POLITICIANS AND CORPORATE BOARDS

by

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(Under the direction of William D. Lastrapes)

ABSTRACT

Corporate boards of directors serve an important function in monitoring
management and reducing agency costs. However, some directors have backgrounds that
seem to offer little to this end. Former politicians, in particular, fall into this category.
The logical explanation for the appearance of such directors is to assist rent-seeking
activities rather than to participate in managerial oversight. Though this approach is
intuitive, it fails to capture the full range of public choice theories. It is possible that
these politically experienced directors obtain their positions through a rent extraction
process. The determinants of board political composition are estimated using a probit
regression. The impact on firm value from the appointment of a politically experienced
director is analyzed using event study procedures. The effectiveness of politically
experienced directors in monitoring management is also examined.

INDEX WORDS: Board of Directors, Politicians, Rent Creation, Rent Extraction, Rent
                Seeking

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CHAPTER 1 – INTRODUCTION

Inherent in the organization of most corporations is the separation of ownership

and control. Because owners typically lack the time and know-how to conduct the day-

to-day operations of the firm, employ managers to fulfill this task.

This arrangement, however, creates a principle-agent problem, where the

incentives of managers may be in conflict with those of owners. Adam Smith, in The

Wealth of Nations, notes that

"the directors of such [joint stock] companies, however, being the managers of
other people's money than of their own, it cannot well be expected, that they
should watch over it with the same anxious vigilance with which the partners in a
private copartnery frequently watch over their own... Negligence and profusion,
therefore, must always prevail, more or less in the management of the affairs of
such a company" (p. 800).

The passage above suggests that managers will likely pursue goals (personal utility

maximization) contrary to those of owners (profit maximization) and that owners must be

aware of these differing goals.

One approach available to owners to monitor manager behavior and often

required by law is to establish a board of directors with the authority to install, reward,

and replace, if necessary, those managers. Ideally, the board of directors should be

independent of existing management to better represent the interests of the owners. With

such a structure, incentives become more closely aligned and agency problems reduced.

This logic has driven the long-held preferences of large institutional investors such as

CalPERS and TIAA-CREF for independent boards. The NASDAQ and NYSE, in

conjunction with the Sarbanes-Oxley Act of 2002, have also adopted new governance requirements mandating more independent boards for this reason.

These independent (or outside) directors have a variety of backgrounds. Some are business leaders, legal professionals, or industry experts, each of whom brings knowledge and expertise to the boardroom in order to better oversee management.

However, some outside directors seem to serve a function other than oversight. Former politicians and other civil servants, for example, are frequently appointed to corporate boards. According to proxy statements from the year 2002 for the 30 Dow Industrials, roughly 10% of the outside directors on those boards had some sort of government experience. Shultz (2001) also notes that 5.3% of outside directors on the boards of S&P 500 firms in 1997 had a background in government, the third largest occupational category behind corporate executives (82%) and private investors (7.2%). The presence of these directors is rather puzzling in an agency framework. Government work hardly exposes its participants to notions of profit maximization, bringing into question their effectiveness as monitors of business activity. Furthermore, politicians serve their constituents as agents themselves in, perhaps, the worst agency problem of them all.

If former government employees do indeed lack the skill for proper managerial oversight, then why do they appear on boards at all? The most logical answer is that these directors can assist the firm in its dealings with the government. By knowing the people and the process, politically experienced directors can better analyze and predict government policy. Such service corresponds to the Fama and Jensen (1983) assertion that outside directors may provide, in addition to oversight, "relevant complementary

knowledge" to management when formulating business strategy. Through case studies,

Mace (1986) reveals that firms seek directors with political experience for this reason.

One corporate executive explains,

"Our business is closely interlocked with Washington regulations, and our future is closely tied to the rules and regulations that come out of Washington. We need someone on the board who is a veteran of the Washington scene, who knows and understands the people involved in the executive and legislative branches of the government, and who keeps an eye on what is going on in Washington. Somebody who has had Washington experience does make a great contribution on our board" (p. 20).

This sort of advisory role might better explain the presence of politically experienced

directors on board than the traditional oversight role of outside directors.

Viewing politically experienced directors solely as advisors, however, fails to

address how firms participate in the legislative process. The implication of such an

approach is that firms acknowledge the potential effect of government policy and adjust

their business strategies in reaction to any relevant policy changes. Rent seeking theory

suggests that firms (as well as other interest groups) actively engage legislators to procure

benefits or divert costs. Since competition in the market for obtaining and defending

rents is intense, it seems only natural that politically experienced directors would be used

to further the interests of shareholders. Failure to do so could place shareholders at a

disadvantage with respect to opposing interest groups. Thus, incorporating rent seeking

theory paints a more accurate picture of politically experienced directors and further

distinguishes them from other outside directors.

The argument developed above misses another possible motivation for the

presence of politically experienced directors on corporate boards by failing to capture all

of the dynamics of the legislative process. More specifically, traditional rent seeking

theories of the Chicago School assume that policy makers passively deal out favors to the highest bidder. The Virginia School of rent seeking posits that legislators, as rational, self-interested players, actively engage themselves in the process. Perhaps, policy makers actively generate personal benefits by threatening legislation to expropriate privately created rents (producer surplus) from shareholders but later withdrawing support for such legislation, receiving a smaller portion of the rents as payment for not taking them all (McChesney, 1997). The payment involved in this extraction process could consist of, among other things, a board seat in the public service afterlife.

The discussion above demonstrates that politically experienced directors are unique compared to other outside directors who also provide advice. The important question, however, is whether their background benefits shareholders. A recent "Market Call" segment on CNNfn titled "Tough Call: Do Ex-Pols on Corporate Boards Increase Performance, or Just Look Good?" indicates the relevance of this question (See Appendix A for a complete transcript). Providing policy insight and/or participating in the rent seeking process could clearly yield benefits to shareholders, but there are costs of such activity—the primary cost being foregone managerial oversight. When shareholders add political experience to the board, they risk entrenching management and increasing agency problems. The trade off then is between the marginal benefits (strategy improvements/additional rents) and the marginal costs (foregone managerial oversight) of political experience. The nature of this trade off will depend on firm and industry level characteristics.

In this paper I attempt to identify those characteristics. By using rent seeking, rent extraction, and corporate governance theories, I outline and test cross-

sectionally the determinants of board composition. I conduct a PROBIT regression to determine what factors influence the appointment of a politically experienced director. I also use a Poisson regression to analyze how these factors affect the level of board political experience. Properly identifying these determinants can provide insight as to why some firms have more politically experienced directors on their boards than others. The results from the studies, however, provide little evidence to corroborate the rent creation or rent extraction stories.

More importantly, this paper also attempts to capture the effect of politically experienced directors on firm value by using event study procedures. I conduct an event study for a sample of outside director announcements and regress the abnormal returns from this procedure on possible determinants of board political composition and relevant director specific attributes. The results from the event study do not indicate that politically experienced directors significantly influence firm value. When controlling for rent creation, rent extraction, and other variables, the appointment of a politically experienced director significantly generates a positive and significant effect on abnormal returns with one sample set. The marginal effects from the rent creation and rent extraction variables do not substantiate the story above. The results do, however, offer some support for the assertion that politically experienced directors are poor monitors of management.

CHAPTER 2 – LITERATURE REVIEW

In order to answer the questions posed above, it is necessary to examine the previous work in two seemingly unrelated fields of study—1) corporate finance and 2) public choice. More specifically, I present studies related to corporate boards of directors, rent creation, and rent extraction. Combining these particular interests should improve our understanding as to why former politicians appear on so many corporate boards.

BOARD OF DIRECTORS

The majority of organizations, be they corporations, non-profit organizations, or professional groups, are governed by boards of directors. Despite this prevalence, very little formal theoretical work exists, until recently, beyond the simple principal-agent scenario: boards of directors help align the divergent interests of owners and managers.

There does exist, however, a large collection of empirical work on corporate boards. The goal of this research, according to Hermalin and Weisbach (2001), seeks to answer three questions:

1) How do board characteristics such as composition or size affect profitability?

2) How do board characteristics affect the observable actions of the board?

3) What factors affect the makeup of boards and how do they evolve over time?

For the study at hand, more attention will be directed towards the literature related to the first question.

Board Characteristics and Firm Performance

There is a great deal of empirical work related to the first question above. The independent variables for board characteristics typically used in this work are board composition and board size.

Board Composition and Firm Performance

Since principal-agent problems provide an intuitive explanation for the presence of directors in corporate organization, it seems only natural for studies to emerge that test whether the level of outside directors on a firm's board (a typical measure of board composition) has an impact on firm performance.

Indeed, a good deal of work has developed to explore this particular question using a variety of approaches. MacAvoy, et al. (1983), Baysinger and Butler (1985), Hermalin and Weisbach (1991), Mehran (1995), Klein (1998), and Bhagat and Black (2000) find no significant relationship between accounting measures of performance and the proportion of outside directors on the board. Mork (1988), Hermalin and Weisbach (1991), and Bhagat and Black (2000) use Tobin's q as a performance measure to capture managerial quality and also find no significant relationship between performance and board composition. Bhagat and Black (2000) further find no significant relationship using long-term stock market returns and accounting measures of performance.

Given that these results contradict predictions from the agency theory framework, it is important to note a few problems inherent in the studies above. First, board composition might be endogenous. Hermalin and Weisbach (1998) propose that poor

performance tends to increase board independence, so, cross-sectionally, this effect could cause firms with more independent boards to look worse. Bhagat and Black (2000) attempt to account for this issue by using simultaneous equations methods where lagged performance is an instrument for current performance and still find no significant relation. Another problem associated with these studies results from estimation of the "composite equation" where errors from the underlying equations appear. More specifically, firm performance is a function of so many different factors that it is difficult to imagine that the effect of occasional board meetings, etc., would be detectable (Hermalin and Weisbach, 2001).

An alternative approach of analyzing the relationship between firm performance and board composition is to measure the impact on firm value due to changes in board composition. Rosenstein and Wyatt (1990) determine the announcement day effect on stock prices when firms publicize the addition of an outside director to their boards. The authors find that, on average, there is a 0.22% increase in stock prices associated with the announcement of outside directors from the *Wall Street Journal's* "Who's News" section for the years 1981-1985. The advantage of this event-study approach is that all firm-specific effects are controlled for. This result is important because, as suggested by Hermalin (1994), Kole (1997), and Hermalin and Wallace (1998), there is probably no optimal level of outside directors for all firms thus increasing the difficulty in identifying, cross-sectionally, the impact of board composition on firm performance.

Board Size and Firm Performance

Along similar lines as the work on board composition, board size might affect firm performance. The logic behind this research, as outlined in Jensen (1993) and Lipton and Lorsch (1992), is that a free-riding problem emerges within larger boards augmenting agency problems and hampering firm performance. Yermack (1996) analyzes the relationship between Tobin's q and board size for a sample of large U.S. firms. When controlling for variables likely to affect q, Yermack finds a significant negative relationship between board size and q for Forbes 500 firms over the years 1981-1985 where a 10% increase in board size reduces Tobin's q by 4.3%. Eisenberg, et al. (1998), likewise, find a significant negative relationship in a sample of small and midsize Finnish corporations.

Other Work

The remainder of the literature relates to questions two and three outlined above. This research attempts to estimate firm actions as a function of board characteristics and to examine factors affecting board composition.

Some empirical regularities have surfaced from this work. First, board characteristics seem to influence board actions. More specifically, firms with greater proportions of outside directors and smaller boards make better decisions regarding acquisitions, poison pills (See Brickley *et al* (1994)), executive compensation (See Core *et al* (1999)), and CEO replacement (See Weisbach (1988)). Second, board composition is influenced by firm performance, CEO turnover, CEO bargaining power, and changes in ownership structures (See Hermalin and Weisbach (1998) and Shivdasani (1993)).

The results from these papers are consistent with agency theory concepts. For example, Byrd and Hickman (1992) examine board composition for acquiring companies and find that the abnormal return associated with the announcement of acquisitions is a -1.86% for insider-dominated boards while the abnormal return for independent boards (outsiders > 50%) is a -0.07% with the differences being statistically significant. This result suggests that independent boards make better acquisitions than insider-dominated boards. Although the context of this work is a bit unrelated to the research at hand and as such is not presented in detail, certain results will be exploited in sections below.

In a recent theoretical paper, Raheja (2004) constructs a model of board size and composition where the optimal board structure is determined by the tradeoff between the private information held by insiders and the cost to outsiders to evaluate projects. This work establishes two important implications. First, highly competitive firms and firms with high inside ownership need smaller boards since the transaction costs for outsiders to convince insiders to reveal their private information will be low. Second, firms that face projects that are easier for outsiders to verify will have a greater proportion of outsiders on their boards. Generally, "the most effective optimal boards are the boards of firms with low verification costs to outside board members and low private benefits to inside board members"(p4).

As a whole the empirical work on corporate boards suggests that outside directors play an important role within an agency framework. However, it is possible that some of these directors serve their boards in a capacity other than as a monitor. Fama and Jensen (1983) and Brickley and James (1987) suggest that some outside directors are employed based on their knowledge and expertise and actively participate in business strategy.

Agrawal and Knoeber (2001) suggest that other outside directors serve a political function. These directors with a legal or political background are especially important when firms have high levels of exports, sales to the government, or costs of environmental regulation.

Agrawal and Knoeber (2001) address this notion by examining the frequency of politically experienced directors (those directors with backgrounds in law or government) on corporate boards. The authors claim that these politically experienced directors are desirable to owners of firms for which politics is an important determinant of profitability because they can better obtain benefits and avoid costs from government actions. Further, they suggest that if some outside directors play a political role, the incidence of such directors should increase as the importance of politics to the firm increases.

The authors test this hypothesis with a sample of 264 manufacturing firms listed in the "Fortune 800" for the year 1987 by regressing the number of politically experienced directors on percentage of sales to the government, percentage of exports, percentage of pollution abatement (all measures are at the 3 or 4-digit SIC industry level), firm size, and various measures of firm and industry level lobbying activities while controlling for board size. The empirical results from a Poisson regression (due to the count nature of the dependent variable) indicate that large firms and firms potentially affected by government purchases and trade policy tend to have more politically experienced directors on their boards. More specifically, a 1 standard deviation increase in these variables leads to an increase of .28, .15, and .11 in the number of politically experienced directors, respectively.

To evaluate the change in the number of politically experienced directors due to a change in the political environment, the authors examine the impact of deregulation in the utilities industry. They note that as a result of the uncertainty during the transition from a regulated to a competitive market, for firms in the electric utility industry, political experience rose a significant 3% in the utilities industry while the level fell 2% for manufacturing firms. These results suggest that shareholders adjust the amount of political experience in response to policy changes.

The Agrawal and Knoeber (2001) paper analyzes corporate boards outside of the traditional agency framework and represents the starting point for the work to follow. Since the structure of their work suffers from the endogeneity issues described above, I focus on changes in board political composition rather than its level. This approach should provide a clearer understanding of the presence and function of politically experienced directors. Furthermore, I can use the event study methods of Rosenstein and Wyatt (1990) to estimate the effect of these directors on firm performance.

Summary

The section above provides some insight into the development of the empirical literature on corporate boards of directors. Studies examining the relationship between board composition and firm performance show mixed results. Cross-sectional tests based on various measures of firm performance conclude that no significant relationship exists between board composition and firm performance. Event-study approaches, however, suggest that there is a positive, statistically significant relationship. Work related to board size and firm performance, however, is much clearer. The general result from

these studies is that there is a negative significant relationship between board size and firm performance.

Given these results, confidence in the agency theory explanation for corporate boards is weakened. As a result additional work has emerged that focuses on the influence of board composition on observable actions by the board (question 2) and the impact of firm-specific factors that affect board composition (question 3). These approaches avoid endogeneity problems and other econometric issues and provide certain stylized facts highlighted above that reinforce the agency theory explanation of corporate boards.

RENT CREATION

As opposed to the work on corporate boards, the rent creation literature contains a rather large body of theoretical work. This section will present the evolution of rent creation theory, in a very broad sense, by examining three particular phases—1) the Stigler model, 2) the cost-predation model, and 3) the Stigler-Peltzman model.

The Stigler Model

In response to the growing dissatisfaction with the traditional view of regulation theory and its normative doctrines of optimal levels of regulation, Stigler (1971) represents a transition toward a positive theory of regulation. This seminal paper asks the simple question that if regulation imposes costs on firms, as posited under the traditional view, then why do firms actively pursue regulation? Stigler concludes that government regulation can create benefits (or rents) for the regulated firm, so if the expected benefits

from regulation exceed the transaction costs involved in obtaining these benefits, then the

firm will, in fact, demand regulation.

Stigler's argument can be described with a simple example of a government

created monopoly. The figure below depicts such a situation.
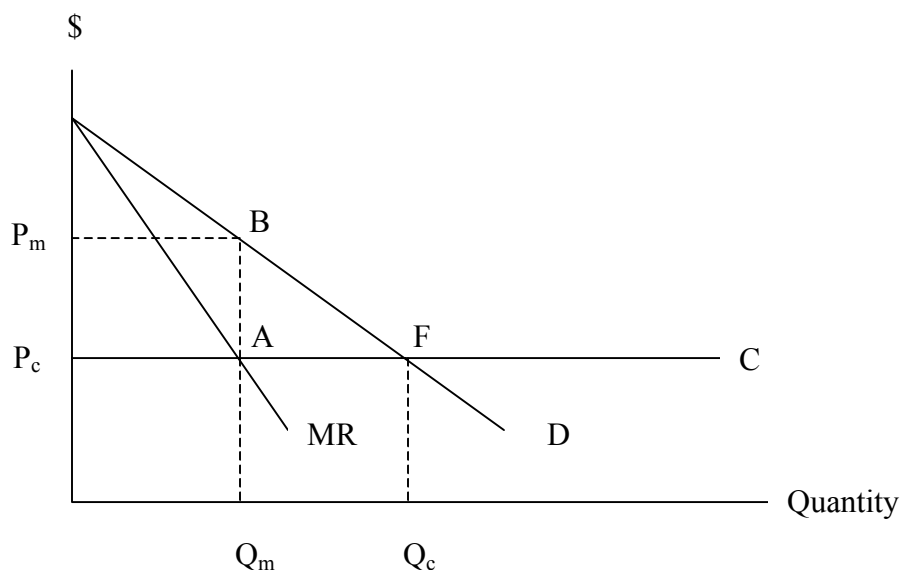
Figure 1: The Stigler model of regulation

In a competitive market with all firms facing identical, constant marginal and average

costs of production, an equilibrium level of outcome, Q_c, is sold at the price P_c such that

any firm charging a higher price will sell no output at all. However, if government

regulation restricts entry into the market and allows only one firm to sell the product, then

the remaining profit maximizing firm will sell the amount Q_m at the price P_m. By

reducing output and raising price, the protected firm will earn rents of P_cP_mBA.

Furthermore, since this result is simply the same as in traditional monopoly/cartel theory,

Stigler suggests that firms will spend resources obtaining these rents up to a point equal to the expected returns (P_cP_mBA).

The Stigler model essentially describes a regulatory environment that involves transfers from consumers to producers through higher prices. However, the model also indicates a real welfare loss from this sort of rent creation. First, a deadweight loss (ABF) arises as a result of the reduction in output from Q_c to Q_m—goods are not produced despite the fact that consumers are willing and able to pay for the costs of production Harberger (1954). Second, firms incur costs procuring this favorable regulation from the government. These expenditures of scarce resources are diverted from wealth enhancing activities to rent seeking activities and should, as Tullock (1967) argues, be treated as further economic losses, so the total loss in welfare is P_cP_mBF.

The Cost Predation Model

The Stigler model does improve upon the traditional view of regulation in that it explains why some forms of regulation appear. However, the argument outlined above does not necessarily apply to all types of regulation. Few industries, for example, possess the government-mandated ability to restrict entry and set prices. Posner (1974) further notes that a good deal of regulation (e.g., consumer protection laws) occurs that might not benefit producers at the expense of consumers.

It is in response to this criticism that another form of rent creation has emerged. This approach suggests that the government, through regulation, can redistribute wealth not only from consumer to producer but also from firm to firm with the creation of inframarginal rents. Such a transfer occurs when one group of relatively similar firms

lobbies to obtain some sort of regulation that benefits itself at the expense of another group of firms.

One method that a particular group of firms could employ to achieve this result is to push legislation that raises its rivals' costs—cost predation. The figure below represents an industry where firms have differing amounts of firm-specific, fixed-cost assets (e.g., capital).
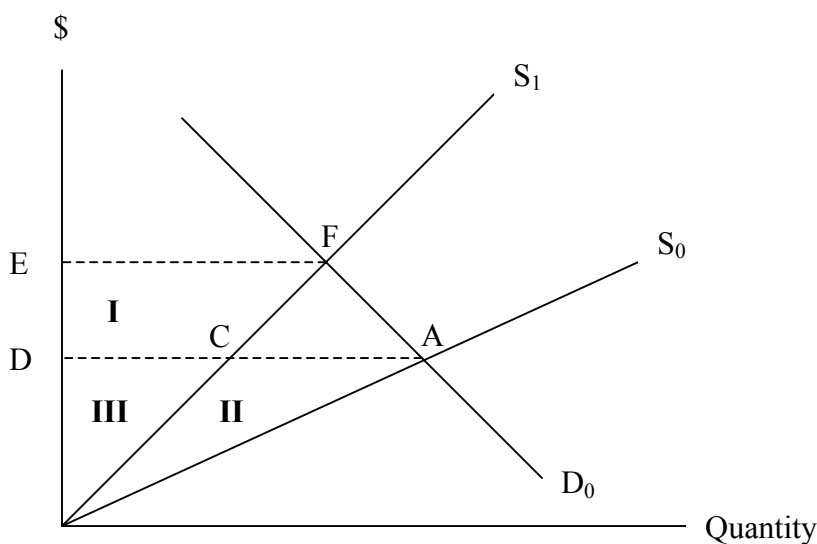
Figure 2: The cost predation model of regulation

The industry supply curve without regulation, S_0, is upward sloping and the returns to the specific assets are captured by the producers' surplus, 0AD. Under the cost predation approach, regulation increases costs for all firms but proportionately more for marginal firms shifting the industry supply curve to S_1 (e.g., regulation increasing the cost of labor

affects relatively labor-intensive firms more than relatively capital-intensive firms). With this new industry supply curve, equilibrium output falls while equilibrium price rises.

The implication of this result is that inframarginal firms (e.g., capital-intensive firms) earn rents if the increase in costs is less than the increase in prices (CDEF > AC0). These firms, as in the Sigler model, would be willing to spend resources on rent seeking activities to obtain such regulation up to the point where the expected net benefit equals zero.   This result differs from the Stigler model, however, in that the rents captured by the inframarginal firms transfers from the marginal firms (e.g., labor-intensive firms) in the industry rather than from consumers.

The Stigler-Peltzman Model

Examining the effects of transfers between subgroups of firms within an industry improves upon the Stigler model by encompassing a larger set of regulatory measures. However, questions regarding the apparent zero-sum nature of this rent creation game lead to an additional phase in the development of rent creation theory.

Based on Stigler (1974) and Peltzman (1976) this model proposes that when faced with the possibility of an adverse wealth transfer, groups (e.g., consumers or marginal firms) will spend resources on lobbying efforts to block such transfers. Like their counterparts in the analysis above (e.g., producers or inframarginal firms), these groups will engage in rent seeking activities up to a point equal to their expected loss. As a result of this behavior, the model suggests that neither group will get their most preferred outcome but that some intermediate solution will emerge (such as a price in between P_m

and P_c in Figure 1) depending on the relative characteristics of the differing groups and their subsequent ability to organize.

RENT EXTRACTION

Despite the simplicity of rent creation theory, for it is, after all, a basic model of exchange, questions regarding the interaction between the private and public sectors still exist. McChesney (1987) describes three particular shortcomings of the rent creation model:

1) The role of the politician has not been integrated satisfactorily in the model.
2) The creation of rents does not seem to explain many of the regulatory statutes that legislators have enacted.
3) The ability of politicians to gain, not by creating rents for some but by creating losses to others.

Since the rent creation approach does not systematically incorporate the behavior of politicians, McChesney (1987) constructs a rent extraction model.

This rent extraction model differs from the rent creation model by focusing specifically on the actions of politicians. More specifically, politicians are viewed not as passive sellers of wealth transfers to competing private party rent seekers but as active players making demands on private parties. Rent extraction essentially reverses the roles of the actors within the rent creation framework allowing for further exploration into the ways that politicians can gain from private parties.

The manner in which politicians obtain benefits under the rent extraction approach can be described as a two-stage process. Politicians first threaten legislation intended to expropriate privately created rents (producer surplus) from firms and then refrain from implementing such legislation while extracting a smaller portion of the rents as payments for not taking them all (McChesney, 1997). The result from this process being that politicians receive payments for allowing firms to earn returns on privately created capital.

One method politicians can employ to extract private rents is to propose legislation that reduces prices. The figure below demonstrates the effect of directly reducing producer surplus through price controls.
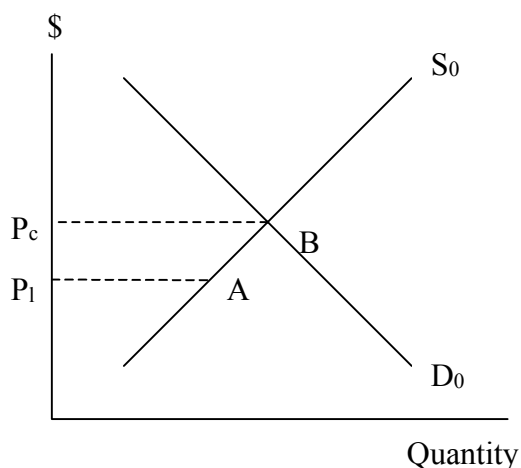
Figure 3: Rent extraction by threatened price controls

In this situation producer surplus declines by P_cBAP_1 as price is legislatively lowered from P_c to P_1. Firms, however, are willing to spend an amount up to this loss to persuade politicians from enacted such legislation.

Politicians can also reduce price indirectly by offering a bill that negates rents from firm-specific assets. Consider a market with two firms having cost structures described below.
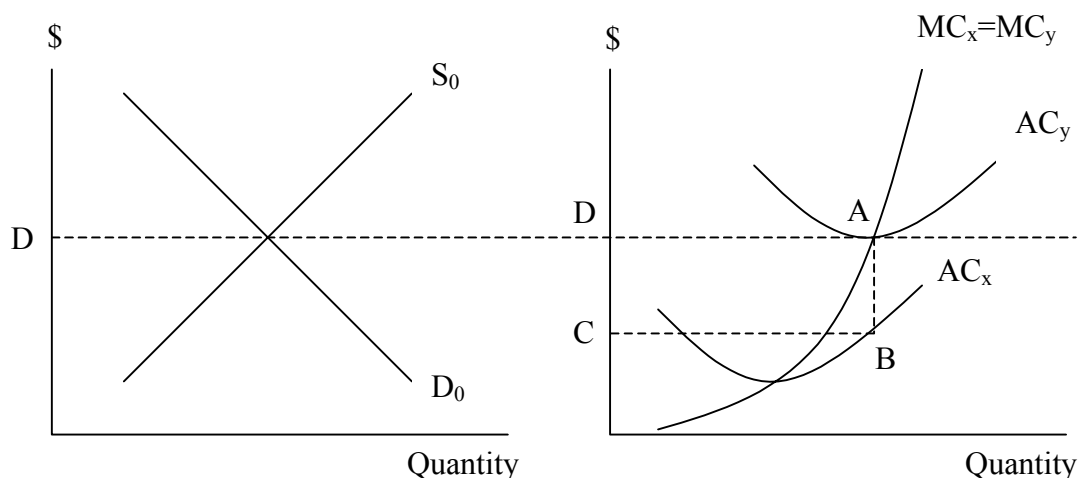
Figure 4: Rent extraction by threatened price reductions

Firm X represents the veteran firm in the market that has invested in reputational capital in the past while firm Y is a firm just entering the market. Since firm Y is new to the market, it must now incur cost building its own brand name and thus, given the additional fixed costs, has a higher average cost curve. As a result of this cost differential, firm X will earn rents of ABCD. Legislation imposing minimum quality standards or mandatory information-disclosure regulations, however, can eliminate this rent, so firm X will be willing to spend up to this amount to convince politicians to reject this type of proposal.

Politicians can also extract privately created rents through legislative threats to raise costs. The figure below depicts cost increases resulting from a proposed excise tax or some other proposal that increases per-unit costs by 0C.
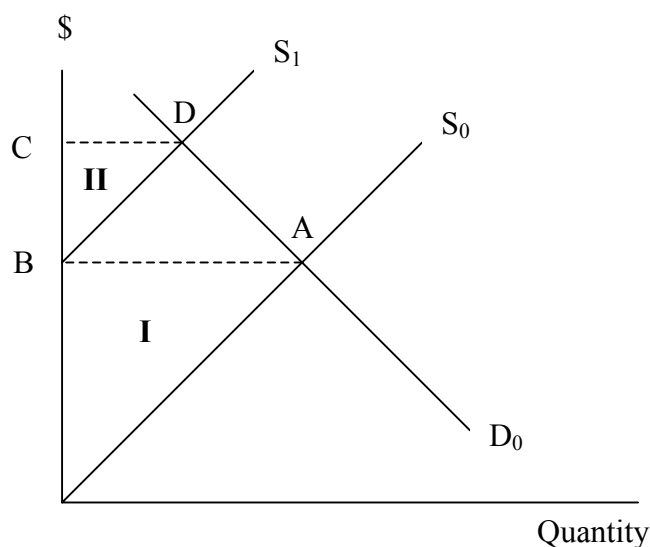
Figure 5: Rent extraction by threatened cost increases

The results from this legislation are similar to those described above in the price reduction case. Producer surplus decreases by area I minus area II (see graph). Firms will be willing to compensate politicians up to this level to withdrawal legislation.

As seen in the examples above, politicians can extract rents from firms by threatening harmful legislation but then, for a price, retracting such proposals. Although this extraction seems like a mere transfer of wealth from firms to politicians, McChesney (1997) indicates that there are real costs associated with rent seeking behavior. First, the possibility that politicians will extract a portion of privately created rents reduces the

returns on that capital creating disincentives to invest. Second, legislative threats induce

inefficient investment of socially less valuable but politically more mobile or salvageable

assets. Third, the extraction process wastes scarce resources by generating significant

transaction costs for both parties involved (legal fees, committee hearings, etc.).

SUMMARY

In this section I decompose the rent-seeking literature into two segments. I first

discuss the rent creation approach of the Chicago School and then relate the rent

extraction approach of the Virginia School. These two philosophies differ considerably

in their assumptions of the role that legislators play in the rent-seeking process. The

Chicago School depicts the policy maker as a passive actor who makes himself/herself

available to "bribes" from interest groups. The Virginia School portrays the legislator as

an active, self-interested player who "extorts" interest groups through his/her position.

This distinction is relevant to the discussion at hand in that it may further our

understanding as to why former politicians appear on so many corporate boards. If

politically experienced directors lack the skills and experience to be effect monitors of

management as I assume, then shareholders hire them in an advisory role. This section

demonstrates, however, that politically experienced directors are significantly different

than other outside directors who serve in such a capacity. The politically experienced

may assist their firms in lobbying activities either directly or indirectly as in the Chicago

School approach. Likewise, former politicians may threaten their way on to corporate

boards through the rent extraction process of the Virginia School and may perceive no

responsibilities to shareholders. These two approaches could influence not only the

incidence of politically experienced directors but also firm performance.

The research to follow analyzes both of these factors. The framework that I use incorporates both schools of thought regarding rent-seeking whereas Agrawal and Knoeber (2001) base their research on the Chicago School only. Additionally, the structure of my research allows for an estimation of the effect of political experience on firm performance which is not possible in the Agrawal and Knoeber (2001) approach.

CHAPTER 3 – DATA

This chapter describes the data set and the collection process for the tests conducted in the chapters to follow. I explain the selection criterion for the sample and the motivation for the variables employed along with their summary statistics. The sample set is outlined first. I then discuss the variables of interest within four categories: 1) Rent Creation, 2) Rent Extraction, 3) Internal Controls, and 4) Other Controls.

SAMPLE SELECTION

The approach taken in this research is different than previous work on corporate boards in that I examine factors influencing marginal changes in corporate boards rather than the overall composition or size. To further that goal, I constructed a sample of single outside director appointments. I collected announcements of these appointments from the Lexis-Nexis newswire database over the years 1997-2001 using "Board of Directors" as the search term. Since the terminology used in the announcements varies, I did not use other qualifiers. This broader search allowed me to retrieve a large number of announcements, but the shear volume of the results using this search term could have allowed some announcements to go unnoticed.   This selection process generated a sample of 979 single outside director appointments representing 18 of the 19 two-digit major business sectors contained within the 1997 North American Industry Classification

System (NAICS). As seen in Table 1 below, only the Public Administration sector (NAICS 92) is not captured.

The next step involved partitioning the announcements based on the backgrounds of the individual appointments, (i.e., their political experience) as specified in the announcements themselves or in the biographical descriptions in the corporate proxy statements. I classified each new director as politically experienced if one of the following conditions is met:

1) Previous employment in a nonacademic capacity for the government at the federal, state, or local levels,
2) Service in the military at the rank of Lieutenant Colonel or higher,
3) Previous employment with a political party,
4) A career as an attorney.

I found 184 announcements that meet the above criteria, of which 134 were employed by the government at all levels (35 elected officeholders), 10 served in the military, 2 worked for a national political party, and 38 were attorneys (See Appendix B for a complete listing). It should be noted that firms are required by the Security and Exchange Commission (SEC) to provide biographies of each director for only the previous five years. Though most firms report a complete work history, some unfamiliar names could have been overlooked and classified as having no political experience.

Table 1: Distribution of Announcements by Sector
Distribution of announcements by NAICS two digit sector for the total sample and the nonpolitically and politically experienced subsamples

NAICS	Sector Title	Total	Nonpolitical	Political
11	Agriculture, Forestry, Fishing & Hunting	1	0	1
21	Mining	29	25	4
22	Utilities	29	17	12
23	Construction	15	9	6
31-33	Manufacturing	504	428	76
42	Wholesale Trade	44	36	8
44-45	Retail Trade	27	21	6
48-49	Transportation & Warehousing	16	11	5
51	Information	113	93	20
52	Finance & Insurance	84	64	20
53	Real Estate & Rental Leasing	6	5	1
54	Professional, Scientific, and Technical Services	60	50	10
56	Administrative, Support, Waste Management, & Remediation Services	20	13	7
61	Educational Services	1	0	2
62	Healthcare & Social Assistance	19	14	5
71	Arts, Entertainment, & Recreation	2	1	1
72	Accommodation & Food Services	6	5	1
81	Other Services	2	2	0
92	Public Administration	0	0	0

DETERMINANTS

The determinants of board political composition can be broken down into three categories—rent creation, rent extraction, and internal controls. Discussion of the relevant variables for each category as well as some other controls appears below.

Rent Creation

Not all firms have the same incentives to participate in the legislative process. Policy affects firms differently and as such, influences the demand for politically experienced directors. This section posits that firms that have a greater opportunity to legislatively create or protect rents will appoint more former politicians to their boards.

Trade policy, for example, can potentially affect firm performance. As a result, owners of firms with high levels of sales abroad and those that face import competition will desire relatively more political experience on their boards in an effort to further their own interests. Dividing the dollar value of export shipments by the dollar value of total sales (both at the four-digit NAICS industry level) yields the percentage of exports for the firm, *PEXORT* (Agrawal and Knoeber, 2001). Similarly, the dollar value of imports (at the four-digit NAICS industry level) divided by the dollar value of total U.S. imports give the percentage of imports, *PIMPORT*. I collect the trade data for these measures at the U.S. International Trade Commission's (ITC) DataWeb database for the year prior to each announcement and the corresponding sales figures from the U.S. Census Bureau's annual sector survey reports. The ITC collects this trade data based on customs documents as the goods enter or exit the country, and as a result, trade in services is typically not included. To address the problem, I refer to the previous Economic Census for these sectors. This approach does not, however, resolve the problem completely since the Economic Census can predate the announcement by a number of years and because only exports are reported for selected industries. I, therefore, have a significant amount of missing values, especially for the *PIMPORT* variable. The Table 2 below contains summary statistics for these variables.

The level of competition that firms face in their industries could also make politically experienced directors useful. Shareholders in industries that are more highly concentrated might demand more political experience either to open up their markets or to insulate them further. The measure for market concentration is the Four Firm Concentration Ratio, *FFCRAT*, which I calculate using sales data (at the four-digit

NAICS industry level) from the COMPUSTAT database. Table 2 contains the summary

statistics for this variable.

Table 2: Summary Statistics for Rent Creation Variables

	N	MAX (%)	MEAN (%)	MIN (%)	St. Dev.
Total					
PEXPORT	756	69.99	14.03	0.00	0.1196
PIMPORT	568	11.22	2.04	0.01	0.0217
FFCRAT	979	99.89	55.16	10.24	0.1697
PSGOVT	686	63.83	11.91	0.00	0.1706
Non-Political					
PEXPORT	631	69.99	11.28	0.02	0.1198
PIMPORT	488	11.22	1.91	0.02	0.0220
FFCRAT	796	99.66	55.37	10.24	0.1640
PSGOVT	574	63.83	112.24	0.00	0.1727
Political					
PEXPORT	125	56.62	14.59	0.00	0.1150
PIMPORT	80	7.74	2.06	0.01	0.0197
FFCRAT	183	99.89	54.28	10.24	0.1926
PSGOVT	112	63.83	10.19	0.00	0.1592

Politically experienced directors may also be necessary when the government

itself is an important customer. Shareholders may desire more political experience on

their boards to assist in obtaining lucrative government contracts or maintaining deals

already in place. Based on Agrawal and Knoeber (2002), I calculated the percentage of

sales to the government, *PSGOVT*, as the dollar value of shipments to the government

(federal, state, and local) divided by the dollar value of total sales (both at the four-digit

NAICS industry level). I collected the data on sales to the government from the most

recent Economic Census prior to each announcement. Since the Census Bureau reports

these figures for only selected industries outside the manufacturing sector, the data set

has a number of missing observations. Furthermore, the Census Bureau narrowed the

scope of its report on government sales for the manufacturing sector with the 1992

Economic Census, so to capture all of the announcements in this sector, I used the 1987

report *Distribution of Sales by Class of Customer*. Information for this variable appears

in Table 2.

Rent Extraction

As discussed above some firms face conditions that allow for the ability to create

(or defend) rents. Other firms, however, may possess certain characteristics that make

them targets of legislative threats to extract rents. Identifying these traits may further

explain the presence of politically experienced directors on corporate boards. That is,

firms that are more susceptible to rent extraction will appoint more politically

experienced directors.

McChesney (1997) suggests that the ability of legislators to successfully extract

rents is related to the level of firm specific assets. This argument implies that policy

initiatives could reduce the returns on investment in those assets, so firms hand over a

portion of the returns to avoid such legislation.

I develop three measures of asset specificity to capture this process. I first

formulated advertising intensity, *ADINT*, by dividing advertising expenditures by total

sales. I then constructed research and development intensity, *RDINT*, by dividing R&D

expenditures by total sales. I also computed a measure of fixed assets, *FAINT*, by

dividing expenditures on property, plant, and equipment by total sales. I collected all the

data for these measures from the COMPUSTAT database. Since firms do not

consistently report these data, I converted all missing values to zero. This approach is

consistent with the accounting literature, but we must take caution when analyzing the

empirical results in the subsequent chapters. Summary statistics for these data appear

below in Table 3.

Table 3: Summary Statistics for Rent Extraction Variables

	N	MAX	MEAN	MIN	St. Dev.
Total					
ADINT	979	29.54	0.04	0.00	0.95
RDINT	979	1200.67	2.39	0.00	41.10
FAINT	979	39.00	0.24	0.00	1.79
Non-political					
ADINT	796	29.54	0.53	0.00	1.05
RDINT	796	1200.67	2.22	0.00	43.04
FAINT	796	21.50	0.16	0.00	0.85
Political					
ADINT	183	0.2841	0.01	0.00	0.03
RDINT	183	415.50	3.16	0.00	31.46
FAINT	183	39.00	0.58	0.00	3.74

Internal Controls

Shareholders can utilize other methods than boards of directors to reduce the

agency problems that develop from the separation of ownership and control. Accounting

for these control mechanisms could also explain board political composition. These

methods could offset the costs of foregone managerial oversight that is possibly

associated with politically experienced directors. Firms that possess greater levels of

internal controls are able to increase the number of politically experienced directors on

their boards.

The corporate governance literature indicates that debt and dividend policy, inside

and institutional ownership, board composition, and shareholder rights are instruments

that counteract self-interested managerial behavior. To measure firm leverage, I

calculated the debt ratio of the firm, *DEBTRAT*, by dividing long-term debt plus current

liabilities by assets. I also computed the firm's dividend payout ratio by dividing

dividends paid by earnings to derive the dividend payout ratio, *DIVRAT*. I gathered the

data for these variables from the COMPUSTAT database. When management has a

significant stake in the firm, incentives become more aligned with shareholders at large.

Table 4: Summary Statistics for Internal Control Variables					
	N	MAX	MEAN	MIN	St. Dev.
Total					
INOWN	979	0.99	0.13	0.00	0.17
INSTOWN	979	0.99	0.40	0.00	0.26
DIVRAT	979	8.49	0.14	-11.57	0.72
DEBTRAT	979	4.22	0.41	0.00	0.31
PNPOUT	979	0.95	0.60	0.00	0.19
GINDEX	979	18.00	9.80	3.0	1.75
Non-political					
INOWN	796	0.99	0.14	0.00	0.18
INSTOWN	796	0.99	0.40	0.00	0.26
DIVRAT	796	8.49	0.16	-6.5	0.63
DEBTRAT	796	4.22	0.41	0.00	0.31
PNPOUT	796	0.95	0.61	0.00	0.19
GINDEX	796	16.00	9.77	3.00	1.75
Political					
INOWN	183	0.99	0.12	0.00	0.17
INSTOWN	183	0.99	0.40	0.00	0.27
DIVRAT	183	1.48	0.04	-11.57	0.99
DEBTRAT	183	2.67	0.43	0.00	0.31
PNPOUT	183	0.92	0.59	0.00	0.19
GINDEX	183	18.00	9.90	4.00	2.00

To capture this effect, I constructed *INOWN* which measures the level of inside

ownership by dividing the shareholdings of top management by the total shares of the

firm outstanding. Since large institutions closely monitor the actions of their holdings,

thereby, reducing agency problems, I derived *INSTOWN* by dividing the number of

shares held by institutions by the total shares of the firms outstanding. I collected data on

these measures from the Compact Disclosure database. Board composition, in this case,

is the level of non-politically experienced directors as a percentage of board size. By

examining director profiles in corporate proxy statements I developed the measure *PNPOUT*. I used the Gompers, Ishii, and Metrick (2003) governance index, *GINDEX*, to proxy for shareholder rights which I collected from the Investor Responsibility Research Center (IRRC). For firms that did not appear in the IRRC database, I constructed the index by reviewing corporate proxy statements. Note that for items in the index which I could not find, I assigned a zero value. A summary of these variables appears in the Table 4 above.

Other Controls

There are a number of other variables that could also influence the incidence of politically experienced directors on corporate boards.

Two variables in particular are not categorized as above because they could influence the ability to create or defend rents as well as the susceptibility to rent extraction. The first is firm size, *SIZE*, as measured by the market value of equity in the CRSP database. The size of the firm determines the availability of resources that shareholders could use to influence policy. On the other hand, size may be a low cost indicator to legislators, making larger firms easy targets in the rent extraction process. The second variable relates to tax policy. Tax liability can greatly affect firm performance and decision-making. Shareholders may desire politically experienced directors to obtain or defend preferential treatment and tax breaks. Likewise, legislators can threaten firms with adjustments to the tax code. McChesney (1997) suggests that this particular threat is the most common approach that legislators use to extract rents. To measure the impact of tax policy, I computed *PTAX* by dividing the value of all taxes

paid (federal, state, local, foreign) by the dollar value of total sales. I collected these data

from the COMPUSTAT database.

The remaining variable relates to board political composition. The tradeoff to

shareholders of additional political experience on the board could depend on the existing

level of board political composition, *PPOLS*, which I determined by examining corporate

proxy statements for the year prior to the announcement. Table 5 contains summary

statistics for these control variables.

Table 5: Summary Statistics for Other Control Variables

	N	MAX	MEAN	MIN	St. Dev.
Total					
SIZE ($mil)	979	602432.90	4918.67	1.00	24534.78
PTAX	979	3.33	0.03	-0.38	0.12
PPOLS	979	54.55	7.22	0.00	9.96
Non-political					
SIZE ($mil)	796	19445.91	3755.77	1.00	14226.46
PTAX	796	3.33	0.03	-0.38	0.13
PPOLS (%)	796	54.55	6.70	0.00	9.50
Political					
SIZE ($mil)	183	602432.90	9943.1	1.00	48037.59
PTAX	183	0.21	0.03	-0.18	0.05
PPOLS (%)	183	50.00	9.50	0.00	10.66

Table 6 below gives a complete listing and descriptions of the variables.

Table 6: Variable Descriptions

A complete listing and description of the variables of interest.

PEXPORT	Percentage of sales as exports measured at the four digit NAICS industry level
PIMPORT	Percentage of imports measured at the four digit NAICS industry level relative to total U.S. imports
FFCRAT	Four firm concentration ratio measured at the four digit NAICS industry level
PSGOVT	Percentage of sales to the government at federal, state, and local levels measured at the four digit NAICS industry level
ADINT	Advertising expenditure relative to sales measured at the firm level
RDINT	R&D expenditure relative to sales measured at the firm level
FAINT	Property, Plant, & Equipment expenditures relative to sales measured at the firm level
INOWN	Percentage of outstanding shares held by management
INSTOWN	Percentage of outstanding shares held by institutions
DIVRAT	Dividends paid relative to earnings
DEBTRAT	Long-term debt plus current liabilities relative to assets
PNPOUT	Percentage of non-politically experienced directors
GINDEX	Gompers, Ishii, and Metrick (2003) governance index
SIZE	Market value of equity
PTAX	Taxes paid at the federal, state, local, and foreign levels relative to sales
PPOLS	Percentage of politically experienced directors

CHAPTER 4 – DETERMINANTS OF BOARD POLITICAL COMPOSITION

The empirical work on corporate boards demonstrates that outside directors monitor management and can mitigate principle-agent problems inherent in the organization of publicly held firms. The studies also show that the level of board independence strengthens this argument, which is consistent with the idea that boards free from the influence of management tend to make better decisions.

Despite its intuitive appeal, agency theory may not explain all aspects of board composition. It is possible that some directors possess certain characteristics that enable them to serve the board in a capacity other than as a monitor of management. Politicians, more than likely, fall into this category.

Agrawal and Knoeber (2001) address this notion by examining the frequency of politically experienced directors (those directors with backgrounds in law or government) on corporate boards. The authors claim that these politically experienced directors are desirable to owners of firms for which politics is an important determinant of profitability because they can better obtain benefits and avoid costs from government actions. Further, they suggest that if some outside directors do play a political role, the incidence of such directors should increase as the importance of politics to the firm increases.

The authors test this hypothesis with a sample of 264 Fortune 800 manufacturing firms by regressing the number of politically experienced directors on percentage of sales to the government, percentage of exports, percentage of pollution abatement (all

measures are at the 3 or 4-digit SIC industry level), firm size, and various measures of firm and industry level lobbying activities while controlling for board size. The empirical results from a Poisson regression (due to the count nature of the dependent variable) indicate that large firms and firms potentially affected by government purchases and trade policy tend to have more politically experienced directors on their boards. More specifically, a 1 standard deviation increase in these variables leads to an increase of .28, .15, and .11 in the number of politically experienced directors, respectively.

To evaluate the change in the number of politically experienced directors due to a change in the political environment, the authors examine the impact of deregulation in the utilities industry. They note that as a result of the uncertainty during the transition from a regulated to a competitive market, for firms in the electric utility industry, political experience rose a significant 3 percent in the utilities industry while the level fell 2 percent for manufacturing firms. These results suggest that shareholders adjust the amount of political experience in response to policy changes.

The analysis developed in Agrawal and Knoeber (2001) provides insight into board composition outside of the agency framework. Under the scenario established in the study, industry conditions motivate shareholders to appoint politically experienced directors to assist in lobbying government officials in an attempt to create or defend rents, rather than to monitor management.

Accounting for rent extraction, however, would provide a more complete description of the interaction between firms and the government. Under this approach the politician takes on the role as an active, utility maximizing participant demanding benefits from the owners of firms rather than as a passive dealer auctioning favors to

owners. The politician, more specifically, realizes these demands by proposing legislation that places the firm's specific privately created capital at risk but then retracts the proposal for a fee.

The payment doled out to the politician can take many forms. Political action committees (PACs), both at the firm and industry level, channel vast amounts of money into the political arena. Direct contributions, purchases of issue ads and tickets to congressional receptions, sponsorships of get-out-the-vote campaigns, invitations for speaking engagements, and other perks are all ways in which PACs can deliver the necessary payments to politicians. I posit that politicians can also demand post-public service directorships as compensation for their retraction of unfavorable legislation.

A broader application of public choice theories in this sense allows for a more accurate portrayal of the relationship between board composition and the legislative environment as well as a clearer interpretation of the political role played by some outside directors. The sort of transaction described above increases the incidence of politically experienced directors on corporate boards, but not for the potential benefits from rent seeking activity as suggested in Agrawal and Knoeber (2001).

It is important to note that these two approaches are not mutually exclusive. If politicians are indeed active participants in the market for rents, as suggested by McChesney (1997), then they have at their disposal two instruments to obtain benefits. They can legislatively create rents for shareholders, or they can legislatively extract rents from shareholders. Politicians decide which approach to invoke based on the firm and industry-level characteristics of their potential targets and then implement an optimal combination of the two. The particular approach chosen by the politician is conditional

on those relevant aspects. More specifically, the advantages of the two strategies are a function of industry supply and demand elasticities (McChesney, 1997).

This chapter seeks to expand on Agrawal and Knoeber (2001) by incorporating a broader range of public choice theories as well as corporate governance principles. The sample used here also reflects a broader range of industries. I first conduct a test, using the same methods of Agrawal and Knoeber (2001), to determine what factors influence the total number of politically experienced directors on corporate boards. I then evaluate to what extent these factors contribute to the appointment of a director with political experience.

THE LEVEL OF BOARD POLITICAL EXPERIENCE

The discussion above suggests that board political composition depends on firm and industry specific variables. A number of empirical approaches can be used to analyze whether these factors determine the incidence of politically experienced directors on corporate boards. Like Agrawal and Knoeber (2001), I use a Poisson model with maximum likelihood methods where the dependent variable is the number of politically experienced directors, *NPOLS,* since this number typically takes on just a few values. I construct this variable by converting the percentage of politically experienced directors, *PPOLS*, into levels. For the data set employed, the average board has 0.63 politically experienced directors, *NPOLS*, with a standard deviation of 0.92.

Under this framework the log likelihood takes the form

$$\ell\left(\beta\right) = NPOLSX\beta - \exp\left(X\beta\right)$$

where *X* represents the rent creation, rent extraction, internal control, and other control

variables outlined in the previous chapter. Given the discussion of the variables in the

previous chapter, I expect the coefficients from this regression to be positive. That is,

increases in each of these variables should increase the number of politically experienced

directors on corporate boards. The results from this regression appear below in Table 7

for two specifications of the model where (1) refers to the full model and (2) drops the

PIMPORT variable to increase the number of usable observations

Table 7 below reveals a number of interesting results. The degree of market

concentration as measured by the four firm concentration ratio, *FFCRAT*, is positive and

statistically significant in the full model affirming the hypothesis that shareholders in

concentrated industries employ more politically experienced directors either to maintain

or to alleviate this situation. In model (1) a one standard deviation increase in *FFCRAT*

leads to an increase of 0.13 politically experienced directors (a 21% increase compared to

the mean). The other rent creation variables, however, are not significant. The positive

and significant coefficient for R&D intensity, *RDINT*, in both specifications provides

some evidence of the opportunity for politicians to obtain board seats via legislative

threats. A one standard deviation in *RDINT* generates a 0.30 (0.25 in model (2)) increase

in the number of politically experienced directors (a 48% and 40% increase compared to

the mean for model (1) and (2) respectively). The negative and significant effect of

advertising intensity, *ADINT*, in model (2) counters the prediction where a one standard

deviation increase in the variable decreases the number of politically experienced

directors by 2.

Table 7: Determinants of Political Board Composition
Coefficients and standard error from Poisson regression of the number of politically experienced directors. Results from the full model are indicated by (1) while model (2) excludes the *PIMOPRT* variable.

	(1)		(2)	
	β_i	**Standard error**	β_i	**Standard Error**
CONSTANT	-1.18	0.7938	-0.34	0.6744
PEXPORT	0.76	0.6199	-0.34	0.5597
PIMPORT	-5.11	3.4323		
FFCRAT	0.64**	0.3239	-0.17	0.3114
PSGOVT	0.12	0.3918	-0.18	0.3796
ADINT	-1.6	1.0736	-2.15**	1.1575
RDINT	0.0075***	0.0024	0.0061***	0.0022
FAINT	-0.03	0.0245	-0.02	0.0232
INOWN	-0.34	0.4036	-0.63	0.4166
INSTOWN	0.85***	0.2954	0.55**	0.2551
DIVRAT	0.13	0.0829	0.18***	0.0636
DEBTRAT	0.23	0.1473	0.18	0.1414
PNPOUT	-3.18***	0.2839	-2.87***	0.2431
LGINDEX	0.52	0.3274	0.34	0.2655
LSIZE	0.14***	0.0303	0.17***	0.0255
PTAX	-3.17***	0.8456	-2.88***	0.7242
Observations	556		660	
R-squared	0.21		0.21	

*, **, *** indicate significance at the 10, 5, and 1% levels respectively.
LSIZE is the logarithm of the market value of equity, *SIZE*.
LGINDEX is the logarithm of the Gompers, Ishii, and Metrick (2003) Governance Index, *GINDEX*.

The results also offer some evidence to my assumption that politically experienced directors are poor monitors of management in that the degree of institutional ownership, *INSTOWN*, and the dividend payout ratio, *DIVRAT*, are both positive and significant. A one standard deviation increase in *INSTOWN* increases the number of politically experienced directors by 0.22 (0.14 in model (2)) representing a 14% increase compared to the mean (9% for model (2)). The percentage of non-politically experienced directors, *PNPOUT*, contradicts those results, however. A one standard deviation increase in this variable causes a 0.60 (0.55 in model (2)) decrease in politically experienced directors (a 38% and 35% increase compared to the mean for model (1) and (2) respectively).

The other control variables offer more information to the level of board political composition. Firm size, *LSIZE*, also significantly increases the incidence of politically experience due to rent creation and/or rent extraction motives by 3.36 (4.17 in model (2)) politically experienced directors for a one standard deviation increase. Contrary to my prediction, tax liability, *PTAX*, significantly reduces board political composition by 0.38 (0.35 in model (2)) representing a 24% decrease (22% for model (2)) compared to the mean.

Like Agrawal and Knoeber (2001), I classify directors with legal backgrounds as having political experience. These directors, however, might not offer the same skills as former government workers. To account for this possibility, I reclassified lawyers as non-politically experienced and ran the above regression again. The results from that test generate numbers and, as such, are not presented.

BOARD POLITICAL EXPERIENCE AT THE MARGIN

Rather than explaining the total number of politically experienced directors, in this section I evaluate the factors that influence the appointment of a new director with political experience. The Agrawal and Knoeber (2001) approach implemented above that examines the level of political experience suffers from the endogeneity problem discussed in Chapter 2. The level of board political experience at a given time is a static measure and does not capture how political composition has evolved. This characteristic clouds any analysis of causality. For example, it is unclear if increases in the percentage of sales as exports, *PEXPORT*, induce shareholders to demand politically experienced directors, or if greater political experience opens foreign markets thereby increasing

PEXPORT. Focusing on changes in board political composition resolves this problem in that the change in political experience cannot plausibly influence prior values of the explanatory variables.

In this approach I use an indicator variable, *POLEXP*, which takes on a value of one for each new director classified as having political experience and zero otherwise, as the dependent variable. I then regress this variable on the determinants detailed in Chapter 3 with the following log likelihood function:

$$\ell(\beta) = POLEXP \log[G(X\beta)] + (1 - POLEXP)\log[1 - G(X\beta)]$$

where X represents the rent creation, rent extraction, internal control, and other control variables, and G represents the standard normal cumulative density function. This approach will yield the probability that a board appointment will have political experience for the given variable. Given the discussion of the variables in the previous chapter, I expect the coefficients from this regression to be positive. More specifically, increases in each of these variables should increase the probability of shareholders appointing politically experienced directors to their boards.

The results from this regression appear below in Table 8 for two specifications of the model where (1) refers to the full model and (2) drops the *PIMPORT* variable to increase the number of usable observations. The results do not offer much insight into the appointments of politically experienced directors. Firm size, *LSIZE*, is significant in both specifications and confirms the hypothesis, but I cannot differentiate a rent creation effect from a rent extraction effect with this test. The internal control variables related to

dividend policy, *DIVRAT*, is significant but contradicts the prediction in both models. A

one percent increase in *DIVRAT* actually decreases the probability of appointing a

politically experienced director by more than .14% and .10% in model (1) and (2)

respectively.

Table 8: Determinants of Politically Experienced Director Appointments
Expected probabilities from a PROBIT regression of an indicator variable, *POLEXP*, that equals one for the appointment of a politically experienced and zero otherwise.

	(1)	(2)
CONSTANT	-0.3063	-0.1881
PEXPORT	-0.1868	-0.3545***
PIMPORT	-0.1755	
FFCRAT	0.0538	-0.04497
PSGOVT	0.0087	0.0001
ADINT	-0.2082	-0.2665
RDINT	-0.0007	-0.0009
FAINT	0.0343	0.0255
INOWN	0.0603	0.0126
INSTOWN	0.0769	0.0611
DIVRAT	-0.1442***	-0.1020***
DEBTRAT	0.0109	0.0354
PNPOUT	-0.0856	-0.0037
LGINDEX	-0.0306	-0.0656
LSIZE	0.0263***	0.0217**
PTAX	-0.0317	0.0974
PPOLS	0.3184**	0.3563**
Observations	556	660
POLEXP=1	80	109
Pseudo R-squared	0.09	0.08

*, **, *** indicate significance at the 10, 5, and 1% levels respectively.

The percentage of exports relative to sales, *PEXPORT*, also refutes my expectations. A

one percent increase in this variable decreases the probability of the appointment having

political experience by .35%. Perhaps, a high level of exports relates to complex

business operations making politically experienced directors less desirable. The results

suggest that a board with greater political composition will be more likely to add another

politically experienced director. More specifically, a one percent increase in board

political composition, *PPOLS*, will increase the probability appointing a politically experienced director by .36% in both models. Though this result contradicts my initial expectation, it may indicate that greater levels of board political experienced contributes to managerial entrenchment. Results classifying lawyers as nonpolitically experienced are similar and not reported.

CHAPTER 5 – POLITICALLY EXPERIENCED DIRECTORS AND FIRM VALUE

While the previous chapter characterizes the determinants of board political composition, it does not capture the effect of such composition on firm performance. That analysis does not address the trade-off involved in appointments of politically experienced directors outlined above. The fact that a major business news provider (CNNfn) aired a segment on this very question highlights its relevancy. Furthermore, a review of the transcript from the "Market Call" piece in Appendix A indicates that the "experts" have no idea of the impact of politically experienced directors on firm value since no existing academic research addresses this issue. In this chapter I attempt to fill the void in the literature by answering this question.

Previous work examining the impact of board composition and performance has focused on the relationship between board independence (percentage of outsiders on the board) and various measures of performance. Given the joint endogeneity of these variables, the results are somewhat mixed (see Hermalin and Weisbach (2001)). That is, the causality between board composition and performance is unclear. However, Rosenstein and Wyatt (1990) demonstrate, through event study methods, that significant, positive abnormal returns (.22%) are associated with the appointments of outside directors. This event study approach avoids this cuasality problem of other research by examining the effect of a specific change in the board on performance. More

specifically, the appointment of an outsider generates an abnormal return, not the other way around.

The study at hand follows the basic approach used in Rosentein and Wyatt (1990) but focuses instead on the impact of outside directors that have previously worked for the government. In this chapter I first discuss the sample selection process. I then present the method and results from the event study. In the last section, I explain the abnormal returns cross-sectionally.

SAMPLE SELECTION

The data set for this event study includes all announcements of the appointment of a single outside director that appear in the Lexis-Nexis newswire database between the years 1997-2001. To isolate the effect of the appointments, I further restrict the data set as follows:

(1) I remove announcements when information is made public regarding other firm actions such as acquisitions, dividends, personnel, etc. during the period starting one day before the announcement, AD-1, through one day afterwards, AD+1.

(2) If there are any systematic missing stock returns over the period from 170 days before the announcement, AD-170, through 20 days afterwards, AD+20, I omit the announcement.

(3) I eliminate announcements if the new director holds a 5% or greater ownership stake in the firm as indicated in the Securities and Exchange Commission (SEC) 13D filings during the year before and after the announcement.

(4) When another outside director is appointed to the board during the estimation
period, AD – 170, AD – 21, I discard the announcement.

This "clean" sample consists of 511 outside director announcements, of which 70
have political experience while the entire sample that does not satisfy the above
restrictions, the "contaminated" sample, consists of 811 announcements with 150
involving politically experienced directors. Table 9 shows the distribution of
announcements both yearly and monthly for the "clean" sample. Other than the slight
drop-off over the years 1999 and 2000, the table indicates that the announcements are
evenly distributed throughout the sample. The distribution of announcements for the
"contaminated" sample appears similar but is not presented.

Table 9: Frequency Distribution of Announcements
Annual and monthly announcements for the "clean" total sample and for the non-political and political subsamples with percentages in parentheses.

	Annual					
	1997	**1998**	**1999**	**2000**	**2001**	**Total**
Total	113 (22.1)	118 (23.1)	85 (16.6)	82 (16.1)	113 (22.1)	511 (100)
Non-political	93 (21.1)	103 (23.3)	77 (17.5)	74 (16.8)	94 (21.3)	441 (100)
Political	20 (28.6)	15 (21.4)	8 (11.4)	8 (11.4)	19 (27.2)	70 (100)
	Monthly					
	Jan	**Feb**	**Mar**	**Apr**	**May**	**Jun**
Total	43 (8.4)	54 (10.6)	46 (9.0)	25 (4.9)	39 (7.6)	38 (7.4)
Non-political	36 (8.2)	46 (10.4)	41 (9.3)	24 (5.4)	30 (6.8)	31 (7.0)
Political	7 (10.0)	8 (11.4)	5 (7.1)	1 (1.4)	9 (12.9)	7 (10.0)
	Jul	**Aug**	**Sep**	**Oct**	**Nov**	**Dec**	**Total**
Total	38 (7.8)	61 (11.9)	44 (8.6)	37 (17.20)	37 (7.2)	49 (9.6)	511 (100)
Non-political	30 (6.8)	54 (12.2)	40 (9.1)	34 (7.7)	34 (7.7)	41 (9.3)	441 (100)
Political	8 (11.4)	7 (10.0)	4 (5.7)	3 (4.3)	4 (4.3)	8 (11.4)	70 (100)

TESTING FOR ABNORMAL RETURNS

Standard event-time methods are implemented to measure abnormal returns with the date of the first Lexis-Nexis newswire announcement of the appointment as the announcement date (AD). The abnormal return for firm i and event date t is calculated as

$$AR_{it} = R_{it} - E(R_{it}|X_t),$$

where AR_{it} is the difference between the actual return and the expected return over the event window (AD -1, AD). Following Rosenstein and Wyatt (1990), I compute the expected return over the estimation period (AD-170, AD-21) using the market model

$$R_{it} = \alpha_i + \beta_i R_{mt} + \varepsilon_{it}$$
$$E(\varepsilon_{it}) = 0, \text{var}(\varepsilon_{it}) = \sigma_\varepsilon^2$$

where R_{it} and R_{mt} are the average daily returns for security i and the CRSP equally weighted index, respectively.

To test the significance of the abnormal returns, I compute three test statistics. The traditional parametric test statistic based on the two-day cumulative standardized abnormal return is constructed as follows:

$$z_1 = \frac{\frac{1}{N}\sum_{i=1}^{N} CSAR_i}{[2(T-2)/N(T-4)]^{1/2}},$$

where

$CSAR_i$ = cumulative standardized abnormal return over the two-day event window

(AD -1, AD) for announcement i,

T = the 150 days in the estimation period, and

N = the number of announcements in the sample.

I also construct the second test statistic based on Mesumeci, Poulsen, and Boehmer (1990) which accounts for possible event-induced variation as follows:

$$z_2 = \frac{\frac{1}{N}\sum_{i=1}^{N}CSAR_i}{\left[\frac{1}{N(N-1)}\sum_{i=1}^{N}\left(CSAR_i - \sum_{1i=1}^{N}\frac{CSAR_i}{N}\right)^2\right]^{1/2}},$$

where the denominator represents the standard deviation of the cross-sectional distribution of cumulative standardized abnormal returns over the two-day event window. The final test statistic involves adjusting traditional nonparametric tests to accommodate any skewness in the cross-sectional distribution of daily returns as specified in Corrado (1989). I calculate this test statistic as follows:

$$z_3 = \frac{\frac{1}{N}\sum_{i=1}^{N}(K_{i0} - 38.5)}{\left[\frac{1}{76}\sum_{P}\left(\frac{1}{N}\sum_{i=1}^{N}(K_{it} - 38.5)^2\right)\right]^{1/2}},$$

where

K_{i0} = rank of two-day abnormal return for announcement i,

38.5 = mean rank for a series of 76 two-day abnormal returns,

K_{it} = rank of the two-day abnormal return for announcement i and time t over

period P,

P = 75 two day periods from AD-170 to AD-21 plus the two-day event window,

and

N = the number of announcements in the sample.

EVENT STUDY RESULTS

Tables 10 and 11 contain results from the event study for the "clean" and

"contaminated" samples. The figures on the estimation period appear in Table 10, while

Table 11 lists the cumulative abnormal returns (CARs) and test statistics for both samples

of all outside director appointments and for subsamples of politically and non-politically

experienced director appointments. The CAR for the total "clean" sample is a positive

0.13% yet is statistically insignificant. The "clean" subsamples show similar results with

a CAR of 0.11% associated with the appointment of a politically experienced director

while other outside director appointments generate a CAR of 0.13%. Both of these

figures are statistically insignificant. The CAR for the total "contaminated" sample is a

negative 0.01% and is not statistically significant. The subsample of politically

experienced directors has a positive yet statistically insignificant CAR of 0.31%.

Table 10: Parameter Estimates and Estimation Period Statistics
Parameter estimates and estimation period statistics for the "clean" and "contaminated" total samples and the non-political and political subsamples.

Clean	Total	Non-political	Political
Mean Total Return	0.00105	0.00112	0.00065
Raw Returns > 0	42.16%	42.52%	43.16%
Alpha	-0.00007	-0.00003	-0.00032
Beta	1.25	1.27	1.10
Mrkt. Model Residual>0	46.80%	46.70%	47.44%
Total Return Variance	0.00255	0.00270	0.00166
Residual St. Deviation	0.04213	0.04329	0.03485
Autocorrelation	-0.0630	-0.0628	-0.0645
Observations	511	441	70
Contaminated	**Total**	**Non-political**	**Political**
Mean Total Return	0.00062	0.00103	0.00096
Raw Returns > 0	44.07%	43.51%	43.61%
Alpha	-0.00022	-0.00000	-0.00005
Beta	1.01	1.16	1.13
Mrkt. Model Residual>0	47.39%	46.74%	46.86%
Total Return Variance	0.00176	0.00226	0.00217
Residual St. Deviation	0.0346	0.03812	0.03742
Autocorrelation	-0.0417	-0.0558	-0.0532
Observations	811	661	150

Table 11: Cumulative Abnormal Returns
Cumulative abnormal returns for the event window (AD-1,AD) for the "clean" and "contaminated" total sample and the subsamples

Clean	N	Mean Cumulative Abnormal Returns	z_1	z_2	z_3	% > 0 2-day Announcements
Total	510	0.0013	0.736	0.734	1.269	49.61%
Non-political	440	0.0013	0.527	0.516	1.482	50.23%
Political	70	0.0011	0.667	0.868	-0.290	45.71%

Contaminated	N	Mean Cumulative Abnormal Returns	z_1	z_2	z_3	% > 0 2-day Announcements
Total	811	-0.0001	-1.444	-1.235	0.317	47.35%
Non-political	661	-0.0008	-0.512	-0.437	-0.327	46.74%
Political	150	0.0031	1.575	1.462	1.458	52.00%

z_1 is the standardized abnormal return test statistic.
z_2 is the Mesumeci, Poulsen, and Boehmer (1990) test statistic.
z_3 is the Corrado (1989) nonparametric test statistic.

The results from the event study indicate that, contrary to Rosenstein and Wyatt (1990), the appointment of an outside director has, on average, no effect on firm value. The background of the director, on average, also does not seem to influence stock returns in my sample. Results when classifying lawyers as nonpolitically experienced are similar and not reported.

There are a variety of reasons that can explain the divergence in results from this study and that of Rosenstein and Wyatt (1990). First, the number of announcements used in this current study is smaller than in the prior study. Second, stock returns were certainly more variable in the late 1990s than in the late 1980s. I conducted the event study using longer estimation periods to smooth out the variability and found some sensitivity to the length of the estimation period, but I retained the 150 day period of Rosenstein and Wyatt (1990) for consistency. Third, the announcements in the Rosenstein and Wyatt (1990) study are collected from the *Wall Street Journal* which could be biased toward larger or more closely followed companies. Additionally, and more probable, there has been a trend toward more independent boards over the years implying that the addition of an outsider to the board should have less of an impact today than a decade ago.

EXPLAINING ABNORMAL RETURNS

Though the event study presented above does not provide evidence that politically experienced directors influence firm value differently than those without such a background, it generates a performance measure that can be explained cross-sectionally. It is necessary to do this analysis because political experience could have a marginal

effect on stock returns after controlling for other effects. Additionally, political experience could contribute to marginal effects of other variables.

I estimate the following regression equation using OLS:

$$CAR_i = \alpha + \beta_1 POLEXP_i + \beta_2 X_i^1 + \beta_3 X_i^2 + \beta_4 X_i^3 + \beta_5 X_i^4 + \beta_6 X_i^1 \times POLEXP_i +$$
$$\beta_7 X_i^2 \times POLEXP_i + \beta_8 X_i^3 \times POLEXP_i + \beta_9 X_i^4 \times POLEXP_i + \varepsilon_i,$$

where X^1, X^2, X^3, and X^4 represent the rent creation, rent extraction, internal control, and other control variables presented in Chapter 3, respectively, while $POLEXP$ is the indicator variable for political experience. I add interaction terms to determine if the variables influence abnormal returns differently according to the background of the directors.

As discussed in the previous chapter, shareholders may find it necessary to appoint a politically experienced director when their profits are linked to government action. Such a situation, by either generating new rents or protecting existing ones, should, therefore, generate positive abnormal returns.

Shareholders may also become targets of a government shake down through a rent extraction process. In this case shareholders may offer a future board seat to government officials as payment for a withdrawal of support for damaging legislation or regulation. This legislative extortion wastes resources and reduces managerial oversight. As a result, abnormal returns should be negatively related with the rent extraction variables.

As discussed in the previous chapters, shareholders may employ a number of internal measures to mitigate agency problems reducing the value of non-politically experienced directors with respect to monitoring. If politically experienced directors are indeed poor monitors of management, as I assume, then the most significant costs associated with the appointment of such directors is the foregone managerial oversight. However, these costs can be mitigated by various internal control measures, so I expect abnormal returns to be positively related to these variables

There are also a number of factors that could influence the announcement effect of the appointment of a politically experience director but do not fit absolutely into the categories specified above. Firm size, *SIZE*, tax liability, *PTAX* were discussed in Chapter 3. That presentation indicates that these variables could be involved in both rent creation and rent extraction activities making prediction on the relationship with abnormal returns uncertain. Likewise, years in government service, *TENURE*, could fall into both categories. The level of director-specific quality could also influence abnormal returns and is proxied by the number of other board seats held, *OTHRBRDS*. This variable should have a positive relationship with abnormal returns regardless of political experience. The percentage of other politically experienced directors on the board, *PPOLS*, could lead to further managerial entrenchment causing negative abnormal returns with the addition of another politically experienced director. The last control measure that I incorporate, *EXPAND,* is a dummy variable that takes on a value of one when the appointment fills a newly created seat on the board and zero for a replacement position. Increasing the size of the board could increase transaction costs and encourage free-riding by the members decreasing the board's effectiveness as a monitor of

management behavior and possibly, firm value. On the other hand, board expansion

could bring in much needed skills which may increase firm value. This interpretation is

probably more applicable to politically experienced directors who, presumably, are poor

monitors.

Table 12 shows the regression results from the model with the "clean" sample while

Table 13 presents the results from the "contaminated" sample. The results from the

regressions offer mixed support for the assertion that when controlling for rent creation,

rent extraction, internal controls, and the other controls, the appointment of a politically

experienced director effects firm value. More specifically, the appointment of such a

director generates a significant increase in abnormal returns of 0.18% and 0.13% in the

two models respectively using the "contaminated" data set. I interpret these coefficients

as indicating that the benefits of political experience (advice/rent creation) outpace the

costs (foregone oversight/rent extraction). The "clean" data set does not corroborate this

assertion. Results classifying lawyers as nonpolitically experienced are similar and not

reported.

There is a bit of a trade-off to this analysis in that the "clean" data set only

contains 35 usable announcements involving political experience while the

"contaminated" sample may contain some noise due to the confounding events. It is

possible that this data set is large enough for the other announcements "contaminating"

the sample to average themselves out, but results from this sample should be viewed with

caution.

The results provide no evidence to support the rent creation story with respect to

the appointment of politically experienced directors. The level of export activity,

PEXPORT, has a significant and negative relationship with abnormal returns in all the specifications. However, the interaction term indicates that this relationship is conditional on political experience. A 1% increase in *PEXPORT* decreases returns by 0.09% in the "clean" sample for non-politically experienced directors while there is no effect for politically experienced directors.

The degree of market concentration, *FFCRAT,* has a positive and significant relationship with abnormal returns in the "contaminated" sample for non-politically experienced directors but no relationship for politically experienced directors. Furthermore, politically experienced directors do not appear to assist in acquiring or maintaining government contracts.

The rent extraction process as discussed above is not verified in the results above. The coefficients for *RDINT* are significant for politically experienced appointments with the "contaminated" sample, but they imply that a 1% increase in *RDINT* generates a .0009% increase in abnormal returns, opposite of what I had predicted. R&D expenditures are often used in the board literature as a proxy for growth opportunities. The regression could be picking up that information. Generally, growth firms value outside directors less given the information requirements to exploit these opportunities. That could explain the negative, albeit insignificant, for outsiders as a whole. Furthermore, the growth potential available to such firms may be conditional on government policy causing the coefficient of the interaction term to be positive. The lack of explanatory power for these variables could be attributed to the possibility that politicians use legislative threats to meet immediate needs and do not extract future board seats. I t could also be due to the distribution political experience within the sample. A

large number of the politically experienced directors served in the public sector as appointees not elected officials. McChesney (1997) explains that appointed civil servants are used by legislators to collect information and execute the extraction process and, therefore, might not receive benefits from legislative threats. Another plausible explanation is that the market recognizes the opportunity of rent extraction and already discounts the stock prices of those firms that are more susceptible to it.

Four of the five internal controls do not significantly affect the abnormal returns associated with the appointment of an outside director, regardless of political experience. The Gompers, Ishii, and Metrick (2003) governance index, *GINDEX*, is consistent with the hypothesis since a higher index translates to weaker shareholder rights and governance, i.e., a weaker governance system (a larger *GINDEX*) should lead to an increase in the abnormal return associated with the appointment of an outside director. The coefficient for this variable implies that a 1% increase in the *GINDEX* generates a .04% increase in the abnormal returns upon the appointment of a non-politically experienced outside director in the "contaminated" sample.

The interaction terms associated with *DEBTRAT*, *PNPOUT*, and *GINDEX* are significant in the model and confirm the prediction that internal controls can offset the foregone managerial oversight when politically experienced directors are appointed to corporate boards. A 1% increase in *DEBTRAT* and *PNPOUT* generate a .07% and .12% increase in the abnormal returns respectively with the appointment of a politically experienced director in the "clean" sample. The coefficient for the *GINDEX* interaction term is negative and significant. This result along with that presented above for non-politically experienced outsiders provides the strongest evidence to justify my assumption

that politically experienced directors are poor monitors of management. A 1% increase in the *GINDEX* leads to a .08% and .06% decrease in abnormal returns with the appointment of a politically experienced director for both "contaminated" models respectively, whereas the same increase in *GINDEX* leads to a .04% increase associated with the appointment of an outsider regardless of experience. When the *GINDEX* is large, costs of monitoring management are also high, so shareholders need effective directors to limit the self-interested behavior of management. Based on these two results, shareholders seem to believe that politically experienced directors will fail to achieve this goal. *DIVRAT* is also significant with the "contaminated" sample, but its sign is contrary to what I had predicted in that a 1% increase in the dividend ratio reduces abnormal returns by 0.06% and 0.04% in models (1) and (2) respectively.

The results from the other control variables are minimal. *SIZE*, *OTHEBRD*, *PTAX*, and *EXPAND* are all insignificant while *TENURE* is significant in three of the specifications. The negative coefficients associated with this variable suggest that government work does not adequately develop business acumen necessary to assist shareholders on the board and reinforces my notion that politically experienced directors lack the skills to effectively monitor management. Longer tenure in government could also indicate a greater opportunity to have extracted rents. Given the results from the rent extraction variables above, I tend to believe the prior explanation. The results for *PPOLS* reaffirm my assumption that politically experienced directors are not effective monitors of management.

Table 12: **Explaining Abnormal Returns**
Coefficients and standard errors from OLS regression of CAR on variables with heteroskedastic consistent standard errors for the "clean" sample. Results from the full model are indicated by (1) while model (2) excludes the *PIMOPRT* variable.

	(1)		(2)	
	β_i	*Standard Error*	β_i	*Standard Error*
CONSTANT	-0.82	0.08	-0.07	0.07
POLEXP	-0.11	0.19	-0.08	0.09
PEXPORT	-0.09**	0.04	-0.05*	0.03
PIMPORT	0.20	0.23		
FFCRAT	0.02	0.03	0.01	0.02
PSGOVT	-0.58	0.04	-0.008	0.03
ADINT	0.02	0.27	0.0297	0.26
RDINT	-0.0003	0.0004	-0.0004	0.0003
FAINT	0.02	0.02	0.02	0.02
INOWN	0.01	0.03	0.006	0.02
INSTOWN	-0.84	0.02	-0.004	0.02
DIVRAT	0.43	0.02	0.006	0.01
DEBTRAT	-0.01	0.01	-0.009	0.01
PNPOUT	0.01	0.03	0.005	0.03
LGINDEX	0.04	0.03	0.04	0.03
LSIZE	-0.002	0.003	-0.003	0.003
PTAX	-0.02	0.07	0.008	0.05)
TENURE	-0.002**	0.0008	-0.001*	0.0007
OTHERBRD	0.0008	0.003	-0.0002	0.002
PPOLS	0.03	0.05	0.03	0.05
EXPAND	-0.005	0.01	-0.002	0.008
*PEXPORT*POLEXP*	0.09	0.08	-0.007	0.07
*PIMPORT*POLEXP*	-0.66	0.53		
*FFCRAT*POLEXP*	-0.08	0.05	-0.01	0.03
*PSGOVT*POLEXP*	0.04	0.06	0.06	0.05
*ADINT*POLEXP*	-0.24	0.43	-0.17	0.30
*RDINT*POLEXP*	0.0003	0.0005	0.0007	0.0005
*FAINT*POLEXP*	-0.02	0.02	-0.02	0.02
*INOWN*POLEXP*	0.09	0.08	0.06	0.06
*INSTOWN*POLEXP*	0.004	0.05	-0.02	0.03
*DIVRAT*POLEXP*	0.06	0.07	-0.007	0.03
*DEBTRAT*POLEXP*	0.07**	0.03	0.02	0.02
*PNPOUT*POLEXP*	0.12**	0.06	0.06	0.04
*LGINDEX*POLEXP*	0.02	0.09	0.008	0.04
*LSIZE*POLEXP*	-0.0006	0.007	0.005	0.005
*PTAX*POLEXP*	0.45	0.48	00.01	0.03
*OTHRBRD*POLEXP*	0.001	0.005	0.002	0.004
*PPOLS*POLEXP*	0.03	0.09	-0.04	0.07
*EXPAND*POLEXP*	-0.0056	0.02	0.005	0.02
Observations	286		344	
POLEXP=1	35		49	
R-squared	.08		.07	

*, **, *** indicate significance at the 10, 5, and 1% levels respectively.

Table 13: Explaining Abnormal Returns

Coefficients and standard errors from OLS regression of CAR on variables with heteroskedastic consistent standard errors for the "contaminated" sample. Results from the full model are indicated by (1) while model (2) excludes the *PIMOPRT* variable.

	(1)		(2)	
	β_i	**Standard Error**	β_i	**Standard Error**
CONSTANT	-0.10	0.05	-0.09	0.04
POLEXP	0.18**	0.08	0.13*	0.07
PEXPORT	-0.07***	0.03	-0.05*	0.02
PIMPORT	0.07	0.14		
FFCRAT	0.04*	0.02	0.03*	0.02
PSGOVT	0.03	0.02	0.01	0.02
ADINT	-0.004***	0.001	-0.004*	0.001
RDINT	-0.34	0.0004	-0.0004	0.0003
FAINT	0.02	0.01	0.02	0.01
INOWN	0.02	0.02	0.01	0.02
INSTOWN	-0.02	0.01	-0.02	0.01
DIVRAT	-0.002	0.004	-0.002	0.004
DEBTRAT	0.009	0.03	0.008	0.02
PNPOUT	0.009	0.02	0.008	0.02
LGINDEX	0.04**	0.02	0.04**	0.02
LSIZE	-0.0001	0.002	-0.0003	0.002
PTAX	0.03	0.08	0.04	0.06
TENURE	-0.001	0.0009	-0.001*	0.0007
OTHERBRD	-0.0001	0.002	-0.0006	0.002
PPOLS	0.05	0.04	0.04	0.03
EXPAND	-0.006	0.006	-0.002	0.006
*PEXPORT*POLEXP*	0.04	0.06	0.03	0.05
*PIMPORT*POLEXP*	-0.13	0.46		
*FFCRAT*POLEXP*	-0.04	0.06	-0.01	0.04
*PSGOVT*POLEXP*	0.02	0.05	0.03	0.05
*ADINT*POLEXP*	-0.02	0.17	-0.01	0.10
*RDINT*POLEXP*	0.0008*	0.0005	0.0009**	0.0004
*FAINT*POLEXP*	-0.02	0.01	-0.02	0.01
*INOWN*POLEXP*	0.02	0.05	0.02	0.04
*INSTOWN*POLEXP*	-0.06	0.05	-0.06	0.04
*DIVRAT*POLEXP*	-0.06***	0.02	-0.04**	0.02
*DEBTRAT*POLEXP*	0.01	0.03	0.02	0.03
*PNPOUT*POLEXP*	0.03	0.05	0.03	0.04
*LGINDEX*POLEXP*	-0.08**	0.03	-0.06**	0.03
*LSIZE*POLEXP*	0.007	0.006	0.005	0.005
*PTAX*POLEXP*	-0.16	0.29	-0.11	0.14
*OTHRBRD*POLEXP*	0.002	0.004	0.003	0.96
*PPOLS*POLEXP*	-0.18*	0.10	-0.13*	0.07
*EXPAND*POLEXP*	0.007	0.02	0.009	0.01
Observations	523		612	
POLEXP=1	80		109	
R-squared	.09		0.7	

*, **, *** indicate significance at the 10, 5, and 1% levels respectively.

CHAPTER 6 – CONCLUSION

In this work I examine both the oversight and the advisory roles of outside directors of corporate boards. What makes this paper unique is that it focuses on politically experienced directors. By narrowing the scope to these directors, I can evaluate the advisory role in more detail, assuming that government work does not provide adequate skills and experience to effectively monitor management. Furthermore, the type of advice that these directors would offer (policy analysis/lobbying) is intuitive and, more importantly, measurable as reflected in Agrawal and Knoeber (2001). In Chapter 2, I refer to this as the Chicago School rent creation approach.

A careful review of the rent-seeking literature indicates that the interaction between firms and government may be more complicated. The Virginia School argument suggests that legislators, as self-interested agents, can possibly obtain board seats in the political afterlife through a rent extraction process. The story here is that legislators retract support for potentially harmful legislation in exchange for a payoff. Adding rent extraction into the analysis creates some separation from the Agrawal and Knoeber (2001) piece.

With this broader view of rent-seeking theory, I first conduct tests to estimate the determinants of board political composition. Like Agrawal and Knoeber (2001), I use a Poisson regression to analyze the number of politically experienced directors, but in addition to rent creation, I incorporate rent extraction and internal controls (to account for the assertion that politically experienced directors are poor monitors of management).

This method, however, may suffer from the endogeneity problems of previous board research, so I conduct a PROBIT regression to evaluate the probability of appointing a politically experienced director.

The results from these tests do not offer much insight into the rent creation explanation of board political composition. The level of market concentration is positive and significant in the Poisson regressions where a one standard deviation increase in *FFCRAT* leads to an increase of 0.13 politically experienced directors (a 21% increase compared to the mean) for the full model. The percentage of sales as exports is significant but has the opposite effect as predicted in that a one percent increase in this variable decreases the probability of the appointment having political experience by .35%. The other rent creation variables, however, are not significant for either method.

The Poisson regression contains some information regarding rent extraction while all of these variables are insignificant in the PROBIT estimation. The positive and significant coefficient for R&D intensity in both specifications of the Poisson regression provides some evidence of the opportunity for politicians to obtain board seats via legislative threats. A one standard deviation in *RDINT* generates a 0.30 (0.25 in model (2)) increase in the number of politically experienced directors (a 48% and 40% increase compared to the mean for model (1) and (2) respectively). The negative and significant effect of advertising intensity in specification (2) with the Poisson approach counters the prediction where a one standard deviation increase in the variable decreases the number of politically experienced directors by 2.

The results from the Poisson estimation offer some evidence to my assumption that politically experienced directors are poor monitors of management in that the degree

of institutional ownership and the dividend payout ratio are both positive and significant. A one standard deviation increase in *INSTOWN* increases the number of politically experienced directors by 0.22 (0.14 in model (2)) representing a 14% increase compared to the mean (9% for model (2)). The percentage of non-politically experienced directors contradicts those results, however. A one standard deviation increase in this variable causes a 0.60 (0.55 in model (2)) decrease in politically experienced directors (a 38% and 35% increase compared to the mean for model (1) and (2) respectively).

The internal control variables related to board composition, *PNPOUT*, and dividend policy, *DIVRAT*, within the PROBIT regression are significant but contradict the prediction in both models. A one percent increase in *PNPOUT* and *DIVRAT* actually decreases the probability of appointing a politically experienced director by more than .30% and .10%, respectively. The percentage of exports relative to sales also refutes my expectations. A one percent increase in this variable decreases the probability of the appointment having political experience by .35%.

The Poisson regression also provides information for the other controls. Firm size also significantly increases the incidence of politically experience due to rent creation and/or rent extraction motives by 3.36 (4.17 in model (2)) politically experienced directors for a one standard deviation increase. Contrary to my prediction, tax liability significantly reduces board political composition by 0.38 (0.35 in model (2)) representing a 24% decrease (22% for model (2)) compared to the mean.

The PROBIT results for the other controls are also limited. Firm size is significant in both specifications and confirms the hypothesis, but I cannot differentiate a rent creation effect from a rent extraction effect with this test. The results suggest that a

board with greater political composition will be more likely to add another politically experienced director. More specifically, a one percent increase in board political composition will increase the probability appointing a politically experienced director by .36% in both models. Though this result contradicts my initial expectation, it may indicate that greater levels of board political experienced contributes to managerial entrenchment.

Despite the weak results summarized above, the structure of the sample allows me to evaluate the effect of political experience on firm value. Event study methods generate cumulative abnormal returns, *CAR*, for the total "clean" sample of a positive 0.13%, yet this result is statistically insignificant. The "clean" subsamples show similar results with a CAR of 0.11% associated with the appointment of a politically experienced director while other outside director appointments generate a CAR of 0.13%. Both of these figures are statistically insignificant. The CAR for the total "contaminated" sample is a negative 0.01% and is not statistically significant. The subsample of politically experienced directors has a positive yet statistically insignificant CAR of 0.31%. The results from the event study indicate that the appointment of an outside director has, on average, no impact on firm value. The background of the director also, on average, does not seem to influence stock returns in my sample.

I also regress the *CAR* on the rent creation, rent extraction, internal control, and other control variables along with interaction terms because political experience could have a marginal effect on stock returns after controlling for other effects. Given this specification, the appointment of a politically experienced director generates a significant increase in abnormal returns of 0.18% and 0.13% in the two models respectively using

the "contaminated" data set. I interpret these coefficients as indicating that the benefits of political experience (advice/rent creation) outpace the costs (foregone oversight/rent extraction).

An additional reason for conducting this cross-sectional test is that political experience could contribute to marginal effects of other variables. The coefficients on the interaction terms for the rent creation variables do not provide much support for the story that politically experienced directors can increase firm value through the creation of rents. Likewise, there is little indication that politically experienced directors obtain their positions through a rent extraction process. The internal control variables, however, offer evidence in support of the assumption that politically experienced directors are poor monitors of management. The interaction terms associated with *DEBTRAT*, *PNPOUT*, and *GINDEX* are significant in the model and confirm the prediction that internal controls can offset the foregone managerial oversight when politically experienced directors are appointed to corporate boards. A 1% increase in *DEBTRAT* and *PNPOUT* generate a .07% and .12% increase in the abnormal returns respectively with the appointment of a politically experienced director in the "clean" sample. The coefficient for the *GINDEX* interaction term is negative and significant. This result along with the significant positive coefficient for non-politically experienced outsiders provides the strongest evidence to justify my assumption that politically experienced directors are poor monitors of management. A 1% increase in the *GINDEX* leads to a .08% and .06% decrease in abnormal returns with the appointment of a politically experienced director for both "contaminated" models respectively, whereas the same increase in *GINDEX* leads to a .04% increase associated with the appointment of an outsider regardless of experience.

Based on these two results, shareholders seem to believe that politically experienced directors will fail to achieve this goal.

APPENDIX A – TRANSCRIPT CNNFN MARKET CALL

CNNfn Market Call Thursday, December 12, 2002, 9:30 AM EST

Headline: Tough Call: Do Ex-Pols on Corporate Boards Increase Performance, Just Look Good?

Rhonda Schaffler, CNNfn anchor, Market Call: Disney earlier this month announced former Senator George Mitchell, already a board member, would take the post of presiding director, overseeing board members without corporate managers present.

It was this, and other business obligations that led Mitchell to resign his post as vice chairman of the President's September 11th panel last week. Corporations routinely appoint former congressmen and cabinet members to their boards of directors. The hope is, they give investors more confidence and boards more respectability. But do former politicians really help companies perform better? Or are they just high profile and high-priced window-dressing? Joining me to make the "Tough Call" is Sarah Teslik, executive director of the Council of Institutional Investors, and James Kristie, editor of "Directors & Boards Journal".

Welcome. It's good to have you both here.

Schaffler: James, I want to start with you. Tell us how prevalent it is that you do have politicians on corporate boards in America?

Kristie: It's very prevalent. And you can almost make the case that a company that is defined by government regulations or bumps up significantly against a regulatory structure might be derelict if it didn't have a former politician on its board of directors.

Schaffler: Why is that?

Kristie: I think they bring a – not every director has to bring the same talents and skills and leadership ability to the boardroom. I think a government official brings a knowledge of how government works, and access to a high-level network of leadership structure that many of the other board members do not.

Schaffler: Sarah, do you believe that's perhaps an advantage to have some of these politicians on the board?

Teslik: It is potentially and advantage. There was a great amount of hope when

politicians first started serving on the boards in large numbers. Both that they would be more expert in the political matters that boards must address, and that they would be more responsive to shareholders because they were used to being responsive to an electorate.

Schaffler: Do you find that is the case when we put it in practice, Sarah?

Teslik: In general, no.

Schaffler: Why?

Teslik: Of course, it's hard for anyone who doesn't sit in a boardroom, which most shareholders don't, to understand for sure which board members played what role in discussions. But viewing from the outside, shareholder groups have not seen an advantage to political people on boards.

Both, that they have not brought any particular expertise that we can measure from the outside; and also that we have not seen them step on to the floor and take courageous actions any more than other directors. In fact, probably less than other directors.

Schaffler: James, let's have you jump back in here. There's been a criticism that, you know, in many ways we have an old boys' network, when we look at the boards of directors on certain companies and that's how some problems occur. Do you think that's the case here? And if what Sarah says is correct, why aren't we having some of these more vocal participation and challenges from some of these politicians who know of the workings of regulation, and the like?

Kristie: I think Sarah is correct. It's very difficult unless you're a fly on the wall in a boardroom to know who a good director is and who a bad director is. That knowledge generally doesn't leave the boardroom.

I have to believe, though, that to get on a corporate board, you're pretty well vetted by your fellow board members and chairman and unless—if you're a dog director of any kind, you just don't get elected to a corporate board, so I have to believe that these politicians bring value to the board.

Schaffler: You know, Sarah, it might be interesting, you figure out who would be the best choice for boards knowing that, of course, knowing there is a time commitment there. So if it's not perhaps somebody from the government side of things, you know, where do we look for now to get good members on these boards? What sort of area would you like to see tapped that perhaps is not being tapped right now by these companies?

Teslik: Well, it's interesting, Jim is correct that it's hard to know outside the boardroom who has said what inside the boardroom. However, there are circumstances where it is possible for shareholders to know who stepped up to the plate and played a leadership role.

In particular, in situations where a CEO is performing sufficiently poorly, that he or she has to be removed, typically people find out afterwards who the directors were, who led that movement. And it's interesting that to my knowledge there have not been any ex-senators, governors, who have been the lead person in these efforts. Typically, the people who lead those kinds of boardroom coups or efforts are recently past or currently serving CEOs of major companies, people like the CEO him or herself.

Schaffler: James, if you could respond to that as far as boardroom coups. If there needs to be one at a company, who might lead it?

Kristie: I think Sarah is probably correct. You wouldn't have a former politician take the lead on that. I think the value that the politician brings is in the business operation in itself and extending business contacts, and opening new channels, and maybe new markets for a business, domestically or internationally where a politician may have very strong contacts at the very highest levels of other governments.

Schaffler: And, James, before we go, from your perspective, what would make up the ideal board? Who would these members be? Where would they come from to give a company what it needs?

Kristie: A board should be made up of a group of very accomplished individuals, very smart, who have the best interests of the company and its shareholders in mind. And they can come from all fields and from all walks of life, and from all leadership agendas and environments. And I certainly think there is room in a board for a former government official.

Schaffler: Sarah, we only have about 10 seconds. Would you add anyone to that list?

Teslik: I agree with that, but none of those qualities have values unless you have people on boards who are willing to walk away from the board if things are not going well. And unfortunately sometimes politicians need the board seats more than other people do.

Schaffler: Sarah Teslik and James Kristie, good talking to you as we make the "Tough Call" on politicians on boards. Thanks so much.

Kristie: Thank you.

Teslik: Thank you.

APPENDIX B – POLITICALLY EXPERIENCED DIRECTORS

Company	Name	Former Political Position
AAR Corp.	Gen. Ronald F. Fogleman	U.S. Air Force
Airgas, Inc.	Lee M. Thomas	Administrator EPA
AirTran Airways	W. J. Usery	Secretary of Labor, Presidential Advisor
ALARIS Medical, Inc.	Hank Brown	U.S. Sneate (R-CO), U.S. House of Representatives, CO State Senate
Allegheny Teledyne	Frank J. Lucchino	Controller Allegheny County
Alliant Energy Corp.	Singleton B. McAlister	General Counsel U.S. Agency for International Development, Congressional Aide
Alliant Techsystems	Frances D. Cook	Ambassador to Oman, Camerooon, Burundi, Consul General in Egypt, Deputy Assistant Secretary of State
Alliant Techsystems	Gen. Robert W.RisCassi	Vice Chief of Staff U.S. Army
Ambassadors	Brigitte M. Bren	Attorney
American Capital Strategies, Ltd.	Kenneth D. Peterson, Jr.	Attorney
American Electric Power	Kathryn D. Sullivan	National Oceanic & Atmospheric Administration, NASA
American General Corp.	Morris J Kramer	Attorney
American International Petroleum Corp.	John H. Kelly	Asst. Secretary of State, Deputy Assistant Secretary of State, Ambassador to Finland, Lebanon
American International Petroleum Corp.	Richard W. Murphy	Asst. Secretary of State, Ambassador to Mauritania, Syria, Philippines, Saudi Arabia
American Science and Engineering	Carl Vogt	Chair National Transportation Safety Board
American Standard Cos.	Jared L. Cohon	Senate Aide
Ameritech	Laura D'Andrea Tyson	National Economic Advisor
Amylin Pharmaceuticals, Inc.	Donald H. Rumsfeld	Secretary of Defense, White House Chief of Staff,

		Ambassador to NATO, U.S.
Amylin (Continued)	Donald H. Rumsfeld	House of Representative
Antigenics, Inc.	Sanford M. Litvack	Asst. Attorney General, Justice Department
Argosy Education Group, Inc.	Jeffrey T. Leeds	U.S. Supreme Court Clerk
Arterial Vascular Engineering, Inc.	Craig E. Dauchy	Attorney
Aviron	Barbara Franklin	Secretary of Commerce
Avnet Inc.	J. Veronica Biggins	Presidential Aide
BEI Electronics, Inc.	Robert Mehrabian	Commerce Department
Blount International	Haley Barbour	Chair Republican National Committee, Presidential Aide
Borg-Warner Automotive, Inc.	Phyllis O. Bonanno	Presidential Advisor
Borland Software Corp.	John R. Kasich	U.S. House of Representatives(R-OH)
Bright Horizons, Inc.	William Donaldson	Undersecretary of State, Vice Presidential Aide
C&D Technologies, Inc.	Adrian A. Basora	Ambassador to Czech Republic, National Security Council
Candlewood Hotel Co.	Thomas H. Nielsen	Asst Secretary USAF
Center Trust, Inc.	Mark S. Ticotin	Attorney
Charles Schwab Corp.	George P. Schultz	Secretary of State, Secretary of Treasury, Director Office of Management and Budget, Secretary of Labor
Chesapeake Corp.	Sir David Fell	Second Permanent Under Secretary of State, Permanent Secretary of Dept. of Economic Development in Northern Ireland, U.K. Ministry of Commerce
Chevron Corp.	J. Bennett Johnston	U.S. Senate (D-LA), LA State House, LA State Senate
Chubb Corp.	Karen Hastie Williams	Chief Counsel Senate Committee on Budget
Chubb Corp.	Sheila P. Burke	Senate Aide
CLARCOR, Inc.	Philip R. Lochner, Jr.	Commissioner of Security & Exchange Commission
Claremont Technology Group, Inc.	Marilyn R. Seymann	Vice Chair Federal Housing Finance Board, Gubernatorial Aide
Clark/Bardes Holdings, Inc.	Bill Archer	U.S. House of Representatives
CMS Energy Corp.	John M. Deutch	Deputy Secretary of Defense, Under Secretary of Defense,

		Under Secretary of Department of Energy, Director Central Intelligence, Director Central
CMS Energy Corp.	John M. Deutch	Intelligence Agency
Colgate-Palmolive Co.	Delano E. Lewis	Ambassador to S. Africa, Dept. of Justice, Equal Opportunity Commission
Conoco, Inc.	A.R. Sanchez, Jr.	Attorney
Crown Cork & Seal	Marie L. Garibaldi	Associate Justice of Supreme Court of New Jersey
Crown Cork & Seal Co.	Hugues du Rouret	Counselor to French Minister of Trade
Cummins Engine Co., Inc.	John M. Deutch	Deputy Secretary of Defense, Under Secretary of Defense, Under Secretary of Department of Energy, Director Central Intelligence, Director Central Intelligence Agency
Cylink Corp.	William J. Perry	Secretary of Defense
Dell Computer Corp.	William H. Gray, III	U.S. House of Representatives (D-PA)
Devon Energy Corp.	Moulton Goodrum, Jr.	Attorney
Diamond Offshore Drilling	Bill Richardson	Secretary of Dept. of Energy, Ambassador to U.N., U.S. House of Representatives (D-NM)
Digital Solutions	Charles R. Dees	Department of Education
Dynamics Research Corp.	Martin V. Joyce, Jr.	Lt. Col. Air National Guard
EDS	William M. Daley	Secretary of Commerce
Electro Rent	S. Lee Kling	Finance Chair Democratic National Committee, Presidential Aide
Eli Lilly & Co.	Martin Feldstein	Chairman Council of Economic Advisors, Chief Economic Advisor
ENDOcare, Inc.	Benjamin Gerson	Food & Drug Administration
Endwave Corp.	Randolph M. Blotky	Attorney
Enron Corp.	William Powers, Jr.	Attorney
Estee Lauder Cos.	Charlene Barshefsky	U.S. Trade Representative
Federated Department Stores, Inc.	Joseph A. Pichler	Department of Labor
Florida Rock Industries, Inc.	Tillie Fowler	U.S. House of Representatives (R-FL)
FMC Corp.	Asbjorn Larsen	Norway Min. of Foreign Affairs
FMC Corp.	E.J. Mooney	Attorney
Galileo International, Inc.	Wim Dik	Netherlands State Secretary

Galileo International, Inc.	Wim Dik	Foreign Trade
Gannett Corp.	H. Jesse Arnelle	Department of Labor
Gateway, Inc.	Elizabeth Dole	Secretary of Transportation, Secretary of Labor, Presidential Advisor
GenCorp	Gen. J. Gary Cooper	Ambassador to Jamaica, Asst. Secretary of USAF, Commissioner AL Department of Human Resources, AL Legislature
Genta, Inc.	Betsy McCaughey	NY Lt. Governor
Gevity HR, SM	Darcy Bradbury	Deputy Asst. Secretary Department of Treasury
Glenayre Technologies, Inc.	Horace H. Sibley	Attorney
GTSI Corp.	Daniel R. Young	Attorney
Handleman Co.	William J. Beckham	Asst. Secretary of Treasury, Dept. Secretary of Transportation
Hartford Financial Services Group	Edward J. Kelly, III	Attorney
Heilig-Meyers Co.	Douglas Wilder	VA Governor
HomeBase, Inc.	Robert W. Cox	Securities & Exchange Commission
Hybrid Networks	Phillip J. Krushner	Attorney
ICN Pharmaceuticals	Andrei V. Kozyrev	Russia Minister of Foreign Affairs, Russia State Duma
IDT Corp.	Adm. Bill Owens	Joint Chiefs of Staff
Industrial Scientific Corp.	Thomas M. Thompson	Attorney
Infosafe Systems, Inc.	Neal B. Freeman	Presidential Aide, Director Corporation for Public Broadcasting
infoUSA	Ben Nelson	NE Governor
Integrated Electrical Services, Inc.	Donald Paul Hodel	Secretary of Energy, Interior
International Rectifier Corp.	Minrou Matsuda	Attorney
J. Ray McDermott, S.A.	Sean O'Keefe	Secretary of Navy, Department of Defense, Congressional Aide
K2, Inc.	Dan Quayle	U.S. Vice President, U.S. Senate (R-IN), U.S. House of Representatives
Kaufman & Board Home Corp.	Steve Bartlett	U.S. House of Representatives (R-TX)
Kaufman & Board Home	Henry Cisneros	Secretary HUD
Labor Ready, Inc.	Carl W. Schafer	Bureau of Budget
lacrosse Footwear, Inc.	John Whitcombe	Attorney

LaserPacific Media Corp.	Craig Jacobson	Attorney
Lattice Superconductor Corp.	Mark O. Hatfield	U.S. Senate (D-OR), OR State Senate, OR State House, OR Secretary of State, OR Governor
Leap Wireless International, Inc.	Anthony R. Chase	Attorney
Lennar Corp.	Donna Shalala	U.S. Secretary of Health & Human Services, Asst. Sec. HUD
Little Switzerland, Inc.	Adrianne J. Dudley	Attorney
Liz Claiborne, Inc.	Raul J. Fernandez	Congressional Aide
Liz Claiborne, Inc.	Bernard W. Aronson	Asst. Secretary of State
LML Payment Systems, Inc.	L. William Seidman	Presidential Aide
Lucille Farms, Inc.	Jay Rosengarten	Attorney
LXR Biotechnology	Neil Flanzraich	Attorney
M.A. Hanna Co.	Robert A. Garda	Commissioner Greater Cleveland Regional Transit Authority
McLeodUSA, Inc.	Anne K. Bingaman	Asst. Attorney General
Merrill Lynch & Co., Inc.	Adm. Joseph W. Prueher	U.S. Navy, Ambassador to China
Mesa Air Group	Maurice Parker	National Labor Relations Board, Federal Aviation Administration
Microsoft Corp.	Ann McLaughlin	Secretary of Labor, Asst. Secretary of Treasury, Under Secretary of Interior, EPA.
Microvision, Inc.	Gen. Dennis J. Reimer	Chief of Staff U.S. Army, Joint Chiefs of Staff
MidAmerican Energy Holdings Co.	Terry E. Branstad	Governor of Iowa
Midwest Express Holdings, Inc.	Ulice Pyane, jr.	WI Commissioner of Securities
Midwest Express Holdings, Inc.	Samuel K. Skinner	Secretary of Transportation Presidential Aide, U.S. Attorney Northern IL District
Millipore Corp.	Elaine L. Chao	Director peace Corps, Deputy Secretary Department of Transportation, Chair Federal Maritime Commission
Mine Safety Appliances Co.	L. Edward Shaw	Attorney
Mississippi Chemical Corp.	Reuben Anderson	Justice of Supreme Court of Mississippi
MONY Group, Inc.	Frederick W. Kanner	Attorney
Moody's Corp.	Connie Mack, III	U.S. Senate (R-FL), U.S. House of Representatives
MUSE Technologies, Inc.	Jack C. Berenzweig	Attorney
Mycogen Corp.	Clayton K. Yeutter	Secretary of Agriculture

Nalco Chemical Co.	Sheila A. Penrose	U.K. Department of Treasury
Nash Finch Co.	Laura Stein	Attorney
New Jersey Resources Corp.	Lawrence R. Codey	New Jersey Board of Public Utilities
Northstar Health Services, Inc.	Timothy L. Pesci	PA State Representative, Armstrong County Controller
Nuevo Energy Co.	Charles M. Elson	Attorney
Nyer Medical Group, Inc.	Robert J. Barrett, III	Attorney
Oakwood Homes Corp.	Lanty L. Smith	Attorney
OGE Energy Corp.	J.D. Williams	Senate Aide
Owens Corning	Curtis H. Burnette	Attorney
Owens Corning	Gaston Caperton	WV Governor
P. H. Glatfelter Co.	Ronald J. Naples	Presidential Advisor, Federal Energy Administration
Parker Driling Co.	Robert M. Gates	Director Central Intelligence, National Security Council
Paychex, Inc.	Betsy S. Atkins	Pension Benefit Guarantee Corp.
Phoenix Technologies	Shih-Chien Yang	People's Republic of China Minister of State
Plenum Communications, Inc.	Larry H. Dale	Executive Director Fannie Mae
PP&L Resources, Inc.	Frederick Bernthal	Nuclear Regulatory Commission
Procter & Gamble Co.	Domenico De Sole	Attorney
Procter & Gamble Co.	Ernesto Zedillo Ponce de Leon	Mexico President, Mexico Under Secretary of Budget, Mexico Secretary of Education
Protective Lfe Corp.	Gen. J. Gary Cooper	Ambassador to Jamaica, Asst. Secretary of USAF, Commissioner AL Department of Human Resources, AL Legislature
Protective Life Corp.	Susan Molinari	U.S. House of Representatives (R-NY)
Protective Life Corp.	Elaine L. Chao	Director peace Corps, Deputy Secretary Department of Transportation, Chair Federal Maritime Commission
Public Service Enterprise Group, Inc.	Conrad K. Harper	U.S. Department of State
QUALCOMM, Inc.	Diana Lady Dougan	Asst. Secretary of State, Director Corporation of Public Broadcasting
R.R. Donnelley	Joseph B. Anderson	Department of Commerce
R.R. Donnelley & Sons, Co.	Oliver R. Sockwell	Sallie Mae
Read-Rite Corp.	Robert M. White	Under Secretary Commerce Department

Republic Engineered Steels, Inc.	Anthony J. Celebrezze, Jr.	OH Attorney General, Ambassador to India, OH Secretary of State, OH State Senate
Rockwell Collins	Gen. Michael P.C. Carns	U.S. Air Force
Ross Stores, Inc.	Lawrence M. Higby	Presidential Aide, Office of Management & Budget
RTI International Metals, Inc.	Edith E. Holiday	Presidential Aide, Secretary of Cabinet, Department of Treasury
Rushmore Financial Group, Inc.	John H. Dalton	Secretary of Navy
Scios Inc.	Donald B. Rice	Secretary of USAF, Department of Defense, Asst. Director Office of Management and Budget, Deputy Asst. Secretary of Defense
Senetek Corp.	Andreas O. Tobler	Attorney
ServiceMaster	Glenda Hatchett	Chief Judge Fulton County Juvenile Court
Southern Co.	Donald M. James	Attorney
Speedway Motorsports, Inc.	Jack Kemp	Secretary HUD, U.S. House of Representatives (R-CA)
Suffolk Bancorp	Terence X. Meyer	Attorney
T Cell Science, Inc.	William J. Ryan	Chief Counsel U.S. Committee on Labor and Human Resources
T. Rowe Price Group, Inc.	James H. Gilliam, Jr.	Attorney
Teknowledge Corp.	Larry E. Druffel	Deputy Under Secretary of Defense
Teledyne Technologies	Adm. Paul D. Miller	U.S. Navy
Terra Industries, Inc.	Robert L. Thompson	Asst. Secretary of Agriculture, Presidential Advisor
Touchstone Applied Science Associates	Joseph A. Fernandez	Chancellor NYC Public Schools, Superintendent Dade County Public Schools
Transatlantic Holdings, Inc.	C. Fred Bergsten	Asst. Secretary of Treasury, National Security Council
Triad Hospitals, Inc.	Nancy-Ann DeParle	Administrator Health Care Financing Administration, Office of Management & Budget, TN Commissioner of Human Services
Trimeris, Inc.	J. Richard Crout	Food & Drug Administration
True North Communications	Mannie Jackson	Depterment of State
U.S. Bioscience, Inc.	George H. Ohye	Attorney
U.S. Surgical Corp.	James R. Mellor	Department of Defense

Unicom Corp.	Elizabeth A. Moler	Deputy Secretary Department of Energy, Chair Federal Energy Regulatory Commission, Deputy Secretary of Energy
Unigene Laboratories, Inc.	Allen Bloom	Attorney
UniSource Energy Corp.	Daniel W. L. Fessler	President CA Public Utilities Commission
Univision Communications, Inc.	Juan Villalonga	Attorney
URS Corp.	J. Bennett Johnston	U.S. Senate (D-LA), LA State House, LA State Senate
Valentis, Inc.	Alan Mendelson	Attorney
Waste Management, Inc.	Carl W. Vogt	Chair National Transportation Board
Western Wireless Corp.	Daniel J. Evans	U.S. Senate, WA Governor
York Research Corp.	Frederic S. Berman	Justice NY Supreme Court

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