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Puertas Giratorias

¿Son Valoradas Por El Mercado Bursátil Español?

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Abstract

Purpose – The purpose of this paper is to examine the effect of political connections in the value of companies listed on the Spanish stock market.
Design/methodology/approach – The authors study two issues on this topic: the impact on the company value of the appointment as director of an ex-politician through an event study; and the long run stock market performance of companies with political connections. The authors employ a sample of listed firms in the Spanish stock market for which the authors collected data about their political connections. The authors perform the study during a wide period (1996-2011), comprising four legislatures.
Findings – The results show that from the market perspective the value ex-politicians bring to the company outweigh their costs, especially in times of crisis or economic recession.
Originality/value – Given the concern of regulators and legislators to increase transparency and good governance of companies, this paper shed light on the role that politicians play on the company boards and and their contribution to their value.

Keywords Event study, Lobbying, Firm value creation, Political connection, Revolving doors, Spanish political context
Paper type Research paper

Resumen estructurado

Propósito – Nuestro objetivo es estudiar el impacto en el valor de las empresas cotizadas en el mercado bursátil español del nombramiento como consejero de un ex-político, y la valoración que el mercado realiza de la existencia de conexiones políticas en las empresas.
Diseño/metodología – Para los años 1996-2011 analizamos el impacto en el valor de la empresa del nombramiento de un político como consejero. Para ello empleamos la metodología del event study en el corto plazo y a través del rendimiento de las carteras estudiamos si estas empresas obtienen rendimientos anormales a largo plazo.
Resultados – Nuestros resultados muestran que desde la perspectiva de mercado el valor que aportan las conexiones políticas supera sus costes, especialmente en momentos de crisis o desaceleración económica.

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Originalidad/valor – Dada la preocupación de los reguladores y legisladores por aumentar la transparencia y los códigos de buen gobierno de las empresas, este trabajo ayuda a entender el papel que los políticos juegan en los consejos de administración de las empresas.

Palabras clave puertas giratorias, lobbies, conexión política, contexto político español, creación de valor en la empresa, event study
Tipo de papel Trabajo de investigación

Introduction

Although this is a widespread phenomenon both geographically and time-wise[1], the existence of revolving doors, or *pantouflage*, has not been in the spotlight up until recently. "Revolving door" is colloquially known as the hiring in private corporations (generally in the Board of Directors) of politicians that have held a responsible position in public administration. Ethical and deontological problems are created by the clear overlapping of large corporations' spheres of interest and the common interests of citizens.

In this respect, the concern of regulators and legislators for increasing transparency and good governance codes in corporations has facilitated the enacting of laws or recommendations that make corporations responsible for reporting the identity of the new members of the board; or, as in the case of Germany, the members' of the Parliament obligation to report their activities in private corporations. This has allowed the dissemination of information related to board members' designations and roles, and empirical studies analysing spin-off effects of former politicians on corporations' Boards of Directors have arisen.

The roles of the Board of Directors in a corporation are varied, among them, directing the corporation to the maximum level, defining corporative strategy and supervising corporation management. In this set of tasks, the members provide business industry and conflict management expertise and knowledge about technological progress, markets, etc. Therefore, they should add value to the company. However, when a politician, usually with little or no business experience, is recruited on a corporation's Board of Director, on the one hand, the question arises as to how politicians contribute in these boards, and on the other hand, whether that is actually a valuable contribution that increases the value of the company.

Previous literature identifies different elements by which the recruitment of former politicians that held a relevant position on Boards of Directors can generate value in the corporation. According to Faccio (2010), some of these are: preferential access to credit, preference in government procurement contracts, lower regulatory control of the corporation, securing tax benefits due to greater knowledge about legislation that the politician may have or reception of financial support. Furthermore, Hillman (2005) highlights that among politicians, the main contributions to Boards of Directors are: personal advising, communication and information channels between the company and external organizations, and preferential access to contracts or to credit lines.

Niessen and Ruenzi (2010), in turn, point out two additional reasons why corporations with political connections could have a higher performance than corporations without politicians on their Board of Directors. First, they contribute with an independent view different from the organization's view, which can improve its performance. And second, efforts aimed at the enhancement of the company can be motivated by the acceptance of politicians that, in order to maintain a good reputation, only work for high-performance companies. However, negative aspects of political connections are underlined by some authors, such as Shleifer and Vishny (1994), politicians some of the income generated by their connections, may incur great costs for the company.

Not only do these elements apply in countries with elevated levels of corruption or a weak legislative system, but also in developed countries with stricter legislations. Thus, the effect that the presence of politicians on Boards of Directors has in the value of the corporation has been analysed both in Indonesia (a country that back in 1998 ranked 45th out of 54 in level of corruption) by Fisman (2001), and in the USA by Goldman *et al.* (2009), as well as in Germany by Niessen and Ruenzi (2010). At the same time, Faccio (2006, 2010) conducted an analysis on the features of corporations with political connections for 47 countries. She observed that political connections are less common in countries with regulation regarding politicians' conflict of interest, and it is in countries with higher levels of corruption and restrictions on foreign investment where the connections are more frequent. Faccio (2010) also analyses whether companies with political connections are different to those that do not have them. The author discovers that, in general, corporations with political connections have more leverage, pay fewer taxes, and have more market power and less book performance than corporations with no political connections. With regard to Spain, Castells and Trillas (2013a, b) found that the stock market does not value the recruitment of a former politician as a member of the Board of Directors, even though the operative performance in politically connected companies is worsened.

The aim of this study is to analyse the impact that the presence of former politicians, who used to hold a relevant position and who are then hired on the Board of Directors, has on the value of the company. In order to do so, we analyse a period from 1996 to 2011, corresponding with the two terms in office presided by José María Aznar (1996-2000 and 2000-2004), leader of the Popular Party (PP) (centre-right) and the two terms in office presided by José Luis Rodríguez Zapatero (2004-2008 and 2008-2011), leader of the Spanish Socialist Workers' Party (centre-left). Undeniably, measuring the impact on the company's value caused by the presence of former politicians on the Board of Directors is not an easy task. Which is why, we decided to tackle it from different perspectives by using quoted companies on the Spanish Stock Market, also known as Spanish Stock Market Interconnection System (SIBE), given that changes in value can be measured more objectively due to the stock market's special features. With all these corporations a database has been created by the authors, indicating whether any politician has been a member of their respective Boards of Directors. After applying a series of filters, we obtained two samples: one made up by corporations that have had high-level politicians (Prime Minister, Minister, Secretary of State or Under Secretary of State) on their Boards of Administration; and another sample made up by corporations where no evidence that a politician had been a member of their Board of Directors was found.

Regarding the analysis made, the impact in the corporation's stock market value due to the announcement of the politician's recruitment was studied in the first place by using the standard methodology of study for short-term events. Then, the trading performance throughout different periods of time in companies with politicians in their portfolios vs companies without them was analysed.

Previous evidence in Spain regarding the value contribution of political connections to corporations is very limited and inconclusive. Thus, Castells and Trillas (2013a) do not find that the involvement of former politicians on quoted firms' Board of Directors adds value to the corporation at the time of recruitment. On the other hand, Bona-Sánchez *et al.* (2014) conclude that there is a positive and significant relation between the corporation's political connections and its value.

Our results indicate that even though there is no immediate effect associated to the recruitment, on a short-term basis, an accumulated positive effect in the value of the company is observed. On the other hand, evidence found in a long-term stock market performance analysis indicates – unlike the results obtained in other studies on the operating performance of Spanish firms – that the presence of former politicians on Boards of Directors adds value during periods of economic slowdown and downturn. This result suggests that political connections are not used by companies as a means to obtain resources, but rather as a kind of assurance against external shocks.

The paper is organized as follows. In the second section, we conduct an evaluation of the previous literature related with the effect of political connections in corporations. In the third section, we briefly describe the legislation and formation of Boards of Directors in Spanish corporations. In the fourth and fifth sections, the sample and methodology of study in the different analyses are presented, respectively. In the sixth section, the achieved results are collected, and finally, we present the discussion of the main practical and theoretical implications of the paper.

Literature review on firms' political connections

Several authors (Agrawal and Knoeber, 2001; Fisman, 2001; Faccio, 2006, 2010; Faccio and Parsley, 2007; Goldman *et al.*, 2009; Chen *et al.*, 2011) advocate for the idea that political connections create value in firms, since a source of future benefit is generated as long as they surpass the costs they entail.

Thus, the role politicians play in corporations' Boards of Directors in connection to the Agency Theory is contextualized by Agrawal and Knoeber (2001). These authors advocate that external members of the board develop an important role in counselling and aligning the objectives of executives and owners. In this regard, politicians' knowledge of governmental procedures, their experience and their capability of predicting future government actions would increase the company's value.

For its part, Hillman (2005) analyses the role of members of the Board with previous political experience from Pfeffer and Salancik's (1978) Resource Dependence Theory perspective. According to this theory, organizations are not self-sufficient, but depend on some external elements to a greater or lesser extent. This dependence generates risk and uncertainty, and it affects its performance. Organizations that create links with their dependence sources can obtain benefits such as uncertainty reduction, given that these links will cushion the impact of changes in their environment (Pfeffer, 1972); transaction cost reduction (Williamson, 1984); or the increase of their survival or performance (Singh *et al.*, 1986). It is in this context where government policies, regulations and implementations appear as leading forces of the company's environment, when links with politicians would be created by companies with a view to reduce uncertainty and increase value. From that perspective, a former politician's incorporation on the Board would be a link to the exterior that would result in the company's increased value.

On the other hand, Faccio (2006) analyses connections among companies and politicians for 42 countries; however, he establishes a political connection only if high executives or major shareholders have been presidents, leaders or ministers of the country. In this study, she finds that political connections are different among countries, and more common in those with higher levels of corruption or with restrictions on investment. Besides, in order to verify whether these connections create value in the corporation, she conducts an event study around two events: the first is the announcement of an executive/major stakeholder switching to the field of politics (reverse revolving door); the second is the recruitment of a politician as a part of the company's executive team (revolving door). In her results, she obtains that an executive or major stakeholder switching to politics creates value, as the benefits of the political connection surpass its costs. However, this creation of value does not appear when a politician becomes a part of the company's executive team, suggesting that in this case, the benefits of the connection do not surpass the costs.

In a subsequent study, Faccio (2010) completes her 2006 study and analyses the differences between connected and non-connected companies in terms of leverage, taxes, market power, productivity, operating performance and market to book ratio for 42 countries. She finds that generally, connected companies have a higher level of leverage, pay fewer taxes and have more market power. However, their operating performance is inferior to that of unconnected companies. Nevertheless, the author points out that these results might not come from political connections in companies, and companies with certain features might be the ones seeking these connections.

In the case of the USA, Goldman *et al.* (2009) analyse whether political connections are important in this country. Taking into account that the USA has regulated financial markets and a strong legal system, as opposite to other countries with weak legal systems and high levels of corruption, where political connections have been proven to be valuable for companies. Stock market price behaviour following the recruitment of a politician as a member of the board is studied and a positive abnormal performance close to the announcement of the recruitment is observed. They also analyse the response of stock market prices to the republican victory in the year 2000 and find increases in the value of companies connected to republicans and decreases in companies connected to democrats.

In the same vein, Niessen and Ruenzi (2010) analyse politically connected German corporations by taking advantage of the transparency law adopted in 2007, whereby information about members of the German Parliament that hold public positions is made public. These authors conducted a comparative study about operating performance and the value in both connected and unconnected firms; moreover, they studied whether political connection created value for the company. Their results show that politically connected companies are larger and have less risk and less growth opportunities, although their operating performance is higher than in unconnected corporations. The market value of connected firms surpasses that of unconnected ones before the data about political connections is made public, and it decreases when the obligation to report parliamentary corporate positions is imposed.

On the other hand, Chen *et al.* (2011) study the presence of political connections in an incentives context of rent seeking politicians. Therefore, and in accordance with Shleifer and Vishny's (1994) line of argumentation, they suggest that in economies with weak property rights, political connections offer companies preferential access to government subsidies, financing opportunities and tax benefits. Besides, politicians would use the regulation to extract income out of business activities. The authors study the case of China, which despite the economic transformations still prioritizes a state control model. This benefits resource localization being dominated by the government, and granting of aids and subsidies being discretionary. This situation fosters private corporations to establish a relationship with the government in order to receive more support.

Previous evidence in Spain is scarce. Castells and Trillas (2013a) analyse the benefits that political connections can provide to listed companies during the period between 2002 and 2009. The authors verify that the announcement of the recruitment of a former politician as a member of the board has no impact on the company's value. Furthermore, they confirm that the participation of former politicians on the Board of

Directors does not result in a higher market value of the company, but it does imply a lower operating performance. Moreover, Castells and Trillas (2013b) analyse the effects of electoral results in Spain in the year 2014, finding that they had no reflection on the market value of listed companies. On the other hand, for the period between 2003 and 2011, Bona-Sánchez *et al.* (2014) analyse the informative capacity of accounting profits in corporations with political connections, finding that due to the information effect, for which both stakeholders and politicians are interested in facilitating as little information as possible to the market, the incidence caused by the presence of political connections is negative in accounting profits credibility. Moreover, by using Tobin's *Q* as a value creation measure, they observe that the presence of politicians on Boards of Directors creates long-term value. In connection with the previous studies, García-Cestona and Surroca (2008) and Cuñat and Garicano (2010) study the role that politicians play in savings banks' Boards of Directors and the relationship of this with their performance. Thus, García-Cestona and Surroca (2008) study the differences between savings banks controlled by non-political institutions and those controlled by local politicians. They find that savings banks with lower political control perform better, and Cuñat and Garicano (2010) observe a negative impact on loan performance caused by the participation of politicians on Boards of Directors. This situation becomes evident when analysing the president of the board's role, as they confirm that savings banks with presidents that have previously held political positions do not perform as well as those whose president has not been a politician.

Boards of directors in Spain

As we have seen in the previous section, the role that politicians play in company's Boards of Directors has been a subject of interest for the past few years, as it has also been shown in the legislation.

In Spain, listed companies are subject to the *Código del Buen Gobierno* (Code of Good Governance) created by the *Comisión Nacional del Mercado de Valores* (Spanish National Stock Market Commission, CNMV) in 1998. This code gathers guidelines aimed at configuring Boards of Directors as a tool for supervision and control of firm management with views to match the interests of the executive team and stakeholders or owners. In 2003, quoted companies were forced to publish an annual corporate governance report (IAGC) through Law 20/2003, including, among other things, the composition of the Board of Directors from 2004 onwards. Finally, in 2006, the *Código Unificado de Buen Gobierno* (Unified Good Governance Code) was approved, which introduced some aspects related to gender diversity on Boards and the need to report Board members' remuneration with views to achieve greater transparency.

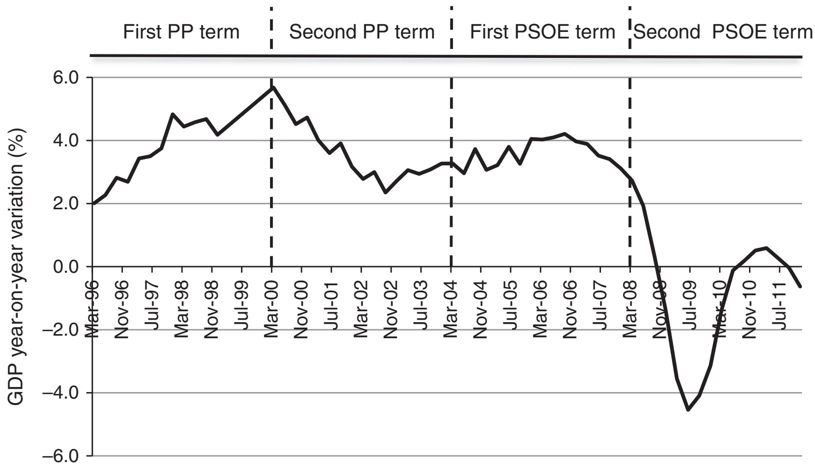
In Spain, a listed company's Board of Directors is made up of executive, domanial and independent members, each performing different tasks. Thus, executive members can either perform senior management duties or be employees; domanial members represent stakeholders on the board and independent members belong neither in the management team nor in the stakeholder's representation, as they are chosen according to their professional capabilities, solvency or experience. The presence of independent members reinforces the management role performed by the Board of Directors, as they are usually professionals of renowned prestige with broad-ranging experience[2]. Two of the many tasks performed by the Board of Directors stand out. First, as experts with plenty information about the organization and its environment, the Board of Directors advises about the firm's strategy, and they monitor the company director's performance in order to reduce conflicts of interest that may arise between executives and stakeholders.

Most of the former politicians are included on Boards of Directors as independent members. Therefore, the idea of including former politicians is to reduce the company's problem of agency. However, as Mateu de Ros (2007) states, if the member has been chosen on the motion of a group of stakeholders with less than 3 per cent share participation, this is enough for her or him to be considered a domanial member.

Data collection

The selected timeframe for this study was the period between 1996 and 2011. Due to the bi-partisanship that has prevailed in the Spanish political context until recently, we have opted for collecting data from at least two full terms of each of the majority parties, namely: the PP, with a centre-right orientation, and the Spanish Socialist Workers' Party (PSOE), with a centre-left orientation. The chosen period of time includes 4 full terms: the first and second terms in which José María Aznar (1996-2000 and 2000-2004), leader of the PP, was Prime Minister; and the first and second terms in which José Luis Rodríguez Zapatero (2004-2008 and 2008-2011), leader of the PSOE, was Prime Minister. A noteworthy aspect is that, in the analysed timeframe, the Spanish economy went through different states (see Figure 1), from a high economic growth in the 1996-2000 period, to years that can be classified as stabile (2004-2008), as well as slowdown periods (2000-2004) and even a recession (2008-2011). This variety of economic environments allows us to link the obtained results with the general evolution of the economy.

Given that our main interest is the creation of value in Spanish companies as a consequence of political connections, we decided to take as an initial sample of all companies that quoted in SIBE at some point of the stated timeframe. Quoted companies were chosen for the study because of the stock market features that allow us to measure changes in value objectively.



Note: Rectified data for seasonal and calendar effects 2008 base
Source: Compiled by authors from bank of Spain data

Figure 1.
Different terms GDP year-on-year variation from 1996 to 2011

By consulting different web pages and annual corporate governance reports made by companies through the Spanish National Stock Market Commission (CNMV), we created a database containing information regarding when a certain person that used to hold a public position has been recruited as a member of the board in a listed firm due to their political status (regardless of the year of recruitment), their political allegiance, and the date of their cessation as members, if applicable.

At this point, we find it necessary to specify that political connection is the participation in the Board of Directors of a person that has previously been a Prime Minister, Minister or Secretary of State, or that has held a comparable position such as Governor of the Bank of Spain. We restricted the study to national politics and focused on the case of politicians that switch from public to business spheres (revolving door) without considering the opposite case; that is, business people that switch to politics and hold relevant positions (reverse revolving door). Most of the literature focuses on the first case (Faccio, 2006, 2010; Goldman *et al.*, 2009; Niessen and Ruenzi, 2010; and Chen *et al.*, 2011, among others), even though there are authors such as Faccio (2006) that analyse the impact caused by the election of a business person in the field of politics on the value of the company.

After the application of the previous criteria, three subsamples were obtained:

(1) A subsample of 58 companies that, in all horizons of the study, had former politicians that met the previously mentioned criteria as members of the boards in order to consider the company as politically connected.

(2) A subsample of 56 companies that, in all or part of the studied horizon, had former politicians that did not meet the previously mentioned criteria as members of the board in order to consider the company as politically connected. In this case, the level of the position held by the former politician is varied: Member of Parliament, mayor, regional government minister, etc.

(3) A subsample of 104 companies for which we did not find any recruitment of former politicians as a member of the board.

In order to conduct this study, we excluded the second of the subsamples, using the third as a control sample.

Data analysis

Obviously, the analysis of the creation of value in companies with former politicians on their Boards of Directors is not an easy task. This is why our strategy for the study has been approached from different perspectives. Specifically, the impact of the announcement of the politician as a member of the board on the company's quotation was analysed by using the standard methodology of event study. We also analysed long-term trading performance in portfolios created under different criteria. Now we proceed to detail how every analysis was performed.

Short-term recruitment impact

In this analysis, we study the market's response to the announcement of the recruitment of a former politician as a member of the Board of Directors in a private company using event study methodology. In order to conduct this analysis, we used a subsample of 75 recruitment announcements of politically connected companies in the study horizon.

Event study methodology has been widely used in corporative finance for analysing the effect of certain economic news on the market value of the company. Therefore, it can be considered as the standard methodology used to analyse the effect that such an event has on the corporation, as shown in the number of studies that use this methodology (Khotari and Warner, 2007). The insight behind the suggested methodology is simple. It basically consists of comparing the value achieved by the company when the information on the analysed event reaches the market, with the value it would have had if the event had not occurred. Under the market efficiency hypothesis, if the announcement involves an increment in company value, these expectations will be reflected by an increase in stock prices. This methodology allows the detection of this reaction in prices, quantifying the effect of the announcement on the market value of the company, and to determine whether it is statistically significant. First of all, in order to proceed with this methodology, it is necessary to define the event that is being studied, and determine the exact moment of the announcement (t_O). Two periods of time that span several days prior to and after the event (known as "event window") are often taken for study in such cases. In this sense, the problem we faced in our study when specifying the date of the event (t_O) was especially critical. In most of the cases, we had a few relevant dates related to the event, namely: the date the company reports the decision to recruit a certain politician as a member of the board, the date the company's decision or intention of carrying out such recruitment appears in the press, and the date in which the general meeting of shareholders ratifies the Board's decision. Out of these, we decided to choose the moment the decision was made public as the date of the event (t_O). In any case, aware of the existing uncertainty, we decided to use a wide event window with a view to being able to collect information leaks and reactions of the market around the date selected as t_O. This meant defining an event window of 20 trading days prior to and after to the t_O date.

The reference period (estimation window) where, presumably, the prices have not been affected by the event of study is often defined after specifying the event window. The regular value or the profitability expected value in case of the non-occurrence of the analysed event is estimated using the estimation window data.

As mentioned before, under the hypothesis of market efficiency we can only expect that if a certain event affects the value of the company, its effect would be immediately reflected in the price of the share as soon as the information reaches the market. Therefore, the event can be quantified as the difference between the real return of the share and the one that would be expected should the event not have taken place. That is:

$$AR_{it} = R_{it} - E\left(R_{it}/X_t\right), \tag{1}$$

where AR_{it} is the abnormal return of the i company in the t day from the event window, R_{it} is the real return obtained by the i company that day, and $E\left(R_{it}/X_t\right)$ is the expected return affected by the required information in the model used for its estimation, X_t, which will be determined by the chosen model to estimate those performances.

The models used to determine the normal or the expected value of profitability in case of the non-occurrence of the analysed event, $E\left(R_{it}/X_t\right)$, can be diverse. However, in the literature regarding this topic (Fama, 1998; García and Ibáñez, 2001), it emerges that in short-term price analysis, such as the one presented here, the chosen model is not relevant to the results.

The effect of the event can be quantified from the estimation of the expected return, as pointed out previously in expression (1), as the difference between the real return of the share around the moment of the event and the return, had the event not occurred.

In our study, with views to avoid the cross-section correlation statistical problem resulting from estimation window of expected return overlapping, and in order to preserve the maximum amount of cases, due to the reiteration of some corporations in the recruitment of former politicians, the abnormal return of the day t in company i (AR_{it}) has been estimated as shown in the following expression:

$$AR_{i,t} = R_{i,t} - R_{IGBM,t}, \tag{2}$$

where R_{it} is company i's performance in day t, and $R_{IGBM,t}$ is the Madrid Stock Exchange General Index (IGBM) return on day t. By using this estimation model there is no need to define the estimation period, which would have led us to the elimination of several firms from the sample due to the impossibility of finding non-contaminated periods of reference.

Once the values for all the corporations on each day of the event window have been determined and using statistical contrasts about the abnormal performances series in the cross-section, the statistical significance of the announcement's effect on prices is determined.

Finally, aiming at considering the global effect of the event in the value of the company, the obtained results for each day are added temporally in periods longer than a day, obtaining the accumulated average abnormal performance ($\overline{CAR}$). In the present case, due to the previously mentioned difficulty to determine the exact date of the announcement and the several information leaks that may be present in the markets, we have opted to estimate the accumulated average abnormal performance from the beginning of the event window (day t_O–20) to its higher interval (day $t_O + 20$) as shown in the following expression:

$$CAR = \sum_{t=-20}^{t=k} AR_t \quad k = -20, \ldots, 20 \tag{3}$$

With the objective of analysing the market's response to the recruitment of a former politician's announcement as a member of the Board of Directors in a company, we compare, on the one hand, the null hypothesis that the cross-section average abnormal return ($\overline{AR_t}$) for each of the days of the event window is equal to zero; and, on the other hand, we contrast whether the accumulated average abnormal return from the t_O–20 date to each one of the rest of the days of the event window ($\overline{CAR}_{-20,t}$) is equal to zero. In order to determine the statistical significance, we use Student's t test by calculating the abnormal return average by using cross-section estimation for each day of the event window. The statistical significance has been corrected by heteroscedasticity and correlation with the methodology suggested by Newey-West.

Long-term stock performance in politically connected companies

In order to evaluate whether political connections add value to corporations in the long-term, we used the event methodology adapted to the analysis of the effect of the arrival of new information in long-term performances. The α-Jensen approximation is found in this methodology, which is widely used in portfolio performance (like investment funds, etc.), also known in this context as calendar-time.

From α-Jensen, we specifically study whether politically connected companies obtain long-term abnormal performances significantly different to zero. This methodology, widely used in finance, consists, essentially, of studying the market value of the corporation through its long-term returns, comparing the ones actually obtained in the market with the estimated theoretical returns from a pricing model that incorporates systematic risk factors. In order to carry out the study, a portfolio with a sample of the corporations mentioned earlier, is made in calendar-time, which, just like in the previous case, requires determining the date when the recruitment is made public. In such a portfolio, companies are incorporated as the studied event occurs – in our case the recruitment of a politician on the Board of Directors – and they are maintained for the studied temporal horizon. Besides, the subsample of politically unconnected companies is used as a control sample, building a portfolio with such corporations as in the previous case. From these portfolios the abnormal performances will be estimated as explained below and in expression (5).

In order to estimate the theoretical or expected return of portfolios, $E(\tilde{R}_p)$, created for both samples, we use the Fama and French (1993) three-factor model that appears in the following expression:

$$E\left(\tilde{R}_p\right) = R_f + \beta_p\left[E\left(\tilde{R}_M\right) - R_f\right] + s_p SMB + h_p HML. \tag{4}$$

In general, every existing pricing model explains assets or portfolio risk premium as a function of the systematic risk factors considered. In Fama and French's (1993) model, returns are explained in correlation to three systematic risk factors; in such way that the portfolio's expected performance is equal to the non-risk asset performance (R_f) plus the market risk premium ($\beta_p[E(\tilde{R}_M) - R_f]$), the risk premium associated to the size of the company ($s_p SMB$) and the premium risk associated to the growth expectations of the company ($h_p HML$).

The comparison between the observed market performance and the theoretical performance predicted by the model is determined by ordinary least squares (OLS) estimation of the portfolio's excess return, using the Fama and French model of time-series regression as it appears in the following expression:

$$R_{pt} - R_{ft} = \alpha_p + \beta_p\left(R_{IGBM,t} - R_{ft}\right) + s_p SMB_t + h_p HML_t + \varepsilon_{pt}, \tag{5}$$

where R_{pt} is the return in t calendar month of the sample portfolio, R_{ft} is the return in t month of treasury bills, $R_{IGBM,t}$ is the monthly return of Madrid Stock Exchange General Index (IGBM), SMB_t is the difference between the return of portfolios created with small and large companies, and HML_t is the difference between the return of portfolios created by the ratio of book value of equity/equity market value, both estimated as local factors[3], and α_p would be the α-Jensen estimation that reflects which part of the return is not explained by the pricing model used. Therefore, and drawn from the hypothesis that the pricing model used is adequate, the estimation of the constant (α_p) allows contrasting the null hypothesis that supports that the portfolio's monthly average abnormal return of sample companies is zero; indicating, therefore, the absence of abnormal performance. In contrast, if such constant reflects a positive value different from zero, it would reflect a positive abnormal performance unjustified by systematic risk factors and that, in our case, would be due to the increase in the market value of the company resulting from political connections.

To provide a clearer vision of the topic studied, the previously mentioned portfolios are created for the following temporal horizons:

- A portfolio with companies connected politically from April 1996 to October 2011, excluding February 1996 and November 2011 for being the months when the general elections took place.
- A portfolio with companies connected politically for each one of the terms of the studied horizon. In each case, the months when the general elections took place have been excluded.

As mentioned previously, we have used portfolios created by the subsample of politically unconnected companies as a control.

Results

Short-term effect of the recruitment's announcement

Table I exhibits the results for the impact on the quotation of a company before the announcement of the recruitment of a former politician as a member of the Board of Directors. As we can see, regarding the average abnormal performance ($\overline{AR_t}$), only data corresponding day t_O–7 is statistically significant (for a 10 per cent level), with a −0.29 per cent value. This absence of significance in the abnormal return around the day of the announcement can be either because the market interprets that the politician's recruitment does not add value to the company, or because of a problem of correct data identification in which the information was leaked to the market as a consequence by the press. The second explanation is the one we opt for in the light of the results shown in Table I for the accumulative average performance from day t_O–20 ($\overline{CAR}_{-20,t}$).

Day to t_0	AR_t	$CAR_{-20,t}$	Day from t_0	AR_t	$CAR_{-20,t}$
−20	0.11	0.11	0	0.09	1.39*
−19	0.42	0.53	1	−0.09	1.30
−18	−0.05	0.48	2	0.34	1.63
−17	0.11	0.59	3	−0.15	1.48
−16	0.03	0.63	4	0.02	1.50
−15	−0.04	0.59	5	0.13	1.63
−14	0.03	0.62	6	0.06	1.70
−13	−0.07	0.55	7	−0.40	1.29
−12	−0.17	0.38	8	0.15	1.45
−11	0.36	0.74	9	−0.04	1.41
−10	0.00	0.74	10	0.22	1.63
−9	0.23	0.96	11	−0.14	1.49
−8	0.19	1.16	12	0.30	1.78
−7	−0.29*	0.87	13	−0.21	1.57
−6	−0.13	0.74	14	0.05	1.62
−5	0.10	0.84	15	0.05	1.66
−4	0.25	1.09	16	−0.32	1.35
−3	−0.08	1.01	17	0.33	1.67
−2	0.01	1.02	18	0.03	1.70
−1	0.28	1.30	19	0.09	1.79
			20	−0.23	1.56

Notes: Abnormal returns are expressed in percentages. *Significant at 10 per cent

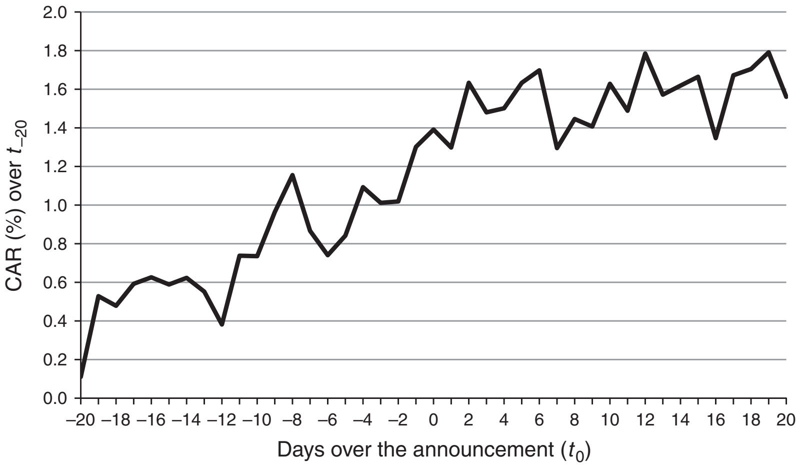
Table I. Abnormal returns around the announcement (t_0) of a politician's recruitment as a member of the board of directors

As also reflected in Figure 2, there is an accumulative average abnormal return increase in the days previous to the date selected as the day of the event, this being statistically important for a 10 per cent level.

This evidence is aligned with that obtained by Goldman *et al.* (2009) for the North American market, though they used a narrower event window than ours. In contrast, our results differ from the ones found by Castells and Trillas (2013b) for the Spanish stock market, since these authors obtain non-significant abnormal returns around the announcement of the recruitment.

Long-term stock performance in politically connected companies

Table II shows the corresponding results of the estimation of long-term abnormal performance for the portfolio of politically connected firms and the portfolio of politically unconnected firms for different periods. Specifically, the Fama and French three-factor model OLS regression abnormal return (a_p), represented in expression (5) is shown. The results show that politically connected companies had a monthly average abnormal



Source: Compiled by the authors

Figure 2. Accumulative average abnormal performance over t_{-20} ($\overline{CAR}_{-20,t}$)

	Politically connected companies	Politically unconnected companies
Complete studied horizon (4/1996-10/2011)	0.48 (0.0309)**	0.22 (0.2335)
PP terms (4/1996-2/2004)	0.23 (0.5257)	0.26 (0.4015)
PSOE terms (4/2004-10/2011)	0.70 (0.0124)**	0.29 (0.1435)
First PP term (4/1996-2/2000)	−0.64 (0.1333)	−0.26 (0.3730)
Second PP term (4/2000-2/2004)	0.69 (0.0649)*	0.32 (0.3509)
First PSOE term (4/2004-2/2008)	0.39 (0.1411)	0.35 (0.1748)
Second PSOE term (4/2008-10/2011)	1.55 (0.0078)***	0.37 (0.3507)

Notes: p-value appears between brackets. Abnormal returns are expressed in percentages. *,**,***Statistically significant at 10, 5 and 1 percent levels, respectively

Table II. Long-term abnormal returns (Fama and French, three-factor model OLS regression α_p represented in expression (5)) of politically connected and unconnected companies for different periods performance in the complete study horizon (April 1996-October 2011), which was 0.48 per cent, significant for a 5 per cent level, while politically unconnected companies do not present significant abnormal performances. That is, their performance is adequate for the risk level, according to the model, keeping this result in all the analysed sub periods.

When dividing the studied horizon in different sub periods, politically connected corporations do not show statistically significant abnormal performances during the PP terms, but do so in the PSOE one, having taken both jointly. However, when we study each one of the four terms individually, we observe that the positive statistically significant abnormal performances are found in the second PP term (2000-2004) and in the second PSOE term (2008-2011), when politically connected corporations show a more prominent abnormal behaviour, since during that period we obtain a monthly average abnormal return of 1.55 per cent, statistically significant at 1 per cent level. That is, during the given period these corporations obtained approximately an annual performance, which was 18 per cent higher than the one corresponding to their risk level.

From our point of view, the interpretation of these results cannot be unlinked to the country's economic situation in each of the analysed periods. In Figure 1, we show the evolution of Spanish GDP year-on-year variation (as a percentage) from 1996 to 2011. As we can see, for the first PP term (1996-2000), the Spanish economy shows higher growth rates each year, going from more than 2 per cent in 1996 to almost 6 per cent in the year 2000. In this strong economic growth environment, our results indicate that the market does not give additional value to the fact that corporations are politically connected. For the subsequent four years (2000-2004), a slowdown in economic growth occurs, since we move from almost 6 per cent in the first quarter of the year 2000 to a growth rate that stabilizes between 2 and 3 per cent in the year 2003. This stability ends in 2008 when the crisis hit Spain with year-on-year variation in GDP rates that reached −4 per cent. In view of the evolution of the GDP, our results suggest that the value contribution of former politician's presence on Boards of Directors is significant in slowdown environments and, especially, in crisis periods.

Discussion of results

Summary

Boards of Directors have many and varied roles, but we can summarize them in two basic ideas. First, pursuing stockholder's interests, i.e., acting as a connector between stakeholders and executive teams; second, acting to maximize the economic value of the company. Thus, someone's recruitment – especially if this person is unconnected to the company – as a member of the Board of Directors can be understood as the recruitment of a valuable asset for the company because of its professional experience, knowledge or any other attribute that adds value to the company, such as, for instance, the relationships that person keeps with the company's environment. A particular case is the recruitment of a former politician as a member of the board.

In this study, we analyse the stock market behaviour of these companies, since it allows us to summarize the influence of political factors through different means. Furthermore, the establishment of net impact in the value of companies enables us to answer more important questions, like why do companies invest in political connections and whether they create an unequal playing field among the different corporations.

The presence of former politicians in private companies' Board of Directors can affect their performance in different ways. Empirical research in this field is necessary, as the political factors net impact in the company is theoretically ambiguous.

On the one hand, literature suggests that political connections can increase the risk of a diversion of resources from the company to political objectives. On the other hand, and in relation to the Resource Dependence Theory, the presence of former politicians in companies facilitates access to bank financing, reduces the cost of capital and increases the possibility of obtaining government contracts and subsidies.

In order to conduct this study, from the group of listed companies in the Spanish stock market (SIBE), we have manually created a sample of companies with political connections, and another without them for the 1996-2011 period, which contains 4 full terms: two with PP government (1996-2000 and 2000-2004), centre-right orientated, and two with Spanish Socialist Workers' Party (2004-2008 and 2008-2011), centre-left orientated. A relevant aspect that needs to be taken into account is that in the studied temporal horizon, periods of economic growth and periods of slowdown and economic crisis can be clearly differenced.

Implications

Our results show that, in the short-term, the date of recruitment has no significant and immediate reaction on the value of the company. However, this might be due to the difficulty to specify the exact moment of the information's arrival to the market, which is a serious handicap for the event study methodology.

Regarding the long-term contribution of value to political connections in companies, we find that the fact that the presence of former politicians is valued significantly (or not) is determined by the economic conditions prevailing in the different analysed sub periods. Thus, the market positively and significantly values the presence of politicians only in slowdown and economic crisis periods, being its valuation non-significant for the rest of periods.

The obtained evidence for the full temporal horizon supports the Resource Dependence Theory, since the recruitment of former politicians facilitates access to valuable resources. These resources can include greater knowledge that former politicians have of government procedures, their capacity of predicting future government actions and their links with spheres of power.

However, the divergence in the results between periods of economic boom (in which there is no visible contribution to the value) and periods of less favourable economic environment (in which the market does value the presence of political connections) can be interpreted as political connections not being used by companies as a means to obtain resources, but as a kind of assurance against external shocks. This second derivative would introduce the possibility of understanding the presence of former politicians in a field of contingent assets, opening a field of research that, as far as we know, is new.

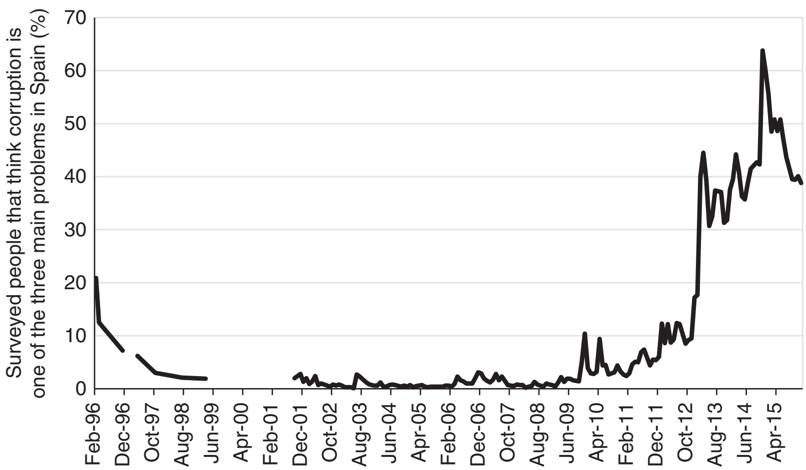
On the other hand, the tests performed suggest that the possibility that some firms may have political connections and others not provokes asymmetries in the behaviour of companies during difficult economic times. These inequalities may call into question basic rules related with fair competition. For instance, professional and ethical problems are presented in the incorporation to Boards of Directors of people that have held relevant public positions in the national government, since it implicates an overlapping of "what is public" and "what is private".

In this regard, an unavoidable question is the discussion is society's perception of such business practices. For a long time, even when aware of its existence, the Spanish society, in the best-case scenario, ignored such practices. This attitude started to change in 2008, in the global financial crisis, and the terms "revolving doors" and "corruption" were associated. This was allied to Spanish society's increasing concern regarding the extent of corruption in Spain. Evidence for this is given by surveys conducted by *Centro de Investigaciones Sociológicas* (Spanish Centre for Sociological Research, CIS). As shown in Figure 3, the percentage of those who replied that corruption is one of the three serious problems in Spain changed from being around 1 per cent in the first decade of the twenty-first century, to reach a maximum of 64 per cent in November 2014.

Another piece of evidence regarding the concern for corruption at European level is constituted by the report by the Group of States against Corruption (GRECO) of the European Council published on the 15 January 2015. The report shed light on the concern regarding a Member of Parliament's possible of his position in order to ensure a future job in a private company. As a consequence, the tightening of regulations for "revolving doors" was one of the star proposals of the majority of political parties in the election campaign for the general elections in December 2015. This is the case for PSOE and Ciudadanos, which obtained 90 and 40 seats (out of 350), respectively. Podemos (with 69 seats) proposed "a lifetime ban of revolving doors to corporations in Ibex35" (translation of the headline of *eldiario.es* press report of the 9 December 2015).

Limitations

The obtained evidence in the research points to the fact that the presence of former politicians on companies' Boards of Directors is not neutral, which is why this issue should be a focus of attention for lawmakers, regulatory bodies, investors, and citizenship in general. From an academic perspective, as previously mentioned, this is a complex topic that can (and should) be analysed from different approaches. Future research should incorporate, for example, the social costs associated to regulations created by politicians who finally join those companies, which have benefitted from those same regulations, the application of contingent assets valuation theories in the valuation of net impact value of political connections, or the possible "expiration" of political connections over the years.



Source: Compiled by the authors from data collected from the CIS webpage

Figure 3.
Surveyed people by the Spanish Centre for Sociological Research (CIS) who think that corruption and fraud constitute one of the three main problems of the country

Notes

1. Charle (1987) dates the start of this activity in France towards 1880.
2. The Unified Good Governance Code of 2006 recommends having between five and 15 members, that domanial members and independents represent a wide majority over the executive members, and that independent members represent, at least, a third of the total.
3. Griffin (2002) shows that local factors provide a better explanation of return series than global factors.

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