



### Political Relations and Finance

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## **Political Relations and Finance**

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School of Banking and Finance UNSW Business School University of New South Wales

A thesis submitted to the University of New South Wales in partial fulfilment of the requirements of the degree of Doctor of Philosophy

March 2018

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#### Abstract 350 words maximum: (PLEASE TYPE)

This thesis consists of three studies that investigate how important political relations are in finance.

In the first study, I find that poor bilateral political relations between the US and other countries negatively influence US media dissemination toward non-US firms with American Depositary Receipts (ADRs). I also show that US media negativity has downward pressure on ADR firms' home market prices and such negative impact is reduced during the year when political relations are poor—an indication that investors react to real media bias. I conclude the first study by showing that negative US media coverage leads to a higher likelihood of ADR firms terminating their ADRs.

The second study finds strong empirical evidence showing that when bilateral political relations between a country and the US are poor, the level of US institutional ownership and the number of institutional investors are low for American Depositary Receipt (ADR) firms from that country. In addition, the second study discusses whether a country's popularity among Americans and an international crisis influence the level of US institutional ownership. Furthermore, following the previous literature, I show empirically that a high level of US institutional ownership promotes better corporate governance; to do so, I look at firm value, class action lawsuits and voluntary disclosure news.

The third study considers whether bilateral political relations affect the board structure of S&P 1500 companies—specifically the proportion of foreign independent directors (FIDs). I find strong empirical evidence that when bilateral political relations between a country and the US are poor, the proportion of FIDs from that country hired by US firms is small. The threat of a firm losing technology and insider information to countries with poor political relations are considered costs by US firms, so when firms do hire FIDs from countries that have poor political relations with the US, I empirically show that the benefits are greater than the costs. I conclude the third study with an M&A analysis, which finds that firms have a high proportion of FIDs from countries where their acquisition targets exist and bilateral political relations do not influence such a proportion.

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Jun Song

March 2018

## Abstract

This thesis consists of three studies that investigate how important political relations are in finance.

In the first study, I find that poor bilateral political relations between the US and other countries negatively influence US media dissemination toward non-US firms with American Depositary Receipts (ADRs). I also show that US media negativity has downward pressure on ADR firms' home market prices and such negative impact is reduced during the year when political relations are poor—an indication that investors react to *real* media bias. I conclude the first study by showing that negative US media coverage leads to a higher likelihood of ADR firms terminating their ADRs.

The second study finds strong empirical evidence showing that when bilateral political relations between a country and the US are poor, the level of US institutional ownership and the number of institutional investors are low for American Depositary Receipt (ADR) firms from that country. In addition, the second study discusses whether a country's popularity among Americans and an international crisis influence the level of US institutional ownership. Furthermore, following the previous literature, I show empirically that a high level of US institutional ownership promotes better corporate governance; to do so, I look at firm value, class action lawsuits and voluntary disclosure news.

The third study considers whether bilateral political relations affect the board structure of S&P 1500 companies—specifically the proportion of foreign independent directors (FIDs). I find strong empirical evidence that when bilateral political relations between a country and the US are poor, the proportion of FIDs from that country hired by US firms is small. The threat of a firm losing technology and insider information to countries with poor political relations are considered costs by US firms, so when firms do hire FIDs from countries that

have poor political relations with the US, I empirically show that the benefits are greater than the costs. I conclude the third study with an M&A analysis, which finds that firms have a high proportion of FIDs from countries where their acquisition targets exist and bilateral political relations do not influence such a proportion.

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# Abbreviations

- $2SLS-Two\ Stage\ Regression$
- US United States of America
- ADR American Depositary Receipt
- FID Foreign Independent Director
- M&A Merger and Acquisition

# **CHAPTER 1: Introduction**

A number of previous studies have examined the impact of bilateral political relations on bilateral trade and find that deterioration in political relations has a significant negative impact on trade. Long (2008), Hegre, O'neal and Russett (2010) and Morrow (1999) observe the impact of military conflict on bilateral trade, while Simmons (2005) considers how disputes over territories also influence trade. Recent studies (e.g., Michaels and Zhi (2010); Dajud (2013)) focus more on less extreme cases, such as the existence of conflicting political objectives instead of wars and military conflict, because such extreme cases rarely occur these days, and data on the annual frequency of less extreme cases are available to researchers from the United Nations General Assembly voting records.

Some previous studies in politics note that the United Nations does not present a perfect image of broader international politics and that UN votes are often considered irrelevant from the perspective of international politics (Russett (1966); Alesina and Weder (2002)). However, the UNGA is the only international arena where we can observe its more than 150 members vote on a variety issues of global concern (Russett (1966); Voeten (2009)) and where there is empirical evidence showing that patterns of UN votes are highly correlated with alternative measures of political alignment, such as alliances and similar interests (Alesina and Weder (2002)). Alam (2012) finds that such voting patterns across a range of issues can be a useful gauge of UN member states' general political orientations, observing that voting alignments over time can help pinpoint changes in political orientation. For the purposes of this thesis, I believe that such characteristics of the UNGA voting system make these votes a good candidate for depicting political alignment or misalignment.

To the best of my knowledge, none of the previous studies has examined whether bilateral political relations influence something other than bilateral trade (Gupta and Yu (2007); Dajud (2013), etc), cross-border acquisitions (John, Lee and Qi (2016); Bertrand, Betschinger and

Settles (2016); Zhang and Mauck (2017)) and sovereign wealth fund investment (Knill, Lee and Mauck (2012); Johan, Knill and Mauck (2013)), and through this thesis, I empirically show that bilateral political relations also have an impact on media coverage (chapter 2), institutional ownership (chapter 3) and board structure (chapter 4).

The second chapter of my thesis examines whether bilateral political relations influence media coverage. Media is a key element in the development of financial markets, as it provides a large amount of quality information to investors on financial assets and their issuers. Engelberg, Reed and Ringgenberg (2012) find that a substantial portion of short sellers' trading advantage comes from their ability to analyze publicly available information. However, there have always been doubts about whether news reporters can separate their personal opinions from the subjects that they cover (Gurun and Butler (2012); Lin and McNichols (1998); Michaely and Womack (1999); Gunther (1992); Dalton, Beck, and Huckfeldt (1998); Gentzkow and Shaprio (2006); Kempner (2001)). Instead of examining the tone of the news, in this chapter, I consider dissemination of more negative news or positive news because it also represents possible media choice or bias. The media are not obliged to report every piece of news about firms and can suppress negative or positive news if they are so inclined.

Using a panel of 2,309 ADR firms from 45 countries and annual UNGA voting data, I empirically show that political proximity has an impact on the US media dissemination toward ADR firms. The US media disseminates more negative news toward ADR firms from countries that have poor political relations with the US. The data for a list of news comes from RavenPack News Analytics, a leading global news database which has recently been used in finance research (e.g., Kosinski, Reed, and Ringgenberg (2013); Dai, Parwada, and Zhang (2015); Shroff, Verdi, and Yu (2014); Dang, Moshirian, and Zhang (2015)). To

address the endogeneity issue, the difference-in-difference and instrumental variable approaches are used.

Next, I test whether such media negative dissemination has an impact on stock performance. Unlike Tetlock (2007), who built media sentiment proxy based on one *Wall Street Journal* column issued every morning, I use all RavenPack news data available from the ADR firms' home market's closing time on the previous day to the market closing time of the day for each country. I find results that are consistent with the previous literature: high media pessimism predicts low returns at short horizons and reversion to fundamentals at longer horizons. However, I am more interested in the role political relations play in the media's impact on stock returns. I closely look into the downward pressure of negativity of the US media on ADR firms' home market stock returns.

I find that when political relations between non-US countries and the US are poor, the degree of negative impact on stock returns from the negativity of the US media is reduced, suggesting that investors already know that the US media report more negative news on ADR firms when political relations are poor. I claim this because if investors already know that the US media are more pessimistic compared to the fundamental value when political relations are poor, investors will react less to such negative news. Luo, Manconi and Massa (2016) find that investors overreact to *perceived* media bias (investors' perceived change in media bias), while my results indicate that investors also react to *real* media bias (actual change in bias).

I conclude the second chapter of the thesis with results showing that ADR firms that had negative US media coverage in the previous year are more likely to terminate their ADRs. Previous studies only look into ADR firms that directly cross-list into the US market (i.e., Level 2 and 3 ADRs and direct ordinary listings). In my chapter, I expand from this barrier and include all levels of ADR firms and test whether poor political relations lead to the termination of ADRs. My political proximity variables are used as instrumental variables in 2SLS analysis to show that the US media are a possible channel through which political relations influence firms' decisions on ADR termination; my results support this.

In the third chapter of my thesis, I examine whether bilateral political relations influence institutional investors. With globalization, foreign capital has become an important source of finance in many capital markets, and foreign investors have started to allocate more of their money abroad (Leuz, Lins and Warnock (2009); Bekaert, Harvey and Lumsdaine (2002); Khorana, Servaes and Rufano (2005)). The role of foreign institutional investors has been covered by number of previous studies (Gillan and Starks (2003); Ferreira and Matos (2008); Aggarwal, Ferreira and Matos (2011)). However, few studies have examined why investors (de-)invest outside of their country; in this chapter, I suggest that conflicts over political objectives are a factor that hampers investors in regard to allocating their money abroad.

Using unique ownership data from the FactSet/LionShares database, I find strong empirical evidence of a direct correlation between political proximity and the level of US institutional ownership in ADR firms. My results show that when bilateral political relations between a country and the US are poor, the level of US institutional ownership is low for ADR firms from that country. Furthermore, I also show that the number of US institutional investors is affected by political relations as well. To address the endogeneity issue, difference-in-difference and instrumental variable approaches are used.

Following previous studies like Ferreira and Matos (2008), the impact of US institutional ownership on firm value is also examined in this chapter. I find that US institutional ownership has a positive correlation with Tobin's Q. As an additional test to investigate whether the level of US institutional ownership promotes better corporate governance, I also review class action lawsuits and firms' voluntary disclosure practices. I empirically show that firms are less likely to get sued, and firms produce more earnings press-release news, when there is large ownership of US institutional investors. Furthermore, from 2SLS regressions with two political proximity variables as instrumental variables, I directly show that US institutional ownership is a channel through which political relations influence corporate governance.

The fourth chapter covers the impact that bilateral political relations have on board structure. Empirical studies of board structure look into how the board structure is related to firm characteristics (Boone, Field, Karpoff, and Raheja (2007); Coles, Daniel, and Naveen (2007); Linck, Netter and Yang (2008)) and find that complex firms have larger and independent boards because the benefits from effective monitoring by outsiders outweigh the increase in monitoring costs. Furthermore, firms with high growth and a high level of information asymmetry (measured by market-to-book ratio, R&D expenditures and the standard deviation of monthly returns) have smaller and less independent boards because transferring firm-specific information to outsiders is costly for such firms. However, very few previous empirical studies have examined what influences the proportion of foreign independent directors (FIDs) inside a board.

The main focus of the fourth chapter is to examine whether bilateral political relations influence the proportion of FIDs within S&P 1500 firms. FIDs are defined as independent directors domiciled in foreign countries. My examination of the boards of S&P 1500 companies from 2000 to 2013 reveals that the proportion of FIDs from countries with poor political relations in the boards of US firms is small. To address the endogeneity issue, difference-in-difference and instrumental variable approaches are used.

In this chapter, I also show that the negative impact of poor political relations on the

proportion of FIDs is worse for firms with high innovation and a high level of information asymmetry. I use yearly research and development costs scaled by total assets to measure the level of innovation of firms and the standard deviation of monthly stock returns to measure the level of information asymmetry of firms. Overall, my results show that it is costlier for firms with high innovation and a high level of information asymmetry to have FIDs from countries that have poor political relations with the US on their boards. Possible technology leakage and possible insider information leakage are considered to be costs by US firms when they hire FIDs. Furthermore, when my sample was closely observed, some firms with high innovation and a high level of information asymmetry still hire FIDs from countries that have poor political relations with the US. My analysis of return on assets and Tobin's Q suggests that when firms choose to have FIDs from countries with poor political relations with the US, there are benefits that outweigh the costs of possibly losing technology or insider information.

I conclude my fourth chapter of the thesis by showing that firms have a high proportion of FIDs from a country in the year and in the year before they announce an M&A with firms from that country. Two years before the acquisition, the proportion of FIDs from that country is not related to the M&A announcement. This infers that M&A announcements and the proportion of FIDs are highly correlated because it is beneficial to have FIDs from targets' home countries (Masulis, Wang and Xie (2012)). FIDs have a better understanding of the institutions and culture of the country. I further test whether political relations influence the correlation between the proportion of FIDs and M&A announcements. The interaction terms, along with my political relation variables, indicate that poor political relations would not stop firms from hiring FIDs from targets' home countries before the cross-border M&A activity. Again, the benefits outweigh the costs.

The remainder of this thesis is organized as follows. Chapter 2 examines the impact of

bilateral political relations on media dissemination. Chapter 3 examines the impact of bilateral political relations on institutional ownership. Chapter 4 discusses the impact of bilateral political relations on board structure. Finally, Chapter 5 concludes this thesis.

# **CHAPTER 2: Political Relations and Media Coverage**

### 2.1. Introduction

The media are a key element in the development of financial markets, as they provide a large amount of quality information to investors on financial assets and their issuers. Engelberg, Reed and Ringgenberg (2012) find that a substantial portion of short sellers' trading advantage comes from their ability to analyze publicly available information. However, there have always been doubts about whether news reporters can separate their personal opinions from the subjects that they cover. Gurun and Butler (2012) document that local media write more favorably about local firms because of local firms' advertising expenditures. Other studies have shown that analysts issue biased and overoptimistic reports to secure current and future investment banking business for the brokerage firms with which they are affiliated (Lin and McNichols (1998); Michaely and Womack (1999)). Additionally, the media could be biased in a way that they conform to readers' views (Gunther (1992); Dalton, Beck, and Huckfeldt (1998); Gentzkow and Shaprio (2006); Kempner (2001)).

Previous studies show that media coverage is influenced by geographical proximity (O'Brien and Tan (2015); Koopmans and Vliegenthart (2011)), economic proximity (Wu (2000) and cultural proximity (Wu (2000); Du, Yu, and Yu (2014)). This article examines the impact of political proximity on US media coverage. In the study of economics, a number of studies have found a negative link between poor political relations and economic flow (Gupta (2007); Michaels and Zhi (2010); Dajud (2013)). I expect that poor political relations between the US and other countries will also have a negative impact on the US media when they disseminate news about foreign firms with American Depositary Receipts (ADRs). I examine only firms with ADRs because ADR firms receive wide coverage among analysts and the press (Baker, Nofsinger and Weaver, 2002; Bailey, Karolyi and Salva, 2003; Lang, Lins and Miller, 2003).

Using a panel of 2,309 ADR firms from 45 countries, I empirically show that political proximity has an impact on the US media dissemination toward ADR firms. I first create my measure of political relations with yearly UN General Assembly votes. Empirical evidence shows that patterns of UN votes are highly correlated with an alternative measure of political alignment, such as alliances and similar interests (Alesina and Weder (2002)). Following Alam (2012), I believe that such characteristics of the UNGA voting system make these votes a good candidate for depicting political alignment or misalignment for the purposes of this chapter. My results show that the US media disseminate more negative news toward ADR firms from countries that have poor bilateral political relations with the US. To proxy for the negativity of US media, I count the annual fraction of positive and negative news for each ADR firm by using RavenPack's sentiment score—the Event Sentiment Score (ESS). The evidence is robust for different proxies of political proximity and alternative methods for estimating media negativity. To mitigate the endogeneity concern, I use the difference-indifference method, which provides a causal link between the political proximity and the negativity of the media.

To employ the difference-in-difference (DiD) estimator, I look for any abnormal shock in the UN voting pattern of non-US countries in terms of alignment with the US vote. Specifically, I examine voting patterns on *important* Human Rights issues and *important* Palestine issues. *Important* votes (defined by the US Department of State) are votes on issues that directly affect US interests and on which the US has lobbied extensively. I find that some countries had consistently voted in line with US with regard to those two topics previously but unexpectedly cast a vote against the US position on December 22, 2007 and November 29, 2012, respectively, for *important* Human Rights issues and *important* Palestine issues. Firms from those countries with unexpected disagreement with the US are included in the treatment group. Firms from countries that consistently disagreed with the US previously as well as on those dates are included in the control group.

Treatment and control firms are matched by propensity score before completion of the DiD analysis. I analyze the two-week period before and after December 22, 2007 and November 29, 2012 and show that firms in the treatment group receive more negative news from the US media after those dates relative to control firms. Only two weeks are considered because the impact of such political shocks tends to be relatively short, as indicated by Du, Ju, Ramirez and Yao (2017). Overall, the results indicate that when I take UN voting as a proxy for political relations, the US media react to an unexpected deterioration in political relations and disseminate more negative news toward ADR firms from countries with temporary political shock with the US.

To further address the endogeneity issue, I use the instrumental variable approach. Following Dajud (2013), I use the Physical Integrity Rights Index (*PRI*) as an instrumental variable because human rights issues are perhaps the most contentious issue in the United Nations. For this reason, most votes occur on resolutions directly or indirectly related to human rights. Additionally, following Dreher and Jensen (2013), I use leader change of a country, *LC*, as an additional instrumental variable. They empirically show that on average, new leaders vote more frequently in line with the US on key votes. This additional analysis with two instrumental variables corroborates my main findings that poor political relations have a negative impact on US media dissemination.

Apart from the government level of proximity, I also test how US citizens' views of a country affect the US media. Following Hwang (2011), I measure each country's popularity among Americans by using Gallup surveys. My results show that when a country is favored by US citizens, ADR firms from that country tend to receive less negative news from the US

media. I also show that such popularity is influenced by political proximity, which infers that US citizens' views of the country is a possible channel through which political proximity influences US media coverage.

Next, to test whether media negativity has an impact on stock performance, I regress the daily version of my dependent variable from the main result, *NegNews*, on daily abnormal stock returns of ADR firms in their home country. To obtain daily measure of *NegNews*, I use the market closing time of each country. Unlike Tetlock (2007), who built a media sentiment proxy based on one *Wall Street Journal* column issued every morning, I use all RavenPack news data available from the ADR firms' home market closing time of the previous day to the market closing time of the day for each country. Each country has a different market closing time as the following day's news. RavenPack news data are based on Greenwich Mean Time (GMT), which is not adjusted to daylight saving time<sup>2</sup> and I adjust RavenPack data time according to daylight saving seasons for each country.

Daily returns of ADR firms in their home markets from January 3, 2000 to December 31, 2013 are collected from Worldscope, and I find results that are consistent with previous studies: high media pessimism predicts low returns at short horizons and reversion to fundamentals at longer horizons. However, I am more interested in the role political relations play in the media's impact on stock returns. Further, I closely examine the downward pressure of US media negativity on ADR home market stock returns. First, I regress daily

<sup>&</sup>lt;sup>1</sup> Market Closing Time data provided by Worldscope

<sup>&</sup>lt;sup>2</sup> Time is adjusted to daylight saving time for Argentina, Australia, Austral, Belgium, Brazil, Canada, Chile, Cyprus, Czech Republic, Denmark, Egypt, Finland, France, Germany, Greece, Hungary, Ireland, Israel, Italy, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Pakistan, Poland, Portugal, Russia, Spain, Sweden, Switzerland, Turkey, and the United Kingdom.

abnormal stock returns on daily US media negativity by every firm year to find the intensity of the US media's impact on stock returns for every firm year.

I find that when the political relations between non-US countries and the US are poor, the degree of negative impact on stock returns from US media negativity is reduced, suggesting that investors already know that the US media report more negative news on ADR firms when political relations are poor. I claim this because if investors already know that the US media are more pessimistic compared to the fundamental value when political relations are poor, investors will react less to such negative news. Luo, Manconi and Massa (2016) find that investors overreact to *perceived* media bias (investors' perceived change in media bias), while my results indicate that investors also react to *real* media bias (actual change in bias).

Finally, I conclude this chapter with results showing that ADR firms that had negative media coverage in the previous year are more likely to terminate their ADRs. Previous studies have only considered ADR firms that directly cross-list into the US market (i.e., Level 2 and 3 ADRs and direct ordinary listings). In this chapter, I expand from this barrier and include all levels of ADR firms and test whether poor political relations lead to termination of ADRs. My political proximity variables are used as instrumental variables in 2SLS analysis to show that the US media are a possible channel through which political relations influence firms' decision on ADR termination; my results support this.

I make contributions to the various strands of the corporate finance literature in number of ways. First, no studies have established a direct correlation between political proximity and the media. I provide empirical support for political proximity having a direct impact on the US media. Second, this chapter also expands on previous studies by examining the impact of media negativity on stock performance with a more recent dataset and better source of media data. My media data source, RavenPack, enables me to remove "repeated" news and "noisy"

news from my dataset to create "unique" and "firm-relevant" news so that my results are not driven by any news that is repeated and noisy. Furthermore, expanding on the previous literature by considering the media's role in stock returns (e.g., Tetlock (2007); Fang and Peress (2009); Garcia (2013)), I use firm-specific news data to test the role of political proximity in correlation between the media and stock returns. Finally, I contribute to the existing literature that considers factors driving firms to cross-(de)list (e.g., Karolyi (1998); Sarkissian and Schill (2004); Daugherty and Georgieva (2011)). I focus on termination of all levels of ADR firms and show that negative media coverage can influence the likelihood of termination of ADRs.

Chapter 2 is structured as follows. Section 2.2 outlines the literature review and hypothesis development. Section 2.3 describes the sample and data collection. Section 2.4 reports the main results, and Section 2.5 presents additional tests. Section 2.6 concludes chapter 2

### 2.2. Hypothesis

### 2.2.1. Media Coverage and Political Proximity

A number of previous studies focus on the impact of geographic proximity on media coverage. Gurun and Butler (2012) find that local media report more favorably about local companies and O'Brien and Tan (2015) show that analysts are 80% more likely to cover IPO firms headquartered in their home states than those in other states. Additionally, Jones, Aelst, and Vliegenthart (2011) examine whether geographic proximity to the US influences visibility in different periods such as post-Cold War years and the post-9/11 period, while Koopmans and Vliegenthart (2011) document the persistent influence of distance on foreign news coverage.

Apart from geographic proximity, Wu (2000) finds the extension of a country's economic proximity and cultural proximity with other countries may affect news coverage. Du, Yu, and Yu (2014) examine cultural proximity using the data of a group of US analysts of Chinese ethnic origin and find that analysts of Chinese ethnicity issue more accurate forecasts about earnings of Chinese firms. They also find market reaction is stronger if analysts of Chinese ethnicity revise their forecasts upwards to issue favorable recommendations about a Chinese firm. What about political proximity?

In the field of economics, numerous papers find a negative link between political proximity and economic flow. Gupta and Yu (2007) find that deterioration in bilateral relations is followed by a significant decrease in economic flows between the US and a country. Michaels and Zhi (2010) estimate that French opposition to the Iraq War in the United Nations Security Council led to a reduction in French imports and exports to and from the US. Empirically, Dajud (2013) finds that political differences have an impact on bilateral trade that is robust to a wide range of econometric specifications. However, no evidence has been found on whether political proximity affects media coverage, which I test in this chapter.

I consider dissemination of more negative news or positive news is also a possible choice or a possible bias of the US media similar to using more negative or positive words in the news. The US media are not obliged to report on every piece of news about firms and can suppress negative or positive news if they so choose. As previous economic studies find that poor political relations have a negative impact on economics, I hypothesize that poor political relations have a negative impact on the US media. In other words, I test whether the US media report more negative news on ADR firms because their home countries are having poor political relations with the US. One possible reason for this is because the US media could be biased in a way that the media conform to readers' views (Gunther (1992); Dalton, Beck, and Huckfeldt (1998); Gentzkow and Shaprio (2006); Kempner (2001)). When political relations are poor, US citizens will favor those countries less, meaning that US citizens may not want to see positive news about firms from those countries, which could lead to more negative news from the US media. This is similar to the *catering hypothesis* from Gurun and Butler (2012), which claims that local media may write favorably about local firms because employees of local firms are more likely to be the audience of local newspapers.

Hypothesis 1a: Poor bilateral relations between a country and the US negatively affect the US media when it disseminates news about ADR firms.

*Hypothesis 1b: US citizens' country favorability is a possible channel through which poor bilateral relations influence US media coverage of ADR firms* 

### 2.2.2. Media Coverage and Stock Performance

Recently, there has been an increase in the number of studies documenting an association between media dissemination and stock market activity (Dyck and Zingales (2003); Tetlock (2007); Fang and Peress (2009); Griffin, Hhirschey and Kelly (2011); Sprenger and Welpe (2011); Garcia (2013); Ahmad, Kearney and Liu (2013); Peress (2014); Ferguson, Philip, Lam, and Guo (2015); Twedt (2016)). Previous studies have suggested that the breadth and sentiment of information dissemination affect stock returns. In this chapter, I focus on Tetlock (2007), who uses Dow Jones Industrial Average daily returns and finds that high media pessimism predicts downward pressure on market prices followed by a partial reversion to fundamentals.

If investors are aware of the fact that bilateral political relations influence the US media, then the downward pressure from negative US media dissemination on stock returns will be reduced. This is because if investors already know that the US media is more pessimistic compared to the fundamental value when political relations are poor, investors will react less to such negative news. This is somewhat similar to Luo, Manconi and Massa (2016), who find that after acquisition of *Dow Jones Newswire* by News Corp, investors overreact to *perceived* media bias even though there is no change in the relative sentiment about Republican and Democratic stocks after acquisition. In my case, I show how *real* media bias influences investors. Consistent with previous studies, using daily abnormal stock returns of ADR firms in their home market, I expect that US media negativity on the day before the market closing time will have downward pressure on stock prices. Furthermore, I hypothesize that such downward pressure is attenuated when political relations are poor if investors perceive the fact that the US media are negatively influenced by poor political relations.

Hypothesis 2: Downward pressure on stock prices from US media negativity is reduced when political relations are poor if investors perceive the fact that poor bilateral political relations negatively affect the US media.

### 2.2.3. Cross-(de)listing

There are many reasons why a non-US firm may choose to cross-list their shares in the US, including 'improved access to capital, greater liquidity, lower capital costs, heightened corporate prestige, and the greater investor protection for minority shareholders that tougher US securities regulations confer upon such firms' (Karolyi (1998)). Sarkissian and Schill (2004) test for geographic and other forms of proximity biases in the overseas financing market and conclude that geographic, economic, cultural and industrial proximity of foreign stock exchanges between two countries plays an important role in host market selection. Their finding suggests that firms prefer to cross-list in countries that are close-to-home markets and share similar language or colonial era ties. Additionally, firms cross-list in the market with which their countries trade heavily and have a similar industrial base to their home country.

Daugherty and Georgieva (2011) find that the cultural aspect plays an important role in the cross-delisting decisions of foreign firms in the US. However, no research has been done on the role of the political aspect in the cross-(de)listing decision. I expect that poor bilateral political relations through US media coverage will stimulate ADR firms' decision to terminate their ADRs. There could be number of direct sanctions from US government towards countries with poor political relations with US, such as economic and financial sanctions that adversely affect ADR firms' business – this would lead to termination of their ADRs. However, in this chapter, I show how the indirect factor – *negative media coverage* – influence the ADR firms' decision on termination. As I state in Hypothesis 1a, I believe that poor political relations have negative impact on US media coverage when they disseminate news about non-US firms. Such negative media coverage will make US investors lose their interest on ADR firms and reduction in US investors can incite termination of firms' ADRs.

In this chapter, I empirically test that poor political relations encourage ADR firms to terminate their ADRs following negative media coverage.

Previous studies have focused on ADR firms that are cross-listed into the US market (i.e., Level 2 and 3 ADRs and direct ordinary listing). I include all levels of ADR firms and test whether ADR firms are more likely to terminate their ADRs when bilateral political relations between the US and their home-countries are poor.

Hypothesis 3: Poor political relations encourage ADR firms to terminate their ADRs following negative media coverage

### **2.3.** Data and Sample

### 2.3.1. Sample (American Depositary Receipt)

Karolyi (1998) gives a detailed explanation of American Depositary Receipts (ADR) and states that the ADR is the most popular vehicle through which firms outside the US cross-list their shares in the US. The ADR is a negotiable certificate issued by a US bank representing a specified number of shares in a foreign stock traded on a US exchange. ADRs provide an interesting opportunity for US investors as US investors can enjoy benefits of international diversification without going abroad and trading shares on foreign stock exchanges. Such diversification benefits from ADRs are demonstrated by Errunza, Hogan, and Hung (1999). There are four different levels of ADRs, which have different levels of accounting disclosure obligations.

Level 1 ADRs trade over-the-counter as OTC Bulletin Board or Pink Sheet issues with no capital-raising activity and require only minimal SEC disclosure and minimal GAAP compliance. In contrast, Level 2 and Level 3 ADRs are exchange-listed securities that require stricter SEC disclosure and compliance with an exchange's own listing rules. Rule 144A are capital-raising issues in which securities are privately placed to qualified institutional buyers and as a result do not require compliance with GAAP or SEC disclosure.

Following previous studies that find that cross-listed ADR firms receive wide coverage among analysts and the press (Baker, Nofsinger and Weaver, 2002; Bailey, Karolyi and Salva, 2003; Lang, Lins and Miller, 2003), I consider all levels of ADRs to observe whether political relations affect the US media when they disseminate news about foreign firms. I believe that even the ADR firms that are not cross-listed in US markets (Level 1 and 144A) still attract the US media's attention because they are intriguing investment opportunities for American investors. My sample consists of all the news for 2,309 non-US companies from 45 countries with American Depositary Receipts from January 2000 through December 2013. To construct a sample that is not biased toward recent ADR events, I use many different data sources for my cross-listing database. Data on non-US firms listing in the US market with ADRs are obtained from the primary depository institutions: Citibank, Bank of New York, JP Morgan, and Deutsche Bank. All institutions have a part of the information, and no individual database includes all US cross-listings available. I add to this information data collected directly from the stock exchanges of non-US listings (including Canadian firms that list directly on US exchanges) from Worldscope.

### 2.3.2. Variables

#### 2.3.2.1. News Variable

The data for a list of news come from RavenPack News Analytics, a leading global news database which has recently been used in finance research (e.g., Kolasinski, Reed, and Ringgenberg (2013); Dai, Parwada, and Zhang (2015); Shroff, Verdi, and Yu (2014); Dang, Moshirian, and Zhang (2015)). RavenPack collects and analyzes real time, firm-level business news from leading news providers, including *Dow Jones Newswire, The Wall Street Journal, Barron's*, and other major publishers. RavenPack also measures news flows and the informational content of news articles across 100 countries, and in this chapter, I only consider reliable US media sources such as *Dow Jones Newswire* and *The Wall Street Journal*<sup>3</sup> because the focus of the chapter is how the US media reacts to political relations. Furthermore, the types of news (e.g., news flash, full article, press release etc) are also given

<sup>&</sup>lt;sup>3</sup> Out of 5 levels of source reliability, I use first- and second-ranked media sources so that my news data are from reliable sources.
in the RavenPack dataset and I delete any news that are press release<sup>4</sup> because it is news report that is written by firms and distributed by the US media. Press-release news does not capture the biasness of the US media.

Among the number of sentiment scores in RavenPack, I use the main sentiment score—the event sentiment score (ESS), which is determined by systematically matching stories typically categorized by financial experts as having short-term positive or negative financial or economic impact. By using ESS, I count the annual number of negative news stories and annual number of positive news stories for each firm. In addition to the news-sentiment score types, RavenPack also provides two other related measures: 1) the event-novelty score (ENS), which represents how novel a news article is, and 2) the news-relevance score (NRS), which indicates how relevant a news article is to a given firm. The ENS variable enables me to distinguish "unique" news from repeated news, while the NRS variable enables me to remove potentially noisy news and focus only on firm-relevant news. I match the list of ADRs to RavenPack news data. I only consider firms with ADRs because foreign firms with ADRs attract US media coverage, such as by *Dow Jones Newswire*.

#### 2.3.2.2. Political Relations

Following previous studies (Dajud (2013); Gupta and Yu (2007)), I construct a measure of political proximity—bilateral political relations—based on voting data from the United Nations General Assembly collected from the US Department of State. This measure provides for each year and for each country, how many UN votes are identical to and in opposition to US votes as well as abstaining and absent votes. I define my political proximity

<sup>&</sup>lt;sup>4</sup> The press release is a written communication directed at members of the news media for the purpose of announcing something ostensibly newsworthy. Such news represents facts about a firm that are not affected by political relations.

variable—*VoteDisagreeus*—as the number of votes cast by a country at the United Nations that are not identical to the US vote scaled by the total number of votes, which is the sum of identical votes, opposing votes, abstentions and absences for each country. Additionally, I collect another political proximity variable—*VoteDivergeus*—which measures the UN vote dissimilarity (-1 of correlation—s2un) from Erick Voeten Dataverse<sup>5</sup>. Voeten's (2009) data capture UN General Assembly voting coincidence between the US and its trading partners, thus aiming to capture the degree of political alignment between the two. It is available up to the year 2012.

Some previous studies in politics note that the United Nations does not give a perfect image of broader international politics and that UN votes are often considered fairly irrelevant from the perspective of international politics (Russett (1966); Alesina and Weder (2002)). However, UNGA is the only international arena where we can observe its more than 150 members vote on a variety issues of global concern (Russett (1966); Voeten (2009)) and there is empirical evidence showing that patterns of UN votes are highly correlated with alternative measure of political alignment, such as alliances and similarity of interests (Alesina and Weder (2002)). Alam (2012) find such voting patterns across a range of issues can be a useful gauge of the general political orientations of UN member states, and observing voting alignments over time can help pinpoint changes in the political orientation. I believe that such characteristics of the UNGA voting system make these votes a good candidate for depicting political alignment or misalignment for the purposes of this chapter.

## 2.3.2.3. Control Variables

Firm-level accounting data are collected from Worldscope. I control for firm-specific

<sup>&</sup>lt;sup>5</sup> https://dataverse.harvard.edu/dataset.xhtml?persistentId=hdl:1902.1/12379

characteristics that are likely to be correlated with media negativity in regression analysis. All firm-level control variables are measured at the beginning of the year. I include size of a firm (*Size*), Tobin's Q (*TobinQ*), leverage (*Leverage*) and return on equity (*ROE*). *Size* is the log of market value of firms (Worldscope datatype - MV) and *TobinQ* equals market capitalization (WC08001) plus total liabilities (WC03351) divided by sum of common equity (WC03501) and total liabilities (WC03351). *Leverage* is calculated as long-term debt (WC03251) divided by total assets (WC02999), while *ROE* is given from Worldscope from its variable—WC08301.

I also include four country-level control variables: log of GDP per capita (*GDPCapita*), GDP growth (*GDPGrowth*), net percent equity flow (*Investhareus*) and economic flow (*TradeShareus*). GDP per capita and GDP growth are collected from World Development Indicators<sup>6</sup>. Net percent equity flow is collected from Treasury International Capital and defined as the difference of "Annual Gross sales of foreign stocks by foreigners to US residents" and "Annual Gross purchases of foreign stocks by foreigners from US residents" divided by the sum of annual gross sales and annual purchases of foreign stocks by foreigners to/from US residents, while economic flow data are collected from the UN Comtrade Database<sup>7</sup> measured as total trade inflow and outflow to/from the US for each country divided by total import and export of the US to the rest of the world. Summary statistics are provided in Table 2-1.

<sup>&</sup>lt;sup>6</sup> http://data.worldbank.org/data-catalog/world-development-indicators

<sup>&</sup>lt;sup>7</sup> http://comtrade.un.org/data/

Table 2-1	Summary	Statistics
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Panel A		N	Mean		STD	P1		Q1	Median	Q3	P99
NegNews		16,833	-0.249		0.379	-1.000		-0.489	-0.273	-0.031	1.000
$VoteDisagree_{US}$		585	0.465		0.170	0.059		0.339	0.456	0.577	0.829
<i>VoteDiverge</i> <sub>US</sub>		534	0.247		0.374	-0.918		0.000	-0.214	0.583	0.843
Size		16,833	15.187		2.189	9.262		13.973	15.355	16.672	18.759
Leverage		16,833	0.163		0.142	0.000		0.032	0.143	0.253	0.529
ROE		16,833	5.628	3	34.676	-132.640	0	2.180	10.010	18.360	57.470
TobinQ		16,833	1.678		1.292	0.593		1.024	1.261	1.813	7.876
$TradeShare_{US}$		585	0.019		0.035	0.000		0.003	0.007	0.016	0.181
$InvestShare_{US}$		585	0.017		0.097	-0.240		-0.031	0.011	0.058	0.304
GDPCapita		585	9.642		1.181	6.610		8.800	10.000	10.600	11.500
GDPGrowth		585	3.005		3.349	-7.000		1.300	3.100	4.900	10.000
Panel B	NegNews	<i>VoteDisagree</i> <sub>US</sub>	VoteDiverge <sub>US</sub>	Size	Leverage	ROE	TobinQ	$TradeShare_{US}$	$InvestShare_{US}$	GDPCapita	GDPGrowth
NegNews	1.000	-0.046	-0.027	0.002	0.059	-0.234	-0.193	0.022	-0.063	0.060	-0.161
$VoteDisagree_{US}$	-0.029	1.000	0.948	0.080	0.022	0.178	0.025	-0.111	0.120	-0.575	0.382
<i>VoteDiverge</i> <sub>US</sub>	-0.007	0.952	1.000	0.121	0.023	0.167	-0.034	-0.127	0.127	-0.568	0.366
Size	0.007	0.105	0.152	1.000	0.288	0.216	-0.302	-0.086	0.019	0.026	-0.125
Leverage	0.053	-0.005	-0.002	0.246	1.000	0.065	-0.175	-0.118	0.008	-0.014	-0.077
ROE	-0.116	0.130	0.136	0.303	0.031	1.000	0.331	-0.177	0.026	-0.107	0.127
TobinQ	-0.113	-0.021	-0.058	-0.381	-0.209	-0.095	1.000	0.073	0.025	-0.016	0.158
$TradeShare_{US}$	0.017	-0.121	-0.151	-0.252	-0.105	-0.142	0.146	1.000	0.008	0.065	-0.030
InvestShare <sub>US</sub>	-0.042	0.205	0.206	0.028	-0.011	0.041	0.008	-0.026	1.000	-0.188	0.145
GDPCapita	0.049	-0.684	-0.680	0.012	0.026	-0.093	-0.014	0.080	-0.266	1.000	-0.393
appa I	0.124	0.427	0.414	0.000	0.002	0.077	0.000	0.072	0.011	0 501	1 000

Correlation Coefficients (Spearman for the upper-right part; Pearson for the bottom-left part)

## 2.4. Main results

Because I am interested in whether political proximity affects the US media, I focus on all levels of ADR firms since all levels of ADR attract the attention of the US media. I first present results on the impact of political proximity on the US media, after which I address the endogeneity issue with a difference-in-difference method and instrumental variable approach. Additionally, I test whether there is subsequent effect of political relations on media coverage and conclude this section with the first difference method as another methodology to support my main findings.

## 2.4.1. Baseline findings

Previous studies have considered some country factors that influence media coverage such as geographic proximity (Jones, Aelst, and Vliegenthart (2011); Gurun and Butler (2012) and O'Brien and Tan (2015)), economic proximity (Wu (2000)) and cultural proximity (Du, Yu, and Yu (2014)). In this chapter, I test another country aspect—political proximity—and show that political proximity is also a possible factor that influences US media coverage.

To test Hypothesis 1a—whether political relations have an impact on the US media—, I construct my proxy for media negativity by using a number of unique negative and unique positive news with the exception of the press release. RavenPack indicates what the news sources are, and I only consider reliable news sources that are based in the US such as *Dow Jones Newswire* and *The Wall Street Journal*. Unlike previous studies, such as Tetlock (2007) and Garcia (2013), which use one or two columns of news, I use every news from the US media that is unique (all subsequent news following the first story is not used) and 100% relevant for each company. I refer to my media negativity proxy variable as *NegNews*, which is calculated as:

$$NegNews_{i,c,t} = \frac{number \ of \ negative \ unique \ news - number \ of \ positive \ unique \ news}{number \ of \ total \ unique \ news}$$

I scale my main dependent variable by total number of unique news because some firms may have more media coverage than other firms. Large firms or those with well-known brand names would have been more likely to receive media coverage during my control period as well as at the time of first cross listing, so this is one of the ways to control for size or other firm characteristics that directly lead to greater media coverage (Liu (2005); Liu, Sherman, and Zhang (2009)).

I perform regression analysis at the firm level to examine the impact of political proximity on media negativity using following equation:

$$NegNews_{i,c,t} = \alpha + \beta_1 PP_{c,t} + \beta_2 X_{i,t} + \beta_3 Y_{c,t} + \Phi_c + \theta_t + \varepsilon_{i,c,t}$$

where the indices i, c and t correspond to firm, country and time, respectively.  $\Phi_c$  and  $\theta_t$  represent country- and year fixed-effects, and  $\varepsilon_{i,c,t}$  represents a firm-time specific error term, which is assumed be correlated within the firms and is heteroskedastic. As such, all standard errors and test statistics are robust to these two departures from the classical regression model (Petersen (2009)) and clustered at the firm-level.  $PP_{c,t}$  represents a political proximity variable, while X<sub>*i*,*t*</sub> represents firm-specific characteristics, including size, leverage, return on equity and Tobins's Q. Y<sub>*c*,*t*</sub> includes country-level control variables; log of GDP per capita, GDP Growth and net percent equity flow and economic flow.

I test two different measures of political proximity. *VoteDisagree*<sub>US</sub> is number of UN opposing votes (unidentical to US votes) cast by a country divided by total number of votes, and *VoteDiverge*<sub>US</sub> is the UN vote dissimilarity between US and non-US countries collected

from "The Affinity of Nations" database<sup>8</sup>. The evidence presented in Table 2-2 shows ADR firms from countries that have poor political relations with the US receive more negative news relative to positive news from the US media during the year. Both *VoteDisagree*<sub>US</sub> and *VoteDiverge*<sub>US</sub> have a positive coefficient with significance level at 1% with my dependent variable - *NegNews*. This provides evidence that poor political relation negatively affects US media coverage when it disseminates news on the non-US firms.

<sup>&</sup>lt;sup>8</sup> s2un: Values for the Affinity data range from -1 (least similar interests) to 1 (most similar interests). The Affinity data are coded with the "S" indicator ("S" is calculated as 1 - 2\*(d)/dmax, where d is the sum of metric distances between votes by dyad members in a given year and dmax is the largest possible metric distance for those votes, see Signorino and Ritter 1999) from 2 category UNGA vote data (1= "yes" or approval for an issue; 2 = "no" or disapproval for an issue), coded as follows: Code for Votes 1 for "Yes", 2 for "Abstain", 3 for "No", 8 for "Absent (country cast no vote and no evidence of non-participation)", 9 for "Non-member" (South Africa is coded as "55" for the 30<sup>th</sup> to 47<sup>th</sup> sessions)" - source: The Affinity of Nations.

## **Table 2-2 Baseline Findings**

In this table, I present regressions of political proximity variables on negativity of US media (NegNews). I run following regression:

 $NegNews_{i,t} = a + B_1Poltical_Proximity_{c,t} + X_{i,t} + Y_{c,t} + \varepsilon_{i,c,t}$ 

where *Political\_Proximity* is the ratio of opposing UN votes to US from a country (*VoteDisagreeUS*) and dissimilarity in UN voting between a country and US (*VoteDivergeUS*). X<sub>i,t</sub> includes firm level control variables—log of book asset value in US dollars (*Size*), total debt divided by total asset (*Leverage*), return on equity (*ROE*) and Tobin's Q (*TobinQ*) while Y<sub>c,t</sub> includes economic flow (*TradeShareUS*), net percent equity flow (*InvestShareUS*), log of GDP per capita (*GDPCapita*) and GDP growth (*GDPGrowth*). Results are obtained from regressions with year and country fixed effects. The values of the t-statistics in parentheses are based on robust standard errors clustered at the firm level.

Dep. Variable	NegNews				
	Model	Model			
	(1)	(2)			
VoteDisagreeus	0.254				
0	(3.24)				
<i>VoteDivergeus</i>		0.218			
		(5.41)			
Size	-0.004	-0.002			
	(-1.52)	(-0.86)			
Leverage	0.119	0.107			
	(4.61)	(3.92)			
ROE	-0.001	-0.001			
	(-8.05)	(-7.93)			
TobinQ	-0.028	-0.025			
	(-8.20)	(-7.03)			
TradeShareus	-0.119	-0.783			
	(-0.25)	(-1.36)			
InvestShareus	0.014	0.031			
	(0.27)	(0.59)			
GDPCapita	0.048	0.035			
1	(1.92)	(1.27)			
GDPGrowth	-0.014	-0.013			
	(-6.81)	(-6.32)			
Fixed Effects	Country/Year	Country/Year			
Observations	16,833	14,832			
R <sup>2</sup>	8.4%	9.1%			

## 2.4.2. Endogeneity tests

## 2.4.2.1. Exogenous Shock

## 2.4.2.1.1. Human Rights

To further investigate whether political proximity influences the US media, I employ the difference-in-difference (DiD) estimator to estimate the differences in media negativity between firms from countries with a political shock in relations with the US and firms from countries without any political shock. To perform such a test, I look for an abnormal voting pattern from any country, i.e., any voting not consistent with previous voting and I observe abnormality in *important* Human Right issues<sup>9</sup>. *Important* votes (defined by the US Department of State) are votes on issues that directly affect US interests and on which the US lobbied extensively.

Important votes in human rights are examined from 2000; 20 countries that had consistently voted in line with the US for important human rights issues unexpectedly voted against the US for "Report of the Human Rights Council" (Res/62/219) on December 22, 2007. Those countries are Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Portugal, Spain, Sweden, Switzerland and the United Kingdom. ADR firms from these countries are in the treatment group, while the control group includes firms from 11 countries—China, Egypt, India, Indonesia, Malaysia, Pakistan, Philippines, Russia, Singapore, South Africa and Thailand—that had consistently voted against the US all of the time regarding important human rights

<sup>&</sup>lt;sup>9</sup> Important human rights issues include "Globalization and Human Rights", "Human Rights in Iran", "Human Rights in Iraq", "Human Rights and Coercive Measures", "Human Rights in the Democratic Republic of the Congo", "Human Rights in Sudan", "Situation of Human Rights in Turkmenistan", "Human Rights in North Korea", "Situation of human rights in Myanmar " and "Human Rights in Belarus".

issues before December 22, 2007. On this date, the US voted "No" to Report of the Human Rights Council (Res/62/219), claiming "the Council's relentless focus during the year on a single country—Israel" while 150 countries voted in favor.

Treatment and control firms are matched by propensity score before performing differencein-difference analysis. When applying propensity score matching, I use all the control variables used in the main results except GDP measures because countries in control and treatment groups are largely different in terms of GDP. I also add another variable for propensity score—NewsGrowth—to help satisfy the parallel trends assumption, as the DiD estimator should not be driven by differences in any firm or country characteristics. To calculate NewsGrowth, I produce weekly NegNews prior to December 22, 2007, after which I subtract weekly NegNews of 1 week prior to the event date to weekly NegNews of 3 weeks prior to the event date. The dependent variable of the pre-matching process is equal to one if the firm belongs to the treatment group and zero otherwise. In the Panel A of Table 2-3, the probit model estimates are presented in column (1) with standard errors clustered at the country level. I then use the predicted probabilities, or propensity scores, from column (1) to perform nearest-neighbor propensity score matching. Before matching, I have 256 firms in the treatment group and 175 firms in control firms. Rather than creating unique matches, which causes significant drops in the number of samples, I use control firms more than one time, which results in duplicates of firms from the control group. The second column shows probit model results after propensity matching.

In Panel B, I examine the difference between the propensity scores of the treatment firms and those of the matched control firms. From the table, I can see that the difference is very small. Panel C reports the univariate comparisons between the treatment and control firms' characteristics and their corresponding t-statistics. No difference in *NewsGrowth* suggests that the parallel trends assumption is not violated.

Table 2-3, Panel D presents the DiD estimators. Column (1) reports the average change in the negativity of news for the treatment group, while Column (2) reports for the control group. The difference is computed by subtracting *NegNews* of two weeks prior to the event date from the *NegNews* of two weeks following the event date. The difference is averaged. In Columns (3) and (4), I report the DiD estimators, and the corresponding two-tailed t-statistics, testing the null hypothesis that the DiD estimators are zero, is statistically significant. This indicates that ADR firms from the treatment group receive more negative news from the US media relative to control firms after December 22, 2007. To further strengthen my result, I test it in a regression framework. I keep two observations for each firm: pre and post.

$$NegNews_{i,c,t} = \alpha + \beta_1 p_t \times d_i + \beta_2 p_t + \beta_3 d_i + \beta_4 X_{i,t} + \beta_5 Y_{c,t} + \varepsilon_{i,c,t}$$

where the indices i, c and t correspond to firm, country and time (pre or post period), respectively.  $\varepsilon_{i,c,t}$  represents the error term that is assumed to be correlated within the country and heteroskedastic. As such, all standard errors and test statistics are robust to these two departures from the classical regression model (Petersen (2009)) and clustered at the country level.  $p_t$  is a dummy variable equal to 1 for the days two weeks after December 22, 2007 inclusive, and 0 otherwise.  $d_i$  equals 1 for the treatment group and 0 for the control group.  $X_{i,t}$  represents firm-specific characteristics, including size, leverage, return on equity and Tobin's Q, while  $Y_{c,t}$  includes country-level control variables; log of GDP per capita, GDP growth and net percent equity flow and economic flow for year 2007. Table 2-3 Panel E shows that  $\beta_1$  is statistically positive and significant meaning that treatment firms receive more negative news from the US media than control firms after the event date. This result indicates that when the US media issue news, it is reacting to such political shock.

#### Table 2-3 Difference-in-Difference Analysis using Human Right issues voting

In this table, I present Difference-in-Difference (DiD) regression on *NegNews* with 22nd December 2007 as an event date. I find abnormal UN voting patterns from 20 countries on Human Rights issues that are "important" to US (i.e. different to previous consistent voting) on 22nd December 2007 and compare *NegNews* two weeks before and after the event date. Panel A presents parameter estimates from the probit model used to estimate propensity scores for firms in the treatment and the control groups. The dependent variable is one if the firm belongs to the treatment group and zero otherwise. Standard errors are clustered at country level and t-statistics are displayed in parentheses. Variables used to match include firm level control variables—log of book asset value in US dollars (*Size*), total debt divided by total asset (*Leverage*), return on equity (*ROE*), Tobin's Q (*TobinQ*) and trend in *NegNews* (*NewsGrowth*)—and country level variables—economic flow (*TradeShareus*) and net percent equity flow (*InvestShareus*). Panel B reports the distribution of estimated propensity scores for the treatment firms and the control firms, and the difference in estimated propensity scores post matching. Panel C reports the univariate comparisons between the treatment and control firms' characteristics and their corresponding t-statistics. Panel D provides the DiD test results and standard errors are given in parentheses. Panel E reports regression estimates of the *NegNews* of the treatment and the control firms surrounding the event date:

#### $NegNews_{i,t} = a + B_1 p_t X d_i + B_2 p_t + B_3 d_i + X_{i,t} + Y_{c,t} + \varepsilon_{i,t}$

where  $p_t$  is a dummy variable equal to 1 for the days after 22nd December 2007 (exclusive) and 0 otherwise.  $d_i$  equals 1 for the treatment group and 0 for the control group.  $B_i$  captures differences between the treatment group and the control group. The values of the t-statistics in parentheses are based on robust standard errors clustered at the country level.

Panel A: Prematch propensity Score Regression and Postmatch Diagnostic Regression					
	(1)	(2)			
	Prematch	Postmatch			
	d	d			
Size	0.157	0.094			
	(2.74)	(2.33)			
Leverage	0.857	0.875			
	(1.63)	(0.97)			
ROE	-0.001	0.001			
	(-0.81)	(0.38)			
TobinQ	-0.190	0.152			
	(-1.45)	(1.10)			
TradeShareus	-15.084	8.207			
	(-2.74)	(0.73)			
InvestShareus	-1.881	1.758			
	(-0.33)	(0.33)			
NewsGrowth	0.042	0.044			
	(0.46)	(0.47)			
Intercept	-1.008	-2.268			
	(-0.82)	(-2.47)			
Observations	431	512			
$R^2$	37.8%	4.1%			

Panel B: Estimated Propensity Score Distributions								
Propensity Scores	No. of Obs.	Min	p5	p50	Mean	SD	P95	Max
Treatment	256	0.072	0.463	0.794	0.769	0.154	0.965	0.984
Control	256	0.008	0.401	0.856	0.798	0.176	0.950	0.950
Difference		0.064	0.062	-0.061	-0.029	-0.022	0.015	0.034

Panel C: Estimated Propensity Score Distributions						
	Treatment	Control	Difference	std err	t-statistic	
Size	16.850	16.560	0.290	0.160	1.818	
Leverage	0.172	0.153	0.019	0.011	1.701	
ROE	19.394	18.146	1.249	2.804	0.445	
TobinQ	1.729	1.659	0.070	0.077	0.909	
$TradeShare_{US}$	0.037	0.027	0.010	0.002	3.938	
<b>InvestShare</b> us	0.016	0.014	0.002	0.004	0.633	
GDPCapita (Not used to match)	10.671	9.152	1.520	-1.337	-1.136	
GDPGrowth (Not used to match)	3.023	9.251	-6.228	0.157	-39.645	
NewsGrowth	0.057	0.021	0.036	0.118	0.302	

	Pan	el D: Difference-in-Diffe	erence Test	
	Mean Treatment Difference (after- before)	Mean Control Difference (after- before)	Mean DiD Estimator (treat-control)	t-statistic for DiD Estimator
NegNews	0.118	-0.225	0.342	6.109
Standard Errors	(0.0553)	(0.0566)	(0.0560)	

Panel E: Difference-in-Difference Analysis					
Dep. Variable	NegNews				
Variable	Model				
	(1)				
- V d	0.242				
$p \ge a$	0.542				
	(2.94)				
p	-0.224				
	(-2.00)				
d	-0.062				
	(-0.54)				
Size	-0.050				
	(-1.74)				
Leverage	0.625				
	(1.65)				
ROE	0.001				
	(1.78)				
TobinQ	-0.037				
	(-0.74)				
<i>TradeShare</i> <sub>US</sub>	-2.017				
	(-2.74)				
InvestShareus	0.059				
	((0, 0))				
<b>CDP</b> Capita	0.021				
GDI Capita	(1.08)				
CDPCrowth	(1.06)				
ODF GIOWIN	-0.000				
Observations	1,024				
$R^2$	8.4%				

## 2.4.2.1.2. Palestine Question

I observe another abnormality in voting by three countries on November 29, 2012 (UN code: A/RES/67/19), when the United Nations General Assembly adopted resolution 67/19 (hereafter, A/RES/67/19) which is a resolution upgrading Palestine to non-member observer state status in the United Nations. Before this resolution, there had been two annual important votes since 2006 regarding the "Palestine Question"<sup>10</sup>.

Those two votes are renewed annually, and the US has consistently voted "disagree" since 2006 for both topics because the US believes that "the continuation of this Committee that embodies institutional discrimination against Israel is inconsistent with UN support for the efforts of the Quartet<sup>11</sup> to achieve a just and durable solution of democratic Israeli and Palestinian states living in peace". Countries such as Canada, Australia and Israel have voted in line with the US regarding the "Palestine Question" since 2006, while countries such as China and South Africa have voted against the US every year. The treatment group in this section is firms from countries that unexpectedly voted against the US on November 29, 2012 for A/RES/67/19. I identify three countries—Australia, Japan and New Zealand—that unexpectedly voted against the US for A/RES/67/19. They agreed at least once with the US regarding the "Palestine Question" between 2006 and 2011. The control group includes firms from countries that have consistently voted against the US on the "Palestine Question" since

<sup>&</sup>lt;sup>10</sup> The first important vote I consider—"Committee on the Exercise of the Inalienable Rights of the Palestinian People"—requests the Committee to continue to exert all efforts to promote the realization of the inalienable rights of the Palestinian people, to support the Middle East peace process, and to mobilize international support for and assistance to the Palestinian people. The second important vote I consider—"Division for Palestinian Rights of the Secretariat"—requests the Secretary-General to continue to provide the Division with the necessary resources and to ensure that it continues to carry out its program of work as detailed in relevant previous resolutions, in consultation with the Committee on the Exercise of the Inalienable Rights of the Palestinian People and under its guidance. For more information, please visit the U.S. Department of State website.

<sup>&</sup>lt;sup>11</sup> The Quartet is a group comprised of the United States, the United Nations, the European Union, and Russia.

2006<sup>12</sup>. The time periods I test are two weeks before and after November 29, 2012 (15-day period, event date not included). Treatment and control groups are matched by propensity score.

When applying propensity score matching, I use all the control variables used in the main results except GDPCapita because it predicts the treatment group perfectly. I also add another variable for propensity score-NewsGrowth-to help satisfy the parallel trends assumption, as the DiD estimator should not be driven by differences in any firm or country characteristics. To calculate NewsGrowth, I produce weekly NegNews prior to November 29, 2012, after which I subtract weekly NegNews of 1 week prior to the event date to weekly NegNews of 3 weeks prior to the event date. The dependent variable of the pre-matching process is equal to one if the firm belongs to the treatment group and zero otherwise. In Panel A of Table 2-4, the probit model estimates are presented in column (1) with standard errors clustered at the country level. I then use the predicted probabilities, or propensity scores, from column (1) to perform nearest-neighbor propensity score matching. Before matching, I have 202 firms in the treatment group and 252 firms in the control groups. Rather than creating unique matches, which causes significant drops in the number of samples, I use control firms more than 1 time, which results in duplicates of firms from the control group. The second column shows probit model results after propensity matching. One thing to emphasize here is that NewsGrowth, which was a significant factor of determining the treatment group, is no longer significant after propensity matching. This indicates that new growth is not a factor that decides whether a firm is in the treatment or control group.

<sup>&</sup>lt;sup>12</sup> Control group countries are Argentina, Brazil, Chile, China, Cyprus, Egypt, Greece, India, Indonesia, Malaysia, Mexico, Pakistan, the Philippines, South Africa, Thailand and Turkey

In Table 2-4, Panel B, I examine the difference between the propensity scores of the treatment firms and those of the matched control firms. From the table, I can see that the difference is very small except for minimum and 5 percentiles. Panel C reports the univariate comparisons between the treatment and control firms' characteristics and their corresponding t-statistics. No difference in *NewsGrowth* suggests that the parallel trends assumption is not violated.

Table 2-4, Panel D presents the DiD estimators. Column (1) reports the average change in the negativity of news for the treatment group while Column (2) reports for the control group. The difference is computed by subtracting *NegNews* of two weeks prior to the event date from the *NegNews* of two weeks following the event date. The difference is averaged. In Columns (3) and (4), I report the DiD estimators and the corresponding two-tailed t-statistics, testing the null hypothesis that the DiD estimators are zero, is statistically significant. This indicates that ADR firms from the treatment group receive more negative news from the US media relative to control firms after November 29, 2012. To further strengthen my result, I test in a regression framework. I keep two observations for each firm: pre and post.

$$NegNews_{i,c,t} = \alpha + \beta_1 p_t \times d_i + \beta_2 p_t + \beta_3 d_i + \beta_4 X_{i,t} + \beta_5 Y_{c,t} + \varepsilon_{i,c,t}$$

where the indices i, c and t correspond to firm, country and time (pre or post period), respectively.  $\varepsilon_{i,c,t}$  represents an error term that is assumed to be correlated within the country and heteroskedastic. As such, all standard errors and test statistics are robust to these two departures from the classical regression model (Petersen (2009)) and clustered at the country level.  $p_t$  is a dummy variable equal to 1 for the days two weeks after November 29, 2012 inclusive and 0 otherwise.  $d_i$  equals 1 for the treatment group and 0 for the control group.  $X_{i,t}$  represents firm-specific characteristics, including size, leverage, return on equity and Tobin's Q, while  $Y_{c,t}$  includes country-level control variables; log of GDP per capita, GDP Growth and net percent equity flow and economic flow for the year 2012. Table 2-4 Panel E shows that  $\beta_1$  is statistically positive and significant, indicating that firms from countries that unexpectedly voted against the US receive a higher level of negativity from the US media than firms from countries that have consistently voted against US. This further strengthens my argument that the US media reacts to political misalignment.

#### Table 2- 4 Difference-in-Difference Analysis using Palestine issues voting

In this table, I present Difference-in-Difference (DiD) regression on *NegNews* with 29th November 2012 as an event date. I find abnormal UN voting patterns from 3 countries on Palestine issues that are "important" to US (i.e. different to previous consistent voting) on 29th November 2012 and compare *NegNews* two weeks before and after the event date. Panel A presents parameter estimates from the probit model used to estimate propensity scores for firms in the treatment and the control groups. The dependent variable is one if the firm belongs to the treatment group and zero otherwise. Standard errors are clustered at country level and t-statistics are displayed in parentheses. Variables used to match include firm level control variables—log of book asset value in US dollars (*Size*), total debt divided by total asset (*Leverage*), return on equity (*ROE*), Tobin's Q (*TobinQ*) and trend in *NegNews* (*NewsGrowth*)—and country level variables—economic flow (*TradeShareus*), net percent equity flow (*InvestShareus*) and GDP growth (*GDPGrowth*). Panel B reports the distribution of estimated propensity scores for the treatment firms and the control firms, and the difference in estimated propensity scores post matching. Panel C reports the univariate comparisons between the treatment and control firms' characteristics and their corresponding t-statistics. Panel D provides the DiD test results and standard errors are given in parentheses. Panel E reports regression estimates of the *NegNews* of the treatment and the control firms surrounding the event date:

 $NegNews_{i,t} = a + B_1 p_t X d_i + B_2 p_t + B_3 d_i + X_{i,t} + Y_{c,t} + \varepsilon_{i,t}$ 

where  $p_t$  is a dummy variable equal to 1 for the days after 29th November 2012 (exclusive) and 0 otherwise.  $d_i$  equals 1 for the treatment group and 0 for the control group.  $B_1$  captures differences between the treatment group and the control group. The values of the t-statistics in parentheses are based on robust standard errors clustered at the country level.

Panel A: Prematch propensity Score Regression and Postmatch Diagnostic Regression					
	(1)	(2)			
	Prematch	Postmatch			
	d	d			
Si- a	0.040	0.072			
Size	-0.049	(1.62)			
_	(-0.95)	(1.63)			
Leverage	-0.505	-0.030			
	(-0.71)	(-0.08)			
ROE	-0.000	-0.022			
	(-1.15)	(-3.26)			
TobinQ	-0.111	0.196			
	(-1.57)	(1.61)			
TradeShareUs	3.727	11.982			
	(0.27)	(0.66)			
$InvestShare_{US}$	4.651	-0.476			
	(0.61)	(-0.03)			
GDPGrowth	-0.247	0.245			
	(-1.36)	(0.57)			
NewsGrowth	-0.088	-0.044			
	(-1.88)	(-0.90)			
Intercept	1.456	-2.087			
	(1.42)	(-1.61)			
Observations	454	404			
$R^2$	15.4%	13.6%			

Panel B: Estimated Propensity Score Distributions								
Propensity Scores	No. of Obs.	Min	p5	p50	Mean	SD	P95	Max
Treatment	202	0.190	0.279	0.610	0.545	0.153	0.711	0.759
Control	202	0.232	0.408	0.582	0.563	0.077	0.660	0.663
Difference		-0.043	-0.129	0.028	-0.017	0.076	0.051	0.096

Panel C: Estimated Propensity Score Distributions						
	Treatment	Control	Difference	std err	t-statistic	
Size	16.038	16.067	-0.029	0.195	-0.148	
Leverage	0.159	0.174	-0.016	0.013	-1.193	
ROE	3.333	11.374	-8.041	1.844	-4.360	
TobinQ	1.336	1.292	0.043	0.070	0.616	
<b>TradeShare</b> <sub>US</sub>	0.037	0.020	0.017	0.003	6.427	
InvestShareus	0.020	0.023	-0.003	0.002	-1.254	
GDPCapita (Not used to match)	10.880	9.241	1.639	0.027	60.472	
GDPGrowth	2.275	1.860	0.416	0.109	3.811	
NewsGrowth	-0.086	-0.063	-0.023	0.069	-0.342	

Panel D: Difference-in-Difference Test						
	Mean Treatment	Mean Control	Mean DiD	t-statistic for DiD		
	Difference (after-before)	Difference (after-	Estimator (treat-	Estimator		
		before)	control)			
NegNews	0.002	-0.237	0.238	3.570		
	(0.0650)	(0.0685)	(0.0668)			

Panel E: Difference-in-Difference Analysis		
	NegNews	
<i>p X d</i>	0.238	
p	-0.236	
d	(-2.54) 0.301	
Size	(1.50) -0.023	
Leverage	(-1.19) -0 524	
Leveruge	(-1.68)	
ROE	0.000 (0.22)	
TobinQ	-0.091 (-3.28)	
TradeShare <sub>US</sub>	-1.931	
InvestShareus	-3.305	
GDPCapita	(-2.52) -0.235	
GDPGrowth	(-2.01) -0.021	
	(-0.88)	
Observations	808	
$R^2$	4.6%	

## 2.4.2.1. Instrumental Variable

Although my findings in the main section are robust to the omitted or unobservable variables by having fixed effects, the results may still suffer from endogeneity. Specifically, a potential problem is that my proxies for political proximity may be determined simultaneously with media negativity, which would bias my results. As a robustness check, I use the instrumental variable approach to address this concern.

Following Dajud (2013), I use the Physical Integrity Rights Index (*PRI*) as an instrumental variable that is constructed by summing up country scores in four matters: torture, extrajudicial killing, political imprisonment, and disappearance. Countries with high scores are those where human rights are better respected. The reason for choosing *PRI* as an instrumental variable is that human rights issues are perhaps the most contentious issues in the United Nations. For this reason, most votes occur on resolutions directly or indirectly related to human rights. Therefore, *PRI* can be seen as highly correlated with *VoteDisagreeus* and *VoteDivergeus*. Furthermore, following Dreher and Jensen (2013), I use leader change of a country, *LC*, as an additional instrumental variable. They empirically show that on average, new leaders vote more frequently in line with the US on key issues. However, leader changes could theoretically impact United Nations General Assembly voting in either direction, either voting with or against the US. Dreher and Jensen (2013) acknowledge that while the precise influence of individual leaders on policy is conditional on political institutions, executives tend to have the most discretion over foreign policy compared to other issue areas.

Table 2-5 shows instrumental variable results. The unreported test statistics support the construction of the instrument. For example, Hansen J statistics for over-identifying restrictions show that instruments are valid and the first-stage F statistics for the weak instrument test are acceptable based on Staiger, Stock, and Watson (1997) guidelines. First-

stage regressions of the instrumental variable show that my instrumental variables are highly correlated with *VoteDisagree*<sub>US</sub> and *VoteDiverge*<sub>US</sub> and the second-stage regression results with predicted values are consistent with my main results. This additional analysis corroborates my findings that political proximity has an impact on the US media.

#### **Table 2-5 Instrumental Variable Apporach**

In this table, I present 2SLS regressions of political proximity variables on negativity of US media (*NegNews*) with two instrumental variables; Physical Integrity Rights Index (PRI) and Leader Change of the country (LC). *VoteDisagreeus* represents the ratio of opposing UN votes to US from a country and *VoteDivergeus* measures dissimilarity in UN voting between a country and US. Control variables include firm level control variables—log of book asset value in US dollars (*Size*), total debt divided by total asset (*Leverage*), return on equity (*ROE*) and Tobin's Q (*TobinQ*)—and country level variables—economic flow (*TradeShareus*), net percent equity flow (*InvestShareus*), log of GDP per capita (*GDPCapita*) and GDP growth (*GDPGrowth*). Panel A reports first and second stage regressions for *VoteDisagreeus* and Panel B is for *VoteDivergeus*. Columns (1) and (2) in each panel show 2SLS regression with Leader Change of the country (LC) as an instrumental variable; Results are obtained from regressions with year and country fixed effects. The values of the t-statistics in parentheses are based on robust standard errors clustered at the firm level.

Panel A	Instrument=	=LC	Instrument=	PRI
Dep. Variable	VoteDisagreeus	NegNews	VoteDisagreeus	NegNews
	Model	Model	Model	Model
	(1)	(2)	(3)	(4)
Instrument	0.010		-0.003	
	(13.21)		(-5.13)	
VoteDisagreeus		2.195		6.742
		(2.72)		(3.09)
Size	0.000	-0.002	0.000	-0.001
	(1.13)	(-1.00)	(0.73)	(-0.55)
Leverage	0.005	0.099	0.005	0.054
	(2.16)	(3.57)	(2.17)	(1.67)
ROE	0.000	-0.001	0.000	-0.001
	(2.96)	(-8.23)	(3.66)	(-7.78)
TobinQ	0.001	-0.027	0.000	-0.027
	(2.29)	(-7.29)	(1.77)	(-6.59)
TradeShareus	1.655	-2.982	1.548	-9.681
	(20.82)	(-2.16)	(20.15)	(-2.90)
InvestShareus	-0.014	0.057	-0.019	0.187
	(-2.73)	(1.10)	(-3.36)	(2.31)
GDPCapita	-0.049	0.117	-0.042	0.254
	(-11.26)	(2.40)	(-9.00)	(2.79)
GDPGrowth	0.003	-0.019	0.003	-0.030
	(14.28)	(-6.20)	(11.46)	(-5.12)
Observations	14,860	14,860	12,970	12,970
$R^2$	95.6%	8.9%	95.5%	8.8%

Panel B	Instrument=LC		Instrument=PRI		
Dep. Variable	VoteDivergeus	NegNews	VoteDivergeus	NegNews	
Variable	Model	Model	Model	Model	
	(1)	(2)	(3)	(4)	
Instrument	0.035		-0.005		
	(19.61)		(-3.75)		
VoteDiverge <sub>US</sub>		0.605		4.245	
		(2.72)		(2.75)	
Size	0.000	-0.002	0.000	-0.002	
	(0.56)	(-0.90)	(0.66)	(-0.62)	
Leverage	0.010	0.103	0.011	0.042	
	(1.70)	(3.77)	(1.81)	(1.09)	
ROE	0.000	-0.001	0.000	-0.001	
	(2.16)	(-8.08)	(2.81)	(-6.68)	
TobinQ	0.001	-0.026	0.000	-0.025	
	(0.89)	(-7.10)	(0.33)	(-5.29)	
TradeShareus	6.305	-3.183	5.552	-22.838	
	(20.43)	(-2.22)	(18.66)	(-2.78)	
InvestShareus	0.002	0.029	-0.014	0.124	
	(0.18)	(0.56)	(-1.35)	(1.70)	
GDPCapita	-0.125	0.084	-0.104	0.411	
	(-10.05)	(2.18)	(-7.60)	(2.70)	
GDPGrowth	0.002	-0.014	0.001	-0.015	
	(4.17)	(-6.59)	(1.11)	(-4.96)	
Observations	14,832	14,832	12,942	12,942	
$R^2$	96.0%	8.5%	96.0%	8.8%	

## 2.4.2.2. Lagged Variables and Changes-in-Changes

I further test number of other regressions to strengthen my main result. Firstly, I take one year lagged values of my political proximity measures - *VoteDisagree<sub>US</sub>* and *VoteDiverge<sub>US</sub>*. I take such a test to show subsequent effect of political relation on US media. Table 2-6, Panel A shows that the previous years' poor political relation proxy variables have positive and significant coefficient with negativity of US media. This suggests that if a country had poor political relation with US in the year before, ADR firms from this country still get more negative news from the US media in the year.

Secondly, I take first difference method to address any unobservable or missing variables because first difference method eliminates time-invariant unobserved effect. Table 2-6, Panel B shows that the coefficients of political proximity variables are still positive and significant indicating that poor political relation has negative impact on US media when it disseminates news about ADR firms. These findings support my main results by showing that my main results still hold with different methods.

## Table 2-6 Lagged Political Proximity and First Difference Regression

In this table, I present different regressions of political proximity variables on negativity of US media (*NegNews*). In Panel A, I lag my political proximity variables by one year and in Panel B, I take first differences of dependent and independent variables. I run following regression:

$$NegNews_{i,t} = a + B_1Poltical_Proximity_{c,t-1} + X_{i,t} + Y_{c,t} + \varepsilon_{i,t}$$

$$\Delta NegNews_{i,t} = a + B_1 \Delta Poltical_Proximity_{c,t} + \Delta X_{i,t} + \Delta Y_{c,t} + \varepsilon_{i,t}$$

where *Political\_Proximity* is the ratio of opposing UN votes to US from a country (*VoteDisagreeus*) and dissimilarity in UN voting between a country and US (*VoteDivergeus*).  $X_{i,t}$  includes firm level control variables—log of book asset value in US dollars (*Size*), total debt divided by total asset (*Leverage*), return on equity (*ROE*) and Tobin's Q (*TobinQ*)—while  $Y_{c,t}$  includes economic flow (*TradeShareUS*), net percent equity flow (*InvestShareUS*), log of GDP per capita (*GDPCapita*) and GDP growth (*GDPGrowth*). Results in Panel A are obtained from regressions with year and country fixed effects. The values of the t-statistics in parentheses are based on robust standard errors clustered at the firm level in both panel.

Panel A		
Dep. Variable	NegNews	NegNews
	Model	Model
	(1)	(2)
VoteDisagreeus_1	0.372	
	(4.74)	
VotaDivargans	(4.74)	0.100
VoleDiverge05,-1		0.130
a.		(3.57)
Size	-0.003	-0.007
	(-1.37)	(-2.78)
Leverage	0.119	0.137
	(4.49)	(5.38)
ROE	-0.001	-0.001
	(-7.90)	(-7.82)
TobinQ	-0.030	-0.030
	(-8.42)	(-8.30)
TradeShare <sub>US</sub>	-0.455	-0.423
	(-0.97)	(-0.84)
InvestShare <sub>US</sub>	-0.012	0.050
	(-0.24)	(0.94)
GDPCapita	0.049	0.057
	(1.94)	(2.24)
GDPGrowth	-0.015	-0.015
	(-7.28)	(-7.33)
Fixed Effects	Country/Year	Country/Year
Observations	16,177	14.053
$R^2$	8.3%	8.7%

Panel B		
Dep. Variable	$\Delta NegNews$	$\Delta NegNews$
	Model	Model
	(1)	(2)
$\Delta Vote Disagree us$	0.110	
	(2.04)	
$\Delta VoteDiverge_{US}$		0.114
		(3.84)
$\Delta Size$	-0.027	-0.031
	(-1.42)	(-1.57)
$\Delta Leverage$	-0.001	-0.001
	(-7.98)	(-8.15)
$\Delta ROE$	0.023	0.013
	(0.35)	(0.18)
$\Delta TobinQ$	-0.042	-0.040
	(-7.42)	(-6.66)
$\Delta TradeShare_{US}$	-1.280	-1.582
	(-1.13)	(-1.34)
$\Delta$ InvestShare <sub>US</sub>	-0.004	0.011
	(-0.06)	(0.17)
$\Delta GDPC apita$	0.272	0.236
	(6.56)	(5.19)
$\Delta GDPGrowth$	-0.019	-0.020
	(-13.97)	(-14.05)
Fixed Effects	-	-
Observations	14,077	12,286
$R^2$	3.6%	4.0%

# 2.5. Additional Tests

## 2.5.1. Placebo Tests

Press releases are controlled by firms. Ahern and Sosyura (2014) find that firms have an incentive to manage media coverage to influence their stock prices during important corporate events. RavenPack provides information on whether news is a press release, and my dependent variable in the main results, *NegNews*, is constructed without press releases because I am interested in how the US media disseminate information on ADR firms rather than how firms report about themselves. I expect that ADR firms will not release more negative or positive news because their home countries have poor political relations with the US. The number of negative and positive *press-release* news is used to create *NegNews* in this section, and Table 2-7 clearly shows that political relations do not affect what firms report about themselves in press releases sent to the US media. The coefficients of two political proximity variables are statistically insignificant.

## **Table 2-7 Press-Release News**

In this table, I present regressions of political proximity variables on negativity of US media (NegNews) using Press-Release news. I run following regression:

 $NegNews_{i,t} = a + B_1Poltical_Proximity_{c,t} + X_{i,t} + Y_{c,t} + \varepsilon_{i,t}$ where *Political\_Proximity* is the ratio of opposing UN votes to US from a country (*VoteDisagreeus*) and dissimilarity in UN voting between a country and US (VoteDivergeus). Xi,t includes firm level control variables-log of book asset value in US dollars (Size), total debt divided by total asset (Leverage), return on equity (ROE) and Tobin's Q (TobinQ)-while Yc,t includes economic flow (TradeShareUS), net percent equity flow (InvestShareUS), log of GDP per capita (GDPCapita) and GDP growth (GDPGrowth). The values of the t-statistics in parentheses are based on robust standard errors clustered at the firm level.

Dep. Variable	NegNews	NegNews
	Model	Model
	(1)	(2)
VoteDisagree <sub>US</sub>	0.180	
	(1.33)	
VoteDivergeus	(====)	-0.046
		(-0.62)
Size	-0.019	-0.017
	(-5.00)	(-4.26)
Leverage	0.303	0.323
	(5.56)	(5.61)
ROE	-0.000	-0.000
	(-1.44)	(-1.49)
TobinQ	-0.036	-0.036
	(-7.64)	(-7.29)
TradeShareus	-1.314	-0.596
	(-1.49)	(-0.52)
InvestShare <sub>US</sub>	0.028	-0.045
	(0.30)	(-0.47)
GDPCapita	0.225	0.227
	(4.55)	(4.41)
GDPGrowth	-0.004	-0.003
	(-0.84)	(-0.59)
Fixed Effects	Country/Year	Country/Year
Observations	9,546	8,527
$R^2$	10.9%	10.6%

For my main results, only US media sources are considered. In Table 2-8, I examine whether political proximity affects non-US media sources. Columns (1) - (2) show results for news sample from non-US media sources except home country media. The coefficients are insignificant, indicating that political relations between the US and a country do not affect how third-party countries' media disseminate news about ADR firms. For example, the results reported in columns (1) and (2) indicate that UK or Japanese media do not produce more negative news on Australian ADR firms because Australia is experiencing poor political relations with the US during the year. Furthermore, columns (3) – (4) show that home country media are also not affected by the political relations between the US and countries ADR firms are from. There is no motivation for a home country's media to report more negative news on its country's ADR firms just because its country is experiencing poor political relations with the US.

#### Table 2-8 Non-US Media Source

In this table, I present regressions of political proximity variables on negativity of US media (NegNews) for sample split into two. First two columns show results with non-US media sources only (except ADR home countries' media), and columns (3) and (4) show results for news sample which are sourced from ADR home countries' media. I run following regression:

## $NegNews_{i,t} = a + \beta Poltical_Proximity_{c,t} + X_{i,t} + Y_{c,t} + \varepsilon_{i,t}$

where Political\_Proximity is the ratio of opposing UN votes to US from a country (VoteDisagreeUS) and dissimilarity in UN voting between a country and US (VoteDivergeUS). Xi,t includes firm level control variables-log of book asset value in US dollars (Size), total debt divided by total asset (Leverage), return on equity (ROE) and Tobin's Q (TobinQ)-while Y<sub>c,t</sub> include economic flow (TradeShareUS), net percent equity flow (InvestShareUS), log of GDP per capita (GDPCapita) and GDP growth (GDPGrowth). Results are obtained from regressions with year and country fixed effects. The values of the t-statistics in parentheses are based on robust standard errors clustered at the firm level. NegNews

Dep. Variable

	Non-US Media		Home Media		
	Model	Model	Model	Model	
	(1)	(2)	(3)	(4)	
VoteDisagree <sub>US</sub>	-0 124		0 761		
0	(-0.35)		(1.53)		
VoteDiverge <sub>US</sub>	( ••••••)	-0.074	(100)	-0.139	
		(-0.33)		(-0.65)	
Size	0.022	0.033	-0.004	0.006	
	(3.08)	(4.06)	(-0.62)	(0.69)	
Leverage	0.333	0.327	0.197	0.202	
	(3.65)	(3.08)	(2.39)	(2.20)	
ROE	-0.001	-0.001	-0.001	-0.001	
	(-2.33)	(-2.28)	(-2.15)	(-1.53)	
TobinQ	-0.026	-0.013	-0.021	-0.011	
	(-2.23)	(-0.95)	(-1.86)	(-0.83)	
TradeShareus	-0.646	-1.075	-3.519	0.087	
	(-0.18)	(-0.25)	(-1.06)	(0.02)	
InvestShare <sub>US</sub>	-0.196	-0.169	0.094	0.192	
	(-1.03)	(-0.72)	(0.34)	(0.61)	
GDPCapita	-0.121	-0.044	0.201	0.103	
	(-0.89)	(-0.31)	(1.49)	(0.65)	
GDPGrowth	-0.001	0.001	-0.007	-0.008	
	(-0.17)	(0.13)	(-0.85)	(-0.90)	
Fixed Effects	Country/Year	Country/Year	Country/Year	Country/Year	
Observations	3,989	3,117	3,918	3,080	
$R^2$	0.048	0.054	0.038	0.034	

The positive relation between clashes in UN votes and US media negativity in Table 2-2 could be driven by changes in sales in the US. As previous studies in economics show, poor political relations lead to reduced bilateral trade flows between two countries (Gupta and Xu (2007); Michaels and Zhi (2010); Dajud (2013)). This could also mean a decrease in sales in the US for ADR firms, which serve as negative news. In Table 2-9, I use two sub-samples: one with ADR firms with sales overseas but not in the US and one with ADR firms with sales in the US. The results from Table 2-9 show that for firms both with and without sales in the US, the negative effect of poor political relations on the US media persists. This indicates that my main results are not driven by a change in US sales from poor political relations.

## Table 2-9 US Sales

In this table, I present regressions of political proximity variables on negativity of US media (*NegNews*) for sample split into two. Columns (1) and (2) show results for firms without segment sales in the US but in other countries during that year; Columns (3) and (4) use firms with sales in the US for that year. I run following regression:

 $NegNews_{i,t} = a + B_1Poltical\_Proximity_{c,t} + X_{i,t} + Y_{c,t} + \varepsilon_{i,t}$ where *Political\_Proximity* is the ratio of opposing UN votes to US from a country (*VoteDisagreeUS*) and dissimilarity in UN voting between a country and US (*VoteDivergeUS*). X<sub>i,t</sub> includes firm level control variables—log of book asset value in US dollars (*Size*), total debt divided by total asset (*Leverage*), return on equity (*ROE*) and Tobin's Q (*TobinQ*)—while Y<sub>c,t</sub> includes economic flow (*TradeShareUS*), net percent equity flow (*InvestShareUS*), log of GDP per capita (*GDPCapita*) and GDP growth (*GDPGrowth*). Results are obtained from regressions with year and country fixed effects. The values of the tstatistics in parentheses are based on robust standard errors clustered at the firm level.

Dep. Variable		1	NegNews	
	No-US	S Sales	US	S Sales
	Model	Model	Model	Model
	(1)	(2)	(3)	(4)
VoteDisagreeus	0.287		0.196	
	(2.55)		(1.77)	
VoteDivergeus	(100)	0.159	(1177)	0.236
		(2.89)		(3.61)
Size	-0.007	-0.005	-0.007	-0.005
	(-1.99)	(-1.34)	(-1.96)	(-1.53)
Leverage	0.103	0.095	0.123	0.109
	(2.74)	(2.31)	(3.01)	(2.61)
ROE	-0.001	-0.001	-0.001	-0.001
	(-5.68)	(-5.66)	(-5.12)	(-4.76)
TobinQ	-0.033	-0.030	-0.026	-0.023
	(-5.85)	(-4.91)	(-5.31)	(-4.45)
<b>TradeShare</b> <sub>US</sub>	-0.068	-0.256	-1.922	-3.386
	(-0.10)	(-0.33)	(-2.66)	(-3.69)
InvestShareus	0.026	0.039	-0.124	-0.055
	(0.39)	(0.57)	(-1.18)	(-0.48)
GDPCapita	0.055	0.028	0.034	0.037
•	(1.59)	(0.72)	(0.77)	(0.78)
GDPGrowth	-0.018	-0.017	-0.007	-0.008
	(-6.91)	(-6.25)	(-1.70)	(-1.89)
Fixed Effects	Country/Year	Country/Year	Country/Year	Country/Year
Observations	8,103	6,892	6,063	5,422
$R^2$	9.4%	10.3%	10.8%	11.7%

## 2.5.2. Country Popularity Score

Apart from the government level of proximity, I also test how the US media react to US citizens' views of a country. To measure each country's popularity among Americans, I use Gallup surveys. Following Hwang (2011), I construct a Country Popularity Score (*CPS*) by multiplying the percentage of survey participants who respond very favorably by four, mostly favorably by three, mostly unfavorably by two and very unfavorably by one; I add these four numbers into one cumulative score.

Column (1) of Table 2-10 shows that when a country is favored by US citizens, ADR firms from that country tend to receive less negative news from the US media. The causality of this correlation is supported by 2SLS regression with instrumental variables as a one-year lag of my two political proximity variables. I believe that previous years' voting has an impact on the Country Popularity Score, which columns (2) and (4) of Table 2-10 support. When the country casts more opposing votes in the previous year, the country's popularity falls in the year. The results with predicted values of *CPS*, in columns (3) and (5), are statistically significant and consistent with that of column (1). These 2SLS regressions indicate that country popularity is a possible channel through which political relations may influence the US media because I examine that political relations first affect a country's popularity, and then that country's popularity influences the US media. Overall, the result is consistent with Hypothesis 1b.

## Table 2- 10 Country Popularity Score

In this table, I present regressions of a country popularity score (CPS) variable on negativity of US media (*NegNews*). I run following regression:  $NeaNews_{i,t} = a + B_t CPS_{a,t} + X_{i,t} + Y_{a,t} + \varepsilon_{i,t}$ 

$$NegNews_{i,t} = \mathbf{a} + B_1 CPS_{c,t} + X_{i,t} + Y_{c,t} + \varepsilon_{i,c,t}$$

where *CPS* is collected from Gallup.  $X_{i,t}$  includes firm level control variables—log of book asset value in US dollars (*Size*), total debt divided by total asset (*Leverage*), return on equity (*ROE*) and Tobin's Q (*TobinQ*)—while  $Y_{c,t}$  includes economic flow (*TradeShareUS*), net percent equity flow (*InvestShareUS*), log of GDP per capita (*GDPCapita*) and GDP growth (*GDPGrowth*). Columns (2) – (5) show second stage regressions (2SLS) using one-year lag of my political proximity variables as instrumental variables. The values of the t-statistics in parentheses are based on robust standard errors clustered at the firm level.

			/oteDisagreeUS Instrument=L.VoteDiver		VoteDivergeUS
Dep. Variable	NegNews	CPS	NegNews	CPS	NegNews
Variable	Model	Model	Model	Model	Model
	(1)	(2)	(3)	(4)	(5)
CPS	-0.060		-4.587		-1.514
	(-2.67)		(-2.22)		(-3.28)
Instrument		-0.107		-0.098	
		(-2.72)		(-10.77)	
Size	-0.005	-0.000	-0.008	-0.000	-0.007
	(-1.83)	(-0.39)	(-2.28)	(-0.47)	(-2.68)
Leverage	0.088	0.006	0.122	0.007	0.108
	(2.80)	(0.86)	(2.68)	(1.08)	(3.42)
ROE	-0.001	0.000	-0.001	0.000	-0.001
	(-6.50)	(1.85)	(-2.27)	(1.79)	(-5.67)
TobinQ	-0.025	-0.002	-0.035	-0.002	-0.030
	(-6.45)	(-1.54)	(-5.16)	(-1.60)	(-7.15)
TradeShareus	0.640	0.935	4.049	1.406	1.726
	(1.24)	(3.47)	(2.94)	(6.28)	(2.60)
InvestShareus	0.075	0.136	0.727	0.129	0.310
	(1.18)	(7.19)	(2.59)	(6.93)	(3.44)
GDPCapita	-0.021	-0.157	-0.673	-0.175	-0.215
	(-0.70)	(-9.56)	(-2.44)	(-11.88)	(-2.83)
GDPGrowth	-0.015	-0.006	-0.041	-0.007	-0.024
	(-5.30)	(-4.44)	(-2.65)	(-5.32)	(-5.26)
Fixed Effects	Country/Year	Country/Year	Country/Year	Country/Year	Country/Year
Observations	10,238	8,729	8,729	8,720	8,720
$R^2$	8.8%	90.6%	9.2%	90.6%	9.2%

## 2.5.3. Return Impact

Unlike Tetlock (2007), who builds a media sentiment proxy based on one *Wall Street Journal* column issued every morning, I use all RavenPack news data from reliable US media sources available from the market closing time of the previous day to the market closing time of the day for each country to create my daily media pessimism variable. Each country has a different market closing time based on Greenwich Mean Time (GMT),<sup>13</sup> and I treat any news after the market closing time as the next day's news. RavenPack news data are based on Greenwich Mean Time (GMT), which is not adjusted to daylight saving time<sup>14</sup> and I adjust RavenPack data time according to daylight saving season for each country.

In this section, I first test how US media dissemination influences ADR firms' home market stock returns. Daily returns of ADR firms from January 3, 2000 to December 31, 2013 are collected from Worldscope, and abnormal returns are calculated by subtracting the daily stock return from beta of the firm (previous year) multiplied by the MSCI market return for each country. I test how the 5 days of *NegNews* influence the abnormal return using this equation:

$$\begin{aligned} AR_{i,c,t} &= \alpha + \beta_1 NegNews_{i,c,t} + \beta_2 L4(NegNews_{i,c,t}) + \beta_3 L5(AR_{i,c,t}) + \beta_4 volume_{i,c,t} \\ &+ Jan + Recession + \varepsilon_{i,c,t} \end{aligned}$$

where the indices i, c and t correspond to firm, country and time, respectively. I include a contemporaneous negativity measure (*NegNews*) as well as all lags up to 4 days of my media negativity variable and include all lags up to 5 days of abnormal stock returns (AR). Volume indicates the daily trading volume of each firm. *Jan* equals one if the abnormal return belongs

<sup>&</sup>lt;sup>13</sup> Market Closing Time data provided by Worldscope

<sup>&</sup>lt;sup>14</sup> Time is adjusted to Daylight Saving for Argentina, Australia, Australia, Belgium, Brazil, Canada, Chile, Cyprus, Czech Republic, Denmark, Egypt, Finland, France, Germany, Greece, Hungary, Ireland, Israel, Italy, Luxembourg, Mexico, the Netherlands, New Zealand, Norway, Pakistan, Poland, Portugal, Russia, Spain, Sweden, Switzerland, Turkey, and the United Kingdom.

to January of each year and 0 otherwise. *Recession* equals 1 if the abnormal return is in the period of global financial crisis and 0 otherwise. The media negativity measure (*NegNews*) equals 0 (neutral) when there is no news released on the day<sup>15</sup>. Consistent with Tetlock (2007), I find that US media negativity predicts low returns at short horizons and reversion to fundamentals at longer horizons. This is not shown in the table, but using such a characteristic, I test how political relations influence the US media's impact on home market stock returns.

By regressing daily abnormal stock returns on daily *NegNews* by every firm-year, I calculate coefficient of five lags of media negativity measure (*NegNews*) for every firm-year, which is then used to create the *ReturnImpact* variable. *ReturnImpact1* is the coefficient of contemporaneous media negativity measure; *ReturnImpact2* is sum of the coefficients of 5 lags of media negativity measure. Table 2-11 shows my results for how the political proximity affects *ReturnImpact*.

$$ReturnImpact_{i,c,t} = \alpha + \beta_1 PP_{c,t} + \beta_2 X_{i,t} + \beta_3 Y_{c,t} + \Phi_t + \theta_t + \varepsilon_{i,c,t}$$

The results in Table 2-11 show that when political relations between non-US countries and the US are poor, *ReturnImpact* becomes more positive, suggesting that investors already know that the US media disseminate more negative news toward ADR firms when political relations between its home country and US are poor. I make this claim in Hypothesis 2, because if investors already know that the US media are more pessimistic compared to the fundamental value when political relations are poor, investors will react less to such negative news. This is shown in columns (1) - (2), as the results show that the initial negative impact

<sup>&</sup>lt;sup>15</sup> I remove firm year observations that has less than 5 unique news released within that year and firm year observations that has less than 125 daily stock return data available.
of *NegNews* on stock return is less for firms from countries that have poor political relations with the US compared to the firms from countries that have good relations with the US. Furthermore, columns (3) - (4) show that overall, the negative impact (5-day period) from negative US media coverage on stock returns is less when political relations are poor. The size of the coefficients for the two political proximity variables is larger than that of columns (1) - (2), which implies that investors already know and quickly adjust to the fact that the US media are negatively influenced by poor political relations.

### **Table 2-11 Return Impact**

In Panel A of this table, I present regressions of political proximity variables on the return impact. I run following regression:

ReturnImapct<sub>i,t</sub> =  $\alpha$  + B<sub>1</sub>Poltical\_Proximity<sub>c,t</sub> + X<sub>i,t</sub> + Y<sub>c,t</sub> +  $\varepsilon_{i,t}$ 

where Political\_Proximity is the ratio of opposing UN votes to US from a country (VoteDisagreeUS) and dissimilarity in UN voting between a country and US (VoteDivergeUS). Xi,t includes firm level control variables—log of book asset value in US dollars (Size), total debt divided by total asset (Leverage), return on equity (ROE) and Tobin's Q (TobinQ)-while Yc,t includes economic flow (TradeShareUS), net percent equity flow (InvestShareUS), log of GDP per capita (GDPCapita) and GDP growth (GDPGrowth). Columns (1) and (2) use the coefficient of contemporaneous NegNews as return impact -ReturnImpact1; Columns (3) and (4) show results for return impact as sum of the coefficients of 5 lags of NegNews for each firm year - ReturnImpact2. Results are obtained from regressions with year and country fixed effects. The values of the tstatistics in parentheses are based on robust standard errors clustered at the firm level.

Dep. Variable	ReturnImpact1	ReturnImpact1	ReturnImpact2	ReturnImpact2
Variable	Model	Model	Model	Model
	(1)	(2)	(3)	(4)
VoteDisagree <sub>US</sub>	0.751		1.634	
	(2.15)		(2.86)	
VoteDivergeus		0.772		1.126
		(3.69)		(3.35)
Size	0.189	0.196	0.239	0.250
	(18.63)	(17.87)	(13.84)	(12.90)
Leverage	0.207	0.201	0.273	0.327
	(1.82)	(1.66)	(1.55)	(1.73)
ROE	0.001	0.001	0.001	0.001
	(1.07)	(1.03)	(1.26)	(1.26)
TobinQ	0.034	0.043	0.066	0.091
	(2.27)	(2.96)	(2.21)	(2.85)
TradeShareUs	-2.273	-7.728	1.445	-4.157
	(-0.93)	(-2.94)	(0.37)	(-0.95)
InvestShareus	-0.287	-0.239	-0.218	-0.102
	(-1.50)	(-1.16)	(-0.62)	(-0.28)
GDPCapita	-0.142	0.034	-0.407	-0.185
-	(-1.17)	(0.27)	(-2.17)	(-0.93)
GDPGrowth	0.011	0.011	0.017	0.013
	(1.24)	(1.17)	(1.10)	(0.85)
Fixed Effects	Country/Year	Country/Year	Country/Year	Country/Year
Observations	10,979	9,565	10,979	9,565
$R^2$	0.099	0.108	0.059	0.065

### 2.5.4. ADR Termination

To test whether ADR firms are more likely to terminate their ADRs because of previous years' negative media coverage, I estimate a series of probit models in the form of:

 $PR(termination) = \alpha + \beta_1 L. NewsNeg_{c,t} + \beta_2 L. X_{i,t} + \beta_3 L. Y_{c,t} + \Phi_t + \theta_t + \varepsilon_{i,c,t}$ where the indices i, c and t correspond to firm, country and time, respectively. The dependent variable—*termination*—equals 1 if a firm terminates its ADR in that year and 0 otherwise.  $\Phi_t$  and  $\theta_t$  represent country- and year-fixed effects, and  $\varepsilon_{i,c,t}$  represents a firm-time specific error term that is assumed be correlated within the firms and heteroskedastic.  $\varepsilon_{i,c,t}$  is the standard normal cumulative distribution and all standard errors are again clustered at the firm level.  $L.X_{i,t}$  represents a one-year lag of firm-specific characteristics, including size, leverage, return on equity and Tobin's Q while  $L.Y_{c,t}$  includes a one-year lag of countrylevel control variables, log of GDP per capita, GDP growth, net percent equity flow and economic flow.

Previous studies have focused on when foreign firms cross-(de)list into the US market by considering firms that actually cross-listed into US markets (via Level 2 and 3 ADR and direct ordinary listing). In this chapter, I consider all levels of ADR firms to see whether the media influences their ADR termination decisions. I examine termination rather than commencement of ADR because before ADR, some firms may get more attention from US media than others. However, once firms gain ADR listings, I believe that the US media show the same or similar level of interest toward all ADR firms. Only firms that hold their ADRs more than 5 years are included in my analysis.

Column (1) of Table 2-12 presents my probit regression with a dependent variable as a dummy equal to 1 if a firm terminated in the year and 0 otherwise. The result shows that ADR firms are more likely to terminate their ADRs if US media coverage is negative in the

previous year. Columns (2) - (5) of Table 2-12 show two-stage regression results using my political proximity variables as instrumental variables. As I have shown in Table 2-2, the first stage of 2SLS regression indicates that poor political relations lead to more negative news from the US media; the coefficients of the predicted values of *NegNews* are statistically significant and consistent with that of Column (1). These two-stage regression results directly imply that media coverage is a possible channel through which political proximity influences firms' ADR termination decisions, which is consistent with Hypothesis 3.

#### **Table 2-12 Termination**

In this table, I present probit regressions of my media variables on ADR termination. My ADR termination variable, *termiation*, equals 1 if the firm terminates its ADR in that year and 0 otherwise. Controls include one-year lag of firm level control variables - log of book asset value in US dollars (*Size*), total debt divided by total asset (*Leverage*), return on equity (*ROE*) and Tobin's Q(TobinQ)—and one year lag of country level variables—economic flow (*TradeShareus*), net percent equity flow (*InvestShareus*), log of GDP per capita (*GDPCapita*) and GDP growth (*GDPGrowth*). Results are obtained from regressions with year and country dummies. The values of the t-statistics in parentheses are based on robust standard errors clustered at the firm level. R-squares for probit models are psuedo R-squares. Columns (2) – (5) show two stage regressions using one-year lag of political proximity variables as instrumental variables.

		Instrument=VoteDisagreeUS		Instrument=V	Instrument=VoteDivergeUS	
Dep. Variable	termination	NewsNeg	termination	NewsNeg	termination	
	Model	Model	Model	Model	Model	
	(1)	(2)	(3)	(4)	(5)	
NewsNeg	0.224		5.153		2.792	
	(2.42)		(1.83)		(2.03)	
Instrument		0.352		0.285		
		(3.71)		(6.03)		
Size	-0.041	0.001	-0.049	0.001	-0.046	
	(-2.20)	(0.45)	(-2.51)	(0.43)	(-2.41)	
Leverage	0.314	0.088	-0.132	0.087	0.082	
	(1.17)	(2.60)	(-0.38)	(2.55)	(0.29)	
ROE	0.000	-0.001	0.005	-0.001	0.003	
	(0.02)	(-5.35)	(1.70)	(-5.39)	(1.54)	
TobinQ	-0.060	-0.021	0.041	-0.021	-0.009	
	(-1.92)	(-4.91)	(0.65)	(-4.92)	(-0.21)	
$TradeShare_{US}$	7.767	-0.475	4.532	-2.197	4.860	
	(1.70)	(-0.76)	(0.95)	(-3.09)	(1.05)	
<b>InvestShare</b> <sub>US</sub>	0.289	-0.008	0.544	0.005	0.435	
	(0.36)	(-0.08)	(0.67)	(0.05)	(0.53)	
GDPCapita	0.124	0.048	-0.008	0.077	0.044	
-	(0.50)	(1.38)	(-0.03)	(2.18)	(0.17)	
GDPGrowth	-0.025	-0.012	0.029	-0.012	0.004	
	(-1.03)	(-4.21)	(0.76)	(-4.24)	(0.13)	
Observations	8,666	8,666	8,666	8,643	8,643	
$R^2$	6.9%	8.0%	6.8%	8.2%	6.7%	

### 2.5.5. Robustness Test

In the previous sections, I closely investigate how the US media disseminate firm-specific information regarding political proximity. However, the US media could be more biased with qualitative information, such as opinions, rumors and verbal communications, rather than quantitative information, such as earnings announcements and financial statements. In this section, I classify my sample into hard and soft news; hard news as quantitative information and soft news as qualitative information. Table 2-13 reports the regression results for different news categories in columns (1), (2), (5) and (6). The results indicate that political proximity influences dissemination of both types of information.

I also perform the same test with repeated news. I test another dependent variable, All News *NegNews*, in columns (3) and (7) of Table 2-13, which shows the overall measure for the negativity of US media since I use the total number of news items, which includes repeated news of unique news. The results are still consistent with my main results.

Rather than using RavenPack's sentiment score, ESS, to simply distinguish between negative and positive news, in columns (4) and (8) of Table 2-13, I include it as a dependent variable and test the direct impact of political proximity on the sentiment score. I take the average ESS score of firms' unique news (*Avg\_ESS*) each year and find that when bilateral political relations between a country and the US are poor, the average sentiment score decreases. This indicates that ADR firms receive more negatively toned news from the US media when their countries experience poor political relations with the US.

### Table 2- 13 Robustness Test

In this table, I present regressions of political proximity variables on different measure of media coverage. In columns (1), (2), (5) and (6), my main variable, *NegNews*, is created for hard news and soft news only. In columns (3) and (7), I use all news available to the firm (i.e. including repeated news) and in columns (4) and (8), I calculate average ESS score for my unique news given by Ravenpack. Two political proximity variables are the ratio of opposing UN votes to US from a country (*VoteDisagreeus*) and dissimilarity in UN voting between a country and US (*VoteDivergeus*). Controls include log of book asset value in US dollars (*Size*), total debt divided by total asset (*Leverage*), return on equity (*ROE*), Tobin's Q (*TobinQ*), economic flow (*TradeShareus*), net percent equity flow (*InvestShareus*), log of GDP per capita (*GDPCapita*) and GDP growth). Results are obtained from regressions with year and country fixed effects. The values of the t-statistics in parentheses are based on robust standard errors clustered at the firm level.

	Hard	Soft	All News	Sentiment Score	Hard	Soft	All News	Sentiment Score
Dep. Variable	NegNews	NegNews	NegNews	AvgESS	NegNews	NegNews	NegNews	AvgESS
Variable	Model	Model	Model	Model	Model	Model	Model	Model
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
		A <b>A</b>						
VoteDisagreeus	0.202 (2.34)	0.377 (3.34)	0.255	-3.799 (-2.15)				
VoteDivergeus	(2.54)	(3.34)	(5.07)	(-2.13)	0.150	0.128	0.215	-3.892
U					(3.36)	(2.16)	(5.21)	(-4.30)
Size	-0.011	0.010	-0.002	0.046	-0.008	0.010	-0.000	0.011
	(-5.14)	(3.19)	(-0.66)	(1.08)	(-3.90)	(3.28)	(-0.18)	(0.25)
Leverage	0.098	0.165	0.106	-2.543	0.096	0.162	0.097	-2.424
-	(3.84)	(4.17)	(3.94)	(-4.92)	(3.57)	(3.95)	(3.44)	(-4.38)
ROE	-0.003	0.001	-0.001	0.035	-0.003	0.001	-0.001	0.037
	(-17.27)	(3.63)	(-7.60)	(12.77)	(-17.17)	(3.78)	(-7.66)	(12.86)
TobinQ	-0.028	-0.015	-0.030	0.548	-0.025	-0.014	-0.028	0.505
	(-7.18)	(-3.61)	(-9.20)	(8.09)	(-6.10)	(-3.31)	(-7.90)	(7.00)
TradeShareus	-0.203	-0.610	0.171	5.626	-0.549	-0.731	-0.461	18.247
	(-0.39)	(-0.92)	(0.35)	(0.49)	(-0.85)	(-0.89)	(-0.78)	(1.28)
InvestShareus	-0.020	0.058	0.020	-0.552	-0.019	0.079	0.035	-1.264
	(-0.39)	(0.81)	(0.38)	(-0.51)	(-0.35)	(1.00)	(0.64)	(-1.09)
GDPCapita	0.065	0.001	0.042	-1.898	0.045	-0.021	0.027	-1.699
	(2.41)	(0.03)	(1.61)	(-3.37)	(1.56)	(-0.53)	(0.95)	(-2.73)
<b>GDPGrowth</b>	-0.017	0.002	-0.014	0.403	-0.017	0.004	-0.014	0.391
	(-8.56)	(0.81)	(-7.00)	(9.21)	(-8.08)	(1.29)	(-6.54)	(8.79)
Fixed Effects	Country/Year	Country/Year	Country/Year	Country/Year	Country/Year	Country/Year	Country/Year	Country/Year
Observations	16,752	15,237	16,833	16,833	14,868	13,497	14,832	14,832
$R^2$	13.4%	3.8%	7.8%	11.9%	14.3%	3.9%	8.6%	12.8%

# 2.6. Conclusion

My main focus in chapter 2 is investigating the impact of political proximity on the US media when they disseminate news on ADR firms. Using a unique dataset of news articles collected from RavenPack, which has its own sentiment indicator for every type of news data, I find strong empirical evidence showing that when bilateral political relations between a country and the US are poor, ADR firms from that country receive more negative news than positive news from the US media.

Consistent with previous studies, I also find that media negativity predicts low returns at short horizons and reversion to fundamentals at longer horizons. In addition, I further find that the downward pressure of negative news on stock returns is attenuated when bilateral political relations between the US and its country are poor. This indicates that investors are already aware of the fact that the US media is influenced by political relations, so they react less to such negative news—an indication that investors react to *real* media bias.

The next important finding of this chapter is that ADR firms that received a large amount of negative news from the US media in the previous year are more likely to terminate their ADRs. I use my political proximity variables as instrumental variables in 2SLS analysis to show that the US media is a possible channel through which political relations influence firms' decision on ADR termination; my results support this.

My primary contribution is to set up a new area of the literature that explores the factors that affect the media. No previous studies have explored such an area and I provide empirical support for the notion that political proximity has a direct impact on the media. I also expand on previous studies by examining the impact of US media negativity on stock performance with a non-US dataset and with a source of media data, which enabled me to remove "repeated" news and "noisy" news from my data. Finally, I contribute to the existing literature by focusing on the termination of all levels of ADR firms rather than only on certain levels of ADR firms.

# **CHAPTER3:**

Political Relations and US Institutional Ownership

# 3.1. Introduction

With globalization, foreign capital has become an important source of finance in many capital markets, and foreign investors have started allocating more of their money abroad (Leuz, Lins and Warnock (2009); Bekaert, Harvey and Lumsdaine (2002); Khorana, Servaes and Rufano (2005)). The role of foreign institutional investors has been examined by a number of previous studies. Gillan and Starks (2003) highlight the special role that institutional investors, particularly foreign institutional investors, play in prompting change in corporate governance practices worldwide. Ferreira and Matos (2008) find that foreign institutional ownership is positively associated with firm value and performance outside of the US, and Aggarwal, Ferreira and Matos (2011) find further evidence that firm-level governance is positively associated with foreign institutional investment. What influences those foreign institutional investors to put money into firms outside their countries?

So far, the existing literature considers how the number of country-level aspects where institutions invest affect the institutional ownership level. US funds targeting foreign markets invest more in firms from countries with strong governance systems (Aggarwal, Klapper and Wysocki (2005); Chan, Covrig and Ng (2005); Li, Morishirian, Pham and Zein (2006); Luez, Lins and Warnock (2009); Ferreira and Matos (2008)). In addition to the country-level aspect in terms of where institutions invest, some studies have considered the country-level aspect as it relates to where institutional investors are from. Forbes (2010) concludes that foreign investors hold a greater amount of their wealth in the US if they have a less developed financial market at home and Abdioglu, Khurshed and Stahopoulos (2013) show institutions that have similar governance as the US invest more in the US market.

Apart from how the corporate governance environment affects institutional ownership, institutional investors prefer the familiar to the unfamiliar, which is based on the familiarity argument (Chan, Covrig and Ng (2005)), since the former allows them to reduce the costs

associated with investment uncertainty and 'prudent man rule' mandates. However, no prior research has covered how dis-similarity in politics influences institutional investors. This chapter focuses on the impact of political misalignment on the level of institutional ownership. A number of previous studies have found the negative link between poor political relations and economic flow (Gupta and Yu (2007); Dajud (2013)). Gupta and Yu (2007) also find that bilateral portfolio and direct investment flows between the US and other countries decrease significantly if political relations between the countries and the US deteriorate. In this chapter, I hypothesize that poor bilateral political relations have a negative impact on US institutional ownership inside ADR firms.

Following previous studies (Dajud (2013); Gupta and Yu (2007)), I construct a measure of political proximity—bilateral political relations—based on voting data from the United Nations General Assembly collected from the US Department of State. Empirical evidence shows that patterns of UN votes are highly correlated with an alternative measure of political alignment, such as alliances and similar interests (Alesina and Weder (2002)). Following Alam (2012), I believe that such characteristics of the UNGA voting system make these votes a good candidate for depicting political alignment or misalignment for the purposes of this chapter.

Using unique ownership data from the FactSet/LionShares database, I find strong empirical evidence of a direct correlation between political proximity and the level of US institutional ownership in ADR firms. My results show that when bilateral political relations between a country and the US are poor, the level of US institutional ownership is low for ADR firms from that country. Furthermore, I also show that the number of US institutional investors is affected by political relations as well. To address the endogeneity issue, a difference-in-difference estimator is used.

To employ the difference-in-difference (DiD) estimator, I look for any abnormal shock in

the UN voting pattern of non-US countries in terms of alignment with the US vote. Specifically, I examine voting patterns in *important*<sup>16</sup> Human Rights issues. *Important* votes (defined by the US Department of State) are votes on issues that directly affect US interests and on which the US has lobbied extensively. I find that some countries had consistently voted in line with the US previously but unexpectedly cast a vote opposing the US on December 22, 2007 for *important* Human Rights issues. ADR firms from those countries with unexpected disagreement with the US are included in the treatment group. ADR firms from countries that consistently disagreed with the US previously as well as on that date are treated as control firms. I compare the level of US institutional ownership one quarter before and after the date because of the data availability. DiD results indicate that after such a political shock, the level of US institutional ownership is reduced for the treatment group and this provides additional evidence that US institutional investors react to political misalignment. Treatment groups and control groups are matched by using a propensity score.

To further mitigate the endogeneity concern, I adopt an instrumental variable approach, which provides a causal link between political proximity and the level of US institutional ownership. Following Gupta and Yu (2007), I use the proportion of tourists admitted to the US in the year (*Tourism*) as an instrumental variable which is constructed by dividing the number of tourists from each country with total number of tourists admitted to the US. 2SLS results with predicted values of *VoteDisagreeUs* and *VoteDivergeUs* are consistent with my main result and further support my argument that poor political relations lead to less US institutional ownership inside ADR firms.

<sup>&</sup>lt;sup>16</sup> Important human rights issues include "Globalization and Human Rights", "Human Rights in Iran", "Human Rights in Iraq", "Human Rights and Coercive Measures", "Human Rights in the Democratic Republic of the Congo", "Human Rights in Sudan", "Situation of Human Rights in Turkmenistan", "Human Rights in North Korea", "Situation of human rights in Myanmar " and "Human Rights in Belarus".

I also test whether US citizens' favorability toward certain countries influences US institutional ownership level and find that when Americans favor a country, US institutional ownership is higher. To measure each country's popularity among American, I use Gallup surveys. Following Hwang (2011), I construct a Country Popularity Score (CPS) by multiplying the percentage of survey participants who respond very favorably by four, mostly favorably by three, mostly unfavorably by two and very unfavorably by one; I add these four numbers into one cumulative score.

International political crises are also examined in this chapter. The data on crises are collected from the International Crisis Behavior project (ICB), which defines crises as not necessarily starting with an attack or military action; rather, it is defined as a perceived change in the probability of a threat resulting in the start or end of an international political crisis. I divide countries into regions (i.e., North America, South America, Asia, Africa, Middle East and Oceania) and determine whether regional conflict leads to less investment from US institutional investors, even though a country is not an actor in the crisis; my results show that when there is a crisis or crises in a region during the year, US institutional investors abstain from putting money into that region. However, if a country is an actor in the crisis, US institutional ownership is not affected. The last point I make with the ICB dataset is that when the US is an actor in international crises, the level of US institutional ownership inside ADR firms is higher during the year, which indicates that when the US is in a relatively unstable condition, US institutions invest outside the US.

Following previous studies like Ferreira and Matos (2008), the impact of US institutional ownership on firm value is also examined in this chapter. I find that US institutional ownership has a positive correlation with Tobin's Q. This result is consistent with previous studies, such as Ferreira and Matos (2008) and Aggarwal, Ferreira and Matos (2011), which show that foreign institutional ownership promotes better corporate governance. However,

different from previous studies, to find the causality of the impact US institutional ownership on firm value, I use my two political proximity variables as instrumental variables and perform 2SLS regression and find consistent results with OLS regression. These 2SLS regression results suggest that the level of US institutional ownership is a possible channel through which political relations may affect values of ADR firms.

As an additional test to investigate whether the level of US institutional ownership promotes better corporate governance, I also consider class action lawsuits. Previous studies find evidence indicating that when corporate governance mechanisms are not maintained, investors or shareholders decide to initiate class action litigation in the event of material misstatement or omission of fact (Agrawal, Jaffe and Karpoff (1998); Strahan (1998); Ferris, Jandik, Lawless and Makhija (2007); Gande and Lewis (2009)). For this section, I only included ADR firms that are required to follow strict SEC disclosure and GAAP compliance (Level 2 and 3 ADR firms) because not all ADR firms are required to follow full SEC disclosure and GAAP compliance.

I collect all the class action lawsuits from the Securities Class Action Clearinghouse and SEC enforcement from the SEC's Accounting and Auditing Enforcement Releases (AAER) and the SEC's litigation releases. I use a probit model and find consistent results with the previous literature by empirically showing that US institutional investors better monitor the firm so that firms with high US institutional ownership are less likely to face class action lawsuits. Since the level of US institutional ownership is influenced by political relations, I claim that political relations may affect class action lawsuits through the level of US institutional ownership with 2SLS regression where two political proximity variables are used as instrumental variables.

Following Tsang, Xie and Xin (2014), I examine the impact of foreign institutional investors on firms' voluntary disclosure practices. However, I use a different news data

source, RavenPack, which is a leading global news database which has recently been used in finance research (e.g., Kolasinski, Reed, and Ringgenberg (2013); Dai, Parwada, and Zhang (2015); Shroff, Verdi, and Yu (2014); Dang, Moshirian, and Zhang (2015)). I only keep press-release news which are related to earnings and empirically show that US institutional ownership significantly increases the frequency of press-release news related to earnings. Furthermore, I test how US institutional ownership influences the media when disseminating press-release news and find a high level of dissemination for earnings press-release news on the same day from the Down Jones Newswire for ADR firms with large US institutional ownership.

Those results indirectly support the notion that US institutional ownership promotes better corporate governance because the effective oversight of firm management by outsiders depends critically on the information available to them (Bushman and Smith 2001; Adams and Ferreira 2007; Harris and Raviv 2008; Armstroing, Guay and Weber 2010; Duchin, Matsusaka and Ozbas 2010). If US institutional investors play less role in corporate governance than domestic institutional investors, firms would not voluntarily disclose more information in the capital market because without such an act, domestic investors still have better access to information and lower cost of monitoring because of geographic proximity (Ayers, Ramalingegowda, Yeung (2014)). My overall results indicate that high level of US institutional ownership have positive impact on the information transmission from firms, which leads to better monitoring from US institutional investors – better corporate governance.

My primary contribution is to set up a new area of the literature that explores the factors that affect US institutional ownership. No previous studies have explored the impact of political proximity on institutional ownership, and I provide empirical support for the notion that political proximity has a direct impact on the level of US institutional ownership for ADR firms. I also obtain results that are consistent with previous studies by showing that high level of US institutional ownership promotes better corporate governance. Furthermore, I empirically show that political relations may affect corporate governance through the level of institutional ownership as a channel. Finally, I also explore how a region's or country's political riskiness influences US institutional investors which has not been examined previously.

This chapter is structured as follows. Section 3.2 describes data and Section 3.3 presents main results and Section 3.4 is additional results. Section 3.5 concludes the chapter 3.

### **3.2. Data**

### 3.2.1. Sample (ADR)

Karolyi (1998) gives a detailed explanation of American Depositary Receipts (ADR) and states that the ADR is the most popular vehicle through which firms outside the US cross-list their shares in the US. The ADR is a negotiable certificate issued by a US bank representing a specified number of shares in a foreign stock traded on a US exchange. ADRs provide an interesting opportunity for US investors as US investors can enjoy benefits of international diversification without going abroad and trading shares on foreign stock exchanges. Such diversification benefits from ADRs are demonstrated by Errunza, Hogan, and Hung (1999). There are four different levels of ADRs, which have different levels of accounting disclosure obligations.

Level 1 ADRs trade over-the-counter as OTC Bulletin Board or Pink Sheet issues with no capital-raising activity and require only minimal SEC disclosure and minimal GAAP compliance. In contrast, Level 2 and Level 3 ADRs are exchange-listed securities that require stricter SEC disclosure and compliance with an exchange's own listing rules. Rule 144A are capital-raising issues in which securities are privately placed to qualified institutional buyers and as a result do not require compliance with GAAP or SEC disclosure.

Following previous studies that find that cross-listed ADR firms receive wide coverage among analysts and the press (Baker, Nofsinger and Weaver, 2002; Bailey, Karolyi and Salva, 2003; Lang, Lins and Miller, 2003), I consider all levels of ADRs to observe whether political relations affect the US media when they disseminate news about foreign firms. I believe that even the ADR firms that are not cross-listed in US markets (Level 1 and 144A) still attract the US media's attention because they are intriguing investment opportunities for American investors. My sample consists of all the news for 2,309 non-US companies from 45 countries with American Depositary Receipts from January 2000 through December 2013. To construct

a sample that is not biased toward recent ADR events, I use many different data sources for my cross-listing database. Data on non-US firms listing in the US market with ADRs are obtained from the primary depository institutions: Citibank, Bank of New York, JP Morgan, and Deutsche Bank. All institutions have a part of the information, and no individual database includes all US cross-listings available. I add to this information data collected directly from the stock exchanges of non-US listings (including Canadian firms that list directly on US exchanges) from Worldscope.

### 3.2.2. Variables

### **3.2.2.1.** Political Relations

Following previous studies (Dajud (2013); Gupta and Yu (2007)), I construct a measure political proximity—bilateral political relations—based on voting data from the United Nations General Assembly collected from the US Department of State. This measure provides for each year and for each country, how many UN votes are identical to and in opposition to US votes as well as abstaining and absent votes. I define my political proximity variable—*VoteDisagreeus*—as 'the number of votes cast by a country during the year at the United Nations that are not identical to the US vote plus 0.5 times the number of abstaining votes' scaled by the total number of votes (the sum of identical votes, opposing votes, abstentions and absences for each country). Additionally, I collect another political proximity variable—*VoteDivergeus*—which measures the UN vote dissimilarity (-1 of correlation—s3un) from Erick Voeten Dataverse<sup>17</sup>. Voeten's (2009) data capture UN General Assembly voting coincidence between the US and its trading partners, thus aiming to capture the degree of political alignment between the two. It is available up to the year 2012.

Some previous studies in politics note that the United Nations does not give a perfect image

<sup>&</sup>lt;sup>17</sup> https://dataverse.harvard.edu/dataset.xhtml?persistentId=hdl:1902.1/12379

of broader international politics and that UN votes are often considered fairly irrelevant from the perspective of international politics (Russett (1966); Alesina and Weder (2002)). However, UNGA is the only international arena where we can observe its more than 150 members vote on a variety issues of global concern (Russett (1966); Voeten (2009)) and there is empirical evidence showing that patterns of UN votes are highly correlated with alternative measure of political alignment, such as alliances and similarity of interests (Alesina and Weder (2002)). Alam (2012) find such voting patterns across a range of issues can be a useful gauge of the general political orientations of UN member states, and observing voting alignments over time can help pinpoint changes in the political orientation. I believe that such characteristics of the UNGA voting system make these votes a good candidate for depicting political alignment or misalignment for the purposes of this chapter.

### 3.2.2.2. Institutional Ownership

The stock holdings data are drawn from the FactSet/LionShares database, which is a leading information source for global institution ownership. Institutions which are defined as professional money managers with discretionary control over assets (such as mutual funds, pension funds, bank trusts, and insurance companies) are frequently required to disclose publicly their holdings. Additionally, the FactSet/LionShares provides a variable indicating where the institutional investors are from and I use it to distinguish only US institutional ownership for this chapter.

I use historical filing of the FactSet/LionShares database from January 2000 through December 2013 and I consider only American Depositary Receipts (ADR) firms because ADR firms attract US institutional investors (Ferreira and Matos (2008)). I combine FactSet/ LionShares data with the ADR lists by using ISIN codes for non-US firms. To handle the issue of different reporting frequency by institutions, I only use the latest holdings of US institutions at each year-end following Ferreira and Matos (2008).

### 3.2.3. Controls

I acquire financial information on firms from Datastream. I winsorize all firm-level control variables at the bottom and top 1% levels. Following Ferreira and Matos (2008), firm level controls include size of firm (*SIZE*), log of book to market ratio (*BM*), investment opportunities (*INVOP*), dividend yield (*DY*), return on equity (*ROE*), leverage (*LEV*), cash (*CASH*), closely held shares (*CLOSE*) and foreign sales (*FXSALES*). Country-level control variables include corporate governance level collected from Kaufmann, Kraay and Mastruzzi (2007) (*KAUFMANN*), GDP growth (*GDP\_GRWOTH*), GDP per capita (*GDP\_CAPITA*) and market capitalization to GDP (*MCAP\_GDP*). Detailed construction of the control variables can be found in the appendix of the chapter and the summary statistics of firm level controls, country level controls, political proximity measure and institutional ownership are provided in Table 3-1.

	Ν	Mean	SD	P1	P25	P50	P75	P99
IO_US	11,511	7.096	8.735	0.007	1.177	3.869	9.477	43.480
<i>VoteDisagree</i> <sub>US</sub>	484	0.552	0.167	0.120	0.437	0.553	0.654	0.909
VoteDiverge <sub>US</sub>	447	0.183	0.315	-0.746	-0.015	0.153	0.470	0.714
SIZE	11,511	16.247	2.710	10.314	14.480	15.976	17.919	23.103
BM	11,511	0.452	0.864	-2.185	-0.037	0.470	1.005	2.610
INVOP	11,511	0.129	0.298	-0.363	-0.001	0.071	0.176	2.050
RET	11,511	0.105	0.414	-0.656	-0.146	0.055	0.282	1.803
TURN	11,511	0.864	0.957	0.000	0.180	0.611	1.193	5.482
DY	11,511	2.451	2.504	0.000	0.640	1.840	3.500	12.920
ROE	11,511	9.845	23.143	-90.350	3.870	10.810	18.860	83.650
LEV	11,511	0.250	0.169	0.000	0.118	0.241	0.362	0.677
CASH	11,511	0.142	0.137	0.002	0.052	0.101	0.182	0.707
CLOSE	11,511	34.198	25.469	0.010	12.210	30.900	54.710	94.000
KAUFMANN	484	0.763	0.799	-0.743	-0.029	0.857	1.525	1.912
GDP_GROWTH	484	3.218	3.343	-6.800	1.440	3.300	5.125	10.600
GDP_CAPITA	484	9.643	1.163	6.721	8.828	9.990	10.565	11.542
MCAP_GDP	484	75.470	58.347	11.738	34.575	58.482	97.589	276.601

# Table 3- 1: Summary Statistics

## **3.3.** Results

The section is constructed into two subsections. In the first sub-section, results for regressions of the level of US institutional ownership with my two political proximity variables are shown. To address the endogeneity issue, the difference-in-difference method and instrumental variable approaches are used. Endogeneity analysis results are in the second sub-section of this section.

### **3.3.1. Baseline Findings**

To investigate whether political proximity influences the level of US institutional ownership inside ADR firms, I use following equation:

$$IO_US_{i,c,t} = \alpha + \beta_1 PP_{c,t} + \beta_2 X_{i,t} + \beta_3 Y_{c,t} + \Phi_c + \theta_t + \varepsilon_{i,c,t}$$

where the indices i, c and t correspond to firm, country and time, respectively.  $\Phi_c$  and  $\theta_t$  represent country- and year fixed-effects, and  $\varepsilon_{i,c,t}$  represents a firm-time specific error term, which is assumed be correlated within the country-year and is heteroskedastic. As such, all standard errors and test statistics are robust to these two departures from the classical regression model (Petersen (2009)) and clustered at country-year level.  $PP_{c,t}$  represents a political proximity variable, while  $X_{i,t}$  represents firm-specific characteristics, including size of firm (*SIZE*), log of book to market ratio (*BM*), investment opportunities (*INVOP*), annual stock return (*RET*), turnover (*TURN*), dividend yield (*DY*), return on equity (*ROE*), leverage (*LEV*), cash (*CASH*) and closely held shares (*CLOSE*).  $Y_{c,t}$  includes country-level control variables; the corporate governance level collected from Kaufmann, Kraay and Mastruzzi (2007) (*KAUFMANN*), GDP growth (*GDP\_GRWOTH*), GDP per capita (*GDP\_CAPITA*) and market capitalization to GDP (*MCAP\_GDP*).

I test two different measures of political proximity. *VoteDisagree*<sub>US</sub> is 'the number of votes cast by a country during the year at the United Nations that are not identical to the US vote plus 0.5 times the number of abstained votes' scaled by total number of UN votes in that year

and *VoteDivergeus* is the UN vote dissimilarity (-1 of correlation—s3un) collected from "The Affinity of Nations" database<sup>18</sup>. I show both *VoteDisagreeus* and *VoteDivergeus* have a negative and statistically significant coefficient with my dependent variable—*IO\_US* in Table 3-2. *IO\_US* is the portion of ownership held by US institutional investors inside ADR firms. Table 3-2 provides evidence that poor political relations negatively affect the level of US institutional ownership for ADR firms. This finding adds to the previous studies by showing that bilateral political relations are also a factor that influences ownership level of foreign institutional investors.

<sup>&</sup>lt;sup>18</sup> s3un: Dyadic affinity score using 3 category vote data (Values for the Affinity index using 3 category vote data (1 = "yes" or approval for an issue; 2 = abstain, 3 = "no" or disapproval for an issue). Values for the Affinity data range from -1 (least similar interests) to 1 (most similar interests). The Affinity data are coded with the "S" indicator ("S" is calculated as <math>1 - 2\*(d)/dmax, where d is the sum of metric distances between votes by dyad members in a given year and dmax is the largest possible metric distance for those vote – source: The Affinity of Nations database.

#### Table 3-2: Main Results

In this table, I present regressions of political proximity variables on the level of US institutional ownership (*IO\_US*). Political relations are proxied as the ratio of opposing UN votes to US from a country (*VoteDisagreeus*) and dissimilarity in UN voting between a country and US (*VoteDivergeus*). Firm level control variables are size of firm (*SIZE*), log of book to market ratio (*BM*), investment opportunities (*INVOP*), annual stock return (*RET*), turnover (*TURN*), dividend yield (*DY*), return on equity (*ROE*), leverage (*LEV*), cash (*CASH*) and closely held shares (*CLOSE*). Country level control variables include corporate governance level collected from Kaufmann, Kraay and Mastruzzi (2007) (*KAUFMANN*), GDP growth (*GDP\_GRWOTH*), GDP per capita (*GDP\_CAPITA*) and market capitalization to GDP (*MCAP\_GDP*). The values of the t-statistics in parentheses are based on robust standard errors clustered at the country year level.

	(1)	(2)
	IO_US	IO_US
VoteDisagree <sub>US</sub>	-8.576	
	(-3.78)	
VoteDivergeus		-3.867
		(-3.02)
SIZE	0.356	0.351
	(5.28)	(4.83)
BM	0.594	0.641
	(5.24)	(5.27)
INVOP	-0.745	-0.715
	(-2.47)	(-2.18)
RET	-0.732	-0.696
	(-3.24)	(-2.87)
TURN	2.171	2.155
	(10.92)	(10.08)
DY	-0.218	-0.216
	(-3.74)	(-3.56)
ROE	0.017	0.015
	(4.43)	(3.90)
LEV	-2.244	-2.184
	(-4.09)	(-3.76)
CASH	3.125	3.257
	(4.16)	(4.01)
CLOSE	-0.045	-0.042
	(-9.52)	(-8.25)
KAUFMANN	-2.677	-2.127
	(-3.01)	(-2.31)
GDP_GROWTH	-0.060	-0.076
	(-1.58)	(-1.99)
GDP_CAPITA	0.123	0.926
	(0.24)	(1.68)
MCAP_GDP	-0.012	-0.011
	(-3.64)	(-3.06)
CONSTANT	5.025	-7.323
	(1.02)	(-1.40)
Year Fixed Effect	Yes	Yes
Country Fixed Effect	Yes	Yes
Observations	11 511	10 180
R-squared	0.353	0.351

### **3.3.2.** Endogeneity Tests

### **3.3.2.1.** Difference-in-Difference

To further investigate whether political proximity influences the level of US institutional ownership, I employ the difference-in-difference (DiD) estimator to estimate the differences in US institutional ownership between firms from countries with a political shock in relations with the US and firms from countries without any political shock. To perform such a test, I look for an abnormal voting pattern from any country, i.e., any voting not consistent with previous voting, and I observe abnormality in *important* Human Right issues<sup>19</sup>. *Important* votes (defined by the US Department of State) are votes on issues that directly affect US interests and on which the US lobbied extensively.

Important votes in human rights are examined from 2000; 20 countries that had consistently voted in line with the US for important human rights issues unexpectedly voted against the US for "Report of the Human Rights Council" (Res/62/219) on December 22, 2007. Those countries are Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Portugal, Spain, Sweden Switzerland and the United Kingdom. ADR firms from these countries are in the treatment group, while the control group includes firms from 11 countries—China, Egypt, India, Indonesia, Malaysia, Pakistan, Philippines, Russia, Singapore, South Africa and Thailand—that had consistently voted against the US most of the time or consistently voted against the US all of the time regarding important human rights issues before December 22, 2007. On this date, the US voted "No" to Report of the Human Rights Council (Res/62/219), claiming "the Council's relentless focus during the year on a

<sup>&</sup>lt;sup>19</sup> Important human rights issues include "Globalization and Human Rights", "Human Rights in Iran", "Human Rights in Iraq", "Human Rights and Coercive Measures", "Human Rights in the Democratic Republic of the Congo", "Human Rights in Sudan", "Situation of Human Rights in Turkmenistan", "Human Rights in North Korea", "Situation of Human Rights in Myanmar " and "Human Rights in Belarus".

single country—Israel" while 150 countries voted in favor.

I compare the level of US institutional ownership one quarter prior to the event date— December 22, 2007, and one quarter following the event date. Even though I believe the impact of accidental deviation of voting pattern on institutional ownership is temporary, the data from FactSet/LionShares database is available quarterly. Therefore, I compare one quarter before and after the natural event date because they are the observations which are closest to the event date. I use following regression to do difference-in-difference analysis.

$$IO_US_{i,c,t} = \alpha + \beta_1 p_t \times d_i + \beta_2 p_t + \beta_3 d_i + \beta_4 X_{i,t} + \beta_5 Y_{c,t} + \varepsilon_{i,c,t}$$

where the indices i, c and t correspond to firm, country and time (pre or post period), respectively.  $\varepsilon_{i,c,t}$  represents the error term that is assumed to be correlated within the country and heteroskedastic. As such, all standard errors and test statistics are robust to these two departures from the classical regression model (Petersen (2009)) and clustered at the country level.  $p_t$  is a dummy variable equal to 1 for the days two weeks after December 22, 2007 inclusive, and 0 otherwise.  $d_i$  equals 1 for the treatment group and 0 for the control group.  $X_{i,t}$  represents firm-specific characteristics including, size of firm (*SIZE*), log of book to market ratio (*BM*), investment opportunities (*INVOP*), annual stock return (*RET*), turnover (*TURN*), dividend yield (*DY*), return on equity (*ROE*), leverage (*LEV*), cash (*CASH*) and closely held shares (*CLOSE*).  $Y_{c,t}$  includes country-level control variables; the corporate governance level collected from Kaufmann, Kraay and Mastruzzi (2007) (*KAUFMANN*), GDP growth (*GDP\_GRWOTH*), GDP per capita (*GDP\_CAPITA*) and market capitalization to GDP (*MCAP\_GDP*).

Before the regression, treatment groups and control groups are matched using propensity score with following control variables: size of firm (*SIZE*), log of book to market ratio (*BM*), investment opportunities (*INVOP*), dividend yield (*DY*), return on equity (*ROE*), closely held shares (*CLOSE*), corporate governance level collected from Kaufmann, Kraay and Mastruzzi

(2007) (*KAUFMANN*), GDP growth (*GDP\_GRWOTH*), GDP per capita (*GDP\_CAPITA*) and market capitalization to GDP (*MCAP\_GDP*).  $\beta_1$  indicates differences in the level of US institutional ownership change between the treatment group and the control group after the political shock date. Table 3-3 shows that  $\beta_1$  is statistically negative and statistically significant which indicates that US institutional investors react to such political shock and reduce their ownership inside ADR firms from countries that have temporary deterioration in political relations with the US.

#### Table 3- 3: Difference-in-Difference

In this table, I examine a natural experiment—change in voting patterns—and show how the US institutional ownership inside ADR firms change after the date of experiment ( $22^{nd}$  December 2007) for the treatment firms relative to the control firms. *p* equals 1 if the period is one quarter after  $22^{nd}$  December 2007, and 0 if the period is one quarter before  $22^{nd}$  December 2007. *d* equals one if the firms are included into the treatment group, and 0 if it is in the control group. Firm level control variables are size of firm (*SIZE*), log of book to market ratio (*BM*), investment opportunities (*INVOP*), annual stock return (*RET*), turnover (*TURN*), dividend yield (*DY*), return on equity (*ROE*), leverage (*LEV*), cash (CASH) and closely held shares (CLOSE). Country level control variables include corporate governance level collected from Kaufmann, Kraay and Mastruzzi (2007) (*KAUFMANN*), GDP growth (*GDP\_GRWOTH*), GDP per capita (*GDP\_CAPITA*) and market capitalization to GDP (*MCAP\_GDP*). The values of the t-statistics in parentheses are based on robust standard errors clustered at the country level.

	(1)
VARIABLES	IO_US
p * d	-0.814
	(-5.18)
p	1.092
	(19.45)
d	-12.819
	(-5.91)
SIZE	0.190
	(1.16)
BM	-1.913
	(-0.81)
INVOP	15.508
	(2.07)
RET	7.715
	(2.53)
TURN	3.717
	(3.43)
DY	-1.772
	(-1.44)
ROE	-0.067
	(-2.53)
LEV	-3.989
	(-1.07)
CASH	7.147
	(2.37)
CLOSE	-0.137
	(-2.79)
KAUFMANN	10.796
	(1.52)
GDP_GROWTH	0.285
	(0.27)
GDP_CAPITA	-2.864
	(-0.52)
MCAP_GDP	-0.034
	(-1.36)
CONSTANT	39.301
	(0.80)
Observations	1 404
Observations	1,484
K-squared	0.550

### **3.3.2.2.** Instrumental Variable

Although my findings in the main section of this chapter are robust to the omitted or unobservable variables by having fixed effect, the results may still suffer from endogeneity. Specifically, a potential problem is that my proxies for political proximity may be determined simultaneously with the level of US institutional ownership which would bias my results. As a robustness check, I use the instrumental variable approach to address this concern.

Following Gupta and Yu (2007), I use the proportion of tourists admitted to US in the year (*Tourism*) as an instrumental variable that is constructed by dividing the number of tourists from each country with the total number of tourists admitted to US. It is collected from Table 26 of Yearbook of Immigration Statistics, Office of Immigration Statistics, US Department of Homeland Security. Tourists are distinguished into countries according to their citizenship status. I believe the number of tourists admitted to US is a good instrument for this chapter because it is unlikely to be correlated with US institutional ownership and because it represents political relation between two countries – this can be shown from the recent case of "Brexit"; United Kingdom (UK) left the EU and it brought to an end the freedom of movement for UK citizens around Europe and Europeans around the UK. Immigration could be a good instrument variable too (Gupta and Yu (2007)) but I do not use it in this chapter since I strongly believe that immigration represents more of individuals rather than the politics.

Column (1) of Table 3-4, Panel A shows the first stage of two-stage regressions with *Tourism* as an instrumental variable. *Tourism* is negatively correlated with *VoteDisagreeus* indicating that when the proportion of the tourist from a country is high during the year, that country disagrees less with US vote. Second stage is shown in Column (2) of Table 3-4, Panel A and even with the predicted value of *VoteDisagreeus*, the coefficient is statistically significant and consistent with that of my main result in Table 3-2. Table 3-4, Panel B shows

results of first- and second-stage regressions for *VoteDiverge*<sub>US</sub> and the coefficient of the predicted value of *VoteDiverge*<sub>US</sub> is also statistically significant and consistent with that of my main result.

### Table 3- 4: Instrumental Variable Approach

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In this table, I present 2SLS regressions of political proximity variables on the level of US institutional ownership (*IO\_US*). Political relations are proxied as the ratio of opposing UN votes to US from a country (*VoteDisagreeus*) and dissimilarity in UN voting between a country and US (*VoteDivergeus*). An instrumental variable is the proportion of tourists from each country admitted to US (*Tourism*). Firm level control variables are size of firm (*SIZE*), log of book to market ratio (*BM*), investment opportunities (*INVOP*), annual stock return (*RET*), turnover (*TURN*), dividend yield (*DY*), return on equity (*ROE*), leverage (*LEV*), cash (CASH) and closely held shares (CLOSE). Country level control variables include corporate governance level collected from Kaufmann, Kraay and Mastruzzi (2007) (*KAUFMANN*), GDP growth (*GDP\_GRWOTH*), GDP per capita (*GDP\_CAPITA*) and market capitalization to GDP (*MCAP\_GDP*). The values of the t-statistics in parentheses are based on robust standard errors clustered at the country year level.

Panel A	(1)	(2)
	VoteDisagree <sub>US</sub>	IO_US
Tourism	-0.804	
	(-4.26)	
VoteDisagree <sub>US</sub> _hat		-13.330
		(-2.41)
SIZE	0.001	0.358
	(2.58)	(5.35)
BM	-0.001	0.586
	(-1.74)	(5.19)
INVOP	-0.000	-0.744
	(-0.08)	(-2.49)
RET	0.002	-0.720
	(0.83)	(-3.24)
TURN	0.000	2.175
	(1.49)	(10.98)
DY	0.000	-0.217
	(0.05)	(-3.77)
ROE	0.000	0.017
	(1.23)	(4.48)
LEV	0.002	-2.228
	(1.06)	(-4.09)
CASH	0.007	3.173
~~~~	(2.31)	(4.21)
CLOSE	0.000	-0.045
	(1.03)	(-9.56)
KAUFMANN	-0.026	-2.557
	(-1.05)	(-2.91)
GDP_GROWIH	0.000	-0.059
	(0.33)	(-1.52)
GDP_CAPITA	0.033	0.149
	(2.70)	(0.29)
MCAP_GDP	0.000	-0.012
	(0.74)	(-3.51)
Year Fixed Effect	Yes	Yes
Country Fixed Effect	Yes	Yes
Observations	11,511	11,511
R-squared	0.961	0.348

Panel B	(1)	(2)
	VoteDiverge <sub>US</sub>	IO_US
Tourism	-1.319	
	(-2.38)	
VoteDiverge <sub>US</sub> _hat		-7.548
		(-2.12)
SIZE	0.000	0.352
	(0.77)	(4.87)
BM	-0.001	0.633
	(-0.83)	(5.24)
INVOP	-0.001	-0.719
	(-0.31)	(-2.22)
RET	0.002	-0.688
	(0.36)	(-2.83)
TURN	0.001	2.162
	(1.75)	(10.19)
DY	0.000	-0.215
	(0.17)	(-3.58)
ROE	0.000	0.015
	(1.68)	(4.02)
LEV	-0.001	-2.182
	(-0.24)	(-3.76)
CASH	0.002	3.283
	(0.35)	(4.05)
CLOSE	-0.000	-0.042
	(-1.28)	(-8.34)
KAUFMANN	-0.073	-2.098
	(-1.23)	(-2.31)
GDP_GROWTH	-0.001	-0.080
	(-0.39)	(-1.99)
GDP_CAPITA	0.116	1.190
	(3.32)	(2.00)
MCAP_GDP	0.000	-0.010
	(1.99)	(-2.67)
Year Fixed Effect	Yes	Yes
Country Fixed Effect	Yes	Yes
Observations	10,180	10,180
R-squared	0.963	0.346

# **3.4.** Additional tests

### 3.4.1. Country Popularity Score

Apart from the government level of proximity, I also test how US citizens' views of a country affect institutional ownership. To measure each country's popularity among Americans, I use Gallup surveys. Following Hwang (2011), I construct a Country Popularity Score (*CPS*) by multiplying the percentage of survey participants who respond very favorably by four, mostly favorably by three, mostly unfavorably by two and very unfavorably by one; I add these four numbers into one cumulative score. Table 3-5 shows that when the country is favored by US citizens, the level of US institutional ownership is high for ADR firms from that country.

### Table 3- 5: Country Popularity Score

In this table, I present regressions of country popularity score on the level of US institutional ownership (*IO\_US*). Firm level control variables are size of firm (*SIZE*), log of book to market ratio (*BM*), investment opportunities (*INVOP*), annual stock return (*RET*), turnover (*TURN*), dividend yield (*DY*), return on equity (*ROE*), leverage (*LEV*), cash (CASH) and closely held shares (CLOSE). Country level control variables include corporate governance level collected from Kaufmann, Kraay and Mastruzzi (2007) (*KAUFMANN*), GDP growth (*GDP\_GRWOTH*), GDP per capita (*GDP\_CAPITA*) and market capitalization to GDP (*MCAP\_GDP*). The values of the t-statistics in parentheses are based on robust standard errors clustered at the country year level.

Panel A	(1)		
	IO_US		
CPS	2.612		
	(3.28)		
SIZE	0.523		
	(5.23)		
BM	0.556		
	(2.89)		
INVOP	-1.808		
	(-3.82)		
RET	-1.087		
	(-2.93)		
TURN	2.199		
	(7.48)		
DY	-0.496		
	(-4.26)		
ROE	0.022		
	(3.54)		
LEV	-4.041		
	(-4.70)		
CASH	4.746		
	(4.10)		
CLOSE	-0.053		
	(-6.03)		
KAUFMANN	-9.912		
	(-5.36)		
GDP_GROWTH	0.005		
	(0.09)		
GDP_CAPITA	0.328		
	(0.48)		
MCAP_GDP	-0.006		
	(-0.88)		
CONSTANT	2.901		
	(0.33)		
Year Fixed Effect	Yes		
Country Fixed Effect	Yes		
Observations	5 693		
R-squared	0 394		

#### **3.4.2.** International Crisis

Apart from bilateral political relations, in this section I examine how the international political crises during 2000 – 2013 (collected from the ICB database) affect US institutional ownership. Berkamn, Jacobsen and Lee (2011) find that international political crises have an impact on both the mean and volatility of world stock market returns. I divide countries into their regions (i.e., North America, South America, Asia, Africa, Middle East and Oceania) and determine whether a regional conflict leads to less investment from US institutional investors, even though a country is not an actor in the crisis. *Crisis\_Region* equals one if there is a crisis or crises in the region for the year and 0 otherwise. Column (1) of Table 3-6 shows that regional political crises (*Crisis\_Region*) have a strong impact on where US institutional investors put money. The coefficient for *Crisis\_Region* indicates that when there is a crisis or crises in a region, US institutional investors refrain from putting money into that region.

I also test country-level crisis by considering actors in the international crisis. Column (2) shows results for the level of US institutional ownership when a country is an actor of the crisis. *Crisis\_Country* equals one if the country is an actor of the crisis for the year and 0 otherwise. The result shows that the coefficient is statistically insignificant, suggesting that US institutions' reaction to a country's internal instability does not only affect the invest strategy in that country but also its neighborhood countries. For example, in the international crisis data set, I have two extremely appalling incidents that involve North and South Korea in year 2006 – Cheon-an Sinking and Yeun-pyeung Island Attack. Both incidents started from the physical attack from North Korea to South Korea and in such cases US institutional investors will surely change their investment strategy in South Korea as well as in Japan and China. Therefore, as Column (2) indicates, the portion of US institutional ownership in South Korea and other countries would not differ because a country's crisis does not affect only one country but also its neighbor because which is shown in Column (1).
*Crisis\_US* equals one if the US is an actor in the crisis for the year and 0 otherwise. Column (3) shows that *Crisis\_US* has positive and statistically significant correlation with the level of US institutional investment in ADR firms. This suggests that US institutions tend to invest outside the US when the US is relatively unstable during the year compared to other years.

## **Table 3- 6: International Political Risks**

In this table, I present regressions of international crisis dummy variables on the level of US institutional ownership (IO\_US). Crisis\_Region equals one if there is a crisis or crises in the region for the year and 0 otherwise. Crisis\_Country equals one if the country is an actor of the crisis for the year and 0 otherwise. Crisis\_US is a dummy that equals one if the US is involved in any crisis during the year. Firm level control variables are size of firm (SIZE), log of book to market ratio (BM), investment opportunities (INVOP), annual stock return (RET), turnover (TURN), dividend yield (DY), return on equity (ROE), leverage (LEV), cash (CASH) and closely held shares (CLOSE). Country level control variables include corporate governance level collected from Kaufmann, Kraay and Mastruzzi (2007) (KAUFMANN), GDP growth (GDP\_GRWOTH), GDP per capita (GDP\_CAPITA) and market capitalization to GDP (MCAP\_GDP). The values of the t-statistics in parentheses are based on robust standard errors clustered at the country year level.

	(1)	(2)	(3)
	IO_US	IO_US	IO_US
Crisis_Region	-0.490		
	(-2.18)		
Crisis_Country		-0.183	
		(-0.65)	
Crisis_US			3.873
			(5.53)
SIZE	0.383	0.382	0.381
	(6.29)	(6.28)	(6.26)
BM	0.628	0.631	0.630
	(6.11)	(6.15)	(6.14)
INVOP	-0.805	-0.797	-0.796
	(-3.09)	(-3.06)	(-3.05)
RET	-0.836	-0.842	-0.845
	(-4.11)	(-4.14)	(-4.17)
TURN	2.093	2.088	2.088
	(11.05)	(11.03)	(11.03)
DY	-0.208	-0.207	-0.207
	(-3.98)	(-3.98)	(-3.96)
ROE	0.015	0.015	0.015
	(4.23)	(4.23)	(4.23)
LEV	-2.345	-2.358	-2.361
	(-4.65)	(-4.66)	(-4.67)
CASH	2.412	2.396	2.395
	(3.57)	(3.55)	(3.55)
CLOSE	-0.048	-0.048	-0.048
	(-10.37)	(-10.34)	(-10.34)
KAUFMANN	-2.360	-2.743	-2.785
	(-2.63)	(-3.13)	(-3.21)
GDP GROWTH	-0.085	-0.082	-0.080
—	(-2.46)	(-2.36)	(-2.30)
GDP CAPITA	0.006	-0.111	-0.111
—	(0.01)	(-0.22)	(-0.22)
MCAP GDP	0.000	-0.000	0.000
_	(0.76)	(-0.05)	(0.02)
CONSTANT	0.834	2.416	2.462
	(0.18)	(0.51)	(0.52)
Year Fixed Effect	Yes	Yes	Yes
Country Fixed Effect	Yes	Yes	Yes
Observations	12.993	12.993	12.993
R-squared	0.343	0.343	0.343

## **3.4.3.** Lagged Political Proximity Variables

To show the subsequent effect of political relations on the level of US institutional ownership inside ADR firms, I take one-year lagged values of my political proximity measures—*VoteDisagree*<sub>US</sub> and *VoteDiverge*<sub>US</sub>. Table 3-7 shows that the previous years' poor political relation proxy variables have a negative and statistically significant coefficient with the level of US institutional ownership. This suggests that if a country had poor political relation with the US in the year before, ADR firms from that country still have low level of US institutional ownership in the year. The subsequent effect could be driven by the nature of some US institutional investors—long-term investors. Once their ownership is influenced by political relations, it will persist for some time.

## **Table 3-7: Lagged Political Proximity Variables**

In this table, I present regressions of one year lagged political proximity variables on the level of US institutional ownership (*IO\_US*). Political relations are proxied as the ratio of opposing UN votes to US from a country (*VoteDisagreeus*) and dissimilarity in UN voting between a country and US (*VoteDivergeus*). Firm level control variables are size of firm (*SIZE*), log of book to market ratio (*BM*), investment opportunities (*INVOP*), annual stock return (*RET*), turnover (*TURN*), dividend yield (*DY*), return on equity (*ROE*), leverage (*LEV*), cash (CASH) and closely held shares (CLOSE). Country level control variables include corporate governance level collected from Kaufmann, Kraay and Mastruzzi (2007) (*KAUFMANN*), GDP growth (*GDP\_GRWOTH*), GDP per capita (*GDP\_CAPITA*) and market capitalization to GDP (*MCAP\_GDP*). The values of the t-statistics in parentheses are based on robust standard errors clustered at the country year level.

	(1)	(2)
	IO_US	IO_US
W . Dr. I		
VoteDisagreeus_lag	-7.160	
	(-3.19)	
VoteDivergeus_lag		-2.917
		(-2.51)
SIZE	0.332	0.330
	(4.66)	(4.63)
BM	0.560	0.566
	(4.65)	(4.70)
INVOP	-0.690	
		-0.697
DET	(-1.99)	(-2.01)
RET	-0.813	-0.820
	(-3.31)	(-3.32)
TURN	2.243	2.245
D.V.	(10.93)	(10.92)
DY	-0.230	-0.231
	(-3.53)	(-3.56)
ROE	0.017	0.018
	(4.02)	(4.01)
LEV	-2.681	-2.694
	(-4.53)	(-4.53)
CASH	3.416	3.407
	(4.17)	(4.17)
CLOSE	-0.045	-0.045
	(-8.77)	(-8.73)
KAUFMANN	-2.426	-2.379
	(-2.34)	(-2.31)
GDP_GROWTH	-0.036	-0.050
	(-1.00)	(-1.39)
GDP_CAPITA	0.085	0.217
	(0.17)	(0.43)
MCAP_GDP	-0.010	-0.010
	(-2.90)	(-2.66)
CONSTANT	5.422	0.557
	(1.09)	(0.11)
Year Fixed Effect	Yes	Yes
Country Fixed Effect	Yes	Yes
Observations	10,055	10,045
R-squared	0.361	0.361

## **3.4.4.** Number of Institutional Investors

Rather than looking at the level of US institutional ownership, this section examines if the actual number of US institutional investors is smaller for the ADR firms because their home countries have poor political relations with the US. I count the number of US institutional investors at the end of each year—*NUMBER\_IO*. Table 3-8 shows negative correlation between the number of US institutional investors and my two political proximity variables. This indicates that the political relation not only affect the level of US institutional ownership inside ADR firms but also the number of US institutional investors. This result supports my main result—US institutional investors refrain from investing into ADR firms from countries that have poor political relations with the US.

## **Table 3-8: Number of Institutional Investors**

In this table, I present regressions of political proximity variables on the total number of US institutional investors (*NUMBER\_IO*). Political relations are proxied as the ratio of opposing UN votes to US from a country (*VoteDisagreeus*) and dissimilarity in UN voting between a country and US (*VoteDivergeus*). Firm level control variables are size of firm (*SIZE*), log of book to market ratio (*BM*), investment opportunities (*INVOP*), annual stock return (*RET*), turnover (*TURN*), dividend yield (*DY*), return on equity (*ROE*), leverage (*LEV*), cash (CASH) and closely held shares (CLOSE). Country level control variables include corporate governance level collected from Kaufmann, Kraay and Mastruzzi (2007) (*KAUFMANN*), GDP growth (*GDP\_GRWOTH*), GDP per capita (*GDP\_CAPITA*) and market capitalization to GDP (*MCAP\_GDP*). The values of the t-statistics in parentheses are based on robust standard errors clustered at the country year level.

	(1)	(2)
	NUMBER_IO_US	NUMBER_IO_US
$VoteDisagree_{US}$	-66.104	
	(-4.30)	
VoteDiverge <sub>US</sub>		-44.379
		(-7.06)
SIZE	10.054	9.767
	(14.27)	(13.73)
BM	1.403	1.859
	(2.69)	(3.29)
INVOP	-2.661	-2.437
	(-2.43)	(-2.04)
RET	-5.740	-5.309
	(-5.22)	(-4.55)
TURN	3.871	3.987
	(4.29)	(4.12)
DY	-0.275	-0.385
	(-1.77)	(-2.30)
ROE	0.067	0.072
	(3.74)	(3.81)
LEV	-16.707	-19.253
	(-7.25)	(-8.25)
CASH	-14.211	-14.680
	(-4.33)	(-4.09)
CLOSE	-0.243	-0.238
	(-10.77)	(-9.81)
KAUFMANN	-0.360	-1.011
	(-0.08)	(-0.22)
GDP_GROWTH	-0.103	-0.228
	(-0.69)	(-1.46)
GDP_CAPITA	-6.445	-2.096
	(-3.24)	(-1.11)
MCAP_GDP	-0.082	-0.072
	(-4.57)	(-3.64)
CONSTANT	-6.183	-64.875
	(-0.31)	(-3.61)
Year Fixed Effect	Yes	Yes
Country Fixed Effect	Yes	Yes
Observations	11,511	10,180
R-squared	0.365	0.362

# **3.5.** Corporate Governance

## 3.5.1. Impact on Firm Value

Following Ferreira and Matos (2008), I also check whether the level of US institutional investors affect firm value. I adopt Tobin's Q as a measure of firm value, which is calculated as the book value of total assets plus the market value of equity minus the book value of equity divided by total assets (Gompers, Ishii, and Metrick (2003); Doidge, Karolyi, and Stulz (2004)). I estimate regressions of ADR firms' Tobin's Q on variables associated with firm value such as size (*SIZE*), growth opportunities (*INVOP*), return (*RET*), leverage (*LEV*), cash holdings (*CASH*) and country controls following Ferreira and Matos (2008). Table 3-9, Panel A presents estimates of the regression and the level of US institutional ownership (*IO\_US*) has a positive correlation with Tobin's Q (Q). This is consistent with previous studies (Ferreira and Matos (2008); McConnell and Servaes (1990)), which find that foreign institutional ownership promotes better corporate governance.

To find the causality of the impact US institutional ownership on firm value, I use my two political proximity variables as instrumental variables and perform 2SLS regressions. Columns (1) and (3) of Table 3-9, Panel B show the first stage of two-stage regressions, which are just the same regressions as those from section 3.3.1. Columns (2) and (4) show results with predicted values of the level of US institutional ownership (*IO\_US*) and the coefficients for the predicted values of *IO\_US* are statistically significant and consistent with that of Table 3-9, Panel A. These 2SLS regression results suggest that the level of US institutional ownership is a possible channel through which political relations may affect values of ADR firms.

## Table 3- 9: Firm Value

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In Panel A of this table, I present regressions of US institutional ownership (*IO\_US*) on firm value (Tobin's *Q*). Panel B shows 2SLS regression results with the ratio of opposing UN votes to US from a country (*VoteDisagreeus*) and dissimilarity in UN voting between a country and US (*VoteDivergeus*) as instrumental variables. Firm level control variables are size of firm (*SIZE*), investment opportunities (*INVOP*), leverage (*LEV*) and cash (*CASH*). Country level control variables include corporate governance level collected from Kaufmann, Kraay and Mastruzzi (2007) (*KAUFMANN*), GDP growth (*GDP\_GRWOTH*), GDP per capita (*GDP\_CAPITA*) and market capitalization to GDP (*MCAP\_GDP*). The values of the t-statistics in parentheses are based on robust standard errors clustered at the country year level.

Panel A	(1)
	Q
IO US	0.002
—	(3.66)
SIZE	0.047
	(13.93)
INVOP	0.119
	(6.92)
RET	0.258
	(14.69)
LEV	-0.098
	(-2.64)
CASH	0.975
	(21.13)
KAUFMANN	-0.003
	(-0.06)
GDP_GROWTH	-0.004
	(-1.56)
GDP_CAPITA	0.212
	(6.19)
MCAP_GDP	0.001
	(3.93)
CONSTANT	-2.799
	(-9.14)
Year Fixed Effect	Yes
Country Fixed Effect	Yes
Observations	11,511
R-squared	0 399

Panel B	Instrument=V	oteDisagreeUS	Instrument=V	oteDivergeUS
Dep. Variable	IO_US	Q	IO_US	Q
	Model	Model	Model	Model
	(1)	(2)	(3)	(4)
Instrument	-7.952		-2.959	
1	(-3.38)		(-2.12)	
IO US	( •••••)	0.046	()	0.044
_		(2.62)		(1.76)
SIZE	0.512	0.025	0.508	0.024
	(6.89)	(2.42)	(6.31)	(1.77)
INVOP	-0.302	0.132	-0.244	0.128
	(-1.08)	(7.27)	(-0.81)	(6.50)
RET	-0.277	0.271	-0.274	0.275
	(-1.15)	(11.93)	(-1.12)	(11.40)
LEV	-1.495	-0.031	-1.378	-0.023
	(-2.71)	(-0.57)	(-2.36)	(-0.37)
CASH	5.075	0.752	5.349	0.746
	(6.28)	(8.56)	(6.18)	(5.48)
KAUFMANN	-1.405	0.068	-0.892	0.043
	(-1.60)	(0.88)	(-0.99)	(0.58)
GDP_GROWTH	-0.046	-0.002	-0.069	-0.001
	(-1.03)	(-0.61)	(-1.59)	(-0.34)
GDP_CAPITA	0.082	0.209	0.694	0.212
	(0.17)	(5.57)	(1.34)	(4.72)
MCAP_GDP	-0.013	0.002	-0.012	0.002
	(-3.48)	(3.81)	(-3.00)	(3.19)
Year Fixed Effect	Yes	Yes	Yes	Yes
Country Fixed Effect	Yes	Yes	Yes	Yes
Observations	11,511	11,511	10,180	10,180
R-squared	0.277	0.395	0.277	0.410

## 3.5.2. Class Action Lawsuit

Not all ADR firms are required to follow full SEC disclosure and GAAP compliance. Level 1 ADRs trade over-the-counter as OTC Bulletin Board or Pink Sheet issues with limited liquidity requiring only minimal SEC disclosure and minimal GAAP compliance. In contrast, Level 2 and 3 ADRs are exchange listed securities which require stricter SEC disclosure and compliance with an exchange's own listing rules. Rule 144A are capital-raising issues in which securities are privately placed to qualified institutional buyers and as a result do not require compliance with GAAP or SEC disclosure.

Using such characteristic of ADR, in this section, I only consider ADR firms which are required to follow strict SEC disclosure and GAAP compliance (Level 2 and 3 ADR firms), and test whether the level of US institutional ownership influences ADR firms' accounting irregularities or financial misrepresentations. The previous studies have investigated corporate governance changes around private lawsuits and government enforcement actions of financial fraud. Agrawal, Jaffe and Karpoff (1998) show some evidences that firms suspected or charged with fraud have unusually high turnover among senior managers and directors. Ferris, Jandik, Lawless and Makhija (2007), Strahan (1998), and Gande and Lewis (2009) document that when the corporate governance mechanisms is not stable, firms are more likely to get sued by investors or shareholders in the event of material misstatement or omission of fact.

I collect all the class action lawsuits from the Securities Class Action Clearinghouse and SEC enforcement from the SEC's Accounting and Auditing Enforcement Releases (AAER) and the SEC's litigation releases. I use a probit model and find consistent results with the previous literature by empirically showing that US institutional investors better monitor the firm so that firms with high US institutional ownership are less likely to face class action lawsuits. Table 3-10, Panel A shows result for the probit test. Dependent variable, *Case*,

equals 1 if the firm is involved in any class action lawsuits during the year, and 0 otherwise. The level of US institutional ownership ( $IO_US$ ) has a negative and statistically significant coefficient and this result is consistent with the previous studies which empirically show that firms are less likely to be involved in class action lawsuits because foreign institutional ownership promotes better corporate governance (Agrawal, Jaffe and Karpoff (1998); Strahan (1998); Gillan and Starks (2003); Ferris, Jandik, Lawless and Makhija (2007); Ferreira and Matos (2008); Gande and Lewis (2009)). Table 3-10, Panel B shows 2SLS results with two political proximity variables as instrumental variables, and the coefficients of predicted values for the level of US institutional ownership are statistically significant and consistent with that of Table 3-10, Panel A. This empirically shows that political relations may affect firms' class action lawsuits through the level of US institutional ownership.

## Table 3-10: Class Action Lawsuit

In Panel A of this table, I present a probit test of US institutional ownership ( $IO_US$ ) on class action laws suits. Panel B shows 2SLS regression results with the ratio of opposing UN votes to US from a country ( $VoteDisagree_{US}$ ) and dissimilarity in UN voting between a country and US ( $VoteDiverge_{US}$ ) as instrumental variables. Firm level control variables are size of firm (*SIZE*), log of book to market ratio (BM), investment opportunities (INVOP), annual stock return (RET), turnover (TURN), dividend yield (DY), return on equity (ROE), leverage (LEV), cash (CASH) and closely held shares (CLOSE). Country level control variables include corporate governance level collected from Kaufmann, Kraay and Mastruzzi (2007) (KAUFMANN), GDP growth ( $GDP_GRWOTH$ ), GDP per capita ( $GDP_CAPITA$ ) and market capitalization to GDP ( $MCAP_GDP$ ). The values of the t-statistics in parentheses are based on robust standard errors clustered at the country year level.

(1)	
Case	
-0.018	
(-2.02)	
0.145	
(6.15)	
-0.134	
(-0.82)	
-0.753	
(-1.05)	
-1.019	
(-3.64)	
0.150	
(1.88)	
0.039	
(1.46)	
0.005	
(1.08)	
-0.471	
(-0.93)	
0.092	
(0.12)	
-0.009	
(-2.33)	
0.028	
(0.11)	
0.085	
(1.45)	
0.323	
(1.00)	
0.004	
(2.51) 8 700	
-0.790	
(-3.70)	
3 752	
0.215	
	(1) $Case$ -0.018 $(-2.02)$ $0.145$ $(6.15)$ $-0.134$ $(-0.82)$ $-0.753$ $(-1.05)$ $-1.019$ $(-3.64)$ $0.150$ $(1.88)$ $0.039$ $(1.46)$ $0.005$ $(1.08)$ $-0.471$ $(-0.93)$ $0.092$ $(0.12)$ $-0.009$ $(-2.33)$ $0.028$ $(0.11)$ $0.085$ $(1.45)$ $0.325$ $(1.66)$ $0.004$ $(2.31)$ $-8.790$ $(-3.76)$ $3.752$ $0.215$

Panel B	Instrument=Vo	oteDisagreeUS	Instrument=V	oteDivergeUS
Dep. Variable	IO_US	Case	IO_US	Case
_	Model	Model	Model	Model
	(1)	(2)	(3)	(4)
Instrument	-9.141		-3.507	
	(-3.51)		(-2.56)	
SIZE		-0.142	× ,	-0.207
		(-2.95)		(-1.93)
BM	-0.569	0.061	-0.583	0.039
	(-7.07)	(1.61)	(-7.24)	(0.48)
INVOP	0.501	-0.060	0.526	0.103
	(2.22)	(-0.38)	(2.38)	(0.66)
RET	0.008	-0.735	0.103	-0.583
	(0.01)	(-0.95)	(0.15)	(-0.79)
TURN	-1.176	-1.237	-0.707	-1.193
	(-2.38)	(-4.27)	(-1.47)	(-3.81)
DY	3.580	0.619	3.616	0.857
	(14.16)	(3.21)	(13.39)	(2.13)
ROE	-0.527	-0.025	-0.516	-0.050
	(-5.49)	(-0.67)	(-5.28)	(-0.71)
LEV	0.025	0.008	0.018	0.005
	(3.19)	(1.82)	(2.20)	(1.15)
CASH	-2.632	-0.764	-2.885	-0.868
	(-2.01)	(-1.40)	(-2.25)	(-1.26)
CLOSE	-1.355	-0.177	-1.634	-0.154
	(-0.89)	(-0.22)	(-1.00)	(-0.19)
KAUFMANN	-0.072	-0.019	-0.071	-0.028
	(-8.64)	(-3.38)	(-8.64)	(-3.06)
GDP_GROWTH	0.115	0.104	0.103	0.091
	(1.25)	(1.75)	(1.02)	(1.44)
GDP_CAPITA	-0.168	0.388	0.264	0.390
	(-0.37)	(2.01)	(0.57)	(2.04)
MCAP_GDP	0.007	0.003	0.004	0.003
	(1.19)	(1.69)	(0.58)	(1.96)
CONSTANT	24.715	-6.779	16.980	-6.082
	(4.79)	(-2.65)	(3.66)	(-1.79)
Observations	3,752	3,752	3,399	3,399
R-squared	0.283	0.221	0.276	0.246

## **3.5.3.** Information Environment

Following Tsang, Xie and Xin (2014), I examine the impact of foreign institutional investors on firms' voluntary disclosure practices. However, I use a different news data source, RavenPack, which is a leading global news database which has recently been used in finance research (e.g., Kolasinski, Reed, and Ringgenberg (2013); Dai, Parwada, and Zhang (2015); Shroff, Verdi, and Yu (2014); Dang, Moshirian, and Zhang (2015)). I only keep press-release news that are related to earnings and count the number of press releases for each firm year from *Dow Jones Newswire—PR\_Count*. Column (1) of Table 3-11, Panel A empirically shows that high level of US institutional ownership significantly increases the frequency of press-release news related to earnings. This result indirectly supports that US institutional ownership promotes better corporate governance because the effective oversight of firm management by outsiders depends critically on the information available to them (Bushman and Smith 2001; Adams and Ferreira 2007; Harris and Raviv 2008; Armstroing, Guay and Weber 2010; Duchin, Matsusaka and Ozbas 2010). The result is showing that the level of US institutional ownership is one of factors creating such environment.

Further, I test how the level of US institutional ownership influences the media dissemination of press-release news. When a firm decides to voluntarily disclose information through a press release, it typically hires a press wire service to act as an agent on its behalf and transmit the release to various media outlets such as *Dow Jones Newswire*. I use the *Dow Jones Newswire* news data only in this section following Twedt (2016) because it represents the most widely circulated financial news in the US (Tetlock 2007). I count the number of "news flashes" after the press release on the same day and sum up for each firm year—*NF\_Count*. Column (2) of Table 3-11, Panel A shows that there is a high level of dissemination for earnings press-release news on the same day from *the Down Jones Newswire* for ADR firms with large US institutional ownership. This could also mean higher

efficiency of the price discovery process, as Twedt (2016) finds that newswire dissemination is associated with large initial price reactions and fast incorporation of the information into price. Such efficiency represents reduced information asymmetries and my result here again indicates that US institutional ownership promotes better corporate governance by creating better information environment.

Table 3-11, Panel B and C show 2SLS regression results with two political proximity variables as instrumental variables. This is to find the causality, and to suggest that the level of US institutional ownership is a possible channel through which political relations may influence information environment. The first column of each tab shows first stage of two-stage regressions which are just my main regressions from section 3.3.1. Second column of each tab shows results with predicted values of US institutional ownership and their coefficients are statically significant and consistent with those of Table 3-11, Panel A. Overall, these results directly imply that the level of US institutional ownership is a possible channel through which political relations influence information environment.

## **Table 3-11: Information Environment**

In Panel A of this table, I present regressions of US institutional ownership  $(IO\_US)$  on the number of press release news during the year  $(PR\_Count)$  and the number of news flashes following press release on the same day during the year  $(NF\_Count)$ . Panel B shows 2SLS regression with the ratio of opposing UN votes to US from a country (*VoteDisagreeus*) and dissimilarity in UN voting between a country and US (*VoteDivergeus*) as instrumental variables. Firm level control variables are size of firm (*SIZE*), investment opportunities (*INVOP*), leverage (*LEV*) and cash (*CASH*). Country level control variables include corporate governance level collected from Kaufmann, Kraay and Mastruzzi (2007) (*KAUFMANN*), GDP growth (*GDP\\_GRWOTH*), GDP per capita (*GDP\\_CAPITA*) and market capitalization to GDP (*MCAP\\_GDP*). The values of the t-statistics in parentheses are based on robust standard errors clustered at the country year level.

	(1)	(2)
	PR_Count	NF_Count
IO_US	0.006	0.006
	(3.03)	(5.30)
SIZE	0.055	0.012
	(7.04)	(5.29)
BM	0.062	0.002
	(3.93)	(0.48)
INVOP	-0.047	-0.049
	(-1.07)	(-2.69)
RET	-0.138	-0.013
	(-3.16)	(-1.16)
TURN	0.040	-0.000
	(2.25)	(-0.02)
DY	-0.028	-0.010
	(-5.45)	(-5.17)
ROE	-0.001	0.000
	(-0.99)	(0.46)
LEV	-0.087	-0.040
	(-1.14)	(-1.71)
CASH	0.352	-0.025
	(3.50)	(-0.72)
CLOSE	-0.001	-0.000
	(-2.22)	(-0.65)
KAUFMANN	-0.155	0.016
	(-0.88)	(0.21)
GDP_GROWTH	0.011	0.003
	(1.38)	(0.85)
GDP_CAPITA	-0.130	-0.064
	(-1.27)	(-1.79)
MCAP_GDP	0.001	0.000
	(0.69)	(0.85)
CONSTANT	0.440	0.390
	(0.45)	(1.20)
Year Fixed Effect	Yes	Yes
Country Fixed Effect	Yes	Yes
Observations	11,511	11,511
R-squared	0.388	0.258

Panel B	Instrument	=VoteDisagreeUS	Instrument	=VoteDivergeUS
Dep. Variable	IO_US	PR_Count	IO_US	PR_Count
	Model	Model	Model	Model
	(1)	(2)	(3)	(4)
Instrument	-8 576		-3 867	
	(-3.78)		(-3.02)	
IO US hat	(0.00)	0.349	(0.02)	0.505
		(3.98)		(3.08)
SIZE	0.356	-0.066	0.351	-0.121
	(5.28)	(-1.59)	(4.83)	(-1.75)
BM	0.594	-0.147	0.641	-0.255
	(5.24)	(-2.12)	(5.27)	(-2.18)
INVOP	-0.745	0.209	-0.715	0.328
	(-2.47)	(1.72)	(-2.18)	(1.88)
RET	-0.732	0.120	-0.696	0.226
	(-3.24)	(1.25)	(-2.87)	(1.55)
TURN	2 171	-0.702	2 155	-1 030
	(10.92)	(-3.45)	(10.08)	(-2.82)
DY	-0.218	0.047	-0.216	0.077
	(-3.74)	(1.60)	(-3.56)	(1.78)
ROE	0.017	-0.006	0.015	-0.007
	(4, 43)	-0.000	(3.90)	(-2.57)
LEV	-2 244	0.692	(3.90)	(-2.37)
	(4.09)	(2, 75)	( 3 76)	(2, 24)
CASH	(-4.09)	(2.75)	(-3.70)	(2.24)
CAISIT	(1.16)	(1.76)	(4.01)	-1.244
CLOSE	(4.10)	(-1.70)	(4.01)	(-1.78)
CLOSE	-0.043	(2, 45)	-0.042	(2.80)
KALIEMANN	(-9.32)	(3.43)	(-8.23)	(2.80)
KAOPWANN	-2.0//	0.837	-2.127	0.875
CDP CPOWTH	(-3.01)	(2.07)	(-2.31)	(1.51)
	-0.060	0.031	-0.0/6	0.042
CDP CADITA	(-1.58)	(2.03)	(-1.99)	(1.84)
	0.123	-0.156	0.926	-0.405
MCAD CDD	(0.24)	(-0.89)	(1.68)	(-1.40)
MCAI_GDF	-0.012	0.005	-0.011	0.006
	(-3.64)	(2.76)	(-3.06)	(2.42)
Year Fixed Effect	Yes	Yes	Yes	Yes
Country Fixed Effect	Yes	Yes	Yes	Yes
Observations	11,511	11,511	10,180	10,180
R-squared	0.349	0.389	0.347	0.378

Panel B cont.	Instrument=	VoteDisagreeUS	Instrument	=VoteDivergeUS
Dep. Variable	IO_US	NF_Count	IO_US	NF_Count
	Model	Model	Model	Model
	(1)	(2)	(3)	(4)
Instrument	-8.576		-3.867	
	(-3.78)		(-3.02)	
IO US hat	(0.00)	0.158	(000)	0.269
		(3.76)		(3.59)
SIZE	0.356	-0.042	0.351	-0.080
	(5.28)	(-2.22)	(4.83)	(-2.37)
BM	0.594	-0.090	0.641	-0.169
	(5.24)	(-2.65)	(5.27)	(-3.05)
INVOP	-0.745	0.064	-0.715	0.136
	(-2.47)	(1.16)	(-2.18)	(1.48)
RET	-0.732	0.101	-0.696	0.171
	(-3.24)	(2.30)	(-2.87)	(2.48)
TURN	2.171	-0.329	2.155	-0.566
	(10.92)	(-3.44)	(10.08)	(-3.39)
DY	-0.218	0.023	-0.216	0.047
	(-3.74)	(1.74)	(-3.56)	(2.08)
ROE	0.017	-0.002	0.015	-0.004
	(4.43)	(-2.95)	(3.90)	(-2.64)
LEV	-2.244	0.306	-2.184	0.548
	(-4.09)	(2.51)	(-3.76)	(2.42)
CASH	3.125	-0.488	3.257	-0.874
	(4.16)	(-2.64)	(4.01)	(-2.58)
CLOSE	-0.045	0.007	-0.042	0.011
	(-9.52)	(3.45)	(-8.25)	(3.34)
KAUFMANN	-2.677	0.456	-2.127	0.587
	(-3.01)	(2.49)	(-2.31)	(2.07)
GDP_GROWTH	-0.060	0.012	-0.076	0.021
	(-1.58)	(1.77)	(-1.99)	(1.91)
GDP_CAPITA	0.123	-0.075	0.926	-0.252
	(0.24)	(-0.95)	(1.68)	(-1.71)
MCAP_GDP	-0.012	0.002	-0.011	0.004
	(-3.64)	(2.79)	(-3.06)	(2.97)
Year Fixed Effect	Yes	Yes	Yes	Yes
Country Fixed Effect	Yes	Yes	Yes	Yes
Observations	11,511	11,511	10,180	10,180
R-squared	0.349	0.258	0.347	0.261

# **3.6.** Conclusion

In this chapter, I examine US institutional investors inside ADRs and investigate how bilateral political relations between two countries influence the level of US institutional ownership. My results show that when bilateral political relations between a country and the US are poor, the level of US institutional ownership is low for ADR firms from that country. I also test the actual number of US institutional investors because the main results could be driven by different firm sizes. Analysis of the number of US institutional investors further support my main finding by showing that US institutional investors refrain from investing in ADR firms from countries that have poor political relations with the US.

Apart from bilateral political relations, a country's popularity among US citizens is also examined in this chapter. I find that when Americans favor a country, US institutional ownership is higher. Additionally, using the ICB dataset, I show that when there is a crisis or crises in a region during the year, US institutional investors abstain from putting money in to that region. However, if the country is the actor in the crisis, US institutional ownership is not affected. Furthermore, when the US is an actor in international crises, the level of US institutional ownership in ADR firms is higher during the year, which indicates when the US is in relatively unstable condition, US institutions invest outside of the US.

Next, I evaluate the impact of US institutional ownership on firm value, class action lawsuits and information environments. The overall results indicate that US institutional ownership promotes better corporate governance for ADR firms. 2SLS regression results with two political proximity variables as instrumental variables imply that US institutional ownership is a possible channel through which political relations influence firm value, class action lawsuits and information environments.

My primary contribution is to set up a new area of the literature that explores the factors that affect US institutional ownership. No previous studies have explored the impact of political proximity on institutional ownership, and I provide empirical support for the notion that political proximity has a direct impact on the level of US institutional ownership for ADR firms. I also obtain results that are consistent with previous studies by showing that high level of US institutional ownership promotes better corporate governance. Furthermore, I empirically show that political relations may affect corporate governance through the level of institutional ownership as a channel. Finally, I also explore how a region's or country's political riskiness influences US institutional investors which has not been examined previously.

# Appendix

Variable	Abbreviation	Definition	
Market capitalization (log)	SIZE	Log annual market capitalization in US\$ (Datastream item MV)	
Book-to-market (log)	BM	Log of the book-to-market equity ratio (market value is Datastream item MV and book value is WorldScope item 03501)	
Investment opportunities	INVOP	Two-year geometric average of annual growth rate in net sales in US (WorldScope item 01001)	
Annual stock return	RET	Annual (end-of-year) geometric stock rate of return (Datastream item RI)	
Turnover	TURN	Annual share volume (Datastream item VO) divided by adjusted shares outstanding (Datastream items NOSH/AF)	
Dividend yield	DY	Dividend yield (WorldScope item 09404)	
Return on equity	ROE	Return on equity (WorldScope item 08301)	
Leverage	LEV	Ratio of total debt (WorldScope item 03255) to total assets (WorldScope item 02999)	
Cash	CASH	Ratio of cash and short-term investments (WorldScope item 02001) to total assets (WorldScope item 02999)	
Closely held shares	CLOSE	Number of shares held by insiders as a proportion of the number of shares outstanding (WorldScope item 08021)	
Tobin's Q	Q	Sum of total assets (WorldScope item 02999) plus market value of equity (WorldScope item MV) minus book value of	
		equity (WorldScope item 03501) divided by total assets	
Corporate Governance Level	KAUFMANN	Average of the six KKM indicators to create a variable which captures the annual average governance quality of a country.	
		These indicators cover several dimensions of a country's governance, related to the level of accountability and freedom of	
		speech, the efficiency and stability of the political system, the quality and independence of public services, the regulatory	
		quality, the rule of law, and the level of corruption	
GDP Growth	GDP_GROWTH	Annual gross domestic product growth in percentage (World Bank WDI)	
GDP per capita (log)	GDP_CAPITA	Annual log gross domestic product per capital in US\$ (World Bank WDI)	
Market capitalization to GDP (log)	MCAP_GDP	Annual ratio of stock market capitalization to gross domestic product in US\$ (World Bank WDI)	

# **CHAPTER 4: Political Relations and Foreign Directors**

# 4.1. Introduction

Recent theories on board structure discuss the different roles of insiders and outsiders in the board because of their difference in information (Hermalin and Weisbach (1998); Adams and Ferreira (2007); Raheja (2005); and Harris and Raviv (2008)). Empirical studies consider how the board structure is related to firm characteristics (Boone, Field, Karpoff, and Raheja (2007); Coles, Daniel, and Naveen (2007); Linck, Netter and Yang (2008)) and find that complex firms (measured by firm size, leverage, firm age and the number of segments) have larger and independent boards because the benefits from effective monitoring of outsider outweigh the increase in monitoring costs. Furthermore, firms with high growth and a high level of information asymmetry (measured by market-to-book ratio, R&D expenditures and the standard deviation of monthly returns) have smaller and less independent boards because transferring firm-specific information to outsiders is costly for such firms. However, very few empirical studies have previously examined what influences the proportion of foreign independent directors inside board.

Foreign independent directors (FIDs) play important roles in a company. A number of previous studies consider the benefits of having foreigners on the board, such as broader knowledge from recruiting internationally experienced members (Cannella Jr, Park, & Lee (2008); Carpenter (2002); Carpenter & Fredrickson (2001); Tihanyi, Ellstrand, Daily, & Dalton (2000)), better performance after acquisition (Masulis, Wang and Xie (2012); Adams, Hermalin and Weisbach (2010)), greater propensity to enter foreign markets (Carter, Simkins, & Simpson (2003); Miller & Carmen Triana (2009); Nielsen (2010)), etc. On the other hand, foreign board members are less likely to attend board meetings and are associated with a greater likelihood of intentional financial misreporting, higher CEO compensation, and a lower sensitivity of CEO turnover to performance (Masulis, Wang and Xie (2012)). Additionally, foreign members could bring conflict to the board (Harrison & Klein (2007);

(Lau & Murnighan, (2005); Earley & Mosakowski (2000); Barkema & Shvyrkov (2007)) and there are costs involved with geographical distance (Lerner (1995); van Veen, Sahib and Aangeenbrug (2014)), cultural distance and institutional distance (van Veen, Sahib and Aangeenbrug (2014)), and with collecting soft information (Coval and Moskowitz (1991, 2001)).

In this chapter, I examine whether bilateral political relations influence the proportion of FIDs within S&P 1500 firms. FIDs are defined as independent directors domiciled in foreign countries<sup>20</sup>. My overall results indicate that poor political relations are considered costs by US firms so that firms only hire FIDs from countries that have poor political relations with the US, when the benefits outweigh the costs.

Following the previous literature (Dajud (2013); Gupta and Yu (2007)), I construct a measure of political proximity—bilateral political relations—based on yearly voting data from the United Nations General Assembly collected from the US Department of State. Empirical evidence shows that patterns of UN votes are highly correlated with an alternative measure of political alignment, such as alliances and similar interests (Alesina and Weder (2002)). Following Alam (2012), I believe that such characteristics of the UNGA voting system make these votes a good candidate for depicting political alignment or misalignment for the purposes of this chapter.

The main purpose of this chapter is to examine whether political relations influence FID nominations. To perform such a test, I collect board data from ISS (formerly RiskMetrics) Directors Database and then create 45 duplicates for every firm year but with different countries. The 45 countries are where FIDs are from in ISS dataset. The main variable *FID* is

<sup>&</sup>lt;sup>20</sup> Following Masulis, Wang and Xie (2012), I defined FIDs, as they do not have to be foreign nationals but can be U.S. citizens working or living in a foreign country. Any foreign nationals working or living in the U.S. are not qualified as a FIDs.

the number of FIDs from a country scaled by total number of independent board members. It is 0 for firm-year-country if there are no FIDs from that country. My examination of the boards of S&P 1500 companies from 2000 to 2013 reveals that US firms' proportion of FIDs from countries that have poor political relations with the US inside the board is small. To address the issue of endogeneity, difference-in-difference estimator is used.

To employ the difference-in-difference (DiD) estimator, I look for any abnormal shock in the UN voting pattern of non-US countries in terms of alignment with the US vote. Specifically, I examine voting patterns in *important*<sup>21</sup> Human Rights issues. *Important* votes (defined by the US Department of State) are votes on issues that directly affect US interests and on which the US lobbied extensively. I find that some countries had consistently voted in line with the US previously but unexpectedly cast a vote opposing the US on December 22, 2007 for *important* Human Rights issues. Firms with FIDs from those countries with unexpected disagreement with the US are included in the treatment group. Firms with FIDs from countries that consistently disagreed with the US previously as well as on that date are treated as control firms. I compared the proportion of FIDs one year before and after the date, and the DiD results indicate that after the political shock, US firms decrease the proportion of FIDs from countries with temporary deterioration in political relations.

To further address the endogeneity issue, I use the instrumental variable approach. Following Dajud (2013), I use the Physical Integrity Rights Index (*PRI*) as an instrumental variable because human rights issues are perhaps the most contentious issue in the United Nations. For this reason, most votes occur on resolutions directly or indirectly related to

<sup>&</sup>lt;sup>21</sup> Important human rights issues include "Globalization and Human Rights", "Human Rights in Iran", "Human Rights in Iraq", "Human Rights and Coercive Measures", "Human Rights in the Democratic Republic of the Congo", "Human Rights in Sudan", "Situation of Human Rights in Turkmenistan", "Human Rights in North Korea", "Situation of human rights in Myanmar " and "Human Rights in Belarus".

human rights. This additional analysis with an instrumental variable corroborates my main findings that poor political relations have a negative impact on the proportion of FIDs in US firms.

Because firms have different numbers of total board members, my main results could be driven by the different number of total independent directors rather than differences in the number of FIDs from certain countries. To confirm that the results are driven by different numbers of FIDs, I use a probit model to check whether firms are unlikely to hire FIDs from countries that have poor political relations with the US. I create a dummy that equals one if there are FIDs from a country and 0 otherwise. The probit regression results support my main result by showing that firms are unlikely to hire FIDs from countries that have poor political relations with the US.

In this chapter, I further show that the negative impact of poor political relations on the proportion of FIDs is worse for firms with high innovation. To test whether possible technology leakage is considered a cost by US firms when they hire FIDs, I use the yearly research and development costs scaled by total assets (R&D) to measure the level of innovation of firms. My results indicate that highly innovative firms have an even lower proportion of FIDs when political relations with FIDs' home countries are poor. This is consistent with previous studies that show that for growth firms (high R&D), it is costlier for outsiders to monitor and to receive firm-specific information.

I also show that firms refrain from recruiting FIDs from countries that have poor political relations with the US because of the threat of information leakage. I use the standard deviation of monthly stock returns (*RetSTD*) to measure the level of information asymmetry of firms and find that firms with a high level of information asymmetry have a lower proportion of FIDs from countries that have poor political relations with the US. As previous studies indicate, it is costly for firms with a high level of information asymmetry to have

outsiders in the board; my results suggest that possibly losing insider information to foreigners from countries that have poor political relations with the US is also regarded as a cost of having foreigners in the board.

When my sample was closely observed, some firms with high innovation and a high level of information asymmetry still hire FIDs from countries that have poor political relations with the US. To test whether having such FIDs in the board is beneficial, I create a new variable that captures the proportion of FIDs from politically opposite countries. I consider countries with more than 75% of votes opposing the US during the year as countries with poor political relations. Firm performance is captured by return on assets and Tobin's Q. Overall, my analysis of ROA and Tobin's Q suggest that when firms choose to have FIDs from countries that have poor political relations with the US, there are benefits that outweigh the costs of possibly losing technology or insider information.

I conclude this chapter by showing that firms have a high proportion of FIDs from a country in the year and in the year before they announce an M&A with firms from that country. Two years before the announcement, the proportion of FIDs from that country is not related to the M&A announcement. This suggests that M&A announcements and the proportion of FIDs are highly correlated because it is beneficial to have FIDs from targets' home countries (Masulis, Wang and Xie (2012)). FIDs have a better understanding of the institution and culture of the country. I further test whether political relations influence the correlation between the proportion of FIDs and M&A announcements. The interaction terms with my two political relations variables indicate that poor political relations would not stop firms from hiring FIDs from targets' home countries before the cross-border M&A activity. With my acquisition analysis, I further strengthen my argument that when the benefits outweigh the costs, political relations would not stop firms from hiring FIDs from countries that have poor political relations with the US. My primary contribution is to set up a new area of the literature that explores the factors that affect a US firm's board. No previous studies have explored the impact of political proximity on board structure, and I provide empirical support for the notion that political proximity has a direct impact on the proportion of FIDs inside the boards of US firms. Furthermore, I show that for some firms it is costlier to have FIDs from countries that have poor political relations with the US, and when they have such FIDs in the board, it is because the benefits outweigh the costs.

This chapter is structured as follows. Section 4.2 describes data and Section 4.3 presents main results and Section 4.4 is additional results. Section 4.5 concludes the chapter 4.

## **4.2. Data**

## 4.2.1. Political Relations

Following previous studies (Dajud (2013); Gupta and Yu (2007)), I construct a measure of political proximity—bilateral political relations—based on voting data from the United Nations General Assembly collected from the US Department of State. This measure provides for each year and for each country, how many UN votes are identical to and in opposition to US votes as well as abstaining and absent votes. I define my political proximity variable—*VoteDisagreeus*—as the number of votes cast by a country at the United Nations that are not identical to the US vote scaled by the total number of votes, which is the sum of identical votes, opposing votes, abstentions and absences for each country. Additionally, I collect another political proximity variable—*VoteDivergeus*—which measures the UN vote dissimilarity (-1 of correlation—s2un) from Erick Voeten Dataverse<sup>22</sup>. Voeten's (2009) data capture UN General Assembly voting coincidence between the US and its trading partners, thus aiming to capture the degree of political alignment between the two. It is available up to the year 2012.

Some previous studies in politics note that the United Nations does not give a perfect image of broader international politics and that UN votes are often considered fairly irrelevant from the perspective of international politics (Russett (1966); Alesina and Weder (2002)). However, UNGA is the only international arena where we can observe its more than 150 members vote on a variety issues of global concern (Russett (1966); Voeten (2009)) and there is empirical evidence showing that patterns of UN votes are highly correlated with alternative measure of political alignment, such as alliances and similarity of interests (Alesina and Weder (2002)). Alam (2012) find such voting patterns across a range of issues can be a useful

<sup>&</sup>lt;sup>22</sup> https://dataverse.harvard.edu/dataset.xhtml?persistentId=hdl:1902.1/12379

gauge of the general political orientations of UN member states, and observing voting alignments over time can help pinpoint changes in the political orientation. I believe that such characteristics of the UNGA voting system make these votes a good candidate for depicting political alignment or misalignment for the purposes of this chapter.

## 4.2.2. Foreign Independent Directors

I collect board data from ISS (formerly RiskMetrics) Directors Database which covers firms in the S&P 1500 index. Only independent directors are considered in this chapter. My sample starts from 2000 to 2013 and I use a variable from ISS—COUNTRY\_OF\_EMPL—to classify an independent director as a *foreign* independent director if his/her primary employer is non-US company following Masulis, Wang and Xie (2012). Since I am interested in how political relations affect US companies, I remove any firms which are incorporated in non-US countries. Furthermore, firms without any foreign independent directors are removed from the sample because I am interested in finding the reason why firms have chosen FIDs from certain countries over FIDs from other countries to monitor their firms. Lastly, I exclude financial firms (SIC codes 6000- 6799) and regulated utilities (SIC code 4910-4949). After all this, I end up with 498 firms and 2,080 firm year observations.

I use firm-year fixed effect in regressions which remove any firm-year level variables in the regression. However, later for interaction terms, I use research and development amount scaled by total assets (*R&D*) from Compustat and volatility of weekly stock returns (*RetStd*) from CRSP which are all in fiscal years. ISS data's MEETINGDATE is in the calendar date and it does not provide a variable for fiscal years. I can manually create fiscal year variable for S&P 1500 firms in ISS data by comparing the month of MEETINGDATE and Compustat's fiscal month, but instead of doing that I download a link table from Lalitha Naveen website. Coles, Daniel and Naveen (2014) ensure that MEETINGDATE falls between the fiscal year beginning and ending dates.

The main purpose of this chapter is examining whether political relations influence FID nomination. To do such test, I create 45 duplicates for each firm year but with different countries. The 45 countries are where FIDs are from in ISS dataset. The main variable— *FID*—is the number of FIDs from a country scaled by total number of independent board members. It is 0 for firm-year-country if there are no FIDs from that country. If there are no total asset observations from Compustat, firm-year observations are removed. Total observation of the sample becomes 65,560 after this.

## 4.2.3. Controls

Firm-year level variables are excluded in the regressions because firm-year fixed effect removes all of them. Later in the chapter, some firm-year level variables are used for interaction terms. Research and development amount scaled by total assets (R&D) and standard deviation of weekly returns (RetStd) are collected from Compustat and CRSP respectively. Segment sales to the FID's country scaled by total sales ( $Foreign_Sales$ )—a firm-year-country level control—is only firm-related control variable in the main regression. Country-level controls include cultural distance<sup>23</sup> ( $Cultural_Distance$ ), a dummy indicating whether a country speaks English (English), distance between the country's capital city and Washington D.C. <sup>24</sup> (Distance) and log of GDP<sup>25</sup> (GDP). Table 4-1 shows summary statistics for all the variables. As the table shows, most of the observations for FID is zero. This is because out of 66,560 samples, there are only around 2000 firm-year-country observations which refer to the firm's FIDs. I manually make it zero if there are no FIDs from that country in the firm-year.

<sup>&</sup>lt;sup>23</sup> Following Hofstede's (1980) four dimension of national culture between countries, I calculate variance of each dimension and then arithmetically averaged. This is the *Cultural\_Distance*.

<sup>&</sup>lt;sup>24</sup> Distances are measured in km using Haversine formula. Then it was logged.

 $<sup>^{25}</sup>$  Log of GDP (*GDP*) is collected from World Bank datasource.

Table 4- 1: Summa	ry Statistics
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	Ν	Mean	SD	P1	P25	P50	P75	P99
FID	66,560	0.005	0.028	0.000	0.000	0.000	0.000	0.143
VoteDisagreeUS	448	0.453	0.173	0.056	0.331	0.447	0.571	0.809
VoteDivergeus	414	0.226	0.390	-0.923	0.000	0.200	0.583	0.836
Foreign_Sales	66,560	0.001	0.012	0.000	0.000	0.000	0.000	0.000
Cultural_Distance	448	1.849	1.208	0.021	0.651	1.692	3.047	4.182
English	448	0.219	0.414	0.000	0.000	0.000	0.000	1.000
Distance	448	8.907	0.573	6.414	8.723	8.856	9.302	9.678
GDP (Log)	448	26.963	1.197	24.255	26.146	26.886	27.942	29.414

# 4.3. **Results**

The section is constructed into two sub-sections. In the first sub-section, results for regressions of the proportion of FIDs from certain countries with my two political proximity variables are shown. To address the endogeneity issue, the difference-in-difference method and instrumental variable approaches are used. Endogeneity analysis results are in the second sub-section of this section.

## 4.3.1. Baseline Findings

As van Veen, Sahib and Aangeenbrug (2014) argues, cultural distance, institutional distance, and geographical distance can be considered to be costs by firms when they hire international members. However, whether the political distance (or political proximity) is treated as costs by US firms has not been tested in previous studies. To investigate whether political proximity influences US board structure—specifically, the proportion of foreign independent directors in the board (*FID*), I use following equation:

$$FID_{i,c,t} = \alpha + \beta_1 PP_{c,t} + \beta_3 Y_{i,c,t} + \Phi_{i,t} + \varepsilon_{i,c,t}$$

where the indices i,c and t correspond to firm, country and time, respectively.  $\Phi_{c,t}$  represents firm-year fixed-effect and  $\varepsilon_{i,c,t}$  represents an error term that is assumed be correlated within the country-year and is heteroskedastic. As such, all standard errors and test statistics are robust to these two departures from the classical regression model (Petersen (2009)) and clustered at the country-year level.  $PP_{c,t}$  indicates a political proximity variable while  $Y_{i,c,t}$ includes segment sales to the FID's country scaled by total sales (*Foreign\_Sales*), cultural distance (*Cultural\_Distance*), a dummy indicating whether a country speaks English (*English*), distance between the country's capital city and Washington D.C. (*Distance*) and log of GDP (*GDP*).

Starting from control variables, I find that firms with high sales at certain countries have a high proportion of FIDs from those countries by looking at the coefficient of *Foreign\_Sales* 

variable. Consistent with van Veen, Sahib and Aangeenbrug (2014), I find that the proportion of FIDs in the board is low if cultural distance is large. Whether FIDs' home countries speak English as an official language, geographical distance and GDP per capita of the country are also considered as important criteria when S&P 1500 firms hire international independent members of the board.

Back to main purpose of the chapter, I test two different measures of political proximity. *VoteDisagreeus* is number of UN opposing votes (unidentical to US votes) cast by a country divided by total number of votes, and *VoteDivergeus* is the UN vote dissimilarity between US and non-US countries collected from "The Affinity of Nations" database<sup>26</sup>. I show both *VoteDisagreeus* and *VoteDivergeus* have a negative and statistically significant coefficient with my dependent variable—*FID*—in Table 4-2. *FID* is the number of FIDs from a certain country inside the board scaled by the total number of independent directors in the board. Table 4-2 provides evidence that poor political relations negatively affect the proportion of FIDs inside US firms' board.

<sup>&</sup>lt;sup>26</sup> s2un: Values for the Affinity data range from -1 (least similar interests) to 1 (most similar interests). The Affinity data are coded with the "S" indicator ("S" is calculated as 1 - 2\*(d)/dmax, where d is the sum of metric distances between votes by dyad members in a given year and dmax is the largest possible metric distance for those votes, see Signorino and Ritter 1999) from 2 category UNGA vote data (1= "yes" or approval for an issue; 2 = "no" or disapproval for an issue), coded as follows: Code for Votes 1 for "Yes", 2 for "Abstain", 3 for "No", 8 for "Absent (country cast no vote and no evidence of non-participation)", 9 for "Non-member" (South Africa is coded as "55" for the 30<sup>th</sup> to 47<sup>th</sup> sessions)" - source: The Affinity of Nations.

## Table 4-2: Main Results

In this table, I present regressions of political proximity variables on the proportion of foreign independent directors inside US firms (*FID*). Political relations are proxied as the ratio of opposing UN votes to US from a country (*VoteDisagreeus*) and dissimilarity in UN voting between a country and US (*VoteDivergeus*). Control variables are segment sales in FID's country scaled by total sales of the firm (*Foreign\_Sales*), cultural distance (*Cultural\_Distance*), a dummy indicating whether a country speaks English (*English*), distance between the country's capital city and Washington D.C. (*Distance*) and log of GDP (*GDP*). Firm-year fixed effect is used. The values of the t-statistics in parentheses are based on robust standard errors clustered at the country-year level.

	(1)	(2)
	FID	FID
VoteDisagreeus	-0.010	
	(-5.13)	
VoteDiverge <sub>US</sub>	()	-0.005
		(-5.69)
Foreign_Sales	0.058	0.061
	(2.66)	(2.70)
Cultural_Distance	-0.001	-0.000
	(-3.05)	(-1.84)
English	0.007	0.007
	(6.26)	(6.17)
Distance	-0.005	-0.004
	(-10.95)	(-9.20)
GDP	0.003	0.003
	(9.68)	(9.31)
Constant	-0.026	-0.037
	(-2.89)	(-3.44)
Firm Year Fixed Effect	Yes	Yes
Observations	66,560	59,556
R-squared	0.052	0.055

## 4.3.2. Endogeneity Tests

## **4.3.2.1.** Difference-in-Difference Regression

To further investigate whether political proximity influences the proportion of FIDs in the board, I employ the difference-in-difference (DiD) estimator. To perform such a test, I look for an abnormal voting pattern from any country, i.e., any voting not consistent with previous voting, and I observe abnormality in *important* Human Right issues<sup>27</sup>. *Important* votes (defined by the US Department of State) are votes on issues that directly affect US interests and on which the US lobbied extensively.

Important votes in human rights are examined from 2000; 20 countries that had consistently voted in line with the US for important human rights issues unexpectedly voted against the US for "Report of the Human Rights Council" (Res/62/219) on December 22, 2007. Those countries are Belgium, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Ireland, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Portugal, Spain, Sweden, Switzerland and the United Kingdom. US firms' proportion of FIDs from these countries are in the treatment group while the control group includes US firms' proportion of FIDs from 11 countries—China, Egypt, India, Indonesia, Malaysia, Pakistan, Philippines, Russia, Singapore, South Africa and Thailand—that had consistently voted against the US most of the time or consistently voted against the US all of the time regarding important human rights issues before December 22, 2007. On this date, the US voted "No" to Report of the Human Rights Council (Res/62/219), claiming "the Council's relentless focus during the year on a single country—Israel" while 150 countries voted in favor.

Table 4-3 shows results with a natural experiment—unexpected change in UN voting

<sup>&</sup>lt;sup>27</sup> Important human rights issues include "Globalization and Human Rights", "Human Rights in Iran", "Human Rights in Iraq", "Human Rights and Coercive Measures", "Human Rights in the Democratic Republic of the Congo", "Human Rights in Sudan", "Situation of Human Rights in Turkmenistan", "Human Rights in North Korea", "Situation of Human Rights in Myanmar " and "Human Rights in Belarus".
pattern. A dummy— $p_t$ —equals one if the year of the proportion of FIDs corresponds to 2008, and 0 if the year is 2006. I test one year before/after the event year because of data availability. Variable  $d_i$  equals one if the firm is in the treatment group and 0 otherwise. The coefficient for interaction term of  $d_i$  and  $p_t$  indicates how the proportion of FIDs change for the treatment group relative to the control group in the post period. Table 4-3 shows that coefficient for the interaction term is negative and statistically significant, and this further supports my argument that political misalignment has negative impact on the proportion of FIDs inside S&P 1500 firms.

$$FID_{i,c,t} = \alpha + \beta_1 p_t \times d_i + \beta_2 p_t + \beta_3 d_i + \beta_4 Y_{i,c,t} + \varepsilon_{i,c,t}$$

where the indices i,c and t correspond to firm, country and time (pre or post period), respectively.  $\varepsilon_{i,c,t}$  represents an error term that is assumed be correlated within the country and heteroskedastic. As such, all standard errors and test statistics are robust to these two departures from the classical regression model (Petersen (2009)) and clustered at country level.  $Y_{i,c,t}$  includes segment sales to the FID's country scaled by total sales (*Foreign\_Sales*), cultural distance (*Cultural\_Distance*), a dummy indicating whether a country speaks English (*English*), distance between the country's capital city and Washington D.C. (*Distance*) and log of GDP (*GDP*).

#### Table 4- 3: Difference-in-Difference

In this table, I examine a natural experiment—change in voting patterns—and show how the proportion of foreign independent directors inside US firms (*FID*) change after the date of experiment ( $22^{nd}$  December 2007) for treatment firms. *p* equals 1 if the year of the panel is 2008 and 0 if the year is 2006. *d* equals one if the firm is included into the treatment group and 0 if it is in the control group. Control variables are segment sales in FID's country scaled by total sales of the firm (*Foreign\_Sales*), cultural distance (*Cultural\_Distance*), a dummy indicating whether a country speaks English (*English*), distance between the country's capital city and Washington D.C. (*Distance*) and log of GDP (*GDP*). The values of the t-statistics in parentheses are based on robust standard errors clustered at the country level.

	(1)
	FID
$p^*d$	-0.036
	(-2.92)
p	0.048
	(6.50)
d	0.011
	(0.84)
Foreign_Sales	0.296
	(3.41)
Cultural_Distance	0.005
	(0.97)
English	0.012
	(1.84)
Distance	0.003
	(0.72)
GDP	0.003
	(0.81)
Constant	-0.065
	(-0.61)
Observations	380
R-squared	0.041

#### 4.3.2.2. Instrumental Variable

Although my findings in the previous section are robust to the omitted or unobservable variables by having fixed effect, the results may still suffer from endogeneity. Specifically, a potential problem is that my proxies for political proximity may be determined simultaneously with the proportion of FIDs which would bias my results. As a robustness check, I use the instrumental variable approach to address this concern.

Following Dajud (2013), I use the Physical Integrity Rights Index (*PRI*) as an instrumental variable that is constructed by summing up country scores in four matters: torture, extrajudicial killing, political imprisonment, and disappearance. Countries with high scores are those where human rights are better respected. The reason for choosing *PRI* as an instrumental variable is that human rights issues are perhaps the most contentious issues in the United Nations. For this reason, most votes occur on resolutions directly or indirectly related to human rights. Therefore, *PRI* can be seen as highly correlated with *VoteDisagreeus* and *VoteDivergeus*.

Column (1) of Table 4-4, Panel A shows the first stage regression on *VoteDisagree*<sub>US</sub> with *PRI*. *PRI* is negatively correlated with *VoteDisagree*<sub>US</sub> indicating that when countries' human rights index is high, they disagree less with the US. Second stage regression result is shown in Column (2) of Table 4-4, Panel A and even with the predicted value of *VoteDisagree*<sub>US</sub>, the result is statistically significant and consistent with my main results in Table 4-2. Table 4-4, Panel B shows results for the first- and the second-stage 2SLS regression for *VoteDiverge*<sub>US</sub> and the outcome further supports my main argument—the proportion of FIDs from countries that have poor political relations with the US is low.

#### **Table 4- 4: Instrumental Variable Approach**

In this table, I present 2SLS regressions of political proximity variables on the proportion of foreign independent directors inside US firms (*FID*). Political relations are proxied as the ratio of opposing UN votes to US from a country (*VoteDisagreeus*) and dissimilarity in UN voting between a country and US (*VoteDivergeus*). Control variables are segment sales in FID's country scaled by total sales of the firm (*Foreign\_Sales*), cultural distance (*Cultural\_Distance*), a dummy indicating whether a country speaks English (*English*), distance between the country's capital city and Washington D.C. (*Distance*) and log of GDP (*GDP*). Firm-year fixed effect is used. The values of the t-statistics in parentheses are based on robust standard errors clustered at the country year level.

Panel A	(1)	(2)
	VoteDisagreeus	FID
PRI	-0.021	
	(-5.15)	
VoteDisagree <sub>US</sub> _hat		-0.014
		(-3.15)
Foreign_Sales	-0.118	0.061
	(-2.26)	(2.68)
Cultural_Distance	0.040	-0.000
	(5.04)	(-1.32)
English	0.072	0.007
	(4.00)	(5.58)
Distance	0.028	-0.004
	(2.64)	(-7.95)
GDP	-0.004	0.003
	(-0.62)	(9.02)
Constant	0.364	-0.032
	(1.62)	(-2.78)
Firm_Year Fixed Effect	Yes	Yes
Observations	52,896	52,896
R-squared		0.053

Panel B	(1)	(2)
	VoteDivergeus	FID
PRI	-0.046	
	(-4.48)	
VoteDiverge <sub>US</sub> _hat		-0.006
		(-3.10)
Foreign Sales	-0.241	0.061
0 _	(-2.04)	(2.68)
Cultural Distance	0.120	-0.000
	(6.69)	(-0.48)
English	0.159	0.007
	(3.71)	(5.68)
Distance	0.096	-0.004
	(3.74)	(-7.16)
GDP	0.004	0.003
	(0.26)	(8.87)
Constant	-0.696	-0.041
	(-1.23)	(-3.12)
Firm Year Fixed Effect	Yes	Yes
Observations	52,677	52,677
R-squared		0.055

### 4.4. Additional tests

#### 4.4.1. Presence of Foreign Independent Director

Rather than looking at the proportion of FIDs, this section examines if the presence of FIDs is influenced by the political relations because the main results could be driven by the different number of total independent directors in the board—which I scale the number of FIDs with. FID\_D is a dummy that equals one if the firm has FIDs from a country during the year and 0 otherwise. Table 4-5, Panel A shows that the coefficients of political relation variables are negative and statistically significant with the probit model. This indicates that S&P 1500 firms are unlikely to hire FIDs from countries that have poor political relations with the US. With respect to other variables, when firms have high operating sales in certain countries, they are likely to have FIDs from those countries. Consistent with van Veen, Sahib and Aangeenbrug (2014), the result shows that firms are less likely to have FIDs from countries which are culturally distanced and geographically far away. Also, high GDP per capita of country and English as an official language of countries are also desirable criteria for S&P 1500 firms when they choose independent directors from different countries.

Table 4-5, Panel B shows 2SLS probit regressions with Physical Integrity Rights Index (*PRI*) as an instrumental variable following the previous section of the chapter. Columns (1) and (3) represent the first-stage regressions of the 2SLS regression to construct the predicted value of political proximity variables. The second-stage regression results with predicted value of political proximity variables are presented in columns (2) and (4) and the coefficients of predicted values are statistically significant and consistent with those of my results in Table 4-5, Panel A. This additional analysis further supports my argument that US firms are unlikely to hire FIDs from countries that have poor political relations with the US.

#### **Table 4- 5: Probit Regression**

In this table, I present probit regressions of political proximity variables on the presence of foreign independent directors inside US firms (*FID\_D*). *FID\_D* is a dummy that equals 1 if the firm has FIDs from a country and 0 otherwise. Political relations are proxied as the ratio of opposing UN votes to US from a country (*VoteDisagreeus*) and dissimilarity in UN voting between a country and US (*VoteDivergeus*). Control variables are segment sales in FID's country scaled by total sales of the firm (*Foreign\_Sales*), cultural distance (*Cultural\_Distance*), a dummy indicating whether a country speaks English (*English*), distance between the country's capital city and Washington D.C. (*Distance*) and log of GDP (*GDP*). Firm-year fixed effect is used. The values of the t-statistics in parentheses are based on robust standard errors clustered at the country-year level.

Panel A	(1)	(2)
	FID_D	FID_D
VoteDisagreeus	-0.652	
C C	(-3.83)	
VoteDivergeus	,	-0.422
-		(-5.88)
Foreign_Sales	1.653	1.772
	(2.96)	(2.95)
Cultural_Distance	-0.118	-0.075
	(-4.53)	(-2.57)
English	0.285	0.325
	(4.08)	(4.40)
Distance	-0.197	-0.179
	(-6.13)	(-5.03)
GDP	0.310	0.335
	(15.89)	(16.31)
Constant	-8.084	-9.222
	(-10.07)	(-10.88)
Firm Year Fixed Effect	Yes	Yes
Observations	65,856	58,459
Pseudo R-squared	0.151	0.161

Panel B	(1)	(2)	(3)	(4)
	VoteDisagreeus	FID_D	VoteDivergeus	FID_D
PRI	-0.021		-0.046	
	(-5.15)		(-4.47)	
PP_hat	()	-1.207		-0.547
		(-2.23)		(-2.22)
Foreign_Sales	-0.102	1.846	-0.218	1.817
	(-1.90)	(2.77)	(-1.77)	(2.72)
Cultural_Distance	0.040	-0.067	0.121	-0.043
	(5.02)	(-1.55)	(6.67)	(-0.86)
English	0.072	0.417	0.159	0.432
	(3.98)	(4.27)	(3.69)	(4.38)
Distance	0.028	-0.175	0.096	-0.157
	(2.64)	(-4.51)	(3.74)	(-3.62)
GDP	-0.004	0.347	0.004	0.359
	(-0.62)	(14.24)	(0.26)	(13.72)
Constant	0.336	-9.192	-0.761	-10.134
	(1.48)	(-9.96)	(-1.34)	(-9.28)
Firm_Year Fixed Effect	Yes	Yes	Yes	Yes
Observations	52,288	52,288	52,077	51,674
R-squared	0.469	0.159	0.462	0.160

#### 4.4.2. Lagged Political Proximity Variables

In this section, I test one-year lagged values of my political proximity measures— *VoteDisagreeus* and *VoteDivergeus*. I take such a test to show the subsequent effect of political relations on the board structure of S&P 1500 firms. Consistent with previous regressions of the chapter, same control variables and firm-year fixed effect are used. Table 4-6 shows that the previous years' poor political relations proxy variables have negative and significant correlation with *FID*. This suggests that the political relations have the subsequent effect on the proportion of FIDs. One of the possible reasons for the subsequent effect is the contract duration of board members—which is usually longer than a year. Therefore, once the previous years' political relations influence board structure, it would persist for some time.

#### **Table 4- 6: Lagged Political Proximity Variables**

In this table, I present regressions of one-year lag of political proximity variables on the proportion of foreign independent directors inside US firms (*FID*). Political relations are proxied as the ratio of opposing UN votes to US from a country (*VoteDisagreeus*) and dissimilarity in UN voting between a country and US (*VoteDivergeus*). Control variables are segment sales in FID's country scaled by total sales of the firm (*Foreign\_Sales*), cultural distance (*Cultural\_Distance*), a dummy indicating whether a country speaks English (*English*), distance between the country's capital city and Washington D.C. (*Distance*) and log of GDP (*GDP*). Firm-year fixed effect is used. The values of the t-statistics in parentheses are based on robust standard errors clustered at the country-year level.

	(1)	(2)
	FID	FID
VoteDisagreeus_Lag	-0.010	
	(-4.50)	
VoteDiverge <sub>US</sub> _Lag		-0.005
		(-5.66)
Foreign_Sales	0.049	0.049
	(2.08)	(2.07)
Cultural_Distance	-0.001	-0.000
	(-3.07)	(-2.13)
English	0.006	0.006
	(5.51)	(5.81)
Distance	-0.004	-0.004
	(-9.41)	(-8.63)
GDP	0.003	0.003
	(9.20)	(9.27)
Constant	-0.028	-0.035
	(-2.91)	(-3.41)
Firm_Year Fixed Effect	Yes	Yes
Observations	47,264	47,108
R-squared	0.051	0.053

#### 4.4.3. Research & Development

Previous sections find that the proportion of FIDs from countries that have poor political relations with the US are small. In this section, I test whether the impact of political relations on the proportion of FIDs is greater for firms with high innovation. US firms related to innovative activity might not recruit FIDs from countries that have poor political relations with the US because leakage of high technology to countries like Russia and China could threaten US national security. I use the yearly research and development costs scaled by total assets (R&D) to measure the degree of innovation for each firm following Brav, Jiang, Ma and Tian (2014). Following the norm in the previous literature, I impute missing values of R&D as zero only if the same firm reports R&D expenditures for at least one year during my sample period. Otherwise, I treat the observation as missing.

Table 4-7 shows that highly innovative firms have a lower proportion of FIDs when political relations with FIDs' home countries are poor. This indicates that highly innovative US firms choose not to hire FIDs from countries that have poor political relations with the US because of technology leakage threats. Previous studies like Jensen (1993) and Linck, Netter and Yang (2008) argue that the cost of advising by outsiders is higher for growth (high R&D) firms. My results in this section add to previous studies by showing that the threat of losing innovations to politically opposing countries is considered a cost by US firms when they hire FIDs.

#### **Table 4-7: Research and Development**

\_\_\_\_

In this table, I present regressions of political relation variables with a high innovation variable on the proportion of foreign independent directors inside US firms (*FID*). The innovation variable (*R&D*) is the amount of research and development scaled by total assets for each firm-year. Control variables are segment sales in FID's country scaled by total sales of the firm (*Foreign\_Sales*), cultural distance (*Cultural\_Distance*), a dummy indicating whether a country speaks English (*English*), distance between the country's capital city and Washington D.C. (*Distance*) and log of GDP (*GDP*). Firm-year fixed effect is used. The values of the t-statistics in parentheses are based on robust standard errors clustered at the country-year level.

	(1)	(2)
	FID	FID
VoteDisagreeus	-0.003	
	(-1.62)	
VoteDisagree <sub>US</sub> * RAD	-0.082	
	(-4.90)	
VoteDivergeus		-0.002
		(-2.45)
VoteDiverge <sub>US</sub> * RAD		-0.036
		(-4.56)
Foreign Sales	0.017	0.023
	(1.18)	(1.40)
Cultural_Distance	-0.001	-0.000
	(-2.97)	(-2.00)
English	0.005	0.005
	(5.50)	(5.45)
Distance	-0.003	-0.003
	(-7.50)	(-6.28)
GDP	0.003	0.003
	(10.59)	(10.22)
Constant	-0.042	-0.051
	(-4.86)	(-5.10)
Firm_Year Fixed Effect	Yes	Yes
Observations	41,216	36,883
R-squared	0.041	0.044

#### 4.4.4. Information Asymmetry

To check whether firms refrain from recruiting FIDs from countries that have poor political relations with the US because of the threat of insider information leakage, I also test the level of information asymmetry. I use the standard deviation of monthly stock returns over the 12 months in the preceding fiscal year (*RetSTD*) to measure the level of information asymmetry of firms (Linck, Netter and Yang (2008)). Following previous studies such as Maug (1997), which finds that it is costly for firms with a high level of information asymmetry to have outsiders in the board, I expect foreigners from countries that have poor political relations with the US are also costly to have in the board for firms with a high level of information asymmetry. The interaction terms of two political proximity variables and *RetSTD* in Table 4-8 show that firms with a high level of information asymmetry have a lower proportion of FIDs from countries that have poor political relations with the US. This suggests that possibly losing insider information to foreigners from countries that have poor political relations with the US is also regarded as a cost of having foreigners in the board.

#### **Table 4- 8: Information Asymmetry**

In this table, I present regressions of political relation variables with an information asymmetry variable on the proportion of foreign independent directors inside US firms (*FID*). The information asymmetry variable (*RetSTD*) is the standard deviation of monthly stock returns that measure the level of information asymmetry. Control variables are segment sales in FID's country scaled by total sales of the firm (*Foreign\_Sales*), cultural distance (*Cultural\_Distance*), a dummy indicating whether a country speaks English (*English*), distance between the country's capital city and Washington D.C. (*Distance*) and log of GDP (*GDP*). Firm-year fixed effect is used. The values of the t-statistics in parentheses are based on robust standard errors clustered at the country-year level.

	(1)	(2)
	FID	FID
	0.005	
voleDisagree0s	-0.005	
	(-1.96)	
VoteDisagree <sub>US</sub> * RetSTD	-0.050	
	(-2.68)	
VoteDiverge <sub>US</sub>		-0.003
		(-2.38)
VoteDiverge <sub>US</sub> * RetSTD		-0.022
		(-2.70)
Foreign_Sales	0.049	0.050
	(2.32)	(2.30)
Cultural_Distance	-0.001	-0.000
	(-2.99)	(-1.76)
English	0.007	0.007
	(6.30)	(6.21)
Distance	-0.004	-0.004
	(-10.46)	(-8.84)
GDP	0.003	0.003
	(9.71)	(9.36)
Constant	-0.027	-0.038
	(-2.99)	(-3.54)
Firm_Year Fixed Effect	Yes	Yes
Observations	63,104	56,283
R-squared	0.053	0.055

#### 4.4.5. Firm Performance

In section 4.3 and 4.4, I show that it is costlier for firms with firms with high innovation and a high level of information asymmetry to have FIDs from countries that have poor political relations with the US. When I closely examine the data, those firms still hire FIDs from countries that have poor political relations with the US. I claim that there must be benefits of taking high costs so I check how the proportion of FIDs from countries that have poor political relations with US influence firm performance in this section. Firm performance is captured by return on assets (ROA) and Tobin's Q (Q). Return on assets is calculated as net income over total assets and Tobin's Q is calculated as firm's market value of assets over its book value of assets, where I compute the market value of assets as the book value of assets plus the market value of common stock minus the book value of common stock. These variables are created by following Masulis, Wang and Xie (2012).

To perform the test, I create a new firm-year level variable—*FID\_PB*—which is the number of the FIDs from countries that have poor political relations with the US scaled by total independent directors in the board during the year. Countries with more than 75% of votes opposing the US during the year are considered as countries that have poor political relations with the US. The interaction terms of *FID\_PB* and the information asymmetry variable (*RetSTD*) in columns (2) and (4) of Table 4-9 show that when firms hire FIDs from countries that have poor political relations with the US, ROA and Tobin's Q are higher for firms with a high level of information asymmetry. For firms with high innovation, benefit of having FIDs from countries that have poor political relations with the US are outlined in the regression with ROA in column (1). Overall, my analysis of ROA and Tobin's Q suggest that when firms choose to have FIDs from countries that have poor political relations with the US, there are benefits that outweigh the costs of possibly losing technology or insider information as shown in section 4.3 and 4.4. Industry and year fixed effect are used with firm-year level control variables. Firm-level variables include market value of the firm (MVE), debt ratio (DEBT), standard deviation of return (RETSTD), amount scaled by total assets (R&D), board independence and board size.

#### **Table 4- 9: Firm Performance**

In this table, I present regressions to test how the proportion of foreign independent directors inside US firms from countries that have poor political relations with the US (*FID\_PB*) influence firm performance. Dependent variables are return on asset (*ROA*) and Tobin's Q (Q). Control variables include market value of the firm (*MVE*), debt ratio (*DEBT*), standard deviation of return (*RETSTD*), research & development (*R&D*), board independence and board size. Industry and year fixed effect is used. The values of the t-statistics in parentheses are based on robust standard errors clustered at the firm level.

	(1)	(2)	(3)	(4)
VARIABLES	ROA	ROA	Q	Q
R&D * FID_PB	7.608		-37.277	
_	(2.25)		(-1.52)	
RETSTD * FID_PB	( )	8.690		57.079
—		(3.87)		(2.51)
FID PB	-0.151	-0.488	1.930	-3.511
—	(-0.83)	(-2.35)	(1.07)	(-1.78)
MVE	0.022	0.023	0.381	0.377
	(4.39)	(4.53)	(6.99)	(7.00)
DEBT	-0.058	-0.056	-1.059	-1.050
	(-1.10)	(-1.05)	(-2.11)	(-2.08)
RETSTD	-0.699	-0.728	2.085	1.953
	(-2.31)	(-2.38)	(1.74)	(1.63)
<i>R&amp;D</i>	-0.814	-0.800	6.561	6.541
	(-4.76)	(-4.70)	(4.53)	(4.52)
Board_Independence	-0.136	-0.140	-0.750	-0.757
	(-2.24)	(-2.29)	(-1.26)	(-1.27)
Board_Size	-0.010	-0.010	-0.118	-0.117
	(-2.64)	(-2.71)	(-3.24)	(-3.22)
Constant	0.239	0.246	0.466	0.504
	(1.79)	(1.83)	(0.60)	(0.65)
Industry/Year Fixed Effect	Yes	Yes	Yes	Yes
Observations	1,130	1,130	1,130	1,130
R-squared	0.259	0.260	0.395	0.396

#### 4.4.6. Merger and Acquisition

Following previous studies, I test in this chapter whether firms change the proportion of FIDs accordingly with their cross-border M&A announcements because FIDs play important roles in a company, when there is a cross-border M&A (Adams, Hermalin and Weisbach (2010); Masulis, Wang and Xie (2012)). I extract acquisition announcement dates from Securities Data Corporation's (SDC) Mergers and Acquisition Database for sample period of 2000 to 2013. I only include deals if they have values disclosed by SDC which are more than \$1 million, and if the acquirer has annual financial statement information available from Compustat for that fiscal year. I also include unsuccessful deals because I am testing whether acquisition announcements influence the proportion of FIDs in the board so the outcome of the acquisition is less interest to me.

Table 4-10 shows that firms have a high proportion of FIDs from a country in the year and in the year before they announce an M&A with firms from that country. Two years before the announcement, the proportion of FIDs from that country is not related to the M&A announcement. This suggests that M&A announcements and the proportion of FIDs are highly correlated because it is beneficial to have FIDs from targets' home countries (Masulis, Wang and Xie (2012)). FIDs have a better understanding of the institution and culture of the country. I further test whether political relations influence the correlation between the proportion of FIDs and M&A announcements. The interaction terms with my two political relations variables indicate that poor political relations would not stop firms from hiring FIDs from targets' home countries before the cross-border M&A activity. My M&A analysis further supports my argument from the previous section—poor political relations would not stop firms from hiring FIDs from countries that have poor political relations with the US, when the benefits outweigh the costs.

#### **Table 4-10: Merger and Acquisition**

(1)

In this table, I present regressions of political proximity variables with M&A variables on the proportion of foreign independent directors inside US firms (*FID*). *Merger\_0* equals 1 for the year of the firm announcing M&A with a company from certain country, 0 otherwise. *Merger\_1b* equals 1 for the previous year of the firm announcing M&A with a company from certain country, 0 otherwise. *Merger\_2b* equals 1 for the two years before the firm announcing M&A with a company from certain country, 0 otherwise. *Political relations are proxied as the ratio of opposing UN votes to US from a country (VoteDisagreeus)* and dissimilarity in UN voting between a country and US (*VoteDivergeus*). Control variables are segment sales in FID's country scaled by total sales of the firm (*Foreign\_Sales*), cultural distance (*Cultural\_Distance*), a dummy indicating whether a country speaks English (*English*), distance between the country's capital city and Washington D.C. (*Distance*) and log of GDP (*GDP*). Firm-year fixed effect is used. The values of the t-statistics in parentheses are based on robust standard errors clustered at the country-year level.

(3)

(4)

(5)

(6)

(7)

(2)

	FID	FID	FID	FID	FID	FID	FID
VoteDisagreeus*Merger ()		0 009					
roleDisagree03 merger_0		(0.94)					
VoteDivergeus*Merger ()		(0.21)	0.004				
, ote2 (rei ge03 intel gel_0			(0.94)				
VoteDisagree <sub>US</sub> *Merger 1b					-0.012		
0 0 _					(-0.88)		
VoteDiverge <sub>US</sub> *Merger 1b						-0.003	
0 0 1						(-0.55)	
Merger_0	0.006	0.002	0.005				
	(1.78)	(0.34)	(1.57)				
Merger_1b				0.006	0.011	0.006	
				(2.00)	(1.47)	(1.83)	
Merger_2b							0.004
							(1.33)
<i>VoteDisagree</i> <sub>US</sub>		-0.010			-0.010		
		(-5.11)			(-5.08)		
<i>VoteDiverge</i> <sub>US</sub>			-0.005			-0.005	
			(-5.68)			(-5.65)	
Foreign_Sales	0.060	0.058	0.061	0.060	0.058	0.061	0.060
	(2.70)	(2.67)	(2.70)	(2.70)	(2.67)	(2.71)	(2.70)
Cultural_Distance	-0.001	-0.001	-0.000	-0.001	-0.001	-0.000	-0.001
	(-5.31)	(-3.04)	(-1.82)	(-5.31)	(-3.05)	(-1.84)	(-5.31)
English	0.006	0.007	0.007	0.006	0.007	0.007	0.006
	(5.88)	(6.23)	(6.14)	(5.89)	(6.23)	(6.14)	(5.89)
Distance	-0.005	-0.005	-0.004	-0.005	-0.004	-0.004	-0.005
	(-13.73)	(-10.90)	(-9.18)	(-	(-	(-9.15)	(-
GDP	0.003	0.003	0.003	0.003	0.003	0.003	0.003
	(9.36)	(9.68)	(9.31)	(9.36)	(9.68)	(9.31)	(9.35)
Constant	-0.023	-0.026	-0.037	-0.023	-0.026	-0.037	-0.024
	(-2.67)	(-2.88)	(-3.43)	(-2.66)	(-2.89)	(-3.44)	(-2.67)
			. ,		. ,		
Firm_Year Fixed Effect	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	66,560	66,560	59,556	66,560	66,560	59,556	66,560
R-squared	0.050	0.052	0.055	0.050	0.052	0.055	0.050

## 4.5. Conclusion

In this chapter, I examine independent directors of US firms who are based in foreign countries and investigate how bilateral political relations between two countries influence the proportion of FIDs. About five hundred S&P 1500 firms had foreign independent directors on their boards during my sample period, which is from 2000 to 2013. My examination of the boards of S&P 1500 companies reveals that when bilateral political relations between countries and the US are poor, the US firm's proportion of FIDs from such countries is small. The probit regressions further support the main result by showing that firms are unlikely to have FIDs from countries that have poor political relations with the US.

I also examine that negative impact of poor political relations on the proportion FIDs is worse for firms with high innovation and with a high level of information asymmetry. This indicates that such firms face the threat of losing their technology and private information to countries that have poor political relations with the US. I next examine then why firms still hire FIDs who are from countries that have poor political relations with the US and show that when firms with high innovation and a high level of information asymmetry choose to have such FIDs, the benefits outweigh the costs, as shown in the regressions with return on assets and Tobin's Q. This is further supported by my M&A analysis, which shows that poor political relations would not stop firms from hiring FIDs from targets' home countries before M&A activity because the benefits outweigh the costs.

My primary contribution is to set up a new area of the literature that explores the factors that affect a US firm's board. No previous studies have explored the impact of political proximity on board structure, and I provide empirical support for the notion that political proximity has a direct impact on the proportion of FIDs inside the boards of US firms. Furthermore, I empirically show that poor political relations are regarded as costs by US firms when they hire FIDs, but when the benefits outweigh the costs, US firms hire FIDs, even when FIDs' home countries have poor political relations with the US.

# **CHAPTER 5: Conclusion**

Overall, my thesis shows that bilateral political relations influence not only bilateral trade but also media coverage, institutional ownership and board structure.

The main focus of the second chapter of this thesis is to investigate the impact of political proximity on US media. Using a unique dataset of news articles collected from RavenPack, which has its own sentiment of news for every news data, I find strong empirical evidence showing that when bilateral political relations between a country and the US is poor, ADR firms from that country receive more negative news from the US media.

In the third chapter of this thesis, I examine US institutional investors inside ADRs and investigate how bilateral political relations between two countries influence the level of US institutional ownership. My results show that when bilateral political relations between a country and the US are poor, the level of US institutional ownership is low for ADR firms from that country because US institutional investors refrain from investing in ADR firms from countries with poor political relations.

The fourth chapter of the thesis examines independent directors of US firms who are based in foreign countries and investigate how bilateral political relations between two countries influence the proportion of FIDs. My examination of the boards of S&P 1500 companies reveals that when bilateral political relations between countries and the US are poor, the US firm's proportion of FIDs from such countries is small. The probit regressions further support the main result by showing that firms are unlikely to have FIDs from countries that have poor political relations with the US.

My primary contribution of this thesis is to set up a new area of the literature that explores the impact of political relations on media dissemination, institutional ownership and board structure. No previous studies have explored the impact of political proximity on such topics, and I provide empirical support for the notion that political proximity has a direct impact on them. Furthermore, I suggest that political relations may influence stock returns, corporate governance, etc. through media or institutional ownership as a channel. Lastly, I empirically show that poor political relations are regarded as costs by US firms when they hire FIDs, but when the benefits outweigh the costs, US firms hire FIDs, even when FIDs' home countries have poor political relations with the US.

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