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Investor Reaction to Covert Corporate Political Activity

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Research summary: Citizens United v. Federal Election Commission *and subsequent developments created a covert channel for firms to allocate resources from corporate treasuries to political activity. Through the use of a financial market event study of an accidental disclosure of firms' contributions to a Republican nonprofit organization, I examine investors' reactions to covert investment in independent political expenditures. I find that, on average, contributing firms experienced positive abnormal returns around the disclosure event and that these abnormal returns were more positive for firms in heavily regulated industries as well as those previously making campaign contributions to candidates. However, firms that recently faced a shareholder resolution on political spending disclosure experienced negative abnormal returns, suggesting that the controversial nature of covert activity moderated investors' reactions.*

Managerial summary: *The purpose of this study is to examine how investors reacted to an accidental disclosure of firms' investments in "dark money," a new form of corporate political activity allowed by the U.S. Supreme Court in its* Citizens United *decision. I find that, on average, investors reacted positively toward firms identified as making these new political investments, especially if the firms previously engaged in electoral politics or operate in heavily regulated industries. However, this reaction turned negative if the firm recently faced a shareholder resolution asking that it voluntarily disclose all of its political investments. An implication for managers is that they should consider their firms' legal and information environments as fully as possible before committing resources to new and potentially controversial political tactics.*

The debate over the effect of corporate political activity (CPA) on firm performance has grown substantially as a result of increasing firm investments in CPA (Bonica, 2016), and more significantly, the prominence of the U.S. Supreme Court's decision in *Citizens United v. Federal Election Commission* (FEC) in 2010. As Werner (2011), and Stratmann and Verret (2015) discussed, *Citizens United*, and subsequent court and regulatory decisions created new channels through which firms may legally invest additional resources in the electoral process both directly and indirectly. These political investments take the form of unlimited independent political expenditures (IPE) that corporations, using general treasury funds, can make directly or can fund through contributions to IPE-only committees (so-called "Super PACs") that disclose their contributors or nonprofit entities formed under section 501(c) of the federal tax code that do not have to disclose their contributors.[1] The latter option allows

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[1] Unions and individuals also gained greater freedom to make IPEs as a result of *Citizens United* and subsequent deregulation. As a result, the share of campaign spending from noncandidate sources has grown. For example, according to the Center for Public Integrity, outside groups were responsible for over 23% of the advertising expenses in gubernatorial races in 2016 (as of October 3), an increase from 18% in 2012 when these same offices

for the covert use of CPA to influence electoral outcomes, which in turn, complicates academic and managerial arguments over the efficacy of corporate investment in politics as the costs and benefits of covert activity is more difficult to monitor and evaluate than disclosed forms of CPA, which are already complex and long-term investment options (see, e.g., Hadani, 2012; Hadani & Schuler, 2013).

As a result, and despite the *Citizens United*'s prominence, investors' views on firms' use of IPEs remain unclear. Several event studies of the Court's decision in the case have produced mixed results. Werner (2011), and Burns and Jindra (2014) found no effect for the decision based on firms' prior political engagements, though the latter study finds that regulated firms experienced positive abnormal returns around the decision's announcement. In contrast, both Yuan (2015), and Stratmann and Verret (2015) found positive abnormal returns for firms based on prior engagement in electoral politics (but not lobbying) and regulation levels, though these two studies disagree as to how persistent these effects are. These differing results appear to be driven by and sensitive to several research design choices, including the events modeled, the event windows estimated, the firms sampled, and the measures of prior political engagement employed. One weakness that all four studies share is that they are all *anticipatory* studies of investors' reactions to the decision's effect and are not based on the *actual* use of IPEs.

In contrast, the event study in this article examines reactions to an instance of *revealed* IPE investment. To do so, I exploit a case of accidental disclosure, in which the names of contributors to the Republican Governors' Public Policy Committee (RGPPC), a 501(c)(4) nonprofit that makes IPEs under the control of the Republican Governors' Association (RGA), were published in the *New York Times* on September 24, 2014 (Weisman, 2014). The *Times* reported the names of 91 firms that contributed to the RGA's committee, 66 of which were publicly traded.[2] To motivate theoretically why investors would react positively to this disclosure event, I employ the political markets framework of Bonardi, Hillman, and Keim (2005), using it and the broader logic of political exchanges (see, e.g., Buchanan & Tullock, 1962) to argue that the forms of CPA allowed by *Citizens United* increase the attractiveness of the demand- (i.e., firm-) side for CPA as they enhance the resources firms can employ to gain a competitive advantage in the nonmarket environment (see, e.g., [Dahan, 2005] for a resource-based view of CPA).

Beyond leveraging this accidental disclosure empirically to speak to Hadani and Schuler's call to explore the effects of "this judicial decision [*Citizens United*], as well as its relationship to firm financial performance" (2013, p. 178), this article ultimately offers three contributions to the nonmarket strategy literature. First, as mentioned in the prior paragraph, I extend the political markets approach and integrate it with a resource-based view of politics by theorizing as to how covert CPA enhances the attractiveness of the demand side of political markets. Further, I also identify a boundary condition on this enhancement in the form of activist shareholders' antipathy toward covert CPA. Second, I examine the effect of engagement in CPA at the state level in the United States, in contrast to the existing literature that largely focuses on the national level (Hadani & Schuler, 2013). This empirical contribution both reveals how the U.S. states represent attractive political markets from the supply side and suggests that national-level findings regarding how regulation affects CPA and firm performance apply at the state level. Third, I demonstrate that investors appear to view covert CPA in the form of IPEs as a complement to traditional financial nonmarket strategies (i.e., the resources firms were previously allowed to employ in the electoral arena) (Hillman & Hitt, 1999) as investors reacted more favorably toward the disclosure of the use of IPEs if firms were previously engaged electorally, but not if they employed informational nonmarket strategies focused on lobbying.

were last on the ballot, and in an analysis of 2014 state legislative and gubernatorial elections, the Brennan Center for Justice found that 501(c) organizations were responsible for over 70% of outside spending.

[2] Despite the limitations of examining any one instance of a complex strategy such as CPA, especially when such a small number of publicly traded firms engage in it, exploring this instance of accidental disclosure to estimate investor reactions to covert CPA is critical as mandatory disclosure of such activity is unlikely. Not only has Congress failed to require disclosure, but in the continuing resolutions funding government agencies that passed in 2015 and 2016, it also prohibited both the Securities and Exchange Commission (SEC) and the Internal Revenue Service (IRS) from using funds to engage in rulemaking on the subject. Additionally, in an October 2015 joint letter, the heads of the Business Roundtable, National Association of Manufacturers, and the U.S. Chamber of Commerce encouraged their members to resist pressure to disclose voluntarily their political activity (Levinthal, 2016).

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The remainder of the article begins by detailing the institutional context of state-level politics and introducing the RGA as a political organization. The next section motivates the main hypothesis as well as three moderating hypotheses that predict the variation observed in the cross-section of abnormal returns of the disclosed RGA contributors. Following that, I detail the market-wide event study employed to test the main hypotheses, present the empirical estimates from it, and evaluate their robustness; I then repeat these steps for the cross-sectional analysis of contributing firms. To preview my results, the market-wide event study reveals that investors reacted positively to the disclosure event, with the firms disclosed as contributors to the RGA experiencing positive abnormal returns on average, and the cross-sectional analysis suggests that these reactions were more positive for firms in heavily regulated industries and for firms that previously engaged in financial nonmarket strategies. However, firms disclosed as contributors that previously faced a shareholder resolution calling for voluntarily disclosure of their use of IPEs ultimately experienced negative abnormal returns on average. The article concludes by discussing the study's limitations, and its managerial and scholarly implications.

Institutional Context: U.S. State Politics and the Republican Governors Association

Most empirical work on CPA focuses on the national level in the United States due to data availability as well as the perceived higher stakes of federal policies. For a variety of reasons, this emphasis is under-inclusive in capturing firms' nonmarket environments and how they vary in terms of their attractiveness for political investment. The U.S. states represent attractive political markets for firms due to their supply- and demand-side characteristics: Not only do the states play a significant role in determining public policy outcomes of interest to business, but also marginal spending by outside groups appears to have a larger impact on state elections due to their lower costs and lower salience to the average voter. To provide institutional context for investor reactions to the case of accidental disclosure analyzed in this article, this section outlines the importance of the states as policymakers, examines electoral dynamics at the state level, and discusses the RGA as an electoral actor.

Roughly 20% of U.S. economic activity is regulated by state governments (Teske, 2004). Policy areas of concern to business that state governments have large influence over include infrastructure, insurance, utilities, health care, education, and taxes. Tort, contract, corporate, and criminal law, all of which help shape the market environment of business, are largely created and enforced by the states as well. Individual states can also affect public policy, and in turn, firm decision-making beyond their borders: Delaware and Nevada corporate law govern the majority of U.S. firms; the "California effect" is a well-documented empirical phenomenon in which that state's government has effectively set national, if not international, standards for some policies (Vogel, 1997); and one state's legislation can become a model bill for other policymaking jurisdictions, helping to reduce regulatory uncertainty for firms (see, e.g., Fremeth & Richter's [2011] discussion of California's e-waste legislation). Finally, state governments also have the authority to preempt local ordinances passed within their boundaries.

Combined, the above attributes provide a supply-side rationale for CPA targeted toward affecting state policymaking, and firms have increasingly dedicated resources to nonmarket strategies aimed at influencing state governments. Between 2010 and 2014, while the number of registered lobbyists in Washington, D.C., declined by 25%, the number of registered lobbyists in state capitals increased by 10% (Kettl, 2016).

Business interests have also engaged in electoral politics at this level because of demand-side considerations. Most importantly, state elections appear to be of low salience to the public. Survey evidence indicates that half as many voters pay attention to state politics as to national politics (Leiserowitz, Maibach, & Roser-Renouf, 2009), and fewer than 20% of voters can identify their state legislators (Vanderbilt University Poll, 2013). Whether disinterest or a lack of media coverage drives this ignorance, the low information nature of state elections makes it easier for special interests to have influence, which in turn, makes state elections a more attractive political investment. For example, businesses' use of IPEs to influence state elections has had a dramatic effect on Republicans' fortunes in state contests: Klumpp, Mialon, and Williams (2016) found that the probability of a Republican candidate winning a state house election post-*Citizens United* increased by 4%;

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comparable effects for the decision have not been found in federal-level elections, perhaps due to the well-documented diminishing returns for campaign spending in high information contests (e.g., Levitt, 1994).

The specific channel through which firms made investments in state-level nonmarket strategy analyzed in this article is the RGPPC, a 501(c)(4) nonprofit arm of the RGA founded in 2004. The RGPPC is run by the RGA, which states that its "primary mission is to help elect Republicans to governorships throughout the nation," leaving little doubt as to the political nature of these organizations. However, given its relative youth and its subsidiary nature, the RGPPC represents an unconventional and nonobvious lever for influence in state-level politics.

Beyond their covertness, contributions to the RGA and its affiliates may be particularly attractive for several supply-side reasons. First, governors are key policymakers with the power to veto legislation in every state and the power to appoint regulators in many states. This makes them powerful actors in economic policy debates of concern to business (Kousser & Phillips, 2012). Second, since the 1980s, there has been a clear link between the partisanship of state policymakers and the liberalism of the policy they produce (Caughy, Warshaw, & Xu, 2016), giving business a powerful motivation to promote Republican candidates. Third, the RGA is a key player in a "vertically networked" Republican Party apparatus across the states, which allocates contributors' monies at the state level in the manner it finds most electorally efficient (Hamm, Malbin, Kettler, & Glavin, 2014). Thus, a contribution to the RGA's RGPPC is almost akin to a contribution to the party directly, and from these modest contributions ($25,000–$250,000), as the *Times* reported, corporate donors gained direct access to Republican governors and their senior staff. This institutional background illustrates how the characteristics of state politics and policymaking make the states an attractive target for CPA; the next section hypothesizes as to how investors will react to the disclosure of covert investment in CPA.

Investor Reactions to Investment in Covert CPA

As Hadani (2012) noted, CPA is a complex, long-term strategic option for firms that is difficult for shareholders to assess in terms of its impact on future firm financial performance. Thus, following the lead of Oler, Harrison, and Allen (2008), I examine firms' abnormal returns around the accidental disclosure event "not … as completely accurate predictions of the longer-term performance implications … " but instead, "as the collective opinions of investors regarding these implications, similar to an opinions survey" (p. 172). In doing so, I adopt Schijven and Hitt's (2012) behavioral perspective for their argument that "share prices reflect only public information, although much, if not most, information about complex organizational events is not publicly available … " (p. 1248) is apt in this instance of accidental (and likely only partial) disclosure of firms' engagement in covert CPA. In this section, I build off of the political attractiveness approach of Bonardi et al. (2005), as well as new subsets of the nonmarket strategy literature on covert CPA and contention around CPA, to argue that investor reactions to the disclosure will be positive, but that these reactions will also be moderated by existing information on managers' political investments in and shareholders' attitudes toward CPA.

The theoretical case for positive investor reactions to CPA broadly rests on politicians being willing to supply firms with revenue growth opportunities (Hillman, Keim, & Schuler, 2004), influence over regulations (Oliver & Holzinger, 2008), or connections/policies that could make firm a more attractive merger or joint venture partner (Baron, 1995). To the degree that firms are able to make greater demands for such policy outcomes because they have greater resources (e.g., money, information, or votes) than other policy demanders (Dahan, 2005), investor reactions ought to be more positive still. Buttressing these arguments, studies show correlations between CPA and firm performance in specific industries, such as the airlines (Shaffer, Quasney, & Grimm, 2000) and utilities (Bonardi, Holburn, & Vanden Bergh, 2006) as well as firm-level correlations between the number of candidates a PAC supports and positive abnormal returns (Cooper, Gulen, & Ovtchnikov, 2010), and between lobbying expenditures and lower effective tax rates (Richter, Samphantharak, & Timmons, 2009).

Although these broader supply- and demand-side dynamics provide a rationale for a positive relationship between firm investment in CPA and investor reactions generally, they do not speak to how

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investors might react to the disclosure of firms' use of the nonmarket financial tactics allowed by *Citizens United*. As detailed in Table 1, which compares and contrasts the legal regulation of the most common forms of CPA (i.e., firms' demand-side resources), there are three key differences between the IPEs allowed by *Citizens United* and political action committee (PAC) contributions, the traditional way firms have engaged in the electoral process. First, unlike PAC contributions, IPEs can be funded from the corporate treasury; PAC contributions are made by a PAC affiliated with a firm, but the firms' employees and shareholders are the source of the contributions, placing an upper limit on how much a PAC can raise, and thus, contribute. Second, the amounts firms can expend on individual IPEs and in aggregate are unlimited; PAC contributions are subject to a relatively low contribution limit to any individual politician or political party and limited in aggregate by the number of counterparties. Combined, these two differences suggest that investors may view IPEs as breaking firms free from the "arms race" dynamic between business and its opponents in the realm of campaign finance (Gray & Lowery, 1997), as they allow firms to deploy unlimited resources that are harder for other policy demanders to replicate and dissipate (Hillman & Hitt, 1999).[3] Third, because firms have the ability to channel their IPEs through a third-party organization, they can break the direct tie linking themselves and politicians, which politicians, as policy suppliers who must seek reelection, may appreciate for fear of being stigmatized via guilt by mere association with firms (McDonnell & Werner, 2016). The trade-off in employing IPEs versus traditional PAC contributions is that the funds do not end up in the candidates' campaign coffers, but there is strong anecdotal evidence that private signaling occurs in which contributors to outside groups make their gifts known to the supported politicians.[4]

That private signaling occurs helps us understand why firms, if they choose to make IPEs, would choose to do so covertly through a 501(c) nonprofit rather than a SuperPAC. SuperPAC contributions, as with a firm's contributions via a PAC, are subject to quarterly reporting with the FEC. Because CPA is viewed negatively by broader society (Smith, 2000), firms face important societal constraints with regard to their engagement in politics (Hiatt & Park, 2013) that may lead managers, investors, and policymakers to prefer that firms engage covertly. In this context, since public disapproval of *Citizens United* is quite strong,[5] and various individual firms—including most prominently Target Corp. for its involvement in the 2010 Minnesota gubernatorial election—have seen damage done to their brands after having contributed to outside spending groups (Torres-Spelliscy, 2016), investors may prefer that managers avoid overtly exploiting the opportunities created by the decision, all else equal.

This preference for discreet engagement may also be informed by firms' already substantial use of resources to engage in politics covertly prior to *Citizens United*. Covert channels that do not require disclosure that firms use include trade associations (501[c]6 business leagues) (Barnett, 2012), informal sponsorships of social movements' boycotts against competing firms (McDonnell, 2016), and "grassroots" campaigns designed to indirectly influence politicians on a firm's behalf (Walker, 2014). Thus, 501(c)4s' introduction as a new financial nonmarket resource available to firms is a natural extension of firms' covert activities, and it is one that is attractive on the demand side because it can be employed at a low marginal cost as the organizational forms involved are minimal in cost yet robust (Barnett, 2012).[6]

[3] These first two attributes also applied to soft money, the unlimited contributions that firms could give directly to the political parties prior to 2002. Through an event study of the elimination of soft money contributions, Ansolabehere, Snyder, and Ueda (2004) found no effect for this restriction on the stock prices of contributing firms, suggesting that investors did not value this channel for political engagement. However, the IPEs here are different from soft money in two key ways: First, they can be used for express advocacy for or against a candidate and not just issue advertising (removing any legal ambiguity regarding their use); and second, if the IPEs are made via a 501(c) organization, then the names of those funding IPEs do not have to be disclosed (provided the contributor did not earmark their contributions specifically for IPEs), unlike those of soft money contributors.

[4] A different campaign finance-related leak provides insights on this point. In a batch of documents leaked to *The Guardian* newspaper, communication between Republican Wisconsin Governor Scott Walker and outside groups supporting his campaigns and political agenda revealed that the latter set of actors made clear to the governor who contributed to their efforts (Gold, 2016).

[5] A Bloomberg News poll in September 2015 found that 78% of respondents disagreed with the decision, disapproved of the new forms of CPA it allowed, and wanted it overturned. See http://www.bloomberg.com/politics/articles/2015-09-28/bloomberg-poll-americans-want-supreme-court-to-turn-off-political-spending-spigot.

[6] Because 501(c)6 business leagues also do not have to disclose their donors, firms could use them to engage in nonmarket financial strategies covertly; however, since most of these organizations

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Table 1
Legal Regulations on Corporate Political Activity (Excluding Individual Employees' Activity)

Political spending category/type	Source of funds	Funds given to/ spent on	Limits on contributions/spending	Disclosure of firm's role required?
Lobbying expenditures	Corporate treasury	In-house/contract lobbyists, research, informational advocacy	None	Yes, quarterly (post-2007)
Political action committee (PAC) contributions	Restricted class of employees and shareholders, and their spouses	Candidate, party campaign committees; other PACs (administrative costs of PAC may be paid by firm directly from corporate treasury)	$5,000 to candidate/election; $15,000 to national party/year; $5,000 to state party or other PAC/year	Yes, quarterly
Contributions to a national party committee account				
Directly by firm	Corporate treasury	Local nonpartisan host committee for national party convention	None	Yes, during presidential cycle
via a PAC	Restricted class of employees and shareholders, and their spouses	Recount/legal fees; facilities; national party convention	$45,000 to each party committee (i.e., national, Senate, House)/year	Yes, quarterly
Communications costs	Corporate treasury	Informs employees/shareholders of political issues, firm endorsements	None	Yes, quarterly and in communication
Issue advocacy (excluding "grassroots campaigns")				
Directly by firm	Corporate treasury	Advocates for a public policy position without expressly advocating for/against a candidate	None	Yes, quarterly and in advertisement
via 527	Corporate treasury	Tax-exempt organization that advocates for a public policy position without expressly advocating for/against a candidate	None	Yes, quarterly
Independent expenditures (post-*Citizens United*)				
Directly by firm	Corporate treasury	Advertising, etc., that can expressly advocate for/against a candidate	None	Yes, quarterly and in advertisement
via "Super PAC"	Corporate treasury	Candidate- or party-affiliated (though independent) or ideological committees that engage in express advocacy	None	Yes, quarterly
via 501(c)(4) or (c)(6)	Corporate treasury	Nonprofit, tax-exempt organization that can expressly advocate for/against a candidate	None, but political activity may not be "primary purpose" of a 501(c)(4)	No, as long as funds are not earmarked for political activity

are trade associations focused on a single industry, it is less difficult to intuit (or for activists to assume they can intuit) which firms contribute to them than to a 501(c)4 organization that has an anodyne name or is associated with a political party that has a multitude of financial backers.

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Additionally, firms may prefer covert engagement via 501(c)4s over SuperPACs because disclosure often creates risks for firms, decreasing the demand-side motivation for CPA. Specifically, "good" firms often make for "good" activist targets as they gain a reputation for acquiescing to activists' demands: As McDonnell, King, and Soule (2015) demonstrated, more transparency leads companies to face more activist challenges and to concede to activists at a higher rate. Should they choose to deploy IPEs as a resource, managers might then opt for a 501(c)4 to curtail such challenges and the limitations on firm strategy they can introduce.

Summarizing these arguments, to the degree that *Citizens United* increases the attractiveness of political markets by (a) increasing the financial resources that firms can offer (albeit indirectly) political candidates they favor, and (b) allowing politicians, as image-conscious policy suppliers, to accept such support covertly, we ought to expect positive investor reactions to the disclosure of covert CPA. Although Bonardi et al. (2005) argued that financial support, as a nonmarket resource, does not allow for differentiation, they obviously could not anticipate the changes ushered in by *Citizens United*, and how the unlimited and covert nature of the new resources at firms' disposal would affect the attractiveness of political markets.

Of course, the attractiveness of these new resources from both a demand- and a supply-side perspective may be mitigated by the salience of this new form of engagement to other policy demanders (i.e., shareholders and voters who dislike such forms of CPA), but any associated controversy should simply drive firms wanting to exploit IPEs toward the darker channel of doing so (i.e., 501[c]s) as it makes it more difficult for competing policy demanders to monitor a firm's behavior. Importantly, this concept—the salience of the resources employed by firms to other stakeholders and the limits/opportunities this salience creates—extends Bonardi et al.'s framework, and as is discussed further in the motivation for Hypothesis 4 below, places a boundary condition on the expectation of positive investor reactions to the disclosure of IPEs.

Finally, the disclosure of covert CPA does, of course, beg the question: If covertness is a key attribute of the activity, then why do we not see *negative* shareholder reactions to disclosure. That is, if transparency eliminates the benefit to the politician discussed above, and thus, dissipates any competitive advantage firms may have due to their use of covert CPA, then their share prices ought to *decline* abnormally around the event. However, there are several reasons we may not see such a reaction, at least in this instance. First, the disclosure of the RGA contributors is a novel event, reducing the informational asymmetry between shareholders and management by releasing to the market, for the first time, details regarding the concrete benefits to engaging in covert CPA. That is, if investors previously had doubts as to the value of firm investments in covert contributions to organizations such as the RGA, then the access granted to contributors detailed in the *Times*'s article ought to have assuaged some of their concerns. In fact, despite its implication for the disclosed firms' immediate competitive advantage in the nonmarket environment, investors may have reacted positively to the firms covered by article, given what they might view as a large return on a small political investment.

Second, it is important to remember that investors are likely reacting to more than just the minimal amounts of covert CPA accidentally disclosed through the RGA leak as it only minimally reduced the information asymmetry between shareholders and management. That is, although only these small political investments and the significant benefits derived from them were leaked, the disclosed contributors may have been investing larger resources contemporaneously or have had plans to increase such political investments. If investors made such inferences and viewed the disclosed information as the "tip of the iceberg" in terms of firms' covert CPA and the benefits thereof, then a positive reaction to the disclosure could be viewed as investors believing that these activities were consistent with the firms' broader strategic goals. Such a positive investor reaction might also serve to incentivize the disclosed firms to continue making IPEs as part of a long-run relational nonmarket strategy and to signal to other firms to engage in covert CPA. Together, these arguments lead to Hypothesis 1:

> *Hypothesis 1 (H1): Firms making covert political contributions will experience positive investor reactions around disclosure of their contributions.*

Moderating Effects on Investor Reactions to Covert CPA

When formulating their reactions to firm behavior, "boundedly rational investors attempt to

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gain insight into management's better informed perceptions … [which] should, in principle, reduce the information asymmetry that investors face" (Schijven & Hitt, 2012, p. 1248). Thus, although a market-wide event study focused on testing Hypothesis 1 can identify investors' average reaction to the disclosure of firms' covert political investments, it cannot disentangle the mechanisms behind that reaction (Krier, 2005). To do so, we can examine how existing information about the disclosed firms' nonmarket environments, including their managements' prior engagement in CPA and their investors' prior views on it, may further close information asymmetries. This section hypothesizes as to how three firm-level attributes may moderate investor reactions: regulation, prior CPA investment, and prior contention over CPA.

First, investors may react more positively to regulated firms being disclosed as covert contributors because the need to manage nonmarket environment uncertainty and to establish political connections are greater in regulated industries in which the government, including the states, has greater control over firm resources and prospects (Hart, 2001; Holburn & Vanden Bergh, 2008; Pfeffer & Salancik, 1978). Due to this demand-side need, the relationship between regulation and engagement in CPA is one of best documented in the nonmarket strategy literature (see, e.g., Grier, Munger, & Roberts, 1994; Shaffer, 1995), with regulation being shown to affect strategic decisions across a variety of industries, including utilities (Russo, 2001), pharmaceuticals (Mathieu, 1997), telecommunications (de Figueiredo & Tiller, 2001), and manufacturing (A. King & Lenox, 2000). Further, this activity bears fruit: In their study of federal-level lobbying's effect on firm performance, Hadani and Schuler (2013) found a positive association between the two only for the subset of the S&P 1,500 firms in regulated industries.

Given that regulation at the state level also has important consequences for an array of firm activities, including merger and acquisition approval in some sectors (Holburn & Vanden Bergh, 2014), and corporate governance for all firms (Werner & Coleman, 2015), we ought not to expect regulated firms to accept state-level regulations as exogenously supplied and strategically adapt to them, but rather to influence them via CPA. Thus, to the degree that covert CPA via IPEs facilitates access to and potentially increases influence over state regulators directly or indirectly through gubernatorial appointments (e.g., Holburn & Vanden Bergh, 2008), their use ought to have more positive consequences for regulated firms.[7] Although not a novel argument, this logic suggests that investor reactions will be more positive for disclosed contributors that operate in regulated industries. Hypothesis 2 formally captures this dynamic:

> *Hypothesis 2 (H2): Investor reactions to the disclosure of firms' covert political activity will be positively associated with firm membership in regulated industries.*

A second attribute of management's decision-making in the nonmarket environment that may moderate investors' reactions to the disclosure of covert CPA is investors' information on a firm's pre-existing investments in CPA. Specifically, investors may react more positively to the degree that a firm's novel CPA investments (e.g., RGA contributions) complement its existing dedication of resources to electoral strategies, as the former political investments are less easily monitored, and thus, replicated, and the latter political investments may indicate an already attractive demand-side for CPA. With regard to the latter, campaign contributions have been linked to contributors having greater understandings of politicians' behavior (Kroszner & Stratmann, 2005; Snyder, 1992), benefiting from barriers to entry in political markets (Dahan, 2005), and having increased access to public policymakers (Kalla & Broockman, 2016; Werner, 2015). Access is a key source of competitive advantage in the nonmarket (Oliver & Holzinger, 2008) as it provides firms with difficult to acquire information that affects market strategy formulation (Hillman, Zardkoohi, & Bierman, 1999). Thus, to the extent that covert CPA is a resource for supplementing investment in traditional financial nonmarket tactics via an unconventional route such as a 501(c)4, investors may react more positively toward firms that previously made campaign contributions as this signals a novel bundling of tactics that is less easily replicated or dissipated (Dahan, 2005) as well as the development of nontraditional nonmarket capabilities.

[7] Access to and influence over policymakers are obviously different nonmarket outcomes, but many scholars have argued that the former is a prerequisite for the latter (Keim & Zardkoohi, 1988; Werner, 2015) as access is associated with legislators dedicating more time and attention to contributors' concerns (Hall & Wayman, 1990).

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This effect may be heightened further as a firm's cumulative political investments increase (Hadani & Schuler, 2013), reflecting its relational capital vis-à-vis the policymakers it seeks ultimately to influence. These expectations lead to Hypothesis 3:

> *Hypothesis 3(H3): Investor reactions to the disclosure of firms' covert political activity will be positively associated with firms' prior investment in financial nonmarket strategies.*

As discussed in the motivation of Hypothesis 1, covert CPA has proven highly controversial. This dislike for the decision in *Citizens United* has motivated politicians, activist investors, legal academics, and public pension managers to pressure firms either to not engage in IPEs or to disclose when they do so. For example, in both 2014 and 2015, political issues constituted over 25% of shareholder resolutions (Welsh & Passoff, 2015), and through December 2015, the SEC had received over 1.2 million public comments in favor of a proposed rule that would have mandated disclosure of all forms of CPA.

Activists and activist investors use tactics such as shareholder resolutions against firms to problematize practices they disagree with, decreasing the attractiveness of related investments (B. G. King, 2011). Thus, being a target of such activism in the past may affect how investors react to the disclosure of a firm being among the RGA's contributors, representing an important boundary condition on covert CPA's effect on the attractiveness of political markets. For example, Hadani (2012) highlighted a poll of shareholders conducted by Mason–Dixon and printed in the *Wall Street Journal*, which found that 85% of those surveyed viewed undisclosed forms of CPA as leading to agency issues.[8] Given these attitudes, we might expect investors to react more negatively toward a firm disclosed as a covert contributor to the RGA if it were known that the firm had previously faced a shareholder resolution on CPA disclosure. That is, disclosure of covert CPA in the wake of being challenged on that practice might raise concerns among investors regarding the firm's management of its nonmarket environment and could potentially trigger further activism against the firm, which in turn, could signal potentially greater risk in the firm's future (Vasi & King, 2013) as well as greater political costs and uncertainty (Ingram, Yue, & Rao, 2010). These arguments lead to the final hypothesis I test:

> *Hypothesis 4 (H4): Investor reactions to the disclosure of firms' covert political activity will be negatively associated with prior firm-level contention over covert CPA.*

Market-wide Event Study

As discussed in the introduction, on September 24, 2014, the *New York Times* identified 66 publicly traded firms as covert contributors to the RGA's independent political expenditure arm, and I exploit the *Times*'s reporting of these contributors' names to identify how investors reacted to the disclosure of the firms' investment in covert CPA. Because the *Times* controlled the timing of its reporting and it is the disclosure of this information that investors are reacting to, I can treat the newspaper's story as an exogenous shock that released new information to the market.[9] As a result, and similarly to the four studies that analyze the decision in *Citizens United* as well as other research examining changes in the regulation of nonmarket strategy

[8] One strain in the broader nonmarket strategy literature theorizes that agency problems are responsible for a negative relationship between CPA and firm performance. Studies in this vein view managers as engaging in CPA at shareholders' expense, and evidence in favor of this view includes Aggarwal, Meschke, and Wang (2012), which found that firm-level soft money and 527 contributions are correlated with decreases in market valuation; Coates (2012), which found that CPA is correlated with other executive perquisites; Bliss and Gul (2012), which found that engagement in CPA decreases firms' perceived credit worthiness; and Werner and Coleman (2015), which found that the ability of firms to make IPEs to influence state elections is associated with the passage of antitakeover statutes.

[9] As the *Times*'s story details, the paper received the information on the RGA's contributors from the public interest group Citizens for Responsibility and Ethics in Washington (CREW). CREW appears to have given the *Times* the first right to make this information public as similar reporting did not appear in any other newspaper on this date, and CREW itself did not issue a press release or provide web access to the RGA documents until the day *after* the *Times* published its article (see http://www.citizensforethics.org/the-documents-the-republican-governors-association-doesnt-want-you-to-see/). These circumstances allow me to make a strong claim for the exogeneity of the reporting; nevertheless, in a robustness check below, I account for potential informational leakage. Additionally, because investors are reacting to the disclosure of this information, as opposed to the act disclosed, selection into being an RGA contributor is of less concern; however, in Appendix S1, I address any lingering selection concerns in my cross-sectional analyses of the CARs around the *Times*'s story.

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(e.g., Ansolabehere et al., 2004), I am able to leverage this publication via an event study of financial market returns in order to assess investors' reactions, keeping in mind the caveats raised by Oler et al. (2008), and Schijven and Hitt (2012) discussed previously.

Before I estimated the market-wide event study, I determined whether or not any of the 66 disclosed firms experienced confounding events on or around September 24, 2014, or already voluntarily disclosed their contributions to 501(c)4 organizations. Using Factiva and firms' 8-K filings with the SEC, I searched for confounding events including corporate restructurings, joint ventures, acquisitions, litigation, executive changes, and layoffs; major price changes in services/products; new product/service announcements; dividends or earnings announcements; changes in forecasted earnings; debt-related events; and contract awards. Similarly, using the 2013 version of the Center for Political Accountability's CPA-Zicklin Index, I determined whether any of the RGA contributors already disclosed their 501(c)4 contributions as the *Times*'s story would not be releasing new information to the financial market under such circumstances. Of the 66 contributing firms, I identified 14 that experienced at least one confounding event during the time period of interest or that voluntarily disclosed their contributions to 501(c)4s. Thus, I excluded these 14 firms, leaving a sample of 52 firms for this market-wide analysis.

To conduct the event study, I first employed a standard market model to estimate the relationship between the returns of each publicly traded firm in the CRSP data set (Firm return_{it}) and the value-weighted returns of a market-wide index (Market return_t) over an estimation window consisting of all trading days (t) in 2013 and 2014 (through August 31, 2014).[10] To do so, I estimated the the following regression:

$$\text{Firm return}_{it} = b_0 + b_1 \text{Market return}_t + e_t. \quad (1)$$

Second, using the parameter estimates from Equation (1), I then calculated each firm's daily expected returns and used the prediction errors (i.e., $\text{Firm abnormal return}_{it} = \text{Firm return}_{it} - \left[\widehat{\beta}_0 + \left(\widehat{\beta}_0 + \widehat{\beta}_1 \text{ Market return}_t\right)\right]$) as sample firm i's daily abnormal return.[11] Third, I calculated each firm's cumulative abnormal return (CAR_i) by summing firm i's abnormal returns over a chosen event window. Given the exogenous nature of the disclosure event, I focused my analysis on a short event window of [0,1], but I also estimated longer event windows of 5, 10, and 20 days post-event to capture additional time investors may have needed to react, given the complicated nature of CPA.[12] Finally, to test Hypothesis 1, I compared the CARs of the disclosed firms to those of the remaining market participants. A major complication for the last step of this event study is that all firms experienced the disclosure event on the same day, which introduces contemporaneous correlation and biases the traditional tests employed to assess statistical significance in event studies toward over-rejection of the null hypothesis. To account for this issue, I employed the adjusted Patell's *Z* and Standardized Cross-Sectional *Z* tests developed by Kolari and Pynnönen (2010), and I used the *p*-values corresponding to these test statistics to assess statistical significance.

Event Study Results and Robustness

The first four rows of Table 2 report the main results of the event study. Across all four event windows in these rows, ranging from 1 to 20 days post-event, the firms disclosed as contributors to the RGA experienced positive cumulative abnormal returns, providing support for Hypothesis 1. Focusing on the narrowest event window of [0,1],

[10] Calculating the market models over the year and a half prior to the event addresses concerns regarding calendar day effects, and ending the estimation window at August 31, provides sufficient distance between it and any of the estimated event windows in this analysis or the robustness check that accounts for information leakage.

[11] The results presented for the market-wide event study are insensitive to using market model expected returns or using market-adjusted expected returns. In the cross-sectional analyses presented below, I employ the market model abnormal returns as my dependent variable and account for systemic risk by including Beta as a control variable.

[12] Oler et al. (2008) recommended estimating event windows as long as 36-months post-event when assessing an event's impact on firms' long-term performance. However, we are not yet 36 months post-event, and as these authors acknowledge (173), such longer-term evaluation requires large samples, for the number of confounding events affecting a small sample of firms would grow along with a longer event window, threatening critical identification assumptions. Additionally, longer event windows also exacerbate issues associated with cross-correlation in firm returns (Kothari & Warner, 2007), which, as is discussed further above, is already a significant issue for event studies in which all firms are "treated" at the same time.

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Table 2
Investor Reactions to the Disclosure of Covert Political Activity

Event window	Cumulative abnormal return (CAR) (%)	% positive returns (%)	Patell's *Z*	Patell's *Z* *p*-value	Standardized cross-sectional *Z*	Standardized cross-sectional *Z* *p*-value	Randomization pseudo-*p*-value
[0,1]	0.36	63.5	1.189	.060	1.620	.091	.066
[0,5]	0.71	51.9	1.841	.038	2.050	.018	.034
[0,10]	0.89	65.4	2.476	.007	2.505	.011	.016
[0,20]	1.94	63.5	2.689	.009	2.646	.006	.010
[−5,5]	0.51	55.8	1.219	.098	1.479	.083	.093
[−20,20]	2.13	71.2	2.508	.004	3.068	.008	.019

Note. Treated observations (n) = 52. *p*-values reported for Patell's *Z* and Standardized Cross-sectional *Z* are bootstrapped. All significance tests are two-tailed.

we can see that the cumulative abnormal return for the 52 disclosed firms modeled was 0.36%, with 63.5% of the disclosed firms experiencing positive abnormal returns around the event. The Patell and Standardized Cross-Sectional test statistics for these numbers correspond to *p*-values of .06 and .09, providing initial evidence to suggest these differences are meaningful statistically.

Consistent with Stratmann and Verret (2015), the substantive magnitudes of the disclosed firms' CARs grow as we elongate the event window, as does our statistical confidence. In the longest event window of [0,20], the CAR for the disclosed firms is +1.94%, and the *p*-values for the Patell's *Z* and Standardized Cross-Sectional *Z* are below .01. Taken together, the results across these four event windows provide us with substantial evidence that, on average, investors' immediate and short-run reactions to or opinion of the *Times*'s disclosure that these 52 firms had contributed to the RGA was positive.

I assessed the robustness of the market-wide event study results in two ways. First, although information leakage is unlikely to have plagued the disclosure event, I account for this possibility in the bottom two rows of Table 2, estimating two additional event windows of [−5,5] and [−20,20]. As the results in both of these rows indicate, the core finding that firms that were disclosed as contributors to the RGA experienced positive abnormal returns around the *Times*'s story holds. In both new windows, the CARs are similar to those estimated in the main analysis, although their statistical significance is more marginal in the [−5,5] event window.

Second, per McWilliams and Siegel's (1997) recommendation and due to the small number of firms that were disclosed as contributors in the event, for all of the event windows presented in Table 2, I estimated and present "bootstrapped" or randomization-based *p*-values in the final column of the table.[13] As this last column reveals, these pseudo-*p*-values are all significant at the $p < .10$ level, and they are all consistent with the *p*-values for the contemporaneous correlation-adjusted Patell's *Z* and Standardized Cross-Sectional *Z* tests presented in the main analysis, providing strong support for Hypothesis 1.

Exploring Cross-sectional Variation in Abnormal Returns

Although the results of the market-wide event study demonstrate that immediate investor reaction to the disclosure of contributions to the RGA was positive on average, they do not allow us to test Hypotheses 2−4, which theorize as to how variation in the CARs for RGA contributors relate to various firm-level attributes typically associated with reactions or outcomes related to firms' CPA. To test these hypotheses, we can estimate the following cross-sectional model using ordinary least squares (OLS) regression:

$$\mathrm{CAR_i} = \mathrm{b}_0 + \mathrm{b}\mathbf{Z_i} + \theta\mathbf{X_i} + \psi_\mathrm{j} + \mathrm{e_i}, \qquad (2)$$

[13] These pseudo-*p*-values were generated following McWilliams and Siegel's approach and represent the proportion of disclosed firms' CARs generated using data from the estimation window that were greater in magnitude than the CAR for these firms during the actual event window; the smaller this number, the more extreme (and unlikely due to chance) we can view the actual event's CAR as being.

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in which CAR_i is firm i's cumulative abnormal return for the [0,1] event window; $\mathbf{Z_i}$ is a vector of the variables of interest operationalized to test Hypotheses 2–4; $\mathbf{X_i}$ is a vector of control variables; and, to control for the possibility that industry-specific events or characteristics might confound this analysis, ψ_j are industry fixed effects based on one-digit SIC membership.

To test Hypothesis 2, which focuses on regulated industries, I coded a dummy variable (Regulation), with firms in regulated industries being coded as 1, and those not as 0. Regulation is defined using Coates's (2012) mapping, which identifies the following Fama-French 48 industries as regulated: 4 (alcohol), 5 (tobacco), 13 (drugs), 24 (aircraft), 26 (guns), 27 (gold), 30 (oil), 31 (utilities), 32 (telecom), 40 (transportation), 44 (banks), 45 (insurance), and 47 (finance). Because this mapping of regulated industries includes several regulated only at the national level, I also estimated model specifications that employ Coates's more narrowly defined subset of heavily regulated industries as a dummy (alcohol, tobacco, aircraft, drugs, utilities, telecom, transportation, banks, and insurance), as with the exceptions of aircraft and drugs, these industries are subject to substantial regulation at the state-level in the United States.[14]

Hypothesis 3 explores how using state-level IPEs might complement other financial nonmarket tactics firms previously employed. I tested this hypothesis by examining whether contributing firms' CARs increase in the margin with their PACs' giving in the last full election cycle (2011–2012) prior to the disclosure event, using a variable that measures the logged dollar amount (plus one) of their federal PAC contributions hand-matched to FEC data.[15] To separate any effect due to firms' informational nonmarket efforts, I also controlled for contributing firms' federal lobbying expenditures in the prior year (2013), using a variable that measures the logged dollar amount of their lobbying expenditures (plus one), as reported by OpenSecrets.org. Finally, because CPA may have a cumulative relationship with investors' reactions to it (see, e.g., Hadani & Schuler [2013] for evidence as to a relational capital effect for regulated firms), I ran model specifications that included contributing firms' PAC contributions over the three electoral cycles (2007–2012) prior to the disclosure event as well as contributing firms' lobbying expenditures over the five years (2009–2013) prior to the event.

To test Hypothesis 4, I operationalized whether specific firms' disclosed contributions were "controversial" for it by coding whether or not the firm faced a shareholder resolution regarding the disclosure of political activity made "with corporate funds or assets," whether "direct and indirect" during the 2013 proxy season. I gathered these data from Institutional Shareholder Services (ISS) and cross-checked them using Si2 and Proxy Impact's *Proxy Preview* (Welsh & Passoff, 2013) as the latter two organizations have been working directly with the Center for Political Accountability to offer such resolutions. I coded this variable as a simple binary, with 1 reflecting that a shareholder resolution was proposed and voted on.

The control variables included in $\mathbf{X_i}$ (all measured as of December 31, 2013) capture other firm-level attributes that may have affected the firms' returns around the disclosure event, including accounting performance, growth prospects, risk, size, and governance. The performance measures include Return on assets and 1-year change in sales (Sales delta) calculated using COMPUSTAT data; growth prospects were measured using Market-to-book ratio calculated using COMPUSTAT data; risk was captured both by including Leverage (total liabilities/total assets from COMPUSTAT) and Beta (calculated using a market model based on firms' monthly returns from 2013 using CRSP data); and total assets (logged) from COMPUSTAT proxied for firm size. These measures of performance, growth, risk, and size are important to include as evidence suggests firms with weaker financial health are more likely to engage in CPA (e.g., Adelino & Dinc, 2014) as are larger firms (Bombardini, 2008).

Finally, because IPEs, such as these firms' contributions to the RGA, are subject to potential agency issues that may affect both whether firms use them

[14] From a resource dependence perspective, drug firms also are highly sensitive to state policymaking, but through the states' role as large customers via the Medicaid program rather than through their role as regulators.

[15] Ideally, I would have used measures of the RGA contributors' campaign contributions and lobbying expenditures at the state level to test this hypothesis. Unfortunately, there are not data of this nature available that are reliable enough for academic research. The closest are data provided by the National Institute for Money in State Politics, but as a study prepared by the RAND Corporation (2014) for the Institute discusses, there are significant questions as to whether the quality of the information it provides is sufficient. For example, Benz et al. (2011) found that over 27% of the 222,592 state-level PAC records from the Institute that they examined were duplicative or contained errors. Additionally, the NIMSP only recently made available partial state-level lobbying data in beta format, and the quality of these data is unclear.

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Table 3
Descriptive Statistics for Cross-sectional Analysis in Table 5 (n = 45)

Variable	Mean	Std. Dev.	Min.	Max.
Cumulative abnormal return (CAR) [0,1]	0.004	0.013	−0.029	0.043
Regulated industry	0.533	0.505	0.000	1.000
Heavily regulated industry	0.422	0.499	0.000	1.000
2012 Cycle PAC contributions[a]	4.657	1.913	0.000	6.243
2013 Lobbying expenditures[a]	5.571	2.079	0.000	7.314
2007–2012 PAC contribtuions[a]	5.039	2.061	0.000	6.662
2009–2013 Lobbying expenditures[a]	6.179	2.305	0.000	7.913
Shareholder resolution	0.022	0.149	0.000	1.000
Return on assets	0.071	0.047	−0.011	0.195
Sales growth	0.063	0.131	−0.125	0.437
Market-to-book ratio	0.387	0.298	−0.643	1.252
Leverage	0.612	0.177	0.227	1.265
Beta	0.669	1.139	−4.434	2.427
Assets[a]	11.904	0.975	9.651	13.991
Blockholder percentage	0.224	0.188	0.000	0.979

[a] Variable is log-transformed.

(Hadani, 2012), and thus, how shareholders react to the disclosure of their use (Aggarwal et al., 2012), I controlled for firm governance by using MSCI data on blockholder share ownership (Blockholder percentage). I focused on blockholders as a governance metric as previous research shows that blockholders have a greater financial interest in scrutinizing managerial decision-making, have more access to managers, and can place more demands on management via their voting rights (Shleifer & Vishny, 1997). The nature of this relationship particularly manifests itself with regard to managers' more significant investment decisions (Edmans, 2014), including the public policy positions advocated for on behalf of the firm.

The availability of these additional data reduced the sample for the cross-sectional analyses by seven firms, dropping the *n* from 52 in the market-wide event study to 45 firms in this analysis. The sample descriptive statistics for the above variables appear in Table 3, and Table 4 reports the correlations between the variables. Of particular importance, Table 3 reports that the mean CAR [0,1] for the 45 firms in this reduced sample is essentially the same as that for the 52 firms in the market-wide event study, lessening worries of sample attrition bias affecting this subsample analysis. Additionally, as Table 4 shows, with the exception of the bivariate correlation between CAR [0,1] and Regulated industry, all of the correlations between CAR [0,1] and the variables of interest are signed as expected, and (unreported) tests run after the OLS models presented below revealed that multicollinearity is not a threat to estimation.

Cross-sectional Results

The results of the cross-sectional analyses are presented in Table 5. They provide partial support for Hypothesis 2 as well as clear support for Hypotheses 3 and 4. Models 1 and 2 focus on testing Hypothesis 2 that membership in a regulated industry is associated with higher CARs among contributing firms. Model 1 reveals that there is no support for this claim when we examine all regulated firms (53% of the sample per Table 2), but Model 2 shows that there is mild support for Hypothesis 2 ($p = .065$) when we conceptualize regulation more narrowly and focus on only those firms in heavily regulated industries (42% of the sample). Using the estimates in Model 2, we can calculate and compare the average CARs [0,1] for both non-heavily regulated (−0.20%, statistically insignificant) and heavily regulated industries (+1.17%; $p < .02$), demonstrating that investors' reactions to the disclosure event were strongly associated with the degree of regulation faced by the disclosed contributor's industry. This finding comports with the findings of Hadani and Schuler (2013), who found positive associations between national-level CPA and firm performance but only for firms in regulated industries as well as Stratmann and Verret (2015), Yuan (2015), and Burns and Jindra (2014), who all

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Table 4
Correlation Matrix for Cross-sectional Analysis in Table 5 (n = 45)

Variable	1.	2.	3.	4.	5.	6.	7.	8.	9.	10.	11.	12.	13.	14.
1. CAR [0,1]														
2. Regulated industry	−0.035													
3. Heavily regulated industry	0.097	0.800												
4. 2012 Cycle PAC contributions[a]	0.109	0.181	0.226											
5. 2013 Lobbying expenditures[a]	0.055	0.236	0.183	0.459										
6. 2007–2012 PAC contribtuions[a]	0.129	0.172	0.212	0.997	0.453									
7. 2009–2013 Lobbying expenditures[a]	0.082	0.239	0.191	0.469	0.998	0.464								
8. Shareholder resolution	−0.218	0.141	0.176	−0.013	−0.007	−0.015	0.003							
9. Return on assets	0.044	−0.356	−0.307	0.062	−0.092	0.079	−0.098	−0.064						
10. Sales growth	−0.185	−0.050	0.024	−0.395	−0.158	−0.390	−0.166	0.259	−0.096					
11. Market-to-book ratio	−0.297	0.345	0.307	0.021	−0.061	0.013	−0.058	0.054	−0.526	0.049				
12. Leverage	0.218	0.070	0.150	0.203	0.095	0.196	0.099	−0.045	−0.302	−0.164	−0.202			
13. Beta	−0.029	0.104	0.027	0.568	0.231	0.577	0.221	−0.108	0.113	−0.196	−0.144	0.202		
14. Assets[a]	−0.151	0.280	0.289	0.731	0.557	0.722	0.550	−0.081	−0.069	−0.324	0.227	0.134	0.421	
15. Blockholder percentage	−0.017	0.013	0.008	−0.287	−0.376	−0.288	−0.374	0.053	−0.298	−0.043	0.133	−0.011	−0.307	−0.462

[a] Variable is log-transformed.

found positive abnormal returns around the decision in *Citizens United* for regulated firms that had previously engaged in electoral politics at the national level.

Models 3 and 4 test Hypothesis 3 while still controlling for heavy regulation at the industry level. In Model 3, firm PAC contributions for the 2011–2012 cycle are included to see if RGA contributors' CARs increase inline with their prior engagement in a financial nonmarket strategy, and firm lobbying expenditures from 2013 are employed as a control. The results partially support Hypothesis 3, with 2012 PAC contributions being positively associated with CARs and marginally statistically significant ($p < .091$). Lobbying expenditures in 2013 are also positively signed, but statistically unassociated with firms' CARs, consistent with Werner (2011). In terms of its substantive impact, if an RGA contributor were to increase its PAC contributions from the mean level ($45,414.13) to $100,000, its CAR would increase by 0.116%. The findings of Model 4, in which prior cumulative CPA is measured, parallel those for Model 3 but are stronger: PAC contributions (for the three most recent cycles) are statistically significant ($p < .05$) and positively signed, and there is no association between lobbying expenditures and CAR. As an RGA contributor's three-cycle PAC contributions increase from $100,000 (just below the sample mean) to $500,000, the contributor's CAR rises by 0.255%.

The results for these four variables suggest that investors' reactions were more positive as firms had more experience not in politics generally, but specifically with regard to engaging in electoral campaigns. That is, investors, perhaps taking a cue from management's prior political investments, appear to have viewed contributing resources to the RGA more favorably if doing so complemented a firm's existing electoral investments, but saw no relationship between the use of IPEs and lobbying expenditures. One potential reason behind the lobbying nonresult is Bertrand, Bombardini, and Trebbi's (2014) finding that lobbyists' connections are more important than their substantive expertise—thus, to the extent that lobbying expenditures reflect already established access to politicians, investors may not view them as complementing a new tactic aimed at further increasing access. A second potential explanation relates to the lack of control firms have over these new electoral investments versus lobbying expenditures; while firms can be very specific

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Table 5
*Explaining Cross-sectional Variation in Cumulative Abnormal Returns (*CAR*s) Following the Disclosure of Covert Political Activity*[a]

Dependent variable:	Model 1 *CAR* [0,1]	Model 2 *CAR* [0,1]	Model 3 *CAR* [0,1]	Model 4 *CAR* [0,1]	Model 5 *CAR* [0,1]
Regulated industry	0.010				
	(0.009)				
Heavily regulated industry		0.014	0.013	0.013	0.014
		(0.007)	(0.007)	(0.007)	(0.007)
2012 Cycle PAC contributions[b]			0.003		
			(0.002)		
2013 Lobbying expenditures[b]			0.001		
			(0.001)		
2007–2012 PAC contributions[b]				0.004	0.004
				(0.002)	(0.002)
2009–2013 Lobbying expenditures[b]				0.001	0.000
				(0.001)	(0.001)
Shareholder resolution					−0.027
					(0.013)
Return on assets	−0.049	−0.057	−0.064	−0.067	−0.070
	(0.065)	(0.063)	(0.066)	(0.065)	(0.062)
Sales growth	−0.016	−0.027	−0.020	−0.019	−0.010
	(0.020)	(0.019)	(0.019)	(0.019)	(0.018)
Market-to-book ratio	−0.005	−0.009	−0.008	−0.007	−0.009
	(0.011)	(0.011)	(0.011)	(0.011)	(0.010)
Leverage	0.016	0.008	0.009	0.009	0.007
	(0.016)	(0.015)	(0.015)	(0.015)	(0.014)
Beta	−0.001	−0.001	−0.003	−0.003	−0.003
	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Assets[b]	−0.006	−0.006	−0.010	−0.011	−0.011
	(0.003)	(0.003)	(0.004)	(0.004)	(0.004)
Blockholder percentage	−0.019	−0.018	−0.020	−0.020	−0.019
	(0.015)	(0.014)	(0.014)	(0.014)	(0.013)
Constant	0.061	0.074	0.111	0.116	0.120
	(0.040)	(0.04)	(0.044)	(0.043)	(0.041)
Industry FEs?	Yes	Yes	Yes	Yes	Yes
Observations (*n*)	45	45	45	45	45
r^2	0.29	0.34	0.39	0.43	0.51

[a] Models 1–5 report OLS estimates; across all models, standard errors reported in parentheses.
[b] Variable is log-transformed.

in how they deploy the latter, due to legal constraints, their control over the former is limited to the initial contribution to a third-party organization. Thus, while managers can likely ensure IPEs are broadly inline with firms' strategic electoral preferences based on the initial contribution, they have little ability to coordinate these IPEs and their lobbying expenditures.

In Model 5, the variables for heavily regulated industry as well as cumulative CPA are included, as is the binary indicatory for shareholder resolution that tests Hypothesis 4. In this fully saturated model, the results for *Heavily regulated industry* and three-cycle PAC contributions remain positive and statistically significant ($p < .04$ and .03, respectively) and are comparable to their magnitudes in the earlier models. Additionally, the *Shareholder resolution* variable is significant, negative, and substantively large, providing strong support for Hypothesis 4. Investors appear to have reacted very negatively toward a firm if it faced a shareholder resolution on the topic of political disclosure in the prior year and then was disclosed as a contributor to the RGA, with such firms experiencing an average CAR 2.7% lower than the other contributors. Similar to prior research on activism's effects, this finding may speak to why firms would like to keep such investment in CPA covert, lest they become the target of shareholder activism and see the potential benefits of CPA turn

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into realized burdens. Patterns in proxy proposals provide support for this supposition, as the percentage of the 66 RGA contributors that faced a shareholder resolution regarding disclosure of their political spending rose by 20% between the year before and the year after the accidental disclosure event per data from ISS.

Finally, in terms of the control variables, only *Firm size* (the log of total assets) is consistently statistically significant across Models 1–5, and it is negatively signed, which is consistent with the findings of Stratmann and Verret (2015), who found that the market did not anticipate that larger firms would benefit from the *Citizens United* ruling. Although this association may be due to fears of rent extraction, as firms with more assets might find themselves on the receiving end of requests for more contributions from groups that make independent expenditures or politicians who want these expenditures made on their behalf, it should be noted that the substantive effect is not large, in part, due to how little firm size varies over the sample and the scale of the underlying variable.

In terms of robustness, the results presented in Table 5 hold when alternative windows are employed to construct the dependent variable and when the independent variables related to prior PAC contributions are split by the partisanship of their recipient. Further, if a Heckman model is utilized to assuage concerns regarding "selection into treatment," the results are virtually identical statistically and substantively to Model 5's results in Table 5. Due to space considerations, these analyses' results are summarized here and presented in greater detail in Appendix S1.

Discussion and Conclusion

This article contributes theoretically and empirically to the nonmarket strategy literature. Theoretically, it provides more nuance to our understanding of the attractiveness of the demand-side for nonmarket activity both by identifying how a new resource available to firms (IPEs funded from the corporate treasury) may allow for greater differentiation among competing policy demanders and by highlighting how the salience (i.e., controversial nature) of IPEs as a resource places a boundary condition on their use and effectively requires firms to employ them covertly, so as to protect their reputations and those of the policy suppliers (i.e., politicians) they are trying to access and influence. These dual understandings help us tie the literatures on the resource-based view of politics (Dahan, 2005) and covert CPA (e.g., Walker, 2014) into models of firms' nonmarket strategy decision-making (e.g., Bonardi et al., 2005) as well as integrate firms' use of IPEs into political science and sociology literatures that argue that business' power is more conditional than is often appreciated (Smith, 2000; Yue, 2015). Interestingly, in the case of IPEs, the boundary condition on firms' instrumental political power is imposed by their own stakeholders, in the form of shareholders' negative reactions to firms' use of IPEs when they previously faced a proxy resolution on political disclosure, and not by the state or broader public.

Empirically, this article provides evidence as to how investors react to firms' *actual* engagement in the tactics allowed by *Citizens United*, as opposed to existing studies, which are all *anticipatory*. At least with regard to the context studied here (contributions to a state-level Republican 501[c]), investors reacted positively to firms' use of covert CPA, and the variation in the disclosed firms' abnormal returns squares with existing understandings of when CPA, broadly conceptualized, is most valuable and how different forms of CPA complement one another. Additionally, the findings presented here demonstrate the supply-side attractiveness of state-level political markets and specifically provide insights as to how state-level regulation (i.e., "heavy" regulation) affects the relationship between CPA and firm performance.

Managerial Implications

The limited nature of the event analyzed in this study restricts the managerial lessons that we can infer from it. As Oler et al. (2008) argued, "For organizational events that are complicated or novel, decision-makers should exercise caution when deciding how much weight to give to information regarding immediate market reactions" (p. 174). Nevertheless, there are two noncontroversial implications that this study supports. First, as in many other realms of nonmarket strategy, firms' actions are not riskless. In this particular case, the new resource of corporate treasury-funded IPEs has been met with both widespread public disapproval and shareholder skepticism. As the support for Hypothesis 4 reveals, this latter set of concerns appears to moderate investors' reactions to the

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disclosure of CPA, and thus, managers may be wise to consider more thoroughly their shareholders' attitudes when formulating nonmarket strategy. For shareholders themselves, the undisclosed nature of IPE investment creates governance challenges. Although the actual sums invested in IPEs are immaterial, the reputational risks management runs in both the market and nonmarket by making use of this resource are not trivial. Shareholders have recourse either via resolutions seeking voluntary firm-level disclosure or public policy that would mandate disclosure by all firms; given the current political environment in the United States, mandatory disclosure is unlikely, suggesting that shareholder resolutions, perhaps combined with pressure from groups such as the Center for Political Accountability, are the best avenue for those seeking to minimize this information asymmetry.

A second implication of these results is that the context of firms' broader nonmarket environments is key to understanding investors' immediate reactions to covert CPA. Thus, any contemplated use of the new resources for CPA opened by *Citizens United* should be done in light of the nonmarket realities firms already face. That is, whether or not a firm is regulated (H2) and the degree to which using IPEs complements the resources a firm already employs in executing its nonmarket strategy appear to be key determinants of investors' reactions to firms' covert CPA. With regard to the latter, as the support for Hypothesis 3 shows, investors reacted more positively toward disclosed RGA contributors who were already making use of a PAC, suggesting that IPEs' ability, as a resource, to make financial nonmarket strategies difficult to replicate and dissipate may provide firms with a competitive advantage.

A final managerial consideration stemming from these findings relates to the broader ethical questions raised by CPA generally. From even the most conservative standpoint, if firms use their power in electoral politics at the state level to distort public policy by seeking or protecting rents for themselves, they may be violating their "social license to operate" (see, e.g., Néron, 2016). Additionally, by participating in CPA covertly, firms may be contributing to or creating electoral information asymmetries that make it difficult for citizens to know who is providing financial support to candidates for public office, raising the question of whether this form of CPA harms democratic accountability.

Limitations and Suggestions for Future Research

As just mentioned, the key limitations of this study are that I have only one incident of accidental disclosure to analyze and that only a relatively small number of firms were involved in this single incident. Recognizing that there is a trade-off between causal inference and "learning from samples of one or fewer" (March, Sproull, & Tamuz, 1991), I must acknowledge that the empirical inferences we can draw are limited in terms of their representativeness. For example, it is unclear if my results would necessarily hold if contributions were made to a Democratic-affiliated nonprofit or to a more controversial, highly ideological actor such as the Americans for Prosperity, rather than a 501(c) organization affiliated with one of the major parties. The link between the RGA's 501(c) and Republican governors is relatively straightforward, and investors may have viewed contributions to the former group as providing a clear return in terms of access to the latter group. These conditions may not hold in other IPE settings, as the mechanisms (e.g., access) that lead financial market participants to believe that the return on these new political investments will be positive will not be as readily discernable, and contributions to nonparty-linked organizations may be more controversial to shareholders and shareholder activists. Similarly, it is unclear if these findings would hold if the contributions studied were made to an organization attempting to affect federal elections as they are high information contests that are less easily moved by outside spending.

Additionally, it is unclear if the positive abnormal returns will hold over a longer term or if we will see similar patterns in other, accounting-based measures of performance. However, estimating longer event windows is difficult due to an increasing number of confounding events narrowing the sample further and due to cross-correlation issues in the abnormal returns being further exacerbated. Further, since the disclosure event occurred just over two years ago, the ability to conduct a long-term analysis of any performance metric is limited.

Finally, this study opens a number of new dimensions for scholars of nonmarket strategy to explore. First, there is much more work to be done to examine the effects of state-level policymaking on firm performance in the United States as well as how firms attempt to influence this relationship. Much of this phenomenon is measurable, though

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currently there are significant data quality issues. Second, there is also a need to study firms' use of nonprofit organizations (both social welfare groups as well as business leagues) for CPA as well as firms' broader decision-making with regard to adopting overt versus covert nonmarket tactics. These questions raise difficult research design issues, however, due to the lack of disclosure; thus, future research may require a qualitative turn, employing tools such as anonymous surveys and interviews in order to tease out the adoption and effects of these new nonmarket resources.

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Supporting Information

Additional supporting information may be found in the online version of this article:

Appendix S1. Supporting information files.
Table S1. Explaining cross-sectional variation in cumulative abnormal returns (*CAR*s) following the disclosure of covert political activity, varying event window length.
Table S2. Explaining cross-sectional variation in cumulative abnormal returns (*CARs*) following the disclosure of covert political activity, reducing PAC contributions to Republican counterparties only.
Table S3. Explaining cross-sectional variation in cumulative abnormal returns (*CAR*s) following the disclosure of covert political activity, summing PAC contributions and lobbying expenditures.
Table S4. Explaining cross-sectional variation in cumulative abnormal returns (*CAR*s) following the disclosure of covert political activity, accounting for "selection into treatment."

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