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Author(s): Eitan Goldman, Jörg Rocholl and Jongil So

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# Do Politically Connected Boards Affect Firm Value?

**Eitan Goldman**

Indiana University

**Jörg Rocholl**

ESMT European School of Management and Technology in Berlin

**Jongil So**

University of North Carolina at Chapel Hill

This article explores whether political connections are important in the United States. The article uses an original hand-collected data set on the political connections of board members of S&P 500 companies to sort companies into those connected to the Republican Party and those connected to the Democratic Party. The analysis shows a positive abnormal stock return following the announcement of the nomination of a politically connected individual to the board. This article also analyzes the stock-price response to the Republican win of the 2000 presidential election and finds that companies connected to the Republican Party increase in value, and companies connected to the Democratic Party decrease in value. (*JEL* G30, G34, G38)

## Introduction

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

While this argument should be true in general, anecdotal stories about the potential influence of political connections in the United States do exist. For example, a 2004 AP newswire reports that “the Army awarded Vice President

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

In this study, we focus on the political connections of the board of directors. Although the political connections of board members can be beneficial both for innocuous reasons, such as providing knowledge about how to navigate government bureaucracies, and for less innocuous ones, it is nevertheless important to explore how pervasive is the impact of these connections on the value of publicly traded U.S. companies. Thus, this article attempts to investigate whether the examples above merely represent isolated idiosyncratic cases in which politically connected boards may have affected value or whether they are the tip of the iceberg of a much larger widespread phenomenon.

To address this question, the article focuses on analyzing the value impact of political connections of major U.S. companies, including all companies in the S&P 500. Testing for whether political connections impact value requires addressing two basic challenges. The first challenge is to identify and define a viable measure of political connections. Given a definition of political connections, the second challenge is to find a setting that would allow one to test whether they do indeed affect company value.

To address the first challenge, the article employs a unique definition of a company's political connections based on new hand-collected data, detailing the former political positions held by each of the board members of all companies that are in the S&P 500 during the years 1996 and 2000.<sup>1</sup> Information about the political background of board members is then used to sort companies into those that are connected to the Democrats and those that are connected to the Republicans.

To address the second challenge, the article looks at two different events. The first is the 2000 presidential election on November 7, 2000.<sup>2</sup> The second is the announcement of the board nomination of all of the directors who are identified

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

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

as having a political connection. The hypothesis is that if political connections matter, then (1) companies with political connections to the Republican Party will increase in value upon the Republican win, while companies connected to the Democratic Party will suffer a drop in value; and (2) the nomination of a politically connected director to the board will result in an increase in firm value due to the revelation that this company is able to hire from a limited supply of politically connected individuals who have the ability to generate future political benefits.<sup>3</sup>

The first main result of the article is that a portfolio of S&P 500 companies classified as having a Republican board significantly outperforms a portfolio of S&P 500 companies classified as having a Democratic board in the post-election period. This is true regardless of whether the portfolios are formed based on equal weighting or value weighting. A company is defined as having a Republican (Democratic) board if it has at least one board member who has a former affiliation to the Republicans (Democrats) but no such member with ties to the Democrats (Republicans). The results also show that, considered separately, the Republican portfolio exhibits a positive and significant cumulative abnormal return (CAR) following the election. Conversely, the Democratic portfolio exhibits a negative CAR following the election. This last result is significant, though only in the value-weighted average, which suggests that the effect of political connections is more pronounced for the larger companies in the sample.

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

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

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

The results in the article are robust to a number of different specifications. For example, the election results remain strongly significant for different choices of event windows surrounding the 2000 elections, and in the cross-section

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<sup>3</sup> Further discussion of the theory and economic motivation behind this test is provided in Section 2.3.

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

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

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

Further industry analysis shows that companies with politically connected boards are relatively evenly distributed across the Fama-French industry groups. It is also worth noting that the industry distribution of Republican companies is statistically not different from the industry distribution of Democratic companies. This further suggests that the results are not driven by any specific industry.<sup>5</sup>

A second interpretation of the results deals with the announcement returns following the board nominations of politically connected directors. One question that arises is whether the same abnormal returns are observed when nonpolitical directors are added to the board of the same company. It might be argued that the observed effect is due to the characteristics of the company itself or to the fact that these directors are independent rather than politically connected. To address this issue, each announcement of the board nomination of a former politician is matched with an announcement by the same company of another nomination of an independent director who is not politically connected. The

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

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

results suggest that independent nonpolitical directors do not generate a positive abnormal return. These results are consistent with Shivdasani and Yermack (1999) and Fich and Shivdasani (2006), who also show that the announcement effect of the nomination of independent directors is either insignificantly different from zero or negative. While Rosenstein and Wyatt (1990) do find a very small positive announcement effect of the order of 0.2%, this effect is much smaller than the effect found here. Furthermore, they find the effect to be significant only for small firms. This is the opposite of the findings in our article, which suggests that the announcement effects here are due to the unique political characteristics of the sample of directors.

A final interpretation of the positive announcement returns following the board nomination could be that these abnormal returns are not due to the board members being politically connected, but rather to their superb quality and expertise. The article controls for this possibility by sorting politically connected board members into two groups: those individuals who had a political position that was functionally related to the company for which they received their board nomination and those individuals whose political position was unrelated. If expertise was indeed the only driving force behind the positive announcement returns, then positive announcement returns should only be observed for board members with related experience. The results in the article show that the announcement return of *related* board members is indeed higher than that for *not related* board members, and that the announcement returns for the latter group are consistently positive and significant.

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

The value from political connections may arise in many different ways. There are both direct channels as well as more subtle indirect channels. For example, Goldman, Rocholl, and So (2008) provide evidence that government officials can influence the allocation of lucrative government contracts toward the connected company. As another example, legislators can impose tariffs on competitors (especially foreign companies) to the benefit of specific companies. In addition, they can use tax incentives to promote the prospects of one product/business area and discourage those of others. Furthermore, the government can change various regulatory requirements that may also have a substantial effect on value. Finally, government officials with ties outside the United States can be beneficial in opening doors abroad. Thus, former politicians with various

backgrounds, either in the administration or in the legislative branch or in any other type of political position, can be valuable to a company.

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

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

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

As mentioned above, this article promotes the idea that political connections *create* value by generating future benefits to the firm. Three recent papers

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

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



that use donation data stop short of making this point. These papers include Jayachandran (2006); Knight (2006); and Shon (2006). Jayachandran (2006) looks at the 2001 departure of Senator Jim Jeffords from the Republican Party to being an independent. She shows that this event results in a decrease in value of firms donating to the Republicans. However, as she argues in the paper, “An important open question that the results do not fully resolve is whether the relationship is casual, that is, whether firms contribute to politicians whose intrinsic views match the firms’ interests or whether donations affect politicians’ behavior” (p. 2).

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

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

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

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<sup>8</sup> Looking at campaign contributions in Brazil, Claessens et al. (2008) find that donating companies experience higher stock returns around elections. Using a different cut of donation data, Cooper et al. (2007) consider the long-run performance of donating companies in the United States.

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



unique contribution of this article is in showing that the impact of political connections on value is more likely to be due to the market's belief that these connections provide companies with political influence.

The second strand of the literature related to this study includes papers that explore whether or not the board of directors can add value to the company (see Hermalin and Weisbach 2003 for a recent survey of this literature). Even more closely related to this article is the growing body of work that looks at director characteristics. For example, Kroszner and Strahan (2001) and Guner et al. (2008) focus on boards with directors that have banking experience. Ferris et al. (2003); Perry and Peyer (2005); and Fich and Shivdasani (2006) all analyze different implications of having directors with multiple board seats. Finally, Adams and Ferreira (2004) analyze boards that have female directors. In the context of these papers, this study focuses on directors with the unique characteristic of having a political background.

The rest of the article is organized as follows. The next section describes the data used in this article. Section 2 presents the empirical analyses and the main results of the article. Section 3 concludes.

## **1. Data Description**

The analyses in this article utilize two types of data. The first data set consists of original data containing information regarding the political affiliation of each board member of all companies in the S&P 500. The second data set consists of information on donations made by publicly traded companies to the Republican and Democratic Parties. Both data sets are described in more detail below. In addition to these data, the article uses Center for Research in Security Prices (CRSP) and Compustat data for the sample companies as well as CRSP data for the market indexes and Fama-French industry return data.

### **1.1 Board data**

Board connections are derived by considering the composition of the board of directors of all S&P 500 companies in the years 1996 and 2000 and analyzing the background of each board member. Section 14 of the Securities and Exchange Commission (SEC) Act requires companies to file definite proxy statements (submission type Def 14a), containing information about their board members. These filings, which are hand-collected from the EDGAR database of the SEC, contain a brief description of each board member's career background. Based on these data, it is possible to identify whether board members are connected to the Republicans, to the Democrats, or to neither. A board member is defined as being politically connected if he or she at any time in his or her past held a position such as senator, member of the House of Representatives, or member of the administration, or has been a director of an organization such as the Central Intelligence Agency. A full list of these positions is provided in Table 1.

**Table 1**  
**Board connections**

	Independent companies		Connected companies		Pure Rep. companies		Pure Dem. companies	
	Mean	Median	Mean	Median	Mean	Median	Mean	Median
<i>Market cap</i> (in \$ million)	20,894	7246	32,028	10,201	31,270	10,693	21,621	7784
<i>Sales</i> (in \$ million)	9014	4534	15,308	8640	13,931	8520	14,267	6103
<i>Assets</i> (in \$ million)	23,545	6140	37,137	13,077	21,747	12,079	49,792	15,149
<i>P/E ratio</i>	35.6	19.8	33.0	19.6	38.1	22.2	24.5	14.9
Number of companies	340	340	153	153	78	78	47	47
Tenure of politically connected board members (years)	NA	NA	5.48	5.5	6.07	6.5	3.32	3.5

This table presents descriptive statistics of the S&P 500 companies in the year 2000 sorted based on the political connections of their board members. The reported values for *Market cap*, *Sales*, *Assets*, and *P/E ratio* are measured as of the end of 1999. This information is (partly) missing for seven companies. A company is classified as politically connected if it has at least one board member with one of the following former positions: president (Gerald R. Ford), presidential (vice-presidential) candidate, senator, member of the House of Representatives, (assistant) secretary, deputy secretary, deputy assistant secretary, undersecretary, associate director, governor, director (CIA, FEMA), deputy director (CIA, OMB), commissioner (IRS, NRC, SSA, CRC, FDA, SEC), representative to the United Nations, ambassador, mayor, staff (White House, president, presidential campaign), chairman of the Party Caucus, chairman or staff of the presidential election campaign, and chairman or member of the president's committee/council. A company is classified as Pure Rep. (Pure Dem.) if it has only Republican (Democratic) affiliated board members.

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

We use the sample of directors serving on the boards of S&P 500 firms in November 2000 to analyze the stock price response of connected companies to the announcement of the results of the presidential election. Table 1 shows descriptive statistics for the sample of these politically connected boards. According to the definition used in this article, 153 of the S&P 500 companies are politically connected at the time of the 2000 election. Out of these 153 companies, 78 companies have at least one board member connected to the Republicans, but no board member connected to the Democrats, while 47 companies have at least one board member connected to the Democrats, but no board member connected to the Republicans. The remaining connected companies have at least one board member connected to the Republicans and at least one board member connected to the Democrats. The vast majority of politically connected board members serve as independent directors, while only four politically connected board members have an internal appointment, mainly as CEO. The descriptive statistics in Table 1 show that, on average, connected

companies tend to be larger than nonconnected companies. The table also documents that, at the time of the 2000 election, politically connected board members have served an average of 5.5 years on their boards. The board member with the longest tenure was nominated in 1981, while the board member with the shortest tenure was nominated in the election year 2000.

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

When analyzing the announcement effect of the nomination of politically connected directors, we start with a sample of 254 connected board members in S&P 500 companies in 1996 and 2000. For this set of directors, we perform a Lexis-Nexis press search to obtain the announcement date of a nomination of these directors to any publicly traded company. This procedure provides a total of 592 nominations, which occur in the time period between 1981 and 2005. We eliminate a number of 243 nominations in which the announcement of the nomination coincides with other price-relevant events such as a dividend or an earning announcement, a share repurchase, or an M&A activity. The final sample of 349 nominations is then analyzed. In this sample, directors serve on average on 4.46 boards (not necessarily at the same time). The maximum number of positions for one board member in the sample is 13.<sup>10</sup> Nominations are considered only if the board member already has a political career at the time of the announcement of the nomination. This restriction rules out the case of board members who are not yet politically connected at the time they are nominated.

## **1.2 Donation data**

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

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

**Table 2**  
**Donations**

A: Donations		
	Population	Sample companies
Total donations (in \$1000)	1,634,288	245,695
Republicans (in \$1000)	896,520	157,502
Total donations (%)	54.9	64.1
Democrats (in \$1000)	722,256	87,764
Total donations (%)	44.2	35.7
Number of companies		315
B: Company characteristics		
	Mean	Median
<i>Market cap</i> (in \$ million)	31,478	7,671
<i>Sales</i> (in \$ million)	13,516	6,288
<i>Assets</i> (in \$ million)	38,038	9,375
<i>P/E ratio</i>	28.5	16.5
Number of companies	315	315

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

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

For each election cycle, the CRP provides information on the twenty largest contributors in each of the eighty industries. The sample in this article is constructed by using this information for the 1999 and 2000 election cycle. A company is included in the sample if it belongs to the twenty largest contributors in the eighty industries classified by the CRP, if it is publicly listed, and if the total donation exceeds \$100,000. This results in a total sample of 315 companies. Table 2 provides an overview of the amounts of money that these companies donate to the Republican and the Democratic Parties. The total donations amount to \$246 million, with \$88 million going to the Democrats and \$158 million going to the Republicans. This compares to total donations of \$1634 million recorded by the CRP. The donation share to the Republicans is higher in the sample than in the overall population, as the largest contributors to the Democrats are not publicly listed organizations (e.g., labor unions). Most of the sample companies donate to both parties, but the relative shares vary substantially. Only 18 of the 315 sample companies donate to only one of the two major parties. The sample companies donate on average \$779,985. The

maximum donation made by one of the sample companies is \$5,075,311, while the minimum amounts to \$100,443.

## 2. Empirical Results

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

### 2.1 Univariate results

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

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

Table 3 analyzes the relation between stock returns following election day and several definitions of political connections of board members for all S&P 500 companies. The first analysis considers only those companies in which there is at least one board member with a connection to one party and no board member with a connection to the other party. These are defined as *pure* connections. In seventy-eight companies, board members have connections only to the Republicans, while in forty-seven companies board members have connections only to the Democrats. The results in panel A of Table 3 show that the market-adjusted postelection returns for companies with connections to the Republicans are positive and significant. This holds for both the equally weighted and the value-weighted average. The market-adjusted postelection stock returns for companies with connections to the Democrats are insignificant in the equally weighted average, but significantly negative in the value-weighted average. This suggests that mainly large companies with connections to the Democrats decrease in value following the election. The difference in returns between companies with connections to the Democrats and Republicans is

**Table 3**  
**Postelection CARs of S&P 500 companies with board connections**

Connection type	Number of companies	Equally weighted CAR (%)			Value-weighted CAR (%)		
		(+1, +2)	(+1, +3)	(+1, +5)	(+1, +2)	(+1, +3)	(+1, +5)
Panel A: Exclusivity of connection							
Pure Rep. (A)	78	2.80 (6.16**)	4.69 (8.69**)	3.46 (4.81**)	3.10 (7.00**)	4.22 (8.12**)	3.63 (4.93**)
Pure Dem. (B)	47	-0.41 (0.28)	0.06 (1.42)	-0.51 (0.39)	-3.99 (6.00**)	-4.87 (5.70**)	-5.34 (5.11**)
Difference (A – B) ( <i>t</i> -value)		3.21 (2.56**)	4.63 (6.71**)	3.97 (2.94**)	7.09 (9.34**)	9.09 (9.79**)	8.97 (7.29**)
Panel B: Relatedness of Republican firms							
Related (C)	34	3.54 (5.08**)	6.10 (7.33**)	5.12 (4.49**)	3.49 (4.57**)	4.52 (5.04**)	6.05 (4.62**)
Not related (D)	44	2.22 (3.74**)	3.60 (5.13**)	2.18 (2.46*)	2.87 (5.29**)	4.04 (6.32**)	2.21 (2.78**)
Difference (C – D) ( <i>t</i> -value)		1.32 (1.47)	2.50 (2.34**)	2.94 (2.09*)	0.62 (0.69)	0.48 (0.45)	3.84 (2.66**)
Panel C: Former career of connected board of Republican firms							
Senate/House, Administration (E)	44	2.79 (4.50**)	4.41 (6.14**)	3.05 (3.23**)	3.21 (5.10**)	4.52 (6.19**)	2.97 (3.14**)
Others (F)	23	2.84 (3.30**)	5.30 (4.96**)	3.89 (2.73**)	5.82 (3.31**)	4.79 (4.89**)	3.27 (2.44*)
Difference (E – F) ( <i>t</i> -value)		-0.05 (-0.05)	-0.89 (-0.72)	-0.84 (-0.51)	-0.60 (-0.30)	-0.27 (-0.22)	-0.30 (-0.19)

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

statistically significant for all event windows and for all specifications, in both the equally weighted and the value-weighted averages.<sup>11</sup>

The subsequent analysis focuses on those companies that are connected to the Republicans and considers the specific political positions that the connected board members held before being nominated to the companies' boards. In the second classification, the sample of Republican companies is thus divided based on whether at least one of its board members' former political positions is related to the industry sector of the company. The goal is to test whether, in addition to the pure existence of a political connection, the expertise and knowledge that the board member gained through his or her political position have an impact. Recall that board members are defined as being related if they are nominated to a company that operates in the same functional area in which they served in their political career. Among the sample companies, thirty-four Republican companies have at least one related board member and forty-four companies have no related board member.

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

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

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

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



significantly higher than the returns for companies with links to the losing party. Furthermore, political connections generate value independently of the specific nature of those connections, while specific expertise generates additional value.<sup>12</sup>

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

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

## **2.2 Cross-sectional results**

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

In the multivariate tests, the dependent variable is the postelection CAR for days (+1, +3) for each S&P 500 company. Each company's return is adjusted by the CRSP value-weighted market index. The control variables comprise several firm characteristics: the log of each company's market capitalization, its book-to-market ratio, and a momentum variable, which is the company's market-adjusted return in the third quarter of 2000. The variables of interest are different categorical and dummy variables that indicate whether a company is connected or donates to either of the two parties.<sup>13</sup> The results are reported in Table 4.

Model 1 tests for the impact of companies' board connections. This impact is measured by the variable *Board Rep-Dem*, which takes a value of 1 if a

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

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

Table 4  
Cross-sectional analysis of postelection CARs adjusted by the market index

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

The sample comprises all S&P 500 companies in the year 2000. The dependent variable is the CAR adjusted by the CRSP value-weighted market index in a period of (+1, +3) days following the 2000 presidential election on November 7, 2000. *lnCap* is the log of the company's market capitalization at the end of 1999. *Book to market* is the ratio of book value of equity and market value of equity at the end of 1999. *Market-adjusted past return* is the average market-adjusted return for each company during the third quarter of 2000. The variable *Board Rep-Dem* is a dummy variable that takes a value of 1 if a company is politically connected to the Republicans, a value of -1 if a company is politically connected to the Democrats, and a value of 0 otherwise. The variable *Donations Rep-Dem* is a dummy variable that takes a value of 1 if a company donates more to the Republicans than to the Democrats, a value of -1 if a company donates more to the Democrats than to the Republicans, and a value of 0 otherwise. All models are adjusted for heteroskedasticity. The *t*-values are in parentheses. The symbols \*, \*\*, and \*\*\* denote statistical significance at the 10%, 5%, and 1% levels, respectively.

company's board is politically connected only to the Republicans, a value of  $-1$  if a company's board is politically connected only to the Democrats, and a value of  $0$  otherwise. The results show that the coefficient is positive and significant at the 1% level. This implies that the political connection of a company's board remains a significant determinant of its postelection stock return even after controlling for other firm characteristics. The same holds true for the variable *Donations Rep-Dem* in model 2, which is constructed analogously to *Board Rep-Dem* based on the donation data. Model 3 includes both *Board Rep-Dem* and *Donations Rep-Dem*, and both variables are again positive and significant at the 1% level.

Starting with model 4, the estimations consider this relation in more depth by analyzing whether it is driven by either or both of the two parties. For this purpose, four more dummy variables and one interaction variable are introduced. The first of these variables takes a value of  $1$  if a company is politically connected only to the Republicans and a value of  $0$  otherwise, whereas the second variable takes a value of  $1$  if a company is politically connected only to the Democrats and a value of  $0$  otherwise. In analogy for the donation part, the third dummy variable takes a value of  $1$  if a company donates more to the Republicans than to the Democrats and a value of  $0$  otherwise, whereas the fourth variable takes a value of  $1$  if a company donates more to the Democrats than to the Republicans and a value of  $0$  otherwise. Motivated by the findings in Faccio and Parsley (2007), who show the impact of the geographic proximity of company headquarters to a politician's hometown, this article constructs an additional dummy variable that takes a value of  $1$  if the Republicans win the majority of the presidential votes in the state in which a company is headquartered and a value of  $0$  otherwise. This variable is interacted with the Republican board dummy variable to test whether there is an effect for companies that are connected to the Republicans and located in a Republican state.

The results in models 4–10 show that all but one of the dummy variables are significant at least at the 5% level. While companies with board connections to the Republicans experience a significantly positive abnormal postelection return (model 4), companies with board connections to the Democrats suffer a significant drop in value (model 6). These returns are also economically significant. Companies with board connections to the Republicans experience nearly a 3% increase in value, while companies with board connections to the Democrats experience nearly a 3% drop in value. Model 5 shows that there is no additional effect for companies with Republican board connections from having their headquarters in a Republican state. The coefficient for the interaction variable is positive, but fails to be significant. The insights from models 4 and 6 still hold when both variables are included simultaneously (model 7) and when the two donation dummy variables are included in models 8–10. The results for the two donation dummy variables show that the coefficient for donations to the Republicans is positive and significant, while the coefficient

for donations to Democrats is negative, but not significant. This might be due to the fewer number of companies donating more to the Democrats than to the Republicans and in particular the even fewer number of those companies with a clear donation tendency to the Democrats.

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

Table 5 reports the results for the case in which the return for each company in the S&P 500 index is adjusted by the equally weighted return of its industry. The industry classification of each company is defined by the Fama-French thirty-industry classification.<sup>14</sup> The explanatory variables are identical to those in Table 4. The results in Table 5 show that all the board connection variables of interest that are significant with market-adjusted returns are still significant with industry-adjusted returns. In particular, neither the categorical variables in models 1–3 nor the dummy variables for board connections in models 4, 6, and 7, lose their significance. In fact, the coefficients for the variables that characterize a company's board connections are significant again at least at the 5% level. In contrast, the dummy variables for donations in models 9 and 10 become insignificant under this specification. This suggests that while the donation variable may likely represent an (endogenous) industry effect, our measure of political connections based on the board data does not. Namely, our measure of connections remains significant even after controlling for these industry effects.

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

### **2.3 Nomination of politically connected board members**

An additional approach to test for the impact of politically connected board members is to analyze the abnormal stock returns following the announcements of their nominations. The underlying economic model is one in which there is a limited supply of individuals with political connections who are both

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

**Table 5**  
Cross-sectional analysis of postelection CARs adjusted by Fama-French thirty-industry returns

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

The sample comprises all S&P 500 companies in the year 2000. Each company is sorted into one of the thirty industries according to Fama-French. The dependent variable is the CAR adjusted by the equally weighted industry return of the Fama-French thirty industries and calculated over a period (+1, +3) days following the 2000 presidential election on November 7, 2000. *InCap* is the log of the company's market capitalization at the end of 1999. *Book to Market* is the ratio of book value of equity and market value of equity at the end of 1999. *Market-adjusted past return* is the average market-adjusted return for each company during the third quarter of 2000. The variable *Board Rep-Dem* is a dummy variable that takes a value of 1 if a company is politically connected to the Republicans, a value of -1 if a company is politically connected to the Democrats, and a value of 0 otherwise. The variable *Donations Rep-Dem* is a dummy variable that takes a value of 1 if a company donates more to the Republicans than to the Democrats, a value of -1 if a company donates more to the Democrats than to the Republicans, and a value of 0 otherwise. All models are adjusted for heteroskedasticity. The *t*-values are in parentheses. The symbols \*, \*\*, and \*\*\* denote statistical significance at the 10%, 5%, and 1% levels, respectively.

*willing* and *able* to use their political connections for the purpose of helping the company. Therefore, there is uncertainty in the market about which of the competing companies that value these connections will be able to obtain this scarce resource. While the announcement by a company that it was able to attract a politically connected individual might be somewhat anticipated by the market, the actual announcement return reflects the resolution of any remaining uncertainty that had existed with respect to which of the group of competing companies was actually able to get hold of this valuable resource of limited supply.<sup>15</sup>

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

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

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

Second, Table 6 shows that nominations of Republican (Democratic) board members are equally likely to occur under Republican and Democratic presidents, but are much more likely to occur in times of Democratic (Republican)

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

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

**Table 6**  
**Timing of nominations**

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

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

control of House and Senate. For example, under Republican Senate majority, 118 out of 202 nominations are of Republican board members, representing 58% of the total. However, under Democratic Senate majority, 115 out of 147 nominations are of Republican board members, representing 78% of the total. Thus, a higher percentage of Republicans are nominated during a period of Democratic majority.

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

<sup>17</sup> As a further illustration of this point, we see that in each of the sample years that follow a year in which the presidential power changes—i.e., 1981, 1993, and 2001—the overwhelming majority of nominated board members come from the losing party. In 1981, the year following the Republican win of the presidential election, six out of seven nominees are affiliated with the Democrats. In 1993, the sample year with the highest number of board nominations, thirty-three of the thirty-seven total nominations are of Republicans. This year follows the Republican loss of the presidency (Congress and House remain Democratic). Finally, in 2001, after the Republican win in the presidential election, twelve out of seventeen nominations are of Democrats.



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

The analysis in Table 7 focuses on the sample of connected board members found in S&P 500 companies in the years 1996 and 2000. As described before, these board members are nominated for a total of 349 positions in companies for which stock market data are available and for which the nominations do not coincide with other price-relevant announcements. The first row of Table 7 shows that the announcement effect of the nomination of politically connected board members is positive and statistically significant in the equally weighted and in the value-weighted averages. The two-day abnormal announcement return amounts to 0.69% in the equally weighted and to 1.20% in the value-weighted average. Furthermore, as the first subclassification in panel A of Table 7 shows, returns are significantly positive for board members with connections to either the Republican or the Democratic Party in both the equally weighted and value-weighted average. Thus, the value impact is not unique to a connection to either of the two parties.

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

As the second subclassification, we form two groups based on a nominee's specific former political career. Consistent with the classification in Table 3, a politically connected board member is classified into the first group if he or she was a senator, a member of the House, or a member of the administration; otherwise, he or she is classified into the second group. The results in panel B of Table 7 suggest that there is no statistical difference between the announcement returns of the two groups in the equal-weighted average, but a statistically significant difference in the value-weighted average. This suggests the possibility that former senators and congressmen add more value to the larger companies relative to others. Third, announcements are separated based on whether they refer to a director's first and second or subsequent nominations.

Table 7.  
The announcement effect of the nomination of connected board members

Connection type	Number of observations	Equally weighted CAR (%) (0, +1)	Value-weighted CAR (%) (0, +1)
All companies	349	0.69 (3.88**)	1.20 (9.41**)
Panel A: Nominee's party			
Rep. nominee (A)	233	0.44 (2.21*)	0.88 (5.54**)
Dem. nominee (B)	116	1.21 (3.61**)	1.40 (6.42**)
Difference (A – B) ( <i>t</i> -value)		–0.77 (–3.05**)	–0.52 (–2.88**)
Panel B: Former career			
Senate, House, Administration (C)	264	0.72 (3.69**)	1.43 (9.60**)
Others (D)	85	0.60 (1.37)	0.19 (1.10)
Difference (C – D) ( <i>t</i> -value)		0.12 (0.29)	1.24 (5.22**)
Panel C: Nomination order in time			
1st and 2nd nomination (E)	178	0.63 (3.16**)	1.70 (10.96**)
Over 2nd nomination (F)	171	0.76 (2.33*)	0.80 (3.30**)
Difference (E – F) ( <i>t</i> -value)		–0.13 (–0.48)	0.90 (4.44**)
Panel D: Administration board and president at nomination			
Same party (G)	81	1.00 (2.08*)	2.10 (5.42**)
Different party (H)	96	0.62 (2.20*)	0.80 (3.13**)
Difference (G – H) ( <i>t</i> -value)		0.38 (0.99)	1.30 (4.03**)
Panel E: Board party and House/Senate party at nomination			
Same party (I)	175	0.51 (1.52)	0.80 (4.31**)
Different party (J)	174	0.87 (3.94**)	1.44 (8.07**)
Difference (I – J) ( <i>t</i> -value)		–0.36 (1.26)	–0.64 (3.52**)
Panel F: Industry 1			
Regulated (K)	79	0.82 (2.81**)	1.25 (3.48**)
Not regulated (L)	270	0.66 (2.86**)	1.18 (8.72**)
Difference (K – L) ( <i>t</i> -value)		0.16 (0.65)	0.07 (0.34)
Panel G: Industry 2			
High procurement (M)	48	0.70 (1.30)	1.40 (2.86**)
Low procurement (N)	90	0.60 (2.76**)	1.24 (7.09**)
Difference (M – N) ( <i>t</i> -value)		0.10 (0.32)	0.16 (0.56)
Panel H: Relatedness			
Related nominee (O)	108	1.16 (3.89**)	2.28 (11.56**)
Not related nominee (P)	241	0.49 (2.09*)	0.77 (4.03**)
Difference (O – P) ( <i>t</i> -value)		0.67 (1.82 <sup>5</sup> )	1.51 (5.50**)

The sample is based on politically connected board members in S&P 500 companies in the years 1996 and 2000. For these board members, a search in the Lexis-Nexis database yields 592 announcements of board nominations. The press reports on 243 of these announcements containing other price-relevant information such as dividend or earning announcements, share repurchases, or M&A activity. Eliminating these announcements yields a final sample of 349 announcements that are used. Companies are subclassified by several methods: panel A is based on the nominated directors' party affiliation, panel B on directors' former political position, panel C on the order in time of the nomination: first two times a directors is nominated versus third nomination and above, panel D on whether the nominee worked for the administration and his or her party is the same as that of the president at the nomination day, panel E on whether the nominee's party and the party with the majority in House or Senate at the nomination day are the same, panel F on whether the nominating company is in the banking or utilities industries, panel G on whether the nominating company is in one of the three industries with the highest levels of government shipments as measured by Agrawal and Knoeber (2001) or in any other of their sample industries, and panel H on the relatedness of the connection (as detailed earlier). The CARs for each of the sample portfolios are calculated in the same way as before. In parentheses are *z*-values. The symbols <sup>5</sup>, \*, and \*\* denote statistical significance at the 10%, 5%, and 1% levels, respectively.

The question is whether politically connected board members are particularly valuable for the first companies whose board they join, as they are less likely to have worn out their welcome in the political circles at that point. While the announcement returns are positive and significant for both groups, the magnitude of the impact for the first and second nominations is much greater than that for subsequent nominations in the value-weighted average. This finding again suggests that, for the larger companies, the director has a greater impact in the early nominations, and this impact may decrease as the director joins more companies.

Fourth, the nominations of former politicians with positions within the administration are divided based on whether or not a director's political party holds the control of the presidency at the time of the announcement. The idea is that a former politician who worked for a previous administration is more likely to be connected to the current administration given that it is of the same party. The results for this subclassification are shown in panel D of Table 7. They indicate that former administration politicians are indeed more valuable when the current administration is from the same party.

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

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

One alternative explanation for our results is that the observed positive stock-price reactions might be due not only to the fact that a board member is politically connected, but also to his or her expertise. As an example, a senator who serves in the finance committee during his or her political tenure may learn about general trends, including risks and challenges in the finance industry, and this knowledge might be of highest importance to companies that operate in banking or insurance. The positive announcement effect in this case would thus be partly due to his or her expertise as well as to his or her being politically connected. While it might be hard to differentiate

between expertise in a specific field and general political connection in each given case, it is still possible to distinguish between related and not related politically connected board members. Thus, in the last classification, panel H of Table 7 reports the results for the announcement returns for both groups of board members. The results suggest that the nomination of both related (defined as a political director who served in a committee, department, or government agency that deals with the industry in which the nominating company operates) and not related board members generates positive and significant abnormal returns. At the same time, the abnormal returns for related board members are higher than those for not related board members. This result suggests that expertise and knowledge are valuable, but that the pure existence of political connections independent of their content also generates abnormal positive returns.

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

The results in panel A of Table 8 show that the announcements in the matched sample do not result in positive stock returns. While they are not statistically different from zero in the equally weighted average, they are even negative and significant in the value-weighted average. The lack of a positive price reaction in the matched sample is thus consistent with the results in the previous literature. Most important, the returns for the original sample are significantly higher than those for the matched sample, and this holds for both the equally weighted and value-weighted average.

To guarantee the highest level of comparability of the results, in the next step, announcements of CEOs and internal promotions (e.g., CFOs) are excluded from the matching sample, as these may cause different stock price reactions than those for outside board members. This procedure generates a subsample of 287 announcements. The results are reported in panel B of Table 8 and show that the announcement returns in the matched sample are still not significantly positive, albeit not significantly negative anymore in the value-weighted average. Again and most important, the difference in returns between the original and the matched sample is positive and highly significant. Finally, twenty-eight more observations are dropped in which multiple board

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

	Number of observations	Equally weighted CAR (%): (0, +1)	Value-weighted CAR (%): (0, +1)
Panel A: Full sample			
Original sample (A)	319	0.76 (3.98**)	1.28 (9.63**)
Matched sample (B)	319	0.07 (0.86)	-0.37 (1.72 <sup>§</sup> )
Difference (A - B) (t-value)		0.69 (4.70**)	1.65 (9.21**)
Panel B: Excluding CEOs and promotions			
Original sample (C)	287	0.81 (4.18)**	1.38 (9.81**)
Matched sample (D)	287	0.10 (0.71)	-0.13 (0.80)
Difference (C - D) (t-value)		0.71 (4.19**)	1.51 (9.93**)
Panel C: Excluding CEOs, promotions, and multiple board announcements			
Original sample (E)	259	0.83 (3.99**)	1.47 (9.98**)
Matched sample (F)	259	-0.09 (0.33)	-0.26 (1.95 <sup>§</sup> )
Difference (E - F) (t-value)		0.92 (3.77**)	1.73 (12.31**)

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

members are announced on the same day. The results, shown in panel C of Table 8, are qualitatively the same as before.<sup>18</sup>

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

**2.4 Further tests and robustness**

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

**2.4.1 Choice of event window.** To test for the robustness of the event window, the analyses are repeated for different events around the election. First, the 2000 presidential election gave Governor Bush only a disputed and tiny lead

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

of votes, ranging from 300 to about 1800 throughout the period of uncertainty, with a final margin of 537 votes. As a consequence, the election was finally decided on December 13, 2000, only after the Federal Court's decision to halt the manual recount of ballots in Florida and the subsequent concession by Vice President Gore. Between the election and the final decision, there are a number of exogenous events, as, for example, court decisions that increase or decrease the probability of a Republican win. These exogenous events provide a unique laboratory in which the value of political connections can be tested. Two events deserve particular attention: first, on December 8, the Florida Supreme Court orders a statewide recount of ballots in counties with under-votes, thereby increasing the chances for the Democrats to win the election. Second, on December 13, Mr. Gore accepts Mr. Bush as the president in a public speech, thereby resolving the uncertainty about the election outcome. The event study for politically connected board members in Table 3 is repeated for these two events. While the value-weighted portfolio of companies with pure connections to the Democrats provides a one-day positive return of 1.45% on December 8, the respective Republican portfolio provides a negative return of  $-1.26\%$ . In contrast, the return for the Republican portfolio on December 13 amounts to  $0.32\%$ , while the return for the Democratic portfolio amounts to  $-1.63\%$ . The differences in returns between the Democratic and the Republican portfolio on both December 8 and December 13 are statistically significant at the 1% level. In general, the correlation between the daily abnormal returns of the Democratic and the Republican portfolio in the time period between November 8 and December 20 is highly negative, with a coefficient of  $-0.46$ , which is significant at the 1% level. This provides further evidence for the value impact of political connections, independent of the choice of the specific event window. Overall, the uncertainty around the 2000 presidential election is expected to aggravate any attempt to find evidence for the impact of political connections on stock returns. The fact that the results in this article are substantial and significant despite the existing uncertainty on the final election outcome stresses even more the importance of political connections for firm value.

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

**2.4.2 Industry clustering.** While Table 5 controls for industry effects, it is still important to consider whether there is a concentration of politically connected companies in certain industries and in particular a concentration of Republican/Democratic companies in certain industries. The analysis of the distribution of the sample companies across the Fama-French thirty-industry classification shows that Republican/Democratic companies based on board



connections are relatively evenly distributed across all of these industries. There are two exceptions to this in the utilities industry, which has 9% of the sample companies, and the banking, insurance, real estate, and trading industry, which includes 15% of the sample.<sup>19</sup> However, both industries have almost the same number of Republican firms as Democratic firms (six Republicans and eight Democrats in utilities and ten and nine in banking, respectively). More formally, a chi-square test of the difference in the industry distribution between Republican and Democratic companies fails to be significant ( $p$ -value = 0.40). Thus, there appears to be no industry bias or clustering in the distribution of Republican and Democratic companies.

Finally, as mentioned before, the industry analysis is repeated for alternative Fama-French industry classifications, yielding the same results. In addition, we control for some specific industries that might have larger political biases such as the oil industry, the defense industry, and utilities. Again, the results remain unchanged.

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

### 3. Conclusion

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

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



Using a measure of connections based on hand-collected data of the political background of all directors on the boards of S&P 500 companies in the year 2000, the article derives the following two main results: first, following the announcement of the Republican win, the return difference between companies classified as having a Republican board and those classified as having a Democratic board is positive. Furthermore, the announcement returns are positive for the Republican portfolio and negative for the Democratic portfolio. These results remain robust after controlling for several firm characteristics as well as for industry effects.

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

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

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