The Board of Directors in Regulated Brazilian Companies: Political Connections and Their Performance

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Introduction

Some factors characterize the regulation environment, restrict actions and make the degree of competition between companies more intense. For example, price limitation, availability and/or obstacles in subsidies use, rate variation and entry control (Stigler 1971). Asymmetric effects between producers, consumers and regulators also pressure companies and so the environment becomes turbulent (Mahon and Murray 1981).

Regulation by agencies began in Brazil in 1997, with the Brazilian government's decision to privatize companies to ease economic crisis and stop acting as a provider State and richness producer, and assume the role of a regulator (Nunes et al. 2007). In order to mitigate regulation effects and seize opportunities in relations with the government, companies developed skills in political strategies to increase their performance. One of the strategies that companies adopted to overcome regulation effects was the approach to the regulated environment through political connections, to thereby increase their competitive power (Shaffer 1995) and protect the assets of expropriation and dissipation (Helland and Sykuta 2003).

Using political strategies, companies seek to reduce the asymmetry of information, uncertainty and transaction costs (Hillman, Zardkoohi and Bierman 1999; Spiller and Liao 2006). Thus, a more favorable environment helps overcome entry barriers (Baysinger 1984), obtaining competitive advantages as a source of profit and finance in product design, production and marketing (Shaffer 1995) and ultimately, with important consequences on the economic and financial performance. Therefore, companies with a greater reliance on regulation use the expansion and structuring of their Board of Directors as a strategy, with members having previous political backgrounds (Helland and Sykuta 2003), especially in emerging markets (Millar, Eldomiaty, Choi and Hilton, 2005).

The literature that investigates political strategies considers that boards also play a strategic role and a board member with previous political experience plays an especially strategic role in articulation of strategies for the business and the company's interests (Adams, Hermalin and Weisbach 2009; Auyero 2009; Keim and Baysinger 1988; Salamon and Seigfried 1977; Shaffer 1995; Shaffer, Quasney and Grimm 2000). The research conducted by Schuler (1996), Marsh (1998) and Hillman & Hitt (1999) proved that public politics and governmental decisions affect all aspects of a business and can significantly compromise the companies' final results. This research is aligned with the studies conducted by Agrawal and Knoeber (2000), Helland and Sykuta (2003) and Hillman (2005).

In these studies, the authors address the participation of advisers with previous politics experience in governance systems of regulated companies in the economy sectors, and if this relationship generated more sales, competition and financial performance, respectively. Studies that focus on companies based in the country have been increasing. In Brazil, this study adheres to studies regarding the political strategies of companies and their effects on performance, similar to the studies by Ramalho (2007), Claessens, Feijen and Laeven (2008), Bandeira-de-Mello and Marcon (2011) and Camilo, Marcon and Bandeira-de-Mello (2012).

Based on previous studies, the aim of this study is to investigate the political connections of board of directors in Brazilian regulated companies and their impact on economic and financial performance. Hence, this study is a contribution to previous studies, since, until this moment, studies with the same objective were not found, precisely in a country where there are turbulent relationships between companies and the government. The results of this study are relevant to the extent that they complement the existing results, and broaden the understanding of the political strategies of companies, as well as encourage new discoveries.

In order to achieve the proposed objective, the paper was structured as following: section 2 is a theoretical review, section 3 details methodology, and sections 4 and 5 describe the results analysis and discussion, as well as final considerations, respectively.

Theoretical Review and Hypothesis

This section covers the topics that directed the research. Using the Theory of Agency we seek to clarify the issue of separation between property and management of the current structures and organization's processes. The Corporate Governance uses a monitoring and control structure to mediate the relationships between agents and owners.

Within this context, the study addresses the Board of Directors, through whom the stock market and the regulators legitimize the corporate relationships and actions. With regulations, the State intervenes in the economy, when it regulates service concessions and the market in order to correct its failures or to pursue its efficiency. Thus, the organizations react with corporate policy strategies to reduce risks, uncertainties, charges and fees applied by the regulated environment, as well as its relationships with the financial and economic performance.

Theory of Agency

With basis in the Theory of Agency context (Jensen and Meckling 1976) the need to adopt actions of control emerges, through Corporate Governance, which is intended to safeguard the organization from various potential or existing transaction costs. To ensure shareholder representation in management, the Corporate Governance advanced, establishing control mechanisms, that is, the shareholders use control mechanisms or monitoring means to monitor agency problems (Jensen and Meckling 1976).

The conceptual bases of Corporate Governance were established from separation of ownership and control; from diverging interests between owners and managers; and from the inadequacy of traditional conceptions regarding the control of open societies and the maximization of profits, which have their roots in the Theory of Agency. In this model the owner (shareholder) delegates the decision-making power of their property to a specialized agent (executive). However, the manager's interests are not always aligned with those of the owner, and as a result, an agency conflict arises or principal-agent problem (Jensen and Meckling 1976). This confrontational relationship between the shareholders and the company's managers is also known as the agency problem (Jensen and Meckling 1976; Fama 1980; Williamson 1985; Eisenhardt 1989; Putterman 1996).

The agency problem happens when managers seek to maximize their personal usefulness at the shareholders expense. From this approach the Theory of Agency was developed (Jensen and Meckling 1976; Fama and Jensen 1983), and it is focused on two possible problems related to agency relationships: when the desires or goals are different between the principal and the agent, and when it is hard or expensive for the principal to check which activities the agent is developing (Eisenhardt 1989). Companies can have their own strategic interests to achieve a higher performance. However, the decision-making power is in managers' (agents') hands, who are hired by the shareholders (principals) through the Board of Directors, whose main purpose is to represent the owners (Jensen and Meckling 1976).

According to Jensen and Meckling (1976), an agency relationship is a contract under which one or more individuals (principal) place another individual (agent) in charge to perform services for them, which involves delegation of decision-making power to the agent.

If both parties in this relationship maximize their usefulness, to the extent that these utilities do not coincide, there are reasons to believe that the agent will not always act on the best interest of the principal. In a relationship between a principal and their agent, the first one expects the other to make efforts at an optimal level for maximizing their utility, but this level of effort may not integrate the agents' interest.

Thus, in the principal-agent relationship, whether it is between manager/employee, shareholder/executive or donor/executive, the principal seeks to implement a monitoring and encouragement framework in order to align the agents' interests to their own (interests) (Machado Filho et al. 2006). According to Jensen and Meckling (1976), some factors will predominant the company's best economic performance and minimization of the company's agency problems: (a) the technical competence of the chosen executives to guide/conduct the company's activities; (b) the alignment of interests' between executives and corporations; (c) the adjustment of the Corporate Governance structure in order to conduct a relationship between the principal (shareholder) and the agent (manager).

Based on this context the need for adopting control measures emerges in order to safeguard the organization from numerous existing or potential transaction costs, due to a network of established contractual relationships (Rodrigues 2003). The need for control measures or mechanisms (Gillan 2006; Andrade and Rossetti 2007) gave rise to the Corporate Governance as a moderating medium of agency relationships (Badulescu and Badulescu 2008).

Corporate Governance

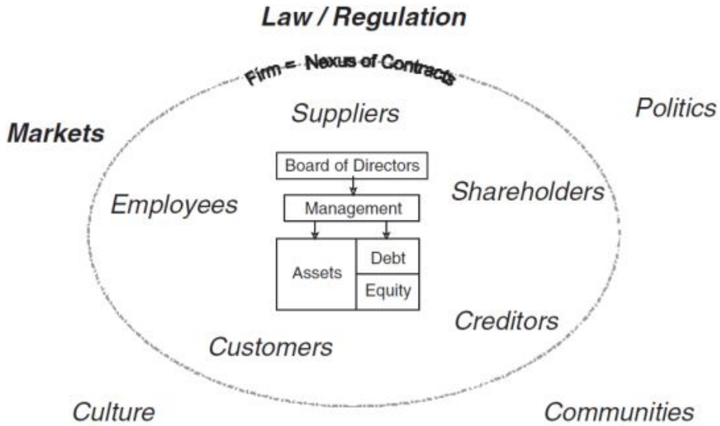
The conceptual foundations of governance came from studies by Berle and Means (1932), when they reported the separation phenomenon between property and management, which was a result of historical evolutionary process of corporations, developed during the last century and even more so nowadays. Factors such as the evolution of capital market, the dilution of companies' ownership in the markets, globalization of capitals, combined with increasing competition, pressured the companies to adopt professional management systems. The latter occurred especially because of the globalization of an organization's ownership structure ,the dispersion of shareholders, the pulverization of property and the higher rotation of shareholder property in stock exchange trading (Andrade and Rossetti 2007). Silveira (2006) points out the determining factors for strengthening the need for Corporate Governance, which include activism of institutional shareholders, represented by pension funds, mutual funds and insurance companies, that perceive the existence of power abuse by managers, and strong indications of wealth expropriation and the domination of the Board of Directors.

The term *corporate governance* is derived from an analogy between city, state and nation governments to a corporate management government. According to Vidigal (2000), *governance* has its origin in the Latin verb *gubernare*, which means rule, that is, it would be the system in which the shareholders "would rule" the corporation. Corporate Governance is a system through which societies are ruled and monitored, involving relationships, rights and responsibilities between Board of Directors, Shareholders, Directory, Independent Audit, Fiscal Committee and Stakeholders (unions, associations, employees and other groups) whom may participate in company management and in defining objectives, instruments and monitoring mechanisms of company's performance (IBGC 2009; OCDE 2007).

Gillan (2006) describes another manner of defining Corporate Governance. He states that the definition of Corporate Governance depends on the way you look at it and on the country you are in. Background studies showed that Corporate Governance can be analyzed from a broader perspective, in which governance is a set of complex restrictions that shape the *ex post* negotiation on incomes generated by the company (Zingales 1998a). Whereas Shleifer and Vishny (1997) define Corporate Governance as the way business finance providers assure a return on their investment. Moreover, from a broader perspective, Gillan and Starks (1998) conceptualize Corporate Governance as a system of laws, rules and factors that control a company's operations.

When the introduced definitions are considered, it is clear that governance comprises the internal and external relationships together with the organizational environment, control mechanisms and their internal and external implications as defined by Gillan (2006) and shown in Figure 1.

Figure 1: Corporate governance: beyond the balance sheet model



Source: Gillan (2006, p. 383)

This structure allows for a broader understanding of the organizational environment, the functions of Corporate Governance as well as allowing the advancement of defining and establishing control in the corporate world, i.e. Corporate Governance mechanisms.

Corporate Governance Mechanisms

Mechanisms are classified as internal and external mechanisms (Denis and Mcconnell 2003; Gillan 2006). Internal mechanisms include: Board of Directors, shareholder wealth, administrator compensation models, shared monitoring, and multidivisional business structure. External controls can be exercised by the definition of regulatory mechanisms, accounting exacting standards, capital market, competitive markets, institutional investors, shareholder activism and performance of private equity funds (*private equity*).

An important mechanism of internal control that Corporate Governance uses to moderate agency problems in organizations is the Board of Directors, where its composition is related to size (Linck et al. 2008) and the type of members (Adams et al. 2009). Size is related to the number of members that compose the board. In regards to types, it is related to the members' origins, if internal or not, to gender, age and form of representation. The characteristics are related to a member's background and professional experience, their independence to work in the board, owners or not of shares and other variables that can influence an advisers performance, for example, performance in public jobs (Agrawal and Knoeber 2001; Helland and Sykuta 2003; Hillman 2005; Goldman et al. 2009); and bankers who perform a controlling role (Byrd and Mizruchi 2005), venture capitalists (Baker and Gompers 2003).

The main task of the Board of Directors is "to assure the continuing existence of the company, considering the interests of all relevant stakeholders with integrity" (Hilb, 2009, p. 41). Since there are different companies in different countries with diverse cultures, it is comprehensible that the Board of Directors performs different functions. In accordance with the country where the company is located, the Board of Directors may assume functions such as selection, review, remuneration, development and dismissal of the CEO or other important members of the Executive Board, participation in co-development and evaluation of corporate strategy and culture, budget development, planning and financial control, sending reports to the shareholders and implementing its self-evaluation (Hilb, 2009). Agrawal and Knoeber (2001), Helland and Sykuta (2003), Gillan (2006), Silveira (2006), Bhagat and Bolton (2008), Adams et al. (2009) are authors who have also investigated the board's function.

According to Andrade and Rossetti (2007, p. 271), the Board of Directors' function is to "act as a link between the property and the executive board, monitoring a group of management risks, conflicts and agency costs". Silveira (2006) states that the Board of Directors is the main internal mechanism to reduce the existing agency costs between shareholders and managers, and between controlling shareholders and minority shareholders. Gillan (2006, p. 385) affirms that the Board of Directors has "a fiduciary duty to the shareholders as well as the responsibility of providing strategic and monitoring direction", which emphasizes the Board of Directors importance on management and governance structure of organizations.

According to Bhagat and Bolton (2008, p. 258), "the Board of Directors have the power to do or, at least, to ratify all important decisions, including decisions about investment policy, manager compensation policy and its own governance and management". In a recent study, Adams et al. (2009) conducted a descriptive survey of studies on the role of the Board of Directors. In this survey, the authors found studies that describe some of the Board of Directors functions, which include: to be a source of assistance and advice; to help define the company's strategic direction; to make hiring and dismissal decisions, and to evaluate the main executives; as well as evaluate and select projects and the company's CEO.

Through a broad analysis of practical, theoretical and empirical research developed around the world, Hilb (2009) proposes an integrated model of Corporate Governance based on the action principle of the Board of Directors under four dimensions: situational, strategic, integrated management, and control (inverted CIES). In the situational dimension, the author defends the organization's differentiation between internal and external context. In the external context, one needs to pay attention to the normative, legal implications and cultural differences of countries, industries and organizations. Within the company's internal context, the developmental phase, the ownership structure and the generating of power from each organization have implications on the board's practices, which reflects on its size, complexity, level of internationalization and ambitions.

External advisers play an important role in companies, because since they carry out monitoring, reward and penalization functions, they can align the agents and shareholders' interests and contribute in solving agency problems (Fama and Jensen 1983). With their experiences and skills acquired in other companies or activities, external advisers bring problem solving knowledge that involves technologies and markets and can be important in defining business strategies, precisely because of their external perspective of opportunities that can be unknown by internal advisers (Agrawal and Knoeber 2001). In their research, Agrawal and Knoeber (2001) found a good number of external advisers that play the role of executives in other companies or as successful investors, consultants, lawyers and politicians. Among external advisers, those who have already played or play policy and legal roles are significant.

With a background in regulated markets, due to previous experiences or knowledge about regulation mechanisms and processes, external advisers can assist companies in business policies, in rate increase applications and nominations, as well as the opportunity for exploration with a major political role in negotiation or prediction of government hostilities regarding the company. The hostilities are manifested through public pressure and regulatory requirements (Adams et al. 2009) from governments and markets in certain economy sectors, to modify an organizations' external environment. Nevertheless according to the authors view, these shifts influence the composition of the Board of Directors and they understand that in the past years, public pressure and regulatory requirements led companies to compose their boards primarily with external advisors.

Regulation

Regulation is an English term and when translated to Portuguese, refers to regulation and rules. In the North American system, the term may have a broader meaning, similar to all activities of organized public powers that constitute the social reality, and in a stricter sense, consists in the determination of legal framework for an economic activity. Regulation is defined by Den Hertog (1999, p. 223) as the "employment of legal instruments for implementing economic, political and social objectives".

Through regulatory standards, the State grants the private sector the provision of services and regulates its use, imposing prices, production quantities, quality standards, and circulation and consumption of goods (Aragão 2007; Salomão Filho 2008). Within the same context, the Organization for Economic Co-operation on Development (OCDE, 1997, p. 6) defines regulation as the "group of instruments through which governments establish rules for companies and citizens". For Boehm (2007, p. 2), regulation "is a coercive intervention from the government, through the establishment of rules and sanctions with objectives of correcting failures observed in a certain industry". These definitions bring the idea of inspection and control by the State over the production sectors. The dependence of firms by regulatory agencies decisions generates interest in intensifying relational relations. This encourages the creation of forms of collective action of stakeholders that seek to reduce uncertainties (Auyero 2009). There are two main regulation objectives, according to Levy and Spiller (1993): (i) to encourage investments – through fair implementations that allows investors profits and establishes confidence on the business' stability and, (ii) to support efficiency in production and use – adopting measures to stimulate competition and use suitable market prices.

In a broader sense, OCDE (1997) states that a good regulation must: (i) serve clearly identified policy objectives, and to be effective in the execution of these objectives; (ii) be based on legal and empirical advice; (iii) produce benefits that justify the costs, as well as the distribution of effects across society, considering the economic, social and environmental effects; (iv) minimize costs and market distortions; (v) promote innovation through market incentives and goal-based approaches; (vi) be clear, simple and practical for users; (vii) be consistent with other regulations and policies, and lastly, (viii) be compatible, as much as possible, with competition, commerce and with principles that facilitate investments at a national and international level.

The existence of a regulatory structure in important sectors of the national economy such as energy, communication and transportation, can influence, and directly and indirectly impact a company's performance and demand specific strategies to overcome them (Holburn et al. 2002). Policy strategies, through political connections, are a manner of attenuating the problems caused by regulation, for example, tariff protection, entry barriers, intellectual property protection and price control (Hillman 2005; Faccio 2006; Goldman et al. 2009; Cooper et al. 2009).

Conversely, the findings that indicate positive implications on a company's performance are not unanimous. There are studies such as the ones conducted by Banker, Das and Ou (1997), Faccio and Parsley, (2007) and Faccio (2009) that have not found statistical significance on performance, but have found the opposite, showing a decrease in a company's value.

Political Strategies and Hypothesis Formulation

Despite the entire existing theoretical framework, studies on political activities between companies and the government have been uneven, fragmented and characterized by a lack of theoretical and methodological cohesion (Shaffer, 1995). As a consequence, there are distinct nomenclatures with similar functions and meanings, such as "corporate political activities" (Baysinger 1984; Shaffer 1995; Holburn and Vanden Bergh 2002; Hillman, Kein and Schuler 2004), "non-market strategies" (Holburn and Vanden Bergh 2002; Bandeira-de-Mello and Marcon 2008) and "political connections" (Hillman 2005; Faccio 2006; Goldman, Rocholl and So 2008; Cooper, Gulen and Ovtchinnikov 2009).

Each approach theoretically develops the participation of companies in activities that involve a relationship with the government, specifically in relation to interests linked to the business and the legislation and regulation process of these companies' action sector. The reasons that led companies to build relationships or "political connections" (Hillman and Hitt 1999) vary according to their interests and the focus the government uses when defining public policies (Shaffer 1995). The author shows a model of interdependency between companies and the government, that details the companies' course of action. According to him, the company adopts an "adaptive" position when the government uses its authority to regulate the companies' actions through legislation or visa-versa, with "interest groups" (Stigler 1971), when there is a governmental intention to develop public policies (Shaffer 1995).

Conceptually, a company is politically connected when there is at least one member of its Board of Directors, including the CEO (Chief Executive Officer) and the Audit Board, with previous political experience, in other words, background as a parliament or ministry member, or any other high bureaucratic position (Boubakri et al. and 2009; Faccio 2006). According to Hillman, Keim and Schuler (2004), these connections are translated to corporate policy and they are measured in two ways: (i) through results in public policies and (ii) through results of the companies' performance.

The interferences of these corporate strategies on public policies were empirically validated in many actions (Hillman, Keim and Schuler 2004). For example, their interference can be found in some areas such as commercial policy (Rehbein and Lenway 1994); monopolistic law practices in the American economy (Ramirez and Eigen-Zucchi 2001); the American bank system versus industry (Ramirez and Long 2001); external commercial policy (Schuler et al. 2002); results in lawsuits (Dean et al. 1998); consumer protection (defective cars) (Shaffer and Ostas 2001); medicine price control and drug refunds by pharmaceuticals (Pracht and Moore 2003); public hearing of regulatory agencies (Campbell 1998); and anti-trust policies (Clougherty 2003).

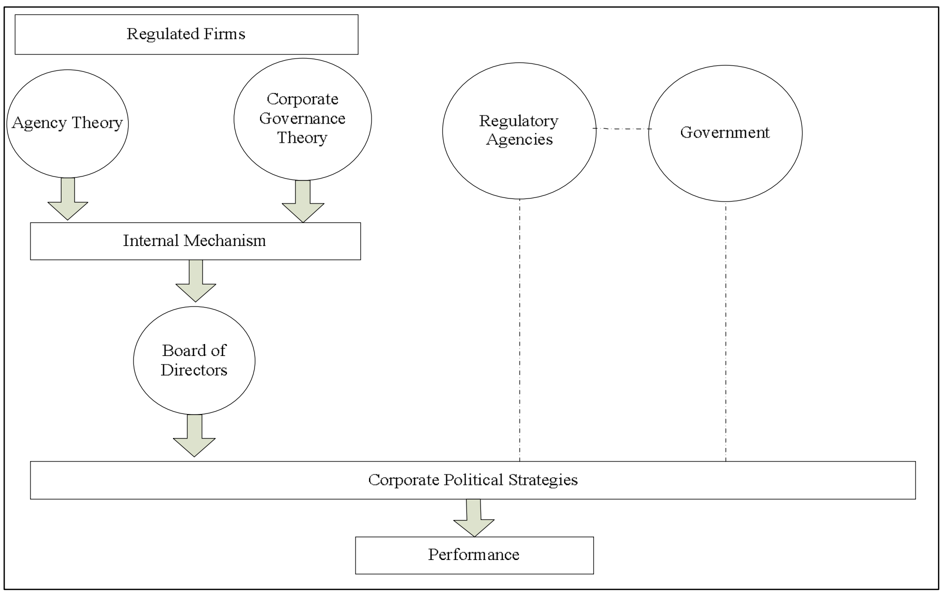
When analyzing existing literature Cooper et al. (2009), defined two manners of classifying these studies: (1) there are those that analyze explicit connections, related to a politician's participation on the Board of Directors (Hillman et al. 2000; Agrawal and Knoeber 2001; Fisman 2001; Helland and Sykuta 2003; Hillman 2005; Faccio 2006; Faccio et al.

2006; Goldman et al. 2009); and (2) there are others that analyze the implicit connections, defined as the indirect relationship through a donation to a politician (Jayachandran 2006; Goldman et al. 2009; Leuz and Oberholzer-Gee 2006).

On one hand, the government can change commercial policies and affect opportunities for companies in regulated sectors such as food, beverage, air transportation and chemical products (Agrawal and Knoeber 2001; Holburn and Vanden Bergh 2002). While on the other hand, Hillman (2005) states that the incorporation of politicians in the Board of Directors can provide companies with the following benefits: (a) exclusive information on public policies; (b) a communication channel or access to politicians, rulers and bureaucrats and other decision makers in order to align interests; (c) the possibility to access those who develop standards that can influence political decisions; (d) legitimacy. This work integrates itself to studies that investigate the political connections of companies using participation of board members with political background as proxies.

Figure 2 is shown for a systemic view of the study, which represents the relationship between the theories and the stakeholders in regulated environments.

Figure 2: Relationships between theories and stakeholders in regulated environments



Source: Authors

Thus, a literature analysis allows us to consider that a company's economic and financial performance may vary according to adopted strategies, as well as the fact that regulation and governmental policies can affect the market size and profitability (Agrawal and Knoeber 2001; Holburn and Vanden Bergh 2002). The interference on public policies can influence a company's final results (Hillman and Hitt 1999; Shaffer et al. 2000) and the Board of Directors plays an important role in the design of the corporate strategy evaluation, budget development, financial planning and control (Adams et al. 2009). Based on this the following research hypothesis was derived

H1: a statistically significant relationship exists between regulated companies that have members of the Board of Directors with previous political experience, and its economic and financial performance.

Methodological Procedures

Based on the companies listed in BM & FBovespa, 127 companies from five regulated sectors were studied between 1999 and 2008. The data were collected from secondary sources and for data analysis the hypothetico-deductive method was used, with data treated through descriptive techniques and regressions. Data analysis occurred through a two-stage process, primarily through descriptive analysis from basic statistics and subsequently through regression analysis with panel data. Panel data is indicated when one wishes to analyze information that involves the social and professional life of individuals and aspects of a social group, organizations, institutions and structures in a time series (Gujarati 1995).

To carry out this research, the Economática® database and information from Annual Information Report (AIR) were used, available in the Securities and Exchange Commission (SEC) and in BM & FBovespa between 1999 and 2008. This period of time was defined because it was the moment after some important sectors of Brazilian economy were privatized (telecommunication, petrol, natural gas and electric energy) beginning in 1995. Economic data were collected from Economática® and from AIR, data on the board members of companies were collected. The Annual Information (AIR) sent by companies to SEC included the list of all elected members after shareholders' assemblies held in the first semester of each year. The identification of the members of the Board of Directors was obtained through data from the Annual Information of each company and in each member's curriculum located in file indexed to the AIR. The sample is non-probabilistic.

Political connections were defined as the relationship between the company and board members with previous political experience at municipal, state and federal levels, in the three branches of government, in other words, legislative, executive and judiciary. In order to determine the presence of political connections in regulated companies, the curricula of the Board of Directors of the companies indexed to the Annual Information (AIR) were analyzed. First, the Board of Directors background was verified, separating the board members by type (Adams et al. 2009), classifying them as: independent, employees, with a degree in legal science (lawyers), company or board representative and representatives of shareholders or other interested parties. Afterwards, the curriculum of each board member was analyzed, separating those who had previous political experience and distributing them in variables that represented their experience in direct, indirect and elective management. Subsequently, the board members with juridical background were separated from the group with previous political experience.

To classify and cluster each company's data, year and Board of Directors, a series of variables were defined according to the research question and to the existing literature about the Board of Directors, types of board members and their functions (Agrawal and Knoeber 2001; Helland and Sykuta 2003; Hillman 2005; Goldman, Rocholl and So 2008; Adams et al. 2009; Hilb 2009). The data were collected from the AIRs (Annual Information Reports) taken from BM&FBovespa website and visualized on DIVEXT software for the period between 1999 and 2008 (Frame 1).

Frame 1 – Variables related to the connections of the Board of Directors

Variable	Description
FIRMA	Company's name
ANO	Year that represents the date of data execution.
TOT_CON	Total effective board members in the Board of Directors of the researched company.
INDEP_C	Number of independent board members that make up the Board of Directors –for IBGC (2009, p. 25) Good Governance practices, the independent board member is characterized as: "not having any link to the company, except possible capital participation; not being a controlling shareholder, member of the controlling group, spouse or relative to the second degree, or connected to organizations related to the controlling shareholder; should not have been an employee or director of the company or of any of its subsidiaries; cannot be supplying or purchasing, directly or indirectly, services and/or products from the company; cannot be an employee or director of an entity that is offering services and/or products to the company; cannot be a spouse or relative up to the second degree of any director or manager of the company; and cannot receive other remuneration from the company in addition to the board member's fees (excluding dividends originating from possible ownership interest).
EMPRE_C	Number of board members who represent the company's employees.
JURIDC	Number of board members with legal background (lawyers, judges).
ORGAN_C	Number of board members who represent the company's administration (directors).
PRES_CEO	1 – "YES" 0 – "NO" – If the Board of Director president is also the chief executive officer (CEO).
DEMAIS_C	Number of board members who are not classified as independent, employees, with law degree and directors.
FCONEC	1 – "YES" 0 – "NO" – If the company has board members (president, vice-president, directors or any other board member, except the alternate member and the supervisory board) with previous political experience or not. To be connected, the company needs to have at least one board member with political experience in direct or indirect administrative public positions or legislative positions at the federal, state or municipal level, considering the board member's term of office as the parameter for the year of connection.
TC_EXPPOL	Total number of board members with political experience in the company in that year.
CEXP_addir	Number of board members with political experience in direct public administration (Federal, State and Municipal) during that year (- Art. 4. Decree Law 200/67 – The federal administration comprises: I – the direct administration that is constituted by integrated services in the management structure of the Republic Presidency and Ministries). Article 37 from the 1988 Constitution extends this classification to the states and municipalities. So they are institutions directly linked to the executive (Presidency, Governor, Mayor, state and municipal ministries and secretaries). Example: Treasury Office, Secretary of Education, Army, ABIN, etc.
CEXP_adind	Number of board members with political experience in indirect public administration (Federal, State and Municipal) during that year. Indirect Public Administration - Art. 4. Decree Law 200/67 – clause II – "The indirect administration comprises the following categories, endowed with their own legal identity: a) Autarchies; b) Public Companies; c) Mixed economic companies; d) Public foundations" – examples: BNDS, BANCO DO BRASIL, INSS, PETROBRAS, BRDE, CENTRAL BANK, etc.).
CEXP_eleito	Number of board members with political experience due to election for a public position. (Board members who have occupied a position as senator, congressman, councilor, president, governor, mayor).
CEXP_EFR	Number of board members with political experience that have had or still have links with companies providing financial resources (Examples: public banks, pension funds from public companies – provide loans).
NOME_ Cexpp	Name of the board member with political experience (as many variables in the table as the number of board members with political experience). Add at the end of the variable the ordinal number according to the number of board members in that company during that year. Ex. NOMECexpp1, NomeCexp2.
FUNÇAO_Ce xp	Name of the main function of the board member with political experience. Main function (position) is the one that represents the highest level of public power.

Source: Research data

The researched sectors which suffer regulation by formalized, legally constituted and independent management regulation agencies are: Petrol, Gas, Biofuels (exploration and/or refineries), Basic Materials (petrochemicals), Construction and Transport (air transport, subway, railway, water transport, road transport, roadways exploration, and storage and support services), telecommunications (fixed and mobile) and public utility (electric energy, water, sanitation and gas).

In this study, the performance of company *i*, in sector *k*, in the year *t*, is determined by the companies' dependent variables, such as: Return on Assets (ROA); Return on Equity (ROE); and Return on Sales (ROS) (Hillman 2005; Boubakri et al. 2009). The statistical software SPSS® was used.

The general model is described as follows:

Performance = *f* (political connections, control variables, €), represented in the following regression equation:
$Performance_{i,k,t} = \beta_o + \beta_1 X_1 + \beta_2 X_2 + \beta_3 X_3 + \beta_4 X_4 + €_{i,k,t}$

In the above model β_o is the intercept. The variables $x_{1it\ldots}$ x_{nit} represent the internal governance mechanisms, including political connections of board members, as well as control variables. The term ε_{it} represents the model's error.

Results Analysis and Discussion

In the survey of existing companies, 147 open companies were found and, after the Board of Directors data analysis and the economic data treatment, a sample with 127 companies was selected. Of these companies 38 had political connections in 1999, and 93 in 2008. During this period, the companies made 12,002 board member positions available, which represented on average 10 board members per year on each board. This average is one point above the maximum recommended by IBGC (2009), since it indicates a minimum of five board members and a maximum of nine board members. The Brazilian average is lower than the United States', with 12 and 11 board members, respectively noted by Lehn et al. (2003) and Fich and Shivdasani (2006). The data indicates that 80% of the companies in the sample have political connection through the Board of Directors.

The board members were classified by term, based on the second presidential term of Fernando Henrique Cardoso (FHC) and the first presidential term of Luiz Inácio Lula da Silva (Lula). From FHC's term to Lula's, a significant increase of connected companies through the Board of Directors was verified, that is, from 62% to 74%. There was an increase from 28.4% to 30.3% in positions occupied by board members with a political background.
During Lula's first presidential term, the companies showed an increase in political activity in their Board of Directors, than in the FHC's second presidential term, supporting Bandeira-de-Mello and Marcon's (2011) findings. On the other hand, the economic and political environment can affect the choices' made by the board members and thus match to the companies' strategies.

The Board of Directors have 41% of their board members as agency representatives (executive officers - *insiders*), against 57% principal representatives (elected or indicated by the shareholders - *outsiders*). The participation of employee representatives (1%) is inexpressive, with only two sectors that register this practice – Public Utility (88%) and Construction and Transport (12%). The Board of Directors of American companies in the year 2000 presented a list of 13% *insider* board members (LEHN *et. al.*, 2003).

A possibility of problems and agency costs occurring may exist, as established by Jensen and Mackling (1976) in the Theory of Agency, due to the existence of 41% of agents in the researched companies and that may behave in ways that are not in line with the principal's interests. This assessment also represents the level of the board's interdependency and the boards of regulated Brazilian companies show a low level of interdependency (2%) in the insider/outsider relationship. Another way to look at this is related to the function of the outsider board members of regulated Brazilian companies. Their role can only be an advisory one in relation to the management or, according to Helland and Sykuta (2003), they can be only a *façade* and will not cause management problems.
Among all positions, independent board members fulfill 1.2% of positions. Thus, the recommendations of better governance practices (IBGC, 2009) are not considered, especially related to board composition of Brazilian companies in the regulated sectors.

It was observed that board members with legal backgrounds fulfill 12% of the board members positions. This number proves Agrawal and Knoeber's (2001) inference on the legal experience of board members in decision-making and to avoid the government's hostile actions with the companies. In the period between 1999 and 2008 a total of 3,501 connections were found, whether by background, in direct or indirect management, and in legislative position (Table 1). Among the total of possible connections, considering the skills for the position, for 29% of them there is some kind of connection mode, from which 12% are experience in direct administration, 15% in indirect administration and 2% by elected political positions. These data show that the Brazilian regulatory process demands corporate political strategies from companies more geared to management at a bureaucratic level than at a legislative level.

Perhaps because companies' political contributions to candidates are institutionalized and standardized in Brazil, the strategy of political connections through the Board of Directors and elected politicians is not necessary (Bandeira-de-Mello and Marcon 2011). These results confirm the findings of Helland and Sykuta (2003). The description of the number of politically connected board members with the type of political organization is detailed in Table 1.

The percentage of board members connected to direct and indirect administrations can also represent the dependency of regulated Brazilian companies on the government. This dependency is probably related to the capture theory (Stigler 1971) where there is a need to pursue and preserve incomes (Krueger 1974) or there is a possibility of mitigating the impacts and taxes imposed by regulation (Schuler et al. 2002).

Table 1 – Political Connections of Board Members

Sector name	Types of Connection			Total number of Connections		Number of Board Members Resources Suppliers
	Direct Adm.	Indirect Adm.	Elected politicians			
Petrol, gas and biofuels	37	35	9	81	2%	21
Basic Materials	35	74	4	113	3%	42
Construction and Transport	122	169	5	296	8%	130
Telecommunications	81	257	2	340	10%	131
Public Utility	1169	1269	233	2671	76%	545
Total	1444	1804	253	3501	100%	869
% Sample	12%	15%	2%	29%		7%

Source: Research data

Another possibility to justify these connections is related to the companies' interest for relevant technical information that board members with political experience have and, with that, they can better define their strategies with regulators, on tax negotiations, contracts and income. Among the board members with political experience, we tried to find if there were board members filling positions in companies that could be resource suppliers. They represent 25% of the identified skills and 7% of the possible ones considering the sample total.

In order to make a comparison between the connected companies and the non-connected companies, a descriptive analysis was done first with the collected financial indicators, to move forward and address the analysis. When comparing calculated indicators, we noticed that the politically connected company's present lower performance averages (ROS, ROE and ROA) than a non-connected companies' average. Thus, with this information the null hypothesis can be accepted. These results confirm the results by Faccio (2007) and Boubakri et al. (2009).

When performance is analyzed, the average rate of revenue growth of the connected companies is 8.38% higher, which indicates a rent-seeking effort (Tullock 1967; Krueger 1974). These results are not transferred to the net profit because the non-connected companies are more efficient, since they present higher final results. To compare the averages of the indicators of non-connected and the connected companies at a significance level of 5%, a t test was used. The results are shown in Table 2.

Table 2: Summary of Statistics Comparison – Connected and Non-Connected

Variable	**Connected Mean**	**Non-Connected Mean**	**Difference**	***t* Value**	***p* Value**
ROA	0.0377	0.0877	-0.0501	-0.8377	0.8185
ROE	0.0043	0.0614	-0.0571	-0.3424	0.5463
ROS	0.0870	0.1424	-0.0555	-0.3093	0.6660

Source: Research data

The results show that the connected regulated Brazilian companies are not influenced by the political connections of their Board of Directors, considering their economic performance. Thus, if using board members with political experience (29%) does not interfere in the company's economic and financial results, its practice is linked to the regulatory environment, and possibly, it may be related to the reduction of regulation effects (Helland and Sykuta 2003), the search for relevant information (Hillman et al. 2004) and counseling management so that they may be coordinated to the regulated environment (Helland and Sykuta 2003). The three equations showing the performance indicators results can be observed in Table 3.

Table 3: Regression analysis coefficients

Coefficients Variable	ROA			ROE			ROS		
	BETA	t	Sig	BETA	t	Sig	BETA	t	Sig
Ln Gross Profit	0.302	3.305	0.001	-0.109	-1.164	0.247	-	-	-
Ln Connected	-0.118	-1.275	0.205	-0.020	-0.226	0.821	-0.019	-0.206	0.837
RB Growth Rate	0.231	2.734	0.007	-0.288	-3.351	0.001	-	-	-
Rate of EXLP/PL Variation	0.001	0.014	0.989	-	-	-	-	-	-
Logn Total Active	-	-	-	-	-	-	0.268	2.919	0.004
Rate EXLP Variation	-	-	-	-0.370	-4.175	0.000	-0.054	-0.619	0.537
R^2	0.147			0.163			0.071		
Adjusted R^2	0.119			0.136			0.048		
SEE	0.251			0.692			0.782		
F	5.259			5.953			3.130		

Source: Research data

The results of the regressions tested in the equations that explain the dependent variables ROA, ROE and ROS show that there is no significant statistical relationship between regulated Brazilian companies and political connections of the members of the Board of Directors in these companies, confirming the conclusion made by Banker, Das and Ou (1997), Faccio and Parsley, (2009) and Boubakri et al. (2009).

Conclusions

The research allowed an analysis of the reality of political connections among listed regulated companies, through the Board of Directors, as well as to verify the impact of these strategies on their economic and financial performance. The results show that, on average, these companies Board of Directors have ten board members in each. Their composition is mostly of outsider members (59%), what makes the insider members 41% in total. This may be related to the Theory of Agency, where the Board of regulated Brazilian companies privilege “agents” over “principal”.

The companies do not follow the good corporate governance practice code with recommendations from BM & FBovespa and IBGC, since they have a low participation of independent board members (1.2%) and employee representatives (0.8%). This can indicate a low governance level of the regulated companies and/or is not an important factor to the regulator. The relevant presence of board members with a legal background (12%) demonstrates the need of the regulation system in legal advising for companies due to the normative and legal uniqueness of regulation. So, companies are less concerned with governance, and more concerned with regulation. From the 127 researched companies, 80% are politically connected through at least one board member with political experience. The percentage of connected board members is 29% and, most of them, with experience in direct (12%) and indirect (15%) administration.

It can be concluded that Brazilian regulation systems demand greater attention from companies in a bureaucratic and procedural relationship than in a legislative one, since only 2% of the board members have connections in elected political positions. On the other hand, there can be other explanations, such as the filling of positions and attending to affection or attention is directed to searching, preserving of income and relevant information about the regulation environment to negotiate contracts and taxes.

In the analysis of political connections with the performance, it was observed that regulated Brazilian companies, through the Board of Directors, does not show statistical significance. The presence of board members with political experience in providing financial resources can explain the finding that, on average, the connected companies get more funding in the long term than the non-connected ones (52%). Such findings can represent the reality of regulated Brazilian companies that were privatized and, together with the growing economy, needed the connections to match to regulations and approve expansion projects. We also concluded that regulated Brazilian companies use the Board of Directors to obtain results related to the normative processes of regulation, for example, the search for relevant information, rather than focus on strategic and operational activities, monitoring, management control and influence in price increases. This statement is justified by the existence of a significant number of executive board members (41%), a percentage of board members with a legal background (12%), and a weak representation of the independent board members (1.2%).

The research has some limitations, which include the difficulty to establish the term of the board members and to prove the truthfulness of the board members professional information, since they are filled in by the companies and do not prove them. The capture of board members' political connections took into account only the formal political experience; the research does not consider the informal or indirect experiences between boards or derived from the board members' social relationships.

In future studies, we recommend researching the companies regarding the types of strategies used and/or evaluate the direct results of corporate political strategies adopted in each sector, for example: contractual modifications, direct selling to the government, etc. Another study could be related to the research on the perceptions of politically connected board members and the board directors, in order to define a model of political connections and the Corporate Political Strategies, as well as their relationships with power and performance. Lastly, all the companies listed in BM & FBovespa can be investigated and the political connections between connected and non-connected companies can be analyzed independently of the regulatory regime.

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