Essays on Political Economy of Finance

Yifan Zhou
ORCID iD: 0000-0003-2882-9497

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Department of Finance

Faculty of Business and Economics

University of Melbourne

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To mum and dad,

for their unconditional love, support, and encouragement.

Abstract

This thesis explores mechanisms that connect firms to politicians, as well as new channels through which firms benefit from being politically connected, under different ecopolitical environments. It contains three essays examining various aspects of finance at its intersection with political science.

The first essay exploits Donald Trump's nonpolitical background and surprise election victory to identify the value of sudden presidential ties among S&P 500 firms. In our setting firms did not choose to become politically connected, so we identify treatment effects comparatively free of selection bias prevalent in this literature. Firms with presidential ties enjoyed greater abnormal returns around the 2016 election. Since Trump's inauguration, connected firms had better performance, received more government contracts, and were less subject to unfavorable regulatory actions. We rule out a number of confounding factors, including industry designation, sensitivity to Republican platforms, campaign finance, and lobbying expenditures.

The second essay finds that borrowers from the same state as the Chairman of the US Senate Banking Committee, whom I term "connected", are able to borrow at spreads 14 basis points lower than other borrowers. Connected borrowers' contributions toward the Chairman are influenced by their cost of loans, but the same is not true for nonconnected borrowers. Findings suggest the Chairman is incentivized by reelection to actively help connected borrowers obtain cheaper loans. Banks that offer a larger fraction of connected loans enjoy higher future excess stock returns. Results are consistent with the existence of a *quid pro quo* relationship triangle between firms, banks, and politicians.

The third essay examines how changes in local political leadership affect firms' governance structures. Using a novel dataset, I document that following the appointment of a new city-level Chinese Communist Party (CCP) secretary, local firms increase (decrease) the fraction of directors who share a common birthplace with the incoming (departing) secretary. This appears to be a channel through which Chinese firms establish political connections. Firms with a higher percentage of birthplace-connected directors exhibit higher abnormal returns around secretary appointments. These firms enjoy superior accounting performances and attract institutional fund flows. I reject an alternative hypothesis that these directors are appointed to company boards on the "orders" of the politician, rather than actively recruited by firms.

Declaration

I declare that

i this thesis is comprised of only my original work towards the PhD, except where indicated in the Preface;

ii due acknowledgment has been made in the text to all other material used; and

iii this thesis is less than 100,000 words in length, exclusive of tables, maps, bibliographies and appendices.

Yifan Zhou

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Preface

Chapter 2 is based on an accepted version of Child, T. B., Massoud, N., Schabus, M., Zhou, Y., 2020. Surprise Election for Trump Connections. *Journal of Financial Economics*, forthcoming.

Chapters 3 and 4 comprise exclusively of my own original unpublished work.

All co-authorships are in accordance with the Graduate Research Training Policy of the University of Melbourne.

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Contents

Chapter 1

Introduction

The longer you can look back, the farther you can look forward.

Wiston Churchill, March 1944

Looking over our history, we cannot fail to recognize the close interdependency between economics and politics. Many economic turmoils have lead to or were lead to by political decisions; there are countless examples of extreme collective wealth or poverty that resulted in or were results of conflicts and wars.

Recent events serve well to remind us of this interdependent relation. In 2020, we witnessed and endured the worst pandemic in a century. Amidst this chaos, the world turned it attention to the most powerful and wealthy economy on earth – the United States of America – for example and leadership.

They failed us. The first case of Covid-19 was reported in the US on 20 January 2020. Precisely one year later, the US has over 24 million cases and more than 400,000 deaths.[1] The botched pandemic response has had severe economic consequences. Goldman Sachs predicts

[1] Coronavirus in the U.S.: Latest Map and Case Count. *The New York Times*, https://www.nytimes.com/interactive/2020/us/coronavirus-us-cases.html. Accessed 20 January 2020.

a 3.5 percent contraction of the US economy in 2020.[2] At the same time, unemployment rate is almost double its pre-pandemic level.[3] In stark comparison to the US and to almost every other major economy, China's GDP grew by 2.3 percent in 2020.[4] This phenomenal achievement can be largely attributed to its swift and forceful response to the pandemic at the very beginning of the outbreak.

The pandemic serves as a good illustration of how politics, whether it be political systems or politicians, is able to heavily influence economies.[5] This direction of influence is the primary focus of this thesis. There is a simple overarching question – *how do politics influence economics?*

The first essay (Surprise Election for Trump Connections) examines firms with business or personal connections to the Trump family prior to the announcement of Donald Trump's 2016 election campaign. The unexpected nature of Trump's 2016 election victory provides us with an identification that is free from self-selection, thus allowing for a unbiased estimation of the average treatment effect. We find that firms with presidential ties enjoyed greater abnormal returns around the 2016 election. Since Trump's inauguration, connected firms had better performance, received more government contracts, and were less subject to unfavorable regulatory actions. A number of confounding factors, including industry designation, sensitivity to Republican platforms, campaign finance, and lobbying expenditures, are ruled out.

In the second essay (Politically Influenced Bank Lending), I find that firms headquartered in the same state as the Chairman of the US Senate Banking Committee (connected

[2]US GDP will be back to pre-pandemic levels by mid-2021 under a Biden presidency and as vaccine progress continues, Goldman says. *Business Insider*, https://www.businessinsider.com/economic-outlook-gdp-recovery-biden-stimulus-coronavirus-vaccine-goldman-sachs-2020-11. Accessed 20 January 2020.

[3]The Employment Situation – December 2020. *Bureau of Labor Statistics*, https://www.bls.gov/news.release/pdf/empsit.pdf. Accessed 20 January 2020.

[4]Most Major Economies Are Shrinking. Not China's. *The New York Times*, https://www.nytimes.com/2021/01/17/business/china-economy-gdp.html. Accessed 20 January 2020.

[5]Although the focus of this thesis is the impact of politics on economics, the relation between the two is in fact one of interdependency. One prominent example of economics impacting politics is the failure of the Weimar Republic that lead to the rise of the Nazi party in Germany. Following the Wall Street Crash of 1929, the US recalled its loans to Germany. This devastated the German economy – wages fell by 39 percent between 1929 and 1932 and people in full employment fell from 20 million to 11 million. The instability of the German economy significantly enhanced the effectiveness of Nazi propaganda, and the rest is history.

firms) are able to borrow at 14 basis points lower interest rates from banks compared to firms headquartered in other states. Connected firms increase their political contributions to the Chairman proportionally to the cheapness of their loans, provided that he has not announced his retirement from the Senate. Firms in states whose previous election (for Senate seats) was closely contested are able to borrow at even lower interest rates, indicating that the Chairman is incentivized by reelection. Banks that provide more loans to connected firms experience higher excess stock returns over the following year, as compared to those that provide fewer loans. These findings are consistent with the existing of a *quid pro quo* relationship triangle between firms, banks, and politicians.

The third essay (Political Leadership and Governance Structure) explores how changes in local political leadership affect firms' board structures. Exploiting the unpredictable nature of China's local CCP secretary turnover, I find that firms in China alter the composition of their boards depending on the birthplace of their headquarter city's Communist Party (CCP) secretary. More specifically, firms increase (decrease) the percentage of directors who share a common birthplace with the incoming (departing) CCP secretary. Evidence suggest that this is to increase the probability of establish connections to the incoming political leader. Firms with a higher percentage of birthplace-connected directors exhibit superior stock returns around CCP secretary appointment announcement days. These firms also demonstrate superior accounting performance and attract institutional fund flows. Furthermore, results suggest that birthplace-connected directors are recruited by firms, rather than "appointed" to company boards by politicians. The discovery complements the existing literature on political economy in China, which so far has largely defined a firm to be politically connected if its board consists of individuals who were previously a member of China's central or local government, or the military.

The remaining chapters of the thesis is organized as follows. Chapter 2 presents the first essay, titled "Surprise Election for Trump Connections". Chapter 3 presents the second essay, titled "Politically Influenced Bank Lending". Chapter 4 presents the third essay, titled "Political Leadership and Governance Structure". Chapter 5 concludes. Reviews of the literature tailored to each essay are presented within their respective chapters.

Chapter 2

Surprise Election for Trump Connections

2.1. Introduction

The US president wields considerable authority to implement policy absent of congressional and judicial oversight (Howell, 2003; Crouch, Rozell, and Sollenberger, 2017), and a broad array of instruments have historically empowered US presidents in this regard (Relyea, 2011). President Donald J. Trump has issued a record number of executive orders carrying major economic implications for environmental protection, infrastructure development, deregulation, trade, procurement, taxation, and subsidization (NBC News, 2017). Given Donald Trump's unique industry background, much public debate has centered on whether the power of the executive office could benefit the president's personal and professional network (Wall Street Journal, 2017).[1] In this paper we endeavor to measure the financial and economic benefits of connectedness to the US president.

We exploit Donald Trump's nonpolitical background and shock election victory to leverage a natural experiment in which many firms inadvertently became politically connected. In particular, we identify individuals and companies with business ties to Donald Trump *prior* to

[1] To this end, media have scrutinized executive influence on diplomacy (New York Times, 2016; Reuters, 2017; Fox News, 2018c) and regulation (BBC News, 2017).

the announcement of his 2016 US presidential campaign. These network ties were established when Trump was a businessman and *not* a politician. His unexpected electoral victory then transformed his existing business network into a political network, effectively overnight. We exploit the sharp discontinuity in S&P 500 firms' political connectedness to identify the impact of executive branch ties on shareholder wealth and real economic outcomes. Because of the accidental nature of these political connections, we are able to identify treatment effects free of sorting on potential gains. Thus, our research design overcomes an important endogeneity concern associated with alternative measures of political connections relied upon in the literature.

We examine financial and real economic outcomes of S&P 500 firms around the 2016 presidential election. We generally find that firms connected to Trump nontrivially benefit from his presidency. First we estimate the impact of presidential ties on firm value in an event study framework. Following the 2016 election, firms connected to Trump had positive and significant cumulative abnormal returns (CARs). Under a value-weighted market model baseline, the difference in CARs between connected and nonconnected firms was approximately 2.3% over a 6-day period following the election, and 3.7% over a 21-day window. Using alternative benchmark return models, we also find significant market reactions.

We then examine the impact of presidential ties on accounting performance, procurement of government contracts, and regulatory exposure. We apply a difference-in-difference regression model to a firm-quarter panel, and analyze differences in post-election real outcomes between connected and nonconnected firms. We find that connected firms in the post-election period (Q1 2017 to Q2 2019) exhibit stronger operating performance and receive more government contracts. We also find that connected firms benefit disproportionately from the actions of US regulators. The economic magnitudes of our results are nonnegligible. In the post-election period, firms with presidential ties enjoyed (on a quarterly basis) greater sales and operating income to the tune of about $1.1 billion and $181 million, respectively. Such firms received over 50% more government contracts, enhancing the value of total procurement by approximately one-half. Finally, presidential ties led to a 7% reduction in

the likelihood of being financially penalized by regulators, and a 4% decline in the likelihood of being subject to new investigations.

Our paper is related to a large strand of literature focusing on the financial and economic benefits of political connections.[2] But surprisingly few papers have examined the value of connections to executive branch officials in developed countries (i.e., democracies with strong institutions). In this respect our findings speak to a much smaller body of evidence (Fisman et al., 2012, Acemoglu et al., 2016; Brown and Huang, 2019; Schoenherr, 2019). Our paper is perhaps closest to Brown and Huang (2019), which shows significant benefits to firms visiting government executives at Obama's White House. But our study is differentiated from Brown and Huang (2019) in two significant ways. First, we examine the implications of personal network ties to the president rather than access to White House officials. In additional tests, our findings suggest White House visits are actually inversely related to (preexisting) network ties with the president. Thus, our study documents a channel of political influence distinct from that of Brown and Huang (2019). Second, White House visits are voluntary, so the causal effects identified by Brown and Huang (2019) are not easily extended to nonvisiting firms. This relates to a much broader concern with the literature on political connections.

Previous studies have regarded firms as politically connected if they (i) make campaign contributions, (ii) invest in lobbying, (iii) employ politically connected directors, or (iv) hold meetings with politicians.[3] Each of the above activities constitute deliberate actions by firms to establish relations with politicians. It is sensible to assume firms exerting such effort are those with the most to gain from political connections. Thus, any causal effects resulting from such connections are difficult to generalize to nonconnected firms. Exploiting pseudo-

[2]For stock market valuations, see Fisman (2001); Johnson and Mitton (2003); Faccio (2006); Fan, Wong, and Zhang (2007); Claessens, Feijen, and Laeven (2008); Goldman, Rocholl, and So (2009); Fisman et al. (2012); Tahoun (2014); Akey (2015); Borisov, Goldman, and Gupta (2016); Akey and Lewellen (2017). Scholars have also studied the real economic benefits of political connections in terms of bailout funds (Faccio, 2006; Duchin and Sosyura, 2012), government contracts (Goldman, Rocholl, and So, 2013; Akey, 2015; Faccio and Hsu, 2017; Brogaard, Denes, and Duchin, 2019), performance effects (Tahoun, 2014; Akey, 2015), and credit availability (Khwaja and Mian, 2005; Claessens, Feijen, and Laeven, 2008; Fang et al., 2017).

[3]For reference, see (i) Jayachandran (2006); Claessens, Feijen, and Laeven (2008); Tahoun (2014); Akey (2015); (ii) Duchin and Sosyura (2012); Tahoun (2014); (iii) Agrawal and Knoeber (2001); Goldman, Rocholl, and So (2009); Amore and Bennedsen (2013); Cingano and Pinotti (2013), Bertrand et al. (2018); and (iv) Acemoglu et al. (2016); Brown and Huang (2019).

random or exogenous variation in these political connections (through, e.g., close elections or politician/director health) permits clean identification of the treatment effect on the treated (TT). But that effect remains conditional on firms having sorted themselves into treatment in the first place.

In our setting, firms did not choose to become politically connected. Rather, our political connection treatment is an accidental byproduct of firms having forged relations with the celebrity businessman Donald Trump. Although firms were not randomly selected into Trump's network, the underlying sorting criteria may be regarded as orthogonal to the determinants of lobbying, campaign finance, and other forms of political engagement. Thus, selection into treatment (albeit still present) is not motivated by potential gains from presidential ties. The uniqueness of our setting therefore permits identifying the average treatment effect (ATE) of political connections with less bias than many studies in this vein of inquiry.

Economists have long considered the identification challenges associated with self-sorting into treatment (see Roy, 1951). Impact heterogeneity often forms the basis of such sorting (Heckman, 2001b; 2001a), implying the TT and ATE are generally not equivalent (Heckman and Vytlacil, 2001). When individuals with large potential gains from treatment disproportionately sort themselves into treatment, identification of the TT will provide only an upper bound for the ATE. That is a typical setting in the literature on political connections. But if treatment effects vary while enrollment into treatment is *not* based on that variation in potential treatment response, then the TT is a reasonable approximation of the ATE (see Heckman and Vytlacil, 2001). Such are the conditions in our setting-the impact of presidential ties may vary across firms, but preexisting relations with Trump were surely driven by separate considerations.

In the above respect, our paper is quite close to Schoenherr (2019), which exploits a natural experiment similar to ours in which a former businessman was elected president in South Korea. Consistent with results herein, Schoenherr (2019) demonstrates benefits of connectedness for stock returns, accounting performance, and public procurement. Moreover,

that paper offers considerable insight into the mechanism by which government contracts are allocated (inefficiently) through networks. Importantly, our paper makes use of a carefully investigated personal network of the president, rather than employing the comparatively coarse proxies of (a) intergenerational alumni networks, and (b) mutual affiliation to large conglomerates. Through our personal measure of connections, we are able to demonstrate benefits of being *directly* associated with the president, which are distinct from Schoenherr's (2019) downstream network formation (in which firms benefit from network ties with president-appointed CEOs rather than network ties to the president himself). Moreover, political economic institutions in South Korea may be sufficiently unique that generalizing to the US context is not straightforward.

Related work by Acemoglu et al. (2016) identifies positive abnormal returns for firms connected to career public servant Timothy Geithner following his nomination to the US treasury secretary. Aside from the above-mentioned issue surrounding identification (and our focus on the US head of state), our paper is further differentiated by analyzing a noncrisis period of economic activity. Following Acemoglu et al. (2016), we invoke muckety.com relationship maps to construct our primary measure of personal connections. These data reveal links between Trump and various people/organizations, including many relations omitted from public profiles.

The muckety.com data were collected in journalistic fashion, record by record, over 11 years and more than 1,200 spreadsheets.[4] These relationship maps offer impressive depth and breadth of coverage but are potentially subject to the biases of individual investigative journalists. For robustness we therefore invoke a second measure of presidential ties reflecting the incidence of joint media exposure between Trump and the relevant entities. Specifically, we survey 67,000 media articles on Trump from 1980 to 2014 (i.e., before the announcement of his presidential campaign) and indicate whether any article contains a reference to the company/director/executive in question. Such joint media references are suggestive of personal or professional connections, albeit still constitute an imperfect signal. Throughout our analysis we show our results are robust to this alternative measure of presidential ties.

[4] Author correspondence with muckety.com (February 27, 2018).

We extend our main analysis in two interesting directions. As mentioned, we first examine the impact of presidential ties on White House visits and actually find a negative effect. Then, in an event study framework we analyze major developments related to the Russia investigation potentially threatening Trump's tenure in office. We find that political developments weakening Trump's grip on power result in a loss of market value for Trump-connected firms. Legal developments incriminating Trump associates, on the other hand, sometimes strengthened stock performance for Trump-connected firms. This suggests market participants may have gauged those events as evidence of Trump's immunity to legal prosecution.

Notably, the broader literature suggests a number of factors potentially confounding the relation between political connections and financial or economic performance. The importance of lobbying and campaign contributions has been established by several authors.[5] Akey and Lewellen (2017) find that policy-sensitive firms have an incentive to become politically connected. Wagner, Zeckhauser, and Ziegler (2018) find that firms with high tax burdens (foreign exposure) experienced positive (negative) CARs following the 2016 presidential election. Accordingly, throughout our main analysis we control for campaign contributions, lobbying expenditures, economic policy sensitivity, tax burden, and foreign exposure. Thus, our findings are not likely confounded by financial ties to the Republican Party, sensitivity to economic policy, or sensitivity to the Trump policy platform.

We further strengthen interpretation with two important exercises. First, we adopt Fama-French 49 industries for our main analysis. But our choice of industry classification/granularity influences benchmark controls and the legitimacy of inference. Accordingly, we demonstrate our findings are robust to a variety of alternative industry definitions, including the Global Industry Classification Standard (GICS) and Hoberg-Phillips Fixed Industry Classification (FIC) systems yielding groups of 24, 50, 69, and 100 industries. Second, our main tests do not exclude the possibility that Trump-connected firms benefit from Republican platforms in general. To rule out this interpretation, we conduct placebo

[5]See Jayachandran (2006); Claessens, Feijen, and Laeven (2008); Duchin and Sosyura (2012); Tahoun (2014); Akey (2015).

tests around three earlier presidential elections. We find little evidence to suggest firms connected to Trump benefit from the prospect of Republican leadership. This differentiates our findings from earlier work establishing the financial impact of Republican presidencies on equity markets (Snowberg, Wolfers, and Zitzewitz, 2007), politically sensitive sectors (Knight, 2006), and firms with policy-sensitive characteristics (Wagner, Zeckhauser, and Ziegler, 2018).

The remainder of our paper is structured as follows. Section 2.2 describes our primary data on Trump's personal network, procurement contracts, regulatory actions, White House visits, campaign contributions, lobbying expenditures, and secondary source financial data. Section 2.3 examines the market reaction around Trump's unexpected rise to the US presidency. Section 2.4 invokes panel tests to examine real economic effects of presidential ties. Section 2.5 extends our main analysis, Section 2.6 conducts robustness, and Section 2.7 concludes.

2.2. Data

Our sample consists of firms comprising the S&P 500 index at the time of Trump's electoral victory. Firms in the S&P 500 often receive the most attention from analysts and investors, and the market capitalization of the index represents around 80% of the US equity market. Our sample spans the period Q1 2014 to Q2 2019. Firms are categorized according to the Fama-French 49 industries. We exclude four firms having undergone major restructuring in the year preceding the 2016 presidential election, leaving 496 sample firms.

In the following subsections we describe our key variables from primary and secondary sources (formal definitions are consolidated in Table 2.A1). Daily stock returns are from the Center for Research in Security Prices (CRSP).[6] Accounting data and firm fundamentals (i.e., *Book-to-market, Leverage, Assets, Revenue, Operating income*, and *Net income*) are

[6]When a company has multiple share classes, we include only the class with the largest average daily trading volume in 2016.

collected from Compustat.[7] Descriptive statistics for all variables are presented in Panel A of Table 2.1. Panel B of Table 2.1 tests for covariate balance in the pre-election period. Connected firms have significantly greater book-to-market ratios, leverage, and assets, and these fundamentals are included as baseline controls throughout our analysis.

2.2.1 Trump's business network

Following Acemoglu et al. (2016), we construct Trump's business network using relationship maps assembled by a group of independent journalists at muckety.com. This database reflects individual associations of public figures across government, business, and nonprofit organizations. The journalists at muckety.com uncovered network relations among public figures using documents from the White House, Congress, Federal Election Commission (FEC), Securities and Exchange Commission (SEC), and news reports from outlets such as the New York Times, Washington Post, and Politico. Prior to Trump's campaign announcement, we record the network connections of Donald Trump, Ivanka Trump, and Jared Kushner - the family members involved in his business empire, his presidential campaign, and ultimately his White House administration.

We consider network connections at both the firm and individual level. A firm is deemed connected to Trump if (a) it had direct business relations with the Trump Organization; or (b) a director/executive had personal connections with the Trump family. For example, Kenneth Duberstein – a Mar-a-Lago member – was a director of Boeing and Travelers in 2016. We therefore regard both Boeing and Travelers as connected to Trump. In our sample (see Table 2.1, Panel A), 64 S&P 500 firms are connected to Trump, based on the indicator (*Connection*) defined above.[8] The Fama-French 49 industries accounting for the most connected firms are trading (14%), banking (13%), insurance (11%), and communication (9%).

[7]For the purpose of consistency with other data items, we match companies' fiscal quarter to calendar quarter based on Compustat's classification. For example, if a company's fiscal year-end is April 30, we would classify its fiscal Q1 (May 1 to July 31) as calendar Q2, since two-thirds of its fiscal Q1 fall in calendar Q2.

[8]Using instead a count measure for the number of connections with the Trump Organization/family yields very similar results throughout our analysis.

Table 2.1

Descriptive statistics and covariate balance. The sample consists of firms comprising the S&P 500 at the time of Trump's 2016 electoral victory. We exclude four firms having undergone restructuring during our sample period (Q1 2014 - Q2 2019), leaving 496 listed companies. A firm is considered to be connected if it had network ties to Donald Trump prior to the announcement of his 2016 presidential campaign. Variable definitions can be found in Table 2.A1. Panel A reports full sample descriptive statistics for all variables. Panel B tests for covariate balance in the pre-election period. Static controls are measured at fiscal year-end prior to the 2016 election. Dynamic controls are measured over the 12 quarters preceding Trump's inauguration.

	N	Mean	S.D.	p1	p50	p99
Panel A: Descriptive statistics						
Value-weighted MM CAR (0, 5)	496	0.35	6.38	−11.85	0.08	16.48
Value-weighted MM CAR (0, 10)	496	0.35	7.67	−18.04	0.17	19.89
Value-weighted MM CAR (0, 20)	496	0.59	9.65	−19.54	−0.41	22.68
Connection	496	0.13	0.34	0.00	0.00	1.00
News	496	0.16	0.36	0.00	0.00	1.00
Campaign contribution ($M)	496	0.03	0.24	0.00	0.00	0.50
Republican	496	0.39	0.49	0.00	0.00	1.00
Policy sensitivity	496	0.37	0.48	0.00	0.00	1.00
Book-to-market	10 365	0.38	0.33	−0.10	0.31	1.40
Leverage	10 365	0.46	1.39	0.00	0.25	3.22
Assets (log $M)	10 365	10.34	1.02	8.60	10.19	13.35
Foreign exposure	10 365	0.21	0.32	0.00	0.00	1.00
Tax burden	10 365	0.22	0.20	0.00	0.20	1.00
Lobbying ($M)	10 365	0.52	0.91	0.00	0.11	4.71
Revenue ($Bn)	10 365	5.47	8.66	0.24	2.38	49.60
Operating income ($Bn)	10 365	0.84	1.42	−0.35	0.37	9.18
Net income ($Bn)	10 365	0.51	0.98	−1.33	0.21	5.73
Procurement contracts	10 365	1.58	2.12	0.00	0.00	8.15
Procurement value ($M)	10 365	30.28	125.03	0.00	0.00	948.88
Procurement value/revenue (%)	10 365	1.24	7.57	0.00	0.00	21.06
Payment	10 365	0.03	0.16	0.00	0.00	1.00
Investigation	10 365	0.01	0.10	0.00	0.00	1.00
WH visits dummy	4730	0.16	0.36	0.00	0.00	1.00
WH visits number	4730	2.76	9.81	0.00	0.00	52.00
WH visits percentile	4730	50.11	16.94	33.33	49.48	98.54

Panel B: Covariates (pre-election)

	Connected				Nonconnected				
	N	Mean	Median	S.D.	N	Mean	Median	S.D.	Diff. in means
Campaign contribution ($M)	64	0.05	0.01	0.09	432	0.03	0.00	0.25	0.02
Republican	64	0.13	0.00	0.33	432	0.43	0.00	0.50	−0.31***
Policy sensitivity	64	0.38	0.00	0.49	432	0.37	0.00	0.48	0.00
Book-to-market	726	0.47	0.34	0.41	5008	0.37	0.31	0.30	0.11***
Leverage	726	0.68	0.33	1.11	5008	0.40	0.23	1.25	0.28***
Assets (log $M)	726	11.17	11.07	1.23	5008	10.12	9.99	0.89	1.05***
Foreign exposure	726	0.29	0.18	0.32	5008	0.29	0.10	0.34	0.00
Tax burden	726	0.25	0.23	0.19	5008	0.21	0.20	0.18	0.03***
Lobbying ($M)	726	1.17	0.72	1.31	5008	0.44	0.10	0.79	0.73***

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

2.2.2 Trump news

Our secondary measure of presidential ties is an indicator (*News*) for whether the entity in question was previously referenced alongside Trump in the news. To build this indicator, we download all media articles from LexisNexis that twice mention Trump and are dated prior to his campaign announcement. This yields approximately 67,000 articles spanning major US media outlets, dating as far back as 1980. From each article we extract all names of individual and company entities. We search over the set of company names for matches with S&P 500 firms and their subsidiaries. When a match is detected, our indicator takes the value of one for the corresponding S&P 500 firm. We next search over the set of individual names extracted from our articles. We cross-check those names against a BoardEx list of S&P 500 company executives and board members, current for the 2016 election date. When a match is detected, our indicator again takes the value of one for the corresponding S&P 500 firm. For example, Steve Burke was CEO of NBC when "The Apprentice" was broadcast. Accordingly, Trump and Burke were frequently mentioned together in the media. As of 2016, Burke is a director at JP Morgan and vice president of Comcast. Hence, our indicator takes the value of one for both JP Morgan and Comcast, both of which are also deemed connected in the muckety.com archives.

Our secondary measure of presidential ties thus indicates whether a company or its contemporary directors or executives had reason to be mentioned in historical media coverage of Trump. This measure is suggestive of network ties to the president, but it is certainly an imperfect signal. For example, some individuals are simply compared to Trump by news commentators or are reported to attend the same large-scale event as Trump. These associations do not constitute meaningful connections, so we strive to remove such weak signals with a manual filter, leaving 78 firms deemed connected to Donald Trump through the news archives.

2.2.3 Government contracts

Procurement data are gleaned from the US government's Federal Procurement Data System (FPDS) and usaspending.gov. For our sample period we gather information on every (non-classified) government contract awarded to S&P 500 firms and their subsidiaries (contracts awarded to the latter are attributed to the former). Our data indicate around 80% of S&P 500 firms receive procurement contracts during the sample period, which is consistent with prior studies (e.g., Goldman, Rocholl, and So, 2013; Tahoun, 2014). Across our sample we see at least one contract being awarded in 50% of firm-quarters. We build variables that capture the number and dollar amount of procurement contracts signed (labeled *Procurement contracts*, *Procurement value*, and *Procurement value/revenue*, respectively). Most contracts are awarded by the Department of Defense, the Department of Energy, or the Department of Veteran Affairs.

2.2.4 Regulatory actions

We obtain data on regulatory actions from Capital IQ Key Developments - a repository of business news released by media outlets, firms, and regulatory agencies. We start by obtaining all news related to US regulatory actions toward S&P 500 firms (by, e.g., the SEC, Department of Justice (DoJ), or Environmental Protection Agency (EPA)). Two-fifths of S&P 500 firms face some regulatory action over our sample period; among these we observe an average of four news items per firm. We sort regulatory news into two categories (for which there are sufficient observations to analyze): (i) the opening of an investigation/inquiry into firm activity; and (ii) payments by firms to regulators in the form of a penalty, fine, or settlement.[9] To measure regulatory actions against each firm, we build firm-quarter indicators for categories (i) and (ii), labeled *Investigation* and *Payment*, respectively. In 107 (286) firm-quarters, *Investigation* (*Payment*) is nonzero.

[9] A theoretical distinction between these outcomes is difficult since firms may settle to avoid publicity or other adverse consequences of penalties. We do not have information regarding the magnitudes of settlements or penalties.

2.2.5 White house access

We source White House visitor logs under both the Obama and Trump presidencies. Obama introduced a voluntary disclosure policy allowing public access to detailed information of (nonclassified) visits. Donald Trump, by contrast, did not voluntarily release visitor logs. We gather information on Trump White House visits from two sources. First, Politico assembled visitors data based on public information of meetings with Donald Trump between inauguration and March 2018. Second, ProPublica filed a Freedom of Information Act request, which led to the release of visitor records between inauguration and November 2017. Altogether we have White House visitor logs data for five quarters of Trump's presidency. To build a comparable reference under the Obama White House, we use visitor logs from the first five quarters of his second term.

One-third of S&P 500 firms visited the White House during our sample period, and the Obama Administration accounts for a majority of overall visits. We build an indicator variable - *WH visits dummy* - equal to one if a firm visits the White House in a particular quarter and zero otherwise. We also build a count variable - *WH visits number* - capturing the total number of visits per quarter. Finally, we construct a quarterly percentile rank measure - *WH visits percentile* - to ensure our results are not sensitive to level shifts in visitation data between the Trump and Obama periods.

2.2.6 Potential political economic confounders

One factor potentially confounding the estimated impact of presidential ties on firm outcomes is the extent of lobbying activity. Accordingly, lobbying expense data are gathered from the Center for Responsive Politics. Under the Lobbying Disclosure Act of 1995, lobbying firms must register on behalf of their client if they received more than $3,000 in income from that client in any given quarter. For companies employing in-house lobbyists, they must register if they spend $12,500 in a given quarter. Registered firms then report lobbying expenditures on a quarterly basis, rounded to the nearest $10,000. Spending by subsidiaries

are included as part of the parent company's lobbying expense (labeled *Lobbying*). During 2016, connected firms spent approximately $5 million on lobbying - more than three times the amount spent by nonconnected firms. Lobbying figures are similar to those reported in related studies (e.g., Tahoun, 2014; Brown and Huang, 2019).

Similar to the above, campaign contributions may constitute an additional correlate of presidential ties that can also influence firm-level outcomes. Political contributions data are obtained from the FEC, which provides transaction-level data by election cycle. Individual donors to federal election campaigns are required to report their employer and job title to the FEC. For each S&P 500 firm we consider contributions to Trump's 2016 presidential campaign by its employees. To this end we construct the variable *Campaign contribution* capturing total contributions made to Trump's PACs. We find Trump-connected firms did not donate significantly more to his presidential campaign than nonconnected counterparts.[10]

Despite the observation above, one may nevertheless suspect Trump-connected firms are Republican leaning and that such companies generally benefit under a Republican president and Congress. To control for political partisanship, we collect contribution data also for the 2012 and 2014 federal elections, calculating each firm's contributions to Republican and Democratic candidates. A firm is classified as *Republican* if more than 70% of its employees' congressional campaign contributions were toward Republican candidates.[11] Notably, we find Trump-connected firms are significantly *less* likely to be Republican leaning under this definition. Taken together, Trump's network appears to be bipartisan in nature.

Because firms resilient to economic uncertainty may perform better around the 2016 election, we invoke the Baker, Bloom, and Davis (2016) Economic Policy Uncertainty Index (EPUI). The EPUI is a macroeconomic time-series index based on the frequency of news articles (among ten major US newspapers) indicating uncertainty about economic policy, expiring tax provisions, and dispersion in analysts' forecasts of macroeconomic indicators.

[10]Perhaps prior business contacts felt little need to contribute to Trump's campaign to benefit from his presidency. Or perhaps those with presidential ties simply expected Trump to lose (thus reflecting a rational cost-benefit analysis of campaign contributions). After all, Zingales (2017) shows Trump did not have endorsements from PACs at any of the top 100 US corporations.

[11]The results of our analysis are robust to alternative thresholds (e.g., 50%, 60%, 80%) and a continuous measure.

To identify policy-sensitive firms, we follow Akey and Lewellen (2017), regressing each firm's daily stock returns on the daily EPUI for 18 months preceding the 2016 presidential election. We then construct a *Policy sensitivity* dummy indicating whether a firm's stock returns are significantly correlated with policy uncertainty at the 10% level of significance.[12] We do not find a significant difference in policy sensitivity among connected and nonconnected firms.

Wagner, Zeckhauser, and Ziegler (2018) find that firms with high tax burden and low foreign exposure benefited from Trump's election. Thus, we control for these characteristics throughout our analysis. We construct a variable measuring *Tax burden* operationalized as cash ETR.[13] We measure *Foreign exposure* as pretax income from foreign operations, divided by total pretax income. Connected firms have significantly higher tax burden than nonconnected firms in the pre-treatment period.

2.3. Value of political connections

To determine the financial value of connections to the US president, we check whether network ties to Donald Trump are associated with positive stock returns following the presidential election of November 8th, 2016. To isolate the impact of new information (e.g., regarding political connections) on stock prices, we calculate CARs using the market model based on the CRSP value-weighted index. Following standard practice in the literature, we adopt a 255-trading day estimation window ending 46 days prior to the event day. For each firm, we require a minimum of 40 observations in the estimation window.

Fig. 2.1 plots CARs for connected and nonconnected firms over a [-20, 20] trading day window surrounding the election results announcement. Visually, the two groups of firms have roughly comparable CARs prior to the announcement day but significant post-election

[12]Specifically, we verify the significance level of β_i in the following statistical model: $R_{it} = \alpha_i + \beta_i EPUI_t + \varepsilon_{it}$. Here R is the stock return; t and i index the day and firm, respectively. We find (perhaps unsurprisingly) all policy-sensitive firms' share prices react negatively to macroeconomic uncertainty.

[13]We use quarterly tax expense as a proxy for tax paid if the firm has yet to pay their annual taxes on profits. This is commonly the case for calendar year 2018. Inferences are unchanged when we employ GAAP Effective Tax Rate (ETR).

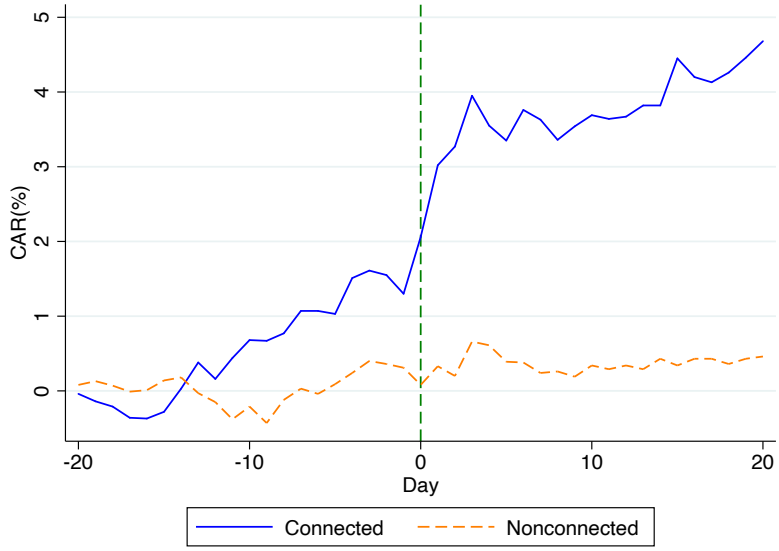

Fig. 2.1: Cumulative abnormal returns (CARs) around the 2016 US presidential election. Day 0 is when election results were announced - November 9, 2016. A firm is considered to be connected if it had network ties to Donald Trump prior to the announcement of his 2016 presidential campaign. CARs are calculated using the value-weighted market model. We adopt a 255-trading day estimation window ending 46 trading days prior to the event day. For each firm, we require a minimum of 40 observations in the estimation window.

divergence. In Table 2.2 we find, regardless of the estimation window, post-election CARs for connected firms are positive and significant.[14] These simple tests suggest pre-existing relationships with Donald Trump generated value to shareholders following his election to the presidency. We next examine the relation between CARs and presidential ties within a multivariate framework by estimating the cross-sectional model:

$$CAR_{ij} = \alpha_j + \beta_1 T_{ij} + \boldsymbol{\beta_2'} G_{ij} + \boldsymbol{\beta_3'} Z_{ij} + \varepsilon_{ij}, \tag{2.1}$$

where CAR is estimated for the event windows [0, 5], [0, 10], and [0, 20]; i indexes the firm; j indexes the industry; T is our treatment indicator for *connection* to Trump; G is a set of potential political economic confounders (*Campaign contribution*, *Republican*,

[14]Under the Patell Z-score, each security's abnormal return is normalized by its estimation period standard deviation to limit the impact of stocks with high return volatility. We also report the standardized cross-sectional Z-score (*StdCsect Z*) to account for event-induced volatility and serial correlation (Boehmer, Masumeci, and Poulsen, 1991). In addition, we conduct a nonparametric test in the form of the generalized sign test (*Gen sign Z*), which judges the proportion of positive and negative CARs (*Pos:Neg*) against an assumed 50% split under the null hypothesis of no reaction to the event (Cowan, 1992).

Lobbying, *Policy sensitivity*, *Tax burden*, and *Foreign exposure*); Z is our set of standard baseline controls (*Book-to-market*, *Assets*, and *Leverage*); and standard errors are clustered by industry (Fama-French 49). Control variables are measured at fiscal year-end before the 2016 presidential election.

Table 2.2
Market reaction to Donald Trump's 2016 election victory. Cumulative abnormal returns (CARs) are calculated using the value-weighted market model. Day 0 is when election results were announced (November 9, 2016). We adopt a 255-trading day estimation window ending 46 trading days prior to the event day. For each firm, we require a minimum of 40 observations in the estimation window. A firm is considered to be connected if it had network ties to Donald Trump prior to the announcement of his 2016 presidential campaign. The *Pos:Neg* column indicates the ratio of firms with positive vs. negative CARs over the corresponding event window. Subsequent columns report the Patell Z-score, the standardized cross-sectional Z-score, and the generalized sign test, respectively.

Window	N	Mean CAR	Pos:Neg	Patell Z	StdCsect Z	Gen sign Z
Panel A: Full sample						
[0, 5]	496	0.35%	249:247	0.165	0.081	0.002
[0, 10]	496	0.35%	251:245	−0.754	−0.443	0.182
[0, 20]	496	0.59%	244:252	−0.317	−0.205	−0.447
Panel B: Connected						
[0, 5]	64	2.04%	38:26	4.896***	2.260**	1.436*
[0, 10]	64	2.38%	40:24	4.072***	2.338**	1.936*
[0, 20]	64	3.39%	37:27	4.369***	2.648***	1.186
Panel C: Nonconnected						
[0, 5]	432	0.10%	211:221	−1.707*	−0.899	−0.550
[0, 10]	432	0.05%	211:221	−2.375**	−1.407	−0.550
[0, 20]	432	0.17%	207:225	−2.021**	−1.319	−0.935

* $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$

OLS regression results based on our primary measure of presidential ties (from muckety.com) are presented in Panel A of Table 2.3. Corresponding results based on our secondary measure (derived from media archives) are reported in Panel B. Across all event windows in Table 2.3 we observe an economically and statistically significant impact of presidential ties on stock returns. Consistent with Wagner, Zeckhauser, and Ziegler (2018), abnormal returns for Trump-connected firms grow as markets digest information. This can be seen by comparing coefficient magnitudes across event windows in both panels. From Panel A, Trump-connected firms enjoyed a minimum CAR of 2.3% over a 6-day window (columns 1 and 2), and 3.7% over a 21-day window (columns 5 and 6). Given that the average connected firm in our sample has a market capitalization of $68 billion, these translate to $1.6 and $2.5

billion in wealth creation for shareholders, respectively.[15]

Table 2.3
The impact of presidential ties on CARs during the 2016 election. This table analyzes the determinants of cross-sectional variation in CARs around the 2016 election. CARs are calculated using the value-weighted market model. Panel A (B) reports results of Eq. (2.1) using *Muckety* (*News articles*) to measure presidential ties. Firm fundamentals and political economic confounders are used as controls. Control variables are measured at fiscal year-end before the 2016 presidential election. Day 0 is when election results were announced (November 9, 2016). A firm is considered to be connected if it had network ties to Donald Trump prior to the announcement of his 2016 presidential campaign. Industry fixed effects are based on the Fama-French 49 industry classification. Detailed definitions of variables can be found in Table 2.A1. t-statistics are in parentheses. Standard errors are clustered by industry.

	[0, 5]		[0, 10]		[0, 20]	
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: Muckety						
Connection	2.255**	2.367**	2.782**	3.168**	3.664**	3.895***
	(2.02)	(2.17)	(2.19)	(2.65)	(2.47)	(2.75)
Book-to-market	3.773***	3.532**	4.411***	4.080**	7.821***	7.446***
	(2.69)	(2.44)	(2.88)	(2.56)	(4.60)	(4.05)
Leverage	0.672***	0.629***	0.686***	0.618***	0.508	0.409
	(7.24)	(5.24)	(3.71)	(2.94)	(1.48)	(1.13)
Assets (log)	-1.240***	-1.508***	-1.521***	-1.714***	-2.033***	-2.280***
	(-4.23)	(-4.31)	(-4.33)	(-4.69)	(-4.08)	(-4.28)
Campaign contribution		1.335**		1.853**		1.821**
		(2.22)		(2.15)		(2.16)
Republican		0.833		1.497*		1.316
		(1.59)		(1.89)		(1.43)
Policy sensitivity		-1.575**		-1.954**		-3.212***
		(-2.16)		(-2.16)		(-3.72)
Foreign exposure		-1.138		-2.044		-2.508
		(-0.99)		(-1.60)		(-1.60)
Tax burden		2.178		2.572		3.268
		(0.74)		(0.74)		(0.79)
Lobbying		0.105		0.070		0.100
		(1.49)		(0.71)		(1.10)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
N	496	496	496	496	496	496
R^2	0.446	0.473	0.457	0.493	0.480	0.519
Panel B: News articles						
News	1.302***	1.258***	2.255***	2.242***	3.234***	3.143***
	(2.83)	(2.77)	(3.12)	(3.18)	(4.15)	(4.08)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Confounders	No	Yes	No	Yes	No	Yes
N	496	496	496	496	496	496

[15] In Table 2.A2 we test market reactions using raw returns and abnormal returns based on the equal-weighted market model, the Fama-French three-factor model, and the Fama-French-Carhart four-factor model. Estimated effects are sizable and significant under most alternative specifications.

Table 2.3 *(continued)*

	[0, 5]		[0, 10]		[0, 20]	
	(1)	(2)	(3)	(4)	(5)	(6)
R^2	0.439	0.466	0.455	0.488	0.479	0.518

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Interestingly, significant CARs for Trump-connected firms emerge only three to four days after the election. This likely reflects a delay in information processing by financial markets, reminiscent of Wagner, Zeckhauser, and Ziegler (2018).[16] Borrowing their logic, market participants may be slow to update their valuations of firms with preexisting ties to president Trump for two reasons. First, information on corporate executives' relations with Donald Trump, although public, is not particularly simple to gather (see, e.g., Sections 2.1 and 2.2). Second, it is not obvious how preexisting ties to the president may translate into higher earnings for connected firms. In fact, such a projection involves considerable conjecture surrounding the effects we painstakingly demonstrate (retroactively) in the following analysis. Given the near-consensus view that Trump would lose the election, it is further possible that the market began considering Trump's connections and their implications only *after* election day. Up to and including election day, the market even seemed confused about the impact of Trump's presidency on *average* stock returns (Wolfers and Zitzewitz, 2018).

2.4. Real outcomes

In the preceding section we establish a connection between abnormal stock returns and network ties to the president. To determine why the market attributes value to presidential ties, we test the impact of political connectedness on real outcomes including firm performance, government contract procurement, and regulatory actions. This analysis invokes a difference-in-difference framework in which we estimate the following model:

$$Y_{it} = \alpha_i + \beta_1 T_i P_t + \boldsymbol{\beta_2'} G_{it} + \boldsymbol{\beta_3'} Z_{it} + \gamma_t + \epsilon_{it}, \tag{2.2}$$

[16] Their findings demonstrate that the market value of firms with large foreign assets and large net deferred tax liabilities were both significantly affected by Trump's election. The corresponding impact on CARs, however, remained undetectable on day one following the election.

where Y is the real outcome; i and t, respectively, index firm and quarter; T is the *Connection* indicator; P is the post-election indicator (where *Post* equals one from Q1 2017 onward); G is a set of potential confounding variables (*Lobbying*, *Tax burden*, and *Foreign exposure*); and Z includes our baseline fundamentals (*Book-to-market*, *Assets*, and *Leverage*). Standard errors are again clustered by Fama-French 49 industries.[17]

2.4.1 Firm performance

Prior literature has shown firm performance benefits from campaign contributions to members of US Congress (Tahoun, 2014; Akey, 2015), and from indirect network associations with the South Korean president (Schoenherr, 2019). It remains unclear, however, whether performance benefits extend to US executive branch connections. Panels A and B of Table 2.4 contain our results for the impact of executive branch connections on accounting measures of performance. The effects of presidential ties on revenue and operating income are positive and statistically significant. Columns 1 and 2 suggest connected firms had \$0.8 to \$1.1 billion more sales per post-election quarter, relative to a pre-election mean of \$10.4 billion. Alternatively, columns 3 and 4 indicate post-election revenue growth of 9% for connected companies. Columns 5 and 6 demonstrate firms with presidential ties also had higher operating income by \$121 to \$181 million – an increase of 6 to 9% relative to their pre-election mean.

The insignificant impact of presidential ties on net income (columns 7 and 8) warrants further discussion. Connected firms' average net income decreased significantly during 2017. Upon closer examination, we see that this is primarily due to these firms incurring significantly negative special items, which includes expenses such as writing off assets, discontinued operations, and other one-off expenses. One possible explanation is the following: connected firms, in anticipation of the Tax Cuts and Jobs Act of 2017 (which decreased companies' benefits from tax shields starting in 2018), decided to use special item expenses to decrease

[17]The results of this section are robust to the inclusion of industry-quarter fixed effects to Eq. (2.2), accounting for potentially spurious industry shocks. Our results are also upheld under a parsimonious version of Eq. (2.2) in which all controls (including fixed effects) are omitted from the right-hand side.

their taxable income before the new law came into effect.

Table 2.4
The impact of presidential ties on firm performance. In a difference-in-difference framework this table examines performance outcomes following the 2016 presidential election. Dependent variables include *Revenue*, *Operating income*, and *Net income*, all expressed in billion dollar terms. *Post* indicates post-election periods (from Q1 2017 onward). Panel A (B) reports results using *Muckety* (*News articles*) to measure presidential ties. A firm is considered to be connected if it had network ties to Donald Trump prior to the announcement of his 2016 presidential campaign. Variable definitions can be found in Table 2.A1. The bottom row of each panel reports within-R^2. t-statistics are in parentheses. Standard errors are clustered by industry (Fama-French 49).

	Revenue		ln(Revenue)		Operating income		Net income	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Panel A: Muckety								
Connection * Post	1.096***	1.089***	0.083**	0.083**	0.181**	0.176**	0.082	0.082
	(2.92)	(2.85)	(2.06)	(2.14)	(2.21)	(2.11)	(1.09)	(1.11)
Book-to-market	1.073***	1.057***	0.349***	0.343***	0.039	0.039	0.064	0.059
	(3.14)	(3.15)	(5.42)	(5.29)	(0.79)	(0.79)	(0.83)	(0.75)
Leverage	-0.021	-0.021	-0.012	-0.012	-0.013	-0.012	-0.056	-0.056
	(-0.54)	(-0.56)	(-1.09)	(-1.17)	(-0.75)	(-0.68)	(-1.66)	(-1.65)
Assets (log)	1.859***	1.844***	0.463***	0.461***	0.383***	0.380***	0.311***	0.306***
	(4.49)	(4.56)	(10.51)	(10.37)	(7.10)	(7.39)	(8.06)	(8.15)
Foreign exposure		0.216		0.107***		-0.009		0.054
		(1.09)		(3.13)		(-0.20)		(0.83)
Tax burden		-0.413*		-0.033		-0.180***		-0.102
		(-1.72)		(-0.72)		(-2.73)		(-1.31)
Lobbying		0.010		-0.003		-0.012		0.016
		(0.07)		(-0.19)		(-0.30)		(0.36)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year-quarter FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	10365	10365	10365	10365	10365	10365	10365	10365
R^2	0.148	0.150	0.093	0.095	0.070	0.074	0.036	0.037
Panel B: News articles								
News * Post	0.817**	0.804**	0.082***	0.079***	0.126*	0.121*	0.063	0.061
	(2.28)	(2.21)	(2.96)	(2.89)	(1.79)	(1.69)	(1.04)	(0.99)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes
Year-quarter FE	Yes	Yes	Yes	Yes	Yes	Yes	No	Yes
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Confounders	No	Yes	No	Yes	No	Yes	No	Yes
N	10365	10365	10365	10365	10365	10365	10365	10365
R^2	0.143	0.145	0.093	0.095	0.068	0.072	0.035	0.037

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

2.4.2 Government contracts

Connections to executive branch officials can enable firms to strengthen procurement of government contracts. Schoenherr (2019) demonstrates this convincingly for firms with network ties to the South Korean president; while Brown and Huang (2019) show procurement benefits stemming from visits to the Obama White House. Due to differences in institutional context and the nature of political connections under study, the aforementioned effects do not necessarily translate to the unexpectedly formed US presidential ties we consider. Accordingly, we examine the impact of Trump connections on the volume and value of procurement contracts.

Results in Panel A of Table 2.5 show that presidential ties provide connected firms with about 50% more contracts in the average post-election quarter (see columns 1 and 2). Moreover, presidential ties lead to an increase in the value of total contracts of over one-half (columns 3 and 4), amounting to 4.8% of total revenue (columns 5 and 6). Panel B results based on our secondary measure of presidential ties are weaker but mostly robust. Due to data availability we are unable to assess whether connected firms benefit due to reduced information asymmetries or preferential treatment (as in Schoenherr, 2019). Our analysis nonetheless demonstrates that pre-existing presidential ties do facilitate procurement of government contracts in the US setting.

2.4.3 Regulatory actions

Large listed firms are regularly scrutinized by various government agencies (e.g., the SEC, DoJ, FTC, and EPA) and can therefore benefit immensely from regulatory relief. Political capture theory (e.g., Stigler, 1971) would suggest firms connected to the president may (i) receive preferential treatment by regulators, or (ii) enjoy informational advantages when dealing with regulators. After all, politicians can interfere with SEC investigations, use budget allocations to control the SEC, or influence the careers of SEC officials (Weingast, 1984). Firms that spend substantially on lobbying and campaign contributions have a lower

Table 2.5
The impact of presidential ties on procurement of government contracts. In a difference-in-difference framework this table examines procurement outcomes following the 2016 presidential election. Dependent variables include the number and value of contracts procured. *Post* indicates post-election periods (from Q1 2017 onward). Panel A (B) reports results using *Muckety* (*News articles*) to measure presidential ties. A firm is considered to be connected if it had network ties to Donald Trump prior to the announcement of his 2016 presidential campaign. Variable definitions can be found in Table 2.A1. The bottom row of each panel reports within-R^2. t-statistics are in parentheses. Standard errors are clustered by industry (Fama-French 49).

	Procurement					
	Contracts		Value		Value/Revenue	
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: Muckety						
Connection * Post	0.451***	0.452***	0.439***	0.439***	4.818**	4.836**
	(7.61)	(7.61)	(6.19)	(6.13)	(2.15)	(2.16)
Book-to-market	-0.010	-0.013	-0.014	-0.015	-0.079	-0.128
	(-0.14)	(-0.16)	(-0.18)	(-0.20)	(-0.26)	(-0.44)
Leverage	0.011	0.011	-0.021	-0.021	-0.024	-0.028
	(0.50)	(0.53)	(-1.07)	(-1.07)	(-0.52)	(-0.58)
Assets (log)	-0.030	-0.035	-0.030	-0.032	-0.546**	-0.586**
	(-0.55)	(-0.64)	(-0.74)	(-0.78)	(-2.15)	(-2.25)
Foreign exposure		-0.051		-0.002		0.351
		(-0.99)		(-0.08)		(0.95)
Tax burden		-0.039		-0.005		-0.194
		(-1.12)		(-0.17)		(-0.88)
Lobbying		0.044*		0.015		0.274
		(1.79)		(0.84)		(1.43)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Year-quarter FE	Yes	Yes	Yes	Yes	Yes	Yes
N	10365	10365	10365	10365	10365	10365
R^2	0.056	0.058	0.071	0.071	0.042	0.043
Panel B: News articles						
News * Post	0.123*	0.124*	0.184***	0.184***	-0.032	-0.039
	(1.74)	(1.75)	(2.74)	(2.73)	(-0.05)	(-0.07)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Year-quarter FE	Yes	Yes	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Confounders	No	Yes	No	Yes	No	Yes
N	10365	10365	10365	10365	10365	10365
R^2	0.036	0.037	0.054	0.054	0.011	0.011

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

hazard rate of being detected for fraud, and incur lower costs from SEC enforcement actions (Yu and Yu, 2011; Correia, 2014). Moreover, Brown and Huang (2019) find that firms with access to White House officials benefit from more positive regulatory developments. Given the above, we seek to determine whether pre-existing ties to the US president lead to favorable regulations in our setting.

In Table 2.6 we operationalize regulatory relief as fewer investigations or fewer payments. Irrespective of how presidential ties are measured, we find them to confer regulatory relief. Columns 1 and 2 suggest connected firms are 4.5% to 7% less likely to make a payment to regulators in the post-election period. In columns 3 and 4 we find that firms with presidential ties are 3% to 4% less likely to have an investigation opened by a regulator following the election. Together these results suggest presidential ties can indeed influence regulatory outcomes, consistent with the literature's findings with respect to other forms of political connections (Yu and Yu, 2011; Correia, 2014; Brown and Huang, 2019).

2.5. Extensions

2.5.1 Presidential ties and White House visits

Brown and Huang (2019) show that firms visiting the Obama White House enjoyed higher abnormal returns and received more government contracts. Moreover, following the 2016 election those firms were found to lose market value.[18] These findings motivate us to assess the relation between White House visits and pre-existing presidential ties. Do firms within Trump's network have disproportionate access to the White House? If so, White House access could thus far constitute the means by which presidential ties confer benefits.

Our results in Table 2.7 (Panel A) suggest that firms connected to Trump are about 21% *less* likely to visit the White House under his presidency (columns 1 and 2). The average

[18]Our visitors data confirm this finding in untabulated results. Firms visiting the Obama White House suffered negative CARs following the 2016 election, but that is only true of firms without connections to Trump. In fact, pre-existing ties to Trump appear to reverse those election period losses.

Table 2.6

The impact of presidential ties on regulation. In a difference-in-difference framework this table examines regulatory outcomes following the 2016 presidential election. Dependent variables include indicators for whether a fine/settlement was paid (*Payment*) and whether an investigation was opened (*Investigation*). *Post* indicates post-election periods (from Q1 2017 onward). Panel A (B) reports results using *Muckety* (*News articles*) to measure presidential ties. A firm is considered to be connected if it had network ties to Donald Trump prior to the announcement of his 2016 presidential campaign. Variable definitions can be found in Table 2.A1. The bottom row of each panel reports within-R^2. t-statistics are in parentheses. Standard errors are clustered by industry (Fama-French 49).

	Regulation			
	Payment		Investigation	
	(1)	(2)	(3)	(4)
Panel A: Muckety				
Connection * Post	-0.069***	-0.069***	-0.042**	-0.042**
	(-3.23)	(-3.23)	(-2.33)	(-2.33)
Book-to-market	0.013	0.012	-0.002	-0.002
	(1.28)	(1.17)	(-0.45)	(-0.50)
Leverage	-0.006***	-0.006***	0.002	0.002
	(-2.99)	(-2.97)	(0.82)	(0.82)
Assets (log)	0.006	0.005	-0.000	-0.001
	(1.06)	(0.83)	(-0.07)	(-0.12)
Foreign exposure		-0.005		0.000
		(-0.53)		(0.06)
Tax burden		-0.013		-0.007
		(-1.17)		(-1.42)
Lobbying		0.011		0.001
		(1.09)		(0.30)
Firm FE	Yes	Yes	Yes	Yes
Year-quarter FE	Yes	Yes	Yes	Yes
N	10365	10365	10365	10365
R^2	0.022	0.023	0.014	0.014
Panel B: News articles				
News * Post	-0.045**	-0.045**	-0.032**	-0.032**
	(-2.34)	(-2.36)	(-2.21)	(-2.22)
Firm FE	Yes	Yes	Yes	Yes
Year-quarter FE	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes
Confounders	No	Yes	No	Yes
N	10365	10365	10365	10365
R^2	0.019	0.020	0.012	0.012

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 2.7
The impact of presidential ties on White House visits. In a difference-in-difference framework this table examines White House visits following the 2016 presidential election. Dependent variables include the incidence (*Dummy*), number, and percentile rank of White House visits. *Post* indicates post-election periods (from Q1 2017 onward). Panel A (B) reports results using *Muckety* (*News articles*) to measure presidential ties. A firm is considered to be connected if it had network ties to Donald Trump prior to the announcement of his 2016 presidential campaign. Variable definitions can be found in Table 2.A1. The bottom row of each panel reports within-R^2. t-statistics are in parentheses. Standard errors are clustered by industry (Fama-French 49).

	WH visits					
	Dummy		Number		Percentile	
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: Muckety						
Connection * Post	-0.215***	-0.214***	-5.026**	-5.009**	-11.706***	-11.632***
	(-4.65)	(-4.53)	(-2.18)	(-2.14)	(-3.96)	(-3.86)
Book-to-market	0.062**	0.062**	2.351**	2.376**	3.597**	3.611**
	(2.20)	(2.21)	(2.02)	(2.02)	(2.35)	(2.35)
Leverage	0.029***	0.030***	1.058***	1.060***	1.666***	1.699***
	(3.08)	(2.87)	(3.79)	(3.32)	(3.23)	(2.99)
Assets (log)	0.012	0.014	0.534	0.535	0.581	0.660
	(0.33)	(0.37)	(0.60)	(0.61)	(0.30)	(0.34)
Foreign exposure		-0.003		-0.515		-0.249
		(-0.13)		(-0.98)		(-0.21)
Tax burden		-0.026		-0.575		-1.572
		(-0.85)		(-0.59)		(-0.96)
Lobbying		-0.009		0.067		-0.435
		(-0.44)		(0.09)		(-0.40)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Year-quarter FE	Yes	Yes	Yes	Yes	Yes	Yes
N	4730	4730	4730	4730	4730	4730
R^2	0.251	0.251	0.167	0.167	0.028	0.029
Panel B: News articles						
News * Post	-0.115**	-0.114**	-1.179	-1.174	-5.788*	-5.738*
	(-2.26)	(-2.23)	(-0.67)	(-0.65)	(-1.99)	(-1.95)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Year-quarter FE	Yes	Yes	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Confounders	No	Yes	No	Yes	No	Yes
N	4730	4730	4730	4730	4730	4730
R^2	0.243	0.243	0.155	0.155	0.014	0.015

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

number of visits for such firms also decreases significantly, as measured by absolute value (columns 3 and 4) or percentile rank (columns 5 and 6). Our results in Panel B are broadly consistent but notably weaker. These findings interpreted together with those of Brown and Huang (2019) suggest there are gains from visiting the White House, but firms with pre-existing presidential ties may not need to carry out official visits to reap economic and financial benefits. As opposed to incurring the financial or reputational costs of an official White House visit, connected firms may opt for other venues and occasions to meet with the president.[19] Given these findings, it is clear our study truly documents a separate channel of political influence than that examined by Brown and Huang (2019).

2.5.2 Major political and legal developments

For a considerable period following Donald Trump's inauguration, the newswires were filled with political and legal developments related to the so-called Russia investigation. Inspired by Fisman and Zitzewitz (2019), we consider ten key events that could conceivably threaten president Trump's tenure in office. We divide these events into two categories: (A) political developments potentially threatening Trump's grip on power, and (B) legal developments (borne of the Russia investigation) that may indirectly implicate Trump in criminal activity. In the political category we examine: (i) the firing of ex-FBI director James Comey; (ii) the appointment of special counsel Robert Mueller to investigate (in part) Trump campaign coordination with Russian agents; (iii) James Comey's testimony before the Senate Intelligence Committee; (iv) the midterm elections affording Democrats a clear majority in the House of Representatives; and (v) Robert Mueller's congressional testimony on the conclusion of the Russia investigation. In the legal category we consider: (vi) the indictments of Paul Manafort (the president's campaign chairman) and Rick Gates (deputy campaign chairman); (vii) the news of a sealed or forthcoming indictment of Michael Flynn - Trump's one-time national security advisor and senior campaign official; (viii) the indictment of 13 Russians for election

[19] Brown and Huang (2019) show access to the Obama White House increases with (financially costly) campaign contributions and lobbying. Reputational costs may result on account of Trump's polarizing nature.

meddling via the Internet Research Agency; (ix) the FBI raid on the office, home, and hotel room of Trump's personal attorney Michael Cohen; and (x) the indictment of 12 Russian spies for hacking the Democratic National Convention's computer network.

Table 2.8
The impact of presidential ties on CARs during major political and legal developments. This table reports the impact of presidential ties on CARs around ten events representing major political and legal developments related to the Russia investigation. The leftmost column indicates which event is studied in the corresponding row (with event date indicated in parentheses). All coefficients and t-statistics correspond to β_1 estimated for *Connection* from Eq. (2.1). CARs are calculated using the value-weighted market model. Firm fundamentals and Fama-French 49 industry effects are included in all specifications; political economic confounders are included in columns (2), (4), and (6). Controls are measured at fiscal year-end preceding the respective event. Our sample begins with firms comprising the S&P 500 at the time of the 2016 election. Over time this sample shrinks due to M&A activity. t-statistics are in parentheses. Standard errors are clustered by industry (Fama-French 49).

	[0, 5]		[0, 10]		[0, 20]	
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: Political developments						
Comey firing (9 May 2017)	-0.552	-0.581	-0.923**	-1.035**	-1.412*	-1.763**
	(-1.21)	(-1.18)	(-2.12)	(-2.12)	(-1.77)	(-2.13)
N	494	494	494	494	494	494
R^2	0.259	0.280	0.207	0.231	0.345	0.363
Mueller appointment (17 May 2017)	-0.689*	-0.838**	-0.934***	-1.069***	-0.877	-1.314**
	(-1.94)	(-2.46)	(-2.88)	(-3.11)	(-1.59)	(-2.37)
N	494	494	494	494	494	494
R^2	0.217	0.235	0.331	0.335	0.352	0.363
Comey testimony (8 June 2017)	-0.029	-0.164	0.171	-0.131	1.039	0.884
	(-0.08)	(-0.45)	(0.44)	(-0.34)	(1.38)	(1.18)
N	494	494	494	494	494	494
R^2	0.223	0.231	0.270	0.274	0.289	0.297
Midterm elections (6 Nov 2018)	-0.763	-0.483	-1.185	-0.824	-2.191	-1.779
	(-1.22)	(-0.72)	(-1.39)	(-0.93)	(-1.56)	(-1.32)
N	476	476	476	476	476	476
R^2	0.315	0.329	0.301	0.324	0.349	0.373
Mueller testimony (24 July 2019)	-0.602	-0.512	-1.441**	-1.209	-2.831***	-2.588**
	(-1.16)	(-0.89)	(-2.04)	(-1.44)	(-2.71)	(-2.16)
N	468	468	468	468	468	468
R^2	0.177	0.187	0.161	0.192	0.214	0.247
Panel B: Legal developments						
Manfort and Gates indictment (30 Oct 2017)	-0.655	-0.428	-0.374	-0.088	0.094	0.382
	(-0.98)	(-0.65)	(-0.56)	(-0.14)	(0.13)	(0.49)
N	487	487	487	487	487	487
R^2	0.340	0.351	0.327	0.340	0.260	0.267
News of Flynn indictment (5 Nov 2017)	0.519	0.787**	0.799	1.091	1.924	2.277*
	(1.58)	(2.07)	(1.35)	(1.62)	(1.58)	(1.79)
N	486	486	486	486	486	486
R^2	0.331	0.344	0.369	0.374	0.385	0.404
13 Russians from IRA indicted (16 Feb 2018)	1.113**	1.222**	1.591*	1.644*	1.186	1.396
	(2.32)	(2.49)	(1.84)	(1.85)	(1.04)	(1.14)
N	485	485	485	485	485	485
R^2	0.151	0.161	0.191	0.212	0.228	0.247
Cohen raids (9 Apr 2018)	0.107	0.019	0.641	0.347	-0.139	-0.334
	(0.24)	(0.04)	(0.91)	(0.48)	(-0.12)	(-0.29)

Table 2.8 *(continued)*

	[0, 5]		[0, 10]		[0, 20]	
	(1)	(2)	(3)	(4)	(5)	(6)
N	483	483	483	483	483	483
R^2	0.371	0.381	0.409	0.421	0.326	0.337
12 Russian spies indicted (13 July 2018)	0.567	0.611	1.722***	1.841***	0.797	1.146
	(1.33)	(1.34)	(2.86)	(2.77)	(0.79)	(1.08)
N	480	480	480	480	480	480
R^2	0.313	0.321	0.288	0.300	0.281	0.305
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Confounders	No	Yes	No	Yes	No	Yes

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

In Table 2.8 we examine the impact of presidential ties on CARs during these ten developments. For each column we estimate the full model of Eq. (2.1), but report only the β_1 coefficient. Event windows are centered on the event date indicated in the header for each subpanel. In general the political developments in Panel A negatively affected the market value of Trump-connected firms. Comey's firing and Mueller's appointment accelerated the Russia investigation that plagued Trump's first two years in office. Comey's testimony, however, lacked new evidence damaging to Trump, potentially explaining the insignificant market response.[20] A weak market reaction to the midterm elections may be attributable to Republican retention of the Senate. Finally, Mueller's confirmation that the special counsel's report did not exonerate the president strengthened calls for impeachment.

At first glance it is surprising that the legal developments in Panel B do not negatively impact the market value of Trump-connected firms. While these developments incriminated associates of the president, however, they did not directly implicate Trump in criminal activity. Political pundits on Trump Administration-friendly airwaves certainly stressed this argument extensively (e.g., Fox News, 2018a; 2018b).[21] It is therefore conceivable these events were actually viewed by the president's supporters as evidence of his exoneration with respect to Russia-related affairs. Public opinion polls, after all, suggest the president

[20]For this reason, Fisman and Zitzewitz (2019) actually find the Comey testimony to reverse Trump long-short index losses incurred over the weeks following Comey's firing.

[21]Following Paul Manafort's conviction, Trump claimed "I didn't know Manafort well, he wasn't with the campaign long." After Michael Cohen's guilty plea, Trump responded: "He's been a lawyer for me. Didn't do big deals, did small deals. Not somebody that was with me that much." The White House also downplayed Michael Flynn's importance to Trump following his indictment (Washington Post, 2019).

did not lose public support following these legal developments.[22] We actually observe some of these legal events to *positively* benefit stock performance of Trump-connected firms, suggesting market participants were convinced these developments vindicated Trump or at least demonstrated his immunity to legal prosecution.

2.6. Robustness

2.6.1 Choice of industry classification

Importantly, our choice of industry classification determines the criteria used for benchmarking peer firms. Fama-French industries reclassify, according to risk profiles, SIC codes reflecting primary business activities (Fama and French, 1997). The GICS system delineates industry boundaries using investor perceptions and revenue/earnings sources (MSCI, 2020). The FIC designation of Hoberg and Phillips (2016) groups firms in the product market space, based on textual similarity of 10-K product descriptions. It is conceptually ambiguous which criteria is most appropriate for selecting control firms in our setting. In fact, some firms (e.g., Boeing) are sufficiently unique that convincing benchmarks are elusive under any of the above classifications.

Within a classification system, the choice of industry granularity also involves important trade-offs related to fixed effects and clustered errors. First, with 496 firms in our cross-section, degrees of freedom are limited. For this we are inclined to adopt coarse industry effects to avoid overidentification. On the other hand, granular industry effects may allow us to designate more similar control units for each treated firm. Second, standard errors clustered at a broad level of aggregation permit flexible spillovers between firms in related subindustries. But earlier research documents inferential challenges in the presence of few data clusters (Cameron, Gelbach, and Miller, 2008). Thus, along both decision parameters (fixed effects and clustered errors), the optimal choice of industry aggregation is also unclear.

[22] Corresponding opinion poll data are available through FiveThirtyEight.

In our analysis we thus far adopt the Fama-French 49 (FF 49) industries. But each classification system and level of granularity involves a unique set of trade-offs. In this section we therefore demonstrate the robustness of our findings to many alternative approaches. We begin by using the comparatively coarse GICS (four-digit) 24 industry groups. Then we invoke progressively finer classifications including: FF 49 baseline, FIC 50, GICS (six-digit) 69, and FIC 100 industries. Table 2.B1 presents cross-sectional CAR tests from Eq. (2.1), including fixed effects and clustered errors according to each industry classification.[23] Tables 2.B2 to 2.B4 report panel results across real outcomes, clustering errors by each industry grouping (industry effects are subsumed into the firm fixed effects of Eq. (2.2)).

In Panel A of Table 2.B1 we report the estimated impact of presidential ties on CARs using GICS (four-digit) 24 industry groups. Relative to the FF 49 baseline results in Panel B, effect sizes and significance levels are similar. In Tables 2.B2 to 2.B4 we present GICS 24 cluster-robust t-statistics for the estimated impact of Trump connections on real outcomes. Our inferences are robust to these broader industry clusters. In Panel C of Table 2.B1 we estimate CAR tests using the FIC 50 categories. Relative to the Panel B baseline, effect sizes and significance levels are again similar. Tables 2.B2 to 2.B4 demonstrate panel inferences are also largely robust under this qualitatively distinct yet equally granular classification.

Next we examine robustness under more fine-grained industry classifications. Using the GICS (six-digit) 69 industries, in Panel D of Table 2.B1 we find Trump-connected firms significantly gained market value following the 2016 election. Effect sizes are smaller under this granular classification, but in Panel E we adopt even more nuanced FIC 100 industries. Under our most disaggregated industry classification, we find effect sizes and significance levels to often *increase* relative to the baseline. This suggests firms connected to Trump do not simply cluster in industries favored by his election (i.e., our results truly reflect *firm*-level benefits of presidential ties). Tables 2.B2 to 2.B4 show panel findings are largely robust under both granular specifications.

Above we alluded to inferential challenges in the presence of few data clusters. Cameron,

[23] To facilitate comparisons, we drop four companies with unassigned FICs, leaving 492 sample firms for this section.

Gelbach, and Miller (2008) show the cluster-robust standard errors of White (1984) and Arellano (1987) can be downward biased when the number of clusters is small. Carter, Schnepel, and Steigerwald (2017) show that cluster size imbalance exacerbates the problem, and introduce a means of calculating the so-called 'effective number of clusters'. When that number is small, they document downward biased standard errors and overrejection based on cluster-robust t-statistics. This issue can arise even when the nominal amount of clusters is large. Using the package of Lee and Steigerwald (2018), we compute the effective number of clusters for each of our industry classifications. For all but the FIC 100 grouping, our effective number of clusters falls below Lee and Steigerwald's (2018) suggested threshold of 25. Accordingly, we calculate critical t-values using the wild cluster bootstrap procedure recommended for settings with few effective clusters (MacKinnon and Webb, 2017; Lee and Steigerwald, 2018). Our inferences are robust when basing p-values on the wild bootstrapped t-distributions. Untabulated results confirm this for all industry classifications discussed.

2.6.2 Placebo elections

Previous authors have demonstrated financial impacts of US presidential elections at various levels of aggregation. Snowberg, Wolfers, and Zitzewitz (2007) find the election of Republican presidents to significantly boost equity markets. Knight (2006) links the 2000 election outcome to stock performance in politically sensitive sectors. And Wagner, Zeckhauser, and Ziegler (2018) identify firm-level determinants of stock performance around the 2016 election. While Snowberg, Wolfers, and Zitzewitz (2007) show economy-wide implications of electing Republican presidents, Knight (2006) and Wagner, Zeckhauser, and Ziegler (2018) demonstrate how Republican policy platforms can be priced into individual equities. Hence, certain firms are expected to benefit under Republican policy platforms. In our study we control for (i) whether firms donate more to Republican congressional campaigns (*Republican*), and (ii) campaign contributions to Donald Trump in particular (*Campaign contribution*). Notably, both controls are positively correlated with abnormal returns in Table 2.3. If these controls constitute imperfect measures of firm sensitivity to Republican policy platforms,

our results could merely suggest Trump-connected firms are those with more to gain under Republican leadership.

To rule out the above interpretation, we conduct placebo CAR tests around earlier US presidential elections. Barack Obama – a Democrat – was elected to office in both 2008 and 2012. If Trump-connected firms generally benefit from Republican policy platforms, Trump connections should be *negatively* associated with stock performance following Obama's election victories.[24] Fig. 2.A1 exhibits CARs around both elections for connected and nonconnected firms. For 2012 we observe no clear difference in outcomes. In 2008, Trump-connected firms suffer negative returns following the election, but those losses are quickly reversed. Table 2.A3 conducts CAR tests for various windows around both elections. As suspected, Trump network ties are unrelated to post-election stock performance in 2012. But we do observe significant negative returns for Trump-connected firms immediately following Obama's 2008 victory. The effect turns increasingly insignificant over longer horizons, however, and is consistently indistinguishable from zero across Panel B.

Next we conduct a placebo test around the 2004 election of Republican president George W. Bush. Post-election trends in Fig. 2.A1 remain difficult to discern, so we turn to formal analysis in Table 2.A4. In columns 1 to 3 we test whether abnormal returns of Trump-connected firms significantly increased following Bush's electoral victory. Across our standard event windows, we find no evidence of systematically higher returns among Trump-connected firms. In columns 4 and 5 we strengthen identification by exploiting a unique natural experiment on election day itself. The following analysis closely follows Snowberg, Wolfers, and Zitzewitz (2007).

Around 3:00pm on election day (November 2, 2004), flawed exit poll data was released suggesting a Republican defeat. From 3:00pm to 4:00pm, the odds of a Bush victory consequently fell by 12 percentage points in prediction markets. Then, from 4:00pm to 9:30am the following day, as vote counts all but assured a Republican victory, Bush's

[24]The strength of the effect will depend on the unexpectedness of election results.

electoral odds rose by 55 percentage points.[25] These shocks to market expectations provide a unique setting to identify the impact of Republican policy platforms on the stock returns of Trump-connected firms. Following Snowberg, Wolfers, and Zitzewitz (2007), we analyze price movements over the two above-mentioned windows. Column 4 (5) measures stock price adjustments as Bush's electoral odds declined (increased) by 12% (55%) from 3:00pm to 4:00pm (4:00pm to 9:30am).[26] We find the change in probability of a Republican presidency to have no significant impact on the stock returns of Trump-connected firms (in either panel). Taken together, our placebo tests suggest the positive CARs we observe for Trump-connected firms in 2016 are not merely attributable to the election of a Republican president.[27]

2.7. Conclusion

We estimate the financial and economic value of network connections to the US president for S&P 500 firms. Our identification strategy relies on relationships forged with the *businessman* Donald Trump, long before firms imagined he may some day become president. We then exploit Donald Trump's surprise victory in the 2016 presidential election to evaluate the benefits of sudden political connectedness among S&P 500 firms. We find that pre-existing network relations with Trump generated abnormal returns of 3.7% over a 21-day post-election period. We also demonstrate a number of real economic benefits enjoyed by connected firms. In the post-election period, firms with presidential ties performed better, received more government contracts, and were subject to more favorable regulation than nonconnected counterparts.

Financial and economic benefits accrued to firms in the president's network may be viewed by his detractors as evidence of cronyism or corruption. The president's supporters, however, would argue Trump is merely resolving information asymmetries between poli-

[25]Electoral odds are calculated by Snowberg, Wolfers, and Zitzewitz (2007) based on data from Tradesports political prediction markets.

[26]For this exercise we obtain additional stock price data from Thomson Reuters Tick History database.

[27]In Tables 2.A3 and 2.A4 the impact of Trump connections is similarly insignificant under specifications dropping confounders, controls, or both.

cymakers and the private sector, by virtue of his extensive industry background. These alternative interpretations are observationally equivalent in our study, so we make no suggestion of cronyism or lack thereof. Notably, this limitation has plagued most studies in this vein of inquiry, with a few important exceptions (see Faccio and Hsu, 2017; Schoenherr, 2019).

Given the unique character and behavior of Donald Trump, readers may question whether our findings are generalizable. In this respect we acknowledge the strength of our analysis lies in its internal (rather than external) validity. Previous studies examining firm connections to a single authoritative figure are subject to the same caveat (e.g., Fisman, 2001; Fisman et al., 2012; Acemoglu et al., 2016; Schoenherr, 2019). At any rate, our findings certainly provide unique insight into the current value and nature of network ties to the highest US government office.

2.8. Appendix A

Fig. 2.A1: CARs around previous US presidential elections. Day 0 is when election results were announced (November 7, 2012; November 5, 2008; November 3, 2004). A firm is considered to be connected if it had network ties to Donald Trump prior to the announcement of his 2016 presidential campaign. CARs are calculated using the value-weighted market model. We adopt a 255-trading day estimation window ending 46 trading days prior to the event day. For each firm, we require a minimum of 40 observations in the estimation window.

Table 2.A1
Variable definitions.

Variable	Definition
Connection	1 for connected firms and 0 otherwise. A firm is considered to be connected if it had network ties to Donald Trump (as defined by muckety.com) prior to the announcement of his 2016 presidential campaign.
News	1 if any of a given firm's directors or executives appeared in the same news article as Donald Trump between 1980 and 2014 and 0 otherwise.
Campaign contribution	The firm's total contributions to Donald Trump's campaign during the 2016 US presidential election, in millions of dollars.
Republican	1 if more than 70% of the firm's campaign contributions went toward Republican candidates in the 2012 and 2014 federal elections and 0 otherwise.
Policy sensitivity	1 if the firm's share price loadings on the Economic Policy Uncertainty Index over the 18 months prior to the 2016 election is statistically significant at the 10% level and 0 otherwise.
Post	1 for periods after Q4 2016 and 0 otherwise.
Book-to-market	Book value of common equity divided by market value of equity. Compustat: $ceq \div mkvalt$.
Leverage	Book value of debt divided by market value of equity. Compustat: $(dltt + dlc) \div mkvalt$.
Assets	Natural logarithmic transformation of market value of assets, in millions of dollars.
Foreign exposure	Pretax income from foreign operations divided by total pretax income. Compustat: $pifo \div pi$. Range restricted to [0,1].
Tax burden	Total tax paid divided by pretax income adjusted for special items. Compustat: $txpd \div (pi - spi)$. Range restricted to [0,1].
Lobbying	A firm's total lobbying expense (including spending by subsidiaries) in a given year (Tables 2.3 and 2.8) or quarter (Tables 2.4 to 7), in millions of dollars.
Procurement contracts	Natural logarithmic transformation of one plus the number of government contracts newly awarded to the firm in a given quarter.
Procurement value	Natural logarithmic transformation of one plus the dollar value of contracts awarded to the firm in a given quarter.
Procurement value/revenue	Dollar value of contracts awarded to the firm in a given quarter scaled by revenue, multiplied by 100 to express in percentage.
Payment	1 if the firm had at least one fine imposed or made at least one payment in a given quarter and 0 otherwise.
Investigation	1 if the firm had at least one investigation or inquiry into the firm's activities opened by regulators in a given quarter and 0 otherwise.
WH visits dummy	1 if at least one of the firm's executives or directors visited the White House in a given quarter and 0 otherwise.
WH visits number	Number of visits made by the firm's executives and/or directors in a given quarter.
WH visits percentile	Percentile ranking of the number of visits made by the firm's executives and/or directors in a given quarter.

Table 2.A2

The impact of presidential ties on CARs with alternative benchmark models. This table reports CARs during the 2016 election based on the value-weighted market model, equal-weighted market model, raw returns, Fama-French three-factor model, and Fama-French-Carhart four-factor model. The leftmost column indicates which model is employed in the corresponding panel. All coefficients and t-statistics correspond to β_1 estimated from Eq. (2.1). Odd (even) columns use *Muckety* (*News articles*) to measure presidential ties. Firm fundamentals and political economic confounders are used as controls throughout. Control variables are measured at fiscal year-end before the 2016 presidential election. Day 0 is when election results were announced (November 9, 2016). Industry fixed effects are based on the Fama-French 49 industry classification. Detailed definitions of variables can be found in Table 2.A1. t-statistics are in parentheses. Standard errors are clustered by industry (Fama-French 49).

	[0, 5]		[0, 10]		[0, 20]	
	(1)	(2)	(3)	(4)	(5)	(6)
Value-weighted MM	2.255**	2.367**	2.782**	3.168**	3.664**	3.895***
	(2.02)	(2.17)	(2.19)	(2.65)	(2.47)	(2.75)
R^2	0.446	0.473	0.457	0.493	0.480	0.519
Equal-weighted MM	1.802*	0.839*	2.451**	1.722**	3.056**	2.552***
	(1.77)	(1.74)	(2.24)	(2.50)	(2.57)	(3.69)
R^2	0.421	0.416	0.457	0.454	0.488	0.488
Raw	2.234*	1.162**	2.977**	2.129***	3.641**	3.041***
	(1.89)	(2.27)	(2.36)	(2.91)	(2.64)	(4.36)
R^2	0.484	0.478	0.518	0.515	0.563	0.562
FF 3-factor	1.412	0.308	1.919*	1.022	2.183*	1.323*
	(1.49)	(0.61)	(1.83)	(1.62)	(1.92)	(1.76)
R^2	0.442	0.439	0.453	0.450	0.443	0.441
FFC 4-factor	1.701*	0.596	2.408**	1.519**	2.966**	2.110**
	(1.80)	(1.17)	(2.31)	(2.37)	(2.60)	(2.66)
R^2	0.411	0.406	0.423	0.419	0.412	0.408
N	496	496	496	496	496	496
Connection measure	Muckety	News	Muckety	News	Muckety	News
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Confounders	Yes	Yes	Yes	Yes	Yes	Yes

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 2.A3

Placebo tests for the 2012 and 2008 US presidential elections. This table analyzes the determinants of cross-sectional variation in CARs around the 2012 and 2008 elections. CARs are calculated using the value-weighted market model. Panel A (B) reports results of Eq. (2.1) using *Muckety* (*News articles*) to measure presidential ties. Firm fundamentals and political economic confounders are used as controls throughout. Control variables are measured at fiscal year-end before the 2016 presidential election. Day 0 is when election results were announced (November 5, 2008 and November 7, 2012). Industry fixed effects are based on the Fama-French 49 industry classification. Detailed definitions of variables can be found in Table 2.A1. t-statistics are in parentheses. Standard errors are clustered by industry (Fama-French 49).

	2012			2008		
	[0, 5]	[0, 10]	[0, 20]	[0, 5]	[0, 10]	[0, 20]
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: Muckety						
Connection	0.363	-0.258	-0.102	-4.634*	-3.793	0.776
	(0.81)	(-0.31)	(-0.07)	(-1.74)	(-1.21)	(0.24)
Book-to-market	-0.462	-0.368	0.007	-1.117	-3.987	-2.410
	(-1.08)	(-0.55)	(0.01)	(-0.94)	(-1.56)	(-1.19)
Leverage	-0.351**	-0.654**	-0.847	-0.489	-2.043	-1.244
	(-2.11)	(-2.48)	(-1.37)	(-0.61)	(-1.44)	(-0.76)
Assets (log)	-0.306	0.305	0.823	0.793	1.696*	2.693**
	(-1.28)	(0.82)	(1.12)	(0.94)	(1.88)	(2.18)
Campaign contribution	-0.126	-0.428	-0.425	-0.082	0.769	-1.404*
	(-0.47)	(-1.36)	(-1.00)	(-0.13)	(0.81)	(-1.72)
Republican	-0.375	-0.824*	-0.476	0.029	-0.307	-1.701
	(-1.07)	(-1.77)	(-0.71)	(0.03)	(-0.29)	(-1.11)
Policy sensitivity	-0.283	-0.679	-1.070	-0.760	-1.993	0.754
	(-0.70)	(-1.33)	(-1.12)	(-0.76)	(-1.45)	(0.50)
Foreign exposure	0.698	1.021	1.782	2.812	4.177	1.158
	(1.06)	(1.33)	(1.31)	(1.40)	(1.63)	(0.41)
Tax burden	-0.681	0.367	-0.457	9.491***	19.309***	10.459**
	(-0.73)	(0.25)	(-0.24)	(3.10)	(4.60)	(2.25)
Lobbying	-0.057	-0.167**	-0.173*	-0.061	-0.283	-0.269
	(-1.17)	(-2.52)	(-1.76)	(-0.22)	(-0.89)	(-0.65)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
N	479	479	479	461	461	461
R^2	0.191	0.151	0.174	0.168	0.270	0.257
Panel B: News articles						
News	0.394	-0.736	-0.640	-0.130	-2.630	-0.977
	(0.70)	(-1.11)	(-0.58)	(-0.07)	(-0.89)	(-0.41)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Confounders	Yes	Yes	Yes	Yes	Yes	Yes
N	479	479	479	461	461	461
R^2	0.192	0.154	0.175	0.154	0.267	0.257

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 2.A4

Placebo tests for the 2004 US presidential election. This table analyzes the determinants of cross-sectional variation in CARs around the 2004 election. CARs are calculated using the value-weighted market model. Panel A (B) reports results of Eq. (2.1) using *Muckety* (*News articles*) to measure presidential ties. Firm fundamentals and political economic confounders are used as controls. Control variables are measured at fiscal year-end before the 2016 presidential election. Day 0 is when election results were announced (November 3, 2004). Industry fixed effects are based on the Fama-French 49 industry classification. Detailed definitions of variables can be found in Table 2.A1. t-statistics are in parentheses. Standard errors are clustered by industry (Fama-French 49).

	[0, 5] (1)	[0, 10] (2)	[0, 20] (3)	[3:00pm, 4:00pm] (4)	[4:00pm, 9:30am] (5)
Panel A: Muckety					
Connection	0.097	0.781	1.801	0.010	0.015
	(0.14)	(0.85)	(1.53)	(0.04)	(0.06)
Book-to-market	-0.628	-0.732	-0.632	0.009	-0.008
	(-0.96)	(-0.78)	(-0.55)	(0.05)	(-0.05)
Leverage	0.626**	1.136***	0.495	0.160	0.062
	(2.33)	(2.89)	(1.12)	(1.01)	(0.83)
Assets (log)	-0.044	-0.112	-0.305	-0.101	0.172*
	(-0.15)	(-0.29)	(-0.77)	(-0.98)	(1.93)
Campaign contribution	-3.065	-7.324	-5.485	-0.362	-0.765
	(-1.43)	(-1.43)	(-0.67)	(-0.32)	(-0.92)
Republican	0.714	0.624	1.209	0.155	0.014
	(1.54)	(1.25)	(1.37)	(0.87)	(0.14)
Policy sensitivity	-0.227	-0.207	-1.166**	-0.267*	-0.029
	(-0.53)	(-0.42)	(-2.15)	(-1.77)	(-0.27)
Foreign exposure	-0.086	-0.433	1.345	-0.225	0.165
	(-0.09)	(-0.33)	(0.88)	(-0.43)	(0.83)
Tax burden	1.502	2.123	1.389	0.593	-0.533
	(1.03)	(1.15)	(0.61)	(0.84)	(-1.40)
Lobbying	0.095	0.125	0.055	0.053*	0.004
	(1.35)	(1.53)	(0.51)	(1.72)	(0.15)
Industry FE	Yes	Yes	Yes	Yes	Yes
N	380	380	380	380	380
R^2	0.294	0.247	0.200	0.198	0.355
Panel B: News articles					
News	-0.561	-0.600	-0.027	0.110	-0.079
	(-0.97)	(-0.86)	(-0.03)	(0.37)	(-0.46)
Controls	Yes	Yes	Yes	Yes	Yes
Confounders	Yes	Yes	Yes	Yes	Yes
Industry FE	Yes	Yes	Yes	Yes	Yes
N	380	380	380	380	380
R^2	0.297	0.247	0.192	0.198	0.355

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

2.9. Appendix B

Table 2.B1
The impact of presidential ties on CARs with alternative industry classifications. This table reports the impact of presidential ties on CARs around the 2016 election. Panels A to E invoke fixed effects and clustering based on GICS 24, Fama-French 49, FIC 50, GICS 69, and FIC 100 industries, respectively. CARs are calculated using the value-weighted market model. Day 0 is when election results were announced (November 9, 2016). We drop four companies with unassigned FICs. t-statistics are in parentheses.

	[0, 5]		[0, 10]		[0, 20]	
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: GICS 24						
Connection	2.035***	2.088***	2.657***	2.981***	3.724***	3.830***
	(5.25)	(4.81)	(4.69)	(5.42)	(4.70)	(4.43)
R^2	0.465	0.516	0.462	0.522	0.476	0.531
News	1.547***	1.249***	2.426***	2.105***	3.421***	2.958***
	(3.48)	(3.04)	(3.19)	(3.45)	(4.50)	(4.61)
R^2	0.462	0.512	0.462	0.517	0.476	0.528
Panel B: FF 49						
Connection	2.369**	2.477**	2.908**	3.304***	3.845**	4.096***
	(2.12)	(2.30)	(2.30)	(2.82)	(2.59)	(2.92)
R^2	0.459	0.483	0.468	0.500	0.493	0.529
News	1.392***	1.364***	2.360***	2.370***	3.390***	3.333***
	(3.06)	(3.06)	(3.33)	(3.46)	(4.40)	(4.42)
R^2	0.452	0.476	0.465	0.496	0.492	0.527
Panel C: FIC 50						
Connection	2.129***	2.029***	2.993***	2.994***	3.977***	3.826***
	(3.16)	(2.91)	(3.27)	(3.51)	(4.54)	(4.64)
R^2	0.400	0.445	0.422	0.471	0.456	0.502
News	1.196**	0.970	2.353***	2.101**	3.353***	2.992***
	(2.10)	(1.60)	(2.79)	(2.40)	(3.19)	(2.71)
R^2	0.394	0.439	0.419	0.466	0.454	0.499
Panel D: GICS 69						
Connection	1.507***	1.318**	1.773**	1.866***	2.597***	2.296**
	(2.76)	(2.24)	(2.65)	(2.72)	(2.80)	(2.64)
R^2	0.588	0.610	0.577	0.604	0.580	0.614
News	1.187**	1.058**	2.042***	1.920***	3.024***	2.763***
	(2.23)	(2.02)	(2.98)	(2.96)	(3.40)	(3.38)
R^2	0.587	0.610	0.580	0.606	0.584	0.618
Panel E: FIC 100						
Connection	2.466***	2.367***	3.075***	3.051***	4.305***	4.134***
	(4.27)	(4.41)	(3.68)	(4.29)	(5.31)	(6.12)
R^2	0.503	0.531	0.513	0.545	0.535	0.570
News	1.598***	1.262**	2.423**	2.052**	3.473***	2.910***
	(2.69)	(2.23)	(2.58)	(2.42)	(3.32)	(3.09)
R^2	0.497	0.524	0.510	0.540	0.531	0.565
N	492	492	492	492	492	492
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Confounders	No	Yes	No	Yes	No	Yes

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 2.B2

The impact of presidential ties on firm performance with alternative industry classifications. In a difference-in-difference framework this table examines performance outcomes following the 2016 presidential election. Dependent variables include *Revenue*, *Operating income*, and *Net income*, all expressed in billion dollar terms. *Post* indicates post-election periods (from Q1 2017 onward). A firm is considered to be connected if it had network ties to Donald Trump prior to the announcement of his 2016 presidential campaign. Variable definitions can be found in Table 2.A1. We drop four companies with unassigned FICs, leaving 492 sample firms. The bottom row of each panel reports within-R^2. t-statistics are in parentheses. Standard errors are clustered by various industry classifications - GICS 24, FF 49, FIC 50, GICS 69, and FIC 100.

	Revenue		ln(Revenue)		Operating income		Net income	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Panel A: Muckety								
Connection * Post	1.114	1.105	0.079	0.079	0.185	0.179	0.090	0.088
GICS 24	(3.03)***	(2.94)***	(3.26)***	(3.37)***	(2.41)**	(2.30)**	(1.25)	(1.27)
FF 49	(2.96)***	(2.88)***	(1.96)*	(2.04)**	(2.25)**	(2.13)**	(1.19)	(1.21)
FIC 50	(2.38)**	(2.27)**	(2.22)**	(2.26)**	(2.15)**	(2.00)*	(1.36)	(1.37)
GICS 69	(2.45)**	(2.37)**	(2.43)**	(2.50)**	(2.05)**	(1.95)*	(1.20)	(1.21)
FIC 100	(3.01)***	(2.90)***	(2.20)**	(2.26)**	(3.04)***	(2.85)***	(1.33)	(1.36)
N	10297	10297	10297	10297	10297	10297	10297	10297
R^2	0.148	0.151	0.093	0.095	0.070	0.074	0.035	0.037
Panel B: News articles								
News * Post	0.829	0.814	0.079	0.075	0.129	0.123	0.069	0.066
GICS 24	(2.21)**	(2.13)**	(3.06)***	(3.09)***	(1.97)*	(1.85)*	(1.13)	(1.07)
FF 49	(2.30)**	(2.23)**	(2.87)***	(2.78)***	(1.83)*	(1.71)*	(1.15)	(1.09)
FIC 50	(1.92)*	(1.82)*	(2.93)***	(2.98)***	(1.67)	(1.55)	(1.40)	(1.33)
GICS 69	(2.27)**	(2.17)**	(3.17)***	(3.14)***	(1.72)*	(1.61)	(1.06)	(1.00)
FIC 100	(2.43)**	(2.32)**	(3.20)***	(3.13)***	(2.36)**	(2.21)**	(1.49)	(1.41)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year-quarter FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Confounders	No	Yes	No	Yes	No	Yes	No	Yes
N	10297	10297	10297	10297	10297	10297	10297	10297
R^2	0.143	0.146	0.093	0.096	0.068	0.072	0.035	0.037

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 2.B3
The impact of presidential ties on procurement of government contracts with alternative industry classifications. In a difference-in-difference framework this table examines procurement outcomes following the 2016 presidential election. Dependent variables include the number and value of contracts procured, both expressed in log terms. *Post* indicates post-election periods (from Q1 2017 onward). A firm is considered to be connected if it had network ties to Donald Trump prior to the announcement of his 2016 presidential campaign. Variable definitions can be found in Table 2.A1. We drop four companies with unassigned FICs, leaving 492 sample firms. The bottom row of each panel reports within-R^2. t-statistics are in parentheses. Standard errors are clustered by various industry classifications - GICS 24, FF 49, FIC 50, GICS 69, and FIC 100.

	Procurement					
	Contracts		Value		Value/Revenue	
	(1)	(2)	(3)	(4)	(5)	(6)
Panel A: Muckety						
Connection * Post	0.445	0.446	0.429	0.430	4.888	4.902
GICS 24	(6.98)***	(6.88)***	(5.72)***	(5.68)***	(2.08)**	(2.09)**
FF 49	(7.92)***	(7.92)***	(6.37)***	(6.31)***	(2.17)**	(2.17)**
FIC 50	(6.27)***	(6.24)***	(5.44)***	(5.40)***	(2.08)**	(2.07)**
GICS 69	(6.40)***	(6.35)***	(5.94)***	(5.89)***	(2.05)**	(2.05)**
FIC 100	(6.08)***	(6.02)***	(5.27)***	(5.23)***	(1.93)*	(1.93)*
N	10297	10297	10297	10297	10297	10297
R^2	0.055	0.057	0.069	0.070	0.043	0.044
Panel B: News articles						
News * Post	0.116	0.117	0.175	0.175	-0.011	-0.023
GICS 24	(1.73)*	(1.75)*	(3.05)***	(3.04)***	(-0.02)	(-0.04)
FF 49	(1.70)*	(1.71)*	(2.73)***	(2.72)***	(-0.02)	(-0.04)
FIC 50	(1.22)	(1.23)	(2.46)**	(2.45)**	(-0.02)	(-0.04)
GICS 69	(1.73)*	(1.73)*	(2.86)***	(2.84)***	(-0.02)	(-0.04)
FIC 100	(1.49)	(1.51)	(2.52)**	(2.51)**	(-0.02)	(-0.04)
N	10297	10297	10297	10297	10297	10297
R^2	0.036	0.037	0.053	0.053	0.010	0.011
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Year-quarter FE	Yes	Yes	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes	Yes	Yes
Confounders	No	Yes	No	Yes	No	Yes

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 2.B4

The impact of presidential ties on regulation with alternative industry classifications. In a difference-in-difference framework this table examines regulatory outcomes following the 2016 presidential election. Dependent variables include indicators for whether a fine/settlement was paid (*Payment*) and whether an investigation was opened (*Investigation*). *Post* indicates post-election periods (from Q1 2017 onward). A firm is considered to be connected if it had network ties to Donald Trump prior to the announcement of his 2016 presidential campaign. Variable definitions can be found in Table 2.A1. We drop four companies with unassigned FICs, leaving 492 sample firms. The bottom row of each panel reports within-R^2. t-statistics are in parentheses. Standard errors are clustered by various industry classifications - GICS 24, FF 49, FIC 50, GICS 69, and FIC 100.

	Regulation			
	Payment		Investigation	
	(1)	(2)	(3)	(4)
Panel A: Muckety				
Connection * Post	-0.070	-0.070	-0.042	-0.042
GICS 24	(-2.54)**	(-2.55)**	(-2.99)***	(-2.99)***
FF 49	(-3.24)***	(-3.24)***	(-2.34)**	(-2.34)**
FIC 50	(-2.90)***	(-2.89)***	(-2.67)**	(-2.66)**
GICS 69	(-2.40)**	(-2.40)**	(-2.31)**	(-2.30)**
FIC 100	(-2.87)***	(-2.86)***	(-3.07)***	(-3.07)***
N	10297	10297	10297	10297
R^2	0.022	0.023	0.014	0.014
Panel B: News articles				
News * Post	-0.045	-0.045	-0.032	-0.032
GICS 24	(-2.23)**	(-2.26)**	(-2.66)**	(-2.67)**
FF 49	(-2.34)**	(-2.35)**	(-2.22)**	(-2.22)**
FIC 50	(-2.19)**	(-2.17)**	(-2.52)**	(-2.51)**
GICS 69	(-2.14)**	(-2.14)**	(-2.16)**	(-2.15)**
FIC 100	(-2.29)**	(-2.28)**	(-2.87)***	(-2.86)***
N	10297	10297	10297	10297
R^2	0.019	0.020	0.012	0.013
Firm FE	Yes	Yes	Yes	Yes
Year-quarter FE	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes
Confounders	No	Yes	No	Yes

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Chapter 3

Politically Influenced Bank Lending

3.1. Introduction

The interaction between finance and politics has always been a hot topic of debate and discussion. With the sudden surge in global populism in recent years,[1] actions of the so-called elites are under much bigger spotlights than they were over the past decades. People in parts of the world are less-than-happy about the *quid pro quo* relationship between corporations and politicians, and the perception that some are abusing their office for personal gains.[2] The notion that large corporations are running governments has gained much traction. Former US vice-president Al Gore said in his book, *The Future*, that the United States Congress... is now incapable of passing laws without permission from the corporate lobbies and other special interests that control their campaign finances."

I contribute to the literature by offering a new channel for politically connected firms' ability to borrow at cheaper rates than nonconnected firms. Defining borrowers to be politically connected if the Chairman of the US Senate Banking Committee is from the

[1] Evident from Le Pen of France, Duterte of the Philippines, Erdogan of Turkey, and Trump of the United States.

[2] For example, Operation Car Wash in Brazil, the sentencing of former South Korean president Park Geun-hye, the Panama papers, FIFA's corruption scandal, and President Xi Jinping's anti-corruption campaign in China.

same state as the borrower's headquarter at the time of loan origination, I find evidence consistent with the notion that the Chairman is incentivized by reelections to actively help his local firms lower their cost of bank loans. Furthermore, I document banks that provide more loans to connected borrowers enjoy higher future excess stock returns. There is a large body of literature on the firms' costs and benefits from being politically connected. Some find that being politically connected is perceived favorably by the market (e.g., Fisman, 2001; Acemoglu, Johnson, Kermani, Kwak, and Mitton, 2016; Akey, 2015; Berkman, Cole, and Fu, 2010; Claessens, Feijen, and Laeven, 2008; Child, Massoud, Schabus, and Zhou, 2020; Faccio, 2006). Others examine tangible costs and benefits. Prior literature has found numerous benefits from being politically connected, including easier access to government relief fundings (Duchin and Sosyura, 2012) and bailouts (Faccio, Masulis, and McConnell, 2006), a higher probability of successfully acquiring targets and avoiding regulatory delays and denials (Ferris, Houston, and Javakhadze, 2016), less regulatory scrutiny (Correia, 2014; Child et al., 2020), and a higher probability of being awarded with government procurement contracts (Schoenherr, 2016; Tahoun, 2014; Child et al., 2020; Goldman, Rocholl, and So, 2013).

Consistent with the exchange of favors hypothesis, there exists a series of papers documenting costs of maintaining political connections. For example, Faccio and Hsu (2017) find that establishments operated by acquisition targets of politically connected private equity firms increase employment more during election years and in states with high levels of corruption. Bertrand, Kramarz, Schoar, and Thesmar (2018) document similar findings in France. They find that companies connected to local politicians increase job creation and reduce job destruction during election years. Tahoun and Vasvari (2017) find that politicians increase new personal liabilities by over 30% of their net worth in the first year of their finance committee membership.[3] They suggest that lenders create political connections with finance committee members in an attempt to obtain regulatory benefits.

Papers that study the effects of political connections on firms' cost of borrowing report

[3]Tahoun and Vasvari (2017) refer to the Senate Banking Committee and the House Financial Services Committee as finance committees.

conflicting results. Using loan-level data from Pakistan, Khwaja and Mian (2005) find that politically connected firms are able to borrow 45% more yet have 50% higher default rates. Bliss and Gul (2012) study Malaysian firms' borrowing behavior and find that politically connected firms bear higher costs of debt due to a higher perceived risk. These contradict Houston, Jiang, Lin, and Ma (2014), who find that politically connected firms enjoy cheaper loans due to lower perceived risks. Infante and Piazza (2014) examine overdraft facilities of Italian firms and find that politically connected firms enjoy lower costs.

I contribute to this debate along three dimensions – a new channel for connected firms' ability to obtain cheaper bank loans that is consistent with the exchange of favors hypothesis, documentation of banks benefiting from providing these loans, and a geographical measure of political connection that provides a direct channel of influence.

First, I offer an alternative channel for connected borrowers' ability to obtain cheaper bank loans. Houston et al. (2014) find that politically connected firms are able to borrow at lower spreads (13 – 20 bps) due to lenders recognizing the borrower's superior creditworthiness as a result of implicit benefits that will be derived due to their political connectedness, implying that politicians do not actively persuade the banks to provide cheaper loans to connected borrowers.

My results suggest that the Chairman may play an *active* role and do so to increase their probability of being reelected. I examine campaign contribution to the Chairman, and find that (i) connected borrowers increase their contribution *after* obtaining cheap loans – one bp saved translates to approximately 25% increase in contribution, (ii) nonconnected borrowers' contribution behavior is not impacted by the price of their loans, (iii) loan prices' impact on connected borrowers' contribution behavior remains similar before and after the Chairman's announcement to step down from the chairmanship, provided the Chairman retains his role as a senator, and (iv) loan prices have no impact on connected borrowers' contribution behavior after the Chairman announces his retirement from Congress. These findings strongly support the notion that the Chairman is incentivized to help local borrowers to increase his probability of winning reelections. Results also suggest that politicians (or

the Chairman of the Senate Banking Committee to be precise) may play an *active* role in helping connected borrowers obtain cheaper bank loans, and are consistent with the exchange of favors hypothesis previously documented in the literature (e.g., Faccio and Hsu, 2017; Bertrand et al., 2018; Tahoun and Vasvari, 2017).

Second, I find that banks benefit from providing loans to connected borrowers. The Chairman of the Senate Banking Committee has significant influence over the banking sector. As such, it is logical that banks would be willing to help their local firms by providing cheaper loans to them. However, it is also logical that banks must be benefiting from providing these loans for this behavior to persist. I document that the percentage of connected loans a bank provides is positively associated with its excess stock return over the next year. The specific channel through which banks enjoy higher stock returns is difficult to pin down, as the Chairman could be returning favors in multiple ways that may change over the years. Nonetheless, this finding is important as it sheds light on banks' incentive.

Third, I adopt a geographical measure of political connection that offers a clear channel of influence that stems from the powers of the Senate Banking Committee. Due to the complex political and legal backgrounds both across and within countries, there is not a standardized way of measuring political connection. Some common measures include top officers' and/or board members' political party affiliation and/or previous government position (e.g., Faccio, 2006; Goldman, Rocholl, and So, 2009; Amore and Bennedsen, 2013; Acemoglu, Hassan, and Tahoun, 2018; Li, Meng, Wang, and Zhou, 2008; Ferris et al., 2016; Agrawal and Knoeber, 2001), political contributions (e.g., Akey, 2015; Jayachandran, 2006), connection to heads of governments (e.g., Johnson and Mitton, 2003; Child et al., 2020; Fisman, 2001; Fisman, Fisman, Galef, Khurana, and Wang, 2012), and geographical proximity (e.g., Faccio and Parsley, 2009; Kim, Pantzalis, and Park, 2012; Agarwal, Amromin, Ben-David, and Dinc, 2018; Kostovetsky, 2015).

The suitability of each measure depends on the question being studied. Previous studies on political connection and loan pricing tend to use generic measures of connectedness that fails to provide a clean channel of influence. For example, Houston et al. (2014) follow

Goldman et al. (2009), and define a firm to be connected if at least one board member and/or director either holds or held an important government or political position." Some positions are obviously powerful and could bring implicit benefits and influence loan prices (e.g., President of the US); others are less obvious (e.g., staff members to political parties). Chen, Shen, and Lin (2014) use affiliation to and public support of political parties as their measure of connectedness. However, the same issue arises – it is not obvious that having once publicly supported the ruling party would lead to cheaper loans.

I define a borrower to be connected if the Chairman of the US Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination.[4] According to the Standing Rules of the Senate, Rule XXV 1(d)(1), the committee has jurisdiction over matters related to banks, banking, and financial institutions, price controls, deposit insurance, export promotion and controls, federal monetary policy, financial aid to commerce and industry, issuance and redemptions of notes, currency and coinage, public and private housing, urban development, mass transit and government contracts. The Chairman has the most authority in the committees, so by extension, he undoubtedly has significant influence over banks.[5]

I rule out several alternative explanations and conduct a number of robustness checks. To start with, some may argue that many of these Chairmen do not face closely-contested reelections. Thus, their motivation to help local borrowers should not be one about votes. Whilst it is true that some Chairmen won their reelections by landslides, by no means does it imply that politicians do not *ex-ante* campaign as hard as they can to maximize the number

[4]The Senate Banking Committee is also known as the Senate Committee on Banking, Housing, and Urban Affairs. Details of Chairmen can be found in Table 3.A3 in the Appendix.

[5]I avoid defining connection to the Chairman of the House Financial Services Committee for my main analyses. This is simply because members of the House of Representatives (hereinafter House) are from what is known as Congressional districts. A state contains multiple districts depending on its size. For instance, as of March 2019, Rhode Island has two Congressional districts; California has 53. Defining politically connection based on districts then, severely restricts the sample size. Nevertheless, I examine borrowers headquarter in the same district as the Chairman of the House Financial Services Committee as a robustness test. Results are qualitatively similar.

of votes they receive.[6] To test my argument, I divide my loan sample into two groups – those that originated following closely-contested reelections (of the Chairman of the Senate Banking Committee) and those that originated following non-closely-contested reelections.[7] I find that connectedness provides an additional 23 bps reduction in borrowing costs for loans originated following closely-contested reelections compared to for those originated following non-closely-contested reelections. This implies that those Chairmen who faced closely-contested reelections offer larger benefits to local firms. It is consistent with the hypothesis that the Chairman is incentivized by reelection.

Additionally, firms' prior contributions could be an alternative explanation of my results. My definition of political connectedness concerns geographic proximity. Therefore, it is not implausible that connected borrowers are more likely to have contributed in the past, and that previous contributions, instead of locality, are the drivers of cheaper loans. I reject this proposition by studying the loan prices of borrowers who contributed to the Chairman in the one and three year(s) prior to loan origination, and find that they do not obtain more favorable loan terms.

A second alternative explanation is that banks actively and voluntarily offer cheaper loans to connected borrowers, either as attempts to appeal to the Chairman, or because they perceive connected borrowers to possess superior credit worthiness. To the former, I offer some discussion around the reasons why banks are unlikely to appeal to the Chairman through cheaper loans to his constituents, chief among which is the banks' ability to contribute directly to the Chairman. To the latter, I find that public debts issued by connected borrowers are no cheaper than those issued by nonconnected borrowers, ruling out superior creditworthiness as the explanation for my findings.

A third alternative explanation is that borrowers connected to powerful senators, not just the Chairman of the Senate Banking Committee, are able to borrow on superior terms.

[6] Voting outcomes are not entirely predictable, as demonstrated by the 2018 US midterm election in New York's 14th district, where Alexandria Ocasio-Cortez, who began her campaign while waiting tables at a Mexican restaurant and operated out of a paper bag hidden behind that bar", beat 10-term incumbent and expected successor to Democratic House leader Nancy Pelosi, Joe Crowley.

[7] I use the *ex-post* winning margins to proxy for the closeness of reelections. Sample is divided into two groups based on the median winning margin.

To test this, I examine loans made to borrowers headquartered in the same states as Chairmen of the Senate (i) Judiciary, (ii) Appropriations, (iii) Intelligence, and (iv) Finance Committees at the time of loan origination. Results show that connection to these Chairmen has no impact on loan prices.

A fourth alternative explanation may be that syndicated loans of connected borrowers are more likely to include local lenders, thereby increasing information efficiency and reducing spreads. However, I find that less than one percent of my sample of syndicated loans contains local lenders; ruling out this explanation without the need for any formal tests.

For robustness, I first examine whether my geographical definition of political connection remains a powerful explanator after accounting for the firm board's connectedness as defined in Houston et al. (2014).[8] Results indicate that geographical connection possesses superior explanatory power than board connectedness.

I also examine the loans of borrowers connected to the Chairman of the House Financial Services Committee, which has similar powers as the Senate Banking Committee. It stands to reason that borrowers connected to the Chairman of the House Financial Committee should also be able to obtain more favorable loan terms. Using the same geographical measure of connectedness (only based on Congressional districts instead of States), I find similar results (i.e., connected borrowers enjoy more favorable loan terms).

In addition, the Chairman of the Senate Banking Committee has, for the majority of the past 15 years, come from relatively smaller states (i.e., states with few firms). This may create econometric concerns, as the sample of connected loans is concentrated in the late 1990's to early 2000's, when the Chairman was from New York and Texas, respectively. To address this concern, I construct a matched sample based on loan origination year, borrower industry, borrower financials, and loan characteristics. Findings remain similar in the matched sample.

[8]Houston et al. (2014) follow Goldman et al.'s 2009 definition of political connectedness. They define a firm to be politically connected if at least one of the board members holds or held an important political or regulatory position. See Table 3.A1 for a more detailed definition.

Moreover, I distinguish between firm and employee contributions.[9] Contributions made by employees may represent individuals' own political beliefs rather than the firm's political strategy (Barber, 2016). I thus exclude employee contributions and examine only those made by firms' PACs. Results suggest that firm PAC contribution is more sensitive to loan prices than employee contribution. This is unsurprising given that individual contributions are likely to be sticky if one assumes they are reflections of beliefs instead of financial benefits.

Finally, I examine prime rate-based loans (as opposed to LIBOR-based loans used in all previous analyses) and show that my results are not limited to LIBOR-based loans. I also discuss reasons why my findings suggest the Chairman's active involvement, rather than banks voluntarily lowering costs of loans extended to connected borrowers.

The rest of the paper is organized as follows. Section 3.2 describes the data and offers some background context. Empirical results and discussions can be found in Section 3.3. Section 3.4 details falsification and robustness tests. Section 3.5 concludes.

3.2. Background and Data

3.2.1 Loan Pricing and Borrower Financial Data

Loan data between 1989 and 2018 are collected from Thomson Reutuers' LPC DealScan.[10] Following Chava and Roberts (2008), I match each loan to a borrower, and obtain data on their financials from Compustat.[11] I exclude loans (i) for which I cannot identify the borrower, (ii) that did not originate in the United States, (iii) made to financial institutions (SIC codes 6000 to 6799), and (iv) for which I cannot obtain the borrower's financial

[9] Firm contributions refer to those made by the firm's PAC. These are discussed in more detail in Section 2.2.

[10] A detailed description and analyses of the LPC DealScan database can be found in Berg et al. (2016). I start my sample from 1989 due to the sparse coverage of the DealScan database in earlier years (Schwert, 2018).

[11] Loan contracts in DealScan are referred to as *packages*, each contract (package) may contain one or more *facilities* (i.e., loans).

statement information from Compustat.

Comparing spreads becomes problematic if connected and nonconnected borrowers exhibit substantially different preferences in their base rates.[12] Figure 3.1 shows that the proportion of loans by base rate is remarkably similar across connected and nonconnected loans, indicating connected firms borrow on similar base rates, on average, as nonconnected borrowers. This allows me to focus on LIBOR-based loans in my main analyses, as they represent nearly 60% of all US-originated loans during the sample period.[13]

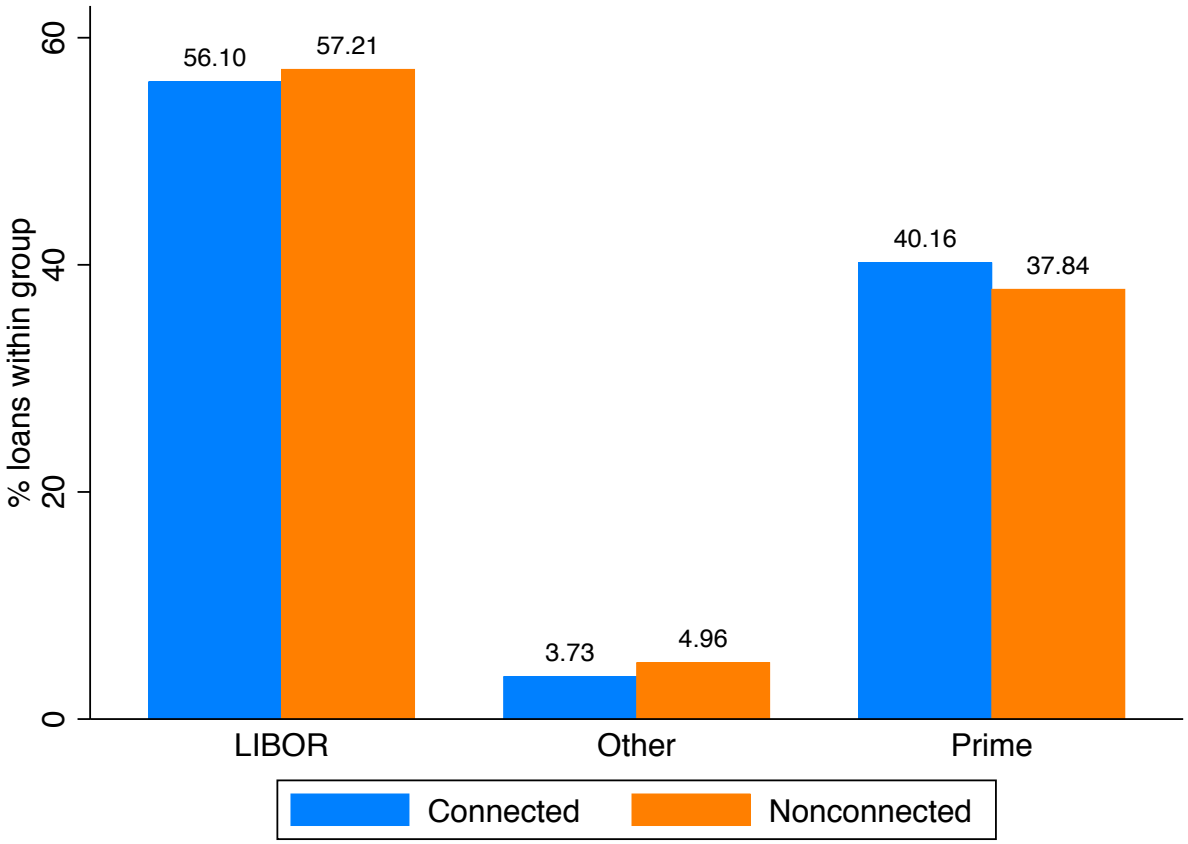

Fig. 3.1: Percentage of loans within each group by base rate. Base rate is the rate on which spreads are quoted. A loan is defined to be connected if the Chairman of the US Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination. The sample used to construct this graph consists of 53,521 US originated loans with identifiable borrower and nonmissing firm characteristics, of which 2,064 are connected. The proportion of base rates across connected and nonconnected loans are very similar, thus allowing me to focus on loans based on LIBOR.

In addition to all-in-spread-drawn (AISD) – the primary measure of loan price adopted

[12]The base rate is the rate on which the loan is quoted (e.g., LIBOR).

[13]I later examine prime rate-based loans, as a robustness test, in Section 3.4 of this paper.

in most studies that utilize the DealScan database – I also adopt a more comprehensive measure as suggested by Berg, Saunders, and Steffen (2016).[14] AISD is a measure of spread over the LIBOR plus any facility fee, and is payable on the drawn portion of the loan.[15] It has to be paid on the *drawn* portion of the loan. Although AISD is commonly used in the literature on bank loan pricing, it may be not the ideal measure given the embedded options that exist in loan contracts (Berg et al., 2016). For example, General Mills took out a $1 billion line of credit in 2014. This does not mean General Mills received $1 billion from the banks, rather it gave them the option to draw any amount up to $1 billion should they choose to. A line of credit, or revolver, then, contains the option to draw at a specific spread.[16]

Comparing a line of credit with a more traditional term loan (where the borrower receives a lump sum cash payment on the loan origination day) then, is problematic. In most cases, the borrower has to pay a *all-in-spread-undrawn* (AISU) to maintain their access to a line of credit (think of AISU as an option's premium), however it typically does not apply to term loans.[17] To exacerbate the problem, there exits a collection of other fees, including but not limited to utilization fee (paid on entire drawn amount once the borrower exceeds a predefined usage threshold), cancellation fee (paid if the syndicated loan is canceled before maturity), and upfront fee (paid upon completion of a syndicated loan). Simply using AISD then, may not offer the cleanest indication of loan prices.

To overcome this obstacle, I adopt Berg et al.'s (2016) *total cost of borrowing* (TCB) as an additional measure of loan pricing.

[14]Some examples of papers that focus on AISD include Lin, Ma, Malatesta, and Xuan (2011), Lim, Minton, and Weisbach (2014), and Houston et al. (2014). Notable exceptions include Shockley and Thakor (1997) and Ivashina (2009).

[15]Facility fee is fee paid on the entire committed amount, regardless of usage.

[16]Berg et al. (2016) identify three main options included in loan contracts – option to draw on a line of credit, option to terminate a loan contract, and option to request a competitive bid.

[17]AISU is defined as the sum of facility fee and commitment fee (i.e., fee paid on unused amount of loan commitments).

$$
\begin{aligned}
TCB = {} & Upfront\ Fee/Expected\ Loan\ Maturity\ in\ Years \\
& + (1 - PDD) \times (Facility\ Fee + Commitment\ Fee) \\
& + PDD \times (Facility\ Fee + Spread) \\
& + PDD \times \text{Prob}(Utilization > Utilization\ Threshold | Usage > 0) \\
& \quad \times Utilization\ Fee \\
& + \text{Prob}(Cancellation) \times Cancellation\ Fee,
\end{aligned}
\tag{3.1}
$$

where *PDD* denotes the probability of draw down. It should be clear from equation (3.1) that the TCB measure reflects many important characteristics of bank loan pricing and includes various fees.[18]

3.2.2 Chairmen and Political Contribution Data

The Senate is the upper chamber of the US Congress.[19] Each state has two senators, who are up for reelection every six years, making a total of one hundred senators. The chairman of all Senate Committees is from the majority party (i.e., the party with the most seats in the Senate), and chairmanship is determined by seniority within the party. Information regarding the Chairman of the US Senate Banking and House Financial Services Committees is from the Official Congressional Directories. Table 3.A3 in the Appendix contains information regarding Chairmen of the Senate Banking Committee between 1989 and 2018.

Contribution data are obtained from the Federal Election Commission (FEC). The FEC assigns a candidate number to each individual running for an office in the US Congress.[20] Strictly speaking, firms cannot contribute to candidates directly, but can only contribute via political action commitees (PACs). I include contributions made by firm employees and PACs. Firms have the option to set up PACs to solicit money from company employees, and the firm contributes the cash as it sees fit. Treasurers of firm PACs are often lobbyists

[18] A detailed explanation of the TCB measure can be found in Section III and the Internet Appendix of Berg et al. (2016).

[19] The lower chamber is the House of Representatives.

[20] If an individual ran for both the House and the Senate, s/he will have two separate candidate numbers.

or individuals with political knowledge and/or connections. Contributions can be made to a politician's campaign committees (a.k.a. candidate committee) or leadership PACs. As the name suggest, contributions made to campaign committees can only used for the purpose of campaigning for elections.

Leadership PACs, on the other hand, are much less scrutinized, and can be established by both current and former members of Congress as well as other prominent political figures. The Centre for Responsive Politics describes leadership PACs' purpose as to make friends and money." For example, Former Democratic senator from Louisiana, Mary Landrieu, gave $5,000 to the campaign of Al Franken, former Democratic senator from Minnesota, during the 2014 federal election cycle. Republican senator Rand Paul from Kentucky spent more than $11,000 from this leadership PAC at restaurants in Italy and Malta in 2018, arguing that they were part of fundraising efforts. Leadership PACs, then, are of great importance to politicians, and contributions made to them should not be neglected.[21]

The FEC sets strict contribution limits, subject to periodic adjustments. In the 2020 federal election cycle, a candidate's campaign committee is allowed to receive a maximum of $2,800 (per election; e.g., primary and general count as two elections) from each individual and $5,000 from each PAC (per election).[22] In the same cycle, a leadership PAC is allowed to receive, separate from campaign committee limits, up to $5,000 (per year) from each individual and $5,000 (per year) from each PAC.

I manually collect each Chairman's candidate number(s) and use these to obtain contribution data related to their campaign committees and leadership PACs. Oftentimes, a candidate will have joint fundraising committees (or joint victory committees). For example,

[21]The relative sizes of campaign committees and leadership PAC vary from politician to politician, but leadership PAC are generally smaller than campaign committees. For example, according to the Centre for Responsive Politics, contributions toward former Connecticut senator Chris Dodd's leadership PAC totaled $2.3 million in the 2008 federal election cycle. Over the same period, his campaign committee received $8.9 million in contributions.

[22]The $5,000 limit is applicable to multicandidate PACs only. To qualify as a multicandidate PAC, a nonconnected committee (i.e., not a party committee or an authorized committee of any candidate) must (i) be registered with the FEC for at least six months, (ii) receive contributions from at least 51 persons, and (iii) contribute to at least five federal candidates. The contribution limit is $2,800 for other nonconnected (i.e, nonmulticandidate) PACs.

Tim Johnson of South Dakota and Paul Wellstone of Minnesota authorized a joint fundraising committee called the Johnson Wellstone Event Committee. Joint committees have been largely ignored in the literature, but their importance has risen quickly in recent years.[23] The Centre for Responsive Politics reports that joint fundraising committees raised $84 million in the 2002 election cycle; that number grew to $1.2 billion in 2016. I split all contributions received by these committees equally among all authorizing candidates.

Table 3.1
Summary statistics. A loan is defined to be connected if the Chairman of the US Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination. Variable definition can be found in Table 3.A1.

	Mean	S.D.	Mean	S.D.	Difference in means
Panel A: Loans					
	Connected ($N = 1,147$)		Nonconnected ($N = 28,743$)		
TCB (bps)	125.51	104.76	142.23	141.55	-16.72^{***}
AISD (bps)	170.51	109.64	191.31	132.49	-10.81^{***}
Syndicate Size	9.16	9.78	8.84	8.70	0.32
Lead Size	1.29	1.41	1.21	0.92	0.08^{*}
Maturity (months)	44.82	25.19	50.70	22.64	-5.88^{***}
Loan Amount ($M)	327.30	540.66	379.26	567.04	-51.96^{***}
Panel B: Borrower-years					
	Connected ($N = 723$)		Nonconnected ($N = 18,906$)		
Profitability	0.19	0.16	0.18	0.13	0.01
Assets ($Bn)	3.94	8.22	5.20	11.69	-1.25^{***}
Interest Coverage	12.70	37.73	21.25	54.54	-8.55^{***}
Leverage	0.35	0.25	0.33	0.23	0.02^{***}
S.D. of Profitability	0.04	0.06	0.03	0.04	0.01^{***}
Book-to-Market	0.61	0.69	0.55	0.62	0.06^{**}
Altman Z-Score	2.98	2.55	3.23	3.36	-0.25^{**}

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Descriptive statistics are provided in Table 3.1. Panel A provides summary for loans. We see that both TCB and AISD are significantly lower for loans of connected borrowers than for those of nonconnected borrowers. The magnitude of differences are also economically significant at 16 and 20 bps, respectively. Given an average loan amount of $330 million and maturity of 45 months, this represents a $2.5 million cash saving on a typical loan lent to a connected firm. Panel B contains statistics regarding firm characteristics. Connected borrowers are able to obtain cheaper bank loans despite having inferior financial

[23]The idea behind joint committees, as described by the Center for Responsive Politics, is that these allow politicians to reap more together than they can on their own". Politicians are still unable to receive more than the contribution limit from donors, but joint committees allow donors to make a single large contribution to be divided among politicians. This is thought to be a more efficient way of soliciting contributions.

measures (i.e., lower asset value, lower interest coverage ratio, higher leverage, more volatile profitability, and lower Altman Z-score) as compared to nonconnected borrowers.

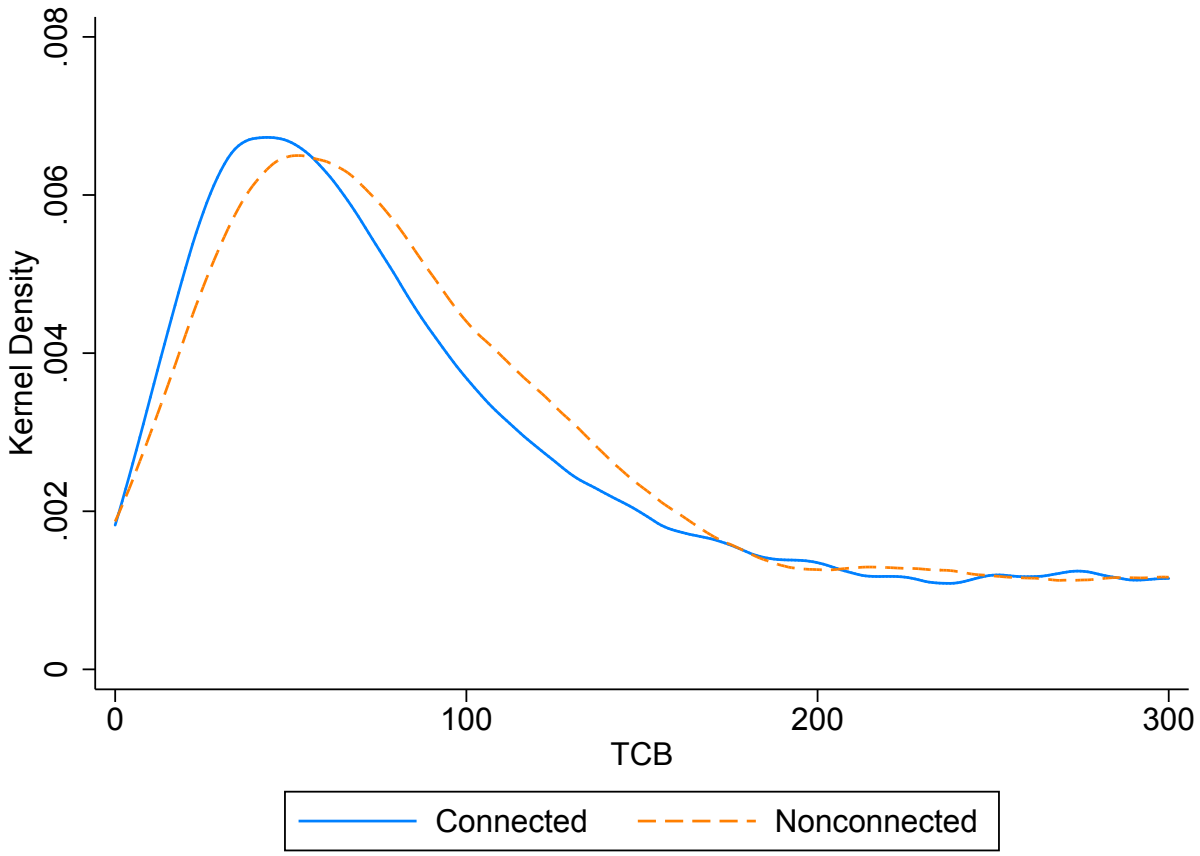

Fig. 3.2: Kernel density of TCB of connected and nonconnected loans. A loan is defined to be connected if the Chairman of the US Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination. TCB is calculated following Berg et al. (2016).

Figure 3.2 visually depicts the difference in TCB between connected and nonconnected borrowers. The kernel density plot of TCB of connected borrowers (blue solid line) has larger mass toward the lower end as compared to that of nonconnected borrowers (orange dashed line), indicating lower average TCB.

3.3. Empirical Results

3.3.1 Banks & Firms – Connected vs. Nonconnected Loans

Having established that connected loans are cheaper despite connected firms having relatively unfavorable characteristics, I test my hypothesis in a more formal multivariate regression setting. The baseline model is

$$\begin{aligned} C_{i,j,t} = \beta_0 + \beta_1 Connection_{j,t} + \gamma' X_{j,t-1} + \delta' Z_{i,j,t} \\ + Industry\ FE + Year\ FE + Loan\ Type\ FE + Lender\ FE + \epsilon_{i,j,t}, \end{aligned} \tag{3.2}$$

where i denotes individual loans, j denotes borrowers, and t denotes the year of loan origination. C is either TCB or AISD. *Connection* is an indicator variable that equals to one if the Chairman of the Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination and zero otherwise. X is a set of borrower characteristics including profitability, assets, interest coverage, leverage ratio, standard deviation of profitability, book-to-market ratio, and the Altman Z-score. Z is a set of loan characteristics including syndicate size and lead size. Industries are classified using the Fama-French 49-industry classification. Year is based on the year of loan origination. Loans are classified into four types – credit line ($<$ 1 year), credit line ($\geq$ 1 year), term loan, and others. Lender is defined as the lead lender if the loan is syndicated. In cases where there are multiple lead lenders, the one with the largest share of the loan is used. Variable definitions are provided in Table 3.A1 of the Appendix.

Table 3.2 contains the results of the baseline regression as presented in equation (3.2). We see that after controlling for borrower characteristics, bank loans made to connected borrowers are 13 bps cheaper as compared to those made to nonconnected firms; this figure

Table 3.2
Loan-level baseline regression showing connected loans are more favorable to the borrower than nonconnected loans. A loan is defined to be connected if the Chairman of the US Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination. Columns 5 to 8 adopt firm fixed effects. For these columns, firms that (i) only take out one loan or (ii) take out all loans in the same year are dropped from the sample. Loans are classified into four types – credit line (< 1 year), credit line (≥ 1 year), term loan, and others. Lender is defined as the lead lender. In cases where there are multiple lead lenders, the one with the largest share of the syndicated loan is used. t-statistics are in parentheses. Standard errors are clustered by industry based on the Fama-French 49-industry classification in columns 1 to 4, and by firm in columns 5 to 8.

	(1) TCB	(2) TCB	(3) AISD	(4) AISD	(5) TCB	(6) TCB	(7) AISD	(8) AISD
Connection	-13.51***	-14.43***	-10.84***	-11.31***	-10.99**	-11.72**	-2.29	-1.92
	(-3.93)	(-4.00)	(-2.74)	(-2.80)	(-2.18)	(-2.41)	(-0.40)	(-0.35)
Profitability	-34.51***	-28.85**	-74.81***	-66.50***	-45.12***	-43.85***	-88.06***	-82.97***
	(-2.69)	(-2.35)	(-5.61)	(-4.49)	(-3.05)	(-3.10)	(-5.39)	(-5.17)
Log(Assets ($M))	-14.43***	-5.00***	-20.82***	-8.48***	-16.90***	-11.07***	-22.96***	-12.32***
	(-11.57)	(-2.97)	(-14.30)	(-4.76)	(-14.89)	(-7.11)	(-18.15)	(-7.63)
Log(Int. Coverage)	-20.84***	-19.71***	-22.72***	-21.66***	-20.24***	-19.17***	-19.39***	-18.24***
	(-15.46)	(-15.25)	(-14.62)	(-13.72)	(-10.07)	(-9.79)	(-9.14)	(-8.81)
Leverage	81.30***	81.85***	61.96***	63.20***	56.42***	57.04***	37.92***	38.44***
	(9.42)	(10.16)	(7.60)	(8.07)	(6.67)	(6.90)	(4.30)	(4.39)
S.D. of Profitability	187.26***	187.98***	236.42***	240.31***	175.31***	182.72***	182.83***	190.08***
	(3.60)	(3.71)	(3.88)	(4.08)	(4.34)	(4.63)	(4.76)	(5.05)
Book-to-Market	-5.34**	-6.59***	-1.07	-2.55	-4.72**	-5.68**	-1.38	-2.90
	(-2.17)	(-2.78)	(-0.39)	(-0.94)	(-2.00)	(-2.43)	(-0.57)	(-1.18)
Altman Z-Score	-0.61	-0.50	-1.00	-0.85	-0.39	-0.34	-1.03	-0.88
	(-1.18)	(-1.07)	(-1.62)	(-1.50)	(-0.52)	(-0.48)	(-1.16)	(-1.06)
Syndicate Size		-1.68***		-1.08***		-1.91***		-1.26***
		(-11.60)		(-8.42)		(-11.02)		(-8.41)
Lead Size		13.11***		7.74***		9.69***		4.70***
		(7.39)		(5.10)		(7.63)		(4.21)
Log(Maturity (mths))		18.88***		25.61***		15.59***		28.66***
		(3.75)		(7.47)		(3.57)		(8.68)
Log(Loan Amt. ($M))		-11.51***		-18.48***		-3.98**		-14.60***
		(-5.15)		(-8.66)		(-2.45)		(-9.61)
Industry FE	Yes	Yes	Yes	Yes	No	No	No	No
Firm FE	No	No	No	No	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Loan Type FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Lender FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	29890	29890	29890	29890	17434	17434	17434	17434
Adjusted R^2	0.340	0.365	0.396	0.426	0.209	0.225	0.207	0.244

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

increases to over 14 bps once loan characteristics are controlled for.[24] It is worth mentioning that coefficients of all control variables are of the expected sign. For example, higher leverage leads to more expensive loans. I also run the same regressions using AISD as the dependent variable. Results are presented in columns 3 and 4. The findings are quantitatively similar, with the saving being 11 to 12 bps. This is unsurprising given that Berg et al. (2016) showed AISD fails to capture the complexity of options embedded in loan contracts. So it is not implausible that this difference is a result of connected firms enjoying lower fees in other categories.

Columns 5 to 8 of Table 3.2 include firm rather than industry fixed effects. This is conceptually more robust, as firm fixed effects account for any time-invariant firm-level unobservables. I exclude firms that (i) only borrow once or (ii) take out all their loans in a single year in the sample period. Results are similar to those presented in columns 1 to 4. I do not adopt firm fixed effects in the rest of the analyses because it entails losing roughly 40% of my sample.

Having established that connected borrowers are able to access cheaper loans, it is natural to examine if this is due to political favoritism. I argue that if this were due to political favoritism, then the Chairman is likely to be favoring firms in his state for reelection purposes. There are at least two mutually non-exclusive ways for the Chairman to benefit, reelection-wise, from firms in his state being able to access cheap loans and hence enjoy superior financial performance. First, cheaper loans directly translate to cash savings, which may be used as contribution toward the Chairman's reelection funds. Second, employees of these firms are likely to enjoy better job security, or even financial rewards, as a result of their employer doing well financially. Both would increase the probability of the Chairman being reelected.

[24] Panel A of Table 3.1 shows connected loans are smaller and shorter in maturity than nonconnected loans. These may be due to capital structure choices made by the borrowers, or implications regarding their debt capacity and creditworthiness; with the latter making it difficult to argue that connected loans have superior terms. Whilst I control for the loan maturity and amount by including these as independent variables in my regression analyses, some researchers choose to use them as dependent variables (e.g., Braggion, Dwarkasing, and Moore, 2017). Following this methodology, Table 3.A2 in the Appendix shows that connectedness has no impact on loan maturity or amount. Excluding loan maturity and amount as controls for all my analyses has no material effect on my results.

To test this hypothesis, I divide the sample into three subsample – loans that originated (i) prior to each Chairman announcing his departure from the chairmanship (Table 3.3 Panel A), (ii) after each Chairman announces his departure and the Chairman is to remain in the Senate (Table 3.3 Panel B), and (iii) after each Chairman announces his departure and retirement from Congress (Table 3.3 Panel C).[25] If the change in chairmanship is due to the majority party losing control of the Senate or the Chairman losing his reelection, then I adopt the election results announcement date as the departure announcement date. If the change in chairmanship is due to Senate Republican's six-year rule, under which a Senator shall serve no more than six years, cumulatively, as chairman of the same standing committee", then I treat 365 days prior to departure as the announcement date. These scenarios are associated with varying degrees of surprise (e.g., departures due to Senate Republican's six-year rule should be fully anticipated by the market). However, this is not a factor of concern, because I am interested in the Chairman's actions, not borrowers', after he decides to retire or anticipates his party losing the Senate. In either case, the announcement date is likely to be *later* than the actual decision or expectation date (e.g., the Chairman is likely to have decided to retire *prior to* making a public announcement), thereby creating noises that work against finding any results.

Panel A of Table 3.3 suggests similar findings as Table 3.2, namely, connected borrowers are able to obtain more favorable bank loans in the pre-departure announcement period. Panels B and C present clear distinctions. Post-announcement, connected loans are cheaper only if the Chairman is remaining in the Senate (Panel B). If the Chairman is retiring from Congress, connected loans originated after his departure announcement exhibit no clear superiority. This is not illogical – if the Chairman is retiring from Congress, he has no incentive to aid local borrowers. It is consistent with the hypothesis that the Chairman helps local borrowers chiefly for reelection purposes, as well as previous literature documenting that politically connected firms actively help their politician friends getting reelected (e.g., Faccio and Hsu, 2017; Bertrand et al., 2018; and Tahoun and Vasvari, 2017).

[25]Retirement from Congress can be voluntarily (e.g., not seeking reelection) or due to reelection loss. I do not distinguish between the two.

Table 3.3
Loan-level regression showing how cheapness of connected loans differ depending on the Chairman's departure decision. If the Chairman is stepping down due to his party losing the majority in the Senate, then I treat the date of election results announcement as the departure announcement date. Panel A contains loans originated prior to announcements. Panel B contains loans orginated after announcements, but the Chairman remains a senator. Panel C contains loans made after announcements, and the Chairman is retiring from Congress. A loan is defined to be connected if the Chairman of the US Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination. Loans are classified into four types – credit line ($<$ 1 year), credit line ($\geq$ 1 year), term loan, and others. Lender is defined as the lead lender. In cases where there are multiple lead lenders, the one with the largest share of the syndicated loan is used. t-statistics are in parentheses. Standard errors are clustered by industry based on the Fama-French 49-industry classification.

	(1) TCB	(2) TCB	(3) AISD	(4) AISD
Panel A: Pre-departure announcement				
Connection	-13.27***	-15.08***	-11.15***	-12.23***
	(-3.45)	(-3.78)	(-2.82)	(-3.10)
N	23700	23700	23700	23700
Adjusted R^2	0.339	0.362	0.389	0.420
Panel B: Post-departure announcement (remains senator)				
Connection	-13.64*	-14.51**	-16.35	-16.50*
	(-1.80)	(-2.13)	(-1.61)	(-1.80)
N	2921	2921	2921	2921
Adjusted R^2	0.353	0.378	0.417	0.439
Panel C: Post-departure announcement (leaves Congress)				
Connection	-10.16	-5.27	-5.51	-2.47
	(-0.89)	(-0.52)	(-0.56)	(-0.26)
Firm Controls	Yes	Yes	Yes	Yes
Loan Controls	No	Yes	No	Yes
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Loan Type FE	Yes	Yes	Yes	Yes
Lender FE	Yes	Yes	Yes	Yes
N	3269	3269	3269	3269
Adjusted R^2	0.346	0.389	0.405	0.441

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

3.3.2 Firms & Politicians – Political Contributions

Given that reelection seems to be a major concern for Chairmen, I turn my attention to campaign finances, namely, contribution to campaign committees and leadership PACs. I examine how the pricing of loans affects changes in contributions made by borrowers toward the Chairman.[26] To test whether borrowers' contribution behavior is influenced by their loan prices, I adopt the model

$$\begin{aligned}\left(\frac{Contribution_{j,(s,s+365)}}{Contribution_{j,(s-365,s)}} - 1\right) = \beta_0 + \beta_1 \overline{C}_{j,t} + \beta_2 \overline{C}_{j,t} \times Connection_{j,t} \\ + \eta' W_{j,t-1} + \omega' \overline{Z}_{j,t} + Industry\ FE + Year\ FE \\ + Loan\ Type\ FE + Lender\ FE + \zeta_{j,t},\end{aligned} \tag{3.3}$$

where s is the day of loan origination. $Contribution_{j,(s,s+m)}$ denotes the total contributions made by firm j between s and $s+m$. W includes X (firm characteristics) and the *connection* main effect.[27] I add one to all contributions to avoid dividing by zero. Because this is a borrower-level regression, I use the mean values (denoted by a bar on top of the variable name) of loan characteristics, and the loan type and lead lender of the loan with the largest dollar value in cases where a borrower takes out multiple loans in a year. The choice to calculate percentage change in (year-to-date) contributions from $s-365$ to $s+365$ days allows for a clear indication of the timing of contributions in relation to that of loan origination. It also provides a better indication of the magnitude of changes as compared to measuring level changes.

Table 3.4 presents the results of equation (3.3). Here I do not distinguish between contributions from employees and firm PACs. In the full sample (Panel A), the coefficient

[26]Strictly speaking, company cannot contribute directly toward politicians' campaign committees. They must first establish a political action committee (PAC), which can in turn contribute toward politicians' campaign committees. I include contributions made by firms' employees and PACs in calculating their contribution toward a politician.

[27]The FEC kept records of contributions (i) greater than \$500 between 1979 and 1988; (ii) greater than \$200 between 1989 and 2014; and (iii) if the contributor's cycle-to-date (year-to-date) amount is greater than \$200 for contributions to candidate committees (PACs and party committees).

of the interaction term is significantly negative across all four columns. This shows that, on average, connected borrowers increase their contributions to the Chairman by roughly 25% per basis point of TCB saved. However, we do not observe any significant results for nonconnected borrowers. In other words, nonconnected borrowers do not alter their contributions to the Chairman based on the cheapness of the loans they receive. This contrast provides evidence supporting the notion that the Chairman of the Senate Banking Committee directly benefits from local firms being able to access cheap bank loans. It is also consistent with anecdotal evidence. For instance, former Speaker of the House Paul Ryan received approximately $500,000 in contributions from Charles and Elizabeth Koch 13 days after the Republican tax bill (what would later become the Tax Cuts and Jobs Act of 2017) passed in the House of Representatives.[28]

Table 3.4

Borrower-year regression showing connected borrowers increase their contribution to the Chairman of the US Senate Banking Committee *after* receiving favorable loan terms. The dependent variable is the percentage change in (year-to-date) contributions made by a firm from 365 days prior to and after loan origination. In cases of multiple loans made to a borrower in a single year, I use the mean values of loan characteristics, and the loan type and lead lender of the loan with the largest dollar value. Panel A contains the full sample of borrowers. Panel B contains borrower-years prior to departure announcements. Panel C contains borrower-years after departure announcements, but the Chairman remains a senator. Panel D contains borrower-years after departure announcements, and the Chairman is retiring from Congress. A borrower is defined to be connected if the Chairman of the US Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination. Coefficient on the *connection* dummy is suppressed. Loans are classified into four types – credit line ($<$ 1 year), credit line ($\geq$ 1 year), term loan, and others. Lender is defined as the lead lender. In cases where there are multiple lead lenders, the one with the largest share of the syndicated loan is used. t-statistics are in parentheses. Standard errors are clustered by industry based on the Fama-French 49-industry classification.

	(1)	(2)	(3)	(4)
Panel A: Full sample				
$\overline{\text{TCB}}$	-0.27	-0.32		
	(-0.31)	(-0.48)		
$\overline{\text{TCB}}$ × Connection	-25.83***	-26.10***		
	(-3.15)	(-3.22)		
$\overline{\text{AISD}}$			-0.41	-0.44
			(-0.56)	(-0.75)
$\overline{\text{AISD}}$ × Connection			-24.96***	-24.93***
			(-2.80)	(-2.81)
N	18906	18906	18906	18906
Adjusted R^2	0.014	0.014	0.014	0.014

[28]This contribution was made to Paul Ryan's joint fundraising committee (Team Ryan), which raises money for his campaign committee (Ryan for Congress), leadership PAC (Prosperity Action), and the National Republican Congressional Committee. As such, the total received by each entity was under the legal limit.

Table 3.4 *(continued)*

	(1)	(2)	(3)	(4)
Panel B: Pre-departure announcement				
$\overline{\text{TCB}}$	-0.28	-0.35		
	(-0.24)	(-0.40)		
$\overline{\text{TCB}}$ × Connection	-32.20***	-32.52***		
	(-2.74)	(-2.79)		
$\overline{\text{AISD}}$			-0.45	-0.49
			(-0.47)	(-0.66)
$\overline{\text{AISD}}$ × Connection			-35.27***	-35.16***
			(-2.91)	(-2.90)
N	14928	14928	14928	14928
Adjusted R^2	0.015	0.016	0.016	0.016
Panel C: Post-departure announcement (remains senator)				
$\overline{\text{TCB}}$	-0.62	-0.57		
	(-1.08)	(-0.84)		
$\overline{\text{TCB}}$ × Connection	-22.69***	-23.00***		
	(-3.14)	(-3.05)		
$\overline{\text{AISD}}$			-0.34	-0.30
			(-0.65)	(-0.59)
$\overline{\text{AISD}}$ × Connection			-11.74**	-12.00**
			(-2.63)	(-2.65)
N	1895	1895	1895	1895
Adjusted R^2	0.052	0.052	0.051	0.052
Panel D: Post-departure announcement (leaves Congress)				
$\overline{\text{TCB}}$	-0.17	-0.20		
	(-0.92)	(-1.07)		
$\overline{\text{TCB}}$ × Connection	-10.02	-9.88		
	(-1.63)	(-1.63)		
$\overline{\text{AISD}}$			-0.33	-0.35
			(-1.10)	(-1.24)
$\overline{\text{AISD}}$ × Connection			1.46	1.55
			(0.49)	(0.52)
Firm Controls	Yes	Yes	Yes	Yes
Loan Controls	No	Yes	No	Yes
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Loan Type FE	Yes	Yes	Yes	Yes
Lender FE	Yes	Yes	Yes	Yes
N	2083	2083	2083	2083
Adjusted R^2	0.032	0.030	0.023	0.022

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Panel B examines loans originated in periods prior to each Chairman's departure announcement. Results are quantitatively similar to those in Panel A. Interestingly, loan prices' influence on borrower contribution in post-announcement periods differ depending on

the nature of the departure. If the Chairman is to remain as a senator after stepping down (Panel C), then loan prices have a similar influence on contribution as in pre-announcement periods. However, if the Chairman is to retire from Congress (Panel D), then loan prices have no influence on contributions. This is consistent with the exchange of favors hypothesis (i.e., connected borrowers returns favors to the Chairman *after* receiving cheap loans.)

Some readers might have concerns over the seemingly large disproportionality between savings on loans and increases in contributions. However, it must be noted that the average firm does not contribute all that much toward senators' campaign committees and/or leadership PACs. For example, former Chairman of the Senate Banking Committee, Chris Dodd of Connecticut, received a total of $173,300 from his *largest* donor, United Technologies, between 2003 and 2008.[29] Contrast this with the average saving of $2.5m per connected loan, it is unsurprising that borrowers would increase their contribution to the Chairman by roughly 25% for each basis point saved.

It is also worth explaining the reason for which Panel D of Table 3.4 is a valid test, as it may seem counter-intuitive for anyone to contribute to a retiring politician (i.e., contribution should be zero for a retiring politician regardless of anything). However, this may not necessarily be the case. To start with, I consider contributions to both campaign committees and leadership PACs; the latter can serve many purposes, chief among which is to make friends in the political world.

In addition, unused cash in campaign committees can be used for many purposes.[30] First, politicians can keep campaign committees running indefinitely, this ensures a full war chest if they ever wish to seek elected office again. Second, politicians may contribute the money to charities. Third, and perhaps most importantly, the money can be contributed to the national party committee, another candidate's committees, or converted into a PAC. As Campaign Legal Center's senior counsel Paul Ryan (not related to former House Speaker Paul Ryan) puts it, ...it can't be converted to personal use, but that it can be used for

[29]These contribution figures are obtained from the Center for Responsive Politics.

[30]Interested readers may refer to the FEC Campaign Guide (available from https://www.fec.gov/resources/cms-content/documents/candgui.pdf) for a comprehensive list of rules related to Congressional and campaign committees.

any other lawful purpose." As such, there is no apparent reason why contributions toward retiring, but not yet retired, politicians should be zero.

Findings suggest that politically connected borrowers are able to obtain significantly cheaper loans as compared to nonconnected borrowers. Their ability to obtain superior loan terms do not disappear after the Chairman announces his departure from the chairmanship, provided he remains a senator. Results also suggest that connected borrowers' political contribution behavior is influenced by their loan prices, but the same is not true for nonconnected borrowers.

3.3.3 Banks & Politicians – Stock Returns

The finding that banks persistently provide cheaper loans to connected borrowers begs the question – what do they stand to gain? Given the significant power that the Chairman yields over banks, it is logical that they would be willing to help his local firms when asked. However, for this behavior to persist, one would expect banks to be benefiting as a result of the Chairman returning favors.

The nature of these returns of favors make it difficult to me to pin down any specific channel. There may be multiple channel through which the Chairman return favors, and these channels may change through time or situation-dependent. However, irrespective of the specific channel, benefits must be reflected either in (future expected) cash flows. As a results, I examine whether the percentage of connected loans that a bank provides has any impact on its excess stock return over the next year.

$$\begin{aligned} Excess\ Stock\ Return_{k,t+1} = \beta_0 + \beta_1 \frac{Num.\ of\ Connected\ Loans_{k,t}}{Total\ Num.\ of\ Connected\ Loans_t} \\ + \delta' V + Year\ FE + Bank\ FE + \phi_{k,t}, \end{aligned} \tag{3.4}$$

where k denotes lead banks and t denotes years. Excess stock return is calculated as the percentage change in mean daily closing price (adjusted for cash and share distributions), minus the mean one-year T-Bill rate, from t to $t+1$. V is a (set of) control(s) that is either

leverage at $t+1$ and t, or the percentage change in leverage from t to $t+1$.

Table 3.5
Bank-year regression showing a bank's previous year's percentage of number of connected loans provided positively impacts its excess stock return in the next year. The dependent variable is excess stock return, calculated as the percentage change in mean daily closing price (adjusted for cash and share distributions), minus the mean one-year T-Bill rate, from t to $t+1$, where t denotes years. A loan is defined to be connected if the Chairman of the US Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination. t-statistics are in parentheses. Standard errors are clustered by industry banks.

	(1)	(2)	(3)	(4)	(5)	(6)
% Connected Loans	1.33***	1.30***	1.34***	0.82**	0.77*	0.83**
	(5.61)	(5.54)	(5.67)	(2.02)	(1.95)	(2.05)
Leverage		0.98			0.50	
		(1.26)			(0.38)	
Leverage (lagged)		-0.43			0.27	
		(-0.80)			(0.29)	
%Δ in Leverage			0.03			0.03
			(1.29)			(1.18)
Year FE	No	No	No	Yes	Yes	Yes
Lender FE	No	No	No	Yes	Yes	Yes
N	957	957	957	957	957	957
Adjusted R^2	0.015	0.022	0.016	0.412	0.416	0.413

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Results presented in Table 3.5 show that a one percentage point increase in a bank's share of the number of connected loans provided in any given year increases its excess stock return by between 0.8 and 1.3% over the next year, depending on model specification. Given that connected loans are cheaper in price, fewer in quantity, and smaller in size (as shown in Table 3.1), all of which suggest either little or negative impact on banks' performance and hence stock returns, findings suggest that the Chairman may be returning favors to banks.[31]

3.4. Falsification and Robustness Tests

In this section, I provide additional evidence consistent with findings in Section 3.3 as well as the exchange of favors hypothesis. I also show that results are robust to alternative model and econometric specifications.

[31]Replacing the dependent variable with the percentage change in common equity market capitalization yield similar results.

3.4.1 Closely- vs. Non-closely-contested Reelections

Some may argue that many of these Chairmen do not face closely-contested reelections. Thus, their incentive to actively help local borrowers obtain cheaper loans should not be one concerning reelection. Whilst it is true that many reelections are not closely-contested, it does not necessarily mean incumbents do not *ex-ante* campaign for the highest possible number of votes. This includes providing favors to local firms. The uncertainty and unpredictability involved in any democratic process are perhaps well-illustrated by the 2018 US midterm election in New York's 14th district. Alexandria Ocasio-Cortez, who began her campaign while waiting tables at a Mexican restaurant and operated out of a paper bag hidden behind that bar", beat 10-term incumbent and expected successor to Democratic House leader Nancy Pelosi, Joe Crowley.

To formally test my counter-argument, I construct a *closely-contested* dummy that equals to one if the loan originated prior to a below-median winning margin reelection, and zero otherwise. The median winning margin is calculated as the median of all reelections faced by a Chairman of the Senate Banking Committee during the sample period.[32] Here I exclude loans that originated following the Chairman's retirement (from Congress) announcement, as there is no subsequent reelection.

Results are presented in Table 3.6. The interaction term is significantly negative and suggests that connectedness offers more than twice the reduction in cost of loans originated prior to closely-contested reelections than they do for those originated prior to non-closely-contested reelections.[33] These suggest that politicians provide larger favors to local firms when facing higher reelection risk, and are consistent with the hypothesis that the Chairman is incentivized to offer cheaper loans to local borrowers to aid his reelection bid.

[32]Data on election results are obtained from the MIT Election Lab and cross-verified against major news outlets such as *The Washington Post*.

[33]The large coefficient of the closely-contested main effect should not be a cause for concern. Given the definition of the *closely-contested* dummy, it necessarily loads similarly to year fixed effects dummies.

Table 3.6

Loan-level regression showing connected loans are cheaper when the Chairman of the Senate Banking Committee faces closely-contested reelections. I use *ex-post* election results to proxy for the *ex-ante* closeness of elections. *Closely-contested* is a dummy variable that equals to one if the loan originated prior to a below-median winning margin reelection of the Chairman and zero otherwise. The median winning margin is calculated as the median of all reelections faced by a Chairman of the Senate Banking Committee during the sample period. Loans originated following the Chairman's retirement announcement are excluded. A loan is defined to be connected if the Chairman of the US Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination. Loans are classified into four types – credit line ($<$ 1 year), credit line ($\geq$ 1 year), term loan, and others. Lender is defined as the lead lender. In cases where there are multiple lead lenders, the one with the largest share of the syndicated loan is used. t-statistics are in parentheses. Standard errors are clustered by industry based on the Fama-French 49-industry classification.

	(1) TCB	(2) TCB	(3) AISD	(4) AISD
Connection	-12.52***	-14.02***	-10.38**	-11.03**
	(-3.10)	(-3.29)	(-2.51)	(-2.61)
Connection × Closely-contested	-22.75***	-23.97***	-25.64**	-29.60***
	(-2.76)	(-2.94)	(-2.47)	(-2.99)
Profitability	-34.77***	-29.31**	-76.42***	-68.14***
	(-2.76)	(-2.43)	(-5.84)	(-4.64)
Log(Assets ($M))	-14.50***	-4.83***	-21.33***	-8.75***
	(-11.58)	(-2.80)	(-14.43)	(-4.74)
Log(Int. Coverage)	-20.38***	-19.21***	-22.36***	-21.28***
	(-14.81)	(-14.79)	(-13.99)	(-13.39)
Leverage	80.72***	82.11***	63.50***	65.00***
	(9.97)	(10.75)	(8.09)	(8.56)
S.D. of Profitability	185.84***	189.09***	238.45***	244.50***
	(3.73)	(3.88)	(3.99)	(4.22)
Altman Z-Score	-0.56	-0.43	-0.92	-0.75
	(-1.03)	(-0.88)	(-1.45)	(-1.29)
Book-to-Market	-5.03**	-6.36**	-1.07	-2.73
	(-2.02)	(-2.62)	(-0.38)	(-0.98)
Closely-contested	-163.32***	-139.24***	-149.55***	-135.56***
	(-11.63)	(-9.16)	(-13.88)	(-12.10)
Syndicate Size		-1.52***		-0.98***
		(-10.58)		(-7.86)
Lead Size		11.95***		7.06***
		(7.17)		(4.81)
Log(Maturity (mths))		17.41***		25.31***
		(3.34)		(7.65)
Log(Loan Amt. ($M))		-12.06***		-18.88***
		(-5.40)		(-9.13)
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Loan Type FE	Yes	Yes	Yes	Yes
Lender FE	Yes	Yes	Yes	Yes
N	26621	26621	26621	26621
Adjusted R^2	0.339	0.363	0.391	0.421

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

3.4.2 Past Contributions vs. Political Connection

An alternative explanation for connected borrowers' ability to access cheaper bank loans is that local firms are also more likely to have previously contributed to the Chairman of the Senate Banking Committee. To test this, I modify equation 3.2 by adding the the *previous donor* dummy that equals to one if the borrower had contributed to the Chairman in the one (Table 3.7 columns 1 to 4) or three (Table 3.7 columns 5 to 8) year(s) prior to loan origination, as well as its interaction term with the connection dummy, allowing me to test for any differences in loan prices between in- and out-of-state borrowers that have donated in the year(s) prior to their loan origination.[34]

Coefficients of both the previous donor dummy and the interaction term are statistically insignificant across all columns, suggesting that previous contributions, whether from local or out-of-state borrowers, do not drive loan prices.

3.4.3 Active Chairman vs. Active Bank

A second alternative explanation is that banks actively and voluntarily offer cheaper loans to connected borrower, either in an attempt to appeal to the Chairman, or because they perceive connected borrowers to have superior credit worthiness. To the former, there are two reasons why this is unlikely. First, banks could simply contribute to the Chairman. It is a much cheaper and most likely more effective way of appealing to him.

Second, it is difficult to conceive how the Chairman could notice banks actively offering cheap loans to connected firms, unless he was involved in the process. For example, connected firm ABC goes to bank XYZ for a loan. It is hard to imagine that ABC would conclude the reason for obtaining a cheaper-than-expected loan is due to their connection to the Chairman of the Senate Banking Committee, unless the Chairman was involved in the process. It is

[34]Headquarter relocation in the one or three year(s) prior to loan origination is unlikely to have any material impact on my findings, given their rare occurrences as documented by Ghosh, Rodriguez, and Sirmans (1995). For our purposes, relocation has a even smaller impact, as borrowers must be relocating into or out of the state of the Chairman of the Senate Banking Committee for it to be meaningful.

Table 3.7

Loan-level regression showing borrowers who previously contributed to the Chairman of the Senate Banking Committee's campaign committees and/or leadership PAC do *not* receive favorable loan terms. *Prev. Donor (1 yr)* equals to one if the borrower had contributed in the past 365 days before the loan origination date, and zero otherwise. The same logic applies to *Prev. Donor (3 yrs)*. Loans are classified into four types – credit line ($<$ 1 year), credit line ($\geq$ 1 year), term loan, and others. Lender is defined as the lead lender. In cases where there are multiple lead lenders, the one with the largest share of the syndicated loan is used. t-statistics are in parentheses. Standard errors are clustered by industry based on the Fama-French 49-industry classification.

	(1) TCB	(2) TCB	(3) AISD	(4) AISD	(5) TCB	(6) TCB	(7) AISD	(8) AISD
Prev. Don. (1 yr)	-0.43	0.29	0.30	1.28				
	(-0.07)	(0.05)	(0.07)	(0.27)				
Prev. Don. (1 yr) × Conn.	10.92	8.89	13.80	11.51				
	(1.24)	(1.01)	(1.49)	(1.17)				
Prev. Don. (3 yrs)					-4.04	-4.29	-0.53	-0.19
					(-0.56)	(-0.61)	(-0.07)	(-0.03)
Prev. Don. (3 yrs) × Conn.					6.66	5.26	10.41	8.69
					(0.90)	(0.72)	(1.28)	(1.01)
Connection	-15.38***	-15.96***	-13.22***	-13.32***	-14.97***	-15.51***	-13.50***	-13.55***
	(-4.29)	(-4.24)	(-3.71)	(-3.74)	(-4.13)	(-4.26)	(-3.67)	(-3.59)
Profitability	-34.40**	-28.76**	-74.67***	-66.39***	-34.44**	-28.80**	-74.71***	-66.42***
	(-2.68)	(-2.34)	(-5.60)	(-4.49)	(-2.69)	(-2.34)	(-5.61)	(-4.49)
Log(Assets ($M))	-14.43***	-5.01***	-20.83***	-8.49***	-14.41***	-4.98***	-20.83***	-8.49***
	(-11.55)	(-2.97)	(-14.29)	(-4.76)	(-11.58)	(-2.97)	(-14.34)	(-4.79)
Log(Int. Coverage)	-20.85***	-19.72***	-22.73***	-21.67***	-20.85***	-19.72***	-22.73***	-21.67***
	(-15.45)	(-15.22)	(-14.62)	(-13.72)	(-15.48)	(-15.26)	(-14.63)	(-13.73)
Leverage	81.27***	81.82***	61.92***	63.17***	81.27***	81.83***	61.92***	63.17***
	(9.40)	(10.15)	(7.57)	(8.05)	(9.40)	(10.16)	(7.58)	(8.06)
S.D. of Profitability	187.24***	187.96***	236.40***	240.29***	187.05***	187.76***	236.33***	240.24***
	(3.60)	(3.71)	(3.89)	(4.08)	(3.59)	(3.70)	(3.88)	(4.08)
Book-to-Market	-5.33**	-6.58***	-1.05	-2.53	-5.35**	-6.59***	-1.06	-2.54
	(-2.17)	(-2.78)	(-0.38)	(-0.94)	(-2.17)	(-2.78)	(-0.39)	(-0.94)
Altman Z-Score	-0.61	-0.50	-1.00	-0.85	-0.61	-0.50	-1.01	-0.85
	(-1.18)	(-1.07)	(-1.62)	(-1.50)	(-1.18)	(-1.07)	(-1.62)	(-1.50)
Syndicate Size		-1.67***		-1.08***		-1.68***		-1.08***
		(-11.61)		(-8.42)		(-11.61)		(-8.44)
Lead Size		13.12***		7.75***		13.11***		7.74***
		(7.39)		(5.10)		(7.38)		(5.07)
Log(Maturity (mths))		18.87***		25.60***		18.86***		25.60***
		(3.74)		(7.47)		(3.74)		(7.45)
Log(Loan Amt. ($M))		-11.51***		-18.48***		-11.51***		-18.47***
		(-5.15)		(-8.66)		(-5.15)		(-8.66)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Loan Type FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Lender FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	29890	29890	29890	29890	29890	29890	29890	29890
Adjusted R^2	0.340	0.365	0.396	0.426	0.340	0.365	0.396	0.426

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

equally hard to image that XYZ would tell ABC that the cheap loan is due to their geographic location, and that ABC should relay this message to the Chairman. If the Chairman cannot notice such efforts made by banks, then banks have no incentive to do so.

Table 3.8
Bond-level regression showing *public* debts (i.e., bonds) issued by connected borrowers are *no cheaper* than those issued by nonconnected borrowers. The dependent variable, treasury spread, is calculated as the difference (in bps) between the bond yield at issuance and the yield on the treasury security with the most similar maturity. Sample is restricted to non-perpetual bonds without embedded options. A borrower is defined to be connected if the Chairman of the US Senate Banking Committee is from the same state as its headquarter at the time of bond issuance. t-statistics are in parentheses. Standard errors are clustered by industry based on the Fama-French 49-industry classification.

	(1) Treasury Spread	(2) Treasury Spread
Connection	-5.15	0.51
	(-0.52)	(0.06)
Profitability	-0.28	-0.23
	(-0.01)	(-0.01)
Log(Assets ($M))	-26.03***	-22.49***
	(-5.72)	(-6.18)
Log(Int. Coverage)	-49.50***	-41.45***
	(-7.81)	(-7.16)
Leverage	286.75***	261.57***
	(6.71)	(5.67)
S.D. of Profitability	80.83	29.97
	(0.64)	(0.24)
Book-to-Market	23.73*	26.48*
	(1.70)	(2.00)
Altman Z-score	2.01	1.16
	(0.67)	(0.39)
Log(Maturity (mths))		-17.72***
		(-3.37)
Log(Loan Amt. ($M))		9.53**
		(2.65)
Inv. Grade		-51.94***
		(-4.01)
Asset-backed		-16.33*
		(-1.93)
Industry FE	Yes	Yes
Year FE	Yes	Yes
N	9679	9679
Adjusted R^2	0.398	0.410

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

To address the latter concern, I obtain public debts issued by my sample borrower over the sample period from Mergent FISD. Using the same definition of connection, I examine whether it has any impact on public debts' (i.e., corporate bond) spread over treasury yield of

the most similar maturity, after controlling for debt and firm characteristics.[35] If connected firms do indeed possess superior credit worthiness due to either implicit benefits that may be derived from their connectedness or any other unobservables, then connection should negatively impact their public debts' spreads. Results presented in Table 3.8 suggest that this is not the case – connectedness has no statistically significant impact on spreads.

Findings documented in this paper are inconsistent with the notion that banks are actively lowering connected borrowers' cost of loans either to appeal to the Chairman of the Senate Banking Committee, or due to connected borrowers' superior credit worthiness. Rather, they point toward possible active involvements from the Chairman.

3.4.4 Powerful Senators vs. Chairman of the Senate Banking Committee

A third alternative explanation for my findings could be that loans of borrowers connected to powerful senators, not necessarily the Chairman of the Senate Banking Committee are cheaper. To test this hypothesis, I replace the connection (to the Chairman of the Senate Banking Committee) dummy with dummies that indicate connections to other powerful senators, namely, Chairmen of the Senate (i) Judiciary, (ii) Appropriations, (iii) Intelligence, and (iv) Finance Committees.

Table 3.9 shows that connection to any of these Chairmen have no impact on borrowers' cost of bank loans; rejecting the notion that connection to any powerful senator help firms obtain superior loan terms.

[35] I restrict my sample to non-perpetual bonds without embedded options. Treasury yield and company data are obtained from the Federal Reserve Bank of St. Louis and Compustat, respectively.

Table 3.9
Loan-level regression showing loans connected to Chairman of the Senate Judiciary/Appropriations/Intelligence/Finance Committee are *no more* favorable to the borrower than nonconnected loans. A loan is defined to be connected if the Chairman of the Senate Judiciary/Appropriations/Intelligence/Finance Committee is from the same state as the borrower's headquarter at the time of loan origination. Loans are classified into four types – credit line ($<$ 1 year), credit line ($\geq$ 1 year), term loan, and others. Lender is defined as the lead lender. In cases where there are multiple lead lenders, the one with the largest share of the syndicated loan is used. t-statistics are in parentheses. Standard errors are clustered by industry based on the Fama-French 49-industry classification.

	(1) TCB	(2) AISD	(3) TCB	(4) AISD	(5) TCB	(6) AISD	(7) TCB	(8) AISD
Connection (Judiciary)	4.13	5.37						
	(0.33)	(0.41)						
Connection (Approp.)			1.74	5.83				
			(0.16)	(0.43)				
Connection (Intel.)					-4.34	-1.30		
					(-0.98)	(-0.32)		
Connection (Finance)							1.94	-2.17
							(0.32)	(-0.41)
Profitability	-28.87**	-66.49***	-28.94**	-66.61***	-28.90**	-66.55***	-28.90**	-66.58***
	(-2.35)	(-4.47)	(-2.35)	(-4.48)	(-2.35)	(-4.47)	(-2.35)	(-4.48)
Log(Assets ($M))	-5.00***	-8.48***	-5.00***	-8.48***	-5.01***	-8.48***	-5.00***	-8.48***
	(-2.96)	(-4.74)	(-2.97)	(-4.75)	(-2.97)	(-4.75)	(-2.96)	(-4.75)
Log(Int. Coverage)	-19.63***	-21.60***	-19.64***	-21.60***	-19.62***	-21.59***	-19.64***	-21.60***
	(-15.35)	(-13.77)	(-15.34)	(-13.80)	(-15.33)	(-13.78)	(-15.36)	(-13.76)
Leverage	81.82***	63.18***	81.82***	63.17***	81.81***	63.18***	81.80***	63.20***
	(10.15)	(8.06)	(10.14)	(8.04)	(10.14)	(8.05)	(10.17)	(8.06)
S.D. of Profitability	187.83***	240.19***	187.85***	240.27***	188.11***	240.28***	187.85***	240.17***
	(3.72)	(4.09)	(3.72)	(4.09)	(3.71)	(4.08)	(3.72)	(4.08)
Book-to-Market	-6.56***	-2.52	-6.57***	-2.53	-6.55***	-2.53	-6.57***	-2.53
	(-2.77)	(-0.93)	(-2.77)	(-0.93)	(-2.77)	(-0.93)	(-2.78)	(-0.93)
Altman Z-Score	-0.51	-0.86	-0.51	-0.86	-0.52	-0.86	-0.51	-0.86
	(-1.09)	(-1.51)	(-1.08)	(-1.51)	(-1.10)	(-1.51)	(-1.08)	(-1.51)
Syndicate Size	-1.68***	-1.09***	-1.68***	-1.08***	-1.68***	-1.09***	-1.68***	-1.08***
	(-11.68)	(-8.45)	(-11.70)	(-8.46)	(-11.68)	(-8.47)	(-11.69)	(-8.48)
Lead Size	13.04***	7.69***	13.03***	7.67***	13.03***	7.68***	13.03***	7.69***
	(7.28)	(5.00)	(7.28)	(5.01)	(7.27)	(4.99)	(7.29)	(5.03)
Log(Maturity (mths))	18.96***	25.67***	18.96***	25.68***	18.99***	25.68***	18.95***	25.68***
	(3.76)	(7.51)	(3.77)	(7.53)	(3.76)	(7.52)	(3.76)	(7.51)
Log(Loan Amt. ($M))	-11.49***	-18.46***	-11.49***	-18.46***	-11.49***	-18.46***	-11.49***	-18.46***
	(-5.16)	(-8.66)	(-5.15)	(-8.65)	(-5.16)	(-8.66)	(-5.16)	(-8.66)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Loan Type FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Lender FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	29890	29890	29890	29890	29890	29890	29890	29890
Adjusted R^2	0.364	0.426	0.364	0.426	0.364	0.426	0.364	0.426

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

3.4.5 Information Efficiency vs. Exchange of Favors

A fourth alternative explanation is that syndicated loans of connected borrowers are more likely to include local lenders (i.e., within the same state) as members of the syndicate. If true, lower costs of connected loans may be due to superior information efficiency, stemming from close geographic proximity between lender(s) and borrower, rather than any exchange of favors.

Using the linking table provided by Schwert (2018), I identify the headquarter of all lenders for each loans. Data reveals that almost no syndicated loan ($< 1\%$) contains local lenders.[36] This implies that information efficiency is not the explanation of my findings.

3.4.6 HQ Location vs. Board Connectedness

One possible concern with equation (3.2) and Table 3.2 is the power of my geographical definition of political connection as compared to that in Houston et al. (2014), namely, a firm is considered to be connected if at least one of the board members holds or held an important political or regulatory position. To test this, I add a new connection dummy – one that is based on Houston et al. (2014) – to equation (3.2).

Results presented in Table 3.10 suggest that both the geographical and the board connectedness definitions of political connection have explanatory power in explaining firms' cost of bank loans. However, it is worth noting that the geographical definition is a superior explanator. In fact, the difference between the coefficients of the two measures of connection is statistically significant in all but two columns (7 and 8). This is evidence supporting the validity and power of the geographical measure of political connection in the context of bank loans.

[36] I exclude borrowers headquartered in the state of New York between 1995 and 1998, when Alfonse D'Amato was the Chairman of the Senate Banking Committee, as the vast majority of the largest banks in the US are also headquartered in New York. Excluding this period from my sample does not affect my results.

Table 3.10
Loan-level baseline regression showing (geographically) connected loans are more favorable to the borrower than nonconnected loans even after accounting for board connection as defined in Houston et al. (2014). A loan is defined to be connected if the Chairman of the US Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination. Columns 5 to 8 adopt firm fixed effects. For these columns, firms that (i) only take out one loan or (ii) take out all loans in the same year are dropped from the sample. Loans are classified into four types – credit line ($<$ 1 year), credit line ($\geq$ 1 year), term loan, and others. Lender is defined as the lead lender. In cases where there are multiple lead lenders, the one with the largest share of the syndicated loan is used. t-statistics are in parentheses. Standard errors are clustered by industry based on the Fama-French 49-industry classification in columns 1 to 4, and by firm in columns 5 to 8.

	(1) TCB	(2) TCB	(3) AISD	(4) AISD	(5) TCB	(6) TCB	(7) AISD	(8) AISD
Connection	-15.83***	-16.70***	-12.59***	-13.13***	-13.78**	-14.43***	-3.98	-3.44
	(-4.65)	(-4.76)	(-3.37)	(-3.43)	(-2.39)	(-2.67)	(-0.59)	(-0.53)
Connection (HJLM)	-5.64***	-5.56***	-4.28*	-4.46**	-5.86*	-5.75*	-3.41	-3.09
	(-3.06)	(-3.15)	(-1.89)	(-2.12)	(-1.69)	(-1.73)	(-0.89)	(-0.84)
Profitability	-35.36***	-29.69**	-75.45***	-67.17***	-45.82**	-44.54**	-88.53***	-83.39***
	(-2.76)	(-2.43)	(-5.71)	(-4.59)	(-2.35)	(-2.14)	(-4.47)	(-3.49)
Log(Assets ($M))	-14.44***	-5.00***	-20.83***	-8.48***	-16.94***	-11.10***	-23.00***	-12.35***
	(-11.54)	(-2.97)	(-14.28)	(-4.75)	(-13.06)	(-5.50)	(-16.28)	(-6.72)
Log(Int. Coverage)	-20.86***	-19.74***	-22.74***	-21.68***	-20.30***	-19.22***	-19.42***	-18.26***
	(-15.39)	(-15.17)	(-14.57)	(-13.68)	(-11.85)	(-11.59)	(-9.53)	(-9.27)
Leverage	81.51***	82.06***	62.11***	63.37***	56.74***	57.36***	38.09***	38.59***
	(9.33)	(10.06)	(7.53)	(8.00)	(6.72)	(6.81)	(4.78)	(4.75)
S.D. of Profitability	188.07***	188.79***	237.03***	240.96***	175.72***	183.10***	182.90***	190.13***
	(3.61)	(3.71)	(3.89)	(4.08)	(4.58)	(4.64)	(4.77)	(4.88)
Book-to-Market	-5.39**	-6.64***	-1.11	-2.59	-4.77**	-5.73**	-1.42	-2.93
	(-2.19)	(-2.80)	(-0.40)	(-0.96)	(-1.99)	(-2.48)	(-0.56)	(-1.17)
Altman Z-Score	-0.61	-0.50	-1.00	-0.85	-0.39	-0.33	-1.03	-0.88
	(-1.17)	(-1.06)	(-1.62)	(-1.49)	(-0.42)	(-0.39)	(-0.97)	(-0.88)
Syndicate Size		-1.67***		-1.08***		-1.91***		-1.26***
		(-11.62)		(-8.45)		(-12.96)		(-9.62)
Lead Size		13.07***		7.71***		9.66***		4.68***
		(7.36)		(5.08)		(5.71)		(3.03)
Log(Maturity (mths))		18.92***		25.65***		15.54***		28.61***
		(3.78)		(7.52)		(2.80)		(7.85)
Log(Loan Amt. ($M))		-11.53***		-18.50***		-3.96*		-14.59***
		(-5.16)		(-8.67)		(-1.68)		(-6.94)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Loan Type FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Lender FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	29890	29890	29890	29890	17434	17434	17434	17434
Adjusted R^2	0.340	0.365	0.396	0.426	0.209	0.225	0.207	0.244

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

3.4.7 House Financial Services Committee

For banks, the Chairman of the House Financial Services Committee is another important politician on Capitol Hill. I thus use the sample of House-connected borrowers' loans as a robustness test. If Senate-connected borrowers are able to obtain cheaper bank loans, then the same should be true for House-connected borrowers. Following this logic, I first identify each borrower's Congressional district from its ZIP code, using the linking table provided by the US Bureau of Census.[37] I find 51 loans originated at the time the borrower's headquarter is in the same Congressional district as where Chairman of the Financial Services Committee is from. I then run the baseline regression model given by equation (3.2).

Table 3.11 is a replica of Table 3.2, but differs in two aspects. First, connection is to the Chairman of the House Financial Services Committee instead of the Senate Banking Committee. Here, a loan is defined to be connected if the Chairman of the House Financial Services Committee is from the same Congressional district as the borrower's headquarter at the time of loan origination. Second, for each Chairman, I restrict the control group to loans within the same state. That is, nonconnected borrowers here are those headquartered in the same state but different districts as connected borrowers. For example, Mike Oxley, from Ohio's 4th district, chaired the House Financial Services Committee between 2007 and 2010. I therefore treat borrowers headquartered in Ohio's 4th district as connected and those headquartered in other parts of Ohio and nonconnected during Oxley's tenure as chairman. State fixed effected are added to equation 3.2 to account for time-invariant state-level characteristics.

The results are qualitatively similar to those in Table 3.2. The coefficient on the connection dummy indicates that House-connected borrower are able to borrow from banks at lower costs – approximately 28 bps lower in terms of TCB under the full specification model (column 2).

[37]Some ZIP codes overlap multiple Congressional districts. In these case, I identify a borrower as being connected if its ZIP code is partially within a district.

Table 3.11
Loan-level baseline regression showing connected loans are more favorable to the borrower than nonconnected loans. A loan is defined to be connected if the Chairman of the US House Financial Services Committee is from the same Congressional district as the borrower's headquarter at the time of loan origination. Sample is restricted to those within the same state as connected borrowers. Loans are classified into four types – credit line ($<$ 1 year), credit line ($\geq$ 1 year), term loan, and others. Lender is defined as the lead lender. In cases where there are multiple lead lenders, the one with the largest share of the syndicated loan is used. t-statistics are in parentheses. Standard errors are clustered by industry based on the Fama-French 49-industry classification.

	(1) TCB	(2) TCB	(3) AISD	(4) AISD
Connection (House)	-30.05*	-32.79*	-31.30**	-28.79**
	(-1.79)	(-1.78)	(-2.59)	(-2.13)
Profitability	-35.00*	-24.27	-63.55***	-56.60**
	(-1.73)	(-0.97)	(-3.16)	(-2.37)
Log(Assets ($M))	-18.58***	-11.24***	-23.82***	-15.41***
	(-8.74)	(-3.38)	(-14.15)	(-5.62)
Log(Int. Coverage)	-11.66**	-9.83**	-11.99***	-9.40**
	(-2.49)	(-2.48)	(-3.02)	(-2.44)
Leverage	126.19***	115.09***	122.76***	122.92***
	(3.58)	(3.63)	(6.28)	(7.21)
S.D. of Profitability	119.35*	113.52**	231.99***	233.66***
	(2.01)	(2.36)	(4.16)	(4.88)
Book-to-Market	17.98	12.63	20.69	18.67
	(0.93)	(0.74)	(1.42)	(1.42)
Altman Z-Score	-0.47	-0.32	-0.39	-0.34
	(-0.52)	(-0.36)	(-0.53)	(-0.42)
Syndicate Size		-2.80***		-1.30**
		(-3.11)		(-2.18)
Lead Size		14.71***		6.21**
		(5.36)		(2.69)
Log(Maturity (mths))		-20.70		21.88**
		(-1.18)		(2.19)
Log(Loan Amt. ($M))		-6.46		-12.10**
		(-1.35)		(-2.56)
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Loan Type FE	Yes	Yes	Yes	Yes
Lender FE	Yes	Yes	Yes	Yes
State FE	Yes	Yes	Yes	Yes
N	1186	1186	1186	1186
Adjusted R^2	0.324	0.358	0.418	0.436

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

3.4.8 Matched Sample

The Chairman of the Senate Banking Committee has, for more the most part of the past 15 years, come from relatively smaller states (i.e., states with few firms), such as Idaho. The majority of my sample of connected loans are concentrated in second half of the 1990's and early 2000's, when the Chairman is from New York (1995 – 1998) and Texas (1999 - 2001). This may lead to econometric issues that year fixed effects may fail to fully resolve.

As such, I adopt a matched sample to address this concern. To construct this sample, I first match each connected loan to nonconnected loans that originated in the same year, before matching on borrower industry. Then, I utilize propensity score matching by running a probit model

$$Connection_{i,j,t} = \nu_0 + \lambda' X_{j,t-1} + \kappa' Z_{i,j,t} + \xi_{i,j,t}, \tag{3.5}$$

where variable definitions are the same as those for equation (3.2). Results of repeating my analysis of equation (3.2) using the matched sample is presented in Table 3.12, and are similar to those in Table 3.2.

3.4.9 Firm PAC vs. Employee Contributions

Table 3.4 includes contributions made by both employees and firm PACs. However, this may be problematic because individual contribution are more likely to reflect ideology compared to PAC contribution. In fact, Barber (2016) find that individuals consistently rank ideological concerns as highly important" when deciding where and whom to contribute.

To alleviate this concern, I construct Table 3.13 – a replica of Table 3.4, but excluding employee contributions. Results are largely unchanged. Connected borrowers' changes in contributions are negatively influenced by loan prices in general (Panel A), in pre-departure announcement periods (Panel B), and in post-departure announcement periods if the Chairman is to remain as a senator (Panel C). If the Chairman is retiring from Congress, connected borrowers' contribution behavior is unaffected by loan prices. Nonconnected borrowers'

Table 3.12
Loan-level *matched-sample* regression showing connected loans are more favorable to the borrower than nonconnected loans. Each connected loan is matched to a nonconnected loans first on year of origination and borrower industry, then on firm and loan characteristics using propensity score (probit model). A loan is defined to be connected if the Chairman of the US Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination. Columns 5 to 8 adopt firm fixed effects. For these columns, firms that (i) only take out one loan or (ii) take out all loans in the same year are dropped from the sample. Loans are classified into four types – credit line ($<$ 1 year), credit line ($\geq$ 1 year), term loan, and others. Lender is defined as the lead lender. In cases where there are multiple lead lenders, the one with the largest share of the syndicated loan is used. t-statistics are in parentheses. Standard errors are clustered by industry based on the Fama-French 49-industry classification.

	(1) TCB	(2) TCB	(3) AISD	(4) AISD	(5) TCB	(6) TCB	(7) AISD	(8) AISD
Connection	-9.76**	-9.52**	-4.15	-3.67	-15.74**	-15.84**	-0.15	-0.38
	(-2.29)	(-2.30)	(-0.96)	(-0.87)	(-2.35)	(-2.36)	(-0.02)	(-0.06)
Profitability	-80.80***	-66.54***	-116.57***	-100.80***	-65.39**	-60.53**	-111.82***	-102.72***
	(-4.38)	(-4.24)	(-5.65)	(-5.79)	(-2.40)	(-2.29)	(-4.11)	(-3.92)
Log(Assets ($M))	-14.76***	-7.31***	-20.67***	-9.82***	-20.56***	-16.64***	-24.83***	-15.14***
	(-10.32)	(-3.72)	(-12.56)	(-6.08)	(-7.71)	(-5.27)	(-11.54)	(-6.63)
Log(Int. Coverage)	-20.94***	-20.64***	-24.75***	-24.59***	-25.19***	-25.00***	-26.05***	-26.13***
	(-5.06)	(-5.00)	(-5.51)	(-5.43)	(-3.36)	(-3.38)	(-3.59)	(-3.72)
Leverage	82.20***	78.78***	65.25***	60.22***	47.45*	48.70*	35.60	35.82
	(4.07)	(3.94)	(3.28)	(3.06)	(1.82)	(1.88)	(1.32)	(1.38)
S.D. of Profitability	84.56**	93.16**	144.99***	158.01***	65.92	68.62	112.08	114.52
	(2.32)	(2.68)	(3.30)	(3.63)	(1.28)	(1.36)	(1.40)	(1.41)
Book-to-Market	-1.21	-2.41	-0.07	-1.33	-2.52	-2.63	-3.83	-4.21
	(-0.19)	(-0.38)	(-0.01)	(-0.24)	(-0.33)	(-0.35)	(-0.55)	(-0.62)
Altman Z-Score	1.15	1.20	0.36	0.47	1.76	2.18	0.49	1.16
	(0.80)	(0.86)	(0.25)	(0.34)	(0.62)	(0.81)	(0.17)	(0.41)
Syndicate Size		-0.08		0.00		-0.20		-0.23
		(-0.24)		(0.01)		(-0.48)		(-0.56)
Lead Size		6.14***		1.69		6.42***		2.36
		(2.84)		(0.81)		(2.98)		(1.22)
Log(Maturity (mths))		16.33**		22.60***		10.80		23.69***
		(2.03)		(3.82)		(0.91)		(3.13)
Log(Loan Amt. ($M))		-14.07***		-18.73***		-7.84***		-15.92***
		(-6.21)		(-8.43)		(-2.64)		(-4.90)
Industry FE	Yes	Yes	Yes	Yes	No	No	No	No
Firm FE	No	No	No	No	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Loan Type FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Lender FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	2293	2293	2293	2293	1340	1340	1340	1340
Adjusted R^2	0.420	0.436	0.489	0.511	0.297	0.303	0.274	0.305

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

contribution behavior is never influenced by their loan prices.

Table 3.13
Borrower-year regression showing connected borrowers increase their contribution to the Chairman of the US Senate Banking Committee *after* receiving favorable loan terms. Contributions are restricted to those made by firms' PACs. The dependent variable is the percentage change in (year-to-date) contributions made by a firm from 365 days prior to and after loan origination. In cases of multiple loans made to a borrower in a single year, I use the mean values of loan characteristics, and the loan type and lead lender of the loan with the largest dollar value. Panel A contains the full sample of borrower-years. Panel B contains borrower-years prior to departure announcements. Panel C contains borrower-years after departure announcements, but the Chairman remains a senator. Panel D contains borrower-years after departure announcements, and the Chairman is retiring from Congress. A borrower is defined to be connected if the Chairman of the US Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination. Coefficient on the *connection* dummy is suppressed. Loans are classified into four types – credit line ($<$ 1 year), credit line ($\geq$ 1 year), term loan, and others. Lender is defined as the lead lender. In cases where there are multiple lead lenders, the one with the largest share of the syndicated loan is used. t-statistics are in parentheses. Standard errors are clustered by industry based on the Fama-French 49-industry classification.

	(1)	(2)	(3)	(4)
Panel A: Full sample				
$\overline{\text{TCB}}$	-0.43	-0.51		
	(-0.31)	(-0.48)		
$\overline{\text{TCB}}$ × Connection	-41.33***	-41.75***		
	(-3.15)	(-3.22)		
$\overline{\text{AISD}}$			-0.66	-0.70
			(-0.56)	(-0.75)
$\overline{\text{AISD}}$ × Connection			-39.94***	-39.90***
			(-2.80)	(-2.81)
N	18906	18906	18906	18906
Adjusted R^2	0.014	0.014	0.014	0.014
Panel B: Pre-departure announcement				
$\overline{\text{TCB}}$	-0.44	-0.56		
	(-0.24)	(-0.40)		
$\overline{\text{TCB}}$ × Connection	-51.51***	-52.03***		
	(-2.74)	(-2.79)		
$\overline{\text{AISD}}$			-0.71	-0.78
			(-0.47)	(-0.66)
$\overline{\text{AISD}}$ × Connection			-56.43***	-56.26***
			(-2.91)	(-2.90)
N	14928	14928	14928	14928
Adjusted R^2	0.015	0.016	0.016	0.016
Panel C: Post-departure announcement (remains senator)				
$\overline{\text{TCB}}$	-0.99	-0.91		
	(-1.08)	(-0.84)		
$\overline{\text{TCB}}$ × Connection	-36.31***	-36.80***		
	(-3.14)	(-3.05)		
$\overline{\text{AISD}}$			-0.54	-0.48
			(-0.65)	(-0.59)
$\overline{\text{AISD}}$ × Connection			-18.78**	-19.21**

Table 3.13 *(continued)*

	(1)	(2)	(3)	(4)
			(-2.63)	(-2.65)
N	1895	1895	1895	1895
Adjusted R^2	0.052	0.052	0.051	0.052
Panel D: Post-departure announcement (leaves Congress)				
$\overline{\text{TCB}}$	-0.27	-0.32		
	(-0.92)	(-1.07)		
$\overline{\text{TCB}}$ × Connection	-16.04	-15.81		
	(-1.63)	(-1.63)		
$\overline{\text{AISD}}$			-0.52	-0.56
			(-1.10)	(-1.24)
$\overline{\text{AISD}}$ × Connection			2.33	2.48
			(0.49)	(0.52)
Firm Controls	Yes	Yes	Yes	Yes
Loan Controls	No	Yes	No	Yes
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Loan Type FE	Yes	Yes	Yes	Yes
Lender FE	Yes	Yes	Yes	Yes
N	2083	2083	2083	2083
Adjusted R^2	0.032	0.030	0.023	0.022

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

An interesting observation is that the magnitude of coefficients of the interaction term contained in Panels A, B, and C of Table 3.13 are much larger than their corresponding ones in Table 3.4, suggesting that PAC contributions are more sensitive to loan prices compared to individual contributions. This is unsurprising given we know that individual contributions mostly reflect ideology, which by extension, must be sticky".

3.4.10 Prime Rate-based Loans

All my findings so far in this paper are based on LIBOR-based loans. Although these loans represent nearly 60% of all US originated loans in the DealScan universe, prime rate-based loans are also another large fraction as shown in Figure 3.1.

To ensure that my main findings are not restricted to LIBOR-based loans, I apply equation (3.2) to prime rate-based loans over the same sample period. The TCB measure is not available to prime rate-based loans as Berg et al. (2016) focused solely on LIBOR-based

Table 3.14
Loan-level regression showing connected *prime rate-based* loans are more favorable to the borrower than nonconnected *prime rate-based* loans. TCB is not possible to construct for prime rate-based loans as Berg et al. (2016) focuses solely on LIBOR-based loans. A loan is defined to be connected if the Chairman of the US Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination. Loans are classified into four types – credit line ($<$ 1 year), credit line ($\geq$ 1 year), term loan, and others. Lender is defined as the lead lender. In cases where there are multiple lead lenders, the one with the largest share of the syndicated loan is used. t-statistics are in parentheses. Standard errors are clustered by industry based on the Fama-French 49-industry classification.

	(1) AISD	(2) AISD
Connection	-9.32*	-9.99**
	(-1.95)	(-2.13)
Profitability	-82.32***	-76.87***
	(-7.29)	(-5.88)
Log(Assets ($M))	-22.88***	-15.32***
	(-14.76)	(-8.70)
Log(Int. Coverage)	-20.80***	-20.13***
	(-12.50)	(-12.27)
Leverage	63.11***	64.09***
	(6.89)	(7.40)
S.D. of Profitability	211.79***	214.85***
	(3.58)	(3.69)
Book-to-Market	-0.56	-1.24
	(-0.25)	(-0.57)
Altman Z-Score	-1.52***	-1.43***
	(-2.79)	(-2.76)
Syndicate Size		-0.56***
		(-3.68)
Lead Size		6.72***
		(3.04)
Log(Maturity)		12.56***
		(4.28)
Log(Loan Amt. ($M))		-9.55***
		(-7.26)
Industry FE	Yes	Yes
Year FE	Yes	Yes
Loan Type FE	Yes	Yes
Lender FE	Yes	Yes
N	19660	19660
Adjusted R^2	0.413	0.422

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

loans in their paper. Loan sample is selected according to the same set of criteria (discussed in Section 2.2) as LIBOR-based loans. Table 3.14 indicates that my findings still stand when we examine prime rate-based loans. Connected loans are roughly nine bps cheaper, in terms of AISD, than nonconnected loans.

3.5. Conclusion

This paper examines the cost of bank loans to politically connected and nonconnected borrowers. Defining a firm to be politically connected if the Chairman of the US Senate Banking Committee is from the same state as the firm's headquarter as the time of loan origination, I find that connected borrowers are able to obtain bank loans roughly 14 bps cheaper than nonconnected borrowers, after controlling for borrower and loan characteristics.

In post-departure announcement periods, connected borrowers continue to enjoy superior loan terms, provided that the Chairman is to remain in as a senator after stepping down from his chairmanship. Connectedness loses its ability to influence loan prices in post-departure announcement periods if the Chairman is retiring from Congress.

Connectedness's influence on loan prices appear to be primarily driven by the Chairman's desire for reelection victories. I find that connected borrowers' changes in contributions to the Chairman are negatively influenced by their loan prices – a one basis point decrease in TCB results in a 25% increase in contributions over the full sample period. More generally, as long as connectedness leads to cheaper loans, connected borrowers' contribution behavior is also influenced by loan prices. Nonconnected borrowers' contribution behavior is never influenced by their cost of loans. These findings support the exchange of favors hypothesis.

Banks benefit from providing more connected loans. A one percentage point increase in the bank's share of the total number of new connected loans in any given year leads to an increase of between 0.8 and 1.3% in its excess stock return over the next year, depending on model specification. Given that connected loans are cheaper in price, fewer in quantity, and

smaller in size, all of which suggest either little or negative impact on banks' performance and hence stock returns, findings suggest that the Chairman may be returning favors to banks.

Furthermore, I provide some falsification and robustness tests and several pieces of evidence consistent with the exchange of favors hypothesis. First, I document that connectedness has larger impacts on loan prices for those loan that originated prior to closely-contested reelections than it has on loans originated prior to non-closely-contested reelections, implying that the Chairman is incentivized by reelections. Second, I reject the notion that connected borrowers are able to access cheaper bank loans because they are more likely to have contributed in previous years. I find that previous contributions do not have any influence on loan prices. Third, connected borrowers' cost of public debt (i.e., bond) is no lower than that of nonconnected borrowers, suggesting their lower cost of bank loans is not due to lower risks as a result of their connectedness. Fourth, other borrowers connected to other powerful senators, namely Chairmen of the Senate Judiciary, Appropriations, Intelligence, and Finance Committees, do not have the ability to obtain cheaper loans. Fifth, geographical definition of connection based on the firm's HQ location is a more powerful explanatory variable of loan costs as compared to one based on firm board's political connectedness. Sixth, connections to the Chairman of the House Financial Services Committee also leads to cheaper loans. Seventh, repeating my main analyses using a matched sample has little impact on my findings. Eighth, the exclusion of employee contributions, which may reflect individual ideology instead of firms' political strategy, does not affect my results. Finally, I show my findings are not restricted to LIBOR-based loans; connected prime rate-based loans are also cheaper than their nonconnected counterparts.

This paper documents the existence of a potential *quid pro quo* relationship triangle among firms, banks, and politicians. With the US achieving its lowest score in seven years on the 2018 Corruption Perception Index, and the EU going through a period of rising anti-establishment sentiments, policymakers may wish to review aspects of the current political system to restore the core values of democracy.

3.6. Appendix

Table 3.A1
Variable Definition.

Variable	Definition
Connection	1 if the Chairman of the US Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination; 0 otherwise.
Profitability	The maximum of EBIT divided by sales and zero.
Log(Assets ($M))	The natural logarithmic transformation of the market value of assets in millions of dollars.
Log(Int. Coverage)	The natural logarithmic transformation of EBITDA divided by interest expenses.
Leverage	Book value of debt divided by market value of equity.
S.D. of Profitability	Standard deviation of the borrower's last three years' profitabilities.
Book-to-Market	Book value of common equity divided by market value of common equity.
Altman Z-score	$1.2 \times \frac{\text{Working Capital}}{\text{Total Assets}} + 1.4 \times \frac{\text{Retained Earnings}}{\text{Total Assets}} + 3.3 \times \frac{\text{EBIT}}{\text{Total Assets}} + 0.6 \times \frac{\text{MV of Equity}}{\text{Total Liabilities}} + 1.0 \times \frac{\text{Sales}}{\text{Total Assets}}$
Syndicate Size	The number of lenders involved in a syndicated loan.
Lead Size	The number of lead lenders involved in a syndicated loan. A lead lender is defined as *agent*, *admin agent*, *arranger*, or *lead bank*.
Log(Maturity)	The natural logarithmic transformation of the expected maturity of the loan given in months.
Log(Loan Amt. ($M))	The natural logarithmic transformation of the loan amount given in millions of dollars.
% Connected Loans	The number of connected loans provided by the bank in any given year divided by the total number of connected loans provided by all banks in that year.
Closely-contested	1 if the loan originated following a below-median winning margin reelection of the Chairman of the Senate Banking Committee; 0 otherwise. The median winning margin is calculated as the median of all reelections faced by a Chairman of the Senate Banking Committee during the sample period.
Prev. Don. (x yr)	1 if the borrower had contributed to the Chairman of the Senate Banking Committee in the x years prior to loan origination; 0 otherwise.
Inv. Grade	1 if the bond is investment grade at issuance; 0 otherwise.

Table 3.A1 *(continued)*

Variable	Definition
Asset-backed	1 if the bond is collateralized by assets; 0 otherwise.
Connection (HJLM)	Definition of political connection as per Houston et al. (2014). 1 if at least one of the board members holds or held an important political or regulatory position, including President, presidential candidate, member of the House of Representatives, Senator, Cabinet secretary/deputy secretary/under secretary or assistant secretary, Governor, United Nations representative, Ambassador, Mayor, staff member to the White House, presidential campaign or political party, appointed member of a presidential committee or council, and Director/Deputy Director/Commissioner to a federal department or agency (including CIA, FEMA, OMB, IRS, NRC, SSA, NRC, FDA, and SEC); 0 otherwise.
Connection (House)	1 if the district from which the Chairman of the US House Financial Services Committee is from is the same as the borrower's headquarter at the time of loan origination; 0 otherwise.

Table 3.A2
Loan-level regression showing connectedness has no impact on loan maturity and size. A loan is defined to be connected if the Chairman of the US Senate Banking Committee is from the same state as the borrower's headquarter at the time of loan origination. Loans are classified into four types – credit line ($<$ 1 year), credit line ($\geq$ 1 year), term loan, and others. Lender is defined as the lead lender. In cases where there are multiple lead lenders, the one with the largest share of the syndicated loan is used. t-statistics are in parentheses. Standard errors are clustered by industry based on the Fama-French 49-industry classification.

	DV: Log(Loan Maturity (mths))				DV: Log(Loan Amount ($M))			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Connection	-0.02	-0.03	-0.02	-0.03	-0.02	-0.04	-0.02	-0.04
	(-1.25)	(-1.45)	(-1.25)	(-1.45)	(-0.70)	(-1.41)	(-0.70)	(-1.41)
Profitability	0.11*	0.10	0.11*	0.10	0.55***	0.50***	0.55***	0.50***
	(1.78)	(1.62)	(1.78)	(1.62)	(3.45)	(3.72)	(3.45)	(3.72)
Log(Assets ($M))	0.03***	0.01*	0.03***	0.01*	0.59***	0.48***	0.59***	0.48***
	(4.72)	(2.01)	(4.72)	(2.01)	(39.44)	(30.83)	(39.44)	(30.83)
Log(Int. Coverage)	0.02***	0.02***	0.02***	0.02***	0.05***	0.04***	0.05***	0.04***
	(3.00)	(2.79)	(3.00)	(2.79)	(5.10)	(4.45)	(5.10)	(4.45)
Leverage	0.18***	0.16***	0.18***	0.16***	0.28***	0.21***	0.28***	0.21***
	(6.97)	(6.64)	(6.97)	(6.64)	(4.84)	(3.88)	(4.84)	(3.88)
S.D. of Profitability	-0.22**	-0.22**	-0.22**	-0.22**	0.03	0.06	0.03	0.06
	(-2.04)	(-2.04)	(-2.04)	(-2.04)	(0.09)	(0.21)	(0.09)	(0.21)
Book-to-Market	0.01	0.01	0.01	0.01	-0.05***	-0.04***	-0.05***	-0.04***
	(1.59)	(1.66)	(1.59)	(1.66)	(-4.26)	(-3.48)	(-4.26)	(-3.48)
Altman Z-Score	0.00	0.00	0.00	0.00	0.01*	0.01*	0.01*	0.01*
	(0.81)	(0.74)	(0.81)	(0.74)	(1.69)	(1.83)	(1.69)	(1.83)
Syndicate Size		0.01***		0.01***		0.04***		0.04***
		(9.96)		(9.96)		(15.74)		(15.74)
Lead Size		0.01***		0.01***		0.02**		0.02**
		(4.17)		(4.17)		(2.45)		(2.45)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Loan Type FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Lender FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	29890	29890	29890	29890	29890	29890	29890	29890
Adjusted R^2	0.601	0.606	0.601	0.606	0.598	0.645	0.598	0.645

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 3.A3
List of Chairmen of the US Senate Banking Committee, 1989 – 2018. The Chairman's tenure typically ends on January 3, but for practical purposes I assume it ends on December 31 of the previous year.

Years	Name	Party	State
1989 – 1994	Donald Riegle	DEM	Michigan
1995 – 1998	Alfonse D'Amato	REP	New York
1999 – 2001[2]	Phil Gramm	REP	Texas
2001 – 2002[2]	Paul Sarbanes	DEM	Maryland
2003 – 2006	Richard Shelby	REP	Alabama
2007 – 2010	Chris Dodd	DEM	Connecticut
2011 – 2014	Tim Johnson	DEM	South Dakota
2015 – 2016	Richard Shelby	REP	Alabama
2017 – 2018[1]	Mike Crapo	REP	Idaho

† The Democrats gained majority control of the Senate in June 2001, after Senator Jim Jeffords, previously a Republican, became an independent and joined the Democratic caucus.
* Crapo continues to serve as the Chairman as of June 2019.

Chapter 4

Political Leadership and Governance Structure

4.1. Introduction

US President Donald Trump's collection of remarks since the beginning of the China-US trade war is a sobering reminder of the seismic effects politics has on the private sector. On August 23, 2019, Trump tweeted "... American companies are hereby ordered to immediately start looking for an alternative to China..." Within five minutes of this tweet, the Dow Jones Industrial Average plummeted 223 points, and plunged another 150 points five minutes later.

There are many aspects to the dynamics between politics and economics. There are large bodies of literature that examine political uncertainty's effects on firms, political capital's effects on governance, and benefits of political connection.[1]

[1]Political uncertainty's effects on firms are discussed in papers such as Julio and Yook (2012), Bhattacharya, Hsu, Tian, and Xu (2017), Jens (2017), and Bonaime, Gulen, and Ion (2018). Political capital's effects on governance are discussed in papers such as Andonov, Hochberg, and Rauh (2018) and Cao, Pan, Qian, and Tian (2017). Benefits of political connection are examined in papers such as Fisman (2001), Faccio (2006), Faccio, Masulis, and McConnell (2006), Johnson and Mitton (2003), Schwert (2018), Duchin and Sosyura (2012), Goldman, Rocholl, and So (2009, 2013), Child, Massoud, Schabus, and Zhou (2020), and Houston, Jiang, Lin, and Ma (2014)

This paper contributes to the literature by documenting comovement between local political leadership and firms' governance structures. More specifically, firms' replace directors who share a common birthplace with the *departing* local political leader with those who share a common birthplace with the *incoming* local political leader. I show that this is a channel through which Chinese firms establish political connections.[2] Findings show that firms engage in the hiring of directors who share a common birthplace with the incoming local CCP secretary in the years following his/her appointment. Furthermore, firms with higher degrees of political connections through common birthplaces are perceived more favorably by markets in the form of higher abnormal stock returns around secretary appointment dates. They also experience superior performance (as shown by their higher ROA, ROE, and asset turnover) and attract institutional fund flows.

I adopt a Chinese setting in this paper as its political environment and system provide a clean identification. First, China's local political leadership changes are unpredictable. In the US, virtually all state governor elections are predictable contests (i.e., polling data is widely available) between at most two candidates that take place every four years.[3] In contrast, China's province- and city-level CCP secretaries do not have fixed terms; they could be replaced at anytime, with dozens, if not hundreds, of potential candidates. Additionally, the notion that special interest groups, whether it be business or otherwise, is able to influence changes in key CCP personnel is implausible.[4] As such, changes to China's local political leadership offer a clean identification to study this paper's research question.

Unlike most Western countries, China operates as a single-party state. There are no elections or political contributions, thus precluding researchers from using campaign

[2] *Laoxiang* (or townsmen) is an important part of the Chinese culture and is discussed in more details in Section 4.2. Local political leadership is defined as the Chinese Communist Party (CCP) secretary of the firm's headquarter city. The CCP secretary is the most senior political role and most powerful person in each administrative region. In comparison, the vice-secretary almost always serves as the local head of government, such as the mayor of a city or governor of a province.

[3] Vermont and New Hampshire's governors have two-year terms.

[4] One piece of anecdotal evidence is Zhang Lichang's tenure as Tianjin's CCP secretary between 1997 and 2007, during which the city's growth rate was the lowest among large urban centers in China and corruption was prevalent with many scandals breaking out. In 2004, over one thousand Tianjin residents waved banners outside China Banking Regulatory Commission's office in Beijing, demanding Zhang's removal. Despite Zhang's unpopularity, he only resigned in 2007 over health concerns. Some Tianjin residents reacted to the news of his death in 2008 by setting off fireworks.

contributions as a measure of political connection. Previous papers that study political connection in China generally follow Fan, Wong, and Zhang's (2007) identification strategy – a firms is defined to be politically connected if at least one of its directors currently or formerly served in the central government (i.e., National People's Congress or People's Political Consultative Conference), local government, or the military. Using a novel dataset, I add to the literature by identifying a new and non-mutually exclusive channel of connection.

Political connection is arguably more important in China than it is in the US or Europe (in other words, the state has greater influence on firm performance). For instance, similar to public equity issuances in the US, where the SEC approval is required, all IPOs and SEOs must be approved by the China Securities Regulatory Commission (CSRC). However, unlike the SEC's approval processes, there exist few "hard rules" (e.g., must meet certain accounting ratios) surrounding China's public equity issuance processes and requirements. Instead, the rules are vague (e.g., internal controls measures must be adequate) and allow for rejection at the discretion of the CSRC. The fact that IPOs in the US may be cleared by the SEC within a matter of weeks contrasts strongly with Chinese IPO approval's seven-step process that often takes two to three years, and has an uncertain outcome (Liu, Stambaugh, and Yuan, 2019). Incidentally, previous studies have found that political connection enhances Chinese firms' access to the primary equity market (Piotroski and Zhang, 2014; Liu, Tang, and Tian, 2013; and Brockman, Firth, He, Mao, and Rui, 2019).

I examine changes in local CCP secretaries of Shanghai, Shenzhen, Hangzhou, and Tianjin – four of the largest local economies in China – between 2003 and 2016. At end of 2016, Shanghai, Shenzhen, Hangzhou, and Tianjin were respectively ranked first, fourth, tenth, and fifth by local GDP, and are collectively headquarters to over 20 percent of all listed firms in China. These four cities are geographically diverse and have dissimilar local cultures and dialects. For example, Shanghai and Shenzhen are 1500 kilometers apart. Shanghai's dialect, known as *Hu*, is a variety of the *Wu* dialect. In comparison, Shenzhen's dialect is Cantonese.

Between 2003 and 2016, Shanghai's CCP secretary changed three times. After Chen

Liangyu's (born in Shanghai) departure from the position, Yu Zhengsheng's (born in Shaanxi) was appointed at the end of 2007.[5] In 2013, Yu was succeeded by Han Zhen (born in Shanghai), who served until the end of 2017. Shenzhen's CCP secretary also changed four times over the same years. Li Hongzhong (born in Liaoning) succeeded Huang Liman (born in Liaoning) in 2005. Liu Yupu (born in Shandong) then served for two years starting in 2008, before Wang Rong's (born in Jiangsu) five-year tenure from 2010 to 2014. Ma Xingrui (born in Heilongjiang) took over from Wang in 2015.

Over the same period, Hangzhou's CCP secretary changed three times. Huang Kunming (born in Fujian) was appointed to the position following Wang Guoping's departure in 2010. Huang was succeeded by Gong Zheng's (born in Jiangsu) two-year tenure starting in 2014, before Zhao Yide (born in Zhejiang) took over the role in 2016. Similarly, Tianjin also had three changes between 2003 and 2016. Zhang Gaoli's (born in Fujian) six-year spell as CCP secretary of Tianjin began in 2007, following his predecessor Zhang Lichang (born in Hebei) retirement earlier in the same year. Sun Chunlan (born in Liaoning) was appointed to the position in 2013, before Huang Xingguo (born in Zhejiang) took over in 2015.

Excluding Xi's short tenure in 2007, Shanghai had two instances of change to its CCP secretary's birthplace. Shenzhen, Hangzhou, and Tianjin each had three changes to their CCP secretaries' birthplaces. These changes allow me to test for my hypothesis – that firms establish political connections through the hiring of directors who share a common birthplace with their local CCP secretary (i.e., birthplace-connected) – over eleven independent events.

Consistent with my hypothesis, I find that firms headquartered in the four cities increase their percentage of directors who are birthplace-connected with the newly-appointed local CCP secretary by between two and seven percentage points (25% and 160%) in the three years following appointment (two years if the secretary's tenure was only two years). For example, Shanghai-based firms increase the fraction of Shanghai-born directors by approximately 6.9 percentage points (50%) in the three-years following Han Zhen's appointment. This is the second-smallest relative increase among the eleven appointments, with the small-

[5] Xi Jinping briefly served as the CCP secretary of Shanghai for six months during 2007.

est being a 25% increase in Zhejiang-born directors among Hangzhou-based firms in the one year following Zhao Yide's appointment.[6] However, it is unsurprising as Shanghai-based firms already had a large percentage of Shanghai-born directors prior to Han's appointment. In contrast, the same firms increased their fraction of Shaanxi-born directors by three percentage points (160%) following Yu Zhengshen's appointment. This is because Shanghai-based firms had very few Shaanxi-born directors prior to Yu's appointment, therefore individual hires lead to much larger relative increases. I also find that some firms start recruiting birthplace-connected directors in the year prior to appointments, suggesting that these firms may possess insider information related to changes in key local CCP personnel. Excluding the year leading up to each appointment in my regression analyses increases the economic significance of my findings.

The appointments of key CCP personnel are *ex-ante* largely unknown. In other words, in the vast majority of instances, most people are unable to anticipate who their next local CCP secretary will be. This provides the opportunity to examine whether markets perceive political connections established through common birthplaces favorably, as some firms would suddenly find themselves to have a strong political connection when the new local CCP secretary is appointed. Examining firms' cumulative abnormal returns (CARs) around each of the eleven appointment announcements, I find that firms with a higher percentage of birthplace-connected directors are viewed favorably by markets (i.e., exhibit higher CARs), after accounting for industry effects. More specifically, a one decile increase in the percentage of birthplace-connected directors translates to a CAR increase of up to 0.42 percentage points over a three-day window and 0.67 over an eleven-day window. These translate to a difference of around four and six percentage points in three- and eleven-day CARs around appointment announcements, respectively, between firms in the top and bottom deciles of birthplace-connected firms.

To examine whether political connections established through common birthplaces translate to real benefits, I test whether the lagged percentage of birthplace-connected directors

[6] Although Zhao Yide's tenured as CCP secretary of Hangzhou lasted until 2018, data availability limits my observations to the end of 2016.

affects next period's accounting performance. Results indicate that a one decile increase in the percentage of birthplace-connected directors translates to 0.15, 0.25, and 0.69 percentage points increases in ROA, ROE, and asset turnover, respectively.

Furthermore, I document evidence suggesting that investors recognize the importance of common birthplace connectedness. Private institutional investors (e.g., mutual funds and qualified foreign institutional investors) increase their holdings in firms with a higher percentage of birthplace-directors. For instance, I find that a one decile increase in the percentage of birthplace-connected directors leads to mutual and hedge funds increasing their equity ownership in the firm by between 0.22 and 0.25 percentage points in the following year.

In a falsification test, I rule out an alternative explanation that directors who share a common birthplace with the CCP secretary are appointed (under the "order" of the incoming local CCP secretary) to company boards, by splitting my sample into state-owned enterprises (SOEs) and non-SOEs. One can imagine that it would be easier for the incoming CCP secretary to place his friends and associates on SOE boards compared to on non-SOE boards. Therefore, results should be stronger for SOEs if connected directors are indeed appointed by incoming CCP secretaries rather than recruited by firms. However, results indicate that across all eleven occasions of local CCP secretary birthplace changes, SOEs engage in the hiring of birthplace-connected directors to a significantly lesser extent compared to that of non-SOEs. Furthermore, on seven of the eleven occasions, I find no evidence to suggest that SOEs engage in director birthplace-connection tactics (i.e., no increase in the percentage of birthplace-connected directors following appointment of new local CCP secretary). These provide support for the notion that firms actively seek political connections through common birthplaces.

4.2. Background and Setup

4.2.1 Importance of Birthplace

Birthplace is an important part of one's identity in Chinese culture. This can be seen by the common existence of *Tongxiang Hui* (or Townsmen Association) both in China and abroad, many of which are supported or established by the Chinese government. *Tongxiang Hui* are commonly structured at the province or city level to facilitate collaboration among those from the same area. The requirements for joining *Tongxiang Hui* differ slightly from association to association. Common requirements are (i) being born in the province/area and/or (ii) fluent in the local dialect.

Another illustration of the importance of birthplace in China is *Juntong* – the military intelligence agency of the Republic of China. *Juntong* was founded in 1938 by Dai Li – born in Jiangshan County. Under Dai, *Juntong*'s leadership consisted of almost exclusively Jiangshan-born individuals, most notably "One Dai Three Mao" – four individuals who controlled *Juntong* (later known as *Baomiju*) between 1938 until its disbandment in 1955. Between 1912 and 1949, there were 65 Jiangshan-born generals, of which 23 worked in *Juntong*.[7]

4.2.2 Data

My sample consists of all publicly listed firms headquartered in Shanghai, Shenzhen, Hangzhou, and Tianjin – four of the largest local economies in China between 2003 and 2016. Table 4.1 presents the cities' CCP secretaries over my sample period. Excluding Xi's short tenure, we see that the birthplaces of Shanghai's CCP secretaries changed from Shanghai to Shaanxi and back to Shanghai. For Shenzhen, this changed from Liaoning to Shandong to Jiangsu and finally to Heilongjiang. Similar to Shenzhen, Hangzhou and Tianjin's CCP secretaries

[7] Jiangshan News, 2011. 民国时期江山县（现江山市）国民党将军名录 [*List of Jiangshan County's Generals During the Republic of China Era*]. Retrived from http://jsnews.zjol.com.cn.

Table 4.1
CCP secretary of Shanghai (SH), Shenzhen (SZ), Hangzhou (HZ), and Tianjin (TJ) between 2003 and 2016. Birthplace is given at the province level. Shanghai, Beijing, Tianjin, and Chongqing are the four directly-administered municipalities in China, and do not belong to any province.

	Shanghai (SH)		Shenzhen (SZ)		Hangzhou (HZ)		Tianjin (TJ)	
Year	Name	Birthplace	Name	Birthplace	Name	Birthplace	Name	Birthplace
2003	Chen Liangyu	Shanghai	Huang Liman	Liaoning	Wang Guoping	Zhejiang	Zhang Lichang	Hebei
2004	Chen Liangyu	Shanghai	Huang Liman	Liaoning	Wang Guoping	Zhejiang	Zhang Lichang	Hebei
2005	Chen Liangyu	Shanghai	Li Hongzhong	Liaoning	Wang Guoping	Zhejiang	Zhang Lichang	Hebei
2006	Chen Liangyu	Shanghai	Li Hongzhong	Liaoning	Wang Guoping	Zhejiang	Zhang Lichang	Hebei
2007	Chen Liangyu	Shanghai	Li Hongzhong	Liaoning	Wang Guoping	Zhejiang	Zhang Gaoli	Fujian
2008	Yu Zhengsheng	Shaanxi	Liu Yupu	Shandong	Wang Guoping	Zhejiang	Zhang Gaoli	Fujian
2009	Yu Zhengsheng	Shaanxi	Liu Yupu	Shandong	Wang Guoping	Zhejiang	Zhang Gaoli	Fujian
2010	Yu Zhengsheng	Shaanxi	Wang Rong	Jiangsu	Huang Kunming	Fujian	Zhang Gaoli	Fujian
2011	Yu Zhengsheng	Shaanxi	Wang Rong	Jiangsu	Huang Kunming	Fujian	Zhang Gaoli	Fujian
2012	Yu Zhengsheng	Shaanxi	Wang Rong	Jiangsu	Huang Kunming	Fujian	Zhang Gaoli	Fujian
2013	Han Zhen	Shanghai	Wang Rong	Jiangsu	Huang Kunming	Fujian	Sun Chunlan	Liaoning
2014	Han Zhen	Shanghai	Wang Rong	Jiangsu	Gong Zheng	Jiangsu	Sun Chunlan	Liaoning
2015	Han Zhen	Shanghai	Ma Xingrui	Heilongjiang	Gong Zheng	Jiangsu	Huang Xingguo	Zhejiang
2016	Han Zhen	Shanghai	Ma Xingrui	Heilongjiang	Zhao Yide	Zhejiang	Huang Xingguo	Zhejiang

each had three birthplace changes – Zhejiang to Fujian to Jiangsu to Zhejiang for Hangzhou and Hebei to Fujian to Liaoning to Zhejiang for Tianjin.

Data on firms' financial statements are obtained from *Financial Statements of Chinese Firms* (CNFS). Stock price and equity market capitalization data are from *Securities Prices of Chinese Public Firms* (CNSP). Data on institutional investors' ownership in firms are from *Institutional Ownership Research Database* (IORD). Company headquarter location data is from Wind. All continuous variables are winsorized at the 1 and 99 percent levels. Descriptive statistics are presented in Table 4.2. Financial observables, as well as board size, are broadly similar across the four cities.

The term "director" in this paper broadly includes senior executives (i.e., C-suite officers), board of directors, and members of the supervisory committee.[8] Director information come from two sources. First, names of directors are from *Individual Characteristics of Listed Company Executives Database* (ICED).[9] Second, I complement this using a proprietary

[8]Companies in China are required, by law, to have a supervisory committee. The purpose supervisors is to monitor the company's financial performance, the actions of directors and executives, and ensure that company bylaws are being followed. The role of supervisors are usually filled by large shareholders and/or employee representatives. Supervisors cannot sit on the company board or be a member of the senior executive team. My results remain similar after excluding members of the supervisory committee.

[9]CNFS, CNSP, IORD, and ICED are all databases within the Chinese Research Data Services Platform (CNRDS).

dataset provided by China's Ministry of Public Security containing birthplaces of identified company directors over my sample period.

4.3. Empirical Analyses

4.3.1 Connections through Common Birthplaces

To test the hypothesis that firms attempt to establish political connections through the hiring of directors who share a common birthplace with their local CCP secretary, I first plot the percentage of directors who share the same birthplace with each of the eleven incoming secretaries. The four panels of Figure 4.1 correspond to each of the four cities – Shanghai (top-left), Shenzhen (top-right), Hangzhou (bottom-left), and Tianjin (bottom-right). They plot the percentages of directors who share a common birthplace with the local CCP secretary. For example, in the top-left panel we see a clear decrease in the percentage of Shanghai-born directors following the departure of Chen Liangyu (born in Shanghai). The opposite is true following the appointment of Han Zhen (born in Shanghai). Similarly, the percentage of Shaanxi-born directors are higher during years when Yu Zhengsheng (born in Shaanxi) was the CCP secretary of Shanghai than during years when he was not.

All four panels of Figure 4.1 follow a similar pattern – the percentage of directors from a certain province is higher when the local CCP secretary was born in the same province than it is when the secretary was born in a difference province. Take Hangzhou as another example – the percentage of Fujian-born directors was higher between 2010 and 2013, when Huang Kunming (born in Fujian) was the city's CCP secretary, compared to other years. One interesting observation across all four panels is that the percentage of birthplace-connected (with the incoming CCP secretary) directors start to increase *prior to* appointments. For example, we observe an increase in the percentage of Shanghai-born directors among Shanghai-based firms in 2012 – a year before Han Zhen's appointment. This suggest that some firms have private information regarding key local CCP personnel

changes. The fact that decreases in the percentage of birthplace-connected directors (with the incumbent) starts prior to departures also supports the private information explanation.[10]

Table 4.2
Descriptive statistics. Firms-years are split by headquarter location (Shanghai, Shenzhen, Hangzhou, and Tianjin). Sample period is between 2003 and 2016.

	Mean	S.D.	p25	p50	p75
Panel A: Shanghai (N = 2049)					
Num. of Directors	15.56	4.84	12.00	15.00	18.00
ROA	3.98	6.35	1.43	3.72	6.67
ROE	7.29	14.37	3.22	7.67	12.51
Revenue (CNY Bn)	8.40	20.91	0.66	1.54	4.96
Assets (CNY Bn)	20.50	75.59	1.24	2.86	8.23
B/M	0.40	0.27	0.20	0.33	0.54
Leverage	0.30	0.10	0.24	0.32	0.38
Panel B: Shenzhen (N = 1632)					
Num. of Directors	16.27	5.32	13.00	15.00	19.00
ROA	3.87	6.15	1.43	3.90	6.75
ROE	7.41	14.37	3.37	7.72	13.14
Revenue (CNY Bn)	6.68	17.75	0.53	1.33	3.33
Assets (CNY Bn)	24.02	93.82	1.19	2.55	7.02
B/M	0.36	0.25	0.18	0.30	0.47
Leverage	0.30	0.12	0.22	0.32	0.39
Panel C: Hangzhou (N = 696)					
Num. of Directors	15.44	4.66	12.00	15.00	18.00
ROA	4.93	6.72	1.60	4.74	7.96
ROE	8.46	14.33	3.82	8.88	13.75
Revenue (CNY Bn)	4.19	8.98	0.68	1.71	3.79
Assets (CNY Bn)	5.26	9.96	1.25	2.68	5.21
B/M	0.36	0.24	0.18	0.30	0.49
Leverage	0.30	0.11	0.22	0.31	0.39
Panel D: Tianjin (N = 487)					
Num. of Directors	16.10	4.65	13.00	16.00	18.00
ROA	2.56	6.60	0.77	2.78	5.33
ROE	5.26	17.54	1.92	6.41	11.20
Revenue (CNY Bn)	5.79	13.97	0.59	1.12	3.47
Assets (CNY Bn)	10.72	24.41	1.41	3.29	8.36
B/M	0.39	0.27	0.19	0.34	0.53
Leverage	0.33	0.10	0.29	0.34	0.40

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

[10]Unlike in most Western countries, where elections results are known months in advance of actual personnel changes (e.g., Trump won the 2016 election on November 8, 2016, but assumed office on January 20, 2017), China's local CCP secretary personnel changes are most commonly recorded on the announcement date. That is, there is no "lag" between appointment announcement and assuming office.

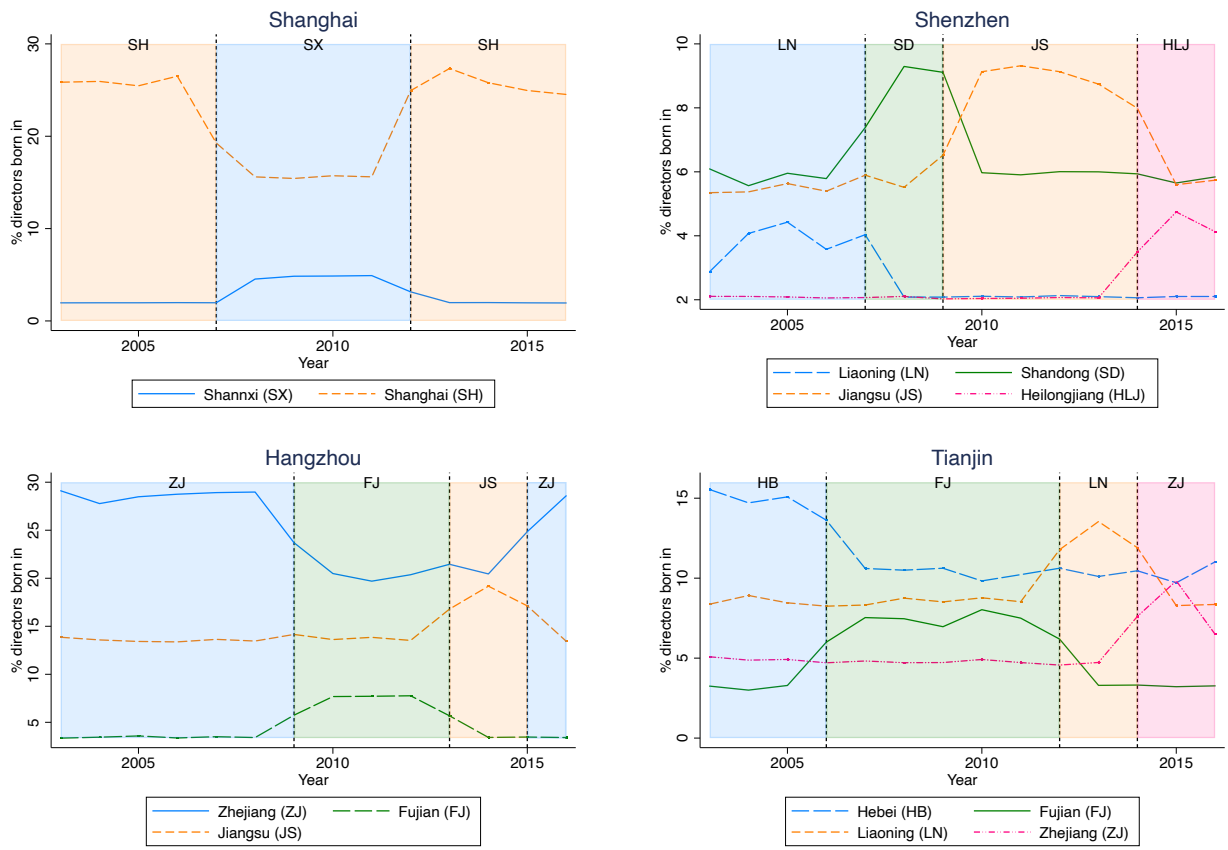

Fig. 4.1: Percentage of directors who share a common birthplace with local CCP secretaries between 2003 and 2016. Each dotted lines represent the appointment of a new local CCP secretary. Birthplace of each newly-appointed secretary is abbreviated and shown at the top of their respective dotted line. The top-left, top-right, bottom-left, and bottom-right panels include firms headquartered in Shanghai, Shenzhen, Hangzhou, and Tianjin, respectively.

To formally test my hypothesis, for each of the eleven incoming secretaries, I compared the percentage of birthplace-connected directors in the three years following their appointments to that in the three years prior to their appointments.[11] More specifically, for each incoming local CCP secretary,

$$CON_{i,t} = \alpha_i + \beta_1 Post_t + \gamma' X_{i,t-1} + \varepsilon_{i,t}, \tag{4.1}$$

where i and t index firm and year, respectively. Sample is restricted to firms headquartered in the city where change of secretary occurred. CON is the percentage of directors who share a common birthplace with the incoming secretary in question. $Post$ is an indicator

[11] I use two years of data for those who only served for two years. Zhao Yide served for three years from 2016 to 2018, but I only use one year of post-appointment data due to limitations on data availability.

variable that equals to one for years after the appointment and zero otherwise. X is a vector of controls including book-to-market, leverage, and the natural logarithmic transformation of total assets. Sample is restricted to Shanghai-based firms for Yu Zhengsheng and Han Zhen's appointments, Shenzhen-based firms for Liu Yupu, Wang Rong, and Ma Xingrui's appointments, Hangzhou-based firms for Huang Kunming, Gong Zheng, and Zhao Yide's appointments, and Tianjin-based firms for Zhang Gaoli, Sun Chunlan, and Huang Xingguo's appointments. If firms do attempt to establish political connection through the hiring of directors who share a common birthplace with their local CCP secretary, then we would expect β_1 to be positive.

Results of equation (4.1) are presented in Panels A (without controls) and B (with controls) of Table 4.3. We see that the percentage of directors who share a common birthplace with each of the eleven local CCP secretaries increases significantly following their respective appointments. For example, column 2 indicates that among Shanghai-based firms, the percentage of Shanghai-born directors are almost seven percentage points higher in the three years after Han Zhen (born in Shanghai) assumed office compared to that in the three years prior, representing a 50% increase in relative terms. This is perhaps unsurprising as Shanghai-based firms had relative high percentages of locally-born director even prior to Han's appointment. In contrast, the same firms increased their percentage of Shaanxi-born directors by almost three percentage points (160%) following Yu Zhengshen's (born in Shaanxi) appointment (column 1). This is because Shanghai-based firms had very few Shaanxi-born directors prior to Yu's appointment – only 1.83% of directors among Shanghai-based firms were born in Shaanxi – therefore individual hires lead to much large relative increases. Similar patterns are found across all eleven CCP secretary appointments. That is, firms increase their percentage of directors who share a common birthplace with their local CCP secretary in the two to three years following his/her appointment. Our coefficient of interest in Panels A and B are similar in economic magnitude, suggesting that this behavior is not driven by firm characteristics.

Given the apparent information leakage surrounding local CCP secretary appointments (as shown in Figure 4.1), I re-examine equation (4.1) after excluding the year leading up

to each appointment. Unsurprisingly, the coefficient of interest presented in Panel C of Table 4.3 are of greater economic significance compared to those in Panels A and B in ten of the eleven columns.[12] Using Han Zhen's appointment as our example, we see that column 2 now suggests the percentage of Shanghai-born director among Shanghai-based firms is more than ten percentage points (Panels A and B suggests between 6.3 and 6.9 percentage points) higher during his tenure as Shanghai's CCP secretary compared to before his appointment. In general, Panels A and B indicate that firms increase the percentage of directors who share a common birthplace with their local CCP secretary by between 1.7 and 6.9 percentage points in the two to three years following each appointment. This range increases to between 2.7 and 10.3 percentage points when the year leading up each appointment is excluded.

Results in Figure 4.1 and Table 4.3 provide strong evidence consistent with my hypothesis, suggesting that firms attempt to establish political connections through the hiring of directors who share a common birthplace with their local CCP secretary.

4.3.2 Market Reaction

Many studies find that politically connected firms enjoy higher CARs around the establishment of their connections (e.g., Fisman, 2001; Faccio, 2006; Acemoglu, Hassan, and Tahoun, 2018; Child et al., 2020).[13] The nature of China's political system means that local CCP secretary appointments are opaque and unpredictable. This means that a firm may find itself to have a high degree of political connectedness with the incoming local CCP secretary, through birthplace-connected directors, when appointments are announced. For example, a firm with a high percentage of Shanghai-born directors would find itself to be strongly connected when Han Zhen (born in Shanghai) was appointed as the CCP secretary

[12]The exception is Yu Zhengsheng's appointment as Shanghai's CCP secretary in late 2007 following Xi Jinping's short stint in the same position. Xi's atypically short tenure (only six months), and thereby Yu's appointment, may have surprised many firms.

[13]Fisman (2001) finds that losing politically connection results in lower CARs for firms that were previously politically connected.

of Shanghai.[14] As such, if the sharing of a common birthplace between directors and local CCP secretary is a channel of political connection through which firms derive value, then one would expect favorable market reaction toward firms with a high percentage of birthplace-connected directors (with the incoming CCP secretary) around appointment announcements.

I adopt an event study methodology to test this hypothesis. Formally, for each incoming local CCP secretary,

$$CAR_{k,i} = \alpha_k + \beta_1 CON^{10}_{k,i} + \gamma' X_{k,i} + \varepsilon_{k,i}, \tag{4.2}$$

where k and i index industry and firm, respectively. Sample is restricted to firms headquartered in the city where change of secretary occurred. CON^{10} is the decile portfolio ranking of firms based on their percentage of directors who share the same birthplace with the *incoming* local CCP secretary in the year prior to each appointment. This is done to reduce noise at the individual firm level. Two CAR windows are selected – [-1, 1] and [-5, 5]. CARs are estimated using the market model with an estimation window of 255 trading days that ends 46 trading days prior to each event day (i.e., appointment announcement). Industry dummies are based on CSCR's 2012 classification.

[14]It is worth noting that I am not suggesting that firms automatically become politically connected by having a higher percentage of directors who share a common birthplace with the local CCP secretary. Rather, having more birthplace-connected directors translates to greater potential for higher degrees of political connectedness.

Table 4.3

Firm-year panel regressions showing that **after a new local CCP secretary is appointed, firms increase their percentage of directors who share a common birthplace with their new local CCP secretary.** The dependent variable is the percentage of directors born in the same province as the incoming party secretary. Shanghai had two changes in local CCP secretary over my sample period; Shenzhen, Hangzhou, and Tianjin each had three. In Panels A and B, for each change, I use three years of data either side of the appointment (for those who served for less than three years, I use up to their tenure number of years). Panel C excludes the one year leading up to each announcement. *Post* is a dummy that equals to one for years after the appointment announcement is made and zero otherwise. Standard errors are clustered by firm and in parentheses.

Sample:	Shanghai		Shenzhen			Hangzhou			Tianjin		
Secretary (Birthplace):	Yu (SX)	Han (SH)	Liu (SD)	Wang (JS)	Ma (HLJ)	Huang (FJ)	Gong (JS)	Zhao (ZJ)	Zhang (FJ)	Sun (LN)	Huang (ZJ)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Panel A: No Controls											
Post	2.79***	6.34***	2.61***	3.04***	1.88***	3.46***	3.34***	5.57***	3.41***	3.02***	2.38***
	(0.14)	(0.62)	(0.70)	(0.70)	(0.23)	(0.22)	(0.42)	(0.70)	(0.27)	(0.49)	(0.31)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	795	1063	384	671	930	286	368	321	150	174	193
Adjusted R^2	0.426	0.128	0.139	0.150	0.144	0.533	0.114	0.182	0.439	0.188	0.112
Panel B: With Controls											
Post	2.77***	6.90***	2.77***	2.97***	1.69***	3.26***	3.83***	5.51***	2.81***	2.86***	1.48***
	(0.15)	(0.77)	(0.74)	(0.77)	(0.31)	(0.26)	(0.70)	(1.05)	(0.38)	(0.57)	(0.40)
B/M	-0.13	7.91***	0.75	2.11	-1.59*	-1.16	3.15	2.68	-1.73	3.72**	-6.87***
	(0.26)	(2.67)	(1.34)	(1.62)	(0.82)	(0.79)	(2.01)	(3.97)	(1.02)	(1.69)	(1.53)
Leverage	-2.44	-3.70	-10.68	9.62	-3.98*	-0.12	7.21	-12.23	7.47	9.86*	-1.51
	(1.57)	(8.02)	(9.52)	(10.22)	(2.29)	(2.71)	(5.39)	(9.57)	(6.04)	(5.25)	(3.58)
Log(Assets)	0.02	0.53	-0.34	-0.46	0.04	0.61*	-0.07	1.14	0.67	1.21	1.53***
	(0.18)	(0.83)	(1.03)	(1.32)	(0.25)	(0.32)	(1.21)	(1.61)	(0.56)	(1.00)	(0.35)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	795	1063	384	671	930	286	368	321	150	174	193
Adjusted R^2	0.425	0.139	0.140	0.150	0.149	0.540	0.121	0.186	0.458	0.226	0.227
Panel C: Excl. Lead-Up Year											
Post	2.72***	10.26***	3.80***	3.48***	2.91***	4.30***	6.52***	7.57***	4.60***	4.00***	2.68***
	(0.19)	(0.80)	(0.86)	(0.88)	(0.39)	(0.26)	(0.93)	(1.11)	(0.39)	(0.55)	(0.41)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	667	881	314	577	747	246	292	241	126	138	156
Adjusted R^2	0.374	0.223	0.159	0.139	0.204	0.663	0.268	0.398	0.624	0.471	0.357

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Results presented in Table 4.4 is consistent with markets perceiving firms with a higher percentage of directors who share the same birthplace with the newly appointed local CCP secretary more favorably. For instance, column 2 of Panel A suggests that a one decile increase in the percentage of Shanghai-born directors results in a 0.23 percentage point increase in CAR over the [-1, 1] window around Han Zhen's (born in Shanghai) appointment on November 20, 2012. We continue to find statistically significant positive market reaction when sample size becomes relatively small. For example, in columns 6, 9, 10, and 11 (where sample sizes are no larger than 40), we find significant positive market reaction over the [-1, 1] window for three of the four appointments. Furthermore, the economic magnitude of the coefficient of interest is also similar to that in other columns.

Similar results are found across all appointments and across both windows. Untabulated results show that findings are qualitatively similar when (i) sorting firms into quintile portfolios (i.e., coefficient of interest is roughly twice the magnitude of when sorting into decile portfolios) and (ii) using longer event windows (e.g., [-10, 10]). These finding provide strong evidence to suggest that connections through common birthplaces is perceived favorably by markets.

4.3.3 Firm Performance

Having documented markets' favorable reactions to firms with a higher percentage of directors who share a common birthplace with the newly appointed local CCP secretary, it is natural to subsequently examine whether these firms enjoy any *real* benefits, on top of financial ones. Previous studies have found that politically connected firms in China enjoy real benefits such as superior performance (Li, Meng, Wang, and Zhou, 2008; Xu, Yuan, Jiang, and Chan, 2015), easier access to the primary capital market (Piotroski and Zhang, 2014; Liu et al., 2013; Brockman et al., 2019), and easier access to bank loans (Li et al., 2008).

Table 4.4

Cross-sectional regressions showing that **markets perceive firms with a higher percentage of birthplace-connected directors more favorably around the announcements of local CCP secretary appointments.** The dependent variables in Panels A and B are CARs over [-1, 1] and [-5, 5] windows, respectively. CARs are calculated using the market model using an estimation window of 255 trading days, ending 46 trading days prior to the event day. CON^{10} is the portfolio rank of firms sorted into decile portfolios based on their previous year-end's percentage of directors who share a common birthplace with the *incoming* local CCP secretary. Industry classification is based on China Securities Regulatory Commission's (CSRS) 2012 classification. Standard errors are clustered by industry and in parentheses.

Sample:	Shanghai		Shenzhen			Hangzhou			Tianjin		
Secretary (Birthplace):	Yu (SX)	Han (SH)	Liu (SD)	Wang (JS)	Ma (HLJ)	Huang (FJ)	Gong (JS)	Zhao (ZJ)	Zhang (FJ)	Sun (LN)	Huang (ZJ)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Panel A: CAR [-1, 1]											
CON^{10}	0.36***	0.23***	0.21**	0.33***	0.28***	0.26***	0.24***	0.26**	0.27	0.42**	0.41***
	(0.04)	(0.03)	(0.08)	(0.09)	(0.05)	(0.08)	(0.06)	(0.09)	(0.22)	(0.12)	(0.09)
B/M	-1.50*	0.39	-0.17	0.42	0.65	2.83	-1.20	-1.93*	-3.15	-2.13***	1.04
	(0.72)	(0.65)	(1.31)	(2.06)	(1.28)	(2.92)	(1.58)	(0.95)	(1.88)	(0.36)	(0.63)
Leverage	1.33	0.41	-2.54	1.62	-0.45	-3.50	5.70**	-6.07	5.64	-2.70	5.90*
	(2.87)	(3.37)	(2.19)	(1.38)	(1.68)	(4.18)	(1.93)	(3.35)	(5.77)	(1.84)	(2.52)
Log(Assets)	0.10	-0.02	-0.04	0.01	0.09	0.11	-0.39	0.25	0.48	0.40	-0.49
	(0.11)	(0.18)	(0.22)	(0.20)	(0.15)	(0.48)	(0.22)	(0.18)	(0.93)	(0.56)	(0.42)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	135	182	70	94	183	40	76	80	24	36	37
Adjusted R^2	0.309	0.167	0.253	0.277	0.197	0.412	0.308	0.276	0.497	0.381	0.500
Panel B: CAR [-5, 5]											
CON^{10}	0.55***	0.31***	0.20	0.40***	0.28***	0.19	0.27***	0.52***	0.41	0.67***	0.35
	(0.07)	(0.07)	(0.12)	(0.12)	(0.08)	(0.20)	(0.07)	(0.10)	(0.52)	(0.18)	(0.23)
B/M	-2.05*	0.74	-2.33	1.09	-0.32	6.11	-2.96*	-0.32	-7.53*	-3.85**	0.13
	(1.10)	(1.31)	(3.47)	(1.83)	(3.19)	(5.68)	(1.43)	(3.85)	(3.28)	(1.47)	(4.92)
Leverage	2.69	2.31	2.43	3.43	2.71	-12.53	-5.50	2.97	13.23	-0.38	0.85
	(6.59)	(5.23)	(3.72)	(2.83)	(2.19)	(7.13)	(4.73)	(3.16)	(7.11)	(3.09)	(8.37)
Log(Assets)	0.24	0.07	-0.17	-0.30	0.17	0.13	-0.41	-0.36	1.03	0.31	-0.82
	(0.22)	(0.37)	(0.41)	(0.29)	(0.32)	(0.79)	(0.44)	(0.59)	(2.04)	(0.37)	(1.11)
Industry FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	135	182	70	94	183	40	76	80	24	36	37
Adjusted R^2	0.299	0.132	0.177	0.188	0.081	0.344	0.226	0.273	0.748	0.347	0.289

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

I examine firms' ROA, ROE, and asset turnover to see if connections through common birthplaces bring measurable benefits to firms. More specifically, I test the pooled model

$$R_{i,t} = \alpha_i + \beta_1 CON^{10}_{i,t-1} + \gamma' X_{i,t-1} + \delta_t + \varepsilon_{i,t}, \tag{4.3}$$

where i and t index firm and year, respectively. R is one of the three performance measures – ROA, ROE, and asset turnover. CON^{10} is the portfolio rank of firms sorted into decile portfolios based on their previous year-end's percentage of directors who share a common birthplace with the *current* local CCP secretary. For instance, for 2013's Shanghai-based firms (when Han Zhen was the CCP secretary), CON^{10} is the portfolio decile ranking based on their percentage of SH-born directors in 2012.

Table 4.5
Firm-year panel regressions showing that **firms with a higher percentage of birthplace-connected directors enjoy superior accounting performance in the following year.** Dependent variables are ROA, ROE, and asset turnover. CON^{10} is the portfolio rank of firms sorted into decile portfolios based on their previous year-end's percentage of directors who share a common birthplace with the *current* local CCP secretary. Standard errors are clustered by firm and in parentheses.

Dependent Variable:	ROA (%)		ROE (%)		Sales/Assets (%)	
	(1)	(2)	(3)	(4)	(5)	(6)
CON^{10}	0.15***	0.15***	0.25**	0.25**	0.69**	0.66**
	(0.05)	(0.05)	(0.10)	(0.10)	(0.32)	(0.32)
B/M		-4.89***		-9.95***		-3.37
		(0.94)		(2.07)		(6.49)
Leverage		-32.19***		-29.69***		31.53
		(2.67)		(8.04)		(19.55)
Log(Assets)		2.41***		4.39***		-5.71
		(0.39)		(0.96)		(3.88)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes
N	4226	4226	4226	4226	4226	4226
Adjusted R^2	0.337	0.420	0.178	0.203	0.796	0.797

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 4.5 presents evidence consistent with the hypothesis that higher degrees of birthplace-connectedness lead to superior performance. After controlling for firm characteristics, as well as firm and year fixed effects, ROA, ROE, and asset turnover respectively increase by 0.15, 0.25, and 0.69 percentage points per decile increase in the percentage of birthplace-connected directors (columns 2, 4, and 6). These findings confirms existing empirical evidence documented in the literature, albeit via a new definition of political connectedness. They

provide evidence supporting the notion that political connection with the firm's headquarter city's CCP secretary may be established through directors who share a common birthplace with the secretary.

4.3.4 Institutional Ownership

Institutional investors are generally considered to be "smarter" than retail investors (Gruber, 1996; Zheng, 1999; Keswani and Stolin, 2008; Frazzini and Lamont, 2008; Barber, Lee, Liu, and Odean, 2008). As such, it is reasonable to expect institutional investors to recognize the value of political connections through common birthplaces and increase their holdings in firms with a higher percentage of birthplace-connected directors.

Institutional investors of different types are likely to have different objective functions, and thus invest differently. In this paper, I identify four major categories of institutional investors applicable to China – mutual and hedge funds (M&H), insurance companies, qualified foreign institutional investors (QFII), and state-controlled funds.[15]

To test this hypothesis, I modify equation 4.3 by replacing the dependent variable with institutional holdings. Table 4.6 shows that mutual and hedge funds and QFII participants' fund flows follow the percentage of birthplace-connected director. That is, these investors increase their holdings in a firm when its percentage of birthplace-connected directors increases. For example, column 2 suggests that mutual and hedge funds increase their ownership in firms by 0.22 percentage points per decile increase in the percentage of birthplace-connected directors.

Insurance companies' lack of reaction to changes in firms' percentage of birthplace-connected directors is perhaps unsurprising, it may be attributable to their lack of "skin in the game". Conventional wisdom suggests that insurance companies invests primarily in

[15]The QFII program was introduced in 2002 to allow licensed foreign investors participate in Chinese stock exchanges. Prior to this, foreign investors were not permitted to trade CNY-denominated A shares. State-controlled funds, such as the Shanghai Municipal Investment Corporation (aka Shanghai Chengtou), are funds operated by central- and local-level government agencies.

fixed income assets and engage in immunization strategies, such as matching durations of investment assets and claim liabilities. Henebry and Diamond (1998) find that the percentage of investment assets allocated to common equity among US life insurance companies had been declining steadily from just six percent in 1988 to three percent by 1995. Consistent with their observation, I find that on average, less than one percent of common equity in Chinese firms were held by insurance companies. As such, insurance companies' lack of large stakes in firms may explain their inaction toward changes in firms' percentage of birthplace-connected directors.

Table 4.6

Firm-year panel regressions showing that **institutional investors increase their holding in firms with a higher percentage of birthplace-connected directors.** The dependent variable is equity ownership in percentage points. Institutional investors are grouped into categories. *M&H* are mutual and hedge funds; *Insurance* includes all insurance companies; *QFII* represents qualified foreign institutional investors; and *State* includes state-controlled or operated funds (e.g., various municipal city funds). CON^{10} is the portfolio rank of firms sorted into decile portfolios based on their previous year-end's percentage of directors who share a common birthplace with the local CCP secretary. Data availability limits sample period to between 2005 and 2016. Standard errors are clustered by firm and in parentheses.

Investor Type:	M&H		Insurance		QFII		State	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
CON^{10}	0.25***	0.22***	0.03	0.03	0.01**	0.01**	-0.07	-0.06
	(0.08)	(0.07)	(0.02)	(0.02)	(0.01)	(0.01)	(0.05)	(0.05)
B/M		-19.55***		0.71		-0.71***		-0.17
		(1.63)		(0.93)		(0.19)		(1.72)
Leverage		-18.30***		-1.35*		-0.74*		0.81
		(3.22)		(0.73)		(0.42)		(5.56)
Log(Assets)		2.67***		0.31**		0.02		1.92**
		(0.43)		(0.12)		(0.04)		(0.82)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	4136	4136	4136	4136	4136	4136	4136	4136
Adjusted R^2	0.449	0.512	0.319	0.324	0.135	0.147	0.913	0.915

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

State-owned institutional investors also do not react to changes in firms' political connectedness. There are several potential explanations for this. First, managers of state-owned funds are likely to be politically well-connected themselves, thereby substituting the need for investing in politically connected firms. Second, the primary objective of Chinese state-controlled funds is often not profit maximization, but social-stability oriented, such as ensuring market stability and maintaining control of strategically important industries and businesses. Finally, state-controlled institutional investors may not be as efficient as

their private counterparts, and neglecting birthplace-connectedness is one aspect of this inefficiency.

Overall, evidence supporting the hypothesis that institutional investors, particularly those that are private, recognize the importance of and benefits from having a high percentage of directors who share a common birthplace with local CCP secretaries. As such, these investors increase their ownership of firms that have a higher percentage of birthplace-connected directors.

4.4. Robustness and Falsification Tests

4.4.1 Appointing vs. Seeking Directors

One plausible alternative explanation of the observed phenomenon documented in this paper is that incoming CCP secretaries "appoint" their friends and associates, with whom they share a common birthplace, to sit on boards of local firms, rather than firms seeking these directors to establish political connections. Incoming CCP secretaries could be engaging in such conducts to favor their personal friends and associates.

To address this concern, I re-examine equation (4.1) after introducing an indicator variable, *SOE*, that equals to one if the firm is an SOE and zero otherwise. More specifically, for each incoming local CCP secretary,

$$CON_{i,t} = \alpha_{j,i} + \beta_1 Post_t + \beta_2 Post_t SOE_i + \gamma' X_{i,t-1} + \varepsilon_{i,t}, \tag{4.4}$$

where i and t index firm and year, respectively. *CON*, *Post*, and X share the same definition as in equation (4.1). One can imagine that it would be easier for the incoming CCP secretary to place his friends on SOE boards compared to non-SOE boards. Therefore, if results are driven by "orders" from incoming CCP secretaries, rather than firms seeking political connections, then we should expect to observe stronger effects for SOEs compared to non-

SOEs. As such, we would expect β_2 to be positive.

Table 4.7 presents results of equation (4.4). The coefficient of the interaction term is significant and *negative* across all columns, suggesting at the very least that SOEs increase their percentage of directors who share a common birthplace with the incoming local CCP secretary to a lesser extent than non-SOEs do. I also formally test the null hypothesis that $\beta_1 + \beta_2 = 0$. The F-test fails to reject the null for seven of the eleven appointments, thereby suggesting that SOEs do not appears to engage in such director hiring strategy at all. These results indicate that it is unlikely that birthplace-connected directors are "appointed", rather than recruited by firms themselves.

4.4.2 Birthplace vs. Jiguan (Ancestral Home)

Jiguan, or ancestral home, has always played a significant role in one's sense of identity in China. Officially, jiguan is defined as the residence of one's paternal grandfather at the time of one's birth; but it is more often loosely defined as where one's ancestors are from. As such, we would expect jiguan and birthplace to be highly correlated – indeed 70 percent of this paper's sample of directors exhibit an overlap between their birthplace and jiguan.

The high percentage of overlap between birthplace and jiguan makes it difficult to distinguish which one (or both) is driving our results. However, two cases offer some evidence supporting the notion that it is birthplace-, rather than jiguan-connections, that firms attempt to establish. First, we look at Ma Xingrui – the CCP secretary of Shenzhen between 2015 and 2016. Ma was born in Heilongjiang, but his jiguan is Shandong. The top-right panel of Figure 4.1 shows that following his appointment, the percentage of Heilongjiang-born directors more than double, whereas the percentage of Shandong-born directors do not change.

Table 4.7

Firm-year panel regressions showing that **after a new local CCP secretary is appointed, SOE firms increase their percentage of directors who share a common birthplace with their new local CCP secretary *less so* than non-SOE firms do.** The dependent variable is the percentage of directors born in the same province as the incoming CCP secretary. Shanghai had two changes in local CCP secretary over my sample period; Shenzhen, Hangzhou, and Tianjin each had three. For each change, I use three years of data either side of the appointment (for those who served for less than three years, I use up to their tenure number of years). *Post* is a dummy that equals to one for years after the appointment announcement is made and zero otherwise. *SOE* is a dummy that equals to one for state-owned enterprises and zero otherwise. Standard errors are clustered by firm and in parentheses. F-statistics are shown for F-tests.

Sample:	Shanghai		Shenzhen			Hangzhou			Tianjin		
Secretary (Birthplace):	Yu (SX)	Han (SH)	Liu (SD)	Wang (JS)	Ma (HLJ)	Huang (FJ)	Gong (JS)	Zhao (ZJ)	Zhang (FJ)	Sun (LN)	Huang (ZJ)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)
Post	3.38***	9.76***	4.69***	5.62***	2.74***	3.19***	5.19***	8.22***	3.82***	3.85***	3.08***
	(0.14)	(0.80)	(1.04)	(1.01)	(0.32)	(0.32)	(0.77)	(1.07)	(0.52)	(0.38)	(0.27)
Post × SOE	-1.69***	-8.14***	-3.59***	-5.16***	-3.10***	-0.93*	-2.71***	-4.31***	-1.89**	-1.31*	-1.52***
	(0.26)	(1.21)	(1.32)	(1.25)	(0.39)	(0.50)	(0.86)	(1.15)	(0.69)	(0.76)	(0.55)
B/M	-0.28	7.45***	0.50	2.38	-1.91***	-1.11	2.20	3.21	-2.36**	2.69	-3.13***
	(0.26)	(2.42)	(1.41)	(1.50)	(0.69)	(0.81)	(1.90)	(3.60)	(0.93)	(1.90)	(1.05)
Leverage	-2.48*	-5.39	-9.87	12.81	-5.06**	-0.37	4.05	-10.38	5.76	4.61	-4.92**
	(1.36)	(7.47)	(8.82)	(9.73)	(2.09)	(3.66)	(4.99)	(7.51)	(6.37)	(4.22)	(2.22)
Log(Assets)	0.03	0.38	-0.43	-0.93	0.03	0.68**	-0.66	1.57	1.04*	-0.19	1.25***
	(0.16)	(0.83)	(0.97)	(1.25)	(0.23)	(0.26)	(0.91)	(1.13)	(0.55)	(0.49)	(0.24)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
N	795	1063	384	671	930	286	368	321	150	174	193
Adjusted R^2	0.463	0.177	0.172	0.179	0.240	0.467	0.126	0.343	0.496	0.231	0.399
F-test: Post + Post × SOE = 0	52.15***	2.20	1.63	0.27	1.26	70.21***	9.15***	2.50	19.57***	0.50	0.02

* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Second, we turn our attention to Sun Chunlan – the CCP secretary of Tianjin between 2013 and 2014. Similar to Ma, Sun's birthplace differs from her jiguan. She was born in Liaoning, but her is Hebei. From the bottom-right panel of Figure 4.1, we observe that during her tenure, approximately 13 percent of directors amongst Tianjin-based firms were born in Liaoning. This is much higher than the nine percentage during other years. In contrast, there is little change in the percentage of Hebei-born directors following her appointment. Collectively, these two cases indicate that it is the sharing of a common birthplace, rather than jiguan, between directors and firms' local CCP secretary that increase firms' political connectedness.

4.5. Conclusion

In the paper, I document a new channel of political connection in China – firms hiring directors who share a common birthplace with their headquarter city's CCP secretary. Exploiting eleven exogenous changes in Shanghai, Shenzhen, Hangzhou, and Tianjin's CCP secretaries between 2003 and 2016, I find that firms increase their percentage of directors who are birthplace-connected with each incoming local CCP secretary by between two and seven percentage points (25% and 160% in relative terms) in the two to three years following appointments.

Potential political connections that may be established through this channel is recognized by market participants. On the day of CCP secretary appointments, markets view firms with a high percentage of birthplace-connected directors favorably – a difference of four and six percentage points in three- and eleven-day CARs around appointment announcements, respectively, between firms in the top and bottom deciles of birthplace-connected firms.

Additionally, I establish that this is a channel of connection that leads to real benefits. Consistent with previous studies on politically connected (through different channels) Chinese firms, I find that connections through common birthplaces lead to superior ROA, ROE, and asset turnover. Whether these are results of political favoritism or information efficiency

remains an open question.

Another piece of evidence in support of the notion that common birthplace is a genuine channel of political connection that creates value for firms is that private institutional investors, such as mutual and hedge funds, increase their holdings in firms with higher percentages of birthplace-connected directors. This suggest that "smart money" recognizes the importance of birthplace-connections, as well as the benefits that they bring.

I rule out an alternative explanation that directors who share a common birthplace with their local CCP secretary are appointed to company boards on the "orders" of politicians. To test this, I split my sample into SOEs and non-SOEs, with the idea that were local CCP leadership to place directors on company board, they are more likely to place them on SOE's board given the nature of the ownership. Results suggest that across all eleven appointments, SOEs alter their board composition, in terms of birthplace of directors, to establish political connections through common birthplaces to a much lesser extent than non-SOEs do. Furthermore, I fail to reject the hypothesis that SOEs do not engage in this birthplace-connection strategy for seven of the eleven CCP secretary changes. These results indicate that it is the non-SEOs that are actively seeking political connections through the hiring of birthplace-connected directors, rather than politicians appointing these directors to company boards.

Establishing political connection through the sharing of a common birthplace between directors and local CCP secretaries may be a product of China's distinctive culture. It would be interesting to see if the same is true for other countries. Nonetheless, given China's status as the world's second largest economy, we should not neglect understanding how Chinese firms operate under the country's unique ecopolitical environment.

Chapter 5

Conclusion

This thesis presents three essays that explore the intersection between financial economics and political science. Building on existing literature, these essays examine mechanisms that connect firms to politicians, as well as new channels through which firms benefit from being connected, under different ecopolitical environments.

In the first essay (Surprise Election for Trump Connections), my coauthors and I examine firms with business or personal connections to the Trump family prior to the announcement of Donald Trump's 2016 election campaign. We find that firms connected to Trump experience positive abnormal stock returns in the days and weeks following his surprise victory. In the two years following his inauguration, connected firms experienced superior accounting performance, received more government procurement contracts, and were less likely to be targeted by regulators, as compared to nonconnected firms. This paper makes two main contributions to the literature. First, given Trump's unexpected victory, the identification is free from self-selection bias; thus, allowing for a clean estimation of the average treatment effect. Second, the paper is the first to document benefits, both financial and real, derived from being directly connected to the US president.

In the second essay (Politically Influenced Bank Lending), I find that firms headquartered in the same state as the Chairman of the US Senate Banking Committee (connected

firms) are able to borrow at lower interest rates from banks compared to firms headquartered in other states. Connected firms increase their political contributions to the Chairman, provided that he has not announced his retirement from the Senate, depending on the cheapness of their loans. Firms in states whose previous election (for Senate seats) was closely contested are able to borrow at even lower interest rates, indicating that the Chairman is incentivized by reelection. The paper identifies specific benefits exchanged by politicians and firms. In doing so, it demonstrates the existence of a *quid pro quo* relationship.

In the third essay (Political Leadership and Governance Structure), I explore how changes in local political leadership affect firms' board structures. Specifically, I identify a new mechanism through which Chinese firms establish political connections. Under China's political environment, firms lack the option to become politically connected via means typically adopted by Western firms, such as campaign contributions. Exploiting a novel dataset of directors' birthplaces, I find that firms in China alter the composition of their boards depending on the birthplace of their headquarter city's Communist Party (CCP) secretary. Using exogenous changes in city-level CCP secretary personnel, I find that firms increase (decrese) the percentage of directors who share a common birthplace with the incoming (departing) CCP secretary. Firms with a higher percentage of birthplace-connected directors exhibit higher stock returns around CCP secretary appointment announcement days. These firms also demonstrate superior accounting performance and attract institutional fund flows. Additionally, evidence suggests that these connected directors are recruited by firms, rather than "appointed" to company boards by politicians. This paper documents a channel of political connection that complements the existing literature on political economy in China, which so far has largely defined a firm to be politically connected if its board consists of individuals who were previously a member of China's central or local government, or the military.

Overall, this thesis demonstrates the crucial role of politics in the study of financial economics. I hope it not only promotes future research in this area, but also brings meaningful insights into our current ecopolitical environment and is able to serve as a reference to policy makers.

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