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TWO ESSAYS ON CEO POLITICAL IDEOLOGY: IMPLICATIONS FOR DIFFERENCES IN RISK AND STOCK MARKET REWARDS

Presented by Alecia J. Reinhardt

a candidate for the degree of Doctor of Business Administration

and hereby certify that in their opinion it is worthy of acceptance.

Bakhtear Talukdar, Ph.D.
Assistant Professor of Finance & Business Law
Committee Co-Chair
SIGNATURE:_____

Avishek Bhandari, Ph.D.
Assistant Professor of Accounting
Committee Co-Chair
SIGNATURE:_____

Rashiqa Kamal, Ph.D.
Associate Professor of Finance & Business Law
Reader
SIGNATURE:_____

TWO ESSAYS ON CEO POLITICAL IDEOLOOGY: IMPLICATIONS FOR DIFFERENCES IN RISK AND STOCK MARKET REWARDS

A Dissertation

Presented to

The Graduate Faculty of

The University of Wisconsin – Whitewater

In Partial Fulfillment

Of the Requirements for the Degree

Doctor of Business Administration

By
ALECIA J. REINHARDT

Dr. Bakhtear Talukdar & Dr. Avishek Bhandari, Dissertation Co-Chairs

DECEMBER 2020

ACKNOWLEDGEMENTS

every single day, you set an example for other women that they can be successful too, and I'm so grateful we were able to partner together for my dissertation.

Third, I am so grateful for my friends who supported me during this dissertation journey. Some of you I got to know by working together in this program. Some of you I've known for a long time. Whenever I was stuck or feeling down, you helped remind me there is light at the end of this tunnel and that the temporary darkness I was feeling would soon pass. You reminded me that I belonged here and that I could do this. To my friends from Cohort 4 (both the original members and the adopted ones), I want you to know that you made this journey special and you made it fun. I think I will always smile at the sight of parsnips and you all know why. I have many fond memories from all the meals we shared at the handful of restaurants in Whitewater, and all the attempts we made to share a meal at the one place that promised us it would be open tomorrow. Well, after three long years, I think it's safe to say they'll be closed again tomorrow.

I am so grateful to all the staff and faculty who supported the University of Wisconsin-Whitewater DBA program from 2017 to now. Thank you, Dr. K. Praveen Parboteeah, for having the vision for this program and ensuring its success. Thank you, Dean John Chenoweth, for standing steadfastly behind this program. Thank you, Joanna Stradusky, for helping with all the administrative tasks and working behind the scenes to make sure the DBA program ran smoothly. Thank you, Naomi Schemm, for your assistance early in my dissertation. Your guidance and direction on search tools and databases was truly invaluable. I also want to express deep gratitude to Karina, a bright graduate student who assisted me in gathering data for my research. Without you, I would not be at the culmination of this program.

the smell of fresh baked cookies that she seemed to always be baking.  She talked with me and played games with me up until the day she moved away to an assisted living facility.  I made up my mind a long time ago that if I lived long enough, I'd be the same sweet, caring grandma to a little boy or little girl, regardless of relation.  Even as a child I could tell Norma genuinely cared about me, and while I didn't realize it then, looking back now it's clear just how much I needed her.  Thank you, Norma, for being kind and caring to that quiet little girl across the street.

TWO ESSAYS ON CEO POLITICAL IDEOLOGY: IMPLICATIONS FOR DIFFERENCES IN RISK AND STOCK MARKET REWARDS

ALECIA J. REINHARDT

Dr. Bakhtear Talukdar and Dr. Avishek Bhandari, Dissertation Chairs

## ABSTRACT

CEO political ideology refers to whether the CEO's personal belief system is aligned to conservativism (Republican party) or liberalism (Democrat party). The upper echelons theory (UET; Christensen, Dhaliwal, Boivie, & Graffin, 2015; Hambrick & Mason, 1984) shows how the board and CEO apply personal beliefs to firm decision-making. This study includes two essays. The first essay reviews the impact of the CEO's political ideology on wealth effects from changes in the levels of idiosyncratic and systematic risk. Idiosyncratic risk is the expected firm-specific loss when the loss exceeds the value-at-risk (VaR) level and systematic risk is the risk inherent in the market (Yamai & Yoshiba, 2005). No prior literature has examined this linkage. The second essay analyzes differences in stock market rewards when new products are announced given the CEO's political ideology. In particular, the study reviews the impact on firm stock performance by assessing the cumulative abnormal returns (CAR). Prior studies have not linked CEO political ideology with CAR and firm new product announcements. Both essays are expected to inform shareholders and Boards of Directors that Republican CEOs provide positive wealth effects for firms when idiosyncratic and systematic risk change and that market rewards are more favorable for Republican CEOs when new products are announced.

Keywords: CEO political ideology, idiosyncratic risk, systematic risk, CAR, wealth effects

TABLE OF CONTENTS

LIST OF TABLES

Essay 1: CEO Political Ideology: Implications for Differences in Risk

Essay 2: CEO Political Ideology: Differences in Stock Market Rewards

CEO POLITICAL IDEOLOGY: IMPLICATIONS FOR DIFFERENCES IN RISK

ALECIA J. REINHARDT

Dr. Bakhtear Talukdar and Dr. Avishek Bhandari, Dissertation Chairs

ABSTRACT

This paper examines whether a CEO's personal political ideology explains the impact to wealth effects from changes in the levels of idiosyncratic and systematic risk. The idiosyncratic risk is the expected loss for an individual firm when the loss is greater than the value-at-risk VaR level and systematic risk refers to the risk inherent in the market (Yamai & Yoshiba ,2005). First, I investigated whether the CEO's political ideology impacts the stock market reaction to changing idiosyncratic and systematic risks. I provide evidence that Republican CEOs are effective at mitigating systematic risks. Second, I investigated whether CEO political ideology impacts the stock market penalty to increasing levels of idiosyncratic and systematic risks. I provide evidence the market penalizes Republican CEOs less compared to non-Republican CEOs. Third, I show the stock market penalizes less tenured CEOs more than experienced CEOs when idiosyncratic and systematic risks are rising. Fourth, I provide support for the idea that the stock market penalty for increasing idiosyncratic and systematic risks is declining in the degree of the CEO's compensation.

In summary, the evidence implies the conservative ideologies associated with a Republican CEO translate into overall positive (less negative) wealth effects for the firm, and investors view political ideology as an important determinant of shareholders' wealth creation.

Prior studies have found support for partisan differences in firm operating decisions, such as debt management and research and development (R&D) investment. In particular, Jost (2006) found personal beliefs for the majority of people align with underlying themes of either the Republican or Democrat party. A growing body of research supports the concept that personal values and political ideologies of business leaders, such as CEOs, partially explain firm performance (Campbell, Notbohm, Smedema, & Zhang, 2018). Another body of research has focused on understanding and accurately estimating expected losses at the far-left end of the distribution curve (Gencay & Selcuk 2004). These loss estimates represent an important factor for investors to consider as they seek to diversify their wealth. Merging these literature streams, I investigated the question of whether a Republican CEO reduces the firm's idiosyncratic risk. I posited a Republican CEO as opposed to a Democrat CEO would reduce the shortfall risk because the former is viewed as a conservative persona in the market. Conversely, I also researched to identify whether the market may be more likely to react less negatively (less positively) toward Republican CEOs (Democrat CEOs) when idiosyncratic expected shortfall (ES) is increasing.

The ideologies of the top managers, particularly the CEO, are important to explore because the CEO is often the most powerful and visible person in the executive team and has strong influence on the overall corporate decision-making process (Hambrick, 2007). The upper echelons theory (UET) states the personal beliefs of executive managers are often present in the firm(s) they lead (Christensen, Dhaliwal, Boivie, & Graffin, 2015; Hambrick & Mason, 1984). Using UET, I propose Republican CEOs conservatively manage firms by taking on fewer excess risks and consistently seeking to reduce overall risk exposure. I propose the market rewards these CEOs since the market sees less volatility in the stock. Conversely, I suggest Democrat

CEOs manage firms with less conservatism and tend to take on more excess risks. I propose market investors will be likely to punish these CEOs since investors see more volatility in the firm's stock. Therefore, the UET provides an explanation as to why there are significant differences in the idiosyncratic risk for a Republican CEO (Democrat CEO) given the same scenario, such as decreasing (increasing) idiosyncratic risk.

Motivated by these theories, I studied whether the CEOs' political ideology impacts the market reward to decreasing levels of idiosyncratic and systematic risk and whether the CEO's political ideology impacts the market penalty applied during periods of increasing idiosyncratic and systematic risk. I extended research by Elnahas and Dongnyoung (2017), which found Republican CEOs manage firms with more conservative corporate policies versus Democrat CEOs. I measured the market reward and market penalty based on changes observed in the idiosyncratic and systematic risk of the stock market each year from 2003 through 2016. Based on analysis of the UET, I anticipated the idiosyncratic and systematic risk would show significant differences for Republican-led firms versus non-Republican-led ones.

Prior studies have shown differences in risk tolerances and risk management decisions for CEOs given the CEOs' political ideologies. For instance, a study by Graham, Hanlon, Shevlin, and Shroff (2014) noted 70% of tax executives view reputation risk as very important to firm management when deciding on tax planning strategies to implement. Additionally, Francis, Iftekhar, Xian, and Wu (2016) found Republican CEOs use tax sheltering strategies more often than Democrat CEOs. These strategies to reduce firm tax liability raise risk regarding management's reputation, which could lead to changes in the market's interpretation of the CEO's risk acceptance (Francis, Iftekhar, Xian, and Wu (2016)). With respect to tax planning strategies, these studies have suggested Republican CEOs might be more accepting of increased

reputation risk in an effort to reduce tax liability (Graham et al., 2014; Francis et al., 2016).

Thus, the relation between CEO political ideology and wealth effects to decreasing (increasing)

levels of idiosyncratic risk remains an empirical question that I attempt to answer.

I measured CEO political ideology by reviewing the CEO's monetary contributions to

Republican or Democrat parties for political campaigns and for candidates running for office in

the House, Senate, or for the Presidency. I used ExecuComp to gather CEO information and tie

it to individual political contribution data from the Federal Election Commission (FEC). My

period of election cycles under review was from 2003 to 2016. I selected this period to remove

potential data biases from major events, such as the 9/11 terrorist attacks, and to ensure a

sufficient body of sample results were available to review. I obtained additional information

from the Center for Research in Securities Prices (CRSP) database.

An understanding of how and to what extent the market reacts differently to changes in

idiosyncratic risk given the CEO's political ideology could prove profitable for shareholders,

especially those who are among the first to recognize the expected trend in idiosyncratic risk.

Additionally, this knowledge benefits senior management and the board because it provides

pertinent information about an individual CEO's level of risk aversion versus risk acceptance so

that the board and senior management can ensure they select a CEO with risk tolerances similar

to their own. Finally, employees benefit from more perceived stability and less volatility as

indicated by the firm's stock movement.

This study provides several significant contributions to the existing literature. First, I add

to the finance literature by combining the analysis of impact on idiosyncratic and systematic

risks given the political ideals of the CEO. By assessing both a positive event (declining levels

of idiosyncratic risk) and a negative event (increasing levels of idiosyncratic risk) within the

same study, I am able to provide robust evidence on differences in wealth effects for firms with Republican CEOs versus Democrat CEOs (Cooper, Gulen, & Ovtchinnikov, 2017).

Second, my research contributes to a growing stream of research that investigates how executive management's personal political ideologies influence the performance of the firm (Christensen et al., 2015; Hambrick & Mason, 1984). I show there are different impacts for the market reaction to the changes in the levels of idiosyncratic risk depending on the partisan association of the CEO's ideologies. I also show how the market penalizes Democrat CEOs more than Republican CEOs when idiosyncratic risk is increasing. While other studies have documented the impact of CEO political ideologies on firm debt leverage levels and tax avoidance (Cronqvist, Makhija, & Yonker; 2012; Hutton, Jiang, & Kumar; 2014), the moderating effects of these ideologies and how they impact market reaction and penalty to changing levels of idiosyncratic risk has not received much coverage by researchers.

Finally, my research contributes to the body of research around UET by adding a new perspective. I interpreted the UET as explaining what motivates the market to react differently to CEOs for changes in idiosyncratic risk levels. Unlike most previous studies, I focused on explaining the CEO's personal values and ideologies through his or her political ideologies. My research shows the market reacts differently to positive and negative changes in idiosyncratic risk depending on the CEO's political ideologies. This could be explained in part by the fact the market interprets actions taken by a Republican CEO to be more conservative than those taken by a Democrat CEO, thereby decreasing the firm's overall level of idiosyncratic risk. In addition, my research demonstrates the beneficial effects Republican CEOs have on firms when idiosyncratic risk is decreasing and firm competition is increasing. Through my research, I

determined the Republican CEO's beneficial effects when idiosyncratic risk is declining and the degree of firm uncertainty is increasing.

## Literature Review and Hypotheses Development

### Upper Echelons Theory

The UET states that personal values, ideologies, and beliefs of executive leadership influence firm performance (Christensen et al., 2015; Hambrick, 2007; Hambrick & Mason, 1984).  According to UET, Hambrick (2007) found executive managers are unable to exclude their personal beliefs when making firm decisions.  Hambrick (2007) also noted a firm decision under UET includes any executive management decision impacting firm operations.  In particular, Cronqvist et al. (2012) found the CEO's personal beliefs about debt influence the firm's leverage levels.  For example, the UET states a CEO who refuses to accept high levels of personal debt will also maintain low firm debt Hambrick (2007).  Georgakakis, Greve and Ruigrok (2017) further supported the UET by noting strategic firm leadership is a partnership between the CEO and top management team (TMT).  Boards may still be motivated to hire Democrat CEOs if the core ideologies of that individual align with the beliefs of the board members.  This is one of the primary tenets of the UET: that TMTs (i.e., boards) often look for like-minded individuals when making CEO hiring decisions.  To predict firm behavior, Georgakakis et al. (2017) found one must understand the intricacies of the relationship between CEO and TMT.  In addition, Georgakakis et al. (2017) noted the relationship between CEO and TMT improves when both are aligned in their beliefs, and the quality of this relationship ultimately impacts the firm's performance.  When ideologies and values of the CEO and TMT are not aligned, Ling, Wei, Klimoski, and Wu (2015) found the firm performance suffers.

Prior literature has provided support for partisan differences in firm operating decisions, including tax sheltering, debt levels, and R&D investment. According to Jost (2006), most people's personal beliefs align with ideologies of either the Republican or Democrat party, while a minority fall in the middle and even fewer claim no alignment. Hutton et al. (2014) and Elnahas and Dongnyoung (2017) found Republican managers tend to demonstrate more conservatism over corporate policies, including corporate debt, R&D expenses, and capital investments. Hutton et al. (2014) also found firms under conservative managers have lower leverage levels and spend less on R&D compared to firms led by less conservative managers. This research also found Republican managers obtain greater profitability versus non-Republican managers (Hutton et al., 2014). According to Kashmiri and Mahajan (2017), Democrat CEOs tend to be more willing to accept higher risk investments in new products versus Republican CEOs. Finally, Jiang, Kumara, and Law (2015) found conservative managers make more conservative financial forecasts for their firms compared to less conservative managers.

Research over auditors' perceptions of risk has found that auditors view Republican CEOs as having lower levels of inherent and control risks, while Democrat CEOs are seen as having higher levels of overall risk (Hutton et al., 2014). Additionally, Bhandari, Golden, and Thevenot (2020) noted auditors base their pricing decisions on two aspects of audit risk: inherent risk and control effectiveness. Since auditors conclude Republican CEOs have lower inherent risks and more effective controls, Bhandari et al. (2020) showed that auditors generally charge lower audit fees to clients with Republican CEOs versus clients with Democrat CEOs. Therefore, Bhandari et al. (2020) concluded CEO political ideology influences auditors' perceptions towards the firm.

All of the prior research cited previously follows the same theme that Republican CEOs tend to have conservative personal values and ideologies whereas Democrat CEOs tend to have less conservative values and ideologies. The studies also have supported the concept that conservative ideologies of Republican CEOs are translated into risk-averse firm behavior. The aforementioned prior research also has supported the notion that personal ideologies and values of the CEO partially influence firm performance, balance sheet structure, investment philosophy, and overall operations. This influence results in the Republican (i.e., conservative) CEO making decisions that ultimately make the firm more risk averse, whereas a Democrat (i.e., liberal) CEO tends to accept more risk for the firm and make riskier investments.

**Extreme Value Theory**

Extreme value theory (EVT) states that distributions at the left and right ends of a normal distribution curve have different characteristics (Gencay & Selcuk 2004). In finance, EVT helps explain extreme movements in market returns. According to McNeil (1999), EVT is the most scientific approach to an inherently difficult problem, that is, predicting the size of a rare event. Researchers and market analysts often measure these extreme movements using a concept called value-at-risk (VaR; Gencay & Selcuk 2004). The VaR was initially developed in response to the financial crises in the 1990s. Over time, this concept has become increasingly popular to identify market risk and aid executive leaders in managing market risk. The VaR serves as an estimation of the worst losses given a specific time horizon and confidence level (Dowd, 2003; Duffie & Pan, 1997; Gencay & Selcuk, 2004; Jorion, 2002). Gencay and Selcuk (2004) studied the financial markets of emerging nations and found significant differences compared to markets of developed nations. Gencay and Selcuk (2004) argued the financial volatility of developing countries impacts the VaR of developed economies. The emerging economies included in

Gencay and Selcuk's (2004) study are: Argentina, Brazil, Hong Kong, Indonesia, Korea, Mexico, Singapore, Taiwan, and Turkey. Gencay and Selcuk (2004) found the generalized Pareto distribution (GPD) fits the tails of the return distributions in these markets rather well, which indicates the daily return distributions have different characteristics at the left and right tails. Thus, the risks and rewards are not equally likely in these economies (Gencay & Selcuk, 2004). A study by Singh, Allen, and Powell (2017) found the Australian stock market performance more closely aligns to Japan than to the United States when extreme gains are realized. In addition, this research noted the Australian stock market depends more heavily on international markets when markets experience extreme losses (Sing et al., 2017).

While VaR can be effective to manage risk, research has found it often ignores losses falling beyond the VaR level, known as the tail risk (Tasche, 2002). As such, a new measure, ES has been proposed and widely accepted as a more accurate depiction of expected losses (Yamai & Yoshiba, 2005). The ES refers to the conditioned expectation of incurring losses greater than the VaR level (Yamai & Yoshiba, 2005). Tasche (2002) noted ES is sometimes called the conditional VaR or tail VaR and found ES allows for recognition of diversification whereas VaR does not. When there is a normal distribution curve, the VaR and ES provide similar information on tail losses; however, the profit and loss distribution in the market is often not normally distributed and, in these circumstances, the VaR tends to ignore or underestimate tail risk (Yamai & Yoshiba, 2005). Still, Yamai and Yoshiba (2005) noted the best measurement of risk may be a combination of VaR with ES. Acerbi, Nordio, and Sirtori (2018) provided a clear differentiation between how VaR is often perceived versus what it actually measures. Acerbi et al. (2018) noted that many misjudge VaR as the "maximum potential loss that a portfolio can suffer" given the "5% worst cases in 7 days." However, Acerbi et al. (2018) pointed out that

what VaR actually calculates is the minimum potential loss that a portfolio can suffer in the 5% worst cases in 7 days.  For the purposes of my research, I used ES since I focused on understanding implications related to the idiosyncratic risk portion of the yield curve.

A study by Longin (1996) examined extreme movements of the U.S. stock market from 1885 to 1990 using EVT as the premise for the study.  As noted by Longin (1996) extreme movements are the lowest and/or highest daily returns of a market index.  Longin (1996) noted an interesting phenomenon: for 28 years of data, the clustering of extremes occurs in the same week and generally the price decreases before it increases.  This research also observed that the shape of the distribution curve for minimums and maximums is rather symmetric (Longin, 1996).  The research found the distribution curve remains the same even when the curve shifts to the right for extremes in maximum return and to the left for extremes in minimum returns (Longin, 1996).  The shape of the tails of these curves is generally constant, even during periods of frequent extremes like the 1930s (Longin 1996).  However, research by McNeil (1999) suggested using methods based on normal distributions will likely underestimate tail risk because the tails of the normal distribution are too thin to adequately address the extreme losses.  McNeil (1999) focused on the peaks-over-threshold (POT) model and demonstrated how this method can be embedded within a stochastic volatility framework to present meaningful estimates of VaR and ES.  According to McNeil (1999) the POT model approach includes modeling all large observations that are greater than a high threshold.  Additionally, McNeil (1999) argued this approach provides more accuracy than a univariate model approach because the univariate analysis assumes losses occurring at different points in time are independent from each other.

A study by Srivastav, Keasey, Mollah, and Vallascas (2017) drew on concepts within EVT and noted how CEO turnover for large banks is linked to idiosyncratic risk.  The study

found a large bank CEO is more likely to experience forced turnover when the idiosyncratic risk is increasing, and they also found forced CEO turnover in relation to idiosyncratic risk is stronger in less concentrated banking industries (Srivastav et al., 2017).

**Risk Types and CEO Risk Tolerances**

The literature discusses two primary risk types: idiosyncratic risk and systematic risk. Bushman, Dai, and Wang (2010) found idiosyncratic risk informs the likelihood of CEO turnover. In particular, they observed idiosyncratic risk increases the likelihood of CEO turnover whereas systematic risk decreases it (Bushman et al., 2010). This observation aligns with previous research since the idiosyncratic risk is unique to the firm and is subject to influence from the CEO, whereas systematic risk represents the risk faced by all firms. Thus, according to Bushman et al. (2010), a firm experiencing increasing idiosyncratic risks is more likely to see the Board replace the current CEO. However, Bushman et al. (2010) notes that when the firm experiences rising systematic risks the Board is incentivized to retain its CEO, and the CEO's decisions often link to expected returns for shareholders, such that the CEO's decisions today should provide for shareholder wealth in the short term. A study by Antia, Pantzalis, and Park (2010) noted pressure on CEOs to deliver to shareholders has significantly increased. They cited the decline in average CEO tenure as one aspect in which pressure has increased, and they observed average CEO tenure has declined since 1990 from eight years to less than four years (Antia et al., 2010). As a result, Antia et al. (2010) argued CEOs are incentivized to make decisions which benefit shareholders in the short term even though these decisions may not be the best benefit to the firm in the long run.

Studies focused on specific industries also have provided support for the importance of the CEO's risk tolerances and the linkage to idiosyncratic risk versus systematic risk.

Researchers Hua, Dalbor, Lee, and Guchait (2016) studied risk behavior of restaurant managers, and the results are generalizable to other industries. Hua et al. (2016) found when the firm beats its benchmarks, it tends to make more risk averse decisions in an effort to maintain its performance; however, when the firm underperforms its benchmarks, the firm management often becomes more aggressive and accepts heightened risk in an effort to improve firm performance. Finally, when CEOs have more authority for making decisions, the firm's bond ratings tends to decline and yield spreads tend to climb (a sign the market views the bond as more risky than other investments). Research by Liu and Jiraporn (2010) found the more powerful the CEO is the more he or she tends to operate within an opaque information environment, which creates unease for shareholders since they perceive they lack all pertinent information needed to make investment decisions.

When it comes to idiosyncratic risk, Hasan and Habib (2019) found that the volatility in the firm's idiosyncratic returns can only partially be explained by firm-specific variables. They noted that regional social capital plays an important role as well (Hasan & Habib, 2019). Several studies have researched implications from idiosyncratic risk, but most studies on this topic have focused only on financial institutions. Straetmans and Chaudhry (2015) suggested that idiosyncratic risk includes non-linear spillover effects, whereas they argued that systemic risk is limited to only capture linear effects; however, their study was limited to comparing banks across Europe to banks in the United States. Pennacchi (2006) noted that federal deposit insurance for bank deposits creates an implicit morale hazard for banks as it shields the bank's true risk profile from market investors. Finally, Bali, Brown, and Caglayan (2012) found a positive statistically significant relationship between systematic risk and returns of hedge funds.

Based on these studies and analyses, I concluded the CEO's risk tolerances and risk-based decision making directly impact systematic risk.

**Hypotheses Development**

In combining concepts from the UET and EVT, I expected the political ideologies of the CEO to influence his or her risk decisions for the firm and to influence investor perceptions of the firm's exposure to idiosyncratic and systematic risks. In particular, I expected the market to view actions by Republican CEOs as risk averse and conservative, made in an effort to reduce the firm's risk exposure (Bhandari & Javakhadze, 2017; Bhandari et al., 2020; Campbell et al., 2018; Hutton et al., 2014; Srivastav et al., 2017). I divided risk into two categories: systematic risk and idiosyncratic risk. The systematic risk refers to the risk implicit in the marketplace whereas the idiosyncratic risk is the unique risk of the firm. Based on this expectation, I present the following hypotheses:

> $H_{1a}$: The market rewards to decreasing systematic risk is increasing in the degree of CEO conservatism.

> $H_{1b}$: The market rewards to decreasing idiosyncratic risk is increasing in the degree of CEO conservatism.

Research by Campbell et al. (2018) and Hutton et al. (2014) found the stock market views Republican CEOs as more risk averse, whereas the market feels Democrat CEOs may willingly accept more excess risk, making these CEOs less predictable in their actions. Under this presumption, the stock market interprets the Democrat CEO's higher risk tolerance as the result of increasing idiosyncratic risk. Singh et al. (2017) demonstrated how the Australian stock market reactions for extreme losses align closely to other major markets like the United States; however, they also showed the Australian market reactions align closely with Japan and Hong

Kong for extreme gains. Thus, Singh et al. (2017) argued that it is important to understand the intricacies of market dependencies given scenarios for both extreme gains and extreme losses.

Perceived firm risk influences actions taken by individual investors, which is particularly important for stock markets dominated by such investors. As noted by Long, Jiang, and Zhu (2018) a perceived increasing level of idiosyncratic risk may lead the individual investor to sell his or her shares. At a higher level, the increased trading activity results in higher turnover. Long et al. (2018) defined turnover as the volume of shares traded within the last 30 days divided by the total outstanding shares. Long et al. (2018) observed that turnover helps explain the negative impact of idiosyncratic risk on Chinese markets dominated by individual investors.

When negative news is delivered about a firm, it is reasonable to expect the stock market to react negatively, but given the previous discussion it should be reasonable to expect the market to react less negatively to a conservative (Republican) CEO during the first year as CEO and more negatively to a less conservative (Democrat) CEO during the first year as CEO. Based on this understanding, I offer the following hypotheses to explain market penalty for increasing levels of firm risk, including idiosyncratic and systematic risks:

$H_{2a}$: The market penalty to increasing systematic risk is decreasing when the Republican CEO is in the first year of that role.

$H_{2b}$: The market penalty to increasing idiosyncratic risk is decreasing when the Republican CEO is in the first year of that role.

Previous studies have shown that, in general, CEOs with more experience manage the firm with greater degrees of conservatism (Bushman et al., 2010). Extrapolating from the literature, I suggest that experienced Republican CEOs should therefore manage the firm with more conservative strategies as he or she gains experience. This suggests that firms seeking to

be cautious of risk exposure should contemplate the tenure of CEO candidates such that firms seeking risk reductions will focus on more experienced CEO candidates. As senior firm leaders, particularly CEOs, gain knowledge and experience in their industries and in holding senior leadership roles, the CEOs begin to expect that they should be more handsomely compensated. Given this information, I propose the following hypotheses:

$H_{3a}$: The market penalty to increasing systematic risk is decreasing in the degree of Republican CEO tenure.

$H_{3b}$: The market penalty to increasing idiosyncratic risk is decreasing in the degree of Republican CEO tenure.

Additionally, prior studies have found the more the firm's success is tied to improving the CEO's own personal wealth, the more the CEO tends to manage the firm's assets as if they were his or her own (Hutton et al., 2014). Thus, I suggest that CEOs with greater levels of compensation tend to reduce the firm's overall risk profile (including both systematic and idiosyncratic risks). Given this information, I propose the following hypotheses:

$H_{4a}$: The market penalty to increasing systematic risk is decreasing in the degree of Republican CEO compensation.

$H_{4b}$: The market penalty to increasing idiosyncratic risk is decreasing in the degree of Republican CEO compensation.

## Research Design

In this section, I present my research design. First, I discuss how I captured the key construct in my study, the CEO's political ideology. Second, I define how I measured systematic and idiosyncratic risks. Finally, I present the model used to test my hypotheses on the market reaction to idiosyncratic and systematic risks and CEO political ideology. My research focused

on risk measurements over time series using regression, specifically on the performance of the lowest 5% of stocks on each of the 252 trading days per year (McNeil, 1999). The market interprets stocks falling in the lowest 5% as the firms with the greatest amount of idiosyncratic risk for that particular day Long et al. (2018).

**CEO Political Ideology**

I defined CEO political ideology through review of his or her affiliation with the Republican or Democrat parties, which is supported by research by Bhandari et al. (2020), Elnahas and Dongnyoung (2017), Hutton et al. (2014), and Hong and Kostovetsky (2012). I designated the CEO's political ideology through review of his or her financial contributions to political campaigns for partisan candidates running for the Senate, House, or Presidential offices. I researched the FEC website for CEO political contribution data, which identities political donors and donees, dollar contributions, and statistics for aggregated contributions (Bhandari et al. 2020). I also used a method employed by Bhandari et al. (2020), Francis et al. (2016), and Hutton et al. (2014) to take CEO information from ExecuComp and build a record of CEO political contributions. I aligned ExecuComp data to FEC data using the donors' occupations and names. Finally, I used indicator variables so that 1 applies to a Republican CEO and 0 applies to a Democrat CEO.

**Systematic and Idiosyncratic Risks**

In this section, I discuss my method for calculating systematic risk and idiosyncratic risk. All my variables are defined in Table 1. I leveraged the systematic risk definition provided by Srivastav et al. (2017) which states that systematic risk is "the average daily return below the 5th group of the yearly distribution of the predicted returns from the market model" (p. 41). Hence,

in my research, systematic risk is the predicted returns. I used the daily bottom 20% of the return

distribution as the 5% and 10% lowest returns did not have adequate data points for my sample

size to conduct the analysis. I began my calculation of systematic risk by obtaining data on firm

performance from CRSP for the years 2003 to 2016. I then determined the lowest 20% of

returns by date from this range. I focused my analysis on the PERMNO and CUSIP values for

firms where the CEOs made political contributions. I ran the following equation on the CRSP

data obtained, as described previously: $R_{i,t} = \beta_1 + \beta_2 R_{m,t} + \beta_3 R_{b,t} + \varepsilon_{j,t}$ (1)

where $R_{i,t}$ represents the expected or predicted shortfall. I took an annual average of the

predicted shortfall to define the systematic component and annual average of the residual as the

idiosyncratic or firm-specific risk component. For $R_{m,t}$ in Equation 1, I used value-weighted

returns excluding dividends (VWRETX) from CRSP, which is the daily market index. The

industry return is represented by $R_{b,t}$. I merged industry return with the firm and market returns

according to date since all firms are part of the same market but not all firms are in the same

industry. I then used STATA commands to predict the firm return, $R_{i,t}$, and took the average to

define systematic risk. Finally, I calculated the average of the residuals by firm identification

number (PERMNO) and by year, which represents the idiosyncratic risk. I leveraged the

idiosyncratic risk definition provided by Acerbi et al. (2018) on page 4, which states that

idiosyncratic risk is the "expected value of the loss of the portfolio in the 5% worst cases in 7

days." The idiosyncratic risk is the expected loss beyond the VaR level and is defined in

Equation 2 in a manner consistent with Yamai and Yoshiba (2005):

$$ES_\infty(X) = E\,[X \mid X >= VaR_\infty(X)] \tag{2}$$

where ES serves as a proxy for the average losses incurred when the loss level is greater than the

VaR level (i.e., idiosyncratic risk). Thus, firms with higher levels of idiosyncratic risk face not

only the market risk inherent in operations (i.e., systematic risk), but these firms also face higher levels of additional firm-specific risk.

## CEO Tenure

In my hypotheses, I discussed the importance of the Republican CEO's tenure. I noted how experienced CEOs are expected to manage risks of the firm (idiosyncratic) and risks of the market (systematic) more effectively than CEOs who are less tenured. For my research, I defined Republican CEO tenure as the years of experience the CEO has with the current firm. The CEO's tenure at the current firm was calculated by using data pulled from ExecuComp. The data was sorted by firm ID number (Gvkey) and the year. I dropped any duplicates from the data. I lined up the EXECID with the Gvkey and determined the number of years each CEO served in that role for a given firm.

## CEO Compensation

The CEO compensation measure for Republican CEOs is based on data available from ExecuComp. For my study, compensation includes the following payments: salary (the dollar value of the base salary earned by CEO during a given year) and bonus (the dollar value of the bonus payment by the CEO during a specific year). In addition, compensation includes other annual payments, including: a) perquisites and other personal benefits, above market earnings on restricted stock, options, or deferred compensation paid during the year but deferred by the CEO; b) earnings on long-term incentive plan compensation paid during the year but deferred at the CEO's request; c) tax reimbursements; and d) the dollar value of difference between the price paid by the officer for company stock and the actual market price of the stock under a stock

purchase plan that is not generally available to shareholders or employees of the company. CEO compensation also includes restricted stock grants and long-term incentive plan compensation.

**Market Reaction and Empirical Models**

My hypotheses consider the impact of the CEO's political ideology on the firm's idiosyncratic risk over time. I controlled for Tobin's Q, which has been found to be significant and a reliable estimate for a firm's investment and growth potential (Lin & Chang, 2012; Mann & Babbar, 2017). Both Mann and Babbar (2017) and Lin and Chang (2012) agreed that firm size is significant when determining stock market value.

To test hypotheses $H_{1a}$, $H_{1b}$, $H_{2a}$, and $H_{2b}$, I used the following models, which depict the moderating effects of CEO political ideology on risk (including both systematic and idiosyncratic risks). I winsorized all variables at 99% to limit the effect from outliers in my data. I expected the coefficient of the *REPUBLICAN* variable to be negative for both hypotheses since increasing degrees of CEO conservatism should yield decreasing levels of systematic and idiosyncratic risk. As shown in Equations 3 and 4, I excluded CEO specific variables and focused on firm performance variables, and I controlled for firm-year fixed effects. I also controlled for the number of firm geographic segments (*NSEGS_GEO*), the number of firm operating business segments (*NSEGS_BUS*), firm size in terms of the log of the book value of firm total assets (*SIZE*), the modified current assets ratio (*MOD_CURR_RATIO*), the firm earnings before interest, taxes, depreciation, and amortization (*EBITDA*), and the minority interest holdings of firm common stock (*MINOR_INT*). I controlled for these variables since previous literature has controlled for these variables (Bhandari et al., 2020; Christensen et al., 2015; Elnahas & Dongnyoung, 2017; Hutton et al., 2014; Srivastav et al., 2017).

I expected the following control variables to have a negative relationship with the dependent variable: *SIZE*, *EBITDA*, *MOD_CURR_RATIO*, and *NSEGS_BUS*. When risks are rising, firm performance is expected to suffer and liquid assets are expected to be utilized. Thus, when either systematic risk or idiosyncratic risk is rising, I expected all these variables to decline. Also, the more diverse a firm is in its operations (i.e., more business segments), the less exposure the firm should have to any one source of risk. In this manner, when one segment is performing well, another segment may be suffering, but the net overall impact to the firm from rising risks should be minimal. Conversely, I expected the following control variables to have a positive relationship with the dependent variables: the number of geographic segments (*NSEGS_GEO*) and minority interest ownership of common stock (*MINOR_INT*). A firm with operations in numerous geographic areas could actually have heightened exposure to rising risks as it has exposed itself to multiple economic environments. Additionally, since most of the firms in my sample are large publicly traded firms, I expected that when risks are rising (either systematic or idiosyncratic), individual investors will be motivated to capitalize on losses from rising risks, and thus, the minority interest ownership in these firms should rise. I expected that individual investors view these firms as strong to weather volatility from rising risks.

$$SYSTEM\_ES = \alpha_0 + \beta_1 REPUBLICAN + \beta_2 NSEGS\_GEO + \beta_3 NSEGS\_BUS + \beta_4 SIZE +$$

$$\beta_5 MOD\_CURR\_RATIO + \beta_6 EBITDA + \beta_7 MINOR\_INT + \varepsilon \tag{3}$$

$$IDIORISK = \alpha_0 + \beta_1 REPUBLICAN + \beta_2 NSEGS\_GEO + \beta_3 NSEGS\_BUS + \beta_4 SIZE +$$

$$\beta_5 MOD\_CURR\_RATIO + \beta_6 EBITDA + \beta_7 MINOR\_INT \tag{4}$$

where *SYSTEM_ES* is the average return below the 5th group of the yearly distribution of the predicted returns from the market model. I divided my population of market returns into five

groups, and I focused on the returns from the lowest 20%. The variable *IDIOSRISK* represents the risk that the firm's returns move more on a given day than three standard deviations from the mean. I divided the population of firm returns into five groups, and I focused on the lowest 20% of firm daily returns. The variable *REPUBLICAN* is 1 if a CEO contributes more to a Republican than Democrat candidate during his or her tenure and 0 otherwise (Hutton et al., 2014; Elnahas & Dongnyoung, 2017). All other variables are defined in Table 1.

I tested hypotheses $H_{2a}$ and $H_{2b}$ using the following models, which depict the moderating effects of the Republican CEO's first year on risk (including both systematic and idiosyncratic risks). I winsorized all variables at 99% to limit the effect from outliers in my data. I expected the coefficient of the *FIRST_YEAR* variable to be negative for both hypotheses since increasing degrees of CEO conservatism should yield decreasing levels of systematic and idiosyncratic risk. As shown in Equations 5 and 6, I included both firm- and CEO-specific variables, and I controlled for firm-year fixed effects. I controlled for the same firm variables as in Equations 3 and 4. The control variables for CEO tenure (*TENURE*), CEO holdings of firm stock (*CEO_HOLD*), the CEO also serving as chairman of the board (*CEO_CHAIR)*, and CEO gender (*FEMALE*) were included in a 2020 study by Bhandari et al. (2020) on the impact of CEO political ideology on contracts with external auditors.

$$\text{SYSTEM\_ES} = \alpha_0 + \beta_1\text{FIRST\_YEAR} + \beta_2\text{NSEGS\_GEO} + \beta_3\text{NSEGS\_BUS} + \beta_4\text{SIZE} +$$
$$\beta_5\text{MOD\_CURR\_RATIO} + \beta_6\text{EBITDA} + \beta_7\text{MINOR\_INT} + \beta_8\text{COMP} + \beta_9\text{TENURE} +$$
$$\beta_{10}\text{CEO\_HOLD} + \beta_{11}\text{CEO\_CHAIR} + \beta_{12}\text{FEMALE} \tag{5}$$

$$\text{IDIORISK} = \alpha_0 + \beta_1\text{FIRST\_YEAR} + \beta_2\text{COMP} + \beta_3\text{TENURE} + \beta_4\text{CEO\_HOLD} +$$
$$\beta_5\text{CEO\_CHAIR} + \beta_6\text{FEMALE} \tag{6}$$

where S*YSTEM_ES* and *IDIOSRISK* are defined the same as in Equations 3 and 4. *FIRST_YEAR*
refers to the CEO's first year serving in that role. All other variables are defined in Table 1.

To test hypotheses $H_{3a}$ and $H_{3b}$, I used the following model, which depicts the moderating
effects of CEO political ideology on risk (including both systematic and idiosyncratic risks). I
winsorized all variables at 99% to limit the effect from outliers in my data. I expected the
coefficient of the *TENURE* variable to be negative for both equations since CEO tenure should
be inversely related to systematic and idiosyncratic risk.

$$SYSTEM\_ES = \alpha_0 + \beta_1 TENURE + \beta_2 COMP + \beta_3 CEO\_HOLD + \beta_4 FIRST\_YEAR +$$
$$\beta_5 CEO\_CHAIR + \beta_6 FEMALE + \beta_7 NSEGS\_GEO + \beta_8 NSEGS\_BUS + \beta_9 SIZE +$$
$$\beta_{10} MOD\_CURR\_RATIO + \beta_{11} EBITDA + \beta_{12} MINOR\_INT \tag{7}$$

$$IDIORISK = \alpha_0 + \beta_1 TENURE + \beta_2 COMP + \beta_3 CEO\_HOLD + \beta_4 FIRST\_YEAR +$$
$$\beta_5 CEO\_CHAIR + \beta_6 FEMALE + \beta_7 NSEGS\_GEO + \beta_8 NSEGS\_BUS + \beta_9 SIZE +$$
$$\beta_{10} MOD\_CURR\_RATIO + \beta_{11} EBITDA + \beta_{12} MINOR\_INT \tag{8}$$

where *SYSTEM_ES* and *IDIORISK* are defined the same as in Equations 3 and 4. These
variables, along with all others in Equations 5 and 6, are defined in Table 1.

To test hypotheses $H_{4a}$ and $H_{4b}$, I used the following model, which depicts the moderating
effects of CEO compensation (*COMP*) on risk (including both systematic and idiosyncratic
risks). I winsorized all variables at 99% to limit the effect from outliers in my data. I expected
the coefficient of the *COMP* variable to be negative for both equations since CEO compensation
should be inversely related to systematic and idiosyncratic risk.

$$SYSTEM\_ES = \alpha_0 + \beta_1 COMP + \beta_2 TENURE + \beta_3 CEO\_HOLD + \beta_4 FIRST\_YEAR +$$

$$\beta_5 CEO\_CHAIR + \beta_6 FEMALE + \beta_7 NSEGS\_GEO + \beta_8 NSEGS\_BUS + \beta_9 SIZE +$$

$$\beta_{10} MOD\_CURR\_RATIO + \beta_{11} EBITDA + \beta_{12} MINOR\_INT \tag{9}$$

$$IDIORISK = \alpha_0 + \beta_1 COMP + \beta_2 TENURE + \beta_3 CEO\_HOLD + \beta_4 FIRST\_YEAR +$$

$$\beta_5 CEO\_CHAIR + \beta_6 FEMALE + \beta_7 NSEGS\_GEO + \beta_8 NSEGS\_BUS + \beta_9 SIZE +$$

$$\beta_{10} MOD\_CURR\_RATIO + \beta_{11} EBITDA + \beta_{12} MINOR\_INT \tag{10}$$

where *SYSTEM_ES* and *IDIORISK* are defined the same as in Equations 3 and 4. These variables, along with all others in Equations 5 and 6, are defined in Table 1.

## Sample Selections and Empirical Results

**Sample Selection**

My sample includes daily market returns for all publicly traded firms from 2003 to 2016 from CRSP. I eliminated firms with missing or incomplete data in CRSP. To determine my CEO sample, I used a technique applied by Bhandari et al. (2020). I gathered all firm CEO names for publicly traded firms from 2003 to 2016 and aligned the CEO name with the name shown in the FEC database. This approach clearly identifies the donation made by the CEO and to which political party. After aligning the CEO names to the names of the firms, I eliminated those firms where there was no matching CEO. At the conclusion of this review, I ended with a sample of 10,461 CEOs, of which 60.50% are Republican CEOs. The CEOs identified as Republican are those who contribute more to Republicans than Democrats during their tenure. I define all my variables in Table 1.

Table 1

*Variable Definitions*

| Variable Name | Definition |
|---|---|
| SYSTEM_ES | The average predicted return in the first quintile (dividing the daily return distribution into five groups) from the market model. I focused on the returns from the lowest 20%. |
| IDIORISK | The average residual return in the first quintile (dividing the daily return distribution into five groups) from the market model. I focused on the returns from the lowest 20%. |
| REPUBLICAN | 1 if a CEO contributes more to a Republican than Democrat candidate during his or her tenure and 0 otherwise (Elnahas & Dongnyoung, 2017; Hutton et al., 2014) |
| COMP | The CEO's total compensation. Total compensation (in thousands of dollars) is TDC1 in the ExecuComp database, which has been defined as "Total compensation for the individual year, comprised of the following: Salary, Bonus, Other Annual, Total Value of Restricted Stock Granted, Total Value of Stock Options Granted (using Black-Scholes), Long-Term Incentive Payouts, and All Other Total." |
| CEO_TENURE | The years of experience at the current firm. |
| CEO_HOLD | The percentage of firm stock owned by the CEO. |
| FIRST_YEAR | 1 if the year under observation is the CEO's first year in that role and 0 otherwise. |
| CEO_CHAIR | The duality of the CEO also serving as the Chairman of the Board. |
| FEMALE | 1 if the CEO is a female and 0 if the CEO is male. |
| NSEGS_GEO | The number of firm geographic segments. |
| NSEGS_BUS | The number of firm operating business segments. |
| SIZE | The log of the book value of firm total assets. |
| MOD_CURR_RATIO | The ratio of current assets less the cash on hand to current liabilities. |
| EBIT | The firm earnings before interest and taxes. |
| MINOR_INT | The percentage of common stock not held by the parent company. |

**Empirical Results**

Table 2 presents the descriptive statistics for the variables in my empirical analyses. Refer to Table 1 for the definitions of the variables included in my analysis. Table 2 presents the descriptive statistics for my analysis when controlling for firm variables, and Table 3 presents the descriptive statistics when controlling for both firm and CEO variables. Note that in both Panels A and B the *SIZE* variable is 8.113, which is consistent with the same variable reported in Bhandari et al. (2020). This demonstrates that the sampled firms in my analysis are large and is consistent with the fact that ExecuComp primarily includes larger firms. Interestingly, in my analysis, the mean CEO total compensation of 8.43 (Panel B) is much higher than the 6.826 reported in Bhandari et al. (2020). Since 60.50% of my sampled CEOs are Republicans, this could suggest that Republican CEOs are better compensated. Additionally, in Tables 2 and 3 the mean *MOD_CURR_RATIO*, which represents a modified and more conservative current asset ratio, is 1.559. This ratio is more conservative because it includes current assets less the most liquid asset, cash. The fact that the *MOD_CURR_RATIO* is above 1 suggests that the firms in my sample are highly liquid and are able to meet current liabilities. This is also consistent with previously cited literature which notes that Republican CEOs typically aim to avoid being highly leveraged.

Table 2

*Descriptive Statistics for Analysis with Firm Variables*

| Variable | *N* | *M* | *SD* | Q1 | Median | Q3 |
|---|---|---|---|---|---|---|
| *REPUBLICAN* | 10,461 | 0.605 | 0.489 | 0.000 | 1.000 | 1.000 |
| *NSEGS_GEO* | 11,608 | 6.720 | 6.791 | 2.000 | 4.000 | 9.000 |
| *NSEGS_BUS* | 11,608 | 6.313 | 5.336 | 2.000 | 3.000 | 9.000 |
| *SIZE* | 10,398 | 8.113 | 1.724 | 6.824 | 8.024 | 9.214 |
| *MOD_CURR_RATIO* | 8,344 | 1.559 | 1.032 | 0.879 | 1.313 | 1.913 |
| *EBITDA* | 9,819 | 894.074 | 2,290.684 | 42.845 | 174.297 | 655 |
| *MINOR_INT* | 10,086 | 13.594 | 60.718 | 0.000 | 0.000 | 0.400 |
| *IDIORISK* | 10,461 | 0.000 | 0.003 | -0.001 | 0.000 | 0.000 |
| *SYSTEM_ES* | 10,461 | 0.023 | 0.011 | 0.016 | 0.021 | 0.027 |

*Note*. Table 2 presents descriptive statistics for the final sample with firm variables only. All variables are defined in Table 1. Q1 is the 25th percentile. Q3 is the 75th percentile.

Table 3

*Descriptive Statistics for Analysis with CEO Variables*

| Variable | *N* | *M* | *SD* | Q1 | Median | Q3 |
|----------|-----|-----|------|-----|--------|-----|
| *REPUBLICAN* | 10,461 | 0.605 | 0.489 | 0.000 | 1.000 | 1.000 |
| *COMP* | 7,250 | 8.43 | 0.911 | 7.81 | 8.467 | 9.094 |
| *CEO_TENURE* | 7,250 | 6.029 | 4.504 | 3.000 | 5.000 | 9.000 |
| *CEO_HOLD* | 7,250 | 1.736 | 3.923 | 0.000 | 0.324 | 1.42 |
| *FIRST_YEAR* | 7,250 | 0.077 | 0.266 | 0.000 | 0.000 | 0.000 |
| *CEO_CHAIR* | 7,250 | 0.208 | 0.406 | 0.000 | 0.000 | 0.000 |
| *FEMALE* | 7,250 | 0.025 | 0.156 | 0.000 | 0.000 | 0.000 |
| *IDIORISK* | 10,461 | 0.000 | 0.003 | -0.001 | 0.000 | 0.000 |
| *SYSTEM_ES* | 10,461 | 0.023 | 0.011 | 0.016 | 0.021 | 0.027 |

*Note.* Table 3 presents descriptive statistics for the final sample with CEO variables only. All variables are defined in Table 1. Q1 is the 25th percentile. Q3 is the 75th percentile.

The correlation matrix in Table 4 presents results for both firm and CEO variables. There was a statistically significant and negative relationship between the Republican CEO and systematic risk. I interpreted this result to suggest that the Republican CEO's influence over the firm reduces the exposure to systematic risk. The following variables had statistically significant and positive relationships with the Republican CEO variable: *SIZE*, *EBIT*, and *MINOR_INT*. Interpreting these results, I suggest that the firms that benefit most from the Republican CEO's leadership are firms that are large, have positive earnings, and where common stock is not held entirely by the parent company.

Table 4

*Correlation Matrix for CEO, Firm, Systematic, and Idiosyncratic Risk Variables*

| | REPUBLICAN | TAILRISK | SYSTEM_ES | COMP | TENURE | FIRST_YEAR | NSEGS_GEO | SIZE | MOD_CURR_RATIO | EBIT | MINOR_INT |
|---|---|---|---|---|---|---|---|---|---|---|---|
| REPUBLICAN | 1.0000 | | | | | | | | | | |
| IDIORISK | -0.0067 | 1.0000 | | | | | | | | | |
| SYSTEM_ES | -0.0201* | 0.0692* | 1.0000 | | | | | | | | |
| COMP | 0.0019 | -0.1430* | -0.2116* | 1.0000 | | | | | | | |
| TENURE | 0.0104 | -0.0067 | -0.0868* | 0.0681* | 1.0000 | | | | | | |
| FIRST_YEAR | 0.0140 | -0.0245* | -0.0019 | -0.0014 | -0.3857* | 1.0000 | | | | | |
| NSEGS_GEO | 0.0093 | -0.0611* | 0.0488* | 0.1589* | -0.0031 | 0.0068 | 1.0000 | | | | |
| SIZE | 0.0420* | -0.2276* | -0.2435* | 0.6014* | 0.0442* | 0.0254* | 0.0343* | 1.0000 | | | |
| MOD_CURR_RATIO | -0.0180 | 0.0572* | 0.0936* | -0.2838* | 0.0584* | -0.0434* | 0.1117* | -0.338* | 1.0000 | | |
| EBIT | 0.0224* | -0.2151* | -0.2177* | 0.4085* | 0.0046 | 0.0307* | 0.1303* | 0.6258* | -0.1313* | 1.0000 | |
| MINOR_INT | 0.0432* | -0.0867* | -0.0794* | 0.2327* | 0.0061 | -0.0022 | 0.1071* | 0.3328* | -0.1135* | 0.5310* | 1.0000 |

*Note:* Table 4 presents the correlation statistics of the variables used in this study.

\*$p < .1$. where \*\*\*\*, \*\*, \* represent 1%, 5%, and 10% statistical significance, respectively.

As shown in Table 5, I controlled for firm variables and fixed year effects. The results showed a statistically significant and negative relationship between the Republican CEO and systematic risk, which provides support for $H_{1a}$. This indicates that Republican CEOs are effective at reducing the firm's exposure to systematic risk. Additionally, the results showed that for the years 2008 and 2009, the systemic risk was statistically significant and positive. This is consistent with my expectations since during those years the U.S. economy was experiencing significant decline, and the systemic risk was higher than in other years under my review. I also found that firm size (*SIZE*) and firm earnings (*EBITDA*) were statistically significant and negatively related to systematic risk. This result suggests that large firms with strong earnings have less exposure to systematic risk compared to smaller firms with weaker earnings. Additionally, Table 5 shows the number of operating segments of the firm (*NSEGS_GEO*) was statistically significant and negatively related to systematic risk. This result implies that the greater the number of operating segments of the firm, the less exposure the firm has to systematic risk. This result is consistent with my expectations since I expected firms with more operating segments to be less impacted by the risk inherent in the market (i.e., systematic risk). I also found that the number of geographic firm segments (*NSEGS_GEO*) was statistically significant and positively related to systematic risk. This result implies that the more geographic operating segments the firm has, the greater its exposure to systematic risk.

Table 5

*CEO and Risk Measures Controlled for Firm Variables*

| VARIABLES | (1) IDIORISK Coeff. | (2) IDIORISK Coeff. | (3) SYSTEM_ES Coeff. | (4) SYSTEM_ES Coeff. | (5) IDIORISK Coeff. | (6) IDIORISK Coeff. | (7) SYSTEM_ES Coeff. | (8) SYSTEM_ES Coeff. |
|---|---|---|---|---|---|---|---|---|
| REPUBLICAN | -0.009* | -0.000 | -0.058*** | -0.064*** | -0.009* | -0.000 | -0.047*** | -0.053*** |
|  | (0.005) | (0.006) | (0.021) | (0.023) | (0.005) | (0.006) | (0.016) | (0.018) |
| NSEGS_GEO |  | -0.001** |  | 0.010*** |  | -0.001** |  | 0.007*** |
|  |  | (0.000) |  | (0.002) |  | (0.000) |  | (0.001) |
| NSEGS_BUS |  | -0.001* |  | -0.005** |  | -0.001* |  | -0.007*** |
|  |  | (0.001) |  | (0.002) |  | (0.001) |  | (0.002) |
| SIZE |  | -0.039*** |  | -0.164*** |  | -0.040*** |  | -0.126*** |
|  |  | (0.003) |  | (0.010) |  | (0.003) |  | (0.008) |
| MOD_CURR_RATIO |  | -0.004 |  | -0.009 |  | -0.004 |  | 0.010 |
|  |  | (0.003) |  | (0.011) |  | (0.003) |  | (0.008) |
| EBIT |  | -0.000*** |  | -0.000*** |  | -0.000*** |  | -0.000*** |
|  |  | (0.000) |  | (0.000) |  | (0.000) |  | (0.000) |
| MINOR_INT |  | 0.000 |  | 0.001*** |  | 0.000 |  | 0.000*** |
|  |  | (0.000) |  | (0.000) |  | (0.000) |  | (0.000) |
| YEAR_2004 |  |  |  |  | -0.037 | -0.033* | 0.028 | -0.023 |
|  |  |  |  |  | (0.032) | (0.017) | (0.082) | (0.043) |
| YEAR_2005 |  |  |  |  | -0.021 | -0.009 | -0.055 | -0.111*** |
|  |  |  |  |  | (0.032) | (0.016) | (0.080) | (0.039) |
| YEAR_2006 |  |  |  |  | -0.012 | -0.006 | -0.095 | -0.149*** |
|  |  |  |  |  | (0.032) | (0.015) | (0.080) | (0.038) |
| YEAR_2007 |  |  |  |  | -0.020 | -0.004 | 0.128 | -0.018 |
|  |  |  |  |  | (0.032) | (0.015) | (0.080) | (0.040) |
| YEAR_2008 |  |  |  |  | -0.058* | -0.022 | 1.953*** | 1.699*** |

# CEO POLITICAL IDEOLOGY RISKS AND REWARDS

| VARIABLES | (1) IDIORISK Coeff. | (2) IDIORISK Coeff. | (3) SYSTEM_ES Coeff. | (4) SYSTEM_ES Coeff. | (5) IDIORISK Coeff. | (6) IDIORISK Coeff. | (7) SYSTEM_ES Coeff. | (8) SYSTEM_ES Coeff. |
|---|---|---|---|---|---|---|---|---|
| | | | | | (0.033) | (0.018) | (0.089) | (0.059) |
| YEAR_2009 | | | | | -0.055* | -0.022 | 1.093*** | 0.790*** |
| | | | | | (0.033) | (0.017) | (0.091) | (0.061) |
| YEAR_2010 | | | | | -0.017 | 0.010 | -0.108 | -0.217*** |
| | | | | | (0.032) | (0.015) | (0.082) | (0.043) |
| YEAR_2011 | | | | | -0.024 | 0.000 | 0.022 | -0.037 |
| | | | | | (0.032) | (0.015) | (0.084) | (0.046) |
| YEAR_2012 | | | | | -0.023 | -0.006 | -0.196** | -0.223*** |
| | | | | | (0.032) | (0.016) | (0.080) | (0.039) |
| YEAR_2013 | | | | | -0.016 | 0.011 | -0.518*** | -0.559*** |
| | | | | | (0.032) | (0.015) | (0.079) | (0.037) |
| YEAR_2014 | | | | | -0.019 | 0.004 | -0.380*** | -0.359*** |
| | | | | | (0.032) | (0.016) | (0.080) | (0.038) |
| YEAR_2015 | | | | | -0.024 | 0.005 | -0.079 | -0.063 |
| | | | | | (0.032) | (0.017) | (0.081) | (0.042) |
| YEAR_2016 | | | | | -0.025 | | -0.033 | |
| | | | | | (0.033) | | (0.082) | |
| Intercept | -0.041*** | 0.291*** | 2.348*** | 3.653*** | -0.014 | 0.304*** | 2.182*** | 3.301*** |
| | (0.004) | (0.024) | (0.017) | (0.078) | (0.031) | (0.027) | (0.079) | (0.071) |
| | | | | | | | | |
| Industry Fixed Effects | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| Adjusted $R^2$ | 0.80% | 9.40% | 6.70% | 17.60% | 1.00% | 9.50% | 45.10% | 49.50% |
| N | 10,461 | 7,058 | 10,461 | 7,058 | 10,461 | 7,058 | 10,461 | 7,058 |

*Note*. This table reports estimation from OLS. For columns 1, 2, 5, and 6, *IDIORISK* is the dependent variable and is defined as the average residual return in the first quintile (dividing the daily return distribution into five groups) from the market model. I focus on the returns from the lowest 20%. For columns 3, 4, 7, and 8, *SYSTEM_ES* is the dependent variable and is defined as the average predicted return in the first quintile (dividing the daily return distribution into five groups) from the market model. I focused on the returns from the lowest 20%. *REPUBLICAN* indicates if a CEO contributes more to Republicans than Democrats during his or her tenure. CEOs who contribute more to

Republicans are represented by 1 and are 0 otherwise (Elnahas & Dongnyoung, 2017; Hutton et al., 2014).  Variable definitions are provided in Table 1.  I used both industry and year fixed effects.  I clustered standard errors by the firm identification number (Gvkey).  Robust standard errors were computed using the Huber-White-Sandwich estimator of variance by clustering on the firm level. Standard errors are reported in the parentheses.  *$p < .1$, **$p < .05$, ***$p < .01$.

Table 6 reports the regression results after controlling for firm and CEO variables. Three CEO variables had statistically significant relationships with systematic risk. These variables are: *COMP*, *CEO_TENURE*, and *FIRST_YEAR*. First, Table 6 shows that CEO *COMP* had a negative and statistically significant relationship with both measures of risk: idiosyncratic risk and systematic risk. This suggests that CEO *COMP* increases while the firm's exposure to idiosyncratic risk and systematic risk declines. Thus, I inferred from the result that firms should be motivated to maintain competitive CEO compensation if the firm desires to mitigate exposure to idiosyncratic and systematic risks. Additionally, Table 6 shows that CEO tenure (*CEO_TENURE*) had a negative and statistically significant relationship with systematic risk. This is consistent with my expectations since I expected that as the CEO becomes more tenured, the firm should experience declines in systematic risk. The result is also consistent with research by Bhuyan, Butchey, Haar, and Talukdar (2020), which showed that CEO tenure and firm performance are impactful to the CEO's compensation, and as the CEO becomes more tenured, cash bonuses are replaced by stock awards and option awards. Therefore, when selecting a new CEO, firms with concerns about exposure to systematic risk should consider the CEO's level of experience (i.e., tenure) as an important factor. Third, the CEO's first year on the job (*FIRST_YEAR*) had a statistically significant and negative relationship with both idiosyncratic and systematic risk. I interpreted this result to signal that the market penalizes the first year CEO less than the experienced CEO when idiosyncratic and systematic risks are rising.

Next, I examined the relationship between firm variables and both measures of risk. Results in Table 6 show that *NSEGS_GEO* was statistically significant and positively related to systematic risk. The variable *NSEGS_GEO* indicates the number of geographic segments in which a firm operates, and the positive relationship to systematic risk is consistent with my

expectations. The more operating locations the firm has, the greater its sensitivity to fluctuations in the market. Firm size (*SIZE*) had a statistically significant and negative relationship with systematic risk. This result suggests the larger the firm is, the less exposure it has to systematic risk, which is consistent with my expectations and consistent with prior research. Larger firms are arguably better equipped to manage fluctuations in the market. Analyzing the modified current assets ratio (*MOD_CURR_RATIO*), there was a positive and significant relationship with systematic risk, meaning that as the systematic risk rises so does the firm's *MOD_CURR_RATIO*. This presents an interesting result and suggests that as the risk in the market rises, the firm responds by reducing its current liabilities and increasing its current assets. In some cases, this could mean the firm extends the maturity of its financing obligations. Typically, the current ratio includes cash on hand in the numerator, but the *MOD_CURR_RATIO* is a more conservative measure of the firm's liquidity since it excludes cash. Conversely, as risk in the market declines, the firm's expected response would be to reduce its *MOD_CURR_RATIO*, thereby reducing the firm's liquidity.

Table 6 also presents results for the *EBITDA*, which had a negative and statistically significant relationship with systematic risk. Therefore, as systematic risk rises, the firm's EBITDA declines. This result is consistent with my expectations since firm performance is generally expected to decline when market risk rises. Finally, as detailed in Table 6, results showed that minority ownership interest in firm stock (*MINOR_INT*) has a positive and statistically significant relationship with systematic risk. The *MINOR_INT* indicates the portion of income that applies to common stock not held by the parent company. This relationship shows that as market risk rises, so do investments in the firm's common stock. Given that most

of the firms in my study are large, it seems reasonable that market investors would shift their

money towards larger firms in the event of market uncertainty and fluctuations.

Table 6

*CEO and Risk Measures Controlled for Firm and CEO Variables*

| VARIABLES | (1) IDIORISK Coeff. | (2) SYSTEM_ES Coeff. | (3) IDIORISK Coeff. | (4) SYSTEM_ES Coeff. | (5) IDIORISK Coeff. | (6) SYSTEM_ES Coeff. | (7) IDIORISK Coeff. | (8) SYSTEM_ES Coeff. |
|---|---|---|---|---|---|---|---|---|
| REPUBLICAN | -0.008 | -0.071*** | -0.008 | -0.072*** | -0.008 | -0.072*** | -0.008 | -0.073*** |
|  | (0.006) | (0.021) | (0.006) | (0.021) | (0.006) | (0.021) | (0.006) | (0.021) |
| COMP | -0.040*** | -0.074*** | -0.040*** | -0.073*** | -0.040*** | -0.072*** | -0.040*** | -0.072*** |
|  | (0.003) | (0.015) | (0.003) | (0.015) | (0.003) | (0.015) | (0.003) | (0.015) |
| CEO_TENURE | -0.002** | -0.015*** | -0.001 | -0.013*** | -0.001 | -0.013*** | -0.001 | -0.013*** |
|  | (0.001) | (0.002) | (0.001) | (0.002) | (0.001) | (0.002) | (0.001) | (0.002) |
| CEO_HOLD | 0.001 | -0.000 | 0.001 | -0.000 | 0.001 | -0.000 | 0.001 | -0.000 |
|  | (0.001) | (0.003) | (0.001) | (0.003) | (0.001) | (0.003) | (0.001) | (0.003) |
| FIRST_YEAR | -0.031*** | -0.095** |  |  |  |  |  |  |
|  | (0.011) | (0.037) |  |  |  |  |  |  |
| CEO_CHAIR | -0.005 | 0.024 | -0.003 | 0.031 |  |  |  |  |
|  | (0.010) | (0.036) | (0.010) | (0.036) |  |  |  |  |
| FEMALE | -0.012 | 0.100 | -0.013 | 0.099 | -0.013 | 0.099 |  |  |
|  | (0.017) | (0.061) | (0.017) | (0.060) | (0.017) | (0.061) |  |  |
| NSEGS_GEO |  | 0.005*** |  | 0.005*** |  | 0.005*** |  | 0.005*** |
|  |  | (0.002) |  | (0.002) |  | (0.002) |  | (0.002) |
| NSEGS_BUS |  | -0.003 |  | -0.003 |  | -0.003 |  | -0.003 |
|  |  | (0.002) |  | (0.002) |  | (0.002) |  | (0.002) |
| SIZE |  | -0.080*** |  | -0.081*** |  | -0.081*** |  | -0.083*** |
|  |  | (0.012) |  | (0.012) |  | (0.012) |  | (0.012) |
| MOD_CURR_RATIO |  | 0.036*** |  | 0.037*** |  | 0.036*** |  | 0.035*** |
|  |  | (0.010) |  | (0.010) |  | (0.010) |  | (0.010) |
| EBITDA |  | -0.000*** |  | -0.000*** |  | -0.000*** |  | -0.000*** |
|  |  | (0.000) |  | (0.000) |  | (0.000) |  | (0.000) |

| VARIABLES | (1) IDIORISK Coeff. | (2) SYSTEM_ES Coeff. | (3) IDIORISK Coeff. | (4) SYSTEM_ES Coeff. | (5) IDIORISK Coeff. | (6) SYSTEM_ES Coeff. | (7) IDIORISK Coeff. | (8) SYSTEM_ES Coeff. |
|---|---|---|---|---|---|---|---|---|
| MINOR_INT | | 0.001*** | | 0.001*** | | 0.001*** | | 0.001*** |
| | | (0.000) | | (0.000) | | (0.000) | | (0.000) |
| YEAR_2004 | -0.060* | -0.150*** | -0.058* | -0.150*** | -0.058* | -0.130*** | -0.058* | -0.135*** |
| | (0.034) | (0.053) | (0.034) | (0.053) | (0.034) | (0.047) | (0.034) | (0.047) |
| YEAR_2005 | -0.045 | -0.214*** | -0.043 | -0.217*** | -0.044 | -0.197*** | -0.043 | -0.201*** |
| | (0.033) | (0.048) | (0.033) | (0.049) | (0.033) | (0.042) | (0.033) | (0.042) |
| YEAR_2006 | -0.044 | -0.235*** | -0.042 | -0.234*** | -0.043 | -0.215*** | -0.042 | -0.219*** |
| | (0.033) | (0.048) | (0.033) | (0.048) | (0.033) | (0.042) | (0.033) | (0.042) |
| YEAR_2007 | -0.042 | -0.093* | -0.041 | -0.098** | -0.042 | -0.081* | -0.041 | -0.084* |
| | (0.034) | (0.050) | (0.033) | (0.050) | (0.034) | (0.045) | (0.034) | (0.045) |
| YEAR_2008 | -0.104*** | 1.597*** | -0.102*** | 1.596*** | -0.102*** | 1.613*** | -0.102*** | 1.610*** |
| | (0.035) | (0.070) | (0.035) | (0.070) | (0.035) | (0.070) | (0.035) | (0.070) |
| YEAR_2009 | -0.096*** | 0.612*** | -0.092*** | 0.615*** | -0.091*** | 0.618*** | -0.091*** | 0.616*** |
| | (0.035) | (0.069) | (0.035) | (0.069) | (0.034) | (0.069) | (0.034) | (0.069) |
| YEAR_2010 | -0.031 | -0.273*** | -0.028 | -0.269*** | -0.026 | -0.268*** | -0.026 | -0.271*** |
| | (0.033) | (0.046) | (0.033) | (0.046) | (0.033) | (0.046) | (0.033) | (0.046) |
| YEAR_2011 | -0.036 | -0.124** | -0.033 | -0.121** | -0.032 | -0.121** | -0.032 | -0.122** |
| | (0.034) | (0.051) | (0.033) | (0.051) | (0.033) | (0.051) | (0.033) | (0.051) |
| YEAR_2012 | -0.029 | -0.282*** | -0.027 | -0.282*** | -0.025 | -0.281*** | -0.025 | -0.283*** |
| | (0.034) | (0.041) | (0.034) | (0.041) | (0.033) | (0.041) | (0.033) | (0.041) |
| YEAR_2013 | -0.014 | -0.564*** | -0.012 | -0.563*** | -0.010 | -0.562*** | -0.010 | -0.564*** |
| | (0.033) | (0.038) | (0.033) | (0.039) | (0.033) | (0.039) | (0.033) | (0.038) |
| YEAR_2014 | -0.013 | -0.370*** | -0.011 | -0.369*** | -0.009 | -0.369*** | -0.009 | -0.370*** |
| | (0.034) | (0.040) | (0.034) | (0.040) | (0.033) | (0.040) | (0.033) | (0.040) |
| YEAR_2015 | -0.016 | -0.067 | -0.014 | -0.068 | -0.012 | -0.068 | -0.013 | -0.069 |
| | (0.034) | (0.043) | (0.034) | (0.043) | (0.034) | (0.043) | (0.034) | (0.043) |

CEO POLITICAL IDEOLOGY RISKS AND REWARDS

| VARIABLES | (1) IDIORISK Coeff. | (2) SYSTEM_ES Coeff. | (3) IDIORISK Coeff. | (4) SYSTEM_ES Coeff. | (5) IDIORISK Coeff. | (6) SYSTEM_ES Coeff. | (7) IDIORISK Coeff. | (8) SYSTEM_ES Coeff. |
|---|---|---|---|---|---|---|---|---|
| YEAR_2016 | -0.021 | | -0.018 | | -0.017 | | -0.017 | |
| | (0.034) | | (0.034) | | (0.033) | | (0.033) | |
| Intercept | 0.321*** | 3.607*** | 0.314*** | 3.586*** | 0.314*** | 3.578*** | 0.312*** | 3.592*** |
| | (0.043) | (0.122) | (0.043) | (0.121) | (0.043) | (0.121) | (0.043) | (0.121) |
| | | | | | | | | |
| Industry Fixed Effects | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| Adjusted $R^2$ | 5.40% | 51.20% | 5.30% | 51.10% | 5.30% | 51.10% | 5.30% | 51.10% |
| N | 7,121 | 4,746 | 7,121 | 4,746 | 7,121 | 4,746 | 7,121 | 4,746 |

*Note*. This table reports estimation from OLS. For columns 1, 3, 5, and 7, *IDIORISK* is the dependent variable and is defined as the average residual return in the first quintile (dividing the daily return distribution into five groups) from the market model. I focused on the returns from the lowest 20%. For columns 2, 4, 6, and 8, *SYSTEM_ES* is the dependent variable and is defined as the average predicted return in the first quintile (dividing the daily return distribution into five groups) from the market model. I focused on the returns from the lowest 20%. *REPUBLICAN* is the independent variable and indicates if a CEO contributes more to Republican than Democrat during his or her tenure. CEOs who contribute more to Republicans are represented by 1 and are 0 otherwise (Elnahas & Dongnyoung, 2017; Hutton et al., 2014). All variable definitions are provided in Table 1. I used both industry and year fixed effects. I clustered standard errors by the firm identification number (Gvkey). Robust standard errors were computed using the Huber-White-Sandwich estimator of variance by clustering on the firm level. *t*-values are reported in the parentheses. ***, **, * represent 1%, 5%, and 10% statistical significance, respectively.

Table 7 reports the regression results on Republican CEOs when I controlled for firm and CEO variables. There were three CEO variables that had statistically significant relationships with systematic risk and provide support for $H_{2a}$, $H_{2b}$, $H_{3a}$, $H_{3b}$, $H_{4a}$, and $H_{4b}$. These variables are: *COMP*, *CEO_TENURE*, and *FIRST_YEAR*. First, Table 7 shows that Republican CEO *COMP* had a negative and statistically significant relationship with both measures of risk: idiosyncratic risk and systematic risk. In fact, this is the only variable in my analysis that showed such a consistent and statistically significant trend. This relationship suggests that as Republican CEO *COMP* increases, the firm's exposure to idiosyncratic risk and systematic risk declines. Thus, I suggest that firms concerned about their risk exposure should be motivated to ensure their Republican CEO is well compensated. Additionally, Table 7 shows that Republican CEO tenure (*CEO_TENURE*) had a negative and statistically significant relationship with systematic risk. This relationship is consistent with my expectations since it indicates that as the Republican CEO becomes more tenured, the firm's exposure to systematic risk declines. Third, the Republican CEO's first year on the job (*FIRST_YEAR*) had a negative relationship with both idiosyncratic and systematic risk; however, the result was not statistically significant. I interpreted this result to suggest that the market penalizes the first year Republican CEO to a lesser degree than the experienced CEO when idiosyncratic and systematic risks are rising.

Table 7

*Republican CEO and Risk Measures Controlled for Firm and CEO Variables*

| Variables | (1) IDIORISK | (2) SYSTEM_ES | (3) IDIORISK | (4) SYSTEM_ES | (5) IDIORISK | (6) SYSTEM_ES | (7) IDIORISK | (8) SYSTEM_ES |
|---|---|---|---|---|---|---|---|---|
| COMP | -0.051*** | -0.068*** | -0.052*** | -0.066*** | -0.052*** | -0.066*** | -0.052*** | -0.065*** |
|  | (0.005) | (0.022) | (0.005) | (0.022) | (0.005) | (0.022) | (0.005) | (0.022) |
| CEO_TENURE | -0.000 | -0.012*** | 0.000 | -0.011*** | 0.000 | -0.011*** | 0.000 | -0.011*** |
|  | (0.001) | (0.003) | (0.001) | (0.003) | (0.001) | (0.003) | (0.001) | (0.003) |
| CEO_HOLD | 0.001 | -0.002 | 0.001 | -0.002 | 0.001 | -0.002 | 0.001 | -0.002 |
|  | (0.001) | (0.003) | (0.001) | (0.003) | (0.001) | (0.003) | (0.001) | (0.003) |
| FIRST_YEAR | -0.019 | -0.062 | | | | | | |
|  | (0.015) | (0.045) | | | | | | |
| CEO_CHAIR | -0.014 | 0.021 | -0.013 | 0.025 | | | | |
|  | (0.013) | (0.046) | (0.013) | (0.046) | | | | |
| FEMALE | 0.048* | 0.109 | 0.047* | 0.109 | 0.048* | 0.108 | | |
|  | (0.026) | (0.074) | (0.026) | (0.073) | (0.026) | (0.073) | | |
| NSEGS_GEO | | 0.003* | | 0.003* | | 0.003* | | 0.003* |
|  | | (0.002) | | (0.002) | | (0.002) | | (0.002) |
| NSEGS_BUS | | 0.001 | | 0.001 | | 0.001 | | 0.001 |
|  | | (0.002) | | (0.002) | | (0.003) | | (0.002) |
| SIZE | | -0.053*** | | -0.054*** | | -0.053*** | | -0.056*** |
|  | | (0.016) | | (0.016) | | (0.016) | | (0.016) |
| MOD_CURR_RATIO | | 0.037*** | | 0.037*** | | 0.037*** | | 0.036*** |
|  | | (0.014) | | (0.014) | | (0.014) | | (0.014) |
| EBITDA | | -0.000*** | | -0.000*** | | -0.000*** | | -0.000*** |
|  | | (0.000) | | (0.000) | | (0.000) | | (0.000) |

| Variables | (1) IDIORISK | (2) SYSTEM_ES | (3) IDIORISK | (4) SYSTEM_ES | (5) IDIORISK | (6) SYSTEM_ES | (7) IDIORISK | (8) SYSTEM_ES |
|---|---|---|---|---|---|---|---|---|
| MINOR_INT | | 0.001*** | | 0.001*** | | 0.001*** | | 0.001*** |
| | | (0.000) | | (0.000) | | (0.000) | | (0.000) |
| YEAR_2004 | -0.021 | -0.209*** | -0.019 | -0.209*** | -0.021 | -0.192*** | -0.021 | -0.198*** |
| | (0.039) | (0.069) | (0.039) | (0.069) | (0.039) | (0.060) | (0.039) | (0.060) |
| YEAR_2005 | -0.016 | -0.197*** | -0.015 | -0.199*** | -0.017 | -0.183*** | -0.017 | -0.188*** |
| | (0.039) | (0.062) | (0.039) | (0.062) | (0.039) | (0.053) | (0.039) | (0.053) |
| YEAR_2006 | -0.015 | -0.260*** | -0.013 | -0.259*** | -0.015 | -0.243*** | -0.014 | -0.246*** |
| | (0.038) | (0.063) | (0.038) | (0.063) | (0.038) | (0.054) | (0.038) | (0.054) |
| YEAR_2007 | -0.013 | -0.131** | -0.011 | -0.134** | -0.013 | -0.118** | -0.012 | -0.122** |
| | (0.039) | (0.066) | (0.039) | (0.066) | (0.039) | (0.060) | (0.039) | (0.060) |
| YEAR_2008 | -0.077* | 1.565*** | -0.075* | 1.564*** | -0.076* | 1.579*** | -0.075* | 1.576*** |
| | (0.041) | (0.090) | (0.041) | (0.090) | (0.041) | (0.090) | (0.041) | (0.090) |
| YEAR_2009 | -0.073* | 0.510*** | -0.071* | 0.513*** | -0.065 | 0.515*** | -0.064 | 0.513*** |
| | (0.041) | (0.088) | (0.041) | (0.088) | (0.040) | (0.087) | (0.040) | (0.087) |
| YEAR_2010 | -0.004 | -0.364*** | -0.001 | -0.362*** | 0.005 | -0.361*** | 0.006 | -0.363*** |
| | (0.039) | (0.059) | (0.039) | (0.059) | (0.038) | (0.059) | (0.038) | (0.059) |
| YEAR_2011 | -0.019 | -0.191*** | -0.017 | -0.190*** | -0.010 | -0.189*** | -0.009 | -0.191*** |
| | (0.039) | (0.066) | (0.039) | (0.066) | (0.038) | (0.066) | (0.038) | (0.065) |
| YEAR_2012 | -0.017 | -0.342*** | -0.015 | -0.342*** | -0.008 | -0.341*** | -0.007 | -0.343*** |
| | (0.039) | (0.053) | (0.039) | (0.053) | (0.038) | (0.053) | (0.038) | (0.053) |
| YEAR_2013 | 0.006 | -0.627*** | 0.008 | -0.626*** | 0.014 | -0.626*** | 0.015 | -0.627*** |
| | (0.038) | (0.050) | (0.038) | (0.050) | (0.038) | (0.050) | (0.038) | (0.050) |
| YEAR_2014 | 0.010 | -0.445*** | 0.012 | -0.445*** | 0.019 | -0.445*** | 0.020 | -0.446*** |
| | (0.039) | (0.051) | (0.039) | (0.051) | (0.038) | (0.051) | (0.038) | (0.051) |
| YEAR_2015 | -0.002 | -0.091 | 0.001 | -0.090 | 0.007 | -0.090 | 0.009 | -0.091* |
| | (0.040) | (0.056) | (0.040) | (0.056) | (0.039) | (0.056) | (0.039) | (0.055) |

| Variables | (1) IDIORISK | (2) SYSTEM_ES | (3) IDIORISK | (4) SYSTEM_ES | (5) IDIORISK | (6) SYSTEM_ES | (7) IDIORISK | (8) SYSTEM_ES |
|---|---|---|---|---|---|---|---|---|
| YEAR_2016 | -0.003 | | -0.001 | | 0.005 | | 0.007 | |
| | (0.040) | | (0.040) | | (0.039) | | (0.039) | |
| Intercept | 0.380*** | 3.297*** | 0.376*** | 3.279*** | 0.375*** | 3.268*** | 0.377*** | 3.291*** |
| | (0.053) | (0.167) | (0.052) | (0.166) | (0.052) | (0.164) | (0.052) | (0.164) |
| Industry Fixed Effects | Yes | Yes | Yes | Yes | Yes | Yes | Yes | Yes |
| Adjusted $R^2$ | 6.80% | 5.15% | 6.80% | 5.15% | 6.80% | 5.15% | 6.70% | 5.15% |
| N | 4,382 | 3,041 | 4,382 | 3,041 | 4,382 | 3,041 | 4,382 | 3,041 |

*Note.* This table reports estimation from OLS. For columns 1, 3, 5, and 7, *IDIORISK* is the dependent variable and is defined as the average residual return in the first quintile (dividing the daily return distribution into five groups) from the market model. I focused on the returns from the lowest 20%. For columns 2, 4, 6, and 8, *SYSTEM_ES* is the dependent variable and is defined as the average predicted return in the first quintile (dividing the daily return distribution into five groups) from the market model. I focused on the returns from the lowest 20%. *COMP*, *CEO_TENURE*, and *FIRST_YEAR* are the independent variables. All variable definitions are provided in Table 1. I used both industry and year fixed effects. I clustered standard errors by the firm identification number (Gvkey). Robust standard errors were computed using the Huber-White-Sandwich estimator of variance by clustering on the firm level. *t*-values are reported in the parentheses. ***, **, * represent 1%, 5%, and 10% statistical significance, respectively.

**Robustness Tests**

**Industry Concentration**

I considered the impact that a fiercely competitive industry could have on firms in my study and particularly on those firms that are poor performers. After all, one could expect the market to penalize firms in highly competitive industries more harshly than firms in industries with lower competition since high competition often equates to little room for errors or poor operating decisions. However, when I ran tests to divide my population by the Herfindahl-Hirschman index, I found my results are not driven by the degree of industry concentration.

**Firm Size**

Larger firms could be better positioned to absorb market penalties for firm-specific risks and could have more cushion to protect them in the event of significant market volatility. Thus, I considered whether the firm's size was impacting my results. I ran tests dividing my population into percentiles of 20 and 10, and I found my research results were not driven by the firm's size.

**Estimation of Standard Errors**

The OLS standard errors may be biased when the residuals are correlated. Thus, I calculated the robust standard errors for the coefficients in the idiosyncratic and systematic risk models. I used the Huber-White-Sandwich estimator of variance by clustering at the firm level. I clustered the standard errors by the firm identification number, the Gvkey.

**Conclusion**

According to the UET, executive leadership's core ideologies are reflected in the firm, resulting in the firm operating according to the executive leader's values. Prior studies have shown differences in risk tolerances and risk management decisions for CEOs given the CEO's

political ideology. My research adds to the literature by combining the analysis of impact from systematic and idiosyncratic risk with the political ideals of the CEO. By assessing both declining and increasing levels of risk in the same study, I provide robust evidence on wealth effects for firms with Republican CEOs. I also contribute to the growing stream of research on how upper management's personal political ideals impact firm performance (Christensen et al., 2015; Hambrick & Mason, 1984). Finally, my research provides a new perspective on the UET since I used the UET to identify and explain the key drivers behind movements in systematic and idiosyncratic risks.

I found that there was a negative and statistically significant relationship between Republican CEOs and systematic risk, which suggests Republican CEOs effectively mitigate firm exposure to systematic risk. Firm size and firm EBIT were also statistically significant and negatively related to systematic risk, so, not surprisingly, larger firms with strong earnings are less impacted by volatility due to systematic risk compared to smaller firms with weak earnings. I also found the CEO's compensation was statistically significant and had an inverse relationship with both idiosyncratic and systematic risk. This result is particularly interesting since it is the only variable in my study that showed significance across both risk types. Clearly, the CEO's compensation is an important factor for firms seeking to manage risk from the market or from unique firm characteristics. Therefore, firms should be incentivized to maintain competitive CEO compensation packages; otherwise, firms risk losing CEOs who are effective risk managers to the competition. Often, higher compensation is closely linked to more experience. My research found CEOs with more experience are more effective at mitigating systematic risk than less experienced CEOs. Thus, when selecting a new CEO, firms should be selective and ensure that the individual selected has the right balance of experience and compensation expectations. Finally, the market

seems to recognize when a CEO is in his or her first year on the job, and the market is not as harsh towards the new CEO compared to the seasoned ones. Perhaps a possible explanation for this is that whenever a firm experiences CEO turnover, the idiosyncratic risk rises, but getting rid of a CEO who was a poor risk manager would be viewed favorably by the market; thus, the new CEO has the market's optimism, at least initially.

It is important to note that while my paper provides evidence that in certain situations the firm senior management and board may be incentivized to retain a Republican as the CEO, there are also situations where a Republican would not be well suited to be the firm CEO. Anecdotal evidence suggests that many firm CEOs are in fact Democrats, and while it is beyond the scope of my research, there are certain situations where firms would be incentivized to retain a Democrat CEO. For instance, a study by Hong and Kostovetsky (2012) observed that Democrat mutual fund managers prioritized investing in socially responsible firms (i.e., having little to no environmental violations) rather than prioritizing the overall firm performance. This suggests the Democrat mutual fund manager applies his or her personal values and beliefs to the investment methodology he or she applies.

While the results of my study could be generalized for application to small or mid-size U.S. firms, it would be interesting to understand the statistically significant differences between large and small firms. Another possible area of future analysis is to assess alternative definitions of Republican CEOs, which could include an assessment of CEOs who contributed just over the $200 reportable threshold to the ones who donated $2,000 to a single campaign. This could help interpret if more moderately conservative CEOs (those who donate $200 to a Republican campaign) have statistically significant differences to those CEOs who contribute $2,000. Future research could analyze additional CEO traits that have an impact on the firm's exposure to

idiosyncratic and systematic risk.  These attributes could provide additional understanding of the CEO's influence over the firm.

My proxy for measuring CEO political ideology may instead be a more accurate depiction of CEO political connectedness whereby CEOs seek to establish and take advantage of networking opportunities with political figures.  Still, previous research by Hutton et al. (2014) showed the proxy is a valid measure and that most political contributions in fact represent the CEO's political ideals.  Additionally, my analysis may suffer from a correlated omitted variable issue.  To remedy this, I included industry and year fixed effects in all my models, and I validated the results by examining whether changes in political tone at the top related to changes in systematic risk.  Finally, the firms in my study are all U.S. firms and the degree of conservatism is based on the U.S. political landscape, so my study is not generalizable outside of the United States.

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CEO POLITICAL IDEOLOGY: DIFFERENCES IN STOCK MARKET REWARDS

ALECIA J. REINHARDT

Dr. Bakhtear Talukdar and Dr. Avishek Bhandari, Dissertation Chairs

ABSTRACT

This paper examines whether a CEO's personal political ideology explains firm wealth effects from a new product announcement.  First, I investigated whether the CEO's political ideology impacts the stock market reaction to new product announcements.  I provide evidence that Republican CEOs are associated with stronger positive stock market reaction to new product announcements compared to the market reaction to new product announcements by Democrat CEOs.  Second, I researched the beneficial effects of the Republican CEO to new product introductions in competitive markets, and I found the positive effects are increasing in the degree of firm competition.

In summary, the evidence implies that the conservative ideologies associated with a Republican CEO translate into overall positive or less negative wealth effects for the firm and that the investors view political ideology as an important determinant of shareholders' wealth creation.

CEO Political Ideology: Differences in Stock Market Rewards

Existing research has devoted much attention to understanding how the CEO influences and affects the firm's performance. In particular, there is a growing body of literature supporting the concept of how the personal values and political ideologies of business managers (CEOs in particular) partially explain firm performance (Campbell, Notbohm, Smedema, & Zhang, 2018). Another expansive body of research has reviewed the impacts from new product announcements on stock prices in the United States and abroad (Chaney & Devinney, 1992; Chaney, Devinney, & Winer, 1991; L.-Y. Chen, Lai, & Chang, 2017; S.-S. Chen, Lin, & Tsai, 2018). Using the existing literature, I investigated whether the stock market may be inclined to react more positively to Republican CEOs than Democrat CEOs when new product announcements are made.

The theory of behavioral consistency (TBC) rationalizes that each individual behaves consistent with his or her personal preferences and beliefs (D. Jiang, Kumara, & Law, 2015). Operating on this premise, Funder and Colvin (1991) found people exhibit preferred behavioral styles across different situations. I extrapolated these concepts for my research to suggest that personal beliefs and preferences can be extracted from political campaign contribution information to indicate if a CEO is more conservative (Republican) or less conservative (Democrat). This information is important to shareholders in particular because, as TBC notes, the CEO tends to make decisions for the firm based on his or her political ideologies (D. Jiang, Kumara, & Law, 2015).

The upper echelons theory (UET) states the same personal beliefs of management executives are often present in the firm(s) they lead (Hambrick & Mason, 1984). Using UET, I propose Republican CEOs conservatively manage their firms by accepting fewer excess risks

and always seeking to reduce risk exposure.  I suggest the stock market rewards these CEOs because market investors perceive less volatility in the stock.  Conversely, I propose Democrat CEOs manage their firms with less conservatism and accept more excess risks.  I suggest stock market investors punish these CEOs because investors perceive higher risk-taking and more volatility in the stock.  Therefore, the UET provides an explanation as to why there are significant differences in the cumulative abnormal return (CAR) for a Republican CEO versus a Democrat CEO when given the same scenario (i.e., a new product announcement).

Motivated by these theories, I examined whether the CEOs' political ideology impacts the market reaction to new product announcements, building upon research by Elnahas and Dongnyoung (2017), which states Republican CEOs manage their firms under more conservative corporate policies compared to Democrat CEOs.  I measured the stock market reward based on observed changes to the CAR of the stock for specific significant event windows ranging from three days prior (-3 days) to the announcement of a new product to two days after (+2 days) the announcement.  Based on my research of the TBC and UET, I expected the CAR results to exhibit differences for new product announcements made by Republican CEOs versus announcements made by Democrat CEOs.

Other research have supported the concept that CEOs differ in their personal risk tolerances and risk management decisions and that these decisions align to the CEO's political ideology.  For example, Graham, Hanlon, Shevlin, and Shroff (2014) found 70% of tax executives rank reputation risk as very important to firm management when deciding not to engage in certain tax planning strategies.  In addition, Hasan, Hoi, Wu, and Zhang (2014) noted banks perceive corporate tax avoidance as risky behavior, and as a result, the banks charge higher loan rates to firms that exhibit tax avoidance activities.  Finally, Francis, Hasan, Sun, and

Wu (2016) concluded Republican CEOs utilize tax sheltering strategies more often than Democrat CEOs. These strategies to reduce the firm's tax liability raise the risk around management's reputation, which could in turn lead to changes in the market's interpretation of the CEO's risk acceptance. In the case of tax planning strategies, these studies have suggested the Republican CEO may be more willing to accept increased reputation risk in order to reduce tax liability (Francis et al., 2016). Thus, the relationship between CEO political ideology and wealth effects to new product announcements remains an empirical question that I attempted to answer in this study.

I measured CEO political ideologies by reviewing each CEO's monetary contributions to Republican or Democrat parties for political campaigns and for candidates running for office in the House, Senate, or for the Presidency. I obtained CEO information from ExecuComp and tied it to individual political contribution data from the Federal Election Commission (FEC). My period of election cycles under review was from 2003 to 2016. I selected this period to remove potential data biases from major events such as the 9/11 terror attacks and the passage of the Sarbanes-Oxley Act and to ensure a sufficient body of sample results were available to review. The FEC data was matched with data from ExecuComp, using donor occupations and CEO names. I obtained additional financial information from the Center for Research in Securities Prices (CRSP) and Compustat databases.

An understanding of how and whether the market reacts differently to news of new products given the CEO's political ideology could prove beneficial for shareholders, especially those who are among the first to react to the new product announcements. Additionally, this knowledge benefits senior management and the board because it provides pertinent information

about an individual CEO's level of risk aversion versus risk acceptance so that the board and senior management can ensure they select a CEO with risk tolerances similar to their own.

This study provides several significant contributions to the existing literature. First, my research contributes to a growing stream of research that investigates how executive management's personal political ideologies influence the performance of the firm (Hambrick & Mason, 1984). I show there are different impacts for the market reaction to the new product announcement depending on the partisan association of the CEO's ideologies. My research also adds to Lin and Chang's (2012) study, which explored the influence of corporate governance on new product strategies for firms. I add to Lin and Chang's (2012) study by incorporating a new variable, CEO political ideology, to offer further explanation on the influence from the CEO on new product strategies and the impact this has on firm wealth effects. Additionally, this provides an interesting area of future research to understand how the CEO's political ideology may impact corporate governance mechanisms. Hendricks and Singhal (1997) concluded there is a negative impact on the firm from delays in new product announcements. My research contributes to this literature by adding a moderating element to these results and showing how the market rewards Republican CEOs more than Democrat CEOs when new products are announced. While other studies have documented the impact of CEO political ideologies on firm debt leverage levels and tax avoidance (Cronqvist, Makhija, & Yonker, 2012; Hutton, Jiang, & Kumar, 2014), the impact of political ideology on market reaction to new product announcements has not received much coverage by researchers.

Finally, my research contributes to the body of research around TBC and UET by adding a new perspective to these theories. I interpreted these theories to explain what motivates the stock market to react differently to CEOs for new product announcements. Unlike most previous

studies, I focused on explaining the CEO's personal values and ideologies through his or her political ideologies. My research shows the market reacts differently to the same positive new product events depending upon the CEO's political ideologies. This could be explained in part by the fact the market assumes actions taken by a Republican CEO are more conservative than those taken by a Democrat CEO so that when a Republican CEO announces there will be a new product, the market interprets the pursuit of the new product as an effort to expand the business with careful consideration of market risk.

The rest of my paper is organized as follows. The next section discusses the prior literature and develops my hypotheses. The following section presents the development of my research design. The next section provides my sample selection and empirical results. The last section discusses my additional analyses and Section 6 concludes.

## Literature Review and Hypotheses Development

### Theory of Behavioral Consistency

The TBC states personality remains largely unchanged over time and impacts how individuals respond to various situations (Campbell et al., 2018; Mischel & Peake, 1982, 1983). The TBC also notes the important role that personal values have in influencing an individual's decisions (Cronqvist et al., 2012; Hutton et al. 2014; D. Jiang et al., 2015). Mischel and Peake (1982, 1983) concluded that individual traits (such as personality and beliefs) are temporally stable, and the traits strongly influence the individual's behavior given a number of different scenarios. Additionally, personal values form for most people at a young age and remain largely unchanged throughout the course of one's life (Burton, 1963). Furthermore, D. Jiang et al. (2015) observed that forecast movements and stock buy/sell/hold recommendations from analysts are more conservative in nature for analysts who contribute to the Republican party.

Therefore, the values, beliefs, and personality of an individual are reliable proxies for how that person will behave in various situations and play a large role in the decisions that person makes (Hu, Jiang, & Lee, 2013). From this review, I concluded differences in individual ideologies will lead to different individual behaviors. As I discuss in the following paragraphs, personal ideologies tend to align with political allegiances, which indicate an individual's comfort with risk (i.e., risk oriented versus risk averse).

**Upper Echelons Theory**

The UET explains the role that personal values, ideologies, and beliefs of the executive leadership team have in affecting the firm's performance (Christensen, Dhaliwal, Boivie, & Graffin, 2015; Hambrick, 2007; Hambrick & Mason, 1984). In particular, the UET posits that core ideologies and values of the executive leadership are readily observable in the firm, and hence, the firm operates in a manner that is consistent with the beliefs of its executive leaders (Hambrick & Mason, 1984). This is the result of executive managers being unable to detach themselves from their personal beliefs when making decisions for the firm (Hambrick, 2007). The UET defines firm decisions as any executive management decision that impacts firm operations (Hambrick & Mason, 1984). Specifically, Cronqvist et al. (2012) found the CEO's personal beliefs regarding debt influence the firm's leverage levels, and the CEO's influence is greater when overall corporate governance is weaker. For example, if a CEO is unwilling to accept high debt levels personally, according to the UET, he or she will force the firm to also maintain low debt. Georgakakis, Greve and Ruigrok (2017) provided further support for the UET and noted firm strategic leadership is a shared activity between the CEO and the top management team (TMT). Furthermore, Georgakakis et al. (2017) observed that understanding the complex relationship between the CEO and the TMT is critical in understanding and

predicting expected firm behavior.  Georgakakis et al. (2017) found firm performance is impacted by the quality of the relationship between the CEO and the TMT, which is improved by the CEO sharing similar beliefs and experiences with the TMT.  Conversely, the positive firm impacts gained from the strategic relationship between the CEO and the TMT are strained when ideologies, values, and experiences of each do not align (Sorescu, Shankar, & Kushwaha, 2007; Warren & Sorescu, 2017).

Previous research has provided support for partisan differences in firm operating decisions such as tax sheltering, debt levels, and research and development (R&D) investment (Graham et al., 2014).  Additionally, Jost (2006) concluded most people align their personal beliefs with ideologies of either the Republican or Democrat party, while a minority fall in the middle and even fewer claim to have no opinion at all.  Hutton et al. (2014) and Elnahas and Dongnyoung (2017) found Republican managers are more likely to be conservative in their approach to corporate policies in general, including: corporate debt, R&D expenses, and capital investments.  Hutton et al. (2014) concluded the firms under the leadership of conservative managers have lower leverage levels and spend less on R&D compared to firms led by less conservative managers.  This research also documented Republican managers achieve greater profitability compared to non-Republican managers (Hutton et al., 2014).  In addition, according to Kashmiri and Mahajan (2017), Democrat CEOs tend to accept riskier investments in new product introductions compared to Republican CEOs.

Other research has shown auditors perceive Republican CEOs as having lower inherent and control risks, whereas Democrat CEOs are viewed as having higher levels of risk (Hutton et al., 2014).  According to Bhandari, Golden and Thevenot (2020), auditors base pricing decisions, in part, on two aspects of audit risk: inherent risk and control effectiveness.  Bhandari et al.

(2020) provided evidence that CEO political ideology influences auditors' perceptions towards the firm, and incidentally, auditors charge lower audit fees to clients with Republican CEOs than to clients with Democrat CEOs.

Finally, a growing body of research has covered how the personal ideologies of managers impact firm financials and disclosures. Campbell et al. (2018) revealed that conservative managers have fewer restatements of financials compared to non-conservative managers. Additionally, Bamber, Jiang, and Wang (2010) concluded financial disclosures of firms are impacted by the manager's age, career, educational background, and military service, all of which would align with the manager's personal ideals. Finally, G. Jiang, Lee, and Zhang (2005) found conservative managers make more conservative financial forecasts for their firms compared to less conservative managers.

All of these studies follow along the same theme that Republican CEOs tend to have conservative personal values and ideologies whereas Democrat CEOs tend to have less conservative values and ideologies. They also show support for the notion that the conservative ideologies of Republican CEOs translate into risk-averse behavior. Additionally, the studies discussed previously support the conclusion that personal ideologies and values of the CEO partially influence the firm's performance, balance sheet structure, investment philosophy, and overall operations, such that a Republican (i.e., conservative) CEO would take strides to make the firm more risk averse, whereas a Democrat (i.e., liberal) CEO would accept more risk for the firm and make riskier investments. The ideologies of the top managers, namely the CEO, are important for my research because the CEO is the most powerful and visible person in the executive team and has strong influence on the overall corporate decision-making process (Hambrick, 2007).

Relying on TBC and UET, I expected the CEOs' political ideologies to affect his or her decision making for the firm and to impact the investors' perceptions of the firm. Specifically, I expected the stock market to interpret actions taken by Republican CEOs as being more risk averse and conservative. Therefore, when a Republican CEO announces the firm is launching a new product, the stock market interprets the news release as thoroughly researched and vetted (Bhandari et al., 2020; Bhandari & Javakhadze 2017; Campbell et al., 2018; Hutton et al., 2014). In addition, the stock market may also presume the Republican CEO avoids making any such announcement until he or she is certain the new product will launch on time and will be successful. This leads to my first hypothesis:

$H_1$: The positive stock market reaction to the new product introductions increases in the

degree of CEO conservatism.

Adams, Almeida, and Ferreira (2005) found that firm performance varies more as the CEO is able to exert more control over critical firm decisions. Extrapolating from this finding, I argue the CEO is central to influencing the firm's performance. This is important for my research because firms operating in highly competitive environments face more pressure to make decisions that improve profit 100% of the time, because competitors are constantly ready to capitalize on the missed opportunities of another firm. However, firms in low competition environments enjoy more flexibility in making decisions that result in a loss or missing a competitive opportunity because there are few if any competitors ready or able to capitalize on the missed opportunity. The success of firms in competitive markets often comes down to the wise investment choices of firm management, especially the CEO. I anticipated the influence of a conservative (Republican) CEO to be more important for firms in highly competitive environments because these firms are under more pressure to appropriately vet and thoroughly

research new products before launch.  Additionally, the market is full of savvy investors who

recognize when firms are positioned in high or low competition markets and investors also

monitor when a firm decides to capitalize on an opportunity or when it misses one.  The market

savvy investors respond to these firm decisions accordingly.  Based on this knowledge, I suggest

that as firm competition increases, the beneficial effects of having a risk-averse CEO (i.e., a

Republican) increase for new product introductions.  Given this information, I propose the

following hypothesis.

> $H_2$: The beneficial effect of the Republican CEOs (i.e., increasing positive stock market
>
> reaction) to the new product introductions increases in the degree of the firm competition.

## Research Design

Since my research focuses on measuring the impact of a company-specific event (i.e.,

new product announcement), I performed an event study (Fama & Macbeth, 1973; Mann &

Babbar, 2017a).  The premise of my event study is that abnormal returns result from the release

of unanticipated information to the market that conveys a message about the firm.  The market's

interpretation of the message results in an impact to the firm's stock price.  I adhered to the event

study method developed by Mcwilliams and Siegel (1997) to measure the impact on stock prices

from an unexpected event. (Hao, Dixon, & Wang, 2017; Mann & Babbar, 2017b).

In this section, I present my research design.  First, I discuss how I captured the key

construct in my study, the CEO's political ideology.  Second, I define how I measured new

product announcements.  Third, I define how I measured the CAR in the stock price.  Fourth, I

discuss how I operationalized firm competition and uncertainty.  Finally, I present the models

used to test my hypotheses on the market reaction to the new product announcements.

**CEO Political Ideology**

I determined CEO political ideology by reviewing the CEO's partisan affiliation (Republican or Democrat), which is in accordance with previous research by Bhandari et al. (2020), Elnahas and Dongnyoung (2017), Hong and Kostovetsky (2012), and Hutton et al. (2014). I assessed the CEO's political ideology by reviewing each CEOs' monetary contributions to political campaigns for Republican and Democrat Senate, House, and Presidential candidates. My study used the FEC's website to obtain CEO political contribution data, which provides details about the identities of political donors and donees, contributions (in dollars), and statistics for aggregated contributions (Bhandari et al., 2020). In accordance with the method employed by Bhandari et al. (2020), Cooper, Gulen, and Ovtchinnikov (2017), Francis et al. (2016), and Hutton et al. (2014), I used CEO information from ExecuComp to build a database on CEO political contributions data. I then matched the ExecuComp data to the FEC data using the donors' occupations and names. I applied an indicator variable of 1 if a CEO is conservative (i.e., donated to a Republican campaign) and 0 if the CEO is liberal (i.e., donated to a Democrat campaign).

**New Product Announcement**

Similar to research done by Lin and Chang (2012), I collected data on new product announcements from firms on the New York Stock Exchange (NYSE) or the American Stock Exchange (AMEX) from 2003 to 2016. The starting point of 2003 was selected because I wanted to capture effects from the year prior to a major election year, and 2004 was a major election year given there was a presidential election that year. I selected 2016 as my end point because it is the most recent year where a major election took place and because firm information is readily available for the entire year. I used the following keywords in the

ProQuest database to determine information on new product announcements: "product

announc*," "new product*," "product launch*," "product introduc*," "introduce product*". I

lined up all announcements for new products with the firm making the announcement. Refer to

Appendix A for the full listing of keyword search terms used in conducting my analysis.

I applied several constraints to ensure my sample information was not misleading. First,

I confirmed the firm making the announcement was listed in the CRSP database. Second, I

removed from analysis any new product announcement that was unofficially released (i.e.,

leaked) within 12 months of the official announcement date to ensure my results were not

skewed by leaked information. Third, I excluded significant announcements (i.e., earnings,

dividends, merger announcements) released five days prior to or five days after the new product

announcement date to eliminate biases in the data from these other announcements. Lastly, I

excluded announcements made by firms where there was no information readily available on the

CEO's political ideology.

**Cumulative Abnormal Return**

I measured the stock market reward in terms of the CAR. Day 0 serves as the date of the

announcement (for a new product). My estimation period expanded on the period used by Lin

and Chang (2012), which was from 200 to 60 days prior to the announcement date. I calculated

the abnormal returns for each firm making an announcement from three days prior to and two

days after the announcement date. To obtain a measurement of the effect on the firm from new

product introductions, I calculated a two-day period of abnormal returns by adding the abnormal

returns for the announcement day with returns for one day prior (Lin & Chang, 2012). The day

prior to the announcement is identified as -1 day and the day after the announcement is identified

as +1 day.

**Firm Competition**

I operationalized the construct of firm competition by using the Herfindahl-Hirschman index (HHI) as a measure of the degree of competition within a market because it provides an effective measure of market concentration.  The Federal Reserve Bank (the Fed) uses the HHI to analyze impacts on industry competition as a result of mergers (Rhoades, 1993).  The Fed uses this analysis to determine whether it will support a new merger or if the effects from the merger will reduce competition below acceptable levels.  On page 8, Rhoades (1993) notes the HHI is calculated by "squaring the market shares of all firms in a market and then summing the squares".

**Market Reaction and Empirical Models**

My hypotheses consider the impact of the CEO's political ideology on the firm's CAR given a new product announcement.  Previous research has considered the importance of a new product announcement and the impact that event has on a firm's CAR.  For instance, Mann and Babbar (2017a) concluded firms experience positive effects on share prices and abnormal stock market returns.  In their research, Mann and Babbar (2017a) measured the effects on the firm's CAR; hence, my research also evaluates this measure.  To conduct the analysis of the CAR, I used the single index model (i.e., market model) introduced by Sharpe (1963) and also used by Mann and Babbar (2017a).  This model calculates an asset return based on a constant and a market portfolio return.  Before I tested my hypotheses, I first determined the CARs and the significance of the CARs.  To do this, I started with estimating Equation 1.

$$R_{IT} = \beta_0 + \beta_1 R_{MT} + \varepsilon_{IT} \tag{1}$$

where $R_{IT}$ represents the return of a given stock $I$ on day $T$, $R_{MT}$ refers to the return on a market

portfolio for a given day $T$, and $\mathcal{E}_{IT}$ is the error term for a stock $I$ on day 0. I then used Equation

2 to calculate the abnormal returns as follows:

$$AR = R_{IT} - \check{R}_{IT} \tag{2}$$

where $AR$ represents the abnormal return for a stock $I$ on day $T$. $R_{IT}$ refers to the realized post-

event return of a stock $I$ on day $T$. $\check{R}_{IT}$ represents the expected return of the same stock on the

same event day.

Next, Equation 3 determines the CAR for a given time interval of $T_1$ to $T_N$ and is

calculated as follows:

$$CARs = \sum_{N}^{TN} AR \tag{3}$$

where $AR$ is the abnormal daily return on day $T$; $\sum AR$ is the sum of abnormal returns of the firms

within the sample, and $N$ is the number of companies. The CARs are calculated by summing all

abnormal daily returns over various time intervals.

Finally, I determined the significance of the CARs using the calculation in Equation 4:

$$\left( \frac{\sum_{N}^{TN} AR}{\partial AR(T)} \right) \text{ x } \sqrt{N} \tag{4}$$

where $AR$ is the abnormal return of all stocks from day $T$ to day $T_N$, $\partial AR(T)$ represents the

standard deviation of $AR$ over an estimated time period, and $N$ is the number of days that $AR$ is

cumulated.

I controlled for Tobin's Q, which previous research has noted to be significant and a

strong proxy for a firm's perceived investment and growth opportunities (Lin & Chang, 2012;

Mann & Babbar, 2017b). Additionally, Mann and Babbar (2017b) and Lin and Chang (2012) agreed that firm size and the level of debt leverage are significant in determining stock market value.

To test my hypotheses $H_1$ and $H_2$, I used the following models, which depict the moderating effects of CEO political ideology on the CAR when a new product is announced. $REP\_DUM$ has a value of 1 if a CEO contributes more to Republican candidates than Democrat ones during his or her tenure and the total donations are greater than \$2,000 and 0 otherwise (Elnahas & Dongnyoung, 2017; Hutton et al., 2014). I expected the coefficient $REP\_DUM$ to have a positive sign due to the market reacting more positively to the new product news from a Republican CEO compared to a Democrat CEO. I used the model in Equation 5 to test $H_1$ by controlling for firm characteristics that have been shown in the literature to affect the CAR (Bhandari et al., 2020; Christensen et al., 2015; Elnahas & Dongnyoung, 2017; Hutton et al., 2014; Lin & Chang, 2012; Mann & Babbar, 2017a).

$$CAR_{(-2,+2)} = \eta_0 + \eta_1 REP\_DUM + \eta_2 SIZE + \eta_3 LEV + \eta_4 TOBINSQ + \eta_5 R\&D + \eta_6 HHI +$$

$$\eta_7 ROA + \eta_8 LOSS + \eta_9 FOROPS + \eta_{10} MB + \eta_{11} FIRMAGE + \eta_{12} SALEGR \qquad (5)$$

where $CAR_{(-2,\_2)}$ represents the announcement period abnormal returns for a firm announcing a new product from two days before the announcement (-2) to two days after the new product announcement (+2); $REP\_DUM$ is represented as defined above; $SIZE$ refers to the natural logarithm of firm total assets; $LEV$ is the ratio of total liabilities divided by total assets; $TOBINSQ$ refers to Tobin's Q, which is the ratio of market to book value of firm assets, and it serves as a proxy for firm investment and growth opportunities; $R\&D$ is the firm's R&D intensity; $HHI$ refers to the Herfindahl-Hirschman Index, which serves as a proxy for the level of firm competition; $ROA$ refers to the return on assets calculated as income before extraordinary

items divided by total assets; *LOSS* refers to the income before interest, taxes, and amortization;

*FOROPS* refers to the firm's foreign operations as indicated by the foreign currency adjustments

to income; *MB* refers to market to book ratio, calculated as market value of equity divided by

book value of equity; *FIRMAGE* refers to the natural logarithm of the number of fiscal years

since a firm was included in the CRSP; and *SALEGR* refers the growth rate in sales over the

previous two years.

In Equation 6, I tested $H_1$ using additional controls. More specifically, I controlled for

firm and CEO characteristics: *GENDER*, *CEOAGE*, and *COMP*. The control variables for CEO

gender (*GENDER*), age (*CEOAGE*), and compensation (*COMP*) were included in a study by

Bhandari et al. (2020) on the impact of CEO political ideology on contracts with external

auditors.

$$CAR_{(-2,+2)} = \eta_0 + \eta_1 REP\_DUM + \eta_2 SIZE + \eta_3 LEV + \eta_4 TOBINSQ + \eta_5 R\&D + \eta_6 HHI +$$

$$\eta_7 GENDER + \eta_8 CEOAGE + \eta_9 COMP + \eta_{10} ROA + \eta_{11} LOSS + \eta_{12} FOROPS + \eta_{13} MB$$

$$+ \eta_{14} FIRMAGE + \eta_{15} SALEGR \tag{6}$$

where additional control variables include *GENDER*, *CEOAGE*, and *COMP*. The indicator

variable *GENDER* is equal to 1 if the CEO is male and 0 otherwise; *CEOAGE* refers to the

natural logarithm of the current age of a CEO; *COMP* refers to the natural logarithm of the total

compensation, including bonus, of a CEO. Other variables are defined in Equation 5.

To test hypothesis $H_2$, I used the model in Equation 7.

$$CAR_{(-2,+2)} = \eta_0 + \eta_1 REP\_DUM + \eta_2 SIZE + \eta_3 LEV + \eta_4 TOBINSQ + \eta_5 R\&D + \eta_6 HHI +$$

$$\eta_7 ROA + \eta_8 LOSS + \eta_9 FOROPS + \eta_{10} MB + \eta_{11} FIRMAGE + \eta_{12} SALEGR +$$

$$\eta_{13} REP\_DUM*HHI \tag{7}$$

where $CAR_{(-2+2)}$ refers to the announcement period abnormal returns two days prior to the new product being announced to two days after the new product is announced. *REP_DUM* and *HHI* are previously defined. The main independent variable of interest is the interaction between the Republican CEO and the level of firm competition (*REP_DUM\*HHI*). A positive coefficient on *REP_DUM\*HHI* indicates that the beneficial effect of the Republican CEOs to the new product introductions is increasing in the degree of firm competition, thereby confirming $H_2$.

Finally, I tested hypothesis $H_2$ using Equations 8, 9, and 10. I performed a cross-sectional analysis test by interacting *REP_DUM* and *HHI*. A positive and significant coefficient on this interaction term supports hypothesis $H_2$.

Furthermore, I controlled for the following additional variables to generate Equations 8, 9, and 10: *ROA*, *LOSS*, *FOROPS*, *MB*, *FIRMAGE*, and *SALEGR* (all defined in Appendix B).

$$CAR_{(-1,+1)} = \eta_0 + \eta_1 REP\_DUM + \eta_2 SIZE + \eta_3 LEV + \eta_4 TOBINSQ + \eta_5 R\&D + \eta_6 HHI +$$
$$\eta_7 ROA + \eta_8 LOSS + \eta_9 FOROPS + \eta_{10} MB + \eta_{11} FIRMAGE + \eta_{12} SALEGR \qquad (8)$$

$$CAR_{(-2,+1)} = \eta_0 + \eta_1 REP\_DUM + \eta_2 SIZE + \eta_3 LEV + \eta_4 TOBINSQ + \eta_5 R\&D + \eta_6 HHI +$$
$$\eta_7 ROA + \eta_8 LOSS + \eta_9 FOROPS + \eta_{10} MB + \eta_{11} FIRMAGE + \eta_{12} SALEGR \qquad (9)$$

$$CAR_{(-3,+1)} = \eta_0 + \eta_1 REP\_DUM + \eta_2 SIZE + \eta_3 LEV + \eta_4 TOBINSQ + \eta_5 R\&D + \eta_6 HHI +$$
$$\eta_7 ROA + \eta_8 LOSS + \eta_9 FOROPS + \eta_{10} MB + \eta_{11} FIRMAGE + \eta_{12} SALEGR \qquad (10)$$

## Sample Selections and Empirical Results

**Sample Selection**

My sample included new product announcements made by firms from 2003 to 2016. I eliminated any duplicate announcements. I also eliminated missing or incomplete data for sample items. For determining the sample of CEO-specific data available for analysis, I leveraged sampling techniques utilized by Bhandari et al. (2020). I collected the names of firm-specific CEOs for new product samples using ExecComp. Then, I matched the CEO names with the names in the FEC data to collect the donations made by CEOs to the political parties. Finally, I matched my sample to the Compustat and CRSP databases to collect the necessary data for my study. After making the necessary adjustments, I observed a total of 1,429 new product announcements were made by firms from 2003 to 2016.

**Empirical Results**

Table 1 presents descriptive statistics for the variables used in my empirical analyses. The mean log of total assets was 8.126, which demonstrates that the sampled firms are large, and this is consistent with the fact that ExecuComp primarily includes larger firms. The descriptive statistics for the firm-specific and CEO-specific variables were consistent with the same variables reported in Bhandari et al. (2020). For instance, the mean CEO total compensation was 6.826, and firm ROA was 4.20%. An average of 3% of my sample reported a loss and an average debt leverage ratio of 58.5% of total assets. Approximately 30.3% of my sample firms maintain foreign operations and reported an average sales growth rate of 10.20%. Interestingly, I found that nearly two-thirds (58.7%) of the firms sampled had CEOs who contributed more to Republican campaigns than to Democrat ones during their tenure as CEO; however, only 24.2%

of the sampled firm CEOs contributed $2,000 or more to Republican campaigns during their tenure. This suggests that while more CEOs may be contributing to Republican campaigns versus Democrat ones, the contributions often do not approach or exceed $2,000; thus, I suggest that most CEOs contributing to Republican campaigns contribute more than $200 (the minimum threshold for reporting to the FEC) but less than $2,000 during their tenure. On a per election basis, I found that on average only about 6.8% of CEOs appear to be strongly conservative CEOs (*REP_DUM2*), that is, they contribute more to Republican campaigns than to Democrat ones and the contribution is more than $2,000 in each election cycle.

Table 1

*Descriptive Statistics*

| Variable | N | M | SD | Q1 | Median | Q3 |
|---|---|---|---|---|---|---|
| REP_DUM | 2,887 | 0.242 | 0.429 | 0.000 | 0.000 | 0.000 |
| REP_DUM2 | 2,887 | 0.068 | 0.252 | 0.000 | 0.000 | 0.000 |
| SIZE | 2,885 | 8.126 | 1.801 | 6.764 | 8.016 | 9.229 |
| LEV | 2,871 | 0.585 | 0.232 | 0.426 | 0.591 | 0.749 |
| TOBINSQ | 2,879 | 1.882 | 1.143 | 1.155 | 1.485 | 2.165 |
| R&D | 2,887 | 0.023 | 0.044 | 0.000 | 0.000 | 0.024 |
| HHI | 2,887 | 947.958 | 600.985 | 596.103 | 795.741 | 1086.125 |
| ROA | 2,885 | 0.042 | 0.076 | 0.014 | 0.041 | 0.077 |
| LOSS | 2,779 | 0.03 | 0.169 | 0.000 | 0.000 | 0.000 |
| FOROPS | 2,887 | 0.303 | 0.46 | 0.000 | 0.000 | 1.000 |
| MB | 2,879 | 0.493 | 0.397 | 0.252 | 0.433 | 0.657 |
| FIRMAGE | 2,887 | 2.893 | 0.904 | 2.352 | 2.971 | 3.606 |
| SALEGR | 2,881 | 0.102 | 0.21 | -0.005 | 0.069 | 0.167 |
| GENDER | 2,887 | 0.968 | 0.177 | 1.000 | 1.000 | 1.000 |
| CEOAGE | 2,856 | 4.018 | 0.136 | 3.932 | 4.025 | 4.111 |
| COMP | 2,877 | 6.826 | 1.202 | 6.516 | 6.848 | 7.177 |
| CAR(-1,+1) | 2,630 | 0.000 | 0.037 | -0.016 | 0.000 | 0.015 |
| CAR(-2,+1) | 2,630 | 0.000 | 0.042 | -0.019 | -0.001 | 0.017 |
| CAR(-2,+2) | 2,630 | 0.000 | 0.046 | -0.021 | -0.001 | 0.020 |
| CAR(-3,+1) | 2,630 | 0.000 | 0.047 | -0.020 | -0.001 | 0.019 |

*Note.* This table presents sample descriptive statistics for the final sample. All variables are defined in Appendix B. N is the number of observations. Mean is the average. SD is the standard deviation. Q1 refers to the 25th percentile. Median is the 50th percentile, and Q3 is the 75th percentile.

       The correlation matrix in Table 2 shows a statistically significant and positive relationship between the conservative CEO variable (which represents those CEOs who contribute more to Republicans than Democrats during their tenure and whose total donations exceed $2,000) and firm size, firm debt leverage, and the CEO's age.  The following variables had statistically significant and negative relationships with the conservative CEO variable (*REP_DUM*): the firm's level of R&D (*R&D*), firm EBITDA (*LOSS*), and the firm's sales growth (*SALEGR*).

Table 2

*Correlation Matrix*

| VARIABLES | CAR (-2,_2), REP_DUM | REP_DUM | SIZE | LEV | TOBINSQ | R&D | HHI | ROA | LOSS | FOROPS | MB | FIRM AGE | SALEGR |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| CAR (-2,+2) | 1.000 | | | | | | | | | | | | |
| REP_DUM | 0.0141 | 1.000 | | | | | | | | | | | |
| SIZE | -0.0022 | 0.2392* | 1.000 | | | | | | | | | | |
| LEV | 0.0156 | 0.0642* | 0.4687* | 1.000 | | | | | | | | | |
| TOBINSQ | -0.0177 | -0.0124 | -0.2963* | -0.2482* | 1.000 | | | | | | | | |
| R&D | -0.0458* | -0.1036* | -0.2906* | -0.2953* | 0.3041* | 1.000 | | | | | | | |
| HHI | -0.0275 | -0.0261 | -0.0819* | -0.0475* | 0.0348 | 0.0511* | 1.000 | | | | | | |
| ROA | 0.0376 | 0.0227 | -0.0396* | -0.2549* | 0.4350* | -0.1301* | -0.0011 | 1.000 | | | | | |
| LOSS | -0.0071 | -0.0446* | -0.1364* | 0.0063 | 0.0022 | 0.2537* | 0.0047 | -0.4907 | 1.000 | | | | |
| FOROPS | 0.0220 | -0.0354 | -0.0357 | -0.0936* | 0.0649* | 0.2134* | 0.1052* | -0.0229 | 0.0296 | 1.000 | | | |
| MB | 0.0226 | -0.0036 | 0.1193* | -0.1054* | -0.5405* | -0.1811* | -0.0559* | -0.2567* | 0.0831* | -0.1053* | 1.000 | | |
| FIRMAGE | -0.0235 | 0.0812* | 0.2743* | 0.0978* | -0.1637* | -0.0643* | 0.0098 | 0.0343 | -0.0555* | 0.0376* | 0.0169 | 1.000 | |
| SALEGR | 0.0279 | -0.0598* | -0.1032* | -0.1109* | 0.1637* | -0.0034 | -0.0405* | 0.1729* | -0.0728* | -0.0401* | -0.0686* | -0.2222* | 1.000 |

*Note.* This table presents the correlation statistics of the variables used in my study. All variables are defined in Appendix B.
$*p < 0.20$, $**p < 0.10$, and $***p < 0.02$..

To reduce concern on the possibility that firm-specific or CEO factors may be influencing the model results, I included several control variables and industry and year fixed effects in all models. Additionally, I winsorized all variables at 99% to limit the effect from outliers in my data. Table 3 depicts the results for a CEO who contributes more to Republican candidates than Democrat ones during his or her tenure and whose contributions total $2,000 or more. In Table 3, I controlled for the effects from certain firm-specific variables, including: *HHI*, *ROA*), foreign operations (*FOROPS*), and sales growth (*SALEGR*). I also held the CAR constant at -2 and +2 days. I drew on the results in Table 3 as evidence of the stock market's positive reaction to the new product announcement made by the Republican CEO. Table 3 provides support for $H_1$.

Table 3

*The Effect of Conservative CEOs on Stock Market Reaction to New Product Announcements*

| Variable | Coefficient |
|---|---|
| *REP_DUM* | 0.0033* |
| | (1.51) |
| *SIZE* | -0.0001 |
| | (-0.14) |
| *LEV* | 0.0065 |
| | (1.00) |
| *TOBINSQ* | -0.0009 |
| | (-0.68) |
| *R&D* | -0.0273 |
| | (-0.81) |
| *HHI* | -0.0001*** |
| | (-4.07) |
| *ROA* | 0.0394* |
| | (1.47) |
| *LOSS* | 0.0074 |
| | (0.82) |
| *FOROPS* | 0.0043** |
| | (2.03) |
| *MB* | 0.0041 |
| | (1.11) |
| *FIRMAGE* | -0.0014 |
| | (-1.18) |
| *SALEGR* | 0.0125** |
| | (2.08) |
| Intercept | 0.0300*** |
| | (3.04) |
| Industry Controls/Year Controls | Yes/Yes |
| Adjusted $R^2$ | 4.30% |
| N | 2526 |

*Note*. This table reports estimation from OLS. $CAR_{(-2,+2)}$ is the dependent variable and is the cumulative abnormal returns generated for each announcing firm over the period from 2 days before to 2 days after the new product announcement date. The independent variable is *REP_DUM*, which is calculated as 1 if a CEO contributes more to a Republican than a Democrat during his or her tenure and the total donations are greater than $2,000 and 0 otherwise. This is consistent with prior research by Hutton et al. (2014) and Elnahas & Dongnyoung (2017). I divided the HHI by 1,000 to make the coefficient visible. Variable definitions are provided in Appendix B. I used

both industry and year fixed effects.  I clustered *t*-values by the firm identification number (Gvkey); *t*-values are reported in the parentheses.
***, **, * represent 2%, 10%, and 20% statistical significance, respectively.

Table 4 depicts the regression results for the effect of conservative CEOs on stock market reaction to new product announcements with additional control for CEO characteristics. As discussed previously, the CEO is a key member of the upper management team who steers the firm in the direction they want the firm to go. Thus, a CEO's individual characteristics may have significant influence on firm performance and stock market reactions. Table 4 presents support for $H_1$ by showing that when the CAR is between two days prior to the new product announcement and two days after the announcement, the conservative CEO has a positive and significant relationship with the CAR. I interpreted these results to suggest that the stock market's positive reaction to new product introductions increases as the CEO's degree of conservatism increases. I also observed the coefficient for *COMP* was positive and significant, which indicates the CEO's compensation should be expected to be rising as the stock market reaction increases. Additionally, Table 4 shows the coefficient for *HHI* was negative and significant. I interpreted this result as indicative of the stock market reacting positively when new product introductions are made in low competition markets, and conversely, reacting negatively to new product introductions in high competition markets. Given that high competition markets mean there are many other substitute products available, it seems reasonable that the stock market reaction would favor new products being introduced to markets where few alternatives and substitute products exist.

Table 4

*CEO Characteristics as Additional Controls*

| Variable | Coefficient |
| --- | --- |
| *REP_DUM* | 0.0030* |
| | (1.37) |
| *SIZE* | -0.0001 |
| | (-0.19) |
| *LEV* | 0.0059 |
| | (0.91) |
| *TOBINSQ* | -0.0007 |
| | (-0.49) |
| *R&D* | -0.0276 |
| | (-0.82) |
| *HHI* | -0.0001*** |
| | (-3.98) |
| *GENDER* | 0.0065 |
| | (1.24) |
| *CEOAGE* | 0.0001 |
| | (0.001) |
| *COMP* | 0.0012** |
| | (1.65) |
| *ROA* | 0.0396* |
| | (1.43) |
| *LOSS* | 0.0084 |
| | (0.91) |
| *FOROPS* | 0.0047** |
| | (2.21) |
| *MB* | 0.0044 |
| | (1.19) |
| *FIRMAGE* | -0.0014 |
| | (-1.17) |
| *SALEGR* | 0.0139** |
| | (2.26) |
| Intercept | 0.0152 |
| | (0.52) |
| Industry Controls/Year Controls | Yes/Yes |
| Adjusted $R^2$ | 4.41% |
| *N* | 2498 |

*Note*. This table reports estimation from OLS. $CAR_{(-2,+2)}$ is the dependent variable and is the cumulative abnormal returns generated for each announcing firm over the period from 2 days before to 2 days after the new product announcement date. The independent variable is *REP_DUM*, which is calculated as 1 if a CEO contributes more to a Republican than a Democrat during his or her tenure and the total donations are greater than $2,000 and 0 otherwise. This is consistent with prior research by Hutton et al. (2014) and Elnahas & Dongnyoung (2017). I divided HHI by 1,000 to make the coefficient visible. I adjusted the coefficient for *CEOAGE* to the fourth decimal place. Variable definitions are provided in Appendix B. I used both industry and year fixed effects. I clustered *t*-values by the firm identification number (Gvkey); *t*-values are reported in the parentheses.
*p < .2, **p < .1, ***p < .02.

The results in Table 5 show support for $H_2$. In this analysis, I controlled for the following variables: firm size (*SIZE*), debt leverage (*LEV*), Tobin's Q, (*TOBINSQ*), R&D expenses (*R&D*), HHI (*HHI*), return on assets (*ROA*), EBITDA (*LOSS*), foreign operations (*FOROPS*), the ratio of market value to book value (*MB*), the natural logarithm of the number of fiscal years the firm has been included in the CRSP database (*FIRMAGE*), and sales growth (*SALEGR*). In this analysis, I held the CAR at -2 and +2 days. The main independent variable of interest is the interaction between the Republican CEO and the level of firm competition (*REP\*HHI*). A positive and significant coefficient on *REP_DUM\*HHI* indicates that the beneficial effect of the Republican CEOs to the new product introductions is increasing in the degree of the firm competition. This confirms $H_2$. The robust *t*-values are reported in parentheses for each variable. Interestingly, after controlling for the firm level competition, the coefficient on *REP_DUM* diminished to the point that it became negative and partially significant. This indicates the positive effect of conservative CEOs on the stock market reaction to the new product announcement disappears if we control for cross-sectional variation in competition.

Table 5

*Test for Hypothesis 2: The Moderating Effect of Firm Competition*

| Variable | Coefficient |
| --- | --- |
| REP_DUM | -0.0061* |
| | (-1.41) |
| SIZE | 0.0001 |
| | (-0.05) |
| LEV | 0.0060 |
| | -0.93 |
| TOBINSQ | -0.0011 |
| | (-0.77) |
| R&D | -0.0261 |
| | (-0.78) |
| HHI | -0.0001*** |
| | (-4.57) |
| ROA | 0.0415* |
| | (1.55) |
| LOSS | 0.0078 |
| | (0.87) |
| FOROPS | 0.0046** |
| | (2.20) |
| MB | 0.0037 |
| | (1.01) |
| FIRMAGE | -0.0016* |
| | (-1.33) |
| SALEGR | 0.0119** |
| | (2.00) |
| REP_DUM*HHI | 0.0101** |
| | (2.29) |
| Intercept | 0.0332*** |
| | (3.35) |
| Industry Controls/Year Controls | Yes/Yes |
| Adjusted $R^2$ | 4.53% |
| N | 2526 |

*Note*. This table reports estimation from OLS. $CAR_{(-2,+2)}$ is the dependent variable and is the cumulative abnormal returns generated for each announcing firm over the period from 2 days before to 2 days after the new product announcement date.  The independent variable of interest is an interaction term *REP_DUM*HHI*, where *REP_DUM* is equal to1 if a CEO contributes more to a Republican than a Democrat during his or her tenure and the total donations are greater than $2,000 and 0 otherwise.  HHI is calculated by summing the squares of the market shares

(in percentage) of each firm competing in each Fama-French 48 industry.  The measure was modified in a way that a higher value of HHI indicates higher competition.  I divided the HHI by 1,000 to make the coefficient visible. Variable definitions are provided in Appendix B.  I used both industry and year fixed effects.  I clustered $t$-values by the firm identification number (Gvkey); $t$-values are reported in the parentheses. ***, **, * represent 2%, 10%, and 20% statistical significance, respectively.

**Additional Analyses**

I ran additional models to assess alternative measures of the CAR and alternative measures of Republican CEOs. In Equation 11, I tested the impact on the CAR using an alternative measure for conservative CEOs, which is represented by *REP_DUM2*. The distinction between *REP_DUM* and *REP_DUM2* is that *REP_DUM2* only considers the CEO's political contributions for each election cycle and if the CEO's total donation was greater than $2,000. Thus, *REP_DUM2* represents CEOs who are strongly conservative since they contribute more than $2,000 in a single campaign to conservative candidates. The CEOs represented by *REP_DUM* include those who contribute more to Republican campaigns than Democrat ones during the course of their tenure where the contribution over the course of the CEO's tenure exceeds $2,000.

$$CAR_{(-2,+2)} = \eta_0 + \eta_1 REP\_DUM2 + \eta_2 SIZE + \eta_3 LEV + \eta_4 TOBINSQ + \eta_5 R\&D + \eta_6 HHI \quad (11)$$

where *REP_DUM2* is a CEO who contributes more to a Republican candidate than a Democrat one during each election cycle and the total donations are greater than $2,000. Other variables are defined previously.

In Equations 12, 13, and 14, I ran regressions using alternative measures for the CAR. In Equation 12, I defined the CAR as the period of abnormal returns from one day before the new product announcement to one day after the new product announcement. Thus, $CAR_{(-1,+1)}$ refers to the announcement period abnormal returns from one day before the new product announcement to one day after the new product is announced. The $CAR_{(-2,+1)}$ in Equation 13 refers to the announcement period abnormal returns from two days prior to the new product announcement to one day after the new product announcement. Similarly, $CAR_{(-3,+1)}$ in Equation 14 refers to the announcement period abnormal returns three days prior to the new product being

announced to one day after the new product is announced.  In all these equations, the variable

*REP_DUM* refers to a CEO who contributes more to Republican candidates than Democrat ones

during his or her tenure and the total donations are greater than $2,000 (Elnahas & Dongnyoung,

2017; Hutton et al., 2014).  Other control variables are defined previously.

$$CAR_{(-1,+1)} = \eta_0 + \eta_1 REP\_DUM + \eta_2 SIZE + \eta_3 LEV + \eta_4 TOBINSQ + \eta_5 R\&D + \eta_6 HHI \quad (12)$$

$$CAR_{(2,+1)} = \eta_0 + \eta_1 REP\_DUM + \eta_2 SIZE + \eta_3 LEV + \eta_4 TOBINSQ + \eta_5 R\&D + \eta_6 HHI \quad (13)$$

$$CAR_{(-3,+1)} = \eta_0 + \eta_1 REP\_DUM + \eta_2 SIZE + \eta_3 LEV + \eta_4 TOBINSQ + \eta_5 R\&D + \eta_6 HHI \quad (14)$$

Table 6 reports on the regression results given an alternative measure for Republican

CEOs.  I did this for the following reasons: a) over the course of a CEO's tenure, he or she may

end up contributing to political campaigns for both Republican and Democrat candidates; and b)

contributions exceeding $200 to political candidates are reportable to the FEC; thus, the more

funds a CEO contributes to a particular candidate, the more one could expect the CEO's beliefs

align with the candidate.  Prior studies have observed that conservative CEOs sometimes

contribute funds to political campaigns for less conservative (i.e., Democrat) candidates (Elnahas

& Dongnyoung, 2017; Hutton et al., 2014).  However, if the CEO's contributions are assessed

over time (i.e., over the duration of his or her tenure as CEO), it becomes clear that while the

CEO is overall conservative (Republican), in some cases the CEO may be motivated to support

the campaign of a less conservative candidate (i.e., a Democrat).  Considering that both the

Democrat and Republican parties have candidates spanning a spectrum of each party's ideals, it

seems reasonable some Democrat candidates could garner monetary support from Republican

CEOs.  As part of my analysis, I delved into how my research results changed when the measure

of a conservative CEO shifts from a CEO who contributes more to Republican campaigns than

Democrat ones during his or her tenure as CEO to the CEO who contributes more than $2,000 to

a Republican campaign in an election cycle.  In the latter scenario this CEO is arguably more

conservative since he or she contributes 10 times more funds in a single election cycle compared

to the CEO who simply contributes more to Republicans than Democrats over the course of

multiple years (i.e., multiple elections).  In Table 6, I controlled for the following: firm size

(*SIZE*), debt leverage (*LEV*), Tobin's Q (*TOBINSQ*), R&D expenses (*R&D*), and HHI (*HHI*).  As

Table 6 depicts, I found support that CEOs who contribute $2,000 or more to a Republican

candidate in each election cycle have statistically significant stock market rewards when the

CAR is between -2 days and +2 days from the new product announcement date.  The positive

coefficient for these CEOs demonstrates the positive stock market reaction.  This further

confirms and provides robust evidence in support of $H_1$.

Table 6

*Alternative Measures of Republican CEOs*

| Variable | Coefficient |
|---|---|
| *REP_DUM2* | 0.0067** |
| | (2.02) |
| *SIZE* | 0.0002 |
| | (0.28) |
| *LEV* | 0.0002 |
| | (0.03) |
| *TOBINSQ* | 0.0003 |
| | (0.29) |
| *R&D* | -0.0455* |
| | (-1.38) |
| *HHI* | -0.0001*** |
| | (-4.02) |
| Intercept | 0.0291*** |
| | (3.26) |
| Industry Controls | Yes |
| Year Controls | Yes |
| Adjusted $R^2$ | 3.96% |
| N | 2616 |

*Note*. This table reports estimation from OLS. $CAR_{(-2,+2)}$ is the dependent variable and is the cumulative abnormal returns generated for each announcing firm over the period from 2 days before to 2 days after the new product announcement date. The independent variable is *REP_DUM2*, which is calculated as 1 if a CEO contributes more to a Republican than a Democrat during his or her tenure and the total donations are greater than $2,000 and 0 otherwise. This is consistent with prior research by Hutton et al. (2014) and Elnahas & Dongnyoung (2017). I divided *HHI* by 1,000 to make the coefficient visible. Variable definitions are provided in Appendix B. I used both industry and year fixed effects. I clustered *t*-values by the firm identification number (Gvkey); *t*-values are reported in the parentheses. ***, **, * represent 2%, 10%, and 20% statistical significance, respectively.

In Table 7, I assessed the impact to the results under alternative measures of the CAR. Table 7 depicts my analysis when the CAR is between -3 and +1 days from the new product announcement date. As depicted in Table 7, the stock market reaction is positive and statistically significant for the Republican CEO, which in the table is defined as a CEO who contributes more to Republican campaigns than to Democrat ones during his or her tenure and whose total donations exceed $2,000. Table 7 shows the stock market's positive reaction is increasing as the CAR window shrinks. Thus, the stock market reaction is greatest when the CAR is between -1 and +1 days; defined another way, the stock market reaction is greatest between the day before the new product announcement and the day after the new product is announced. In Table 7, I controlled for firm size, debt leverage, Tobin's Q, R&D expenses, and HHI. I concluded from Table 7 that CEOs contributing more than $2,000 to a Republican candidate during their tenure as CEO have statistically significant positive coefficients, and I interpreted this to suggest that the stock market rewards these CEOs more than less conservative CEOs when a new product is announced. Overall, my main results hold under various alternative measures of CAR. More specifically, the Republican CEO independent variable continues to be positive and significant. This provides further robust evidence in support of $H_1$.

Table 7

*Alternative Measures of Cumulative Abnormal Return*

|  | (1) | (2) | (3) |
| --- | --- | --- | --- |
|  | *CAR(-1,+1)* | *CAR(-2,+1)* | *CAR(-3,+1)* |
| Variable | Coefficient | Coefficient | Coefficient |
| *REP_DUM* | 0.0049*** | 0.0044** | 0.0043** |
|  | (2.90) | (2.12) | (1.88) |
| *SIZE* | -0.0003 | -0.0005 | 0.0002 |
|  | (-0.53) | (-0.79) | (0.28) |
| *LEV* | 0.0024 | 0.0059 | 0.0036 |
|  | (0.53) | (1.06) | (0.60) |
| *TOBINSQ* | 0.0010* | 0.0006 | 0.0018** |
|  | (1.31) | (0.71) | (1.74) |
| *R&D* | 0.0105 | -0.0096 | -0.0213 |
|  | (0.40) | (-0.29) | (-0.63) |
| *HHI* | -0.0000*** | -0.0000** | -0.0000** |
|  | (-3.56) | (-2.16) | (-1.81) |
| Intercept | 0.0202*** | 0.0173** | 0.0093 |
|  | (2.72) | (2.16) | (1.06) |
| Industry Controls | Yes | Yes | Yes |
| Year Controls | Yes | Yes | Yes |
| Adjusted $R^2$ | 2.65% | 2.26% | 1.48% |
| *N* | 2616 | 2616 | 2616 |

*Note.* This table reports estimation from OLS. Table 7 column 1 shows the results using $CAR_{(-1,+1)}$ as the dependent variable, which is the cumulative abnormal returns generated for each announcing firm over the period from 1 day before to 1 day after the new product announcement date. Table 7 column 2 depicts the results showing $CAR_{(-2,+1)}$ as the dependent variable, which is the cumulative abnormal returns generated for each announcing firm over the period from 2 days before to 1 day after the new product announcement date. Finally, column 3 in Table 7 shows the results with $CAR_{(-3,+1)}$ as the dependent variable, which is the cumulative abnormal returns generated for each announcing firm over the period from 3 days before to 1 day after the new product announcement date. The independent variable for all columns is *REP_DUM*, which is calculated as 1 if a CEO contributes more to a Republican than a Democrat during his/her tenure and the total donations are greater than $2,000 and 0 otherwise. This is consistent with prior research by Hutton et al. (2014) and Elnahas & Dongnyoung (2017). Variable definitions are provided in Appendix B. I used both industry and year fixed effects. I clustered *t*-values by the firm identification number (Gvkey); *t*-values are reported in the parentheses. ***, **, * represent 2%, 10%, and 20% statistical significance, respectively.

In addition to my analysis from Table 7, I performed a supplemental analysis, which included additional control variables. The results of my additional analysis are depicted in Table 8. Simply, I ran the regression models in Table 7 using additional control variables, and the new results are reported in Table 8. The additional control variables include: *ROA*, *LOSS*, *FOROPS*, *MB*, *FIRMAGE*, and *SALEGR*. Even after controlling for these additional controls, the main results continued to hold. More specifically, the Republican CEOs independent variable continued to be positive and significant. This provides additional robust evidence in support of $H_1$.

Table 8

*Alternative Measures of Cumulative Abnormal Returns and Additional Control Variables*

| Variable | (1)<br>CAR(-1,+1)<br>Coefficient | (2)<br>CAR(-2,+1)<br>Coefficient | (3)<br>CAR(-3,+1)<br>Coefficient |
|---|---|---|---|
| REP_DUM | 0.0048*** | 0.0043** | 0.0044** |
| | (2.79) | (2.02) | (1.87) |
| SIZE | -0.0005 | -0.0005 | 0.0004 |
| | (-0.76) | (-0.76) | (0.49) |
| LEV | 0.0073* | 0.0094* | 0.0108* |
| | (1.48) | (1.59) | (1.64) |
| TOBINSQ | 0.0005 | -0.0001 | 0.0008 |
| | (0.46) | (-0.12) | (0.60) |
| R&D | 0.0227 | -0.0031 | -0.0179 |
| | (0.89) | (-0.10) | (-0.54) |
| HHI | -0.0000*** | -0.0000** | -0.0000** |
| | (-3.32) | (-2.20) | (-1.90) |
| ROA | 0.0380** | 0.0300* | 0.0570** |
| | (1.89) | (1.30) | (2.01) |
| LOSS | 0.0088 | 0.0078 | 0.0242** |
| | (1.06) | (0.87) | (1.96) |
| FOROPS | 0.0025* | 0.0049*** | 0.0074*** |
| | (1.59) | (2.72) | (3.55) |
| MB | 0.0042* | 0.0026 | 0.0067* |
| | (1.29) | (0.71) | (1.57) |
| FIRMAGE | 0.0002 | -0.0012 | -0.0020* |
| | (0.16) | (-1.02) | (-1.52) |
| SALEGR | 0.0057 | 0.007 | 0.0133** |
| | (1.11) | (1.21) | (1.84) |
| Intercept | 0.0140** | 0.0166** | 0.0032 |
| | -1.69 | -1.84 | -0.3 |
| Industry Controls | Yes | Yes | Yes |
| Year Controls | Yes | Yes | Yes |
| Adjusted $R^2$ | 2.77% | 2.31% | 2.54% |
| N | 2526 | 2526 | 2526 |

*Note.* This table reports estimation from OLS. Table 8 column 1 shows the results using $CAR_{(-1,+1)}$ as the dependent variable, which is the cumulative abnormal returns generated for each announcing firm over the period from 1 day before to 1 day after the new product announcement date. Table 8 column 2 depicts the results showing $CAR_{(-2,+1)}$ as the dependent variable, which is the cumulative abnormal returns generated for each announcing firm over the period from 2 days before to 1 day after the new product announcement date. Finally, column 3 in Table 8 shows

CEO POLITICAL IDEOLOGY RISKS AND REWARDS

the results with *CAR*$_{(-3,+1)}$ as the dependent variable, which is the cumulative abnormal returns generated for each announcing firm over the period from 3 days before to 1 day after the new product announcement date. The independent variable for all columns is *REP_DUM*, which is calculated as 1 if a CEO contributes more to a Republican than a Democrat during his or her tenure and the total donations are greater than $2,000 and 0 otherwise. This is consistent with prior research by Hutton et al. (2014) and Elnahas & Dongnyoung (2017). Variable definitions are provided in Appendix B. I used both industry and year fixed effects. I clustered *t*-values by the firm identification number (Gvkey); *t*-values are reported in the parentheses. ***, **, * represent 2%, 10%, and 20% statistical significance, respectively.

**Conclusion**

A growing body of literature supports the concept that personal values and political ideologies of business managers (particularly CEOs) partially explain firm performance (Campbell et al., 2018). Another expansive body of research has assessed the impacts on stock prices from new product announcements Lin and Chang (2012). However, prior research has not assessed the influence of the CEO's political ideology on stock market reactions to new product announcements. This pivotal point for the firm provides an opportunity for shareholders to profit and aids firms in anticipating the stock market's reaction to news of a new product. I aimed to bridge this knowledge gap by assessing the impact of the CEO's political ideals on new product announcements and the corresponding stock market reaction.

I found that Republican CEOs have a statistically significant and positive effect on the stock market's reaction to news of a new product. Additional analyses using alternative measures of Republican CEOs, alternative measures of CAR, and alternative model specifications offered support that my results are robust, and the main results continued to hold. Furthermore, this study provides evidence that the link between CEO conservative ideology and stock market reactions to new product announcements is more pronounced in firms facing strong competition.

It is important to note that while my paper provides evidence that in certain situations the firm senior management and Board may be incentivized to retain a Republican as the CEO, there are also situations in which a Republican would not be well suited to be the firm CEO. Anecdotal evidence suggests that many firm CEOs are in fact Democrats, and while it was beyond the scope of my research, there are certain situations in which firms would be incentivized to retain a Democrat CEO. For instance, a study by Hong and Kostovetsky (2012)

observed that Democrat mutual fund managers prioritize investing in socially responsible firms (i.e., having little to no environmental violations) rather than prioritizing the overall firm performance. This suggests the Democrat mutual fund manager applies his or her personal values and beliefs to the investment methodology he or she applies.

Future researchers could identify additional CEO traits that have an impact on the stock market's reaction to new product announcements. These attributes could help to provide additional understanding of the CEO's influence over the firm. Another possible avenue for future research on this topic would be to bifurcate the CEO's contributions to Republican campaigns for president versus Republican campaigns for congressional offices to assess if the stock market reacts differently. Yet another possible avenue of future research would be assessing if there is a difference in the stock market's reaction to a CEO who contributes to Republican campaigns where the candidate is re-elected more often than not. Another possible avenue of research could focus on CEO political contributions to campaigns in swing states; that is, focusing contributions on campaigns in states that are closely divided between Republican and Democrat candidates and that could have an impact on which party controls the executive and/or the legislative branches of the government. Furthermore, in some elections the political leaning of the judicial branch (i.e., the Supreme Court) is also at stake.

While my research provides strong evidence that CEOs who contribute more to Republicans than Democrats during their tenure as CEO have a statistically significant and positive interaction with the stock market's reaction to news of a new product, this interpretation is subject to some limitations. First, my proxy for measuring CEO political ideology may be a more accurate depiction of CEO political connectedness whereby CEOs seek to establish and take advantage of networking opportunities with political figures. However, previous research

by Hutton et al. (2014) concluded the proxy is valid and that most political contributions do in fact represent the CEO's political attributes.  Second, my analysis may suffer from a correlated omitted variable issue.  To remedy this, I included industry and year fixed effects in all my models, and I validated the results by examining whether changes in political tone at the top related to changes in stock market reactions.

**Appendix A**

Keyword Search Terms for New Product Announcements

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The following is a list of keywords used in my research to search the ProQuest database and

yield results for new product announcements.  Note the "*" was used to capture all variations of

tense of a specific keyword:

  Launch*
  Unveil*
  Announc*
  Introduc*
  New Product*
  Open*
  New*
  Release*
  Expand*

CEO POLITICAL IDEOLOGY RISKS AND REWARDS

**Appendix B**

Variable Definitions

| | | |
|---|---|---|
| *REP_DUM* | = | 1 if a CEO contributes more to a Republican than a Democrat during his or her tenure and the total donations are greater than $2,000, and 0 otherwise (Elnahas & Dongnyoung, 2017; Hutton et al., 2014). |
| *REP_DUM2* | = | 1 if a CEO contributes more to Republicans than Democrats during each election cycle and the total donations are greater than $2000, and 0 otherwise. The measure captures very strong conservative CEOs. |
| *CAR(-1,+1)* | = | cumulative abnormal returns generated for each announcing firm over the period from 1 day before to 1 day after the new product announcement date. |
| *CAR(-2,+1)* | = | cumulative abnormal returns generated for each announcing firm over the period from 2 days before to 1 day after the new product announcement date. |
| *CAR(-2,+2)* | = | cumulative abnormal returns generated for each announcing firm over the period from 2 days before to 2 days after the new product announcement date. |
| *CAR(-3,+1)* | = | cumulative abnormal returns generated for each announcing firm over the period from 3 days before to 1 day after the new product announcement date. |
| *SIZE* | = | the natural logarithm of total assets. |
| *LEV* | = | total liabilities divided by total assets. |
| *TOBINSQ* | = | Tobin's Q calculated as the market value of the equity minus book value of the equity plus book value of the total assets, all scaled by the book value of the total assets. |
| *R&D* | = | research and development intensity calculated as the total research and development expense divided by total assets. |
| *HHI* | = | Herfindahl–Hirschman index calculated by summing the squares of the market shares (as percentages) of each firm competing in each Fama-French 48 industry. |
| *ROA* | = | return on assets, calculated as income before extraordinary items divided by total assets. |
| *LOSS* | = | 1 if income before interest taxes and amortization is negative, and 0 otherwise. |

| | | |
|---|---|---|
| *FOROPS* | = | 1 if a firm has foreign operations as indicated by the foreign currency adjustments to income, and 0 otherwise. |
| *MB* | = | market to book ratio, calculated as market value of equity divided by book value of equity. |
| *FIRMAGE* | = | the natural logarithm of the number of fiscal years since a firm was included in the CRSP database. |
| *SALEGR* | = | the growth rate in sales over the previous two years. |
| *GENDER* | = | 1 if a company's CEO is a male, and 0 otherwise. |
| *CEOAGE* | = | the natural logarithm of the current age of a CEO. |
| *COMP* | = | the natural logarithm of the total compensation, including bonus of a CEO. |

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VITA


Alecia J. Reinhardt was raised in Beulah, North Dakota. She completed her undergraduate work at Minot State University in Minot, North Dakota where she received a B.S. in Finance with an Accounting major (2009). She completed her Masters of Business Administration degree with an emphasis in Management at the University of Wisconsin-Whitewater, in Whitewater, Wisconsin (2016). Alecia is currently employed at Goldman Sachs where she leads a team of internal auditors who provide assurance of the quality of controls over compliance and financial crime risks.