Corporate Political Activities: Antecedents and Consequences

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To My Mom ...

Declaration

I confirm that this is my own work, and the use of all material from other sources has been properly and fully acknowledged.

Statement of Double PhD Award

I confirm that this dissertation is also submitted to Politecnico di Milano for a double PhD Degree.

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I confirm that Chapter 1 of the dissertation (*Politicians on Board! What Drive Foreign Firms to Build Political Connections?*) is jointly co-authored with Davide Castellani (Henley Business School), Stefano Elia (Politecnico di Milano), and Irina Surdu (Warwick Business School), and I contributed more than 50% of the work.

Signature:

Irakli Barbakadze

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Abstract

Companies are active in the political market to access valuable government resources, build legitimacy, and influence the policy in their favour. The main question in the political strategy literature is to understand which firms participate in the political market and how these political activities affect firm-level outcomes. The dissertation studies both aspects of political activities in three independent chapters.

The first chapter, *"Politicians on Board! What Drives foreign firms to Build Political Connections"* (co-authored with Davide Castellani, Stefano Elia, and Irina Surdu) studies the differences between foreign and domestic firms in their propensity to build political connections. The study examines the variation in firms' political connections based on a comprehensive dataset of 22,672 firms from 41 countries (BEEPS). The findings show that foreign ownership is an important antecedent of a firm's political connection status. Specifically, foreign-owned firms are 2.8 percentage points less likely to be politically connected than their domestic-owned counterparts. By integrating Liability of Outsidership (LoO) and Resource Dependency Theory (RDT), the results also document that the propensity of political connections for foreign firms increases with the degree of dependency on local market conditions. Foreign firms use political connections more when they (1) have higher local market commitment; (2) operate in industries with high informal regulation; or (3) operate in an autocratic political system.

While the first chapter studies the antecedents of political connections, the second chapter (*"With a Little Help from My Friend: Political Connections and Allocation of COVID-19 Aid"*) focuses on the impact of political connections on the allocation

of government support programs during the COVID-19 pandemic. Using Enterprise Survey (BEEPS) data and the corresponding COVID follow-up survey rounds covering 11,853 firms from 30 countries, the study shows that a firm's political connection status does not affect the overall propensity of receiving government support. However, results are heterogeneous and depend on the program type. Politically connected firms have a higher propensity (3.6 percentage points) to obtain direct cash transfers than those without political connections; the effect is muted for other programs, such as credit payment deferral, access to new credit, fiscal exemption, and wage subsidy. Furthermore, political bias in distributing cash transfers was only observed during the first few months of the COVID-19 pandemic when the rules of government programs still needed to be set, and the eligibility criteria were not defined. The study also provides evidence that political bias may lead to resource misallocation. The results show that the value of political connections was much larger among firms that did not experience any negative shock during the pandemic; political connection compensates firms' non-eligibility status and allows them to receive cash transfers. Lastly, the value of political connections does not vary much, and it is equally observed in different institutional contexts.

The third chapter, *"Political Insurance. Lobbying Behaviour of UK-Listed Firms"*, also focuses on the impact of political activities on firm-level outcomes. Specifically, the study investigates how firms' lobbying activities affect their disclosed political risk. Beyond the traditional rent-seeking benefits, lobbying can also overcome information asymmetry between firms and policymakers, which enables them to mitigate their exposure to political risk. To test this relationship empirically, the study uses a novel dataset of the lobbying meetings between firms and UK government officials and combines it with firms' disclosed political risk. The final sample, therefore, consists of 430 UK-based publicly listed firms from 2012 through 2020. The results show that lobbying reduces firms' exposure to political risk. An additional meeting with government officials is associated with a 0.89% drop in firm-level political risk. To unlock the information advantage mechanism, the study argues that the benefits of lobbying depend on the type of firm-level risk. The results document that lobbying is not an effective tool to mitigate

the risk coming from non-political sources. Also, lobbying can reduce firms' exposure to political risk, but its effectiveness depends on the political risk type. The risk coming from economic policies, not fully controlled by the home government, is difficult to mitigate. Lastly, the value of lobbying is larger during periods of high economic policy uncertainty when the demand for policy information is high.

Overall, the findings of the dissertation demonstrate that political strategy is an effective mechanism to obtain legitimacy in the host country market, receive financial support from the government, and acquire policy information to hedge against political uncertainty.

Contents

List of Tables

List of Figures

Chapter 1

Introduction

Business and politics are highly interconnected. As main political actors, governments set policies and regulations and allocate public finance through procurement and government subsidies, which significantly affect firms' operations and future prospects. Considering such high stakes in the political market, companies decide to participate in the political process to access valuable government resources, build legitimacy, and influence the policy in their favour. There is substantial evidence that corporate political activities (CPA) significantly affect firm-level performance and country-level economic and political outcomes (Akcigit et al., 2023; Faccio, 2006; Huneeus and Kim, 2018; Blanga-Gubbay et al., 2020).

Besides the practical importance, the topic has gained significant scholarly interest from many disciplines, such as management, economics, and political science. Although different disciplines have different research questions to address, everyone agrees that CPA is a promising research area to explore. In management literature, corporate political activities are considered an integral part of firms' non-market strategy and are defined as proactive actions to affect the public policy environment in a way favourable to the firm (Hillman et al., 2004). Since the influential work by Epstein (1969), studying the role of corporations in American politics, the field of CPA has grown rapidly, especially in the last few decades. Many systematic literature review papers have been published recently (Lawton et al. (2013); Lux et al. (2011); Mellahi et al. (2016); see

also Katic and Hillman (2022) and Wei et al. (2022)) for the most recent reviews), which highlight the significant development of the field in many different directions. Nevertheless, the (1) different forms of CPA tactics, (2) antecedents of CPA, and (3) consequences of CPA are still considered prominent areas of current and future research.

In terms of CPA tactics, there are various activities firms can employ to build political ties and participate in the political process. These include party contributions, political lobbying, personal connections with government officials, or directly appointing former politicians into corporate positions. Despite the common goals, political activities have different characteristics; therefore, some tactics are more frequently adopted than others[1]. The empirical literature has disproportionally focused on lobbying and campaign contributions due to the legal nature of those activities in the United States and the data availability. However, there are some important changes in this direction. First, there is a growing number of papers identifying newer tactics of firms' political activities, such as political advocacy, political CSR, and corporate political philanthropy (Wettstein and Baur, 2016; Bertrand et al., 2020, 2021; Flammer, 2018). Second, other papers have focused on tactics commonly used in CPA practice but have been difficult to study empirically because of the data limitation. For instance, different types of political connections through family or social networks and revolving doors when former politicians have corporate roles in companies (Acemoglu et al., 2016; Schoenherr, 2019; Faccio, 2006; Okhmatovskiy, 2010; Sofka et al., 2021; Akcigit et al., 2023; El Nayal et al., 2021). This dissertation contributes to this new development of CPA tactics not only by studying relatively unexplored political activities (i.e., political appointments) but also by better understanding the mechanism of how the existing political tactics work (i.e., lobbying).

Not all firms are active in the political market. Firms have different incentives and capabilities to adopt political strategies, affected by their own characteristics as well as industry and institutional-level factors (Hillman et al., 2004). While some CPA ante-

[1]See Hillman and Hitt (1999) for the original classification of political activities and Katic and Hillman (2022) for the updated version.

cedents are already well-documented in the empirical literature, including firm size, slack resources, government ownership, dependency on government, and industry regulations (Weymouth (2012); Bombardini (2008); Hillman (2005); see Lux et al. (2011) for a review), others require further investigation. Firm foreign ownership is one of the CPA antecedents that has gained considerable research interest in the last few decades. There is a growing literature in International Business (IB) that highlights the importance of political strategies for Multinational Enterprises (MNEs) to overcome the Liability of Outsidership (LoO) associated with initial unfamiliarity with local rules and regulations, gain legitimacy, and attain some degree of political influence in the host country market (Sojli and Tham, 2017; Banerjee et al., 2019; Desbordes and Vauday, 2007). The literature often studies MNEs' political strategies in isolation which does not allow for comparison between foreign and domestic firms in their ability to build political connections. There are a few exceptions. Earlier papers by Hansen and Mitchell (2000) and Mitchell et al. (1997) studied the role of foreign ownership in using different types of corporate political activity. However, these papers mainly focus on the 1987-1988 election campaign in the US, which makes it harder to generalize the results in different country contexts and for recent periods. The issue of generalizability is also a concern for the work by Wöcke and Moodley (2015), where they investigate the differences between corporate political activities of local and foreign firms in the South African Health Sector.

This dissertation enriches CPA and IB literature by directly studying the effect of foreign ownership on political connections in the most recent and multi-country setup and identifying the different market conditions affecting this relationship. This research also provides institutional comparisons, allowing us to understand the role of institutions in political strategy. Considering that most papers in this literature are country-specific (mostly US-centric - (Acemoglu et al., 2016; Goldman et al., 2013; Bertrand et al., 2021), to name a few; Denmark - Amore and Bennedsen (2013); South Korea - Schoenherr (2019); Pakistan - Khwaja and Mian (2005); Brazil – Claessens et al. (2008); Italy - Akcigit et al. (2023); Lithuania - Baltrunaite (2020); and many others), such cross-country comparison is an essential contribution for both CPA and IB research.

Lastly, when it comes to the impact of political activities on firm-level outcomes, the results are not conclusive. Some politically active firms enjoy a better financial performance, but others do not (Akcigit et al., 2023; Bertrand et al., 2018; Fisman, 2001; Acemoglu et al., 2016; Ovtchinnikov et al., 2020; Amore and Bennedsen, 2013). This can be explained by the costs associated with political activities, the firm capabilities, type of political connections, institutional context, etc. Nevertheless, the link between political activities and firm financial performance is not well-understood; someone needs to examine the mechanism of how the political marketplace works, what types of resources are exchanged between firms and policymakers, and what benefits firms can expect to obtain in this market. This dissertation fills a gap in the literature by studying two other outcome variables of political activities (i.e., access to government support programs and firm-level political risk) and identifying the channel through which such results can be achieved. While rent-seeking benefits of political activities are relatively well-explored (Schoenherr, 2019; Baltrunaite, 2020; Titl and Geys, 2019; Faccio et al., 2006), this dissertation unlocks a novel information advantage mechanism that enables firms to overcome information asymmetry between themselves and policymakers and help to reduce political risk exposure.

Overall, the dissertation contributes to the CPA literature by better understanding which firms are politically active, how different market conditions affect firms' political participation, and what type of benefits firms receive in the political market. The dissertation comprises three independent research projects explained below.

1. Politicians on Board! What drives foreign firms to build political connections? (with Davide Castellani, Stefano Elia, and Irina Surdu)

2. With a Little Help from My Friend: Political Connections and Allocation of COVID-19 Aid.

3. Political Insurance. Lobbying Behaviour of UK-Listed Firms.

The first chapter studies the relationship between firms' foreign ownership and their political connection status; it asks whether foreign-owned firms are more/less likely to

be politically connected than their domestic counterparts. Here, a political connection is defined as having an owner/CEO/top manager/board member previously elected or appointed to a political position. Although the benefits of political connections for foreign firms are significant in terms of overcoming the LoO and gaining legitimacy in the host country market, the relationship is not trivial, especially if we consider the costs associated with such a high-commitment political strategy.

One of the contributions of this study is to explore the link between foreign ownership and political connection based on the most recent and comprehensive version of the Business Environment and Enterprise Performance Survey (BEEPS), compiled by the European Bank for Reconstruction and Development (EBRD) and the World Bank, and including nearly 25,000 firms from 41 economies. BEEPS has gained significant scholarly interest in the last decades due to the large coverage of firms from multiple countries as well as the particular focus on business and government relationships (Desbordes and Vauday, 2007; Aisbett and McAusland, 2013; Campos and Giovannoni, 2007; Chong and Gradstein, 2010). Using the latest wave of BEEPS VI conducted in 2019, first, the results document that political connections are pervasive and observed in both developed and developing countries. There is also a significant heterogeneity across firms in using political connections. The empirical results show that firms' foreign ownership status does play a significant role in building political connections, and the relationship is negative. Specifically, foreign firms are less likely to be politically connected than domestic firms. This result can be explained by the significant accompanying costs of political connection faced by foreign firms in the host country market. For instance, foreign firms have high search costs to identify relevant stakeholders and build political capital. Also, foreign firms are likely to have more controls as they require to legitimize their operations not only in the host country but also in their home country, to headquarters, and other global stakeholders (Hillman and Wan, 2005; Meyer et al., 2020). Furthermore, political connections risk losing organizational autonomy and expropriation activities through self-dealing and tunneling (Bertrand et al., 2018), which is particularly pronounced for foreign firms as they often possess superior international knowledge and technological

capabilities. All these may discourage foreign firms from using such high-commitment political strategies abroad. However, this relationship is not persistent, and it is mainly context-dependent. To the best of our knowledge, this is one of the first comparative studies highlighting the differences between foreign and domestic firms in the political market.

In terms of theoretical contributions, this study integrates the Resource Dependency Theory (RDT) and LoO perspectives and conceptualizes that the relationship between foreign ownership and political connection changes in the presence of dependency on local market conditions. As the dependency grows, foreign firms require more domestic knowledge and expertise to overcome their outsider status, which creates extra incentives for them to build political connections. There is empirical support for all three moderating factors. In particular, foreign-owned firms use political connections more when they (1) have higher local market commitment; (2) operate in industries with high informal regulations; or (3) operate in an autocratic political system. These findings suggest the importance of institutions in developing political strategies and motivating cross-country comparative studies in the future.

The second chapter uses the same BEEPS VI survey data and the corresponding COVID-19 Follow-up Enterprise Survey (CFES) and studies the distribution of COVID-19 support programs. It is already well-documented that the COVID-19 pandemic had significant negative economic consequences (Bloom et al., 2021; Chetty et al., 2020; Brucal et al., 2021; Apedo-Amah et al., 2020). Such unprecedented health shock forced businesses around the globe to shut down and caused a severe liquidity crunch for millions of firms. Governments worldwide devoted substantial financial resources to help firms in need and facilitate economic recovery (i.e., Paycheck Protection Program in the US, Covid Corporate Financing Facility program in the UK, European Guarantee Fund (EGF) in the EU, and many other programs). The central question in this literature is to study the effectiveness of these support programs. As it is difficult to estimate the long-run effects of the policy because of the relatively short time after the treatment, this chapter studies only the distribution phase and investigates whether there were

any political distortions in the process. Specifically, this study asks whether firms with former politicians as owners, CEOs, or board members had better access to COVID-19 support programs than similar firms without political connections.

Thus, the study contributes to the political economy literature by better understanding the value of political connections during the most recent COVID-19 pandemic. While the benefits of political connections in securing government contracts, receiving corporate bailouts, and having preferential access to external finance are relatively well-documented (Baltrunaite, 2020; Goldman et al., 2013; Titl and Geys, 2019; Faccio et al., 2006; Khwaja and Mian, 2005; Schoenherr, 2019), the less is known about the value of political connections during the emergency events such as natural disasters, financial crises, or the most recent global pandemic when government support policies are critically important for firm survival and long-term economic recovery.

The empirical analysis in this chapter is based on the two major datasets; it combines BEEPS VI data with the COVID-19 Follow-up Enterprise Survey (CFES) conducted multiple times during the pandemic. The CFES provides detailed information on the impact of the COVID-19 shock on firms' performance, layoffs, expectations, and access to government support policies. The main identification strategy for the empirical analysis is the unexpected nature of the COVID-19 shock and the fact that firms' political connection status are observed just before the start of the pandemic in 2019 and the access to government support programs right after.

The empirical results of the study speak to the political economy and the COVID economics literature. First, the results show no significant evidence of political bias in distributing COVID-19 support policies either in intensive or extensive margins, which is surprising as previous studies documented the strong positive effect of political connections in accessing government support (Vukovic (2021); Blau (2017); Choi et al. (2021) during the 2008-09 financial crisis and Barrick et al. (2021) during the COVID-19 pandemic). To provide further insights and identify the mechanism behind the allocation of government support, each support program is studied individually. The results show that political connections matter only for distributing cash transfers, whereas the effect

is muted for other programs, such as deferral of credit payment, access to new credit, tax reduction, and wage subsidy. These findings can be explained by the unique features of direct cash transfers, which make it the most desirable policy tool and also allow government officials to use their discretionary power to allocate relief money according to their political interests.

The study also sheds new light on the time dimension of the value of political connections. The results indicate that political connections provided better access to cash transfer programs only during the first few months of the COVID-19 pandemic when the rules were not yet set, and the eligibility criteria were not well defined. In the later periods, economic determinants of funding allocation became more significant, and the political connections were no longer statistically important.

To study whether political bias may lead to resource misallocation, one would need to analyze the financial performance of politically connected and unconnected firms before and after receiving government support and compare the results. Due to the unavailability of firms' long-term financial performance, this study focuses on allocative efficiency instead. The results document that the value of political connections was higher among the firms that were not eligible for government support; political connections compensate for the firms' non-eligibility status and give them the same propensity to receive cash transfers as their eligible counterparts. Since the allocation of public support is an important pre-condition for the overall effectiveness of the program, these results have important policy implications. Lastly, the study shows that political bias is equally observed in different institutional contexts, regardless of the quality of institutions or the effectiveness of the government, and the value of political connections remains unchanged. It explains why political connections are relevant in all institutions and observed in many countries worldwide.

Compared to the first and the second chapters, studying political connections as a way of political activities and using cross-country firm-level data, the third chapter explores lobbying practices in the UK. The country's current economic and political development makes it an excellent case to study, especially during Brexit, the COVID-19

pandemic, and the multiple cabinet changes. As the lobbying literature is US-centric, studying lobbying activities outside the US is an important contribution to the political economy literature. Specifically, this study shows how firms lobby in the UK and whether such lobbying activities help firms to reduce their exposure to political risk and uncertainty.

Considering the growing trend in economic policy uncertainty in the UK and worldwide and its detrimental effect on firms' performance (Gulen and Ion, 2016; Jens, 2017; Bhattacharya et al., 2017; Bonaime et al., 2018; Pástor and Veronesi, 2013), it is critical to understand how firms manage such uncertainty and mitigate its negative consequences. A recent stream of research considers political activities, i.e., political lobbying, party donations, and other forms of political connections, as effective risk-hedging tools. However, they often study political strategy as a moderator in the uncertainty and firm performance relationship and importantly, they fail to identify the underline mechanism of how such effect can be achieved (Cheng et al., 2021; Ferracuti et al., 2022; Wellman, 2017; Azzimonti, 2018). This research fills a gap in the literature by examining the direct link between lobbying and firm-level political risk and unlocks a novel information advantage mechanism. By engaging in lobbying activities, firms reduce the information asymmetry between themselves and policymakers, enabling them to better anticipate and influence policy outcomes and therefore, reduce their political risk exposure.

To study this relationship empirically, the chapter exploits three major datasets. First, the study joins the burgeoning literature on using political risk measured at the firm level (Egerod and Aaskoven, 2022; Hassan et al., 2019; Shang et al., 2021). It is a reported political risk disclosed in firms' quarterly conference call reports. Firm-level political risk is an advantageous measure compared to other time series political risk data (i.e., Baker et al. (2016) as it allows firms' political risk to vary in the time series and the cross-section. Firms have different exposure to political risk given the overall level of uncertainty in the economy. Second, the study pioneers research on measuring lobbying activities by counting the number of lobbying meetings between firms and policymakers.

Compared to other monetary measures, the lobbying variable in this study allows us to observe firms' actual interaction with the government and helps us unlock information exchange mechanism. The last set of data is OSIRIS which covers the financial and balance sheet information for the sampled firms.

The empirical results of the study support the main hypothesis that lobbying reduces firm-level political risk. Several additional analyses have been done to further examine the idea that lobbying helps firms obtain policy-relevant information, allowing them to report a lower political risk. First, the results document that the effectiveness of lobbying as a risk-mitigating tool varies across different political risk types. For instance, the largest effect of lobbying on political risk reduction is observed in the risk coming from institutions and political processes, tax policy, and the environment. In contrast, the smallest effect is in trade policy. This is consistent with the information advantage mechanism; the risk from economic policies, i.e., trade policy, that is not fully controlled by the government are difficult to mitigate, as there is little information exchange between firms and policymakers. Second, lobbying as a political strategy tool is less effective for managing the risk coming from non-political sources. Third, the value of lobbying is larger during periods of high economic policy uncertainty when the demand for policy information is high. These findings provide direct empirical evidence that lobbying should be considered not only as a rent-seeking mechanism but also as a tool to mitigate external risk coming from government policies and regulations. By doing so, the study contributes to the political economy literature by better understanding the new benefits of lobbying activities and identifying the channel through which such benefits are achieved.

Overall, this dissertation makes significant contributions to different strands of literature. First, it enriches CPA and political economy literature by better understanding the different forms of political activities and studying their effectiveness in terms of different firm-level outcomes. Specifically, the second chapter estimates the effect of political connections (through revolving doors) on receiving government support, whereas the third chapter studies the role of political connections (through lobbying) in redu-

cing political risk exposure. The underlying mechanism in both cases is that politically connected firms have better access to government officials, enabling them to obtain important government resources, either financial or information. Despite the significant benefits of political connections, not all firms are equally active in the political market due to the accompanying costs of political activities. Firms have different incentives and capabilities to build political connections. The first chapter enriches CPA and IB literature by directly studying the differences between domestic and foreign firms in their political activities and understanding the role of institutions in political strategy formulation. Lastly, the empirical results of the dissertation also have managerial implications; they provide valuable insights for company managers on how to design their political activities better and how to use their political capital to deal with political risk and uncertainty, including the most recent COVID-19 pandemic.

The rest of the dissertation is structured as follows. Chapter 2, Chapter 3, and Chapter 4 presents individual studies, which constitute the main body of the dissertation. Chapter 5 discusses the implications of the main findings and provides a broad outlook for future research in corporate political activities.

Chapter 2

Politicians on Board! What Drive Foreign Firms to Build Political Connections?

2.1 Introduction

Firms continually face changing government policies and regulations, which create risk and uncertainty, and significantly alter their operations. From a Resource Dependency Theory (RDT) (Hillman et al., 2009; Pfeffer and Salancik, 2003) perspective, firms can reduce the uncertainty from external dependency by cultivating business-government relationships, such as establishing political connections that serve corporate interests.

Extant literature in corporate political activities has mainly focused on party contributions and lobbying (Aggarwal et al. (2012); Yim et al. (2017); Shi et al. (2021); see Katic and Hillman (2022) for a recent review) and, only relatively recently, on political connections by involving former politicians in senior corporate roles (often called as revolving doors) (Okhmatovskiy, 2010; El Nayal et al., 2021; Sofka et al., 2021). Such political connections are expected to secure greater access to key political decision-makers and generate firm-specific political knowledge, which is costly and difficult to obtain due

to its complexity. Unlike transactional approaches (e.g., lobbying and party contributions), which are episodic, the political connection is considered riskier, longer-term, and a higher commitment political strategy (Hillman, 2005). Therefore, it is crucial to understand which firms adopt such political connections and how local market conditions affect their political strategy choice.

This chapter studies the relationship between firms' political connections and their foreign ownership status. International Business (IB) literature highlights the importance of political connections for foreign-owned firms to overcome the liability of outsidership, access to local market knowledge, and attain the legitimacy needed to avoid their outsider status (Sojli and Tham, 2017; Bucheli and Salvaj, 2018; Johanson and Vahlne, 2009). However, due to the significant accompanying costs, foreign firms are not always willing to engage in high-commitment political strategies. Building political connections in a host country requires relatively high search costs to identify relevant stakeholders and build political capital. Furthermore, foreign firms are likely to have more controls as they require to legitimize their operations not only in the host country but also in their home country, to headquarters, and other global stakeholders (Hillman and Wan, 2005; Meyer et al., 2020). Balancing legitimization at various levels may discourage foreign firms from using high-commitment political strategies abroad. Additionally, political connections risk losing organizational autonomy and expropriation activities through self-dealing and tunneling (Bertrand et al., 2018), which is particularly pronounced for foreign firms as they often possess superior international knowledge and technological capabilities. Hence, the relationship between foreign ownership and political connections is more nuanced and requires an empirical test to show how the costs and benefits of political connections vary across firms and depend on different local market conditions.

To test this relationship, the study uses a comprehensive and up-to-date firm-level dataset - Business Environment and Enterprise Performance Survey (BEEPS) conducted between 2018 and 2020 - which contains information about the political connections of 22,672 firms from 41 economies. Firms are considered politically connected if they have an owner/CEO/top manager/board member previously elected or appointed to

a political position. The baseline model, including the large set of firm-level control variables and industry and country fixed effects, shows that foreign firms are about 2.8 percentage points less likely to be politically connected than their domestic counterparts. Furthermore, drawing on the RDT and LoO perspectives, the study proposes that the benefits of building political connections that foreign firms gain by overcoming their outsider status depend on different local market conditions.

First, the results show that foreign firms have a higher propensity to be politically connected if they consider the host country as a main market. As the dependency on the local market increases, foreign firms require more local knowledge, which increases the cost of outsidership and raises the need for political connections. Second, the study differentiates between formal and informal regulations at the country-industry level. The results from interacting industry regulations and foreign ownership shows that foreign firms are more likely to be politically connected in industries with high informal regulations. Political capital helps foreign firms to obtain unique knowledge of local markets and informal business practices. However, the same moderating effect does not hold for formal regulations. Lastly, the results document that the probability of political connection for foreign firms is higher in autocratic countries where access to policy information is limited, and the politically connected firms have the largest influence on the political process.

This study makes three main contributions. First, it contributes to the IB and political strategy literature by comparing political connections in foreign and domestic firms. While the majority of studies in IB analyze political strategies of foreign multinationals in isolation and case study bases[2], the little is known about the comparison between foreign and domestic firms and their ability to build political connections. The earlier work by Hansen and Mitchell (2000) and Mitchell et al. (1997) are notable exceptions. They studied the differences between foreign and domestic firms using different types of

[2]Sun et al. (2010) – European and the US car manufacturers in China, Darendeli and Hill (2016) – Turkish construction MNEs in Libya, Barron et al. (2017) - Toyota and Hyundai Motor companies in Brussels, Mbalyohere et al. (2017) - advanced and emerging market MNEs in Uganda's electricity industry, Rodgers et al. (2019) – service MNEs in Ukraine, to name only a few.

corporate political activity during the 1987-88 election cycle in the US. Similar to our findings, they also document that foreign firms are less likely to make political contributions and engage in public lobbying, but they are about as likely as domestic firms to have a lobbying presence in Washington. This study builds on this literature by providing the most recent empirical evidence of political activities among foreign and domestic firms and focusing on different types of political connections through political appointments.

Second, the study identifies some market conditions that create additional incentives for foreign firms vis-à-vis domestic firms to build political connections. Existing such moderating factors explains why the gap in political connections between foreign and domestic firms exists in some markets and not in others. By doing so, this research enriches the RDT by unpacking dependency into three main types: market dependency, industry regulation dependency, and dependency on the political system, all of which might interact with LoO to explain why some foreign firms benefit more from political connections in the host country market. Third, the study contributes to the empirical political strategy literature by studying firms' political connections in 41 countries from European Union, Eastern Europe, Central Asia and the Middle East, and North Africa. To our best knowledge, this is one of the first studies (after the seminal work by Faccio (2006)) that explores political connections on such a large scale, allowing for studying the differences between institutional contexts in adopting political connections. This type of political connection, through appointing former politicians, is suitable for cross-country analysis. In most countries, such political appointments are permitted, and companies are free to hire former politicians depending on their business needs. In comparison, lobbying and corporate political donations are banned in many countries, and if they are allowed, the meaning and the interpretation might vary across countries[3]. Additionally, the sample covers all different sizes of firms which helps to explore the political activities of small and medium-sized enterprises, which are often overlooked in the literature.

[3]According to the data collected by IDEA (International Institute for Democracy and Electoral Assistance), out of 44 European countries corporate political donations are banned in 18 countries.

The rest of the chapter is organized as follows. Section 2.2 summarizes the related literature. Section 2.3 sets the hypotheses. Section 2.4 describes the data and presents the main empirical model. Section 2.5 discusses the empirical findings. Section 2.6 provides additional robustness checks. The last section 2.7 discusses the main findings and the limitations of the research and suggests potential avenues for future research.

2.2 Related Literature

Foreign ownership is one of the important firm-level antecedents of political connections. Foreign firms are politically active to overcome the LoO associated with initial unfamiliarity with local rules and regulations (Sojli and Tham, 2017; Kim, 2019), gain legitimacy in the host market (Banerjee et al., 2019; Bucheli and Salvaj, 2018; Rodgers et al., 2019), and attain some degree of political influence which may enable them to better compete with local competitors (Desbordes and Vauday, 2007).

It has been found that foreign firms use a variety of political strategies to achieve their political goals. Most notable amongst these non-market strategies are government affairs activities (Blumentritt and Rehbein, 2008; Barron et al., 2017), party contributions and lobbying expenditure (Shi et al., 2021), mobilizing grassroots political campaigns (Shirodkar and Mohr, 2015), paying bribes (Yu and Lee, 2021), or building personal ties with public officials (Chen et al., 2018). Relatively less is known about whether foreign firms appoint former politicians into key corporate roles in the host country market. A recent exception is the work by (Sofka et al., 2021). The authors studied the hiring of former government employees in Denmark. They showed empirically that foreign MNC subsidiaries pay these employees salary premiums vis-à-vis domestic firms, motivated by the fact that these political directors help them to better understand host country institutional requirements.

Compared to other political activities (i.e., lobbying, party contributions, bribery), hiring former politicians into high-level corporate positions can generate valuable political knowledge in the company. These individuals may exploit their human and social

capital developed while they serve as politicians. A political connection may also enable firms to secure a longer-term relationship with the government, access timely information about the public policy process, and even influence the policy outcomes (see also a recent review by (Wei et al., 2022) where they highlight the significant differences between lobbying and political connections). Notably, Stark and Vedres (2012) distinguished revolving door from other political strategies by stating that "[i]t is one thing for a chief executive to contribute $2,000 to a politician's campaign or a corporate PAC [political action committee]. It is quite another thing for that executive to have a party politician sitting at the table with her board of directors".

While the literature on political strategy is vast, fewer studies recognize the risks and costs of what we call a high-commitment political strategy, bringing former politicians into key corporate roles. For instance, political directors are often identified as having limited managerial skills, so they may underperform in their monitoring functions. In a study, Kang and Zhang (2018) found that political directors were more likely to miss board meetings, and their appointments were greeted more negatively. Liedong and Rajwani (2018) and Chaney et al. (2011) also showed that political ties can lead to reduced financial reporting quality and information disclosure. Furthermore, firms may risk losing organizational autonomy when political directors put their political party preferences ahead of a firm's objectives (Bertrand et al., 2018), which is why expropriation activities through self-dealing and tunneling tend to be more pronounced in politically connected firms. Political connections may also become a political liability in the aftermath of a radical shift in political institutions (Darendeli and Hill, 2016; Jiang et al., 2021; Leuz and Oberholzer-Gee, 2006). Indeed, few studies examined the effect of political ties on firms' financial performance and showed that the benefits of political connections do not necessarily exceed the costs. For instance, using the dataset of over 20,000 firms from 47 countries, Faccio (2006) documented that companies that appointed politicians to a board experienced negative but insignificant cumulative abnormal returns (CAR). Okhmatovskiy (2010) studied commercial banks in Russia between 2001 and 2003 only to find that direct political ties to the government did not significantly impact firms' return

on assets (ROA). Some examples even indicate a strong negative effect of political connections on firm value. Based on a sample of Chinese listed firms during the regulatory changes in 2009, Shi et al. (2018) showed that politically connected independent directors may destroy firm value as they are less effective in monitoring and also divert resources from a firm. See also Sun et al. (2012) for the theoretical framework of the contingent value of corporate political ties. Given the benefits and costs of such high-commitment political connections, the following section conceptualizes how foreign-owned firms build political connections compared to their domestic-owned counterparts.

2.3 Hypotheses

Resource Dependence Theory (RDT) is the main theoretical lens of the study. According to RDT, firms with larger dependency on the government are more likely to be politically active (Pfeffer and Salancik (2003); Hillman et al. (2009); see also Mellahi et al. (2016) for a review). In the context of the study, we argue that, compared to domestic firms, foreign firms depend less on the host country's government due to their international focus and hence use fewer political connections. Furthermore, foreign-owned firms may also face significant risks and costs when building political connections. Indeed, even considering the benefits of overcoming the Liability of Outsidership (LoO) and gaining legitimacy in the host country (Johanson and Vahlne, 2009), foreign firms may still have a lower propensity to be politically connected than domestic-owned firms. The rationale is three-fold and as follows.

First, building political connections in a host country carries significant search costs; it requires the firm to identify the relevant stakeholders to appoint in key corporate roles. This means spending time and effort to select the right individuals who can serve as managers or directors and effectively divert their political resources (i.e., knowledge, networks) to the firm. Search costs are higher for foreign firms, which are often considered outsiders to the local environment (Johanson and Vahlne, 2009), and thus, less aware of who the most effective appointments may be.

Second, foreign subsidiaries need to coordinate their political strategies with headquarters, home institutional stakeholders, and other sister subsidiaries (Hillman and Wan, 2005; Blumentritt and Nigh, 2002; Schnyder and Sallai, 2020). Since bringing former politicians into the company is often associated with significant reputation risk through political tagging and party control (Stark and Vedres, 2012; Jiang et al., 2021), it may adversely affect the firm's operation both in foreign and domestic markets. Thus, such a decision requires more careful consideration. High reputation risk and coordination costs may discourage foreign subsidiaries from hiring former politicians.

Third and relatedly, political connections may also create an additional risk of expropriation and information leaking, which is more pronounced for foreign subsidiaries because of their preferential access to foreign knowledge and reliance on superior know-how and technologies. Overall, foreign-owned firms face higher costs and risks associated with political connections than domestic-owned firms, which reduces the value of such political strategy and discourages them from adopting it. Specifically, the first hypothesis states that

Hypothesis 1 (H1): There is a negative relationship between foreign ownership and political connections.

Further, the value of political connections is likely to be context-dependent. By combining RDT and LoO perspective, as the dependency on the host market environment increases foreign firms require more knowledge about the local context to overcome their outsiders status leading to higher incentives to seek for political connections. The study differentiates between firm-level, industry-level, and country-level dependencies as potential moderators that affect foreign firms' propensity to build political connections and reduce the gap with domestic firms.

First, a firm's local market dependency will likely affect the relationship between foreign ownership and political connections. The dependency on the local business environment increases as the firm relies more on the local market to sell its products and

services. In this case, foreign firms need to be better informed about domestic policies and regulations, build legitimacy in the eyes of local stakeholders, and seek political influence in key strategic markets. Thus, the value of political connections increases, motivating foreign firms to take higher risks and invest in high-commitment political connections. It should also be noted that market and non-market strategies will likely be aligned. A high local market dependency reflects foreign firms' long-term interest in the market, which justifies using a corresponding long-term and high-commitment political strategy. The second hypothesis states that

Hypothesis 2 (H2): The negative relationship between foreign ownership and political connections is weaker for firms with high host market commitment.

Second, the more regulated an industry is, the more dependent firms become on the local market environment. In highly regulated industries, the government has greater control over commercial opportunities, and building political connections helps the firm to manage such government dependency (Hillman, 2005). The same intuition applies to informal industry regulations, which further incentivizes foreign firms to build political connections. Whereas foreign firms, with their superior foreign knowledge and expertise, may, to some extent, be able to understand and manage host country formal regulations, informal regulations are much more idiosyncratic and require greater embeddedness and more profound local knowledge (Mbalyohere and Lawton, 2021; Sofka et al., 2021). As the costs of outsidership increase, foreign firms are likely to become more incentivized to respond by building political connections. Bringing former politicians into high-level corporate positions may ensure local market legitimacy, a better understanding of local business practices, overcoming red tape, and more effective enforcing market contracts. Therefore, the third hypothesis states that

Hypothesis 3 (H3): The negative relationship between foreign ownership

and political connections is weaker for firms operating in highly regulated industries.

Third, beyond the industry-level policies and regulations, firms may become dependent on the broader institutional environment in which they operate. Different institutions create different incentives for foreign firms to build political connections and overcome their outsider status (Rajwani and Liedong, 2015; De Villa et al., 2019; Chen et al., 2018). In this case, the study focuses specifically on firms' decisions around the effectiveness of political strategies in autocratic compared to democratic political regimes. The autocracy versus democracy dichotomy is particularly relevant when discussing power relationships and access to local knowledge that a firm would benefit from when bringing a former politician on board.

In an autocracy, where a few high-level bureaucrats make most policy decisions, access to policy information is limited, and political influence can only be made by the most connected firms (Guriev and Treisman, 2019; Filippaios et al., 2019; Oneal, 1994). Here, embeddedness in the local political system becomes important, and foreign firms are incentivized to be politically connected. In contrast, in a democracy, the information about policies and regulations is easily accessible, public resources are distributed competitively, and policy influence can be easily achieved even without having close ties with political actors. As a result, foreign firms may be less dependent on political knowledge obtained through political connections. As such, the demand for political connections may be lower in countries with democratic political systems. Consequently, the final hypothesis states that

Hypothesis 4 (H4): The negative relationship between foreign ownership and political connections is weaker for firms operating in an autocratic political system.

2.4 Data and Model

2.4.1 Data

To test these hypotheses, the study uses the data from the Business Environment and Enterprise Performance Survey (BEEPS) provided by World Bank in collaboration with European Bank for Reconstruction and Development (EBRD) and European Investment Bank (EIB). The survey was conducted between 2018 and 2020 and covers enterprises from 41 economies of the European Union, Eastern Europe, and Central Asia, as well as the Middle East and North Africa. BEEPS data is collected from enterprises operating in manufacturing and key service sectors by using a global methodology that includes standardized survey instruments and a uniform sampling methodology in every country[4]. The latest wave of the survey (BEEPS VI) is the most comprehensive as it covers the most extensive set of firms compared to other previous waves. Still, it also includes the specific question about firms' political connection status, the main variable of interest. After cleaning the dataset, our final sample consists of 22,672 firms distributed across 41 countries (Table A.1) and 26 industries (Table A.2)[5].

Dependent Variable. Political Connection is a dummy variable that takes the value of "1" if the company has an owner/CEO/top manager/board member previously elected or appointed to a political position and "0" otherwise. It directly comes from the questioner and it is a standard measure of political connection through revolving doors (Sofka et al., 2021; El Nayal et al., 2021).

Independent variable. Foreign ownership is a dummy variable computed based on the percentage of a firm's shares owned by private foreign individuals, companies, or organizations. In the main specification, a firm is considered foreign-owned if the percentage of foreign ownership is higher or equal to 10% and domestic-owned otherwise (similar to Aisbett and McAusland (2013); Desbordes and Vauday (2007); Kimura and Kiyota (2007)). Further, the study also examines the different cut-off points for foreign

[4]For details on the methodology, please visit: https://www.beeps-ebrd.com/data/2018-2020/

[5]Multi-establishment firms are dropped from the main analysis as some questions were asked at the firm-level (i.e., legal status, type of ownership, political connections) and others - at the establishment-level (i.e., product innovation, number of employees). However, the results are robust for the full sample.

ownership; it is a categorical variable that distinguishes whether the firm is domestically owned (0% - 10% foreign ownership), minority foreign-owned (11% - 50% foreign ownership), majority foreign-owned (51%-99% foreign ownership), or a wholly foreign-owned subsidiary (100% foreign ownership).

Moderating Variables. Market Dependency is a dummy variable that takes the value of "1" if the firm considers the local market as the primary market of their operation and "0" otherwise. It is a perception-based measure; firms are directly asked about their main markets, i.e., where they conduct most of their sales and derive most of their revenues. For foreign-owned firms, the local market is a host country market where they operate. For robustness, the share of local sales to total sales is also used as an alternative measure of local market dependency. Specifically, the study uses a 50% sales cut-off to differentiate between local market-oriented ($\geq$ 50% of sales from the local market) and international market-oriented firms ($<$ 50% of sales from the international market).

The study also uses two different proxies for industry regulation. Formal regulation is measured as the percentage (%) of senior management time spent on dealing with government regulations, i.e., "time tax" (De Rosa et al., 2010). Since the survey question is asked at the individual firm level, the responses are then aggregated at the industry-country level; therefore, the industry regulation variable accounts for both within-country and across-country (within the industry) variation. To ensure a relatively representative sample of firms in each country-industry group, the study limits the analysis to those industries where the number of firms is larger than 10. Our industry regulation measure is a continuous variable that varies from 0 to 38.1%. For instance, the highest level of regulation is recorded in the electronics industry in Hungary (which includes the firms producing telecommunication equipment, manufacturing electricity distribution and control apparatus); this industry classification is aligned with other studies where electricity and telecommunication are considered as highly regulated industry (see for example, Hillman (2005) and Pang and Wang (2020)). To measure informal regulation, the study uses the degree of corruption in each industry. One of the

advantages of the BEEPS data is that it provides comprehensive and granular information about informal payments and bribes at the firm level. Specifically, companies were asked about the money they spend on informal payments, measured as a share of total annual sales. Using the same methodology as in the formal regulations, average informal payments are aggregated at the country-industry level.

Lastly, the study differentiates between Democratic and Autocratic political systems. This measure is taken from the POLITY5 project, which provides political regime characteristics for all independent countries with a total population greater than 500,000 in 2018[6]. The original Polity score is measured on a scale ranging from -10 (strongly autocratic) to +10 (strongly democratic); then it is transformed into a dummy variable taking the value of "1" for autocratic countries when the score is negative, and "0" for democratic countries when the score is greater or equal to 0.

Control Variables. The model also includes a large set of firm-level characteristics to ensure that foreign and domestic firms are very similar in many dimensions except their foreign ownership status and reduce the bias from the omitted confounding factors. For instance, large firms are expected to be more politically connected than smaller firms (Hillman, 2005), and firm size also affects firms' foreign ownership status. Firm size is measured as the average number of permanent full-time employees at times t-1 and t-3. Further, the model includes firm age as a proxy for experience, visibility, and reputation; experienced firms may better understand the market and find it easier to build political connections, or experience may reduce the need for such connections. Firm age is measured as the number of years since starting the operation; both firm size and age variables are transformed using the natural logarithm.

Firm governance structure also affects the political strategy choice (Aisbett and McAusland, 2013; Weymouth, 2012); it includes government ownership, family ownership, and having a board of directors. Government-owned firms are expected to be more politically connected through their direct connections with current and previous politi-

[6]The POLITY5 dataset covers most of the countries from our sample except for Malta, Bosnia and Herzegovina and West Bank and Gaza.

cians. The opposite can be true for family-owned firms as there may seek to protect their socio-emotional wealth and reputation (Combs et al., 2020) and avoid building a high-commitment political strategy. Having a board of directors may also affect the propensity of being politically connected, as it implies additional checks and balances, which might encourage/discourage appointing former politicians.

Further, highly diversified firms are expected to have lower levels of government dependency and, thus, invest less in political connections. Product concentration is used as a proxy for diversification, i.e., the share of main products in total sales. Physical proximity to government officials may also create an extra incentive to build political connections (Kanol, 2015; Weymouth, 2012). It is a capital city dummy variable and measures whether a firm is located in the capital city. The model also includes other types of political activities, namely business association membership. A firm's propensity to be politically connected might be linked with using other political strategies, complementing or substituting each other.

Lastly, market and non-market strategies are highly intertwined, and foreign and domestic firms may differ greatly in their innovation and other market activities. To account for such confounding factors, the model includes product innovation, business strategy, and foreign technology license as proxies for firms' activities in the product market. A summary of all variables used and the original questions posed in the BEEPS survey is presented in Table A.3.

2.4.2 Model

To study the relationship between foreign ownership and political connections, the following baseline model is used:

$$Political\_Connection_{i,j,s} = \beta_0 + \beta_1 \times Foreign\_Ownership_{i,j,s} + \gamma \times X_{i,t,s} + \delta j + \theta_s + \epsilon_{i,t}$$

for firm i operating in industry s in country j. Political Connection is a binary variable measures the political connection of the firm; Foreign Ownership is also a binary

indicator of the firm's foreign ownership status. $X_{i,t,s}$ is the vector of all firm-level control variables discussed above. The main model includes country δj and industry θ_s fixed effects, which allow us to compare firms operating in the same country and industry. In some specifications, country $\times$ industry and survey fixed effects are also used. Throughout the analyses, the standard errors are clustered at the country level. Due to the dichotomous dependent variable, all models are estimated as a Probit model and the corresponding marginal effects are provided.

2.5 Empirical Results

Table 2.1 shows the baseline results. Columns (1-2) illustrate the unconditional mean difference in the propensity of political connections between foreign-owned and domestic-owned firms. The results are statistically insignificant, even in the presence of country and industry-fixed effects. However, after including additional control variables in Columns (3-7), the relationship between Foreign Ownership and Political Connections becomes negative and statistically significant. This result confirms the H1 that foreign firms are less likely to be politically connected than domestic-owned firms. Interestingly, significant differences emerge between foreign and domestic firms, particularly when controlling for firm size (Column (3)). Foreign-owned firms tend to be larger and larger firms are more likely to use political connections; thus, failing to control for firm size (as in Columns (1-2)) can result in an upward-biased estimate of the foreign ownership coefficient.

Further, foreign-owned firms differ from domestic firms on a range of other characteristics that are also related to political connections. Once controlling for additional firm characteristics, the negative differential becomes even more pronounced (Column (4)). The analysis reveals that foreign firms are 2.8 percentage points less likely to appoint former politicians than their domestic market counterparts. Column (7) shows the results estimated by a linear probability model; results are similar to what we obtained in non-linear models (Probit in Column (4) and Logit in Column 6); however,

Table 2.1: The Relationship Between Foreign Ownership and Political Connection

	(1) probit	(2) probit	(3) probit	(4) probit	(5) probit	(6) logit	(7) OLS
Foreign Ownership	0.005	-0.006	-0.023***	-0.028***	-0.029***	-0.027***	-0.032***
	(0.009)	(0.008)	(0.008)	(0.007)	(0.009)	(0.008)	(0.008)
Firm Size (ln)			0.018***	0.006***	0.007***	0.006***	0.007***
			(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Firm Age (ln)				0.006**	0.006*	0.007**	0.006**
				(0.003)	(0.003)	(0.003)	(0.003)
Government Ownership				0.031**	0.032*	0.027**	0.080**
				(0.014)	(0.017)	(0.013)	(0.032)
Family Ownership				-0.002	-0.001	-0.001	-0.004
				(0.004)	(0.005)	(0.005)	(0.005)
Board of Directors				0.039***	0.048***	0.039***	0.043***
				(0.004)	(0.005)	(0.005)	(0.006)
Product Concentration				-0.025***	-0.029**	-0.027***	-0.032**
				(0.010)	(0.012)	(0.010)	(0.014)
Location				-0.019*	-0.022	-0.020*	-0.020*
				(0.011)	(0.014)	(0.012)	(0.011)
Business Association Membership				0.030***	0.036***	0.030***	0.031***
				(0.005)	(0.006)	(0.006)	(0.007)
Product Innovation				0.015***	0.015***	0.015***	0.018**
				(0.005)	(0.006)	(0.005)	(0.007)
Business Strategy				0.014***	0.015***	0.015***	0.014***
				(0.004)	(0.005)	(0.005)	(0.005)
Foreign Technology License				0.016***	0.018**	0.016***	0.023**
				(0.006)	(0.007)	(0.006)	(0.009)
Market Dependency				0.003	0.007	0.003	0.004
				(0.008)	(0.009)	(0.008)	(0.010)
Constant							-0.045***
							(0.015)
Country Fixed Effects	No	Yes	Yes	Yes	No	Yes	Yes
Industry Fixed Effects	No	Yes	Yes	Yes	No	Yes	Yes
Country x Industry Fixed Effects	No	No	No	No	Yes	No	No
Observations	22,672	22,672	22,672	22,672	19,115	22,672	22,672
Pseudo R^2	0.000	0.047	0.073	0.120	0.152	0.119	0.057

Note: The models in Columns (1)-(5) are estimated as Probit models, and in Column (6) - a Logit model. The corresponding marginal effects are reported. Column (7) shows the results from the linear probability model, estimated by OLS. Standard errors are clustered at the country level. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

the magnitude of the coefficients is relatively higher in absolute terms.

The baseline model also provides other interesting findings; specifically, government-owned and older firms are more likely to be politically connected. Further, firms that have formalized business strategy, foreign technology licenses, and are more innovative have a higher propensity to be politically connected. Interestingly, business association membership and political connection are positively correlated, which contradicts the

Table 2.2: The Relationship Between Different Types of Foreign Ownership and Political Connection

	(1) Probit
Foreign Ownership [Base: Domestic Firm]	
Minority share (Foreign Ownership >10% and <50%)	-0.008
	(0.011)
Majority share (Foreign Ownership >50% and <100%)	-0.013
	(0.008)
Wholly-Owned (Foreign Ownership = 100%)	-0.037***
	(0.004)
Firm Size (ln)	0.007***
	(0.002)
Firm Age (ln)	0.006**
	(0.003)
Government Ownership	0.029**
	(0.014)
Share of Family Ownership	-0.002
	(0.005)
Board of Directors	0.039***
	(0.004)
Product Concentration	-0.025***
	(0.009)
Location	-0.019*
	(0.011)
Business Association Membership	0.029***
	(0.005)
Product Innovation	0.015***
	(0.005)
Business Strategy	0.014***
	(0.004)
Foreign Technology License	0.016***
	(0.006)
Market Dependency	0.002
	(0.008)
Country Fixed effects	Yes
Industry fixed effects	Yes
Observations	22,672
Pseudo R^2	0.121

Note: The model is estimated as a Probit model. The corresponding marginal effects are reported. Standard errors are clustered at the country level. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

idea that different political activities are used as alternative strategies, but in fact, they complement each other. It can be explained by the fact that lobbying through business associations aims to affect industry-level outcomes while building a long-term connection with former politicians targets private gain. And finally, firms in capital cities are less

likely to have political connections compared to firms from other locations - perhaps political connections are easier to establish in relatively smaller cities.

Table 2.2 shows the results with different foreign ownership cut-off points. The findings suggest that as foreign ownership increases, the propensity of foreign-owned firms to be politically connected declines. For instance, wholly-owned foreign firms have the lowest propensity to be politically connected. As the share of foreign ownership increases, firms become more risk averse due to the high cost of expropriation and reputation damage, adversely affecting their incentives to engage in high-commitment political connections. Also, wholly owned foreign firms face higher search costs in the host country market, whereas shared ownership allows them to learn the domestic market through existing local partnerships.

In Table 2.3, the models include interaction terms and study the moderating effects of different local market environments. In Column (1), the interaction term between foreign ownership and market dependency is positive and statistically significant, albeit only marginally. Figure A.1 shows the predicted probabilities of political connections at different margins of Market Dependency. Nearly 4% of foreign-owned firms with local market dependency are politically connected, while the same figure for internationally oriented foreign-owned firms sits at 2%. The probability of being politically connected for domestic firms is around 6% and not particularly sensitive to the domestic market dependency. Thus, the gap between foreign and domestic firms is reduced by half when firms depend on the local market, which is consistent with hypothesis H2.

In Column (2), the interaction term between foreign ownership and formal industry regulation is not statistically different from zero, meaning that formal industry regulation does not significantly moderate the relationship (see Figure A.2). In turn, informal regulation has a positive and significant moderating effect (Column (3)). Foreign-owned firms exposed to a high level of informal regulation choose to employ political connections more in order to overcome their outsider status. Figures A.3 show that the gap between foreign and domestic firms only exists in industries without informal regulations. It starts shrinking even at the very low level of informal regulations. The gap vanishes when

Table 2.3: The Relationship Between Foreign Ownership and Political Connection at Different Margins of Market Conditions

	(1) Probit	(2) Probit	(3) Probit	(4) Probit
Foreign Ownership	-0.035***	-0.016**	-0.028***	-0.030***
	(0.010)	(0.007)	(0.004)	(0.007)
Foreign Ownership x Market Dependency	0.018*			
	(0.011)			
Market Dependency	-0.001	0.003	0.003	0.001
	(0.010)	(0.009)	(0.008)	(0.007)
Foreign Ownership x Formal Industry Regulation		-0.066		
		(0.077)		
Formal Industry Regulation		0.079		
		(0.063)		
Foreign Ownership x Informal Industry Regulation			0.680***	
			(0.190)	
Informal Industry Regulation			-0.220	
			(0.291)	
Foreign Ownership x Autocratic System				0.037**
				(0.017)
Autocratic System				-0.016*
				(0.010)
Firm Size (ln)	0.006***	0.006***	0.006***	0.008***
	(0.002)	(0.002)	(0.002)	(0.002)
Firm Age (ln)	0.006**	0.007***	0.007***	0.003
	(0.003)	(0.003)	(0.003)	(0.003)
Government Ownership	0.031**	0.030**	0.028*	0.036**
	(0.014)	(0.015)	(0.016)	(0.015)
Share of Family Ownership	-0.002	-0.001	-0.001	-0.003
	(0.004)	(0.005)	(0.005)	(0.008)
Board of Directors	0.039***	0.039***	0.040***	0.040***
	(0.004)	(0.004)	(0.004)	(0.007)
Product Concentration	-0.025***	-0.024**	-0.024**	-0.023**
	(0.010)	(0.010)	(0.010)	(0.011)
Location	-0.020*	-0.016	-0.015	-0.014
	(0.011)	(0.012)	(0.012)	(0.010)
Business Association Membership	0.029***	0.030***	0.030***	0.021***
	(0.005)	(0.005)	(0.005)	(0.008)
Product Innovation	0.015***	0.014***	0.014***	0.020***
	(0.005)	(0.005)	(0.005)	(0.007)
Business Strategy	0.014***	0.014***	0.014***	0.017***
	(0.004)	(0.005)	(0.005)	(0.005)
Foreign Technology License	0.016***	0.016***	0.016***	0.014**
	(0.006)	(0.006)	(0.006)	(0.007)
Country Fixed effects	Yes	Yes	Yes	No
Industry Fixed effects	Yes	Yes	Yes	Yes
Observations	22,672	21,127	21,127	21,947
Sample	Full	>= 10 firms in industry	>= 10 firms in industry	Full
Pseudo R^2	0.120	0.118	0.119	0.083

Note: All models are estimated as Probit models. The corresponding marginal effects are reported. Standard errors are clustered at the country level. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

informal regulations are already very high. Thus, informal regulation in an industry, even at a low level, creates sufficient uncertainty to increase the cost of outsidership and motivates foreign-owned firms to build political connections. Hypothesis H3 is, therefore, partially supported.

Lastly, the study investigates the country-level variation in adopting political connections. The interaction term between foreign ownership and the country's autocratic political system is positive and statistically significant, which supports our hypothesis H4 (Column (4)). The gap between foreign and domestic-owned firms exists only in democracy when the value of political connections is limited, and foreign firms have little motivation to engage in high-commitment political strategy. In an autocracy, foreign firms have better incentives to build political connections as the value of such connections increases. Consequently, in an autocracy, the propensity that foreign firms are politically connected is not statistically different from the same propensity for domestic firms (see also Figure A.4).

2.6 Robustness

This section includes several robustness checks. To further control for observable differences between foreign and domestic-owned firms, the model now uses a matched sample based on Propensity Score Matching (PSM) technique. PSM is a common methodology used in the management literature (i.e., Cannizzaro (2020); Qi and Nguyen (2021); Sojli and Tham (2017)) to reduce the disparity between treatment and control groups. We estimated a conditional probability model of being 'foreign owned' using all covariates and fixed effects and then performed a matching (1-1) without replacement. Column (1) in Table 2.4 shows the results based on the matched sample. The coefficient for political connection has the correct sign and significance but is higher in magnitude. Further, to achieve a more comparable sample, firms with a probability higher than 0.8 are excluded from the analysis. Column (2) shows the regression results; the coefficient for foreign ownership is correct both in sign and magnitude. In Column (3), the sample is further

restricted and only includes the firms with a probability less than 0.4. The results are very close to the results in Column (2). In Column (4), the full sample is used, including both single and multi-establishment firms; the results are robust to the baseline findings. Furthermore, including survey fixed effects does not change the results (Column (5)).

Table 2.4: Robustness Checks with Different Samples and Measures

	(1) Probit	(2) Probit	(3) Probit	(4) Probit	(5) Probit	(6) Probit	(7) Probit
Foreign Ownership	-0.029**	-0.028***	-0.031***	-0.023***	-0.029***	-0.033***	-0.009
	(0.013)	(0.007)	(0.007)	(0.006)	(0.007)	(0.008)	(0.009)
Foreign Ownership x Market Dependency						0.014	
						(0.090)	
Foreign Ownership x Autocratic system							0.002**
							(0.001)
Firm Size (ln)	0.011***	0.006***	0.006***	0.006***	0.006***	0.006***	0.008***
	(0.004)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)	(0.002)
Firm Age (ln)	-0.004	0.006**	0.007**	0.007***	0.006**	0.007**	0.004
	(0.009)	(0.003)	(0.003)	(0.002)	(0.003)	(0.003)	(0.003)
Government Ownership	0.044**	0.031**	0.032**	0.038***	0.031**	0.032**	0.034**
	(0.020)	(0.014)	(0.014)	(0.013)	(0.014)	(0.014)	(0.015)
Share of Family Ownership	-0.015	-0.002	-0.003	0.001	-0.002	-0.002	-0.002
	(0.011)	(0.004)	(0.004)	(0.005)	(0.004)	(0.005)	(0.008)
Board of Directors	0.041***	0.039***	0.039***	0.039***	0.039***	0.039***	0.039***
	(0.013)	(0.004)	(0.004)	(0.004)	(0.005)	(0.004)	(0.007)
Product Concentration	-0.064**	-0.025***	-0.026***	-0.031***	-0.025***	-0.025***	-0.024**
	(0.028)	(0.010)	(0.010)	(0.009)	(0.010)	(0.010)	(0.011)
Location	-0.048**	-0.019*	-0.017	-0.012	-0.020**	-0.019*	-0.015
	(0.020)	(0.011)	(0.011)	(0.014)	(0.010)	(0.011)	(0.011)
Business Association Membership	0.041**	0.029***	0.029***	0.033***	0.029***	0.029***	0.020**
	(0.017)	(0.005)	(0.005)	(0.005)	(0.005)	(0.005)	(0.008)
Product Innovation	0.038***	0.015***	0.015***	0.015***	0.015***	0.015***	0.021***
	(0.013)	(0.005)	(0.005)	(0.005)	(0.005)	(0.005)	(0.007)
Business Strategy	0.016	0.014***	0.015***	0.015***	0.014***	0.014***	0.018***
	(0.013)	(0.004)	(0.004)	(0.005)	(0.004)	(0.004)	(0.006)
Foreign Technology License	0.033**	0.016***	0.015***	0.016**	0.016***	0.016***	0.014**
	(0.014)	(0.006)	(0.006)	(0.006)	(0.006)	(0.006)	(0.007)
Market Dependency	0.031**	0.003	-0.002	0.005	0.003	-0.006	-0.000
	(0.015)	(0.008)	(0.008)	(0.007)	(0.008)	(0.006)	(0.007)
Country fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	No
Industry fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Survey x Year fixed effects	No	No	No	No	Yes	No	No
Sample	Matched Sample	Pr(Foreign) <0.8	Pr(Foreign) <0.4	Inc. Multi est. Firms	Main Sample	Main Sample	Main Sample
Observations	2,780	22,664	22,178	25,371	22,672	22,585	21,947
Pseudo R^2	0.155	0.12	0.12	0.117	0.122	0.120	0.081

Note: All models are estimated as Probit models. The corresponding marginal effects are reported. The sample size varies across models. In Column (6), Market Dependency is measured as a dummy variable that takes the value "1" if at least 50% of total sales comes from the local market and "0" otherwise. In Column (7), Autocratic system is a continuous measure computed by multiplying the POLITY score by -1. Thus, it takes positive values for more autocratic countries. Standard errors are clustered at the country level. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Lastly, Columns (6)-(7) show that the results of the moderating effects are qualitatively unchanged when using alternative measures for market dependency and autocracy. The model in Column (6) uses market dependency as a dummy variable which takes the value of "1" if at least 50% of the firm's total sales come from the local market and "0" otherwise. Column (7) uses a continuous measure of the POLITY score instead of the dummy for autocracy/democracy. Both in Columns (6) and (7), the interaction terms are positive and marginally significant, as per H2 and H4.

2.7 Discussion and Conclusion

Political strategy is considered a crucial factor in firms' success by effectively managing their political environment. However, firms are heterogeneous in how they adopt and benefit from such political strategies. It is particularly relevant for political connections through revolving doors as it has some distinctive characteristics which create different incentives for firms to engage in such a highly risky and high-reward political strategy. This study mainly focuses on the differences between foreign and domestic-owned firms and their ability to build political connections. Such a comparative study is beneficial to understand whether a firm's political strategy choice depends on its foreign ownership status. Until now, most papers in International Business literature use a case-study approach to study MNE subsidiaries' political strategies, which does not allow for such comparison. Thus, the first contribution of this chapter is to show empirically that firms' foreign ownership status does play a significant role in building political connections. The study argues that while foreign-owned firms have a high demand for political connections to gain political legitimacy in the host country and to overcome their outsider status, the risk associated with a high-commitment political strategy might prevent them from building such political connections. However, the gap between foreign and domestic firms in political connection is not persistent and is largely context-dependent.

The other contribution of this chapter is to understand the factors that affect the value of political connections and moderate the relationship. The study integrates the

RDT and LoO perspectives and conceptualizes that the relationship between foreign ownership and political connection changes in the presence of dependency on local market conditions. As the dependency grows, foreign firms require domestic knowledge and expertise to gain legitimacy and overcome their outsider status, incentivizing them to build political connections. This research also enriches the RDT view by unpacking dependency into three different categories, such as local market dependency, industry dependency, and institutional dependency. In doing so, this study offers a more granular understanding of how different local market conditions create different incentives for foreign firms to seek political connections. For instance, whereas foreign firms respond to high informal regulations by employing former politicians (who likely possess explicit as well as tacit knowledge about local informal institutions), the same does not hold for formal industry regulations, as foreign firms can manage such dependency internally by exploiting their superior foreign knowledge and expertise.

Lastly, the study contributes to the empirical political strategy literature by testing the hypotheses using large-scale firm-level data that covers firms from 41 countries. The approach adopted here helps us to overcome some of the limitations of previous studies, which are typically based on case studies and do not allow for comparison between industries and countries. The empirical findings document that different institutions create different incentives for foreign firms to choose their political strategies. Although building political ties with an autocratic political system can create significant reputation damage, it is still preferable for foreign firms to seek political connections as the dependency on an authoritarian political system is very high. The opposite is true in a democracy, with limited incentives to build up political capital.

From a managerial perspective, this study proposes that there is no "one size fits all" political strategy. Foreign firms' managers should properly evaluate the benefits and costs associated with any given political strategy before engaging in it. It is particularly important for longer-term, high-commitment political connections, such as appointing former politicians to the company board. Namely, managers may put higher weight on the benefits of political connection when the company (i) largely depends on the local

host market, (ii) operates in an industry with high informal regulations, or (iii) operates in countries with autocratic political systems.

The chapter comes with some challenges and limitations that future scholarship may address. Theoretically, we integrated RDT and LoO to understand how the costs and benefits of political connections affect the firm's decision to build such a political strategy. However, we only observe the political connection status of the firm and not the specific costs and benefits. To better disentangle the correct mechanism, future research should examine the performance implications (both costs and benefits) of political connections. Relatedly, future research could also delve deeper into how firms learn from political connections. Since appointing former politicians is expected to generate valuable firm-level political capital, it is crucial to understand which firms benefit more from such political knowledge. Foreign firms with more experience and greater absorptive capacity may be able to use political connections more effectively and learn more about local market conditions. Alternatively, highly experienced firms may draw on their broader experience to learn organically and avoid costly political connections. Future research may also focus on whether and how foreign-owned firms can transfer the knowledge and practices learned from political actors in one market to other subsidiaries and headquarters.

Another potential avenue for future research is to understand further the concept of "liability of insidership" and over-embeddedness in the political connection context. It may be that prolonged involvement of political actors in firm practices, in fact, dampens innovation, increases dependence, and prevents the formation of new relationships in the market outside the network of those political actors. Furthermore, more studies may seek to understand better the interaction between different types of non-market strategies, such as CPA and CSR (Corporate Social Responsibility). There is no clear-cut empirical evidence of whether non-market strategies complement or substitute each other. Hence, political connections could help firms invest in the right types of projects at the right time and increase their legitimacy in the eyes of local stakeholders. However, some firms may also use these non-market strategies interchangeably and avoid building political connections when they already do public relations activities.

Lastly, methodologically, there are some areas for further improvement. Due to the confidential nature of the firms participating in the survey, it is not possible to collect additional information about firm characteristics and the nature of political connections. This type of analysis would potentially benefit if we knew the actual political experience of former politicians, i.e., their political party affiliation, previously held government positions, and seniority. Not all political connections are the same, and the value of such connections largely depends on the politicians themselves. Also, using the cross-section survey data does not guarantee a strong causal estimate. Firms' foreign ownership status is not completely exogenous, and there may be observable and unobservable confounding factors that may bias the results. Someone needs to find an exogenous instrument that changes firms' foreign ownership status and provides more precise estimates. Finding such an instrument in the closed survey setup is very difficult, but controlling for large firm-level characteristics ensures that the potential omitted variable bias is limited and the estimated coefficients are close to their true values. The results have shown that the gap between foreign and domestic firms in the propensity of being politically connected increases in magnitude (becoming more negative) once controlling for various firm-level factors. Thus, the potential selection bias is likely positive, meaning that the results are lower bound estimates, and the gap between foreign and domestic firms is likely to be even larger.

Chapter 3

With a Little Help from My Friend: Political Connections and Allocation of COVID-19 Aid

3.1 Introduction

"I completely accept that former prime ministers are in a different position to others because of the office that we held and the influence that continues to bring."
- David Cameron, former Prime Minister of the United Kingdom[7].

The COVID-19 pandemic triggered an unprecedented economic shock, which forced businesses around the globe to shut down and caused a severe liquidity crunch for millions of firms and their owners. To limit the economic damage caused by the pandemic, governments worldwide devoted substantial financial resources as aid to help struggling firms. Since the effectiveness of this fiscal assistance depends partly on its targets, it is crucial to understand the allocation of such funding, particularly in light of recent political scandals involving former politicians and their sustained influence on the political

[7]Oral evidence: Lessons from Greensill Capital, Treasury Committee, House of Commons, Document

process. For instance, former Prime Minister David Cameron allegedly used his personal contacts with current ministers and other officials to unlock barriers to Greensill being admitted to the Covid Corporate Financing Facility (CCFF) - the same company where David Cameron was appointed as an advisor in 2018 after the end of his administration. The case is still under investigation; however, Mr. Cameron admitted that a former Prime Minister should think and act differently when it comes to lobbying. A formal email or letter would have been more appropriate than private texts and phone calls to the former colleagues. Thus, the Greensill scandal illustrates the importance of political connections in lobbying and political influence, especially during the current economic downturn when the role of government re-distributive politics is critical. Importantly, this raises two broader key questions, namely, (1) which firms have gained access to COVID-19 government programs, and (2) whether there might have been any allocating distortions.

The aim of this chapter is to study the extent to which the distribution of government aid is shaped by political rather than purely economic considerations. Specifically, the study investigates whether firms with former politicians as owners, CEOs, or board members have better access to such support programs than similar firms without connections. Thus, the chapter contributes to the political economy literature by studying the value of political connections during the most recent COVID-19 pandemic. While the benefits of political connections in securing government contracts, receiving corporate bailouts, and having preferential access to external finance are relatively well-understood (Baltrunaite, 2020; Brugués et al., 2020; Schoenherr, 2019; Claessens et al., 2008), less is known about the allocation of emergency funding related to natural disasters, financial crisis, or the global pandemic like COVID-19 (see Trinh et al. (2022); Vukovic (2021); Barrick et al. (2021); Kubinec et al. (2020) as exemptions). Such unexpected events create significant uncertainty not only for firms but also for policymakers, who are forced to take immediate actions and mitigate the negative effect of the shock. Therefore, it is an empirical question to ask whether the political motives in distributing government support also exist in such cases when the effectiveness of public support can be critical

for long-term economic recovery.

The empirical analysis in this chapter relies on two large firm-level data sets. One is the Business Environment and Enterprise Performance Survey (BEEPS VI) collected by the EBRD and the World Bank right before the start of the pandemic in 2019. It contains a rich set of firm-level information, including a firm's political connection status, which is the main variable of interest in this analysis. Firms are considered politically connected if their owners, CEOs, or board members have been previously appointed or elected to a political position. The second dataset is the COVID-19 Follow-up Enterprise Survey (CFES), which was conducted multiple types during the pandemic and gathers information on the effect of the COVID pandemic on firms' financial condition, layoffs, expectations, and access to government support programs. One of the advantages of CFES is that it can be merged with BEEPS VI data, allowing to observe the same set of firms right before the start of the pandemic. Since the BEEPS VI survey is designed to be representative at the country level, the combined dataset also satisfies the same property. Both datasets have been actively used in the current economics literature due to the frequently updated information on firms' performance during the pandemic and the large coverage of firms from multiple countries (see Grover and Karplus (2021), Muzi et al. (2021), Liu et al. (2021), Wagner (2021)). After merging and cleaning, the final sample includes 11,853 firms from 30 countries.

The empirical results show no significant evidence of pervasive political bias in distributing government support, neither in extensive (any government support) nor intensive margins (the number of different support programs). However, results are heterogeneous and depend on the program type. While politically connected firms have a higher propensity to receive direct cash transfers, the effect is muted for other programs, such as deferral of credit payment, access to new credit, tax reduction, and wage subsidy. Having a political connection is associated with 3.6 additional percentage points in the propensity to obtain cash transfers. Considering that only 15.0% of firms received cash transfers in our sample, the implied effect is 24% which can also be considered economically significant.

Two key factors can drive these results. First, cash transfers are the most desirable policy instrument during financial crises, as they directly cater to firms' liquidity constraints. Unconditional cash transfers are also more flexible and allow firms to allocate relief money based on their needs and preferences. Second, as cash transfers are a more general form of support and hence demand weaker justification, governments had the highest discretionary power over their distribution. In the case of other support programs, the role of government (and therefore the value of political connections) was somewhat limited. For instance, programs such as access to new credit and deferral of credit payments required negotiation with commercial banks and other stakeholders, which left little room for political bias (Cororaton and Rosen, 2021; Granja et al., 2020; Core and Marco, 2020). Additionally, many support policies were designed as universal (i.e., wage subsidies and fiscal exemptions), and all firms had equal access to the programs regardless of their political connection status.

The study also examines the timing of receiving cash transfers. As many programs were implemented relatively quickly, targeting was not the primary concern due to the high cost of inaction, especially in the first few months of the pandemic. The results show that political connections played an important role in allocating cash transfers during the first wave of the pandemic when there were no established formal rules or criteria for funding allocation. In subsequent periods, however, political connections appeared less important, as economic criteria (such as suffering a negative demand shock) played an increasingly bigger role.

Since political bias does not necessarily imply resource misallocation, the study further explores the value of political connections depending on firms' exposure to the COVID-19 demand shock. As negative demand shock positively correlates with receiving all types of government support, it can be considered a main eligibility criterion for the programs (Harasztosi et al., 2022; Cirera et al., 2021). The results show that political connections helped firms obtain cash transfers, especially when they were not eligible for such funding. Political connection is associated with a 7.2 percentage points higher propensity to get cash transfers among non-eligible firms, whereas the same effect

is only 2.2 percentage points for eligible firms. Estimated probabilities also imply that political connections can fully compensate for the firms' non-eligibility status in receiving cash transfers. These results explain some of the earlier findings in the literature that many firms that did not experience any negative shock during the COVID-19 pandemic still received public funding, whereas the most affected firms stayed without government support (Cirera et al., 2021).

Lastly, the study exploits the country-level variation in distributing government cash transfers. Using different moderators, the results show no significant evidence of heterogeneity in the value of political connections in different institutional contexts. The result is not unexpected, as political connections are shown to be valuable in different countries, regardless of the quality of institutions or the effectiveness of the government (Denmark - (Amore and Bennedsen, 2013), US - (Goldman et al., 2013; Acemoglu et al., 2016), South Korea - (Schoenherr, 2019), China - (Li et al., 2008), Pakistan - (Khwaja and Mian, 2005), Ecuador - (Brugués et al., 2020), Brazil - (Claessens et al., 2008)). Also, since the COVID-19 shock was unexpected and unprecedented in size and complexity, putting every country in the same position, governments worldwide implemented similar policies and faced similar challenges regarding the distribution of support programs.

This chapter makes several key contributions. First, it contributes to the political economy literature by studying the value of political connections in the most recent COVID-19 pandemic case. Compared to other papers in the literature that study politically connected firms in a single country and analyze a particular government program, this study has several advantages. It looks at multiple support policies, allows time heterogeneity in receiving government support, and covers firms from a large set of countries, especially Central and Eastern Europe, which has not been studied yet in this context. Moreover, the chapter focuses on allocating emergency funding rather than the well-studied public procurement contracts, which is an important extension of the political economy literature.

The chapter also adds to the burgeoning literature on COVID Economics and provides a detailed analysis of the allocation of different COVID-19 support programs worldwide.

While the previous studies are based on a single program (Paycheck Protection Program in the US - Granja et al. (2020), Li and Strahan (2021), Barrios et al. (2020), Denes et al. (2021), wage subsidy in Danmark - Bennedsen et al. (2020), payroll tax cuts in China - Cui et al. (2020), public guarantee scheme in Italy - Core and Marco (2020)), this study allows for comparison between programs and understand which firm-level characteristics matters the most for receiving which government program.

In addition, the chapter bears more general policy implications. First, it documents the potential misallocation of public funding through political connections. Second, by studying the value of political connections in different support policies, the study also helps to identify which programs are more likely to be affected by political considerations. Since political bias is only observed in distributing cash transfers and only in the first few months of the pandemic, this should motivate policymakers to design better support policies to prevent such misallocation of public resources in the future.

The rest of the chapter is structured as follows. Section 3.2 reviews the literature on political connections. Section 3.3 explains the context of the study and discusses different COVID-19 support policies worldwide. Section 3.4 describes the data and the model. Section 3.5 presents the main results. Section 3.6 shows some robustness tests and additional analysis, and Section 3.7 concludes.

3.2 Related Literature

The benefits of political connections are well documented in the political economy literature. We know from previous episodes that a firm's political connection plays an important role in securing government contracts (Goldman et al., 2013; Schoenherr, 2019; Baltrunaite, 2020; Brugués et al., 2020; Brogaard et al., 2021), receiving corporate bailouts (Faccio, 2006; Vukovic, 2021), having preferential access to external finance (Khwaja and Mian, 2005; Claessens et al., 2008; Li et al., 2008; Bussolo et al., 2021), and dealing with economic uncertainty (Acemoglu et al., 2016). However, little is known about the value of political connections during the emergency events such as natural

disasters, financial crises, or the most recent global pandemic when government support policies are critically important for firm survival and long-term economic recovery.

Vukovic (2021), Blau (2017), and Choi et al. (2021) study the 2008–2009 financial crisis and the allocation of government support policies in the US. All three papers document the existence of political bias in distributing government programs. Specifically, Vukovic (2021) finds that among Troubled Asset Relief Program (TARP) recipients, firms that lobbied the government, donated to political campaigns, or whose top executives had direct connections to politics received better bailout deals. Similarly, Blau (2017) shows that banks that were politically connected, either through lobbying or employment of politically connected individuals, were significantly more likely to participate in the Federal Reserve's emergency loan programs. And lastly, Choi et al. (2021) also show that firms with political connections to state legislators were 2.5 times more likely to secure a grant from American Recovery and Reinvestment Act (ARRA) program. Overall, if political connection matters in general, it matters even more in times of crisis and uncertainty. However, such political bias might have a detrimental effect on the overall effectiveness of the program. Choi et al. (2021) find that the job creation effect of fiscal stimulus is predominantly driven by non-connected firms. Thus, how the government support policies are allocated across firms is an essential precondition for the success of the program.

The role of political connections during the most recent COVID-19 crisis is still relatively unexplored, and only a few studies emphasize this issue. For instance, Kubinec et al. (2020) collected the online survey data of business employees and managers in Ukraine, Egypt, and Venezuela and showed that a political connection is a way to get rid of government regulations and remain open during the COVID-19 pandemic. Businesses with political connections are significantly less likely to be shut down and to engage in social-distancing policies. On the other hand, Barrick et al. (2021) studied the role of different types of political connections on the allocation of government support programs in the US. Their results show that the odds of receiving governmental assistance were larger for firms with political influence, whether that happens through direct lobbying,

PAC contributions, lobbying through a trade association or an invitation to testify in Congress. This study is distinct from these papers in several ways. First, it covers a large set of firms from 30 different countries, allowing us to explore the variation in the value of political connections within and across countries. Second, the study uses an implicit measure of political connection through revolving doors when former politicians are appointed to corporate positions. Third, it studies the effect of political connections on multiple government support programs and observes the timing of receiving such support. Fourth, it steps forward to study the effectiveness of government policies by investigating the allocation distortions in the process.

The chapter also contributes to a growing literature on COVID economics based on The World Bank Enterprise Survey and its COVID follow-up rounds. Previous papers focus on different firm characteristics and performance during the COVID-19 crisis (management practices and firm survival - Grover and Karplus (2021), productivity and firm exit - Muzi et al. (2021), web presence and firm survival - Wagner (2021), women-led businesses and firm closure - Liu et al. (2021), firms with favorable organizational resources (such as state ownership and affiliation with parent companies) and firm survival - Liu et al. (2021)), and less attention on the allocation of government support programs. The latter is the main focus of this study, which provides another useful application of the Enterprise Survey data.

3.3 COVID-19 Pandemic and Government Support

The spread of the coronavirus and the related containment measures imposed at the beginning of 2020 have triggered an unprecedented economic shock, leading to a slowdown of economic activities, and causing severe financial problems for many firms worldwide. To mitigate the adverse economic impact of the COVID-19 pandemic, national governments implemented a series of programs to support the firms in need. Considering the size of the COVID-19 economic shock (the worst recession since the great depression in the 1930s), government support policies were also unprecedented in the amount of

money devoted to business support. For instance, the US government allocated over $700 billion for a Paycheck Protection Program to allow certain businesses to apply for low-interest private loans (Neilson et al., 2020). Similarly, the Bank of England lent about £37 billion to 107 different companies and supported more than 200 businesses under the Covid Corporate Financing Facility program (Kulam, 2022). The European Investment Bank Group also set up the €24.4 billion European Guarantee Fund (EGF) to help businesses get back on track after the COVID shock and support innovation and transformation. The EGF is only part of the €540 billion EU recovery package agreed upon in 2020 by European leaders. It is still an early stage to evaluate the overall effectiveness of these programs; however, the previous episodes demonstrate that the impact of fiscal stimulus is not only determined by how much is spent but also by how the funding is distributed across recipients (Choi et al., 2021).

There is a growing body of literature on the distribution of COVID-19 support programs across firms. For instance, Neilson et al. (2020) showed that the information friction and the "first-come, first-served" design of the Paycheck Protection Program (PPP) in the US skewed its resources towards larger firms and reduced its effectiveness. They also found that the small businesses were less aware of the PPP's existence and less likely to apply. Guerrero et al. (2021) showed similar findings in Latin American countries. Small and informal firms were less aware of government programs, applied less, and received less assistance. Thus, information friction and informality are important impediments for small firms accessing government support.

Others also emphasized the role of commercial banks in distributing government policies. Granja et al. (2020), Li and Strahan (2021), and Amiram and Rabetti (2020) in the US and Core and Marco (2020) in Italy found that the preexisting relationship between banks and borrowers matters for the allocation of public guaranteed credit. Their findings suggest that banks favor their preexisting clients by giving them significantly larger loans and faster approvals.

Productivity is another determinant correlated with funding allocation. The evidence from Portuguese firms suggests that highly productive firms were more likely to remain

open, less likely to cut employment, and make less use of government support (Kozeniauskas et al., 2020). The same results are observed among Japanese firms. Morikawa (2021) found that firms that received support had lower productivity prior to the pandemic, suggesting that inefficient firms have been severely affected by the COVID-19 shock. Moreover, also in Japan, Hoshi et al. (2021) found that less efficient firms were more likely to apply for and receive subsidies and concessional loans, even after controlling for the negative sales shock during the pandemic.

Using large-scale survey data covering more than 120,000 firms in 60 countries, Cirera et al. (2021) documented that the support measures mainly targeted firms reporting larger sales drops. However, the cases of misallocation still exist. Specifically, firms that did not experience a negative shock still benefited from government policies, whereas firms that experienced large negative shocks did not have access to government support. Despite the growing literature on firm characteristics and the allocation of government support programs, the exact mechanism of why some firms had privileged access to government programs, and others did not need to be explored further.

3.3.1 COVID-19 Follow-up Survey

Studying the allocation of government support policies from different countries is complicated due to the variety of instruments they use as well as the different objectives those policies have. However, in their COVID-19 Follow-up Enterprise Survey (CFES), the World Bank identified the most widely used support measures (such as (1) Cash transfers for business, (2) Deferral of credit payments, rent or mortgage, suspension of interest payments, (3) Access to new credit, (4) Fiscal exemptions or reductions, and (5) Wage subsidies) and asked the representative sample of firms from 30 countries whether they received any of the government support during the pandemic.

The distribution of government support by country is in Table 3.1. Overall, 46.3% of firms reported receiving national or local government support in response to the COVID-19 crisis. However, the distribution is heterogeneous across countries. The highest take-up rate is in Serbia (84%), Slovenia (78%), and Malta (77%), and the

lowest in Belarus (5%) and Moldova (8%). It is consistent with the argument that more developed countries devoted more funding to business support than less developed ones (Cirera et al., 2021).

Table 3.1: Distribution of The COVID-19 Support Programs by Country

	Government Support	Cash Transfer	Defferal of credit Payment	Access to New Credit	Fiscal Exemption	Wage Subsidy	# of Government support
Albania	39%	4%	9%	10%	3%	33%	0.585
Azerbaijan	63%	13%	5%	6%	13%	46%	0.830
Belarus	5%	0%	3%	0%	1%	1%	0.047
Bosnia and Herzogovina	52%	12%	4%	0%	1%	47%	0.645
Bulgaria	30%	28%	3%	1%	4%	25%	0.578
Croatia	67%	11%	12%	6%	19%	64%	1.092
Cyprus	72%	26%	16%	5%	18%	69%	1.302
Czech Republic	69%	39%	9%	4%	10%	47%	1.017
Estonia	45%	1%	7%	1%	5%	42%	0.567
Georgia	53%	6%	26%	4%	31%	24%	0.810
Greece	77%	29%	47%	25%	62%	61%	2.059
Hungary	44%	8%	10%	6%	15%	39%	0.725
Italy	69%	43%	26%	18%	17%	50%	1.346
Jordan	34%	0%	2%	4%	7%	24%	0.364
Kazakhstan	13%	1%	2%	3%	8%	0%	0.141
Latvia	24%	12%	5%	4%	10%	21%	0.473
Lithuania	68%	45%	13%	7%	3%	61%	1.220
Malta	77%	13%	36%	10%	20%	75%	1.484
Moldova	9%	1%	2%	1%	3%	2%	0.091
Mongolia	29%	13%	15%	11%	21%	17%	0.759
Montenegro	53%	2%	17%	5%	13%	50%	0.874
Morocco	47%	22%	22%	7%	28%	43%	1.119
North Macedonia	47%	5%	10%	11%	0%	43%	0.679
Poland	70%	52%	33%	23%	37%	46%	1.853
Portugal	50%	33%	13%	17%	11%	35%	1.022
Romania	46%	7%	12%	11%	13%	36%	0.756
Russia	10%	1%	6%	2%	7%	3%	0.186
Serbia	84%	7%	28%	10%	41%	79%	1.636
Slovakia	65%	22%	9%	7%	8%	61%	1.014
Slovenia	78%	6%	8%	5%	12%	73%	1.026
Total	46%	17%	14%	8%	16%	36%	0.873

Note: Author's own calculation based on the COVID-19 Follow-up Enterprise Survey data.

In terms of the distribution of each government policy, we observe that the most frequently used government support is wage subsidy (36% of take-up rate), followed by cash transfers (17%), fiscal exemptions (16%), deferral of credit Payment (14%), and access to new credit (8%). Also, not all policies are equally used in different countries. For instance, 52% of sampled firms in Poland received cash transfers, whereas this policy had not been used in Belarus and Jordan. Similarly, the highest take-up rate in accessing

new credit is observed in Greece (25% of firms), whereas none of the firms from Belarus and Bosnia and Herzegovina received that support. At the intensive margin, Greek firms received the highest number of support policies, on average, two different support measures, followed by Poland (1.8 different programs), Serbia (1.6), and Italy (1.3). Firms from Belarus received the least support.

3.4 Data and Model

3.4.1 Data

For the empirical analysis, this chapter relies on two main datasets. The first data set is the sixth round of the Business Environment and Enterprise Performance Survey (BEEPS VI), collected jointly by the EBRD, The World Bank, and EIB in 2018-19. The BEEPS is a nationally representative survey of formal firms with at least five employees in manufacturing or service industries. Because of the common sampling methodology and standardized survey instruments, the data is fully comparable across countries. The latest version of BEEPS covers almost 28,000 enterprises in 41 economies of the EU, Eastern Europe, Central Asia and the Middle East, and North Africa. The survey collects information about a large set of firms' characteristics, their financial performance, as well as their relationship with the government, including their political connection status. The fact that the BEEPS VI was completed in 2018-2019, right before the start of the COVID-19 pandemic, can be used as a baseline survey.

The second dataset is the COVID-19 Follow-up Enterprise Survey (CFES), conducted up to three times during the pandemic. The CFES provides detailed information on the impact of the COVID-19 pandemic on firms' performance, layoffs, expectations, and access to government support policies. For the purpose of this study, the most important questions are firms' exposure to COVID-19 shock and the use of government support policies. One of the advantages of CFES is that it uses the same sample of firms as BEEPS VI, which allows for merging these two datasets and observing the same firms before and after the start of the pandemic.

Among the 41 countries in the BEEPS VI sample, the CFES has been conducted only in 30 countries (when writing this chapter), automatically reducing our baseline sample to 17,252 firms. After merging these two datasets and keeping the firms that are interviewed at least once during the COVID follow-up survey and the information is available for all dependent and independent variables, the final sample includes 11,853 firm observations[8]. Due to the high response rate in the COVID follow-up survey, there is no systematic response bias in our combined data, compared to the BEEPS VI, neither in terms of firm size nor industry composition[9]. Since the BEEPS VI survey was designed to be representative at the country level, the combined data should also satisfy the same property.

3.4.2 Variables and Model

The study relies on the following identification strategy to test the relationship between a firm's political connection and the propensity to receive government support. First, since the COVID-19 shock was unexpected and the information about political connections was observed just before the shock, firms could not adjust their political connection status to receive COVID-19 support programs, which rules out the possibility of potential reverse causality or selection on the outcome (ex-ante selection). Also, it is reasonable to assume that firms could not change their political connection right after the start of the pandemic because of a relatively short period to act (ex-post selection). Second, the richness of the data allows controlling for a large set of pre-pandemic firm-level factors that ensures comparing firms with similar characteristics. Considering the research design and the wide range of the confounding factors included as covariates in the econometric model, empirical results of the study can be interpreted as causal and are unlikely to be affected by reverse causality and unobserved confounding factors.

Different sets of dependent variables are used to study the intensive and extensive

[8]The response rate in CFES is 87% which means that 14,966 firms out of 17,252 participated in at least one follow-up survey round. Also, 41.8% of firms responded to all three waves of the follow-up survey, 23.1% of firms were surveyed twice, and 35.1% of firms answered the survey only once. A detailed distribution of firms across countries and the COVID survey rounds is in Table B.1 and Table B.2.

[9]see the Table B.3 in Annex for a detailed industry distribution.

margins of receiving government support and differentiate between different support programs. First, in the main specification, the dependent variable ($POLICY$) is a dummy variable that combines information from all government support programs and measures whether or not a firm received government support during the pandemic. Second, each program is considered individually - the outcome variable varies across programs. All variables are dummy variables and measure whether a firm received (1) a cash transfer for a business, (2) a deferral of credit payments, utility bills, rent or mortgage, suspension of interest payments, (3) a new credit, (4) a tax reduction, or (5) a wage subsidy. Lastly, as firms could take multiple government support programs, the intensive margin of the relationship is also explored by counting the number of different support programs the firm received.

The main independent variable ($POL\_CONNECTION$) is the firm's political connection status. A firm is considered politically connected if it has an owner/CEO/top manager/board member who was previously elected or appointed to a political position. The information about political connections is observed right before the pandemic and comes from the BEEPS VI survey. Although political connection through revolving doors is widely used in the empirical political economy literature (Khwaja and Mian, 2005; Faccio, 2006; Bertrand et al., 2018; Faccio et al., 2006), it is still possible that such measure does not account for all possible ways firms can be politically connected. Some of the earlier studies propose much broader definitions for political connections, namely through family relations (Amore and Bennedsen, 2013; Fisman, 2008), university cohort network (Schoenherr, 2019) campaign contributions (Claessens et al., 2008). Since the other types of political connections are not observed in the survey, the value of political connections in this study can be understood as a lower bound.

The model also includes a large set of firm-specific control variables. Firm size, firm age, and manager's experience are expected to be positively correlated with receiving government support. Large and older firms (managers) are more experienced in dealing with such uncertainty and, therefore, have a better chance of obtaining government support. Government-owned firms are also more likely to receive support because of

their direct ties with the government. Controlling government ownership also ensures that the value of political connections comes directly from the revolving doors or political appointments and not from government ownership itself. The model also includes firms' innovation and export activities, which controls for the firm's pre-pandemic productivity level. There is empirical evidence that less productive firms are more likely to receive government support (Hoshi et al., 2021; Morikawa, 2021; Kozeniauskas et al., 2020); however, productive firms are usually better informed and more capable of dealing with government policies and regulations, which increase their propensity to apply for and receive government support. On the other hand, governments might also prefer helping productive firms to enhance the overall effectiveness of the support program.

The model also accounts for having a female top manager. Liu et al. (2021) documented that women-led businesses were subject to a higher likelihood of closure during the pandemic, and therefore, COVID-19 policy measures should not be gender-neutral. Also, firms in the capital city can be better informed about government support and more likely to obtain it. In addition, the model includes membership in business associations and securing government contracts during the pre-pandemic period as alternative ways of building political connections and accessing government bureaucrats. All these variables discussed above correlate with firms' political connection status as well as receiving government support policies. They play an important role in the identification strategy to minimize the risk of potential unobserved confounders. Table B.4 and Table B.5 show a detailed description of the variables and summary statistics.

Notably, the model also includes the firm-level COVID-19 shock variable. Although many government support programs did not have formal requirements and clear targeting, exposure to the COVID-19 shock has been considered the main eligibility criterion (Cirera et al., 2021). By controlling for the exposure to COVID-19 shock, the results show the firms' choice and ability to access government funding rather than the eligibility itself. In the CFES, we observe different measures for the COVID-19 shock, such as demand shock, supply shock, and sales shock. A demand shock measures whether the demand for a firm's products and services increased, decreased, or remained unchanged

during the pandemic. Similarly, supply shock measures how firms' supply of inputs, raw materials, and finished goods changed compared to the same month in 2019. Lastly, the survey also collects information on the changes in sales during the COVID-19 pandemic. The firms report whether the sales increased or decreased during the pandemic and by how much. The main analysis relies on the demand shock variable because of its exogenous nature. However, supply shock and changes in sales are used as alternative measures for robustness check purposes.

The model also accounts for country and industry differences in the allocation of government support programs by including the corresponding fixed effects. Countries are heterogeneous in their ability to respond to the COVID-19 pandemic and to provide support policies (see Table 3.1). Access to support programs was lower in countries with limited COVID-19 support funding. There is also empirical evidence supporting the hypothesis that the probability of receiving public support increases along with the countries' income status (Cirera et al., 2021). Similarly, the COVID-19 pandemic affected different sectors in different ways; therefore, the allocation of government funds is biased towards the most affected industries Harasztosi et al. (2022). Lastly, since the firms were surveyed at different points in time, depending on which CFES they participated in, and the access to government funding might vary over time, the model also includes survey time fixed effects[10]. More formally, the empirical model has the following specification:

$$POLICY_{i,t_1} = \delta_0 + \delta_1 \times POL\_CONNECTION_{i,t_0} + \delta_3 \times X_{i,t_0} + SHOCK_{i,t_1} + \gamma_c + \rho_s + \theta_t + \epsilon_{i,t_1}$$

Where $POLICY_{i,t_1}$ is a dummy variable measuring whether a firm obtained government support during the pandemic. $POL\_CONNECTION_{i,t_0}$ measures a firm's political connection status. X_{i,t_0} is the vector of all other firm-level control variables described above. $SHOCK_{i,t_1}$ is a proxy for the COVID-19 related demand shock. The

[10]For each Firm, the time fixed effect is defined as the date when the firm was interviewed last time in the CFES. For instance, if the firm is interviewed only once, the date of the interview is used as a time-fixed effect. Alternatively, if the firm is interviewed twice, the date of the second interview is used as a corresponding time-fixed effect. The same applies to the case when the firm is interviewed three times - the date of the third follow-up survey round is used as a time-fixed effect

time indicator in the model shows when the data is collected and from which survey it comes. For instance, the t_0 subscript indicates that the data is collected before the COVID-19 pandemic and comes from the BEEPS VI survey. In the same way, t_1 indicates the period after the pandemic and combines information from all three waves of the CFES. The model also includes country (γ_c), industry (ρ_s), and survey time (θ_t) fixed effects. In some specifications, country x industry and country x industry x survey time fixed are also used. Standard errors are clustered at the country level. All models are estimated as linear probability models (due to the more straightforward interpretation of the coefficients); however, the results from the non-linear logit model are also presented in the appendix for robustness check purposes.

3.5 Empirical Results

3.5.1 Baseline Results

The empirical results of the baseline model are reported in Table 3.2. Different columns are based on different dependent variables. Column (1) shows the result when receiving any type of government support is used as a dependent variable, Column (2) uses Cash transfers, Column (3) - Credit payment deferral, Column (4) - Access to new credit; Column (5) - Fiscal exemption, and Column (6) - Wage subsidy. First, in Column (1), the coefficient for political connection is almost zero and statistically insignificant, meaning that political connections do not contribute much to receiving government support. However, the results are heterogeneous when studying each program separately. The value of political connections is the largest and statistically significant in distributing cash transfers, whereas it is indistinguishable from zero in any other program. The results show that politically connected firms have 3.6 percentage points higher probability of receiving cash transfers than similar firms without such political connections.

Some distinctive characteristics of the cash transfer program may explain this result. First, cash is the most liquid asset and, therefore, the most desirable policy tool for liquidity-constrained firms during an economic crisis. Second, compared to the other

Table 3.2: The Relationship Between Political Connection and Receiving Government Support

	(1)	(2)	(3)	(4)	(5)	(6)
Political Connection	-0.005	0.036**	0.013	0.017	0.004	0.002
	(0.019)	(0.014)	(0.013)	(0.010)	(0.013)	(0.018)
Demand Shock						
(base category = Positive Shock)						
No Shock	0.010	-0.000	0.002	0.003	0.004	0.026
	(0.026)	(0.015)	(0.017)	(0.010)	(0.022)	(0.021)
Negative Shock	0.162***	0.058**	0.072***	0.034**	0.057*	0.169***
	(0.035)	(0.023)	(0.025)	(0.013)	(0.032)	(0.032)
Firm Size (ln)	0.018*	-0.001	0.008	0.004	0.009	0.018**
	(0.009)	(0.008)	(0.005)	(0.003)	(0.006)	(0.008)
Firm Age (ln)	0.000	-0.009	-0.010	-0.005	-0.014***	-0.007
	(0.006)	(0.006)	(0.007)	(0.004)	(0.004)	(0.007)
Foreign Owned	-0.012	-0.015	-0.022	-0.016	-0.001	0.008
	(0.017)	(0.010)	(0.014)	(0.010)	(0.015)	(0.017)
Government Owned	0.017	0.002	0.027	-0.020	0.011	0.005
	(0.035)	(0.017)	(0.021)	(0.014)	(0.021)	(0.029)
Business Association	0.025**	0.023**	0.019	0.015	0.014	0.021*
	(0.011)	(0.010)	(0.012)	(0.009)	(0.012)	(0.011)
Product Innovation	0.020**	0.008	-0.001	0.007	0.006	0.013
	(0.007)	(0.005)	(0.007)	(0.005)	(0.007)	(0.009)
Government Contract	0.004	-0.012	-0.007	0.006	-0.015	0.014
	(0.014)	(0.009)	(0.009)	(0.007)	(0.011)	(0.012)
Exporter	0.018*	-0.001	-0.001	0.013*	-0.002	0.018**
	(0.011)	(0.007)	(0.008)	(0.006)	(0.008)	(0.008)
Manager Experience (ln)	-0.010*	0.003	-0.007	-0.003	-0.001	-0.012**
	(0.006)	(0.004)	(0.004)	(0.003)	(0.005)	(0.005)
Female Top Manager	-0.000	-0.002	-0.006	-0.002	-0.008	0.007
	(0.016)	(0.012)	(0.010)	(0.006)	(0.009)	(0.012)
Capital City	-0.008	0.008	0.030*	0.011	0.008	0.001
	(0.014)	(0.012)	(0.016)	(0.013)	(0.013)	(0.016)
Constant	-0.390**	-0.135	-0.124*	-0.074	-0.086	-0.313**
	(0.156)	(0.089)	(0.062)	(0.046)	(0.051)	(0.123)
Country Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Industry Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Survey Time Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes
Observations	11853	11853	11853	11853	11853	11853
Adjusted R^2	0.287	0.208	0.138	0.084	0.179	0.281

Note: Dependent variables vary across specifications. Column (1) - Government support, any type; Column (2) - Cash transfers; Column (3) - Credit payment deferral; Column (4) - Access to new credit; Column (5) - Fiscal exemption; Column (6) - Wage subsidy. All models are estimated as linear probability models. Standard errors are clustered at the country level. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

policy instruments, such as deferral of credit payments, rollover of debt, and access to new credit, cash transfers are unconditional and do not require repayment or other corresponding costs. Also, cash transfers do not come with specific purposes, and firms are free to use the money based on their needs and preferences. Lastly, in many countries, cash subsidies were administered by bureaucrats themselves, which gave government officials the discretionary power to distribute public money according to their own interests. As a comparison, support policies such as access to new credits and deferral of credit payments were managed by commercial banks and other intermediaries. Therefore, the role of political bias was rather limited. Thus, considering both the demand and the supply aspects of this relationship, the baseline results are consistent with the idea that politically connected firms use their advantageous position to ask for the preferred policy, and government officials can distribute this support program to their politically connected firms.

As expected, the demand shock variable is statistically significant across all specifications. Firms that experienced a negative demand shock during the COVID-19 pandemic were always more likely to receive government support than those with a positive demand shock. Such results indicate that the support programs targeted the most vulnerable firms. However, the fact that other firm-level characteristics, including a political connection, are also statistically significant shows that the demand shock was not the only determinant of aid allocation, which raises questions related to favoritism and misallocation of government resources. The results of other control variables are mixed. No variable is statistically significant in all models. However, some variables remain consistent in different specifications. For instance, in most cases, the coefficient for business association membership is positive and statistically significant, indicating the importance of information advantage and a lobbying function of business associations.

Table 3.3 provides the evidence at the intensive margin of the relationship. The dependent variable is the number of different government support programs a firm obtained during the pandemic. All independent variables are the same as in the base model. Results from both the linear and the count data models show that a firm's political con-

Table 3.3: The Relationship Between Political Connection and Total Number of Government Support

	(1) OLS	(2) Neg. Binomial
Political Connection	0.073	0.072
	(0.045)	(0.058)
Demand Shock		
(base category = Positive Shock)		
No Shock	0.034	0.001
	(0.076)	(0.096)
Negative Shock	0.390***	0.472***
	(0.114)	(0.110)
Firm Size (ln)	0.038	0.049
	(0.025)	(0.031)
Firm Age (ln)	-0.046**	-0.045**
	(0.019)	(0.021)
Foreign Owned	-0.045	-0.058
	(0.051)	(0.057)
Government Owned	0.025	0.047
	(0.076)	(0.169)
Business Association	0.092*	0.095**
	(0.046)	(0.043)
Product Innovation	0.033	0.052**
	(0.020)	(0.025)
Government Contract	-0.015	-0.006
	(0.034)	(0.045)
Exporter	0.027	0.049
	(0.023)	(0.031)
Manager Experience (ln)	-0.020	-0.032*
	(0.015)	(0.019)
Female Top Manager	-0.011	-0.004
	(0.040)	(0.053)
Capital City	0.058	0.058
	(0.061)	(0.072)
Constant	-0.733**	-23.270***
	(0.351)	(1.030)
Country Fixed Effects	Yes	Yes
Industry Fixed Effects	Yes	Yes
Survey Time Fixed Effects	Yes	No
Observations	11853	11853
Adjusted R^2	0.271	0.131

Note: The dependent variable is the total number of government support programs a firm received during the pandemic. It ranges from 0 to 5. In Column (1), the model is estimated by OLS, in Column (2) - Negative Binomial Model is used. Standard errors are clustered at the country level. Survey time fixed effects are dropped from the negative binomial model due to the lack of convergence. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

nection status positively correlates with the number of government support programs; however, the coefficients are not statistically significant. As there are five different government programs in total and political connection only affects the distribution of cash transfers, it is expected that political connection does not significantly affect the overall distribution of government support.

3.5.2 Timing of Cash Transfers

Since political connections play a significant role in distributing cash transfers, in the subsequent sections, the study explores the different margins of this relationship. First, starting with the timing of receiving government funding. A recent study by Denes et al. (2021) finds that the firms receiving PPP loans later become more financially distressed, registering lower economic activity and shutting down. These findings emphasize the importance of timely fiscal support during crises; firms facing negative economic shocks prefer receiving government support sooner rather than later. However, the quick distribution of government support policies comes with administrative difficulties. Many have highlighted already that, during the first few months of implementing COVID-19 support programs, there were problems with mistargeting because of missing the formal rules and requirements to define which firms were eligible for funding. This might have triggered corruption and political favoritism and created opportunities for political actors to distribute the public money to their own interests.

To study the importance of political connections in different periods during the pandemic, the study relies on the different waves of the CFES to observe firms' access to cash transfers in different survey periods. For instance, Period 1 is the time between the start of the pandemic and the first wave of CFES. In the majority of cases, this covers the period between March 2020 and October 2020, with some exceptions (such as Azerbaijan, Bosnia and Herzegovina, Kazakhstan, Montenegro, and Serbia, where the first follow-up survey was conducted relatively late and therefore covers a much longer period, as shown in Table B.2). The first wave of the follow-up survey studies whether firms have obtained cash transfers since the start of the COVID-19 pandemic (*COVf2a*).

Table 3.4: The Relationship Between Political Connection and Receiving Cash Transfers at Different Periods

	(1) Period 1	(2) Period 2	(3) Period 3
Political Connection	0.023*	0.018	-0.002
	(0.013)	(0.013)	(0.012)
Demand Shock (Base Category = Positive Shock)			
No Shock	-0.006	0.003	0.026
	(0.013)	(0.009)	(0.023)
Negative Shock	0.022	0.035***	0.057***
	(0.017)	(0.011)	(0.016)
Firm Size (ln)	-0.001	-0.006	0.006
	(0.005)	(0.006)	(0.008)
Firm Age (ln)	-0.008*	-0.000	-0.002
	(0.004)	(0.004)	(0.004)
Foreign Owned	-0.017	-0.009	-0.003
	(0.010)	(0.008)	(0.013)
Government Owned	-0.011	-0.012	-0.023
	(0.014)	(0.029)	(0.019)
Business Association	0.005	0.024*	0.004
	(0.007)	(0.013)	(0.010)
Product Innovation	0.004	0.007	-0.002
	(0.007)	(0.006)	(0.008)
Government Contract	-0.004	-0.004	-0.002
	(0.007)	(0.007)	(0.009)
Exporter	0.001	-0.001	-0.003
	(0.009)	(0.010)	(0.007)
Manager Experience (ln)	0.004	-0.006	0.009
	(0.004)	(0.005)	(0.011)
Female Top Manager	0.008	0.001	-0.024
	(0.006)	(0.007)	(0.015)
Capital City	0.001	0.007	-0.005
	(0.009)	(0.008)	(0.016)
Constant	-0.035	-0.032	-0.088
	(0.037)	(0.028)	(0.073)
Country Fixed Effects	Yes	Yes	Yes
Industry Fixed Effects	Yes	Yes	Yes
Survey Time Fixed Effects	Yes	Yes	Yes
Observations	11455	7143	6313
Adjusted R^2	0.177	0.097	0.106

Note: The dependent variable is receiving a cash transfer but in different survey periods. Column (1) studies Period 1 (from the beginning of the pandemic till the Wave 1 COVID-19 follow-up survey), Column (2) - Period 2 (between the Wave 1 and Wave 2 follow-up survey), and Column (3) - Period 3 (between the Wave 2 and Wave 3 follow-up survey). The number of observations varies across models. Model (1) covers the firms interviewed during the first wave of the COVID-19 follow-up survey. Model (2) only includes the firms interviewed in the first and second survey waves. And in Model (3), the firms are surveyed in the second and third waves. All models are estimated as linear probability models. Standard errors are clustered at the country level. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Period 2 is the time between the first and the second follow-up surveys (in most cases, November 2020 - February 2021). Firms in the second wave were asked whether they had obtained cash transfers since wave 1 (*COV2f2a*). This question was only asked to those firms surveyed in the first wave. It, therefore, restricts the sample for firms interviewed in both waves. Lastly, Period 3 covers the time between the second and the third waves (April 2021 - August 2021). As in the previous case, firms reported their access to cash transfers between these two periods (*COV3f2a*). Table 3.4 shows the results for three follow-up survey periods. Two interesting observations can be made in Column (1), which covers Period 1. First, the coefficient for political connection is positive and statistically significant. Second, the negative demand shock is not significant anymore. These results confirm the hypothesis that, during Period 1, the political motives of funding allocation were more prominent than the economic ones. Therefore, cash transfers that should have targeted the most affected firms were allocated according to other rules and criteria, including firms' political connection status. In contrast, in Column (2) and Column (3), the economic determinants of funding allocation become significant, and the political ones stop being statistically relevant. In Periods 2 and 3, the coefficient for the negative demand shock is positive and statistically significant, while the effect of political connections becomes non-distinguishable from zero. Two factors can explain these findings. Either politically connected firms used their political power to get cash transfers earlier in Period 1 (therefore becoming less demanding in later periods), or the targeting of support programs improved over time (with better rules and requirements), and political actors became less flexible in allocating relief money to their political interests.

3.5.3 Missallocation of Cash Transfers

Political bias in distributing government support policies can harm economic recovery if it creates misallocation and redistributes government resources to firms that are not eligible for funding. To understand the allocative efficiency of government relief programs, the study tries to estimate the value of political connection at different margins

Table 3.5: The Relationship Between Political Connection and Receiving Cash Transfers at Different Margins of Eligibility

	(1) OLS
Political Connection	0.016
	(0.017)
Non-Eligible	-0.060***
	(0.017)
Political Connection x Non-Eligible	0.043*
	(0.022)
Firm Size (ln)	-0.002
	(0.008)
Firm Age (ln)	-0.009
	(0.006)
Foreign Owned	-0.014
	(0.010)
Government Owned	0.001
	(0.017)
Business Association	0.023**
	(0.010)
Product Innovation	0.007
	(0.005)
Government Contract	-0.012
	(0.009)
Exporter	-0.001
	(0.007)
Manager Experience (ln)	0.003
	(0.004)
Female Top Manager	-0.002
	(0.012)
Capital City	0.008
	(0.012)
Constant	-0.076
	(0.084)
Country Fixed Effects	Yes
Industry Fixed Effects	Yes
Survey Time Fixed Effects	Yes
Observations	11853
Adjusted R^2	0.208

Note: The eligibility criterion is derived from the demand shock variable. A firm is considered eligible for government support if it experienced a negative demand shock and non-eligible for positive or no demand shock. The model is estimated as a linear probability model. Standard errors are clustered at the country level. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$. These are the predicted probabilities of receiving cash transfers at different margins of political connection and eligibility, calculated based on the corresponding logit model. Pr(cash | political connection = 0, Non-eligible = 0)=0.186; Pr(cash | political connection = 0, Non-eligible = 1)=0.124; Pr(cash | political connection = 1, Non-eligible = 0)=0.208; Pr(cash | political connection = 1, Non-eligible = 1)=0.196

of a firm's eligibility for funding. In terms of non-eligibility/eligibility[11], the same demand shock variable is used as in the main model but converted it to a dummy variable. Specifically, a firm is considered non-eligible (=1) if the demand for its products and services increased or did not change during the pandemic and eligible (=0) if the demand decreased.

Results are in Table 3.5. The interaction term is positive and statistically significant, meaning that firms that are non-eligible for government support but have political connections have a higher probability of getting cash transfers than non-eligible firms without such connections. Another interpretation is that a political connection is more valuable among non-eligible firms. A note in Table 3.5 shows the probabilities of obtaining cash transfers at different margins of political connection and non-eligibility status. Political connections help non-eligible firms to get access to cash transfers (0.196-0.124=0.072 (7.2 percentage points)), while the same effect is relatively small (only 2.2 percentage points) for eligible firms. Thus, political connections are not needed to receive cash transfers when the firms are eligible for the funding - the value of political connections is small. The opposite is true for non-eligible firms; in this case, political connections can be the only way to access government support. For comparison, the probability of receiving cash transfers for politically connected but non-eligible firms (Pr(cash | political connection = 1, Non-eligible = 1)) is 0.196, while the same probability for non-politically connected but eligible firms (Pr(cash | political connection = 0, Non-eligible = 0)) is 0.186. This indicates that a political connection fully compensates for a firm's non-eligibility status and guarantees the same probability of receiving cash transfers as their eligible counterparts.

3.5.4 Political Connection and Country Heterogeneity

Lastly, the value of political connections may differ in different institutional settings. Earlier studies have shown that political connections are widespread and equally observed in both developed and developing countries. For instance, Fisman (2001) studied

[11] Using a non-eligibility dummy instead of eligibility comes from convenience reasons only.

Table 3.6: The Relationship Between Political Connection and Receiving Cash Transfers at Different Margins of Institutional Characteristics

	(1) OLS	(2) OLS	(3) OLS	(4) OLS	(5) OLS
Political Connection	0.024	0.035*	0.034**	0.033***	0.033***
	(0.016)	(0.018)	(0.012)	(0.011)	(0.012)
Political Connection x Democracy	0.001				
	(0.003)				
Political Connection x Autocracy		-0.000			
		(0.004)			
Political Connection x Voice and Accountability			0.013		
			(0.016)		
Political Connection x Government Effectiveness				0.011	
				(0.025)	
Political Connection x Regulatory Quality					0.008
					(0.023)
Demand Shock					
(Base Category = Positive Shock)					
No Shock	0.005	0.005	-0.000	-0.000	-0.000
	(0.015)	(0.015)	(0.015)	(0.015)	(0.015)
Negative Shock	0.066***	0.066***	0.057**	0.058**	0.058**
	(0.023)	(0.023)	(0.023)	(0.023)	(0.023)
Firm Size (ln)	-0.002	-0.002	-0.001	-0.001	-0.001
	(0.008)	(0.008)	(0.008)	(0.008)	(0.008)
Firm Age (ln)	-0.009	-0.009	-0.009	-0.009	-0.009
	(0.006)	(0.006)	(0.006)	(0.006)	(0.006)
Foreign Owned	-0.012	-0.012	-0.014	-0.014	-0.014
	(0.011)	(0.011)	(0.010)	(0.010)	(0.010)
Government Owned	0.002	0.001	0.004	0.003	0.003
	(0.018)	(0.018)	(0.017)	(0.017)	(0.017)
Business Association	0.029***	0.029***	0.023**	0.023**	0.023**
	(0.010)	(0.010)	(0.010)	(0.010)	(0.010)
Product Innovation	0.008	0.008	0.008	0.008	0.008
	(0.006)	(0.006)	(0.005)	(0.005)	(0.005)
Government Contract	-0.013	-0.013	-0.012	-0.012	-0.012
	(0.009)	(0.009)	(0.009)	(0.009)	(0.009)
Exporter	-0.003	-0.003	-0.001	-0.001	-0.001
	(0.007)	(0.007)	(0.007)	(0.007)	(0.007)
Manager Experience (ln)	0.003	0.003	0.003	0.003	0.003
	(0.005)	(0.005)	(0.005)	(0.005)	(0.005)
Female Top Manager	-0.003	-0.003	-0.002	-0.002	-0.002
	(0.012)	(0.012)	(0.012)	(0.012)	(0.012)
Capital City	0.009	0.009	0.008	0.008	0.008
	(0.012)	(0.012)	(0.012)	(0.012)	(0.012)
Country Fixed Effects	Yes	Yes	Yes	Yes	Yes
Industry Fixed Effects	Yes	Yes	Yes	Yes	Yes
Survey Time Fixed Effects	Yes	Yes	Yes	Yes	Yes
Observations	11436	11436	11853	11853	11853
Adjusted R^2	0.216	0.216	0.208	0.208	0.208

Note: Column (1) includes the interaction between political connection and Democracy score, Column (2) - political connection and autocracy, Column (3) - political connection and Voice and Accountability, Column (4) political connection and government effectiveness, and Column (5) political connection and regulatory quality. All models include country fixed effects. Therefore, the coefficients for institutional variables are not estimated. All models are estimated as linear probability models. Standard errors are clustered at the country level. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

the value of political connections in Indonesia, Khwaja and Mian (2005) in Pakistan, Goldman et al. (2013) and Acemoglu et al. (2016) in the US, Amore and Bennedsen (2013) in Denmark, Schoenherr (2019) in Korea and Li et al. (2008) in China, to name a few. However, these papers are country-specific and do not allow for comparisons across institutions. Since the data in this chapter covers the firms from a large set of countries, it allows for studying the country-level variations in the value of political connections, specifically, whether politically connected firms in different institutions have the same advantage in receiving cash transfers.

To test this relationship, the model includes the interaction term between the firms' political connection status and the countries' institutional characteristics, such as the democracy/autocracy scale from the POLITY5 project, voice and accountability, government effectiveness, and regulatory quality from the World Governance Indicators project. Results are in Table 3.6. Neither of the interaction terms is statistically significant, meaning that the value of political connections does not seem to differ significantly across different institutional settings. One potential explanation for this finding is that our sample covers countries with relatively similar institutional characteristics. Another reason for the homogeneity of the results could be that the unexpected and unprecedented COVID-19 shock put every country in a similar economic condition. Governments, therefore, implemented similar policies against the COVID-19 shock and faced similar challenges during the policy implementation stage.

3.6 Robustness

This section includes further checks and sensitivity analysis for the main findings. Columns (1)-(2) in Table 3.7 show the result when the model includes country x industry and country x industry x survey time fixed effects. The coefficient for political connection remains consistent in magnitude and significance. In Column (3), standard errors are clustered at the country x industry level. The results are identical to the main findings.

Models in Columns (4)-(7) use different measures for the COVID-19 shock. In

Table 3.7: Robustness Checks with Alternative Measures

	(1) OLS	(2) OLS	(3) OLS	(4) OLS	(5) OLS	(6) OLS	(7) OLS	(8) OLS
Political Connection	0.037**	0.032*	0.036**	0.034**	0.036**	0.035**	0.034**	0.043***
	(0.016)	(0.017)	(0.015)	(0.014)	(0.014)	(0.014)	(0.014)	(0.016)
Demand Shock								
(Base Category = Positive Shock)								
No Shock	0.003	0.004	-0.000		-0.017			0.003
	(0.016)	(0.016)	(0.012)		(0.015)			(0.017)
Negative Shock	0.058**	0.057**	0.058***		0.037			0.062***
	(0.025)	(0.026)	(0.014)		(0.024)			(0.020)
Supply Shock								
(Base Category = Positive Shock)								
No Shock				0.030*	0.032**			
				(0.016)	(0.012)			
Negative Shock				0.067***	0.037**			
				(0.021)	(0.014)			
Sales Shock								
(Base Category = Positive Shock)								
No Shock						-0.003		
						(0.015)		
Negative Shock						0.062**		
						(0.023)		
Changes in Sales							-0.083***	
							(0.026)	
Constant	-0.122	-0.046	-0.135***	-0.137	-0.148	-0.139	-0.137	
	(0.094)	(0.049)	(0.048)	(0.095)	(0.093)	(0.092)	(0.104)	
Firm Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country Fixed Effects	No	No	Yes	Yes	Yes	Yes	Yes	Yes
Industry Fixed Effects	No	No	Yes	Yes	Yes	Yes	Yes	Yes
Survey Time Fixed Effects	Yes	No	Yes	Yes	Yes	Yes	Yes	Yes
Country x Industry FE	Yes	No	No	No	No	No	No	No
Country x Industry x Survey Time FE	No	Yes	No	No	No	No	No	No
Observations	11853	11853	11853	11747	11747	11803	11405	10788
Adjusted R^2	0.255	0.335	0.208	0.206	0.208	0.209	0.202	0.228

Note: All models include the same set of firm-level control variables. Model (1) includes Country X Industry fixed effects. Model (2) includes Country x Industry x Survey Time Fixed effects. In Model (3) standard errors are clustered at the country x industry level. Models (4) includes supply shock instead of demand shock. In model (5) both demand and supply shocks are used together. Model (6) and (7) include changes in sales. All models (1)-(7) are estimated as linear probability models. Model (8) is estimated as a logit model and the corresponding marginal effects are reported. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Column (4), the demand shock is replaced by the supply shock; in Column (5), both demand and supply shocks are included in the model; Column (6) uses sales shock, which is a categorical variable and measures whether a firm experienced positive, negative, or no sales shock during the pandemic; in Column (7), changes in sales are used instead. The coefficient for political connections does not change much. Consistent with the main findings, the COVID-19 shock variables are always significant, meaning that firms that experienced negative supply or sales shocks are always more likely to get cash transfers than firms that weren't exposed to such shocks.

As the linear probability model might bias the results when estimating the model with a dummy dependent variable, Column (8) shows the marginal effects of the non-linear logit model. Qualitatively the results are similar to Column (2) in Table 3.2; however, the coefficient for political connection is now higher in magnitude, and the model fit improves.

Table 3.8: Robustness Checks with Different Parametric and Non-parametric Estimates

	Covariate Matching	PSM (N=1)	PSM (N=5)	PSM (Caliper=0.1)	IPW	IPWRA	Entropy Balance
Political Connection	0.038**	0.045**	0.035**	0.045**	0.035**	0.036***	0.036**
	(0.018)	(0.018)	(0.014)	(0.018)	(0.014)	(0.014)	(0.015)
Firm Controls	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Country Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Industry Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Survey Time Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	11853	11853	11853	11853	11853	11853	11853

Note: Receiving a Cash Transfer is a dependent variable in all models. Covariate Matching is a nearest neighbor approximate matching based on the same firm characteristics as in the main model. PSM is a Propensity Score Matching with different parameters depending on the number of nearest neighbors and the caliper value. IPW is non-parametric Inverse Probability Weighting estimation technique and IPWRA is Inverse Probability Weighted Regression Adjustment. Entropy Balance sets a restriction on the first and the second moments. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Lastly, Table 3.8 summarizes the results from non-parametric matching estimates to further check the validity of the initial findings. The results from Covariate Matching and Propensity Score Matching (PSM) provide much larger estimates than the main result.

At the same time, Inverse Probability Weighting (IPW), Inverse Probability Weighted Regression Adjustment (IPWRA), and Entropy Balance provide results very close to the initial findings. The political connection is positive and statistically significant in all specifications, supporting our baseline results.

3.7 Discussion and Conclusion

The chapter addresses some of the key questions in the political economy literature. Specifically, how the political connections affect the distribution of public money and whether it leads to resource misallocation and inefficiency. This topic is especially relevant during the current economic downturn caused by the COVID-19 pandemic, when the role of the government's re-distributive politics is critically important. The political bias in distributing relief money might affect the economic recovery, likely making it slower, less efficient, and more difficult.

Compared to the standard findings in the literature that political connections play a significant role in accessing government resources, this study finds no evidence of political bias in distributing COVID-19 support policies either in intensive or extensive margins. To provide further insights and identify the mechanism behind the allocation of government support, each support program is studied individually. The regression results show that political connections matter only for cash transfers, whereas the effect is muted for any other programs, such as deferral of credit payment, access to new credit, tax reduction, and wage subsidy. These findings can be explained by the unique features of the direct cash transfer program, which make it the most desirable policy tool against the negative COVID-19 shock. It also allows government officials to use their discretionary power to allocate relief money according to their political interests. Compared to other policy measures, cash transfers ease a firm's liquidity constraints; they are unconditional, do not require repayment or other corresponding costs, and are free to use depending on a firm's needs and preferences. Thus, by studying the heterogeneous effect of political connections on receiving different government programs,

this study enriches political economy literature, which usually concentrates on a specific program and does not allow for such a comparison.

The other contribution of this chapter emerges from studying the timing of receiving government support. Earlier works estimated the average value of political connections and did not differentiate the effect over time. The results indicated that political connections provide better access to cash transfer programs only during the first few months of the COVID-19 pandemic. In contrast, the value of political connections is insignificant afterward. Thus, having political connections ensures faster access to government programs, which can be explained by the information advantage that politically connected firms might have or the fact that, during the start of the COVID-19 pandemic, there were no formal rules or requirements for distributing relief money. The latter may incentivize the opportunistic behavior of politically connected firms and, consequently, trigger resource misallocation and political distribution of government resources. It has important policy implications, particularly how well-defined rules and regulations can avoid corruption and political bias in distributing public money.

To better develop the argument of political misallocation, the study estimates the value of political connections in two groups: (1) firms that were eligible for government support and (2) those that were not. The results indicate that political connections helped non-eligible firms to obtain cash transfers, and political bias was more pronounced among non-eligible firms. Political connections compensate for the firms' non-eligibility status and give them the same propensity to receive cash transfers as their eligible counterparts.

This finding is one of the first indicative evidence of the allocative inefficiency of government support programs during the COVID-19 pandemic. Previous studies only explored some of the firm characteristics related to the funding allocation; however, none further identified the potential distortions in the process. It is difficult to study the overall effectiveness of support programs due to the relatively short time passed after the treatment; however, the distortions in the distribution stage can significantly affect the overall effectiveness of these programs.

This chapter also adds a comparative aspect to the political economy literature by studying political connections in different institutional contexts. The results provide no significant evidence of heterogeneity in the value of political connections; political bias is observed with the same intensity in all sampled countries. To better understand the institutional context and country-level comparisons, future studies should collect the data from a larger sample of countries with more diverse institutional characteristics to get better insights.

The study does not come without limitations. While the research design ensures that political connection is antecedent to the shock and the government support policies, thus reassuring on the reverse causality, the time-invariant nature of the political connection may raise concerns about its exogeneity. Ideally, one would like to observe a change in political connection in order to identify the causal effect even better. Furthermore, future studies would benefit from observing the type of political connections (high or low-rank political ties) and the party affiliation of politically connected firms. Due to data restrictions, a detailed analysis is not possible in the present study. Yet, it would be interesting to know whether all types of political connections matter for receiving government support or only the higher-level political connections, as in the Greensill case involving former UK Prime Minister David Cameron. Finally, to quantify the economic losses associated with funding misallocation, it is important to know the actual volume of cash transfers that politically connected firms received and to observe the future performance of these firms after a meaningful period of time. If future studies address some of the issues discussed here, it will help us to better understand how the political connection mechanism works and evaluate the effectiveness of government support policies during the COVID-19 pandemic.

Chapter 4

Political Insurance. Lobbying Behaviour of UK-Listed Firms

4.1 Introduction

Government policies and regulations represent a large source of uncertainty for many firms, which affect firms' decisions regarding capital investments (Gulen and Ion, 2016; Jens, 2017; Julio and Yook, 2012), corporate innovation (Bhattacharya et al., 2017), merger and acquisitions (Bonaime et al., 2018; Nguyen and Phan, 2017), stock prices and other aspects of firms' operation (Pastor and Veronesi, 2012). Therefore, it becomes critical to understand how firms mitigate such political risk and uncertainty[12].

Corporate political activities are considered one of the tools that can be used to deal with policy uncertainty and mitigate its negative effect. Although political economy literature has highlighted the financial benefits of lobbying and other political strategies, namely securing government contracts (Goldman et al., 2013; Schoenherr, 2019; Baltrunaite, 2020; Brugués et al., 2020; Brogaard et al., 2021), receiving corporate bailouts (Faccio, 2006; Vukovic, 2021), having preferential access to external finance (Khwaja

[12]Consistent with Pástor and Veronesi (2013) political risk/uncertainty is defined as uncertainty regarding potential policy changes and any potential impact new policies will have on firms' performance. Political risk/uncertainty and policy risk/uncertainty are used interchangeably throughout the analysis.

and Mian, 2005; Claessens et al., 2008; Li et al., 2008; Bussolo et al., 2021), the little attention has been given to how the information-transfer mechanism of lobbying can mitigate firms' exposure to policy uncertainty. By engaging in lobbying activities, firms reduce the information asymmetry between themselves and lawmakers, enabling them to be better positioned to anticipate and influence policy outcomes. In fact, lobbying usually involves a substantial information exchange, which can give the lobbying firms access to superior policy-relevant information and understand the timing, content, and impact of potential policy alternatives, which then can be used to mitigate their exposure to political risk. To examine whether an information advantage is a channel through which lobbying plays a risk-mitigating role, this chapter investigates how the firm-level political risk varies with the intensity of lobbying.

The study uses three major datasets in the analysis. First is firm-level political risk data developed by Hassan et al. (2019), which measures the level of risk and uncertainty disclosed in firms' quarterly conference call reports. This measure has several advantages. First, it is a perception-based measure of risk that help us understand the information advantage mechanism of lobbying activities. Lobbying firms with better information on policy development may use less uncertain language in their quarterly reports and therefore report lower political risk. Nevertheless, the authors showed that firm-level political risk correlates with more objective firm-level risk measures, such as firms' stock return volatility. Thus, firm-level political risk is a good indication of risk in the company. Next, firm-level political risk measure is also advantageous compared to other country-level aggregated political risk measures as it allows that political risk to vary across firms and over time. Hassan et al. (2019) document a significant firm-level variation in political risk meaning that firms have different exposure to political risk considering the overall level of risk and uncertainty in the economy. It can be explained by at least two main factors. Firms might have different risk perceptions even when facing the same type of risks, or firms act differently to reduce their risk exposure, including engaging in lobbying activities which is the main focus of this research.

The second dataset in this study comes from the ministerial meetings between UK

government officials and external groups. The meetings data allows us to construct the lobbying measure by counting the number of meetings a firm participated in for a given year. Such lobbying measure fits the propose of the study, as every lobbying meeting can be considered as an information exchange between firms and policymakers, which support the information advantage mechanism of lobbying. The last set of data is OSIRIS which covers the financial and balance sheet information for the sampled firms. After merging and cleaning, the final sample consists of 430 UK-based publicly-listed firms and 2264 firm-year observations from 2012 through 2020.

Results from a two-way fixed effect model document a strong negative relationship between lobbying and firm-level political risk. An additional meeting with government officials is associated with a 0.89% decline in political risk. Considering the average number of lobbying meetings in the dataset, four meetings every year (eight meetings if firms with no lobbying activities are dropped), it generates a 3.6% (7.1%) drop in political risk, which can be considered economically significant in magnitude.

The study does several additional analyses to further examine the idea that lobbying helps firms obtain policy-relevant information that allows them to reduce reported political risk. First, using the same baseline model with different outcome variables, the study finds that the impact of lobbying on a firm's overall and non-political risk is statistically insignificant. Thus, the benefits of lobbying are minimal for managing other types of risk coming from non-political sources.

Furthermore, the results also reveal that the effectiveness of lobbying varies across different political risk types, depending on the quality of policy information exchanged between firms and policymakers. For instance, the largest effect of lobbying on political risk reduction is observed in the risk coming from institutions & political processes, tax policy, and the environment. In contrast, the smallest effect is in trade policy. Consistent with the information advantage argument, some lobbying meetings are more valuable than others depending on the complexity of the economic policy they are targeting to. Although government officials have information on the whole political process, there are some policy aspects, such as trade policy, that is not entirely controlled by the home

government. Therefore, lobbying the home country's government can't fully mitigate the trade policy risk.

Lastly, the results document that the risk-mitigating effect of lobbying is more pronounced when the overall uncertainty is high in the economy. This can be explained by the fact that during periods of high policy uncertainty, the policies are not yet settled, and lobbying firms can obtain information about different policy alternatives and reduce their exposure to political risk. When uncertainty is low, there is little information exchange between firms and policymakers, and lobbying activities are less valuable.

The main results are robust using the battery of robustness tests and alternative specifications. The key challenge of the identification strategy is firms' non-random participation in lobbying meetings. The model includes firm-fixed effects and a large set of time-varying firm characteristics to address this issue. Additional sub-sample analyses have been done to ensure that the selected group of firms has equal access to policymakers and the reverse causality issue is minimal; the results are qualitative and quantitatively unchanged.

This chapter makes important contributions to different strands of literature. First, it builds on the burgeoning political economy literature on the effectiveness of lobbying. While the first-order financial benefits of political activities are already well documented (Zingales, 2017), the study unlocks relatively unexplored mechanism of information advantage that helps lobbying firms hedge against political uncertainty, second-order benefits. These findings provide direct empirical evidence that lobbying should be considered not only as a rent-seeking mechanism but also as a tool to mitigate external risk coming from government policies and regulations. Selecting political risk as an outcome variable and exploring the information advantage mechanism is motivated by the context of the study and the measure of lobbying used in the analysis. Compared to the US, where money in politics is more prevalent, and lobbying is often considered as a rent-seeking mechanism (Bombardini and Trebbi, 2020), lobbying in the UK can be understood as informational when the exchange of information between firms and policymakers play a bigger role, similar to lobbying in EU (Belloc, 2015; Dellis and Sondermann, 2017; Coen

et al., 2021). This interpretation is further supported by the fact that lobbying is measured as the meetings between interest groups and policymakers rather than lobbying expenditure.

Second, the study expands the lobbying literature beyond the US context. As the majority of lobbying papers are based on the US case, because of the availability of the lobbying data and the importance of US politics (see Wiedemann (2022) for lobbying in the EU), this study is one of the first in the economics and business literature that concentrates on lobbying activities in the UK. Understanding lobbying in the UK is important for at least three reasons: first, the country experienced significant economic and political uncertainty in the last decades caused by Brexit, the COVID-19 pandemic, and multiple cabinet changes. Therefore, it is critical to understand how firms mitigate such uncertainty and participate in policy-making. Lobbying meetings can also be helpful for policymakers to better understand the policy impact and design effective policies. Second, the institutional environment differs between the US and the UK, which allows studying different types of lobbying distinct from the well-studied quid-pro-quo lobbying in the US. The UK's political market features relatively less money in political lobbying and party donations (McKay and Wozniak, 2020; Draca et al., 2022). Most lobbying is done in-house through direct meetings with policymakers, often called informational lobbying. Thus, studying lobbying in the UK allows for a better understanding of some new features of lobbying activities. Third, transparency remains a main challenge in the current UK's lobbying market (McKay and Wozniak, 2020). Despite some steps taken to promote lobbying transparency by creating the universal lobbying register and mandatory disclosure of all lobbying meetings between external groups and policymakers, there have been several lobbying scandals in the country's recent history, including the Greensill scandal involving former Prime Minister Mr. Davide Cameron[13]. Thus, by assembling the new dataset of firms' lobbying activities in the UK, this study encourages

[13]In the report, Accountable Influence: Bringing Lobbying Out of the Shadows, Transparency International mentioned at least 15 major lobbying scandals involving Ministers, former Parliamentarians, and other public officials that happened during the five years since David Cameron claimed that lobbying would be "the next big scandal waiting to happen" in 2010.

further research in this direction which might facilitate the transparency of the lobbying process.

Next, the chapter contributes to the growing literature on political uncertainty measured at the firm level (Hassan et al., 2019; Shang et al., 2021; Egerod and Aaskoven, 2022). Considering lobbying as a risk-managing tool, the results of the study provide a potential explanation for why individual firms have different exposure to aggregate political risk. Lastly, in terms of empirical analysis, this research is one of the pioneers in using lobbying meetings data at the firm level and merging it with other firm-level databases. Compared to the standard measures of lobbying, which counts the money spent on lobbyist services, observing the actual meetings between firms and policy-makers has important advantages as it helps to unlock the information transfer mechanism of lobbying activities.

The rest of the chapter is structured as follows. Chapter 4.2 covers the related literature. Chapter 4.3 gives an overview of lobbying practices in the UK. Chapter 4.4 explains the data and the baseline empirical model. Chapter 4.5 summarizes the main empirical findings, 4.6 provides additional analysis and robustness checks, and the last Chapter 4.7 concludes.

4.2 Related Literature

The literature on political uncertainty has grown rapidly in the last decades, both in terms of developing new measures as well as studying its immediate consequences. On the one hand, there is a consensus that political uncertainty has an established negative impact on economic outcomes. At the macroeconomic level, policy uncertainty influences capital flows, drives the business cycle, and impedes economic growth (Bloom et al., 2018; Baker et al., 2016; Handley and Limão, 2017; Bloom, 2009; Azzimonti, 2018). At the firm level, policy uncertainty affects corporate investment (Gulen and Ion, 2016; Jens, 2017; Julio and Yook, 2012), innovation (Bhattacharya et al., 2017), merger and acquisition decisions (Bonaime et al., 2018; Nguyen and Phan, 2017), and stock prices (Pastor and

Veronesi, 2012).

On the other hand, much can be done to study how to mitigate the negative effect of political uncertainty. A recent stream of research considers political risk as an antecedent of firms' political activities. However, empirical results are mixed depending on the type of political risk and political strategy. For instance, Shang et al. (2021) find that economic policy uncertainty raises firms' incentives to lobby policymakers to access policy information and influence policy outcomes. However, it is not true for non-lobbying firms as they are less likely to initiate lobbying during periods of high uncertainty, mostly due to high lobbying entry costs. Using the Canadian Lobbyists Registry data measuring the number of times lobbyists have contacted government ministries each month, (Cooper and Boucher, 2019) show that lobbying intensity does respond differently to different types of uncertainty. Whereas events introducing issue information uncertainty have a statistically significant positive relationship with lobbying, events introducing policy objective uncertainty do not. In the case of the US, Hassan et al. (2019) document the strong positive relationship between uncertainty and lobbying. Firms that express greater concern about political uncertainty put more effort into corporate lobbying. However, using the same set of firms and the same measures, Egerod and Aaskoven (2022) find only a weak relationship between political uncertainty and lobbying intensity and a null effect among firms with no history of lobbying.

In the international business context, De Villa et al. (2019) showed that MNE subsidiaries prefer non-engaged political activities when senior management perceives high political risk in the host country market. This strategy includes actively adapting and complying with government policies rather than actively engaging with the host country's government and influencing public policies through lobbying or other constituency-building activities. Relatedly, using the Hungarian context as a case study, Sallai and Schnyder (2019) find that the choice of political strategy depends on the political risk type, whether it is a constantly high-risk environment (continuous risk) or when risk drastically increases due to some unexpected events such as Brexit, the COVID pandemic, et.c. (continuous risk). They document that in the case of continuous risk, firms

may rely more on non-engaged strategies; when risk is discontinuous, MNE subsidiaries engage in a combination of engaged and non-engaged political strategies.

Another stands of research study the relationship between time-series measure of policy risk and uncertainty and firm performance when the relationship is moderated by firms' political activities. For instance, Cheng et al. (2021) show that banks are cautious when facing policy uncertainty, but the effect is alleviated when banks are politically connected. Similarly, Bradley et al. (2016) finds that the policy risk has less of an impact on a firm's cost of debt when the firm makes more PAC contributions or spends more money on lobbying. Using the data of non-financial private listed companies in China, Liu et al. (2021) document that the negative effect of policy uncertainty on fixed-asset investment is lower in politically connected firms than in non-connected firms, especially in industries with low asset reversibility and regions with a high degree of marketization. Ferracuti et al. (2022) also find that politically active firms are better equipped to navigate high policy uncertainty periods and outperform their industry peers. Specifically, they show that politically active firms exercise their advantage by timing large investments during periods of policy uncertainty, enabling them to increase profit margins and amass market power.

However, sometimes the empirical results are mixed, and there are cases when political activities do not fully mitigate the negative effect of political uncertainty. Wellman (2017) shows that political connections only partially offset the negative relation between corporate investment and political uncertainty. And political connections do not usually mitigate the negative effect coming from general economic uncertainty. Azzimonti (2018), on the other hand, finds the opposite results. In the case of partisan conflict and the corresponding policy uncertainty, the negative impact on capital investment is stronger for firms with political connections. This implies that engaging in corporate political donations heightens firms' exposure to the damaging consequences of partisan conflict.

This stream of research documents the moderating effect of political strategy, but it fails to identify the underline mechanism of how this effect can be achieved. There is little

empirical evidence on whether politically active firms truly enjoy information advantage due to lobbying activities that enable them to mitigate the exposure to political risk. The lack of research in this direction is mostly explained by the unavailability of firm-level political risk/uncertainty measures. However, the recent advancement in computational linguistics and natural language processing made it possible to study companies' periodic reports and construct a new measure of political risk faced by individual firms (Hassan et al., 2019). Although there are few other papers based on the same political risk dataset (Shang et al., 2021; Egerod and Aaskoven, 2022), to the best of my knowledge, there is yet to be a study that directly tests the relationship between firms' political activities and their political risk exposure. The closest papers that try to unlock the information advantage mechanism of political activities are by Pham (2019) and Christensen et al. (2022); however, they study the firm's overall risk and not the political risk directly.

Pham (2019) constructed a measure of disclosure uncertainty as the ratio of the number of Loughran-McDonald (L-M) uncertainty words to the total number of words in firms' quarterly reports. Then he showed that, in the face of rising economic policy uncertainty, the financial reports of firms with strong political connections exhibit less-uncertain language than non-connected peers, consistent with the information advantage channel that enables connected firms to hedge against policy uncertainty. Similarly, Christensen et al. (2022) find that greater political hedging is associated with reduced firm risk (measured as stock return volatility, investment volatility, or earnings volatility), particularly during periods of high policy uncertainty.

This study is distinct from these papers in at least two main ways. First, it directly measures firm-level political risk and its different sub-categories. Compared to Christensen et al. (2022), where they calculate firm risk based on the observable outcomes, the political risk in this paper is perception based, disclosed in the corporate reports. Considering that the aim of the paper is to study the information advantage mechanism of lobbying activities, self-reported risk can be a preferable risk measure as information directly affects managers' perceptions, whereas firm volatility can also be affected by firm fundamentals, which is difficult to disentangle. Second, the study uses

lobbying intensity as a measure of political activity which counts the number of meetings between firms and government officials. As every meeting is an information transfer between meeting participants, such a lobbying measure can be an ideal candidate for studying the information-sharing mechanism of lobbying. Conversely, political party contributions may reflect the attempt to influence policy-making, rather than firms' information-gathering efforts. Overall, using two unique sets of datasets, the study provides one of the first empirical evidence of how lobbying reduces firm-level political risk.

4.3 Lobbying in the UK

Lobbying practices in the UK are somewhat different than in many developed countries, i.e., US and Canada, when it comes to transparency. Only recently, the UK government put some new measures in place to effectively regulate lobbying activities and facilitate the transparency of the process. First, in 2010 the government established a new requirement in the Ministerial Code, which enforced every government department to disclose the list of external groups with whom government officials meet each quarter. The name of the organization or individual, the date of the meeting, and the purpose of the meeting must be reported. This new rule only applies to the top two of the three tiers of government ministers (the Secretaries of State and the Ministers of State) and the high level of civil servants (the Permanent Secretaries). Other civil servants at the lower levels do not have to report their meetings.

Second, in 2014 the UK parliament introduced a new act on Transparency of Lobbying, Non-Party Campaigning and Trade Union, which regulates the lobbying activities in the country. Under this new regulation, all the consultant lobbyists must be registered and the registrar must keep and publish the list of all active lobbyists periodically. To enhance transparency, registered lobbyists must publish the client information on whose behalf the lobbying was done. Compared to the US Lobbying Disclosure Act of 1995, the amount of money the clients pay to lobbyists is not required to be reported. Also,

the government does not ask consultant lobbyists for the names or offices of their lobbying targets or the subjects they are lobbying. Despite the steps taken by the UK government to improve the transparency of the lobbying process, many argue that this is only a minimalist effort that can't prevent future lobbying scandals. We do not go into details, but these two main datasets (lobby register and the Ministerial Meetings) can be used to study lobbying activities in the UK.

McKay and Wozniak (2020) evaluate the usability of the Ministerial Meetings data and the compatibility with lobby register data. The main concerns that the paper emphasizes are the missing content of the meetings (i.e., 10% of the reports fail to offer any policy-specific information discussed during the meetings) and the difficulty of searching and combining the meeting data from different ministries. Although the data is publicly available, the information is scattered on different government web pages. The Meetings data, therefore, are seldom analyzed.

The first issue is still unresolved and can be problematic if someone studies the content of the meetings. However, in this setting, it is less of a concern as every meeting can be classified as lobbying, regardless of the topic of the discussion. A new initiative of Transparency International mostly resolves the second problem. Under the Open Access UK project, the Transparency International team collected, harmonised, and made meetings data available online - https://openaccess.transparency.org.uk/. However, the standardised names of the companies and their unique identifiers are still missing from the data. This issue remains critical, particularly for research purposes. To overcome this problem, the study uses the manual matching technique and combines firms' lobbying with other firm-level databases. The matching procedures are explained in the next section.

Regarding compatibility between Meetings data and lobbying registry, McKay and Wozniak (2020) show that 91% of ministerial meetings are with groups and individuals whose names do not appear as clients in the lobby register. Such a high number is anticipated as many firms and interest groups lobby the government directly (in-house) without hiring consultants and professional lobbyists. Another observation is that of-

tentimes registered lobbyists don't lobby. It can be explained by the fact that lobbyists may register their clients as a matter of routine, while the actual meetings with ministers may depend on the necessity and current conditions. Considering all these drawbacks of the lobbying registry database and the fact that meetings data is much larger and complete, the study uses the Meetings data throughout the analysis in this chapter. To give the intuition about the scale difference between these two databases, registered lobbyists account for less than 1% of meetings in the meetings data. There are about 80,000 unique meetings recorded in the Meetings data since 2012, whereas there are only 200 registered lobbyists and 1000 clients in the lobbying registry database since 2015.

4.4 Data and Model

There are three main datasets used in this chapter. (1) Firm-level political risk measure comes from Hassan et al. (2019) and a companion web page firmlevelrisk.com, (2) Lobbying information is collected from openaccess.transparency.org.uk, (3) firm-level financial information is taken from Osiris database.

4.4.1 Firm-level political risk

Using textual analysis based on the quarterly earnings conference-call transcripts, Hassan et al. (2019) developed a new measure of the extent and type of political risk individual firms face. The dataset covers all publicly listed companies and contains information about different types of firm-level political risk, which are used as dependent variables in this analysis.

Political risk is the ratio of the total number of occurrences of bigrams indicating discussion of a given political topic within the context of "risk" and "uncertainty" divided by the total number of bigrams in the transcript. More precisely, it has the following specification:

$$PRisk_{it} = \frac{\sum_{b}^{B_{it}} \left(1[b \in \mathbb{P}\backslash\mathbb{N}] \times 1[|b-r| < 10] \times \frac{f_{b,\mathbb{P}}}{B_{\mathbb{P}}}\right)}{B_{it}} \tag{1}$$

where $PRisk_{it}$ is firm-level political risk for firm i in quarter t. The first two terms in the numerator count the number of bigrams associated with discussion of political topics ($P \backslash \mathbb{N}$) that occur in proximity to a synonym for risk or uncertainty (within 10 words) ($1[|b - r| < 10]$). The third term in the numerator weights each bigram with a score that reflects how strongly the bigram is associated with the discussion of political topics, where $f_{b,\mathbb{P}}$ is the frequency of bigram b in the political training library and $B_{\mathbb{P}}$ is the total number of bigrams in the political training library. The denominator is the total number of bigrams in the text.

The database also includes topic-specific political risk measures, such as (1) economic policy & budget; (2) environment; (3) trade; (4) institutions & political process; (5) health care; (6) security & defense; (7) tax policy; and (8) technology & infrastructure. The methodology of measuring topic-specific political risk is similar to the general measure; however, it counts the number of political bigrams which cover a particular political topic[14]. Although firm-level political risk is the main dependent variable, different topic-specific political risk measures will also be used in the subsequent analysis.

The following data-cleaning steps were taken for the purpose of the study. First, keeping the firms headquartered in the UK[15]. Second, restricting the sample period between 2012 and 2020 due to the availability of lobbying data. Third, aggregating quarterly political risk variables into the annual measure simply by taking the average. Earnings conference call reports are available on quarterly bases with no systematic structure across firms; some firms release the reports every quarter, but more often, the reports are available either in the 1^{st} and the 3^{rd} quarters, or in the 2^{nd} and the 4^{th} quarters. The annual aggregation reduces the idiosyncratic quarterly volatility and makes the political risk measure comparable across firms (average risk over time in Figure

[14]For a detailed methodology, you can refer to the original paper by Hassan et al. (2019) and its supplementary materials where they provide the complete list of the bigrams for each topic and provide the detailed calculation.

[15]Although there is a variable in the dataset that refers to the headquarters location of a firm, there are cases when firms are officially registered in the UK due to the listing purposes on the London Stock Exchange; however, their operating headquarters are outside the UK. These firms are less likely to be involved in lobbying activities in the UK since such lobbying can't mitigate their exposure to political risk, which reflects the uncertainty in their home countries. These firms are dropped from the analysis.

C.1). Lastly, using company names to merge political risk data with lobbying data and ISIN code to get firms' financial information.

4.4.2 Lobbying

The Meetings data includes all meetings between external groups (firms) and government officials from 2012 till 2020[16]. Each row corresponds to a uniquely identified meeting and contains information about the name of the government official who hosted the meeting, their unique personal ID, policy level, department, the names of external groups or organizations, and the date of the meeting.

The main difficulty of merging lobbying meetings with political risk data is the absence of a unique firm identifier. Therefore, the matching is done using company names taken from the political risk database and searched in the Meetings data. The exact matching technique with further manual checks and corrections is used to get the most accurate results. Computationally it is much harder than a fuzzy-matching algorithm, but it guarantees the most accurate results and the minimal risk of false negative matching. The detailed methodology of matching is described in Appendix C.

The Meetings data allows for constructing different lobbying variables. The main variable in the analysis is the intensity of lobbying, which measures each firm's total number of meetings in a given year. However, the study also differentiates whether a meeting is private (one-to-one) or a group meeting when many companies meet government officials simultaneously. These lobbying variables will be used in the subsequent analysis and further discussed in the next sections.

As the political risk database is used as a base sample and then these firms are searched in the Meetings data, the combined dataset has no missing values. The companies that are not in the Meetings data are assigned zero values, meaning they did not participate in lobbying activities in the study period[17].

[16]During the time of data collection, lobbying data was also available for the first three quarters of 2021. Such incomplete data would bias (downward) our annual lobbying measure; therefore, 2021 is dropped from the main sample. However, the results are very similar when including the incomplete 2021 data in the analysis.

[17]See the distribution of lobbying in Figure C.2 and Figure C.3.

4.4.3 Osiris

The last data set in this analysis is the OSIRIS database, which covers all publicly listed companies and provides key financial and firm demographic information. The matching between the base sample and OSIRIS has been done through unique ISIN codes and company names (if ISIN was unavailable). The matching rate is very high, as only six firms were not in the OSIRIS database. However, some missing values still exist, as not all variables are available for all years.

After cleaning and merging, the final sample consists of 430 firms and 2,264 firm-year observations between 2012 and 2020 (see the distribution of firms by industry in Table C.2). Since the political risk measure is only observed for those years when the company was listed on the stock market, it is an unbalanced panel data with an average of 5.3 observations per firm.

4.4.4 Model

To study the effect of lobbying on firm-level political risk, the following empirical model is used:

$$PRisk_{i,t} = \delta_0 + \delta_1 \times Lobby_{i,t} + \delta_3 \times X_{i,t} + \gamma_i + \rho_t + \epsilon_{i,t}$$

where $PRisk_{i,t}$ is a log of political risk for company i in time t. It is a zero-bounded continuous variable. $Lobby_{i,t}$ measures the number of meetings the company i has in year t. Depending on the type of lobbying and political risk, dependent and independent variables can vary in different empirical specifications. The model also includes time-varying firm covariates ($X_{i,t}$) such as total assets (ln), operating revenue, return on assets, profit margin, current ratio, and solvency ratio. The rationale for including these control variables is that firm size and profitability might affect both firms' ability to lobby the government and also the exposure to political risk (see the descriptive statistics in Table C.1). Different sets of control variables are used depending on the availability of the data. All variables are winsorized at 1% (below) and 99% (above) levels to control for

potential outliers. Lastly, the model includes firm fixed effects γ_i and time fixed effects ρ_t to account for the time-invariant heterogeneity across firms and any macro shocks over time. Standard errors are clustered at the firm level to deal with serial correlation.

The two-way fixed effect model ensures that the risk of potential omitted variables is minimal and there is little room for alternative explanations. However, there are possibilities that firms might have different abilities to participate in the lobbying meeting that varies over time, which potentially biases our results. For causal interpretation, someone needs to find an exogenous shock that affects firms' lobbying behaviour. To the best of my knowledge, such cost/demand shifter of lobbying is difficult to find in this setup, especially the ones that vary across firms and over time. However, the study provides various robustness tests and sub-sample analyses to ensure the stability of the results. The findings are very robust across different specifications.

4.5 Empirical Results

4.5.1 Baseline Results

Table 4.1 shows the results from different models. Column (1) starts with a simple pooled OLS model with no firm and time-fixed effects. The coefficient of lobbying is positive but not statistically significant. In Column (2), results from the two-way fixed effect model are presented, including both year and firm fixed effects. The lobbying coefficient becomes negative and statistically significant. The differences in results between POLS and FE models might explain the fact that firms facing higher political risk may engage more in lobbying activity. These firms have the largest incentive to acquire information from policymakers in order to reduce their political risk exposure. Another way of looking at this finding is that the self-selection of firms into lobbying tends to attenuate the effect of lobbying on firm political risk. This is reassuring as it would suggest that a two-way fixed effects results may be considered as an upper bound to the true effect of lobbying on political risk reduction. If the study manages to fully account for the reverse causality and the negative selection in lobbying activities, the results will probably become more

negative.

An additional meeting with government officials is associated with about 0.89% ($100 \times exp^{-0.00889} - 1$) decrease in firm-level political risk. Considering the average number of lobbying meetings per year (four meetings), the corresponding drop in political risk is about 3.6%. Similarly, if we exclude the firm x year observations with no-lobbying activities, the average number of meetings increases to eight lobbying meetings per year, generating a 7.1% drop in political risk. Since firms' exposure to political risk is often considered unavoidable, such a decline in firm-level political risk due to political lobbying can be considered significant both statistically and economically.

In Column (3), the model also includes other control variables in order to reduce the potential bias from firm-level time-varying confounding factors. The coefficient of lobbying increased in magnitude, ensuring that the baseline result in Column (2) is an upper bound. The true effect of lobbying on political risk can be even larger if controlling for all confounding factors. It should be noted as well that no other control variables have a significant effect on firms' reported political risk; only the current ratio is marginally significant. These findings have significant implications as they show that firms' size and profitability alone do not have a significant effect on risk reduction. The only mechanism for managing political risk goes through lobbying activities. Potentially, large and more profitable firms have better resources to engage in lobbying, which therefore helps them to reduce political risk. Including additional control variables come with the expense of reduced sample size and less efficient estimates. Therefore the model in Column (2) remains the main specification throughout the analysis.

These findings support the idea that lobbying acts as a hedging instrument against political risk and uncertainty. This can be achieved via two mechanisms: (1) firms with regular meetings with government officials are better informed about current or potential risks in the political environment, and (2) lobbying allows for political influence over government policies and regulations. To distinguish between these two mechanisms empirically is rather difficult as no data is available that measures firms' direct policy influence. The lobbying variable in this analysis is the actual meetings between firms

Table 4.1: The Relationship Between Lobbying and Political Risk

	(1) POLS	(2) FE	(3) FE
Lobbying	0.00137	-0.00889**	-0.01020**
	(0.00450)	(0.00440)	(0.00491)
Total Assets (ln)	0.18028***	0.14585*	0.14986
	(0.02176)	(0.08779)	(0.16431)
Operating Revenue (ln)			0.00097
			(0.13267)
Return on Assets			-0.00893
			(0.00666)
Profit Margin			0.00216
			(0.00307)
Current ratio			-0.02301*
			(0.01290)
Solvency Ratio			0.00083
			(0.00410)
Constant	1.86033***	2.37535*	2.33840
	(0.32063)	(1.28189)	(1.82976)
Firm Fixed Effects	No	Yes	Yes
Year Fixed Effects	No	Yes	Yes
Number of companies	430	430	382
Observations	2,264	2,264	1,929
Adjusted R^2	0.0711	0.0658	0.0768

Note: The dependent variable is firm-level political risk in all models. The model in Column (1) is estimated by OLS, with no firm and year fixed effects. Columns (2) and (3) show the results from the two-way fixed effect model. In Column (3), the sample size is smaller due to the missing values in the firm-level control variables. Standard errors are clustered at the firm level. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

and government officials, so the information advantage channel can be more pronounced. Still, it does not exclude the potential policy influence mechanism.

The subsequent analysis tries to disentangle the information advantage mechanism and provides additional support to the findings.

4.5.2 Lobbying and Non-Political Risk

If lobbying has the property to hedge against political risk through better access to policy-relevant information, it should not be useful to mitigate other types of risk coming from non-political sources. In the political risk database, there are two other risk measures. First, it is an overall firm-level risk ($Risk$), which counts the frequency of

mentions of risk or uncertainty and divides it by the length of the report. Second, is a non-political risk ($NPRisk$) which measures a firm's exposure to non-political risk in the same way as political risk ($PRisk$) but counts and weights non-political bigrams rather than political ones.

Table 4.2: The Relationship Between Lobbying and Non-Political Risk

	(1) NPRisk	(2) Risk
Lobbying	0.00169	-0.00284
	(0.00510)	(0.00290)
Total Assets (ln)	0.07050	0.05381
	(0.09124)	(0.05521)
Constant	5.12369***	3.36080***
	(1.33605)	(0.80635)
Firm Fixed Effects	Yes	Yes
Year Fixed Effects	Yes	Yes
Number of companies	430	430
Observations	2,264	2,264
Adjusted R^2	0.0299	0.0741

Note: The dependent variable in Column (1) is Non-political risk and in Column (2) - Overall risk. Standard errors are clustered at the firm level. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

The results of the baseline model with ($Risk$) and ($NPRisk$) as outcome variables are shown in Table 4.2. Lobbying is not statistically significant in either model. The magnitude of the coefficients decreases significantly and is non-distinguishable from zero. These results support the initial hypothesis that the information advantage is the main mechanism for reducing firm-level political risk. Information sharing between firms and government officials can't be beneficial for managing other types of risk coming from non-political sources.

4.5.3 Lobbying and Different Political Risks

The other advantage of the political risk database is that it decomposes political risk into eight different topic-specific political risk measures, such as (1) economic policy & budget, (2) environment, (3) trade, (4) institutions & political process, (5) health care,

(6) security & defence, (7) tax policy, and (8) technology & infrastructure. To check the relative effectiveness of lobbying as a risk-mitigating strategy, eight different models have been estimated where the outcome variable varies according to the type of political risk. Table 4.3 shows the results.

The coefficient of lobbying is negative in all specifications; however, it varies in magnitude and significance. As dependent variables have very similar distributions in terms of the mean value and standard deviation, the coefficients from different models can be compared. The largest effect of lobbying on political risk reduction is observed in the case of risk coming from institutions, the environment, and tax policy. Contrary, the smallest effect is on trade policy, and the result is not statistically significant.

Table 4.3: The Relationship Between Lobbying and Different Topic-specific Political Risks

	(1) Budget	(2) Trade	(3) Environment	(4) Institutions	(5) Health	(6) Security	(7) Tax	(8) Technology
Lobbying	-0.00833*	-0.00499	-0.01128**	-0.00994**	-0.00609	-0.00642	-0.01112**	-0.00793
	(0.00480)	(0.00523)	(0.00512)	(0.00478)	(0.00475)	(0.00477)	(0.00461)	(0.00545)
Total Assets (ln)	0.14127	0.22114*	0.17641	0.14188	0.13020	0.11489	0.15507	0.12646
	(0.10178)	(0.12132)	(0.10887)	(0.10089)	(0.09768)	(0.10546)	(0.11069)	(0.10283)
Constant	5.93564***	4.26657**	5.32766***	5.37818***	5.80564***	6.26851***	5.55433***	5.68419***
	(1.48852)	(1.77848)	(1.59083)	(1.47151)	(1.43042)	(1.54206)	(1.62010)	(1.50743)
Firm Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Number of companies	430	430	430	430	430	430	430	430
Observations	2,264	2,264	2,264	2,264	2,264	2,264	2,264	2,264
Adjusted R^2	0.0636	0.0538	0.0729	0.0665	0.0627	0.0630	0.0601	0.0715

Note: Dependent variables vary across models. They represent different types of firm-level political risk. Standard errors are clustered at the firm level. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

Such heterogeneity of results can be explained by the quality of information exchanged between firms and policymakers. Although government officials are usually better informed about the political process in the country, there are some aspects of the policy when government input can't be particularly helpful in reducing firms' perceived political risk.

For instance, one of the explanations why lobbying does not help to reduce trade

policy uncertainty is the nature of trade policy itself and EU membership. First, trade policy is decided by two country governments simultaneously and the home government has limited control over all aspects of the policy. Regular meetings with the home government can reduce only a part of the risk and uncertainty while the external risk remains unresolved. Second, during the period of analysis, the UK was part of the EU; hence it had little control over trade policy.

All of these findings enforce the main argument of the information advantage mechanism of lobbying activities. Lobbying can't fully mitigate political risk if the home government does not have full control of the process. Therefore there is not much information sharing between firms and government officials. Another example is the COVID pandemic and related health policy uncertainty. In Column (5), the lobbying coefficient is smaller in magnitude and not statistically significant.

Overall, lobbying is a useful tool for dealing with all types of political uncertainty. However, it can be more helpful in managing some risks but not for others.

4.5.4 Lobbying and Economic Policy Uncertainty

The study also investigates the value of lobbying during periods of high economic policy uncertainty. The results are in Table 4.4. The interaction term between lobbying intensity and the time series index of policy uncertainty (both for the UK and globally) is negative and statistically significant. Consistent with the findings by Pham (2019) and Christensen et al. (2022), the effect of political activities on risk reduction is larger when the uncertainty is high in the economy. In fact, high policy uncertainty means that the policy is not yet settled and there are different alternatives for policy development. Regular meetings with government officials allow lobbying firms to obtain valuable information about policy options and reduce their exposure to political risk. Conversely, lobbying meetings do not provide much information advantage when the overall uncertainty is already very low. Another explanation is that high policy uncertainty leads to high firm-level political risk; however, lobbying allows firms to hedge against such uncertainty, making them less exposed to political risk.

Table 4.4: The Relationship Between Lobbying and Political Risk at Different Margins of Economic Policy Uncertainty

	(1) PRisk (ln)	(2) PRisk (ln)
Lobbying	0.07637**	0.08147**
	(0.03732)	(0.03631)
Lobbying x EPU_UK (ln)	-0.01669**	
	(0.00717)	
Lobbying x EPU_Global (ln)		-0.01622**
		(0.00629)
Total Assets (ln)	0.13303	0.12709
	(0.08857)	(0.08924)
Constant	2.54239**	2.60821**
	(1.29176)	(1.29942)
Firm FE	Yes	Yes
Year FE	Yes	Yes
Number of companies	430	430
Observations	2,264	2,264
Adjusted R^2	0.0673	0.0678

Note: Both models include year fixed effects. Therefore, the coefficients for EPU_UK(ln) and EPU_Global(ln) are not estimated. Standard errors are clustered at the firm level. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

4.6 Robustness

4.6.1 Different Specifications of Lobbying Variable

This section provides additional analysis and robustness tests to support the main findings. Table 4.5 shows the results from the baseline model with different specifications of the independent variable. In Column (1), the model includes several lags of lobbying variable to study the dynamic effect of lobbying on political risk reduction. As the political capital is accumulated over time and the previous lobbying meetings can be equally helpful for managing political risk, I included both the 1^{st} and the 2^{nd} lags of lobbying variable in the model. First, the result confirms that current lobbying (lag 0) plays an important role in risk reduction even after controlling for the previous lobbying activities. Second, lagged values themselves are not statistically significant. This can be explained by the importance of acquiring the most recent information on policy de-

velopment. As the policies are changing rather quickly, the information obtained from the previous lobbying meetings can be outdated and irrelevant; however, the previous lobbying experience can be necessary for maintaining access to key policymakers.

Table 4.5: Robustness Checks with Different Measures

	(1) PRisk (ln)	(2) PRisk (ln)	(3) PRisk (ln)	(4) PRisk (ln)
Lobbying	-0.01122**			
	(0.00483)			
Lobbying (Lag 1)	0.00366			
	(0.00744)			
Lobbying (Lag 2)	0.00832			
	(0.00724)			
Lobby (3 years rolling window)		-0.00234		
		(0.00348)		
Lobby (Cumulative # of meetings)			-0.00293***	
			(0.00106)	
Lobby (Cumulative # of years)				-0.03764
				(0.02604)
Total Assets (ln)	0.06487	0.07102	0.11912	0.12761
	(0.10642)	(0.10552)	(0.08849)	(0.08835)
Constant	3.30939**	3.26986**	2.72684**	2.60496**
	(1.56039)	(1.54861)	(1.29182)	(1.29048)
Firm Fixed Effects	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	Yes
Number of companies	408	408	430	430
Observations	1,840	1,840	2,264	2,264
Adjusted R^2	0.0691	0.0679	0.0675	0.0660

Note: In Column (1), different lags of lobbying variable are used. In Column (2), lobbying is measured as the total number of lobbying meetings in the last three years, rolling window. In Column (3), lobbying is a cumulative measure and counts the total number of lobbying meetings since the start of the sample period, 2012. In Column (4), the lobbying variable measures the years of lobbying experience. Standard errors are clustered at the firm level. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

In Column (2), the study uses a three-year rolling window of lobbying activities, a similar methodology as in Christensen et al. (2022) and Pham (2019). Qualitatively, the result is similar to the main finding, but the lobbying coefficient loses statistical significance. In Column (3), the lobbying variable is a cumulative sum of all previous lobbying activities since the start of the sample in 2012. As it is a two-way fixed effect

model, such cumulative lobbying measure still allows for studying the effect of additional lobbying meetings on political risk reduction, but it also considers the previous lobbying experience. The result is negative and statistically significant but lower in magnitude as cumulative lobbying measure has a much larger scale. Another way of measuring lobbying experience is the number of years when a firm was involved in lobbying activities. It shows an extensive margin and does not account for the intensity of lobbying. The lobbying coefficient in Column (4) is still negative but not statistically significant, highlighting the importance of lobbying intensity. Overall, the results in Table 4.5 confirm that lobbying helps reduce political risk even after controlling for previous lobbying activities.

4.6.2 Potential Selection and Simultaneous Bias

Studying the causal impact of lobbying on political risk exposure is a difficult task as firms are not randomly selected in lobbying activities, and they have different possibilities to access government officials, potentially biasing the results. Here are some additional robustness tests to address selection issues and endogeneity concerns.

Columns (1)-(2) in Table 4.6 show the results based on specific sub-samples. In Column (1), the sample includes only firms with at least one lobbying episode. In Column (2), there is a sample of firms that lobbied in all years. Because lobbying initiation is costly (high fixed cost of entry) and not all firms have equal opportunity to participate in lobbying meetings, such sub-sample analysis allows a comparable set of firms. Since firms lobby regularly regardless of their political risk exposure, the potential concerns about self-selection and reverse causality can be minimal. Also, firms with intensive lobbying experience may face a lower marginal cost of additional lobbying meetings, which can be considered exogenous and independent of their political risk. In both Columns (1)-(2), the coefficient of lobbying is negative, but in Column (2), the coefficient is not statistically significant. This can be explained by a relatively small sample size.

In Column (3), the model uses a group lobbying variable. Compared to individual

Table 4.6: Robustness Checks with Different Sub-samples and Specifications

	(1) PRisk (ln)	(2) PRisk (ln)	(3) PRisk (ln)	(4) PRisk (ln)	(5) PRisk (ln)
Lobbying	-0.00964**	-0.00054	-0.01022*	-0.01084**	-0.01035
	(0.00455)	(0.00756)	(0.00540)	(0.00542)	(0.00631)
Total Assets (ln)	0.21076**	0.50046*	0.14425	0.07463	0.19890
	(0.09434)	(0.27819)	(0.08769)	(0.08743)	(0.14322)
Constant	1.42428	-3.53541	2.39147*	4.01540***	1469.2574***
	(1.39651)	(4.59050)	(1.28058)	(1.32852)	(195.4941)
Firm Fixed Effects	Yes	Yes	Yes	Yes	Yes
Year Fixed Effects	Yes	Yes	Yes	No	Yes
Year x Industry Fixed Effects	Yes	Yes	Yes	Yes	Yes
Number of companies	335	60	430	430	430
Observations	1,891	463	2,264	2,264	2,264
Adjusted R squared	0.0679	0.0220	0.0657	0.0813	0.235

Note: In Column (1), the sample only includes the firms that lobbied at least once during the sample period. In Column (2), the sample only includes the firms that lobbied in all years. In Column (3), the group lobbying variable is used instead of the total lobbying variable (total lobbying=group lobbying+individual lobbying). Column (4) includes industry x year fixed effects. Column (5) includes firm-specific time trends. Standard errors are clustered at the firm level. * $p < 0.10$, ** $p < 0.05$, *** $p < 0.01$.

lobbying meetings, which are often initiated by individual firms depending on their needs and privileged access to policymakers, group meetings have a round table discussion format. They are organized by the government in order to enhance the transparency of the policy-making process. Therefore, participation in such group meetings is less affected by an individual firm's exposure to political risk and can be considered independent of the firm's choice. The coefficient of lobbying in this model is negative and statistically significant, consistent with the main finding. Also, group lobbying can be more effective in reducing firm-level political risk, as it is associated with better information transfers between firms and policy-makers and among the firms themselves.

In Column (4), year x industry fixed effects are added to the model to control for time-varying industry-level variation. It ensures that our estimates are robust to the arbitrary changes at the industry level that similarly affect firms in the same industry. The coefficient of lobbying is negative and statistically significant. This specification will nevertheless be inconsistent if there are firm-level time-varying confounding factors;

however, it ensures that such bias is minimal. Finally, in Column (5), the model includes firm-specific linear time trends that capture long-standing political risk trends within a firm. The most saturated model gives an estimate which is higher in magnitude than the baseline result, but it is only marginally statistically significant (p=0.102).

Lastly, simultaneity bias is another concern related to that type of setting. Since firms' lobbying activities and their reported political risk can be jointly determined, this may bias the results. Egerod and Aaskoven (2022) provides an illustrative framework for how these two variables are interconnected. First, a high political risk leads firms to engage in lobbying activities. Once they obtain policy-related information through lobbying, it helps them reduce political risk exposure. This relationship can be observed in different time lags but can also happen simultaneously. Since both lobbying and political risk measures are aggregated at the annual level, it smooths out the quarterly volatility, and it is reasonable to argue that these two variables are simultaneously determined. Although the standard panel-data models (two-way fixed effect) do not account for simultaneity, it can't be a major issue in this setting as the simultaneity bias could only lead regression estimates to be positively biased, i.e., to understate the magnitude of the effect of lobbying on political risk (Chalfin and McCrary, 2013)[18]. Since the goal of this study is not to perform a cost-benefit analysis but, more broadly, to show that lobbying helps firms reduce their exposure to political risk, having conservative estimates due to the simultaneous bias should not significantly affect the main findings.

4.7 Discussion and Conclusion

In the last few decades, political risk and uncertainty have become integral to the business environment in many countries and worldwide. Countries like the United Kingdom

[18] Chalfin and McCrary (2013) study the relationship between police and crime and estimate elasticities from different models. Although the setting differs from the lobbying and political risk example, there exists simultaneity bias in both cases, potentially affecting the results. They showed that the least squares estimate (standard panel data model) of the elasticity of crime to police is persistently negative but modest in magnitude; the estimates from quasi-experiments and using two-stage IV models are typically five times larger in magnitude than those estimated via least squares. Thus, the sign of the bias is likely positive, leading the least squared estimates to underestimate the magnitude of the police elasticity.

experienced severe changes in their economic policy due to Brexit and several cabinet changes. The recent COVID-19 pandemic and the war in Ukraine also contributed significantly to the growing trend of global policy uncertainty. Firms are adversely affected by such political uncertainty as it slows down their business operations and has negative financial consequences. Although firms cannot fully reduce political risk in the economy, using different political strategies (i.e., lobbying, party contributions, political connections), firms can reduce their exposure to political risk and mitigate its negative consequences. However, academic literature on this topic is relatively scarce, and there is little empirical evidence on how this mechanism works.

This study argues that, beyond the traditional rent-seeking benefits of political activities such as accessing government resources and easing financial constraints, lobbying can also overcome information asymmetry between firms and policymakers, which helps mitigate the negative impacts of political uncertainty caused by frequent adjustment to policy. By doing so, this chapter contributes to the political economy literature by studying the other benefits of lobbying activities and identifying the channel through which such benefit is generated. The benefit is reducing political risk exposure, and the channel is an information advantage.

To study this question empirically, this study uses two novel datasets. First, a firm-level political risk database developed by Hassan et al. (2019). It is a reported (perception-based) measure of firm-level political risk disclosed in earnings conference-call transcripts. Since this research aims to study firms' exposure to political risk and identify the information advantage mechanism, this measure is better than other measures of firm volatility and country-level political risk datasets. Second, this study is one of the pioneers of measuring lobbying activities by counting the actual lobbying meetings between firms and policymakers. Compared to monetary measures of lobbying (i.e., total money spent on lobbying activities), this lobbying measure has significant advantages as it allows us to observe the frequency of actual lobbying meetings. Such meetings can be used as a proxy for information exchanged between meeting participants. In the case of lobbying expenditure, it isn't easy to understand how the money is spent and how the

information advantage is achieved.

Using the two-way fixed effect model, the study finds that an additional meeting with government officials is associated with 0.89% lower firm-level political risk. Consistent with the information advantage hypothesis and the fact that lobbying meetings are the exchange of policy-relevant information between firms and government officials, lobbying can be considered an effective tool for managing political risk. Still, it does not have a significant impact on the exposure to overall and non-political risk.

Next, the effectiveness of lobbying as a risk-mitigating strategy depends on the quality of information exchanged between firms and government officials, which varies over different political risk types. Some political risks are better managed by lobbying activities than others. When decomposing the political risk into eight different topic-specific political risk measures, the results show that lobbying helps to mitigate all types of political risk. However, it is more effective in reducing the risk coming from institutions/political processes, environment, and tax policy, whereas it is less effective for trade policy uncertainty. Due to the complex nature of trade policy and the limited ability of the home government to control its content, lobbying can't fully mitigate the exposure to trade policy risk. Lastly, the study shows that lobbying is more effective when the demand for policy-relevant information is high during periods of high policy uncertainty.

This chapter comes with limitations. First, political risk variable may contain measurement errors as it is only an indication of risk reported in the conference call reports, and the actual risk faced by companies may be different. Second, the Meetings data only cover the official/reported meetings between interest groups and government officials; however, there is a possibility that lobbying and policy influence can be achieved informally, which is difficult to observe and quantify. Third, every meeting is classified as a lobbying meeting, but in reality, some meetings are introductory and beyond the scope of policy discussion. However, the effect of lobbying on political risk reduction should be even stronger if one can strictly identify the lobbying meetings. Also, firms' access to policy-relevant information and influence over political outcomes are complementary.

They are interrelated activities, and both channels impact the relationship between lobbying and firm risk. To distinguish between these two mechanisms empirically is rather difficult, but considering the lobbying variable used in the analysis, the information advantage channel can be more pronounced. However, it does not exclude the potential policy influence mechanism. Lastly, firms are not randomly selected for lobbying activities. Therefore, the results might be subject to reverse causality and simultaneity biased. However, different robustness tests and empirical specifications are used to ensure that if the bias exists, it is positive, and the results are lower bound estimates.

Since political activities have gained significant academic interests from different disciplines (i.e., management, economics, and political science), much can still be done in this literature. For instance, it is important to identify which type of lobbying is more effective in managing political risk. Firms can lobby different departments and at different policy levels, depending on the seniority of the politicians. High-ranked politicians usually have access to a larger set of policy information; therefore, such lobbying meetings can be more beneficial. However, access to such high-level politicians should be relatively costly as well. It is also important to study the diversity/breadth of lobbying activities. Lobbying breadth acts as insurance, protecting a firm from political risk by expanding both influence and information exchange across a larger portion of the political landscape. It will be helpful if future research addresses those questions.

Besides the academic contribution, this research has important practical implications. First, it gives the managers an effective tool to mitigate the risk exposure from political uncertainty. Firms that can manage external uncertainty (i.e., political risk) are likely to make better investment decisions and gain a dominant market position, improving their long-term perspectives. As lobbying is a two-way process, it can be useful not only for firms but also for government officials to improve the transparency of the policy-making process and to design better policies.

Chapter 5

Conclusion

5.1 Overview of the Findings

Motivated by the increasingly growing role of corporations in countries' politics and the importance of political strategies in firms' operations, this dissertation explores the different antecedents and the outcomes of firms' political activities. It aims to answer the following research questions:

1. Which firms are politically active?

2. How do different market conditions affect firms' political participation?

3. What type of benefits do firms receive in the political market?

The dissertation draws on different novel datasets to address these research questions empirically. The first chapter uses the most recent and the largest cross-country firm-level survey data (BEEPS VI), covering nearly 25,000 firms from 41 economies, to study the antecedents of firms' political connections. To the best of my knowledge, this is the first-ever large-scale evidence of political connections after the influential work by Faccio (2006). The results document the significant heterogeneity in firms' political connection status, especially when comparing domestic and foreign-owned firms. On

average, foreign firms tend to be less politically connected than their domestic counterparts. However, some local market conditions create extra incentives for foreign firms to become politically connected, affecting the relationship. Considering both practical and scholarly interests in studying the differences between foreign and domestic firms, this study provides one of the first comparative evidence on how these two types of firms behave in the political market.

The second chapter uses the unexpected COVID-19 shock and the corresponding COVID-19 follow-up Enterprise Survey data (CFES) to study the value of political connections. The combined dataset (BEEPS VI and CFES) has some unique features as it allows us to observe the same set of firms just before and after the start of the pandemic. The dataset has been actively used recently to study the various aspects of firms' operations during the pandemic; however, this research provides one of the novel applications of the dataset by studying the link between firms' political connections and receiving COVID-19 government support.

As the first and the second chapters of the dissertation are based on the same datasets, they are highly interrelated and complementary. While the first chapter studies the distribution of political connections across firms, the second chapter investigates whether politically connected firms received government support during the pandemic. The results show that firms' political connections do not play a significant role in receiving government support. However, the results are heterogeneous and depend on the program type. Firms with political connections have a better chance of obtaining cash transfers than non-connected firms, but this effect is muted for other support programs. Next, the results show that such political bias might lead to government resource misallocation as some cash transfers were allocated to firms that were politically connected but not eligible for receiving the funding.

Although the political connection is helpful for those politically connected firms, it can be detrimental to the overall effectiveness of the support programs and the economic recovery. It is beyond the scope of the dissertation to study the long-run effects of the political allocation of government resources, but it is an important area for future

research; especially when the results document that such political bias is equally observed in all countries, regardless of the quality of institutions and the effectiveness of the government.

The third chapter moves from using cross-country firms-level survey data and investigates firms' lobbying activities in a single country setup, in this case, the UK. This study is one of the pioneers of measuring lobbying by counting the number of ministerial meetings between firms and policymakers. Compared to the standard measures of lobbying expenditures, this lobbying variable allows us to observe firms' actual interactions with the government and helps us unlock the information exchange mechanism. This chapter combines the lobbying dataset with the novel firm-level political risk data and studies how the degree of firms' disclosed political risk varies with the intensity of lobbying activities.

The main empirical result shows that lobbying reduces firm-level political risk. Consistent with the idea that lobbying reduces the information asymmetry between firms and policymakers and allows firms to obtain policy-relevant information, the result from the supplementary analysis shows that lobbying is an effective mechanism to lower only the political risk while the effect of lobbying on other types of non-political risks is statistically insignificant. The results are also heterogeneous depending on the political risk type and the overall uncertainty in the economy. The underlying mechanism behind these findings is that the effectiveness of lobbying depends on the quality of information exchanged between firms and government officials. The higher the value of information, the larger the effect of lobbying on political risk reduction.

Considering the empirical findings of the dissertation and the variety of the datasets used in the empirical analysis, this research makes significant contributions to different strands of literature and opens possibilities for further research. The next subsections (1) summarize the scholarly contributions of the dissertation, (2) provide the managerial implications of the findings, (3) discuss the limitations of empirical analysis, and (4) suggest potential avenues for future research.

5.2 Contribution to the Literature

First and foremost, the dissertation enriches CPA literature by better understanding the different forms of political activities, studying their antecedents, and estimating the impact on firm-level outcomes. Despite the growing scholarly interest in political connections, the research is still US-centric because of the data availability (i.e., lobbying and political party contributions) and the importance of US politics worldwide. This dissertation provides one of the first large-scale empirical evidence of a firm's political connections outside the US. Specifically, the first and the second chapters of the dissertation study political connections in 41 economies from Eastern Europe, Central Asia, the Middle East, and North Africa, which have not been studied yet in this context. Such a cross-country setting is advantageous as it allows us to study the role of institutions in political strategy, which is an important contribution to CPA literature. The third chapter explores lobbying activities in the UK which is an interesting case to study, considering the country's current economic and political development.

The empirical results of the first chapter also add to the IB literature by highlighting the importance of political strategies for MNEs in the host country market and identifying the different sets of local market conditions that increase their incentives to build political connections compared to domestic-owned firms. As the study is based on a cross-country firm-level dataset, it also allows us to explore firms' political strategies in different institutional contexts, contributing to the international business aspects of the CPA literature. Theoretically, the study contributes to RDT by decomposing resource dependency into three main components: market dependency, industry regulation dependency, and dependency on the political system. Moreover, by integrating the LoO perspective with the RDT, the study conceptualizes that higher dependency on local market conditions increases the cost of outsidership and motivates foreign firms to build political connections.

The second chapter of the dissertation contributes to the CPA, political economy, and COVID economics literature by studying the role of political connections in alloc-

ating COVID-19 support policies. This study introduces two different margins of the relationship and documents that the value of political connections depends on the type of government policy and the timing of receiving such support. Previous studies do not provide such insights as they usually study one type of policy and estimate the average effect of political connections. Another contribution of this research is that it examines the distribution of emergency funding rather than standard government procurements. Therefore, the results have important implications for understanding the economic recovery after the COVID-19 economic shock. The findings of this research are also policy-relevant, as they show that the distribution of some government support policies can be subject to political bias, which may lead to resource misallocation. These findings should motivate policymakers to design better support policies to prevent such misallocation of public resources in the future. Lastly, the study adds to the burgeoning literature on COVID Economics. It provides a detailed and timely analysis of the allocation of different COVID-19 support programs in a large set of countries.

The third chapter of the dissertation also contributes to the CPA literature by studying the effectiveness of firm-lobbying activities. While the rent-seeking benefits of political activities are already well documented, this study unlocks a novel information advantage mechanism that considers lobbying a political risk-mitigating tool. Regarding the empirical contributions, this study introduces a new measure of lobbying based on the ministerial meetings between firms and government officials. While most of the previous lobbying papers use the lobbying expenditure variable, this new lobbying measure provides a better insight into the lobbying process and opens up the possibility of future research. Lastly, this research also joins the growing literature on measuring political risk and uncertainty at the firm level. Since the methodology of measuring firm-level political risk has been developed relatively recently and there are only a few studies that use the firm-level political risk data, this research provides one of the novel applications of the dataset, particularly merging it with firms' lobbying activities.

5.3 Managerial Implications

Political strategies have recently become an integral part of the company's overall corporate strategy. Company managers and CEOs devote substantial organization resources to manage the political environment where they operate. However, not all firms are active in the political market because of the complex nature of political strategy. It requires firms to have a nuanced understanding of the country's political and institutional environment, their own capabilities, and the benefits and costs of a particular political activity. The empirical results of the dissertation have important managerial implications as they help company managers to identify the factors that affect firms' incentives to build political connections and understand the different sets of benefits of political activities.

First, the study shows that the firm's foreign ownership status plays a significant role in political connections. Foreign firms are, on average, less likely to be politically connected than domestic firms. The main implication of the finding is that managers of foreign MNE subsidiaries need to consider the high accompanying costs of political connections related to identifying the right politicians in the host country, coordinating their political strategy with headquarters, and losing organizational autonomy. The research also provides foreign subsidiary managers with practical information on how foreign firms adopt their political strategies depending on various local market conditions. Large-scale empirical evidence shows that foreign firms increase their propensity to be politically connected when they are highly dependent on the host country's market, operate in industries with high informal regulations, and in countries with autocratic political systems. Nevertheless, we do not know how valuable political connections can be in these settings as we only observe firms' political connection status, but these findings can be indicative evidence for company managers to understand how similar firms behave in the political market.

Regarding the actual outcomes of political strategies, this research identifies two different types of benefits that company managers can expect in the political market.

The first set of benefits is privileged access to government support programs, especially during periods of large economic downturns when government support is increasingly important for a firm's survival. This result also illustrates how previously built political connections can become valuable in later periods. Thus, company managers planning their political strategy should consider that political connections might not have an immediate effect, and the value of such connections can materialize when the need arises.

The research also documents that political strategies allow firms to access policy-relevant information, reducing their exposure to political risk and uncertainty. Since political uncertainty has a detrimental effect on a firm's operation and is often unavoidable, managing such uncertainty through lobbying can consider political strategy an important risk-mitigating tool. However, the results show that lobbying is not a universal tool, and it can't mitigate all types of political and non-political risks. Thus, company managers require a detailed understanding of what type of policy information they want to obtain during lobbying and what political risk they wish to mitigate.

Overall, the empirical findings of the dissertation provide new insights into firms' political activities both in terms of antecedents and outcomes and potentially help company managers better manage their activities in the political market.

5.4 Limitations

The dissertation does not come without limitations. Despite the significant advantages of the datasets used in the empirical analysis and the corresponding identification strategies, much can be done to improve the current setting and estimate the causal effects.

More generally, BEEPS VI, the main dataset used in the first and second chapters, is an anonymous firm-level survey that limits the empirical analysis. As we do not identify the firms in the sample, it is impossible to combine the BEEPS VI data with other firm-level datasets or collect additional information on firm characteristics. Thus, in most cases, the research relies on the variables provided in the questionnaires. Also, BEEPS VI is a cross-sectional data which does not allow us to observe the same firms at different

times and construct firm-level panel data.

More specifically, in the first chapter, the treatment is not strictly exogenous. Foreign and domestic firms may differ in many dimensions, potentially biasing the results. Although the study uses a large set of firm-level control variables, unobserved confounders may still exist and affect the results. Furthermore, political connection variable may have measurement errors. Since it is a survey-based measure, there is a risk of misreporting due to the sensitivity of the topic. Also, it is difficult to identify the true nature of political connections, whether previous politicians act as owners, CEOs, directors, or board members in those politically connected firms. Another limitation is that the dataset is static. We only observe firms' political connection status at a particular time, which does not allow us to study firms' political connections and foreign ownership over time.

The second chapter faces limitations similar to the first chapter, as the empirical analysis is based on the same BEEPS dataset. Nevertheless, this chapter uses a better identification strategy and additional datasets, which improves the empirical analysis. Specifically, this study exploits the unexpected nature of the COVID-19 pandemic, and the fact that firms were observed just before and after the start of the pandemic, which reduces the problems related to reverse causality and ex-post and ex-ante selection. However, firms' non-random selection in political connections may still bias the results. There are also potential measurement issues in the dependent variables. Even though the World Bank, in the COVID follow-up survey, identified five general government support programs, it is possible that these support programs vary in different countries, both in terms of the magnitude of the support and the implementation. To account for these cross-country differences, the study controls for country-fixed effects, but estimating the average effect and generalizing the results may still be problematic. Also, this chapter studies the misallocation of government resources only at the distribution stage. We have no evidence of how these politically connected and unconnected firms performed before and after receiving government support. Relatedly, it is important to know the actual amount of cash transfers that politically connected firms received to quantify the

economic losses associated with funding misallocation. Unfortunately, this information is not part of the dataset.

The third chapter uses the panel data setup with firm and time fixed effect to account for time-invariant firm heterogeneity and the overall macro trends in the economy. However, the reverse causality and the simultaneous bias might still affect the results. Regarding the measures, the political risk variable may contain measurement error as it is only an indication of risk reported in the conference call reports, and the actual risk faced by companies may be different. Also, the lobbying meetings data only covers the official meetings between interest groups and government officials; however, there is a possibility that lobbying can be done informally, which is difficult to observe and quantify. Lastly, the research considers every meeting as a lobbying meeting which might not be the case and biases the results. If someone distinguishes between these two types of meetings, the value of lobbying can be even larger, which means that the results in this study can be interpreted as a lower bound. Overall, this research comes with limitations. However, the richness of the data used in the empirical analysis and the large sets of robustness tests done in each chapter ensures that the potential risk of bias is minimal.

5.5 Future Research

As much as the dissertation significantly contributes to the CPA and political economy literature, it also opens new possibilities for further research.

Empirically, future studies should further explore the datasets used in this dissertation. BEEPS VI dataset allows for studying cross-country differences in firms' political connections. Since the existing studies are mostly country-specific, the CPA literature will benefit if future research identifies the institutional factors that positively correlate with the prevalence of political connections. Also, BEEPS is a regular survey conducted by the Work Bank every 3-4 years, which allows for merging this dataset with more recent waves in the future, if the same set of firms is interviewed and the same set of

questions is asked in the survey.

Ministerial meetings data also create an interesting avenue for future research. Someone needs to merge the lobbying data with other firm-level datasets to better understand the lobbying process and compare the firms that actively lobby the government and those that do not. Due to the purpose of the dissertation, I only study publicly listed firms here, but many firms in the lobbying dataset are not yet explored. The lobbying data also allows us to differentiate whether lobbying has been done individually or in groups. Since these two types of lobbying are highly interconnected, one can study the empirical relationship between these two political strategies and compare their effectiveness. The other advantage of lobbying data is that it provides information about the politicians participating in the lobbying meetings. It is interesting to understand which firms lobby which politicians and how this relationship evolves over time. Future research can also explore the diversity of lobbying activities in terms of lobbying different politicians, different government departments, and different levels of political positions. Importantly, to address some of the limitations of this dissertation and understand the context of lobbying, one can use the text analysis of the lobbying meetings' transcripts and identify the topics that are more frequently lobbied by firms and other interest groups. For instance, in the current UK case, it is critical to learn which interest groups affected the EU-UK Trade and Cooperation Agreement and in which direction; also, whether there is evidence of political favouritism in the process.

Theoretically, much can be done to identify the different margins of the value of political connections and understand the mechanism of how such value can be generated. Future research can also benefit by exploring the costs and risks associated with political strategies. Considering the growing trends in countries' political polarization and high political partisanship, and more global geopolitical uncertainty such as the power distribution between the US and China, the invasion of Ukraine by Russia, Brexit, and COVID-19, it is crucial to understand how firms respond such uncertain events by choosing the optimal political strategies. Some political activities can be valuable in certain contexts, but they can also generate significant costs and become a liability in other

contexts, depending on the country, time, and the type of political risk and uncertainty. A recent example is the financial sanctions on firms and business oligarchs connected with the Russian government. Therefore, it will be beneficial if future studies explore the dynamic aspects of political activities and compare the benefits and costs of such political activities in different contexts. This type of research is especially relevant for IB, as MNEs need to develop political activities not only in their home countries but also in the host countries. They also need to ensure that political strategies in different countries are compatible and that political connections in one country do not have negative spillovers on their operations in other countries. Thus, engaging in political activities in different contexts requires careful consideration and estimating all potential costs and benefits.

Lastly, future research must also explore how firms' political activities affect industry and policy-level outcomes. Firms can directly lobby the government and influence the policies in their favour, or they might use their political connections to access government resources and gain a dominant market position. These should have significant implications on industry dynamics, as politically connected firms can control market entry, influence trade and tax policies, and affect the allocation of government resources. Political connections are also associated with political corruption and resource misallocation, which are policy questions and require further investigation.

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Appendix A

Appendix: Politicians on Board! What Drive Foreign Firms to Build Political Connections?

Table A.1: Distribution of Firms by Country

Country	# of firms	Country	# of firms
Albania*	267	Lithuania*	307
Armenia^	496	Malta	203
Azerbaijan^	151	Moldova	315
Belarus*	500	Mongolia*	325
Bosnia and Herzegovina	300	Montenegro*	144
Bulgaria^	682	Morocco*^	384
Croatia*	330	North Macedonia*	322
Cyprus*	302	Poland	1,036
Czech Republic*^	406	Portugal*^	811
Egypt^	2,738	Romania*^	726
Estonia*	290	Russia*	1,165
Georgia^	516	Serbia*	300
Greece*	370	Slovak Republic^	379
Hungary*^	615	Slovenia*	347
Italy*	592	Tajikistan	239
Jordan	493	Tunisia^	456
Kazakhstan	1,216	Turkey*	1,404
Kosovo*	189	Ukraine*	1,048
Kyrgyz Republic*	268	Uzbekistan	1,073
Latvia*	233	West Bank and Gaza	222
Lebanon^	512	Total	22,672

Note: Firms are surveyed in different years. It can be either in 2019 (majority of firms), or 2018 (*) and 2020 (^).

Table A.2: Distribution of Firms by Industry

Industry	# of firms
Food	3,043
Textiles	717
Garments	1,214
Leather	263
Wood	450
Paper	203
Publishing & printing	329
Refined petroleum product	28
Chemicals	434
Plastics & rubber	765
Non-metallic mineral	1,055
Basic metals	244
Fabricated metal product	1,665
Machinery and equipment	1,179
Electronics	303
Precision instruments	115
Transport machines	153
Furniture	577
Recycling	111
Construction Section	1,796
Services of motor vehicle	475
Wholesale	1,721
Retail	3,343
Hotel and restaurants	1,112
Transport	947
IT	430
Total	22,672

Table A.3: Definition of Variables

Variable	Definition
Political Connection	=1 if the company has an Owner/CEO/Top Manager/Board Member who has ever been elected/appointed to political position? Dummy variable [0;1] BEEPS VI - bmb5
Foreign Ownership	=1 if the shares owned by private foreign individuals, companies, or organizations is higher than 10% Dummy variable [0;1] BEEPS VI – b2b
Market Dependency	=1 if the domestic (local or national) market is the main market for firm's main product Dummy variable [0;1] BEEPS VI – e1
Formal Industry Regulation	share of senior management time spent on dealing with government regulations Averaged at country and industry level BEEPS VI – j2
Informal Industry Regulation	share of total annual sales paid on informal payments Averaged at country and industry level BEEPS VI – j7a
Autocratic System	= 1 if POLITY score is negative Dummy [0;1] * POLITY is a score ranging from -10 (most autocratic) to +10 (most democratic) POLITY V Project
Firm Size	Average number of permanent, full-time employees at the end of last three fiscal years Average employment in natural logs BEEPS – l1,l2
Firm Age	Number of years (in natural logs) since the establishment began operations (or was formally registered) BEEPS – b5

Table A.3: Definition of Variables (Continued)

Variable	Definition
Government Ownership	=1 if the firm is majority-owned by the government/state Dummy variable [0;1] BEEPS – b2c
Family Ownership	share of the firm owned by the same family BEEPS – bmb1
Board of Directors	= 1 if the firm has Board of Directors or supervisory board Dummy variable [0;1] BEEPS – bmb4
Product Concentration	share of main product/service in total annual sales BEEPS - d1a3
Location	=1 if the firm is located in the capital city Dummy variable [0;1] BEEPS – a3b
Business Association Membership	=1 if the firm is part of a business membership organization/trade association/ Dummy variable [0;1] BEEPS – bmb6
Product Innovation	=1 if the firm has introduced new products/services over the last three years Dummy variable [0;1] BEEPS – h1
Business Strategy	=1 if the firm has a formalized written business strategy Dummy variable [0;1] BEEPS – bmb3
Foreign Technology License	=1 if the firm uses technology licensed from a foreign-owned company Dummy variable [0;1] BEEPS – e6

Table A.4: Descriptive Statistics

	Obs.	Mean	St.Dev.	Min	Max
Political Connection	22672	0.053	0.225	0	1
Foreign Ownership	22672	0.066	0.249	0	1
Market Dependency	22672	0.885	0.319	0	1
Formal Industry Regulations	21127	0.092	0.06	0	0.381
Informal Industry Regulations	21127	0.005	0.011	0	0.107
Autocratic System	21947	0.374	0.484	0	1
Firm Size (ln)	22672	3.156	1.288	0	14.474
Firm Age (ln)	22672	2.729	0.756	0	5.323
Government Ownership	22672	0.011	0.104	0	1
Family Ownership	22672	0.447	0.474	0	1
Board of Directors	22672	0.333	0.471	0	1
Product Concentration	22672	0.895	0.176	0.01	1
Location	22672	0.182	0.386	0	1
Business Association Membership	22672	0.454	0.498	0	1
Product Innovation	22672	0.237	0.425	0	1
Business Strategy	22672	0.414	0.493	0	1
Foreign Technology License	22672	0.145	0.352	0	1

Figure A.1: Predicted Probabilities of Political Connection at Different Margins of Market Dependency

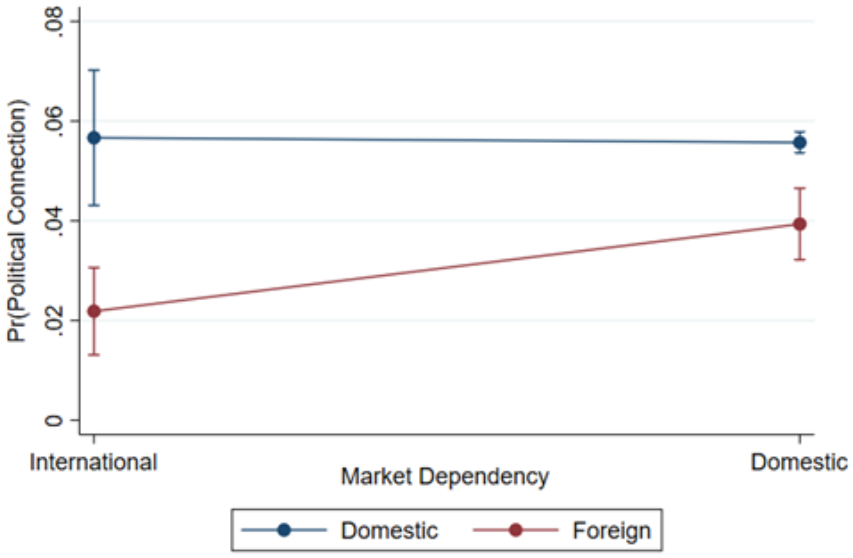


Figure A.2: Predicted Probabilities of Political Connection at Different Margins of Formal Industry Regulations

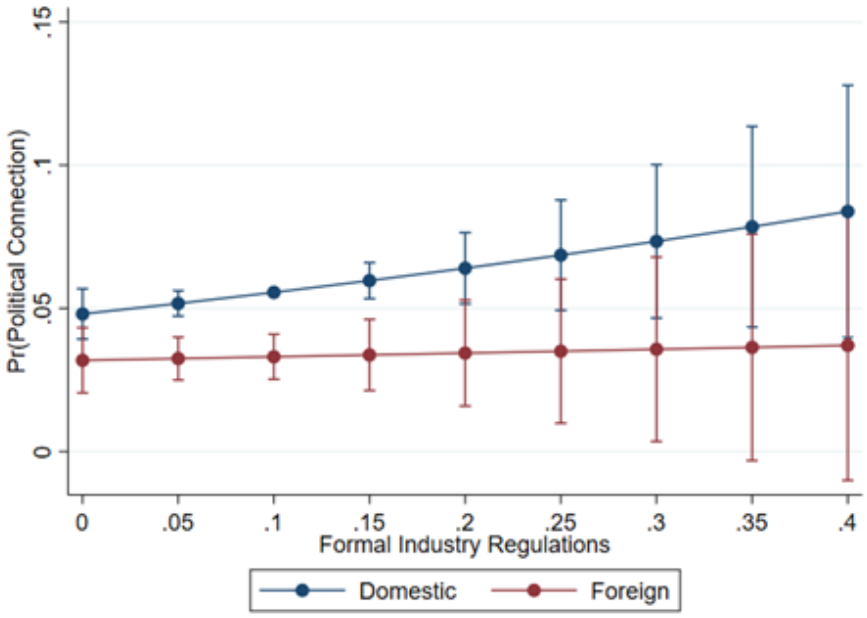


Figure A.3: Predicted Probabilities of Political Connection at Different Margins of Informal Industry Regulations

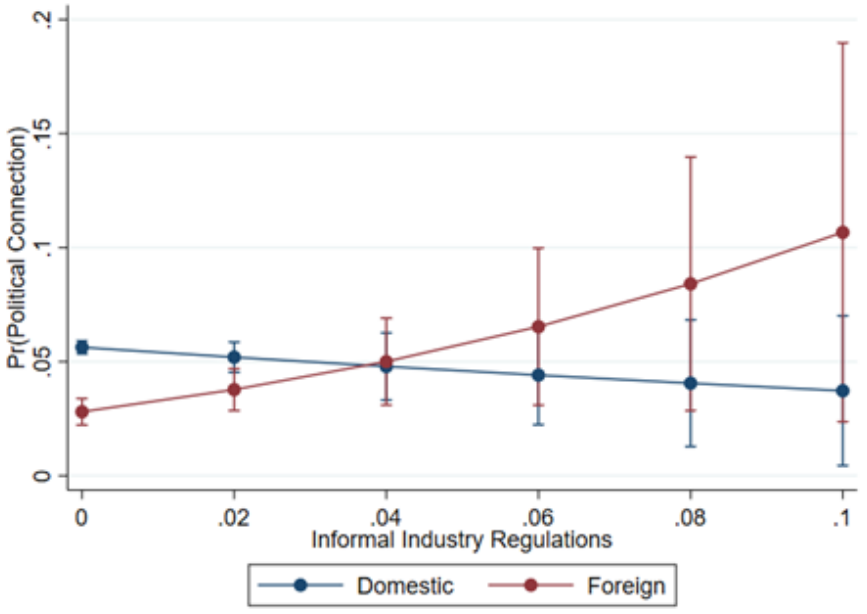
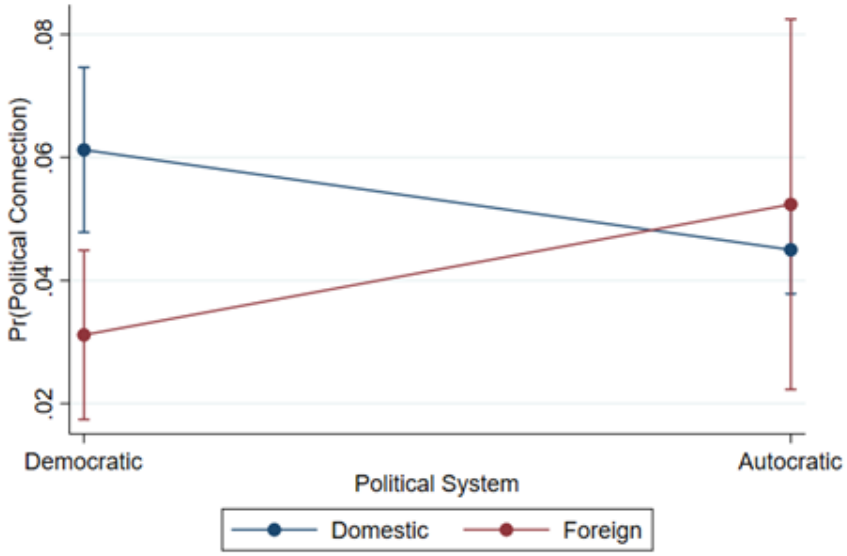


Figure A.4: Predicted Probabilities of Political Connection at Different Margins of Autocracy/Democracy



Note: Probabilities in all these figures are estimated based on the corresponding Probit models. 90% confidence interval bars are shown.

Appendix B

Appendix: With a Little Help from My Friend: Political Connections and Allocation of COVID-19 Aid

Table B.1: Distribution of Firms by Country and the COVID-19 Follow-up Survey Round

Country	BEEPS VI	COVID Round 1	COVID Round 2	COVID Round 3	Final Sample
Albania	377	347			347
Azerbaijan	225	105			105
Belarus	600	551			551
Bosnia and Herzegovina	362	241			241
Bulgaria	772	559	541	545	673
Croatia	404	351	336	336	381
Cyprus	240	171	177	186	219
Czech Republic	502	405	402	446	482
Estonia	360	272	296	266	340
Georgia	581	514	493		550
Greece	600	532	545	551	582
Hungary	805	630	647	670	746
Italy	760	453	473	466	581
Jordan	601	564	514	448	570
Kazakhstan	1,446	871			871
Latvia	359	244	266	180	344
Lithuania	358	214	234	246	311
Malta	242	196	196	192	228
Moldova	360	286	283	254	325
Mongolia	360	314	323		329
Montenegro	150	138			138
Morocco	661	518	492	491	623
North Macedonia	360	292	360		360
Poland	1,369	1,005	1031	999	1,195
Portugal	1,062	820	822	892	963
Romania	814	532	485	526	680
Russia	1,323	1,191			1,191
Serbia	361	318			318
Slovak Republic	429	338	305	328	371
Slovenia	409	249	252	221	351

Note: BEEPS VI column shows the number of companies interviewed in the BEEPS VI survey in each country. Original BEEPS VI covers 41 countries but this study focuses only on 30 countries where the corresponding COVID-19 follow-up survey has been conducted at least once. Therefore, countries like Armenia, Egypt, Kosovo, Kyrgyz Republic, Tajikistan, Tunisia, Turkey, Ukraine, Uzbekistan, West Bank and Gaza, and Lebanon are excluded from the sample. In some countries, follow-up surveys were conducted only once, but in the majority of cases twice or three times. The last column shows the number of firms that participated in the COVID-19 follow-up survey at least once.

Table B.2: Distribution of Firms by Country and the COVID-19 Follow-up Survey Date

	2020								2021							
	May	June	July	Aug	Sept	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July	Aug
Albania		347														
Azerbaijan												57	48			
Belarus				551												
Bosnia and Herzegovina										154	87					
Bulgaria			358	180	21		297	244				437	108			
Croatia					351			1	335				302	34		
Cyprus		171					104	73				186				
Czech Republic					255	150			237	165			227	219		
Estonia						272				296					6	260
Georgia		514				236	257									
Greece		527	5				545					474	77			
Hungary					630				355	292			196	474		
Italy	95	358					401	72				349	117			
Jordan			456	108			1	402	111					433	15	
Kazakhstan									114	535	222					
Latvia						233	11			266					121	59
Lithuania						214				234					182	64
Malta					110	86			196				177	15		
Moldova	286					137	146						216	38		
Mongolia				314						323						
Montenegro										138						
Morocco			212	306						492			28	463		
North Macedonia						278	14						296	64		
Poland			56	949			802	229					819	180		
Portugal					698	122			495	327			354	538		
Romania				276	256		103	382					381	143		
Russia		1191														
Serbia										318						
Slovak Republic					193	145			189	116			210	118		
Slovenia			238	11			183	69					170	51		

Note: Red color indicates the first wave of the follow-up survey, yellow - the second wave, and blue - the third wave.

Table B.3: Distribution of Firms by Industry

	# of Firms	share (%)
Retail	2,142	18.07
Food	1,523	12.85
Fabricated metal products	954	8.05
Construction	942	7.95
Wholesale	907	7.65
Machinery and equipment	749	6.32
Garments	597	5.04
Hotel and restaurants	559	4.72
Transport	486	4.1
Non metallic mineral products	384	3.24
Furniture	338	2.85
Plastics & rubber	334	2.82
Services of motor vehicles	303	2.56
Wood	232	1.96
IT	225	1.9
Textiles	200	1.69
Publishing, printing, and Recorded media	183	1.54
Chemicals	159	1.34
Electronics	152	1.28
Basic metals	100	0.84
Transport machines	92	0.78
Paper	91	0.77
Leather	84	0.71
Precision instruments	64	0.54
Recycling	36	0.3
Refined petroleum product	14	0.12
Tobacco	3	0.03
Total	11853	

Table B.4: Definition of Variables

Variable	Definition
Policy	Since the outbreak of COVID-19 pandemic, has this establishment received any national or local government support in response to the crisis? Did any of these measures involve any of the following: - Cash transfers for businesses - Deferral of credit payments, utility bills, rent or mortgage, suspension of interest payments, or rollover of debt - Access to new credit - Tax reductions or tax deferrals - Wage Subsidies
Political Connection	=1 if the firm has Owner/CEO/Top Manager/Board Member which has ever been elected/appointed to a political position, =0 otherwise
Demand Shock	=1 if the demand for this firm's products and services increased compared to the same month in 2019, =2 demand did not change, =3 demand decreased
Supply Shock	=1 if the firm's supply of inputs, raw materials, or finished goods and materials purchased to resell increased compared to the same month in 2019, =2 supply did not change, =3 supply decreased
Sales Shock	=1 if the firm's sales increased compared to the same month in 2019, =2 sales did not change, =3 sales decreased
Change in Sales	By what percentage did the sales increase or decrease
Firm Size	The average number of permanent, full-time employees in the last fiscal year [mostly 2018] and 3 years ago, measured in logs
Firm Age	The number of year since the firm began operations (or formally registered), measured in logs
Foreign Owned	=1 if at least 10% of the company is owned by private foreign individuals, companies or organizations, =0 otherwise

Table B.4: Definition of Variables

Variable	Definition
Government Owned	=1 if the part of the firm is owned by Government/State, =0 otherwise
Business Association	=1 if the firm is part of a business membership organization/trade association/Etc., =0 otherwise
Product Innovation	=1 if the firm has introduced new products/services introduced over the last three years, =0 otherwise
Government Contract	=1 if the firm secured government contract in the last 12 month, =0 otherwise
Exporter	=1 if the firm exports directly, =0 otherwise
Manager Experience	The number of years of experience working in this sector the top manager has, measured in logs
Female Manager	=1 if the the top manager of the firm is female, =0 otherwise
Capital City	=1 if the firm is located in a capital city, =0 otherwise
Democracy	a measure of democracy from Polity5 project
Autocracy	a measure of autocracy from Polity5 project
Voice & Accountability	the extent to which a country's citizens are able to participate in selecting their government, as well as freedom of expression, freedom of association, and a free media. It comes from the World Governance indicators
Government Effectiveness	the quality of public services, the quality of the civil service and the degree of its independence from political pressures, the quality of policy formulation and implementation, and the credibility of the government's commitment to such policies. It comes from the World Governance indicators
Regulatory Quality	the ability of the government to formulate and implement sound policies and regulations that permit and promote private sector development. It comes from the World Governance indicators

Table B.5: Descriptive Statistics

	Obs.	Mean	Std. Deviation	Min.	Max.
Policy					
Government support	11853	0.41	0.49	0	1
Cash transfer	11853	0.15	0.35	0	1
Credit payment deferral	11853	0.12	0.33	0	1
Access to new credit	11853	0.075	0.26	0	1
Fiscal exemption	11853	0.13	0.34	0	1
Wage subsidy	11853	0.32	0.47	0	1
Total support	11853	0.80	1.21	0	5
Firm characteristics					
Political Connection	11853	0.049	0.22	0	1
Firm Size (ln)	11853	3.28	1.34	0	12.4
Firm Age (ln)	11853	2.78	0.73	0	5.32
Foreign Owned	11853	0.091	0.29	0	1
Government Owned	11853	0.015	0.12	0	1
Business Association	11853	0.40	0.49	0	1
Product Innovation	11853	0.30	0.46	0	1
Government Contract	11853	0.19	0.39	0	1
Exporter	11853	0.27	0.45	0	1
Manager Experience (ln)	11853	2.83	0.71	0	4.25
Female Manager	11853	0.20	0.40	0	1
Capital City	11853	0.16	0.36	0	1
COVID Shock					
Demand Shock	11853	2.47	0.69	1	3
Supply Shock	11747	2.40	0.65	1	3
Sales Shock	11803	2.53	0.67	1	3
Changes in Sales	11405	-0.23	0.32	-1	3
Institutional characteristics					
Democracy	11436	7.58	3.44	0	10
Autocracy	11436	1.13	2.21	0	7
Voice and Accountability	11853	0.20	0.84	-1.55	1.26
Government Effectiveness	11853	0.31	0.53	-0.98	1.34

Appendix C

Appendix: Political Insurance. Lobbying Behaviour of UK-Listed Firms

Matching Procedures

These are the steps for matching company names in the Meetings Data.

- I dropped all legal abbreviations from the company names (i.e., PLC, LTD, LLC).
- I cleaned the company names from the general words such as "Group", "Holdings", "Pharmaceuticals", "Medical", "Therapeutics", "Health" "International", "Reit (Real estate investment trust)", "Engineering", "Technologies", et.c. The reason for such a procedure is that the Meetings database is very unstructured and contains company names in various formats. Searching for company names without any attributes guarantees to identify the firms from different formats and reduce the false positive error. However, such a simplified search can generate a large false negative error. The cases when there are more matching than there should be positively inflate our results.
- To overcome this issue, I manually detected the potential false negative results and used a more conservative search with different attributes of company names. For instance, instead of searching "BP", now I search for "BP PLC" which guarantees correct matching but it omits the cases where the company name is recorded as "BP". This is particularly true in those cases when many company names are listed in a single cell.
- To deal with this issue, I identified the most frequently used separation (punctuation) between company names and searched for the following construction ", BP,". This method correctly detects the cases which were omitted in the previous step and ensures no false negative error. Although this technique does not cover the cases when the company name is at the beginning or at the end of the text (as it does not require some punctuation marks), however, these are only a few cases and do not significantly affect the overall numbers.

Table C.1: Descriptive Statistics

Variable	Obs	Mean	Std. dev.	Min	Max
Political Risk (ln)	2,264	4.555	1.276	0	6.931
Non Political Risk (ln)	2,264	6.267	1.342	0	8.494
Risk (ln)	2,264	4.153	0.855	0	5.707
Topic Specific Political Risk (ln)					
Economic Policy & Budget	2,264	7.930	1.416	0	10.288
Trade	2,264	7.465	1.601	0	10.257
Institutions & Political Process	2,264	7.414	1.441	0	10.015
Health care	2,264	7.719	1.410	0	10.225
Security & Defense	2,264	7.897	1.421	0	10.344
Tax Policy	2,264	7.798	1.515	0	10.215
Technology & Infrastructure	2,264	7.512	1.497	0	9.992
Environment	2,264	7.870	1.470	0	10.520
Lobbying	2,264	3.987	8.222	0	41
Group Lobbying	2,264	3.049	6.266	0	31
Individual Lobbying	2,264	0.798	1.900	0	9
Total Assets (ln)	2,264	14.915	1.862	8.645	20.399
Operating Revenue (ln)	2,246	14.040	1.886	0	17.604
Return on Assets	2,251	4.427	11.950	-62.700	36.410
Profit Margin	2,065	9.543	20.771	-75.030	82.030
Current Ratio	2,102	3.165	8.025	0.240	52.980
Solvency Ratio	2,261	40.483	24.041	-30.990	96.000

Table C.2: Distribution of Firms by Industry

Industry	# of obs.	Share (%)
Accommodation and food service activities	85	3.75
Administrative and support service activities	121	5.34
Arts, entertainment and recreation	46	2.03
Construction	69	3.05
Electricity, gas, steam and air conditioning	45	1.99
Financial and insurance activities	332	14.66
Human health and social work activities	7	0.31
Information and communication	211	9.32
Manufacturing	586	25.88
Mining and quarrying	118	5.21
Other service activities	17	0.75
Professional, scientific and technical	119	5.26
Real estate activities	160	7.07
Transportation and storage	85	3.75
Water supply; sewerage, waste management	48	2.12
Wholesale and retail trade	215	9.5

Figure C.1: Average Risk by Year

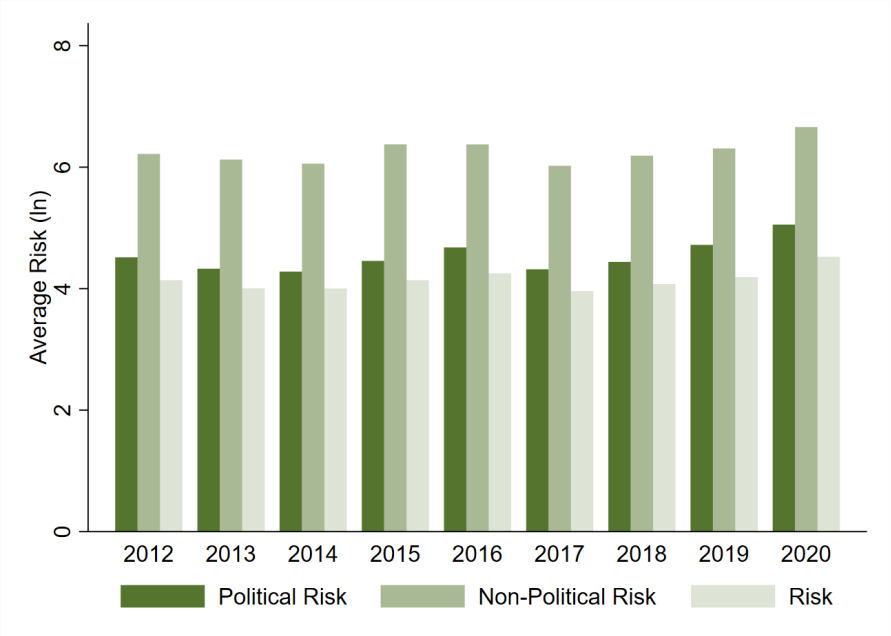


Figure C.2: Distribution of Lobbying

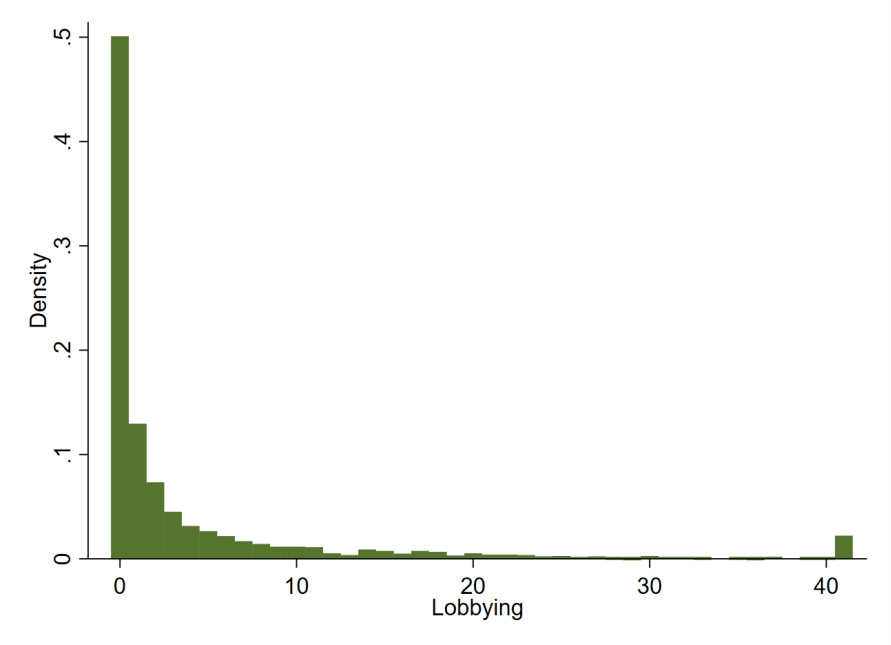


Figure C.3: Total Number of Lobbying Meetings by Year