

Reexamining investor reaction to covert corporate political activity: A replication and extension of Werner (2017)

Ishva Minefee¹ | Mary-Hunter McDonnell² | Timothy Werner³

¹Ivy College of Business, Iowa State University, Ames, Iowa

²The Wharton School, University of Pennsylvania, Philadelphia, Pennsylvania

³McCombs School of Business, University of Texas at Austin, College of Business Administration, Austin, Texas

Correspondence

Ishva Minefee, Ivy College of Business, Iowa State University, 3117 Gerdin Business Building, 2167 Union Drive, Ames, IA 50011.

Email: iminefee@iastate.edu

Abstract

Research Summary: Exploiting a whistleblower's leak of the American Legislative Exchange Council's (ALEC) corporate sponsors, we quasi-replicate and extend Werner's (2017) event study of investor reaction to covert corporate political activity (CPA). Werner found that investors reacted positively to the accidental disclosure of covert ties to the Republican Governors Association. In contrast, when we apply the same research design to the ALEC leak, we find that, on average, firms tied to ALEC experienced negative abnormal returns. In cross-sectional models, we also find that the abnormal returns of ALEC sponsors were more negative for firms that faced shareholder contention around CPA and had liberal-leaning employees, yet less negative for firms engaged in higher levels of institutional corporate social responsibility. The latter two cross-sectional findings extend Werner's results.

Managerial Summary: We replicate and extend a study that examined how investors reacted to the disclosure of firms' covert contributions to a conservative-leaning nonprofit organization. In contrast to that paper, we find that investors react negatively toward firms that contributed to ALEC, given its controversial positions on sociopolitical issues such as "stand your ground" gun laws. Investors reacted more negatively if the firm's employees were more liberal leaning or if the firm recently faced a shareholder resolution requesting

that it voluntarily disclose all political contributions. However, investors' reactions were less negative if the firm engaged in high levels of corporate social responsibility. An implication for managers is that they should consider the risk associated with their firms' covert ties to political organizations perceived as controversial by the media.

KEY WORDS

corporate political activity, event study, nonmarket strategy, replication, secrecy

1 | INTRODUCTION

Scholars have increasingly shown interest in understanding firms' covert corporate political activity (CPA), defined as a firm's secretive efforts to influence public policy outcomes (Hillman, Keim, & Schuler, 2004). Most research in this area focuses on firms' engagement in astroturfing, or the undisclosed sponsorship of coalitions that indirectly lobby politicians on firms' behalf (Lyon & Maxwell, 2004; Walker, 2014). Other work documents firms secretly funding expert witnesses who testify before legislative committees and regulatory bodies, presenting arguments that benefit their sponsors (Oreskes & Conway, 2010).

In addition to these tactics (or perhaps as a way of funding them), firms can make undisclosed financial contributions to nonprofits organized under section 501(c) of the U.S. tax code. These include charities (501[c]3s), social welfare organizations (501[c]4s), and trade associations (501[c]6s).¹ To examine whether this breed of covert CPA is beneficial for firms, Werner (2017) published a study in *Strategic Management Journal* that employed an event study to analyze how investors reacted to the accidental disclosure of the list of firms that provided financial support to a 501(c)4 run by the Republican Governors Association (RGA). To date, this is the only research that examines investor reaction to the actual use of covert CPA. Werner found that, on average, firms experienced positive cumulative abnormal returns (CARs) around the disclosure event, but as he cautions in his conclusion, the study rests on an *n* of one, and investors' reactions may vary with the identity of the recipient of covert CPA. In this study, with the goal of enhancing our cumulative knowledge of the increasingly significant phenomenon of covert CPA, we revisit Werner's findings by quasi-replicating and extending his research via an event study that examines investor reaction to a whistleblower's leak of the corporate sponsors of the American Legislative Exchange Council (ALEC). Notably, the results of this quasi-replication differ in sign from Werner's, as we find across a battery of tests that firms connected to ALEC experienced negative CARs around the disclosure.

¹Firms have always been free to make undisclosed contributions from their general treasuries to these 501(c) nonprofit corporations, provided these monies were not used for electoral activity. See, Barnett (2012) for a discussion of firms' use of 501(c)6 trade associations, for example. Post-2010 and the U.S. Supreme Court's decision in *Citizens United v. Federal Election Commission*, subject to varying restrictions (see, Werner, 2017), firms can now also make undisclosed contributions to these entities (except for 501[c]3 charities which are strictly prohibited from engaging in electoral activity) for electoral purposes, provided the contributions are not earmarked for electoral use.

Our goals in this study are two-fold. First, we use Werner's methods to analyze a new population in order to quasi-replicate his main study. Second, we extend his study by adopting new methods and exploring alternative explanations for our results, given that they yield discrepant findings. We adopt this approach as it will "simultaneously provide information about the generalizability of the original study and the robustness of the measures, method, and model in the new population" (Bettis, Helfat, & Shaver, 2016, p. 2195). That is, in quasi-replicating Werner's research, we employ his methodological approach in our new context before we, in stages, probe its robustness to different methods so as to offer novel arguments regarding why our main finding differs. Our aim throughout is not to test formal hypotheses nor to invalidate Werner's results but, rather, to explore boundary conditions of his findings and expand our cumulative empirical knowledge of covert CPA. In so doing, we aim to "provide insight into how the field should advance in light of the conflicting findings" (Bettis et al., 2016, p. 2202).

The remainder of this paper begins by introducing the specific empirical contexts—the RGA and ALEC leaks of corporate contributors—that Werner and we examine, respectively. Next, we conduct a market-wide event study that parallels and probes the sensitivity of Werner's design choices to examine the main effect of the disclosure of covert CPA before also replicating his cross-sectional analyses on our sample of firms. We then discuss and analyze one possible post hoc reason for why we reach a different main finding. We conclude by discussing our study's limitations, its scholarly and managerial implications, and avenues for future research.

2 | WERNER'S (2017) CONTEXT AND FINDINGS

Werner (2017) examines investors' reactions to the *New York Times'* reporting in 2014 on the accidental disclosure of the names of 66 corporate contributors to a 501(c)4 social welfare organization linked to the RGA. The RGA's objective is to elect and support Republican gubernatorial candidates and governors. Drawing from a political markets framework (Bonardi, Hillman, & Keim, 2005), Werner argues that investors would respond favorably to firms being financially connected to the RGA via its 501(c)4, as this connection signals that these firms have access to governors and their high-level staff. Additionally, Werner argues that, within the set of firms identified as RGA contributors, this main reaction would be positively moderated for firms in regulated industries and for firms that engaged in more traditional forms of CPA, whereas firms that confronted a shareholder resolution related to covert CPA would experience negative moderation.

To test these hypotheses, Werner first calculates the RGA contributors' CARs around the publication of the *Times'* article using a standard market model, finding that RGA contributors experienced positive CARs (ranging from +0.36 to +2.13%, depending on the event window). Werner then turns to a cross-sectional ordinary least squares (OLS) regression to analyze the within-RGA contributor sample. There he documents that, over the [0,1] event window, firms in heavily regulated industries and with more active political action committees (PACs) over a three-electoral-cycle period experienced more positive CARs but firms that had faced a shareholder resolution on CPA experienced more negative CARs. In concert, these findings lead Werner to speculate that because "[t]he link between the RGA's 501(c) and Republican governors is relatively straightforward... investors may have viewed contributions to the former group as providing a clear return in terms of access to the latter group" (2440).

3 | OUR CONTEXT: THE “ALEC EXPOSED” LEAK

In his conclusion, Werner (2017) writes that it is unclear if his findings would hold if firms were found to be connected covertly to a nonpartisan, third party political actor, as “contributions to nonparty-linked organizations may be more controversial to shareholders and shareholder activists” (2440). Our quasi-replication of Werner focuses on extending his work under just such circumstances by examining investors’ reactions to the disclosure of firms’ covert ties to the ALEC, a conservative 501(c)3 nonprofit that is “dedicated to the principles of limited government, free markets and federalism.”² Although ALEC claims to be officially nonpartisan, the vast majority of its membership of 2,000 state legislators identifies as Republican (Hertel-Fernandez, 2014). Founded in 1973, ALEC’s primary political activity is to draft model bills that friendly state legislators can tailor and introduce in local legislative bodies. These model bills have goals that include reducing taxes for firms and wealthier individuals, reducing regulations on firms, and privatizing education - goals that align with the Republican party’s agenda (e.g., Strauss, 2018). On average, across the United States, state legislators have introduced more than 800 ALEC-originated model bills per year, and the states have enacted approximately 15% of these bills into law (Hertel-Fernandez, 2014).

On July 13, 2011, aided by a whistleblower inside of ALEC, a liberal watchdog group called the Center for Media and Democracy (CMD) launched and promoted an “ALEC Exposed” website that listed ALEC’s corporate sponsors. In contrast to the rather neutral reporting on the RGA that Werner exploits in his event study, at the time “ALEC Exposed” went live, ALEC was facing significant reputational issues. These stemmed from the “secretive” manner in which the organization operated (Greenblatt, 2011), allegations that the organization abused its charitable status (Baker, 2012), and its controversial positions on salient issues, such as voter registration laws and “stand your ground” gun laws (Hertel-Fernandez, 2014). For example, many local communities perceive ALEC’s model bills on voter registration as suppressive given that the bills call for stricter identification requirements, such as possessing a state-issued ID card, in order to vote (e.g., Center for Media and Democracy, 2011). These bills may disproportionately and negatively affect minorities and low-income citizens who are less likely to possess the type of identification required to vote (Hajnal, Lajevardi, & Nielson, 2017).

As Werner (2017) did in the context of the RGA, we exploit this unanticipated exposure to identify how investors reacted to the disclosure of covert CPA. Because the CMD controlled the timing and publicity of ALEC-firm ties, we treated the disclosure as an exogenous shock that released new information to the market with no leakage prior to the website going live, making a financial market event study an ideal method for assessing investor reaction.

4 | MARKET-WIDE EVENT STUDY

4.1 | Quasi-replication of Werner

As suggested by Bettis et al. (2016), we began our quasi-replication of Werner (2017) by applying its exact approach to our market-wide event study of the disclosure of firms tied to ALEC. To construct our sample of ALEC sponsors, we began with the 180 publicly traded firms identified on the ALEC Exposed website. Following Werner, and as is standard practice

²See, <https://www.alec.org/about/>.

(e.g., Flammer, 2013), we searched Factiva, Thomson One Banker, the Institutional Brokers' Estimate System, the Center for Research in Security Prices (CRSP), and these firms' 8-K reports to the Securities and Exchange Commission for confounding events in the [0,1] event period. These events included restructurings, mergers and acquisitions, litigation, executive changes, contract awards, new products/services, earnings/dividend announcements, and debt service announcements. After taking these confounding events into account, our sample size was 169 firms.³

Applying Werner's methodology to our sample, we employed the standard market model to estimate the relationship between the daily returns of each firm and the returns of a value-weighted index of all publicly traded U.S. firms.⁴ We gathered return data from the CRSP. Our estimation window consisted of one year's worth of trading days (252 days) and ended 20 trading days before the event.⁵ To calculate ARs during our event period we used the parameter estimates from our market model to generate each firm's predicted return on each day in the event window. We then took the difference between these predicted returns and the firm's actual return. Then, we summed these differences across the relevant days for each event window to arrive at each firm's CAR for that window; we employed seven event windows: [0]; [0,1]; [0,5]; [0,10]; [0,20]; [-5,5]; and [-20,20]. Finally, to assess whether or not these CARs were statistically significant, we relied upon the same three tests as Werner: the Adjusted Patell's Z, the Adjusted Standardized Cross-Sectional Z-test (Kolari & Pynnönen, 2010), and the randomization-based test of McWilliams and Siegel (1997).

Panel a of Table 1 reports the results of our quasi-replication of Werner's market-wide event study. Across all seven event windows and all three ways of assessing statistical significance, we find that ALEC sponsors experienced negative CARs around the disclosure event (all *p*-values for these tests fell below .05, for both parametric and non-parametric approaches). The estimated CARs range from -0.06% for the [0] event window to -2.66% for the [0,20] event window. Across all windows, a high percentage of firms that were ALEC sponsors experienced negative returns, ranging from 59.2% in the [0,10] event window to 66.9% in the [0,5] event window. As a whole, our results provide strong evidence that, in the short-run, investors reacted to firms' connections to ALEC in a statistically significant but oppositely signed direction than they did to firms' connections to the RGA.

4.2 | Market-wide extensions and robustness

Although the above analysis provides initial evidence for a negative investor reaction, on average, to a firm's sponsorship of ALEC, we extended beyond replicating Werner's analysis on this new sample by probing the robustness of our findings in multiple ways. First, in Panel b of Table 1, we reran the standard market model on all of the same event windows as in Panel a, but on a sample that does not exclude confounded firms. In this check, our results are highly

³Online Appendix 1 provides the names of the publicly traded ALEC contributors, as well as additional details on how the makeup of this sample compares to the broader population of publicly traded firms.

⁴Recent nonmarket-focused event studies by Flammer (2013) and Hawn, Chatterji, and Mitchell (2018) also employed the standard market model but, unlike Werner, did so using an equally weighted market index. More technical details on our event study methodology are available in Online Appendix 2.

⁵Despite finding no evidence of information leakage, we ended our estimation window 20 days pre-event to provide sufficient distance between it the event. Additionally, estimating our market model over a year's worth of trading data prior to the event addresses concerns regarding calendar-day effects.

TABLE 1 Investor reactions to the disclosure of ALEC sponsorship, replicating, and extending Werner (2017), table 2^a

Panel a: Excluding treated firms with confounding events in the [0,1] event window (<i>n</i> = 169)						
Event window	CAR (%)	% Negative returns (%)	Patell's Z	p-value	Patell's Z	Standardized cross-sectional Z p-value
[0]	-0.06	63.9	-1.793	.002	-2.971	.004 .005
[0,1]	-0.17	59.2	-1.604	.008	-2.404	.015 .023
[0,5]	-0.55	66.9	-3.102	.001	-3.589	.001 .003
[0,10]	-0.76	59.8	-3.012	.001	-2.913	.005 .011
[0,20]	-2.66	65.7	-5.297	.001	-4.112	.001 .003
[-5,5]	-0.35	59.8	-2.073	.011	-2.513	.013 .009
[-20,20]	-2.32	60.9	-3.772	.001	-3.567	.001 .002

Panel b: All treated firms (<i>n</i> = 180)						
Event window	CAR (%)	% Negative returns (%)	Patell's Z	p-value	Patell's Z	Standardized cross-sectional Z p-value
[0]	-0.04	62.8	-1.797	.036	-2.697	.007 .001
[0,1]	-0.13	57.8	-1.780	.034	-1.812	.031 .043
[0,5]	-0.54	65.0	-3.444	.091	-3.854	.001 .001
[0,10]	-0.72	58.9	-3.204	.001	-2.938	.005 .013
[0,20]	-2.41	63.9	-5.436	.001	-3.964	.001 .002
[-5,5]	-0.38	60.0	-1.780	.075	-2.376	.009 .011
[-20,20]	-2.05	59.4	-3.059	.002	-3.995	.001 .001

Abbreviations: ALEC, American Legislative Exchange Council's; CAR, cumulative abnormal return.

^aCARs estimated using a standard market model; *p*-values reported for Patell's Z and Standardized Cross-Sectional Z are bootstrapped; all significance tests are two-tailed.

TABLE 2 Robustness tests of Table 1^a

Panel a: Robustness of Table 1's estimates using event window [0,1] and alternative market models			
Alternative market model	CAR (%)	Standardized cross-sectional Z	p-Value
<i>Excluding treated firms with [0,1] confounding events (n = 169)</i>			
Fama–French three-factor	−0.16	−2.426	.008
Carhart four-factor	−0.14	−2.192	.029
Buy-and-hold	−0.13	−2.145	.033
Precision-weighted	−0.17	−2.428	.009
Industry-adjusted	−0.15	−2.311	.022
<i>All treated firms (n = 180)</i>			
Fama–French three-factor	−0.08	−2.608	.011
Carhart four-factor	−0.09	−2.341	.010
Buy-and-hold	−0.09	−2.366	.009
Precision-weighted	−0.11	−2.578	.005
Industry-adjusted	−0.10	−2.494	.007

Panel b: Robustness of Table 1's estimates using event window [0] and alternative market models			
Alternative market model	CAR (%)	Standardized cross-sectional Z	p-Value
<i>Excluding treated firms with [0,1] confounding events (n = 169)</i>			
Fama–French three-factor	−0.07	−2.867	.001
Carhart four-factor	−0.06	−2.736	.009
Buy-and-hold	−0.08	−3.315	.003
Precision-weighted	−0.07	−3.142	.004
Industry-adjusted	−0.06	−2.697	.007
<i>All treated firms (n = 180)</i>			
Fama–French three-factor	−0.05	−1.790	.033
Carhart four-factor	−0.05	−2.480	.009
Buy-and-hold	−0.07	−2.712	.004
Precision-weighted	−0.12	−2.941	.002
Industry-adjusted	−0.09	−2.384	.009

Abbreviation: CAR, cumulative abnormal return.

^ap-Values reported for Standardized Cross-Sectional Z are bootstrapped; all significance tests are two-tailed.

similar substantively and statistically to those obtained without confounded firms. Second, in Panel a of Table 2, on the sample that excludes confounds and the sample that does not, we reran our event study in the [0,1] event window using CARs generated using five different alternatives to the standard market model: Fama and French's (1993) three-factor, Carhart's (1997) four-factor, and Kothari and Warner's (2007) buy-and-hold, as well as the precision-weighted and industry-adjusted approaches discussed in Flammer (2013). Across both samples and all five methods, we found results remarkably consistent with our standard market models: the

CAR estimates are all negatively signed and statistically significant ($p < .05$). The results of these sensitivity tests strongly buttress the findings of our stricter quasi-replication in Table 1.

Third, in Panel b of Table 2, we repeated the same methods as in Panel A, re-running the standard market models without and with confounded firms, but we employed an event window [0] that consists solely of the day of the event. We analyzed this additional event window due to increasing evidence that investors react to nonmarket events in relatively rapid fashion (e.g., Flammer, 2015; Lewis & Carlos, 2019). As above, these results are remarkably consistent with our findings in Table 1. Regardless of sample or of event study methodology, the ARs for ALEC sponsors on the day that ALEC Exposed went live are negative and statistically significant ($p < .05$), though the magnitude of the effect is slightly smaller than in the [0,1] event window.

Our fourth and final robustness check of our market-wide model attempts via randomization inference to address concerns arising from the small number of ALEC sponsors (i.e., treated firms) and endogenous selection of firms into ALEC sponsorship.⁶ We present this check fully in Online Appendix 3, but we note here that its results are entirely consistent with those presented in Tables 1 and 2, assuaging selection bias concerns for our market-wide study.

Taken together, these four robustness checks extend the approach employed by Werner in his main event study of covert CPA. Further, they also give us greater confidence in the significance and magnitude of our finding, despite it being oppositely signed to Werner's.

4.3 | Reconciling our market-wide result with Werner's

Recognizing that we are similarly bound as Werner in not being able to draw inferences from a single case study, in this section, we conducted a content analysis of media coverage of both ALEC and the RGA in the hopes of reconciling these oppositely signed event study results. The pairwise comparison of results across these event studies suggests that investors' views of ALEC may differ from their views of the RGA, producing an adverse reaction to disclosure of firms' covert association with ALEC. Although both ALEC and the RGA are conservative organizations, many media outlets, political elites, academics, and activists viewed ALEC as a less legitimate organization than the RGA for firms to associate with at the time of their respective events, given ALEC's positions on highly salient and divisive nonmarket issues unrelated to business (e.g., stand-your-ground gun laws), as well as its status as a 501(c)3 charitable organization (see, e.g., Greenblatt, 2003, 2011; Hertel-Fernandez, 2014).

In particular, ALEC has come under fire from good-government groups (e.g., Common Cause), state ethics regulators, and even its former chairwoman for its willingness to test the legal limits of allowable political activity by its 501(c)3 status. Per Internal Revenue Service (IRS) rules, a 501(c)3 will lose its standing as a charity if "a substantial part of its activities is attempting to influence legislation (commonly known as *lobbying*),"⁷ and ALEC's critics argue that it should be stripped of its designation. These criticisms have been made both in the media (e.g., Jacobs, 2012) and in the form of a formal IRS complaint by Common Cause (Weiner, 2012). Although ALEC has fought back against these claims, the public nature of the dispute has called its reputation and legitimacy into question.

To assess whether this view of ALEC as an illegitimate actor was widely held at the time of the event, we performed a manual content analysis to compare media portrayals of ALEC and

⁶We note, however, that, as was the case in the RGA accidental disclosure that Werner analyzes, although firms self-selected into contributing to ALEC, firms did not select into being revealed as sponsors via the ALEC Exposed website.

⁷See, <https://www.irs.gov/charities-non-profits/lobbying>.

the RGA using a self-constructed political controversy dictionary.⁸ We searched Factiva for every article mentioning ALEC or the RGA in the 1-year prior to the accidental disclosure of their corporate contributors. Next, we pulled any phrases in each article that described each organization. A total of 145 articles provided a descriptive phrase for the RGA, and 71 articles provided a descriptive phrase for ALEC. Next, we compared the incidence of words in our political controversy dictionary in each subsample. In this baseline analysis, words denoting political controversy were used in 0.7% of the articles describing the RGA and 5.6% of the articles describing ALEC. A *t* test of means shows this difference is significant at the $p = .05$ level. In Online Appendix 4, we provide a robustness test of this analysis with an extended dictionary that generates similar results and thus further supports our conjecture that stakeholders such as the media perceive ALEC as a less legitimate organization than the RGA.⁹

We suspect that ALEC being portrayed as a more controversial actor than the RGA in the media in the run-up to their respective disclosure events is one possible mechanism for the difference between our negative event study result for ALEC and Werner's positive result for the RGA, as the disclosure of an association with ALEC may have heightened stakeholders' perceptions of the riskiness of ALEC sponsors' nonmarket strategies (den Hond, Rehbein, de Bakker, & Kooijmans-van Lankveld, 2014; McDonnell & Werner, 2016) and this heightened risk may have affected how financial market participants viewed these firms (Vasi & King, 2012). To be clear, we offer this post hoc argument not as a formal hypothesis nor do we offer our content analysis as data from which we can draw empirical inferences beyond this pairing, but rather as a potential explanation to reconcile our study with Werner's. Below in our extension of Werner's cross-sectional analysis, we explore whether there is any additional evidence for this possible mechanism.

5 | EXPLORING CROSS-SECTIONAL VARIATION IN ABNORMAL RETURNS

5.1 | Quasi-replication of Werner

Although the results of the market-wide event study above demonstrate that the short-run investor reaction to the disclosure of firms' sponsorship of ALEC was negative on average, they do not allow us to explore how variation in the CARs for ALEC sponsors relates to various firm-level attributes. To do so, following Werner (2017), we estimated the following cross-sectional model using OLS regression:

$$\text{CAR}_i = b_0 + b \mathbf{Z}_i + \theta \mathbf{X}_i + \psi_i + e_i \quad (1)$$

in which CAR_i is firm i 's standard market model-based CAR for the [0,1] event window¹⁰; \mathbf{Z}_i is a vector of variables used to test the variables of interest from Werner; \mathbf{X}_i is a vector of controls; and ψ_i are industry fixed effects based upon the one-digit SIC industry membership.

⁸For additional details on our dictionary and coding, see Online Appendix 4.

⁹Support for this assertion can also be found in internal ALEC documents analyzed by *The Guardian* newspaper in the wake of ALEC Exposed. ALEC's board identifies "controversy" as the reason many corporate sponsors left in the wake of the event, and its staff indicates that many of these former sponsors would be willing to return if the organization created a new 501(c)4 organization that would resolve legal and legitimacy questions (Pilkington & Goldenberg, 2013).

¹⁰We employed the [0,1] event window here following Werner; we continued to employ it throughout our cross-sectional analyses as the results of a firm-day analysis of abnormal returns we conducted (presented in Online Appendix 5) revealed that the vast majority of investor reaction to the ALEC disclosure event occurred on the day of and first day after the event.

The variables of interest in Werner (2017) were industry regulation (specifically, whether industries were “heavily” regulated), traditional CPA in form of both PAC contributions and lobbying expenditures, and shareholder resolutions related to required disclosure of CPA. Werner’s control variables were: firm size (logged total assets), performance (return on assets and 1-year sales growth), leverage (total liabilities/total assets), risk (Beta, as calculated using a market model based on firms’ monthly returns over 2010), and governance (percentage of shares held by 5% or greater blockholders).¹¹

Due to missing data, our sample size in the cross section is reduced to 135. Table 3 reports the descriptive statistics, as well as the correlation matrix, for these dependent and independent variables, as well as several additional variables, introduced below, that we employ to extend Werner’s analysis.

5.1.1 | Accounting for selection into treatment

As we mentioned in our market-wide event study, firms are not randomly assigned to ALEC sponsorship, suggesting selection bias may affect our cross-sectional analyses. Although Werner did not find evidence for such a bias in his cross-sectional examination of RGA contributors’ abnormal returns, we followed his lead in estimating a two-stage Heckman selection model to assess whether this bias was present our quasi-replication.

In the first (or selection) stage probit model, we employed the same exogenous instrument to predict selection into being an ALEC sponsor as Werner did with the RGA: a binary indicator that codes whether or not the firm made a “soft money” contribution of any magnitude to the Republican Party when it was legal to do so (pre-June 2002). This variable meets the key properties to serve as a selection instrument (Certo, Busenbark, & Woo, 2016), as it is likely predictive of giving to other conservative causes, such as ALEC, and it also fulfills the exclusion restriction, as it is unlikely to be related to firms’ CARs in July 2011 since the disclosure event occurred over 9 years after soft money contributions became illegal. In addition to whether the firm was a Republican soft money contributor prior to June 2002, in our first stage, we also included firm size (total assets, logged) since it is a robust predictor of CPA (Hillman et al., 2004). This first-stage model allowed us to estimate lambda (i.e., the inverse Mills ratio or the proxy for the correlation between the error terms in the first- and second-stage models), which we then included in our second-stage models.

5.1.2 | Cross-sectional quasi-replication results

We report the results of our quasi-replication of Werner’s main cross-sectional model (appearing as Model 5 of his table 5) in Model 1 of our Table 4. There are two key takeaways. First, the statistically significant coefficient for λ (the inverse Mills ratio) in the model’s second stage indicated that we need to address selection bias. Second, we find mixed evidence that the variables of interest in Werner’s study of the RGA leak covaried in a significant manner with the CARs surrounding the ALEC event. Specifically, we failed to replicate Werner’s findings that firms subject to heavy regulation and firms with greater PAC contributions experienced more

¹¹Details on all of these variables are available in Online Appendix 6; we note here that our measurement decisions and data sources mirror those employed by Werner in his cross-sectional model.

TABLE 3 Descriptive statistics and correlation matrix for treated firms (ALEC sponsors)^a

	Mean	SD	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.	13.	14.	15.	16.
1. Carhart four-factor CAR [0,1]	-0.216	1.217																
2. Heavily regulated industry	0.452	0.500	0.02															
3. 2005–2010 PAC contributions ^b	5.327	2.072	-0.01	0.22														
4. 2006–2010 lobbying expenditures ^b	6.256	2.168	0.13	0.19	0.45													
5. Shareholder resolution	0.153	0.362	-0.12	0.02	0.15	0.20												
6. Employee ideology	45.77	15.58	-0.12	0.18	0.10	0.18	0.04											
7. Community ideology	57.12	14.45	-0.08	0.20	0.02	0.13	0.08	0.42										
8. Net institutional CSR	2.984	3.825	0.15	0.11	0.29	0.44	0.01	0.28	0.23									
9. Media coverage	0.032	0.253	-0.06	0.01	-0.11	-0.14	0.12	0.05	0.06	-0.05								
10. Media sentiment	0.057	0.232	0.05	0.06	0.15	0.17	0.09	0.05	0.31	0.15	0.25							
11. Return on assets	0.052	0.055	0.21	-0.13	0.29	0.23	-0.01	-0.07	-0.15	0.34	0.02							
12. Sales growth	10.94	18.40	0.20	-0.19	-0.01	0.05	-0.04	-0.14	-0.19	-0.19	-0.02	0.19						
13. Market-to-book ratio	0.489	0.398	-0.07	0.13	-0.02	-0.01	0.05	0.12	0.12	-0.07	-0.11	-0.24	-0.17					
14. Leverage	0.621	0.191	0.03	0.29	0.16	0.14	0.06	0.02	0.02	0.01	-0.03	-0.22	-0.13	-0.34				
15. Beta	0.965	0.491	0.11	-0.44	-0.03	-0.10	-0.03	-0.10	-0.18	-0.26	0.07	0.03	0.21	-0.06	-0.01			
16. Assets ^b	11.69	0.843	0.14	0.21	0.49	0.49	0.23	0.17	0.25	0.53	-0.06	0.27	0.01	0.02	0.11	-0.20		
17. Blockholder percentage	18.25	16.47	0.04	0.02	-0.04	-0.26	-0.10	-0.08	-0.23	-0.32	0.12	-0.01	0.09	-0.14	0.10	0.22	-0.38	-0.38

Abbreviations: ALEC, American Legislative Exchange Council's; CAR, cumulative abnormal return; CSR, Corporate Social Responsibility; PAC, political action committee.

^an = 124; excludes treated firms with missing data, as well as treated firms that were confounded in the [0,1] event window.
^bVariable is log-transformed.

TABLE 4 Explaining cross-sectional variation in abnormal returns following the disclosure of ALEC sponsorship, replicating, and extending Werner (2017), table 5^a

Panel a: Second-stage results with selection correction				
	Model 1	Model 2	Model 3	Model 4
Abnormal return method:	Market model	CFF	CFF	CFF
Event window	[0,1]	[0,1]	[0,1]	[0,1]
Heavily regulated industry	−0.228 (0.386)	−0.283 (0.383)	−0.338 (0.429)	−0.409 (0.414)
2005–2010 PAC contributions ^b	0.087 (0.059)	0.086 (0.059)	0.082 (0.054)	0.097 (0.073)
2006–2010 lobbying expenditures ^b	−0.019 (0.052)	−0.008 (0.052)	−0.027 (0.057)	−0.009 (0.054)
Shareholder resolution	−0.647 (0.298)	−0.644 (0.296)	−0.831 (0.318)	−0.539 (0.206)
Employee ideology			−0.015 (0.007)	−0.017 (0.007)
Community ideology			0.005 (0.008)	0.006 (0.008)
Net institutional CSR			0.105 (0.040)	0.060 (0.018)
Media coverage			−0.360 (0.665)	−0.452 (0.683)
Media sentiment			−0.374 (0.510)	−0.586 (0.502)
λ (inverse Mills ratio)	0.492 (0.247)	0.486 (0.242)	0.460 (0.138)	0.437 (0.159)
Constant	−1.008 (2.912)	−0.782 (2.892)	0.253 (3.214)	−1.702 (3.072)
Confounds excluded [0,1]?	Yes	Yes	Yes	Yes
Controls from Werner (2017)?	Yes	Yes	Yes	Yes
Industry FEs?	Yes	Yes	Yes	Yes
Observations (<i>n</i>)	124	124	124	135

Panel b: First-stage selection model results				
	Model 1	Model 2	Model 3	Model 4
Dependent variable:	ALEC sponsorship (0,1)			
Republican soft money donor pre-2003	1.167 (0.113)	1.167 (0.113)	1.131 (0.116)	1.167 (0.113)
Assets ^b	0.405 (0.048)	0.405 (0.048)	0.393 (0.049)	0.405 (0.048)
Constant	−6.457 (0.531)	−6.457 (0.531)	−6.346 (0.538)	−6.457 (0.531)
Observations (uncensored)	4,274	4,274	4,274	4,285
Wald χ^2	110.75	103.94	109.19	103.25

Abbreviations: ALEC, American Legislative Exchange Council's; CSR, Corporate Social Responsibility; OLS, ordinary least square; PAC, political action committee.

^aModels in Panel a report OLS estimates; models in Panel b report probit estimates; SEs reported in parentheses.

^bVariable is log-transformed.

positive CARs around disclosure of their covert CPA. However, like Werner, we did find statistically significant evidence that firms that recently faced a shareholder resolution on CPA disclosure experienced more negative CARs (−0.647% lower) at the time of the event.

We assessed the robustness of these findings in two ways. First, as Model 2 of Table 4 reports, we reestimated Model 1 using the Carhart four-factor model [0,1] CAR as the dependent variable and obtained virtually identical results. Second, in an unreported test, we

reestimated Model 1 on a sample which included the firms that experienced a confounding event in the [0,1] event window, and this too did not alter our statistical or substantive conclusions.

5.2 | Extending Werner's cross-sectional analysis in the ALEC Exposed context

To further explore the mechanism we proffered above that might explain the discrepant results across our study and Werner's, we extended our cross-sectional analyses by specifically examining whether those firms whose stakeholders' values were less consistent with ALEC's experienced more negative abnormal returns, using the Carhart four-factor model [0,1] CAR, around the disclosure event (Carlos & Lewis, 2017; King & McDonnell, 2015). We assessed whether misalignments between a firm's sponsorship of ALEC and its employees' and communities' political preferences were negatively correlated with investor reaction to the ALEC leak. As a possible break on these negative effects, however, we also examined whether a firm's overall approach to stakeholder management in the form of institutionally focused corporate social responsibility (CSR) limited negative investor reaction toward ALEC sponsorship. In addition to adding these variables to Werner's cross-sectional model specification, to address the possibility that the variation in abnormal returns we observed is driven by the nature of the event and not just media coverage of the exposed firms, we also add two new controls related to media coverage and sentiment.

First, there is increasing empirical evidence that prospective and current employees seek out employers whose social and political values match their own. For example, prospective employees with pro-social attitudes are willing to work for less compensation when a firm is revealed to be socially responsible (Burbano, 2019), and this is particularly true of the highest performers (Burbano, 2016). Further, social activist boycotts that accuse a firm of malfeasance tend to increase turnover among organizational elites who sympathize with the challenging movement (McDonnell & Cobb, 2020). Employees who are pro-socially oriented also perform at higher rates when their employers act as more than mere profit maximizers (Flammer & Luo, 2017). Evidencing this in the realm of covert CPA, when Target Corporation faced a reputational crisis following its contribution to a Republican-leaning Super PAC in 2010, it primarily responded via internal memoranda to its employees that attempted to assuage concerns that the firm may be deviating from its long-term commitments to progressive causes like sustainability and LGBT rights (Palmer & Phillip, 2012).

To measure employees' political preferences, we assumed that these preferences are reflected in employees' aggregate personal campaign contributions (Gupta, Briscoe, & Hambrick, 2017). Following Gupta et al. (2017), we measured a firm's employees' political preferences by constructing a composite index equal to the average of four items coded from FEC data on each firm's employees' personal federal campaign contributions.¹² Toward against election cycle-specific shocks, we gathered and used employee contributions for the 2006, 2008, and

¹²The four items are (a) the dollar amount donated to the Democratic Party divided by the total amount donated to both parties; (b) count of donations to the Democratic Party divided by the count of donations to both parties; (c) count of unique employee donors to the Democratic Party divided by the count of donors to both parties; and (d) count of unique Democratic donation recipients divided by the count of all recipients.

2010 election cycles. We scaled this measure 0–100, with higher values measuring greater liberalism and thus, greater misalignment between an ALEC sponsor and its employees.

Second, a firm's sponsorship of ALEC also ran the risk of conflicting with the ideology of its headquarters community. Geographic communities, such as cities or states, in which firms are embedded can shape firms' behaviors via standards of appropriateness to which local organizations are expected to conform (Marquis, Glynn, & Davis, 2007; Scott, 2001), and as part of firms' desire to appear legitimate within the communities in which they are embedded, firms often align their social and political activities with the ideology of their local community (Marquis et al., 2007). To the degree that firm–community misalignment could harm a firm's ability to compete in local labor markets or prevent a firm from gaining pecuniary benefits (e.g., tax breaks) or reputational goodwill, investors may see cause for concern. Further, a problematic relationship between a firm and its local community may leave the firm open to greater coercive pressures from higher levels of government, which could impose greater political costs in the form of enhanced or less tailored regulation (e.g., Simons, Vermeulen, & Knoben, 2016).

To capture the political preferences of a firm's community, we focused on electoral results from its headquarters county; specifically, we used the average of the two-party vote for the Democratic presidential candidate in the headquarters county over the three presidential elections (2000, 2004, and 2008) prior to the disclosure of ALEC sponsorship. We gathered these data from the M.I.T. Election Data and Science Lab.¹³ As with employee ideology, this community ideology variable ranges 0–100, with higher values measuring greater liberalism and thus, greater misalignment between an ALEC sponsor and its headquarters community.

Third, investors may react less negatively to sponsorship of ALEC if firms have reputations as being more socially responsible, as this may offer firms a buffer when they are involved in controversy or exposed as engaging in risky strategies (Godfrey, Merrill, & Hansen, 2009; Muller & Kräussl, 2011). Reputable organizations are less negatively affected because they build up a “reservoir of goodwill” (Jones, Jones, & Little, 2000), which suggests that stakeholders, choosing to focus on positive information and discount negative information, will give organizations the benefit of the doubt when they are challenged (Coombs & Holladay, 2006). Several scholars have found that engagement in CSR can protect firms when they confront controversies (e.g., Godfrey et al., 2009; McDonnell & King, 2013) and that engagement in CSR signals that firms are concerned with addressing societal issues (Schueth, 2003). In the political realm, Werner (2015) finds that CSR targeted toward external stakeholders and internal diversity and inclusion efforts (“institutional” CSR) is a strong signal of corporate citizenship. So, although a disclosure of covert CPA may signal that firms' nonmarket actions are riskier than their investors might want, investors may give the benefit of the doubt to those perceived to be highly engaged in “institutional” CSR, and react less adversely.

To measure firms' perceived levels of “institutional” CSR, we followed Werner (2015) and employed a slightly modified version of his measure of net institutional CSR.¹⁴ To construct this

¹³See, <https://electionlab.mit.edu/data>.

¹⁴As Werner (2015) notes, KLD modified its data collection practices between 2009 (the last year of his study) and 2010. The impact of this change on this variable is that KLD rated firms on slightly fewer dimensions of community strengths and concerns and diversity strengths and concerns; the total number of environmental dimensions evaluated remained unchanged. Were we comparing across years, these changes would prove problematic; however, our analysis is within-year, across firms. Nevertheless, to ensure this measure captures the same underlying phenomenon, for the sample of ALEC sponsors, we calculated the correlation between their 2009 and 2010 net institutional CSR scores. Despite the measurement changes (as well as any changes in firm practices rated by KLD), these 2 years' worth of data were highly and significantly correlated ($r = .87$; $p < .001$).

indicator, we used the 2010 KLD Stats dataset and across the KLD categories of environment, community, and diversity categories first summed each firm's strengths before netting out the sum of its concerns. The placement of these categories into the institutional side of CSR is based upon a factor analysis conducted by Mattingly and Berman (2006), and its empirical validity in the political context is demonstrated by Werner's (2015) findings.

Finally, to control for the possibility that investors are reacting simply to an adverse media event and not the disclosure of the covert connection between the firm and ALEC, similar to King and Soule (2007), we included two new control variables related to media coverage and sentiment. The first variable (media coverage) captures how many articles in Factiva's All Sources database involved an adverse mention of the firm with regard to the ALEC leak in the tested event window around the launch of the "ALEC Exposed" website. The second variable (media sentiment) captures the emotional valence of attention paid to the firm around ALEC Exposed to control for how sentiment toward the firm might affect reactions to the disclosure. We construct this variable through a content analysis of every article in the largest six U.S. media outlets—*The New York Times*, *Washington Post*, *Chicago Tribune*, *Los Angeles Times*, *Wall Street Journal*, and *USA Today*—that was released in the event window and mentioned each sampled company in its headline. Following prior work (McDonnell, 2016; Pfarrer, Pollock, & Rindova, 2010), we used the Linguistic Inquiry Word Count (LIWC) program to analyze the affective valence of each article. LIWC employs an extensive dictionary of over 900 affectively valenced words to provide summary statistics on the extent of positive and negative affect of an analyzed text.¹⁵ Following prior work, we constructed a measure of the ratio of positive to negative content in each article, then further collapsed the articles into three categories: "positive" if at least 60% of affective content was positive, "negative" if at least 60% of affective content was negative, and "neutral" otherwise (Pfarrer et al., 2010). Finally, we aggregate all articles about a company within the event window for each study into a measure of media sentiment using the Janis and Fadner (1965) (JF) coefficient of imbalance (Deephouse, 2000; McDonnell, 2016; Pollock & Rindova, 2003). The JF coefficient is computed as:

$$(P^2 - PN)/V^2 \text{ if } PN < 0, 0 \text{ if } P = N, \text{ and } (PN - N^2)/V^2 \text{ if } NP,$$

where P is the number of positive articles about a firm in the event window, N is the number of negative articles, and V is the total number of articles. The JF coefficient produces a measure ranging from -1 (for wholly negative coverage) to 1 (for wholly positive coverage). For firms that received no media coverage within an event measure, we set this variable to 0, or neutral.

5.2.1 | Cross-sectional extension results

Models 3 and 4 of Table 4 present the results of cross-sectional models including these variables (and employing the CFF-generated CARs as dependent variables) before rerunning them on samples that exclude ($n = 124$) and include ($n = 135$) confounded firms, respectively. In both models, we found significant results for shareholder resolutions, as well as two of the three

¹⁵See, <http://liwc.net> for additional information on the tool's dictionary and method of analysis.

variables of interest: employee ideology and net institutional CSR.¹⁶ Among the set of ALEC sponsors, having faced a recent shareholder resolution and having more liberal employees are both negatively correlated with their ARs on the day the ALEC Exposed website went live, while having a better net institutional CSR score is positively correlated with ARs on that event day. Notably, these effects occur while controlling for media coverage of the event and media sentiment toward the firm—and we note that neither of these variables is statistically significant.

In substantive terms, if a firm that contributed to ALEC faced a shareholder resolution during the 2010 proxy season, then its abnormal return on the day of the ALEC leak was -0.54 to -0.83% lower than the average ALEC sponsor. This result is consistent with Werner's finding that shareholder contention is negatively correlated with ARs around the disclosure of covert CPA, providing additional evidence for the claim that dissonance between shareholder preferences and managerial decision-making on covert CPA can have significant negative economic consequences.

For each percentage point that an ALEC sponsor's employees' political contributions were more liberal, it experienced ARs that were approximately -0.02% lower. This finding extends Werner's analysis and sheds light on how stakeholder management beyond shareholders can affect investor reaction to covert CPA. That is, alignment between a firm's disclosed covert CPA and its employees' political preferences may be taken by the market as a signal for how covert CPA could affect a firm's future relationships with employees.

Finally, for each point increase in an ALEC sponsor's net institutional KLD score, its ARs were 0.06 – 0.11% higher. It is important to note that this insurance-like value of CSR (Godfrey et al., 2009) appears in a linear fashion across the range of the variable, suggesting that investors both punish "irresponsible" firms when they engage in covert CPA, but give the benefit of the doubt to "responsible" firms engaging in the very same behavior. One possible explanation for this seemingly contradictory behavior is that investors use CSR to make inferences about the firm's motives for engaging in CPA.¹⁷

6 | DISCUSSION AND CONCLUSION

6.1 | Contributions

Although it plays an increasingly prominent role in the firms' tactical repertoire for engaging in political markets, we know very little about the strategic value and rationale of covert CPA. Werner's (2017) study in this journal provides provocative initial insight into the phenomenon by demonstrating that investors reacted positively to the disclosure of firms' covert ties to the RGA. In interpreting this effect, Werner reasons that the market perceived these ties as signals

¹⁶Although the firm-day abnormal return analysis in Online Appendix 5 indicates that investors' reactions to the ALEC disclosure were concentrated in the $[0,1]$ event window, as a final robustness check in Online Appendix 7, we reran our cross-sectional extension models using six alternative event windows. With the exception of the widest of these windows $[-20,20]$, our statistical and substantive conclusions are robust to these alterations of the dependent variable's measurement.

¹⁷In a further attempt to see if firms were punished for "bad deeds" or were protected for "good deeds," we also ran unreported regression models in which we included institutional CSR strengths and institutional CSR concerns separately, instead of netting the latter out of the former. We found no evidence that one effect dominated over the other, as the two indicators were statistically significant and of similar magnitude (though oppositely signed).

of supporters' superior political access to governors. Yet these findings, while valuable, present an important puzzle for the CPA literature more broadly: if investors respond favorably to the disclosure of covert CPA, why don't firms voluntarily disclose all of the recipients of their political largesse? A fuller empirical picture of the boundary effects and contingencies of Werner's (2017) findings is necessary for understanding the strategic rationale of covert CPA. Of course, opportunities to study this important category of CPA are few, as most undisclosed CPA remains hidden from the public eye.

In this study, we exploit a second accidental disclosure of covert CPA as an opportunity to quasi-replicate and extend Werner's (2017) findings by examining investors' reactions to disclosed corporate support of another right-wing political organization, ALEC. Contrary to Werner (2017), we find that investors reacted negatively, on average, to these disclosed ties. To explore potential explanations for this discrepancy, we conducted post hoc archival content analyses of media mentions of both the RGA and ALEC. Our results corroborate the claim that investors' negative reactions in our case may stem from the more controversial nature of ALEC *relative to* the RGA, as prior to ALEC Exposed, the media portrayed ALEC as a less legitimate political entity than the RGA. These findings suggest what may be an important contingency of disclosed CPA: although activity linked to a reputable organization, such as a political party, may be perceived as a signal of valuable political capital, activity linked to a more controversial organization may be perceived as a signal of exacerbated enterprise risk.

We further contribute to research on covert CPA by exploring new conditions under which investors may react more or less negatively to disclosure of covert CPA. We replicate Werner's (2017) finding that investors react more negatively to disclosed covert CPA when firms face shareholder pressure for increased political transparency. We also provide evidence that investors react more negatively to disclosed covert CPA that does not align with employees' political preferences. Finally, we find preliminary evidence that firms with greater CSR engagement may enjoy a halo effect that tempers negative reactions to controversial political activity. Together, these findings provide some support for prior claims that investors view corporate engagement in politics as a matter of social responsibility (see, Lyon et al., 2018).

6.2 | Limitations and future research

We note two limitations of this research. First, just like in the Werner (2017) study we replicate, we rely upon only one instance of a disclosed connection between a small sample of firms and a controversial political nonprofit organization. Accordingly, our inferences are only empirically and theoretically valid to the extent that ALEC is representative of the broader population of controversial 501(c) actors. Second, the ALEC Exposed event only allows us to examine controversial CPA that has its ideological origins on the right of American politics. As a result, we cannot fully rule out that investors might react differently if firms were linked to a controversial actor on the left.

Turning to areas of future research, researchers should continue to exploit what leaks of covert CPA become available to probe its causes and consequences. We encourage replications of this research in order to continue building a cumulative body of knowledge. Moreover, research on firms' use of 501(c)6 trade associations and the nature of these organizations' political activity would be particularly beneficial. Firms are not just sponsors of or contributors to trade associations but are true members of these organizations and typically engage in these organizations in a much more substantive manner than they do with 501(c)3s or 501(c)4s

(Barnett, 2012). Further (perhaps qualitative) studies on the relationships between firms and the political activity of their trade associations may prove fruitful both for understanding the ways in which firms attempt to shape public policies at the state and national levels in the United States and for understanding reputational and broader dynamics between for- and non-profit organizations.

7 | CONCLUSION

Covert CPA remains an underexplored phenomenon in strategy research. As firms' covert ties continue to be disclosed, largely due to the efforts of whistleblowers, opportunities may abound for researchers to increase our knowledge on this topic. Such inquiries are imperative for a more complete understanding of firms' strategic formulation of CPA.

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SUPPORTING INFORMATION

Additional supporting information may be found online in the Supporting Information section at the end of this article.

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