

Corporate Cash and Political Uncertainty

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Cash and Uncertainty

- Uncertainty decreases investment
- There is tension here
 - Less investment \Rightarrow less cash needed
 - Possible future investment \Rightarrow save cash
- Literature shows larger cash holdings with higher cash flow volatility, product market competition, R&D volatility, and tax uncertainty.
 - Are shocks to these uncertainty measures exogenous?
 - Can we separate effects on cash holdings from effect on other decisions?

Cash and Political Uncertainty

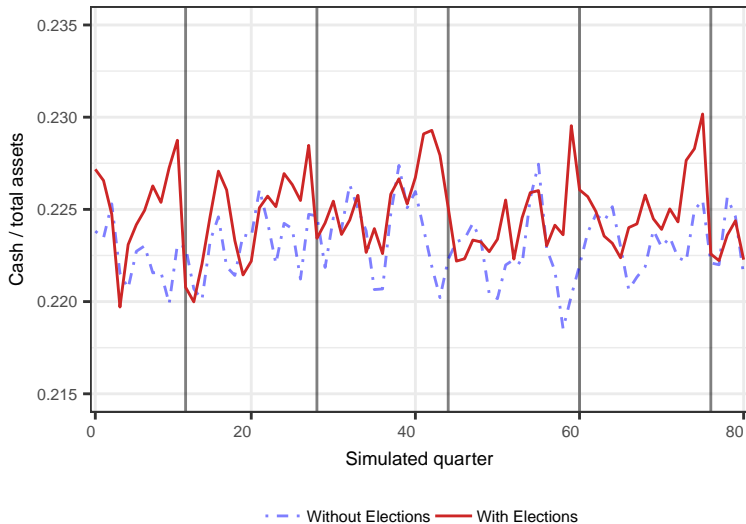
Why study **political** uncertainty?

- Political uncertainty matters for investment decisions
Julio and Yook (2012); Gulen and Ion (2016); Jens (2017); Bonaime, Gulen, and Ion (2017); Nguyen and Phan (2017); Atanassov, Julio, and Leng (2016); Cao, Li, and Liu (2019); and Chen, Cihan, Jens, and Page (2019)
- Firms are holding more cash over time
Sánchez and Yurdagul (2013)
- Political uncertainty and polarization are increasing
Baker, Bloom, and Davis (2016) and Boxell, Gentzkow, and Shapiro (2017)
- Our measure of political uncertainty: gubernatorial elections
 - Gubernatorial elections are exogenous
 - Both time series and cross-sectional variation → diff-in-diff

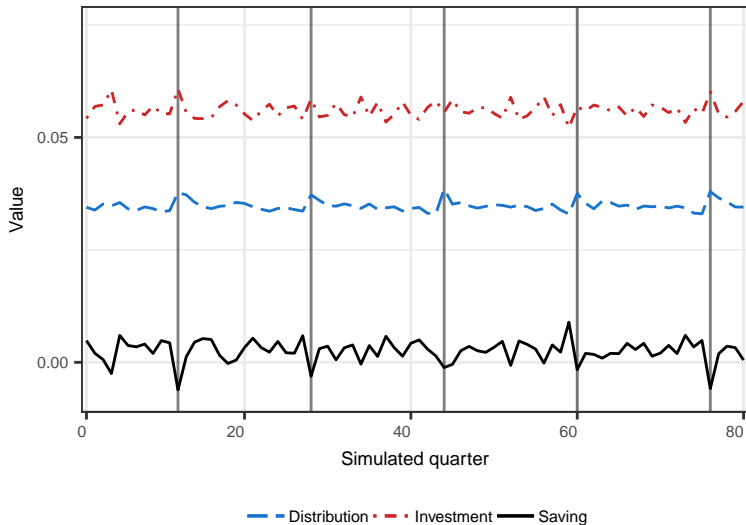
The model

- Riddick & Whited (2009)
 - Dynamic model of investment, payout, and savings
 - Random productivity shocks
 - Capital adjustment costs
 - Costly external financing
 - Cash earns interest, but it's taxed
- Plus uncertainty
 - 16 quarter election cycle
 - Elections affect economic environment
 - “Friendly” governor leads to upward biased productivity growth
 - “Unfriendly” governor leads to downward-biased productivity growth
 - 90% probability of incumbent winning

Simulated Cash Holdings



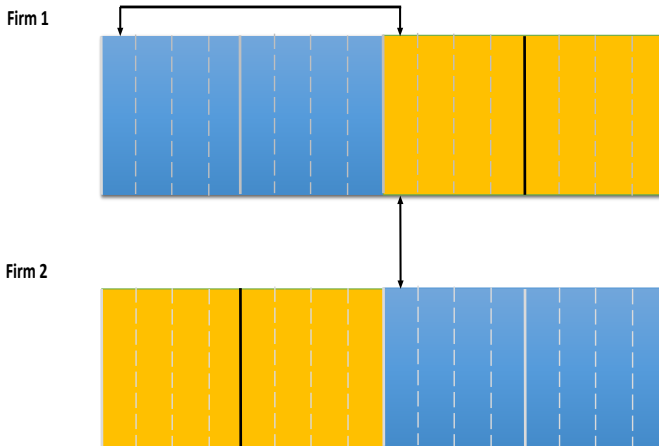
Simulated Flows



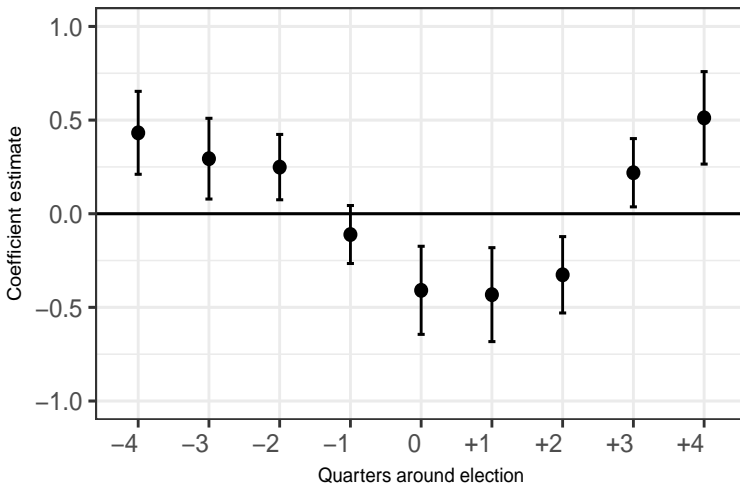
Data

- Gubernatorial election data (Congressional Quarterly Press)
- Dependent variables and firm controls (Compustat quarterly files)
- Macroeconomic controls (BLS, BEA, NBER)
- For robustness
 - Economic Policy Uncertainty (EPU) index (Baker, Bloom, and Davis, 2016)
 - Macroeconomic Uncertainty (Jurado, Ludvigson, and Ng, 2015)
 - Financial Uncertainty (Ludvigson, Ma, and Ng, 2018)

Gubernatorial Election Diff-in-Diff



Cash Holdings around Gubernatorial Elections

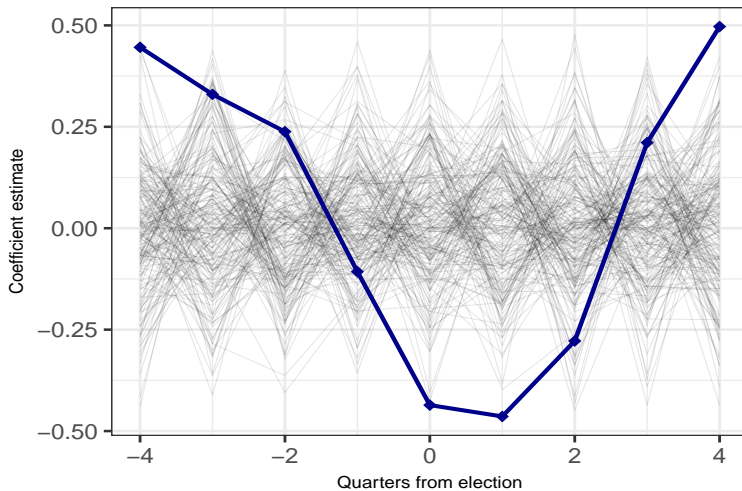


Is It Elections?

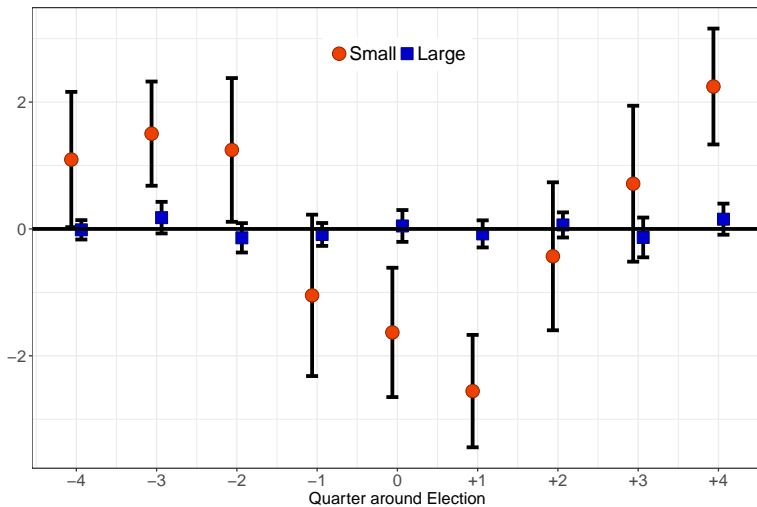
We include other uncertainty proxies in the regression

- Economic Policy Uncertainty Index
 - Our coefficients change very little
 - Both EPU-news or EPU-baseline have significantly negative coefficients
- Macroeconomic and Financial Uncertainty Indexes
 - Our coefficients change very little
 - Macroeconomic uncertainty has a significant negative coefficient
 - Financial uncertainty has a marginally significant negative coefficient
- FYI – presidential election dummies have similar, but larger in magnitude, coefficients

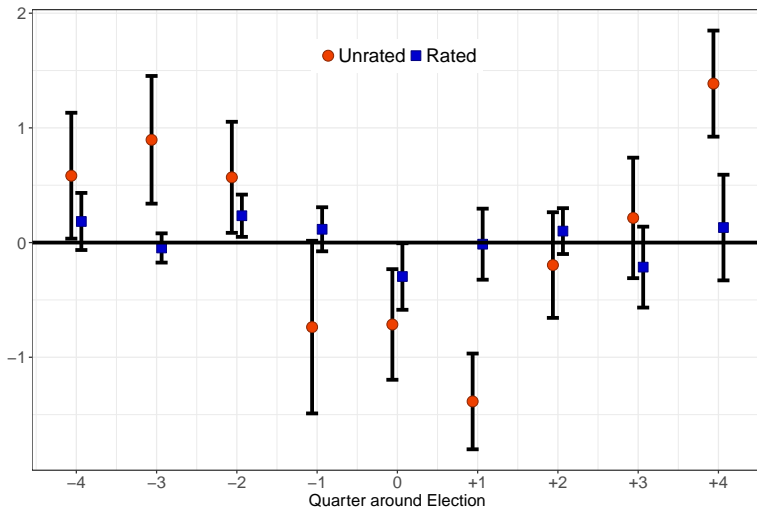
Placebo Test



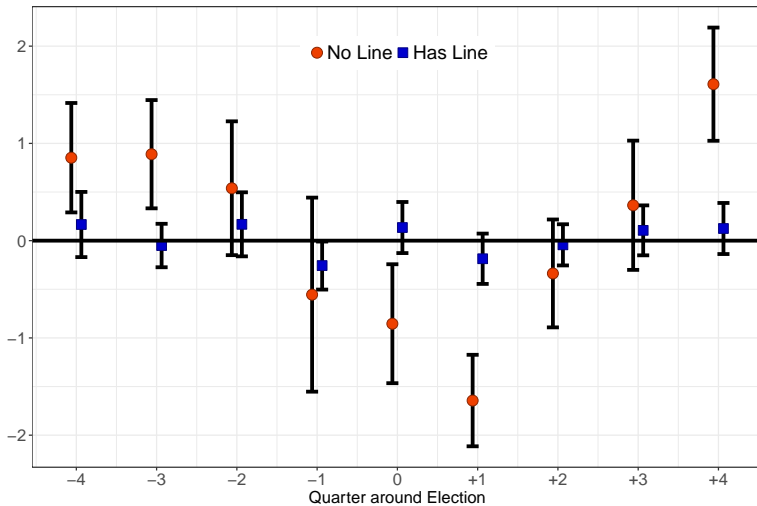
Cash Holdings by Firm Size



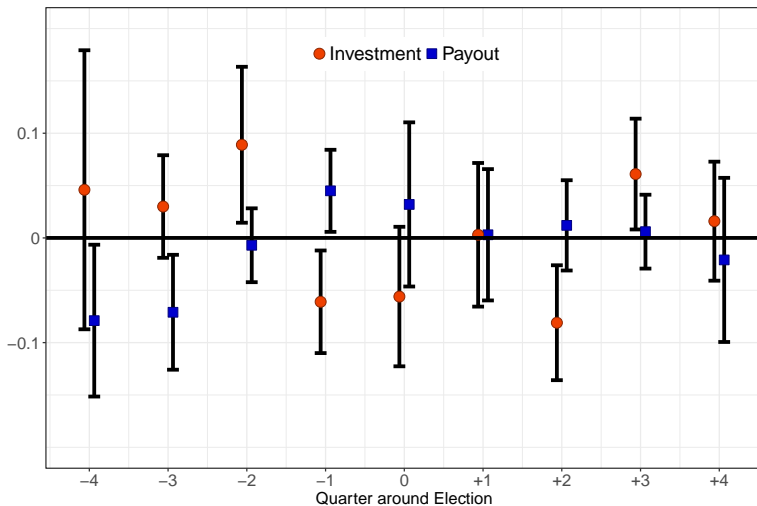
Cash Holdings by Credit Rating



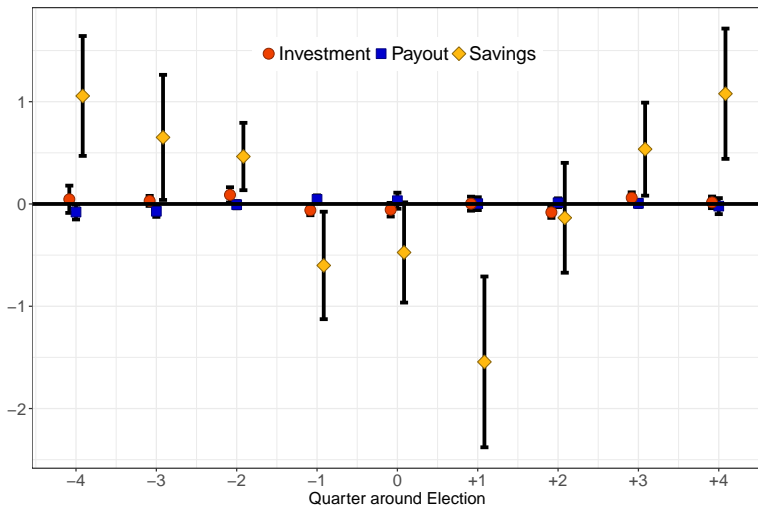
Cash Holdings by Line of Credit



Investment and Payout around Elections



Savings, Investment, and Payout around Elections

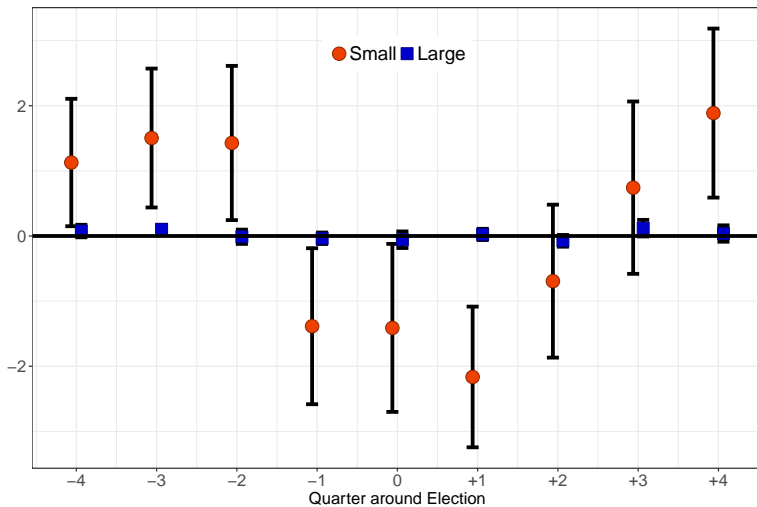


Payout vs. Equity Issuance

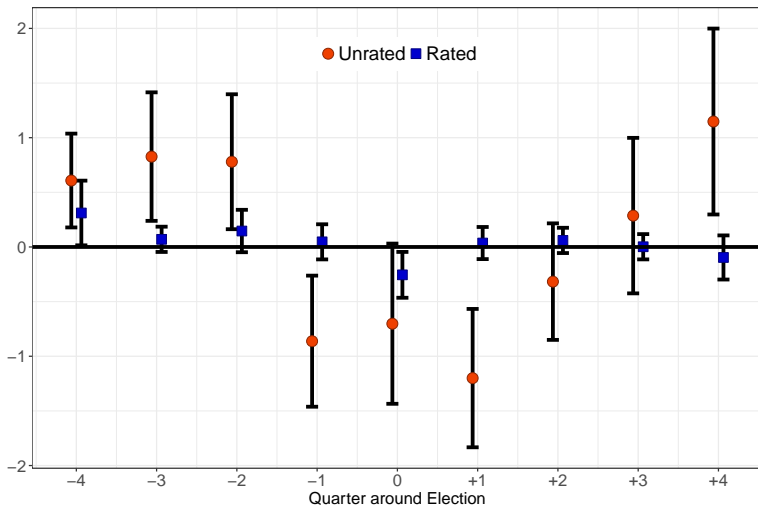
	Prob. Payout	Prob. SEO	SEO/Assets
Large firms	52.38	2.12	14.22
Small firms	6.84	16.52	42.61
With line of credit	41.38	3.26	23.47
Without lines of credit	26.79	6.50	34.36
With bond rating	54.85	2.19	13.59
Without bond rating	19.16	9.41	38.45

Note: DeAngelo, DeAngelo, and Stulz (2010) show 63% of SEO firms would run out of cash without it

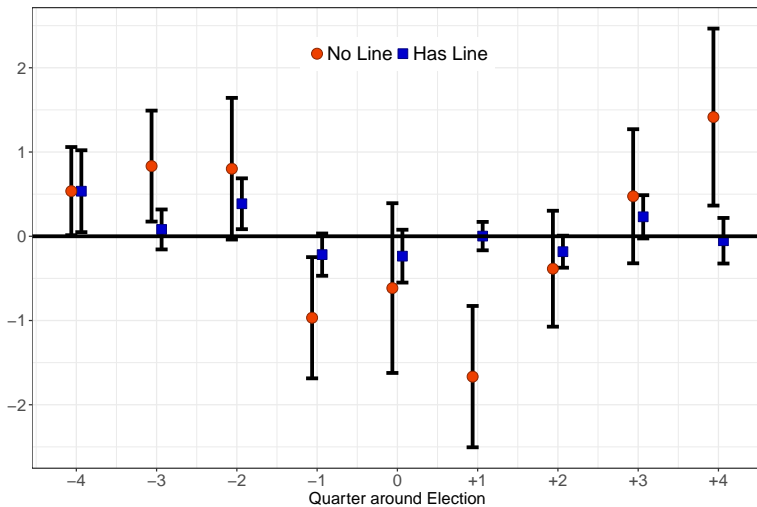
SEOs by Firm Size



SEOs by Credit Rating



SEOs by Line of Credit



Conclusion

- Diff-in-diff = causal evidence on uncertainty and cash holdings
- Firms actively manage their cash holdings around gubernatorial elections
- Exposure to political uncertainty matters
 - Firms build savings by decreasing payout if they can
 - Firms most exposed to gubernatorial election uncertainty have no payout to decrease, rely on costly equity issuance