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Sudipto Dasgupta
The Chinese University of Hong Kong, ABFER, CEPR, and ECGI

Ran Guo
China-ASEAN Institute of Financial Cooperation, Guangxi University,

Xiao Ren
Shenzhen Finance Institute, Chinese University of Hong Kong, Shenzhen,

Tao Shu
Shenzhen Finance Institute, Chinese University of Hong Kong, Shenzhen

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Abstract

We find that similarity of political views between the CEO and independent directors ("political homophily") encourages the CEO to share adverse information with the board. Firms with higher political homophily have lower stock price crash risk, and are more likely to divest previously acquired assets with poor performance. Furthermore, the effect of political homophily is complemented by strong shareholder governance which prevents friendly board from insulating the CEO in the case of ex post negative outcomes. Our identification utilizes the exogenous variation in political beliefs associated with the entry of a conservative television network in local markets. Our findings show that a friendly board facilitates CEO-board communication which is crucial for the board to function effectively in its advisory role.

Keywords: friendly board, CEO-board communication, political homophily, crash risk, corporate governance

JEL Classifications: D72, G32, G34, G41, M12, M14

Sudipto Dasgupta
Professor
Chinese University of Hong Kong, Department of Finance
12 Chak Cheung Street,
Shatin, N.T.,, Hong Kong
phone: + (852) 39431913
e-mail: s.dasgupta@cuhk.edu.hk

Ran Guo
China-ASEAN Institute of Financial Cooperation,
East Daxue Road #100
Nanning, Guangxi 530004, China
e-mail: rguo@thecaifc.cn

Xiao Ren*
Assistant Professor
Chinese University of Hong Kong, Shenzhen,
School of Management and Economics
2001 Longxiang Road
Shenzhen, China
e-mail: renxiao@cuhk.edu.cn

Tao Shu
Chinese University of Hong Kong, Shenzhen,
School of Management and Economics
2002 Longxiang Road
Shenzhen, China
e-mail: shutao@cuhk.edu.cn

*Corresponding Author

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Sudipto Dasgupta
Chinese University of Hong Kong
ABFER, CEPR, and ECGI
s.dasgupta@cuhk.edu.hk

Ran Guo
China-ASEAN Institute of Financial Cooperation
Guangxi University
rguo@thecaifc.cn

Xiao Ren
School of Management and Economics
Shenzhen Finance Institute
Chinese University of Hong Kong, Shenzhen
renxiao@cuhk.edu.cn

Tao Shu
School of Management and Economics
Shenzhen Finance Institute
Chinese University of Hong Kong, Shenzhen
shutao@cuhk.edu.cn

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Similarity Breeds Trust: Political Homophily and CEO-Board Communication

Abstract

We find that similarity of political views between the CEO and independent directors ("political homophily") encourages the CEO to share adverse information with the board. Firms with higher political homophily have lower stock price crash risk, and are more likely to divest previously acquired assets with poor performance. Furthermore, the effect of political homophily is complemented by strong shareholder governance which prevents friendly board from insulating the CEO in the case of *ex post* negative outcomes. Our identification utilizes the exogenous variation in political beliefs associated with the entry of a conservative television network in local markets. Our findings show that a friendly board facilitates CEO-board communication which is crucial for the board to function effectively in its advisory role.

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The willingness of a privately informed CEO to share adverse information with the corporate board has major implication for shareholder value. The common adage about "a stitch in time" applies for corporate decision making: timely corrective actions are likely to limit future losses. When a CEO has private information that an existing project is value-destroying and would likely lead to a large loss to the company, she needs to decide whether to take a chance (e.g., wait for improved external environment or explore opportunities elsewhere by "jumping a sinking ship") or take corrective actions. The latter choice can reduce the likelihood of a large loss and stock price crash risk, but for corrective actions to happen, the CEO typically needs to inform the board, and sometimes seek its approval (for example, for major corporate decisions such as divesting loss-making assets). An important constraint is that revealing adverse information to the board may reflect negatively on the CEO's own past performance and credibility with the board.[1] Not much is known, however, as to what may overcome this constraint and facilitate the sharing of negative information.

In this paper, we study the role of a "friendly board" in facilitating the CEO's communication of negative information with the board. Our approach is motivated by the recent literature on sociology and politics suggesting that similar political views promote homophily, i.e., trust and bonding among individuals.[2] To this end, we examine if the more congruent political ideologies of the CEO and the independent directors facilitate the sharing of information, especially adverse information, and in turn reduce the later incidence of significant adverse outcomes and crash risk.

Our research question is closely related to, but distinct from, the theoretical arguments

[1] Boot (1992) proposes a model that builds on the idea that managers of low ability may not divest underperforming assets because of the reputational costs.

[2] See, for example, McPherson, Smith-Lovin, and Cook (2001), Huber and Malhotra (2017), and Banda, Carsey and Severenchuk (2020). Section 1 discusses the details of these findings.

about a friendly board. For example, in Adams and Ferreira's (2007) model, a friendly board provides the advisory benefit from sharing information while refraining from monitoring the CEO more intensively or limiting her private benefits.[3] Our research question complements the existing literature on both the advisory and the monitoring roles of a friendly board. Regarding the advisory role, while our hypothesis also assumes a smooth communication between the CEO and the friendly board, we do not require the board to necessarily "advise" the CEO on the shared negative information. Regarding the monitoring role, our hypothesis also assumes less strict monitoring (and more trust) by the friendly board. Such leniency becomes beneficial when the CEO needs to take corrective actions. Nonetheless, since our setting is subsumed in the broader notion of board friendliness and provides important evidence on its key tenets, we refer to a board that has a high degree of political homophily with the CEO as a "friendly board" throughout this paper.

Our sample consists of 20,354 firm-years between 1999 and 2019. Each firm-year has an average of 7.4 independent directors. We construct a measure of CEO-board political homophily, *Political Homophily Index* (henceforth *PHI*), based on political contributions made by the CEO and independent directors to political committees/candidates during the previous election cycle. Using such contributions as a "revealed preference" measure of an individual's political orientation, *PHI* captures, in the U.S. bipartisan setup, the extent to which the CEO and the "average" independent director of a firm have similar political views.[4]

We first examine the relationship between *PHI* and the firm's stock price crash risk. If political homophily facilitates the CEO's sharing of negative information and therefore helps

[3] In Adams and Ferreira (2007), the board's monitoring intensity is a function of its monitoring cost, which could be determined by board composition (e.g., the degree of board independence). The key result is that there could be an (interior) optimal degree of board independence which balances the monitoring and advisory roles.
[4] The similarity measure is the Euclidean distance between the political orientation of the CEO and the average political orientation of independent directors.

address the firm's problems in a timely manner, then high *PHI* firms will have a lower likelihood of a large unexpected loss and a lower stock price crash risk. We follow the literature and construct two measures of a firm's stock price crash risk: one-year ahead negative skewness, and asymmetric (down-to-up) volatility of daily stock returns (e.g., Chen, Hong, and Stein, 2001; Kim, Li, and Zhang, 2011a, 2011b; Callen and Fang, 2015; Xu, Xuan, and Zheng 2021).

To test our hypothesis, we estimate the panel regressions of crash risk measures on *PHI* which control for a broad set of firm level characteristics. Consistent with our prediction, we find that the coefficient of *PHI* is negative and statistically significant at the 1% level in the regressions of both crash risk measures. For robustness, we follow the literature and construct four alternative measures of political homophily based on alternative measurement windows or alternative selections of contributions, and our regression results remain very similar using these alternative measures. These results indicate that, consistent with friendly board facilitating CEO-board communication of negative information, political homophily is negatively associated with future stock price crash risk.

We acknowledge that the reverse causality or omitted variables might drive the observed negative relationship between a firm's political homophily and stock price crash risk. For example, firms with lower crash risk might affect board homophily via endogenous changes in board composition. To address the endogeneity concerns, we utilize the exogenous variation in political beliefs associated with the entry of the Sinclair Broadcast Group, the largest U.S. local television station operator, into different U.S. regions. Starting in the 1980s, Sinclair has expanded mostly via acquisitions of local television stations across the states. Sinclair has a strong conservative orientation, and it often broadcasts news that is in favor of and favored by the Republicans (Martin and McCrain, 2019).

Consistent with the literature that people's political views can be significantly affected by public media and propaganda (e.g., DellaVigna and Kaplan, 2007; Durante, Pinotti and Tesei, 2019), we find evidence that Sinclair's entry into a county significantly shifts the local directors' political leaning towards the Republican party.[5] To capture this issue, we construct an instrumented *PHI* measure, *PHISinclair*, using individual directors' predicted contributions subsequent to Sinclair acquisitions. The observed significantly negative relationship between political homophily and future crash risk remains robust when we use *PHISinclair* as the independent variable. In all our regressions we also include the independent directors' predicted political orientation subsequent to Sinclair's entry as a control variable. This variable is either insignificant or has an opposite sign to *PHISinclair*, suggesting that our results are driven by greater political homophily rather than a stronger Republican orientation of the board.[6]

To investigate the channels through which the CEO-Board political homophily reduces crash risk, we conduct two analyses to test if political homophily promotes information sharing and corrective actions. Our test of information sharing is motivated by Ravina and Sapienza's (2010) finding that the insider purchases by independent directors earn positive abnormal returns but such returns are lower relative to executives' insider purchases. This suggests that executives possess more private information than independent directors. We find that when there is higher political homophily, independent directors' insider purchases become more profitable, and the performance gap with the executives' insider purchases narrows. This result is consistent with the

[5] In contrast, the Sinclair entry does not have a significant impact on CEOs' political leaning. This is the possibly due to the fact that CEOs are ex ante already much more Republican-oriented than the directors, and that CEO overconfidence (e.g., Malmendier and Tate, 2005, 2008) makes CEOs update their beliefs to a lesser degree than directors in response to media.

[6] An alternative explanation of the observed negative relationship between *PHI* and crash risk is that greater political homophily helps CEO resist shareholder pressure for pursuing risky strategies and the CEO is able to take less risk. Inconsistent with this explanation, we find that higher political homophily does not lead to a lower level of risk taking.

premise that political homophily encourages CEOs to share more private information with directors.

To test for corrective actions, we examine divestitures of previously acquired assets with poor performance. We follow the literature and use firms' acquisition announcement returns to measure performance, and find that acquired assets with poor performance are more likely to be divested subsequently when political homophily is higher. This result is consistent with the premise that political homophily increases managers' incentives to take corrective actions and avoid further losses.

Finally, we examine shareholder governance because the positive effect of a friendly board on CEO-board communication may rely on strong shareholder governance. When shareholder governance is weak, the CEO will be reasonably assured that she would enjoy downside protection from a friendly board even if negative outcomes occurred from an absence of timely action on her part. In such a scenario, homophily needs not lead to more information sharing. However, when shareholder governance is strong and external pressure is high, even a friendly board will not be able to protect the CEO's job upon a large loss. Therefore, we expect that strong external governance, and in particular, strong shareholder governance, is essential for a friendly board to facilitate the communication of negative information. In this case, the friendly board acts as a complement to shareholder governance.

We follow the literature and construct two commonly used indicators of shareholder governance – ownership by institutional investors (e.g., Denis, Denis, and Sarin, 1997; Harford, Jenter, and Li, 2011), and the E-Index (Bebchuk, Ferrell, and Cohen, 2009). We first show that, consistent with Lee, Lee, and Nagarajan (2014), for our overall sample, the negative relationship between CEO turnover and past performance is absent when political homophily is high, which is

consistent with a friendly board offering downside protection to the CEO. However, we find that this downside protection effect only holds in subsamples where shareholder governance is weak. Homophily has no weakening effect on turnover-performance sensitivity when shareholder governance is strong.

We further examine the interactive effect of PHI and shareholder governance on stock price crash risk. We find that the negative relationship between political homophily and stock price crash risk is concentrated in the subsamples where shareholder governance is strong but disappears in the subsamples where shareholder governance is weak. This result, together with the results on CEO turnovers, suggest that the effect of a friendly board on CEO-board communication relies on strong shareholder governance.

We make several contributions to the literature. First, while existing literature has investigated the dual monitoring and advisory roles of boards, there is limited evidence on which board attributes encourage more information sharing by the CEO. With the exception of Adams (2010), who provides survey evidence that independent directors receive less strategic information from the management when they monitor more intensively, we are not aware of any paper that directly examines the key idea that by committing to less intensive monitoring, a friendly board can encourage more information sharing. Under the presumption that political homophily promotes more trust and tolerance of negative outcomes (at least as long as they are brought promptly to the board's attention), our results provide evidence on this very important aspect of the theory.

Second, in tandem with Lee, Lee, and Nagarajan (2014), who document that political homophily between the CEO and the board weakens the board's monitoring role, we show that political homophily encompasses both the features of the friendly board theory – monitoring and

information sharing. While we do not explicitly consider the board's advisory role, we suggest a new benefit of sharing negative information – the ability to take timely actions to avert even worse consequences in the future. Further, our results suggest that when the CEO is considering revealing negative information to the board – be it for the board's advice or just to seek the board's support for timely, corrective actions – the homophily measure may have some advantage over other measures, such as social connections between the CEO and members for the board. This is because when the information is negative, the CEO must trust the entire board not to take actions against herself. However, Schmidt (2015) reports that only 4% of board members, on average, are connected to the CEO via social ties, and another 4% via employment ties. Such weak ties may not provide the CEO with the tolerance she needs.

Furthermore, we show that shareholder governance can complement the role played by a friendly board. When the board is friendly, stronger shareholder governance encourages timely information sharing with the board. It is noteworthy that in the theory of friendly boards (Adams and Ferreira, 2007), there is no presumption that a friendlier board would necessarily increase or decrease firm value. This follows because, to the extent that there is an interior optimum level of board independence, a friendlier board could affect firm value in either direction. Lee, Lee, and Nagarajan (2014) find that more homophily lowers Tobin's Q. We find that while this negative relationship holds for the overall sample, it is only observed for subsamples with weaker shareholder governance. However, there is no such association for the subsample of stronger shareholder governance.

1. Related Literature

1.1 Friendly boards

Our paper relates to the literature on friendly boards. In the theoretical model proposed by Adams and Ferreira (2007), the CEO faces a trade-off when she decides whether or not to disclose private information to the board. If the CEO shares information with the board, she will be able to gain better advice. However, sharing private information imposes costs to the CEO as a more informed board would monitor the CEO more intensively. Holmstrom (2005), Raheja (2005), and Harris and Raviv (2008) also provide models suggesting that the presence of independent directors may affect the advising role of the board.

Faleye, Hoitash, and Hoitash (2011) highlight the trade-offs between independent directors' monitoring and advising roles, and show that when a majority of independent directors sit on two or three important monitoring committees, the quality of monitoring improves at the expense of advising, and firm value deteriorates. The authors argue that when the board monitors more intensively, it receives less strategic information. Schmidt (2015) examines social connections between the CEO and board members and finds that for acquirer firms with severe agency problems, the social ties are associated with worse acquirer returns, suggesting weaker monitoring. Conversely, for acquirer firms where the board's advisory role is more important, the social ties are associated with higher acquirer returns. Kang, Liu, Low, and Zhang (2018) also measure board friendliness using CEO-director social ties and find that firms with friendly boards tend to produce more patents and receive more citations, especially when firms' advisory needs are higher.

Lee, Lee, and Nagarajan (2014) find that political homophily between the CEO and independent directors leads to lower operating profitability and lower firm value. Additionally, political homophily is associated with lower CEO's turnover-performance sensitivity, suggesting

that friendly boards tolerate poor performance of CEOs. Their findings are consistent with weaker monitoring by friendlier boards.

1.2 Political homophily and friendliness

In the social science literature, homophily is well researched. The homophily principle proposed by McPherson, Smith-Lovin, and Cook (2001) states that people's personal networks are homogeneous with regard to many sociodemographic, behavioral, and intrapersonal characteristics. In contrast, ties between non-similar individuals dissolve at a higher rate than those between similar individuals. Earlier research has convincingly demonstrated the beneficial effect of social identification on cooperation (e.g., Edney, 1980; De Cremer and Van Vugt, 1999).

It is widely believed that political orientation has important effects on the formation of social ties. In a nationwide randomized experiment, Huber and Malhotra (2017) find that people evaluate potential dating partners more favorably if these partners have political views similar to their own. The effect of political orientation is as large as other major personal characteristics such as education and race. Banda, Carsey, and Severenchuk (2020) conduct survey experiments and show that people evaluate objects linked to the opposing party less favorably than otherwise identical non-partisan objects. Moreover, partisan bias influences evaluations of people as much as evaluations of inanimate objects. They suggest that political orientation has a similar impact on people's social interactions as other fundamental attributes like gender, race, and religion.

Political homophily can potentially facilitate information exchange as previous studies find that interpersonal similarity plays an important role in facilitating human communication. For example, Rogers and Bhowmik (1970) show that communication between two parties is more effective when they are more similar to each other. Mccroskey, Richmond, and Daly (1975) also

find that opinion leaders are perceived by the audience as more homophilous on the dimensions of attitude, morality, and background.

1.3 Time-varying political orientation of individuals

Our identification strategy for political homophily (i.e., Sinclair acquisitions) relies on the assumption that an individual's political view can be time-varying. While early political science literature commonly holds the static view that an individual's political orientation is largely time-invariant, more recent literature shows that partisanship is a running tally of party utilities that is updated continuously according to parties' positions on different issues and personal evaluations of party performances (e.g., Berry, Ringquist, Fording, and Hanson, 1998; Bonica, 2014).

People's political views can be significantly affected by public media programs and propaganda. For example, DellaVigna and Kaplan (2007) find that Republicans gained support in the towns that broadcast Fox News. Durante, Pinotti, and Tesei (2019) show that Italian individuals with early access to Berlusconi's private TV network were more likely to vote for Berlusconi's party when he first ran for office. The effect persists for five elections and is driven by heavy TV viewers. Similarly, Wang (2020) find that districts exposed to anti-FDR broadcast experienced a significant decrease in FDR's votes in the 1936 presidential election. Recent studies also find that access to broadband internet and more media choices contribute to the increased political polarization in the past decades (e.g., Prior, 2007; Lelkes, Sood, and Iyengar, 2017). Motivated by this literature, we exploit the shocks to political media exposure introduced by the staggered expansions of Sinclair Broadcast Group (Sinclair) into the U.S states through acquiring local TV stations.

2. Sample and Measure Constructions

2.1 Construction of the Political Homophily Index

We obtain the data on CEOs from the Execucomp database and the data on independent directors from BoardEx. Our baseline sample includes the firms that are covered by both the Execucomp and the BoardEx databases and have all the regression variables available. The sample consists of 20,354 firm-years between 1999 and 2019, and each firm-year has an average of 7.4 independent directors.

Following standard practice in the literature (e.g., Hong and Kostovetsky, 2012; Di Giuli and Kostovetsky, 2014; Hutton, Jiang, and Kumar, 2014, 2015; Lee, Lee, and Nagarajan, 2014), we collect the individual campaign donation data from the website of the Federal Election Commission (FEC) to measure the political leanings of the directors and CEOs. The FEC individual contributions file contains information about each contribution made by an individual to a political committee/candidate, which is disclosed by the recipient of the contribution under the requirement of federal law.[7] Our sample includes contributions made to candidate committees, party committees, as well as hybrid PACs and super PACs with partisan affiliations. The party affiliations of candidates and party committees are obtained from the committee master file provided by the FEC. For the hybrid PACs and super PACs which have more than 1,000 transaction records, we manually search for the political orientations of the PACs using OpenSecrets.org and Google.com. For each individual donation, we obtain the date of donation, the dollar amount, the employer of the donor, and the party affiliation of the recipient. We then match the donation records to the CEOs from Execucomp and directors from BoardEx by names and employers.

[7] Note that not all individual donations are subject to mandatory disclosure. In 1989-2014, a contribution was required to reported if the reporting period amount is $200 or more. After 2014, a contribution is required to be reported if the person's total donation to-date during the current election cycle is over $200. for a candidate or if the total calendar year-to-date donation is over $200 for political action committees (PACs) and party committees. We include only the donations subject to mandatory disclosure in the sample to avoid potential selection bias of voluntary disclosure.

Following the literature (e.g., Hong and Kostovetsky, 2012; Hutton, Jiang, and Kumar, 2014, 2015), we first calculate each CEO/director's Republican index, *Rep*, using the following equation:

$$Rep_{p,t} = \frac{R_{p,t} - D_{p,t}}{R_{p,t} + D_{p,t}}, \quad (1)$$

where $R_{p,t}$ ($D_{p,t}$) denotes the total dollar amount of donations made by individual *p* to Republican (Democratic) recipients in the election cycle preceding year *t*. *Rep* therefore captures the time-varying political leaning of the CEOs and directors, with a higher value of *Rep* indicating that the individual is more Republican-oriented. We then calculate the CEO-board political homophily index, *PHI*, for each firm-year using the following equation:

$$PHI_{i,t} = 1 - \frac{|RepCEO_{i,t} - RepIndep_{i,t}|}{2}, \quad (2)$$

where $RepCEO_{i,t}$ is the Republican index of the CEO of firm *i* in year *t*. $RepIndep_{i,t}$ is the equal-weighted average Republican index of the independent directors of firm *i* in year *t*. By construction, *PHI* is bounded between zero and one. A higher *PHI* indicates that the CEO and independent directors of the firm are more politically aligned.

2.2 Construction of the Crash Risk Measures

We construct two measures for crash risk, namely, negative coefficient of skewness and down-to-up volatility, following the literature (e.g., Chen, Hong, and Stein, 2001; Xu, Xuan, and Zheng, 2021). We first estimate firm-specific daily returns for each firm-year using the following regression:

$$r_{i,d} = \alpha + \beta_1 r_{m,d-2} + \beta_2 r_{m,d-1} + \beta_3 r_{m,d} + \beta_4 r_{m,d+1} + \beta_5 r_{m,d+2} + \epsilon_{i,d}, \quad (3)$$

where $r_{i,d}$ is the return of stock i on day d, and $r_{m,d}$ is the return of the CRSP value-weighted market index on day d. The firm-specific daily returns, denoted by $R_{i,d}$, is calculated as the natural logarithm of one plus the residual return in Equation (3).

The first measure, negative coefficient of skewness (*NCSKEW*), is calculated for each firm-year as the opposite number of the third moment of the firm-specific daily returns divided by the standard deviation of the firm-specific daily returns raised to the third power:

$$NCSKEW_{i,t} = -\left[n(n-1)^{\frac{3}{2}}\sum R_{i,d}^3\right] / \left[(n-1)(n-2)(\sum R_{i,d}^2)^{\frac{3}{2}}\right], \quad (4)$$

The second measure, down-to-up volatility (*DUVOL*), is calculated as follows:

$$DUVOL_{i,t} = log\{\left[(n_u - 1)\sum_{DOWN} R_{i,d}^2\right] / \left[(n_d - 1)\sum_{UP} R_{i,d}^2\right]\}, \quad (5)$$

where "DOWN" ("UP") indicates the days when the firm-specific returns are below (above) the mean of year t. n_u (n_d) is the number of up (down) days of firm i in year t. Higher values of these two measures indicate greater crash risks.

2.3 Summary Statistics

Table 1 presents the summary statistics of the measures for our sample firms. The dependent variable, *NCSKEW*, has a mean of 0.05 and a standard deviation of 1.71. *DUVOL* has a mean of -0.03 and a standard deviation of 0.36. The average CEO Republican orientation (*RepCEO*) is 0.14, whereas the average independent director Republican orientation (*RepIndep*) is 0.02, indicating that the CEOs are on average more Republican-orientated than the directors. The independent variable of interest, *PHI*, has a mean of 0.81 and a standard deviation of 0.21.

We also construct a number of firm characteristics as control variables following the prior literature (e.g., Chen, Hong, and Stein, 2001; Kim, Li, and Zhang, 2011a, 2011b; Callen and Fang, 2015; Xu, Xuan, and Zheng, 2021). These variables include firm-specific stock return volatility in year t (*Sigma*), the cumulative firm-specific daily returns in year t (*Ret*), the average monthly share

turnover in year *t* minus the average monthly share turnover in year *t-1* (*Dturn*), market-to-book ratio (*MB*), book leverage (*Lev*), return on assets (*ROA*), the natural logarithm of market value (*LnMV*), and discretionary accruals (*DA*). We also control for the natural logarithm of board size (*LnBoardSize*) and the percentage of a firm's directors who are socially connected to the CEO (*Connection*). Following Dasgupta, Zhang, and Zhu (2015), we define a director as connected to a CEO if (1) the director and the CEO studied at the same institution during an overlapping period, or (2) they worked for the same firm (other than the focal firm) at least five years before they started working for the focal firm. Table 1 also presents the summary statistics of these control variables.

3. Empirical Results

3.1 Political Homophily and Crash Risk

As discussed in the previous section, if political homophily facilitates the CEO's sharing of negative private information with the board, then we expect the political homophily to be associated with lower future crash risk. In this section, we test this hypothesis by first estimating the baseline panel regressions and then using Sinclair acquisitions to address endogeneity.

3.1.1 Panel Regressions of Crash Risk on Political Homophily

To examine the relationship between crash risk and political homophily, we estimate the following panel regression:

$$Crash\_Risk_{i,t} = \alpha + \beta_1 PHI_{i,t-1} + \sum_k \beta_k Controls^k_{i,t-1} + \varphi_i + \eta_t + \epsilon_{i,t}, \qquad (6)$$

where $Crash\_Risk_{i,t}$ is the crash risk of firm *i* in year *t*, measured by negative coefficient of skewness ($NCSKEW_{i,t}$) or down-to-up volatility ($DUVOL_{i,t}$). $PHI_{i,t-1}$ is the political homophily index of firm *i* in year *t-1*. $Controls_{i,t-1}$ is a set of control variables which include $RepIndep_{i,t-1}$, $Sigma_{i,t-1}$, $Ret_{i,t-1}$, $Dturn_{i,t-1}$, $MB_{i,t-1}$, $ROA_{i,t-1}$, $LnMV_{i,t-1}$, $DA_{i,t-1}$, $LnBoardSize_{i,t-1}$, and $Connection_{i,t-1}$.

For the ease of interpretation, we standardize the crash risk variables ($NCSKEW_{i,t}$ and $DUVOL_{i,t}$) and political orientation variables ($PHI_{i,t-1}$ and $RepIndep_{i,t-1}$) by scaling the variables by their sample standard deviation and subtracting the sample mean. We include firm and year fixed effects in the regressions and cluster standard errors by firm.

The results are presented in Table 2. Columns (1) and (2) report the regressions using $NCSKEW_{i,t}$ and $DUVOL_{i,t}$ as the dependent variables, respectively. As can be seen, the coefficient on $PHI_{i,t-1}$ is negative and statistically significant at the 1% level in both specifications. In terms of economic magnitude, the coefficient estimate implies that a one standard deviation increase in *PHI* is associated with a 2.9% standard deviation decrease in both *NCSKEW* and *DUVOL*. We stress the directional results rather than the economic magnitude because the latter depends not only on by how much political homophily affects information sharing but also the rate of arrival of adverse information and how not acting on that information subsequently affects stock returns. Even when adverse information arrives infrequently, not talking timely actions on the basis of that information can have major consequences for shareholders. Taken together, the results presented in Table 2 indicate that, consistent with our prediction, political homophily is negatively associated with future stock price crash risk.

3.1.2 Robustness Tests

We follow Lee, Lee, and Nagarajan (2014) and conduct robustness checks using alternative measures of *PHI* based on different assumptions on individuals' political leanings. Specifically, *PHI (Time-invariant)* is the political homophily index constructed using the individuals' Republican index based on their total amount of contribution up to the year 2019 (rather than the previous political cycle).[8] The second alternative measure is *PHI (Prior)*. To construct this

[8] This time-invariant measure of *PHI* can reduce the measurement error of political orientation in election cycles, but has the forward-looking problem.

measure, we first calculate the Republican index for each individual *p* in year *t* using her historical contribution made before year *t*, and then aggregate it at the firm level. *PHI (Strong)* is the political homophily index constructed using the Republican index of the individuals whose contribution to one party net of her contribution to the other party exceeds $2,000 in an election cycle. This measure is constructed following Hong and Kostovetsky (2012) and captures the political views of only those individuals who have strong bipartisanship. *PHI (Large)* is the political homophily index constructed using the Republican index of the individuals whose historical total amount of contribution exceeds $2,000. This measure reduces the noise induced by small donors.

We estimate a model similar to that specified by Equation (6) but using the alternative *PHI* measures discussed above. The results are presented in Table 3, in which Panel A reports the regressions using *NCSKEW* (*DUVOL*) as the dependent variable and Panel B reports the regressions using *DUVOL* as the dependent variable. As can be seen, in all four sets of regressions, the coefficients of the negative association between *PHI* and future crash risk is robust when we use alternative measures of *PHI* (t-statistics ranging from -2.64 to -3.61).

3.1.2 Identification Using Sinclair Acquisitions

We acknowledge that the observed negative relation between *PHI* and crash risk can be caused by omitted variables, especially because the employment decisions of CEO or directors are not exogenous. For example, some omitted firm characteristics may attract CEOs and independent directors with aligned political views and in the meantime are related to policies that reduce crash risk. Therefore, to identify the causal effect of *PHI* on crash risk, we exploit the exogenous variations in the independent directors' political views caused by Sinclair Broadcast Group's acquisitions of local television stations.

Sinclair began its rapid expansion in the United States in the early 1980s by acquiring local television stations across the states. In the year 2019, Sinclair is the largest local television station operator in the U.S. in terms of both the number of stations owned (191) and the coverage (89% of U.S. markets).[9] The company is documented by both the media (e.g., Glaser, 2018) and academic researchers (e.g., Martin and McCrain, 2019) to have strong Republican-leaning views, as it often broadcasts news that is in favor of the Republicans. A recent paper by Ren (2020) finds that the acquisitions of local TV stations by Sinclair significantly shifts local residents' political orientation towards Republican. Ren (2020) further shows that the Sinclair acquisitions are not driven by local economic condition or political leaning, and therefore unlikely to be related to fundamentals of firms.[10] Therefore, we exploit the exogenous shock to people's political orientation and in turn the political homophily caused by the Sinclair acquisitions.

We obtain information on Sinclair's acquisitions of local TV stations from RabbitEars.info, which is a database that contains comprehensive information on media markets in the U.S. The sample consists of 163 acquisitions made by Sinclair in 96 designated market areas (DMA) from 1984 to 2018. To identify the location of a CEO or director, we take the self-disclosed addresses in her FEC donation records and use the county in which she makes the largest amount of donation in a given year as her county of residence in that year. In the cases where a CEO or director's address cannot be found in the FEC database, we use her firm's headquarter county as her county of residence.[11] We then match the CEOs and directors' counties of residence to DMAs using the

[9] For details, see the official Sinclair website at http://sbgi.net/.
[10] See Ren (2020) for a more detailed discussion of the Sinclair acquisitions.
[11] Since firms may change their headquarters locations (e.g., Heider and Ljungqvist, 2015), we obtain the firms' historical headquarter addresses by scraping the firms' index pages on the Electronic Data Gathering, Analysis, and Retrieval system (EDGAR). If a director works for multiple companies in the same year, then we use the headquarters county of the firm in which the director holds an executive position as her county of residence. In the few cases where a director holds executive positions in multiple companies, or does not hold executive position in any company, we use the headquarter county of the firm for which she has worked for the longest time period as her county of residence.

DMA-county matching information from Wikipedia.[12]

To examine whether the Sinclair acquisitions significantly affect the political orientation of the independent directors and CEOs, we estimate the following OLS regression:

$$REP_{p,t} = \alpha + \beta_1 Sinclair_{p,t-1} + \sum_k \beta_k Controls^k_{p,j,t-1} + \epsilon_{i,t}, \quad (7)$$

where $REP_{i,t}$ is the Republican index of director or CEO p in year t, and $Sinclair_{i,t-1}$ is a dummy variable that equals one if the director or CEO is affected by a Sinclair acquisition in her county of residence in year *t-1*, and zero otherwise. We also include the same set of firm-level control variables ($Controls_{p,j,t-1}$) as those in Equation (6).

Column (1) of Table 4 presents the regression for our sample directors, which shows that the Sinclair acquisitions significantly shift the directors' political leaning towards Republican. Specifically, the coefficient of Sinclair is positive and significant at the 5% level. This effect is also economically significant, as the coefficient indicates that a Sinclair acquisition increases a director's *REP* by 0.014, which is approximately 58% of its sample mean (=0.014/0.024). Column (2) presents the regression for sample CEOs, which shows that, interestingly, the Sinclair acquisitions do not have a significant impact on the CEOs' political leaning. This is possibly due to two reasons. First, as noted before, the CEOs are ex-ante much more Republican-oriented than the directors and therefore the marginal effect of Sinclair broadcast may be lower for CEOs. Second, it has been well documented by the existing literature that CEOs tend to be overconfident (Malmendier and Tate, 2005, 2008), which may also make CEOs update their beliefs to a lesser degree than directors in response to media. These findings are consistent with Ren (2020) who finds that Sinclair acquisitions significantly shift non-CEO employees' political contributions towards Republicans but do not affect the CEOs' contributions.

[12] The information can be found at https://en.wikipedia.org/wiki/List_of_United_States_television_markets.

3.1.3 Sinclair-predicted PHI and Crash Risk

The previous sub-section shows that Sinclair acquisitions have a significant impact on the political orientations of directors, which in turn can affect the CEO-board political homophily. In this subsection, we estimate the following model to examine how this exogenous variation in political homophily impacts crash risk:

$$Crash\_Risk_{i,t} = \alpha + \beta_1 PHISinclair_{i,t-1} + \sum_k \beta_k Controls^k_{i,t-1} + \varphi_i + \eta_t + \epsilon_{i,t}, \quad (8)$$

This equation is similar to Equation (6) except that we replace the independent variable of interest, $PHI_{i,t-1}$, by $PHISinclair_{i,t-1}$. $PHISinclair_{i,t-1}$ is the political homophily index constructed using individual directors' Republican index predicted by Sinclair acquisitions using Equation (7). We also control for the firm-level average Sinclair-predicted director Republican index ($RepSinclair_{i,t-1}$) instead of the raw average director Republican index ($RepIndep_{i,t-1}$), to distinguish the homophily effect from that of a more Republican orientation of the board associated with Sinclair's entry. For ease of interpretation, we standardize the crash risk variables ($NCSKEW_{i,t}$ and $DUVOL_{i,t}$) and political orientation variables ($PHISinclair_{i,t-1}$ and $RepSinclair_{i,t-1}$) by scaling the variables by their sample standard deviation and subtracting the sample mean.

Columns (1) of Table 5 reports the regression using *NCSKEW* as the dependent variable, which shows that the exogenous variation in *PHI* caused by Sinclair acquisitions has a significantly negative impact on firms' future crash risk. The coefficient of political homophily is slightly smaller than that in our baseline regression and statistically significant at the 1% level (t-statistic -2.99). Since *PHISinclair* is a generated regressor, we follow the existing literature and calculate t-statistics based on standard errors using a block bootstrap with 2,000 replications (e.g., Wang, 2011; Han, 2013; Engelberg, Reed, and Ringgenberg, 2018). We use bootstrapped standard errors for the remaining tests in this paper unless otherwise specified. In Column (2), the t-statistics with

bootstrapped standard errors are very similar to those in Column (1). Columns (3) and (4) present regressions using *DUVOL* as dependent variables, and the coefficient on *PHISinclair* is negative and significant at the 1% level in both specifications (t-statistics -2.97 and -3.00). These results indicate that the exogenous variation in political homophily due to the Sinclair acquisitions affects future firm crash risk negatively.

3.2 Mechanisms of the Effect of Board Friendliness on Crash Risk

Our results so far have shown that political homophily has a significantly negative impact on future crash risk. We hypothesize that *PHI* negatively affects crash risk by encouraging the CEOs to share negative information with the board members, therefore allowing them to take actions and prevent potentially adverse events from actually happening. Although we cannot directly observe the communication between the CEOs and directors, we conduct two tests to provide supporting evidence on the mechanism of information sharing. Specifically, we examine if political homophily increases the directors' insider trading returns, and if political homophily increases the firms' likelihood to sell off previously acquired assets that perform badly.

3.2.1 Board Friendliness, Information Sharing, and Insider Trading Returns

Ravina and Sapienza (2010) find that independent directors earn significantly positive returns on their insider purchases but such performance is lower than that on executives' insider purchases, which is consistent with the argument that executives possess more private information about their firms than independent directors. If political homophily encourages CEOs to share private information with the directors, then the increased information sharing will increase independent director's insider trading returns and narrow their performance gaps with executives.

We examine this conjecture by obtaining insider purchases made by directors and executives from Thomson Reuter's Insider Data for our sample firms.[13] Following Ravina and Sapienza (2010), we calculate the market-adjusted returns of an individual's long position for 0, 30, 60, 90, and 180 trading days. For each insider, we assign a dummy variable that equals one if the person is an independent director, and zero otherwise (*Independent*). As argued in Fidrmuc, Goergen, and Renneboog (2006), transaction size could potentially correlate with the informativeness of the insider trading. We therefore calculate the trade size for each transaction as a fraction of the firm's market capitalization (*TradeSize*). We then regress insider trading returns on the triple interaction between *PHISinclair*, *Independent*, and *TradeSize*. We control for *RepSinclair* and its interactions with *Independent* and *TradeSize* in all regressions. Other control variables include return on assets (*ROA*), the ratio of capital expenditure to property, plant, and equipment (*CAPEX*), the ratio of R&D expenses to total assets (*RD*, set to zero is missing), the natural logarithm of total assets (*LnAsset*), book leverage (*Lev*), the natural logarithm of board size (*LnBoardSize*), and the percentage of board members connected to the CEO (*Connection*). For ease of interpretation, we standardize the insider trading return variables and political orientation variables ($PHISinclair_{i,t-1}$ and $RepSinclair_{i,t-1}$) by scaling the variables by their sample standard deviation and subtracting the sample mean.

Table 6 reports the results, in which Columns (1) to (5) present regressions for various return windows from one day to 180 days. The interaction between *PHISinclair*, *Independent*, and *TradeSize* is significantly positive in all specifications except one-day returns, indicating that the informed trades made by independent directors in firms with higher *PHI* are more profitable. The coefficients on *TradeSize* are significantly positive and the coefficients on the interaction between

[13] We focus on insider purchases rather than sales since Ravina and Sapienza (2010) argue that purchases are more likely to be information-driven.

Independent and *TradeSize* are significantly negative, which is consistent with Ravina and Sapienza (2010) who find that larger trades made by insiders are more informative and that independent directors have less private information than executives do. These results support the hypothesis that higher *PHI* encourages the CEOs to share more information with the independent directors.

3.2.2. Board Friendliness and the Subsequent Divestitures of Acquired Assets

In this subsection, we examine whether a friendly board (a board with high *PHI*) makes the CEO more willing to admit her mistakes in decision-making. Specifically, we identify the CEOs' willingness to admit their mistakes by testing whether the firms will sell off previously acquired assets that are perceived to have lower value. We first obtain the sample of completed acquisitions from the Capital IQ Mergers and Acquisitions Database.[14] We then identify, for each acquisition, whether the acquired firm is subsequently sold off by the acquirer. To measure the perceived value of an acquisition to the acquirer, we calculate the acquirer's cumulative abnormal return (CAR), estimated using the market model, in the three trading days centered on the original acquisition announcement date. We then estimate the following linear probability model:

$$Divest_j = \alpha + \beta_1 PHISinclair_j \times CAR_j + \beta_2 PHISinclair_j + \beta_3 CAR_j + \sum_k \beta_k Controls_j^k + \eta_t + \epsilon_j, \quad (9)$$

where $Divest_j$ is a dummy variable that equals one if the acquired firm in transaction j is subsequently divested in the three years after the completion date of the acquisition. The variable of interest is the interaction between the Sinclair-predicted political homophily of the acquirer ($PHISinclair_j$) and the acquirer's three-day CAR around the announcement date of transaction j

[14] Since Capital IQ uses a unique identifier (FIRMID) to track each firm even after it is acquired, we are able to identify the acquired firms that are subsequently sold off.

(CAR_j). $Controls_j$ is a vector of control variables that include $RepSinclair_j$ and its interaction with CAR_j, the natural logarithm of the acquirer's total assets ($AcqSize_j$), the acquirer's market-to-book ratio ($AcqMB_j$), the acquirer's book leverage ($AcqLev_j$), the acquirer's return on assets ($AcqROA_j$), the natural logarithm of the value of the acquisition ($LnDealValue_j$, set to zero if missing), a dummy variable that equals one if the transaction value is missing, and zero otherwise ($MissingDealValue_j$), a hostile takeover dummy ($Hostile_j$), a stock merger dummy ($Stock_j$), and a tender offer dummy ($Tender_j$).[15] The acquirer variables are measured at the end of the fiscal year before the announcement date of the transaction. For ease of interpretation, we standardize the political orientation variables ($PHISinclair_{i,t-1}$ and $RepSinclair_{i,t-1}$) by scaling the variables by their sample standard deviation and subtracting the sample mean. We include year fixed effects in the regressions.

Table 7 presents the regression results. Column (1) presents the regression of $Divest_j$ on CAR_j, in which the coefficient on CAR_j is significantly negative (t-statistic -2.57). This result indicates that the acquired assets with lower perceived values to the acquirers are more likely to be divested in the future. Column (2) presents the regression of $Divest_j$ on the interaction between $PHISinclair_j$ and CAR_j. The interaction is negative and significant at the 5% level (t-statistic -1.96), which indicates that acquirers with greater political homophily are more likely to divest lower-valued acquired assets. We repeat the analyses with industry (at the two-digit SIC level) and year fixed effects and report the results in Columns (3) and (4). The coefficient on the interaction between $PHISinclair_j$ and CAR_j remains significant in this specification (t-statistics -2.19). Taken

[15] Since the sample includes many acquisitions with private targets, we can obtain target characteristics for only a small portion of the sample. Therefore, we do our best and control for acquirer characteristics and deal characteristics that are available in Capital IQ.

together, the results in Table 6 suggest that, great political homophily makes CEOs more willing to admit their mistakes by selling off acquired assets with low value.

3.2.3 PHI and Risk Taking

Our previous findings suggest that the lower crash risk associated with political homophily is a manifestation of better information sharing and more timely actions. However, it is worth noting that lower crash risk can also be caused by less risk taking. Specifically, if greater political homophily helps CEO resist shareholder pressure for pursuing risky strategies, then we will also observe a negative association between *PHI* and crash risk but the channel is a lower level of general risk-taking rather than better information sharing.[16] To examine this possibility, we examine the relation between a firm's political homophily and the firm's risk-taking. Specifically, we estimate the following model:

$$RiskTaking_{i,t} = \alpha + \beta_1 PHISinclair_{i,t-1} + \sum_k \beta_k Controls^k_{i,t-1} + \varphi_i + \eta_t + \epsilon_i, \quad (10)$$

where *RiskTaking* is one of the three measures of risk taking, including book leverage (Lev_t), stock return volatility (Vol_t), and idiosyncratic return volatility ($IdioVol_t$, estimated using the Fama-French three-factor model). $PHISinclair_{i,t-1}$ is the political homophily index constructed using individual directors' Republican index predicted by Sinclair acquisitions using Equation (7). $Controls_{i,t-1}$ is a vector of control variables which include $RepSinclair_{i,t-1}$, return on assets ($ROA_{i,t-1}$), the ratio of capital expenditure to property, plant, and equipment ($CAPEX_{i,t-1}$), the ratio of R&D expenses to total assets ($RD_{i,t-1}$, set to zero is missing), the natural logarithm of total assets ($LnAsset_{i,t-1}$), lagged book leverage ($Lev_{i,t-1}$), the natural logarithm of board size ($LnBoardSize_{i,t-1}$), and the percentage of board members connected to the CEO ($Connection_{i,t-1}$). For ease of

[16] Giannetti and Zhao (2019) find that greater discrepancy in board members' opinions and values may lead to inefficiencies in the decision-making process and high performance volatility. It is also possible that political homophily between the CEO and board reduces the conflicts and uncertainties in decision-making, so *PHI* negatively associates with general performance volatility.

interpretation, we standardize the risk taking measures and political orientation variables (*PHISinclair*$_{i,t-1}$ and *RepSinclair*$_{i,t-1}$) by scaling the variables by their sample standard deviation and subtracting the sample mean. We also include firm and year fixed effects in the regressions.

Table 8 presents the regression results. We find that the coefficient of *PHISinclair* is positive rather than negative, and insignificant in all three regressions (t-statistics from 0.50 to 1.21), which suggests that greater political homophily does not lead to lower level of risk taking. These results show that the negative impact of political homophily on crash risk is unlikely a reflection of less risk-taking by firms with greater political homophily.

4. Corporate Governance and the Effect of Political Homophily

In previous sections we have shown that the political alignment between CEOs and directors decreases future crash risk. We argue that the channel through which this comes about is that friendly boards encourage the CEO to share information, especially negative information. The motivation for negative information sharing is a tradeoff for CEOs. On the one hand, past poor decisions may reflect poorly on the CEO, which can lead to penalty to the CEO for such decisions. On the other hand, such disclosures make it possible to take more timely corrective actions so that worse future outcomes are avoided. A friendly board is likely to penalize the CEO less for such decisions, which encourages negative information sharing by the CEO. On the contrary, if the board is not friendly, the CEO might prefer not to disclosure negative information and instead take a chance that the problem will get resolved, or might even look for alternative employment before the problem manifests.

However, this argument presupposes that a friendly board would not be able to stand by the CEO if the CEO does not take immediate corrective action and in turn causes a publicly observable negative outcome. If the CEO gets "downside protection" from a friendly board, she

might prefer not to disclose ex ante negative information because disclosure of such information could come at some immediate costs to the CEO, such as the board (even when friendly) tying the CEOs hands, or divesting pet projects. Therefore, if the CEO has downside protection from the friendly board, she might try to avoid such costs and take a chance that the problem will get resolved.

Thus, whether or not a friendly board encourages negative information sharing depends on the extent of this downside protection. This is where corporate governance, and in particular, shareholder power, is important. We argue that a friendly board would not be able to offer downside protection when shareholder power is high. This implies that the observed negative relation between political homophily and lower crash risk should only manifest when shareholder power is high. In our subsequent analysis, we use two common measures of shareholder power to test this implication: institutional ownership (e.g., Denis, Denis, and Sarin, 1997; Harford, Jenter, and Li, 2011) and the E-Index (e.g., Bebchuk, Ferrell, and Cohen, 2009). We first show that the negative relationship between *PHI* and crash risk only holds for firms with strong shareholder power measured by these two metrics. We then show that, consistent with our hypothesis, the CEO receives more protection from poor performance when the board is friendly, but only among firms with weak shareholder power.

4.1 Board Friendliness, Governance, and Crash Risk

Panel A of Table 9 reports regressions of crash risk on *PHISinclair* for the two subsamples based on whether the firms' institutional ownership is above or below the sample median. The independent variable is *NCSKEW* in Columns (1) and (2) and *DUVOL* in Columns (3) and (4). For ease of interpretation, we standardize the crash risk variables ($NCSKEW_{i,t}$ and $DUVOL_{i,t}$) and political orientation variables ($PHISinclair_{i,t-1}$ and $RepSinclair_{i,t-1}$) by scaling the variables by their

sample standard deviation and subtracting the sample mean. As can be seen, the association between *PHI* and future crash risk is significantly negative in the high institutional-ownership subsample (t-statistics -3.13 and -3.15) but insignificant in the low institutional-ownership subsample (t-statistics -0.86 and -0.62). In addition, the economic magnitude of the effect of *PHI* on crash risk almost doubles in the high institutional-ownership subsample. For example, the coefficient on *PHISinclair* in Column (1) indicates that a one standard deviation increase in political homophily is associated with a 4.7% standard deviation decrease in *NCSKEW* in the high institutional-ownership subsample, which is 1.74 times the size of the effect in the full sample (=4.7%/2.7%). In Panel B, we further present the regressions for the two subsamples based on E-index. We find that the coefficient of *PHI* is significantly negative in the low E-index subsample but small and insignificant for the high E-index subsample. Therefore, the results using both corporate governance measures show that, consistent with our prediction, the association between *PHI* and future crash risk is significantly negative only for the firms with strong shareholder power.

4.2 Board Friendliness, Governance, and CEO Turnover-performance Sensitivity

In this subsection, we examine the relationship between political homophily and CEO turnover-performance sensitivity. As discussed in the previous section, we hypothesize that political homophily provides "downside protection" for CEOs only when shareholder power is weak. We test this hypothesis by estimate the following linear probability model:

$$Turnover_{i,t} = \alpha + \beta_1 PHISinclair_{i,t-1} \times Ret_{i,(t-1,t-4)} + \beta_2 PHISinclair_{i,t-1} + \beta_3 Ret_{i,(t-1,t-4)} + \sum_k \beta_k Controls^k_{i,t-1} + \varphi_i + \eta_t + \epsilon_i, \quad (11)$$

where $Turnover_{i,t}$ is a dummy variable that equals one if firm *i* experiences a CEO turnover in year *t*, and zero otherwise. Following Lee, Lee, and Nagarajan (2014), we use four-year accumulated stock return from year *t-4* to *t-1* as the measure of CEO performance. The variable of interest is

the interaction between $PHISinclair_{i,t-1}$ and $Ret_{i,(t-1,t-4)}$. $Controls_{i,t-1}$ is a vector of control variables including $RepSinclair_{i,t-1}$ and its interaction with $Ret_{i,(t-1,t-4)}$, a dummy variable for CEO above 65-year-old ($RetireAge_{i,t-1}$), the natural logarithm of the CEO's tenure ($LnTenure_{i,t-1}$), the natural logarithm of the firm's total assets ($LnAsset_{i,t-1}$), market to book ratio ($MB_{i,t-1}$), and a dummy variable for dividend-paying firms ($DividendPay_{i,t-1}$). For ease of interpretation, we standardize the political orientation variables ($PHISinclair_{i,t-1}$ and $RepSinclair_{i,t-1}$) by scaling the variables by their sample standard deviation and subtracting the sample mean. We include firm and year fixed effects in the regressions.

Table 10 presents the regression results. Column (1) presents the regression of CEO turnover on past performance, in which the coefficient on *Ret* is significantly negative. This result indicates that CEOs with poor past performance are more likely to be replaced, which is consistent with the existing literature (e.g., Jenter and Lewellen, 2021). Column (2) further includes the interaction between *PHISinclair* and *Ret.* We find that, consistent with Lee, Lee, and Nagarajan (2014), the coefficient of this interaction is significantly positive, indicating that CEO turnover-performance sensitivity is lower in firms with greater political homophily.

We then run the regressions separately for the subsamples based on corporate governance. For each subsample, we report both the regression with only *Ret* and the regression with the interaction between *PHISinclair* and *Ret*. Columns (3) and (5) show that the coefficient on *Ret* is significantly negative in both the subsamples with high and low institutional ownership. Columns (4) and (6) show that the interaction term between *PHI* and *Ret* becomes small and insignificant for high institutional-ownership firms but remains significantly positive for low institutional-ownership firms. This contrast shows that for firms with strong shareholder power, political homophily does not provide any downside protection for CEOs. We then turn to the subsamples

based on firms' E-index. Columns (7) and (9) show that the coefficient on *Ret* is significantly negative in both the subsamples with high and low E-index. Columns (8) and (10) show that the interaction between *PHISinclair* and *Ret* is insignificant for low E-index firms but remains significant for high E-index firms.[17] Taken together, these results indicate that strong shareholder power seems a necessary condition for political homophily to encourage the CEO to share negative information with the board rather than hide it and in turn cause worse performance.

4.3 Board Friendliness, Governance, and Firm Value

Lee, Lee, and Nagarajan (2014) show that political homophily has a negative impact on firm value by reducing monitoring intensity. While our focus is the CEO's sharing of negative information, our results in the previous sections show that corporate governance interacts with the effect of political homophily. Therefore, in this subsection, we reexamine the relationship between political homophily, corporate governance, and firm value. Specifically, following Lee, Lee, and Nagarajan (2014), we estimate the following model:

$$Tobin's\ Q_{i,t} = \alpha + \beta_1 PHISinclair_{i,t-1} + \sum_k \beta_k Controls^k_{i,t-1} + \varphi_i + \eta_t + \epsilon_i, \quad (12)$$

where the specifications are similar to those in Equation (10), except that we replace the risk-taking measures with firms' Tobin's Q. For ease of interpretation, we standardize *Tobin's* $Q_{i,t}$ and political orientation variables ($PHISinclair_{i,t-1}$ and $RepSinclair_{i,t-1}$) by scaling the variables by their sample standard deviation and subtracting the sample mean. We also include firm and year fixed effects in the regressions.

Column (1) of Table 11 reports the regression results for the full sample. We find that the coefficient on *PHISinclair* is significantly negative, indicating that, consistent with Lee, Lee, and Nagarajan (2014), political homophily negatively affects firm value. We then conduct the

[17] The coefficients on *Ret* in the subsamples with the inclusion of the interaction terms remain qualitatively similar to those without the inclusion of the interaction terms, although they are less statistically significant.

regression analysis separately for subsamples based on the corporate governance measures. Columns (2) and (3) present results for subsamples based on shareholder power, and Columns (4) and (5) present the results for subsamples based on E-index. We find that the coefficient on *PHISinclair* is significantly negative only in the subsample of firms with low institutional ownership and the subsample of firms with high E-index. These results suggest that while political homophily leads to lower firm value, this effect is concentrated among firms with weaker shareholder power. For firms with strong shareholder power, political homophily does not lead to lower firm value, which suggests that for these firms, the negative effect of political homophily is potentially offset by the positive effect of better information sharing (and in turn more timely actions) when the CEO does not enjoy downside protection from a friendly board.

5. Conclusion

An influential idea in corporate governance is that a board that is predisposed to monitoring the CEO intensively (e.g., via committees without insider representation) may discourage the CEO from sharing information, which in turn may compromise the board's advisory role. There is some empirical evidence consistent with the broad concept that board "friendliness", as reflected, for example, by social connections between the CEO and independent board members, can both exacerbate agency problems as well as benefit the firm in situations where board expertise could be valuable. However, the crucial issue of whether more friendliness encourages more information sharing has been difficult to establish.

In this paper, we argue that the similarity of political views promotes trust and bonding, and when the CEO and board enjoy greater political homophily, the CEO is encouraged to share adverse information with the board in a timely manner. We construct a measure of political homophily between the CEO and the board (the Political Homophily Index (PHI)) using an

individual's political donations. We find that firms' stock price crash risk decreases in PHI, which suggests that future negative outcomes are prevented via timely information sharing and the prompt addressing of problems. The results are robust when we instrument the *PHI* using acquisitions of local television stations by the Sinclair Broadcast Group, known for its strong Republican-leaning views.

As evidence of information sharing, we show that insider trading profits are higher for independent directors when *PHI* is higher, suggesting that the directors do receive more information from the CEO. As evidence of corrective actions, we find that when *PHI* is higher, the firm is more likely to divest previously acquired assets that exhibited low performance. Finally, we show that stronger shareholder governance is a necessary condition for the positive effect of a friendly board on information sharing: the effect of *PHI* on crash risks is only significant in firms with stronger shareholder rights (higher institutional ownership or lower E-index). Correspondingly, we find that higher *PHI* leads to lower CEO turnover-performance sensitivity, which is consistent with the "downside protection" provided by friendly boards, but such downside protection is absent in the subsample of strong shareholder governance. These results are consistent with the view that it is in the CEO's interest to share adverse information with a friendly board and to address problems in a timely manner when she may not enjoy "downside protection". Finally, we find that while for firms with weaker shareholder rights, increases in *PHI* are associated with lower firm value, there is no effect of *PHI* on firm value in firms with strong shareholder governance.

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Table 1: Summary Statistics

This table presents the summary statistics of the baseline sample. The sample consists of 20,354 firm-years covered by both Execucomp and BoardEx between 1999 and 2019. *NCSKEW* and *DUVOL* are two main measures of crash risk used in the paper. *NCSKEW* is the negative ratio of the third moment of firm-specific daily returns over the standard deviation of firm-specific daily returns raised to the third power. *DUVOL* is the natural logarithm of the ratio of down-day to up-day standard deviation of firm-specific returns. *PHI* is the political homophily index between a firm's CEO and independent directors. *PHISinclair* is the political homophily index calculated using directors' Republican indices predicted by Sinclair acquisitions. *RepCEO* is the Republican index of a firm's CEO. *RepIndep* is the average Republican index of a firm's independent directors. *RepSinclair* is a firm's average director Republican index predicted by Sinclair acquisitions. The other variables include firm-specific stock return volatility (*Sigma*), the cumulative firm-specific daily returns (*Ret*), the average monthly share turnover in year *t* minus the average monthly share turnover in year *t-1* (*Dturn*), market-to-book ratio (*MB*), book leverage (*Lev*), return on assets (*ROA*), the natural logarithm of market value (*LnMV*), discretionary accruals (*DA*), the natural logarithm of board size (*LnBoardSize*), and the percentage of a firm's directors who are socially connected to the CEO (*Connection*). Definitions of all other variables are provided in the Appendix.

	Mean	Std	P10	P25	Median	P75	P90	N
Variable	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
NCSKEW	0.049	1.709	-1.569	-0.668	-0.062	0.623	1.943	20,354
DUVOL	-0.026	0.355	-0.442	-0.239	-0.037	0.178	0.423	20,354
PHI	0.812	0.212	0.500	0.563	0.929	1.000	1.000	20,354
PHISinclair	0.814	0.216	0.502	0.538	0.963	0.991	0.994	20,354
RepCEO	0.138	0.561	-0.660	0.000	0.000	0.500	1.000	20,354
RepIndep	0.024	0.106	-0.100	0.000	0.000	0.083	0.167	20,354
RepSinclair	0.026	0.050	-0.037	0.010	0.016	0.048	0.091	20,354
Sigma	0.022	0.012	0.011	0.014	0.019	0.027	0.037	20,354
Ret	-0.052	0.334	-0.415	-0.254	-0.090	0.094	0.335	20,354
Dturn	0.020	0.863	-0.841	-0.330	0.014	0.356	0.900	20,354
MB	3.196	4.350	0.953	1.491	2.336	3.861	6.488	20,354
Lev	0.195	0.179	0.000	0.018	0.174	0.300	0.426	20,354
ROA	0.133	0.096	0.045	0.088	0.130	0.180	0.244	20,354
LnMV	14.571	1.661	12.594	13.478	14.476	15.602	16.779	20,354
DA	0.139	0.310	0.011	0.026	0.055	0.114	0.267	20,354
LnBoardSize	2.002	0.299	1.609	1.792	2.079	2.197	2.398	20,354
Connection	0.022	0.068	0.000	0.000	0.000	0.000	0.100	20,354

Table 2: Regressions of Crash Risk on Political Homophily

This table presents the regressions of the crash risk measures on the political homophily index. *NCSKEW* is the negative ratio of the third moment of firm-specific daily returns over the standard deviation of firm-specific daily returns raised to the third power. *DUVOL* is the natural logarithm of the ratio of down-day to up-day standard deviation of firm-specific returns. *PHI* is the political homophily index between a firm's CEO and independent directors. Definitions of all other variables are provided in the Appendix. All regressions include firm and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	$NCSKEW_t$	$DUVOL_t$
	(1)	(2)
PHI_{t-1}	-0.029***	-0.029***
	(-3.24)	(-3.17)
$RepIndep_{t-1}$	0.011	0.007
	(1.29)	(0.78)
$Sigma_{t-1}$	10.083***	6.172***
	(6.64)	(4.59)
Ret_{t-1}	0.247***	0.308***
	(11.24)	(14.11)
$Dturn_{t-1}$	-0.002	-0.001
	(-0.30)	(-0.17)
MB_{t-1}	0.009***	0.010***
	(4.55)	(4.67)
Lev_{t-1}	-0.247***	-0.305***
	(-3.01)	(-3.57)
ROA_{t-1}	1.805***	2.181***
	(12.27)	(14.53)
$LnMV_{t-1}$	-0.256***	-0.293***
	(-13.77)	(-15.54)
DA_{t-1}	0.004	0.003
	(0.15)	(0.10)
$LnBoardSize_{t-1}$	0.141***	0.142***
	(2.71)	(2.69)
$Connection_{t-1}$	-0.217	-0.190
	(-1.14)	(-1.01)
Firm FE	Yes	Yes
Year FE	Yes	Yes
Observations	20,354	20,354
R^2	0.162	0.174

Table 3: Regressions of Crash Risk on Political Homophily: Robustness Tests using Alternative Measures of Political Homophily

This table presents the regressions of crash risk measures on the alternative measures of political homophily. *PHI (Individual)* is the alternative political homophily index constructed using the individuals' time-invariant Republican index calculated using their cumulative amounts of contributions up to the year 2019. *PHI (Prior)* is the alternative political homophily index constructed using the individuals' historic Republican index (i.e., for each individual *p* in year *t*, the Republican index calculated using her historic contribution made before year *t*). *PHI (Strong)* is the alternative political homophily index constructed using the Republican index of the individuals whose differences in contributions to the two parties exceed $2,000 in the election cycle. *PHI (Large)* is the alternative political homophily index constructed using the Republican index of the individuals whose historical total amounts of contribution exceed $2,000. Control variables are included but not reported to conserve space. Panel A (Panel B) reports the regressions using *NCSKEW* (*DUVOL*) as the dependent variable. All regressions include firm and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Panel A: Regressions of Negative Coefficient of Skewness

Dep. Var.	$NCSKEW_t$			
	(1)	(2)	(3)	(4)
PHI_{t-1} *(Time-invariant)*	-0.039***			
	(-3.31)			
PHI_{t-1} *(Prior)*		-0.046***		
		(-3.61)		
PHI_{t-1} *(Strong)*			-0.033***	
			(-3.25)	
PHI_{t-1} *(Large)*				-0.046***
				(-3.56)
Controls	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	20,354	20,354	20,354	20,354
R^2	0.162	0.162	0.162	0.162

Panel B: Regressions of Down-to-up Volatility

Dep. Var.	$DUVOL_t$			
	(1)	(2)	(3)	(4)
PHI_{t-1} *(Time-invariant)*	-0.033***			
	(-2.71)			
PHI_{t-1} *(Prior)*		-0.040***		
		(-3.10)		
PHI_{t-1} *(Strong)*			-0.027***	
			(-2.64)	
PHI_{t-1} *(Large)*				-0.039***
				(-3.03)
Controls	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	20,354	20,354	20,354	20,354
R^2	0.174	0.174	0.174	0.174

Table 4: Regressions of Executives and Directors' Republican Indices on Sinclair Acquisitions
This table presents the regressions of directors' Republican indices (Column 1) and CEOs' Republic indices (Column 2) on Sinclair acquisitions. *REP* is the Republican index of an individual, calculated as the difference between the individual's dollar amount of donation to Republican recipients and her dollar amount of donation to Democratic recipients divided by her total dollar amount of donation to either Republican recipients or Democratic recipients in an election cycle. *Sinclair* is a dummy variable that equals one if the individual is affected by a Sinclair acquisition in a given year, and zero otherwise. Definitions of all other variables are provided in the Appendix. All regressions include firm and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	REP_t	
	Directors	CEOs
	(1)	(2)
$Sinclair_{t-1}$	0.014**	-0.013
	(1.99)	(-0.42)
$RepIndep_{t-1}$	0.476***	0.019
	(52.33)	(0.38)
$Sigma_{t-1}$	0.172*	0.318
	(1.69)	(0.52)
Ret_{t-1}	0.002	0.005
	(0.87)	(0.54)
$Dturn_{t-1}$	-0.000	-0.001
	(-0.02)	(-0.16)
MB_{t-1}	0.000	0.001
	(0.10)	(0.97)
Lev_{t-1}	-0.003	-0.077*
	(-0.40)	(-1.65)
ROA_{t-1}	0.037***	-0.037
	(3.20)	(-0.49)
$LnMV_{t-1}$	-0.002	0.013
	(-1.43)	(1.34)
DA_{t-1}	0.003	0.001
	(1.32)	(0.11)
$LnBoardSize_{t-1}$	-0.004	-0.032
	(-0.93)	(-1.05)
$Connection_{t-1}$	0.004	-0.022
	(0.24)	(-0.17)
Firm FE	Yes	Yes
Year FE	Yes	Yes
Observations	160,586	20,668
R^2	0.071	0.425

Table 5: Regressions of Crash Risk on Political Homophily Calculated Using Individual-level Republican Index Predicted by Sinclair Acquisitions

This table presents the regressions of the crash risk measures on the political homophily index calculated using individual-level Republican indices predicted by Sinclair acquisitions. *NCSKEW* is the negative ratio of the third moment of firm-specific daily returns over the standard deviation of firm-specific daily returns raised to the third power. *DUVOL* is the natural logarithm of the ratio of down-day to up-day standard deviation of firm-specific returns. *PHISinclair* is the political homophily index between a firm's CEO and independent directors, calculated using individual-level Republican index predicted by Sinclair acquisitions. Definitions of all other variables are provided in the Appendix. All regressions include firm and year fixed effects. The parentheses in Columns (1) and (3) report t-statistics generated using standard errors clustered by firm. The parentheses in Columns (2) and (4) report t-statistics generated using bootstrapped standard errors. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	$NCSKEW_t$		$DUVOL_t$	
	(1)	(2)	(3)	(4)
$PHISinclair_{t-1}$	-0.027***	-0.027***	-0.027***	-0.027***
	(-2.99)	(-3.41)	(-2.97)	(-3.00)
$RepSinclair_{t-1}$	-0.012	-0.012*	-0.015*	-0.015*
	(-1.41)	(-1.82)	(-1.69)	(-1.65)
$Sigma_{t-1}$	10.068***	10.068***	6.163***	6.163***
	(6.62)	(6.24)	(4.58)	(5.04)
Ret_{t-1}	0.246***	0.246***	0.307***	0.307***
	(11.20)	(9.10)	(14.08)	(13.47)
$Dturn_{t-1}$	-0.002	-0.002	-0.001	-0.001
	(-0.30)	(-0.25)	(-0.16)	(-0.18)
MB_{t-1}	0.009***	0.009***	0.010***	0.010***
	(4.56)	(4.66)	(4.67)	(4.73)
Lev_{t-1}	-0.249***	-0.249***	-0.307***	-0.307***
	(-3.03)	(-3.16)	(-3.60)	(-3.61)
ROA_{t-1}	1.808***	1.808***	2.184***	2.184***
	(12.30)	(12.83)	(14.57)	(14.69)
$LnMV_{t-1}$	-0.257***	-0.257***	-0.294***	-0.294***
	(-13.82)	(-14.23)	(-15.58)	(-16.93)
DA_{t-1}	0.004	0.004	0.003	0.003
	(0.17)	(0.16)	(0.12)	(0.11)
$LnBoardSize_{t-1}$	0.142***	0.142***	0.143***	0.143***
	(2.73)	(2.77)	(2.71)	(2.72)
$Connection_{t-1}$	-0.215	-0.215	-0.187	-0.187
	(-1.13)	(-1.09)	(-0.99)	(-1.06)
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	20,354	20,354	20,354	20,354
R^2	0.162	0.162	0.174	0.174

Table 6: Political Homophily and Returns of Insider Trades

This table reports the regressions of insider trading returns on the political homophily index calculated using individual-level Republican index predicted by Sinclair acquisitions. The sample includes insider purchases made by directors and executives from Thomson Reuter's Insider Data. *Ret0*, *Ret30*, *Ret60*, *Ret90*, and *Ret180* are the market-adjusted returns of an insider's long position for 0, 30, 60, 90, and 180 trading days, respectively (i.e., the return of investing one dollar mimicking the insider trade minus the return of taking the opposite position in the CRSP value-weighted market index). *PHISinclair* is the political homophily index between a firm's CEO and independent directors, calculated using individual-level Republican index predicted by Sinclair acquisitions. *Independent* is a dummy variable that equals one if an individual is an independent director, and zero otherwise. *TradeSize* is the size of an insider trade, measured by the dollar amount of the trade as a fraction of the firm's market capitalization. Definitions of all other variables are provided in the Appendix. All regressions include firm and year fixed effects. Robust t-statistics, calculated using bootstrapped standard errors, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	*Ret0*	*Ret30*	*Ret60*	*Ret90*	*Ret180*
	(1)	(2)	(3)	(4)	(5)
PHISinclair×*Independent*×*TradeSize*	0.002	0.007**	0.006*	0.006**	0.010**
	(0.56)	(2.30)	(1.88)	(2.40)	(2.18)
PHISinclair×*Independent*	0.010	-0.001	0.008	-0.012	-0.004
	(0.46)	(-0.02)	(0.28)	(-0.38)	(-0.12)
PHISinclair×*TradeSize*	-0.002	-0.007**	-0.005**	-0.007**	-0.005
	(-0.62)	(-2.42)	(-2.42)	(-2.44)	(-1.61)
Independent×*TradeSize*	-0.003	-0.028**	-0.025**	-0.028***	-0.045**
	(-0.30)	(-2.49)	(-2.34)	(-2.94)	(-2.38)
PHISinclair	0.021	0.030	0.025	0.043	0.036
	(1.05)	(1.39)	(0.85)	(1.56)	(1.33)
Independent	-0.072	-0.050	-0.099	-0.032	-0.077
	(-0.85)	(-0.41)	(-0.89)	(-0.25)	(-0.56)
TradeSize	0.002	0.034***	0.028***	0.033***	0.030**
	(0.33)	(3.17)	(3.15)	(3.16)	(2.05)
RepSinclair×*Independent*×*TradeSize*	-0.006*	-0.007*	-0.003	-0.004	-0.007*
	(-1.76)	(-1.76)	(-1.18)	(-1.22)	(-1.94)
RepSinclair×*Independent*	0.042**	0.042*	0.051*	0.041	0.074**
	(1.99)	(1.78)	(1.96)	(1.11)	(2.15)
RepSinclair×*TradeSize*	0.004	0.006**	0.004*	0.005	0.010**
	(1.49)	(2.42)	(1.77)	(1.56)	(2.52)
RepSinclair	-0.021	-0.030*	-0.028	-0.013	-0.044
	(-1.57)	(-1.79)	(-1.44)	(-0.55)	(-1.57)
ROA	-0.280	-0.327	-0.128	-0.046	0.167
	(-1.45)	(-1.52)	(-0.50)	(-0.13)	(0.65)
CAPEX	-0.054	-0.168**	-0.282***	-0.328**	-0.457***
	(-0.85)	(-2.06)	(-2.82)	(-2.33)	(-2.87)
RD	-0.034	-0.010	0.320	0.600	0.717
	(-0.10)	(-0.02)	(0.49)	(0.75)	(0.86)
LnAsset	0.223***	0.177***	0.134***	0.087*	-0.051
	(4.65)	(3.51)	(2.60)	(1.67)	(-0.87)

Dep. Var.	*Ret0*	*Ret30*	*Ret60*	*Ret90*	*Ret180*
	(1)	(2)	(3)	(4)	(5)
Lev	0.397	0.409	0.430	0.436	0.697**
	(1.37)	(1.63)	(1.63)	(1.41)	(2.28)
LnBoardSize	0.209	0.173	0.133	0.205	0.040
	(1.04)	(1.01)	(0.64)	(0.86)	(0.17)
Connection	-0.046	0.032	0.041	0.092	0.059
	(-0.29)	(0.26)	(0.21)	(0.41)	(0.25)
Firm FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	43,933	43,933	43,933	43,933	43,933
R^2	0.900	0.818	0.764	0.739	0.690

Table 7: Political Homophily and the Subsequent Divestitures of Acquired Assets

This table presents the linear probability regressions of subsequent divestitures of acquired assets. The sample includes completed acquisitions covered by Capital IQ. *Divest* is a dummy variable that equals one if an acquired firm is subsequently divested in the three years after the completion date of the acquisition. *PHISinclair* is the political homophily index between an acquirer's CEO and independent directors, calculated using individual-level Republican index predicted by Sinclair acquisitions. *CAR* is the acquirers' three-day cumulative abnormal returns around the announcement dates of the acquisitions, estimated using the market model. Definitions of all other variables are provided in the Appendix. Columns (1) and (2) include year fixed effects. Columns (3) and (4) include industry (at the two-digit SIC level) and year fixed effects. Robust t-statistics, calculated using bootstrapped standard errors, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	*Divest*			
	(1)	(2)	(3)	(4)
PHISinclair×CAR		-0.026**		-0.027**
		(-1.96)		(-2.19)
PHISinclair		0.000		0.000
		(0.11)		(0.02)
CAR	-0.038**	0.056	-0.038**	0.059
	(-2.57)	(1.11)	(-2.46)	(1.12)
RepSinclair×CAR		0.009		0.011
		(0.73)		(0.96)
RepSinclair		-0.000		0.000
		(-0.04)		(0.45)
AcqSize	0.000	0.001	0.000	0.000
	(0.97)	(1.01)	(0.62)	(0.80)
AcqMB	-0.000	-0.000*	-0.000	-0.000
	(-1.56)	(-1.73)	(-1.50)	(-1.47)
AcqLev	0.001	0.001	0.000	-0.000
	(0.20)	(0.18)	(0.01)	(-0.00)
AcqROA	-0.020*	-0.020	-0.023*	-0.023*
	(-1.69)	(-1.55)	(-1.84)	(-1.76)
LnDealValue	0.000	0.000	0.000	0.000
	(0.57)	(0.51)	(0.72)	(0.92)
MissingDealValue	0.000	-0.000	0.001	0.000
	(0.01)	(-0.01)	(0.23)	(0.24)
Hostile	-0.018***	-0.019***	-0.017***	-0.018**
	(-3.04)	(-2.70)	(-2.91)	(-2.57)
Stock	-0.008**	-0.008*	-0.008**	-0.008**
	(-2.08)	(-1.72)	(-2.06)	(-2.56)
Tender	0.009	0.009	0.009	0.009
	(1.23)	(1.11)	(1.27)	(1.17)
Industry FE	No	No	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	17,117	17,117	16,775	16,775
R^2	0.004	0.005	0.013	0.013

Table 8: Political Homophily and Risk Taking

This table presents the regressions of firm's risk-taking measures on the political homophily index. *Lev*, *Vol*, and *IdioVol* are a firm's book leverage, stock return volatility, and idiosyncratic return volatility, respectively. *PHISinclair* is the political homophily index between a firm's CEO and independent directors, calculated using individual-level Republican index predicted by Sinclair acquisitions. Definitions of all other variables are provided in the Appendix. All regressions include firm and year fixed effects. Robust t-statistics, calculated using bootstrapped standard errors, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	Lev_t	Vol_t	$IdioVol_t$
	(1)	(2)	(3)
$PHISinclair_{t-1}$	0.002	0.006	0.008
	(0.50)	(0.79)	(1.21)
$RepSinclair_{t-1}$	-0.002	0.010*	0.009
	(-0.52)	(1.80)	(1.26)
ROA_{t-1}	0.001	-2.030***	-2.183***
	(0.01)	(-13.88)	(-13.75)
$CAPEX_{t-1}$	0.001	0.174**	0.127**
	(0.03)	(2.55)	(2.40)
RD_{t-1}	0.011	0.369	0.581
	(0.04)	(0.95)	(1.25)
$LnAsset_{t-1}$	0.016	-0.162***	-0.224***
	(1.40)	(-7.22)	(-8.97)
Lev_{t-1}	3.584***	0.696***	0.765***
	(63.09)	(8.15)	(9.64)
$LnBoardSize_{t-1}$	0.021	-0.051	-0.015
	(0.82)	(-1.18)	(-0.29)
$Connection_{t-1}$	0.092	-0.131	-0.129
	(0.87)	(-1.00)	(-0.72)
Firm FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Observations	19,719	20,354	20,354
R^2	0.838	0.693	0.671

Table 9: Crash Risk and Political Homophily: Cross Sectional Analyses Based on Corporate Governance

This table presents the regressions of crash risk measures on political homophily index in the subsamples of firms based on corporate governance. In Panel A (Panel B), the subsamples are based on whether a firm's institutional ownership (E-index) is above or below the sample median. *NCSKEW* is the negative ratio of the third moment of firm-specific daily returns over the standard deviation of firm-specific daily returns raised to the third power. *DUVOL* is the natural logarithm of the ratio of down-day to up-day standard deviation of firm-specific returns. *PHISinclair* is the political homophily index between a firm's CEO and independent directors, calculated using individual-level Republican index predicted by Sinclair acquisitions. Definitions of all other variables are provided in the Appendix. All regressions include firm and year fixed effects. Robust t-statistics, calculated using bootstrapped standard errors, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Panel A: Regressions of Crash Risk on Political Homophily: Subsamples of Institutional Ownerships

Dep. Var.	$NCSKEW_t$		$DUVOL_t$	
	High IO	Low IO	High IO	Low IO
	(1)	(2)	(3)	(4)
$PHISinclair_{t-1}$	-0.047***	-0.011	-0.049***	-0.008
	(-3.13)	(-0.86)	(-3.15)	(-0.62)
$RepSinclair_{t-1}$	0.000	-0.030***	0.000	-0.034***
	(0.03)	(-2.92)	(0.02)	(-2.92)
$Sigma_{t-1}$	15.402***	5.561**	9.717***	3.362*
	(5.23)	(2.44)	(4.56)	(1.75)
Ret_{t-1}	0.311***	0.241***	0.388***	0.303***
	(7.06)	(8.18)	(11.71)	(9.83)
$Dturn_{t-1}$	-0.017	0.003	-0.017	0.006
	(-1.34)	(0.26)	(-1.37)	(0.54)
MB_{t-1}	0.013***	0.007***	0.014***	0.008**
	(3.83)	(3.07)	(4.13)	(2.28)
Lev_{t-1}	-0.305***	-0.134	-0.305**	-0.260**
	(-2.73)	(-1.02)	(-2.38)	(-2.11)
ROA_{t-1}	1.843***	1.640***	2.228***	2.013***
	(8.39)	(7.99)	(8.56)	(9.77)
$LnMV_{t-1}$	-0.350***	-0.255***	-0.400***	-0.288***
	(-9.05)	(-11.26)	(-11.25)	(-11.47)
DA_{t-1}	-0.019	0.010	-0.017	0.006
	(-0.44)	(0.29)	(-0.57)	(0.19)
$LnBoardSize_{t-1}$	0.193**	0.129*	0.230**	0.099
	(2.30)	(1.68)	(2.49)	(1.21)
$Connection_{t-1}$	-0.274	0.128	-0.204	0.076
	(-0.92)	(0.54)	(-0.64)	(0.32)
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	9,966	9,934	9,966	9,934
R^2	0.201	0.208	0.209	0.224

Panel B: Regressions of Crash Risk on Political Homophily: Subsamples of E-index

Dep. Var.	$NCSKEW_t$		$DUVOL_t$	
	High E-index	Low E-index	High E-index	Low E-index
	(1)	(2)	(3)	(4)
$PHISinclair_{t-1}$	-0.017	-0.028**	-0.023	-0.027**
	(-0.95)	(-2.36)	(-1.28)	(-2.16)
$RepSinclair_{t-1}$	-0.043**	0.001	-0.040**	-0.005
	(-2.15)	(0.11)	(-2.37)	(-0.41)
$Sigma_{t-1}$	9.887***	8.274***	5.673**	4.714***
	(3.56)	(4.25)	(2.29)	(3.05)
Ret_{t-1}	0.305***	0.264***	0.387***	0.327***
	(7.86)	(9.47)	(9.31)	(10.36)
$Dturn_{t-1}$	-0.005	-0.010	-0.010	-0.002
	(-0.38)	(-0.81)	(-0.61)	(-0.26)
MB_{t-1}	0.015***	0.008***	0.014***	0.010***
	(3.10)	(3.03)	(2.84)	(3.30)
Lev_{t-1}	-0.299**	-0.302**	-0.355**	-0.345***
	(-2.05)	(-2.53)	(-1.98)	(-3.24)
ROA_{t-1}	2.222***	1.983***	2.702***	2.340***
	(7.58)	(11.05)	(8.41)	(13.86)
$LnMV_{t-1}$	-0.339***	-0.282***	-0.363***	-0.332***
	(-10.11)	(-10.09)	(-7.93)	(-11.81)
DA_{t-1}	0.036	-0.004	0.010	-0.005
	(0.79)	(-0.11)	(0.23)	(-0.14)
$LnBoardSize_{t-1}$	0.240*	0.102	0.198*	0.129*
	(1.77)	(1.38)	(1.88)	(1.86)
$Connection_{t-1}$	-0.217	-0.397	-0.253	-0.326
	(-0.64)	(-1.30)	(-0.97)	(-1.11)
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	6,673	11,709	6,673	11,709
R^2	0.238	0.189	0.243	0.204

Table 10: Political Homophily Index and CEO Turnover-performance Sensitivity

This table reports the linear probability regressions of CEO turnovers on firms' stock returns. *Turnover* is a dummy variable that equals one if a firm experiences a CEO turnover in a given year, and zero otherwise. *Ret* is a firm's cumulative stock returns in the past four years. *PHISinclair* is the political homophily index between a firm's CEO and independent directors, calculated using individual-level Republican index predicted by Sinclair acquisitions. Definitions of all other variables are provided in the Appendix. Columns (1) and (2) report the regressions in the full sample. Columns (3) to (6) (Columns (7) and (10)) report the regressions in subsamples based on whether a firm's institutional ownership (E-index) is above or below the sample median. All regressions include firm and year fixed effects. Robust t-statistics, calculated using bootstrapped standard errors, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	$Turnover_{t+1}$									
			Institutional ownership				E-index			
	Full sample		High		Low		High		Low	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
$PHISinclair_t \times Ret_{(t-3,t)}$		0.077***		-0.018		0.149***		0.092***		0.072
		(2.70)		(-0.54)		(3.74)		(2.75)		(1.48)
$PHISinclair_t$		-0.011*		0.006		-0.016*		-0.014*		-0.003
		(-1.79)		(0.81)		(-1.78)		(-1.69)		(-0.27)
$Ret_{(t-3,t)}$	-0.102***	-0.370***	-0.091**	-0.031	-0.113**	-0.628***	-0.081**	-0.407***	-0.094*	-0.340*
	(-3.39)	(-3.23)	(-2.05)	(-0.23)	(-2.52)	(-4.37)	(-2.07)	(-3.26)	(-1.93)	(-1.78)
$RepSinclair_{t-1} \times Ret_{(t-1,t-4)}$		-0.011		0.012		-0.011		-0.002		-0.013
		(-0.53)		(0.37)		(-0.42)		(-0.06)		(-0.42)
$RepSinclair_{t-1}$		0.003		-0.001		0.006		0.001		0.007
		(0.71)		(-0.14)		(0.82)		(0.08)		(1.06)
$RetireAge_t$	0.096***	0.097***	0.121***	0.121***	0.084***	0.087***	0.093***	0.094***	0.099***	0.098***
	(5.30)	(5.54)	(4.20)	(3.42)	(3.29)	(3.25)	(4.07)	(4.26)	(2.78)	(2.66)
$LnTenure_t$	0.262***	0.261***	0.269***	0.270***	0.283***	0.283***	0.265***	0.265***	0.356***	0.358***
	(19.68)	(18.12)	(13.38)	(12.77)	(14.44)	(15.35)	(15.09)	(18.73)	(12.62)	(13.80)
$LnAsset_t$	0.028**	0.028***	0.014	0.014	0.029*	0.029*	0.048***	0.048***	-0.033*	-0.034**
	(2.47)	(2.86)	(0.83)	(0.97)	(1.72)	(1.70)	(3.15)	(3.80)	(-1.65)	(-2.16)
MB_t	-0.001	-0.001	0.001	0.001	-0.003	-0.003	-0.001	-0.001	0.001	0.001
	(-0.77)	(-0.73)	(0.42)	(0.49)	(-1.34)	(-1.14)	(-0.66)	(-0.67)	(0.23)	(0.31)
$DividendPay_t$	0.015	0.015	-0.004	-0.004	0.036	0.035	0.011	0.012	0.044	0.044
	(0.89)	(1.04)	(-0.16)	(-0.18)	(1.48)	(1.61)	(0.55)	(0.74)	(1.34)	(1.37)
Firm FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	10,212	10,212	4,970	4,970	4,945	4,945	3,806	3,806	6,201	6,201
R-squared	0.235	0.236	0.273	0.273	0.280	0.283	0.307	0.308	0.275	0.276

Table 11: Political Homophily and Tobin's Q

This table presents the regressions of Tobin's Q on the political homophily index. Tobin's Q is calculated as the ratio of a firm's market value of assets to its book value of assets. *PHISinclair* is the political homophily index between a firm's CEO and independent directors, calculated using individual-level Republican index predicted by Sinclair acquisitions. Definitions of all other variables are provided in the Appendix. Column (1) reports the regression in the full sample. Columns (2) and (3) (Columns (4) and (5)) report the regressions in subsamples based on whether a firm's institutional ownership (E-index) is above or below the sample median. All regressions include firm and year fixed effects. Robust t-statistics, calculated using bootstrapped standard errors, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	*Tobin's Q_t*				
	Full sample	High IO	Low IO	High E-index	Low E-index
	(1)	(2)	(3)	(4)	(5)
$PHISinclair_{t-1}$	-0.010*	-0.003	-0.019***	-0.014*	-0.000
	(-1.75)	(-0.36)	(-2.59)	(-1.65)	(-0.01)
$RepSinclair_{t-1}$	-0.009	-0.010	-0.003	-0.017*	-0.009
	(-1.41)	(-1.09)	(-0.35)	(-1.73)	(-0.97)
ROA_{t-1}	3.625***	3.579***	3.565***	3.086***	3.874***
	(21.44)	(13.63)	(13.96)	(11.04)	(16.42)
$CAPEX_{t-1}$	0.746***	0.677***	0.788***	0.655***	0.662***
	(10.22)	(7.04)	(7.71)	(6.01)	(8.82)
RD_{t-1}	2.643***	1.285*	3.587***	2.534***	2.016**
	(4.69)	(1.88)	(6.57)	(3.14)	(2.29)
$LnAsset_{t-1}$	-0.252***	-0.298***	-0.255***	-0.220***	-0.295***
	(-10.19)	(-8.37)	(-7.29)	(-5.91)	(-7.58)
Lev_{t-1}	-0.077	0.015	-0.033	-0.101	-0.034
	(-1.25)	(0.11)	(-0.26)	(-0.62)	(-0.33)
$LnBoardSize_{t-1}$	-0.128***	-0.196***	-0.025	-0.055	-0.113*
	(-2.80)	(-3.22)	(-0.33)	(-1.01)	(-1.81)
$Connection_{t-1}$	0.222*	-0.017	0.403**	0.104	0.371**
	(1.87)	(-0.14)	(2.02)	(0.52)	(2.16)
Firm FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	20,354	9,966	9,934	6,673	11,709
R^2	0.766	0.795	0.778	0.831	0.787

Appendix: Definition of variables

Variables	Definition
NCSKEW	Negative ratio of the third moment of firm-specific daily returns over the standard deviation of firm-specific daily returns raised to the third power, calculated using Equation (4)
DUVOL	Natural logarithm of the ratio of down-day to up-day standard deviation of firm-specific returns, calculated using Equation (5)
PHI	Political homophily index between a firm's CEO and independent directors, calculated using Equation (2)
PHISinclair	Political homophily index between a firm's CEO and independent directors, constructed using director Republican indices predicted by Sinclair acquisitions.
RepCEO	Republican index of a firm's CEO, calculated using Equation (1).
RepIndep	Average Republican index of a firm's independent directors, calculated using Equation (1).
RepSinclair	Average Republican index of a firm's independent directors predicted by Sinclair acquisitions.
Sigma	The yearly standard deviation of a firm's daily firm-specific stock returns.
Ret	Cumulative firm-specific daily returns in a given year.
Dturn	Average monthly share turnover in year *t* minus the average monthly share turnover in year *t-1*.
MB	Market-to-book ratio, defined as market value of equity (PRCC_F×CSHO) divided by book value of equity (CEQ).
Lev	Book leverage, defined as book value of long-term debt (DLTT) divided by total assets (AT).
ROA	Return on assets, defined as operating income before depreciation (OIBDP) divided by book value of assets (AT).
LnMV	Natural logarithm of market value of equity (PRCC_F×CSHO).
DA	Discretionary accruals, estimated using the Jones (1991) model.
LnBoardSize	Natural logarithm of the number of directors in a firm.
Connection	Percentage of a firm's directors who are socially connected to the CEO, constructed following Dasgupta, Zhang, and Zhu (2015).
Sinclair	A dummy variable that equals one if a director or CEO is affected by a Sinclair acquisition in her county of residence in a given year, and zero otherwise
Ret0	The market adjusted return of an insider's purchase for 0 trading days (i.e., the return of investing one dollar mimicking the insider trade minus the return of taking the opposite position in the CRSP value-weighted market index).
Ret30	The market adjusted return of an insider's purchase for 30 trading days (i.e., the return of investing one dollar mimicking the insider trade minus the return of taking the opposite position in the CRSP value-weighted market index).
Ret60	The market adjusted return of an insider's purchase for 60 trading days (i.e., the return of investing one dollar mimicking the insider trade minus the return of taking the opposite position in the CRSP value-weighted market index).
Ret90	The market adjusted return of an insider's purchase for 90 trading days (i.e., the return of investing one dollar mimicking the insider trade minus the return of taking the opposite position in the CRSP value-weighted market index).
Ret180	The market adjusted return of an insider's purchase for 180 trading days (i.e., the return of investing one dollar mimicking the insider trade minus the return of taking the opposite position in the CRSP value-weighted market index).

Independent	A dummy variable that equals one if an trading insider is an independent director, and zero otherwise.
TradeSize	Size of an insider transaction, defined as the fraction of the firm's market capitalization.
CAPEX	Capital expenditure (CAPX) divided by net property, plant, and equipment (PPENT).
RD	Research and development expenses (XRD) divided by total assets (AT).
LnAsset	Natural logarithm of book value of total assets (AT).
Divest	A dummy variable that equals one if the acquired firm in a transaction is subsequently divested in the three years after the completion date of the acquisition.
CAR	An acquirer's three-day cumulative abnormal return around the announcement date of transaction, estimated using the market model.
AcqSize	Natural logarithm of an acquirer's total assets.
AcqMB	Market-to-book ratio of an acquirer.
AcqLev	Book leverage of an acquirer.
AcqROA	Return on assets of an acquirer.
LnDealValue	Natural logarithm of the transaction size of an acquisition, set to zero if missing.
MissingDealValue	A dummy variable that equals one if the transaction value is missing, and zero otherwise.
Hostile	A dummy variable that equals one if an acquisition is flagged as hostile in the Capital IQ database, and zero otherwise.
Stock	A dummy variable that equals one if an acquisition is flagged as a stock merger in the Capital IQ database, and zero otherwise.
Tender	A dummy variable that equals one if an acquisitions is flagged as an tender offer in Capital IQ database, and zero otherwise.
Turnover	A dummy variable that equals one if a firm experiences a CEO turnover in a given year, and zero otherwise.
RetireAge	A dummy variable that equals one if a CEO is above 65-year-old, and zero otherwise.
LnTenure	Natural logarithm of a CEO's tenure.
DividendPay	A dummy variable that equals one if a firm pays dividend in a given year, and zero otherwise.
Tobin's Q	Tobin's Q, defined as market value of equity (PRCC_F×CSHO) plus book value of assets (AT) minus book value of equity (CEQ) minus deferred taxes (TXDB, set to zero if missing) divided by book value of assets.
Vol	Standard deviation of a firm's daily stock returns in a given year.
IdioVol	Idiosyncratic stock return volatility, estimated using the Fama-French three-factor model.
PHI (Time-invariant)	Political homophily index constructed using the individuals' Republican index based on their total amount of contribution up to the year 2019.
PHI (Prior)	Political homophily index constructed using the individuals' historic Republican index (i.e., for each individual *p* in year *t*, the Republican index calculated using her historic contribution made before year *t*).
PHI (Strong)	Political homophily index constructed using the Republican index of the individuals whose differences in contributions to the two parties exceed $2,000 in the election cycle.
PHI (Large)	Political homophily index constructed using the Republican index of the individuals whose historical total amounts of contribution exceed $2,000.

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