

✦ Introduction

A majority of studies on the effects of politics on firms focus on developing countries. Using their findings, in this project , we tried to see if similar relationships can be found in pre-World War I London Banks.

Current analysis suggest that political connection provides both costs and benefits and rational firms , though not always successful, try to juggle the two for their gain. (Faccio, 2006.) Specifically, for banks we consider the following:

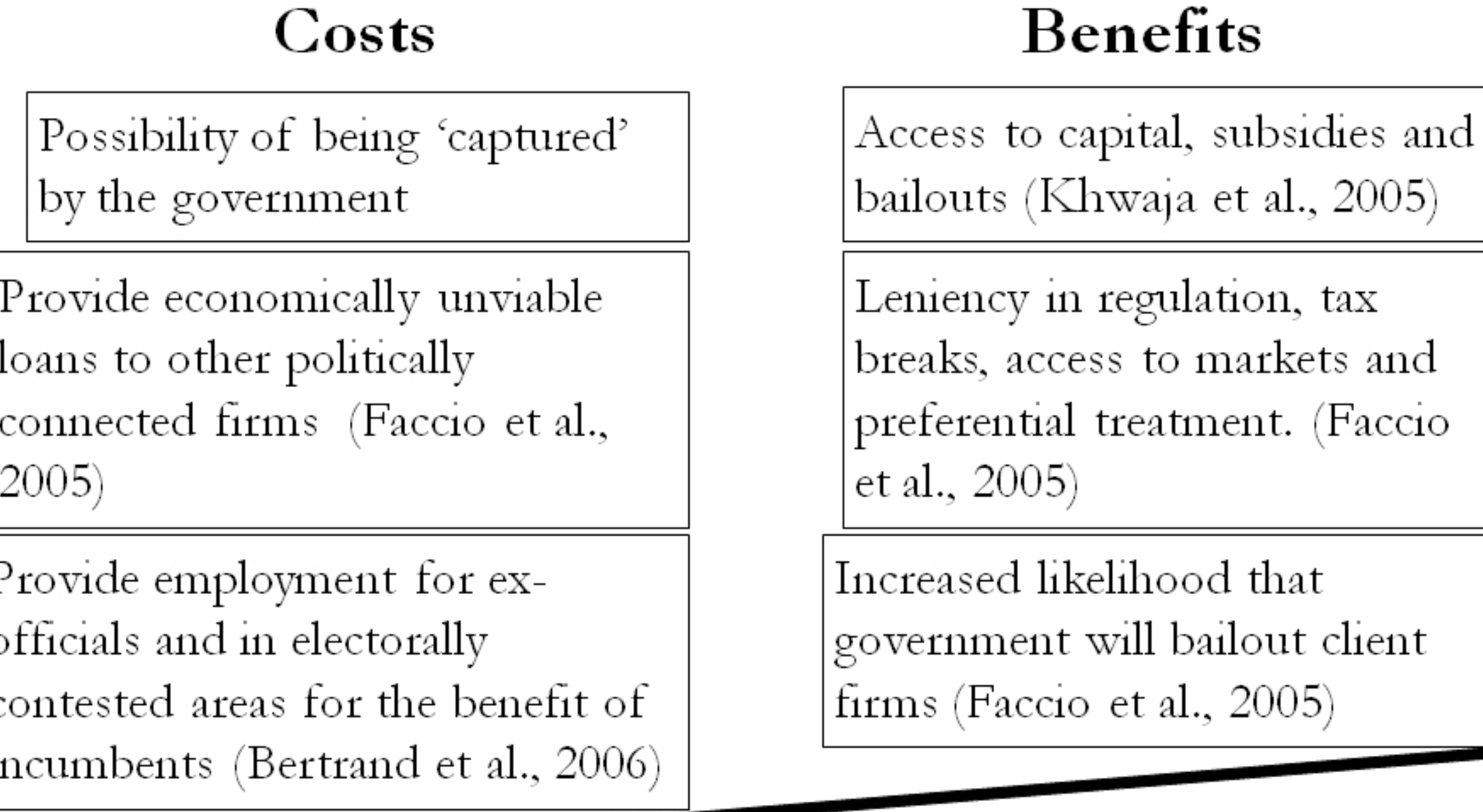


Diagram 1: Costs and Benefits of Political Connection

✦ Data and Variables

Our two major source are: *the Intelligence* and *the Yearbook*, stock market yearbooks published annually. These publications include information on the banks’ board members, stock prices & history. Since the members of the banks’ boards tend to remain the same, data was collected every two years from 1875 to 1913. Data on political connections were collected by taking note of the titles of the board members. Titles indicate service to the government, nobility, service to the monarchy, membership to special societies or a position in the parliament.

**Method:** We used the logistic model to explore possible correlations.

**Dependent Variables:**

**Distress** – A binary variable that indicates liquidation, suspension of payments, reconstruction, failure or takeover. The value 1 indicates having undergone “distress.”

**Merger** – A binary variable that indicates a merger or amalgamation. The value 1 indicates having undergone merger or amalgamation.

**Ltd** – A binary variable that indicates being listed as *Limited* or not at the point of entry in our data. The value 1 indicates as having limited liability.

**Independent Variables:**

**MP Dummy** takes the value of 1 if an MP, member of parliament, was present in the board for the year that the bank first appeared in the data.

**MP Ratio** is the ratio of the number of MPs over the total number of board members on the first year that the bank appeared.

**Title Dummy** takes the value of 1 if any board member has a title for the year that the bank first appeared in the data.

**Title Ratio** is the ratio of the number of titled individuals over the total number of board members on the first year that the bank appeared.

✦ Results

VARIABLES	(1) distress	(2) distress	(3) distress	(4) distress	(5) distress	(6) distress	(7) distress
MP Dummy	1.725*** (0.263)				1.258*** (0.337)		4.013*** (0.772)
MP ratio		7.673*** (1.326)				4.757*** (1.461)	-31.17*** (8.764)
Title Dummy			1.410*** (0.289)		0.718* (0.371)		0.196 (0.447)
Title Ratio				3.267*** (0.513)		2.737*** (0.578)	2.086*** (0.759)
Constant	-4.518*** (0.184)	-4.186*** (0.139)	-4.769*** (0.244)	-4.361*** (0.151)	-4.769*** (0.244)	-4.423*** (0.156)	-4.769*** (0.244)
Observations	3300	3260	3300	3260	3300	3260	3260
Standard errors in parentheses		*** p<0.01, ** p<0.05, * p<0.1					

VARIABLES	(8) merger	(9) merger	(10) merger	(11) merger	(12) merger	(13) merger	(14) merger
MP Dummy	1.087*** (0.209)				1.482*** (0.328)		3.957*** (0.823)
MP ratio		4.232*** (1.370)				4.677*** (1.347)	-29.86*** (9.691)
Title Dummy			0.336* (0.197)		-0.512* (0.310)		-0.455 (0.412)
Title Ratio				0.344 (0.597)		-0.390 (0.655)	-0.00849 (0.882)
Constant	-3.656*** (0.121)	-3.469*** (0.104)	-3.539*** (0.134)	-3.412*** (0.111)	-3.539*** (0.134)	-3.446*** (0.114)	-3.539*** (0.134)
Observations	3300	3260	3300	3260	3300	3260	3260
Standard errors in parentheses		*** p<0.01, ** p<0.05, * p<0.1					

VARIABLES	(15) Ltd	(16) Ltd	(17) Ltd	(18) Ltd	(19) Ltd	(20) Ltd	(21) Ltd
MP Dummy	1.149*** (0.107)				0.570*** (0.124)		-0.896*** (0.300)
MP ratio		12.40*** (1.105)				10.77*** (1.067)	15.44*** (2.992)
Title Dummy			0.999*** (0.0721)		0.786*** (0.0842)		1.106*** (0.145)
Title Ratio				2.451*** (0.319)		1.273*** (0.319)	-1.683*** (0.487)
Constant	0.0331 (0.0360)	0.00726 (0.0360)	-0.173*** (0.0423)	-0.0118 (0.0397)	-0.173*** (0.0423)	-0.0661 (0.0406)	-0.173*** (0.0423)
Observations	3637	3589	3637	3589	3637	3589	3589
Standard errors in parentheses		*** p<0.01, ** p<0.05, * p<0.1					

Our results indicate strong correlations between the presence of politically connected individuals on the board and key bank events and characteristics. The values presented in the tables are the coefficients obtained after estimating the logistic model.

- The chance of a Bank **distress** (equations 1 to 7) increases with the presence of both MPs , and in most cases with Titled individuals sitting in the board. The results are significant at the 5% level, suggesting strong correlations between the variables.
- The probability of Bank **mergers** (equations 8 to 14,) on the other hand, likewise increase with the presence of MPs, but not necessarily with that of titled individuals. Most of the results are also significant suggesting correlation between the variables, especially that representing the presence of MPs.
- Lastly, the probability that a Bank will have limited liability status (**Ltd**, equations 15 to 21,) increases with the presence of MPs and titled individuals. The values are significant suggesting strong correlations between the variables.

The values obtained are consistent with the results of other studies , that is political connections are correlated with bank performance. These correlations, likewise seem to coincide with the explanations presented in prior research.

✦ Further Research

The estimates presented on the left are initial work that ascertain a correlation between politics and bank performance in pre World War I London. Further work is needed to understand the entire picture.

- **Control for more factors** – Other factors that affect bank performance will be controlled for such as economic downturns and regions where the banks operated. This will help isolate the effects of having politically connected persons on the banks’ boards.
- Duration Models** – Duration models can be used to see how long banks survived as a performance indicator and how politically connected individuals affected them. Duration models can be used to account for the different lengths of time that banks existed as many banks closed and opened from 1875 to 1913.
- Stock Prices** – Data on stock prices have also been collected and can be used as an indicator of bank performance. Panel data estimations can be used and will allow us to consider changes over time in our model.
- Titles** – Our data likewise show variations in titles. Our current approach is to focus on the presence of MPs, as by the late 19<sup>th</sup> century, hold the most power in legislative affairs. Other titles, however, may also prove important as they indicate close relationship with the nobility or service to British Empire.

✦ Reference

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