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The Impacts of Political Uncertainty on Asset Prices: Evidence from the Bo Scandal in China☆

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Abstract

Models of political risk predict that increases in political uncertainty cause stock prices to fall, especially for politically sensitive firms. We use the event of the Bo Xilai political scandal in 2012 in China as an exogenous shock to identify the impact of political uncertainty on asset prices. We document that the Bo scandal caused a significant drop in stock prices, especially for firms that are more politically sensitive. Further analysis shows that the stock price drop is mainly driven by a change in discount rate, providing strong support for the existence of priced political risk.

JEL Classification: G11; G12; G14

Keywords: Political uncertainty; Politically sensitive firms; Stock returns; Discount rate news; Cash flow news

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1. Introduction

Recently, the impact of political uncertainty on asset prices has attracted a lot of academic and public attention. Uncertainty about government or central bank actions often has domino effects on global financial markets, as was the case during the 1997 Asian financial crisis, the 2008-2009 global financial crisis, the 2011-13 European debt crisis, the late 2015-early 2016 Chinese yuan depreciation, and the 2016 Britain's vote to leave European Union (Brexit). Theoretical models suggest that an increase in political uncertainty will cause stock prices to fall, especially for firms that are more sensitive to government policy changes. For example, Pástor and Veronesi (2012) build a general equilibrium model predicting that stock prices will drop upon the announcement of a government policy change and that the price drop will be greater amid higher policy uncertainty. Pástor and Veronesi (2013) extend the simpler model of Pástor and Veronesi (2012) to show that political uncertainty commands a risk premium whose magnitude is larger under weaker economic conditions.

Many empirical studies have documented an effect of political uncertainty on asset prices and volatility. Pástor and Veronesi (2013) employ the political uncertainty index constructed by Baker, Bloom, and Davis (2015) and confirm that political uncertainty indeed commands a risk premium and that stocks are more volatile during times of higher uncertainty. Kelly, Pástor, and Veronesi (2015) find that political uncertainty is also priced in equity option markets.[1] These

[1] Other examples exist. Croce, Nguyen, and Schmid (2012) demonstrate that political uncertainty may also increase the long-run risk. Brogaard and Detzel (2015) use a search-based measure to capture country-by-country economic policy uncertainty and find that market returns fall and volatility rises when economic policy uncertainty increases. Chan and Wei (1996) find that political news related to the Sino-British confrontation on the future status of Hong Kong increases stock volatility. Boutchkova, Doshi, Durnev, and Molchanov (2012) document that political uncertainty affects industry return volatility. Belo, Gala, and Li (2013) find that during Democratic presidencies,

empirical studies have made important and significant contributions to the literature. However, except for Kelly, Pástor, and Veronesi (2015) who use expected events, national elections and global summits, none of the existing studies has been able to rule out the issue of endogeneity and isolate political uncertainty from economic uncertainty. In this study, we identify an unexpected political event that occurred in China on March 14, 2012, the Bo Xilai scandal, as an exogenous shock to political stability. This exogenous shock serves as an ideal setting to test the causal link between political uncertainty and asset prices, because the event was unforeseen and led to increased political uncertainty immediately following its occurrence.

As will be discussed in detail in the next section, the scandal had very significant implications for the stability of the country at the time as there was much uncertainty about whether the transfer of power and leadership from the fourth generation of leaders (led by former President Hu Jintao and Premier Wen Jiabao) to the fifth generation (to be led by Xi Jinping and Li Keqiang) would proceed smoothly and peacefully. We further provide supporting evidence that Bo's event indeed increased political uncertainty, by documenting media article discussions and internet search results. Bloom, Bond, and van Reenen (2007) and Bloom (2009), among others, analytically and empirically show that marked increases in uncertainty after major shocks, such as the 9/11 terrorist attacks, have a significant impact on investment, output, and employment. Using the policy uncertainty index constructed by Baker, Bloom, and Davis (2015) and firm-level investment data, Gulen and Ion (2015) find strong support for the argument that policy uncertainty depresses corporate investment due to investment irreversibility. These studies have made important contributions to the understanding of the real effects of uncertainty in

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firms with greater government exposure have higher cash flows and higher stock returns, while the opposite is true during Republican presidencies.

general or policy uncertainty in particular. Our study complements the previous work by specifically focusing on the impact of political uncertainty on asset pricing and the price of political risk.

We use three measures to capture the policy sensitiveness of firms. The first one is related to monetary policies and is the average of the absolute returns of a firm around the time when the People's Bank of China (China's central bank) announced its plans to adjust the reserve requirement ratio (RRR). Note that the central bank in China is not completely independent and is normally very accommodative of Chinese central government policies. A larger absolute announcement return implies higher policy sensitiveness. The second measure is associated with fiscal policies and is the proportion of state-owned enterprise (SOE) expenditures in total expenditures on fixed asset investment in each province. Firms headquartered in a province with a higher proportion of SOE expenditures are more sensitive to policy changes. The third measure is related to political connection and is the number of board of directors in a firm who have political connections. Politically connected firms are more policy-sensitive.

Using daily stock returns from the A-shares of firms listed on the Shanghai and Shenzhen Stock Exchanges around the Bo scandal as an event date (March 14, 2012), we find that increases in political uncertainty caused a significant drop in stock prices (the average three-day cumulative raw return (i.e., March 13-15, 2012) in our final sample drops by 5.027%), especially for firms that were more sensitive to policy changes as measured by the abovementioned three proxies. The results are robust no matter whether we use mean comparison based on portfolio analysis or regression analysis. A drop in stock prices, however, may be caused by increases in the discount rate as predicted by political risk models such as those of Pástor and Veronesi (2012; 2013) or it may be caused by decreases in expected cash flows when political connections or

political rents are lost. We therefore run further tests to differentiate these alternative explanations.

We first measure changes in expectations for a firm's cash flow based on changes in analysts' earnings forecasts for years 2012-2014. We find that changes in analysts' earnings forecasts are more negative for the least than for the most policy-sensitive firms in nine out of 12 cases and six of them are significant, contradicting the cash flow hypothesis. To strengthen our results, we also measure changes in realized cash flow based on return on assets (ROA) or other profitability measures after the Bo scandal, although realized cash flow contains look-ahead bias. We also find results similar to those based on analysts' earnings forecasts.

On the other hand, we document a large increase in stock volatility right after the Bo scandal for all groups of policy-sensitive firms, especially for firms that are more sensitive to policy changes. All these results are consistent with the predictions of the political risk models proposed by Pástor and Veronesi (2012; 2013). The drop in stock price was not purely driven by the changes in cash flow news resulting from expected decreases in a firm's cash flow, but rather by the change in the discount rate following an increase in political uncertainty, especially for firms that were more sensitive to changes in government policy.

Finally, we identify a group of firms that have connections with Bo. Since political connection has value, the cash flow effect should show up mainly in this group of connected firms. Although we find that firms connected with Bo through government agencies in Chongqing did experience significantly more negative cumulative abnormal returns (CARs), our results are qualitatively and quantitatively similar after controlling for or deleting these firms. To conclude, the evidence provides strong support for the existence of priced political risk.

Our paper makes several contributions. First, we document that, consistent with the predictions of existing models, increases in political uncertainty cause a contemporaneous drop in share prices. Moreover, the drop is more significant for firms that are more sensitive to policy changes. Second, using exogenous shocks to political stability provides a clean setting to test the causal link between political uncertainty and share prices.[2] Third, shocks to political stability cause uncertainty and/or the discount rate to go up beyond their impacts on firms' future cash flows.

The remainder of the paper proceeds as follows. In Section 2, we briefly describe Bo's political scandal and the uncertainty surrounding the leadership transition in China. In Section 3, we develop our hypotheses. In Section 4, we describe our data. Section 5 presents and discusses our results, while Section 6 tests for alternative explanations. Finally, Section 7 concludes the paper.

2. Bo's Political Scandal and Leadership Transition in China in 2012

Year 2012 witnessed the transition of power in China. Former President Hu Jintao and Premier Wen Jiabao stepped down and new leaders in the Politburo Standing Committee were elected at the 18th National Congress of the Communist Party of China held in fall 2012 in Beijing. Hu Jintao and his administration were elected back in 2002 as the fourth generation of leaders in China (see, for example, Mohanty, 2003). The transition of power in 2002 was smooth and peaceful. In 2012 the political power transfer from the fourth to the fifth generation was

[2] Kelly and Ljungqvist (2012) use the announcement of mergers and closures involving brokerage firms as exogenous shocks to the firms followed by these brokerage firms to study the causal link between changes in asymmetric information and changes in the cost of capital measured by stock announcement returns. We use a similar identification strategy but study a different research question.

proceeding in a similarly orderly manner, that is, until the Bo Xilai scandal emerged which rocked Beijing. An article in *South China Morning Post* on October 1, 2012 wrote that "An even scarier thought is that mainland leaders were reportedly divided on how to deal with Bo after the scandals broke. This led to months of political uncertainty about the party's plan to install a new generation of leaders, including Xi, who will take over as president, and current Vice-Premier Li Keqiang, who will be named premier (Ref. 1)."[3]

Bo Xilai is the son of Bo Yibo, one of the "Eight Immortals," the most powerful elders in China's Communist Party in the 1980s and 1990s (Ref. 2). He was once considered a rising star in Chinese politics and a strong candidate for the new Politburo Standing Committee at the 18th Party Congress (Ref. 3). Bo formerly served as the mayor of Dalian, the governor of Liaoning province, and the Minister of Commerce. In 2007, he was appointed as the leader of Chongqing, and was inducted into the 25-member Politburo (Ref. 4). The Bo administration in Chongqing adopted a set of economic and social policies widely known as the "Chongqing model," which represented increased state control and was seen as a departure from the mainstream state policy at that time (Ref. 5).

The Bo scandal first officially broke on February 9, 2012, when the former police chief of Chongqing, Wang Lijun, reportedly fled to the US consulate in Chengdu and asked for political asylum but later left the consulate voluntarily (Ref. 6). The Wang incident aroused much public suspicion. But it was not until about a month later on March 14, 2012, when Premier Wen Jiabao gave a press conference at the National People's Congress, that Bo was implicated in the incident (Ref. 7). The next day, Bo Xilai was dismissed from his Politburo post in the Communist Party of China (Ref. 8). In August 2012, Bo's wife, Bo Gu Kailai was charged with the murder of a

[3] All media references are provided in Appendix A. For example, Ref. 1 refers to media reference #1.

British businessman and given a suspended death sentence (Ref. 9). Wang Lijun was sentenced to 15 years in prison for his role in covering up the murder (Ref. 10). Later it was revealed that Bo Xilai knew of his wife's role in the murder. On September 28, 2012, Bo was expelled from the Communist Party. On September 22, 2013, Bo was found guilty on all counts, including accepting bribery and abuse of power, and was stripped of all his personal assets and sentenced to life imprisonment (Ref. 11).

Premier Wen made public Beijing's views toward Bo for the first time on March 14, 2012. We argue that the Bo scandal dramatically heightened the political uncertainty surrounding the upcoming power transfer at the 18th National Congress, as summarized in an article published on May 9, 2012 in *Time*: "But with the downfall of Bo Xilai, … factional rivalries may well be hardening between at least two main camps: the princelings (offspring of Communist Party royalty, including Xi) and the Communist Youth League alumni (represented by presumed future No. 2 Li). … But with prominent princeling Bo sidelined and his wife suspected in the murder of a British businessman in China, the delicate balance of power between the various factions within the Party may well be upset" (Ref. 12). This increasing uncertainty became obvious with the delay of the 18th Party Congress. The meeting was originally anticipated to be announced in late summer and held in October 2012 but was instead postponed to November 8, 2012. The delay in naming a date for the Congress was widely perceived as evidence of infighting and disagreement within the Party. As one article on September 9, 2012 in *Los Angeles Times* wrote: "The congress, widely anticipated in October, was apparently pushed back amid discord among party elders over how to deal with Bo, 63, a charismatic figure who had been a top contender for a leadership post" (Ref. 13).

Fig. 1 presents the number of online searches for the words "Wang Lijun" or "Bo Xilai" in Chinese from October 2011 to June 2012. Panel A of Fig. 1 shows the search volume on Google, while Panel B presents the search volume on Baidu—the most popular search engine in China. The time-series patterns reported in these two panels are rather similar. Several features of the graphs are worth discussing.

First, Bo drew significantly more attention than Wang over almost the entire time period in terms of the number of searches in Chinese. It reflects the public view that Bo, with his "princeling" status, is a prominent political figure, while Wang is relevant only because he is one of Bo's top lieutenants. Second, the amount of attention given to both Wang and Bo rose dramatically during the scandal period. In the week of February 9, 2012, as illustrated in Panel A, the number of Google searches in Chinese for Wang and Bo rose from almost zero to the first peak, especially for Wang Lijun. The search volume reached an all-time high in the week of April 11, 2012, when the Central Committee in China decided to launch an investigation on Bo. The second peak emerged in the week of March 14, 2012, after Premier Wen's speech. The interest in Bo was about three to five times stronger than the interest in Wang in terms of the search volume after Premier Wen's speech.

To further establish the impact of the Bo scandal on political uncertainty, we report the number of Baidu searches for "revolution" in Chinese as shown in Fig. 2. The search index per day shot up from almost none to more than 40,000 in the second half of March 2012.[4] This online search interest further confirms our argument that the Bo scandal carried such serious

[4] According to the official explanation of the Baidu index, the number displayed on its platform does not refer to the actual number of searches on Baidu, but they are positively related. Therefore, it is more meaningful to look at its change over time.

implications that it raised public concerns over the possibility of a revolution. More direct evidence for our argument is the fact that these concerns even had an impact on firms' real activities. On April 3, 2012, *South China Morning Post* reported that "… two global firms that [plan to] set up Yuan-dominated private equity funds there [in Chongqing] have decided to put negotiations on hold due to concerns about political uncertainties…" (Ref. 14).

In this section, we have established that the Bo scandal led to significant increases in political uncertainty in China.[5] In the next section, we will discuss how we can take advantage of this event to test the impact of political uncertainty on asset prices.

3. Hypothesis Development

The theory of political uncertainty (e.g., Pástor and Veronesi, 2013) predicts that political uncertainty commands a risk premium. In equilibrium, risk-averse investors demand a higher expected return for holding stocks during periods of high political uncertainty. In other words, stock prices should drop to reflect this higher required rate of return amid increasing political uncertainty (e.g., Pástor and Veronesi, 2012). We thus expect stock prices to fall when political uncertainty increases. If political uncertainty represents a risk, then when political uncertainty is high, firms with higher exposure to this political risk should be more severely affected. We construct three proxies for policy sensitiveness with respect to three different dimensions, namely the monetary policy, the fiscal policy, and political connections.

We first consider the stock return around the announcements of a RRR adjustment by the People's Bank of China. Although China is the second largest economy in the world, it is still a

[5] The Bo scandal should only have had a short-term effect on political uncertainty due to the tight control of the Communist Party.

developing country. In fact, China's central bank is not completely independent. It is typically very accommodative of government policy, suggesting that uncertainty about power transition would lead to uncertainty about monetary policy. The RRR is one of the most important monetary policies implemented by China's central government and has a direct impact on the market interest rate. A monetary policy-sensitive firm would respond more strongly to these announcements. On the other hand, a firm whose operating and financing activities are more independent of the government's monetary policy would be less likely to experience volatility in its stock price when these policy announcements are made. We thus measure a firm's monetary policy sensitiveness by the average of the absolute values of announcement returns over a fixed period surrounding the event date.

Second, we quantify the relevance of the government's fiscal policies to each firm in China. We measure the proportion of government expenditures in total fixed asset expenditures in each province. We assign firms to each province based on their headquarters. Firms located in provinces with a higher proportion of government expenditures are more fiscal policy-sensitive.

Finally, we construct a political connection measure. We measure a firm's political connection by the number of directors on the board who have political connections. We argue that politically connected firms are more exposed to the risk of political uncertainty. Previous studies have documented that political connections have value (e.g., Fisman, 2001), but that is true only if the people involved remain in power. Growing uncertainty surrounding a power transition increases the possibility that these connections may lose their value. As a result, politically connected firms are more sensitive to political uncertainty.

Using these three measures as proxies for policy sensitiveness, we derive the following hypothesis from political uncertainty risk models:

H1: The aggregate announcement returns around the Bo scandal are negative. In addition, these announcement returns are more negative among firms that have larger absolute returns around the past announcements of RRR adjustments, among firms whose headquarters are located in the provinces with a greater proportion of government expenditures, and among more politically connected firms.

The announcement returns around the Bo scandal may be negative for several alternative reasons. Besides the increase in the risk premium (i.e., the discount rate news), an alternative explanation is the decrease in future cash flow (i.e., the cash flow news). If we consider a simple discounted cash flow model of stock price, a negative return—or in other words a drop in stock prices—can arise when the expected discount rate increases or the expected future cash flow decreases. If the latter is the case, one would expect that analysts' earnings forecasts as a measure of expected cash flow will drop after the scandal and that firms' future operating performance—as captured by the realized cash flow—will also drop after the scandal. More importantly, the cash flow hypothesis further predicts that expected future cash flow will drop to a greater extent for firms with stronger exposure to political uncertainty. No such prediction of future cash flows can be made based on the political uncertainty risk story. The cash flow hypothesis is stated as follows:

H2: The cash flow explanation predicts that expected cash flow will drop on average around the Bo scandal, especially for more policy-sensitive firms, while the political uncertainty explanation makes no such prediction.

Future cash flow could fall if political connections lose their value. It is possible that the negative returns are driven by the reduced value of political connections for politically connected firms and not by increasing uncertainty. To differentiate these two explanations, we investigate the change in stock return volatility over the Bo scandal period. The economic rationale or mechanism suggests that political news (or political signals in the learning model) moves stock prices, especially for politically-sensitive firms. Therefore, if the negative return during the scandal period is caused by increasing political uncertainty, we would expect stock return volatility to increase over the same period, especially for more policy-sensitive firms. On the other hand, if the negative return only reflects a fall in future cash flow, there would be no rise in volatility. The above discussions lead to our third hypothesis:

H3: The political uncertainty explanation predicts that stock return volatility will increase after the Bo scandal, especially for more policy-sensitive firms, while the cash flow explanation associated with political connections makes no such prediction.

4. Data Description

We collect financial information on firms from the China Stock Market and Accounting Research Database (CSMAR) maintained by GTA Information Technology. Our initial sample includes all non-financial firms publicly listed for at least one year and traded in the A-share market in mainland China as of the end of 2011. Financial firms are excluded because their financial statements are compiled under different accounting standards. We drop another 81 firms that were not traded during the three-day window centered on the Bo scandal. Out of these

81 firms, 23 were suspended from trading for more than one year.[6] We further drop another 63 firms because there is not enough data to estimate the parameters in the market model and calculate the cumulative abnormal return CAR1 around the time of the Bo scandal. After excluding another 30 firms for which information on other variables used in our analyses is missing, the final sample consists of 1,862 firms. However, we add 62 out of the 63 firms deleted earlier for lack of data back into the sample to calculate cumulative abnormal returns (CAR2) based on the market-adjusted returns and therefore the final sample for CAR2 is 1,924.[7] The stock IDs and English names of the 174 deleted firms are given in Appendix B; stock IDs marked with '*' refer to firms that are added back for calculating CAR2. All the variable definitions are described in Appendix C.

The announcement dates for the RRR adjustments are collected from the People's Bank of China website.[8] Appendix D summarizes the 31 announcements made from January 2007 to December 2011 with the announcement dates and adjustment size. For each announcement, we measure the three-day cumulative abnormal return (CAR) centered on the announcement date for each firm and rank all firms by the absolute value of these cumulative abnormal returns. The rank is further converted into a number between 0 and 1.[9] Finally, we take the value-weighted average for each firm over all the announcement events for firms with enough data. The weight is the aggregate market absolute return over the event date. Since the market reaction around the

[6] Stock trading must be suspended if there is any material and uncertain event going on with the firm until all uncertainties are cleared in China.

[7] We leave one stock out because of lack of data to compute idiosyncratic return volatility (IVol) used in the regression analysis.

[8] http://www.pbc.gov.cn/zhengcehuobisi/125207/125213/125434/125798/17085/index1.html.

[9] The conversion is calculated by rank/(number of firms + 1).

announcement date captures the surprise component of the policy, the weighting scheme assigns a larger weight to the announcements containing a bigger surprise to the market. We name this variable *Policy announcement*.

Total investment in fixed assets in each province is obtained from the 2010, 2011, and 2012 China Statistical Yearbooks. According to these yearbooks, the investment in fixed assets in China is classified by the ownership of investment entities and regions. For each province, we use the average proportion of fixed investment from state-owned enterprises (SOEs) over 2010, 2011, and 2012 as a proxy for government investment. This variable is termed *Fixed investment*.[10] The remaining entities are classified as private sectors. To reduce possible noise in 2012 caused by the scandal, we also consider the average ratios over 2009, 2010 and 2011. The results when this alternative measure is used are very similar to the ones reported in the paper and are omitted to save space. We obtain a firm's headquarter location from CSMAR.

Finally, the political connection data are hand-collected from the curriculum vitae (CV) of the public companies' board directors available from the annual reports. Following Fan, Wong, and Zhang (2007), we define a person as politically connected if he or she was or is an official of the central government, a local government, or the military. We count the number of directors on the board who have such connections. The political connection variable is the natural logarithm of one plus the number of politically connected board directors.

[10] Empirical evidence shows that government capital investment in the public sector can have implications for asset prices. Belo and Yu (2013) find that in the United States, government capital investment in the public sector is associated with risk premiums at both the aggregate and firm levels. In particular, higher growth rates predict higher risk premiums. The result is in sharp contrast with the result documented by Titman, Wei, and Xie (2004) and others in the private sector. Titman et al. (2004) document that higher capital investment predicts lower future stock returns in the cross section of exchange-listed firms.

5. Empirical Results

5.1 Summary statistics

Table 1 reports the summary statistics for the main variables used in the paper. All the variables are denominated in *yuan*.[11] The natural logarithm of the market value of equity one week before the Bo scandal (LnSZ) has a mean of 22.251 (which equals 4.608 billion *yuan*) and a median of 22.066 (which equals 3.829 billion *yuan*). The book-to-market equity ratio (B/M) has a mean of 0.407 and a median of 0.366, which is slightly lower than the mean. The leverage ratio is around 0.445 with the 25th percentile of around 0.264 and the 75th percentile of around 0.621. The summary statistics suggest that our sample is comparable to those used in other studies such as Calomiris, Fisman, and Wang (2010), Liao, Liu, and Wang (2014), and Giannetti, Liao, and Yu (2015). More importantly, the average three-day cumulative raw return (CRR) is strongly negative with a cross-sectional mean of -5.027% (of which 86.95% of the observations is negative), suggesting that the Bo political scandal caused great political uncertainty in China.[12] The wealth loss during this event window is equivalent to approximately 192.51 million *yuan* for a firm of median size (i.e., 3.829 billion *yuan*) in the sample.

[11] At the end of 2011 and 2012, one US dollar equaled 6.30 and 6.22 *yuan*, respectively.

[12] Since raw returns (i.e., CRRs) are driven by common factors such as the market, they are not i.i.d. across firms. There is no well-accepted standard approach to estimate the standard deviation of the cross-sectional mean without further assumptions. We therefore do not provide a formal significance test. This concern also applies to raw changes in forecasted earnings per share (EPS), in accounting performance, and in return volatility reported later. For comparison, the cumulative three-day value-weighted market return during the same event window is -3.378%, which is still very large but much lower than our sample equal-weighted average. This indicates that large firms suffer much smaller wealth losses than do small firms. Hence we need to control for firm size in regression analysis.

Table 2 summarizes two policy sensitiveness measures. Panel A of Table 2 reports the monetary policy sensitiveness measure across industries. For each industry, we take the equal-weighted average of the firm-level measures across all firms in that particular industry. The real estate industry has the highest sensitiveness with a mean value of 0.583. This result makes sense as the real estate industry heavily depends on external financing for its development. Any interest rate-related policy changes would have a huge impact on the financing costs of real estate firms and potential home buyers, and thus affect the value of these firms. The other monetary policy-sensitive industries include mining (mean = 0.514) and transportation (mean = 0.485), which arguably also rely strongly on external financing. On the other hand, information technology (mean = 0.338), furniture (mean = 0.341), and other manufacturing industries (mean = 0.342) are the least sensitive industries.

Panel B of Table 2 reports the list of provinces ranked in ascending order by the proportion of government expenditures. The province having the highest government investment is Tibet (ratio = 0.720), which is in part due to the fact that Tibet attracts less private investments. Since government investment is the main source of financing for development in Tibet, firms located there are no doubt sensitive to potential changes in government policies. Gansu (ratio = 0.523) and Qinghai (ratio = 0.471) provinces are the runner-ups, reflecting China's Great Western Development Strategy.[13] At the other extreme, Shandong (ratio = 0.142), Henan (ratio = 0.164), Jiangsu (ratio = 0.175), and Liaoning (ratio = 0.206) attract much less investment from SOEs.

[13] The Great Western Development Strategy is a campaign "to promote the fast and healthy development of the western areas" in order to address economic development inequalities between China's western hinterlands and coastal east. The development of infrastructure is an important component of the strategy.

5.2 Results from univariate tests

To measure the market reactions to the Bo scandal, we construct a three-day (i.e., from the market close on March 12 to the market close on March 15, 2012) cumulative *abnormal* return (CAR) centered on the Bo scandal date *t* (March 14, 2012) using two different models: the market model and the market-adjusted return. For the market model, we estimate the following regression to obtain the abnormal return:

$$Ret_{i,t} = \alpha_i + \beta_i R_{M,t} + \epsilon_{i,t}, \quad (1)$$

where $Ret_{i,t}$ is the return on stock *i* on day *t* and $R_{M,t}$ is the value-weighted market return on day *t*.[14] The model is estimated for each firm over the six-month period (i.e., from August 7, 2011 to February 6, 2012) with a minimum of 100 days prior to the Wang scandal (February 9, 2012) to obtain the estimated coefficients $\hat{\alpha}_i$ and $\hat{\beta}_i$.[15] The realized market returns ($R_{M,\tau}$) and realized individual firm returns ($Ret_{i,\tau}$) over the event window (τ = -1, 0, 1, where 0 is the announcement date of the Bo scandal, i.e., March 14, 2012) are used to construct the abnormal return (*ARet*) as $ARet_{i,\tau} = Ret_{i,\tau} - (\hat{\alpha}_i + \hat{\beta}_i R_{M,\tau})$. CAR1 is calculated as $\sum_{\tau=-1}^{1} ARet_{i,\tau}$, using the three-day window centering on the scandal event. For robustness checks, we also use the market-adjusted return involving no estimation to calculate the abnormal return, which is defined as the stock

[14] The empirical results throughout the paper are essentially the same if we use the equal-weighted market return in calculating abnormal returns either based on the market model or the market-adjusted returns.

[15] To avoid any bias caused by the contaminated event, i.e., the Wang scandal, we choose the start date of the Wang scandal rather than the Bo scandal as the end of the estimation window. Rumors about Wang's fleeing to the US consulate in Chengdu started on February 7, although officials did not confirm the incident until February 9, 2012 (Ref. 15). Our estimation period thus ends on February 6, 2012.

return minus the value-weighted market return. CAR2 is the cumulative market-adjusted returns over the three-day window centered on the Bo scandal.

Since there is only one event clustered on the same day in our study, CARs across firms may still be correlated even though we have already removed the common component of the market return. For example, the CARs of firms from the same province and/or within the same industry may still be systematically correlated. For this reason, we modify the standard event methodology suggested by Brown and Warner (1985) and others to estimate the standard deviation or error of CARs for each policy-sensitive group as follows. We first calculate the daily (equal-weighted) averages of abnormal returns, denoted by $\overline{AR}_t$ (t = August 7, 2011 to February 6, 2012), from either the market model or the market-adjusted return. We then compute the daily standard deviation of $\overline{AR}_t$, denoted by $Std(\overline{AR})$, from the time series. The standard deviation of average CARs, denoted by $Std(\overline{CAR})$, is computed as $\sqrt{3}\times Std(\overline{AR})$. The *t*-statistic based on this method is in general more conservative than those based on the assumption that CARs are i.i.d. across firms in each group.

Moreover, when testing the difference in CARs (or other variables of interest reported later) between the two extreme groups, we use the regression method with two-way clustering (industry and province) to better control for the within-industry and within-province correlations and to maintain consistency with our regression analysis later. More specifically, we regress CARs (or any variable of interest) on an intercept and an indicator that equals one if the observations are from the most sensitive group and zero if the observations are from the least sensitive group. Compared with the simple mean comparison, this method in general produces more conservative *t*-statistics and is more appropriate for our case.

Table 3 reports CAR1 and CAR2 over the three-day window centered on the Bo scandal. We further group firms by the three policy sensitiveness measures (*Policy announcement*, *Fixed investment*, and *Political connection*). For each measure, we group firms into terciles based on the sorting variable and report their CAR1 and CAR2. Panels A, B and C in Table 3 report the results for the monetary policy sensitiveness measure, the fiscal policy sensitiveness measure, and the political connection measure, respectively. We find that CAR1 and CAR2 are all negative for all three different politically sensitive groups of firms.[16] More importantly, both CARs monotonically decrease with all three political sensitiveness measures except one case. The differences in CARs between the most and the least policy-sensitive firms are all negative in the first three panels and are significant at the 5% level or better except for one case.

The last panel (Panel D) uses a combined measure of political sensitiveness (*All three*) as a sorting variable, which is the sum of the three political sensitiveness measures, standardized to have a mean of 0 and a standard deviation of 1. This combined measure can diversify away the error in each individual measure. This measure yields similar results but with a much larger magnitude. Specifically, the return difference between the most and the least policy-sensitive groups rises to around -0.856% (*t*-stat = -3.68) based on CAR1. For a firm of median size (i.e., 3.829 billion *yuan*) in the sample, this represents an additional wealth loss of about 32.78 million *yuan* for the most sensitive firms compared to the least sensitive firms during the three-day event window. We argue that this is not only statistically significant but also economically important.

[16] CARs in all three groups are negative because we have used the value-weighted market returns to compute CAR1 and CAR2 and the value-weighted average CRR (-3.38%) is much less negative than the equal-weighted one (-5.03%). If we use equal-weighted market returns to compute abnormal returns, CAR1 and CAR2 are all positive in the least sensitive group and all negative in the most sensitive group.

We also find that our results and conclusions are not sensitive to the measures of abnormal returns.

The finding that the announcement returns around the Bo scandal are strongly negative and the returns are more negative for the most than the least sensitive firms is consistent with Hypothesis 1. Increasing political uncertainty causes stock prices to fall, especially for policy-sensitive firms. The fact that the combined measure yields higher return spreads suggests that all three measures capture slightly different dimensions of policy sensitiveness.

5.3 Baseline results from regression analysis

Previous studies have documented that cross-sectional stock returns are also associated with firm characteristics in the United States and other countries (e.g., Fama and French (1992); Daniel, Titman, and Wei (2001)). The results in Table 3 do not consider other factors that may affect stock returns. Table 4 reports regression results with control variables. We control for firm size (LnSZ), book-to-market equity (B/M), leverage (Leverage), the return over the past week (BHR), and daily idiosyncratic volatility (IVol). BHR is the buy-and-hold stock return in percentage from two weeks to one week before the Bo scandal. IVol (in %) is the standard deviation of the daily residuals from the market model used to estimate CAR1 as described in Equation (1).[17] To control for the within-industry and within-province correlations among firms, standard errors are clustered by industry and province separately (i.e., two-way clustering) in all

[17] We require at least 20 days of returns data to estimate IVol associated with CAR2 during the same estimation window used to estimate the market model. The value of IVol associated with CAR2 is not reported in Table 1 to save space.

regression analyses throughout the paper. Note that even without clustering, all conclusions in the paper remain unchanged.

The dependent variables in Panels A and B of Table 4 are CARs based on the market model (CAR1) and the market-adjusted return (CAR2), respectively. The estimated slope coefficients are essentially similar in Panels A and B. For brevity, we thus restrict our discussion to the results in Panel A. Consistent with Hypothesis 1 and results in Table 3, all policy sensitiveness measures have a significantly negative impact on CARs even with these controls. More specifically, the coefficients on *Policy announcement*, *Fixed investment*, *Political connection*, and *All three* are -1.064 (*t*-stat = -2.09), -2.956 (*t*-stat = -3.50), -0.331 (*t*-stat = -2.94), and -0.249 (*t*-stat = -5.06), respectively. All four coefficients are highly significant at the 1% level, except for the coefficient on *Policy announcement*, which is significant at the 5% level. The estimated slope coefficients on control variables deserve discussions. We find that small firms, firms with high leverage, and firms with high idiosyncratic risk suffer more wealth loss (i.e., earn lower returns) during this event window than large firms, firms with low leverage, and firms with low idiosyncratic risk. The results suggest that risky firms suffer greater wealth loss than safe firms during this political uncertainty event window, which is consistent with the risk-based explanation. We also find that growth firms and firms with higher past week returns suffer less wealth loss (i.e., earn relatively higher returns) during this event window.

5.4 Is ownership important?

Before we go on to test alternative explanations, we carry out tests across two subsamples: state-own enterprises (SOEs) and non-SOEs. Previous studies have documented the important differences between SOEs and non-SOEs in China. However, there is no clear theoretical

guidance on whether political uncertainty is more prominent for SOEs or non-SOEs. One may argue that all SOEs are similar in the sense that they all belong to the government and no matter who is in power, these state-owned assets will always form an integral part of the authority. Therefore, there should be no difference among SOEs. However, since this argument applies mainly to those SOEs controlled by the central government, which we call central government-owned entities or agencies (*central SOEs* hereafter), we thus exclude local SOEs from our analysis when comparing SOEs with non-SOEs.[18] In contrast, non-SOEs are more diverse and independent, and thus are more vulnerable to potential policy changes. The policy sensitiveness results would be more prominent in the non-SOE subsample.

On the other hand, one may also argue that SOEs are more sensitive to political uncertainty as they belong to the current authority, while non-SOEs are on their own anyway so they are less affected by the power transition. At the end of the day, the difference in the effects of political uncertainty between these two subsamples is an empirical issue.

Panels A and B of Table 5 report the regression results of cumulative abnormal returns based on the market model (CAR1) on policy sensitiveness measures for the SOE subsample and the non-SOE subsample, respectively. For the SOE subsample, none of the policy sensitiveness measures has a significant coefficient. On the other hand, the non-SOE subsample generates significant results for all four policy-sensitive measures. For example, the coefficients on *Policy announcement*, *Fixed investment*, *Political connection*, and *All three* are -1.095 (*t*-stat = -1.71), -4.300 (*t*-stat = -3.94), -0.399 (*t*-stat = -2.64), and -0.309 (*t*-stat = -6.86), respectively. All four coefficients are highly significant at the 1% level except for the coefficient on *Policy*

[18] In unreported results, we find that political uncertainty also has significant impacts on local SOEs, more so than on central SOEs but less so than on private firms. The results are available upon request.

announcement, which is significant at the 10% level.[19] These results suggest that the results reported in Table 4 are likely mainly driven by private firms.[20]

6. Alternative Explanations

We have shown that the Bo scandal caused a significant drop in stock prices, especially for policy-sensitive firms. But a stock price drop may be caused by a cash flow effect or a discount rate effect. To differentiate the political uncertainty explanation from the cash flow explanation stated in Hypothesis 2, we measure the expected change in cash flows based on changes in analysts' earnings forecasts to reflect investors' expectation. If the announcement return was driven by expected changes in cash flows, we should observe a significant drop in analysts' earnings forecasts, especially for policy-sensitive firms. We measure the change in earnings forecasts as the difference in the median earnings forecast per share (EPS) between six months after and six months before the Bo scandal, divided by the stock price two days prior to that scandal. To facilitate interpretation of the results, we convert the change to a percentage. We

[19] The results in Table 5 are essentially the same if we use CAR2 as the dependent variable.

[20] There are two ways to conduct the test to examine whether SOEs and non-SOEs differ in their response to a political event. Apart from the one used in the current analysis, we can also use an interaction term approach by including an interaction term *sensitiveness*×*SOE* in the regression, where SOE is a dummy with a value of one if a firm is an SOE and zero otherwise. The advantage of our subsample approach, however, is that the regression coefficients are allowed to be different on all control variables as well. SOEs are different from non-SOEs in many ways. For example, as our results show, leverage has quite an effect on non-SOE firms but not on SOE firms, reflecting the fact that non-SOE firms are more financially constrained. This justifies our two-subsample test approach.

consider forecasts for years 2012, 2013, and 2014 because analysts routinely make multi-year-ahead earnings forecasts.

6.1 Expected cash flow analysis

We first provide univariate tests to see if the change in analysts' earnings forecasts (ΔForecast EPS) is negative, especially for policy-sensitive firms. From the summary statistics reported in Table 1, we find that analysts revised the earnings downward substantially from before to after the Bo scandal as indicated by the strongly negative cross-sectional means of ΔForecast EPS_2012 (-0.812%), ΔForecast EPS_2013 (-1.011%), and ΔForecast EPS_2014 (-0.627%) in our sample.[21]

Panels A1–A4 in Table 6 report the univariate tests for each of the policy sensitiveness measures separately. The results show that changes in analysts' earnings forecasts are negative in all policy-sensitive groups, suggesting that the Bo scandal caused analysts to revise their earnings forecasts downward for the current and the next two years. At first glance, the result seems to be consistent with the cash flow hypothesis. However, it is also consistent with the finding documented in the accounting literature that analysts tend to first issue optimistic forecasts and then walk down their forecasts (e.g., Richardson, Teoh, and Wysocki (2004)). More importantly, the result in the last two columns indicates that the drop in analysts' earnings forecasts is smaller for more policy-sensitive firms in nine out of 12 cases, and six of them are

[21] The percentages of observations with negative (positive) values for these three measures are 71.81% (11.65%), 70.37% (13.47%), and 49.17% (16.02%), respectively. The remaining percentages of observations indicate no change in analysts' earnings forecasts before and after the Bo scandal.

significant at the 10% level or better.[22] The evidence is inconsistent with the prediction of the cash flow hypothesis stated in Hypothesis 2, which predicts that the drop in analysts' earnings forecasts should be larger for more policy-sensitive firms.

We next conduct regression analysis to check robustness of our results by including control variables. Panels A, B, and C of Table 7 report the results for years 2012, 2013, and 2014, respectively. Hypothesis 2 predicts that the regression coefficient on the policy sensitiveness measure is negative. We find that none of the policy sensitiveness measures are significantly and negatively related to these changes in earnings forecasts. Interestingly, we find that the fixed investment measure even has significantly positive coefficients at the 5% level or better in all three panels as shown in Table 7, which contradicts Hypothesis 2.

6.2 Realized cash flow analysis

Besides changes in expected cash flow, we also employ realized cash flow as a proxy for changes in investors' expectation for cash flow to strengthen our results. Although realized cash flow contains look-ahead bias information, if the result remains, it would strengthen our argument. We measure a firm's operating performance by net income divided by total assets (ROA), by operating profits divided by total assets (OPOA), and by sales divided by total assets (SOA). From the summary statistics reported in Table 1, we find that realized earnings are substantially reduced from 2011 to 2012 as evidenced by the strongly negative cross-sectional means of ΔROA (-1.174%), ΔOPOA (-1.347%), and ΔSOA (-3.179%) in our sample, where

[22] There is only one case (i.e., ΔForecast EPS_2012) where the drop is significantly larger for more policy-sensitive firms.

ΔROA, ΔOPOA, and ΔSOA are the changes in ROA, OPOA, and SOA from fiscal year 2011 to fiscal year 2012.[23]

Panels B1–B4 of Table 6 report the univariate test results based on changes in these profitability measures. The results show that realized cash flow is decreased in all policy sensitiveness groups, which coincides with the beginning of the decline in economic growth in China. More importantly, the decrease tends to be more substantially for less policy-sensitive firms, which is inconsistent with the prediction of Hypothesis 2.

To check the robustness of the results reported in Table 6, Panels A, B and C of Table 8 show the regression results for ΔROA, ΔOPOA, and ΔSOA, respectively. As can be seen from Table 8, most of the policy sensitiveness measures have significantly positive coefficients. Specifically, the political connection measure has a significantly positive coefficient in both Panels A and B, and the fiscal policy sensitiveness measure has a significantly positive coefficient in both Panels B and C. In addition, the coefficient on the combined measure – *All three* – is significantly positive in all three panels. More specifically, the estimated coefficients on *All three* are all significant at the 5% level or better: 0.125 (*t*-stat = 2.21), 0.112 (*t*-stat = 2.58), and 0.475 (*t*-stat = 2.17) in Panels A, B, and C, respectively. These results contradict the cash flow explanation. Thus there is no evidence suggesting that after the Bo scandal, firms that were more politically sensitive experienced worse operating performance.

Combining the results reported in Tables 6–8 suggests that increases in political uncertainty are more likely than reductions in expected or realized cash flow to have caused more politically

[23] The percentages of observations with negative (positive) values for these three measures are 65.63% (34.37%), 66.38% (33.62%), and 59.08% (40.92%), respectively.

sensitive firms to produce more negative returns than less politically sensitive firms over the scandal period. All these results tend to reject Hypothesis 2 (i.e., the cash flow hypothesis).

6.3 Changes in volatility analysis

Next, we test the change in volatility as stated in Hypothesis 3. We measure the change in volatility from before to after the Bo scandal in percentage (ΔVol). Daily stock returns are used to construct volatility. We start from the first day of the second week after the Bo Scandal (i.e., March 17, 2012) and use one month as the post-Bo scandal period. Due to seasonality, the pre-Bo scandal period is defined as the same calendar time window as in the previous two years (i.e., March 17 – April 16 in 2011 and 2010) to construct a more robust volatility benchmark.

From the summary statistics reported in Table 1, we find that the cross-sectional mean of daily stock return volatility in our sample increased substantially from before to after the Bo scandal (ΔVol = 0.280% with 69.01% (30.99%) of the observations being positive (negative)). Table 9 presents univariate tests to assess if volatility increased more for policy-sensitive firms. The results indicate that the increase in volatility is larger for the most than the least policy-sensitive firms in all four panels. In addition, the difference in the increase in volatility is significant for the fixed investment and the combined policy sensitiveness measures.

We next conduct regression analysis to control for more confounding factors. Table 10 reports the estimates. The results show that volatility increased significantly after the Bo scandal, especially for firms that are more politically sensitive. For example, the coefficients on *Policy announcement*, *Fixed investment*, *Political connection*, and *All three* are 0.119 (*t*-stat = 1.69), 0.536 (*t*-stat = 2.01), 0.031 (*t*-stat = 0.98), and 0.035 (*t*-stat = 3.03), respectively. All coefficients are significant at the 10% level or better except for *Political connection*. The evidence suggests

that the results are more consistent with increasing uncertainty or the discount rate explanation than with decreasing cash flow or the cash flow explanation (Hypothesis 3).

6.4 Bo-connected firms

Finally, we identify a subsample of firms that have connections with Bo Xilai. We define connections based on whether a firm's directors have ever worked in any government agencies in Chongqing. Past studies have emphasized the value of political connections (Fisman, 2001, among others). Bo's scandal would have caused these connected firms to lose value because of the loss of their political connections. Table 11 reports the results with a dummy variable representing whether a firm has a connection with Bo (*Bo-connectedness*).

Panel A of Table 11 reports the CAR1 regression results. The evidence shows that these Bo-connected firms did experience larger stock return drops, with the dummy variable carrying a significantly negative coefficient.[24] However, more importantly, even with this dummy variable included in the regression, the coefficients on political sensitive measures are still significant, and the magnitudes of slope coefficients are similar to those reported in Table 4. Panel B of Table 11 reports the volatility regression results. The evidence indicates that the Bo-connection dummy is not significant, while the magnitudes and significance levels of the regression coefficients on all political sensitive measures are about the same as those reported in Table 10.

[24] Using the same method described in Table 11, we also identify firms connected to any government agencies in Liaoning Province or in the Ministry of Commerce of China that were governed by Bo before he was reassigned as the Communist Party Secretary of Chongqing in November 2007. Unreported results show that the difference in CAR between connected and non-connected firms is not statistically different from zero. A possible reason could be that these old connections are weaker than recent connections through government agencies in Chongqing.

In addition, unreported results show that excluding these connected firms does not change our results and conclusions reported in Table 11.

We are not arguing that political connection is valueless or the cash flow effect does not exist. What we are arguing is that the results are not purely driven by the cash flow effect and that there exists a discount rate effect. The evidence is consistent with the models that emphasize the existence of priced political risk.

7. Conclusion

Recent theoretical models and empirical evidence have shown that an increase in political uncertainty causes a contemporaneous drop in stock prices but an increase in future expected returns. However, previous empirical studies have not been able to rule out endogeneity issues except for the recent study by Kelly, Pástor, and Veronesi (2015). In this paper, we test the causal link between political uncertainty and asset prices in an unexpected event involving an exogenous shock to the political stability in China in 2012. The Bo Xilai political scandal posed the greatest threat to China's political stability in the years since the country began its economic reform in 1978. Due to its significance, the Bo scandal represents an ideal setting for us to test the impact of political uncertainty on asset prices in the absence of endogeneity.

Using daily stock returns from A-shares of firms listed on the two Chinese stock exchanges, we document significant drops in stock prices around the Bo scandal, in particular the stock prices of firms that were the most sensitive to changes in government policies. We measure the sensitiveness to policy changes using three proxies: (1) stock price sensitivity to the announcements of the adjustments of the reserve requirement ratio (RRR), (2) the proportion of SOE expenditures in total expenditures on fixed assets in each province, and (3) the degree of

political connections. In addition, we find that the return volatility right after the Bo scandal increased to a greater extent for the most policy-sensitive firms than for the least policy-sensitive firms. Finally, the decreases in analysts' earnings forecasts and in the realized accounting performance after the Bo scandal are not significantly greater for the most policy-sensitive firms than for the least policy-sensitive firms. The results remain the same even after controlling for or deleting firms having connections with Bo. Our results thus are more consistent with the existence of priced political risk.

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Appendix A. Summary of major media references

Reference number	Source of media reference
Ref. 1	Wang Xinwen, "The frightening implications of Bo Xilai's harsh punishment," *South China Morning Post,* October 1, 2012.
Ref. 2	*BBC News*, "Profile: Bo, Xilai," September 21, 2012.
Ref. 3	Jane Duckett, "China leadership transition," *Political Insight,* April 2012.
Ref. 4	"The Curriculum vitae of Bo, Xilai" by XinhuaNet, 2007.
Ref. 5	See Lu (2012) among others.
Ref. 6	http://news.xinhuanet.com/legal/2012-09/24/c_113183202.htm.
Ref. 7	Wen Jiabao said that "The present Chongqing municipal party committee and the municipal government must reflect seriously and learn from the Wang Lijun incident." Taken from: http://news.xinhuanet.com/politics/2012-03/14/c_111655106_8.htm.
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Ref. 9	http://www.cq.xinhuanet.com/2012-08/20/c_112780997.htm.
Ref. 10	http://news.xinhuanet.com/legal/2012-09/24/c_113183202.htm.
Ref. 11	http://en.wikipedia.org/wiki/Bo_Xilai.
Ref. 12	"Party Intrigue: Will Political Scandal Delay China's Once-a-Decade Leadership Transition?" by Hannah Beech, *Time,* May 9, 2012.
Ref. 13	"China may struggle to move beyond Bo Xilai scandal," by Barbara Demick and Julie Makinen, *Los Angeles Times,* September 29, 2012.
Ref. 14	George Chen, "Bo's purge hurts Chongqing's finance hub bid; Two global private equity firms suspend their plans to set up yuan funds after surprise sacking of party boss, " *South China Morning Post,* April 3, 2012.
Ref. 15	http://blog.sina.com.cn/s/blog_50e0f9720102dv60.html.

Appendix B. Firms not included in the final sample due to missing data

This appendix lists those firms deleted from the final sample. Stock IDs marked with '*' refer to those firms that are added back for calculating CAR2.

Stock ID	Firm name in English
000005	Shenzhen Fountain Corporation
000008	China High-Speed Railway Technology Co., Ltd.
000010	Shenzhen Ecobeauty Co., Ltd.
000017	China Bicycle Company (Holdings) Limited
000035	China Tianying Inc.
000038	Shenzhen Capstone Industrial Co., Ltd.
000049	Shenzhen Desay Battery Technology Co., Ltd
000055	China Fangda Group Co., Ltd.
000056	Shenzhen Wongtee International Enterprise Co., Ltd.
000058	Shenzhen Seg Co., Ltd.
000068	Shenzhen Huakong Seg Co., Ltd.
000088	Shenzhen Yan Tian Port Holdings Co., Ltd.
000156	Wasu Media Holding Co., Ltd.
000403	Zhenxing Biopharmaceutical & Chemical Inc.
000415*	Bohai Financial Investment Holding Co., Ltd.
000498	Shandong Hi-Speed Road & Bridge Co., Ltd.
000504*	Nanhua Bio-Medicine Co., Ltd.
000509	Huasu Holdings Co., Ltd.
000520*	Chang Jiang Shipping Group Phoenix Co., Ltd.
000522	Guangzhou Baiyunshan Pharmaceutical Co., Ltd.
000524*	Guangzhou Lingnan Group Holdings Company Limited
000539*	Guangdong Electric Power Development Co., Ltd.
000545	Jilin Gpro Titanium Industry Co., Ltd.
000552*	Gansu Jingyuan Coal Industry and Electricity Power Co., Ltd.
000553	Hubei Sanonda Co., Ltd.
000555	Digital China Information Service Company Ltd.
000557	Ningxia Western Venture Industrial Co., Ltd.
000571*	Sundiro Holding Co., Ltd.
000582	Beibuwan Port Co., Ltd.
000587*	Jinzhou Cihang Group Co., Ltd.
000595*	Baota Industry Co., Ltd.
000605	Bohai Water Industry Co., Ltd.
000611*	The Inner Mongolia Chilechuan Technology & Development Co., Ltd.
000622	Hengli Industrial Development Group Co., Ltd.
000625*	Chongqing Changan Automobile Company Limited
000628*	Chengdu Hi-Tech Development Co., Ltd.
000629	Pangang Group Vanadium Titanium & Resources Co., Ltd.
000652	Tianjin Teda Co., Ltd.
000655*	Shandong Jinling Mining Co., Ltd.
000657	China Tungsten and Hightech Materials Co., Ltd.
000662*	Teamax Smart City Technology Corporation Limited
000670	Infotmic Co., Ltd.
000672	Gansu Shangfeng Cement Co., Ltd.
000677	CHTC Helon Co., Ltd.

000681	Visual China Group Co., Ltd.
000688	Jianxin Mining Co., Ltd.
000693	Chengdu Huaze Cobalt and Nickel Material Co., Ltd.
000716	Nanfang Black Sesame Group Co., Ltd.
000719*	Central China Land Media Co., Ltd.
000722	Hunan Development Group Co., Ltd.
000723*	Shanxi Meijin Energy Co., Ltd.
000739*	Apeloa Pharmaceutical Co., Ltd.
000752	Tibet Galaxy Science & Technology Development Co., Ltd.
000755*	Shanxi Sanwei Group Co., Ltd.
000757	Sichuan Haowu Electromechanical Co., Ltd.
000759*	Zhongbai Holdings Group Co., Ltd.
000767*	Shanxi Zhangze Electric Power Co., Ltd.
000785*	Wuhan Zhongnan Commercial Group Co., Ltd.
000787	Powerise Information Technology Co., Ltd.
000791*	GEPIC Energy Development Co., Ltd.
000805	Jiangsu Goral Times Online Co., Ltd.
000810	Skyworth Digital Co., Ltd.
000815	MCC Meili Paper Industry Co., Ltd.
000816*	Jiangsu Nonghua Intelligent Agriculture Technology Co., Ltd.
000820	Jincheng Paper Co., Ltd.
000831	China Minmetals Rare Earth Co., Ltd.
000861*	Guangdong Highsun Group Co., Ltd.
000863	Sanxiang Co., Ltd.
000889	Maoye Communication and Network Co., Ltd.
000900*	Xiandai Investment Co., Ltd.
000908	Hunan Jingfeng Pharmaceutical Co., Ltd.
000958	Shijiazhuang Dongfang Energy Co., Ltd.
000959*	Beijing Shougang Co., Ltd.
000975	Yintai Resources Co., Ltd.
000976	Guangdong Kaiping Chunhui Co., Ltd.
000996	China Cifco Investment Co., Ltd.
002002	Hongda Xingye Co., Ltd.
002035*	Vatti Corporation Limited
002046	Luoyang Bearing Science & Technology Co., Ltd.
002051	China CAMC Engineering Co., Ltd.
002096*	Hunan Nanling Industrial Explosive Materials Co., Ltd.
002112	San Bian Science & Technology Co., Ltd.
002118*	Jilin Zixin Pharmaceutical Industrial Co., Ltd.
002145	CNNC Hua Yuan Titanium Dioxide Co., Ltd.
002198	Guangdong Jiaying Pharmaceutical Co., Ltd.
002214*	Zhejiang Dali Technology Co., Ltd.
002239*	Aotecar New Energy Technology Co., Ltd.
002296*	Henan Splendor Science & Technology Co., Ltd.
002302	China West Construction Group Co., Ltd.
002382*	Blue Sail Medical Co., Ltd.
002464*	Kee Ever Bright Decorative Technology Co., Ltd.
002467	Net263 Ltd.
002498*	Qingdao Hanhe Cable Co., Ltd.
002528	Shenzhen Infinova Limited
300026*	Tianjin Chase Sun Pharmaceutical Co., Ltd.

300028*	Geeya Technology Co., Ltd.
300043*	Rastar Group Co., Ltd.
300061*	Shanghai Conant Optics Co., Ltd.
300098*	Gosuncn Technology Group Co., Ltd.
300136	Shenzhen Sunway Communication Co., Ltd.
300157*	Landocean Energy Services Co., Ltd.
600038	Avicopter Plc.
600056	China Meheco Co., Ltd.
600094*	Greattown Holdings Ltd.
600096	Yunnan Yuntianhua Co., Ltd.
600121*	Zhengzhou Coal Industry & Electric Power Co., Ltd.
600132*	Chongqing Brewery Co., Ltd.
600133	Wuhan East Lake High Technology Group Co., Ltd.
600145	Xinjiang Yilu Wanyuan Industrial Investment Holding Co., Ltd.
600146*	Shangying Global Co., Ltd.
600155	Hebei Baoshuo Co., Ltd.
600168	Wuhan Sanzhen Industry Holding Co., Ltd.
600180*	CCS Supply Chain Management Co., Ltd.
600198	Datang Telecom Technology Co., Ltd.
600228	Jianxi Changjiu Biochemical Industry Co., Ltd.
600234	Guanghe Landscape Culture Communication Co., Ltd., Shanxi
600253	Henan Topfond Pharmaceutical Co., Ltd.
600275*	Hubei Wuchangyu Co., Ltd.
600313*	Zhongnongfa Seed Industry Group Co., Ltd.
600315*	Shanghai Jahwa United Co., Ltd.
600332	Guangzhou Baiyunshan Pharmaceutical Holdings Company Limited
600338	Tibet Summit Industry Co., Ltd.
600363*	Jiangxi Lianchuang Opto-Electronic Science & Technology Co., Ltd.
600385	Shandong Jintai Group Co., Ltd.
600392	Shenghe Resources Holding Co., Ltd.
600401	Hareon Solar Technology Co., Ltd.
600408*	Shanxi Antai Group Co., Ltd.
600421	Hubei Yangfan Holding Co., Ltd.
600444	Sinomach General Machinery Science & Technology Co., Ltd.
600448*	Huafang Co., Ltd.
600455	But'one Information Corporation, Xi'an
600462	Shenzhen Geoway Co., Ltd.
600478*	Hunan Corun New Energy Co., Ltd.
600517*	Shanghai Zhixin Electric Co., Ltd.
600552	Triumph Science & Technology Co., Ltd.
600556	Guangxi Future Technology Co., Ltd.
600578	Beijing Jingneng Power Co., Ltd.
600579	Qingdao Tianhua Institute of Chemistry Engineering Company Limited
600590	Tellhow Sci-Tech Co., Ltd.
600603	Dazhou Xingye Holding Co., Ltd.
600613	Shanghai Shenqi Pharmaceutical Investment Management Co., Ltd.
600617	Shanxi Guoxin Energy Corporation Limited
600633	Zhejiang Daily Media Group Co., Ltd.
600634	Shanghai Zhongji Investment Holding Co., Ltd.
600656*	Zhuhai Boyuan Investment Co., Ltd.
600678	Sichuan Golden Summit (Group) Joint-Stock Co., Ltd.

600681*	Bestsun Energy Co., Ltd.
600687	Gansu Gangtai Holding (Group) Co., Ltd.
600691	Yangmei Chemical Co., Ltd.
600699	Ningbo Joyson Electronic Corp.
600705	Avic Capital Co., Ltd.
600706	Xi'an Qujiang Cultural Tourism Co., Ltd.
600711*	Chengtun Mining Group Co., Ltd.
600722	Hebei Jinniu Chemical Industry Co., Ltd.
600735*	Shandong Hiking International Co., Ltd.
600738	Lanzhou Minbai Shareholding (Group) Co., Ltd.
600751	Tianjin Tianhai Investment Co., Ltd.
600760*	Zhonghang Heibao Co., Ltd.
600766	Yantai Yuancheng Gold Co., Ltd.
600771	Guangyuyuan Chinese Herbal Medicine Co., Ltd.
600780	Shanxi Top Energy Company Ltd.
600787	CMST Development Co., Ltd.
600790*	Zhejiang China Light & Textile Industrial City Group Co., Ltd.
600793	Yibin Paper Industry Co., Ltd.
600803*	ENN Ecological Holdings Co., Ltd.
600817	Xi’an Hongsheng Technology Co., Ltd.
600870	Xiamen Overseas Chinese Electronic Co., Ltd.
600882	Shandong Hualian Mining Holdings Co., Ltd.
600885	Hongfa Technology Co., Ltd.
600892	Baocheng Investment Co., Ltd.
600894	Guangzhou Guangri Stock Co., Ltd.
600985*	Anhui Leiming Kehua Co., Ltd.
600988	Chifeng Jilong Gold Mining Co., Ltd.
601005	Chongqing Iron & Steel Company Limited

Appendix C. Variable definitions

Variable	Definition and Data Source
Policy announcement	The weighted average ranking of the absolute returns over the three-day window around the announcement of the adjustment of the reserve requirement ratio during the period from 2007 to 2011. For each adjustment, we rank all firms by the absolute value of these cumulative abnormal returns in ascending order. This rank is further converted into a number between 0 and 1 using the formula: rank/(number of firms + 1). To reflect the relative significance of these adjustments, a weight of the absolute market return over the three-day window around the announcement is assigned to calculate this weighted average ranking variable. Source: Manually collected from the People's Bank of China website.
Fixed investment	The average proportion of fixed investment from government-owned entities over the three-year period from 2010 to 2012 at the province level. Source: China Statistical Yearbooks of 2010, 2011, and 2012.
Political connection	The natural logarithm of one plus the number of directors on the board who have political connections. A director is defined as politically connected if he or she is a current or former government bureaucrat following Fan et al. (2007). Source: Manually collected from annual reports.
All three	The sum of policy announcement, fixed investment, and political connection, standardized to have a mean of 0 and a standard deviation of 1.
CRR	The cumulative raw return over the three-day window (i.e., March 13-15, 2012) centered on the Bo scandal (March 14, 2012) in percentage. Source: CSMAR.
CAR1	The cumulative abnormal return over the three-day window (i.e., March 13-15, 2012) centered on the Bo scandal (March 14, 2012) in percentage based on the market model. Source: CSMAR.
CAR2	The cumulative abnormal return over the three-day window (i.e., March 13-15, 2012) centered on the Bo scandal (March 14, 2012) in percentage based on the market-adjusted return. Source: CSMAR.
ΔVol	The difference in volatility of daily stock returns in percentage over a one-month window following the Bo scandal (March 17 – April 16, 2012) and during the same calendar time window in the previous two years (i.e., March 17 – April 16 in 2010 and 2011). Winsorized at the 0.5% and 99.5% levels. Source: CSMAR.
ΔForecast EPS_2012	The change in analysts' earnings forecasts per share (EPS) divided by the stock price two days prior to the Bo scandal in percentage for year 2012. The change in analysts' EPS forecasts is defined as the difference between the median EPS forecast six months after the Bo scandal and the median EPS forecast six months before the Bo scandal. Winsorized at the 0.5% and 99.5% levels. Source: CSMAR.
ΔForecast EPS_2013	The change in analysts' EPS forecasts divided by the stock price two days prior to the Bo scandal in percentage for year 2013. ΔForecast EPS_2013 is defined similarly to ΔForecast EPS_2012. Source: CSMAR.
ΔForecast EPS_2014	The change in analysts' EPS forecasts divided by the stock price two days prior to the Bo scandal in percentage for year 2014. ΔForecast EPS_2014 is defined similarly to ΔForecast EPS_2012. Source: CSMAR.
SD_EPS_2012	Standard deviation of analysts' EPS forecasts for year 2012 in the (-6m, +6m) window around the Bo scandal. Winsorized at the 0.5% and 99.5% levels. Source: CSMAR.
SD_EPS_2013	Standard deviation of analysts' EPS forecasts for year 2013 in the (-6m, +6m) window around the Bo scandal. Winsorized at the 0.5% and 99.5% levels. Source: CSMAR.
SD_EPS_2014	Standard deviation of analysts' EPS forecasts for year 2014 in the (-6m, +6m) window around the Bo scandal. Winsorized at the 0.5% and 99.5% levels. Source: CSMAR.

ROA(2012)	Return on assets and is defined as net income divided by total assets for the fiscal year of 2012 in percentage. Winsorized at the 0.5% and 99.5% levels. Source: CSMAR.
ROA(2011)	ROA for the fiscal year of 2011. Winsorized at the 0.5% and 99.5% levels. Source: CSMAR.
ΔROA	The change in ROA from fiscal 2011 to fiscal 2012 = ROA(2012) – ROA(2011)
OPOA(2012) = Operating Profit / Total Assets	Operating profit divided by total assets (OPOA) for the fiscal year of 2012 in percentage. Winsorized at the 0.5% and 99.5% levels. Source: CSMAR.
OPOA(2011) = Operating Profit / Total Assets	Operating profit divided by total assets (OPOA) for the fiscal year of 2011 in percentage. Winsorized at the 0.5% and 99.5% levels. Source: CSMAR.
ΔOPOA	The change in OPOA from fiscal 2011 to fiscal 2012 = OPOA(2012) – OPOA(2011)
SOA(2012) = Sales/Total Assets	Sales divided by total assets (SOA) for the fiscal year of 2012 in percentage. Winsorized at the 0.5% and 99.5% levels. Source: CSMAR.
SOA(2011) = Sales/Total Assets	Sales divided by total assets for the fiscal year of 2011 in percentage. Winsorized at the 0.5% and 99.5% levels. Source: CSMAR.
ΔSOA	The change in SOA from fiscal 2011 to fiscal 2012 = SOA(2012) – SOA(2011)
LnSZ	The natural logarithm of the firm market value as of one week before the Bo scandal. Winsorized at the 0.5% and 99.5% levels. Source: CSMAR.
B/M	Book-to-market ratio, constructed as the book value of equity as of the end of 2011 divided by the market value of equity as of one week before the Bo scandal. Winsorized at the 0.5% and 99.5% levels. Source: CSMAR database.
Leverage	Total liabilities divided by total assets, winsorized at the 0.5% and 99.5% levels. Source: CSMAR.
SOE	A dummy variable that equals one if the ultimate controller of a firm is a government-owned entity or a government agency, and zero otherwise. Source: CSMAR.
BHR	Buy-and-hold stock return from two weeks to one week before the Bo scandal in percentage. Source: CSMAR.
AbsBHR	Absolute value of the buy-and-hold stock return from two weeks to one week before the Bo scandal. Source: CSMAR.
Beta	Beta obtained from the market model in estimating the cumulative abnormal return. Source: CSMAR.
IVol	Idiosyncratic volatility, which is defined as the standard deviation of the daily return residuals from the market model used to estimate the cumulative abnormal return, multiplied by 100. Source: CSMAR.
Bo-connectedness	A dummy variable that equals one if one or more directors of a firm have working experience in government agencies in Chongqing.

Appendix D. Announcement dates of the adjustment of the reserve requirement ratio from 2007 to 2011

This appendix reports the announcement dates and adjustment size for the adjustment of the reserve requirement ratio made by People's Bank of China. Column 1 shows the announcement dates. Column 2 shows the adjustment size for big financial institutions and Column 3 for small and medium financial institutions.

Announcement date	Adjustment size (big financial institutions)	Adjustment size (small and medium financial institutions)
January 5, 2007	0.50%	0.50%
February 16, 2007	0.50%	0.50%
April 15, 2007	0.50%	0.50%
April 29, 2007	0.50%	0.50%
May 18, 2007	0.50%	0.50%
July 30, 2007	0.50%	0.50%
September 6, 2007	0.50%	0.50%
October 13, 2007	0.50%	0.50%
November 10, 2007	0.50%	0.50%
December 8, 2007	1.00%	1.00%
January 16, 2008	0.50%	0.50%
March 18, 2008	0.50%	0.50%
April 16, 2008	0.50%	0.50%
May 12, 2008	0.50%	0.50%
June 7, 2008	1.00%	1.00%
September 15, 2008	0.00%	-1.00%
October 8, 2008	-0.50%	-0.50%
November 26, 2008	-1.00%	-2.00%
December 22, 2008	-0.50%	-0.50%
January 12, 2010	0.50%	0.00%
February 12, 2010	0.50%	0.00%
May 2, 2010	0.50%	0.00%
November 19, 2010	0.50%	0.50%
December 10, 2010	0.50%	0.50%
January 14, 2011	0.50%	0.50%
February 18, 2011	0.50%	0.50%
March 18, 2011	0.50%	0.50%
April 17, 2011	0.50%	0.50%
May 12, 2011	0.50%	0.50%
June 14, 2011	0.50%	0.50%
November 9, 2011	0.50%	0.50%
November 30, 2011	-0.50%	-0.50%

Table 1
Summary statistics

This table provides summary statistics for the variables used in the paper. Financial information on firms is obtained from the China Stock Market and Accounting Research Database (CSMAR) maintained by GTA Information Technology. Our initial sample includes all non-financial firms listed for at least one year and publicly traded in the A-share market in mainland China as of the end of 2011. All variables are defined in Appendix B.

Variable	Mean	S.D.	p25	p50	p75
Policy announcement	0.431	0.282	0.193	0.390	0.657
Fixed investment	0.280	0.089	0.230	0.257	0.363
Political connection	0.654	0.601	0.000	0.693	1.099
All three	0.000	1.773	-1.302	-0.085	1.170
CRR (%)	-5.027	4.819	-8.163	-5.822	-2.949
CAR1 (%)	-0.938	4.680	-3.831	-1.762	0.859
CAR2 (%)	-1.750	4.847	-4.898	-2.550	0.294
ΔVol (%)	0.280	0.818	-0.102	0.263	0.686
ΔForecast EPS_2012 (%)	-0.812	1.223	-1.246	-0.360	0.000
ΔForecast EPS_2013 (%)	-1.011	1.492	-1.566	-0.508	0.000
ΔForecast EPS_2014 (%)	-0.627	1.312	-1.145	0.000	0.000
SD_EPS_2012	0.168	0.153	0.068	0.125	0.210
SD_EPS_2013	0.230	0.194	0.105	0.172	0.290
SD_EPS_2014	0.306	0.292	0.113	0.207	0.390
ROA (2012)	3.468	5.401	1.092	3.152	6.001
ROA (2011)	4.642	5.467	1.961	4.189	6.965
ΔROA (%)	-1.174	5.030	-2.582	-0.664	0.412
Operating Profit/Total Assets (2012)	3.567	6.196	0.742	3.260	6.522
Operating Profit/Total Assets (2011)	4.914	6.254	1.716	4.497	7.684
ΔOPOA (%)	-1.347	4.937	-3.050	-0.882	0.471
Sales/Total Assets (2012)	66.402	49.448	33.969	54.393	83.046
Sales/Total Assets (2011)	69.581	51.326	35.577	57.690	87.615
ΔSOA (%)	-3.179	16.653	-9.280	-1.792	4.094
LnSZ	22.251	0.945	21.592	22.066	22.749
B/M	0.407	0.226	0.253	0.366	0.514
Leverage	0.445	0.224	0.264	0.455	0.621
SOE	0.478	0.500	0.000	0.000	1.000
BHR	1.806	3.762	-0.650	1.253	3.494
AbsBHR	0.029	0.030	0.010	0.021	0.038
Beta	1.254	0.256	1.092	1.254	1.434
IVol	1.853	0.572	1.460	1.786	2.189

Table 2
Policy sensitiveness measures

Panel A of this table reports the average policy announcement measure across industries in ascending order. Panel B reports the fixed investment measure by province in ascending order.

Panel A. Ranking industries by the policy announcement measure

Industry	Policy announcement	Industry	Policy announcement
Information Technology	0.338	Pharmaceutical Products	0.433
Furniture	0.341	Metal	0.451
Other Manufacturing	0.342	Apparel	0.452
Communication & Culture	0.374	Agriculture	0.464
Food	0.377	Retail & Wholesale	0.469
Social Services	0.391	Utilities	0.470
Electronic	0.394	Conglomerate	0.483
Machinery	0.404	Transportation	0.485
Construction	0.414	Mining	0.514
Gas and Chemistry	0.416	Real Estate	0.583
Printing	0.419		

Panel B. Ranking provinces by the fixed investment measure

Province	Fixed Investment	Province	Fixed Investment	Province	Fixed Investment
Shandong	0.142	Hainan	0.285	Shanghai	0.380
Henan	0.164	Guangxi	0.296	Heilongjiang	0.397
Jiangsu	0.175	Hubei	0.303	Xinjiang	0.409
Liaoning	0.206	Fujian	0.303	Guizhou	0.432
Hebei	0.207	Hunan	0.324	Shanxi	0.434
Zhejiang	0.230	Ningxia	0.337	Yunnan	0.436
Jiangxi	0.235	Chongqing	0.349	Shaanxi	0.447
Anhui	0.241	Sichuan	0.363	Qinghai	0.471
Guangdong	0.257	Inner Mongolia	0.364	Gansu	0.523
Jilin	0.260	Tianjin	0.371	Tibet	0.720
Beijing	0.265				

Table 3

Univariate tests on market reaction

The table presents the univariate tests on the market reaction to the Bo scandal. CAR1 (CAR2) is the cumulative abnormal returns over the three-day window around Bo Scandal (March 14, 2012) calculated from the market model (the market-adjusted return), where the market return is value-weighted. In each panel, all firms in the sample are split into three groups by a proxy for policy sensitiveness. In Panel A, the sorting variable is *Policy announcement*, which is the weighted-average ranking of the absolute returns over a three-day window around the announcement of the adjustment of the reserve requirement ratio during the period from 2007 to 2011, where the weight is the aggregate market absolute return over the event date. In Panel B, the sorting variable is *Fixed investment*, which is the average proportion of fixed investment from government-owned entities over the three-year period from 2009 to 2011 at the province level. In Panel C, the sorting variable is *Political connection*, which is the natural logarithm of one plus the number of directors on the board who have political connections. In Panel D, the sorting variable is *All three*, which is the sum of all three policy sensitiveness measures above, standardized to have a mean of 0 and a standard deviation of 1. In the first three columns, the *t*-statistics based on the portfolio method are reported in parentheses. In the last column, the *t*-statistics are calculated based on robust standard errors clustered by industry and province separately. ***, ** and * represent statistical significance at the 1%, 5% and 10% levels, respectively.

	1 (Lowest)	2	3 (Highest)	3 minus 1
Panel A: Policy announcement				
CAR1 (%)	-0.624	-0.810	-1.380**	-0.756**
	(-0.811)	(-1.137)	(-2.243)	(-2.131)
CAR2 (%)	-1.459	-1.607*	-2.184***	-0.725**
	(-1.596)	(-1.839)	(-2.769)	(-2.105)
Panel B: Fixed investment				
CAR1 (%)	-0.592	-0.965	-1.250*	-0.658***
	(-0.825)	(-1.397)	(-1.905)	(-3.057)
CAR2 (%)	-1.497*	-1.693**	-2.048**	-0.551**
	(-1.688)	(-1.994)	(-2.514)	(-2.219)
Panel C: Political connection				
CAR1 (%)	-0.845	-0.901	-1.219**	-0.374**
	(-1.131)	(-1.403)	(-1.966)	(-2.121)
CAR2 (%)	-1.736*	-1.661**	-1.981**	-0.245
	(-1.902)	(-2.049)	(-2.572)	(-1.078)
Panel D: All three				
CAR1 (%)	-0.432	-1.094*	-1.288**	-0.856***
	(-0.523)	(-1.670)	(-2.140)	(-3.681)
CAR2 (%)	-1.328	-1.864**	-2.059***	-0.730***
	(-1.333)	(-2.349)	(-2.630)	(-3.235)

Table 4

Regression results of abnormal returns on policy sensitivity proxies

This table reports the effect of policy sensitiveness on cumulative abnormal returns (CAR) over the three-day window around the Bo scandal. In Panel A, the dependent variable is CAR1, which is derived from the market model based on the value-weighted market returns. In Panel B, the dependent variable is CAR2, which is derived from the market-adjusted model also based on the value-weighted market returns. *Policy announcement* is the weighted-average ranking of the absolute returns over the three-day window around the announcement of the adjustment of the reserve requirement ratio, where the weight is the aggregate market absolute return over the event date. *Fixed investment* is the average proportion of fixed investment from government-owned entities at the province level. *Political connection* is the natural logarithm of one plus the number of directors on the board who have political connections. *All three* is the sum of all three policy sensitiveness measures above, standardized to have a mean of 0 and a standard deviation of 1. *LnSZ* and *B/M* are the logarithm of a firm's market value and book-to-market ratio one week before the Bo scandal. *Leverage* is the ratio of total liabilities to total assets. *BHR* is the buy-and-hold stock return from two weeks to one week before the Bo scandal. *IVol* refers to idiosyncratic volatility obtained from the market model (Panel A) or the market-adjusted return (Panel B) used to estimate cumulative abnormal returns. N is the number of observations. The *t*-statistics calculated based on robust standard errors clustered by industry and province separately are reported in parentheses. ***, ** and * represent statistical significance at the 1%, 5% and 10% levels, respectively.

Panel A: CAR from the market model (CAR1)				
	(1)	(2)	(3)	(4)
Policy announcement	-1.064**			
	(-2.087)			
Fixed investment		-2.956***		
		(-3.495)		
Political connection			-0.331***	
			(-2.938)	
All three				-0.249***
				(-5.061)
LnSZ	0.663***	0.667***	0.672***	0.699***
	(5.533)	(5.440)	(5.443)	(5.861)
B/M	-3.224***	-3.310***	-3.218***	-3.303***
	(-5.530)	(-5.397)	(-5.321)	(-5.284)
Leverage	-2.053***	-2.330***	-2.367***	-2.028***
	(-2.893)	(-3.231)	(-3.224)	(-2.878)
BHR	0.122***	0.122***	0.121***	0.121***
	(3.367)	(3.332)	(3.222)	(3.467)
IVol	-1.335***	-1.332***	-1.352***	-1.372***
	(-4.188)	(-4.368)	(-4.333)	(-4.350)
Intercept	-10.787***	-10.359***	-11.070***	-11.952***
	(-3.547)	(-3.310)	(-3.581)	(-4.037)
N	1,862	1,862	1,862	1,862
Adjusted R^2	0.067	0.066	0.065	0.071

Table 4 – Continued

Panel B: CAR from the market-adjusted returns (CAR2)				
	(1)	(2)	(3)	(4)
Policy announcement	-1.169**			
	(-2.184)			
Fixed investment		-2.852***		
		(-5.198)		
Political connection			-0.267**	
			(-2.353)	
All three				-0.244***
				(-5.195)
LnSZ	0.895***	0.897***	0.899***	0.930***
	(6.675)	(6.514)	(6.524)	(7.060)
B/M	-3.059***	-3.134***	-3.034***	-3.118***
	(-3.881)	(-3.836)	(-3.733)	(-3.789)
Leverage	-2.149***	-2.446***	-2.486***	-2.151***
	(-3.804)	(-4.167)	(-4.125)	(-3.816)
BHR	0.086**	0.085**	0.084**	0.084**
	(2.154)	(2.115)	(2.071)	(2.197)
IVol	-1.693***	-1.680***	-1.692***	-1.714***
	(-5.587)	(-5.594)	(-5.579)	(-5.593)
Intercept	-15.858***	-15.466***	-16.130***	-17.067***
	(-4.936)	(-4.614)	(-4.895)	(-5.522)
N	1,924	1,924	1,924	1,924
Adjusted R^2	0.082	0.081	0.079	0.085

Table 5

Regression results of abnormal returns on policy sensitivity proxies split by ownership

This table reports the effect of policy sensitiveness on cumulative abnormal returns (CAR) over the three-day window around the Bo scandal for state-own enterprises (SOEs) and private firms separately. The dependent variable is CAR1, which is derived from the market model based on the value-weighted market returns. Panel A reports results for SOEs, while Panel B presents results for private firms. SOEs are restricted to all those firms controlled by central government agencies or entities. Private firms are all non-SOEs. *Policy announcement* is the weighted-average ranking of the absolute returns over the three-day window around the announcement of the adjustment of the reserve requirement ratio, where the weight is the aggregate market absolute return over the event date. *Fixed investment* is the average portion of fixed investment from government-owned entities at the province level. *Political connection* is the natural logarithm of one plus the number of directors on the board who have political connections. *All three* is the sum of all three policy sensitiveness measures above, standardized to have a mean of 0 and a standard deviation of 1. *LnSZ* and *B/M* are the logarithm of a firm's market value and book-to-market ratio one week before the Bo scandal. *Leverage* is the ratio of total liabilities to total assets. *BHR* is the buy-and-hold stock return from two weeks to one week before the Bo scandal. *IVol* refers to idiosyncratic risk obtained from the market model used to estimate cumulative abnormal returns. N is the number of observations. The Wald test statistic is used to test for the equality of the regression coefficient on the corresponding policy sensitiveness in Panels A and B. N is the number of observations. The *t*-statistics calculated based on robust standard errors clustered by industry and province separately are reported in parentheses. The *t*-statistics are reported in parentheses. ***, ** and * represent statistical significance at the 1%, 5% and 10% levels, respectively.

Panel A: SOE Firms

	(1)	(2)	(3)	(4)
Policy announcement	-0.391			
	(-0.448)			
Fixed investment		1.411		
		(0.607)		
Political connection			-0.168	
			(-0.405)	
All three				-0.039
				(-0.264)
LnSZ	0.363**	0.367**	0.377**	0.366***
	(2.450)	(2.286)	(2.362)	(2.667)
B/M	-2.230***	-2.235***	-2.196***	-2.212***
	(-3.509)	(-3.234)	(-3.473)	(-3.254)
Leverage	-0.991	-1.045	-1.073	-1.028
	(-1.121)	(-1.193)	(-1.197)	(-1.160)
BHR	0.071	0.068	0.070	0.071
	(1.221)	(1.110)	(1.172)	(1.160)
IVol	-1.039*	-1.037*	-1.061*	-1.044*
	(-1.728)	(-1.647)	(-1.689)	(-1.755)
Intercept	-5.787	-6.460	-6.134	-6.011*
	(-1.473)	(-1.455)	(-1.595)	(-1.694)
N	256	256	256	256
Adjusted R^2	0.014	0.014	0.014	0.014

Table 5 – Continued

Panel B: Non-SOE (Private firms)				
	(1)	(2)	(3)	(4)
Policy announcement	-1.095*			
	(-1.713)			
Fixed investment		-4.300***		
		(-3.936)		
Political connection			-0.399***	
			(-2.644)	
All three				-0.309***
				(-6.864)
LnSZ	0.679***	0.689***	0.704***	0.712***
	(5.187)	(5.073)	(5.178)	(5.090)
B/M	-3.683***	-3.949***	-3.752***	-3.969***
	(-7.635)	(-6.612)	(-7.111)	(-6.166)
Leverage	-2.393**	-2.793***	-2.746***	-2.317**
	(-2.497)	(-2.824)	(-2.664)	(-2.431)
BHR	0.098**	0.092**	0.097**	0.093**
	(2.462)	(2.467)	(2.480)	(2.446)
IVol	-1.578***	-1.614***	-1.632***	-1.642***
	(-5.836)	(-6.050)	(-5.880)	(-5.775)
Intercept	-10.252***	-9.558***	-10.845***	-11.462***
	(-3.001)	(-2.602)	(-3.029)	(-3.139)
N	972	972	972	972
Adjusted R^2	0.062	0.066	0.063	0.071
Test for equal slope on policy sensitiveness in Panels A and B				
The Wald test statistic	0.52	12.34***	0.52	3.03*

Table 6

Univariate tests on the changes in expected and realized cash flow around the Bo scandal

The table presents the univariate test on the changes in expected and realized cash flow in Panels A1–A4 and B1–B4, respectively. Expected cash flow is measured by analysts' consensus EPS forecasts. ΔForecast EPS_2012 (2013; 2014) is changes in EPS forecasts in 2012 (2013; 2014) divided by the stock price two days prior to the Bo scandal in percentage. Realized cash flow is measured by realized Returns on Assets (ROA), Operating Profit/Total Assets (OPOA), or Sales/Total Assets (SOA). ΔROA, ΔOperating Profit/Total Assets, or ΔSales/Total Assets is the difference in realized ROA, OPOA, or SOA between 2012 and 2011. In each panel, all firms in the sample are split into three groups by a proxy for policy sensitiveness. In Panels A1 and B1, the sorting variable is *Policy announcement*, which is the weighted-average ranking of the absolute returns over a three-day window around the announcement of the adjustment of the reserve requirement ratio during the period from 2007 to 2011, where the weight is the aggregate market absolute return over the event date. In Panels A2 and B2, the sorting variable is *Fixed investment*, which is the average proportion of fixed investment from government-owned entities over the three-year period from 2009 to 2011 at the province level. In Panels A3 and B3, the sorting variable is *Political connection*, which is the natural logarithm of one plus the number of directors on the board who have political connections. In Panels A4 and B4, the sorting variable is *All three*, which is the sum of all three policy sensitiveness measures above, standardized to have a mean of 0 and a standard deviation of 1. The *t*-statistics calculated based on robust standard errors clustered by industry and province separately are reported in parentheses. ***, ** and * represent statistical significance at the 1%, 5% and 10% levels, respectively.

	1 (Lowest)	2	3 (Highest)	3 minus 1	
				Difference	*t*-stat
Panel A1: Policy announcement					
ΔForecast EPS_2012	-0.691	-0.922	-0.826	-0.136**	(-2.238)
ΔForecast EPS_2013	-0.906	-1.116	-1.015	-0.109	(-0.859)
ΔForecast EPS_2014	-0.815	-0.546	-0.507	0.308	(1.150)
Panel A2: Fixed investment					
ΔForecast EPS_2012	-0.926	-0.785	-0.729	0.197***	(3.469)
ΔForecast EPS_2013	-1.130	-0.950	-0.955	0.175*	(1.875)
ΔForecast EPS_2014	-0.862	-0.540	-0.440	0.422***	(2.829)
Panel A3: Political connection					
ΔForecast EPS_2012	-0.757	-0.912	-0.696	0.060	(0.788)
ΔForecast EPS_2013	-1.036	-1.097	-0.784	0.253*	(1.882)
ΔForecast EPS_2014	-0.589	-0.645	-0.661	-0.072	(-0.341)
Panel A4: All three					
ΔForecast EPS_2012	-0.834	-0.847	-0.750	0.084	(1.244)
ΔForecast EPS_2013	-1.091	-1.059	-0.868	0.223***	(3.542)
ΔForecast EPS_2014	-0.852	-0.619	-0.336	0.516*	(1.829)

Table 6 – Continued

	1 (Lowest)	2	3 (Highest)	3 minus 1	
				Difference	*t*-stat
Panel B1: Policy announcement					
ΔROA	-1.123	-1.356	-1.043	0.080	(0.342)
ΔOperating Profit/Total Asset	-1.302	-1.554	-1.185	0.117	(0.373)
ΔSales/Total Asset	-3.410	-2.972	-3.155	0.255	(0.393)
Panel B2: Fixed investment					
ΔROA	-1.450	-1.136	-0.941	0.510**	(2.264)
ΔOperating Profit/Total Asset	-1.741	-1.150	-1.150	0.591**	(2.499)
ΔSales/Total Asset	-4.208	-2.547	-2.779	1.430	(1.473)
Panel B3: Political connection					
ΔROA	-1.343	-1.269	-0.603	0.740**	(1.972)
ΔOperating Profit/Total Asset	-1.467	-1.422	-0.923	0.544	(1.384)
ΔSales/Total Asset	-3.216	-3.674	-1.968	1.248	(0.849)
Panel B4: All three					
ΔROA	-1.458	-1.330	-0.734	0.725***	(4.899)
ΔOperating Profit/Total Asset	-1.695	-1.392	-0.955	0.740***	(6.381)
ΔSales/Total Asset	-3.946	-3.084	-2.509	1.437	(1.435)

Table 7

Expected cash flow regression analyses

This table reports the effect of policy sensitivity on the change in analysts' earnings per share (EPS) forecasts. In Panels A, B and C, the dependent variable is the change in forecasted EPS divided by the stock price two days prior to the Bo scandal (ΔForecast EPS) in percentage for years 2012, 2013, and 2014, respectively. The change in EPS forecasts (ΔForecast EPS) is defined as the difference between the median EPS forecast in the six months after the Bo scandal and the median EPS forecast in the six months before the Bo scandal. *Policy announcement* is the weighted-average ranking of the absolute returns over the three-day window around the announcement of the adjustment of the reserve requirement ratio, where the weight is the aggregate market absolute return over the event date. *Fixed investment* is the average portion of fixed investment from government-owned entities at the province level. *Political connection* is the natural logarithm of one plus the number of directors on the board who have political connections. *All three* is the sum of all three policy sensitiveness measures above, standardized to have a mean of 0 and a standard deviation of 1. *SD_EPS*_2012 (2013; 2014) is the standard deviation of analysts' EPS forecasts for year 2012 (2013; 2014) in the (-6m, +6m) window around the Bo scandal. *LnSZ* and *B/M* are the logarithm of a firm's market value and book-to-market ratio one week before the Bo scandal. Leverage is the ratio of total liabilities to total assets. *AbsBHR* is the absolute value of the buy-and-hold stock return from two weeks to one week before the Bo scandal. *Beta* is market beta and *IVol* refers to idiosyncratic risk obtained from the market model used to estimate cumulative abnormal returns. *ROA*(2011) is the net income divided by total assets for the fiscal year of 2011 in percentage. N is the number of observations. The *t*-statistics calculated based on robust standard errors clustered by industry and province separately are reported in parentheses. ***, ** and * represent statistical significance at the 1%, 5% and 10% levels, respectively.

Panel A: Dependent variable = ΔForecast EPS_2012

	(1)	(2)	(3)	(4)
Policy announcement	0.062			
	(0.499)			
Fixed investment		0.744**		
		(2.440)		
Political connection			0.020	
			(0.377)	
All three				0.031
				(1.633)
SD_EPS_2012	-2.825***	-2.784***	-2.826***	-2.797***
	(-5.905)	(-5.707)	(-5.911)	(-5.717)
LnSZ	0.101**	0.092**	0.102**	0.093**
	(2.347)	(2.137)	(2.318)	(2.040)
B/M	-1.034***	-1.015***	-1.027***	-1.023***
	(-2.780)	(-2.777)	(-2.790)	(-2.825)
Leverage	-0.807**	-0.778**	-0.788***	-0.834***
	(-2.424)	(-2.533)	(-2.604)	(-2.639)
AbsBHR	-0.498	-0.408	-0.478	-0.398
	(-0.302)	(-0.245)	(-0.287)	(-0.241)
Beta	-0.524***	-0.537***	-0.517***	-0.542***
	(-3.085)	(-3.184)	(-3.002)	(-3.172)
IVol	0.174	0.173	0.175	0.184
	(1.371)	(1.307)	(1.331)	(1.394)
ROA(2011)	0.003	0.005	0.004	0.003
	(0.170)	(0.285)	(0.192)	(0.187)
Intercept	-1.596*	-1.608*	-1.640*	-1.384
	(-1.712)	(-1.741)	(-1.811)	(-1.394)
N	901	901	901	901
Adjusted R^2	0.195	0.198	0.195	0.197

Table 7 – Continued

Panel B: Dependent variable = ΔForecast EPS_2013				
	(1)	(2)	(3)	(4)
Policy announcement	0.124			
	(0.773)			
Fixed investment		0.684***		
		(4.723)		
Political connection			0.110	
			(1.236)	
All three				0.054**
				(2.201)
SD_EPS_2013	-2.337***	-2.313***	-2.335***	-2.297***
	(-4.647)	(-4.664)	(-4.653)	(-4.518)
LnSZ	0.083	0.077	0.084	0.069
	(1.353)	(1.250)	(1.316)	(1.072)
B/M	-1.209***	-1.183***	-1.188***	-1.183***
	(-3.713)	(-3.639)	(-3.655)	(-3.684)
Leverage	-0.856*	-0.791*	-0.831*	-0.882**
	(-1.809)	(-1.832)	(-1.931)	(-1.974)
AbsBHR	-2.585	-2.500	-2.475	-2.385
	(-1.123)	(-1.086)	(-1.062)	(-1.028)
Beta	-0.491**	-0.495**	-0.478**	-0.525**
	(-2.483)	(-2.457)	(-2.269)	(-2.541)
IVol	0.148	0.147	0.158	0.163
	(0.824)	(0.796)	(0.848)	(0.888)
ROA(2011)	0.023	0.025	0.023	0.023
	(1.176)	(1.297)	(1.221)	(1.208)
Intercept	-1.337	-1.390	-1.451	-0.967
	(-0.926)	(-0.958)	(-1.007)	(-0.644)
N	854	854	854	854
Adjusted R^2	0.150	0.151	0.151	0.153

Table 7 – Continued

Panel C: Dependent variable = ΔForecast EPS_2014				
	(1)	(2)	(3)	(4)
Policy announcement	0.355			
	(0.660)			
Fixed investment		1.575**		
		(2.449)		
Political connection			-0.062	
			(-0.437)	
All three				0.064
				(1.471)
SD_EPS_2014	-0.955*	-0.955**	-0.979*	-0.947**
	(-1.921)	(-1.976)	(-1.892)	(-1.972)
LnSZ	0.094	0.103	0.110	0.092
	(0.983)	(0.931)	(1.015)	(0.871)
B/M	-0.470	-0.485	-0.533***	-0.439
	(-0.954)	(-0.954)	(-3.097)	(-0.871)
Leverage	0.780	0.909	0.934	0.841
	(0.945)	(1.363)	(1.363)	(1.205)
AbsBHR	-3.686	-3.388	-3.659	-3.599
	(-1.169)	(-1.113)	(-1.138)	(-1.135)
Beta	0.239	0.166	0.295	0.164
	(0.520)	(0.353)	(0.596)	(0.340)
IVol	-0.002	-0.051	-0.037	0.006
	(-0.004)	(-0.114)	(-0.078)	(0.014)
ROA(2011)	0.028	0.031***	0.028*	0.027*
	(1.639)	(3.103)	(1.857)	(1.892)
Intercept	-3.123	-3.517	-3.351	-2.899
	(-1.466)	(-1.430)	(-1.406)	(-1.316)
N	181	181	181	181
Adjusted R^2	0.073	0.080	0.069	0.075
	0.024	0.032	0.020	0.027

Table 8

Realized cash flow regression analyses

This table reports the effect of policy sensitiveness on the future accounting performance of firms. In Panels A, B and C, the dependent variables are the changes in earnings divided by total assets (ΔROA), operating profits divided by total assets (ΔOPOA), and sales divided by total assets (ΔSOA) from fiscal 2011 to fiscal 2012, respectively. *Policy announcement* is the weighted-average ranking of the absolute returns over the three-day window around the announcement of the adjustment of the reserve requirement ratio, where the weight is the aggregate market absolute return over the event date. *Fixed investment* is the average proportion of fixed investment from government-owned entities at the province level. *Political connection* is the natural logarithm of one plus the number of directors on the board who have political connections. *All three* is the sum of all three policy sensitiveness measures above, standardized to have a mean of 0 and a standard deviation of 1. *LnSZ* and *B/M* are the logarithm of a firm's market value and book-to-market ratio one week before the Bo scandal. *Leverage* is the ratio of total liabilities to total assets. N is the number of observations. The *t*-statistics calculated based on robust standard errors clustered by industry and province separately are reported in parentheses. ***, ** and * represent statistical significance at the 1%, 5% and 10% levels, respectively.

Panel A: Dependent variable = ΔROA				
	(1)	(2)	(3)	(4)
Policy announcement	-0.316			
	(-0.806)			
Fixed investment		1.852		
		(1.440)		
Political connection			0.495**	
			(2.287)	
All three				0.125**
				(2.208)
LnSZ	-0.548**	-0.561**	-0.585**	-0.577**
	(-2.168)	(-2.132)	(-2.376)	(-2.227)
B/M	-0.598	-0.548	-0.650	-0.584
	(-0.822)	(-0.784)	(-0.914)	(-0.833)
Leverage	2.838***	2.701***	2.702***	2.555***
	(3.318)	(3.576)	(3.435)	(3.246)
Intercept	10.148*	9.808*	10.592*	10.771*
	(1.813)	(1.782)	(1.941)	(1.885)
N	1,862	1,862	1,862	1,862
Adjusted R^2	0.020	0.021	0.023	0.022

Table 8 – Continued

Panel B: Dependent variable = ΔOPOA				
	(1)	(2)	(3)	(4)
Policy announcement	-0.268			
	(-0.785)			
Fixed investment		2.065*		
		(1.712)		
Political connection			0.376*	
			(1.680)	
All three				0.112***
				(2.577)
LnSZ	-0.683**	-0.696**	-0.711***	-0.709***
	(-2.541)	(-2.502)	(-2.710)	(-2.595)
B/M	-0.961	-0.905	-1.001	-0.948
	(-1.306)	(-1.247)	(-1.393)	(-1.314)
Leverage	2.942***	2.817***	2.830***	2.694***
	(4.735)	(5.047)	(4.891)	(4.371)
Intercept	13.049**	12.676**	13.385**	13.609**
	(2.201)	(2.153)	(2.307)	(2.269)
N	1,862	1,862	1,862	1,862
Adjusted R^2	0.029	0.030	0.030	0.030

Panel C: Dependent variable = ΔSOA				
	(1)	(2)	(3)	(4)
Policy announcement	1.413			
	(1.118)			
Fixed investment		7.696**		
		(2.223)		
Political connection			0.618	
			(0.891)	
All three				0.475**
				(2.166)
LnSZ	-0.068	-0.093	-0.096	-0.152
	(-0.165)	(-0.215)	(-0.240)	(-0.357)
B/M	1.162	1.385	1.107	1.230
	(0.531)	(0.666)	(0.502)	(0.582)
Leverage	-4.094**	-3.801**	-3.693**	-4.343**
	(-2.029)	(-2.035)	(-1.994)	(-2.405)
Intercept	-0.927	-2.150	-0.246	1.623
	(-0.105)	(-0.251)	(-0.028)	(0.178)
N	1,862	1,862	1,862	1,862
Adjusted R^2	0.001	0.002	0.001	0.003

Table 9

Univariate tests on the changes in volatility around the Bo scandal

This table presents the univariate tests on the changes in daily stock return volatility (ΔVol) from before to after the Bo scandal in percentage. The post-event period is defined as March 17 – April, 2012 and the pre-event period is defined as March 17 – April 16 in 2010 and 2011. In each panel, all firms in the sample are split into three groups by a proxy for policy sensitiveness. In Panel A, the sorting variable is *Policy announcement*, which is the weighted-average ranking of the absolute returns over a three-day window around the announcement of the adjustment of the reserve requirement ratio during the period from 2007 to 2011, where the weight is the aggregate market absolute return over the event date. In Panel B, the sorting variable is *Fixed investment*, which is the average proportion of fixed investment from government-owned entities over the three-year period from 2009 to 2011 at the province level. In Panel C, the sorting variable is *Political connection*, which is the natural logarithm of one plus the number of directors on the board who have political connections. In Panel D, the sorting variable is *All three*, which is the sum of all three policy sensitiveness measures above, standardized to have a mean of 0 and a standard deviation of 1. N is the number of observations. The *t*-statistics calculated based on robust standard errors clustered by industry and province separately are reported in parentheses. ***, ** and * represent statistical significance at the 1%, 5% and 10% levels, respectively.

				3 minus 1	
	1 (Lowest)	2	3 (Highest)	Difference	*t*-stat
Panel A: Policy announcement					
ΔVol	0.269	0.266	0.306	0.037	(0.627)
Panel B: Fixed investment					
ΔVol	0.220	0.254	0.365	0.145***	(2.954)
Panel C: Political connection					
ΔVol	0.285	0.273	0.288	0.003	(0.057)
Panel D: All three					
ΔVol	0.243	0.272	0.326	0.083*	(1.895)

Table 10

Regression results of volatility changes on policy sensitivity proxies

This table reports the effect of policy sensitiveness on the change in daily stock return volatility from before to after the Bo scandal in percentage (ΔVol). The post-event period is defined as March 17 – April, 2012 and the pre-event period is defined as March 17 – April 16 in 2010 and 2011. *Policy announcement* is the weighted-average ranking of the absolute returns over the three-day window around the announcement of the adjustment of the reserve requirement ratio, where the weight is the aggregate market absolute return over the event date. *Fixed investment* is the average proportion of fixed investment from government-owned entities at the province level. *Political connection* is the natural logarithm of one plus the number of directors on the board who have political connections. *All three* is the sum of all three policy sensitiveness measures above, standardized to have a mean of 0 and a standard deviation of 1. *LnSZ* and *B/M* are the logarithm of a firm's market value and book-to-market ratio one week before the Bo scandal. *Leverage* is the ratio of total liabilities to total assets. *AbsBHR* is the absolute value of the buy-and-hold stock return from two weeks to one week before the Bo event. *Beta* is market beta and *IVol* refers to idiosyncratic risk obtained from the market model used to estimate cumulative abnormal returns. N is the number of observations. The *t*-statistics calculated based on robust standard errors clustered by industry and province separately are reported in parentheses. ***, ** and * represent statistical significance at the 1%, 5% and 10% levels, respectively.

	(1)	(2)	(3)	(4)
Policy announcement	0.119*			
	(1.668)			
Fixed investment		0.536**		
		(2.011)		
Political connection			0.031	
			(0.978)	
All three				0.035***
				(3.030)
LnSZ	-0.126***	-0.126***	-0.127***	-0.131***
	(-5.652)	(-5.605)	(-5.569)	(-5.863)
B/M	0.038	0.052	0.037	0.049
	(0.262)	(0.381)	(0.265)	(0.353)
Leverage	0.245*	0.271**	0.281**	0.232*
	(1.938)	(1.987)	(2.066)	(1.723)
AbsBHR	3.438***	3.445***	3.464***	3.485***
	(5.082)	(5.052)	(5.018)	(5.114)
Beta	0.169***	0.172***	0.176***	0.164***
	(4.240)	(4.554)	(4.333)	(4.266)
IVol	0.075	0.074	0.075*	0.081*
	(1.634)	(1.624)	(1.671)	(1.822)
Intercept	2.471***	2.378***	2.489***	2.637***
	(4.591)	(4.137)	(4.500)	(4.776)
N	1,862	1,862	1,862	1,862
Adjusted R^2	0.051	0.052	0.050	0.055

Table 11

Regression results of cumulative abnormal returns and volatility changes on policy sensitivity proxies: Bo-connected firms

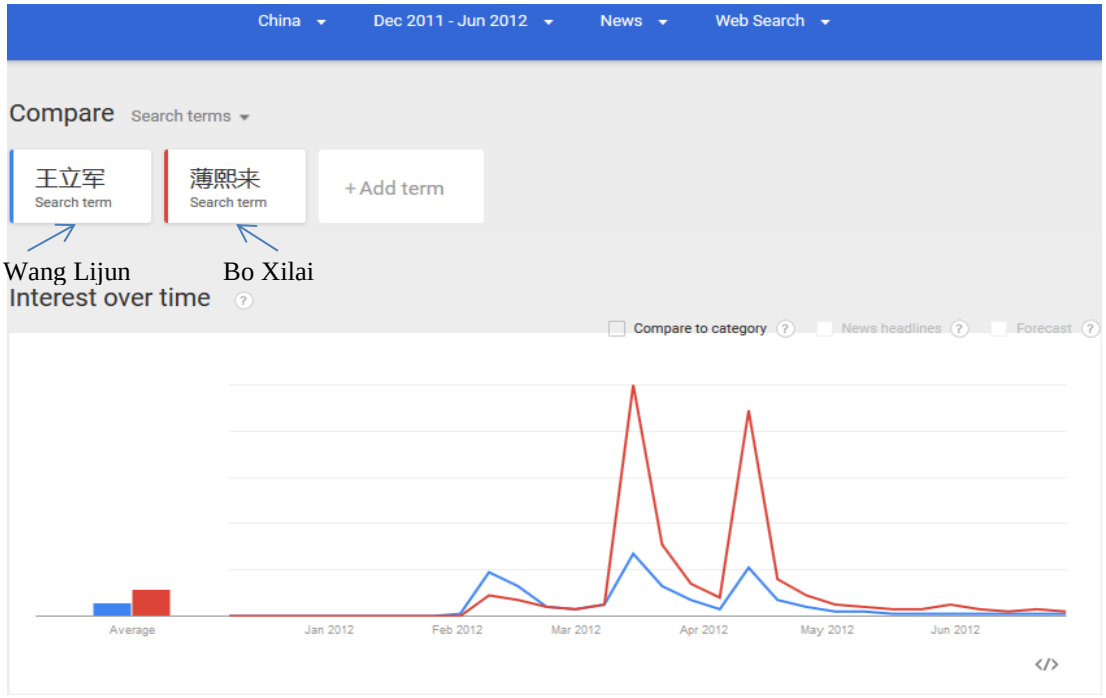
This table reports the effect of policy sensitiveness on cumulative stock returns (CAR1) and changes in volatility around the Bo scandal. CAR1 is derived from the market model based on the value-weighted market returns. The change in volatility (ΔVol) is the calculated volatility in one month starting from March 17, 2012 minus the volatility estimated from the same calendar time window in the previous two years (i.e., March 17 – April 16 in 2010 and 2011). Panel A reports the CAR regression results, while Panel B displays the volatility regression results. *Bo-connectedness* is a dummy variable that is equal to one if one or more directors of a firm have working experience in government agencies in Chongqing. *Policy announcement* is the weighted-average ranking of the absolute returns over the three-day window around the announcement of the adjustment of the reserve requirement ratio, where the weight is the aggregate market absolute return over the event date. *Fixed investment* is the average proportion of fixed investment from government-owned entities at the province level. *Political connection* is the natural logarithm of one plus the number of directors on the board who have political connections. *All three* is the sum of all three policy sensitiveness measures above, standardized to have a mean of 0 and a standard deviation of 1. *LnSZ* and *B/M* are the logarithm of a firm's market value and book-to-market ratio one week before the Bo scandal. *Leverage* is the ratio of total liabilities to total assets. *AbsBHR* is the absolute value of the buy-and-hold stock return from two weeks to one week before the Bo event. *Beta* is market beta and *IVol* refers to idiosyncratic risk obtained from the market model used to estimate cumulative abnormal returns. N is the number of observations. The *t*-statistics calculated based on robust standard errors clustered by industry and province separately are reported in parentheses. ***, ** and * represent statistical significance at the 1%, 5% and 10% levels, respectively.

Panel A: CAR regression results				
	(1)	(2)	(3)	(4)
Policy announcement	-1.082**			
	(-2.119)			
Fixed investment		-2.866***		
		(-3.346)		
Political connection			-0.294***	
			(-2.745)	
All three				-0.241***
				(-4.191)
Bo-connectedness	-1.744***	-1.592***	-1.496***	-1.370***
	(-3.574)	(-3.387)	(-3.568)	(-3.105)
LnSZ	0.667***	0.670***	0.673***	0.625***
	(5.608)	(5.494)	(5.465)	(5.212)
B/M	-3.224***	-3.307***	-3.218***	-3.232***
	(-5.505)	(-5.383)	(-5.318)	(-5.700)
Leverage	-2.029***	-2.315***	-2.354***	-2.080***
	(-2.874)	(-3.210)	(-3.210)	(-2.895)
BHR	0.121***	0.120***	0.119***	0.126***
	(3.319)	(3.283)	(3.178)	(3.638)
IVol	-1.338***	-1.335***	-1.352***	-1.360***
	(-4.204)	(-4.381)	(-4.336)	(-4.284)
Intercept	-10.836***	-10.422***	-11.094***	-10.318***
	(-3.571)	(-3.333)	(-3.587)	(-3.350)
N	1,862	1,862	1,862	1,862
Adjusted R^2	0.068	0.067	0.065	0.075

Table 11 – continued

Panel B: Regression results of changes in volatility				
	(1)	(2)	(3)	(4)
Policy announcement	0.119*			
	(1.686)			
Fixed investment		0.537**		
		(1.977)		
Political connection			0.032	
			(0.943)	
All three				0.035***
				(2.910)
Bo-connectedness	0.016	-0.014	-0.011	-0.033
	(0.086)	(-0.075)	(-0.057)	(-0.177)
LnSZ	-0.126***	-0.126***	-0.127***	-0.131***
	(-5.680)	(-5.621)	(-5.576)	(-5.867)
B/M	0.038	0.053	0.037	0.049
	(0.262)	(0.381)	(0.265)	(0.354)
Leverage	0.245*	0.271**	0.281**	0.233*
	(1.917)	(1.975)	(2.053)	(1.719)
AbsBHR	3.440***	3.443***	3.463***	3.481***
	(5.059)	(5.021)	(4.999)	(5.097)
Beta	0.169***	0.172***	0.176***	0.165***
	(4.222)	(4.544)	(4.328)	(4.265)
IVol	0.075	0.074	0.075*	0.081*
	(1.623)	(1.617)	(1.671)	(1.821)
Intercept	2.471***	2.377***	2.489***	2.636***
	(4.609)	(4.149)	(4.510)	(4.777)
N	1,862	1,862	1,862	1,862
Adjusted R^2	0.051	0.052	0.050	0.054

Panel A. Search intensity for news on "Lijun Wang" and "Xilai Bo" in Chinese on Google originated from mainland China from Oct 2011 to Jun 2012 (the intensity peaked in the weeks of February 5-11 , March 11 – 17 and April 8 - 14, 2012)



Panel B. Search intensity for news and media coverage on "Lijun Wang" and "Xilai Bo" in Chinese on Baidu from Oct 2011 to Jun 2012 (the intensity peaked on February 10, March 15 and April 11, 2012)

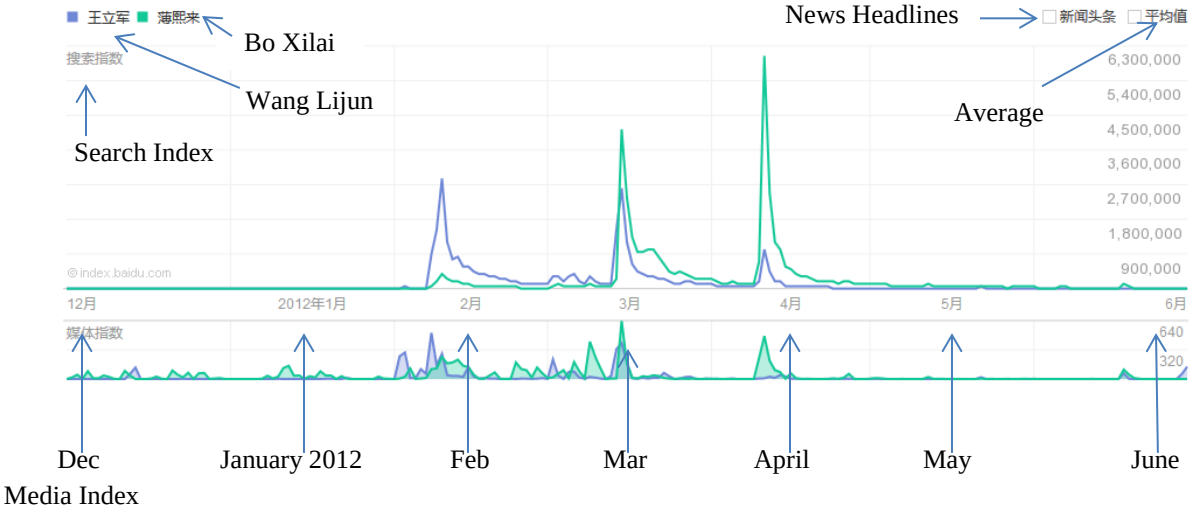


Fig. 1. Search intensity on Google and Baidu

(The intensity peaked on March 21, 2012)

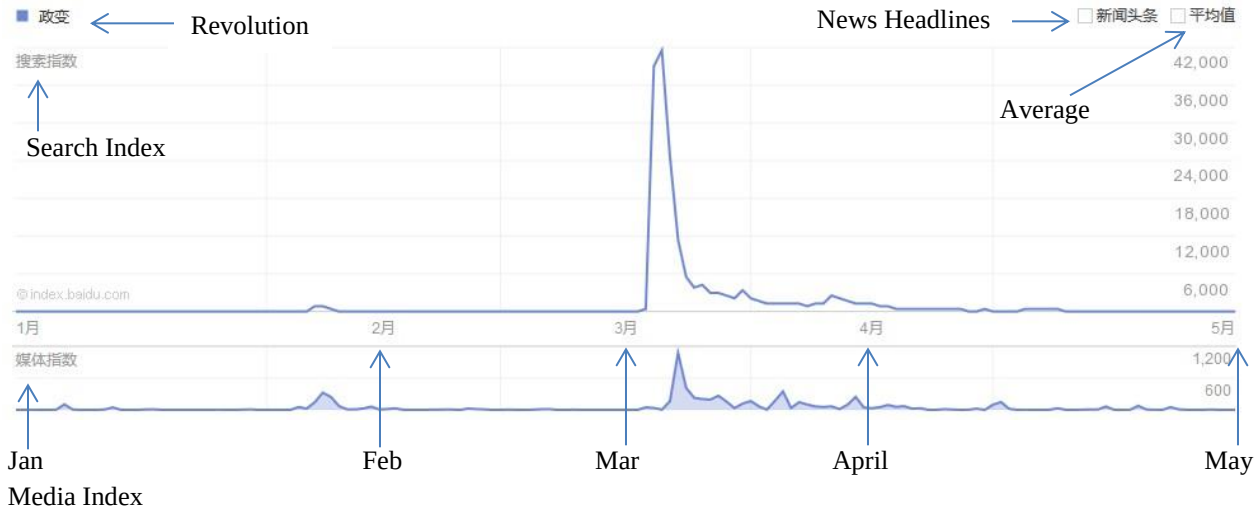


Fig. 2. Baidu search results for “revolution” in Chinese