Ideological Customer Capital: Measurement and Asset Pricing Implications

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ABFER
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Motivation

Ideological customer capital is important to firm performance

- It captures the customer base loyal to a firm's brand due to shared ideology
- Firms derive cash flows from customers who care about socio-political ideologies

  e.g., partisan affiliation, sustainability stance
- It can have distinct asset pricing implications

Valuing ideological customer capital is difficult

- Literature values customer capital via investment-based approach or survey data

  Tend to conflate distinct components of customer capital

  e.g., Dou et al. (2021); Belo et al. (2022)
- Customers typically hold heterogeneous ideological beliefs
- We rarely observe how ideologies affect firm cash flows in consumer markets

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Motivation

This paper: **Examine the value of firm ideological customer capital attributed to U.S. federal government procurement**

- Government acts as a large customer purchasing from firms

  Procurement constitutes a significant portion of cash flows for many firms

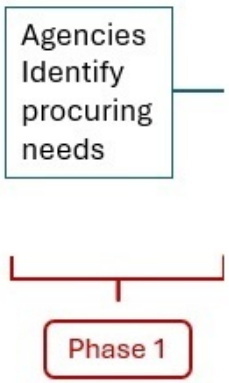
- Many procurement contracts are subject to full and open competition

  Government has the discretion to consider ideological factors. (e.g., FAR)

- Detailed contract-level data on procurement decisions and outcomes

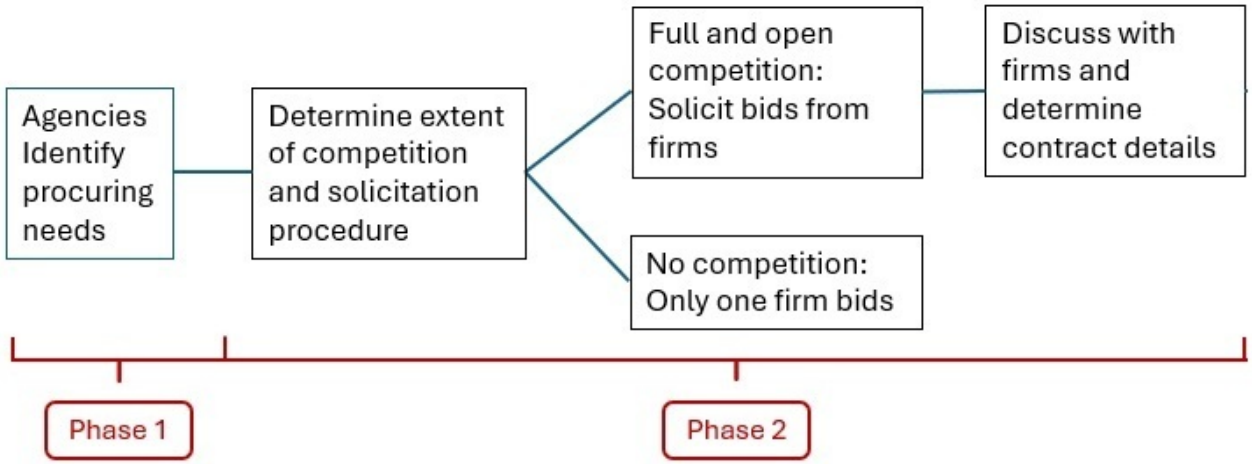
  Help us infer how ideological factors affect a firm's cash flows from procurement

General procurement process



Phase 1: Project planning

General procurement process



Phase 1: Project planning

Phase 2: Solicitation and competition strategy

- Choosing the solicitation method:

  Most common: **Negotiated procurement** incorporates non-price considerations

  Other methods: sealed bidding, simplified acquisition, etc.

- Determining the competition structure:

  Full and open competition, or **No competition** if justified

- Announcing the opportunity to vendors and soliciting bids

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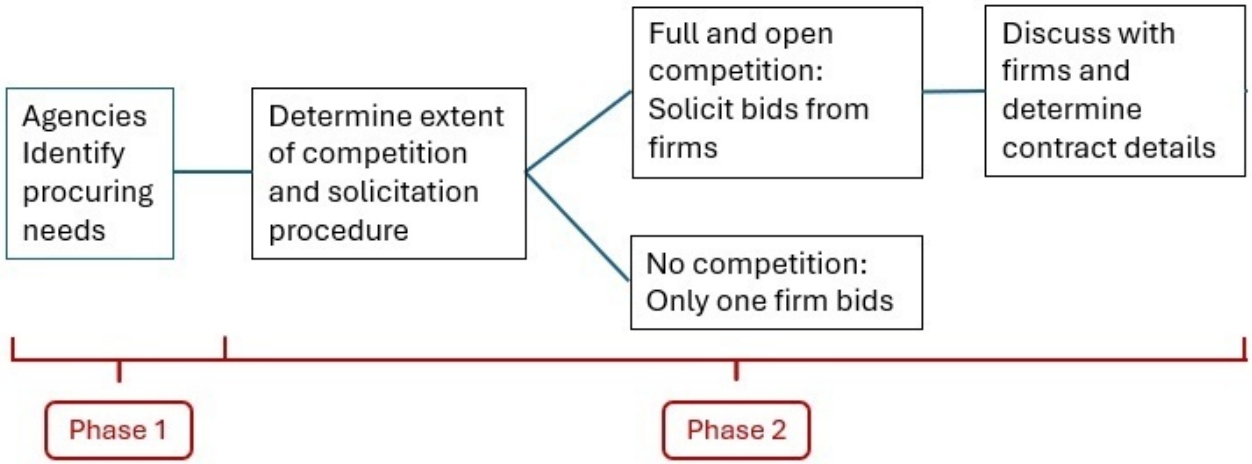

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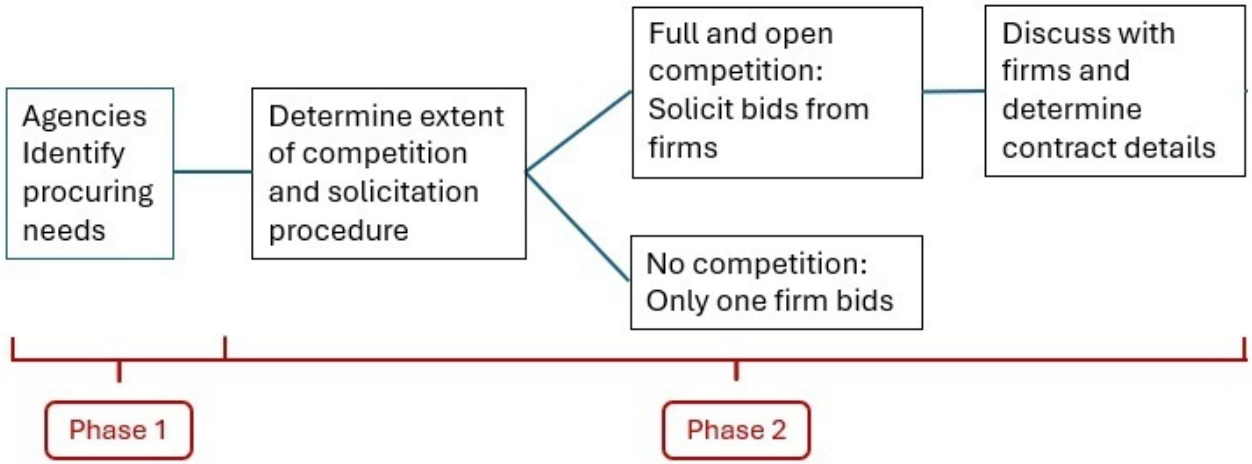

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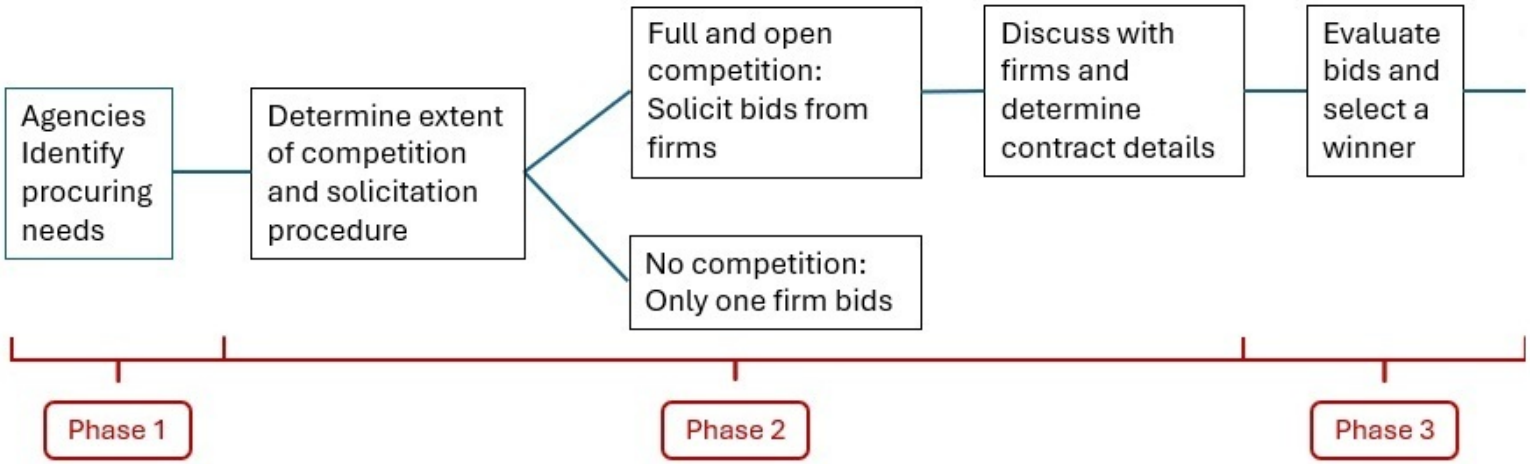

Phase 3: Evaluation and winner selection in negotiated procurement

- Bidders submit proposals
- Agencies evaluate bids using a combination of price and non-price factors

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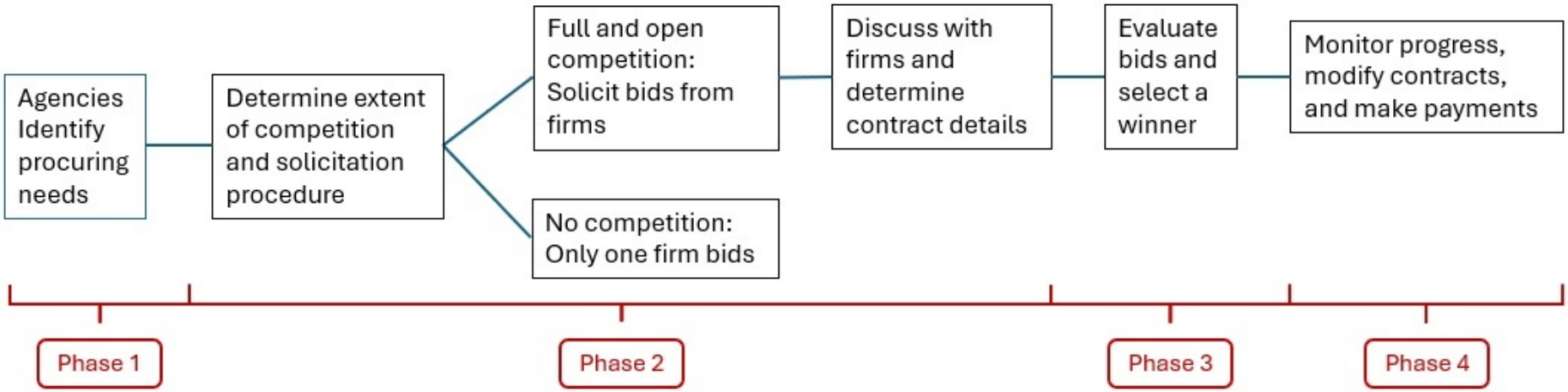

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Phase 4: Contract formation, execution, and ex-post adjustment

- Adjustments may occur due to technical changes, delays, or random outcomes
- Agencies issue contract modifications, which often increase cost or extend duration

Takeaway: Government agencies exercise significant discretion in negotiated procurement, over competition, contract terms, and selection criteria

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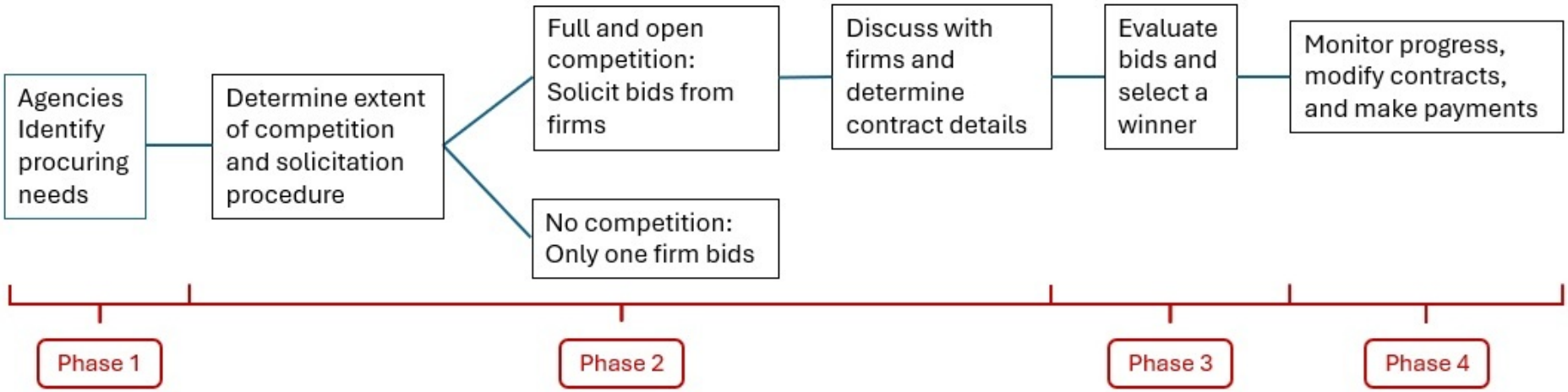

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Main contributions

1. A novel dataset that links

- Contract-level details from the US Federal Procurement Data System (FPDS)
- Four ideological characteristics: (1) political alignment; (2) carbon emission; (3) female leadership; (4) supply-chain connection to China

The data cover three broad sectors: IT, Office, and Transportation & logistics

2. Analytically tractable auction-theoretic framework to model procurement

- Optimal mechanism design, rather than fixed, pre-defined bidding schemes

  $\Rightarrow$ capture strong discretion of government agencies in reality

- Firms differ in multidimensional characteristics and private efficiency type

  $\Rightarrow$ capture multidimensional heterogeneity and information asymmetry

3. Quantifying the impact of firm ideology on its cash flows from procurement

- Measure ideological customer capital attributed to the government
- Examine the asset pricing implications of ideological customer capital

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Main results

1. Firms' ideol. char. significantly affect firm cash flow from procurement

- In IT, the government favors firms that
  - have lower carbon emission
  - have less female leadership presence
- In office management, the government favors firms that
  - are more politically aligned
  - have less female leadership presence
- In transportation & logistics, the government favors firms that
  - are more politically misaligned
  - have lower carbon emission
  - are less connected to China

2. Ideological customer capital (ICC) significantly affects asset prices

- We construct measures of ICC associated with all and each ideol. char.
- Firms with higher ICC are less exposed to aggregate cash flow risk

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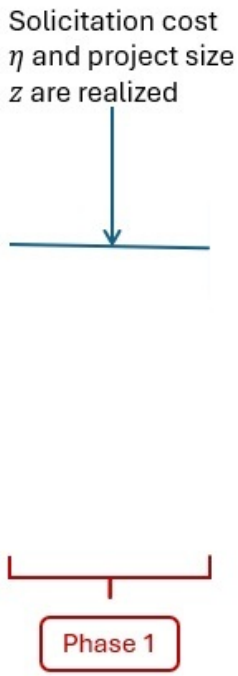
Outline

Model overview



Optimal auction design by the government:

- Phase 1: Procurement project starts

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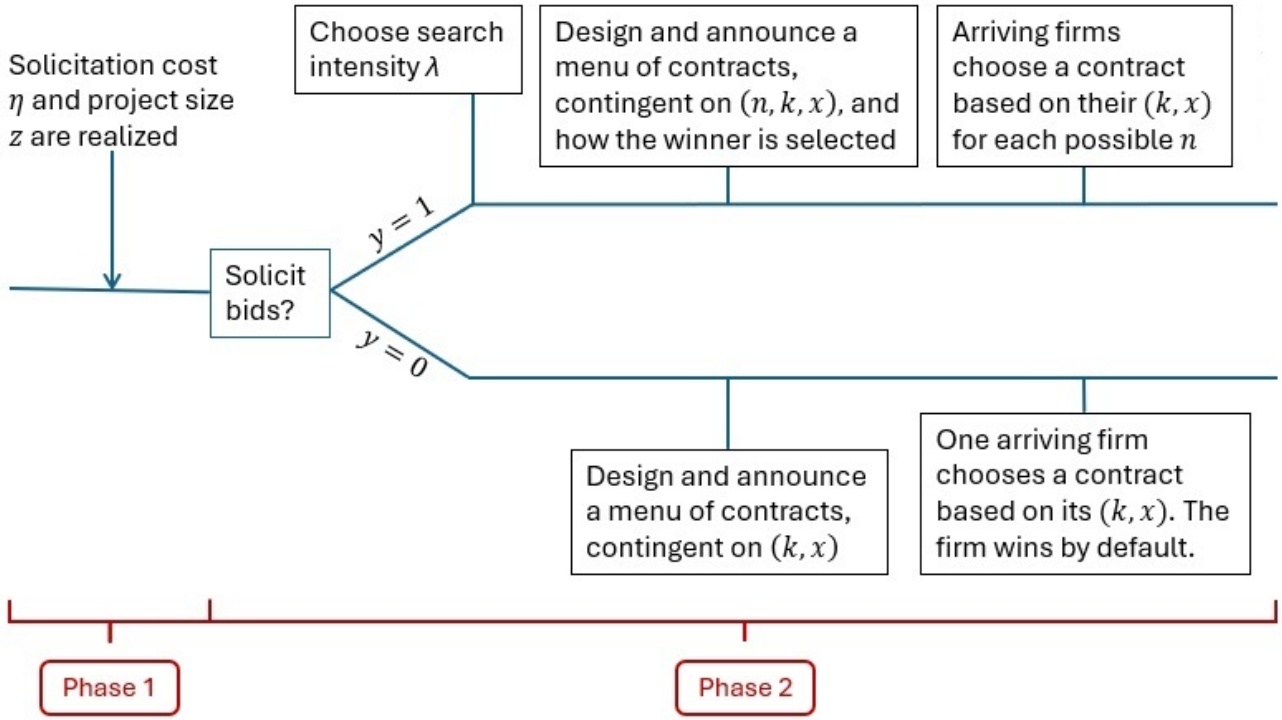

Optimal auction design by the government:

- Phase 1: Procurement project starts
- Phase 2: Government decides the competition structure, and designs payments and the winner selection

Firms differ in private efficiency type *k* and observable characteristics *x*

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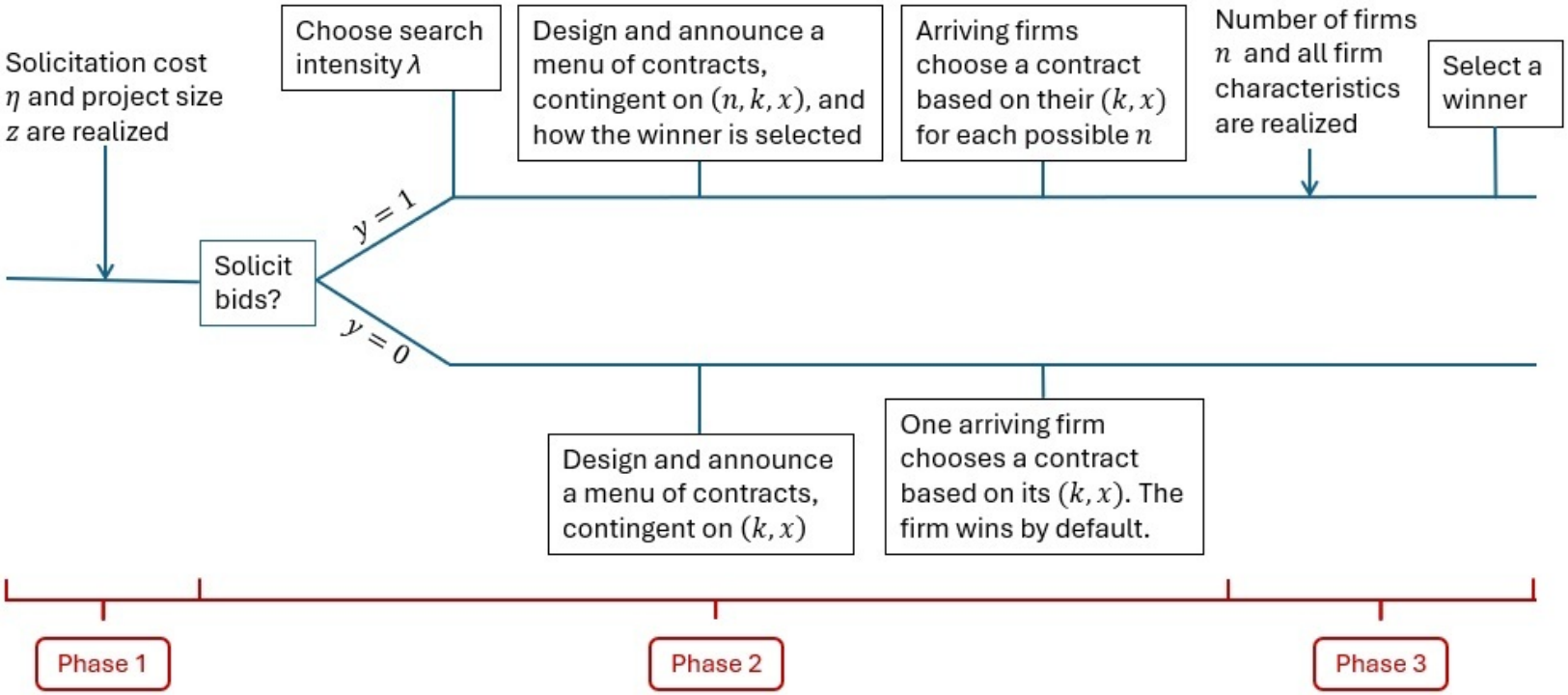

Optimal auction design by the government:

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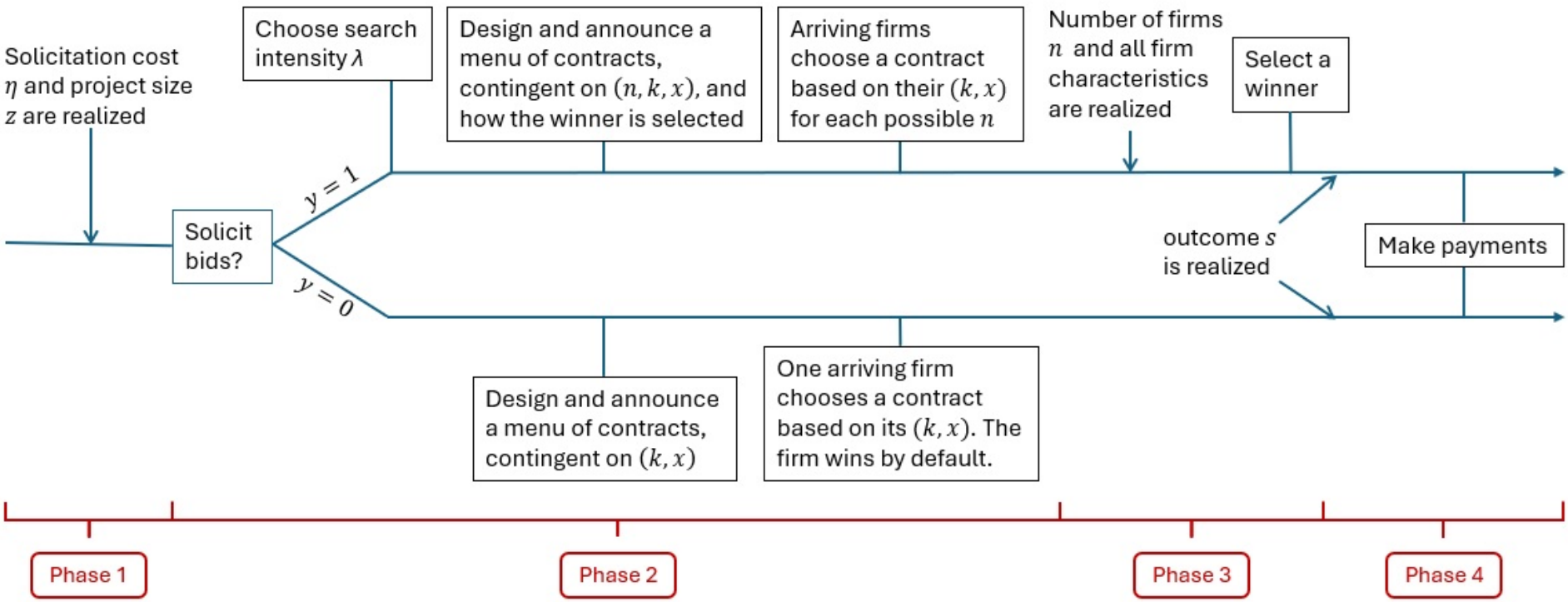

Optimal auction design by the government:

- Phase 1: Procurement project starts
- Phase 2: Government decides the competition structure, and designs payments and the winner selection
- Phase 3: Firms arrive to bid and the government selects the winner
- Phase 4: A random outcome is realized, and payment adjustments may occur

Firm and Government

Firms incur fixed and variable costs:

- Type k firm incurs a fixed cost $\gamma_k z$ and an uncertain variable cost $c(s)z$
- High-efficiency firms ($k = H$) have lower costs than low-efficiency firms ($k = L$):

$$\gamma_H < \gamma_L \text{ and } \int c(s) f_H(s) \mathrm{d}s < \int c(s) f_L(s) \mathrm{d}s.$$

Government designs base and variable payments, and winner selection rule:

- Government's realized cost:

$$h^n(s;k,x)z = \Big(\underbrace{p^n(k,x) + q^n(s;k,x)}_{\text{pecuniary}} + \underbrace{b(x)}_{\text{non-pecuniary}} \Big) z$$

- Government's auction design problem:

$$H(n;z) = \min_{p^n, q^n, \Phi^n} \int \underbrace{\int h^n(s;k,x) z \, f_k(s) \, \mathrm{d}s}_{\text{Expected cost if winner is } (k,x)} \underbrace{n \Phi^n(k,x) g(k,x) \mathrm{d}k \mathrm{d}x}_{\text{Prob of winner is } (k,x)},$$

s.t. firms' IR, IC, and limited liability constraints

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Solution - winner selection rule

- The government awards the project to the firm with the lowest value of

$$\overbrace{b(x)}^{\text{Non-pecuniary component}} + \overbrace{\underbrace{C(k)}_{\text{Firm expected execution cost}} + \underbrace{\mathbb{1}_{k=L}\Upsilon(x)}_{\text{Extra cost from private type}}}^{\text{Pecuniary component}}$$

- Ties are broken randomly

Outline

FPDS procurement Data

- Covers nearly all federal procurement contracts
  - including their initiations and subsequent modifications
- Provides detailed contract-level information:
  - Basic information:
    procuring subagency, winning contractor, industry
  - Solicitation information:
    competitive or non-competitive solicitations, number of bids
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Firm characteristics data

Political alignment between the firm and the subagency

- Firm political affiliation:
  - Political Action Committee (PAC) donations from FEC
  - Firm executives' political affiliation from L2 Inc
- Procuring subagency heads' political affiliation:
  - Official sources

    e.g., official websites, Marquis Who's Who, U.S. Government Manual
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Firm characteristics data (Cont'd)

Carbon emission intensity: from Trucost

Female leadership dummy: Whether a firm has female executives

China connection: Whether a firm has a customer/supplier based in China

- Based on supply-chain relationship data from FactSet Revere

Controls: the firm's brand value from BAV, past contracting experience, and size

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Estimation procedure - Bayesian estimation

Step 1 - Externally estimated distributions:

- Firm type and characteristics distribution, $g(k, x)$
- Outcome distribution of each type, $f_k(s)$

Step 2 - Bayesian approach to estimate the structural parameters:

- Assume

$$b(x) = \sum_{l \in \mathcal{L}} \beta_l x_l + \beta_\epsilon \epsilon, \quad \mathcal{L} = \{\text{poli}, \text{emit}, \text{fem}, \text{china}, \text{past}, \text{brand}, \text{size}\},$$

  where ϵ captures characteristics unobserved by the econometrician

- Estimate joint posterior of parameters and ϵ for all observations

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Key structural estimates

Table: Estimates of the weights β on the four ideological characteristics

	Political alignment	Carbon emission	Female leadership	China connection
IT	−8.07	100.34	34.31	13.51
	(1.53)	(2.96)	(2.81)	(5.17)
Office	−2.51	0.99	6.31	−0.65
	(0.82)	(1.90)	(1.20)	(1.08)
T&L	14.39	7.86	1.86	6.75
	(2.81)	(1.12)	(0.77)	(1.31)

A positive β means the government prefers this characteristic to be lower

But the magnitude of β is not directly comparable across characteristics and industries

Outline

Impact of firms' ideological characteristics

How do the firm's ideol. char. affect its cash flow from procurement?

- Simulate the median firm's type and characteristics over time
- Compute the firm's average cash flow from procurement
- Compute % diff. in cash flow with the firm with 1-STD lower average ideol. char.

(%)	Political alignment	Carbon emission	Female leadership	China connection
IT	−2.77			
Office				
T&L				

IT: ↓ average political alignment ⇒ ↓ average cash flow from procurement

Firms less politically aligned derive slightly less cash flows from procurement

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(%)	Political alignment	Carbon emission	Female leadership	China connection
IT	−2.77	10.06		
Office				
T&L				

IT: ↓ average carbon emission ⇒ ↑ average cash flow from procurement

Firms with lower emission derive significantly more cash flows from procurement

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(%)	Political alignment	Carbon emission	Female leadership	China connection
IT	−2.77	10.06	9.62	
Office				
T&L				

IT: ↓ average female leadership presence ⇒ ↑ average cash flow from procurement

Firms with less female leadership presence derive significantly more cash flows

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(%)	Political alignment	Carbon emission	Female leadership	China connection
IT	−2.77	10.06	9.62	2.92
Office				
T&L				

IT: $\downarrow$ average connection to China $\Rightarrow \uparrow$ average cash flow from procurement

Firms less connected to China derive slightly more cash flows

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(%)	Political alignment	Carbon emission	Female leadership	China connection
IT	−2.77	10.06	9.62	2.92
Office	−9.02	2.97	17.67	0.42
T&L				

Office: Firms less politically aligned derive significantly less cash flows

Firms with less female leadership presence derive significantly more cash flows

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(%)	Political alignment	Carbon emission	Female leadership	China connection
IT	−2.77	10.06	9.62	2.92
Office	−9.02	2.97	17.67	0.42
T&L	19.41	12.16	−0.38	6.89

Transportation & logistics : Firms that are less politically aligned, have lower emission, or are less connected to China derive significantly more cash flows

Measure Ideological Customer Capital

Measure ideological customer capital (ICC) attributed to the government

- Compute each procurement firm's expected cash flows conditional on ideol. char. We consider conditioning on all 4 ideol. char. and on each ideol. char.
- Aggregate procurement firms' expected cash flows to CRSP parent firm level
- Compute ICC as the ratio of expected procurement cash flows over income

$$ICC = \frac{\sum_{s \in \text{Subsiadiary}} \mathbb{E}\left(\text{Procurement Cash Flow} | s\text{'s Ideol. Char.}\right)}{\text{Firm Income}}$$

Asset Pricing Implications

What are the implications of ICC for asset prices?

- Examine the effect of ICC on firm exposure to aggregate cash flow risk

$$\widetilde{r}_{i,t} = \beta_0 + \beta_1 \widetilde{x}_t + \beta_2 \text{ICC}_{i,t-1} + \beta_3 \widetilde{x}_t \times \text{ICC}_{i,t-1} + \epsilon_{i,t},$$

- $\widetilde{r}_{i,t}$: firm i's accumulated log excess return
- $\widetilde{x}_t$: accumulated market log return on equity or log dividend growth
- $ICC_{i,t-1}$: the measures of ideological customer capital.

	(1)	(2)	(3)	(4)	(5)
	Overall	Individual Ideological Characteristic			
		Political alignment	Carbon emission	Female leadership	China connection
			A. Log ROE		
$\widetilde{x}_t$	1.729	1.731	1.729	1.729	1.730
	(0.150)	(0.150)	(0.150)	(0.150)	(0.150)
$\widetilde{x}_t \times \text{ICC}_{i,t-1}$	−2.184	−2.484	−2.241	−2.088	−2.248
	(0.231)	(0.300)	(0.256)	(0.229)	(0.255)
			B. Dividend growth		
$\widetilde{x}_t$	0.732	0.733	0.732	0.732	0.732
	(0.055)	(0.055)	(0.055)	(0.055)	(0.055)
$\widetilde{x}_t \times \text{ICC}_{i,t-1}$	−1.399	−1.517	−1.404	−1.299	−1.411
	(0.478)	(0.562)	(0.504)	(0.480)	(0.499)

Asset Pricing Implications

What are the implications of ICC for asset prices?

- Examine the effect of ICC on firm exposure to aggregate cash flow risk

$$\widetilde{r}_{i,t} = \beta_0 + \beta_1 \widetilde{x}_t + \beta_2 \text{ICC}_{i,t-1} + \beta_3 \widetilde{x}_t \times \text{ICC}_{i,t-1} + \epsilon_{i,t},$$

  - $\widetilde{r}_{i,t}$: firm i's accumulated log excess return
  - $\widetilde{x}_t$: accumulated market log return on equity or log dividend growth
  - $ICC_{i,t-1}$: the measures of ideological customer capital.

	(1)	(2)	(3)	(4)	(5)
	Overall	Individual Ideological Characteristic			
		Political alignment	Carbon emission	Female leadership	China connection
			A. Log ROE		
$\widetilde{x}_t$	1.729	1.731	1.729	1.729	1.730
	(0.150)	(0.150)	(0.150)	(0.150)	(0.150)
$\widetilde{x}_t \times \text{ICC}_{i,t-1}$	−2.184	−2.484	−2.241	−2.088	−2.248
	(0.231)	(0.300)	(0.256)	(0.229)	(0.255)
			B. Dividend growth		
$\widetilde{x}_t$	0.732	0.733	0.732	0.732	0.732
	(0.055)	(0.055)	(0.055)	(0.055)	(0.055)
$\widetilde{x}_t \times \text{ICC}_{i,t-1}$	−1.399	−1.517	−1.404	−1.299	−1.411
	(0.478)	(0.562)	(0.504)	(0.480)	(0.499)

Conclusion

Develop and estimate an auction model for procurement process

- The government has the discretion to consider ideological factors
- We derive closed-form solutions and construct a novel dataset for estimation

Examine firms' ideological customer capital (ICC) attributed to the government

- Ideological characteristics significantly affect firm cash flow from procurement
  These effects vary significantly across industries
- Construct empirical measures of ICC associated with all and each ideol. char.
- Firms with higher ICC are less exposed to aggregate cash flow risk

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