Political Power, Local Policy Uncertainty and IPO Pricing

Abstract

Greater partisan alignment among lawmakers enhances their ability to respond rapidly to adverse shocks, but it also undermines the quality of checks and balances and encourages excessive governmental intervention in local areas aligned with the ruling party. We investigate how this form of local policy risk affects IPO underpricing. One standard-deviation increase in political alignment between local politicians and the federal government translates into an extra $1.58 million being left on the table, which corresponds to 5.39% of the average valuation discount. This effect is concentrated in firms that are vulnerable to legislative interventions and has important long-term implications. Our robustness analysis also shows that our baseline results are not sensitive to the inclusion/exclusion of influential states and years with high IPO activity.

JEL Classifications: *G10; G14; G32; G39*

Keywords: Initial Public Offering, Underpricing, Political Uncertainty, Legislative Intervention, Congressional Activity

1. Introduction

Although there is a widespread acceptance of the notion that political uncertainty has a pervasive influence on corporations, most of the existing evidence on this topic focuses on the consequences of electoral risk (the uncertainty about election outcomes) or, more generally, on the economic implications of a politically charged atmosphere (e.g., political bickering in the media).[1] However, anecdotal evidence suggests that there is another kind of political risk: the likelihood of excessive and biased political intervention. That is, the temptation of powerful politicians of all political colors to readily initiate policy change, whether in terms of a wide range of socioeconomic policies, or simply the way that companies interact with financial markets.[2] This political behavior is facilitated by higher concentrations of political power that, arguably, make it easier to unilaterally impose a partisan legislative agenda. However, such high levels of political discretion can erode the quality of checks and balances within a political system and may also lead to less predictable economic outcomes in the future, because they facilitate more sudden and one-sided changes in laws and regulations.

In spite of these potentially severe consequences, this form of policy risk has received limited attention in the academic literature. Perhaps more importantly, prior studies of politics and finance have mostly focused on large, established corporations, thus giving far less attention to small, young, fast-growing, entrepreneurial firms such as those conducting initial public offerings (IPOs). Given the crucial role of political institutions in stimulating or hindering entrepreneurial growth (Doidge et al., 2017; Gao et al., 2013; Dambra et al., 2015; Butler et al., 2019), this paper contributes to the extant literature by studying whether and how the concentration of legislative power within the U.S.

[1] A large stream of research on political economy shows that the risk arising from election events brings about a deterioration in firms' information environments (e.g., Julio and Yook, 2012; Boutchkova et al., 2012; Brogaard and Detzel, 2015, Kelly et al., 2016; Jens, 2017). Similarly, the uncertainty arising from the intensity of media discussions about future policy actions (Baker et al., 2016) or partisan conflicts (Azzimonti, 2018) depresses corporate investment and undermines firms' growth prospects (e.g., Gulen and Ion, 2016; Bonaime et al., 2018; Cao et al., 2019; Pham, 2019).

[2] For example, many commentators argue that the uncertainty induced by the political system in the aftermath of the 2008 global financial crisis – as reflected in a wave of government interventions – was a major contributing factor to the sluggish economic recovery (The Economist, 2013).

political system (in terms of partisan alignment of leading political actors across the different tiers in the hierarchy of political authority) affects the operations of newly listed firms.[3]

The economic implications of a perfect partisan alignment between the executive (President), legislative (Congress), and local (state) branches of U.S. government can be significant for economic agents. Kim et al. (2012) argue that greater alignment of local leading politicians with the ruling (presidential) party has two contrasting effects on the political environment. On the one hand, it curtails partisan conflict among federal lawmakers, thus reducing the likelihood of gridlock, shutdown, or, more generally, dysfunctional government (Antia et al., 2013). On the other hand, it erodes the quality of governmental checks and balances, because it enables the victorious party to impose a one-sided political regime (Alesina and Drazen, 1991; Fiorina, 1992; Jones, 2001). It also leads to the emergence of new items on the political agenda and a greater array of policy initiatives, both of which translate into more (radical) policy change. The intensity of the resulting legislative interventions injects uncertainty into the economy, because it presents markets with a less familiar framework, making it harder for investors to assess the nature and impact of a government's future policies on market participants (Pastor and Veronesi, 2013; Baker et al., 2016; Gulen and Ion, 2016; Bonaime et al., 2018).

The idea that powerful governments can increase policy uncertainty is consistently supported both by the finance and the political science literature (e.g., Füss and Bechtel, 2008; Fowler, 2006; Kim et al., 2012; Bradley et al., 2016; Kim et al., 2018). Yet, such uncertainty is not spread evenly across locations, but rather is more pronounced in those areas where the administration's policy efforts are focused (Kim et al., 2012). Naturally, these areas tend to be the home states of the most active and effective legislators (e.g., Congressional members originating from states closely aligned

[3] An issue that has garnered significant regulatory attention in recent years is the viability of the IPO market (Gao et al., 2013). While new companies are being founded on a regular basis, these small private companies are being acquired with increasing frequency by large, already-public companies (Lowry et al., 2017). From an antitrust perspective, this raises obvious concerns because it undermines entrepreneurial activity and operating efficiency (Grullon et al., 2019). In this respect, understanding whether and to what extent the political environment contributes to a vibrant IPO market is of paramount importance.

with the federal government). Arguably, politicians from states with high proximity to political power are more likely to shape an administration's policy agenda and spearhead new legislative activities by serving as chairs of Congressional committees (Bradley et al., 2016). Importantly, the actions of these legislators will be driven by re-election concerns (Mayhew, 1974; Mouw and Mackuen, 1992; Roberts, 1990; Jayachandran, 2006; Cohen et al., 2011) and, to some extent, the levels of cooperation with local government (McCann et al., 2015). As a consequence, we anticipate that states that are ideological aligned with the ruling party are more likely to be targeted in the process of legislative change. Such locations will thus be exposed to more drastic policy changes, introducing additional uncertainty for local firms.[4]

In light of the above, we predict that IPO issuers located in states exposed to drastic policy change (a form of policy uncertainty), as a result of closer alignment with the current government, will choose to withhold investment until the uncertainty surrounding the government's future actions is resolved (Julio and Yook, 2012; Bloom, 2014; Jens, 2017). This will translate into less sustainable, and possibly lower, subsequent profitability. In addition, if the information environments of firms located in areas of high proximity to political power are disproportionately infused with a local political component, the local investors' information set can become distinct from the national norm (Aabo et al., 2016). In this case, the effectiveness of the external monitoring of managers – especially from the perspective of non-local investors – becomes weaker. This, in turn, may exacerbate information asymmetry problems and result in more pronounced agency conflicts between managers and shareholders. Recognizing this adverse selection problem, rational investors will price-protect themselves by demanding higher compensation for bearing such additional risks (Rock, 1986; Michaely and Shaw, 1994).

Based on above arguments, local policy risk emanating from greater alignment with the ruling party should have a first-order (adverse) effect on the ability of private firms to raise capital in

[4] The idea that powerful local politicians affect the economic environment is not new. Faccio and Parsley (2009) report performance declines following the sudden deaths of dominant politicians in firms' home areas.

the primary equity market. In response, IPO issuers, along with their investment bankers, will discount their stock in order to render their issues more attractive and to stimulate investor demand. However, the degree of such IPO underpricing will not be uniform across the political map; instead, it should be more pronounced in those areas that are most likely to be targeted by the federal legislative process.

To test this hypothesis, we employ the political alignment index (PAI) constructed by Kim et al. (2012) as a proxy for the likelihood of partisan political intervention in local markets. The PAI is a geography-based measure of partisan alignment because it relies on the dynamic evolution of the U.S. political landscape as it emerges from federal and state-level elections. Due to local and federal elections the U.S. political map is redrawn every two years, thereby causing firms' positions to shift in terms of political geography, which, in turn, may expose them to varying degrees of policy risk. Therefore, to the extent that the PAI indicates which local areas are most likely to be subject to partisan Congressional legislative interventions, it provides exogenous state-level variation in policy uncertainty that extends beyond election cycles.

Using a comprehensive sample of U.S. IPOs from 1996 to 2018, we document a distinct impact for political proximity to the ruling party on IPO valuation: the PAI is significantly and positively related to IPO underpricing. The economic effect is sizeable, since a one-standard-deviation increase in the PAI score translates into $1.58 million being left on the table, which accounts for 5.39% of our sample period underpricing. Notably, this effect is driven primarily by the degree of alignment at federal government level (between the President and Congress), with the level of alignment between federal and state governments being less influential. This is not surprising, given that PAI-related uncertainty typically emanates from Congressional activities rather than those of state legislatures.

Since our baseline findings suggest that the financial claims of IPO investors are contingent on changes in firms' geopolitical environments, we contend that the PAI effect will be more evident

in firms that are vulnerable to political shocks originating from legislative interventions (Wellman, 2017; Pham, 2019). Consistent with this conjecture, we find that the PAI effect is more pronounced among firms without active corporate political strategies and firms with limited geographic scope of operations; in areas characterized by higher political turnover (i.e., locations in which new faces appear in key political positions) and more intense legislative activity (i.e., when new items are placed on the local political agenda by a firm's home-state politicians); and in states with a high dependence on government spending or low institutional quality.

Having established the channels through which the PAI measure affects underpricing, we ask whether our inferences are subject to various forms of selection bias. Additional tests do not provide any support to the idea that the PAI–underpricing relationship is spurious due to selection bias associated with the deliberate choice of a firm's headquarters, the timing of its IPO, past IPO activity, or local pessimism/optimism. Finally, we consider whether the economic implications of heightened local policy risk have a long-lasting effect on newly public firms. We find that IPOs originating from states characterized by high policy risk exhibit significantly greater stock return volatility in the aftermarket, confirming the notion that the information environment is worse among such firms. Further, we report a substantive negative impact of the PAI on the real economic outcomes for these firms: IPOs exposed to greater local policy risk are associated with lower investment activity, poorer operating performance, and lower survival rates in the years following their initial offering.

Our work contributes to the flourishing research on the impact of policy uncertainty on the cost of financing activities. Recent works have explored the effect of policy uncertainty on the equity risk of seasoned firms (Boutchkova et al., 2012; Kim et al., 2012; Pantzalis and Park, 2014; Brogaard and Detzel, 2015; Addoum and Kumar, 2016; Pham, 2019), the debt market (Waisman et al., 2015; Bradley et al., 2016; Kaviani et al., 2020), mergers and acquisitions (Harford et al., 2016; Nguyen and Phan, 2017), and the options market (Goodell and Vähämaa, 2013; Kelly et al., 2016). The

common theme of these studies is that capital markets are an informative gauge of the cost of policy risk. Our novel contribution to this literature is that policy risk is also priced into the primary (IPO) equity market. To the extent that governments frequently aim to stimulate the economy by supporting the vibrancy of financial markets (Gao, et al., 2013; Dambra et al., 2015), the IPO market provides an ideal setting to examine the economic impact of policy risk originating from the concentration of political power.

Our paper also adds to an emerging literature that analyzes the impact of the political environment on primary markets. Çolak et al. (2017) show that electoral risk and, specifically, the uncertainty arising from gubernatorial elections adversely affects local IPO volumes. While our study revisits the role of local politics in IPOs, our identification strategy relies on post-election, legislation-driven policy risk, which shifts every two years in each state in a staggered fashion. The uncertainties about future law changes associated with each re-alignment in the political map following election events is the main driver of this type of policy risk. In addition, our study documents that this form of policy risk plays a major role in the IPO price-setting process and has significant long-term implications. We show that different types of political risk affect IPOs in different ways, thereby providing a broader view of how newly public firms interact with the political environment.

2. Literature Review

In this section, we discuss the mechanism through which the interplay between partisan alignment and legislative activity in Washington DC generates uncertainty about the impact of an administration's future policies. Notably, we highlight an important geographic dimension of this form of policy risk: how political cost considerations (i.e., electoral motivations and proximity to state governments) encourage federal lawmakers to focus their efforts toward particular states, thus generating an inconsistent influence across different areas.

2.1 The Link Between Partisan Alignment, Federal Legislative Activity, and Policy Risk

Arguably, an increase in the concentration of political power, as reflected in the degree of alignment across the tiers of a government, alleviates the pressure on leading political actors to compromise or negotiate over their proposed policies when they attempt to introduce and pass new laws (Alesina and Rosenthal, 1995). Most importantly, greater partisanship may translate into a more one-sided political regime (irrespective of its intentions) because it better enables the victorious party to unilaterally implement its agenda. This inevitably leads to the emergence of new items on the political agenda and, potentially, to more radical policy change.[5] In line with this argument, empirical studies find that when the executive and legislative branches in Washington DC are not politically divided (i.e., when the President has full control of the upper and lower houses in Congress), the likelihood of policy change is higher (Fowler, 2006; Bradley et al., 2016).

Why might greater political alignment and the associated increase in policy change at times be harmful for the economy? Pastor and Veronesi (2012, 2013) theorize that a major source of policy risk originates from the intensity of legislative activity, conceptualized as the likelihood of policy change. A greater array of policy initiatives increases information uncertainty, because it introduces a less familiar legislative and regulatory framework to the markets, thereby making it harder for investors to assess what kind of policies are going to be adopted and what their impact will be on a firm's future prospects. Relatedly, Cohen et al. (2013) show empirically that the market is slow to recognize the impact of Congressional bills, especially complex ones, on firms. Furthermore, some studies document that uncertainty about the U.S. federal government's future actions makes stocks more volatile, commands a risk premium, and dampens corporate investment (Baker et al., 2016; Gulen and Ion, 2016).

Integrating the theoretical and empirical evidence outlined above, a natural conclusion emerges: greater partisan alignment across the tiers of a government encourages (more biased)

[5] The literature also claims that majority-party politicians might be tempted to behave opportunistically and exploit their political discretion in order to extract rents; for instance, by threatening to regulate particular firms or industries (McChesney, 1987; Beck et al., 1992).

government interventions. However, legislative intervention injects uncertainty into the economy and the markets because it increases the probability of (a wide array of) policy change. To the extent that a greater range of policy change translates into less predictable outcomes in terms of the (re)distribution of future growth opportunities, it is conceivable that the increased policy risk associated with powerful governments will negatively influence firms' investment decisions as well as investors' perceptions as to the expected payoffs from investing in these firms. Several studies confirm this conjecture, demonstrating that powerful politicians increase the probability of policy change, and that in times of unified governments, financial markets operate under higher risk than in periods with divided ones (e.g., Füss and Bechtel, 2008; Cohen et al., 2011; Kim et al., 2012; Bradley et al., 2016; Kim et al., 2018; Kim and Nguyen, 2019).

2.2 Why Congressional Activities May Heterogeneously Affects Firms in Different States

The discussion thus far involves the implicit assumption that policy risk emanating from unified governments affects all firms in a similar manner. However, we argue that the effect of a federal government's actions is not uniform across geographical regions; rather, it will be more pronounced in areas afforded greater political discretion, that is, in locations with greater proximity to the dominant political power. To this end, we draw upon two interrelated attributes of the U.S. political setting: its federalist character and the political considerations of leading politicians.

According to the U.S. constitution, a policy initiative can be introduced, passed, and implemented if three conditions are fulfilled. First, politicians across different tiers of the federal government must cooperate and coordinate effectively in order to ensure that a proposed law becomes a Congressional bill. This implies that the path to the final passage of a Congressional bill requires either bipartisan cooperation or a minimum alignment of the President and both chambers of the U.S. Congress.

Second, federal lawmakers tend to consider the needs and preferences of their voting districts. Several studies in the political science literature argue that because Congressional members

are elected by direct vote at the state level, they have powerful electoral motivations to care about the economic conditions of their constituency (e.g., Mayhew, 1974; Mouw and Mackuen, 1992). Therefore, these federal legislators have strong incentives to channel national funds to their own voting districts or, more generally, to draft, sponsor, and/or amend bills with an eye on firms located in their home states (see, for example, Roberts, 1990; Jayachandran, 2006; Cohen et al., 2011). Kim et al. (2012) argue that this is more likely to happen in the case of federal politicians from states having greater alignment with the President (i.e., the ruling party), because their closer political proximity to power enables them to dominate the Senate and House committees in Congress and, hence, to exert substantial influence on setting the policy agenda and passing new legislation. This reasoning suggests that policy initiatives are more likely to pass into law when directed toward firms and constituents in the home states of such federal legislators. As a consequence, policy uncertainty is not evenly distributed across different areas of the political map but will, instead, be more pronounced in states having stronger political alignment with the President.

The third condition concerns the alignment of state politicians (governors and state legislatures) with the ruling party.[6] While alignment at federal government level ensures that a draft bill may pass and eventually become a Congressional law, the cooperation of local government helps to determine how easily federal reforms will be implemented at state level (McCann et al., 2015), and must be considered by federal lawmakers. Anecdotal evidence supports such a conjecture.[7]

3. Hypothesis Development

[6] While governors and state legislators have no role in crafting federal policies, by constitution they may have a certain amount of discretion in how they implement a federal policy (Lee and McGuire, 2017). In this respect, alignment between national and local government may be relevant in our context.

[7] For instance, Medicaid expansion under the Affordable Care Act of 2010 was passed because the Democratic Party controlled the presidency and both houses of Congress. However, Medicaid is administered at state level. Hence, one would expect its implementation to be more readily facilitated in Democrat-controlled states than Republican ones and, indeed, Democratic state governments more fully and quickly enacted the Medicaid expansion, while many Republican state governments declined, attempted to veto, or delayed it (https://www.kff.org/medicaid/issue-brief/status-of-state-medicaid-expansion-decisions-interactive-map/). It seems that for a policy change to take effect, alignment between federal and local politicians is necessary. Therefore, to the extent to which the chain of political authority that links federal and state governments is unbroken, firms located in states with greater proximity to political power (i.e., to the U.S. Congress in Washington DC and to the President) may be subject to more policy change and hence exposed to greater policy risk.

The preceding discussion suggests that political developments in Washington DC do not have a uniform impact on markets in different geographic locations. Extending this reasoning, we argue that in states where the implications of federal legislative activity are profound, IPO stocks will exhibit a local pricing component because (a) the operating activities and future expected payouts of local IPO issuers will be disproportionately affected by federal government, and (b) the information set available to local investors may be distinct from the national norm (Aabo et al., 2016).

With respect to IPO issuers, we conjecture that firms located in states that are closely aligned with the President will be exposed to greater uncertainty, since these areas are more likely to be the target of federal government's future policies. The increased policy risk would result in a widening of the distribution of the projected cash flows of these firms, because it increases the range of possible future outcomes. In response, some firms located in states where (this form of) policy risk is elevated may choose to "downsize" until uncertainty about the impact of future policies on their growth opportunities has abated (Julio and Yook, 2012). Naturally, this decision will undermine their competitiveness and will lead to inferior financial performance in the future (Bloom, 2014; Jens, 2017). In light of this, we conclude that local policy risk emanating from greater partisan alignment distorts the investment schedules and profitability dynamics of IPO issuers.

In terms of the behavior of investors in the primary equity market, we predict that their decisions to invest in a firm located in a state will be partially determined by that state's degree of alignment with the ruling party. Because higher proximity to powerful politicians increases the uncertainty about the impact of future policy actions on local markets, it will exacerbate information asymmetries regarding the prospects of IPOs located in such areas. In this respect, it would be more difficult for investors to discern the quality of IPOs in states closely aligned with the President. Acknowledging this adverse selection problem, rational investors, especially the less informed ones (e.g., non-local investors), will price-protect themselves by demanding higher compensation for

bearing extra risk (Beatty and Ritter, 1986; Rock, 1986; Michaely and Shaw, 1994). This adverse discount-rate effect can result in a greater cost of equity capital (lower offer prices).

Based on these arguments, we hypothesize that local policy uncertainty induced by greater alignment with the federal government could aggravate the adverse selection costs of local IPOs. Given the severe information asymmetry problems of newly listed firms, as well as their tendency to fail in the aftermarket (Michaely and Shaw, 1994; Brav and Gompers, 1997; Lowry et al., 2017), we argue that such alignment will have a first-order effect on the pricing of IPOs. In particular, we predict that IPO price setters will respond to the risk of local policy shocks by underpricing the issue to make it more attractive and stimulate investor demand. Hence, our main hypothesis:

Policy Exposure Hypothesis: *IPO firms located in states with greater alignment with federal government are exposed to higher policy risk and thus exhibit greater levels of underpricing.*

4. Sample Selection and Methodology

Our sample selection starts with the retrieval of all IPOs between 1996 and 2018 from the U.S. common stock data file of the Securities Data Company (SDC) database. In order to match our sample IPOs with political geography data, we carefully hand-collect information about the state in which the issuer has its headquarters by utilizing IPO prospectuses from the EDGAR system of the U.S. Securities and Exchange Commission (SEC), which are available for 1996 onwards. Consistent with the literature (e.g., Loughran and Ritter, 2004), we apply standard IPO filters to exclude foreign issues, unit offerings, reverse leveraged buyouts (LBOs), spin-offs, closed-end funds, real-estate investment trusts (REITS), royalty trusts, financial institutions, limited partnerships, and American Depositary Receipts (ADRs), as well as all IPOs with an offer price below $5.

We obtain IPO background and issuance information from the SDC, including the issue data, offer price, total proceeds raised, whether the firm is backed by venture capital, and the identity of the underwriters. We identify the quality of an underwriter according to its prestige ranking,

developed by Carter and Manaster (1990) and updated by Loughran and Ritter (2004). Accounting data are retrieved from the Compustat database, and public trading prices are obtained from the Center for Research and Security Prices (CRSP). After combining the IPO data with the corresponding accounting and stock market information and eliminating observations with missing values, we end up with a sample of 2,942 IPO firms.

Data regarding the external political environment are collected from a variety of sources, depending on the type of election concerned. Starting with the state in which the firm's headquarters are located, we gather state-level election results from different volumes of *Taylor's Encyclopedia of Government Officials, Federal and State* to identify the party affiliation of the majority of a state's legislative body. Results for gubernatorial and Congressional elections are obtained from Dave Leip's Atlas of U.S. Presidential Elections (http://uselectionatlas.org). Election results for the U.S. House of Representatives are extracted from the website of the Office of the Clerk (http://clerk.house.org). Where necessary, information about the majority in both chambers of Congress is complemented by the Biographical Directory of the United States Congress (http://bioguide.congress.gov). Finally, state-level data, such as real GDP growth rates, personal incomes, and unemployment rates, are extracted from the Regional Economic Accounts database provided by the Bureau of Economic Analysis (BEA).

4.1 Measuring Partisan Alignment and Local Policy Risk

We employ the political alignment index (PAI) proposed by Kim et al. (2012) as our main proxy of local policy risk deriving from partisan alignment. The PAI index conceptualizes policy risk as the likelihood of federal governmental intervention in particular geographic regions. Because such governmental involvement is facilitated by greater partisan alignment, it follows that the likelihood of policy change will be more pronounced in areas where the administration's policy efforts are typically focused, that is, in states that are closely aligned with the ruling party. Therefore, given that policy interventions inject uncertainty into the economic environment, it is anticipated that firms

located in areas with high proximity to political power will be subject to a greater array of policy interventions and hence exposed to higher local policy risk.

An important feature of the PAI is that it relies on the strength of geographical ties between the federal government and local politicians (i.e., politicians either within or from the firm's home state), as they emerge from changes in the U.S. political map following election events. In this respect, the PAI exploits the dynamic nature of the U.S. political landscape and reflects exogenous variation in the degree of partisanship within the federal government, and between the federal government and state legislatures. Hence, although a firm's headquarters location can be regarded as being fixed over time, the dynamic nature of the U.S. political map causes the firms' position to shift in terms of political geography, which, in turn, exposes firms to varying degrees of policy risk.

Because the U.S. political map is redrawn every two years, following presidential, Congressional, or mid-term elections, the PAI is computed at the state level on a biennial basis. In particular, it is constructed by accounting for the percentage of each state's representatives in Congress that belong to the ruling party (i.e., the state's representatives in the Senate and the House in Washington DC), and the degree of the presidential party's control of each of the state's political institutions (i.e., governor's mansion and state legislatures), as follows:

$$PAI = \frac{1}{4} \times Senators + \frac{1}{4} \times Representatives + \frac{1}{4} \times Governor + \frac{1}{4} \times \left(\frac{1}{2} \times State\ Senators + \frac{1}{2} \times State\ Representatives \right) \qquad (1)$$

where *Senators* is the percentage of each state's senators in the U.S. Senate that belong to the President's party; *Representatives* is the fraction of each state's House representatives in Washington DC that belong to the President's party;[8] *Governor* is a dummy variable that takes a value of 1 if a governor belongs to the same party as the President, and 0 otherwise; *State Senators* is a dummy variable that has a value of 1 if more than 50% of the state senate members belong to the President's

[8] The U.S. Congress consists of two chambers; the Senate and the House of Representatives. The Senate is composed of 100 senators, 2 from each state, whereas the House of Representatives is made up of 435 elected members, divided among the 50 states in proportion to their total population.

party, and 0 otherwise; *State Representatives* is a dummy variable that has a value of 1 if more than 50% of the state house members belong to the President's party, and 0 otherwise.

4.2 Empirical Model

The major focus of this study is to investigate the relationship between local policy risk and IPO underpricing. We test this relation using multivariate regression analyses that control for firm, IPO, and state characteristics. We also include industry, state, and year fixed effects (*Fixed Effects*) to mitigate the time-invariant omitted-variable bias problem. We cluster standard errors at the state level. In accordance with our main hypothesis, our baseline model takes the following form:[9]

$$Underpricing = \beta_0 + \beta_1 Local\ Policy\ Risk\ (PAI) + \beta_2 Control\ Variables + Fixed\ Effects + \varepsilon_i \quad (2)$$

Our dependent variable is underpricing. IPO underpricing represents the first-day returns and is estimated as the percentage difference between the immediate aftermarket price and the IPO offer price. From an issuer's perspective, a small discount, that is, an offer price that is closer to the aftermarket price, is preferable because it allows the firm to capture more of the value created during the offering process (Certo et al., 2001). From an investor's perspective, it represents the market's initial response to a company's stock offering (Higgins and Gulati, 2006). In either case, lower levels of underpricing reflect a superior ability to raise capital, because the need to discount the offer (and hence make the issue more attractive) is mitigated for firms exposed to lower risks.

The main variable of interest is the *Political Alignment Index* (PAI), which serves as a proxy for local policy risk because it captures how uncertainty about a federal government's future legislative activities is spread among different states, based on the degree of alignment of a firm's home-state politicians with the ruling party (Kim et al., 2012).

It could be argued that policy uncertainty generated by the U.S. federal government entails an economy-wide component as well as a state-specific component. Because heightened aggregate economic uncertainty has been a prevalent characteristic for the last decade (Brogaard and Detzel,

[9] In untabulated analysis, we also cluster standard errors at the state level and year and our results remain unchanged.

2015; Gulen and Ion, 2016), it is essential to consider its role in our modeling process. We use the monthly Economic Policy Uncertainty (EPU) index of Baker et al. (2016) to differentiate between local and aggregate political uncertainty. Furthermore, while a high value of the PAI indicates a high degree of alignment with the national government, and hence less-severe partisan conflicts (disagreements with the ruling party), it does not capture (adequately) the control of voting procedures and, importantly, the role of polarization (disagreements across party lines). Partisan tensions and political polarization have been markedly higher during the last 15 years (Wellman, 2017). Thus, we also include in our model the Partisan Conflict Index (PCI) of Azzimonti (2018).

Variations in IPO activity might affect the choice of whether or when to go public. Prior research has documented that IPO volumes are lower in periods of greater electoral uncertainty (e.g., Çolak et al., 2017), and that adverse conditions can change the "type" of firms that go public (e.g., Bernstein, 2015). Therefore, variations in IPO activity might affect the quality of firms that go public, or the timing of when a firm goes public (Çolak and Günay, 2011). Because the degree of political alignment of each firm's home state with the President is public information, a potential concern is that IPO candidates choose whether and when to enter the IPO market on the basis of the PAI. In this regard, the PAI–underpricing link could be attributed to differences in firm quality rather than the impact of local policy risk on initial IPO returns. To control for this possibility, we follow Yung et al. (2008) and use *Market Heat*, defined as the moving average, MA(4), of the number of IPOs in each state per quarter, divided by its corresponding sample average.

We incorporate *IPO Revision* to control for price changes that occur due to revelations in private investor information during bookbuilding (Lowry and Schwert, 2002). We use *Firm Age* as a surrogate for risk: the underlying assumption is that firms that have operated for longer have proven their resilience to changes in the market and thus constitute safer investments (Carter et al., 1998). We also use the natural logarithm of total assets (*Size*) and total proceeds (*Proceeds*) at the time of listing as proxies for firm size and visibility (Butler et al., 2014; Lowry et al., 2017).

Dolvin and Jordan (2008) suggest that an increased proportion of shares held by managers, namely *Overhang*, is positively associated with higher levels of underpricing. In addition, Loughran and Ritter (2004) use market returns as a measure of investor sentiment and document that they are positively related to IPO initial returns. Moreover, Lee and Wahal (2004) and Chiang et al. (2019) argue that while financial intermediaries, such as underwriters and venture capitalists (VCs), play a certification role in the IPO process, they also have strong incentives to improve the first-day returns for their clients. Thus, we control for the presence of *VCs* and prestigious *Underwriters*. We also include earnings per share (*EPS*) in the year prior to the IPO to capture the influence of profitability on underpricing. Prior studies show that immediate aftermarket returns depend on the level and nature of risk in the firm's external operating environment (Loughran, 1993; Loughran and Ritter, 2004). To this end, we also consider whether IPO firms were in the *Internet* or *Technology* sectors or were incorporated via *Nasdaq*, the preferred marketplace for small, young, and high-tech IPOs. Besides typical company characteristics, we also control for *Real GDP Growth Rate*, *Personal Income*, and *Unemployment Rate* at the state level, because changes to the political landscape may be partially determined by a state's economic fundamentals (Bradley et al., 2016; Çolak et al., 2017).

5. Empirical Results

5.1 Descriptive Analysis

Table 1 presents the distributional statistics for IPO activity, underpricing, and the PAI. Panel A of Table 1 focuses on the time-series dimension, while Panel B reports how these measures vary across industries. An inspection of Panel A reveals that the number of IPOs and the level of underpricing tend to decrease after stock market and/or economic crises, as indicated by the Dot-com Bubble and the Credit Crunch of, respectively, 2000 and 2007. An explanation of this behavior lies in the sensitivity of investor sentiment to economic shocks (Loughran and Ritter, 2004) and the so-called "strategic waiting" phenomenon (Çolak and Günay, 2011), both of which affect the timing of IPOs. In contrast, the PAI exhibits relatively more consistent behavior over time.

Table 2 shows the summary statistics for PAI ratings and IPO initial aftermarket returns. Panel A suggests that the average value of the PAI is slightly higher during Democratic presidencies, with a mean of 0.51, compared to 0.48 for Republican presidencies. Panel B indicates that average first-day returns are also higher during Democratic presidencies.

Table 3 shows the mean values of corporate fundamentals and state-level characteristics for firms located in states with high and low PAI values (relative to the PAI median). Panel A clearly indicates that firms with headquarters in states with high proximity to political power tend to experience higher levels of IPO underpricing, thus providing preliminary support to our policy risk exposure hypothesis. The comparison between the two PAI groupings of the remaining corporate-level variables shows that, on average, firms in the high- and low-PAI states are not significantly different from each other, except in terms of IPO revision, profitability, VC backing, and the prestige of their underwriters. Lastly, Panel B of Table 3 indicates that states with high PAI values tend to differ from states with low ones in terms of GDP growth rate, personal income, and unemployment rates. However, these differences are not economically large.

5. 2 Multivariate Regressions

5.2.1 The Effect of the Political Alignment Index (PAI) on IPO Underpricing

Table 4 presents the results of our ordinary least-squares (OLS) regression tests on the association between the PAI and IPO underpricing. Column 1 documents a strong and significant positive relation between the PAI and initial aftermarket returns, suggesting that, after controlling for firm-specific and state-level economic factors and fixed effects, higher PAI values tend to increase first-day IPO returns. Specifically, a one-standard-deviation increase in the PAI score (0.37) increases the average local IPO firm's underpricing by 1.01%, which, in turn, translates to $1.58 million being left on the table.[10] This is a sizable effect in economic terms, given that the average

[10] The increase in underpricing for a firm located in a state that exhibits a one-standard-deviation (SD) increase in the level of PAI is calculated as follows: 0.37 (PAI SD) × 2.74% (PAI coefficient) = 1.01%. In addition, the average amount of proceeds in our sample is $155.61 million. Hence, a one-SD increase in PAI translates to (1.01% × $155.61 million =)

underpricing in our sample period is 18.73% (i.e., the amount of money left on the table is $29.15 million). As such, it seems that 5.39% of our average sample underpricing is attributable to variation in the PAI.

The findings pertaining to the control variables are interesting in their own right. The coefficients on the aggregate political uncertainty indexes (EPU and PCI) are positive. However, only the PCI is significantly associated with underpricing. *Market Heat* is positively related to IPO underpricing, consistent with the idea that rising IPO waves are associated with inferior corporate quality (Yung et al., 2008). *IPO Revision* is positively and strongly related to underpricing, which is in line with the predictions of Hanley (1993) and Lowry and Schwert (2002) that information production during bookbuilding is associated with higher initial IPO returns.

The coefficient for corporate age is negative, which is consistent with the notion that longer-lived companies involve lower levels of uncertainty. Similarly, leverage and EPS tend to increase initial returns to investors; however, their coefficients are indistinguishable from zero. The coefficient for corporate size is also negative, which is consistent with the idea that larger companies are associated with lower information asymmetry and hence less underpricing. It is also worth noting that the coefficient on IPO proceeds is positive. A possible explanation for this observation is that some companies tend to offer larger offer-price discounts in order to maximize proceeds (Gounopoulos et al., 2017).

We obtain a significantly positive coefficient for *Overhang*, which is in line with Dolvin and Jordan (2008). Consistent with Loughran and Ritter (2004), both VCs and prestigious underwriters contribute positively to immediate aftermarket returns. Technology, Internet, and Nasdaq stocks tend to be positively related to underpricing. We also obtain a positive and highly significant coefficient for market returns. Finally, the coefficients for the state-level variables do not show any significant relationship to underpricing.

$1.58 million being left on the table. In our sample, 19 states experienced a change in partisan alignment greater than the sample SD for PAI (0.37), and of our 2,942 observations, 533 have a PAI value greater than the sample SD for PAI. Therefore, it seems that changes of such magnitude do not constitute a rare event.

5.2.2 The Effect of PAI Variants and PAI Changes on IPO Underpricing

While the results in Column 1 of Table 4 support the notion that the PAI is a valid proxy for policy risk, they are not informative regarding the extent to which such policy risk is attributable either to alignment within the federal government or alignment between federal and state governments. To address this issue, we experiment with two alternative forms of PAI. Our first variant, *Federal PAI*, is a pure Congress-alignment measure that is formed by dropping the state institution components from the original measure (see equation (1)) and assigning equal weights to the federal government components, that is, the Senators and House Representatives of Congress (Antia et al., 2013). Our second PAI variant, *State PAI*, is formed by dropping the Congressional member components from the original measure and assigning equal weights to the governor and state legislatures (Aabo et al., 2016).[11]

An inspection of Columns 2 and 3 of Table 4 reveals that both *Federal PAI* and *State PAI* are significantly and positively related to IPO underpricing. However, the coefficient on *Federal PAI* is larger (3.80) than that on *State PAI* (1.23) or the overall *PAI* (2.74). Given that PAI-related uncertainty is driven to a greater extent by the federal government than by state government, it is not surprising that the political alignment within the federal government exerts a stronger impact on IPO underpricing than that between the federal government and state legislatures. Finally, we consider a much broader PAI definition that takes into account the political alignment of geographic regions, rather than states, with the President and their administration (*Regional PAI*). To do so, we classify states into four regions (West, Midwest, South, and Northeast) and average the PAI values across all of the states within each region. Column 4 of Table 4 shows that *Regional PAI* is positively related to IPO underpricing.

[11] *Federal PAI* represents the degree of alignment within the federal government and captures the capacity of national legislators to introduce, draft, amend, and pass congressional laws. Because of electoral motivations, it is expected that such interventions will be targeted toward states whose federal politicians belong to the same party as the President. *State PAI* reflects the degree of cooperation between the federal and state governments. Unlike federal lawmakers, state politicians have no role in crafting federal policy; at best, they have a modest discretion in how they implement it. Therefore, *State PAI* affects only the implementation of federal laws at the state level. In light of this, we expect *Federal PAI* rather than *State PAI* to be the main driver of local policy risk emanating from Congressional legislative activities.

Overall, the results from Columns 1 to 4 are supportive of the policy risk exposure hypothesis and consistent with the notion that, on average, the information environment of an IPO firm deteriorates when its home-state's position on the political map shifts toward the center of political power. Nevertheless, one could argue that these results might be biased because, in some states, the PAI might exhibit stability over time (i.e., high within-state time persistence), thereby enabling IPO issuers to choose the location of their headquarters according to the predicted level of the PAI in the local state. To address this concern, in Panel B of Table 4 we consider changes in the degree of political alignment, because this variable is less likely to be anticipated. Columns 1 to 4 show that changes in the degree of political proximity are reliable predictors of underpricing across all PAI variants. Thus, it seems that our results are not driven by bias related to a predictable component of PAI. In section 6.1, we elaborate further on this issue.

6. Is the Relationship Between PAI and IPO Underpricing Heterogeneous?

Our baseline results indicate that firms located in states with greater alignment with the ruling political party are exposed to heightened local policy uncertainty. This interpretation is consistent with our hypothesis that federal legislative activity heterogeneously affects firms in different locations, because areas with greater proximity to political power are subject to a greater range of policy change, and are thus exposed to more policy uncertainty in terms of the nature and impact of future legislative initiatives of the federal government. However, it is also conceivable that federal legislators will be encouraged to pass laws that benefit their own electoral districts, or to allocate a disproportionate amount of resources (government spending projects and programs) to their political home states in order to enhance their re-election prospects in the political arena (e.g., Mayhew, 1974; Mouw and Mackuen, 1992). If this behavior is prevalent in our sample, then IPO firms located in areas under strong control of the ruling party might be able to gain benefits in the form of enhanced growth opportunities or more limited downside risk. In this case, IPOs with greater corporate political proximity should have better future prospects and a lower need to discount their share issue.

While our baseline results do not support this conjecture, we cannot rule out the possibility that, at least in some cases, the net impact of political proximity on underpricing can become ambiguous or even negative. This begs the following question: what precisely does the PAI capture; exposure to increased policy risk or preferential political treatment? To resolve this issue empirically, we resort in the first instance to the literature that explicitly studies whether systematic direct government interventions and, specifically, fiscal spending shocks are beneficial to private-sector economic activity. In this respect, both Cohen et al. (2011) and Kim and Nguyen (2019) report that policy interventions in the form of positive exogenous shocks in government spending – captured either by changes in Congressional committee chairmanships or population count revisions in census years – reduce corporate investment by hurting firms' investment opportunity sets. From this perspective, it seems unlikely that local investors will perceive such government interventions in politically important areas favorably. Even under benevolent governments, the existence of uncertain political costs makes the nature and impact of future policy actions hard to predict, thereby commanding a risk premium (Pastor and Veronesi, 2012; 2013).

In order to further alleviate the concern that the PAI may be associated with preferential political treatment rather than greater exposure to local policy risk, we employ a wide set of factors with the aim of uncovering the mechanism by which it affects local markets. These factors are: corporate political activity, corporate geographical dispersion, political turnover of Congressional chairpersons, the intensity of federal legislative activity driven by a firm's home-state politicians, politically sensitive industries, a state's dependence on government spending, and the quality of local political institutions.

6.1 Active Corporate Political Strategies

If firms regard political interventions induced by greater partisan alignment as a source of political uncertainty, then one might expect that (pre-existing) active corporate political strategies would allow them to hedge the associated policy risk. Essentially, these strategies aim to attract

preferential political treatment and gain access to privileged information about policy initiatives. They range from adding politicians to the board of directors (Goldman et al., 2009), to making financial contributions to election campaigns and lobbying initiatives (Correia, 2014), exploiting top management's past service in governmental or military positions (Wu et al., 2012), and promoting equity ownership by influential politicians (Faccio, 2006; Tahoun, 2014).

While these corporate political strategies vary in terms of their nature and effectiveness, a legitimate question concerns whether they represent rational responses to political developments. Bradley et al. (2016) report that local proximity to political power increases the cost of debt, but only for firms that do not engage in lobbying or contribute to political action committees (PACs), whereas Gross et al. (2016) report that policy risk only exerts a significant influence on financial reporting choices and a firm's information environment for firms that are not politically active. Similarly, Wellman (2017) and Pham (2019) both find that political connections (partially) offset the negative relationship between corporate investment and political uncertainty.

Therefore, from a resource perspective, corporate political strategies can be viewed as an intangible asset, a source of political intelligence that enhances firms' abilities to better time their responses to political developments (Amore and Minichilli, 2018; Kim et al., 2018). If the IPO market does, indeed, regard this form of political capital as an indication of a firm's capability to better negotiate the complexities of the political system, such political activism should mitigate the information asymmetries within IPOs. Gounopoulos et al. (2017) support this notion, showing that politically active firms experience lower levels of IPO underpricing. Thus, we further hypothesize that the underlying mechanism driving the relationship between underpricing and corporate political donations is the degree of exposure to local political uncertainty. IPO issuers could potentially benefit from political strategies because such actions decrease exposure to policy risk.

We put this hedging hypothesis to the test by analyzing the companies that engage in active corporate political strategies (CPS) either by lobbying or making PAC contributions (*CPS* = 1;

otherwise *CPS* = 0). Then, we examine whether CPS can effectively protect IPO firms from policy risk by performing OLS regressions in CPS and non-CPS subsamples or by examining the interaction in the pooled sample of CPS with the PAI.[12] Panel A of Table 5 shows that the association between the PAI and IPO underpricing is not statistically significant among firms actively pursuing political strategies, while the influence of policy risk on underpricing is strengthened in the absence of political money contributions.[13] We also find that the coefficient of the interaction variable is significantly negative, suggesting that corporate political activities act as effective tools for hedging against the local policy risk associated with PAI.[14]

A potential problem with these results is endogeneity. Among others, Gounopoulos et al. (2017) document that the decision to engage in political actions is not random, but rather it is likely to be related to factors reflecting the resource availability of a firm, as well as its external environment. In this case, the standard errors in the models previously estimated could be biased, that is, overstated or understated, because firms tend to self-select when participating in political activities. Only 11 percent of the IPO firms in our sample engage in political activity, so we cannot rule out the possibility that our inferences are subject to a potential selection bias problem.

To alleviate these concerns, we follow two distinct strategies. First, in an attempt to ensure that firms with active political strategies (the treatment group) and those without (the control group) are comparable across a range of observable characteristics associated with underpricing, we follow

[12] Data regarding lobbying activities and PAC contributions are carefully hand-collected from the OpenSecrets.org database. Our lobbying and PAC sample covers a 19-year period from January 2000 to December 2018. When we match our IPO sample with the OpenSecrets.org database, we identify 158 firms with lobbying experience and 53 PAC-active IPOs. In addition, the number of firms actively pursuing CPS is 196. See Section A2 and Figure 13 in the Internet Appendix for more information about the distribution of CPS and their implications for firm characteristics.

[13] At this point, it should be noted that the univariate correlation between our policy uncertainty proxy (*PAI*) and political connections is low (less than 11%). Notably, the correlation between PAI and policy risk variables used in previous studies (*EPU* and *PCI*) in our sample is again very low (6% and 15%, respectively). As such, the PAI clearly captures a distinctive set of information when compared to the variables used in previous studies to represent the political environment.

[14] Our conclusions are similar when we use the natural logarithm of the amount of lobbying instead of the *CPS* dummy variable. Likewise, the results are unaffected when we use the dollar value of PACs.

Hainmueller (2012) and employ entropy-balancing matching.[15] Our results, in Panel B of Table 5, confirm that the effect of the PAI on underpricing is weakened among firms that engage in corporate political activism.

Second, we attempt to control for self-selection bias in an alternative way by utilizing the two-stage least-squares (TSLS) method. In the first stage, we estimate the probability of engaging in corporate political activities, while in the second stage we replace the hypothesized endogenous variable with its predicted value.[16] Column 3 of Panel B (Table 5) indicates that the sign and significance of the interaction variable (*PAI* × *Predicted CPS*) remain essentially the same as in Panel A. We conclude that the interplay between PAI and corporate political strategies is not sensitive to endogeneity issues.

6.2 The Underlying Political Mechanisms: Political Turnover and Legislative Activity

While firms engage in corporate political activities to obtain political intelligence and prevent or benefit from regulatory interventions, political developments typically work in the opposite direction. In this subsection, we consider a mechanism that may affect the timing, nature, and impact of future policy initiatives: the emergence of new faces in key political positions.

Krueger and Walker (2008) note that when new faces that emerge in a state's main political posts, more uncertainty is created for market participants when assessing the possibility of policy change and the likelihood that newly adopted policies will be successfully and promptly

[15] Entropy balancing is a relatively new matching technique designed to achieve covariate balance between treatment and control groups through a reweighting process such that the distributional properties of treatment and control observations are virtually identical (Jacob et al., 2018; Chapman et al., 2019). Diagnostic tests of entropy balancing are presented in Section A3 of the Internet Appendix.

[16] First-stage results are presented in Section A2.1 of the Internet Appendix. Our first instrument, *Industry-Year Average CPS*, is defined as the percentage of politically connected firms within each industry after exclusion of the focal firm. The selection of this instrument is motivated by Agrawal and Knoeber (2001), who find that firms from different industries have different incentives to build political connections. In addition, Hersch and McDougall (2000) show that the political activity of rival firms affects a firm's decision to spend likewise. Our second instrument, *Distance*, is defined as the distance between a firm's headquarters and Washington DC. Houston et al. (2014) argue that firms that are close to Washington may have better opportunities to engage in corporate political activism. Our third instrument, *State-Level Voter Turnout*, is calculated as ballots counted divided by the voting-eligible population for general elections. The selection of this instrument is motivated by Heese et al. (2017), who argue that it can be a proxy for a state population's political engagement, and is thus likely to be related to the political connectivity of a given firm.

implemented. In addition, high turnover rates among local politicians erode familiarity and weaken the ties between politicians and firms, thus compromising the effectiveness of existing corporate political strategies. Therefore, high rates of local politician turnover can be regarded as another indicator of increased policy uncertainty.

We identify influential local politicians by focusing on the role of Congressional committees and the importance of their chairmens' agenda-setting powers, because the latter have considerable discretion as to the outcome of the legislative process (e.g., Roberts, 1990). We predict that a change in chairmanship of an influential committee involving a politician from a given state may have implications for firms located in that state. Specifically, we anticipate that apart from making it more difficult to predict future policy changes, a new chairmanship for a home-state politician may be negatively perceived by IPO investors, because Cohen et al. (2011) show that chairmen of important committees earmark public spending for their home states, crowding out private investment. To test for such effects, we follow Gross et al. (2016) and for each fiscal year and state we build a dummy variable, *Chairmen Change*, that indicates whether or not there has been a change in the number of influential Congressional committee members from that state in that year (Stewart, 2012). In Table 6, we combine this political turnover variable with the PAI and find that the resulting interaction variable is positively related to underpricing, which is consistent with our expectations.

Another mechanism that may shape the impact of political innovations lies in the introduction of new items to the political agenda. We measure the intensity of the federal legislative activity of home-state politicians, that is, 'local' politicians that serve in the Senate and House chambers of the U.S. Congress (home-state politicians in the federal government), by considering the natural logarithm of the number of bills they introduced in Congress over the quarter preceding IPO (*No. of Bills*). An increase in the intensity of federal legislative activity leads to more policy change, which

in turn injects fresh uncertainty into the business environment.[17] Because the legislative efforts of influential politicians are mainly directed toward their home constituents, we expect that the policy uncertainty induced by such legislative interventions will be more pronounced in states with higher alignment with the ruling party. In Table 6, we combine the *No. of Bills* with *PAI* and find that the resulting interaction variable is positively related to underpricing, which is line with our expectations. Overall, Table 6 confirms our assertion that the effect of the PAI measure on underpricing is rooted in political uncertainty.

6.3 The Role of a Firm's Geographic Scope of Operations

Because the PAI is a geography-based measure, it is pertinent to examine how its impact on underpricing varies with factors that shape a firm's exposure to local exogenous shocks. If the PAI is a valid measure of local policy risk, its effect on underpricing should be more pronounced in firms with more geographically concentrated operations. To examine this conjecture, we consider three proxies of business diversification: (i) the degree of business concentration (*Concentration*), (ii) the ratio of international to total sales (*International Sales*), and (iii) the number of geographic segments in which the firm operates (*Segments*). We expect that firms with activities concentrated within a state, a lower proportion of foreign sales, and/or a business portfolio with relatively low levels of geographical diversification will be more exposed to local shocks arising from political innovations and, hence, be subject to greater local policy risk. The significant coefficients of the interactions with the PAI of these three proxy measures, shown in Panel A of Table 7, support our conjectures.

6.4 Industry and State Infrastructure

[17] In Tables IA3 and IA4 of the Internet Appendix, we take a closer look at the interplay between the PAI and Congressional activities by focusing on two crucial aspects of lawmaking: the intensity and the complexity of the legislative process. We sort states into quartiles based on the time-series changes in the PAI (and ΔPAI) and compare the federal legislative activities of politicians from these states that serve in the Senate and House chambers of the U.S. Congress. We find that politicians from states that become more aligned with the presidential party introduce and pass more bills in Congress, which is indicative of their influence on the legislative process.

Another way to test whether PAI-related government intervention is beneficial or harmful for IPO issuers is to explore the role of PAI in politically sensitive industries (PSIs). PSIs are defined as those more likely to face regulatory changes that affect the business operations and corporate decisions of the firms involved.[18] Julio and Yook (2012) and Jens (2017) show a pronounced negative effect for political risk on corporate investment within PSIs. Boutchkova et al. (2012) further demonstrate that equity return volatility is greater in industries that are sensitive to political shocks. We extend this line of reasoning by stating that the effect of the PAI on IPO pricing may be more pronounced for firms operating in industries vulnerable to regulatory change, because such firms may be subject to more policy interventions (Kostovetsky, 2015).

In a similar vein, we identify politically sensitive states as those areas that are prone to political interference, because they attract the lion's share of government spending. In this case, we claim that the influence of PAI could be partially driven by a state's dependency on government spending (SDGS) that tilts toward particular industries and geographic areas. Following Aabo et al. (2016), we measure the SDGS of each state using the concentrations of the state's firms in key industries such as energy, high-tech, health, defense, and construction.[19]

Alternatively, we can argue that government intervention is more severe for firms located in areas that are subject to weak institutional constraints (see, for example, Shleifer and Vishny, 1994, 1998). Arguably, low institutional quality will not be very effective in discouraging or mitigating any disproportionate impact from partisan political interventions. In this respect, we posit that if regulatory initiatives inject uncertainty into the business environment, the ability of federal politicians to (adversely) affect the local economic environment will be more pronounced in areas with lower institutional quality. To operationalize institutional quality, we use the state economic

[18] Specifically, we define firms operating in the Tobacco Products, Pharmaceuticals, Healthcare Services, Defense, Petroleum and Natural Gas, Telecommunications and Transportation industries as politically sensitive, where the identification is based on the Fama-French 48-industry classification scheme (Jens, 2017). We create a dummy variable that takes a value of 1 for firms that operate in one of these politically sensitive industries (and 0 otherwise).

[19] A modified 11-industry classification is used to classify firms for this purpose (Aabo et al., 2016). The concentration is measured on the basis of the amount of sales.

freedom (EF) index from the Fraser Institute. Higher values of economic freedom translate into a better state political and economic infrastructure, which implies that firms in such states are subject to less market friction, such as excessive government intervention or regulatory burdens. In this respect, we expect that the PAI effect on IPO initial returns will be weakened for firms located in states with high EF indices.

Panel B of Table 7 presents our findings on the mediating role of industry and state factors. Specification (1) considers the interaction of the PAI with *PSI* and indicates that the PAI effect on underpricing is stronger when firms operate in politically sensitive industries.[20] Specifications (2) and (3) consider the interactions of the PAI with *SDGS* and *EF*, respectively, and demonstrate that in states characterized by high government dependence or low institutional quality, the relationship between policy risk and initial aftermarket returns is strengthened.

7. Selection-bias Concerns

In this section, we address concerns associated with the potential endogeneity surrounding the decision to go public, the location of a firm's headquarters, the timing of the issuance, and local sentiment. If these factors are related to time-series variations in the proximity of local firms to political power, the estimated relationship between the PAI and underpricing could be spurious.

7.1 Selection Bias Associated with the Choice of Headquarters Location

A potential concern is that our results might be driven by a firm's deliberate choice of its headquarters location. It might be, for instance, that if particular states exhibit high persistence in their PAI values (low historical time-series variability), an IPO issuer might observe such historical patterns of partisan alignment at the state level and formulate its decision about the location of its headquarters accordingly.

[20] In Section A4 of the Internet Appendix, we show that the politically sensitive industries that drive our results are the following: Pharmaceuticals, Healthcare Services, and Petroleum and Natural Gas.

We initially evaluate the validity of this conjecture by examining whether there is sufficient variation in the level of the PAI itself. Figures 1 to 12 in the Internet Appendix show that there is a great deal of movement in the PAI as the political map changes, exhibiting substantial fluidity over our sample period. This observation supports the notion that the PAI is a good measure of policy risk because it reflects shifts in political power across location and time. As such, it is unlikely that a lack of within-state time-variation in the PAI is driving our results. To further support this conclusion and to examine whether the IPO decision is affected by particular patterns of PAI variation, we combine the PAI with *PAI Persistence* and evaluate whether the resulting interaction variable loads significantly on underpricing. Table 8 shows that the interactive effects across all PAI variants are not statistically significant.

7.2 Selection Bias Related to the Decisions of Whether/When to Go Public

Another concern that might undermine our inferences is that the PAI does not only affect IPO pricing but also the decisions regarding whether and when to go public. If this is so, the IPO location and timing choices are first-order decisions and the impact of the PAI on underpricing is a second-order effect. As argued in the previous section, we believe that it is unlikely that the PAI systematically affects the headquarters location or the going-public decisions because it is highly unpredictable across states and regions. This makes it difficult for IPO issuers to decide whether/when/where to go public on the basis of an anticipated level of local political proximity. In fact, Panel A of Table 9 shows that there is no meaningful relationship between the PAI and IPO activity (number of IPOs) at the state level.

An alternative explanation that could drive our results is that variation in the PAI may not just capture exposure to local policy risk due to political alignment, but reflects other factors too, such as differences in IPO characteristics caused by local IPO waves or the timing of an IPO issuance date in the context of a rising IPO cycle. Yung et al. (2008) document that hot markets increase the temptation of bad firms to pool (cold markets decrease it). Thus, if variation in the PAI coincides

with or affects changes in local IPO activity (number of IPOs), then its effect on underpricing should be partially driven by differences in corporate quality. Likewise, Çolak and Günay (2011) show that, due to strategic waiting, the average corporate quality is lower during the early stages of an expanding IPO cycle than in its later stages. Based on this finding, we expect that if firms time the IPO issuance date on the basis of public information (which includes the degree of political alignment), then the PAI's effect on underpricing might reflect differences in the risk-based composition of IPO issuers rather than their exposure to policy risk.

In Panel A of Table 9, we investigate whether the PAI is related to the number of days between an IPO and the start of a rising IPO cycle (S*trategic Waiting Days*).[21] The results reveal a significant relation between the PAI and the IPO cycle, which suggests that although the PAI might influence the clustering within the type of firms going public in a particular state, it does not affect the number of firms doing so (*Past IPO Activity*). Hence, it is possible that the effect of the PAI on IPO underpricing is driven by this form of selection bias rather than by policy risk. However, when we consider the interaction of the PAI with *Past IPO Activity* and *Strategic Waiting Days* (see Panel B of Table 9), we find that the effect of the PAI is not significantly explained by these factors. This suggests that selection bias associated with IPO timing is not a significant concern in our analysis.

8. Further Analyses

In this section, we conduct several robustness tests to explore whether and how policy risk might affect the information production process during IPO roadshows. We also examine whether alternative explanations, such as investor optimism, drive our results. Further, we study the extent to which our results might be explained by particular states or time periods.

[21] In modelling IPO volumes for this context, we follow Çolak et al. (2017) and include as controls the following variables: lagged state GDP growth rate; lagged state personal income; lagged state unemployment rate; the previous year's number of IPOs; the 1-year lagged market (S&P 500 index) return; the 1-year lagged long-term interest rate of Treasury bonds; the 1-year lagged total capacity utilization rate compiled by the Federal Reserve Bank. We also include a hot-IPO market dummy as in Yung et al. (2008), as well as state fixed effects to control for the differences in IPO volumes across states.

8.1 Additional Tests and Alternative Explanations

In the Internet Appendix, we investigate whether the PAI affects the bookbuilding process. Our analysis reveals that firms exposed to high policy risk tend to offer conservative initial price estimates and are associated with more valuation difficulties in the pre- and post-IPO periods, as indicated by the positive links between the PAI and underwriter fees and stock turnover. In addition, we explore whether the influence of PAI-related policy risk is rationally priced in by IPO investors. If investors misunderstand the policy risk implications of political alignment, the value of IPOs should not be the equal of their equilibrium level in states with high PAI values. This suggests that the ratio of the offer price or the first closing market price to its fair value (based on comparably seasoned firms, *as per* Purnanandam and Swaminathan, 2004) should have a significant relationship with the PAI. However, when we replace IPO underpricing with this ratio we do not observe this significant relationship (Table IA10). Furthermore, Table IA14 shows that local policy risk exacerbates agency problems between IPO issuers, VCs and prestigious underwriters, because it brings about a deterioration in the firm's information environment and facilitates opportunistic behavior by agents with ulterior motives (Chang et al., 2017).

8.2 Time Varying Effect of PAI on IPO First-Day Returns

The bulk of the literature on the effect of political environment on firms focuses on quasi-experimental settings, and particularly, on U.S. election events, as a source of exogenous variation of political uncertainty (see, for example, Julio and Yook, 2012; Gao and Qi, 2013). However, another source of exogenous variation in political risk can be traced to shifts in political geography (Kim et al., 2012; Antia et al., 2013; Kostovetsky, 2015; Addoum and Kumar, 2016). Since such shifts stem from the dynamism in the political landscape that occurs after presidential or general elections, we conjecture that the effect of PAI on IPO underpricing may depend on various political outcomes. To investigate this possibility, we explore the PAI impact across three aspects of the political cycle (election vs. non-election years, Democratic vs. Republican presidencies, and President change) and

two proxies of political discretion (President control in Congress and the Presidential margin of victory).

The evidence in Panel A of Table 10 provides some support to the hypothesis that the PAI effect becomes stronger in periods preceding elections (election years) and abates thereafter. This finding is consistent with the idea that shifts in political power around (presidential) election are associated with a resolution of some uncertainty (who is going to be elected or which policies are going to be implemented) or the notion that policy interventions become more prevalent at the end of presidential tenures. The sample partitioning between Democratic and Republican presidencies shows that the PAI effect is significant during both of these periods. However, the PAI coefficient seems to be stronger during Democratic presidencies; this observation is reinforced by the PAI x Democrats interactive effect. A stronger PAI coefficient when the President is a Democrat indicates easier federal policy implementation at the state level (and hence greater probability of policy change) because of the greater political alignment during Democratic presidencies (see Table 2). Alternatively, one could attribute this finding to the fact that Democratic (Republican) administrations promote less (more) business friendly policies. Finally, the PAI coefficient is higher when there is no change in the presidency (after elections).

In Panel B of Table 10, we explicitly consider factors that might affect the likelihood of policy change after elections. Theoretical and empirical work (e.g., Fowler, 2006) suggests that winning parties have more leeway to propose and implement more extreme versions of their political agenda during periods of unified governments and after an election if they win with a wide margin. This implies that when the President controls both chambers of the congress or when the margin of victory (for either party) increases, there will be greater policy uncertainty. If investors expect this, then the PAI effect on underpricing should be more pronounced in such cases. The evidence in Panel B reveals a positive interactive effect between PAI and *President control* or the *Low margin of*

victory (*Presidential margin of victory)*. However, only the former is statistically significant. Hence, our results provide some empirical support to the above policy risk predictions.

8.3 Dominant States and Time Trends

Table 1 shows that a large proportion (~29%) of our sampled IPOs are from California. That state is also associated with a high PAI value (0.53, versus an average across states of 0.50) and higher levels of underpricing (24.42%, versus an average across states of 18.73%). Sections A8 and A9 of the Internet Appendix show that our baseline results are not sensitive to the inclusion/exclusion of influential states (having high IPO volumes) or to alternative fixed effects specifications (Table IA15).

Furthermore, Figure 14 indicates that there are significant time-based trends in both underpricing and the PAI, because they experience a huge uptick around the turn of the century. This suggests that our results could be driven either by particularly influential states and/or by certain time periods. In Panel C of Table 10, we re-estimate our baseline regression before and after the stock market bubble. An inspection of columns (1) and (2) reveals that the coefficient of PAI is significant in both sub-periods. However, its effects is economically stronger after the dot-com bubble, given that average underpricing decreases after the bubble period, it is unlikely that our PAI-underpricing is driven by time-trends.

9. Long-term Implications of the PAI

The analyses thus far demonstrate that, as with any form of ambiguity, political interventions induced by greater alignment of home state politicians with the ruling party increase the risk of holding financial claims in firms' assets. However, it is not clear whether this impact extends beyond the first trading day, nor is it clear precisely how the PAI adversely affects IPO issuers. In this section, we attempt to shed light on these questions by examining a comprehensive set of outcomes in the post-IPO period.

9.1 Secondary Market Volatility

Our central finding is that a higher PAI value is associated with a higher initial return, thereby serving as a potential indicator of *ex ante* uncertainty about an IPO's valuation. This finding is also consistent with a number of theories suggesting that underpricing constitutes an efficient response to the complexity of the valuation problem (Ritter, 1984; Welch, 1992), because it enables issuers to mitigate information asymmetry in the context of the markets' aggregate demand for a firm's shares (Rock, 1986; Beatty and Ritter, 1986).

However, as Lowry et al. (2010) note, the initiation of trading does not necessarily result in the elimination of an investor's policy-related adverse selection costs. One reason for this is that corporate insiders may, rationally, avoid revealing their superior (private) information about how future government actions may affect the prospects of their firm, especially in areas exposed to greater policy risk. Alternatively, it may be hypothesized that at the time of the IPO, neither investors nor issuers are fully knowledgeable about the nature, timing, and impact of future government actions. Based on this logic, we anticipate that, as long as political proximity is associated with possible future policy changes, it will adversely affect the precision of the price-setting process beyond the first trading day (Yung et al., 2008). To test this conjecture, we explore the extent to which the effect of the PAI is associated with the magnitude and persistence of idiosyncratic volatility in secondary stock returns.

Panel A of Table 11 demonstrates that idiosyncratic volatility is higher for firms with greater alignment with the federal government. This relationship seems to hold for the first year after the initiation of trading, which is consistent with the notion that investors do, indeed, need some time to observe and understand the post-IPO effect of policy changes on firms.

9.2 Real Investment Decisions

Apart from the well-documented adverse financial effects of policy risk, there is ample evidence that policy uncertainty also has real investment implications (see, for instance, Gulen and

Ion, 2016; Bhattacharya et al., 2017; Jens, 2017). This line of research suggests that, either because of the higher discount rate associated with policy uncertainty or because of investment irreversibility, firms anticipating policy-related shocks tend to delay investment in order to limit their exposure to downside risk. However, regardless of the policy changes, the policy uncertainty that is associated with policy changes would create incentives for firms to underinvest for several reasons. First, the expected policy outcomes could heterogeneously affect the attractiveness of different investment opportunities, thereby distorting the allocation of spending across these alternative investment opportunities (Julio and Yook, 2012). Second, since policy uncertainty would disrupt their external financing and create financial constraints (Gungoraydinoglu et al., 2017), the firms would have a preference for less risky investments (Almeida et al., 2011), which reduces the total investment they would actually make.

Taken together, the above arguments suggest that firms located in areas with high PAI values may find it advisable to reduce investment expenditures until the associated uncertainty is resolved. We investigate the validity of this argument by focusing on the relationship between the PAI and investment expenditures in the years after IPO. As shown in Panel B of Table 11, the coefficient for *PAI* is negative and significant irrespective of whether the nature of the investment projects is organic (capex and/or R&D) or inorganic (acquisitions). This result reinforces our main hypothesis that firms located in areas of the political map that are closely associated with the President face greater policy-related uncertainty.

9.3 Post-IPO Operating Performance and Survival

Our final set of tests is concerned with post-IPO operating performance and the probability of survival (i.e., the ability to operate as an independent organization) in the stock market. Previously, we found that high PAI values undermine the ability of IPO issuers to raise capital, distort the post-IPO information environment, and disrupt a firm's regular planned investment activities. Hence, one might argue that the cumulative effect of the PAI on future performance can be quite substantial. To

test this conjecture, we consider four performance metrics: return on assets (ROA); cash ROA, to account for the confounding effect of accruals; Tobin's Q, to capture the market's perception of a firm's ability to expand and to capitalize future investment opportunities; IPO failure (defined as the incidence of delisting for negative reasons or acquisition), which is arguably the ultimate measure of performance (Welbourne and Andrews, 1996; Audretsch and Lehmann, 2005).[22]

Panel C of Table 11 shows that when an OLS specification is applied, Tobin's Q and both ROA measures are negatively related to the PAI. To assess the survivability of IPO issuers we use survival and hazard functions (Jain and Kini, 2000; Gounopoulos and Pham, 2018). To this end, we employ Cox (1972) proportional hazards and accelerated failure time (AFT) models in preference to OLS and binary dependent variable models because the IPO data are right-censored, with many firms that went public still trading (Demers and Joos, 2007), and because these models allow us to take into account the length of time that a company survives. In the Cox model, the dependent variable is failure risk (a value of 1 is assigned if a firm is delisted within five years of its IPO), while in the AFT model it is the natural logarithm of the survival time (in months).

Panel D of Table 11 shows the results of the survival analysis. Column 1 assesses the impact of the PAI using the Cox model and documents a strong and significant positive coefficient for political alignment. Similarly, Column 2 assesses the impact of the PAI using the AFT method and suggests a shorter survival time in the period following their offering for firms operating in states with higher PAI values. In short, we confirm our prediction that IPOs originating from a state that is characterized by high policy risk face a higher probability of failure.

10. Conclusion

[22] It should be noted that the time horizon for which we examine the survival of each firm after its issuance is five years; therefore, our sample period spans 1996 to 2012. Tracking for five years after the issue date, 23.96% of the firms survived, and 76.04% failed either due to voluntary (49.16% were acquired) or involuntary (26.88% were dropped) delisting. However, delisting due to a merger or acquisition (M&A) does not necessarily represent failure because a firm may become a target for such due to its unique competitive advantages. Given this ambiguity, we classified M&As as survivors too. This approach did not alter our inferences about the relationship between the PAI and IPO survival.

We analyze how policy uncertainty induced by concentration of political power affects the ability of IPO issuers to raise capital. We operationalize the associated political uncertainty by focusing on the structure of the U.S. political system as reflected in the PAI measure developed by Kim et al. (2012). This measure captures the degree of political alignment of leading local politicians with the ruling party. Given that politicians from states that are more aligned with the presidential party are better positioned to implement a partisan political agenda, we consider such political proximity as a major source of policy risk. During political alignment periods between local and federal lawmakers, there are more legislative proposals and such a heavy legislative agenda injects more uncertainty to the local economy. We document a strong positive relationship between the PAI and levels of IPO underpricing, which supports the idea that such a political alignment commands a risk premium in the IPO market.

To investigate the degree to which the negative effect of policy uncertainty on IPO success varies in the cross-section, we analyze how firms respond to policy risk. We find that political connections, established either through contributions to PACs or through lobbying activities, act as effective tools for hedging the exposure to local policy risk. Another dimension of cross-sectional heterogeneity that we explore is the uncertainty about the timing, nature, and impact of future policy changes. Treating political turnover and the intensity of legislative activity as two major sources of policy risk, we find that they amplify the effect of the PAI on underpricing. We also document that the positive impact of the PAI on IPO underpricing is stronger among firms with geographically concentrated operations, and/or in industries or states that are vulnerable to government interventions.

Overall, our study has three important implications. First, it suggests that when formulating policy decisions, regulators should be mindful of the fact that uncertainty surrounding this process can be as damaging as making the wrong decision. Second, it indicates that in assessing the role of the political environment, one should be aware that the impact of policy-related risk on corporations

depends crucially on the political and regulatory framework of the states and industries in which firms operate in. Third, local policy risk can have long-lasting effects, negatively impacting the investment, profitability, and survival rate of IPO firms.

Acknowledgments

We are grateful to Daniella Acker, Pat Akey, Carol Alexander, Vladimir Atanasov, Wolfgang Aussenegg, Sonny Biswas, Alice Bonaime, Sabri Boubaker, Daniel Bradley, Thomas Chemmanur, Ephraim Clark, Mark Clatworthy, Douglas Cumming, Viet Dang, Susanne Espenlaub, Marc Goergen, Paula Hill, Balint Horwath, Tim Jenkinson, Ranko Jelic, Andreas Kaeck, Kirak Kim, Piotr Korczak, Timo Korkeamaki, Roni Michaely, Vikram Nanda, David Newton, Neslihan Ozkan, Christos Pantzalis, Jung Chul Park, Pietro Perotti, Jay Ritter, Mariano Scapin, Ben Sila (FMA Discussant), Anh Tran, David Storey, Laura Wellman, Mike Wright, Fangming Xu, and Liyi Zheng. This research is supported in part by KBS Faculty Seed Funding from the University of Limerick. We would like to thank the seminar participants from the Universities of Aberdeen, Bristol, and Hanken School of Economics as well as participants at the 2019 Panorisk (Angers) 2019, Financial Management Association (FMA, Glasgow), 2018 Irish Accounting and Financial Association (IAFA), the 2018 European Accounting Association (EAA) Conference, the 2018 Young Finance Scholar (YFS) Conference 2018, the World Finance Conference (Mauritius, 2018) and the EAA Talent Workshop 2018 for their helpful comments. Special thanks go to Jonathan Berk for his useful comments and suggestions. This paper is the recipient of the Best Paper Award at the 2018 Young Finance Scholar Conference in Brighton.

Appendix A: Definitions of Variables

Variable	Definition
	Panel A: IPO Pricing
Underpricing	The difference between the first secondary market closing price available in CRSP and the IPO offer price, divided by the IPO offer price.
IPO Revision	It is equal to the ratio of difference between the offer price and the mid-point of the price range over the latter.
Market Heat	It is defined as the moving average MA(4) of the number of IPOs in each state-quarter divided by its corresponding sample average.
Past IPO Activity	It is defined as the number of IPOs which is measured by state-year.
Strategic Waiting Days	The number of days between an IPO and the start of a rising cycle. Following Çolak and Günay (2011), the rising cycle is measured as the period in which the moving average of the quarterly IPO issuance observations has risen for at least three back-to-back quarters.
	Panel B: Firm and IPO Characteristics
Firm age	The number of years elapsed between a firm's foundation and IPO date, using foundation dates from the Thomson Financial database as well as from the Field-Ritter dataset. The variable is transformed into the regressions by adding 1 and taking the natural logarithm.
VC	Dummy variable set to 1 for venture-capital-backed firms, and 0 otherwise.
Size	The natural logarithm of total assets in the fiscal year prior to IPO.
Proceeds	The natural logarithm of gross proceeds raised by the IPO, estimated as shares offered times the offer price.
International Sales	It is the ratio of international sales to total sales in the year prior to the IPO.
Segments	The number of a firm's geographic segments.
Overhang	The ratio of shares retained by the pre-IPO shareholders to shares issued in the offering.
Underwriter	Dummy variable set to 1 for the most prestigious underwriters, and 0 otherwise. The most prestigious underwriters are those with a ranking score of 9.0 or above according to Jay Ritter's underwriter (prestige) rankings.
Internet	Dummy variable set to 1 for IPOs of Internet firms, and 0 otherwise. Internet firms are classified as those with business descriptions containing any of the words "Internet", "Online", eBusiness", "eCommerce", and "Website".
Technology firm	Dummy variable set to 1 for IPO firms with SIC codes 3571, 3572, 3575, 3577, 3578 (computer hardware), 3661, 3663, 3669 (communications equipment), 3671, 3672, 3674, 3675, 3677, 3678, 3679 (electronics), 3812 (navigation equipment), 3823, 3825, 3826, 3827, 3829 (measuring and controlling devices), 3841, 3845 (medical instruments), 4812, 4813 (telephone equipment), 4899 (communications services), and 7371, 7372, 7373, 7374, 7375, 7378, and 7379 (software); 0 otherwise.
Nasdaq	Dummy variable set to 1 for NASDAQ-listed IPOs, and 0 otherwise.
R&D	The ratio of total research & development expense to total sales in the fiscal year prior to the IPO
Leverage	The ratio of total liabilities over total assets in the fiscal year prior to IPO.
EPS	Dummy variable set to 1 for positive earnings per share in the fiscal year prior to IPO, and 0 otherwise.
ROA	Ratio of net income to total assets in the fiscal year prior to the IPO.
Cash ROA	Ratio of cash flows to total assets in the fiscal year prior to the IPO.
Tobin's Q	The ratio of market value of assets to book value of assets.
Total Investment	The sum of capital expenditures, R&D expenditures, and acquisition expenses, divided by the lagged value of total assets.
Organic Investment	The sum of capital expenditures and R&D expenditures, divided by the lagged value of total assets.
Inorganic Investment	Acquisition expenses divided by the lagged value of total assets.
Market Return	The compounded daily return on CRSP value-weighted index over the 20 trading days trailing the IPO.
	Panel C: State-Level Characteristics
Unemployment Rate	The state annual unemployment rate from the Federal Reserve Economic Data (FRED).
Real GDP Gr. Rate	The annual state GDP growth rate using state GDP (in 2009 dollars) from the Federal Reserve Economic Data (FRED).
Personal Income	The natural logarithm of the annual state personal income from the Bureau of Economic Analysis (BEA).
Concentration	We measure the degree of a firm's geographic dispersion using a normalized Herfindahl-Hirschman Index (HHI) based on the state citations where the firm has headquarters (this information is collected from IPO prospectuses using a web-crawling algorithm) (following Platikanova and Mattei, 2016). The index ranges from zero to one, where the lower values indicate higher levels of geographic dispersion across different states. The index takes value 1 if the firm's business is concentrated solely at the headquarters location. High Concentration is a dummy variable that takes the value of 1 if a firms' HHI index is above the sample median
	Pane D: Political and Other Variables
PAI	The Political Alignment Index developed by Kim et al. (2012) is used as the main proxy for policy risk: PAI = (1/4)*Senators + (1/4)*Representatives + (1/4)*Governor + (1/4)*[(1/2)*State Senators + (1/2)*State Representatives]
State PAI	The first variant of PAI: State-PAI = (1/2)*Governor + (1/2)*[(1/2)*State Senators + (1/2)* State Representatives]
Federal PAI	The second variant of PAI: Federal-PAI = (1/2)*Senators + (1/2)*Representatives
Regional PAI	The fourth variant of PAI: it is computed after averaging the PAI values across all states in a particular geographic region (Northeast, South, Midwest, and West). Geographic regions are defined in Note 6.
PAI Persistence	It is defined as the inverse of the rolling standard deviation of PAI within a state. We utilize all observations up to the most recent fiscal year but require a minimum of five year observations.
Federal PAI Persistence	It is defined as the inverse of the rolling standard deviation of Federal PAI within a state utilizing all observations up to the most recent fiscal year but requiring a minimum of five year observations.

State PAI Persistence	It is defined as the inverse of the rolling standard deviation of State PAI within a state. We utilize all observations up to the most recent fiscal year but require a minimum of five year observations.
Regional PAI Persistence	It is defined as the inverse of the rolling standard deviation of Regional PAI within a state. We utilize all observations up to the most recent fiscal year but require a minimum of five year observations.
ΔPAI	The annual change in PAI.
Federal ΔPAI	The annual change in Federal PAI.
State ΔPAI	The annual change in State PAI.
No. of Bills	The natural logarithm of the number of bills introduced in Congress by home-state politicians over the quarter preceding IPO.
EPU	The monthly Economic Policy Uncertainty (*EPU*) index constructed by Baker et al. (2016). The data for the EPU index can be accessed at http://www.policyuncertainty.com.
PCI	Partisan Conflict Index constructed by Azzimonti (2018).
CPS	Dummy variable set to 1 for IPOs with lobbying and/or PAC contributions, and 0 otherwise.
Chairmen Change	Dummy variable set to 1 if a firm has been exposed to a relevant change in chairmanship on any of the House or Senate Committees, and 0 otherwise (following Gross et al., 2016). We obtain data on the composition of Congressional committees from Charles Stewart's website (http://web.mit.edu/17.251/www/data_page.htm) and follow Stewart (2012) in identifying the ten most influential committees. As in Gross et al. (2016), at the end of each month, we identify all chairmen and ranking minority members with considerable influence in House and Senate committees. Data on chairmen changes are available until 2017.
Politically Sensitive Industries (PSI)	It is a dummy variable set to 1 for firms that operate in one of the following industries: Tobacco Products, Pharmaceuticals, Healthcare Services, Defense, Petroleum and Natural Gas, Telecommunications and Transportation where the industry classifications are based on Fama-French 48 industries (following Kostovetsky, 2015 and Jens, 2017)
State's Dependency on Government Spending (SDGS)	It is defined as the concentration of the state's firms in the beneficial industries including energy, high tech, health, defense, and construction. The modified 11-industry classification is used to classify firms.
Economic Freedom (EF)	The index of Economic Freedom captures the likelihood of government interference and is extracted from the Fraser Institute (http://www.freetheworld.com). This index is constructed to capture three main elements: the size of government of a state, its discriminatory taxation, and its regulation. By definition, a higher degree of economic freedom is inversely related to the size, and regulatory intervention of local governments, which, in turn implies a lower ability for politicians to shape the broader environment in which the firm operates. Economic Freedom is not available for 2018. In this case, we run our models for the time period 1994-2017.
Democrats	It is a dummy variable equal to one if the IPO firm is issued under a Democratic administration, and zero otherwise.
President Control	It is an indicator variable which is one if both Chambers in Congress (Senate and House) are controlled by the President, and zero otherwise.
President Change	It is a dummy variable that takes one during the first two-years of a new President, and zero otherwise.
Election Year	It is a dummy variable which is equal to one for the Presidential election years, and zero otherwise.
Presidential Margin of Victory	It is the state-level difference in the percentage of votes received by the winning candidate from the percentage of votes in the presidential elections by her opponent (Julio and Yook, 2012; Jens, 2017).
High Margin of Victory	It is a dummy variable equal to one if the difference in the percentage votes is in the highest tercile of the presidential vote differential.
Low Margin of Victory	It is a dummy variable equal to one if the high margin of victory is equal to zero.
Pane E: IPO Survival	
Failure	Dummy variable set to 1 if the firm is delisted within five years of its IPO, and 0 otherwise.
Survival Time	The natural logarithm of the time to delist (survival time) which is measured in months.

References

Aabo, T., Pantzalis, C., and Park, J. C. 2016. Political Interference and Stock Price Consequences of Local Bias. The Financial Review 51, 151-190.

Addoum, J., and Kumar, A. 2016. Political Sentiment and Predictable Returns. Review of Financial Studies 29(12), 3471-3518.

Agrawal, A., and Knoeber, C. 2001. Do Some Outside Directors Play a Political Role? Journal of Law and Economics 44(1), 179-198.

Alesina, A., and Drazen, A. 1991. Why are Stabilizations Delayed? American Economic Review 81(5), 1170-1188.

Alesina, A., and Rosenthal, H. 1995. Partisan Politics, Divided Government, and the Economy. Cambridge University Press.

Almeida, D., Campello, M., and Weisbach, M. 2011. Corporate Financial and Investment Policies When Future Financing is Not Frictionless. Journal of Corporate Finance 17, 675-693.

Amore, M., and Minichilli, A. 2018. Local Political Uncertainty, Family Control, and Investment Behavior. Journal of Financial and Quantitative Analysis, 1-24.

Anderson, W., Box-Steffensmeier, and Sinclair-Chapman, V. 2003. The Keys to Legislative Success in the U.S. House of Representatives. Legislative Studies Quarterly 28(3), 357-386.

Antia, M., Kim, I., and Pantzalis, C. 2013. Political Geography and Corporate Political Strategy. Journal of Corporate Finance 22, 361-374.

Audretsch, D., and Lehmann, E. 2005. Does the Knowledge Spillover Theory of Entrepreneurship Hold for Regions? Research Policy 34(8), 1191-1202.

Azzimonti, M. 2018. Partisan Conflict and Private Investment. Journal of Monetary Economics. Forthcoming.

Baker, S.R., Bloom, N., and Davis, S.J. 2016. Measuring Economic Policy Uncertainty. The Quarterly Journal of Economics 131(4), 1593-1636.

Bhattacharya, U., Hsu, P.-H., Tian, X., and Xu, Y. 2017. What Affects Innovation More: Policy or Policy Uncertainty? Journal of Financial and Quantitative Analysis 52(5), 1869-1901.

Beatty, R., and Ritter, J. 1986. Investment Banking, Reputation, and the Underpricing of Initial Public Offerings. Journal of Financial Economics 15(1-2), 213-232.

Beck, R., Hoskins, C., and Connolly, J. M. 1992. Rent Extraction through Political Extortion: An Empirical Examination. Journal of Legal Studies 21, 217-224.

Benveniste, L., and Spindt, P. 1989. How Investment Bankers Determine the Offer Price and Allocation of New Issues. Journal of Financial Economics 24, 343-361.

Bernstein, S. 2015. Does Going Public Affect Innovation? Journal of Finance 70(4), 1365-1403.

Bloom, N. 2014. Fluctuations in Uncertainty. Journal of Economic Perspectives. American Accounting Association 28(2), 153-176.

Bonaime, A., Gulen, H., and Ion, M. 2018. Does Policy Uncertainty Affect Mergers and Acquisitions? Journal of Financial Economics 139(3), 531-558.

Boutchkova, M., Doshi, H., Durnev, A., and Molchanov, A. 2012. Precarious Politics and Return Volatility. Review of Financial Studies 25(4), 1111-1154.

Bradley, D., Pantzalis, C., and Yuan, X. 2016. Policy Risk, Corporate Strategies, and the Cost of Debt. Journal of Corporate Finance 40(8), 254-275.

Brav, A., and Gompers, P. 1997. Myth or Reality? The Long-Run Underperformance of Initial Public Offerings: Evidence from Venture and Nonventure Capital-Backed Companies. Journal of Finance 52(5), 1791-1821.

Brogaard, J., and Detzel, A. 2015. The Asset Pricing Implications of Government Economic Policy Uncertainty. Management Science 61(1), 3-18.

Butler, A. Keefe, M. O., and Kieschnick, R. 2014. Robust Determinants of IPO Underpricing and their Implications for IPO Research. Journal of Corporate Finance 27, 367-383.

Butler, A., Fauver, L., and Spyridopoulos, I. 2019. Local Economic Consequences of Stock Market Listing. Journal of Financial and Quantitative Analysis 54(3), 1025-1050.

Buttonwood, 2013. Where Will the Boot Land Next? The Economist.

Cao, X., Lemmon, M., Pan, X., Qian, M., and Tian, G. 2019. Political Promotion, CEO Incentives, and the Relationship Between Pay and Performance. Management Science 65(7), 2947-3448.

Carter, R., Dark, F., and Singh, A., K. 1998. Underwriter Reputation, Initial Returns, and the Long-Run Performance of IPO Stocks. The Journal of Finance 53(1), 285-311.

Carter, R., and Manaster, S. 1990. Initial Public Offerings and Underwriter Reputation. Journal of Finance 45(4), 1045-1067.

Certo, S. T., Covin, J. G., Daily, C. M., and Dalton, D. R. 2001. Wealth and the Effects of Founder Management among IPO Stage New Ventures. Strategic Management Journal 22, 641-658.

Chahine, S., Çolak, C., Hasan, I., and Mazboudi, M. 2019. Investor Relations and IPO Performance. Review of Accounting Studies 25(2), 474-512.

Chang, C., Chiang, Y., Qian, Y., and Ritter, J. 2017. Pre-Market Trading and IPO Pricing. Review of Financial Studies 30(3), 835-865.

Chaplinksy, S., Hanley, K., and Moon, S. 2017. The JOBS Act and the Costs of Going Public. Journal of Accounting Research 55, 795-836.

Chapman, K., Miller, G., and White, H. 2019. Investor Relations and Information Assimilation. The Accounting Review 94, 105-131.

Chiang, Y.-M., Lowry, M., and Qian, Y. 2019. The Information Advantage of Underwriters in IPOs. Management Science 65(12), 5449-5956.

Cohen, L., Coval, J., and Malloy, C. 2011. Do Powerful Politicians Cause Corporate Downsizing? Journal of Political Economy 119(6), 1015-1060.

Cohen, L., Diether, K., and Malloy, C. 2013. Legislative Stock Prices. Journal of Financial Economics 110(3), 574-595.

Çolak, G., and Günay, H. 2011. Strategic Waiting in the IPO Markets. Journal of Corporate Finance 17 (3), 555-583.

Çolak, G., Durnev, A., and Qian, Y. 2017. Political Uncertainty and IPO Activity: Evidence from U.S. Gubernatorial Elections. Journal of Financial and Quantitative Analysis 52(6), 2523-2564.

Correia, M. 2014. Political Connections and SEC Enforcement. Journal of Accounting and Economics 57, 241-262.

Cox, D., 1972. Regression Models and Life-Tables. Journal of Royal Statistical Society (Series B) 34(2), 187-220.

Dambra, M., Field, L. C., and Gustafsan, M. T. 2015. The JOBs Act and IPO Volume: Evidence that Disclosure Costs Affect the IPO Decision. Journal of Financial Economics 116(1), 121-143.

Demers, E., and Joos, P. 2007. IPO Failure Risk. Journal of Accounting Research 45(2), 333-371.

Dolvin, S., and Jordan, B. 2008. Underpricing, Overhang, and the Cost of Going Public to Preexisting Shareholders. Journal of Business and Finance Accounting 35(3-4), 434-453.

Doidge, D., Karolyi, A., and Stulz, R. 2017. The U.S. Listing Gap. Journal of Financial Economics 123, 464-487.

Duchin, R., and Sosyura, D. 2012. The Politics of Government Investment. Journal of Financial Economics 106 (1), 24-48.

Faccio, M. 2006. Politically Connected firms. American Economic Review 96, 369- 386

Faccio, M., and Parsley, D. 2009. Sudden deaths: Taking Stock of Geographic Ties. Journal of Financial and Quantitative Analysis 44, 683-718.

Fama, E., and French, K. 2004. The Capital Asset Pricing Model: Theory and Evidence. Journal of Economic Perspectives 18(3), 25-46.

Fiorina, M. P. 1992. An Ear of Divided Government. Political Science Quarterly 107(3), 387-410.

Fowler, J.H. 2006. Elections and Markets: the Effect of Partisanship, Policy Risk, and Electoral Margins on the Economy. Journal of Politics 68, 89–103.

Füss, R., and Bechtel, M. 2008. When Investors Enjoy Less Policy Risk: Divided Government, Economic Policy Change and Stock Market Volatility in Germany, 1970–2005. Swiss Political Science Review 14, 287–314.

Gao, P., and Qi, X. 2013. Political Uncertainty and Public Financing Costs: Evidence from U.S. Municipal Bond Markets. Working Paper, City University of Hong Kong.

Gao, X., Ritter, J., and Zhu, Z. 2013. Where Have All the IPOs Gone? Journal of Financial and Quantitative Analysis 48(6), 1663-1692.

Goldman E, Rocholl, J., and So, J. 2009. Do Politically Connected Boards Affect Firm Value? Review of Financial Studies 22, 2331–2360.

Goodell, W. J., and Vähämaa, S. 2013. US Presidential Elections and Implied Volatility: the Role of Political Uncertainty. Journal of Banking and Finance, 37(3), pp. 1108-1117.

Gounopoulos, D., Kallias, K., Kallias, A., and Tzeremes, P. 2017. Political Money Contributions of US IPO Firms. Journal of Corporate Finance 43, 19-38.

Gounopoulos, D., and Pham, H. 2018. Specialist CEOs and IPO Survival. Journal of Corporate Finance 48, 217-243.

Gross, C., Konigsgruber, R., Pantzalis, C. and Perotti, P. 2016. The Financial Reporting Consequences of Proximity to Political Power. Journal of Accounting Public Policy 35, 609-634.

Grullon, G., Larkin, Y., and Michaely, R. 2019. Are U.S. Industries Becoming More Concentrated? Review of Finance 23(4), 697-743.

Gulen, H., and Ion, M. 2016. Policy Uncertainty and Corporate Investment. Review of Financial Studies 29(3), 523-564.

Gungoraydinoglu, A., Çolak, G., and Öztekin, Ö. 2017. Political Environment, Financial Intermediation Costs, and Financing Patterns. Journal of Corporate Finance 44, 167-192.

Hainmueller, J. 2012. Entropy Balancing for Causal Effects: A Multivariate Reweighting Method to Produce Balanced Samples in Observational Studies. Political Analysis 20, 25-46.

Hanley, K.W. 1993. The Underpricing of Initial Public Offerings and the Partial Adjustment Phenomenon. Journal of Financial Economics 34(2), 231-250.

Harford, J., Bhagwat, V., and Dam, R. 2016. The Real Effects of Uncertainty on Merger Activity. Review of Financial Studies 29(11), 3000-3034.

Heese, J. 2015. Government Preferences and SEC Enforcement Unpublished Manuscript. Harvard Business School.

Heese, J., Khan, M., and Ramanna, K. 2017. Is the SEC Captured? Evidence from Comment-Letter Reviews. Journal of Accounting and Economics 64, 98-122.

Hersch, P. L., and McDougall, G. S. 2000. Determinants of Automobile PAC Contributions to House Incumbents: Own versus Rival Effects. Public Choice 104(3-4), 329-343.

Higgins, M. C., and Gulati, R. 2006. Stacking the Deck: The Effects of Top Management Backgrounds on Investor Decisions. Strategic Management Journal 27(1), 1-25.

Hill, M., Kelly, W., Lockhart, G., B., and Van Ness, R. 2013. Determinants and Effects of Corporate Lobbying. Financial Management 42, 931-957.

Houston, J. F., Jiang, L., Lin, C., and Ma, Y. 2014. Political Connections and the Cost of Bank Loans. Journal of Accounting Research, 52(1), 193-243.

Hutton, I., Jiang, D., and Kumar, A. 2015. Political Values, Culture, and Corporate Litigation. Management Science 61(12), 2825-3096.

Jain, B., and Kini, O. 2000. Does the Presence of Venture Capitalists Improve the Survival Profile of IPO Firms? Journal of Business Finance and Accounting 27(9-10), 1139-1183.

Jacob, M., Michaely, R., and Muller, M. 2018. Consumption Taxes and Corporate Investment. Review of Financial Studies 32(8), 3144-3182.

Jayachandran, S. 2006. The Jeffords Effect. Journal of Law and Economics 49(2), 397-425.

Jens, C. 2017. Political Uncertainty and Investment: Causal Evidence from U.S. Gubernatorial Elections. Journal of Financial Economics 124, 563-579.

Jones, D. R. 2001. Party Polarization and Legislative Gridlock. Political Research Quarterly 54, 125-141.

Julio, B., and Yook, Y. 2012. Political Uncertainty and Corporate Investment Cycles. The Journal of Finance 67(1), 45-83.

Julio, B., and Yook, Y. 2016. Policy Uncertainty, Irrepressibility, and Cross-Border Flows of Capital. Journal of International Economics 103, 13-26.

Kaldor, N. 1972. The Irrelevance of Equilibrium Economics. Economic Journal 82, 1237-1255.

Kaviani, S., M., Kryzanowski, L., Maleki, H., and Savor, P. 2020. Policy Uncertainty and Corporate Credit Spreads. Journal of Financial Economics. In Press.

Kelly, B., Pastor, L., and Veronesi, P. 2016. The Price of Political Uncertainty: Theory and Evidence from the Option Market. The Journal of Finance 71(5), 2417-2480.

Kim, C., Pantzalis, C., and Park, C. 2012. Political Geography and Stock Returns: The Value and Risk Implications of Proximity to Political Power. Journal of Financial Economics 106(1), 196-228.

Kim, C., Kim, I., Pantzalis, C., and Park, C. 2018. Policy Uncertainty and the Dual Role of Corporate Political Strategies. Financial Management, 1-32.

Kim, T., and Nguyen, Q. H. 2019. The Effect of Public Spending on Private Investment. Review of Finance, 24(2), 415-451.

Kostovetsky, L. 2015. Political Capital and Moral Hazard. Journal of Financial Economics 116(1), 144-159.

Krueger, S., and Walker, R. 2008. Dividend Government, Political Turnover, and State Bond Ratings. Public Finance Review 36(3), 259-286.

Krutz, G. 2005. Issues and institutions: winnowing in the U.S. Congress. American Journal of Political Science 49, 313–326.

Lee, D., and McGuire, M. 2017. Intergovernmental Alignment, Program Effectiveness, and U.S. Homelessness Policy. The Journal of Federalism 47(4), 622-647.

Lee, P. M., and Wahal, S. 2004. Grandstanding, Certification and the Underpricing of Venture Capital Backed IPOs. Journal of Financial Economics 73(2), 375-407.

Loughran, T. 1993. NYSE vs NASDAQ Returns: Market Microstructure or the Poor Performance of Initial Public Offerings? Journal of Financial Economics 33(2), 241-260.

Loughran, T., and Ritter, J. 2004. Why has IPO Underpricing Changed over Time? Financial Management 33(3), 5-37.

Lowry, M., and Schwert, G. 2002. IPO Market Cycles: Bubbles or Sequential Learning. Journal of Finance 57, 1171-1200.

Lowry, M., Michaely, R., and Volkova, G. 2017. Initial Public Offerings: A Synthesis of the Literature and Directions for Future Research. Forthcoming Foundations and Trends in Finance.

Lowry, M., Officer, M., and Schwert, W. 2010. The Variability of IPO Initial Returns. Journal of Finance 65(2), 425-465.

McCann, M. J. C., Shipan, C. R., and Volden, C. 2015. Top-Down Federalism: State Policy Responses to National Government Discussions. The Journal of Federalism 45(4), 495-525.

McChesney, F. S. 1987. Rent Extraction and Rent Creation in the Economic Theory of Regulation. Journal of Legal Studies 16, 101-118.

Malkiel, B. 1979. The Capital Formation Problem in the United States. Journal of Finance 34, 291-306.

Mayhew, D. 1974. Congress: The Electoral Connection. Yale University Press, New Haven.

Michaely, R., and Shaw, W. 1994. The Pricing of Initial Public Offerings: Tests of Adverse-Selection and Signaling Theories. Review of Financial Studies 7(2), 279-319.

Mouw, C., and Mackuen, M. 1992. The Strategic Agenda in Legislative Politics. American Political Science Review 86(1), 87-105.

Nguyen, N., and Phan, H. 2017. Policy Uncertainty and Mergers and Acquisitions. Journal of Financial and Quantitative Analysis 52(2), 613-644.

Pantzalis, C., and Park, J. C. 2014. Too close for comfort? Geographic Propinquity to Political Power and Stock Returns. Journal of Banking and Finance 48, 57-78.

Pastor, L., and Veronesi, P. 2012 Uncertainty About Government Policy and Stock Prices. The Journal of Finance 67(4), 1219-1264.

Pastor, L., and Veronesi, P. 2013. Political Uncertainty and Risk Premia. Journal of Financial Economics 110(3), 520-545.

Pham, A. V. 2019. Political Risk and Cost of Equity: The Mediating Role of Political Connections. Journal of Corporate Finance 56, 64-87.

Platikanova, P., and Mattei, M. 2016. Firm Geographic Dispersion and Financial Analysts' Forecasts. Journal of Banking and Finance 64, 71-89.

Purnanandam, A. K., and Swaminathan, B. 2004. Are IPOs Really Underpriced? Review of Financial Studies 17(3), 811-848.

Ritter, J. 1984. The 'Hot Issue' Market of 1980. Journal of Business 57, 215-240.

Ritter, J., and Welch, I. 2002. A Review of IPO Activities, Pricing and Allocation, Journal of Finance 57, 1795-1828.

Roberts, B. 1990. Political Institutions, Policy Expectations, and the 1980 Election: A Financial Market Perspective. American Journal of Political Science 34(2), 289-310.

Rock K. 1986. Why New Issues Are Underpriced., Journal of Financial Economics. 15, 187-212.

Shleifer, A., and Vishny, R., 1994. Politicians and Firms. Quarterly Journal of Economics 109, 995-1025.

Shleifer, A., and Vishny, R. 1998. The Grabbing Hand: Government Pathologies and Their Cures. Harvard University Press, Cambridge MA.

Stewart C. 2012 The Value of Committee Assignments in Congress since 1994. Unpublished Manuscript. MIT.

Tahoun, A., 2014. The Role of Stock Ownership by US Members of Congress on the Market for Political Favors. Journal of Financial Economics 111(1), 86-110.

Waisman, M., Pengfei, Y. and Yun, Z. 2015. The Effect of Political Uncertainty on the Cost of Corporate Debt. Journal of Financial Stability 16(3), 106-117.

Welbourne, T., and Andrews, A. 1996. Predicting the Performance of Initial Public Offerings: Should Human Resource Management Be in the Equation? The Academy of Management Journal 39(4), 891-919.

Welch, I. 1992. Sequential Sales, Learning, and Cascades. Journal of Finance 47(2), 695-732.

Wellman, L. 2017. Mitigating Political Uncertainty. Review of Accounting Studies 22, 217-250.

Wu, W., Wu, C., Zhou, C., and Wu, J. 2012. Political Connections, Tax Benefits and Firm Performance: Evidence from China. Journal of Accounting and Public Policy 31(3), 277-300.

Yung, C., Çolak, G., and Wang, W. 2008. Cycles in the IPO Market. Journal of Financial Economics 89(1), 192-208.

Table 1: Distribution Statistics

This table presents distributional statistics for a sample of 2,782 U.S. IPOs from 1 January 1996 to 31 December 2018. In Panel A the IPOs are described by issue-year, whereas in Panel B the IPOs are distributed by industry. Finally, Panel C reports state-level distribution characteristics of PAI, underpricing, and IPO Volume. All variables are defined in Appendix A. IPO deals are retrieved from the Securities Data Company (SDC) database.

Panel A: Yearly Distribution of IPO Activity, Underpricing and Political Alignment Index (PAI)

Year	President	Senate	House of Representatives	N.	%	Underpricing	PAI
1996	Clinton (D)	R	R	344	11.69	16.88%	0.41
1997	Clinton (D)	R	R	376	12.78	13.29%	0.43
1998	Clinton (D)	R	R	223	7.58	25.88%	0.42
1999	Clinton (D)	R	R	200	6.80	137.38%	0.59
2000	Clinton (D)	R	R	260	8.84	55.62%	0.65
2001	Bush (R)	D	R	58	1.97	13.16%	0.36
2002	Bush (R)	R	R	48	1.63	8.60%	0.48
2003	Bush (R)	R	R	47	1.60	12.31%	0.40
2004	Bush (R)	R	R	125	4.25	12.10%	0.49
2005	Bush (R)	R	R	114	3.87	10.28%	0.54
2006	Bush (R)	R	R	124	4.21	11.14%	0.57
2007	Bush (R)	D	D	111	3.77	14.73%	0.42
2008	Bush (R)	D	D	17	0.58	14.13%	0.48
2009	Obama (D)	D	D	37	1.26	12.48%	0.53
2010	Obama (D)	D	D	72	2.45	7.67%	0.60
2011	Obama (D)	D	R	68	2.31	12.25%	0.51
2012	Obama (D)	D	R	80	2.72	17.28%	0.55
2013	Obama (D)	D	R	136	4.62	21.99%	0.55
2014	Obama (D)	D	R	171	5.81	18.05%	0.66
2015	Obama (D)	R	R	103	3.50	21.92%	0.58
2016	Obama (D)	R	R	68	2.31	15.97%	0.54
2017	Trump (R)	R	R	66	2.24	13.89%	0.55
2018	Trump (R)	R	R	94	3.20	11.59%	0.45

Panel B: Distribution of IPO Activity, Underpricing and Political Alignment Index (PAI) by Industry

Industry	SIC	N.	Percentage	Underpricing	PAI
Oil and Gas	(13)	111	3.77%	5.72%	0.47
Food Products	(20)	38	1.29%	11.59%	0.48
Chemical Products	(28)	517	17.57%	11.81%	0.57
Manufacturing	(30-34)	66	2.24%	20.62%	0.48
Computer Equipment & Services	(35, 73)	902	30.66%	23.65%	0.48
Electronic Equipment	(36)	216	7.34%	33.04%	0.52
Scientific Instruments	(38)	230	7.82%	15.27%	0.53
Transportation & Public Utilities	(41, 42, 44-49)	255	8.67%	11.45%	0.46
Wholesale & Retail Trade	(50-59)	306	10.40%	18.72%	0.45
Entertainment Services	(70,78, 79)	70	2.38%	11.19%	0.45

Table 1: Distribution Statistics (continued)

Panel C: State Distribution of IPO Activity, Underpricing and Political Alignment Index (PAI)

	PAI	Underpricing	IPO Activity		PAI	Underpricing	IPO Activity
State	Mean	Mean	N	State	Mean	Mean	N
AL	0.45	10.53	4	MT	0.25	33.27	3
AR	0.51	16.62	3	NC	0.77	15.52	76
AZ	0.22	20.61	44	ND	0.41	14.44	2
CA	0.53	24.42	865	NE	0.46	54.58	7
CO	0.49	14.09	84	NH	0.55	13.31	7
CT	0.60	17.36	42	NJ	0.44	17.81	127
DE	0.44	20.34	14	NV	0.50	1.62	15
FL	0.57	18.09	85	NY	0.44	16.44	152
GA	0.65	12.61	77	OH	0.38	15.87	33
HI	0.84	12.07	2	OK	0.28	11.64	36
IA	0.25	103.42	5	OR	0.50	8.38	8
ID	0.43	9.68	4	PA	0.29	7.69	116
IL	0.35	14.36	115	RI	0.65	10.19	2
IN	0.44	17.51	22	SC	0.42	6.74	2
KS	0.30	28.03	10	SD	0.35	36.83	9
KY	0.52	6.59	13	TN	0.26	7.78	46
LA	0.41	15.44	12	TX	0.45	8.65	256
MA	0.85	12.30	232	UT	0.27	17.36	25
MD	0.73	26.32	60	VA	0.51	17.86	76
ME	0.35	19.56	2	VT	0.51	18.95	51
MI	0.52	7.68	28	WA	0.73	21.04	60
MN	0.63	13.68	48	WI	0.43	28.65	26
MO	0.64	15.48	27	WV	0.55	10.39	2
MS	0.44	7.20	3	WY	0.25	30.70	5

Table 2: Distribution of PAI and Underpricing by Administration

This table shows the mean and standard deviation of PAI (Panel A) and underpricing (Panel B) based on whether the President is Democrat or Republican.

Panel A: Distribution of PAI by Administration							
Party	All	Democrats	Republicans	Democrats	Republicans	Democrats	Republicans
President		Clinton	Bush	Obama	Trump	only	only
Mean	0.50	0.47	0.48	0.58	0.49	0.51	0.48
St. Dev	0.37	0.28	0.28	0.37	0.40	0.33	0.32
Panel B: Distribution of Underpricing by Administration							
Party	All	Democrats	Republicans	Democrats	Republicans	Democrats	Republicans
President		Clinton	Bush	Obama	Trump	only	only
Mean	18.73	26.11	11.92	17.19	12.50	23.02	12.05
St. Dev	40.13	56.36	19.90	32.02	23.76	49.49	20.81

Table 3: Summary Statistics

This table presents the descriptive statistics for a sample of 2,942 U.S. IPOs from 1 January, 1996 to 31 December, 2018. Firm fundamentals and offering characteristics are illustrated in Panel A. State characteristics are reported in panel B. Tests of differences in means between the two sub-samples of IPO firms with high and low PAI are based on t-tests. All variables are defined in Appendix A.

Panel A: Firm Fundamentals and Offering Characteristics					
	Full Sample (N=2,942)		**High PAI**	**Low PAI**	**Difference**
	Mean	SD	Mean	Mean	p-value
Underpricing	18.73	40.13	23.35	16.99	0.0088
IPO Revision	-0.02	0.17	-0.01	-0.05	0.0050
Market Heat	1.77	2.83	1.65	1.72	0.3345
Firm Age	14.24	20.38	13.84	14.66	0.2529
Leverage	0.84	1.43	0.87	0.84	0.5420
Proceeds ($ mil)	155.61	516.74	163.40	147.29	0.3715
Size($ mil)	931.53	569.07	938.62	923.85	0.4683
EPS	0.45	0.51	0.38	0.56	0.0000
VC	0.44	0.50	0.46	0.42	0.0187
Underwriter	0.34	0.45	0.42	0.36	0.0140
Internet	0.15	0.57	0.18	0.13	0.0092
Technology	0.38	0.46	0.38	0.36	0.2500
Nasdaq	0.68	0.47	0.68	0.67	0.5531
Panel B: State and Other Characteristics					
Real GDP Growth Rate	3.42	2.65	3.53	3.36	0.0075
Personal Income	10.37	0.27	10.37	10.31	0.0000
Unemployment Rate	5.54	1.93	5.52	5.67	0.0540
EPU	115.30	32.30	84.10	73.60	0.0000
PCI	113.27	39.23	106.45	100.05	0.0000

Table 4: Partisan Alignment and IPO Underpricing

This table displays the effect of partisan alignment (PAI) on IPO underpricing using ordinary least square (OLS) regressions. The sample consists of initial public offerings from 1996 to 2018 in the U.S. stock market. The dependent variable, underpricing, is calculated as the percentage changes from the first day closing price to offer price. PAI is the Political Alignment Index. Models (1), (2), (3), and (4), include PAI, State PAI, Federal PAI, and Regional PAI as the main independent variable of interest, respectively. Panel B reports the results of OLS regression of annual changes in PAI (ΔPAI), federal PAI (Federal ΔPAI), state PAI (State ΔPAI), and regional PAI (Regional ΔPAI) on IPO underpricing. Year, state, and industry fixed effects (FE) are included but coefficient estimates are not reported. T-statistics are included in the parentheses, and are adjusted for heteroscedasticity robust standard errors and clustered by state. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. All variables are defined in Appendix A.

Panel A: PAI and Underpricing

	(1)	(2)	(3)	(4)
PAI	2.74***			
	(3.55)			
Federal PAI		3.80***		
		(3.75)		
State PAI			1.23***	
			(2.80)	
Regional PAI				1.44*
				(1.72)
EPU	0.03*	0.05*	0.04	0.04*
	(1.70)	(1.66)	(1.60)	(1.67)
PCI	0.14*	0.15*	0.14*	0.14*
	(1.90)	(1.94)	(1.86)	(1.93)
Market Heat	0.91**	0.82**	0.90**	0.81**
	(2.40)	(2.60)	(2.50)	(2.45)
IPO Revision	0.63**	0.57**	0.55**	0.48**
	(2.20)	(2.15)	(2.19)	(2.04)
Firm Age	-1.67*	-1.74**	-1.38**	-1.55**
	-(2.30)	(-2.40)	(-2.38)	(-2.18)
Leverage	0.45	0.56	0.45	0.66
	(0.19)	(0.25)	(0.22)	(0.24)
Size	-2.60***	-2.85***	-2.90***	-2.91***
	(-3.10)	(-3.07)	(-3.05)	(-3.15)
Proceeds	5.25***	5.15***	5.23***	5.18***
	(3.10)	(3.25)	(3.40)	(3.26)
EPS	4.25	4.20	4.22	3.70
	(1.55)	(1.45)	(1.51)	(1.35)
Overhang	1.35***	1.33***	1.28***	1.30***
	(3.31)	(3.30)	(3.45)	(3.48)
VC	3.65***	3.75***	3.15***	3.70***
	(3.95)	(3.98)	(4.10)	(3.90)
Underwriter	4.30***	4.35***	4.20***	4.15**
	(3.41)	(3.55)	(3.50)	(3.30)
Internet	3.40**	3.30**	3.39**	2.95**
	(2.05)	(2.23)	(2.25)	(2.20)
Technology	5.10*	5.15*	5.22**	5.05**
	(1.95)	(2.01)	(2.10)	(2.11)
Nasdaq	3.60**	3.20**	3.80**	3.85**
	(2.20)	(2.41)	(2.40)	(2.45)
Market Return	0.15***	0.16***	0.27***	0.24***
	(3.20)	(3.41)	(3.45)	(3.24)
Real GDP Growth Rate	0.14	0.16	0.15	0.15
	(1.02)	(1.29)	(1.29)	(1.32)
Personal Income	-16.21	-16.25	-16.33	-16.32
	(-0.97)	(-0.94)	(-0.93)	(-0.98)
Unemployment Rate	0.52	0.55	0.48	0.54
	(0.51)	(0.58)	(0.44)	(0.52)
Year, Industry, and State FE	Y	Y	Y	Y
N	2,942	2,942	2,942	2,942
Adjusted R^2	0.2680	0.2675	0.2685	0.2678

Panel B: Changes of PAI and Underpricing				
	(1)	(2)	(3)	(4)
ΔPAI	3.87***			
	(2.65)			
Federal ΔPAI		4.42***		
		(3.12)		
State ΔPAI			2.54***	
			(3.45)	
Regional ΔPAI				1.65**
				(2.24)
Control Variables	Y	Y	Y	Y
Year, Industry, and State FE	Y	Y	Y	Y
N	2,882	2,882	2,882	2,882
Adjusted R^2	0.2261	0.1919	0.1981	0.1930

Table 5: The Mitigating Role of Active Corporate Political Strategies

This table presents the analysis on the relation between policy risk and underpricing after considering the role of active corporate political strategies (CPS). In Column (1) of Panel B, we report the results after employing the Entropy Balancing procedure of Hainmueller (2012), whereas in Column (2) we report the results of the second stage results of the estimation of the Two-Stage Least Squares (TSLS) model. Predicted CPS is the instrumented CPS. First-Stage Results for TSLS Model are reported in Appendix. The sample consists of initial public offerings from 2000 to 2018 in the U.S. stock market. The dependent variable, underpricing, is calculated as the percentage changes from the first day closing price to offer price. PAI is the Political Alignment Index. Control variables are the same as in Table 4. We also report the Wald test *F*-statistics indicating whether the coefficients of PAI are the same between the subsamples (Panel A). Year, state, and industry fixed effects (FE) are included but coefficient estimates are not reported. T-statistics are included in parentheses, and are adjusted for heteroscedasticity robust standard errors and clustered by state. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. All variables are defined in Appendix A.

Panel A: The Mitigating Role of Active Political Strategies on the PAI-Underpricing Link using OLS Method

	(1)	(2)	(3)
	(CPS=0)	(CPS=1)	All
PAI	7.90***	-5.75	4.30***
	(3.85)	(-0.70)	(2.80)
CPS			-0.74*
			(-1.83)
PAI × CPS			-1.69**
			(-2.29)
Control Variables	Y	Y	Y
Year, Industry, and State FE	Y	Y	Y
N	1,633	196	1,799
Adjusted R^2	0.2815	0.6305	0.2695
Wald χ2 test	0.00***		

Panel B: The Role of CPS: using the Entropy Balancing and the Two-Stage Least Squares (TSLS) Methods

	Entropy Balancing	**TSLS Model**
	(1)	(2)
PAI	5.02**	5.77***
	(2.40)	(4.90)
PAI × CPS	-2.55*	
	(-1.91)	
CPS	-2.01*	
	(-1.80)	
Predicted CPS		-0.49*
		(-1.75)
PAI × Predicted CPS		-3..23*
		(-1.74)
Control Variables	Y	Y
Year, Industry, and State FE	Y	Y
N	1,799	1,799
Adjusted R^2	0.3364	0.2670

Table 6: The Underlying Political Mechanisms

This table investigates the underlying political mechanisms driving the positive relationship between local political proximity (PAI) and IPO underpricing. The variable Chairmen Change indicates whether a firm is located in state which experienced a change in chairmanship on any of the House or Senate committees. We deem a change relevant if a House member or a senator of any firm's affiliated state gains or loses power on any of the House or Senate committee within the last reporting period. Chairmen Change is a dummy variable equal to one if a firm is subject to a change in the number of influential Congressional committee members (measured by state-year) and zero otherwise (following Gross et al., 2016). Number of Bills is the natural logarithm of the number of bills introduced in Congress by politicians from a given state, in the quarter year prior to the IPO. Control variables are the same as in Table 4. T-statistics are included in the parentheses and are adjusted for heteroscedasticity robust standard errors and clustered by state. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. All variables are defined in Appendix A.

	Political Turnover	**Number of Bills**
	(1)	(2)
PAI	1.22** (2.54)	1.90** (2.62)
Chairmen Change	-0.60** (-2.25)	
PAI × Chairmen Change	2.33** (2.20)	
No. of Bills		2.09 (1.51)
PAI × No. of Bills		1.94** (2.45)
Control variables	Y	Y
Year, Industry, and State FE	Y	Y
N	2,848	2,942
Adjusted R^2	0.1995	0.1975

Table 7: The Heterogeneous Impact of Partisan Alignment

This table evaluates the role of PAI in a cross-sectional setting. The sample consists of U.S. initial public offerings from 1996 to 2018. The dependent variable, underpricing, is calculated as the percentage change from the first day closing price to the offer price. PAI is the Political Alignment Index. Panel A considers the role of the firm's geographic scope of operations using three proxies: (the degree of) state concentration, (the proportion of) international sales, and (the number of) segments. Panel B considers if the firm belongs to a politically sensitive industry (PSI), following Kostovetsky (2015) and Jens (2017). It also accounts for the degree of a state's dependency on government spending (SDGS), following Aabo et al. (2016) and the likelihood of government interference using the index of Economic Freedom (EF) from the Fraser Institute. Control variables are the same as in Table 4. Year, state, and industry fixed effects (FE) are included but coefficient estimates are not reported. T-statistics are included in the parentheses, and are adjusted for heteroscedasticity robust standard errors and clustered by state. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. All variables are defined in Appendix A.

Panel A: The Role of the Firm's Geographic Scope of Operations

	(1)	(2)	(3)
PAI	1.28** (2.11)	3.35** (2.05)	1.40** (2.10)
Concentration	-2.51** (-2.48)		
PAI × Concentration	1.74* (1.96)		
International Sales		-2.70** (-2.05)	
PAI × International Sales		-1.55** (2.05)	
Segments			-1.20 (-1.60)
PAI × Segments			-1.40** (2.11)
Control Variables	Y	Y	Y
Year, Industry, and State FE	Y	Y	Y
N	2,942	2,942	2,942
Adjusted R^2	0.2209	0.2235	0.2340

Panel B: Politically Sensitive Firms at the Industry- and State-Level

	(1)	(2)	(3)
PAI	1.90** (2.05)	2.32*** (4.10)	2.40* (1.97)
PSI	0.45 (1.08)		
PAI × PSI	0.98** (2.31)		
SDGS		-1.89 (-1.64)	
PAI × SDGS		1.28** (2.40)	
EF			-1.15 (-1.64)
PAI × EF			-1.96* (-1.75)
Control variables	Y	Y	Y
Year and State FE	Y	Y	Y
Industry FE	N	Y	Y
N	2,972	2,942	2,848
Adjusted R^2	0.2680	0.2702	0.2840

Table 8: Selection-bias Related to the Choice of the Firm's Headquarters and Historical Alignment Persistence

This table explores whether the effect of PAI on IPO underpricing is driven by bias related to the selection of the firm's state headquarters and historical patterns in PAI variation. The sample consists of initial public offerings from 1996 to 2018 in the U.S. stock market. The dependent variable, underpricing, is calculated as the percentage change from the first day closing price to the offer price. PAI is the Political Alignment Index. Persistence in political proximity is defined as the in inverse of the standard deviation of PAI, Federal PAI, State PAI, and Regional PAI, respectively. We calculate these measures on a rolling basis, utilizing all observations up to the most recent fiscal year, but requiring a minimum of five year observations. Control variables are the same as in Table 4. Year, state and industry fixed effects (FE) are included but coefficient estimates are not reported. T-statistics are included in the parentheses, and are adjusted for heteroscedasticity robust standard errors and clustered by state. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. All variables are defined in Appendix A.

	(1)	(2)	(3)	(4)
PAI	2.33***			
	(2.65)			
PAI × PAI Persistence	0.44			
	(0.39)			
Federal PAI		3.12**		
		(2.23)		
Federal PAI × Federal PAI Persistence		-0.60		
		(-1.09)		
State PAI			1.58**	
			(2.17)	
State PAI × State PAI Persistence			0.88	
			(0.37)	
Regional PAI				1.61*
				(1.76)
Regional PAI ×Regional PAI Persistence				-0.96
				(-0.84)
Control Variables	Y	Y	Y	Y
Year, Industry, and State FE	Y	Y	Y	Y
N	1,940	1,940	1,940	1,940
Adjusted R^2	0.2264	0.1923	0.1954	0.1931

Table 9: Selection-bias Related to Past IPO activity and the IPO-timing Decision

This table explores whether the effect of PAI on IPO underpricing is driven by selection-bias related to past IPO volume and the decision to time the IPO. The sample consists of initial public offerings from 1996 to 2018 in the U.S. stock market. Panel A shows the effect of PAI on IPO Activity and Strategic Waiting Days. IPO Activity is defined as the number of IPOs at the state-level, prior to the IPO-year. Waiting days is the number of days passed between the start of the rising cycle and the IPO date of the firm (Çolak and Günay, 2011). The rising cycle is measured as the period in which the moving average of the quarterly IPO issuance observations has risen for at least three back-to-back quarters, following Çolak and Günay (2011). Panel B presents considers the potential interactive between PAI, Past IPO Activity, and Waiting Days on underpricing. Year, state, and industry fixed effects (FE) are included but coefficient estimates are not reported. Control variables are the same as in Table 4. Control variables in Column (2) of Panel A and in Panel B are the same as in Table 4. T-statistics are included in the parentheses, and are adjusted for heteroscedasticity robust standard errors and clustered by state. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. All variables are defined in Appendix A.

Panel A: The Direct Relationship between PAI, Past IPO Activity, and the Time of Issuance within a Rising Cycle

Dependent Variable	Past IPO Activity	Strategic Waiting Days
	(1)	(2)
PAI	0.87	-7.35**
	(1.59)	(-2.10)
Control Variables	Y	Y
Year, Industry, and State FE	Y	Y
N	2,738	2,785
Adjusted R^2	0.5420	0.6100

Panel B: The Mediating Role of Past IPO Activity and the IPO Timing Decision on the PAI Effect

	(1)	(2)
PAI	1.68**	1.54*
	(2.15)	(1.95)
Past IPO Activity	-0.08	
	(-1.54)	
PAI × Past IPO Activity	0.14	
	(1.09)	
Strategic Waiting Days		-0.02*
		(-1.69)
PAI × Strategic Waiting Days		0.54
		(0.71)
Control Variables	Y	Y
Year, Industry, and State FE	Y	Y
N	2,738	2,785
Adjusted R^2	0.2160	0.1950

Table 10: Time Effects of PAI on IPO First-Day Returns

This table demonstrates the results of OLS regressions of PAI on IPO underpricing along different political periods. The dependent variable, underpricing, is calculated as the percentage change from the first day closing price to offer price. Election year is a dummy variable that is equal to one for the Presidential election years. President Control is an indicator variable which is one if both Chambers in Congress (Senate and House) are controlled by the President. Democrats is a dummy variable equal to one if the IPO firm is issued under a Democratic administration. President change is a dummy variable that takes one during the first two-years of a new President. Presidential Margin of Victory is the state-level difference in the percentage of votes received by the winning candidate from the percentage of votes in the presidential elections by her opponent (Julio and Yook, 2012; Jens, 2017). High margin of victory is a dummy variable equal to one if the difference in the percentage votes is in the highest tercile of vote differential. Low margin of victory is a dummy variable equal to one if the high margin of victory is equal to zero. Panel A presents the effect of PAI during different political periods. Panel B presents the effect of Presidential Margin on Victory on the association between PAI and underpricing, whereas Panel C reports the effect of PAI before and after the bubble period. Year, state, and industry fixed effects are included but coefficient estimates are not reported. Control variables are the same as in Table 4. T-statistics are included in the parentheses, are adjusted for heteroscedasticity robust standard errors and clustered by state. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. All variables are defined in Appendix A.

Panel A: Time Effects based on Political Periods

	Election Year	Non-election Year	All	Dem. Admin.	Rep. Admin.	All	President Change	Non-President Change	All
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(6)
PAI	4.50**	1.29*	2.28*	4.65**	1.60*	1.19*	0.40*	3.29**	2.74*
	(2.10)	(1.71)	(1.86)	(2.20)	(1.67)	(1.96)	(1.98)	(2.24)	(1.69)
Election Years			1.11						
			(1.29)						
PAI × Election Years			1.96*						
			(1.84)						
Democrats						1.09***			
						(5.60)			
PAI × Democrats						1.64**			
						(2.33)			
President Control									
PAI × President Control									
President Change									1.66
									(0.17)
PAI × President Change									-1.90
									(-1.53)
Control Variables	Y	Y	Y	Y	Y	Y	Y	Y	Y
Year, Industry, and State Fixed Effects	Y	Y	Y	Y	Y	Y	Y	Y	Y
State Cluster	Y	Y	Y	Y	Y	Y	Y	Y	Y
N	894	2,048	2,942	2,138	804	2,942	719	2,223	2,942
Adjusted R^2	0.2523	0.1710	0.1965	0.2240	0.2180	0.1945	0.1158	0.2165	0.1920
Wald $\chi 2$ test (p-value)	0.12			0.16			0.16		

Panel B: The Effect of Presidential Margin of Victory

	President Control	Non-President Control	All	Low Margin of Victory	High Margin of Victory	All
	(1)	(2)	(3)	(4)	(5)	(6)
PAI	2.72** (2.45)	1.75* (1.70)	1.54* (1.77)	1.91* (1.70)	2.35* (1.75)	2.38* (1.94)
President Control			-1.94 (-1.51)			
PAI × President Control			1.85* (1.96)			
High Margin of Victory						2.34 (0.42)
PAI × High Margin of Victory						0.57 (0.45)
Control Variables	Y	Y	Y	Y	Y	Y
Year, Industry, and State Fixed Effects	Y	Y	Y	Y	Y	Y
State Cluster	Y	Y	Y	Y	Y	Y
N	603	2,339	2,942	1,960	982	2,942
Adjusted R^2	0.2275	0.2048	0.1950	0.2189	0.1883	0.1918
Wald $\chi 2$ test (p-value)	0.15			0.26		

Panel C: Time Period Analysis

	Before Bubble Period (1996-2000)	After Bubble Period (2001-2018)
	(1)	(2)
PAI	2.05** (2.10)	3.80*** (4.67)
Control Variables	Y	Y
Year, Industry, and State Fixed Effects	Y	Y
State Cluster	Y	Y
N	1,403	1,539
Adjusted R^2	0.1940	0.2380

Table 11: The Long-term Implications of Concentration of Power

This table reports the long-term implications of partisan alignment (PAI). Panel A presents the results of the effect of PAI on Post-IPO Idiosyncratic Volatility. Panel B reports the results of the effect of PAI on investment outcomes. Total Investment is the sum of organic and inorganic investment. Organic Investment is the sum of capital expenditures, and research and development expenditures divided by the lagged value of total assets. Inorganic Investment is acquisition expenses divided by the lagged value of total assets. All investment measures are averaged over the next three years after the IPO. Panel C reports the results of the effect of PAI on three post-IPO operation performance measures. Our first measure, ROA, is the ratio of net income divided by total assets. Our second measure, Cash ROA, is cash flows divided by total assets. Our third measure, Tobin's Q, is the ratio of market value of assets to book values of assets. All performance measures are industry adjusted at the two-digit SIC (Standard Industry Classification) system and averaged over the next three years after the IPO. Finally, Panel D illustrates the estimation of Cox proportional hazards model of the probability of failure and time-to failure as well as the estimation of the Accelerated Failure Time (AFT) model. In Model (1), the dependent variable is whether or not a firm survived 5 years after its IPO, whereas in Model (2), the dependent variable is the time to failure. Year, state, and industry fixed effects (FE) are included but coefficient estimates are not reported. Control variables are the same as in Table 4. In some of the analyses the sample size decreases either because some firms get delisted or due to data unavailability in Compustat. T-statistics are included in the parentheses, and are adjusted for heteroscedasticity robust standard errors and clustered by state. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. All variables are defined in Appendix A.

Panel A: PAI and Post-IPO Idiosyncratic Volatility

Post-IPO window:	+5 to +26 trading days	+5 to +63 trading days	+5 to 126 trading days	+5 to +189 trading days	5 to +252 trading days	5 to +504 trading days	5 to +756 trading days
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
PAI	0.002** (2.30)	0.003*** (2.70)	0.001** (2.60)	0.001** (2.41)	0.002*** (3.20)	-0.010 (-1.10)	-0.001 (-0.11)
Control variables	Y	Y	Y	Y	Y	Y	Y
Year, Industry, and State FE	Y	Y	Y	Y	Y	Y	Y
N	2,940	2,934	2,925	2,907	2,879	2,634	2,292
Adjusted R^2	0.5531	0.5780	0.6122	0.6044	0.5850	0.5630	0.5536

Panel B: PAI on Investment Policies

Dependent Variable:	Total Investment	Organic Investment	Inorganic Investment
	(1)	(2)	(3)
PAI	-0.02** (-2.01)	-0.01** (-2.25)	-0.02** (-2.01)
Control variables	Y	Y	Y
Year, Industry, and State FE	Y	Y	Y
N	2,517	2,517	2,517
Adjusted R^2	0.0690	0.0685	0.0688

Panel C: PAI and Post-IPO Performance

Dependent Variable:	ROA	Cash ROA	Tobin's Q
	(1)	(2)	(3)
PAI	-0.24** (-2.35)	-0.15** (-2.16)	-0.54** (-2.50)
Control variables	Y	Y	Y
Year, Industry, and State FE	Y	Y	Y
N	2,517	2,517	2,517
Adjusted R^2	0.2014	0.3010	0.1110

Panel D: PAI and IPO Survival

	Cox Model		**AFT Model**	
Dependent Variable:	Failure (delisting event)		Time-to-failure	
	(1)		(2)	
	Coefficient	Hazard Ratio	Coefficient	Time Ratio
PAI	0.29*** (3.17)	1.336	-0.28*** (-3.40)	0.756
Control Variables	Y		Y	
Year and Industry Fixed Effects	Y		Y	
N	2,304		2,304	