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at Norwegian Business School BI

- Political economy and corporate  
governance: Political connection of board  
directors and political moderation of CEO-  
wages in Norwegian state-owned  
companies-

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## Summary

This thesis examines the relationship between political connection of board directors and CEO-wages in 27 Norwegian state-owned companies and enterprises in 2000-2010. I hypothesize that political connected directors possessing a “political rationale” moderates CEO-wages, because excess CEO-wages are prone to public critiques which gives bad reputation for the politicians. Further I hypothesize that political connected directors with background from right parties (H, FrP) will have a *less* moderating effect compared to leftist board directors. Finally, I extend first hypothesis and state that political connectedness and political moderation of CEO-wages has a stronger effect in commercial companies. Main findings shows that there is weak support of political influence on CEO-wages and that there are no strong ideological preferences. However, the results shows some albeit weak moderating effect in commercial companies. Another finding is that rightist board directors tend to contribute to an increase in CEO-wages in non-commercial (monopoly) companies. Presumably, this is because of the understanding in the complex of managing such companies, thus rewarding CEOs.

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## 1.0 Introduction

Excess chief executive offices (CEO)-wages are prone to public critique. Managerial contracts are not private because by law the details of the contract are public information. Public information on “what the boss make” affects contract with other employees – thus, increases union demands in labor negotiations (Jensen and Murphy 1990).

In this thesis I examine of *politics* influence CEO-wages in state-owned companies? I use politically connected board directors as a measure of political influence, and investigate if politics contribute to moderation of CEO-wages in state-owned companies. CEO-wage contracts are *internal* tools utilized by board of directors to provide managerial incentives. In a study of CEO-compensation and company performance, Murphy and Jensen (1990) found a weak connection (\$ 3.25 increase for every \$ 1000 increase in shareholder wealth) between CEO-pay and company performance during a 50 year period. The authors explain this weak connection by “political influences” and the natural resist in innovative incentive contracts. A following interesting question is what constitutes political influences? Why do political influences have a moderating effect of incentives contracts/CEO-salaries?

The board of directors in Norwegian state-owned companies is responsible for company performance and public critique (St. meld. nr. 13, 2010-2011). In a study of CEO-wages in Norwegian state-owned companies, the owner (the state) expressed that what defines “competitive wages” and “leading wages” is up to the board of directors to evaluate and interpret (The Office of the Auditor General of Norway 2011). Thus, leaving much freedom to board of directors when setting CEO-wages.

I use principal-agent theory and theories from political economy and hypothesize that politicians care about reputation and want to appear as “good politicians” to voters and that this cause agency costs in the board rooms.

If excess CEO-wages is connected to the company where the politician is board director, this can violate good reputation. If there is a moderating effect on CEO-wages when board directors is politically connected, then this will be at the expense of the risk-averse CEO (rewards will be lower).

From previous studies, the term political connection in companies has been defined in various ways, for instance the connection of CEO, president, vice-president, large shareholders, secretary, board of directors and chairmen to politics. This study looks at *political connection of board of directors* (including chairmen). In previous studies, political connection has been defined as friendship with head of state, ministers and members of parliament, or/and experience as ministers or membership of political organizations. I define political connection as previous

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experience as minister or member of parliament, and experience of being listed in political party organizations. In this way, I sort out “passive” members. Being on a political nomination list and/or having experience as member of parliament and/or minister is distinguished from “passive” members where I assume that those who commit to lists and have experience as professional politicians have stronger political incentives. Existences of intrinsic political incentives of those connected to politics or are in a position where they seek office/political power is supported by theoretical models in the discipline of political economy. From Downs (1957) and Wittman (1973) political incentives are formed by the nature of political competition, thus politicians care about a good reputation. If politically connected board directors possess intrinsic political incentives and “political rationale”, they are more sensitive to political and political-economic questions because they care about their reputation. The following questions are the main research questions which are investigated in this thesis.

- *Do politically connected board members pursue political objectives in boards?*
- *Do politically connected board members lead to political moderation of CEO-wages (sensitive for public critique) in Norwegian state-owned companies and enterprises?*
- *Is this effect strongest for commercial companies who have more market characteristics than non-commercial monopoly enterprises?*
- *If political forces translate into lower CEO-wage, is there variation of preferences across political parties and ideology?*
- *For instance, do right parties such as Høyre (H) and Fremskrittspartiet (Frp), who are more in favor of market oriented decisions compared to left-wing parties, contribute less to a moderation of CEO-wage?*

To explore these questions I collected information on the political background of 389 board members (this is information not collected previously) and CEO wages in 27 Norwegian state-owned companies and enterprises in the period 2000-2010 and constructed a panel data set. I will use OLS regression estimates and econometric methods such as fixed effects to take into account time-invariant characteristics of companies and enterprises that can give biased estimation. With this model as my base-line, I look at CEO-wages in two ways, as the log of real wages (2000) which tells us about the change in *levels*, secondly I look at first differenced CEO-wages, which tells us if politically connected boards explain variations in the *growth* of CEO-wages.

The main findings shows weak support on the relationship between political connected board directors and moderation of CEO-wages. Thus, I interpret that there are no strong tendencies

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of mixing role as politicians versus board director of political directors when forming CEO-wages in state-owned companies. The finding of weak political connection is consistent with Ludvigsen (2010), however, this must be interpreted with caution as she includes different aspects of CEO total compensation.

However, when only including commercial companies in the sample there is some weak support of political moderation of CEO-wage growth. Further, for non-commercial companies, rightist political directors tend to contribute to an increase in CEO wages. For commercial companies the analysis show weak decreasing effect of wage growth rates when increasing board share of right-party political director. This suggests that there are no substantial left-right dimension in CEO-wages. It seems that CEOs in companies with broad policy goals (non-commercial) are more rewarded than CEOs in commercial companies. CEOs in non-commercial companies meet complex challenges and find it difficult to balance between efficiency goals and social goals. The reward might be an expression of the understanding of the complexity, thus rewarding the CEOs to take risks and meet challenges.

A reason for the weak support in the data is the small or no relation of political directors and CEO-wages. CEO-wages might be less political sensitive compared all other management decisions taken in boards. Perhaps the political director considers “good reputation” as to be associated with high performing companies, implying that CEOs must be rewarded to take risks.

CEO-wages are usually composed of variable and fixed components. In listed commercial companies, some CEOs receive variable pay in terms of bonus and stock options. Different components of wage-contracts might vary in political sensitiveness. Thus, maybe political sensitivity varies in how the contract is composed and not the actual wage level or growth.

Another alternative explanation of the weak support is that high wage levels and also increase in wage growth can motivate the owner to select politicians (Sørensen 2010) as board directors thus practice political control in boards. And also, dependent on type of company, political experience and competence might be relevant competence in boards.

The thesis provides a theoretical framework around characteristics and motivation of politicians, board composition, and wage contracts. In this section I provide a theoretical model to show why we should expect that politicians to moderate CEO-wages. Section 3.0 provides previous research on politically connected companies, CEO-wages and agency problems. Section 4.0 develops hypotheses and detailed econometric strategy description for examining the hypotheses. Section 5.0 shows data collection strategies and description of variables. In section 6.0 results are presented followed by discussion, analysis, fallacies with the model and econometric challenges. Finally, 7.0 draw some concluding remarks.

## **2.0 Theoretical framework**

The theoretical framework in this study consists of elements from the discipline of finance and the discipline of political economy to present how nature of politics and the political competition is formed, political incentives/behavior of politician and, most importantly, *why* politicians favors a moderation of CEO-wages.

This chapter is divided in two parts. The first part will go through theories of corporate governance from the finance perspective. The second part will give a theoretical discussion and derive a simple model of agency problems and politicians in the board of directors when setting CEO-wages.

### ***Part I***

#### ***2.1 Corporate Governance***

Corporate governance addresses the interactions between managers, the board of directors, shareholders and external stakeholders in the process of decision-making and control over firm resources. The approach of this study is focused on the board of directors.

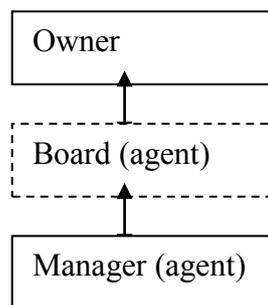
The majority of studies of boards have been dominated by the agency theory perspective from Jensen and Meckling (1976). The principal agent theory is one of the prime theories used in corporate governance (Bøhren 2011). The essence is that the agency relationship is a contract where one or more persons (the principals engage another person, the agent) to perform some service on their behalf which involves delegating decision making authority (Jensen and Meckling 1976; Fama and Jensen 1983; Schleifer and Vishny 1997; Bøhren 2011). In a corporate governance context, the firm owner is the principal who delegates decision-making authority to the chief executive officer (CEO). As both parts are utility maximizers, there is potential for conflicting interests, referred to as agency costs. For instance, trade-offs occur between economic interests of the principal, who wants to minimize costs and maximize productivity (more work hours), and the agent who want to work less and earn more.

The role of the board lies between the principal (owner) and the agent (manager). The agency problems are one of the key challenges of effective corporate governance. The role of the board is to create productivity and value. Thus, the board functions as an additional agent. Also here, potential of agency costs exists because board members' interests do not always reflect the owner's interests. Figure 1 illustrates this structure. The dashed line shows the role of the board as

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an agent. Corporate governance involves governance and decision-making at several levels, this paper is centered on the board.

Figure 1 Principal-agent model



(Bøhren 2011, p. 106 )

The board has two main functions. First it has a controlling role where it employs, monitors and dismiss chief executive officer (CEO). Secondly, it functions as an additional advisory body next to the directors. Good boards require that it possess the right incentives, are informed and efficient. This section will provide a quick overview of the essential features of each of the characteristics.

Incentives and boards is much about independence. A normative argument for an independent board (from managers) is that those who control only control efficiently if it is independent from those who are being controlled. Good governance codes also states that the majority of the board should not be previous or present employees, consultants, contractor or family members of directors. By meeting these requirements, the board is qualified as independent. However, if too much emphasis is put on requirements of independence, knowledge of the firm, industry, competition and generally information access will be less in strong independent boards. Thus the competence to control is high, at the expense of the competence of advising.

The quality of the two main functions (control and advice) of the board's function is dependent on the access to information. This is an argument for having managers in boards, however, having managers in boards will undermine the code of independence. Further, according to the agent theory, external managers will undermine the quality requirements of a board, because managers from other firms are primary agents who can potentially defend the managers interests, for instance within decisions around wages and bonuses.

Finally, the efficiency of a board is related to the ability to make good decisions, given board member's incentives and access to information. Further this is related with the board composition determined by factors such as gender, age, education, work experience, and if employed in the firm. From an agency perspective employee representative will cause conflicts because of employee interests that are not necessarily in line with the owner's primary interests. However, employee representatives can contribute to a more diverse board which has potentially a positive influence to its controlling and advisory function. Similarly, the normative argument for gender balance in boards is the increased diversity and further increased productivity. Another influencing factor is the size of board where greater size potentially increase the level of conflict, extend the decision process and potentially increase the pressure to yield to the majority. However, greater size of a board increase the ability to think more complex and see more opportunities, because in sum, the board's ability to think is broader (Bøhren 2011; Monks and Minow 1995).

## ***2.2 The principal-agent model and CEO wage contract forms***

The principal-agent theory in relation to CEO wage contracting requires that the CEO is controlled and monitored by owners and/or boards. Alternatively, control and monitoring via internal forces such as incentives schemes – either bonus pay or stock options. One important assumption is the misalignment of interests. Both parts want to maximize own interests, which also regards economic interests. A rational approach is that owners want to maximize company performance, while CEOs want to maximize own economic capital with less working hours. Assuming a one-to-one correspondence between firm value, created by CEOs effort and CEO wage, a strong and efficient instrument to maximize owner's interest is to provide the right incentives for CEOs. Thus, the principal has to a priori form contracts that provide the right incentives of CEO if he wants to maximize interests (Randøy and Skalpe 2007 ). CEO wage contracts are decisions made by the company's board of directors. An important key aspect here is that the interests between board of directors and the owner then must be aligned. However, from the principal-agent model, we know that this is not always the reality. This problem will be more thoroughly elaborated in the next sections. First we will look at different components of CEO wage contracts.

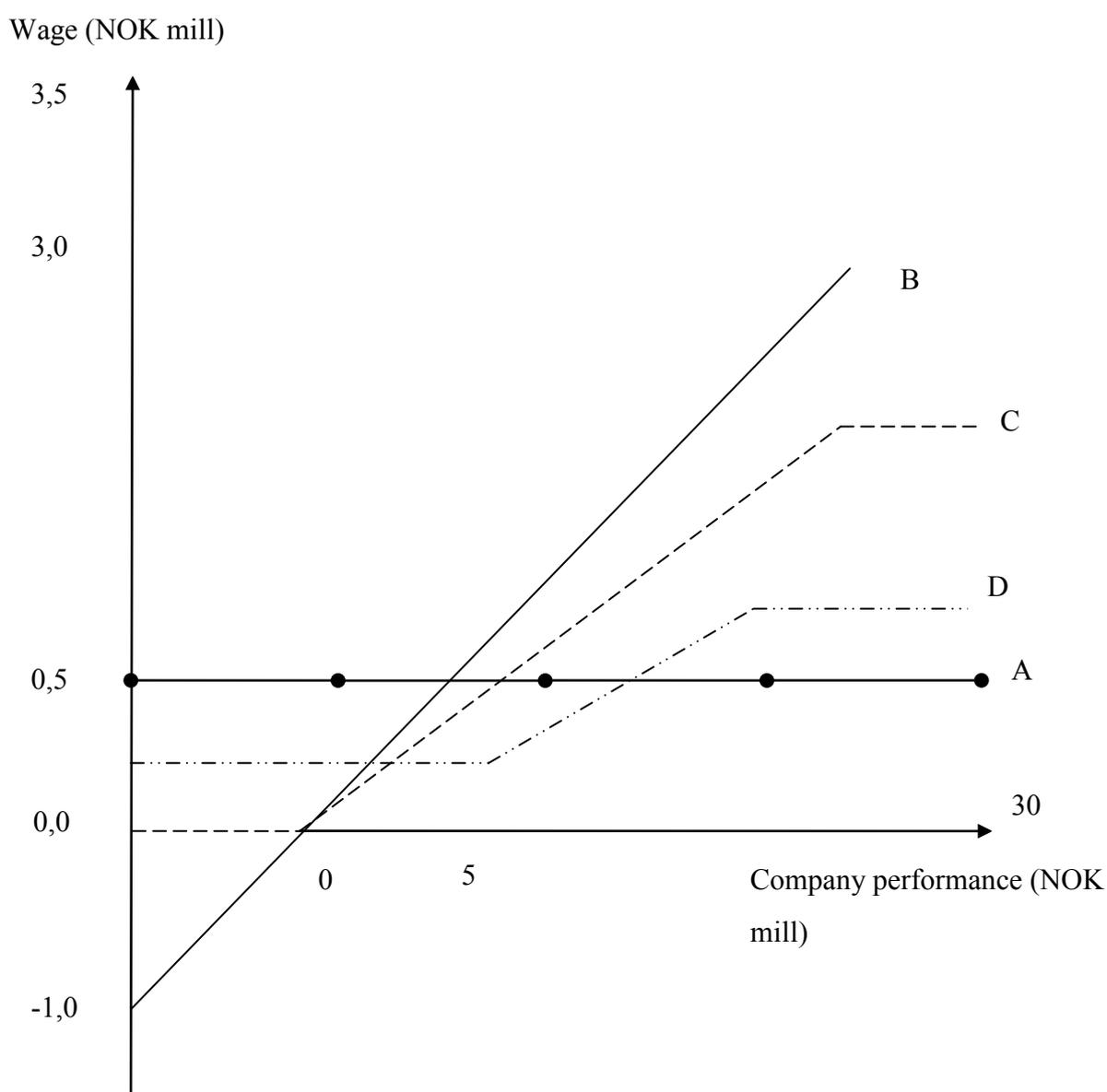
One important key requirements of a wage contract is the verifiable criterion. The verifiable criterion requires a clear and consistent connection between effort and the wage base. If the wage base is strongly exogenously affected, then the verifiable criterion is weak. If, for instance CEO wage in an oil company is based on stock prices, then the oil price will be a determining unstable and exogenous component of the wage base the effort. Further, this can potentially cause weak incentives because wage is determined by components outside the managers' control limit. Bad or

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good luck will be more representative components of the wage instead of effort and competence. Wrong distribution of risk between manager and owner is also a potential danger of weak verifiable criterion. These uncontrolled components can be controlled by adjusting the wage base.

Bøhren (2011) shows four examples of a CEO contract. Figure 2 is from Bøhren (2011), here he compares four contracts and shows how CEO contracts vary. Company annual performance is measured on the horizontal axis, and wage in the vertical axis. Contract A and B shows extreme cases where A is fixed wage contract and B is a variable wage contract. In B the floor is NOK -1 million and the ceiling is NOK 3 million and the change rate is 10 % (wage changes with NOK 0, 10 when profits increase with NOK 1.00) – for contract B the incentive is equal in all parts and the CEO is highly risk averse for economic losses when large deficit and public critique when high profits. The idea of a floor is to establish the wage's minimum level. This part protects the manager from unreasonable bad luck from uncontrolled factors. Further, the ceiling's primary function is to reduce too much luck. Additionally, it should dampen public critics on excessive wages. In sum, a floor and a ceiling function as lower and upper limit of a wage contract. An important aspect is that these parts of the wage contract are based on an incentive free zone. Much of the decision-power lies in the board of directors. In the incentive zone, there is a linear relationship between wage and incentive. Higher wage is based on higher incentive. If the contract is strongly incentive based, (common in Anglo-American countries), the curve is steep (Bøhren 2011).

Contract D and C are less extreme and varies with number of incentives zones. Contract C have widest incentive zone and largest rate of change.



(Bøhren 2011, p. 148)

## ***Part II***

### ***2.3 Political economy: the nature of politics and political competition***

Political economy employs traditional economic theories to study political events and government decision-making in a democracy. Rational choice models have emerged from the discipline of political economy. Powerful models in social theories such as classical microeconomics, allows developments of axioms of choice and preference, not only in a context of consumer and producer behavior, but also in a context of politician and voter behavior. In this way, researchers have used economic models or rational choice models in a political context to explain election outcomes in a modern democracy (Ordershook 1990).

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In Anthony Down's influential study on the nature of government, he explains the logic of behavior of individuals within a party who share the ambition to control the governing apparatus by gaining office in a democratic election. Being in office gives prestige and power. Thus politicians never seek office as a means of carrying out particular policies but as a means of holding office per se. Therefore, parties formulate policies in order to win elections, rather than win elections in order to formulate policies. This was Down's (1957) fundamental hypothesis, inspired by Joseph A. Schumpeter's profound analysis of democracy, "Capitalism, Socialism and Democracy" from 1950.

*"(...) the social meaning or function of parliamentary activity is no doubt to turn out legislation and, in part, administrative measures. But in order to understand how democratic politics serve this social end, we must start from the competitive struggle for power and office and realize that the social function is fulfilled, as it were, incidentally – in the same sense as production is incidental to the making of profits".*

(Schumpeter 1950, p. 282; Downs 1957, p. 29)

With "the competitive struggle", we are able to analyze political behavior (Boncheck and Shepsle 1997), in a democratic country.

From Down's (1957) analysis the politician wishes to maximize political support, it carries out those acts of spending which gain the most votes by means of those acts of financing which lose the fewest votes. In other words, expenditures are increasing until the vote-gain of the marginal dollar spent equals the vote-loss of the marginal dollar spent.

In this way, the nature of politics and political competition rationalize behavior of politicians.

Politicians want to maximize votes because and therefore he cares about his reputation. There are several types of politicians. From Downs' analysis (1957) politicians only goal is to stay in or get office. The approach of Downs (1957) essentially says that parties formulate policies in order to win elections, rather than win elections in order to formulate policies. In contrast with Downs (1957) Donald Wittmann (1973), preoccupied with a more optimistic view of humanity, hypothesized that politicians have policy seeking rather than office seeking goals. Many politicians appear to enter politics because of their strong policy preferences.

## ***2.4 Politicians in board rooms***

Why should we expect political moderation of CEO wages when politicians are affiliated in boards? On what basis can we expect political control by having politicians in board rooms?

To form a theoretical framework, I have integrated theoretical elements from the discipline of political economy to explain nature of politics and the political competition etc., and from the discipline of finance. In this section I will elaborate on how theories from the discipline of political economy can give expectations of political control when politicians are affiliated in boards of state-owned companies.

### *2.4.1 A simple model of agency problems and politician in board*

On what basis can we expect agency problems by having politicians in board rooms? I use elements of board theories from corporate governance and theories about the logic of political behavior from the discipline of political economy, to explain why we should expect political control and agency costs in board rooms.

From behavioral theories of boards, we see that various factors of board composition such as employee background, and who represents employee interests, is potentially in conflict with other director's interest of the company, thus maximizing agency problems. Similar reasoning goes for factors such as gender, experience etc. Board size is also said to be a determining factor of efficiency. Greater size means slower decision process, but might potentially give a higher quality in final decisions. Elements such as gender, education, experience etc., are common variables in the board behavior literature and empirical research, this model will look at how political connection among board directors can cause agency problems.

From political economy models, for instance from Downs (1957) we see that politicians have intrinsic political incentives and possess a "political logic" because he cares about his reputation. What is interesting here is the question if directors with political background use their positions as directors to practice policies. Another important question is if "politically correct" decisions are conflicting with decisions regarding efficiency for the company. Assuming that this is true, the situation will then violate the efficiency criteria of the board of directors and agency costs will increase.

Why should we expect this trade-off in a board?

Assuming that politicians are resourceful, mobile and busy people who are good in committing themselves to a number of enquiries of various duties, either in connection with politics

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or not, for instance, board position in a state-owned company and enterprises, we can shift the context to the board room of a state-owned company or enterprise. During board meetings, there are a number of choices to make (i.e. redistribution of company resources) which is potentially of societal relevance (Monks and Minow 1995), including CEO-wage contracts, employment etc. Further, assuming two types of board members; politicians and non politicians, the potential of conflicting interest between politicians with intrinsic political motives and political logic and a goal to reap good reputation, and non-politicians with experience from private companies are large. In this thesis, I want to use the same logic of politician's behavior from the discipline of political economy to explain incentives of politicians in a board context of state-owned company/enterprise, and the potential of political control. Further, I assume that in state-owned companies and enterprises, boards are composed of (1) politicians and (2) non-politicians (board members recruited from business). Thus, the potential for agency problems is large. How do decisions around forming CEO-wage contract create agency problems in a board consisting of (1) politicians and (2) non-politicians?

Politicians in boards have two choices when forming CEO-wage:

- (1) CEO rewards
- (2) Good reputation

Given that resources are scarce and resources are subsidized from owners i.e. distributed from tax incomes, more CEO rewards means bad reputation (excess CEO-wages often signals bad distribution of resources, and decrease of welfare of other citizens i.e. various welfare projects such as education, health etc.), and vice versa. The intuition is that high rewards to CEOs which to the public seems as stealing resources from welfare projects and gives bad reputation. Lower levels of CEO-wage means lower CEO wealth, which is more acceptable to voters and increase chances of good reputation. Thus, politicians face a trade off between these two choices.

Political parties differ from each other along multiple policy dimension. For instance, when considering socioeconomic aspects, there is a left-right division between the party preferences. There are three aspects that especially highlight this division. These are (1) the government versus private ownership of the means of production, (2) strong and weak role of government in economic planning, and (3) support of or opposition to redistribution to low income groups. Rightist politicians are typically more anxious about a strong governmental role in economic decisions. While left-wing policies prefer strong governmental role and more redistribution (Ljiphart 1989).

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#### 2.4.2 *A simple model of politicians, agency costs and political moderation of CEO wages*

Now that we have theoretical support of existence of “political incentives” of politicians, and given that a board in a state-owned company or enterprise consist of (1) politicians, and (2) non-politicians, I will in this section provide a model of political moderation of CEO-wages.

Assume a public owner, for instance the Ministry of Trade and Industry who owns several companies and enterprises varying in the structure of ownership. A new White Paper is published, containing primary strategies for the future. This also requests strategy amendments in the state-owned companies and enterprises. A key component here is that these strategies are influenced by new public management which is oriented towards more market efficiency and business management. The reason for this is the increased competition in the economy and pressure from international organization. This type of orientation is common in Anglo-American countries such as the UK, US and Australia (Hall and Soskice 2001). This will potentially have consequences for important economic decisions for the company, including decisions around CEO wages. A market oriented strategy allows core ideas of the free market to be one of the key elements in the strategy. This includes strong competition and a minimum level of government intervention, thus to achieve more efficiency and productivity.

#### Model of setting CEO wages

##### Assumptions:

- A “Political logic” meaning that politicians think of aspects outside boardroom: for instance reaping good reputation among voters
- The board consist of politician and non-politician
- The CEO is risk-averse
- Two choices: CEO rewards and good reputation (to voters)
- When considering if wages are high and low, it depends on what it is compared to. Employee wages is a common benchmark, thus connecting CEO-wages to broad interest groups such as for employees

When the Ministry of Trade and Industry reveals new strategies the board can decide to either increase the wage (rewards for taking risks) or leave it unchanged.

Thus, in this model, setting wages for CEOs implies two choices

$$(1) W' > W_{pre}$$

$$(2) W_{pre} < W'$$

Figure 3 Political moderation of CEO-wages

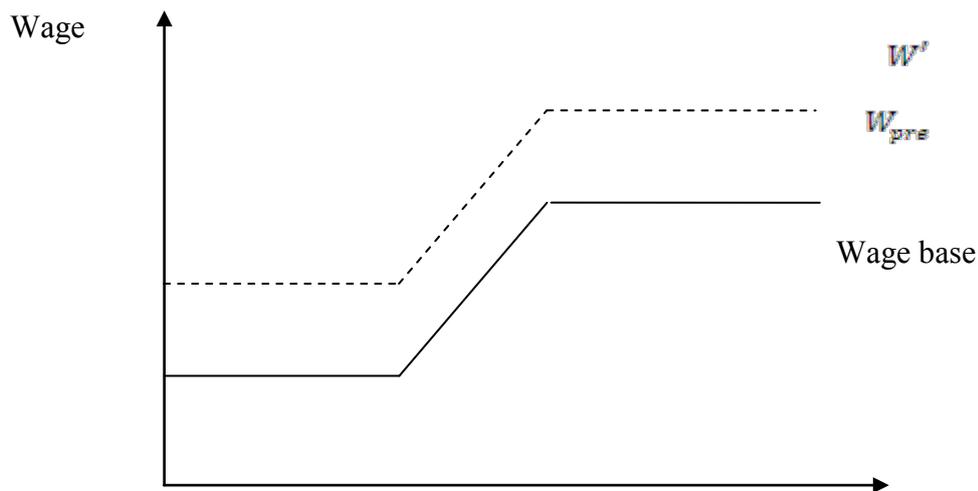


Figure 3 is a reconstruction from figure 2. The curve shows the same contract as C and D in figure 2 and shows that the wage is composed of different parts. On the horizontal axis shows wage base, i.e. if part of the wage is incentives based or not. The vertical axis shows the amount of wage.

$W_{pre}$  is the present wage before the publication of new reform from the Ministry of Trade and Industry.

$W'$  is a wage level that rewards the CEO to take risks

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Choosing  $W_{PRE}$  instead of  $W'$  implies low rewards for the CEO and good reputation for the politician

Choosing  $W'$  instead of  $W_{PRE}$  implies high rewards for the CEO and bad reputation for the politicians.

In the board room there are two groups of board members; politicians and non-politicians. Non-politicians are recruited from and have extensive experience from private business companies. Politicians have intrinsic motivation and make decisions based on “political logic”. Given the two choices and that CEO is risk-averse, and given that politicians practice “political logic”, politicians will choose  $W_{PRE}$  ( $<W'$ ), because he will gain good reputation. Non-politicians will choose  $W'$  ( $>W_{PRE}$ ) which reflects higher rewards for the CEO. Increased competition in the economy requires more monitoring and control to measure performance, thus rewards compensate for more working hours and also higher ability incentives to take risks.

I draw propositions<sub>1</sub> (which I will elaborate more in chapter 4.0):

With theoretical support from political economy, politicians possess political motivation and a “political logic” because they care about reputation and how they appear in public. If this is also true for politicians having positions as directors, politically connected directors will contribute in moderating CEO-wages when forming CEO wages.

### **3.0 Political connection, corporate governance and CEO contracts**

#### ***3.1 Politics and corporate governance***

There has been an international growing consensus on the need for monitoring and awareness of good practice of corporate governance for both private and public companies. International organizations and regional institutions such as OECD and EU have over the last decade worked to increase awareness of good practice of corporate governance. In 2005, the OECD provided corporate governance codes as guidelines to ensure an effective legal and regulatory framework for state-owned companies. The EU published an Action Plan to modernize the Company Law, with a main goal of strengthening corporate governance (Global Corporate Governance Forum 2008). CEO-compensations and board compositions are among others important subjects in corporate governance. The EU explicit recommend criteria of board directors for instance, they cannot be an employee of company or have been the last three years, can not represent controlling shareholder, can not be a close family member of an executive or managing director of the company (Global Corporate Governance Forum 2008). According to guidelines from OECD (2005) boards are responsible for company performance, and should act in the best interest

of the company. Boards should be composed so that they can exercise objective and independent judgments. A working group in the corporate governance committee of the OECD stresses the advantage and disadvantage of politicians as board directors. Although there is a consensus that politicians can create inefficiencies, it also states that political competence can be relevant to provide knowledge of for example the government system (Fredrick 2011).

In Norway – The Norwegian state owns companies and enterprises with an aggregated value of NOK 600 billions, measured at the end of year 2010. Listed companies constitute approximately NOK 500 billions. Listed state-owned companies constitute one third of the value – added in the Norwegian stock market. These are resources the state administers on behalf of the public. Thus, the Norwegian state plays an important role in the development of the domestic industry. The companies are value-adding and create workplaces. Optimal practice of ownership is therefore important. Guidelines from Stoltenberg II cabinet (set 31.3.2011) states that CEO-wages in Norwegian state-owned companies and enterprises should be competitive but not leading within similar companies. Companies have to contribute if necessary to moderation of CEO-wages. Further, the board of directors have to make sure that CEO-wage contract does not give unfavorable consequences or impaired reputation for the company and enterprise. When regarding board composition, the Norwegian state stresses the importance of different competence relevant for the company's core operation. Among others, they mention concretely the increase of female (because of current female underrepresentation) and the importance of geography, age etc. In Norway they also states that political competence can be useful, but not a determinant factor to be affiliated as board director (St.meld. nr. 13, 2010-2011; NOU 2004).

### 3.2 *Wage contracts*

CEO-wages are composed of two elements; a variable part and a fixed part. The variable part is determined at the end of the year and typically reflects performance during the year. The fixed part is set in the beginning of the year (Hall and Liebmann 1998). Setting ex ante fixed wages, implies two things; (1) considering risks the CEO face, and (2) set a reasonable upper limit to avoid critique. The following equation shows how CEO-wages can be composed.

$$W = f + Y$$

where  $Y = \chi + \theta$

$f$  is a fixed component, and  $Y$  is the variable component of total salary which is a component of bonus payments and stock options. In this thesis, I hold the variable part  $Y$  constant, therefore my approach on CEO annual wage is the ex ante fixed wage

$$W = f$$

Numbers from 2005 shows that on average 72% of Norwegian total CEO-wages is fixed and the rest is incentive based. Comparable numbers over time in Norway is lacking but international

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studies shows an increase of the variable part. In the US, the variable part is larger compared to Scandinavian. In Norwegian state-owned companies, the use of incentive part has increased. In 2005, 35% had incentive wages, which is an increase from 10% in 2000. The variable part constituted on average 17% of the total wages among the companies with these types of contract. Compared to private companies and state owned-companies with commercial goals, full state-owned enterprises have lower connection of wage and the companies' profits (less use of incentive schemes) (Rattsø and Sørensen 2011; Ludvigsen 2010). However, the wage levels are approximately the same (Bøhren 2011).

Whether CEO-wages are too high or too low depends on what they are compared to. In public debates they are often compared to employee wage level. In an international context, a study shows that differences between Scandinavian CEO-wages are low. CEO wages in the US was 170% above the mean for other countries, taking into account company size, wage risks and ownership structure, the difference is reduced to 43%, further, taking into account CEO's experience and other characteristics, the difference is reduced to 12%. This shows the challenges of comparing CEO wages across companies and countries. For instance, company size, the most robust international empirical findings on the dependency of CEO wages is the relationship between company size and CEO wages where small companies gives lower CEO wages compared to larger companies (Bøhren 2011). In this analysis, there are some further challenges when comparing CEO wages across Norwegian state-owned companies because of the heterogeneousness in goals of the companies and enterprises. State-owned companies are alternatives to traditional public administration. The division of state-owned companies and enterprises is between companies and enterprises with commercial versus non-commercial goals. Companies with commercial goals have to take into account efficiency and market oriented strategies in order to be competitive and earn profits. Non-commercial goals are broad societal goals (for example health care) (The Norwegian Ministry of Trade and Industry 2009). However, empirical findings shows that average CEO-wage level in large Norwegian state-owned enterprises are not different from large listed private companies at Oslo Børs (Bøhren 2011). In a Norwegian White Paper (St.meld.nr. 13 2006-2007), the state express concerns around a higher increase of CEO-wages than what is desired. A report from the Office of the Auditor General of Norway (2011) shows that in the period 2004-2007, the fixed part of the CEO-wages in 42 state-owned companies increased with an average of 8 %. In 2007 and 2009 the growth increased to 13%. The aggregated wage compensation in 2007 and 2009 increased on average 11 %. This is doubled increase compared to the reference group in the analysis. For CEOs in non-commercial (full state-ownership) companies the average wage increased with 35 % in the period 2004-2009. The aggregated growth in partly state-owned companies was 24%.

### ***3.3 Agency problems, political connection and CEO wages***

Studying agency problems and political moderation of CEO-wages connects research in corporate governance and finance, and also, when drawing questions considering characteristic of politicians, theoretical and empirical discussions within the field of political economy might be useful to get insights on how people connected to politics behave, and thus, why we can expect political moderation of CEO wage when board director is politically connected. In this section I will go through three different research areas to highlight essential empirical findings. The first part concerns corporate governance and board composition, the second part will go through previous research in political connected firms and also how previous research has defined “political connection”, the third part goes through previous studies on political connection and CEO wages.

#### ***3.3.1 Research on board behavior and board composition***

A growing body of empirical research examines the structure and effectiveness of corporate governance systems. An important insight from this literature is about the monitoring and control by the boards of directors. Much empirical research has examined whether board structure is related to in particular company performance. According to theories boards have several functions and various board designs. Fundamentally, board designs are to (1) align interests of principal and agents, (2) to provide information for monitoring and advice and (3) to foster decision-making effectiveness. Composition of boards includes among other things independence of board, composition of gender, director’s experience and education, employee representatives, and if director have present or previous positions as manager. These are also components included in surveys. Thus it is possible to look at composition trends over time (Monks and Minow 1995). Prior research on board structure relies upon a premise that monitoring by the board can improve the quality of manager’s decisions. Companies and organizations that have tracked shifts in board size, composition and structure see significant changes. Bøhren (2011) examine the relationship between board composition and efficiency across Norwegian listed firms and finds that companies with statutory provision of gender balance have low profits. What is interesting here is that employees create agency problems because they keep their special interests. According to Sørensen (2010) and Bøhren and Strøm (2005), the more heterogeneous boards, the higher potential that boards will not fulfill central functions. When regarding board size, Yermack (1996) finds negative significant relationship between large boards and firm value across large U.S. industrial corporation (1984-1991). This is also consistent with findings from Lipton and Lorsch (1992) and Jensen (1993), the

authors state that problems of poor communication and poor decision-making overwhelm the effectiveness of the board.

As earlier research point out, composition of boards is relevant for the behavior of a company. If factors such as gender, education, experience and employee background is affecting outcomes, then an interesting question is how directors with political connection behave? Directors carry different logics, and these differences in cognitions, actions and values lead to a different rationality and therefore a different outcome. From different theories we can expect that politicians act differently than non-politicians because of intrinsic political incentives and a “political rationale”. As board director, they possess controlling power over the company’s resources. The interesting question here is if politicians mix roles between being a politicians and board of director.

### *3.3.2 Research on political connected companies and enterprises*

Evidence from previous empirical findings shows that we can expect that companies with politically connected boards deviate from companies with non-connected boards in terms of economic results and other decisions. Although the large varieties in the *type* of studies in terms of methods and variables, common for all is that they are politically connected in some way and the purpose of this section is to show consequences whether positive or negative, of political connection (in varieties of ways) to business. Obviously the fact that companies are politically connected in some way has created curiosity.

The term political connection of companies has been defined in various ways, for instance connection in some way of the CEO, president, vice-president, large shareholders, secretary, amount of state-ownership, board of directors and chairmen to politics. “Connection” has been defined as friendship with head of state, ministers and members of parliament, or/and experience as ministers, membership of political organizations.

According to Schleifer and Vishny (1994), observers of state-owned companies stress the high inefficiencies and that this is due to political pressures from the politicians who control them. Politicians seeking votes to employ too many people leads to excess employment that is in conflict with profit-oriented decisions.

Faccio (2010) looks at differences between politically connected and non-connected firms in terms of leverage, taxation, market power, productivity, and market to book ratio. On average politically connected companies have higher leverage, lower taxation, display much greater market power and have lower market valuation. Greater differences found when companies are connected through owners, close relationships or through a minister (rather than a member of parliament). Menozzi, Urtaga and Vannoni (2010) Investigate 114 Italian public utilities during 1994-2004. Politically

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connected directors have a positive and significant impact on the level of employment. And also, relative to board size, the number and proportion of politicians in the board turns out to be more important than board size in reducing accounting performance of Italian state-owned enterprises. In this study politically connected directors are identified by their present or past activity in the political arena, as represented by political charge, the membership to a political party, the candidacy for election. Goldman et.al (2008) explores importance of political connections in the U.S. to company value. This study is different from other studies mentioned in this section because it explores differences between politically connected companies and not with non-connected companies. In countries with well-functioning legal systems, such as the US, companies are not expected to receive a substantial competitive advantage from being politically connected. In this study political connection regards board directors. It looks at data in the two periods 1996 and 2000. The first is the 2000 presidential election, and the second event is the board nomination of all directors who are identified as having political connection. The hypothesis is that if political connections matter, then companies with political connections to the Republican Party will increase in value upon the republican win, while companies connected to the Democratic Party will suffer a reduction in value. Results shows that following the announcement of the Republican win, the return difference between companies classified as having a Republican board and those classified as having Democratic board is positive. Announcement returns are positive for the Republican portfolio and negative for the Democratic portfolio. Following the announcement of the board nomination of a politically connected individual, there is on average a positive and significant stock-price response. This positive announcement effect is more pronounced for the larger companies in the sample, but holds for the Republican directors as well as for Democratic directors.

Research on politically connected companies also finds benefits of being politically connected. Niessen and Ruenzi (2010) finds that characteristics of politically connected German companies outperform politically unconnected companies in terms of market- as well as accounting based performance. Having politically connected board directors at the same time when board director is member of the Bundestag is positively correlated with better accounting. In sum, we see that earlier research has pointed out that politically connected boards may create more or less board efficiency, that further affect company-related characteristics. Previous research has suggested that companies with politically connected boards behave differently across both national companies and international companies. Thus, I interpret that board directors connected to politics may be carriers of “political logics” and special interests in the board.

### *3.3.3 Political connection and CEO- wages*

CEO wages has been of interest for researchers for nearly a century, and the relationship of CEO wages and company performance is extensive and has been of interest for a long time (from Berle and Means 1932; Jensen and Murphy 1985). One of the well known papers (Murphy 1985; Jensen and Murphy 1985) introduced the relationship between CEO-wage and company performance, using fixed effects and first difference models. In this study we examine the relationship between board composition (agency problems), particularly the effect of politically connected board of directors and CEO-wages. Previous research on politically connected board directors and CEO-wages is less extensive as CEO and company performance. In fact few studies have related the level of CEO wages to the concepts in the principal-agent literature (Garen 1994). Randøy and Skalpe (2007) shows that chair-women tend to give lower CEO wages for unlisted Norwegian companies.

Ludvigsen (2010) examines principal-agent model in setting CEO-wage contracts in Norway and Sweden. Ludvigsen (2010) look at both fixed and variable (incentive schemes) components of the CEO-wage. She tests several characteristics such as chairman's professional background, if the company has compensation committee, board size, state control etc. She suggests increased potential of political control when the chairman are political representatives and state control is strong (large ownership), compared to companies with weak state control and non-political chairmen. For both countries, however, results shows weak support on the effect of political forces through politically connected chairman on less lucrative wages and golden parachutes. But looking at bonus payments boards with political chairmen pay an average bonus pay of 2%, compared to 10 % by boards with non-political chairmen. Although she concludes weak support on political control of CEO pay levels, Ludvigsen (2010) emphasize that political forces results in mixed effects the CEO-wage contract.

## **4.0 Hypothesis and econometric strategy**

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## 4.1 Hypothesis

In this thesis I want to investigate if political connection of board directors contribute to a political moderation of CEO-wage. The approach is to study the log of real wages (2000) and the first difference of log real wages (2000). Both measurements are previously used in studies of CEO-wages. From political economy models we see that politicians care about reputation, and therefore possess a “political logic”. Preferences of politicians will however differ because of ideology (Lijphart 1989). For instance, in economic matters right wing parties are more market oriented than left parties. Thus,

*H<sub>1</sub>: Politically connected directors set low CEO wage level, or, contribute to negative wage growth rate.*

*H<sub>2</sub>: Right wing directors set higher CEO-wage level compared to left wing directors. Equivalently, right wing directors contribute to increase in wage growth rate more than left wing directors.*

In this analysis, I assume that there is relatively more market orientation in commercial companies as these companies are more autonomous, aims to increase profits in a strongly competitive market arena. Because of the competitive environment CEO-wages here are more likely to increase to attract good managers. Thus, violating the politician’s good reputation.

*H<sub>1a</sub>: Politically connected directors set low CEO wage, or , contribute to negative wage growth rate. This effect is strongest in commercial companies.*

*H<sub>2a</sub>: Right wing directors set higher CEO-wage level, or, contribute to increase in wage growth rate. This effect is strongest in commercial companies.*

## 4.2 Econometric strategy

To test the hypotheses I will use OLS estimation with panel data. A panel is a cross-section of a group of people, countries or in this case companies who are surveyed periodically over a given time frame. Equation (1), presents a theoretical population model of the impact on political connection and political ideology on CEO wages.

(1)

$$y_{it} = \beta + \lambda x_{it} + \phi' \text{controls}_{it} + \varepsilon_{it}$$

where  $\varepsilon_{it} = \eta_i + \gamma_t + u_{it}$

$i$  is for each company in year  $t$ ;  $y_{it}$  is the inflation adjusted CEO annual real wage<sup>1</sup>. Instead of only looking at wage levels, I also look at changes in wage growth. The purpose of this is to test the robustness of each indicator. I treat annual wages as: (1) using the log of wages  $\log(\text{real wage } 2000)_{it}$  to impose a constant percentage effect of political connection and political ideology on CEO wages, and (2) the first difference of annual real wage which shows the wage growth of real wage which is  $[\log(\text{real wage})_{it+1} - \log(\text{real wage})_{it}]$ , respectively. In this way, I look at how political connection and political ideology affects the wage growth.

In equation (1),  $\beta$  is a constant term;  $\lambda$  is a vector of coefficients for all explanatory variables  $x_{it}$  and  $\phi$  is the coefficient vector for control variables in the equation.  $\beta$ ,  $\lambda$  and  $\phi$  are the coefficients I want to estimate.  $x_{it}$  is (1) political connection which measure the share of political connected members in all, and (2) political ideology where political connection measure the share of political connected members according to ideology (party affiliation) (SV, Ap, V, KrF, Sp, H, FrP). Political connection and political ideology basically measures the same, but political ideology will potentially tell us something about if left, right and center politicians have different preferences around decisions of CEO-wages.

The control variables are mean levels of board experience, gender, birth year, age and board size. By including control variables, we are able to control for its effect on log real wages (2000) and  $\Delta \log$  real wages (2000). Factors such as gender and age tend to affect decisions around being political active and also what party you support as noted. Board experience and board size tend to affect decisions around CEO-wages.

$\varepsilon$  is the error term which represents all other variables that affect CEO annual real wage which is not controlled for in these models, more specified, the error term contains;  $\eta_i$  which are company specific year-independent effect on CEO annual real wage;  $\gamma_t$  which are year specific firm-independent effect on CEO annual real wage and  $u_{it}$  are idiosyncratic error term that affect log real wages (2000) and  $\Delta \log$  real wages (2000).

Properties of OLS are prone to biased estimation, however, it is possible to establish the unbiasedness of OLS under a simple set of assumption. The four assumptions (Gauss-Markov assumptions) says that (1) linear population parameters (i.e. that model (1) are the true population model), (2) all error terms have the same variance, referred to as homoskedasticity, (3) the true population model is random sampled where each error  $\varepsilon_i$  is a random drawing from the population distribution, independent of the other error term, and (4) the error term  $\varepsilon$  has an expected value of

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<sup>1</sup> Real wages expressed in year 2000 million NOK and adjusted for consumer price index (CPI) from Statistics Norway <http://www.ssb.no/kpi/tab-01.html>

zero given any value of the explanatory variable  $E(\varepsilon_{it}|x_{it}) = \mathbf{0}$  (Wooldridge 2009; Verbeek 2008). Accuracy of the mean of an estimated coefficient depends on the properties of the error term. I will discuss importance of some possible errors.

Unbiased OLS estimation requires that all variables (dependent, independent and errors) are random sampled. However, there is the possibility that this is violated. If board members who did not respond are affiliated in companies with high level of CEO-wages, it is likely with biased estimation. I assume no prominent characteristics of those who not answered, i.e. they do not differ from sampled board members.

I correct for serial correlation between error terms within the same companies by clustering standard errors around companies. All regressions are estimated with Huber-White robust standard errors in order to overcome problems with heteroscedasticity.

$\eta_i$  (from the error term) are company specific year-independent factors that may affect CEO annual real wage. In practice it is unlikely that this have no effect on CEO-wages. Each company has its own time-invariant individual-specific characteristics that may influence the dependent and independent variables. Factors such as company size might influence the way the board considers what is fair wage level for the risk averse CEO. For instance, large oil companies such as Statoil might over time always give higher CEO wage than small companies such as Electronic Chart Centre AS, thus violating the zero conditional mean  $E(\varepsilon_{it}|x_{it}) \neq \mathbf{0}$ . To avoid biased OLS estimation resulted from omittance of such variables, I use fixed effects (FE) transformations. When using FE we assume that something within companies may impact or bias dependent and independent variables and there we need to control for this. FE removes the effect of those time-invariant characteristics from the predictor so we can assess the predictors' net effect (Wooldridge 2009).

Model (2) gives the FE model. All variables are expressed as deviations from their individual means. Here, all unobserved factors that previously made up  $\eta_i$  in (1) is transformed away, since  $\eta_i$  is equal to its mean. This method is also used by Ludvigsen (2010).

(2)

$$(y)_{it} - (\bar{y})_i = \lambda[(x)_{it} - (\bar{x})_i] + \phi[(controls)_{it} - (\overline{controls})_i] + u_{it} - \bar{u}_i$$

where

$$(\bar{y})_i = \frac{(y)_{i1} + (y)_{i2} + \dots + (y)_{iT}}{T}$$

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$$\bar{x}_i = \frac{(x)_{i1} + (x)_{i2} + \dots + (x)_{iT}}{T}$$

$$\bar{\eta}_i = \frac{(\eta)_{i1} + (\eta)_{i2} + \dots + (\eta)_{iT}}{T} = \frac{T * \eta_i}{T} = \eta_i$$

To control for time trends or other company-independent shocks (for instance global economic crisis) that affect CEO real wage, I construct year dummies in all regression with 2000 as base year. An advantage of panel data is the ability to model individual dynamics. Many economic models suggest that current behavior depends on past behavior. Including a lagged real wage in all regressions imposes dynamism. An advantage of using lagged dependent variable is that it allows me to estimate both the direct effect of for instance exogenous shocks on current wage growth and the indirect effect through lagged real wages. It is likely to be that CEO wage in year  $t-1$  affects currently CEO wages. Including lagged real wages also controls for omitted variables. Thus, I include  $y_{t-1}$  in the right side of equation (1)<sup>2</sup>.

I also take into account affect of explanatory variables with a lag. It is likely to be that board of directors that set conditions around CEO wages in year  $t-1$  or  $t-2$  affects CEO-wages today. The idea is to see whether in aggregate the CEO-wage level and growth is linked to political directors in boards. Lagging independent variables (board decisions) is also consistent with method of Ludvigsen (2010), here she argues that that because annual reports of year  $t$  was agreed upon year  $t-1$  historical effect might actually have impact. This is convincing as she also includes performance based wage (bonus etc.) as a measure of CEO compensation. As mentioned in section 3.1 variable pay is determined at the end of the year and typically reflects performance during the year. The fixed part is set in the beginning of the year (Hall and Liebmann 1998). As most data in this sample is fixed elements which is in theory not company performance dependent, I take into account both effects of  $x_t$  and  $x_{t-1}$ .

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<sup>2</sup> Lagging dependent variable can also cause biased estimation, thoroughly explanation in Wooldridge 2009, chapter 9, from page 610, and Verbeek 2008, chapter 10.4, from page 377)

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## 5.0 Data and variables

### 5.1 Sampling

The sample consists of 27 Norwegian state-owned companies and enterprises. The sample is collected from the Report of State Ownership 2009 (*Statens Eierberetning 2009*)<sup>3</sup>. There are a total of 53 state-owned companies and enterprises. State-owned companies and enterprises is where the state is partly or fully owner, and the ownership is directly administered by the departments. In this sample, all four company categories which describe the main goals of each company type are included. Table 1 shows all four categories and the spread of the companies and enterprises included in this sample.

Table 1 Distribution of state-owned companies and enterprises across categories

Category	No. companies/enterprises
1. Commercial goals	5
2. Commercial goals and national anchor of head office	7
3. Commercial goals and other specified goals	6
4. Sectorial policy goals	9
N <sub>company and enterprises</sub> =27	

(The Ministry of Trade and Industry 2009; NOU 2004)

To collect information of board members in the period 2000-2010 I first collected all annual reports available at web pages. There were some requirements when constructing my sample. The first is that companies and enterprises must be in operation in the period 2000-2010. Secondly, to have required access to information, this includes that the company and enterprise must have web pages and published annual reports available here or at least via key persons who provided me with lacking annual reports via regular mail and e-mail. Companies established within this period (>2003) were excluded. Some of the companies and enterprises in my sample are established within the period 2000-2003 (Gassco, Argentum, Cermaq, Mesta, Regional Health Enterprises), and

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<sup>3</sup> I include the regional health entities in category 4, because of the similarities in goals. There are broad social and political goals for all category 4-companies. In the new report of state-ownership, the health entities are categorized as 5 (The Ministry of Trade and Industry 2010).

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therefore I have missing information for these years. The Regional Health Enterprises; Helse Sør and Helse Øst were merged to Helse Sør-Øst in 2007, but I have treated these as one enterprise the period before 2007. In total 27 companies and enterprises complied with these requirements. In total, number of board members of 27 companies and enterprises in the period 2000-2005 is 657. These were sampled via annual reports. Further, contact information (e-mail, phone number, regular mail) were sampled from the data base on company information *Proff Forvalt*. 657 board members were primarily contacted via phone, mail and regular mail (also board members addressed abroad). Naturally, not all responded via personal contacting (phone, e-mail and mail). Therefore, as a secondary method, I collected information with awareness via internet search motors and by matching, I found CV, home pages, profiles of board members at accountable web pages such as *Stortinget* and *Business Week*. In sum, I ended with information from 389 board members. Data on political connectedness of the board of directors in Norwegian state-owned companies has not been collected before.

## **5.2 Variables**

### **5.2.1 Dependent variable**

A CEO-wage contract includes several aspects, mainly dividing between fixed and variable components. This thesis looks at the fixed part of the CEO-wage. The reason for the approach of fixed part of CEO-wage is because of some difficulties when collecting data. Companies and enterprises have introduced bonus payment at different time (most companies have introduced bonus payments late in the period 2000-2010). The main pattern is that there is moderate use of incentive schemes for CEOs in state-owned companies (Rattsø and Sørensen 2011). For these reasons bonus and stock options are not included in this study.

Prior research on CEO compensation varies from looking at separate components to total packages. The chosen strategy of this study is based on characteristics of sample in the period 2000-2010. There are several reason for this. In Norway and Sweden this part varies typically between 60-70 % of the total compensation. Use of variable salary is however increasing. In 2000, 10 % of Norwegian state-owned companies had implemented incentive based wage, this increased to 35 % in 2005. In Norwegian listed companies, those who had this type of contract, the variable salary constituted on average 17%. A comparison of private companies and state enterprises shows a weak coupling of CEO wage and company performance (Bøhren 2011; Ludvigsen 2010). Interpretation of this thesis is that it seems that for most of the public CEO-wage contract, the fixed salary is more representative. And of those who have contracts with variable pay, the variable pay (bonus, stock

options) constitutes a less dominating share of total wage contract, at least compared to U.S. where typically variable salary constitutes up to 80 %. Ludvigsen (2010) also states that incentive schemes are inappropriate measure of CEO-wage in non-commercial companies. In the sample collected (from period 2000-2010), most of the companies and enterprises did not have variable salary in terms of bonus and equity earnings, this was also developed relatively late in the period. Because of these challenges, I constructed a data set based on the fixed salary.

CEO real wages appears in logarithm form and semi-elasticity. Taking the log can mitigate problems of heteroskedasticity. Using the log means that we are looking at the percentage change in wage level. This measurement is common in CEO wage studies. I also look at CEO wage as changes in wage growth. In this way I look at variations in growth. This measurement has been used previously, for instance Kato et al. (2005).

### **5.2.2 Independent variables**

#### *Political connection*

Political connection is defined as being on a list of political organization, having experience of being on list, currently or previously member of parliament and also experience as minister. The variable is coded 0 if there is no such connection and 1 if connected, and is measured as board share.

#### *Political ideology*

Data of political ideology is sampled at the same time as political connection. Here I simply asked those who are connected which party they represent. The sample consisted of the parties Høyre, Fremskrittspartiet, Kristelig Folkeparti, Venstre, Arbeiderpartiet, Senterpartiet and Sosialistisk Venstre. The variable is coded with three dummies where *Political ideology 1* consist of left parties Arbeiderpartiet and Sosialistisk Venstre, *Political ideology 2* is center parties such as Kristelig Folkeparti, Venstre and Senterpartiet, *Political ideology 3* is the right parties Høyre and Fremskrittspartiet. Effects of ideology is also used by Goldmann et al. (2008) where they examine difference of company performance between boards with Republican directors and Democratic directors. Grendstad et al. (2010) also used an ideology-explanation approach when analyzing the Supreme Court's involvement in the policy making process in establishing national legal standards. The authors argues that when Supreme Court justices fail to speak with one voice on legal issues, extra-legal forces influence their decisions. Their results show that geography and ideology significantly explain economic votes of justice, whereas a justice born in Oslo, with experience of

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having been pointed by social-democratic government has more than twice the probability of voting for public interest than justices in rural places and appointed by non-socialist government.

### *Controls*

The data set allows me to include control variables such as age, gender, birth year and board experience of directors, and also company characteristics as board size. Age, birth year and board experience and gender are share variables. These are variables common to include in empirical studies of CEO-wages. Board size which can be interpreted as size of company (board size usually increase with company size), is the most robust empirical findings that affect CEO-wages (Bøhren 2011; Ludvigsen 2010). Other examples from the literature is gender composition in boards and CEO-wage, from (Randøy and Skalpe 2007). If the board of directors have high competence, the CEO will be less rewarded.

## **6.0 Results and analysis**

### **6.1 Results**

Below I examine if politically connected board directors contribute to moderation of CEO-wages in state-owned companies, using collected panel data from 27 Norwegian state-owned companies in the time period 2000-2010. Theoretical models from the discipline of political economy tell us how political competition forms political incentives. Politicians care about reputation and want to appear as “good politicians” to voters. If excess CEO-wages is connected to the company where the politician is board director, this can potentially violate his good reputation.

From agency theory, we know that different compositions of a board of directors dependent on factors such as board size, age of directors, gender composition, independency, varies in effecting decision making process in general. One of the most robust findings in empirical research is that board size matter to company performance (Yermack 1996), too much heterogeneousness creates agency costs because of increasing inefficiency and slower decision process. If politicians bring political attitudes and special political interests in board rooms which differs in logic than other board directors, this increase the heterogeneousness, thus creating agency costs when deciding CEO-wage.

There are many factors that affect decisions of CEO-wage-contract. The board of directors has a central role in forming CEO-wages. There are many findings of the effect of heterogeneousness in boards (Bøhren 2011; Frederick 2011; Randøy and Skalpe 2007). But previous studies shows an unclear net effect. Randøy and Skalpe (2007) found that female chairmen

have a significant negative effect on CEO-wages, but this is not significant for listed companies. Ludvigsen (2010) found weak but significant negative effect on bonus levels of boards of directors with politically connected chairmen in non-commercial and commercial state-owned companies. The effect was stronger for commercial companies.

I draw three main hypotheses. The first states that increase of political connected board directors in board has a moderating effect of CEO-wage. The moderating effect is larger for left politicians than right politicians in boards. Further I extend the hypothesis and interpret that effect of political connection in boards is larger for commercial companies. This is also in line with previous studies (Sørensen and Rattsø 2011; Ludvigsen 2010).

Previous research on the effect of political connection on CEO wage contract has shown weak support of a causal relationship. Ludvigsen (2010) identifies political influence or connection as state control (the amount of state-ownership) and political background of chairmen. She finds weak support to the notion that political chairmen and full state ownership (state control) put restriction on CEO-compensation contracts, in terms of pay level. For instance, she finds that CEOs in partly state ownership are paid 3,6% higher than CEOs under full ownership with a significance level of  $p < .10$ .

Table 2 Summary statistics

<b>Variable</b>	<b>Mean</b>	<b>St.dev (overall)</b>	<b>Min</b>	<b>Max</b>	<b>Obs</b>
Real wage (2000)	2129.956	1385.611	275	9228.942	271
Political connection	.289	.282	0	1	264
Political ideology 1	.144	.017	0	1	264
Political ideology 2	.072	.138	0	.6	264
Political ideology 3	.073	.137	0	.666	264
Experience	5.442	1.334	1	9	271
Gender	.600	.126	.285	1	271
Birth year	1952.483	4.271	1940	1961	271
Age	52.808	3.728	44.333	68	271
Board size	8.339	2.475	3	23	271

Real wages stated in 1000 NOK

Table 2 summarizes key properties of the frequency distributions for each variable used in the regression. The calculated average CEO-wage for 27 Norwegian state-owned company in the period 2000-2010 is 2 130 NOK (real wages in 1000 NOK). This is half of the average total package (this also includes bonus and other variable pay) of Norwegian CEOs also from private companies in the period 2004-2008, which is 4 100 NOK (Bøhren 2011). The number from this analysis is also in line with numbers from the Office Auditor and General of Norway's (2011) analysis of state-owned companies. They also show that the average wage-level for fully stat-owned

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companies is less than listed companies and partly owned state-owned companies. In the period 2004-2009, the average CEO-wage in fully owned companies increased 35%, and for partly owned 25 % and listed companies 21 %.

Average share of politically connected board directors is 28 %. Average board share of political ideology (left parties: Ap and SV) is 14 %. Average board share of political ideology 2 and 3 are 7 %. This is half of leftists' share and shows that leftists are more represented. Reasons for this is either of natural reasons such as size of organization and the size of share of seat at the parliament. For instance, Arbeiderpartiet (Ap) has a history as one of the largest party in Norway. This also shows a relatively small share of SV, since SV recently got voted in the parliament. Otherwise, the reason for the high share of leftists might also be because of selection. Control variables shows an average experience of 5,4 years, average age is 52,8 years, and average board size is 8,3. Gender distribution is 60 % male board directors in the period 2000-2010

Table 3 the relationship between CEO-wage level and growth, political connection and controls

<i>logreal wages (2000)</i>		$\Delta \log \text{ real wages (2000)}$		
<b>Model</b>	<b>(1) OLS</b>	<b>(2) OLS-FE</b>	<b>(2) Category 4</b>	<b>(2) Category &lt;4</b>
Political connection	.036 [.014]**	-.021 [.018]	.001 [.190]	-.096 [.037]**
Experience	.003 [.004]	.001 [.009]	-.045 [.043]	-.009 [.010]
Gender	.094 [.030]**	.025 [.005]	.083 [.206]	.069 [.144]
Birth year	.002 [.001]*	.000 [.016]	-.002 [.015]	-.004 [.004]
Age	.000 [.001]	-.000 [.001]	-.014 [.011]	-.000 [.000]
Board size	.101 [.006]**	.094 [.016]**	-.053 [.007]*	-.100 [.013]*
<i>R-squared</i>	.929	.858	.466	.488
<i>Observations</i>	264	264	76	161
<i>Lagged logreal wages (2000)</i>				
Political connection			-.152 [.083]	.114 [.090]
Experience			.156 [.140]	-.108 [.039]**
Gender			-.039 [.004]	.001 [.013]
Birth year			-.060 [.226]	.023 [.177]
Age			-.001 [.015]	.002 [.003]
Board size			-.013 [.014]	.007 [.004]
<i>R-squared</i>			-.072 [.000]**	-.105 [.027]**
<i>Observations</i>			.332	.413
			210	144

\*\*\*Significant at 1 % level      \*\*Significant at 5 % level      \*Significant at 10 % level

In all regressions I use controls, robustness test and time dummies

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Table 3 shows the results. Model (1) (second column) is the simple OLS and shows coefficients and standard deviation (in brackets) for *log real wages (2000)*. Here, including controls and robustness check the coefficient shows that an increase of politically connected directors, increases wages significantly ( $p < .050$ ) 3,6 %. Model (2) is transformed with fixed effects taking into account heterogeneousness across companies. Here political connection shows a weak insignificant decrease (2,1%) of log CEO real wages. When looking at  $\Delta \log$  CEO real wages with fixed effects, we see an insignificant decrease of 0.3 % of wage growth if share of politically connected directors increases with 1 percentage-point. So far, we have estimated coefficients for political connection in all types of companies. In this thesis I hypothesize that effect of political control/political moderation of CEO wages will vary dependent on company categories. I hypothesized that this effect is strongest for commercial companies which are companies within categories 1, 2 and 3. These have commercial goals and some other goals such as national head quarters etc. Companies within these categories operate in competitive markets and aims to be similar with private companies.

The fifth column shows coefficient for the effect of political connection on first differenced log real wages for non-commercial companies, these are monopoly companies in category 4. The coefficient shows a weak positive effect on wage growth. However, for commercial companies, there is a significant ( $p < .050$ ) decrease of 0,9 percentage-point on wage growth when increase of 1 percentage-point politically connected directors in boards. This is consistent with the hypothesis.

Lagging first differenced real wage shows insignificant negative effect on wage growth for all companies but this turns to positive when only including non-commercial companies. By including only commercial companies (category 1,2 and 3) we still see that 1 percentage-point increase of political connection in board decrease the wage growth with 0,10 %. It seems that this effect is not dependent on the effect of last year's wage growth. In sum, table 2 shows that increase of political connection with 1 percentage-point leads to a negative wage growth. These are regressions with fixed effect transformation<sup>4</sup>.

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<sup>4</sup> I also explored regressions for lagged wage levels, but found no significant evidence (results not reported).

Table 4 the relationship between CEO-wage level and growth, political ideology and controls

<i>logreal wages (2000)</i>		$\Delta$ log real wages (2000)			
<b>Model</b>	<b>(1) OLS</b>	<b>(2) OLS-FE</b>	<b>(2) Category 4</b>	<b>(2) Category &lt;4</b>	
Political ideology 1	.040 [.017]**	-.023 [.017]	-.016 [.053]	.263 [.162]	-.007 [.060]
Political ideology 2	.067 [.027]**	-.032 [.041]	-.121 [.103]	-.011 [.271]	-.137 [.079]
Political ideology 3	.009 [.002]	-.011 [.030]	.015 [.066]	.348 [.151]**	-.105 [.073]
Experience	.002 [.004]	.001 [.009]	-.009 [.015]	-.052 [.041]	-.009 [.011]
Gender	.094 [.031]**	.002 [.058]	.052 [.078]	.088 [.001]	.068 [.144]
Birth year	.002 [.001]*	-.000 [.001]	-.007 [.000]	-.004 [.016]	-.004 [.004]
Age	.000 [.001]	-.000 [.001]	-.005 [.004]	-.013 [.012]	-.000 [.004]
Board size	.101 [.006]**	.094 [.016]**	-.006 [.010]**	-.055 [.007]**	-.101 [.012]**
<i>R-squared</i>	.930	.858	.383	.479	.490
<i>Observations</i>	264	264	237	76	161
<i>Lagged logreal wages (2000)</i>					
Political ideology 1			-.015 [.060]	-.083 [.085]	.077 [.097]
Political ideology 2			-.060 [.054]	.274 [.342]	-.067 [.059]
Political ideology 3			-.097 [.107]	.007 [.191]	-.088 [.098]
Experience			-.024 [.073]	.315 [.021]	-.165 [.063]**
Gender			-.002 [.021]	-.086 [.057]	.000 [.016]
Birth year			.055 [.099]	.108 [.258]	.052 [.001]
Age			.003 [.004]	-.009 [.019]	.006 [.003]
Board size			.005 [.005]	-.020 [.020]	.011 [.004]**
<i>R-squared</i>			-.070 [.010]**	-.062 [.006]**	-.103 [.002]**
<i>Observations</i>			.385	.534	.447
			210	66	144

\*\*\*Significant at 1 % level    \*\*Significant at 5 % level    \*Significant at 10 % level

In all regressions I use controls, robustness test and time dummies

Table 4 shows the effect of political ideology board share variables. The first half part of the table shows regression coefficients of political ideology for wage level. Model (1), column 2 shows a significant ( $p < .050$ ) 4 % increase on wage level when political connected directors with left background increase with 1 %. For all ideologies there are positive effects, but weakest and insignificant for right parties. Center parties shows strongest effects (6%) on wage level ( $p < .050$ ). With fixed effect transformation (model 2, column 3) we see that for all ideologies, effect on wage level insignificantly decreases. This pattern is also the same as *political connection* on wage level (from previous table). With first differenced log real wages (second half of table 4), the same model (OLS-FE) shows negative effect for left and center, but changes to positive for right politicians. For non-commercial companies, this effect even increases with an effect of 0,34% percentage-point on wage growth when right-wing political directors increases with 1 percentage point. For commercial companies, the effect on wage growth is negative and insignificant for all ideologies. In the lower columns, the table shows coefficients for lagged first difference log real wages. Lagging dependent variable shows an insignificant decrease in wage growth. Lagging the dependent variable doesn't show any significantly change in the regression coefficient for all companies. However, for non-commercial companies, the effect of right wing politicians (0,34 % percentage-point) on wage growth shown from the upper column, gets insignificant with lagged dependent variable. For commercial companies, we see the same pattern as non-lagged first differenced log real wages shown from last upper column last, however, by lagging dependent variable, effect of a 1 percentage-point increase of right politicians in board (last lower column) significantly ( $p < .050$ ) decreases wage growth with 0,16 %.

In sum, we see that by transforming the model to fixed effects, the effect from all ideologies changes from an increase to a decrease in wage levels. This is also the pattern from political connection model shown in previous table. The fixed effect transformation is in line with the hypothesis for political connection, and for political ideology we see that right politicians have weakest effect when moderating wage levels. These results are insignificant. By measuring the wage growth instead of wage level, we see that a 1 percentage-point increase of directors with background from right parties such as Høyre and Fremskrittspartiet significantly increases wage growth for non-commercial monopoly companies. In these companies, CEOs are typically rewarded as bureaucrats, which means that use of incentive schemes is low (Ludvigsen 2010; Hall and Liebman 1998), but our results shows that there is a tendency that political board directors from right parties rewards the CEOs in these companies. For commercial companies, lagging dependent variable shows a decrease of 0,16 % on wage growth when increasing the board with 1 percentage-point of right wing directors. For commercial companies we see from table 2 that whether with or

without lagging the wage growth, we see a significant ( $p < .050$ ) decrease in wage growth, in table 3, we get the same effect for all ideologies, but this preference is significant ( $p < .050$ ) and strongest for directors with background from right parties<sup>5</sup>. This violates the hypothesis that right-wing political directors, compared to right party directors, have a less moderating effect on CEO-wages. Thus, there are no left-right ideology dimension regarding CEO-wages.

The net effect when controlling for experience, gender and age among directors, and board size, which are variables that are considered affecting CEO-wages from previous studies, political connection has a weak decreasing/moderating effect on wage growth for commercial companies. Political connected directors with background from right parties has an weak increasing effect on wage growth for non-commercial companies, and a decreasing effect on wage growth for commercial companies<sup>6</sup>.

Further, it is interesting to see if and how these result changes when imposing dynamism in the model. Use of data over time might potentially reveal delayed effects of board decision around CEO-wages, for instance it is likely that board of directors make long-term decisions of for example change of *type* of wage contract adopted internally in year  $t-1$  which is set to be lawful in year  $t$ . The idea here is that board decisions might have delayed effect.

Table 5 Relationship between wage *growth* lagged political ideology 3 and controls<sup>7</sup>

<i>Alog real wages (2000)</i>		
<b>Model</b>	<b>(2) Category 4</b>	<b>(2) Category &lt; 4</b>
Political ideology 1	.157 [.240]	-.062 [.086]
Political ideology 2	-.102 [.260]	-.233 [.093]**
Political ideology 3	.306 [.149]***	-.096 [.006]
<i>Lagged 1</i> Political ideology 3	.323 [.438]	-.087 [.066]
<i>Lagged 2</i> Political ideology 3	.006 [.236]	.051 [.089]
Experience	-.108 [.053]***	-.015 [.014]
Gender	.126 [.254]	.028 [.160]***
Birth year	-.019 [.022]	-.001 [.000]
Age	-.027 [.022]	.004 [.004]
Board size	-.068 [.005]***	-.092 [.016]***
<i>R-squared</i>	.601	.445
<i>Observations</i>	57	125

*Lagged Alog real wages (2000)*

<sup>5</sup> I also explored regressions for lagged wage levels, but found no significant evidence, (results not reported).

<sup>6</sup> As robustness check I have also est. eq. (1) in first differences and the results are similar to those estimated by fixed effects (not shown.)

<sup>7</sup> In all regressions I use controls, robustness test and time dummies

<i>Lagged <math>\Delta</math>log real wages (2000)</i>	-.123 [.134]	.169 [.207]
Political ideology 1	.245 [.338]	-.046 [.087]
Political ideology 2	-.080 [.247]	-.000 [.086]**
Political ideology 3	.291 [.139]**	-.119 [.070]
<i>Lagged 1 Political ideology 3</i>	.315 [.459]	-.079 [.071]
<i>Lagged 2 Political ideology 3</i>	-.033 [.222]	.063 [.103]
Experience	-.001 [.057]***	-.015 [.014]
Gender	.001 [.253]	.025 [.150]
Birth year	-.021 [.023]	-.001 [.004]
Age	-.030 [.023]	.005 [.004]
Board size	-.065 [.005]***	-.095 [.017]***
<i>R-squared</i>	.596	.463
<i>Observations</i>	57	125

\*\*\*Significant at 1% level

\*\*Significant at 5% level

\*Significant at 10% level

Table 5 shows that lags of political ideology 3 (variable for right parties) for non-commercial companies are positive but insignificant. However, the results also show that lagging political ideology 3 for non-commercial companies gives same effect for political ideology 3 at year  $t$  ( $p < .010$ ). This also holds when lagging the wage growth, although with a weaker effect. For commercial companies we see a much stronger effect for the center parties Kristelig Folkeparti, Senterpartiet and Venstre. A 1 percentage-point increase in center parties decreases wage growth with 0,23 %. But this effect almost disappears when lagging dependent variable.

As to the control variables board size has positive and strongly statistically significant ( $p < .010$ ) effect in all models when using wage level indicator. Presumably, this is parallel to the most robust findings of CEO-wages, where increased company size gives larger CEO-wages. This changes to negative effect, but still statistically significant ( $p < .010$ ) when using wage growth indicator. Effects of age, gender, birth year and experience have unclear effects.

## 6.2 Discussion

The net effect of the regression results from previous sections shows in general lack of power to confirm the hypothesis in this study. There are some effect that shows *weak* support of the relationship between political connected directors and political moderation of CEO-wages. There is also no evidence that there is a left-right ideology dimension concerning CEO-wages. However, the results indicate, although weak, but interesting effects when dividing company categories. I looked

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at CEO wages as *wage level* and *wage growth*, further I also look at the effects in different company categories (commercial versus non-commercial). We see that model for wage level shows no significant moderation of wage level for all companies<sup>8</sup>. This is also the same for political ideology. These are models transformed to fixed effects.

When looking at wage growth we don't get large changes, however, for commercial companies we see that there are some (weak) moderation of wage growth, and this is also true when lagging wage growth (effect of last years growth on current growth). This gives a weak support for hypothesis one, which states that political control or moderation of CEO-wages is strongest for commercial companies. When looking at different political ideologies, we see that directors with right party background, tends to contribute to a wage growth of 0,34 % percentage point, in non-commercial companies, which means that our test shows that while there are some political moderation of CEO-wage in commercial companies, we see that for CEOs in monopoly enterprises, connected directors with background from Høyre and Fremskrittspartiet tend to contribute to increase in wage growth. In commercial goals however, directors with same background tend to contribute to a *decrease* in CEO-wage growth. One interpretation of this is that rightist politicians reward CEOs in large monopoly enterprise higher than CEOs in commercial companies. Incentive schemes are less used in non-commercial companies (Ludvigsen 2010). CEOs in monopolies are thus "paid as bureaucrats". Rewarding CEOs in non-commercial companies might indicate sympathy over the difficult tasks of managing a company who have to take into account both political goals and efficiency goals (Rattsø and Sørensen 2011). An interesting comparison is that The Office of the Auditor General of Norway (2011) shows an average higher wage level and wage growth for non-commercial companies. From previous section, I mentioned that in the period 2004-2009, the wage growth for non-commercial companies was 35%, for commercial companies 25% and for listed companies 21 %.

In this thesis, I interpret that moderating CEO-wages are a cause of "political logic/rationale", "political attitude" and/or "political special interest" to reap good reputation (from political economy theory). Is increase of CEO-wages in non-commercial companies with broad social goals also a result of political logic? In a study of Norwegian state-owned companies, the accountability judgment does not vary large between boards in commercial and non-commercial companies.

However, the boards in regional health entities express that they are more prone for public critique. It is convenient to believe that this is because of high political sensitivity on quality of welfare goods such as health (Rattsø and Sørensen 2011). Right-wing directors thus give positive

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<sup>8</sup> Tested also for different companies with no change in result

wage growth to reward CEOs to manage such complex goals. If politically connected directors care about reputation, it seems that right-wing political directors in non-commercial companies prefer to be associated with companies who reach complex social goals and therefore reward CEOs more than in commercial goals. This is also a question of whether excess wages in commercial companies is more political sensitive than non-commercial companies. If so, that might be because of also voters reward CEOs in non-commercial companies with broad social and complex goals.

### *6.2.1 Agency costs and politicians in boards*

Theoretical models suggest a relationship between political connection and political moderation of CEO-wage. Models from political economy shows that the political competition creates political incentives to either win office (Downs 1957) or fulfill policy goals (Wittman 1973). Thus, the politicians care about good reputation to capture votes. I transfer this logic when studying politicians in boards. The interpretation here is that excess CEO-wages which are prone to public critique are bad for the reputation of the politician affiliated as board director in that company. Political board director that possess “political logic” brings special interests in the board, affecting the efficiency of decision-making process, increasing agency costs.

I derived a theoretical model that showed potential conflict between a political director and non-political director. Given that efficiency criteria, profit earnings and growth are important in all companies (which is a strong assumption), it is important to reward and insure the CEO in order to do a challenging job. The basic idea of a company is to hold the board of directors accountable to company performance and public critique. CEO's are risk-takers (Minow and Monks 1995). Assuming a theoretical model where the board is composed by politicians and non-politicians. Non-political directors are recruited from private business, bringing inside board rooms no special interests of political logic or attitude. It is likely that non-politicians adopt efficiency oriented decisions. Political directors who carry political logic, rationale, attitude and special political interests and cares about reputation, will more likely set lower wages to avoid public critiques on excess wages. Thus, moderating CEO-wages and easing market efficiency decisions.

From the regression results, we see weak support for this model for all companies. However, the results shows weak significant ( $p < .050$ ) support when only including commercial companies. Although the regression coefficient shows weak effects, it seems that political moderation is more likely in companies operating in competitive market arena (efficiency goals dominating, no conflicts between broad policy goals and efficiency goals). Right-wing directors tend to have a significantly moderating effect. In this way – we get some support to the model, but rejection to left-right ideology of dimension. An interpretation of this is that political ideology theory is weak

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because CEO-wage is not directly connected to redistribution, than for example other economic matters such as taxes.

### 6.2.2 *Why weak support?*

In general for all state-owned companies, studies reveal weak and unclear signals from the owner and lack of flexibility when using resources (Direktoratet for Forvaltning og IKT2011). Non-commercial companies have difficult tasks and struggle in balancing between efficiency and broad policy goals (Rattsø and Sørensen 2011; Direktoratet for Forvaltning og IKT 2011). This leads to some challenges to the management and the boards. Because of the complexities in the nature of state-owned companies, there might be a broad consensus in the board in rewarding the CEO to take risks and meet these challenges to steer the company towards expansion, profits and growth. Political connected board directors might appreciate to be associated to high performing companies, as there is substantive evidence that the competence and actions of CEO are important to the productivity of the company (Jensen and Murphy 1990), thus reaping good reputation.

Another explanation is that presumably, CEO-wages is not connected to politics (or represents core preferences of voters). What we hear in public and in the media might not be representative for all companies, thus causing a wrong impression of CEO-wages and politics.

Do effects of political influence vary across a range of board decisions?

For instance, level of employment, price charges, company value, market performance etc. as Schleifer and Vishny (1994) suggest. Clearly previous research shows that politically connected companies, however, broad defined, is relevant for company performance. Schleifer and Vishny (1994) argue that for example employment is political sensitive because people want to keep their jobs. And also one crucial political agenda for most politicians is to keep employment level high, especially in rural places. However, it is a paradox that CEO-wages is completely unrelated to politics. The most common comparison of CEO-wage, is to employee wages (Bøhren 2011). In Norway CEO-wages is ten times higher than employee wages. If this increase, large and influential employee interests groups such as LO will not accept the increase. Murphy and Jensen (1990) and Ludvigsen (2010) emphasize the importance of the role of third parties or *external* forces in the contracting process. It is not only the board directors who set requirements but also parties such as employees, labor unions, consumer groups and media. If employees who is a larger group than CEOs do not prefer excess CEO-wages, it is likely that politicians will “listen” to this requirement.

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In this section I argue that decisions taken in board rooms might vary in degree of political sensitivity. Board directors take a lot of decisions, and not all are equally sensitive to politics or voters.

A recent study of Norwegian state-owned companies highlights difficulties experienced by some companies around role conflicts and political signals in boards, however this studies shows that potential for role conflict regarding CEO-wages is not incident (Direktoratet for Forvaltning og IKT 2011). Thus, suggesting that potential for role conflict (if political board directors practice political strategies in boards) might vary dependent on the political sensitivity of the numerous decisions taken in the board.

In chapter 2.0 and 3.0 I show that contracts may vary in forms dependent on amount of variable and fixed pay. In chapter 3.0 I show that there are varieties in this composition between countries where the countries such as US have higher shares of variable pay. I also showed that compositions varies within countries whereas full state-owned companies have low connection of salary to company performance, (thus low variable pay), but in general all type of Norwegian state-owned companies have moderate use of bonus and stock options compared to private companies. This proves that both type of wage contract and practice of pay varies across countries and within countries. This gives potential challenges for research. Another crucial insight is the variation of wage indexes.

Studies change between looking separately at different wage components and total pay. In sum, this cause substantial challenges when studying CEO-wages, and makes it difficult to compare with other studies. As my results suggest, there is weak support of political influences on CEO-wages. Presumably, on what part of wage contract is politically influencing? Is it observable for us? Maybe the way CEOs are paid matters more (politically) than pay level and growth?

There are some challenges to document the influence of the political process on CEO-wages. According to Jensen and Meckling (1990) it is difficult to measure “politics” and “political influences”. We see from previous studies that there is no consensus on a definition of “political connection”. An important criterion when defining political connection of board director is to consider degree of political incentives. If we know the source of political influence, we get a better understanding of how politics influence board decisions including decisions around CEO-wages. Because I assume that there are different degrees of political incentives in a population, political connection is here defined if board of directors have experience in being in a political party list of nomination, where I assume the political incentives are stronger. But there might be different weaknesses here because political incentives might also differ within a list. For instance this might

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vary between number 1 candidate and number 10, and also between candidates and alternate candidates. Another important division absent in the study's definition is the division between national and local politicians. Maybe there are stronger political incentives for national politicians. Local politicians need only votes from local population, thus, if he is a board member of a company with no relation to his local area, then political incentives might be weaker. This discussion is however absent in the articles reviewed in this thesis. I also differentiate political connection with different party ideology, effects here might also vary because I assume that preferences differ between parties (this is also same approach as Goldman et al. 2008).

### *6.2.3 Methodological challenges and problems with simultaneity*

Our weak results face some questions to methods and model. In the econometrical strategy chapter, I discussed possible errors and solutions to solve them. However, there remain some methodological challenges which is not taken into account in this paper. Because of the small sample size in a statistical context, results must be interpreted with caution, as small N studies can give biased estimation. This is, in particular, important for my separate analysis of different company categories (non-commercial and commercial) where sample size is substantially reduced.

Several econometric problems may occur when estimating equation (1) in section 4.2. In this study I use fixed effect to constrain time-invariance in the model (footnote: this was also done using first difference, but with no large change (results not shown)). I also use lagged dependent and independent variable to impose dynamism in the model and investigate if there are any delayed effect of political influences. In this way, I wanted to investigate whether political connected board directors possess a causal effect on a moderation of CEO-wages in Norwegian state-owned companies and enterprises. However, causality may run both ways, from political connectedness to wages level and/or growth and from wage level and/or growth to political connection. Therefore, OLS-estimation of equation (1) in 4.2 potentially contains the effect from high or low wage levels and/or growth to political connectedness., thus resulting I biased estimation. A suggestion for further research is to address this simultaneity issue, for example by using instruments and a 2 stage least squares method (2SLS). A thoroughly outline of this method can be found in most well established econometrics books, including Wooldridge (2009).

While these are solutions in statistical sense, there are some support of an inverse causation in theory. From the political economy literature – McCubbins, Noll and Weingast (1987) and McCubbins and Schwartz (1984) – discusses the way Congress prefers to allow third parties to oversee performance in the public administration, either by means of established rules (fire alarms) or examining a sample of agencies at its own initiative as a more direct way of oversight (police

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patrol). Is this also true for state-owned companies and enterprises? Public administration has long been seen as inefficient and non-expanding. This has also been documented from research. The aim of organizing public supplies and utilities as company – is the efficiency goals and goal of expanding and innovate (Rattsø and Sørensen 2009).

What this study does not examine is if the state as owner practice political control to influence decisions around setting CEO-wages. The state gives superior direction in White Papers, but all decisions in state-owned companies boils down to the board of directors. When decisions in boards face problems such as efficiency versus fairness (policy goals) in state-owned companies – these decisions might be disturbed by political influence to reach “political correct” decisions, which might be implemented at the expense of efficiency-oriented decisions. This can either be levels of employment, the decisions around whether a company/a cornerstone company should be closed, as well as forms, levels and growth of CEO-wage. If the state observes high growth of CEO-wages, it is likely that the owner, then select politicians as board director. In Dagens Næringsliv (19.08.2011), the minister of industry and trade, Trond Giske (Ap) stated for example that they do not wish privatization of the state-owned company Statkraft. These are examples of topics that are politically and ideological attached which the state has tendencies to “hold on” to. If privatization causes efficiency, growth and innovation, then such decisions stated by Trond Giske might reflect a trade-off to efficiency goals in the company. Same reasoning can be made with CEO-wages. If CEO-wages is connected to company performance because it rewards the CEO to take risks, then rewarding CEOs is an efficiency solution. If excess CEO-wages is observed by the state (owner) who primarily set a CEO-wage policy that moderate growth, then it is likely that the state practice political control (in a “police control” fashion) by inserting politicians as board directors. Selecting politicians as board directors has not only a disturbing effect to efficiency goals. Political competence might be relevant as companies are directly connected to the state, because they have knowledge in how public administration function and also possess a larger network of people connected to politics in different policy areas. If state-owned companies have close relation to the political system, then it is efficient to have political board directors who possess knowledge in the state system.

Strategies of selecting board members from the Ministry of Trade and Industry (St.meld. 13, 2010-2011) emphasize the importance of heterogeneousness in boards, they further emphasize that political competence might be relevant, but gives no clear signal in the selection practice. In an OECD corporate governance working group, they surveyed board directors in state-owned companies where there were consensus in the existence of both advantages and disadvantages of having politicians in boards (Frederick 2011). The awareness is present, but no single strategy is given in public documents. Presumably this might be because of the absent (or weak)

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documentation of the effect. Selection of politicians in boards causes controversy in the public. For instance, a profiled Norwegian businessman Stein-Erik Hagen reacted negatively when the minister of trade and industry selected a politician from Arbeiderpartiet (Labor party) to a state-owned company. He reacted on the fact that politicians can be selected and be board directors – but there are strictly rules of having board directors with current positions as CEO in other companies, which he means possess the right experience and knowledge as board director (Dagens Næringsliv 01.06.2011 ). Questions regarding the effects of political selection of board directors remains unknown.

## 7.0 Summary and concluding remarks

The purpose of this study was to try to document if political forces and political influence among the board of directors cause a political moderation of CEO-wages in terms of level and growth, and also how preferences of CEO-wages differ across and left-right ideology dimension. Theoretical models suggest that politicians care about good reputation and I hypothesized that political connected board of directors will contribute to low level of CEO-wages or growth ( $H_1$ ). I extended this and hypothesized that rightist board of directors, compared to leftist, will contribute less to a moderation of CEO-wages or CEO-wage growth ( $H_2$ ). If rightist are more market oriented than leftist, they will prefer to reward CEOs to take risks that further gives growth, profits and innovation in state-owned companies. Main goal of establishing companies instead of traditional public administration is the efficiency-oriented character (Rattsø and Sørensen 2011). I further extend the first hypothesis and state that political moderation of CEO-wages will have strongest effect in commercial companies (profit-oriented) ( $H_{1a}$ ). To test these hypotheses, I collected information on board members' political connection and party affiliation (not sampled before) and wage information via annual wage and personal contact of board members, constructed a panel data set, and draw some econometric models. Using panels means that there might be some biases in the estimation which must be accounted for to get credible results. For instance I use fixed effects transformation to take into account heterogenousness across companies.

The main findings in this study, is that there is weak support of the relationship between political connectedness and moderation of CEO-wages. This is consistent with findings from Ludvigsen (2010). However, this comparison must be interpreted with caution as Ludvigsen (2010) measured the total CEO-wage (including bonuses). When controlling for different company categories, results show a weak positive effect of political connectedness and moderation of *wage growth* (the first-differences log real wages). Further rightist board directors contribute strongest to a decrease in wage growth in commercial companies. Rightist board directors contribute to an

---

increase in wage growth in commercial companies. This is true independent of lagged variables (dependent and independent). In sum, the evidence shows

- Weak support for  $H_1$
- No support for  $H_2$
- Weak support for  $H_{1a}$
- No support for  $H_{2a}$

I suggest some reasons for these results;

- Politician want to reward CEOs in non-commercial companies because of the understanding of the complex challenges he or she faces
- Politician wants to reward CEOs in non-commercial companies to reap good reputation. The CEOs get rewards for taking risks thus meeting broad social goals (i.e. health care). Politicians then reap good reputation
- Political influence on CEO-wages might be unobservable for us
- Political connection might differ in degree of political incentives within candidates on the list (i.e. between first and last person, and also between alternate and non-alternate candidate)
- Fragile of regression model: measurement problems and omitted variables not taken into account in this model
- Inverse causal relationship where wage levels and growths cause selection of politicians as board directors.
- Small sample size, especially for each company category, can create biased OLS estimation

For further research, I thus suggest continuing collection of data on board members, look at different elements in wage-contract, use instruments and take into account simultaneousness.

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## **9.0Appendix**

A: Copy of data collection approval from Norwegian Social Science Data Services

Norsk samfunnsvitenskapelig datatjeneste AS  
NORWEGIAN SOCIAL SCIENCE DATA SERVICES



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Org.nr. 985 321 884

Vår dato: 05.05.2011

Vår ref: 26824 / 3 / KS

Deres dato:

Deres ref:

## TILRÅDING AV BEHANDLING AV PERSONOPPLYSNINGER

Vi viser til melding om behandling av personopplysninger, mottatt 24.03.2011. Meldingen gjelder prosjektet:

26824	<i>Political Economy of Corporate Governance in Norwegian State-owned companies</i>
Behandlingsansvarlig	<i>Handelshøyskolen BI, ved institusjonens overste leder</i>
Daglig ansvarlig	<i>Lars C. Monkerud</i>
Student	<i>Renira Angeles</i>

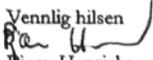
Personvernombudet har vurdert prosjektet, og finner at behandlingen av personopplysninger vil være regulert av § 7-27 i personopplysningsforskriften. Personvernombudet tilrår at prosjektet gjennomføres.

Personvernombudets tilråding forutsetter at prosjektet gjennomføres i tråd med opplysningene gitt i meldeskjemaet, korrespondanse med ombudet, eventuelle kommentarer samt personopplysningsloven/helseregisterloven med forskrifter. Behandlingen av personopplysninger kan settes i gang.

Det gjøres oppmerksom på at det skal gis ny melding dersom behandlingen endres i forhold til de opplysninger som ligger til grunn for personvernombudets vurdering. Endringsmeldinger gis via et eget skjema, [http://www.nsd.uib.no/personvern/forsk\\_stud/skjema.html](http://www.nsd.uib.no/personvern/forsk_stud/skjema.html). Det skal også gis melding etter tre år dersom prosjektet fortsatt pågår. Meldinger skal skje skriftlig til ombudet.

Personvernombudet har lagt ut opplysninger om prosjektet i en offentlig database, <http://www.nsd.uib.no/personvern/prosjektoversikt.jsp>.

Personvernombudet vil ved prosjektets avslutning, 01.09.2011, rette en henvendelse angående status for behandlingen av personopplysninger.

Vennlig hilsen  
  
Bjørn Henrichsen

  
Katrine Utaaker Segadal

Kontaktperson: Katrine Utaaker Segadal tlf: 55 58 35 42  
Vedlegg: Prosjektvurdering  
Kopi: Renira Angeles, Sofies gate 29, 0168 OSLO

**Personvernombudet for forskning**



**Prosjektvurdering - Kommentar**

Prosjektnr: 26824

Det vil i prosjektet bli registrert sensitive opplysninger om politisk oppfatning, jf. personopplysningsloven § 2 nr. 8 c).

Det gis skriftlig informasjon og innhentes et skriftlig samtykke ved at respondentene besvarer spørreskjemaet.

Prosjektslutt er angitt til 01.09.2011. Senest ved prosjektslutt vil datamaterialet slettes.

B: List of companies and enterprises

Argentum Fondsinvesteringer AS  
Cermaq ASA  
DnB NOR ASA  
Electronic Chart Centre AS  
Entra Eiendom AS  
Flytoget AS  
Gassco AS  
Helse Midt-Norge RHF  
Helse Nord RHF  
Helse Sør-Øst RHF  
Kommunalbanken AS  
Kongsberg Gruppen ASA  
Mesta AS  
NSB AS  
Nammo AS  
Norsk Hydro ASA  
Petoro AS  
Posten Norge AS  
SAS AB  
Statkraft SF  
Statnett SF  
Statoil ASA  
Statskog SF  
Store Norske Spitsbergen Kullkompani  
Telenor ASA  
Universitetsenteret på Svalbard AS  
Vinmonopolet AS

**MSc Political Economy – Preliminary thesis report  
at Norwegian Business School BI**

**- Political economy and corporate  
governance: state-ownership in  
Norwegian state-owned companies-**

GRA1902 – Preliminary thesis report

January - 2011

Supervisor: Lars C. Monkerud

BI Oslo

Master of Science in Political Economy

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**Content**

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## Summary

### ***1.0 Background***

*“The state should act as an informed and active owner and establish a clear and consistent ownership policy, ensuring that the governance of state-owned companies is carried out in a transparent and accountable manner, with the necessary degree of professionalism and effectiveness”.*

(OECD 2005: 23)

State intervention in economic activity can be traced back to the period before the Great Depression (Stiglitz 1989). This reminds us that state-owned companies and capitalism has co-existed for more than hundred years. In the beginning of the 1980s privatization reforms was placed on the political agenda in several European countries, as well as in countries outside Europe such as Mexico and Australia (OECD 2005). Wright (1994) identifies underlying factors that forced privatization, such as general skepticism of the states’ ability to reach economic goals, because of reactions against high taxation, high levels of inflation and high public indebtness, changing nature of some industries because of technological advancement, increasing internationalization, the creation of the EU markets, and the massive capital needs for major companies, whether public or private. Reforms to readjust the market structure were needed to meet efficiency and productivity criteria claimed by external forces. There were doubts that the government could meet these criterias (Hirschman 1982; Schleifer and Vishny 1997). Therefore expectation that the state could fulfill a “business role”, were low.

In the aftermath of the privatization period, the scope of state-ownership is still significant. In a survey of corporate governance and state-owned companies by OECD in 2003, SOCs represent up to 40% of value added, around 10 % of employment and 50% of market capitalization in different OECD countries. State-ownership in these cases is still concentrated in strategic and infrastructure sectors and the effect of these sectors on the competitive environment is an important determinant of overall economic performance. On average, more than a half of the SOCs from a sample of 24 OECD countries, are fully owned by the state and 20 percent are majority owned. Almost three quarters are fully or majority owned by

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the state. On average 10 percent are listed, and the variation is high. Norway and Finland are among those who score above average.

Efforts to identify how state-owned companies de facto performed increased, studies have mainly focused on economic performance, and private companies were often put as benchmark. This knowledge is important as we get to know how privatization as a tool allocates resources. Different types of studies have looked at the performance of state – owned companies, across countries within one sector (Galal et al. 1994; Wallensten 2000), and also across sectors and countries (Megginson and Netter 2001).

However, studies of economic performance, does not give us insight on how governance is performed. This is important as governance potentially determine economic outcomes. Governance can be placed as a connecting link between the process of outlining company goals, and on the other side outcome, or economic performance. From the academic literature, one finds several perspectives on governance studies. This research project wants to empirically examine *characteristics of governance* in state-owned companies across Norwegian state-owned companies. This perspective merge several disciplines, on one side, corporate governance from management discipline, finance discipline (private, listed), and law (investor protection), and, on the other side, political science and political economy. In the discipline of finance and management, studies on corporate governance is an old tradition – although on private, listed and/or non-listed companies. Agency problems, conflicts of interest between corporate insiders, such as managers and controlling shareholders on the one hand, and outside investors such as minority shareholders are central analysis of the modern corporation (study from Berle and Means 1932, and Jensen and Meckling 1976 in the U.S.). Questions from these perspectives are potentially useful insights when studying state-owned companies. On the other side, political science and political economy discipline gives us insight in the nature of the state, politicians, bureaucrats, and the interaction with voters. These disciplines have potential in providing knowledge on how the state fulfills its role as “business owners”. For instance, how does the state act when considering what is most profitable for the company – and, at the same time the interest of voters? Theories from these different subjects and disciplines give expectations on how state – owned companies performs in a governance perspective. From corporate governance, we get insights on efficient/profitable factors such as ownership

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structure and CEO wage. From political economy, we get insights on the motivation of politicians, and also nature in dynamics of political competition. Therefore, we should expect governance in state-owned companies different from private companies, as these companies are relatively more connected to politics than private companies. Relative to the political economy tradition, corporate governance is cost minimizing oriented, which is not always on the agenda of politicians. This combination of theories reveals some important questions when regarding governance of state-owned companies.

The Norwegian report on governance and democracy (Makt –og demokratiutredningen) during the period 1988-2003 report that state owned enterprises are inefficient and dominated by the administration. The critique is especially targeted towards the ownership where the state is characterized as a slack owner with a slack strategy lacking incentives to reach goals.

Are there elements of political control in the governance of the corporation? Is the board fully independent? Is the state-owner active or passive? Are state-owned companies efficient?

On a report to the Storting (St. meld.) (no. 13, 2006-2007), the government demands “active” ownership policies where they put pressure on the boards to gain efficiency and also to create good practice of governance. One concrete example is the conditions when setting wages and other compensation to the leaders, which must be reasonable/fair and moderate. Compensation contracts to top leaders must be competitive but not a leading level in Norwegian context. The Office of the Auditor General of Norway (Riksrevisjonen) published a report on top leader’s compensation in 42 Norwegian state-owned enterprises 2010-2011. By looking at the changes of wages from 2004 to 2009, they concluded that the increase in wages of the leaders was as twice of size compared to the general wage increase in the period 2007-2007, and the annual change of leaders’ wages in state owned enterprises was higher in this period compared to 2004-2007. The Office of the Auditor General of Norway states that the increase in leaders’ wages in state owned enterprises has not been that moderate as they aim to be, referring to the government report to the Storting (no. 13, 2006-2007). What are the reasons for this situation? What are the underlying factors behind this observed situation, is it connected to the governance of the state owned enterprises? These are some important question to ask in order to get a deep understanding of the situation. These are interesting question because the answers can give as a good basis for

making the governance of the state owned enterprises more efficient, fair and good for the society (samfunnsnyttig). These insight can provide a better understanding of the economic role of the state in a dynamic society, especially the double role that occur in partly owned, listed public companies where the state as an owner not only is obliged to listen to the voters, but also shareholders, which is a group that value efficiency.

## **2.0 Theories**

### ***2.1 Political economy***

Theoretical models from the political economy literature can explain the motivation of and decisions made by politicians. One central theory is the median voter model which formulate in its simplest form that within a framework of a one-dimensional model, the opinion held by the median voter will become the public policy decision. By satisfying the median voter, the chances of being re-elected increase.

Another view of the motivational factors of politicians is their ideological orientation, with the simple claim that different parties pursue different party profile when in office. Ljiphart (1984) emphasis three leftist versus rightist party position on socioeconomic policy where the first concerns government versus private ownership of the means of production, second, a strong versus weak governmental role in economic planning, and third support of versus opposition to redistribution of wealth from the rich and to the poor. This makes an expectation that left-wing politics would be concerned about securing political control of state owned enterprises, and right-wing politicians would seek to avoid unwarranted political inference in the governance of state owned companies.

### ***2.2 Corporate Governance***

Corporate governance is about how corporations are managed. The principal-agent model is the basis when studying corporate governance; the dynamics between the suppliers of finance, the managers and the board is crucial when making decisions (Schleifer and Vishny 1999). Potential for agency problems occur in corporate contracting (Jensen and Meckling 1976). Agency problem in corporate governance context is the separation of ownership and

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control or decision making. The dynamic here is that the entrepreneur raises funds from investors for productive use for the firm. Suppliers of finance invest and want to maximize returns of their funds, but problems such as asymmetrical information and expropriation from the owner that might occur can make investments a financial loss. What is true is that investors face a risk for supplying money to a corporation. Investors will try to minimize this risk. Generally investors and owners sign a specified (how the returns are divided etc.) contract, but in many cases, especially in a dynamic system such as the market, the future is hard to foresee, and even if there are competent speculators, they're forecast can be wrong. As agency problems are linked to inefficiencies, what is true is that corporate governance goes as a factor of production, thereby, inefficiencies between decision makers occurs at the expense of the profitability. From a financial perspective Bøhren (forthcoming) identify ten symptoms of weak corporate governance of listed firms; high liquidity, low efficiency, unfocused growth, low debt, low dividends, the leaders don't communicate with to the owners, wage not connected to performance, passive owners, absent of owners in the board, big owners steal from minority owners.

### *2.2.1 Ownership*

There are several types of ownership structure. A structure with high ownership concentration is where there are few owners, but high shares. Opposite, a structure with low concentration or dispersed is a structure where there the number of owners are higher and shares are typically smaller. Institutions, governments, families, and non-institutional (private household) defines types of suppliers of finance (Bøhren forthcoming).

### *2.2.2 Leaders*

From a corporate governance perspective on of the CEO contract's main function is to reduce the cost by separating ownership from control. If CEO wage ( $R$ ) is a wage of incentive based on the value creation from owners ( $V$ ) which is determined by the leaders' effort ( $E_L$ ):

$$L = f[V(E_L)]$$

However, the effort ( $E_L$ ) and value creation ( $V$ ) doesn't always reflect eachother. In practice, ( $L$ ) is determined from a wagebasis ( $LG$ ) that deviates from ( $V$ )

$$L=g(LG)$$

This could be fixed wage contract (no connection between wage, effort and value creation). Alternatively, the contract gives fixed wage plus a variable that can be negative based on the annual account. In the end, the CEO contract faces quality requirements such as control (connection between effort and wage base), and independence (top leaders work depends on others, an effect of this is that the leader motivate colleagues, but unfortunately also the free rider problem).

### ***3.0 Research approach***

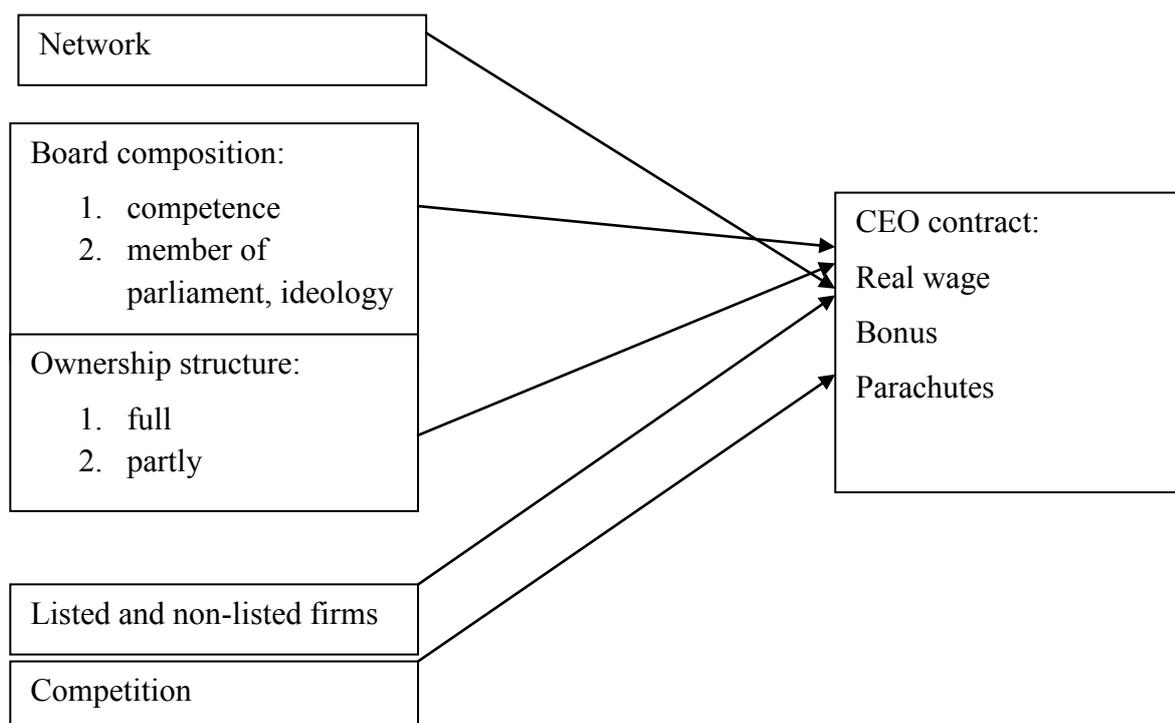
With perspectives from corporate governance and political economy models this thesis will investigate the characteristics of corporate governance in state owned enterprises. Similarly studies has also been done from Faccio (2006), Brenner and Schwalbach (2009) and This approach is also in line with the doctoral thesis of Ludvigsen (2010). What separate this study from previous study is new approaches of governance mechanisms (independent variables). For instance competence level of board members, political ideology, and also external factors such as competition. Similar approach is also to be found, Schiell and Bellavance (2009) investigated effect of governance mechanism such as board independence and CEO ownership on CEO contracts in a sample of publicly traded Canadian firms. Faccio (2006) investigated the CEO contract in political and non-political connected firms.

Thus (\*) states the research question, and figure 1 illustrate the research model

*(\*) What governance characteristics generate more generous CEO contracts than others?*

Figure 1 Research model

Governance characteristic:



From this follows central sub questions the thesis want to investigate. Why do CEO contracts differ between Norwegian state-owned companies? Why are some CEOs paid more and differently? How does the composition of the board influence the quality of CEO contracts? Are there less generous CEO contracts in politically connected firms? Does high competition generate high CEO compensation? Does full ownership generate less generous contracts compared to partly owned?

### 3.1 Dependent variable:

Over the pas decade, CEO compensation contracts have come under major public scrutiny and populist attack. This is in line with the general increase in the focus on corporate governance because of the increase in number of scandals and crisis. There is also observed increase in reforms of good governance principles both from organizations such as OECD and the European Union and also at

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country level. A variable such as corporate governance is wide, therefore, this thesis measure corporate governance as CEO contracts which is determined by (1) extent of bonus package, (2) golden parachutes, and (3) wage. CEO contracts is also a political sensitive issue where it is unaccepted that contracts get unreasonably high, because this often means that less money is distributed to welfare projects.

### *3.2 Independent variable:*

The variables that are used to determine CEO contracts are (1) network between leaders and the board where *number* of ties is used to measure network, (2) board competence using education level and experience (seniority), (3) political connection (if board member has background as a politician) (4) political ideology (left versus right), (5) ownership structure (100% ownership or not), (6) if the company is listed or not, and finally (7) degree of competition between the firms within one sector.

### *3.3 Data and method*

In order to study corporate governance in 40 Norwegian state-owned companies, practice of corporate governance is measured as CEO compensation, which is composed as (1) annual wage, and (2) bonus package. Decision mechanism on CEO packages potentially reflects how the board works, and additionally, it is a controversial issue in the public sphere. The variables I use to determine CEO compensation are (1) political connection (if board member has background as a politician) (2) ownership structure (widely or dispersed), and (3) if the company is listed or not.

I will use econometric analysis, i.e. cross-sectional, panel data (year effects) study with sample of 40 companies and agencies, basically a sample from the Norwegian White Paper of State Ownership (2009), to predict how these explanatory variables affect outcomes of CEO annual wage, and bonus packages. Further, I will use advanced methods such as fixed effects to control for variances in competence of CEO's in state-owned companies. And also, robustness checks to test the strength of the model. As there are poor historical and present data on these variables, I expect to mostly collect data from annual company reports.

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There are a number of previous studies on my explanatory variables – which will also be helpful when constructing measurements of those variables. Data will be collected from the companies' annual report, the database Proff Forvalt, and also a survey will be distributed to board members in order to get information about political experience etc. I will use Proff Forvalt to gather contact information of the board members. The following paragraph identify preliminary hypothesis, this project want to examine

### ***3.4 Hypothesis***

Based on aspects from the corporate governance –and political economy literature, four hypothesis is revealed to be tested.

The first relationship to test is the extent of network between leaders and the boards. As connection through friendship or blood might increase the chance for more generous CEO contracts. For instance, the most eager board members could even guarantee that the top leader could do a great job.

*H<sub>1</sub>: Greater ties between leaders and board yield generous contracts*

Has the state as owner retained political control? Assuming that the median voter prefer less generous CEO contracts, a normative argument would be that CEO contracts in state-owned companies should be less generous as these are resources that potentially benefit voters and citizens, and also, political competition generate motives for the politician to be re-elected. Therefore boards with politically connected members should be more averse to generate less generous CEO contracts, further if the politically connected member is leftist politician, relying on Ljiphart (1984) ideology dimension analysis, the chances of less generous contracts is also more likely. Also, full ownership would reflect more political representation than partly owned, and less competition makes the state owned company more visible in the public sphere and therefore more vulnerable for voters' preference. If there is high competition, then according to corporate governance theory, mechanism for attracting the best candidate would be to increase Thus, full ownership and less competition generate less generous CEO contracts.

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*H<sub>2</sub>: CEO pay is less generous when (1) politically connected board members, (2) when politically connected board members are leftist, (3) full ownership, and (4) less competition*

If the board members have high education and a lot of experience, the top leaders would be less involved in decision making. By following traditional corporate governance on tope leader's pay, less effort would reflect less generous contracts.

*H<sub>3</sub>: High board competence yields moderate CEO contracts*

Because the stock market is a relatively strong market arena where also shareholders (either private, institutions, foreigners) is a part of the decision making. As shareholders are return-maximizers they value a good leader. La Porta et al (1998) examined a cross country analysis of investor or shareholder protection where they revealed that variances was explained by legal traditions (Common Law versus Civil Law), where there was strongest protection in Common Law countries (UK, US, etc.). Strong protection is defined by the degree of power of shareholders in form of votes. Therefore, depending on investor protection, shareholders interests is likely to be represented in construction of CEO contracts.

*H<sub>4</sub>: Listed companies generate more generous CEO contracts*

## **4.0 Summary**

This preliminary research proposal wants to examine cross-section variances in corporate governance and Norwegian state-owned companies in a political economy perspective. Efforts in revealing performance of public companies has been many, but most studies have assessed economic performance of state-owned companies. By, studying how governance is practiced and performed, we get knowledge on how state-owned companies de facto operate. And also, there are relatively more studies on listed state-owned companies than non-listed. This might be a result of better and easier access of data on listed companies. By including non-listed companies in the dataset – one might get more insights in practice of corporate governance in state-owned companies. After all, the stock market arena has a relatively stronger market characteristic than outside stock markets.

This study unifies different disciplines, and constitutes as an example, that approaching a research question with one theory alone, comes short in explaining new knowledge. It seems that, to get in-line with developments in society,

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interdisciplinary approach is requested. How adequate is political economic theory in the field of state-owned companies?

Finally, how does this research approach reveal the behavior of the state (surrounded by myths) in an era where policy reforms are focused on efficiency (cost-minimizing)? Should boards be fully independent of political connection, and vote maximizing politicians to gain optimal corporate governance? Or should boards have political representation to avoid controversially generous bonus packages?

## 5.0 Preliminary literature

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