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RESEARCH NOTES AND COMMENTARIES

RED AND BLUE: THE RELATIONSHIP BETWEEN THE INSTITUTIONAL CONTEXT AND THE PERFORMANCE OF LEVERAGED BUYOUT INVESTMENTS

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This paper advances the debate concerning the relationship between politics and business conduct by investigating the influence of the institutional context on leveraged buyout investments. We propose that the formal and informal institution context in 'red' states (those dominated by the U.S. Republican Party) is more aligned with the principal strategies through which leveraged buyout investors create value than such a context is in 'blue' states (those dominated by the Democratic Party). Therefore, according to institutional theory, one would expect, ceteris paribus, a higher likelihood of buyout transactions in red states and vice versa. We analyze a sample of 10,746 U.S. buyout investments in 4,633 distinct target companies made by 2,396 different funds managed by 1,300 private equity firms from 1980 to 2003. The results indicate strong evidence of a positive association between a more aligned institutional context and both the volume of buyout activity and different measures of performance for these buyouts.

INTRODUCTION

The relationship between business activity and the institutional context has been the focus of extant theoretical and empirical research. Theoretically grounded in institutional theory (North, 1990; Scott, 1995), a number of studies have documented the influence of different formal and informal aspects of the institutional context on firm behavior or performance in a variety of situations. Examples include Multinational Enterprise (MNE) strategies (Henisz, 2000; Kostova and Zaheer, 1999; Miller and Eden, 2006; Rosenzweig and Singh, 1991; Westney, 1993; Zaheer, 1995; Chan, Isobe, and Makino, 2008; Meyer *et al.*, 2009), corporate responses to environmental demands (Delmas and Tofel, 2008), the costs of adopting an environmental management system (Darnall and Edwards, 2006), the promotion of corporate sustainable development (Bansal, 2005), firm disclosure strategies (Reid and Toffel, 2009), and the process of strategic decision making in general (Papadakis, Lioukas, and Chambers,1998).

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The last few decades have ushered in fundraising and investment activity of leveraged buyout funds (hereinafter referred to as buyouts or LBOs), responsible for almost half of all worldwide merger and acquisition activity in the first half of 2007 (*Economist*, 2007). The amount of capital committed to U.S. private equity funds has grown from $5 billion in 1980 to $300 billion in 2004, totaling more than $3.6 trillion globally over the last 35 years, $2.7 trillion of which represent LBOs undertaken after 2000 (Strömberg, 2007). These trends have led to an increased level of interest in understanding the drivers of buyout activity and performance. Buyout investments are characterized by limited contractual lifetimes and standalone performance improvements in a given acquired firm based mostly on restructuring-oriented value-creating strategies.

Anecdotal evidence suggests that buyout activity is influenced by the institutional context. For example, LBO activity (as a function of gross domestic product [GDP]) across the European Union varies substantially from one country to another, and these differences are not easily explained solely by structural or economic factors (European Venture Capital Association [EVCA, 2008]).[1] Similarly, as our analyses confirm, some states within the United States have experienced a higher-than-proportional level of LBO activity that cannot fully be explained by the characteristics of the local economy, the industrial base, or the local presence of buyout investors. However, little is known about the link between the local formal and informal institutional context and its attractiveness for LBO investments. This lack of knowledge stands in sharp contrast to the prevalence of buyout activity and the unique value-creating strategies. Buyouts, thus, represent a blind spot within the strategy literature that has long been interested in the relationship between business activity and the institutional context.

This paper explores the influence of institutional context on the volume and the performance of buyout activity. We investigate whether buyout investors are more likely to tilt toward specific institutional contexts while making their investment decisions. We focus our attention on the United States as the largest and oldest buyout market. We analyze state-level presidential election results as proxies for a variety of unobservable aspects of the formal and informal institutional context that influence the transaction costs of implementing buyout value-creation strategies. In doing so, we distinguish between an institutional context that is in line with the views of the platform of the Democratic Party ('blue') versus one in line with those of the Republican Party ('red'). Specifically, we show that the economic and societal norms in the blue states are more accurately characterized as those that support firms' commitments to employees, unions, the environment, and community issues (per the 2004 Democratic Party Platform) than are such norms in the red states. Importantly, we do not infer causality between election results and buyout investment preferences but, rather, use election results as proxies for the institution context, a context which, in turn, affects buyout decision making. Accordingly, we expect higher transaction costs related to the implementation of typical restructuring-oriented buyout value-generation strategies in blue states than in red states. Consequently, we expect, *ceteris paribus*, a higher likelihood and better performance of buyout transactions in red states.

Several factors make the investment criteria and performance outcomes of buyouts particularly germane when analyzing the relationship between *within-country* heterogeneity in institutional contexts and business activity. First, most buyout funds have a limited contractual lifetime, after which they have to exit their investments. Second, unlike other types of investors (e.g., mutual funds) who seek to maximize the performance of a portfolio of firms, buyouts are non-synergistic, standalone acquisitions with the goal *of maximizing the market value* of the acquired firm within a limited investment horizon (e.g., Jensen, 1989; 2002). Accordingly, the influence of the institutional context on buyout value-generation strategies can be more accurately observed than it would in the case of other types of investments.

In order to shed light on this issue, this paper analyzes the activity of LBO funds in the United States between 1980 and 2003. Using a unique dataset concerning the investment decisions and performance of buyout funds *at the deal level*, we are able to conduct an analysis of the relationship

[1] For example, according to The EVCA Yearbook 2008, while in Sweden buyout activity accounted from 1.022 percent of GDP in 2008, the corresponding figure for Norway was 0.239 percent. Similarly, while in France buyout activity accounted from 0.450 percent of GDP in 2008, the corresponding figure for Italy was 0.193 percent.

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between election outcomes in the United States and buyout transactions from 1980 to 2003. Our data include information on 10,746 buyout investments in 4,633 distinct target companies made by 2,396 different funds managed by 1,300 private equity (PE) firms. Overall, the evidence paints a consistent picture. There is strong evidence for the expected impact of the institutional context on the attractiveness of LBOs in a given state. Consistent with the view that the transaction costs related to the implementation of buyout value-creation strategies are lower in red states, we find a higher likelihood of buyout transactions and a greater buyout success rate in states where, at the time of the investment, the dominant political beliefs are Republican rather than Democratic. In other words, our findings suggest that value-creation strategies employed by restructuring-oriented corporate acquirers are less costly and more efficiently implemented in a red state institutional context.

In addition, we find evidence that changes in dominant political beliefs have an additional impact on buyout activity. These findings are unaffected when we control for traditional predictors of buyout activity or fund performance. We also show that our results are not driven solely by firms' industry or state unionization rates. We conclude by discussing the implications of these findings for future research on success drivers of corporate acquisitions and the link between institutional context and business activity.

THEORY AND HYPOTHESES

Buyouts are standalone, controlling-stake acquisitions of a company (or a division) from its owners, usually with a limited time horizon, financed through a combination of equity and debt, and with strong involvement from specialized financial investment companies (Berg and Gottschalg, 2005). Buyout investors seek to build value by improving the cost structure of the firm (Kaplan and Strömberg, 2008), tightening the controls on corporate spending (Kaplan, 1989; Magowan, 1989; Anders, 1992; Holthausen and Larcker, 1996), initiating cost-reduction programs (Muscarella and Vetsuypens, 1990; Baker, 1992), increasing plant productivity (Lichtenberg and Siegel, 1990; Harris, Siegel, and Wright, 2005), lowering labor costs (Bertrand and Mullainathan, 1999), and reducing working capital requirements (Holthausen and Larcker, 1996). Post-acquisition activities often involve selling or shutting down less efficient units or projects (Magowan, 1989; Phan and Hill, 1995), improving the quality of the management team (Acharya, Hahn, and Kehoe, 2008), and improving corporate governance in order to better align management incentives with those of shareholders (Jensen, 1986; 1989).

Like virtually all aspects of business today, buyouts are affected by the institutional context in one way or another (e.g., Bettis and Prahalad, 1983), and their ability to successfully implement value-creating strategies depends on political and social elements of the particular institutional environment in which they operate (e.g., North, 1990; Hoskisson *et al*., 2000; Meyer and Peng, 2005; Tsui, 2004). Those elements are reflected in the dominant political view in a given location (Bansal, 2005; Bertrand and Mullainathan, 2003; Rubin, 2008; LaPorta *et al*., 1997), and U.S. surveys confirm that institutional contexts vary substantially across Democratic and Republican states (e.g., Gelman *et al*., 2008.).

The Republican Party is, in general, the more socially conservative and economically libertarian of the two major U.S. parties. It has closer ties to Wall Street (large corporations) and little support among labor union leadership. In contrast, the Democratic Party platform emphasizes support for industrial policies that sustain unionized manufacturing jobs, raising the minimum wage (e.g., the Living Wage regulations), introducing paid time-off regulations that exceed federal laws, and promoting broad social programs such as Social Security and universal health care.

We propose that an institutional context dominated by characteristics of the Republican Party platform facilitates buyout value creation, while the Democratic Party platform is likely to impede it. In other words, the institutional environment in blue states will create higher transaction costs related to the implementation of restructuring-oriented buyout value-generating strategies than will the institutional environment in red states.

Our arguments are illustrated in Figure 1. The population of companies (potential targets) that are active in a given location at a given point in time differs with respect to the value that can be created by acquiring them in a buyout transaction. We rank firms by this level of possible buyout value creation: the net of the transaction

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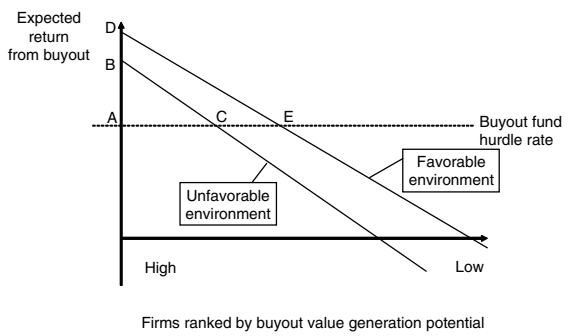

Figure 1. Impact of shift in environmental conditions on buyout volume and activity

costs related to the implementation of the corresponding restructuring strategies. We observe that some firms will lose value through buyouts, others will create value below the required (and competitively determined) expected rate of return for buyout investors, and others will offer a value-creation potential that is above that 'hurdle rate.' In general, buyout investors will only undertake investments that fall into this third category, which corresponds to the distance between points A and C in Figure 1, assuming an 'unfavorable' buyout environment. In this situation, the average expected performance of the transactions that occur is determined by the average height of the triangle between points A, B, and C. In case of a 'favorable' buyout environment, the number of occurring transactions will be higher, that is, it will correspond to the distance between points A and E. Likewise, the average expected performance of buyouts will be higher, that is, it will correspond to the average height of the triangle between points A, D, and E. Accordingly, whether the political environment is more or less favorable to buyout value generation influences both the expected level of buyout activity and its expected performance.[2]

In line with this reasoning, we hypothesize that, *ceteris paribus,* the level of activity and the average performance of buyouts will be higher in Republican states than in Democratic states.

Hypothesis 1a: The level of activity of leveraged buyouts will be higher in Republican states than in Democratic states.
Hypothesis 1b: The average performance of buyouts of companies located in Republican states will be higher than in Democratic states.

The institutional context tends to evolve over time, as becomes apparent when a state's dominant political party changes following elections. This raises the question of how such shifts in political views influence the level of activity and the average performance of leveraged buyouts. We can again illustrate this effect based on Figure 1. Consider the evolution of the institutional context from a less favorable (Democratic) to a more favorable (Republican) orientation. In this case, the level of potential buyout returns shifts to the northeast corner of the chart, which corresponds to a higher level of potential buyout value generation for all firms. This increases the number of attractive transactions to a number equivalent to the distance between points A and E and increases the average expected performance, as determined by the average height of the triangle between points A, D, and E. The reverse logic applies to the case of a shift from a more favorable (Republican) to less favorable (Democratic) state of the world.

While institutional context is likely to evolve gradually, election results serve as strong signals to investors that such changes are taking place. For example, a Republican victory in a formerly Democratic state signals a trajectory toward an institutional environment that is particularly advantageous for buyouts. This puts many additional target companies in the area of suitable buyout targets (areas B, D, C, and E), which creates unexploited opportunities for buyout investors. Accordingly, we hypothesize that recent shifts toward Republican dominance will result in increased buyout activity, and vice versa. Along the same lines, we predict that the performance of such transactions will be higher.

Hypothesis 2a: The level of activity of leveraged buyouts will be higher in states that recently shifted from Democratic to Republican.
Hypothesis 2b: The average performance will be higher for buyouts of companies located in states that recently shifted from Democratic to Republican.

[2] One needs to consider, in this context, that sellers will take advantage of this situation by adjusting their reservation prices to the demand in the market for corporate control or will attempt to maximize the value of the venture themselves. These actions will obviously reduce the surplus buyout investors can capture. Given the uncertainties involved, however, it is reasonable to assume that with the nature of most transactions and the financial and operational specialization of buyout managers, sellers are unlikely to take full advantage of this situation and capture the entire surplus from additional value-generation potential.

DATA AND RESEARCH DESIGN

Data sources

We gathered political data at the state and county levels from the presidential and gubernatorial election results as reported at www.uselectionatlas.org. We obtained information on the activities and performance of private equity funds raised from 1980 to 2003 from Thomson Venture Economics. This database has been widely used in academic research and contains information on private equity investments in 29,739 companies (e.g., Phalippou and Gottschalg, 2009; Kaplan and Schoar, 2005). Several of these investments have received funding at different points in time (rounds) and by different private equity funds so that the total number of investments (investor-target-round dyads) is 134,641. Data on investments include information about the target company (location, industry description, age), the investment (time of investment, stage, group of coinvestors (syndicate), equity amount provided by each fund, exit date and exit mode for liquidated investments), and the fund (investment focus, vintage year).

To examine our theoretical predictions, we formulate two distinct models that explain the impacts of the local political environment on (1) the *level of buyout activity* and (2) the *exit success of individual transactions*.

Sample selection and dependent variables

The dependent variable in our analysis of the *local level of buyout activity* is a count of all buyouts made in a given calendar year of companies located in any of the 50 states and Washington, D.C. Our sample covers 750 state-year observations.

We also analyze the *exit success of individual transactions.* Our unique data allow us to consider *deal-level outcomes* across a range of realization options for the buyout market. We focus on a subsample of 4,385 transactions (i.e., acquired companies) completed between 1980 and 2000 and, thus, have sufficient time to materialize. We measure their exit success in two ways: first, as a binary variable 'Successin 5' that takes a value of '1' if a successful exit (initial public offering, secondary LBO, or trade sale) has been observed within five calendar years following the investment date and takes a value of '0' otherwise; second, as three categorical variables—successful exit (defined as above), unrealized (censored, living-dead), and write-off.

Explanatory variables

We operationalize the relevant aspects of the local political environment prior to, at the time of, and after the buyout decision through five dummy variables (Table 1 summarizes the operationalization of the political environment variables). Our analyses are conducted at the state level since county level data are not available for the majority of our covariates. Note, however, that state and county political outcomes are relatively highly correlated (0.62 over the period analyzed) (Besley and Case, 1995). The variable 'RedState' has a value of '1' if the Republicans won the presidential elections that directly preceded the buyout in the focal state and a value of '0' otherwise. The variable 'Turned Blue' has a value of '1' if both the Democrats won the presidential elections that directly preceded the buyout in the focal state and the Republicans won the presidential elections before that; it has a value of '0' otherwise. The variable 'Turned Red" has a value of '1' if both the Republicans won the presidential elections that directly preceded the buyout in the focal state and the Democrats won the presidential elections before that; it has a value of '0' otherwise.

We control for *alternative determinants of buyout activity* through the following variables. First, we consider a proxy for the investment opportunity landscape facing buyouts in a given state and year (the unobserved availability of investment opportunities). We approximate the set of potential targets based on two factors: (a) the number of publicly listed companies (according to Compustat) that are active in each industry category in the focal year *t*

Table 1. Overview election outcomes and explanatory variables

Focal election outcome t	Previous election outcome t-1	Red state dummy	Turned blue dummy	Turned red dummy
R	R	YES	NO	NO
R	D	YES	NO	YES
D	R	NO	YES	NO
D	D	NO	NO	NO

R = Republican Party majority.
D = Democratic Party majority.

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Table 2. Descriptive statistics for the determinants of buyout activity

Variables	Mean	s.d.	min	max	1	2	3	4	5	6	7	8
1 Current BO Activity	4.8905	8.3938	0	75								
2 Red State	0.5307	0.4999	0	1	0.094							
3 Turned Blue	0.0809	0.2752	0	1	−0.006	−0.407						
4 Turned Red	0.0400	0.1980	0	1	0.028	0.253	−0.103					
5 Count Of Offices	4.0392	10.1089	0	65	0.626	0.162	0.045	−0.068				
6 Prev BO Activity	4.8775	8.3988	0	75	0.732	0.077	−0.062	−0.008	0.566			
7 Target Fraction	97.6131	152.7985	0	1339	0.652	0.204	0.018	−0.009	0.632	0.523		
8 Age BO Activity	9.7975	6.3980	0	23	0.189	0.180	−0.032	0.290	0.132	0.255	0.379	
9 State Union Mem	10.2436	5.0364	1.9	26	−0.241	−0.362	0.094	−0.142	−0.018	−0.205	0.008	−0.013

in state *s* and (b) the fraction of overall cumulative countrywide buyout activity, until year *t*, that occurred in each industry category. We then cross multiply both vectors to derive the variable 'Target Fraction.'[3] Second, we control for a possible impact of proximity between the location of PE firm offices and target firm headquarters based on a count of the number of PE firm offices in a given state (CountOfOffices). This variable is measured as of 2003, as the data are not available over time. We further include the lagged effect (count of deals) of the buyout activity in a given state in year $t - 1$ (PrevBOActivity) and the age of the buyout industry in a given state (AgeBOActivity), measured as the number of years since the first buyout that occurred in the focal state. Descriptive statistics for the full set of variables related to the analysis of buyout activity are reported in Table 2.

We control for *alternative determinants of the exit success of individual transactions* with the following variables. To capture target-specific effects, we use the age of the acquired firm measured at the acquisition date (Target Age); the size of the investment is measured as the natural logarithm of the amount of equity (in 2003 tsd US$) invested in the target company by the (syndicate) buyout fund(s) (ln(Total_Amt)). A syndicated deal (ClubDealDummy) is coded '1'; and '0' otherwise. The history of success of the (syndicate) buyout fund(s) is captured by three measures: 1) (average) success rate (percentage of successful exits observed through the entire observation period) of (syndicate) buyout fund(s) participating in the transaction (AvgOfFirmSuccess), 2) average historic success rate of buyouts in the focal industry (AvgIndSuccess), and 3) average historic success rate of buyouts in the focal state (AvgStateSuccess). Other (syndicate) buyout fund(s) characteristics included in our models to proxy for experience and reputational capital of the fund(s) are the following: (average) age of buyout fund(s) in the (syndicated) deal at the time of the transaction (AvgOfFirmAge) as well as the natural logarithm of the (average) capital under management as of 2003 (ln(AvgCapitalMGT)). Descriptive statistics for the full set of variables related to analysis of the exit success of individual buyouts are reported in Table 4.

Fixed effects

Since our main covariates of interest are measured at the state level, we use the Census Bureau-designated areas to absorb all other area-specific characteristics. Note that the definitions of the Census Bureau areas are stable over the period of the analysis and that areas include states with different political views as well as politically stable and swing states. Time effects are controlled with year-fixed effects in the state activity analysis and with investment-year-fixed effects in the outcome analyses. Finally, industry effects are captured with industry categories codified by VentureXpert (based on the one-digit VEIC classification).

ANALYSES AND RESULTS

Determinants of the level of buyout activity

Our model assumes that buyout transactions can occur annually, $t = 1983, \ldots 2003$, in all states in the United States (including Washington, D.C.),

[3] Following Ljungqvist and Richardson (2003), we use, for robustness, the lagged annual number of companies (logged) that received funding in a given industry. An increase in the number of 'electronics' companies being funded is assumed to signal an improvement in electronic investment opportunities. The results using this alternative measure are qualitatively similar.

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$s = 1, \ldots 51$. The number of buyout transactions in state s in year t is expressed as

$$\begin{aligned}
&\text{BO_}Activity\ s,t = \alpha \text{Red}State \\
&\quad + \beta_1 TurnedBlue + \beta_2 Turned\text{Red} \\
&\quad + \vec{\chi}\, StateControls + \\
&\alpha \text{Red}State + \beta_1 TurnedBlue \\
&\quad + \beta_2 Turned\text{Red} \\
&\quad + \chi_1 Unexpected Blue \\
&\quad + \chi_2 Unexpected\text{Red} + \vec{\delta}\, StateControls \\
&\quad + CensusBureauAreaF.E. \\
&\quad + YearF.E. + IndustryF.E. + \varepsilon_{s,t}, \qquad (1)
\end{aligned}$$

where the control vector includes additional determinants of buyout activity at the state level: 'TargetFraction,' 'CountOfOffices,' 'PrevBOActivity,' and 'AgeBOActivity.' The lagged count of local buyout activity (PrevBOActivity) for predicting current local activity helps to account for the possibility that our empirical models suffer from specification problem due to unobserved heterogeneity, permitting greater confidence when inferring causal relationships (Heckman, 1980; Jacobson, 1990). Since many state-year dyads are censored, we estimate Equation (1) by zero-inflated Poisson (ZIP).

The results strongly support our theoretical arguments (see Table 3 Model 3). Findings indicate that the outcomes of the most recent presidential elections have the predicted impact. The level of buyout activity is higher by a factor of 1.090 (0.45 additional transactions per year over the mean level in our sample) when the most recent presidential elections have been won by a Republican candidate—supporting Hypothesis 1a ($p < 0.05$). In addition, the history of political conditions also has a significant impact. We observe a significantly higher level of buyout activity in states that 'TurnedRed' (by a factor of 1.18)—states not only where Republicans have won the most recent election but also where the preceding presidential elections had been won by the Democratic candidate ($p < 0.05$), thus supporting Hypothesis 2a. Along the same lines, we observe a significantly lower level of buyout activity in states that 'TurnedBlue' (by a factor of 0.81)—states not only where Democrats have won the most recent election but also where the preceding presidential elections had been won by the Republican candidate ($p < 0.01$). Together, these results are consistent with the view that a change in the institutional context toward the political right increases the number of attractive buyout targets and vice versa.

Determinants of the exit success of individual buyouts

We run a number of nested models of ordered probit and probit regressions to explain the *exit success of individual buyout transactions*. The success of transaction i, located in state s, at time t ($t = 1983, \ldots 2000$), belonging to industrial sector j, and managed by fund (syndicate) f is presented by

$$\begin{aligned}
&\text{Success of Transaction } i,s,t,j,f = \\
&\alpha \text{Red}State + \beta_1 TurnedBlue \\
&\quad + \beta_2 Turned\text{Red} \\
&\quad + \vec{\chi}\, TransactionControls_{i,t-1,f} + \\
&\vec{\phi}\, FundControls_{s,t-1,j,f} \\
&\quad + CensusBureauAreaF.E. \\
&\quad + FundVintageF.E. + \\
&IndustryF.E. + \varepsilon_{i,s,t,j,f} \qquad (2)
\end{aligned}$$

where the dependent variable is 'SuccessScore' for the ordered probit model and 'SuccessIn 5' for the probit model (as a robustness check). The political environment variables are defined above. The vector of transaction controls includes 'TargetAge,' 'ln(Total_Amt),' and 'ClubDealDummy.' The vector of buyout controls includes the attributes of the buyout fund or average attributes of syndicate members in club deals. Specifically, the characteristics are 'ln(AvgCapitalMGT),' 'AvgOfFirmAge,' 'AvgOfFirmSuccess,' 'AvgIndSuccess,' and 'AvgStateSuccess.'

The results show that our theoretical model fits our data (see Table 5, Model 5). The coefficients of our focal covariates of interest indicate that the likelihood of a successful exit is 6.6 percent higher when the most recent presidential election prior to the buyout transaction has been won by a Republican candidate ($p < 0.01$). Thus, we find support for Hypothesis 1b. In addition, the history of political conditions has a significant impact. We observe a 14.3 lower level of exit success in the case of 'TurnedBlue,' that is, for transactions made

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Table 3. Local political environment and buyout activity

Variables	(1)	(2)	(3)
Count Of Offices	0.0094***	0.0052***	0.0516***
	(0.0011)	(0.0013)	(0.0110)
Prev BO Activity	0.0356***	0.0391***	0.0185***
	(0.0013)	(0.0015)	(0.0017)
Target Fraction	0.0278***	0.0176***	0.0320
	(0.0037)	(0.0024)	(0.0186)
Age BO Activity	0.0194***	0.0185***	0.0120**
	(0.0027)	(0.0030)	(0.0048)
Red State		0.1573***	0.0861**
		(0.0557)	(0.0409)
Turned Blue			−0.2107***
			(0.0796)
Turned Red			0.1657**
			(0.0854)
Census Bureau-designated areas F.E.	no	no	yes
Time F.E.	no	yes	yes
Industry F.E.	no	no	yes
#of observations	750	750	750
Nonzero Observations	545	545	545
Zero Observations	205	205	205
Log likelihood	−2746	−2369	−1751
Prob > chi 2	0.0000	0.0000	0.0000
z value for Vuong test of ZIP vs. standard Poisson	12.44	9.55	8.58

*, **, *** statistically distinct from 0 at the 10, 5, 1%level, respectively.

in a state in which Democrats won the most recent presidential elections prior to the buyout when the preceding presidential elections were won by the Republican candidate ($p < 0.05$). Results suggest a positive, yet insignificant, effect of 'TurnedRed.' Together, these results provide partial support for Hypothesis 2b and are consistent with the view that a change in institutional context toward the political right increases the number of attractive buyout targets.

We undertake a number of additional checks to test the robustness of our findings to differences across states regarding unionization of labor (using annual states and industries unionization rates) and reverse causality (using socio-demographic variables to predict variation in election results). Our reported results have not changed.

SUMMARY AND CONCLUSION

This paper explores the relationship between politics and business conduct by investigating the influence of institutional context on levels and performance of buyout acquisitions. Our findings indicate that the success of a given strategy is inherently linked to the degree to which the local institutional environment facilitates or constrains the implementation of this strategy. We hypothesize that the institutional context aligned with the Democratic Party platform creates direct or indirect friction and, therefore, increases the costs of implementing the mechanisms through which buyout investors create value. Thus, it negatively impacts the volume and performance of local buyout activity.

Findings suggest that local political beliefs do indeed have a statistically significant and economically meaningful impact on the volume and performance of buyouts. Specifically, we find a higher likelihood of buyout transactions and successful outcomes for companies headquartered in states where the dominant institutional context is Republican and vice versa. Furthermore, we find an interesting effect from shifts in dominant political views that have an additional impact on buyout volume and activity. Situations in which the dominant political view recently shifted from Republican to Democratic lead to particularly low levels of activity and performance.

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Table 4. Descriptive statistics for the determinants of the exit success of individual transactions

Variables	Mean	s.d.	min	max	1	2	3	4	5	6	7	8	9	10	11	12	13	14
1 Success Score	0.2727	0.4926	−1	1														
2 Success In 5	0.2109	0.4080	0	1	0.714													
3 Target Age	13.4619	9.5381	1	71	0.041	0.041												
4 ln(Total_Amt)	8.9741	1.9751	0.69	15.29	0.033	0.026	0.178											
5 Club Deal Dummy	0.3886	0.4875	0	1	0.066	0.062	0.024	0.148										
6 ln(Avg Capital MGT)	7.0987	1.6312	0.41	10.49	0.089	0.090	−0.056	0.147	−0.056									
7 Avg Of Firm Age	12.7337	11.5159	0.33	131.00	0.004	0.018	−0.021	0.016	0.011	0.189								
8 Avg Of Firm Success	0.3136	0.1839	0	1	0.451	0.431	−0.104	−0.093	0.067	0.201	0.083							
9 Avg Ind Success	0.3250	0.0746	0.27	0.80	0.147	0.164	−0.104	−0.068	0.088	0.080	0.037	0.167						
10 Ave State Success	0.3256	0.0888	0	0.90	0.138	0.117	0.002	−0.024	0.036	0.045	0.123	0.093	0.084					
11 Red State	0.4517	0.4977	0	1	0.052	0.030	−0.024	−0.022	0.005	−0.050	−0.039	−0.024	−0.059	−0.105				
12 Turned Blue	0.0927	0.2900	0	1	−0.018	−0.029	−0.009	−0.002	−0.035	0.047	−0.017	0.037	0.048	−0.030	−0.329			
13 Turned Red	0.0482	0.2142	0	1	0.037	0.024	0.036	0.046	0.021	−0.055	0.020	−0.106	0.019	0.091	0.279	−0.092		
14 State Union Mem	10.2436	5.0364	1.9	26	−0.058	−0.071	0.093	0.078	0.063	0.094	0.104	0.205	0.135	0.106	−0.362	0.094	−0.142	
15 Industry Union Mem	11.7184	7.5304	0.5	45	−0.074	−0.053	0.064	0.090	0.071	0.108	0.187	0.166	0.179	0.215	−0.287	0.113	−0.163	0.406

Our results regarding the impact of within-country variation in political context complement existing work in the area of institutional theory that has largely studied cross-country phenomena (e.g., Kostova and Zaheer, 1999; Miller and Eden, 2006; Rosenzweig and Singh, 1991; Westney, 1993; Zaheer, 1995; Chan *et al*., 2008; Meyer *et al*., 2009). In this context, it is important to keep in mind that the private equity governance structure has been argued to be superior to the public corporation (Jensen, 1989) in terms of transaction costs related to the internal organization of economic activity (Williamson, 1975; 1985). Hence, interstate variations in the determinants of transaction costs related to the external institutional context could be more easily observed in this particular case.

We see this study as a first step toward a deeper understanding of the ways in which institutional context acts as a moderator of performance consequences in alternative corporate development strategies. Given our findings, further research that uses more fine-grained measures of institutional context seems well warranted.

Accordingly, our results point to a number of avenues for future theoretical and empirical research. Promising areas of analysis include the impact of institutional context on other corporate development strategies, such as growth-oriented or technology-grafting acquisitions or strategic alliances. Similarly, a more detailed assessment of the exact mechanisms through which local political context influences firm conduct and performance is also likely to lead to interesting findings that would complement the present study. Finally, additional research on the role of changes in institutional context on firm conduct and performance seems warranted, possibly based on a longitudinal research design.

While we use industry and state data on union membership as a proxy, we acknowledge that our data do not allow us to study the impact of differences in union incentives across firms. We predict that buyouts renegotiating the cost structure of an acquired firm will find substantial differences between unions that have an equity stake in the firm compared to unions that try to sustain only job security and benefits. It seems that the current shakeouts in the automobile industry serve as a good example.

One can also derive several normative implications from our study. First, our results indicate

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Table 5. The determinants of the exit success (successscore) of individual transactions

Variables	(1)	(2)	(3)	(4)	(5)
Target Age	0.0042**	0.0064*	0.0037**	0.0029*	0.0027*
	(0.0021)	(0.0034)	(0.0018)	(0.0013)	(0.0013)
In(Total_Amt)	0.0152***	0.0203**	0.0228***	0.0232***	0.0246***
	(0.0056)	(0.0101)	(0.0097)	(0.0110)	(0.0107)
Club Deal Dummy		0.1949***	0.0831***	0.0723**	0.0713**
		(0.0346)	(0.0367)	(0.0401)	(0.0417)
In(Avg Capital MGT)		0.0396***	−0.0072	−0.0098	−0.0099
		(0.0107)	(0.0115)	(0.0135)	(0.0134)
Avg Of Firm Age		0.0002	0.0019	0.0039	0.0034*
		(0.0015)	(0.0016)	(0.0018)	(0.0017)
Avg Of Firm Success			3.2589***	3.2832***	3.2794***
			(0.1146)	(0.1285)	(0.1284)
Avg Ind Success			0.8054	1.0913	1.2876
			(2.6628)	(2.9014)	(2.9055)
Ave State Success			1.2639***	1.2435***	1.7111***
			(0.2032)	(0.2432)	(0.2468)
Red State				0.0943***	0.0638***
				(0.0344)	(0.0361)
Turned Blue					−0.1569**
					(0.0733)
Turned Red					0.0421
					(0.0940)
Industry F.E.	no	yes	no	yes	yes
Investment Vintage F.E.	no	no	yes	yes	yes
Census Bureau-designated areas F.E.	no	no	no	no	yes
#of observations	4385	4385	4385	4385	4385
Log likelihood	−4782	−3972	−3840	−2817	−2658
Prob > (Chi)∧2	0.0000	0.0000	0.0000	0.0000	0.0000

*, **, *** statistically distinct from 0 at the 10, 5, 1% level, respectively.

that differences in transaction costs related to the implementation of restructuring-oriented strategies between red and blue states may not be accurately reflected in the acquisition price. This points to the need for acquirers and sellers to pay closer attention to local institutional conditions and to adjust their valuation metrics (such as the required hurdle rate or the valuation multiple) accordingly. Acquirers who develop 'location-specific' valuation skills seem to be able to generate higher returns than their counterparts who lack these skills. It seems plausible that as the motivation for some transactions becomes less driven by availability of debt financing and as corporate earnings soften, those 'location-specific' skills will become more important. At the same time, the fact that PE firms are major donors in presidential elections is cast in a different light by our results. These firms' support of Republican candidates seems rational from a business point of view, as a broad shift in opinion toward the Democratic platform will be expected to have negative consequences for the activity and performance of their funds.

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