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Similarity Breeds Trust: Political Homophily and CEO-Board Communication

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Abstract

We find evidence that similarity of political views between the CEO and independent directors ("political homophily") encourages the CEO to share adverse information with the board. Firms with higher political homophily have lower stock price crash risk, are more likely to divest previously acquired assets with poor performance, and write down loss-making assets. Greater political homophily also increases the profitability of independent directors' insider trading and reduces the performance gap relative to CEOs' insider trades. Furthermore, the effect of political homophily is complemented by strong external governance which prevents a friendly board from insulating the CEO following ex post negative outcomes. Our identification utilizes the exogenous variation in political beliefs associated with the entry of a conservative television network in local markets.

Keywords: friendly board, CEO-board communication, political homophily, crash risk, external governance

JEL Classifications: D72, G32, G34, G41, M12, M14

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Abstract

We find evidence that similarity of political views between the CEO and independent directors ("political homophily") encourages the CEO to share adverse information with the board. Firms with higher political homophily have lower stock price crash risk, are more likely to divest previously acquired assets with poor performance, and write down loss-making assets. Greater political homophily also increases the profitability of independent directors' insider trading and reduces the performance gap relative to CEOs' insider trades. Furthermore, the effect of political homophily is complemented by strong external governance which prevents a friendly board from insulating the CEO following *ex post* negative outcomes. Our identification utilizes the exogenous variation in political beliefs associated with the entry of a conservative television network in local markets.

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I. INTRODUCTION

The willingness of a privately informed CEO to share adverse information with the corporate board has major implication for shareholder value. The common adage about "a stitch in time" applies to corporate decision making: timely corrective actions are likely to limit future losses. When a CEO has private information that an existing project is value-destroying and would likely lead to a large loss to the company, she needs to decide whether to take a chance (e.g., wait for improved external environment or explore opportunities elsewhere by "jumping a sinking ship") or take corrective actions. The latter choice can reduce the likelihood of a large loss and stock price crash risk, but for corrective actions to happen, the CEO typically needs to inform the board, and sometimes seek its approval (for example, for major corporate decisions such as divesting loss-making assets). An important constraint is that revealing adverse information to the board may reflect negatively on the CEO's past performance and credibility with the board.[1] Not much is known, however, as to what may overcome this constraint and facilitate the sharing of negative information.

In this paper, we study the role of political homophily – the similarity in political views between a CEO and non-executive board members – in facilitating the CEO's communication of negative information with the board. Our approach is motivated by the recent literature on sociology and politics suggesting that similar political views promote homophily, i.e., trust and bonding among individuals.[2] To this end, we examine if more congruent political ideologies of the CEO and the independent directors facilitate the sharing of information, especially adverse

[1] For example, Boot (1992) proposes a model in which managers of low ability may not divest underperforming assets because of the reputational costs.

[2] See, for example, McPherson, Smith-Lovin, and Cook (2001), Huber and Malhotra (2017), and Banda, Carsey, and Severenchuk (2020). Section II discusses the details of these findings. The concept of political homophily in the corporate finance literature was first introduced by Lee, Lee, and Nagarajan (2014).

information, and in turn reduce the later incidence of significant adverse outcomes and stock price crash risk. More broadly, our findings have implications for the growing importance of political polarization and political ideology in American society (e.g., Iyengar et al., 2019; Bertrand and Kamenica, 2023).[3] We document the growing ideological alignment between CEOs and their non-executive board members, and examine the consequence of this alignment for corporate performance.

Our research question is closely related to, but distinct from, the theoretical arguments regarding a "friendly board" in Adams and Ferreira's (2007) model, where board friendliness facilitates information sharing between the CEO and the board, enhancing the board's advisory role but weakening its monitoring.[4] We posit that political homophily between the CEO and the board can facilitate information sharing (especially the sharing of adverse information) by the CEO with the board, which in turn enables corrective actions. Arguably, such information sharing *may* also benefit the board's advisory role, but the corrective actions and improved shareholder outcomes require the board's approval rather than improved advising. Because of the close alignment of our arguments with those in Adams and Ferreira (2007), we refer to a board that has a high degree of political homophily with the CEO as a "friendly board" throughout this paper.

An additional ingredient of our arguments is the role of *external* governance. It is well documented in the literature that external governance has strong impacts on corporate value and decisions. In our context, the CEO's incentive to share adverse information stems from the threat of dismissal following unfavorable outcomes if timely actions are not taken – a credible threat that

[3] Recent literature documents that political identity is becoming increasingly important not only in social relationships (Huber and Malhotra, 2017; Iyengar, Konitzer, and Tedin, 2018) but also in top executive teams (Fos, Kempf, and Tsoutsoura, 2023).

[4] The key result of their model is that there could be an (interior) optimal degree of board independence which balances the monitoring and advisory roles.

requires strong external governance (e.g., strong shareholder power). On the contrary, with weak external governance, the CEO will be protected despite ultimate bad outcomes ("downside protection") and therefore has little incentive to share negative information. Therefore, we expect the ex-ante information sharing, resulting in lower stock price crash risk, to occur only when external governance is strong.[5]

Since we do not directly observe CEO-board information sharing (although we present suggestive evidence, discussed below), our empirical tests primarily focus on the associations between CEO-board homophily and firm outcomes that are likely affected by the sharing of adverse information. Our sample consists of 26,228 firm-years between 2000 and 2019, with each firm-year having an average of 7.6 independent directors. Following Lee, Lee, and Nagarajan (2014), we construct a measure of CEO-board political homophily, *Political Homophily Index* (henceforth *PHI*), using political contributions made by the CEO and independent directors during the previous election cycle. Using such contributions as a "revealed preference" measure of an individuals' political orientations, *PHI* captures the extent to which the CEO and the "average" independent director of a firm share similar political views.[6] We find that the average *PHI* increases steadily by approximately 18% from 2000 to 2019, indicating a growing alignment in political views between CEOs and independent directors in corporate America over recent years.

We first examine the relationship between *PHI* and a firm's stock price crash risk. As illustrated in Figure 1, if political homophily facilitates prompt correction of a firm's mistakes, then high *PHI* firms will have a lower likelihood of a large unexpected loss and in turn a reduced stock price crash risk. We follow the literature and construct two measures of stock price crash

[5] Dismissal need not be the only cost to the CEO due to poor performance in the future. If external governance is strong, the board is likely to limit the CEO's compensation growth if performance is poor.
[6] The similarity measure is the Euclidean distance between the political orientation of the CEO and the average political orientation of independent directors.

risk: one-year ahead negative skewness, and asymmetric (down-to-up) volatility of daily stock returns (e.g., Chen, Hong, and Stein, 2001; Kim and Zhang, 2016). We estimate panel regressions of these crash risk measures on *PHI*, controlling for a broad set of firm characteristics. Consistent with our prediction, we find that the coefficient of *PHI* is negative and significant at the 1% level. Our regression results remain robust when using alternative measures of political homophily based on different measurement windows or political contributions, and when controlling for the political orientations of the CEO and the board.

We acknowledge that there may be unobserved firm or CEO/board characteristics that influence both political homophily and stock price crash risk. For example, firms with strong corporate governance may be more likely to appoint directors with diverse backgrounds, including political ideologies, and may also have lower crash risk due to better risk management practices. To address the endogeneity concerns, we exploit exogenous variation in political beliefs induced by the expansion of Sinclair Broadcast Group, the largest operator of local television stations in the U.S. Since the 1980s, Sinclair has predominantly grown through acquisitions of local television stations nationwide. Known for its strong conservative slant, Sinclair often airs news content that aligns with Republican viewpoints (Martin and McCrain, 2019).

Consistent with the literature that public media and propaganda significantly influence people's political views (e.g., DellaVigna and Kaplan, 2007; Durante, Pinotti, and Tesei, 2019), we find that Sinclair's entry into a county significantly shifts local directors' political leanings towards the Republican Party.[7] Therefore, we explore the exogenous variation in *PHI* caused by Sinclair's acquisitions and examine its impact on firms' crash risk using a three-step procedure

[7] This effect is economically significant, equivalent to 64.5% of the sample mean political orientation. In contrast, the entry of Sinclair does not significantly impact the political leanings of CEOs. This could be because CEOs are ex ante already much more Republican-oriented than directors. Additionally, CEO overconfidence (e.g., Malmendier and Tate, 2005, 2008) may lead CEOs to update their beliefs less than directors in response to media.

following Adams, Almeida, and Ferreira (2009). Specifically, in the first stage, we estimate the impact of Sinclair acquisitions on the political views of individual directors. In the second stage, we calculate the political homophily index using the individual directors' predicted political orientation from the first stage (*PHISinclair*). In the third stage, we estimate our baseline model using *PHISinclair* as an instrumental variable for *PHI*. Our findings confirm the negative relationship between political homophily and future crash risk.

To investigate the underlying mechanisms, we conduct three analyses to examine whether political homophily enhances information sharing and facilitates the timely implementation of corrective actions. First, Ravina and Sapienza (2010) find that insider trades by independent directors earn lower returns than those from executives' insider trades, suggesting that executives possess more private information than independent directors. We find that greater political homophily increases the profitability of independent directors' insider trading and reduces the performance gap relative to CEOs' insider trades. This result is consistent with political homophily promoting more extensive sharing of private information by CEOs with directors. Second, we find that acquired assets with poor performance are more likely to be subsequently divested when political homophily is higher. This result is consistent with the premise that political homophily strengthens managers' incentives to take corrective actions and prevent further losses. Third, following the methodology of Lawrence, Sloan, and Sun (2013), we show that political homophily increases the likelihood of managers recognizing losses through asset write-downs.

We further examine the impact of political homophily on crash risk by controlling for other types of homophily between the CEO and the directors, including gender, age, racial background, work experience, and location. We find that political homophily continues to have a significant impact, while the other homophily dimensions do not, suggesting that political homophily has a

unique impact on the trust and communication between CEOs and directors.

We then test the prediction that the positive effect of a friendly board on CEO-board communication relies on strong external governance. We use two indicators of external governance: institutional ownership (e.g., Denis, Denis, and Sarin, 1997; Harford, Jenter, and Li, 2011) and the E-Index (Bebchuk, Cohen, and Ferrell, 2009). Consistent with Lee, Lee, and Nagarajan (2014), we find that the negative relationship between CEO turnover and past performance is absent when political homophily is high, indicating that a friendly board offers downside protection to the CEO. However, this downside protection effect is observed only in the subsample of weak external governance. When external governance is strong, political homophily does not reduce the turnover-performance sensitivity. Furthermore, we find that the negative relationship between political homophily and stock price crash risk is concentrated in the subsample with strong external governance but disappears in the subsample with weak external governance. This result, together with our results on CEO turnover, suggests that the beneficial effect of a friendly board on CEO-board communication relies on strong external governance.

Finally, we examine the interactive effect of *PHI* and external governance on firm value. We first show that *PHI* negatively impacts Tobin's Q in the full sample, consistent with Lee, Lee, and Nagarajan (2014), who suggest that CEO-board political homophily reduces directors' monitoring intensity and thus negatively affects firm value. We then find that this negative impact manifests only in firms with weak external governance and disappears in firms with strong external governance. These results indicate that, in the presence of strong external governance, the negative effect of political homophily on directors' monitoring may be offset by the benefits of enhanced information sharing and more timely corrective actions.

Our paper contributes to the literature in several ways. First, while existing literature has

investigated the dual monitoring and advisory roles of boards, there is limited evidence regarding which specific board attributes encourage more information sharing by the CEO. Adams (2010) provides survey evidence that independent directors receive less strategic information from management when their monitoring is more intensive; however, we are not aware of any existing study that directly examines the key idea that a friendly board, by committing to less intensive monitoring, can encourage more information sharing. Under the presumption that political homophily promotes more trust and tolerance for negative outcomes, our results provide direct evidence on this very important aspect of the theory.

Second, in tandem with Lee, Lee, and Nagarajan (2014), who document that CEO-board political homophily weakens the board's monitoring role, we show that political homophily encompasses both features of the friendly board theory: monitoring and information sharing. While we do not explicitly consider the board's advisory role, we suggest a new benefit of sharing negative information – the ability to take timely actions to avert even worse consequences in the future. Further, our results suggest that when a CEO considers revealing negative information to the board, political homophily may be more relevant than other types of homophily.[8]

Furthermore, our paper shows that external governance can complement the role played by a friendly board. Specifically, when the board is friendly, stronger external governance encourages timely information sharing with the board. In the theory of friendly boards (Adams and Ferreira, 2007), to the extent that there is an interior optimum level of board independence, a friendlier board could affect firm value in either direction. Lee, Lee, and Nagarajan (2014) find that greater homophily lowers Tobin's Q. We confirm their findings and provide new evidence that while this

[8] The homophily measure may also be more meaningful than social connections between the CEO and board members because when the information is negative, the CEO must trust the entire board not to take actions against her. However, Schmidt (2015) reports that only 4% of board members are connected to the CEO via social ties, and another 4% via employment ties. Such weak ties may not provide the CEO with the tolerance she needs.

negative relationship is observed in the subsample with weaker external governance, it does not exist in the subsample where external governance is strong.

II. RELATED LITERATURE AND TIMELINE ILLUSTRATION

II.1 Related Literature

Our paper relates to the literature on friendly boards. In the theoretical model by Adams and Ferreira (2007), the CEO faces a trade-off regarding the disclosure of private information to the board. If the CEO shares information with the board, she will be able to gain better advice. However, sharing private information imposes costs on the CEO, as a more informed board would monitor the CEO more intensively. Holmstrom (2005), Raheja (2005), and Harris and Raviv (2008) also provide models suggesting that the presence of independent directors may affect the advising role of the board.

Faleye, Hoitash, and Hoitash (2011) show that an increased presence of independent directors on crucial monitoring committees enhances the quality of monitoring at the expense of advising. In Laux and Mittendorf's (2011) model, greater board dependence leads to higher CEO incentive pay and more efficient project selection by the CEO. In addition, Schmidt (2015) in acquirer firms with severe agency problems, social ties between the CEO and board members are associated with worse acquirer returns. Conversely, for acquirer firms where the board's advisory role is more important, the social ties are associated with higher acquirer returns. Kang et al. (2018) find that board friendliness, as measured by CEO-director social ties, is related to higher innovation output. Berger, Cai, and Qiu (2023) show that cultural proximity between CEOs and directors is associated with worse M&A performance for firms with weak corporate governance.

Our paper also contributes to the literature on the interaction between board structure, corporate governance, and corporate outcomes such as accounting conservatism (Ahmed and

Duellman, 2007), information environment (Armstrong, Balakrishnan, and Cohen, 2012; Armstrong, Core, and Guay 2014), and payroll (Gleason et al. 2021). Ertimur, Ferri, and Stubben (2010), and Joe, Louis, and Robinson (2009) show that directors' incentives are affected by factors including reputation concerns, shareholder pressure, and media exposure. We extend this literature by documenting how CEO-director political homophily affects the sharing of adverse information, and the interplay between board structure and external governance.

Furthermore, our paper relates to the literature on connections/homophily among various stakeholders. For example, Gompers, Mukharlyamov, and Xuan (2016) demonstrate that venture capitalists are more likely to form syndicates with partners who share their backgrounds. Similarly, Ishii and Xuan (2014) reveal that social ties between acquiring and target firms can adversely affect merger outcomes. In the asset management sector, Kuhnen (2009) documents how business connections between mutual fund managers and advisory firms influence their hiring decisions, while Pool, Stoffman, and Yonker (2015) show that socially connected fund managers exhibit similar investment patterns. Our study extends this literature by revealing that political homophily between CEOs and directors significantly impacts firm outcomes, even after controlling for other forms of homophily and connections.

Lastly, our paper extends the literature on managerial communication incentives. A broad and well-established body of literature documents CEOs' incentives to delay, obscure, or conceal unfavorable information (e.g., Kothari, Shu, and Wysocki, 2009; Ertimur, Sletten, and Sunder, 2014; Baginski et al., 2018; Bao et al., 2019; Bao, Kim, and Su, 2022; Bertomeu et al. 2022). Grenadier, Malenko, and Malenko (2016) discuss the effectiveness of communication between the principal and an agent in the setting of dynamic decision-making. Kakhbod et al. (2023) study the effectiveness of shareholder-manager communication when they have different beliefs. Our paper

complements these studies by focusing on private communication between the CEO and the board, and how that facilitates timely corrective actions.

II.2 Hypothesis Development

Figure 1 presents a timeline that starts at T=0 with the CEO becoming privately informed about a project's likely poor performance. If this project is divested at T=1 (which requires the board to be informed by the CEO) then the loss at T=2 is avoided. Conversely, if this project is not divested at T=1, it is likely to incur significant losses at T=2. At T=1, an unfriendly board will dismiss the CEO upon the sharing of adverse information, while a friendly board will not dismiss the CEO.

As shown in Figure 1, when the board is unfriendly, the CEO faces a higher cost from revealing adverse information at T=1 (immediate dismissal) than from non-disclosure, where the CEO can gamble that the bad outcome at T=2 is not realized. As a result, the CEO will choose not to inform the board, leading to likely significant losses at T=2 and, in turn, heightened stock price crash risk. On the other hand, when the board is friendly, the CEO's decision to share information depends on the strength of external governance. If external governance is strong, the CEO prefers to reveal the adverse information to the friendly board at T=1, thus avoiding potential dismissal at T=2. However, if external governance is weak, which allows the CEO to hold on to the job even if substantial losses occur at T=2, the CEO will have little incentive to disclose adverse information or actively pursue divestment at T=1. Appendix A presents the parameter assumptions under which sharing adverse information is incentive compatible for the CEO if, and only if, the board is friendly and external governance is strong

III. SAMPLE AND MEASURE CONSTRUCTIONS

III.1 Construction of the Political Homophily Index

We obtain the data on CEOs from the Execucomp database and the data on independent directors from BoardEx. Our baseline sample includes the firms that are covered by both Execucomp and BoardEx databases, which also have all the regression variables available. The sample consists of 26,228 firm-years between 1999 and 2019, with an average of 7.6 independent directors per firm-year.

Following the literature (e.g., Hong and Kostovetsky, 2012; Di Giuli and Kostovetsky, 2014; Hutton, Jiang, and Kumar, 2014, 2015; Lee, Lee, and Nagarajan, 2014), we collect individual campaign contribution records from the Federal Election Commission (FEC) website to measure the political leanings of directors and CEOs. The FEC's individual contributions file contains information about each contribution made by individuals to political committees or candidates, as disclosed by the recipients in compliance with federal regulations.[9] Our sample includes donations to candidate committees, party committees, as well as hybrid PACs and super PACs with partisan affiliations. We determine the party affiliations of candidates and party committees using data from FEC's committee master file. For hybrid and super PACs with over 1,000 transactions, we manually search for their political orientations using sources such as OpenSecrets.org and Google.com. For each individual donation, we obtain the date, amount, donor's employer, and the recipient's party affiliation. We then match the donation records to the CEOs from Execucomp and directors from BoardEx by names and employers.

Following the literature (e.g., Hong and Kostovetsky, 2012; Hutton, Jiang, and Kumar, 2015), we measure each CEO/Director's political leaning by calculating her Republican index,

[9] In 1989-2014, a contribution was required to be reported only if the amount reached $200 or more with a reporting period. After 2014, the rule was adjusted to require reporting of contributions if the person's total donation to-date during the current election cycle is over $200 for a candidate or if the total calendar year-to-date donation is over $200 for political action committees (PACs) and party committees. We include only the donations subject to mandatory disclosure in the sample to avoid potential selection bias of voluntary disclosure.

Rep, using the following equation:

$$Rep_{p,t} = \frac{R_{p,t} - D_{p,t}}{R_{p,t} + D_{p,t}}, \quad (1)$$

where $R_{p,t}$ ($D_{p,t}$) denotes the total amount of donations made by individual p to Republican (Democratic) recipients in the election cycle preceding year t.[10] *Rep* therefore captures the time-varying political leaning of the CEOs and directors, with a higher value of *Rep* indicating that the individual is more Republican-oriented. We then calculate the CEO-board political homophily index, *PHI*, following Lee, Lee, and Nagarajan (2014):

$$PHI_{i,t} = 1 - \frac{|RepCEO_{i,t} - RepIndep_{i,t}|}{2}, \quad (2)$$

where $RepCEO_{i,t}$ is the Republican index of the CEO of firm i in year t. $RepIndep_{i,t}$ is the equal-weighted average Republican index of the independent directors of firm i in year t. By construction, *PHI* ranges from 0 to 1, where a higher *PHI* indicates stronger political alignment between the CEO and the independent directors of the firm.

III.2 Construction of the Crash Risk Measures

We construct two measures for crash risk, namely, negative coefficient of skewness (*NCSKEW*) and down-to-up volatility (*DUVOL*), following the literature (e.g., Chen, Hong, and Stein, 2001; Xu, Xuan, and Zheng, 2021). We first estimate firm-specific daily returns for each firm-year using the following regression:

$$r_{i,d} = \alpha + \beta_1 r_{m,d-2} + \beta_2 r_{m,d-1} + \beta_3 r_{m,d} + \beta_4 r_{m,d+1} + \beta_5 r_{m,d+2} + \epsilon_{i,d}, \quad (3)$$

[10] We include both presidential and congressional election cycles. For example, $R_{p,2013}$ and $D_{p,2013}$ are calculated using donations in 2011 and 2012. $R_{p,2014}$ and $D_{p,2014}$ are calculated using donations in 2013 and 2014.

where $r_{i,d}$ is return of stock i on day d, and $r_{m,d}$ is return of the CRSP value-weighted market index on day d. The firm-specific daily returns, denoted by $R_{i,d}$, is calculated as the natural logarithm of one plus the residual return in Equation (3).

The first measure, *NCSKEW*, is calculated for each firm-year as the opposite number of the third moment of the firm-specific daily returns divided by the standard deviation of the firm-specific daily returns raised to the third power:

$$NCSKEW_{i,t} = -\left[n(n-1)^{\frac{3}{2}}\sum R_{i,d}^3\right] / \left[(n-1)(n-2)(\sum R_{i,d}^2)^{\frac{3}{2}}\right], \quad (4)$$

The second measure, *DUVOL*, is calculated as follows:

$$DUVOL_{i,t} = log\{\left[(n_u - 1)\sum_{DOWN} R_{i,d}^2\right] / \left[(n_d - 1)\sum_{UP} R_{i,d}^2\right]\}, \quad (5)$$

where "DOWN" ("UP") indicates the days when the firm-specific returns are below (above) the mean of year t. n_u (n_d) is the number of up (down) days of firm i in year t. Higher values of these two measures indicate greater crash risks.

III.3 Summary Statistics

Table 1 presents summary statistics of the variables used in our paper. For political orientations, we find that CEOs on average exhibit a stronger Republican orientation (*RepCEO* mean = 0.14) than independent directors (*RepIndep* mean = 0.03). The main independent variable, *PHI*, has a mean of 0.80 and a standard deviation of 0.21. Figure 2 plots the time-series of average *PHI* for our sample firms, which shows an increase over the past two decades. Specifically, average *PHI* has increased from 0.72 in 2000, the beginning of our sample period, to 0.85 by 2019, suggesting a growing political alignment between CEOs and directors in the U.S.

Table 1 also presents the summary statistics of control variables constructed following prior literature (e.g., Chen, Hong, and Stein, 2001; Kim, Li, and Zhang, 2011a, 2011b; Callen and Fang, 2015; DeFond et al., 2015; Xu, Xuan, and Zheng, 2021; Hsu, Wang, and Whipple, 2022).

These include stock return volatility in year *t* (*Sigma*), cumulative daily returns in year *t* (*Ret*), average monthly share turnover in year *t* minus the average monthly share turnover in year *t-1* (*Dturn*), market-to-book ratio (*MB*), book leverage (*Lev*), return on assets (*ROA*), the natural logarithm of market value (*LnMV*), and the absolute value of discretionary accruals (*DA*).[11] We also control for the natural logarithm of board size (*LnBoardSize*), and the percentage of a firm's directors with social connection to the CEO (*Connection*), where a connection is defined following Dasgupta, Zhang, and Zhu (2021) as either an educational overlap or shared past employment outside the focal firm at least five years before they started working for the focal firm. The definitions of all these variables are provided in Appendix B.

IV. EMPIRICAL RESULTS

IV.1 Political Homophily and Crash Risk

To examine the effect of political homophily on stock price crash risk, we first conduct the baseline panel regression analysis. We then address the potential endogeneity concerns by implementing an instrumental variable (IV) analysis.

IV.1.1 Panel Regressions of Crash Risk on Political Homophily

We estimate the following panel regression:

$$Crash\_Risk_{i,t} = \alpha + \beta_1 PHI_{i,t-1} + \sum_k \beta_k Controls^k_{i,t-1} + \varphi_i + \eta_t + \epsilon_{i,t}, \quad (6)$$

where $Crash\_Risk_{i,t}$ is the crash risk of firm *i* in year *t*, measured by negative coefficient of skewness (*NCSKEW*) or down-to-up volatility (*DUVOL*). $PHI_{i,t-1}$ is the political homophily index of firm *i* in year *t-1*. $Controls_{i,t-1}$ is a set of firm-level control variables as discussed in the previous section. We further include the average Republican index of the firm's directors (*RepIndep*), and that of the firm's CEO (*RepCEO*) to control for the political orientation of directors and the CEO.

[11] Firm financial data are obtained from Compustat.

For the ease of interpretation, we standardize the crash risk measures and *PHI* to mean zero and standard deviation of one. We include firm and year fixed effects in the regressions and cluster standard errors at the firm level.

In Table 2, the coefficient on *PHI* is negative and statistically significant at the 1% level in regressions of both crash risk measures. In terms of economic magnitude, the coefficients indicate that a one standard deviation increase in *PHI* is associated with a 2.3% standard deviation decrease in *NCSKEW* and a 2.5% standard deviation decrease in *DUVOL*. We stress the directional results rather than the economic magnitude because the latter depends not only on the extent to which political homophily affects information sharing but also on the frequency of arrival of adverse information and how acting on that information subsequently affects stock returns. Even when adverse information arrives infrequently, not taking timely actions on the basis of that information can have major consequences for shareholders.

Regarding the control variables, the coefficients on *Sigma*, *Ret*, and *MB* are significantly positive, while the coefficient on *Lev* is significantly negative. These results are consistent with findings in the existing stock price crash risk literature (e.g., Kim, Li, and Zhang, 2011a, 2011b; Callen and Fang, 2015; DeFond et al., 2015). The coefficient on *DA* is positive but statistically insignificant, which is also in line with prior studies.[12] Overall, the results in Table 2 indicate that, consistent with our prediction, political homophily is negatively associated with future stock price crash risk.

IV.1.2 Robustness Tests

We follow Lee, Lee, and Nagarajan (2014) and conduct robustness checks using alternative

[12] Additionally, the coefficient is significantly positive for ROA, significantly negative for LnMV, and insignificant coefficients on Dturn. Prior studies find mixed evidence for these coefficients (e.g., Kim, Li, and Zhang, 2011a, 2011b; Callen and Fang, 2015; DeFond et al., 2015; Xu, Xuan, and Zheng, 2021), likely due to differences in samples and regression designs.

measures of *PHI* based on varying approaches to calculate donations and the exclusion of small donors. The first alternative measure, *PHI (Time-invariant)* is constructed using each individual's Republican index based on their total amount of contribution up to the year 2019 (rather than the previous political cycle).[13] The second alternative measure, *PHI (Prior)*, is constructed using each Republican index based on their historical contribution made before year *t* (rather than the previous political cycle). The third alternative measure, *PHI (Strong)*, is constructed using only the Republican index of the individuals whose contribution to one party net of her contribution to the other party exceeds $2,000 in an election cycle.[14] The fourth alternative measure, *PHI (Large)*, is constructed using only the Republican index of the individuals whose historical total amount of contribution exceeds $2,000. In Table 3. Panel A reports the regressions using *NCSKEW* as the dependent variable, and Panel B reports the regressions using *DUVOL* as the dependent variable. In all four sets of regressions, we find a consistently negative association between *PHI* and future crash risk, with t-statistics of the *PHI* coefficient ranging from -2.41 to -3.44.

In addition, we conduct two robustness tests by controlling for lagged *NCSKEW* in the regressions of crash risk measures on political homophily (e.g., Kim, Li, and Zhang, 2011a, 2011b; Callen and Fang, 2015; DeFond et al., 2015) as well as including industry fixed effects (at the 2-digit SIC level) instead of firm fixed effects. As reported in Panel C of Table 3, our baseline results hold under these alternative specifications.

IV.1.3 Identification Using Sinclair Acquisitions

We acknowledge that the observed negative relation between *PHI* and crash risk can be caused by omitted variables, especially because the selection of CEOs and directors can be

[13] This time-invariant measure of *PHI* can reduce the measurement error of political orientation in election cycles, but potentially has forward-looking bias.
[14] This measure is constructed following Hong and Kostovetsky (2012) to capture the political views of only those individuals who have strong partisanship.

endogenous. To identify the causal effect of political homophily on crash risk, we employ the exogenous variations in independent directors' political views caused by Sinclair Broadcast Group's acquisitions of local television stations. Our approach is motivated by the research suggesting that media exposure can significantly shape people's political views (e.g., DellaVigna and Kaplan, 2007; Martin and Yurukoglu, 2017; Durante, Pinotti, and Tesei, 2019). Recent studies also find that the proliferation of internet and the diversification of media choices contribute to the increase in political polarization (e.g., Prior, 2007; Lelkes, Sood, and Iyengar, 2017).

Since the early 1980s, Sinclair Broadcast Group has rapidly expanded its reach in the United States by acquiring local television stations. By 2019, Sinclair had become the largest local television station operator in the U.S. in terms of both the number of stations owned (191) and the coverage (89% of U.S. markets).[15] The company is recognized for its Republican-leading disposition in news broadcasts, as documented by both media analyses and academic studies (e.g., Glaser, 2018; Martin and McCrain, 2019). Based on a Pew Research Center survey from 2018, local television is a primary news source for 37% of the U.S., with cable television serving a similar role for 28%.[16] This prevalence underscores the potential for Sinclair's market entry to shift local residents' political views. Indeed, Ren (2021) finds that Sinclair's acquisitions of local TV stations significantly shifted local residents' political orientations towards the Republican side. He further shows that Sinclair's acquisitions appear to be independent of the local economic condition or political leaning, thereby providing an exogenous source of variation in political orientation.

We obtain data on Sinclair's ownerships and acquisitions of local TV stations from

[15] For details, see the official Sinclair website at http://sbgi.net/.
[16] The survey information can be found at https://www.pewresearch.org/short-reads/2018/01/05/fewer-americans-rely-on-tv-news-what-type-they-watch-varies-by-who-they-are/.

Wikipedia and RabbitEars.info.[17] The sample consists of 163 acquisitions by Sinclair in 96 designated market areas (DMA) from 1984 to 2018. To identify the locations of CEOs and directors, we use the county from a person's FEC donation records in a given year as her residence for that year. In the cases of a person disclosing multiple donations from different counties in the same year, we select the county of the largest donation in that year as her residence. In the cases donations are absent or addresses are not available in the FEC database, we use the corporate headquarters' county for the individual's residence.[18] We then match these county locations to DMAs using the DMA-county matching information from Wikipedia.[19]

To examine the impact of Sinclair acquisitions on the political orientations of independent directors and CEOs, we estimate the following OLS regression:

$$REP_{p,t} = \alpha + \beta_1 Sinclair_{p,t-1} + \sum_k \beta_k Controls^k_{p,j,t-1} + \epsilon_{p,t}, \qquad (7)$$

where $REP_{p,t}$ is the Republican index of director or CEO p in year t, and $Sinclair_{p,t-1}$ is a dummy variable that equals one if the director or CEO resides in a county affected by a Sinclair acquisition in year *t-1*, and zero otherwise. We include the same set of firm-level control variables ($Controls_{p,j,t-1}$) as those in Equation (6). If a director serves multiple firms within a year, the firm characteristics are obtained from the company with the longest tenure.

We present the regression results in Table 4, which sows that the Sinclair acquisitions significantly shift the directors' political leanings towards Republican, as the Sinclair coefficient is positive and significant at the 1% level in both Columns (1) and (2). This effect is also

[17] Sinclair's ownerships of local TV stations are obtained from RabbitEars.info at https://rabbitears.info/search.php?request=owner_search&owner=Sinclair&sort=state. Additionally, Sinclair's acquisitions of local TV stations are obtained from Wikipedia at https://en.wikipedia.org/wiki/List_of_stations_owned_or_operated_by_Sinclair_Broadcast_Group#cite_note-MPSM-26.

[18] To account for relocation of corporate headquarters (e.g., Heider and Ljungqvist, 2015), we obtain historical headquarter addresses by scraping the firms' index pages from EDGAR. When a director works for multiple companies in a year, we use the headquarters county of the firm where the director is an executive as her county of residence.

[19] The information can be found at https://en.wikipedia.org/wiki/List_of_United_States_television_markets.

economically significant, as the coefficient of 0.023 in Column (1) indicates that Sinclair's acquisitions are associated with a 0.023 increase in the Republican index for a director, equating to 74.2% of its sample mean (0.031). In contrast, the regressions for sample CEOs in Columns (3) and (4) show that Sinclair acquisitions do not significantly impact CEOs' political leanings. This is possibly due to two reasons. First, as noted earlier, the CEOs are ex-ante much more Republican-oriented than the directors and therefore the marginal effect of Sinclair broadcast acquisitions may be lower for CEOs. Second, the well-documented CEO overconfidence (e.g., Malmendier and Tate, 2005, 2008) may render CEOs less susceptible to media influences compared to directors. Consequently, we use the shocks from Sinclair acquisitions to directors' beliefs to construct an instrumental variable for *PHI*.

IV.1.4 Sinclair-predicted PHI and Crash Risk

We adopt a three-stage approach following Adams, Almeida, and Ferreira (2009) to determine the causal impact of *PHI* on firms' crash risk using Sinclair's acquisitions. Specifically, in the first stage, we estimate model (2) of Table 4 for individual directors.[20] In the second stage, we construct the political homophily index using individual directors' Republican indices predicted from the first stage (*PHISinclair*). In the third stage, we utilize *PHISinclair* as the instrument for *PHI* and apply an instrumental variable approach to estimate Equation (6).

The results of the third stage of the procedure are presented in Table 5, which shows that the coefficients on *PHI* are similar to those in our baseline regressions and remain statistically significant at the 1% level. These findings indicate that the exogenous variation in political homophily, induced by the Sinclair acquisitions, exerts a significant impact on firms' future crash risk. For the remaining empirical tests in the paper, we will utilize the three-step procedure when

[20] Our results remain robust when we estimate the model with director/CEO fixed effects included.

PHI is included as an independent variable.

To explore the potential long-term effects of Sinclair acquisitions on people's political views, we perform regressions similar to those in Table 4, except that we replace $Sinclair_{t-1}$ with $Sinclair\_Alt_{t-1}$, which is a dummy variable that equals one if a director is affected by a Sinclair acquisition in any year up to *t-1*, and zero otherwise. Therefore, *Sinclair_Alt* captures the long-term impact of Sinclair acquisitions on directors' political views. Table B1 of the Appendix shows that, similar to *Sinclair*, *Sinclair_Alt* is significantly positive for directors but not CEOs. We then perform the three-stage regressions similar to those in Table 4, with *Sinclair_Alt* used to predict individual directors' Republican indices and in turn the political homophily index (*PHISinclair_Alt*), which we then use as an instrument for *PHI* in the third stage. Table B2 of the Appendix shows that our results are similar when using this alternative specification for Sinclair acquisitions.

IV.2 Mechanisms of the Effect of Board Friendliness on Crash Risk

We hypothesize that *PHI* mitigates crash risk by encouraging the CEOs to share negative information with board members, therefore allowing timely corrective actions that prevent loss accumulation. Although directly observing CEO-director communications is not feasible, we conduct three tests to investigate the information-sharing mechanism based on directors' insider trading returns, divestitures of previously acquired assets, and asset write-downs.

IV.2.1 Insider Trading Returns

It is well-documented that corporate insiders often use their private information to earn excess returns through insider trading (e.g., Jenter, 2005; Louis, Sun, and White, 2010; Dechow, Lawrence, and Ryans, 2016). Ravina and Sapienza (2010) find that while independent directors earn significantly positive returns from their insider purchases, their performance is lower than

that of executives, suggesting a disparity in the level of private information between CEOs and directors. If political homophily encourages CEOs to share private information with directors, we would expect an increase in the insider trading returns of directors as the communication narrows their performance gaps with CEOs.

To test this prediction, we obtain data on insider purchases by independent directors and CEOs from the Thomson/Refinitiv Insider Data for our sample firms. Following Ravina and Sapienza (2010), we calculate market-adjusted returns for an insider's long position over the intervals of 30, 60, 90, and 180 trading days subsequent to each transaction. For each transaction, we assign a dummy variable (*Independent*) that equals one if the transaction is made by an independent director, and zero for those made by CEOs. Since Fidrmuc, Goergen, and Renneboog (2006) show that the transaction size of an insider trading is indicative of its informativeness, we measure each transaction's size as a fraction of the firm's market capitalization (*TradeSize*). We then regress insider trading returns on the triple interaction among *PHI*, *Independent*, and *TradeSize*. [21] We control for firm, board, and CEO characteristics, as in other regressions. For ease of interpretation, we standardize insider trading returns and *PHI* to have a mean of zero and a standard deviation of one.

Panel A of Table 6 reports the results. The coefficient on *TradeSize* is significantly positive, indicating that larger insider trades are more profitable, consistent with large insider trades incorporating private information. The interaction between *Independent* and *TradeSize* is significantly negative, echoing Ravina and Sapienza's (2010) finding as independent directors earn significantly lower returns on large insider trades compared to CEOs. The triple interaction between *PHI*, *Independent*, and *TradeSize* is positive in all specifications and statistically

[21] PHI and its interactions are instrumented by *PHISinclair* and the corresponding interactions.

significant for the 30- and 180-day windows. This result indicates that, the CEO-director return gap for large trades is significantly smaller in firms with higher *PHI*. These findings suggest that political homophily mitigates independent directors' informational disadvantage in large trades.

Following Ravina and Sapienza (2010), the above analysis focuses on insider purchases rather than sales.[22] We further extend the investigation to insider sales by CEOs and directors, where we examine market-adjusted returns for an insider's short position over the intervals of 30, 60, 90, and 180 trading days subsequent to each transaction. In Panel B of Table 6, we find that the coefficient on the triple interaction term is positive in all four models and statistically significant in two of them. Collectively, the results in Table 6 are consistent with political homophily promoting more extensive sharing of private information by CEOs with directors.

IV.2.2 Board Friendliness and the Subsequent Divestitures of Acquired Assets

In this subsection, we examine the effect of a friendly board, characterized by high *PHI*, on a CEO's propensity to take corrective actions by divesting previously acquired assets with poor performance. We obtain our sample of completed acquisitions from the Capital IQ Mergers and Acquisitions Database, and then identify whether the acquired firms are subsequently divested by the acquirers.[23] We measure the perceived value of an acquisition using the acquirer's cumulative abnormal return (CAR), estimated using the market model, in the three-day window surrounding the acquisition announcement date. We then estimate the following linear probability model:

$$Divest_j = \alpha + \beta_1 PHI_j \times CAR_j + \beta_2 PHI_j + \beta_3 CAR_j + \sum_k \beta_k Controls_j^k + \eta_t + \epsilon_j, \quad (8)$$

where $Divest_j$ is a dummy variable that equals one if the acquired firm in transaction j is divested in the three years after the completion of the acquisition. The variable of interest is the interaction

[22] Insider sales are more likely driven by liquidity or consumption needs and are generally found to be less informative (e.g., Gu and Li, 2007; Veenman, 2012).

[23] Since Capital IQ uses a unique identifier (FIRMID) to track each firm even after it is acquired, we are able to identify the acquired firms that are subsequently sold off.

between *PHI* and *CAR*.[24] $Controls_j$ is a vector of control variables that include acquirer, deal, and CEO characteristics. We also include industry and year fixed effects in the regressions. To facilitate interpretation, we standardize *PHI* to have a mean of zero and a standard deviation of one.

Column (1) of Table 7 presents the regression of *Divest* on *CAR*, in which the coefficient on CAR_j is significantly negative (t-statistic -2.36), indicating a higher likelihood of divesting acquired assets that are perceived as less valuable to the acquirers. Column (2) further includes the interaction between *PHI* and *CAR*, in which the interaction is negative and significant at the 5% level (t-statistic -2.27), suggesting that acquirers with higher *PHI* are more likely to divest low-value acquired assets. Taken together, the results in Table 7 suggest that political homophily increases CEOs' propensity to take corrective actions by selling off acquired assets with low value.

3.2.3 Board Friendliness and Asset Write-Downs

Lawrence, Sloan, and Sun (2013) document that firms with higher book-to-market ratios tend to report larger asset write-downs, aligning with Generally Accepted Accounting Principles (GAAP), which mandate that assets to be written down when their fair values drop sufficiently below their book values. However, the subjectivity within GAAP, such as the flexibility in determining the face value of goodwill, allows for managerial discretion in these write-downs. In this subsection, we investigate whether a friendly board, as characterized by a high *PHI*, influences a CEO's propensity to share negative information and recognize losses in asset value, leading to larger asset write-downs.

We follow Lawrence, Sloan, and Sun (2013) and construct two measures of asset write-downs. The first measure, *SPI*, is a firm's special items scaled by its market capitalization at the

[24] PHI and its interaction are instrumented by *PHISinclair* and its interaction.

end of the previous year. The second measure, WD_t, is the sum of the firm's asset write-downs and goodwill impairments, scaled by its market capitalization at the end of the previous year.[25] We begin our analysis by estimating an OLS regression of *SPI* on the firm's lagged book-to-market ratio (BTM_{t-1}). For ease of interpretation, we standardize *SPI* and *BTM* to have a mean of zero and a standard deviation of one. Column (1) Table 8 presents the regression results, in which the coefficient of *BTM* is negative and significant at the 1% level in both regressions. Since write-downs are recorded in negative values, this result indicates that higher book-to-market firms have larger asset write-downs, corroborating the findings of Lawrence, Sloan, and Sun (2013).

Next, we include the interaction between *PHI* and *BTM* in the regressions, as well as the firm-level control variables.[26] Columns (2) of Table 8 shows that the coefficient of the interaction term is significantly negative, suggesting that among high book-to-market firms where assets write-downs are expected, firms with higher political homophily are more likely recognize losses in asset value.[27] Columns (3) and (4) of Table 8 present the regressions of *WD*, and the results are similar to those using *SPI*. Overall, the results in Table 8 are consistent with our hypothesis that friendly board encourages managers to recognize previously made mistakes.

IV.3 Alternative Explanation and Other Types of Homophily

IV.3.1 Alternative Explanation Based on Risk Taking

Our findings suggest that the lower crash risk associated with political homophily is a manifestation of enhanced information sharing and more timely corrective actions. However, an alternative explanation is that political homophily enables CEOs to withstand shareholder pressure

[25] Special items include significant nonrecurring items, asset write-downs, impairments of goodwill, and restructuring charges.
[26] *PHI* and its interactions are instrumented by *PHISinclair*. We also standardize *PHI* for ease of interpretation.
[27] In untabulated analysis, we regress the asset write-down measures on *PHI* without the interaction term, and find that the coefficient on *PHI* is insignificant, indicating that the effect of board friendliness on write-downs is concentrated in high book-to-market firms.

for pursuing high-risk strategies.[28] To examine this alternative explanation, we examine the relation between a firm's political homophily and risk-taking by estimating the following model:

$$RiskTaking_{i,t} = \alpha + \beta_1 PHI_{i,t-1} + \sum_k \beta_k Controls^k_{i,t-1} + \varphi_i + \eta_t + \epsilon_i, \quad (9)$$

where *RiskTaking* is one of the three measures of a firm's risk taking, including book leverage (Lev_t), stock return volatility (Vol_t), and idiosyncratic return volatility ($IdioVol_t$, estimated using the Fama-French three-factor model). We instrument *PHI* with *PHISinclair*. For ease of interpretation, we standardize the risk-taking measures and *PHI* to have means of zero and standard deviations of one.

Table 9 presents the regression results, in which the coefficient of *PHI* is very small and statistically insignificant in each regression (t-statistics from -0.98 to 0.10), suggesting that political homophily is not associated with a reduction in risk taking. Consequently, these results show that the observed negative impact of political homophily on crash risk is unlikely a reflection of less risk-taking by firms with greater political homophily.

IV.3.2 Other Types of Homophily

Literature suggests that several dimensions of homophily in the board room such as age, gender, racial background, industry experience, and location could impact on firms' decision-making (e.g., Bernile, Bhagwat, and Yonker, 2018; Bogan, Potemkina, and Yonker, 2021; Balogh and Yonker, 2024; Giannetti and Zhao, 2019; Griffin, Li, and Xu, 2021; Adams and Ferreira, 2009; Field, Souther, and Yore, 2020; Gompers, Mukharlyamov, and Xuan, 2016). In this section, we conduct a robustness test by including various types of homophily into our regression analysis. This analysis also provides evidence on if political homophily plays a unique role in facilitating

[28] Giannetti and Zhao (2019) find that discrepancy in board members' opinions and values may lead to inefficiencies in the decision-making process and performance volatility. It is also possible that political homophily reduces the conflicts and uncertainties in decision-making, so *PHI* negatively associates with general performance volatility.

CEO-Board communication compared to other types of homophily.

We construct homophily measures following the aforementioned literature. Gender homophily is the fraction of a firm's independent directors who identify as the same gender as the CEO (*Gender_Homophily*). Age homophily is the negative of the absolute difference between the CEO's age and the directors' mean age (*Age_Homophily*).[29] Racial homophily is the fraction of directors who share the same racial background as the CEO (*Race_Homophily*).[30] Work homophily is the negative of the Euclidean distance between the CEO's industry experience and the directors' industry experience (*IndExp_Homophily*). Location homophily is the fraction of directors who reside in the same county as the CEO (*Location_Homophily*).

Table 10 presents our baseline regressions that include both political homophily and other types of homophily. Columns (1) and (2) use the original *PHI* measure, and Columns (3) and (4) instrument *PHI* by *PHISinclair*. In all four regressions, the coefficient on *PHI* remains significantly negative, whereas the coefficients on other types of homophily are insignificant. These results not only show that the effect of political homophily is robust after controlling for other types of homophily, but also suggest that political homophily has a unique impact on CEO-director communication compared to other types of homophily.

V. EXTERNAL GOVERNANCE AND THE EFFECT OF POLITICAL HOMOPHILY

As discussed earlier, the positive effect of political homophily on information sharing presupposes strong external governance. In this section, we investigate the interactive effect of

[29] We obtain CEO (director) gender and age information from Execucomp (BoardEx).

[30] We use the Ethnicolr algorithm to infer the racial background of CEOs/directors based on their full names. Ethnicolr is a machine learning model trained on Florida Voter Registration data from 2017 that contains the full names of 13 million voters in Florida. The algorithm assigns probabilities that a given name belongs to one of four races: non-Hispanic white, non-Hispanic Black, Asian, and Hispanic/Latino. See Sood and Laohaprapanon (2018) for a detailed discussion of the algorithm. Recent studies that apply the algorithm include Marschke et al. (2018) and Box-Couillard and Christensen (2023).

external governance and political homophily using two common measures of external governance: institutional ownership (e.g., Denis, Denis, and Sarin, 1997; Harford, Jenter, and Li, 2011) and the E-Index (e.g., Bebchuk, Cohen, and Ferrell, 2009).[31]

V.1 Board Friendliness, External Governance, and Crash Risk

We first examine if the negative relationship between *PHI* and crash risk only holds for firms with strong external governance. Panel A of Table 11 reports regressions of crash risk on *PHI* (instrumented by *PHISinclair*) for the two subsamples based on whether firms' institutional ownership is above or below the sample median. The independent variable is *NCSKEW* in Columns (1) and (2) and *DUVOL* in Columns (3) and (4). For ease of interpretation, we standardize the crash risk variables and *PHI* to have means of zero and standard deviations of one. We find that the association between *PHI* and future crash risk is significantly negative in the subsample with high institutional ownership (t-statistics of -2.32 and -2.79) but insignificant in the subsample with low institutional ownership (t-statistics of -1.41 and -1.15).

In Panel B of Table 11, we further present the regressions for the two subsamples based on E-index. We find that the coefficient of *PHI* is significantly negative in the low E-index subsample, but small and insignificant for the high E-index subsample. Therefore, the results using both external governance measures consistently support our prediction that the negative association between *PHI* and future crash risk depends on the presence of strong external governance.

V.2 Board Friendliness, External Governance, and CEO Turnover-performance Sensitivity

Next, we examine the relationship between political homophily and CEO turnover-performance sensitivity. We hypothesize that political homophily provides "downside protection"

[31] Institutional ownership data are obtained from Thomson/Refinitiv. Data used to construct E-index are obtained from Institutional Shareholder Services (ISS) Governance Database.

for CEOs only when external governance is weak. We test this hypothesis by estimating the following linear probability model:

$$Turnover_{i,t} = \alpha + \beta_1 PHI_{i,t-1} \times Ret_{i,(t-1,t-4)} + \beta_2 PHI_{i,t-1} + \beta_3 Ret_{i,(t-1,t-4)} + \sum_k \beta_k Controls^k_{i,t-1} + \varphi_i + \eta_t + \epsilon_i, \quad (10)$$

where $Turnover_{i,t}$ is a dummy variable that equals one if firm *i* experiences a CEO turnover in year *t*, and zero otherwise. Following Lee, Lee, and Nagarajan (2014), we use four-year cumulative stock return from year *t-4* to *t-1* as the measure of CEO performance. The variable of interest is the interaction between $PHI_{i,t-1}$ and $Ret_{i,(t-1,t-4)}$. Both *PHI* and its interaction with *Ret* are instrumented by *PHISinclair* and its interaction with *Ret*. $Controls_{i,t-1}$ is a vector of control variables including Republican index of the firm's directors (*RepIndep*), Republican index of the firm's CEO (*RepCEO*), a dummy variable for CEO above 65-year-old ($RetireAge_{i,t-1}$), the natural logarithm of the CEO's tenure ($LnTenure_{i,t-1}$), the natural logarithm of the firm's total assets ($LnAsset_{i,t-1}$), market to book ratio ($MB_{i,t-1}$), and a dummy variable for dividend-paying firms ($DividendPay_{i,t-1}$). For ease of interpretation, we standardize *PHI* to have a mean of zero and a standard deviation of one.

In Table 12, Column (1) presents the regression of CEO turnover on past performance, in which the coefficient on *Ret* is significantly negative. This result indicates that CEOs with poor past performance are more likely to be replaced, which is consistent with the existing literature. Column (2) further includes the interaction between *PHI* and *Ret.* Consistent with Lee, Lee, and Nagarajan (2014), the coefficient of this interaction is significantly positive, indicating that CEO turnover-performance sensitivity is reduced in firms with greater political homophily.

We then run the regressions separately for the subsamples based on institutional ownership. Columns (3) and (5) of Table 12 show that the coefficient on *Ret* is significantly negative in both the subsamples with high and low institutional ownership. Importantly, Columns (4) and (6) show

that the interaction between *PHI* and *Ret* is small and insignificant for firms with high institutional ownership but significantly positive for firms with low institutional ownership. We then turn to the subsamples based on the firms' E-index. Columns (7) and (9) show that the coefficient on *Ret* is significantly negative in both the subsamples. Columns (8) and (10) show that the *PHI* interaction is insignificant for low E-index firms but remains significant for high E-index firms.[32] These results collectively indicate that strong external governance seems a necessary condition for political homophily to encourage the CEO to share negative information with the board rather than hide it and in turn cause worse performance.

V.3 Board Friendliness, Governance, and Firm Value

Lee, Lee, and Nagarajan (2014) show that political homophily negatively impacts firm value by reducing the intensity of monitoring. Since our findings show that the effect of political homophily depends on external governance, we revisit the interactive effect of political homophily and external governance on firm value. Following Lee, Lee, and Nagarajan (2014), we estimate the following model:

$$Tobin's\ Q_{i,t} = \alpha + \beta_1 PHI_{i,t-1} + \sum_k \beta_k Controls^k_{i,t-1} + \varphi_i + \eta_t + \epsilon_i, \qquad (11)$$

where the specifications are similar to those in Equation (10), except that we replace the risk-taking measures with firms' Tobin's Q. For ease of interpretation, we standardize *Tobin's Q* and *PHI* to have means of zero and standard deviations of one.

Column (1) of Table 13 reports the regression results for the full sample. We find that the coefficient on *PHI* is significantly negative, confirming the findings of Lee, Lee, and Nagarajan (2014) that political homophily negatively impacts firm value. We then conduct the regression

[32] The coefficients on *Ret* in the subsamples with the inclusion of the interaction terms remain qualitatively similar to those without the inclusion of the interaction terms, although they are less statistically significant.

analysis for subsamples based on institutional ownership (Columns (2) and (3)) or E-index (Columns (4) and (5)). We find that the coefficient on *PHI* is significantly negative in the subsamples with low institutional ownership or high E-index. Conversely, the coefficient on *PHI* is insignificant in the subsamples with high institutional ownership or low E-index. These results suggest that while political homophily leads to lower firm value, this effect is concentrated among firms with weak external governance. For firms with strong external governance, political homophily does not lead to lower firm value, suggesting that for these firms, the negative effect of political homophily is potentially offset by the positive effect of better information sharing.

VI. Conclusion

An influential idea in corporate governance is that a board that is predisposed to monitoring the CEO intensively may discourage the CEO from sharing information, which in turn may compromise the board's advisory role. There is some empirical evidence that board "friendliness" can both exacerbate agency problems as well as benefit the firm in situations where board expertise could be valuable. However, the crucial issue of whether friendliness encourages more information sharing has been difficult to establish.

In this paper, we argue that the similarity of political views promotes trust and bonding, and when the CEO and board enjoy greater political homophily, the CEO is encouraged to share adverse information with the board in a timely manner. We construct a measure of political homophily between the CEO and the board, *PHI*, using an individual's political donations. We find that firms' stock price crash risk decreases in *PHI*, which suggests that future negative outcomes are prevented via timely information sharing and the prompt addressing of problems. The results are robust when we instrument the *PHI* using acquisitions of local television stations by the Sinclair Broadcast Group, known for its strong Republican-leaning views.

As evidence of information sharing, we show that insider trading profits for independent directors increase with *PHI*, suggesting that directors likely receive more information from the CEO. In terms of corrective actions, we find that higher *PHI* leads to a higher likelihood of firms divesting previously acquired assets with poor performance and writing down assets with depreciated value. In addition, the impact of political homophily is more pronounced when the CEOs and directors face higher exposure to political tension.

Additionally, we show that stronger external governance is a necessary condition for the positive effect of a friendly board on information sharing: the effect of *PHI* on crash risks is only significant in firms with stronger external governance (higher institutional ownership or lower E-index). Correspondingly, we find that higher *PHI* leads to lower CEO turnover-performance sensitivity, which aligns with the "downside protection" provided by friendly boards. However, such downside protection is absent in the subsample of strong external governance. Finally, we find that while increases in *PHI* are associated with lower firm value for firms with weaker external governance, there is no effect of *PHI* on firm value in firms with strong external governance, suggesting that the benefits of information sharing associated with a friendly board can offset the costs of weak monitoring.

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Figure 1: Timeline: Political Homophily, CEO-Board Communication, and Crash Risk
This figure plots the timeline for the effect of political homophily on CEO-board communication and future stock price crash risk.

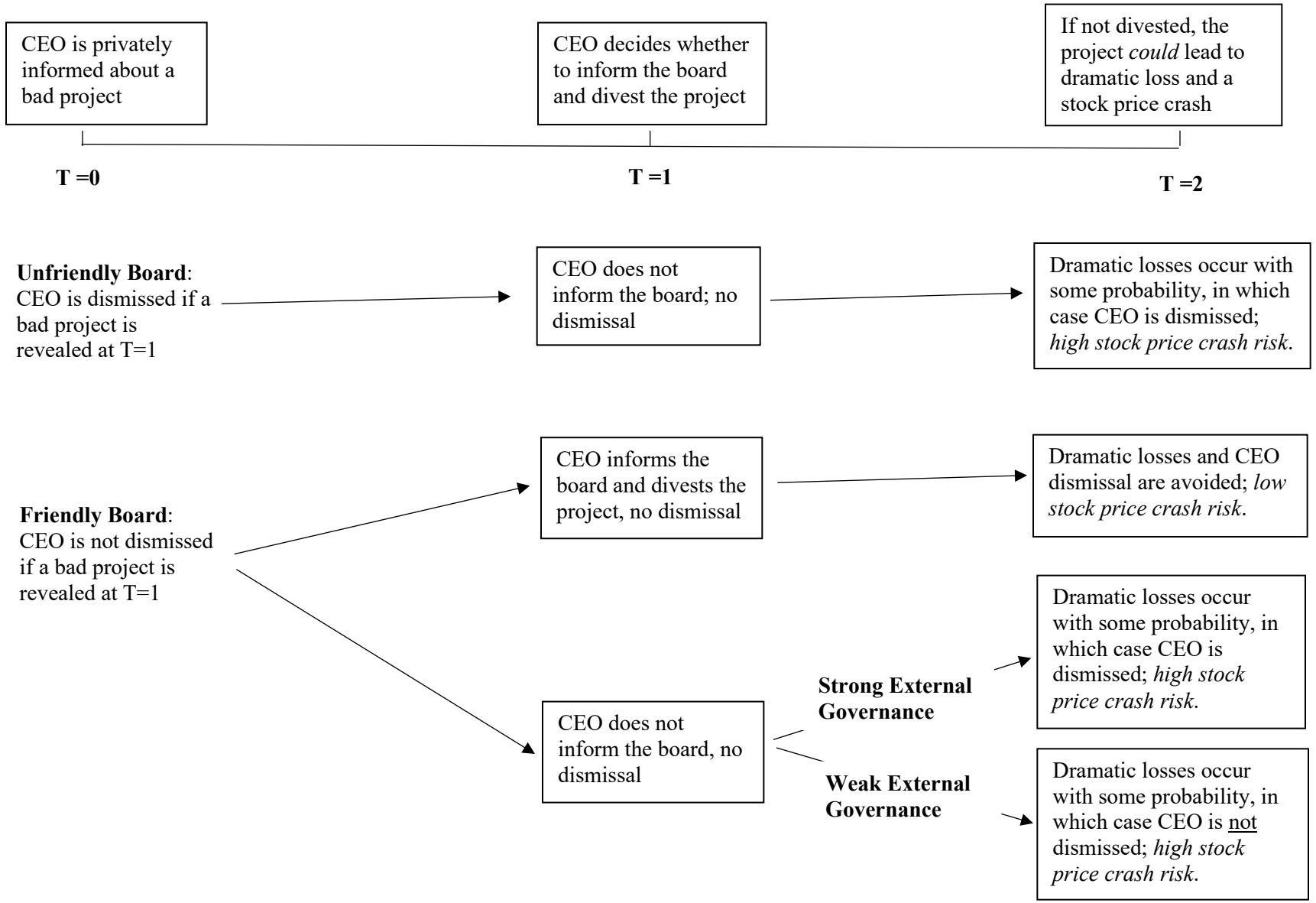

Figure 2: Time-series of Average *PHI*

This figure plots the time-series of the average political homophily index (*PHI*) between a firm's CEO and independent directors for our sample firms. The sample consists of 26,228 firm-years between 2000 and 2019.

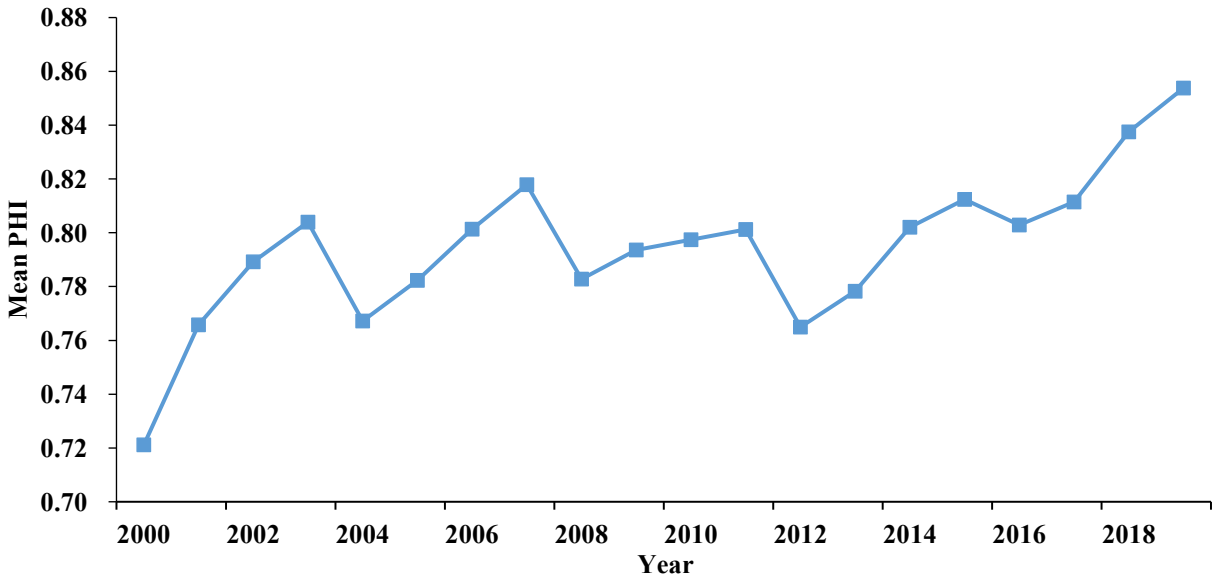

Table 1: Summary Statistics

This table presents the summary statistics of the baseline sample. The sample consists of 26,228 firm-years covered by both Execucomp and BoardEx between 2000 and 2019. *NCSKEW* and *DUVOL* are two main measures of crash risk used in the paper. *NCSKEW* is the negative ratio of the third moment of firm-specific daily returns over the standard deviation of firm-specific daily returns raised to the third power. *DUVOL* is the natural logarithm of the ratio of down-day to up-day standard deviation of firm-specific returns. *PHI* is the political homophily index between a firm's CEO and independent directors. *PHISinclair* is the political homophily index calculated using directors' Republican indices predicted by Sinclair acquisitions. *RepCEO* is the Republican index of a firm's CEO. *RepIndep* is the average Republican index of a firm's independent directors. The other variables include firm-specific stock return volatility (*Sigma*), the cumulative firm-specific daily returns (*Ret*), the average monthly share turnover in year *t* minus the average monthly share turnover in year *t-1* (*Dturn*), market-to-book ratio (*MB*), book leverage (*Lev*), return on assets (*ROA*), the natural logarithm of market value (*LnMV*), the absolute value of discretionary accruals (*DA*), the natural logarithm of board size (*LnBoardSize*), and the percentage of a firm's directors who are socially connected to the CEO (*Connection*). Definitions of all other variables are provided in Appendix B.

	Mean	Std	Q1	Median	Q3	N
Variable	(1)	(2)	(3)	(4)	(5)	(6)
NCSKEW	0.040	1.636	-0.621	-0.064	0.565	26,228
DUVOL	-0.026	0.343	-0.230	-0.037	0.168	26,228
PHI	0.795	0.210	0.563	0.910	1.000	26,228
PHISinclair	0.801	0.220	0.510	0.982	0.985	26,228
RepCEO	0.139	0.583	0.000	0.000	0.663	26,228
RepIndep	0.031	0.127	0.000	0.000	0.111	26,228
Sigma	0.022	0.012	0.013	0.019	0.026	26,228
Ret	-0.049	0.332	-0.247	-0.088	0.094	26,228
Dturn	0.029	0.872	-0.310	0.021	0.349	26,228
MB	2.982	3.906	1.388	2.155	3.594	26,228
Lev	0.187	0.176	0.024	0.157	0.293	26,228
ROA	0.120	0.097	0.068	0.117	0.171	26,228
LnMV	14.610	1.657	13.515	14.503	15.642	26,228
DA	0.156	0.387	0.024	0.054	0.113	26,228
LnBoardSize	2.033	0.310	1.792	2.079	2.303	26,228
Connection	0.024	0.073	0.000	0.000	0.000	26,228

Table 2: Regressions of Crash Risk on Political Homophily

This table presents the regressions of the crash risk measures on the political homophily index. *NCSKEW* is the negative ratio of the third moment of firm-specific daily returns over the standard deviation of firm-specific daily returns raised to the third power. *DUVOL* is the natural logarithm of the ratio of down-day to up-day standard deviation of firm-specific returns. *PHI* is the political homophily index between a firm's CEO and independent directors. Definitions of all other variables are provided in Appendix B. All regressions include firm and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	$NCSKEW_t$	$DUVOL_t$
	(1)	(2)
PHI_{t-1}	-0.023***	-0.025***
	(-2.86)	(-3.06)
$RepIndep_{t-1}$	0.009	0.005
	(1.14)	(0.67)
$RepCEO_{t-1}$	0.002	-0.001
	(0.21)	(-0.11)
$Sigma_{t-1}$	8.850***	4.981***
	(6.97)	(4.41)
Ret_{t-1}	0.240***	0.300***
	(12.41)	(15.45)
$Dturn_{t-1}$	-0.002	-0.003
	(-0.22)	(-0.40)
MB_{t-1}	0.011***	0.012***
	(5.36)	(5.70)
Lev_{t-1}	-0.224***	-0.265***
	(-2.98)	(-3.41)
ROA_{t-1}	1.802***	2.143***
	(13.44)	(15.63)
$LnMV_{t-1}$	-0.254***	-0.288***
	(-15.50)	(-17.25)
DA_{t-1}	0.021	0.015
	(1.08)	(0.82)
$LnBoardSize_{t-1}$	0.200***	0.214***
	(4.54)	(4.79)
$Connection_{t-1}$	-0.138	-0.082
	(-0.97)	(-0.56)
Firm FE	Yes	Yes
Year FE	Yes	Yes
Observations	26,228	26,228
R^2	0.152	0.165

Table 3: Robustness Tests

This table presents the robustness tests on the relation between *PHI* and crash risk. Panels A and B report the regressions of crash risk measures on the alternative measures of political homophily. *PHI (Individual)* is the alternative political homophily index constructed using the individuals' time-invariant Republican index calculated using their cumulative amounts of contributions up to the year 2019. *PHI (Prior)* is the alternative political homophily index constructed using the individuals' historic Republican index (i.e., for each individual *p* in year *t*, the Republican index calculated using her historic contribution made before year *t*). *PHI (Strong)* is the alternative political homophily index constructed using the Republican index of the individuals whose differences in contributions to the two parties exceed $2,000 in the election cycle. *PHI (Large)* is the alternative political homophily index constructed using the Republican index of the individuals whose historical total amounts of contribution exceed $2,000. Control variables are included but not reported to conserve space. The regressions include firm and year fixed effects. Panel C reports the regressions of crash risk measures on political homophily, controlling for lagged *NCSKEW*. The regressions include industry (at the 2-digit SIC level) and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Panel A: Regressions of Negative Coefficient of Skewness on Alternative PHI Measures

Dep. Var.	$NCSKEW_t$			
	(1)	(2)	(3)	(4)
PHI_{t-1} *(Time-invariant)*	-0.025**			
	(-2.41)			
PHI_{t-1} *(Prior)*		-0.035***		
		(-3.14)		
PHI_{t-1} *(Strong)*			-0.029***	
			(-3.29)	
PHI_{t-1} *(Large)*				-0.034***
				(-3.07)
Controls	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	26,228	26,228	26,228	26,228
R^2	0.152	0.152	0.152	0.152

Panel B: Regressions of Down-to-up Volatility on Alternative PHI Measures

Dep. Var.	$DUVOL_t$			
	(1)	(2)	(3)	(4)
PHI_{t-1} *(Time-invariant)*	-0.030***			
	(-2.82)			
PHI_{t-1} *(Prior)*		-0.037***		
		(-3.33)		
PHI_{t-1} *(Strong)*			-0.031***	
			(-3.44)	
PHI_{t-1} *(Large)*				-0.036***
				(-3.18)
Controls	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	26,228	26,228	26,228	26,228
R^2	0.165	0.165	0.165	0.165

Panel C: Regressions of Crash Risk on Political Homophily Controlling for Lagged Negative Coefficient of Skewness and Industry Fixed Effects

Dep. Var.	$NCSKEW_t$	$DUVOL_t$
	(1)	(2)
PHI_{t-1}	-0.017**	-0.018**
	(-2.28)	(-2.50)
$NCSKEW_{t-1}$	0.015	0.018**
	(1.58)	(2.02)
Controls	Yes	Yes
Industry FE	Yes	Yes
Year FE	Yes	Yes
Observations	23,619	23,619
R^2	0.031	0.046

Table 4: Regressions of Executives and Directors' Republican Indices on Sinclair Acquisitions
This table presents the regressions of directors' Republican indices (Columns 1 and 2) and CEOs' Republic indices (Columns 3 and 4) on Sinclair acquisitions. *REP* is the Republican index of an individual, calculated as the difference between the individual's dollar amount of donation to Republican recipients and her dollar amount of donation to Democratic recipients divided by her total dollar amount of donation to either Republican recipients or Democratic recipients in an election cycle. *Sinclair* is a dummy variable that equals one if the individual is affected by a Sinclair acquisition in a given year, and zero otherwise. Definitions of all other variables are provided in Appendix B. If a director holds positions in multiples firms in a given year, the firm characteristics are obtained from the firm where the director has served the longest tenure. Regressions in Columns (1) and (3) include firm and year fixed effects. Regressions in Columns (2) and (4) include firm, director/CEO, and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	REP_t			
	Directors		CEOs	
	(1)	(2)	(3)	(4)
$Sinclair_{t-1}$	0.023***	0.018***	-0.012	-0.028
	(3.04)	(3.06)	(-0.47)	(-1.10)
$RepIndep_{t-1}$	0.449***	0.315***	-0.015	0.024
	(39.59)	(30.63)	(-0.57)	(0.87)
$RepCEO_{t-1}$	0.002	0.002	0.462***	0.331***
	(1.08)	(1.21)	(66.56)	(42.87)
$Sigma_{t-1}$	0.172	0.059	0.080	-0.335
	(1.24)	(0.45)	(0.18)	(-0.65)
Ret_{t-1}	0.003	0.004*	0.005	0.011
	(1.55)	(1.95)	(0.56)	(1.23)
$Dturn_{t-1}$	0.001	0.001	0.001	0.000
	(0.85)	(1.29)	(0.22)	(0.11)
MB_{t-1}	-0.000	0.000	0.000	0.000
	(-1.03)	(0.15)	(0.40)	(0.23)
Lev_{t-1}	0.006	-0.003	-0.029	-0.061
	(0.49)	(-0.27)	(-0.91)	(-1.53)
ROA_{t-1}	0.022	-0.002	0.018	0.064
	(1.18)	(-0.09)	(0.32)	(1.00)
$LnMV_{t-1}$	-0.001	-0.001	0.013**	0.009
	(-0.30)	(-0.26)	(2.06)	(1.14)
DA_{t-1}	0.001	0.001	-0.007	-0.004
	(0.42)	(0.31)	(-0.96)	(-0.57)
$LnBoardSize_{t-1}$	0.000	-0.003	-0.021	-0.015
	(0.03)	(-0.47)	(-1.01)	(-0.59)
$Connection_{t-1}$	0.013	-0.006	0.015	-0.009
	(0.53)	(-0.25)	(0.20)	(-0.08)
Firm FE	Yes	Yes	Yes	Yes
Director/CEO FE	No	Yes	No	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	167,039	167,039	25,072	25,072
R^2	0.079	0.507	0.555	0.650

Table 5: Crash Risk and Political Homophily: Results from the Three-stage Instrumental Variable Approach

This table presents the regressions of the crash risk measures on *PHI*, with *PHI* instrumented by *PHISinclair*, the political homophily index constructed using individual directors' Republican indices predicted by the model of Table 4. *NCSKEW* is the negative ratio of the third moment of firm-specific daily returns over the standard deviation of firm-specific daily returns raised to the third power. *DUVOL* is the natural logarithm of the ratio of down-day to up-day standard deviation of firm-specific returns. Definitions of all other variables are provided in Appendix B. All regressions include firm and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	$NCSKEW_t$	$DUVOL_t$
	(1)	(2)
PHI_{t-1}	-0.023***	-0.025***
	(-2.78)	(-2.96)
$RepIndep_{t-1}$	0.009	0.005
	(1.14)	(0.67)
$RepCEO_{t-1}$	0.002	-0.001
	(0.21)	(-0.10)
$Sigma_{t-1}$	8.850***	4.981***
	(6.97)	(4.41)
Ret_{t-1}	0.240***	0.300***
	(12.41)	(15.45)
$Dturn_{t-1}$	-0.002	-0.003
	(-0.22)	(-0.40)
MB_{t-1}	0.011***	0.012***
	(5.36)	(5.70)
Lev_{t-1}	-0.224***	-0.264***
	(-2.98)	(-3.41)
ROA_{t-1}	1.802***	2.143***
	(13.44)	(15.63)
$LnMV_{t-1}$	-0.254***	-0.288***
	(-15.50)	(-17.26)
DA_{t-1}	0.021	0.015
	(1.08)	(0.82)
$LnBoardSize_{t-1}$	0.200***	0.214***
	(4.54)	(4.79)
$Connection_{t-1}$	-0.138	-0.081
	(-0.97)	(-0.56)
Firm FE	Yes	Yes
Year FE	Yes	Yes
Observations	26,228	26,228

Table 6: Political Homophily and Returns of Insider Trades

This table reports the regressions on the relation between returns of insider trading and the political homophily index. In Panel A, the sample includes insider purchases made by independent directors and CEOs from Thomson Reuter's Insider Data. *Ret30*, *Ret60*, *Ret90*, and *Ret180* are the market-adjusted returns of holding the position for 30, 60, 90, and 180 trading days, respectively (i.e., the return of investing one dollar mimicking the insider trade minus the return of taking the opposite position in the CRSP value-weighted market index). *Independent* is a dummy variable that equals one if a transaction is made by an independent director, and zero if it is made by a CEO. *TradeSize* is the size of an insider trade, measured by the dollar amount of the trade as a fraction of the firm's market capitalization. Definitions of all other variables are provided in Appendix B. *PHI*×*Independent*×*TradeSize*, *PHI*×*Independent*, *PHI*×*TradeSize*, and *PHI* are instrumented by *PHISinclair*×*Independent*×*TradeSize*, *PHISinclair*×*Independent*, *PHISinclair*×*TradeSize*, and *PHISinclair*. Panel B is similar to Panel A except that the sample includes insider sales rather than insider purchases. All regressions include firm and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Panel A: Returns of Insider Purchases

Dep. Var.	*Ret30*	*Ret60*	*Ret90*	*Ret180*
	(1)	(2)	(3)	(4)
PHI×*Independent*×*TradeSize*	0.007**	0.005	0.005	0.009*
	(2.12)	(1.50)	(1.43)	(1.80)
PHI×*Independent*	-0.031	0.003	0.000	0.002
	(-1.36)	(0.08)	(0.01)	(0.07)
PHI×*TradeSize*	-0.006**	-0.004	-0.005	-0.004
	(-2.00)	(-1.19)	(-1.33)	(-0.90)
Independent×*TradeSize*	-0.028**	-0.020*	-0.025*	-0.044**
	(-2.26)	(-1.74)	(-1.86)	(-2.18)
PHI	0.043*	0.016	0.026	0.033
	(1.80)	(0.38)	(0.66)	(0.98)
Independent	0.103	-0.045	-0.037	-0.052
	(1.15)	(-0.33)	(-0.27)	(-0.48)
TradeSize	0.030**	0.021*	0.026*	0.026
	(2.28)	(1.74)	(1.90)	(1.48)
$RepIndep_{t-1}$	0.027	0.100	0.128	0.134
	(0.34)	(0.85)	(1.20)	(1.19)
$RepCEO_{t-1}$	0.050	0.052	0.063	0.093*
	(1.17)	(0.94)	(1.14)	(1.69)
ROA	-0.183	-0.100	-0.067	0.199
	(-1.26)	(-0.42)	(-0.25)	(0.69)
CAPEX	-0.097*	-0.157*	-0.179*	-0.296**
	(-1.67)	(-1.84)	(-1.74)	(-2.50)
RD	0.120	0.571	0.876	1.102
	(0.29)	(0.96)	(1.32)	(1.50)
LnAsset	0.126***	0.138***	0.100**	-0.010
	(4.10)	(3.63)	(2.54)	(-0.20)
Lev	0.323*	0.387	0.510*	0.764***
	(1.79)	(1.49)	(1.94)	(2.64)
LnBoardSize	0.074	0.072	0.089	-0.113
	(0.65)	(0.46)	(0.54)	(-0.60)
Connection	-0.005	0.115	0.205	0.343
	(-0.04)	(0.59)	(0.98)	(1.33)

Dep. Var.	*Ret30*	*Ret60*	*Ret90*	*Ret180*
	(1)	(2)	(3)	(4)
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	54,934	54,934	54,934	54,934

Panel B: Returns of Insider Sales

Dep. Var.	*Ret30*	*Ret60*	*Ret90*	*Ret180*
	(1)	(2)	(3)	(4)
PHI×Independent×TradeSize	0.003	0.006**	0.008**	0.007
	(1.31)	(2.26)	(2.54)	(1.62)
PHI×Independent	-0.024	-0.040**	-0.050**	-0.023
	(-1.24)	(-1.98)	(-2.00)	(-0.65)
PHI×TradeSize	-0.004**	-0.006***	-0.007***	-0.005
	(-2.25)	(-2.84)	(-2.85)	(-1.50)
Independent×TradeSize	-0.015	-0.026**	-0.034***	-0.031*
	(-1.49)	(-2.41)	(-2.64)	(-1.85)
PHI	0.042*	0.049**	0.065**	0.031
	(1.94)	(2.17)	(2.20)	(0.78)
Independent	0.081	0.134*	0.162*	0.072
	(1.04)	(1.69)	(1.66)	(0.53)
TradeSize	0.018**	0.023***	0.026***	0.016
	(2.48)	(2.99)	(2.85)	(1.37)
$RepIndep_{t-1}$	-0.176	-0.129	0.018	0.365
	(-1.20)	(-0.91)	(0.11)	(1.02)
$RepCEO_{t-1}$	-0.020	-0.017	0.021	0.049
	(-0.69)	(-0.64)	(0.59)	(0.87)
ROA	-0.732**	-0.808**	-0.760**	-0.065
	(-2.34)	(-2.49)	(-2.09)	(-0.14)
CAPEX	0.318	0.425*	0.520**	0.865***
	(1.39)	(1.91)	(2.33)	(3.90)
RD	-0.531	-0.628	-1.018	-1.234
	(-0.84)	(-1.02)	(-1.52)	(-1.41)
LnAsset	-0.391***	-0.336***	-0.258***	-0.100
	(-4.23)	(-3.62)	(-2.67)	(-0.92)
Lev	-0.154	-0.223	-0.201	-0.170
	(-0.90)	(-1.29)	(-1.19)	(-1.00)
LnBoardSize	-0.130	-0.203*	-0.271**	-0.287**
	(-1.12)	(-1.74)	(-2.23)	(-2.07)
Connection	0.092	0.358	0.538	0.309
	(0.33)	(1.22)	(1.63)	(0.77)
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	447,847	447,847	447,847	447,847

Table 7: Political Homophily and the Subsequent Divestitures of Acquired Assets

This table presents the linear probability regressions of subsequent divestitures of acquired assets. The sample includes completed acquisitions covered by Capital IQ. *Divest* is a dummy variable that equals one if an acquired firm is subsequently divested in the three years after the completion date of the acquisition. *CAR* is the acquirers' three-day cumulative abnormal returns around the announcement dates of the acquisitions, estimated using the market model. Definitions of all other variables are provided in Appendix B. *PHI×CAR* and *PHI* are instrumented by *PHISinclair×CAR* and *PHISinclair*. All regressions include industry (at the two-digit SIC level) and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	*Divest*	
	(1)	(2)
PHI×CAR		-0.037**
		(-2.27)
PHI		0.000
		(0.41)
CAR	-0.037**	0.106
	(-2.36)	(1.59)
$RepIndep_{t-1}$		0.008
		(1.30)
$RepCEO_{t-1}$		-0.001
		(-0.69)
AcqSize	0.002*	0.002*
	(1.96)	(1.96)
AcqMB	-0.000	-0.000
	(-0.80)	(-0.79)
AcqLev	-0.008	-0.008
	(-1.26)	(-1.26)
AcqROA	-0.037***	-0.036***
	(-2.90)	(-2.94)
LnDealValue	-0.000	-0.000
	(-0.18)	(-0.19)
MissingDealValue	-0.001	-0.001
	(-0.25)	(-0.29)
Hostile	0.007	0.007
	(0.20)	(0.19)
Stock	-0.011**	-0.011**
	(-2.28)	(-2.26)
Tender	0.023***	0.024***
	(2.77)	(2.79)
Industry FE	Yes	Yes
Year FE	Yes	Yes
Observations	21,515	21,515

Table 8: Political Homophily and Asset Write-downs

This table presents the regressions of asset write-downs on the political homophily index. SPI_t is a firm's special items in year *t*, including significant nonrecurring items, asset write-downs, impairments of goodwill, and restructuring charges, scaled by its market capitalization at year *t-1*. WD_t is the sum of a firm's asset write-downs and goodwill impairments in year *t* scaled by its market capitalization at year *t-1*. *BtM* is a firm's book value of assets divided by its market value of assets. Definitions of all other variables are provided in Appendix B. *PHI*×*BtM* and *PHI* are instrumented by *PHISinclair*×*BtM* and *PHISinclair*. All regressions include firm and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	SPI_t		WD_t	
	(1)	(2)	(3)	(4)
$PHI_{t-1} \times BtM_{t-1}$		-0.018**		-0.016*
		(-1.98)		(-1.75)
PHI_{t-1}		0.047**		0.048**
		(2.49)		(2.49)
BtM_{t-1}	-0.445***	-0.365***	-0.379***	-0.313***
	(-22.53)	(-8.86)	(-19.23)	(-7.45)
$RepIndep_{t-1}$		-0.054		-0.065
		(-0.96)		(-1.13)
$RepCEO_{t-1}$		0.009		0.018
		(0.65)		(1.29)
ROA_{t-1}		0.028		-0.301**
		(0.19)		(-2.30)
$CAPEX_{t-1}$		-0.204***		-0.279***
		(-3.09)		(-4.02)
RD_{t-1}		0.214		0.817**
		(0.54)		(2.35)
$LnAsset_{t-1}$		-0.081***		-0.181***
		(-2.87)		(-6.51)
Lev_{t-1}		-0.304***		-0.104
		(-2.82)		(-1.10)
$LnBoardSize_{t-1}$		0.026		0.022
		(0.44)		(0.38)
$Connection_{t-1}$		0.126		0.108
		(0.73)		(0.60)
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	25,521	25,521	25,521	25,521

Table 9: Political Homophily and Risk Taking

This table presents the regressions of firm's risk-taking measures on the political homophily index. *Lev*, *Vol*, and *IdioVol* are a firm's book leverage, stock return volatility, and idiosyncratic return volatility, respectively. *PHI* is instrumented by *PHISinclair*. Definitions of all other variables are provided in Appendix B. All regressions include firm and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	Lev_t	Vol_t	$IdioVol_t$
	(1)	(2)	(3)
PHI_{t-1}	-0.005	-0.001	0.001
	(-0.98)	(-0.21)	(0.10)
$RepIndep_{t-1}$	-0.001	0.003	0.004
	(-0.25)	(0.59)	(0.75)
$RepCEO_{t-1}$	-0.003	-0.003	-0.001
	(-0.55)	(-0.54)	(-0.14)
ROA_{t-1}	0.594***	-2.177***	-2.351***
	(6.26)	(-16.17)	(-16.51)
$CAPEX_{t-1}$	-0.164***	0.231***	0.171***
	(-3.42)	(3.90)	(2.84)
RD_{t-1}	-0.676**	0.261	0.475
	(-1.97)	(0.65)	(1.11)
$LnAsset_{t-1}$	-0.072***	-0.119***	-0.180***
	(-4.08)	(-5.56)	(-7.94)
Lev_{t-1}	2.331***	0.730***	0.800***
	(31.47)	(9.74)	(9.96)
$LnBoardSize_{t-1}$	0.067**	-0.088**	-0.058
	(2.13)	(-2.21)	(-1.40)
$Connection_{t-1}$	-0.070	0.013	-0.004
	(-0.71)	(0.11)	(-0.03)
Firm FE	Yes	Yes	Yes
Year FE	Yes	Yes	Yes
Observations	26,171	26,228	26,228

Table 10: Regressions of Crash Risk on Political Homophily and Other Types of Homophily
This table presents the regressions of the crash risk measures on the political homophily index controlling for other types of homophily. *NCSKEW* is the negative ratio of the third moment of firm-specific daily returns over the standard deviation of firm-specific daily returns raised to the third power. *DUVOL* is the natural logarithm of the ratio of down-day to up-day standard deviation of firm-specific returns. *PHI* is the political homophily index between a firm's CEO and independent directors. In Columns (1) and (2), *PHI* is not instrumented. In Columns (3) and (4), *PHI* is instrumented by *PHISinclair*. *Gender_Homophily* is the fraction of a firm's independent directors who identify as the same gender as the CEO. *Age_Homophily* is the negative of the absolute value of the difference between the CEO's age and the directors' mean age. *Race_Homophily* is the fraction of directors who share the same racial background as the CEO. *IndExp_Homophily* is the negative of the Euclidean distance between the CEO's industry experience and the directors' industry experience. *Location_Homophily* is the fraction of directors who reside in the same county as the CEO. Details of the construction of these homophily measures are provided in Section IV.3.2 and Appendix B. All homophily measures are standardized for ease of comparison. Definitions of all other variables are provided in Appendix B. All regressions include firm and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	$NCSKEW_t$	$DUVOL_t$	$NCSKEW_t$	$DUVOL_t$
	(1)	(2)	(3)	(4)
PHI_{t-1}	-0.022***	-0.023***	-0.022***	-0.023***
	(-2.66)	(-2.86)	(-2.58)	(-2.77)
$Gender\_Homophily_{t-1}$	-0.002	-0.002	-0.002	-0.002
	(-0.16)	(-0.18)	(-0.16)	(-0.18)
$Age\_Homophily_{t-1}$	0.006	0.004	0.006	0.004
	(0.66)	(0.43)	(0.66)	(0.44)
$Race\_Homophily_{t-1}$	0.013	0.013	0.013	0.013
	(1.24)	(1.19)	(1.24)	(1.19)
$IndExp\_Homophily_{t-1}$	0.008	-0.003	0.008	-0.003
	(0.65)	(-0.24)	(0.65)	(-0.24)
$Location\_Homophily_{t-1}$	-0.005	-0.008	-0.005	-0.008
	(-0.58)	(-0.83)	(-0.58)	(-0.84)
Controls	Yes	Yes	Yes	Yes
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	26,210	26,210	26,210	26,210
R^2	0.152	0.165	0.037	0.044

Table 11: Crash Risk and Political Homophily: Cross Sectional Analyses Based on Corporate Governance

This table presents the regressions of crash risk measures on political homophily index in the subsamples of firms based on corporate governance. In Panel A (Panel B), the subsamples are based on whether a firm's institutional ownership (E-index) is above or below the sample median. *NCSKEW* is the negative ratio of the third moment of firm-specific daily returns over the standard deviation of firm-specific daily returns raised to the third power. *DUVOL* is the natural logarithm of the ratio of down-day to up-day standard deviation of firm-specific returns. *PHI* is instrumented by *PHISinclair*. Definitions of all other variables are provided in Appendix B. All regressions include firm and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Panel A: Regressions of Crash Risk on Political Homophily: Subsamples Based on Institutional Ownership

Dep. Var.	$NCSKEW_t$		$DUVOL_t$	
	High IO	Low IO	High IO	Low IO
	(1)	(2)	(3)	(4)
PHI_{t-1}	-0.031**	-0.015	-0.037***	-0.013
	(-2.32)	(-1.41)	(-2.79)	(-1.15)
$RepIndep_{t-1}$	0.011	0.017*	0.006	0.014
	(0.86)	(1.68)	(0.48)	(1.30)
$RepCEO_{t-1}$	0.016	-0.011	0.014	-0.013
	(1.15)	(-1.01)	(1.03)	(-1.26)
$Sigma_{t-1}$	12.915***	5.045***	7.856***	2.542*
	(5.84)	(3.12)	(4.14)	(1.72)
Ret_{t-1}	0.273***	0.257***	0.346***	0.316***
	(8.25)	(10.21)	(10.82)	(12.30)
$Dturn_{t-1}$	-0.011	0.001	-0.011	-0.004
	(-1.01)	(0.09)	(-0.98)	(-0.35)
MB_{t-1}	0.014***	0.008***	0.015***	0.010***
	(4.74)	(2.90)	(4.92)	(3.11)
Lev_{t-1}	-0.235**	-0.122	-0.246**	-0.201*
	(-2.07)	(-1.06)	(-2.17)	(-1.71)
ROA_{t-1}	1.794***	1.788***	2.178***	2.095***
	(8.62)	(10.00)	(10.42)	(11.00)
$LnMV_{t-1}$	-0.343***	-0.253***	-0.391***	-0.289***
	(-12.84)	(-11.66)	(-15.08)	(-12.98)
DA_{t-1}	0.032	0.004	0.020	0.006
	(1.08)	(0.14)	(0.71)	(0.21)
$LnBoardSize_{t-1}$	0.251***	0.199***	0.310***	0.187***
	(3.41)	(3.17)	(4.22)	(2.90)
$Connection_{t-1}$	-0.151	-0.003	-0.087	0.029
	(-0.62)	(-0.01)	(-0.36)	(0.14)
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	12,818	12,774	12,818	12,774

Panel B: Regressions of Crash Risk on Political Homophily: Subsamples Based on E-index

Dep. Var.	$NCSKEW_t$		$DUVOL_t$	
	High E-index	Low E-index	High E-index	Low E-index
	(1)	(2)	(3)	(4)
PHI_{t-1}	-0.007	-0.023*	-0.015	-0.025*
	(-0.51)	(-1.82)	(-1.07)	(-1.92)
$RepIndep_{t-1}$	-0.007	0.015	-0.008	0.012
	(-0.49)	(1.41)	(-0.54)	(1.05)
$RepCEO_{t-1}$	0.035**	-0.006	0.028**	-0.009
	(2.53)	(-0.48)	(2.06)	(-0.72)
$Sigma_{t-1}$	10.453***	10.115***	4.739**	5.926***
	(4.04)	(4.98)	(2.11)	(3.23)
Ret_{t-1}	0.347***	0.281***	0.425***	0.362***
	(9.07)	(9.11)	(11.27)	(11.48)
$Dturn_{t-1}$	-0.014	-0.008	-0.015	-0.008
	(-1.04)	(-0.70)	(-1.10)	(-0.71)
MB_{t-1}	0.021***	0.008***	0.021***	0.011***
	(4.20)	(2.63)	(4.14)	(3.50)
Lev_{t-1}	-0.248*	-0.248**	-0.253*	-0.282**
	(-1.74)	(-2.05)	(-1.79)	(-2.32)
ROA_{t-1}	2.490***	2.194***	2.906***	2.528***
	(9.00)	(10.21)	(10.60)	(11.35)
$LnMV_{t-1}$	-0.411***	-0.280***	-0.454***	-0.341***
	(-12.72)	(-10.40)	(-14.36)	(-12.84)
DA_{t-1}	0.047	0.018	0.039	0.005
	(1.37)	(0.59)	(1.19)	(0.16)
$LnBoardSize_{t-1}$	0.191**	0.203***	0.195**	0.265***
	(2.01)	(3.09)	(2.10)	(3.87)
$Connection_{t-1}$	0.008	-0.500*	0.075	-0.398
	(0.04)	(-1.84)	(0.34)	(-1.46)
Firm FE	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes
Observations	12,478	13,344	12,478	13,344

Table 12: Political Homophily Index and CEO Turnover-performance Sensitivity

This table reports the linear probability regressions of CEO turnovers on firms' stock returns. *Turnover* is a dummy variable that equals one if a firm experiences a CEO turnover in a given year, and zero otherwise. *Ret* is a firm's cumulative stock returns in the past four years. *PHI*×*Ret* and *PHI* are instrumented by *PHISinclair*×*Ret* and *PHISinclair*. Definitions of all other variables are provided in Appendix B. Columns (1) and (2) report the regressions in the full sample. Columns (3) to (6) (Columns (7) and (10)) report the regressions in subsamples based on whether a firm's institutional ownership (E-index) is above or below the sample median. All regressions include firm and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	$Turnover_{t+1}$									
	Full sample		High IO		Low IO		High E-Index		Low E-Index	
	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)
$PHI_t \times Ret_{(t-3,t)}$		0.058**		-0.024		0.125***		0.077**		0.042
		(2.24)		(-0.67)		(3.13)		(2.48)		(1.11)
PHI_t		-0.007		0.006		-0.014*		-0.005		-0.007
		(-1.39)		(0.75)		(-1.78)		(-0.78)		(-0.83)
$RepIndep_{t-1}$		0.056*		0.033		0.071		0.037		0.064
		(1.91)		(0.78)		(1.59)		(1.02)		(1.48)
$RepCEO_{t-1}$		0.005		0.011		-0.004		-0.001		0.012
		(0.72)		(1.09)		(-0.33)		(-0.15)		(1.26)
$Ret_{(t-3,t)}$	-0.114***	-0.320***	-0.099**	-0.013	-0.103**	-0.543***	-0.120***	-0.397***	-0.091**	-0.241*
	(-4.11)	(-3.28)	(-2.42)	(-0.10)	(-2.52)	(-3.57)	(-3.57)	(-3.38)	(-2.27)	(-1.70)
$RetireAge_t$	0.102***	0.102***	0.118***	0.118***	0.095***	0.098***	0.109***	0.109***	0.094***	0.094***
	(5.93)	(5.90)	(4.29)	(4.27)	(3.93)	(4.06)	(4.86)	(4.85)	(3.80)	(3.78)
$LnTenure_t$	0.240***	0.239***	0.254***	0.253***	0.264***	0.264***	0.289***	0.289***	0.251***	0.249***
	(19.51)	(19.40)	(13.63)	(13.57)	(14.71)	(14.54)	(17.10)	(17.02)	(14.07)	(13.88)
$LnAsset_t$	0.025**	0.024**	0.017	0.017	0.021	0.022	0.005	0.005	0.042**	0.041**
	(2.29)	(2.26)	(1.06)	(1.06)	(1.31)	(1.35)	(0.34)	(0.37)	(2.49)	(2.47)
MB_t	-0.000	-0.000	0.002	0.002	-0.003	-0.003	-0.001	-0.001	-0.001	-0.001
	(-0.34)	(-0.31)	(0.99)	(1.04)	(-1.35)	(-1.36)	(-0.67)	(-0.65)	(-0.31)	(-0.30)
$DividendPay_t$	0.012	0.012	-0.000	-0.000	0.016	0.015	-0.002	-0.002	0.010	0.009
	(0.79)	(0.80)	(-0.01)	(-0.02)	(0.63)	(0.60)	(-0.10)	(-0.07)	(0.54)	(0.52)
Firm and Year FEs	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Observations	11,977	11,977	5,823	5,823	5,839	5,839	5,631	5,631	5,937	5,937

Table 13: Political Homophily and Tobin's Q

This table presents the regressions of Tobin's Q on the political homophily index. Tobin's Q is calculated as the ratio of a firm's market value of assets to its book value of assets. *PHI* is instrumented by *PHISinclair*. Definitions of all other variables are provided in Appendix B. Column (1) reports the regression in the full sample. Columns (2) and (3) (Columns (4) and (5)) report the regressions in subsamples based on whether a firm's institutional ownership (E-index) is above or below the sample median. All regressions include firm and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	*Tobin's Q_t*				
	Full sample	High IO	Low IO	High E-index	Low E-index
	(1)	(2)	(3)	(4)	(5)
PHI_{t-1}	-0.014**	-0.005	-0.021**	-0.012*	-0.008
	(-2.01)	(-0.57)	(-2.07)	(-1.94)	(-1.01)
$RepIndep_{t-1}$	0.006	-0.003	0.022**	0.012**	0.002
	(0.91)	(-0.42)	(2.26)	(2.11)	(0.22)
$RepCEO_{t-1}$	-0.000	-0.007	0.001	-0.011*	0.012
	(-0.06)	(-0.81)	(0.13)	(-1.90)	(1.46)
ROA_{t-1}	1.812***	2.005***	1.483***	2.066***	2.103***
	(10.65)	(8.84)	(5.79)	(21.47)	(16.76)
$CAPEX_{t-1}$	0.842***	0.720***	0.974***	0.550***	0.894***
	(11.34)	(7.99)	(8.16)	(10.03)	(13.05)
RD_{t-1}	1.930***	1.069	2.162**	0.614*	1.558***
	(3.21)	(1.42)	(2.38)	(1.68)	(3.73)
$LnAsset_{t-1}$	0.035	0.050	0.025	0.062***	-0.021
	(1.46)	(1.51)	(0.57)	(3.61)	(-1.06)
Lev_{t-1}	0.087	0.101	0.188	0.220***	0.097
	(1.03)	(0.96)	(1.36)	(3.75)	(1.34)
$LnBoardSize_{t-1}$	-0.263***	-0.218***	-0.263***	-0.138***	-0.236***
	(-5.60)	(-4.03)	(-3.64)	(-3.54)	(-5.31)
$Connection_{t-1}$	0.158	-0.053	0.281	0.058	0.244
	(1.12)	(-0.40)	(1.27)	(0.56)	(1.55)
Firm FE	Yes	Yes	Yes	Yes	Yes
Year FE	Yes	Yes	Yes	Yes	Yes
Observations	26,228	12,889	12,837	12,478	13,344

Appendix A. **Parameter Assumptions for Main Testable Implications**

Our empirical predictions depend on several parameter assumptions regarding the relative costs to a CEO, who is privately informed at $T = 0$, of (a) disclosing negative information about a project early (at $T = 1$, please see the timeline in Figure 1) so that a bad outcome at $T = 2$ is avoided, or (b) not revealing the information and taking a chance that not taking corrective action at $T = 1$ does not result in a bad project outcome at $T = 2$.

Assumptions:

- If the CEO reveals adverse information about the project to a friendly board at $T = 1$, a penalty of $\boldsymbol{\alpha_F > 0}$ is imposed by the board. This penalty could involve stopping or divesting the project (from which the CEO might derive private benefits), curbs on compensation growth, or even making the information public, which might affect the CEO's reputation (Boot, 1992).

- Revealing adverse information to a non-friendly board is associated with harsher penalty, which might involve firing the CEO, or stricter curbs on compensation growth, stopping or scrutinizing other projects (with the possibility that some could be cancelled). We denote these casts by $\boldsymbol{\alpha_{NF} > 0}$ and assume $\boldsymbol{\alpha_{NF} > \alpha_F}$.

- If negative information remains undisclosed, and consequently corrective action is not taken at $T = 1$, the probability that a bad outcome is realized at $T = 2$ is $p > 0$.

- If the bad outcome happens at $T = 2$, we assume that the information becomes public. If the CEO retains her job, a penalty of $\boldsymbol{\beta > 0}$ is imposed on the CEO. Conversely, if the CEO is fired, the penalty is $\boldsymbol{\gamma > \beta}$.

The following assumptions regarding the parameters introduced above are required for our empirical predictions:

$$\boldsymbol{\alpha_{NF} > p\gamma > \alpha_F > p\beta}.$$

To see this, we collect the following observations:

Observation 1. Since $\boldsymbol{\alpha_{NF} > \alpha_F > p\beta}$, the CEO has no incentive to share information at $T = 1$ with either a friendly or a non-friendly board if she is guaranteed to keep her job even if bad outcome happens at $T = 2$.

Observation 2. Since $\boldsymbol{\alpha_{NF} > p\gamma}$, the CEO has no incentive to share information at $T = 1$ with a non-friendly board, given that she is sure to be fired at $T = 2$ if bad information is revealed.

We also assume:

- If the board is non-friendly, CEO will be fired (irrespective of whether external governance is weak or strong) if the bad outcome is revealed at $T = 2$.

- If the board is friendly, the CEO is fired at $T = 2$ conditional on the bad outcome if, and only if, external governance is strong.

These additional assumptions lead to the following:

Observation 3. The condition $\boldsymbol{p\gamma > \alpha_F > p\beta}$ implies that the CEO shares information with a friendly board if and only if external governance is strong.

Observations 2 and 3 imply the following:

Proposition. The only situation in which information sharing at $T = 1$ occurs is if (i) the board is friendly, and (ii) external governance is strong. Under these conditions, there is no stock price crash risk caused by the revelation of a bad project outcome at $T = 2$.

The proposition provides the rationale behind the tests reported in Table 10. However, given that the proposition implies that there is no relation between board friendliness and crash risk when external governance is weak, the relation, when the weak and strong external governance samples are pooled together, is also implied to be negative (Tables 2 and 3).

Appendix B: Definition of Variables and Additional Results

Variables	Definition
NCSKEW	Negative ratio of the third moment of firm-specific daily returns over the standard deviation of firm-specific daily returns raised to the third power, calculated using Equation (4)
DUVOL	Natural logarithm of the ratio of down-day to up-day standard deviation of firm-specific returns, calculated using Equation (5)
PHI	Political homophily index between a firm's CEO and independent directors, calculated using Equation (2)
PHISinclair	Political homophily index between a firm's CEO and independent directors, constructed using director Republican indices predicted by Sinclair acquisitions.
RepCEO	Republican index of a firm's CEO, calculated using Equation (1).
RepIndep	Average Republican index of a firm's independent directors, calculated using Equation (1).
Sigma	The yearly standard deviation of a firm's daily firm-specific stock returns.
Ret	Cumulative firm-specific daily returns in a given year.
Dturn	Average monthly share turnover in year *t* minus the average monthly share turnover in year *t-1*.
MB	Market-to-book ratio, defined as market value of equity (PRCC_F×CSHO) divided by book value of equity (CEQ).
Lev	Book leverage, defined as book value of long-term debt (DLTT) divided by total assets (AT).
ROA	Return on assets, defined as operating income before depreciation (OIBDP) divided by book value of assets (AT).
LnMV	Natural logarithm of market value of equity (PRCC_F×CSHO).
DA	Absolute value of discretionary accruals, estimated using the Jones (1991) model.
LnBoardSize	Natural logarithm of the number of directors in a firm.
Connection	Percentage of a firm's directors who are socially connected to the CEO, constructed following Dasgupta, Zhang, and Zhu (2021).
PHI (Time-invariant)	Political homophily index constructed using the individuals' Republican index based on their total amount of contribution up to the year 2019.
PHI (Prior)	Political homophily index constructed using the individuals' historic Republican index (i.e., for each individual *p* in year *t*, the Republican index calculated using her historic contribution made before year *t*).
PHI (Strong)	Political homophily index constructed using the Republican index of the individuals whose differences in contributions to the two parties exceed $2,000 in the election cycle.
PHI (Large)	Political homophily index constructed using the Republican index of the individuals whose historical total amounts of contribution exceed $2,000.
Sinclair	A dummy variable that equals one if a director or CEO is affected by a Sinclair acquisition in her county of residence in a given year, and zero otherwise
Ret0	The market adjusted return of an insider's purchase for 0 trading days (i.e., the return of investing one dollar mimicking the insider trade minus the return of taking the opposite position in the CRSP value-weighted market index).
Ret30	The market adjusted return of an insider's purchase for 30 trading days (i.e., the return of investing one dollar mimicking the insider trade minus the return of taking the opposite position in the CRSP value-weighted market index).

Ret60	The market adjusted return of an insider's purchase for 60 trading days (i.e., the return of investing one dollar mimicking the insider trade minus the return of taking the opposite position in the CRSP value-weighted market index).
Ret90	The market adjusted return of an insider's purchase for 90 trading days (i.e., the return of investing one dollar mimicking the insider trade minus the return of taking the opposite position in the CRSP value-weighted market index).
Ret180	The market adjusted return of an insider's purchase for 180 trading days (i.e., the return of investing one dollar mimicking the insider trade minus the return of taking the opposite position in the CRSP value-weighted market index).
Independent	A dummy variable that equals one if a transaction is made by an independent director, and zero if it is made by a CEO.
TradeSize	Size of an insider transaction, defined as the fraction of the firm's market capitalization.
CAPEX	Capital expenditure (CAPX) divided by net property, plant, and equipment (PPENT).
RD	Research and development expenses (XRD) divided by total assets (AT).
LnAsset	Natural logarithm of book value of total assets (AT).
Divest	A dummy variable that equals one if the acquired firm in a transaction is subsequently divested in the three years after the completion date of the acquisition.
CAR	An acquirer's three-day cumulative abnormal return around the announcement date of transaction, estimated using the market model.
AcqSize	Natural logarithm of an acquirer's total assets.
AcqMB	Market-to-book ratio of an acquirer.
AcqLev	Book leverage of an acquirer.
AcqROA	Return on assets of an acquirer.
LnDealValue	Natural logarithm of the transaction size of an acquisition, set to zero if missing.
MissingDealValue	A dummy variable that equals one if the transaction value is missing, and zero otherwise.
Hostile	A dummy variable that equals one if an acquisition is flagged as hostile in the Capital IQ database, and zero otherwise.
Stock	A dummy variable that equals one if an acquisition is flagged as a stock merger in the Capital IQ database, and zero otherwise.
Tender	A dummy variable that equals one if an acquisitions is flagged as a tender offer in Capital IQ database, and zero otherwise.
SPI	A firm's special items (SPI) in year *t* divided by the firm's market capitalization (PRCC_F×CSHO) at the end of year *t-1*.
WD	A firm's asset write-downs (WDP) and goodwill impairments (GDWLIP) in year *t* divided by the firm's market capitalization (PRCC_F×CSHO) at the end of year *t-1*.
BtM	Total assets (AT) divided by the sum of market capitalization (PRCC_F×CSHO) plus total assets (AT) minus the book value of common equity (CEQ).
Vol	Standard deviation of a firm's daily stock returns in a given year.
IdioVol	Idiosyncratic stock return volatility, estimated using the Fama-French three-factor model.
Gender_Homophily	The fraction of a firm's independent directors who identify as the same gender as the CEO.

Age_Homophily	The negative of the absolute value of the difference between the CEO's age and the directors' mean age.
Race_Homophily	The fraction of directors who share the same racial background as the CEO.
IndExp_Homophily	The negative of the Euclidean distance between the CEO's industry experience and the directors' industry experience. Specifically, for firm *i* in year *t*, we first construct a vector $C = (c_{1,t}, c_{2,t}, \dots, c_{N,t})$, where $c_{j,t}$ is the number of years the CEO worked in 2-digit SIC industry *j* prior to year *t* divided by the total number of years the CEO worked in any industry prior to year *t*. The vector thus measures the CEO's relative experience in each 2-digit SIC industry. We then construct another vector $D = (d_{1,t}, d_{2,t}, \dots, d_{N,t})$, where $d_{j,t}$ is the sum of the number of years the directors of the firm worked in 2-digit SIC industry *j* prior to year *t* divided by the sum of the total number of years the directors worked in any industry prior to year *t*. The vector thus measures the directors' time-weighted average relative experience in each 2-digit SIC industry. Finally, we calculate *IndExp_Homophily* as the negative of the Euclidean distance between *C* and *D* ($\sqrt{(c_1 - d_1)^2 + (c_2 - d_2)^2 + \cdots + (c_N - d_N)^2}$). *IndExp_Homophily* thus measures the homophily in industry experience between the directors and the CEO. A higher value of *IndExp_Homophily* indicates higher industry experience homophily between the directors and the CEO.
Location_Homophily	The fraction of directors who reside in the same county as the CEO.
Turnover	A dummy variable that equals one if a firm experiences a CEO turnover in a given year, and zero otherwise.
RetireAge	A dummy variable that equals one if a CEO is above 65-year-old, and zero otherwise.
LnTenure	Natural logarithm of a CEO's tenure.
DividendPay	A dummy variable that equals one if a firm pays dividend in a given year, and zero otherwise.
Tobin's Q	Tobin's Q, defined as market value of equity (PRCC_F×CSHO) plus book value of assets (AT) minus book value of equity (CEQ) minus deferred taxes (TXDB, set to zero if missing) divided by book value of assets.

Table B1: Regressions of Executives and Directors' Republican Indices on Sinclair Acquisitions: Alternative Definition of Sinclair

This table presents the regressions of directors' Republican indices (Column 1) and CEOs' Republic indices (Column 2) on Sinclair acquisitions with alternative definition. *REP* is the Republican index of an individual, calculated as the difference between the individual's dollar amount of donation to Republican recipients and her dollar amount of donation to Democratic recipients divided by her total dollar amount of donation to either Republican recipients or Democratic recipients in an election cycle. $Sinclair\_Alt_{t-1}$ is a dummy variable that equals one if the individual is affected by a Sinclair acquisition in any given year before and including year *t-1*, and zero otherwise. Definitions of all other variables are provided in Appendix B. If a director holds positions in multiples firms in a given year, the firm characteristics are obtained from the firm where the director has served the longest tenure. All regressions include firm and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	REP_t	
	Directors	CEOs
	(1)	(2)
$Sinclair\_Alt_{t-1}$	0.039***	0.013
	(5.20)	(0.79)
$RepIndep_{t-1}$	0.448***	-0.015
	(39.59)	(-0.56)
$RepCEO_{t-1}$	0.002	0.462***
	(1.07)	(66.59)
$Sigma_{t-1}$	0.162	0.077
	(1.17)	(0.17)
Ret_{t-1}	0.003	0.005
	(1.46)	(0.55)
$Dturn_{t-1}$	0.001	0.001
	(0.80)	(0.23)
MB_{t-1}	-0.000	0.000
	(-1.02)	(0.39)
Lev_{t-1}	0.006	-0.028
	(0.52)	(-0.90)
ROA_{t-1}	0.022	0.017
	(1.15)	(0.31)
$LnMV_{t-1}$	-0.001	0.013**
	(-0.48)	(2.04)
DA_{t-1}	0.001	-0.007
	(0.37)	(-0.96)
$LnBoardSize_{t-1}$	-0.000	-0.021
	(-0.06)	(-1.03)
$Connection_{t-1}$	0.014	0.015
	(0.57)	(0.19)
Firm FE	Yes	Yes
Year FE	Yes	Yes
Observations	167,039	25,072
R^2	0.063	0.432

Table B2: Crash Risk and Political Homophily: Results from the Three-stage Instrumental Variable Approach with Alternative Definition of Sinclair

This table presents the regressions of the crash risk measures on *PHI*, with *PHI* instrumented by *PHISinclair_Alt*, the political homophily index constructed using individual directors' Republican indices predicted by the model of Table B1. *NCSKEW* is the negative ratio of the third moment of firm-specific daily returns over the standard deviation of firm-specific daily returns raised to the third power. *DUVOL* is the natural logarithm of the ratio of down-day to up-day standard deviation of firm-specific returns. Definitions of all other variables are provided in Appendix B. All regressions include firm and year fixed effects. Robust t-statistics, clustered by firm, are reported in parentheses. *, **, and *** represent statistical significance at the 10%, 5%, and 1% levels, respectively.

Dep. Var.	$NCSKEW_t$	$DUVOL_t$
	(1)	(2)
PHI_{t-1}	-0.023***	-0.024***
	(-2.75)	(-2.94)
$RepIndep_{t-1}$	0.009	0.005
	(1.14)	(0.67)
$RepCEO_{t-1}$	0.002	-0.001
	(0.21)	(-0.09)
$Sigma_{t-1}$	8.851***	4.982***
	(6.97)	(4.41)
Ret_{t-1}	0.240***	0.300***
	(12.41)	(15.45)
$Dturn_{t-1}$	-0.002	-0.003
	(-0.22)	(-0.40)
MB_{t-1}	0.011***	0.012***
	(5.36)	(5.70)
Lev_{t-1}	-0.224***	-0.264***
	(-2.98)	(-3.41)
ROA_{t-1}	1.801***	2.143***
	(13.44)	(15.63)
$LnMV_{t-1}$	-0.254***	-0.288***
	(-15.50)	(-17.26)
DA_{t-1}	0.021	0.015
	(1.08)	(0.82)
$LnBoardSize_{t-1}$	0.200***	0.214***
	(4.54)	(4.79)
$Connection_{t-1}$	-0.138	-0.081
	(-0.97)	(-0.56)
Firm FE	Yes	Yes
Year FE	Yes	Yes
Observations	26,228	26,228

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