

EXECUTIVE POLITICAL PREFERENCES  
AND CORPORATE DECISIONS  
AND OUTCOMES

by

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## ABSTRACT

Corporate decisions and policies made by executives have real effects on the financial valuation of firms. Therefore, the behavior of executives, including underlying causes and subsequent implications, is important in the study of finance. This dissertation investigates executive behavior by examining how the political preferences of executives affect their corporate decisions and the subsequent outcomes.

The first essay focuses on the impact of executive political preferences on mergers. Using a rare and hand-collected dataset of executive political donations and CEO retention following mergers, I investigate how shared political preferences between executives of merging firms affect the probability of a merger and subsequent merger outcomes. The second essay focuses on how CEO political preferences affect firm policies and market distribution. In this paper, I use the dataset of executive political donations to examine if Republican-led firms have less risky policies, such as less use of earnings management and lower likelihood of restating earnings. I also test if these less risky policies by Republican managers result in less risky stock return distributions for their firms.

## DEDICATION

This dissertation is dedicated to God, my family, and my friends. I could not have completed the doctoral program, in particular this dissertation, without them. I am forever grateful to my parents, Stuart and Rose, who provided endless support and motivation, and to my sister Rachel, who provided endless encouragement. I am also thankful for my friends, Katie, Kelly, and Mary Brooke, for providing much-needed fun and joy to me throughout this process.

## LIST OF ABBREVIATIONS AND SYMBOLS

$p$	Probability associated with the occurrence under the null hypothesis of a value as extreme as or more extreme than the observed value
$t$	Computed value of $t$ test
$z$	$z$ statistic
F	F-test for regression significance
Chi2	Chi Square regression test
FE	Fixed effects
Ln	Natural log
+	Additions
=	Equal to
H	Hypotheses

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## CONTENTS

ABSTRACT .....	ii
DEDICATION .....	iii
LIST OF ABBREVIATIONS AND SYMBOLS .....	iv
ACKNOWLEDGMENTS .....	v
LIST OF TABLES .....	vii
1. INTRODUCTION .....	1
2. EFFECTS OF SHARED POLITICAL PREFERENCES ON MERGERS.....	3
3. REPUBLICAN CEOs AND CRASH RISK .....	31
4. CONCLUSION.....	54

## LIST OF TABLES

2.1 Summary Statistics.....	23
2.2 Systematic Risk Reduction .....	25
2.3 Probability of Merger Event .....	26
2.4 Target CEO Retention.....	27
2.5 Target Cumulative Abnormal Returns.....	28
2.6 Acquirer Cumulative Abnormal Returns.....	29
3.1 Summary Statistics.....	48
3.2 Skewness and Crash Risk .....	49
3.3 Earnings Management .....	50
3.4 Republican and Democrat CEOs .....	51
3.5 Firm Headquarters .....	52

## CHAPTER 1

### INTRODUCTION

Corporate decisions and policies made by executives have real effects on the financial valuation of firms. Therefore, the behavior of executives, including underlying causes and subsequent implications, is important in the study of finance. This dissertation examines the political preferences of executives and how those preferences affect corporate decisions and outcomes. The first essay focuses on the impact of executive political preferences on mergers. Using a rare and hand-collected dataset of executive political donations and CEO retention following mergers, I investigate how shared political preferences between executives of merging firms affect the probability of a merger and subsequent merger outcomes.

Political preferences of executives represent ideological beliefs that transcend into how they lead their firms. Shared political views between executives of merging firms also channel a familiarity effect, and this results in an increase in the probability of a merger occurring between firms that share similar political views. CEOs of target companies are also more likely to be retained in the resulting firm following the merger when both executives are Democrats. The stock market reacts negatively to merger announcements when firm executives share Democratic preferences. Mergers between two Republican-led firms are more risk-reducing than those between firms with Democratic or differing political views.

The second essay focuses on how CEO political preferences affect firm policies and market distribution. In this paper, I use the dataset of executive political donations to examine if

Republican-led firms have less risky policies that result in less risky stock return distributions. Firms with Republican CEOs are less likely to experience a stock price crash. Republican-led firms are also less likely to experience negative conditional skewness in their return distributions, which is an established indicator of stock price crash risk.

Conservative hallmarks of individual accountability and risk-aversion influence the corporate decisions made by Republican executives. Republican CEOs are less likely to engage in earnings management, as measured by levels of discretionary accruals, which indicate an obscurity of earnings reports. Republican-led firms are also less likely to issue earnings restatements. These measures of providing transparency in earnings by Republican CEOs contribute to lower stock price crash risk.

CHAPTER 2  
EFFECTS OF SHARED POLITICAL PREFERENCES ON MERGERS

**2.1 Introduction**

Political views can be uniting or dividing. Many people are very passionate about politics, and many people are equally passionate about money. I intend to examine what occurs when the two are intertwined and politics become a part of business decisions.

AT&T announced it intended to buy T-Mobile USA for \$39 billion in March 2011 but withdrew the bid after a Democrat-led FCC announced its opposition to the merger. AT&T Inc. Chairman Randall Stephenson had not made a political donation in 21 years, and that donation was \$5000; however, six weeks after the merger collapse he donated \$30,800, the legal maximum, to the Republican National Committee. While that could be a coincidence, this example shows that executives' politics and businesses may be more closely linked than we realize<sup>1</sup>.

In this paper, I investigate whether shared political preferences between executives have an effect on merger outcomes such as risk reduction, target CEO retention, and abnormal stock returns around the merger announcement date. There is already compelling evidence that political views are a personality trait and can affect business decisions. Carney, Jost, Gosling, and Potter (2008) find that an individual's political preferences reflect their core beliefs and

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<sup>1</sup> <http://www.bloomberg.com>

attitudes. They also find that liberals and conservatives have significant differences in personality, with liberals being more open-minded and creative and conservatives being more orderly and conventional.

An emerging literature on behavioral corporate finance finds that personal traits of managers affect corporate policies (see, e.g., Bertrand and Schoar (2003) and Malmendier and Tate (2005)). Managerial personal traits ranging from age (Bertrand and Schoar (2003)) to military service (Malmendier, Tate, and Yan (2011)) to risk aversion (Graham, Harvey, and Puri (2013)) have been found to significantly affect firm decisions and policies. Further, Hutton, Jiang, and Kumar (2013) look directly at political preferences and find that the conservatism of a manager as revealed by their political contributions affects firm decisions. They conclude that conservative managers adopt more conservative financial policies.

Also, shared political preferences can be seen as a form of network. Political ideologies are especially interesting because they can be shared in the same way religion or a common educational background can be. New behavioral literature examines shared interest effects on mergers and acquisitions. Ahern, Daminelli, and Fracassi (2012) find that national cultures affect mergers, and they also find that mergers are more likely to occur between two countries that share a common religion. Ishii and Xuan (2013) find that social ties between executives and directors of two firms significantly affect the likelihood of a merger between them. This evidence suggests that non-financial considerations, such as personal attributes of executives and directors, can affect the likelihood and outcomes of a merger.

This paper seeks to contribute to a new and underexplored area of research regarding the effects of personal traits of managers across firms instead of just looking at the effects within firms. In this paper, I consider how shared political preferences of top managers affect the

outcomes of mergers. One advantage of this approach is that an individual's political ideology is formed over a long period of time; therefore, as with school ties, it is established before their current merger decisions, thus precluding reverse causality.

I examine systematic risk reduction due to a merger event and find that related mergers, defined as mergers in which the acquirer and target share political preferences, are more risk-reducing than unrelated mergers. I find mergers in which both firms are Republican drive this reduction in risk. I also find that shared Democratic preferences and shared Republican preferences increase the likelihood of a merger event based on a matched sample. When two firms do not share political preferences, a merger is less likely to occur.

I find that there is a significant effect on merger outcomes when the merging firms' executives share Democratic political preferences. When both firms are Democrat, there is a significant increase in the likelihood of target CEO retention. There is limited evidence that shared Republican preferences result in a higher likelihood of target CEO retention, but these results do not remain significant when controls are added.

I examine the effects of firm political preferences on target and acquirer abnormal stock returns around the announcement date. I find that shared Democratic preferences between merging firms result in lower abnormal returns for the target. Shared Republican preferences along with individual firm preferences have no effect on target abnormal returns. I find that firm political preferences do not affect acquirer abnormal returns around the announcement date.

In the remainder of this paper, I present the evidence of the findings mentioned above. Section 2.2 presents a review of the literature. Section 2.3 presents my hypotheses and addresses some potential issues. Section 2.4 details the data compilation and the methodology. Section 2.5

reports and discusses the results, and Section 2.6 summarizes and concludes the findings. Section 2.7 Appendix A includes relevant tables.

## **2.2 Literature Review**

As previously mentioned, a strand of literature has emerged that focuses on the traits and behaviors of executives. Authors are examining different executive attributes and how those attributes affect their business decisions. Bertrand and Schoar (2003) find that manager fixed effects have a significant impact on investment, financing, and organizational strategy within the firms they manage. They also find that older managers make more conservative decisions, while managers with an MBA degree employ more aggressive strategies. Graham, Li, and Qiu (2012) find that firm and manager fixed effects can explain the majority of variation in executive compensation, indicating that firm culture and manager's individual traits could have a significant effect on executive compensation. Gervais, Heaton, and Odean (2011) demonstrate through their theoretical model that firm decisions are driven by the interaction between manager's individual attributes and contractual incentives.

Specific attributes have been shown to have a significant effect on firm decisions. Malmendier, Tate, and Yan (2011) find that managerial beliefs and experiences, such as military service or experiencing the Depression, have a significant effect on corporate financing. They find that CEOs who experienced the Depression are reluctant to use debt, while CEOs with a military background choose more aggressive financial policies, such as increased leverage. Graham, Harvey, and Puri (2013) find that attitudes of managers, such as optimism and risk aversion, have an impact on firm decisions.

The attribute I focus on in this paper is the executive's political preference. Carney, Jost, Gosling, and Potter (2008) find that there are significant personality differences between liberals

and conservatives, with liberals being more open-minded and creative and conservatives being more orderly and conventional. McCrae (1996) states that liberals are more open to experience, more inclined to seek out new experiences, change, and novelty. Settle, Dawes, Christakis, and Fowler (2010) find that having a certain genetic allele coupled with having more friends in adolescence is connected to being more liberal. Greene (2004) concludes that members of the two political parties perceive greater differences between their parties due to in-group favoritism, which occurs when group members mentally enhance their group's positive qualities. Bonica (2014) finds that corporate executives donate to political campaigns based on their ideologies as opposed to PACs, which tend to simply favor the powerful politicians. He does comment, however, that this doesn't exclude the possibility that executives are donating to political campaigns for the access to network on behalf of themselves and their firms.

A new section of literature is specifically examining the cross-section of political preferences and business decisions. Lee, Lee, and Nagarajan (2014) show that shared preferences between CEOs and directors result in lower firm valuation and increased likelihood of management entrenchment and accounting fraud. DeVault and Sias (2014) provide evidence that the political affiliation of hedge fund managers affect their stock holdings, with Republicans holding less volatile stocks with higher dividends. This is a similar finding to Hong and Kostovetsky (2012), who show that Democratic mutual fund managers prefer socially responsible stocks compared to Republicans. Francis, Hasan, and Sun (2012) find that firms with Republican CEOs have increased tax avoidance, especially when the firms are well-governed. Giuli and Kostovetsky (2011) examine corporate social responsibility and find that firms with Democratic executives and board members are more socially responsible. Hutton,

Jiang, and Kumar (2013) find that firms with conservative Republican managers maintain lower levels of debt and research and development and make less risky investments.

The majority of existing literature on mergers focuses on quantifiable within-firm financial variables to explain success of mergers and the subsequent value performances. These variables include leverage (Maloney, McCormick, and Mitchell 1993), the method of payment (Travlos 1987), and size (Moeller, Schlingemann, and Stulz 2004).

Another strand of mergers and acquisitions literature focuses on the role different individuals can have in M&A. Agrawal, Cooper, Lian, and Wang (2011) examine the cases when targets and acquirers share the same advisors and find that having common advisors results in a lower likelihood that deals are completed. Cai and Sevilir (2012) show that mergers between two firms with board connections perform better than those between firms without board connections. Ishii and Xuan (2013) used school-side ties and previous employment ties between managers and directors of merging firms as a proxy for social networks. They provide evidence that firms with social ties are more likely to merge and also that these firms are more likely to employ the target CEO and target board members as board members of the newly combined firm.

CEO and board retention have also been studied in the merger and acquisition literature. Hartzell, Ofek, and Yermack (2004) focus on golden parachutes and cash bonuses and find a negative relationship between these negotiated cash payouts and CEO retention. Martin and McConnell (1991) find that the retention of target managers has no effect on announcement period abnormal returns for acquirers and targets. However, Matsusaka (1993) shows a positive association between target CEO retention and acquirer abnormal stock returns around the announcement date, which he attributes to the market rewarding managerial synergy. Wulf

(2004) examines mergers-of-equals and finds that a measure of shared control, target representation on the board in the post-merger firm, is negatively correlated to target abnormal stock returns around the announcement date. As previously mentioned, Ishii and Xuan (2013) find a greater likelihood of target CEO retention when merging firms have social ties.

This paper contributes both to managerial attributes literature and to literature that investigates the effect of individuals on mergers and acquisitions since it examines how managers' political preferences affect the performance of mergers.

## **2.3 Hypotheses and Potential Issues**

### *A. Hypotheses*

H1: Mergers between firms with Republican political preferences will be more risk-reducing than those with Democratic or different political preferences.

Chatterjee and Lubatkin (1990), expanding upon Lubatkin and O'Neill (1987), find that mergers between related firms result in a larger reduction in systematic risk than unrelated mergers because related firms can "draw on common corporate skills and activities." Since CEO political preferences are shown in corporate literature to effect how executives manage their firms, shared political preferences can represent common corporate outlooks. My first hypothesis, then, is that mergers between related firms, as measured by shared political preferences, will be more risk-reducing than mergers between unrelated firms. Because Republicans are widely considered more-risk averse, I expect mergers between Republican firms will drive any systematic risk-reduction found.

H2: Mergers are more likely to occur between firms with shared political preferences.

Psychology and corporate literature both establish that people prefer familiar goods and people. Most related to the interests of this paper, Ishii and Xuan (2013) find evidence that mergers are more likely to occur between firms with social connections, as measured by school-side and employment ties. I expect shared political preferences to similarly channel a familiarity and networking effect, thus I anticipate that mergers are more likely to occur between firms with shared political preferences than between firms with differing preferences.

H3: Target CEOs are more likely to be retained following mergers between firms with shared political preferences.

One aspect of merger outcomes that could be affected by shared ideologies of executives is target CEO retention. Ishii and Xuan (2013) indeed find that target CEO retention is more likely in mergers with social connections. Whether shared political preferences between executives represent shared corporate values or invoke a networking effect, I expect that target CEO executives are more likely to be retained in mergers where firms share political preferences.

### *B. Potential Issues*

While considering political preferences of managers, Hutton, Jiang, and Kumar (2011) experienced an endogeneity issue because it was not initially clear whether the manager implemented conservative policies or the firm chose the manager to continue with its current policies. They find that corporate policies become more conservative as levels of managerial conservatism increase. Endogeneity should not be a problem when looking at how political preferences of managers affect mergers because whether the firm chose the manager to continue implementing its already conservative policies or whether the manager actively introduced conservative policies is inconsequential. Based on Hutton et al, conservative firms and

conservative managers get matched. The only aspect of importance for this paper is whether the current top managers in the firm share the same political preferences of the managers of the company with which they intend to merge, regardless of whether the firm itself is conservative or is run by conservative managers.

There is also the potential argument that managers may donate to a candidate just to establish a relationship with an individual politician. This should not be a problem in the context of this paper because the public donation could still provide a networking tool between the managers and directors of the two companies if they donate to the same party or candidate. In this case, the shared party or candidate could represent a social tie, much as educational background and previous employment did in the Ishii and Xuan (2013) paper. Recently, Cooper, Gulen, and Ovtchinnikov (2010) find a correlation between firms' political contributions and future abnormal returns, indicating significance of firm political connectedness. This paper contributes to an already established literature on the significance of political connectedness with papers such as Faccio (2006), who examines firms with connections to national governments or parliaments.

## **2.4 Data and Methodology**

I obtain data on the political preferences of corporate managers and directors from several sources. Hutton, Jiang, and Kumar graciously provided the data on executive political preferences based on political donations in exchange for individually-examined director donation data. Data on the five highest paid executives of each firm comes from Execucomp from 1992 to 2008, which covers S&P 1500 firms, which consist of S&P large-cap 500, S&P mid-cap 400, and S&P small-cap 600. Based on the name and title indicated in Execucomp, executives are matched with their individual political contributions reported on the Federal Election

Commission's (FEC) website. The FEC makes all political donations above \$200 available to the public. The FEC reports the donation amounts and information about the donor, including the name, occupation, and address. The resulting executive donation dataset includes 5,183 unique managers in these S&P 1500 firms who made personal political contributions of at least \$200 during the time period of 1992 to 2008.

I obtain data on mergers and acquisitions between those 1500 companies from Thomson Financial SDC database from 1992 to 2008. In order to determine target CEO retention, for each acquisition I searched EDGAR for the annual report and proxy statements filed by both the target and acquirer the year before the merger and the annual report and proxy statements filed by the acquirer at least three years following the merger. The DEFM14A forms provided the most information on target CEO retention as they pertain specifically to the mergers, but I also examined the 8-k, 10-k, and DEF14a forms for any mention of the target CEOs' positions in the resulting corporation. If the pre-merger statements indicated the target CEO would be retained, I checked the resulting corporation's statements after the completion of the merger to verify the target CEO was indeed retained. I also looked for the target CEO in the Execucomp top five executives of the acquirer following the merger.

For firm control variables, I obtain firms' financial data such as total assets, debt, and net sales from Compustat. I acquire data on firms' stock returns from the Center for Research in Security Prices (CRSP) database, and I find executive data from Execucomp.

#### *A. Identifying Political Preferences*

The FEC reports all contributions to political candidates above \$200 on its public website. Along with the donor's name and donation amount, the FEC data includes the occupation and address of the donor and the donation date. Hutton, Jiang, and Kumar used these

data items to match executives to Execucomp manager data by mapping Execucomp fiscal years to election cycles that contain the beginning of that fiscal year. After the matching is completed using a computer algorithm, each match is examined visually to ensure that the match is accurate.

For each manager, the measure of political preference is found by taking the difference between contributions to Republican and Democratic candidates, and this difference is then divided by the manager's total contribution to both the Republican and Democratic candidates for that cycle. This measure therefore ranges from -1 to +1, where +1 signifies that the manager made contributions only to the Republican party in that election cycle and -1 signifies only Democratic contributions. The average measure across election cycles is taken for each manager, resulting in a full-sample political preference measure for each manager. For a firm-level preference measure, the political preferences for the top five managers of each firm are aggregated using weights based on the Execucomp rankings. With this method, the highest paid manager has the highest rank, the second highest paid manager has a weight that is one half of the weight of the highest paid manager, and so on.

### *B. Descriptive Statistics*

The final sample consists of 484 publicly traded companies which completed a merger between 1992 and 2008 and in which at least one acquirer top five executive made a political contribution in that time period. Panel A presents the summary statistics of political preferences for acquirers and targets. As seen, Republican preferences are predominant on the firm level, which takes into account the top five executives, and also for individual CEOs of both acquirers and targets. The individual CEOs have a stronger preference measure, whether Republican or Democrat, than the top five executive measure. Target executives in the sample have stronger

political preferences than acquirers. Panel B presents firm and acquisition summary statistics. As expected, acquirers are larger than targets. The mean cumulative abnormal return for acquirers is negative, and the mean cumulative abnormal return for targets is positive. Eighteen percent of mergers in the sample are tender offers, about half of the mergers are financed with stock, and over half the mergers involved two firms within the same industry. Panel C presents average political preferences of acquirers and targets by industry as measured by the firm 2-digit SIC code.

## **2.5 Results**

I first do a univariate analysis to examine the change in systematic risk as a result of a merger event in Table 2. The methodology follows Chatterjee and Lubatkin (1990), and systematic risk is measured as the beta estimate from a simple market model:  $R_{it} = \alpha_i + \beta_i R_{mt} + \epsilon_{it}$ , where  $R_{it}$  is the individual firm's return in period  $t$  and  $R_{mt}$  is estimated by an equal-weighted CRSP portfolio. The difference between the beta estimate post-merger and pre-merger represents a change in systematic risk caused by the merger.

In order to control for the systematic risk contributed by the target firm, a hypothetical beta is calculated to simulate the shift in risk investors could achieve by altering their portfolios. Introducing this hypothetical beta allows me to test for a reduction in systematic risk caused by the merger that investors could not achieve themselves. The hypothetical beta is a weighted average of the pre-merger betas of the acquirer and target where the weights are determined by the market values computed on a daily basis.

The pre-merger time period is 150 days and ends 150 days prior to the merger announcement date in order to avoid possible biases caused by the anticipation of the merger. The post-merger period is 150 days and begins 50 days following the merger completion date.

A difference score,  $z$ , is computed for each merger as the post-merger beta divided by its standard error minus the pre-merger beta divided by its standard error. The betas are standardized to control for possible bias in the t-statistics due to heteroskedasticity of the error terms. The standardized difference scores are then averaged across firms of similar type, and the mean is tested for its difference from zero.

Table 2 reports the results of the statistical tests for changes in systematic risk. The average difference between post- and pre-merger betas are reported along with the standard deviations. The standardized  $z$  score used for statistical tests is not reported. All acquisitions, whether acquirers are Republican or Democratic, have on average a post-merger beta lower than the hypothetical pre-merger beta; however, the mean is not significantly different than zero. Consistent with the Chatterjee and Lubatkin (1990) results, related mergers, as measured in this paper by shared political preferences, are more risk-reducing than unrelated mergers. Mergers with shared political preferences have a significantly lower beta post-merger than pre-merger ( $p < 0.05$ ), indicating systematic risk is reduced following the merger. There is a significant difference ( $p < 0.10$ ) between the means of related mergers and unrelated mergers. The reduction in risk is most evident in mergers between two Republican firms. For robustness, in unreported results betas are computed using the Fama French market model, and the risk-reduction results in related mergers, specifically between Republicans, remain consistent.

Table 3 employs a matched sample to determine the effect of shared political preferences on the probability of a merger event. Each actual acquirer is matched with a random firm. The random firm is within the same industry as the acquirer and in the year of merger announcement is the closest in size for which political preference data is available. The same matching method is employed for each actual target. I place a restriction that the random firms cannot have been

involved in a merger in the sample. There are three observations for each merger: the actual acquirer and actual target, the actual acquirer paired with the random target match, and the actual target paired with the random acquirer match. The dependent variable is equal to one if a merger occurred and zero otherwise.

Because I am interested in shared political preferences between merging firms, I include preference interaction terms. As Ai and Norton (2003) and Powers (2005) explain, determining the magnitude and significance of an interaction term in non-linear models is not straightforward. The interaction term in the logit model must be carefully and correctly estimated based on the cross-partial derivative. The stata command `inteff` (Norton, Wang, and Ai (2004)) correctly estimates interaction effects following logit regressions and is used whenever possible.

In Table 3, I present matched logit results on the probability of a merger event. I confirm significance of the interaction terms in unreported linear probability models for which the interpretation of interaction coefficients is more straightforward. I find that shared preferences, whether Democratic or Republican, increase the probability of a merger occurrence. In Model (1), I examine shared Democratic preferences and find an increase in likelihood of a merger if both firms are Democratic. In Model (2), I find an increase in the likelihood of a merger if both firms are Republican. I find an equally significant negative effect on merger probability when firms have differing political preferences, as seen in Models (3) and (4). As expected, these results provide evidence that mergers are more likely to occur between firms that share political preferences and are less likely to occur when firms do not share political views.

Table 4 presents results of the effect of political preferences on target CEO retention following the merger. Because target CEO retention is a dummy variable and I am interested in the effects of shared preferences, I again must carefully examine the interaction effects;

therefore, I present both linear and logit models. All models include control variables such as target log assets, target leverage, target prior stock performance, and CEO age. In logit models, I present the marginal effects along with corresponding z-statistics, where the marginal effect on the interaction term is determined using the Stata `inteff` command. In Models (1) and (2), I find that when both firms have Democratic executives, the target CEO is more likely to be retained in the resulting firm. In Models (3) and (4), I add control variables and find shared Democratic preferences still result in increased likelihood of target CEO retention. In Models (5) and (6), I find that shared Republican preferences also result in a greater likelihood of the target CEO being retained. Once I add control variables in Models (7) and (8), however, the significance on the interaction term dissipates. While I initially expected any shared preferences to result in a higher likelihood of target CEO retention, the evidence suggests that shared Democratic preferences have the biggest effect on the probability of target CEO retention.

I examine how firm political views affect target cumulative abnormal returns around the announcement date in Table 5. I find the abnormal returns for the target firms as the firms' daily return minus the equal-weighted market index return for that day. I then cumulate the abnormal returns over the trading window (-1, +1), where the merger announcement date is day zero. The interaction effect is easier to interpret in these linear models, which include year and industry fixed effects and target and deal control variables.

In the first two specifications, I look at the effect of shared Democratic preferences on target abnormal returns. I find that target abnormal returns are lower when both firms have Democratic preferences. In Models (3) and (4), I examine shared Republican preferences and find that these do not affect target abnormal returns around the announcement date. In Model (5), I include both interaction terms in the specification and all control variables. Shared

Republican preferences still do not affect target abnormal returns, and shared Democratic preferences still result in lower target abnormal returns around the announcement date.

In Table 6, I examine acquirer abnormal returns around the announcement date, where the abnormal returns are calculated in the same way as target abnormal returns. I find political preferences of firms are mostly insignificant when examining acquirer abnormal returns. In Models (1) and (5), the acquirer having Democratic preferences has a slightly significant positive effect on abnormal returns. Tables 5 and 6 provide evidence that shared Democratic preferences result in lower target returns, but political preferences do not have a real effect on acquirer abnormal returns.

## **2.6 Conclusions**

In this paper, I present evidence that political preferences of firm executives have an effect on merger outcomes. Based on previous literature regarding political preferences of executives, I posit that because political preferences have an effect on corporate decisions, shared political preferences between executives represent shared corporate ideologies. Whether these shared ideologies are similar business philosophies or represent a networking effect or both, I expected shared political preferences to affect merger outcomes. Specifically, I expected shared political views between two firms to increase the likelihood of a merger event and the retention of target CEOs. I also expected mergers between firms with shared Republican preferences to be more risk-reducing.

I provide evidence that acquisitions with shared political preferences, especially Republican, are more risk-reducing than acquisitions with differing acquirer and target political preferences. Shared political preferences between two firms also result in a higher probability of a merger occurring based on a matched sample. When two firms have different political

preferences, a merger is less likely to occur. When two firms share political preferences, especially Democratic, the target CEO is more likely to be retained in the resulting firm. I also find that shared Democratic preferences, specifically, result in lower target abnormal stock returns around the announcement date. Shared political preferences, however, do not appear to affect acquirer abnormal returns.

In unreported results, I find that there is no effect of political preferences on the acquisition premium. I also find no significance of political preferences when examining post-merger ROA and the long-term stock performance of the post-merger firm. Why the market reacts negatively to the target when firms share Democratic preferences, however, could be an avenue to be explored in future research.

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## 2.8 Appendix A: Tables

**Table 2.1**  
**Summary Statistics**

This table presents summary statistics for the acquisitions in my sample. All acquirers and targets are publicly traded companies, and at least one of the top 5 acquirer executives made a political donation in the time period from 1992 to 2008. Panel A presents the summary statistics of the political preferences at the firm-level and of CEOs for acquirers and targets. Firm preference measure is a weighted average of the top 5 executives of the firm, where each executive preference = (Republican donations - Democratic donations)/Total donations. The preference measure ranges from -1 (only Democratic donations) to +1 (only Republican donations).

**Panel A: Political Preferences**

	<b>Rep</b>	<b>Dem</b>	<b>Missing</b>	<b>Total</b>								
Acquirer	351	133	0	484								
Target	191	103	190	484								

  

Variable	Acquirers						Targets					
	Mean	St. Dev.	Q1	Median	Q3	N	Mean	St. Dev.	Q1	Median	Q3	N
All Firms												
Firm Preference	0.13	0.32	-0.03	0.10	0.37	484	0.11	0.32	0.00	0.00	0.37	484
CEO Preference	0.15	0.56	0.00	0.00	0.61	484	0.15	0.57	0.00	0.00	0.62	484
Republican Firms												
Firm Preference	0.27	0.24	0.06	0.27	0.43	351	0.42	0.22	0.23	0.44	0.58	191
CEO Preference	0.34	0.38	0.00	0.00	0.94	351	0.63	0.46	0.15	0.94	1.00	191
Democratic Firms												
Firm Preference	-0.23	0.18	-0.33	-0.18	-0.09	133	-0.29	0.17	-0.44	-0.25	-0.15	103
CEO Preference	-0.35	0.43	-0.77	-0.33	0.00	133	-0.45	0.50	-1.00	-0.41	0.00	103

**Panel B**

Variable	Mean	Median	St. Dev.	N
Acquirer Assets	22968	8689	44980	484
Target Assets	3234	751	7247	484
Acquirer Debt	3486	1367	7618	484
Target Debt	752	129	1767	484
Acquirer EBITDA	3206	1089	5088	484
Target EBITDA	480	103	1266	484
Acquirer CARs (-1, +1)	-0.02	-0.01	0.07	458
Target CARs (-1, +1)	0.19	0.16	0.21	458
Transaction Value (\$millions)	4156	1038	10103	484
Tender Offer	0.18	0.00	0.38	484
Pure Stock Deal	0.53	1.00	0.50	484
Same Industry	0.64	1.00	0.48	484

**Panel C: Political Preferences by Industry**

Industry (SIC 2)	Acq Firms	Acq Ave Firm Pref	Acq CEO Pref	Tar Firms	Tar Ave Firm Pref	Tar CEO Pref
10	5	-0.02	-0.01	10	0.07	-0.14
13	22	0.35	0.40	26	0.19	0.24
14	1	0.28	0.29	0		
15	2	0.08	0.00	4	0.30	0.00
20	15	0.00	0.05	15	0.13	0.07
21	2	0.11	0.00	1	0.53	0.00
22	0			3	0.29	0.67
23	2	-0.10	-0.64	0		
24	1	0.62	0.88	1	0.82	0.83
25	1	0.50	1.00	0		
26	15	0.32	0.31	10	0.41	0.67
27	5	0.07	0.10	5	0.02	0.00
28	45	0.24	0.40	34	0.09	0.14
29	10	0.54	0.78	6	0.47	0.74
30	1	0.54	1.00	6	0.19	0.33
31	0			1	0.44	1.00
32	2	0.42	0.73	5	0.04	0.08
33	15	0.29	0.29	13	0.16	0.19
34	2	0.29	0.50	3	0.12	0.29
35	38	0.10	0.24	44	0.06	0.06
36	42	0.22	0.33	46	0.11	0.19
37	14	-0.01	0.00	11	0.07	0.05
38	28	0.09	0.12	33	0.03	0.07
39	2	-0.54	-0.76	3	0.30	0.33
40	3	-0.05	0.03	5	0.36	0.61
41	1	0.01	0.00	0		
42	3	0.51	0.98	5	0.36	0.66
44	0			2	-0.56	-0.41
45	3	-0.01	0.10	2	-0.44	-1.00
47	1	-0.44	-1.00	0		
48	46	-0.04	-0.02	35	0.01	0.14
49	9	0.01	0.14	8	0.31	0.53
50	6	0.05	-0.10	6	-0.07	-0.17
51	10	0.18	0.28	8	0.06	0.10
52	1	0.01	0.00	0		
53	8	0.16	0.25	8	-0.01	-0.13
54	5	0.49	0.73	4	0.26	0.16
55	2	0.36	1.00	2	-0.05	0.00
56	1	0.20	0.00	1	-0.39	-1.00
57	1	0.28	0.67	3	0.40	0.78
58	6	0.10	-0.17	6	0.17	0.33
59	9	0.00	-0.28	10	0.21	0.39
70	2	-0.41	-0.60	0		
73	56	0.09	-0.03	68	0.06	0.08
75	1	0.00	0.00	0		
78	0			4	-0.19	-0.11
79	5	-0.26	-0.21	7	0.19	0.20
80	7	0.13	0.22	11	0.16	0.20
82	0			3	0.13	0.05
87	4	0.50	0.41	6	0.13	-0.09
99	24	0.06	-0.47	0		

**Table 2.2**  
**Changes in Systematic Risk**

This table presents merger event-induced changes in systematic risk. Systematic risk is measured as the Beta estimate from the market model  $R_{it} = \alpha_i + \beta_i R_{mt} + e_{it}$ , where  $R_{it}$  is the individual firm's return in period  $t$  and  $R_{mt}$  is estimated by an equal-weighted CRSP portfolio. Changes in systematic risk are measured as the difference in post-merger Beta and pre-merger Beta. The pre-merger period is a 150-day period prior to the merger announcement date, while the post-merger period is a 150-day period that begins 50 days following the merger completion. For each merger, the pre-merger Beta is a hypothesized Beta determined by forming a market value weighted portfolio of the acquirer and target's common stock. For each merger, pre- and post-merger Betas are standardized by their respective standard errors. The difference between these standardized Betas is then averaged with other mergers of the same type, i.e. Republican acquirers or Democratic acquirers. A mean difference score different than zero indicates a change in systematic risk due to a merger that an investor portfolio could not duplicate. The average difference in Betas and standard deviation are reported as descriptive statistics. The standardized Beta difference is used for t-tests to determine if the mean is different than zero, and the significance is indicated by asterisks.

Sample	N	Statistical Tests: Post - Pre	
		Average Difference	Standard Deviation
Republican Acquirers	351	-0.0425	0.5477
Democratic Acquirers	133	-0.0264	0.6132
t-test of mean difference			1.20
Related Mergers: Shared Preferences	165	-0.0935**	0.5799
Unrelated Mergers	319	0.001	0.5999
t-test of mean difference			1.69*
Both Firms Republican	127	-0.1889***	0.5094
Both Firms Democratic	38	-0.0649	0.5983
t-test of mean difference			1.94*

**Table 2.3**  
**Probability of a Merger Event**

This table presents matched logit models to estimate the effect of shared political preferences on the probability of a merger occurring. Each actual acquirer is matched with a random firm by size within the same industry in the same year as the actual merger for which political preference data is available. Each actual target is matched to a random firm with the same conditions. For each merger, there are three observations: the actual acquirer and target, the actual acquirer paired with the random matched target, the actual target paired with the random matched acquirer. The dependent variable, merger, is a dummy variable = 1 if a merger occurred between two firms. Acq (Tar) Dem is a dummy variable equal to one if the acquirer (target) top 5 executives have Democratic political preferences. Acq (Tar) Rep is a dummy variable equal to one if the acquirer (target) top 5 executives have Republican political preferences. Definitions of control variables are provided in Appendix I. Z-statistics are reported in parentheses below coefficient estimates where \*\*\*, \*\*, and \* indicate significance at the 1%, 5%, and 10% level, respectively.

	(1)	(2)	(3)	(4)
Acq Dem*Tar Dem	2.444*** (6.40)			
Acq Rep*Tar Rep		1.539*** (4.64)		
Acq Rep*Tar Dem			-2.444*** (-6.40)	
Acq Dem*Tar Rep				-1.539*** (-4.64)
Acq Dem	-0.289 (-1.37)			0.856*** (3.78)
Tar Dem	-1.060*** (-5.10)		1.384*** (3.95)	
Acq Rep		-0.856*** (-3.78)	0.289 (1.37)	
Tar Rep		-2.267*** (-6.94)		-0.727*** (-3.78)
Log Acquirer Assets	1.222*** (6.40)	1.239*** (6.59)	1.222*** (6.40)	1.239*** (6.59)
Log Target Assets	-0.069 (-0.50)	-0.155 (-1.06)	-0.069 (-0.50)	-0.155 (-1.06)
Acquirer Leverage	-0.544 (-0.96)	-0.932* (-1.67)	-0.544 (-0.96)	-0.932* (-1.67)
Target Leverage	-0.069 (-0.16)	0.130 (0.29)	-0.069 (-0.16)	0.130 (0.29)
Acquirer OPA	1.546 (1.43)	1.386 (1.30)	1.546 (1.43)	1.386 (1.30)
Target OPA	-1.599** (-2.15)	-0.813 (-1.04)	-1.599** (-2.15)	-0.813 (-1.04)
Mergers with Match Pairs	480	480	480	480
Chi2	118.27	134.33	118.27	134.33
P-value	0	0	0	0

**Table 2.4**  
**Target CEO Retention**

This table presents the effect of shared political preferences on the probability of target CEO retention. The dependent variable is a dummy variable equal to one if the target CEO was retained in the consolidated firm and zero otherwise. Acq (Tar) Dem is a dummy variable equal to one if the acquirer (target) top 5 executives have Democratic political preferences. Acq (Tar) Rep is a dummy variable equal to one if the acquirer (target) top 5 executives have Republican political preferences. Definitions of control variables are provided in Appendix I. Year dummy variables are included in some specifications, but coefficient estimates for year dummies are not reported for brevity. Marginal effects are reported for logit regressions along with z-statistics. T-statistics in linear models are reported in parentheses below coefficient estimates where \*\*\*, \*\*, and \* indicate significance at the 1%, 5%, and 10% level, respectively.

	<b>Linear</b>	<b>Logit</b>	<b>Linear</b>	<b>Logit</b>	<b>Linear</b>	<b>Logit</b>	<b>Linear</b>	<b>Logit</b>
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Acq Dem*Tar Dem	0.376*** (2.78)	0.302** (2.26)	0.257** (2.26)	0.225* (1.79)				
Acq Dem	-0.071 (-1.15)	-0.116 (-1.44)	-0.067 (-0.25)	-0.102 (-1.21)				
Tar Dem	-0.051 (-0.70)	0.008 (0.12)	0.036 (0.14)	0.088 (0.58)				
Acq Rep*Tar Rep					0.207** (2.08)	0.211** (2.28)	0.069 (0.72)	0.063 (0.67)
Acq Rep					-0.062 (-1.07)	-0.043 (-0.65)	-0.126 (-0.22)	0.020 (0.07)
Tar Rep					-0.073 (-1.16)	-0.151 (-1.58)	-0.023 (-0.38)	-0.149 (-0.53)
Target Log Assets			-0.019 (-1.22)	-0.023 (-1.42)			-0.016 (-1.01)	-0.016 (-0.99)
Target OPA			0.276* (1.71)	0.391 (1.71)			0.265 (1.64)	0.391* (1.72)
Target Leverage			-0.223** (-2.35)	-0.302*** (-2.64)			-0.211** (-2.18)	-0.292** (-2.56)
Target Stock Performance			-0.005 (-1.25)	-0.002 (-0.22)			-0.004 (-1.03)	0.000 (0.02)
Relative Deal Size			0.057*** (5.13)	0.063*** (5.60)			0.057*** (5.04)	0.062*** (5.55)
Stock Deal			0.206*** (3.57)	0.169*** (3.37)			0.204*** (3.47)	0.160*** (3.21)
Same Industry			0.010 (0.22)	0.002 (0.04)			0.002 (0.05)	0.000 (0.01)
Tender Deal			0.007 (0.10)	0.029 (0.46)			0.003 (0.04)	0.022 (0.35)
CEO Age			-0.003 (-1.12)	-0.003 (-0.94)			-0.003 (-0.88)	-0.003 (-0.96)
Year Fixed Effects	Y	N	Y	N	Y	N	Y	N
Number of obs	484	484	478	478	484	484	478	478
CEOs retained	236	236	234	234	236	236	234	234
CEOs not retained	248	248	244	244	248	248	244	244
Chi2		5.57		95.45		5.69		92.11
F	7.16		12.84		18.19		11.07	
P-value	0	0.135	0	0	0	0.128	0	0

**Table 2.5**

**Target Cumulative Abnormal Returns**

This table presents the effect of shared political preferences on target cumulative abnormal returns for days -1 to +1 around the announcement date. The dependent variable, Target CARs (-1,+1), is the sum of target daily abnormal returns from one day before the merger announcement to one day after the announcement. Acq (Tar) Dem is a dummy variable equal to one if the acquirer (target) top 5 executives have Democratic political preferences. Acq (Tar) Rep is a dummy variable equal to one if the acquirer (target) top 5 executives have Republican political preferences. Definitions of control variables are provided in Appendix I. Year and target industry dummy variables are included, but coefficient estimates are not reported for brevity. T-statistics are reported in parentheses below coefficient estimates where \*\*\*, \*\*, and \* indicate significance at the 1%, 5%, and 10% level, respectively.

	<b>Target CARs (-1, +1) around Announcement Date</b>				
	(1)	(2)	(3)	(4)	(5)
Acq Dem*Tar Dem	-0.124*** (-2.87)	-0.106** (-2.51)			-0.127*** (-2.64)
Acq Dem	0.021 (0.82)	0.028 (1.16)			0.049 (1.43)
Tar Dem	-0.009 (-0.37)	-0.008 (-0.35)			-0.006 (-0.20)
Acq Rep*Tar Rep			-0.015 (-0.33)	-0.010 (-0.21)	-0.038 (-0.90)
Acq Rep			0.021 (0.79)	0.004 (0.16)	0.043 (0.83)
Tar Rep			0.005 (0.12)	0.020 (0.55)	
Target Log Assets		-0.022*** (-3.12)		-0.026*** (-3.80)	-0.021*** (-2.93)
Target OPA		-0.068 (-0.98)		-0.058 (-0.82)	-0.062 (-0.90)
Target Leverage		0.023 (0.46)		0.021 (0.40)	0.022 (0.44)
Target Stock Performance		-0.019 (-0.74)		-0.014 (-0.52)	-0.018 (-0.71)
Relative Deal Size		0.018*** (3.28)		0.017*** (3.25)	0.017*** (3.13)
Stock Deal		-0.041 (-1.30)		-0.040 (-1.25)	-0.043 (-1.37)
Same Industry		0.010 (0.53)		0.014 (0.74)	0.010 (0.52)
Tender Deal		0.150*** (4.53)		0.153*** (4.57)	0.149*** (4.40)
Year Fixed Effects	Y	Y	Y	Y	Y
Industry Fixed Effects	Y	Y	Y	Y	Y
Number of obs	458	458	458	458	458
Adjusted R-squared	0.068	0.150	0.051	0.139	0.146

**Table 2.6**

**Acquirer Cumulative Abnormal Returns**

This table presents the effect of shared political preferences on acquirer cumulative abnormal returns for days -1 to +1 around the announcement date. The dependent variable, Acquirer CARs (-1,+1), is the sum of acquirer daily abnormal returns from one day before the merger announcement to one day after the announcement. Acq (Tar) Dem is a dummy variable equal to one if the acquirer (target) top 5 executives have Democratic political preferences. Acq (Tar) Rep is a dummy variable equal to one if the acquirer (target) top 5 executives have Republican political preferences. Definitions of control variables are provided in Appendix I. Year and acquirer industry dummy variables are included, but coefficient estimates are not reported for brevity. T-statistics are reported in parentheses below coefficient estimates where \*\*\*, \*\*, and \* indicate significance at the 1%, 5%, and 10% level, respectively.

<b>Acquirer CARs (-1, +1) around Announcement Date</b>					
	(1)	(2)	(3)	(4)	(5)
Acq Dem*Tar Dem	-0.008 (-0.53)	0.011 (1.38)			-0.019 (-1.08)
Acq Dem	0.017* (1.72)	0.013 (1.55)			0.022* (1.70)
Tar Dem	0.012 (1.36)	-0.017 (-1.20)			0.008 (0.73)
Acq Rep*Tar Rep			0.005 (0.33)	0.016 (-1.02)	0.023 (1.32)
Acq Rep			-0.013 (-1.37)	-0.014 (-1.53)	
Tar Rep			-0.012 (-0.88)	-0.025* (-1.93)	-0.030** (-1.97)
Acquirer Log Assets		0.006** (2.05)		0.007** (2.04)	0.007** (2.07)
Target Industry MarketCap/Book Median		-0.000* (-1.82)		0.000 (-1.28)	0.000 (-1.24)
Target Stock Performance		-0.009 (-1.12)		-0.009 (-0.91)	-0.008 (-0.91)
Relative Deal Size		-0.002 (-1.26)		-0.002 (-0.85)	-0.002 (-0.91)
Stock Deal		-0.027*** (-3.37)		-0.028*** (-3.04)	-0.028*** (-2.99)
Same Industry		-0.002 (-0.25)		0.001 (0.10)	0.000 (0.06)
Tender Deal		0.005 (0.54)		0.003 (0.34)	0.004 (0.38)
Year Fixed Effects	Y	Y	Y	Y	Y
Industry Fixed Effects	Y	Y	Y	Y	Y
Number of obs	458	458	458	458	458
Adjusted R-squared	0.017	0.103	0.047	0.111	0.108

### Appendix 1 - Variable Definitions

Variable	Definition
<b>Dependent Variables</b>	
Target CEO Retention	Dummy variable = 1 if the target CEO was retained in the newly formed firm as either an executive or director and 0 otherwise
Target (Acquirer) CARs (-1, +1)	The sum of target (acquirer) daily abnormal returns from one day before the merger announcement to one day after the announcement. The abnormal return for each day is the rate of return on the target's (acquirer's) common stock after subtracting the equal-weighted market index return for that day.
<b>Political Preference Variables</b>	
Acq (Tar) Dem	Dummy variable = 1 if the top 5 executives of the acquirer (target) have Democratic preferences and 0 otherwise. The political preference measure, (Republican contributions - Democrat contributions)/Total contributions, is averaged across all campaign cycles for each manager. The firm-level measure is a weighted average of the top 5 executive preferences, where the CEO has a weight of $\omega$ , the second highest paid manager has a weight of $1/2\omega$ , and so on. A firm is designated Democratic if the average political preference measure $< 0$ .
Acq (Tar) Rep	Dummy variable = 1 if the top 5 executives of the acquirer (target) have Republican preferences and 0 otherwise. The political preference measure, (Republican contributions - Democrat contributions)/Total contributions, is averaged across all campaign cycles for each manager. The firm-level measure is a weighted average of the top 5 executive preferences, where the CEO has a weight of $\omega$ , the second highest paid manager has a weight of $1/2\omega$ , and so on. A firm is designated Republican if the average political preference measure $> 0$ .
<b>Independent Variables</b>	
Target(Acquirer) Log Assets	Natural log of total assets
Target OPA	Target's EBITDA/Total Assets for the fiscal year prior to merger announcement
Target Leverage	Target's Total Debt/Total Assets for the fiscal year prior to merger announcement
Target(Acquirer) Stock Performance	The buy-and-hold abnormal return over days -219 to -20 relative to merger announcement date using CRSP equal-weighted index
Target Industry MarketCap/Book Median	The median of Market Cap/Book Value for all Compustat firms in the target's 2-digit primary SIC code industry in the acquisition announcement year
Relative Deal Size	(Amount paid to acquire the target excluding target liabilities)/Market value of acquirer
Stock Deal	Dummy variable = 1 if the acquirer pays with stock and 0 otherwise
Same Industry	Dummy variable = 1 if the target and acquirer share the same two-digit SIC industry code and 0 otherwise
Tender Deal	Dummy variable = 1 if the acquirer makes a tender offer directly to target shareholders and 0 otherwise
CEO Age	Age of CEO the year of merger announcement

## CHAPTER 3

### REPUBLICAN CEOS AND CRASH RISK

#### **3.1 Introduction**

Most people can easily describe many ways in which Republicans and Democrats differ. Republicans are most often associated with conservatism, which includes attributes like personal responsibility and aversion to change and risk. Conversely, liberals are considered to be more open to new ideas and risk, while being less orderly and structured. The behavioral finance literature has recently begun investigating how the political views, along with the corresponding attributes, of top management affect corporate policy decisions.

Hutton, Jiang, and Kumar (2013) provide evidence that Republican CEOs project their conservative values onto a broad range of firm policies. They find that Republican executives display more risk aversion by utilizing less leverage, investing in less risky assets, and engaging in less research and development. Litigation targeted at the firm can also be related to the political leanings of the CEO (Hutton, Jiang, and Kumar (2014)). Republican-managed firms experience fewer cases of litigation over intellectual property rights and securities fraud, while firms under Democratic management experience fewer cases of environmental and labor litigation. Further, Rubin (2008) and Giuli and Kotovesky (2014) find that firms headquartered in Republican counties and firms with Republican CEOs engage in less corporate social

responsibility activity. The premise of this literature stream is that the political ideology of management, in particular the CEO, can influence firm policies.

While the current literature addresses firm policies under differing managerial political regimes, there has been little discussion of market implications for firms under these regimes. Business decisions made by executives certainly affect firm returns and volatility. For example, Adams, Almeida, and Ferreira (2005) find that CEO power has a significant effect on stock return variability, concluding that stock return variability increases with CEO power. If Republican managers implement more conservative policies, then these real decisions may be reflected in the return distribution of these firms.

In this paper, I address the relationship between the political leaning of the CEO and the propensity for stock price crashes. I provide evidence that suggests that firms under Republican CEOs experience a less negatively skewed return distribution, which is a widely accepted measure for stock price crash risk. I also find that Republican-led firms actually do experience fewer stock price crashes. Furthermore, I identify additional firm policy mechanisms that may impact the firm's return distribution. First, I find that under a Republican CEO, firms engage in less upward earnings management. I also find that firms with Republican executives are less likely to restate their earnings. Each of these policies is consistent with the Republican ideology of market discipline and individual accountability outlined in Hutton, Jiang, and Kumar (2013).

In the remainder of this paper, I present the evidence of the findings mentioned above. Section 3.2 presents a review of the literature and lists the hypotheses. Section 3.3 details the data compilation and the methodology. Section 3.4 reports and discusses the results, and Section 3.5 summarizes and concludes the findings. Section 3.6 includes the relevant tables.

### 3.2 Literature Review and Hypotheses

Over the past decade, corporate finance literature has recognized the importance of heterogeneity of firm management and its effects on business decisions. Motivated by Bertrand and Schoar (2003), who find that manager fixed effects have an impact on financing, investment, and strategic decisions, researchers have examined a variety of CEO attributes that drive variation in firm policies. Gervais, Heaton, and O'Dean (2011) show that manager's attributes interacted with contractual incentives affect firm decisions. Malmendier and Tate (2005) find that CEO overconfidence is associated with sub-optimal investing and financing activity. CEO overconfidence is also associated with wealth-destroying acquisitions (Malmendier and Tate (2008)) and overly optimistic earnings guidance (Hribar and Yang(2013)). Yim (2013) finds that CEO age has a significant effect on firm acquisition propensity. Lin, Lin, Song, and Li (2011) show that CEOs' education levels and political connections have positive effects on firm's innovation activities.

Political preferences, specifically, have been examined in literature that investigates the relationship between managerial political alignment and firm policies. As previously mentioned, Hutton, Jiang, and Kumar (2013) find that firms with Republican managers have lower levels of corporate debt, lower capital and R&D expenditures, and less investment in risky assets. Giuli and Kostovetsky (2014) show that Democratic-led firms are more socially responsible than Republican-managed firms, and Hong and Kostovetsky (2012) show that Democratic mutual fund managers prefer socially responsible stocks. DeVault and Sias (2014) find that Republican hedge fund managers hold less risky stocks than Democratic managers do. Lee, Lee, and Nagarajan (2014) find lower firm valuation and an increased likelihood of accounting fraud

when CEOs and directors share political preferences. This literature as a whole suggests that Republicans adopt less risky corporate policies.

There is an established literature on firm use of discretionary accruals and stock price crash risk. Kim, Li, and Zhang (2011) provide evidence of a positive relationship between corporate tax avoidance and stock price crash risk. Jin and Myers (2006) find that “opaque” firms (a lack of transparency) are more likely to experience a crash, which is characterized by large negative returns. Hutton, Marcus, and Tehranian (2009) echo this result using earnings management to measure firm opacity. I also use earnings, specifically accruals, management as an indicator of firm opacity. Sloan (1996) finds that stock prices do not fully reflect all publicly available information regarding accruals and cash flows. This paper, along with others, shows that accruals management contributes to firm fundamental obscurity.

The effect of individual managers on earnings restatements has also been examined in financial literature. Agrawal and Chadha (2005) find that companies with board or audit committees with an independent director who is a financial expert are less likely to restate their earnings, while companies in which the CEO belongs to the founding family are more likely to restate their earnings. Agrawal and Cooper (2007) show that firms that restated their earnings are more likely to experience turnover of CEOs, CFOs, and top management. Lisic, Neal, Zhang, and Suny (2015) find that firms with more powerful CEOs are more likely to restate earnings, which they argue is due to powerful CEOs providing lower quality information to audit committees.

H1: Firms with Republican CEOs experience fewer crash events and less negative skewness in return distribution.

As previously discussed, the literature on political preferences of executives finds that Republican managers are more risk averse. Hutton, Jiang, and Kumar (2013) show that Republican managers adopt conservative policies, and DeVault and Sias (2014) find that Republican hedge fund managers prefer less volatile stocks. I therefore expect that the return distribution of firms' stocks with Republican CEOs will reflect a less risky corporate policy, as evidenced by fewer crash events and less negative skewness of stock returns.

H2: Republican CEOs engage in less earnings management.

In addition to less risky financing and investment policy, managerial discretion over earnings management policy can impact firm specific risk. Hutton, Marcus, and Tehranian (2009) find that firms who employ high levels of discretionary accruals experience more stock price crashes and exhibit more negatively skewed return distributions. The employment of earnings smoothing measures by management is often interpreted as decreasing information availability of the firm. Earnings smoothing is often associated with obscuring financial statements to the benefit of the firm by meeting or beating analyst earnings forecasts (Matsumoto (2002)). However, two of the core Republican ideologies, "individual accountability" and "market discipline", highlighted by Hutton, Jiang, and Kumar (2013) suggest that the political ideology of Republican CEOs would be in favor of less earnings manipulation. Therefore, I hypothesize that Republican CEOs will engage in less earnings management, which is associated with lower crash risk and negative return skewness.

H3: Firms with Republican CEOs are less likely to restate their earnings.

Firm CEOs can heavily influence the probability of a firm restating its earnings, as shown in existing financial literature. Because earnings restatements can be an indicator of corporate misbehavior, or at the very least an indicator of lower quality firm output, I expect firms with

Republican CEOs to be less likely to restate their earnings. Due to the Republican principles cited above of individual accountability and risk averseness, I expect Republican CEOs will be more diligent in providing higher quality information, which should result in fewer earnings restatements.

### **3.3 Data and Methodology**

My primary sample begins with all firms in the ExecuComp database from 1993 to 2008. I exclude all firms in the utility (SIC 4000 – 4900) or finance industry (SIC 6000-6900). Firm characteristics and earnings management variables are obtained from Compustat. Executive characteristics and compensation variables are constructed from ExecuComp data. Stock return and volatility measures come from CRSP. Earnings restatement data is gathered from Audit Analytics. CEO campaign contribution data is graciously provided by Hutton, Jiang, and Kumar in exchange for director campaign contribution data. I obtain county voting data for presidential elections from 1992 to 2008 from the U.S. Census website. The U.S. Census website no longer maintains its county level data, but I were able to download this data before it was terminated.

Executive campaign contribution data is sourced from the Federal Election Committee website. The FEC reports all contributions to political candidates above \$200 on its public website. Along with the donor's name and donation amount, the FEC data includes the occupation and address of the donor and the donation date. Hutton, Jiang, and Kumar used these data items to match executives to Execucomp manager data by mapping Execucomp fiscal years to election cycles that contain the beginning of that fiscal year. After the matching is completed using a computer algorithm, each match is examined visually to ensure that the match is accurate. Individually-examined director contribution data was exchanged with Hutton, Jiang, and Kumar in order to receive executive contribution data.

For each manager, the measure of political preference is found by taking the difference between contributions to Republican and Democratic candidates, and this difference is then divided by the manager's total contribution to both the Republican and Democratic candidates for that cycle. This measure therefore ranges from -1 to +1, where +1 signifies that the manager made contributions only to the Republican party in that election cycle and -1 signifies only Democratic contributions. A measure greater than 0 indicates the CEO's contributions to the Republican party were greater than their contributions to the Democratic party, and vice versa for measures less than 0. The average measure across election cycles is taken for each manager, resulting in a full-sample political preference measure for each manager. RepCEO is my primary variable of interest. It is a dummy variable equal to one if the average political measure  $> 0$ . If the CEO political measure  $< 0$  or the CEO makes no contributions, then I set RepCEO = 0. Similarly, I construct DemCEO using Democratic campaign contributions, where DemCEO equals one only if the average political measure  $< 0$ . I also construct RepCFO using the campaign contribution data of CFOs. Table 1 presents the summary statistics. In my panel, approximately 38% of my 19,221 firm years are identified as having a Republican CEO at the helm, while Democratic CEOs are accounted for in 15% of firm years. Only 11% of firm years are classified as having a Republican CFO.

Political views of counties in which firms are headquartered are determined by the county's presidential voting record during the election closest to the observation year. For each county, I find the proportion of Democratic votes out of total votes and the proportion of Republican votes out of total votes in each presidential election. A county is indicated Republican if it voted primarily Republican in the presidential election closest to the observation year and Democratic if it voted primarily Democratic. If the observation year fell directly

between two presidential elections, an average of the two elections' voting results is used to determine the county's political leaning.

I construct measures of crash risk (Crash) and return skewness (NCSkew) following Kim, Liu, and Zhang (2011). Using CRSP data for each firm fiscal year, I estimate the extended market model:

$$r_{j,t} = \alpha_j + \beta_{1jrm,t-2} + \beta_{1jrm,t-1} + \beta_{1jrm,t} + \beta_{1jrm,t+1} + \beta_{1jrm,t+2} + \varepsilon$$

where  $r_{j,t}$  is the weekly return for firm  $j$  in week  $t$  and  $r_{m,t}$  is the weekly return of the CRSP equally weighted index in week  $t$ . I transform the residuals from the estimated model by taking the natural log of one plus the residual. I set the binary variable Crash equal to one in fiscal years where any of the transformed weekly residual returns are 3.2 standard deviations below the mean of the transformed weekly residuals for that fiscal year. In my sample, the average firm-specific risk, defined as the standard deviation of  $\ln(1 + \text{residual return})$ , is 4.7%. As an example, if the average firm experienced a 3.2 standard deviation decline in a week, this would translate to an abnormal weekly return of -15%. In my sample, 18% of firm-years experience a crash event.

For a continuous measure of idiosyncratic risk (NCSkew), in each fiscal year I calculate the third moment, conditional skewness, of the distribution of the transformed weekly residual returns for each fiscal year. Following Chen, Hong, and Stein (2001) and for convenience of interpretation, I take the negative of the conditional skewness when creating NCSkew. Hong and Stein (2003) and Chen et al. (2001) explain the use of negative skewness as a measure of stock price risk. Because the stock market is more likely to experience significant decreases rather than increases, aggregate market returns are asymmetrically distributed. Contributing to this notion is a large literature that provides evidence that negative returns are associated with

increased volatility. Chen et al. also cite literature documenting that since the market crash of October 1987, stock index option prices provide strong evidence of a negative asymmetry in returns. Therefore, it is widely accepted that there exists negative skewness in market returns. Taking the negative of the conditional skewness implies that I accept the general notion that a higher value of NCSkew is indicative to a stock having a more left-skewed distribution and therefore being more prone to price crashes.

To measure discretionary accruals, I use the modified Jones (1991) model suggested by Dechow, Sloan, and Sweeney (1995). First, I estimate the following regression for each firm-year observation:

$$TA_{j,t}/A_{j,t-1} = a_1(1/A_{j,t-1}) + a_2(\Delta REV_{j,t}/A_{j,t-1}) + a_3(PPE_{j,t}/A_{j,t-1}),$$

where  $TA_{j,t}$  is total accruals for firm  $j$  at time  $t$ ,  $A_{j,t}$  is assets for firm  $j$  at time  $t$ ,  $\Delta REV_{j,t}$  is the change in revenue for firm  $j$  at time  $t$ , and  $PPE_{j,t}$  denotes property, plant, and equipment for firm  $j$  at time  $t$ .  $TA$ , total accruals, equals income before extraordinary items minus cash flow from operating activities adjusted for extraordinary items and discontinued operations (Comp #123 - (Comp #308 - Comp #124)). Following Dechow, Sloan, and Sweeney (1995), I modify the Jones model by taking the estimated values from the regression above and using them to estimate the following model:

$$\text{Disc. Accruals} = TA_{j,t}/A_{j,t-1} - [\alpha_1(1/A_{j,t-1}) + \alpha_2(\Delta REV_{j,t} - \Delta REC_{j,t}/A_{j,t-1}) + \alpha_3(PPE_{j,t}/A_{j,t-1})]$$

This model subtracts the change in receivables,  $\Delta REC$ , from the change in revenue because the original Jones (1991) model implicitly assumes that discretion is not exercised over revenue, so this modified model avoids measurement error. Discretionary accruals are used as an indicator of earnings manipulation because the accuracy of reported earnings depends on how truthfully

accruals estimate expected future cash flows linked with past transactions. If a manager engages in earnings manipulation, she may report inaccurate positive accruals that must later be offset by negatively signed accruals instead of actual cash flows.

### 3.4 Results

#### *A. Crash Risk*

To test my first hypothesis that Republican-led firms experience fewer crash events and less negative skewness in return distribution, I propose the two following models:

$$\text{NCSkew}_{j,t} = \alpha + \beta * \text{RepCEO}_{j,t-1} + \beta * \text{Controls}_{j,t-1} + \beta * \text{Year}_t + \beta * \text{Firm}_j \quad (1)$$

$$\text{Crash}_{j,t} = \alpha + \beta * \text{RepCEO}_{j,t-1} + \beta * \text{Controls}_{j,t-1} + \beta * \text{Year}_t + \beta * \text{Firm}_j \quad (2)$$

I report results for my primary hypothesis H1 in Table 2. Models (1) through (3) present the OLS coefficients for the baseline model on negative skewness proposed in Equation 1. The dependent variable is the negative conditional skewness of the weekly return residuals from the extended market model for fiscal year  $t$ . The primary independent variable of interest is the dummy variable RepCEO in fiscal year  $t-1$ . In each model I include controls for the lagged conditional skewness, CEO turnover, market capitalization, market to book value of equity, leverage, return on assets, firm specific return, and firm specific risk in year  $t$ . I also include firm and year fixed effects and cluster standard errors by firm.

In the baseline regression in Model (1), the coefficient on RepCEO suggests that the presence of a Republican leaning CEO in year  $t-1$  is associated with a significantly lower measure of negative conditional skewness in year  $t$ . I find similar results in Model (2) after adding an indicator variable for Republican CFOs, which is insignificant. In Model (3), I include independent variables for the composition of CEO compensation, CEO delta and CEO vega, and

I still find a negative and significant effect of Republican CEOs on negative conditional skewness. Interestingly, the political leaning of the CFO and the composition of CEO compensation do not have a significant effect on the following year's negative conditional skewness. These results suggest that, all else equal, the presence of a Republican CEO leads to a less negatively skewed return distribution in the following year.

I present the results in Models (4) through (7) of Table 2 of the conditional logit model for crash risk proposed in Equation 2. In each logit model, the dependent variable is an indicator for a crash event in year  $t$ . As in Models (1) to (3), the independent variable of interest is the dummy variable RepCEO. I include several controls, including lagged conditional skewness, CEO turnover, market capitalization, and firm specific risk in year  $t$ . I also include firm and year fixed effects and cluster standard errors by firm.

In the baseline logit model (4) of Table 2, the coefficient on RepCEO is negative and significant, suggesting that the presence of a Republican CEO is associated with a lower probability of a firm stock price crash in the following year. The results hold in Model (5), where CEO compensation composition variables are included. In Models (6) and (7), a crash event is redefined. In the previous models, Crash equals one in fiscal years where any of the transformed weekly residual returns are 3.2 standard deviations below the mean of the transformed weekly residuals for that fiscal year. In Model (6), Crash equals one in the fiscal years where any of the transformed weekly residual returns are 4 standard deviations below the mean, and in Model (7) a 5 standard deviation threshold is used. Increasing the standard deviation threshold significantly reduced the number of crash events, however the negative effect of Republican CEOs on the likelihood of a stock price crash event remains even when stricter definitions of stock price crashes are employed.

Together, the results from Table 2 suggest that firms with a Republican CEO experience less negative skewness in return distribution and lower probability of stock price crashes. These results are intuitive based on Hutton, Jiang, and Kumar's finding that Republican managers adopt more conservative financing and investing strategies, which I expected to be reflected in the distribution of returns.

### *B. Earnings Management*

As proposed in my second hypothesis (H2), one of the channels that could reduce the risk of adverse price shocks may be transparent communication about the state of the firm. As Hutton, Marcus, and Tehranian (2009) find, firms with high levels of discretionary accruals and deferrals experience more stock price crashes and exhibit more negatively skewed return distributions. The propensity to either communicate transparently or to distribute misinformation may be an attribute that can be measured with political orientation. To test this hypothesis, I propose the following two models:

$$\text{DiscAccr}_{j,t} = \alpha + \beta * \text{RepCEO}_{j,t-1} + \beta * \text{Controls}_{j,t-1} + \beta * \text{Year}_t + \beta * \text{Firm}_j \quad (3)$$

$$\text{Restatement}_{j,t} = \alpha + \beta * \text{RepCEO}_{j,t-1} + \beta * \text{Controls}_{j,t-1} + \beta * \text{Year}_t + \beta * \text{Firm}_j \quad (4)$$

In Table 3, I present the results of my tests of the models proposed in Equations 3 and 4. The dependent variable, DiscAccr, is the level of discretionary accruals used by management in year t, which is found by the modified Jones (1991) model described in the Data section. The independent variable of interest is the indicator variable for a Republican CEO, RepCEO.

In Models (1) and (2) of Table 3, the dependent variable includes both positive and negative levels of discretionary accruals. The coefficient on RepCEO is negative and significant, indicating that the presence of a Republican CEO is associated with a lower level of

discretionary accruals in the following fiscal year. In Model (3), I limit the sample to fiscal years where discretionary accruals are positive. Once again, Republican CEOs have a negative and significant effect on levels of discretionary accruals. In Model (4), I limit the sample to fiscal years where discretionary accruals are negative. Unlike the case of positive accruals, the coefficient on RepCEO is not significantly different from zero. The results from these models imply that Republican CEOs rely less on positive discretionary accruals.

In Models (5) and (6) of Table 3, I present the results from the conditional logit model of earnings restatements in Equation 4. The dependent variable, Restatement, is equal to one if the firm restated its earnings in year  $t$ , and the variable of interest is the indicator variable for Republican CEOs. As seen in Models (5) and (6), the coefficient on the Republican CEO dummy variable is negative and significant, indicating firms with Republican CEOs are less likely to restate their earnings. The results of Table 3 provide evidence that Republican managers deliver less misinformation about firm earnings.

### *C. Other Possibilities*

One possible alternative is that my results may be driven by politically active CEOs and not unique to Republican CEOs. To verify that my results are not driven simply by a strong political preference as evidenced by campaign donations, I construct the dummy variable DemCEO. DemCEO is constructed similarly to RepCEO, as described in the data section. DemCEO is a dummy variable equal to one if the CEO's average political preference measure  $< 0$  and zero if the CEO's average political preference  $> 0$  (indicating Republican preferences) or if the CEO did not contribute to any political campaigns. I add DemCEO to the crash risk models and earnings management models.

I present the results using DemCEO in the various models in Table 4. In Models (1) and (2), I reconsider crash risk and negative skewness of return distribution. Using the full set of controls, the coefficient on DemCEO is insignificant in both specifications, while the coefficient on RepCEO remains negative and significant. The results suggest that Republican CEOs are driving the reduction in stock price crash risk, while CEOs being Democratic has no effect on stock price crash risk. In Model (3), I revisit the model for earnings management policy using discretionary accruals. Again, I find that DemCEO is not significant, while RepCEO is still significantly related to lower levels of discretionary accruals. In Model (4), I re-examine the effects of the political preferences of CEOs on earnings restatements. The Republican CEO variable still indicates a significantly lower likelihood of an earnings restatement, while the Democratic CEO variable has an insignificant effect on earnings restatements. Combined, these results support the supposition that the conservative ideology of Republican CEOs is driving my results.

I also want to examine the affect of firm headquarters' political climates on my results. I do this in Table 5 by interacting the Republican CEO dummy with a Republican county dummy variable in the crash risk and earnings models. Crash and Restatement are originally nonlinear logit models in Tables 2 and 3. However, in this context because the variable of interest is an interaction, the coefficient must be interpreted carefully. I report results of linear probability models with the interaction terms for ease of interpretation and separately confirm the statistical significance or insignificance in unreported logit models. As seen in Table 5, the firm location political climate and the location interacted with the Republican CEO dummy are not significant in all specifications. The Republican CEO remains statistically significant in all models; however, in the Discretionary Accruals Model (3), adding the firm headquarters' political

climate results in the Republican CEO variable losing some significance. The results of this table suggest that Republican managers are individually driving the firm policies and stock price crash risk, and the political climate of the firm headquarters do not affect the results.

### **3.5 Conclusion**

In this paper, I examine the market implications for firms with Republican CEOs. Prior research suggests that Republican CEOs implement more conservative firm policies, consistent with the political ideology of the Republican party. I expect conservative policies and individual-accountability principles of Republicans to be reflected in firm returns. I specifically investigate the effect Republican managers have on stock price crash risk and earnings management.

I provide evidence that firms with Republican CEOs experience fewer stock price crashes. I also find that the return distribution of these firms is less negatively skewed, another measure of stock price crash risk. I identify additional firm policies that may contribute to fewer adverse stock price events. I show that Republican CEOs engage in less earnings management, specifically by employing lower levels of positive discretionary accruals. I also find that firms with Republican CEOs are less likely to present earnings restatements. I find that none of the results are present in firms with Democratic CEOs, and the political climate of the location of the firm headquarters does not affect stock crash risk or earnings management in our sample. I conclude then that conservative financial policies of individual Republican managers are driving the results.

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### 3.7 Appendix A: Tables

**Table 3.1**  
**Summary Statistics**

This table presents the summary statistics for our sample. The sample of firm-years comes from Execucomp (S&P 1500 firms) for the years 1993 to 2008. Utility (SIC 4000 - 4900) and finance industry (SIC 6000-6900) firms are excluded. Definitions of variables are provided in

	Obs	Mean	St. Dev.	Q1	Median	Q3
RepCEO	19221	0.377	0.485	0	0	1
RepCFO	19221	0.112	0.315	0	0	0
DemCEO	19221	0.158	0.365	0	0	0
Rep County	25617	0.33	0.047	0	0	1
Crash	27339	0.179	0.383	0	0	0
NCSkew	23953	0.04	0.723	-0.385	-0.016	0.39
Discretionary Accruals	22007	0.158	0.301	0.024	0.061	0.148
Restatement	27661	0.037	0.188	0	0	0
Log(Market Cap)	24102	7.34	1.609	6.252	7.236	8.362
Market to Book Ratio	24101	3.141	4.11	1.517	2.248	3.605
Firm-Specific Return	23983	-0.001	0.002	-0.002	-0.001	0
Firm-Specific Risk	23977	0.047	0.026	0.028	0.04	0.057
Leverage	24198	0.188	0.173	0.032	0.16	0.295
ROA	24198	0.126	0.108	0.072	0.126	0.183
CEO Vega	22825	112.372	209.944	11.569	40.029	113.508
CEO Delta	22023	772.5	2038.523	69.916	202.695	580.349
External Financing	18362	-25.769	549.622	-50.103	-0.165	35.479
Analyst Coverage	23172	2.436	0.703	1.946	2.485	2.944

**Table 3.2**  
**Skewness and Crash Risk**

This table presents the effect of Republican CEO preferences on negative conditional skewness of stock returns and on the probability of a stock crash event. Columns (1) through (3) examine negative skewness of stock returns using OLS, while Columns (4) through (7) are conditional logit models that examine firm stock crashes. Negative conditional skewness is the third moment of the distribution of transformed stock returns. Crash is a dummy variable equal to one if the any of the transformed weekly residuals from the extended market model are 3.2 standard deviations lower than the mean of the transformed weekly residuals for that year. In columns (6) and (7), crash is equal to one if the transformed weekly residuals are 4 and 5 standard deviations, respectively, lower than the mean of the transformed weekly residuals. The independent variable of interest, RepCEO, is a dummy variable = 1 if the average political preference measure of the firm CEO > 0. Definitions of control variables are provided in Appendix I. Year and firm fixed effects are included, but the results are not reported for brevity. Heteroskedasticity-consistent t-statistics (z-statistics in Crash logit models) are reported in parentheses below coefficient estimates where \*\*\*, \*\*, and \* indicate significance at the 1%, 5%, and 10% level, respectively. Standard errors are clustered by firm.

	NCSkew (1)	NCSkew (2)	NCSkew (3)	Crash (4)	Crash (5)	Crash (4 st. dev) (6)	Crash (5 st. dev) (7)
RepCEO	-0.032** (-2.37)	-0.033** (-2.42)	-0.037*** (-2.62)	-0.143*** (-3.03)	-0.153*** (-3.19)	-0.185*** (-2.66)	-0.220*** (-3.02)
RepCFO		0.018 (0.90)		0.045 (0.66)			
Lag(NCSkew)	0.006 (0.59)	0.006 (0.58)	0.005 (0.48)	0.026 (0.91)	0.044 (1.51)	0.120 (1.56)	0.104** (2.03)
CEO Turnover	0.236*** (3.35)	0.236*** (3.36)	0.217*** (2.97)	0.592*** (2.78)	0.519** (2.37)	0.6161* (1.85)	0.539 (1.51)
Log(Market Cap)	0.022*** (4.51)	0.022*** (4.38)	0.028*** (4.76)	-0.027 (-1.48)	-0.021 (-1.02)	-0.128*** (-3.42)	-0.117*** (-2.97)
Market to Book Ratio	0.002 (1.08)	0.002 (1.12)	0.002 (1.20)	0.013** (2.27)	0.013** (2.14)	0.029*** (4.01)	0.031*** (4.25)
Firm Specific Return	67.915*** (6.26)	67.876*** (6.26)	71.285*** (6.29)	172.878*** (3.85)	173.991*** (3.78)	181.578*** (6.44)	101.370*** (6.27)
Firm Specific Risk	5.057*** (5.55)	5.054*** (5.54)	5.382*** (5.63)	12.685*** (3.63)	12.875*** (3.60)	63.306*** (10.19)	65.416*** (9.79)
Leverage	-0.044 (-1.00)	-0.045 (-1.01)	-0.056 (-1.23)	0.053 (0.38)	0.069 (0.48)	1.024 (0.70)	1.142 (1.06)
ROA	0.367*** (5.19)	0.365*** (5.16)	0.383*** (5.21)	0.525** (2.30)	0.547** (2.34)	0.343*** (3.82)	0.570*** (4.27)
CEO Vega			-0.000 (-1.17)		-0.000 (-0.60)	-0.000 (0.01)	0.000 (0.04)
CEO Delta			-0.000 (-1.58)		-0.000 (0.03)	-0.000 (-0.29)	-0.000 (-0.28)
Firm Fixed Effects	Y	Y	Y	Y	Y	Y	Y
Year Fixed Effects	Y	Y	Y	Y	Y	Y	Y
Number of obs	14626	14626	13805	11782	10960	10960	10960
F	17.315	16.789	15.402				
Chi 2				318.358	314.886	426.15	405.29
P-value	0.000	0.000	0.000	0.000	0.000	0.000	0.000

**Table 3.3**  
**Earnings Management**

This table presents the effect of Republican CEO preferences on earnings management. Columns (1) through (4) examine levels of discretionary accruals using OLS, while Columns (5) and (6) are conditional logit models that model earnings restatement events. Discretionary accruals are estimated from the modified Jones (1991) model. Restatement is equal to one if the firm restated its earnings zero otherwise. The independent variable of interest, RepCEO, is a dummy variable = 1 if the average political preference measure of the firm CEO > 0. Definitions of control variables are provided in Appendix I. Year and firm fixed effects are included, but the results are not reported for brevity. Heteroskedasticity-consistent t-statistics (z-statistics in logit models) are reported in parentheses below coefficient estimates where \*\*\*, \*\*, and \* indicate significance at the 1%, 5%, and 10% level, respectively. Standard errors are clustered by firm.

	<b>Discr. Accr.</b>	<b>Discr. Accr.</b>	<b>Disc. Accr. (+)</b>	<b>Disc. Accr. (-)</b>	<b>Restatement</b>	<b>Restatement</b>
	(1)	(2)	(3)	(4)	(5)	(6)
RepCEO	-0.063*** (-3.40)	-0.056** (-2.56)	-0.108*** (-2.71)	0.0020 (0.19)	-0.267*** (-2.92)	-0.245** (-2.46)
Market to Book Ratio		0.020** (2.21)	0.036** (2.18)	0.0000 (0.16)		-0.022** (-2.10)
Stock Volatility		-15.305** (-2.18)	-18.5080 (-1.40)	-11.501** (-2.02)		31.515 (0.99)
External Financing		0.0000 (0.18)	0.0000 (0.02)	0.0000 (0.39)		0.000 (1.25)
Analyst Coverage		0.0230 (1.00)	0.0500 (1.14)	-0.0020 (-0.14)		0.081 (0.87)
ROA		-0.1530 (-1.48)	-0.2730 (-1.47)	-0.0750 (-1.01)		-1.290*** (-2.82)
Log(Market Cap)		-0.035*** (-3.08)	-0.062*** (-2.81)	-0.0090 (-1.55)		-0.146*** (-3.17)
Asset Growth		0.0140 (0.27)	-0.0080 (-0.08)	0.066*** (3.04)		0.073 (0.32)
Firm Fixed Effects	Y	Y	Y	Y	Y	Y
Year Fixed Effects	Y	Y	Y	Y	Y	Y
Number of obs	18990	14488	7409	7079	5819	4320
Chi 2					552.81	398.40
F	47.456	29.626	14.65	23.831		
P-value	0	0	0	0	0	0

**Table 3.4**  
**Republican and Democrat CEOs**

This table presents the effect of Republican and Democratic CEO preferences on negative conditional skewness of stock returns, the probability of a stock crash event, earnings management, and earnings restatements. Crash is a dummy variable equal to one if the any of the transformed weekly residuals from the extended market model are 3.2 standard deviations lower than the mean of the transformed weekly residuals for that year. Negative conditional skewness is the third moment of the distribution of transformed stock returns. Discretionary accruals are estimated from the modified Jones (1991) model. Restatement is a dummy variable equal to one if the firm restated its earnings. The independent variable of interest, RepCEO, is a dummy variable = 1 if the average political preference measure of the firm CEO > 0. Definitions of control variables are provided in Appendix I. Year and firm fixed effects are included, but the results are not reported for brevity. Heteroskedasticity-consistent t-statistics (z-statistics in Crash and Restatement logit models) are reported in parentheses below coefficient estimates where \*\*\*, \*\*, and \* indicate significance at the 1%, 5%, and 10% level, respectively. Standard errors are clustered by firm.

	<b>Crash</b>	<b>NCSkew</b>	<b>Disc. Accr.</b>	<b>Restatement</b>
	(1)	(2)	(3)	(4)
Rep CEO	-0.141*** (-2.74)	-0.030** (-2.04)	-0.047** (-2.08)	-0.212** (-1.99)
Dem CEO	0.0440 (0.64)	0.0240 (1.09)	-0.001 (-0.30)	0.110 (0.88)
Lag(NCSkew)	0.0440 (1.50)	0.0050 (0.46)		
Turnover	0.520** (2.37)	0.217*** (2.97)		
Market Cap	-0.0220 (-1.07)	0.027*** (4.65)	-0.008*** (-5.66)	-0.150*** (-3.24)
Market to Book	0.013** (2.15)	0.0020 (1.22)	0.001 (1.38)	-0.022** (-2.11)
Return	172.977*** (3.76)	70.883*** (6.25)		
Volatility	12.797*** (3.58)	5.351*** (5.60)		
Leverage	0.0640 (0.45)	-0.0590 (-1.29)		
ROA	0.551** (2.36)	0.385*** (5.24)	-0.010 (-0.64)	-1.276*** (-2.78)
CEO Vega	-0.000 (-0.61)	-0.000 (-1.19)		
CEO Delta	-0.000 (-0.00)	-0.000 (-1.64)		
External Financing			-0.000** (-2.44)	0.000 (1.25)
Total Risk			4.094*** (2.62)	30.559 (0.96)
Number of Analyst			0.009*** (3.06)	0.081 (0.87)
Total Assets			0.010* (1.79)	0.075 (0.32)
Firm Fixed Effects	Y	Y	Y	Y
Year Fixed Effects	Y	Y	Y	Y
Number of obs	10960	13805	13721	4320
F		15.23	19.48	
Chi 2	314.48			398.40
P-value	0	0	0	0

**Table 3.5**  
**Firm Headquarters**

This table presents the effect of Republican CEO preferences and Republican headquarters on negative conditional skewness of stock returns, the probability of a stock crash event, earnings management, and earnings restatements. Crash is a dummy variable equal to one if the any of the transformed weekly residuals from the extended market model are 3.2 standard deviations lower than the mean of the transformed weekly residuals for that year. Negative conditional skewness is the third moment of the distribution of transformed stock returns. Discretionary accruals are estimated from the modified Jones (1991) model. Restatement is a dummy variable equal to one if the firm restated its earnings. RepCEO is a dummy variable = 1 if the average political preference measure of the firm CEO > 0. Rep County is a dummy variable = 1 if the presidential election voting results were Republican in the county in which the firm is headquartered. Definitions of control variables are provided in Appendix I. Year and firm fixed effects are included, but the results are not reported for brevity. Heteroskedasticity-consistent t-statistics (z-statistics in Crash and Restatement logit models) are reported in parentheses below coefficient estimates where \*\*\*, \*\*, and \* indicate significance at the 1%, 5%, and 10% level, respectively. Standard errors are clustered by firm.

	<b>Crash</b>	<b>NCSkew</b>	<b>Disc. Accr.</b>	<b>Restatement</b>
	(1)	(2)	(3)	(4)
Rep CEO	-0.025*** (-2.68)	-0.048*** (-2.64)	-0.006* (-1.91)	-0.012*** (-2.67)
Rep County	-0.002 (-0.18)	0.009 (0.44)	0.006 (1.56)	0.000 (-0.07)
Rep CEO*Rep County	0.022 (1.43)	0.040 (1.45)	0.001 -0.19	0.014* (1.86)
Lag(NCSkew)	0.005 (0.99)	-0.001 (-0.07)		
Turnover	0.092** (2.27)	0.276*** (3.48)		
Market Cap	-0.002 (-0.51)	0.029*** (4.77)	-0.007*** (-4.91)	-0.005*** (-2.68)
Market to Book	0.001 (1.07)	0.002 (0.81)	0.001 (1.52)	-0.001* (-1.82)
Return	30.728*** (4.71)	73.203*** (6.03)		
Volatility	2.297*** (4.22)	5.406*** (5.37)		
Leverage	0.000 (-0.01)	-0.064 (-1.35)		
ROA	0.066* (1.70)	0.344*** (4.62)	-0.016 (-0.97)	-0.060*** (-2.82)
CEO Vega	0.000 (-0.66)	0.000 (-1.00)		
CEO Delta	0.000 (-0.08)	0.000 (-1.62)		
External Financing			-0.000*** (-2.91)	0.000 (1.54)
Total Risk			3.930** (2.44)	0.133 (0.08)
Number of Analyst			0.007** (2.34)	0.004 (0.96)
Total Assets			0.011* (1.93)	-0.005 (-0.50)
Firm Fixed Effects	Y	Y	Y	Y
Year Fixed Effects	Y	Y	Y	Y
Number of obs	10145	12830	12811	11239
F	9.84	20.31	18.86	18.51
P-value	0	0	0	0

### Appendix 1 - Variable Definitions

Variable	Definition
Rep CEO	Dummy variable = 1 if the CEO's contribution to Republican party > their contribution to Democratic party and 0 otherwise
Rep CFO	Dummy variable = 1 if the CFO's contribution to Republican party > their contribution to Democratic party and 0 otherwise
Dem CEO	Dummy variable = 1 if the CEO's contribution to Democratic party > their contribution to Republican party and 0 otherwise
Rep County	Dummy variable = 1 if the county in which the firm is headquartered voted primarily Republican in the presidential election closest to the observation year. If the observation year is directly between two election years, an average of voting records for both elections is used.
Crash	Dummy variable = 1 if firm experiences crash event in year t and 0 otherwise. A year t is defined as having a crash event if any of the transformed market model of weekly residual returns ( $\ln(1+\text{residual return})$ ) are 3.2 standard deviations below the mean of the transformed weekly residuals for that year. The extended market model: $r_{j,t} = \alpha_j + \beta_{1j}r_{m,t-2} + \beta_{1j}r_{m,t-1} + \beta_{1j}r_{m,t} + \beta_{1j}r_{m,t+1} + \beta_{1j}r_{m,t+2} + \varepsilon$
NCSkew	The negative of the conditional skewness of weekly stock returns, which is the third moment of the distribution of transformed weekly returns ( $\ln(1+\text{residual returns})$ ) for each fiscal year divided by the standard deviation cubed
Market Cap	$\text{Log}(\text{Price per share} * \text{Number of shares outstanding})$
Market to Book Ratio	Market value of equity divided by book value of equity
Firm Specific Return	Average of $\ln(1+\text{residual})$ for the year, where the residual comes from the extended market-model regression
Firm Specific Risk	Standard deviation of $\ln(1+\text{residual})$ for the year, where the residual comes from the extended market-model regression
Leverage	Total debt/Total assets
ROA	Operating income/Total assets
Discretionary Accruals	Estimated from modified Jones(1991) model: $\text{DiscAccr} = \text{TA}_{j,t}/A_{j,t-1} - [\alpha_1(1/A_{j,t-1}) + \alpha_2(\Delta\text{REV}_{j,t} - \Delta\text{REC}_{j,t}/A_{j,t-1}) + \alpha_3(\text{PPE}_{j,t}/A_{j,t-1})]$ where TA is Total Accruals, which is Income before Extraordinary Items minus Cash Flow from Operating Activities adjusted for Extraordinary Items and Discontinued Operations (Comp #123 - (Comp #308 - Comp #124))
CEO Vega	Dollar change in CEO's option holdings for a 1% change in stock return volatility.
CEO Delta	Dollar change in CEO's option holdings for a 1% change in stock price.
External Financing	Sum of net cash received from equity and debt issuance scaled by total assets.
Analyst Coverage	$\text{Log}(1 + \text{number of analysts following the firm's stock})$

## CHAPTER 4

### CONCLUSION

This dissertation consists of essays on political preferences of executives and corporate policies and outcomes. The first essay focuses on how political preferences of executives of merging firms affect merger probability and merger outcomes. I find that shared political views between executives result in a higher probability of a merger occurring. Mergers between firms with Republican executives are more risk-reducing than mergers between firms with Democratic executives or firms with differing political views. When both of the merging firms have Democratic executives, the target CEO is more likely to be retained and target abnormal stock returns around the announcement date are lower. The second essay examines if executive political preferences have an effect on firm stock price crash risk. Republican-led firms are less likely to experience a stock price crash and are less likely to engage in earnings management or restate earnings.