Election and IPOs Don't Mix

In recent times, the world has experienced many instances of elevated political uncertainty. Numerous reputable companies and think-tanks have pointed out that political instability, especially instability driven by elections, and its impact on businesses are on the rise in both developing and developed countries. For example, a 2014 study by Citigroup ("Vox Populi Risk," 2015) argues that "not only that vox populi risk (elections and other political events) has intensified, but also, perhaps more relevant for companies and markets, it is taking place in middle-income emerging markets and industrialized countries that are more integrated into the global economy, and thus are more likely to generate wider market impact." In our new study, we find that fewer privately held businesses are willing to go public (conduct Initial Public Offerings, IPOs) during election years, suggesting that political uncertainty has a significant effect on business decisions. IPOs are important for both individual firms and the aggregate real economy. For an individual firm, an IPO is an important milestone that raises capital, propels growth and improves its competitive advantage. For the local or national economy, an active IPO market increases employment and facilitates positive spillover effects to non-IPO firms. Hence, it is important to understand whether and how firms change their IPO decisions in response to political uncertainty.

"ELECTION PERIODS ARE CHARACTERIZED BY ELEVATED UNCERTAINTY. WHO TAKES THE STATE OFFICE AS A GOVERNOR IS SHOWN TO AFFECT TAXES, STATE AND FEDERAL CONTRACTS, AND WAGES."

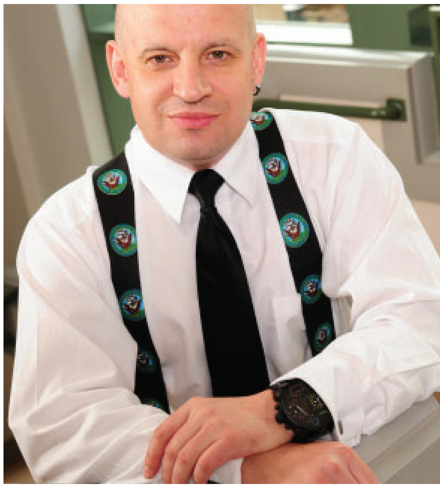
Our research examines IPO activity by U.S. businesses headquartered in states with the elections of governors between 1988 and 2011. Election periods are characterized by elevated uncertainty. Who takes the state office as a governor is shown to affect taxes, state and federal contracts, and wages. For example, when a new governor comes to power he or she may change the allocation of government contracts and subsidies to firms, thus changing firms' competitive positions. Moreover, periods of governor elections are characterized by policy uncertainty over state taxes and labor policies, which in turn, can manifest itself into uncertainty regarding companies' cash flows and their present values. We conjecture that small private firms such as the pre-IPO firms are especially affected by the policy uncertainty prevalent in their domiciled states.

Our research finds 15 percent fewer IPOs were conducted in states during election years, dropping from an average of 29 the year before an election to 25 during election year. Activity then rebounded significantly the year after an election, to an average 31, and then to 36 at the midpoint of the states' election cycles.

The results show that business managers are wary of committing their firm's resources during a time of political uncertainty and prefer to wait until the electoral uncertainty has settled down. The results also show that capital can be costlier because the offer prices are set lower than fair market value during election years, which makes it more expensive for firms to grow.

The study finds the IPO depression is even more pronounced in states with more IPO activity, where the average number of IPOs drops from 90 in the year before an election to 78 during an election year.

ARTEM DURNEV



BIOGRAPHY

ART DURNEV is an Associate Professor of Finance, University of Iowa Faculty Council Member, University of Iowa Faculty Senate Member, Henry B. Tippie Research Fellow, Ph.D. Director at the Henry B. Tippie College of Business, University of Iowa, and an Associate Editor of *International Review of Finance*. Before joining the University of Iowa, he was an Assistant Professor at the Desautels Faculty of Management at McGill University (Montreal, Canada) and the University of Miami, Florida. His research interests are primarily focused on corporate finance, political cycles, governance, corporate social responsibility, and financial markets development. He published his work in top academic and practitioner journals, such as the *Journal of Finance*, *Review of Financial Studies*, Journal of Accounting Research, *Management Science*, *Journal of Financial and Quantitative Analysis*, *Journal of Applied Corporate Finance*, *Journal of International Business Studies*, *Journal of Corporate Finance*, *Michigan Law Review*, and *Economics of Transition*. His research is cited over 4,000 times according to Google Scholar. He taught classes for undergraduates, MBAs, PhDs, and executives in the U.S., Canada, Hong Kong, U.K., Japan, and Russia. He presented his work at over 100 seminars and conferences worldwide. His passions are finance and competitive judo.

TESTIMONIAL

I am very grateful for the funding I received from the CSI Research Foundation. I started working in the area of elections and political uncertainty when I was a faculty member in Canada. For the empirical part of my paper, I had to hand collect data from various private and public sources. The funding helped me hire a team of research assistants for data collection and processing. Moreover, I used the funding to finance conference travel to disseminate my research.

Firms that are especially susceptible to this dampening effect are those that rely more heavily on government contracts, and those with businesses concentrated in their home states and thus more dependent on home state policies. ■

The paper, "Political Uncertainty and IPO Activity: Evidence from U.S. Gubernatorial Elections," was co-authored with Gonul Colak of the Hanken School of Economics in Helsinki, Finland and Yiming Qian of the University of Iowa. It is accepted for publication in the Journal of Financial and Qualitative Analysis and is available at

http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2281269