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Political donations and political risk in the UK: Evidence from a closely-fought election

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ABSTRACT

UK regulation discourages corporate political donations but is relatively benign in respect of individual donations. Few UK listed companies make political donations but many more company directors do. We use a unique, hand-collected dataset of political donations to examine whether UK corporate political connections are perceived as being created indirectly *via* directors' personal donations. Basing our tests on the sensitivity of company returns to opinion polls preceding the 2010 General Election we find that, on average, firms in industries which donate only to the Conservative Party exhibit higher sensitivity to the electoral success of the Conservatives. However, within industries, there is no consistent evidence that the firms which employ directors who make these donations exhibit higher sensitivity than firms which do not. We justify basing our inferences on return sensitivity to polls by confirming that UK domestic political risk, as proxied by opinion poll changes, is priced around General Elections.

1. Introduction

The existence of ties between politicians and the corporate world is not a new phenomenon and there is a growing body of research which investigates links between politics and stock markets. Early work, such as Jayachandran (2006), suggests that domestic political risk is priced, evidence supported by subsequent research such as Boutchkova et al. (2012) and Belo et al. (2013), which links the cash flow variability of individual firms or industries to government activities. More recently, attention has turned to the sources and value of corporate political connections.

One of the most frequently analysed sources of connection, particularly in the US, is corporate political donations. Such donations represent a significant proportion of political finance in the US and there is mounting evidence that they contribute to corporate value. For example, Cooper et al. (2010) find that corporate donations to political candidates and parties affect both share returns and future profitability (see also Claessens et al., 2008 and Akey, 2015).

The US political finance framework contrasts sharply with that of the UK, where regulation discourages corporate political contributions: UK companies must obtain shareholder approval for political donations above £5,000 during any 12-month period and all political contributions over £200 must be disclosed in the annual financial statements. Conversely, the UK system is relatively benign in respect of individual contributions: while US federal law restricts the amounts that individuals can contribute to each political party or candidate, there is no such limit in the UK. Only 6% of the 300 largest listed UK companies donated to the two main political parties—Conservatives and Labour—in the period between 2005 and 2010, but 17% of these companies employed at least one director who made a personal contribution. While total corporate political donations from these 300 companies amounted to less than £500,000 over the period, their directors donated about £2.4 million.[1] These amounts may seem small but, unlike in the US, campaign expenditure in the UK is capped, potentially increasing the salience of a large individual donation: in 2010 the maximum expenditure during the year preceding the polling date was £19.5 million per party (Electoral Commission, 2011, p2). In addition, whereas in the US company managers might make donations as a group *via* corporate PACs, in the UK the value of an individual director's political donations is more transparent.

An intriguing question is whether the different regulatory frameworks that apply to political finance in the US and UK have implications for the roles played by corporate and individual donations. In particular, since the contribution made by UK listed com-

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[1] Contributions from privately-held companies were higher than from listed companies and their directors, potentially giving these firms an influential role in the political process.

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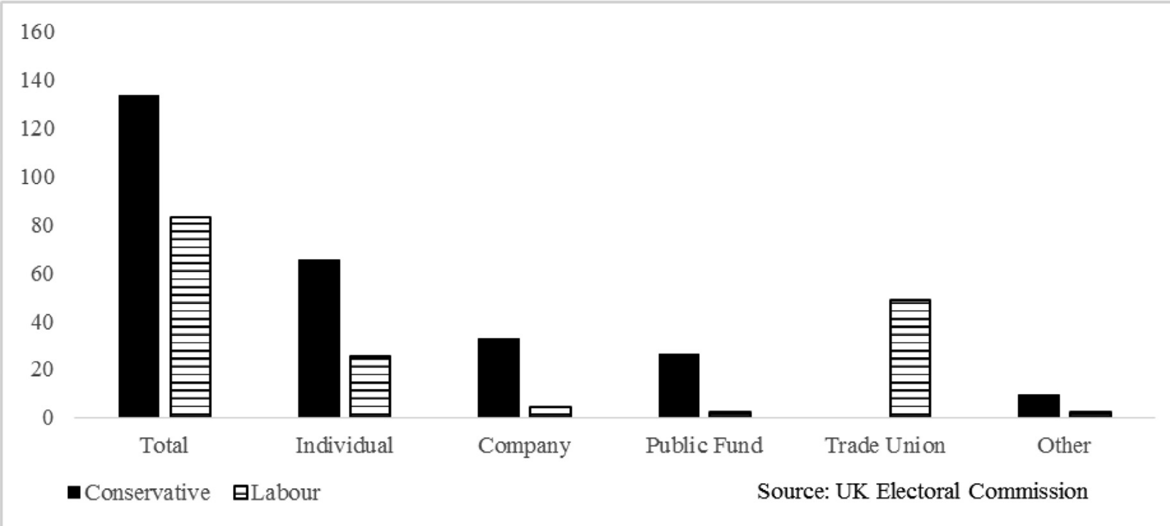

Fig. 1. Sources of political finance 2005 to 2010
Notes. 1. The figure summarizes the sources of political finance for the main two political parties. The *y*-axis denotes the monetary value of all donations between June 2005 and March 2010 in £millions.

panies is so slight, might it be that political donations made by their directors are viewed as surrogate corporate donations? This paper investigates these questions and, to our knowledge, is the first to do so.

Although some of our results suggest that directors' donations could be perceived as associated with the company on whose board they sit, we find no fully convincing evidence that this is the case. However, it does appear that political donations, either by the company or by a director, do indicate an *industry-wide* political affiliation. Our most consistent results suggest that industries which, in our sample, donate exclusively to the Conservative Party, comprise of companies which are particularly sensitive to the electoral fortunes of the Conservatives.

Our empirical analysis exploits a unique, hand-collected dataset of political contributions made by directors of UK companies, data available only since 2001. Fig. 1 summarises the sources of political finance for the two main UK parties between 2005 and 2010, and shows that the Conservatives, traditionally more pro-business, have greater access to funds. Almost half of their donations (£65 million out of £133 million) came from individuals, a higher level of donations than any other group. The trades unions were the major source of funding for the Labour Party (£49 million out of £84 million), potentially creating indirect political links for companies in highly-unionised sectors. We therefore augment our political donations data with industry-level measures of worker unionisation rates.

We base our identification strategy around the 2010 UK General Election. Following Acker and Duck (2015) we use the high-frequency reporting of opinion poll data during election campaigns to obtain firm-level measures of political affiliation and sensitivity. The response of share prices to changes in the polls allows us to identify companies as being either pro-Conservative or pro-Labour.[2] Unlike a standard event study approach, which would examine stock price reactions to the announcement of the election outcome, the technique does not rely on the outcome's unexpectedness, or on the precision with which the event date is determined. This is a particularly attractive feature in the case of the 2010 election, the outcome of which – a Conservative-led coalition government – was unclear for several days following polling day.

Before analysing the role of political donations, we first confirm that our measure of political sensitivity captures the sign and size of individual companies' political affiliation. To do this we examine the relationship between our measure and post-polling day abnormal returns for five UK General Election campaigns from 1992 to 2010. Using multiple elections allows us to sharpen our tests, contrasting the results for closely-fought elections where the outcome was highly uncertain with those for elections which involved much less political risk. The results strongly suggest that a priced political factor does exist around elections, and that our poll-based measure is a suitable proxy for firms' general political sensitivity.

We then use our political sensitivity measure for 2010 to address our main question: whether political finance derived from directors of UK listed companies appears to have implications for the companies themselves. We examine the relationships between the political finance sources and both the sign and the size of the political sensitivities but find no consistent evidence that firms with Conservative director-donors exhibit higher political sensitivity than those without.

However, we also compare different groups of industries, focusing on a set where we observe donations – whether direct corporate donations or *via* directors – going *only* to the Conservative Party. We contrast these with a set of 'mixed donor' industries, which either donate to both parties or which do not donate at all. We find that firms in the Conservative-only donating industries exhibit, on average, higher sensitivity to a Conservative victory than do firms in the mixed donor industries. Robustness checks using cumulative abnormal returns and share prices from the Intrade prediction market confirm these results. By contrast, we find no evidence of a relationship between our industry-level measure of the degree of worker union membership and political sensitivity.

Our results suggest that any links that might exist between political donations and corporate value in the UK are more tenuous than in the US. While it is possible that political donations are made by directors in the expectation of a tangible benefit, and that there are spillover benefits from donating firms and directors to entire industries, our findings are open to other interpretations. For

[2] Related papers in the political science literature (e.g. Herron, 2000 and Knight, 2007) first identify firms which they predict should be sensitive to particular election outcomes due to director political connections, and then examine the accuracy of the prediction. We allow the data to identify firms' sensitivities. Similarly, Coulomb and Sangnier (2014) find share prices of companies connected to the French presidential candidate Sarkozy react positively to an increase in the perceived probability of his election, whereas those of companies connected to his main rival react negatively.