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**ARTICLE**

# Political connections, tacit power and corporate misconduct

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**Abstract**

This paper examines the impact of political connections (i.e., lobbying and political contributions) on the time it takes to detect corporate misconduct and the size of penalties following securities class actions (SCAs), restatements and Accounting and Auditing Enforcement Releases (AAERs). We find firms with political connections exhibit longer misconduct periods for SCAs, and such ability to conceal misconduct for longer translates into a larger settlement size. In addition, we find politically connected firms are associated with greater shareholder losses and are less likely to be involved in Securities Exchange Commission enforcement actions on restatements. Finally, while we do not find any relation between political connections and the likelihood of AAERs being settled, we find political connections are associated with lower AAER settlement size.

**KEYWORDS**

AAER, corporate governance, corporate misconduct, enforcement, political connections, restatements, securities and exchange commission, securities class actions, tacit power

**JEL CLASSIFICATION**

G18, G38, K22, M41, M42

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## 1 | INTRODUCTION

Corporations play an important role in the political process through lobbying and political contributions. Firms with political connections can gain access and potentially benefit from the relationship. For instance, Ngo and Sunsjara (2020) find that the cost of debt is lower for firms that are strategically important federal government suppliers. Firms with political connections can gain access and influence the policymaking process, giving them additional and, some may argue, undue power. This influence is likely to extend well beyond the political landscape. Economic agents may be unwilling to oppose these powerful firms for fear of repercussions (i.e., coercive power) or as a result of their “soft power,” which alters the preferences of economic agents in the interest of the firm through appeal and attraction.<sup>1</sup> This paper examines whether tacit power, be it coercive or soft in nature, signaled by political connections is related to the time it takes to uncover corporate misconduct and the associated size of penalties.

Various economic agents are responsible for revealing corporate misconduct. Fraud-detecting agents include analysts, auditors and employees (Dyck et al., 2010). These agents face retaliatory consequences if they try to reveal illegal corporate activities or may be swayed by soft power into believing these powerful politically connected firms are unlikely to commit fraud. A good example of both tacit coercive and tacit soft power is Enron, which spent millions on lobbying and political contributions and was a very politically influential company. Soft power may have led analysts and auditors to be less suspicious about Enron’s activities since prior to its fall from grace, it was seen as a leading innovator, as exemplified by six consecutive awards between 1996 and 2001 from *Forbes* as the “Most Innovative Company in America.” Furthermore, consistent with the notion of soft power, Enron experienced very little negativity before declaring bankruptcy. One exception that also serves as an example of coercive tacit power is the case of John Olson, an outspoken Merrill Lynch analyst. Olson was critical of Enron and was replaced after giving Enron a “neutral” rating. Olson’s replacement upgraded the Enron rating in an alleged effort to win more investment banking business (Opper, 2002). While Enron did not directly influence the decision to replace John Olson, his dismissal was allegedly made to appease manager dissatisfaction. The Enron case characterizes how high tacit power, as reflected in political connection, can influence economic agents’ behavior. These agents will not be as willing or as likely to voluntarily investigate potential corrupt corporate activities in firms with high tacit power, thereby perpetuating managerial misconduct. This is supported by Yu and Yu (2011) who demonstrate the ability of lobbying firms to avoid corporate fraud detection for 117 days longer.

Despite the widespread belief that regulators should ideally be non-partisan, there is evidence to suggest that regulatory enforcement actions are not uniform. On the one hand, there are studies that report evidence that the Securities Exchange Commission (SEC) is politically captured. For example, Correia (2014) find that firms with political connections are less likely to be involved in SEC enforcement actions and face lower penalties. Similarly, Mehta, Srinivasan, and Zhao (2020) show that firms in the districts of SEC-relevant politicians are less likely to receive SEC enforcement actions relative to other firms and, when faced with enforcement, receive smaller penalties. Considering the literature examining the capture-related determinants of SEC enforcement efforts and penalties, Mehta and Zhao (2020) document that regulator’s enforcement efforts are influenced by politician’s career-based incentives.

On the other hand, there are studies that suggest the SEC is not politically captured, but there are other factors that influence SEC enforcement actions. First, because of resource constraints, the SEC is more likely to investigate firms located closer to its offices and with higher visibility, which suggests that regulation is only effective when it is local (Kedia & Rajgopal, 2011). Second, Heese (2015) demonstrates that voters’ interest drives the political influence on the SEC, and the SEC incorporates such influence in its enforcement actions, independent of firms’ lobbying for special interests. Third, Heese et al. (2017) find that firms with political connections are positively associated with comment-letter reviews, which are inconsistent with the SEC being captured, and their findings point to a more nuanced relation between politically connected firms and SEC oversight than previously suggested. Finally, a recent paper by Zheng

<sup>1</sup> The concept of soft power has been used in the international relations literature (Nye, 1990) for some time, but a derivative of it has recently been used in the corporate finance context by Khanna et al. (2015), who discuss the “soft influence” of CEOs and its role in facilitating fraud.

(2021) reports that the SEC's private incentives affect enforcement venue selection and possibly enforcement outcomes. That is, SEC is more likely to use administrative proceedings when political and economic costs are greater and use federal courts when political and economic benefits are greater. This suggests that the SEC may act in favor of politically connected firms when it matters most.

This paper examines whether political connections are related to the time it takes to uncover managerial misconduct and the associated penalties. Following Correia (2014), we use two proxies for political connectedness that are used widely in the literature: (1) political action committee (PAC) contributions and (2) lobbying expenditures. We use three proxies to examine the occurrence of misconduct: (1) securities class actions (SCAs), (2) Accounting and Auditing Enforcement Releases (AAERs) and (3) restatements. First, the length of the period investors or the SEC claim the alleged misconduct took place is analyzed. Second, this paper investigates the impact of political connections on the probability of a case being settled. Finally, the extent of the damages caused by the managerial malfeasance is examined in relation to the politically connected firms by looking at the losses investors accrued and the size of the settlement. Specifically, this study addresses three research questions: (1) Are firms with political connections able to get away with their misconduct for longer? (2) Are firms with political connections more likely to settle? (3) Do politically connected firms that are sued or firms involved in SEC enforcement actions cause more damage and face greater reputational penalties?

Our main results are summarized as follows. First, we find political connections to be positively related to class period length and settlement size. These results are consistent with managers of politically connected firms being able to get away with their misconduct for longer and cause more damage in terms of shareholder wealth. The most likely reason for these findings is the tacit power wielded by the politically connected firms, making economic agents unwilling to speak out against them. As a result, it is more difficult to detect and obtain proof that managers have violated any laws. These findings are however not evident in the length of restatement and AAERs periods.

Second, we find politically connected firms are associated with greater shareholder losses and are less likely to be involved in SEC enforcement actions on restatements. Third, while we do not find any relation between political connections and the likelihood of AAERs being settled, we find political connections to be associated with lower settlement size. Overall, these results suggest that politically connected firms hold a substantial amount of tacit power that hindered the process through which managerial misconduct is revealed. The findings suggest that the enactment of new regulations (e.g., (i) Sarbanes–Oxley Act in 2002; (ii) Honest Leadership and Open Government Act in 2007; (iii) Dodd–Frank Act in 2010 and (iv) Protected Disclosures Act in 2014) during the sample period has not resulted in a consistent impact on reducing the tacit power of politically connected firms or improving the incentives for economic agents to reveal corporate misconduct. As such, these results call into question whether regulations are an appropriate method for improving the discovery of corporate malfeasance for powerful firms.

Our study makes several contributions to the existing literature. First, we extend the study by Yu and Yu (2011) that analyzes whether lobbying affects the time it takes to detect fraud for a sample period from 1998 to 2004. Using a much more extensive sample period from 2000 to 2018, different measures of political connections (i.e., lobbying and PAC contributions) and a broader set of outcomes (i.e., SCAs, restatements and AAERs), we find firms with political connections are able to get away with misconduct for longer following SCAs but not for restatements and AAERs. Second, it analyzes the impact of political connections on the probability of a settlement and the damages that managers subject to SCAs, restatements and AAERs have caused. Finally, we provide insight into the impact of regulatory change on the discovery of corporate misconduct. The empirical analysis indicates that regulatory change has not had a consistent impact on uncovering misconduct for firms with political connections.

The remainder of the paper is organized as follows. Section 2 provides an overview of the existing literature and develops three hypotheses for this paper. Section 3 provides an overview of the method and data employed. Section 4 presents and discusses the empirical results. Section 5 contains the concluding remarks.

## 2 | HYPOTHESES DEVELOPMENT

Various economic agents can uncover corporate misconduct. Dyck et al. (2010) perform an in-depth analysis of the different incentives and potential conflicts that these agents face. The agents identified by Dyck et al. (2010) include analysts, the media, employees, auditors and the SEC.

Lobbying and political contributions are typically targeted at government entities or politicians. It is unlikely to directly impact any of the fraud-detecting agents identified by Dyck et al. (2010), with the possible exception of the SEC. The literature suggests that politically connected firms may be able to influence political decisions (see Blau et al., 2013; Duchin & Sosyura, 2012; Goldman et al., 2013) and in so doing wield a substantial amount of tacit power. The influence and power imbalance between politically connected firms and fraud-detecting agents discourage action that opposes these firms for fear of potential repercussions. Each of the key agents identified by Dyck et al. (2010) faces substantial disincentives against revealing corporate misconduct. The repercussions are likely to be worse for more influential firms.

Whistleblowers face the threat of job loss if their accusations of corporate misconduct conflict with their employers. Analysts may be less likely to bring misconduct to light if it interferes with the investment banking services offered by the analyst's company (Michaely & Womack, 1999).<sup>2</sup> Analysts' tendency to herd in order to "share the blame" (Scharfstein & Stein, 1990) may also affect their incentives to reveal misconduct. Journalists may face similar pressure to not reveal misconduct for fear that it could alienate potential or actual advertisers.<sup>3</sup>

Given that the most successful analysts and journalists employed by the more prestigious media outlets are more likely to be whistleblowers (Dyck et al., 2010), the potential repercussions faced by most analysts and journalists outweigh the incentives to blow the whistle. Consequently, more powerful firms strongly disincentivize the revelation of corporate misconduct. If lobbying firms wield greater tacit power, analysts and journalists may be less willing to accuse politically connected firms of wrongdoing for fear of more severe repercussions. Employee whistleblowers subject to post-revelation misconduct penalties face a subsequent job loss, forced industry and residential relocations because of harassment (Dyck et al., 2010). Equally auditors, despite access to internal and external information, may also be hesitant to reveal evidence of fraudulent activities for fear of losing business.

One of the few fraud-detecting agents that could be directly affected by lobbying or political contribution activities is the SEC (Dyck et al., 2010). Correia (2014) finds that politically connected firms face fewer SEC enforcement actions, lower penalties and lower potential enforcement costs.<sup>4</sup> Similarly, Fulmer et al. (2012) find that Chief Executive Officers (CEOs) that make political contributions receive less severe penalties from the SEC. Hence, political connections may negatively impact the effectiveness of the SEC as a regulatory entity.

Overall, the environment is such that agents may be unwilling to reveal misconduct as a result of politically connected firms' soft power. Soft power alters the preferences of economic agents to the interest of the firm through appeal and attraction. As a result, politically connected firms may be able to get away with their misconduct for longer because the fraud-detecting agents are less willing to bring misconduct to light. Consistent with this expectation, Yu and Yu (2011) find that fraudulent firms that lobby evade detection for 117 days longer than non-lobbying firms. This leads to our first hypothesis as follows.

**Hypothesis 1:** *Politically connected firms are able to conceal their misconduct for longer.*

There are two primary outcomes to SCAs: (1) dismissed in favor of the firm or (2) an out-of-court settlement. Very few cases ever go to trial. An SCA puts the onus on the plaintiff to prove that any managerial wrongdoing has occurred. To receive a settlement payout, investors need to prove that managers have actually violated securities laws.

<sup>2</sup> See "Enron's Collapse: The Analyst; Man Who Doubted Enron Enjoys Recognition" by John Schwartz, January 21, 2002, *The New York Times*.

<sup>3</sup> See "10 Months Ago, Questions on Enron Came and Went with Little Notice" by Felicity Barringer, January 28, 2002, *The New York Times*.

<sup>4</sup> When lobbyists have an SEC employment history, and the SEC is lobbied directly.

In this paper, we argue that the fear of repercussion and the risk of backlash due to the tacit power wielded by politically connected firms hindered economic agents' willingness to expose the details of managerial misconduct. An unwillingness to testify against material wrongdoing will have also impeded investor lawsuits and SEC enforcement actions. Consequently, investors or the SEC will have found it more difficult to win a class action or enforcement action against a firm with political connections. This leads to our second hypothesis as follows.

**Hypothesis 2:** *Politically connected firms are less likely to settle class actions and AAERs.*

Not all SCAs, restatements and AAERs are meritorious. Numerous class actions, restatements and AAERs are frivolous in nature where the plaintiff or SEC attempts to regain losses unrelated to illegal activities. Firms may settle these class actions or enforcement actions to avoid potential negative publicity or the costs of litigation. Since directors' and officers' insurance generally covers these settlements, settling can be an attractive way of getting rid of a frivolous case. Therefore, settled cases can either be meritorious or frivolous.

Hypothesis 1 predicts that managers of politically connected firms evade detection for longer. The longer detection time gives delinquent managers more opportunities to commit misconduct, destroying investors' wealth and firms have more time for impropriety, accruing losses that should incur harsher penalties.

Prior research has found that the size of the settlement is related to the provable loss and the length of the period the misconduct occurred, both of which can be seen as a measure of the extent or complexity of the violation (Cox & Thomas, 2006; Karpoff et al., 2007). This indicates that the greater the damage due to manager misconduct, the more severe the penalties are in terms of the settlement size. Therefore, politically connected firms are expected to accrue greater losses as a result of being able to evade detection for longer. Therefore, they should end up having to pay larger settlements when they are sued. This leads to our third hypothesis as follows.

**Hypothesis 3:** *Politically connected firms generate more damage and face a larger settlement.*

### 3 | METHOD

#### 3.1 | Length of the misconduct period

Hypothesis 1 examines whether politically connected firms will be able to get away with misconduct for longer. Three different proxies are used to examine misconduct: (1) SCAs, (2) restatements and (3) AAERs. For each of these, we examine the period where the misconduct was alleged to have taken place as the measure of misconduct length.

For SCAs, the misconduct period is defined as the class period. The class period is the length of time the alleged misconduct occurred over, which is specified by the investors in the SCA.<sup>5</sup> For restatements, the misconduct period is defined as the number of days between the restated period beginning and ending date as provided by Audit Analytics. Finally, for AAERs, the misconduct period is the alleged fraud period specified in the release. AAERs frequently do not contain specific dates to signify the beginning and end of the alleged misconduct. For releases without specific dates, we round the date to the beginning (end) of the nearest month, quarter or year based on the information contained within the AAER. While these are imperfect measures, it gives a good indication of the length of time managers were able to avoid detection.

Equation (1) is estimated to determine if the misconduct period is longer for firms that are politically connected.

$$\text{Day sin MP} = \beta_0 + \beta_0 \text{Political Connection} + \sum \beta \cdot \text{Controls} + \varepsilon. \quad (1)$$

<sup>5</sup> The length of the class period is defined by investors, so it may not precisely measure the actual time period of the misconduct, if any misconduct even occurred.

The dependent variable in this model is the natural log of the number of days in the misconduct period. *PoliticalConnection* represents several measures for the extent of lobbying or political contributions a firm makes. For lobbying, two variables are constructed: First, a dichotomous variable that takes a value of one if the firm has undertaken lobbying at any point in time during the 2 years prior to the filing year and zero otherwise; second, the log of the total dollar value of lobbying expenses undertaken in the 2 years prior to the filing year.<sup>6</sup> There are two reasons for using this 2-year period. First, 2 years should be an adequate amount of time for a political relationship to have been developed. Second, the length from the beginning of the class period, when the accusation of malfeasance is made, to the filing date can be considerable. The average length of the class period is 424 days, and the filing delay has an average length of 141 days in the sample.<sup>7</sup> Since the primary focus is on whether political connection facilitates misconduct, 2 years should be an adequate amount of time to effectively capture this effect.<sup>8</sup>

To examine the impact of political contributions on the misconduct period length, two more variables are used. These two variables are similar to those used to examine lobbying except instead of using a 2-year period, a 4-year window is used. Specifically, we use a dummy variable that is equal to one if a firm has made any political contributions via a firm's PAC in the 4 years prior to the filing year and zero otherwise. Furthermore, we also use a log of the total PAC contributions made in the 4 years prior to the filing year. Due to the lumpiness of the political contributions, particularly around the presidential election, we use a 4-year period to ensure we are capturing at least one presidential election cycle within our metrics. These four measures of lobbying and political contributions are used throughout the analysis.

A series of control variables are also included in this model. Several variables are used to control for the extent or the complexity of the misconduct. For SCAs, these include three variables, *Settled*, *Provable Loss* and *Days to File*. *Settled* is a dichotomous variable taking the value of one if the class action is settled and zero otherwise. *Provable Loss* is the percentage change in the firms' market capitalization from the beginning of the class period to the end of the class period. *Days to File* represents the number of days between the end of the class period and the filing day.

For restatements, the case-specific independent variables include *SEC Investigation* and *Days to Disclosure*. *SEC Investigation* is a dichotomous variable taking the value of one if the restatement also had an associated SEC investigation and zero otherwise. *Days to Disclosure* is defined as the number of days between the end of the restatement period and the date when the restatement disclosure was made.

Finally, for AAERs, two measures for the extent or complexity of the case are used: *Settled* and *Days to AAER*. Similar to the SCA settled variable, *Settled* is a dichotomous variable taking the value of one if the AAER is settled and zero otherwise. *Days to AAER* is the number of days between the end of the alleged fraud and the AAER date.

The model also incorporates four firm characteristics. *Size* is the firm size measured as the natural log of the firm's market capitalization. *Leverage* is the ratio of total debt to assets. *ROA* is the firm's net income divided by the beginning-of-year total assets. *B/M* is the ratio of the book value of the equity-to-market value of equity. All firm financial characteristics used in the regressions throughout the analysis are calculated for the year ending prior to the year the class action was filed and the disclosure date of restatement and AAERs. Forty-eight industry dummy variables, as specified by Fama and French (1997), are included to control for industry effects. Yearly dummy variables are also included to control for time and market-related effects.

<sup>6</sup> Re-running the analysis using the total dollar value of lobbying expenses scaled by the total value of assets provides quantitatively similar results.

<sup>7</sup> The filing delay is the period between the end of the class period and the filing of the class action.

<sup>8</sup> Yu and Yu (2011) define a firm as a lobbying firm if they have lobbied at any point during their sample period, irrespective of when the firm was sued. Using information on firm lobbying activities in the 2 years before the filing of a class action will better reflect the influence that they held during the period of alleged misconduct.



## 3.2 | Damages of misconduct

### 3.2.1 | SCAs

For SCAs, the logit regression model given by equation (2) is used to test hypothesis 2. The model is estimated for all sued firms. The dependent variable, *Settled*, takes the value of one if the case is settled and zero otherwise.

$$\text{Settled} = \beta_0 + \beta_1 \text{Political Connection} + \Sigma\beta \cdot \text{Controls} + \varepsilon. \quad (2)$$

According to hypothesis 2, firms with political connections will be less likely to settle a class action filed against them implying that the *Political Connection* coefficient in equation (2) will be negative and statistically significant. The model employs control variables similar to those used by Karpoff et al. (2007) and Cheng et al. (2010).

Hypothesis 3 states that tacit power associated with political connectedness will provide managers with greater opportunities to accrue more substantial losses and will face greater penalties as a result. We examine hypothesis 3 using two measures of the damages caused by managerial misconduct: (1) the losses associated with the class actions and (2) the size of the settlement.<sup>9</sup> Equation (3) is estimated for all firms with a class action filed against them.

$$\text{Provable Loss} = \beta_0 + \beta_1 \text{Political Connection} + \Sigma\beta \cdot \text{Controls} + \varepsilon. \quad (3)$$

*Provable Loss* is measured as the percentage change in the firms' market capitalization from the beginning of the class period to the end of the class period. This measure is similar to that used by Karpoff et al. (2008).<sup>10</sup> From hypothesis 3, if political connections allow managers to cause more significant damage, the *Political Connection* coefficient should be negative and significant.

We also estimate an Ordinary Least Squares (OLS) regression over all class actions that were settled using the size of the settlement as the dependent variable. The model is specified in equation (4).

$$\text{Settlement} = \beta_0 + \beta_1 \text{Political Connection} + \Sigma\beta \cdot \text{Controls} + \varepsilon. \quad (4)$$

*Settlement* in this model is the log of the cash settlement amount. If hypothesis 3a holds, the *Political Connection* coefficient will be positive and significant. This suggests that politically connected firms will face larger settlements due to greater damages caused as a result of the misconduct.

### 3.2.2 | Restatements

Restatements are not settled in a similar way to SCAs. As such, we are unable to examine hypothesis 2 for restatements. Two measures of damages are used to analyze hypothesis 3: (1) whether there was an SEC investigation associated with the restatement and (2) the stockholder loss that occurred over the restatement period. To examine the impact of political connections on the restatement damages, the following two regressions were run.

$$\text{SECInvestigation} = \beta_0 + \beta_1 \text{Political Connection} + \Sigma\beta \cdot \text{Controls} + \varepsilon, \quad (5)$$

<sup>9</sup> Karpoff et al. (2007) show that these two measures are related and should provide consistent results.

<sup>10</sup> Karpoff et al. (2008) define their provable loss measure as the percentage change in the firms' market capitalization from its highest point during the violation period to the first day news of a possible violation is revealed. The violation period used in their analysis will not be the same as the class period that is used in this analysis. Similarly, the first day news of a possible violation is revealed will not be the same day as the end of the class period. Despite these differences, the provable loss used by Karpoff et al. (2008) should be quantitatively similar to the one used in this study.



$$\text{StockholderLoss} = \beta_0 + \beta_1 \text{Political Connection} + \sum \beta \cdot \text{Controls} + \varepsilon. \quad (6)$$

*SEC Investigation* is equal to one if there is an SEC investigation undertaken following a restatement and is zero otherwise. *Stockholder Loss* is the cumulative change in stockholder equity over the restatement period divided by the total stockholder wealth at the beginning of the restatement period. If political connections allow managers to cause more significant damage, the *Political Connection* coefficient should be positive in equation (5) and negative in equation (6).

### 3.2.3 | AAERs

Finally, to examine hypothesis 2 for AAERs, we use the same model presented in equation (2). The dependent variable in this instance is equal to one if the AAER was settled and is zero otherwise. As in the examination of SCAs, if hypothesis 2 is correct and firms with political connections are less likely to settle an AAER, then the *Political Connection* coefficient will be negative and statistically significant. Table 1 provides detailed definitions for all key variables used throughout the analysis.

## 4 | DATA

### 4.1 | Sample selection

Data for SCAs in the United States are obtained from the Stanford Securities Class Action Clearinghouse (SCAC).<sup>11</sup> All class actions listed between 2000 and 2018 are used for this analysis. The Stanford SCAC provides information on the filing date of the suit, the class period, ticker symbol and Standard Industrial Classification (SIC) code for all class actions filed after the institution of the Private Securities Litigation Reform Act. The outcome of the case has also been collected by reading through the case reports provided by the Stanford SCAC, and a dataset of settlement amounts has been compiled. Information about restatements is sourced from Audit Analytics. Similar to SCAs, all restatements made between 2000 and 2018 are analyzed. Finally, details about AAERs are obtained from the SEC website.<sup>12</sup> For each AAER, we matched the respondent's name to the names of companies contained in the Centre for Research in Security Prices (CRSP)/Compustat universe. For each release successfully matched to a CRSP/Compustat name, we obtain the beginning and end date of the alleged fraud period as well as details on whether the AAER was settled and for how much if that information was disclosed. As with SCAs and restatements, all AAERs made between 2000 and 2018 are examined.

Individual firm financial data up to the end of 2018 are obtained from the CRSP/Compustat merged database. All firms with available data listed on the New York Stock Exchange (NYSE), National Association of Securities Dealers Automated Quotations (NASDAQ) or American Stock Exchange (AMEX) are included in the primary sample. Firms incorporated outside of the United States are excluded from the sample due to possible differences in reporting standards.

The Lobbying Disclosure Act of 1995 requires any organization whose lobbying expenses exceed \$20,000 semi-annually to file with the Senate Office of Public Records (SOPR) and the clerk of the House of Representatives. The

<sup>11</sup> <http://securities.stanford.edu/>

<sup>12</sup> <https://www.sec.gov/divisions/enforce/friactions.htm>

**TABLE 1** Variable definitions

Panel A: Key independent variables	
Variables	Definition
<i>Lobby Dummy</i>	Dummy variable equal to one if the firm has lobbied over the prior 2 years and zero otherwise. <i>Source: CRP</i>
<i>Lobby Amount</i>	Natural log of the total dollar value of lobbying expenses undertaken over the prior 2 years. <i>Source: CRP</i>
<i>PAC Dummy</i>	Dummy variable equal to one if the firm has contributed any money via its PAC over the prior 4 years and zero otherwise. <i>Source: CRP</i>
<i>PAC Amount</i>	Natural log of the total dollar value contributed via a firm's PAC over the prior 4 years. <i>Source: CRP</i>
Panel B: Measures of the extent of and complexity of the violation	
<i>Settled</i>	Dummy variable equal to one if the class action was settled and zero otherwise. <i>Source: Stanford SCAC</i>
<i>Settlement</i>	The log of the cash settlement. <i>Source: Stanford SCAC</i>
<i>Provable Loss</i>	The percentage change in the firm's market capitalization from the beginning of the class period to the end of the class period. <i>Source: CRSP</i>
<i>Days in CP</i>	The number of days in the class period. <i>Source: Stanford SCAC</i>
<i>Days to File</i>	The number of days between the end of the class period and the filing date. <i>Source: Stanford SCAC</i>
<i>Days in Restatement Period</i>	The number of days in the restatement period. <i>Source: Audit Analytics</i>
<i>SEC Investigation</i>	Dummy variable equal to one if a firm has an SEC investigation associated with a restatement. <i>Source: Audit Analytics</i>
<i>Stockholder Loss Restatement</i>	Percentage change in shareholder value during the restatement period. <i>Source: Audit Analytics</i>
<i>Days in AAER Fraud Period</i>	The number of days in an AAER. <i>Source: SEC</i>
<i>AAER Settled</i>	Dummy variable equal to one if an AAER was settled and zero otherwise. <i>Source: SEC</i>
<i>AAER Settlement</i>	The log of the settlement size disclosed for an AAER. <i>Source: SEC</i>
Panel C: Other variables	
<i>Size</i>	Natural log of the firm's market capitalization. <i>Source: Compustat</i>
<i>Leverage</i>	Ratio of total book value of current and long-term debt (#34 + #39) to assets (#6). <i>Source: Compustat</i>
<i>ROA</i>	Ratio of net income (#172) to beginning of year assets (#6). <i>Source: Compustat</i>
<i>B/M</i>	Ratio of the book value of equity (#60) to market capitalization. <i>Source: Compustat</i>
<i>Ind</i>	48 industry dummy variables in accordance with Fama and French (1997). <i>Source: Compustat</i>
<i>Year</i>	Dummy variables equal to one for a particular year and zero otherwise

Center for Responsive Politics (CRP) maintains a database of the quarterly reports filed at SOPR since 1998.<sup>13</sup> One of the drawbacks of this database is that there is no breakdown as to how much is spent on lobbying particular agencies since firms are not required to disclose such information. To calculate the lobbying variables that are used in the study, 2 years of prior data are required. In particular, lobbying firms are firms that have undertaken lobbying activities at any point in time during the 2 years prior to the filing year. Since lobbying information is only publicly available from 1998, this means that after calculating the lobbying variables, there is sufficient data available to conduct the analysis from the year 2000 onward. The CRP also maintains a database of political contributions. All PACs associated with the universe of CRSP/Compustat firms are identified. This campaign finance data is available from 1990. However, to align the analysis with the lobbying data, we calculate the PAC variables from the year 2000 onward.

## 4.2 | Sample statistics

Table 2 presents summary statistics of key variables for the sample of SCAs, restatements and AAERs analyzed in this paper. For the political connection variables, the mean lobby amount over the 2 years prior is between \$2 and \$6.5 million, whereas the mean amount of political contributions made through the company PAC over the prior 4 years is between \$200,000 and \$400,000. This difference in the size of the amount spent on lobbying versus the amount spent on political contributions is largely a result of PAC contributions being capped, whereas there is no limit to the amount spend on lobbying activities.

From Panels A and C, we can see that the average size of firms facing AAERs are typically larger than firms facing SCAs. This is consistent with the SEC being more likely to focus their relatively limited resources on investigating and prosecuting the largest firms where relatively larger improprieties may have occurred.

Looking at the days in the fraud period across all three different samples, we can see the average days in the alleged fraud period is the smallest for SCAs. The mean fraud period for both the restatement period (721 days) and the AAER period (1244 days) are significantly longer than the mean days in the class period (424 days). Interestingly, the average settlement size of SCAs is also typically larger than the settlement size of AAERs.

## 5 | RESULTS

### 5.1 | Length of misconduct period

In the first part of the analysis, the relationship between political connections and the length of the misconduct period is examined (hypothesis 1). To examine this relationship, equation (1) is estimated using the three proxies for the misconduct period. The results from this analysis are presented in Tables 3 and 4. Table 3 uses two lobbying metrics as the measure of political connectedness, whereas Table 4 uses the two measures of political contributions as the key independent variables.

For all four political connection measures, we find a positive and highly significant relationship with the number of days in the class period. This finding is consistent with hypothesis 1 and Yu and Yu (2011). These results confirm that the class period is significantly longer for political-connected firms. However, we do not find a relationship between the restatement period or the number of days in the AAER period and the political connectedness.

It should be noted that restatements are an imperfect measure of misconduct, as numerous restatements are not associated with any corporate wrongdoing. Similarly, as mentioned previously, AAERs do not provide the exact dates for the alleged misconduct, so we have had to impute these dates to the nearest month, quarter or year. As a result,

<sup>13</sup> CRP maintains this database at <https://www.opensecrets.org/>.

**TABLE 2** Descriptive statistics

Panel A: Summary statistics of securities class actions (SCAs) sample						
	N	Mean	Median	Std dev	Min	Max
<b>Political connections</b>						
<i>Lobby Dummy</i>	1671	0.27	0.00	0.44	0	1
<i>Lobby Amount (Prior 2 Years)</i>	451	2,100,000	380,000	4,400,000	5000	39,000,000
<i>PAC Dummy</i>	1671	0.15	0.00	0.36	0	1
<i>PAC Amount (Prior 4 Years)</i>	274	320,000	120,000	560,000	500	4,400,000
<b>SCA Info</b>						
<i>Days in Class Period</i>	1671	423.89	309	392.67	1	4140
<i>Days to File</i>	1671	148.87	87	181.03	1	1834
<i>Provable Loss</i>	1671	-0.23	-0.35	1.00	-1.00	23.39
<i>Settled</i>	1671	0.57	1	0.50	0	1
<i>Settlement (millions)</i>	846	42.00	7.90	270.00	0.03	7200.00
<b>Firm characteristics</b>						
<i>Market Cap</i>	1671	6.50	0.68	24.79	0.00	280.00
<i>Leverage</i>	1671	0.22	0.12	0.65	0.00	24.61
<i>ROA</i>	1671	-0.19	0	2.5	-100.01	0.49
<i>B/M</i>	1671	0.61	0.39	1.63	-25.16	20.55
Panel B: Summary statistics of restatement sample						
	N	Mean	Median	Std dev	Min	Max
<b>Political connections</b>						
<i>Lobby Dummy</i>	2871	0.20	0.00	0.40	0	1
<i>Lobby Amount (Prior 2 Years)</i>	580	2,900,000	610,000	6,900,000	10,000	79,000,000
<i>PAC Dummy</i>	2871	0.12	0.00	0.32	0	1
<i>PAC Amount (Prior 4 Years)</i>	343	200,000	69,450	420,000	100	5,800,000
<b>Restatement info</b>						
<i>Days in Restatement Period</i>	2871	721.23	457	681.00	7	8034
<i>Days to Disclosure</i>	2871	210.96	151	162.17	7	2689
<i>SEC Investigation</i>	2871	0.07	0	0.25	0	1
<i>Stockholder Loss</i>	2158	-0.02	0.00	0.12	-2.61	1.05
<b>Firm Characteristics</b>						
<i>Market Cap</i>	2871	2.69	0.32	11.23	0.00	180.00
<i>Leverage</i>	2871	0.22	0.17	0.23	0.00	2.36
<i>ROA</i>	2871	-0.06	0.01	0.32	-4.35	1.22
<i>B/M</i>	2871	0.74	0.51	1.85	-8.87	73.56
Panel C: Summary statistics of Accounting and Auditing Enforcement Release (AAER) sample						
	N	Mean	Median	Std dev	Min	Max
<b>Political connections</b>						
<i>Lobby Dummy</i>	301	0.40	0.00	0.49	0	1
<i>Lobby Amount (Prior 2 Years)</i>	120	6,500,000	1,600,000	12,000,000	20,000	75,000,000

(Continues)

TABLE 2 (Continued)

Panel C: Summary statistics of Accounting and Auditing Enforcement Release (AAER) sample						
	N	Mean	Median	Std dev	Min	Max
<i>PAC Dummy</i>	301	0.28	0.00	0.45	0	1
<i>PAC Amount (Prior 4 Years)</i>	83	370,000	140,000	560,000	1500	2,700,000
<b>AAER info</b>						
<i>Days in AAER Period</i>	301	1244.09	1094	1036.61	3	9130
<i>Days to AAER</i>	301	1216.41	1154	608.35	71	3526
<i>Settled</i>	301	0.61	1	0.49	0	1
<i>Settlement (millions)</i>	185	33.00	3.10	140.00	0.02	1700.00
<b>Firm characteristics</b>						
<i>Market Cap</i>	301	13.98	1.16	38.63	0.00	360.00
<i>Leverage</i>	301	0.24	0.20	0.23	0.00	1.33
<i>ROA</i>	301	-0.03	0.01	0.26	-2.24	0.36
<i>B/M</i>	301	1.24	0.50	4.75	-33.71	41.28

Note: Table 2 reports descriptive statistics for key characteristics across the samples between 2000 and 2018 of SCAs, restatements and AAERs. Panel A presents statistics of the sample of SCAs, Panel B presents statistics for the sample of restatements and Panel C presents statistics for the sample of AAERs. The table includes the number of observations, the mean, median, standard deviation, minimum and maximum for the selected variables. Variables definitions are in Table 1.

there is a high level of imprecision in the measurement of AAER periods. These factors could have resulted in insignificant political connection coefficients.

Overall, these findings suggest that firms with political connections are able to evade detection for some types of misconduct for longer. We argue that this is due to the tacit power exerted by politically connected firms in the form of repercussions to whistleblowers and penalties on parties opposing them. Consequently, politically connected firms are able to get away with their misconduct for longer.

## 5.2 | Damages of misconduct

### 5.2.1 | SCAs

Next, we examine the relationship between political connectedness and the probability of settling an SCA (hypothesis 2). Using a logit regression model (i.e., equation (2)), where the dependent variable takes a value of one if the class action is settled and zero if it is dismissed, we test if politically connected firms are less likely to settle a class action. The results are reported in Columns 1 and 2 of Tables 5 and 6. Consistent with hypothesis 2, none of the political connection variables are significant. This finding suggests that despite being able to get away with their misconduct for longer, politically connected firms are not more or less likely to have to settle a class action.

Next, we examine the relationship between political connections and the damages caused by the alleged misconduct. Equation (3) is estimated to test hypothesis 3. The dependent variable, *Provable Loss*, is the percentage change in the firm's market capitalization from the beginning to the end of the class period. It measures the cost of damage to the firm due to manager misdeeds. The results reported in Columns 3 and 4 of Tables 5 and 6 show that the coefficients for the four political connection variables are all insignificant. As such, there is no evidence that lobbying firm managers cause more damage.

**TABLE 3** Impact of lobbying on days in misconduct period

	Log of days in class period		Log of days in restatement period		Log of days in AAER period	
	(1)	(2)	(3)	(4)	(5)	(6)
<i>Lobby Dummy</i>	0.17*** (0.06)		-0.03 (0.05)		0.01 (0.13)	
<i>Lobby Amount</i>		0.02*** (0.01)		0.00 (0.00)		0.00 (0.01)
<i>Settled (SCA)</i>	0.30*** (0.06)	0.30*** (0.06)				
<i>Provable Loss</i>	0.01 (0.02)	0.01 (0.02)				
<i>Days to File</i>	-0.01 (0.02)	-0.01 (0.02)				
<i>SEC Investigation</i>			0.52*** (0.06)	0.52*** (0.06)		
<i>Days to Disclosure</i>			0.01 (0.03)	0.01 (0.03)		
<i>Settled (AAER)</i>					0.51*** (0.17)	0.51*** (0.17)
<i>Days to AAER</i>					-0.29*** (0.10)	-0.29*** (0.10)
<i>Size</i>	-0.02 (0.02)	-0.03 (0.02)	0.08*** (0.01)	0.08*** (0.01)	0.03 (0.04)	0.03 (0.04)
<i>Leverage</i>	0.02 (0.09)	0.02 (0.09)	0.09 (0.08)	0.10 (0.08)	-0.09 (0.26)	-0.09 (0.26)
<i>ROA</i>	0.02 (0.02)	0.02 (0.02)	0.24*** (0.05)	0.24*** (0.05)	0.51** (0.21)	0.51** (0.21)
<i>B/M</i>	0.02 (0.01)	0.02 (0.01)	0.00 (0.01)	0.00 (0.01)	0.01 (0.01)	0.01 (0.01)
<i>Intercept</i>	6.14*** (0.21)	6.15*** (0.21)	5.17*** (0.38)	5.17*** (0.38)	8.46*** (0.75)	8.46*** (0.75)
<i>R<sup>2</sup></i>	0.12	0.12	0.13	0.13	0.37	0.37
<i>N</i>	1671	1671	2871	2871	301	301

Note: Table 3 reports the OLS regression estimates for the effect the lobbying has on the number of days in the class period, number of days in the restatement period and number of days in the AAER period, using equation (1). The first two columns present the regressions estimated for the number of days in the class period. Columns 3 and 4 present the regressions estimated for the number of days in the restatement period. The last two columns present the regressions estimated for the number of days in AAER fraud period. Robust standard errors are reported in parentheses. Variables definitions are in Table 1.

\*, \*\* and \*\*\* statistically different from zero at the 10%, 5% and 1% significance levels, respectively.

**TABLE 4** Impact of political action committee (PAC) contributions on days in misconduct period

	Log of days in class period		Log of days in restatement period		Log of days in AAER period	
	(1)	(2)	(3)	(4)	(5)	(6)
<i>PAC Dummy</i>	0.27*** (0.08)		-0.01 (0.06)		-0.05 (0.14)	
<i>PAC Amount</i>		0.03*** (0.01)		0.00 (0.01)		0.00 (0.01)
<i>Settled (SCA)</i>	0.29*** (0.06)	0.29*** (0.06)				
<i>Provable Loss</i>	0.01 (0.02)	0.01 (0.02)				
<i>Days to File</i>	-0.01 (0.02)	-0.01 (0.02)				
<i>SEC Investigation</i>			0.52*** (0.06)	0.52*** (0.06)		
<i>Days to Disclosure</i>			0.00 (0.03)	0.01 (0.03)		
<i>Settled (AAER)</i>					0.51*** (0.17)	0.51*** (0.17)
<i>Days to AAER</i>					-0.29*** (0.10)	-0.29*** (0.10)
<i>Size</i>	-0.03 (0.02)	-0.03* (0.02)	0.08*** (0.01)	0.08*** (0.01)	0.04 (0.04)	0.04 (0.04)
<i>Leverage</i>	0.00 (0.09)	0.00 (0.09)	0.09 (0.08)	0.09 (0.08)	-0.08 (0.26)	-0.08 (0.26)
<i>ROA</i>	0.01 (0.02)	0.01 (0.02)	0.24*** (0.05)	0.24*** (0.05)	0.50** (0.21)	0.50** (0.22)
<i>B/M</i>	0.02 (0.01)	0.02 (0.01)	0.00 (0.01)	0.00 (0.01)	0.01 (0.01)	0.01 (0.01)
<i>Intercept</i>	6.25*** (0.23)	6.28*** (0.23)	5.18*** (0.38)	5.17*** (0.38)	8.41*** (0.74)	8.41*** (0.74)
<i>R<sup>2</sup></i>	0.12	0.12	0.13	0.13	0.37	0.37
<i>N</i>	1671	1671	2871	2871	301	301

Note: Table 4 reports OLS regression estimates for the effect the PAC contributions have on the number of days in the class period, number of days in the restatement period and number of days in AAER period, using equation (1). The first two columns present the regressions estimated for the number of days in the class period. Columns 3 and 4 present the regressions estimated for the number of days in the restatement period. The last two columns present the regressions estimated for the number of days in AAER fraud period. Robust standard errors are reported in parentheses. Variables definitions are in Table 1.

\*, \*\* and \*\*\* denote statistically different from zero at the 10%, 5% and 1% significance levels, respectively.



**TABLE 5** Impact of lobbying on class action outcomes

	SCA Settled		SCA Provable Loss		SCA Settlement	
	(1)	(2)	(3)	(4)	(5)	(6)
<i>Lobby Dummy</i>	-0.16 (0.15)		0.01 (0.09)		0.23** (0.12)	
<i>Lobby Amount</i>		-0.01 (0.01)		0.00 (0.01)		0.02** (0.01)
<i>Provable Loss</i>	-0.28** (0.12)	-0.28** (0.12)			-0.15* (0.09)	-0.15* (0.09)
<i>Days in Class Period</i>	0.33*** (0.07)	0.33*** (0.07)	0.01 (0.03)	0.01 (0.03)	0.16*** (0.05)	0.16*** (0.05)
<i>Days to File</i>	-0.11*** (0.04)	-0.11*** (0.04)	-0.01 (0.02)	-0.01 (0.02)	-0.02 (0.02)	-0.02 (0.02)
<i>Settled</i>			-0.18*** (0.05)	-0.18*** (0.05)		
<i>Size</i>	-0.07* (0.04)	-0.07* (0.04)	0.01 (0.02)	0.01 (0.02)	0.45*** (0.03)	0.44*** (0.03)
<i>Leverage</i>	0.07 (0.25)	0.07 (0.25)	-0.04 (0.08)	-0.04 (0.08)	0.36* (0.20)	0.36* (0.20)
<i>ROA</i>	-0.02 (0.06)	-0.02 (0.06)	-0.01 (0.02)	-0.01 (0.02)	0.08 (0.05)	0.08 (0.05)
<i>B/M</i>	-0.01 (0.03)	-0.01 (0.03)	0.00 (0.02)	0.00 (0.02)	0.03 (0.02)	0.03 (0.02)
<i>Intercept</i>	0.16 (1.19)	0.17 (1.19)	-0.78*** (0.24)	-0.78*** (0.24)	12.07*** (0.51)	12.11*** (0.51)
<i>R</i> <sup>2</sup>	0.21	0.21	0.10	0.10	0.50	0.50
<i>N</i>	1671	1671	1671	1671	719	719

Note: Table 5 reports regression estimates for the effect the lobbying has on the probability of a class action being settled (logit), size of the provable loss associated with a class action (OLS) and the settlement size of a class action (OLS). The first two columns present the regressions estimated for the probability of a class action being settled. Columns 3 and 4 present the regressions estimated for the size of the provable loss. The last two columns present the regressions estimated for the settlement size of a class action. Robust standard errors are reported in parentheses. Variables definitions are in Table 1. \*, \*\* and \*\*\* denote statistically different from zero at the 10%, 5% and 1% significance levels, respectively.

There are several reasons for this result. First, any damage being done may be offset by performance enhancements that come from lobbying or political contribution. Prior research has found that lobbying firms typically perform better in the long run (Chen et al., 2015; Hill et al., 2013; Kim, 2008), possibly offsetting any extra damage due to managers' actions. Second, politically connected firms may evade detection for longer period, but they may not take advantage of such an opportunity.

We also estimate equation (4) using settlement size to test if the political connection is related to the severity of the misconduct. The results from these regressions are presented in Columns 5 and 6 of Tables 5 and 6. For both *Lobby Dummy* and *Lobby Amount* variables in Table 5, we find a positive and significant coefficient. However, for the political contribution variables, the *PAC Amount* is positive and marginally significant, whereas the *PAC Dummy* variable is

**TABLE 6** Impact of PAC contributions on class action outcomes

	SCA Settled		SCA Provable Loss		SCA Settlement	
	(1)	(2)	(3)	(4)	(5)	(6)
<i>PAC Dummy</i>	0.01 (0.19)		0.07 (0.14)		0.23 (0.15)	
<i>PAC Amount</i>		0.01 (0.02)		0.00 (0.01)		0.02* (0.01)
<i>Provable Loss</i>	-0.28** (0.12)	-0.28** (0.12)			-0.15* (0.09)	-0.15* (0.09)
<i>Days in Class Period</i>	0.33*** (0.07)	0.32*** (0.07)	0.01 (0.03)	0.01 (0.03)	0.16*** (0.05)	0.16*** (0.05)
<i>Days to File</i>	-0.11*** (0.04)	-0.11*** (0.04)	-0.01 (0.01)	-0.01 (0.01)	-0.02 (0.02)	-0.02 (0.02)
<i>Settled</i>			-0.18*** (0.06)	-0.18*** (0.06)		
<i>Size</i>	-0.08** (0.04)	-0.09** (0.04)	0.01 (0.02)	0.01 (0.02)	0.45*** (0.03)	0.45*** (0.03)
<i>Leverage</i>	0.06 (0.25)	0.05 (0.26)	-0.05 (0.08)	-0.04 (0.08)	0.36* (0.20)	0.36* (0.20)
<i>ROA</i>	-0.02 (0.06)	-0.02 (0.06)	-0.01 (0.02)	-0.01 (0.02)	0.08 (0.05)	0.08 (0.05)
<i>B/M</i>	-0.01 (0.03)	-0.01 (0.03)	0.00 (0.02)	0.00 (0.02)	0.03 (0.02)	0.03 (0.02)
<i>Intercept</i>	0.25 (1.21)	0.32 (1.20)	-0.73*** (0.25)	-0.74*** (0.25)	12.06*** (0.51)	12.09*** (0.51)
<i>R<sup>2</sup></i>	0.21	0.21	0.10	0.10	0.49	0.49
<i>N</i>	1671	1671	1671	1671	719	719

Note: Table 6 reports regression estimates for the effect the PAC contributions have on the probability of a class action being settled (logit), size of the provable loss associated with a class action (OLS) and the settlement size of a class action (OLS). The first two columns present the regressions estimated for the probability of a class action being settled. Columns 3 and 4 present the regressions estimated for the size of the provable loss. The last two columns present the regressions estimated for the settlement size of a class action. Robust standard errors are reported in parentheses. Variables definitions are in Table 1. \*, \*\* and \*\*\* denote statistically different from zero at the 10%, 5% and 1% significance levels, respectively.

insignificant. Taken together, these findings suggest that politically connected firms are more likely to face larger settlements from class actions, which is consistent with these firms causing greater damage as a result of being able to get away with their misconduct for a longer period, consistent with hypothesis 3.

## 5.2.2 | Restatements

In this section, we examine whether political connectedness is associated with the severity of the damages caused by restatements. To analyze this relationship, we run regressions examining whether there was an SEC investigation as a result of a restatement and the stockholder loss that occurred during the restatement period as presented in equations (5) and (6). The results from these regressions are presented in Table 7. The results when the SEC

**TABLE 7** Impact of political connections on restatement outcomes

	Restatement SEC Investigation				Restatement Stockholder Loss			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<i>Lobby Dummy</i>	-0.59** (0.23)				-0.01** (0.01)			
<i>Lobby Amount</i>		-0.04** (0.02)				-0.00** (0.00)		
<i>PAC Dummy</i>			0.22 (0.26)				-0.01* (0.01)	
<i>PAC Amount</i>				0.03 (0.02)				-0.00** (0.00)
<i>Days in Restatement Period</i>	0.69*** (0.09)	0.69*** (0.09)	0.69*** (0.09)	0.69*** (0.09)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
<i>Days to Disclosure</i>	-0.41*** (0.12)	-0.41*** (0.12)	-0.42*** (0.12)	-0.42*** (0.12)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
<i>SEC Investigation</i>					-0.02 (0.01)	-0.02 (0.01)	-0.02 (0.01)	-0.02 (0.01)
<i>Size</i>	0.07 (0.05)	0.07 (0.05)	0.00 (0.05)	0.00 (0.05)	0.01*** (0.00)	0.01*** (0.00)	0.01*** (0.00)	0.01*** (0.00)
<i>Leverage</i>	0.25 (0.34)	0.24 (0.34)	0.15 (0.34)	0.15 (0.34)	-0.04 (0.03)	-0.04 (0.03)	-0.04 (0.03)	-0.04 (0.03)
<i>ROA</i>	-0.43** (0.20)	-0.44** (0.20)	-0.43** (0.20)	-0.43** (0.20)	0.00 (0.01)	0.00 (0.01)	0.00 (0.01)	0.00 (0.01)
<i>B/M</i>	-0.08 (0.08)	-0.08 (0.08)	-0.09 (0.08)	-0.09 (0.08)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)	0.00 (0.00)
<i>Intercept</i>	-2.69* (1.55)	-2.64* (1.57)	-2.30 (1.49)	-2.25 (1.50)	-0.25* (0.15)	-0.25* (0.15)	-0.25* (0.15)	-0.25* (0.15)
<i>R<sup>2</sup></i>	0.12	0.12	0.11	0.11	0.07	0.07	0.07	0.07
<i>N</i>	2668	2668	2668	2668	2158	2158	2158	2158

Note: Table 7 reports regression estimates for the effect the lobbying and PAC contributions have on restatement outcomes. The first four columns present logit regressions estimated for the probability of an *SEC Investigation* being undertaken related to a restatement. The last four columns present OLS regressions estimated for the stockholder loss during the restatement period. Robust standard errors are reported in parentheses. Variables definitions are in Table 1.

\*, \*\* and \*\*\* denote statistically different from zero at the 10%, 5% and 1% significance levels, respectively.

*Investigation* is the dependent variable are reported in the first four columns (i.e., Columns 1 to 4). The last four columns (i.e., Columns 5 to 8) report results where the *Stockholder Loss* is the dependent variable.

Both the *Lobby Dummy* and *Lobby Amount* variables are significantly negatively associated with the SEC investigation dummy variable. This finding indicates that lobbying firms are less likely to face an SEC investigation following a restatement. This could be a result of the SEC being less willing to investigate politically connected firms with significant tacit power. However, this relationship is not observed for both *PAC Dummy* and *PAC Amount* variables.

**TABLE 8** Impact of political connections on AAER outcomes

	AAER Settled				AAER Settlement Size			
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<i>Lobby Dummy</i>	0.46 (0.55)				-0.00 (0.47)			
<i>Lobby Amount</i>		0.01 (0.04)				-0.00** (0.04)		
<i>PAC Dummy</i>			0.23 (0.66)				-0.04 (0.51)	
<i>PAC Amount</i>				-0.01 (0.05)				-0.00** (0.04)
<i>Days in AAER Period</i>	0.96*** (0.31)	0.96*** (0.31)	0.97*** (0.32)	0.96*** (0.32)	0.71** (0.28)	0.72** (0.28)	0.70** (0.28)	0.70** (0.28)
<i>Days to AAER</i>	0.23 (0.42)	0.27 (0.43)	0.28 (0.43)	0.29 (0.43)	0.64* (0.35)	0.64* (0.35)	0.64* (0.35)	0.64* (0.35)
<i>Size</i>	0.31** (0.13)	0.34** (0.13)	0.33*** (0.13)	0.37*** (0.13)	0.59*** (0.11)	0.56*** (0.13)	0.59*** (0.10)	0.60*** (0.11)
<i>Leverage</i>	0.76 (1.59)	0.78 (1.62)	0.74 (1.61)	0.82 (1.63)	1.36* (0.73)	1.36* (0.72)	1.37* (0.72)	1.38* (0.73)
<i>ROA</i>	-1.66 (1.17)	-1.65 (1.20)	-1.58 (1.24)	-1.69 (1.27)	-1.27** (0.60)	-1.24** (0.61)	-1.28** (0.60)	-1.29** (0.60)
<i>B/M</i>	-0.03 (0.04)	-0.03 (0.04)	-0.02 (0.04)	-0.03 (0.04)	0.08** (0.03)	0.08** (0.03)	0.08** (0.03)	0.08** (0.03)
<i>Intercept</i>	-12.86*** (4.42)	-13.36*** (4.54)	-13.60*** (4.63)	-13.78*** (4.60)	-5.08 (3.56)	-4.87 (3.56)	-5.13 (3.58)	-5.21 (3.57)
<i>R<sup>2</sup></i>	0.07	0.06	0.07	0.05	0.54	0.54	0.54	0.54
<i>N</i>	230	230	230	230	185	185	185	185

Note: Table 8 reports regression estimates for the effect the lobbying and PAC contributions have on AAER outcomes. The first four columns present logit regressions estimated for the probability of an AAER being settled. The last four columns present OLS regressions estimated for the AAER settlement size. Robust standard errors are reported in parentheses. Variables definitions are in Table 1.

\*, \*\* and \*\*\* denote statistically different from zero at the 10%, 5% and 1% significance levels, respectively.

For all four political connection variables, we find a negative and significant relationship with the size of the stockholder loss observed during the restatement period. This result is consistent with hypothesis 2 and suggests that politically connected firms cause more damage to shareholder wealth as a result of restatements.

### 5.2.3 | AAERs

Next, we explore whether political connectedness has an impact on whether an AAER was settled or the size of an AAER settlement. Using similar models outlined in equations (2) and (4), we estimate the impact of political connections on the outcome of AAERs. The empirical results are presented in Table 8.

From these results, we find that political connections do not have an impact on whether an AAER was settled. The size of the settlement is significantly negatively related to the extent of lobbying and political contribution (*Lobby Amount* and *PAC Amount*). However, neither dummy variable for political connectedness is significantly associated with the AAER settlement size. These findings suggest that despite politically connected firms not being able to avoid being penalized, they face lower AAER settlements, which is related to the extent of their political activities, compared with non-politically connected firms. This indicates that the SEC may be less willing to impose large financial penalties on firms with significant tacit power.

#### 5.2.4 | Post-regulatory reforms

In this section, we attempt to shed some light on whether specific regulatory changes have some impact on the relation between political connections and the discovery of corporate misconduct. Our sample period from 2000 to 2018 covers various regulatory changes that include: (i) Sarbanes–Oxley Act (SOX) in 2002, (ii) Honest Leadership and Open Government Act in 2007, (iii) Dodd–Frank Act in 2010 and (iv) Protected Disclosures Act in 2014. The enactment of these regulations were all responses to high-profile cases of fraud and misconduct aimed at cleaning up corporate America after a host of corporate scandals around the turn of the century. These changes in the regulatory environment may also have impacted the amount of tacit power held by politically connected firms.

SOX introduced severe penalties to top executives if evidence of fraudulent activity is discovered. Similarly, Jack Abramoff's guilty plea led to the conviction of more than 20 elected representatives, congressional staff and executive branch officials (Borisov et al., 2016). By design, these penalties make managers and other stakeholders more accountable, reducing the incentive to commit fraud as well as curbing unethical managerial behavior. SOX improved the incentives and ability for auditors, employees and the SEC to reveal corporate misconduct. The Jack Abramoff case placed the lobbying process under intense public and media scrutiny, damaging political affiliations with lobbyists. The Honest Leadership and Open Government Act strengthened public disclosure requirements around lobbying activities and funding. These changes encourage agents to reveal evidence of corrupt corporate activities within firms generally, but their effect is likely more pronounced in the cases of firms with high tacit power (i.e., the measures mitigated the tacit power of lobbying firms in particular). In addition, the Dodd–Frank Act was enacted with the objective of promoting financial stability by improving accountability and transparency within the financial system and, more importantly, to strengthen the corporate governance practices in protecting investors' interests. Finally, the Protected Disclosures Act provides protection and redress for employee whistleblowers, further incentivizing the discovery of corporate misconduct.

To examine whether these regulations have had an impact on the time it takes to detect misconduct, the model specified in equation (1) was re-run for different sub-periods across our sample. As there were numerous regulations across our sample period, we have split our sample into four sub-periods. The first sub-period is defined as a pre-regulatory period (i.e., 2000 to 2004), which occurs before most regulatory changes occur. The other sub-periods are split evenly across the regulatory changes from 2005 to 2009, 2010 to 2014 and 2015 to 2018. Partitioning the sample this way also allows us to identify if a specific piece of legislation has caused a significant impact on the relationship between political connections and misconduct length. For this analysis, we focus on the length of the class period, as that was the most significant result found.

The results from the sub-period analysis are reported in Table 9. The *Lobby Dummy* coefficient is positive and significant in the 2000 to 2004 period. However, for the 2005 to 2009 and 2015 to 2018 periods, the variable is statistically insignificant. In the 2010 to 2014 period, the *Lobby Dummy* coefficient is marginally significant. These findings suggest that during the pre-regulatory period, lobbying firms were able to get away with their misconduct for a longer period. However, after the regulatory changes, politically connected firms were not able to consistently avoid detection. This

**TABLE 9** Impact of lobbying on days in class period

	Dependent variable: Log of days in class period							
	Pre-regulatory: 2000 to 2004		Post-regulatory: 2005 to 2009		Post-regulatory: 2010 to 2014		Post-regulatory: 2015 to 2018	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
<i>Lobby Dummy</i>	0.22** (0.09)		-0.11 (0.15)		0.25* (0.13)		0.32 (0.22)	
<i>PAC Dummy</i>		0.13 (0.13)		0.09 (0.18)		0.33* (0.17)		0.69** (0.33)
<i>Settled</i>	0.24*** (0.08)	0.24*** (0.08)	0.19 (0.12)	0.19 (0.12)	0.44*** (0.12)	0.41*** (0.12)	0.16 (0.25)	0.17 (0.24)
<i>Provable Loss</i>	-0.11 (0.07)	-0.11 (0.07)	0.11** (0.05)	0.11** (0.05)	0.02 (0.03)	0.02 (0.02)	0.00 (0.07)	-0.02 (0.07)
<i>Days to File</i>	0.01 (0.02)	0.01 (0.02)	0.04 (0.04)	0.04 (0.04)	0.00 (0.04)	-0.01 (0.04)	-0.09 (0.06)	-0.10* (0.06)
<i>Size</i>	-0.04* (0.02)	-0.03 (0.02)	0.04 (0.05)	0.01 (0.05)	-0.05 (0.04)	-0.05 (0.04)	0.12** (0.06)	0.09 (0.07)
<i>Leverage</i>	0.19 (0.18)	0.21 (0.18)	0.01 (0.25)	0.00 (0.25)	0.13 (0.20)	0.07 (0.20)	0.00 (0.32)	0.02 (0.32)
<i>ROA</i>	0.01 (0.03)	0.00 (0.03)	-0.27 (0.27)	-0.24 (0.26)	0.05 (0.05)	0.03 (0.05)	-0.77*** (0.18)	-0.71*** (0.18)
<i>B/M</i>	0.04** (0.02)	0.04** (0.02)	-0.04* (0.02)	-0.03* (0.02)	0.08 (0.07)	0.07 (0.07)	0.04 (0.04)	0.02 (0.04)
<i>Intercept</i>	5.10*** (0.33)	5.10*** (0.34)	5.27*** (0.85)	5.47*** (0.84)	6.26*** (0.38)	6.38*** (0.42)	4.38*** (0.76)	4.69*** (0.79)
<i>R<sup>2</sup></i>	0.18	0.18	0.20	0.20	0.19	0.19	0.23	0.23
<i>N</i>	750	750	357	357	326	326	238	238

Note: Table 9 reports OLS regression estimates for the effect the lobbying has on the number of days in the class period, using equation (1). The dependent variable in these regressions is the natural log of the number of days in the class period. Columns 1 and 2 present the regressions estimated for the pre-regulatory reforms period, from 2000 to 2004. The last six columns present the regressions estimated for the post-regulatory reforms period, from 2005 to 2018. Robust standard errors are reported in parentheses. Variables definitions are in Table 1.

\*, \*\* and \*\*\* denote statistically different from zero at the 10%, 5% and 1% significance levels, respectively.

would suggest that the regulatory changes that occurred during the sample period may have improved misconduct detection.<sup>14</sup>

<sup>14</sup> In unreported results we also estimated the models using an instrumental variables regression. Two separate instruments were used to determine a firm's political activities. The first instrument is the log of the distance between a firm's headquarters and Washington DC. This serves as a proxy for the cost of lobbying because firms that are located further from Washington face higher communication and information costs (Cao et al., 2018; Igan et al., 2011; Unsal et al., 2016). Hence, the distance to Washington will impact a firm's decision to lobby but will have no effect on any financial misconduct. The second instrument is the average lobbying expenditures by other firms in the same industry over the previous 2 years (Correia, 2014). Prior work indicates that lobbying by industry peers is an important factor for determining corporate lobbying (Grier et al., 1994) but is independent of financial misconduct. Our results are robust using the instrumental variables for the pre-regulatory period, and this is consistent with Yu and Yu (2011). However, for the post-regulatory period, the instruments are found to be weak, and therefore there is clearly a need to find more appropriate instruments in the context of politically connected firms.

The *PAC Dummy* coefficient is positive and significant for the two later sub-periods from 2010 to 2014 and 2015 to 2018. However, for the two earlier sub-periods, the *PAC Dummy* coefficient is statistically insignificant. These findings are in contrast to the lobbying results. The political contribution results suggest that politically connected firms were only able to get away with their misconduct for longer after a lot of regulations to improve fraud detection and disincentivize corporate malfeasance had been enacted. This suggests that the regulatory changes have not significantly reduced politically connected firm tacit power. Taken together, there is no clear evidence that the regulatory changes have improved stakeholders' ability to detect corporate misconduct.

## 6 | CONCLUSION

This paper examines the impact of political connections (i.e., lobbying and political contributions) on the time it takes to detect corporate misconduct and the size of penalties following SCAs, restatements and AAERs. We find that firms subject to SCAs that have political connections are able to get away with misconduct for a longer period. These firms experience larger settlement sizes consistent with their ability to conceal misconduct for a longer period. In addition, we also report that politically connected firms are associated with greater shareholder losses and are less likely to be involved in SEC enforcement actions on restatements. Finally, while the likelihood of AAERs being settled is not related to a firm's political connections, we do report that AAER settlement size is lower for politically connected firms.

Our study analyzes data from an extensive sample period covering 2000 to 2018 to test the association between firm's lobbying and firm's PAC contributions and the outcomes from SCAs, restatements and AAERs. Our main results make three important contributions to the literature examining the consequences of corporate misconduct. First, we report evidence of a positive association between political connections, class period length and settlement size. The results suggest that managers of politically connected firms are able to get away with their misconduct for a longer period and cause more damage in terms of shareholder wealth. In the context of our study, these findings imply that politically connected firms wield tacit power rendering economic agents less willing to speak out against the executive management team. This type of influence makes it more difficult to detect corporate misconduct and legally prove that managers have been negligent in violating any laws. There is no evidence of a longer malfeasance period for alleged fraud periods in AAERs or length of restatements.

Second, greater shareholder losses and a lower probability of being involved in SEC enforcement actions on restatements represent the negative impacts associated with political connections. Third, political connections are related to lower AAER settlement size; however, there is no evidence of an association between political connections and the likelihood of AAERs being settled.

Our results are subject to a number of limitations. As highlighted by Yu and Yu (2011), due to data restrictions, with the exception of fraud detection, researchers are unable to explore other aspects of corporate fraud such as the length of litigations and settlement arrangements, which could also be affected by lobbying and political contributions. Zheng (2021) voices similar concerns about the lengthy SEC enforcement process and its opacity due to data limitations. Since we cannot observe the entire enforcement process and the SEC does not provide all the enforcement step data, modeling the whole selection process of enforcement actions is difficult. Another limitation is that we do not observe corporate misconducts that were not caught during our sample period. With respect to our unreported endogeneity tests,<sup>14</sup> we find our results are robust using the instrumental variables for the pre-regulatory period (similar to Yu & Yu, 2011). However, for the post-regulatory period, the instruments are found to be weak, and therefore there is clearly a need to find more appropriate instruments in the context of politically connected firms. In addition, omitted variable bias is a concern given that lobbying and non-lobbying firms vary across a number of dimensions. We attempted to



address this concern by obtaining a matched sample using propensity score matching. However, the estimated models from the matched sample had low power because of the reduced sample size.<sup>15</sup>

Notwithstanding these limitations overall the results support the view that politically connected firms have exercised a substantial amount of tacit power, effectively hindering the revelation of managerial misconduct. Furthermore, the enactment of new regulations during the sample period has not consistently reduced the tacit power of politically connected firms or improved the incentives for economic agents to reveal corporate misconduct. Therefore, in order to curb political influence and reduce the impact of corporate malfeasance, stronger regulations or alternative methods of disincentivizing misconduct are required.

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## CONFLICT OF INTEREST

The authors have no conflict of interest to declare.

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<sup>15</sup> To obtain the matched sample, we estimated the probability of a firm to engage in lobbying activity using characteristics that have been used in the literature as control variables (Hill et al., 2013). The sample of sued lobbying firms were then matched to a sued non-lobbying firm with the closest propensity score within the same industry (two-digit SIC) and were sued in the same year. From the sample of 451 sued lobbying firms, we were able to successfully find an appropriate match for 90 sued lobbying firms. Re-examining the impact of lobbying on the class period length, we find that the two lobbying variables become insignificant. This insignificance is likely a result of losing a substantial number of lobbying observations during the matching process. These results are available upon request from the authors.

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