ISSN 1045-6333

HARVARD

JOHN M. OLIN CENTER FOR LAW, ECONOMICS, AND BUSINESS

CORPORATE GOVERNANCE AND CORPORATE POLITICAL ACTIVITY: WHAT EFFECT WILL CITIZENS UNITED HAVE ON SHAREHOLDER WEALTH?

John C. Coates IV

Discussion Paper No. 684

09/2010

Harvard Law School
Cambridge, MA 02138

Corporate Governance and Corporate Political Activity: What Effect will *Citizens United* have on Shareholder Wealth?

First draft: September 21, 2010

John C. Coates IV
John F. Cogan, Jr. Professor of Law and Economics
Harvard Law School

Abstract

In *Citizens United*, the Supreme Court relaxed the ability of corporations to spend money on elections, rejecting a shareholder-protection rationale for restrictions on spending. Little research has focused on the relationship between corporate governance – shareholder rights and power – and corporate political activity. This paper explores that relationship in the S&P 500 to predict the effect of *Citizens United* on shareholder wealth. The paper finds that in the period 1998-2004 shareholder-friendly governance was consistently and strongly negatively related to observable political activity before and after controlling for established correlates of that activity, even in a firm fixed effects model. Political activity, in turn, is strongly negatively correlated with firm value. These findings – together with the likelihood that unobservable political activity is even more harmful to shareholder interests – imply that laws that replace the shareholder protections removed by *Citizens United* would be valuable to shareholders.

Corporate Governance and Corporate Political Activity:
What Effect will *Citizens United* have on Shareholder Wealth[*]

In *Citizens United*, the Supreme Court relaxed the ability of corporations to spend money on elections, and in so doing, it rejected a shareholder-protection rationale for restrictions on spending, in part on the ground that shareholders are generally capable of defending their own interests through "corporate democracy."[1] Another possible (but unstated) reason for the Court's rejection of shareholder protection as a basis for restrictions on the political activities of corporations is that there has been surprisingly little research focused on the relationship between corporate governance – shareholder rights and power – and corporate political activity. This paper explores that relationship in the S&P 500 to predict the effect of *Citizens United* on shareholder wealth.

The paper finds that in the period 1998-2004 shareholder-friendly governance was consistently and strongly negatively related to observable political activity before and after controlling for established correlates of that activity, even in a firm fixed effects model. Political activity, in turn, is strongly negatively correlated with firm value. These findings – together with the likelihood that unobservable political activity is even more harmful to shareholder interests – imply that laws that replace the shareholder protections removed by *Citizens United* would be valuable to shareholders. If as seems likely Congress eventually enacts legislation responding to *Citizens United*, or otherwise attempting to protect shareholders in the corporate political sphere, the evidence presented here should help demonstrate that such legislation serves as a legitimate and compelling purpose separate from the anti-corruption and other purposes that have traditionally justified campaign finance laws.

Part I briefly (a) describes the US Supreme Court's decision in *Citizens United*, and (b) reviews relevant literatures on (1) corporate governance and its relationship to shareholder wealth, and (2) corporate political activity. Part II develops hypotheses to be tested, and describes the data used to test the hypotheses. Part III summarizes data on corporate governance, corporate political activity, and shareholder wealth. Part IV relates the data on corporate political activity to the data on corporate governance. Univariate and multivariate results are presented, and the robustness of the findings is tested with alternative specifications. The paper then briefly concludes with implications for law and policy.

[*] I extend thanks for comments and discussions to Dick Fallon, Frank Michelman, Rick Pildes, Jesse Fried, Heather Gerken, and participants in the Harvard Law School Faculty Workshop and ... [other commenters]. Jin-Hyuk Kim graciously provided data on corporate political activity.

[1] 558 U.S. __ (2010) at 46 (quoting *Bellotti*, 435 U. S. 765, 794 & n. 34). The Court also asserted that the laws at issue in the case were poorly tailored to the goal of shareholder protection. For a critique of the Court's legal and institutional analysis on that and other points, see Coates 2010.

1. Prior Literatures

1.1. Citizens United

In *Citizens United*, the US Supreme Court decided that long-standing laws barring corporations (and unions) from making independent political expenditures were unconstitutional under the First Amendment. Those laws effectively constrained corporations from actively campaigning on behalf of politicians in the period from World War II through 2010, greatly curtailed the amount of money that corporations could spend even indirectly on election activity, and reduced (though they did not eliminate) the ability of corporations to influence campaigns through contributions. Corporations have been permitted to establish and pay the expenses of political action committees (***PACs***) but may not donate corporate funds to those PACs, which must instead solicit donations from corporate managers, employees and shareholders. While those laws have not constrained lobbying – that is, efforts to present information and otherwise persuade lawmakers, once elected, to pursue particular policies – they have limited the ability of corporations to influence the choice of lawmakers by voters, and (since lawmaker time and attention is a limited resource) limited the effectiveness of past lobbying efforts. As discussed below, the complementary relationship between lobbying and election activities are established in the literature on corporate political activity. The clear implication is that *Citizens United* can be expected to increase all kinds of political activity by corporations.

If corporate managers could be trusted to spend corporate money on political activity that would benefit shareholders, then this relaxation in the constraints on corporate political activity might still be of concern to voters generally worried about the disproportionate power that the concentrated wealth represented by the largest corporations and its effect on government policy. Rent seeking of a sort beneficial to shareholders might be harmful to taxpayers or consumers, for example. But at least one would not worry about any additional burden of such activity on capital formation or the economic benefits that flow from well-governed public companies. Unfortunately, existing research establishes beyond doubt that, at least at a large number of public companies, managers cannot be trusted with other people's money, and that observable corporate governance provisions consistently predict the degree to which faithless managers divert shareholder wealth for their own ends, destroy corporate wealth, and reduce public welfare.

1.2. Corporate Governance

Corporate governance literature is vast, multidisciplinary and yet largely siloed – that is, articles in accounting journals cite other articles in accounting journals; articles in finance journals cite other finance articles; law review cite law reviews, and so forth, even when addressing topics related or even identical to those addressed in other disciplines. For surveys, see, for example, Shleifer and Vishny 1997 and Bischoff 2009. But few strands

of this literature have touched on corporate political activity (***CPA***).[2] Bischoff 2009 reviews 141 corporate governance articles published 1997 to 2009 and finds none focused on CPA. Instead, its focus has tended to be agency theory (Jensen and Meckling 1976): to what extent and how corporate managers (or dominant shareholders) act in ways that harm or fail to benefit shareholders (or minority shareholders), and to what extent and how contracts (for example, stock options), transactions (for example, hostile takeovers, buyouts), institutions (for example, boards, institutional investors, stock exchanges), or regulations (for example, Sarbanes-Oxley) can efficiently constrain agency costs. For example, Berle and Means 1932 posited that ***shareholder dispersion*** would increase managerial slack, enabling managers to obtain greater private benefits. Jensen and Murphy 1990 argued that increasing ***manager ownership*** (particularly through stock options) would align manager and shareholder interests. Shleifer and Vishny 1997 suggest that ***large blockholders*** can reduce managerial agency costs (albeit with the risk that they may create conflicts among shareholders), although other studies question this claim (for example, Ryan and Schneider 2002, Hendry 2006).

Gompers et al. 2003 show that firm-specific shareholder-friendly ***corporate governance provisions*** – found in corporate charters, bylaws, and executive contracts – correlate positively with firm value (as measured by industry-adjusted book/price ratios[3]), operating performance, and shareholder returns.[4] Bebchuk et al. 2009 show a similar set of correlations with a simpler index that is better grounded on theories relating corporate governance provisions to mechanism of corporate control, as first analyzed in Coates 2000. Bebchuk and Cohen 2005 and Faleye 2007 show a similar correlation between corporate value and what is arguably the most important corporate governance provision – the presence or absence of a ***classified board***, which imposes delay on the ability of shareholders to remove a majority of directors. Such a correlation can be partly explained by the effect that classified boards have on hostile takeovers, as shown by

[2] There are lines of corporate governance research that argue that ownership and control structures emerge in response to political pressures, or vice versa. For example, Roe 1994 argues that important features of US corporate governance result from general political suspicion of concentrated power; Roe 2003 argues that variation in ownership structures at large companies is explained by varying political pressure for redistribution; Morck et al. 2005, argue that corporate governance structures can result in high concentrations of corporate power in small elites, which in turn can result in socially harmful political and economic outcomes. But these lines of research generally take individual nations as units of analysis and do not attempt to explain or draw lessons from variation in corporate governance or CPA within a country.

[3] More precisely value is measured by a ratio somewhat misleadingly referred to as "Tobin's Q," which following Kaplan and Zingales 1997 is calculated as [BVA+MVCE-BVCE-DT] / BVA, where BVA is book value of assets, MVCE is current common stock market capitalization – that is, stock prices – BVCE is book value of common equity, which is typically a nominal value, and DT is the book value of deferred taxes. The original idea of Tobin's Q was to relate the market value of an asset to its replacement value, Tobin and Brainard 1977, but the market value of a firm's assets are not readily observable. If book and market values for a firm's assets diverge (as when a firm's assets include significant intellectual property), the value as so measured will differ from true Q.

[4] Core et al. 2006 confirm the finding of shareholder-friendly governance correlating with strong operating performance, but show that the finding of a correlation with shareholder returns was fragile and did not persist in the early 2000s, a change Bebchuk et al. 2010 confirm for the whole of the 2000s and attribute to investor learning. However, Bebchuk et al. 2010 show the correlation between governance provisions and corporate value (measured by industry-adjusted book/price ratios) persisted in the 2000s.

Bebchuk, Coates and Subramanian 2002, and first analyzed in Coates 2000. Finally, a number of studies (for example, Bebchuk and Fried 2004) have suggested that higher ***CEO pay*** will be extracted from firms with weaker shareholder rights.

All of these studies have potential endogeneity problems (for example, Listokin 2008). it is not implausible that corporate governance provisions are adopted or modified over time in light of actual or expected corporate performance. It is also likely that the models omit important unobservable causes of firm performance and value, and some of those omitted factors (for example, manager attitudes towards shareholders) may also be systematically correlated with governance terms. For policy purposes, it also seems likely that optimal governance will vary across firms, and that the parameters reflected in these studies may differ from those for out-of-sample firms (and perhaps for a majority of public companies). Still, these studies establish that governance provisions are reliable correlates of performance and value, and shift the burden of proof to those who believe that such provisions are epiphenomenal or derivative, and have no causal relationship with performance or value.

Among the few corporate governance scholars to address CPA, Brudney 1981 defended restrictions on CPA from a shareholder perspective, noting that early US corporations were limited in their activities by charter restrictions that would effectively have forbidden CPA, and defending a rule requiring a supermajority of (or even unanimity among) shareholders under the First Amendment. *Citizens United* and potential legislative responses have stimulated a few corporate governance papers focusing on CPA Bebchuk et al. 2010 argue that public company shareholders are more vulnerable to managerial agency problems in the CPA context than in other contexts, and argue for new legislative default rules (which shareholders could opt out of) requiring disclosure and prior shareholder approval of CPA. Gilson and Klausner 2010 worry that CPA risks involving public companies in polarizing debates and shareholder votes and argue for shareholder approval requirements so as to minimize the potential costs of such debates.

1.3. Corporate Political Activity

A smaller but still extensive literature in management, political science, and economics explores non-governance determinants of corporate political activity. Hillman et al. 2004 surveys articles in major scholarly journals 1995-2002 in strategic management, sociology, political science, economics, and finance on antecedents of CPA, and its effects on public policy and firm performance.[5] They report that independent ongoing CPA in the US is more common for firms that are ***larger*** (for example, Hansen and Mitchell 2000), ***more dependent on government*** (for example, more sales to government, Hart 2001, or more exports, Schuler 1999), ***diversified*** (for example, more business lines, Brasher and Lowery 2006), ***older*** (where firm age is generally interpreted as a proxy for firm "experience" or "reputation," for example, Baron 1995), and owned by US (as opposed to foreign) shareholders (for example, Getz 1996). Firms in ***concentrated***

[5] See also Potters and Sloof 1996, which surveys empirical studies in the public choice, economics, and political economy literatures on political activities of interest groups, including corporations.

industries tend to engage in more CPA (for example, Schuler et al. 2002),[6] and as firms often match competitors' contributions, CPA clusters by industry (for example, Grier et al. 1994). Brasher and Lowery 2006 find that ***US public companies*** are more likely to engage in lobbying than otherwise similar non-public US companies, a finding consistent with the general view from the corporate governance literature that managerial agency problems are more severe at public US companies than at non-public US companies, although this implication is not developed in that article.

Ansolabehere et al. 2002 show a strong complementarity between types of CPA, with over 86% of all contributions coming from firms with both a lobbyist and PAC; see also Schuler et al. 2002 (firms tend to combine contributions and lobbying). Contributions buy access, and lobbying exploits access to affect policy (see, for example, Wright 1990, Austen-Smith 1995, Tripathi et al. 2002). Kim 2008 compares determinants of contributions and of lobbying, and finds that empirical proxies for free riding and rent seeking correlate with both types of CPA, while financial distress correlates with lobbying, but not contributions.

Many studies find evidence that interest groups exchange money and/or information for political benefits of various kinds, such as trade barriers (Goldberg and Maggi 1999), academic earmarks (de Figueiredo and Silverman 2006), reduced or easier regulatory inspections (Gordon and Hafer 2005), favorable rate regulation (Bonardi et al. 2006), and lower tax rates (Richter et al. 2009). Humphries 1991 and Langbein 1986 provide some empirical evidence that contributions are indeed used to buy more contacts with politicians. Researchers focusing on specific issues or industries have found evidence of influence via lobbying or other political activity (see, for example, Schuler 1996 (steel), Kroszner and Stratmann 1998 (financial services), and de Figueiredo and Tiller 2001 (communications)). Firms withhold contributions from officials who vote against their interests (see, for example, Jackson and Engel 2003 (China policy) and Franca (2001 (NAFTA policy)).

Event studies have revealed political influence on stock prices, and thus on firms. US equity markets are affected by the control of Congress (Jayachandran 2006) and policy platforms (Knight 2006); see also Fisman 2001 (Indonesian stock market). But these studies do not distinguish between policies (that may be adopted for public-regarding reasons) and those adopted for the private benefit of companies, or in exchange for contributions or lobbying. More recently, Cooper et al. 2010 find a positive correlation between corporate PAC contributions and subsequent abnormal stock returns and accounting earnings in the US, with the strongest effects for contributions to House Democrats, although they are not able to conclude the effect is causal. Kim 2008 finds that lobbying expenditures increase a firm's raw and market-adjusted (but not industry-adjusted) equity returns in the following year. While these findings are inconsistent with an extreme form of agency cost explanation of CPA – one in which CPA provides no benefits for companies and shareholders – they are not inconsistent with more

[6] Some studies find industry unionization increases corporate political activity, e.g., Mitchell et al. 1997, but others do not, e.g., Schuler et al. 2002.

conventional agency cost theories, in which managers attempt to pursue strategies for private reasons even when they are less than optimal for shareholders.

Little prior work has focused on managerial agency costs as a potential cause of CPA. Some have theorized that "slack" may determine CPA (for example, Yoffie 1987; Schuler, 1996; Schuler et al., 2002). But what corporate governance researchers mean by "slack" – that is, the ability of managers to divert firm resources for non-shareholder-oriented ends – differs from how "slack" is used in the management literature, where it often means financial resources more generally (for example, firm size, debt-to-equity or current ratios, as in Schuler 1996, or free cash flow, as in Schuler et al. 2002), which might be more or less constrained regardless of whether managers are perfect agents for shareholders. In any event, only firm size has been found to have a statistically significant relationship with CPA. A few researchers have also focused on whether political activity of top managers predicts CPA, but this relatively uncommon work has focused on small companies (for example, Cook and Barry 1995), where alignment between ownership and management makes the correlation between manager and firm political activity unproblematic from a corporate governance perspective.[7] Other work suggests that CPA represents a form of managerial "consumption" good – consistent with the possibility that it is pursued at the expense of shareholders (see, for example, Ansolabehere et al. 2003, surveying numerous prior studies). Even if CPA was a form of consumption for managers, however, CPA would not necessarily represent agency costs – CPA might represent a form of consumption for owner-managers even in companies with no separation of ownership and control, and be unaffected by corporate governance, or be offset in public companies by lower manager compensation.

One study employs an empirical strategy akin to the one used in this paper (Kim 2008).[8] That study includes one governance variable (the "g" index from Gompers et al. 2003) in modeling the determinants of CPA, as a proxy for managerial slack, and finds that (after controlling for other factors) weak shareholder rights (higher g's) correlate positively with the propensity to lobby and to sponsor a PAC, and with lobbying expenditures, but not with PAC contribution levels. Agency theory, however, was one of many theories tested, so the results on "g" are not explored in detail or tested for robustness, and the expenditure and contribution results rely on fragile empirical specifications.[9] This paper analyzes the relationship between corporate governance and CPA more intensively,

[7] Some work in sociology suggests managers are a (but not the sole) determinant of CPA. Blumentritt 2003 used survey data in a cross-country study of the CPA of foreign subsidiaries of US-based multinational companies, and found that subsidiary top manager beliefs about the value of investments in CPA were more important than firm size, technological development or access to export markets in predicting CPA, but the study did not test whether CPA in fact benefited shareholders. With 1980 data, Burris 2001 found that firm contribution patterns differed significantly from contributions by firms' top managers, but the study design did not allow examination whether differences in governance contributed to these differences.

[8] The author of that study graciously shared his data, which is included in the sample tested below.

[9] Specifically, lobbying expenditures and PAC contributions are estimated with Heckman two-stage selection models in which first- and second-stage regressors are identical (save for lambda in the second-stage), so the system is identified – that is, observations vary – only by the non-linearity of lambda, and likely suffer from collinearity and produce fragile results. Puhani 2000; Little and Rubin 1987.

testing different samples and measures of governance, with additional sets of controls and empirical specifications, and produces findings that suggest that corporate governance and CPA (including PAC contribution levels) are even more tightly linked than suggested in Kim 2008.

All empirical studies of CPA are challenged by the fact that only certain kinds of CPA are required to be disclosed, even by public companies. If Exxon hires a registered lobbyist or lobbying firm to act as such, the lobbyist and/or firm must disclose that fact, but nothing requires Exxon to disclose the fact that it may hire a law firm (not registered as a lobbyist) that engages in activities that are essentially political in nature, and would be identified as "lobbying" in ordinary speech.[10] Books, television ads or appearances, op eds, pamphlets, Congressional testimony, efforts to stimulate "grassroots" letter writing campaigns, and public comments on proposed regulations, and all lobbying activities by those whose lobbying activities constitute less than 20 percent of the time engaged in services are all arguably exempt from the legal definition of "lobbying contacts," depending on the facts. Lobbying disclosure laws are also largely unenforced. More important, even contributions and election expenditures were exempt under the pre-*Citizens United* disclosure regime if they were funneled through independent organizations. While those organizations might have been subject to a disclosure requirement if they in turn made contributions or expenditures, there was nothing in the disclosure regime that would have required a public company that donated money to, for example, a commonly controlled but formally independent non-profit to disclose its donations to the non-profit, or to force the non-profit to disclose to the public the identity of its donors.

As a result, the control and funding of many organizations active in politics was and remains a mystery. Any research claiming to have assessed the aggregate amount of political activity by businesses or corporations should thus be viewed skeptically. Nevertheless, for purposes of this paper, the effect of there being potentially very large unobservable political activity by corporations is to make it harder for any negative relationship that might exist between corporate governance and corporate political activity to be detected. If a negative relationship can be found based on observable data on CPA, then it is even more likely that this relationship is understated in the analysis, because (for obvious reasons) managers will be more likely to engage in non-shareholder-wealth related CPA that is not observable, and more likely to engage in CPA that will create wealth for shareholders if it is observable. (For the same reason, if a positive relationship can be found in existing data, one would worry that it simply follows from this example of the classic "searching under the streetlights" problem.)

[10] See generally 2 USC § 1602 (definitions of lobbying activities and related terms).

2. Hypotheses and Samples

2.1. Hypotheses

The literature on corporate governance suggests that agency problems will tend to be more acute when shareholders are most dispersed, when managers have low ownership, when blockholders are not present, and when shareholder rights are weakest. The literature on CPA suggests that CPA may represent a form of managerial perquisite – a "consumption good" for those who control the CPA – that is, managers. CPA could represent, in this view, pursuit of a pet project that is at best unrelated to shareholder interests, and at worst could actively harm them. Putting these points together suggests several straightforward hypotheses:

Hypothesis 1: CPA will correlate positively with corporate governance measures – ownership dispersion, low insider ownership, low blockholder ownership, weaker shareholder rights, and higher CEO pay – even after controlling for other determinants of CPA.

An alternative view of CPA, however, suggests that CPA can be value maximizing for shareholders. CPA may produce rents for companies, or defend existing corporate strategies against rent seeking by competitors. More generally, at most optimistically, CPA may produce public policy that is aligned with both public and shareholder interests, as when (for example) "lobbying" activities – including the provision of true and useful information to elected officials – lead to a better fit between social welfare and regulations. This alternative view leads to a set of alternative hypotheses:

Alternative hypothesis 1b: CPA should be uncorrelated with such factors, particularly after appropriately controlling for factors likely to determine the relationship between politics and corporate performance, such as industry, size, and firm age.

Another possibility, not developed in the CPA literature, but implicit in the corporate governance literature, is that CPA requires additional managerial effort, or could expose managers to personal (political or reputational) risks. If the effort required or the risks are different in kind from the effort or risks created by non-CPA manager roles, managers might avoid CPA even when doing so would benefit shareholders. This leads to a second alternative hypothesis:

Alternative hypothesis 1c: CPA will be negatively correlated with corporate governance factors, even after controlling for known determinants of CPA.

Finally, even if CPA represents a "consumption" good for corporate managers, it might be optimal or at least neutral for shareholders if managers were willing to "pay" for the right to cause companies to engage in CPA in the form of lower compensation. This leads to a third alternative hypothesis:

Alternative hypothesis 1d: CPA will be negatively correlated with managerial compensation.

2.2. Sample

The foregoing hypotheses are tested on a sample consisting of data on the S&P 500 in the period 1998 through 2004. For lobbying, the unit of observation is a firm-year, and the sample includes all firm-years in that period; for PAC activity, the unit of observation is a firm in a two-year election cycle (for example, 1997 and 1998, 1999 and 2000, etc.), using firm-year data for the second-year in the cycle, and the sample includes all election cycles in that period. By construction, the sample consists of large publicly held firms and, as shown below (and reported in prior research), CPA correlates with firm size. Thus, the strength of the relationships reported below is likely to fall as one beyond this sample. However, prior research (for example, Drope and Hansen 2006) shows that the tendency of researchers to focus on larger firms does not seem to significantly bias the picture of CPA overall. More importantly, the S&P 500 represents a large fraction of US public companies, corporate revenues and assets, and economic activity.

2.3. Explanatory Variables: Data on Corporate Governance

In the analysis below, shareholder rights are measured in several ways. Data on the most widespread measure – the **G_INDEX** from Gompers et al. 2003, which is based on 24 corporate governance provisions tracked by IRRC (now RiskMetrics) and published in volumes dated 1998 through 2006 – are taken from IRRC via the WRDS website.[11] These data are available for all firms in the S&P 500 plus roughly 1,500 other firms deemed important by IRRC. Data on the **E_INDEX**, which is described in Bebchuk et al. 2009 and is based on six provisions tracked by IRRC, is taken from Lucian Bebchuk's website.[12] Each of those indices is constructed of provisions that restrict shareholder power, so higher scores indicate less shareholder-friendly governance. Following Gompers et al. 2003, I define "Democracy" firms and "Dictatorship" firms as having especially shareholder-friendly governance and especially bad governance, respectively, based on the extremes of the G-Index. **DEMOCRACY_G** firms have G-Index score is five or lower, and **DICTATORSHIP_G** firms have G-Index scores of 14 or higher, while **DEMOCRACY_E** firms have E-Index scores of zero and **DICTATORSHIP_E**

[11] http://wrds.wharton.upenn.edu. I have three G datasets: one from the Metrick website (http://www.som.yale.edu/faculty/am859/data.html), which is based on IRRC publications; one from IRRC (now RiskMetrics) from the WRDS website; and one from Kim, who derived his data from the Metrick website. For the S&P 500 sample, the datasets are nearly identical (correlation coefficients > .99), as one would hope, but they are not identical: there are a few (<35) mismatches between the ~1750 observations common to each pair of datasets. The discrepancies range from ±1 to ±7, with means of ~2 (G ranges from 2 to 16). These discrepancies do not affect any results reported here. I use the IRRC dataset because it is reported in WRDS for all years, although a review of the data shows that the dataset on WRDS has simply interpolated data for missing years – that is, every other year – from the prior year. None of the qualitative results are affected by using only the years of IRRC publications.

[12] http://www.law.harvard.edu/faculty/bebchuk/data.shtml. The E_INDEX is provided only for years covered by the IRRC publications – every other year – so I interpolate missing data from the prior year. None of the qualitative results are affected by using only the years of IRRC publications.

firms have E-Index scores of five or higher. In addition, I use data on classified boards (**C_BOARD_IRRC**) from IRRC, via WRDS.[13]

Ownership dispersion is measured by the logged number (**LNCSHR**) of record holders (**CSHR**) reported by a given company, as reported by Compustat. The true item of interest is beneficial ownership, but data on the number of beneficial owners for most companies is not available, because the SEC does not require it to be disclosed, even though companies have the data. Nevertheless, interviews with proxy solicitors confirm that the number of record owners is a noisy but correlated proxy for beneficial ownership, and in a separate paper (Coates 2010), I find that the number of record owners is correlated with a number of merger and acquisition practices (such as contract terms) with which theory suggests ownership dispersion should be correlated.

Data on ownership of voting shares by insiders (that is, all officers and directors) (**INSIDER_OWN**) and 5+% owners (**BLOCK_OWN**) is taken from Dlugosz et al. 2004 (for 1998 through 2001) and from the noisier CDA Spectrum database (for 2002 through 2004). CEO compensation is taken from Execucomp, via WRDS, also derived from annual proxy statements. The measure used is the log (**LOGTDC1**) of total direct compensation (**TDC**), which includes cash and deferred compensation, including the Black-Scholes value of new option grants.

2.4. Other Explanatory Variables

In addition to the foregoing governance-related regressors, the models below include proxies customarily included in models of CPA, all drawn from prior research on CPA summarized above. The key regressors are:

- **SALES** (sales) and **LNSALES** (logged sales), **EMPLOYEES** (number of employees), and **LOGEMP**, serve as proxies for firm size and/or for the size of the pool from which a company may solicit donations to a corporate PAC, all from Compustat;
- **SALES3LS**, the firm's last three-year least-squares sales growth rate, using quarterly data, as a proxy for resources potentially available for CPA;
- **COMPANYAGE**, the company's age (since founding), from the Corporate Library (available primarily for years 2003 and 2004), with missing years interpolated, as a proxy for firm reputation or credibility;
- **FAMA**, industry dummies using the Fama-French 1997 mapping of standard industrial classification codes to 48 categories;[14]
- **REG**, a regulated-industry dummy for firms in regulated industries;[15]

[13] The Corporate Library also provides data on classified boards for the years 2001 to 2004, and I compare that data with IRRC, and find that they are nearly identical (correlation coefficient > .95), but again, not identical, with 42 mismatches out of 1811 observations in common. Again, the discrepancies do not affect results for the subperiod of overlap between the datasets.

[14] http://mba.tuck.dartmouth.edu/pages/faculty/ken.french/data_library.html

- **YEAR**, annual dummies, to control for time trends;
- **C4**, the four-firm concentration ratio for a firm's industry (using 6-digit NAICS codes), as reported periodically by the Census Bureau,[16] as a proxy for lower costs of political organization or potential benefits from lobbying against regulatory intervention; and,
- **GOVSHARE**, the share of all government expenditures received by a firm's industry, as reported periodically by the Census Bureau, as a proxy for potential benefits from lobbying.

In addition, consistent with the corporate governance literature, firm value is approximated as the log of median-industry-adjusted book/price ratios (that is, "Tobin's Q," see note 2 above, or **RELQ**). For the industry adjustment, Fama's 48-industry groups are used, and RELQ equals the log of the firm's Q over the industry's median Q. As in prior research, Q is defined as market value of assets over book value of assets, where market value of assets is approximated as the book value of assets plus the market value of common stock less the book value of common stock less the balance sheet value for deferred taxes).

2.5. Dependent Variables: Data on Corporate Political Activity

Data on corporate PAC activity and lobbying activity from the "Open Secrets" website,[17] which has a search engine and summaries of data from the Federal Election Commission (PAC contributions) and U.S. Senate (lobbying) websites, derived from Kim 2008. Two variables measure the propensity of firms to engage in CPA: **LOBBY_YN** is a dummy set to one if the firm participated in lobbying in a given year; **CONTRIBUTE_YN** is a dummy set to one if the firm's PAC contributed in the prior two-year election cycle. Two variables measure the extent of participation: **LOBBYAMOUNT** is the amount in $000s (and **LOGLOB** is logged amount) of annual lobbying expenditures by the firm (inflation-adjusted), **CONTRIBUTEAMOUNT** is the amount in $000s (and **LOGCONTRIBUTE** is the logged amount) of total PAC contributions sponsored by the firm to federal candidates over the prior two-year cycle (inflation-adjusted). Each participation variable is the log of one plus, for non-zero observations, the observed value, to preserve zero observations in the sample.

3. Summary Data

Table 1 sets forth summary data (Panel A). As can be seen, most of the S&P 500 is politically active, with 71% engaged in annual lobbying on average, and an average of 70% sponsoring PACs that made donations in an election cycle. For the S&P 500, consistent with prior research, the two types of CPA are complements: the correlation coefficient of lobbying activity and PAC contributions is 0.5, and the correlation among

[15] Regulated Fama 48-industries are 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).

[16] http://www.census.gov/epcd/www/concentration.html.

[17] http://www.opensecrets.org.

lobbying and contribution amounts is 0.6. S&P 500 firms spent roughly three times more on lobbying in a given year than their PACs give in an election cycle, or roughly six times more per year. The distribution of both kinds of CPA is right-skewed (4.2 and 2.9) and kurtotic (29.6 and 23.6), and logged amounts are significantly closer to a distribution normal (skew of -0.3 and -0.6, kurtosis of 1.7 and 1.6).

Summary statistics for G and E are comparable to those reported in Gompers et al. 2003 and Bebchuk et al. 2009. Roughly 60% of the S&P 500 had a classified board over the period, declining from 59% in 1998 to 57% in 2004, consistent with prior research. In this large company sample, the median firm had 18,000 record shareholders, and only a few (between one and 15, depending on the year) had few enough record owners (<300) to be able to "go dark" – that is, deregister with the SEC. Directors and officers own 6% of firm shares at the median; blockholders own 14%; CEOs are paid $6.5 million per at the median.

4. Data Analysis

4.1. Univariate Analysis: Corporate Governance and CPA

Table 2 sets forth the fraction of firms engaged in lobbying or PAC sponsorship and medians of expenditures and contributions, compares them for firms with different G- and E-INDEXes, and presents p-values for a simple one-way analysis of variance testing the null that CPA does not vary by G- or E-INDEX.[18] Figure 1 charts the participation rates against the E-INDEX. Firms with high G- and E-INDEX scores are much more likely to engage in CPA than firms with lower scores. Roughly three-quarters of firms with a G-INDEX of 13 or more engage in lobbying, and 79% sponsor active PACs, contrasted with only 62% of firms with a G-INDEX of six or less that engage in lobbying, only 60% with active PACs. The contrast between high- and low-E-INDEX firms is even stronger: 76% vs. 56% for lobbying, and 90% vs. 63% for PAC activity. The relationship between the indexes and CPA is not perfectly monotonic – across the mid-range of scores, CPA is either flat (for the E-INDEX) or it rises and falls somewhat (for the G-INDEX). Nevertheless, the general slopes of the relationship between CPA and these measures of shareholder rights are clearly positive -- and since the indexes are higher for fewer shareholder rights, the relationship between CPA and shareholder rights is clearly negative.

4.2. Regression Analysis: Corporate Governance and CPA

Tables 3 through 6 set forth the regression results for CPA in the S&P 500. Each table contains two panels. Each top panel reports results for logistic models of participation in CPA – that is, whether a firm engages in any lobbying, or sponsors a PAC that made any contributions. Each bottom panel reports results for ordinary lease squares models of the

[18] Similar analyses are not conducted here for the other corporate governance variables because they are all likely to be strongly affected by firm size and industry, so that simple univariate relationships would not be very meaningful. In unreported analyses, the same qualitative relationships reported below in Tables 3 and 4 are confirmed in ANOVA and/or ranksum tests.

extent of participation -- that is, models of the amount of lobbying expenditures or PAC contributions. Tables 3 and 4 present models of lobbying. Tables 5 and 6 present models of PAC contributions. OLS is used for the expenditure and contribution models, rather than Heckman selection models, because there are no natural subsets of variables to omit to achieve identification, and because the inverse Mills ratio from unreported first-stage selection models for each type of participation that includes all regressors is, not surprisingly, highly correlated with the regressors in the second-stage spending models (in excess of 0.97 for G-INDEX, for example) (see note 8 above).

Many of the corporate governance variables are highly correlated (see the correlation matrix in the Appendix). Including all of them in a single regression could produce spurious results due to collinearity. Thus, each corporate governance variable is first modeled on its own, and then on its own with a full set of non-governance variables from prior research, as well as industry and year dummies. These results are presented in Tables 3 and 5. Finally, each of the G-INDEX and E-INDEX is separately combined with INSIDER_OWN, and LNCSHR, with and without non-governance variables. TDC1 is not included because it lacks explanatory power in Tables 3 and 5, and because it is available for only a subset of the sample. Likewise, even with interpolated data, COMPANYAGE is available for only subsets of the sample, and is added to the final model only.

In the simple regressions without other explanatory variables (left half of Table 3), each of the corporate governance variables correlates strongly with lobbying propensity, except for the extreme anti-shareholder variables, DICTATOR-G and DICTATOR-E. Across the full-range of both the G- and E-INDEX, more shareholder rights is correlated with less lobbying, and classified boards with more lobbying. When insiders or blockholders own more stock, their firms lobby less. When shareholders are more dispersed, firms lobby more. CEO compensation is higher in firms that lobby. The same correlations are generally true of lobbying expenditures, although the E-INDEX (and its extremes) and classified boards are not statistically related to lobbying expenditures.

When other explanatory variables are added (right half of Table 3), all of the results retain or increase their significance –in both economic and statistical terms. Both G- and E-INDICES are strongly related to lobbying propensity, G remains strongly correlated with lobbying expenditures, and the E-INDEX – which had not been correlated on its own with lobbying expenditures – becomes statistically significant. The only exceptions are INSIDERS_OWN, which falls in significance in the lobbying propensity regression, although it remains statistically and economically significant in the lobbying expenditure regressions, and the "DICTATOR" firms – the firms with the weakest shareholder rights – which on their own do not differ strongly from other firms. Firms with the strongest shareholder rights, however, are less likely to engage in lobbying, and engage in less of it.

Not only are the corporate governance variables statistically related to CPA, but they are important. In Table 4, three corporate governance variables on their own – either of the

G- or E-INDICES, INSIDERS-OWN and LNCSHR – generate pseudo-R-squareds and R-squareds of roughly 14% and 26% in models of lobbying propensity and lobbying expenditure regressions, roughly half of the goodness-of-fit statistics for the full models that include the variety of explanatory variables developed to date in the CPA literature. Collectively, corporate governance matters as much as other factors – such as firm size, industry concentration and regulation, and government purchasing. The coefficients from moving from a G-INDEX of six (the 10^{th} percentile) to 13 (the 75^{th} percentile) in model (3) in Panel A of Table 4 would imply, holding everything else in the model constant at their sample averages, an increase in the odds ratio of lobbying by eight, and increasing ownership dispersion from the 10^{th} to the 90^{th} percentile would a further increase in the odds ratio of six, so that the odds of lobbying by a shareholder-friendly firm (at the 10^{th} percentile of each of those variables) would be fourteen times lower than for a shareholder-unfriendly firm. Economically, corporate governance matters less to the amounts of lobbying expenditures than some other factors, such as firm size, but lobbying expenditures increase by 5% or more as one varies shareholder rights and ownership concentration, among otherwise similar firms.

The story is much the same for PAC sponsorship and PAC contributions, except that CEO compensation appears to be less relevant. The other governance variables have similar relationships with PAC activity as they do with lobbying and stronger relationships with PAC contribution levels than they do with lobbying expenditure levels.

Contrary to alternative hypothesis 1d, managerial compensation is actually higher, not lower, at firms that actively engage in CPA. Rather than serving as a fully compensated form of managerial perk, CPA appears to represent either an additional means by which shareholder value is diverted by managers already using their power to extra higher-than-normal compensation, or it may function empirically as another proxy for poor corporate governance (recall that the other measures of corporate governance are highly noisy, at best, as proxies for shareholder power). In unreported regressions, I find that indeed, LOGTDC1 is positively related to G-INDEX (and other measures of corporate governance). If managerial compensation is subject to an upper bound, due (for example) to an "outrage constraint" (Bebchuk and Fried), then CPA represents a second-best way for managers of firms with weak shareholder rights to extract private value for themselves in a manner that is hard to observe or control. (As noted below, unobservable political activity may represent another channel for managerial wealth extraction, one even more subject to abuse than the observable political activity modeled here.)

4.3. *Firm-Fixed Effects Regressions: Corporate Governance and CPA*

The robustness of the foregoing results could in theory be tested with firm fixed effects regressions, which would measure the relationship between changes in CPA at one firm as it changes its corporate governance. While S&P 500 firms change their G-INDICES not infrequently,[19] the changes are minor: the median change in both indices is one; only

[19] Recall that in the observed values for the G- and E-INDICES change only every two years, because IRRC publications from which the data on which the indices were released only every other year. Thus, the indices could change from the prior years only in years 2000, 2002 and 2004. In those years, 36.5% of

10% of the changes in the G-INDEX are greater than two, amounting to only 3.7% of the observation years in which the indices could change; and only 5% of the changes in the E-INDEX are greater than one, amounting to only one percent of the observation years in which the indices could change. Only two percent of sample firms change whether they have a classified board in those years. The ownership dispersion and blockholder variables are also fairly stable for a given firm from year to year, with 64% and 55% of each variable changing by less than 1% on average per year.

As a result, one should not expect that firm fixed effects regressions on corporate governance variables to produce powerful results, particularly if the most important differences among companies is not between those with marginally different values, but between firms at opposite extremes. The weak power of such tests is compounded for models of PAC activity by the fact that such activity is observed only every other year, and for both lobbying and contribution participation because each dependent variable can only take on one of two values (0 or 1), limiting possible variation from year to year. Nevertheless, it is clear that fluctuation in CPA is an order of magnitude greater than fluctuation in corporate governance: the median standard deviation of lobbying expenditures by firm over the sample period is 105, and the median lobbying expenditure is 166; the median standard deviation of the G-INDEX is 0.5, and the median G-INDEX is 10.

If any of the corporate governance variables are likely to show strong relationships in a fixed effects setting, one would expect to see it where the average cross-sectional relationship between the G-INDEX and CPA are the strongest – at the breakpoint between DEMOCRACY-G firms and other firms. An in fact, Table 7 shows that firm fixed effects regressions show a negative correlation between lobbying propensity, lobbying expenditures, and PAC contribution amounts, on the one hand, and DEMOCRACY-G, on the other hand, even after including other explanatory variables that vary within firms over the sample period – LNSALES, LOGEMPLOY and SALE3LS. The other firm fixed effects relationships (not reported) are insignificant or sensitive to inclusion of other explanatory variables.

4.4. *Approximated Tobin's Q and CPA*

Prior research has established that strong shareholder rights correlate with higher Tobin's Q. This paper has presented evidence that CPA correlates negatively with strong shareholder rights. The question remains, is the former correlation mediated in part by CPA? That is, does CPA correlate negatively with Tobin's Q, and thus represent one of the channels through which corporate governance affects firm value? Table 8 presents evidence that it does.

Table 8 (Panel A) shows that a rough measure of firm value -- RELQ -- is higher for firms that do not engage in lobbying and for firms that do not sponsor PACs making

---

the firms experienced changes in their G-INDEX, consistent with a range of annual change of between 18.3% and 36.5%, and 20.7% experienced changes in the E-INDEX, consistent with a range of annual change of between 10.3% and 20.7%.

contributions in the current year. These findings hold after including the standard set of additional explanatory variables used in prior research, including the log of book value of assets, the log of company age, a dummy for Delaware incorporation, return on assets, three-year sales growth, capital expenditure intensity (capital expenditures over assets), research and development (R&D) intensity (equal to research and development expenditures to sales), dummies for missing R&D and ownership data, and annual dummies. The regressions use robust standard errors, clustered by firm.

In sum, not only does corporate political activity correlate with weak corporate governance, it also correlates (negatively) with firm value. Firms with corporate governance provisions giving shareholders more power engage in less political activity. Corporations that engage in political activity generate lower value for their shareholders relative to the value of the assets they control.

The foregoing empirical analysis does not definitively prove that political activity harms shareholders (or, if shareholder anticipate the effect on firm value and pay lower prices for shares, harms entrepreneurs who face higher costs of capital). But, given the complexity of the relationship between corporate governance and social welfare, and the difficulty of finding clean empirical tests of competing hypotheses on how governance structures work, such proof is never likely to be forthcoming, and policy must be built on a combination of theory and suggestive evidence. In this respect, research on the effects of CPA – and the findings presented above – are no less reliable than the broader body of corporate governance research on the relationship between governance and firm value.

5. Conclusion

In *Citizens United*, the Supreme Court relaxed the ability of corporations to spend money on elections, and in so doing, the Court rejected a shareholder-protection rationale for restrictions on spending. This paper has explored the relationship between existing data on corporate governance and corporate political activity in the S&P 500 with the goal of predicting the effect of *Citizens United* on shareholder wealth, and of investigating whether there is evidence that corporate political activity could harm shareholder interests. The paper found that in the period 1998-2004 shareholder-friendly governance was consistently and strongly negatively related to observable political activity before and after controlling for established correlates of that activity, even in a firm fixed effects model. Political activity, in turn, was found to be strongly negatively related to firm value. These findings – together with the likelihood that unobservable political activity is even more harmful to shareholder interests – imply that laws that replace the shareholder protections removed by *Citizens United* would be valuable to shareholders.

Bibliography

Ansolabehere, S., Snyder, J., and Tripathi, M. 2002. Are PAC contributions and lobbying linked? New evidence from the 1995 Lobby Disclosure Act. Business and Politics, 4: 131–155.

Ansolabehere, Stephen, John M. de Figueriredo and James M. Snyder, Jr., Why is There so Little Money in U.S. Politics?, 17 J. Econ. Persp. 105-130 (2003)

Austen-Smith, David 1995. "Campaign Contributions and Access." American Political Science Review 89: 566—581.

Baron, D. 1995. Integrated strategy: Market and nonmarket components. California Management Review, 37(2): 47–65.

Bebchuk, Lucian A., Coates IV, J.C., Subramanian, G.. The powerful antitakeover force of staggered boards: theory, evidence and policy. Stanford Law Review 54, 887–951 (2002).

Bebchuk, Lucian A., Alma Cohen, and Allen Ferrell, "What Matters in Corporate Governance." *Review of Financial Studies* 22(2): 783-827 (2009)

Bebchuk, Lucian A., Alma Cohen and Charles C.Y. Wang, Learning and the Disappearing Association Between Governance and Returns, Working Paper (2010)

Bebchuk, Lucian A., and Jesse Fried, Pay without Performance: The Unfulfilled Promise of Executive Compensation (2004).

Bebchuk, Lucian A., and Robert J. Jackson, Jr., Corporate Political Speech: Who Decides?, 124 Harv. L. Rev. __ (forthcoming Nov. 2010).

Berle, Adolph A., and Gardiner C. Means. *The Modern Corporation and Private Property*. New York: Macmillan Company (1932)

Bischoff, Steven M., Recent Corporate Research in the United States: The Highlights, Working Paper (2009)

Blumentritt, T. 2003. Foreign subsidiaries' government affairs activities: The influence of managers and resources. Business and Society, 42: 202–233.

Bonardi, Jean-Philippe, Guy Holburn, and Richard Vanden Bergh (2006). "Nonmarket Performance: Evidence from U.S. Electric Utilities." Academy of Management Journal 49: 1209—1228.

Brasher, Holly, and David Lowery 2006. "The Corporate Context of Lobbying Activity." Business and Politics Vol. 8: Iss. 1, Article 1.

Brudney, Victor, *Business Corporations and Stockholders' Rights Under the First Amendment*, 91 YALE L.J. 235 (1981)

Burris, V. 2001. The two faces of capital: Corporations and individual capitalists as political actors. American Sociological Review, 66: 361–381.

Coates, John C., Citizens United, Corporate Governance, and a New Era of Crisis in the Supreme Court's Legitimacy, Working Paper (July 2010)

Coates, John C., Takeover Defenses in the Shadow of the Pill: A Critique of the Scientific Evidence, 79 Tex. L. Rev. 271-382 (2000).

Coates, John C., The Powerful and Pervasive Effects of Ownership on M&A, Working Paper (2010), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1544500

Coates, John C., and Reinier Kraakman, CEO Tenure, Performance and Turnover in S&P 500 Companies, Working Paper (2010).

Cook, R., and Barry, D. 1995. Shaping the external environment: A study of small firms' attempts to influence public policy. Business and Society, 34: 317–344.

Cooper, Michael J., Huseyin Gulen and Alexei V. Ovtchinnikov, Corporate Political Contributions and Stock Returns, 65 J. Fin. 687 (2010)

Core, John E., Wayne R. Guay, and Tjomme O. Rusticus, "Does Weak Governance Cause Weak Stock Returns: An Examination of Firm Operating Performance and Investors' Expectations," *Journal of Finance* 61: 655-687 (2006).

Drope, Jeffrey, and Wendy Hansen 2006. "Does Firm Size Matter? Analysing Business Lobbying in the United States." Business and Politics Vol. 8: Iss. 2, Article 4.

Faleye, Olubunmi, Classified Boards, Firm Value, and Managerial Entrenchment, Journal of Financial Economics, 83, 501-529 (2007)

de Figueiredo, John, and Brian Silverman 2006. "Academic Earmarks and the Returns to Lobbying." Journal of Law and Economics 49: 597—625.

de Figueiredo, John, and Emerson Tiller 2001. "The Structure and Conduct of Corporate Lobbying: An Empirical Analysis of Corporate Lobbying at the Federal Communications Commission." Journal of Economics and Management Strategy 10: 91—122.

Denis, David J., Diane K. Denis and Atulya Sarin, Ownership Structures and Top Executive Turnover, 45 J. Fin. Econ. 193-224 (1997).

Fama, Eugen F. and Kenneth R. French, Industry Costs of Equity, 43 J. Fin. Econ. 153-

193 (1997).

Franca, P. 2001. The effects of the North American Free Trade Agreement on corporate and labor PACcontributions. American Politics Research, 29(1): 98–109.

Getz, K. 1996. Politically active foreign-owned firms in the US: Elephants or chickens? in D. Woodward and D. Nigh (Eds.), Beyond us and them: Foreign ownership and US competitiveness. Columbia, SC: University of South Carolina Press.

Gilson, Ronald and Michael Klausner, That's My Money You're Using, Forbes (Mar. 29, 2010).

Goldberg, Pinelopi, and Giovanni Maggi (1999). "Protection for Sale: An Empirical Investigation." American Economic Review 89: 1135—1155.

Gordon, Sanford and Catherine Hafer (2005). "Flexing Muscle: Corporate Political Expenditures as Signals to the Bureaucracy." American Political Science Review, Volume 99: 245—261.

Gompers, Paul, Joy Ishii, and Andrew Metrick 2003. "Corporate Governance and Equity Prices." Quarterly Journal of Economics 118: 107—155.

Gordon, Sanford and Dimitri Landa 2007. "Consumption or Investment? On Motivations for Political Giving." Journal of Politics 69: 1057—1072.

Hansen, W., and Mitchell, N. 2000. Disaggregating and explaining corporate political activity: Domestic and foreign corporations in national politics. American Political Science Review, 94: 891–903.

Hart, D. 2001. Why do some firms give? Why do some firms give a lot?: High-Tech PACs, 1977–1996. Journal of Politics, 63: 1230–1249.

Hendry John, et al., *Owners or Traders? Conceptualizations of Institutional Investors and Their Relationship with Corporate Managers*, 59 HUM. REL. 1101, 1102-03 (2006)

Hillman, Amy, and Michael Hitt 1999. "Corporate Political Strategy Formulation: A Model of Approach, Participation, and Strategy Decisions." Academy of Management Review 24: 825—842.

Hillman, Amy, Gerald Keim, and Douglas Schuler 2004. "Corporate Political Activity: A Review and Research Agenda." Journal of Management 30: 837—857.

Jackson, D., and Engel, S. 2003. Don't bite the PAC that feeds you: Business PAC punishment over the China vote. American Politics Research, 31(2): 138–154.

Kim, Jin-Hyuk, Corporate Lobbying Revisited, Business and Politics 10(2):1-23 (2008).

Kroszner, Randall, and Thomas Stratmann 1998. "Interest-Group Competition and the Organization of Congress: Theory and Evidence from Financial Services' Political Action Committees." American Economic Review 88: 1163—1187.

Kroszner, R., and Stratmann, T. 2000. Does political ambiguity pay? Corporate campaign contributions and the rewards to legislator reputation (NBERWorking Paper 7475). Cambridge, MA: National Bureau of Economic Research.

Jensen, Michael and William Meckling, Theory of the Firm: Managerial Behavior, Agency Costs, and Ownership Structure, 3 J. Fin. Econ. 305-360 (1976)

Jensen, Michael and Kevin Murphy, Performance Pay and Top Management Incentives, 98 J. Pol. Econ. 225-263 (1990)

Langbein, Laura (1986). "Money and Access: Some Empirical Evidence." Journal of Politics 48: 1052—1062.

Listokin, Yair, Interpreting Empirical Estimates of the Effect of Corporate Governance, 10 Amer. L. Econ. Rev. 90-109 (2008).

Little, R.J.A. and Rubin, D.B., Statistical Analysis with Missing Data (1987)

Mitchell, N., Hansen, W., and Jepsen, E. 1997. The determinants of domestic and foreign corporate political activity. Journal of Politics, 59: 1096–1113.

Morck, Randall, Daniel Wolfenzon and Bernard Yeung, *Corporate Governance, Economic Entrenchment, and Growth*, 57 J. ECON. LIT. 655, 657 (2005).

North, David S., The Role of Managerial Incentives in Corporate Acquisitions: The 1990s Evidence, 7 J. Corp. Fin. 131-149 (2001).

Puhani, P.A., The Heckman Correction for Sample Selection and its Critique, 14 J. Econ. Surveys 53-68.

Richter, Brian K. and Krislert Samphantharak, Lobbying and Taxes, 53 Am. J. Pol. Sci. 893 (2009)

Roe, Mark J., Strong Managers Weak Owners: The Political Roots of American Corporate Finance (1994).

Roe, Mark J., Political Determinants of Corporate Governance: Political Context, Corporate Impact (2003).

Ryan, Lori Verstegen and Marguerite Schneider, *The Antecedents of Institutional Investor Activism*, 27 ACAD. MGMT. REV. 554, 554 (2002).

Schuler, D. 1996. Corporate political strategy and foreign competition: The case of the steel industry. Academy of Management Journal, 39: 720–737.

Schuler, D. 1999. Corporate political action: Rethinking the economic and organizational influences. Business and Politics, 1(1): 83–97.

Schuler, D., and Rehbein, K. 1997. The filtering role of the firm in corporate political involvement. Business and Society, 36: 116–139.

Schuler, D., Rehbein, K., and Cramer, R. 2002. Pursuing strategic advantage through political means: A multivariate approach. Academy of Management Journal, 45: 659–672.

Shleifer, Andrei and Robert Vishny, A Survey of Corporate Governance, 52 J. Fin.. 737 (1997)

Tobin, James and W.C. Brainard, Asset Markets and the Cost of Capital, in Economic Progress, Private Values and Public Policy (1977).

Tripathi, Micky, Steven Ansolabehere, and James Snyder (2002). "Are PAC Contributions and Lobbying Linked? New Evidence from the 1995 Lobby Disclosure Act." Business and Politics Vol. 4: Iss. 2, Article 2.

Wright, John (1990). "Contributions, Lobbying, and Committee Voting in the U.S. House of Representatives." American Political Science Review 84: 417—438.

Yoffie, D. R. 1987. Corporate strategies for political action, in A. A. Marcus, A. M. Kaufman, and D. R. Beam (Eds.), Business strategy and public policy: Perspectives from industry and academia: 43-60. New York: Quorum.

Table 1.

Summary Statistics

S&P 500 Sample (1998-2004)

	Mean or % positive	Median	St. dev.	Min	Max	N
LOBBY_YN	71.2	--	45.3	0	1	3433
CONTRIBUTE_YN	70.4	--	45.6	0	1	1992
LOBBYAMOUNT	958.3	167.4	1992.1	0	25772.5	3433
CONTRIBUTEAMOUNT	237.4	54.1	476.1	0	4676.1	1992
G-INDEX	9.6	10.0	2.5	2	16	3482
E-INDEX	2.4	2.0	1.3	0	6	3078
DEMOCRACY-G	5.1	--	22.0	0	1	3482
DICTATORSHIP_G	5.8	--	23.3	0	1	3482
DEMOCRACY-E	10.0	--	30.0	0	1	3078
DICTATORSHIP -E	4.2	--	20.2	0	1	3078
C_BOARD_IRRC	58.4	--	49.3	0	1	3078
CSHR	75.4	17.8	225.8	.001	4675.2	2863
INSIDER_OWN	13.1	6.0	15.2	0	1	1863
BLOCK_OWN	16.4	14.4	13.1	0	58.6	1782
TDC	11116.4	6481.5	23688.3	0	734427.9	3360
SALES	12651.9	5838.3	22735.9	36.5	286103.0	3458
EMPLOYEES	43.9	19.0	84.5	0.1	1700	3377
SALES3LS	14.7	8.2	35.7	-52.5	1028.2	3396
COMPANYAGE	52.7	36.0	44.6	1	220	3314
REG	35.5	--	47.9	0	1	3486
C4	39.6	35.6	19.5	1.5	98.9	3486
GOVSHARE	6.3	3.1	9.5	0	91.5	3486
RELQ	1.2	1.0	0.6	0.2	4.0	2203

Notes. Amounts in $000s or 000s. LOBBYAMOUNT and CONTRIBUTEAMOUNT are inflation adjusted, using 1998 as the base year.

Table 2.

Univariate Analysis

S&P 500 1998-2004

	G-INDEX								
	<7	7	8	9	10	11	12	13+	p-value of ANOVA
LOBBY_YN (%)	61.7	62.4	64.3	68.4	78.4	82.6	72.1	74.7	0.0000
LOBBYAMOUNT	146.6	64.1	109.0	121.0	201.0	321.0	135.5	154.5	0.0000
N	418	306	440	465	485	505	358	454	
CONTRIBUTE_YN (%)	60.0	61.0	66.0	69.5	71.2	80.1	71.3	78.8	0.0000
CONTRIBUTEAMOUNT	63.0	18.7	32.8	51.1	54.3	87.8	30.3	61.5	0.0045
N	230	177	256	275	285	291	216	260	

	E-INDEX						
	0	1	2	3	4	5+	p-value of ANOVA
LOBBY_YN (%)	55.7	71.7	71.3	74.0	76.6	76.3	0.0000
LOBBYAMOUNT	85.5	217.2	177.7	167.4	146.7	161.0	0.0000
N	309	509	774	828	512	131	
CONTRIBUTE_YN (%)	63.0	70.9	67.7	72.2	76.2	89.6	0.0001
CONTRIBUTEAMOUNT	81.3	59.6	51.9	51.3	43.0	69.1	0.0000
N	173	292	458	486	298	77	

Figure 1.

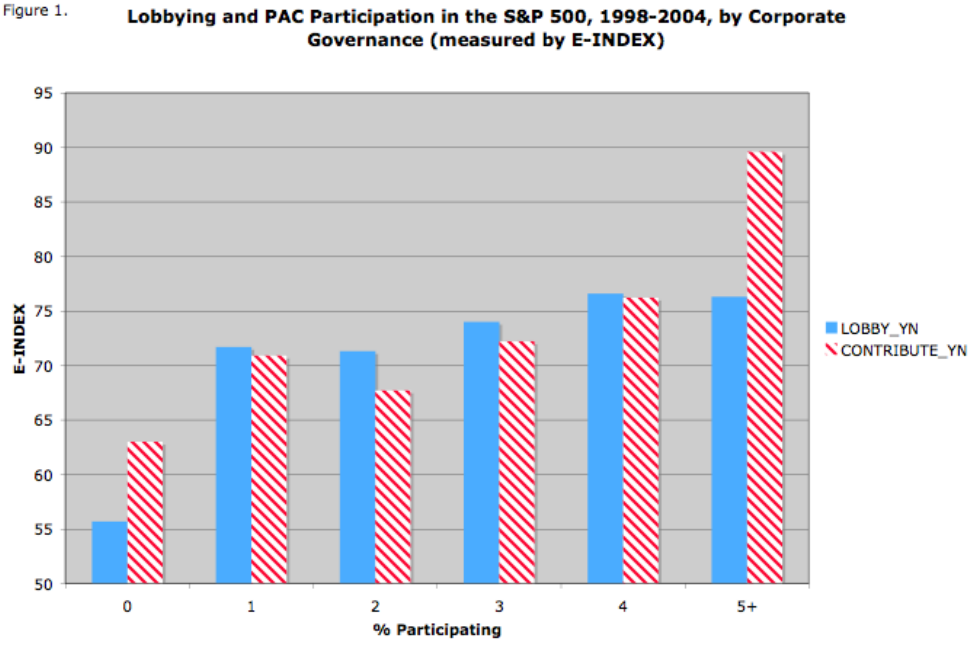

Table 3.

Lobbying Regressions – Individual Corporate Governance (CG) Variables – S&P 500 Sample

A. Lobbying Participation (Logistic)

Explanatory variable	Each CG variable on its own				Each CG on its own, plus other RHS variables				
	Odds ratio	p-value	Ps-R2	N	Odds ratio	p-value	Ps-R2	N	LR test
G-INDEX	1.11	.000	.011	3431	1.15	.000	.321	2754	.0000
E-INDEX	1.18	.000	.008	3063	1.30	.000	.317	2530	.0000
C_BOARD	1.32	.001	.003	3063	1.47	.002	.310	2530	.0018
INSIDERS_OWN	0.94	.000	.021	1856	0.41	.131	.308	1554	.1396
BLOCK_OWN	0.97	.000	.012	1774	0.99	.029	.311	1628	.0219
LNCSHR	1.75	.000	.036	2835	1.37	.000	.353	2309	.0000
LOGTDC	1.26	.000	.036	3327	1.13	.037	.312	2746	.0152
DEMOCRACY-G	0.44	.000	.016	3431	0.13	.000	.328	2754	.0000
DEMOCRACY-E	0.45	.000	.004	3063	0.19	.000	.325	2530	.0000
DICTATOR-G	0.90	.502	.006	3431	0.84	.426	.310	2754	.4553
DICTATOR-E	1.29	.223	.009	3063	0.89	.637	.307	2530	.6749

B. Lobbying Expenditures (Logged) (OLS)

Explanatory variable	Each CG variable on its own				Each CG on its own, plus other RHS variables				
	Coef.	p-value	R2	N	Coef.	p-value	R2	N	LR test
G-INDEX	0.07	.002	.003	3431	0.10	.000	.539	2884	.0000
E-INDEX	0.02	.720	.000	3063	0.19	.000	.550	2698	.0000
C_BOARD	-0.05	.680	.000	3063	0.22	.010	.546	2698	.0009
INSIDERS_OWN	-4.43	.000	.049	1856	-1.19	.007	.536	1686	.0006
BLOCK_OWN	-0.06	.000	.070	1774	-0.01	.007	.556	1753	.0002
LNCSHR	0.84	.000	.240	2835	0.22	.000	.557	2439	.0000
LOGTDC	0.51	.000	.039	3327	0.13	.002	.535	2876	.0004
DEMOCRACY-G	-0.64	.021	.002	3431	-1.21	.000	.540	2884	.0000
DEMOCRACY-E	-0.35	.117	.001	3063	-0.83	.000	.550	2698	.0000
DICTATOR-G	-0.40	.067	.001	3431	-0.19	.271	.533	2884	.2784
DICTATOR-E	-0.21	.368	.001	3063	-0.02	.937	.544	2698	.9420

Notes. All p-values reflect robust standard errors. LR test reports the p-value of the likelihood ratio test, assuming that the reduced model (with other RHS variables alone) is nested inside the full model including relevant CG variable. Results reported in ight half of each panel reflect other right-hand side variables not reported (LNSALES, LOGEMPLOY, SALES3LS, REG, C4 and GOVSHARE, as well as Fama 48-industry and yearly dummies).

Table 4.

Lobbying Regressions – Combined Corporate Governance (CG) Variables – S&P 500 Sample

A. Lobbying Participation (Logistic)

	(1)		(2)		(3)		(4)		(5)	
Explanatory variable	Odds ratio	p-value	Odds ratio	p-value	Odds ratio	p-value	Odds ratio	p-value	Odds ratio	p-value
G-INDEX	1.10	.001			1.10	.014				
E-INDEX			1.22	.000			1.25	.003	1.28	.002
INSIDERS_OWN	0.33	.005	0.35	.010	0.70	.578	0.92	.903	0.99	.996
LNCSHR	1.74	.000	1.77	.000	1.37	.000	1.33	.000	1.33	.000
LNSALES					6.23	.000	6.64	.000	6.82	.000
LOGEMPLOY					0.39	.000	0.40	.000	0.38	.000
SALES3LS					0.97	.000	0.97	.000	0.97	.000
REG					2.77	.009	2.92	.009	2.88	.018
C4					1.01	.058	1.01	.062	1.01	.053
GOVSHARE					1.01	.608	1.01	.068	1.00	.938
COMPANYAGE									1.01	.031
Fama 48-Industry dummies?	No		No		Yes		Yes		Yes	
Year dummies?	No		No		Yes		Yes		Yes	
N	1529		1474		1192		1119		1087	
Pseudo-R-sq	0.143		0.145		0.318		0.312		0.316	

B. Lobbying Expenditures (Logged) (OLS)

	(1)		(2)		(3)		(4)		(5)	
Explanatory variable	Coef.	p-value	Coef.	p-value	Coef.	p-value	Coef.	p-value	Coef.	p-value
G-INDEX	0.05	.060			0.08	.003				
E-INDEX			0.06	.231			0.17	.000	0.19	.000
INSIDERS_OWN	-2.01	.000	-2.06	.000	-0.81	.083	-0.64	.000	-0.43	.371
LNCSHR	0.85	.000	0.86	.000	0.21	.000	0.19	.001	0.17	.002
LNSALES					1.70	.000	1.70	.000	1.78	.000
LOGEMPLOY					-0.54	.000	-0.48	.002	-0.54	.000
SALES3LS					-0.02	.000	-0.02	.000	-0.02	.000
REG					0.83	.003	0.80	.005	0.95	.001
C4					0.02	.000	0.02	.000	0.02	.000
GOVSHARE					0.02	.054	0.14	.070	0.01	.278
COMPANYAGE									0.01	.000
Fama 48-Industry dummies?	No		No		Yes		Yes		Yes	
Year dummies?	No		No		Yes		Yes		Yes	
N	1529		1474		1419		1370		1314	
R-sq	0.262		0.262		0.559		0.564		0.573	

Notes. All p-values reflect robust standard errors.

Table 5.

PAC Regressions – Individual Corporate Governance (CG) Variables – S&P 500 Sample

A. Corporate PAC Participation (Logistic)

Explanatory variable	Each CG variable on its own				Each CG on its own, plus other RHS variables				
	Odds ratio	p-value	Ps-R2	N	Odds ratio	p-value	Ps-R2	N	LR test
G-INDEX	1.12	.000	.013	1990	1.17	.000	.365	1515	.0000
E-INDEX	1.18	.000	.008	1784	1.28	.000	.367	1442	.0001
C_BOARD	1.49	.000	.001	1784	1.76	.001	.364	1442	.0007
INSIDERS_OWN	0.30	.007	.001	942	0.37	.253	.359	789	.2550
BLOCK_OWN	0.97	.000	.003	877	0.98	.078	.359	699	.0740
LNCSHR	1.77	.000	.139	1610	1.27	.001	.323	1181	.0004
LOGTDC	1.24	.000	.012	1896	1.06	.421	.353	1511	.3289
DEMOCRACY-G	0.59	.013	.003	1990	0.20	.000	.361	1515	.0000
DEMOCRACY-E	0.65	.011	.003	1784	0.60	.072	.360	1442	.0721
DICTATOR-G	1.16	.493	.000	1990	1.01	.982	.352	1515	.9841
DICTATOR-E	3.60	.001	.001	1784	2.07	.067	.360	1442	.0779

B. Corporate PAC Contributions (Logged) (OLS)

Explanatory variable	Each CG variable on its own				Each CG on its own, plus other RHS variables				
	Coef.	p-value	R2	N	Coef.	p-value	R2	N	LR test
G-INDEX	0.21	.000	.009	1990	0.25	.000	.485	1613	.0000
E-INDEX	0.21	.000	.003	1784	0.40	.000	.489	1531	.0000
C_BOARD	0.66	.013	.013	1784	1.01	.000	.487	1531	.0009
INSIDERS_OWN	-3.40	.005	.009	942	-0.97	.409	.475	836	.4042
BLOCK_OWN	-0.08	.000	.045	877	-0.02	.080	.514	864	.0542
LNCSHR	1.42	.000	.219	1610	0.38	.001	.476	1352	.0001
LOGTDC	0.71	.000	.025	1896	0.02	.853	.475	1609	.8064
DEMOCRACY-G	-0.66	.315	.001	1990	-1.50	.001	.478	1613	.0015
DEMOCRACY-E	-0.53	.277	.001	1990	-0.88	.020	.482	1531	.0014
DICTATOR-G	0.30	.556	.001	1784	0.23	.584	.474	1613	.5995
DICTATOR-E	1.68	.000	.004	1784	1.34	.002	.482	1531	.0095

Notes. All p-values reflect robust standard errors. LR test reports the p-value of the likelihood ratio test, assuming that the reduced model (with other RHS variables alone) is nested inside the full model including relevant CG variable. Results reported in ight half of each panel reflect other right-hand side variables not reported (LNSALES, LOGEMPLOY, SALES3LS, REG, C4 and GOVSHARE, as well as Fama 48-industry and yearly dummies).

Table 6.

PAC Regressions – Combined Corporate Governance (CG) Variables – S&P 500 Sample

A. Corporate PAC Participation (Logistic)

	(1)		(2)		(3)		(4)		(5)	
Explanatory variable	Odds ratio	p-value	Odds ratio	p-value	Odds ratio	p-value	Odds ratio	p-value	Odds ratio	p-value
G-INDEX	1.13	.003			1.19	.002				
E-INDEX			1.34	.000			1.49	.000	1.53	.000
INSIDERS_OWN	1.21	.745	1.47	.517	1.08	.932	1.44	.700	1.83	.6533
LNCSHR	1.86	.000	1.36	.000	1.32	.008	1.28	.016	1.29	.011
LNSALES					5.16	.000	5.07	.000	5.30	.000
LOGEMPLOY					0.47	.008	0.52	.013	0.51	.012
SALES3LS					0.99	.754	0.99	.823	1.00	.980
REG					3.21	.039	3.29	.031	3.10	.049
C4					1.01	.168	1.01	.166	1.01	.107
GOVSHARE					0.98	.164	0.99	.284	0.98	.182
COMPANYAGE									1.00	.761
Fama 48-Industry dummies?	No		No		Yes		Yes		Yes	
Year dummies?	No		No		Yes		Yes		Yes	
N	752		741		591		582		565	
Pseudo-R-sq	0.154		0.145		0.347		0.357		0.361	

B. Corporate PAC Contributions (Logged) (OLS)

	(1)		(2)		(3)		(4)		(5)	
Explanatory variable	Coef.	p-value	Coef.	p-value	Coef.	p-value	Coef.	p-value	Coef.	p-value
G-INDEX	0.23	.005			0.31	.000				
E-INDEX			0.48	.000			0.62	.000	0.67	.000
INSIDERS_OWN	0.79	.516	1.04	.387	0.57	.669	0.89	.494	-1.34	.317
LNCSHR	1.57	.000	2.11	.000	0.44	.009	0.41	.015	0.41	.014
LNSALES					3.03	.000	3.05	.000	3.15	.000
LOGEMPLOY					-1.29	.000	-1.16	.001	-1.21	.001
SALES3LS					-0.01	.294	-0.01	.284	-0.01	.342
REG					1.22	.067	1.23	.072	1.29	.068
C4					0.02	.043	0.02	.033	0.03	.016
GOVSHARE					-0.15	.575	-0.01	.713	-0.23	.421
COMPANYAGE									0.00	.337
Fama 48-Industry dummies?	No		No		Yes		Yes		Yes	
Year dummies?	No		No		Yes		Yes		Yes	
N	752		741		591		681		654	
R-sq	0.239		0.243		0.503		0.511		0.517	

Notes. All p-values reflect robust standard errors.

Table 7.

Firm Fixed Effects Regressions – DEMOCRACY-G and Political Activity

A. Lobbying Participation (Logistic)

Explanatory variable	With firm fixed effects				With other RHS variables, plus firm fixed effects			
	Coef.	p-value	N	Firms	Coef.	p-value	N	Firms
DEMOCRACY-G	-2.26	.005	986	143	-1.93	.051	954	142

B. Lobbying Expenditures (Logged) (OLS)

Explanatory variable	With firm fixed effects				With other RHS variables, plus firm fixed effects			
	Coef.	p-value	N	Firms	Coef.	p-value	R2	N
DEMOCRACY-G	-0.64	.000	3431	498	-0.51	.006	3303	496

C. PAC Contributions (Logged) (OLS)

Explanatory variable	With firm fixed effects				With other RHS variables, plus firm fixed effects			
	Coef.	p-value	N	Firms	Coef.	p-value	N	Firms
DEMOCRACY-G	-1.23	.010	1990	498	-1.18	.016	1879	496

Notes. All p-values reflect robust standard errors. Results reported in right half of each panel reflect other right-hand side variables not reported (LNSALES, LOGEMPLOY, and SALES3LS, as defined in the text).

Table 8.

Political Activity and Firm Value

Industry-Adjusted Tobin's Q (OLS)

Explanatory variable	Each explanatory variable on its own				Each explanatory variable separately, with other RHS variables			
	Coef.	p-value	R-squared	N	Coef.	p-value	R-squared	N
LOBBY_YN	-0.22	.000	0.03	2187	-0.14	.020	.163	1632
CONTRIBUTE_YN	-0.19	.001	0.02	1077	-0.11	.066	.142	798

Notes. All models are OLS with median-industry-adjusted Tobin's Q as the dependent variable, defined as described in the text. All p-values reflect robust standard errors, clustered by firm. Results reported in right half of each panel reflect other right-hand side variables not reported (log book value of assets, log of company age, dummy for Delaware incorporation, return on assets, three-year sales growth, capital expenditure / assets, R&D / sales, and a dummy for missing R&D data.

Appendix

Correlation Matrix for Corporate Governance Variables

	G-INDEX	E-INDEX	COARD	INSIDER-OWN	BLOCK-OWN	LNCSHR
E_INDEX	0.7109					
CBOARD_IRRC	0.5476	0.6513				
INSIDERS_OWN	-0.0435	-0.0662	-0.0506			
BLOCK_OWN	0.0167	0.0271	-0.0266	0.5363		
LNCSHR	0.0035	-0.0546	-0.0033	-0.3073	-0.3387	
LOGTDC1	-0.0334	-0.0776	-0.0505	-0.0143	-0.1009	0.1392