

# EARNINGS CREDIBILITY IN POLITICALLY CONNECTED FAMILY FIRMS

Carolina Bona-Sánchez  
Jerónimo Pérez-Alemán\*  
Domingo Javier Santana-Martín  
University of Las Palmas de Gran Canaria

\* Facultad de Ciencias Económicas y Empresariales. Campus Universitario de Tafira. C.P.:  
35017. Las Palmas de Gran Canaria (Spain). Jeronimo.perez@ulpgc.es

## **Abstract**

We investigate whether politically connected family firms provide the market with more or less credible earnings compared with unconnected family firms. Our results evidence that politically connected family firms show higher earnings informativeness than unconnected family firms. Our findings are consistent with the market perceiving that, in the presence of political ties, family firms are more likely to reduce information asymmetries by signalling their superior earnings quality.

## **Keywords**

Family control, political ties, earnings informativeness, signalling theory, bonding mechanisms.

## INTRODUCTION

Significant events affecting the Spanish economy have renewed interest in the role played by political ties in family businesses. One illustration of this concern is Abengoa, a leading politically connected family firm in renewable energy, which experienced a major debt crisis in late 2014. This led the company to use different accounting gimmicks to conceal its enormous debt ratio. Experiences such as this have renewed public interest in the role played by politicians in family firms' corporate governance and particularly in shaping their financial reporting incentives, raising the question of whether such events constitute the exception rather than the rule. In this sense, academic research into how political ties affect earnings quality remains scarce and usually predicts a negative incidence of political ties on earnings quality (Fan, Guan, Li & Yang, 2014; Bona, Pérez, & Santana, 2014; Chaney, Faccio, & Parsley, 2011; Riahi-Belkaoui, 2004). However, while previous studies have analysed the relation between political ties and different properties of accounting earnings, none have specifically considered previous interaction in family firms, even though such firms might offer an ideal environment for establishing political ties (Morck & Yeung, 2004; Bertrand & Schoar, 2006). Considering the above, we investigate whether politically connected family firms provide the market with more or less credible earnings compared with unconnected family firms. We focus on earnings informativeness since this aspect of accounting earnings plays a key role when assessing the quality of accounting information (Schipper & Vincent, 2003; Cascino, Pugliese, Mussolino & Sansone, 2010). Analysing earnings informativeness in politically connected family firms is potentially interesting since both features of a company's governance structure (political ties and family control) have often been felt to affect the properties of accounting earnings, albeit in an opposite direction (Chaney *et al.*, 2011; Riahi-Belkaoui, 2004; Wang, 2006; Bona *et al.*, 2014; Ali, Chen & Radhakrishnan, 2007; Fan *et al.*, 2014).

The current study is accomplished in the Spanish context. According to Fan *et al.*, (2014), political ties are particularly important in environments where formal institutions offer weak protection for business transactions, as is the case in continental Europe (La Porta, Lopez-de-Silanes, Shleifer & Vishny, 1998). Our results show that political ties enhance communication between the controlling family and those who use accounting information. These results are consistent with the signalling effect, which predicts that in the presence of political ties, family firms evidence greater incentives to signal their transparency to the market.

By using a theoretical approach that combines agency theory and signalling theory, our study makes several contributions. First, compared with previous studies on the effect of political ties on earnings informativeness (*e.g.*, Riahi-Belkaoui, 2004; Gul, 2006; Chaney *et al.*, 2011; Chen, Li, Zu & Sun, 2011; Bona *et al.*, 2014), we show the importance of considering the nature of the controlling shareholder when assessing the impact of political connections on earnings informativeness. Second, our results extend previous studies on the properties of accounting earnings in the context of family firms (Cascino *et al.*, 2010; Ali *et al.*, 2007; Wang, 2006) by showing a new driver (political ties) of earnings informativeness in family firms. Third, we also contribute to studies exploring the relationship between board composition and earnings quality (Ahmed & Duellman, 2007; Peasnell, Pope & Young, 2000; Vafeas, 2000) by showing that politically connected directors play a relevant role in family firm corporate governance by improving earnings informativeness.

The rest of the study is organised as follows. First, we develop our hypotheses regarding how family firms' political ties influence earnings informativeness. Second, we present our methodology and the empirical results. To conclude, we present the conclusions to emerge from the study.

## **THEORETICAL BACKGROUND AND HYPOTHESES DEVELOPMENT**

## **Political ties and family firms**

Studies analysing the effect of political ties on the properties of accounting earnings generally support lower earnings quality for politically connected firms. Using data from 32 countries, Riahi-Belkaoui (2004) concludes that the level of earnings opacity increases with the percentage of politically connected firms, and decreases with both the percentage of market capitalization of previous companies and the level of legal enforcement in the country. In an international study, Chaney *et al.* (2011) show a negative incidence of political ties on earnings quality. Their results are consistent with less need to respond to market pressures in politically connected firms. Moreover, Fan *et al.* (2014) consider that political networks are likely to have both a valuation effect, which increases earnings persistence and hence the earnings informativeness of the firm's value, and a measurement effect, which decreases earnings informativeness. Their empirical results suggest that the measurement effect dominates the valuation effect. Finally, focusing on the Spanish context, Bona *et al.* (2014) posit that political ties reduce earnings informativeness. Their results are consistent with the existence of an information effect, in which shareholders and politicians are reluctant to disclose much information to the market in an effort to avoid unnecessary scrutiny.

Previous studies have analysed the relation between political ties and different properties of accounting earnings, yet none have directly considered how family firms' distinctive features might affect the relation between political ties and earnings credibility. The results in Chaney *et al.* (2011) leave unanswered the question of whether connected family firms display greater or less earnings quality than their unconnected family peers. Furthermore, Fan *et al.* (2014) do not consider how distinctive features of family firms in conjunction with political ties shape the properties of accounting earnings. In fact, their empirical study of politically connected firms might consider non-family controlled firms connected with corrupt bureaucrats through

kinship. Bona *et al.* (2014) do not consider the relation between political ties and earnings informativeness to be conditional upon the nature of the controlling shareholder. In this sense, previous literature has also noted that whereas ownership concentration measures the power of shareholders to influence managers, owner identity has implications for their objectives and how they exercise their power (Thomsen & Pedersen, 2000; Anderson & Reeb, 2003; Villalonga & Amit, 2006). In a setting where the vast majority of listed companies are closely held, as occurs in continental Europe, the main differences arise in terms of the nature and type of controlling owner rather than in ownership concentration (Cascino *et al.*, 2010).

Family firms might establish political ties for several reasons. In this sense, given their blood ties with politicians, families might present intrinsic advantages as rent seekers (Morck & Yeung, 2004; Bertrand & Schoar, 2006). Moreover, family firms retain high ownership stakes, hold poorly diversified portfolios and have long-investment horizons (Anderson & Reeb, 2003). Consequently, politicians might find family firms to be better rent-seeking partners given that the relation will last longer and because of the prospect of repeat deals (Morck & Yeung, 2004). La Porta, Lopez-de-Silanes & Shleifer (1999) show that pyramids are prevalent in most countries, and Morck & Yeung (2005) describe how pyramids allow a small number of families to govern major parts of corporate industries in most countries. Fukuyama (1995) argues that families in major pyramidal groups are well placed to make up-front side payments to politicians easily because of the huge financial resources available to them. Moreover, La Porta *et al.* (1998) evidence that large family groups encompass listed and unlisted firms. By drawing on income or investments from their unlisted companies, families can offer corrupt officials greater discretion than CEOs in free-standing widely controlled firms. As the number of oligarchs is small, cooperation is easier and the transaction costs of coordinating their actions are correspondingly low. This makes politicians more likely to establish relations with family oligarchs (Morck & Yeung, 2004). Modelling trust allows the family to set the foundation for

the ethical behaviour that provides the guidelines for cooperation and coordination, together with the principles of reciprocity and exchange (Bubolz, 2001).

All of the above makes family firms better able to establish and sustain political ties. Previous literature has also posited that establishing connections with governments can help family firms to reap huge benefits (Fisman, 2001; Faccio, 2006; Bunkanwanicha & Wiwattanakantang, 2009; Chen *et al.*, 2011; Bunkanwanicha, Fan & Wiwattanakantang, 2013; Xu, Xu & Yuan, 2013). In a similar vein, Fisman (2001), Leuz & Oberholzer (2006), Fan, Rui & Zhao (2008), and Faccio & Parsley (2009) show that a breakup of former political connections has negative consequences for family firms.

### **Earnings informativeness in politically connected family firms**

Although previous empirical evidence suggests that political ties might provide family firms with substantial benefits, little is known about how family firms' distinctive features could affect the relationship between political ties and earnings credibility. In this sense, previous studies have emphasized how market and political forces affect the performance of different market participants (Ball, Robin & Wu, 2003; Bushman & Piotroski, 2006). In this sense, different competing views might help to explain earnings informativeness in politically connected family firms. In particular, political ties might affect the supply and demand of family firms' earnings quality in different ways.

First, based on agency theory Qian, Pan & Yeung (2011) analyse the incidence of political ties on tunnelling and self-dealing behaviour. They find that expropriation activities of dominant owners through self-dealing and tunnelling are more prominent in politically connected companies because in these firms political ties contribute to secure bank support. Thus, political ties might promote access to debt financing by reducing the risk of bankruptcy (Johnson & Mitton, 2003; Bai, Lu & Tao, 2006; Fraser, Zhang & Derashid, 2006; Li, Meng, Wang & Zhou,

2008; Faccio, 2010; Qian *et al.*, 2011; Bliss & Gul, 2012). This could prove particularly important for family firms, since controlling families might be more likely to use debt to finance new growth opportunities in order to prevent their dominant control from being diluted. The desire to avoid this “dilution control” (Du & Dai, 2005) makes family firms more likely to appoint political directors as a way of securing bank financing. Access to finance other than through external capital markets therefore reduces capital market discipline and would make the controlling family more likely to use political ties, not only to facilitate rent-seeking but also to promote tunnelling. Since the Spanish institutional setting is characterized by weak investor protection, ineffective enforcement mechanisms (La Porta *et al.*, 1998) and internal control mechanisms, such as a board of directors lacking the necessary independence to act as an effective control mechanism (Cuervo, 2002; Bona *et al.*, 2014), this self-serving behaviour is less likely to be persecuted and penalized effectively.

In such a context, in order to reduce the likelihood of market participants detecting this opportunistic behaviour, the market expects financial reporting to reflect more closely the family owner’s self-interest rather than the business’s economic situation. According to the entrenchment effect (supply side), family firms’ political ties are therefore associated with lower earnings informativeness.

However, according to Wang (2006), the lower earnings quality that stems from the above-mentioned effect may be offset by an increased demand for earnings quality from those who use financial statements. If such users perceive the entrenchment of politically connected family firms, they will likely increase their demands for high-quality earnings in order to safeguard their interests. Due to reputation concerns, politically connected families might be more prone to satisfy these greater demands to obtain better contracting positions. In line with the

entrenchment effect (demand side), politically connected family firms will therefore provide higher earnings credibility.

From a different perspective, the presence of political ties might lead to an increase in information asymmetries due to the existence of secret deals between insiders and politicians, deals that may wish to be covered up (Fan & Wong, 2002; Bona *et al.*, 2014). However, family firms' distinctive features, such as their high ownership stakes, weakly diversified portfolios and long-term investment horizons (Anderson & Reeb, 2003; Villalonga & Amit, 2006), make these companies more likely to place politically connected directors on the board for innocuous reasons that benefit all shareholders, not only the controlling family. In such contexts, transparency entails more benefits than costs. Consequently, politically connected family firms would have greater incentives to address previous information asymmetries by signalling their superior earnings quality to the market. Under this signalling effect, the market expects politically connected family firms' financial reporting to reflect the business's economic situation rather than the family owner's self-interest, leading to a positive effect on earnings informativeness.

In line with the above arguments, the interactions between family firms' unique features, political connections and earnings informativeness is an empirical question. Thus, in family controlled firms, the agency theory predicts both a positive impact of political ties on earnings informativeness (demand perspective) and a negative one (supply perspective). Furthermore, signalling theory predicts a positive impact of political ties on earnings informativeness.

Thus, we test the following hypothesis:

*H1: Political ties affect earnings informativeness in family firms*

*H1a: Political ties increase earnings informativeness in family firms*

*H1b: Political ties reduce earnings informativeness in family firms*



## **RESEARCH DESIGN**

### **Data**

We start by selecting the 117 non-financial Spanish listed firms at the end of 2016. We exclude 18 financial firms and one company whose values are not listed in the OSIRIS database. As a result, the initial sample contains 1,133 firm-year observations. In our regression analysis, we eliminate outliers, which amount to 12.1% of the total sample, by using Hadi (1994). We thus obtain a panel of 565 family firm-year observations for the period 2003-2016. The sample commences in 2003, when a law, which entails Spanish listed firms to issue an annual corporate governance report, was passed.

### **Family firms and political ties**

To classify a firm as family controlled and politically connected, we use data from Bona *et al.* (2014) and Guerra, Bona & Santana (2015). Since our study covers the period 2003-2016, we need to complete the aforementioned database with new data covering the period between 2013 and 2016. According to the control chain methodology proposed by La Porta *et al.* (1999) we consider the existence of a family firm when two conditions are jointly met. First, the main owner of the firm retains both directly or indirectly a percentage of voting rights not lower than 20%. Second, this owner is a family or an individual.

Moreover, in line with previous studies (Faccio, 2006; Chaney *et al.*, 2011; Chen *et al.*, 2011; Boubraki, Guedhami, Mishra & Saffar, 2012; Duchin & Sosyra, 2012; Bona *et al.*, 2014; Guerra *et al.*, 2015), the existence of politically connected boards proxy for the presence of political ties.

### **Variables and models**

According to Dechow, Ge & Schrand (2010), studies on investor responsiveness to earnings are included in earnings quality studies and traditionally entail the use of an earnings response coefficient to proxy for earnings quality. The main advantage of this measure is that it directly ties in with decision usefulness, in other words quality, although only in the particular context of equity valuation decisions. Using a return-based earnings response coefficient does, however, have its limitations (Dechow *et al.*, 2010). Nevertheless, its use as a measure for earnings quality is widespread in accounting studies (Francis, Schipper & Vincent, 2005; Wang 2006; Bona *et al.*, 2014). Thus, the following equation is estimated to test H1:

$$CAR_{it} = \alpha_0 + \alpha_1 NI_{it} + \alpha_2 POLITICS_{it} \times NI_{it} + \alpha_3 BIG4_{it} \times NI_{it} + \alpha_4 CROSSL_{it} \times NI_{it} + \alpha_5 DIVERGENCE_{it} \times NI_{it} + \alpha_6 MKBOOK_{it} \times NI_{it} + \alpha_7 LEV_{it} \times NI_{it} + \alpha_8 SIZE_{it} \times NI_{it} + \eta_k + \phi_j + \varepsilon_{it} \quad Eq. (1)$$

Thus, the effect of a firm's political connection on earnings informativeness is thus captured by the coefficient  $\alpha_2$ . Moreover, firms may signal their transparency by binding instruments such as hiring Big Four auditors and cross-listing (Teo & Wong 1993; Becker, DeFond, Jiambalvo & Suramanyam, 1998; Krishnan 2003; Lang, Raedy & Wilson, 2006; Francis & Yu, 2009). In order to control both effects, we therefore include  $BIG4_{it}$  and  $CROSSL_{it}$ . Additionally, to control for the effect of the controlling owner's voting-cash flow wedge, we include the variable  $DIVERG_{it}$ . We also include the market-to-book ratio ( $MKBOOK_{it}$ ), leverage ( $LEV_{it}$ ) and size ( $SIZE_{it}$ )<sup>1</sup>. All variables are defined in Appendix.

## EMPIRICAL RESULTS

### Descriptive statistics

The proportion of Spanish firms with a dominant shareholder (a company has a dominant shareholder if the principal shareholder owns at least 20% of voting rights) is shown in Table 1

---

<sup>1</sup> For a discussion justifying the inclusion of these variables, see Fan & Wong (2002).

(Panel A). Results suggest that over half of Spanish listed companies have a dominant owner in all the years under study. As seen, 55.56% of companies were closely held in 2003, a percentage which rose to over 60% after 2006. Moreover, family controlled firms range from 34.38% in 2004 to 56.10% in 2007. Therefore, approximately 13% of closely held firms are not family firms. These results are consistent with early research on Spain (Santana & Aguiar, 2006; Bona *et al.*, 2014; Guerra *et al.*, 2015). Finally, the percentage of family firms with political ties ranges from 13.54% in 2016 to 32.94% in 2013. Compared to the results in Guerra *et al.* (2015), which show that around half of Spanish listed firms were politically connected, the previous percentage drops considerably if we consider only listed family firms.

#### *Table 1*

Table 1 (Panel B) reports the presence of political connections in family firms. Results show that political connections remain stable over time. Approximately 56% of family firms are politically connected for over half of the years under study and about 36% of family firms have never been politically connected. Table 1 (Panel C) reports the means difference test between politically connected and unconnected family firms. Results show that family firms with political ties have significantly higher net earnings, divergence, growth opportunities, leverage, size and audit quality. However, in the univariate analysis the two groups do not differ in terms of stock return and cross-listing. Table 1 (Panel D) suggests that multicollinearity has no impact on subsequent regressions. Furthermore, in our models, the highest VIF is well below 5 (Studenmund, 1997).

#### **Multivariate tests**

The main regressions are estimated using fixed-effects and Generalized Method of Moments (GMM). Thus, we address the individual heterogeneity problems, such as family culture (Lozano, Martínez & Pindado, 2016), which leads certain family firms to be more or less likely

to become politically connected. In order to address this source of endogeneity<sup>2</sup>, we therefore control for it by modelling it as an individual effect, which is then eliminated.<sup>3</sup>

Models 1 (Fixed-Effects) and 2 (GMM) in Table 2 show the results on the relationship between political ties and earnings informativeness in family firms. In particular, Models 1 and 2 evidence that politically connected boards have a positive influence on earnings informativeness in family firms ( $\alpha_2 = 0.21$ ,  $p < 0.05$ , in Model 1;  $\alpha_2 = 0.16$ ,  $p < 0.01$ , in Model 2). These results are consistent with H1a. Thus, in line with the entrenchment effect (demand side), it is more likely that the controlling family will respond to demands for earnings quality as a result of political ties being seen as aggravating controlling family entrenchment. The results are also consistent with the market perceiving that, in the presence of political ties, family firms display greater incentives to signal their superior earnings quality to the market in order to reduce information asymmetries.

### Table 2

Turning our focus to the control variables and consistent with previous studies (Francis *et al.*, 2005; Fan & Wong, 2002; Santana, Bona & Pérez, 2007; Lee, 2007; Bona, Pérez & Santana, 2013; Bona *et al.*, 2014), Table 2 shows positive coefficients on  $BIG4_{it} \times NI_{it}$ , (Fan & Wong, 2002; Francis *et al.*, 2005; Bona *et al.*, 2014) and  $SIZE_{it} \times NI_{it}$ ,  $MKBOOK_{it} \times NI_{it}$ . Furthermore, we reveal that divergence negatively affects earnings informativeness.

### Sensitivity analysis

---

<sup>2</sup> In line with Greene (2000) and Wooldridge (2002), we broadly define endogeneity bias as any situation where the disturbance term of the structural equation is correlated with one or more independent variables.

<sup>3</sup> We refer readers to Bona *et al.* (2014) for a more comprehensive description of the GMM estimator.

In order to check that our results are not purely determined by a different method being applied to eliminate outliers, our variables are winsorized at 1% (Model 3 in Table 3). Results do not differ from those shown in Table 2. Furthermore, an alternative measure of our dependent variable ( $CAR12.31_{it}$ ) is considered in Model 4 (Table 3). Results are in line with the ones reported in Table 2. Additionally, in Model 5 (Table 3) we use an alternative definition of family firms by considering a voting right threshold not lower than 50% in the hands of the controlling family. Overall, our findings (Model 5) are in line with previous results shown in Table 2.

### *Table 3*

To check whether our results also hold in periods of greater financial and political uncertainty, we carried out additional analyses. During such periods, firms might apply alternative accounting methods in an effort to influence the output of the accounting reports in a particular way depending on their own needs and profile (Graham, King & Bailes, 2000; Fields, Lys & Vicent, 2001; Davis-Friday, Eng & Liu, 2006; Ramanna & Roychowdhury, 2010; Choi, Kim & Lee, 2011; Iatridis & Dimitras, 2013; Dai & Ngo, 2018). Thus, in order to consider the effect of financial crisis and political uncertainty in our analysis, we included the variables  $CRISIS_{it}$  and  $UNCERT_{it}$ , as well as their interactions with  $POLITICS_{it}$  (Models 6 and 7, Table 3). In this sense, while some previous studies evidence that earnings quality increases in periods of economic and political turbulence (e.g., Ahmad-Zaluki, Campbell & Goodcare, 2011; Ramanna & Roychowdhury, 2010), others provide evidence vis-à-vis a decrease in earnings quality during periods of uncertainty (Jenkins, Kane & Veluri, 2009). Our results show that family firms are more likely to satisfy the greater demands for earnings quality during periods of increased uncertainty concerning future outcomes. Overall, our findings also show that politically connected family firms display positive earnings informativeness even in periods of financial and political uncertainty.

Finally, we examine other earnings quality measures that might provide insights into which causes could make earnings more credible for politically connected family firms. The first is the Jones (1991) model, modified by Kothari, Leone & Weasley (2005) and with the extension proposed by Francis *et al.* (2005). An additional measure is suggested by Peasnell *et al.* (2005) which ignores the long term component of total accruals.<sup>4</sup> The following regressions are thus estimated:

$$AbsQ1_{it} = \chi_0 + \chi_1 POLITICS_{it} + \chi_2 BIG4_{it} + \chi_3 CROSSL_{it} + \chi_4 DIVERGENCE_{it} + \chi_5 MKBOOK_{it} + \chi_6 LEV_{it} + \chi_7 SIZE_{it} + \eta_k + \phi_j + \varepsilon_{it} \quad Eq. (2)$$

$$AbsQ2_{it} = \chi_0 + \chi_1 POLITICS_{it} + \chi_2 BIG4_{it} + \chi_3 CROSSL_{it} + \chi_4 DIVERGENCE_{it} + \chi_5 MKBOOK_{it} + \chi_6 LEV_{it} + \chi_7 SIZE_{it} + \eta_k + \phi_j + \varepsilon_{it} \quad Eq. (3)$$

Models 8 and 11 in Table 4 present the results of the influence of  $POLITICS_{it}$  on performance-adjusted accruals quality. The coefficients on  $POLITICS_{it}$  are negative, showing that political ties and accruals quality are positively related in family controlled firms. These results are consistent with the greater earnings credibility of politically connected family firms. Moreover, Models 9, 10, 12 and 13 show the effect of political ties on accruals quality during periods of economic and politic turbulence. As can be seen, results are consistent with those presented in Table 3.

Table 4

### Further analysis

Our results with regard to a positive impact of political ties on family firms' earnings informativeness are consistent with both the entrenchment effect (demand side) and the signalling effect. In order to shed more light on previous explanations, we performed additional

---

<sup>4</sup> For a more detailed explanation of the two measures, see Francis *et al.* (2005).

analyses. In order to determine whether the entrenchment effect (demand side) is the main driver of our results we partitioned our sample into two different groups, where the weight of demand side explanations differ. We then tested whether the impact of political ties on earnings informativeness differs across the subsamples. Given that the entrenchment effect (demand side) is based on the notion that political connections allow access to private sources of financing that are subject to less monitoring than public sources, we partitioned the sample depending on the need for external financing on the basis of the company's cash holding. We then analysed whether the impact of political ties on family firms' earnings informativeness differs across the subsamples. In this sense, if the entrenchment effect (demand side) is the main driver of our results, political ties should be expected to reduce earnings informativeness for those politically connected family firms that evidence less need for external financing given that the cost of transparency would increase their benefits. However, as shown (Model 14, Table 5), both subsamples show a positive relationship between political ties and earnings credibility. Consequently, "demand side" considerations do not appear to be the main driver of our results.

#### *Table 5*

Adopting a different perspective based on signalling theory, previous literature has evidenced that one effective way for firms to signal their superior earnings quality in a code-law country is to cross-list on an international capital market (Ball *et al.*, 2000; 2003). Thus, cross-listed firms are presumed to have greater incentives to enhance earnings quality since they are subject to restrictions imposed by different countries and are subject to a greater risk of litigation. Earnings quality may thus be expected to improve when a firm is listed on an international capital market (Ball *et al.*, 200; 2003). Similarly, adopting a BIG4 audit is often associated with significantly higher earnings quality (*e.g.*, DeFond and Jiambalvo, 1991, 1994; Becker *et al.*, 1998; Francis *et al.*, 1999; Gore & Singh, 2001).

Thus, by running a Probit model that includes an instrumental variable<sup>5</sup>, we test whether the presence of political ties makes family firms more likely to adopt a BIG4 audit and/or to cross-list (Models 15 and 16, Table 6). As shown, compared with unconnected family firms, politically connected family firms are more likely to choose a BIG4 audit and to cross-list.

*Table 6*

In order to test whether politically connected family firms that have voluntarily adopted a BIG4 audit and have decided to cross-list on an international capital market show greater earnings quality than those that have not adopted previous bonding mechanisms, we then examine the interaction terms POLITICS\*CROSS-LISTED and POLITICS\*BIG4. To this end, we run Models 17 and Model 18 (Table 7) and Models 19, 20, 21 and 22 (Table 8). Our results show that politically connected family firms that have voluntarily adopted previous bonding mechanisms show superior earnings quality. This provides support to our results concerning the presence of higher earnings quality in politically connected family firms. Accordingly, it is the signalling effect and not the entrenchment effect (demand side) that seems to emerge as the main driver of our results. Our results are thus consistent with the market perceiving that political ties increase controlling family incentives to reduce information asymmetries by using certain bonding mechanisms that allow the family to signal their superior earnings quality.

*Table 7 and 8*

## **DISCUSSION AND CONCLUSIONS**

An increasing body of research has investigated whether and under what circumstances board structure matters vis-à-vis earnings quality (Bushman, Piotrosky & Smmith, 2004; Beekes, Pope & Young, 2004; Vafeas, 2000). However, previous evidence remains inconclusive and

---

<sup>5</sup> The instrumental variable is a dummy variable that takes the value 1 if the firm is included in IBEX-35 and 0 otherwise.



has mainly focused on the size of the board and the role played by executive as opposed to outside directors (Peasnell *et al.*, 2000; Klein, 2002; Ahmed & Duellman, 2007). In this sense, very few studies have considered how the presence of politically connected directors might affect earnings quality (Bona *et al.*, 2014; Chaney *et al.*, 2011). The results from this limited body of research generally support lower earnings quality for firms having politically connected boards. However, no previous study has specifically considered how family firms' distinctive features might affect the governance role played by politically connected directors, even though family firms might create an ideal environment for establishing and sustaining political ties (Morck & Yeung, 2004; Bertrand & Schoar, 2006).

The results in Chaney *et al.* (2011) on a negative effect of political ties on earnings quality leave unanswered the question of whether connected family firms show more or less earnings quality than their unconnected family peers. Fan *et al.* (2014) show an important increase in the earnings informativeness of a sample of firms that maintain family ties with high-level Chinese bureaucrats involved in corruption scandals before and after the exogenous breakdown of the networks. However, their empirical study of politically connected firms might include non-family controlled firms connected with corrupt bureaucrats through kinship. In the Spanish context, Bona *et al.* (2014) analyse the incidence of political ties on earnings informativeness although the authors do not feel this relation to be conditional upon the nature of the controlling shareholder. As a result, no previous study has considered how distinctive features of family firms might interact with political ties with regard to shaping the properties of accounting earnings.

Our work strives to fill this gap. While previous studies have drawn attention to the earnings informativeness of family firms, comparing it with those of non-family firms (Ali *et al.*, 2007; Wang, 2006), we focus on earnings informativeness within family firms, by studying how

family firms' distinctive features might impact earnings informativeness in the presence of political ties in a continental European setting.

In a context where many firms are currently controlled by families, we show that politically connected family firms provide more informative earnings than non-connected family firms. Our evidence is consistent with the presence of a signalling effect that makes politically connected family firms more likely to use certain bonding mechanisms such as cross-listing or choosing a BIG4 audit to signal their superior earnings quality to the market.

We provide several theoretical contributions. First, we add to the studies on the relationship between political ties and earnings informativeness. Particularly, our results differ from Fan *et al.* (2014), Bona *et al.* (2014) and Chaney *et al.* (2011) and emphasize the need to consider the nature of the controlling shareholder when examining the incidence of political ties on earnings informativeness. In particular, our results show that the earnings opacity generally associated with the presence of political ties entails greater costs and lower benefits in family firms. Second, our results also extend previous empirical studies on family firms' reporting incentives (Ali *et al.*, 2007; Wang, 2006). In this sense, in the financial accounting subfield there is still a lack of "market-based research" on family firms (Prencipe, Bar-Yosef & Dekker, 2014). Our work therefore helps extend this body of research by showing that family firms' political ties enhance communication between the controlling family and those who use financial statements through higher earnings credibility. We therefore contribute to previous research on family firms' reporting incentives by showing a new driver of earnings informativeness. Third, we add to the studies on the incidence of board composition on earnings quality (Peasnell *et al.*, 2000; Klein, 2002; Ahmed & Duellman, 2007). Politically connected directors who provide key benefits to firms (Zahra & Pearce, 1989; Adams, Hermalin & Weisbach, 2010) also contribute to improve earnings informativeness.

Our study offers several practical implications. Knowing how family firms respond to the influences of institutional reporting might prove beneficial to various market participants. In this sense, understanding how family firms affect the relation between politically connected boards and earnings informativeness provides potential benefits to investors. In particular, knowing that political ties improve earnings informativeness in family firms should help investors in their investment decisions. Our findings also suggest that politically connected family firms should not be a priority on regulators' agenda, at least with regard to increasing financial transparency and promoting protection for investors and market confidence. The results might also be beneficial to financial analysts and auditors since they underscore the relevance of jointly considering political ties and the nature of the controlling owner when aiming to properly assess the informativeness of accounting earnings.

### **Limitations and future research**

Our study has several limitations, especially regarding the difficulty involved in measuring political connectivity. In this sense, due to limitations concerning access to information, close informal relations with political elites were not considered in the present study. Finally, our work points to certain future research avenues. While it seems reasonable to assume that the current study provides major implications that could be generalised to other contexts displaying analogous institutional features, analysis of how political ties impact on earnings informativeness in family controlled firms needs to be extended to other institutional settings so as to further our understanding of previous interactions. Moreover, it would be interesting to consider how controlling shareholders other than the family might affect this relationship. Finally, it would also be worth analysing how the role of the controlling family as the founder or descendant might impact on the relation between politically connected boards and earnings credibility. We leave such inquiry for future research.



## REFERENCES

- Adams, R.B., Hermalin, B.E., Weisbach, M.S. (2010). The Role of Boards of Directors in Corporate Governance: A Conceptual Framework and Survey. *Journal of Economic Literature*, American Economic Association, 48: 58-107.
- Ahmad-Zaluki, N. A., Campbell, K., Goodacre, A. (2011). Earnings management in Malaysian IPOs: The East Asian crisis, ownership control, and post-IPO performance. *The International Journal of Accounting*, 46(2): 111-137.
- Ahmed, A. S., Duellman, S. (2007). Accounting conservatism and board of director characteristics: An empirical analysis. *Journal of Accounting and Economics*, 43: 411-437.
- Ali, A., Chen, T. Y., Radhakrishnan, S. (2007). Corporate disclosures by family firms. *Journal of Accounting and Economics*, 44: 238-286.
- Anderson, R. C., Reeb, D. M. (2003). Founding-family ownership and firm performance: evidence from the S&P 500. *The Journal of Finance*, 58: 1301-1328.
- Bai, C. E., Lu, J., Tao, Z. (2006). Property rights protection and access to bank loans. *Economics of Transition*, 14: 611-628.
- Ball, R., Robin, A., Wu, J. S. (2000). Accounting standards, the institutional environment and issuer incentives: Effect on timely loss recognition in China. *Asia-Pacific journal of accounting & economics*, 7(2): 71-96.
- Ball, R., Robin, A. Wu, J.S. (2003). Incentives versus standards: Properties of accounting income in four East Asian countries. *Journal of Accounting and Economics*, 35: 235-270.
- Becker, C.L., DeFond, M.L. Jiambalvo, J. Subramanyam, K.R. (1998). The effect of audit quality on earnings management. *Contemporary accounting research*, 15: 1-24.
- Beekes, W., Pope, P. Young, S. (2004). The link between earnings timeliness, earnings conservatism and board composition: Evidence from the UK. *Corporate Governance*, 12: 47-59.
- Bertrand, M. Schoar, A. (2006). The role of family in family firms. *Journal of Economic Perspectives*, 20: 73-96.
- Bliss, M.A. Gul, F.A. (2012). Political connection and cost of debt: some Malaysian evidence. *Journal of Banking & Finance*, 36:1520-1527.
- Bona Sánchez, C., Pérez Alemán, J. Santana Martín, D.J. (2013). Control institucional dominante y capacidad informativa de los resultados contables. *Revista Española de Financiación y Contabilidad*, 159: 371-394.
- Bona Sánchez, C., Pérez Alemán, J., Santana Martín, D. J. (2014). Politically connected firms and earnings informativeness in the controlling versus minority shareholders context: European evidence. *Corporate Governance: An International Review*, 22: 330-346.

- Boubakri, N., Guedhami, O., Mishra, D. Saffar, W. (2012). Political connections and the cost of equity capital. *Journal of Corporate Finance*, 18: 541-559.
- Bubolz, M. M. (2001). Family as source, user, and builder of social capital. *The Journal of Socio-Economics*, 30: 129-131.
- Bunkanwanicha, P. Wiwattanakantang, Y. (2009). Big business owners in politics. *Review of Financial Studies*, 22(6): 2133-2168.
- Bunkanwanicha, P., Fan, J. P., Wiwattanakantang, Y. (2013). The value of marriage to family firms. *Journal of Financial and Quantitative Analysis*, 48: 611-636.
- Bushman, R., Piotroski, J.D. (2006). Financial reporting incentives for conservative accounting: The influence of legal and political institutions. *Journal of Accounting and Economics*, 42:107-148.
- Bushman, R., Piotroski, J., Smith, A. (2004). What Determines Corporate Transparency? *Journal of Accounting Research*, 42: 207–52.
- Cascino, S., Pugliese, A., Mussolino, D., Sansone, C. (2010). The influence of family ownership on the quality of accounting information. *Family Business Review*, 23: 246-265
- Chaney, P.K., Faccio, M., Parsley, D. (2011). The quality of accounting information in politically connected firms. *Journal of Accounting and Economics*, 51: 58-76.
- Chen, C.J.P., Li, Z., Zu, X., Sun, Z. (2011). Rent-seeking incentives, corporate political connections, and the control structure of private firms: Chinese evidence. *Journal of Corporate Finance*, 17: 229-243.
- Choi, J. H., Kim, J. B., Lee, J. J. (2011). Value relevance of discretionary accruals in the Asian financial crisis of 1997–1998. *Journal of Accounting and Public Policy*, 30: 166-187.
- Dai, L., Ngo, P.T.H. (2018). Political Uncertainty and Accounting Conservatism. Working Paper. Available at [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2196224](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2196224).
- Cuervo, A. (2002). Corporate governance mechanisms: A plea for less code of good governance and more market control. *Corporate Governance: An International Review*, 10: 84-93.
- Davis-Friday, P., Eng, L.L., Liu, C.S. (2006). The effects of the Asian crisis, corporate governance and accounting system on the valuation of book value and earnings. *The International Journal of Accounting*, 41: 22-40.
- Dechow, P., Ge, W., Schrand, C. (2010). Understanding earnings quality: A review of the proxies, their determinants and their consequences. *Journal of accounting and economics*, 50(2), 344-401.
- DeFond, M. L., Jiambalvo, J. (1991). Incidence and circumstances of accounting errors. *Accounting review*: 643-655.
- DeFond, M. L., Jiambalvo, J. (1994). Debt covenant violation and manipulation of accruals. *Journal of accounting and economics*, 17(1-2): 145-176.

- Du, J., Dai, Y. (2005). Ultimate Corporate Ownership Structures and Capital Structures: evidence from East Asian economies. *Corporate Governance: An international Review*, 13: 60-71.
- Duchin, R., Sosyura, D. (2012). The politics of government investment. *Journal of Financial Economics*, 106: 24-48.
- Faccio, M., Parsley, D.C. (2009). Sudden deaths: Taking stock of geographic ties. *Journal of Financial and Quantitative Analysis*, 44: 683-718.
- Faccio, M. (2006). Politically-connected firms. *American Economic Review*, 96: 369-386.
- Faccio, M. (2010). Differences between Politically Connected and Non connected Firms: A Cross-Country Analysis. *Financial Management*, 39: 905-928.
- Fan, J.P.H., Rui, O.M., Zhao, M. (2008). Public governance and corporate finance: Evidence from corruption cases. *Journal of Comparative Economics*, 36(3): 343-364.
- Fan, J.P.H., Wong, T.J. (2002). Corporate ownership structure and the informativeness of accounting earnings in East Asia. *Journal of Accounting and Economics*, 33: 401-425.
- Fan, J.P.H., Guan, F., Li, Z., Yang, Y.G. (2014). Relationship networks and earnings informativeness: Evidence from corruption cases. *Journal of Business Finance & Accounting*, 41: 831-866.
- Fields, T.D., Lys, T.Z., Vincent, L. (2001). Empirical research on accounting choice. *Journal of accounting and economics*, 31: 255-307.
- Fisman, R. (2001). Estimating the value of political connections. *American Economic Review*, 91: 1095-1102.
- Francis, J., Schipper, K., Vincent, L. (2005). Earnings and dividend informativeness when cash flow rights are separated from voting rights. *Journal of Accounting and Economics*, 39: 329-360.
- Francis, J.R., Yu, M.D. (2009). Big 4 office size and audit quality. *The Accounting Review*, 84: 1521-1552.
- Fraser, D.R., Zhang, H., Derashid, C. (2006). Capital structure and political patronage: The case of Malaysia. *Journal of Banking & Finance*, 30: 1291-1308.
- Fukuyama, F. (1995). *Trust: The social virtues and the creation of prosperity*. New York: Free Press.
- Gore, P., Pope, P., Singh, A. (2001). Discretionary accruals and the distribution of earnings relative to targets. WP, Lancaster University, January version.
- Graham, R., King, R., Bailes, J. (2000). The value relevance of accounting information during a financial crisis: Thailand and the 1997 decline in the value of the baht. *Journal of International Financial Management & Accounting*, 11, 84-107.
- Greene, W.H. (2000). *Econometric Analysis* (Upper Saddle River, NJ: Prentice Hall).
- Guerra Pérez, S., Bona Sánchez, C., Santana Martín, D. J. (2015). Politically connected firms in Spain. *BRQ Business Research Quarterly*, 18: 230-245.
- Gul, F. A. (2006). Auditors' response to political connections and cronyism in Malaysia. *Journal of Accounting Research*, 44(5): 931-963.

- Hadi, A. (1994). A Modification of a Method for the Detection of Outliers in Multivariate Samples, *Journal of the Royal Statistical Society*, 56: 393-396.
- Iatridis, G., Dimitras, A.I. (2013). Financial crisis and accounting quality: evidence from five European countries, *Advances in Accounting*, 29: 154-160.
- Jenkins, D. S., Kane, G. D., Velury, U. (2009). Earnings conservatism and value relevance across the business cycle. *Journal of Business Finance & Accounting*, 36(9-10): 1041-1058.
- Johnson, S., Mitton, T. (2003). Cronyism and capital controls: evidence from Malaysia. *Journal of Financial Economics*, 67: 351-382.
- Jones, J. J. (1991). Earnings management during import relief investigations. *Journal of accounting research*, 29: 193-228.
- Klein, A. (2002). Audit committee, board of director characteristics, and earnings management. *Journal of Accounting and Economics*, 33: 375-400.
- Kothari, S.P. Leone, A.J., Weasley. C.E. (2005). Performance matched discretionary accruals measures. *Journal of Accounting and Economics*, 39: 163-197.
- Krishnan, G.V. (2003). Audit quality and the pricing of discretionary accruals. *Auditing: A Journal of Practice & Theory*, 22: 109-126.
- La Porta, R., Lopez-de-Silanes, F., Shleifer, A., Vishny, R.W. (1998). Law and Finance. *Journal of Political Economy*, 106: 1113-1155.
- La Porta, R., López-de-Silanes, F., A. Shleifer, A. (1999). Corporate ownership around the world. *The Journal of Finance*, LIV: 471-517.
- Lang, M., Raedy, J.S., Wilson, W. (2006). Earnings management and cross listing: Are reconciled earnings comparable to US earnings? *Journal of accounting and economics*, 42: 255-283.
- Lee, K. W. (2007). Corporate voluntary disclosure and the separation of cash flow rights from control rights. *Review of Quantitative Finance and Accounting*, 28(4): 393-416.
- Leuz, C., Oberholzer-Gee, F. (2006). Political relationships, global financing, and corporate transparency: Evidence from Indonesia. *Journal of financial economics*, 81(2): 411-439.
- Li, H., Meng, L., Wang, Q., Zhou, L.A. (2008). Political connections, financing and firm performance: Evidence from Chinese private firms. *Journal of Development Economics*, 87: 283-299.
- Lozano, M.B., Martínez, B., Pindado, J. (2016). Corporate governance, ownership and firm value: Drivers of ownership as a good corporate governance mechanism. *International Business Review*, 25: 1333-1343.
- Morck, R., Yeung, B. (2004). Family control and the rent-seeking society. *Entrepreneurship. Theory and Practice*, 28: 391-409.
- Morck, R, Yeung, B. (2005). Corporate governance, economic entrenchment, and growth. *Journal of Economic Literature*, 43: 655-720.



- Peasnell, K.V., Pope, P.F., Young, S. (2000). Accrual management to meet earnings targets: UK evidence pre and post Cadbury. *British Accounting Review*, 32: 415-445.
- Prencipe, A., Bar-Yosef, S., Dekker, H. C. (2014). Accounting research in family firms: Theoretical and empirical challenges. *European Accounting Review*, 23(3): 361-385.
- Qian, M., Pan, H., Yeung, B. (2011). Expropriation of minority shareholders in politically connected firms, SSRN Working Paper.
- Ramanna, K., Roychowdhury, S. (2010). Elections and discretionary accruals: Evidence from 2004. *Journal of Accounting Research*, 48: 445-475.
- Riahi-Belkaoui, A. (2004). Politically-Connected Firms: Are They Connected to Earnings Opacity? *Research in Accounting Regulation*, 17: 25-38.
- Santana Martín, D.J., Aguiar Díaz, I. (2006). El último propietario de las empresas cotizadas españolas. 1996-2002. *Cuadernos de Economía y Dirección de la Empresa*, 26: 47-72.
- Santana Martín, D.J., Bona Sánchez, C., Pérez Alemán, J. (2007). Estructura de propiedad y capacidad informativa de los resultados contables. *Revista Española de Financiación y Contabilidad*, 133: 55-72.
- Schipper, K., Vincent, L. (2003). Earnings quality. *Accounting Horizons*, 17: 97-110.
- Studenmund, A. H. (1997). *Using Econometrics: A Practical Approach*, Boston: Addison-Wesley.
- Teo, S.H., Wong, T.J. (1993). Perceived auditor quality and the earnings response coefficients. *The Accounting Review*, 68: 346-367.
- Thomsen, S., Pedersen, T. (2000). Ownership structure and economic performance in the largest European companies. *Strategic Management Journal*, 21: 689-705.
- Vafeas, N. (2000). Board structure and the informativeness of earnings. *Journal of Accounting and Public Policy*, 19: 139-160.
- Villalonga, B., Amit, R. (2006). How do family ownership, control and management affect firm value? *Journal of Financial Economics*, 80: 385-417.
- Wang, D. (2006). Founding family ownership and earnings quality. *Journal of Accounting Research*, 44(3): 619-656.
- Wooldridge, J. M. (2002). *Econometric Analysis of Cross Section and Panel Data* (Cambridge, MA: MIT Press).
- Xu, N., Xu, X., Yuan, Q. (2013). Political connections, financing friction, and corporate investment: Evidence from Chinese listed family firms. *European Financial Management*, 19: 675-702.
- Zahra, S. A., Pearce, J. (1989). Boards of directors and corporate financial performance: A review and integrative model. *Journal of Management*, 15: 291-334.

## Appendix

<i>CAR</i>	Firm's equal-weighted market-adjusted cumulative monthly stock return for the 12-month period concluding three months after the end of the fiscal year.
<i>CAR31.12</i>	Firm's equal-weighted market-adjusted cumulative monthly stock return for the 12-month period ending December 31 <sup>st</sup> (fiscal year).
<i>NI</i>	Net earnings in year t divided by the market value of equity at the beginning of year t.
<i>POLITICS</i>	Dummy variable that takes the value one when at least one director has held a past political position at the European, Spanish or local scale, and zero otherwise.
<i>BIG4</i>	Dummy variable that takes the value of one if the firm is audited by Deloitte, Price Waterhouse Cooper, Ernst & Young or KPMG, and zero otherwise.
<i>CROSSL</i>	Dummy variable that takes the value of one if the firm is a cross-listed company in the United States and zero otherwise. Information was obtained from firms' annual reports.
<i>DIVERGENCE</i>	Degree of divergence between the dominant owner's voting and cash flow rights.
<i>MKBOOK</i>	The value of equity ratio at the end of the year.
<i>LEV</i>	Total debt in year t divided by total assets at the beginning of year t.
<i>SIZE</i>	The natural logarithm of the market value of equity.
<i>CRISIS</i>	Dummy variable that takes the value of one between 2008 and 2016, and zero otherwise.
<i>UNCERT</i>	Dummy variable that takes the value of one in the year leading up to a national election, and zero otherwise.
<i>AbsAQ1</i>	Absolute value of the performance-adjusted measure of abnormal accruals.
<i>AbsAQ2</i>	Absolute value of the performance-adjusted measure of abnormal working capital accruals.

Table 1. Descriptive statistics

Panel A. Family and Politically Connected Firms														
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
<i>Firms with dominant owner (ownership &gt;20%)</i>	55.56	51.56	55.22	60.27	65.85	67.07	65.06	66.67	64.71	63.53	64.71	63.22	67.37	68.37
<i>Family Firms</i>	39.68	34.38	41.79	49.32	56.10	54.88	55.42	52.38	52.94	51.76	54.12	50.57	49.47	50.00
<i>Politically Connected Family Firms</i>	20.63	20.31	23.88	30.14	32.93	31.71	30.12	32.14	31.76	30.59	32.94	29.89	15.79	13.54
Panel B. Politically Connected Family Firms (%)														
<i>Never politically connected</i>	36.5													
<i>Politically connected between 0% and 50% of years</i>	7.9													
<i>Politically connected between 50% and 75% of years</i>	15.9													
<i>Politically connected 100% of years</i>	39.7													
Panel C. Politically Connected Family Firms versus Non-Politically Connected Family Firms														
	Politically Connected Family Firms (N=304)			Non-Politically Connected Family Firms (N=261)			t- student							
	Average	Median	S.D.	Average	Median	S.D.								
<i>CAR<sub>it</sub></i>	-0.01	0.01	0.33	-0.01	0.04	0.33	0.28							
<i>NI<sub>it</sub></i>	0.04	0.05	0.08	0.02	0.04	0.10	2.02*							
<i>DIVERGENCE<sub>it</sub></i>	6.54	0.46	9.3	4.49	0.09	6.9	2.59***							
<i>MKBOOK<sub>it</sub></i>	2.73	2.00	2.33	2.11	1.61	1.85	3.06***							
<i>LEV<sub>it</sub></i>	0.65	0.68	0.21	0.60	0.59	0.17	2.80***							
<i>SIZE<sub>it</sub></i>	14.10	14.2	1.6	12.5	12.35	1.61	10.07***							
	Percentage			Percentage			X <sup>2</sup>							
<i>BIG4<sub>it</sub></i>	95.44			89.71			12.81***							
<i>CROSSL<sub>it</sub></i>	4.56			8.57			1.47							

**Table 1**

<b>Panel D. Correlation matrix</b>									
	<i>CAR<sub>it</sub></i>	<i>NI<sub>it</sub></i>	<i>POLITICS<sub>it</sub></i>	<i>DIVERG<sub>it</sub></i>	<i>MKBOOK<sub>it</sub></i>	<i>LEV<sub>it</sub></i>	<i>SIZE<sub>it</sub></i>	<i>BIG4<sub>it</sub></i>	<i>VIF</i>
<i>NI<sub>it</sub></i>	0.29***								1.07
<i>POLITICS<sub>it</sub></i>	0.01	0.09**							1.25
<i>DIVERG<sub>it</sub></i>	-0.01	-0.01	0.12***						1.03
<i>MKBOOK<sub>it</sub></i>	0.13***	0.17***	0.14***	0.10**					1.25
<i>LEV<sub>it</sub></i>	-0.09**	0.02	0.13***	0.04	0.02				1.03
<i>SIZE<sub>it</sub></i>	0.18***	0.23***	0.43***	0.13***	0.42***	0.14***			1.79
<i>BIG4<sub>it</sub></i>	0.06	0.04	0.11**	0.06	0.10**	0.03	0.30***		1.11
<i>CROSSL<sub>it</sub></i>	0.08*	0.06	0.07	-0.03	0.09**	0.03	0.25***	0.02	1.08

\*\*\*, \*\*, \*: Statistically significant at p .01, p .05 and p .10, respectively. In parentheses, t-statistics based on robust standard errors.

**Table 2. Political connections, family firms and earnings informativeness**

Models 1 & 2:  
 $CAR_{it} = \alpha_0 + \alpha_1 NI_{it} + \alpha_2 POLITICS_{it} \times NI_{it} + \alpha_3 BIG4_{it} \times NI_{it} + \alpha_4 CROSSL_{it} \times NI_{it} + \alpha_5 DIVERGENCE_{it} \times NI_{it} + \alpha_6 MKBOOK_{it} \times NI_{it} + \alpha_7 LEV_{it} \times NI_{it} + \alpha_8 SIZE_{it} \times NI_{it} + \eta_k + \phi_j + \varepsilon_{it}$

	Fixed effects		GMM
	Model 1		Model 2
$NI_{it}$	0.62*	(1.81)	0.63***
$POLITICS_{it} \times NI_{it}$	0.21**	(1.99)	0.16***
$BIG4_{it} \times NI_{it}$	0.56*	(1.91)	0.43***
$CROSSL_{it} \times NI_{it}$	3.51	(1.16)	4.29
$DIVERGENCE_{it} \times NI_{it}$	-0.08*	(-1.70)	-0.004*
$POLITICS_{it} \times NI_{it}$	0.21**	(1.99)	0.16***
$MKBOOK_{it} \times NI_{it}$	0.03***	(3.19)	0.02***
$LEV_{it} \times NI_{it}$	0.05	(0.60)	0.01
$SIZE_{it} \times NI_{it}$	0.04*	(1.82)	0.05***
Constant	0.07***	(3.40)	0.05
Year effect	Yes		Yes
Industry effect	No		Yes
Observations	565		565
Adjusted R <sup>2</sup>	0.11		
F	5.58***		
Hansen			35.12 (0.85)
Test m2			-0.69 (0.49)
Test z1			149.05***
Test z2			15.99***
Test z3			42.27***

The dummy variables  $\eta_k$  and  $\phi_j$  control for year and industry effects, respectively.

$\varepsilon_{it}$  is the error term for firm  $i$  in year  $t$ .

Hansen, test of over-identifying restrictions.

$m2$ , statistic test for lack of second-order serial correlation in the first-difference residual.

$z1$ , Wald test of the joint significance of the reported coefficients.

$z2$ , Wald test of the joint significance of time dummies.  $z3$ , Wald test of the joint significance of industry dummies.

\*\*\*, \*\*, \*: Statistically significant at p .01, p .05 and p .10, respectively. In parentheses, t-statistics based on robust standard errors.

**Table 3. Political connections, family firms and earnings informativeness. Sensitivity analysis I**

Model 3 & 5:  
 $CAR_{it} = \alpha_0 + \alpha_1 NI_{it} + \alpha_2 POLITICS_{it} \times NI_{it} + \alpha_3 BIG4_{it} \times NI_{it} + \alpha_4 CROSSL_{it} \times NI_{it} + \alpha_5 DIVERGENCE_{it} \times NI_{it} + \alpha_6 MKBOOK_{it} \times NI_{it} + \alpha_7 LEV_{it} \times NI_{it} + \alpha_8 SIZE_{it} \times NI_{it} + \eta_k + \phi_j + \varepsilon_{it}$

Model 4:  
 $CAR12.31_{it} = \alpha_0 + \alpha_1 NI_{it} + \alpha_2 POLITICS_{it} \times NI_{it} + \alpha_3 BIG4_{it} \times NI_{it} + \alpha_4 CROSSL_{it} \times NI_{it} + \alpha_5 DIVERGENCE_{it} \times NI_{it} + \alpha_6 MKBOOK_{it} \times NI_{it} + \alpha_7 LEV_{it} \times NI_{it} + \alpha_8 SIZE_{it} \times NI_{it} + \eta_k + \phi_j + \varepsilon_{it}$

Model 6:  
 $CAR_{it} = \alpha_0 + \alpha_1 NI_{it} + \alpha_2 POLITICS_{it} \times NI_{it} + \alpha_3 CRISIS_{it} \times NI_{it} + \alpha_4 POLITICS_{it} \times CRISIS_{it} \times NI_{it} + \alpha_5 BIG4_{it} \times NI_{it} + \alpha_6 CROSSL_{it} \times NI_{it} + \alpha_7 DIVERGENCE_{it} \times NI_{it} + \alpha_8 MKBOOK_{it} \times NI_{it} + \alpha_9 LEV_{it} \times NI_{it} + \alpha_{10} SIZE_{it} \times NI_{it} + \eta_k + \phi_j + \varepsilon_{it}$

Model 7:  
 $CAR_{it} = \alpha_0 + \alpha_1 NI_{it} + \alpha_2 POLITICS_{it} \times NI_{it} + \alpha_3 UNCERT_{it} \times NI_{it} + \alpha_4 POLITICS_{it} \times UNCERT_{it} \times NI_{it} + \alpha_5 BIG4_{it} \times NI_{it} + \alpha_6 CROSSL_{it} \times NI_{it} + \alpha_7 DIVERGENCE_{it} \times NI_{it} + \alpha_8 MKBOOK_{it} \times NI_{it} + \alpha_9 LEV_{it} \times NI_{it} + \alpha_{10} SIZE_{it} \times NI_{it} + \eta_k + \phi_j + \varepsilon_{it}$

	Model 3 (winsorized 1 <sup>st</sup> /99 <sup>th</sup> )	Model 4 (CAR12.31 <sub>it</sub> )	Model 5 (Family 50%)	Model 6 (Financial crisis)	Model 7 (Political uncertainty)
$NI_{it}$	1.12** (2.34)	1.04*** (7.35)	5.81* (1.69)	0.65*** (11.29)	0.82*** (7.93)
$POLITICS_{it} \times NI_{it}$	0.40* (1.89)	0.32*** (7.35)	1.81** (2.18)	1.60*** (5.89)	0.11*** (6.23)
$CRISIS_{it} \times NI_{it}$				0.19** (2.64)	
$UNCERT_{it} \times NI_{it}$					0.40*** (37.47)
$POLITICS_{it} \times CRISIS_{it} \times NI_{it}$				-1.40*** (-5.31)	
$POLITICS_{it} \times UNCERT_{it} \times NI_{it}$					-0.09*** (-2.97)
$BIG4_{it} \times NI_{it}$	0.006** (2.52)	0.13** (2.02)	0.68 (1.52)	0.11*** (5.56)	0.15*** (8.87)
$CROSSL_{it} \times NI_{it}$	3.4 (0.54)	3.67 (0.93)		1.75 (1.46)	1.02 (0.82)
$DIVERGENCE_{it} \times NI_{it}$	-0.02** (-2.37)	-0.001*** (-11.72)	-0.08*** (-3.87)	-0.002 (-0.40)	-0.01*** (-22.39)
$MKBOOK_{it} \times NI_{it}$	0.13* (2.37)	0.03*** (11.72)	0.03 (3.87)	0.01*** (0.40)	0.05*** (22.39)

	(1.76)	(5.31)	(1.07)	(3.90)	(16.54)
$LEV_{it} \times NI_{it}$	0.62	0.10***	1.00***	0.17***	0.02
	(0.74)	(2.02)	(3.30)	(12.51)	(1.27)
$SIZE_{it} \times NI_{it}$	0.05	0.17***	-0.39	0.06***	0.06***
	(0.45)	(14.63)	(-1.19)	(11.81)	(7.62)
Constant	-0.008	0.02	-0.22	-0.06***	-0.05***
	(-0.07)	(0.27)	(-0.99)	(-6.07)	(-2.87)
Year effect	Yes	Yes	Yes	Yes	Yes
Industry effect	Yes	Yes	Yes	Yes	Yes
<i>Observations</i>	643	565	339	565	565
Hansen	34.60 (0.79)	35.55 (0.84)	9.88 (0.77)	45.25 (0.58)	48.29 (0.75)
Test m2	-0.63(0.53)	35.55 (0.84)	0.28 (0.78)	0.63 (0.53)	0.82 (0.41)
Test z1	19.04***	189.8***	15.37***	156.3***	143.57***
Test z2	6.29***	28.87***	7.16***	17.96***	11.87***
Test z3	15.13***	48.15**	9.22***	13.20***	3.02**

The dummy variables  $\eta_k$  and  $\phi_j$  control for year and industry effects, respectively.

$\varepsilon_{it}$  is the error term for firm  $i$  in year  $t$ .

Hansen, test of over-identifying restrictions.

$m2$ , statistic test for lack of second-order serial correlation in the first-difference residual.

$z1$ , Wald test of the joint significance of the reported coefficients.

$z2$ , Wald test of the joint significance of time dummies.  $z3$ , Wald test of the joint significance of industry dummies.

\*\*\*, \*\*, \*. Statistically significant at p .01, p .05 and p .10, respectively. In parentheses, t-statistics based on robust standard errors.

**Table 4. Political connections, family firms and accruals quality. Sensitivity analysis II**

Model 8:

$$AbsQ1_{it} = \chi_0 + \chi_1 POLITICS_{it} + \chi_2 BIG4_{it} + \chi_3 CROSSL_{it} + \chi_4 DIVERGENCE_{it} + \chi_5 MKBOOK_{it} + \chi_6 LEV_{it} + \chi_7 SIZE_{it} + \eta_k + \phi_j + \varepsilon_{it}$$

Model 9:

$$AbsQ1_{it} = \chi_0 + \chi_1 POLITICS_{it} + \chi_2 CRISIS_{it} + \chi_3 POLITICS_{it} \times CRISIS_{it} + \chi_4 BIG4_{it} + \chi_5 CROSSL_{it} + \chi_6 DIVERGENCE_{it} + \chi_7 MKBOOK_{it} + \chi_8 LEV_{it} + \chi_9 SIZE_{it} + \eta_k + \phi_j + \varepsilon_{it}$$

Model 10:

$$AbsQ1_{it} = \chi_0 + \chi_1 POLITICS_{it} + \chi_2 UNCERT_{it} + \chi_3 POLITICS_{it} \times UNCERT_{it} + \chi_4 BIG4_{it} + \chi_5 CROSSL_{it} + \chi_6 DIVERGENCE_{it} + \chi_7 MKBOOK_{it} + \chi_8 LEV_{it} + \chi_9 SIZE_{it} + \eta_k + \phi_j + \varepsilon_{it}$$

Model 11:

$$AbsQ2_{it} = \chi_0 + \chi_1 POLITICS_{it} + \chi_2 BIG4_{it} + \chi_3 CROSSL_{it} + \chi_4 DIVERGENCE_{it} + \chi_5 MKBOOK_{it} + \chi_6 LEV_{it} + \chi_7 SIZE_{it} + \eta_k + \phi_j + \varepsilon_{it}$$

Model 12:

$$AbsQ2_{it} = \chi_0 + \chi_1 POLITICS_{it} + \chi_2 CRISIS_{it} + \chi_3 POLITICS_{it} \times CRISIS_{it} + \chi_4 BIG4_{it} + \chi_5 CROSSL_{it} + \chi_6 DIVERGENCE_{it} + \chi_7 MKBOOK_{it} + \chi_8 LEV_{it} + \chi_9 SIZE_{it} + \eta_k + \phi_j + \varepsilon_{it}$$

Model 13:

$$AbsQ2_{it} = \chi_0 + \chi_1 POLITICS_{it} + \chi_2 UNCERT_{it} + \chi_3 POLITICS_{it} \times UNCERT_{it} + \chi_4 BIG4_{it} + \chi_5 CROSSL_{it} + \chi_6 DIVERGENCE_{it} + \chi_7 MKBOOK_{it} + \chi_8 LEV_{it} + \chi_9 SIZE_{it} + \eta_k + \phi_j + \varepsilon_{it}$$

	Model 8 (AbsAQ1)	Model 9 (AbsAQ1; Financial crisis)	Model 10 (AbsAQ1; Political uncertainty)	Model 11 (AbsAQ2)	Model 12 (AbsAQ2; Financial crisis)	Model 13 (AbsAQ2; Political uncertainty)
<i>POLITICS<sub>it</sub></i>	-0.09** (-2.11)	-0.13*** (-5.60)	-0.16** (-2.19)	-0.11*** (-3.23)	-0.15** (-2.19)	-0.11** (-2.35)
<i>CRISIS<sub>it</sub></i>		-0.22*** (-3.59)			-0.17** (-2.06)	
<i>UNCERT<sub>it</sub></i>			-0.10*** (-3.01)			-0.08** (-2.49)
<i>POLITICS<sub>it</sub> x CRISIS<sub>it</sub></i>		0.02*** (4.78)			0.03*** (2.94)	
<i>POLITICS<sub>it</sub> x UNCERT<sub>it</sub></i>			0.079** (2.12)			0.07* (1.78)
<i>BIG4<sub>it</sub></i>	-0.15 (-1.41)	-0.05 (-0.55)	-0.17 (-1.09)	-0.21 (-1.26)	-0.06 (-0.52)	-0.38* (-1.77)
<i>CROSSL<sub>it</sub></i>	-0.35***	-0.44***	-0.55***	-0.30***	-0.28*	-0.38***



	(-3.18)	(-4.89)	(-4.99)	(-2.77)	(-1.72)	(-3.06)
<i>DIVERGENCE<sub>it</sub></i>	0.002***	0.01***	0.01**	0.003***	0.08***	0.08**
	(2.85)	(2.76)	(2.46)	(2.70)	(2.81)	(2.22)
<i>MKBOOK<sub>it</sub></i>	-0.02***	-0.008***	-0.023***	-0.02***	-0.005***	-0.009*
	(-2.71)	(-2.89)	(-3.76)	(-3.09)	(-2.77)	(-1.70)
<i>LEV<sub>it</sub></i>	0.20**	0.21*	0.27***	0.02	0.05	0.16**
	(2.42)	(1.93)	(4.58)	(0.31)	(0.43)	(2.03)
<i>SIZE<sub>it</sub></i>	-0.008	-0.04**	-0.03**	0.004	0.01	0.03
	(-0.38)	(-2.59)	(-2.47)	(0.10)	(0.58)	(1.48)
<i>Constant</i>	0.41	-0.04	-0.12	0.27	0.29	0.07
	(1.50)	(-0.19)	(-0.42)	(0.87)	(0.91)	(0.21)
<i>Year effect</i>	Yes	Yes	Yes	Yes	Yes	Yes
<i>Industry effect</i>	Yes	Yes	Yes	Yes	Yes	Yes
<i>Observations</i>	565	565	565	565	565	565
<i>Hansen</i>	22.59 (0.79)	25.52 (0.89)	30.01 (0.91)	36.18 (0.91)	16.66 (0.74)	29.35 (0.92)
<i>Test m2</i>	0.45 (0.65)	1.25 (0.21)	0.49 (0.62)	0.71 (0.47)	0.58 (0.55)	1.20 (0.22)
<i>Test z1</i>	5.23***	41.38***	28.7***	5.38***	12.32***	11.76***
<i>Test z2</i>	6.26***	11.92***	67.6***	17.24***	13.30***	8.16***
<i>Test z3</i>	9.04***	11.94***	7.96***	12.28***	4.54***	11.8***

The dummy variables  $\eta_k$  and  $\phi_j$  control for year and industry effects, respectively.

$\varepsilon_{it}$  is the error term for firm  $i$  in year  $t$ .

Hansen, test of over-identifying restrictions.

$m2$ , statistic test for lack of second-order serial correlation in the first-difference residual.

$z1$ , Wald test of the joint significance of the reported coefficients.

$z2$ , Wald test of the joint significance of time dummies.  $z3$ , Wald test of the joint significance of industry dummies.

\*\*\*, \*\*, \*: Statistically significant at p .01, p .05 and p .10, respectively. In parentheses, t-statistics based on robust standard errors.

**Table 5. Political connections, family firms and earnings informativeness. Further analyses I**

Model 14:  
 $CAR_{it} = \alpha_0 + \alpha_1 NI_{it} + \alpha_2 POLITICS_{it} \times NI_{it} + \alpha_3 DIVERGENCE_{it} \times NI_{it} + \alpha_4 MKBOOK_{it} \times NI_{it} + \alpha_5 LEV_{it} \times NI_{it} + \alpha_6 SIZE_{it} \times NI_{it} + \alpha_7 BIG4_{it} \times NI_{it} + \alpha_8 CROSSL_{it} \times NI_{it} + \eta_k + \phi_j + \varepsilon_{it}$

	Model 14	
	High financial constraint	Low financial constraint
$NI_{it}$	1.85*** (5.23)	1.08*** (2.91)
$POLITICS_{it} \times NI_{it}$	0.36** (2.82)	0.11*** (2.09)
$DIVERGENCE_{it} \times NI_{it}$	-0.02*** (-3.94)	-0.004* (-1.65)
$MKBOOK_{it} \times NI_{it}$	0.02** (2.53)	0.05*** (3.58)
$LEV_{it} \times NI_{it}$	0.05 (0.40)	0.39*** (6.37)
$SIZE_{it} \times NI_{it}$	0.14*** (5.66)	0.002 (0.40)
$BIG4_{it} \times NI_{it}$	0.11 (1.62)	0.49 (1.17)
$CROSSL_{it} \times NI_{it}$	2.64*** (4.90)	7.28 (0.65)
Constant	0.09* (1.78)	0.13 (0.67)
Year effect	Yes	Yes
Industry effect	Yes	Yes
Observations	282	283
Hansen	17.40 (0.56)	6.82 (0.65)
Test m2	-0.63(0.53)	-1.60 (0.11)
Test z1	155.18***	69.32***
Test z2	6.70***	10.8***
Test z3	5.47***	11.84***

The dummy variables  $\eta_k$  and  $\phi_j$  control for year and industry effects, respectively.

$\varepsilon_{it}$  is the error term for firm  $i$  in year  $t$ .

Hansen, test of over-identifying restrictions.

$m2$ , statistic test for lack of second-order serial correlation in the first-difference residual.

$z1$ , Wald test of the joint significance of the reported coefficients.

$z2$ , Wald test of the joint significance of time dummies.  $z3$ , Wald test of the joint significance of industry dummies.

\*\*\*, \*\*, \*: Statistically significant at p .01, p .05 and p .10, respectively. In parentheses, t-statistics based on robust standard errors.

**Table 6. Political connections, audit quality and cross listing. Further analyses II**

Model 15:

$$BIG4_{it} = \alpha_0 + \alpha_1 POLITICS_{it} + \alpha_2 DIVERGENCE_{it} + \alpha_3 MKBOOK_{it} + \alpha_4 LEV_{it} + \alpha_5 SIZE_{it} + \eta_k + \phi_j + \varepsilon_{it}$$

Model 16:

$$CROSSL_{it} = \alpha_0 + \alpha_1 POLITICS_{it} + \alpha_2 DIVERGENCE_{it} + \alpha_3 MKBOOK_{it} + \alpha_4 LEV_{it} + \alpha_5 SIZE_{it} + \eta_k + \phi_j + \varepsilon_{it}$$

	Model 15 ( <i>BIG4</i> )	Model 16 ( <i>CROSSL</i> )
<i>POLITICS</i>	1.974*** (4.32)	1.91*** (8.65)
<i>DIVERGENCE</i>	-0.01 (-0.21)	0.058 (0.95)
<i>MKBOOK</i>	0.129* (1.70)	0.004 (0.37)
<i>LEV</i>	1.53* (1.88)	3.34** (2.08)
<i>SIZE</i>	0.19 (1.27)	0.063 (0.43)
Constant	-2.204* (-1.69)	-4.95 (-1.51)
Year effect	<i>Yes</i>	<i>Yes</i>
Industry effect	<i>Yes</i>	<i>Yes</i>
Observations	565	565
Long pseudo-likelihood	-251.30	-127.72
Wald $\chi^2$	160.87***	131.02***
Test wald of exogeneity	4.47**	12.38***

The dummy variables  $\eta_k$  and  $\phi_j$  control for year and industry effects, respectively.

$\varepsilon_{it}$  is the error term for firm  $i$  in year  $t$ .

\*\*\*, \*\*, \*: Statistically significant at p .01, p .05 and p .10, respectively. In parentheses, t-statistics based on robust standard errors.

**Table 7. Political connections, family firms and earnings informativeness. Further analysis III**

Model 17:

$$CAR_{it} = \alpha_0 + \alpha_1 NI_{it} + \alpha_2 POLITICS_{it} \times NI_{it} + \alpha_3 POLITICS_{it} \times BIG4_{it} \times NI_{it} + \alpha_4 BIG4_{it} \times NI_{it} + \alpha_5 CROSSL_{it} \times NI_{it} + \alpha_6 DIVERGENCE_{it} \times NI_{it} + \alpha_7 MKBOOK_{it} \times NI_{it} + \alpha_8 LEV_{it} \times NI_{it} + \alpha_9 SIZE_{it} \times NI_{it} + \eta_k + \phi_j + \varepsilon_{it}$$

Model 18:  $CAR_{it} = \alpha_0 + \alpha_1 NI_{it} + \alpha_2 POLITICS_{it} \times NI_{it} + \alpha_3 POLITICS_{it} \times CROSSL_{it} \times NI_{it} +$

$$\alpha_4 BIG4_{it} \times NI_{it} + \alpha_5 CROSSL_{it} \times NI_{it} + \alpha_6 DIVERGENCE_{it} \times NI_{it} + \alpha_7 MKBOOK_{it} \times NI_{it} + \alpha_8 LEV_{it} \times NI_{it} + \alpha_9 SIZE_{it} \times NI_{it} + \eta_k + \phi_j + \varepsilon_{it}$$

	Model 17 (BIG4)	Model 18 (CROSSL)
$NI_{it}$	0.30* (1.72)	0.92*** (6.23)
$POLITICS_{it} \times NI_{it}$	0.93** (2.29)	0.15*** (5.53)
$POLITICS_{it} \times BIG4_{it} \times NI_{it}$	0.97** (2.36)	
$POLITICS_{it} \times CROSSL_{it} \times NI_{it}$		1.45*** (8.94)
$BIG4_{it} \times NI_{it}$	0.13*** (4.51)	0.08** (2.79)
$CROSSL_{it} \times NI_{it}$	1.37* (1.71)	1.06* (1.80)
$DIVERGENCE_{it} \times NI_{it}$	-0.02* (-1.86)	-0.02*** (-4.75)
$MKBOOK_{it} \times NI_{it}$	0.01 (0.7)	0.01 (0.65)
$LEV_{it} \times NI_{it}$	0.20* (1.90)	0.05 (1.35)
$SIZE_{it} \times NI_{it}$	0.07 (0.30)	0.08*** (5.81)
Constant	-0.22 (-1.15)	-0.009 (0.32)
Year effect	Yes	Yes
Industry effect	Yes	Yes
Observations	565	565
Hansen	34.71 (0.87)	38.89 (0.68)
Test m2	0.78 (0.52)	0.34 (0.82)
Test z1	127.44***	165.83***
Test z2	8.33***	12.62***
Test z3	15.93**	24.16**

The dummy variables  $\eta_k$  and  $\phi_j$  control for year and industry effects, respectively.

$\varepsilon_{it}$  is the error term for firm  $i$  in year  $t$ .

Hansen, test of over-identifying restrictions.

$m2$ , statistic test for lack of second-order serial correlation in the first-difference residual.

$z1$ , Wald test of the joint significance of the reported coefficients.

$z2$ , Wald test of the joint significance of time dummies.  $z3$ , Wald test of the joint significance of industry dummies.

\*\*\*, \*\*, \* †: Statistically significant at p .001, p .01, p .05 and p .10, respectively. In parentheses, t-statistics based on robust standard errors.

**Table 8. Political connections, family firms and accruals quality. Further analysis IV**

Model 19:

$$AbsQ1_{it} = \chi_0 + \chi_1 POLITICS_{it} + \chi_2 POLITICS_{it} \times BIG4_{it} + \chi_3 BIG4_{it} + \chi_4 CROSSL_{it} + \chi_5 DIVERGENCE_{it} + \chi_6 MKBOOK_{it} + \chi_7 LEV_{it} + \chi_8 SIZE_{it} + \eta_k + \phi_j + \varepsilon_{it}$$

Model 20:

$$AbsQ1_{it} = \chi_0 + \chi_1 POLITICS_{it} + \chi_2 POLITICS_{it} \times CROSSL_{it} + \chi_3 BIG4_{it} + \chi_4 CROSSL_{it} + \chi_5 DIVERGENCE_{it} + \chi_6 MKBOOK_{it} + \chi_7 LEV_{it} + \chi_8 SIZE_{it} + \eta_k + \phi_j + \varepsilon_{it}$$

Model 21:

$$AbsQ2_{it} = \chi_0 + \chi_1 POLITICS_{it} + \chi_2 POLITICS_{it} \times BIG4_{it} + \chi_3 BIG4_{it} + \chi_4 CROSSL_{it} + \chi_5 DIVERGENCE_{it} + \chi_6 MKBOOK_{it} + \chi_7 LEV_{it} + \chi_8 SIZE_{it} + \eta_k + \phi_j + \varepsilon_{it}$$

Model 22:

$$AbsQ2_{it} = \chi_0 + \chi_1 POLITICS_{it} + \chi_2 POLITICS_{it} \times CROSSL_{it} + \chi_3 BIG4_{it} + \chi_4 CROSSL_{it} + \chi_5 DIVERGENCE_{it} + \chi_6 MKBOOK_{it} + \chi_7 LEV_{it} + \chi_8 SIZE_{it} + \eta_k + \phi_j + \varepsilon_{it}$$

	Model 19 (AbsAQ1; BIG4)	Model 20 (AbsAQ1; CROSSL)	Model 21 (AbsAQ2; BIG4)	Model 22 (AbsAQ2; CROSSL)
<i>POLITICS<sub>it</sub></i>	-0.33* (-1.99)	-0.13*** (-2.71)	-0.86** (-2.28)	-0.12*** (-3.31)
<i>POLITICS<sub>it</sub> x BIG4<sub>it</sub></i>	-0.85* (-1.84)		-0.79** (-2.21)	
<i>POLITICS<sub>it</sub> x CROSSL<sub>it</sub></i>		-0.33* (-1.75)		-0.48*** (-3.33)
<i>BIG4<sub>it</sub></i>	-0.39* (-1.95)	-0.25** (-2.18)	-0.87*** (-3.13)	-0.35* (-1.94)
<i>CROSSL<sub>it</sub></i>	-0.16* (-1.92)	-0.44* (-1.82)	-0.30* (-1.88)	-0.33*** (-3.54)
<i>DIVERGENCE<sub>it</sub></i>	0.02** (2.55)	0.01* (1.83)	0.09* (1.80)	0.02*** (2.83)
<i>MKBOOK<sub>it</sub></i>	-0.009 (-0.99)	-0.01* (-1.87)	-0.01*** (-3.03)	-0.03*** (-4.62)
<i>LEV<sub>it</sub></i>	0.13 (1.18)	0.24* (1.85)	0.08 (0.63)	0.26*** (3.03)
<i>SIZE<sub>it</sub></i>	-0.05 (-0.30)	-0.01 (-0.74)	-0.01 (-0.62)	0.01 (1.00)

<i>Constant</i>	0.32 (1.27)	0.14 (0.59)	1.94*** (2.95)	0.02 (0.18)
<i>Year effect</i>	Yes	Yes	Yes	Yes
<i>Industry effect</i>	Yes	Yes	Yes	Yes
Observations	565	565	565	565
<i>Hansen</i>	23.14 (0.71)	20.66 (0.90)	25.00 (0.84)	25.22 (0.92)
<i>Test m2</i>	1.33 (0.18)	0.58 (0.56)	0.90 (0.36)	0.70 (0.48)
<i>Test z1</i>	15.34***	57.4***	62.3***	10.41***
<i>Test z2</i>	11.52***	51.4***	15.4***	80.9***
<i>Test z3</i>	20.54***	17.57***	8.54***	9.42***

The dummy variables  $\eta_k$  and  $\phi_j$  control for year and industry effects, respectively.

$\varepsilon_{it}$  is the error term for firm  $i$  in year  $t$ .

Hansen, test of over-identifying restrictions.

$m2$ , statistic test for lack of second-order serial correlation in the first-difference residual.

$z1$ , Wald test of the joint significance of the reported coefficients.

$z2$ , Wald test of the joint significance of time dummies.  $z3$ , Wald test of the joint significance of industry dummies.

\*\*\*, \*\*, \*: Statistically significant at p .01, p .05 and p .10, respectively. In parentheses, t-statistics based on robust standard errors.