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Corporate Boards in Germany and Spain**

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## 1. Introduction

The participation of individuals with experience in the public sector in corporations can be beneficial when corporations interact with the policymaking process and can foster efficient communication between the private and public sector (LaPira and Herschel, 2014). However, such situations may lead to suspicions of conflicts of interest, and this is what makes the concept an interesting research topic. Despite social debates about 'revolving doors' – defined as "personnel exchange between the public and private sector" (Coen & Vannoni, 2016) – there is very little research on the private sector and its efforts to hire managers with public sector experience (Coen & Vannoni, 2016).

Additionally, the scant research about revolving doors seems geographically focused on the US (Coen & Vannoni, 2016). Meanwhile, recent studies on this phenomenon in the European market – which has been limited in number – have produced conflicting results. A recent report from Transparency International EU (2017) shows that many former EU politicians are currently employed by organisations listed in the EU lobby register. Yet Coen & Vannoni (2016) find evidence that calls into doubt the phenomenon of revolving doors in Europe.

In this paper we stop short of investigating the effects that revolving doors have on corporate performance. We aim to explore general patterns of revolving doors in Spain and Germany – and observe the differences between these countries. More specifically, we look at the boards of companies listed on the German stock market index (the DAX 30) and the Spanish IBEX 35 stock market index.

## 2. Theoretical foundations and formulation of hypotheses

### 2.1 The concept and history of revolving doors

The phenomenon of the revolving door and the academic research on it originated in the United States in the 1980s (Coen & Vannoni, 2015). In those early days it was more common for high-ranking business executives to take key positions in public administration. Only later would the reverse become true, and would the movement of former public servants towards the private sector become more frequent (Vogel, 1996).

The success and progress of companies can generally be significantly influenced by their political connections (Faccio, Masulis & McConnell, 2006). Past studies suggest that there is a sizable market for these political connections (Blanes i Vidal et al., 2012). In line, research indicates that movement between private and public sectors is increasingly common (OECD, 2010).

Revolving doors are a type of political connectedness, and they take on a number of structural forms. Firstly, it is possible to distinguish the directions of the revolving doors (Dal Bó, 2006). Former business employees can join public administrations, or former public servants can seek employment in the private sector<sup>1</sup>. This study focuses on the latter movement. One can further distinguish between direct and indirect employment (Gormley, 1979). In the former, a former public servant joins a firm as an employee (perhaps working as a lobbyist). In the latter, the individual works either as a self-employed lobbyist, or for a lobby firm that is then contracted by another company. There is a broad academic consensus that firms generally benefit from being politically connected (Faccio et al., 2006; Khwaja & Mian, 2005) and political connections are perceived positively by investors (Faccio et al., 2006; Hillman, Zardkoohi & Bierman, 1999).

More generally, firms have multiple reasons for employing former public servants. The regulatory schooling hypothesis suggests that companies recruit former public servants mainly because of their expertise and experience (Agarwal, Lucca, Seru, & Trebbi, 2014; LaPira & Thomas, 2014). In contrast, the rent-seeking hypothesis suggests that firms mainly value the lobbying capacity of former public servants and their presumably high level of access to and influence on public figures (Che, 1995; LaPira & Thomas, 2014; Lazarus, McKay & Herbel, 2016).

Only recently have researchers started to analyse European revolving doors. Coen and Vannoni (2015, 2016) find that doors generally revolve less in the European Union than in the United States. They also provide evidence of a lack of a “private sector [career] premium” (Coen & Vannoni, 2015) in the European Union – meaning that experience in the public sector does not help individuals progress in their careers. In contrast, the level of revolving doors in the EU documented by Transparency International gives rise to concern (Daniel & Yannik, 2017).

Very little research exists on the revolving door phenomenon in individual European countries, or on the political connectedness of firms (Cerrillo-I-Martínez, 2017; David-

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<sup>1</sup> In some cases, individuals also assume positions in the public and private sectors at the same time, which also falls under the revolving doors definition (Larcker & Tayan, 2011; Niessen & Ruenzi, 2010).

Barrett, 2011; Niessen & Ruenzi, 2010). Due to several major political scandals regarding revolving doors (Cerrillo-I-Martínez, 2017), Spain is a particularly interesting country for an empirical analysis. In contrast, there is less media attention on this issue in Germany.

## 2.2 Benefits and risks of revolving doors

Exchanges between the private and public sector can have several positive effects.

*Cross-fertilisation.* By exchanging personnel between the private and public sectors, expertise and experience is exchanged more effectively. This can be beneficial for both sides: regulatory processes can become more efficient and policymakers can gain sector-specific knowledge that enables them to make more rational decisions (LaPira & Thomas, 2014).

*Talent attraction in the public sector.* The prospect of well-paid future employment in the private sector may motivate highly skilled individuals to take on a lower paid position in the public sector, thus increasing the capabilities and talent of public administration in general (Cerrillo-I-Martínez, 2017; OCDE, 2010).

*Financial benefits.* Moreover, Faccio et al. (2006) show that politically connected firms have significantly easier access to debt, pay less income tax, and have more market power.

With regard to the benefits of revolving doors for companies, some research points out that political connections only have positive effects for firms operating in highly regulated environments (Larker and Tayan 2014) (this might explain why certain industries are much more likely to experience revolving doors (Transparency International UK [2012])).

Nevertheless, revolving doors also create a set of risks:

*Unfair advantage.* Scholars argue that democratic and fair market processes may suffer due to the importance and value of personal connections: representatives may be heard not because of an issue's relevance, but because of personal ties (LaPira & Thomas, 2014).

*Loss of public trust.* The indication that public officials are influenced by highly paid and well-connected former public sector colleagues in the lobbying industry can worsen the public's perception of the political environment and process (Blanes i Vidal et al., 2012) and undermine public trust in institutions (OECD, 2010).

*Conflict of interest.* Potential conflicts of interest are the most prominently suggested negative effect of revolving doors (Blanes i Vidal et al., 2012). The forms of conflict of interest may include: (1) abuse of office by an acting official to influence regulation in favour of a potential future private employer; and (2) undue influence, where a former senior official uses his/her access to incumbents to capture regulation.

### **2.3 Revolving door regulation in Germany and Spain**

A country's institutional framework can greatly affect the importance of political connections for firms (Moser & Lüchinger, 2014). Coen and Vannoni (2016) suggest that the differences between the political systems of the United States and the European Union (personal contacts versus information) may explain to a large degree why the revolving doors differ between them. In this study we compare two countries within Europe.

Germany only recently passed regulation on cooling-off periods for members of government (for this and the following, see Goebel 2015). Ministers and deputy ministers are required to inform the government of any business position they wish to take within the first 18 months after leaving public office. The government can then decide whether or not to allow the former (deputy) minister to accept the position. No similar regulation has been passed for lower-hierarchy members of the executive branch, nor for members of parliament.

Spain has a more comprehensive framework for regulating revolving doors. The most important legislation is Act 3/2015, which targets senior public officials, namely ministers, state secretaries, and other high ranking individuals (for this and the following, see Cerrillo-I-Martínez 2017). The legislation stipulates a cooling-off period of two years before accepting private sector positions that are related to the decisions the individual took part in when in office. During this two year period, every planned activity in the private sector must be reported to the Conflicts of Interest Office, which may then approve or prohibit the activity (for this and the following, Cerrillo-I-Martínez 2017).

Interestingly, the German and Spanish revolving doors legislations only apply to the Executive Branch of government. Neither Germany nor Spain regulate the revolving doors of their legislative (i.e. parliamentary) branch.

### **2.4 Corporate governance regulation in Germany and Spain**

German companies follow a two-tier board structure which comprises a management board ('Vorstand') – the top management body for strategy and business policy – and a supervisory board ('Aufsichtsrat') that oversees the management board (Larcker & Tayan, 2011). Members of the management board cannot serve as members of the supervisory board and vice versa. Management board members are appointed by the supervisory board. If a company's total number of employees exceeds 2000, then German legislation requires at least half of the supervisory board members to be firm employees (Larcker & Tayan, 2011). These members are nominated by employees and trade unions (Baums & Birkenkaemper, 1998). The shareholder representatives of the supervisory board are appointed in shareholder meetings (Baums & Birkenkaemper, 1998).<sup>2</sup>

From a regulatory point of view, Spanish companies are only required to have a single board of directors (for this and the following, see Calkoen 2015). This structure differs

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<sup>2</sup> Supervisory boards show a significant presence of bankers acting as board members and creditors at the same time (Dittmann, Maug, & Schneider, 2010).

from the German two-tier system. Nevertheless, in most cases, the board of directors assigns a large amount of executive power and operational responsibility to an executive committee made up of top managers, which can be considered as the equivalent to the German management board.

In Spain, in contrast to the German system, the chair of the board of directors may also be the CEO (García-Sánchez, 2010). Moreover, it is common practice for Spanish companies to form a nomination or remuneration committee, mostly comprised of independent directors (those who are neither top management nor shareholder representatives), with the right to nominate candidates for the board. The actual appointment through a vote is then conducted by the shareholders meeting.

## 2.5 Data collection and analysis

We collected data for all of the directors on the board of firms listed in the IBEX35 and DAX30. Data was collected during the year 2017 from the official website of the trading venues that operate the two stock indices: Bolsa de Madrid and Deutsche Börse.

The following table synthesizes the data collected:

Table 1: Synthesis of data collected

	<b>Germany</b>	<b>Spain</b>	<b>Total</b>
Total number of data points / individuals analysed	687	945	1632
Total number of analysed management board members <sup>3</sup>	196	466	662
Total number of analysed supervisory board members	491	479	970
Total number of analysed individuals with public background	27	187	214
Total number of analysed companies	30	35	65
Total number of analysed boards (management and supervisory)	60	70	130

## 3. Results

### 3.1 Results of the descriptive statistics

The figures below show the total number of individuals or data points in the sample for Germany and Spain respectively, indicating whether they belong to the management or supervisory board – and whether they have a public service background. For Germany, the average size of a supervisory board is 16.4; while the average size of a management board is 6.5. In contrast, Spanish supervisory and management boards

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<sup>3</sup> Management board for German companies, Executive committees for Spanish ones.

tend to be similar in size. For Spain, the average size of a supervisory board is 13.7; while the average size of a management board is 13.3.

Only 1.5% of all German management board members have a public service background, while the figure in Spain is 9.9%. For supervisory boards, 6.3% of all German board members have held a public sector position; and in Spain the figure is 30.3%.

Figure 1: Total number and share of board members with or without a public background



Only one Spanish company (1.5%) employs no former public servants on its boards. In Germany, the split between companies with and without public background board members is almost equal.

Table 2: Companies with and without public background board members

	Companies with members with public background	Companies with members without public background
Spain	34	1
Germany	14	16
Total	48	17

The boards of Spanish index companies have a strong tradition of revolving doors. For both management and supervisory boards, the average number of members with a public service background is significantly lower in Germany than in Spain.

Table 3: Number of board members with public service backgrounds

	Mean	Median	Min	Max
<b>Management board (total)</b>	0.75	0	0	4
Germany	0.1	0	0	1
Spain	1.31	1	0	4
<b>Supervisory board (total)</b>	2.71	2	0	12
Germany	1.03	1	0	6
Spain	4.14	3	0	12

Table 4 analyses the board members with public service backgrounds in a more detailed way by categorising them in terms of the type of public position they once held. It shows that across both board types and countries, the overwhelming majority of those individuals formerly held a public position in an executive function, followed by a considerably smaller number of former judicial or legislative public servants.

Table 4: Number of board members with public service background by background type

	Executive	Judicial	Legislative	Total
<b>Management board (total)</b>	<b>46</b>	<b>1</b>	<b>1</b>	48
Germany	2	0	0	2
Spain	44	1	1	46
<b>Supervisory board (total)</b>	<b>159</b>	<b>3</b>	<b>4</b>	166
Germany	27	2	1	30
Spain	137	1	3	141
<b>Total</b>	<b>205</b>	<b>4</b>	<b>5</b>	<b>214</b>

Half of the German firms studied operate in highly politically-affected sectors, while in Spain, two-thirds do so. (We coded as politically-affected sectors the following: industries with particular regulatory oversight networks (i.e. telecoms, energy, post, and railway), banking, pharmaceuticals, and toll-road management companies – the latter because of their dependence on public contracting.)

Importantly, in our analysis we yet have to control for being a state-owned company, and the effect (which is presumably high) of a company being state-owned on the probability of having former public officials in its corporate boards.

Table 5: Companies politically-influence or not

	Politically-affected	Not politically-affected	Total
<b>Germany</b>	17	13	30
<b>Spain</b>	22	13	35
<b>Total</b>	39	26	65

### 3.2 A special note on Spain: Civil servants on leave

It is worth noting an extraordinary phenomenon for Spain, namely that of Spanish civil servants on corporate boards. The former public officials from the executive branch that have occupied political positions (such as Minister) in Spain are usually also civil servants.

Interestingly, out of the 205 board members with public sector experience in the executive branch observed in this study (i.e. in Germany and Spain), 181 of them can be found in Spanish companies. Among these 181, 101 are civil servants *on leave* (i.e. they can go back to their former civil service posts if they wish to do so). Two civil service corps cover most of the cases: state attorneys (54) and state economists (19).

Table 6: N° of civil service corps members in boards (Spain)

	State Att.	State Econ.	Fisc. Insp.	State Adm.	State Audit.	State Eng.	Diplo.	Mil.	Parl. Law.	Insur. Insp.	Mil. Insp.	Bank Insp.	Traf. Insp.	Total
MB	16	3	3		1	1		1	1	1		1		28
SB	38	16	7	5	3	1	1				1		1	73
<b>Total</b>	54	19	10	5	4	2	1	1	1	1	1	1	1	101

### 3.3 Results of regression analysis

The statistical inferential analysis of our data, using various dependent variables,<sup>4</sup> consistently produces the following:

- Country matters. The revolving door phenomenon is more prevalent in Spain than in Germany
- Sector matters. Firms in politically-affected sectors are more likely to place former public officials on their boards.
- Board type matters. Supervisory boards are more likely to include former public officials.
- Firm size does not matter.

Spanish doors revolve more than German doors. A possible explanation may be that Spanish boards do not require employee representation (German supervisory boards do) and therefore have a higher share of external directors, with a range of profiles. Another driver could be the higher share of politically-affected firms in the Spanish stock index. An additional explanation may be the different types of capitalism in Spain and Germany. Hall and Soskice (2001) define two specific types of capitalist economies: liberal market economies (i.e. UK); coordinated market economies (i.e. Germany); and the Mediterranean type (i.e. Spain), which is a hybrid between the other two models.

The revolving door phenomenon is more present in supervisory than management boards. A possible explanation is that in management boards, operational (technical or managerial) business expertise is much more valuable than knowledge of the political process and personal connections to regulators.

Politically-affected firms tend to employ more former public servants. This pattern is very plausible: knowledge of political process and personal connections are probably much more valuable in such companies.

Two additional interesting observations are that the size of the company does not apparently influence the share of board members with public service backgrounds; and the great majority of individuals that step through the revolving door come from the executive branch of the public sector (>90%).

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<sup>4</sup> Share of board members with a public service background per company; share of board members with a public service background per board; & likelihood of a board member having a public service background.

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In politics, the "revolving door" is a movement of personnel between roles as legislators and regulators, on one hand, and members of the industries affected by the legislation and regulation, on the other. It has also been used to refer to the constant switching and ousting of political leaders from offices such as the Prime Minister of Australia and Japan. The difference between automatic and manual revolving doors is that automatic revolving doors start rotating when approached while the latter requires the user to push the door wing. However, our recent innovations include manual revolving doors that provide power assistance, positioning, automatic security locking, integration with access control systems, or even generate energy! In Spain, parts of the industrial and construction sectors are returning to work. 4/13/20, 11:12 AM CEST. Jean-Claude Juncker urges "plain language" on Hungary's state power grab. "This case is a good example of how the revolving door blurs the distinction between being inside and outside of the EU institutions in the Brussels bubble," said Vicky Cann of Corporate Europe Observatory, a group that argues for stricter transparency rules. Too many questions remain unanswered, says Corporate Europe Observatory. "Kallas was a senior EU commissioner for 10 years, then he left, then he rejoined as a special adviser, and now he also been authorized to take a role with one of the Baltic states' bigger companies," Cann said.