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Three Essays on Corporate Governance and Politically Connected Firms

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THREE ESSAYS ON CORPORATE GOVERNANCE AND POLITICALLY CONNECTED FIRMS

by

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Master of Accountancy
Honours Bachelor of Commerce

DISSERTATION

Submitted to the Lazaridis School of Business and Economics in partial fulfilment
of the requirements for Doctor of Philosophy in Management

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Abstract

In this dissertation three essays on corporate governance and politically connected firms are presented. The first essay "Interlocked Boards of Directors, Corporate Governance and Earnings Quality" studies the effects of interlocked boards of directors on voluntary governance disclosures, governance practices and earnings quality. The Canadian environment, where director interlocks are prevalent, is examined. A checklist of twenty voluntary disclosure measures from proxy statements is developed and a direct measure of interlocking directorships is employed. It is found that interlocked boards of directors are negatively associated with voluntary governance disclosures and positively associated with earnings quality. From an accounting perspective, greater earnings quality provides evidence that regulator rules and policies limiting interlocks may be unnecessary.

Research has shown that firms can benefit when they are politically connected. The extant literature has shown that politically connected firms benefit from procurement contracts, reduced regulatory issues and lower costs of capital. However, with more politicians joining corporate boards, the effect of political connectedness on corporate governance remains unclear. The second essay is entitled "Politically Connected Directors and Corporate Governance", and it examines the association between politically connected directors and corporate governance. A sample of high ranking politicians that have joined firm boards of directors is examined. I find that firms with politician directors have higher corporate governance scores. Additional tests also indicate that an addition of a politician to a board of directors increases the governance quality.

The extant literature has also demonstrated that both political connections and cross-listing can benefit firms in various aspects, such as superior stock returns and a lower cost of capital. The third paper, entitled "The Value of Political Connections for Cross-Listed Firms", examines whether cross-listed firms can obtain incremental financial benefits by also being

politically connected. 142 Canadian cross-listed firms are examined to determine the extent of their political connections and to assess whether any incremental benefits are gained in politically connected cross-listed firms. The results show that politically connected cross-listed firms have higher analyst following, higher market valuations and greater market liquidity.

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Chapter 1:

Introduction

The following chapters in this dissertation present three essays on corporate governance and politically connected firms. Although these are designed as three separate business studies, common themes appear throughout. The importance of board membership is featured in all of the essays. The board of directors are vital to corporations as they are tasked with a fiduciary duty and have several important responsibilities including monitoring, controlling, hiring and firing management, as well as setting the firm's governance policies (Cadbury, 1992; Fama & Jensen, 1983). Essays one and two focus on corporate governance. Several corporate governance scandals in the past couple of decades have brought this issue to the forefront—especially with many of them involving accounting fraud. Essays one and three examine the Canadian business environment- which remains one of the largest economies in the world. Finally, both essays two and three look at politically connected firms. The importance of political connections in business has been recognized for many years and still benefits many firms today (Faccio, 2006).

The first essay examines interlocked boards of directors and drawing upon agency, full disclosure and alignment effect theories, it studies the relationship between interlocked boards and corporate governance and earnings quality. The second essay continues the work of recent literature on retired politicians joining corporate boards. It takes a resource dependence view and asks whether these politically connected firms are associated with higher quality corporate governance and whether politicians improve the corporate governance quality of such firms. The third essay combines the academic literatures of politically connected firms and cross-listed firms and examines whether cross-listed firms also benefit from being politically connected. It utilizes three common measures of political connections in determining whether these

connections enhance the benefits firms obtain from cross-listing.

Key insights found in this dissertation include: 1) interlocked board of directors are positively associated with earnings quality, but negatively associated with governance disclosures; 2) firms with politicians on the board of directors improve their corporate governance quality; and 3) Firms which are both cross-listed firms and politically connected benefit through higher analyst following, higher market valuations, greater market liquidity, and are more likely to receive procurement contracts than non-connected cross-listed firms.

Each essay presents an introduction, an overview of the related literature, hypotheses or research question development, the methodology employed, the empirical results, additional testing performed, and a conclusion.

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Chapter 2:

Interlocked Boards of Directors, Corporate Governance and Earnings Quality

Abstract

This paper studies the effects of interlocked boards of directors on voluntary governance disclosures, governance practices and earnings quality. The Canadian environment, where director interlocks are prevalent, is examined. A checklist of twenty voluntary disclosure measures from proxy statements is developed and a direct measure of interlocking directorships is employed. I find that interlocked boards of directors are negatively associated with voluntary governance disclosures and positively associated with earnings quality. From an accounting perspective, greater earnings quality provides evidence that regulator rules and policies limiting interlocks may be unnecessary.

1. Introduction

Within the emergence of corporate governance research in the late twentieth century, one of the most controversial topics has been interlocking directors (Cai et al., 2014; Davis, 1996). A board interlock is defined as sharing a common member on respective boards of directors or as a circumstance in which a person affiliated with one organization sits on the board of directors of another organization (Mizruchi, 1996; Reppenhagen, 2010). Interlocking directorships have been prevalent for many years and are formed for various reasons; however, the literature has remained divided on the impact of board interlocks. Critics argue that boards with interlocks serve as ineffective internal control mechanisms that impair independence and lead to biased decision making. Supporters counter that interlocks allow firms to hire more desirable directors and privately facilitate the exchange of information. While directors undoubtedly play a vital role in organizations (Fama & Jensen, 1983), studies have found both positive and negative performance and governance effects resulting from interlocking boards (Borgatti & Foster, 2003; Brown, 2011; Erickson et al., 2006; Klein, 2002). This study investigates whether and how director interlocks are associated with governance and/or accounting quality; specifically I examine voluntary governance disclosures and earnings quality. By focusing on these outcomes, the study aspires to present evidence informing whether rules and policies limiting interlocks are necessary.

Corporate governance and director interlocks vary by country. Researchers have looked at the effects of board interlocks in various countries, although the unique Canadian environment has not been extensively studied. This study examines the Canadian capital market—where various types of board interlocks have long been prevalent (Baginski et al., 2002), corporate governance disclosures have mainly been voluntary and International Financial Reporting

Standards (IFRS) have allowed for flexibility in financial reporting. This allows for testing in an institutional environment where directors can have significant influence over a firm's governance and financial reporting practices.

The literature regarding voluntary disclosures has shown mostly positive benefits from increasing the level of disclosure (e.g. Botosan, 1997).[1] While interlocked boards have been found to exercise wider accounting discretion (Bowen et al., 2008), the impact to governance disclosures and earnings quality from interlocks has not been extensively investigated. The orientation of disclosures is significantly influenced by the cultural environment in which companies operate (Gray, 1988). In Canada, the extent of voluntary governance disclosures and earnings quality varies widely among corporations. Although firms' disclosure choices are often sticky over time (Healy et al., 1999), interlocked directors serve as conduits for information that can lead to changes in corporate disclosure policies (Cai et al, 2014). Moreover, interlocked directors may have a self-serving interest that could be exploited through the management of earnings and corporate governance practices.

To study the effects of how the corporate interlock structure relates to accounting quality, a proxy disclosure score of voluntary governance disclosures is developed based on guidelines from the Canadian Coalition of Good Governance. Additionally, accrual models are employed to proxy for earnings quality. Results using a measure of direct interlocks show a negative relationship between board interlocks and governance disclosures and a positive relationship between board interlocks and earnings quality. Supplemental analysis demonstrates that there is no association between board interlocks and simple or basic voluntary disclosures (items that only deal with disclosures in the proxy statements), but there is a strong negative relationship between board interlocks and corporate governance (policies and practices) disclosures.

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[1] There are also many costs to increasing the level of disclosure, such as the risk of losing proprietary information.

Using an alternative proxy of governance quality, Globe and Mail governance scores, I also find a negative relationship with board interlocks. However, firms headquartered in the two largest provinces, Ontario and Quebec, seem to be driving the results. Busy boards are shown to have a positive relationship with governance disclosure, but not necessarily with earnings quality. Consistent with previous research, the results also show that a strong relationship exists between an independent chairperson and a high level of disclosures.

This paper contributes to the extant literature by examining both the negative and positive effects of interlocked boards of directors. Although recommendations to reduce board interlocks have been presented in prior research, these proposals have not always been empirically supported. Consistent with the literature regarding directors sitting on multiple boards (Byrd, et al., 2010; Ferris, et al., 2003), interlocked board members may have a positive effect on the performance of a firm. The paradox of director interlocks providing fewer voluntary disclosures, but enhanced earnings quality, can best be explained by extending alignment effect theory. Alignment effect theory (Demsetz & Lehn, 1985; Shleifer & Vishny, 1986) predicts that concentrations create incentives to report high quality earnings, as the close groups have incentives to keep earnings management within proper bounds. Thus, as interlocked directors are almost always reciprocal shareholders, interlocked firms are more likely to have longer term incentives and sufficient monitoring, but low motivation to disclose proprietary information. This study differs from other studies in the area, such a Chiu et al. (2013). In this paper accrual models are used rather than restatements for earnings management and a direct measure of interlocks is employed, rather than common directors.

The remainder of this paper is organized as follows: The next section presents relevant information regarding boards of directors and director interlocks. Section three provides further

relevant literature and proposes research hypotheses. Section four describes the research methodology. The results are reported in section five. Supplemental analysis is shown in section six. The final section of the paper discusses the findings of the study.

2. Literature Review

Board of Directors and Director Interlocks

A great deal of research and regulation has focused on boards of directors, as they play a vital role in monitoring management and reducing agency conflicts (Fama & Jensen, 1983). Directors are vital to an organization as they are responsible for setting an ethical tone for the company; directors also monitor, select, retain and discipline top management as well as protecting the organization's assets (Schwartz et al., 2005). Interlocking boards of directors have been prevalent for the last century–since the creation of modern organizations (Dooley, 1969). A board interlock is defined as multiple organizations sharing common members on respective boards of directors (Reppenhagen, 2010). Mizruchi and Stearns' (1988) work finds that there are three main reasons for the formation of director interlocks: (i) cooptation and monitoring; (ii) collusion; (iii) legitimacy, career advancement and social cohesion. Interlocking directorates occur regularly across industries and often mobilize a scarce resource in the expertise of senior managers and directors of large corporations (Fich & White, 2005). This practice is legal, but often raises questions regarding the quality and independence of board decisions. Nonetheless, research has produced conflicting and inconclusive results concerning the effects of interlocks.

While researchers and North American regulators generally contend that multiple outside directorships constitute a form of managerial opportunism, recent literature has generally found that directors that who on multiple boards are positively related to the long-term performance of

a firm (Byrd et al., 2010; Ferris et al., 2003; Geletkanycz & Boyd, 2011). Indeed, firms tend to hire high profile directors as a signalling mechanism to the market (Deutsch & Ross, 2003). Board interlocks also allow firms to observe the behavior of other firms as well as reduce uncertainty associated with strategic initiatives that they undertake (Borgatti & Foster, 2003).[2] Conversely, several studies have found that the presence of interlocked directors is indicative of weak governance and that inadequately comprised boards can have negative consequences such as groupthink and bullying (Fich & Shivdasani, 2007; Maharaj, 2008). Furthermore, there are significant reputational penalties not only for firms accused of fraudulent financial reporting, but also for firms that are linked through a board interlock (Kang, 2008). Likewise, the results are mixed when examining the performance effects of interlocks. For instance, firms that have interlocking directorships are significantly more likely to receive private equity offers (Stuart & Yim, 2010).[3] Meanwhile, Devos et al. (2009) document that director interlocks lead to lower than optimal sensitivity of CEO turnover to firm performance.

International Perspective

Pederson and Thomsen (1997) find that governance models (including board structures) are developed by historical waves of nationalization and privatization, industry structure and countries' attractiveness as recipients of foreign direct investment. Furthermore, first mover industrial countries have less government ownership, while late movers in industrialization have industrial policies aimed at catching up with government ownership of strategic industries. Corporate governance varies across jurisdictions and director interlock studies from different countries have produced results that have seen both benefits and drawbacks of interlocks. For

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[2] Communication of successful strategies through director interlocks often allows firm managers to imitate the activities of other firms to which they are tied (Haunschild, 1993).
[3] The study finds that firms that have directors with private equity deal exposure gained from interlocking directorships are significantly more likely to receive private equity offers. Private equity offers benefit firms in various ways such as raising the market value of the target firm.

instance, in European countries such as Germany, Belgium, and Austria, a two-board system is employed. In this model, one board is made up of company executives, who generally run day-to-day operations, while the supervisory board, consisting of non-executive directors who represent shareholders and employees, monitor the executive board, determine executive compensation, and review major business decisions (Stokman et al., 1985).

Researchers have found that board interlocks around the world produce varied effects on an organization. In a Malaysian study, the presence of a limited number of interlocked directors on a board provided an incentive for diligent monitoring as they have the knowledge, expertise, skill and incentive to actively monitor the actions of management (Hasim & Rahman, 2011). Similarly, a Columbian study found a positive relation between both the ratio of outside directors and the degree of board interlock, with firm return on assets (Pombo & Gutiérrez, 2011). In contrast, Santella et al. (2009) find that large corporations ("blue chips") in Italy, Germany and France are linked to each other through a small number of interlocking directors who serve on several company boards at the same time, allowing the corporations to operate under covert mutual scrutiny. Moreover, Italian corporations have been found to use board interlocks for collusive purposes (Drago et al., 2011). Finally, other more neutral (networking) effects have also been found. For example, Davison et al. (1984) find that in Australia there is a significant relationship between the number of director interlocks and the probability that interlocked companies are audited by the same public accounting firm. In summary, board interlocks have developed in varying ways internationally, with the research showing positive, negative and neutral effects across jurisdictions.

3. Canadian Setting and Hypotheses Development

Similar to the United States, Canada's legal system, with the notable exception of Quebec[4], is based on British Common law, which is known to have the strongest investor protection (La Porta et al., 1998). Leuz et al. (2003) finds that Canada ranks high on legal enforcement of commercial law and low on the prevalence of earnings management. Furthermore, Canada is known to have relatively weak creditor rights, compared to other industrialized countries, such as Germany or Japan (La Porta et al., 1998). Thus, banks play a "relatively weak" role in influencing corporate governance mechanism in the country and often do not have significant equity in medium and large capital firms (La Port et al., 1999).

The Canadian regulatory environment is ideal for the study of corporate governance, interlocked boards of directors and accounting quality for a variety of reasons. Historically, directors of Canadian corporations have not been the subject of intense scrutiny and more board interlocks have been prevalent than in the United States (Baginski et al., 2002). As well, corporate governance disclosures and practices are mainly voluntary.[5] Similarly, the shift to International Financial Reporting Standards has provided more flexibility in financial reporting. Moreover, Canada is unique in that it has no federal regulatory agency, but rather multiple provincial regulators.[6] Although these provincial agencies and the Canadian Security Administration have worked together towards relatively uniform standards, timely responses are often lacking for emerging issues.[7]

Canada is also known to have a large number of family and closely controlled

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[4] The province of Quebec operates under French Civil law, which has weaker investor protection.
[5] It can be classified as a comply-or-explain regime, where firms either voluntary comply with regulator's recommendation or explain why they do not comply (MacAulay et al., 2009).
[6] In 2011, a proposed Canadian Securities Act would have established a national regulator. However, it was rejected by the Supreme Court of Canada.
[7] For example, in 2013, the Canadian Security Administration released Paper 54-401: Review of the Proxy Voting Infrastructure. This was after similar reports were issued in the United Kingdom (2007), Australia (2008) and the United States (2010).

corporations (Smith & Amoako-Adu, 1999).[8] When family ownership is highly concentrated, the firm tends to lose value and experience governance failures (Silvia & Majluf, 2008). Furthermore, Richardson (1987) finds that in the Canadian environment the least profitable nonfinancial corporations tend to be negatively affected by director interlocks.

With securities scandals such as Enron, Worldcom, YBM Magnex International and Livent, pressure to improve governance practices, such as more effective boards of directors, has influenced the Canadian market. According to Shipilov et al. (2010), as part of a trend to improve corporate governance practices, board reforms spread through large Canadian organizations between 1999 and 2005. This wave of board reforms emphasized increased board independence, separating the CEO and board chairperson positions, and full independence of a board's audit and compensation committees. With the introductions of Bill 198 in 2003, Canada's answer to Sarbanes Oxley (SOX), directors have been discouraged from sitting on too many boards and governance scores have increased (MacAulay et al., 2009). While regulations recommend that Canadian corporations have a majority of independent directors (a minimum of three independent directors are needed for the audit committee), there still tends to be a "cozy-ness" in Canadian corporate governance and proxy battles are unusual (McMillan Binch LLP, 2004). Nonetheless, compared to regulatory environments with more stringent reporting standards, interlocked directors in Canada may have the incentives and opportunities to manage corporate governance information and allow firms to manage earnings.

Institutional investors are also active in the Canadian environment and can influence governance policies. Dedicated institutional investors, who hold more concentrated portfolios with low turnover, may have the incentives to invest in monitoring management and thus influence corporate governance. On the other hand, transient investors, who hold stocks for

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[8] For example Bombardier, McCain, Rogers and Saputo to name a few.

trading purposes, may influence management to engage in less conservative financial reporting practices (Lin, 2016). Activist institutional investors attempt to influence various aspects of corporate governance by private discussions with management and through shareholder proposals (Kahan & Rock, 2007). As well, institutional investors in Canada occasionally go to regulatory authorities to challenge board decisions and processes (McMillan Binch LLP, 2004).

Governance Disclosure Level

The benefits of voluntary disclosures have been well documented in accounting research. Lower cost of capital and increased market liquidity are the main reasons for a firm to voluntarily disclosure additional information (Botosan, 1997; Verrecchia, 1990). On the other hand, there are several indirect costs of voluntary disclosure, such as revealing information to competitors, unions and regulators, as well as litigation risks (Bozec et al., 2004; Dye, 1986). The orientation of disclosures is significantly influenced by the cultural environment in which companies operate (Gray, 1988). In Canada, the extent of voluntary disclosures varies widely among corporations (Bujaki & McConomy, 2002).

There are several reasons why management and directors may want to increase the extent of voluntary disclosures, including governance based disclosures. Decreasing information symmetry via disclosures decreases the cost of external financing and capital and decreases the likelihood of a firm's undervaluation. This in turn should reward management (and directors) with increased stock compensation (Healy & Palepu, 2001). Additionally, a firm may be motivated to voluntarily disclose information in order to increase analyst coverage and signal management talent (Graham et al., 2005). Both of these reasons would benefit executives involved with interlocked directorships.

Although not extensively utilized in the literature, a company's management information

circulars (hereafter known as proxy statements) are the primary communication link with the board of directors for most shareholders (Canadian Coalition for Good Governance, 2012). Important information, such as interlocked boards of directors, director engagement and shareholder engagement, is often only found in a firm's proxy statements. Furthermore, as shown in the literature review, corporate governance disclosure standards change frequently, often on a yearly basis in Canada (Shipilov et al., 2010).

Accurate and complete disclosures are an external control mechanism that reduces firm costs and are fundamental for a number of stakeholders including analysts and investors. The monitoring function of corporate governance significantly influences the propensity for better disclosure practices (Elshandidy & Neri, 2015). Further, board interlocks create a network structure that influences board-level decisions through the sharing of knowledge and experiences, which includes best disclosure policies (Cai et al., 2014; Shropshire, 2010).

Voluntary information disclosures are also driven by a cost-benefit trade-off between proprietary cost concerns and market valuation benefits (Verrecchia, 1983). Additionally, while the quality of its voluntary disclosures is influenced by a firm's governance (Eng & Mak, 2003), boards with less independent non-executive directors are negatively associated with comprehensive disclosures (Chen & Jaggi, 2000). Therefore, consistent with recent studies (Hermalin & Weisbach, 2012), where director interlocks are often perceived negatively, there could very well be a limit to the optimal level of governance disclosure for such firms.

Discretionary governance disclosures may be withheld by a firm due to the negative associations found with interlocked boards of directors. For instance, interlocked boards contribute to higher CEO compensation across industries (Hallock, 1997). Brown (2011) finds that board interlocks increase the likelihood of a firm adopting tax or corporate-owned life

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insurance shelters. Finally, compensation-based incentive to commit financial accounting fraud, such as backdating of stock options, are positively related to interlocked boards (Bizjak et al., 2009; Erickson et al., 2006). Although a firm's disclosure choices are often sticky over time (Healy et al., 1999), Cai et al. (2014) argue that interlocked directors serve as conduits for information that leads to changes in corporate practices and disclosure policies. Furthermore, voluntary governance disclosures provide information directly related to directors' biographies as well as the practices and policies for which they are responsible. Thus, interlocked boards may have a self-serving interest to manage which pieces of information are disclosed. Specifically, interlocked directors may manage information related to corporate governance. Thus, the first set of hypotheses are formed:

> **H1a**: *Agency argument*, there is a <u>negative</u> relationship between interlocking
>
> directorships and the level of voluntary governance disclosures
>
> **H1b**: *Full disclosure argument,* there is a <u>positive</u> relationship between interlocking
>
> directorships and the level of voluntary governance disclosures

Earnings Quality

Earnings quality generally refers to how reasonable and sustainable is the net income of an organization (Dechow & Dichev, 2002). Analogous with voluntary disclosures, firms have choices on which accounting methods and policies to use from a mandatory set (Watts & Zimmerman, 1990). Management may have an incentive to manipulate the accounting numbers depending on the firm's debt/equity ratio or to obtain an optimal bonus, among other motivations (Healy, 1985; Watts & Zimmerman, 1978). Klein (2002) finds that reductions in board independence are associated with lower earnings quality. Using restatements as a proxy for earnings management, Chiu et al. (2013) find that fraudulent accounting practices spread to firms

through interlocked boards of directors. They also argue that interlocked directors can transfer different kinds of knowledge about earnings management to board-linked firms. This could lead to a "hierarchical agency" problem where there are not only conflicts of interest between managers and shareholders, but also conflicts of interest between the board and the shareholders (Cyert et al., 2002). Accordingly, if there is moral hazard inherent in interlocked directors (including an asymmetric information advantage over other directors), then earnings management may be employed as a mechanism to extract private benefits (e.g. higher compensation, more lucrative appointments).

On the other hand, alignment effect theory (Demsetz & Lehn 1985; Shleifer & Vishny, 1986) states that corporate structures may vary systematically (via ownership concentration, management, directors), but do so in order to maximize firm value. Wang (2006) shows that the alignment effects motivate family firms to report earnings of higher quality than nonfamily firms. Although interlocked directors are not "family", they are by definition a concentrated group, and should have incentives to effectively monitor management.[9] If directors have an inherent interest in the firm (above the legal requirements) then this could improve their stewardship role in mitigating information asymmetry. Moreover, Bowen et al. (2008) demonstrates that poor governance practices (such as interlocks) do not necessarily lead to earnings management or poorer firm performance. Additionally, Hasim and Rahman, (2011) find that directors with multiple appointments (busy directors) can result in higher earnings quality. Thus, interlocked directors, which are often considered independent and often have a reputation to maintain, should have an incentive to curb managerial opportunism. Therefore, the second set of hypotheses follows:

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[9] Alignment effect theory is not exclusive to family firms. For example, other studies have shown an alignment effect in global management (Singh et al., 2011) and equity compensation (Devers et al., 2008).

H2a: *Agency argument,* there is a <u>negative</u> relationship between interlocking

directorships and earnings quality

H2b: *Alignment effect argument,* there is a <u>positive</u> relationship between interlocking

directorships and earnings quality

4. Design and Method

Canadian firms have mandatory information that they need to disclose in proxy

statements, such as the nominated directors and executive compensation. However, there are

many quantitative and qualitative items that are optional. For instance, visual aids, details

regarding board interlocks and director succession plans are not required, but are often included.

Following the work of several researchers (Botosan, 1997; Francis, et al., 2005; Xiao & Yuan,

2007), a checklist of voluntarily disclosure proxy statement items (as discussed below) named

the *PDScore* was developed. The items included in the checklist, as well as the scoring, can be

found in Table 1. While other indices focus on other corporate governance elements, such as

board composition or shareholder rights[10], this checklist deals mainly with voluntary governance

disclosures in the proxy statements.

All of the items in the checklist were developed from the Canadian Coalition for Good

Governance's (CCGG) 2011 Best Practices for Proxy Circular Disclosures.[11] The Canadian

Coalition for Good Governance believes that good governance practices contribute to a

company's ability to create value for its shareholders. Its members include institutional investors

that manage approximately $3 trillion in assets on behalf of pension funds, mutual funds and

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[10] For instance, Gompers et al.'s (2003) Governance Index, Brown and Caylor (2006) Gov-Score Index, and
Bebchuk et al.'s (2009) Entrenchment Index.
[11]The Canadian Coalition for Good Governance is a leading non-profit organization/market leader in governance
practices. In several proxy statements examined, firms with a commitment to good governance follow its practices
and/or have its directors meet with the organization to improve its governance.

other investors. The CCGG states that, "(due to) the cumbersome nature of many regulatory filings and the degree of expertise required to understand (...) disclosures can often be greatly improved through the use of plain language." (Canadian Coalition for Good Governance, 2012). Thus, disclosures should be easy to find, easy to understand and provided in context so the information is meaningful. Furthermore, the CCGG provides recommendations for which governance guidelines should be voluntarily disclosed. This includes, but is not limited to, director independence, director interlocks, skills of the board, committees of the board and shareholder engagement.

The checklist employed in this study takes twenty of the most prominent and quantifiable guidelines and develops a score out of twenty. These guidelines from the CCGG tend to be above the minimum requirements of the TSX. Each proxy is thoroughly analyzed to determine whether the underlying guideline has been disclosed, with a score of either one or zero given.[12] Appendix I provides examples of illustrative disclosures. The raw score is then divided by twenty for the regressions.

[Insert Table 1 here]

Interlocks have been measured through various methods in the literature. Fich and White (2005), in their study of CEO interlocks, define director interlocks as reciprocal or mutually interlocking relationships–when directors serve together on at least two boards of two different corporations. This is consistent with the definition of regulators and firms in this study, "an interlock occurs when two or more board members are also board members of another public company" (Bank of Montreal, 2011). Figure 1 visually displays the difference between the direct *Interlock* variable and what is not considered an interlocking relationship in this study.

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[12]Although there is a degree of subjectivity involved, the author applied a consistent approach to all the proxy statements examined. Further, strong internal consistency was found within industries.

The study gathers data regarding directorships from a sample of 120 Toronto Stock Exchange (TSX) medium and large cap listed firms during the 2011 fiscal year. Due to data availability for Canadian firms, the sixty firms from the S&P/TSX 60 are chosen along with a random sample of sixty firms. The starting point was the 60 S&P/TSX 60, which represents a portfolio index of leading Canadian companies in leading industries. The sample was then expanded to include an additional 60 firms from the S&P/TSX 300 (12 firms from the additional sample dropped due to insufficient data and replaced). Data is obtained from COMPUSTAT, the System for Electronic Document Analysis and Retrieval (SEDAR) and the System for Electronic Disclosure by Insiders (SEDI). The following model is employed to test H1:

$$PDScore_i = \alpha_0 + \alpha_1 Interlock_i + \alpha_2 BusyDIR_i + \alpha_3 Size_i + \alpha_4 BoardSize_i + \alpha_5 INDChair_i$$
$$+ \alpha_6 Leverage_i + \alpha_7 BKMK_i + \alpha_8 YoungCEO_i + \alpha_9 OldCEO_i + \alpha_{10} CEOTenure_i$$
$$+ \alpha_{11} Cross\text{-}Listed_i + \alpha_{12} Institutional_i + \alpha_{13\text{-}16} Industry_i + \mu \qquad \text{Eqn. (1)}$$

In the above model, *Interlock* is a dummy variable with a value of one if there was a director interlock and zero otherwise. The paper controls for other factors that may influence disclosure quality: Busy directors, *BusyDIR,* is calculated as the number of other directorships board members hold, scaled by board size (Ferris et al., 2003). Firm size is controlled for, as it is positively related to the level of voluntary disclosure in many jurisdictions (Chow & Wong-Boren, 1987; Hossain, et al., 1994). *Size* is measured using the natural log of the total assets of a corporation. Board size has been found to be positively correlated with firm value and the market responds favorably to board size increases, while unfavorably to large board size decreases (Larmou & Vafeas, 2010). However, an increase in multiple directors often reduces corporate disclosure (Eng & Mak, 2003). *BoardSize* is measured as the total number of directors on board.

The corporate governance literature suggests that when the CEO or another executive is also the chairperson of the board, often too much power is obtained, which leads to an agency problem (Shleifer & Vishny, 1997). Therefore, *INDChair* is a dummy variable with a value of one if there was an independent chair and zero otherwise. *Leverage* is measured as a firm's total debt divided by its total assets. Book-to-market (*BKMK*) is calculated as the book value of equity, excluding preferred shares, divided by the market value of the firm on the balance sheet date. CEO age and CEO tenure have been found to be associated with performance, ethics and financial quality (Dikolli et al., 2014; Huang et al., 2012). Thus, as the literature has found significant differences between younger and older CEOs, *YoungCEO* is an indicator variable if the CEO is under the age of fifty, *OldCEO* is an indicator variable if the CEO is sixty or older and *CEOTenure* measures the number of years in that position. *Cross-listed* is an indicator variable if the firm is listed in the United States. *Institutional* is a dummy variable with a value of one if the firm was owned by an eligible institutional investor and zero otherwise. Finally, as firms often follow the voluntary disclosure trends of their industry, *Industry* dummy variables have been added to control for any inter-industry differences. *Industry2, Industry3, Industry4* and *Industry5* correspond to their two-digit NAICS codes of 21- 23, 31-33, 42-48 and 51-54 respectively, as shown in Table 2, Panel B. A value of one is given if the company is in the specific industry, with a value of zero otherwise. The data is then winsorized for all non-dummy control variables at the 1% and 99% levels. Appendix II provides a list of all the variables.

[Insert Table 2 here]

The modified Jones model as set forth by Dechow et al. (1995), commonly used in accounting research, is employed to determine whether companies with interlocking directors have lower earnings quality. Total accruals are regressed as:

$$TA = \alpha_1(1/A_{it-1}) + \alpha_2 (\Delta REV_{it} - \Delta REC_{it}) + \alpha_3(PPE_{it}) + \mu \qquad \text{Eqn. (2)}$$

where

TA= total accruals scaled by total assets at t-1

$\Delta REVt$ = revenues in year t less revenues in year t-1, scaled by total assets at t-1

$\Delta RECt$ = net receivables in year t less net receivables in year t-1, scaled by total assets at t-1

PPEt = gross property, plant and equipment in year t, scaled by total assets at t-1

At-1 = total assets at t-1

$\alpha1, \alpha2, \alpha3$ = firm specific parameters

μ = the residual

Discretionary accruals (DA) for each firm i in each industry are defined as the difference between the total accruals (TA) and the fitted value of equation (2), as follows:

$$DA_{it} = |TA - [\hat{a}_1 (1/A_{it-1}) + \hat{a}_2 (\Delta REV_{it} - \Delta REC_{it}) + \hat{a}_3(PPE_{it}) | \qquad \text{Eqn. (3)}$$

where

DA= discretionary accruals for company i at time t

A higher amount of discretionary accruals indicates lower quality earnings. The preceding cross-sectional regression is performed for the industry groups in NAICS 21- 23, 31- 33 and 42-48. Since a higher amount of discretionary accruals indicates lower quality earnings, Earnings Quality (*EQ*) is then measured as DA multiplied by negative one.

To test the second hypothesis, a similar regression is run:

$$EQ_i = \alpha_0 + \alpha_1 Interlock_i + \alpha_2 BusyDIR_i + \alpha_3 Size_i + \alpha_4 BoardSize_i + \alpha_5 INDChair_i +$$

$$\alpha_6 Leverage_i + \alpha_7 BKMK_i + \alpha_8 YoungCEO_i + \alpha_9 OldCEO_i + \alpha_{10} CEOTenure_i +$$

$$\alpha_{11} FemaleDIR_i + \alpha_{12} Cross\text{-}listed_i + \alpha_{13} PDScore + \alpha_{14} NetLoss$$

$$+ \alpha_{15\text{-}17} Industry_i + \mu \qquad\qquad \text{Eqn. (4)}$$

The model is similar to Eqn. (1), as the earnings quality literature in accounting often uses similar variables as disclosures for controls, such as *Size*, *Leverage* and *BKMK*. Similarly, many papers control for other governance variables when attempting to isolate a corporate governance effect. Thus, *INDChair*, *YoungCEO*, *OldCEO*, and *CEOTenure* are kept in the model, along with the *PDScore* (for examples of these standard controls and governance controls used in the literature see: Burnett et al., 2015; Chiu et al., 2013; Kim et al., 2012; Nelson & Devi, 2013; Wang, 2006 and Xie et al., 2003). Women on the board of directors have been shown to be linked with more conservative practices, such as a lower likelihood of fraud (i.e. Abbott et al., 2012). Thus, *FemaleDIR* measures the percentage of females on the board. Firms with negative net income are more likely to have lower earnings quality (Dechow et al., 2010). *NetLoss* is a dummy variable with a value of one if the firm had a net loss in the year and zero otherwise. As the modified Jones model is not applicable to financial firms, *Industry5* is eliminated from the equation.[13] Similarly, the three corporations labeled as utilities and three firms in other industries have been removed from this test for the same reason. A description of the samples selected for both hypotheses is shown in Table 2.

[Insert Table 3 here]

5. Results

Sample selection and descriptive statistics

Table 3, Panels A and B, shows the current number of director interlocks of the sample of

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[13] A majority of the firms in the NAICS 51-54 sample were financial organizations.

120 medium and large cap firms listed on the TSX. Data was obtained from 2011-2012 proxy

statements. Canadian organizations have an average of almost one interlocked directorship on

each board of directors. The energy, materials and financial industries (or mining, utilities and

construction & information, financial, insurance, real estate, management and professional

services industries via the NAICS codes) have the highest concentration of interlocked

directorships. While the Securities and Exchange Commission (SEC) in the United States

decrees that a non-independent director cannot serve on an interlocked board of directors in the

same industry (Clayton Antitrust Act of 1914, 2012), the findings reveal that there is a presence

of non-independent board members among the sample that serve on an interlocked directorship

in the same industry.[14]

Descriptive statistics for the sample are shown in Table 4. The financial numbers were

obtained using COMPUSTAT for 88 of the firms. The data for the other firms, which was not

available on COMPUSTAT, were obtained from annual reports on SEDAR. Information on

institutional investors was obtained from SEDI.[15] Corporations with an interlocked board of

directors are larger on average than non-interlocked corporations, especially in regards to total

assets (p-value < 0.05), as well as total PPE and Sales (p-value < 0.10). Interlocked firms also

have significantly higher book-to-market ratios. This could imply that investors perceive

interlocked boards of directors as being a negative factor and incorporate this information into

their stock valuations. Interlocked firms also tend to have a larger board size and be more

leveraged. Non-interlocked firms have shorter CEO tenures (by over two years) and have a

significantly higher percentage of female directors. There is no significant difference between

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[14] Although not specifically looked for in the sample, at least a half dozen non-independent board members have interlocking directorships in the same two-digit NAICS code.

[15] In 2011, owners with a 10% or greater shareholding were required to be identified.

interlocked and non-interlocked firms on the *PDScore*. However, interlocked firms do have significantly lower discretionary accruals across all industries.

[Insert Table 4 here]

Table 5 shows the summary statistics for the mean *PDScores*. The effectiveness of the compensation program/historical compensation had the highest score with 95% of the firms disclosing this information. This is most likely attributed to the large amount of executive compensation data that is required to be disclosed—often taking up close to half the proxy statements examined. On the other hand, only 53% of firms examined included a compensation-performance linkage chart, which is seen as a higher level of voluntary disclosure. Attendance of committee meetings is usually detailed, nominee profiles including share and option ownership, board self-assessment and table of contents or other organizing mechanism scored the next highest, respectively. These disclosures have become common in proxies and are relatively easy to disclose. A policy limiting interlocks and a table clearly showing independence with non-independence explained, seen as high level good governance by the CCGG, are the least likely to be voluntarily disclosed. Among alternative explanations, this could suggest that many of the corporations do not believe that interlocks and independence are materially important.

Not surprisingly, non-interlocked firms were significantly more likely to disclose a policy limiting interlocks as well as to reveal director succession plans (both significance at p-value < 0.05). However, interlocked firms were significantly more likely to have independence policies, disclosed detailed attendance of committee meetings and include a directors' skills matrix (p-value < 0.01). Additionally, interlocked firms were more likely to disclose information regarding nominee profiles showing share and option ownership data (p-value < 0.05).

[Insert Table 5 here]

Table 6 and Table 7 displays Pearson-Spearman correlation of variables matrixes for proxy disclosure scores and earnings quality, respectively. As expected, size and independent chair are both significantly positively correlated with *PDScore*, while CEO Tenure is significantly negatively correlated with *PDScore. Size* and *Board Size* are positively correlated over 0.50 in both the Pearson and Spearman correlations. Multicollinearity is addressed in Section 6. Earnings Quality (EQ) is significantly negatively correlated with *NetLoss* firms, which is hardly surprising. The relationships between both *PDScore* and *EQ* with *Interlock* is positive, but not at significant levels. Size and book-to-market are significantly correlated with *Interlock,* while CEO tenure and female directors' percentage are negatively correlated with *Interlock.*

[Insert Table 6 here]

[Insert Table 7 here]

Multivariate results

The results of the OLS regression for voluntary disclosures are shown in Table 8. The main test variable, director *Interlock*, is found to have a significant negative association with voluntary governance disclosures on a two-tailed t-test. This provides support for the agency argument (H1a) at 0.04, which states that interlock directors may have an incentive to withhold information.

There is a strong negative relation between *PDScore* and *OldCEO* (supported at 0.02). This is consistent with the notion that older CEOs are associated with lower disclosure quality. The results also indicate that there are positive associations between both firm *Size* and *INDChair* with the *PDScore* (supported at < 0.01). The positive coefficient of independent chair is consistent with prior research that finds having an independent chairperson improves corporate governance practices. *BusyDIR* are found to have a positive association with the governance

disclosures (supported at 0.03), consistent with research on multiple boards that busy directors

can have positive effects on a firm. Moreover, *Board Size*, *Leverage*, *BKMK*, *CEOTenure,*

YoungCEO, Cross-listed, *Institutional* are all insignificant in the model. Thus, when other

characteristics of good governance are controlled for, there is no longer an insignificant

difference between the interlocked and non-interlocked firms.

[Insert Table 8 here]

The results of the OLS regression for earnings quality are shown in Table 9. *Interlock*

firms have greater earnings quality. This provides support for the alignment effect argument

(H2b), supported at 0.06. The only control variable to have a significant effect is *NetLoss*, which

is significantly associated with lower earnings quality (higher discretionary accruals), as has

been shown in the extant literature. All of the other control variables are insignificant in the

model.

[Insert Table 9 here]

6. Supplementary Analysis

Additional Testing

As an alternative to the checklist method for testing H1, the Globe and Mail/Report on

Business Board Games 2011 governance ratings are utilized. These governance rankings,

perhaps the most widely known in Canada, rank major corporations on best corporate

governance practices annually. The Board Games methodology and scoring for 2011 are: board

composition (out of 31), shareholder rights (out of 31), shareholding and compensation (out of

26) and disclosure (out of 12). Although not a direct substitute for voluntary governance

disclosures, it is still predicted to have the same relationship with interlocking directors. Table 10

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shows the Pearson-Spearman correlations between *PDScore* with *GlobeScore* and the Globe sub-categories. *PDScore* and *GlobeScore* are significantly correlated (p-value < 0.01) at 0.72 and 0.73 in the respective correlation results. Additionally, *PDScore* is significantly correlated with all the Globe sub-categories. Next, *GlobeScore* is substituted for *PDScore* as follows:

$$GlobeScore_i = \alpha_0 + \alpha_1 Interlock_i + \alpha_2 BusyDIR_i + \alpha_3 Size_i + \alpha_4 BoardSize_i + \alpha_5 INDChair_i$$

$$+ \alpha_6 Leverage_i + \alpha_7 BKMK_i + \alpha_8 YoungCEO_i + \alpha_9 OldCEO_i + \alpha_{10} CEOTenure_i$$

$$+ \alpha_{11} Cross\text{-}Listed_i + \alpha_{12} Institutional_i + \alpha_{13\text{-}16} Industry_i + \mu \qquad \text{Eqn. (5)}$$

Table 11 shows the results from the Globe and Mail governance scores regressions. Firms from the proxy disclosure sample that were not included in the Board Games scoring list were dropped. In the first column, the test is run with the full score out of 100. Since board composition is endogenous with *Interlock* and other variables in the model, the board composition category is dropped and scored out of 69 in the second column. The coefficient on *Interlock,* similar to the *PDScore*, is negatively and significantly associated with *GlobeScore* in both of the columns. In fact, the significant level of the first *GlobeScore* regression show a stronger negative relationship with *Interlock* (supported at 0.03) than the main regression- this is explored further in the sensitivity analysis. Also noted is that *BusyDIR* is not significant in this model.

[Insert Table 10 here]

[Insert Table 11 here]

With each province having its own corporate rules and regulations, corporate interests have distinctively multi-jurisdictional models of corporate governance (Gray, 2010). Table 12 reruns the *PDScore* regressions by province to determine whether there are any provincial effects

on *Interlock* with the *PDScore*. The provinces with the most observations—Alberta, Ontario and Quebec— along with all the other provinces combined are examined. Results show that firms headquartered in Ontario and Quebec (60% of the sample) are strongly driving the negative *Interlock-PDScore* association. This is consistent with the notion that Quebec's civil law provides weaker investor protection. There is no significant effect found for Alberta firms, but consistent (albeit not significant) results for the group of other provinces. *EQ* is also regressed by province; however no significant results are found (with sample sizes of only 17-30, it is likely that the tests lack power). Finally, a pooled regression is run (not tabulated) which shows that the negative interlock relationship is strongest and only significant in the subsample of Ontario firms.

[Insert Table 12 here]

The Kothari et al. (2005) performance matched discretionary accrual model is utilized as an alternative earnings quality test. First, discretionary accruals are measured based on the modified-Jones model with return on assets (*ROA*). Each firm is then matched with the closest *ROA* firm in its industry and performance-matched discretionary accruals are equal to the difference between discretionary accruals and the corresponding performance-matched firm's discretionary accruals. Once again *EQ* is equal to DA multiplied by minus one. Table 13 shows the results of the Kothari model. The magnitude of the coefficients are actually larger, but measured with less precision in this model. For instance, *Interlock* has a 0.028 coefficient versus 0.017in the main regression. In this model, firms with a higher *PDScore* are associated with higher earnings quality (significant at 0.07). The rest of the results show consistent directions as the main regression; however none of the variables except for *Size* have a significant relationship.

[Insert Table 13 here]

Data from the two main models (Governance Disclosures and Earning Quality) are also examined comparing the firms with one interlocking directorship against firms with more than one interlocking directorship. No significant differences are found for Governance Disclosures or Earning Quality (proxy disclosure scores are found to be almost identical for both interlocked groups). Similarly, the regressions are rerun comparing firms with no interlocking directorships to firms with multiple interlocking directorships. Once again, the results are robust/show almost identical results as the main regressions for both models (not tabulated). Finally, two measures of tax avoidance, GAAP-effective tax rate and cash-effective tax rate, are run using a similar model as Eqn. (1) and Eqn. (4). These tests are performed since the structure of the board can influence the tax policy of a firm (Kim & Zhang, 2016). The regressions (not tabulated) show no association between *Interlock* and how much GAAP-based or actual cash taxes a firm pays.

Sensitivity Analysis

Instead of *Interlock* being an indicator variable, an alternative measure- *%Board-Interlocked* was inserted into Eqn. (1). Percentage of board interlocked is measured as the number of directors in interlocking relationships divided by the total number of board members. The first column of Table 14 (pdscore_20) shows the result of the regression. The results are identical to the original model with *%Board-Interlocked* and *OldCEO* having a significant negative association with *PDScore* and *BusyDIR, Size* and *INDChair* having a significant positive association with *PDScore.* Additionally, to address possible multicollinearity between *Size* and *Board Size*, an alternative measure for *Board Size* was employed (board size divided by the log of total assets). This measure is not significantly correlated with *Size* and the regressions (not tabulated) show that the results are consistent.

To eliminate possible endogeneity from the dependent proxy disclosure score variable and the independent *INDChair* variable, Best Practice Disclosure number six (Independence of the Board Chair), is eliminated and a new *PDScore* is calculated out of 19[16]. The results of the robustness test, based on Eqn. (1), are shown in Table 14. *INDChair* is still significant at the 1% level. The negative effect of *Interlock* (and positive effect of *BusyDIR*) on *PDScore19* are essentially the same. Similarly, to address concerns about possible endogeneity from interlock, Best Practice Disclosure numbers four and five are taken out of *PDScore*[17]. The score is then calculated out of 18. Finally, all three checklist items (Best Practice Disclosure numbers four, five and six) are eliminated from the checklist. Once again the results for all of the models are still essentially the same.

[Insert Table 14 here]

PDScore is separated into two parts: checklist items that only deal with disclosures in the proxy statements (*DisclosuresOnly*) and items that also encompass governance policies or practices (*PoliciesPracticesDisclosures*). Eight of the items are identified as dealing with corporate policies and/or best practices (numbers three, five, six, eleven, fifteen, sixteen, seventeen, and twenty- see Table 1), while the remaining twelve are considered purely disclosures. Descriptive statistics (not tabulated) reveal that interlocked firms actually scored higher on the *DisclosuresOnly* category (8.78 vs. 7.81), but interlocked firms scored lower on the *PoliciesPracticesDisclosures* category (4.58 vs. 4.77). The new checklists are substituted for *PDScore* and regressions are run, as shown in Table 15. The *DisclosuresOnly* column shows that there are no significance differences between interlock and non-interlocked firms. However, interlocked firms score significantly lower in the *PoliciesPracticesDisclosures* column. Thus, the

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[16] Although this checklist item measures whether the chairperson is independent, whether this information is clearly shown in the proxy statement <u>and</u> whether this information is discussed.

[17] These two checklist items measure whether interlocks and interlock policies are discussed in the proxy statements.

results show that it is the disclosure of governance practices driving the results, rather than just the other disclosures recommended by the CCGG. As well, these results are consistent with those found while employing *GlobeScore* as the dependent variable. Additionally, it should be noted that older CEOs have significantly negative relationships with all the governance scores. Thus, this gives stronger evidence for H1a that there is an agency effect in regards to governance disclosures. Interlock directors are not associated with simple or basic disclosures (measured by *DisclosuresOnly*), but are negatively associated (supported at <0.01) with higher level governance disclosures (measured by *PoliciesPracticesDisclosures*).

[Insert Table 15 here]

Overall, the results suggest that there is a negative relationship with interlocks and voluntary governance disclosures/corporate governance. Although the univariate statistics do not find a significant difference between *Interlock* and *PDScore*, when other governance factors are controlled for then the relationship is revealed. Furthermore, the *PDScore* is highly correlated with the *GlobeScore* (0.73) which also documents this relationship- as do a number of robustness and additional tests. Finally, standard errors robustness tests for heteroskedasticity are performed for all the regressions and no significant changes to the results were found.

7. Discussion and Conclusion

This study contributes to ongoing corporate governance research regarding interlocked board of directors. Using a sample of 120 medium and large cap Canadian firms, the study extends prior research by examining the relationship of interlocked directorships and the level of voluntary governance disclosures, governance quality and the quality of reported earnings. Previous work has found mixed results linking interlocked board of directors with corporate

governance and accounting measures. Using a direct measure of interlocks and accruals as a proxy for earnings quality, this study finds that board interlocks have a negative effect on the level of governance disclosures, but a positive effect on earnings quality. This supports an agency theory perspective (hypothesis 1a) for disclosures where interlocked boards have a self-serving interest to manage which pieces of information about them are disclosed. On the other hand, as earnings quality is often seen by investors as more imperative than voluntary disclosures, the interlock findings suggest that interlocked boards may have an overall positive effect on the performance of a firm. Governance disclosures are also most significantly associated with firm size and the independence of the chairperson.

Interlocked boards of directors are found to provide fewer governance disclosures, but enhanced earnings quality. This suggests that regulation limiting board interlocks may not be necessary, at least from an accounting point of view. The results are consistent with (hypothesis 2b) alignment effect theory. Alignment effect theory predicts that ownership concentration creates incentives to report high quality earnings, as the controlling shareholders have incentives to keep earnings management within proper bounds. Family, blockholder or other closely controlled corporations have a long term investment horizon, are more likely to be actively involved in management and are less likely to focus on short term earnings (Villalonga & Amit, 2006). The results found here can extend alignment effect theory to include interlocks. By interlocking boards of directors, firms can obey regulations, such as independence rules, while establishing reciprocal relationships with other firms where ownership concentration is high.[18] Interlocked boards of directors are almost always reciprocal shareholders. Moreover, this aspect of alignment theory can explain the low voluntary governance disclosure/high earnings quality

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[18] Desender et al. (2013) and Di Bartolomeo & Canofari (2015) provide comprehensive discussions on interlocked directors, board structures and ownership concentrations.

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findings of this paper, as these firms have long term incentives and sufficient monitoring (Demsetz & Lehn, 1985), but low motivation to disclose proprietary information (in this case important governance information relating to a firm's policies and practices).

To the author's knowledge this is the first paper examining how interlocks relate to corporate governance and earnings quality in the Canadian environment. It adds to the literature by finding that when firms have some reporting discretion, interlocked boards of directors are associated with lower corporate governance disclosures, but higher earnings quality. Although this study employs a cross-sectional methodology in measuring interlocked directorships, a potential limitation is that only one year was analyzed. This year was particularly good for Canadian firms, compared with 2009 and 2010 when earnings were lower due to a recession. Thus, other accrual based models may be examined along with time series regressions. While this study shows that interlocking directorships do affect disclosures and earnings quality, future research may determine whether these associations are permanent over a longer period. Other related accounting, finance and general corporate governance variables can also be analyzed. Moreover, future research could also focus explicitly on who appoints the interlocked directors—be it CEO recommendations or institutional investors.

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Table 1
Voluntary Proxy Disclosure Score (PDScore) Checklist

Best Practice Disclosure	Scoring (1 if disclosed, 0 otherwise)
1) Table of contents or other organizing mechanism	Coded 1 if a table of contents or a similar organizing mechanism is provided
2) Visual aids employed	Coded 1 if a number of coloured graphs or charts are provided and/or directors' pictures are provided
3) Majority voting policy	Coded 1 if a majority voting policy has been implement and clearly disclosed
4) Board interlocks/no board interlocks discussed	Coded 1 if board interlocks (or lack of) are clearly shown and discussed
5) Policy limiting interlocks	Coded 1 if a policy limiting board interlocks is discussed
6) Policy of board chair independence	Coded 1 if there is a policy for the board chairperson's independence and it is clearly shown in the proxy and discussed
7) Table clearly showing independence with non-independence explained	Coded 1 if a table clearly showing the independence of each director is provided, with all non-independent directors explained why
8) Nominee profiles including share and option ownership	Coded 1 if disclosures show the share and options ownership of each director in main nominee profile
9) Nominee profiles are well organized, provide useful information and are easy to read	Coded 1 if director information is well organized, clear, easy to read and not overly wordy in description (easy for reader to find desired information)
10) Director skills matrix	Coded 1 if a clear director skills matrix is provided, (e.g. listing the directors on the vertical axis and the skills on the horizontal axis)
11) Director succession plan	Coded 1 if disclosures indicate that a director succession plan is in place and some details are provided
12) Director compensation is detailed, well-organized and written in plain language	Coded 1 if director compensation is detailed, well-organized and written in plain language
13) Table/chart to show committees of the board	Coded 1 if a clear table, chart or matrix is provided, listing the directors on one axis and the committees on the other axis
14) Attendance of committee meetings is detailed	Coded 1 if attendance for each committee member is provided
15) Board of Directors peer evaluation	Coded 1 if a director's peer evaluation program has been disclosed with details beyond the minimum requirements
16) Board of Directors self-assessment	Coded 1 if a directors' self-assessment program has been disclosed with details beyond the minimum requirements
17) Directors continuing education program details	Coded 1 if disclosures indicate a directors' continuing education program with details beyond the minimum requirements

18) Effectiveness of the compensation program/historical compensation	Coded 1 if disclosures discuss the effectiveness of the compensation program or historical compensation is shown beyond the minimum requirements
19) Compensation-performance linkage chart	Coded 1 if a visual mechanism is employed to show the reader the link between executive compensation and performance
20) Shareholder Say on Pay	Coded 1 if a shareholder "Say on Pay" program has been implemented and clearly disclosed

TOTAL SCORE /20

Table 2
Sample Descriptions

Panel A: Sample description for Voluntary Disclosures

Total sample[19]	132
Less 12 for which data or proxy statements were not available	(12)
Final Sample for H1	120

Panel B: Sample description for Earnings Quality

Final Sample for H1	120
Less 24 Financial firms not included in the modified Jones model	(24)
Less 3 Utilities firms not included in the modified Jones model	(3)
Less 3 Other Industry firms not included in the modified Jones model	(3)
Final Sample for H2	90

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[19] Includes 12 random firms with insufficient data, which were then replaced to arrive at the final sample size of 120

Table 3
Industry Composition of Sample TSX Firms

Panel A: Industry Composition

Industry	Sample	% with Interlocks	Average # Interlocks
Consumer	25	44.00%	0.44
Energy	23	73.91%	1.30
Financial	13	69.23%	1.08
Health Care	1	0.00%	0.00
Industrial	17	47.06%	0.82
Information Technologies	2	50.00%	0.50
Materials	23	56.52%	1.04
Media	6	50.00%	0.67
Telecommunication Services	3	66.67%	1.33
Transportation	2	100.00%	3.00
Utilities	3	66.67%	1.00
Wholesale	2	0.00%	0.00
TOTAL	120	56.67%	0.93

Panel B: Industry Composition by NAICS Code

Industry	Sample	% with Interlocks	Average # Interlocks
21- 23 Mining, Utilities and Construction			
	44	68.18%	1.27
31-33 Manufacturing			
	27	44.44%	0.59
42-48 Retailers and Wholesalers			
	22	50.00%	0.73
51-54 Information, Financial, Insurance, Real Estate, Management and Professional Services			
	24	58.33%	0.88
71-72 Entertainment, Accommodation and Food Services			
	3	33.33%	0.67
TOTAL	120	56.67%	0.93

Table 4
Descriptive Statistics of Interlocked and Non-Interlocked Firms

Variable	Interlocked Mean (n=68)	Non-Interlocked Mean (n=52)	T-test between Interlocked vs. Non-Interlocked firms
Asset	62925	16991	2.00**
PPE	10754	6565	1.58*
Sales	8945	6445	1.37*
BoardSize	11.6	10.5	1.83*
Leverage	0.239	0.197	1.58*
BKMK	0.819	0.566	2.39**
CEOTenure	6.471	8.654	-1.85*
FemaleDIR	0.129	0.165	-1.77*
Cross-listed	0.471	0.462	0.10
Institutional	0.147	0.154	0.10
PDScore	13.37	12.58	1.08
DA	(n=51) 0.040	(n=39) 0.051	-1.40*

See Appendix II for variable definitions
*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level, two-tailed

Table 5
Summary Statistics of Proxy Disclosure Scores

	Interlocked	Non-Interlocked	T-test between Interlocked and Non-Interlocked	All
1) Table of contents or other organizing mechanism	0.81	0.81	0.02	0.81
2) Visual aids employed	0.74	0.65	0.96	0.70
3) Majority voting policy	0.65	0.73	-0.97	0.68
4) Board interlocks/no board interlocks discussed	0.69	0.65	0.43	0.68
5) Policy limiting interlocks	0.07	0.21	-2.23**	0.13
6) Independence policies	0.74	0.52	2.49***	0.64
7) Table clearly showing independence with non-independence explained	0.35	0.37	-0.14	0.36
8) Nominee profiles including share and option ownership	0.93	0.81	1.96**	0.88
9) Nominee profiles are well organized, provide useful information and are easy to read	0.78	0.71	0.84	0.75
10) Director skills matrix	0.51	0.27	2.77***	0.41
11) Director succession plan	0.46	0.65	-2.18**	0.54
12) Director compensation is detailed, well-organized and written in plain language	0.78	0.79	-0.12	0.78
13) Table/chart to show committees of the board	0.66	0.56	1.16	0.62
14) Attendance of committee meetings is detailed	0.97	0.83	2.77***	0.91
15) Board of Directors peer evaluation	0.68	0.69	-0.18	0.68
16) Board of Directors self assessment	0.85	0.83	0.38	0.84
17) Directors continuing education program details	0.71	0.71	-0.07	0.71
18) Effectiveness of the compensation program/historical compensation	0.97	0.92	1.18	0.95
19) Compensation-performance linkage chart	0.59	0.44	1.59*	0.53
20) Shareholder Say on Pay	0.44	0.42	0.20	0.43

Non-Interlocked: Mean score for non-interlocked firms
Interlocked: Mean score for interlocked firms
T-test: Two tailed t-tests between Non-Interlocked and Interlocked means
All: Mean score for all firms in sample
*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level

Table 6
Correlation Matrix of Variables for Voluntary Disclosures, Pearson (Spearman) correlations above (below) diagonal

	PDScore	Interlock	Busy DIR	Size	Board Size	IND Chair	Leverage	BKMK	CEO Tenure
PDScore		0.05	0.10	0.48***	0.42***	0.45***	0.09	-0.07	-0.22**
Interlock	0.03		0.14	0.21**	0.20**	0.18*	0.12	0.21**	-0.19**
Busy DIR	0.10	0.10		-0.10	-0.08	-0.02	0.10	-0.03	0.00
Size	0.51***	0.20**	-0.04		0.64***	0.13	0.13	0.03	-0.13
Board Size	0.41***	0.20**	-0.07	0.64***		0.18*	0.26***	-0.09	-0.14
IND Chair	0.47***	0.18*	-0.05	0.14	0.18*		0.06	-0.05	-0.19*
Leverage	0.09	0.13	0.09	0.23**	0.26***	0.09		0.07	-0.17*
BKMK	0.07	0.23**	-0.10	0.14	0.07	0.03	0.19*		-0.01
CEO Tenure	-0.19*	-0.20**	-0.06	-0.13	-0.12	-0.16	-0.16	-0.12	

See Appendix II for variable definitions
*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level

Table 7
Correlation Matrix of Variables for Earnings Quality, Pearson (Spearman) correlations above (below) diagonal

	EQ	Interlock	Size	Leverage	BKMK	Female DIR	Cross-listed	NetLoss	PDScore
EQ		0.15	0.04	0.10	-0.24**	0.10	0.03	-0.35***	0.11
Interlock	0.13		0.16	0.24**	0.24**	0.26**	-0.08	-0.05	0.08
Size	0.01	0.17		0.30***	0.07	0.19*	0.16	-0.21*	0.50***
Leverage	0.04	0.21**	0.26**		0.10	0.02	-0.10	-0.01	0.10
BKMK	-0.15	0.23**	0.14	-0.04		-0.24**	-0.14	-0.36***	-0.04
Female DIR	0.04	-0.29***	0.25**	0.07	-0.11		0.04	-0.13	0.14
Cross-listed	0.11	-0.07	-0.10	-0.10	-0.05	0.10		0.11	0.16
NetLoss	-0.26**	-0.05	-0.03	-0.04	0.25**	-0.11	0.11		-0.11
PDScore	0.08	0.05	0.53***	0.14	0.03	0.20*	0.14	-0.12	

See Appendix II for variable definitions
*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level

Table 8
Results of OLS Regression for Voluntary Disclosures

$PDScore_i = \alpha_0 + \alpha_1 Interlock_i + \alpha_2 BusyDIR_i + \alpha_3 Size_i + \alpha_4 BoardSize_i + \alpha_5 INDChair_i + \alpha_6 Leverage_i + \alpha_7 BKMK_i + \alpha_8 YoungCEO_i + \alpha_9 OldCEO_i + \alpha_{10} CEOTenure_i + \alpha_{11} Cross\text{-}Listed_i + \alpha_{12} Institutional_i + \alpha_{13\text{-}16} Industry_i + \mu$

Variable	Expected Sign	OLS Coefficient (t-statistic)
Interlock	?	-0.063**
		(-2.03)
BusyDIR	+	0.058**
		(2.17)
Size	+	0.049***
		(4.23)
BoardSize	+	0.105
		(1.53)
INDChair	+	0.179***
		(5.63)
Leverage	-	-0.135
		(-1.27)
BKMK	-	0.001
		(0.03)
YoungCEO	+	0.018
		(0.49)
OldCEO	-	-0.084**
		(-2.17)
CEOTenure	-	-0.001
		(-0.36)
Cross-listed	+	0.001
		(-0.04)
Institutional	+	-0.047
		(-1.14)
Constant	?	-0.101
		(-0.71)
Industry Effects		Yes
Observations		120
R²		0.515

See Appendix II for variable definitions
*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level, two-tailed

Table 9
Results of OLS Regression for Discretionary Accruals

$EQ_i = \alpha_0 + \alpha_1 Interlock_i + \alpha_2 BusyDIR_i + \alpha_3 Size_i + \alpha_4 BoardSize_i + \alpha_5 INDChair_i + \alpha_6 Leverage_i + \alpha_7 BKMK_i + \alpha_8 YoungCEO_i + \alpha_9 OldCEO_i + \alpha_{10} CEOTenure_i + \alpha_{11} FemaleDIR_i + \alpha_{12} Cross\text{-}listed_i + \alpha_{13} PDScore + \alpha_{14} NetLoss + \alpha_{15\text{-}17} Industry_i + \mu$

Variable	Expected Sign	OLS Coefficient (t-statistic)
Interlock	?	0.017* (1.90)
Size	+	-0.004 (-1.07)
INDChair	+	-0.006 (-0.65)
Leverage	-	0.029 (0.93)
BKMK	-	-0.009 (-1.26)
YoungCEO	+	0.013 (1.35)
OldCEO	-	0.012 (1.05)
CEOTenure	-	0.000 (0.59)
FemaleDIR	+	0.024 (0.51)
Cross-listed	+	0.010 (1.04)
PDScore	+	0.031 (1.16)
NetLoss	-	-0.029** (2.10)
Constant	?	-0.050 (-1.65)
Industry Effects		Yes
Observations		90
R²		0.233

See Appendix II for variable definitions
*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level, two-tailed

Table 10
Pearson-Spearman Correlation for Proxy Disclosures and Globe and Mail Governance Scores

	PD Score	Globe Score	Globe_ Board	Globe_ Shareholder	Globe_ Comp	Globe_ Disclosure
PD Score		0.72***	0.62***	0.54***	0.56***	0.58***
Globe Score	0.73***					
Globe_ Board	0.66***					
Globe_ Shareholder	0.58***					
Globe_ Comp	0.56***					
Globe_ Disclosure	0.58***					

PD Score: Proxy Disclosure score (/20)
Globe Score: Globe and Mail/Report on Business Board Games governance score (/100)
Globe_Board: Globe score Board Composition category (/31)
Globe_Shareholder: Globe score Shareholder Rights category (/31)
Globe_Comp: Globe score Shareholding and Compensation category (/26)
Globe_Disclosure: Globe score Voluntary Disclosures category (/12)

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level

Table 11
Results of OLS Regression for Globe and Mail Governance Scores[20]

$GlobeScore_i = \alpha_0 + \alpha_1 Interlock_i + \alpha_2 BusyDIR_i + \alpha_3 Size_i + \alpha_4 BoardSize_i + \alpha_5 INDChair_i + \alpha_6 Leverage_i + \alpha_7 BKMK_i + \alpha_8 YoungCEO_i + \alpha_9 OldCEO_i + \alpha_{10} CEOTenure_i + \alpha_{11} Cross\text{-}Listed_i + \alpha_{12} Institutional_i + \alpha_{13\text{-}16} Industry_i + \mu$

Variable	OLS Coefficient (t-statistic) (globe_100)	OLS Coefficient (t-statistic) (globe_69)
Interlock	-0.057**	-0.060*
	(-2.27)	(-1.96)
BusyDIR	0.016	0.025
	(0.73)	(0.95)
Size	0.055***	0.067***
	(5.59)	(5.61)
BoardSize	0.003	0.002
	(0.51)	(0.35)
INDChair	0.126***	0.102***
	(5.08)	(3.35)
Leverage	-0.065	-0.068
	(-0.79)	(-0.68)
BKMK	-0.066**	-0.073**
	(-2.52)	(-2.27)
YoungCEO	-0.033	-0.037
	(-1.16)	(-1.04)
OldCEO	-0.030	-0.054
	(-0.99)	(-1.43)
CEOTenure	-0.004*	-0.004*
	(-1.91)	(-1.70)
Cross-listed	-0.021	-0.037
	(-0.81)	(-1.18)
Institutional	-0.026	-0.009
	(-0.77)	(-0.21)
Constant	0.375	0.343
	(3.50)	(2.61)
Industry Effects	Yes	Yes
Observations	96	96
R²	0.605	0.536

See Appendix II for variable definitions
*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level, two-tailed

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[20] Table 11 has the Globe and Mail/Report on Business Board Games governance score (*GlobeScore*) as the dependent variable, in place of the Proxy Disclosure Score (*PDScore*).

Table 12
Results of Provincial Effects on Voluntary Disclosures[21]

$PDScore_i = \alpha_0 + \alpha_1 Interlock_i + \alpha_2 BusyDIR_i + \alpha_3 Size_i + \alpha_4 BoardSize_i + \alpha_5 INDChair_i + \alpha_6 Leverage_i + \alpha_7 BKMK_i + \alpha_8 YoungCEO_i + \alpha_9 OldCEO_i + \alpha_{10} CEOTenure_i + \alpha_{11} Cross\text{-}Listed_i + \alpha_{12\text{-}15} Industry_i + \mu$

Variable	OLS Coefficient (t-statistic) (Alberta)	OLS Coefficient (t-statistic) (Ontario)	OLS Coefficient (t-statistic) (Quebec)	OLS Coefficient (t-statistic) (Other provinces)
Interlock	0.008	-0.150***	-0.161**	-0.157
	(0.08)	(-3.31)	(-2.97)	(-1.42)
BusyDIR	0.053	0.038	0.115**	0.093
	(0.50)	(1.07)	(2.29)	(0.97)
Size	0.008	0.070***	-0.029	0.133**
	(0.14)	(4.69)	(-0.82)	(2.91)
BoardSize	0.269	0.181	-0.150	-0.025
	(0.87)	(2.10)	(-0.81)	(-0.09)
INDChair	0.156	0.192***	0.225***	0.295*
	(0.98)	(3.84)	(3.32)	(2.27)
Leverage	-0.414	0.030	-0.087	-0.013
	(-1.01)	(-0.21)	(-0.28)	(-0.05)
BKMK	-0.070	0.003	-0.005	0.095
	(-0.58)	(0.10)	(-0.13)	(0.90)
YoungCEO	-0.057	0.073	0.063	-0.118
	(-0.31)	(1.20)	(0.82)	(-0.99)
OldCEO	-0.149	0.037	-0.069	-0.208
	(-1.04)	(0.67)	(-0.77)	(-1.74)
CEOTenure	0.001	-0.005	-0.015***	-0.010
	(0.03)	(-1.22)	(-3.27)	(-1.29)
Cross-listed	0.027	-0.096	-0.090	-0.033
	(0.23)	(-1.87)	(-1.11)	(-0.33)
Constant	-0.390	-0.331	1.230	-0.533
	(-0.57)	(-1.77)	(3.29)	(-1.03)
Industry Effects	Yes	Yes	Yes	Yes
Observations	26	48	24	22
R^2	0.610	0.726	0.890	0.833

See Appendix II for variable definitions
*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level, two-tailed

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[21] Table 12 runs the main disclosures model separately for firms headquartered in the provinces of Alberta, Ontario, Quebec, and in any other province.

Table 13
Results of Robustness Test for Discretionary Accruals[22]

$EQ_i = \alpha_0 + \alpha_1 Interlock_i + \alpha_2 BusyDIR_i + \alpha_3 Size_i + \alpha_4 BoardSize_i + \alpha_5 INDChair_i + \alpha_6 Leverage_i + \alpha_7 BKMK_i + \alpha_8 YoungCEO_i + \alpha_9 OldCEO_i + \alpha_{10} CEOTenure_i + \alpha_{11} FemaleDIR_i + \alpha_{12} Cross\text{-}listed_i + \alpha_{13} PDScore + \alpha_{14} NetLoss + \alpha_{15\text{-}17} Industry_i + \mu$

Variable	Expected Sign	OLS Coefficient (t-statistic)
Interlock	?	0.028 (1.45)
Size	+	-0.017** (-2.16)
INDChair	+	-0.026 (-1.27)
Leverage	-	0.042 (0.64)
BKMK	-	-0.016 (-1.12)
YoungCEO	+	0.000 (0.02)
OldCEO	-	0.015 (0.62)
CEOTenure	-	-0.001 (-0.58)
FemaleDIR	+	-0.013 (-0.13)
Cross-listed	+	0.027 (1.40)
PDScore	+	0.107* (1.85)
NetLoss	-	-0.028 (0.99)
Constant	?	0.083 (1.33)
Industry Effects		Yes
Observations		90
R²		0.158

See Appendix II for variable definitions
*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level, two-tailed

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[22] Table 13 employs the Kothari et al. (2005) performance matched discretionary accrual model of earnings quality is run instead of the main (Dechow, et al., 1995) model.

Table 14
Results of Robustness Tests of Voluntary Disclosures[23]

$PDScore_i = \alpha_0 + \alpha_1 Interlock_i + \alpha_2 BusyDIR_i + \alpha_3 Size_i + \alpha_4 BoardSize_i + \alpha_5 INDChair_i + \alpha_6 Leverage_i + \alpha_7 BKMK_i + \alpha_8 YoungCEO_i + \alpha_9 OldCEO_i + \alpha_{10} CEOTenure_i + \alpha_{11} Cross\text{-}Listed_i + \alpha_{12-15} Industry_i + \mu$

Variable	OLS Coefficient (t-statistic) (pdscore_20)	OLS Coefficient (t-statistic) (pdscore_19)	OLS Coefficient (t-statistic) (pdscore_18)	OLS Coefficient (t-statistic) (pdscore_17)
Interlock		-0.062* (-1.86)	-0.056* (-1.74)	-0.059* (-1.74)
%Board-Interlocked	-0.172* (-1.87)			
BusyDIR	0.064** (2.35)	0.060** (2.11)	0.056** (2.01)	0.058* (1.98)
Size	0.050*** (4.31)	0.052*** (4.27)	0.050*** (4.22)	0.053*** (4.21)
BoardSize	0.073 (1.07)	0.100 (1.38)	0.121* (1.72)	0.125* (1.69)
INDChair	0.168*** (5.39)	0.132*** (3.98)	0.187*** (5.74)	0.144*** (4.19)
Leverage	-0.148 (-1.40)	-0.139 (-1.25)	-0.104 (-0.95)	-0.106 (-0.92)
BKMK	-0.013 (-0.51)	-0.007 (-0.27)	0.002 (0.06)	-0.002 (-0.06)
YoungCEO	0.008 (0.24)	0.015 (0.39)	0.022 (0.59)	0.024 (0.62)
OldCEO	-0.092** (-2.38)	-0.092** (-2.27)	-0.090** (-2.27)	-0.092** (-2.21)
CEOTenure	-0.001 (-0.52)	-0.001 (-0.22)	0.000 (0.05)	0.000 (0.05)
Cross-listed	-0.006 (-0.17)	0.002 (0.08)	0.004 (0.12)	0.007 (0.20)
Constant	-0.114 (-0.34)	-0.114 (-0.72)	-0.155 (-1.00)	-0.154 (-0.94)
Industry Effects	Yes	Yes	Yes	Yes
Observations	120	120	120	120
R^2	0.507	0.459	0.526	0.472

See Appendix II for variable definitions
*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level, two-tailed

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[23] In the first column of Table 14, the main disclosures model is run with *%Board-Interlocked* as an alternative to the *Interlock* dummy variable. Columns two to four run the main disclosures model, but eliminate possible endogenous items from the Proxy Disclosure Score (*PDScore)* (reducing the score to 19, 18 and 17, respectfully).

Table 15
Results of Robustness Tests of Proxy Disclosures Score[24]

$Score_i = \alpha_0 + \alpha_1 Interlock_i + \alpha_2 BusyDIR_i + \alpha_3 Size_i + \alpha_4 BoardSize_i + \alpha_5 INDChair_i + \alpha_6 Leverage_i$
$+ \alpha_7 BKMK_i + \alpha_8 YoungCEO_i + \alpha_9 OldCEO_i + \alpha_{10} CEOTenure_i + \alpha_{11} Cross\text{-}Listed_i +$
$\alpha_{12} Institutional_i + \alpha_{13\text{-}16} Industry_i + \mu$

Variable	Expected Sign	OLS Coefficient (t-statistic) (DisclosuresOnly)	OLS Coefficient (t-statistic) (PoliciesPracticesDisclosures)
Interlock	?	0.002	-0.152***
		(0.06)	(-4.65)
BusyDIR	+	0.054*	0.068**
		(1.74)	(2.43)
Size	+	0.042***	0.072***
		(3.09)	(5.90)
BoardSize	+	0.010	-0.003
		(1.39)	(-0.50)
INDChair	+	0.122***	0.267***
		(3.28)	(7.98)
Leverage	-	-0.166	-0.058
		(-1.33)	(-0.52)
BKMK	-	-0.022	0.022
		(-0.73)	(0.81)
YoungCEO	+	0.014	0.023
		(0.27)	(0.60)
OldCEO	-	-0.113**	-0.050
		(-2.49)	(-1.21)
CEOTenure	-	-0.003	0.002
		(-0.88)	(0.59)
Cross-listed	+	-0.034	0.050
		(-0.90)	(1.47)
Institutional	+	-0.018	-0.085*
		(-0.37)	(-1.94)
Constant	?	0.167	-0.195
		(1.21)	(-1.57)
Industry Effects		Yes	Yes
Observations		120	120
R^2		0.409	0.608

See Appendix II for variable definitions
*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level, two-tailed

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[24] Table 15 separates *PDScore*, the dependent variable in the main disclosures model, into two parts: checklist items that only deal with disclosures in the proxy statements (*DisclosuresOnly*) and disclosures that encompass governance policies or practices (*PoliciesPracticesDisclosures*).

Figure 1
Interlock Measure

Interlock (or "Direct Interlock")

Not an Interlock

3) Majority voting policy
Our policy provides that in an uncontested election of directors at an annual meeting of shareholders, the votes cast in favour of the election of a director nominee must represent a majority of the total votes cast at the Meeting. If that is not the case, that director must tender his or her resignation for consideration by the balance of the Board. If for any reason the Board does not accept the resignation, it will promptly disclose its final decision in a press release. (TransAlta Corporation)

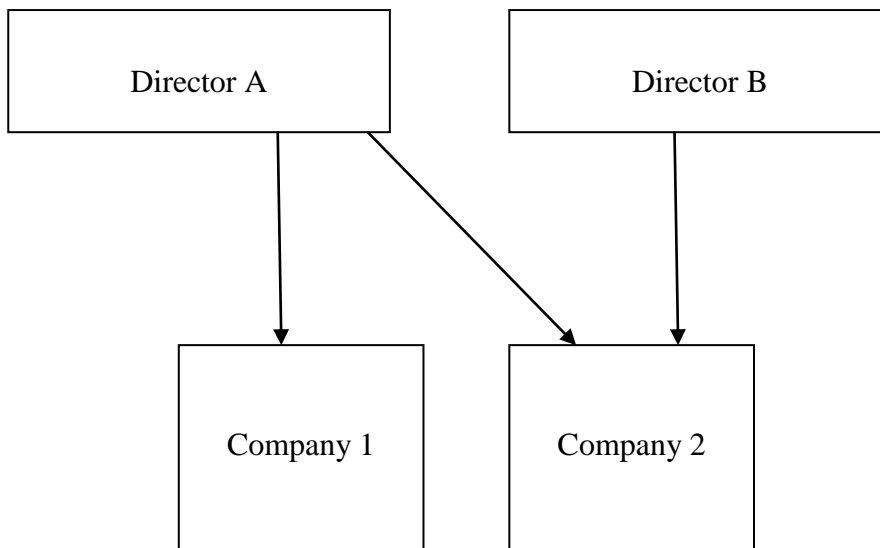| **5) Policy limiting interlocks** |
|---|
| To avoid potential conflicts of interest, our corporate governance guidelines do not allow interlocking directorships. An interlocking directorship would occur if a member of senior management of our company serves on the board or as a trustee of a company or institution that employs one of our directors. We do not have any directors who serve together on boards of other public companies. (Thomson Reuters Corporation) |

11) Director succession plan
The Committee identifies and assesses candidates for board appointment or nomination. Our forward-looking skills matrix identifies skills with the greatest opportunity to strengthen the board and our search for future nominees is focused on continually increasing diversity within the boardroom.
Before recommending a new board candidate, the Committee considers his or her performance, independence, competencies, financial acumen, skills and diversity. Behavioural attributes such as integrity, accountability and independent mindedness are also required.
(...)
The Committee requires the Secretary to maintain an evergreen list of potential directors whose skills complement the board and whom the Committee would evaluate, if the individual is available when an opening arises. (Nexen Inc.)

15) Board of Directors peer evaluation & 16) Board of Directors self assessment
The Board of Directors has implemented, and reviews, from time to time, a comprehensive process to annually assess its effectiveness, the effectiveness of its committees, the Board Chair, the Committee Chairs and individual directors. This process is under the supervision of the Corporate Governance and Nominating Committee and the Board Chair and is comprised of the following steps:
(...)
The Board Chair leads on an annual basis a peer review process through one-on-one meetings with each individual director. The Corporate Governance and Nominating Committee also considers on an annual basis the appropriateness of conducting a peer assessment through an independent advisor. (Canadian National Railway Company)

17) Directors continuing education program details
On an ongoing basis, the bank: • Ensures that directors have timely access to materials and information required to properly discharge their responsibilities   • Maintains a secure directors' portal for prompt dissemination of information and provides published information, articles of interest and other relevant materials to directors in between meetings   • Conducts information sessions for directors on significant, specialized or complex aspects of business operations   • Schedules at least one off-site board meeting a year to familiarize directors with regional and international operations, including visits to the bank's operations and meetings with local senior management   • In 2011, the board visited the bank's operations in Bangkok, Thailand, and the board also met in Nova Scotia, as part of the annual shareholder meeting   • Canvasses directors for suggestions as to topics and issues about which they would like to receive a seminar, briefing or a report   All of the directors are members of the Institute of Corporate Directors ("ICD") and have access to ICD events designed to foster director education and advocate for best practices in governance.   (Bank of Nova Scotia)

20) Shareholder Say on Pay
PotashCorp implemented an advisory say on pay vote in connection with its 2010 Annual Meeting and currently intends to hold an advisory say on pay vote at each annual meeting as part of the Corporation's process of shareholder engagement.   (...)   Our "Say on Pay" resolution received overwhelming shareholder support with over 97% affirmative votes.   (Potash Corporation of Saskatchewan Inc.)

Appendix II
Variable List

PDScore: Proxy Disclosure score
Interlock: Dummy equal to one if the firm has a direct interlock
%Board-Interlock: the number of directors in interlocking relationships divided by the total number of board members
Size: Log of total assets
Asset: Total firm assets (in millions)
PPE: Gross property, plant and equipment of the firm (in millions)
Sales: Gross sales revenue (in millions)
BoardSize: Number of directors on the board
Leverage: Debt of the firm as a percentage of total assets
BKMK: Book-to-Market value
CEOTenure: Number of years as CEO (proxy statement date)
YoungCEO: Dummy equal to one if the CEO is under the age of fifty
OldCEO: Dummy equal to one if the CEO is aged sixty or older
Cross-Listed: Dummy equal to one if the firm is listed in the U.S.
DA: Absolute value of Discretionary Accruals
EQ: Earnings Quality
FemaleDIR: Percentage of directors which are female
NetLoss: Dummy equal to one if the firm had a net loss
Institutional: Dummy equal to one if the firm had a institutional investor
Globe Score: Globe and Mail/Report on Business Board Games governance score (/100)
Globe_Board: Globe score Board Composition category (/31)
Globe_Shareholder: Globe score Shareholder Rights category (/31)
Globe_Comp: Globe score Shareholding and Compensation category (/26)
Globe_Disclosure: Globe score Voluntary Disclosures category (/12)
DisclosuresOnly: Score of PDScore items that only deal with disclosures
PoliciesPractices: Score of PDScore items that encompass policies and/or practices

Chapter 3:

Politically Connected Directors and Corporate Governance

Abstract

Research has shown that firms can benefit when they are politically connected. The extant literature has shown that politically connected firms benefit from procurement contracts, reduced regulatory issues and lower costs of capital. However, with more politicians joining corporate boards, the effect of political connectedness on corporate governance remains unclear. This paper examines the association between politically connected directors and corporate governance. A sample of high ranking politicians that have joined firm boards of directors is examined. I find that firms with politician directors have higher corporate governance scores. Additional tests also indicate that an addition of a politician to a board of directors increases the governance quality.

I. Introduction

Politicians often have the power and influence to benefit corporations. In 2007, Tenet Healthcare was suffering through regulatory and reputational problems, when it decided to appoint former Governor Jeb Bush and former Senator Bob Kerrey to its board of directors. By 2009, the corporation was the second best performing stock on the S&P 500 for the year and has since become one of the largest healthcare companies in the United States (Krantz, 2010). In contrast, in the midst of the Chesapeake Energy scandal—where the company failed to disclose the CEO's questionable financial practices—were two powerful ex-politicians. Senator Don Nickles and Governor Frank Keating enjoyed several perks, such as access to the firm's private planes for travel, while failing to maintain their fiduciary duty (McIntyre & Zajac, 2012). However, while more attention is paid to scandals regarding governance failures, these directors were likely an anomaly compared to the many politicians sitting on boards that bring value to firms. Thus, this paper empirically examines the association between politicians on corporate boards and corporate governance.

Academics, the business media and governance experts have started to take a closer look at ex-politicians sitting on corporate boards. While there has been an increasing amount of literature recently regarding politically connected firms, the extant literature has tended to focus on countries with underdeveloped financial markets or in highly corrupt political environments. However, political figures, albeit often retired from public office, being nominated to board positions in the United States is becoming more common. Politicians identified in this paper are those that have sat on high level public positions, such as former presidential candidates, senators, congressmen, big city mayors, governors, secretaries, and ambassadors. These politicians are independent directors and are less likely to have direct business connections than

other outside directors.

To date, the extant literature on director nominations often takes a resource dependence view (Pfeffer & Salancik, 1978). The board of directors can be viewed as a linking instrument between the organization and the external environment. Political leaders (who can be classified as community influence type directors) often have different background than other types of board members (business experts/insiders, support specialists). However, these politicians share many of the same traits, skills, and previous job experiences as other corporate directors. These directors are often high profile and have been shown to help business procure government contracts, reduce borrowing costs, and allow firms to benefit from becoming more tax aggressive (Chaney et al., 2011; Goldman et al., 2013; Kim & Zhang, 2016).

Data was collected from management information circulars (proxy statements), Compustat, CRSP and ISS/RiskMetrics, for the years 2007 to 2012. 6372 firm-years are examined and show that 29% of listed firms in the sample have or had at least one politician on its board of directors. Furthermore, these politically connected firms tend to have different firm and governance characteristics than their counterparts. However, there is little difference in their performance characteristics.

Utilizing the Entrenchment Index (Bebchuk et al., 2009), this paper hypothesizes and finds that firms with politician directors are associated with higher corporate governance scores. This relationship persists after controlling for firm-level, performance, and other governance based variables. The paper also documents that firms which add former politicians to their board of directors improve their corporate governance quality. Dropping politicians from boards has minimal or a negative effect on governance quality. Additional testing, including a propensity scoring matching model and difference-in-differences, provide support for these hypotheses.

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This paper contributes to the corporate governance literature and to the diverse research field of politically connected firms. To the best of the author's knowledge, this is the first paper to examine the connection between politicians as directors and corporate governance quality, using a relatively large sample size. While previous literature has focused on the performance effects of being politically connected, this paper finds that adding politicians to corporate boards can also be an effective governance mechanism.

The rest of the paper is organized as follows: The next section presents background information regarding boards of directors and political connections. Hypotheses development is described in the third section. Section four outlines the research methodology. Results are reported in the fifth section. Section six provides additional testing. The final section of the paper concludes the study.

II Background

Prior Literature on Politically Connected Firms

Watts and Zimmerman's (1978) influential paper on Positive Accounting Theory put forward the political cost hypothesis. Their model demonstrated that firms may use accounting methods to lower profits so as not to attract the attention of politicians. Shleifer and Vishny (1994) put forward an alternative model where politicians will extract rents from politically connected firms. Firms are able to enhance their value when the benefits of these connections outweigh their rents (costs). However, when there is the potential for political exploitation, firms often can take steps towards mitigate these risks, such as hiring high quality auditors (Gul, 2006).

Much of the extant literature has examined firms with political connections in emerging or corrupt markets, often in both. These studies have mainly focused on politician ownership of

firms or politicians in high management positions, with only a few focusing primarily on the board of directors. Furthermore, these papers tend to focus on countries with underdeveloped financial markets or in highly corruption political environments (Carretta et al., 2012). For instance, in emerging markets and highly corrupt countries, Faccio et al. (2006) find that firm value increases when an entrepreneur is elected to a top political position. Asian studies have shown that politically connected firms are often given special privileges by the government (Effiezal Aswadi et al., 2011). In recent years, a number of studies have examined the political connectivity of Chinese firms since the country's move towards privatization. Fan et. al. (2007) find that politically connected CEOs have poorer post-IPO stock performance and that these firms are more likely to appoint other bureaucrats, rather than directors with relevant professional backgrounds, to the board of directors. Private Chinese firms with politically connected managers are more likely to obtain government subsidies (Wu et al., 2012), are more likely to expropriate from minority shareholders (Cheung et al., 2010; Qian et al., 2011) and are less likely to be forced to resign than poorer performing state owned firms (Chang & Wong, 2009).

In the United States, it is rare for an active or former politician to obtain control of a corporation or the CEO position in a firm. However, politicians being nominated to board positions is becoming more prevalent. Politically connected firms are most likely to occur in regulated industries (Agrawal & Knoeber, 2001). At the same time, these companies often need to improve their accounting transparency and are more likely to hire a Big Four auditor (Guedhami et al., 2014). Additional studies on politically connected firms have shown that these firms are more likely to receive corporate bailouts and more preferential treatment in procurement contacts (Faccio et al., 2006; Lenway & Rehbein, 1991).

However, few papers have examined how politician directorships affect the corporate governance of firms in developed markets. A seminal study in this literature by Goldman et al. (2009) did find that politically connected director nominations are associated with significant cumulative abnormal returns (CARs) in the United States, although the study focused mainly on CARs around the time of presidential elections. Nonetheless, both Republican and Democratic affiliated board nominations were found to have significant effects. Other papers on politically connected firms have shown that political connections, and especially politically connected directors, can be extremely beneficial to firms. Hillman (2005) finds that firms with ex-politicians on the board of directors are associated with better market-based performance, especially in heavily regulated industries. Similarly, the cost of bank loans is significantly lower for companies that have board members with political ties (Houston et al., 2014).

Director Nominations

Since Fama and Jensen (1983) a great deal of research and regulation has focused on the board of directors, as they play a vital role in monitoring management, setting policies and reducing agency conflicts. Rather than just playing an advisory role, directors are often needed to facilitate better access to important resources in the firm's external environment (Pfeffer, 1972). This includes providing direct connections to important stakeholders (Mizruchi, 1996) such as creditors, customers and the government. Furthermore, board members are often nominated as a means for a firm to gain legitimacy. Thus, firms tend to hire high profile directors as a credible signalling mechanism to the market (Deutsch & Ross, 2003).

Directors are often nominated by the nominating committee of a board, although CEOs often have a considerable amount of influence over the process (Zajac & Westphal, 1996). To ensure the quality of the board, directorships are recommended to be staffed with independent,

experienced and knowledgeable members (Vafeas, 1999). Once a nomination is made, shareholders then ratify director candidates selected by the board itself. Director nomination candidates are rarely voted down by shareholders, unless there is an ongoing proxy battle - often caused by institutional investors (MacGregor & Campbell, 2008). Furthermore, it has been noted that directors can be categorized into four types: insiders (e.g. current or former firm executives), business experts (e.g. CEOs or directors of other firms), support specialists (e.g. lawyers and bankers) and community influencers (e.g. political leaders and university faculty) (Hillman et al., 2000). Thus, unlike the first three categories where the directors often have significant business experience, politicians are nominated for alternative reasons.

III Hypotheses Development

Resource Dependence and Other Theories

The board of directors can be seen as a linking instrument between the organization and the external environment. Resource dependence theory is often employed in political connectedness research to explain why firms become politically connected and nominate former politicians to their boards. Resource dependence theory, as posited by Pfeffer and Salancik (1978), argues that interdependent relationships are needed by organizations in order to both reduce uncertainty and enhance power. To minimize conflicts, an organization will often nominate a representative of the source of the constraint onto its governing board. Although the organization might forgo some of its autonomy, an individual appointed to a board is expected to support and aid the organization in its problems (Pfeffer & Salancik, 1978).

Based on resource dependence theory, Kim and Zhang (2016) show that politically connected firms, including those with politicians as board members, are associated with (and

benefit from) tax aggressiveness. Likewise, Chaney et al. (2011) find that while the cost of debt is higher for firms with lower quality reported earnings, politically connected firms are able to report poorer quality earnings without a negative effect to their cost of debt. Thus, the academic literature has begun to demonstrate that nominating politicians to the board of directors can be an efficient strategy for enhancing corporate outcomes.

Other theories have also been proposed to explain the emergence of politically connected firms. Agency theory deals with potential conflicts between political directors and management (e.g. Ellstrand, et al., 2002; Lee. et al., 2014). Embeddedness theory takes an economic-sociological perspective in studying inter-organization costs and constraints when politicians are involved (Siegel, 2007; Okhmatovskiy, 2010). Exchange theory in this literature describes the interdependence of suppliers and demanders of public policy (Schuler et al., 2002). Finally, some studies have taken more of a philosophical approach, such as a Confucian perspective for political appointments (Li & Liang, 2015) or ethical perspectives, such as how political connections relate to corporate social responsibility (Li & Zhang, 2010).

Former Politicians as Corporate Directors

Successful high level politicians share many of the same traits as corporate directors. Namely, their job requires them to be accountable (both professionally and legally) and be performance orientated along with having strong leadership, decision making, and communication skills (Romzek, 2000). Moreover, previous government experience allows them to provide valuable advice and counsel regarding the public policy environment of a firm. This includes, "channels of communication to existing government officials, bureaucrats, and other political decision makers; influence over political decisions; and legitimacy" (Lester et al., 2008). Moreover, politicians are independent directors and are less likely to have direct business connections than

other outside directors. These directors also have a high reputation to keep and, with their public profiles, are more likely to be scrutinized than other directors—incentives to avoid poor governance practices.

Directors are directly linked with the setting, monitoring, and reviewing of all top level corporate policies and decisions. The argument can be made that firm performance is positively associated with good corporate governance quality (Gao, et al., 2016; Gompers et al., 2003; Ueng, 2016, among others). Nonetheless, the aforementioned literature generally suggests that politicians on boards of directors *do* benefit corporations in multiple ways. For example, studies of the university faculty, the other community influencer type of director, have shown that professors in the boardroom have positive effects on the corporate governance of firms (Francis et al., 2015; Huang et al., 2016).

As resource dependence theory suggests, firms will bring in resources, such as directors, to manage uncertainty, especially when dealing with governments or regulators (Pfeffer, 1987). The aforementioned extant literature demonstrates that politicians are an effective human resource, especially when dealing with government intervention or regulatory issues- which high level politicians often have a comprehensive understanding on the policy and regulatory processes. Ex-politicians as directors are an important source of human and social capital (Lester et al., 2008) and are known to provide firms with important expertise on legislative and bureaucratic procedures (Goldman et al., 2009). Furthermore, these politicians have the knowledge and experience on how to appease constituents (a.k.a. shareholders). Thus, the hypotheses are provided in alternative form:

H1: Firms with former politicians on their board of directors are associated with higher quality corporate governance.

H2: Firms that add former politicians to their board of directors improve their

corporate governance quality.

IV Method

The data collected in this paper derives from management information circulars (proxy statements), Institutional Shareholder Services (ISS)/RiskMetrics, Compustat and the Center for Research in Security Prices (CRSP) databases. Prior studies have utilized various measures and model specifications to measure political connectedness. For instance, campaign contributions, lobbying expenditures, or authors have created their own political alignment indexes. Here, only board members with prior political experience are examined, as directors are directly linked with the setting, monitoring, and reviewing of all top level corporate policies and decisions.[25]

The sample begins with all firms that contain data from 2007 to 2012 in ISS. Firms that do not have the necessary information in ISS/Riskmetrics, proxy statements from EDGAR (the Electronic Data Gathering, Analysis, and Retrieval system) or Compustat are removed due of insufficient data. Similarly, trusts, which have different governance structures, and government sponsored entities (such as Fannie Mae), which are politically connected by design, were taken out of the sample. This left a total of 6372 firm-year observations. The detailed sample description is presented in Table 1.

[Insert Table 1 here]

Politicians are identified by the Goldman et al. (2009) method via a textual analysis. The proxy statements for all of the firms in the sample are downloaded from EDGAR and entered into a java-based program co-developed by the author. Next, all of the proxy statements are

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[25] This is one of the most popular measures of political connectedness (see. Goldman et al., 2009; Duchin & Sosyura, 2012; Kostovetsky, 2015).

analyzed and a company is classified as politically connected if it has at least one board member with one of the following former positions: president, presidential (vice-presidential) candidate, senator, member of the House of Representatives, (assistant) secretary[26], deputy secretary, deputy assistant secretary, undersecretary, associate director, governor, director (CIA, FEMA), deputy director (CIA, Office of Management and Budget), commissioner (IRS, NRC, SSA, FDA, SEC), ambassador, mayor, White House staff, chairman of the presidential election campaign, and chairman or member of the president's council. During this process, each result was manually checked (by reading through the proxy statement) to determine whether or not the result was referring to a director's past position.

To test whether these firms also have provisions that enable them to be entrenched, Bebchuk et al.'s (2009) Entrenchment Index[27] (E Index) was utilized.[28] The E index is a subset of Gompers et al.'s (2003) Governance Index (G Index), based on what Bebchuk et al. (2009) identified as the six most important corporate governance items. These six corporate governance provisions that determine whether a board is entrenched are: a staggered board, limits to amend bylaws, limits to amend charter, supermajority voting rules, golden parachutes and poison pills. All of the governance provisions are provided in the ISS/RiskMetrics data and the E Index is calculated from there. Prior studies that have used the Entrenchment Index as a proxy for corporate governance have shown that firms which score higher on the E Index are associated with lower

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[26] All secretary positions refer to federal executive departments of the United States

[27] As posited by Manne (1965) and Shleifer and Vishny (1989), management entrenchment occurs when management and the board are given the power to make firm- level decisions that decreases the likelihood of being forced to vacate their position. This includes protecting against mergers, acquisitions, hostile takeovers or other events that may disrupt their power. Shareholders may be harmed by management shirking, empire-building or extraction of benefits such as higher compensation. Entrenchment is known to cause agency problems with negative valuation consequences (Zerni et al., 2010). However, entrenchment is not necessarily associated with CEO tenure, as many long tenured executives hold on to their positions due to valid reasons, such as superior performance. Rather it is a corporate governance concept that focuses on (poor) alignment between management and shareholder interests.

[28] This study utilizes the E Index as a proxy for corporate governance quality and does not attempt to make a direct connection between political directors and management entrenchment.

creditor ratings, excessive CEO compensation, tax aggressiveness and lower firm valuations (see Alali et al., 2012; Brown & Caylor, 2006; Francis et al., 2013; Hoppe & Moers, 2011; Skantz, 2012; Veld & Wu, 2013).

The following regression was then performed:

$$E\ Index_{it} = \alpha 0_{it} + \alpha 1 PoliticianOnBoard_{it} + \sum Controls_{it} + \mu_{it} \qquad\qquad Eqn.\ (1)$$

where Entrenchment Index is the dependent variable and lower scores suggest higher corporate governance quality.

Characteristics of the Board

Various studies have examined the corporate governance effects of age and other board composition variables. Hunt and Jennings (1997) show that younger aged managers tend to make the most unethical decisions. Similarly, older, more educated and female managers are found to be more ethical than their counterparts and may reduce firm level risk (Deshpande, 1997). CEO age is also positively associated with financial reporting quality (Huang et al., 2016), although CEOs acquire more power over time by participating in the appointment of board members and once they pass their first five years in office, their dismissal likelihood declines (Shen & Cannella, 2002). Kim and Zhang (2016) note that firms with politicians as board members often pay less taxes. Older directors on the audit committee are negatively related to the cost of equity capital (Dao et al., 2013). However, Ali et al. (2014) find mixed results when testing between board age diversity and performance. When prior firm performance is better, the former CEO is more likely to be retained on the board (Evans et al., 2010). Finally, busy and long tenured directors may be associated with governance problems (Niu & Berberich, 2015).

Controls in this study include: *Size,* which is measured using the natural log of the total assets of a corporation. *ROA* measures the return on assets for the firm in the current year. *Book-to-market*

is calculated as the book value of equity, excluding preferred shares, divided by the market value

of the firm on the balance sheet date. *Leverage* is measured as a firm's total debt divided by its

total assets. *Firm Age* is measured as the number of data years (as a public company) available

on CRSP.[29] *Cash Effective Tax Rate* is calculated as the amount of tax paid in cash divided by

the firm's net income. *GAAP Effective Tax Rate* is also run as a tax avoidance substitute for *Cash*

ETR. Other governance variables related to the structure of the board are also controlled for:

Board Size measures the size of the board of directors, divided by the natural log of the total

assets. *Independent Chair* is also a dummy variable, with a value of one if the chairman of the

board was independent from the CEO and zero otherwise. *Female Directors* measures the

percentage of directors on the board that are female. *CEO Age* is the age of the chief executive

officer on the proxy statement date—including *Young CEO* if the CEO is younger than fifty

years of age and *Old CEO* if the CEO is sixty years of age or older—while *CEO Tenure* is the

number of years as chief executive officer on the same date. *Directors' Average Age* measures

the average age of all the directors (endogeneity testing is done to measure the average age

without the politicians and/or CEOs). Finally, *Busyness* or busy directors measures the average

number of other public directorships per board member.

A similar regression to Eqn (1) is then performed to determine whether there are any incremental

effects from adding or dropping politicians from the board of directors:

$$E\ Index_{it} = \alpha0 + \alpha1 PoliticianOnBoard_{it} + \alpha2 Add\_politician_{it} +$$

$$\alpha3 Drop\_politician_{it} + \sum Controls_{it} + \mu_{it} \qquad\qquad Eqn.\ (2)$$

where *Add_politician* is an indicator value of one if a politician has been added to the board of

directors, zero otherwise and *Drop_politician* is an indicator value of one if a politician has been

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[29] The CRSP database only goes back to 1925. 34 (3.2%) of the firms in the sample have the maximum value of 82-87 years. The results are unchanged when the natural log of firm age is substituted.

dropped from the board of directors, zero otherwise. All non-indicator variables are winsorized at the 1% and 99% levels for the two equations. Finally, to address the issue of independence in time-series data, robust standard errors are required. Thus, the regressions are run with standard errors clustered by firm.

V Results

Table 2 shows the distribution of politicians over the 2007-2012 sample periods. Approximately 24% of the firms had at least one politician on its board of directors. The number of politically connected firms, and total number of politicians on boards, increased by about five percent over the sample period. Table 3 presents the descriptive statistics for the sample. Panel A provides the descriptive statistics for all the firms in the sample. Additional analysis shows that approximately 29% (304/1062) of the firms in the sample had a politician on its board of directors for at least one of the sample years. Descriptive statistics in Panel B show firms with political directors have higher corporate governance (lower Entrenchment Index scores). Consistent with the extant literature (e.g. Kim & Zhang, 2016), these firms are also significantly larger than firms without a former politician on its board of directors. The "political firms" are significantly older, have larger boards as well as retain a higher percentage of female directors. *Politician on Board* firms are more likely to be audited by the Big 4 versus the control group (consistent with Guedhami et al., 2014). Furthermore, the "political boards" are older, but with directors having shorter average tenures on those boards, and with outside directors hold significantly more other directorships. Finally, consistent with Faccio (2010) and other studies, it was found that politically connected firms are more leveraged than non-politically connected firms.

Table 4 presents the correlations matrix. The maximum correlation is between *Size* and

Board Size at 0.625, while the minimum correlation is between *ROA* and *book-to-market*

valuation at -0.58. Consistent with expectations, *Politician on Board* and the *E Index* are

negatively correlated (p < 0.01). The E Index is positively correlated with a larger *Board Size*

and a higher *book-to-market* valuation. It is negatively correlated with *Size*, older firms, return on

assets, *Female Directors*, and *Director Tenure*. Meanwhile, *Politician on Board* is positively

correlated with both firm *Size* and *Board Size*, along with *Firm Age*, higher *Leverage*, *Female*

Directors, older CEOs, longer tenured directors and *Busy Directors*. *Politician on Board* has a

negative correlation with a higher *Book-to-market* valuation, independent chair, younger CEOs

and *Director Age*.[30]

[Insert Table 4 here]

Table 5 presents the results of the regressions. The base model is shown in the first

column, followed by *Eqn (1)* in the second column and *Eqn (2)* in the third column. The base

model shows that there is a significant negative relationship (p < 0.01) between the E Index and

Politician on Board (once again a lower index score shows higher governance quality). The full

model shows that this significant relationship persists (p < 0.05) after controls are added. This is

consistent with H1 (firms with a politician on the board of directors have superior corporate

governance quality). The final column shows the incremental effect of adding or dropping

politicians from the board of directors. There is a significantly negative (p < 0.05) relationship

between the *E Index* and *Add_politician*, while there is no significant relationship between the *E

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[30] Also of note, the *E Index* has a very strong positive correlation with the *G Index*. This alternative index is explored
further in section VI Additional Testing.

Index and *Drop_politician.* This provides some evidence to support H2 (adding a politician to the board improves governance quality).

The firm level variables show that larger firms have significantly lower governance scores (higher *E Index*), while higher leveraged and larger firms have significantly higher corporate governance scores (lower *E Index*). This is consistent with the notion that larger firms are under more scrutiny and more leveraged firms are riskier. Similarly, higher *Book-to-Market* firms (lower market valuation) are positively associated with the *E Index*. As can be expected when it comes to governance quality, the governance variables show that larger boards have significantly more entrenchment provisions, while boards with an independent chairperson have less provisions/higher governance scores. Finally, boards with older (on average) directors have significantly lower corporate governance quality.

[Insert Table 5 here]

 VI Additional Testing

Propensity Score Matching

Following Armstrong, Jagolinzer, and Larcker (2010), an ordered logistic-propensity score model was run, which models the probability that the *EIndex* will be affected by whether a firm has *Politicians on Board*. Matched pairs are formed by selecting an observation politically connected firm and matching it with a non-politically connected firm with the closest propensity score, based on size, industry and year, from the control group. This is performed with no replacement. Results are presented in Table 6. Similar to the ttest and the other linear models, the average treatment effect (ATT) of adding a politician to the board of directors shows a negative relationship between *Politician on Board* and the *E Index*. A regression run with the matched

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pairs also documents this relationship ($p < 0.05$). This provides additional support for H1.

[Insert Table 6 here]

Difference-in-Differences

A difference-in-differences design is also used to analyze the comparisons of the *EIndex* around the year of an additional or withdrawal of a politician to a company's board of directors. Here the control firms are those that have not added (or dropped) a politician to its board of directors from 2008-2012. Table 7 reports mean values of across the baseline (2007-2011) and follow-up periods (2008-2012). During the sample period, 117 firms added a politician to its board, while 92 politicians were dropped from boards of directors. Panel A shows that there is a significant governance quality increase (lower score) in the *EIndex* after a politician joins a board. Meanwhile, Panel B shows that there is a significantly governance quality decrease (higher score) in the *EIndex* after a politician is dropped from a board. This provides additional support for H2.

[Insert Table 7 here]

Governance Index as a lagged indicator

To address the possibility that politicians on board effect future governance quality, the following regressions were also run:

$$E\ Index_{it+1} = \alpha0_{it} + \alpha1 politicianonboard_{it} + \sum Controls_{it} + \mu_{it} \qquad Eqn.\ (3)$$

where the *Entrenchment Index* is now one year forward. Table 8 presents the results. The results are consistent with the main regression. The negative relationship between the *EIndex* and *PoliticianOnBoard* is still significant ($p < 0.05$), once again, implying higher governance quality. This provides support for both of the hypotheses. Further endogeneity testing is performed with distance to Washington, D.C. employed as an instrumental variable for *PoliticianOnBoard*.

Distance to Washington, D.C. is often used as an instrumental variable in the political connections literature (for example Houston et al., 2014; Kim & Zhang, 2016). *DistanceDC* is measured as the natural logarithm of one plus the distance from a firm's headquarter to Washington, D.C. There is no reason that this excluded variable would have a direct impact on the *E Index*. A Heckman two-stage regression and a two-stage least squares regression are run. Untabulated results from the Heckman two-stage regression shows that the instrumental variable for *PoliticianOnBoard* is still significant ($p < 0.05$), however none of the variables are significant in the two-stage least squares model.

[Insert Table 8 here]

Alternative Governance Index Measures

In Bebchuk et al. (2009), the authors measure the entrenchment index both as a raw score and as an indicator variable. Consistent with their approach, Eqn. (1) is rerun with a logistic regression. In this model a firm has a value of 1 if the *E Index* is equal or greater than two. The results are presented in Table 9. The results show that *PoliticianOnBoard* has a significant negative relationship with the *E Index* ($p < 0.01$), providing additional support for H1. The rest of the results are essential the same as the main regression, except for three variables (*Book-to-market, IndChair and Director's Age)* which show lower significance.

[Insert Table 9 here]

As an alternative to the *E Index*, Gompers et al.'s (2003) (G Index) is utilized. The G Index identifies 24 governance provisions that proxy for shareholder rights. These are sorted into five categories: 1) Delay (provisions intended to delay hostile takeover bidders); 2) Voting (provisions dealing with shareholder voting rights); 3) Protection (provisions protecting directors and officers); 4) State (state takeover laws); and 5) Other (provisions related to takeover

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defenses). Prior studies that have used the Governance Index as a proxy for corporate governance have shown that firms that score higher on the G Index are associated with earnings management, higher underwriting fees, less investment in R&D and reduced capital expenditures, and an increased risk of default (see Cao et al., 2015; Chakraborty & Sheikh, 2010; Jiraporn et al., 2008; Lin & Ulupinar, 2013). The score is calculated from the ISS/RiskMetrics data and the regression is clustered for standard errors. The G Index is substituted for the E Index as follows:

$$G\ Index_{it} = \alpha0_{it} + \alpha1 politicianonboard_{it} + \sum Controls_{it} + \mu_{it} \qquad\qquad Eqn.\ (4)$$

Table 10 presents the results of this regression. Although the two indices are significantly correlated with each other, the negative relationship documented by *Politician on Board* and the *G Index* is not significant here. One possible explanation is provided by Bebchuk et al. (2009), which states that the *G Index* has several unnecessary provisions. Similar to the main models, there is a positive association between both *Leverage* and *Board Size* with the index. Unlike the previous models, *Female* and *Busy Directors* are positively associated with the *G Index*.

[Insert Table 10 here]

VII Conclusion

Prior research has shown that politically connected firms help business procure government contracts, obtain financing, and allow firms to become more tax aggressive. Former politicians joining corporate boards have been linked to abnormal positive stock returns, reduced borrowing costs and overall increase market based performance. Nevertheless, the association between politician directors and corporate governance remains unclear.

This paper hypothesizes and finds that firms with politician directors are associated with

higher corporate governance scores. This relationship persists after controlling for firm-level, performance, and other governance based variables. A propensity scoring matching model and employing the index as a lagged variable confirms the results. Difference-in-differences regressions show that adding a politician to a board of directors is positively associated with governance quality, while dropping a politician from a board of directors is negatively associated with governance quality. Causality cannot be implied since the antecedents and determinants of why firms hire politicians are not empirically tested in this paper. However, the results, combined with the extant literature, do imply that successful politicians as directors enhance corporate governance.

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Table 1: Sample Description

Number of firm-year observations from ISS/RiskMetrics	8815
Less: Firms with missing data	(1555)
Less: Trusts and government sponsored entities	(192)
Less: Firms with missing EDGAR or Compustat data	(696)
Final Sample	6372

Table 2: Politicians by Year

Year	# of Firms with Politician on Board	% of Firms with Politician on Board	Total # of Politicians on Boards
2007	241	22.7%	320
2008	246	23.2%	323
2009	254	23.9%	337
2010	262	24.7%	350
2011	255	24.0%	339
2012	253	23.8%	335

Table 3: Descriptive Statistics

Panel A: Entire Sample

Variable	Mean	Min	25%	Median	75%	Max
Politician on Board	0.237	0	0	0	0	1
GIndex	7.329	0	6	7	9	16
EIndex	2.643	0	2	3	4	6
Size	8.204	5.079	6.989	8.037	9.285	12.710
Firm Age	29.684	1	15	24	40	87
Leverage	0.556	0	0.405	0.558	0.704	0.998
Big4	0.985	0	1	1	1	1
ROA	0.040	-0.345	0.014	0.047	0.085	0.560
BKMK	0.628	-0.011	0.325	0.513	0.777	2.129
Cash ETR	0.227	0	0.067	0.217	0.327	1
Board Size	9.561	4	8	9	11	18
IND Chair	0.479	0	0	0	1	1
Female Directors	0.127	0	0	0.110	0.200	0.570
CEO Age	57.039	35	52	57	61	91
CEO Tenure	9.840	1	4	7	13	39
Directors' Age	62.279	46	59.9	62.4	64.6	77.9
Directors' Tenure	9.118	1	6.5	8.5	11	20.7
Busy Director	1.065	0	0.5	0.8	1.2	2.6

Panel B: Differences between Politician on Board and No Politician Firms

Variable	Politician on Board Mean (n=1511)	No Politician Mean (n=4861)	T-test between Groups
Gindex	7.279	7.488	-2.49***
EIndex	2.493	2.689	-4.74***
Size	9.094	7.927	24.34***
Firm Age	36.267	27.637	14.91***
Leverage	0.614	0.537	11.27***
Big4	0.985	0.938	7.36***
ROA	0.048	0.037	1.35
BKMK	0.583	0.643	-2.19**
Cash ETR	0.228	0.226	0.40
Board Size	10.525	9.261	18.44***
IND Chair	0.393	0.506	-7.70***
Female Directors	0.145	0.121	8.35***
CEO Age	57.367	56.938	2.10**
CEO Tenure	9.604	9.914	-0.34
Directors' Age	63.166	62.003	10.72***
Directors' Tenure	8.704	9.247	-3.82***
Busy Director	1.065	0.784	19.74***

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level
See Appendix I for variable descriptions

Table 4: Correlations Matrix

	gindex	eindex	politician onboard	nlsize	firmage	leverage	roa	bkmk	cashetr	boardsize	indchair	femaledir	youngceo	oldceo	directors age	tenure	busyness
gindex	1																
eindex	0.7444*	1															
politicianonboard	-0.0385*	-0.0616*	1														
nlsize	0.1204*	-0.0969*	0.2803*	1													
firmage	0.0208	-0.0329*	0.1303*	0.3428*	1												
leverage	0.1369*	0.0149	0.1514*	0.5338*	0.1992*	1											
roa	-0.0565*	-0.0668*	-0.0069	-0.1349*	-0.0167	-0.3800*	1										
bkmk	0.0051	0.0457*	-0.0474*	0.0905*	0.0309	0.0554*	-0.5826*	1									
cashetr	0.0178	0.0267	-0.0024	-0.0752*	-0.0411*	-0.1432*	0.3420*	-0.1637*	1								
boardsize	0.1646*	0.0472*	0.2277*	0.6251*	0.3531*	0.4062*	-0.0974*	0.0535*	-0.0239	1							
indchair	-0.0275	-0.013	-0.0960*	-0.1288*	-0.1191*	-0.0710*	-0.0296	-0.0018	-0.016	-0.0422*	1						
femaledir	0.0540*	-0.0486*	0.1186*	0.2807*	0.1833*	0.2474*	-0.0166	-0.0556*	0.0015	0.2835*	-0.0516*	1					
youngceo	-0.0067	0.0203	-0.0403*	-0.0957*	-0.1551*	-0.0718*	0.0347*	-0.0632*	0.0408*	-0.0805*	0.1710*	-0.0327*	1				
oldceo	-0.0166	-0.0112	0.0325*	0.0275	0.0894*	-0.0226	-0.006	0.0563*	-0.0026	0.0366*	-0.2216*	-0.0733*	-0.2803*	1			
directorsage	-0.0451*	-0.0423*	0.137*	0.0788*	0.19*	0.0123	-0.028	0.0903*	-0.0042	0.1004*	-0.0615*	-0.1642*	-0.2420*	0.3137*	1		
tenure	-0.0792*	-0.0315	-0.0786*	-0.1067*	0.1378*	-0.1040*	0.0285	0.0315	0.015	-0.0377*	-0.0376*	-0.1708*	-0.1105*	0.1741*	0.4256*	1	
busyness	0.1324*	-0.0219	0.2393*	0.3485*	0.2013*	0.1332*	0.0821*	-0.1563*	0.0153	0.2361*	-0.0507*	0.1782*	-0.0199	-0.0316	-0.0142	-0.2753*	1

* Significant at the 1% level
See Appendix I for variable descriptions

Table 5: Regression Results

Model: E Index$_{it}$ = α0$_{it}$ + α1PoliticianOnBoard$_{it}$ + ∑Controls$_{it}$ + μ$_{it}$

Variable	OLS Coefficient (t-stat) EIndex	OLS Coefficient (t-stat) EIndex	OLS Coefficient (t-stat) EIndex
Politician on Board	-0.196***	-0.170**	-0.154**
	(-2.72)	(-2.31)	(-2.04)
Add_politician			-0.202**
			(-1.97)
Drop_politician			-0.100
			(-0.83)
Firm Level Variables			
Size		-0.198***	-0.198***
		(-7.50)	(-7.47)
Firm Age		-0.001	-0.001
		(-0.40)	(-0.37)
Leverage		0.651***	0.649***
		(4.12)	(4.11)
Performance Based Variables			
ROA		0.207	0.203
		(0.73)	(0.71)
BKMK		0.180***	0.179***
		(2.62)	(2.62)
Cash ETR		-0.072	-0.074
		(-0.70)	(-0.70)
Other Governance Variables			
Board Size		0.095***	0.096***
		(6.20)	(6.24)
IND Chair		-0.101**	-0.102**
		(-1.96)	(-1.97)
Female Directors		0.313	0.306
		(1.12)	(1.09)
Young CEO		-0.003	-0.002
		(-0.04)	(-0.03)
Old CEO		-0.050	-0.049
		(-0.93)	(-0.91)
Directors Average Age		0.025***	0.024***
		(2.66)	(2.64)
Directors' Tenure		-0.005	-0.005
		(-0.51)	(-0.53)
Busy Director		-0.006	-0.006
		(-0.09)	(-0.10)
Industry Effects		Yes	Yes
Year Effects		Yes	Yes
Observations	6372	6372	6372
Adjusted R²	0.001	0.4135	0.4139

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level, two-tailed tests. See Appendix I for variable descriptions

Table 6: Propensity Score Matching

Model: $\mathrm{p}(PoliticianOnBoard_{it}) = \alpha0_{it} + \alpha1Size_{it} + \alpha2Industry_{it} + \alpha3Year_{it} + \mu_{it}$

$E\ Index_{it} = \alpha0_{it} + \alpha1PoliticianOnBoard_{it} + \sum Controls_{it} + \mu_{it}$

Variable	Sample	Treated	Controls	Difference	t-stat
EIndex	Unmatched	2.495	2.689	-0.194	-4.69***
	ATT	2.507	2.558	-0.122	-2.57**

Variable	OLS Coefficient (t-stat)
Politician on Board	-0.119**
	(-2.20)
Firm Age	-0.004***
	(-2.95)
Leverage	-0.198
	(-1.36)
Performance Based Variables	
ROA	-2.522***
	(-5.48)
BKMK	-0.115
	(-1.54)
Cash ETR	0.404***
	(2.95)
Other Governance Variables	
Board Size	0.026**
	(1.99)
IND Chair	-0.121**
	(-2.18)
Female Directors	0.471**
	(2.23)
Young CEO	0.099
	(1.63)
Old CEO	-0.069
	(-1.64)
Directors Average Age	0.080***
	(12.00)
Directors' Tenure	-0.039***
	(-6.11)
Busy Director	0.367***
	(8.60)
Observations	3010
Adjusted R²	0.0204

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level, two-tailed tests. See Appendix I for variable descriptions

Table 7: Difference-in-Differences

Panel A: E-Index, Politician Added to Board

	Baseline	Follow-up	Diff-in-Diff (t-stat)
Control Group *N=6249* (No Politicians Added)	2.522	3.298	
Treatment Group *N=117* (Politician Added to Board)	2.177	2.333	
Difference (T-C)	-0.345**	-0.965***	-0.619*
(t-stat)	(-2.44)	(-3.18)	(-1.85)
R²	0.04		

Panel B: E-Index, Politician Dropped from Board

	Baseline	Follow-up	Diff-in-Diff (t-stat)
Control Group *N=6274* (No Politicians Added)	2.524	3.277	
Treatment Group *N=92* (Politician Dropped from Board)	1.987	3.400	
Difference (T-C)	-0.537***	0.123	0.092*
(t-stat)	(-3.40)	(0.34)	(1.69)
R²	0.04		

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level
See Appendix I for variable descriptions

Table 8: Additional Regression Results

Model: E Index$_{it+1}$ = α0$_{it}$ + α1politicianonboard$_{it}$ + ∑Controls$_{it}$ + μ$_{it}$

Variable	OLS Coefficient
	(t-stat)
	EIndex
Politician on Board	-0.182**
	(-2.34)
Firm Level Variables	
Size	-0.207***
	(-15.14)
Firm Age	-0.001
	(-1.52)
Leverage	0.628***
	(7.35)
Performance Based Variables	-0.066
ROA	(-0.31)
BKMK	0.202***
	(4.68)
Cash ETR	0.020
	(0.26)
Governance Variables	
Board Size	0.090***
	(6.31)
IND Chair	-0.114**
	(-2.07)
Female Directors	0.410
	(1.37)
Young CEO	-0.016
	(-0.19)
Old CEO	-0.053
	(-0.89)
Directors Average Age	0.026***
	(2.62)
Directors' Tenure	-0.005
	(-0.48)
Busy Director	0.005
	(0.08)
Industry Effects	Yes
Year Effects	Yes
Observations	5305
Adjusted R²	0.3831

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level, two-tailed tests. See Appendix I for variable descriptions

Table 9: Logistic Regression Results

Model: E Index$_{it}$ = $\alpha 0_{it}$ + $\alpha 1 PoliticianOnBoard_{it}$ + $\sum Controls_{it}$ + μ_{it}

Variable	OLS Coefficient (t-stat) EIndex
Politician on Board	-0.368***
	(-2.66)
Add_politician	
Drop_politician	
Firm Level Variables	
Size	-0.342***
	(-6.27)
Firm Age	-0.001
	(-1.46)
Leverage	1.011***
	(3.03)
Performance Based Variables	0.093
ROA	(0.11)
BKMK	0.289*
	(1.69)
Cash ETR	-0.100
	(-0.40)
Other Governance Variables	0.135***
Board Size	(4.28)
IND Chair	-0.147
	(-1.32)
Female Directors	0.488
	(0.78)
Young CEO	0.018
	(0.11)
Old CEO	-0.071
	(-0.62)
Directors Average Age	0.044**
	(2.21)
Directors' Tenure	-0.018
	(-0.91)
Busy Director	-0.018
	(-0.14)
Industry Effects	Yes
Year Effects	Yes
Observations	6372
Pseudo R²	0.2340

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level, two-tailed tests. See Appendix I for variable descriptions

Table 10: G-Index

Model: G Index$_{it}$ = α0$_{it}$ + α1PoliticianOnBoard$_{it}$ + ∑Controls$_{it}$ + μ$_{it}$

Variable	OLS Coefficient
	(t-stat)
	GIndex
Politician on Board	-0.129
	(-0.92)
Firm Level Variables	
Size	-0.053
	(-0.99)
Firm Age	-0.002
	(-0.65)
Leverage	1.189***
	(3.76)
Performance Based Variables	0.015
ROA	(-0.04)
BKMK	0.163
	(1.24)
Cash ETR	-0.138
	(-0.67)
Governance Variables	
Board Size	0.135***
	(4.46)
IND Chair	-0.119
	(-1.17)
Female Directors	1.367**
	(2.45)
Young CEO	-0.093
	(-0.65)
Old CEO	-0.078
	(-0.78)
Directors Average Age	0.029
	(1.57)
Directors' Tenure	-0.002
	(-0.10)
Busy Director	0.394***
	(3.22)
Industry Effects	Yes
Year Effects	Yes
Observations	6372
Adjusted R²	0.3047

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level, two-tailed tests. See Appendix I for variable descriptions

Appendix I: Variable Definitions

EIndex- Entrenchment Index, corporate governance measure of how many entrenchment provisions a company employs

GIndex- Governance Index, corporate governance measure of how provisions limit shareholder rights

Size- measured using the natural log of the total assets of a corporation.

ROA measures the return on assets for the firm in the current year

Firm Age- number of years as a public company

Leverage - measured as a firm's total debt divided by its total assets.

Big 4- indicator variable of whether the company has a big four auditor

ROA- Return on Assets, measures as net income divided by total assets

Book-to-market- calculated as the book value of equity, excluding preferred shares, divided by the market value of the firm on the balance sheet date

Cash ETR- Cash Effective Tax Rate, calculated as the amount of tax paid in cash divided by the firm's net income

Board Size- measures the size of the board of directors

Independent Chair- indicator variable, with a value of one if the chairman of the board was independent from the CEO and zero otherwise

Female Directors- measures the percentage of directors on the board that are female

CEO Age- age of the chief executive officer on the proxy statement date

CEO Tenure- number of years as chief executive officer on the proxy statement date

Directors' (Average) Age- measures the average age of the board of directors

Directors' Tenure- average number of years the directors have served on the board

Busyness- average number of other public directorships per board member

Politician on Board- Indicator variable if the firm had at least one politician on its board of directors

Add_politician- indicator value of one if a politician has been added to the board of directors, zero otherwise

Drop_politician- indicator value of one if a politician has been dropped from the board of directors, zero otherwise

ATT- Average Treatment Effect of adding a politician to the board of directors.

DistanceDC- measured as the natural logarithm of one plus the distance from a firm's headquarter to Washington D.C.

Chapter 4:

The Value of Political Connections for Cross-Listed Firms

Abstract

The extant literature has demonstrated that both political connections and cross-listing can benefit firms in various aspects, such as superior stock returns and a lower cost of capital. This paper examines whether cross-listed firms can obtain incremental financial benefits by also being politically connected. 142 Canadian cross-listed firms are examined to determine the extent of their political connections and to assess whether any incremental benefits are gained in politically connected cross-listed firms. The results show that politically connected cross-listed firms have higher analyst following, higher market valuations and greater market liquidity.

I. Introduction

While there are risks associated with being cross-listed or politically connected, such as increased business costs, increased regulatory attention, and risks of expropriation (Dodd, 2013; Doidge et al., 2004; Faccio, 2006; Khwaja & Mian, 2005; Watts & Zimmerman, 1978), many firms still choose to pursue these paths. Cross-listed firms benefit from increased analyst following (Baker et al., 2002), higher market valuations (Doidge et al., 2004), improved stock liquidity (Dodd, 2013) and a significant reduction in the cost of equity capital (Errunza & Miller, 2000). Moreover, firms with political connections often benefit in similar ways by receiving preferential treatment from governments (Goldman et al., 2013; Khwaja & Mian, 2005). This paper examines whether cross-listed firms benefit from also being politically connected.

This study utilizes 142 Canadian firms which were cross-listed in the U.S. between 2010 and 2014 and examines whether politically connected firms benefit from increased analysts' coverage, increased market value, increased trading value, along with superior return on assets, return on equity and procurement contracts. Political connections are measured in three ways: lobbying, campaign contributions and political directors. The results show that compared to non-politically connected cross listed firms, politically connected cross-listed firms have higher analyst following, higher market valuations, and higher liquidity and have significantly more government procurement contracts. To the author's knowledge, this is one of the first papers to combine the political connectedness literature with the cross-listed literature. It contributes to the literature by demonstrating that political connections enhance the benefits firms receive from cross-listing. The findings are consistent with the recent literature that highlights the ongoing importance of political connections for firms.

The remainder of this paper is organized as follows: The next section presents a literature

review on politically connected firms and cross-listed firms. Section three describes the research question and methodology. The results are reported in section four. Additional testing is done in section five. The final section of the paper discusses the findings of the study.

II. Literature Review

Politically Connected Firms

The extent of research regarding Politically Connected Firms (PCFs) is vast covering the areas of management, finance, economics as well as accounting. Early research in the field revealed that PCFs tend to be larger in size and more dependent on government regulation or contracts (Lenway & Rehbein, 1991). In relation to corporate political strategies, firms with larger market share are more involved (Schuler, 1996) and PCFs may benefit from reduced uncertainty and transaction costs as well as increased survival (Hillman et al., 1999). Rehbein and Schuler (1995) propose that firms with political experience, sufficient resources, unrelated diversification, and a high degree of stakeholder dependence should have the ability and willingness to engage in political activities.

Firms often use a combination of tactics to access politicians including contributing to political action committees, staffing offices in the capital city, and hiring lobbyists and political consultants (Schuler et al., 2002). Moreover, firms are devoting more resources to legislative activities, including hiring former politicians as outside directors for social and human capital reasons (Lester et al., 2008). However, while political activities can enhance firm profitability, Hadani and Schuler (2013) argue that political directors actually worsen firm performance. Chizema et al. (2015) contend that the executive pay-performance link is weaker with politically connected directors.

Khwaja and Mian (2005) show that in a corrupt environment, PCFs receive preferential treatment and politicians extract up to two percent of the country's GDP through rent-seeking measures. Similarly, Faccio (2006) documents that political connections between firms and governments are widespread across the world, especially prevalent in countries that are perceived highly corrupt, and in countries that impose restrictions on foreign investments and in larger size firms. On the other hand, Amore and Bennedsen (2013) present a unique study in Denmark, "arguably the least corrupt country in the world" (ibid., p. 387), and find that even in this environment having access to politicians significantly improves the performance of PCFs.

In a longitudinal U.S. study, Santa-Clara and Valkanov (2003) find that stock market returns are significantly higher during the years of Democratic presidents compared to Republican presidents. On the other hand, following a Republican presidential win, Goldman et al. (2009) show that a portfolio of companies with Republican directors outperforms a portfolio of companies with Democratic directors. Similarly, procurement contracts are more likely to be awarded to PCFs with connections to the winning party (Goldman et al., 2013). Finally, Kim et al. (2012) argue that geographical proximity to successful politicians is related to superior stock returns.

Recent literature has shown that firms can also benefit when individual employees are politically connected. Individual contributions to politicians are directly related to greater operating performance, especially where there is greater industry clustering and those politicians are economically relevant (Ovtchinnikov & Pantaleoni, 2012). As Hong and Kostovetsky (2012) outline, mutual fund managers' political orientation is a strong determinant of which companies they invest in. Conversely, Lee, Lee and Nagarajan (2014) reveal that when the political orientations of CEOs and independent directors are aligned, firms often suffer negative

consequences from this lack of diversity (lower firm valuations, lower operating profitability, lower CEO pay-performance sensitivity, etc.).

Politically Connected Firms in the accounting literature

The influence of politicians on accounting standards has long been known and studied. Watts and Zimmerman (1978) presented the political-cost hypothesis, which examines the tax, regulatory, political and compensation implications of lobbying. Firms will use earnings management and other accounting methods to lower their income in situations where profits may attract the negative attention of politicians. Although not as popular as some of the other propositions Watts and Zimmerman put forward, other studies have, implicitly or explicitly, tested the political-cost hypothesis over the years. For example, Cahan (1992) investigates political agencies that rely on accounting earnings to enforce antitrust laws against monopolies. He finds that these firms use discretionary accruals to lower income in response to political costs. Similarly, PCFs rely on income decreasing discretionary accruals when outsourcing activities are a potential detriment (Ramanna & Roychowdhury, 2010). Finally, Mills et al. (2013) demonstrates that firms that receive federal contracts pay a higher amount of taxes, especially when political visibility is greater.

The accounting literature has documented many benefits from being politically connected. Houston et al. (2014) argue that political connections reduce the borrower's cost of debt, thus increasing the value of PCFs and reducing monitoring costs and credit risk faced by banks. Correia (2014) finds that PCFs are less likely to face enforcement actions from the Securities and Exchange Commission and suffer lower overall penalties. Likewise, Kim and Zhang (2016) show that when political connections mitigate enforcement actions, PCFs are more tax aggressive.

The audit literature has also provided insights into how PCFs are valued and perceived. Gul (2006) demonstrates that PCFs are less profitable when government and regulators no longer provide favorable policies, which leads auditors to charge higher fees in order to mitigate the increased risk. However, these audit fees decrease once favorable policies return. Guedhami at al. (2014) argue that when there is the potential for political exploitation, firms turn to higher quality auditors to provide assurance to the market.

Internationally, authors have also examined how the cost of equity and the cost of debt relate to PCFs. In general, the accounting literature finds that lower quality accounting information is associated with a higher cost of debt. However, Chaney et al. (2011) find that PCFs can afford disclosing lower quality accounting information without it affecting the cost of debt. Moreover, Ben-Nasr et al. (2012) demonstrate that the cost of equity is higher for firms with government ownership, especially in less developed countries.

A wealth of studies has appeared in recent years examining China. The Chinese institutional environment is unique as privatization has been going on for the past two decades, but government influence is still vastly important. O'Connor et al. (2006) develop a model to illustrate how political constraints mediate economic liberalization forces. PCFs in China are more likely to list overseas (Hung et al., 2012) and are more likely to receive government subsidiaries (Lee, Walker & Zeng, 2014). Non-accounting research has also shown that while the risk of government expropriation is higher for PCFs, political connections are still important (Berkman et al., 2010; Cheung et al., 2010; Shi et al., 2014; Shibin et al., 2011). Meanwhile in Malaysia, Fung et al. (2015) argue that the more politically connected a firm is (proxied by the length of the relationship), the greater its performance is related to the performance of the government (i.e., election results).

Cross-listed firms

Similar to being politically connected, research has shown that firms can benefit from cross-listing. However, there are several reasons why a firm may not want to cross-list. The costs of cross-listing include a higher standard of disclosures, financial reporting, and compliance. There is also additional cost and time associated with the listing requirements. As well, increased scrutiny on the executives can lead to a loss of private benefits for management (Hope et al., 2007). Thus, firms where the controlling shareholder has the opportunity to expropriate from the firm (or from minority shareholders) are significantly less likely to cross-list (Doidge et al., 2004).

The extant literature in business has identified (and debated) several reasons why firms list on foreign exchanges. For instance, cross-listing is a way to overcome investment barriers, improve stock liquidity and gain access to a larger number of investors. Additionally, a cross-listing decision may be an integral part of a firm's global strategy (Dodd, 2013). Furthermore, Baker et al. (2002) assert that firms gain additional media coverage and the potential of more analysts' coverage for cross-listed firms. Likewise, Lang et al. (2003) contend that firms which cross list in the U.S. have greater analyst coverage and increased forecast accuracy.

The legal bonding aspect of cross-listing states that firm-level risk can be reduced by complying with strict listing requirements of a foreign market. Additional mandatory disclosure requirements reduce information asymmetry between corporate managers and investors (Dodd, 2013). Abdallah (2008) finds that firms with concentrated control, with a higher level of risk and those with more pronounced financing needs are more likely to cross-list on a market with better investor protection. Abdallaha and Ioannidisb (2010) later show that legal bonding has diminished over time as international markets have become more integrated. However, their

work also documents that market segmentation benefits (cross-listing to overcome investment barriers) have not diminished over time.

Along with market segmentation, there are several reasons why Canadian firms have the largest number of cross-listed shares on U.S. stock exchanges (King & Segal, 2009). Geographical proximity is an important determinant in cross-listing, with firms often listing in the nearest large market.[31] This has led to an almost double number of listing in the United States since the early 1990s, with only a handful of Canadian corporations listing in Europe (Chouinard & D'Souza, 2004). Ammer et al. (2012) find that the most important determinant of the amount of U.S. investment a foreign firm receives is whether the firm cross-lists on a U.S. exchange. Firms that mandatorily adopt International Financial Reporting Standards exhibit significantly higher cross-listing propensity and benefit from higher creditor ratings when cross-listed (Chan et al., 2013; Chen et al., 2015). Finally, Doidge et al. (2004) contend that foreign firms with shares cross-listed in the U.S. had significantly higher Tobin's Q than the non cross-listed firms from the same country. This suggests that the market favourably values cross-listed firms. However, it should be noted that Davis-Friday et al. (2005) document certain Mexican firms that chose to list in the U.S. had significantly weaker ex-post financial performances than non-cross-listed Mexican firms that were eligible to cross-list.

Cross-listing in the U.S. by non-U.S. firms is associated with a significant reduction in the cost of equity capital (Errunza & Miller, 2000). Consistent with the predictions of market segmentation theory, Foerster and Karolyi (1999) report significant abnormal returns experienced by 153 firms from Canada, and other countries, when listed in U.S. markets. King and Segal (2009) document a permanent increase in the valuation of Canadian firms cross-listed in the U.S. for firms that attract and maintain investor recognition. Similarly, Doukas and

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[31] For example, Irish firms listing in England, New Zealand firms listing in Australia.

Switzer (2000) and Mittoo (2003) find that Canadian firms experience significant positive abnormal returns around cross-listing in the U.S. However, Mittoo's work also documents that Canadian firms strongly underperform the market in the years following the cross-listing.

Cross-listing generally improves the stock liquidity of Canadian firms that cross-list in the U.S. Foerster & Karolyi (1993) report an increase of 62 percent in total trading volume and an increase in domestic trading volume of 26 percent after cross-listing. Mittoo (1997) reports an increase in domestic trading volume of stocks listed on the Toronto Stock Exchange, but a decrease of those listed on the Vancouver Stock Exchange. Foerster & Karolyi (1998) documents that the total trading volume significantly increases, while trading volume on the home market decreased slightly, as some portion of trading activity migrated to the foreign market. They further show a significant decrease in trading costs, particularly for firms that have a significant portion of total trading activity taking place in the U.S.

Recent literature on cross-listed firms has examined cross-delisting. There are often surges and contradictions in host markets. Firms often enjoy the economic synergies of cross-listing only when initially implemented under the most attractive conditions (Sarkissian & Schill, 2016). However, when the market is no longer "hot", and firms must deal with increased monitoring, disclosures and compliance costs, then they are nearly twice as likely to delist within three years (Yung et al., 2008).

III. Research Question and Methodology

Both the decisions to become politically connected and cross-list are not haphazard, but require considerable strategic planning from management. The benefits from cross-listing include greater analyst following, improved stock liquidity and potentially greater stock performance. Furthermore, both political connections and cross-listing can benefit firms in

various aspects. For instance, both approaches can lead to a lower cost of capital and higher market valuations. On the other hand, the literature also shows that the benefits from both can quickly be diminished if there is a change in the political landscape or information environment. Similarly, the political connections and cross-listing branches of literature have shown some similar costs, such as increased public scrutiny. However, what is not yet known is whether firms can reap incremental benefits from being both cross-listed and politically connected. Is there any value for firms to choose to be both cross-listed and politically connected?

Anecdotal evidence suggests that firms may reap similar benefits from cross-listing and being politically connected. For instance, the aforementioned political-cost hypothesis (Watts & Zimmerman, 1978) describes conditions where firms generate increased attention. While firms often attempt to deter regulatory attention, increased attention in the form of analysts following and trading volume is often desirable for cross-listed firms. Similarly, many firms cross list in order to take advantage of profitable opportunities (Dodd, 2013). Political connections may allow firms to obtain a competitive advantage, especially through favorable policy or regulatory changes and profitable projects, such as government procurement contracts. Formally stated:

Research Question: Do cross-listed firms benefit from also being politically connected?

Data collection and models

Three of the most common methods to identify whether a firm is politically connected are by measuring whether a firm employs lobbyists, contributes to political campaigns or whether a firm has a politician on its board of directors. Bertrand et al. (2014) argue that corporations employ lobbyists for their political connections, rather than their expertise. Thus, classifying a firm as politically connected based on lobbying expenditures is often found in the literature (Correia, 2014). Cooper et al. (2010) argue that political contributions lead to significant future

abnormal returns.[32] Similarly, other studies measure election and/or Political Action Committee (PAC) contributions as a proxy for political connectedness (Hong & Kostovetsky, 2012; Schuler et al., 2002). Finally, studies have shown that politicians with board memberships can utilize their connections to obtain governments support for firms (Duchin & Sosyura, 2012; Kostovetsky, 2015).

Data is collected for 142 Canadian cross-listed firms (entire population with available data) that were cross-listed between 2010 and 2014. The regression models are:

$$Analysts_{i,t} = \alpha_0 + \alpha_1 PCF\ measure_{i,t} + \alpha_2 Size_{i,t} + \alpha_3 Big4_{i,t} + \alpha_4 Leverage_{i,t} + \alpha_5 CapExp_{i,t} +$$

$$\alpha_6 Divs_{i,t} + \alpha_7 M\&Aactivity_{i,t} + \alpha_8 Growth_{i,t} + \alpha_9 BKMK_{i,t} + \alpha_{10} Loss_{i,t} + \alpha_{11} Intangibles_{i,t} +$$

$$\alpha_{12} StockVolatility_{i,t} + \alpha_{13} StockReturn_{i,t} + industry\&year\ effects_{i,t} + \mu \tag{1}$$

$$DV_{i,t} = \alpha_0 + \alpha_1 PCF\ measure_{i,t} + \alpha_2 Size_{i,t} + \alpha_3 Big4_{i,t} + \alpha_4 Leverage_{i,t} + \alpha_5 CapExp_{i,t} +$$

$$\alpha_6 Divs_{i,t} + \alpha_7 M\&Aactivity_{i,t} + \alpha_8 Growth_{i,t} + industry\ effects + year\ effects_{i,t} + \mu \tag{2}$$

where

Analysts measures the average number of analysts following a company in a given year. This information is obtained from the I/B/E/S database. The dependent variable (*DV*) is one of the other aforementioned benefits from cross-listing and are defined as follows: *Tobin's Q* is measured as the ratio of market value of assets divided by book value of assets. *Volume* refers to the yearly trading volume of the firm, measured as the log of total volume. *ROA* and *ROE* refer to the return on assets and return on equity, respectively.[33] The latter four measures are obtained from Compustat.

The *PCF measures* are as follows*: Lobbying* measures whether or not the company has

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[32] slightly better for firms that support Democratic candidates
[33] ROA and ROE are measured as net profit over assets and equity. Thus, the minimum value is 0. This is done because there are several companies with no revenue in the sample and these extreme values would cause a negative skewness effect.

lobbying expenditures. (*Campaign) Contributions* measures whether or not a company

contributes to a PAC, Super PAC or 527 organization.[34] These two variables are obtained from

opensecrets.org. (*Political) Directors* are identified through the Goldman et al. (2009) method,

which identifies directors that have held prominent government positions. Politicians are

identified as Canadian (domestic), American or International. This data primarily comes from

proxy statements found on SEDAR. Consistent with the extant literature (Cooper et al, 2010;

Goldman et al., 2009; Kim & Zhang, 2016; Yu & Yu, 2011), all three measures are indicator

variables with a value of 0 or 1. *Pol_sum* is the summation of the three indicator variables.

Pol_active measures whether the company had at least 1 firm year of lobbying, campaign

contributions or political director in the sample period.

The control variables in the model follow Abdallah (2008). Although, since only one

country (Canada) is being examined there is no need for country specific controls. *Size* is

measured as the log of total assets. *Big4* is an indicator variable if the company has a big four

auditor. *Leverage* is calculated as total liabilities over total assets. Capital Expenditures

(*CapExp)* are measured as the total capital expenditures for the year over total assets. Dividends

(*Divs)* is an indicator variable of whether the firm paid out dividends in the year. *M&Aactivity* is

also an indicator variable, examining whether the firm had a mergers and acquisitions event in

the year. Finally, *Growth* refers to the year-over-year sales growth. This data was obtained from

Compustat.

Additional controls are employed for *Analysts*. These variables come from the cross-

listed literature on financial analysts (Dhaliwal et al., 2012; Tan et al., 2011), once again

excluding country specific controls. Book-to-market (*BKMK*) is calculated as the book value of

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[34] Political Action Committee (PAC), independent-expenditure only committees (known as Super PACs) and 527 organizations- tax-exempt organizations created primarily to influence the selection, nomination, election, appointment or defeat of candidate. Firms can contribute to these groups since 2010 - *Citizens United v. FEC*

equity, excluding preferred shares, divided by the market value of the firm on the balance sheet date. *Loss* is an indicator variable with a value of one if the firm had a net loss in the year. *Intangibles* are measured as the ratio of intangible assets to total assets. *StockVolatility* is the standard deviation of a firm's stock in the prior year. Lastly, *StockReturn* is the return of a firm's stock in the prior year.

IV. Results

Table 1, Panel A shows descriptive statistics regarding political connections of the cross-listed corporations. Among the three measures, politician directors is the most common (28% of firm-years) followed by lobbying (16%) and campaign contributions (15%). Approximately 28% of firms had political directors in the years captured (comparable to 29% of U.S. firms in Chapter 3). A majority of these were domestic Canadian directors, 250 (74%) of the director years, 66 (19%) were American political directors, while 24 (7%) of the director years were international (non-Canadian or U.S.). This is significantly more dispersed than the 99% of domestic (U.S.) directors in Chapter 3. Additional analysis shows that 41% of the firms were politically active at some point in the sample years (had at least one year of lobbying, political contributions or politician director). Approximately 5% of the sample had all three measures in a given year. Four firms (close to 3% of the sample) had lobbying, political contributions <u>and</u> politician directors in every year from 2010 to 2014.

Table 1, Panel B shows descriptive statistics regarding political connections of the cross-listed corporations, broken down by year. The table shows that all three measures were almost complete uniform over the time period. This implies that the firms who employ these practices do so on a fairly consistent basis.[35] The average lobbying and campaign contribution spending is

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[35] Campaign Contributions in non-election years is based on the previous year. Almost all firms that contributed to

also presented. The campaign contributions reached the highest point in 2012-the year of the presidential election. Table 1, Panel C presents Spearman correlations of the three measures. Lobbying, political contributions and politician director are all significantly correlated to each other at the 1% level.

[Insert Table 1 here]

Table 2 displays the descriptive statistics and Table 3 shows the Spearman correlations for the model variables. The variables are winsorized at the 1% and 99% levels. To address the issue of independence in time-series data, robust standard errors often need to be controlled for. Thus, the regressions are run with standard errors clustered by firm. Several variables are significantly correlated with size. Possible multicollinearity issues are dealt with in the following Additional Testing section.

[Insert Table 2 here]

[Insert Table 3 here]

The regression results begin with Table 4 that gives the results with *Analysts* following as the dependent variable. The control variables are as one would expect in the literature, with *Size* having the strongest relationship with the number of *analysts*. *Pol_sum* and *Pol_active* are both significantly positively associated with *Analysts* (significant at the 1% level). *Pol_sum* and *Pol_active* are fairly consistent measures (with each other) throughout all the regressions. In the third column, both *Lobbying* and *Contributions* are significantly positively associated with analysts' following (at the 1% and 5% levels, respectfully), while *Directors* is significantly

political campaigns did so consistently for all measurable years.

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negative associated with analysts' following (at 5% level). This latter relationship is explored further in section five. Nonetheless, this provides some evidence that political connections are associated with a greater analyst following in cross-listed firms. *Size, StockVolatility* and *Divs* are significantly positively associated with *Analysts*, as analysts tend to follow bigger firms that pay out dividends. *Capexp* is significantly negatively associated with *Analysts*, as these tend to be early, stage growth firms which analysts rarely follow.

[Insert Table 4 here]

Table 5 shows the models regressed with *Tobin's Q* as the dependent variable. Consistent significant results are found with *Pol_sum* and *Pol_active* both having a significant positive relationship with *Tobin's Q* (at the 1% level). Looking at the individual factors, *Lobbying* has no significant association, while *Contributions* and *Directors* are significantly positively associated with the *Tobin's Q* (at the 1% and 5% levels, respectfully). Thus, the evidence presented suggests that political connections are associated with a high market valuation in cross-listed firms. Additionally, the market tends to speculate on growth firms, which is evidenced by *Size* being negatively associated with *Tobin's Q*, while *Leverage* and *Capexp* are positively associated with *Tobin's Q* (all at the 1% level).

[Insert Table 5 here]

Table 6 shows the models with *Volume* as the dependent variable. Consistent significant results are shown with both *Pol_sum* and *Pol_active* having a significant positive relationship with trading volume. Looking at the individual factors, *Lobbying* has no association, while *Contributions* and *Directors* are significantly positively associated with *Volume* (at the 10% and 5% levels, respectively). This provides evidence that political connections are associated with

higher market liquidity in cross-listed firms. Larger firms and those with a big four auditor are also positively associated with *Volume*.

[Insert Table 6 here]

Table 7 shows the models with *ROA* as the dependent variable. *Pol_sum* is not significantly associated with return on assets. This is further explored in the regressions that examine the size quartiles and the largest industries in the sample. Similarly, *Pol_active*, *Lobbying*, *Contributions* and *Directors* have no significant association with *ROA*. Firms with high sales growth and a large amount of capital expenditures are positively associated with *ROA* at the 1% and 5% levels, respectively), while higher leveraged firms are negatively associated with *ROA* (at the 1% level).

[Insert Table 7 here]

Table 8 shows the models with a similar measure, *ROE*, as the dependent variable. However, none of the political connection variables of interest have a significant association with *ROE*. Interesting, *Leverage* is negatively associated with *ROE* (at the 1% level). This is likely due to the capital structure of the highly leveraged firms.

[Insert Table 8 here]

V. Additional Testing

Table 9 re-runs the regressions with the main variable of interest, *Pol_sum,* and a one-year lag on all the variables.[36] The results using a one-year lag are almost identical to the results

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[36] Pol_sum can also be chosen since it has the strongest results and, on average, marginally higher adjusted R².

with current year variables. The only change being that *Pol_sum* is slightly less positively

significant with *Tobin's Q* (5% vs. 1% previously).

[Insert Table 9 here]

Table 10 breaks down the firms into four size quartiles (there are too many omitted

variables in the regressions when examining quintiles[37]). This is done for two reasons: first

several of the dependent variables are strongly correlated with *Size*. Untabluated results show

that when separated into quartiles, the average correlation between *Size* and P*ol_sum*, *Analysts*,

Tobin's Q, *ROA* and *ROE* are 0.11, 0.16, -0.21, 0.24, 0.16 and 0.20, respectively. Second, several

of the cross-listed firms are resource companies in the exploration stage and this helps study how

these smaller firms may be affecting the results.

Table 10 shows that the largest cross-listed firms benefit the most from political

connections, as both *Analysts* and *Tobin's Q* are significantly associated with *Pol_sum* at the 1%

level, while *Volume* is significantly associated with *Pol_sum* at the 5% level. Moreover, there is

not a positive association between *Pol_sum* and *ROA* (at the 1% level). These results suggest that

the biggest cross-listed firms benefit the most when also being politically connected. The results

are also interesting when examining the second quartile. There is a significant positive

association with *Tobin's Q* (1% level), but a negative relationship with *Analysts* (10% level).

Untabulated results show that it is a negative relationship between *Directors* and *Analysts* that is

driving this result in the second quartile (this relationship is insignificant in the other quartiles).

Furthermore, *ROA* and *ROE* have a significantly positive association with *Pol_sum* (at the 1%

level). The third quartile shows a significant positive association with *Tobin's Q* and *Volume*

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[37] For example, in quintiles all of the largest firms employ a big four auditor and none of the smallest firms pay
dividends.

(1% level), but none of the other variables of interest are associated with *Pol_sum*. For the

smallest firms, only *Volume* has a significant positive association with *Pol_sum* (5% level).

However, ROA is negatively associated (10% level), which could possibly suggest the political

connections could actually be detrimental to these smaller firms.

[Insert Table 10 here]

Tables 11 and 12 re-run the regressions for the two most populous industries in the

sample (two digit SIC codes). Mining/resource companies (SIC 10-14) shows that all the prior

relationships with *Pol_sum* are significant (1% level). However, *ROA* has no significant

relationship and *ROE* is negative (at the 10% level). This appears to be a strong driver of the

results (with many exploration stage companies having no revenue). Manufacturing companies

(SIC 20-39) shows that *Pol_sum* is significantly positively associated with *Analysts* and *Volume*,

but none of the other dependent variables.

[Insert Table 11 here]

[Insert Table 12 here]

Political connection may not be only enhancing the benefits of being cross-listed, but also

providing benefits seen in the PCFs literature. Following Goldman et al. (2013), data on

procurement contracts is collected from the Federal Procurement Data System-Next Generation

(FPDS-NG). This database contains all procurement contracts that are awarded by the US

government and exceed a value of $2,500. As these contracts are often multi-year, an indicator

variable is used to measure whether a company was awarded a procurement contract in at least

one year of the sample period. 25 firms (or approximately 21% of the sample) was award at least

one procurement contracts during this time period. Table 13 presents the regressions with

Procurement as the dependent variable. The results show that the PCFs in the sample have a strong positive association (significant at the 1% level) with *Procurement* when regressed with *Pol_sum* and Pol_*active*. However, the third column shows that both lobbying and directors are not associated with *Procurement*, but it is the campaign *Contributions* that is the most significant factor for firms obtaining procurement contracts.

[Insert Table 13 here]

VI. Conclusion

Firms choose to cross-list for many reasons, such as increased liquidity, investor recognition, growth opportunities, and as part of a firm's global strategy (Dodd, 2013). Likewise, political connections can enhance a firm's reputation, decrease regulatory risk and lead to more profitable opportunities for firms (Faccio, 2006). This study asks whether being politically connected enhances the benefits of cross-listing.

The results show that compared to non-politically connected cross-listed firms, politically connected cross-listed firms have higher analysts following, higher market valuations, and higher liquidity. These benefits persist after a one-year lag and extend the most to the largest cross-listed firms. While some PCFs may experience lower profitability, this is largely confined to the smaller, exploration type resources firms who would cross-list for other reasons (such as access to an increased amount of capital). Furthermore, additional analysis shows that politically connected cross-listed firms that contribute to political campaigns are significantly more like to obtain government procurement contracts.

This is one of the first studies to combine the political connectedness and cross-listed literatures. Although this study shows that there are benefits for cross-listed firms to also be

politically connected, there are limitations to this study. The decision for a firm to become either

politically connected or cross-list is inherently endogenous. Thus, causality of when the benefits

are extracted cannot be implied. Further studies can develop alternative models in order to

demonstrate a stronger casual link.

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Table 1: Descriptive Statistics

Panel A: Political Connections by firm-years

Variable	Mean (observations)	Standard Deviation	Average Spending (US dollars)
Lobbying	0.157 (120)	0.364	$634,746
CampaignContributions	0.154 (118)	0.361	$61,961
PoliticalDirector	0.277 (212)	0.448	

Panel B: Political Connections by years

Variable	Mean (observations)	Standard Deviation	Average Spending (US dollars)
2010			
Lobbying	0.144 (22)	0.352	$579,879
CampaignContributions	0.157 (24)	0.365	$47,631
PoliticalDirector	0.275 (42)	0.448	
2011			
Lobbying	0.163 (25)	0.371	$597,976
CampaignContributions	0.157 (24)	0.365	
PoliticalDirector	0.281 (43)	0.451	
2012			
Lobbying	0.157 (24)	0.365	$656,837
CampaignContributions	0.150 (23)	0.359	$83,146
PoliticalDirector	0.281 (43)	0.451	
2013			
Lobbying	0.157 (24)	0.365	$629,767
CampaignContributions	0.163 (25)	0.371	
PoliticalDirector	0.275 (42)	0.448	
2014			
Lobbying	0.163 (25)	0.371	$579,808
CampaignContributions	0.144 (22)	0.352	$47,612
PoliticalDirector	0.275 (42)	0.448	

Panel C: Correlations Table

	Lobbying	CampaignContributions	PoliticalDirector
Lobbying	1		
CampaignContributions	0.5522*	1	
PoliticalDirector	0.1987*	0.2612*	1

* Significant at the 1% level

Table 2: Descriptive Statistics

Variable	Mean	Standard Dev.	Minimum	Maximum
Lobbying	0.157	0.369	0	1
Contributions	0.154	0.373	0	1
Directors	0.277	0.451	0	1
Pol_sum	0.613	0.883	0	3
Analysts	6.800	6.677	0	26.1
Tobin's Q	2.011	2.253	0.059	16.499
Volume	18.430	1.773	13.749	21.741
ROA	0.037	0.055	0	0.299
ROE	0.013	0.112	0	2.338
Size	7.211	2.658	1.477	13.530
Big4	0.924	0.265	0	1
Leverage	0.432	0.277	0.015	1.325
Capexp	0.080	0.078	0	0.340
Divs	0.425	0.495	0	1
M&Aactivity	0.038	0.191	0	1
Growth	0.237	0.930	-1	6.707

Table 3: Spearman Correlations Table

	pol_sum	analysts	tobinq	volume	ROA	ROE	size	big4	leverage	capexp	divs	M&A	growth
pol_sum	1.00												
analysts	0.51***	1.00											
tobinq	-0.06	0.11**	1.00										
volume	0.44***	0.61***	0.20***	1.00									
ROA	0.22***	0.35***	0.07*	0.19***	1.00								
ROE	0.28***	0.33***	0.09**	0.17***	0.81**	1.00							
Size	0.62***	0.73***	-0.32***	0.74***	0.40**	0.41***	1.00						
big4	0.14***	0.31***	-0.02	0.33***	0.13**	0.14***	0.34***	1.00					
leverage	0.39***	0.36***	-0.09**	0.19***	0.11**	0.29***	0.44***	0.15***	1.00				
capexp	-0.06*	0.05	0.04	0.23***	0.22***	0.10**	0.13***	0.09**	-0.17***	1.00			
Divs	0.53***	0.58***	-0.12***	0.52***	0.35***	0.37***	0.75***	0.25***	0.36***	0.13***	1.00		
M&A	-0.03	0.11**	-0.01	0.01	0.03	0.03	0.04	0.03	0.11**	-0.12***	-0.04	1.00	
growth	-0.05	0.01	0.18**	0.07**	0.27***	0.20***	0.06	0.08**	0.01	0.09*	0.05	0.08**	1.00

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level
See Appendix I for variable definitions

Table 4: Analysts Following

Model: $Analysts_{i,t} = \alpha_0 + \alpha_1 PCF\ measure_{i,t} + \alpha_2 Size_{i,t} + \alpha_3 Big4_{i,t} + \alpha_4 Leverage_{i,t} + \alpha_5 CapExp_{i,t} + \alpha_6 Divs_{i,t} + \alpha_7 M\&Aactivity_{i,t} + \alpha_8 Growth_{i,t} + \alpha_9 BKMK_{i,t} + \alpha_{10} Loss_{i,t} + \alpha_{11} Intangibles_{i,t} + \alpha_{12} StockVolatility_{i,t} + \alpha_{13} StockReturn_{i,t} + industry\&year\ effects_{i,t} + \mu$

Variable	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)
Pol_sum	0.887*** (3.63)		
Pol_active		0.861** (1.97)	
Lobbying			1.084** (2.06)
Contributions			2.876*** (5.13)
Directors			-1.202** (-2.45)
Size	1.501*** (12.73)	1.597*** (13.86)	1.389*** (11.98)
Big4	0.224 (0.35)	0.064 (0.10)	0.149 (0.24)
Leverage	-0.860 (-1.50)	-0.784 (-1.36)	-1.046* (-1.87)
Capexp	-5.127** (-2.22)	-5.787** (-2.22)	-5.127** (-2.33)
Divs	1.234*** (2.57)	1.143** (2.35)	1.687*** (3.57)
M&Aactivity	0.529 (0.61)	0.197 (0.23)	0.809 (0.95)
Growth	-0.075 (-1.41)	-0.079 (-1.46)	-0.076 (-1.47)
BKMK	-0.368 (-1.67)	-0.377 (-1.70)	-0.403* (-1.88)
Loss	0.237 (0.61)	0.291 (0.74)	0.219 (0.58)
Intangibles	0.634 (0.56)	0.203 (0.18)	0.832 (0.75)
StockVolatility	0.446*** (7.64)	0.471*** (8.08)	0.462*** (8.12)
StockReturn	-0.100 (-1.08)	-0.100 (-1.07)	-0.069 (-0.76)
Industry Effects	YES	YES	YES
Year Effects	YES	YES	YES
Observations	710	710	710
Adj. R^2	0.6308	0.6258	0.6510

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level
See Appendix I for variable definitions

Table 5: Market Value

Model: Tobin's $Q_{i,t} = \alpha_0 + \alpha_1 PCF\ measure_{i,t} + \alpha_2 Size_{i,t} + \alpha_3 Big4_{i,t} + \alpha_4 Leverage_{i,t} + \alpha_5 CapExp_{i,t} + \alpha_6 Divs_{i,t} + \alpha_7 M\&Aactivity_{i,t} + \alpha_8 Growth_{i,t} + industry\&year\ effects_{i,t} + \mu$

Variable	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)
Pol_sum	0.445*** (3.49)		
Pol_active		0.706*** (3.13)	
Lobbying			0.049 (0.17)
Contributions			0.788*** (2.57)
Directors			0.485** (2.20)
Size	-0.695*** (-11.90)	-0.673*** (-11.84)	-0.694*** (-11.72)
Big4	0.371 (1.08)	0.344 (1.00)	0.368 (1.07)
Leverage	1.470*** (4.85)	1.492*** (4.91)	1.460*** (4.81)
Capexp	4.278*** (3.85)	4.175*** (3.42)	4.311*** (3.53)
Divs	0.938*** (3.67)	0.879*** (3.42)	0.928*** (3.59)
M&Aactivity	-0.057 (-0.13)	-0.241 (-0.53)	-0.200 (-0.43)
Growth	0.046 (1.58)	0.045 (1.56)	0.046 (1.60)
Industry Effects	YES	YES	YES
Year Effects	YES	YES	YES
Observations	710	710	710
Adj. R^2	0.2766	0.2741	0.2769

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level
See Appendix I for variable definitions

Table 6: Liquidity

Model: Volume$_{i,t}$ = α$_0$ + α$_1$PCF measure$_{i,t}$ + α$_2$Size$_{i,t}$ + α$_3$Big4$_{i,t}$ + α$_4$Leverage$_{i,t}$ + α$_5$CapExp$_{i,t}$ + α$_6$Divs$_{i,t}$ + α$_7$M&Aactivity$_{i,t}$ + α$_8$Growth$_{i,t}$ + industry&year effects$_{i,t}$ + μ

Variable	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)
Pol_sum	0.183*** (2.96)		
Pol_active		0.445*** (4.09)	
Lobbying			0.032 (0.23)
Contributions			0.249* (1.67)
Directors			0.259** (2.42)
Size	0.520*** (18.33)	0.514*** (18.77)	0.524*** (18.24)
Big4	0.645*** (3.87)	0.658*** (3.98)	0.647*** (3.88)
Leverage	0.076 (0.52)	0.077 (0.53)	0.077 (0.53)
Capexp	-0.716 (-1.21)	-0.682 (-1.16)	-0.701 (-1.18)
Divs	-0.034 (-0.27)	-0.078 (-0.63)	-0.052 (-0.41)
M&Aactivity	0.209 (0.95)	0.141 (0.65)	0.198 (0.89)
Growth	0.026* (1.84)	0.026* (1.88)	0.026* (1.84)
Industry Effects	YES	YES	YES
Year Effects	YES	YES	YES
Observations	710	710	710
Adj. R²	0.6374	0.6415	0.6373

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level
See Appendix I for variable definitions

Table 7: Return on Assets

Model: $ROA_{i,t} = \alpha_0 + \alpha_1 PCF\ measure_{i,t} + \alpha_2 Size_{i,t} + \alpha_3 Big4_{i,t} + \alpha_4 Leverage_{i,t} + \alpha_5 CapExp_{i,t} + \alpha_6 Divs_{i,t} + \alpha_7 M\&Aactivity_{i,t} + \alpha_8 Growth_{i,t} + industry\&year\ effects_{i,t} + \mu$

Variable	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)
Pol_sum	0.003 (0.91)		
Pol_active		-0.003 (-0.45)	
Lobbying			-0.007 (-0.98)
Contributions			0.009 (1.12)
Directors			0.007 (1.22)
Size	0.003* (1.67)	0.003** (2.29)	0.003* (1.78)
Big4	-0.008 (-0.90)	-0.009 (-1.04)	-0.008 (-0.89)
Leverage	-0.031*** (-3.20)	-0.030*** (-3.16)	-0.031*** (-3.21)
Capexp	0.082** (2.48)	0.077** (2.48)	0.083** (2.51)
Divs	0.012* (2.48)	0.012* (1.85)	0.011 (1.61)
M&Aactivity	-0.015 (-1.28)	-0.017 (-1.42)	-0.016 (-1.33)
Growth	0.008*** (3.34)	0.008*** (3.29)	0.008*** (3.34)
Industry Effects	YES	YES	YES
Year Effects	YES	YES	YES
Observations	710	710	710
Adj. R²	0.0982	0.0974	0.0990

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level
See Appendix I for variable definitions

Table 8: Return on Equity

Model: $ROE_{i,t} = \alpha_0 + \alpha_1 PCF\ measure_{i,t} + \alpha_2 Size_{i,t} + \alpha_3 Big4_{i,t} + \alpha_4 Leverage_{i,t} + \alpha_5 CapExp_{i,t} + \alpha_6 Divs_{i,t} + \alpha_7 M\&Aactivity_{i,t} + \alpha_8 Growth_{i,t} + industry\&year\ effects_{i,t} + \mu$

Variable	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)
Pol_sum	0.016 (1.19)		
Pol_active		0.013 (0.052)	
Lobbying			-0.001 (-0.04)
Contributions			0.037 (1.13)
Directors			0.013 (0.53)
Size	-0.043*** (-6.86)	-0.041*** (-6.75)	-0.043*** (-6.80)
Big4	0.061 (1.63)	0.058 (1.56)	0.060 (1.63)
Leverage	0.559*** (17.12)	0.561*** (17.18)	0.558*** (17.06)
Capexp	0.368** (2.50)	0.318** (2.42)	0.330** (2.51)
Divs	0.053* (1.91)	0.052* (1.87)	0.053* (1.92)
M&Aactivity	-0.034 (-0.70)	-0.042 (-0.86)	-0.033 (-0.68)
Growth	0.005 (1.52)	0.005 (1.49)	0.005 (1.52)
Industry Effects	YES	YES	YES
Year Effects	YES	YES	YES
Observations	710	710	710
Adj. R²	0.3404	0.3394	0.3390

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level
See Appendix I for variable definitions

Table 9: One Year Lagged Effects:

Model: $DV_{i,t} = \alpha_0 + \alpha_1 PCF\ measure_{i,t-1} + \alpha_2 Size_{i,t-1} + \alpha_3 Big4_{i,t-1} + \alpha_4 Leverage_{i,t-1} + \alpha_5 CapExp_{i,t-1}
$+ \alpha_6 Divs_{i,t-1} + \alpha_7 M\&Aactivity_{i,t-1} + \alpha_8 Growth_{i,t-1} + industry\&year\ effects_{i,t-1} + \mu$

Variable	OLS Coefficient (t-statistic) DV= Analysts	OLS Coefficient (t-statistic) DV= Tobin's Q	OLS Coefficient (t-statistic) DV= Trade Volume	OLS Coefficient (t-statistic) DV = ROA	OLS Coefficient (t-statistic) DV = ROE
Pol_sum	1.442*** (5.25)	0.358** (2.53)	0.197*** (2.89)	0.003 (0.63)	0.024 (1.09)
Size	1.627*** (12.86)	-0.660*** (-10.11)	0.504*** (16.03)	0.001 (0.73)	-0.011 (-0.61)
Big4	0.379 (0.51)	0.346 (0.97)	0.612*** (3.34)	-0.001 (-0.05)	0.112 (1.10)
Leverage	-1.068* (-1.69)	0.935*** (2.87)	0.132 (0.84)	-0.021 (-2.31)	0.438*** (5.03)
Capexp	-2.662 (-1.04)	3.065** (2.31)	0.321 (0.50)	0.079** (2.06)	0.480 (1.35)
Divs	1.648*** (2.93)	1.073*** (3.69)	-0.028 (-0.20)	0.009* (1.19)	0.109 (1.41)
M&Aactivity	0.925 (0.91)	-0.030 (-0.06)	0.455* (1.80)	-0.025* (-1.82)	0.011 (0.07)
Growth	-0.078 (-1.36)	0.007 (0.24)	0.022 (1.57)	-0.001 (-1.32)	-0.008 (-1.00)
Industry Effects	YES	YES	YES	YES	YES
Year Effects	YES	YES	YES	YES	YES
Observations	568	568	568	568	568
Adj. R^2	0.6153	0.2566	0.6406	0.0826	0.2394

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level
See Appendix I for variable definitions

Table 10: Size Deciles

Model: $DV_{i,t} = \alpha_0 + \alpha_1 PCF\ measure_{i,t} + \alpha_2 Size_{i,t} + \alpha_3 Big4_{i,t} + \alpha_4 Leverage_{i,t} + \alpha_5 CapExp_{i,t} + \alpha_6 Divs_{i,t} + \alpha_7 M\&Aactivity_{i,t} + \alpha_8 Growth_{i,t} + industry\&year\ effects_{i,t} + \mu$

Quartile 1 (Largest Firms)

Variable	OLS Coefficient (t-statistic) DV= Analysts	OLS Coefficient (t-statistic) DV= Tobin's Q	OLS Coefficient (t-statistic) DV= Trade Volume	OLS Coefficient (t-statistic) DV = ROA	OLS Coefficient (t-statistic) DV = ROE
	2.435***	0.086***	0.143**	0.008***	0.007
Pol_sum	(5.95)	(2.68)	(2.48)	(3.00)	(0.98)
Controls	YES	YES	YES	YES	YES
Industry Effects	YES	YES	YES	YES	YES
Year Effects	YES	YES	YES	YES	YES
Observations	177	177	177	177	177
Adj. R^2	0.4023	0.4235	0.5198	0.4040	0.2358

Quartile 2

Variable	OLS Coefficient (t-statistic) DV= Analysts	OLS Coefficient (t-statistic) DV= Tobin's Q	OLS Coefficient (t-statistic) DV= Trade Volume	OLS Coefficient (t-statistic) DV = ROA	OLS Coefficient (t-statistic) DV = ROE
	-0.895*	0.264***	0.014	0.020**	0.025***
Pol_sum	(-1.69)	(3.62)	(0.14)	(3.38)	(2.69)
Controls	YES	YES	YES	YES	YES
Industry Effects	YES	YES	YES	YES	YES
Year Effects	YES	YES	YES	YES	YES
Observations	178	178	178	178	178
Adj. R^2	0.3647	0.2965	0.4495	0.1504	0.1703

Quartile 3

Variable	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)
	DV= Analysts	**DV= Tobin's Q**	**DV= Trade Volume**	**DV = ROA**	**DV = ROE**
	0.939	0.813***	1.281***	0.001	-0.112
Pol_sum	(1.33)	(3.62)	(4.15)	(0.11)	(-1.30)
Controls	YES	YES	YES	YES	YES
Industry Effects	YES	YES	YES	YES	YES
Year Effects	YES	YES	YES	YES	YES
Observations	177	177	177	177	177
Adj. R^2	0.5512	0.2485	0.2709	0.0732	0.0782

Quartile 4 (Smallest Firms)

Variable	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)
	DV= Analysts	**DV= Tobin's Q**	**DV= Trade Volume**	**DV = ROA**	**DV = ROE**
	0.088	1.480	0.663**	-0.031*	-0.483
Pol_sum	(0.21)	(1.62)	(2.24)	(-1.75)	(-0.31)
Controls	YES	YES	YES	YES	YES
Industry Effects	YES	YES	YES	YES	YES
Year Effects	YES	YES	YES	YES	YES
Observations	178	178	178	178	178
Adj. R^2	0.3532	0.3267	0.2823	0.0345	0.0841

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level
See Appendix I for variable definitions

Table 11: Mining/Resource Companies (SIC 10-14)

Model: $DV_{i,t} = \alpha_0 + \alpha_1 PCF\ measure_{i,t} + \alpha_2 Size_{i,t} + \alpha_3 Big4_{i,t} + \alpha_4 Leverage_{i,t} + \alpha_5 CapExp_{i,t} + \alpha_6 Divs_{i,t} + \alpha_7 M\&Aactivity_{i,t} + \alpha_8 Growth_{i,t} + year\ effects_{i,t} + \mu$

Variable	OLS Coefficient (t-statistic) DV= Analysts	OLS Coefficient (t-statistic) DV= Tobin's Q	OLS Coefficient (t-statistic) DV= Trade Volume	Variable DV = ROA	OLS Coefficient (t-statistic) DV = ROE
Pol_sum	1.923*** (5.44)	0.609*** (4.80)	0.290*** (2.67)	-0.002 (-0.33)	-0.051* (1.82)
Size	1.848*** (10.86)	-0.410*** (-6.72)	0.588*** (11.26)	0.001 (0.16)	0.040** (2.13)
Big4	-0.573 (-0.78)	1.078*** (4.09)	0.474** (2.10)	-0.011 (-0.99)	-0.149* (-1.85)
Leverage	-1.598 (-1.34)	-0.490 (-1.14)	-1.177*** (-3.21)	-0.019 (-1.07)	-0.351*** (-2.68)
Capexp	-7.229*** (-3.23)	0.913 (1.14)	-0.866 (-1.26)	0.073** (2.09)	0.450* (1.83)
Divs	2.020*** (3.33)	0.360* (1.66)	-0.012 (-0.07)	0.000 (0.01)	0.087 (1.31)
M&Aactivity	0.675 (0.32)	0.220 (0.29)	0.851 (1.32)	0.018 (0.19)	0.106 (0.46)
Growth	-0.083* (-1.69)	-0.016 (-0.91)	0.014 (0.97)	0.001 (0.31)	0.001 (0.20)
Industry Effects	YES	YES	YES	YES	YES
Year Effects	YES	YES	YES	YES	YES
Observations	340	340	340	340	340
Adj. R^2	0.6581	0.2866	0.5570	0.0820	0.0859

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level
See Appendix I for variable definitions

Table 12: Manufacturing Companies (SIC 20-39)

Model: $DV_{i,t} = \alpha_0 + \alpha_1 PCF\ measure_{i,t} + \alpha_2 Size_{i,t} + \alpha_3 Big4_{i,t} + \alpha_4 Leverage_{i,t} + \alpha_5 CapExp_{i,t} + \alpha_6 Divs_{i,t} + \alpha_7 M\&Aactivity_{i,t} + \alpha_8 Growth_{i,t} + year\ effects_{i,t} + \mu$

Variable	OLS Coefficient (t-statistic) DV= Analysts	OLS Coefficient (t-statistic) DV= Tobin's Q	OLS Coefficient (t-statistic) DV= Trade Volume	Variable DV = ROA	OLS Coefficient (t-statistic) DV = ROE
	1.792***	0.481	0.321***	0.009	0.002
Pol_sum	(3.64)	(1.45)	(2.65)	(1.21)	(0.03)
	1.733***	-0.975***	0.590***	0.008**	0.099***
Size	(8.37)	(-6.98)	(11.58)	(2.58)	(2.62)
	1.532	-2.576**	1.001**	-0.021	-0.340
Big4	(0.94)	(-2.34)	(2.50)	(-0.89)	(-1.14)
	0.104	0.900	0.122	-0.031	0.688***
Leverage	(0.11)	(1.41)	(0.52)	(-1.64)	(3.96)
	5.256	23.196***	0.870	0.095	-0.397
Capexp	(0.76)	(4.99)	(0.51)	(0.91)	(-0.31)
	-1.382	0.881	-0.808***	-0.013	0.069
Divs	(-1.28)	(1.21)	(-3.03)	(-0.82)	(0.35)
	0.263	0.647	0.156	-0.030	-0.215
M&Aactivity	(0.18)	(0.64)	(0.43)	(-1.42)	(-0.79)
	0.123	0.650***	0.194***	0.013**	0.061
Growth	(0.42)	(3.27)	(2.68)	(2.34)	(1.12)
Industry Effects	YES	YES	YES	YES	YES
Year Effects	YES	YES	YES	YES	YES
Observations	195	195	195	195	195
Adj. R^2	0.5680	0.4108	0.6518	0.1004	0.2478

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level
See Appendix I for variable definitions

Table 13: Procurement Contracts

Model: Procurement$_{i,t}$ = α_0 + α_1PCF measure$_{i,t}$ + α_2Size$_{i,t}$ + α_3Big4$_{i,t}$ + α_4Leverage$_{i,t}$ + α_5CapExp$_{i,t}$ + α_6Divs$_{i,t}$ + α_7M&Aactivity$_{i,t}$ + α_8Growth$_{i,t}$ + industry&year effects$_{i,t}$ + μ

Variable	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)	OLS Coefficient (t-statistic)
Pol_sum	0.057*** (3.01)		
Pol_active		0.168*** (5.04)	
Lobbying			0.002 (0.05)
Contributions			0.154*** (3.40)
Directors			0.016 (0.48)
Size	0.056*** (6.47)	0.052*** (6.30)	0.054*** (6.16)
Big4	-0.149*** (-2.92)	-0.139*** (-2.77)	-0.151*** (-2.97)
Leverage	0.010 (0.22)	0.010 (0.23)	0.005 (0.10)
Capexp	-0.236 (-1.30)	-0.226 (-1.27)	-0.233 (-1.29)
Divs	-0.123*** (-3.50)	-0.154*** (-4.07)	-0.123*** (-3.22)
M&Aactivity	0.089 (1.32)	0.068 (1.02)	0.097 (1.43)
Growth	-0.002 (-0.43)	-0.002 (-0.38)	-0.002 (-0.44)
Industry Effects	YES	YES	YES
Year Effects	YES	YES	YES
Observations	710	710	710
Adj. R^2	0.3493	0.3641	0.3528

*** Significant at the 1% level; ** Significant at the 5% level; * Significant at the 10% level
See Appendix I for variable definitions

Appendix I: Variable Definitions

Lobbying- indicator variable equal to 1 if the firm has lobbying expenditures

Contributions- indicator variable equal to 1 if the firm has campaign contributions

Directors- indicator variable equal to 1 if the firm has a politician director

Pol_sum- Summation of Lobbying, CampaignContribution and PoliticalDirector

Active- whether the firm had at least one year of Lobbying, CampaignContribution or PoliticalDirector in the sample period

Analysts- the number of analysts following a company in a given year

Tobin's Q- the ratio of the market value of assets divided by the book value of assets

Volume- log of the yearly total trading volume of the firm's stock

ROA- return on assets, calculated as net profit divided by total assets

ROE- return on equity, calculated as net profit divided by total shareholder's equity

Size- log of total firm assets

Big4- indicator variable equal to 1 if the firm has a big four auditor

Leverage- calculated as total liabilities over total assets

CapExp- capital expenditures, calculated as total capital expenditures divided by total assets

Divs- indicator variable equal to 1 if the firm paid out dividends in the year

M&Aactivity- indicator variable equal to 1 if the firm had a mergers and acquisitions event

Growth- year-over-year sales growth, calculated as yearly change in revenue divided by previous year's revenue

BKMK- Book-to-market, calculated as the book value of equity, excluding preferred shares, divided by the market value of the firm on the balance sheet date

Loss- indicator variable with a value of one if the firm had a net loss in the year

Intangibles- intangible assets, calculated as intangible assets divided by total assets

StockVolatility- the standard deviation of a firm's stock in the prior year

StockReturn- the return of a firm's stock in the prior year

Procurement- indicator variable equal to 1 if firm was granted a procurement contract during the sample period

Chapter 5:

Conclusion

The previous chapters in this dissertation were motivated by large scale corporate governance failures (e.g. Enron, WorldCom), increased calls from stakeholders to improve governance practices, and new rules and regulations, such as 2010's Citizens United v. FEC—which essentially allows corporations to unlimitedly contribute to political campaigns. Each of the three essays in this dissertation provide valuable insights into these issues by investigating the associations between corporate governance, accounting quality, financial performance, interlocked board structures, cross-listed firms as well as politically connected firms and directors.

The first essay developed a proxy disclosure score and employs accruals models to proxy for earnings quality. The results show board interlocks have a negative relationship with governance disclosures and overall corporate governance quality, but a positive effect on earnings quality. Supplemental analysis demonstrates that there is no association between board interlocks and simple or basic voluntary disclosures, but there is a strong negative relationship between board interlocks and corporate governance (policies and practices) disclosures.

The second essay performed a large scale textual analysis on company proxy statements and documented the prevalence of politicians joining corporate boards. Results from the study showed that politicians as board directors are associated with higher corporate governance scores. This relationship persists after controlling for firm-level, performance, and other governance based variables. The results also imply that adding a politician to a board of directors increases the firm's corporate governance quality.

Finally, the third essay examined nearly the entire population of Canadian firms which were cross-listed in the U.S. It documents that while political connections are on the same level as U.S. firms, political connections enhance the benefits of cross-listing for Canadian cross-listed firms. Specifically, cross-listed firms which are also politically connected benefit through higher analyst following, higher market valuations, greater market liquidity, and are more likely to receive procurement contracts than their cross-listed counterparts.

Overall, the three essays in this dissertation expand the extant literature in the areas of board of directors' composition, corporate governance, cross-listed corporations and politically connected firms. Although the findings presented here do have some limitations. Corporate governance research is inherently endogenous, whereby faulty conclusions about theoretical propositions can be a problem. Each of the essays employs a number of additional tests- from endogeneity to robustness to sensitivity analyses. However, econometric problems such as omitted variables, reverse causation and serial correlation may still be present. Thus, the results should only be interpreted as presented. Future research may utilize these findings and further expand on the analyses by longer time series models, conducting natural experiments, or applying the methodology to different jurisdictions around the world.