Spillover Effects of Political Connectedness and Corporate Social Responsibility: Evidence From the Trump Administration

Kelly E. Carter
Morgan State University

Sheela Thiruvadi
Morgan State University

This paper does not argue for or against President Trump. Rather, it examines potential spillover from a mutually exclusive choice between political connectedness and corporate social responsibility (CSR). We find that a firm's investment in political connectedness with Trump (in CSR) causes the stock prices of rival firms to increase (decrease), suggesting spillover. A rational interpretation of the results follows. As human beings, shareholders do value CSR. At the same time, they consider the marginal benefits and marginal costs of each investment type in a given situation and invest accordingly.

Keywords: political connectedness, corporate social responsibility, CEO departures, President Donald Trump, manufacturing jobs initiative, strategic and policy forum

INTRODUCTION

In December 2016, President-Elect Trump formed the Strategic and Policy Forum to advise him on the impact of policy on firms. About two months later, President Trump formed the Manufacturing Jobs Initiative to assist him in creating manufacturing jobs. However, both councils would be short-lived. On August 12, 2017, supremacists and inclusive protesters clashed in Charlottesville, Virginia, and three people died. When Trump initially remained silent, many politicians (i.e., informed spectators) were surprised that he did not condemn the supremacists, promote inclusivity, and bolster his political capital. Trump's silence may have also surprised the CEOs of Merck, Under Amour, and Intel, as they resigned from the Initiative two days later, citing a moral obligation (i.e., CSR). Later, Trump stated that there were upstanding people on both sides of the confrontation. He surprised many informed spectators because a suggestion, whether intentional or not, that supremacists and inclusive protestors are on the same moral plane is not expected from a U.S. President. Also, Trump spoke impromptu, meaning that the content could not have leaked. This surprise caused two more organizations to resign from the Initiative. After still more resignations, Trump ended both councils. At that time, all members had resigned from the Forum, but most of the Initiative's members remained (Domm and Pramuk, 2017).

In this paper, we use the setting discussed above to examine whether a firm's investment in political connectedness with Trump or CSR spills over onto its rivals. This study is important because it expands managers' information set regarding potential changes in the wealth of their shareholders due to the actions of a different firm. This paper takes a politically neutral position and thus does not argue for approval or

disapproval of President Trump. Rather, this paper uses a surprise event related to Trump to measure financial spillover. Also, this paper deals only with a firm's connectedness with Trump related to the Charlottesville event and thus does not consider the potentially many connections that firms might have to other parts of the federal government or to state or local government.

To investigate this issue, we use the rivals of firms that resigned from or remained onboard a council after Trump's surprising comments about the Charlottesville march. We use rival firms because they are large in number. By contrast, the number of council firms is small, meaning that the number of uncontaminated council firms is smaller. Importantly, the council firms resign-or-remain decision is exogenous to the rival firms, allowing for causality to be examined.

The setting of this study is meaningful because it involves social justice, the most important aspect of CSR to customers (Bradford et al. 2017). In deciding whether to resign from or remain onboard a council, the CEOs considered whether to maintain a political connection with the President of the United States or to sever ties in the name of CSR. Usually, choosing between political connectedness and CSR is not mutually exclusive. However, in this situation, the CEOs on the Forum and Initiative effectively faced a mutually exclusive choice because, given Trump's penchant to punish disloyalty, resigning from a council effectively means that a firm severs its political ties to Trump. Thus, we are able to isolate the effects of political connectedness versus CSR on shareholder wealth.

This study generalizes to nearly all decisions that involve preserving or severing political connections because of the all-or-nothing nature of political connections. For instance, to reap the benefits of political connectedness, firms needed to choose to support the winning presidential party (Goldman et al. 2009). Otherwise, the firms would have forfeited the benefits. It follows that, to reap the benefits of political connectedness to Trump, firms needed to support him by remaining onboard a council. Otherwise, the firms would lose those benefits.

To motivate the discussion of the results of spillover tests, it is necessary to state the effect of the resign-or-remain decision on council firms. Firms that remain onboard the Initiative cause cumulative abnormal returns (CARs) to shareholder value, as measured by market value of equity (MVE), of 0.85 percent, or $345 million per firm. If their rivals experience positive (negative) CARs, a contagion (competitive) effect, as termed by Lang and Stulz (1992), will exist. There are no firms that remain onboard the Forum because all Forum firms resigned collectively. Regarding firms that resign from the Forum or Initiative, the resignations cause CARs to shareholders of -0.52 percent, or $570 million in MVE per firm. If their rivals experience negative (positive) CARs, contagion (competitive) effects will exist, per Lang and Stulz (1992).

We find that a firm's choice of political connectedness or CSR spills over onto its rivals. Relative to other rival firms, the rivals of firms that resigned from the Initiative suffer CARs that are lower by 1.98 percentage points, or $59.4 million in MVE per firm. This result suggests that spillover contagion (Lang and Stulz 1992) exists because the firms that resign from the Initiative experience negative CARs. A likely explanation for the negative contagion is that the market expects resigning firms' industries to lose shareholder value when a member of that industry severs a key political connection.

However, the rivals of firms that resigned from the Forum have CARs that are higher by 1.98 percentage points, or $59.4 million in MVE. This result suggests that competitive effects of spillover (Lang and Stulz 1992) exist because the firms that resigned from the Forum experience negative CARs. The rivals of firms that remain onboard the Initiative have CARs that are higher than those of other rivals by 1.26 percentage points, or $180 million in MVE per firm. An explanation for this result lies in the mission of the Forum. Unlike the Initiative, whose mission was to create manufacturing jobs, the mission of the Forum was more strategic – to advise Trump on policy. While the members of the Forum certainly sought favorable policies for their industries, they likely sought favorable policies and projects for their firms first. Thus, upon a Forum member's resignation, rival shareholders may have expected Trump to appoint a substitute firm to the Forum. This idea is consistent with Grossman and Hart (1986) and Rajan and Zingales (1998), who imply that political connections can enhance firm value through the creation of policies that favor the connected firm. The results of this paper show mixed robustness to a firm's level of CSR investment and to the mean analyst recommendation of a firm's shares.

This paper generally finds positive (negative) spillovers to rival firms when council firms invest in political connectedness with Trump (invest in CSR), meaning that entire industries incur gains (costs) when one of their members maintains (severs) a top political connection. The results should be interpreted carefully. The results do not suggest that shareholders and CEOs do not value CSR. As human beings, they recognize the benefits of CSR. Also, CSR can sometimes be more beneficial, consistent with Jensen (2002). At the same time, the results do suggest that shareholders and CEOs should rationally consider in each situation the marginal benefits and marginal costs of investing in political connectedness or CSR because circumstances are not always the same.

As stated above, the results of this paper generalize to nearly all political situations due to the all-or-nothing nature of supporting a politician. At the same time, because this paper focuses only on Charlottesville, it does not provide insights into the conditions under which shareholders would prefer political connectedness or CSR or would be indifferent. To do so, a data set of several events similar to Charlottesville would need to be assembled, and the characteristics of the events would need to be controlled for. Assembling that database will be difficult because, as stated earlier, the choice between political connectedness and CSR is typically not mutually exclusive. However, over time and space, more situations that require a mutually exclusive choice will arise, facilitating the creation of a database. Reporting the conditions under which shareholders would prefer managers to invest in political connectedness or CSR or would be indifferent is thus an area for future research.

An issue with this study is the impossibility of knowing a CEO's true motives for resigning from or remaining onboard a council. For instance, it is possible for a CEO to privately disagree with Trump but remain onboard a council if the CEO believes that the connection with Trump will maximize shareholder wealth. Likewise, it is possible for a CEO to privately agree with Trump but resign from a council if the CEO believes that resigning from a council will maximize shareholder wealth. Thus, we approach this issue as follows: If CEOs act in shareholders' best interest, resigning from (remaining onboard) a council indicates that they believe that investing in CSR (political connectedness) will maximize shareholder wealth. This approach is valid because Trump selected firms to join a council, meaning that firms could not apply to join to satisfy private motives.

This paper adds to the literature that uses presidential events to study the financial markets (e.g., Santa-Clara and Valkanov 2003; Sy and Zaman 2011; Wagner et al. 2018). Also, this paper adds to the literature on political connectedness (e.g., Houston and Ferris 2015) and CSR (e.g., Xu et al. 2019). In addition, this paper adds to the literature on spillover effects (e.g., Lang and Stulz 1992; Chen et al. 2016). Furthermore, this study adds to the debate about the goal of the firm. Friedman (1962, 1970) asserts that the objective of the firm should be to maximize shareholder value and that satisfying that objective equates to CSR because the firm cannot employ workers or contribute to charities if it is not profitable. However, Jensen (2002) argues that, while the long-run objective of the firm should be to maximize shareholder value, the interests (e.g., social justice, CSR) of other stakeholders sometimes need to be pursued in the short run and could potentially add value.

REVIEW OF RELEVANT LITERATURE AND HYPOTHESIS DEVELOPMENT

Friedman (1962, 1970) argues that the firm should exist to maximize shareholder value. To accomplish that objective, firms often form political connections, which can benefit firms via favorable economic policy (Grossman and Hart 1986; Rajan and Zingales 1998). Several authors find positive value effects to politically-connected firms. Faccio (2006) finds that positive abnormal returns (ARs) of 2.29 percent accrue to politically-connected firms. Kim et al. (2012) find that higher returns accrue to firms that are located in U.S. states where the leading politicians inside those states are more politically aligned with the party of the incumbent president. Wagner et al. (2018) also examine the relationship between political connections and value surrounding Trump's surprise victory in the 2016 U.S. presidential election. They find that the stocks of firms in heavy manufacturing and finance – two industries that Trump targeted for growth – increase in value.

These positive ARs could spill over onto rival firms for two reasons. One, the favorable economic policy discussed by Grossman and Hart (1986) and Rajan and Zingales (1998) will affect all firms in a politically-connected firm's industry, not just that firm. Two, Houston and Ferris (2015) find that the positive returns that accrue to politically-connected firms exist over the long run. The persistence of the positive returns suggests that investors expect the political connections to enhance the firm's profitability by introducing the firm to new growth opportunities. Since no single firm can accept all growth projects, other firms in the industry will accept some of the growth projects. This situation will lead to spillover in the same direction, to which Lang and Stulz (1992) refer as contagion. Given the findings of contagion in primary seasoned equity offerings (Bradley and Yuan 2013), private equity issues by publicly-traded firms (Chen et al. 2016), and other phenomena, contagion in political connectedness could also exist. This possibility leads to the hypothesis below.

Hypothesis: *A contagion effect exists with respect to political connectedness.*

At the same time, Jensen (2002) argues that, while the long-run objective of the firm should be to maximize shareholder value, investing in other interests (e.g., social justice, CSR) could maximize shareholder value in the short run. Investing in CSR can lead to positive ARs. Filbeck et al. (2009) find that firms that have a reputation for investing in CSR, as measured by inclusion onto *Business Ethics* magazine's list of the 100 Best Corporate Citizens, experience positive ARs. Filbeck et al. (2009) also find that a portfolio of firms on the *Business Ethics* list consistently outperforms the Standard and Poor's (S&P) 500 Index. Harjoto and Laksmana (2016) find that CSR is associated with smaller deviations from optimal risk-taking. This result suggests that CSR, like debt (Jensen 1986), is a disciplining device that promotes optimal firm value. Ferrell et al. (2016) find that CSR weakens the negative relationship between firm value and managerial entrenchment. They also find a positive relationship between CSR and value as measured by Tobin's Q.

Evidence of positive spillover onto rival firms is also documented in the literature. Cai (2007) examines whether spillover onto rival firms exists when a firm is announced for inclusion into the Standard and Poor's (S&P) 500 Index. He finds that the added firm and its rivals incur positive returns, suggesting positive contagion. In addition, evidence of positive spillover onto firms in different industries is documented. Xu et al. (2019) find that CSR impacts a firm's supply chain, as socially responsible firms receive more trade credit. This result suggests that CSR causes same-directional spillovers to firms in other industries. With more generous trade credit, socially responsible firms can purchase more input from their suppliers, leading to greater profitability for the suppliers. Customer firms can also benefit because they can be confident that they are buying inputs from a supplier that is financially viable and that is likely to be a going concern.

Given that intra-industry spillover exists regarding S&P 500 inclusion announcements and that extra-industry spillover exists along the supply chain to affect firms in different industries, it is quite plausible that investments in CSR will spill over onto intra-industry rival firms. This hypothesis is below.

Hypothesis: *A contagion effect exists with respect to CSR.*

The aforementioned hypotheses posit that contagion effects will exist regarding investments in political connectedness or CSR. However, such an investment could spill over in the opposite directions onto rival firms. Lang and Stulz (1992) refer to this phenomenon as the competitive effects of spillover.

Political connections sometimes erode the performance and value of the connected firms. Boubakri et al. (2008) and Faccio (2010) find that politically-connected firms have worse accounting performance than non-connected firms. Fan et al. (2007) examine the effect of political connectedness on Chinese firms that are privatized in part but not in full. They find that connected firms perform worse than non-connected firms by 18 percent for three years after the partial IPO and have lower growth in earnings and sales. Moreover, Bebchuk and Jackson (2010) find that managerial preferences for various social outcomes affect the general welfare and could negatively impact shareholder value.

Research also suggests that competitive spillover could potentially exist regarding political connectedness. Niessen and Ruenzi (2010) examine the potential benefits of political connectedness in Germany. They find that politically-connected firms have lower market valuations and fewer growth opportunities than non-connected firms. This situation benefits non-politically-connected firms because they will take on the growth opportunities and will generate higher returns, leading to higher valuations. Thus, competitive spillover onto rival firms could exist. This hypothesis is stated below.

Hypothesis: *A competitive effect exists with respect to political connectedness.*

Likewise, investments in CSR sometimes erode value. Starks (2009) presents results from a Mercer Consulting survey that finds that CSR is not very important to most investors. Mercer found that 39 percent of investors consider corporate sustainability (i.e., CSR) as very important. This finding suggests that resigning from the Forum or Initiative to uphold CSR will lead to negative returns because most investors (61 percent) do not consider CSR very important and will punish the firm if it resigns. Moreover, Nollet et al. (2016) find that a negative relationship between CSR and firm value exists in the short run.

Brammer et al. (2006) examine the relationship between CSR and stock returns using disaggregated CSR data on U.K. firms. They find that involvement in environmental and community initiatives drives the negative returns. It follows that, if CSR firms eschew their political connections to invest in CSR, their rivals' share prices will increase because the rivals will invest in those political connections. As a result, a competitive effect regarding CSR could exist for rivals' firms. This hypothesis is stated below.

Hypothesis: *A competitive effect exists with respect to CSR.*

DATA

We begin with the population of organizations that were on the Forum or the Initiative. We eliminate non-publicly-traded and contaminated firms. A contaminated firm is defined as having a confounding event on a [-3, 3] event window that is known to affect returns. Such events include dividend announcements, earnings announcements, stock splits, mergers, acquisitions, and scandals. To identify confounding events, we search *The Wall Street Journal Abstracts* in Lexis-Nexis using a [-3, 3] window about the date on which an executive decided to resign from or remain onboard a council. We use only uncontaminated firms.

We use uncontaminated rival firms in the same four-digit Standard Industrial Classification (SIC) codes as the uncontaminated resigning or remaining firms. We also eliminate firms in SIC code 9999 because that code contains firms that do not fit into another SIC code. This process results in 256 uncontaminated rival firms in event studies. Of those rivals, 105 are rivals of firms that resigned from the Initiative on August 14, 2017. Eight are rivals of firms that resigned from the Initiative on August 16, 2017. 65 are rivals of firms that remained onboard the Initiative until Trump dissolved both councils on August 16, 2017, and 78 are rivals of firms that resigned from the Forum on the same date.

APPROACH

We use OLS regression analysis to identify the factors that explain CARs to rival firms. The independent variables are defined below in the section on regression analysis. By using only CARs as the dependent variable, we depart from Wagner et al. (2018), who use both ARs and CARs from several days to several months after Trump's election. Wagner et al. (2018) use ARs and extended CARs because their goal is to test the market's reaction to Trump's election, realizing that the market might need weeks or months to interpret Trump's policy because his presidency could potentially be for the long run (here, at least four years). Instead, our purpose is to explain CARs to Trump's actions surrounding a short-run, surprise event that is independent of his policy.

TABLE 1
MEMBERS OF THE STRATEGIC AND POLICY FORUM

Organization	Share Price ($)	MV Equity ($ Billions)
BlackRock	380.54	61.67
Blackstone Group	27.03	15.46
Boeing	155.68	96.08
Boston Consulting Group	-	-
Cleveland Clinic	-	-
EY (formerly Ernst & Young)	-	-
General Electric	31.60	279.55
General Motors	34.84	53.20
Global Infrastructure Partners	-	-
Hoover Institution	-	-
IBM	165.99	157.83
IHS Markit	35.41	15.87
JPMorgan Chase	86.29	308.77
Patomak Global Partners	-	-
PepsiCo	104.63	150.06
Walmart	69.12	212.42
Average	109.11	135.09

TABLE 2
MEMBERS OF THE MANUFACTURING JOBS INITIATIVE

Organization	Share Price ($)	MV Equity ($ Bil.)	Resignation Date
Merck	58.87	162.31	Aug. 14, 2017
Under Armour	29.05	5.34	Aug. 14, 2017
Intel	36.27	171.88	Aug. 14, 2017
Alliance for American Mfg.	-	-	Aug. 15, 2017
AFL-CIO (two members)	-	-	Aug. 15, 2017
3M	178.57	107.40	Aug. 16, 2017
Campbell's Soup	60.47	18.57	Aug. 16, 2017
United Technologies	109.62	90.26	Aug. 16, 2017
Johnson & Johnson	115.21	313.43	Aug. 16, 2017
General Electric	31.60	279.55	Aug. 16, 2017
Dow Chemical	57.22	64.17	N/A
Harris	102.47	12.73	N/A
Dell	-	-	N/A
Nucor	59.52	18.96	N/A
Whirlpool	181.77	13.65	N/A
Ford	12.13	47.34	N/A
Lockheed Martin	249.94	73.23	N/A
Dana	18.98	2.73	N/A
Arconic	18.54	8.13	N/A
Timken	39.70	3.09	N/A
U.S. Steel	33.01	5.69	N/A
Boeing	155.68	96.08	N/A
Tesla	213.69	32.05	N/A
Caterpillar	92.74	54.26	N/A
Newell	44.65	21.54	N/A
International Paper	53.06	21.82	N/A
Corning	24.27	23.09	N/A
Average	82.38	68.64	N/A

Tables 1 and 2 are included solely to provide background on the firms on the Forum and the Initiative. Table 1 presents financial data on the population of organizations that comprised the Forum on August 12, 2017, the date of the Charlottesville march. The data are organized alphabetically by Organization. Data for the Share Price column are from December 30, 2016. The market value of equity is computed as the product of the share price and the number of outstanding shares, both as of December 30, 2016. A dash ("-") indicates that data are not available because the organization did not trade publicly. All members of the Forum resigned on August 16, 2017.

Although Walt Disney and Tesla were original members of the Forum, we exclude them because their respective CEOs, Bob Iger and Elon Musk, resigned from the Forum on June 1, 2017, to protest Trump's withdrawal from the Paris Climate Accords (Mitchell 2017). Thus, Disney and Tesla were not part of the Forum on August 12, 2017. Also, Uber CEO Travis Kalanick resigned from the Forum on February 1, 2017, citing disagreement with Trump's immigration policies and his proposed Muslim travel ban (Zeleny and Segall 2017). Thus, Uber was not part of the Forum on August 12, 2017. Also, six organizations were not publicly traded, as indicated by the missing data for Share Price and market value of equity (MV Equity). The average value of Share Price is almost $110, and the average MV Equity is slightly over $135 billion.

Table 2 presents financial data on the population of organizations that comprised the Initiative on August 12, 2017. The data are organized by Resignation Date. Data in the Resignation Date column are from Yu and Ell (2017). A value of "N/A" in that column indicates that the organization never resigned. A dash ("-") indicates that data are not available because the organization did not trade publicly. The average share price is $82.38, and the average value of MV Equity is $68.64 billion. Three firms resigned from the Initiative on August 14, 2017. Two organizations resigned from the Initiative on August 15, 2017, and five resigned on August 16, 2017. 17 organizations never resigned from the Initiative and thus remained onboard until Trump ended it on August 16, 2017.

REGRESSION ANALYSIS OF SPILLOVER ONTO RIVAL FIRMS

This section contains OLS regressions of CARs on various rival firm and industry characteristics. We present results for (1) the rivals of firms that resigned from the Initiative, (2) the rivals of firms that resigned from the Forum, and (3) the rivals of firms that remained onboard the Initiative. Due to multi-collinearity, we are not able to include Herfindahl Index in some models. Also, for reasons of multi-collinearity, we are not able to include CARs to council firms in any regressions. This situation likely suggests that little variation exists in the CARs to main firms, making the entries in that column close to a multiple of the intercept.

Although this paper focuses on spillover onto rival firms due to their large number, we briefly state the direct effects of the resign-or-remain decision on council firms to facilitate the interpretation of spillover results. Firms that remain onboard the Initiative cause cumulative abnormal returns (CARs) to shareholder value, as measured by market value of equity (MVE), of 0.85 percent, or $345 million per firm. If their rivals experience positive (negative) CARs, a contagion (competitive) effect will exist. There are no firms that remain onboard the Forum because all Forum firms resigned collectively. Regarding firms that resign from the Forum or Initiative, the resignations cause CARs to shareholders of -0.52 percent, or $570 million in MVE per firm. If their rivals experience negative (positive) CARs, contagion (competitive) effects will exist.

While the choice of resigning or remaining is endogenous to the council firms, it is exogenous to the rival firms, meaning that causality can be established. Financial statement data are from the Fundamentals Quarterly version of the CRSP-Compustat Merged Database. For each firm, we choose data for the end of the fiscal quarter closest to August 2017. To augment these data, we also hand-collect the data described below.

Rival of Firm that Resigned from Initiative (Forum) equals one if a firm is in the same industry as a firm that resigned from the Initiative (Forum). Rival of Firm that Remained onboard Initiative equals one if a firm is in the same industry as a firm that stayed on the Initiative. Also, we control for firms' CSR

ratings because CSR affects returns (Filbeck et al. 2009; Nollet et al. 2016). To that end, we use each firm's ESG Score from Bloomberg. Although (1) the ESG Score measures a firm's CSR in all three aspects and (2) CSR relates directly to the "Social" component, we use the full ESG Score because the Social Score does not exist for several firms.

We control for a firm's existence in a heavy industry or in the financial industry. Controlling for existence in either industry is important because Wagner et al. (2018) point out that Trump promised to re-invigorate heavy industry and deregulate the financial industry. Thus, investors will rationally expect firms in those Trump-backed industries to generate higher returns. Heavy Industry equals one for firms in a heavy industry, defined as SIC codes 2621, 2821, 3312, 3334, 3531, 3562, 3711, 3721, and 3724. Financial Industry equals one for firms in the financial industry, defined as existing in the SIC code 6000 range. Including these variables is also a way to control for heavy- and finance-industry fixed effects.

We control for firm size because it could affect the CSR-performance relationship. Orlitzky (2008) finds that size does not affect that relationship. However, Udayasankar (2008) finds that firm size affects investment in CSR. Size is measured as the natural logarithm of the market value of total assets, defined as the sum of the market values of total debt and total equity. In computing the market value of total assets, the market value of debt is defined as the book value of total liabilities, and the market value of total equity is the product of the number of shares outstanding and the closing share price, both as of the end of a firm's fiscal quarter immediately prior to August, 2017.

We control for profitability, defined as the natural logarithm of net income. When net income is negative, we assign a value of -5 to Ln(Net Income) because that value is lower than lowest value of Ln(Net Income) for a positive net income. Also, we control for a firm's growth opportunities via Tobin's Q, defined as the ratio of a firm's MVE to book value of equity. We segment the data set based on whether Q is greater than one. Consistent with many studies, we define firms with $Q > (\leq) 1$ as growth (value) firms.

On one hand, growth firms could be more likely than value firms to maintain political connectedness. Growth firms, which derive a large portion of their market value from growth projects (Myers and Majluf 1984), will take on those projects to maximize value. Also, managers of growth firms will realize the importance of political connections for securing current and future growth projects. On the other hand, growth firms could be less likely to maintain political connectedness if it conflicts with social justice. Since social justice is the most important aspect of CSR to consumers (Bradford et al. 2017), managers of growth firms will hesitate to offend consumers, reduce sales, and harm profitability and firm value. Consistent with the literature on spillover effects (e.g., Lang and Stulz 1992; Bradley and Yuan 2013), we control for industry concentration by controlling for an industry's Herfindahl Index. Lang and Stulz (1992) find that spillover effects can differ based on industry concentration.

Regarding firm fixed effects, we control for a firm's debt ratio and its dividend level. Debt Ratio is the ratio of total liabilities to total assets. The static-tradeoff theory of capital structure (DeAngelo and Masulis 1980) suggests that, up to and including the optimal leverage ratio, leverage is positively related to profitability. However, empirical evidence (often termed the "Microsoft Paradox") finds a negative relationship between leverage and profitability. Regarding dividends, Lintner (1956) documents their stickiness, making them a fixed effect. Ln(Dividends) is the natural logarithm of total cash dividends as of the end of a firm's fiscal quarter immediately prior to August 2017. When dividends are zero, we assign a value of -5 to Ln(Dividends) because that value is lower than lowest value of Ln(Dividends) for a positive dividend level.

TABLE 3
REGRESSIONS OF CARS TO RIVAL FIRMS

Dependent Variable: CAR	Model 1	Model 2	Model 3
	[0, 1]	[0, 1]	[0, 1]
Intercept	-2.40	-4.39	-4.21**
	(2.97)	(2.83)	(1.99)
Rival of Firm that Resigned from Initiative	-1.98**		
	(0.97)		
Rival of Firm that Resigned from Forum		1.98**	
		(0.97)	
Rival of Firm that Remained onboard Initiative			1.26**
			(0.51)
Bloomberg ESG Score	0.005	0.005	0.006
	(0.04)	(0.04)	(0.02)
Tobin's Q	0.33**	0.33**	0.24**
	(0.13)	(0.13)	(0.10)
Ln(Net Income)	-0.13	-0.13	-0.08
	(0.10)	(0.10)	(0.07)
Herfindahl Index	-0.00003	-0.00003	
	(0.00006)	(0.00006)	
Ln(Market Value of Assets)	0.22	0.22	0.22
	(0.22)	(0.22)	(0.15)
Debt Ratio	0.007	0.007	0.007
	(0.01)	(0.01)	(0.01)
Ln(Dividends)	0.05	0.05	-0.01
Heavy Industry	(0.11)	(0.11)	(0.06)
Financial Industry	-1.94[a]	-1.94*	-0.27
	(1.18)	(1.18)	(0.58)
N	126	126	215
R^2	0.125	0.125	0.095

Note: Standard errors are in parentheses. The superscript "a" indicates significance at the 10.2-percent level.

Table 3 shows the results of OLS regressions of the CARs to rival firms on various characteristics. The coefficient of Rival of Firm that Resigned from Initiative in Model 1 indicates that those rival firms incur CARs that are lower by 1.98 percentage points. Based on an average MVE of $3 billion for those rival firms, shareholders lose $59.4 million. Since, as stated above, the firms that resigned from the Initiative experienced negative CARs, the finding of negative CARs to rival firms is evidence of spillover contagion (Lang and Stulz 1992). Also, a unit increase in Tobin's Q causes shareholder value to increase by 0.33 percentage points. In addition, firms in the financial industry incur returns that are lower by 1.94 percentage points. In Model 3, the coefficient of Rival of Firm that Remained onboard Initiative indicates that those rivals experience CARs that are higher by 1.26 percentage points. Based on an average MVE of $3.1 billion for those rivals, shareholders gain $39 million. Since the firms that remained on the Initiative experience positive CARs, the positive CARs to rival firms indicate spillover contagion (Lang and Stulz 1992).

The coefficient of Rival of Firm that Resigned from Forum in Model 2 indicates that shareholder value increases by 1.98 percentage points upon the decision of a main firm to resign from the Forum. Based on an average MVE of $9 billion for those rival firms, shareholders gain almost $180 million. Since the firms that resigned from the Forum experienced negative CARs, the positive CARs to the rival firms indicate competitive effects of spillover (Lang and Stulz 1992). The explanation for this result lies in the mission of the Forum. Unlike the Initiative, whose mission was to create manufacturing jobs, the mission of the Forum was more strategic – to advise Trump on policy. While the members of the Forum would certainly seek

favorable policies for their industries, they likely sought favorable policies and projects for their firms first. Thus, upon a Forum member's resignation, shareholders of that firm's rivals may have expected (1) Trump to appoint a substitute firm to the Forum and (2) that substitute firm to pursue policies that benefit it first and its industry second. This idea is consistent with Grossman and Hart (1986) and Rajan and Zingales (1998), who imply that political connections can enhance firm value through the creation of policies that favor the connected firm.

We would like to point out that the coefficients in Model 2 are similar to those in Model 1. This similarity also holds when running Models 1 and 2 over different CAR intervals. This situation likely exists because the Forum and the Initiative include many firms from the same or similar industries. For that reason, the rival firms that experienced negative CARs in Model 1 due to contagion effects (Lang and Stulz 1992) experienced the same magnitude of positive CARs in Model 2 due to competitive effects (Lang and Stulz 1992).

ROBUSTNESS TESTS

TABLE 4
ROBUSTNESS TEST AGAINST BLOOMBERG ESG SCORE

Dependent Variable: CAR	Model 1	Model 2	Model 3
	[0, 1]	[0, 1]	[0, 1]
Intercept	-0.66	-0.92	-1.87
	(2.55)	(2.43)	(1.74)
Rival of Firm that Resigned from Initiative	-1.13		
	(0.94)		
Rival of Firm that Resigned from Forum		1.36	
		(0.92)	
Rival of Firm that Remained from Initiative			1.63***
			(0.53)
Ln(Market Value of Assets)	0.04	-0.09	0.03
	(0.17)	(0.18)	(0.13)
Ln(Net Income)	-0.01	0.02	-0.01
	(0.10)	(0.10)	(0.07)
Tobin's Q		0.33**	0.22**
		(0.13)	(0.11)
High Bloomberg ESG Score	1.18	1.24	0.45
	(0.86)	(0.84)	(0.63)
Herfindahl Index	-0.00002	-0.00003	
	(0.0007)	(0.0001)	
Debt Ratio	0.002	0.01	0.004
	(0.01)	(0.01)	(0.01)
Ln(Dividends)	0.04	0.10	0.02
	(0.10)	(0.10)	(0.06)
Heavy Industry	-1.65	-1.45	-0.04
	(1.56)	(1.54)	(0.68)
Financial Industry	-1.43	-1.54	-0.13
	(1.17)	(1.15)	(0.59)
N	153	153	249
R^2	0.044	0.086	0.072

Note: Standard errors are in parentheses.

Table 4 shows the results of a robustness test against low versus high levels of CSR. We define low-CSR (high-CSR) firms as having a CSR rating less than or equal to (above) the median rating. Lins et al. (2017) find that high-CSR firms are associated with higher returns than low-CSR firms. Thus, the CSR ratings of the rival firms could overturn the main findings of this paper. Specifically, high CSR ratings for the rivals of resigning firms could overturn the earlier findings of lower returns to those rival firms. Likewise, low CSR ratings for the rivals of remaining firms could overturn the earlier findings of higher returns to those rival firms.

To conduct this robustness test, we introduce the variable High Bloomberg ESG Score into the regressions but exclude the continuous variable Bloomberg ESG Score due to multicollinearity. High Bloomberg ESG equals one if a firm's ESG score exceeds the mean. Those results are shown in the robustness test table. Although now shown, the results are qualitatively similar if we segment the sample into high- versus low-ESG firms and run the regression model above (excluding High Bloomberg ESG Score since the sample has been split based on that variable). Table 4 shows that only the spillover contagion found for rivals of firms that remained onboard the Initiative is robust to a high level of CSR.

TABLE 5
ROBUSTNESS TEST AGAINST MEAN ANALYST RECOMMENDATION

Dependent Variable: CAR	Model 1	Model 2	Model 3
	[0, 1]	[0, 1]	[0, 1]
Intercept	0.30	1.01	-0.90
	(2.60)	(2.68)	(1.91)
Rival of Firm that Resigned from Initiative	-0.15		
	(0.76)		
Rival of Firm that Resigned from Forum		0.84	
		(0.88)	
Rival of Firm that Remained from Forum			1.02**
			(0.49)
Ln(Market Value of Assets)	0.04	-0.02	0.10
	(0.18)	(0.18)	(0.13)
Ln(Net Income)	0.05	0.04	0.01
	(0.09)	(0.09)	(0.06)
Tobin's Q	0.20*	0.20*	0.14
	(0.11)	(0.11)	(0.09)
Mean Analyst Rec.	-0.39	-0.35	-0.26
	(0.46)	(0.46)	(0.31)
Debt Ratio	-0.004	(0.01)	-0.004
	(0.01)	(0.01)	(0.01)
Ln(Dividends)	-0.004	0.04	-0.015
	(0.09)	(0.09)	(0.06)
Heavy Industry	0.03	-0.74	0.47
	(1.35)	(1.43)	(0.59)
Financial Industry		-1.65	-0.61
		(1.06)	(0.54)
Herfindahl Index	-0.00002	-0.00002	
	(0.0001)	(0.0001)	
N	131	131	215
R^2	0.045	0.064	0.091

Note: Standard errors are in parentheses.

Table 5 shows the results of a robustness test based on a rival firm's mean analyst recommendation (Mean Analyst Recommendation) from the Institutional Brokers' Estimate System (I/B/E/S). Mean Analyst Recommendation is the average of analysts' recommendations, where an analyst ranks a security from one to five, respectively, to indicate the following ratings: strong buy, buy, hold, underperform, and sell. Thus, the closer Mean Analyst Recommendation is to one, the more bullish the analyst is on the stock. Values of Mean Analyst Recommendation that are close to one could weaken or overturn the negative CARs to all rivals of resigning firms and the rivals of firms that resigned from the Initiative. Also, values of Mean Analyst Recommendation that are close to five could weaken or overturn the positive CARs to the rivals of firms that resigned from the Forum and the rivals of firms that stayed on the Initiative. As with Table 4, Table 5 shows that only the spillover contagion found for rivals of firms that remained onboard the Initiative is robust to the mean analyst recommendation.

CONCLUSION

We examine whether a firm's choice of investing in political connectedness or CSR spills over onto its rivals. To do so, we use the uncontaminated rivals of the uncontaminated firms that resigned from or remained onboard the Manufacturing Jobs Initiative or the Strategic and Policy Forum after President Trump's surprising reaction to a supremacist march in Charlottesville, Virginia. This paper does not argue for approval or disapproval of Trump. Rather, the paper uses a surprise event related to Trump to measure financial spillover to rival firms when a given firm in an industry preserves or severs its political connection to him.

Since it is impossible to know a CEO's true motives behind his or her decision, we take the position that the CEOs acted in the best interest of shareholders. Under this view, the CEOs who remained onboard (resigned from) a council believed that investing in political connectedness (in CSR) would maximize shareholder value. Typically, the choice between political connectedness and CSR is not mutually exclusive. In this situation, however, the choice is mutually exclusive because Trump has a tendency to reward loyalty but punish disloyalty. Thus, investing in political connectedness with Trump can be viewed as showing loyalty to him while investing in CSR can be viewed as being disloyal. We measure the cumulative abnormal returns to the rival firms from the council firms' decisions to resign from or remain onboard the Forum or the Initiative. Importantly, the council firms' decisions are exogenous to the rival firms, allowing for causality of spillover to be assessed.

This paper generally finds positive (negative) spillovers to rival firms when council firms invest in political connectedness with Trump (invest in CSR). This result suggests that, on average, entire industries benefit (incur costs) when one of their members maintains (severs) a top political connection. Also, the result suggests that, when CEOs face a mutually exclusive choice, they should carefully consider each situation and weigh the relative value effects of keeping a political connection or investing in CSR. While this paper finds that political connectedness is more beneficial to shareholders, CSR could be more beneficial at other times, consistent with Jensen (2002). Since this paper uses only the Charlottesville event, and since most situations do not present a mutually-exclusive choice between political connectedness and CSR, this paper does not provide insights into the conditions under which shareholders would prefer political connectedness or CSR or would be indifferent. To do so, a data set of several events similar to Charlottesville would need to be assembled, and the characteristics of the events would need to be controlled for. This area is fruitful for future research.

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