

Research Question

How do firm-level political risks impact corporate new debt issuance maturity?

Abstract

I examine the impact of firm-level political risk on the maturity structure of newly issued corporate debt. Using Hassan et al.'s (2019) political risk measure, I find that higher political uncertainty leads firms to issue debt with shorter maturities. This relationship exists across multiple proxies for new debt maturity, and is moderated by firm size, credit ratings, patents maturity nearing expiration, and institutional ownership. Moreover, path analysis confirms that cash flow volatility partially mediates this relationship. Political bipartisanship, contributions/lobbying to and alignment with the federal ruling party at the state level help moderate the relationship. Moreover, the configuration of Congress and its alignment with the ruling federal party matter. Clustering analyses indicate a significant rise in shorter-term debt issuance during Q1-Q3 of presidential election years. Political risk drives up borrowing costs as lenders adjust for increased uncertainty. I use multiple econometric techniques to mitigate endogeneity concerns.

Research Gap

- Prior research focuses on the impact of macroeconomic uncertainty and political risks on *existing* debt maturity.
- Existing debt reflects the market’s response, while new debt issuances reflect management’s response.

Sample and Data Source

- New debt maturity: Refinitive Eikon SDC Platinum.
- Firm-level political risk generated using textual analysis of earnings call transcripts: Hassan et al. (2019).
- 79,289 separate debt issuances aggregated to firm-quarter-issue-type level (41,380 observations).
- Issue-size-weighted average maturity of all new debt issued by a firm (*i*) in quarter (*t*) - $\frac{\sum_j(new\ debt\ issued_{ijt} \times maturity_{ijt})}{\sum_j(new\ debt\ issued_{ijt})}$
- Final Sample: 8,872 firm-quarter observations from Q1-2002 to Q1-2022.
- I use natural logarithm of political risk [Log(PR)] and maturity of weighted average new debt issuance [Log(Maturity)].

Main Results

Amid higher firm-level political risks:

- Firms issue shorter-term new debt
- Higher external financing costs

Baseline Model Outcome

$$Log(Maturity)_{it} = \alpha + \beta_1 Log(PR)_{it-1} + \sum_m \beta_m X_{it-1}^{(m)} + \varphi_t + \lambda_i + \varepsilon_t$$

- 1% increase in Log(PR):
 - 0.2094% decrease in Log(Maturity)
 - 18.89% decrease in the untransformed maturity
- 1-unit increase in the untransformed political risk:
 - Untransformed maturity decreases by 20.50%
- If the untransformed maturity of a loan is 10 years: For a 1-unit increase in political risk, maturity decreases by 16.21 months.

How Do Log(PR) Affect Proxies of Log(Maturity)?

1% increase in Log(PR) :

- Increases *Short-term Investment Ratio* by 0.2333 units
- Decreases *Interest Expense Ratio* by 0.4897 units
- Decreases the *R&D-to-Sales Ratio* by 0.1208 units

Firm-level Adjustment Mechanisms

Credit Ratings
Near-term Patent Maturity
Firm Size
Institutional Ownership

Higher credit quality mitigates the negative effect of political risk on debt maturity.

Firms with at least one patent expiring within 3 and 5 years from quarter *t* shorten new debt maturity.

Larger firms are geographically diversified, often have stable cash flows, high creditworthiness, and can issue longer-term debt.

Small firms (young and start-ups) often rely on short-term financing (private placements, bank loans), and their heterogeneous, noisy responses to political risk produce a weak effect.

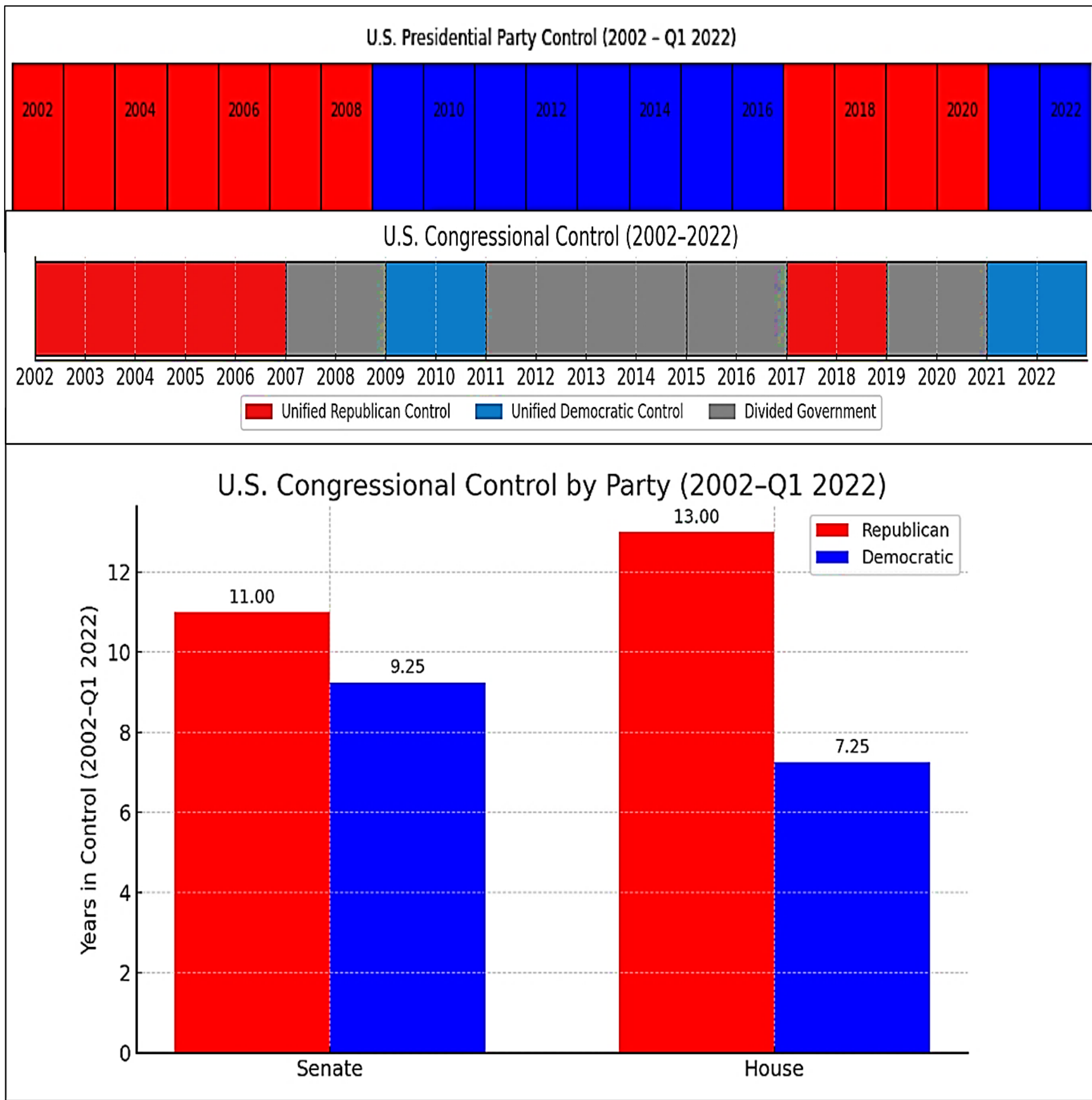
Institutional ownership does not meaningfully alter the effect of Log(PR) on Log(Maturity).

Path Analysis- Cash Flow Volatility

Cash flow volatility (CFV) partially mediates the relationship between political risk and new debt maturity.

About 7.2% of the total effect of political risk on debt maturity is transmitted through CFV.

Impact of Political Ties



Lobbying Efforts

- Political alignment and higher total contribution improve firms’ ability to issue longer-term debt.
- Bipartisan engagement does not meaningfully alter the sensitivity of debt maturity to political risk.

Congressional Alignment with the Federal Gov Party

- Under a unified Republican Congress with a Republican ruling government, the negative impact of political risk on debt maturity offsets.
- Under Democratic administrations with a divided Congress, political risk increases maturity.
- Under a unified Democratic Congress with a Democratic ruling government, the negative impact of political risk on debt maturity increases.

State-level Alignment with the Federal Gov Party

If a headquarters state governor’s political affiliation matches the ruling party, firms can issue longer-maturity debt even when political risk is elevated.

Placebo test confirms the results.

Firms headquartered in both Republican- and Democratic-governed states, higher political risk shortens debt maturities regardless of local party control.

If the federal ruling party is Democrat and the headquarters’ state Governor is Republican, firms will issue shorter-term debt when political risk is high.

Does New Debt Maturity Cluster Right Before Presidential Elections?

- ElectionQuarters = 1 if debt issued in Q1-Q3 of Presidential election years, or 0.

$$Log(Maturity)_{it} = \alpha + \beta_1 Log(PR)_{it} \times ElectionQuarters_t + \beta_2 Log(PR)_{it-1} + \sum_m \beta_m X_{it-1}^{(m)} + \varphi_t + \lambda_i + \varepsilon_t$$

Higher political risk increases the likelihood of issuing shorter-term debt during election quarters.

Binary Logistic Model (BLR)

maturityBin = 1: Firms with Log(Maturity) < 2.27

maturityBin = 2: Firms with Log(Maturity) ≥ 2.27

$$Log \left(\frac{P(maturityBin = 1)}{P(maturityBin = 2)} \right) = \alpha + \beta_1 Log(PR)_{it-1} + \sum_m \beta_m X_{it-1}^{(m)} + \varepsilon_t$$

Log odds of a firm issuing ST debt 33.67% higher than issuing LT debt.

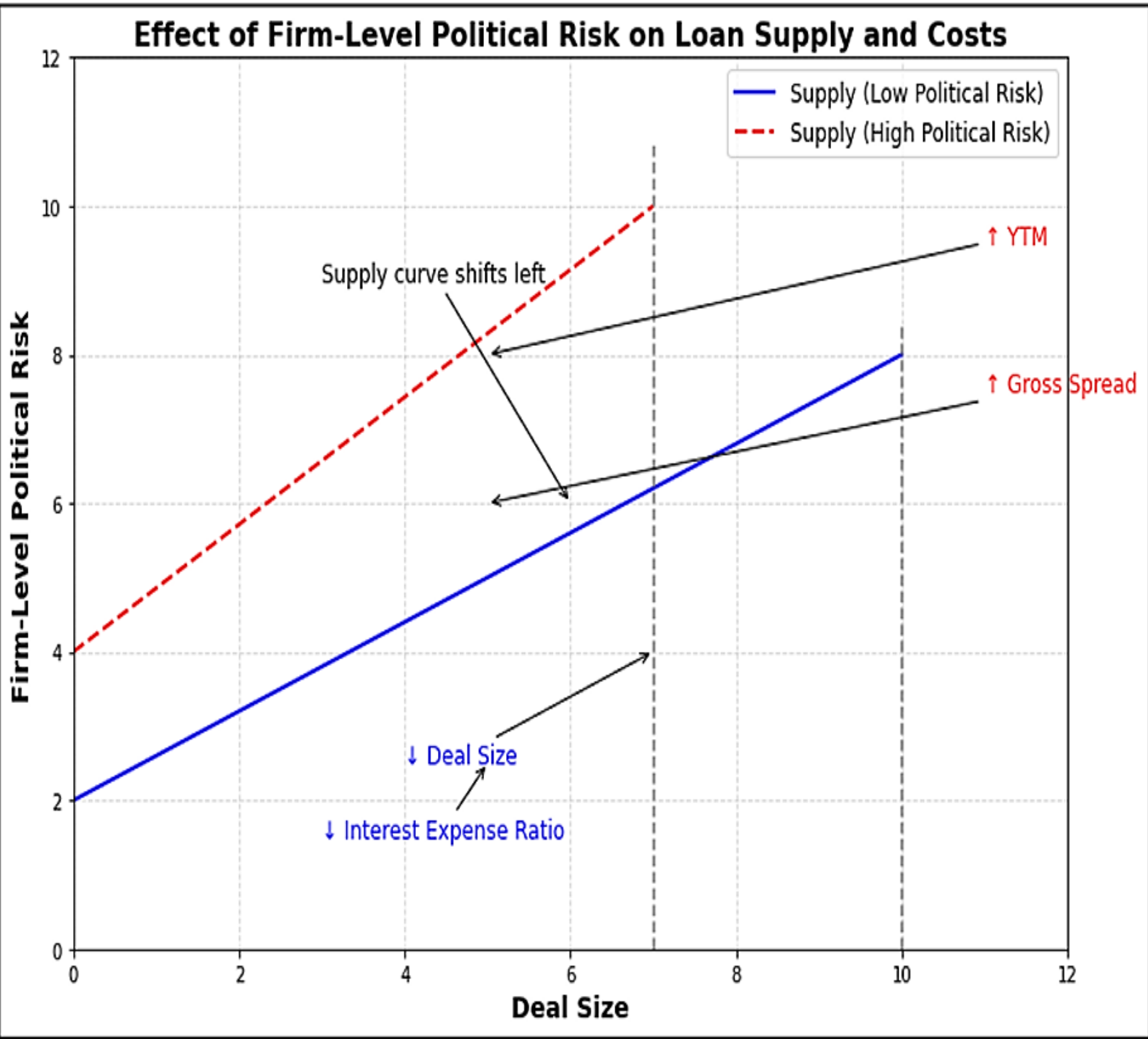
Supply-side Adjustments

Gross spread: Underwriting fee.

Credit spread: Difference between firm’s average offer YTM on new debt issuance and matched Treasury yield of comparable maturity.

Offer YTM: Market-required return.

$$DebtCost_{it} = \alpha_0 + \beta_1 Log(PR)_{it-1} + \sum_m \beta_m X_{it-1}^{(m)} + \lambda_i + \varphi_t + \varepsilon_t$$



Borrowing cost increases as political risk increases.

Macroeconomic Shocks

Economic Policy Uncertainty (EPU) Index (Baker et al.,2016).

Term spread (TS) = 10-year minus 3-month treasury rates.

Volatility Index (VIX).

High Log(PR) & EPU/TS/VIX combinedly shortens Log(Maturity)

Robustness Checks

Bartik Instrument Test with National Geopolitical Risk Index

Firm *i* of industry *j* respond to past GPR shocks (β_i) —

$$Log(Maturity)_{it} = \alpha_0 + \beta_i GPR_{t-1} + \sum_m \beta_m X_{it-1}^{(m)} + \lambda_i + \gamma_{jt} + \varepsilon_t$$

Industry-level exposure to GPR: averaging β_i within each *j* —

$$\bar{\beta}_j = \frac{1}{N_j} \sum_i \epsilon_j \hat{\beta}_i$$

Bartik instrument = Baseline exposure × Aggregate shock

$$Z_{it} = \bar{\beta}_j \times GPR_t$$

2SLS model:

$$Log(\widehat{PR})_{it} = \alpha_0 + \beta_1 Z_{it} + \sum_m \beta_m X_{it}^{(m)} + \gamma_{jt} + \lambda_i + \varepsilon_t$$

$$Log(Maturity)_{it} = \alpha_0 + \theta_1 Log(\widehat{PR})_{it-1} + \sum_m \beta_m X_{it-1}^{(m)} + \gamma_{jt} + \lambda_i + \varepsilon_t$$

Statistically significant and positive relationship between the Bartik instrument and Log(PR).

Predicted Log(PR) is negatively and statistically significantly related to Log(Maturity).

PSM Test

- Firms with political risk exposure above the median = treatment group (1); those below the median = control group (0).
- Controls from Eq. 1 to estimate the PS with Logit model.
- Nearest neighbor matching with a 0.01 caliper.
- ROA, IER, capital ratio, size, debt-to-invested capital ratio, D/E ratio, current ratio, HH index, and SIC - matching variables.

Treated firms have 3.88% shorter Log(Maturity) compared to the control group firms.

Tercile Regression Analyses

- Firms are grouped into 3 categories based on Log(PR).
- 1st group = low-risk; 2nd group = medium-risk; 3rd group = high-risk firms.
- All baseline controls from Eq. 1 are used.

Low-risk firms show a slightly positive association between Log(PR) and Log(Maturity).

Medium and high-risk firms exhibit a negative relationship.

Recommendation

- Managers can maintain liquidity buffers and diversify maturities.
- Political lobby and regulatory advocacy can help hedge risk.
- Policymakers can stabilize markets via targeted interventions (loan guarantees, central bank facilities).

Reference

- Gad, M., Nikolaev, V., Tahoun, A., & Van Lent, L. (2024). Firm-level political risk and credit markets. *Journal of Accounting and Economics*, 77(2-3), 101642.
- Houston, J. F., Jiang, L., Lin, C., & Ma, Y. (2014). Political Connections and the Cost of Bank Loans. *Journal of Accounting Research*, 52(1), 193-243.