

PAC-ing a Punch:

Economic Effects of Corporate Political Statements

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Abstract

This paper examines the motivations and financial consequences of corporate political statements. We use the announcements of a pause in corporate donations to political action committees (PAC) following the January 2021 Capitol riots. Firms operating in a politically polarized environment are more likely to make these announcements, irrespective of firm-level political risks. The average announcement returns are negative for firms exposed to high polarization and who face high political risks but positive for firms exposed to high polarization and facing low political risks. However, both these groups of firms gain in quarterly sales revenues and profitability after announcements. Our results highlight political polarization among consumers as a determinant of the strategic choice of firms to engage in political debates.

JEL Codes: D21, D82, G32, L21

Key Words: Political Strategy, Firm Value, Consumer Polarization

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Introduction

In recent times, large American firms have publicly commented on controversial political issues, notably the voting legislation in Georgia and the ratification of the 2020 presidential election results. A key feature of these comments is that these issues are not directly financially relevant to these firms' activities (Chatterji and Toffel 2019; Larcker et al. 2018). While big businesses have traditionally lobbied the politicians, they have publicly maintained silence on political issues.¹ Why are firms now deviating from that status-quo by publicly engaging in political debates? What is the effect of such actions on the shareholders' wealth?

This paper investigates the motivations and economic effects of direct corporate political statements through the lens of the unexpected mob attack on the US Capitol on 6th January 2021. The attack was linked to a faction within the Republican party who refused to accept the results of the 2020 Presidential elections. Following the attack, many US companies announced that they would pause contributions to Political Action Committees (PAC) of House and Senate lawmakers.² While the pause in corporate PAC donations immediately after a Presidential election is likely to be merely symbolic for the politicians, it is risky for the companies as these announcements could antagonize a subset of consumers who don't share the companies' worldview on the Capitol riots (Chatterji and Toffel 2019).³

The decision by companies to stop or temporarily pause donations to PACs is significant for two reasons. First, the managers of most US companies lean more towards the Republican party (Cohen et al., 2019). Second, while as individual citizens, the managers may disagree with the Capitol riots and the role of the Republican party in it, they could have withheld their donation without public announcements. Therefore, the public announcement of their company's stance is likely a signal to stakeholders - customers, employees, suppliers, and investors.

¹ Please see (Glazer and Cutter 2021) at <https://www.wsj.com/articles/capitol-riot-business-trump-biden-11610591424>

² PACs are organized for electoral campaigns, and they represent business, labor, or ideological interests.

³ Some companies announced pausing PAC donations completely, while others announced pausing donations to (Republican) lawmakers who refused to ratify the 2020 Presidential election results.

There is increasing evidence that stakeholder management, especially on social and environmental matters, is beneficial for the firm (Albuquerque et al. 2019; Flammer, 2015; Kassinis and Vafeas, 2006). As far as customers, employees and suppliers gravitate towards socially conscious firms, it improves profitability, and if such activities increase operational costs, it will be detrimental to financial performance. Investors prefer higher to lower returns on their investment and, hence, if being socially conscious positively affects return on investment, investors should favour that too. In the case of the environment, while those concerned about the issues will support environment-friendly activities/statements of companies, those who are not concerned will not oppose it. However, with politically charged announcements (such as the pausing of PAC donations), there could be customers who support the issue and those who oppose them. It is difficult for investors to know the net economic effects of these announcements, but their management increasingly has more information about their customer preferences. Therefore, a systematic examination of the strategic motives of announcing PAC donations pause is warranted.

We start by showing what determines a firm’s likelihood of announcing that they are pausing PAC donations following the Capitol attack.⁴ Specifically, we focus on two dimensions that predict the likelihood of companies making a direct political statement: the potential financial returns from such actions and the political risks a firm faces. First, we hypothesize that firms that operate in more politically polarized environments have more to gain from making such political statements. It makes them more likely to announce a pause in PAC donations following the capital riots. When the socio-political opinion of stakeholders is highly polarized, the effectiveness of the mass-market advertising strategy decreases (Melloni, Pataconi, and Vikander 2019). In such scenarios, firms can segment the market by “virtue-signalling” to one side of the partisan divide. The value of virtue signalling is more vivid on socially divisive issues - like political issues in the US - than on issues with a broader consensus (Hambrick and Wowak 2021).

⁴ For a discussion on the reconciliation of direct political statements with other related constructs such as lobbying, and donations, please see Hambrick & Wowak, 2021.

Second, we argue that firms with higher *ex-ante* political risks are less likely to pause PAC donations. Some companies are exposed to more political risks in their operating environment. Such risks emanate from firms' reliance on government contracts, dependence on export subsidies, and industry regulations. Firms attempt to mitigate these risks by making political donations and lobbying (Hassan et al., 2019). Making a political statement following the storming of the Capitol by a pro-Trump mob is likely to exacerbate such risks. Therefore, it follows that firms exposed to high political risks should be less likely to have paused political donation after the Capitol riots.

We use a measure of political polarization developed by (Kaplan, Spenkuch, and Sullivan 2019) to determine the exposure of a firm's operations to political polarization. This measure is constructed based on the spatial sorting of Republican and Democrat voters within a state.⁵ The higher the state's rank in the Kaplan, Spenkuch, and Sullivan (2019) index, the larger the fraction of the population who cares about socio-political causes, and the smaller the fraction of neutral customers.⁶ We show in Appendix 1 how the geographic sorting of voters (potential consumers) allows firms to create local monopolies through political statements. We overlay the polarization of US states in 2016 on the state-level operations of US public firms from their 10-K filings (García and Norli 2012).⁷ From the distribution of polarised environments of S&P 500 firms, we focus on companies operating in a highly polarized environment (*HP*) and low polarized environment (*LP*).⁸ The underlying logic is that firms' management reacts to the pressure of local stakeholders. Therefore, political polarization among stakeholders in states where they operate meaningfully determines the political actions of firms (Giannetti and Wang 2021).

⁵ This argument is consistent with recent evidence that the US electorate is shifting away from centrist ideologies, and that Democrat and Republican voters are increasingly clustering in spatial enclaves, even within the boundaries of a state (Draca and Schwarz 2021; Brown and Enos, 2018:)

⁶ The states with the highest *within*-state partisan polarization are Georgia, Illinois, Louisiana, Maryland, Mississippi, Missouri, New York, Tennessee, Texas, and Virginia.

⁷ The Kaplan, Spenkuch, and Sullivan (2019) measure correlates well with other manifestations of political polarization (Gangopadhyay and Homroy 2020). We discuss the tests for validity of this measure in the appendix.

⁸ Even though many of the S&P 500 firms have a global reach, the decisions related to political activities of these firms are likely to be affected by domestic institutional factors.

We rely on the method developed by Hassan et al. (2019) to calculate firm-level political risks. It is a computational linguistic method that uses transcripts of CEOs' quarterly earnings calls with equity analysts and calculates the weightage of political uncertainty related words used by the CEOs. It is a forward-looking measure of how a company's management perceives the political risk to affect their operations. From the distribution of political risks faced by S&P 500 firms, we focus on firms' operations in high political risk (*HR*) and low political risk (*LR*) environments⁹. The underlying logic is that all else being equal, companies exposed to higher political risk are less likely to make direct political statements than companies that face lower political risk.

We map the 152 companies that announced PAC donations between 7th January 2021 and 11th January 2021 along the four quadrants defined by (high and low) polarized environment and (high and low) political risk indicators - *HPHR*, *HPLR*, *LPHR*, and *LPLR*.¹⁰ We find no events in the *LPHR* and *LPLR* quadrants: firms that operate in a low polarized environment (*LP*) are less likely to announce pausing PAC donations, irrespective of their level of political risk. On the other hand, 69 percent of the events are mapped to the *HPLR* quadrant. These results suggest that political polarization in the operating environment triggers firms to make political statements to segment the market and profit from it. In *LPHR* and *LPLR*, the trigger is absent, and hence we see no firms in those quadrants. In *HPLR*, the presence of the trigger coupled with low political risk to the firms can explain why over two-thirds of the events are observed there. The curious case is that of *HPHR*, where the trigger is present, but the firms face more political risk - we see 31 percent of the observations in this quadrant. It appears that, for the companies, strategic priority to segment the market (*HP*) dominates the high political risks.

We then attempt to estimate how shareholders are affected by these direct political statements of firms in the short term. On average, investors react negatively to these announcements: cumulative average abnormal returns is -0.15% and statistically significant in a 3-day event window. From cross-

⁹ The *HR* and *LR* classifications are based on companies in the bottom and the top quartiles of the sample distribution of political risks.

¹⁰ There are only two trading days in this interval following the Capitol riots on 6th January 2021: Friday 7th January 2021 (32 events) and Monday 11th January 2021 (42 events, including two announcements made over the weekend).

sectional regressions, we find that the average value effect is driven by firms' strong negative announcement returns in the *HPHR* quadrant. In contrast, the announcement returns for companies in the *HPLR* quadrant are moderately positive. These negative announcement returns for *HPHR* companies are likely to reflect the investors' perception that high political risks will negatively impact the future cash flows of announcing firms.

Finally, we examine if firms' market segmentation motives in *HP* conditions lead to better financial outcomes in the long run. The strategic advantage of direct political statements should reflect in higher sales among polarized consumers. Therefore, we focus on sales revenues in the three quarters following the Capitol riots and the subsequent announcements (March 2021, June 2021, and September 2021). Using firm-fixed effects regressions, we show that the average sales revenues of announcing firms increase in the quarters after announcing PAC pause compared to the three quarters before the announcements. Complementing the longitudinal results, we show a cross-sectional increase in quarterly sales revenues for firms in both *HPLR* and *HPHR* quadrants relative to the *LPLR* group.

Asymmetric information explains the difference in short-term (announcement returns) and long-term economic effects (profitability) for the *HPHR* firms. Managers have more information about the political polarization among their customers and the potential benefits of market segmentation along partisan lines. Investors, who are less likely to have such information, know about the high political risk and perceive the political statements as potentially value-destroying.

We contribute to stakeholder theory and the burgeoning literature on the “socio-political” purpose of the corporation (Gangopadhyay and Homroy, 2021; Mkrtchyan, Sandvik, and Zhu, 2021). Emerging literature suggests that firms engage in social debates to cater to their customers' opinions or because their employees demand it. We add to this literature by showing that political polarization among consumers has real economic effects. Our results suggest that, under high political polarization, firms benefit from creating symbolic value for one group of stakeholders by making a political statement.

Finally, we contribute to the emerging debate on the purpose of modern corporations. Our results imply that when consumers are increasingly focused on consumptions with a “purpose”, stakeholder engagement is consistent with the objectives of shareholder value maximization.

Hypotheses Development

Stakeholder theory posits that a firm caters to wider stakeholders' preferences, not just the shareholders (Donaldson and Preston 1995; Friedman and Miles 2002; Laplume, Sonpar, and Litz 2008). In recent times, stakeholders of US companies are increasingly polarized along partisan lines and shifting away from centrist ideologies (Draca and Schwarz 2021). Consumers gravitate to brands that align with their value systems; firms then attempt to align themselves to the consumers' value (Hambrick and Wowak, 2021). Symbolism plays a prominent role as consumer purchasing decisions becomes an expression of identity (Aaker 1997).

As discussed in Appendix 1, companies can benefit from strategically signalling ideological associations in a polarised marketplace. When companies announced pausing PAC donations following the storming of the US Capitol by a pro-Trump mob, they were taking an ideological political stance. We hypothesize that companies that operate (both in terms of their production units and stores) will be more likely to announce pausing PAC donations to create symbolic value for a subgroup of their consumers.

Hypothesis 1: Companies that operate in more politically polarized environments are more likely to announce PAC donations pause.

However, firms differ in the level of political risks they face, which emanate from their exposure to regulations and government agencies. Companies that face more political risks decrease their investment and employment growth (Bloom, Bond, and Van Reenen 2007; Pindyck 1991). Companies manage political risk by donating to political campaigns or lobbying politicians (Hassan et al., 2019; Peltzman 1976). Therefore, companies that face higher political risk will be less likely to stop political donations following the Capitol riots.

Hypothesis 2: Companies exposed to higher political risks are less likely to announce PAC donations pause.

Ultimately, companies that announce pausing of PAC donations following the Capitol riots are motivated to make strategic choices that simultaneously benefit multiple stakeholders (Tantalo and Priem 2016). The financial impact of this strategy is likely to be jointly determined by the polarized operating environment and the firms' exposure to political risks. Firms perceive that the financial benefits accrue through market segmentation (Gangopadhyay and Homroy 2020; Melloni, Patacconi, and Vikander 2019). Consumers who identify their views in these announcements will buy more from announcing companies, even if another group stops buying from them. However, consumers are unlikely to make their purchasing decision based on the political risk-exposure of the firm. Therefore, we test the following hypothesis about the financial impacts of announcing the pause of PAC donations:

Hypothesis 3: Profitability of companies announcing PAC donations pause will be positively correlated to the political polarization among the consumer base but uncorrelated to the firm-level political risk

Data and Sample Selection

We begin by collecting all announcements made by S&P 500 firms that they are pausing PAC donations in the aftermath of the attack on the US Capitol on 6th January 2021 from Lexis Nexis, Factiva, and other publicly available sources such as the Wall Street Journal and the Washington Post. Even though several other firms announced pausing PAC donations, we focus on the S&P 500 because of their higher visibility to the stakeholders. In addition, we obtain data on state-level political polarization from (Kaplan, Spenkuch, and Sullivan 2019) and data on firm-level political risk from Hassan et al. (2019). Finally, we obtain companies' location and financial data from COMPUSTAT and share price data from Thomson Reuters Eikon.

Our main dependent variable is a binary variable that equals 1 if a firm declares pausing PAC donations (*PAC Pause*) between January 7th and 11th, 2021, and zeroes otherwise. 152 firms in the S&P 500 index with 44 percent of the combined market value announced pausing PAC donations¹¹. The first main independent variable is the political polarization in the operating environment of firms. We use the (Kaplan, Spenkuch, and Sullivan 2019) index, which measures the degree of sorting within states and across counties in Presidential and elections for the House of Representatives. We use this measure of political polarization within the state for three reasons. First, the partisan sorting of voters within a state allows companies to create local monopolies and earn higher profits. In appendix A, we provide a detailed discussion of this argument. Second, the average polarization across the states of firms' operations gives us a higher granularity of political preference over a binary “Red State vs Blue State” classification.¹² Finally, it is a measure of polarization that is calculated before the 2020 elections. Therefore, any concerns regarding the effect of the election itself on political polarization are mitigated.

We map the US states in which a firm has operations (factories, warehouses, and sales offices) using data provided by Garcia and Norli (2012) to the polarization index.¹³ On average, firms in our sample operate in 13 states, and only 1 percent of firms operate across all states.¹⁴ We then calculate the average polarization score (*Polarized Environment*) for a company which denotes the aggregate polarization in a firm's operating environment. The mean (median) of *Polarized Environment* for our sample firms is 0.100 (0.098). Companies in the highest quartile of the polarization distribution of the sample firms (*Polarized Environment* > 0.133) are classified as exposed to high polarization (*HP*). Similarly, companies in the lowest quartile (*Polarized Environment* < 0.074) of the polarization distribution is classified as low polarization (*LP*).

¹¹ 44 of these announcing firms paused PAC donations to the lawmakers who objected to ratifying the election results. The rest 105 firms announced PAC donations to all federal and congressional candidates.

¹² In the appendix, we show that Red of Blue classification of the state in which a firm is headquartered has no meaningful effect on the likelihood of announcing the pause of PAC donations.

¹³ In the appendix, we differentiate between companies with more reliance on domestic sales vs companies with less reliance on domestic sales.

¹⁴ This is consistent with the geographic dispersion of US firms reported by Garcia and Norli (2012).

The second main independent variable is the political risk faced by a firm. We collect information on firm-level political risks from (Hassan et al. 2019). It is a measure developed by analysing the transcripts of quarterly conference calls of CEOs with equity analysts. The weightage of words related to political risks in the total transcript provides a metric for measuring the political risk exposure of individual firms. We use the political risk faced by our sample firms in quarter 4 of 2020 (*Political Risk Exposure*). The mean (median) of *Political Risk Exposure* is 193.50 (108.44). Companies in the highest quartile of the political risk distribution of the sample firms (*Political Risk Exposure* > 241.66) are classified as exposed to high political risk (*HR*). Similarly, companies in the lowest quartile (*Political Risk Exposure* < 45.62) of the political risk distribution is classified as exposed to low political risk (*LR*).

We use this high/low polarized environment and high/low political risk to create a 2x2 matrix. We map the 152 announcements of PAC donations pause by S&P 500 companies along the four quadrants. The distribution is shown in Figure 1. There are no observations in the *LPLR* and *LPHR* quadrants, 102 in the *HPLR* quadrant, and 36 in the *HPHR* quadrant¹⁵. This distribution of events along these quadrants highlights the role of political polarization among stakeholders to trigger corporate political statements. Even when political risk is low, operating environments with low political polarization do not have any strategic benefits of such announcements.

We control for firm-level and industry-level confounding factors. We control for the log of total assets (*Firm Size*), profitability (*ROA*), leverage (*Debt-to-Equity Ratio*), and institutional ownership (*Institutional Shareholding*). Further, we control the company's dependence on domestic stakeholders by the ratio of domestic sales to total sales. We use Compustat to obtain net sales by geographic segments and compute sales for “USA” and “USA Operations”. We also control for corporate governance characteristics: the number of directors on the board (*Board Size*) and the fraction of independent directors (*Board Independence*). Motives to engage in socio-political discussions and the value effects are both stronger in more competitive industries (Gangopadhyay

¹⁵ The remaining fourteen announcements are by firms that are not in the highest or lowest quartiles of polarization and political risk.

and Homroy 2020). Therefore, we also control for industry competitiveness using a Herfindahl-Hirschmann index constructed using 3-digit NAICS codes. All independent variables are lagged by one period. Finally, we control for the proportion of total PAC donations by the CEO made to the Republican Party in the 2020 presidential election as a proxy for the political orientation of the managers.

Empirical Analysis

Likelihood of Announcing a pause in PAC Donations

We begin by estimating a linear probability model to estimate the likelihood of *PAC Pause* conditional on firm, CEO, and corporate governance characteristics. We estimate specifications of the type with robust standard errors:

$$\begin{aligned} & \Pr(\text{PAC Pause}) \\ & = g(\text{Firm Characteristics, Corporate Governance Characteristics, Industry Characteristics}) \end{aligned} \tag{1}$$

We present the results in table 1. We show that the likelihood of announcing PAC donations are statistically significantly higher for companies operating in a polarized environment. The likelihood of announcing a pause in PAC donations increases by 2.2% for a one-unit increase in *Polarized Environment*. However, there is no statistically significant effect of *Political Risk Exposure* on the likelihood of announcing PAC Pause. In terms of the control variables, larger, more profitable firms operating in more competitive industries are more likely to pause PAC donations. Therefore, polarization among firms' consumers seems to be the key determinant of these announcements.

[Table 1 here]

Next, we introduce the interaction terms to examine the joint effects of the polarized operating environment and the political risk faced by the firm. We examine the interaction effect of $HP*HR$, $HP*LR$, $LP*HR$ with respect to the baseline of $LP*LR$. We find that both sets of companies characterized by $HP*HR$ and $HP*LR$ are more likely, and $LP*HR$ have no statistically significantly

different likelihood of announcing *PAC Pause* than the baseline group of companies. These cross-sectional results corroborate the descriptive analysis presented in figure 1.

Short-run price effects

We examine the effect of announcing PAC donations pause on shareholders' wealth using an event study approach. The Capitol riots and subsequent pausing of corporate PAC donations are unexpected events for the market. The abnormal returns for participating firms can be seen as the investors' sentiments about the present value of future profitability of announcing companies. We compute cumulative abnormal returns (CARs) using a standard market-adjusted return model over a three-day event window centred at the announcement date (-1 to +1). The abnormal return is the difference between a firm's return and the value-weighted market return on the S&P 500 index. We control for the cross-sectional correlation in stock returns using the (Kolari and Pynnönen 2010) method. We present the results in Figure 2 and Table 2.

[Table 2 and Figure 2 here]

We show that, on average, an announcing firm has a 0.15% lower cumulative abnormal return than the market portfolio in the three-day event window. The mean 5-day cumulative return for announcing companies is -0.25%. Both these estimates are statistically significant at the 5% level. PAC donations pause, for the average announcing company, is not met with market approval.

Since companies differ in their exposure to political polarization and the political risk in their operating environment, we examine the cross-sectional differences in equity returns. We estimate cross-sectional regressions of the investor reactions conditional on firm characteristics, the interaction terms $HP*HR$, $HP*LR$, $LP*HR$, and industry characteristics. We present the results in table 3.

We document differences in announcement returns depending on the interaction of political risk and exposure to political polarization. Announcing firms categorized as $HP*LR$ have higher CAR than the baseline, and firms characterized by $HP*HR$ have significantly lower CAR than the baseline. Investors react positively to PAC pause announcements from companies that operate in highly

polarized states and face lower political risks. These companies have more to gain from the polarization and investors price than in the equity market. However, investors react negatively to PAC pause announcements from companies operating in highly polarized states and face high political risks. The large difference in the magnitudes of effects (0.08 for *HPLR* vs -0.31 for *HPHR*) drives the net negative price reaction documented in table 2.

[Table 3 here]

Longer-Term economic effects

What is the longer-term financial impact on firms who make corporate political statements? We examine this question using quarterly financial data. We argue that if political statements are strategic, we should detect a positive effect of the PAC pause announcements on future sales revenues and profitability. Announcement of PAC donations pause are one-off events, and the effect is likely to be localized immediately following financial quarters. Therefore, we estimate specifications of the following type:

$$\begin{aligned} \ln Sales_{qt} = \beta_1 PAC\ Pause_{qt-1} + \\ \phi \left(\begin{array}{l} Firm\ Characteristics_{qt},\ Corporate\ Governance\ Characteristics_{qt}, \\ Industry\ Characteristics_q \end{array} \right) + Firm\ FE \end{aligned} \quad (2a)$$

$$\begin{aligned} \ln Quarterly\ ROA = \alpha_1 PAC\ Pause + \\ \lambda \left(\begin{array}{l} Firm\ Characteristics_{qt},\ Corporate\ Governance\ Characteristics_{qt}, \\ Industry\ Characteristics_q \end{array} \right) + Firm\ FE \end{aligned} \quad (2b)$$

In these regressions, β_1 and α_1 is the within-firm variation in sales turnover and profitability before (2020 Q1 - 2020 Q4) and after the announcement of PAC-donations pause (2021 Q1 - 2021 Q3). These specifications, with firm-fixed effects, allow us to control for unobserved firm-level factors that might affect sales and profitability, so long as these factors are constant over the short time window within which we constrain our observations. We show the results in columns 1 and 2 of table 4.

Firms that announce PAC donations pause have higher sales turnover and profitability in the two following quarters.

We also estimate cross-sectional regressions with the interaction terms $HP*HR$, $HP*LR$, $LP*HR$ to examine the differential effects of firms with varying exposure to political polarization and political risk. In columns 3 and 4 of table 4, we introduce the interaction terms. We see that compared to the baseline group of $LP*LR$, both $HP*HR$ and $HP*LR$ groups gain in sales and profitability. These long-term effects contrast with the short-term price effects where $HP*LR$ companies have positive announcement returns, but $HP*HR$ companies have negative announcement returns.

[Table 4 here]

What explains the difference in short-term and long-term economic effects of $HP*HR$ following the announcement of PAC donations pause? A plausible explanatory factor is the availability of information about risks and consumer polarization. A likely explanation is that investors are well-informed about the firm-level political risks. Therefore, when they receive a political announcement from firms with high political risk exposure, they perceive that as a moral-hazard problem.¹⁶ Consequently, investors assess the statement of PAC donations pause to have a long-term detrimental effect on the future cash flows.

On the other hand, managers have more information on *both* the political risk exposure of the firm and the political polarization among its customer bases. Therefore, they engage in this strategic play to gain from the polarized environment in terms of higher sales and profitability in the longer run. In the long run, these strategic actions are congruent with the maximization of shareholders' wealth.

Robustness

We present a range of robustness tests to ensure that our results are not artefacts of the variable constructions.

¹⁶ Please see Becker and Strömberg (2012) and Gilje (2016) for excessive corporate risk-taking in high-risk situations.

First, many US companies have a global reach and may be influenced by international political factors. We examine if companies with higher dependence on domestic sales are more likely to announce pausing PAC donations and have different financial returns from such strategies. We don't find that to be the case.

Second, instead of using the (Kaplan, Spenkuch, and Sullivan 2019) measure of polarization, we use the gap between Republican and Democrat voters within the states to construct our polarization measures: the closer the gap, the more polarized a state is. The measure we use is the difference in the average fraction of votes received by the Democrat and the Republican candidates in the 2020 Presidential Elections in the states of operations of a firm. Our baseline results remain unchanged. This result assures the validity of our polarization measure.

Further, we check if the political preference for one party and not political polarization among the consumers is driving our results. We classify firms as Red and Blue based on the partisan-leaning of the headquarter state using data on headquarter location from Compustat and the average proportion of vote to Republican candidates in the last three Presidential elections. We construct a dummy, *Red State*, which equals 1 if the fraction of votes received by Republican presidential candidates is higher than the Democrat candidates. We find no statistically significant effect of *Red State* on the likelihood of announcing the pause of PAC donations.

Finally, we examine if the political orientation of the firm (management) affects the likelihood of announcements. If so, these announcements could also be seen as personal consumption for the CEOs. Since there is no legal requirement to disclose corporate political donations in the US, and such donations can be made through opaque and indirect channels, we focus on the political donations of the CEO (Cohen et al., 2019). Using data from Federal Election Commission, we classify *Republican-Leaning CEOs* who donate at least 25 percent more to Republicans than Democrats. *Republican-Leaning CEOs* has no economically meaningful and statistically significant effect on the likelihood of announcement.

These results are presented in the appendices.

Conclusion

The social and political impacts of large corporations are sharply in focus in recent times. This paper shows that the public statements of US corporations on political issues in recent times is a strategic response to politically polarized consumers in the marketplace. We show that political polarization in the states of operations strongly predicts firms' likelihood of pausing PAC donations following the Capitol riots of January 2021. However, there is no statistically significant relationship of firm-level political risks to such announcements.

Additionally, we find that firms with high political polarization in their operating environment but are exposed to low political risk have positive stock price reactions to announcing PAC pause. In contrast, firms with high political polarization in their operating environment but exposed to high political risk have negative stock price reactions to announcing PAC pause. However, both these groups of firms gain in sales and profits in the following two quarters.

Our results are consistent with the strategic nature of corporate political actions. We also highlight those corporate strategies have no stakeholder-shareholder tradeoff when the marketplace is sufficiently politically polarized. Therefore, it is likely that companies will champion corporate purpose only in situations where such tradeoffs are absent.

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Figure 1: Distribution of PAC Donations Pause Announcements

This figure shows the fraction of events along the 2x2 matrix of political risk and polarization.

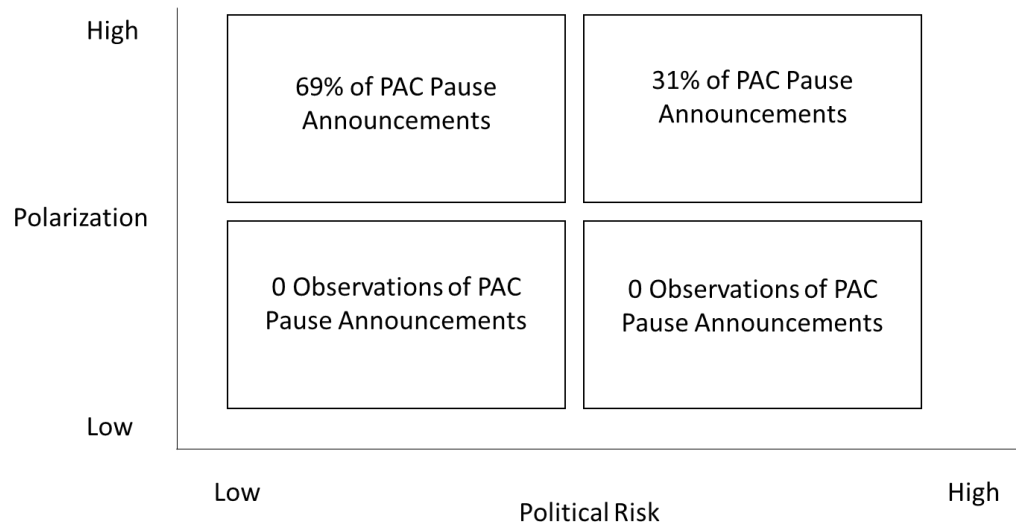


Table 1: Likelihood of PAC Donations Pause

This table provides the linear probability estimates of the likelihood of CEO activism, conditional on the firm (column 1), CEO. (column 2) and corporate governance characteristics (column 3). All specifications are estimated with industry dummies and year dummies. Robust standard errors are in the brackets.

	Dependent Variable: <i>PAC Pause</i>		
	(1)	(2)	(3)
Polarized Environment _{t-1}	0.029*** (0.009)	0.022*** (0.007)	0.022*** (0.007)
Political Risk Exposure _{t-1}	0.017 (0.011)	0.016 (0.010)	0.016 (0.014)
ROA _{t-1}		0.154 (0.051)	0.156 (0.058)
Size _{t-1}		0.323 (0.109)	0.319 (0.115)
Leverage _{t-1}		0.027 (0.025)	0.028 (0.025)
High Competition _{t-1}		0.069*** (0.023)	0.067** (0.024)
Board Size _{t-1}			0.020 (0.017)
Board Independence _{t-1}			0.029 (0.022)
Institutional Ownership _{t-1}			-0.009 (0.012)
Industry dummies	Yes	Yes	Yes
N	505	505	505
Adjusted- R^2	0.215	0.232	0.248

Figure 2: Announcement returns of PAC donations pause by US firms.

In this figure, we show the average abnormal returns for PAC pause announcers following the Capitol riots.

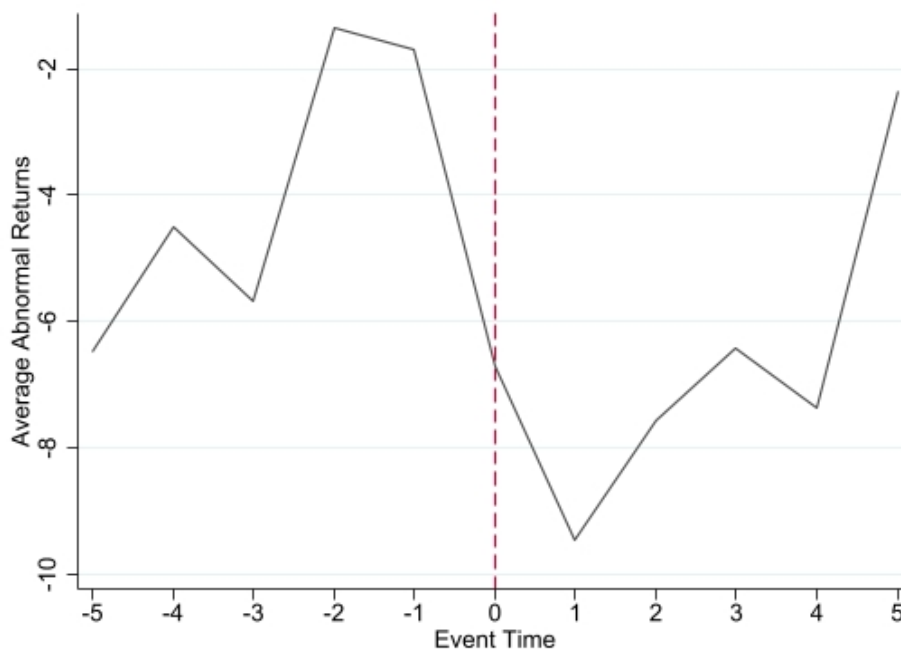


Table 2: Cumulative Announcement Return

This table presents the estimates from the event study using equally weighted CARs (panel A) and value-weighted CARs (panel B). The estimation period is from day 250 to day 7 before the Capitol Attacks. T-statistics are in the brackets.

	Panel A: Equally weighted CARs		Panel B: Value Weighted CARs	
	(+3,-3)	(+1,-1)	(+3,-3)	(+1,-1)
<i>PAC</i>	-0.254%**	-0.153%**	-0.248%**	-0.159%**
<i>PAUSE</i>	(2.137)	(2.529)	(2.318)	(2.486)
N	505	505	505	505

Table 3: Multivariate CAAR regressions

In this table, we provide the multivariate regressions of the price reaction. The dependent variable is CAR in the period (-1, +1) days around PAC donations announcements. In column 1, we use firm-level controls, and in column 2, we add the variables related to political polarization. Robust standard errors are in the brackets.

<i>Dependent Variable</i>	CAR [-1, +1]	
	(1)	(2)
Polarized Environment _{q-1}	0.019** (0.009)	
Political Risk Exposure _{q-1}	0.008 (0.006)	
<i>HP x LR</i>		0.008*** (0.002)
<i>HP x HR</i>		-0.030** (0.014)
<i>LP x HR</i>		0.002 (0.003)
<i>HP</i>		0.004** (0.002)
<i>HR</i>		-0.003** (0.001)
ROA _{q-1}	0.090** (0.041)	0.096** (0.044)
Size _{q-1}	0.127*** (0.045)	0.121** (0.050)
Leverage _{q-1}	0.012 (0.015)	0.008 (0.011)
High Competition _{q-1}	0.038*** (0.013)	0.035** (0.015)
Board Size _{q-1}	0.009 (0.009)	0.008 (0.006)
Board Independence _{q-1}	0.010 (0.013)	0.007 (0.010)
Institutional Ownership _{q-1}	0.005 (0.004)	0.003 (0.002)
N	152	152
Adjusted- <i>R</i> ²	0.195	0.247

Table 4: Long Term Economic Effects

In this table, we provide the multivariate regressions of the price reaction. The dependent variable is CAR in the period (-1, +1) days around PAC donations announcements. In column 1, we use firm-level controls, and in column 2, we add the variables related to political polarization. Robust standard errors are in the brackets.

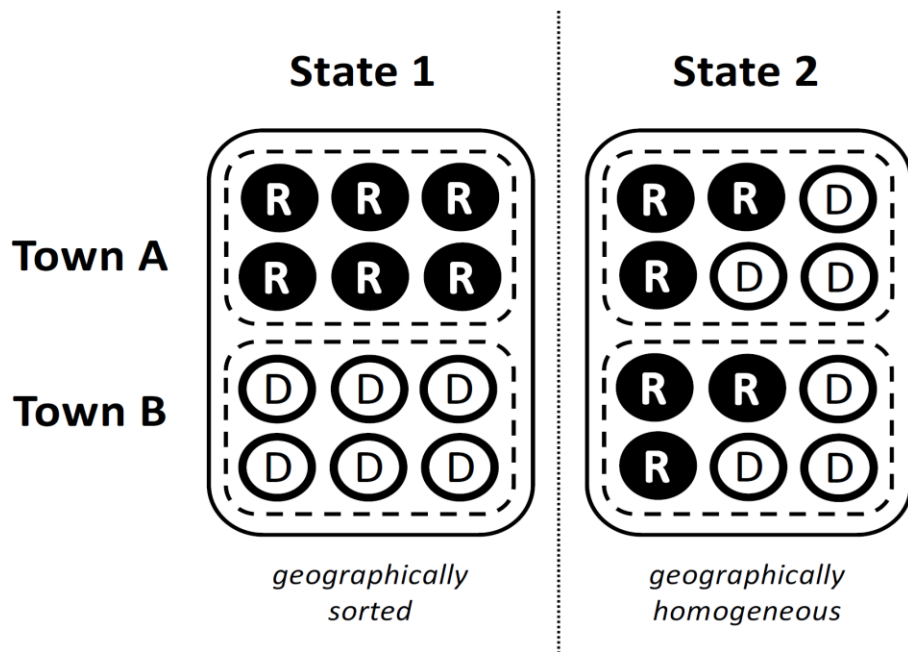
	Ln(Sales Revenues)			ROA		
	(1)	(2)	(3)	(3)	(4)	(6)
PAC Pause	0.026*** (0.009)	0.009 (0.005)	0.011 (0.008)	0.019*** (0.006)	0.010 (0.008)	0.007 (0.008)
PAC Pause x Polarized Environment _{t-1}		0.028*** (0.008)			0.023*** (0.007)	
PAC Pause x Political Risk Exposure _{t-1}		0.010 (0.007)			-0.001 (0.004)	
PAC Pause x <i>HP</i> x <i>LR</i>			0.020** (0.009)			0.024** (0.011)
PAC Pause x <i>HP</i> x <i>HR</i>			0.012** (0.005)			0.010** (0.004)
PAC Pause x <i>LP</i> x <i>HR</i>			0.003 (0.003)			0.001 (0.002)
Polarized Environment _{t-1}		0.006 (0.008)			0.012 (0.010)	
Political Risk Exposure _{t-1}		-0.002 (0.003)			-0.006 (0.005)	
<i>HP</i> x <i>LR</i>			0.004 (0.006)			0.009 (0.006)
<i>HP</i> x <i>HR</i>			0.010 (0.009)			0.003 (0.008)
<i>LP</i> x <i>HR</i>			0.003 (0.004)			0.004 (0.003)
<i>HP</i>			0.002 (0.002)			0.004 (0.006)
<i>HR</i>			-0.007 (0.006)			-0.001 (0.002)
Control Variables	Yes	Yes	Yes	Yes	Yes	Yes
Firm Fixed Effects	Yes	No	No	Yes	No	No
Quarter Dummies	No	Yes	Yes	No	Yes	Yes

Industry Dummies	No	Yes	Yes	No	Yes	Yes
N	3,535	3,535	3,535	3,535	3,535	3,535
Adjusted- R^2	0.207	0.233	0.281	0.220	0.242	0.285

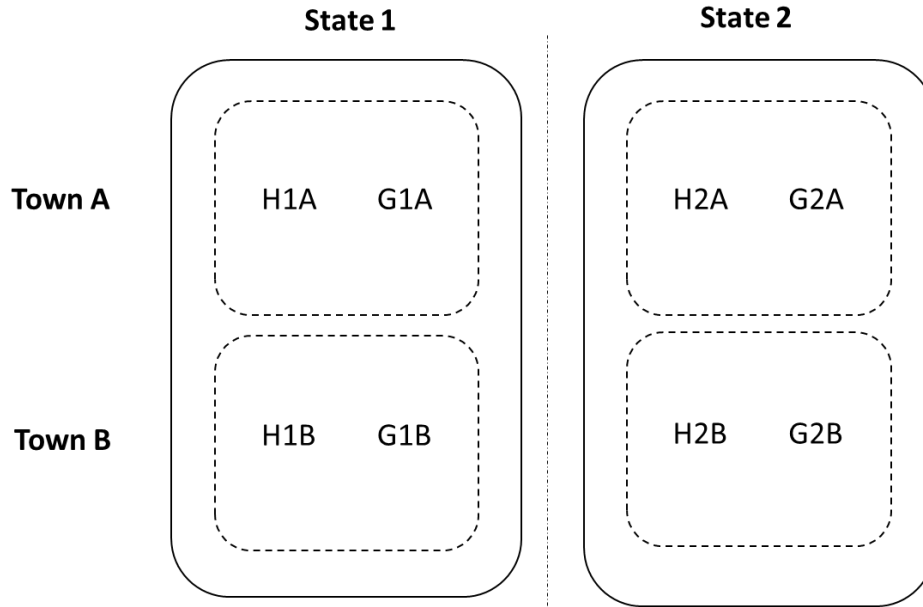
Appendix 1: Description and Validity of the Polarization Measure

The political polarization measure used in this paper is based on Kaplan et al. (2019). In this appendix, we discuss why this specific measure of polarization is appropriate for our analysis.

Kaplan et al. (2019) measure is developed based on the spatial sorting of Republican (R) and Democrat (D) voters within the state boundaries. Take, for example, the diagram (reproduced from Kaplan et al. 2019). In both states 1 and 2, there are two towns - Town A and Town B. In each of these states, there are 6 R and 6 D voters. In state 1, the R and D voters are segregated in spatial enclaves - all R voters reside in town A whereas all D voters reside in town B. In state 2, there are no such spatial segregation and 3 R and 3 D voters reside in both the towns. Therefore, the Kaplan et al. (2019) index classifies State 1 as more polarized than State 2.



Now, consider two companies **G** and **H**, operating in states 1 and 2. They each have a shop in towns A and B. In the diagram below, we denote the shops as **G1A**, **G1B** (shops of **G** in state 1 towns A and B) and **H1A**, **H1B** (shops of **H** in state 1 towns A and B). Similarly, we have shops **G2A**, **G2B** and **H2A**, **H2B** for state 2. Let us assume that companies **G** and **H** have equal market shares in each town: 3 customers buy from **G**, and three customers buy from **H**.



In a random process, company **H** makes a political statement that they will stop PAC donations in response to the Capitol riots linked to the Republican party. In state 1, its shop in town A with 6 R voters will lose customers who will move to **G**. In town B; company **H** will gain all D voters who will support such a political statement. In this process, company **G** gains a monopoly in town A of state 1 and company **H** gains a monopoly in town B in state 1.¹⁷ As is well established in microeconomic theory, companies will prefer to have one monopoly than two duopolies. Therefore, this is a win-win for both companies operating in state 1. Note that this is a symmetric process, and company **G** making a political statement instead of **H** would have yielded the same outcome.

What happens in state 2? In both towns A and B, there are 3R and 3D voters. Therefore, making a political statement will not lead to any gain in market power by either company. It can lead to all D voters buying from the company that announces stopping of PAC donations following the Capitol riots (and vice-versa), but there will be no change in market shares.

Therefore, when a company operates in a politically polarized state, it gains market share by making politically controversial statements. In the absence of political polarization, such announcements produce little or no economic advantages.

¹⁷ A reasonable assumption here is that voters' location choices are independent of a company's political statement, i.e. they don't move between states and towns in response to a company's announcement of pausing PAC donations.

Appendix 2: Variable Descriptions

Variables	Definition
PAC Pause	Dummy = 1 if a company announced a pause of PAC donations following the violence in the US Capitol on January 6, 2021.
Polarized Environment	Dummy = 1 if at least 50% of the states in which a firm operates in in the ten most polarized states in the Kaplan et al. (2019) measure.
Political Risk Exposure	Firm-level political risk measure based on Hassan et al. (2019)
<i>HP</i>	Dummy = 1 if a company is the top quartile of the <i>Polarized Environment</i> distribution.
<i>LP</i>	Dummy = 1 if a company is the bottom quartile of the <i>Polarized Environment</i> distribution.
<i>HR</i>	Dummy = 1 if a company is the top quartile of the <i>Political Risk Exposure</i> distribution.
<i>LR</i>	Dummy = 1 if a company is the bottom quartile of the <i>Political Risk Exposure</i> distribution.
ROA	Net profits/Total Assets
Size	Natural log of Total Assets of the firm
Leverage	Debt-to-Equity Ratio
High Competition	Dummy = 1 if the firm is in the bottom quartile of the HHI distribution
Board Size	Number of Directors on the Board
Board Independence	The fraction of Non-executive Independent Directors on the Board
Institutional Ownership	The fraction of Shares Outstanding held by institutional investors
Fraction Domestic Sales	Sales in “USA” and “USA Operations” as a fraction of total annual sales turnover.
Red State	Dummy = 1 if the average fraction of votes received by the Republican candidate in 2012, 2016 and 2020 Presidential elections is higher than the Democrat candidate in the state a firm is headquartered.
Democrat-Republican Gap	The difference in the average fraction of votes received by the Democrat and the Republican candidates in the 2020 Presidential Elections in the states of operations of a firm.
Republican CEO	Dummy = 1 if the CEO’s political donations to the Republican party is at least 25% more than that to the Democratic party.

Appendix 3: Summary Statistics

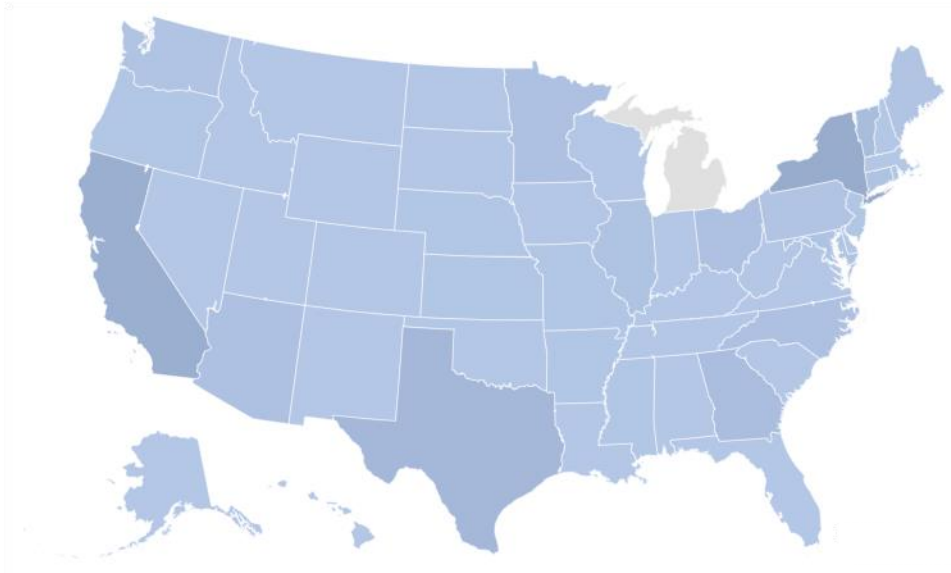
	N	Mean	SD
PAC Pause	505	0.300	0.118
Polarized Environment	505	0.478	0.229
Political Risk Exposure	505	220.20	338.67
ROA	505	0.109	0.073
Size	505	10.095	1.677
Leverage	505	0.399	0.194
High Competition	505	0.250	--
Board Size	505	10.47	2.390
Board Independence	505	0.548	0.113
Institutional Ownership	505	0.095	0.036
Fraction Domestic Sales	505	0.408	0.344
Red State	505	0.348	--
Democrat-Republican Gap	505	0.091	0.108
Republican CEO	505	0.731	--

Appendix 4: Robustness Tests

This table provides the linear probability estimates of the likelihood of CEO activism, with control for the fraction of domestic sales (column 1), an alternate measure of polarization (column 2), a measure of partisan-leaning of corporate headquarters (column 3) and with controls for CEOs' political views (column 4). All specifications are estimated with the full set of control variables, the industry dummies and year dummies. Robust standard errors are in the brackets.

	Dependent Variable: PAC Pause			
	(1)	(2)	(3)	(4)
Polarized Environment _{t-1}	0.029*** (0.009)			0.027*** (0.007)
Political Risk Exposure _{t-1}	0.017 (0.011)	0.016 (0.010)	0.018 (0.014)	0.016 (0.011)
Fraction Domestic Sales _{t-1}	0.234 (0.212)			
Democrat - Republican Gap _{t-1}		0.019*** (0.005)		
Red State _{t-1}			0.009 (0.006)	
Republican Leaning _{t-1}				0.003 (0.002)
Control Variables	Yes	Yes	Yes	Yes
Industry dummies	Yes	Yes	Yes	Yes
N	505	505	505	505
Adjusted- R^2	0.215	0.177	0.164	0.218

Appendix 5A: Spatial Distribution of Headquarters of Companies Pausing PAC donations



Appendix 5B: Polarized States in the US as per Kaplan et al. (2019)

