

AMERICAN UNIVERSITY OF BEIRUT

CORPORATE POLITICAL ACTIVITY AND FIRM
OWNERSHIP STRUCTURE

by
MANAL HASSAN TARHINI

A project
submitted in partial fulfillment of the requirements
for the degree of Master of Business Administration
to the Suliman S. Olayan School of Business
at the American University of Beirut

Beirut, Lebanon
January 2014

AMERICAN UNIVERSITY OF BEIRUT

CORPORATE POLITICAL ACTIVITY AND FIRM
OWNERSHIP STRUCTURE

by

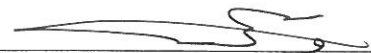
MANAL HASSAN TARHINI

Approved by:



Dr. Samer Khalil, Assistant Professor
Suliman S. Olayan School of Business

First Reader



Dr. Wassim Dbouk, Assistant Professor
Suliman S. Olayan School of Business

Second Reader

Date of project presentation: January 14th, 2014

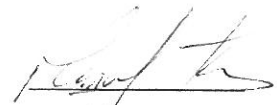
AMERICAN UNIVERSITY OF BEIRUT

PROJECT RELEASE FORM

I, Manal Hassan Tarhini

authorize the American University of Beirut to supply copies of my project to libraries or individuals upon request.

do not authorize the American University of Beirut to supply copies of my project to libraries or individuals for a period of two years starting with the date of the project deposit.


Signature

14th Jan, 2014
Date

ACKNOWLEDGMENTS

I would like to offer my appreciation to Dr. Samer Khalil and Dr. Wassim Ddbouk for their great help and assistance.

I would have not finished this project without the support of my husband, mother, and father who have always been there for me whenever I needed them. Thank you.

Last but not least I would like to thank my daughters, Sara & Zena, for putting up with the long hours of studying required for the completion of this project, and primarily being responsible of each other during my travel to Lebanon.

AN ABSTRACT OF THE PROJECT OF

Manal Hassan Tarhini for Master of Business Administration
Major: Business Administration

Title: Corporate Political Activity and Firm Ownership Structure.

Corporate political activity refers to corporate tactics that attempt to influence and impact government policymaking in a way that reaps favorable consequences to the firm. This paper investigates the relationship between CPA and the family ownership structure. We examine whether the likelihood of CPA in family firms is significantly different from that in non-family firms.

We rely on prior research that has investigated CPA mainly in international context and various theories associated with family firms in our attempt to explore variables that impact political activity on a firm level.

Our sample consists of 10,678 observations from 2009 through 2012 for firms listed on the North American stock exchange. We conduct a probit analysis for panel data from 2009-2012 using STATA by including the corporate political activity as a dependent variable, the family ownership as an independent variable, as well as other control variables found previously significant in the literature. We document that family firms are more likely to engage in corporate political activity when compared to non-family firms. Furthermore, our model reveals that size and age of the firm to be strong predictors for engagement in political corporate activity.

CONTENTS

	Page
ACKNOWLEDGEMENT	v
ABSTRACT.....	vi
LIST OF TABLES.....	ix
Chapter	
I. INTRODUCTION.....	1
II. LITERATURE REVIEW.....	5
A. Corporate Political Activity (CPA)	5
1. Lobbying.....	6
2. Government Membership on Company Boards.....	6
B. Family Ownership Structure	7
1. Political Activity in Family Firms versus Non Family Firms.....	7
a. Institutional Ownership	7
b. Managerial Influence.....	7
c. Founder vs. Non Founder Firms.....	8
d. Ethnicity and Political Preference at the Family Firm Level	9
e. Social and Educational Relationships	9
f. Firm Size.....	9
g. Copy Effect among Family Firms	10
h. Firm's Specific Industry.....	10
i. Leverage.....	10
C. Consequences.....	11
III. HYPOTHESES DEVELOPMENT.....	14
A. Corporate Political Activity and Firm Ownership Structure	14

IV. RESEARCH METHODOLOGY	16
A. Sample	16
B. Model	17
1. Test Variables	17
2. Control Variables.....	18
V. ANALYSIS	20
A. Descriptive Statistics	20
B. Regression Analysis.....	22
VI. CONCLUSION	24
BIBLIOGRAPHY	27

TABLES

Table	Page
1. Variable definition	18
2. Descriptive statistics of the main variables	20
3. Descriptive statistics divided by firm type	21
4. Correlation matrix of the main variables	22
5. Random effects Probit Regression of the CPA.....	23
6. Summary Table of Literature Results.....	25

To

My Daughters

Sara, Zena & Serena

CHAPTER I

INTRODUCTION

In 2010, the ruling in the Citizen United case by the U.S. Supreme court, which tossed a century old precedent and declared the government restriction on corporate political spending to be unconstitutional, brought to the front the topic of CPA (Corporate Political Activity). Investors' interest in this topic surged as they requested more disclosure on lobbying expenditure and demanded more boards' transparency when it comes to political activities. The center for Responsive politics' website shows that between 2006 and 2010, corporate political spending has increased four times, and it is increasing constantly every fiscal quarter. A 2011 Si2 study found that S&P 500 companies spent a total of \$1.1 billion on 2010 political contributions, where 87% of this total was spent on federal lobbying expenditure (Forbes). In 2012, a study conducted by Kang & Zhang revealed that the number of US publicly listed firms that have appointed former government officials as their outside directors has increased from 31.47% in 1990 to 54.53% by 2007. Scholarly research in the area of CPA has been conducted in order to better understand the causes and consequences of political activities at the corporate level and overall revealed mixed evidence. What motivates firms to appoint government directors and the impact on firm's value had been the subject of inquiry of many researchers. Many studies revealed that having politicians on board is more prevalent in countries with weak legal systems and high levels of corruption (Fisman 2001; Faccio 2006; Chen 2010; You 2012). It builds on the assumption that in countries with strong legal system such as in the US, companies are less susceptible to receive preferential treatment from political connections. Though this argument is

logically correct, studies are revealing the opposite. Going back to Usury law in the 19th century, Benmelech and Moskowitz (2007) found evidence that it was used by incumbents with political power to restrain competitors to access certain markets across different states in the US. More recently, Goldman *et al.* (2009) concluded that within the confine of the strong legal system in the US, political connections have a prevalent impact on the value of public companies; to be more specific, he detected a positive abnormal stock return following the announcement of the nomination of a politically connected individual to the board. Also, Vidal (2010) examined the evidence of political connection in the US and was able to measure the value of political connections. His study revealed that a connection to an active senate translates into approximately 23% increase in lobbying revenue while a connection to a serving Representative translates into an increase of 8%.

While these studies enhance our understanding of the implications of political connections on firm value, we find that studies examining direct links between ownership in corporations and political activity in the United States aren't fully developed. Most research on corporate political activity has focused primarily on broad industry level influences and ignored to consider the ownership structure. Muntean significantly highlights the lack of incorporating the ownership variable into corporate political activity studies and stresses that overlooking this key factor leads to omitted variable bias and misleading results (Muntean 2009).

In an attempt to demystify how boards are constructed and why they differ across different types of firms, Klein (1998) builds on the resource dependency theory that promotes the linkage of a firm to its external environment in an attempt to secure its needs.

Klein (1998) detects strong association between the specific economic needs of

companies and the incidence of directors most likely to fulfill these needs. In particular, theoretical and empirical evidence is presented that most affiliated directors are not puppets of management, but are placed on boards to serve specific, strategic needs of firms. Furthermore, he proves that the economical needs hypothesis holds true where directors are placed on board in direct proportion to how they fill the economic needs of the company.

From a different perspective, family firms are currently viewed from two different perspectives: the alignment or entrenchment standpoints (Khalil *et al.* 2008). The alignment perspective suggests that family ownership aligns shareholders' interests with those of small shareholders and consider continuity and stability as the ultimate objective. On the other hand, the entrenchment perspective states that family members will use their position to influence minority shareholders. This leads us to two conflicting views discussed by Khang (2012). The first one, the monitoring/advising view, government directors are nominated to the boards because they bring several benefits to the firm since they have valuable connections and information about the public policy process that can facilitate business with government. The second view, the rubber stamp view, suggests that (ex) political figures are appointed on boards to act more like high profile costly window dressing (Khang 2012) that meets less productive motives and plays less important value enhancing role. These views help explain the causes and the consequences of political activity at the corporate level.

Building on the resource dependency theory, the alignment perspective, and the monitoring/advising view; this paper will examine whether political connections are more or less prevalent in family firms than non-family firms. This study contributes main strands of literature investigating political connections in the following ways. It investigates whether the likelihood of political connection varies with the firm

ownership structure and whether there is a correlation between CPA and firm ownership structure. We present the causes of CPA and include the majority as our control variables in our logistic regression.

This paper proceeds in the following way: we present the literature review and hypotheses development. Then, we discuss the methodology including our sample selection and statistical models, followed by the results, additional analysis, and discussion and conclusion.

CHAPTER II

LITERATURE REVIEW

To examine whether political connections are more or less prevalent in family firms than non-family firms, this review intends to identify the causative factors that lead firms to engage in political activities and to shed light on possible consequences. Through our literature review, we pinpoint a crucial element that impacts political engagement at the firm level and that is, firm's ownership structure. Under this headline, we spot that founder family versus non founder family, institutional ownership, CEO tenure and top management team heterogeneity, are all influencing factors; in addition to this, we reveal other explanatory factors at the firm level: ethnic & political preferences, social & educational relationships, firm's specific industry, size, and leverage.

A. Corporate Political Activity (CPA)

Corporate political activity is commonly regarded as an effective means of influencing policy makers in Washington D.C (Chressanthis 1991). It includes all activities that enable a firm to reach policymakers in order to satisfy firm objectives. Firms have been influencing governments through direct lobbying, government membership on company boards, political action committees, and direct contributions (Lawton 2012; Delmas 2010; Okhmatovisky 2010).

Given the significant figures and trends pertaining to lobbying and government membership on boards that we presented earlier, we'll be discussing these 2 factors in details below.

1. Lobbying

Vidal (2011) shed light on a dominant feature of the lobbying industry in the US, “the revolving door phenomenon”. It describes how former experienced ex-government officials exploit their personal connections acquired during their public service through lobbying activities. Companies or interest groups can acquire indirect links to serving politicians by hiring their former employees. Ex-staffers can sell access to powerful politicians by 'cashing in on their connections', since connections to people in power are an asset. Acemoglu (2011) also points out the importance of “the power of access”, which he refers to as the legal currency of lobbyists. In simple terms, Acemoglu explains that power of access permits influencing powerful people when they make decisions.

2. Government Membership on Company Boards

Searching for the causes behind the inclusion of different types of directors, Klein (1998) detected a strong association between the specific economic needs of firms and the incidence of directors most likely to fulfill these needs. Through the board of directors, the firm attempts to secure its overall economic needs and reduce associated costs. Firm size, firm specific risk, whether the firm is in a regulated industry, and the need to external financing were cited as positively related factors to the incidence of ex-political figures on the board (Klein 1998).

The ability to bring benefits to a firm through valuable connections and privileged information about the public policy process and the ability to divert government actions towards the firm's best interest were cited as leading factors that usually lead to the appointment of political figures on board (Zhang 2012). This is in line with the productive motive and the “advising/monitoring view” that we referred to

earlier.

B. Family Ownership Structure

1. Political Activity in Family Firms versus Non Family Firms

Zooming into specific firm influences, researchers started to investigate the ownership structure in firms and its impact on being engaged in political activities.

Thus, I present below a discussion of specific explanatory factors stemming from the ownership structure that explains a firm's engagement in political activities.

a. Institutional Ownership

An interesting study by Hadani (2010) investigated institutional ownership and corporate political activity revealed that ownership concentration is crucial in curtailing manager's opportunistic behavior. It postulates that higher levels of institutional investor ownership are associated with lower levels of CPA. The reasoning behind it is that, given the equity stakes of the largest institutional investor, they might be the ones to lose the most by allowing firms to engage in political speech if it isn't in line with their own agenda.

b. Managerial Influence

Ozer (2009) investigated the influence of top management teams on CPA and concluded that conditional on CEO tenure and top management team heterogeneity, senior executives' involvement in a particular political activity affects their firm's commitment to that political activity.

c. Founder vs. Non Founder Firms

Chen (2010) disclosed that in a concentrated control structure, rent seeking through political connections might thrive more since the controlling owner gets to retain all of the benefits from connections with politicians. Likewise, Muntean (2009) revealed that owner-entrepreneurs type of family firms that are managed by the family owners are better able to translate strong political preference into rational political action. Hadani (2007) suggested that founding family firms tend to be more inclined to be engaged in corporate political activity only when the founder of the firm is still in an executive position since the latter has power over decision making and direct control over financial resources that can be diverted towards political activities.

On the other hands, Carney (2005) considered heirs to large family firms to be more likely to engage in political lobbying than founder family firms in an attempt to preserve their wealth. Likewise, Wallevik (2009) reported that second and third generation firms are more likely to appoint outside directors (which includes politicians). In line with these studies, Carney (2005) considers the competitive advantage of family controlled firms stems from their system of corporate governance. Unlike the widespread view that family firms have a lower agency cost due to the unification of ownership and control, Carney (2005) raises awareness to the inefficiencies in family controlled firms caused by shareholder expropriation. Due to the capital premium that public traded family firms have to pay to compensate their minority investors, public family firms run the risk of being able to raise capital which inhibits the growth of the firm. Hence, heirs to family firms are more concerned to preserve their wealth through political lobbying.

d. Ethnicity and Political Preference at the Family Firm Level

Some findings suggest that closely held firms, like family firms, may be more inclined to establish political connections (Chaney 2011; Morck *et al.* 2000; Morck and Yeung 2004). In the context of family business, studies show that ethnicity and political preferences matter more; Hadani (2010) suggests that CPA maybe personally motivated. Hence, some family firms which possess political and ideological inclinations tend to translate it into coherent political actions (Muntean 2011), in an attempt to create “axes of solidarity” (Carney 2005).

e. Social and Educational Relationships

Khang (2012) stressed the significance of social and educational relationships between CEOs and government directors since CEOs are more likely to recommend the appointment of government directors when they have social ties to them. Muntean posits that founding families share social networks with political elites, and since family controlled firms are concerned with long term investments, developing long term relationships with party elites becomes more like a long term strategy. This complies with the alignment and resource dependency theory that we discussed earlier.

f. Firm Size

Muntean (2011) investigates the firm size factor in engaging in CPA and discusses it as a factor affecting CPA. He argues that size by itself should not be causative for engagement in political activity. However, from a resource based perspective, it can be argued that firms with larger revenue might have bigger resources to give to politics as size might make it more visible for politicians.

g. Copy Effect among Family Firms

Wallevik (2009) shed light on the “copy effect” in family firms as he observed similar board practices among firms of comparable structure and size. The phenomenon behind is “What works for them should work for us” (Wallevik 2009; Loining 2001).

h. Firm’s Specific Industry

Khang (2012) revealed that politicians on board of directors are distributed across all industries but more probably to be present in regulated industries that conduct close business with the government. The incidence of having politically experienced directors on board was higher in sectors whereby cooperation with the government was more important; more specifically when sales to government are larger, exports are larger, and lobbying is larger (Agrawal and Knoeber 2001). A positive relation was detected between the incidence of (ex)-political figures on the board and whether the firm is a utility or in the defense industry (Klein 1998); Similarly, Burris found that Aerospace, defense contractors, utilities, and large commercial banks give more to incumbents. A different view was marked by So (2009), companies with politically connected boards are evenly distributed across the Fama-French industry groups.

i. Leverage

Leverage is another reason why we think family firms would engage more in political activities compared to non-family firms. La Porta *et al.* (1999) marked that family control imposes a capital constraint that might hinder the growth of the firm; hence, heirs to family firms are more likely to attempt preserving their wealth through political lobbying (Carney 2005; Morck *et al.* 1998).

This review focused more on the structural ownership of the firm as it was

evident that past studies lacked full consideration of this aspect. The factors that we pinpointed are: firm size, leverage, institutional ownership, CEO tenure and top managerial influence, founder family vs non founder, firm's ethnic and political preferences, social & educational relationships, firm's specific industry, and copy effect among family firms.

C. Consequences

Having discussed the causes behind corporate political activity, the part below will examine the consequences and implications it can exhibit on the firm.

Across different types of organizations and environments, different implications out of political connections have been reported. Most of the studies that investigated the relationship between corporate governance and firm performance were done for emerging markets. Studies conducted on emerging markets reported mixed impact on firm value, which we'll be discussed briefly below.

Many researchers argue that political connections impact firm value favorably. They argue that political connections are valuable since it would help them establish ties with the government and in return this help firms to gain comparative advantages, which enhances firm performance and value (Wu 2010; Fisman 2001; Goldman *et al.* 2009; Johnson and Mitton 2003). After examining the value of political connections as a factor of ownership structure, whether the firm is state or privately owned in China, (Wu 2010) found that private firms with politically connected managers have a higher value than those lacking such managers. Many other advantages were reported as well, for instance, easier access to loans from state-owned bank (Claessens *et al.* 2008), more favorable tax treatment (Faccio 2006), greater chance of government bailout in case of default, higher IPO price (Francis *et al.* 2009).

On the other hand, negative outcomes were also detected. Poor accounting quality and poor corporate governance have been detected in politically engaged firms compared to non-connected ones (Qian 2011; Faccio 2009). Gedajlovic (2012) reported that the limited access to powerful politicians makes successful rent seeking limited to few family firms, which in turn leads to creating a class of “villainous” and “oligarchic” families. You (2012) related CEOs turnover to political connectedness in China; his study showed that CEO’s political ties had an adverse effect on CEO’s turnover as it reduced turnover- performance sensitivity. Boubakri (2012) conducted an international study covering 31 countries to address the impact of political connections on cash holdings, and concluded that political connections are conducive to agency problems.

In the United States, studies examining the impact of political connections on firm value are still at infancy. Vidal provided the first quantitative evidence to political connections in the US. His study focused on putting a value for connections at a moment of intense financial crisis. He found a strong connection between being connected to a serving politicians and revenue. His estimate suggests that an active senate connection translates into approximately \$372,000 per year in lobbying revenue, while the exit of a senator leads to approximately \$182,000 per year fall in revenues for each affiliated lobbyist. Yu and Yu (2010) concluded that firms with more connections to government are treated more favorably by the Securities and Exchange Commission (SEC) in the event of accounting fraud. Furthermore, Goldman *et al.* (2009) analyzed the impact on U.S. firms by examining the change in control in both the House and the Senate following the 1994 midterm election, and the Presidency election in 2000. The study yielded that firms connected to the winning party experienced an increase in value whereas those connected to the losing party experienced a decrease. The study provided evidence that political connections affect the allocation of procurement contracts as

well. Do (2012) also investigated the value of political connections in the US and found that it is more valuable in small firms, in firms that rely more on external finance, and in firms with some activities in the politician's state prior to the election, and in a state with a higher level of regulation and corruption.

In conclusion, based on the review above, this study aims at investigating whether political connections are more or less prevalent in US family firms.

CHAPTER III

HYPOTHESES DEVELOPMENT

A. Corporate Political Activity and Firm Ownership Structure

In this Chapter, we develop our hypothesis to test for the likelihood of corporate political activities for family firms compared to non-family firms. Within the frame of the two perspectives on family firms that we discussed earlier, the alignment and the entrenchment perspective, in addition to the resource dependence theory, and the advising /monitoring view that we presented earlier, we initially test whether the likelihood of political activity for family firms is significantly different from that of non-family firms.

From an alignment perspective, Morck (2004) argue that oligarchic families have an innate advantage as political rent seekers because of their blood ties with political elites, life span, small number, diplomacy, and power. These exclusive traits enable them to create trustworthy relationships with public officials that raise the returns to political rent seeking. Furthermore, Zahra (2010) noted that owner-managers enjoy considerable discretion in cultivating and leveraging their personal social networks. Based on these findings pertaining to the corporate political activity, viewing family firms from the alignment (entrenchment) standpoint makes it more (less) for these firms to be engaged in corporate political activity compared to non- family firms.

From the entrenchment standpoint, Hadani (2010) argues in line with recent scholarship findings that due to the complexity of monitoring firm CPA and the mixed outcomes so far associated with CPA, agency cost is higher as CPA diminishes the informativeness of managerial behavior and increases the monitoring cost of politically

active firms.

Increasing board independence is a key title and objective of the Sarbanes-Oxley Act. It specifies the proportion of independent directors serving on US public company boards and clarifies the definition of what constitutes “independence of a director”, all in order to improve board’s oversight responsibilities, increase internal control and protect stakeholders. Applying this in the context of family firm, controlling family members hold key positions, and can have major impact on the elections of the board members (dual class shares); and due to their ethic and political preferences that we mentioned earlier, we expect family firms to have more (ex) politicians or government buddies on their board of directors that are compared to non-family firms, in their attempt to increase board independence in order to preserve continuity and survival of the firm in the market.

Hence, given all the arguments presented above, we expect family firms tend more to engage in political corporate activity than non-family firms. We thus test the following hypothesis:

H: Family ownership is associated with corporate political activity

CHAPTER IV

RESEARCH METHODOLOGY

In this chapter, we initially describe our sample: source database, selection, and matching criteria. We then construct our model. Finally, we discuss the test and results.

A. Sample

We obtain our initial sample from matching 2 databases: The Corporate Library, a leading independent provider of U.S. corporate governance research where we got detailed data related to the composition of board of directors over the period of 2009-2012. The corporate library contains 2 Tables, one related to the companies, and one that is related to the directors. We obtained the directors information and the name of the company they worked in.

Then we obtain firms' financial information from Compustat and merge all the above data. We match the companies' board information with the compustat data on the TIC symbols. We exclude firms with no Compustat data and missing values.

The final matching sample consists of 10,678 filings for firms traded on NYSE and NASDAQ.

We filtered our data based on the political connections of the board of. The criteria that we used was similar to the one's used in Goldman *et al.* (2009) as it was the first study to apply a viable measure and a clear definition of political connections. A company was identified as politically connected if at least one board member held such a post:

President, Presidential Candidate, Senator, Member of the House of Representatives, (Assistant) Secretary, Deputy Secretary, Deputy

Assistant Secretary, Under Secretary, Associate Director, Governor, Director (CIA, FEMA), Deputy Director (CIA, OMB), Commissioner (IRS, NRC, SSA, CRC, FDA, SEC), Representative to the United Nations, Ambassador, Mayor, Staff (White House, President, Presidential campaign), Chairman of the Party Caucus, Chairman or Staff of the Presidential Election campaign, and Chairman or member of the President's Committee/Council.

We then retain the directors' profile that match with the above and assigned a CPA value as equal to 1. We extract the name of the companies of only the directors that are currently active. We dismiss the companies related to the directors that were previously active but aren't currently.

B. Model

We test our hypothesis investigating whether the likelihood of corporate political activities in family firms is significantly different than that in non-family firms using logistic regression. We will use logistic regression as in the following equation:

$$\text{CPA} = \alpha_0 \text{INTERCEPT} + \alpha_1 \text{FF} + \alpha_2 \text{LNASSET} + \alpha_3 \text{LEVER} + \alpha_4 \text{BDINDEP} + \alpha_5 \text{INDUSTRY} + \alpha_7 \text{INSCONT} + \alpha_8 \text{INSTITMAJ} + \gamma$$

Variables definitions are state in Table 1

1. Test Variables

We incorporated a dummy equal to one in the logistic regression model in case the firm is classified as a family firm. H1 predicts if political connections in family firms is significantly different than that in non-family firms

Table 1. Variable definition

Variable	Description	Source
CPA	1 if the firm engages in political activity, and 0 otherwise	Corporate Library, DirProfile
LNASSET	Natural log of Total assets	Compustat, at
LNFIRMAGE	Natural log of Firm age	Corporate Library, Firm age
FF	1 if the firm is classified as a family firm, and 0 otherwise	Corporate Library, OwnershipCategory
LEVER	long-term debts divided by total assets	Compustat
BDINDEP	percentage of independent directors n board	Corporate Library, DirectorsOutsidePct
INDUSTRY	Firm's specific Industry (regulated or not)	Corporate Library: SIC code then check if it's regulated or not
INSCONT	1 (whether) or 0 (not) a majority of outstanding shares are held by top management and/or directors	Corporate Library, insidercontrol
INSMAJ	1 (whether) or 0 (not) a majority of outstanding shares are held by institutions	Corporate Library, institutions majority

2. Control Variables

Consistent with prior studies, we expect that the ownership structure, board characteristics, and firm's characteristics to affect political engagement. We control for firms' institutional ownership (INSMAJ) as Hadani (2010) posited that institutional ownership is associated with reduced CPA among S&P 500 firms. We control for the size factor defined by ASSET or LNASSET (total assets or natural logarithm of total assets) as Goldman *et al.* (2009) marked that connected companies tend to be larger than non-connected in the US. As we highlighted earlier, the composition and the independence of the board is a crucial factor. As we control for the percentage of independent directors on board (BDINDEP) as Goldman *et al.* (2009) clearly highlighted that CPA increases as the independence of the firm decreases. We control

for the industry (INDUSTRY) as Muntean (2011) found it's one of the most important factors, but we will take it as a binary variable (regulated or not) as regulated industries are more close to the government and are more susceptible for political activity. We control for insiders control by incorporating the dummy variable (INSCONT) to indicate whether or not a majority of outstanding shares are held by top management and/or directors. Furthermore, we control for INSTITMAJ which indicates whether or not a majority of outstanding shares are held by institutions.

CHAPTER V

ANALYSIS

A. Descriptive Statistics

We obtained the summary statistics of each variable of the full sample in Table 2. We note particularly that 72% of board directors are independent on average and 5% of the companies are associated with corporate political activity.

Table 2. Descriptive statistics of the main variables

N = 3783	Minimum	Maximum	Mean	Std. Deviation
CPA	0	1	.05	.217
INDUSTRY	0	1	.36	.479
INSCONT	0	1	.08	.271
INSTITMAJ	0	1	.63	.482
FF	0	1	.21	.404
BDINDEP	.0000	1.0000	.722090	.1467969
LEVER	.0000	3.3552	.190578	.2221639
LNASSET	1.6006	14.6330	7.300549	1.7895490
ASSET	5	2264909	11679.60	86584.249
LNFIRMAGE	0.693	5.455	3.413	0.906

The sample was then divided into family/non-family firms and summary statistics were reported in Table 3. 20.5% of the companies are family firms. The most notable differences in means were ASSET: family firms tend to be smaller in size than non-family firms by 70%, insider control is largely adopted in family firms (26%) and practically inexistent in non-family firms (3%) (means difference = 786%). Corporate political activity CPA is more prevalent in family firms than in non-family firms means difference = 5%. To check further the significance of this difference, we performed a

means difference t-test of the 2 groups.

Table 3. Descriptive statistics divided by firm type

	Non FF (N = 3005)		FF (N = 778)	
	Mean	Std. Deviation	Mean	Std. Deviation
CPA	.049	.216	.052	.222
INDUSTRY	.36	.481	.34	.473
INSCONT	.03	.182	.26	.437
INSTITMAJ	.64	.480	.61	.488
BDINDEP	.742762	.1416342	.642323	.1389291
LEVER	.194938	.2195881	.173753	.2311776
LNASSET	7.441647	1.8169242	6.756093	1.5655049
ASSET	13666.74	96757.526	4011.78	15088.881
LNFIRMAGE	3.43	0.93	3.34	0.777

Table 4 reports the Pearson correlation matrix of our studied variables. There are correlations that are significant at the level of 95% confidence interval (shaded in light yellow) and other that are significant at the 99% confidence interval (shaded in dark yellow). There is a strong positive correlation between LNASSET (size) and CPA (political activity) as asserted previously by So (2009). Also the smaller the size of the firm, the more it tends to be a family firm (negative correlation) and the most likely is to have a non-independent board (highest negative correlation = -0.27). To note that despite that the correlation is significantly less than one, but they are statistically significant for values higher than 0.037, since the sample size is large (N = 3783). However, we have to be cautious when it comes to analyzing correlation matrix, given that we have panel data.

Table 4. Correlation matrix of the main variables

	CPA	INDUSTRY	INSCONT	INSTITMAJ	FF	BDINDEP	LEVER	LNASSET	LNFIRMAGE
CPA	1.000								
INDUSTRY	-.041	1.000							
INSCONT	-.004	-.067	1.000						
INSTITMAJ	-.019	.069	-.134	1.000					
FF	.009	-.025	.363	-.026	1.000				
BDINDEP	.018	.070	-.318	.104	-.314	1.000			
LEVER	.026	-.062	.045	-.018	-.039	-.066	1.000		
LNASSET	.104	-.147	-.118	.170	-.164	.219	.176	1.000	
LNFIRMAGE	-.026	-.024	-.019	.093	-.039	.116	-.013	-.178	1.000

3783 sample size

± .032 critical value .05 (two-tail)

± .042 critical value .01 (two-tail)

B. Regression Analysis

The collected data is a panel data and varies across 4 years. Since the output variable CPA is categorical and binary, we perform a probit analysis for panel data using STATA. We should choose between fixed effects or random effects model. Fixed effects model is chosen when we believe there is relationship between entities across years and we want to isolate the time effect from the entity itself. Random effects model is chosen when we believe that the entities are time-invariant, that is the correlation between the entity and time is 0. We adopt the random effect model since 4 years is considered a short very period relative to the chosen variables and results should not vary across time according to a certain relationship, but only according to chance. We obtained the results in Table 6.

INDUSTRY, INSCONT, INSTITMAJ and FF were set as categorical variables. Variables p-values that are less than 0.05 indicate they are significant: the only variables that are significant is LNASSET, LNFIRMAGE, INSTITMAJ and the constant. However the overall model is quite significant (Chi2 = 55.7, p<0.0001). rho is the percentage of the variance that is explained by the time, which is negligible as

assumed (3.06 e-07). Therefore we can consider that time doesn't contribute to the explanatory power of the model. We can also conclude that family firms are more likely to be politically connected than non-family firms.

Table 5. Random effects Probit Regression of the CPA

Model Summary						
Nb of Obs	Nb of Gr	-2 Log likelihood	Wald Chi2(8)	Prob> Chi2		
3783	2153	-739.04266	55.97	0.00000		
Variables in the Equation						
	B	S.E.	z	P> z 	95% conf int	
LNASSET	0.14	0.02	6.49	0.00	0.09	0.18
FF	0.18	0.09	1.89	0.06	-0.01	0.36
LEVER	0.09	0.16	0.53	0.60	-0.23	0.40
LNFIRMAGE	-0.09	0.04	-2.31	0.02	-0.16	-0.01
INDUSTRY	-0.13	0.08	-1.66	0.10	-0.28	0.02
DDINDEP	0.21	0.27	0.75	0.45	-0.33	0.74
INSCONT	-0.04	0.15	-0.28	0.78	-0.33	0.25
INSTITMAJ	-0.16	0.08	-2.08	0.04	-0.31	-0.01
_cons	-2.46	0.26	-9.36	0.00	-2.98	-1.94
Lnsig2u	-15	367			-734	704
Sigma_u	.0005531	.101473			3.8e-160	8.1e+152
Rho	3.06e-07	.0001122			0	1

CHAPTER VI

CONCLUSION

This project investigates the relationship between corporate political activity and family ownership. We test for the effect of family ownership on the likelihood of engaging in political activities while controlling for other factors relating to industry, size, leverage, firm age, and board composition. As discussed in our literature, we expected the alignment perspective and the resource dependency theory to justify and support CPA at the family firms' level compared to non-family firms. The results of our test proved our expectations to be correct. Our sample consists of 3783 filings of directors' profiles during the period 2009 through 2012. After running a probit analysis on the panel, we find that family firms are more likely to engage in corporate political activity when compared to non-family firms. Our study was the first to explore the impact of family ownership on the firm and engagement in corporate political activity. Through our test, we found the relationship between CPA and family ownership structure to be present. However, we find the firm size and age to impact the likelihood of CPA as well. That is, larger firms seem more likely to engage in CPA. This finding is consistent with prior research findings by Goldman *et al.* (2009). Therefore, our project exposes new findings to the stream of research pertaining to political connections and to family firms. Family ownership is associated with corporate political activity. Since we detected a relation between family firms and CPA, future research may investigate the impact it may entail on the family firm.

Table 6. Summary Table of Literature Results

Author	Research Question	Findings
Goldman <i>et al.</i> , 2009	Do Politically Connected Boards Affect Firm Value?	A positive abnormal stock return following the announcement of the nomination of a politically connected individual to the board was detected.
Faccio, 2006	Do connections add to company value?	Significant increase in corporate value was traced around the time of the announcements that politicians are joining boards.
Muntean, 2011	Why corporations engage in politics?	A positive correlation between size and political activity was evident. Corporations contribute to ideological causes and demonstrate party loyalty.
Hadani ,2010	What is the relationship between institutional investors and firm CPA?	Institutional ownership is associated with reduced CPA.
Hadani, 2007	What is the relationship between publicly traded FFFs and CPA, in particular expenditures?	The presence of the original founder manage the firm is associated with higher political activity than in non-FFFs.
Do, 2012	What is the impact of political connections on firm value in US?	The value of political connections in the US is more valuable in small firms, in firms that rely more on external finance, and in firms with some activities in the politician's state prior to the election, and in a state with a higher level of regulation and corruption.
Chaney <i>et al.</i> , 2011	What is the impact of political connection on the quality of accounting information?	CPA is associated with lower quality of accounting earnings.

“Table 6 – *Continued*”

Khang, 2012	What motivates firms to appoint government directors? And the impact of their presence on boards?	The role of government directors is associated with rubber stamp view. Their presence add value only when there is business with the government or regulatory agencies.
Agrawal, 2001	Do Some Outside Directors Play a Political Role?	Positive association between larger firms and the incidence of directors with political experience. Higher CPA detected where cooperation with the government is more important.
Boubakri, 2012	What is the impact on cash holdings in politically connected firms?	Cash holdings is higher in politically connected firms than non-connected peers.

BIBLIOGRAPHY

- Agrawal, A. and Knoeber, C.R. (2001). Do some outside directors play a political role? *Journal of Law and Economics* 44(1): 179-198.
- Benmelech, E. and Moskowitz, T.J. (2007). The political economy of financial regulation: Evidence from U.S. State Usury laws in the 18th and 19th century.
- Blanes, I.V., Draca, M. and Fons-Rosen, C. (2012). Revolving door lobbyists. *The American Economic Review* 102(7): 3731-3748.
- Boubakri, N., Cosset, J., Saffar, W. 2009. Politically connected firms: an international event study. Unpublished paper.
- Carney, M. (2005). Corporate governance and competitive advantage in family-controlled firms. *Entrepreneurship Theory and Practice* 29(3): 249-265.
- Chaney, P.K., Faccio, M. and Parsley, D.C. (2011). The quality of accounting information in politically connected firms; available from <http://dx.doi.org/10.2139/ssrn.966379>; Internet; accessed on March 2013.
- Chen, C.J.P., Li, Z., Su, X. and Sun, Z. (2011). Rent-seeking incentives, corporate political connections, and the control structure of private firms: Chinese evidence. *Journal of Corporate Finance* 17(2): 229.
- Chressanthis, G.A., Shaffer, S.D. (1991). PAC contributions and the return of incumbent US senators. *Quart Rev Econ Bus* 31:78-94.
- Claessens, S., Feijen, E. and Laeven, L. (2008). Political connections and preferential access to finance: The role of campaign contributions. *Journal of Financial Economics* 88: 554-580.
- Clark Muntean, S. 2009. A political theory of the firm: Why ownership matters. Order No. 3355888. ProQuest Dissertations and Theses, University of California, San Diego, 184-n/a.
- Do, Q., Lee, Y.T. and Nguyen, B.D. (2012). Political connections and firm value: Evidence from the regression discontinuity design of close gubernatorial elections.
- Faccio, M. (2006). Politically connected firms. *The American Economic Review* 96(1): 369-386.
- Faccio, M. (2010). Differences between politically connected and non-connected firms: A cross country analysis. *Financial Management* 39: 905-928.

- Fisman, R. (2001). Estimating the value of political connections. *The American Economic Review* 91(4): 1095-1102.
- Fisman, R. (2001). Estimating the value of political connections. *American Economic Review* 91: 1095–1102.
- Francis, B.B., Hasan, I. and Sun, X. (2009). Political connections and the process of going public: Evidence from China. *Journal of International Money and Finance* 28: 696–719.
- Gedajlovic, E., Carney, M., Chrisman, J.J. and Kellermanns, F.W. (2012). The adolescence of family firm research: Taking stock and planning for the future. *Journal of Management* 38(4): 1010-1037.
- Goldman, E., Rocholl, J. and So, J. (2009). Do politically connected boards affect firm value? *Review of Financial Studies* 22: 2331–2360.
- Goldman, E., Rocholl, J. and So, J. (2009). Politically connected boards of directors and the allocation of procurement contracts. *Review of Finance* 17(5): 1617.
- Hadani, M. (2007). Family matters: Founding family firms and corporate political activity. *Business and Society* 46(4): 395-407,410,412-428.
- Hadani, M. (2012). Institutional ownership monitoring and corporate political activity: Governance implications. *Journal of Business Research* 65(7), 944.
- Johnson, S. and Mitton, T. (2003). Cronyism and capital controls: Evidence from Malaysia. *Journal of Financial Economics* 67: 351–382.
- Jorissen, A., Laveren, E., Martens, R. and Anne-Mie Reheul. (2005). Real versus sample-based differences in comparative family business research. *Family Business Review* 18(3): 229-246.
- Kang, J. and Zhang, L. (2012). From backroom to boardroom: Role of government directors in U.S. public firms and their impact on performance; available from <http://dx.doi.org/10.2139/ssrn.2115367>; Internet; accessed 20 July 2014.
- Khalil, S.K., Cohen, J.R. and Trompeter, G.M. (2011). Auditor resignation and firm ownership structure. *Accounting Horizons* 25(4): 703-727.
- Klein, A. (1998). Affiliated Directors: Puppets of Management or Effective Directors? Working Paper No. 98-010. New York University, Center for Law and Business.
- Monks, Robert A.G., and Nell Minow. 2011. *Corporate governance*. 5th Ed. Malden, Mass.: Blackwell Pub.
- Morck, R. and Yeung, B. (2003). Agency problems in large family business groups. *Entrepreneurship Theory and Practice* 27(4): 367-382.

- Ozer, Mine. (2010). Top management teams and corporate political: Do top management teams have influence on corporate political activity? *Journal of Business Research* 63(11): 1196-1201.
- Qian, M., Pan, H. and Yeung, B.Y. (2011). Expropriation of minority shareholders in politically connected firms; available from <http://dx.doi.org/10.2139/ssrn.1719335>; Internet; accessed 20 July 2014.
- Skroupa, C. (2012). Investors Want Disclosure of Corporate Political Contributions and Lobbying Expenditures. *Forbes*; available from <http://www.forbes.com/sites/christopherskroupa/2012/04/20/investors-want-disclosure-of-corporate-political-contributions-and-lobbying-expenditures-2/>; Internet; accessed 10 December 2013.
- Wallevik, K. 2009. Corporate Governance in Family Firms: The Norwegian Maritime Sector. Copenhagen Business SchoolCopenhagen Business School, Institut for International Økonomi og Virksomhedsledelse, Department of International Economics and Management.
- Wu, W., Wu, C. and Rui, O.M. (2010). Ownership and the value of political connections. *Rochester*; available from <http://dx.doi.org/10.2139/ssrn.1639714>; Internet; accessed 10 December, 2013.
- You, J. and Du, G. (2012). Are political connections a blessing or a curse? Evidence from CEO turnover in china. *Corporate Governance: An International Review* 20(2): 179-194.
- Yu, F. and Yu, X. (2010). Corporate lobbying and fraud detection. *Journal of Financial and Quantitative Analysis* 46(6): 1865.