

# Study: firm governance key as shareholders assess risk of political activity

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It's the structure of a firm's governance that may cause shareholders to walk away if they think they can't hold the firm accountable for its political activity, according to a new study.

The research provides [empirical evidence](#) to inform the debate

surrounding whether companies should be required to disclose details of their investments in political activities as a means of increasing accountability to both shareholders and the public.

Published by the *Journal of Business Ethics* and available online, the study was co-authored by Hollis Skaife, an accounting professor at the University of California, Davis, and Timothy Werner, an associate business professor at the University of Texas at Austin.

"The study clearly presents the various ways that U.S. companies can influence the [political process](#) via campaign finance," Skaife said, "and what risk it presents to the average investor because of the lack of transparency over the amounts spent."

## **Market reaction to Citizens United**

The authors used the U.S. equity market's reaction to Citizens United to assess the reputational risks in the opportunities that the U.S. Supreme Court ruling created for managers to spend unlimited, and potentially undisclosed, firm resources on independent political expenditures, or IPEs. These opportunities include channeling "dark money," which is untraceable, through certain nonprofits and trade associations.

Skaife and Werner found that companies known to be engaged in political spending and with concentrated decision rights experienced significant declines in market value at the time of four events surrounding Citizens United v. Federal Election Commission.

Skaife said that more than nine years later, it remains difficult, if not impossible, for shareholders and the public to determine the IPE investments managers are making. "One of the few ways in which shareholders can hold managers to account for the opportunity to engage in such forms of covert (corporate political activity) is to exercise their

rights to 'exit' the firm by selling their shares," the study notes.

## **Focus on agency risk**

The study focused on the risk inherent in managers acting as agents of shareholders. Skaife said managers are tasked to put company resources to their best use—including political spending when it could benefit shareholders. However, to the extent managers use company resources for their own benefit or to achieve their own political aspirations, [shareholder](#) value is at risk.

To examine the effect of the concentration of decision rights, Skaife and Werner used as proxies "CEO duality"—when the chief executive also chairs the board—and shares owned in large blocks. Data from campaign finance disclosures made publicly available in years prior to Citizens United stood in for the now-untraceable flows of corporate campaign donations funneled into IPEs.

They found that politically active firms with CEO duality experienced, on average, a—0.2 percent to -0.9 percent decline in share value as a result of Citizens United. In contrast, firms with blockholdings had market gains that averaged 2.2 percent above normal. As firms' known political activity increased, however, these positive reactions lessened.

"Taken together, these findings suggest that market participants anticipated that previously politically active firms with concentrated decision rights ... posed greater agency and thus, reputational risks for the average shareholder," the authors wrote.

## **Evidence for debate on mandatory disclosure**

"The findings of our study provide evidence to inform those

policymakers, scholars, and shareholder activists deliberating the mandatory disclosure of firms' political spending as a mechanism to hold managers accountable for their firms' (corporate political activity)," the authors wrote.

Skaife, a former practicing certified public accountant, is a member of the faculty in UC Davis' Graduate School of Management, where she researches and teaches on financial reporting issues and corporate governance.

**More information:** Hollis A. Skaife et al. Changes in Firms' Political Investment Opportunities, Managerial Accountability, and Reputational Risk, *Journal of Business Ethics* (2019). [DOI: 10.1007/s10551-019-04224-6](https://doi.org/10.1007/s10551-019-04224-6)

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