8-2017

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Recommended Citation

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Abstract

We examine the relation between CEOs political ideology and their firms' investment decisions, particularly their M&A decisions. Employing individual financial contributions data for the period from 1993 to 2006, we find that firm's investment decisions vary with CEO's political ideology. Our evidence indicates that Republican CEOs are less likely to engage in M&A activities. When they do undertake acquisitions, they are more likely to use cash as the method of payment, and their targets are more likely to be public firms and to be from the same industry. Further, Republican CEOs tend to avoid high information asymmetry acquisitions that involve the use of "earnout" clauses. Conditional on the merger, CEO political ideology appears to have a significantly impact on long-run firm valuation. However, we find no evidence that CEO political ideology creates value in the short-run. All our results are robust to controlling for CEO overconfidence.

Keywords: CEO Political Ideology; Mergers and Acquisitions; Conservatism; Overconfidence.

JEL classification: G31, G34, P16.

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1. Introduction

A growing literature has examined individual as well as corporate financial decisions in the context of the "behavioral consistency principle", the notion that individuals' preferences, attitudes, and personal traits can translate consistently across various choice problems (Wernimont and Campbell, 1968). For example, Cronqvist, Makhija and Yonker (2011) document the behavioral consistency of CEOs' leverage choices in the mortgages of their primary residences and the debt ratios of their firms. Bonaparte, Kumar and Page (2010), Hong and Kostovetsky (2012), and Jiang, Kumar and Law (2011) show that personal political preferences have a significant influence on the investment decisions of individual investors and professional money managers, as well as on the forecasts of equity analysts. Similarly, Malmendier and Tate (2005) and (2008) point out that CEOs' overconfidence can adversely impact their firms' capital expenditures and M&A decisions, while Bertrand and Schoar (2003) analyze how other characteristics of CEOs, such as age, education, and region, can also affect their corporate decisions.

More recently, Hutton, Jiang and Kumar (2014) test whether the personal political ideology of CEOs influences the level of financial conservatism in their firms. Their results show that firms with Republican CEOs exhibit more conservative corporate policies in the form of lower leverage ratios, lower capital and R&D expenditures, less risky investment, higher dividend payouts, and greater profitability. Unsal, Hassan and Zirek (2016) show that Republican CEOs engage more in lobbying and that political orientation affects the association between lobbying and firm performance. Further, Francis, Hasan, Sun and Wu (2016) show that firms with politically partisan CEOs are associated with higher level of tax sheltering as compared to firms with neutral CEOs.

Our paper extends this literature by examining the effect of CEO political ideology on the merger and acquisition (M&A) decisions of their firms. Following Hutton, Jiang and Kumar,

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(2014), Hong and Kostovetsky (2012), Francis, Hasan, Sun and Wu (2016), and Unsal, Hassan and Zirek (2016) , we use CEOs' personal political contributions to identify their political orientations, and thereby to assess the degree of their political and fiscal conservatism. Investigating the possible effect of CEOs political ideology on their M&A decisions is important because acquisitions are among the most significant investment decisions CEOs make, which can have a substantial impact on shareholders' wealth.

To empirically examine the effect of CEO political ideology on M&A decisions, we compile a sample of 1,007 publicly traded U.S. firms and 2,100 CEOs that are covered by COMPUSTAT ExecuComp. Our final sample consists of 12,928 CEO-year observations between 1993 and 2006. Our findings contribute to the literature by shedding light on how CEO political ideology affects (1) firm's preference for acquisition (external investment) versus capital expenditures (internal investment), (2) Acquirer's choice of payment method (cash vs. stock), type of target (public vs. private), and deal type (focus increasing vs. diversification), and (3) market's reaction to M&A announcements and the long-run performance of acquiring firms. Further, we test CEOs political ideology effect on their firms' engagement in acquisitions that involve high degree of information asymmetry captured by the inclusion of "earnout" clauses.

First, we test the effect of CEO political ideology on the likelihood of engagement in mergers. We find that Republican CEOs are significantly less likely to engage in M&A activities. The results are robust to controlling for other CEO characteristics, such as age, tenure, and gender, as well as standard M&A determinants including, Tobin's q, size, free-cash-flow, leverage, R&D and capital expenditures, and industry concentration level. We use industry and year fixed effects to remove the within-industry and time effects. Our evidence is consistent with the view suggested in the previous literature (Jost, Glaser, Kruglanski and Sulloway, 2003; Wilson, 1973b; and Kish,

Netterberg and Leahy, 1973) that conservative individuals exhibit a strong disposition to preserve the status quo and are less likely to seek strong external stimulation and to engage in sensation-seeking behavior. Our results indicate that this behavioral consistency of conservatives extends to their corporate investment/M&A decisions.

Using seemingly unrelated regression (SUR), we further test Republican CEOs' choice of acquisition (external investment) over capital expenditures (internal investment). We find that CEO Republican ideology is negatively associated with external investment (M&A), but positively associated with internal investment (capital expenditures) after controlling for firm-level investment opportunity (Tobin's q) and industry concentration level. Republican CEOs' choice can be explained by the higher degree of uncertainty and information asymmetry in the environment surrounding external investment (M&A) addressed in Harford and Li (2007).

Further, our results show that Republican CEOs are significantly less likely to choose stock as a payment method for M&A. Gilson (1986) documents that stock payments lead to substantial offer delays in the United States due to security registration and shareholders' approval requirements. Fishman (1989) argues that cash enables more rapid deal completion, and thus reducing the risk of competitive bids. Furthermore, holding acquisition price constant, using cash lowers the likelihood of bid rejection by target management. Since using stocks would increase the uncertainty of deal consummation, conservative CEOs are therefore less likely to use it as a payment method. Our empirical results are consistent with this prediction.

CEOs with Republican ideology are also more likely to choose focus-increasing M&As. Glasgow and Cartier (1985) argue that conservatives tend to prefer familiar stimuli over unfamiliar stimuli. They are also more sensitive to the possibility of loss. Diversifying M&A are shown to

have negative announcement returns (Morck, Shleifer and Vishny, 1988). Similarly, diversified firms are seem to exhibit a diversification discount on valuation (Berger and Ofek, 1995; Lang and Stulz, 1994; and Rajan, Servaes and Zingales, 2000). Republican CEOs are therefore more likely to acquire within-industry targets to the extent that their sensitivity to unfamiliar stimuli and potential loss from diversifying merger is greater than non-Republican CEOs.

We also find that Republican CEOs are more likely to choose public targets over private targets. One possible explanation for this finding is the difference in information availability on private/subsidiary and public targets. Lack of information on private targets makes the value of their assets highly uncertain, which might cause conservative CEOs to favor acquiring public targets.

To investigate whether CEOs political ideology affect the value of their firms by undertaking acquisitions, we analyze market's reaction to M&A announcements. We find no statistically significant difference in market response to announcements by firms with Republican or non-Republican CEOs in multivariate regression test. One possible explanation for this finding is that M&A decisions made by Republican CEOs could be suboptimal. Our results show that Republican CEOs are more likely to use cash as the payment method (associated with positive announcement returns), are more likely to conduct focus-increasing M&A (associated with positive announcement returns), and are more likely to acquire public targets (associated with negative announcement returns).

In particular, acquiring public targets could be a suboptimal decision in creating firm value. Fuller, Netter and Stegemoller (2002) argue that, due to the lack of liquidity in private and subsidiary targets, acquiring such firms can result in positive announcement returns. However,

information on private and subsidiary targets is generally more opaque and less available than public targets. Thus, given the preference for greater uncertainty avoidance, CEOs with conservative ideology are more likely to prefer acquiring public targets, resulting in negative market response.

Interestingly, the analysis of long-term performance indicates that Republican CEOs add value to their firms. Over the five-year post-M&A period, stocks of firms with Republican CEOs outperform those with non-Republican CEOs by 20.73% (significant at a 5% level). This finding is consistent with Hutton, Jiang and Kumar (2014) who show that firms run by Republican CEOs have better operating performance. It is possible that the cautious management style of conservative CEOs results in fewer mistakes and hence better performance.

We perform several robustness checks for our results, for example, by controlling for CEO overconfidence. Malmendier and Tate (2005) show that management overconfidence is an important aspect of CEO behavioral bias that has a significant impact on firm's investment decisions. We show that our results remain unchanged after controlling for CEO overconfidence.

As an additional robustness check for the association between CEO political orientation and information asymmetry, we test Republican CEOs' involvement in acquisitions that include earnout clauses. Kohers and Ang (2000) show that earnout agreements are more commonly used in deals that involve high degree of information asymmetry. Similarly, Reuer, Shenkar and Ragozzino (2004) show that firms with less acquisition experience use earnouts to acquire targets in high-tech and service industries.[3] Earnout test results lend further support to the idea that

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[3] Several other papers also study the use of earnout agreements in M&A. for example, Barbopoulos and Wilson (2013), Cadman, Carrizosa, and Faurel (2014), Cain, Denis, and Denis (2006), Datar, Frankel, and Wolfson (2001), and Lukas and Heimann (2014).

Republican CEOs tend to avoid deals with higher degree of information asymmetry. Republican CEOs are less likely to engage in earnout acquisitions as compared to non-Republican CEOs.

This paper contributes to several areas of the literature. In a broad sense, this paper contributes to the literature on the effect of cultural dimensions on economics and corporate decision making (Boubakri and Saffar, 2016; Holderness, 2014; Li, et al., 2013; and Lievenbrück and Schmid, 2014).[4] This paper contributes to the emerging literature on the effect of political ideology on corporations (Hong and Kostovetsky, 2012; Hutton, Jiang and Kumar, 2014; Unsal, Hassan and Zirek, 2016; and Francis, Hasan, Sun and Wu, 2016). Further, our empirical results contribute to our understanding of mergers and acquisitions (Agrawal, Jaffe and Gershon, 1992; and Agrawal, Jaffe and Mandelker, 1992), and to the literature on earnout M&A (Cain, Denis and Denis, 2006; Kohers and Ang, 2000; and Reuer, Shenkar and Ragozzino, 2004).

The remainder of the paper proceeds as follows. Section 2 reviews literature and develops our hypotheses. Section 3 describes the data and the measures of political ideology. Section 4 presents empirical results and their interpretations, and we conclude in Section 5.

2. Literature review and hypotheses development.

The basic premise of our analysis is that CEOs' political ideology extends to their firms' financial and investment decisions. Carney, Jost, Gosling and Potter (2008) show that left-right differences in ideologies exist and are related to their relative openness to changes versus the preservation of traditional values. Jost *et al.* (2003) argue that conservatives exhibit a strong disposition to preserve the status quo while liberals are more willing to embrace changes and seek

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[4] See also Adair et al. (2004), Barr, et al. (2009), Brett et al. (1998), Chui, Titman, and Wei (2010), Giannetti and Yafeh (2012), Gorodnichenko and Roland (2010), Guiso, Sapienza, and Zingales (2006), Oosterbeek, Sloof, and Van de Kuilen (2004), and Li, Griffin,Yue, and Zhao (2013).

novelty. In particular, conservatives are less likely to seek strong external stimulation (Wilson, 1973a), less open to unconventional views (Jost and Thompson, 2000), less likely to engage in sensation seeking behaviors (Kish, Netterberg and Leahy, 1973), and more cautious about making major changes in life (Feather, 1979).

In addition, external investment (M&A) and internal investment (capital expenditures) decisions are the choice of CEOs since they are similar ways of increasing firm's assets base and productive capacity. Andrade and Stafford (2004) analyze industry patterns in M&A and Capital expenditures, and find that M&As are similar to Capital expenditures in a sense that both are means for firms to improve their capital base in reponse to growth opportunity measured by Tobin's q and sales growth. However, Harford and Li (2007) report that CEOs treat Capital expenditures and M&A differently and argue that the incentives to undertake each differ as well due to the uncertainty and information asymmetry in the environment surrounding M&As.

Consequently we expect politically conservative CEOs to take more conservative financial decisions for their firms. Thus, those CEOs would be less likely to undertake major investment decisions such as mergers and acquisitions for their firms, and are expected to favor internal investment (capital expenditures) over external investment (M&A). This leads to the following hypothesis,

H 1: *Republican CEOs are less likely to engage in acquisitions than non-Republican CEOs.*

The M&A literature has documented negative announcement returns for acquirer's stocks in stock-financed mergers (e.g., Servaes, 1991; and Travlos, 1987). In fact, the acquiring firms' poor stock performance goes beyond the announcement period. Agrawal, Jaffe and Gershon (1992) document that post-acquisition stock returns are lower for acquisitions that are stock-financed than

those that are cash-financed. Linn and Switzer (2001) find that acquiring firms that use stocks as the method of payment experience significantly lower industry- and size-adjusted operating performance for up to five years following acquisitions than firms that use cash payment. Consequently, if conservatives are more sensitive to the possibility of loss as argued by Wilson (1973a), it is reasonable to expect that Republican CEOs would be more sensitive to potentially poor stock performance and hence would be less likely to choose stock as the method of payment for acquisitions.

Moreover, Wilson (1973a), Gillies and Campbell (1985), and McAllister and Anderson (1991) point out that conservatives also exhibit greater aversion to ambiguity, uncertainty, and complexity. While stock payments is shown byGilson (1986) to cause substantial offer delays in the United States, due to security registration and shareholders' approval requirements, cash is shown by Fishman (1989) to enable more rapid deal completion and thereby reduce the risk of competitive bids. Martin (1996) also finds that stock offers are more likely to be used than cash when targets involve high uncertainty. Holding the acquisition price constant, paying cash also lowers the likelihood of bid rejection by target firms. The above discussion leads to the following hypothesis,

> H 2: *Republican CEOs are less likely to use stock as a method of payment for acquisitions than non-Republican CEOs.*

There are many explanations for the different market reaction to M&As with different types of targets (Chang, 1998; Hansen and Lott, 1996; and Fuller, Netter and Stegemoller, 2002). Particularly, Fuller, Netter and Stegemoller (2002) argue that private targets are associated with positive announcement returns due to the liquidity effect for private/subsidiary target. The lack of liquidity on those targets makes the investments less attractive, resulting in price discount

(liquidity effect). Thus, with the higher sensitivity to the possibility of loss (Wilson, 1973b), we can conjecture that Republican CEOs are more likely to favor acquiring private targets. However, information about private/subsidiary targets is generally more opaque and less available than public targets (information effect). Thus, given the preference for greater uncertainty avoidance, CEOs with conservative ideology are more likely to prefer acquiring public targets. Collectively, Republican CEOs' choice of type of target is not clear.[5] This leads to the following hypothesis,

H 3: *Republican CEOs are more likely to acquire public (Private) target if information effect for public target is greater (smaller) than liquidity effect for private/subsidiary target.*

Ruth Glasgow, Cartier and Wilson (1985) argue that conservatives also prefer familiar versus unfamiliar stimuli. Morck, Shleifer and Vishny (1990) find that diversifying M&A have negative (value-destroying) announcement returns. Other studies also document diversification discounts (Berger and Ofek, 1995; Lang and Stulz, 1994; and Rajan, Servaes and Zingales, 2000). If conservative CEOs indeed prefer familiar stimuli and are more sensitive to poor performance, we expect that they are more likely to engage in focus-increasing rather than diversifying acquisitions by choosing within-industry targets. This leads to the following hypothesis,

H 4: *Republican CEOs are more likely to acquire targets that are in the same industry.*

Hutton, Jiang and Kumar (2014) provide evidence that CEO conservatism affects corporate financing, payout, and investment decisions. They report that firms with Republican CEOs have lower level of leverage (financing policy), higher level of dividend payout (payout policy), higher

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[5] It is worth nothing that conservative people are expected to favor loss and ambiguity avoidance over gains achievement. I,e, conservative people would discount any information related to possible gains and would amplify information related to ambiguity avoidance. So, in case the liquidity effect and the information effect are of equal magnitude, conservative CEOs would still prefer public targets with less ambiguity over private targets with high discounts. Indeed, what would get conservative CEOs to pick private target is a liquidity effect that is comfortably higher than information effect.

level of profitability (operating performance), and tend to have less investment in capital expenditures and even less investment in R&D expenditures (investment policy). On one hand, they argue that the cautious financing decision and operating style leads firms to be less risky and more profitable. Whereas, on the other hand, conservative investment policy may be costly to shareholders and hence they conclude that the impact of these policy choices on firm valuation is not clear.

Regarding M&A announcement returns, many studies document the following as the major determinants of short-term firm valuation (announcement returns), method of payment, type of target, and within-industry M&A. Since all the aforementioned factors are direct choices of CEOs, we can examine the impact of CEO policy choices on firm valuation. In general, cash offers are associated with greater abnormal announcement returns than stock offers (Travlos, 1987; Fishman, 1989; and Brown and Ryngaert, 1991). Hansen and Lott (1996) and Fuller, Netter and Stegemoller (2002) report that acquiring private targets generates higher announcement returns. Also, Comment and Jarrell (1995) find that focus-increasing acquisitions are consistent with shareholders' wealth maximization. Thus, the short-term firm value created/destroyed by M&A will be contingent on CEOs' choices [cash (stock): + (-), private (public): + (-), focus-increasing (diversifying): + (-)].

Regarding long-term firm valuation, due to their conservative management style (Hutton, Jiang and Kumar, 2014), M&A made by Republican CEOs are expected to outperform those by non-Republican CEOs. The above discussion leads to the following hypotheses,

H 5a: *M&A announcement returns are conditional on CEOs choice of deal characteristics.*

H 5b: *M&A made by Republican CEOs outperforms those by non-Republican CEOs, on the long-run.*

3. Data

We draw the initial sample of CEOs from the COMPUSTAT Executive Compensation (ExecuComp) database. Our sample primarily covers firms in the S&P 1500 index between 1993 and 2006. ExecuComp provides the full name, title, position, age, gender, and "Became CEO" date to compute CEO tenure for each fiscal year. We acquire CEOs' political contributions data from the Federal Election Commission (FEC).[6]

We match CEOs' personal and political information obtained from ExecuComp and FEC with the M&A database. Securities Data Company (SDC) is used to obtain announcement dates and merger financing information for completed deals by our sample firms as well as to specify which deals include earnout clauses. We require that the acquiring firm obtains at least 51% of the target's shares (and hence control). We also require deal size to be greater than $1 million. This criterion is important because acquisitions of small targets may not require active involvement of the acquirer's CEO. Firm-level accounting variables are obtained from COMPUSTAT.[7] The Fama-French industry group information comes from Professor Kenneth French's data library. This procedure generates a final sample of 1,007 firms, 2,100 CEOs and 12,928 CEO-year observations.

Following Hong and Kostovetsky (2012), Hutton, Jiang and Kumar (2014), Unsal, Hassan and Zirek (2016), and Francis, Hasan, Sun and Wu (2016), we use CEOs' political contributions to Republican and Democratic senate, house, presidential candidates and party committees in

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[6] the Federal Election Commission (FEC) data could be found at www.fec.gov
[7] Variables definitions are available on the Appendix.

political campaigns to determine their political affiliations. Individual donation data is obtained from the Federal Election Commission (FEC) from 1993 to 2006. We collect the direct contributions by CEOs to identify their political orientation because companies' Political Action Committees (PACs) usually make simultaneous contributions to both parties (Cooper, Gulen and Ovtchinnikov, 2010).

We construct two measures of CEO political ideology. Our first measure is similar to extant literature and is an index variable for party orientation, which is calculated as the difference between CEO's political contributions to the Republican Party candidates (or its committees) and those to the Democratic Party (or its committees) divided by CEO's total contributions to both parties during his/her entire tenure. Similar to Hutton, Jiang and Kumar (2014), our measures are based on self-revealed preferences (e.g., political donations) of CEOs and can therefore capture their embedded political identities and ideologies which they subscribe.

Our second measure is the tenure-specific Republican dummy measured for each CEO. This dummy variable identifies strong Republican CEOs during their tenure. It takes the value of one if the CEO's political contributions during his/her entire tenure is all toward the Republican Party, and of zero otherwise. The fact that this measure does not vary during the sample period captures the idea that party identification is developed and established in one's earlier years of adolescence or early adulthood and remains fairly stable afterwards (Green, Palmquist and Schickler, 2002). This measure of CEO political orientation also eliminates the potential noise that could be introduced by varying party popularity at given years.

[Please insert Table 1 here]

Table 1 presents the summary statistics of our sample. Panel A shows the differences in firm-specific and CEO-specific variables between firms with Republican CEOs and firms with non-Republican CEOs. First, we examine the association between CEO political ideology and investment decisions. As shown in Panel A, the M&A dummy shows that a lower proportion of Republican CEOs (44%) engages in M&A activities than non-Republican CEOs (47%). Further, firms with Republican CEOs have, on average, a larger amount of capital expenditures compared to those with non-Republican CEOs. These initial findings are consistent with our first hypothesis that Republican CEOs are less likely to engage in M&A, and that they prefer internal over external investments (Andrade and Stafford, 2004).

We next check the difference in firm's operating performance. Hutton, Jiang and Kumar (2014) find that firms with Republican CEOs have higher profitability. Consistent with their findings, firms with Republican CEOs in our sample also have higher profitability, higher operating margin, and higher ROA than those with non-Republican CEOs. In our sample, firms with Republican CEOs have higher leverage. This is inconsistent with the findings of Hutton, Jiang and Kumar (2014). A possible explanation could be that firms with Republican CEOs in our sample have more tangible assets, enabling them to borrow more at lower costs.

Panel B presents pairwise correlations between the Republican CEO dummy and other CEO characteristics. All correlation coefficients are lower than 0.1. However, correlation between CEO Republican dummy and CEO age is 0.117. Following Yim (2013), we control for CEO age in our models to prevent its direct effects from contaminating our results.

4. Analysis and results

To find out whether CEOs' individual traits may influence their investment decisions, our main empirical analysis tests the link between CEOs' political ideology and their firms' investment choices. We investigate CEOs' preferences for internal vs. external investment, and in the event of acquisitions, their choices of payment method (stock vs. cash), target type (public vs. private), and deal characteristics (focus-increasing vs. diversification).

4.1. CEO political ideology and the likelihood of M&As.

To test our first hypothesis, we use the following probit regression specification:

$$\Pr\{Y_{it} = 1 | P_{it}, X_{it}\} = G(\beta_1 + \beta_2 P_{it} + X'_{it}B) \tag{1}$$

Y in Eq. (1) is a dummy variable where 1 signifies that the firm engages in M&A in a given year. *P* stands for the measure for political ideology of CEOs. *X* is a set of control variables. *G* stands for the logistic distribution. In estimating Eq. (1), we use two proxies for *P*, the Republican dummy and the index variable. Following Yim (2013), we control for CEO age. We control for CEO tenure following Roll (1986) and Malmendier and Tate (2008). We also control for CEO gender following Tate and Yang (2015). Further we control for standard M&A determinants including, Tobin's q as a measure of investment opportunities (Servaes, 1991; and Lang and Stulz, 1994), size (Moeller, Schlingemann and Stulz, 2004), free-cash-flow as a measure of internal resources (Jensen, 1986; and Lang, Stulz and Walkling, 1991), leverage (Lang, Ofek and Stulz, 1996; and Lewellen, 1971), R&D(Phillips and Zhdanov, 2013) and capital expenditures (Lang, Ofek and Stulz, 1996).

Table 2 reports two sets of results related to testing our first hypothesis. In models (1) and (2), we test the likelihood of Republican CEOs engagement in M&A controlling for the abovementioned variables in addition to CEO founder dummy, Herfindahl index (measure of

industry competition), and a dummy variable for high-tech industry. We also include industry and year fixed effects to control for within-industry variations and time trends in the likelihood of M&A.

[Please insert Table 2 here]

The effect of CEO Republican measures on merger frequency appears to be negative after including the controls and industry and year-fixed effects with standard errors robust to two-dimensional clustering effect from model (1) and (2). The estimate of the Republican dummy measure is -0.079, significant at a 5% level, and the estimate of the Republican index measure is -0.060, significant at a 10% level. To understand the economic significance of the effect of political ideology on M&A frequency, we compute the marginal effects. The marginal effect of the Republican dummy measure is -2% and the marginal effect of the Republican index variable is -1.4%. This finding supports the notion that Republicans tend to prefer familiar rather than unfamiliar stimuli (Glasgow, Cartier and Wilson, 1985), and also tend to exhibit the greater aversion to ambiguity, uncertainty, and complexity (Wilson, 1973a; Gillies and Campbell, 1985; and McAllister and Anderson, 1991).

To further investigate the relation between CEOs political ideology and investment decisions, we use a simultaneous equation approach to investigate how political ideology is related to the two different types of investments; external investment (M&A) and internal investment (capital expenditures). We estimate the following system of equations using seemingly unrelated regression (SUR), in which the residuals are correlated:

$$X_{i,t} = f(Republican\ CEO\ + Controls) + \varepsilon_{i,t} \tag{2}$$

$$Y_{i,t} = h(Republican\ CEO\ + Controls) + \gamma_{i,t} \qquad (3)$$

Where, i indexes firms, t indexes years, $X_{i,t}$ is the external investment decision (M&A), and $Y_{i,t}$ is the internal investment decision (Capital expenditures). Using this specification, we analyze whether Republican ideology has similar or differential effects on the two investment decisions. Within the specification, the likelihood of external investment and that of capital expenditures are simultaneously estimated by regression on the set of control variables and the main variable – Republican CEO.

Models (3) and (4) in Table 2 estimate the system of two equations with the M&A dummy and the capital expenditures measure normalized by total assets as the dependent variables. Our regression results show that firms with Republican CEOs are less likely to engage in M&A and are more likely to rely on capital expenditures, which is consistent with our first hypothesis. Notably, our results are also consistent with the implications of (Andrade and Stafford, 2004). In their comparative study of mergers and internal corporate investment at the industry and firm levels, they find that both merger and internal investment are positively related to the firm's Tobin's Q but differently related to industry landscape. In our models (3) and (4), tobin's Q is positively related to both investment decisions, while industry competition is positively (negatively) related to capital expenditures (M&A)

4.2. CEO political ideology and deal characteristics.

In this section, we examine CEOs' choice of method of payment, type of target, and diversification. These three aspects of acquisition are shown by the literature to be among the main determinants of acquirer's returns. Studies that examine the method of payment include Myers and Majluf (1984), Hansen (1987), Martin (1996), and Fuller, Netter and Stegemoller (2002), while

those that focus on the type of target include Hansen and Lott (1996), Chang (1998), Mulherin and Boone (2000), and Fuller, Netter and Stegemoller (2002). Diversification in M&As is investigated by Berger and Ofek (1995), Lang and Stulz (1994), and Rajan, Servaes and Zingales (2000). We use the following probit regression specification to explore CEOs' choices of these deal characteristics:

$$\Pr\{Y_{it} = 1 | P_{it}, X_{it}\} = G(\beta_1 + \beta_2 P_{it} + X'_{it} B) \qquad (4)$$

Where, Y_{it} is a dummy variable at which 1 signifies that the CEO uses stock as payment in models (1) and (2) of Table 3. Y_{it} in models (3) and (4) is a binary variable where 1 signifies that the type of target firm in M&A is private. In models (5) and (6), Y_{it} is a binary variable where 1 signifies that the first two digits of SIC code are identical for the acquirer and the target.

[Please insert Table 3 here]

Table 3 reports the regression results. In models (1) and (2), we find that firms with Republican CEOs are less likely to use stock as a payment method. The estimates in models (1) and (2) after controlling for CEO characteristics and firm characteristics are -0.338 and -0.277, respectively. Both these estimates are statistically significant at a 1 % level. Their marginal effects are -3.6% and -4.4%, respectively. This result can be explained by the nature of CEO ideology. Given the uncertainty in bidders' stock offer as a method of payment (Gilson, 1986; and Fishman, 1989), selecting cash payment is consistent with greater uncertainty aversion exhibited by conservative CEOs. Further, as reported in Hutton, Jiang and Kumar (2014) and shown in Table 1, firms with Republican CEOs tend to have more cash holdings due to the better operating performance (higher ROA, profitability, and operating margin). When they have enough cash-holding, bidders are less likely to face financing constraints.

Next we test the relation between CEO political ideology and the type of target. Many studies identify the type of target as an important determinant of announcement returns. Fuller, Netter and Stegemoller (2002) argue that the differential market reaction to the acquisitions of private/subsidiary versus public targets is due to the fact that bidders can acquire private or subsidiary firms at a lower price because these targets, unlike public firms, suffer lack of liquidity. On the other hand, there are significant differences in information availability on private/subsidiary targets relative to public targets. Unlike information on public targets that is more readily available, acquirers must collect private information and hence must incur higher information costs when buying a non-public target.

Thus, the effect of CEOs' political ideology on the choice between private/subsidiary and public target is not clear because it depends on the relative size of reduced price gains (liquidity effect) as compared to information acquisition costs (information effect). In models (3) and (4) of Table 3, we find that Republican CEOs' are less likely to acquire private targets and more likely to acquire public targets. The estimate is -0.196 in models (3), and -0.175 in model (4). Both estimates are statistically significant at a 1 % level and their marginal effects are -4.0% and -3.6%, respectively.

We use diversification as a proxy for CEOs' tendency to maintain the status quo. First, due to that tendency and the low degree of information asymmetry associated with targets within the same industry, Republican CEOs are more inclined to conduct focus-increasing M&A. In addition, there is much evidence in the literature documenting a diversification discount (Berger and Ofek, 1995; Lang and Stulz, 1994; and Rajan, Servaes and Zingales, 2000). If conservative ideology is associated with loss aversion and preference for similarity, then Republican CEOs are more likely to pursue deals that are focus-increasing. We find that Republican CEOs are indeed more likely to

complete focus-increasing M&A, compared to non-Republican CEOs. In models (5) and (6) of Table 3, the estimate for the Republican CEO dummy is 0.087, significant at a 10 % level, and that for the Republican CEO index variable is 0.092, significant at a 5% level. Their marginal effects are -1.2% and -1.1%, respectively.

4.3. CEO political ideology and firm value

We test the impact of CEO political ideology on short-term as well as long-term firm valuation following M&A. For the short-term effect, we follow the standard event study methodology to compute acquirers' cumulative abnormal returns (CARs) for the three-day period (-1, 1) around M&A announcement dates. We estimate abnormal returns using the following market adjusted model:

$$AR_i = r_i - r_m \qquad (5)$$

where r_i is the daily return on acquirer i and r_m is the daily return on the CRSP value-weighted index.

[Please insert Table 4 here]

Table 4 reports the average abnormal announcement returns. The market response to M&A conducted by Republican CEOs is not significantly different from that conducted by non-Republican CEOs. This result suggests that CEO political ideology may not have a positive impact on firm valuation. One possible explanation is that, as shown in the previous tests, there is a tendency for Republican CEOs to choose deal characteristics in a way consistent with their conservative ideology. For example, they are more likely to use cash as a method of payment, are more likely to acquire within-industry targets, and are more likely to acquire public targets. However, each choice would affect announcement returns differently (cash payment (+), focus-

increasing (+), and public target (-)). Thus, the effect of CEO political ideology on short-term firm valuation could be unclear.

In the long-run, however, we find that Republican CEOs outperform non-Republican CEOs over the five-year post-M&A announcement. We use buy-and-hold average abnormal returns over holding periods that extend from one to five years following M&A announcements. The buy-and-hold abnormal return (BHAR) is calculated as follows:

$$BHAR_{(i,a,b)} = \prod_{t=a}^{b}(R_{it} + 1) - \prod_{t=a}^{b}(R_{mt} + 1) \qquad (6)$$

Where, $BHAR_{(i,a,b)}$ is Excess return for event firm i over the time period from day a to day b; R_{it} is the return on the common stock of event firm i on day t; and R_{mt} is the return on the stock of the matched firm on day t. Matched firms are selected following Liu, Szewczyk and Zantout (2008) based on size and ratio of book-to-market value of equity. The post-announcement long-term abnormal returns do not include the abnormal returns over days -1 through 0 relative to the announcement date. If an event firm is delisted before the end of the buy-and-hold period, its truncated return series is still included in the analysis, and it is assumed to earn the daily return of the benchmark for the remainder of the period.

[Please insert Table 5 here]

Our results show that M&A conducted by Republican CEOs outperform those by non-Republican CEOs over 5 years. In Table 5, the average abnormal buy-and-hold returns for M&A by Republican CEOs is 11.27%, whereas BHAR for M&A by non-Republican CEOs is -9.46%. The difference between the two BHARs is 20.73% and is statistically significant at a 5% level. This result is interesting when compared with the results of other post-merger long-term studies reporting poor post-merger performance. Studies of long-term post-merger returns report that

acquirers experience significantly negative abnormal returns over one to three(five) years after the merger (Agrawal, Jaffe and Mandelker, 1992; and Andrade, Mitchell and Stafford, 2001). Specifically, Agrawal, Jaffe and Mandelker (1992) report that acquirers suffer a significant wealth loss of approximately 10 percent over the five years following merger completion. The wealth loss over the five years for mergers conducted by non-Republican CEOs is -9.46 percent which is consistent with the finding of Agrawal, Jaffe and Mandelker (1992). However, the abnormal buy-and-hold return for M&A conducted by Republican CEOs is 11.27%. This result suggests that different managerial ideology may have an impact on post-merger long-term performance.

[Please insert Table 6 here]

Cross-sectional regression results reported in Table 6 confirm those of the time-series analysis. After controlling for CEO characteristics (age, tenure, and gender) and for deal characteristics (size, relative size, type of target, method of payment, deal attitude (Friendly vs. Hostile), and tender offer), we find that M&A conducted by Republican CEOs outperform those conducted by non-Republican CEOs. The coefficient for the Republican CEO dummy is 0.220 and that for the Republican CEO index variable is 0.109. Both estimates are statistically significant at a 5% level. Thus, while Republican CEOs may make suboptimal investment decisions on the short-run by following their conservative preference, they seem to manage their firms in a way that ultimately enhances their firm value on the long-run.

4.4. Robustness check, CEO political ideology and earnout agreements

In the previous sections, our results show that Republican CEOs prefer internal investments over M&As and public over private targets. Our results also show that they are less likely to participate in diversification-increasing acquisitions. We explain these results using the fact that Republican CEOs are expected to avoid situations that involve high degree of information

asymmetry. In order to further validate our assertions about the association between CEO political ideology and information asymmetry avoidance, we test the likelihood of engagement in earnout acquisitions by Republican CEOs.

Cain, Denis and Denis (2006) define earnout as "*a contractual agreement in which payment to shareholders in acquisition can consist of two components: an upfront fixed payment and additional future payments that are contingent upon some observable measure of performance*". Earnouts are supposed to serve two main objectives, bridging valuation gap between acquirer and target, and retaining skilled human capital. These agreements are commonly used in deals that involve high degree of information asymmetry such as acquiring private firms and parent-owned subsidiaries (Kohers and Ang, 2000) and targets that belong to high-tech and service industries (Reuer, Shenkar and Ragozzino, 2004). Our arguments as well as our previous results predict that Republican CEOs would avoid engagement in acquisitions that include earnout clauses. We run the logit regression models of the determinants of the likelihood of engaging in acquisitions that include earnout clauses. Coefficient estimates of these models are reported in table 7.

[Please insert Table 7 here]

Logit regression results reported in Panel A of table 7 lend further support to our hypothesis. After controlling for CEO and firm characteristics, Republican CEOs seem to avoid earnout agreements. Coefficients of Republican dummy in models (1) and (2) are -0.567 and -0.371, respectively. Further, Coefficients of Republican dummy in models (3) and (4) are -0.567 and -0.548, respectively. These estimates are statistically significant at a 1% level. These results lend further support to the notion that CEO with conservative political ideology are less likely to engage in deals that involve high degree of information asymmetry.

4.5. Robustness check, CEO political ideology and Overconfidence

Malmendier and Tate (2008) analyze the effect of CEO overconfidence on corporate M&A decisions. They find that the level of CEO overconfidence has an impact on merger frequency, merger financing, and deal quality, resulting in significantly negative announcement returns. Since CEO overconfidence is a dimension of her/his personality that might interlink with conservatism, we estimate our regression models while controlling for CEO overconfidence. To construct the CEO overconfidence measure, we follow Campbell et al.(2011).[8] Panel B in Table 7 shows a pairwise correlation between the conservative measure and the overconfidence measure. The correlation is negative and is less than 0.1, implying that conservatism and overconfidence are in opposite directions and are not strongly correlated. Panel C in Table 7 confirms that our previous results hold even after controlling for overconfidence and for the same set of control variables.

5. Conclusion

This paper tests the effect of CEO political ideology on M&A decisions. Specifically, following the literature on behavioral consistency which shows that CEOs' personal attributes could affect their corporate decisions, we examine the effect of CEO political ideology -that captures level of conservatism- on firms M&A decisions. Further, we test whether M&A conducted by Republican CEOs have value implications.

We find that Republican CEOs are significantly less likely to engage in M&A activities. The result is also robust to controlling for standard M&A determinants (Q, size, free-cash-flow, leverage) as well as using industry and year fixed effects to remove within industry and time effects. Our analysis also tests the likelihood that Republican CEOs would choose stock versus cash as a

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[8] See Campbell, et al. (2011).

method of payment. Consistent with the notion of being conservative, we find that Republican CEOs are indeed significantly less likely to use stock as a payment method. We also find that Republican CEOs are more likely to prefer focus-increasing M&As as they are more likely to acquire within-industry targets. This result is consistent with the argument that conservatives have greater tendency to maintain the status quo and greater concern for better performance. Our results also show that Republican managers are less likely to engage in deals that involve high degree of information asymmetry captured by the use of earnout agreements.

To address the question of whether CEOs political ideology affect value of their firms through their M&As decisions, we analyze market reaction to M&A announcements. In a multivariate regression test, we do not find statistically significant difference in M&A announcement returns between Republican and non-Republican CEOs. However, the long-term performance analysis shows that Republican CEOs do add value to their firms. Over the five years post- announcement horizon, Republican CEOs outperform non-Republican CEOs by 20.73%. Our findings are consistent with (Hutton, Jiang and Kumar, 2014) who show that firms run by Republican CEOs tend to have better operating performance.

Appendix A: Definitions of variables

Variables	Definitions
CEO characteristics	
Republican CEO	Defined as the difference between the CEO's political contributions to Republican and Democratic party-affiliated candidates or party committees divided by the CEO's total contribution s to Republican and Democrat-affiliated committees.(Hutton, Jiang and Kumar, 2014)
Republican CEO dummy	Binary where 1 signifies that the CEO donates only to Republicans
CEO age	Log of CEO age in the given year
CEO tenure	Log of the number of years the CEO had held his/her current position in a given year with a given firm
Gender	Binary variable where 1 signifies that the CEO is female
Founder	Binary variable where 1 signifies that the CEO is founder
Overconfident CEO	Binary variable where 1 signifies that the CEOs hold stock options that are more than 67% in the money (Malmendier and Tate(2005) and Campbell et al (2011))
Firm characteristics	
Firm size	Log of book value of total assets (item6).
Book leverage	Book value of debts (item34 + item9) over market value of total assets (item6−item60 + item25 ∗ item199).
Cash holdings	Cash and short term investments(Item1) divided by total assets(Item6)
R&D expenditures	R&D expenditures (Item46) divided by total assets (Item6). Missing values are substituted with zero, unless indicated
Capital expenditures	Capital expenditures divided by total assets(Item6)
Tobin's Q	Market value of assets over book value of assets: (item6−item60 + item25 ∗ item199)/item6.
Free cash flow	Operating income before depreciation (item13) – interest expenses (item15) – income taxes (item16) – capital expenditures (item128), scaled by book value of total assets (item6)
High tech	Binary variable where 1 signifies that acquirer and target are both from high tech industries whose SICs are in 3571,3572,3575,3577,3578,3661,3663,3669,3674,3812,3823,3825, 3826,3827,3829,3841,3845,4812,4813,4899,7370,7371,7372,7373,7374,7375,7378,7379. This classification is defined by Loughran and Ritter (2004)
Sales Growth	Sales(Item12) divided by lag sales
Profitability	Operating income before depreciation(item13)+Total interest rate and related expense(Item15)-Deferred taxes and investment tax credit(Item35) divided by total asset(Item6)
Operating margin	Operating income before depreciation(item13) divided by sales(Item12)
ROA	Operating income before depreciation(item13) divided by total asset(Item6)
Industry competition	Measured by the Herfindahl index
Tangibility	Total property, plant and equipment(Item 141) divided by total assets(Item6)
Deal Characteristics	
Public target	Binary variable where 1 signifies 1 that the target is public
Private target	Binary variable where 1 signifies1 that the target is private
Subsidiary target	Binary variable where 1 signifies1 that the target is subsidiary
Cash payment	Binary variable where 1 signifies that the payment is cash
Stock payment	Binary variable where 1 signifies that he payment is cash

Focus	Binary variable where I signifies that the first 2 digits of SICs of the acquirer and the target are same
Relative value	Deal value (from SDC) over bidder market value of equity defined above
Deal attitude	Binary variable where 1 signifies when the deal is defined as "friendly"
Tender	Binary variable where 1 signifies when a tender offer is launched for the target

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Table 1. Summary statistics

This table reports summary statistics of our sample. The sample consists of 1,007 publicly traded U.S. firms and 2,100 CEOs covered by the COMPUSTAT Execucomp with 12,928 CEO-year observations between 1993 and 2006. *Republican CEO Dummy* is binary variable where 1 signifies that the CEO donates only to Republicans. Panel A is the summary statistics of firms with Republican CEOs (taking value of 1) versus firms with non-Republican CEOs (taking value of 0). Panel B provides correlation coefficients among CEOs characteristics. Financial variables are reported in $mil. ***, **, and * indicate statistical significance at 1%, 5% and 10% level, respectively. The definitions of other variables are in the Appendix.

Panel A. Summary statistics

	All	1	0	Diff (1-0)	
N	12,928	5,628	7,310		
M&A Dummy	0.45	0.44	0.47	-0.03	***
Firm size	8.51	8.61	8.43	0.19	***
Sales	8.01	8.16	7.90	0.26	***
Book to Market	0.45	0.46	0.44	0.02	***
Tobin's Q	2.17	2.03	2.28	-0.25	***
Profitability	0.11	0.12	0.11	0.01	***
Operating Margin	0.19	0.21	0.17	0.04	***
Free Cash Flow	0.08	0.09	0.08	0.01	***
ROA	0.13	0.14	0.13	0.01	***
Capital	0.05	0.05	0.05		
Expenditures				0.00	**
R&D Expenditures	0.03	0.02	0.03	-0.01	***
Tangibility	0.30	0.33	0.28	0.05	***
Leverage	0.23	0.24	0.22	0.02	***
Firm Age	3.17	3.25	3.11	0.14	***
CEO Age	55.76	56.75	55.00	1.75	***
CEO Tenure	7.57	8.08	7.19	0.89	***
Gender	0.00	0.00	0.01	-0.01	***
Founder	0.06	0.06	0.06	0.00	

Panel B. Pearson correlations

	Republican CEO	Gender	Age
Republican CEO	1		
Gender	-0.041	1	
Age	0.117	-0.038	1
Founder	0.001	-0.013	0.024

Table 2. Propensity to engage in M&A activity

This table reports the results of probit regressions in (1) and (2) and the estimated relations between M&A decision and the level of capital expenditures using SUR (Seemingly unrelated regression in (3) and (4). In (1) and (2), the dependent variable is binary where 1 signifies that the CEO engages in M&A in a given year. In (3) and (4), M&A binary variable and the level of capital expenditures normalized by total asset are used as dependent variables. *Republican CEO Dummy* is a binary variable where 1 signifies that the CEO donates only to Republicans. *Republican CEO Index* is defined as the difference between the CEO's political contributions to Republican and Democratic party-affiliated candidates or party committees divided by the CEO's total contributions. We report *t*-values In parentheses based on standard errors robust to heteroscedasticity and clustering by firm and year. All models are estimated with the year and industry fixed effects. ***, **, and * indicate statistical significance at 1%, 5% and 10% level, respectively. The definitions of other variables are in the Appendix.

Variable	(1) M&A	(2) M&A	(3) M&A	Capital Expend.	(4) M&A	Capital Expend.
Republican CEO Dummy	-0.079**		-0.018**	0.002**		
	(-2.04)		(-2.11)	(2.10)		
Republican CEO Index		-0.060*			-0.013*	0.002***
		(-1.80)			(-1.75)	(2.61)
CEO age	-1.232***	-1.241***	-0.281***	-0.002	-0.284***	-0.002
	(-7.51)	(-7.57)	(-7.99)	(-0.63)	(-8.06)	(-0.60)
Tenure	0.115***	0.112***	0.025***	0.002***	0.024***	0.002***
	(4.78)	(4.67)	(4.75)	(3.74)	(4.64)	(3.87)
Female Dummy	0.107	0.117	0.045	-0.015**	0.047	-0.015***
	(0.34)	(0.37)	(0.65)	(-2.55)	(0.69)	(-2.58)
Founder Dummy	0.021	0.022	0.003	0.001	0.004	0.001
	(0.29)	(0.30)	(0.21)	(1.03)	(0.23)	(1.01)
Size	0.232***	0.229***	0.051***	-0.001***	0.050***	-0.001***
	(15.60)	(15.50)	(15.99)	(-4.91)	(15.87)	(-4.77)
Tobin's Q	0.025**	0.025**	0.004***	0.001***	0.004***	0.001***
	(2.09)	(2.09)	(3.17)	(4.93)	(3.17)	(4.93)
Free cash flow	-1.225***	-1.226***	-0.165***	-0.049***	-0.165***	-0.049***
	(-4.44)	(-4.43)	(-3.77)	(-13.12)	(-3.77)	(-13.14)
Leverage	0.746***	0.739***	0.157***	0.001	0.155***	0.001
	(5.48)	(5.43)	(5.49)	(0.24)	(5.44)	(0.29)
Capital Expenditures	-2.664***	-2.659***				
	(-5.25)	(-5.24)				
R&D Expenditures	0.949**	0.966**	0.248**	-0.044***	0.252**	-0.044***
	(2.05)	(2.08)	(2.51)	(-5.14)	(2.55)	(-5.19)
Industry Competition	-5.249*	-5.188	-1.366**	0.280***	-1.353**	0.280***
	(-1.66)	(-1.64)	(-2.07)	(4.91)	(-2.06)	(4.91)
High Tech Dummy	0.589***	0.588***	0.146***	0.002	0.145***	0.002
	(9.88)	(9.85)	(11.35)	(1.44)	(11.32)	(1.48)
Constant	2.189***	2.225***	0.949***	0.076***	0.958***	0.076***
	(3.30)	(3.36)	(6.63)	(6.16)	(6.69)	(6.13)
Ind./year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	12,928	12,928	12,928	12,928	12,928	12,928
Pseudo R-squared	0.08	0.08	0.11	0.34	0.11	0.34

Table 3. CEO political ideology and method of payment, type of target, and focus-increasing

This table displays the results of probit regressions with different dependent variables. The dependent variable in (1) and (2) is a binary variable where 1 signifies that the M&A was financed using only stock. The dependent variable in (3) and (4) is a binary variable where 1 signifies that the type of target firm in M&A is private. In the (5) and (6), the dependent variable is a binary variable where 1 signifies that the first two digits of SICs of acquirer and target are same. *Republican CEO Dummy* is binary variable where 1 signifies that the CEO donates only to Republicans. *Republican CEO Index* is defined as the difference between the CEO's political contributions to Republican and Democratic party-affiliated candidates or party committees divided by the CEO's total contributions to Republican and Democrat-affiliated committees. We report *t*-values In parentheses based on standard errors robust to heteroskedasticity and clustering by firm and year. All models are estimated with the year and industry fixed effects. ***, **, and * indicate statistical significance at 1%, 5% and 10% level, respectively. The definitions of other variables are in the Appendix.

Variable	Method of payments		Type of target		Focus-increasing	
	(1)	(2)	(3)	(4)	(5)	(6)
Republican CEO Dummy	-0.338***		-0.196***		0.087*	
	(-4.42)		(-3.07)		(1.79)	
Republican CEO Index		-0.277***		-0.175***		0.092**
		(-4.13)		(-3.19)		(2.25)
CEO age	-0.762**	-0.810***	-0.164	-0.194	0.848***	0.852***
	(-2.51)	(-2.68)	(-0.65)	(-0.76)	(4.07)	(4.10)
Tenure	0.101**	0.095*	-0.046	-0.051	-0.063**	-0.060**
	(2.07)	(1.95)	(-1.12)	(-1.24)	(-2.12)	(-2.03)
Female Dummy	0.268	0.309	-0.401	-0.378	0.549	0.545
	(0.55)	(0.64)	(-0.94)	(-0.89)	(1.51)	(1.50)
Founder Dummy	0.175	0.179	0.002	0.007	0.334***	0.333***
	(1.25)	(1.28)	(0.02)	(0.07)	(3.29)	(3.27)
Size	-0.189***	-0.198***	-0.188***	-0.193***	-0.334***	-0.332***
	(-6.27)	(-6.55)	(-6.92)	(-7.11)	(-17.98)	(-17.89)
Tobin's Q	0.117***	0.115***	0.036**	0.036**	-0.015***	-0.015***
	(3.62)	(3.57)	(2.22)	(2.23)	(-2.79)	(-2.78)
Free cash flow	-2.899***	-2.930***	-0.458	-0.461	0.446*	0.439*
	(-6.53)	(-6.62)	(-1.30)	(-1.31)	(1.81)	(1.79)
Leverage	-2.261***	-2.287***	-0.548**	-0.549**	-0.404***	-0.399***
	(-8.08)	(-8.20)	(-2.35)	(-2.37)	(-2.66)	(-2.63)
Dividend Dummy	-0.086	-0.072			1.526**	1.501**
	(-0.56)	(-0.46)			(2.08)	(2.06)
Industry Competition	-27.013***	-27.537***	-12.793**	-12.722**	8.102**	8.113**
	(-2.66)	(-2.69)	(-2.07)	(-2.06)	(2.00)	(2.01)
High-Tech Dummy	0.329***	0.334***	0.364***	0.365***	0.105	0.108
	(3.30)	(3.35)	(4.61)	(4.62)	(1.48)	(1.52)
Deal Value	0.207***	0.206***	-0.291***	-0.291***	-1.036**	-1.046**
	(7.63)	(7.58)	(-10.91)	(-10.93)	(-2.04)	(-2.06)
Relative Value	-0.147	-0.157	-2.709***	-2.711***		
	(-1.14)	(-1.21)	(-5.26)	(-5.26)		
Focus Dummy	0.042	0.049	-0.329***	-0.327***		
	(0.53)	(0.61)	(-4.96)	(-4.92)		
Public Target Dummy	1.038***	1.037***				
	(12.34)	(12.31)				

Table 3. Cont'd

Stock Payment Dummy			0.722***	0.724***		
			(9.00)	(9.03)		
Constant	3.007**	3.225**	3.434***	3.563***	1.929**	1.954**
	(2.31)	(2.49)	(3.26)	(3.39)	(2.23)	(2.25)
Ind./year fixed effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	5,830	5,830	5,830	5,830	5,830	5,830
Pseudo R-squared	0.27	0.27	0.17	0.17	0.08	0.08

Table 4. Market Response to the announcement of M&A bids

This table reports market response to the announcement of M&A bids. The event window starts one day before and ends one day after the announcement of the bid. The dependent variable is the Cumulative abnormal return on the bidder's stock during the event window. Cumulative abnormal returns are calculated as follows, $AR_i = r_i - r_m$, where expected returns are the daily return on the CRSP value-weighted index. We report t-values In parentheses based on standard errors robust to heteroscedasticity and clustering by firm and year. All models are estimated with the year and firm fixed effects. ***, **, and * indicate statistical significance at 1%, 5% and 10% level, respectively. The definitions of other variables are in the Appendix.

Variable	(1)	(2)	(3)	(4)
Republican CEO Dummy	0.002		0.005	
	(0.76)		(0.94)	
Republican CEO Index		0.001		0.005
		(0.52)		(1.21)
Price run-up	-0.005	-0.005	-0.008	-0.008
	(-1.08)	(-1.08)	(-1.24)	(-1.24)
Target Premium			-0.000	-0.000
			(-0.28)	(-0.29)
Female Dummy	-0.022	-0.022	-0.109**	-0.109**
	(-0.82)	(-0.83)	(-1.99)	(-2.00)
CEO age	0.010	0.010	0.031	0.032
	(1.10)	(1.13)	(1.56)	(1.61)
Tenure	-0.003**	-0.003**	-0.005	-0.005
	(-2.15)	(-2.13)	(-1.52)	(-1.48)
Founder Dummy	0.009**	0.009**	0.008	0.008
	(2.41)	(2.41)	(0.82)	(0.82)
Focus Dummy	0.001	0.001	0.002	0.002
	(0.27)	(0.26)	(0.36)	(0.33)
Stock Payment Dummy	-0.003	-0.003	-0.001	-0.001
	(-1.01)	(-1.03)	(-0.16)	(-0.16)
Public Target Dummy	-0.018***	-0.018***	0.022	0.023
	(-5.77)	(-5.74)	(0.63)	(0.65)
Deal Attitude	0.005	0.005	0.011	0.011
	(0.63)	(0.63)	(1.31)	(1.31)
Deal Value	-0.000	-0.000	-0.008***	-0.008***
	(-0.00)	(-0.00)	(-4.43)	(-4.42)
Relative Value	-0.017***	-0.017***	-0.009	-0.009
	(-2.71)	(-2.69)	(-1.02)	(-1.02)
Tender Offer	0.012**	0.012**	0.013**	0.013**
	(2.57)	(2.57)	(2.37)	(2.39)
Size	-0.003***	-0.003***	0.005**	0.005**
	(-3.26)	(-3.24)	(2.43)	(2.46)
Tobin's Q	0.001**	0.001**	0.004***	0.004***
	(2.10)	(2.09)	(6.30)	(6.30)
Free cash flow	-0.008	-0.008	-0.099	-0.097
	(-0.24)	(-0.23)	(-0.90)	(-0.90)

Table 4. Cont'd

Leverage	0.013	0.013	0.049*	0.049**
	(1.38)	(1.40)	(1.93)	(1.98)
Capital Expenditures	0.025	0.025	-0.032	-0.031
	(0.90)	(0.90)	(-0.38)	(-0.37)
R&D Expenditures	-0.026	-0.026	-0.015	-0.015
	(-0.79)	(-0.80)	(-0.16)	(-0.16)
High Tech Dummy	0.001	0.001	0.002	0.002
	(0.26)	(0.26)	(0.28)	(0.28)
Industry Competition	-0.261*	-0.262*	0.159	0.154
	(-1.68)	(-1.68)	(0.25)	(0.24)
Constant	0.022	0.021	-0.198**	-0.203**
	(0.57)	(0.55)	(-2.16)	(-2.23)
Firm/year fixed effects	Yes	Yes	Yes	Yes
Observations	4,623	4,623	1,100	1,100
Adjusted R-squared	0.04	0.04	0.13	0.13

Table5. Long-run performance

This table reports the long-term buy-and-hold average abnormal returns over holding periods that extend from one to five years following M&A announcements. The buy-and-hold abnormal return (BHAR) for each event firm is calculated as follows,

$$BHAR_{(i,a,b)} = \prod_{t=a}^{b}(R_{it} + 1) - \prod_{t=a}^{b}(R_{mt} + 1)$$

Where $BHAR(i,a,b)$ is excess return for event firm i over the time period from day a to day b, Rit is the return on the common stock of event firm i on day t, and Rmt is the return on the stock of the matched firm on day t. Matched firms are selected using size and ratio of book to market value of equity. The post-announcement long-term abnormal returns do not include the abnormal returns over days -1 through 0 relative to the announcement date. If an event firm is delisted before the end of the buy-and-hold period, its truncated return series is still included in the analysis, and it is assumed to earn the daily return of the benchmark for the remainder of the period. The statistical significance of each of the BHARs is tested using the parametric t-test, based on the cross sectional standard deviations. ***, **, and * indicate statistical significance at 1%, 5% and 10% level, respectively.

Mean Buy-and-Hold Average Abnormal Returns (%)						
	N	1-year	2-years	3-years	4-years	5-years
(1) Full sample	3,557	-4.42	-7.83	-5.88	-5.67	-5.74
(2) Republicans	637	0.65	-0.21	-1.74	7.05	11.27
(3) Non-Republicans	2,920	-5.53	-9.95	-6.79	-8.45	-9.46
Difference (2) - (3)		6.19**	9.30*	5.05	15.5**	20.73**
t-statistic for the difference		(2.15)	(1.77)	(0.84)	(2.26)	(2.31)

Table 6. Cross sectional regression of BHAR on CEOs political ideology

This table reports the results of the cross-sectional regression analysis of the post-announcement buy-and-hold abnormal returns to the M&A-event firms *BHARj* on Republican CEO measures with the several control variables. The specified model is:

$$BHAR_j = \beta_0 + \beta_1 Republican\ CEO + CONTROLS + \varepsilon_J$$

We report *t*-values In parentheses based on standard errors robust to heteroscedasticity. ***, **, and * indicate statistical significance at 1%, 5% and 10% level, respectively. The definitions of other variables are in the Appendix.

Variable	(1)	(2)
Republican CEO Dummy	0.220**	
	(1.93)	
Republican CEO Index		0.109*
		(1.73)
CEO age	0.878***	0.859***
	(2.77)	(2.72)
Tenure	-0.105***	-0.104***
	(-2.78)	(-2.77)
Female dummy	0.365	0.384
	(1.25)	(1.32)
Deal size	-0.001	-0.001
	(-0.97)	(-0.84)
Relative size	0.340**	0.342**
	(2.08)	(2.09)
Private target	0.133	0.129
	(1.57)	(1.52)
Subsidiary target	0.146	0.151
	(1.54)	(1.58)
Stock payment	0.000	0.001
	(0.24)	(0.14)
Cash payment	-0.000	-0.001
	(-1.40)	(-1.39)
Acquirer Size	0.030	0.025
	(1.29)	(1.08)
Deal attitude	-0.206	-0.216
	(-1.08)	(-1.13)
Tender offer	-0.111	-0.106
	(-1.00)	(-0.96)
Observations	3,501	3,501
Adjusted R-squared (%)	0.50	0.42

Table 7. CEO political ideology, earnout agreements, and overconfidence

We present several robustness checks in this table. Panel A reports the likelihood of Republican CEO engagement in acquisitions that include earnout clauses. Dependent variable is a binary variable that takes the value of "1" if the deal includes an earnout clause, and the value of "0" otherwise. Panel B shows the correlation between CEOs' political ideology and overconfidence measure ((Malmendier and Tate, 2005)). Panel C repeats the previous regression analyses with overconfidence measure. The dependent variable in model (1) is a binary variable where 1 signifies that the CEO engages in M&A in a given year. The dependent variable in model (2) is a binary variable where 1 signifies that the CEO use stock as a method of payment for merger bid. The dependent variable in model (3) is a binary variable where 1 signifies that the firm made a focus-increasing merger bid in a given year. The dependent variable in model (4) is the CAR (cumulative abnormal return) on the bidder's stock from the two-day before through the two day after the announcement of the bid. The dependent variable in model (5) is the 5-year BHAR (post-announcement buy-and-hold abnormal returns). The coefficients in model (1), (2), and (3) are presented as odds ratios. All standard errors in Panel B are robust to heteroscedasticity and clustering by firm and year. We report *t*-values In parentheses based on standard errors robust to heteroscedasticity. ***, **, and * indicate statistical significance at 1%, 5% and 10% level, respectively. The definitions of other variables are in the Appendix.

Panel A. propensity to engage in M&As that include earnout clause

	(1)	(2)	(3)	(4)
Republican CEO Dummy	-0.567**	-0.371		
	(-2.36)	(-1.52)		
Republican CEO Index			-0.567***	-0.548***
			(-3.66)	(-3.03)
Controls	No	Yes	No	Yes
Ind./year fixed effects	Yes	Yes	Yes	Yes
Observations	13,147	8,416	13,147	8,416
Pseudo R-squared	0.01	0.19	0.01	0.19

Panel B. Correlations with confidence and political ideology

	Republican CEO Dummy	Overconfidence
Republican CEO Dummy	1	
Overconfidence	-0.033	1

Panel C. Previous regressions with confidence and political ideology measures

	(1)	(2)	(3)	(4)	(5)
Republican CEO Dummy	-0.85**	-0.69***	1.21*	-0.00	0.22**
	(0.02)	(0.003)	(0.09)	(0.99)	(0.04)
Overconfidence	1.42***	1.59***	0.86	0.65***	0.29
	(0.00)	(0.00)	(0.16)	(0.00)	(0.67)
Controls	Yes	Yes	Yes	Yes	Yes
Ind./year fixed effects	Yes	Yes	Yes	Yes	No
Observations	9,766	3,569	3,569	3,568	3,501