

Study finds political contributions can play an important role in a successful IPO

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Political donations can have immediate and measurable gains on issue day.

Credit: University of Portsmouth

A firm's political donations can have a significant effect on initial public offering (IPO) underpricing, leading to immediate and measurable gains on issue day, according to new research from the University of Portsmouth.

The study, published in the *Journal of Corporate Finance*, found that if a prospective IPO firm in the United States spends an additional 10 per cent on political money contributions (PMC), IPO underpricing is reduced by 2.5 per cent. With a median of US\$ 71,000, PMC comprise a surprisingly cost-effective strategy to combat the principal friction in the going-public process.

The research found that firms which increased spending on lobbying and politically action committees (PACs) had greater bargaining power in pricing negotiations with the lead underwriter. It also found there is less discord on the value of such offerings among aftermarket investors as politically connected firms' shares trade with less volatility. This supports the notion that access to the highest echelon of government, as a signaling mechanism, eases concerns on the liquidity or price level of new equities.

Lead author of the study Dr Konstantinos Kallias, Lecturer in the University's Portsmouth Business School, said: "Our findings have important implications for prospective issuers. We show how a firm's political donations, commonly associated with remote and indirect benefits, translate into an immediate and measurable gain on the IPO day. Firms which are less known to the market and vulnerable to underwriters' attempt to extract rents from underpricing could benefit substantially from PMC. Given the cash-scarcity prior to an IPO, our insight facilitates the efficient appropriation of an issuer's political budget."

The researchers have assembled a unique U.S. IPO database by manually searching firms in the archives of the U.S. Federal Election Commission and Center for Responsive Politics for PAC and lobbying contributions, respectively. The sample includes 1578 IPOs that were floated on the US exchanges from 1 January 1998 to 30 June 2013.

The analysis of the two routes to PMC: lobbying (which is uncapped and targets the legislative process rather than specific politicians) and PAC (which is capped at US\$ 5,000 and organised for the purpose of raising and spending money to elect and defeat candidates) provided an unexpected result on the type of recipient candidates.

Dr Kallias said: "Our findings dispel the notion attaching special prestige

to U.S. senators; supporting campaigns for the House of Representatives generates a stronger effect in terms of IPO underpricing. Splitting across party lines, we show that supporting a Democratic candidate results in the least underpricing.

"At an individual level, lengthy tenures of accomplishment and home state candidacies maximise the effect. In addition, the least underpriced IPOs are shown to have employed some blend of lobbying and PAC, whereby lobbying caters for the size factor by being uncapped and PAC for the personalised dimension by entering into candidates' coffers."

More information: Dimitrios Gounopoulos et al. Political money contributions of U.S. IPOs, *Journal of Corporate Finance* (2017). [DOI: 10.1016/j.jcorpfin.2016.12.011](https://doi.org/10.1016/j.jcorpfin.2016.12.011)

Provided by University of Portsmouth

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