ARTICLE IN PRESS

JBR-08387; No of Pages 8

Journal of Business Research xxx (2015) xxx–xxx

Contents lists available at ScienceDirect

Journal of Business Research

The CEO as chief political officer: Managerial discretion and corporate political activity

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ARTICLE INFO

Article history:
Received 25 September 2013
Received in revised form 26 March 2015
Accepted 28 March 2015
Available online xxxx

Keywords:
Corporate political activity
CEO discretion
Firm performance
Agency theory
Stewardship
Corporate governance

ABSTRACT

Corporate political activity (CPA) is an important nonmarket strategy aimed at advancing a firm's interests by influencing public policy. Yet studies report mixed results as to the impact of CPA on firm outcomes. Building on recent extant research we suggest that one reason for the ambivalent evidence regarding the impact of CPA on firm performance is the moderating role of CEO discretion on the CPA-firm performance relationship. In a longitudinal study of S&P 1000 firms over 10 years, we test competing perspectives regarding the moderating impact of CEO discretion on the CPA-corporate performance relationship. We find that some aspects of CEO discretion, in particular CEO duality, moderate the relationship between CPA and performance. The findings provide some support for an agency view of the impact of CEO discretion the CPA-performance relationships, which carry implications for both scholarship and regulation in the areas of CPA and corporate governance.

1. Introduction

Corporate political activity (CPA) constitutes firm initiatives designed to influence the public policy making process and its outcomes (Hillman & Hitt, 1999). While accurate as an overarching characterization of CPA, this definition leaves out the question of *whose* private ends will be advanced. The dominant view is that "management scholars emphasize strategic choice and assume that managers choose to engage in political activity to enhance the value of the firm" (Hillman, Keim, & Schuler, 2004, p. 839). Despite the explosion of research on CEO and top management team influence on firm strategy, little research has challenged this dominant view by exploring the role of top executives in determining the level and form of CPA. This is surprising, given the suggestion of Hart (2010, p. 179) and others that: "CEOs may also be quite autonomous in their political activities, […] in the corporate hierarchy, CEOs control so many resources that their subordinates are unlikely to object to such behavior".

In this context, we address in this article the following question: Does CEO discretion have a significant moderating influence on CPA outcomes? Our research question is important because research to date on the impact of CPA on firm performance is mixed and unsettled.

A possible line of explanation for these mixed results is the unexplored internal dynamics of CEO discretion. As Li and Tang (2010, p. 48) pointed out, "when top executives have more discretion, their impact on their firms are stronger". More specifically, we contend that the difference between instances when CPA influences firm-level performance and when it does not may be whether a high-discretion CEO had a hand in the decision or not. In investigating this research question, we use and contrast agency versus stewardship perspectives to explore the moderating effect of CEO discretion on CPA outcomes (namely, financial and accounting performance). Our research question is important insofar as mainstream research and theorizing on CPA may have overlooked some CPA motivations other than maximizing shareholder interest. In the present article, we therefore explore an important linkage in understanding when CPA is effective and when it is less so. This exploration can inform theorizing on CPA as well as governance scholars and practitioners concerned with CEO discretion's impact.

Our article is organized as follows. We first summarize the literature on CPA outcomes followed by a brief review of CEO involvement in firm's political activities. We then explore how CEO discretion might be put to use, either for the benefit of shareholders or for personal gain. Our hypothesis below converges these scholarship streams to explore the interactive impact of CPA and CEO discretion on firm performance. Lastly, after the methods section, we discuss new findings based on an empirical study of S&P 1000 firms for the years 1998–2008.

2. CPA, performance and CEO discretion

2.1. CPA and performance

Scholars have examined the impact of CPA on various firm-level performance measures and reported positive and negative impacts, as well

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http://dx.doi.org/10.1016/j.jbusres.2015.03.046
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Please cite this article as: Hadani, M., et al., The CEO as chief political officer: Managerial discretion and corporate political activity, *Journal of Business Research* (2015), http://dx.doi.org/10.1016/j.jbusres.2015.03.046

as no impact. On the positive side of the argument, some empirical studies show that CPA can result in obtaining government subsidies (Haley & Schuler, 2011), lowering effective tax rates (Richter, Samphantharak, & Timmons, 2008), attaining trade protections (Drope & Hansen, 2004), or receiving permission for rate increases by US electrical utilities (Bonardi, Holburn, & Vanden Bergh, 2006; see also Hillman, 2005).

Other studies, however, concluded that CPA has a negative impact on firm outcomes (Aggarwal, Meschke, & Wang, in press; Coates, 2012) or no effect on policy outcomes (Ansolabehere, De Figueiredo, & Snyder, 2003). Hadani and Schuler (2013), for instance, reported evidence to suggest that CPA has a negative impact on market value.

Yet another research stream shows no effect – positive or negative – of CPA on performance. For example, Ansolabehere, Snyder, and Ueda (2004) reported no obvious impact of campaign contributions on performance, consistent with Hersch, Netter, and Pope's (2008) findings that campaign contributions do not create any financial capital. Faccio (2006) reported that while politically connected firms were able to influence policies regarding financial bailouts, these same firms faced poorer operating performance.

The results of these past empirical studies suggest that there may be missing contextual factors that influence or shape the degree to which CPA can generate performance benefits, and this mixed and unsettled literature is the starting point for our investigation of the potential role of the CEO in influencing the CPA-performance relationship.

2.2. CEO involvement in CPA

CPA is a complex mix of a wide variety of discrete activities such as electoral campaign donations, lobbying, grassroots advocacy, petitioning, organizing media campaigns, participating in trade associations and other related activities. These various activities can be combined coherently to implement an overall strategy that matches the firm's resources and objectives with its given political environment (Hart, 2010; Hillman & Hitt, 1999).

The notion that CEOs steer firm CPA is not new. Decades ago, Epstein (1969) proposed that CEOs initiate and drive corporate political activities: “Another reason for corporate involvement in politics is based as much on managerial personality and prerogative as on the requirements of *Realpolitik*” (Epstein, 1969, p. 129; see also Leone, 1977). This observation was later supported by Post and Griffin's (1997) work indicating the involvement of top executives in CPA. Blumentritt (2003), Hart (2004, p. 56), Hart (2010) and Ozer (2010) also confirmed CEO influence over CPA decisions.

2.3. CEO discretion: a conceptual overview

In analyzing CEO authority, Hambrick argued, “if we want to understand why organizations do the things they do, or why they perform the way they do, we must consider the biases and dispositions of their most powerful actors — their top executives” (Crossland & Hambrick, 2007, p. 334). Hambrick and Finkelstein (1987) argued that discretion determines the potential impact leaders can have on organizations. Indeed, contexts in which CEOs have considerable discretion provide an opportunity for CEOs to more directly influence firm performance (Finkelstein & Boyd, 1998), for good or for bad.

Thus, we focus on the concept of managerial discretion, what Hambrick and Abrahamson defined as “latitude of action” (Hambrick & Abrahamson, 1995, p. 1427); its obverse being constraint (Hambrick & Finkelstein, 1987, p. 374). Many empirical studies have confirmed that when top executives have more discretion, their influence on the firms they oversee is stronger (e.g., Crossland & Hambrick, 2007; Finkelstein & Boyd, 1998; Finkelstein & Hambrick, 1990; Mackey, 2008). However whether that impact is negative or positive remains unsettled. On the one hand, drawing on agency perspectives, most economics-based research views managerial discretion as a negative byproduct of flawed corporate governance, leading to serious damage to shareholder value (Eisenhardt, 1989), as discretion allows CEOs to take advantage of firm actions and to leverage such actions to their own opportunist ends. On the other hand, the dominant view among management scholars assumes positive upside of managerial discretion (Finkelstein & Peteraf, 2007, p. 238). Indeed, managerial discretion may be necessary to allow executives enough latitude of actions to provide their firm the full measure of their individual value added (Cannella & Monroe, 1997). We explore these two views in the context of CPA below.

3. Agency and stewardship perspectives on CEO discretion and the CPA-performance link

3.1. CEO discretion and CPA outcomes: agency and stewardship perspectives

Donaldson and Davis (1991) suggested that the question of whether CEO discretion has positive or negative impacts on performance outcomes is dependent on assumptions derived from stewardship theory versus agency theory. Applied to CPA, the impact of CEO managerial discretion over CPA on corporate performance can be similarly positioned, leading to two competing hypotheses. Given the mixed results of past empirical studies regarding the impact of CPA on firm performance, looking into the moderating effect of CEO discretion may uncover a link largely overlooked by scholarship so far.

3.2. CEO discretion and CPA outcomes: a stewardship driven perspective

Management scholars have traditionally viewed CPA as a financially rational corporate strategy (Bonardi, Hillman, & Keim, 2005), generating firm-level benefits (Hillman & Hitt, 1999; Rehbein & Schuler, 1999). Some authors have found that the stock market expects political activity to benefit firms (Hillman, Zardkoohi, & Bierman, 1999; Roberts, 1990; Shaffer, Quesnay, & Grimm, 2000) and that in some industrial contexts CPA does improve corporate performance (Bonardi et al., 2005; Hillman, 2005; Hillman & Dalziel, 2003). In these situations, executives who decided to pursue CPA do so as stewards of their firm's shareholders.

Consistent with this perspective, we argue that CPA influenced by high-discretion CEOs will benefit firm-level performance, for several reasons. CEOs are uniquely situated at the interface between the internal hierarchy and the external environment of their firms, allowing them to understand more intimately than most other employees and board members their firm's internal and external situations as well as interest. Their better grasp of their firm's internal standing is due to their holistic view of their organization, cutting across all functions and locations, a strategic position only possible from the very top, and developed with longer experience and power in that position (Luo, Kanuri, & Andrews, 2014). This unique position can be especially meaningful for CPA. For example, Hadani (2007) found that firms controlled by the founder's family, in which the firm founder is still involved, are more likely to be politically active. He suggested that their intimate knowledge of firm processes and capabilities enhances their personal influence on strategy making. In other words, the more knowledgeable top executives are about their firm, the better positioned they are to navigate its strategic landscape.

Externally, CEOs may have access to exclusive information about the public policy environment through personal contacts and social capital (with journalists, public officials, other CEOs, heads of business associations, etc.) accrued by their positions' prestige, high visibility and many opportunities (often initiated by CEOs) for socializing with public policy makers (Hart, 2004, 2010; Reich, 2010). Therefore, their boundary spanning position may lead them to develop unique insights about public policy that are potentially beneficial to their firm, and which CEO discretion allows them to realize.

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