Political Connections and the Cost of Equity Capital

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Abstract

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JEL classification: G32; G34
Key words: Corporate Governance, Political Connections, Cost of Equity

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In this paper, we examine the cost of equity capital for politically connected firms. After controlling for several firm- and country-level determinants, our results show that politically connected firms have a lower cost of equity capital than their non-connected peers. Our results are robust to alternative measures and proxies for the cost of equity capital. We thus provide strong evidence that investors require a lower cost of capital for politically connected firms, suggesting that these firms are generally considered to be less risky than non-connected firms. Our findings imply that the benefits of political connections outweigh their costs. We conjecture that this perception is fueled by the soft budget constraints generally enjoyed by politically connected firms, and by their lower default probability, given the assurance of corporate bailout in the event of financial downturns.

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1. Introduction

Attracted by anecdotal evidence on the ties between politicians and firms in a large number of developed and developing countries, an increasing number of recent studies examine the phenomenon of politically connected firms (PCFs hereafter).[1] In countries where the legal system is too weak to secure the rights of private investors and the level of corruption is high (Hay and Shleifer, 1998; McMillan and Woodruff, 1999; Frye and Zhuravskaia, 2000), political connections and close ties to the government are valuable in helping corporations to "overcome these market and state failures and avoid ideological discrimination" (Li et al., 2008).

Empirical evidence on this issue and the value of political connections, more generally, is available in several studies. In a cross-country sample, Faccio (2006) finds that PCFs are more prevalent in countries with high levels of corruption and a weak legal system. Fisman (2001) shows that companies connected to the Suharto family in Indonesia are negatively affected by the announcement of Suharto's illness. In the same vein, Faccio and Parsley (2008) find that companies located in a politician's hometown decrease in value upon the announcement of the politician's unexpected death. Finally, Faccio et al. (2006) identify a direct channel through which connections create value by showing that PCFs are more likely than unconnected firms to be bailed out by the government.

However, political connections are not exclusive to these types of environments. Goldman et al. (2006) show that political connections are also important in the U.S., where financial markets are well-developed, and shareholders well-protected. An analysis of the stock price response to the announcement of the board nomination of a politically connected director shows a positive abnormal stock return.[2] Also, Morck et al. (2000) study the political influence

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[1] In the spirit of Faccio (2006), a firm is politically connected if at least one of the firm's largest shareholders or one of its top officers is a member of parliament, a minister, a head of state, or is closely related to a top official. Other similar definitions exist in the literature. For example, Fan et al. (2007) define a Chinese firm as being politically connected if the CEO is a current or former officer of the central government, local government, or the military. Bertrand et al. (2007) classify a firm as politically connected in France if its CEO attended elite schools and was previously employed as a civil servant or had a government position. Ferguson and Voth (2008) consider firms to be politically connected if the executives and supervisory board members were close to the ruling party in the early 1930s in Germany. In this study, we follow Faccio (2006).

[2] In an international event study, Boubakri et al. (2008b) document that the nomination of a politician or of an entrepreneur in politics to the BOD of publicly listed firms, leads to an increase in the firms'

of dominant business families in Canada and argue that if the government plays a central role in the economy, family connections to politicians may provide access to limited resources, which in turn may lead to an even greater concentration of political influence in the hands of a few families. The literature also shows that shareholders in PCFs seem, on average, to benefit from their close ties to the government. Examples of these benefits include being able to borrow on preferential terms from state-owned banks (e.g., Sapienza, 2004; Dinç, 2005; Charumilind et al., 2006), and government sponsored bailouts (Faccio et al., 2006). Several studies also show that political connections help firms to secure favourable regulatory conditions (Agrawal and Knoeber, 2001) and access to resources such as bank loans, and to obtain import licences more easily, at more favourable terms (Khwaja and Mian, 2005; Mobarak and Purbasari, 2006); which ultimately drives up the value of these firms or improves their performance (Ramalho, 2007; Johnson and Mitton, 2003; Li et al., 2008). In a recent study on the characteristics of PCFs, Faccio (2007) focuses on three sources of benefits —preferential access to credit, tax discounts and market power— and confirms that connected firms indeed have higher leverage (i.e., preferential access to credit), lower tax rates (i.e., tax discounts), and greater market shares (i.e., market power).

The above review shows that the literature has predominantly focused on the benefits of political connections. Very few studies provide *direct* evidence that political connections may prove detrimental to a firm's public shareholders. Evidence on such costs is mainly documented in the privatization literature. For instance, Boubakri et al. (2008a) indicate that if boards are politically connected, privatization will not create the necessary managerial incentives to maximize shareholders' wealth and improve overall firm performance. In the same context, Cuervo and Villalonga (2000) argue that the replacement of pre-privatization managers is called for in order to allow internal changes in the governance of newly privatized firms, while Barberis et al. (1996) specifically state that management skills rather than political acceptability are the main requirements for privatization to work. Related arguments in other studies sustain that government relationships are potentially detrimental to shareholder value. For instance, Frye and Shleifer (1997) and Shleifer and Vishny (1998) argue that governments

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performance and risk-taking after the establishment of a political connection. They also show that the political connection is more valuable for firms with closer ties to political power, and confirm that PCFs gain easier access to credit and reap benefits in terms of performance from their ties with politicians. Faccio (2006) also shows that the value of PCFs increases when their executives enter politics.

may have a "grabbing hand", leading them to expropriate shareholder wealth. Consistent with their conjecture that politicians have strong incentives to conceal the diversion of corporate resources for political purposes, Guedhami et al. (2008) find evidence that state-owned firms are associated with lower demand for accounting transparency. In a related country-level study, Bushman et al. (2004) find that state ownership undermines financial transparency. Other studies show that state ownership undermines financial transparency. find evidence that Shleifer and Vishny (1994) model that politicians prefer private to public ownership of cash flows since higher private ownership leads to more efficient resource allocation than political control. Consequently, politicians are able to increase the amount of resources they can extract from private shareholders through bribes or supplementary employment.

The objective of this study is to examine the net effects of political connections by focusing on the cost of equity of PCFs rather than on performance or value measures. This approach allows us to determine the impact of political connections on the cost of capital, an important channel of influence on firm value. Indeed, some political connections are a reflection of a firm's agency problems and corporate governance. Thus, our investigation reflects arguments that the costs of external finance are driven by the extent of firms' agency and information problems (e.g., Easley and O'Hara, 2004; Hughes et al., 2007), and our use of the cost of equity as a test vehicle allows us to uncover the extent of such problems in PCFs. Moreover, a potential advantage of using the cost of equity rather than firm value, largely measured by Tobin's *Q*, is that the former allows us to deal with the fact that Tobin's *Q* is also a measure of the firm's growth opportunities. Suchard et al. (2007: 7) indicate that, "*A change in Q over time may simply reflect changes to the valuation of future growth opportunities which can arise in part from exogenous factors to managerial decisions such as economic and industry conditions. The cost of equity, on the other hand, …. is based on the current risk in the firm's operations. It is able to react more accurately to year to year changes in the firm's corporate governance environments without being affected by exogenous factors that affect future growth and profitability*".

Our study is related to two different streams of academic research, namely the literature on political connections, and that on corporate governance and the expropriation of minority shareholders. To address our research question, we consider a multinational sample which enables us to control for cross-country variations in legal systems and levels of corruption, and

the extent of law enforcement (La Porta et al., 1998; Faccio, 2006); all of which are proven to strongly influence the likelihood of political connections at the corporate level. Our results show that PCFs have a lower cost of equity capital than their non-connected peers. These findings are robust to alternative measures and proxies for the cost of equity capital, suggesting that investors require a lower cost of capital for PCFs. This is consistent with evidence in Chaney et al. (2008) who find that PCFs benefit from a lower cost of debt. We conjecture that it is because of the soft budget constraints generally enjoyed by these firms, given the assurance of corporate rescue in the event of financial crisis/distress, that investors require a lower rate of return and consider these firms as more valuable than unconnected firms.

The remainder of the paper is structured as follows: in the next section, we review the literature on the potential costs and benefits of political connections and derive our main testable hypothesis. Section 3 describes the data, while Section 4 outlines and discusses our main results. Section 5 presents several robustness tests. Section 6 links political connection to ownership structure and bailouts. Finally, Section 7 concludes.

2. Literature Background

The interpenetration of political and economic power increases the importance of political connections for businesses within "the entrepreneurial state alliance". Entrepreneurs endeavour to make political connections because this increases the likelihood that they will be successful in their businesses (Bunkanwanicha and Wiwattanakantang, 2008). Political connections in fact benefit both parties (power/money exchange): While government officials hand out rewards (policies and privileges) to entrepreneurs for their political cooperation and their own benefit, the entrepreneurs make use of their political connections to enrich themselves (Bunkanwanicha and Wiwattanakantang, 2008).[3]

Prior academic research has predominantly argued that shareholders in firms with close ties to governments gain from political connections (e.g., Fisman, 2001; Leuz and Oberholzer-

[3] Shleifer and Vishny (1994) provide a theoretical model to show how politicians use their connections in firms to further pursue their political objectives. Empirical evidence that PCFs can help politicians appears in Bertrand et al. (2007).

Gee, 2006 for Indonesia; Johnson and Mitton, 2003 for Malaysia).[4] However, few studies have argued that government relationships could potentially be detrimental to shareholder value, based on the "grabbing hand" perception of governments as in Frye and Shleifer (1997), and Shleifer and Vishny (1998). Shleifer and Vishny (1994) also show that politicians prefer private to public ownership of cash flows, under the assumption that private ownership will lead to more efficient resource allocation than public control. In this case, politicians can extract more resources from private shareholders, through bribes or supplementary employment. Hence, in this model, corporate value will increase if the marginal benefits of the connections to firm owners are higher than their marginal costs (i.e., rent extraction from politicians). Caprio et al. (2008) provide empirical evidence that firms structure their asset holdings so as to shelter assets from politicians and bureaucrats, especially in countries where the threat of political extraction is high.

In what follows, we review the literature on the potential benefits and costs of political connections in more detail, before we derive our main hypothesis.

2. 1. Potential Benefits of Political Connections

The literature suggests that "systematic exchanges of favors" between politicians and firms add value to PCFs (Chaney et al., 2008). Government officials can influence the economic value of a corporation by awarding lucrative government contracts, imposing tariffs on competitors, or reducing regulatory requirements, to name a few (Goldman et al., 2006). More generally, PCFs enjoy soft budget constraints and are not sensitive to market pressures or prevailing competition. In this regard, Mobarak and Purbasari (2006) document that import licenses are systematically awarded to firms connected with the Suharto regime in Indonesia, at the expense of other firms in the same industry that are not politically connected. Faccio et al. (2006) give further evidence on the soft budget constraints of PCFs, documenting that governments are more likely to bail out connected firms in the event of economic downturn or financial distress. Also, these firms generally pay less taxes (Faccio, 2007), hence they benefit from lower operating costs. Chaney et al. (2008) add to this evidence by showing that although

[4] Further evidence is provided in Roberts (1990) and Goldman et al. (2006) who show that on average, the connections created by campaign contributions add value to U.S. firms. Similar evidence for firms linked to Brazilian President Collor de Mello appears in Ramalho (2007), while Feguson and Voth (2008) study German connected firms during the Nazi party's rise to power.

the quality of earnings reported by PCFs is significantly poorer than that of similar unconnected companies, they are not penalized by the market because their cost of debt is actually lower than that of their comparable non-connected peers.

Additional evidence on the soft budget constraints enjoyed by PCFs appears in Khwaja and Mian (2005) who illustrate the role of ex-politicians in providing government bank loans to politically connected Pakistani firms. Likewise, Agrawal and Knoeber (2001) bring to light the fact that politically-experienced directors are more prevalent in U.S. manufacturing firms where politics might affect their performance (through, for example, government purchases, trade policy, and environmental regulation). In the same regard, Leuz and Oberholzer-Gee (2006) show that PCFs in Indonesia are less likely to cross list, either because they want to avoid the scrutiny of the international financial markets or because they can easily use their political connections to obtain funds from state-owned banks. Finally, Johnson and Mitton (2003) find that the value of PCFs in Malaysia declined during the 1997 Asian financial crisis, perhaps due to a reduction in the value of their connections. However, the same firms outperformed unconnected firms after the imposition of capital controls, perhaps because this restriction increased the opportunities for cronyism (Cheung et al., 2005).

The literature discussed above identifies several channels through which firms can benefit from political connections. Being able to borrow from state-owned banks on preferential terms is one such channel. The finding by La Porta et al. (2002) that government ownership of banks is pervasive around the world, especially in low-income countries and those with underdeveloped financial sectors, inefficient governments, and poor protection of property rights, provides us with an idea of the importance of preferential access to credit to PCFs around the world. Few papers explore this issue in detail. For example, Dinç (2005) finds that banks controlled by the government increase their lending during election years relative to private banks. Charumilind et al. (2006) show that Thai firms with connections to banks and politicians obtained more long-term loans and needed less collateral during the period preceding the Asian financial crisis of 1997 compared to firms without such connections. Sapienza (2004) shows that Italian state-owned banks tend to lend to larger firms and those located in economically depressed areas, at lower interest rates than privately owned banks. Interestingly, she confirms the evidence in Dinç (2005) and also finds "*an association between the bank's lending behaviour at the*

local level and the electoral strength of the political party affiliated with the bank's top management." Finally, La Porta et al. (2003) examine lending by Mexican banks to firms controlled by the bank's owners, and report that related loans carry lower interest rates compared to arm's length loans.

Corporate bailouts represent another direct evidence of the soft budget constraints enjoyed by PCFs. Faccio et al. (2006) examine a large sample of firms in developed and developing countries and find that PCFs use more debt financing than non-connected firms and are also more likely to receive bailouts when they face financial distress.

2.2. Potential Costs of Political Connections

While political connections seem to add value to firms, arguments from the corporate governance literature suggest that agency (private benefits of control) and governance issues may plague PCFs, and lead to detrimental rent-seeking activities. Leuz and Oberholzer-Gee (2006) suggest that politically connected Indonesian firms choose not to cross list on U.S. markets, to avoid the scrutiny and strict listing requirements imposed on foreign firms. They explain that cross listing is costly to PCFs as it reduces the private benefits of control extracted by the owners, thereby out-weighting the possible advantages of cross listing. The authors suggest that Indonesian PCFs opt for private benefits instead of external finance opportunities, even though the latter would benefit minority and other shareholders. In relationship-based systems, they argue, a high level of corporate transparency and political ties are alternative ways to create value.

Chaney et al. (2008) show that PCFs report earnings of lower quality than their unconnected peers, suggesting that PCFs are entrenched because managers/politicians have no incentives to improve transparency, and only care about extracting private benefits at the expense of wealth maximization for other stakeholders in the firm. Reflecting greater incentives to extract private benefits for political purposes, Guedhami et al. (2008) provide firm-level evidence that state ownership is associated with low quality financial reporting. Evidence from the privatization literature suggests that when firms are politically connected, they underperform their unconnected newly privatized counterparts (Boubakri et al., 2008a). Political connections in these firms help the government and affiliated politicians to extract *political*

benefits at the expense of wealth maximization for the benefit of other stakeholders in the firm. The authors show that political and judicial conditions influence political appointments in newly privatized firms and that leveraged firms, operating in regulated sectors and located in major cities, are more likely to be politically connected. In the same context, Fan et al. (2007) report that politically connected newly privatized Chinese firms underperform relative to unconnected firms, during the three years following their Initial Public Offering (IPO). These firms tend to be based in regions with large fiscal deficits and high unemployment, suggesting that they pursue political rather than profit enhancement objectives. Bertrand et al. (2007) find that profits in French firms managed by politically connected CEOs tend to decline as the fraction of their employment located in politically contested areas increases, due to higher wage bills. These firms exhibit poorer accounting and stock market performance than their non-connected counterparts. They also display higher rates of job and plant creation and a lower rate of plant closings, especially in election years. In the same vein, Faccio (2007) finds that, in spite of the advantages they obtain, PCFs show poorer accounting performance than unconnected firms.

Another interesting study that shows that, on average, political connections are detrimental for minority shareholders in publicly listed firms in China is by Cheung et al. (2005). The authors argue that their study provides *direct* evidence of this phenomenon by examining connected transactions that "*can provide direct opportunities for connected parties to extract cash from listed companies (by selling assets, goods, or services to the firm through self-dealing transactions), to transfer assets from the listed company to other companies under their control, or to dilute the interests of minority shareholders by acquiring additional shares at a preferential price. These activities are frequently referred to as "tunnelling" (Johnson et al., 2000).*" (Cheung et al., 2005: 1). Finally, surveys conducted in China and analyzed in Cull and Xu (2005) show that a large proportion of Chinese managers perceive contracts with government officials to be detrimental to the firm.

The costs of these rent-seeking activities go beyond shareholder expropriation. These activities actually lead to a suboptimal allocation of resources in the economy. For instance, Caprio et al. (2008) hypothesize that firms structure their asset holdings so as to shelter assets from extraction by politicians and bureaucrats. Specifically, they conjecture that firms will hold a lower fraction of their assets in liquid form in countries where the threat of political extraction

is higher. Their results from a multinational sample of firms in 109 countries confirm this conjecture as they find that, across countries, corporate holdings of cash and marketable securities are negatively correlated with measures of political corruption. The resulting tax avoidance or tax evasion is costly to the economy and the society as a whole. The costs of rent-seeking activities to the society, including government licenses, quotas, permits, authorizations, approvals, and franchise assignments, which can lead to price distortion and imperfect competition, are also discussed in Choi and Zhou (2001), who conclude that these activities can ultimately lead to adverse effects on economic growth and structural change (Bhagwati, 1982; Choi and Zhou, 2001).

In light of this discussion on the potential benefits and costs of political connections, we derive our main testable hypothesis: *If the benefits (costs) of political connections outweigh their costs (benefits), the cost of equity will be negatively (positively) related to the cost of equity of PCFs.*

3. Data and Descriptive Statistics

3.1. Political Connections Sample

Our study investigates the equity financing costs of PCFs. We use the sample of PCFs from Faccio (2006). Our analysis covers 1997 to 2001 period as political connections are recorded over this period. A company is classified as politically connected if at least one of its large shareholders (anyone controlling more than 10% of voting rights, directly or indirectly) or top officers (CEO, chairman of the board, president, vice-president, or secretary) is a member of parliament, a minister or a head of state, or is closely related to a politician or party by friendship, past top corporate or political positions (e.g., a head of state or minister), or other ties identified in prior research.

3.2. Cost of Capital Sample

We use firms represented in three databases: Thompson Institutional Brokers Earnings Services (I/B/E/S), WorldScope/Disclosure, and Political Connection Database (Faccio, 2006). We start by extracting earnings forecast data recorded in the fiscal month plus ten for all firms for which the I/B/E/S earnings history file contains i) a positive mean earnings forecast for the first two years, ii) five-year mean growth rate or third-year earnings forecast, ii) at least two

analysts providing earnings forecasts for year 1 and year 2, iii) statistics period precedes the forecast period, iv) I/B/E/S price history file contains price for the corresponding statistics record period, v) positive book value per share available in WorldScope, and finally vi) we proxy firms' long-term growth using the five-year mean growth rate, where available; otherwise replaced by the growth in the mean forecasted earnings over the first three years, and we keep the firm-years with a earnings growth rate within +/- 200%.

From this matched database, we estimate the cost of equity closely following Hail and Leuz (2006) and Dhaliwal et al. (2006) for firms that are from countries (and in the Campbell (1996) industries) with at least one politically connected company in the Faccio (2006) database. This procedure results in an initial sample of 2,906 companies from 25 countries involving 8,357 firm-years from 1997 to 2001. Out of this sample, only 6,632 firm-years have a valid cost of equity estimate with at least one connected firm represented in a particular industry from each country during the sample period. Therefore, our final sample consists of 2,537 firms and 6,632 firm-years from 25 countries. The sample includes 690 firm-year observations of 227 PCFs with valid data.

3.3 Cost of Equity Estimates

The study tests whether or not political connection can be priced through the discount rate of the firm. We use the discount rate estimated following recent studies, primarily in accounting.[5] This approach provides a more direct measure of the expected return concept in the asset pricing theory, namely the ex-ante expected returns implied in the current market value and future cash flows of the firm. This approach has gained popularity in recent empirical accounting and finance studies (e.g., Claus and Thomas, 2001; Gebhardt et al., 2001; Gode and Mohanram, 2003; Dhaliwal et al., 2005, 2006; Hail and Leuz, 2006; Guedhami and Mishra, 2007; Attig et al., 2008; among others). Yet, the literature features substantial variation in the choice of

[5] While the asset pricing literature has been using average realized returns as a proxy for an asset's expected returns, our use of the discount rate is motivated by the contention that average realized returns serve this purpose poorly (Elton, 1999; Fama and French 1997, 2002, 2004). Elton (1999) in his presidential speech, argued for an alternative proxy for expected returns and, accordingly, Fama and French (1997: 153) conclude that "*Estimates of the cost of equity for industries are imprecise … Estimates of the cost of equity for firms and projects are surely less precise*."

model(s) for the implied cost of equity capital and provides little guidance on the superiority of one model over another.

We follow Hail and Leuz (2006), Dhaliwal et al. (2006), Boubakri et al. (2007), among others, and use four models to estimate our cost of equity capital. These models are based on the principles advanced in the residual income valuation methods of Edwards and Bell (1961), Ohlson (1995), and Feltham and Ohlson (1995), and in the abnormal growth models of Ohlson and Juettner-Nauroth (2005). The four models are Easton (2004 ES), Ohlson and Juettner-Nauroth (2005 OJ), Gebhardt, Lee and Swaminathan (2001 GLS), and Claus and Thomas (2001 CT). The cost of equity estimates of each model are identified in the subscripts *kES*, *kOJ*, *kGLS,* and *kCT*, respectively. Our final cost of equity estimate '*K*' is the average of the cost of equity estimates of these four models. The cost of equity estimates of the individual models exhibit different degrees and types of association with some risk proxies. For example, GLS estimates are often negatively associated with long-term growth rates while OJ and ES are associated positively (see Dhaliwal et al., 2006). Accordingly, Botosan and Plumlee (2005) find that *kGLS* is inconsistently associated with some risk proxies, while Guay et al. (2005) find *kGLS* to be the best predictor of expected returns. Our use of the average across the cost of equity estimates of all four models mitigates this concern by reducing the possibility of spurious results that are likely to appear if we use the cost of equity estimates based on a single model.

In implementing these four models, we follow Hail and Leuz (2006) and estimate the cost of equity for the fiscal year end month plus ten. According to Hail and Leuz (2006), this period appropriately accounts for the lag between which the market gets the firm's annual financial information and incorporates it into pricing securities. Appendix A.2 provides more details on the implementation of these four models in estimating firms' cost of equity capital.

Table 1 provides basic statistics for the implied cost of equity estimates. The model average cost of equity estimates are higher for the abnormal growth valuation models (kES and kOJ) compared to those of the other two models. These model averages are consistent with the literature (see e.g., Gode and Mohanram, 2003; Dhaliwal et al., 2006; and Hail and Leuz, 2006). Reasonably consistent with this literature, *kOJ* and *kES* exhibit a higher correlation with *K*, while *kGLS* and *kCT* exhibit lower correlations with *K* (Dhaliwal et al., 2006). Judging from the relative magnitude of the cost of equity estimates, and their relative correlation coefficients, the cost of

equity estimates in this sample reasonably represent statistical properties of those found in larger samples. In Table 2, we report country-specific statistics of the cost of equity estimates of connected and unconnected firms. The connected firms in 16 out of 25 countries exhibit a lower cost of equity capital than the sample of non-connected firms from the same countries. Specifically, we find that the lower cost of equity for PCFs compared to non-connected firms is substantial in different countries (e.g., The Philippines, Finland, and Thailand).

Insert Tables 1 and 2 about here

3.4. Control Variables

Before reporting our regression results, we outline a number of firm and country characteristics that we use as controls in our multivariate analysis. In identifying and specifying the set of control variables, we refer to prior studies that showed these controls to be associated with the cost of equity capital at the firm or at the country level.

First, we use firm size (*SIZE)* as a proxy for information availability, which is expected to be negatively related to the cost of equity capital (Gebhardt et al., 2001; Francis et al., 2005). Second, the variance of analysts' forecasts, which is measured with the natural log of standard deviation of the first-year analyst forecasts divided by mean earnings forecasts (*LNDISPERTION*), is expected to be positively related to the cost of equity capital (Dhaliwal et al., 2006). Third, firms' expected growth rate proxied by the I/B/E/S five-year consensus earnings growth rate (*GROWTH*), which is a risk factor, is expected to positively affect the cost of equity capital (Lee et al., 2004; Dhaliwal et al., 2005, 2006). Fourth, we compute the firm's leverage with the ratio of total debt to total capital (*LEVERAGE*). As past literature suggests (e.g., Hamada, 1969; Gode and Mohanram, 2003; Dhaliwal et al., 2006), *LEVERAGE* is expected to be positively associated with the cost of equity capital. Fifth, firm risk is captured by the standard deviation of monthly prices divided by the average of the monthly price (*VARIANCE*). The *VARIANCE* includes properties of the firm's beta as well as a part of the firm's risk that is not included in beta.[6] We expect *VARIANCE* to be positively related to the cost of equity

[6] Gode and Mohanram (2003) compute this factor as the standard deviation of residuals from the market model.

(Guedhami and Mishra, 2007; Hail and Leuz, 2006).[7] Sixth, market to book *(MTB)*, measured as the market value of equity divided by book value of equity, is expected to be negatively associated with the cost of equity capital, consistent with the finding that higher book to market (lower *MTB*) firms earn higher *ex-post* returns (Fama and French, 1992). Finally, corporate governance literature points out the significance of legal institutions in limiting expropriation of firms in countries with strong legal institutions associated with higher valuation and lower financing costs (La Porta et al., 1997; Hail and Leuz, 2006; Guedhami and Mishra, 2007). Following Chaney et al. (2008), we proxy the quality of legal institutions using the protection of minority shareholders against managers or controlling shareholders (*ANTIDIRECTOR*) extracted from La Porta et al. (2006), and the extent of exercise of public power for private gain in the country (*CORRUPTION*) from Transparency International. We expect the former to be negatively associated with the cost of equity, consistent with Guedhami and Mishra (2007). Garmaise and Liu (2005) conjecture that corruption increases firms' exposure to systematic risk. The empirical test of their model reveals that corruption is positively associated with firms' betas, especially in countries with weak shareholder rights. Therefore, we expect *CORRUPTION* to be positively associated with cost of equity capital.

Table 3 provides descriptive statistics of all explanatory variables, which are summarized in Appendix A.1, and their pair-wise correlations. All explanatory variables, except for political connections and country-specific institutional variables are winsorized at the 1st and 99th percentiles. All variables involving measurement in currency are expressed in U.S. dollars. Panel A reports the statistical properties of individual explanatory variables. Panel B of Table 2 provides pair-wise correlation coefficients across explanatory variables. The correlation coefficients that are statistically significant at 1% are boldfaced. None of the variables show extreme correlations, suggesting that multicollinearity is not a serious concern in our regressions.

Insert Table 3 about here

[7] We use price volatility as the proxy for a firm's market risk given that the empirical literature in implied cost of equity capital finds little or no association of beta with the implied cost of capital. In an international sample, the use of beta requires a benchmark global portfolio (e.g., world market portfolio) which may unduly underestimate the beta of firms from segmented markets due to the lower covariance with those countries' market. For example, see Gebhardt et al. (2001) and Lee et al. (2004) for the first argument; Mishra and O'Brien (2005) and Hail and Leuz (2006) for the second argument.

4. Results

4.1. The Model

The literature argues both ways on the effects of political connections to a firm's shareholders. A large part of the literature suggests that shareholders in PCFs gain from the close ties to politicians. However, some papers have also argued that government relationships could potentially be detrimental to shareholder value. We examine the net effects of political connections by focusing on the cost of equity of PCFs. To do so, in our empirical tests we use several variations of the following cross-sectional time series model. We adjust the standard errors for both heteroskedasticity in the error term and clustering of observations at the country level.

$$K = \alpha_0 + \alpha_1 \textit{ Test Variables} + \alpha_2 \textit{ Controls} + \textit{Fixed effects} + \varepsilon \quad (1)$$

Subscripts in equation 1 are suppressed for notational convenience; we specify the regression variables as follows:

K =	the average implied cost of equity capital estimated using four models outlined in Section 3.3;
Test Variables=	variables related to political connections and the source of such connections;
Controls =	a set of firm, industry, and country level control variables described in Section 3 and in Appendix A.1;
Fixed effects =	dummy variables controlling for fixed effects of years, country and industry groups based on Campbell's 12 industry classifications;
ε =	an error term.

Our focus is on coefficient α_1, which measures the sensitivity of the cost of equity capital to whether or not firms are politically connected.

4.2. Main Results on Political Connection and Cost of Equity

We start by estimating the relation between political connections and the cost of equity capital after conditioning on key firm- and country-level determinants of cost of equity reported in prior work and discussed above. In Table 4, we report the multivariate regression results from estimating Equation (1) for the pooled sample including years 1997-2001. We initially use all-

inclusive measures of connections. We then partition these connections into individual types in Models 6 and 7. We note that, together, these factors explain over 37% of the variability in firms' cost of equity capital (adjusted R^2 ranges from 37.2% to 41.5%). These values are comparable to those reported by Hail and Leuz (2006) in their firm-level cross-country analysis involving forty countries. In Model (1), our basic regression, where we do not condition on year and industry effects, the coefficient for *POLITICAL* is negative and statistically significant at the 1% level, suggesting that the cost of equity financing is lower for PCFs than for unconnected firms, consistent with substantial benefits from political connection. Our dependent variable, nominal cost of equity, is likely to vary over time. When we include in Model (2) year fixed effects, the coefficient for *POLITICAL* remains negative and statistically significant at the 5% level. Given that our sample covers firms from various industries, we control in Model (3) for industry effects using Campbell's (1996) industry classifications, which allows to capture unspecified variation across industries and effects due to concentrations of PCFs in certain industries. The sign and significance of the coefficient for *POLITICAL* persist at the 1% level. These results are also economically significant. The coefficient estimate in Model 3 implies that politically connected firms enjoy an approximately 50 basis-point lower equity financing costs.

Models (4) through (7) condition on year, industry, and country fixed effects. In Model (4), we continue to find a negative and statistically significant relation between the cost of equity capital and our test variable *POLITICAL* after controlling for country effects. In Model (5), we re-estimate equation (1) after replacing firm size with the number of analysts' coverage (*ANALYSTCOVR*) and report a negative and statistically significant coefficient for *POLITICAL*. Overall, these results indicate that the sign, magnitude, and significance of the coefficient for *POLITICAL* are not affected by controlling for year, industry, and country effects, or by using alternative proxy for firm size. Collectively, this evidence suggests that PCFs experience cheaper equity financing compared to their non-connected counterparts.

In the rest of Table 4 regressions, we extend our analysis to examine the effects of the types of political connections. Faccio (2006) found that connections through close relationships are more valuable to firms than connections through a member of parliament. This likely reflects the larger benefits these firms receive and may need to hide. Similarly, previous findings document a larger impact from connections through a block-holder, relative to

connections through a director. Given our prior evidence on the effects of political connection, we expect companies with stronger connections to exhibit a lower cost of equity capital.

In Models 6 and 7, we re-estimate our regressions after replacing *POLITICAL* with the proxies identifying the types of connections, namely *GOVERNMENT*, *MP, CLOSERELATION*, *DIRECTORSHIP,* or *OWNERSHIP*, which are as defined in Appendix A.1. Among all these variables, we find that only *CLOSERELATION* and *OWNERSHIP* load negative and significant. These findings suggest that companies with stronger connections have a lower cost of equity capital. Additionally, we find that the coefficients associated with the stronger types of connections are more significant than those associated with weaker types.

Altogether, the results from this classification of PCFs into specific types support the earlier findings and suggest that PCFs have a lower cost of equity capital, especially when the political ties are strong. We conjecture that it is because of the soft budget constraints generally enjoyed by these firms, given the assurance of corporate rescue in the event of financial crisis/distress, that investors require a lower rate of return and consider these firms to be more valuable. Indeed, and supporting our conjecture, we find in our sample that PCFs have a higher *LEVERAGE* (39.51%) compared to unconnected firms (34.30%). This difference is statistically significant at the 1% level.

Turning our discussion to the control variables, in all models we find that our control variables exhibit signs consistent with recent literature on the implied cost of capital. First, we report a negative and highly significant coefficient of the proxy for firm size (*SIZE*) and *ANALYSTCOVR*—our proxy for firm size and information availability—across all models, which is consistent with Fama and French (1992) and Gebhardt et al. (2001). Second, we find that analyst forecast accuracy *VARIANCE* is consistently positive and statistically significant at the 1% level, in line with Gode and Mohanram (2003) and Dhaliwal et al. (2006). Third, we find positive and significant (at the 1% level) relations across all models between the cost of equity capital and firm's risk, growth, leverage and industry cost of equity, in line with prior empirical research on the cost of capital (e.g., Guedhami and Mishra, 2007). Finally, we find that the coefficient for *MTB* is negative and significant at the 1% level across all models, consistent with Gode and Mohanram (2003), Botosan and Plumlee (2005), and Hail and Leuz (2006).

As for the country control variables, we find that *CORRUPTION* is positively and significantly related to the cost of equity. In countries with high corruption, equity financing is expensive. This is consistent with our expectation and with the findings of Garmaise and Liu (2005) that *CORRUPTION* increases firms' systematic risk. The coefficient for *ANTIDIRECTOR* does not seem to explain the cost of capital across all models. However, this is not a major concern in our tests as this is a control variable to ensure that our main results on political connections remain strong after these controls.

Insert Table 4 about here

5. Robustness Checks

We perform several sensitivity tests to ensure the robustness of our results, some of which are reported in Tables 5, 6 and 7. These additional tests provide strong support for our earlier evidence that equity financing costs are lower in PCFs.

5.1. Endogeneity

One potential concern in the regressions in Table 4 is that the dummy variable *POLITICAL* may not be exogenous. Specifically, some unobserved determinants of firms' cost of equity may also explain political connections, causing our reported OLS estimates to be biased and inconsistent. In this section, we describe the results obtained from the estimation of instrumental variables. We use the firm's location as our instrumental variable for political connections. This choice is motivated by previous studies providing evidence on the influence of the firm's location on political connections (Roberts, 1990; Agrawal and Knoeber, 2001; Bertrand et al., 2007). In the first stage regression, we predict political connections (via a probit estimation) using the location of the company's headquarters *CAPITAL* as an instrument (a dummy variable that takes the value one if the company is headquartered in the capital of its country, and zero otherwise), along with the set of independent variables that we included in the previous regressions. The first-stage fitted values for political connections *I_POLITICAL* are then used in the second stage OLS regressions.

We report these results in Table 5. In the first stage, the results show that the presence of a firm's headquarters in the capital city is a good predictor of political connections. Moreover,

in the second stage regression, the instrumented value of connections *I_POLITICAL* is negatively statistically significant as well. This result suggests that PCFs enjoy a lower cost of equity capital compared to their non-connected counterparts.

5.2. Dependent Variable

While model-specific cost of equity estimates are likely to be different for the same firm and year, the degree of difference in these estimates is likely to vary across firms depending on firm-specific features (whether known or unknown), as well as analyst forecast features. As explained in motivating these cost of equity estimates, there is some danger that the use of the estimates from a single model is likely to produce spurious results. For example, according to Dhaliwal et al. (2006: 699) "*Limiting empirical analysis to just one measure may produce spurious results if particular attributes of the model are correlated with the variable of interest. To mitigate the effect that particular assumptions of each model might have on our results, we follow Hail and Leuz (2006) and use the average of the four implied cost of equity estimates in our empirical tests*." To test the sensitivity of our main results to the use of model-specific cost of equity estimates, we re-estimate Model 4 in Table 4 using model-specific cost of equity capital. We report these results in Table 5, from Models 1 to 4 as column headings indicate. While a variation in the results across models is not surprising (it is rather very common), we find that our main predictions related to political connection remain unaffected. We report that the coefficient for *POLITICAL* is negative under all models and statistically significant at the 5% level for all but the *kGLS* model. We conclude that our results are not sensitive to the measure of the cost of equity capital.

International asset pricing literature (e.g., Harvey, 1995) makes use of expected returns over risk free rate, where risk free rate is the U.S. treasury yield. In our main tests, we instead follow Hail and Leuz (2006) and use the raw cost of equity capital as the dependent variable. In order to check the robustness of our results, we test all our specifications from Table 3 using risk premium (cost of equity capital less U.S. Treasury Bond Yield). In Model 5 of Table 5, we report the results based on our basic specifications. The association between political connections and the cost of capital remains unaffected in these reported (and other unreported) results when we use the risk premium as the dependent variable.

Our initial estimates of the cost of equity rely on the dividend payout ratios that are truncated between 50% and 100%. This truncation assumes that in the long-run, firms are

expected to distribute earnings back to shareholders; hence, dividend payouts of less than 50% underestimate long-term dividend payments. However, this assumption may not necessarily be true for all firms. In order to test if our results are driven by this assumption, we reproduce our cost of equity estimates assuming the minimum dividend payout equivalent to the industry average dividend payout ratio, which we estimate using Campbell's (1996) classification, for firms with dividend payouts below the 25% threshold. Second, we use the industry median expected return on equity (*ROE*) —estimated as forecasted earnings per share for year 1 (*FEPS1*) divided by the book value per share at the beginning of the year (*BV0*) — to estimate *FEPS4* to *FEPS12* used in our initial estimates of the cost of equity under the GLS model. We reproduce our cost of equity estimates based on the GLS model, and instead use the industry median of realized *ROE*. In unreported tests, our core results remain qualitatively unaffected when we use these cost of equity estimates as the dependent variable.

5.3. Median and Industry Fixed Effects Regressions

We also re-estimate our basic equation using a median regression framework (Model 7) to better control for the presence of outliers, and panel industry fixed effects regressions (Model 8) to control for industry-specific effects. This specification controls for the unobserved heterogeneity that can lead to spurious correlations. Using either the median regression or fixed effect regressions does not affect our results.

Insert Table 5 about here

5.4. Exclusion of Non-financial Firms and Countries

In our regressions, we control for industry effects using Campbell's (1996) classifications. Yet, financial firms are expected to have higher leverage ratios than non-financial firms, which may drive the results. In order to mitigate this concern, in Model 1 of Table 6 we report results using only non-financial firms (i.e., we exclude firms with SIC codes from 6000-6999). Our main results remain unaffected; political connection remains negatively associated with the cost of capital of non-financial firms.

Fisman (2001) and Johnson and Mitton (2003) document substantial effects associated with PCFs in Indonesia and Malaysia. To make sure that our results are not driven by observations from these two countries, we re-run our analysis while excluding these firms from

our sample. The results, which are reported in Model 2, show that the coefficient for *POLITICAL* remains negative and significant at the 1% level. Further, to check that our results are not driven by any specific country, we recursively exclude each country from the regressions. The coefficient for *POLITICAL* is generally negative and significant at conventional levels. This provides evidence that our results are not driven by any one or a small group of countries.

The descriptive statistics reported in Table 2 suggest that there are many countries in our sample where the number of PCFs is substantially low. For example, the Russian Federation has only one politically connected and one non-connected firm, and there is substantial difference in the cost of equity estimates between them. One may wonder whether the results are unduly affected by such thinly represented countries. In Table 6, we report our main results after excluding countries from which only a few firms are represented. *First*, Model 3 reports the results based on the sample of 6,568 firm-years from 21 countries with at least two PCFs. This restriction excludes Denmark, Finland, Hungary, and the Russian Federation, but our results are robust to this change. *Second*, Model 4 shows the results based on the sample of 6,219 firm-years from 17 countries with at least three PCFs. This restriction further excludes Canada, Hong Kong, Ireland, and Sweden. Again, our results are robust to this change. *Third*, Model 5 reports the results based on the sample of firms from 14 countries with at least four PCFs. This restriction excludes another three countries —Germany, India, and Spain— leaving 5,887 firm years in the sample. Yet, our results remain practically unchanged. *Finally*, Model 6 reports the results based on the sample of firms from ten countries with at least five PCFs. This restriction further excludes Belgium, South Korea, Philippines and Taiwan, leaving 5,448 firm-years in the sample. Our results remain robust even with these changes. These tests provide further evidence that our results are not driven by dispersions in the cost of equity between connected and unconnected firms (as Table 2 may suggest) in countries with a lower number of firms featured in the sample.

5.5. Alternative Controls and Country Risk

In our main regressions, we use *LNDISPERSION* as a proxy for dispersion of analyst forecasts, or inaccuracy of forecasted earnings. This is a typical control in multivariate regressions that use the implied cost of equity as the dependent variable. *FORECASTBIAS* is

another proxy of the inaccuracy of analysts' forecasts, often seen in the literature, which is estimated as the spread between one year ahead actual earnings and forecasted earnings. We report the results using *FORECASTBIAS* in Model 7 of Table 6. In these reported and other unreported results, our main finding on the association between political connections and the cost of equity capital remains unaffected.

Country-specific risk has been found to have a substantial impact on firms' cost of equity capital domiciled in a particular country (Erb et al., 1996). Therefore, the cost of equity estimates for similar firms domiciled in two different countries are likely to be higher or lower due to the difference in the specific risk of each country, which may drive our firm-level results. To mitigate this concern, we control for country credit ratings, measured by the natural logarithm of 100 minus Institutional Investor country ratings *LN(100-CREDITRATING)* in our regressions. Although the loading of country credit ratings does not appear to be significant after controlling for country effects, our main results related to political connection remain robust with the use of this control, as shown by the negative and significant coefficient for *POLITICAL* in Models 8 to 10 in Table 6.

Insert Table 6 about here

5.6. Matching Firms

In our tests, the control sample consists of firms matched by country-industry. In other words, if we have one PCF from country x in industry y, we take all firms belonging to country x in industry y as a control sample, where industry is defined following Campbell (1996). To tackle any selection bias issues that may exist in our procedure, we replicate our results by selecting only those firms that are within a 60% range of the size of PCFs based on market capitalization (measured in U.S. dollars) as the proxy of size, which leaves 3,896 firm-years of controls for 668 PCFs. More specifically, we include all control firms whose market capitalization is 40% or higher of the lowest market capitalization PCFs from a country-industry, and 160% or lower than the highest market capitalization PCFs from a country-industry. Replicating our findings using this sample leaves our results unaffected (Model 1, Table 7). Our results are robust to repeating our analysis within 40% of market capitalization (3,526 firm-year controls and 663 PCFs; the coefficient for *POLITICAL* is significant at 1%as reported in Model 2),

and 20% of market capitalization (3,161 firm-year controls and 661 PCFs; the coefficient for *POLITICAL* is significant at 5%as reported in Model 3).[8] This mitigates the concern that the selection of our control sample may have affected the association between political connection and the cost of equity.

In a nutshell, the results of these sensitivity tests reinforce our basic inferences on the negative effects of political connections on firms' cost of equity capital.

Insert Table 7 about here

5.7. Ownership Structure

The ownership structure of a firm may affect the level of expropriation of minority shareholders by management and large shareholders. Empirical evidence suggests that the effect of ownership structure is embedded in firms' cost of capital. Therefore, we replicate our tests after controlling for two measures of ownership structure, and report the results in Table 8. Model 1 controls for *INSIDER&AFFILIATE* which takes the value one if 50%or more members of the board consist of insiders or their affiliates. Model 2 controls for *CLASSIFIEDBOARD*, a dummy taking the value of one for classified boards, and zero otherwise, while Model 3 controls for the first principal component of these two variables (*PRINCIPAL*). Our main results related to the association between political connections and the cost of equity is robust to these controls.

Insert Table 8 about here

7. Conclusion

Prior academic research has shown that PCFs are prevalent around the world, regardless of a country's level of economic development (Faccio, 2006). The literature also argues that shareholders in PCFs gain from the close ties to politicians (e.g., Fisman, 2001; Leuz and Oberholzer-Gee, 2006 for Indonesia; Johnson and Mitton, 2003 for Malaysia). However, few studies have argued that government relationships could potentially be detrimental to

[8] Please note the regressions reported in the tables automatically exclude observations if any of the control variables have a missing value. The sample observations indicated here represent the observations with a valid estimate for the cost of equity capital that meet these additional criteria, which may be slightly higher than shown in the tables in some cases.

shareholder value. The objective of this study is to examine the net effects of political connections by focusing on the cost of equity of PCFs. This approach allows us to determine the impact of political connections on the cost of capital, an important channel of influence on firm value.

We use a multinational sample of firms which allows us to control for cross-country variations in legal systems and extent of law enforcement, as well as corruption. Our results show that PCFs have a lower cost of equity capital than their non-connected peers. These conclusions are robust to a battery of checks including alternative proxies for the dependent variable, selection bias concerns, as well as alternative control samples of non-connected comparable firms. Our main conclusion is that because of the soft budget constraints generally enjoyed by these firms, and the assurance of corporate rescue in the event of financial crisis/distress, the benefits from being politically connected outweigh the costs (i.e., the likelihood of expropriation), leading investors to require a lower rate of return for investing in PCFs. Another interesting result brought to light in this study is that the cost of capital is especially lower for those PCFs with the strongest ties.

Appendix A.1

Firm and Industry Specific Control Variables

Panel A. Firm-Specific Variables		
POLITICAL	A dummy Variable that is equal to one if the firm is politically connected	Faccio (2006)
GOVERNMENT	A dummy Variable that is equal to one if the firm is politically connected through a member of the government	Faccio (2006)
MP	A dummy Variable that is equal to one if the firm is politically connected through a member of parliament	Faccio (2006)
CLOSERELATION	A dummy Variable that is equal to one if the firm is politically connected through a close relationship	Faccio (2006)
DIRECTORSHIP	A dummy Variable that is equal to one if the firm is politically connected through directorship	Faccio (2006)
OWNERSHIP	A dummy Variable that is equal to one if the firm is politically connected through ownership	Faccio (2006)
SIZE	Natural Log of Total Assets	WorldScope
LEVERAGE	Total Debt *divided* by Total Capital	WorldScope
MTB	Market to book value ratio estimated as market value divided by book value of equity	WorldScope
VARIANCE	Variance of firm's monthly share prices divided by average prices	Estimates I/B/E/S
LNDISPERTION	Natural log of dispersion of estimated first-year earnings per share *divided* by mean earnings per share forecasts for the first year	I/B/E/S
GROWTH	I/B/E/S five-year earnings growth rate where available, otherwise estimated as growth in forecasted earnings from Year 1 to Year 3	I/B/E/S
ANALYSTCOVR	Number of analysts providing earnings' forecasts for the particular I/B/E/S statistics release period	I/B/E/S
Panel B. Country-Specific Variables		
CORRUPTION	Transparency International Corruption Perceptions Index (CPI). The index measures the degree to which corruption is perceived to exist among public officials and politicians. The 1997 CPI is rescaled from 0 to 10, with higher values indicating higher corruption.	Transparency International www.transparency.org
ANTIDIRECTOR	The Anti-Director Rights Index is formed by adding one when (1) the country allows shareholders to mail their proxy vote to the firm, (2) shareholders are not required to deposit their shares prior to the general shareholders' meeting, (3) cumulative voting or proportional representation of minorities in the board of directors is allowed, (4) an oppressed minorities mechanism is in place, (5) the minimum percentage of share capital that entitles a shareholder to call for an extraordinary shareholders' meeting is less than or equal to ten percent, or (6) shareholders have pre-emptive rights that can be waived only by a shareholders' vote.	LLS 2006

Appendix A.2: Models of Implied Cost of Equity Capital[9]

$K_{Subscript}$ = Cost of equity estimate of the model identified in subscript
$FEPS_{T+t}$ = I/B/E/S consensus earnings forecast for the t^{th} year from the estimation year recorded in June of the estimation year
P_T = I/B/E/S market price at the statistics release date for the estimation year
B_T = Book value per share for the estimation year, $B_{T+i} = B_{T+i-1} + FEPS_{T+i} - D_{T+i}$
D_{T+I} = $FEPS_{T+i}$*Dividend Payout [firm's dividend payout, where available, otherwise 50% as in Claus and Thomas (2001)]

Model 1: K_{OJ} - Ohlson and Juttner-Nauroth (2005 OJ) as implemented in Gode and Mohanram (2003)

$$K_{OJ} = A + \sqrt{A^2 + \frac{FEPS_{T+1}}{p_T}\left[g_2 - (y-1)\right]}, \quad (1)$$

$A = \frac{1}{2}\left((y-1) + \frac{D_{T+1}}{P_T}\right)$, $g_2 = \frac{FEPS_{T+2} - FEPS_{T+1}}{FEPS_{T+1}}$, y = a constant which is equal to 1+ long-term growth rate, the long-term growth rate (y-1) was fixed at U.S. inflation premium, estimated as annualized U.S. Treasury Bills yield *minus* 2%.

Model2: K_{CT} - Claus and Thomas (2001 CT)

$$P_T = B_T + \frac{FEPS_{T+1} - K_{CT}B_T}{(1+K_{CT})} + .. + \frac{FEPS_{T+5} - K_{CT}B_{T+4}}{(1+K_{CT})^5} + \frac{(FEPS_{T+5} - K_{CT}B_{T+4})(1+gn)}{(K_{CT} - gn)(1+K_{CT})^5} \quad (2)$$

The forecasts beyond two years are taken as reported where available, otherwise generated based on the five-year consensus growth rate forecast or the average growth in $FEPS_1$ to $FEPS_3$. The long-term growth rate beyond five years g_n= annualized U.S. Treasury Bills yield minus 2%. Finally, we manually search for K_{CT} that satisfies equation 2 by searching for K_{CT} within 0 to 100%. We exclude observations that do not converge.

Model 3: K_{GLS} - Gebhardt, Lee and Swaminathan (2001 GLS)

$$P_T = B_T + \frac{FEPS_{T+1} - K_{GLS}B_T}{(1+K_{GLS})} + ... + \frac{FEPS_{T+i} - K_{GLS}B_{T+t-1}}{(1+K_{GLS})^i} + ... + \frac{FEPS_{T+t+1} - K_{GLS}B_{T+t}}{K_{GLS}(1+K_{GLS})^i} \quad (3)$$

$FEPS_{T+4}$ to $FEPS_{T+12}$ is forecasted such that *ROE* gradually (linearly) converges to industry *ROE* in the 12^{th} year. Industry *ROE* is estimated as the mean of all firm's *year 1 ROE* at Fama-French 48 Industry Portfolios for the estimation period. Growth in earnings after the 12^{th} year is assumed to be zero. We manually search for K_{GLS} within 0 to 100%.

Model 4: K_{ES} Easton - (2004 ES)

$$P_T = \frac{FEPS_{T+2} + K_{ES}.D_{T+1} - FEPS_{T+1}}{K_{ES}^2} \quad (4)$$

We manually search for K_{ES}.

[9] Adapted and modified from Attig et al., (2008).

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Table 1

Properties of Cost of Equity Estimates

	Basic Statistics				Correlation Coefficients			
Variable	N	Mean	Stdev	Median	*kES*	*kOJ*	*kCT*	*kGLS*
kES	6632	0.134	0.077	0.116				
kOJ	6632	0.145	0.076	0.127	0.988			
kCT	6632	0.127	0.102	0.105	0.536	0.528		
kGLS	6632	0.069	0.063	0.053	0.702	0.68	0.502	
K	6632	0.119	0.068	0.102	0.922	0.914	0.791	0.808

This table reports basic statistics and correlation coefficients for the cost of equity estimates of the four models, and our estimate of the firm's ultimate cost of equity capital for 6,632 firm-year observations from 25 countries over the period 1997-2001. $K_{AVERAGE}$ is the proxy for the firm's ultimate cost of capital, estimated as the equally weighted average of K_{OJ}, K_{ES}, K_{CT}, and K_{GLS}, where the latter respectively represent implied cost of equity estimates of Ohlson and Juttener-Narouth (2000), Easton (2004), Claus and Thomas (2001), and Gebhardt, Lee, and Swaminathan (2001) models. Appendix A.1 reports detailed definitions and data sources for all variables.

Table 2

Cost of Equity by Country

Country	Political	N	Mean	STDEV	Min	Q1	Median	Q3	Max
BELGIUM	0	40	0.102	0.066	0.050	0.072	0.081	0.102	0.363
	1	13	0.103	0.048	0.064	0.089	0.097	0.100	0.260
CANADA	0	56	0.087	0.023	0.050	0.075	0.085	0.094	0.175
	1	6	0.133	0.083	0.070	0.079	0.091	0.193	0.277
DENMARK	0	29	0.125	0.039	0.075	0.101	0.119	0.139	0.253
	1	1	0.161		0.161	0.161	0.161	0.161	0.161
FINLAND	0	14	0.171	0.060	0.089	0.128	0.167	0.204	0.292
	1	4	0.111	0.004	0.105	0.108	0.111	0.114	0.116
FRANCE	0	539	0.115	0.054	0.038	0.083	0.104	0.135	0.685
	1	48	0.099	0.035	0.058	0.081	0.088	0.107	0.289
GERMANY	0	90	0.119	0.073	0.052	0.083	0.096	0.143	0.659
	1	8	0.093	0.029	0.060	0.066	0.087	0.124	0.130
HONG KONG	0	132	0.162	0.097	0.053	0.110	0.137	0.171	0.825
	1	10	0.135	0.056	0.084	0.087	0.114	0.191	0.236
HUNGARY	0	10	0.139	0.030	0.106	0.117	0.131	0.154	0.197
	1	4	0.262	0.049	0.218	0.222	0.254	0.301	0.321
INDIA	0	153	0.155	0.075	0.053	0.101	0.141	0.191	0.434
	1	11	0.172	0.119	0.033	0.081	0.116	0.291	0.389
INDONESIA	0	119	0.249	0.146	0.073	0.148	0.218	0.286	0.891
	1	33	0.206	0.102	0.074	0.133	0.185	0.242	0.576
IRELAND	0	16	0.121	0.016	0.091	0.110	0.117	0.135	0.146
	1	6	0.106	0.018	0.081	0.090	0.110	0.121	0.124
ITALY	0	211	0.108	0.037	0.031	0.081	0.105	0.129	0.262
	1	30	0.098	0.038	0.047	0.067	0.086	0.121	0.202
JAPAN	0	1818	0.086	0.041	0.026	0.060	0.076	0.099	0.396
	1	43	0.077	0.034	0.037	0.055	0.065	0.094	0.171
KOREA (SOUTH)	0	201	0.203	0.073	0.051	0.147	0.200	0.242	0.487
	1	9	0.217	0.129	0.068	0.104	0.243	0.315	0.408
MALAYSIA	0	270	0.130	0.064	0.057	0.096	0.117	0.145	0.795
	1	90	0.126	0.048	0.054	0.092	0.116	0.146	0.331
MEXICO	0	101	0.162	0.064	0.058	0.114	0.151	0.198	0.477
	1	22	0.198	0.098	0.067	0.113	0.195	0.263	0.400
PHILIPPINES	0	90	0.189	0.124	0.063	0.115	0.157	0.200	0.673
	1	11	0.141	0.092	0.088	0.090	0.103	0.158	0.405
RUSSIAN FEDERATION	0	1	0.716		0.716	0.716	0.716	0.716	0.716
	1	1	0.253		0.253	0.253	0.253	0.253	0.253
SINGAPORE	0	170	0.145	0.081	0.047	0.094	0.124	0.167	0.715
	1	15	0.137	0.067	0.056	0.077	0.123	0.188	0.278
SPAIN	0	60	0.115	0.033	0.036	0.098	0.107	0.127	0.243
	1	10	0.118	0.037	0.080	0.088	0.105	0.136	0.204
SWEDEN	0	114	0.121	0.031	0.064	0.099	0.122	0.141	0.237
	1	9	0.127	0.013	0.109	0.120	0.125	0.136	0.150
SWITZERLAND	0	170	0.116	0.057	0.030	0.085	0.105	0.133	0.608
	1	17	0.104	0.032	0.069	0.079	0.095	0.114	0.178
TAIWAN	0	59	0.118	0.051	0.037	0.088	0.109	0.136	0.373
	1	16	0.106	0.028	0.076	0.088	0.099	0.115	0.171
THAILAND	0	87	0.190	0.098	0.063	0.118	0.159	0.254	0.488
	1	36	0.152	0.087	0.023	0.103	0.126	0.178	0.471
UNITED KINGDOM	0	1392	0.116	0.046	0.028	0.083	0.107	0.138	0.378
	1	237	0.104	0.046	0.032	0.080	0.095	0.117	0.534

This table reports statistical properties for the cost of equity estimates of four models individually, and our estimate of the firm's ultimate cost of equity capital for 6,632 firm-year observations from 25 countries over the period 1997-2001. $K_{AVERAGE}$ is the proxy for the firm's ultimate cost of capital, estimated as the equally weighted average of K_{OJ}, K_{ES}, K_{CT}, and K_{GLS}, where the latter respectively represent implied cost of equity estimates of Ohlson and Juttener-Narouth (2000), Easton (2004), Claus and Thomas (2001), and Gebhardt, Lee, and Swaminathan (2001) models. Appendix A.1 reports detailed definitions and data sources for all variables.

Table 3

Descriptive Statistics and Correlation Matrix of Explanatory Variables

Panel A: Descriptive Statistics

Name	N	Mean	STDEV	Min	Q1	Median	Q3	Max
POLITICAL	6632	0.104	0.305	0.000	0.000	0.000	0.000	1.000
SIZE	6632	13.785	1.857	10.117	12.421	13.664	14.987	18.709
ANALYSTCOVR	6632	10.393	7.135	2.000	5.000	8.000	14.000	47.000
VARIANCE	6632	0.180	0.112	0.040	0.103	0.149	0.221	0.615
MTB	6632	3.057	3.761	0.130	1.140	1.895	3.280	23.890
LNDISPERSON	6632	1.830	1.627	0.022	0.509	1.526	2.574	7.443
LEVERAGE	6632	34.845	24.696	0.000	14.630	32.445	51.295	96.690
GROWTH	6632	18.459	19.104	-11.720	8.348	13.860	22.000	118.478
ANTIDIRECTOR	6616	3.081	1.861	0.500	1.400	3.100	3.100	8.000
CORRUPTION	6632	3.085	1.862	0.500	1.400	3.100	3.100	8.000

Panel A reports descriptive statistics on all variables used in the regressions. The sample includes 6,632 firm-year observations from 25 countries over the period 1997-2001.

Panel B: Correlation Coefficients

Variable	*POLITICAL*	*SIZE*	*ANALYSTCOVR*	*VARIANCE*	*MTB*	*LNDISPERSON*	*LEVERAGE*	*GROWTH*	*ANTIDIRECTOR*
SIZE	**0.111**								
ANALYSTCOVR	**0.140**	**0.571**							
VARIANCE	**0.004**	**-0.214**	**-0.069**						
MTB	0.025	**-0.188**	0.021	**0.142**					
LNDISPERSON	-0.033	**0.042**	**-0.094**	**0.168**	**-0.110**				
LEVERAGE	**0.064**	**0.365**	**0.067**	**0.010**	**-0.064**	0.115			
GROWTH	**-0.060**	**-0.154**	**-0.132**	**0.209**	**0.124**	**0.159**	0.032		
ANTIDIRECTOR	-0.020	**-0.093**	**-0.148**	**-0.072**	**0.096**	**-0.119**	**-0.105**	**-0.088**	
CORRUPTION	**0.048**	0.000	**0.083**	**0.203**	**-0.098**	**0.428**	**0.072**	**0.081**	**-0.460**

Panel B reports Pearson's correlation coefficients for all variables used in the regressions. Spearman correlations (unreported for brevity) are consistent with the Pearson correlations. Boldface indicates statistical significance at the 1% level. Appendix A.1 reports detailed definitions and data sources for all variables.

Table 4

Political Connections and Cost of Equity Capital

Models	1	2	3	4	5	6	7
Constant	0.151***	0.141***	0.146***	0.133***	0.086***	0.137***	0.137***
	(13.141)	(12.228)	(8.871)	(7.900)	(5.997)	(11.819)	(11.634)
POLITICAL	-0.006***	-0.005**	-0.005***	-0.005**	-0.005**		
	(-2.631)	(-2.433)	(-2.683)	(-2.378)	(-2.199)		
GOVERNMENT						0.028	
						(1.125)	
MP						-0.002	
						(-0.880)	
CLOSERELATION						-0.016***	
						(-2.828)	
DIRECTORSHIP							-0.002
							(-0.913)
OWNERSHIP							-0.009**
							(-2.123)
SIZE	-0.005***	-0.005***	-0.005***	-0.005***		-0.005***	-0.005***
	(-6.222)	(-6.413)	(-4.880)	(-5.292)		(-5.472)	(-5.446)
LEVERAGE	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***
	(5.137)	(5.151)	(5.717)	(5.809)	(4.923)	(5.527)	(5.609)
MTB	-0.004***	-0.004***	-0.003***	-0.004***	-0.003***	-0.004***	-0.004***
	(-5.444)	(-5.122)	(-4.465)	(-4.304)	(-4.295)	(-4.794)	(-4.806)
VARIANCE	0.070***	0.072***	0.072***	0.075***	0.074***	0.073***	0.074***
	(3.268)	(3.599)	(3.342)	(3.787)	(3.985)	(3.586)	(3.579)
LNDISPERSION	0.008***	0.008***	0.008***	0.008***	0.008***	0.008***	0.008***
	(3.146)	(3.682)	(3.001)	(3.511)	(4.007)	(3.539)	(3.554)
GROWTH	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***
	(4.050)	(4.189)	(4.142)	(4.285)	(4.230)	(4.103)	(4.126)
ANALYSTCOVR					-0.002***		
					(-8.543)		
CORRUPTION	0.002***	0.002***	0.007**	0.007***	0.008***	0.002**	0.002**
	(5.722)	(7.099)	(2.475)	(3.353)	(4.210)	(2.295)	(2.414)
ANTIDIRECTOR	0.004***	0.005***	0.002	0.003	0.004	0.004	0.004
	(5.774)	(5.953)	(0.663)	(0.889)	(1.246)	(1.556)	(1.544)
Industry Effect	NO	NO	YES	YES	YES	YES	YES
Year Effect	NO	YES	NO	YES	YES	YES	YES
Country Effect	YES	YES	YES	YES	YES	YES	YES
Adj. R^2	0.372	0.394	0.383	0.405	0.415	0.403	0.402
N	6,616	6,616	6,616	6,616	6,616	6,616	6,616

This table reports regression results of firm's cost of equity capital on variables representing political connections, and all others are control variables. The sample consists of 6,632 firm-year observations from 25 countries over the period 1997-2001. $K_{AVERAGE}$ is the dependent variable, estimated as the equally weighted average of the cost of equity capital estimates based on the four models described in Appendix A.2. Political connections data is from Faccio (2006). Appendix A.1 reports detailed definitions and data sources for all variables. Beneath each coefficient is the robust *t*-statistic clustered at the country level. The superscript asterisks ***, **, * denote statistical significance at the 1%, 5%, and 10% levels, respectively. All two-tailed.

Table 5

Robustness Tests, Set 1

Model	1st Stage	2nd Stage	1.KCT	2.KES	3.KGLS	4.KOJ	5.Risk Premium	6. Median Regression	7.Industry Fixed Effect
Constant	-3.169***	0.112***	0.152***	0.128***	0.117***	0.137***	0.071***	0.126***	0.129***
	(-10.164)	(4.852)	(9.560)	(6.748)	(4.624)	(7.391)	(4.084)	(18.117)	(12.037)
CAPITAL	0.111**								
	(1.989)								
I_POLITICAL		-0.070**							
		(-2.355)							
POLITICAL			-0.005**	-0.006**	-0.003	-0.006**	-0.005**	-0.004***	-0.005**
			(-2.190)	(-2.051)	(-1.234)	(-2.102)	(-2.385)	(-2.879)	(-2.210)
SIZE	0.173***	-0.002	-0.004***	-0.006***	-0.003***	-0.006***	-0.005***	-0.004***	-0.005***
	(11.537)	(-1.293)	(-3.251)	(-5.135)	(-3.041)	(-5.278)	(-5.275)	(-14.309)	(-10.709)
LEVERAGE	0.000	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***
	(-0.272)	(5.880)	(5.124)	(5.798)	(2.733)	(5.735)	(5.806)	(16.068)	(13.925)
MTB	0.019***	-0.003***	-0.004***	-0.004***	-0.004***	-0.003***	-0.004***	-0.003***	-0.004***
	(3.080)	(-3.894)	(-4.316)	(-4.064)	(-4.830)	(-3.937)	(-4.304)	(-24.881)	(-18.668)
VARIANCE	0.216	0.074***	0.076***	0.083***	0.054***	0.084***	0.075***	0.043***	0.075***
	(0.909)	(3.467)	(3.436)	(3.669)	(3.652)	(3.676)	(3.802)	(10.237)	(11.488)
LNDISPERSION	0.002	0.007***	0.007**	0.009***	0.004**	0.010***	0.008***	0.004***	0.008***
	(0.082)	(3.548)	(2.533)	(2.979)	(2.559)	(3.047)	(3.514)	(8.642)	(10.069)
GROWTH	-0.005***	0.000***	0.001***	0.000***	0.000	0.001***	0.000***	0.000***	0.000***
	(-3.038)	(4.526)	(3.304)	(6.577)	(0.936)	(7.260)	(4.290)	(18.782)	(12.551)
CORRUPTION	0.062**	0.008***	0.007**	0.010***	0.004**	0.009***	0.007***	0.007***	0.007***
	(1.677)	(3.724)	(2.546)	(3.126)	(1.990)	(2.774)	(3.193)	(9.642)	(6.375)
ANTIDIRECTOR	-0.099	0.002	-0.006**	0.011***	-0.002	0.010***	0.003	0.008***	0.003
	(-1.098)	(0.533)	(-2.292)	(2.861)	(-0.342)	(2.853)	(0.827)	(4.135)	(1.065)
Industry Effect	YES	YES	YES	YES	YES	YES	YES	YES	YES
Year Effect	YES	YES	YES	YES	YES	YES	YES	YES	YES
Country Effect	YES	YES	YES	YES	YES	YES	YES	YES	YES
Adj. R^2	0.138	0.410	0.172	0.418	0.350	0.406	0.417	0.270	0.392
N	6,167	6,167	6,616	6,616	6,616	6,616	6,616	6,616	6,616

This table reports regression results of firm's cost of equity capital on variables representing political connections, and all others are control variables. The sample consists of 6,632 firm-year observations from 25 countries over the period 1997-2001. $K_{AVERAGE}$ is the dependent variable, estimated as the equally weighted average of the cost of equity capital estimates based on the four models described in Appendix A.2. Political connections data is from Faccio (2006). Appendix A.1 reports detailed definitions and data sources for all variables. Beneath each coefficient is the robust *t*-statistic clustered at the country level. The superscript asterisks ***, **, * denote statistical significance at the 1%, 5%, and 10% levels, respectively. All two-tailed.

Table 6

Robustness Tests, Set 2

Model	1.Non Financial	2. No Malaysia & Indonesia	3. At least 2	4.At least 3	5.At least 4	6.At least 5	7.ForecastBias	8.C.Rating 1	9.C.Rating 2	10.C.Rating 3
Constant	0.165***	0.126***	0.133***	0.129***	0.138***	0.171***	0.112***	0.142***	0.140***	0.132***
	(10.902)	(18.117)	(7.808)	(7.211)	(11.26)	(17.25)	(9.397)	(6.030)	(5.465)	(4.462)
POLITICAL	-0.005**	-0.004***	-0.005**	-0.005**	-0.006**	-0.006**	-0.005**	-0.005**	-0.005**	-0.005**
	(-2.129)	(-2.879)	(-2.322)	(-2.578)	(-2.482)	(-2.405)	(-2.305)	(-2.306)	(-2.114)	(-2.177)
SIZE	-0.005***	-0.004***	-0.005***	-0.004***	-0.005***	-0.005***	-0.004***	-0.005***	-0.005***	-0.005***
	(-5.006)	(-14.309)	(-5.258)	(-5.213)	(-6.801)	(-6.551)	(-4.772)	(-5.321)	(-5.226)	(-5.454)
LEVERAGE	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***
	(6.802)	(16.068)	(5.790)	(5.918)	(5.588)	(5.206)	(5.904)	(5.699)	(5.820)	(5.678)
MTB	-0.004***	-0.003***	-0.004***	-0.004***	-0.003***	-0.003***	-0.004***	-0.004***	-0.004***	-0.004***
	(-4.476)	(-24.881)	(-4.295)	(-4.284)	(-4.649)	(-5.058)	(-4.539)	(-4.300)	(-4.298)	(-4.374)
VARIANCE	0.071***	0.043***	0.075***	0.076***	0.073***	0.060***	0.071***	0.074***	0.077***	0.077***
	(3.772)	(10.237)	(3.758)	(3.615)	(3.268)	(3.685)	(4.163)	(3.703)	(3.719)	(3.793)
LNDISPERSION	0.007***	0.004***	0.008***	0.008***	0.008***	0.008**		0.008***	0.007***	0.009***
	(3.349)	(8.642)	(3.483)	(3.389)	(3.412)	(3.171)		(3.631)	(3.162)	(4.203)
FORECASTBIAS							0.007***			
							(3.878)			
GROWTH	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***	0.000***
	(4.104)	(18.782)	(4.212)	(4.086)	(3.968)	(3.779)	(5.813)	(4.221)	(4.161)	(3.918)
CORRUPTION	0.007***	0.007***	0.007***	0.008***	0.009***	0.006***	0.014***	0.008**	0.008***	
	(17.027)	(9.642)	(3.324)	(3.693)	(4.932)	(4.438)	(28.15)	(2.617)	(2.852)	
ANTIDIRECTOR	-0.007***	0.008***	0.003	0.008***	-0.000	-0.009***	0.008**	0.004		-0.002
	(-4.378)	(4.135)	(0.885)	(4.211)	(-0.179)	(-8.253)	(2.814)	(0.936)		(-0.315)
LN(100-CREDIT RATING)								-0.004	-0.001	0.011
								(-0.520)	(-0.060)	(1.471)
Industry Effect	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Year Effect	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Country Effect	YES	YES	YES	YES	YES	YES	YES	YES	YES	YES
Adj. R^2	0.396	0.387	0.405	0.411	0.423	0.407	0.409	0.406	0.405	0.403
N	6,211	6,104	6,568	6,219	5,887	5,448	6,547	6,616	6,632	6,616

This table reports results after excluding non-financial firms, Malaysian and Indonesia firms, and countries with the smallest number of politically connected firms, and after changing some independent variables. For example, Model 3 includes countries with at least two politically connected firms, while Model 6 includes countries with at least five politically connected firms. Beneath each coefficient is the robust t-statistic clustered at the country level. The superscript asterisks ***, **, * denote statistical significance at the 1%, 5%, and 10% levels, respectively. All two tailed.

Table 7

Robustness Tests, Set 3

Variables	1. 60% of range of market cap	2. 40% of range of market cap	3. 20% of range of market cap
Constant	0.169***	0.155***	0.151***
	(8.918)	(8.997)	(8.188)
POLITICAL	-0.005***	-0.005**	-0.004**
	(-2.648)	(-2.488)	(-2.124)
SIZE	-0.004***	-0.004***	-0.004***
	(-4.878)	(-4.592)	(-5.035)
LEVERAGE	0.000***	0.000***	0.000***
	(6.780)	(6.417)	(7.388)
MTB	-0.003***	-0.003***	-0.003***
	(-3.737)	(-3.763)	(-4.043)
VARIANCE	0.069***	0.075***	0.075***
	(3.793)	(3.610)	(3.802)
LNDISPERSION	0.007***	0.007***	0.007**
	(2.715)	(2.608)	(2.503)
GROWTH	0.000***	0.000***	0.000***
	(4.208)	(3.553)	(3.293)
CORRUPTION	-0.008**	-0.008**	-0.009**
	(-2.321)	(-2.424)	(-2.576)
ANTIDIRECTOR	-0.004	0.000	0.001
	(-1.211)	(0.055)	(0.184)
Industry Effect	YES	YES	YES
Year Effect	YES	YES	YES
Country Effect	YES	YES	YES
Adj. R^2	0.397	0.399	0.390
N	4,555	4,180	3,814

This table reports robustness tests by changing the criteria for selecting the control sample based on size. For example, Model 1 includes firms that are within a 60% range of the size of politically connected firms based on market capitalization. Beneath each coefficient is the robust *t*-statistic clustered at the country level. The superscript asterisks ***, **, * denote statistical significance at the 1%, 5%, and 10% levels, respectively. All two tailed.

Table 8

Political Connection and Ownership Structure

Variables	1.Board	2.Board	3.Board
Constant	0.161***	0.162***	0.160***
	(5.688)	(5.521)	(5.593)
POLITICAL	-0.006**	-0.006**	-0.006**
	(-2.509)	(-2.556)	(-2.550)
INSIDER&AFFILIATE	-0.002		
	(-0.980)		
CLASSIFIEDBOARD		-0.002	
		(-1.402)	
PRINCIPAL			-0.001*
			(-1.793)
SIZE	-0.003***	-0.003**	-0.003**
	(-2.873)	(-2.754)	(-2.816)
LEVERAGE	0.000***	0.000***	0.000***
	(7.154)	(7.046)	(7.181)
MTB	-0.002***	-0.002***	-0.002***
	(-4.938)	(-4.954)	(-4.963)
VARIANCE	0.047***	0.047***	0.047***
	(4.498)	(4.525)	(4.543)
LNDISPERSION	0.007**	0.007**	0.007**
	(2.627)	(2.643)	(2.637)
GROWTH	0.000***	0.000***	0.000***
	(2.783)	(2.763)	(2.778)
CORRUPTION	0.002	0.002	0.002
	(0.704)	(0.619)	(0.606)
ANTIDIRECTOR	-0.007	-0.008	-0.008
	(-1.405)	(-1.425)	(-1.413)
Industry Effect	YES	YES	YES
Year Effect	YES	YES	YES
Country Effect	YES	YES	YES
Adj. R^2	0.320	0.320	0.320
N	3,549	3,549	3,549

This table reports robustness tests of our basic specification by including controls for ownership variables. Beneath each coefficient is the robust *t*-statistic clustered at the country level. The superscript asterisks ***, **, * denote statistical significance at the 1%, 5%, and 10% levels, respectively. All two tailed.