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Executive Partisanship and Corporate Investment

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Abstract

I show that an alignment in partisan affiliation, between a firm's management and the president, is associated with higher levels of investment. Using insider trading data, I find that managers become more optimistic about their companies' prospects when their preferred party is in power. This optimism-driven increase in investment is amplified by herding and associated with both lower profitability and stock returns. Overall, managers' political beliefs produce heterogeneous expectations about future cash flows and distort investment decisions.

I.   Introduction

The widening gap between the views of Republicans and Democrats has been one of the most defining trends in the American public in the past 2 decades. Party identification has been found to be a more significant predictor of Americans' political values than any other demographic or social attribute, including race, religion, and education (Westwood, Iyengar, Walgrave, Leonisio, Miller, and Strijbis (2018)). The sharp contrast between partisan views is particularly stark in the electorate's optimism about future economic growth. Survey evidence from the Pew Research Center shows that individuals become more optimistic when the president from their political party assumes power and that this relation holds across different age, education, and income groups (https://www.pewresearch.org/politics/2020/02/07/views-of-nations-economy-remain-positive-sharply-divided-by-partisanship/).

This behavior has become so pervasive that even Ben Bernanke, the former Chair of the Federal Reserve, in a 2017 interview with the *New York Times* remarked after the election of Donald Trump that "There is this kind of partisan coloring, it is really striking, the election result completely reversed people's views of the state of the economy. Republicans who thought that we were in a dystopia now think things

look great, and Democrats, the opposite. And, it shows that it is not all based on an objective assessment of the economy (https://www.nytimes.com/2017/04/24/business/dealbook/partisan-divide-over-economic-outlook-worries-ben-bernanke.html).

In this article, I conjecture that managers alter their expectations about their firms' future cash flows when their preferred party controls the Executive branch and that these changes in expectations can lead to over-investment and the destruction of shareholder value. To test this hypothesis, I infer managers' partisan affiliations from their lifetime political contributions and exploit the variation in political leadership from national elections. To disentangle the expectations hypothesis from other explanations, I examine insider trades by managers who work at the same firm but support different parties. I also look at both financial and operating outcomes.

My main finding is that managers increase firm investment by 1.9% when their party assumes power. This partisan investment behavior is stronger when their party controls both the legislative and executive branches, and when partisan affiliation is only measured using high-contributing individuals. These results are robust to allowing for changes in the political affiliation of a firm's managers. They also cannot be explained by government connections, the allocation of government contracts for politically sensitive industries, or other firm characteristics.

To cleanly test the expectations hypothesis, I compare the opportunistic trades made by executives who support different parties but work at the same firm at the same time. By exploiting variation in executives' party affiliations, this approach accounts for confounding factors and alternative channels since insiders with similar access to information should be expected to make the same decisions absent partisan influences on their decision-making. I find, however, that individuals who align with the president are 69% less likely than their political counterparts to sell their companies' shares during the president's first term. Narrowing this test to the years immediately surrounding elections yields similar results and shows that individuals' expectations regarding their firms' growth are conditional on their identification with the party of the sitting president. I also find complementary evidence that partisan-similar firms are more likely to issue optimistic annual earnings guidance and are less likely to meet these expectations.

Next, I examine how investment decisions due to partisan-based optimism affect performance outcomes. To determine whether these decisions are based on behaviorally biased expectations of future growth, I interact partisan similarity to the president with the firms' level of investment. On the one hand, if firms do not exercise all of their growth options partisan investment can be value-improving. On the other hand, over-investment can result in lower profitability. My results are more consistent with the value-destroying hypothesis. I find that firms with investment levels equal to the sample mean experience a 1.7% and 5% decrease in stock returns and a 0.5% and 0.6% decrease in operating profits in the subsequent 1 and 2 years following these investment decisions. Finally, I find that CEOs experience higher turnover as a result of their partisan-based optimism, managers sort on partisan preferences when making career decisions, and that they continue their over-investment decisions at their new firm.

The main contribution of this study is to provide novel evidence that managers with different party affiliations display different levels of optimism, resulting in economically large distortions in firms' investment policies and

negative performance outcomes. Until this point, evidence of partisanship producing material changes in economic behavior has been both mixed and limited. While some studies document a significant effect of partisan bias on household spending (Makridis (2019)), others find no effect (McGrath et al. (2017), Mian, Sufi, and Khoshkhou (2018)). In terms of financial outcomes, papers mainly focus on retail investors and credit analysts. My article is the first to find that partisanship among executives can result in economically significant investment choices.

My findings are closely related to the literature that studies how party affiliation can affect individuals' optimism and subsequent financial beliefs. Meeuwis, Parker, Schoar, and Simester (2018) show that individuals living in Republican regions increased their share of equity and the market beta of their portfolios after the 2016 presidential election. Cookson, Engelberg, and Mullins (2020) show that the optimism of Republican users on the social platform StockTwits remains unchanged during the Covid-19 pandemic while other users have become more pessimistic. Kempf and Tsoutsoura (2018) find that the economic optimism of more sophisticated individuals (i.e., credit ratings analysts) depends on who controls the Executive branch. My article adds to this literature by showing that partisan-related optimism is strong enough to affect corporate investment decisions.

This article also contributes to the literature on how the federal government can affect firm performance and investment decisions. The prior literature focuses primarily on changes in political connections (Faccio (2006), Duchin and Sosyura (2012)), industry sensitivity to government spending (Belo, Gala, and Li (2013)), and uncertainty surrounding elections (Julio and Yook (2012)) as channels that can affect firms. I provide evidence that the political affiliation of the current regime can directly affect managers' economic optimism and their subsequent investment policies.

A related study by Schwartz (2019) finds an association between the political affiliation of a CEO's birth county and overconfidence during different presidencies, and Knill, Liu, and McConnell (2021) find that partisan media slant can affect managers' investment decisions. My article complements these findings by showing that managers' political beliefs affected investment decisions for a large sample of firms over different political regimes. My measure does not rely on geography and has been shown to be an accurate proxy for political affiliation. Additionally, using insider trades I am able to provide concrete evidence that managers from different political parties, at the same level within the same firm, exhibit greater optimism when their preferred party is in power.

II.   Data

A.   Sample Construction

My sample consists of financial data from the Compustat Fundamentals Annual file and managerial data from ExecuComp for the years 1992–2016.[1] I use executives' full names listed on ExecuComp to identify their political

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[1]The sample period ends in 2016 due to data availability issues. Both the marginal tax rate data, used to construct the primary dependent variable, and the disambiguated political contribution data, used to construct the primary independent variable, end in 2016.

contributions and insider trades. I focus my analysis on the top 5 managers to get a more accurate picture of the political affiliation of firms' top decision-makers. To control for the effects of regulation, which can vary depending on the political party in control, I exclude all utility firms (SIC codes 4900–4999) and financial firms (SIC codes 6000–6999) as well as all firms categorized as public service, international affairs, or nonoperating establishments (SIC code 9000+). Finally, following Peters and Taylor (2017), I discard firms with missing or nonpositive book value of assets or less than $5 million in physical capital in order to exclude small firms who may have more volatile accounting data and skewed investment patterns. This results in a sample of 33,706 firm years corresponding to 2,644 unique firms.

B.   Political Contributions

I use executives' personal campaign contributions over the period of 1979 to 2016 from the Harvard disambiguated Federal Election Commission (FEC) campaign contribution database to identify managers' political affiliations (https://dataverse.harvard.edu/dataset.xhtml?persistentId=doi:10.7910/DVN/BQN6XE). There is strong evidence that contributions are a suitable proxy for an individual's partisan affiliation and views on certain political topics.[2] Contributions from executives are fairly stable over time and, when compared with firms' political action committees (PACs) contributions, target losing candidates more often which provides evidence that they are a reflection of partisan preferences and not attempts to seek political favors.

The disambiguated data include the same individual contributions to all campaign committees (national, candidate, etc.) as the FEC's bulk data set, with the addition of assigned identities. Using these data is advantageous as once you correctly identify the contribution of an executive, you have access to that individual's other contributions that were identified using the disambiguation algorithm.[3]

Once an individual's total contribution exceeds the FEC's disclosure limits for a particular year ($500 for 1975–1988; $200 for 1989–present), each campaign committee must disclose the donor's name, address (excluding street), and occupation, as well as the contribution amount and date. Although I can observe contributions to both PACs and individual committees (candidate, party, etc.), only the latter is useful for identifying partisan affiliations. This is because PACs donate to multiple parties in any given election cycle (Cooper, Gulen, and Ovtchinnikov (2010)), making them a noisy measure.

To create my contributions sample, I first match the committee master file from the FEC bulk data set to the Harvard disambiguated data set using committee ID. The FEC committee file has identifying information for each campaign committee, including its name, type, and party identification. There are many committees that identify with a party that is neither Democratic nor Republican (e.g., Federalist, Freedom Party, Labor Party). I manually research these parties

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[2]See the extensive validation work done by Adam Bonica (https://www.dropbox.com/s/2ntrx9au zifgujp/dime_validation.pdf?dl=1).

[3]Without contributor disambiguation, one cannot observe contributions from an executive when they are employed at a firm that is not covered by ExecuComp.

and categorize them as Democratic or Republican based on their standing within the political spectrum (e.g., Green Party = Democratic).[4] I then match the resulting file to ExecuComp using a custom algorithm that allows for more accurate matching and greater coverage.[5] After verifying the accuracy of the matches, my final sample consists of 564,556 individual contributions for 13,783 unique executives resulting in 101,521 executive contribution years covering approximately 75% of ExecuComp firms.

C.   Measuring Political Affiliation

I follow the approach used by Lee, Lee, and Nagarajan (2014) and construct a firm-level political orientation measure using the average orientation of that firm's management team in a given year. First, I measure each manager's individual political orientation, called PARTY, and define it as the difference between the inflation-adjusted dollar amount of contributions (adjusted to 2016 dollars) to the Republican Party and the Democratic Party divided by total contributions to both parties:

$$(1) \qquad\qquad \text{PARTY}_i = \frac{R_i - D_i}{R_i + D_i},$$

which ranges from -1 (Democratic) to 1 (Republican). Following the prior literature (Hong and Kostovetsky (2012), Lee et al. (2014), Hutton, Jiang, and Kumar (2015), and Wintoki and Xi (2020)), I use individuals' total contribution history to calculate their political orientation. This is done to minimize measurement errors, since contributions over several years are more likely to reflect an individual's true orientation, even if they sometimes contribute to another party. For each executive, PARTY remains constant throughout the sample with the assumption that an individual's political stance is stable in adulthood and is determined in his or her formative years (Green, Palmquist, and Schickler (2004)).

Next, I measure a firm's political orientation as the equal-weighted average of the top 5 managers' PARTY for each year, using the sum of their salary and bonus to determine their ranking. I focus on the top 5 managers because Graham, Harvey, and Puri (2015), using an survey of 1,000 CEOs, find that corporate investment is one of the most delegated capital allocation decisions. Therefore, including several important executives will yield a better connection between partisanship and investment.[6]

Because disclosure limits are relatively low, especially for these high-wealth individuals, I assume that noncontributing executives are as partisan as those who contribute equally to both parties and set their PARTY equal to 0.[7] The main benefit of including nondonors is that it allows for a less noisy measure of a firm's political orientation, for example, if one out of five managers in a specific firm only donated

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[4]Results are robust to using contributions to only the Democratic or Republican Party.

[5]See the Supplementary Material for a more detailed explanation of the matching algorithm.

[6]Consistent with finding, in unreported tests I find that the partisan similarity among executives is a stronger predictor of investment than the partisan similarity of the CEO.

[7]A 2014 Pew Research Center poll found that individuals who are more independent in their political views are less likely to contribute to political campaigns. *Source:* Pew Research Center.

$1,000 (in total between 1979 and 2016) to the Republican Party, that firm would be seen as highly Republican (equal to 1) while its true orientation might be more moderate (closer to 0). Another benefit of including nondonors is that for firmyears where no executives have donated, the inclusion of these observations allows me to estimate the fixed effects and coefficients on control variables more precisely.

My main variable of interest is the Political Homophily Index, first developed by Lee et al. (2014), which is equal to the normalized inverse Euclidean distance between the affiliation of a firm's top 5 managers and the president:

$$(2) \qquad PHI_{Top5ft} = 1 - \frac{|PARTY_{Top5ft} - PARTY_{Prest}|}{2},$$

where $PARTY_{Top5} = [0,1]$ and $PARTY_{Pres} = [-1,1]$, $-1(1)$ is a Democratic (Republican) president. PHI_{Top5} is a measure of partisan similarity between a firm's management team and the president and can take any value between 0 (least similar) and 1 (most similar). Because managers' party affiliations are fixed throughout the sample period, variation in this measure is solely driven by both managerial turnover and changes in the party of the presidency.

Table 1 presents the summary statistics for this sample. These statistics show that the majority of management teams lean Republican, which is consistent with prior studies. Table A2 in the Supplementary Material presents the average party affiliation of firms' top 5 managers based on their industry and the state where their headquarters are located. Although there is significant separation between the least and most Republican industries and states, they represent a very small fraction of the firms in my sample. This helps ease concerns that my results could be driven by Republican managers aggregating into firms in certain industries or states that can be systematically affected by which party is in power.

D.   Insider Trading and Options Exercise Data

I use data from Table 1 of the Thomson Reuters insider transaction database, which consists of all transactions filed using Form 4 of the U.S. Securities and Exchange Commission. For the years 1986–2016, I follow the prior literature (Cohen, Malloy, and Pomorski (2012)), and focus on open market purchases and sales which can be identified by transaction codes "P" and "S." When an insider makes multiple trades of the same stock in the same month, I aggregate the total number of shares traded monthly. I then merge the data with CRSP using NCUSIP and scale the total number of shares traded by an executive by that month's shares outstanding.

I then follow the method employed by Cohen et al. (2012) to identify opportunistic trades. The rationale is that routine trades are more likely to reflect personal liquidity and diversification motives or to be the result of routine events like the issuance of stock grants; they are less likely to be a signal of managers' expectations of their firms' future cash flows. Following their main identification method, I identify insiders as a "routine" trader once they have traded in the same month for 3 consecutive years; insiders who do not display predictable behavior are labeled "opportunistic." After removing all routine insider-trade observations I aggregate all insider trade information to the executive-year level and merge it

TABLE 1

Summary Statistics

Table 1 presents summary statistics for the main variables used in this analysis. The sample consists of 2,644 firms, excluding utility and financial firms and those with less than $5 million in physical capital, from 1992 to 2016. See the Supplementary Material for variable definitions.

	No. of Obs.	Mean	Std. Dev.	25th Pct	Median	75th Pct
Panel A. Political Variables						
PARTY$_{Top5}$	35,318	0.12	0.30	0.00	0.03	0.27
PHI$_{Top5}$	35,318	0.48	0.16	0.40	0.50	0.58
STRONG_PARTY$_{Top5}$	35,318	0.04	0.17	0.00	0.00	0.15
STRONG_PHI$_{Top5}$	35,416	0.49	0.09	0.49	0.50	0.50
PHI$_{State}$	35,227	0.52	0.28	0.25	0.52	0.78
CONTRIBUTIONS	35,318	0.12	0.69	−0.09	0.00	0.67
LOBBYING	35,318	0.18	0.38	0.00	0.00	0.00
TRIFECTA	35,318	0.31	0.46	0.00	0.00	1.00
Panel B. Other Variables						
TOTAL_INV	34,981	0.19	0.15	0.02	0.09	0.14
Q	32,911	1.51	2.08	0.47	0.87	1.66
SIZE	35,192	7.17	1.61	6.02	7.04	8.20
CASH	34,959	0.22	0.36	0.03	0.09	0.25
LEVERAGE	34,981	0.28	0.35	0.05	0.20	0.37
CASH_FLOW	34,981	0.16	0.16	0.09	0.14	0.21
PROFIT	34,923	0.25	0.21	0.14	0.21	0.31
RET	34,040	0.12	0.56	−0.20	0.05	0.32
DIVIDEND	35,416	0.48	0.50	0.00	0.00	1.00
SHARES	128,209	−0.03	0.11	−0.01	0.00	0.00
SALE	128,209	0.32	0.47	0.00	0.00	1.00
PURCHASE	128,209	0.08	0.27	0.00	0.00	0.00
log(TOTAL_COMP)	121,952	7.16	1.03	6.40	7.09	7.84
TENURE	128,209	3.75	3.87	1.00	3.00	5.00
EXERCISED	170,311	0.36	0.48	0.00	0.00	1.00
EXERCISED_N	161,638	1.37	1.95	0.00	0.00	3.04
EXERCISED_$	143,684	2.43	3.39	0.00	0.00	5.75
CEO_TUROVER	28,287	0.05	0.21	0.00	0.00	0.00
NON-CEO_TURNOVER	28,445	0.76	0.91	0.00	1.00	0.00
OVER_60	28,287	0.25	0.44	0.00	0.00	1.00
GREATER_THAN_ANALYST	7,871	0.39	0.49	0.00	1.00	1.00
MISS_GUIDANCE	10,637	0.54	0.50	0.00	1.00	1.00
CAR(−1,+7)	2,916	−0.00	0.08	−0.04	0.00	0.04
CAR(−5,+5)	2,951	0.00	0.09	−0.04	0.00	0.05
PUBLIC_TARGET	3,103	0.48	0.50	0.00	1.00	1.00
SAME_INDUSTRY	3,103	0.60	0.49	0.00	1.00	1.00
log(DEAL_SIZE)	2,170	6.35	1.30	5.30	6.04	7.21

with ExecuComp based on firms' CUSIPs and executives' first and last names. To be included in the sample, an executive must make at least one opportunistic insider trade during the sample period.

To capture the level of trading done by an executive I create a variable called SHARES, which is the number of scaled shares purchased minus shares sold per year. To better understand whether managers are trading in different directions I use the variables SALE, which is an indicator variable that takes a value of 1 if an executive sold shares in year *t,* and 0 otherwise, and PURCHASE, which is an indicator variable that takes a value of 1 if an executive purchased shares in year *t,* and 0 otherwise. I also control for an executive's total compensation using ExecuComp item TDC1, TOTAL_COMP, and for an executive's tenure at the firm, TENURE.

After excluding routine insider trades, I am left with 504,958 insider transactions, which aggregate to 49,773 executive-year observations with at least one trade. I have data on 29,408 executive insiders trading across 2,727 unique firms.

Table 1 describes the resulting sample. During the sample period, 32% of all executive years contain an insider sale and 8% a purchase. Out of the nonmissing observations, 18% of executive years consist only of purchases, 80% consist only of sales, and 2% consist both of sales and purchases.[8] The fact that most trades by executives are sales may be due to the rise in stock-based compensation. Also, for most of the executive years, there are no trades, which is a direct result of screening for opportunistic trades only.

In addition to insider trades, I also utilize options data provided by Execu-Comp. I only include a firm's top 5 executives, for each year, who have had an unexercised but exercisable stock option package at least once in the sample period. To capture an insider's options exercising behavior, I create a variable called EXERCISED, which is an indicator equal to 1 if an executive has exercised a stock option in year t, and 0 otherwise. I create two additional variables to measure how many options are exercised, EXERCISED_N, and the value of options exercised, EXERCISED_$. Table 1 shows that similar to insider trading behavior, executives only exercise options in approximately 36% of executive years. To control for outliers I winsorize the top and bottom 1% of all nonindicator insider trading and stock options variables.

E.   Financial and Other Variables

Over the past few decades U.S. companies have moved from manufacturing to more high-tech entities and as a result rely less on physical capital such as property, plant, and equipment and more on intangible capital (Kahle and Stulz (2017)). To account for this change in the relative importance of these two forms of investment and to allow for substitution between them, I follow Peters and Taylor (2017) and define total investment (TOTAL_INV) as the sum of CAPX, R&D, and 30% SG&A.

In addition to TOTAL_INV, I use the following financial variables constructed from Compustat: profitability (PROFIT); total book leverage (LEVERAGE); assets size (SIZE); investment opportunities (Q); cash and short-term investments (CASH); cash flow (CASH_FLOW); and stock returns (RET). All financial variables are scaled by the firm's book value of total capital (i.e., the replacement cost of property, plant, and equipment plus the replacement cost of intangible capital).[9] To control for outliers, I winsorize all firm financial regression variables at the 1% level. My summary statistics for TOTAL_INV, CASH_FLOW, and Q are similar to those reported by Peters and Taylor (2017) but differ slightly because the sample periods are different.

To study M&A announcement returns, I rely on the Thomson Securities Data Company (SDC) merger database to identify all takeover attempts for the firms in my sample. I create a sample of 3,103 mergers and acquisitions of majority interest of U.S. private and public targets during the sample period (SDC Form of the Deal: A (Acquisition), M (Merger), AM (Acquisition of Majority Interest)). I exclude all

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[8]Results are unchanged when excluding these 2% of transactions.

[9]The effective cost of intangible investment is calculated as (1-marginal tax rate) times intangible investment. When available, I use the nonparametric marginal tax rates from Blouin, Core, and Guay (2010), if missing the marginal tax rate is assumed to be 24% which is the sample average.

mergers with a deal size of less than $100 million. My main outcome variables are cumulative abnormal returns, defined as the sum of the differences between the acquiring firm's daily stock returns and the CRSP value-weighted market returns around the announcement of the proposed transaction with windows of $(-1,7)$ and $(-5,5)$. I control for deal characteristics by using the following control variables to account for whether the target is publicly traded, PUBLIC_TARGET, has the same 2-digit SIC code, SIMILAR_INDUSTRY, and the size of the deal, log(DEAL_SIZE).

For political control variables I use lobbying data from the Center for Responsible Politics (CRP) to identify firms that lobby in the prior and current year, LOBBYING. I also use the partisan composition of a state's U.S. senators and representatives from the Biographical Directory of the United States Congress to control for whether a state's congressional members are in the same party as the president, PHI_{State}. Finally, I use FEC contributions data to control for the total donations made by a firm's employees, to the party in power, in the prior election cycle, CONTRIBUTIONS.

To identify which firms are sensitive to government spending, I use the high-sensitivity industries determined by Belo et al. (2013). Using Input–Output tables, they identify industries such as oil and gas extraction and defense firms, among others, to be the most sensitive.[10] Additionally, it is possible some firms in non-sensitive industries could have the government as a major customer. To identify this, I use the S&P Business Description, Compustat variable BUSDESC, which is a textual description of a company's business operations, to identify firms that have the government as a customer.[11] The Supplementary Material provides a comprehensive description of variable definitions.

III.   Empirical Approach and Results

A.   Empirical Approach

This section presents the empirical findings related to changes in corporate investment for Democratic and Republican firms during the terms of presidents from different parties. I begin my analysis with a multivariate regression, which exploits variation in the degree of partisan similarity between firms and the president through national elections and managerial turnover, controlling for firm characteristics and for different proxies for political connections. I then show that this relation is empirically robust and explore the effects partisan investment can have on firm performance.

Given a lack of instrumental variables (IVs), I rely on a 2-pronged approach for addressing endogeneity. First, I provide evidence of a behavioral channel by using both fixed-effects regressions, to determine which sources of variation are driving the relation between partisan similarity and investment, and insider trades to compare executives who make decisions within the same firm and fiscal year.

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[10]See the Supplementary Material for the list of SIC codes.

[11]I use keywords such as agencies, department, navy, and so forth to identify the government as a major customer.

Second, I use strict sample exclusions to exclude firms for whom political connections are a material part of their operations. Although this approach does not allow me to explicitly estimate a causal relationship it does provide evidence that endogeneity is not a primary factor.

B. Does Partisanship Affect Investment?

To determine the effect partisan similarity between firms and the president can have on investment, I run the following augmented version of the standard investment-Q specification to evaluate changes in investment during different partisan presidential cycles, conditional on firms' party identification with the president, that cannot be explained by the standard explanatory variables:

$$(3) \qquad \text{TOTAL\_INV}_{ft} = \beta_0 + \beta_1 \text{PHI}_{\text{Top5}ft} + \beta_2 \text{PARTY}_{\text{Top5}ft} + Q_{ft-1}$$
$$+ \text{CASH\_FLOW}_{ft} + \alpha_f + \alpha_t + \varepsilon_f,$$

where f indexes firms and t indexes years. The dependent variable, TOTAL_INV, is defined as the sum of SG&A, CAPEX, and R&D expenditures scaled by beginning-of-year total capital, as defined by Peters and Taylor (2017). The explanatory variable of interest, PHI_{Top5}, is a measure of similarity between the party affiliation of a firm's top 5 managers and president. The coefficient on the similarity measure is designed to capture changes in the conditional investment rate that are driven by changes in the presidency as well changes in the partisanship of firms' executive teams. Following both Julio and Yook (2012) and Peters and Taylor (2017), I use the investment-Q framework as the baseline specification, as it has a solid theoretical foundation as well as good empirical support relative to other investment regression models (Eberly, Rebelo, and Vincent (2008)). As discussed in Section III.C, the main results are robust to various alternative specifications as well as to different measurements of investment and partisan similarity. Firm and year-fixed effects are included in the specification and standard errors are clustered by firm.

Table 2 reports the results for my baseline specification. The first column reports the regression of investment on PHI alone. The following column reports the regression of investment on a firm's unconditional party affiliation. In line with Hutton et al. (2015), I find a weak negative relation between Republican managers and corporate investment policies. As a result, I control for partisan affiliation for the remainder of the article. When including both partisan similarity and affiliation in the same specification, party affiliation becomes a much weaker predictor of investment, supportive of the idea that the dynamics between affiliations are more important. In the remaining columns, I add controls for firms' investment opportunities and cash flows and find that investment is positively related to both, and is negatively related to how Republican a firm's managers are.

In column 5, which represents my baseline specification throughout the rest of the article, I control for the effect that time-varying political connections can have on a firm's investment policies, which can result from additional procurement contacts or favorable regulation, for example.

TABLE 2

Investment and Partisan Similarity

Table 2 represents the baseline specification. The dependent variable, TOTAL_INV, is the sum of CAPEX, SG&A, and R&D scaled by total capital. The main explanatory variable, PHI, is the partisan similarity between a firm's management team and the president. PARTY is the average party affiliation of a firm's managers. TRIFECTA is an indicator equal to 1 if one party controls the executive and legislative branches. STRONG_PHI and STRONG_PARTY are strong versions of the political measures. Controls include Q, CASH_FLOW, LOBBYING, PHI$_{State}$, and CONTRIBUTIONS. The sample consists of firms with over \$5 million in physical capital and excludes financial and utility firms. See the Supplementary Material for variable definitions. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

	1	2	3	4	5	6	7
PHI$_{Top5}$	0.022***		0.021***	0.019***	0.021***	0.013***	
	(0.006)		(0.005)	(0.004)	(0.004)	(0.007)	
PARTY$_{Top5}$		−0.011*	−0.009	−0.007	−0.006	−0.007	
		(0.007)	(0.007)	(0.005)	(0.005)	(0.005)	
PHI × TRIFECTA						0.023***	
						(0.007)	
STRONG_PHI$_{Top5}$							0.027***
							(0.008)
STRONG_PARTY$_{Top5}$							−0.012
							(0.008)
Q				0.029***	0.029***	0.029***	0.029***
				(0.001)	(0.001)	(0.001)	(0.001)
CASH_FLOW				0.198***	0.198***	0.198***	0.198***
				(0.013)	(0.013)	(0.013)	(0.013)
LOBBYING					0.006***	0.006***	0.006**
					(0.003)	(0.003)	(0.000)
CONTRIBUTIONS					−0.001***	−0.001***	−0.001***
					(0.000)	(0.000)	(0.000)
PHI$_{State}$					0.006**	0.006**	0.007**
					(0.003)	(0.003)	(0.003)
No. of obs.	34,953	34,953	34,953	33,706	33,706	33,706	33,706
Adj. R^2	0.563	0.563	0.563	0.712	0.714	0.736	0.736
Within R^2	0.001	0.0003	0.001	0.355	0.358	0.358	0.357
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes

Consistent with the hypothesis that partisan similarity to the president is positively related to investment, PHI in column 5 increases the conditional mean investment rate in an economically and statistically significant way. These estimates show that investment increases by 0.0037 with a 1-standard-deviation in partisan similarity, this translates into an economically significant 1.9% increase in corporate investment, relative to the sample average. For firms on the far ends of the political spectrum, investment increases by 0.019 when the newly elected president belongs to same party as the firm's managers, an increase of 10% relative to the sample average.

If this relation is in fact driven by managers' beliefs that their president will deliver strong economic growth, then the relation between investment and partisan similarity should be stronger when one party controls both the executive and legislative branches (government trifecta). One party control of both the house and senate can greatly improve the odds of a president of achieving the legislative agenda, and should therefore make managers more optimistic when their president has fewer hurdles when passing legislation. Consistent with this idea, in column 6, I find that the relation between partisan similarity and corporate investment is stronger when there is a government trifecta.

Finally, in column 7, I also show that the positive relation between partisan similarity and investment is stronger when measuring the alignment of high-contributing managers only. STRONG_PHI and STRONG_PARTY are political alignment variables constructed by only using managers who donate more than the median manager, in terms of dollars contributed as a percentage of total annual compensation. The point estimate for this measure is 28% larger than the baseline estimate. Using this measure, firms on the far ends of the political spectrum increase in investment by 14.7% relative to the sample average. As expected, managers who contribute more to one party, and are likely to be more political, are more biased when making investment decisions.[12]

C.   Robustness

In this section, I perform several robustness checks. I start by examining the importance of partisan similarity by changing it from a contemporaneous to lagged variable. ExecuComp lists an executive if she or he has worked at the current firm for more than half of the fiscal year. Although the different start dates for a firm's executives does indeed add noise to the estimation of a management team's partisan similarity, the level of investment in the year after the firm's estimated similarity is lower (see column 1 of Table 3); this could be the result of election and post-election years, but it is still significant both economically and statistically. Despite evidence that individuals' partisan preferences are stable in adulthood and that most managers contribute consistently to one party, it could be the case that individuals' party affiliations change later in their adult lives. In column 2 of Table 3, I address whether the assumption that party identity is consistent in adulthood is necessary. To do this, I define individuals' party affiliation as the 5-year rolling average of their political contributions. The relation with investment is largely unaffected by changes to this assumption.

The third column of Table 3 reports the results with the lagged dependent variable on the right-hand side of the regression equation. Eberly et al. (2008) note that lagged investment has been found to be correlated with contemporary investment. Still, there may be concern that autocorrelation in TOTAL_INV drives the results found in this article. I find that the main finding is robust to the inclusion of lagged investment rates. In column 4 of Table 3, I construct a random political similarity measure to address the concern that there may be some underlying time trend in the data that is not captured by the year dummy variables or that political similarity is simply not important. For each firm-year observation, I assign each firm a random political similarity measure from a normal distribution so that the mean and standard deviation are equal to the sample statistics for the variable PHI_{Top5}. The coefficient for this random variable is close to 0 and insignificant, suggesting that the changes in investment are not due some to underlying time trend in the data. Finally, in the fifth column of Table 3, I include additional control variables such as lagged SIZE, LEVERAGE, CASH, and state-level GDP growth, GDP_{State}, and find that the main result holds. For additional robustness, which can

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[12]In Table A3 in the Supplementary Material, I deepen the analysis by exploring which components of TOTAL_INV vary with changes in partisan similarity. I find that firms hire employees, spend more per employee, and increase overall tangible and intangible investment.

TABLE 3

Alternative Specifications

Table 3 shows the robustness of the baseline results to different specifications. The dependent variable, TOTAL_INV, is the sum of CAPEX, SG&A, and R&D scaled by total capital. The main explanatory variable, PHI, is the partisan similarity between a firm's management team and the president. PARTY is the average party affiliation of a firm's managers. ROLLING_AVERAGE is the PHI calculated using a 5-year rolling window of political contributions. LAGGED_INVESTMENT is the main dependent variable lagged by 1 year. RANDOM_SIMILARITY is a placebo partisan similarity measure drawn from a normal distribution with the same mean and standard deviation as the sample PHI. LAGGED_PHI is the baseline explanatory variable lagged by 1 year. Controls in column 5 include, SIZE, LEVERAGE, CASH, and state-level GDP growth, in addition to the firm control variables included in column 5 of Table 2. The sample consists of firms with over $5 million in physical capital and excludes financial and utility firms. See the Supplementary Material for variable definitions. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

	LAGGED PHI_{Top5}	ROLLING AVERAGE	LAGGED INVESTMENT	RANDOM SIMILARITY	Additional Controls
	1	2	3	4	5
PHI_{Top5}	0.015***	0.019***	0.014***	0.003	0.017***
	(0.004)	(0.005)	(0.003)	(0.003)	(0.004)
No. of obs.	31,781	33,706	33,706	33,643	33,635
Adj. R^2	0.702	0.700	0.700	0.759	0.751
Within R^2	0.356	0.357	0.483	0.357	0.456
Firm FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes	Yes

be found in Table A5 in the Supplementary Material, I rerun my baseline specification using alternative proxies for investment including the percentage changes in book assets, total capital, PP&E, and CAPEX; I also scale CAPEX by physical capital instead of total capital.[13] My results are qualitatively similar and statistically significant across the different measures of investment.

D.   Partisan Based Optimism

Having shown that the relation between political similarity and investment is robust, I now explore the potential explanations for this finding. The main channel that can be driving this relation, and the main focus of this article, is that managers become more optimistic when their preferred party is in power, whether due to in-group favoritism or partisan-perceptual screening, and subsequently invest more.[14] In order to show that the observed findings are behavioral in nature it will first be useful to establish which sources of variation in PHI are associated with changes in TOTAL_INV. If the relation between PHI and investment is solely driven by changes in the party of the presidency, as the result of national elections, then my results could be driven by time-varying omitted variables with no behavioral explanation.

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[13]In unreported test, I include different fixed effects to account for state, industry, city, fiscal year-end, and other time-varying trends in TOTAL_INV. I also double cluster the standard errors by firm and year, firm and president, and so forth, with results remaining quantitatively similar.

[14]Campbell, Converse, Miller, and Stokes (1960) first develop the idea of partisan perceptual screening which states that when individuals interpret information, they tend to see what is favorable to their political orientation.

1.   Sources of Variation

To observe whether the relation between partisan similarity and investment is the result of omitted variable bias (OMB), and therefore not captured by firm fixed effects, I determine which sources of variation are driving my results. To do this, I rerun my baseline specification from column 5 of Table 2 and use different fixed effects to isolate changes due to elections and to managerial turnover. I also study to what extent changes in presidential approval ratings can affect investment because even though this is not a source of variation in this article, this channel would provide some evidence of a behavioral explanation.

Table 4 reports the results of this analysis. In the first column, I use firm, year, and party fixed effects to determine how changes in partisan similarity due to national elections affects management teams while holding their partisan affiliation constant. In this setting, there is only identification when management teams experience no turnover between managers with different affiliations but experience a change in PHI due to national elections. Consistent with both the OMB and behavioral explanations, I find that management teams invest more when their preferred candidate becomes president. In column 2 of Table 4, I use firm-by-president and year-fixed effects to study the changes in investment due to changes in management teams during each president's tenure. With this specification, there is identification only when partisan similarity changes after a turnover in management. Interestingly, this effect is isolated to the president's first term, likely a result of increasing uncertainty surrounding the next election outcome in the second term. In this setting, I find evidence consistent with the behavioral channel of investment. In column 3 of Table 4, I use firm-by-president, year, and party fixed effects to see how changes in presidential approval affect investment, while holding the team's partisan affiliation and the president fixed. REP_APPROVAL is the average yearly

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TABLE 4
Sources of Variation

Table 4 explores the different sources of variation. The dependent variable, TOTAL_INV, is the sum of CAPEX, SG&A, and R&D scaled by total capital. The main explanatory variable, PHI, is the partisan similarity between a firm's management team and the president. PARTY is the average party affiliation of a firm's managers. Column headings categorize the source of variation in PHI. REP_APPROVAL is the mean approval rating of the president by Republicans for year t. Firm control variables are included in column 5 of Table 2. The sample consists of firms with over $5 million in physical capital and excludes financial and utility firms. See the Supplementary Material for variable definitions. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

	Elections	Turnover	Approval
	1	2	3
PHI_{Top5}	0.014**	0.018**	
	(0.005)	(0.009)	
$PHI_{Top5} \times TERM2$		−0.012	
		(0.007)	
$PARTY_{Top5} \times REP\_APPROVAL$			0.029*
			(0.018)
No. of obs.	30,588	32,476	29,288
Adj. R^2	0.791	0.817	0.779
Within R^2	0.305	0.237	0.207
Firm FE	Yes		
Firm × president FE		Yes	Yes
$PARTY_{Top5}$ FE	Yes		Yes
Year FE	Yes	Yes	Yes
Controls	Yes	Yes	Yes

presidential approval rating by Republicans and identification comes from Republican changes in approval of the president. The more favorably a Republican management team views the president, assuming their views mirror the general public's, the more they invest. Overall, this table shows that the relation between partisan similarity and investment is not solely driven by changes in the presidency, but is also driven by changes in management teams and changes in presidential approval.

2. Amplification Effects of Herding

Next, I examine whether my observed relation is stronger for firms with homogeneous teams, compared to balanced ones. Although my measure is designed to capture when teams are fully aligned, it does not distinguish between teams with a few strongly partisan members and teams with all weakly partisan but aligned members. When all members of an executive team are aligned to the same party, the observed partisan optimism may be reinforced by these team members. Since CEOs tend to delegate capital investment decisions to other members of their team (Graham et al. (2015)), if homogeneous teams amplify this relation then we would expect the relation between the CEO's partisan similarity to the president and investment to be stronger when their team is fully aligned (Table 5).

To test this hypothesis, I run a similar specification to equation (3) by interacting a CEO-level measure of PHI with the indicator HOMOGENEOUS_TEAM, which equals one if all other executives belong to the same party as the CEO.[15] Following Dagostino, Gao, and Ma (2020), I compare the effect CEO alignment can

TABLE 5

Amplification Effects of Herding

Table 5 examines the amplification effects of executive team herding. The dependent variable, TOTAL_INV, is the sum of CAPEX, SG&A, and R&D scaled by total capital. The main explanatory variable, PHI_{CEO}, is the partisan similarity between a firm's CEO and the president. $PARTY_{CEO}$ is the average party affiliation of a firm's CEO. HOMOGENEOUS_TEAM is an indicator equal to 1 if the whole executive team belongs to the same party as the CEO, and is equal to 0 if it is balanced. Firm control variables are included in column 5 of Table 2. The sample consists of firms with over $5 million in physical capital and excludes financial and utility firms. See the Supplementary Material for variable definitions. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

	1	2
PHI_{CEO}	0.006***	−0.008
	(0.002)	(0.006)
$PHI_{CEO} \times HOMOGENEOUS\_TEAM$		0.023***
		(0.008)
$PARTY_{CEO}$	−0.003	−0.004
	(0.002)	(0.005)
HOMOGENEOUS_TEAM		−0.005
		(0.011)
No. of obs.	31,250	10,857
Adj. R^2	0.712	0.743
Within R^2	0.358	0.334
Firm FE	Yes	Yes
Year FE	Yes	Yes
Controls	Yes	Yes

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[15]An executive is assigned to either political party based on their total net contributions.

have on the lead executive's partisan optimism when their team is aligned and balanced. Teams are identified as balanced if half of remaining executives are Democrats (and the rest Republicans), are all unaligned, or some combination of the two. In column 1 of 5, I observe a strong relation between partisan-aligned CEOs and corporate investment. When interacting the measure for CEO alignment to the president with homogeneous teams (in column 2), this generates a significant and positive coefficient, indicating that CEOs with homogeneous teams exhibit higher levels of partisan optimism compared to CEOs who belong to balanced teams.

3. Individual-Level Evidence: Insider Trading and Options Exercising

Even though the above results show that changes in investment are due to variation in PHI that is driven by managerial turnover and that the observed partisanship is mainly driven by homogeneous teams, determining whether partisan-related heterogeneous beliefs are driving the observed changes in investment is still empirically challenging. This is mainly because I cannot tie investment outcomes to these individuals and because manager selection is endogenous, even if its timing is exogenous (i.e., caused by mandatory retirement, or death, for example). Hiring more Republican managers during a Republican presidency could introduce unobserved political connections to the party in power.

To overcome these challenges and to provide evidence that partisan bias can change an individual's level of optimism conditional on the party of the president, I exploit executives' opportunistic insider trading decisions (and options exercising behavior) and compare them to decisions made by other executives, with different political affiliations, within the same firm and year. This setting provides the perfect environment for testing whether the PHI-investment relation is due to a behavioral channel (i.e., increased optimism created by partisan similarity), because managers will make trading decisions that they believe will maximize their own wealth thereby revealing their level of optimism about their own firms' business outlook. For example, if a Republican becomes president, for the nonbehavioral channel to be true one would not expect Republican managers to systemically exhibit different trading behavior than non-donor or Democratic managers after the election outcome. Instead, given the same information set, they all have the same ex ante expectations of their firms future performance.

My identification strategy tests whether managers within the same firm exhibit different levels of optimism, conditional on their partisan similarity to the president, by regressing insider trades and options exercising by executive i in firm f in year t on firm $\times$ year-fixed effects and individual executive fixed effects. Additionally, I cluster standard errors at both the executive and firm levels. I also allow for differential behavior during later stages of each presidency, as individuals may want to purchase their companies shares in the beginning of the presidency and either hold their positions and/or sell in the president's second term to realize gains before a potential regime change. This is done by running the following regression:

$$(4) \quad \text{TRADE}_{ift} = \beta_0 + \beta_1 \text{PHI}_{ift} + \beta_2 \text{PHI}_{ift} \times \text{TERM2} + \text{CONTROLS}_{ift} + \alpha_{ft} + \alpha_i + \varepsilon_{i,f}.$$

PHI in this analysis is a discrete variable equal to 0 or 1 for executives depending on their partisan affiliation and the party in power (1 = similar) and

0.5 for managers who are non-donors, and PHI×Term2 is equal to a manager's PHI in the second term of each presidency.[16] As in my main analysis in Section III.D.1, I include non-donors to estimate the fixed effects and coefficients on control variables more precisely. I also include controls for total compensation and tenure since Democratic (Republican) managers in mainly Republican- (Democratic-) controlled firms could have both lower pay and shorter tenures which could systematically affect their trading decisions.

Because of the long time horizon, the inclusion of executive years with no trades, and the fact that not all managers regularly make opportunistic insider trades, I include individual executive fixed effects in my regression. As a result, the coefficient on PHI will be identified only based on Republican and Democratic managers whose partisan similarity measure PHI switches from 0 to 1. By including firm-by-year-fixed effects, I am comparing managers who are employed by the same firm and at the same point in time. This means that the results of this analysis are less prone to endogeneity issues or omitted variable bias. If the relation between PHI and TOTAL_INV is to some extent due to increased optimism stemming from partisan bias, then one would expect managers who belong to the same political party as the president to be more likely to purchase their own companies' shares, or be less likely to sell them. This behavior should be more pronounced near the beginning of each president's term because there is a longer time horizon before there is renewed uncertainty about who will control the White House.

Results from this analysis are reported in Table 6. For every variable besides PURCHASE, a clear relation emerges. During the first term of a presidency, executives who belong to the same party as the president are less likely to sell their shares than non-donor executives and those of the opposing party within the same company. In column 1, the positive coefficient for SHARES of 0.007 implies that managers belonging to the same party as the president hold 20% more shares in their company than the sample average. To get a better idea of this behavior (i.e., to see if managers trade in different directions), I look at indicators for sales and purchases. In column 2, affiliated executives sell fewer shares than other executives within the same company when a president is first elected, a decrease in the probability of selling of 69% relative to the sample average. In column 3, this relation is not significant which is most likely due to the lower frequency of insider purchases in the sample. Taken together, these results indicate that executives who belong to the same party as the president have higher expectations of their firms' performance and are more likely to hold onto their shares. When looking at results during the president's second term, executives' optimism seems to decrease as uncertainty of the next election outcome increase and subsequently behave similarly to managers with different partisan affiliations. This is evident from the joint p-value being statistically insignificant for all specifications.[17]

I provide complementary evidence, using the same identification strategy as in the previous table, by showing that executives also exhibit optimistic behavior in

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[16]This analysis is unaffected by changing PHI for nondonors to 0 due to executive fixed effects.

[17]In Tables A8 and A9 in the Supplementary Material, I find consistent evidence of the optimism channel when observing trades that occur in years immediately surrounding all presidential elections and the election of 2001, the closest election in my sample.

TABLE 6
Evidence from Insider Behavior

Table 6 reports insider trading results. The dependent variables are SHARES, the net number of shares purchased (+) and sold (−) scaled by the number of shares outstanding; SALE, an indicator variable equal to 1 if there was a sale made in year t, and 0 otherwise; PURCHASE, an indicator variable equal to 1 if there was a purchase made in year t, and 0 otherwise; EXERCISED, an indicator equal to 1 if the executive exercises options in year t, and 0 otherwise; EXERCISED_N, the log of the number of options exercised in year t; and EXERCISED_$, the log of the total value of options exercised in year t. The main explanatory variables are PHI, the partisan similarity between an executive and the president; and PHI × TERM2, the partisan similarity in the president's second term. log(TOTAL_COMP) is the log of an executive's total compensation and TENURE is the manager's length of employment at their current firm. For readability, the estimates for SHARES are multiplied by 100. The sample excludes all financial and utility firms. See the Supplementary Material for variable definitions. Standard errors are clustered by firm and executive, and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

	SHARES	SALE	PURCHASE	EXERCISED	EXERCISED_N	EXERCISED_$
	1	2	3	4	5	6
PHI_{Exec}	0.007***	−0.028**	−0.000	−0.015*	−0.048	−0.091*
	(0.003)	(0.010)	(0.004)	(0.008)	(0.033)	(0.054)
PHI_{Exec} × TERM2	−0.007**	0.038**	−0.001	0.023**	0.083*	0.136*
	(0.003)	(0.014)	(0.006)	(0.010)	(0.044)	(0.073)
log(TOTAL_COMP)	0.031**	−0.021***	0.011***	0.0400***	−0.062***	−0.106***
	(0.001)	(0.005)	(0.003)	(0.004)	(0.017)	(0.0271)
TENURE	−0.010***	0.139***	−0.022***	0.027***	0.152***	0.222***
	(0.002)	(0.008)	(0.004)	(0.002)	(0.008)	(0.014)
No. of obs.	116,109	116,109	116,109	165,594	155,895	155,887
Adj. R^2	0.319	0.384	0.375	0.469	0.519	0.531
Within R^2	0.001	0.009	0.001	0.006	0.006	0.004
Test: PHI + PHI × Term 2 = 0						
F-stat.	0.01	0.93	0.09	1.71	2.80	2.06
p-value	0.912	0.336	0.768	0.191	0.095	0.152
Firm × year FE	Yes	Yes	Yes	Yes	Yes	Yes
Executive FE	Yes	Yes	Yes	Yes	Yes	Yes

deciding whether to exercise stock options. If executives are optimistic, about the prevailing and future economic conditions induced by their partisan similarity to the president, they would be less likely than executives from the opposing party to exercise their stock options in the president's first term because they would expect their options to be more in-the-money (ITM) as time progresses. This relationship would naturally reverse in the second term because these same executives will have to exercise their options before they expire and because there will be more uncertainty about the next election outcome. To test for this hypothesis I control for executives' total compensation and tenure, exploit within firm-year differences in executives partisan affiliations with the president, and control for executive time-invariant characteristics. My outcome variables measure whether an executive exercised options in a particular year, EXERCISED, the number of options they exercised, EXERCISED_N, and the value of options exercised, EXERCISED_$. Consistent with the managers being less likely to exercise stock options in the first term of their preferred president's tenure because they expect their options to be more ITM in the future, column 4 shows that executives are 4% less likely to exercise their options when they belong to the same party as the president. These partisan-similar individuals then exhibit behavior in their presidents second term that is similar to that of other executives. This same relationship holds when replacing the binary EXERCISED variable with the number or value (columns 5–6) of options exercised.

I also aggregate insider trading and options exercising behavior to the firm level. I augment the regression design from column 4 of Table 9 by swapping the insider trading measures with PROFIT, include the current period's return RET_t as an control variable, and interact it with PHI_{Top5}. By doing this I am able to measure how partisan alignment causes managers to behave differently given a certain return. The results from this analysis can be found in Table A7 in the Supplementary Material. In column 1, I find a negative relation between stock returns and the number of that managers by and sell SHARES. This implies that when firms perform well, and returns are higher, managers sell shares to realize their gains. When looking at the interaction between returns and partisan alignment, I find a positive relation. This implies that given a certain percentage stock return, higher PHI teams are more likely to hold onto shares in their company. Columns 2–4 show a similar result when looking at options exercising behavior. In these specifications, there is a positive relation between stock returns and the different measures of options exercising. When looking at the interaction between stock returns and PHI, I find a negative relation with options exercising. This indicates that aligned teams are less likely to exercise stock options, and exercise less options (when measured using dollar value), when compared to less aligned teams.

E.   Partisan Clustering

Having shown that the relation between political similarity and investment rates are driven by managerial optimism, I explore whether the observed effect can be explained by other factors as well. One explanation could be related to the findings of Hong and Kostovetsky (2012), who show that Democratic and Republican fund managers have different industry investment preferences, but applied to the setting of managers' employment choices. Managers may on average choose to work in industries based on their partisan preferences—for example, Republican managers may be more likely to choose to work for companies in the defense or oil and gas industries, and these same industries could be more likely to receive government support by presidents with similar partisan preferences. Similarly, individuals may choose to work in states whose citizens belong the same party, and these states are more likely to be supported by partisan-similar presidents (Cen, Dasgupta, Rice, and Zhang (2023)).

In either case, this effect should be captured by controlling for investment opportunities and cash flows but it is well established that the different proxies for Q are noisy approximations and therefore may not fully account for partisan clustering.[18] To check if such mismeasurement is driving my results, I rerun my baseline regression equation on different subsamples. In column 1 of Table 7, I exclude the industries identified by Belo et al. (2013) as sensitive to government spending.[19] In the second column, I label industries as partisan if they are on of the top 10 most Republican or Democratic industries based on firms' partisan affiliations, for the

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[18]As discussed in Section III.C, my results hold with the inclusion of state-year and industry-year-fixed effects, which should account for this.

[19]These industries were identified using IO tables from 2001. See the Supplementary Material for details.

TABLE 7
Partisan Clustering

Table 7 examines the influence of partisan clustering. The dependent variable, TOTAL_INV, is the sum of CAPEX, SG&A, and R&D scaled by total capital. The main explanatory variable, PHI, is the partisan similarity between a firm's management team and the president. Column headings represent different subsamples where SENSITIVE_IND_EXCLUDED excludes industries which are sensitive to government spending, PARTISAN_IND_EXCLUDED excludes the top 10 most Republican and Democratic industries, and PARTISAN_STATES_EXCLUDED excludes the top 10 most Republican and Democratic states. Firm control variables are included in column 5 of Table 2. The sample consists of firms with over $5 million in physical capital and excludes all financial and utility firms. See the Supplementary Material for variable definitions and for a list of government-related industries. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

	Sensitive Ind. Excluded	Partisan Ind. Excluded	Partisan States Excluded
	1	2	3
PHI_{Top5}	0.023***	0.023***	0.022***
	(0.004)	(0.005)	(0.005)
No. of obs.	30,734	25,404	26,083
Adj. R^2	0.722	0.721	0.725
Within R^2	0.365	0.371	0.369
Firm FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Controls	Yes	Yes	Yes

whole sample period. Finally, in the third column, I make the same exclusion for states based on the average affiliation of firms within them. Across all sample restrictions, the relation between PHI_{Top5} and investment is even more economically and statistically significant than my baseline result. In comparison with the full sample, only 12% of firms are in partisan industries or in partisan states.

F.   Partisan Connection Seeking

So far my results have relied on the assumption that political contributions are a reliable proxy for an individual's political affiliation. Despite evidence from the political science literature that this may be the case, a key alternative explanation for the positive relation between PHI_{Top5} and TOTAL_INV is that personal political contributions are actually an attempt to establish political connections. This would imply that my findings are the result of gains and losses of political connections linked to the party in power, rather than from changes in optimism. While there is evidence that strategic political contributions can be beneficial to firm value (Cooper et al. (2010)), this seems unlikely to explain my findings for the following reasons. First, half of the executives in my sample only donate to one party and 68% make more than 80% of their contributions to one party. This would imply that managers are revealing their preferred party, or are only building connections with one party instead of strategically donating to both. Second, the median total contributions over the whole sample period for executives is approximately $6,000 (the mean is $37 k). This amount is trivial in comparison with the total contributions given by firms' PACs and the amount of money spent on lobbying.[20]

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[20]Ansolabehere, De Figueiredo, and Snyder (2003) suggest that political contributions are commonly used to express one's political orientation and ideology rather than to establish political connections.

TABLE 8

Partisan Connection Seeking

Table 8 examines the influence of political connections. The dependent variable, TOTAL_INV, is the sum of CAPEX, SG&A, and R&D scaled by total capital. The main explanatory variable, PHI, is the partisan similarity between a firm's management team and the president. Columns 1–3 represent different measurements of PHI, where PARTIES_AND_PRESIDENTS uses only contributions to party committees and the president to estimate partisan similarity, ELECTION_CYCLE_AVERAGE is the mean of all election cycle PHIs, and POLARIZERS use only executives who have donated at least 80% of their total contributions to one party to estimate a discrete version of PHI and PARTY, with all other executives equal to 0. Columns 4–5 represent different subsamples where LOBBYING_FIRMS_EXCLUDED excludes firms who have lobbied at least once during the sample period and GOVT_CUSTOMER_EXCLUDED excludes all firms who have the federal government as a major customer. Firm control variables are included in column 5 of Table 2. The sample consists of firms with over $5 million in physical capital and excludes financial and utility firms. See the Supplementary Material for variable definitions and for a list of government-related industries. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

	Parties and Presidents	Election Cycle Average	Polarizers	Lobbying Firms Excluded	Govt. Customer Excluded
	1	2	3	4	5
PHI_{Top5}	0.025***	0.023***	0.014***	0.019***	0.020***
	(0.003)	(0.002)	(0.004)	(0.007)	(0.004)
No. of obs.	31,781	33,706	33,706	16,583	32,109
Adj. R^2	0.700	0.706	0.713	0.729	0.715
Within R^2	0.358	0.357	0.357	0.358	0.359
Firm FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes	Yes

To test for this alternative explanation I repeat my baseline specification in column 5 of Table 3 but with different estimations of PHI and omit firms for whom government contracts are important. Ovtchinnikov and Pantaleoni (2012) find that firms in congressional districts with greater industry clustering choose to support politicians with jurisdiction over their industry and are associated with improvements in operating performance. In column 1 of Table 8, I account for this by calculating individuals' partisan affiliations by only including contributions to presidential candidates and to party committees, which pool funds and distribute them to politically important congressional races.[21]

My baseline variable, PHI, is calculated using the total dollar amount donated by an individual over the entire sample period. Therefore, a large opportunistic donation to the Republican Party in a single election cycle, for instance, would categorize that individual as a Republican even if they donated to only the Democratic Party in every other election cycle. This would imply that I am measuring political connections and partisan affiliation. In column 2, I test for this by measuring each manager's PHI as the equal-weighted average of every election-cycle-specific PHI. This alternative measure is less likely to be affected by large opportunistic donations made in a single election cycle and therefore is less subject to concerns related to the timing of strategic donations.

Another way to control for the connections explanation would be to only include executives who donate 80% more to a single party in the analysis as they are likely to be "true" Republicans or Democrats. While it is true that firms could seek connections only with individuals who belong to their party, evidence from prior

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[21]It is very unlikely that political parties notify each candidate of the companies that contributed to the party's campaign. Additionally, contributions by executives could be made to unrelated candidates in other states.

studies suggest that most firm PACs donate to both parties. Therefore, I reestimate PHI_{Top5} by making $\text{PARTY}_{\text{Top5}}$ equal to 1 for firms whose managers donated at least 80% to the Republican Party over the sample period, and -1 for firms who donated at least 80% to the Democratic Party. The result in column 3 indicates that for firms that are polarized, a change in the party of the president results in a 7% change in investment. Because the relation is only identified in polarized firms, the results are similar if I exclude nonpolarized ones.

Finally, in the last 2 columns, I exclude firms for whom political connections would be beneficial. In column 4, I use lobbying data to exclude all firms identified by the Center for Responsible Politics (CRP) as having lobbied at least once during the sample period. In column 5, I use S&P Business descriptions, which describe each firms core business and major customers, in order to exclude all firms that have the government listed as a customer. In both of these subsamples, the results are identical to the baseline specification. Overall, the results from Table 8 suggest that political connections are unlikely to be a cause of concern.

G. Performance Outcomes

1. Firm Value and Operating Performance

After presenting evidence that changes in investment during different partisan cycles can be attributed to individuals becoming more optimistic when their preferred party is in power, I determine whether these optimism-based investment decisions create distortions in investment efficiency. If firms invest more because optimistic managers believe economic conditions will improve because the party they favor holds the presidency, this would imply that their investment decisions are not the result of fundamentals-based expectations. If true, partisan similarity should be negatively associated with future performance because managers would accept lower-NPV projects, after exhausting better growth opportunities, that they otherwise would not accept. To test this hypothesis, I run the following specification:

$$(5) \quad Y_{ft} = \beta_0 + \beta_1 \text{PHI}_{\text{Top5}ft} + \beta_2 \text{PHI}_{\text{Top5}ft} \times \text{TOTAL\_INV}_{ft} + \beta_3 \text{PARTY}_{\text{Top5}ft}$$
$$+ \text{CONTROLS}_{ft} + \alpha_f + \alpha_t + \varepsilon_f,$$

where f indexes firms and t indexes years. I test for both contemporaneous stock price and operating performance as well as perform additional specifications with one- and 2-year-ahead performance measures to account for the delay in realized gains or losses that would occur with long-term investments (i.e., R&D and SG&A). To analyze the valuation effects I calculate annual returns using fiscal year-end stock prices. Following the extant literature, I include control variables for political connections, size, cash, total investment, leverage, and profitability. For operating performance, I use operating profits as the independent variable and include control variables for political connections, size, cash, total investment, and leverage. For both specifications, I cluster standard errors at the firm level and include both firm and year-fixed effects. Given the well-documented evidence that firms in government-related industries and firms with the government as a principal customer both experience increased stock price performance and cash

TABLE 9

Valuation and Operating Performance

In Table 9, the main dependent variables are annual stock returns, (RET), and profitability, (PROFIT). The main explanatory variable, PHI, is the partisan similarity between a firm's management team and the president. PARTY is the average party affiliation of a firm's managers. All control variables are contemporaneous. The sample consists of firms with over $5 million in physical capital and excludes financial and utility firms as well as those in government related industries or have the government as a customer. See the Supplementary Material for variable definitions and for a list of government-related industries. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

| | RET_t | RET_{t+1} | RET_{t+2} | $PROFIT_t$ | $PROFIT_{t+1}$ | $PROFIT_{t+2}$ |
	1	2	3	4	5	6
PHI_{Top5}	0.086**	0.074**	0.040	0.018	0.024*	0.028**
	(0.036)	(0.033)	(0.034)	(0.014)	(0.013)	(0.012)
$PHI_{Top5} \times TOTAL\_INV$	−0.111	−0.456***	−0.409**	−0.142	−0.168*	−0.198**
	(0.187)	(0.160)	(0.179)	(0.099)	(0.086)	(0.078)
$PARTY_{Top5}$	0.002	−0.010	−0.017	0.023***	0.021**	0.018**
	(0.018)	(0.018)	(0.017)	(0.008)	(0.008)	(0.008)
LOBBYING	−0.015	0.023**	0.022**	0.011**	0.017***	0.017***
	(0.011)	(0.011)	(0.011)	(0.005)	(0.005)	(0.005)
CONTRIBUTIONS	−0.002	−0.000	−0.000	0.001	0.000	0.000
	(0.001)	(0.001)	(0.001)	(0.000)	(0.000)	(0.000)
PHI_{State}	0.045***	0.027**	0.000	0.011**	0.012***	0.005
	(0.013)	(0.012)	(0.012)	(0.005)	(0.004)	(0.004)
SIZE	−0.160***	−0.202***	−0.103***	−0.024***	−0.088***	−0.096***
	(0.009)	(0.009)	(0.007)	(0.005)	(0.005)	(0.005)
TOTAL_INV	−0.702***	0.037	0.225**	0.746***	0.325***	0.202***
	(0.106)	(0.098)	(0.104)	(0.051)	(0.044)	(0.039)
LEVERAGE	−0.004	0.047***	0.037**	0.055***	−0.001	0.006
	(0.017)	(0.016)	(0.018)	(0.009)	(0.008)	(0.007)
CASH	0.076***	−0.159***	−0.095***	0.099***	0.071***	0.009
	(0.022)	(0.019)	(0.019)	(0.013)	(0.011)	(0.011)
PROFIT	0.392***	−0.442***	−0.323***			
	(0.036)	(0.039)	(0.038)			
No. of obs.	29,524	28,991	27,895	30,496	29,374	27,295
Adj. R^2	0.125	0.142	0.117	0.711	0.655	0.637
Within R^2	0.033	0.044	0.015	0.378	0.241	0.182
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes

flows, especially when there is increased government spending, which typically occurs under Democratic presidents, I remove them from this analysis.

The results from this analysis can be found in Table 9. Columns 1–3 clearly show that, when holding partisan similarity constant, there is a negative relation between investment and stock returns in the years following the initial investment decisions; this can be attributed to the time lag between investments and their subsequent realized returns. Because I exclude government-related firms, as defined by industry and customers, the positive relation between PHI and contemporaneous returns is most likely due to shareholder expectations that firms with partisan-similar managers could be better positioned to benefit from new regulations or other favorable treatment. This observed relation could also be a result of partisan-similar investors buying firms that invest more because they also have biased expectations of future economic growth. Columns 2–3 show the economic outcomes; when holding investment equal to the sample average, a 1-standard-deviation increase in political similarity is associated with stock returns 1.7% and 5% lower than the sample average. Columns 4–6 report the operating outcomes due

to increased investment. Consistent with the valuation results, there exists a negative relation between investment and profitability conditional on a firm's partisan similarity. For columns 5–6, when holding investment equal to the sample average, a 1-standard-deviation increase in political similarity is associated with operating profits 0.5% and 0.6% lower than the sample average. In Table A12 in the Supplementary Material, I rerun the same specifications as in Panel A, but with the inclusion of the "strong" versions of the political measures (PHI and PARTY). Intuitively, the negative effects of partisan-based optimism on investment efficiency are stronger when I measure political alignment only with "strong" partisan managers. It is important to note that these results are not purely mechanical since I capitalize investments in both R&D and SG&A so that they do not affect operating profits.[22]

2.   M&A Announcement Returns

Finally, after showing that TOTAL_INV is negatively associated with financial and operating performance for partisan-similar firms, I explore whether there is also a negative association with larger investment decisions. Takeovers are not only one of the most important capital allocation decisions a firm can make, but they are also a good empirical setting because they are publicly observable investment decisions whose quality can be determined using market reactions to their announcement.

If partisan managers have higher expectations of economic growth, they may take on lower NPV projects. These poorer investment decisions could be reflected in the quality of their takeover attempts. To test this hypothesis, I run the following specification:

$$(6) \qquad CAR_{ft} = \beta_0 + \beta_1 PHI_{Top5ft} + \beta_2 PARTY_{Top5ft} + CONTROLS_{ft-1} + \alpha_i + \alpha_t + \varepsilon_f,$$

where f indexes firms, i indexes industries, and t indexes years. The dependent variable is the cumulative abnormal return (CAR) measured over the windows $(-1,+7)$ or $(-5,+5)$. I include control variables for political connections; for firm-specific characteristics, including size, cash, leverage, and investment opportunities; and for deal characteristics, including whether the target is a publicly traded firm, whether it is in the same industry, and the natural log of the deal value. I cluster standard errors at the firm level and include both industry and year-fixed effects. Table 10 reports the results of this analysis. In columns 1 and 3, I regress CARs on my main explanatory variable and firm characteristics, in the remaining columns, I include deal-specific controls. Across all specifications, there is no statistical relationship between PHI and deal quality.

The are several possible reasons for the absence of a result. Unlike the performance results presented in the previous table, takeover attempts occur at a lower frequency; this can reduce the preciseness of my analysis since most firms will not announce an acquisition over different presidencies, which prevents me from controlling for firm-specific time-invariant omitted variables. Additionally, because of the size and complexity of these decisions, their public disclosure may cause them to receive more scrutiny than decisions that are made incrementally

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[22]Both sets of results are quantitatively similar with the inclusion of industry-by-year-fixed effects to account for time-varying industry trends.

TABLE 10

M&A Announcement Returns

In Table 10, the main dependent variables are M&A announcement CARs. The main explanatory variable, PHI, is the partisan similarity between a firm's management team and the president. PARTY is the average party affiliation of a firm's managers. Political controls are contemporaneous and firm controls are lagged. The sample consists of proposed M&As with a deal value greater than $100 million, firms with over $5 million in physical capital, and excludes financial and utility firms. See the Supplementary Material for variable definitions. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

| | CAR(−1,+7) | | CAR(−5,+5) | |
	1	2	3	4
PHI_{Top5}	0.001	−0.003	−0.005	−0.005
	(0.011)	(0.013)	(0.011)	(0.014)
$PARTY_{Top5}$	0.009*	0.015**	0.009	0.017**
	(0.005)	(0.006)	(0.006)	(0.007)
CONTRIBUTIONS	0.002*	0.001	0.001	−0.000
	(0.001)	(0.001)	(0.001)	(0.001)
LOBBYING	−0.002	−0.001	−0.001	0.004
	(0.005)	(0.006)	(0.005)	(0.006)
PHI_{State}	0.008	0.006	0.008	0.010
	(0.006)	(0.008)	(0.007)	(0.008)
SIZE	−0.004***	−0.001	−0.005***	−0.003
	(0.001)	(0.002)	(0.001)	(0.002)
CASH	−0.000	−0.001	0.000	−0.001
	(0.001)	(0.004)	(0.000)	(0.002)
LEVERAGE	−0.002	−0.003	−0.002	−0.004
	(0.002)	(0.004)	(0.002)	(0.003)
CASH_FLOW	0.002	0.006	−0.002	0.001
	(0.006)	(0.006)	(0.002)	(0.007)
Q	0.000	0.000	−0.000	0.000
	(0.000)	(0.000)	(0.000)	(0.000)
PUBLIC_TARGET		−0.020***		−0.024***
		(0.005)		(0.005)
log(DEAL_SIZE)		−0.007***		−0.004**
		(0.002)		(0.002)
SIMILAR_INDUSTRY		0.009**		0.005
		(0.004)		(0.004)
No. of obs.	2,871	1,997	2,887	2,011
Adj. R^2	0.018	0.050	0.021	0.045
Within R^2	0.012	0.044	0.013	0.044
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes

throughout the year (such as hiring decisions or R&D spending), which can reduce the effects of partisan optimism.[23] Finally, it could also be that stock returns surrounding the announcement cannot be completely attributed to expectations regarding the effect of the takeover on the bidder's profitability (Fuller, Netter, and Stegemoller (2002)).

Overall, these results provide support for the value-destroying hypothesis since forward-looking measures of operating performance and shareholder value are negatively associated with partisan similarity for firms with higher levels of investment.[24]

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[23]In unreported test, I find a negative relation between PHI_{Top5} and abandoning mergers with negative announcement returns.

[24]In Table A11 in the Supplementary Material, I find that executive teams who are more aligned with the president's party are more likely to issue earnings forecast that are greater than the average analyst's forecast. I also find that firms are less likely to meet these earnings targets.

H.   Executive Turnover, Sorting, and Learning

One natural question that arises from the results of this article is whether the executive labor market allows the persistence of this behavior given the pecuniary cost of poor investment decisions. If managers face career costs then they should learn from these investment mistakes and correct this behavior. My hypothesis is that CEOs primarily face career costs as a result of these decisions, even though my results suggest that other top executives contribute to this over-investment, and when managers switch employers they will choose teams with similar partisan preferences.

First, I test whether over-investment affects CEO and non-CEO executive turnover by running the following specification:

$$(7) \qquad \text{TURNOVER}_{ft} = \beta_0 + \beta_1 \text{PHI}_{\text{Top5}ft} + \beta_2 \text{PHI}_{\text{Top5}ft} \times \text{TOTAL\_INV}_{ft}$$
$$+ \beta_3 \text{PARTY}_{\text{Top5}ft} + \text{CONTROLS}_{ft} + \alpha_f + \alpha_t + \varepsilon_f,$$

where f indexes firms and t indexes years. In the specifications for CEO turnover, the dependent variable is an indicator for the CEOs last fiscal year at the firm.[25] In the specifications for other executive turnover, the dependent variable is a count of how many executives do not appear in the next fiscal year. In addition to the control variables included in Table 9, I also include controls for whether a CEO is also a director, and whether they are over 60 years old. I cluster standard errors at the firm level and include both firm and year-fixed effects. Panel A of Table 11 reports the results from this analysis. In columns 1–2, I find a positive, and weakly significant, relation between CEO turnover and partisan investment. In columns 3–4, there is no statistically significant relation between partisan investment and non-CEO executive turnover. These results are intuitive as CEOs are heads of the company and as a result, their employment is the most sensitive to poor firm-level decision-making.

Next, I test whether managers, who move to other firms covered by Execu-Comp, choose to work with executive teams who share a similar partisan ideology. Tajfel, Turner, Austin, and Worchel (1979) developed the idea of in-group favoritism, which posits that individuals identify with a group based on perceived similarities and prefer others who are in the same group. Consistent with this idea, a paper by Fos, Kempf, and Tsoutsoura (2022) finds that political sorting among executive teams has increased by 7.7 percentage points between 2008 and 2020. To test this using my data, I run the following specification:

$$(8) \quad \text{NEW\_FIRM\_PARTY}_{ft-1} = \beta_0 + \beta_1 \text{PARTY}_{it} + \beta_2 \text{OVER\_60}_{it} + \alpha_v + \alpha_s + \alpha_t + \varepsilon_i,$$

where f indexes firms, i indexes individuals, and t indexes years. The main dependent variable is $\text{PARTY}_{\text{Top5}}$ of the new firm that an executive moves to, measured in the year before the executive joins the firm. I control for the age of executives and include industry, state, and year-fixed effects. Standard errors are clustered at the

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[25]ExecuComp identifies a CEO as working if they are present for more than half the fiscal year; that is why I also include a lagged version of this variable.

TABLE 11

Executive Turnover, Sorting, and Learning

In Table 11, the main dependent variables are, TURNOVER, an indicator equal to 1 if it is the CEO's last year or a count of other executive turnover, NEW_FIRM_PARTY$_{Top5}$, the prior year's PARTY of an executives new employer, and NEW_FIRM_OI, the over-investment of an executives new employer. The main explanatory variables are PHI, is the partisan similarity between a firm's management team and the president, and PARTY, the average party affiliation of a firm's managers. Firm control variables are included in Table 11 and are contemporaneous, CEO-specific controls include whether the CEO was a director, and an indicator for whether they were over 60 years old. The sample consists of firms with over \$5 million in physical capital and excludes financial and utility firms as well as those in government-related industries or have the government as a customer. See the Supplementary Material for variable definitions and for a list of government-related industries. Standard errors are clustered by firm and are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Panel A. Turnover

	CEOs		Other Executives	
	TURNOVER$_t$	TURNOVER$_{t+1}$	TURNOVER$_t$	TURNOVER$_{t+1}$
	1	2	3	4
PHI$_{Top5}$	−0.027*	−0.012	0.091	0.083
	(0.014)	(0.022)	(0.072)	(0.073)
PHI$_{Top5}$ × TOTAL_INV	0.108*	0.172*	−0.101	−0.038
	(0.063)	(0.100)	(0.367)	(0.374)
PARTY$_{Top5}$	−0.005	0.003	−0.079*	−0.069*
	(0.009)	(0.015)	(0.047)	(0.048)
TOTAL_INV	−0.0251	−0.0434	0.510**	0.474**
	(0.035)	(0.059)	(0.202)	(0.205)
No. of obs.	27,857	25,342	27,998	27,363
Adj. R^2	0.030	0.075	0.088	0.089
Within R^2	0.026	0.032	0.008	0.008
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes

Panel B. Sorting

	NEW_FIRM_PARTY$_{Top5,t-1}$			
	1	2	3	4
PARTY$_{Exec}$	0.117***	0.094***	0.100***	0.086***
	(0.014)	(0.014)	(0.014)	(0.014)
OVER_60	0.012	0.002	0.011	0.003
	(0.023)	(0.021)	(0.022)	(0.020)
No. of obs.	1,827	1,822	1,824	1,819
Adj. R^2	0.063	0.160	0.123	0.192
Within R^2	0.045	0.032	0.035	0.0279
Industry FE	Yes	Yes	Yes	Yes
State FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes

Panel C. Learning

	NEW_FIRM_OI			
	1	2	3	4
PRIOR_FIRM_OI	0.064*	0.068*	0.064*	0.068*
	(0.038)	(0.039)	(0.038)	(0.039)
PHI$_{Top5}$			0.025**	0.029***
			(0.012)	(0.011)
PARTY$_{Top5}$			0.015***	0.016***
			(0.005)	(0.006)
No. of obs.	1,736	1,734	1,736	1,734
Adj. R^2	0.026	0.025	0.030	0.030
Within R^2	0.029	0.032	0.035	0.038
Industry FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Controls	Yes	Yes	Yes	Yes

individual level. Panel B of Table 11 reports the results of this analysis. Across all specifications, I find a robust positive relation between an executives party affiliation and the average affiliation of their new team. The average similarity between managers and their new team is 0.81%. These results indicate that managers choose to work with groups who have similar partisan preferences.

Finally, if firms hire CEOs who belong to a similar party as the average executive, and this herding is what exacerbates partisan-related investment decisions, then CEO turnover alone may not allow for executives to learn. To test this, I use the same sample of executive transitions but now focus on whether managers who moved, from firms who previously over-invested, move to firms who also over-invest. To test this using my data, I run the following specification:

(9) $\text{NEW\_FIRM\_OI}_{ft} = \beta_0 + \beta_1 \text{PRIOR\_FIRM\_OI} + \beta_2 \text{CONTROLS}_{ft} + \alpha_i + \alpha_t + \varepsilon_f,$

where f indexes firms, and t indexes years. The main dependent variable NEW_FIRM_OI is the level of over-investment for an executive's new employer.[26] The main independent variable, PRIOR_FIRM_OI is the level of over-investment of an executive's prior firm, measured during their last year there. Controls include the current employers PHI and PARTY for the top 5 executives. The results from this can be found in Panel C of Table 11. Across all specifications, managers who moved from firms that in past have over-invested, move to firms who also over-invest themselves. This relation holds when controlling for the current firms partisan alignment to the president and when including both industry and year-fixed effects.

Taken together, these results suggest that even though CEOs face some career concerns due to their partisan-related investments, they tend to move to firms whose teams have similar partisan preferences, and continue to over-invest as a result of this sorting.

IV.   Conclusion

I study how a political affiliation between managers and the president affect firms' investment decisions and their subsequent valuation and performance. Using a sample of 2,644 firms for the years 1992 to 2016, I find that firms whose managers' party affiliation is the same as that of the president increase total investment more than firms whose managers' party is different. I show that this relation is not driven by partisan clustering into certain industries or states, or by changes in political connections. After isolating changes in partisan similarity that are solely due to management turnover and exploiting individuals' insider trading decisions, I show that managers who belong to the same party as the president are more optimistic about their firms future performance. As a result of these nonfundamental based expectations, I find that higher investment is associated with lower valuations and operating performance for firms that are more politically aligned with the party in power. Finally, I find that only CEOs face career costs of these

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[26]I measure firm-level over-investment as the deviation of investment than what would be expected given a firm's investment opportunities and cash flows, controlling for firm time-invariant characteristics and yearly trends.

poor investment decisions, and tend to move to firms who share a similar partisan ideology and firms who also over-invest themselves.

Overall, my results indicate that managers can have heterogeneous expectations about future business conditions based on the party in power and their partisan affiliations. Investment decisions based on this partisan optimism do not appear to be associated with any tangible benefits. In fact, investments made by partisan-similar firms are negatively associated with both stock returns and operating performance.

These findings are important for a few reasons. First, this behavior can be insidious, as it is not clear whether shareholders are aware of the effects partisan bias can have on economic agents. Second, compensation contracts should drive individuals to make value-maximizing decisions, but if managers believe their decisions are maximizing shareholder value but are in fact driven by political beliefs, then additional corporate fixes are warranted. It would be beneficial for directors and institutional shareholders to design governance mechanisms that control for this behavior, such as greater political diversity.

Supplementary Material

To view supplementary material for this article, please visit http://doi.org/10.1017/S0022109023000546.

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