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How do corporate political connections influence financial reporting? A synthesis of the literature

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ABSTRACT

A large stream of research has analyzed the effects of corporate political connections (CPCs) on firms, including first evidence on their effects on financial reporting behavior. However, the evidence so far is inconclusive, and attempts to explain the causality of effects on reporting are limited. In this article, we present the results of a systematic review of the literature on CPCs. We draw on findings in the accounting, finance, and economics literature and derive a framework that identifies four channels through which CPCs affect financial reporting. Our review of the literature suggests that effects of political connections tend to be more ambiguous than suggested by individual studies that often offer directional hypotheses. We also identify eight distinct types of political connectedness and discuss their interrelations and the proxies used in the literature to measure them.

1. Introduction

Corporate political connections (CPCs) have been a subject of study in the accounting and finance literature for more than a decade now. In general, accounting articles hypothesize that politically connected firms exhibit more earnings management and lower accounting quality than non-connected firms (e.g., Chaney et al., 2011). However, the exact causal relation between firms' political connections and the quality of corporate financial disclosures is not well understood, and preliminary results are ambiguous. For example, while Correia (2014) finds that connected firms face less strict enforcement from the Securities and Exchange Commission's (SEC's) Department of Enforcement, Heese et al. (2017) find that they are more likely to receive a comment letter from the SEC's Department of Corporation Finance and more likely to subsequently receive a substantive review.

While the literature on management strategy has investigated corporate political *activities* since at least the 1980s (e.g., Keim and Zeithaml, 1986), articles investigating the effects of CPCs began appearing only around 2000 (e.g., Fisman, 2001; Faccio, 2006). The management literature has attempted to conceptualize and integrate the many heterogeneous studies on corporate political activities (e.g., Hillman et al., 2004), whereas the literature on CPCs is much less developed. The notion of corporate political connectedness itself is not homogeneously conceptualized. Empirical studies use strongly divergent proxies, ranging from firms providing financial contributions to politicians via political action committees (PACs) (Correia, 2014), to family connections between corporate owners and politicians (Faccio, 2006), to metrics based on political geography (Piotroski et al., 2015).

In this article, our primary objective is to develop a conceptual framework describing *how* CPCs affect financial reporting outcomes. To pursue this objective, we carry out a systematic review of the literature (Tranfield et al., 2003; Rousseau et al.,

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2008) in academic journals in the fields of accounting, economics, and finance. While an increasing number of empirical studies have investigated the impact of CPCs on variables of interest to accounting researchers, such as SEC enforcement, auditor choice, and accounting quality, we deliberately extend our search to the neighboring disciplines of economics and finance in which a majority of seminal articles on CPCs have been published. This approach enables us to inductively derive a framework that identifies channels that causally link political connections to disclosure quality. In a related article, Habib et al. (2018) also review empirical evidence on the effects of political connections on financial reporting. In contrast with their work, our focus is on the pathways through which CPCs affect accounting outcomes.

Furthermore, we find multiple heterogeneous metrics used to proxy for CPCs and a lack of an overarching definition of the concept. For example, individual articles use proxies that are based on personal relations between corporate management or owners and politicians, on the geographic location of a firm whose actions affect the well-being and implicitly voting behavior of a politician's electorate, on corporate political donations, and so on. We thus develop a classification scheme of types of political connections used in the literature and elaborate a general definition. Drawing on our review of the articles and the various approaches used, we propose the following definition of CPCs: Firms are politically connected if their continued existence and success affect the interests of at least one powerful political actor. This definition puts the political actor's incentives central. In its general form, it encompasses the individual types of CPCs we identify. In a subsequent section on open research questions, we rely on this definition to relate the CPC literature to the literature on corporate political activities and on classification of economic and political systems to identify fruitful avenues for future research.

We classify the different proxies used in empirical studies in eight categories: (1) *financial contributions* to a politician's election campaigns; (2) *lobbying*; (3) *equity ownership by politician*, which links a politician to a firm if he or she owns a substantial investment in the firm; (4) *geographic links*, which tie firms to a politician if the politician is affected by, for example, unemployment resulting from layoffs of that firm; (5) *state ownership*, which constitutes a form of political connectedness, as politicians are likely to be held responsible for publicly held firms in public opinion; (6) *social ties*, such as friendship or family affiliation that link a politician to a firm's top managers or owners; (7) *personal service*, which captures instances in which a current or former politician holds an important position (e.g., a board member in a firm); and (8) *indirect measures*, or metrics that infer political connectedness from observable variables (e.g., abnormal stock returns after political events) that are not in themselves political.

Our analysis of the articles suggests that CPCs have an impact on the quality of corporate disclosures via four channels. Importantly, while individual articles tend to argue for a directional relation, a synthesis of the literature suggests that the ultimate effect on corporate disclosures is ambiguous. The first channel stems from connected firms' enhanced access to financial resources. Politically connected firms are more likely to obtain government procurement contracts and have better access to debt finance. This potentially creates an incentive to obscure the favors obtained and diminishes the capital market pressure for high-quality disclosures. By contrast, some evidence shows that lower market pressure and better access to government assistance in case of financial difficulties decrease connected firms' need to engage in earnings management. Second, politicians connected with a firm have an incentive to use corporate means for political ends (e.g., delaying layoffs in election years). Engaging in such political quid pro quo in turn creates incentives to obfuscate the firm's true economic condition. At the same time, connected firms may implement high-quality monitoring systems or put increased emphasis on high-quality auditors to signal the trustworthiness of their financial reports to stakeholders aware of such incentives. The third channel comes from changes to the level of enforcement of regulations on connected firms. While some articles suggest that connected firms are subject to less strict regulation, which may lead to lower disclosure quality, some evidence indicates an opposite effect. Increased public and media scrutiny of politically connected firms constitutes the fourth channel. Such firms are a more interesting target for journalists and therefore have incentives to be transparent and preempt scandals. At the same time, the increased public attention may incite such firms to be less forthcoming with information.

Overall, our review shows that the impact of CPCs on the quality of financial reporting is more complex than assumed in the empirical literature. The construct of CPCs is multifaceted, and the channels of influence are poorly understood. While some aspects provide incentives for firms to be less forthcoming with information, others have the opposite effect of enticing them to become more transparent. Our definitions and classification scheme can help structure findings in this literature and inform future studies.

The remainder of this article proceeds as follows: Section 2 details our methodology. We first describe how we select articles for inclusion and then show how we analyze them. Section 3 presents the effects of CPCs. We structure this section by general (i.e. not accounting-related) effects, effects on accounting outcomes and the four channels through which CPCs affect accounting outcomes. In Section 4, we address the fact that CPCs are conceptualized and operationalized in many different ways in the literature. We thus propose our generic definition of CPCs because it encompasses many different CPC types, and we derive a classification scheme. In Section 5, we present results of studies investigating individual economic sectors. Section 6 discusses identification issues and causality in CPC studies. Section 7 draws on the preceding sections and identifies open research questions as well as offers some speculations on these. Section 8 summarizes and concludes.

2. Methodology

In contrast with traditional literature reviews, systematic literature reviews follow a well-defined methodology to select or reject individual articles for inclusion in the review. Originally developed in the field of medicine, these reviews are also becoming a standard in the area of business studies (e.g., Tranfield et al., 2003; Jones and Gatrell, 2014). Reviews are impor-

tant because they put individual studies in a context. Systematic reviews apply scientific rigor to the selection and interpretation of articles reviewed, thereby overcoming biases that may arise in traditional literature reviews (Petticrew and Roberts, 2006).

In our review, we proceed in two stages. In the first stage, we identify relevant articles that appeared in the literature until September 2015 and analyze them to inductively derive a framework of the effects of CPCs (from here on called stage I). In the second stage, we repeat the procedure and identify articles accepted for publication or published between September 2015 and June 2020 using the same set of criteria and apply the framework to the newer articles to investigate whether major conceptual changes have occurred (from here on called stage II). In analyzing these new articles, we make some minor adjustments to our classification scheme but find it still applicable overall.

2.1. Selection of articles

As major contributions are likely to be published in top journals (Webster and Watson, 2002), we begin by consulting the academic journal guide of the Chartered Association of Business Schools to identify top-tier journals in the fields of accounting, economics, and finance. We note that choosing a different journal ranking would have yielded substantially similar results. We limit ourselves to these three fields, as prescreening revealed that articles in these fields are reasonably comparable in terms of methodology and the use of the term "corporate political connections" or its synonyms. Articles from other related fields, such as management, differ substantially in structure, making a systematic comparison difficult. We identify 37 different journals.

We use the search terms "political connection" and "political connections" and retain articles for analysis if they cumulatively fulfill five inclusion criteria. First, the article must involve original research. We discard journal indices, book reviews, tables of content, front and back matter, miscellanea, editor reports, and so on. Second, the search term must appear in the article's main body. We accept synonyms such as "political links" but discard articles that mention political connections in references or bibliographies only. Third, CPCs must be operationalized empirically. We discard theoretical pieces that do not include an empirical element. Fourth, the study must investigate the *effects* of political connections. We discard articles that solely examine the *determinants* of CPCs. Fifth, CPCs must be the focus of the articles. We discard articles in which political connections are included as a control variable without further analysis or in which the results for the political connections variable are not reported.

The first step of stage I yields 91 articles from the fields of accounting, economics and finance. To ensure that our review of top journal articles does not introduce a bias or make us miss important contributions in our core area of financial reporting, we proceed to inspect papers referenced in the stage I articles. We use Web of Science to download the reference lists and are thus able to track the 85 articles. The remaining six articles cannot be located on Web of Science or do not have reference lists. We download 2920 references. After eliminating duplicate articles and articles already identified during the initial keyword search, we obtain 1489 new references. Of these, we limit ourselves to articles that have the term "politic*" in either title or abstract or are cited at least five times in our original sample of top-tier articles. This leaves us with 235 articles. We retain only those articles that fulfill our inclusion criteria and focus on financial reporting or auditing, yielding five additional articles which we add to our sample. The small number of additions resulting from the application of this procedure leaves us confident that our selection of journals does not make us miss many contributions. We hence do not apply the procedure to stage II top-tier articles.

Finally, we subjectively add seven articles that we encountered during our general research process but that would not have been included from the application of the procedure described previously. Table 1 summarizes the selection process.

2.2. Analysis of articles

After a preliminary reading of the identified stage I articles, we concluded that a majority could be intuitively classified as "accounting papers" and "non-accounting papers". To make that distinction systematic, we rely on Bushman and Smith (2003, p. 65), who define financial accounting information as "the product of corporate accounting and external reporting systems that measure and routinely disclose audited, quantitative data concerning the financial position and performance of publicly held firms." Applying this definition allows us to separate articles into what we call accounting outcomes (i.e., articles that investigate effects that fall under our definition of financial reporting) and accounting environment (i.e., all other articles). A majority of the articles do not fit our definition of financial reporting outcomes. However, most show an *indirect* effect on accounting outcomes, confirming our choice to label them as "accounting environment".[1] We note that this classification does not fully correspond to a classification of the academic fields of the journals in which we find the articles: several articles published in accounting journals investigate effects that fall into our definition of the accounting environment, while we classify some articles published in finance journals as accounting outcome articles.

We carry out our investigation of the channels through which CPCs affect financial reporting quality in three steps. First, we read and excerpt articles studying accounting outcomes. In an iterative process of excerpting, discussing, and classifying, we inductively develop four categories of accounting outcomes investigated in these papers. Second, we read and excerpt

[1] Classification of an effect as either "accounting outcome" or "accounting environment" based on this definition was straightforward in most cases. In cases of ambiguity, a decision was reached by discussion between the authors.

Table 1
Selection of articles.

	Sum	Inclusion
Stage I: Papers accepted for publication until September 2015		
Search in top-tier journals		
Keyword search accounting journals	45	20
Keyword search economics journals	54	11
Keyword search finance journals	149	60
	248	**91**
Search in reference lists of top-tier journal articles		
Number of articles on Web of Science	85	
Number of referenced articles	2920	
New references after eliminating duplicates	1489	
Number of articles with keywords in title or abstract or cited at least five times	**235**	**5**
Total number of articles analyzed in stage I		**96**
Stage II: Papers accepted for publication between September 2015 until June 2020		
Search in top-tier journals		
Keyword search accounting journals	40	14
Keyword search economics journals	24	4
Keyword search finance journals	145	55
Total number of articles analyzed in stage II	**209**	**73**
Number of articles subjectively added		**7**
Total number of articles		**176**

articles investigating the accounting environment, again following an iterative process of excerpting, discussing, and classifying. As these effects are more heterogeneous than those we qualify as accounting outcomes, we follow a three-step-procedure of inductive content analysis (e.g., Elo and Kyngäs, 2008). For each article, we extract text passages explaining the construct of interest and proxies being used to empirically measure them. We then group them into generic categories. From these generic categories, we distill and name six main categories. Third, to link the accounting environment and accounting outcomes, we re-read articles investigating accounting outcomes, excerpting text passages speculating about (and, in some cases, empirically testing) the channels through which CPCs affect accounting outcomes. In a process analogous to that used in the first and second steps, we group relevant text passages and, after abstracting, obtain four channels. We repeat the analysis for stage II articles using this inductively derived framework. Only two articles differ from the existing categorization, which is why we add the main category "other". Eventually, empirical evidence on the relation between CPCs and the accounting environment is categorized into 19 generic, and seven main categories. A detailed description of our procedure for selection and analysis of stage II articles is given in the Appendix A.

Analysis of the individual articles reveals that CPCs are operationalized in widely divergent ways. The finding that different forms of connectedness plausibly result in different interactions with politicians is hardly addressed in the literature. In particular, we find that politicians' incentives are not explicitly addressed in the CPC literature. Instead, articles usually assume that politicians will provide some form of support to firms with which they are connected or to managers of such firms. Some articles investigate the determinants of political connections (i.e., the antecedents that explain why firms and politicians become connected), but evidence of how politicians (vs. firms) behave after a connection has been established is scarce. To address this dearth and guide future research, we establish a typology of CPCs. Again, we begin by excerpting passages describing the construct of political connection and empirical proxies in individual articles and proceed to collapse these into higher-order categories. Finally, we elaborate a definition of CPCs that (i) includes the politician with which the firm is connected as a rational self-interested actor, (ii) encompasses the different forms of connectedness found in the literature we analyzed, and (iii) distinguishes CPCs from more general corporate political activity (e.g., Hillman et al., 2004).

2.3. An analytical framework

Fig. 1 visually summarizes the results from the steps outlined in the preceding sections. All elements of this framework have been derived inductively from an analysis of the literature as explained in Sections 2.1 and 2.2. We use this framework to structure our review of the literature. In Section 3.1, we discuss studies that investigate the effects of CPCs on what we call the accounting environment, that is, aspects that do not meet our definition of an accounting outcome but plausibly indirectly affect accounting outcomes. In Section 3.2, we present studies that directly assess the effects of CPCs on financial reporting (i.e., accounting outcomes). Finally, Section 3.3 discusses channels through which CPCs may affect accounting outcomes as hypothesized in accounting outcome articles.[2]

[2] It follows from the previous discussion that our classification scheme yields a pluri-dimensional structure: accounting outcomes and accounting environment, channels, and CPC proxies. Several articles also investigate more than one effect of CPCs and/or use various metrics to proxy for political connection. To ensure the readability of the paper, we refrain from citing all articles in all sections in which they appear in the classification scheme.

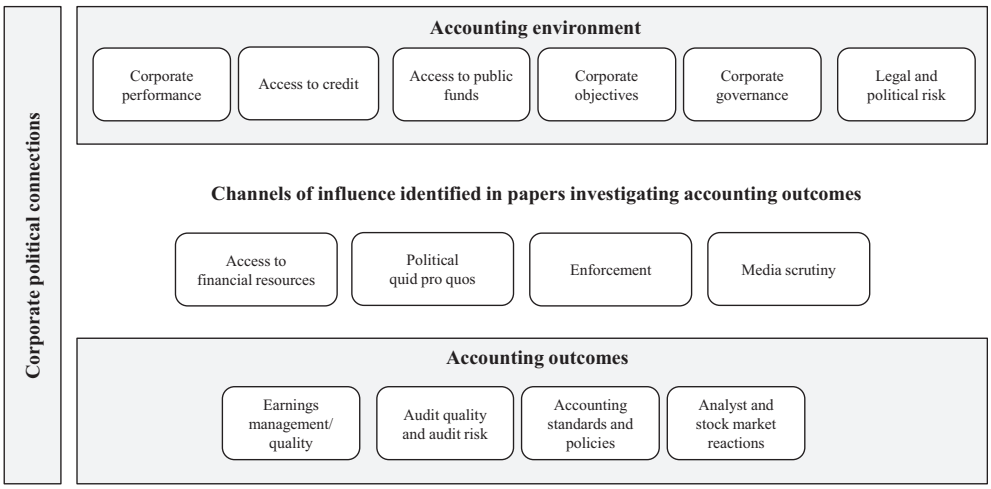

Fig. 1. An analytical framework.

We add a summary document of our analysis as an online appendix. In that document, we detail for each article whether we classified it as accounting outcome or accounting environment, the main effects of CPCs investigated, the countries investigated, the events studied (if applicable), as well as the empirical strategies used to address endogeneity concerns.

3. The effects of CPCs on the accounting environment and accounting outcomes

3.1. Empirical results on the relation between CPCs and the accounting environment

In this subsection, we review the effects of CPCs that have been investigated in the fields of accounting, economics, and finance. We call this the "accounting environment" because it concerns aspects of the economic reality that affect firms' accounting choices and outcomes. We begin by reviewing the effects of CPCs on the external environment in which financial reporting takes place. We inductively identify six areas that are affected by political connections: (i) corporate performance, (ii) access to credit, (iii) access to public funds, (iv) corporate objectives, (v) corporate governance, and (vi) legal accountability. For reference, we provide Table B.1 Panel A in the appendix that summarizes categories and variables investigated in these studies.

3.1.1. Corporate performance

An overall question about CPCs is whether they create or destroy value for shareholders. A priori, the answer to this question is unclear. On the one hand, connected firms may receive beneficial treatment from politicians, but they may also be required to engage in activities that transfer wealth from shareholders. Politicians may set policies that favor their connected firms and enable them to capture market share (Bunkanwanicha and Wiwattanakantang, 2009), they may provide them with privileged access to finance (Claessens et al., 2008), government procurement contracts (Cohen et al., 2011), and so forth. On the other hand, connected firms may be expected to help their political patrons by, for example, making inefficient investment decisions to uphold a high level of employment, particularly preceding elections (Bertrand et al., 2018), or by making politically motivated acquisitions (Schweizer et al., 2019). Furthermore, formal institutions or street protests may help put a check on political rent-seeking, thus limiting the effects of CPCs (Acemoglu et al., 2018). In this subsection, we discuss the findings of studies that attempt to estimate the overall effect of CPCs on corporate performance, measured as stock market returns or accounting profitability.

Several studies examine stock returns around political events to assess the value of CPCs. Goldman et al. (2009) show that companies connected with the Republican Party increased in value whereas those connected with the Democratic Party decreased in value after the Republican victory in the 2000 U.S. presidential election. Akey (2015) compares U.S. firms donating to winning and losing candidates and finds that postelection abnormal returns are 3 percent higher for firms giving to winning candidates. Acemoglu et al. (2016) show that while in most cases, the nomination of a new treasury secretary does not lead to abnormal positive returns for firms with which he is connected, it did in the case of Timothy Geithner in 2008. The authors argue that this is because, in countries with strong institutions, political connections have value in the context of a crisis. The guilty plea of lobbyist Jack Abramoff and the subsequent media attention made it damaging for politicians to be associated with lobbyists, creating an opportunity to estimate the value of the possibility to lobby for firms. Borisov et al. (2016) examine the market reaction to this event and find that firms that spent more on lobbying experienced a significantly greater decrease in value.

Investigating the stock price reactions of a sample of Indonesian firms connected with President Suharto to rumors about Suharto's deteriorating health, Fisman (2001) finds that they lost more value than less dependent firms. Similarly, in Indone-

sia, Johnson and Mitton (2003) estimate that 9 percent of the loss in market value of connected firms following the Asian financial crisis can be attributed to reduced subsidies. Fung et al. (2015) investigate the effects of the 2008 General Election loss of the supermajority by the ruling party in Malaysia on stock prices. They find that firms were less negatively affected when the connection prevailed over a longer period. They argue that long-time connectedness allows firms to build credibility and gain access to informal political networks. Ferguson and Voth (2008) document that German firms that politically or financially supported the NSDAP in the earlier days of its movement outperformed the market by up to 8 percent after the party came into power. Faccio and Parsley (2009) analyze a global sample of unexpected deaths of politicians and find a 1.7 percent decline in the value of companies headquartered in the politician's hometown. In a global sample of firms that have high-level politicians as major shareholders or top officers, Faccio (2006) finds a significant abnormal return when a businessperson enters politics but no significant effect for the opposite situation when a politician is appointed to a corporate board. Using a Chinese sample, Hung et al. (2015) find that political scandals that destroy political connections are associated with worse stock market reactions than scandals that signal destruction of firms' market credibility. Conversely, shareholders pay a market premium for connected Chinese firms when they go public (Liu et al., 2013).

Other studies investigate stock market returns of connected firms over a longer period or following a merger-and-acquisition transaction or initial public offering (IPO). Cooper et al. (2010) examine the effects of connections established through financial contributions to U.S. politicians and find that the extent of support for candidates is positively related to abnormal returns. This effect is particularly strong for support of candidates who have the ability to help the firm (i.e., the firm's headquarters is located in the politicians' electoral district). Ferris et al. (2016) show that connected firms avoid regulatory delay for corporate acquisitions and exhibit higher postmerger performance. Boubakri et al. (2012) investigate a multinational sample of politically connected firms over a five-year period and find that connected firm exhibit lower cost of equity capital than similar non-connected firms. They suggest that connected firms are considered less risky than non-connected firms. Humphery-Jenner and Powell (2014) argue that large acquirer size is commonly associated with agency conflicts and lower acquisition returns. However, when country governance is weak and political connections are widespread, large firms enjoy benefits such as market power and access to political networks that compensate for the negative consequences of firm size. In a Chinese setting, Li et al. (2019) find that the positive impact of trust on IPO underpricing is less pronounced for politically connected firms, consistent with the interpretation that the government provides a "helping hand". Lee et al. (2019) show that Chinese firms lacking political connections are more likely to list by engaging in a reverse merger rather than an IPO, in line with the argument that political connections attenuate the uncertainties of the IPO process. Wang and Wu (2020) similarly find that companies backed by politically-connected VCs are more likely to obtain IPO approval from the Chinese Securities Regulatory Commission. Nonetheless, reviewing three-year post-IPO stock returns Fan et al. (2007) find that Chinese newly privatized firms whose CEO is a former or current government bureaucrat underperform other newly privatized firms by a high degree.

A particular political relation between firms and governments arises for partially state-owned listed firms. While such firms are more likely to be subject to value-destroying political interference, directing corporate resources to pursue political and social objectives (Li and Yamada, 2015), they may also benefit from an implicit bailout guarantee (Ben-Nasr et al., 2012; Boubaker et al., 2018; Boubakri et al., 2018). Ben-Nasr et al. (2012) investigate a global sample of newly privatized firms and find evidence of higher cost of equity capital when remaining state ownership is higher, indicating that the political interference effect outweighs the guarantee effects. In a similar vein, D'Souza et al. (2017) provide evidence that "de novo" private firms perform better than formerly state-owned firms, even though these firms are subject to greater financial, corruption, and legal hurdles. In a European sample, Cumming et al. (2017) show that private venture capital-backed companies have better exit performance than firms backed by governmental venture capital funds. Gupta (2005) investigates privatized firms in India and finds that even partial privatization that leaves control with the state improves profitability and productivity because of better monitoring incentives. In line with the guarantee effect, Beuselinck et al. (2017) find that European firms with government ownership experienced a lesser reduction in firm value than firms without government ownership in the 2005–2009 period, which covers the 2008 financial crisis. They show that the effect was driven by firms from countries with less corruption and better investor protection. In a Chinese sample, Calomiris et al. (2010) find that in contrast with evidence from other countries, the market response to an unexpected announcement of the sale of government-owned shares was negative. They argue that in China, the benefits of political ties outweigh the efficiency costs of government shareholdings.

In addition to stock market effects, several studies investigate accounting profitability measures to gauge the overall effects of CPCs. Cingano and Pinotti (2013) find that a sample of Italian firms connected with local politicians exhibit a revenue premium of 5.7 percent, stemming from changes in domestic sales but not in exports and not linked to improvements in productivity. Their evidence suggests that local politicians use their power to help connected firms on the domestic product market. Amore and Bennedsen (2013) find that even in Denmark, a low-corruption country, an exogenous increase in the power of municipalities led to a doubling in operating profits of firms related by family to local politicians. Braggion (2011) finds evidence that having a member of the U.K. parliament on the board of directors in their sample was associated with reduced firm profits of 20 percent on average. Ovtchinnikov and Pantaleoni (2012) find that changes in financial contributions in a congressional district are positively associated with subsequent improvements in local firms' operating performance. In contrast with these results, Cao et al. (2018a) find a negative association between corporate lobbying and firm performance and argue that agency costs of managers pursuing causes dear to them at the expense of their employer explain these results. Boubakri et al. (2008) find that for a global sample of newly privatized firms, politically connected firms exhibit weaker accounting performance than non-connected peers.

Overall, the picture that emerges from the empirical studies reviewed is that connections between firms and the political sphere tend to have adverse capital market consequences if they stem from government ownership but beneficial consequences if they stem from other forms of political connectedness. Government ownership appears to have beneficial consequences in adverse circumstances, as state-owned firms benefit from an implicit bailout guarantee.

3.1.2. Access to credit

An important effect of political connectedness on firms is the access to credit. Several studies from different jurisdictions have found that firms that are close to the state enjoy privileged access to debt financing, leading to distortions in the economy. Claessens et al. (2008) investigate Brazilian firms and find that those providing contributions to federal deputies substantially increase their bank financing compared with a control group after elections; firms contributing to winning candidates enjoy better access to finance. The authors also show that these firms have lower return on assets and estimate the capital misallocation stemming from this effect to be at least 0.2 percent of gross domestic product. In the U.S., Houston et al. (2014) find that companies with connected board members enjoy lower costs of bank loans. Their evidence indicates that lenders regard connected firms as having lower credit risk. Conversely, proximity to political power, as measured by political alignment between a firm's home state and the federal president, can also impose policy risk on firms, leading to higher yield spreads (Bradley et al., 2016a). U.S. banks that received funds under the Troubled Asset Relief Program (TARP) also appeared to reciprocate the political favor by increasing mortgage and small business lending inside their local representatives' political districts (Chavaz and Rose, 2019). Infante and Piazza (2014) find that Italian firms benefit from lower interest rates on bank credits when they have political connections on the local level. This preferential treatment is exacerbated for firms borrowing from banks with politicians on their boards. Cull et al. (2015) show that Chinese firms with government-appointed CEOs face less tight financial constraints probably due to their enhanced status in the Chinese credit market. Similarly, Cong, Gao et al. (2019) show that after 2008, the allocation of bank credits in China disproportionately went to state-owned enterprises (SOEs), as the implicit government guarantees were perceived as more important during recessions. Firms connected with the state by partial state ownership benefit from better credit terms because of a perceived implicit bailout guarantee by the state also in other settings. Meng et al. (2020) find that short sales tighten firms' financial constraints in a Chinese sample and that this relation is more pronounced for state-owned firms. They interpret this as suggesting that the possibility of short sales inhibits the financing advantage of inefficient SOEs. Borisova and Megginson (2011) investigate a sample of European partially and fully privatized firms and find that higher remaining government ownership is associated with lower credit spread. Conversely, Bunkanwanicha and Wiwattanakantang (2009) find that while the value of Thai companies increases substantially after their owners' successfully run for office, their financing is not affected.

A major provider of politically motivated lending is government-owned banks. Coleman and Feler (2015) show that in the wake of the 2008 crisis, Brazilian government banks substantially increased lending. Their evidence indicates that this lending was both politically targeted and inefficiently allocated. In one of the first studies examining lending behavior of global state-owned banks, Dinç (2005) shows that such banks increase their lending in election years compared with private banks. In a Chinese sample, Bailey et al. (2011) show that state banks provide loans to prevent connected firms from bankruptcy. Firth et al. (2008) also find that Chinese state-owned banks provide more lenient credit terms to firms with greater state ownership, leading to an overinvestment bias in such firms. Ru (2018) finds that government credit to state-owned firms tends to crowd out private firms in the same industry but has the opposite effect on downstream firms. Khwaja and Mian (2005) provide evidence that politically connected firms in Pakistan borrow substantially more despite having substantially higher default rates. They obtain preferential treatment from government-owned banks but not from private banks. While these studies clearly suggest a positive effect of political connections on access to bank credit, political connections have no impact on trade credit by commercial partners (Liu et al., 2016).

3.1.3. Access to public funds

An important way that the government can support politically connected firms is by offering a bailout in case of financial difficulties. Several studies have shown that connected firms indeed have a higher probability of obtaining a bailout. Politicians linked to financial institutions through personal equity holdings are also more likely to vote in favor of the Economic Emergency Stabilization Act, which authorized the U.S. Treasury to spend $700 billion to stabilize financial markets (Tahoun and Van Lent, 2019). Duchin and Sosyura (2012, 2014) show that while there is no evidence that the decision to apply for the Capital Purchase Program under the Troubled Asset Relief Program in the U.S. was associated with political connectedness, the likelihood of approval was. Kostovetsky (2015) finds similar results for banks that are geographically connected with a member of the U.S. Senate Banking Committee. Adelino and Dinç (2014) show that U.S. firms in weaker financial health spent more on lobbying during the period of the 2009 stimulus package. Lobbying firms were subsequently more likely to receive stimulus funds. Faccio et al. (2006) find that politically connected firms are more likely to receive bailouts in a global sample. Chen et al. (2011c) find that private firms in a Chinese sample pursue political connections both to minimize expropriation by government officials and to gain benefits in the form of subsidies. Conversely, Poczter (2016) finds no evidence that political connections with President Suharto were a determinant of receiving recapitalization under Indonesia's bank recapitalization program resulting from the Asian financial crisis of 1997.

Another channel of government funds to firms is government procurement contracts. Goldman et al. (2013) find that companies connected with the winning party of the U.S. 1994 election experienced a significant increase in government contracts subsequent to the election and vice versa for firms connected with the losing party. Their study is one of the few to show that in

democracies with alternation of power, being affiliated with the "wrong" side can become a handicap. Cohen et al. (2011) show that accession to the chairmanship of a powerful congressional committee is associated with an increase of 40–50 percent in federal earmark spending, a 9–10 percent increase in state-level government transfers, and a 24 percent increase in government contracts for the home state of the senator or representative. Tahoun (2014) investigates stock ownership by politicians and finds that firms that have a higher stock ownership by members of the U.S. Congress and higher contribution from these firms obtain more government contracts. In an Indian setting, Ryan (2020) shows that connected firms anticipate their higher bargaining power in contract renegotiations and adopt a different bidding strategy in order to win public contracts.

Access to government funds is sensitive to the political agenda of the ruling party. Belo et al. (2013) find evidence that return differences between industries with high and low exposure to government spending can be explained by presidential partisan cycles. Under Democratic (Republican) presidencies, firms in industries with high exposure overperform (underperform) by 6.1 (4.8) percent. However, political connections do not appear to protect firms from losing U.S. government contracts in case of fraud allegations (Heese and Pérez-Cavazos, 2019). In a Korean setting, Schoenherr (2019) finds that the allocation of government contracts to firms within the president's network is intermediated by the appointment of individuals from that network to CEO positions in state-owned firms. An additional way to channel public funds to connected firms is by selling natural resources to them at a lower price than to other buyers (Chen and Kung, 2019).

3.1.4. Corporate objectives

The advantages political connections confer to firms and their shareholders may be counteracted by an expectation that the firm will reciprocate in some kind. Several studies find evidence that connected firms take the interests of incumbent politicians with respect to a high level of employment into account. Bertrand et al. (2018) find that French firms managed by CEOs who had previously worked in government exhibit a higher level of job and plant creation in election years. In a similar vein, Carvalho (2014) finds that in Brazil, firms eligible for government bank lending increase employment in politically competitive regions before elections and Chen et al. (2020) find that firms headquartered in the hometown of key political leaders in China set up more subsidiaries in the home province in order to strengthen their ties to these leaders. Direct government involvement through partial state ownership leads to similar results. Boubakri et al. (2013) investigate newly privatized firms from 57 countries and find that firms with residual state ownership pursue a conservative investment policy, presumably in an attempt to stabilize employment. Chen et al. (2017) find similar results in a global sample of newly privatized firms from 64 countries. Li and Yamada (2015) show that both local and central governments in China have a pronounced impact on partially privatized SOEs' efforts to preserve employment. Chinese firms linked to the government by either majority state ownership or appointment of politically connected managers have lower investment efficiency, in line with the argument that such firms help the government accomplish social and political objectives (Chen et al., 2011d). They also react more strongly to stimulus packages while exhibiting lower investment efficiency than non-connected private firms (Deng et al., 2020) and high labor costs induce relatively less innovation for them than for non-connected private firms (Li et al., 2020).

At the same time, connected firms may decrease their investment level as a bargaining tool in times of political turnover (An et al., 2016) or because they have lesser need of creating a strategic entry barrier (Li and Cheng, 2020). Wei et al. (2020) on the other hand find that firms are forced to pay higher wages after the loss of political connections, presumably because they are now perceived as riskier employers. In the U.S., pension funds with a higher percentage of politically affiliated trustees are more likely to favor investments in firms that support local politicians (Bradley et al., 2016b; Andonov et al., 2018). Faccio and Hsu (2017) show that a buyout by a politically connected private equity is generally followed by an increase in employment, particularly during election years. Investment policies that correlate with financial contributions may not only be a response to political agendas but also be a reflection of corporate ideologies. Hutton et al. (2014) show that lower levels of investment expenditures, risk taking, and leverage ratios are characteristics of more conservative, Republican-leaning managers.

In addition to ensuring a high level of employment, politicians may use connected firms in other ways to enhance their own career. Hung et al. (2012) show that politically connected Chinese firms are more likely to list overseas, which provides managers a higher level of media coverage and an increased likelihood of promotion to a senior government position. In a similar vein, Zhang and Liu (2020) argue that managers of state-owned firms are more likely to engage in finance leases rather than operating leases because of their empire building incentives. Piotroski and Zhang (2014) find that when Chinese politicians are rewarded for capital market development, IPOs accelerate before these politicians' transfer. While politicians with whom firms are connected may use corporate resources to enhance their electoral chances, firms may voluntarily engage in politically and socially desirable activities independent of external intervention in an attempt to curry favor with politicians. In line with this argument, Borghesi et al. (2014) find that U.S. managers who donate to both Republicans and Democrats – and therefore are more likely to act strategically than ideologically – are also more likely to invest in corporate social responsibility. In a Chinese setting, McGuinness et al. (2017) argue that foreign investors strategically invest in corporate social responsibility to establish networks with political decision makers. Yao and Zhong (2013) find evidence that Chinese firms with political ties are more likely to allow unionization.

3.1.5. Corporate governance

Politically connected firms exhibit differences in terms of elements of corporate governance. In this subsection, we discuss in particular tunneling, executive compensation, and corporate control structures. Cheung et al. (2010) investigate

related party transactions of Chinese firms and both local and central governments. They find that for firms connected with local governments, the effect of related party transactions on minority investors is the opposite of the effect for firms connected with the central government. In particular, they document substantial wealth transfers from minority shareholders to state-owned controlling shareholders for firms connected with the local government (in line with the "grabbing hand hypothesis") but the reverse for firms connected with the central government, which appears to prop up underperforming firms (in line with the "helping hand hypothesis"). Peng et al. (2011) also investigate related party transactions of Chinese firms and similarly find that the same transactions can be used for "tunneling" or "propping up". They also show that announcement returns upon such transactions can be positive or negative depending on the market's assessment of which type of incentives prevail.

Political connections appear to have a negative impact on the announcement effect, suggesting that the market considers the tunneling motivation to prevail for connected firms. Liu and Tian (2012) find a decrease in excess borrowing at connected firms with excess control rights after the introduction of the Chinese non-tradeable share reform. They argue that the reform, which enabled controlling owners to sell their shares at market value, made them more responsive to capital market movements and consequently decreased their incentives to raise capital for tunneling purposes. Liu et al. (2015) show that tunneling of Chinese family firms with high cash holdings is exacerbated if the founder has political connections. Hu et al. (2020) find that though politically connected independent directors are associated with greater levels of expropriation of minority shareholders, they nevertheless react negatively to their departure, suggesting that they estimate the overall effect to be positive for them.

Investigating executive pay in a sample of Chinese firms, Chen et al. (2011b) find that political power, measured as the duality of the functions of executive and party secretary, is related to higher executive compensation. Drawing on social identity theory, Du et al. (2012) argue that politically connected executives of Chinese SOEs have a higher level of affinity with officials from the State-Owned Assets Supervision and Administration Commission of China who evaluate them. In line with this argument, they present evidence that political connection positively affects the subjective performance evaluation executives receive from the commission. Politically connected CEOs also have a lower probability of being replaced as a result of weak corporate performance (Cao et al., 2017). Li et al. (2007) investigate Chinese twins and find that individuals' earnings are 10 percent higher for Chinese Communist Party members in an ordinary least squares regression but that the premium disappears in within-twin-pair estimates.

Chen et al. (2011c) examine how political connections influence the concentration of control rights in firms. They argue that homogeneity of controlling owners' interests reduces the costs of collective actions, facilitates the maintenance of political connections, and reduces the need to transfer information about rent-seeking activities. They therefore predict more concentration in connected firms. Investigating a Chinese sample, they suggest that controlling owners of connected firms tend to concentrate their shareholders and occupy the position of chairman or CEO. Fan et al. (2017) argue that officials prefer dealing with a single firm than multiple firms along the value chain. They predict and find that a higher degree of corporate connectedness with officials is associated with a higher level of vertical integration. Fan et al. (2007) examine a sample of partially privatized firms in China and find that CEOs who are former or current government bureaucrats are more likely to appoint other bureaucrats to the board of directors. They argue that politically connected CEOs need allies on the board and prefer bureaucrats to professionals who might obstruct their objectives. Xu et al. (2015) argue that CPCs constitute a specialized asset that is not easily transferrable. They show that connected founders are substantially more likely to transmit the CEO/chairman function or board membership to second-generation family members to minimize the cost of transferal of their political connections.

In a U.S. setting, Jagolinzer et al. (2020) find evidence of informed insider trading by officers and directors of politically connected banks ahead of TARP payments. They interpret their findings as suggesting that political connections procure an information advantage and that insiders are willing to trade on it.

3.1.6. Legal and political risk

Several studies argue that politically connected firms may be held less strictly accountable for violating the law and may be less subject to strict regulatory enforcement. Correia (2014) examines U.S. firms investigated by the SEC. She finds that firms connected with politicians through donations to PACs are less likely to be subject to SEC enforcement actions; if they are, they face less severe penalties. The relation is stronger for connections with more senior politicians or politicians sitting on relevant committees that allow them to put pressure on the SEC. In a similar vein, Yu and Yu (2011) find that fraudulent firms politically connected through lobbying expenditures have a significantly lower hazard rate of being detected. They also show that fraudulent firms have significantly higher lobbying expenditures than non-fraudulent firms, indicating that they lobby to achieve more lenient treatment. Lobbying also appears to offer firms a degree of protection against environmental lawsuits in courts (Liu et al., 2020). However, more recent studies show that the relation between political connections and regulatory enforcement is more complex than suggested by studies arguing that regulatory institutions are "captured" by connected firms. In contrast with Correia's (2014) results, Heese et al. (2017) find that the SEC's Division of Corporate Finance is indeed more (rather than less) likely to issue a comment letter to connected firms. Related results also indicate that the SEC seems to take into account potential employment effects of its regulatory actions (Heese, 2019) and that politicians sitting on committees relevant for the SEC are punished by voters when a local firm faces SEC enforcement (Mehta and Zhao, 2020). Similarly, in a Chinese setting, connected firms have lower demand for directors' and officers' liability insurance, as they exhibit lower litigation risk, but this relation is insignificant for firms that are socially important to the local govern-

ment (Jia et al., 2019). The authors interpret this as such firms receiving government protection which substitutes for political connections.

With respect to the severity of tax enforcement, the studies we identified in our review unambiguously suggest more lenient enforcement on connected firms. Politically connected U.S. firms are often more tax aggressive. Kim and Zhang (2016) suggest that one of the reasons for this is that connected politicians may be able to provide protection against Internal Revenue Service audits. Francis et al. (2016) argue that in addition to this reason, idiosyncratic factors such as connected directors' political ideology with respect to taxation play a role in explaining differential tax-sheltering decisions by connected firms. Lin et al. (2018) examine the relation between firms' effective tax rates and measures of tax enforcement strictness in a Chinese setting and similarly find a significantly weaker relation for connected firms. When political connections are established through partial ownership by a governmental body, the more lenient enforcement is partly offset by the conflicting incentives of the government as a tax collector. Local governments in China have accordingly balanced their roles as tax collectors and controlling shareholders (Tang et al., 2017). Somewhat in contrast to the above results, Sam and Zhang (2020) find that negative market reactions to the announcement of a new environmental enforcement regime in China was not mitigated by political connections. They conclude that political connections were not conceived as detrimental to the effectiveness of the inspections under the new regime.

Knoeber and Walker (2013) investigate the effect of stricter enforcement in the wake of the 2001 U.S. corporate scandals on foreign firms and find that around the period of the high-profile arrest of three corporate executives, the cumulative abnormal return for foreign firms was 4.7 percent worse than for domestic firms, indicating that foreign firms faced higher costs from tougher enforcement. In line with the argument that CPCs can partially shield them from these costs, the authors find that the number of congressional politicians supported by foreign firms is positively associated with abnormal returns over that period. Canadian evidence confirms an antiforeign bias of courts but finds no indication that CPCs mitigate this disadvantage (Mai and Stoyanov, 2019).

Imai (2009) investigates bank regulation in Japan and finds that banking regulators delayed bank failures, which resulted in a higher extent of government takeover of ownership for banks located in prefectures supporting the ruling Liberal Democratic Party than those located in other prefectures. In a Chinese setting, Berkman et al. (2010) examine the effects of three regulatory changes intended to improve minority investor protection. While they find that in the overall sample, firms with weaker corporate governance experienced larger abnormal announcement returns from that regulation, this relation does not hold for firms with ties to the Chinese government. They interpret their finding as indicating that investors were skeptical that the state-controlled regulator would enforce the new rules on these firms. Berkowitz et al. (2015) similarly find that a new Chinese law giving more rights to creditors had less strong effects on politically connected firms, but they argue that the connections serve as an informal form of collateral, thus limiting the positive impact of the possibility to use more tangible collaterals. Fisman and Wang (2015) show that in the absence of fatalities, politically connected Chinese firms receive fewer reports for violations of safety regulations; at the same time, worker death rates of such firms are substantially higher than those for non-connected firms. They argue that CPCs enable connected firms to avoid costly compliance.

With respect to the political risk of politically connected firms, empirical results indicate the ambiguous nature of the effects of CPCs. The proximity to the political process that comes with political connectedness naturally makes connected firms more sensitive to the hazards of the political process, and some researchers consider connectedness a measure of exposure to political risk (e.g., Kim et al., 2012; Kostovetsky, 2015; Xu et al., 2016; Liu et al., 2017). While connected firms may thus be more exposed to political risk, at the same time their political connections may provide them with better information and insights, helping them mitigate those very risks. Studies have accordingly shown that CPCs partially offset the negative association between policy uncertainty and corporate investment and innovation (Wellman, 2017; Ovtchinnikov et al. (2020) as well as the positive association between policy uncertainty and cost of equity (Pham, 2019). Furthermore, CPCs help connected analysts make better recommendations for politically sensitive stocks (Christensen et al., 2017) and help hedge funds earn higher returns on such stocks (Gao and Huang, 2016).

3.2. Empirical results on the relation between CPCs and accounting outcomes

In this subsection, we review studies that directly address the effects of CPCs on financial reporting. For reference, we provide Table B.1 Panel B in the appendix which summarizes categories and variables investigated in these studies.

3.2.1. Earnings management and earnings quality

Several articles assess the effects of CPCs on earnings management and earnings quality, arguing that earnings are a primary indicator of financial reporting quality (Chaney et al., 2011). In general, these studies hypothesize that connected firms exhibit more earnings management and lower earnings quality. Some evidence provides support for this hypothesis, though, overall, the evidence is not unambiguous. Using a global sample from 19 different countries, Chaney et al. (2011) find that connected firms exhibit a higher standard deviation of discretionary accruals than non-connected firms. They interpret this as lower earnings quality of connected firms and show that the causality is not driven by firms with ex ante low earnings quality establishing political connections. In addition, they test the association between earnings quality and cost of debt and find a negative relation for non-connected firms but not for connected firms. Their findings are thus consistent with the argument that less capital market pressure enables connected firms to pay less attention to earnings quality.

Analysing a Chinese sample, Wang et al. (2017) find that while increased managerial ability leads to less accounting fraud, this relation is weaker for politically connected firms. Also for China, Hope et al. (2020) show that the financial reporting quality increased for firms losing their political connections after the introduction of a rule disallowing officials from serving as directors of listed firms. The effect is stronger for non-state-owned enterprises than for SOEs, suggesting that for them political connections via directors are more important. Ramanna and Roychowdhury (2010) investigate the accounting choices of U.S. firms engaging in outsourcing activities around the 2004 elections. Outsourcing and related U.S. job losses were an intensively debated issue during those elections, and being connected with outsourcing firms may have been detrimental to the electoral chances of candidates for the U.S. Congress. The authors find a positive association between the extent of connected firms' outsourcing activities and their income-decreasing discretionary accruals in the two periods preceding the election. Their study is interesting as it links the CPC literature in accounting to the political costs literature (Watts and Zimmerman, 1978, 1986).

While the three studies cited previously find the expected relation between CPCs and earnings management/quality, Batta et al. (2014) find the opposite. Using standard deviation of changes net income (a proxy for earnings smoothing), small positive net income (a proxy for earnings management to avoid reporting losses), timely loss recognition, and absolute abnormal accruals as their proxy for earnings quality, they find that connected firms in their sample indeed have higher earnings quality than non-connected firms. In line with the argument that CPCs shield firms from government expropriation (e.g., Humphery-Jenner and Powell, 2014), they argue that in the Venezuelan setting they study, political connections diminish connected firms' needs to obfuscate their profitability. Therefore, in contrast with the less strict enforcement argument, they argue that political connections enable firms to exhibit higher accounting quality. He et al. (2012) find that politically connected firms in China are more likely to replace accrual-based earnings management with real earnings management by, for example, selling available-for-sale securities after the introduction of IFRS-based new China Accounting Standards than non-connected firms.

3.2.2. Audit quality and audit risk

Political connections also have indirect effects on firm auditors. The literature identifies two main reasons for these effects: CPCs have an impact on connected firms' choice of auditor (and, thus, of audit quality), and connected firms present a different audit risk for the auditor and thereby affect the auditor's audit effort and audit fees.

The direction of the first effect is a priori unclear and empirically ambiguous. The politicians to whom a connected firm is linked as well as the connected managers may have an incentive to avoid transparency to enable political quid pro quo. In line with this argument, Guedhami, Pittman, and Saffar (2009) find that in a global sample, partially privatized firm are less likely to choose a Big 4 auditor (a proxy for high-quality audits) the higher the remaining ownership stake of government is. They argue that governments may prefer auditors willing to accept financial statements that are less informative about true performance, to protect their political interests. In line with this argument, the authors find that this association is stronger in countries with poorer governance institutions. In a similar vein, Wang, Wong, and Xia (2008) find that Chinese SOEs are more likely to hire small local auditors that can be more easily subjected to government pressure. For listed firms, however, there is a countervailing force. Rational investors anticipate that connected firms may be more likely to engage in practices that are detrimental to them. To counteract this impression, connected firms have incentives to commit to a high level of transparency by choosing a high-quality auditor. Accordingly, investigating a global sample Guedhami et al. (2014) find that firms connected with high-level politicians through their shareholders or top officers are indeed *more* likely to appoint a Big 4 auditor. Connected firms appointing Big 4 auditors also exhibit less earnings management and benefit from higher valuations and lower costs of capital. By contrast, Chen et al. (2011a) find that in a Chinese sample, Big 8 auditors are associated with less earnings management for non-SOEs but not for SOEs.

The effects of political connectedness on audit risk are similarly ambiguous. On the one hand, politically connected firms may present a higher risk of financial misstatements for the reasons discussed in Section 3.1.1. In turn, this leads to higher audit effort and higher audit fees. In line with this argument, Gul (2006) shows that in the course of the Asian financial crisis, audit fees increased more for connected firms than for non-connected firms. On the other hand, the proximity to political decision makers may make connected firms less risky overall, as politicians can intervene on their behalf. In this vein, Liu and Subramaniam (2013) find that Chinese SOEs incur lower audit fees than non-SOEs.

Finally, auditors may themselves be politically connected, which may have an impact on their audit strategy. Connected auditors may feel protected from any negative effects of their actions and thus exhibit more aggressive audit behavior. Conversely, they might feel more exposed and thus refrain from aggressive auditing so as not to jeopardize the value of their connections. Gul et al. (2013) find evidence supporting the first argument in a Chinese setting. They show that auditors who are members of the Communist Party are associated with more aggressive audits as proxied by the prevalence of modified audit opinions and metrics of earnings management of audited firms. Yang (2013) shows that non-top-tier audit firms reduce IPO rejection risk for their clients and accordingly raise their IPO audit fees when their partners are appointed to the Stock Issuance Examination and Verification Committee of the China Securities Regulatory Commission.

3.2.3. Accounting standards and policies

In addition to the research on the effects of CPCs on earnings management and earnings quality presented in Section 3.1.1, studies have investigated other elements of firms' accounting choices. Before accrual choices, firms have the ability to influence their transparency through higher-level choices, such as the voluntary adoption of high-quality financial reporting stan-

dards, the choice of general accounting policies, or cross-listing decisions that commit the firm to high-quality financial disclosures. As discussed in the preceding sections, a priori, the direction of the effect of CPCs is ambiguous.

A strong commitment to high-quality financial disclosures comes from cross-listing in jurisdictions with strict enforcement of securities regulations, such as the U.S. Firms cross-listing to such a capital market bond themselves to the regulations prevailing there (Coffee, 2002; Lang et al., 2003). Leuz and Oberholzer-Gee (2006) provide evidence that Indonesian firms with close ties to President Suharto were less likely to cross-list securities on a foreign market but became more likely to do so in successive periods. They interpret their findings as suggesting that transparency considerations play a role in the tradeoff between benefits from political ties and cross-listing. Guedhami et al. (2014) similarly report evidence that connected firms in their global sample are less likely to adopt international accounting standards.

Chen et al. (2010a) provide evidence in line with the argument that connected firms are less subject to capital market pressures. They find that Chinese SOEs adopt less conservative accounting principles than non-SOEs. They argue that because SOEs are important for the government to achieve political objectives, they are more likely to receive support when running into financial trouble. Because conservatism is believed to stem from lenders' demands for protection, a lower downside risk reduces the pressure for conservative accounting practices.

Finally, connected firms may use their political ties to secure more favorable financial disclosure rules from regulators. Ramanna (2008) investigates members of U.S. Congress taking positions in congressional hearings on a proposed accounting standard on goodwill accounting. In line with the argument of connected firms exerting influence on accounting rules via political channels, he shows that the more members of Congress take positions favored by firms, the more financial contributions they receive from donating firms. This stands in contrast with Thornburg and Roberts (2008), who show that policy-motivated financial contributions made by accounting firms did not influence voting behavior during the policy-making process of the Sarbanes-Oxley Act. One difference between the two studies is that Ramanna (2008) investigates connections of firms from various industries whereas Thornburg and Roberts (2008) specifically investigate targeted contributions made by the accounting profession. Bischof, Daske and Sextroh (2020) find that politicians' involvement in the accounting debate on fair value accounting in the context of the 2008 financial crisis is associated with their connection to special interests when the debate focused on technical issues but not when it focused on economic consequences.

3.2.4. Analyst and market reactions

Corporate financial transparency can be examined indirectly by investigating capital market reactions of and decisions taken by capital market participants. Several studies analyze the effects of CPCs on such metrics. Compared with the more mitigated results discussed in the preceding sections, empirical results indicate that stock market participants find politically connected firms less transparent.

In a global sample of partially privatized firms, Ben-Nasr and Cosset (2014) find that remaining government ownership is strongly negatively associated with stock price informativeness. They argue that governments tend to pursue political objectives conflicting with profit maximization. To hide this expropriation from shareholders, governments may encourage managers to manipulate or selectively disclose information, which results in less information being incorporated in stock prices. Investigating bid-ask spreads of a sample of European firms, Borisova and Yadav (2015) obtain similar results. They find evidence of fewer informed trades stemming from skilled analysis of public information and more informed trading arising from explicitly private information. Piotroski et al. (2015) and Cao et al. (2018b) investigate stock market behavior around political events in China. Both sets of authors find that firms geographically affiliated with politicians experience a reduction in negative stock price skewness before such an event. They interpret this as consistent with negative news being temporarily suppressed before political events and released thereafter. Baloria and Heese (2018) find similar results in a U.S. setting for firms subject to potentially negatively biased coverage by Fox News Channel.

Chen et al. (2010b) report lower accuracy of analyst reports of connected firm in a global sample from 17 countries. This relation is stronger in jurisdictions with higher levels of corruption. Guedhami et al. (2014) report similar findings. They show that the negative impact of political connections is mitigated for connected firms with a Big 4 auditor. For a sample of Chinese firms, Firth et al. (2013) find that brokerage firms' stock recommendations exhibit a positive bias if both the CEO of brokerage firm and the CEO of the covered firm previously held positions as government officials or members of the People's Congress. They interpret this result as stemming from political pressures.

3.3. Channels of influence

3.3.1. Improved access to financial resources

Connected firms have better access to financial resources due to, for example, better access to the credit market and to public funds. The indirect effect of this on corporate financial reporting is a priori ambiguous. On the one hand, studies argue that improved access to financial resources reduces the capital market pressure for high-quality reporting. In line with this argument, Houston et al. (2014) find that in a U.S. sample, higher smoothing, higher total accruals, and higher discretionary accruals are all significantly positively related to loan costs. However, the interaction with political costs is significantly negative (i.e., the penalties for not being transparent are lower for connected firms). Chaney et al. (2011) obtain similar results in a global sample. They find that the cost of debt is negatively related to their measure of earnings quality for non-connected firms but not for connected firms. Hung et al. (2018) analyse a global sample of 24 countries and find that connected firms are less likely to issue management earnings forecasts than non-connected firms, in line with the argument that a lesser

need to raise capital from the public for these firms implies lower incentives for voluntary disclosure. In a Chinese sample, Chen et al. (2010a) find evidence that SOEs adopt less conservative accounting than non-SOEs because lenders anticipate that SOEs are politically favored and will receive additional funding from government in case of financial difficulties. In addition, they show that the fraction of total loans obtained from state-owned banks is negatively related to conservatism, consistent with the argument that state-owned banks themselves have less need for the availability of sufficient net assets from their debtors. Wang et al. (2008) similarly find that Chinese SOEs are more likely to hire small local auditors than non-SOEs, in line with the argument that access to capital and government bailouts implies less demand for reputed auditors. Leuz and Oberholzer-Gee (2006) analyze a sample of Indonesian firms and also conclude that cross-listing, which comes at the price of increased transparency requirements, and political connections are substitutes.

On the other hand, some studies note that better access to financial resources available to connected firms reduces the pressure for earnings management. For example, in China a firm will be delisted if it reports a loss for three consecutive years (He et al., 2012). This evidently creates strong pressure to report positive earnings to maintain the listing status, which may be diminished if the firm is able to secure funding from government. In line with this argument, Chen et al. (2011a) find that SOEs' reports exhibit a lower level of discretionary accruals. They interpret their finding as indicating that the anticipation of government assistance diminishes the need for earnings management. Indirect evidence for this argument also comes from audit fees. For instance, Liu and Subramaniam (2013) find that Chinese SOEs are charged lower audit fees than non-SOEs, consistent with the argument that higher probability of government bailout in case of financial distress limits audit risk. In a similar vein, Gul (2006) shows that audit fees of connected Malaysian firms declined after capital controls were introduced, allowing government assistance to politically favored firms.

3.3.2. Political quid pro quo

While firms may benefit from their political connections, relations between firms and politicians are more typically characterized by some form of give-and-take. Government officials may be provided with monetary and non-monetary benefits in the form of campaign donations, salary bonuses, luxurious offices, or generous travel expenses (Cheung et al., 2010). They may also appoint like-minded board members in an attempt to gain support and disguise rent-seeking activity (Fan et al., 2007; Cheung et al. 2010). Furthermore, firms can support their reelection efforts by targeting their investment and employment decisions or otherwise help politicians in the pursuit of political goals. Carvalho (2014) illustrates this logic by showing a quid pro quo in Brazil: government banks provide firms with preferential loan terms, and in exchange the firms expand employment in politically contested regions before elections. Both sides share an interest in concealing their implicit or explicit dealings (Ben-Nasr et al., 2015; Gross et al., 2016). Examining a multinational sample, Guedhami et al. (2009) show that government owners of partially privatized firms protect their political interests by selecting smaller (non-Big 4) auditors to facilitate collusion.

In addition to direct distortion of financial reports, individual researchers identify other reasons that financial disclosures of connected firms may be less informative. Bailey et al. (2011) argue that bank loans signal the creditworthiness of a firm and thus provide information to the stock market. However, this signal is distorted when lending decisions are made based on political expediency rather than sound analysis of financial fundamentals. Chen et al. (2010b) claim that political favoritism often results in a windfall that distorts the time-series pattern of financial reports, making it more difficult for financial analysts to accurately predict future development of the firm. In addition, in corrupt environments, analysts may be subject to pressure from politicians and connected firms (Chen et al., 2010b).

While the interactions described previously present arguments for why political quid pro quo leads to worse financial reporting outcomes, there are also some reasons to believe that the opposite is true under certain circumstances. For example, Batta et al. (2014) argue that in an environment characterized by an intense threat of state intervention (in their case, Venezuela), firms limit information about their productive assets in an attempt to shield them from government expropriation. Political connections provide a substitute for concealment of information as a means to prevent expropriation. In such a setting, capital market incentives for high-quality reporting can only prevail in connected firms. Moreover, if skeptical investors anticipate being expropriated by majority investors and require a price discount to invest in connected firms, such firms have an ex ante incentive to invest in credible disclosures. Accordingly, Guedhami et al. (2014) find that connected firms in their global sample are more likely to appoint a Big 4 auditor. Guedhami et al. (2009) argue that this effect is driven in part by foreign owners who are particularly sensitive to the risk of politically motivated expropriation. Wang et al. (2008) find evidence that investors anticipate SOEs' ability to pressure local auditors into lower audit quality and consequently that hiring small local auditors is associated with share price discounts.

3.3.3. Enforcement

A majority of studies argue that politically connected firms may be less subject to strict enforcement of financial reporting regulation. Multiple studies provide evidence suggesting that laws and regulations may be less strictly enforced on connected firms. Yu and Yu (2011) show that fraudulent U.S. firms that engage in lobbying evade detection 117 days longer on average than other firms. Kim and Zhang (2016) show that CPCs measured in a variety of ways, including PAC contributions, lobbying expenditures, and board membership by politicians, are associated with higher levels of tax aggressiveness, indicating that politicians may be able to provide protection to connected firms (e.g., from Internal Revenue Service audits). Knoeber and Walker (2013) provide evidence indicating that foreign firms face higher costs of enforcement from the U.S.

Sarbanes-Oxley Act than domestic firms only if they are not politically connected. In a Chinese setting, Fisman and Wang (2015) show that politically connected firms are able to avoid costly measures to comply with workplace safety regulations.

In the concrete area of securities regulation, Correia (2014) finds that CPCs can protect firms from enforcement of the U.S. SEC. Effects of connections through PAC contributions or lobbying expenditures include both a lower probability of being involved in an SEC enforcement action and low penalties when prosecuted by the SEC. Highlighting the probable causality of the link, Correia also shows that contributions to politicians who have high ranks or are members of relevant Congressional committees are more effective. Conversely, Heese et al. (2017) find that connected firms are indeed more likely to receive comment letters from the SEC's Division of Corporation Finance. They caution that their evidence is not consistent with political capture of the SEC. Investigating a series of regulatory changes intended to protect minority investors in China, Berkman et al. (2010) find that abnormal returns to the announcement of these changes were positively related to the value of firms' related-party transaction, an inverse proxy for the quality of corporate governance. In line with the interpretation that minority investors were skeptical about the enforcement of these rules on politically connected firms, this relation does not hold for the group of firms with the strongest links to the Chinese government. In an Indonesian setting, Leuz and Oberholzer-Gee (2006) show that connected firms are less likely to cross-list shares, indicating that they avoid the higher transparency requirements associated with a foreign listing. Importantly, Hung et al. (2012) find a different result for a Chinese sample. They show that politically connected Chinese firms are indeed more likely to list overseas than non-politically connected firms. They argue that the incentives are different in China where foreign listings help managers achieve political recognition and enhance their political careers. Enhanced transparency requirements from cross-listing concern them to a lesser degree after they have made the next step in their political career.

3.3.4. Media scrutiny

Connected firms tend to be a more relevant subject than non-connected firms for the public and therefore face higher media scrutiny, which in turn may have an impact on those firms' financial reporting–related decisions. Several studies have demonstrated the role of media in corporate governance. Drake, Guest, and Twedt (2014) show that the press contributes to disseminating accounting information and thereby enhances the capital market's ability to impound this information in stock prices. Dyck and Zingales (2002) argue that media attention affects corporate behavior via three channels: (a) it may force regulators and legislators into action, (b) it affects the reputation of the firm among investors, and (c) it affects the reputation of managers in society at large. They argue that the second and third channels operate very differently because investors tend to care only about their own economic well-being whereas society cares about a large number of non-economic issues. Depending on individual circumstances, while media attention may push managers to act less in their own interests (i.e., limiting an agency problem), it may push them to act either more or less in the interest of investors (i.e., potentially replace one agency problem with another). In a sample of 39 countries, media pressure appears among the dominant factors limiting private control benefits (Dyck and Zingales, 2004).

In line with Dyck and Zingales' (2002) argument, media attention to politically connected firms may have a beneficial or detrimental effect on financial reporting. On the one hand, media scrutiny may serve as a deterrent to manipulation, complementing other mechanisms such as securities regulation. Qi, Yang, and Tian (2014) examine a Chinese sample and present evidence suggesting that firms with more media exposure engage in less earnings management. Cheung et al. (2010) find that while the central government in China tends to use related party transactions to prop up majority SOEs, local governments, which are less visible to the press and the judiciary, tend to use such transactions to expropriate minority shareholders. Wang et al. (2008) similarly find that Chinese SOEs controlled by the province, the city, or the county government are more likely to select small local auditors; SOEs controlled by the central government only do so in institutionally less developed regions. On the other hand, political incentives may blur capital market incentives for transparency. Ramanna and Roychowdhury (2010) investigate reporting by connected firms around the 2004 U.S. elections and find that firms engaging in outsourcing activities (an important campaign issue during these elections) make income-decreasing accrual choices to shield candidates they support from criticism. Piotroski et al. (2015) find that Chinese firms geographically affiliated with a politician temporarily suppress negative information during political events. Baloria and Heese (2018) show that firms with ties to the Democratic Party released less negative information in preelection years when they were located in areas with access to the Fox News Channel, a news outlet with clear ideological preferences.

In a global sample, Guedhami et al. (2014) show that connected firms are more likely to appoint Big 4 auditors particularly when the extent of media scrutiny is high. Except for this study, and even though other articles mentioned this channel, we did not identify any study formally testing the effect of media scrutiny.

4. Multiple forms of corporate political connectedness

In Section 3, we followed the literature by treating CPCs as a homogeneous construct. In this section, we address CPCs' heterogeneous operationalization in the literature. For example, Correia (2014) measures CPCs using U.S. firms' financial contributions to politicians and lobbying expenditures; Goldman et al. (2009) examine board members' careers and classify them as politically connected if they have served in the U.S. Congress, in government administration, or as a director of an agency such as the Central Intelligence Agency; Chen et al. (2018a) use managers' political ranks, creating an ordinal rather than dichotomous measure of political connectedness; Kostovetsky (2015) considers a firm politically connected if it is head-

Table 2
CPC types.

Connection type	Description	Typical proxies
Financial contributions	Donations aimed to support a political actor or party during elections	• Amount of contributions/number of supported politicians • Long-term firm–candidate relationships • Bipartisan contributions versus ideological contributions
Lobbying	Continuous involvement with a political party intended to influence governmental decisions	• Lobbying expenditures and number of lobbyists • Numbers of issues lobbied
Equity ownership by politician	A politician holds a substantial amount of equity	• Ownership based on large or major shareholdings • Financial investment regardless of stake size
Geographic links	The location of a firm's headquarters defines a connection through state-preference, political alignment, or proximity to the state capital	• Firm headquartered in a politician's electoral district or birthplace/place of residency • Geographic distance to political institution • Local voters' financial contributions • Political characteristics of firm home state/province
State ownership	The firm is (at least partly) state-owned	• Partial or full state ownership or ownership by state-related entity • Residual state ownership/golden share after privatization • Former state ownership (privatized firms)
Social ties	A senior manager is closely connected with a political actor (friendship or family affiliation)	• Kinship- or friendship-based association between politicians and owners/managers
Personal service	A current or former politician maintains a representative position in the firm, including the executive team, inside and outside directors, auditors, and any other individual linked to both the firm and the government	• Executives/top officers or board members • General employment relation
Indirect measures	Firm characteristics that are known to be significantly influenced by CPCs serve as indicator variables of corporate politically connectedness	• Stock price reactions to news about connected politician • Loans from state-owned banks • Amount of government subsidies • Industry exposure to government spending

quartered in a state whose senator is a member of an influential U.S. Senate Committee; similarly, Du et al. (2018) use location in Beijing as an indicator of connectedness. Several studies find that ownership structure, in particular former or current state ownership, creates links to governments (e.g., Ben-Nasr, 2016). However, these characteristics constitute metrics that proxy for corporate political connectedness rather than defining it.[3] In this section, we present a classification of CPC proxies found in the literature and discuss how different types of political connections may have different effects on corporate financial reporting. We propose the following definition of corporate political connections which encompasses the divergent operationalization found in individual studies: A firm is considered politically connected if its continued existence and success affect the interests of at least one powerful political actor.

We classify the proxies used in the studies reviewed in eight categories. Perhaps the most-studied form of political connections, at least in the U.S., is the expenditure of monetary resources by firms, flowing directly to a politician's campaign chest either in the form of financial contributions or in the form of lobbying expenditures used to strategically transfer information to political decision makers. Other measures take into account that a politician may have financial interests in firms in the form of personal equity ownership, that the politician's electoral fate may be influenced by a firm that is a large employer in his or her electoral district (geographic ties) or by the actions of state-owned firms for which he or she is held responsible, that a firm may be connected with a politician through social ties of its management, and that the firm may employ a current or former politician (personal service). In addition to these seven categories, some studies use an indirect approach by measuring outcomes argued to reflect political connections such as stock price reactions to news about the health of a certain politician. Table 2 provides an overview of the different types of CPCs, including typical proxies used for each category.

5. Specific industries

A subset of the articles we identify focus on connected firms belonging to a certain economic sector. This approach allows these studies to emphasize aspects that are less easy to detect (or are not present) in cross-sectional studies. We group these studies in three clusters: banks, investment funds and analysts, and audit firms.

[3] There is also an amount of terminological vagueness in the literature. For instance, whereas many studies examining a U.S. sample use PAC contribution and lobbying expenditures as *proxies* for political connectedness, Albuquerque et al. (2020) present PAC contributions and lobbying expenditures as *alternatives* to political connections (measured as board members or top managers holding/having held a position in a governmental organization) in a firm's political activities.

5.1. Banks

A number of studies investigate the effects of political connectedness on banks. Banks exhibit at least two characteristics that make them an obvious target of interest for a study on the effects of CPCs. As a central actor in financial markets, their lending decisions have an important influence on the availability of funding for other firms, i.e., banking has high externalities. As a consequence of this fact, governments tend to take a close look at banks' activities. In a number of countries, this involves widespread government ownership of banks which increased further during the 2008 financial crisis (Coleman and Feler, 2015). Even when they are not directly owned by the government, banks are subject to strong regulatory regimes, providing them with incentives to establish close ties to regulators and politicians (Farag and Dickinson, 2020).

In line with the externalities argument, political connectedness has been found to affect their lending behavior and hence the availability of funds for their debtors in a number of different political regimes. In a Chinese setting, Firth et al. (2009) show that firms that have the state as a minority owner obtain bank loans more easily and interpret this as suggesting that political connections facilitate access to bank finance. During the period of their study, close to 100 percent of the banks were government-owned. Overall, they concluded that influences of political connections still persist in China's banking sector although the banks were becoming more and more market-oriented at the time of their 2009 study. In a similar vein Claessens et al. (2008) show that in Brazil, which is characterized by a large share of state-owned banks, firms that are linked to politicians via campaign contributions obtain preferential access to bank credit. They furthermore show that such firms have significantly lower return on asset, implying a capital misallocation resulting from these lending decisions. They estimate the annual economic costs of this misallocation to be at least 0.2 percent of gross domestic product. Coleman and Feler (2015) similarly find that lending by Brazilian government banks provided counter-cyclical support during the financial crisis but that this lending was politically targeted and inefficiently allocated, creating distortions in the market. Khwaja and Mian (2005) use loan-level data from Pakistan and explicitly distinguish between government banks and private banks. They find that politically connected firms receive 45 percent larger loans while having 50 percent higher default rates on these loans. They show that such preferential treatment of connected firms is only granted by government banks but not by privately owned ones. Faccio et al. (2006) argue that lenders factor in the higher probability of politically connected borrowers to be bailed out, hence rationally providing them with greater leverage.

In a U.S. setting, Chavaz and Rose (2019) investigate the geographic distribution of mortgage and small business lending of banks receiving funds under the TARP program. They find that these banks reciprocated by lending substantially more inside the political district of their Congress representative than in comparable areas outside of it. TARP recipients adopted looser standards in these areas than their non-TARP competitors and consequently incurred a higher incidence of non-performing loans. Also in a U.S. context, Duchin and Sosyura (2012) find that financial institutions' political connections are positively associated with the likelihood of approval of an application for TARP funds and that politically connected TARP funds recipients underperform non-connected recipients on both stock-based and accounting-based performance measures.

A second set of results from these studies is that political connections appears to lead to moral hazard in banks. Connected firms anticipated being bailed out in case of financial difficulties and engaged in higher risk-taking than comparable non-connected institutions. Kostovetsky (2015) shows that connected and non-connected firms from the financial sector had largely similar leverage ratios prior to the start of the U.S. housing bubble but firms geographically connected to a senator sitting on the Senate Banking Committee had leverage ratios approximately 18 percent higher by the first quarter of 2008. Further tests lead him to conclude that financial institutions' decisions during the housing bubble were influenced by these firms' beliefs that their political connections would shield them from their risk exposures. These beliefs appear to have been at least partly justified as Kostovetsky (2015) also shows that controlling for other factors, connected firms were slightly less likely to go bankrupt. In a follow-up study to their 2012 article cited above, Duchin and Sosyura (2014) furthermore show that after being approved for federal assistance, banks took on *more* risk in three core bank operations, retail lending, corporate lending and investment activities. They provide evidence that this shift in risk taking is causally linked to government support and interpret their findings as an indication of moral hazard contributing to banks' risk taking. In slight contrast to the above results, Farag and Dickinson (2020) provide evidence that directors' connections actually decrease financial companies' risk. Their definition of connectedness is broader, including political, regulatory and government connections. They also use stock return volatility as their proxy for company risk whereas Duchin and Sosyura (2014) and Kostovetsky (2015) investigate risk taking at a more operational level.

5.2. Funds and analysts

A number of studies investigate the effects of having a politically connected investor on the investee. In a Chinese setting, companies backed by a venture capital (VC) firm with a top executive who holds or held a high political function are more likely to obtain IPO approval from the regulator. This effect appears to be driven more by a treatment effect of the connected VC firm than by the selection effect of connected VCs picking better investments. Furthermore, the treatment effect appears to reside in connected VC's using their political relationships rather than exerting additional monitoring over their investments (Wang and Wu, 2020). In a U.S. context, Faccio and Hsu (2017) investigate the other side of a political exchange of favors, i.e., the use of investees to help a connected politician. They find that target firms of politically connected private equity funds exhibit higher job creation than those of non-connected peers. Consistent with a causal link, Faccio and Hsu (2017) show that the relation is stronger during election years and positively associated with the likelihood of the incum-

bent's reelection. They furthermore find that target firms of connected funds benefit from awarding of government contracts and grants. Boubaker et al. (2018) argue that there are opposing forces on investors' expectations and hence cost of capital which result from having a government-related investor. On the one hand, it may constitute an implicit government guarantee implying a positive impact on firms' financing; on the other hand, the investment may be dictated by sociopolitical and economic goals rather than value-maximization. Investigating Sovereign Wealth Funds (SWF) investments, they find that a domestic SWF investment is associated with lower implied cost of equity financing, consistent with the interpretation that domestic but not foreign governments provide an implicit bailout guarantee.

One of the main mechanisms through which political connections may provide advantages even in a setting with strong rule of law is the transmission of relevant information. Christensen et al. (2017) accordingly show that politically connected brokerage houses issue more profitable stock recommendations. Examining recommendations surrounding the passage of a high-profile policy and using propensity score matching, they conclude that their results are driven by brokerage houses obtaining relevant information from their political connections rather than stemming from a selection effect. Gao and Huang (2016) similarly find that politically connected hedge funds outperform benchmarks. In particular, higher returns are earned on their holdings of politically sensitive stocks and the outperformance decreased significantly after the enactment of the STOCK act which exposes funds trading on private political information to charges of insider trading, consistent with the effect being driven by information transmission. Bradley et al. (2016b) investigate investments of state pension funds. They see information advantage as one possible driver of politically connected funds investing in local firms. However, they find that local political bias has a pronounced negative effect on fund performance and conclude that the information advantage is outweighed by the negative impact of political motivations of such investments. Andonov et al. (2018) similarly find that the representation of state officials on pension fund boards is negatively related to the performance of the fund's private equity investments. Further results are consistent with state officials making politically motivated investments but not with their lack of expertise driving their underperformance.

5.3. Auditors

Studies on auditors mirror results described above for financial firms. Gul (2006) investigates Malaysian auditors' reaction to events in the Asian financial crisis of the late 1990s. He shows that audit fees for politically connected firms increased more than those of non-connected peers with the onset of the crisis but declined again after capital controls were introduced. Based upon Johnson and Mitton's (2003) findings suggesting that the crisis deprived connected firms of the government's ability to provide privileges and subsidies whereas the imposition of capital controls subsequently allowed higher subsidies again, Gul (2006) argues that audit fees reflect auditors' anticipation of connectedness benefits of their auditees. When these decline, audit risk increases and vice versa. Investigating a Chinese sample, Gul et al. (2013) show that individual auditors who are members of the Communist Party are associated with more aggressive outcomes. They interpret that such auditors anticipate that their political affiliations may provide them with some protection from penalties, thus encouraging them to act more aggressively. Also in a Chinese setting, and reflecting results of politically connected VC investors discussed above, Yang (2013) shows that non-top-tier audit firms (but not top-tier audit firms) reduce IPO rejection risks for their clients and significantly increase their IPO audit fees after obtaining political connections. He concludes that this result may both be explained by better knowledge obtained by connected auditors and by their more effective lobbying on their clients' behalf.

6. Empirical strategies and identification

Estimating the effects of CPCs is evidently subject to endogeneity concerns. Firms pursue political strategy purposefully and many forms of political connectedness, such as engaging in lobbying or contributing to PACs, are the result of deliberate choices. Connections between the government and firms are hence hardly random and there are various reasons why studies suffer from reversed causality, selection bias, omitted variable bias or simultaneity. For instance, reversed causality occurs if firms with opaque financial reporting quality pursue political connections in an attempt to protect themselves against expensive enforcement action. An omitted variable bias could arise if the same factor, e.g. an increase in government expropriation risk following regime changes, causes firms to establish political connections and to modify their financial reporting quality. We notice a considerable trend towards explicitly testing causality over the years. While earlier papers present endogeneity methodologies in robustness test sections, recent publications present identification strategies centrally in the papers or include them in the abstract (e.g., Borisov et al., 2016; Hope et al., 2020; Mehta et al., 2020).

In order to obtain an overview of identification strategies used, we follow Larcker and Rusticus (2010) and Lennox et al. (2012) and search all reviewed articles for the keywords "endogeneity", "Heckman", "selection", "treatment effect", "2SLS", "3SLS", and "instrumental variable". If an article addresses endogeneity of the political connection in this way, we include the respective method used to overcome it in our online appendix.[4] Statistical methods most often appearing are, in descending frequency: two-stage instrumental variable estimation; (propensity score) matching; difference-in-differences analysis; Heckman selection model; fixed effects; additional control variables or a supplementary event study. Moreover, researchers increasingly apply placebo tests to rule out spurious correlation.

[4] Some articles do not discuss endogeneity of the CPC but endogeneity of other variables. We do not analyze those.

Estimating causal effects on accounting outcomes involves the additional challenge that the mechanism tends to be less straightforward. Whereas it is intuitively plausible that politicians award government procurement contracts to connected firms, it is less straightforward to see why there is an effect on earnings management and earnings quality, audit quality and audit risk, accounting standards and policies, and analyst and stock market reactions. For studies which we classify as "accounting outcomes", we hence additionally closely read each paper to determine the identification strategies used. As described in Section 2, we determine for each accounting outcome paper whether a specific channel linking CPCs to the accounting variable is being discussed. From this, we inductively derive four main channels. We hence identify for each paper the main results, the channel discussed, the empirical strategy used to derive the main results and the empirical tests of the channel suggested. Table C.1 in the appendix presents an overview.

In recent years, criticism of commonly used methodology for causality purposes in accounting studies has grown.[5] Instead, the importance of testing causal links via exogenous shocks and natural experiments with staggered implementation has received substantial attention (Leuz and Wysocki 2016). While finding appropriate settings in the context of CPCs is challenging, one reasonably exogenous end of political connectedness stems from the implementation of "Rule 18" in China in 2013. This rule requires that party and government officials above a certain rank are prohibited from holding a position in an enterprise and forced officials to resign immediately and has been used by a number of studies using a Chinese sample (e.g., Hope et al., 2020). In a clever research design, Baloria and Heese (2018) use the gradual geographic expansion of TV channel Fox News as natural experiment to test the effects of a changing information environment. Other examples of approaches of potential use in an accounting setting are presented by Borisov et al. (2016), Child et al. (2020) and Faccio and Parsley (2009). Borisov et al. (2016) exploit the public arrest of top lobbyist Jack Abramoff that made it more difficult for firms to derive value through lobbying activities. Child et al. (2020) study the value effect of Donald Trump's surprise election at firms who had ties to the president *prior to* his political career. Faccio and Parsley (2009) use sudden deaths of politicians as identification strategy. All settings provide exogenous shocks to the quid-pro-quo channel. Our online appendix further denotes whether a reviewed paper explicitly states that it employs an exogenous event.

Finally, the framework presented in Fig. 1 may serve as an overview of the status quo of research on the effects of CPCs. It should be noted that it is inductively derived to structure our presentation of the studies we review and there are plausible interrelations between the individual categories. Gow et al. (2016) recommend the use of causal diagrams to distinguish between different categories of interrelations which should be conditioned on differently. While the introduction of a control variable in a multiple regression design is appropriate if the construct is a confounder, it means "throwing out the baby with the bathwater" (i.e., eliminating part of the overall effect from the regression) if it is a mediator and may even flip the sign of relevant coefficient if it is indeed a collider (Swanquist and Whited, 2018). The four channels we derive from the literature are typically mediators between CPCs and an accounting outcome. However, some constructs may also become colliders in certain research designs. For instance, according to studies discussed in Sections 3.1.2 and 3.2.2, respectively, CPCs may affect both access to credit and audit quality. It is not implausible to assume that audit quality furthermore affects access to credit. A typical control variable such as leverage may in this case at least partly reflect access to credit, in which case its inclusion may exacerbate rather than alleviate a bias of the coefficient of the effect of CPCs on audit quality.

7. Recent trends and avenues for future research

In this section, we identify recent trends as well as gaps in the literature and make suggestions on promising research areas. In particular, we argue that five areas of research warrant further attention: (a) the effects of CPCs in times of economic crises, (b) an analysis of the impact of the economic and political system in which firms are connected with politicians, (c) an analysis of the different effects of particular types of political connectedness as discussed in Section 4, (d) an analysis of the potential interactions between particular types of CPC, (e) an analysis of the public visibility of the CPC, and (f) an analysis of foreign CPCs. Our reflections in these areas are by necessity more speculative than those in the preceding sections.

7.1. Effects of CPCs during economic crises

Economic crises present interesting opportunities for the study of the effects of political connections. On the one side, they typically represent an exogenous shock hence presenting a possible identification strategy for testing the effects of CPCs. For instance, Adelino and Dinç (2014) use the 2008 financial crises to study the effects of firms' financial health on corporate lobbying. They argue that the crisis was largely unanticipated and its effect on each firm likely unrelated to past lobbying. This allows them to use a difference-in-differences design and address problems of omitted variables and reverse causality. At the same time, they are likely to affect both connected firms' and political actors' incentives. We draw on analytical framework developed in Section 3 to discuss how changed incentives of both firms and politicians potentially affect the accounting environment and accounting outcomes.

[5] For instance, Shipman et al. (2017) discuss the use of propensity score matching, Larcker and Rusticus (2010) review the use of instrumental variables and Lennox et al. (2012) focus on selection models. Reporting on the *Causality in the Social Sciences Conference* held at the Stanford Graduate School of Business, in 2014, Bertomeu, Beyer and Taylor (2016) conclude that the use of quasi-natural experiments in itself does not bestow the ability to draw causal inferences.

In times of economic crises, the demand for governmental funds, e.g., in the form of bailouts, increases while the government's possibility to provide them may be impaired. Economically weakened firms are more likely to lobby for government aid (Adelino and Dinç, 2014) and connected firms are more likely to obtain them (Duchin and Sosyura, 2012; Kostovetsky, 2015). Private lenders pay more attention to implicit government guarantees for connected firms during crises (Cong et al., 2019). At the same time, Johnson and Mitton (2003) find that connected Malaysian firms lost access to subsidies during the Asian financial crisis until capital controls were installed, demonstrating that extreme events may make government funds unavailable when they are most needed. Gul (2006) finds that Malaysian auditors accordingly first increased audit fees for connected clients and subsequently decreased them once capital controls were in place, illustrating knock-on effects from private parties. On the other hand, Acemoglu et al. (2016) argue for what they call a "connections in a crisis" effect. In time of crisis, governments may have unusual powers while at the same time being more likely to draw on connected firms for quick expertise.

In Section 3.1.4, we cite evidence that connected firms may be expected by politicians to take social and political objectives, such as low unemployment, into account. Furthermore, as discussed in Section 5.1, existing evidence suggests that politically connected financial institutions are more likely to engage in counter-cyclical lending. Political connections of firms or their investors also seem to lead to higher job creation. It is evident that such considerations take on increased urgency for politicians during times of economic crises. Carney et al. (2020) argue that being linked to connected firms via board interlocks (and hence being indirectly linked to political decision-makers) makes firms benefit from access to information while avoiding the costs of being connected oneself. However, investigating the effects of such political networks on accounting performance and stock returns in nine East Asian countries during the financial crisis, they find a positive effect in weak institutional environments only.

There is also some evidence that economic crises affect the corporate governance consequences of political connectedness which we discuss in Section 3.1.5. The actions taken by governments to counter the effects of economic crises open up possibilities for abuse and may create moral hazard. Jagolinzer et al. (2020) show that TARP funds disbursement triggered insider trading by connected boards. Kostovetsky (2015) and Duchin and Sosyura (2014) find that before and during the financial crises, connected banks took more risks.

Effects of crises on the accounting environment are accompanied by direct and indirect effects on accounting outcomes. While under most circumstances, politicians do not care much about financial reporting, presumed economic consequences of accounting standards make the issue receive attention in times of crises. Investigating U.S. congressional hearings around fair value accounting, Bischof et al. (2020) find that politicians' involvement in the debate was explained by their ideological stance when the issue was linked with bank bailouts whereas it was more explained by their links to special interests at times when technical issues were discussed. In the international arena, the International Accounting Standards Board received requests from EU politicians to change reclassification rules for financial assets in the context of the financial crisis and amended relevant standards outside of its usual due process for setting accounting standards (Fiechter, 2011). In a Japanese setting, Skinner (2008) argues that the adoption of new deferred tax accounting rules was part of a regulatory forbearance strategy, allowing major Japanese banks to recognized deferred tax assets without which they would have been insolvent. In addition to standard setters, politicians may also lean on enforcement agencies in order to obtain more lenient treatment for connected firms. For instance, Heese (2019) finds that large employers located in home states of senators sitting on SEC oversight committees face fewer enforcement actions during election years. While he does not specifically address the effects of economic crises, it is plausible to assume that the effect is more pronounced during hard times.

Positive Accounting Theory (Watts and Zimmerman, 1978, 1986) argues that political costs generally provide firms with incentives to understate their financial situation. While there is some empirical support for this conjecture (e.g., Ramanna and Roychowdhury, 2010 for politically connected firms), there is also evidence that it is not generally true across the business cycle. For instance, Makar and Alam (1998) find that firms under merger-related investigations by the U.S. Department of Justice or the Federal Trade Commission use income-decreasing discretionary accruals during economic expansions but not during recessions. Liberty and Zimmerman (1986) similarly fail to find evidence of earnings management during labor contract negations with unions and interpret that during their sample period unionized firms had no incentive to use income-decreasing accounting choices as they were already performing poorly. During economic crises, this argument would apply even more strongly. It may indeed invert incentives for earnings management as firms have incentives to demonstrate their long-term economic viability rather than their need in order to obtain a bailout. At the same time, increased incentives and possibilities for quid-pro-quo exchanges between firms and governments during times of crisis may provide incentives for opaqueness. Columbia Business School professor Shivaram Rajgopal entitled a column for the magazine Forbes "The $500 Billion In Corporate Aid Will Be A Corrupt Cash Grab If We Don't Ask The Right Questions".[6] Clearly he is concerned about transparency of expected bailouts.

In light of the arguments presented above, the economic crisis induced by the Covid-19 virus hence presents a unique opportunity for researchers to study the effects of CPCs. Compared to previous crises such as the financial crisis of 2008, its economic effects are broader (as more sectors are directly concerned), deeper (the estimated magnitude of the economic impact is multitudes larger) and presumably also more long-term.

[6] The column is available at: https://www.forbes.com/sites/shivaramrajgopal/2020/03/31/the-500-billion-in-corporate-assistance-will-end-up-as-a-corrupt-cash-grab-if-we-dont-ask-the-right-questions/.

7.2. Effects of the economic and political system

A majority of the studies reviewed in Section 3 use a single-country setting. In particular, more recent studies, published between 2015 and 2020, tend to focus mostly on one of two countries: the U.S. or China. Although studies that use a cross-country setting (e.g., Chaney et al., 2011; Guedhami et al., 2014) investigate the effects of individual country-level variables, such as the quality of the institutional infrastructure, they do not tend to investigate differences between political and economic systems. Arguably, this setting can have an important influence on the effects of a firm's political connections on its reporting quality. Scholars have developed multiple ways to cluster countries on the basis of their legal origin (La Porta et al., 1997, 1998) and nature of government involvement in market relations (Hall and Soskice, 2001).

Leuz et al. (2003) group countries into clusters on investor relation mechanisms and find that these clusters are closely related to the respective countries' legal origin. Other studies confirm the importance of a country's legal system on financial reporting outcomes (Ball et al., 2000; Bushman and Piotroski, 2006; Daske et al., 2008). The legal system appears to most directly affect the enforcement channel linking CPCs to financial reporting outcomes, as discussed in Section 3.3. While studies on the effects of legal origin tend to find that common-law countries offer better protection to outside investors than code-law countries, the effect of CPCs may be stronger in either. As discussed in Section 3.3.3, available empirical evidence suggests that enforcement of legal rules on connected firms is weaker. Whether this marginal effect is stronger in common-law countries, which tend to have stricter enforcement of investor protection rules, or in code-law countries is a priori unclear. We thus formulate a non-directional hypothesis: The effects of CPCs on financial reporting outcomes via the enforcement channel differ between code-law countries and common-law countries.

The literature on varieties of capitalism classifies political economic systems into liberal market economies (LMEs) and coordinated market economies (CMEs), depending on the role of government in facilitating market transaction (Hall and Soskice, 2001). These differences imply variances in the optimal design of accounting regulation and the role of accounting information in the economy (Perry and Nölke, 2006; Walker, 2010). Differences between LME and CME may affect the channels identified in Section 3.3. Politicians wanting to grant access to financial resources to connected firms will find doing so easier in CMEs in which the role of the state is relatively stronger than that in LMEs. We thus expect an effect via this channel to be stronger in CMEs. Similarly, we expect a greater amount of political quid pro quo in CMEs. Conversely, effects on the media scrutiny channel for politically connected firms are likely to be stronger in LMEs in which the government is likely to have a more limited role and political connections may thus encounter more suspicion.

7.3. Effects of different types of CPCs

Although studies have operationalized CPCs in substantially different ways, few specifically address the differential effects of different forms of political connectedness.[7] Arguably, the expectations on both the firm's and the politician's side are substantially different between, for example, a connection established by financial contributions of the firm and one based on calculations rooted in political geography. Mehta et al. (2020) find that antitrust merger reviews tend to be more favorable when acquirer or target are located in political districts represented by politicians sitting on committees with antitrust regulatory oversight but find evidence of effects of other forms of connectedness such as political contributions, lobbying or personal connections only in some subsamples. Similarly, the effects of financial contributions may differ depending on who provides them. Babenko et al. (2020) find that while CEO support of a political candidate appears to influence employee contributions to the candidate, cumulative abnormal returns around the election are higher when a CEO-supported candidate wins than when an employee-supported candidate wins, suggesting that CEO contributions are more aligned with shareholder interests. We therefore consider this area a promising potential avenue for future research. In this subsection, we draw on the corporate political strategy literature in the field of management to offer some speculations about potential effects.

Hillman and Hitt (1999) distinguish between "relational" and "transactional" approaches to corporate political strategy. In their terminology, a transactional approach describes a short-term interaction while a relational approach refers to a long-term exchange relationship. While the notion of CPCs would seem to indicate a long-term relationship, we note that some of the concrete metrics used to operationalize the construct, such as lobbying expenditures or PAC contributions, have also served to proxy for a more transactional approach to CPS. The impact on corporate financial reporting via the channels identified in Section 3.3 is likely different between firms that have long-standing connections with a political actor and those approaching them in a more transactional manner. The political quid pro quo is likely more explicit in the case of transactional contacts and more implicit for long-term relationships. Similarly, firms with long-standing connections may encounter a higher level of general media scrutiny, while a transactional intervention, if publicly observable, may attract a spike in media attention.

[7] The more recent literature has begun recognizing this aspect. For example, Fidrmuc et al. (2018) note that to provide a full picture of coordinated corporate political actions, they complement their main proxy of lobbying expenditures by also investigating PAC contributions (a proxy often conjointly investigated with lobbying expenditures) and, in particular, equity ownership by politicians. As do other studies, however, they treat their alternative proxies mostly as robustness checks and do not specifically investigate possible interactions (e.g., whether they are complements or substitutes).

The distinction between active and passive political connections also arguably has importance for the effects of CPCs. Active connections stem from the deliberate political actions of firms (e.g., offering financial contributions, engaging in lobbying), whereas passive connections are exogenous (e.g., due to the geographic situation of a firm's headquarters or operations) (Kim et al., 2012). Connections that are incurred passively rather than pursued actively may be perceived as more legitimate and therefore receive less critical media scrutiny. For example, a connected firm may face a lower risk of public criticism for receiving a bailout when the connection is based on geographic considerations (and, thus, the politician's concerns about voters' loss of jobs) than when it is linked to a politician through financial contributions. Ramanna and Roychowdhury (2010) show that firms engaging in outsourcing activities exhibited more income-decreasing earnings management during the period surrounding the 2004 U.S. elections when they were large donors to politicians, presumably in an attempt to shield their connected politicians from criticism. It is plausible to assume that geographically connected firms would not have felt such a need. In a related vein, the implied political quid pro quo is also presumably different between different forms of connections. A question related to that on active versus passive connections pertains to intentionality. While empirical studies show that connected firms obtain more lenient treatment from enforcement agencies (Correia, 2014), this does not prove that firms entered the connection with this objective in mind. The impact of CPCs on financial reporting may well be incidental.

Finally, a conceptual distinction exists between economically motivated political connections and ideologically motivated connections. In a multiparty setting, economic motivations would presumably trigger firms to share their attention equally between parties (potentially weighted by considerations such as whether a particular party is part of the government), while individuals within a firm may have personal ideological preferences. For example, Unsal et al. (2016) investigate differences in lobbying behavior and firm performance of U.S. firms whose CEOs have affiliations with the Republican versus the Democratic Party. Bischof et al. (2020) investigate politicians' involvement in standard setting in two high-profile cases. They find that politicians get involved in the process in line with their ideological preferences when the debate focuses on economic consequences. When technical issues dominate, their involvement is better explained by connections to firms affected by the standards.

7.4. Interactions between different types of CPCs

While different types of CPCs are likely to have different effects, as discussed in the preceding subsection, there may also be interactions between different forms of connectedness. These interactions may be substitutive or complementary. Antia et al. (2013) provide an example of a substitutive relation. They investigate the relation between firms' lobbying expenditures and the political alignment of their home state with the federal government. Their results indicate that firms increase lobbying expenditures when this alignment decreases, suggesting that firms in this case invest in alternative channels of influence on the governing elite. Other forms of connectedness may have a complementary relation. Ansolabehere et al. (2002) find a strong connection between firms' financial contributions and their lobbying expenditures. This is in line with the pay-to-play hypothesis, which argues that firms purchase access to politicians through campaign contributions and use this access to feed information to the policy-making process by lobbying (Cotton, 2012). Brown and Huang,(2020) use White House visits as a proxy for access to key policy-makers and find that relative to control firms, firms whose executives visit the White House receive more government contracts following the visit. They find that these firms tend to be larger but do not investigate what other factors explain their access. Kim and Zhang (2016) find that firms exhibiting three types of connections (connected directors, financial contributions, and lobbying) are more tax aggressive than firms with two types of connections, which in turn are more aggressive than firms with one type of connection. Changes in the environment may affect connected firms differently depending on the type of connection they have established. For instance, Albuquerque et al. (2020) find that following a U.S. Supreme Court decision that lifted bans on corporations' using financial resources to advocate for a political candidate, firms that were politically connected via board members or top management connections experienced negative announcement returns but the same was not true for firms connected via lobbying or PAC contributions. They argue that some of the value of personal connections is subsumed by other forms of corporate political activism.

Anecdotal evidence also suggests that politicians may find it easier to justify the distribution of political benefits to contributing firms or projects located in their home state. When Representative Jerry Lewis was accused of exchanging support for appropriations bills against more than $60,000 in campaign donations, he responded: "I encourage a thorough review of any project I have helped secure *for my constituents*" (Associated Press, 2006, emphasis added; the case is also described by Tahoun [2014]). To our knowledge, no study has addressed potential interactions between the effects of different types of CPCs in an accounting setting.

7.5. Public visibility of CPCs

In line with the notion that firms have incentives to shield a connected politician from bad publicity, an emerging topic of interest is whether some firms prefer to engage in political strategies that are less visible to the public eye. PAC contributions can be used to identify dyadic firm-politician relationships, while contributions to so-called Super PACs and lobbying expenditures do not reveal their ultimate target (Baloria et al., 2019). Rather than making political contributions, firms may as well adopt investment strategies or provide financial support to public causes that cater to a politicians' career incentives (Bertrand et al., 2018; Borghesi et al., 2014). In a recent paper, Bertrand et al. (2019) find that firms donate to charities that are represented by, or located in the congressional district of economically relevant politicians. In the extreme, company

members may even deliberately obfuscate CPCs. McDonnell and Werner (2018) present evidence that CEOs of firms that face a reputational threat circumvent the Federal Election Commission's rule on individual contribution disclosure by not filling in questions on occupation or employer, or by using vague terminology. An unexplored research question is whether a relationship exists between the existence of easily accessible information on CPCs e.g. through voluntary CPC disclosure in annual reports, and financial reporting quality.

In Section 3.3.4 we argue that media scrutiny has the potential to either increase or decrease firms' incentives to adhere to high quality financial reporting. Cingano and Pinotti (2013) note that the effect of CPC on revenues follows a curvilinear function dependent on the connected individual's political office. While political power increases a politician's ability to channel favors to connected firms, visibility associated with high-profile offices decreases it. Prominence of the connected politician or the extend of the firms' political involvement may similarly influence firms' accounting choices.

7.6. Foreign political connections

A final topic that has received little attention in CPCs research, which typically examines connections to members of the national parliament, is the impact of foreign politicians on firm outcomes. By contrast, practitioners and regulators are quite aware of and distinctly refer to them as "politically exposed persons" (PEPs). These are individuals who hold prominent public functions, their close associates or their immediate family (The Financial Action Task Force, 2013). While the academic view suggests that CPCs improve credit access or decrease audit risk, it may be argued that, especially in the wake of several accounting scandals involving influential foreign individuals, these realities have changed. Banks and auditors may find it hazardous to give loans to or provide audit services to clients that are represented or owned by PEPs, which in turn affects the financial reporting mechanisms outlined in Section 3.3. E.g., in its 2015 Guidance on Anti-Money Laundering and Counter-Terrorist Financing, the Dutch National Bank (2015, p. 28) draws attention to the possibility that providing services to PEPs exposes financial institutions to reputational damages. As PEPs cause differences in credit access and quid pro quo risk assessment, we suggest they constitute an interesting sample to broaden knowledge on the relation between political influence and financial reporting.

8. Conclusion

In this article, we review the accounting, economics and finance literature on the effects of CPCs on financial reporting outcomes. We find that results are ambiguous, with some studies indicating that CPCs lead to results usually associated with lower quality of financial reporting (e.g., less strict financial reporting enforcement by regulators, lower earnings quality) and others showing results usually associated with higher quality of reporting (less earnings management, higher likelihood of Big 4 auditor). We also conclude from the review of this literature that scant conceptual work has tried to determine how (via which channels) CPCs influence financial reporting outcomes. Most of the hypotheses development in these articles appears rather ad hoc.

We therefore set out to develop an analytical framework of how CPCs affect financial reporting. To do so, we follow an iterative process to derive individual channels of influence from the empirical literature. We extend our search to include articles on CPCs from accounting, economics, and finance journals. We extract effects of CPCs from all articles found and categorize them in inductively derived categories. Summarizing arguments found in individual studies, we derive four channels through which we argue that CPCs affect the quality of financial reporting.

Our review provides two major sets of results. First, we develop a conceptual model of the relation between CPCs and financial reporting. We argue that CPCs influence reporting outcomes through (i) easier access to financial resources for connected firms, (ii) political quid pro quo between connected firms and the politicians to which they are connected, (iii) effects on enforcement of accounting regulation for connected firms, and (iv) increased media scrutiny for connected firms. Importantly, our review suggests that the impact of political connections on corporate reporting is ambiguous. We argue that there are economic forces for both higher and lower financial reporting quality stemming from firms' political connectedness. This is in contrast with much of the existing literature in accounting, which tends to hypothesize simple directional effects.

Our second set of results pertains to the notion of CPC itself. The literature we review uses different metrics to proxy for the unobservable construct of political connectedness. We argue that these different metrics capture different aspects of a multifaceted construct and thus propose a definition of CPCs that encompasses these metrics. Our definition offers the conceptual advantage of focusing on the perspectives of the politicians involved. Arguably, in a well-specified model of CPCs, politicians' interests deserve as much consideration as the connected firms'. Politicians' interests in concealing or rather highlighting their actions on behalf of firms – depending, presumably, on the anticipated effects on other parties (e.g., workers) – are an important factor in explaining the effects of CPCs on financial reporting. So far, the politician seems to be rather absent from CPC analyses. We also derive a classification scheme of the different types of political connections and argue that the type of political connection moderates the influence of CPCs on financial reporting.

While we foremost wish to contribute to the accounting literature on the effects of CPCs on financial reporting, we believe that our article is of relevance to a larger audience. Our definition and classification scheme of types of CPCs may help structure the literature in other areas as well as in the field of accounting. Furthermore, to our knowledge our review is the first to systematically structure the effects of CPCs by drawing on empirical studies in three fields, accounting, economics, and finance.

Declaration of Competing Interest

The authors declare that they have no known competing financial interests or personal relationships that could have appeared to influence the work reported in this paper.

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Appendix A. Selection and analysis of reviewed papers

As described in Section 2, our review of the literature was conducted in two stages. In both rounds, we use the search terms "political connection" and "political connections" in the same set of top-tier journals in the fields of accounting, economics, and finances, as identified by the academic journal guide of the Chartered Association of Business Schools. In the first round, both authors independently analyzed whether the articles meet the predefined inclusion criteria. In case of disagreement, points of divergence were discussed until agreement was reached. Of the 248 articles identified, 91 were ultimately retained. Among these, 20 were published in accounting journals, 11 in economics journals, and 60 in finance journals (see also Table 1). Moreover, we screen articles referenced by articles included in the first step of stage I. The objective of this procedure is to become more confident that our results are not driven by selection inherent in the choice of top-tier journals. We believe that our set of articles represents a comprehensive representation of the literature in our core area of accounting, given that only five out of 235 articles fulfill our inclusion criteria while simultaneously investigating themes related to financial reporting or auditing. We do not repeat this procedure for the stage II articles.

In stage II, we apply the same inclusion criteria as in stage I and exclude one article to which we could not obtain access. As a result, we retain 14 articles from accounting journals, four articles from economics journals, and 55 articles from finance journals. Comparing the relative distribution of the three academic fields shows that while the proportion of articles published in accounting journals remains largely unchanged (22 percent in stage I (top-tier journals) vs. 19 percent in stage II), the proportion of articles published in economics journals decreases from 12 percent to 5 percent. The dominance of finance journals in this area of investigation accordingly increases from 66 percent to 75 percent. The difference to 100 percent is due to rounding.

To analyze the stage II articles, we use the framework inductively derived in stage I and examine whether it is still useful to classify the articles identified in stage II. We again distinguish between articles investigating the effects of CPCs on accounting outcomes and the accounting environment. In stage II, only two of 52 articles fulfill our definition of accounting outcomes; we classify the remainder as accounting environment. For each article, we first classify the variables of interest in the categories and subcategories identified in stage I (see also Table 2). All variables fall into one of the categories identified in stage I, so no new category emerges. We broaden one subcategory and add a new one for one of the categories; otherwise, no adjustments need to be made to the classification scheme. We also classify the effects of CPCs (i.e., the dependent variable in these studies) in the categories "generic effect" and "main effect" as identified in stage I (see also Table B.1 in Appendix B). We investigate both the construct the authors of a particular article are interested in and the proxy they use in their empirical tests. Our classification is based on the construct they use, not their proxy (i.e., "what" they attempt to measure not "how" they measure it). This implies that the same proxy may be used in more than one category. For example, whereas Piotroski et al. (2015) use the metric of skewness of stock returns to test for temporary suppression of negative information, Chen et al. (2018b) use this metric to examine the effect of political risk on crash risk. Accordingly, we classify these articles into different categories. Similarly, while cumulative abnormal returns are normally classified in the generic category "stock market returns" and the main category "corporate performance," Liu et al. (2020) use it to investigate the effects of lawsuits on firms. We thus classify it as "legal accountability and legal risk" in the main category "legal and political risk". While these two examples demonstrate the necessity to make choices and, thus, the inevitable inherent subjectivity of some classifications, most classifications are fairly straightforward.

We find two articles that do not fit into our main categories as derived in stage I. We thus add a main category "other" to our classification scheme.[8] Otherwise, the main categories are sufficient to classify all new works.[9] On the classification level below the main effect, we broaden three generic effects (e.g., from "post-IPO performance" to "post-IPO/M&A performance")

[8] Goh et al. (2020) investigate connected firms' transparency in their political connections, not the effect on accounting outcomes or elements of the accounting environment. Ding et al. (2018) examine the relation between political connections and international trade. We do not include that category in our presentation of the results.

[9] Some studies test how CPCs *moderate* the relation between other constructs that are a priori unrelated to CPCs. For example, Manchiraju and Rajgopal (2017) investigate whether the effect of a regulatory reform on corporate social responsibility on shareholder value is different between connected and nonconnected firms. We include such studies for completeness but generally do not find them to add sufficiently to our subject to justify a separate category.

and add one new generic effect "price discrimination". These minor adjustments of the original classification scheme allow us to classify all new articles.

Appendix B. Categorization of effects of CPCs

See Table B.1.

Table B.1
Categorization of effects of CPCs.

Panel A: Empirical results on the relation between CPCs and the accounting environment		
Main category	Generic category	Examples of proxies for dependent variables
3.1.1. Corporate performance	1. Stock market performance	Tobin's Q, (cumulative) abnormal, buy and hold and net returns, book-to-market ratio, cost of equity, Diversion of proceeds, ROA, ROS, revenue growth, earnings growth, sales growth, abnormal return, (long term) post IPO stock return, IPO rejection risk, operating income, market share, market capitalization
	2. (Post) IPO/M&A performance	Diversion of proceeds, ROA, ROS, revenue growth, earnings growth, sales growth, abnormal return, (long term) post IPO stock return, IPO rejection risk, operating income, IPO underpricing
	3. Accounting performance	ROA, ROE, ROS, EPS, asset utilization, total assets, sales growth, employment growth, labor productivity, earnings growth, net sales, profit margin, EBIT, EBITDA, exports, future sales etc.
3.1.2. Access to credit	4. Cost and availability of credit	Credit spread, debt-to-asset ratios, total debt, leverage growth, loans from state-owned banks, interest rates, debt contract restrictions, abnormal returns around policy announcements
	5. Connected banks' lending policies	Borrower characteristics, bailout obligation, loan size and price, disbursed credit
3.1.3. Access to public funds	6. Bail-out	Capital infusion, application and receipt of stimulus funds, bankruptcy probability, newly issued debt or equity, government purchase of company assets
	7. Allocation of government funds	Domestic sales, federal funds, government procurement contracts, subsidies, contract volume with government
	8. Tax charges	Tax charges, tax rates, tax exemptions
	9. Price discrimination	Price discount on land transactions
3.1.4. Corporate objectives	10. Hiring decisions	Number of employees, local and firm employment growth, employment change
	11. Risk taking and investments	Cash holdings, earnings volatility, distance to default, investment in (in)tangible assets, research and developments and capital expenditures (scaled), investment-q-sensitivity, investment sensitivity to external financing, cash holdings, plant creation, pre-crisis leverage ratio
	12. Listing decision	IPO decision, cross-listing, diversion of proceeds, ROA, ROS, revenue growth, earnings growth, sales growth, abnormal return, (long term) post IPO stock return, IPO rejection risk, operating income
	13. Corporate social behavior	Union activities, corporate social responsibility investments, average employee wage
3.1.5. Corporate governance	14. Agency conflicts	Abnormal returns announcement of and around date of related-party transaction, excess leverage, inter-corporate loans
	15. Compensation	Remuneration, monthly earnings
	16. Control structure	Control rights, cash flow rights, outstanding shares held by controlling owner, chairman as controlling owner, board composition (size, gender, political status, educational level), second generation succession, vertical integration
	17. Evaluation	Subjective performance evaluations, CEO tenure
3.1.6. Legal and political risk	18. Legal accountability and legal risk	Resolution of insolvency, tax aggressiveness, tax enforcement, accounting enforcement, class actions, public reports of workplace safety audits, non-compliance fines, workplace fatalities, abnormal returns around regulatory changes, anti-foreigner bias in court
	19. Political risk and political information	Beta, cash flow volatility, return volatility, moderation of relation between political uncertainty and corporate investments, outcome of merger review process
3.1.7. Other		Firm exports, voluntary disclosure of political spending

Table B.1 (*continued*)

Panel B: Empirical results on the relation between CPCs and accounting outcomes	
Main category	Examples of proxies for dependent variables
3.2.1. Earnings management and earnings quality	Absolute accruals, discretionary accruals, earnings smoothing, earnings management around targets, performance adjusted accruals, real earnings management, timely loss recognition
3.2.2. Audit quality and audit risk	Big 4 auditor, size of audit firm, audit fee, probability of a modified audit opinion
3.2.3. Accounting standards and policies	Adoption of international accounting standards, accounting conservatism, presence of securities that require 20-F filing, holding private versus public securities, lobbying against standard change
3.2.4. Analyst and market reactions	Analyst following, forecast accuracy, analyst optimism, stock price informativeness (synchronicity, private information trading, earnings response coefficient), informed trading (bid-ask spread component), negative stock price skewness

Appendix C. Empirical approaches in accounting outcome articles

To improve readability of the table, we code channels as follows: [1] Improved access to financial resources [2] Political quid pro quo [3] Enforcement [4] Media scrutiny (Table C.1).

Table C.1
Empirical approaches in accounting outcome articles.

Paper	Channel	Empirical approach to test main accounting outcome	Empirical approach to verify channel
Baloria and Heese (2018)	[4]	Event study with three-way interaction design: Regression of negative stock price skewness on the interaction of fox news channel availability, political affiliation and election timing	Channel investigated through identification strategy: Fox news expansion is used as exogenous shock to connected firms' media environment (exposure to media slant) Subsample regression: Partition by firm-level visibility measured as Fortune 500 membership and analyst following
Batta et al. (2014)	[2]	Regression of earnings benchmark-beating and abnormal accruals on political connection indictor Piecewise linear regression of accruals as dependent variable and cash flows to capture asymmetrically timely gain and loss recognition. Interaction of political connection with cash flows from operations and indicator variable if cash flows are negative	T-test on differences in earnings smoothing at high and low expropriation risk sample in connected and non-connected sample measured as labor intensity Interaction: Regression of earnings management measures on interaction of estimated labor intensity and political connection
Ben-Nasr et al. (2015)	[1] [2]	Regression of discretionary accruals and earnings persistence on ownership variables (state and foreign ownership) Earnings response coefficient: Regression of cumulative abnormal returns on the interaction of unexpected earnings with ownership variables	Subsample regression: Partition by country-level expropriation risk measured as various institutional indexes
Ben-Nasr and Cosset (2014)	[2]	Regression of stock price informativeness on state ownership; informativeness is measured as stock price synchronicity, private information trading and earnings response coefficient	Subsample regression: Partition by country-level expropriation risk measured as various institutional indexes
Bischof et al. (2020)	/	Regression of indicator variable (politician made negative statement on fair value accounting/stock option expensing) on ideology, special interest and the interaction of ideology and special interest with timing of the statement	/
Borisova and Yadav (2015)	[2]	Regression of informed trading on measures of state ownership and privatization. Informed trading is measured as adverse selection component of bid ask spread Event study: Regression of informed trading on interaction of state ownership and earnings announcement indicator variable and regression of informed trading on event indicator in sample of government-owned and non-government owned	/

(*continued on next page*)

Table C.1 (*continued*)

Paper	Channel	Empirical approach to test main accounting outcome	Empirical approach to verify channel
		firms	
Cao et al., 2018b	[4]	Event study: Regression of negative stock price skewness on CCDI (Central Commission for Discipline Inspection) inspection month indicator variable	Channel investigated through identification strategy: Chinese anti-corruption campaigns by the CCDI are used as exogenous setting of heightened scrutiny placed on politicians and connected firms. Negative news may alert investigation teams about possible corruption
Chaney et al. (2011)	[1]	Regression of earnings quality (accrual measure) on political connection	T-test on differences of cost of debt at high or low earnings quality in connected and non-connected sample Interaction: Regression of cost of debt on the interaction of political connection and accrual measure
Chen et al. (2010b)	[1] [2]	Regression of forecast accuracy on indicator variable of political connection	Interaction: Regression of forecast accuracy on the interaction of political connection and corruption perception index
Chen et al. (2010a)	[1]	Piecewise linear regression of accruals as dependent variable and cash flows to capture asymmetrically timely gain and loss recognition. Interaction of state ownership with cash flows from operations and indicator variable if cash flows are negative	T-test on differences of loan defaults at state-owned and non-state-owned firms Regression of loan default on state ownership
Chen et al. (2011a)	[1]	Regression of discretionary accruals on top 8 auditor, state ownership and on the interaction of top 8 auditor and state ownership Regression of cost of equity on top 8 auditor, state ownership and on the interaction of top 8 auditor and state ownership	/
Firth et al. (2013)	/	Regression of analyst recommendations on client pressure. Political connection serves as control variable to account for possible political pressure	/
Gross et al. (2016)	[2] [3]	Regression of discretionary accruals on political alignment index	/
Guedhami et al. (2009)	[2]	Regression of auditor choice (big 4) and auditor switches on state ownership and foreign ownership in a sample of privatized firms	Subsample regression: Partition by country-level investor protection and state control relinquishment following privatization (indicator variable). Investor protection is measured as various institutional indexes and developed economy classification indicator variable
Guedhami et al. (2014)	[1] [2] [4]	Regression of auditor choice (big 4) on indicator variable of political connection indicator and state ownership Matched sample of non-connected firms (based on country, industry, year, and total assets decile; additional propensity score match)	Interaction: Regression of auditor choice on interaction of connected and variables indicative of: firm-level vulnerability of minority investors and expropriation risk; firm-level complexity; country-level public scrutiny; country-level debt market development (several variables per category) Subsample regression: Partition by country-level expropriation risk measured as various institutional indexes Economic outcomes analysis: Regression of multiple dependent variables on the interaction of connection and auditor choice. The dependent variables are: earnings management; analyst forecast coverage and accuracy; accounting standard choice; valuation; equity pricing
Gul (2006)	[1]	Event study: Regression of audit fees on political connection in a sample of three periods that are: (i) the pre-crisis period; (ii) the Asian financial crisis period; (iii) the post crisis period Two regressions: one for pre-crisis period and one in pooled sample including the interaction of political connection with indicator variables for period (i) and (iii)	Channel investigated through identification strategy: Implementation of capital controls following Asian financial crisis restored governments' ability to support connected firms financially
Gul et al. (2013)	/	Regression of audit outcomes (modified audit opinions, accrual measure for earnings management) on political party affiliation of the auditor	/
He et al. (2012)	[1]	Event study: Regression of real earnings management (measured as debt restructuring) on the interaction of political connection and indicator variable for the 2007 switch to the new China Accounting Standards	Channel investigated through identification strategy: Switch caused negative fair value changes at some firms and thus motivated (real) earnings management. Connected firms enjoy improved access to financing and are better able to offset these losses.

Table C.1 (*continued*)

Paper	Channel	Empirical approach to test main accounting outcome	Empirical approach to verify channel
Hope et al. (2020)	[1]	Event study: Regression of financial reporting quality measured as discretionary accruals and real earnings management on political connection and on the interaction of political connection with event indicator variable (introduction of Rule 18 which forced the resignation of politically connected directors)	Subsample regression: Partition by variables that are indicative of capital market pressure for transparency and refinancing pressure. The variables are: provincial-level institutional development variables (financial market development, provincial-level efficiency of the judiciary system), firm-level financing costs (prior to law change) and firm-level state ownership (ultimate owner is the state) Additional tests on the consequences of anti-corruption campaign: Regression of subsidies and long-term bank loans on the interaction of political connection with post Subsample regression of subsidies and long-term bank loans on the interaction of political connection with post: Partition by financial reporting quality
Hung et al. (2018)	[1] [2] [3]	Regression of voluntary disclosure (frequency of voluntary management forecasts) on political connection	Subsample regression of management forecast frequency on political connection: Partition by country-level market efficiency; industry-level litigation; industry-adjusted R&D; country-level corruption
Leuz and Oberholzer-Gee (2006)	[1]	Regression of the presence of publicly traded foreign securities on measure of political connection to Indonesian president Suharto	Regression of presence of securities that require a 20-F filing, and presence of private foreign securities on political connection
Liu and Subramaniam (2013)	[1] [2]	Regression of audit fees on government ownership	Interaction: Regression of audit fee on interaction of state ownership and variables indicative of: greater monitoring (audit firm size), the propensity to receive political benefits (various provincial-level institutional indexes and firm-level subsidies) Additional analysis of type of state ownership (owned by province, city or country government)
Piotroski et al. (2015)	[2] [4]	Event study: Regression of negative stock price skewness on indicator variable that is equal to one if a firm is located in province in which a politically important event takes place (National Congress meetings and political promotions)	Channel investigated through identification strategy: Political events imply greater visibility and motivate the suppression of negative news Interaction: Regression of negative stock price skewness on interaction of event indicator and variables indicative of capital market pressure for transparency (provincial-level equity market development, firm-level indicator variable equal to one if the firm issued tradable B-shares)
Ramanna (2008)	/	Regression of pro-pooling congressperson indicator variable on PAC contributions from pro-pooling groups	/
Ramanna and Roychowdhury (2010)	[4]	Event study: Regression of discretionary accruals on outsourcing activity in a sample of connected firms around the 2004 congressional election Two regressions: (i) mid-2004 (no timing indicator variable); (ii) mid-2003 until mid-2005; indicator variable for mid-2004	Channel investigated through identification strategy: scholars analyze a specific sample of firms that are expected to engage in earnings management with the aim to remain inconspicuous Interaction: Regression includes the interaction of outsourcing activity and indicator variable for closely watched race
Thornburg and Roberts (2008)	/	Regression of PAC contributions made by accounting profession to a Congressperson on Congresspersons' cumulative voting record (pro-business rating between 0 and 100)	/
Wang et al. (2017)	[2] [3]	Regression of financial reporting fraud on political connection, managerial ability and the interaction of political connection with managerial ability	/
Wang et al. (2008)	[1] [2]	Regression of auditor choice (small local auditor) on local and central state ownership	Interaction: Regression of auditor choice on the interaction of local and central state ownership with various institutional indexes indicative of the quality of regional institutions
Yang (2013)	/	Regression of audit fees, audit firm market share, and IPO rejection likelihood on audit firm political connection	/

Appendix D. Supplementary material

Supplementary data to this article can be found online at https://doi.org/10.1016/j.jaccpubpol.2020.106802.

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