

**RELATIONSHIP BETWEEN POLITICAL PREFERENCE AND
CORPORATION PERFORMANCE**

by

Yuan Tian

Bachelor of Accounting, Dongbei University of Finance and Economics 2013

and

Min Sun

Bachelor of Marketing, University of Wisconsin- Eau Claire 2012

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Abstract

This paper conducted an empirical analysis of the correlation between corporate political preference and financial performance. By using data from 2nd vote app and WRDS database we analyze the relation between abnormal return and political lean score. We find that there is relation between a firm's political score and its profitability. Specifically, companies leaning Republican have a higher probability of performing well financially compared to companies leaning Democrat. Furthermore, companies in the middle of the spectrum tend to have average performance.

Keywords: Corporation performance, liberal and conservative skill, corporate social responsibility, abnormal return

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Contents

1. Introduction.....	1
2. Literature Review	1
2.1 Corporate Social Responsibility	1
2.2 Corporate Social Responsibility and Financial Performance	2
3. Source of data	4
3.1 Political data source	4
3.2 Financial data source	5
4. Methodology	5
4.1 Sample	5
4.2 Dependent variable	6
4.3 Independent variable.....	6
4.4 Hypothesis	6
4.5 Method.....	7
5. Results and Analysis.....	7
6. Conclusion	9
7. References.....	13

1. Introduction

Nowadays, political beliefs in the United States have become more and more polarized. Politics always impact the economy as a whole due to different attitude towards issues like economic development. Liberal believe that a market system in which government regulates the economy is the best, government should be motivated by the public interest and it should protect citizens from the greed of big business. While Conservative belief is that government should stay small and let the free market operate with minimal intervention, which should help economy grow, create more job opportunity and thus increase the standard of living.

We thus reasonably assume that political preference might have influence on individual corporation performance. To determine the validity of this assumption, this paper analysis the correlation between financial performance which is represented by abnormal return alpha and political leaning score calculating from a social responsibility perspective. Recently the Nashville-based company offers a new free application that provides ranking of companies based on their liberal-conservative scale ranging from 1 to 5, with 1 meaning Liberal, 2 meaning leaning Liberal, 3 meaning neutral, 4 meaning leaning Conservative, and 5 meaning Conservative. The app details the political leanings of major corporations: where they invest and what stands they take. This provides us a great database for verifying our assumption.

2. Literature Review

2.1 Corporate Social Responsibility

According to the United Nations Industrial Development Organization (UNIDO), Corporate Social Responsibility is a “management concept whereby companies integrate social and environment concerns in their business operations and interactions with their stakeholders”.¹

¹ Taken from the United Nations Industrial Development Organization website

Companies can obtain a balance of economic, environmental and social imperatives; while at the same time meet the expectation of shareholders and stakeholders. Some key CSR issues are: environmental management, eco-efficiency, social equity, human rights etc. Different companies might have different understanding and implementations in details.

2.2 Corporate Social Responsibility and Financial Performance

It is natural to provide a literature review of the relationship between CSR and financial performance as it is strongly related to the study. One would think that corporations that engage in CSR are in general leaning Democratic (Rubin, 2008). The opposite is true about Republican leaning; they would probably claim that the sole role of a corporation is to maximize profit. This view is an analogy: a corporation should maximize profit similarly to the view that the government should be small and taxes should be low. Hence, there is no role for a “big corporation” that takes on responsibilities that are not in its mandate. For example, instead of the corporation donating money for society, shareholder can donate the money from dividend payments if they wish.

Many studies have been done about the relationship between the corporate social responsibility and their financial performance. However, the results are somewhat different due to different methodology and databases.

After examining the alphas and abnormal returns for 28 socially screened equity portfolio invested, Diltz (1995) found that there were no statistically significant performance difference between traditional investment and socially responsible investments. The same result also held for a study concerning the period from 1990 – 2001. By using an international databases and controlling for investment style, no evidence of significant differences were found in risk-adjusted returns between ethical and conventional funds (Bauer, Koedijk, & Otten, 2005).

For those studies that come up with a statistically significant level of relationship, Sauer (1997) finds that the application of social-responsibility screens does not necessarily have an adverse impact on performance by examining the performance characteristics of a carefully constructed, well diversified portfolio of socially screened stocks with two unrestricted benchmark portfolios. This result is inconsistent with the normal knowledge that most firms face a trade-off between social responsibility and financial performance. And the cost incurred from socially responsible actions put an economic disadvantage compared to other less responsible firms (Aupperle, Carroll, & Hatfield, 1985).

Studies that isolate each individual social responsibility factor also result in different conclusions varying from positive to negative correlation.

Abraham and Zenu assessed the impact of environment corporate social responsibility (ECSR) on Corporate Financial Performance (CFP) measured by ROA and Tobin's Q. The study indicates a negative and statistically significant relationship between the firms' return on assets (ROA) and ECSR (Abraham Lioui, Zenu Sharma, 2012). However, in a study on the same topic high sustainability-rated portfolios have performed better than low-rated portfolios on a style-adjusted basis. And the same results hold for four out of five sub-ratings of which the sustainability rating is composed (Velde, Vermeir, & Corten, 2005). People also found that employee satisfaction was associated with positive abnormal returns in countries with high labor market flexibility (Edmans, Li, & Zhang, 2014). Another relative similar result is portfolio with high rank on eco-efficiency characteristics provide substantially higher average returns compared with the counterpart with low rank and this performance differential cannot be explained by difference in market sensitivity, investment style or industry-specific components (Derwall, Bauer, Guenster, & Koedijk).

People also find some relationship in studies typically about political view and economic consequence. As a leading indicator of economic activity, stock market shows a favor on Republicans. During the nine elections from 1940 to 1972, stock price changes after elections were generally positive with the largest increase occurring after Republican victories (Reilly

& Eugene, 1976).

These previous study achievements indicate that there is a connection between political preference and performance on social responsibility and that relationship between the corporate social responsibility and financial performance varies from negative to positive or not significantly related. The purpose of this paper is to find whether there is a relationship between political preference and financial performance by examining the corporate social responsibility factors captured in the political preference.

3. Source of data

3.1 Political data source

2nd Vote is a clever application written by conservatives. It is intended to help conservatives vote with the pocketbooks by detailing who and who isn't supporting the conservative agenda (or the app writer's version of the conservative agenda). It is however, also an app that could be used by liberals to support the companies that the conservatives don't want supported.

Insert a table1 about here

The companies are rated on particular issues including Second Amendment rights, environment, gay marriage, and abortion. All the companies are also categorized by industry. The scoring system is based on the information of: direct and indirect corporate donations; activities and stated policies from these companies; documented sponsorship for various political and advocacy-related events; corporate leadership donations, activity and advocacy; lobbying spent for or against various issues on the federal and state levels. The political preference rating ranges from 1 to 5, with 1 meaning Liberal and 5 meaning Conservative.

Take Apple for example, it rates a very low 1 on environment which is mainly because Apple leaving Chamber of Commerce over the opposition to the Obama administration's climate policy, notably the Environmental Protection Agency's decision to regulate greenhouse-gas

emissions². This action is opposite to point of view from Conservative on this topic as they believe that any change in global temperature s nature over long periods of time³. Another example is that Apple gets a 2 in Marriage since it received a 100 from the Human Rights Coalition for their support of the Lesbian Gay Bisexual and Transgender community. And Liberal held the same opinion the same-sex marriage.

If a company doesn't score well, the app suggests similar companies that might be a better politically aligned alternative. Further, each score is supplemented with additional information, but the source of that information isn't disclosed.

3.2 Financial data source

In order to measure financial performance of targeted companies, we use Wharton Research Data Services (WRDS) – a web-based business data research service from Wharton School at the University of Pennsylvania. It is a common tool for research for over 290 institutions and is recognized by the academic and financial research community around the world. Apart from WRDS, we also use data from CRSP which is one of the 12 Research and Learning Centers at Chicago Booth.

4. Methodology

4.1 Sample

The data for the analysis were collected from two sources. First, we extracted monthly return data for 2008–2013 and monthly value-weighted return from Wharton Research Data Services (WRDS) database. Second, we collected company's political lean score from 2nd Vote APP including total scores and 4 scores for Second Amendment rights, environment, gay marriage, and abortion. The 2nd Vote APP contains complete data for 385 companies since 2013, from which we delete 34 non-profit organizations and delete 165 companies which did

² Taken from The Wall Street Journal website:
<http://blogs.wsj.com/environmentalcapital/2009/10/05/exodus-apple-leaves-chamber-of-commerce-over-climate-spat/>

³ Taken from "Conservative vs. Liberal Beliefs" at StudentNewsDaily.com

not go public. The remained scores are for 186 companies. We extracted corporation performance data for the same 186 companies for the period of 2008–2013, which yielded a total of 12969 observations (186 companies 5 years) for our final analysis.

4.2 Dependent variable

In order to measure financial performance of targeted companies, we use abnormal return (alpha) as our proxy. Abnormal return is the difference between the actual return of a security and the expected return. The component of the return is not due to systematic influences (market-wide influences). In other words, abnormal returns are above those predicted by the market movement alone.

In this part, we do the multivariate linear regression between monthly return and monthly value-weighted return (includes distributions) using STATA , running the regression separately for each company. Thus we use 60 monthly returns and 60 value-weighted returns to do the linear regression for each company, and extract from that the intercept – which can be considered the alpha of the regression. Hence, we regard the constant as the abnormal return (alpha) in each single regression.

4.3 Independent variable

In our paper, all political lean scores are obtained from 2nd Vote APP. We take 5 scores for each company. The first one is total score. The second one is the score on Second Amendment rights. The third one is the score on environment. The fourth one is the score on gay marriage. The fifth one is the score on abortion.

4.4 Hypothesis

There is a relationship between political lean score and company's abnormal return. And it still need test to prove whether it is positive or negative.

4.5 Method

The dependent variable is return and the independent variable is the value weighted index. The intercept of the regression is the alpha. Then we do a t-test to see if alpha is associated with the score of political leaning. According to our t-test result, we find that the relationship between the two variables is significant at the 90% level. It means the political lean score was associated with alpha (coefficient=0.00356, $P < 0.10$). In other words, there is a 90% probability that there is a positive correlation between political lean score and abnormal return. Therefore, our hypothesis is substantiated.

Insert a table2 about here

In the same way, we also do the t-test for the other coefficients. It also shows the positive coefficient. But some results are not significant. To be noticed, we find that the relationship between prolife score and abnormal return is significant at the 99% level and the relationship between marriage score and abnormal return is significant at the 90% level.

Insert a table3 about here

In addition, we divide 186 companies into 3 equal groups based on score ranking. We rank the score from the lowest to the highest. Each group includes 62 observations. Then we calculate the mean of each group, which is 0.0027925, 0.0071055, 0.0099875, respectively. Based on the calculation, we find the companies with higher political scores have higher alpha than that with lower political scores.

5. Results and Analysis

In this subsection, we get a result that the abnormal return of targeted companies is positively related to the political preference rating from 2nd vote at a 90 percent significant level. Or in other words, since the higher the CSR score the companies have the more conservative they are and the lower the CSR score the companies have the more liberal they are, companies holding conservative political view tend to be more profitable than those standing with liberal. Based on the results from previous study that Democratic companies tend to be with a high CSR rating and Republican companies tend to be with a low CSR, we could get a further

result that companies devoting more to meet expectation beyond what is required by law and regulation might be less profitable.

Since the political lean score is based on environment, second amendment, pro-life and marriage -- four social responsibility factors, the result could also be understood as the achievement of the combination of these factors may result in a poorer financial performance. This is consistent with the findings that some specific complementary CSR practices are likely to negatively affect firm performance (Cavaco & Crifo, 2010).

One of the possible explanations for this particular result is that socially responsible firms may have a competitively disadvantage due to the cost incurred in order to meet expectation from stakeholders reduce profit while the cost could be avoided in socially irresponsible firms. For example, if a chemical plant wants to over-satisfy the requirement of local environment protection organization it might purchase a set of new equipment and new technical support system which may boost the cost of wastewater treatment. This typical cost will be treated as expense and deteriorate the profitability due to increase the financial burden of the company. It would be nature for companies in this industry to lean to Conservative which have a passive attitude on the environment issue.

From the political perspective, there is a common statement that “the Democrats are the party of labor, the Republicans the party of business”. Republicans expresses more confidence in big business, while Democrats expressed more confidence in organized labor⁴. This fact is also consistent with our research result which could be explained by the political view of Republicans such as suggesting supporting lower taxes and a small government in order to create more incentive for people to work, save, invest and engage in entrepreneurial endeavors. It is obvious that low tax policy will be supported by corporations which pursue maximization of their profit.

⁴ Taken from “Democrats More Confident in Labor; Republicans, in Business” from Gallup website

Our study also shows a 99 percent significant level of positive relationship between abnormal return and political view about prolife. Companies leaning Conservative on this issue tend to have a better financial performance than those leaning Liberal. Typically, companies who support legislation to prohibit abortions have a higher probability of earning a great abnormal return than those who believe. On the view of same-sex marriage, we find a 90 percent significant level of the positive relationship between of the view and abnormal return. This indicates that companies opposing same-sex marriage tend to have a better financial profitability and the opposite one may not perform well.

6. Conclusion

Research has been conducted to study the potential influence of corporate social responsibility and political lean of company on financial performance. The purpose of this paper is to find whether such correlation between political view of companies and financial performance exist. Through analyzing the political preference score and social responsibility component of the scores, we find that there is a positive relationship between political lean and financial performance. Specifically, Republicans tend to have a higher profitability which is indicated by abnormal return than Democratic. This could result from the fact that Democratic may contribute more resource in order to meet the expectation from stakeholders while Republicans avoid this expenditure and dedicate to business and the political view of Republicans is more appealing to the economic development.

Table 1 2nd Vote

iPad back 1:14 Details 51%

Apple

Electronics, Technology & Software
👤 308 🗳️ 235

1.2

SHARE MAP VOTE CHECK IN

Breakout Scores

🗳️ 2nd Amendment Rights	1
🎓 Education	2
🌿 Environment	1
💍 Marriage	1
👤 Pro-Life	1

Better Options

Vizio Electronics, Technology & Software	3
Acer Electronics, Home Improvement, Technology & Software	3
Radio Shack Electronics, Retail	3
Ingram Micro Technology & Software	2.7
Intel Technology & Software	2.7
Texas Instruments Technology & Software	2.5

Scorecard Updates Votes More

Table 2 the Relation between the Score of Political Leaning and Alpha

The dependent variable is abnormal return (alpha) and the independent variable is the score of political leaning. Then we do a t-test to see if alpha is associated with the score of political leaning based on 186 observations. The coefficient is 0.00356 and the constant is -0.00129. According to $p\text{-value} < 0.1$, we find that the relationship between the two variables is significant at the 90% level.

VARIABLES	(1) alpha
score	0.00356*
Constant	-0.00129
Observations	186
R-squared	0.017

Standard errors in parentheses
*** $p < 0.01$, ** $p < 0.05$, * $p < 0.1$

Table 3 the Relation between Alpha and Single Score of Political Leaning

The dependent variable is abnormal return (alpha) and the independent variable is the score of political leaning about Second Amendment Right (Environment in second table, Marriage in third table, Prolife in fourth table). Then we do a t-test to see if there is a correlation based on 140 (167 in second table, 171 in third table, 173 in fourth table) observations. The coefficient is 0.00148(0.000615 in second table, 0.00267 in third table, 0.00475 in fourth table) and the constant is -0.00330(0.00393 in second table, 0.00161 in third table, -0.00169 in fourth table). According to p-value, we find that the relationship between the two variables is not significant in first table and second table. To be noticed, according to the t-test result, we find that the relationship between prolife score and abnormal return is significant at the 99% level and the relationship between marriage score and abnormal return is significant at the 90% level.

VARIABLES	(1) alpha
Amendment	0.00148
Constant	0.00330
Observations	140 ^①
R-squared	0.005

VARIABLES	(1) alpha
Environment	0.000615
Constant	0.00393
Observations	167 ^②
R-squared	0.003

VARIABLES	(1) alpha
Marriage	0.00267*
Constant	0.00161
Observations	171 ^③
R-squared	0.020

VARIABLES	(1) alpha
Prolife	0.00475***
Constant	-0.00169
Observations	173 ^④
R-squared	0.049

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

- ① There are 46 companies without scores in Second Amendment Rights.
- ② There are 19 companies without scores in Environment.
- ③ There are 15 companies without scores in Gay Marriage.
- ④ There are 19 companies without scores in Abortion.

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