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Do specialized board committees impact the transparency of corporate political disclosure? Evidence from S&P 500 companies

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A B S T R A C T

This study examines how the specific attributes of one type of voluntary corporate governance mechanism, a specialized political contribution committee, improves the transparency of corporate political disclosure (CPD). The results demonstrate that the existence of a committee that establishes and reviews key political activities and disclosure policies, particularly one composed entirely of outside directors, significantly enhances the transparency of corporate political disclosure, and reveal that an under-studied board committee, the political contribution committee, effectively improves CPD transparency. The results are consistent with agency theory and further support the more generalizable idea that specialized governance mechanisms (e.g., a political contribution committee) and fully independent committees lead to more transparent disclosure. Finally, the results suggest that the existence of a political contribution committee and committee independence are channels to improve CPD transparency. Public-policy makers and regulators seeking to enhance CPD transparency might consider implementing regulations that mandate or recommend these governance mechanisms as best practice.

Introduction

Motivated by agency theory, this study examines voluntary corporate governance mechanisms for improving the transparency of corporate political disclosure (hereafter CPD). It answers two important research questions. First, does the existence of a specialized board committee enhance the voluntary disclosure of political contributions? Second, does the independence of such committees impact the transparency of CPD disclosure?

Making a corporate political contribution is an important part of a firm's nonmarket strategies and an integral component of its overall ethical climate (Hillman, Keim, & Schuler, 2004). The vast multi-disciplinary literature on the determinants and consequences of corporate political connections shows that corporate political connections impact firm value and are associated with managerial opportunism (e.g., Bagley, Freed, & Sandstrom, 2015; Coates & Lincoln, 2011a; Goldman, Rocholl, & So, 2009, 2013). Political spending by corporations comes with great risks, as political investments are often solicited in an atmosphere that amounts to little more than a shakedown, and may not yield long-term benefits to the firm. If these contributions are made public, they can hurt corporate brands and alienate potential customers and shareholders with different political views (Porter, 2015). Due to the uncertain and risky nature of political contributions, external providers of debt or equity capital (such as institutional investors) are reluctant to approve the deployment of corporate resources to make corporate political contributions that establish or strengthen the firm's political connections (Aggarwal, Meshke, & Wang, 2012; Ozer & Alakent, 2012). Therefore, the transparent disclosure of the corporate political contributions that establish and strengthen political connections can keep market stakeholders informed of such value relevant activities and help to constrain managerial opportunism. In an interview, Robert Menendez, a member of the Senate Banking Committee, who has been pushing the SEC to issue a rule on the disclosure of corporate political contributions, pointed out that "it is important to shareholders and investors to know how their money is being spent … such disclosure casts a bright light on dark money. It would ultimately have a chilling effect on the use of corporate money in elections if companies had to disclose what they were spending and whom they were spending it on" (Salant, 2016).

CPD communicates sensitive information about a corporation's political contributions, which are associated with risks to "a company's reputation, its employee relationship, its legal footings, and attainment of its business strategies" (Bagley et al., 2015). How companies handle their political investments is becoming an important public policy consideration, as pressure from shareholder activist groups increases. Increasingly, Americans are worried about the power of corporations and other wealthy donors to

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influence political candidates; this even became a prevalent talking point in the 2016 Presidential election campaign (O'Connor, 2015; Gold, 2015). Such talking points have spurred public and regulatory concern about corporate political contributions.

There is mounting pressure from shareholder groups, in both the private and public sectors, for greater CPD accountability. For example, in March 2015, the New York State Common Retirement fund, which owned over $20 million of United States Steel stock, forced the corporation to disclose its political contributions in order to mitigate agency problems between investors and management. Although making political contributions public is a vital step toward corporate transparency and accountability, there is a surprising dearth of research into the determinants of CPD transparency.

Reacting to this mounting tension, researchers have become increasingly focused on the use of corporate governance mechanisms to enhance the transparency of companies' voluntary financial and non-financial disclosure (e.g., management forecasts, executive compensation disclosure, Corporate Social Responsibility (CSR hereafter) disclosure, or environmental disclosure).[1] Previous studies have established that corporate governance enhances the transparency of voluntary non-financial disclosure of CSR activities and environmental risk (e.g., Jizi, Salama, Dixon, & Stratling, 2014; Peters & Romi, 2014). However, there are no research studies on the determinants of CPD that specifically focuses on the effectiveness of a specialized board committee. This study uses agency theory to examine the association between one dimension of corporate governance—the existence and independence of a voluntarily established political contribution committee—and the transparency of CPD. Using a sample of 456 S&P 500 companies spanning the 2011–2015 period, the empirical evidence is consistent with the study's predictions. The results demonstrate that the existence of a specialized political contribution committee that establishes and reviews key political activity and disclosure policies, particularly a committee composed entirely of outside directors significantly enhances the transparency of political contribution disclosure. These results are consistent with agency theory and further support the more generalizable idea that specialized governance mechanisms (e.g., political contribution committees) and fully independent committees lead to more transparent non-financial disclosure (e.g., Gul & Leung, 2004; Liao, Luo, & Tang, 2015; Peters & Romi, 2014).

This study has important implications for corporate directors and officers, policy makers, regulators, and academic researchers. First, the findings suggest that a political contribution committee is an effective governance mechanism for improving the quality of CPD disclosure. Second, professional organizations, public-policy makers, and regulators seeking to enhance CPD transparency might consider regulations that mandate or recommend such governance mechanisms in their best practice guidelines. Enhancing CPD transparency is especially important for politically active corporations (such as those in the real estate and healthcare industries) (Akey & Lewellen, 2017), as politically active companies are subject to stronger scrutiny by stakeholders (e.g., Eng & Mak, 2003), due to the higher information asymmetry caused by the opaque financial reporting of some politically active companies (e.g., Riahi-Belkaoui, 2004). Lastly, for academics, the study identifies and uses a unique CPD dataset to examine the influence of governance mechanisms on voluntary disclosure transparency in a domain that has never been examined: corporate political contributions. Moreover, the study extends the corporate governance literature by providing evidence that is consistent with prior studies showing that board-specific committees, such as audit committees, CSR committees, and environmental committees, promote more transparent disclosure of financial performance, CSR activities, and environmental risks, respectively (Cowen, Ferreri, & Parker, 1987; Klein, 2002; Peters & Romi, 2014). This study identifies an under-studied board committee, the political contribution committee that effectively improves CPD disclosure.

This paper develops as follows. The next section provides the institutional and public policy background on political contributions and their disclosure. Next, there is a review of the related literature and development of the hypotheses. The subsequent section presents the research design, followed by a section reporting the empirical results. In the penultimate section, there is a discussion of the sensitivity tests. In the final section, conclusions and future research synergies are discussed.

Institutional and public policy background

Concerns about corporate political spending have a long history in the U.S. Congress first banned corporations from funding federal campaigns in 1907 with the Tillman Act. In 1947, the Taft-Hartley Act extended the ban to labor unions. In 1971, the Federal Election Campaign Act (FECA) required the disclosure of campaign expenditures and contributions. This act severely limited the amount of expenditures and funding a corporation could give an individual or campaign. In 1976, the expenditure limits were struck down by the Supreme Court's decision in Buckely vs. Valeo 424 U.S. 1 (Polsby, 1976), but the strict limits on contributions were left intact.

In January 2010, the Supreme Court issued its landmark *Citizens United* vs. *Federal Election Committee* ruling (CU) providing First Amendment protection to corporate political spending. This precedent-setting Supreme Court case gave corporations and unions the green light to spend unlimited sums on advertisements and other political tools.[2] A key legal finding in the CU case affirmed First Amendment protection to limited corporate political spending in connection with funding separate segregated funds, also referred to as political action committees (PAC). However, donations to actual political parties by a corporation were still prohibited under the FECA guidelines (currently available under the FECA, 52 U.S.C. §30118(a)). On July 22, 2010, following two subsequent FECA advisory opinions, unlimited contributions were allowed to "Super PACs," as long as the Super PAC does not coordinate with political parties or political candidates to decide how the money is spent.

Currently, accounting regulators have not promulgated any formal rules to govern CPD. However, firms have experienced political pressure from numerous advocacy groups and elected officials to adopt comprehensive CPD policies, including full disclosure of their donations. For example, the Center for Political Accountability (CPA), an advocacy group in Washington, D.C., has been pushing for the full disclosure of political spending since 2003. Since it started championing full disclosure, it has reached disclosure agreements with 145 of the companies in the Standard & Poor's 500-stock index (CPA-Zicklin, 2015). In 2015, 44 Democratic senators sent a letter to SEC Chairwoman, Mary Jo White, encouraging her to take action on disclosure rules for corporate political contributions. Ms.

[1] See, for example, studies of the impact of corporate governance on voluntary financial and non-financial disclosure (Eng & Mak, 2003), management forecasts (Karamanou & Vafeas, 2005), executive compensation disclosure (Laksmana, 2008), CSR disclosure (Bebbington, Larrinaga, & Moneva, 2008; Chan, Watson, & Woodliff, 2014; Cheng & Courtenay, 2006; Cowen, Ferreri, & Parker, 1987; Jizi, Salama, Dixon, & Stratling, 2014), and environmental risk disclosure (Gibson & O'Donovan, 2007; Kathy Rao, Tilt, & Leste , 2012; Liao, Luo, & Tang, 2015; Mallin, Michelon, & Raggi, 2013; Peters & Romi, 2014).

[2] Citizens United vs. Federal Election Committee (2010). Retrieved from: https://www.supremecourt.gov/opinions/09pdf/08-205.pdf (Accessed 26 July 2016)