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Does it help to have friends in high places? Bank stock performance and congressional committee chairmanships

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ABSTRACT

Does a politician with power in the U.S. Congress positively affect the value of firms headquartered in their home state? We investigate this question by examining the profitability and stock performance of commercial banks. Banks can be enormously influenced by the political and regulatory environment. We find that banks headquartered in states where a Senator or member of the House of Representatives serves as the chairman on their respective banking committee in Congress outperform banks headquartered in other states. In addition, we find that this "chair effect" is more pronounced when the committee chairs are strongly aligned with other politicians in Congress, when they are more experienced, and when banks are clustered in the home state, suggesting that the potential benefits generated from chairmanship are in more demand. Overall, our results suggest that there are some important value implications of a local politician's power in Congress.

1. Introduction

A growing body of research finds that political connections may be valuable for organizations (Fisman, 2001; Johnson and Mitton, 2003; Faccio, 2006; Faccio et al., 2006; Ferguson and Voth, 2008; Niessen and Ruenzi, 2010; Chaney et al., 2011, among others). The importance of these connections has also been highlighted as firms adopt a variety of political strategies, such as adding politically connected individuals to their board of directors (Goldman et al., 2009, 2013), making significant political campaign contributions (Cooper et al., 2010) or incurring significant lobbying expenditures (Hill et al., 2011). In contrast, other recent work found that when a member of a state's delegation becomes chair of a powerful committee in the U.S. Congress, there typically will be a positive inflow of federal spending in that state, but there can also be negative impacts on private businesses in that state as they may be pushed to downsize (Cohen et al., 2011). Thus, there is some question about the net effects of political power and connections in specific industries and in particular states.

This paper focuses on the interplay of political power and firm performance in the banking industry. Specifically, we consider whether or not banks headquartered in a particular state experience significantly higher returns when their respective members of the U.S. Congress hold seats of influence on banking committees. That the political environment affects banking is clear; the industry has certainly undergone significant change over the past 30 years, consolidating from over 15,000 banks to fewer than 7000 today. As a regulated industry, banking is clearly affected by actions taken by the Congress, with numerous major legislative actions passed over the last several decades. Among those are the Financial Institutions Reform, Recovery and Enforcement Act of 1989 (FIRREA), the FDIC Improvement Act of 1991, the Riegle-Neal Interstate Banking Act of 1994, the Gramm-Leach-Bliley Act of 1999, the Sarbanes-Oxley Act of 2002, and others. In the U.S., banking is one of the most heavily regulated industries, with industry structure, lending and borrowing activity, deposit insurance, and other activities being reviewed and questioned by various governmental authorities. The banking industry now finds itself in a unique position among industry groups in the United States with the onset of the financial crisis, additional regulations imposed by the Dodd-Frank Act, increased scrutiny from Congress, the White House, the Federal Reserve and others concerned about the flow of money and credit in the economy. Barth et al. (2012) provide a comprehensive summary of these developments. The banking industry is now perhaps more heavily influenced by regulatory and legislative actions than at any time in recent history. This suggests that bankers must be highly attuned to the political environment given the possible impact of new legislation or regulatory changes.

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Given the importance of the legislative environment, banks have traditionally been active in the political arena through organizations such as the American Bankers Association and others. While the overall involvement of the industry would seem to indicate that there are positive expected benefits from that political activity, a question arises about the distribution of those benefits. This question has yet to be answered in the banking literature. This study looks at political influence as measured by whether or not a bank's home state Senator or Congressman chairs their respective banking committee, examining whether such a position of considerable political power and influence measurably affects the stock performance of banks in that member's state. Since the chair has the power to set the legislative agenda in their respective committees, the chair is in a position to have a strong influence on what legislation is brought to a vote, what hearings are held, which industry officials or CEOs (if any) are called to testify, which issues are discussed, and so on. We are not claiming that there is any sort of specific "quid-pro-quo" between members of the House and Senate and their home state banking interests (nor need there be for stock market participants to act as if there was one); we simply examine whether there appear to be any differences in stock performance measures.

Our findings indicate that when one of the Senators or members of the House of Representatives serves as a chairman on the respective banking committee in the Congress, banks in their home state outperform those in other states, ceteris paribus. It is worth emphasizing that our results are not driven by the choice of estimation methodology. We conduct various robustness tests based on state-fixed effect, firm-fixed effect, White's (1980) heteroskedasticity correction, and OLS without any fixed effects and heteroskedasticity correction. Throughout these different robustness checks, our results remain unaltered.

We also address endogeneity concerns. If a state includes many banks which perform well, this economic situation might lead to banks in that state pushing one of their state's elected representatives for the banking committee chairmanship. To address this potential problem, we examine the change in bank performance around chair change events. Consistent with our expectation, the results show that local banks' performance is improved after their state's politician becomes the chair of the banking committee. If a political leader becomes a new chair of the banking committee, banks headquartered in that home state see an improvement in their ROA by 1.05% following the chair change event. This improvement is substantial; it is larger in magnitude than the sample ROA's standard deviation of 0.99%.

This *chair effect* is found to be correlated with the chair's political power and experience in the Congress as well as the political environment he faces. We find that the effect is most powerful when the committee chairs are strongly aligned (through being in the same political party) with other politicians in Congress, when they are relatively more experienced, and when bank headquarters are clustered in their home state. While the results indicate a positive effect on firm value, we do not suggest any overt legislative action demonstrating favoritism by any member of the U.S. House or Senate. Nonetheless, as a highly regulated industry, the results do strongly suggest that the power of political connections in Washington matters, even if simply by affecting market perceptions, and that these effects on bank stock performance are both statistically significant and substantial in size.

The paper is structured as follows. Section 2 addresses the related literature. Section 3 describes the data sources and how the dataset was constructed. Section 4 contains a discussion of the paper's main results, based on univariate and multi-factor regression tests of the relationship between bank performance and banking committee chairmanship. Section 5 contains additional tests performed in order to clarify the nature of the aforementioned relationship. Section 6 provides the time-series asset pricing tests, and the last section contains concluding remarks.

2. Political connections in the banking industry

2.1. Political connections and effects

Most of the aforementioned research has focused more on political influence on regulatory issues as well as monetary and fiscal policy issues in the broader sense. Little work has been done in terms of relating the direct influence of U.S. Congressional leadership to bank performance, and linking that back to specific states. For general industries, various corporate political strategies have been studied, including building political connections by contributing money to politician's campaigns. Cooper et al. (2010) find that corporate contributions to political campaigns are positively and significantly correlated with the firms' future returns. Moreover, this effect is stronger when firms support more candidates who hold their office in the same state that the firm is based. One may think of that as something of a "home state" bias with regard to political influence.

Corporate lobbying may also be viewed as an investment. As noted in De Figueiredo and Silverman (2006) and Milyo et al. (2000), corporate lobbying is one of the primary avenues through which firms attempt to influence policy. According to Hill et al. (2011), between 1998 and 2006, lobbying expenditures increased from $1.45 billion to $2.6 billion and the number of registered lobbyists grew from 10,693 to 15,247. Yu and Yu (2011) state that more than half of former Senators and House members become lobbyists for companies after leaving elected office. The disclosure of lobbying expenditures has been mandated since the Lobbying Disclosure Act of 1995. Hill et al. (2011) find that lobbying firms significantly outperform non-lobbying firms, suggesting that lobbying can be a strategically effective way to increase firm value.

Firms can also be politically connected through their top management group or board of directors. Goldman et al. (2009) refer to a USA Today report indicating that by the year 2000 at least 55% of the Fortune 1000 firms had a politically connected individual on their boards. They show that stock-price responses to the Republican win in the 2000 presidential election were positive for companies connected to the Republican Party and negative for those connected to the Democratic Party.

2.2. Political connections in the banking industry

The banking committees in Congress oversee the financial services industry as well as considering the work of the Federal Reserve, the U.S. Department of the Treasury, the U.S. Securities and Exchange Commission, and other financial services regulators. In our sample period, 1989–2010, all Senate banking chairs have worked on the Committee on Banking, Housing, and Urban Affairs. The House banking committee has been under different official titles in our study period. The chairmen in our sample are spread out into three eras: Henry Gonzalez on Banking, Finance, and Urban Affairs (1989–1994); James Leach on Banking and Financial Services (1995–2001); and Michael Oxley and Barney Frank on Financial Services (2001–2010). The chair of the committee enjoys considerable power to set the legislative agenda and shape the debate on regulations affecting the financial services industry. Thus, while every member of the Senate or House of Representatives has some political power and influence, the chair of the committee enjoys a great deal more power than other members. A simple but telling reflection of that power is that major legislative acts sometimes become known by the names of the chairmen; Sarbanes-Oxley and Dodd-Frank are good examples. Because of this power, we fo-

cus on the committee chair as the key position of political power and influence.

As noted earlier, there has been relatively little in the literature in regard to the effects of political connections in the banking industry. However, Kroszner (1999) considers the connection between politics and the banking system in his expository work. He draws a number of conclusions. First, he argues that interest groups and their competition can be a determinant of final regulations in the financial system. He cites Kane (1996) who contended that parties on both sides of the interstate banking issue (i.e., regulators and certain banking entities) each tended to offer misleading information regarding the costs associated with such geographic expansion. Kroszner further contends that interest group competition can serve to mitigate self-serving regulation. He also found that the organizational structure for both regulatory offices and other similar governmental institutions can be influential. His fifth major point is that greater transparency can also serve to reduce any inefficiencies caused by undue political influence. A final conclusion of Kroszner is that a greater foreign presence typically means less well connected entities and hence a better prospect of positive reforms and regulations.

In a later study, Kroszner (2001) also examined political effects on banking deregulation, specifically with regard to branching, over a 30 year period. Essentially, his work attempted to determine whether branching deregulation was accelerated or delayed due to political influence. Looking at action to deregulate intrastate branching, Kroszner found that the time to deregulate was slowed when the share of smaller banks in a state was larger, where banks were allowed to engage in insurance activities, and when the influence of the Democrat party was larger. Kroszner then considered political influence on branching deregulation at the federal level. Focusing on the Riegle-Neal Interstate Banking Act of 1994 and several related legislative actions, he again finds that financial deregulation was dependent to a degree on the percent of small banks in a given state.

Sapienza (2004), in a study of Italian banks finds that election results do indeed affect bank lending actions. Another study by Micco et al. (2007) considered bank performance and ownership in a multi-country context by comparing state owned vs. private banks. They conclude that public or state owned banks tend to have different levels of performance and that difference increases during election cycles. Their study covers a number of countries and uses a dummy variable to indicate an election cycle. To further analyze any differences, they consider developing countries vs. developed countries. The findings do vary, with state owned banks located in developing countries showing lower return on assets than privately owned banks.

There is the issue of the transmission of any influence from the political environment to bank performance. As we have stated, it is not possible to identify any specific legislative quid-pro-quo between a political leader and any particular bank. However, banks headquartered in a state where an elected official holds a chair position may derive some benefit from having greater access to that official on the local level and hence a greater ability to discuss and perhaps convince that elected official of a particular position on some banking issue. In the United States, members of the U.S. House and Senate return frequently to their home states for meetings with citizens at large and with constituent groups such as bankers. Most states have some banking organizations and typically will invite Congressional officials to meet and speak with these groups. Hence, those banks may be able to advance their positions, or at least be sure that their positions are well known to their Senators or Congressmen. As an example, in the current debate over Basel III, many small and community bankers feel these standards impose unduly high costs of compliance, and bankers may indeed be lobbying to gain relief from these costly regulatory provisions. Senators and congressmen will generally listen to issues of concern to everyone in their home state constituencies; one would expect that if and when the state bankers association contacted their elected representatives, they would be listened to carefully.

3. Data and sample selection

We collect all firm-year observations for firms with Standard Industry Classification (SIC) code of 6020, which includes commercial banks, for a sample period, 1989–2010, drawing from both CRSP as well as Compustat. This is a useful time period to study as meaningful regulatory changes in banking industry were made frequently in this period. In our tests, we do not consider the entire congressional membership of the banking committee (we focus on the chair) to study political influences on banks. There are several reasons to consider the chair states only. First, if we consider the states of all members in the banking committee, too many states (especially for the House) are included in the politically connected group (e.g. almost every bank would be considered politically connected). Second, the chairs of the committees are regarded as the members who are by far the most politically influential. It is the chair who has the ability to schedule hearings and committee votes. Hence the chair has significant power to either push legislation through the process or to delay or squash legislation. Therefore, we focus on the chair as the key position of political influence in our study.

Our data on stock prices for the banks are obtained from the Center for Research in Security Prices (*CRSP*). From *Compustat*, we obtain annual data on accounting variables as well as the geographic location of firm headquarters. We require a firm to have financial and accounting data on both *CRSP* and *Compustat*. We exclude firms in the District of Columbia because our study utilizes a set of political variables that are only available at the state level. Following prior research (Fahlenbrach and Stulz, 2011, among others), we exclude small banks whose total assets are less than $1 billion. These requirements yield a final sample of 505 commercial banks with 4333 bank-year observations.

We hand-collect the biographical and political information from *Wikipedia* (http://www.wikipedia.org/) and other sites such as *Biographical Directory of the United States Congress* (http://bioguide.congress.gov/biosearch/biosearch.asp). This includes information on the controlling parties in Congress and biographical information about the chairmen of the respective banking committees in the U.S. Congress. We use several political variables to test whether the chair effect is purely a political effect (not other state-fixed effect). These additional political proxies include: politicians' voting records from Voteview (http://www.voteview.com/) and voter turnout rates from the PEW Center on the States (http://www.pewcenteronthestates.org/).

Table 1 presents descriptive statistics for the banking committee chairs. There are six different chairmen in the Senate and four different chairmen in the House of Representatives over the 11 Congresses we study, from 101st to 111th. We observe that 279 (6.44%) out of 4333 bank-years are defined to have a chair effect. The party affiliation is evenly distributed with three Democrats and three Republicans from the Senate group. The House group has two Democrats and two Republicans. They are not from any one state in any given Congress but rather are across nine different states including Michigan, New York, Texas, Maryland, Alabama, Connecticut, Iowa, Ohio and Massachusetts. The average years of service in Congress while holding the chair position ranges from 15.5 to 35.5 years. The youngest chair in the sample was Donald Riegle of Michigan and his average age during his service time

Table 1
Summary of banking committee chairs.

	Year	Congress	Chamber	Committee	State	Party	Average service year in Congress while in chair service	Average age while in chair service
Donald Wayne Riegle, Jr.	1989–1994	101–103	Senate	Banking, Housing, and Urban Affairs	Michigan	Democratic	24.5	53.5
Alfonse Marcello D'Amato	1995–1998	104–105	Senate	Banking, Housing, and Urban Affairs	New York	Republican	15.5	59.5
William Philip Gramm	1990–2000	106	Senate	Banking, Housing, and Urban Affairs	Texas	Republican	20.5	57.5
Paul Spyros Sarbanes	2001–2002	107	Senate	Banking, Housing, and Urban Affairs	Maryland	Democratic	30.5	68.5
Richard Craig Shelby	2003–2006	108–109	Senate	Banking, Housing, and Urban Affairs	Alabama	Republican	25.5	70.5
Christopher John Dodd	2007–2010	110–111	Senate	Banking, Housing, and Urban Affairs	Connecticut	Democratic	33.5	64.5
Henry Barbosa Gonzalez	1989–1994	101–103	House	Banking, Finance, and Urban Affairs	Texas	Democratic	30.5	75.5
James Albert Smith Leach	1995–2000	104–106	House	Banking and Financial Services	Iowa	Republican	20.5	55.5
Michael Garver Oxley	2001–2006	107–109	House	Financial Services	Ohio	Republican	30.5	59.5
Barney Frank	2007–2010	110–111	House	Financial Services	Massachusetts	Democratic	35.5	68.5

This table provides the biographical and political information of chairmen of the banking committees in the U.S. Congress for the period, 1989–2010. We hand-collect the information from *Wikipedia* (http://www.wikipedia.org/) and other sites such as *Biographical Directory of the United States Congress* (http://bioguide.congress.gov/biosearch/biosearch.asp). The *Wikipedia* web addresses of banking committee chairs are as follows. Donald Wayne Riegle, Jr. (http://en.wikipedia.org/wiki/Donald_W._Riegle,_Jr.), Alfonse Marcello D'Amato (http://en.wikipedia.org/wiki/Al_D'Amato), William Philip Gramm (http://en.wikipedia.org/wiki/Phil_Gramm), Paul Spyros Sarbanes (http://en.wikipedia.org/wiki/Paul_Sarbanes), Richard Craig Shelby (http://en.wikipedia.org/wiki/Richard_Shelby), Christopher John Dodd (http://en.wikipedia.org/wiki/Chris_-Dodd), Henry Barbosa Gonzalez (http://en.wikipedia.org/wiki/Henry_B._Gonzalez), James Albert Smith Leach (http://en.wikipedia.org/wiki/Jim_Leach), Michael Garver Oxley (http://en.wikipedia.org/wiki/Mike_Oxley), and Barney Frank (http://en.wikipedia.org/wiki/Barney_Frank).

was 53.5 years old, which is 22 years younger than the most senior chair, Henry Gonzalez of Texas, who was 75.5 years old.

4. Findings

4.1. Descriptive statistics

Before introducing the various empirical tests, we present the summary statistics of the sample. In Panel A of Table 2 our sample firms display an average ROA of 0.79%, with a standard deviation of 0.99%. In the following tests, we find that the average ROA difference between the firms in the chair states and others is about 0.15%. The return difference is particularly meaningful because only bank location is considered and everything else is assumed to be equal. The average firm in the sample generates an income of $0.2B, has total assets of $23.5B, and presents a book-to-market ratio of 0.9447.

We present state-level descriptive statistics in Panel B. There are 880 state-years, i.e. 40 states in each year.[1] In the later section, we use state-level political information to understand the connection effect generated from the banking committee chair. Two variables are collected to measure aspects of the chair's political environment. They are the *voter turnout rate* and the *number of banks* located in the state. Panel B shows an average *voter turnout rate* of 0.5033 with a standard deviation of 0.1120. We find that each state on average has five banks within its borders.

Panel C provides statistics for yearly variables that are used to proxy for the chair's political power and experience. *Perfect party alignment* is an indicator that takes a value of 1 if two banking committee chairs, the President and majority groups in two chambers are aligned in one party, and 0 otherwise. There are only 8 years (i.e., 36% of 22 years in the report) that have a perfect party alignment. *Party unity vote rate* is the rate of party unity votes, where a party unity vote is defined when at least 50% of one party votes against at least 50% of the other party. The average value of the two chambers is used. We find that 56% of votes made were party unity vote. The chairs of the respective banking committees have average service years in Congress of 27 years and their age averages 63 years old. Democrat presidents held office for ten of the sample years (i.e., 45% of 22 years).

4.2. Chair effect on local bank performance

We examine the significance and magnitude of the *chair effect* on local bank performance utilizing univariate tests and regression analysis. Panel A of Table 3 reports the mean values of ROAs for *chair* group and *not chair* group, where *chair* (*not chair*) includes banks located in a state where one (none) of the state's Senators or House Representatives serves as chair of the banking committee in Congress. Consistent with our expectation, the *chair* group presents a higher mean ROA than the *not chair* group. The difference in ROA between the two groups is 0.15%, which is statistically significant at a 1% level, and economically substantial given the fact that mean and median ROA is 0.79% and 1.01%, respectively.

We next test the relationship between *chair* and ROA with other controls such as firm size and book-to-market.

$$ROA = \beta_0 + \beta_1 Chair + \beta_2 Size + \beta_3 Book\text{-}to\text{-}market + \sum \beta\, State, \quad (1)$$

where *Size* is measured by the natural log of one plus market value of common equity (items 24 × 25). *Book-to-market* is computed by the ratio of total assets (item 6) to the market value of firm (total assets (item 6) − the book value of common equity (item 60) + the market value of common equity (items 24 × 25)). We also include the state-fixed effects.

The intercept in this regression is the chair effect on non-local banks, and the coefficient on *Chair* (β_1) represents the chair effect (i.e., additional ROA effect to chair state banks). Panel B of Table 3

[1] It indicates that there are 10 states per year that do not have any bank headquarters, but it should not be interpreted that no banks are available in these states.

Table 2
Descriptive statistics.

	N	Mean	Standard deviation	Minimum	Median	Maximum
Panel A: Firm-year variables						
Return on assets	4333	0.0079	0.0099	−0.0459	0.0101	0.0207
Income before extraordinary items	4333	198	951	−5611	27	21,111
Total assets	4333	23,521	116,039	1000	3203	2,264,909
Size	4333	22.3039	1.3777	20.7236	21.8874	28.4486
Book-to-market	4333	0.9447	0.1514	0.4266	0.9489	10.0679
Panel B: State-year variables						
Voter turnout rate	880	0.5033	0.1120	0.2020	0.5048	0.7837
Number of banks	880	4.9261	4.3428	1.0000	3.5000	28.000
Panel C: Year variables						
Perfect party alignment	22	0.3636	0.4924	0.0000	0.0000	1.0000
Unit vote rate	22	0.5600	0.0587	0.4640	0.5583	0.6717
Congress experience	22	26.7727	5.7812	16.0000	28.0000	36.0000
Seniority	22	62.9091	3.9359	55.5000	64.0000	68.0000
Democratic presidency	22	0.4545	0.5096	0.0000	0.0000	1.0000

This table provides descriptive statistics for the sample. *Return on assets* = the ratio of income before extraordinary items (Compustat item 18) to total assets (item 6). *Size* = the natural log of one plus market value of common equity (items 24 × 25). *Book-to-market* = the ratio of total assets (item 6) to the market value of firm (total assets (item 6) − the book value of common equity (item 60) + the market value of common equity (items 24 × 25)). *Voter turnout rate* = the rate of voters who made effective votes. *Number of banks* = the number of commercial banks whose total assets are greater than 1 billion dollars in the state. *Perfect party alignment* = an indicator that takes 1 if two banking committee chairs, the President and majority groups in two chambers are aligned in one party, and 0 otherwise. *Party unity vote rate* = the rate of party unity votes, where a party unity vote is defined when at least 50% of one party vote against at least 50% of the other party. The average value of two chambers is used. *Congress experience* = the two chairs' average service year in Congress while in chair service. *Seniority* = the two chairs' average of ages while in chair service. *Democratic presidency* = a dummy that takes 1 if the President belongs to the Democratic Party, and 0 otherwise.

gives a detailed overview of our regression results. The estimated coefficient on *chair* is 0.0014 ($t = -2.17$) in the model that omits other firm variables. The estimate suggests that if we move from a *not chair* state to a *chair* state, the implied increase in ROA is 0.14%, similar to the 0.15% reported in the univariate test above. This strong relation persists when we include other controls in model [II]. The other variables (*size* and *book-to-market*) show signs consistent with findings in Fahlenbrach and Stulz (2011) and they are statistically significant at the l% level.

We conduct robustness checks to see whether our results are sensitive to the method of estimation. Petersen (2009) argues that any chosen method can be incorrect and yield different results in many cases. Therefore, we re-examine the relationship using several different methods to see whether our findings stand. First, we estimate the relationship using an ordinary least squares (OLS) model without any fixed effects and without heteroskedasticity correction (models [I] and [II]). Second, we estimate the model using White's (1980) robust standard errors to address heteroskedasticity problems (models [III] and [IV]). Third, we report results controlling for firm-fixed effects instead of state-fixed effects (models [V] and [VI]). The results of these robustness checks are reported in Panel C. We find that all regressions show a consistent pattern of committee chairmanship on home state bank stock returns. Therefore, the results we find using state-fixed effects in Panel B are confirmed by several alternative estimation methods.

4.3. Change in bank performance following chair events

This sub-section presents evidence on bank performance changes following changes in chairmanship as a means of addressing endogeneity issues. In particular, there is a possibility of reverse causality in that local banks with high performance may push strongly to have a committee chairman from that home state. In order to address this issue, we focus on the change in bank performance around chair change events. Specifically, we measure how bank performance is changed between 1-year before and 1-year after the change in chairmanship.

In Panel A of Table 4, we directly compare the performance (ROA) between before and after the chair change using only the sample of banks that experience chair changes. We separate the change into two different cases: (1) not chair to chair and (2) chair to not chair.[2] We find that local bank's performance (ROA) increases when none of politicians was the chair in the banking committee but one of them becomes the chair. We also find that local bank performance decreases in the cases where no local politician holds the chair position, although one was the chair a year before.

We then create chair change variables to test them in our regression models. We code $\Delta Chair_{y-1,y}$ with 1 if none of the state's Senators or House Representatives is chair on the banking committee in Congress in the previous year $y-1$, but one of them becomes the chair in year y. It has a value of −1 if one of the state's Senators or House Representatives was chair in year $y-1$ but none of them holds the chair position in year y. We assign 0 for the firms whose states do not show any change in chairmanship between year $y-1$ and y. We also test the model by separating the chairmanship changes into two groups. Therefore, the two additional variables are as follows. $\Delta Chair^{+}_{y-1,y}$ equals 1 if none of the state's Senators or House Representatives is chair on the banking committee in Congress in the previous year $y-1$ but one of them becomes the chair in year y, and 0 otherwise. In contrast, $\Delta Chair^{-}_{y-1,y}$ equals 1 if one of the state's Senators or House Representatives was chair in year $y-1$ but none of them holds the chair position in year y, and 0 otherwise. Finally, we compute the change in ROA around these chair events, i.e. ROAs between year $y-1$ and $y+1$.

Table 4 presents the estimated coefficient on the change in chairmanship in the state-fixed effect regression of changes in ROA. The results conform to our expectation that local banks' performance is improved after a state's politician assumes the chair position on the banking committee. The effect related to the positive impact from the chair event is substantially large. The estimated coefficient on $\Delta Chair_{y-1,y}$ is 0.0105 with a t-statistic of 6.00 in model [II] in which we control for size and book-to-market.[3] This evidence suggests that if one of the Senators or House

[2] We would like to thank an anonymous referee for his or her suggestion on the endogenous test and this separation test.

[3] The results hold even if we use changes in size and book-to-market in lieu of raw values.

Table 3
Chairing the banking committee and local bank performance.

	Return on assets
Panel A: Comparison of ROAs	
Not chair	0.0078
Chair	0.0093
Chair − Not chair	0.0015***
[*p*-value]	[0.0063]

	Dependent variable: ROA	
	[I]	[II]
Panel B: Chair effect on local bank performance		
Chair	0.0014**	0.0014**
	(2.17)	(2.09)
Size		0.0005***
		(4.60)
Book-to-market		−0.0126***
		(−13.15)
Constant	0.0078***	0.0081***
	(50.82)	(2.97)
State-fixed effects	Yes	Yes
No. of observations	4333	4333
R-squared	0.0014	0.0504

Dependent variable: ROA	Basic OLS		Heteroskedasticity		Firm-fixed effects	
	[I]	[II]	[III]	[IV]	[V]	[VI]
Panel C: Robustness Checks						
Chair	0.0015**	0.0012**	0.0015***	0.0012***	0.0012*	0.0014**
	(2.49)	(2.07)	(3.34)	(2.86)	(1.70)	(2.15)
Size		0.0005***		0.0005***		−0.0022***
		(4.53)		(4.52)		(−8.71)
Book-to-market		−0.0136***		−0.0136		−0.0106***
		(−13.95)		(−1.15)		(−11.09)
Constant	0.0078***	0.0098***	0.0078***	0.0098	0.0078***	0.0068***
	(49.91)	(3.74)	(49.12)	(0.77)	(56.31)	(11.65)
State-fixed effects	No	No	No	No	No	No
Firm-fixed effects	No	No	No	No	Yes	Yes
No. of observations	4333	4333	4333	4333	4333	4333
R-squared	0.0014	0.0505	0.0014	0.0505	0.0014	0.0494

Panel A reports the mean values of return on assets and the mean difference test on the third row. *Return on assets* = the ratio of income before extraordinary items (Compustat item 18) to total assets (item 6). *Chair* indicates that the bank is located in the state where one of the state's Senators or House Representatives is the chair on the banking committee in Congress. *Not chair* indicates that the bank is located in the state where none of the state's Senators or House Representatives is the chair on the banking committee in Congress. Panel B reports the estimated coefficients of state-fixed effect regression. *Size* = the natural log of one plus market value of common equity (items 24 × 25). *Book-to-market* = the ratio of total assets (item 6) to the market value of firm (total assets (item 6) − the book value of common equity (item 60) + the market value of common equity (items 24 × 25)). Panel C reports robustness checks of the regressions. Models [I] and [II] conducts an ordinary least squares (OLS) model without any fixed effects and heteroskedasticity correction. Models [III] and [IV] report results using standard errors robust to White's (1980) heteroskedasticity. Models [V] and [VI] report results controlling for firm-fixed effects.

*** Significance at the 1% level
** Significance at the 5% level.
* Significance at the 10% level.

members becomes a new chair of the banking committee, banks in their home state exhibit a large improvement in stock returns of about 1.05% between 1-year before and after the chair event. The improvement is slightly more than one standard deviation, 0.99%. Moreover, the results also indicate that local banks see performance worse than before if their home state politician resigns from the chair position in Congress.

In the following regressions [III] to [VIII], we separate the bank chair change in two ways. Consistent with the results obtained from the general change variable ($\Delta Chair_{y-1,y}$), we find that a positive change (not chair to chair, $\Delta Chair^{+}_{y-1,y}$) is associated with positive bank performance change, while a negative change (chair to not chair, $\Delta Chair^{-}_{y-1,y}$) is related with negative bank performance change.

5. Understanding the chair effect

As mentioned earlier, the chair effect could be viewed as the result of local banks' connections with politicians in positions of power who may provide influence or superior information on political developments. As noted earlier, these benefits may be either real or perceived.

In this section we present and discuss tests designed to address the relative importance of the aforementioned view of the chair effect. To operationalize this, we employ a number of political variables (state-year variables and year variables) to understand how and when the chair effects occur. We expect that the chair effect could be affected by political environment the bank chair faces, by political structure in different eras, or even by the chair's own characteristics. We therefore examine by interacting the bank chair effect with the chair's political power, political experience, community's political effect, and a particular presidency.

5.1. Chair's political power and the chair effect

First, we examine whether a chair's political power is partly responsible for the chair effect. We expect the political effect the bank chair can generate to be stronger when politicians are more aligned, consistent with Kim et al. (2012) show that a positive political effect on stock returns is stronger when more local politi-

Table 4
Change in bank performance following chair events.

	Before change			After change				After − Before
Panel A: Comparison of ROA between before and after bank chair change								
Not chair to chair		0.0082			0.0216			0.0134***
Chair to not chair		0.0114			0.0050			−0.0064***
Dependent variable: $\Delta ROA_{y-1,y+1}$	[I]	[II]	[III]	[IV]	[V]	[VI]	[VII]	[VIII]
Panel B: Regression analysis								
$\Delta Chair_{y-1,y}$	0.0105***	0.0105***						
	(6.01)	(6.00)						
$\Delta Chair^{+}_{y-1,y}$			0.0145***	0.0146***			0.0142***	0.0142***
			(5.93)	(5.94)			(5.80)	(5.81)
$\Delta Chair^{-}_{y-1,y}$					−0.0071***	−0.0070***	−0.0063**	−0.0062**
					(−2.66)	(−2.63)	(−2.36)	(−2.33)
Size		0.0002		0.0002		0.0002		0.0002
		(0.63)		(0.72)		(0.64)		(0.67)
Book-to-market		−0.0056***		−0.0057***		−0.0056***		−0.0056***
		(−2.92)		(−2.95)		(−2.91)		(−2.94)
Constant	−0.0019***	−0.0019***	−0.0021***	−0.0006	−0.0018***	0.00004	−0.0020***	−0.0003
	(−6.17)	(−6.17)	(−6.81)	(−0.11)	(−5.69)	(0.01)	(−6.46)	(−0.05)
State-fixed effects	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
No. of observations	3742	3742	3742	3742	3742	3742	3742	3742
R-squared	0.0092	0.0122	0.0110	0.0141	0.0008	0.0037	0.0116	0.0146

Panel A compares ROA between before and after bank chair change. Panel B reports the estimated coefficients of state-fixed effect regression. *Return on assets* = the ratio of income before extraordinary items (Compustat item 18) to total assets (item 6). We compute the change in ROA ($\Delta ROA_{y-1,y+1}$) around these chair events, i.e. ROAs between year $y-1$ and $y+1$. $\Delta Chair_{y-1,y} = 1$ if none of the state's Senators or House Representatives is chair on the banking committee in Congress in the previous year $y-1$, but one of them becomes the chair in year y; −1 if one of the state's Senators or House Representatives was chair in year $y-1$ but none of them holds the chair position in year y; or 0 if the firms whose states do not show any change in chairmanship between year $y-1$ and y. $\Delta Chair^{+}_{y-1,y} = 1$ if none of the state's Senators or House Representatives is chair on the banking committee in Congress in the previous year $y-1$ but one of them becomes the chair in year y, and 0 otherwise. $\Delta Chair^{-}_{y-1,y} = 1$ if one of the state's Senators or House Representatives was chair in year $y-1$ but none of them holds the chair position in year y, and 0 otherwise. *Size* = the natural log of one plus market value of common equity (items 24 × 25). *Book-to-market* = the ratio of total assets (item 6) to the market value of firm (total assets (item 6) − the book value of common equity (item 60) + the market value of common equity (items 24 × 25)).

*** Significance at the 1% level.

** Significance at the 5% level.

cians are aligned with the President's party. We devise two dimensions based on politicians' party affiliation and the party unity vote rate in the Congress in order to measure the level of a chair's political power. The first variable (*perfect party alignment*) is a variable to capture perfect party alignment among important political groups. It takes a value of one if two banking committee chairs, the President and majority groups in two chambers are aligned in one party. The bank chair effect can be more effective if the members in Congress tend to make party unity votes. The party unity vote is defined when at least 50% of one party vote against at least 50% of the other party. We construct the second variable (*party unity vote rate*) as the rate of party unity votes. Because *perfect party alignment* is a time variable to indicate a year of perfect party alignment, we only convert *party unity vote rate* to a time indicator (*High party unity vote rate*) that takes a value of 1 if the party unity vote rate is higher than the median value of the sample period and 0 otherwise.

Panel A of Table 5 reports the ROAs of the sub-groups formed after sorting on chairmanship and political power. The univariate tests show that the chair effect is sizeable and highly significant when a chair has strong political power, whereas it becomes weaker when a chair does not have power. More specifically, if we move a firm from the *not chair* group to the *chair* group and if the chair has power in their political service, ROA improves by 0.35%. This magnitude is 2.3 times greater than what we report earlier for the whole sample in Table 3. However, the positive chair effect diminishes when the chairs are not powerful.

In the cross-sectional regression models, we interact the political variables with *Chair*.

$$ROA = \beta_0 + \beta_1 Chair + \beta_2 Political\ \ variable + \beta_3 Chair * Political\ \ variable + \beta_4 Size + \beta_5 Book\text{-}to\text{-}market + \sum \beta\, State, \quad (2)$$

where *political variable* is alternatively *perfect party alignment* or *high unity vote rate*.[4] We report the regression results in Panel B. The results show that the interactions of the *chair* variable with political power proxies are positive and significant (see columns [II] and [IV]). The estimated coefficient is 0.0037 and is statistically significant at the 1% level in the two models. It suggests that a significant portion of the chair effect is coming from the interacted term (β_3). One interesting result we find is that the 'pure' chair effect (i.e., the coefficient on *chair*) is insignificant once we control for this interaction effect. Therefore, these results suggest that chair's political power, measured by *perfect party alignment* and *party unity vote rate*, extensively explains the *chair* effect. In particular, the political power or influence a chair possesses seems to exaggerate the beneficial chair effects on local banks' performance.

5.2. Chair's political experience and the chair effect

The past literature has shown that senior politicians are more influential and powerful. For instance, Blanes i Vidal et al. (2010) argue the level of politician's seniority is valuable. They find that lobbyists connected to the most senior exiting Senators suffer a significant decrease in revenue, while lobbyists connected to exiting junior Senators are statistically unaffected by such exit.

Therefore, we extend our investigation on the chair effect by exploring whether the positive relationship between chairmanship and local bank ROA is exacerbated by the chair's political experience. As found in the previous tests, we expect that the chair may have greater effect on home state banks through valuable connections when the chair has more experience. Further, the committee chairs would have more strong networks in the Congress when

[4] In the following tests, *Political variable* is alternatively *long Congress experience*, *high seniority*, *high turnover rate*, *bank clustering*, or *Democratic presidency*.

Table 5
Chair's political power and the chair effect.

	No perfect party alignment	Perfect party alignment	Perfect − No perfect [*p*-value]
Panel A: Comparisons of ROAs			
Not chair	0.0085	0.0068	−0.0017*** [0.0000]
Chair	0.0087	0.0103	0.0015** [0.0425]
Chair − Not chair [*p*-value]	0.0003 [0.3410]	0.0035*** [0.0014]	
	Low party unity vote rate	High party unity vote rate	High − Low [*p*-value]
Not chair	0.0095	0.0065	−0.0030*** [0.0000]
Chair	0.0094	0.0093	−0.0001 [0.4470]
Chair − Not chair [*p*-value]	−0.0001 [0.4048]	0.0027*** [0.0028]	

	Dependent variable: ROA			
	[I]	[II]	[III]	[IV]
Panel B: Chair effect on local bank performance				
Chair	0.0014** (2.11)	0.000002 (0.00)	0.0013** (2.02)	−0.0007 (−0.76)
Perfect party alignment	−0.0015*** (−5.06)	−0.0017*** (−5.66)		
*Chair * Perfect party alignment*		0.0037*** (2.90)		
High party unity vote rate			−0.0026*** (−9.02)	−0.0029*** (−9.53)
*Chair * High party unity vote rate*				0.0037*** (3.05)
Size	0.0005*** (4.51)	0.0005*** (4.46)	0.0005*** (4.47)	0.0005*** (4.47)
Book-to-market	−0.0127*** (−13.30)	−0.0127*** (−13.31)	−0.0125*** (−13.09)	−0.0125*** (−13.10)
Constant	0.0091*** (3.32)	0.0093*** (3.40)	0.0099*** (3.65)	0.0101*** (3.72)
State-fixed effects	Yes	Yes	Yes	Yes
No. of observations	4333	4333	4333	4333
R-squared	0.0560	0.0572	0.0676	0.0684

Panel A reports the mean values of return on assets and the mean difference tests. *Return on assets* = the ratio of income before extraordinary items (Compustat item 18) to total assets (item 6). *Chair* indicates that the bank is located in the state where one of the state's Senators or House Representatives is the chair on the banking committee in Congress. *Not chair* indicates that the bank is located in the state where none of the state's Senators or House Representatives is the chair on the banking committee in Congress. *Perfect party alignment* = an indicator that takes 1 if two banking committee chairs, the President and majority groups in two chambers are aligned in one party, and 0 otherwise. *Party unity vote rate* = the rate of party unity votes, where party unity vote is defined when at least 50% of one party vote against at least 50% of the other party. The average value of two chambers is used. *High party unity vote rate* = a time indicator that takes 1 if *party unity vote rate* is higher than the median value of the sample period and 0 otherwise. Panel B reports the estimated coefficients of state-fixed effect regression. *Size* = the natural log of one plus market value of common equity (items 24 × 25). *Book-to-market* = the ratio of total assets (item 6) to the market value of firm (total assets (item 6) − the book value of common equity (item 60) + the market value of common equity (items 24 × 25)).

*** Significance at the 1% level.

** Significance at the 5% level.

they have served a longer period than other chairs. We measure the chair's political experience in two ways. First, we count the total years the chair serves in the U.S. Congress while he is on the chair position. We compute the average value of chairs in two chambers. Second, we collect a chair's seniority by averaging two chairs' ages. We also create two time indicators using these two political experience variables.

Table 6 reports the test results of the interaction of the political experience measures with the *chair* effect. In Panel A we show that the chair effect is associated with higher returns when the chair has more service years. This effect disappears when the chair is relatively less experienced, even turning negative, although it is not statistically significant. More specifically, chair state banks present an average ROA of 0.94%, which is actually 0.05% lower than the average ROA of the banks in not chair states. The positive bank chair effect is strongly shown when the chair's Congress experience is relatively high. The table presents that the difference in ROA is 0.35% with the 1% significance level. This pattern is also shown when we consider the chair's age in lieu of the number of years of service. The average ROA of chair state banks is 0.03% lower when the chairs are younger. The effect, however, becomes beneficial and very positive (i.e., the difference is 0.32%) when the chairs are older.

A politician's age may serve as a proxy for other factors not as easily measured such as knowledge of an industry, and the number of industry connections and contacts. Certainly, in a legislative sense, age may capture other experience outside of Congressional service. The old adage that "with age comes wisdom" comes to mind here.

Panel B provides results we obtain when we re-examine the same issues but in a setting of cross-sectional tests of ROAs. We include *chair*, the political experience variable and their interaction in addition to other control variables. In line with the evidence in Panel A, the coefficient of the interaction term is positive and sig-

Table 6
Chair's political experience and the chair effect.

	Short Congress experience	Long Congress experience	Long − Short [*p*-value]
Panel A: Comparisons of ROAs			
Not chair	0.0099	0.0057	−0.0042*** [0.0000]
Chair	0.0094	0.0092	−0.0002 [0.4140]
Chair − Not chair [*p*-value]	−0.0005 [0.1685]	0.0035*** [0.0014]	
	Low seniority	High seniority	High − Low [*p*-value]
Not chair	0.0101	0.0054	−0.0046*** [0.0000]
Chair	0.0097	0.0087	−0.0011 [0.1093]
Chair − Not chair [*p*-value]	−0.0003 [0.2437]	0.0032*** [0.0041]	

	Dependent variable: ROA			
	[I]	[II]	[III]	[IV]
Panel B: Chair effect on local bank performance				
Chair	0.0011*	−0.0009	0.0010	−0.0010
	(1.76)	(−1.10)	(1.61)	(−1.22)
Long Congress experience	−0.0035***	−0.0039***		
	(−12.41)	(−13.03)		
Chair ∗ Long Congress experience		0.0048***		
		(3.93)		
High seniority			−0.0040***	−0.0044***
			(−14.16)	(−14.78)
Chair ∗ High seniority				0.0051***
				(4.15)
Size	0.0005***	0.0005***	0.0005***	0.0005***
	(4.39)	(4.37)	(4.46)	(4.46)
Book-to-market	−0.0118***	−0.0118***	−0.0117***	−0.0117***
	(−12.49)	(−12.45)	(−12.49)	(−12.47)
Constant	0.0098***	0.0100***	0.0099***	0.0100***
	(3.65)	(3.72)	(3.69)	(3.76)
State-fixed effects	Yes	Yes	Yes	Yes
No. of observations	4333	4333	4333	4333
R-squared	0.0832	0.0849	0.0926	0.0937

Panel A reports the mean values of return on assets and the mean difference tests. *Return on assets* = the ratio of income before extraordinary items (Compustat item 18) to total assets (item 6). *Chair* indicates that the bank is located in the state where one of the state's Senators or House Representatives is the chair on the banking committee in Congress. *Not chair* indicates that the bank is located in the state where none of the state's Senators or House Representatives is the chair on the banking committee in Congress. *Congress experience* = the two chairs' average service year in Congress while in chair service. *Seniority* = the two chairs' average of ages while in chair service. *Long Congress experience* = a time indicator that takes 1 if *congress experience* is longer than the median value of the sample period and 0 otherwise. *High seniority* = a time indicator that takes 1 if *seniority* is higher than the median value of the sample period and 0 otherwise. Panel B reports the estimated coefficients of state-fixed effect regression. *Size* = the natural log of one plus market value of common equity (items 24 × 25). *Book-to-market* = the ratio of total assets (item 6) to the market value of firm (total assets (item 6) − the book value of common equity (item 60) + the market value of common equity (items 24 × 25)).
*** Significance at the 1% level.
* Significance at the 10% level.

nificant, which again suggests that the *chair* effect is larger when a chair is more experienced in the Congress. Overall, the results from Tables 5 and 6 can be interpreted as consistent with the notion that the *chair* effect is enhanced by the chair's political power and experience.

5.3. Community's political influence and the chair effect

In our analysis thus far we have not considered the dynamic nature of the political environment and chairmanship. In this sub-section we examine whether the strength of the *chair* effect varies with political environment and level of activity. We posit that the political environment for the chair is more 'serious' when his state residents are more active in voting. Also, the chair effect would be more in demand if relatively more banks are located in the home state. We collect information on the percent of voters who cast effective votes. The variable is denoted as the *Voter turnout rate*. This variable represents action by a rational voter who wants to exhibit own political preference. Rational voters participate only when expected benefits from voting exceed costs (Downs, 1957; Dhillon and Peralta, 2002; Geys, 2006). Bartle (1997) argues that one with more political knowledge is more likely to participate in voting. Therefore, we expect that the chair will generate more beneficial effects to his state especially when his state residents are more knowledgeable in politics and expect more benefits.

Consequently, two dummy variables are created by the community political influence variables. *High voter turnout rate* is a dummy variable that takes 1 if *voter turnout rate* is higher than the median value of the sample period and 0 otherwise, while *bank clustering* is a dummy variable that equals 1 if the *number of banks* is higher than the median value of the state-year sample and 0 otherwise. For the number of banks, we include commercial banks whose total assets are greater than 1 billion dollars in the state.

We perform univariate analysis and cross-sectional tests to examine the importance of the community influence on the *chair* effect, and document these results in Table 7. Panel A reports that bank stock returns are more strongly related to the chair effect

Table 7
Community's political influence and the chair effect.

	Low voter turnout rate	High voter turnout rate	High − Low [*p*-value]
Panel A: Comparisons of ROAs			
Not chair	0.0081	0.0075	−0.0007*** [0.0183]
Chair	0.0077	0.0097	0.0021** [0.0276]
Chair − Not chair [*p*-value]	−0.0005 [0.3568]	0.0023*** [0.0010]	
	No bank clustering	Bank clustering	Clustering − No clustering [*p*-value]
Not chair	0.0075	0.0080	0.0005** [0.0452]
Chair	0.0054	0.0111	0.0057*** [0.0000]
Chair − Not chair [*p*-value]	−0.0021** [0.0366]	0.0030*** [0.0000]	

	Dependent variable: ROA			
	[I]	[II]	[III]	[IV]
Panel B: Chair effect on local bank performance				
Chair	0.0014** (2.17)	−0.0012 (−0.85)	0.0014** (2.10)	−0.0021* (−1.88)
High voter turnout rate	−0.0003 (−0.73)	−0.0004 (−0.97)		
Chair ∗ High voter turnout rate		0.0033** (2.10)		
Bank clustering			−0.0001 (−0.23)	−0.0008 (−1.26)
Chair ∗ *Bank clustering*				0.0052*** (3.77)
Size	0.0005*** (4.57)	0.0005*** (4.54)	0.0005*** (4.60)	0.0005*** (4.53)
Book-to-market	−0.0126*** (−13.15)	−0.0126*** (−13.13)	−0.0126*** (−13.15)	−0.0125*** (−13.08)
Constant	0.0083*** (3.03)	0.0085*** (3.07)	0.0082*** (2.98)	0.0086*** (3.14)
State-fixed effects	Yes	Yes	Yes	Yes
No. of observations	4333	4333	4333	4333
R-squared	0.0511	0.0516	0.0499	0.0513

Panel A reports the mean values of return on assets and the mean difference tests. *Return on assets* = the ratio of income before extraordinary items (Compustat item 18) to total assets (item 6). *Chair* indicates that the bank is located in the state where one of the state's Senators or House Representatives is the chair on the banking committee in Congress. *Not chair* indicates that the bank is located in the state where none of the state's Senators or House Representatives is the chair on the banking committee in Congress. *Voter turnout rate* = the rate of voters who made effective votes. *High voter turnout rate* = a dummy variable that takes 1 if *voter turnout rate* is higher than the median value of the state-year sample and 0 otherwise. *Bank clustering* = a dummy variable that takes 1 if the *number of banks* is higher than the median value of the state-year sample and 0 otherwise, where *number of banks* is the number of commercial banks whose total assets are greater than 1 billion dollars in the state. Panel B reports the estimated coefficients of state-fixed effect regression. *Size* = the natural log of one plus market value of common equity (items 24 × 25). *Book-to-market* = the ratio of total assets (item 6) to the market value of firm (total assets (item 6) − the book value of common equity (item 60) + the market value of common equity (items 24 × 25)).
*** Significance at the 1% level.
** Significance at the 5% level.
* Significance at the 10% level.

when the local residents are more actively involved in political elections. The return difference is large and significant only when the state has a high voter turnout rate and more banks than average. Interestingly, ROA is significantly lower for the chair banks when banks are not clustered in the chair's state. This may shed light on the fact that committee chairs have a stronger incentive to support banks when they are clustered in his home area. The regression results in Panel B are consistent with the findings in the univariate tests. The interaction terms between chair and the community influence variables have positive effects on bank returns. In particular, the coefficient on chair in column [IV] is negative ($t = -1.88$) confirming the lost connection effect in a no bank-clustering state.

5.4. Democratic presidency and the chair effect

Next, we examine the chair effect under different presidencies to see whether presidential party explains the relationship between chairmanship and local bank performance. One of the myths of the stock market is that the financial markets prefer Republican presidencies. Republicans have been viewed as the party of business by some. However, higher average returns have been obtained during Democrat administrations than during Republican administrations. Kim et al. (2012), Santa-Clara and Valkanov (2003), Chittenden et al. (1999), and Huang (1985) report much higher excess returns in the market during Democrat administrations than during Republican administrations. As many prominent journalists often express, the two parties differ much in their approach to major issues of policy. Kiewiet and Krehbiel (2002) show that a change from a Republican to a Democrat President increases predicted discretionary spending. Therefore, it is expected that positive value effects of chairmanship would be stronger under Democratic presidency.

Panel A of Table 8 reports the ROAs of the sub-groups formed after sorting on chairmanship and presidential party affiliation. Consistent with our expectation, the test shows that the chair effect is only significant under Democrat presidential administra-

Table 8
Democratic presidency and the chair effect.

	Republican presidency	Democratic Presidency	Democratic – Republican [*p*-value]
Panel A: Comparisons of ROAs			
Not chair	0.0082	0.0073	−0.0009***
			[0.0026]
Chair	0.0090	0.0099	0.0009
			[0.1505]
Chair – Not chair	0.0008	0.0026***	
[*p*-value]	[0.1359]	[0.0093]	

	Dependent variable: ROA [I]	[II]
Panel B: Chair effect on local bank performance		
Chair	0.0013**	0.0002
	(2.00)	(0.25)
Democratic presidency	−0.0012***	−0.0013***
	(−3.98)	(−4.37)
Chair ∗ Democratic presidency		0.0026**
		(2.00)
Size	0.0005***	0.0005***
	(4.63)	(4.68)
Book-to-market	−0.0127***	−0.0127***
	(−13.25)	(−13.25)
Constant	0.0086***	0.0086***
	(3.16)	(3.14)
State-fixed effects	Yes	Yes
No. of observations	4333	4333
R-squared	0.0521	0.0527

Panel A reports the mean values of return on assets and the mean difference tests. *Return on assets* = the ratio of income before extraordinary items (Compustat item 18) to total assets (item 6). *Chair* indicates that the bank is located in the state where one of the state's Senators or House Representatives is the chair on the banking committee in Congress. *Not chair* indicates that the bank is located in the state where none of the state's Senators or House Representatives is the chair on the banking committee in Congress. *Democratic presidency* = a dummy that takes 1 (0) if the President belongs to the Democratic (Republican) Party. Panel B reports the estimated coefficients of state-fixed effect regression. *Size* = the natural log of one plus market value of common equity (items 24 × 25). *Book-to-market* = the ratio of total assets (item 6) to the market value of firm (total assets (item 6) – the book value of common equity (item 60) + the market value of common equity (items 24 × 25)).
*** Significance at the 1% level.
** Significance at the 5% level.

Table 9
Time-series tests of monthly returns,

	Constant	$R_m^M - R_m^F$	*SMB*	*HML*	*UMD*	*R*-squared
Panel A: Chair and not chair portfolios						
Not chair portfolio	0.0008	0.7779***	0.4500***	0.8001***	−0.0724*	0.6029
	(0.39)	(15.41)	(6.85)	(11.36)	(−1.70)	
Chair portfolio	0.0050*	0.7039***	0.3502***	0.7546***	−0.1584***	0.4938
	(1.94)	(11.81)	(4.51)	(9.08)	(−3.15)	
Panel B: Zero net investment portfolio						
Arbitrage portfolio	0.0041*	−0.0741	−0.0998	−0.0455	−0.0860**	0.0274
(Chair – Not chair)	(1.92)	(−1.47)	(−1.53)	(−0.65)	(−2.03)	

This table reports the estimated coefficients in the time-series tests of four-factor models for the chair and not-chair portfolios and for the arbitrage portfolio that were formed by buying the banks in the chair states and selling the banks in the no-chair states. The sample includes 264 monthly observations spanning from January 1989 to December 2010.

$$R_m^C - R_m^F (\text{or } R_m^{NC} - R_m^F) = \alpha_0 + \beta_1 (R_m^M - R_m^F) + \beta_2 SMB_m + \beta_3 HML_m + \beta_4 UMD_m + e_m,$$
$$R_m^C - R_m^{NC} = \alpha_0 + \beta_1 (R_m^M - R_m^F) + \beta_2 SMB_m + \beta_3 HML_m + \beta_4 UMD_m + e_m,$$

where R_m^C is the portfolio that includes banks in the state where one of Senators and House Representatives serves as a chairman on the banking committee. R_m^{NC} is the portfolio that includes banks in the state where none of Senators and House Representatives are a chairman. R_m^F = the 1-month Treasury bill rate. R_m^M = the value-weighted market return. *SMB* (small minus big) = the difference each month between the return on small and big firms, while *HML* (high minus low) = the monthly difference of the returns on a portfolio of high book-to-market and low book-to-market firms. *UMD* (up minus down) = the momentum factor computed on a monthly basis as the return differential between a portfolio of winners and a portfolio of losers.
*** Significance at the 1% level.
** Significance at the 5% level.
* Significance at the 10% level.

tions. Under Democrat presidential administrations, the difference in ROA between the chair and not chair groups is 0.26% with a 1% significance level. This reduces to 0.08% under Republican administrations. In Panel B, the cross-sectional model shows that the

Table 10
Time-series tests of monthly returns: Interactions with political variables.

	No perfect party alignment	Perfect party alignment	Perfect – No perfect
Panel A: No perfect party alignment vs. Perfect party alignment			
Not chair portfolio	0.0066**	−0.0075**	−0.0141***
	(2.45)	[4.40]	(−3.15)
Chair portfolio	0.0086***	−0.0013	−0.0099*
	(2.70)	[0.09]	(−1.86)
Arbitrage portfolio	0.0020	0.0062*	
(Chair – Not chair)	(0.76)	[3.09]	
	Low party unity vote rate	High party unity vote rate	High – Low
Panel B: Low party unity vote percentage vs. High party unity vote percentage			
Not chair portfolio	0.0069**	−0.0040	−0.0110**
	(2.18)	[2.03]	(−2.57)
Chair portfolio	0.0094**	0.0011	−0.0083*
	(2.52)	[0.10]	(−1.67)
Arbitrage portfolio	0.0025	0.0051*	
(Chair – Not chair)	(0.77)	[3.24]	
	Short Congress experience	Long Congress experience	Long – Short
Panel C: Short Congress experience vs. Long Congress experience			
Not chair portfolio	0.0039	−0.0064**	−0.0103**
	(1.35)	[4.55]	(−2.47)
Chair portfolio	0.0065*	−0.0010	−0.0075
	(2.52)	[0.09]	(−1.51)
Arbitrage portfolio	0.0025	0.0053*	
(Chair – Not chair)	(0.82)	[2.91]	
	Low seniority	High seniority	High – Low
Panel D: Low seniority vs. High seniority			
Not chair portfolio	0.0059**	−0.0070**	−0.0129***
	(2.04)	[5.22]	(−3.06)
Chair portfolio	0.0065*	0.0004	−0.0061
	(1.89)	[0.01]	(−1.22)
Arbitrage portfolio	0.0006	0.0074**	
(Chair – Not chair)	(0.21)	[5.61]	
	Republican Presidency	Democratic Presidency	Democratic – Republican
Panel E: Republican Presidency vs. Democratic Presidency			
Not chair portfolio	0.0028	−0.0029	−0.0057
	(0.97)	[0.81]	(−1.32)
Chair portfolio	0.0027	0.0067*	0.0040
	(0.78)	[2.97]	(0.77)
Arbitrage portfolio	−0.0001	0.0096***	
(Chair – Not chair)	(−0.04)	[8.84]	

This table reports the estimated intercept coefficient (i.e., the "alpha" or abnormal return) from time-series tests of four-factor models where the dependent variables are the monthly returns of portfolios formed after double-sorting on the chair indicator and on other political variables. The sample includes 264 monthly observations spanning from January 1989 to December 2010.

$$R_m^C - R^F (\text{or } R_m^{NC} - R_m^F) = \alpha_0 + \beta_1 (R - m^M - R_m^F) + \beta_2 SMB_m + \beta_3 HML_m + \beta_4 UMD_m + e_m,$$

$$R_m^C - R_m^{NC} (\text{or} R_m^H - R_m^L) = \alpha_0 + \beta_1 (R_m^M - R_m^F) + \beta_2 SMB_m + \beta_3 HML_m + \beta_4 UMD_m + e_m,$$

where R_m^C is the portfolio that includes banks in the state where one of Senators and House Representatives serves as a chairman on the banking committee. R_m^{NC} is the portfolio that includes banks in the state where none of Senators and House Representatives are a chairman. R_m^H is the portfolio that includes firms with the high values of political variables (i.e., perfect party alignment in Panel A, high unit vote rate in Panel B, long Congress experience in Panel C, high seniority in Panel D, and Democratic presidency in Panel E). R_m^L is the portfolio that includes firms with the low values of political variables (i.e., no perfect party alignment in Panel A, low unit vote rate in Panel B, short Congress experience in Panel C, low seniority in Panel D, and Republican presidency in Panel E). R_m^F = the 1-month Treasury bill rate. R_m^M = the value-weighted market return. *SMB* (small minus big) = the difference each month between the return on small and big firms, while *HML* (high minus low) = the monthly difference of the returns on a portfolio of high book-to-market and low book-to-market firms. *UMD* (up minus down) = the momentum factor computed on a monthly basis as the return differential between a portfolio of winners and a portfolio of losers. Political variables are as follows. *Perfect party alignment* = an indicator that takes 1 if two banking committee chairs, the President and majority groups in two chambers are aligned in one party, and 0 otherwise. *Unit vote rate* = the rate of unit votes, where a party unit vote is defined when at least 50% of one party vote against at least 50% of the other party. The average value of two chambers is used. *Congress experience* = the two chairs' average service year in Congress while in chair service. *Seniority* = the two chairs' average of ages while in chair service. *Democratic presidency* = a dummy that takes 1 (0) if the President belongs to the Democratic (Republican) Party.

*** Significance at the 1% level.

** Significance at the 5% level.

* Significance at the 10% level.

interactions of *chair* with *democratic presidency* is positive and significant (see columns [II]). The estimated coefficient of 0.0026 indicates that the chair effect on ROA under Democrat administrations is 0.26%, the same as the finding in the univariate test.

6. Time-series asset pricing tests

We examine the risk-adjusted return performance of portfolios formed after sorting on chairmanship every 2 years using a time-

series asset pricing model that includes the Fama and French (1992, 1993) risk factors and momentum factors.

$$R_m^C - R_m^F (\text{or } R_m^{NC} - R_m^F) = \alpha_0 + \beta_1 (R_m^M - R_m^F) + \beta_2 SMB_m + \beta_3 HML_m + \beta_4 UMD_m + e_m, \quad (3)$$

where R_m^C and R_m^{NC} are the *chair* portfolio's and the *not chair* portfolio's monthly return, respectively, R_m^F is the 1-month Treasury bill rate, R_m^M is the value-weighted market return, *SMB* (small minus big) is the difference between the monthly returns of the small and large firm portfolios, *HML* (high minus low) is the difference between the monthly returns of high book-to-market and low book-to-market firm portfolios, and *UMD* (up minus down) is the momentum factor computed as the monthly return differential between a portfolio of winners and a portfolio of losers. We also construct zero net investment portfolios formed by buying firms in the *chair* portfolio and selling the firms in the *not chair* portfolio. The monthly return of the zero-investment portfolio is the difference in returns between R_m^C and R_m^{NC}. The asset pricing model for the zero investment portfolio returns is as follows:

$$R_m^C - R_m^{NC} = \alpha_0 + \beta_1 (R_m^M - R_m^F) + \beta_2 SMB_m + \beta_3 HML_m + \beta_4 UMD_m + e_m. \quad (4)$$

The results are shown in Table 9. We do not find any significant abnormal return for the *not chair* group of firms. The estimation of model (1) yields an intercept of 0.0008 with a *t*-statistic value of 0.39. However, we find that it substantially increases to 0.0050 when firms are located in the state where a local politician holds a chair position in the banking committee. As shown in the *chair* arbitrage portfolio return regressions, a significant portion of the *chair* arbitrage portfolio returns cannot be explained by the conventional risk factors. For example, the average abnormal return of a zero-investment arbitrage portfolio that buys the *chair* firms and sells the *not chair* firms is 41 basis points per month, which is different from zero at the 10% level. This is particularly impressive in light of the fact that these portfolios do not need to be rebalanced on a monthly basis as is the case with most investment strategies yielding abnormal returns, but rather every 24 months. Thus, the asset pricing test results reveal a strong impact of likelihood of political connection on stock returns.

To gain further insight into the fundamental nature of the *chair* effect we estimate time series asset pricing models for different portfolios and present the intercepts and corresponding *t*-statistics in Table 10. In Panels A and B, we show the results obtained after forming test portfolios based on double-sorting on *chair*, and on the political power variables. These panels show that the *chair* arbitrage portfolio alpha is sizeable and significant only in the case of powerful chairs. In Panels C and D, we explore the possibility that the *chair* effect could be driven by the chair's political experience. The results indicate that the *chair* effect is significant when the chair is more experienced.[5] In Panel E, we find that the abnormal return of the arbitrage portfolio is larger under Democrat presidential administrations.

Overall, the asset pricing test results suggest that when the chair has more effective power or meaningful experience, the chair effect is stronger, but the conventional risk factors have limited ability to capture the political effects. In addition, a Democrat presidency generates a more pronounced chair effect.

[5] We do not test with a method of sorting the firms by chairmanship and community's political influence variables because we do not get a complete time series of returns for the chair group that is interacted by the high or low community influence groups.

7. Conclusions

This paper investigates the impact of influential politicians – those who hold congressional committee chairmanships – on banks with which they are politically connected by virtue of coming from the same home state. Such political connections can prove valuable as firms adjust their competitive strategies in their ongoing efforts to thrive in a changing competitive environment. As Congress has enacted numerous pieces of legislation that have impacted the banking industry over the past several decades, it is interesting and important to examine whether and to what extent there are value implications for banks of political connections.

In this paper we investigate the existence and magnitude of these potential value implications. Our results indicate that when one of the Senators or members of the House of Representatives serves as a chairman on their respective banking committee in Congress, banks headquartered in their home state tend to outperform those in other states. Our univariate test generates a result that banks in the *chair* states outperform those in the *not-chair* states by 0.15%. Our state-fixed effect model shows a similar implied effect of chairmanship on the performance of local banks, which is around 0.14%. We confirm that the regression results hold using various estimation methodologies. The difference in ROA is both statistically significant and sizable. In our sample period, the mean and median ROA for commercial banks is 0.79% and 1.01%, respectively. Our results indicate that being located in the chair states is associated with 0.14–0.15% improvement in ROA.

We address any endogeneity concern in our tests given the potential for such a problem if there is a possibility of reverse causality. That is, local banks with high performance levels may at least implicitly influence the selection of a home state Senator or House member to the chair position. To address this issue, we use the change in bank performance around chair change events, such as those that occurred when the majority party in control of either the Senate or the House switched between Democrats and Republicans, and vice versa. This event occurs several times, and is a good approximation to an exogenous shift that allows us to address the endogeneity issues, as it seems implausible that banks in one state can realistically cause the shift in the balance of power across the entire Senate or House of Representatives which leads to new committee chairs being selected. The results conform to our expectation that local bank performance is improved after that state's politician becomes the chair of the banking committee. When one of Senators or members of the House of Representatives becomes the new chair of the banking committee, banks in the home state realize an improvement in ROA between 1-year before and after the chair event; this improvement is around 1.05%, which is larger than one standard deviation across the dataset. Moreover, the results also indicate that local banks generate stock performance worse than before if their home state politician moves out of the committee chair position.

Additional tests show that the *chair* effect is explained in part by the chair's political power and experience in the Congress as well as the political environment he faces. We show that the effect is most powerful when the committee chairs are strongly aligned with other politicians in Congress, when they are relatively more experienced, and when the home state banking community contains a larger cluster of banking headquarters. In addition, a Democrat presidency is found to add strength to the chair effect.

The banking industry is highly regulated, and our results strongly suggest that the power of political connections in Washington matters for bank stock performance. While we certainly do not argue that such political connections directly drive legislative or regulatory decisions, nonetheless, there appears at least a perception in the market of some benefit by home state banks. In

summary, the results do suggest that it pays to have connections to people in high places.

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