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Corporate Political Activities and the SEC's Oversight Role in the IPO Process

Abstract

We study how the regulator (SEC) responds to IPOs that have a higher political profile. We find that IPOs with issuers (intermediaries) that actively pursue political strategies receive more (less) SEC comment letters than IPOs without such actors. Cross-sectional analysis reveals that the IPO's political environment moderates the relationship between social pressure for more corporate transparency and SEC scrutiny. Additional tests indicate that the political activities of issuers (intermediaries) contribute to a less (more) efficient IPO process, that is, a smoother, faster, and less costly offering. Overall, our findings suggest that politically active intermediaries have stronger incentives to accurately portray the IPO financial reporting environment than politically active issuers because they have greater reputational and political capital at stake; quite simply, the former have more to lose. We draw out the implications for theory, in terms of agency and visibility.

JEL Classifications: *G14, M13, M41, K22, G38*

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INTRODUCTION

While much attention has been paid to the implications of corporate political activities (e.g., Bonardi et al., 2005; Doh et al., 20012; Jia and Zhang, 2014; Sun et al., 2015; Sun et al., 2016), there is less research on how regulatory authorities might respond to firms with political influence. A popular assumption is that politicians can disrupt the investigative activities and capabilities of the U.S. Securities and Exchanges Commission (SEC): not only can they damage SEC officials' careers, but they also use budget allocations to undermine or influence this body (Peltzman, 1976; Stigler, 1971). Consistent with this idea, one strand of the literature argues that the regulator, and in particular, the SEC's Division of Enforcement (DOE) may be politically captured, because the risk of (costly) enforcement actions may become too great (e.g., Chaney et al., 2011; Correia, 2014).

However, another strand of the literature argues that despite their lucrative benefits[1], corporate political activities increase firm visibility and attract unwanted (negative) media attention as well as public criticism (Skaife and Werner, 2020), due to their sometimes covert and often dubious nature (Minefee et al., 2020; Hadani and Schuler, 2013; Werner, 2017; Werner and Coleman, 2015). If a firm has its house in order and is successful in competing in the open market, it should be less necessary to rely on non-market strategies. In line with this view, Heese et al. (2017) find that the SEC's Division of Corporation Finance (DCF) is more likely to target politically active firms, suggesting that the regulator (at least the DCF division) is not politically captured.

We contribute to this debate by investigating how the SEC responds to corporate political engagement in the context of initial public offerings (IPOs). In particular, we focus on the communications between the SEC and IPO firms and examine whether the SEC filing review process is affected by the IPO's political environment. The SEC reviews corporate filings to ensure sufficient information disclosure, thereby enabling market participants to make informed judgments (Li and Liu, 2017; Lowry et al., 2020). This process leads to a dialogue between the SEC and targeted firms, which may result in a series of comment letters (CLs) from the DCF, and responses from the firms concerned, with the risk of enforcement action (Ertimur and Nondorf, 2006; Li and Liu, 2017).

While previous literature has studied the SEC filling review process for established firms (see, for example, Cassell et al., 2013; Brown et al., 2018; Johnston and Petacchi, 2017), the IPO setting imparts some unique features.[2] Previous studies show that closer scrutiny in the form of more comment letters disciplines the IPO pricing process and enhances the information transparency of the offering (Li and Liu, 2017; Lowry et al., 2020). However, these studies also find that more SEC scrutiny results in an elongated waiting period, distracting managers from the normal course of operations, distorting the timing of the IPO, and increasing compliance costs as well as the risk of withdrawal. We add to this literature by considering whether politically active IPOs receive more or less comment letters, as well as how the communication between politically affiliated IPOs and the SEC affects the price discovery process and the direct issuance costs. Arguably, these issues are of paramount importance; yet, they cannot be addressed in the context of already public firms.

In the case of IPOs, issuers do not have the sole responsibility for the preparation of registration filings and the accounting statements therein. In fact, specialized financial and information intermediaries, such as auditors, venture capitalists (VCs), and investment bankers have significant influence on both the disclosure quality as well as the registration process. For example, auditors are required to certify the financial statements and issue a comfort letter to underwriters (Beatty and Welch, 1996; Westfall and Omer, 2018). VCs, through their voting power and director positions, can shape the information transparency of their portfolio companies (Morsfield and Tan, 2006; Nam et al., 2014). Similarly, by performing due diligence investigations, underwriters can reduce the information asymmetry and certify to the market that the terms of the IPO are fair based on all material information. To our knowledge, ours is the first study examining the role of politically active IPO financial intermediaries in the U.S. market.[3] This is particularly important, since, as we argue below, the regulator may not (necessarily) respond to the political actions of all IPO parties (that is issuers and intermediaries) in the same manner.

Our central premise is that regulatory scrutiny of politically active firms may at least partially be driven by voter pressure for transparency and accountability, which is, arguably, heightened when a firm is in the spotlight and draws public attention to itself (Thompson, 2022). When corporate political activities attract adverse media coverage (McDonnell and Werner, 2016), they may fuel public criticism and disquiet towards firms which are actively involved in politics, thereby motivating elected officials (who oversee the SEC) to balance special interests against voter support; the latter may provide strong incentives to the SEC to place politically active firms under greater regulatory scrutiny (Heese et al., 2017; Thompson, 2022).

Building on this reasoning, we posit that corporate political engagement plays a pivotal role in the IPO context; it can help explain the pressures and risks IPO players experience when they prepare registration material (and the accounting reports/disclosures within) and, in turn, the manner in which the SEC perceives politically active IPOs.[4] If issuers or intermediaries engage in political activities which are associated with questionable business practices and attempts to mask such practices from the public (by distorting the firm's information environment), they will attract adverse public attention and more regulatory scrutiny (Heese et al., 2017; Thompson, 2022). This agency view of corporate political activities suggests that politically active IPOs will receive more SEC comment letters.

However, as rational agents, it could be argued that the politically active IPOs are well aware of the risks of their activities, including a greater likelihood of reputational damages and litigation threats (Wu and Ye, 2020). Hence, one would expect that (at least some) these IPO players seek to preempt the risk of regulatory scrutiny through reporting more conservatively (Kong et al., 2017; Watts and Zimmerman, 1990) or by enhancing the quality of their disclosures, especially if they are not involved in questionable transactions (Guedhami et al., 2014; Jennings et al., 2021). This visibility (reputation) view of corporate political activities predicts that politically active IPOs will receive less SEC comment letters.

It could therefore be argued that the IPO's political environment will moderate the relationship between social pressures for transparency and the number of comment letters; depending on how the SEC perceives the IPO's political activities. In a similar vein, it could be further argued that the adverse impact of comment letters on the bookbuilding process and IPO issuance costs, which is well documented by prior studies (Li and Liu, 2017; Lowry et al., 2020), will be influenced by the IPO's political environment.

We investigate the validity of the above predictions using a sample of 937 IPOs between 2005 and 2018 and political money contributions (PMC), that is, lobbying expenditures and donations to political candidates, as our main proxy of corporate political activity.[5] We find that the average issuer receives 6 comment letters and spends $352,834 for political money contributions, whereas the average financial intermediary invests around $1,531,000 in political causes. We also document that IPOs with politically active issuers (intermediaries) attract more (less) SEC comment letters than IPOs without such political actors, suggesting that the political strategies of IPO issuers are more likely to serve as a useful heuristic for issues the DCF seeks to address at the CL stage.

Additional tests confirm our hypothesis that the IPO's political environment can moderate the relationship between social pressure for transparency and SEC scrutiny as well as the link between SEC comment letters and factors reflecting IPO success, with politically active issuers (intermediaries) heightening (mitigating) the regulator's concerns about the quality of the offering and affecting the viability of the IPO accordingly. Overall, our results indicate that politically active intermediaries attract less public criticism and are subject to lower SEC scrutiny than politically active issuers because they have more reputational and political capital at stake, and hence, stronger incentives to care about the financial reporting quality of the IPO.

THEORETICAL BACKGROUND AND HYPOTHESES DEVELOPMENT

In this section, we introduce the context of our study and discuss why corporate political activities may be related to greater regulatory scrutiny as well as how such firms might respond to the risks of the latter. Then, we theorize whether and how political affiliations might shape the financial reporting incentives of the key parties which are directly involved in the IPO process (i.e., both issuers and financial intermediaries, such as ventures capitalists, underwriters, and auditors) and develop our hypotheses accordingly. Our theoretical framework is graphically summarized in Figures 1-3.

The SEC Filing Review Process

The United States (U.S.) Securities and Exchange Commission (SEC) reviews filings of publicly listed firms to ensure that "investors have access to high-disclosure materials that are useful to investment decision making" (SEC, 2019, p. 128). As part of this goal, the SEC's Division of Corporation Finance (DCF) reviews filings to identify disclosures that may be materially deficient or require additional information (SEC, 2015). The reviews are conducted by a team of individuals at the SEC with the appropriate industry, financial, and legal expertise (Palmrose et al., 2004; Johnson, 2010; Ettredge et al., 2011; Johnston and Petacchi, 2017).

The review process considers two broad types of fillings: periodic reports and registration statements. Periodic reports, such as Forms 10-K, 10-Q, 8-K, and proxy statements, have to be filed under the Securities Exchange Act of 1934. In contrast, in the case of registration statements, which are also referred to as transaction filings, include IPOs (Form S-1) and mergers (Form S-4), the underlying securities are required to be registered under the Securities Act of 1933. While the SEC issues comment letters for virtually every type of filing on a selective basis, it sets forth priority to filings under the Securities Act of 1933 and reviews almost all initial registration statements (Ertimur and Nondorf, 2006).

If questions arise during a review, the DCF issues a comment letter to the registree. The comment letter is an expression of concern by the SEC and an opportunity to respond to the agency's questions about the firm's disclosure practices (Cassell et al., 2019). In each comment letter, the DCF may request several clarifications and amendments, including supplemental information, revisions of prior disclosures or provision of additional disclosures in a future filing with the SEC. Upon receipt of a CL, a company must prepare a response letter, providing clear information about the manner in which it addresses the SEC's concerns. Nevertheless, the SEC may reissue a follow-up letter, if the issues/questions raised in the original CLs are not satisfactorily resolved in the company's response. Therefore, the correspondence between the SEC and firms may consist of several iterations of comment letters, and the CL process is complete upon the resolution of all issues related to a filing review (Palmrose et al., 2004; Johnson, 2010; Johnston and Petacchi, 2017; Ettredge et al., 2011).

How Firms Can Respond to the Criticism Associated with their Political Activities?

Several studies show that a firm's political activities reduce the likelihood of enforcement actions and the magnitude of the associated penalties, suggesting that the SEC's enforcement division is politically captured (e.g., Chaney et al., 2011; Correia, 2014; Yu and Yu, 2011). However, it would be difficult to draw conclusions about the laxness of regulatory oversight of politically active firms based on enforcement actions alone. Motivated by this concern, Heese et al. (2017) examine the role of political expenditures on the SEC's (advisory) DCF division and document a positive relationship between political money contributions and the likelihood of receiving a comment letter. Based on this finding, they suggest that SEC capture is not indicated in the CL review process, and that the corporation's political profile increases the appetite for risk taking in terms of financial reporting decisions and raises the SEC's legitimacy and reputation concerns.

Therefore, firms pursuing corporate political activities can attract either less or more scrutiny from the SEC's DCF division depending on: (a) the extent to which this division is politically captured or exposed to legitimacy threats associated with firms affiliated with politicians and (b) the degree to which the interaction between corporate political strategies and SEC oversight impacts on managerial financial reporting incentives. Figure 1 presents how corporate political influence might affect the regulator's decision-making process. In the following section, we discuss in detail the possibility and implications of these dynamics in the IPO context.[6]

To the extent that the SEC criteria for reviewing filings are the same for both seasoned and IPO firms[7], we anticipate the political capture hypothesis to be also rejected at the comment letter stage of firms going public. Hence, one could argue that the main force driving the SEC scrutiny over politically active IPOs would be the public criticism fueled by the belief that the secret and often dubious nature of political activities facilitates rent-seeking at shareholder's expense and provides managers strong motives to mask questionable business transactions from the public by undermining the firm's information transparency. In this case, it would be tempting to conclude that the political involvement of IPO issuers would translate into greater SEC scrutiny and more comment letters.

However, this conjecture may be premature and one-sided as it disregards the possibility that (at least some) politically active firms will not remain passive to the criticism associated with their political activities; rather, they may decide to adopt an active stance and manage this political cost though conservative reporting preempting risks of investigation (Watts and Zimmerman, 1990). In line with this idea, Kong et al. (2017) show that, in order to reduce the political costs associated with (adverse) publicity, firms with lobbying expenditures are more likely to report lower earnings through recognizing bad news in a timely fashion and deferring the recognition of gains. Again, Jennings et al. (2021) find evidence that firms report less opportunistically following on an increase in their engagement with politicians that have influence over the SEC, suggesting that such affiliations discourage the pursuit of aggressive financial reporting practices.

Once more, politically active firms can convince outside investors that they do not engage in self-dealing by facilitating external monitoring and seeking external certification. Such actions enable these firms not only to deflect scrutiny but also to safeguard their position as information lobbying agents, which in turn, permits them to maintain long-term relationships with politicians and achieve strategic objectives (Hillman and Hitt, 1999). In support of this notion, Guedhami et al. (2014) find that firms respond to the negative attention related to political activities by hiring reputable auditors.

The Role of the IPO's Political Environment on SEC Oversight

It is well documented that, due to severe information asymmetry between insiders and outsiders and the high uncertainty surrounding IPOs, both issuers and intermediaries face a number of moral hazard problem (Chemmanur and Fulghieri, 1994). On the one hand, if these players are myopic, they will misprice the issue in the hope of enjoying short-term benefits, in the form of inflated proceeds (the issuers and VCs) or increased transaction fees (the underwriters and the auditors). Since accounting numbers directly influence the pricing process (Willenborg et al., 2015), issuers can achieve this goal if they exaggerate the firm's prospects, either through opaque disclosures or by distorting financial statements. Similarly, intermediaries can price the offer above its intrinsic value if they acquiesce (or encourage) opportunistic financial reporting practices. On the other hand, if these IPO parties are concerned with their long-term reputation and the litigation consequences of such actions, they will price the equity fairly and they will be eager to credibly convey this fact to the market by enhancing the quality of the IPO's information environment.

Therefore, if the pursuit of political activities exacerbates agency conflicts and information asymmetry problems between insiders and prospective IPO investors, it will distort the offering's information environment. In this case, IPOs with politically active issuers or intermediaries will draw negative attention and public criticism, which place the regulator under greater pressure for delivering transparency and accountability. This reasoning predicts that the IPO's political environment will attract greater SEC scrutiny in the form of more comment letters. If, however, IPOs with politically active issuers or intermediaries attempt to reduce the costs associated with their political strategies, they are less likely to report opportunistically, and thus attract less negative attention from the public or the media. Under this scenario, they will be subject to lower regulatory scrutiny.

This leads to the question as to whether the agency motives or visibility (reputation) motives of these IPO players dominate. In addition, if there is a governing force shaping their behavior, is it the same for both issuers and intermediaries? More specifically, it is not clear a priori whether IPOs with politically active issuers (intermediaries) attract more or less SEC scrutiny than IPOs without such politically active parties. However, it could be argued that politically active intermediaries are less likely to exacerbate agency and information asymmetry problems than politically active issuers; the former are more sensitive than issuers to the (negative) publicity associated with their political activities, and its potential impact on their credibility and long-term viability because they have relatively more reputational and political capital at stake.

Unlike issuers, intermediaries are repeat players in the financial markets. As such, they build up their reputational capital through repeated dealings with other capital market participants (Chemmanur and Fulghieri, 1994); they may be especially vulnerable to increased litigation costs and severe long-term losses that may place their survival at risk if they display an opportunistic behavior. If this is true, then politically active intermediaries may be less likely to encourage opportunistic accounting practices or over-hype the IPO's stock than politically active issuers.

In addition, it is likely that intermediaries (and particularly auditors and underwriters) are more mature – in terms of size and age – than issuers.[8] To the extent that older and bigger firms invest more heavily in political expenditures (Hung et al., 2018), it follows that politically active intermediaries have greater accumulated political capital than politically active issuers. Since creditworthiness is critical for politically active parties to act as lobbying agents and consolidate successful personal relationships with affiliated politicians in the long-run (Hillman and Hitt, 1999), this may suggest that they are less likely to acquiesce in problematic accounting practices. In this case, they are less likely to be at the spotlight due to negative reasons, suggesting that SEC will be more concerned about the transparency of IPOs with politically active issuers rather than IPOs with politically active intermediaries.

Whilst the preferences of politically active intermediaries for more conservative accounting practices seem plausible, it remains theoretically unclear as to whether their reputation concerns are sufficiently strong to trump their agency motives, and if the SEC is more or less likely to view the political activities of IPO issuers as a red flag for additional scrutiny than the political activities of their financial intermediaries. Hence, it is uncertain as to how the IPO's political activities are associated with regulatory oversight. Since this issue can be resolved only empirically, we state our first hypothesis in an alternative form:

H1a: IPOs with politically active issuers or intermediaries have a less transparent environment and receive more SEC comment letters than their counterparts.

H1b: IPOs with politically active issuers or intermediaries have a more transparent environment and receive less SEC comment letters than their peers.

Does the Political Environment of IPOs Moderate the Relationship between Public Pressure for Corporate Transparency and SEC Scrutiny?

An underlying assumption of our study is that SEC scrutiny is largely shaped by the social pressure promoting more transparent corporate (accounting and political) practices. Hence, if political activities attract public criticism, the regulator will demonstrate prompt responsiveness and placate public discontent by scrutinizing more intensively firms with problematic financial reporting practices, in order to maintain its own legitimacy (Heese et al., 2017).

Yet, the regulator will not necessarily view all political actors in the same manner. If the actions of politically active issuers or intermediaries are governed by agency concerns (visibility concerns), then the pressure of public voters – who elect the officials overseeing the SEC – for more corporate transparency and accountability would be greater (lower) among politically active IPOs. In this case, regulatory scrutiny, fueled by public criticism over the political activities of IPO issuers or their intermediaries, will be greater. Alternatively, if politically active issuers or intermediaries are benevolent, they will be deeply concerned as to the unintended consequences of their political actions and they will strive to exhibit higher transparency, thereby attracting less criticism from the media or the public. In this case, regulatory scrutiny is preempted. As before, it is not clear ex ante whether the agency or visibility view of political activities dominate. Thus, we state our second hypothesis as follows:

H2: The presence of politically active issuers (intermediaries) will moderate the relationship between social pressure for corporate transparency and SEC comment letters during the IPO process.

Figure 2 visually summarizes how political influence might affect SEC oversight during the IPO process. It also displays the moderating effect of corporate political activity on the association between social pressure for corporate transparency and SEC scrutiny.

The Moderating Role of the IPO's Political Environment on IPO Success

Finally, we consider whether the potential impact of the IPO's political environment on the comment letter process has financial implications. Previous studies suggest that while the comment letter process leads to an improvement in the overall information environment of IPOs, it may also increase the direct compliance costs (i.e., transaction costs, such as underwriter fees, legal fees, and accounting fees) as well as the indirect costs of going public by causing delays in the going-public process, which in turn, increase the likelihood of IPO withdrawal and generate negative investor reactions (Li and Liu, 2017; Lowry et al., 2020). Motivated by these findings, we contend that the IPO's political environment may influence SEC oversight during the bookbuilding period not only directly through determining the number of comment letters, but also and indirectly by driving the content of comment letters.

The manner in which the SEC perceives IPOs with politically active issuers or intermediaries determines the degree of IPO success accordingly. If, for example, the regulator views corporate political activities as a flag for additional scrutiny, then IPOs with politically active issuers or intermediaries will receive relatively more substantives letters, that is, longer letters or letters with more issues raised. If this is the case, then holding the number of comment letters constant, the adverse impact of CL on the bookbuilding process (waiting period, number of drafts, and the offer price revision), which is documented by prior literature, will be stronger among IPOs with politically active issuers or intermediaries. Similarly, the adverse impact of CLs on the IPO compliance costs should be more pronounced among IPOs with politically active issuers or intermediaries.

Of course, the opposite would be the case, if the behavior of politically active issuers or intermediaries is governed by reputation or visibility concerns. Hence, the adverse impact of comment letters on IPOs will be less pronounced among IPOs with politically active issuers or intermediaries. Taken together, we cannot determine a priori how the regulator regards politically active IPOs or if the regulators views politically active issuers differently from their politically active intermediaries. We visually summarize the above discussion in Figure 3 and develop our last hypothesis as follows:

H3: The presence of politically active issuers (intermediaries) will moderate the relationship between the number of SEC comment letters and outcomes reflecting IPO process.

SAMPLE SELECTION PROCEDURE

We obtain a sample of IPO firms that went public from May 12, 2005, to December 31 2018, from the Thomson ONE Banker database. We begin our sample period in 2005, because the SEC began disclosing all comment letters on May 12, 2005.[9] Consistent with the existing literature (e.g., Colak et al., 2021; Lowry et al., 2020), we apply standard IPO filters to exclude IPO withdrawals, foreign issues, unit offerings, reverse leveraged buy-outs (LBOs), spin-offs, closed-end funds, real-estate investment trusts (REITS), royalty trusts, financial institutions, limited partnerships, American Depository Receipts (ADRs), IPOs without any comment letters, and all IPOs with an offer price below $5.00. This process yields 937 IPOs.

IPO background and issuance information data were retrieved from the Thomson ONE Banker database, including the issue data, offer price, amount of total IPO proceeds, whether the firm is backed by VCs, and the details of the underwriters and auditors involved; the accounting data are retrieved from the Compustat database. For the underwriter prestige metrics, the study employs Jay

Ritter's rankings of underwriter quality. We also calculated firm age using the year of founding from the Thomson ONE Banker database as well as from Jay Ritter's website.

For each IPO firm, we sought to extract all SEC comment letters related to IPOs (S-1 and SB-2 registration filings) posted to the EDGAR database. In particular, we download all "UPLOAD" documents that were registered on the firm's EDGAR directory up to two years after the IPO.[10] We used this long window because although SEC letters related to the IPO are written before the company goes public, they are not publicly released on EDGAR until a minimum of 20 business days after the issue date. Since our focus in this paper is on comment letters for IPO firms (i.e., firms filing an S-1 or SB-2 registration statement for an initial public offering of common stock), in Figure 4, we provide a general timeline of the IPO filing process and show how the comment letter process fits into the SEC's overall review process.

Following prior literature (Yu and Yu, 2011; Correia, 2014; Gounopoulos et al., 2017; Heese et al., 2017), we used two primary measures to capture political influence: lobbying expenditures and PAC donations.[11] Data regarding corporate lobbying activities and PAC contributions are carefully hand-collected from the OpenSecrets database. We identify politically active IPO parties (issuers and intermediaries) as those which have donated to lobbying expenditures or PACs in the closest election cycle preceding the IPO. When we match our IPO sample with the political data from the OpenSecrets database, we identify 107 politically active IPOs (issuers with either lobbying expenses and/or PAC involvement), 90 firms with politically active VCs, 590 firms with active underwriters, and 703 firms with politically active auditors.

RESEARCH DESIGN

Baseline Empirical Model

To investigate the relationship between the IPO's political environment and the SEC comment letter process, we estimate the following baseline empirical specification:

$$No\ of\ SEC\ CLs = \beta_0 + \beta_1 IPO\ PMC + \beta_2 Control\ Variables + Fixed\ Effects + \varepsilon_i \quad (1)$$

Following Lowry et al. (2020), our proxy for SEC concerns during the IPO process is the number of SEC comment letters (*No. of SEC CLs*), concerning S-1/SB-2 filings.[12] The main independent variable of interest, *IPO_PMC*, represents the political money contributions (PMC) of the IPO issuer (*Issuer_PMC*) and the involved financial intermediaries: venture capitalists (*VC_PMC*), underwriters (*UW_PMC*), and auditors (*AUD_PMC*). For each IPO player, PMC is calculated as the natural logarithm of (one plus) the total dollar amount of lobby expenditures and PAC contributions in the closest election cycle preceding the IPO (Cooper et al., 2010; Correia, 2014).

The selection of the first set of control variables of our baseline regression model is mainly motivated by SOX 408, as well as by previous studies on the determinants of comment letters (c.f. Cassell et al., 2013; Heese et al., 2017). SOX section 408 (paragraph b) identifies firms for the SEC to consider in its reviews of corporate filling: (1) issuers that have issued material restatements of financial results; (2) issuers that experience significant stock return volatility; (3) issuers with large market capitalization; (4) emerging companies with disparities in valuation ratios; (5) issuers with large economic importance, and (6) and any other factors the Commission may consider relevant.

With respect to factor (1), we include proxies for internal control weaknesses (*IC_Weak*) and failures in financial reporting (*Restatement*). Regarding factor (2), issuers do not have history of market returns; therefore, we use the quarterly volatility of industry-adjusted sales over the past two years prior to the IPO to capture firm stability (*Sales_Volatility)*. With respect to factors (3) and (5), we include the size of IPO proceeds (*Log_Market_Cap*), whereas factor (4) is captured using the firm's growth expectations (*Market_to_Book*). Factor 6 allows discretion to the SEC in determining which variables can be used to justify more or less scrutiny over the firm. Thus, we include an array of additional firm-specific and IPO-specific characteristics that we believe might affect SEC oversight.

We include firm age (*Firm Age*) because a longer operating history may reduce information asymmetry for newly listed firms and thus indicate a less rigorous review process (Colak et al., 2021).

Apart from the natural logarithm of the market capitalization, we also use the natural logarithm of the firm's sales (*Sales*) because previous studies show that a major topic of SEC comment letters is revenue recognition issues (Lowry et al., 2020). We use leverage (*Leverage*) and earnings per share (*EPS)* to capture financial distress problems (Cassell et al., 2019; Duro et al., 2019).

Turning our attention to the IPO-specific variables, we anticipate that social awareness and public skepticism as to corporate activities, and in particular, negative media IPO coverage, might influence how rigorous the SEC reviews will be (Thompson, 2022). To the extent that the tone of media citations captures public (and regulatory) perceptions about the firm's political environment, including the variable *Negative Media_Attention* will help to isolate the effect of our main variables of interest. Political activities might be initiated to hedge political uncertainty (Bradley et al., 2016). If this is so, we expect that some IPOs may disclose the term political uncertainty or political instability in their registration filling as a potential risk factor *(S-1 Disclosed Policy Risk*), in which case this variable might serve as discretionary factor for the SEC (because these firms may be viewed as politically sensitive).[13] The SEC might also look for factors capturing the overall quality of the IPO's governance (*Corporate Governance*), since superior governance system should be effective in restraining the opportunistic use of shareholders' funds towards political causes.

We also account for the shares retained by pre-IPO shareholders over the shares issued in the offering (*Overhang*). Li and Liu (2017) and Lowry et al. (2020) show that the presence of venture capitalists (*VCs*) and prestigious auditors (*Big 4 Auditor*) are significantly correlated with the IPO's information environment and the SEC comment letter process. Therefore, including these variables in our models helps to isolate the incremental effect of the political activities of these key IPO players on SEC scrutiny. We control whether the IPO firm is an Internet (*Internet*) or technology (*Technology*) company and if it is listed on Nasdaq (*Nasdaq*). Finally, we include both time-fixed effect and industry-fixed effect dummy variables in all regressions and cluster standard errors at both the year and industry levels (Liu and Ritter, 2011; Petersen, 2009).

EMPIRICAL RESULTS

Descriptive Statistics

Table I presents the summary statistics of the SEC comment letters, IPO process, firm and offering characteristics as well as the incidence of IPO political activity along with the average dollar amounts of corporate political contributions. Panel A shows that, on average, the waiting period (i.e., number of days from the initial filing of an S-1 through the IPO effective date) is 117 days. The average firm receives 6 rounds of comment letters from the SEC, resulting in a similar number of registration filings (S-1) and amendments (S-1/A) filed per sample firm. On average, the number of words in the first-round comment letter is 2,815. The average number of questions (or comments) in the first-round letter that IPO firms receive is 37. Overall, our descriptive statistics regarding the IPO and SEC comment letter process are comparable with those of prior relevant studies (e.g., Li and Liu, 2017; Lowry et al., 2020).

[INSERT TABLE I ABOUT HERE]

Panel B displays the descriptive statistics of the accounting and disclosure characteristics. On average, 9% of the firms in our sample have issued material restatements, whereas 16% of them have material weaknesses. The average post-IPO fraud detection likelihood is approximately 4%. Around 5% of the IPO firms are referred in the media with a negative tone, while the average IPO discloses approximately 3 times political uncertainty as a risk factor in its prospectus.

Panel C presents the statistics of the firm and offering characteristics for all IPOs. On average, IPO firms are 12 years old, have \$171 million IPO proceeds, and sales of \$281 million. More than one-third of the companies have positive earnings per share, whereas the average leverage ratio is 38% and the sales growth is around 5%. Regarding the IPO variables, the ratio of shares retained by the pre-IPO shareholders over shares issued in the offer is 3.56. In addition, 60% are backed by VCs, 53% are underwritten by top-tier investments banks, and 70% of the IPO firms are audited by a Big 4 auditor. Finally, 34% of the firms operate in the technology sector, 12% are in the Internet sector, and 69% are listed on Nasdaq.

Panel D shows that 11% of the IPO firms have established political activities. Around 16% of the IPO issuers are backed by politically active VCs; 63% have politically active top-tier investment banks, and 75% of the auditors of IPO firms are politically active. Finally, Panel E presents the dollar amounts of the political contributions. The average lobbying expenditure for politically active IPO issuers is around $0.352 million and PAC expenditures are almost five times less than lobbying expenses. Politically active underwriters have contributed around $2.96 million ($110 thousand) to lobbying (PAC) activities, while active auditors and venture capitalists have donated $1.69 million ($45 thousand) and $1.50 million ($40 thousand) to these political causes, respectively.

The Impact of Corporate Political Activities on SEC Comment Letters

Does the political environment of IPOs attract greater or less SEC scrutiny? Does it depend on the nature of political activities or on the type of IPO players with political influence? To answer these questions, we conduct regression analysis to investigate whether the political expenditures of issuers, VCs, underwriters, and auditors of IPO firms are related to the rounds of SEC comment letters.

Table II assesses the relationship between the political activities of issuers and their financial intermediaries on the number of SEC comment letters, after controlling for various firm and offering characteristics. For each IPO party, we initially investigate separately the effect of lobbying and PAC expenditures and then their sum (i.e., PMC). Because the inferences about lobbying and PAC and largely consistent with PMC, we focus our discussion on the latter.

We find that the coefficient of *Issuer_PMC* is positive and statistically distinguishable from zero, suggesting that the SEC is more likely to target IPOs whose issuers invest large amounts of political money contributions than IPOs with issuers investing small amounts in political causes. This result is consistent with *H1a* and Heese et al. (2017) showing that corporate political activities entail adverse unintended consequences, such as heightened regulatory scrutiny.[14]

In contrast, the negative coefficients of all PMC intermediaries imply that IPOs backed by politically active advisors are more favorably perceived than IPOs without politically active advisors, thus supporting *H1b*. Importantly, the comparison of the coefficient of PMC issuers with the coefficients of PMC intermediaries reveals that their differences are statistically different from zero, providing further support to the notion that the SEC is more likely to view the political expenditures of IPO issuers as a red flag for additional scrutiny during the filling review process than the political expenses of IPO intermediaries. This finding corroborates recent research suggesting that political activities and the associated visibility may act as a disciplining mechanism, mitigating agency concerns because they push firms to comply with best practices and foster more or better disclosure (Guedhami et al., 2014; Jennings et al., 2021).

Turning our attention to the control variables, our results indicate that larger firms or IPOs with volatile operations receive more letters than their counterparts. Sales are also related to more letters, whereas EPS and the quality of corporate governance tend to alleviate SEC concerns. Interestingly, negative media attention attracts more SEC scrutiny, which supports the notion that legislators prefer strict oversight of PMC firms following public outcry against such firms (McCubbins and Schwartz, 1984). The sign and significance of the variables controlling for the presence of (prestigious) intermediaries are generally consistent with prior studies (e.g., Lowry et al., 2020).

[INSERT TABLE II ABOUT HERE]

Financial Reporting Incentives of PMC Issuers and their PMC Intermediaries

The results of the baseline regressions indicate that the agency effects are more likely to trump visibility ones in the case of PMC issuers than PMC intermediaries. This may be because, as noted above, intermediaries have a greater reputational and political capital at stake than IPO issuers, and as such, they are less inclined to facilitate opportunistic accounting choices or to over-hype their firm’s stock; if they did not act with greater restraint, they may severely undermine their reputational and political affiliations due to the resulting increased regulatory scrutiny. Hence, politically active intermediaries (issuers) should have relatively stronger (weaker) incentives to care about the financial reporting quality of the offering.

To examine this conjecture, in Table III, we replace the number of comment letters with a list of variables capturing the quality of the firm's information environment, including real and accruals earnings management, accounting restatements as well as the propensity to engage in fraud. Consistent with our expectations, the results indicate that politically active intermediaries are less likely to be associated with worse financial reporting quality and litigation risk than political active issuers.

[INSERT TABLE III ABOUT HERE]

IDENTIFICATION CONCERNS

Our findings thus far suggest strong associations between the IPO's political environment and the number of SEC comment letters. Although the inclusion of industry and year-fixed effects absorbs any omitted industry-varying and time-varying heterogeneity, the relationship between the IPO parties' political involvement and comment letters is still prone to various forms of endogeneity bias. In this regard, we employ various methods to ensure that our findings are robust.

Two-Stage Least Squares (TSLS) Approach

To address the endogeneity concerns, we initially follow Bradley et al. (2016) and employ an instrumental variable (IV) approach. In the first stage, we estimate the probability of engaging in corporate political expenditures, whereas in the second stage we replace the hypothesized endogenous variable with its instrumented value. In particular, we first regress PMC for each IPO party (issuer, underwriter, VC, and auditor) on our instruments and control variables. For valid instruments, we need to obtain exogenous variation, that is, variables that are related to political activities (to satisfy the relevance condition) but do not have an impact on the SEC comment letter proxies (to satisfy the exclusion criterion). As such, our instruments should affect the SEC comment letter proxies only through corporate political strategies.

Our first instrument, *Industry-Year Average PMC,* is defined as the percentage of politically money contributions within each industry after excluding the focal firm.[15] To select this instrument, we follow Agrawal and Knoeber (2001), who suggest that companies from different sectors have different incentives to establish political strategies. Furthermore, Hersch and McDougall (2000) show that the political strategies of competitors affect a company's decision to spend on political causes. A problem with the above instrument arises if industry-wide political costs drive both firm-level CL and industry- and firm (intermediary)-level political money contributions (Watts and Zimmerman, 1986). If this is the case, then the above instrument is not valid. Therefore, we use two other instruments that are less susceptible to this concern.

Our second instrument, *Distance*, is defined as the distance between an issuer's (or intermediary's headquarters) and Washington D.C., the seat of the national government. Houston et al. (2014) support that companies that are close to Washington may have better opportunities to pursue political strategies. Lastly, we utilize the state-level *Voter Turnout*, calculated as ballots counted divided by the voting-eligible population for general elections. Unsal et al. (2016) suggest that this variable can proxy for local political engagement and is expected to be related to the political strategies of a given company. We assume that it is unlikely that *Industry-Year Average PMC*, *Distance* or *Voter Turnout* have a direct effect on the SEC comment letter proxies, at least after adjusting for industry and year-fixed effects.

Table IV shows the results of our IV approach. With respect to the first stage, our selected instruments are strongly correlated with the political activities of the IPO issuer and its financial intermediaries. The coefficient of *Distance* is negative and significant, showing that the likelihood of engaging in political activities is lower for issuers and intermediaries whose headquarters are located further from Washington D.C. In addition, the coefficient on *Industry-Year Average PMC* is positive and significant. Finally, the coefficient on *Voter Turnout* is positive and significant, suggesting that local political engagement affects corporate political investments in the same geographical area (state). In addition to this, we perform a plethora of tests to establish the relevance and validity of our instruments and find that our instruments are not weak. The results of the second stage IV regressions are consistent with the main results reported earlier.

[INSERT TABLE IV ABOUT HERE]

Entropy Balancing

Previous studies show that the propensity to engage in political activities depends on the firm's available resources, the exposure to political uncertainty, or the firm's industry (Gounopoulos et al., 2017). As such, treatment (politically active issuers or intermediaries) and control (issuers or intermediaries with no political activities) groups may not be randomly assigned.

To address these issues, we employ entropy balancing separately – for the issuers and each of the intermediaries – in order to achieve a covariate balance between politically active parties (treatment) and non-active parties (control) through a reweighting process such that the main distributional properties (mean and variance) of the treatment and control observations are virtually identical (Hainmueller, 2012; Hendricks et al., 2019). Untabulated results show that our main inferences remain the same.[16]

Cross Sectional tests

In this section, we investigate alternative channels through which PMC can affect IPOs. We initially argue that PMC affects SEC comment letters not only directly but also indirectly, by considering its potential moderating role on the relationship between public pressure for more transparency and SEC scrutiny. Accordingly, we examine how IPO PMC can influence the adverse impact of CLs on the bookbuilding and the pricing discovery process.

The Interplay Between PMC and the Social Pressure for Corporate Transparency

An assumption of our study is that when there is social pressure for more transparent corporate (accounting and political) practices, the regulator may opt for stricter oversight (McCubbins and Schwartz, 1984). In this case, the SEC is subject to heightened legitimacy threats and will demonstrate prompt responsiveness and placate public discontent by scrutinizing more intensively firms with problematic financial reporting practices.

The positive association between adverse media coverage (a proxy of public pressure for more scrutiny) and the number of CLs, which is reported in Table V, supports this conjecture. In light of this and the findings of Table III, our documented positive (negative) link between the PMC issuers (intermediaries) and the number of CLs, implies that the political activities of issuers (intermediaries) should attract more (less) negative media attention because they are associated with relatively worse (superior) financial reporting quality. In addition, a natural hypothesis emerging from the above is that the IPO political environment should moderate the impact of regulatory pressure for stricter oversight over IPO firms.

To evaluate this hypothesis, we interact the political activities of issuers and their intermediaries with three proxies of social pressure for more transparency and litigation costs: (a) negative media attention; (b) propensity to engage in fraudulent reporting practices, (c) industries with high litigation risk. We believe that when there is more negative media attention, firms are more prone to fraud, or exposed to greater litigation risk, corporate political activities become more politically contested, thereby placing both the regulator (who is overseen by elected politicians) and corporations (who are affiliated with those politicians) under more pressure. Following this logic, we interact the above three proxies of social pressure with PMC issuers (PMC intermediaries) and predict a positive (negative) coefficient on the resulting interactive variables, which implies that PMC financial intermediaries are less likely to be scrutinized by the SEC than PMC issuers when the IPO firm is under the spotlight due to negative reasons.[17]

Columns 1-3 in Table V provide evidence in support of the moderating role of PMC on the link between social pressure and CLs (*H2*), as they indicate that PMC issuers receive more comment letters when the SEC is exposed to litigation and reputation threats, whereas the opposite is true for PMC intermediaries. Overall, the results are consistent with the notion that the incentives of PMC intermediaries to reign in financial misreporting are more likely to increase with their litigation concerns, than in the case of PMC issuers because the former have a greater reputation and political capital at stake than the latter.

[INSERT TABLE V ABOUT HERE]

Pricing Implications of the IPO's Political Environment

Li and Liu (2017) show that the SEC disciplines IPO firms' disclosures and mitigates IPO hyping through its comment letters, as manifested in downward offer price revisions. They attribute this finding to the fact that investors are willing to pay lower IPO prices for IPOs subject to more scrutiny, i.e., IPOs with less transparent and overoptimistic disclosures. However, more comment letters result to an elongated IPO process, which translates into a prolonged waiting period, more amendments in registration filings and, of course, higher transaction costs given that more resources are needed to obtain assistance from accounting and legal experts to address the concerns of the regulator (Li and Liu, 2017; Lowry et al., 2020).

We predict that the IPO's political environment may influence the SEC not only directly through the number of comment letters but also indirectly, through the impact of (the content of) comment letters on the bookbuilding process, offering prices, and the IPO transaction costs. If, for example, the SEC views the political activities of intermediaries more favorably than those of issuers, then IPOs with PMC intermediaries (issuers) will receive fewer (more) substantive letters in terms of length or the number of issues raised. If this is the case, then holding the number of comment letters constant, the adverse impact of comment letters on the bookbuidling process (waiting period and number of drafts) and the offer price revision will be weaker among politically active intermediaries rather than active issuers. Similarly, the adverse impact of comment letters on the IPO compliance costs should be less pronounced among politically active intermediaries rather than active issuers.

The results of Table VI support these conjectures. We find that IPO firms receiving more comment letters are subject to a lengthier IPO process with more registration drafts and downward offer price revision, consistent with Li and Liu (2017). Notably, these findings are more (less) pronounced amongst IPOs with politically active issuers (intermediaries), as indicated by the interactive variables. Our findings show that IPOs with more comment letters are charged higher fees, supporting the idea that addressing the regulator's concerns is costly (Li and Liu, 2017). We also report that IPOs with politically active issuers pay higher fees when they receive more letters from the

SEC, whereas this not the case among firms with politically active IPO advisors. Overall, the results for PMC issuers (intermediaries) support *H3*.

[INSERT TABLE VI ABOUT HERE]

DISCUSSION AND CONCLUSION

Despite considerable scholarly attention to the implications of corporate political activities, the interaction between firms actively pursuing political strategies and regulatory agencies is understudied. A popular assumption is that regulators are receptive to political pressures, and thus, may be captured by organizations with substantial political capital (Peltzman, 1976; Stigler, 1971). Existing evidence from the management and finance literature provides empirical support to this conjecture (Chaney et al., 2011; Correia, 2014; Hadani et al., 2016; Yu and Yu, 2011).

While it would be tempting to argue that the SEC's Division of Corporate Finance (DCF) and the filing review process is similarly captured, Heese et al. (2017) note that this conclusion would be premature, as they report that the DCF is more likely to target politically active firms. This would suggest that PMC is used, during the SEC comment letter process, as a way of flagging where financial reporting issues need to be addressed.[18] Evidence from China suggests that politically affiliated firms are, in fact, more likely to receive comment letters from regulators (Chen et al., 2020); we seek to explore these phenomena through a focus on U.S. IPOs by providing a fuller theoretical explanation as to why this might be the case. As noted earlier, the SEC's budget and the nomination of key staff members (commissioners and the chairperson) are both largely determined by the U.S. Congress and the executive administration (Heese, 2017). It is well documented that corporate political activities expose firms to heightened visibility and greater public scrutiny (mainly due to their secret and often dubious nature), which arguably subjects politicians and regulators alike to pressure to promote greater transparency (Hadani and Schuler, 2013; Werner, 2017; Werner and Coleman, 2015).

Taken together, these arguments imply that corporate political activities make regulators especially sensitive to threats of their legitimacy due to their reliance on support from external constituencies, i.e., elected politicians whose re-election concerns will motivate them to balance special interest favors (such as interceding with the SEC to secure a lenient treatment to their politically affiliated firms) with voter support.

Building on the above, we provide new insights into the interplay between corporate political strategies and regulatory oversight, by investigating how the political environment of IPO firms affects the SEC concerns during the filing review process. In doing so, we also consider whether the role of SEC oversight on the pricing of the offering and its direct issuance costs is influenced by the IPO's political money contributions. This research question is of paramount importance for IPOs, given that prior studies show that although SEC scrutiny enhances the transparency of IPO and mitigates overpricing, it also translates to delays in the public going process, higher compliance costs, lower investor demand for the IPO stocks, and a higher incidence of withdrawal (Li and Liu, 2017; Lowry et al., 2020).

Importantly, we consider the political involvement of both issuers and financial intermediaries backing the IPO, such as venture capitalists, underwriters, and auditors. Given that financial intermediation is a repeated business game with a limited number of competitors, the survival as well as the future expected profitability of these IPO parties, is strongly influenced by their reputation, and their reputation is directly affected by the quality of their services delivered to IPO issuers (Nam et al., 2014). If investors feel misled by a financial intermediary in their prior IPO investments, then this intermediary will find it much more costly to be involved in future issues. From this perspective, one could argue that PMC intermediaries are more sensitive to reputation and litigation threats associated with their political actions than PMC issuers. This further raises the possibility that PMC intermediaries have stronger motives to detect and remediate accounting irregularities than non-PMC peers (intermediaries), whereas this is less likely to be the case when comparing the financial reporting incentives of PMC issuers with non-PMC issuers. As such, it is more likely that the political contributions of issuers serve as useful heuristic for addressing financial reporting issues than the political contributions of intermediaries during the comment letter process.

Our findings reveal that PMC issuers attract more comment letters than their non-PMC peers, whereas IPOs with PMC intermediaries receive less comment letters than IPOs with non- PMC counterparts. We also document that the political contributions of issuers (intermediaries) contribute to a less (more) efficient (i.e., smoother, faster, and less costly) IPO process. To delve more deeply into the mechanism driving these results, we consider the financial reporting motives of these IPO parties. Consistent with the notion that SEC is more likely to target firms which are prone to higher misreporting risk, we find that PMC issuers are associated with worse reporting quality relative to their peers, while PMC intermediaries have superior reporting quality than their counterparts.

Using negative media attention, litigation risk, or the propensity to engage in accounting fraud as proxies of social public pressure for greater corporate transparency and accountability, we also examine whether the SEC's (and the IPO parties') response to corporate political activities is contingent to public perceptions about the firm and its practices. We find that the SEC becomes more concerned with PMC issuers than PMC intermediaries, as there is greater public demand for transparency and scrutiny in the case of the former. This finding suggests that PMC intermediaries have more reputation (and, perhaps, more political capital because they generally spend more on political causes) at stake than politically active issuers. As such, they mitigate SEC scrutiny because they are less likely to misstate the IPO's financial reports.

Overall, our analysis indicates that the SEC is more likely to use the political money contributions of issuers than the contributions of intermediaries as a red flag for additional SEC scrutiny. This finding is also intriguing in the sense that the SEC's DCF does not necessarily target to the same extent all IPO politically parties; rather the degree of SEC scrutiny also depends on how the PMC parties respond to the increased visibility and (unwanted) attention associated with their political actions.

Theoretical Contribution

Our paper makes several important contributions. To our knowledge, this study is the first to explore how the SEC perceives the political environment of IPO firms. While the literature has mostly considered the role of the regulator on seasoned corporations[19], we fit into a small but growing number of papers that examine SEC comment letters to discern the value of the regulator during the process of going public (Ertimur and Nondorf, 2006; Li and Liu, 2017; Lowry et al., 2020; Köchling et al., 2021). These papers show that while SEC scrutiny (in the form of more SEC comment letters) disciplines the IPO pricing process and enhances the information transparency of the offering, it comes at a cost, as it results in an elongated waiting period, thereby distracting managers from the normal course of operations, distorting the timing of the IPO, and increasing compliance costs as well as the risk of withdrawal. We complement and extend these efforts by arguing that the interactions between the SEC and IPO firms are contingent on the political strategies of the IPO's key players and have important implications for the success of the offering.

Our paper also relates to the ongoing debate in the literature over the role of the regulator. In this respect, several papers argue that the SEC's enforcement division is captured because they find that PMC mitigates regulatory scrutiny (Chaney et al., 2011; Yu and Yu, 2011; Correia, 2014). However, Heese et al. (2017) suggest this conclusion cannot be applied to the SEC's Division of Corporate Finance because they document that the SEC is more likely to target politically active firms during the filing review process. We differentiate from this study along the following dimensions. Initially, we consider not only the impact of political activities on SEC concerns (the number of comment letters), but also its consequences on the price discovery process and the compliance costs of going public. Given that the main purpose of an IPO is to raise funds for the issuing firms and that the listing process itself entails substantial expenses (accounting, underwriting, legal, etc.), identifying factors that might affect these outcomes is pivotal for understanding the determinants of a vibrant IPO market.

Perhaps, most importantly, we consider the political activities of financial intermediaries such as venture capitalists, underwriters and auditors, in addition to the political activities of IPO issuers. Although increased visibility and negative media attention may increase regulatory scrutiny for both PMC issuers and intermediaries, the latter may have more reputation at stake because, unlike issuers, they build their credibility through repeated dealings in the financial markets (e.g., Chemmanur and Fulghieri, 1994; Megginson and Weiss, 1991). We conclude that for intermediaries visibility concerns trump agency phenomena. Based on this reasoning, PMC intermediaries should have stronger incentives to accurately portray their underlying performance than non-PMC intermediaries, whereas this is less likely to be the case for PMC issuers and their non-PMC peers. By theorizing and showing that the SEC might view differently the political involvement of intermediaries compared to that of issuers, we provide a more complete picture of the effect of IPO political environment on the SEC comment letter process.

Our work is also closely related to earlier studies exploring the role of politically active intermediaries in the Chinese IPO market and the effects of political activities on regulatory comment letters generally (Chen et al., 2020). For instance, Wang and Chaopeng (2020) documented that politically active venture capital-backed companies are more likely to get IPO approval in China, whereas Chen et al. (2017) suggest that politically active VCs and underwriters increase the probabilities of clients’ IPO applications being approved by the China Securities Regulatory Commission (CSRC). These studies demonstrate that political activities can play a decisive role towards a successful IPO. However, an important distinguishing feature of the U.S. market is the particularly prominent role accorded to financial intermediaries (Lazonick and Shin, 2019). In light of this, our paper adds to this line of literature by showing that political activities of intermediaries (venture capitalists, underwriters, and auditors) also matter in the U.S. IPO market.

Policy, Managerial, and Regulatory Implications

This study has important implications for capital market participants, policy makers, and scholars of campaign finance and corporate governance. One implication is that potential IPO investors and managers should be aware that despite its lucrative benefits, political activities increase (negative) visibility, which in turn, entails more scrutiny, and that, in particularly, PMC intermediaries need to take due care.

Furthermore, our results should be of interest to policy makers and advocates on various sides of the political, legislative, and regulatory debates, concerning the role of corporate donations in American politics. In the U.S.A. there is an intense debate over the mandatory disclosure of firms' PMC as a mechanism for enhancing managerial accountability (Skaife and Werner, 2020). One side advocates the enhanced disclosure of political contributions so that investors are better informed of the political decisions taken by management (see, e.g., Bebchuk and Jackson, 2010) as well as the associated brand and reputational risks. The other side, argues that disclosure of new forms of political investments (such as independent political expenditures) may expose firms to harassment, boycotts, and other reputational threats that may position the firm in a disadvantageous competitive position.

By examining how social pressure and litigation risk affect the SEC's reaction to corporate political strategies, we contribute by evaluating how the regulator perceives the role of political activities in shaping corporate disclosure, information asymmetries and the related agency conflicts. Therefore, our findings provide new evidence to inform those policymakers, scholars, and shareholder activists deliberating the mandatory disclosure of corporate political spending as a mechanism to hold managers accountable for their firms' political strategies.

Limitations and Suggestions for Future Research

Our recommendations for future research also reflect the limitations of our paper. First, it would be worthy to examine the responses of the firm to the SEC's comment letter are contingent on the firm's political activities or other nonmarket strategies (such as CSR). It would be also interesting to investigate whether our findings hold in other countries. Additionally, future work can consider the role of analysts' forecasts and corporate governance on the association between political activities and CLs. We suggest that effective monitoring mechanisms may moderate the relationship between PMC and comment letters. It would also be worthwhile to explore the role of CFO, or more generally the prior work experience of the top management team on SEC's comment letters of IPOs. Finally, further studies can investigate how SEC comment letters influence other transition events (e.g., mergers and acquisitions), withdrawn offerings, and follow-up financing costs (e.g., seasoned equity offerings).

Notes

1. Political influence constitutes a valuable resource because it enables firms to enjoy preferential treatment from the government and regulatory authorities which, in turn, can benefit them in many ways (Pfeffer and Salancik, 1978). For instance, empirical studies show that pursuing political activities can result in reduced uncertainty about election outcomes and future policy initiatives (Gross et al., 2016), the receipt of government contracts (Agrawal and Knoeber, 2001), lowering effective tax rates (Kim and Zhang, 2016), and government support during periods of economic hardship (Faccio et al., 2006). Similarly, other studies find that corporate political activities secure preferential access to credit and equity capital, suggesting that providers of external capital perceive firms with political ties as being less risky than their peers (Dinc, 2005).

2. The role of the SEC is salient for newly public firms not only because regulatory involvement can protect uninformed investors from the winner's curse and contribute to vibrant financial markets (Colak et al., 2021), but also because a registrant's offering cannot become effective until the SEC certifies that all comments have in the filling review process have been addressed (Ertimur and Nondorf, 2006).

3. While several studies exploring the role of politically active intermediaries in the Chinese IPO market (e.g., Chen et al., 2017; Wang and Chaopeng, 2020), their conclusions cannot be applied to the U.S. IPO setting because the institutional background of China is completely different from that of U.S. (Piotroski et al., 2015).

4. Due to limited public records, IPO firms are subject to substantial information asymmetry between insiders and outsiders and heightened uncertainty about their future prospects (Colak et al., 2021). Motivated by this consideration, the literature argues that IPO issuers and intermediaries have both ample opportunities and strong incentives to hype their stocks through opportunistic (inadequate or inappropriate) disclosures in the registration statements (e.g., Chen and Ritter, 2000). However, reputation and litigation concerns may discipline the actions of the IPO players. Hence, both issuers and intermediaries face a dynamic trade-off when preparing registration materials.

5. Throughout the paper we use the terms politically active firms or PMC firms interchangeably.

6. For a detailed discussion on why and how corporate political involvement might affect SEC oversight please see section A1 of the Supplemental File.

7. The only difference is the priority. While the SEC issues comment letters for virtually every type of filing on a selective basis, it sets forth priority to filings under the Securities Act of 1933 and reviews almost all initial registration statements.

8. The average age (since establishment) of IPO issuers is 12 years, whereas the average age of VCs is 20 years, and more than 70 years for underwriters and auditors. Similarly, the average size of IPO issuers is $ 0.4m, whereas the average size of underwriters and auditors is more than $20b and $40b, respectively. Hence, compared to VCs, underwriters and auditors are more likely to be at mature stages of their life cycle stages than

IPO issuers. The above data are retrieved from previous studies (e.g., Basnet et al., 2022 and Jay Ritters' website) and verified by the authors' research.

9. On June 24, 2004, the DCF announced it would make comment and response letters related to filings filed after August 1, 2004, publicly available to the SEC's Electronic Data Gathering, Analysis and Retrieval (EDGAR) system (SEC, 2004). This initiative was motivated by the desire to enhance the transparency of the CL review process by ensuring that all comment letters would be made available to all investors in a timely manner and at no cost (Duro et al., 2019). On May 12, 2005, the SEC actually began to release comment letters (SEC, 2004). The initial policy was to disseminate CLs no late than 45 days after the conclusion (end) of a filing review, but beginning January, 1, 2012, this was reduced to the current policy of 20 business days (SEC, 2011).

10. We use EDGAR instead of Audit Analytics to construct the comment letters data as the former has better coverage.

11. PACs are established by companies and other special groups and have the explicit aim of supporting or fighting against a candidate's election. Rather than being directed at specific politicians, lobbying activities are funded by shareholders' funds and aims at influencing the legislative process. Hence, the purpose of lobbying is to advance a company's perspective of the institutional framework within which it works (Gounopoulos et al., 2017).

12. In the Supplemental File, we also use the natural logarithm of the number of words a given IPO firm receives from the SEC in the first-round comment letter (*Ln Length of Comment Letter*), and the number of questions a given firm receives from the SEC in the first-round comment letter (*Questions in the First Letter*). Our main inferences remain unchanged.

13. In particular, the list of words that we use for political investment is the following: lobbying and PACs, whereas for policy risk is the following: political, political risk, political investments, political uncertainty, political instability, and policy uncertainty

14. In untabulated analysis, we do not find evidence supporting the idea that the association between political money contributions and the number of comment letters is nonlinear (using data partition approaches or the squared PMC). The results are available upon request.

15. When we focus on the political activities of IPO financial intermediaries, we measure Industry-year Average PMC as the percentage of politically money contributions of IPO intermediaries (VCs, underwriters or auditors) within each industry after excluding the focal intermediary.

16. The results are available upon request.

17. Alternatively, it could be argued that the relationship between PMC intermediaries and SEC concerns becomes less negative when the issuer is also active. This would suggest that PMC issuers contract with PMC intermediaries for less strict monitoring (for example, less audit effort) when they have strong incentives to manipulate earnings (such as during the IPO).

18. DOE handles investigations of possible violations of federal securities laws, such as violations related to the preparation and presentation of financial reports in accordance with the U.S. GAAP. On the other hand, DCF performs an advisory role, as it provides interpretive assistance to listed companies (or companies planning an IPO) with regards to SEC rules, in an attempt to enhance disclosure quality and compliance and to minimize information asymmetries between managers and investors.

19. Existing studies show that the SEC filing review process affects several outcomes of seasoned firms, such as the readability (Cassell et al., 2019), financial reporting (Duro et al., 2019), corporate disclosure (Brown et al., 2018), tax avoidance (Kubick et al., 2016), and earnings management (Cunningham et al., 2019). For an excellent a review, please see Cunningham et al. (2021).

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Appendix A: Definitions of Variables

Variable	Definition
	Panel A: IPO and Comment Letter Process Variables
Waiting Period	The number of days from the filing date of the initial S-1 to the effective date of the IPO.
Drafts	The number of registration statements a given firm files, that is the initial S-1 statement and the subsequent amendments.
Revision_Down	It is equal to the absolute value of revision when revision is negative, else zero. Revision is the difference between the offer price and the mid-point of the price range over the latter.
No. of CLs	The number of comment letters (concerning S-1 filings) from the SEC to a given firm.
	Panel B: Accounting and Disclosure Characteristics
REM	Aggregate level of real earnings management in the offering year, calculated as the sum of abnormal cash flow from operations and abnormal discretionary expenses.
Abnormal Accruals	Abnormal accruals in the offering year, computed using the modified Jones (1991) model and adjusted for the abnormal accruals of a performance-matched, non-IPO firm based on year, industry, and ROA according to the performance matching procedure suggested by Kothari et al. (2005)
Restatement	Dummy variable equal to one if the firm's financial restatement for the offering year is restated, and zero otherwise.
IC_Weak	An indicator variable set equal to 1 if the internal control audit opinion (under SOX Section 404) or the management certification (under SOX Section 302) as reported in Audit Analytics is qualified for a material weakness in the pre-IPO year.
Negative Media Attention	It is the number of times IPO firm is cited negatively in media up to 30 days prior to listing. In the regressions, we use the natural logarithm of the negative media attention.
S-1 Disclosed Policy Risk	The natural logarithm of one plus the number of times that the following list of words that include the word "political" are referred in the S-1 file. In the regressions, we use the natural logarithm of the S-1 disclosed policy risk. The list of words that we use for political investment is the following: lobbying and PACs, whereas for policy risk is the following: political, political risk, political investments, political uncertainty, political instability, and policy uncertainty.
	Panel C: Firm and CEO Characteristics
Firm age	The number of years elapsed since firm's foundation to IPO date, using foundation dates from 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 equal to one for venture capital-backed firms, and zero otherwise.
Proceeds	Gross proceeds raised by the IPO estimated as shared offered times the offer price.
Sales	Total sales in the fiscal year prior to IPO. In the regression, we use the natural logarithm of sales.
Log_Mark_Cap	The natural log of market capitalization, calculated as shares offered times the offer price.
Market_to_Book	IPO firm's market value scaled by firm's book value.
Sales Volatility	It is the quarterly standard deviation of industry-adjusted sales using two prior to the IPO. In the regressions, we use the natural logarithm of sales volatility.
Overhang	The ratio of shares retained by the pre-IPO shareholders over shares issued in the offering.
Underwriter	Dummy variable equal to one for most prestigious underwriters, zero otherwise. Most reputable underwriters are those with a ranking score of 9.0 or above based on Jay Ritter's underwriter (prestige) rankings.
Big 4 Auditor	Dummy variable equal to one if the firm is audited by a big four audit firm, and zero otherwise. Big four audit firms include Ernst & Young, Deloitte & Touche, KPMG, and PricewaterhouseCoopers.
Internet	Dummy variable equal to one for IPOs of Internet firms, and zero otherwise. Internet firms are classified those with business description containing any of the words "Internet", "Online", eBusiness", "eCommerce", and/or "Website".
Technology	Dummy variable: one 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).
Nasdaq	Dummy variable equal to one for NASDAQ-listed IPOs, and zero otherwise.
Leverage	The ratio of total liabilities over total assets in the fiscal year prior to IPO.
Corporate Governance	It is constructed by taking the first factor of applying principal component analysis to the following variables: board independent measured as the ratio of the number of independent outside directors to the total number of directors; a dummy variable equal to one if the board has a nominating committee that is composed solely of independent directors, and zero otherwise;, the percentage of outside directors on the board that were appointed after the current CEO took office; the natural logarithm of the average number of other directorships held by independent directors serving on the board; a dummy variable, equal to one if the majority of outside directors on the board serve on three or more other boards; the natural logarithm of the number of board meetings; and the natural logarithm of the number of directors serving on the board.
Post-IPO Fraud	Dummy variable equal to one if a firm has committed a fraud and has been detected (post-IPO year), zero otherwise, following Wang et al. (2010). Data are retrieved from Securities Class Action

	Clearinghouse.
Fraud Geographical Density	It is defined as the ratio of corporate frauds revealed during the pre-IPO year to publicly traded firms in the same state. Data are retrieved from Securities Class Action Clearinghouse.
Litigious Industry	An indicator variable that takes the value of 1 if the IPO firm is in the biotech (SIC codes 2833-2836 and 8731-8734), computer (3570-3577 and 7370-7374), electronics (3600-3674), or retail (5200-5961) industry, and 0 otherwise (Francis et al., 1994).
Underwriting Fees	The percentage of underwriting fees divided by offer proceeds.
Accounting Fees	The percentage of accounting fees divided by offer proceeds.
Legal Fees	The percentage of legal fees divided by offer proceeds.
Panel D: Political Variables	
Issuer_Lobby	The natural logarithm of one plus the amounts of lobbying expenses of the IPO issuer.
Issuer_PAC	The natural logarithm of one plus the amounts of PAC expenses of the IPO issuer.
Issuer_PMC	The natural logarithm of one plus the amounts of lobbying and PAC expenses (political money contributions) of the IPO issuer.
VC_Lobby	The natural logarithm of one plus the amounts of lobbying expenses of the venture capitalist.
VC_PAC	The natural logarithm of one plus the amounts of PAC expenses of the venture capitalist.
VC_PMC	The natural logarithm of one plus the amounts of lobbying and PAC expenses ((political money contributions)) of the venture capitalist.
UW_Lobby	The natural logarithm of one plus the amounts of lobbying expenses of the underwriter.
UW_PAC	The natural logarithm of one plus the amounts of PAC expenses of the underwriter.
UW_PMC	The natural logarithm of one plus the amounts of lobbying and PAC expenses ((political money contributions)) of the underwriter.
AUD_Lobby	The natural logarithm of one plus the amounts of lobbying expenses of the auditor.
AUD_PAC	The natural logarithm of one plus the amounts of PAC expenses of the auditor.
AUD_PMC	The natural logarithm of one plus the amounts of lobbying and PAC expenses ((political money contributions)) of the auditor.
Industry-Year Average PMC	It is defined as the percentage of political money contributions (of Issuers, Underwriters, VCs, or Auditors) within each industry after excluding the focal firm (issuer or intermediary).
Distance	It is the natural logarithm of the distance (kilometres) between an intermediary's or issuer's headquarters and Washington, DC.
Voter Turnout	It is calculated as ballots counted divided by the voting-eligible population for the general elections (following Unsal et al., 2016).

Figure 1: How Do Public Voters and the Regulator Perceive Politically Active Firms?

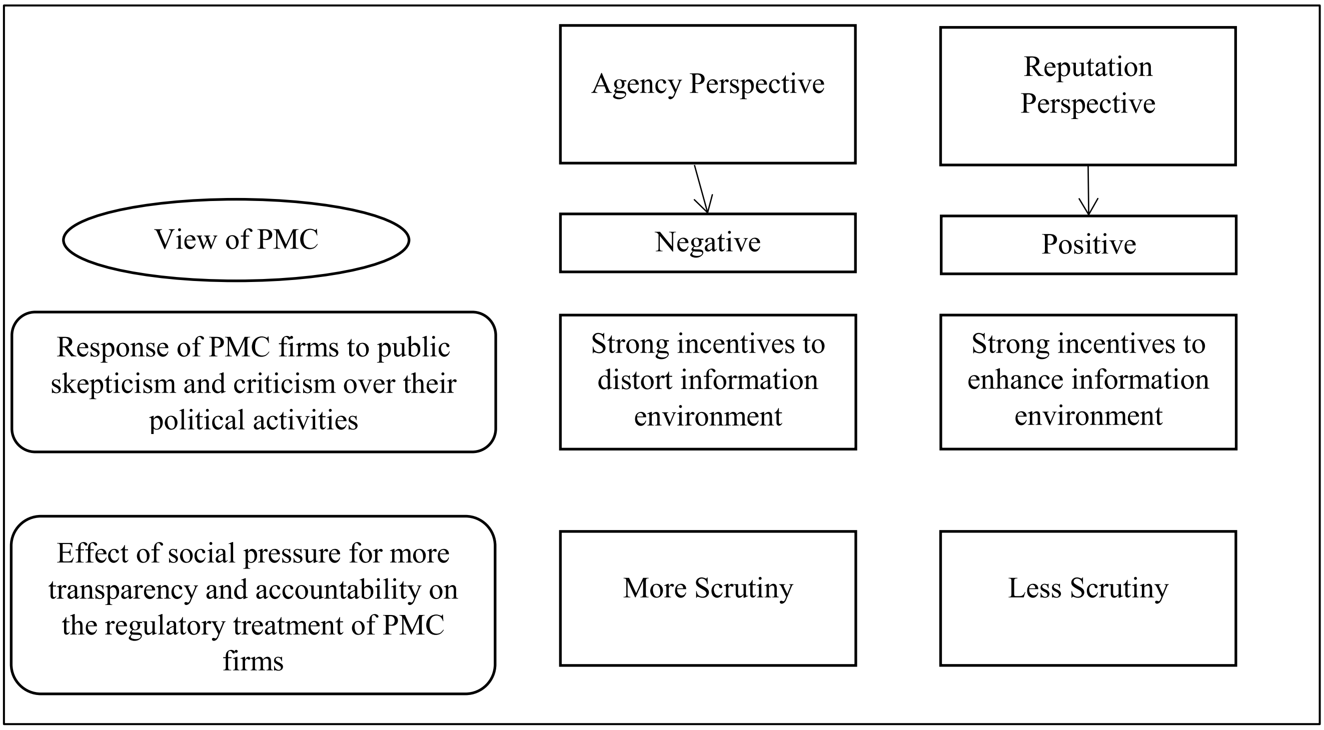

Figure 2: How Does the IPO Political Environment Affect SEC Scrutiny?

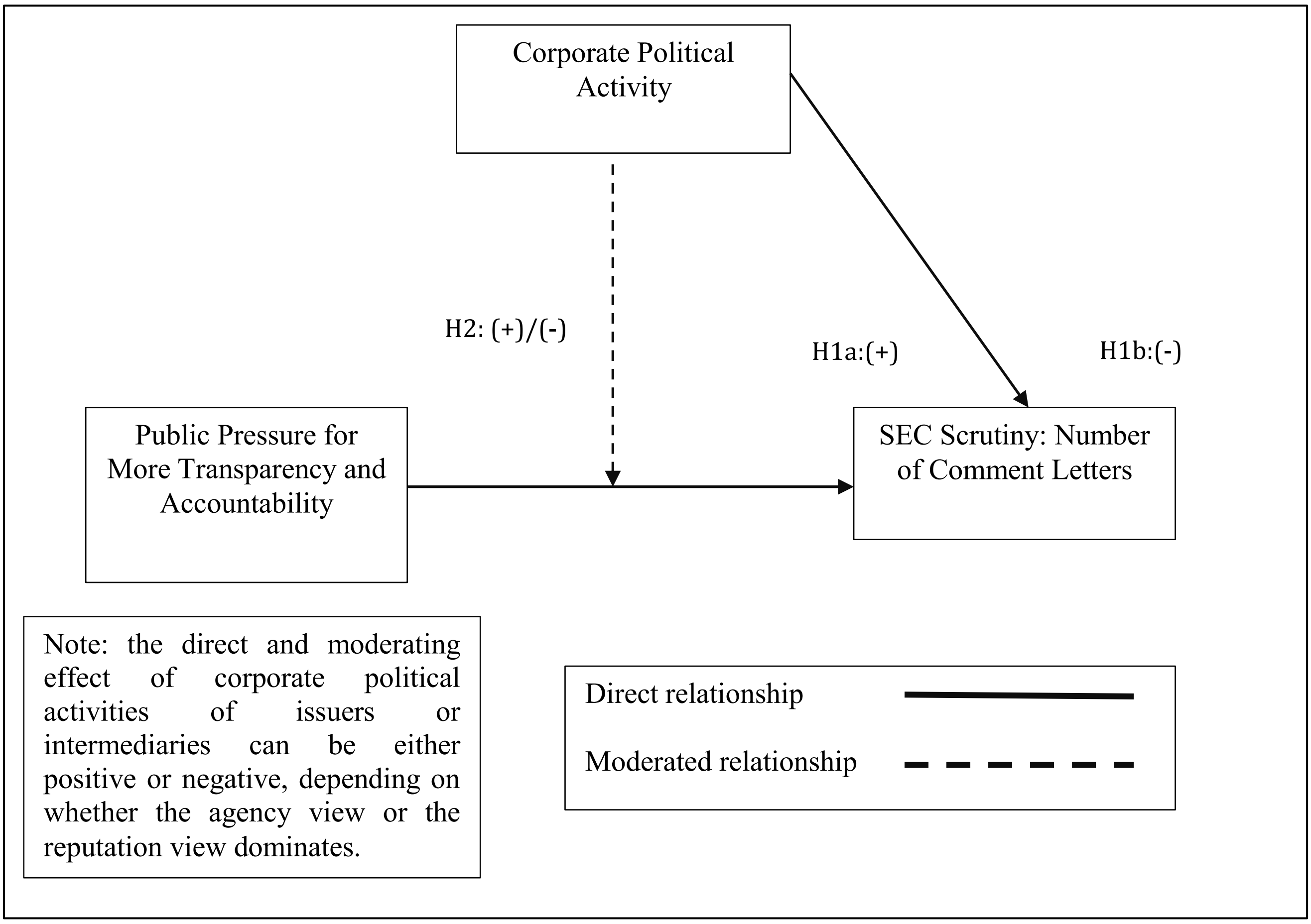

Figure 3: The Moderating Role of the IPO's Political Environment on the Relationship between SEC Scrutiny and IPO Success Outcomes

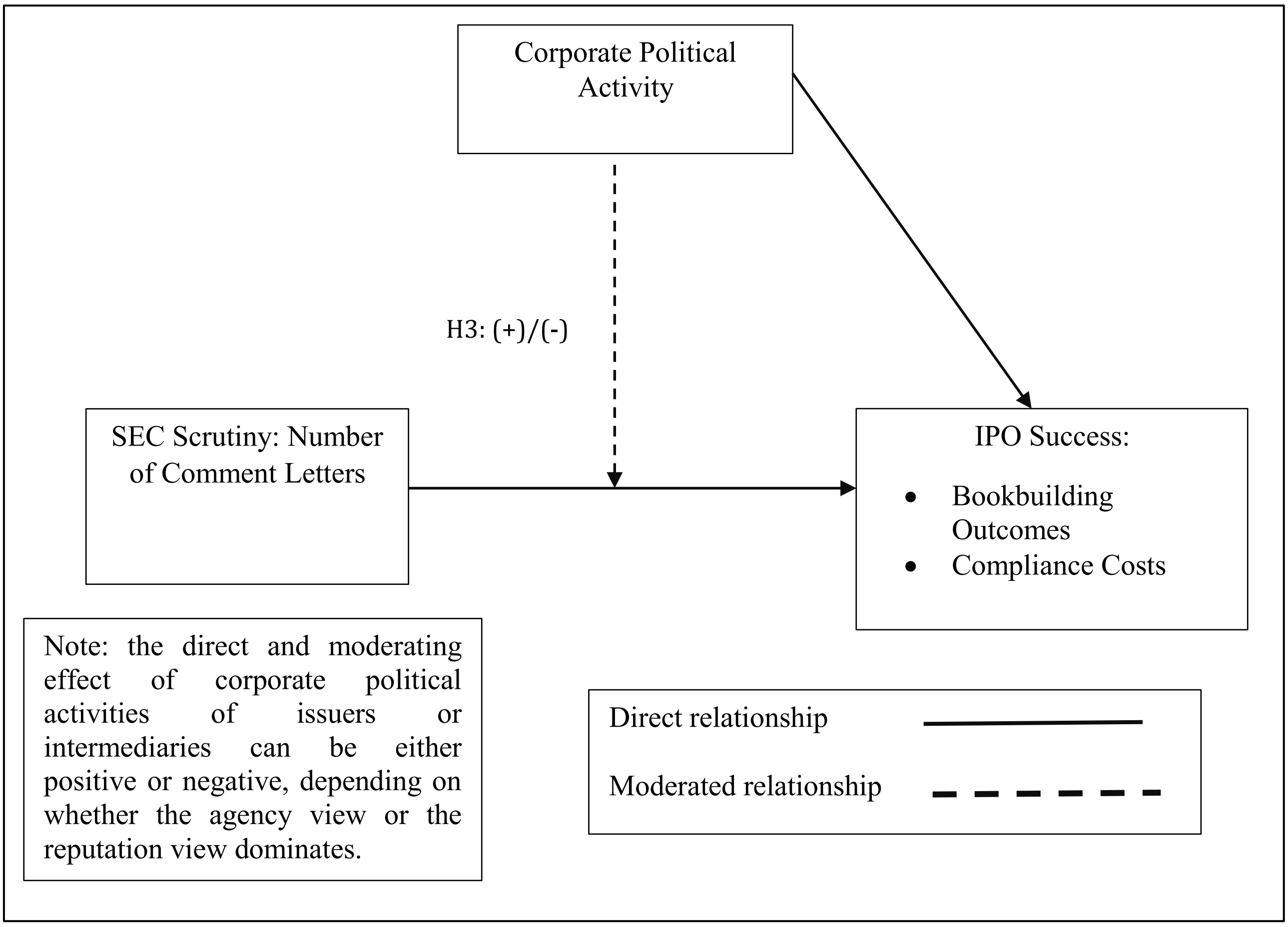

Figure 4: The IPO Process
This figure shows the typical timeline of an IPO, for offerings during our 2005-2018 sample period.

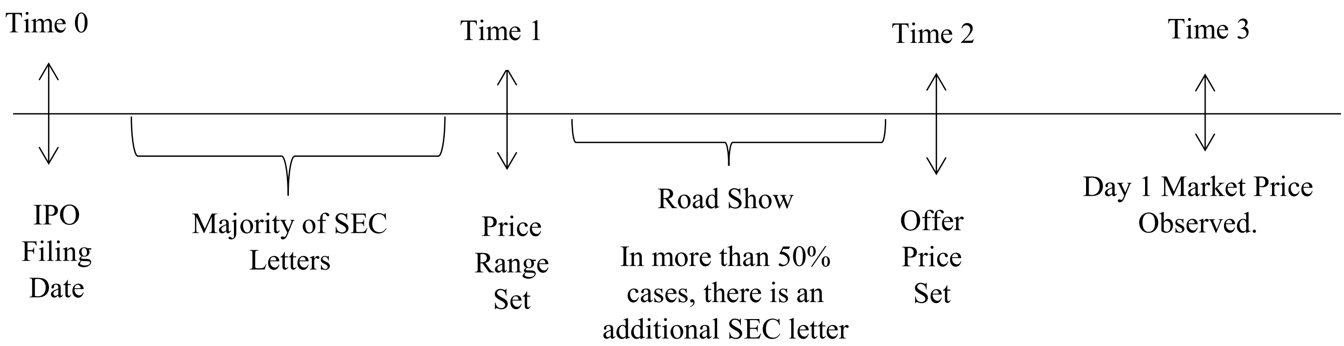

Table I: Descriptive Statistics

The table presents descriptive statistics for a sample of 937 U.S. IPOs over the period from May 12, 2005 to December 31, 2018. Panel A presents the summary statistics for variables related to the comment letter process. Panel B displays the summary statistics for accounting and disclosure characteristics. Panel C reports the summary statistics of firms and offering characteristics. Panel D reports the incidence of politically active issuers, venture capitalists, underwriters, and auditors in our sample. Panel E reports the average dollar values of the political contributions of politically active issuers, venture capitalists, underwriters, and auditors. The number of observations for each variable is 937. All variables are defined in Appendix A.

Panel A: Description Statistics for IPO and Comment Letter Process Variables

	Mean	**SD**	**Min**	**P25**	**P75**	**Max**
Drafts	6.24	2.98	1	4	8	22
No. of CLs	3.99	1.91	1	4	5	15
Length of Comment Letter (Words)	2,815	1,467	118	1,653	3,801	10,334
Questions in the First Letter (Number)	36.95	20.17	1	22	49	137

Panel B: Accounting and Disclosure Characteristics

	Mean	**SD**	**Min**	**P25**	**P75**	**Max**
REM	-0.34	1.26	-9.25	-0.69	0.20	5.27
Abnormal Accruals	-0.19	1.01	-10.87	-0.29	0.09	2.91
Restatement	0.09	0.29	0	0	0	1
IC_Weak	0.16	0.37	0	0	0	1
Negative Media Attention	4.71	14.55	0	2.25	3.70	6.40
Post-IPO Fraud	0.04	0.16	0	0	0	1
S-1 Disclosed Policy Risk	3.15	3.03	0	1	4	30

Panel C: Firm and Offering Characteristics

	Mean	**SD**	**Min**	**P25**	**P75**	**Max**
Firm Age	12.34	16.22	0.11	5	14	125
Proceeds	$172.91	$572.92	$1.28	$56.53	$154	$16,007
Sales	$281.10	$1,579.41	$1.10	$1.14	$123.90	$41,190
Market_to_Book	1.32	14.74	-85.97	0.61	1.16	391.30
Sales Volatility	$548,735	$345,31	$0	$4.41	$128.79	$39,309
Leverage	0.38	0.43	0.01	0.06	0.57	3.31
EPS	0.35	0.48	0	0	1	1
Corporate Governance	-0.02	0.08	-0.29	-0.06	0.02	0.27
Revision_Down	5.38	9.87	0	0	7.69	53.84
Overhang	3.56	3.89	-0.16	1.87	4.38	92.24
VC	0.60	0.49	0	0	1	1
Underwriter	0.53	0.50	0	0	1	1
Big 4 Auditor	0.70	0.46	0	0	1	1
Technology	0.34	0.47	0	0	1	1
Internet	0.12	0.33	0	0	0	1
Nasdaq	0.69	0.46	0	0	1	1

Panel D: Incidence of Politically Active Issuers and Intermediaries

	Mean	**SD**	**Min**	**P25**	**P75**	**Max**
Issuer_PMC	0.11	0.27	0	0	0	1
VC_ PMC	0.16	0.37	0	0	0	1
UW_ PMC	0.63	0.48	0	1	1	1
AUD_ PMC	0.75	0.43	0	1	1	1

Panel E: Average Amounts of Political Money Contributions (PMC) of Key IPO Parties

	Issuers	Venture Capitalists (VC)	Underwriters (UW)	Auditors (AUD)
Lobby Money	$352,834	$1,464,000	$2,960,000	$1,694,000
PAC Money	$72,190	$40,000	$110,000	$45,000

Table II: IPO Political Environment and SEC Comment Letters

This table displays the relationship between the IPO's political environment and the number of SEC comment letters using ordinary least square (OLS) regressions. The sample consists of initial public offerings from May 12, 2005 to December 31, 2018 in the US stock market. The dependent variable is the number of SEC comment letters. T-statistics are included in parentheses and are adjusted for heteroscedasticity robust standard errors clustered by industry and year. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. All variables are defined in Appendix A.

Panel A: The Impact of the IPO's Political Environment on SEC Comment Letters

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)
Issuer_Lobby	0.04***								
	(2.84)								
Issuer_PAC	0.02*								
	(1.76)								
Issuer_PMC		0.04***	0.03***	0.04**	0.03***	0.04***	0.03**	0.03**	0.04***
		(2.82)	(2.75)	(2.70)	(2.80)	(2.95)	(2.50)	(2.55)	(2.80)
VC_Lobby			-0.03***						
			(-3.05)						
VC_PAC			-0.01						
			(-0.80)						
VC_PMC				-0.03***					-0.02***
				(-2.75)					(-2.70)
UW_Lobby					-0.02**				
					(-2.40)				
UW_PAC					0.01				
					(0.30)				
UW_PMC						-0.02**			-0.01*
						(-2.25)			(-1.90)
AUD_Lobby							-0.04*		
							(-1.85)		
AUD_PAC							-0.03*		
							(-1.70)		
AUD_PMC								-0.03*	-0.02*
								(-1.80)	(-1.69)
Test of Equal Coefficients (p-value)									
Issuers_ PMC Vs VC_PMC				0.0000					0.0000
Issuers_ PMC Vs UW_PMC						0.0000			0.0000
Issuers_ PMC Vs AUD_PMC								0.0005	0.0007
Section 408 Criteria									
IC_Weak	0.24	0.28	0.26	0.27	0.20	0.22	0.26	0.25	0.26
	(1.07)	(1.10)	(0.95)	(1.04)	(0.90)	(1.05)	(1.12)	(1.08)	(1.10)
Restatement	0.03	0.03	0.04	0.03	0.03	0.04	0.05	0.06	0.05
	(1.20)	(1.15)	(0.22)	(1.12)	(0.14)	(0.40)	(0.15)	(0.20)	(0.25)
Sales Volatility	0.05*	0.05*	0.04*	0.04*	0.04*	0.05*	0.04*	0.04*	0.04*
	(1.70)	(1.75)	(1.72)	(1.70)	(1.68)	(1.69)	(1.70)	(1.71)	(1.70)
Log Market Cap	0.24**	0.24**	0.23**	0.24**	0.20**	0.22**	0.21**	0.21**	0.21**
	(2.38)	(2.35)	(2.15)	(2.10)	(2.11)	(2.05)	(2.20)	(2.25)	(2.30)
Market_to_Book	-0.03	-0.03	-0.01	-0.02	-0.02	-0.03	-0.02	-0.02	-0.02
	(-0.90)	(-0.87)	(0.92)	(-0.85)	(-0.92)	(-0.80)	(-0.90)	(-0.85)	(-0.95)
Firm Characteristics									
Firm Age	-0.11	-0.12	-0.11	-0.12	-0.12	-0.11	-0.11	-0.11	-0.12
	(-1.47)	(-1.22)	(-1.38)	(-1.20)	(-1.35)	(-1.10)	(-1.15)	(-1.13	(-1.30)
Sales	0.06*	0.05*	0.06*	0.05*	0.06*	0.05*	0.05*	0.04*	0.04*
	(1.75)	(1.70)	(1.68)	(1.71)	(1.74)	(1.70)	(1.75)	(1.74)	(1.69)
Leverage	-0.06	-0.05	-0.06	-0.05	-0.05	-0.05	-0.07	-0.06	-0.05
	(-0.45)	(-0.50)	(-0.40)	(-0.48)	(-0.45)	(-0.50)	(-0.40)	(-0.35)	(-0.40)
EPS	-0.24**	-0.23**	-0.22**	-0.23**	-0.21**	-0.22**	-0.20**	-0.20**	-0.23**
	(-2.21)	(-2.15)	(-2.20)	(-2.05)	(-2.35)	(-2.08)	(-2.05)	(-2.00)	(-2.35)
Corporate Governance	-0.31*	-0.28*	-0.36*	-0.33*	-0.41*	-0.38*	-0.35*	-0.39*	-0.38*
	(-1.90)	(-1.85)	(-1.86)	(-1.80)	(-1.85)	(-1.79)	(-1.75)	(-1.80)	(-1.85)
Negative Media Attention	0.75*	0.80*	0.65**	0.70*	0.74*	0.79*	0.81*	0.70*	0.78*
	(1.95)	(1.90)	(2.01)	(1.95)	(1.95)	(1.95)	(1.85)	(1.81)	(1.85)
Technology	0.06	0.06	0.04	0.05	0.04	0.05	0.04	0.05	0.03
	(0.37)	(0.26)	(0.24)	(0.25)	(0.28)	(0.30)	(0.20)	(0.25)	(0.21)

Table II: IPO Political Environment and SEC Comment Letters (continued)

Internet	0.13	0.13	0.12	0.12	0.13	0.12	0.11	0.11	0.11
	(1.63)	(0.68)	(1.50)	(1.20)	(1.55)	(1.45)	(1.30)	(1.35)	(0.80)
Nasdaq	0.10	0.10	0.12	0.11	0.11	0.12	0.11	0.12	0.11
	(0.45)	(0.55)	(0.40)	(0.41)	(0.45)	(0.52)	(0.50)	(0.45)	(0.40)
IPO Characteristics									
S-1 Disclosed Policy	0.02	0.04	0.03	0.04	0.02	0.03	0.02	0.03	0.02
Risk	(0.40)	(0.25)	(0.85)	(0.80)	(0.95)	(1.05)	(1.02)	(1.10)	(0.75)
Overhang	0.01	0.02	0.01	0.02	0.01	0.02	0.02	0.01	0.02
	(0.76)	(0.50)	(0.75)	(0.65)	(0.70)	(0.60)	(0.65)	(0.58)	(0.60)
Underwriter	0.08	0.08	0.07	0.06	0.07	0.06	0.07	0.07	0.07
	(0.85)	(0.61)	(0.80)	(0.75)	(0.79)	(0.90)	(0.75)	(0.70)	(0.85)
VC	-0.58***	-0.58***	-0.56***	-0.57***	-0.57***	-0.55***	-0.56***	-0.56***	-0.54***
	(-3.62)	(-3.61)	(-3.68)	(-3.70)	(-3.65)	(-3.75)	(-3.70)	(-3.80)	(-3.60)
Big 4 Auditor	-0.04**	-0.02*	-0.03*	-0.03*	-0.05*	-0.04*	-0.02	-0.03	-0.03
	(-2.21)	(-1.87)	(-1.75)	(-1.80)	(-1.75)	(-1.68)	(-1.60)	(-1.55)	(-1.55)
Year & Industry FE	Y	Y	Y	Y	Y	Y	Y	Y	Y
Adjusted R^2	0.1103	0.1108	0.1125	0.1120	0.1127	0.1115	0.1105	0.1110	0.1130
Number of Observations	937	937	937	937	937	937	937	937	937

Table III: IPO Political Environment and Accounting or Disclosure Outcomes

This table displays the relationship between the IPO's political environment and IPO Accounting Outcomes, using ordinary least square (OLS) regressions. The sample consists of initial public offerings from May 12, 2005 to December 31, 2018 in the US stock market. The dependent variables are the real earnings management (REM), abnormal accruals, restatement, and post-IPO fraud. T-statistics are included in parentheses and are adjusted for heteroscedasticity robust standard errors clustered by industry and year. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. All variables are defined in Appendix A.

	REM	**Abnormal Accruals**	**Restatement**	**Post-IPO Fraud**
	(1)	(2)	(3)	(4)
Issuer_PMC	0.02	0.04*	0.02*	0.02*
	(1.36)	(1.85)	(1.86)	(1.73)
VC_PMC	-0.03*	-0.04**	-0.03**	-0.02*
	(-1.69)	(-2.65)	(-2.10)	(-1.70)
UW_PMC	-0.02*	-0.02	-0.02	-0.01*
	(-1.60)	(-0.40)	(-0.80)	(-1.80)
AUD_PMC	-0.03*	-0.02*	-0.01*	-0.01
	(-1.70)	(-1.40)	(-1.70)	(-0.40)
Control Variables	Y	Y	Y	Y
Year & Industry FE	Y	Y	Y	Y
Adjusted R^2	0.1069	0.0637		
Pseudo R^2			0.0980	0.0983
Number of Observations	937	937	937	937

Table IV: Instrumental Variable Analysis

This table reports the results from the TSLS estimation of the effect of the IPO political environment on the number of SEC comment letters. The sample consists of initial public offerings from May 12, 2005 to December 31, 2018 in the US stock market. Panel A shows the first-stage model where the dependent variables are the dollar amounts of political money contributions of IPO issuers, venture capitalists, underwriters, and auditors. Panel B presents the results from the second-stage models, where the dependent variable is the number of comment letters, after replacing the PMC of each IPO party with its instrumented value from the first-stage. ***, *, and * denote significance at the 1%, 5%, and 10% levels, respectively. All variables are defined in Appendix A.

Panel A: First-Stage Results

	(1)	(2)	(3)	(4)
Dependent Variable	**Issuer_PMC**	**VC_PMC**	**UW_PMC**	**AUD_PMC**
Instruments				
Industry-Year Average	0.40***	0.20***	0.45***	0.60***
	(4.50)	(3.10)	(3.40)	(3.60)
Distance	-0.01**	-0.01***	-0.01***	-0.01**
	(-2.20)	(-2.90)	(-3.05)	(-2.55)
Voter Turnout	1.80***	2.10**	1.70***	2.05**
	(2.70)	(2.40)	(2.85)	(2.05)
Remaining Control Variables				
Section 408 Criteria				
IC_Weak	0.01	-0.03*	-0.02*	0.03
	(1.40)	(-1.90)	(-1.75)	(1.38)
Restatement	0.02	-0.02	0.04	0.01
	(0.50)	(-1.55)	(0.20)	(0.40)
Sales Volatility	0.03	0.07	0.04	0.05
	(0.75)	(1.40)	(1.50)	(1.35)
Log Market Cap	0.52**	0.02	0.05***	0.02**
	(5.66)	(0.50)	(3.20)	(2.05)
Market_to_Book	0.02***	-0.02	0.01	-0.01
	(5.40)	(-0.40)	(1.50)	(-1.05)
Firm Characteristics				
Firm Age	0.42**	0.01**	0.04	0.01**
	(2.26)	(2.50)	(0.80)	(2.05)
Sales	0.09	0.02	0.02	0.01**
	(1.26)	(0.80)	(0.60)	(2.10)
Leverage	0.16	0.05**	0.01	0.01
	(0.65)	(2.10)	(0.25)	(0.40)
EPS	-0.04	-0.03***	-0.05	-0.02*
	(-0.95)	(-3.50)	(-1.20)	(-1.90)
Corporate Governance	-0.20***	-0.07	-0.09	-0.11
	(-2.70)	(-0.30)	(-0.80)	(-1.25)
Negative Media Attention	0.25**	-0.09	0.14	-0.11**
	(2.05)	(-1.40)	(1.05)	(-2.08)
Technology	-0.37**	0.02	0.06***	-0.03*
	(-2.33)	(1.40)	(3.50)	(-1.85)
Internet	0.16	0.02**	-0.01	-0.04
	(0.42)	(2.10)	(-0.30)	(-1.40)
Nasdaq	-0.12	0.01	-0.02*	-0.01
	(-0.59)	(0.50)	(-1.70)	(-1.05)
IPO Characteristics				
Issuer_PMC		0.11*	-0.02**	0.02
		(1.95)	(-2.05)	(1.50)
S-1 Disclosed Policy Risk	0.41*	0.01	-0.01	0.01
	(1.99)	(0.40)	(-0.10)	(1.50)
Overhang	0.02	-0.03	0.01	-0.01
	(0.95)	(-0.30)	(0.20)	(-0.80)
Underwriter	0.29	-0.02	0.20***	0.01
	(1.28)	(-1.30)	(3.70)	(0.50)
VC	0.62**	0.18***	0.04**	0.03***
	(2.14)	(5.30)	(2.05)	(3.55)
Big 4 Auditor	-0.34	0.01	0.08**	0.30***
	(-1.31)	(0.40)	(2.20)	(3.20)
Year & Industry FE	Y	Y	Y	Y
Adjusted R^2	0.1171	0.1160	0.1210	0.1105
N	937	937	937	937

Panel B: Second-Stage Results

Dependent Variable	(1) **No. of CLs**	(2) **No. of CLs**	(3) **No. of CLs**	(4) **No. of CLs**
Predicted Issuer_PMC	0.20*** (5.50)			
Predicted VC_PMC		-0.14*** (-3.30)		
Predicted UW_PMC			-0.11** (-2.45)	
Predicted AUD_PMC				-0.09* (-1.75)
Control Variables	Y	Y	Y	Y
Year & Industry FE	Y	Y	Y	Y
Tests of endogeneity, relevance, and validity of instruments				
First-Stage partial F-Statistic	130.40***	150.50***	160.20***	175.20***
Hansen's J Test	0.205	0.200	0.130	0.240
Hausman Test for exogeneity	0.0350**	0.0450**	0.0345**	0.0045***
Adjusted R^2	0.1130	0.1060	0.1150	0.1080
N	937	937	937	937

Table V: Cross-Sectional Analysis

This table displays the relationship between corporate political activities and SEC Comment Letters when the SEC is subject to social pressure for corporate transparency using ordinary least square (OLS) regressions. The sample consists of initial public offerings from May 12, 2005 to December 31, 2018 in the US stock market. The dependent variable is the number of comment letters (No. of CLs). To save space, we do not report the direct effects of political activities. Columns (1), (2), and (3) show the effect negative media attention, fraud geographical density, litigious industry, respectively as proxies for social pressure. T-statistics are included in parentheses and are adjusted for heteroscedasticity robust standard errors clustered by state. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. All variables are defined in Appendix A.

	(1) **Negative Media Attention**	(2) **Fraud Geographical Density**	(3) **Litigious Industry**
Proxy for Social Pressure	0.55* (1.95)	0.08 (1.05)	0.30** (2.05)
Issuer_PMC × Proxy for Social Pressure	1.80** (2.10)	0.02** (2.50)	0.06** (2.20)
VC_PMC × Proxy for Social Pressure	-1.70*** (-3.30)	-0.06* (-1.80)	-0.03* (-1.80)
UW_PMC × Proxy for Social Pressure	-1.20 (-0.80)	-0.03 (-1.10)	-0.02** (-2.01)
AUD_PMC × Proxy for Social Pressure	-1.60* (-1.70)	-0.02 (-0.15)	-0.03* (-1.70)
Control Variables	Y	Y	Y
Year & Industry FE	Y	Y	Y
Tests of Equality of Coefficients (p-values)			
Interacted (Issuer_PMC – VC_PMC)	0.0006	0.0440	0.0002
Interacted (Issuer_PMC – UW_PMC)	0.0825	0.0840	0.0000
Interacted (Issuer_PMC – AUD_PMC)	0.0009	0.2510	0.0002
Adjusted R^2	0.1155	0.1155	0.1235
Number of Observations	937	937	937

Table VI: IPO Political Activities and IPO Process

This table displays the relationship between the IPO's political environment and several IPO outcomes using ordinary least square (OLS) regressions. The sample consists of initial public offerings from May 12, 2005 to December 31, 2018 in the US stock market. The dependent variables are several IPO outcomes related to the bookbuilding process, IPO pricing, and IPO compliance costs. T-statistics are included in parentheses and are adjusted for heteroscedasticity robust standard errors clustered by industry and year. ***, **, and * denote significance at the 1%, 5%, and 10% levels, respectively. All variables are defined in Appendix A.

	Ln Waiting Period	**Drafts**	**Revision_Down**	**Underwriting Fees**	**Accounting Fees**	**Legal Fees**
	(1)	(2)	(3)	(4)	(5)	(6)
No. of CLs	0.13***	0.63***	0.19*	0.02*	0.01*	0.03***
	(6.50)	(6.49)	(1.90)	(1.80)	(1.74)	(5.84)
Issuer_PMC	0.03*	0.02*	0.04	0.01*	0.02**	0.01
	(1.86)	(1.75)	(0.59)	(1.75)	(1.85)	(1.53)
Issuer_PMC × No. of CLs	0.06**	0.02	-0.01*	0.04*	0.01*	0.01*
	(2.11)	(1.52)	(-1.77)	(1.85)	(1.70)	(1.77)
VC_PMC	-0.04*	-0.30	1.06	0.05	-0.06	-0.06
	(-1.75)	(-1.10)	(0.40)	(1.55)	(-1.10)	(-0.90)
VC_PMC × No. of CLs	-0.07**	-0.03**	-0.05*	-0.04***	-0.03**	-0.01*
	(-2.55)	(-2.05)	(-1.90)	(-3.10)	(-2.10)	(-1.70)
UW_PMC	-0.04*	-0.07*	0.60***	-0.05	-0.04	-0.02
	(-1.70)	(-1.85)	(3.40)	(-1.30)	(-1.60)	(-1.15)
UW_PMC × No. of CLs	-0.03*	-0.02*	-0.08**	-0.04	-0.01*	-0.01*
	(-1.80)	(-1.85)	(-2.30)	(-0.90)	(-1.90)	(-1.95)
AUD_PMC	-0.02	-0.04	-0.65	-0.02	0.03*	0.04*
	(-0.70)	(-1.30)	(-0.50)	(-1.10)	(1.70)	(1.90)
AUD_PMC × No. of CLs	-0.01**	-0.04*	-0.10**	-0.03*	-0.03	-0.01
	(-2.10)	(-1.85)	(-2.20)	(1.90)	(-1.45)	(-0.40)
Control Variables	Y	Y	Y	Y	Y	Y
Year & Industry FE	Y	Y	Y	Y	Y	Y
Test of equality of coefficients						
Interacted (Issuer_PMC – VC_PMC)	0.0000	0.0415	0.1120	0.0000	0.0325	0.0492
Interacted (Issuer_PMC – UW_PMC)	0.0310	0.0450	0.0810	0.1020	0.0335	0.0435
Interacted (Issuer_PMC – AUD_PMC)	0.0352	0.0464	0.0940	0.0410	0.0920	0.2010
Adjusted R^2	0.4261	0.4606	0.1516	0.5025	0.5268	0.4916
Number of Observations	937	937	937	937	937	937