law have left many

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<sup>6</sup> Relatedly, in his 2010 report to the shareholders of the New York City Retirement Systems, John C. Liu, Comptroller of the City of New York, indicated that, “In the wake of *Citizens United*, it is even more important that boards provide the oversight and disclosure necessary to ensure that any political spending ultimately benefits shareholders, not the managers who control the corporate purse strings” (Comptroller of the City of New York 2010, p. 3).

managing directors to believe that money is not the only unrestricted resource to be used for political means, but that employees can be used, too (e.g., Paarlberg 2012; Charles 2012; McCarthy 2012).<sup>7</sup>

Given their overarching negative influence, corporate political connections may harm shareholder value. Fan, Wong, and Zhang (2007) and Caprio, Faccio, and McConnell (2008) show that politicians may attempt to extract a politically connected firm's resources to advance their own agendas. Aggarwal, Meschke, and Wang (2012) and Boubakri, El Ghouli, and Saffar (2012) find that politically connected firms are marred by agency conflicts. If political connections *decrease* firm value, the announcement of new regulations that effectively approve and promote corporate political activism should be accompanied by a *negative* reaction to historically politically connected firms. Therefore, the argument for political connections having value-destroying implications predicts a negative market reaction to politically connected firms surrounding the *Citizens United* decision. Moreover, as agency costs are associated with higher

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<sup>7</sup> Examples of agency conflicts within politically connected organizations are abundant. For instance, consider Roland Arnall, founder of Ameriquest Mortgage Co. and the single biggest contributor to President George W. Bush during the 2002-2004 time frame. During the 2002-2007 period, Mr. Arnall and his wife contributed at least \$12.25 million to the Bush campaign – an investment that would generate a very high rate of return. For example, in several states, Ameriquest benefited from the relaxing of stringent regulations that would have adversely affected the company's subprime lending practices. Moreover, President Bush later appointed Mr. Arnall to the prestigious position of ambassador to the Netherlands. Lastly, in exchange for their generosity, the Arnalls were invited to the inaugural dinner in January 2005, along with numerous other balls, receptions, and galas (Simpson 2007; Esdall and Bimbaum 2005). As a more recent example, a March 2012 *Associated Press* report revealed that “more than half of President Barack Obama's most generous campaign fundraisers have visited the White House at least once for meetings with top advisers, holiday parties, or state dinners... [and] scores have made multiple visits” (Gillum 2012). As another example, a December 2010 meeting hosted by President Obama involved 20 of the most politically active CEOs in corporate America. Collectively, these 20 executives had made \$8.2 million in political contributions over the prior 20 years and were described by the Center for Responsive Politics as “a pretty friendly crowd” (Riley 2010).

cash holdings, the Agency Cost Hypothesis predicts that politically connected firms are more likely to hoard cash relative to their less-connected counterparts.<sup>8</sup>

### **B. Value Enhancing Hypothesis**

Political connections may instead extend value-enhancing benefits to shareholders. In an international study, Faccio, Masulis, and McConnell (2006) find that politically connected firms are significantly more likely to be bailed out by the government in times of distress relative to non-politically connected firms. Relatedly, Claessens, Feijen, and Laeven (2008) document politically connected firms' preferential access to financing. As an example, Solyndra, a former manufacturer of solar panels, is thought to have reaped significant financial benefits in response to its political connections. Specifically, in 2009, the company received a \$535 million loan guarantee from the Department of Energy. In August 2011, Solyndra filed for bankruptcy, with the government projected to recoup a mere 19 cents on the dollar (Bathon 2012). A twist in this story originates in George Kaiser, an extremely wealthy Oklahoma oilman whose foundation owned one-third of the company. Kaiser is reported to have raised between \$50,000 and \$100,000 for President Barack Obama's 2008 campaign for presidency. One might conclude that Kaiser's loyalty to the President paid off in a big way; namely, some have suggested that the Solyndra plant built in Kaiser's hometown of Tulsa, Oklahoma, was secured through his generous political contributions (Mildenberg and Robison 2011).

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<sup>8</sup> A direct relationship between cash holdings and agency problems has garnered support from much of the relevant, extant literature. See, for example Jensen (1986), Stulz (1990), Harford (1999), Faleye (2004), Dittmar, Mahrt-Smith, and Servaes (2003); and Chen, Chen, Schipper, Xu, and Xue (2012).

Another instance of politicians catering to their donors arises through the combined efforts of congressional representatives Brian Bilbray, Erik Paulsen, and Jim Gerlach, who in June 2012 voted against a 2.3% excise tax on medical devices (H.R. 436) that went on to pass by a vote of 270-146. An examination of the legislators' contribution inflows reveals clear political motives, with PACs of leading health care companies such as Abbott Laboratories, Life Technologies Corporation, and the Medical Device Manufacturers Association topping Bilbray's list of major donors (Walters 2012). A politician's decision to promote the profitability of his donors (in this case, through tax breaks) represents a clear channel through which firms can use political contributions to enhance their financial stability and, by extension, firm value. Furthermore, a politically connected firm may derive value-enhancing benefits from a reduction in risk and lower cost of capital (Boubakri, Guedhami, Mishra, and Saffar 2012; Goldman, Rocholl, and So 2009; Faccio 2006).

If political connections *increase* firm value, the announcement of new regulations that effectively approve of and promote corporate political activism should be accompanied by a *positive* reaction to historically politically connected firms. As such, the notion that political connections are value-enhancing predicts a positive market reaction to politically connected firms surrounding the passage of *Citizens United*. Moreover, the value-enhancing effects of political connections may also be derived from liquidity and soft-budget constraints that effectively free up the flow of cash (e.g., Boubakri, Cosset, and Saffar 2012). Thus, according to the Value Enhancing Hypothesis, politically connected firms respond to their financially *unconstrained* position by holding *less* cash relative to their less-connected counterparts.

### III. SAMPLE

We obtain political contributions data from the Center for Responsive Politics (CRP). The CRP provides numerous data sets that can be used to gauge political activism, including campaign finance, lobbying, and the personal financial conditions of members of Congress and has been used repeatedly in related literature (e.g., Aslan and Grinstein 2012; Goldman et al. 2009). The focus of this paper is on corporate campaign finance activity, as gathered from the CRP and originating through Federal Election Commission (FEC) records. Major subsets of the campaign finance data include individual contributions and political action committee (PAC) contributions, both to candidates and to committees. Any individual contributing more than \$200 is required by law to report the contribution, as well as to disclose their employer and occupation to the FEC. The stringency of this requirement sheds light on employee-level contributions as being an important component of a company's political activism.

To compute a measure of corporate campaign finance activity, we gather contribution-level observations for contributions made to candidates by PACs and by employees, both those tied to parent and to wholly-owned subsidiary companies. Subsequently, we pool all contributions at the parent-level each fiscal year. PAC committee names and identifying information are gathered from the FEC and then matched to contribution-level observations in the CRP data. Employee contributions are identified by company name within the CRP data.<sup>9</sup> Consistent with Goldman, Rocholl, and So (2009) and Coates (2012), among others, we restrict

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<sup>9</sup> We manually reviewed all search results for actual matches and coded them accordingly.

the sample to S&P 500 firms. Financial statement data are gathered from the Compustat Fundamentals Annual file, stock returns are collected from CRSP, and names of subsidiary companies are retrieved from Mergent Online. We pull governance data from the RiskMetrics Directors database, RiskMetrics Shareholders Proposals file, and Execucomp Annual Compensation database. Our sample spans federal election cycle years 2006, 2008, 2010, and 2012, or fiscal years from 2005 to 2011.<sup>10</sup> To be included in the sample, a firm must appear in the data set in at least one pre-*Citizens United* year (2005, 2006, 2007, or 2008), and at least one post-*Citizens United* year (2010 or 2011).

#### IV. EMPIRICAL ANALYSIS

Table 1 provides descriptive statistics of political contributions on aggregate (Panel A) and firm-level (Panel B) bases. The mean (median) of firm-level political contributions is \$142,448 (\$57,225) across all firms, \$24,703 (\$4,800) for historically non-politically connected firms, and \$297,735 (\$169,170) for historically politically connected firms. When considering the sample in the aggregate, PAC contributions represent about 53% of the 373,393 contribution-level observations in our data set, but 67% of the sample-wide total contributions of slightly more than \$441 million dollars. Non-executive employee contributions represent 35% of all contributions by count and 23% by dollar value, while executive contributions constitute 12% of all contributions by count and 9% by dollar value.

[Insert Table 1 about here]

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<sup>10</sup> To provide a cleaner test, fiscal year 2009 observations (i.e., those immediately preceding passage of *Citizens United*) are excluded. The main results of the paper are qualitatively very similar if this restriction is not imposed.

## A. Tests of hypothesis

January 21, 2010 marked a significant day of change in corporate political activism. Specifically, the Supreme Court's controversial decision in favor of *Citizens United* lifted long-standing limits on corporate political contributions. We exploit the announcement of *Citizens United* as a means to assess the effect of political connectedness on firm value. However, evaluating the market reaction to *Citizens United* is complicated by the fact that all sample firms have the same event date (January 21, 2010). Event clustering in calendar time induces cross-correlation in estimates of abnormal returns which creates downward-biased standard errors and upward-biased test statistics. As such, rather than use standard event study methodology, we instead estimate each sample firm's reaction to the ruling through a seemingly unrelated regression (SUR). The SUR framework simultaneously estimates a set of firm-specific equations that include cross-correlated error terms:

$$R_i = \alpha_i + \beta_i R_m + \delta_i Event + \varepsilon_i \quad (1)$$

where  $R_i$  is the return series for individual firm  $i$ ,  $R_m$  is the return series for the CRSP value-weighted index (including dividends), and  $Event$  is a dummy variable that equals 1 on days included in the event window (0 otherwise). For example, for the (0,+2) window,  $Event$  is set to one on January 21, 2010 (Thursday), January 22, 2010 (Friday), and January 25, 2010 (Monday), and is zero otherwise. Daily returns are measured between April 1, 2008, and March 31, 2010, and are retrieved from the CRSP daily returns file. The SUR methodology was developed by Schipper and Thompson (1983) and has since become increasingly utilized in corporate finance

research (e.g., Doidge and Dyck 2012; Fernandes, Lel, and Miller 2010). This method enables us to measure the overall stock market reaction to *Citizens United*, while also accounting for cross-correlation in abnormal returns. Our main interest is in firm-specific estimates of  $\hat{\delta}_i$  and, in particular, whether (1) the estimates jointly and significantly differ from zero, and (2) the estimates significantly differ across firms having varying degrees of political connectedness.

Table 2 reports the market reaction to *Citizens United* for our sample of historically politically connected firms (“POLITICAL”) and historically non-politically connected firms (“NEUTRAL”). Our measure of historical political connectedness is based on median firm-level pre-*Citizens United* contributions (scaled by net total assets), where POLITICAL captures firms in the fourth quartile and NEUTRAL captures firms in the first quartile as well as historically non-politically active firms.<sup>11</sup> Since  $\hat{\delta}_i$  represents the average abnormal return for firm  $i$ , we multiply the average value of  $\hat{\delta}_i$  estimates in each event window by increments of 100% for each day in the event window to obtain the cumulative abnormal return (CAR). For example,  $CAR(0,+2)$  is computed as the average value of  $\hat{\delta}_i$  estimates resulting from a SUR regression where  $Event = 1$  on days 0, +1, and +2, multiplied by 300% for the three days in the event window. Panel A provides descriptive statistics of abnormal returns for all sample firms and degrees of historical political connectedness. The mean (median) abnormal return on the date of the *Citizens United* decision is  $-0.08\%$  ( $-0.12\%$ ) with a standard deviation of 1.59%. The mean

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<sup>11</sup> Using this definition, an example of a historically politically connected company in our data set is Corning Inc. A 2006 *New York Times* article declared Corning to be one of then-senator Hillary Clinton’s largest sources of campaign contributions (McIntire and Hernandez 2006). Notably, in response to the announcement of *Citizens United*, shareholders of Corning Inc. realized a cumulative abnormal loss of  $-0.79\%$  five-days after the announcement date of *Citizens United*.

(median) cumulative abnormal return for the (0,+5) window surrounding *Citizens United* is –0.48% (–0.61%) with a standard deviation of 3.65%. The average firm in our sample of POLITICAL and NEUTRAL firms has total assets (net of cash) of approximately \$18.2 billion and market-to-book ratio of 2.25.

Panel B of Table 2 provides univariate tests of CARs. Results indicate a negative market reaction to historically politically connected firms persisting for five days beyond the announcement date, with a statistically significant negative reaction noted for all event windows considered [(0, 0), (0,+2), and (0,+5)]. On the announcement date, the average abnormal return to politically connected firms is –48 basis points (p-value = 0.028), with an average cumulative loss of 122 basis points five days after announcement date (p-value = 0.028). In contrast, historically *non*-politically connected firms exhibit a positive but insignificant market reaction over all event windows studied. For example, on announcement date, this “neutral” sub-sample realized an average abnormal return of 0.240% (p-value = 0.173), and an average cumulative abnormal return of 0.123% five days after announcement date (p-value = 0.728). Tests for differences in means are statistically significant for all three event windows (p-values of 0.010, 0.007, and 0.041 for the (0, 0), (0,+2), and (0,+5) windows, respectively). Nonparametric test results, provided in Panel B of Table 2, also support this result, with approximately 72%, 77%, and 68% of the POLITICAL group’s CARs being negative for the (0, 0), (0,+2), and (0,+5) windows, respectively, all of which are statistically significant. Overall, these results suggest that

politically connected firms face an unfavorable market reaction to *Citizens United*, and provide preliminary evidence that political connections destroy shareholder value.<sup>12</sup>

[Insert Table 2 about here]

As a formal test of our prediction that the market reacted differently to *Citizens United* based on whether the firm was politically connected, we examine how the estimated CARs (average  $\hat{\delta}_i$  from equation 1, expressed as percentage returns) differ with regard to a measure of historical political connectedness. To do so, we estimate the following regression model using ordinary least squares:

$$\hat{\delta}_i = \beta_0 + \beta_1 \text{Political Dummy}_i + \beta_2 \mathbf{X}_i + \varepsilon_i \quad (2)$$

where  $\hat{\delta}_i$  originates from the SUR estimation in equation 1, Political Dummy is our measure of historical political activism, and  $\mathbf{X}_i$  is a vector of control variables measured in fiscal year 2009. For precise definitions of variables, see the Appendix.

Table 3 reports the coefficient estimates corresponding to equation 2. After controlling for size, the market-to-book ratio, and leverage, we find that the coefficient on Political Dummy

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<sup>12</sup> Contrary to our and Coates's (2012) findings, Werner (2011) finds that *Citizens United* constituted a "nonevent," posing no impact to firm value. Our research design differs from the Werner (2011) study in several respects. First, we use a seemingly unrelated regression design to account for the fact that all sample firms have the same event date. Second, consistent with Goldman et al. (2009), Coates (2012), and others, we utilize a sample of S&P 500 firms. The S&P 500 should yield more representative results than Werner's sample of Fortune 500 firms. Third, we classify firms into politically and non-politically connected sub-groups based on their *median* firm-level pre-*Citizens United* political contributions. Using *total* firm-level pre-*Citizens United* contributions as Werner does could bias the classification methodology when firms entered or exited the Fortune 500 during his sample period. This bias is likely more severe in a study of Fortune 500 firms than of S&P 500 firms, given the high degree of year-to-year turnover in the Fortune 500 (for a list of Fortune 500 exits in 2011, see <http://money.cnn.com/magazines/fortune/fortune500/2011/movers/exits.html>). Fourth, we follow Aggarwal et al. (2012), Claessens, Feijen, and (2008), Goldman et al. (2009), among others, in basing our definition of political connectedness on campaign contributions rather than the lobbying expenditures utilized in Werner (2011). Lastly, we provide a much more expansive study of *Citizens United*'s impacts, spanning the areas of firm value, corporate policies, and governance implications.

is negative and statistically significant for all three event windows studied (p-values of 0.007, 0.012, and 0.042, for the (0, 0), (0,+2), and (0,+5) windows, respectively). In terms of economic significance, the coefficient on Political Dummy suggests that the day of the *Citizens United* decision resulted in the market penalizing historically politically connected firms by 75 basis points compared to historically non-politically connected firms. Considering the cumulative effect of *Citizens United* spanning the announcement day through the five days following, historically politically active firms realized a 133 basis points loss relative to their less-connected counterparts.<sup>13</sup> The evidence shown in Tables 2 and 3 lend support to the main prediction of this paper in favor of the Agency Cost Hypothesis.<sup>14</sup>

[Insert Table 3 about here]

## **B. Corporate policies and *Citizens United***

Given our finding that political connections destroy firm value, we next investigate whether the cash management practices of historically politically connected firms significantly differed from those of historically non-politically connected firms following passage of *Citizens United*. Table 4 provides univariate tests of cash holdings for firms exhibiting varying degrees of pre-*Citizens United* political connectedness. Panel A of Table 4 demonstrates that the most

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<sup>13</sup> In untabulated results, we investigate whether the negative reaction of politically connected firms holds using an alternate definition of political connectedness. Specifically, we create a rank variable based on median firm-level pre-*Citizens United* contributions (scaled by Net Total Assets). The results remain intact when we conduct the multivariate market reaction regression on this alternative political connectedness measure.

<sup>14</sup> In untabulated results, we examine the potential price reversals of politically connected firms in the long-run. Specifically, we construct monthly, equally-weighted portfolios that are long in politically connected firms and short in neutral firms in the post-*Citizens United* period (March 2010-December 2012). We regress the returns to this portfolio on the four factors from the Fama and French (1992) and Carhart (1997) models. The intercept term of this regression is insignificant, suggesting that there is no price reversal in the long run.

politically connected firms (upper quartile) hold significantly larger cash balances than less politically connected firms (lower quartile) in both the pre- and post-*Citizens United* periods. Comparing cash holdings levels in the pre- and post-*Citizens United* periods within each quartile, we find that most politically connected firms report larger cash balances (as a proportion of net total assets) in the post-*Citizens United* period. That is, politically connected firms significantly increased their cash holdings from the pre- to post-*Citizens United* periods, whereas the difference in cash holdings (pre- versus post-*Citizens United*) of the least politically connected firms is not statistically significant.<sup>15</sup> This initial evidence supports the existence of agency costs in politically connected firms.

We also examine the association between traditional determinants of cash holdings and political connections. From Panel B of Table 4, we find no significant difference between the most politically connected firms (upper quartile) and least politically connected firms (lower quartile, ignoring non-politically active firms) on important, traditional determinants of cash holdings. Specifically, in the post-*Citizens United* period, politically connected firms do not significantly differ from non-politically connected firms on the basis of size (either in terms of Net Total Assets or Sales), leverage, profitability, or the propensity to pay dividends. Moreover, as demonstrated in Panel C of Table 4, in the post-*Citizens United* period, these groups of firms do not significantly differ on the basis of any of the key governance metrics studied. Moreover, within quartiles of historical political connectedness, very few firm characteristics or measures of

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<sup>15</sup> The mean (median) annual contributions-to-assets ratio across all firm-years is approximately 0.7% (0.5%). Although we do not claim that the amount of campaign contributions will be especially large for all firms in all fiscal years, it is important to point to their cumulative impact over time as being economically meaningful.

governance quality significantly differ in the post-*Citizens United* period relative to the pre-*Citizens United* period. Collectively, these results suggest that political connectedness is distinct from both traditional determinants of cash holdings and governance measures.

[Insert Table 4 about here]

Did historically politically connected firms indeed increase their campaign contributions following the *Citizens United* decision? To investigate how political contributions changed in the post-*Citizens United* period and as a function of *historical* political connectedness, we estimate the following model during the post-*Citizens United* period (2010-2011):

$$\text{Contributions/NTA}_{i,t} = \beta_0 + \beta_1 \text{Political Dummy}_i + \beta_2 \mathbf{X}_{i,t-1} + \varepsilon_{i,t} \quad (3)$$

where Political Dummy is our measure of historical political activism, and  $\mathbf{X}_i$  is vector of control variables. We use lagged values of control variables to overcome a potentially endogenous relationship between contemporaneous political contributions and cash holdings. A positive (negative)  $\beta_1$  coefficient would suggest that historically politically connected firms increased (decreased) their political contributions following the *Citizens United* decision. We note that our main interest is not in the amount in which historically politically connected firms contribute following *Citizens United*, but rather in their cash management policies surrounding this exogenous shock.

Table 5 provides the results of this equation estimated just for fiscal years 2010-2011. The positive and statistically significant coefficient on the Political Dummy (our measure of historical political activism) suggests that politically connected firms increased their political contributions following *Citizens United*.

[Insert Table 5 about here]

To examine how cash holdings changed as a function of the change in political contributions in the post-*Citizens United* period relative to the pre-*Citizens United* period for our S&P 500 firms, we estimate the following changes specification:

$$\Delta\text{Log}(\text{Cash}/\text{NTA})_i = \beta_0 + \beta_1\Delta\text{Contributions}/\text{NTA}_i + \beta_2\Delta\mathbf{X}_i + \varepsilon_i \quad (4)$$

where Contributions/NTA is our measure of political involvement,  $\mathbf{X}_i$  is vector of traditional determinants of cash holdings, and changes are computed as the value in 2010 (post-*Citizens United*) relative to the value in 2008 (pre-*Citizens United*). If the level of corporate cash holdings is increasing in the degree of political connectedness (suggesting the *existence* of agency costs), we expect to find a positive  $\beta_1$  coefficient. In modeling the determinants of cash holdings, we control for several firm characteristics. Specifically, consistent with Opler, Pinkowitz, Stulz, and Williamson (1999), Harford, Mansi, and Maxwell (2008) and others, we control for firm size, leverage, growth opportunities, contemporaneous cash flows, the standard deviation of cash flows, net working capital, R&D expenditures, capital expenditures, and the propensity to pay dividends. Although this model does not consider historical political activism, it provides a preliminary look into whether and, if so, how cash holdings and political contributions differed in 2010 relative to 2008.

Table 6 reports coefficient estimates corresponding to the simple difference regression (post- relative to pre-*Citizens United*) specified in equation 4. We find a positive and significant coefficient on  $\Delta\text{Contributions}/\text{NTA}$  (p-value = 0.043). That is, as political contributions increased from the pre- to post-*Citizens United* periods, so did corporate cash holdings. This

evidence is consistent with the notion that politically connected firms are marred by agency conflicts.

[Insert Table 6 about here]

To formally investigate whether the cash holdings levels of politically connected firms significantly differed from that of their less-connected counterparts following the *Citizens United* decision, we use a difference-in-differences research design. In this test, the differences stem from (1) a measure of *historical* political activism, and (2) pre- versus post-*Citizens United* periods. We model cash holdings as a function of historical political activism in the pre- versus post-*Citizens United* periods:

$$\begin{aligned} \text{Log(Cash/NTA)}_{i,t} = & \beta_0 + \beta_1 \text{Political Dummy}_i + \beta_2 \text{Post-Citizens United Dummy}_{i,t} \\ & + \beta_3 (\text{Political Dummy}_i * \text{Post-Citizens United Dummy}_{i,t}) \\ & + \beta_4 \mathbf{X}_{i,t-1} + \varepsilon_{i,t} \end{aligned} \quad (5)$$

where Post-*Citizens United* Dummy is set to 1 for fiscal years 2010 and 2011 (0 otherwise), and all other variables are as defined previously. Regarding equation 5,  $\beta_1$  measures the relation between cash holdings and political connectedness, while  $\beta_3$  measures the *differential* relation between cash holdings and political connectedness during the post-*Citizens United* period. The test of our hypothesis becomes  $\beta_3 \neq 0$ . Specifically, in reference to equation 5,  $\beta_3 < 0$  ( $> 0$ ) would suggest that political connections motivate a firm to hold less (more) cash relative to their less-connected counterparts following passage of *Citizens United* compared to before its passage.

Table 7 provides coefficient estimates corresponding to equation 5. We find a positive association between political connections and cash holdings. Specifically, the relation between cash holdings and our measure of historical political connectedness significantly increased

during the post-*Citizens United* period relative to the pre-*Citizens United* period (p-value = 0.059). In contrast, cash holdings of historically non-politically connected firms fell following *Citizens United*, although this finding is not statistically significant. In terms of economic significance, switching from non-politically connected status to politically connected status results in an incremental increase in corporate cash holdings of 19.84% following passage of *Citizens United*.<sup>16</sup> Taken as a whole, these findings are consistent with the view that politically connected firms suffer from agency problems (indicated by the retention of high cash holdings), but their less politically connected counterparts do not.

Coefficient estimates on traditional determinants of cash holdings are also largely consistent with previous studies (Opler et al. 1999; Harford et al. 2008). Specifically, current year cash holdings are positively associated with lagged values of cash holdings, the market-to-book ratio, cash flow, cash flow volatility, and R&D expense. Current year cash holdings are negatively related to size, leverage, net working capital, capital expenditures, and the propensity to pay dividends. We also note that the adjusted R<sup>2</sup> of 79.2% provided in Table 7 is consistent with prior studies utilizing similar specifications that include the lagged value of cash holdings as an explanatory variable (e.g., Harford, Mansi, and Maxwell 2008; Agarwal and Nasser 2012).

### **C. Corporate governance quality and political connections**

The evidence presented so far in this paper is consistent with the hypothesis that politically connected firms are characterized by agency problems. In this section, we examine

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<sup>16</sup> The incremental and economic effect of politically connected status in the post-*Citizens United* period =  $e^{0.181} - 1 = 0.1984$ .

whether corporate governance quality incrementally affects this overall finding. Existing evidence suggests that poor corporate governance quality magnifies agency conflicts between managers and stakeholders and diminishes the value of cash holdings (Dittmar, Mahrt-Smith, and Servaes 2003; Dittmar and Mahrt-Smith 2007; Harford, Mansi, and Maxwell 2008). Our purpose is to investigate whether poorly-governed, historically politically connected firms have higher cash holdings relative to well-governed and/or historically non-politically connected firms.

We capture governance quality through four measures. The first measure is the managerial entrenchment index (E-Index) proposed by Bebchuk, Cohen, and Ferrell (2009). Firms that facilitate the entrenchment of managers, characterized by staggered boards, limits to shareholder bylaw amendments, poison pills, golden parachutes, and supermajority requirements for mergers and charter amendments, are of inferior governance quality. The second measure is the external involvement of board members. Busy boards, defined here as the proportion of independent directors that serve on three or more boards, tend to become distracted and are less effective monitors because their attention is diverted away from the “home” corporation (Fich and Shivdasani 2006). The third measure of governance quality is defined in terms of excess CEO compensation. Excessive CEO compensation is more common in corporations with poor corporate governance structures (Core, Holthausen, and Larcker 1999). Since governance quality is decreasing in all three of these measures, we predict that the agency conflicts plaguing politically connected firms will be amplified when managerial entrenchment levels, the proportion of busy board members, and level of excess CEO compensation are high.

Our fourth measure of corporate governance quality addresses the role of investor activism as a monitoring mechanism. In the context of corporate political contributions, we search the RiskMetrics Shareholder Proposals database for politically-oriented shareholder proposals. We are not necessarily interested in determining the fate of these proposals, but instead consider the mere knowledge that a proposal is being considered to act as a monitoring mechanism and, as such, impose restraints on a manager's tendency to hoard cash. For our POLITICAL (NEUTRAL) subgroup, 54.7% (65.5%) of firms entertained a politically oriented shareholder proposal during our sample period.

To test our predictions, we augment the cash holdings difference-in-differences model (equation 5) by incorporating measures of corporate governance:

$$\begin{aligned}
 \text{Log(Cash/NTA)}_{i,t} = & \beta_0 + \beta_1 \text{Political Dummy}_i + \beta_2 \text{Post-Citizens United Dummy}_{i,t} \\
 & + \beta_3 \text{Governance}_{i,t} + \beta_4 (\text{Political Dummy}_i * \text{Post-Citizens United Dummy}_{i,t}) \\
 & + \beta_5 (\text{Political Dummy}_i * \text{Governance}_{i,t}) \\
 & + \beta_6 (\text{Post-Citizens United Dummy}_{i,t} * \text{Governance}_{i,t}) \\
 & + \beta_7 (\text{Political Dummy}_i * \text{Post-Citizens United Dummy}_{i,t} * \text{Governance}_{i,t}) \\
 & + \beta_8 \mathbf{X}_{i,t-1} + \varepsilon_{i,t}
 \end{aligned} \tag{6}$$

where Governance is one of the four measures of corporate governance quality mentioned previously. Since we take governance quality to be worsening in the magnitude of managerial entrenchment, the busy-ness of directors, excessive compensation to CEOs, and a lack of investor activism in politically-oriented matters, we posit that the agency problems (as captured by a build-up of cash) of historically politically connected firms in the post-*Citizens United* period are more severe when the degree of managerial entrenchment, the proportion of busy board members, and excessive compensation to the CEO are high, and when the firm is not

required to entertain a politically-oriented shareholder proposal. That is, for these four proxies of governance quality, our prediction becomes  $\beta_7 > 0$ .

Table 8 provides results of our tests of the impact of governance quality on the agency implications of corporate political connections. Columns I, II, and III provide estimates of equation 6 using the first three proxies of governance quality. The results are consistent with agency costs of politically connected firms. Specifically, we find that higher managerial entrenchment levels are associated with a build-up of cash among politically connected firms following the *Citizens United* decision (p-value = 0.070). Additionally, we find that the busyness of boards is associated with larger cash holdings for historically politically connected firms in the post-*Citizens United* period (p-value = 0.075). Similarly, an excessively compensated CEO is associated with an incremental enhancement of agency problems in historically politically connected firms following the *Citizens United* decision (p-value = 0.048). Taken together, the results provided in the first three columns of Table 8 are consistent with the prediction that weak governance exacerbates agency problems in politically connected firms.

[Insert Table 8 about here]

The remaining three columns of Table 8 provide the results of estimating equation 6 using politically-oriented shareholder proposals as the measure of governance quality (columns IV, V, and VI). Consistent with expectations, we find that failing to entertain a politically-oriented shareholder proposal during either the 2007-2008 (pre-*Citizens United*) or 2010-2011 (post-*Citizens United*) periods results in an incremental increase in the cash holdings of historically politically connected firms relative to historically non-politically connected firms in

the post-*Citizens United* period relative to the pre-*Citizens United* period (p-value = 0.019). We further find that the incremental increase in agency problems (and cash holdings) is much greater for politically-oriented shareholder proposals entertained during the post-*Citizens United* period (column VI of Table 8; p-value = 0.046). This result supports the intuition that the passage of a rule that lifted long-standing restrictions on corporate political activism only amplified existing agency conflicts of politically connected firms. Taken together, these findings support a positive association between political connections and agency costs.

#### **D. A clash of colors: Red versus blue corporate contributions**

The results of this paper suggest that political connections are value-destroying, and that connected firms are marred by agency conflicts. Agency conflicts arise when a manager's motives diverge from that of his stakeholders. It is rational to expect agency problems to be heightened by a divergence in the party affiliation of political contributions made by executive employees and those made by *non-executive* employees. To capture the degree of political tension within a corporation, we calculate the absolute deviation between the proportion of executive employee contributions to Republicans and the proportion of non-executive employee contributions to Republicans for historically politically active firms. We compute the median firm-level deviation during the pre-*Citizens United* period, and sort firms into deciles. To examine for the existence of agency costs in the post-*Citizens United* period, we estimate the following model:

$$\text{Log(Cash/NTA)}_{i,t} = \beta_0 + \beta_1 \text{Political Deviation}_i + \beta_2 \text{Post-} \textit{Citizens United} \text{ Dummy}_{i,t}$$

$$\begin{aligned}
& + \beta_3 (\text{Political Deviation}_i * \text{Post-Citizens United Dummy}_{i,t}) \\
& + \beta_4 \mathbf{X}_{i,t-1} + \varepsilon_{i,t}
\end{aligned} \tag{7}$$

where Political Deviation is a continuous variable ranging from 0.10 (bottom decile of deviation) to 1.00 (top decile of deviation) and  $\mathbf{X}_i$  is a vector of lagged control variables as defined previously. Equation 7 is estimated for firms in the upper quartile of pre-*Citizens United* contributions and for years in which these firms report both positive executive contributions and positive non-executive contributions. We predict agency conflicts to be increasing in the extent to which the party affiliation of executive contributions deviates from that of non-executive contributions. Moreover, we expect *Citizens United* to only exacerbate the agency problems of firms with historically high degrees of political tension. Given our predictions, we expect to find a positive  $\beta_3$ .

Table 9 depicts the impact of within-firm political tension on cash holdings. The results suggest that as the degree of deviation between the party affiliation of executive and non-executive political contributions increases, corporate cash holdings increase in the post-*Citizens United* period (p-value = 0.036). These results lend further support to agency conflicts as a plausible explanation for the value-destroying effects of corporate political connections.

[Insert Table 9 about here]

## E. Alternative explanations & Robustness checks

*Alternative explanations.* We next address several alternative explanations of our findings. First, we acknowledge the possibility that *Citizens United* transformed the competitive

landscape to a focus on corporate political activism (and its associated impact on cash holdings). To account for this possibility, it is important that we incorporate metrics whose reliability is not affected by *Citizens United*. Our analysis of corporate governance quality achieves this goal. That is, by focusing on widely-accepted governance metrics whose dependability was not affected by *Citizens United*, we are better able to exploit the exogenous enhancement in firm value and corporate policies that accompanied *Citizens United*.

Second, we recognize that the media scrutiny and related negative attention accompanying *Citizens United* may have made it more difficult for all companies to use political involvement as a means to enhance firm value. To address this concern, we have utilized a measure of political connectedness that is based on *historical* campaign contributions. Specifically, our finding that politically connected firms realized a negative market reaction to the *Citizens United* decision is based on their political activism in the pre-*Citizens United* period. Most importantly, this result does not depend on the amount, cost, and potentially unfavorable consequences of their post-*Citizen United* political activity.

Lastly, we revisit our presumption that *Citizens United* more meaningfully impacted historically politically active firms relative to their politically *inactive* counterparts. A counter-argument states that because *Citizens United* lifted restrictions on certain forms of previously barred political activities, the decision gave the upper hand to historically non-politically active firms. If true, we would expect to observe a significant positive market reaction on the part of historically non-politically active firms. Instead, our results reveal that *Citizens United* was

accompanied by an insignificant (though positive) market reaction to non-politically active firms, thus disputing this counter-argument.

*Potential confounding events.* A fundamental concern underlying event studies is that other events occurred during the event window. These confounding events can interfere with our ability to draw accurate inferences about the impact of the event of interest. We repeat our analysis of the market reaction to *Citizens United* after excluding firms that announced earnings or other significant corporate events, as identified in company press releases and newswire reports in the *LexisNexis Academic* database. Of the combined, initial sample of POLITICAL and NEUTRAL firms (133 observations), the number of firms with confounding events ranged from 8 (for the  $-1, 0$  window) to 43 (for the  $-1, +5$  window). Results of this sensitivity check, provided in section I (Panels A and B) of Table 10, are consistent with earlier event study results (Tables 2 and 3). For example, after excluding firms with potential confounding events, Panel A, section I of Table 10 demonstrates that historically politically connected firms realized an abnormal price drop of  $-0.592\%$  on announcement date ( $p\text{-value} = 0.002$ ) and a cumulative abnormal loss of  $-0.785\%$  five days after announcement date ( $p\text{-value} = 0.090$ ). Thus, our finding that political connections are value-decreasing is robust to controlling for confounding events.

[Insert Table 10 about here]

*Politically exposed industries.* Firms belonging to the defense, energy, and utilities industries face significantly greater political exposure relative to other industries. One might expect that politically exposed companies would be unduly harmed by *Citizens United* since they

are, by definition, compelled to contribute to political campaigns. In particular, it is possible that the value-destroying effects of political connections documented in this paper are primarily driven by companies whose political contributions are largely involuntary and, as such, most likely not attributable to agency conflicts.

To ensure that these politically exposed industries are not driving the results, we repeat our analysis of the market reaction to *Citizens United* as well as the primary difference-in-differences test used to evaluate whether political connections are positively associated with agency costs. First, similar to Goldman, Rocholl, and So (2009), we repeat our analysis after excluding the defense, energy, and utilities industries. Second, we redefine our measure of historical political connectedness (Political Dummy) based on a firm's median firm-level pre-*Citizens United* contributions relative to the industry median. Results of sensitivity tests on the market reaction results, provided in Panels A and B (sections II and III) of Table 10, and those on the primary difference-in-differences results, provided in Table 11, demonstrate that our empirical results are qualitatively unchanged after accounting for varying degrees of political exposure, suggesting that political exposure cannot explain the findings of this paper.<sup>17</sup>

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<sup>17</sup> In untabulated results, we evaluate the market reaction and cash holdings implications of *Citizens United* after defining an indicator variable, Exposed Dummy, to capture the defense, energy, and utilities industries. Specifically, our multivariate test of the market reaction to *Citizens United* becomes  $\hat{\delta}_i = \beta_0 + \beta_1 \text{Political Dummy}_i + \beta_2 \text{Exposed Dummy}_i + \beta_3 (\text{Political Dummy}_i * \text{Exposed Dummy}_{i,t}) + \beta_4 X_i + \varepsilon_i$ . The resulting  $\beta_3$  coefficient is statistically insignificant for all three event windows (i.e., p-values of 0.833, 0.846, and 0.448 for the (0, 0), (0,+2), and (0,+5) windows, respectively), lending further support to our prediction that politically exposed firms are not driving the results. To evaluate the impact of *Citizens United* on the cash holdings of politically exposed firms, we adopt a difference-in-difference-in-differences specification. This specification parallels equation 6, with Exposed Dummy taking the place of the Governance term. The main coefficient of interest,  $\beta_7$ , is statistically insignificant (p-value = 0.919), again favoring the notion that our findings are robust to controlling for the degree of corporate political exposure.

*Financial firms.* Financial firms are also known to systematically differ from other sectors of the economy along key corporate policy and governance dimensions. In untabulated sensitivity tests, we exclude financial firms (SIC codes 6000-6999) and find qualitatively similar results with regard to the direction, magnitude, and significance of the market reaction to *Citizens United* and its implications on corporate policies, both for politically and non-politically connected firms. Thus, financial firms do not drive the results of the paper.

*Excess cash.* Our main test of whether politically connected firms are marred by agency conflicts utilized a difference-in-differences research design, where the dependent variable was defined as the level of corporate cash holdings (scaled by net total assets). To more explicitly control for industry and time series patterns in cash holdings, we adjust the continuous variables in equation 5 by their annual industry medians. This approach enables us to account for both cross-sectional and time-series variation in variables of interest. Table 12 reports the results from regressing this measure of excess cash on industry-adjusted traditional determinants and measures of political connectedness. We continue to find a positive and significant effect of political connectedness on cash holdings, demonstrating that our empirical conclusions do not depend on variation either within industry or across time.

[Insert Table 12 about here]

## **V. CONCLUSION**

Political connections may enhance or harm shareholder value. However, existing insights attempting to address the impact of corporate political connectedness on shareholder value are inconclusive. In an effort to test for the existence of a causal link between political connections

and changes in shareholder value, we pose our research questions in the context of a natural experiment. Specifically, we focus on an exogenous enhancement in the value implications of political connectedness that accompanied the landmark Supreme Court case, *Citizens United*.

The findings in this paper support a negative relation between political connections and firm value. Using an event study methodology and a seemingly unrelated regression design, we find that politically connected firms realized significant negative abnormal returns following the announcement of the *Citizens United* decision. Specifically, historically politically connected firms realized an abnormal price drop of  $-0.475\%$  on announcement date and a cumulative abnormal loss of  $-1.219\%$  five days after announcement date, while historically non-politically connected firms enjoyed positive returns on announcement date in the order of  $0.240\%$ . Collectively, these findings are consistent with a positive association between agency costs and political connectedness.

Given the negative implications of political connectedness on firm value, we investigate whether the corporate policy decisions of politically connected firms are suggestive of agency conflicts. Building upon previous studies that document a positive association between agency problems and cash holdings (e.g., Jensen 1986; Stulz 1990; Harford 1999), we evaluate whether the corporate cash holdings of connected firms significantly differ from those associated with their less-connected counterparts.

The findings in this paper reveal a connection between political activism and corporate policies. Using a difference-in-differences research design that controls for relevant firm characteristics, we find that politically connected firms increased their cash holdings following

passage of *Citizens United* relative to before its passage. Poor corporate governance quality, captured by managerial entrenchment, busy board members, excessive remuneration to the CEO, and investor inactivism in the context of politically-oriented shareholder proposals also aggravates the existing agency conflicts within politically connected firms, as evidenced by an incrementally and significantly greater level of cash holdings. Finally, political tension within a firm, defined as divergence in the party affiliation of political contributions of executive employees relative to that of *non-executive* employees, is associated with incrementally greater cash holdings. Collectively, our findings are consistent with the existence of agency problems in politically connected firms.

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**Appendix**  
**Variable Definitions**

(with Compustat Fundamentals Annual variable names shown in parentheses, where applicable):

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*Panel A: Political Connectedness*

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Contributions/NTA	Annual Political Contributions / [Total Assets (AT) – Cash & Cash Equivalents (CHE)] computed at the parent-level and measured in year $t$ , where political contributions include donations made by PACs and employees associated with parent and wholly-owned subsidiary companies, unless indicated otherwise
Post-Citizens United Dummy	An indicator variable equal to 1 for fiscal years 2010 and 2011, 0 otherwise
Political Dummy	An indicator variable to capture the degree of historical political connectedness as determined by median firm-level pre-Citizens United contributions (scaled by Net Total Assets), set equal to 1 for firms in the fourth quartile and equal to 0 for firms in the first quartile and for historically non-politically active firms
Political Deviation	A ranked variable to capture the degree of historical within-firm divergence in political beliefs among historically politically active firms (i.e., where Political Dummy = 1), determined by the median firm-level absolute difference in the proportion of executive employee contributions to Republicans and the proportion of non-executive employee contributions to Republicans as observed during the pre-Citizens United period; ranging from 0.10 (bottom decile) to 1.00 (top decile)

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*Panel B: Traditional Determinants of Corporate Cash Holdings*

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Log(Cash/NTA)	The logarithm of Cash & Cash Equivalents (CHE) / [Total Assets (AT) – Cash & Cash Equivalents (CHE)], measured in year $t$
Log(Net Total Assets)	The logarithm of [Total Assets (AT) – Cash & Cash Equivalents (CHE)], measured in year $t$
Debt/NTA	[Long-term Debt (DLTT) + Debt in Current Liabilities (DLC)] / [Total Assets (AT) – Cash & Cash Equivalents (CHE)], measured in year $t$
Market-to-Book	[Market Value of Equity (CSHO * PRCC_F) + Total Liabilities (LT)] / [Total Assets (AT) – Cash & Cash Equivalents (CHE)], measured in year $t$
Cash Flow/NTA	[Operating Income before Depreciation (OIBDP) – Interest Expense (DP) – Taxes (TXT) – Common Dividends (DVC)] / [Total Assets (AT) – Cash & Cash Equivalents (CHE)], measured in year $t$
Std(Cash Flow/NTA)	The trailing volatility of cash flow (OIBDP), computed over a minimum (maximum) of 5 (10) years ending in year $t-1$

Net Working Capital/NTA	$[\text{Working Capital (WCAP)} - \text{Cash \& Cash Equivalents (CHE)}] / [\text{Total Assets (AT)} - \text{Cash \& Cash Equivalents (CHE)}]$ , measured in year $t$
R&D/Sales	Research and Development Expenditures (XRD) / Sales (SALE), measured in year $t$ (and set to 0 if missing)
R&D Missing Dummy	An indicator variable equal to 1 if the firm does not report Research & Development Expenditures (XRD) in year $t$ , 0 otherwise
Capital Expenditures/NTA	Capital Expenditures (CAPX) / $[\text{Total Assets (AT)} - \text{Cash \& Cash Equivalents (CHE)}]$ , measured in year $t$
Dividend Dummy	An indicator variable equal to 1 if the firm paid common dividends (DVC) in year $t$ , 0 otherwise

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*Panel C: Corporate Governance*

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Busy Directors	The proportion of independent directors who serve on three or more boards in year $t$
Compensation Dummy	An indicator variable equal to 1 when a CEO's excess compensation in year $t$ (defined as the residual from a regression of the logarithm of total CEO compensation on lagged Log(Total Assets), the lagged Market-to-Book ratio, industry effects based on two-digit SIC code classifications, and year fixed effects (Cheng, Hong, and Scheinkman 2010), where total compensation is set equal to TDC1 in the Execucomp database) is positive; 0 otherwise
E-Index	An index of managerial entrenchment, ranging from 0 to 6, where higher values indicate a greater degree of managerial entrenchment (Bebchuk et al. 2009)
Shareholder Inactivism Dummy	An indicator variable equal to 1 when a firm does <i>not</i> entertain a shareholder proposal pertaining to political contributions in year $t$ , 0 otherwise

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**Table 1. Aggregate and firm-level statistics of political contributions.***Panel A: Aggregate statistics*

	Total	Executives	Non-Executives	PACs
No. of contributions	373,393	45,315	130,587	197,491
Percent of total sample	100%	12.14%	34.97%	52.89%
Aggregate dollar amount	\$441,090,114	\$41,411,371	\$102,535,972	\$297,142,771
Percent of total sample	100%	9.39%	23.25%	67.36%

*Panel B: Firm-level statistics*

	Mean	Std Dev	Lower Quartile	Median	Upper Quartile
Political Contributions (unscaled)	142,448	215,406	11,950	57,225	182,214

Aggregate statistics are computed on the full data set of political contributions made by the employees and PACs of parent and subsidiary companies belonging to the S&P 500 for which sufficient data are available during fiscal years 2005-2011. A firm that entered and/or departed the S&P 500 during the sample period is included in the analysis during the years in which they belonged to the index. Data for the 2012 election cycle were not available in full at time of this draft. As such, we restrict the upper bound of the sample to fiscal year 2011. Since most of our statistical analyses utilize a measure of *historical* political activism, defined in terms of political contributions during years 2005-2008, we do not require political contributions for year 2012, even if those data were available. Consistent with recommendations offered in the Center for Responsive Politics' OpenSecrets user's guide, we impose several exclusions. In the employee subsample, the following contribution-level observations are excluded: noncontributions (RealCode beginning with "Z9"), contributions to committees (RecipID beginning with "N"), and contributions to PACs (RecipID beginning with "P"). In the PAC subsample, the following contribution-level observations are excluded: noncontributions (RealCode beginning with "Z9") and transfers between committees as well as contributions to joint fundraising committees (RealCode beginning with "Z4").

**Table 2. The market reaction to *Citizens United*: Descriptive statistics and univariate analyses.**

<i>Panel A: Descriptive statistics (N = 133).</i>					
	Mean	Std Dev	Lower Quartile	Median	Upper Quartile
CAR(0, 0), in %	-0.082	1.591	-1.051	-0.116	0.846
CAR(0,+2), in %	-0.123	2.039	-1.279	-0.334	1.142
CAR(0,+5), in %	-0.482	3.648	-2.142	-0.612	0.995
Net Total Assets, in \$ millions	18,215	25,816	4,571	9,844	23,056
Market-to-Book	2.254	1.281	1.440	1.868	2.666
Debt/NTA	0.266	0.153	0.170	0.261	0.340

  

<i>Panel B: Univariate results for sub-samples of political connectedness.</i>												
	POLITICAL (N = 60)				NEUTRAL (N = 73)				POLITICAL – NEUTRAL			
	Mean $\hat{\delta}$ (%)	t-statistic	% Positive	t-statistic	Mean $\hat{\delta}$ (%)	t-statistic	% Positive	t-statistic	Diff. in $\hat{\delta}$	t-stat	Diff. in % Pos.	$\chi^2$ stat
CAR(0, 0)	-0.475**	-2.256	28.33%***	-3.690	0.240	1.377	56.16%	1.050	-0.715**	-2.616	-27.83%***	10.373
CAR(0,+2)	-0.633***	-2.902	23.33%***	-4.840	0.300	1.146	50.69%	0.120	-0.929***	-2.746	-27.36%***	10.421
CAR(0,+5)	-1.219**	-2.248	31.67%***	-3.030	0.123	0.349	43.84%	-1.050	-1.343**	-2.074	-12.17%	2.063

Panel A presents descriptive statistics for a combined sample of POLITICAL and NEUTRAL firms. “POLITICAL” refers to our sample of historically politically connected firms, defined as firms in the fourth quartile of median firm-level pre-*Citizens United* contributions (scaled by NTA). “NEUTRAL” refers to our sample of historically non-politically connected firms, defined as firms in the first quartile of median firm-level pre-*Citizens United* contributions (scaled by NTA), as well as firms that did not contribute to political campaigns prior to *Citizens United*. CARs are estimated surrounding the date of the *Citizens United* decision, January 21, 2010, and represent average  $\hat{\delta}$  estimates, where the parameter  $\hat{\delta}$  is derived from the seemingly unrelated regression (SUR),  $R_i = \alpha_i + \beta_i R_m + \delta_i Event + \varepsilon_i$ . In this specification,  $R_i$  is the return series for individual firm  $i$ ,  $R_m$  is the return series for CRSP value-weighted index (including dividends), and  $Event$  is a dummy variable that equals 1 on days included in the event window (0 otherwise). Daily returns are measured between April 1, 2008, and March 31, 2010, and are retrieved from the CRSP daily returns file. The event parameter estimate  $\hat{\delta}$  corresponds to the average abnormal return for firm  $i$  in a given event window, and is multiplied by increments of 100% for each day in the event window to obtain the cumulative abnormal return (CAR). Control variables are measured as of fiscal year-end 2009 and are winsorized at the 1st and 99th percentiles // Panel B presents summary statistics and univariate tests of average  $\hat{\delta}$  estimates for the subsamples of POLITICAL and NEUTRAL firms, in addition to a nonparametric test based on the proportion of positive CARs. t-statistics reflecting the statistical significance of differences in mean  $\hat{\delta}$  values assume unequal variances between the two groups. Statistical tests of the difference in proportions of positive CARs between the two sub-groups utilize the Chi-squared distribution.

**Table 3. The market reaction to *Citizens United*: Cross-sectional analysis.**

Variable	CAR(0, 0)	CAR(0,+2)	CAR(0,+5)
	I	II	III
Political Dummy	-0.750*** (0.007)	-0.915** (0.012)	-1.327** (0.042)
Log(Net Total Assets)	-0.042 (0.747)	-0.046 (0.788)	-0.022 (0.944)
Market-to-Book	0.268** (0.020)	0.047 (0.756)	0.085 (0.753)
Debt/NTA	0.112 (0.898)	0.378 (0.742)	1.095 (0.598)
R <sup>2</sup>	0.103	0.055	0.037
N	133	133	133

The results represent estimates from a multivariate ordinary least squares regression where average  $\hat{\delta}$  estimates are regressed on a measure of historical political connectedness (Political Dummy) and control variables. The parameter  $\hat{\delta}$  is derived from the seemingly unrelated regression (SUR),  $R_i = \alpha_i + \beta_i R_m + \delta_i Event + \varepsilon_i$  where  $R_i$  is the return series for individual firm  $i$ ,  $R_m$  is the return series for CRSP value-weighted index (including dividends), and  $Event$  is a dummy variable that equals 1 on days included in the event window (0 otherwise). Daily returns are measured between April 1, 2008, and March 31, 2010, and are retrieved from the CRSP daily returns file. The event parameter estimate  $\hat{\delta}$  corresponds to the average abnormal return for firm  $i$  in a given event window, and is multiplied by increments of 100% for each day in the event window to obtain the cumulative abnormal return (CAR). Control variables are measured as of fiscal year-end 2009 and are winsorized at the 1<sup>st</sup> and 99<sup>th</sup> percentiles. Net Total Assets (NTA) is computed as Total Assets less Cash & Cash Equivalents. Standard errors are corrected for contemporaneous cross-correlation in the residuals through use of the SUR methodology. p-values are shown in parentheses. \*, \*\*, \*\*\* indicates significance at the 0.10, 0.05, 0.01 level for a two-tailed t-test.

**Table 4. Univariate analysis.**

		All firms		Political Contribution Quartiles								Difference	
		N	Mean	1		2		3		4		(1) – (4)	t-statistic
		N	Mean	N	Mean	N	Mean	N	Mean	N	Mean	(1) – (4)	t-statistic
<i>Panel A: Cash holdings.</i>													
Log(Cash/NTA)	Pre-Citizens United	871	-2.652	217	-2.818	224	-2.718	220	-2.761	210	-2.295	-0.523***	-4.127
	Post-Citizens United	454	-2.423	111	-2.619	115	-2.414	112	-2.650	116	-2.025	-0.594***	-3.462
	Pre – Post		-0.229***		-0.199		-0.304**		-0.111		-0.269*		
	t-statistic		-2.980		-1.389		-2.068		-0.710		-1.691		
<i>Panel B: Traditional determinants of cash holdings.</i>													
Log(Total Assets)	Pre-Citizens United	871	9.371	217	9.146	224	9.338	220	9.732	210	9.260	-0.114	-1.063
	Post-Citizens United	454	9.566	111	9.392	115	9.414	112	9.949	116	9.512	-0.120	-0.812
	Pre – Post		-0.195***		-0.246*		-0.075		-0.217**		-0.252*		
	t-statistic		-2.980		-1.892		-0.519		-2.061		-1.961		
Log(Sales)	Pre-Citizens United	871	9.319	217	9.140	224	9.271	220	9.568	210	9.295	-0.154	-1.473
	Post-Citizens United	454	9.436	111	9.296	115	9.308	112	9.671	116	9.469	-0.173	-1.183
	Pre – Post		-0.116*		-0.155		-0.037		-0.102		-0.174		
	t-statistic		-1.840		-1.264		-0.249		-1.129		-1.335		
Debt/NTA	Pre-Citizens United	870	0.255	217	0.242	224	0.272	220	0.273	209	0.230	0.012	0.858
	Post-Citizens United	454	0.284	111	0.250	115	0.312	112	0.306	116	0.268	-0.017	-0.923
	Pre – Post		-0.030***		-0.008		-0.041**		-0.033*		-0.038**		
	t-statistic		-3.330		-0.481		-2.104		-1.941		-2.187		
Market-to-Book	Pre-Citizens United	871	2.380	217	2.128	224	2.220	220	2.374	210	2.815	-0.687***	-4.680
	Post-Citizens United	454	2.163	111	1.963	115	2.146	112	2.114	116	2.418	-0.454***	-2.889
	Pre – Post		0.217**		0.165		0.075		0.259		0.398**		
	t-statistic		2.480		1.303		0.496		1.239		2.051		
Cash Flow/NTA	Pre-Citizens United	866	0.113	216	0.109	223	0.111	220	0.103	207	0.130	-0.021***	-3.200
	Post-Citizens United	450	0.112	111	0.109	113	0.115	112	0.106	114	0.119	-0.010	-1.056
	Pre – Post		0.001		0.000		-0.004		-0.003		0.011		
	t-statistic		0.160		0.018		-0.624		-0.345		1.265		
Std(Cash Flow/NTA)	Pre-Citizens United	871	0.036	217	0.032	224	0.034	220	0.034	210	0.043	-0.011***	-2.761
	Post-Citizens United	454	0.035	111	0.027	115	0.036	112	0.035	116	0.041	-0.014***	-3.521
	Pre – Post		0.001		0.005		-0.002		-0.001		0.002		
	t-statistic		0.480		1.439		-0.586		-0.113		0.481		
Net Working Capital/NTA	Pre-Citizens United	871	0.001	217	0.039	224	-0.002	220	-0.001	210	-0.032	0.071***	5.368
	Post-Citizens United	454	0.008	111	0.040	115	0.006	112	-0.001	116	-0.010	0.050***	3.042
	Pre – Post		-0.007		-0.001		-0.009		0.000		-0.022		
	t-statistic		-0.970		-0.054		-0.513		-0.023		-1.291		
R&D/Sales	Pre-Citizens United	871	0.038	217	0.026	224	0.036	220	0.034	210	0.056	-0.030***	-4.563
	Post-Citizens United	454	0.035	111	0.024	115	0.029	112	0.034	116	0.051	-0.027***	-3.187
	Pre – Post		0.003		0.001		0.006		0.000		0.005		
	t-statistic		0.780		0.216		0.892		0.039		0.553		

R&D Missing Dummy	Pre-Citizens United	871	0.369	217	0.327	224	0.362	220	0.432	210	0.352	-0.025	-0.548
	Post-Citizens United	454	0.368	111	0.306	115	0.365	112	0.438	116	0.362	-0.056	-0.888
	Pre – Post		0.001		0.021		-0.004		-0.006		-0.010		
	t-statistic		0.030		0.383		-0.065		-0.098		-0.174		
Capital Expenditures/NTA	Pre-Citizens United	871	0.060	217	0.066	224	0.060	220	0.057	210	0.054	0.012***	2.764
	Post-Citizens United	454	0.051	111	0.059	115	0.053	112	0.054	116	0.040	0.018***	3.507
	Pre – Post		0.008***		0.007		0.007		0.003		0.014***		
	t-statistic		3.390		1.224		1.316		0.956		3.881		
Dividend Dummy	Pre-Citizens United	871	0.836	217	0.848	224	0.813	220	0.841	210	0.843	0.005	0.145
	Post-Citizens United	454	0.855	111	0.856	115	0.817	112	0.857	116	0.888	-0.032	-0.721
	Pre – Post		-0.019		-0.008		-0.005		-0.016		-0.045		
	t-statistic		-0.890		-0.190		-0.109		-0.387		-1.118		

*Panel C: Governance variables.*

E-Index	Pre-Citizens United	213	4.132	51	3.863	61	4.393	43	3.930	58	4.241	-0.379*	-1.799
	Post-Citizens United	357	1.742	87	1.690	93	1.882	85	1.506	92	1.870	-0.018	-1.164
	Pre – Post		2.389***		2.173***		2.512***		2.424***		2.372***		
	t-statistic		26.190		11.555		13.555		14.396		13.477		
Proportion of Busy Directors	Pre-Citizens United	327	0.176	74	0.173	86	0.167	79	0.162	88	0.201	-0.028	-1.224
	Post-Citizens United	380	0.132	88	0.114	97	0.137	95	0.142	100	0.134	-0.020	-1.259
	Pre – Post		0.044***		0.059***		0.031		0.019		0.067***		
	t-statistic		4.330		3.005		1.526		0.846		3.591		
Excess CEO Compensation	Pre-Citizens United	868	-0.047	216	-0.175	222	-0.085	220	0.035	210	0.039	-0.214**	-2.066
	Post-Citizens United	453	0.099	111	0.067	115	0.053	112	0.248	115	0.030	0.037	0.315
	Pre – Post		-0.146**		-0.242**		-0.139		-0.213*		0.009		
	t-statistic		-2.510		-2.078		-1.396		-1.655		0.077		
Shareholder Inactivism Dummy	Pre-Citizens United	251	0.570	51	0.667	63	0.746	74	0.378	63	0.540	0.127	1.373
	Post-Citizens United	237	0.578	45	0.600	56	0.750	71	0.451	65	0.554	0.046	0.477
	Pre – Post		-0.008		0.067		-0.004		-0.072		-0.014		
	t-statistic		-0.190		0.672		-0.049		-0.880		-0.160		

Univariate analyses are computed on the full sample of S&P 500 firms for which sufficient data are available during fiscal years 2005-2011. Quartiles of political connectedness are based on the Political Dummy, defined as median firm-level pre-Citizens United contributions (scaled by NTA). To provide a cleaner test, fiscal year 2009 observations (i.e., those immediately preceding passage of Citizens United) are excluded. Net Total Assets (NTA) is computed as Total Assets less Cash & Cash Equivalents. See the Appendix for other variable definitions. All continuous variables are winsorized at the 1<sup>st</sup> and 99<sup>th</sup> percentiles. \*, \*\*, \*\*\* indicates significance at the 0.10, 0.05, 0.01 level for a two-tailed t-test.

**Table 5. The differential relation in political contributions for historically politically connected firms relative to historically non-politically connected firms in the post-*Citizens United* period.**

Variable	Coef. (p-value)
Political Dummy	1.556* (0.075)
Contributions/NTA	0.808*** (0.000)
Log(Net Total Assets)	-0.234 (0.536)
Debt/NTA	-2.148 (0.392)
Market-to-Book	0.035 (0.930)
Cash Flow/NTA	-2.603 (0.719)
Std(Cash Flow/NTA)	3.465 (0.789)
Net Working Capital/NTA	-0.870 (0.770)
R&D/Sales	-3.649 (0.622)
R&D Missing Dummy	0.399 (0.659)
Capital Expenditures/NTA	-12.201 (0.299)
Dividend Dummy	-0.756 (0.487)
Adj. R <sup>2</sup>	0.776
N	259

The results represent pooled regressions of Political Contributions/NTA on traditional determinants of cash holdings and a measure of historical political connectedness (Political Dummy), and are estimated for the period 2010-2011 for which sufficient data are available. All traditional determinants of cash holdings are lagged in an effort to alleviate endogeneity. To provide a cleaner test, fiscal year 2009 observations (i.e., those immediately preceding passage of *Citizens United*) are excluded. Net Total Assets (NTA) is computed as Total Assets less Cash & Cash Equivalents. Political Dummy is a measure of historical political connectedness and is based on median firm-level pre-*Citizens United* contributions (scaled by NTA), set equal to 1 for firms in the fourth quartile and equal to 0 for firms in the first quartile and for historically non-politically active firms. See the Appendix for other variable definitions. All continuous variables are winsorized at the 1<sup>st</sup> and 99<sup>th</sup> percentiles. p-values are shown in parentheses. \*, \*\*, \*\*\* indicates significance at the 0.10, 0.05, 0.01 level for a two-tailed t-test.

**Table 6. The change in cash holdings modeled as a function of the change in political contributions as computed in year 2010 (post-*Citizens United*) relative to year 2008 (pre-*Citizens United*).**

Variable	Coef. (p-value)
$\Delta$ Contributions/NTA	0.017** (0.043)
$\Delta$ Log(Net Total Assets)	-0.820*** (0.000)
$\Delta$ Debt/NTA	1.745*** (0.004)
$\Delta$ Market-to-Book	0.172** (0.020)
$\Delta$ Cash Flow/NTA	1.401 (0.102)
$\Delta$ Std(Cash Flow/NTA)	1.914 (0.454)
$\Delta$ Net Working Capital/NTA	-0.339 (0.583)
$\Delta$ R&D/Sales	1.759 (0.593)
$\Delta$ R&D Missing Dummy	-0.502 (0.162)
$\Delta$ Capital Expenditures/NTA	-4.885** (0.015)
$\Delta$ Dividend Dummy	0.191 (0.640)
Adj. R <sup>2</sup>	0.186
N	236

The results represent pooled regressions of 236 firm-level differences computed as observed values in 2010 (post-*Citizens United*) less observed values in 2008 (pre-*Citizens United*). The dependent variable is  $\Delta$ Log(Cash/NTA). To provide a cleaner test, fiscal year 2009 observations (i.e., those immediately preceding passage of *Citizens United*) are excluded. Net Total Assets (NTA) is computed as Total Assets less Cash & Cash Equivalents. See the Appendix for other variable definitions. All continuous variables are winsorized at the 1<sup>st</sup> and 99<sup>th</sup> percentiles. p-values are shown in parentheses. \*, \*\*, \*\*\* indicates significance at the 0.10, 0.05, 0.01 level for a two-tailed t-test.

**Table 7. The differential relation in cash holdings for historically politically connected firms relative to historically non-politically connected firms in the post-*Citizens United* relative to pre-*Citizens United* periods.**

Variable	Coef. (p-value)
Political Dummy	-0.017 (0.780)
Post- <i>Citizens United</i> Dummy	-0.038 (0.559)
Political Dummy * Post- <i>Citizens United</i> Dummy	0.181* (0.059)
Log(Cash/NTA)	0.771*** (0.000)
Log(Net Total Assets)	-0.013 (0.602)
Debt/NTA	-0.308* (0.072)
Market-to-Book	0.022 (0.354)
Cash Flow/NTA	0.713 (0.154)
Std(Cash Flow/NTA)	1.390* (0.054)
Net Working Capital/NTA	-0.089 (0.637)
R&D/Sales	0.704 (0.149)
R&D Missing Dummy	-0.089 (0.117)
Capital Expenditures/NTA	-2.134*** (0.001)
Dividend Dummy	-0.151** (0.038)
Adj. R <sup>2</sup>	0.792
N	707

The results represent a regression of Log(Cash/NTA) on traditional determinants of cash holdings and a measure of historical political connectedness (Political Dummy), and are estimated for the period 2005-2011 for which sufficient data are available. All traditional determinants of cash holdings are lagged in an effort to alleviate endogeneity. To provide a cleaner test, fiscal year 2009 observations (i.e., those immediately preceding passage of *Citizens United*) are excluded. Net Total Assets (NTA) is computed as Total Assets less Cash & Cash Equivalents. Political Dummy is a measure of historical political connectedness and is based on median firm-level pre-*Citizens United* contributions (scaled by NTA), set equal to 1 for firms in the fourth quartile and equal to 0 for firms in the first quartile and for historically non-politically active firms. See the Appendix for other variable definitions. All continuous variables are winsorized at the 1<sup>st</sup> and 99<sup>th</sup> percentiles. p-values are shown in parentheses. \*, \*\*, \*\*\* indicates significance at the 0.10, 0.05, 0.01 level for a two-tailed t-test.

**Table 8. The differential relation in corporate cash holdings with respect to political connectedness and governance quality in the post-*Citizens United* relative to pre-*Citizens United* periods.**

Variable	Proposal					
	E-Index	Busy Boards	High Compensation	Entertained during 2007-2008 or 2010-2011	Entertained during 2007-2008	Entertained during 2010-2011
	I	II	III	IV	V	VI
Political Dummy	0.528 (0.252)	0.156 (0.266)	0.031 (0.710)	0.111 (0.506)	-0.129 (0.614)	0.043 (0.773)
Post- <i>Citizens United</i> Dummy	0.009 (0.976)	0.199 (0.104)	0.151 (0.134)	0.241 (0.157)	-0.044 (0.851)	0.258 (0.126)
Political Dummy * Post- <i>Citizens United</i> Dummy	-0.562 (0.250)	-0.168 (0.351)	-0.051 (0.724)	-0.065 (0.702)	-0.140 (0.534)	-0.070 (0.636)
Weak Governance	-0.036 (0.577)	0.738* (0.095)	0.008 (0.919)	-0.299 (0.172)	0.112 (0.709)	-0.263 (0.227)
Political Dummy * Weak Governance	-0.152 (0.158)	-0.863 (0.152)	-0.091 (0.431)	-0.236 (0.260)	0.129 (0.646)	-0.135 (0.508)
Post- <i>Citizens United</i> Dummy * Weak Governance	-0.082 (0.358)	-0.727 (0.260)	-0.296** (0.025)	-0.253 (0.230)	0.134 (0.613)	-0.249 (0.243)
Political Dummy * Post- <i>Citizens United</i> Dummy * Weak Governance	0.246* (0.070)	1.646* (0.075)	0.383** (0.048)	0.658** (0.019)	-0.011 (0.975)	0.566** (0.046)
Control variables?	Yes	Yes	Yes	Yes	Yes	Yes
Adj. R <sup>2</sup>	0.805	0.827	0.793	0.854	0.849	0.853
N	316	380	705	238	238	238

The results represent a regression of Log(Cash/NTA) on traditional determinants of cash holdings, a measure of historical political connectedness (Political Dummy), a measure of weak corporate governance (the E-Index in column I, Busy Directors in column II, Compensation Dummy in column III, or Shareholder Inactivism Dummy in columns IV, V, and VI), and are estimated for the period 2005-2011 for which sufficient data are available. Data used to estimate the E-Index and Busy Directors measures are derived from RiskMetrics and available for the period 2007-2011. Data used to estimate the Compensation Dummy are derived from Execucomp and available for the period 2005-2011. All traditional determinants of cash holdings are lagged in an effort to alleviate endogeneity. To provide a cleaner test, fiscal year 2009 observations (i.e., those immediately preceding passage of *Citizens United*) are excluded. Net Total Assets (NTA) is computed as Total Assets less Cash & Cash Equivalents. Political Dummy is a measure of historical political connectedness and is based on median firm-level pre-*Citizens United* contributions (scaled by NTA), set equal to 1 for firms in the fourth quartile and equal to 0 for firms in the first quartile and for historically non-politically active firms. Control variables include the lagged values of Log(Cash/NTA), Log(Net Total Assets), Debt/NTA, the Market-to-Book ratio, Cash Flow/NTA, Std(Cash Flow/NTA), Net Working Capital/NTA, R&D/Sales, R&D Missing Dummy, Capital Expenditures/NTA, and the Dividend Dummy. See the Appendix for other variable definitions. All continuous variables are winsorized at the 1<sup>st</sup> and 99<sup>th</sup> percentiles. p-values are shown in parentheses. \*, \*\*, \*\*\* indicates significance at the 0.10, 0.05, 0.01 level for a two-tailed t-test.

**Table 9. The differential relation in cash holdings as a function of within-firm deviation of political beliefs in the post-*Citizens United* relative to pre-*Citizens United* periods.**

Variable	Coef. (p-value)
Political Deviation	-0.136 (0.327)
Post- <i>Citizens United</i> Dummy	-0.316** (0.037)
Political Deviation * Post- <i>Citizens United</i> Dummy	0.539** (0.036)
Log(Cash/NTA)	0.845*** (0.000)
Log(Net Total Assets)	0.010 (0.790)
Debt/NTA	-0.423 (0.146)
Market-to-Book	-0.010 (0.745)
Cash Flow/NTA	0.424 (0.527)
Std(Cash Flow/NTA)	0.634 (0.554)
Net Working Capital/NTA	0.177 (0.516)
R&D/Sales	0.390 (0.553)
R&D Missing Dummy	-0.065 (0.437)
Capital Expenditures/NTA	-2.919** (0.011)
Dividend Dummy	-0.196 (0.105)
Adj. R <sup>2</sup>	0.844
N	281

The results represent a regression of Log(Cash/NTA) on traditional determinants of cash holdings and a measure of historical within-firm diversion in political beliefs (Political Deviation), and are estimated for the period 2005-2011 for which sufficient data are available. To be included in the test, the firm-year observation must report positive executive contributions and positive non-executive contributions, and be drawn from our sample of historically politically active firms (i.e., the upper quartile of pre-*Citizens United* political contributions). All traditional determinants of cash holdings are lagged in an effort to alleviate endogeneity. To provide a cleaner test, fiscal year 2009 observations (i.e., those immediately preceding passage of *Citizens United*) are excluded. Net Total Assets (NTA) is computed as Total Assets less Cash & Cash Equivalents. Political Deviation is a ranked variable to capture the degree of historical, within-firm divergence in political beliefs, ranging from 0.10 (bottom decile) to 1.00 (top decile). Deciles are formed based on the median firm-level absolute difference in the proportion of PAC contributions to Republicans and the proportion of executive contributions to Republicans as observed during the pre-*Citizens United* period. See the Appendix for other variable definitions. All continuous variables are winsorized at the 1<sup>st</sup> and 99<sup>th</sup> percentiles. p-values are shown in parentheses. \*, \*\*, \*\*\* indicates significance at the 0.10, 0.05, 0.01 level for a two-tailed t-test.

**Table 10. Robustness checks on the market reaction to *Citizens United*.**

**Panel A: Univariate analysis.**

*I. After accounting for confounding events.*

	POLITICAL			NEUTRAL			POLITICAL – NEUTRAL	
	N	Mean $\hat{\delta}$ (%)	t-statistic	N	Mean $\hat{\delta}$ (%)	t-statistic	Difference	t-statistic
CAR(0, 0)	55	-0.592***	-3.240	70	0.227	1.260	-0.820***	-3.190
CAR(0,+2)	50	-0.737***	-3.480	67	0.253	1.050	-0.989***	-3.090
CAR(0,+5)	34	-0.785*	-1.750	56	-0.010	-0.030	-0.775	-1.330

*II. After excluding the defense, energy, and utilities industries.*

	POLITICAL			NEUTRAL			POLITICAL – NEUTRAL	
	N	Mean $\hat{\delta}$ (%)	t-statistic	N	Mean $\hat{\delta}$ (%)	t-statistic	Difference	t-statistic
CAR(0, 0)	50	-0.548**	-2.474	64	0.211	1.092	-0.759**	-2.582
CAR(0,+2)	50	-0.631**	-2.581	64	0.336	1.203	-0.967**	-2.604
CAR(0,+5)	50	-1.413**	-2.231	64	0.237	0.609	-1.650**	-2.220

*III. After redefining POLITICAL on the basis of within-industry pre-Citizens United contributions.*

	POLITICAL			NEUTRAL			POLITICAL – NEUTRAL	
	N	Mean $\hat{\delta}$ (%)	t-statistic	N	Mean $\hat{\delta}$ (%)	t-statistic	Difference	t-statistic
CAR(0, 0)	58	-0.272	-1.391	67	0.229	1.294	-0.500*	-1.899
CAR(0,+2)	58	-0.459**	-2.113	67	0.275	1.015	-0.734**	-2.113
CAR(0,+5)	58	-0.766*	-1.784	67	0.080	0.210	-0.845	-1.476

**Panel B: Multivariate analysis.**

Variable	<i>I. Confounding events</i>			<i>II. Politically exposed firms</i>			<i>III. Redefining POLITICAL</i>		
	CAR(0,0)	CAR(0,+2)	CAR(0,+5)	CAR(0,0)	CAR(0,+2)	CAR(0,+5)	CAR(0,0)	CAR(0,+2)	CAR(0,+5)
Political Dummy	-0.841*** (0.001)	-0.975*** (0.006)	-0.653 (0.298)	-0.804*** (0.008)	-0.985** (0.016)	-1.735** (0.022)	-0.549** (0.041)	-0.752** (0.043)	-0.807 (0.176)
Log(Net Total Assets)	-0.092 (0.481)	-0.047 (0.788)	-0.259 (0.475)	-0.074 (0.603)	0.065 (0.739)	0.182 (0.614)	-0.034 (0.789)	-0.006 (0.971)	-0.004 (0.989)
Market-to-Book	0.297*** (0.008)	0.096 (0.509)	-0.270 (0.413)	0.294** (0.015)	0.056 (0.728)	0.165 (0.582)	0.258** (0.023)	0.104 (0.503)	0.052 (0.835)
Debt/NTA	-0.002 (0.998)	0.443 (0.676)	-0.339 (0.849)	0.216 (0.814)	0.759 (0.542)	1.091 (0.636)	0.085 (0.922)	0.118 (0.922)	1.227 (0.526)
R <sup>2</sup>	0.159	0.080	0.028	0.128	0.059	0.051	0.084	0.038	0.021
N	125	117	90	114	114	114	125	125	125

This table presents sensitivity analyses on the results provided in Table 2 Panel B and Table 3. In analysis I, we exclude firms that are associated with a confounding event, defined as a firm filing a form 8-K with the SEC during the event window or the day preceding the *Citizens United* decision. In analysis II, we

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exclude politically exposed firms, i.e., those belonging to the defense, energy, or utilities industries, where Fama-French 48-industry classifications are used to identify firms belonging to the defense (industry code 26), energy (industry codes 29 and 30), and utilities (industry code 31) industries. In analysis III, Political Dummy is redefined in terms of median firm-level pre-*Citizens United* contributions (scaled by Net Total Assets) within each 1-digit SIC industry, set equal to 1 for firms in the fourth quartile and equal to 0 for firms in the first quartile and for historically non-politically active firms. // Panel A presents summary statistics and univariate tests of average  $\hat{\delta}$  estimates, where the parameter  $\hat{\delta}$  is derived from the seemingly unrelated regression (SUR),  $R_i = \alpha_i + \beta_i R_m + \delta_i Event + \varepsilon_i$  where  $R_i$  is the return series for individual firm  $i$ ,  $R_m$  is the return series for CRSP value-weighted index (including dividends), and  $Event$  is a dummy variable that equals 1 on days included in the event window (0 otherwise). Daily returns are measured between April 1, 2008, and March 31, 2010, and are retrieved from the CRSP daily returns file. The event parameter estimate  $\hat{\delta}$  corresponds to the average abnormal return for firm  $i$  in a given event window, and is multiplied by increments of 100% for each day in the event window to obtain the cumulative abnormal return (CAR). “POLITICAL” refers to our sample of historically politically connected firms, defined as firms in the fourth quartile of median firm-level pre-*Citizens United* contributions (scaled by NTA). “NEUTRAL” refers to our sample of historically non-politically connected firms, defined as firms in the first quartile of median firm-level pre-*Citizens United* contributions (scaled by NTA), as well as firms that did not contribute to political campaigns prior to *Citizens United*. t-statistics reflecting the statistical significance of differences in means assume unequal variances between the two groups // Panel B provides estimates from a multivariate ordinary least squares regression where average  $\hat{\delta}$  estimates are regressed on a measure of historical political connectedness (Political Dummy) and control variables. Control variables are measured as of fiscal year-end 2009 and are winsorized at the 1<sup>st</sup> and 99<sup>th</sup> percentiles. Net Total Assets (NTA) is computed as Total Assets less Cash & Cash Equivalents. Standard errors are corrected for contemporaneous cross-correlation in the residuals through use of the SUR methodology. p-values are shown in parentheses. \*, \*\*, \*\*\* indicates significance at the 0.10, 0.05, 0.01 level for a two-tailed t-test.

**Table 11. The differential relation in cash holdings for historically politically connected firms relative to historically non-politically connected firms in the post-*Citizens United* relative to pre-*Citizens United* periods after controlling for politically exposed industries.**

Variable	Coef.	Coef.
	(p-value)	(p-value)
	I	II
Political Dummy	-0.027 (0.668)	-0.022 (0.713)
Post- <i>Citizens United</i> Dummy	-0.031 (0.644)	-0.016 (0.818)
Political Dummy * Post- <i>Citizens United</i> Dummy	0.176* (0.071)	0.154 (0.112)
Log(Cash/NTA)	0.774*** (0.000)	0.782*** (0.000)
Log(Net Total Assets)	-0.005 (0.847)	-0.016 (0.521)
Debt/NTA	-0.259 (0.126)	-0.331* (0.056)
Market-to-Book	0.024 (0.293)	0.015 (0.523)
Cash Flow/NTA	0.599 (0.218)	0.771 (0.154)
Std(Cash Flow/NTA)	1.308** (0.041)	2.120** (0.011)
Net Working Capital/NTA	-0.056 (0.759)	-0.027 (0.885)
R&D/Sales	0.747 (0.115)	0.550 (0.261)
R&D Missing Dummy	-0.023 (0.698)	-0.066 (0.248)
Capital Expenditures/NTA	-1.560** (0.050)	-1.894*** (0.005)
Dividend Dummy	-0.145** (0.041)	-0.126 (0.106)
Adj. R <sup>2</sup>	0.786	0.797
N	596	669

This table represent a regression of Log(Cash/NTA) on traditional determinants of cash holdings and a measure of historical political connectedness (Political Dummy), and are estimated for the period 2005-2011 for which sufficient data are available. The results parallel those provided in Table 7 after controlling for politically exposed firms. In column I, firms belonging to the defense, energy, and utilities industries are excluded, where Fama-French 48-industry classifications are used to identify firms belonging to the defense (industry code 26), energy (industry codes 29 and 30), and utilities (industry code 31) industries. In column II, Political Dummy is redefined in terms of median firm-level pre-*Citizens United* contributions (scaled by Net Total Assets) within each 1-digit SIC industry, set equal to 1 for firms in the fourth quartile and equal to 0 for firms in the first quartile and for historically non-politically active firms. All traditional determinants of cash holdings are lagged in an effort to alleviate endogeneity. To provide a cleaner test, fiscal year 2009 observations (i.e., those immediately preceding passage of *Citizens United*) are excluded. Net Total Assets (NTA) is computed as Total Assets less Cash & Cash Equivalents. See the Appendix for other variable definitions. All continuous variables are winsorized at the 1<sup>st</sup> and 99<sup>th</sup> percentiles. p-values are shown in parentheses. \*, \*\*, \*\*\* indicates significance at the 0.10, 0.05, 0.01 level for a two-tailed t-test.

**Table 12. Regressions of the level of industry-adjusted cash on measures of political connectedness and industry-adjusted forms of traditional determinants.**

Variable	Coef. (p-value)
Political Dummy	-0.064 (0.319)
Post- <i>Citizens United</i> Dummy	-0.160** (0.017)
Political Dummy * Post- <i>Citizens United</i> Dummy	0.254** (0.013)
Industry-adjusted Log(Cash/NTA)	0.708*** (0.000)
Industry-adjusted Log(Net Total Assets)	-0.010 (0.703)
Industry-adjusted Debt/NTA	-0.287 (0.125)
Industry-adjusted Market-to-Book	0.016 (0.491)
Industry-adjusted Cash Flow/NTA	0.949* (0.071)
Industry-adjusted Std(Cash Flow/NTA)	0.972 (0.199)
Industry-adjusted Net Working Capital/NTA	-0.138 (0.600)
Industry-adjusted R&D/Sales	0.802 (0.200)
Industry-adjusted R&D Missing Dummy	0.027 (0.727)
Industry-adjusted Capital Expenditures/NTA	-1.465* (0.086)
Industry-adjusted Dividend Dummy	-0.069 (0.321)
Adj. R <sup>2</sup>	0.670
N	559

The results represent a regression of Industry-adjusted Log(Cash/NTA) on measures of political connectedness and the Industry-adjusted forms of traditional determinants of cash holdings, and are estimated for the period 2005-2011 for which sufficient data are available. Industry-adjusted forms of all continuous variables are defined relative to the annual industry median. Fama-French 48-industry classifications are used for the industry adjustment. To be included in the test, the industry corresponding to each firm-year observation must include a minimum of five observations for that year. All traditional determinants of cash holdings are lagged in an effort to alleviate endogeneity. To provide a cleaner test, fiscal year 2009 observations (i.e., those immediately preceding passage of *Citizens United*) are excluded. Net Total Assets (NTA) is computed as Total Assets less Cash & Cash Equivalents. Political Dummy is a measure of historical political connectedness and is based on median firm-level pre-*Citizens United* contributions (scaled by NTA), set equal to 1 for firms in the fourth quartile and equal to 0 for firms in the first quartile and for historically non-politically active firms. See the Appendix for other variable definitions. All continuous variables are winsorized at the 1<sup>st</sup> and 99<sup>th</sup> percentiles. p-values are shown in parentheses. \*, \*\*, \*\*\* indicates significance at the 0.10, 0.05, 0.01 level for a two-tailed t-test.