

CEO Political Values and Crash Risk

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Motivation

- **Crash risk** is the risk that an asset suffers a large negative shock
- Proxied by large negative outliers in the firm-specific returns
 - Negative Conditional Skewness
 - Large Negative Return Event
- An important source of risk, because, unlike volatility risk, crash risks **might not be diversifiable**

Why do crashes happen?

- **Bad information hoarding:** insiders have to absorb too much firm-specific bad news, and decide to "give up" (Jin and Myers (2006))
- Accumulated negative firm-specific news suddenly becomes publicly available
- Specific Mechanisms
 - Earnings Management/Opaque Financials (Hutton, Marcus, and Tehranian (2009))
 - Tax avoidance (Kim, Li, and Zhang (2011))
 - CFO incentives (Kim, Li, and Zhang (2011))
 - Ethical considerations/Risk aversion (Callen and Fang (2012))

Role of Executives' Political Leaning

- Republican culture: More conservative/risk-averse (Hutton, Jiang and Kumar (*Forthcoming, JFQA*))
 - Hoarding information/window-dressing has risk-return trade-off
 - Can “cover up” bad info if things turn-around later ((Agarwal, Gay and Ling (2014)) **but..**
- Republican ideology: protection of property rights and individual economic interests
 - Market can self-discipline
 - E.g., Fewer lawsuits for securities fraud and intellectual property rights (Hutton, Jiang and Kumar (2014, *MS*))
- Republican party ideology: individual accountability and market discipline more effective solution to corporate misbehavior

Republican values and “ingredients” of crash

- Higher risk aversion/conservatism (Hutton, Jiang and Kumar Forthcoming))
- More honest/transparent to markets (Hutton, Jiang and Kumar (2014, *MS*))
- Less corporate tax avoidance (Christensen et al. (2014), Francis et al (2012))

- *Hypothesis: Firms with Republican-leaning CEOs face fewer stock price crashes*

Preview of Initial Results

- Firms with Republican CEOs are associated with fewer crashes
- Potential channel: 1) Better financial reporting
 - Previous studies have found other channels
- Potential channel: 2) Less tolerant of crashes
 - Rep CEOs willing to accept pay cut after crashes
- No effect of Democratic CEOs either way
- Current evidence does not claim causality. Working on it.

Data and Main Variables

- CRSP/Compustat: Company financial and stock prices
- Federal Election Commission (FEC): Political contribution data
 - Same as Hutton, Jiang and Kumar (*JFQA*, *Forthcoming*)
- Sample period from 1992 to 2008
- **Main Variables**
 - ***REPCEO*** = 1 if CEO's contribution to Rep party > contribution to Dem party
 - ***CRASH*** = 1 if ever **Weekly Stock Return** < (**Mean Return** – 3***Std. Dev.**) in a year
 - ***NCSKEW*** = **Negative Idiosyncratic Skewness** of weekly returns over a year

Summary Stats (Partial)

	Obs.	Mean	Std. Dev.	Q1	Median	Q3
REPCFO	19221	0.38	0.49	0.00	0.00	1.00
REPCFO	19221	0.11	0.32	0.00	0.00	0.00
DEMCEO	19221	0.16	0.37	0.00	0.00	0.00
CRASH	27339	0.18	0.38	0.00	0.00	0.00
NCSKEW	23953	0.04	0.72	-0.39	-0.02	0.39

Other control variables are comparable to prior literature.

Republican CEOs and
Crash Risk
(Panel Regressions)

	NCSKEW	NCSKEW	NCSKEW	CRASH	CRASH	CRASH
REPCEO	-0.030**	-0.030**	-0.034**	-0.127***	-0.125***	-0.139***
	(-2.26)	(-2.22)	(-2.52)	(-2.67)	(-2.64)	(-2.89)
REPCFO	0.015			0.036		
	(0.78)			(0.53)		
NCSKEW	0.001	0.002	0.001	0.012	0.012	0.030
	(0.15)	(0.16)	(0.13)	(0.41)	(0.41)	(0.99)
DTURNOVER	0.254***	0.254***	0.234***	0.566**	0.565**	0.494**
	(3.46)	(3.45)	(3.09)	(2.43)	(2.43)	(2.08)
LOG(MARKET CAP)	0.024***	0.024***	0.031***	-0.015	-0.014	-0.005
	(4.68)	(4.79)	(5.24)	(-0.83)	(-0.78)	(-0.20)
MARKET TO BOOK RATIO	0.002	0.002	0.002	0.010*	0.010*	0.010*
	(1.01)	(0.97)	(1.03)	(1.92)	(1.90)	(1.69)
FIRM SPECIFIC RET	73.624***	73.647***	77.208***	206.369***	206.386***	208.602***
	(6.65)	(6.66)	(6.68)	(4.38)	(4.38)	(4.32)
FIRM SPECIFIC RISK	5.369***	5.368***	5.701***	15.223***	15.219***	15.481***
	(5.84)	(5.84)	(5.92)	(4.24)	(4.23)	(4.21)
LEVERAGE	-0.033	-0.033	-0.050	0.054	0.055	0.070
	(-0.76)	(-0.75)	(-1.09)	(0.37)	(0.38)	(0.47)

Other controls: ROA, CEO Vega, Delta, Industry (FF 48) and Year Fixed Effects

Evidence from Change in CEO's Ideology

Change in *CRASH* one year in the future

Transition	N	Crash _(t+1) -Crash _(t)	t-value
Dem to Rep _(t)	354	-0.137***	-2.67
Rep to Dem _(t)	384	0.008	0.14
Diff-in-Diff		-0.144**	1.96

Change in *NCSKEW* one year in the future

Transition	N	Ncskew _(t+1) -Ncskew _(t)	t-value
Dem to Rep _(t)	355	-0.087***	-3.06
Rep to Dem _(t)	384	-0.003	-0.10
Diff-in-Diff		-0.085**	2.19

Potential Channels (Financial Reporting)

Firms with Republican CEOs exhibit less absolute discretionary accruals, and fewer earnings restatements

	AbsDiscr Accruals	AbsDiscr Accruals	Restate	Restate
REPCEO	-0.007**	-0.005*	-0.309***	-0.245**
	(-2.49)	(-1.73)	(-3.13)	(-2.46)
MARKET TO BOOK RATIO		0.001		-0.022**
		(1.36)		(-2.10)
FIRM SPECIFIC RISK		-0.000**		0.000
		(-2.44)		(1.25)
EXTERNAL FINANCING		4.051***		31.515
		(2.60)		(0.99)
ANALYST COVERAGE		0.009***		0.081
		(3.07)		(0.87)
ROA		-0.010		-1.290***
		(-0.62)		(-2.82)
LOG(MARKET CAP)		-0.008***		-0.146***
		(-5.75)		(-3.17)
ASSET GROWTH		0.010*		0.073
		(1.78)		(0.32)
N	13793	13793	14085	14085

Less tolerant of crashes

Current (Cash) compensation
of Republican CEOs
decreases following a crash

	Log(CurrentComp)	Log(CurrentComp)
CRASH	-0.057***	0.008
	(-3.35)	(0.42)
REPCEO		0.032
		(1.32)
CRASH*REPCEO		-0.060**
		(-2.01)
LOG(MARKET CAP)		0.261***
		(26.54)
MARKET TO BOOK RATIO		-0.021***
		(-8.32)
LEVERAGE		0.444***
		(5.31)
ROA		0.213*
		(1.85)
N	20947	16529

Rep. CEO vs. Dem. CEO

- No effect of Democratic CEOs either way
- The Effect seems to come from Republican CEOs being particularly conservative than rest of the sample

	CRASH	NCSKEW	AbsDiscr Accruals	RESTATE	Log(CurrentComp)
REPCEO	-0.127**	-0.027*	-0.005*	-0.212**	0.048*
	(-2.45)	(-1.86)	(-1.68)	(-1.99)	(1.96)
DEMCEO	0.043	0.027	-0.001	0.110	0.061
	(0.63)	(1.26)	(-0.32)	(0.88)	(1.46)
CRASH					0.014
					(0.63)
CRASH * REPCEO					-0.066**
					(-2.10)
CRASH * DEMCEO					-0.021
					(-0.48)
Other Controls	Yes	Yes	Yes	Yes	Yes

Causality and Conclusion

- We are working on testing if the relation is causal
 - The change regression of lag effects “hints” some causality
- Concern: Republican CEOs choose firms with less crash risk
 - Still an interesting association
- Overall
 - We find an interesting association between CEOs political values and crash risk
 - Nicely complements the existing literature.
 - Just an initial attempt. Much to be done

Thank you

Your comments are very welcome!