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Stock purchases by senators generate abnormal returns for firms

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Stock purchases by U.S. senators generated abnormal positive returns for the firms whose stock was purchased, according to a new study by U of

A researchers.

Based on public perception of politicians as unethical, the researchers hypothesized that stock markets would respond positively to purchases by senators.

They examined a broad sample of stock purchases by members of the U.S. Senate between 2012 and 2020 and found that the firms experienced greater returns around the date the purchase was disclosed.

"Addressing the question of investments by public servants, our study provides insights into important public policy questions related to transparency and ethics in government," said Jason Ridge, professor and chair of the Department of Strategy, Entrepreneurship and Venture Innovation in the Sam M. Walton College of Business. "It's a complex problem, because much of it based on perception rather than what really might be going on."

The researchers framed their study on public perception of politicians as unethical, as well as "information asymmetry" regarding public policy and regulation. This asymmetry refers to a gap in quality information between investors and sitting members of Congress about current or future public policy and regulation focused on investments and the stock market.

"Senators are perceived to have an informational advantage," Ridge said. "Investors think they are trading on inside information. Though the information asymmetry is real, the perception of politicians using it for personal benefit is not necessarily true. But, here we have one of those situations where perception might be more important than reality, because this perception is driving investment behavior. The market is responding positively, based on these assumptions."

The researchers found that abnormal returns were even higher if the senator had direct jurisdiction over the firm through a committee assignment. Again, returns were abnormally high as well in situations where the senator sponsored or supported legislation lobbied for by the firm. They were high also when firms had made contributions to a political action committee supporting the senator.

However, 6 to 12 months following the transaction date, stocks purchased and sold by senators experienced negative abnormal returns, the researchers found. Ridge said this finding suggests investors' perception of senators purchasing stocks based upon governmental knowledge is likely inaccurate over the long term, at least on average.

"To our knowledge, this is the first study that examines investor reactions to congressional stock purchases," Ridge said. "Our results suggest not only do firms accrue potential market gains from legislators' stock purchases, but also that the firm's corporate political activities, such as lobbying a senator's legislative proposals and campaign contributions, can amplify benefits when legislators have jurisdiction over the firm."

The researchers' study was published in *Strategic Management Journal*.

More information: Mirzokhidjon Abdurakhmonov et al, Perceptions of political Self-Dealing ? An empirical investigation of market returns surrounding the disclosure of politician stock purchases, *Strategic Management Journal* (2022). DOI: 10.1002/smj.3459

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