TWISTING THE HAND THAT FEEDS YOU: POWER CONTESTATION BETWEEN FIRMS AND THEIR INSTITUTIONAL ENVIRONMENT

By

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To my mom and dad who lit the fire, to my husband who keeps it burning, and to my children who make every day brighter

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This dissertation integrates agency and institutional theories to bring power and agency into the institutional literature. It investigates the efficacy of the regulatory environment (regulation creation and regulation enforcement) in constraining managerial self-interest (CEO excess returns). Further, this study examines the regulatory environment as an antecedent to firm manipulation tactics (political contributions and firm-regulator networks) to offer insight into power contestation during institutionalization processes. Although a number of studies have sought to explain the nature of managerial self-interest, this study takes a different approach by suggesting the regulatory environment is an important determinant of excess CEO compensation. Outcomes of these manipulations are further explored to determine if the tactics deployed by corporate elites grant them greater discretion and control over the organization and thereby allow them to extract disproportionate value from the organization's shareholders.

I tested the hypotheses using a sample of firms from the investment banking industry from 1992 to 2010. Results reveal that certain sources of regulatory pressure,

namely legislative control, congressional liberalism, and regulatory culture are negatively associated with CEO excess returns. I also find a positive relationship between aspects of the regulatory environment and firm manipulation tactics, suggesting firms are indeed actively engaging in the institutionalization process. I did not, however, find a significant relationship between either firm lobbying contributions or firm-regulator networks and CEO excess returns. The dissertation concludes with a discussion of theoretical and practical implications.

CHAPTER 1
INTRODUCTION AND LITERATURE REVIEW

Introduction

> [Occupy Wall Street] is fighting back against the corrosive power of major banks and multinational corporations over the democratic process, and the role of Wall Street in creating an economic collapse that has caused the greatest recession in generations. (www.occupywallst.org)

On September 17, 2011 a group of 1,000 protesters took to the streets of New York in protest of corporatism in Washington and since then this movement has spread across the country and the globe. The protesters hold Wall Street largely responsible for the current financial crisis and are outraged by government bailouts and exorbitant CEO pay (Love, 2011). The global financial crisis resulted in large financial institutions such as Bear Sterns and Lehman Brothers collapsing, national governments bailing out banks, and major declines in the stock and housing markets. Investigation of the causes of the financial crisis by the U.S. Senate found "the crisis was not a natural disaster, but the result of high risk, complex financial products; undisclosed conflicts of interest; and the failure of regulators, the credit rating agencies, and the market itself to rein in the excesses of Wall Street." (Levin & Coburn, 2011:1) Regardless of whether the finger is pointed at the investment bankers or those in charge of regulating their behavior, the fact is a number of actors are responsible for the economic calamity (Story & Morgenson, 2011) and those are not the same individuals left bearing the majority of the burden.

Traditionally the corporate governance literature discusses the divergence of management and shareholder interests and the efforts to align them (Berle & Means, 1932). The extant literature highlights the inadequacies of these systems in constraining managerial self-interest. For example, there is evidence that the board of directors is not

an independent monitor of top management, incentive structures are only minimally tied to firm performance, and highly lucrative severance packages render corporate takeovers an inefficient deterrent (e.g., Galbraith, 2004; Westphal & Zajac, 1995; Dalton, Daily, Ellstrand, & Johnson, 1998; Tosi, Werner, Katz, & Gomez-Mejia, 2000; Westphal & Bednar, 2008; Dalton, Hitt, Certo, & Dalton, 2007). Economic historians, however, have a different perspective on who is the appropriate party to monitor and enforce contracts. Economic historians and institutional theorists view the function of neutral third party enforcement to be an important role of the state (Scott, 2008). They discuss power in terms of normative isomorphism where the professions are the powerful actors (Scott, 2008). Scott (2008) proposes that professions define, interpret, and employ institutional elements such that they have become the most powerful creators of institutions in modern times but they hardly operate in isolation. Other actors in the institutional environment also seek to establish order and extract compliance.

The role of the state, or in theory terms, coercive isomorphism, has received less attention in the literature than other forms of institutional isomorphism (Clegg, 2010) and yet this perspective may offer an important alternative to traditional governance mechanisms, in that the institutionalization of regulation creates a framework of rules where the rewarding and sanctioning is stabilized and legitimized (Scott, 2008). Institutional theory offers a complementary explanation for resolving agency conflicts. Actors or agents employ power not just to create institutions, but also to preserve and maintain them over time, and yet power contestation in institutional theory has received little attention in the literature in recent years.

This dissertation seeks to integrate agency and institutional theories to investigate power and agency and emphasize the role of the regulatory environment (regulation creation and regulation enforcement) in limiting managerial self-interest (CEO excess returns). Moreover, this dissertation investigates firm manipulations (political contributions and regulator networks) over time, which provides an opportunity to examine power contestation during institutionalization processes. By investigating the financial sector, characterized by significant variations in its level of regulation over time, I offer an opportunity to examine managerial pursuit of self-interest under distinct circumstances.

The remainder of this chapter will proceed as follows. First I will review the institutional theory and agency theory literatures, with a particular emphasis on the role of power from each perspective. Chapter 2 focuses on developing hypotheses to predict the relationships between different sources of regulatory pressures and management appropriation of firm value, the deployment of manipulation strategies to mitigate these constraints, and the effect of consensus in the environment on managerial agentic behavior. Chapter 3 presents an empirical test of the hypotheses using panel regression models. The final chapters present the results, discussion, and the theoretical and practical implications.

Theoretical Background

Environmental Constraints and Firm Responses

Institutional theory offers an explanation of the constraining potential of a firm's environment in protecting shareholder interests. Organizations are clearly influenced by their external environments, and the study of organizations focuses on the effects and influences of the environment or institutional context on firm decision-making and

performance. The institutional context is defined as the widespread understandings (rationalized myths) that determine what it means to be rational and thereby legitimate in the eyes of a firm's constituents (Greenwood, Oliver, Hahlin & Suddaby, 2008). Organizations seek to adapt and mold to their institutional contexts (i.e., become isomorphic) as an indication of their relative appropriateness to ascertain and maintain legitimacy from their environment. By 'appearing to be rational' (Scott, 1983: 160) organizations avoid social sanctions, minimize pressures for external accountability, increase the potential of securing resources, and improve their likelihood of survival (Hayward & Boeker, 1998; Westphal & Zajac, 1998; 2001; Greenwood et al., 2008).

Institutional theory

The institutional context is "the rules, norms, and ideologies of the wider society" (Meyer & Rowan, 1983: 84). At its simplest level, this can be described as organizations conforming to the expectations of their population (DiMaggio & Powell, 1983; Rowan, 1982). This is demonstrated in the literature when industry "gatekeepers" were found to have a significant impact on organizational structure and effectiveness (Hirsch, 1975). There are "three mechanisms of isomorphic institutional change": coercive, normative, and mimetic. Coercive isomorphic mechanisms occur when external agencies, on which the organization is dependent, impose or force changes in organizations, particularly through regulatory means. Institutions from this perspective restrain and regularize behavior (Scott, 2008). Economic historian, Douglass North (1990) conceptualizes institutions as:

> analogous to the rules of the game in a competitive team sport. That is, they consist of formal written rules as well as typically unwritten codes of conduct that underlie and supplement formal rules . . . the rules and informal codes are sometimes violated and punishment is enacted.

> Therefore, an essential part of the functioning of institutions is the costliness of ascertaining violations and the severity of punishment. (p. 4)

Regulatory processes establish rules, inspect compliance, and, as necessary, manipulate sanctions (rewards or punishments) in an attempt to influence subsequent behavior or interactions (Scott, 2008). The economists and political scientists that maintain this perspective of institutions typically view the individuals and organizations responsible for the creation of or conformity to rule systems as pursuing their own self-interests (Scott, 2008). These processes may operate through formal or informal means. Informal mechanisms may include sanctions such as discrediting or distancing activities, while formalized mechanisms may involve specific actors, such as the police or courts. For example, organization structure (e.g., level of diversification) varies in relation to federal regulation (e.g., antitrust policies) (Fligstein, 1990; 1991).

Normative isomorphic mechanisms encourage conformity via expectations and senses of appropriateness. Moreover, there is evidence that adaptations perceived as less professionally appropriate are slower to be imitated (Jonsson & Regner, 2009). Phillip Selznick (1948) focuses on the constraints on action arising from social control imposed by institutionalization, arguing that institutionalization will reflect the organizations unique history of those that have been in it, the groups it embodies, and its adaptation to its environment. Selznick (1957) claims "'to institutionalize is to *infuse with value* beyond the technical requirements of the task at hand". (p. 16-17) Normative systems can both empower and enable social action on one hand or constrain social behavior on the other (Scott, 2008).

Finally, mimetic mechanisms involve a certain taken-for-grantedness, i.e., the way we do things, and are culturally supported ways of operating and arranging

organizational life. (Scott, 2008; Clegg, 2010). However this appears to neglect the fact that culture also exists outside of the individual (DiMaggio & Powell, 1991). Therefore DiMaggio and Powell (1991) introduce an objective element to this previously subjective model. Scott (2008) describes these mimetic processes as cultural-cognitive in that they possess both internal and external components and recognizes that our "external" cultural frameworks influence our "internal" interpretive processes (Scott, 2008: 57). Thus, mimetic processes occur because other options of behaving seem inconceivable. Roles are prescribed as agreements, which suggest particular actions are affiliated with particular actors (Berger & Luckmann, 1967). Obviously, organizations may differ in the degree to which they respond or conform to changes in their external environment (DiMaggio & Powell, 1983; Judge & Zeithaml, 1992). For example, regulatory policies and an organization's strategic positioning (Fennel and Alexander, 1987; Judge and Zeithaml, 1992) could either amplify or neutralize the pressures for isomorphism.

The forgotten role of power

Institutional theory tends to focus on the continuity and constraint of social structures but the efforts of individual actors to establish, preserve, and transform institutions should not be ignored; in other words, we should not overlook the role of agency in institutions. Agency concerns an actor's ability to influence institutions by modifying rules, relational ties, or the allocation of resources (Scott, 2008). The existence of agency presents a non-determinant "voluntaristic" theory of action: "to be able to 'act otherwise' means being able to intervene in the world, or to refrain from such intervention, with the effect of influencing a specific process or state of affairs" (Giddens 1984: 14).

Institutions do not mystically arise. They always contest with, borrow from, and to differing extents, supplant prior institutions (Scott, 2008). DiMaggio (1988) insists upon the importance of "bringing agency back in" to discussions of institutional processes. He acknowledges the tendency to overlook the role of self-interest and power processes as we typically focus on the outcome from the perspective of the victor, where opposition has been silenced.

> Put simply . . . institutionalization is a product of the political efforts of actors to accomplish their ends . . . the success of an institutionalization project and the form that the resulting institution takes depends on the relative power of the actors who support, oppose, or otherwise strive to influence it. . . . Central to this line of argument is an apparent paradox rooted in the two senses in which the term *institutionalization* is used. Institutionalization as an *outcome* places organizational structures and practices beyond the reach of interest and politics. By contrast, institutionalization as a *process* is profoundly political and reflects the relative power of organized interests and the actors who mobilize around them. (DiMaggio 1988: p. 13; italics original)

Two major areas of focus for DiMaggio & Powell (1983) are the conceptual importance of organizational fields and the mechanisms of organizational change through institutional isomorphism (Clegg, 2010). An organizational field is "those organizations that, in the aggregate, constitute a recognized area of institutional life: key suppliers, resource and product customers, regulatory agencies, and other organizations that produce similar services" (DiMaggio & Powell, 1983: 148). They later extend this definition to include all those who may or may not have a voice (Clegg, 2010). The third major area of interest in their paper is the link between institutions and "the influence of elite interests" (1983: 157). However, the issue of power has been largely missing from the application and extensions of DiMaggio and Powell's seminal work (Greenwood & Meyer, 2008; Clegg, 2010).

Stinchcombe (1968: 107) describes more clearly the role of agency and power, as is evident in his definition of institutions: “a structure in which powerful people are committed to some value or interest.” This perspective proposes prescribed values and interests are only preserved as long as those promoting them remain in power. Stinchcombe’s analysis centers on the preservation of power. He asserts: “By selection, socialization, controlling conditions of incumbency, and hero worship, succeeding generations of power-holders tend to regenerate the same institutions” (Stinchombe 1968:111).

Institutionalization is not a predetermined process. Order within institutions is fragile and open to potential disruption by agents who are either unaware of the rules or deliberately attempt to change them by offering what they perceive to be appropriate or the norm (Garfinkel, 1967). Order is dependent upon interactions of common actors in normal contexts. Order is fragile and requires a certain degree of maintenance, and much effort is required to sustain its ceremonial façade (Goffman, 1959). Order is likely to be challenged and is rarely fully institutionalized (Clegg, Courpasson, & Phillips, 2006).

Institutionalized myths alone are inadequate to create the process of institutionalization. Institutionalization is the social processes by which duties or realities reach rule-like status in social thought and behavior. This outcome is achieved only after regulated conflict resulting in cooperation, creating a façade of social order. When sources of conflict are excluded from the process tension results, which challenges order and obstructs institutionalization (Clegg, 2010). Reproduction of the accepted structures is not a given in subsequent interactions (Goffman, 1961). Systems of

meaning are often disputed (Foucault, 1977). For any social order to be recognized as "the way we do things around here" a significant amount of strategic agency has to occur, and it is through this process that both social structures and practices are contested (Clegg, 2010). Destructuration is equally as important to understanding institutional process as structuration. In contested social systems, which all systems are to some extent, those in power ensure power stays in their hands in order to maintain some level of predictability, while the less powerful actors have a desire to engage in counterhegemonic, destructurational practices (Clegg, 2010). Strategic action is concurring with the tenants of oppositional logic during the questionable moments when institutionalization is not responsible for the outcome (Derrida, 1976).

Agency scholars suggest power is an important consideration in the discussion of institutional processes:

> Actors, under both stable and unstable institutional conditions, are not just captured by shared meanings in their fields… Instead they operate with a certain amount of social skill to reproduce or contest systems of power and privilege. (Fligstein 2001: 111)

Although the literature has remained generally silent on issues of institutional social power there exists some evidence of power struggles in either decoupling (passive) or willfully manipulative (active) methods (Greenwood et al. 2008). Hayward and Boeker (1998) found that security analysts tend to rate their firm's clients' securities more favorably than other analysts rating the same securities. Westphal and Zajac (1998, 2001) analyzed how corporations publicly adopt but never implement symbolic practices (such as long-range incentive plans for chief executives) meant to satisfy shareholders and positively influence share values.

Institutional actors not only employ power to create institutions, but also to maintain and protect these institutions in the future (see DiMaggio 1988; Stinchombe 1968). Both transaction cost and agency theorists emphasize the importance of designing appropriate governance structures (see Pratt and Zeckhauser 1985). However, if regulation becomes institutionalized, the control and incentive systems are sanctioned in a framework of rules. Power becomes stable and legitimate, or rather "institutionalized", by the establishments of rules, regulations, or laws (Scott, 2008). Thus the regulative dimension of institutionalization becomes incredibly relevant in understanding the dynamics of power in organizational fields.

There are a number of factors which could possibility undermine the success of actors in creating institutions in their favor:

- "Specific institutional arrangements invariably have multiple effects" (p. 109), many of which are unanticipated, unplanned, and may be undesirable.
- "Institutional designers may not act instrumentally" (p. 110), but rather be influenced by norms of "appropriateness," by trends, or by attempts to apply conventional solutions to unconventional situations.
- "Institutional designers may have short time horizons" (p. 112) whereas the institutions they create have long-term effects that commonly contradict original intentions.
- The context for the original institutional design has changed which leads to unexpected effects.
- Institutional designs assume stability in relevant actors and their interests, whereas in reality, actors and their interests vary over time. (Pierson, 2004 in Scott, 2008)

Institutional theoreticians emphasize the ambiguity in the relationship between social structures and organizational behavior and suggest that increased institutionalization can ultimately lead to deviance and change (Huegans & Lander, 2009). Social structures might be the cause of deviance, entrepreneurship, and

improvisation (Hoffman, 1999; Washington & Ventresca, 2004). They may be launching pads for organizations to engage in self-directed, agentic behaviors (Giddens, 1979). Specific organizational field–level isomorphic forces can result in efforts to resist or defy institutional influences, particularly if they organize themselves in protest against dogmatically decreed and accepted social norms (DiMaggio, 1988). Continuous field-level institutionalization is likely to manifest in endogenous pressures for change (Huegans & Lander, 2009). As gradually restrictive isomorphic pressures decrease the flexibility of social systems, these social systems become more susceptible to exogenous shocks and can even collapse due to their own rigidity (Schneiberg, 2005). Restrictive isomorphic pressures may also inspire institutional actors to initiate change that restores their power or position in the field. Next in the spirit of furthering the discussion of agency in institutional processes, executive power and agency theory are discussed to better understand private organizational interests and the motivations of the executives in charge (DiMaggio, 1988).

Executive Power

Much of the discourse, in both research and practice, regarding top management teams in corporations is over managerial power and decision-making (e.g., Finkelstein & Boyd, 1998; Finkelstein & Hambrick, 1990; Finkelstein, Hambrick, & Cannella, 1996; Hambrick & Finkelstein, 1987; Haleblian & Finkelstein, 1993). Power is defined as the ability of individual actors to exert their will (Finkelstein, 1992; Hickson, Lee, Schneck, & Pennings, 1971; Pfeffer, 1981). Power can also be understood as the capacity of one to bring about desired outcomes and, with regards to managerial discretion, power is the latitude of managerial action within the organization (Salancik & Pfeffer, 1974; Hambrick & Finkelstein, 1987). While higher managerial discretion is sometimes beneficial to the

firm (e.g., Finkelstein & Hambrick, 1990; Boyd, 1995; Finkelstein & D'Aveni, 1994), it becomes an issue when managers' goals differ from those of shareholders, the owners of the firm. Agency theory and its closely related theoretical perspective, managerial capitalism are the most frequently cited theories used to explain constraints on managerial power.

Agency theory and managerial capitalism

Agency theory. The agency relationship is "a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent" (Jenson & Meckling (1976) p. 308). It is built around the concept of a firm as a "legal entity that serves as a nexus for a complex set of contracts (written and unwritten) among disparate individuals" (Jensen, 1983, p. 326; Spence & Zeckhauser, 1971; Ross, 1973). Generally, the shareholders (owners) or board of directors (representing the owners) are identified as the principals and top management as the agents. Agency theory implies an inherent conflict of interest between principals and agents.

The owners face two primary challenges with the CEO: moral hazard and adverse selection. Moral hazard is the CEO's lack of exerted effort or the misuse of firm resources to serve his or her personal interests. Moral hazard can result from a contract based on imperfect measures of behavior (Baiman, 1982). Possible solutions for this problem are an information system that eliminates information asymmetry or a monitoring and contracts system that appeal to and constrain a manager's natural self-seeking behavior (Jensen & Meckling, 1976; Baiman, 1982; Simon, 1991). Adverse selection is the misrepresentation of his or her ability by the CEO. Adverse selection arises if CEOs are motivated to misrepresent their private information to achieve their

personal goals. This problem can be addressed through an information-seeking process that reveals the CEOs' private information or through a risk-sharing approach, which minimizes returns for CEOs who misrepresent themselves or the situation.

The solutions to agency problems result in agency costs incurred by the owner in order to insure the CEO executes decisions that are in the owner's best interest. Agency costs include monitoring costs, bonding expenditures, and the residual loss. Owners attempt to minimize agency costs by balancing the costs of monitoring, risk sharing, and unresolved agency problems (Jensen & Meckling, 1976). Monitoring costs are born by the principal (owners) and arise from the need to initiate incentive schemes, monitoring procedures, supervision, additional hierarchical levels to the organization, information systems, budgeting systems, reporting procedures and boards of directors (Eisenhardt, 1989; McGuire, 1988; Jenson & Meckling, 1976). Risk sharing costs are born by the agent (management) and are the bonding expenditures which guarantee the agent will not take certain actions which would harm the principal or if harm does occur the agent will compensate the principal. Residual losses are the costs arising from unresolved agency problems and consequently a reduction in welfare of the principal (Jensen & Meckling, 1976).

Managerial capitalism. A theoretical approach that predates agency, managerial capitalism is based on the idea that there is no "justification for assuming that those in control of a modern corporation will also choose to operate it in the interest of the owners" (Berle & Means, 1932, p. 121). A central tenet of managerial capitalism is the belief that managers have both discretion and control of the firm due to the broad dispersion of stock ownership. Many of the possible constraints on firm managers are

eliminated or reduced when ownership is so widely distributed that the gain to any individual stockholder (through an increase in share value) is significantly offset by the costs of imposing the constraint (Hindley, 1970). As a result, managers are given autonomy which allows them to maximize their personal utility through increased personal financial gain, increased power and discretion, working conditions in excess of those dictated by competitive conditions, job security or labor-leisure trade-off, and goals that diverge from the profitability goals of owners (Berle & Means, 1932; McEachern, 1975).

Resolving the agency problem

Three primary approaches were proposed to minimize the agency problem: independence, market for corporate control, and equity. The first, the “independence” approach, suggests that boards of directors, designed to be independent of management, can monitor managers to insure that management’s interests do not diverge substantially from those of owners (Fama, 1980; Fama & Jensen, 1983a, 1983b; Jensen & Meckling, 1976; Mizruchi, 1983). The second approach, the “market for corporate control”, advances the principle that corporate markets may serve to discipline managers who improperly leverage their agency advantage. In these cases, self-serving executives may find their firms acquired by other firms (Fama & Jensen, 1983a; Jensen & Roback, 1983; Manne, 1965). The third approach, the “equity” approach, proposes that managers with equity in the firm are more likely to embrace the interests of other equity holders, namely shareholders, and accordingly, to direct the firm in the direction of their joint interests (Fama & Jensen, 1983b; Jensen & Meckling, 1976).

Independence approach. There are a couple of different tactics, which can be employed to address potential independence problems. The first focuses on the composition of the boardroom. Daily, Johnson, & Dalton (1999) identified three categories: (a) inside directors, (b) affiliated directors, and (c) outside directors where only outside directors are considered as independent. However, there is evidence that regardless of a director's formal relationship or lack of relationship directors are never independent. Galbraith (2004) captured this sentiment by claiming that the very idea that boards could be independent is an "accepted fraud," and that "alleged directors in any sizable enterprise are fully subordinate to the management" (p. 28). Research further suggests the only reason directors are appointed and retained is because they are supportive and sympathetic to the CEO (e.g., Solomon, 1978; Wade, O'Reilly, & Chandratat, 1990; Westphal & Zajac, 1995). Even if the director does not have a significant employment relationship with the firm, if he or she was appointed to the board during the CEO's tenure he or she may be considered "interdependent" (e.g., Boeker, 1992; Daily & Dalton, 1995; Wade et al., 1990

Research supports this contention as it shows that no director is independent after he or she has served five or more years on any particular board (Sutton, 2004). There is also substantial wealth associated with board service (e.g., salary, stock options, etc.) and the literature suggests board members may become increasingly dependent upon management as this wealth accumulates (e.g., Bebchuk & Fried, 2004; Dalton, 2005). If this is true, it is a disturbing notion as the compensation of directors has increased dramatically over the years (e.g., Conference Board, 2005; National Association of Corporate Directors, 2011; Shearman & Sterling, LLP, 2011; Spencer Stuart, 2011).

Research also draws attention to the ability of the CEO and board members to diminish the influence of “independent directors. Walsh and Seward (1990) provide an overview of the “tactics” available for neutralizing internal control mechanisms, such as adjusting incentive contracts or managers altering the assessments to determine turnover. Further Westphal and colleagues (e.g., Westphal 1998, 1999; Westphal, Boivie, & Ching, 2006; Westphal & Khanna, 2003; Westphal & Milton, 2000; Westphal & Stern, 2006, 2007; Westphal & Zajac, 1994, 1995), provide intriguing insights into how management can effectively modify board “independence” which is often perceived by management and the board as noncomplying, distracting behavior (Dalton et al., 2007). These maneuvers include but are not limited to cooptation, individual and social influence, reciprocity, demographic similarity in selection, and inter-firm referrals that are consistent with prevailing board norms.

The second key element of board independence concerns the leadership structure of the boardroom or the roles of the CEO and chairperson of the board. CEO duality is defined as one person holding both the positions of CEO and board chairperson; on the other hand, these roles may be occupied by two separate individuals (e.g., Dalton et al., 1998; Davidson, Jiraporn, Kim, & Nemec, 2004; Finkelstein, & D’Aveni, 1994). Fama and Jensen (1983a, b; See also Mizruchi, 1983) found fault with the combined alternative and contended it would compromise the board’s ability to successfully monitor the CEO. This was referred to as the basic equivalent of the “CEO grading his own homework” (Brickley, Coles, Jarrell, 1997, p. 190).

Market for corporate control. In spite of declarations that the market for corporate control is a highly efficient mechanism for disciplining wayward executives

(e.g., Jensen & Ruback, 1983; for an alternative perspective, see Walsh & Seward, 1990), the market for corporate control has dissipated in recent years. Its downfall was initiated from a number of different directions and began in the late 1980s and early 1990s (Dalton et al., 2007). Corporate management greatly opposed the market for corporate control and the associated employment risk, and thus, incited their boards to enact antitakeover provisions such as poison pills, dual-class stock, and other protective mechanisms (Bainbridge, 2006; Hawley & Williams, 2000). Next some states enacted legislation that made takeovers more difficult, while court rulings (e.g., in Delaware) increased the board's ability to resist takeover attempts (Dalton et al., 2007). Perhaps Jensen (2005) best summarizes the overall decline, noting that by 1990, "the era of the control market came to an end" (p. 33).

In principle, takeovers are described as a disciplinary mechanism to assist in mitigating the fundamental agency problem (Fama & Jensen, 1983a; Jensen & Ruback, 1983; Manne, 1965). However, Dalton and colleagues (2007) bring this very proposition into question when they investigated executives' departures through the market of corporate control. They emphasize the practical implications for exiting CEOs (e.g., their employment contracts, accelerated options, change-of-control provisions, accelerated restricted shares, etc.) and how these executives receive hundreds of millions of dollars in "separation" pay (Dalton et al., 2007). Therefore, based on extant evidence, the market for corporate control is a difficult means of controlling agency costs, and in some cases could raise these costs. It is a means of last resort, exercised only after other governance mechanisms have failed to reduce or rectify agency problems.

Equity approach. Jensen and Meckling (1976) propose that there exists a positive relationship between management ownership and firm performance, which serves to close the risk gap between principal and agent. They suggest that as management's ownership claims decline, their "fractional claim on outcomes falls," leaving management more likely "to appropriate larger amounts of the corporate resources in the form of perquisites" (p. 313).

Executive compensation presents an opportunity for alignment between management and shareholder interests. As Jensen and Murphy (1990) restate, "Agency theory predicts that compensation policy will tie the agent's expected utility to the principal's objective. . . . therefore, agency theory predicts that CEO compensation policies will depend on changes in shareholder wealth" (p. 242). In a meta-analysis of this proposed relationship, Tosi and colleagues (2000) confirm significant results in support of Jensen and Murphy's findings, however, firm performance only accounted for approximately 5% of the variance in total CEO compensation. Nyberg, Fulmer, Gerhart, and Carpenter (2010) find significant positive co-variation between measures of CEO and shareholder return. Following agency logic, more equity-based components of management's compensation should provide better alignment between the interests of executives and shareholders. In fact, Hall (2000) suggests, "Options are the best compensation mechanism we have for getting managers to act in ways that ensure the long-term success of their companies and the well-being of their workers and stockholders" (p. 122). Consistent with this proposition, Mehran (1995) found a positive relationship between firm performance and the proportion of equity-based compensation.

Other research, alternatively, is not uniformly supportive of the predicted agency relationship. Several recent studies have addressed the potentially detrimental effects of stock options. For example, Bergstresser and Philippon (2006) find that the manipulation of corporate earnings through the use of discretionary accruals was more pronounced when the CEO's total compensation was more closely linked to stock and stock options. A related study found a notable relationship between the exposure of the CEO's option portfolio to stock price and the likelihood of misreporting corporate earnings (Burns and Kedia, 2006). Denis, Hanouna, and Sarin (2006, p. 467; see also Becher, Campbell, & Frye, 2005; O'Connor, Priem, Coombs, & Gilley, 2006) reference the "dark side" of incentive compensation in their study, which verified a relationship between this type of compensation and securities fraud allegations.

CEO Excess Returns

Another opportunity to observe the alignment of managerial interests with that of shareholders is the return to top management for their services relative to the returns to shareholders (Kolev, Wiseman, Gomez-Mejia, & Belin, 2011). In other words, to what extent does management appropriate firm value at the expense of firm owners? Nyberg et al. (2010) posit that the literature misidentifies CEOs as employees (agents) when in reality their compensation structure, heavily composed of equity-based compensation, more accurately creates co-owners. The percentage of stock-based compensation is now two thirds of CEO compensation packages whereas it used to be a trivial portion. "In this role, a CEO pays attention to the return on his or her accumulated equity holdings as much as any other shareholder, arguably more so given the typically large percentage of personal wealth tied up in this one investment" (Nyberg et al., 2010: 11).

Although this statement may be true, this dependency on equity-based compensation may present an opportunity for a host of new agency costs.

Kolev and colleagues (2011) introduce the concept of CEO excess returns to capture the extent to which CEOs capture a greater portion of firm value than firm owners. If CEO returns are higher than that of shareholders, the CEO is acquiring a larger portion of the firm residuals than shareholders (Kolev et al., 2011). It is difficult to imagine a circumstance where it is appropriate for executives to receive returns prior to shareholders. In fact, CEOs are already considered compensated above "normative expectations" (Berrone, 2008). The extent to which agency costs increase is captured by the magnitude of the positive residuals, while negative values indicate shareholders are the primary beneficiaries, or appropriating more of firm value than CEOs (Kolev et al., 2011). The authors found collectively that increases in shareholder value were supplanted by even larger increases in CEO returns, and this difference grows as the potential for managerial opportunism escalates. Moreover, CEOs experienced positive returns even when shareholder returns were zero. These findings are further evidence that whether we conceptualize the CEO as an "agent" or "just another investor or principal" (Nyberg et al., 2010), if left unconstrained he or she can take advantage of other principals (Kolev et al., 2011). Following the approach of Kolev and colleagues (2011) this dissertation utilizes the concept of CEO excess returns as evidence of managerial self-interest and engages institutional theory as an alternative constraint to corporate governance mechanisms.

Summary

The overarching emphasis of the current literature on institutional theory is the role of shared meanings, institutional processes and institutional conformity. Despite the

contribution of these studies to the institutional perspective, they downplay the role of struggle and conflict in the theory. The role of the state, or in theory terms, coercive isomorphism, has largely been missing in the discussion on institutional processes (Clegg, 2010). It becomes difficult for one to imagine an organization or group of actors of lesser status being pressured to change without conjuring up images of power and domination (Greenwood & Meyer, 2008). Institutionalization as a process is intensely political and mirrors the relative power and interests of those who mobilize around them (DiMaggio, 1988). This dissertation contributes to the literature by empirically demonstrating the dynamic nature of power contestation in organizational fields. I propose that not only is there an ongoing attempt to influence institutional structure but also that those that are more successful in their influence will reap more rewards and value as further indication of their efforts. These rewards will be evidenced as CEO excess returns, where the CEO claims residuals on the firm before shareholders.

Moreover, in the case that board independence, incentive alignment, and the market for corporate control fail to reign in wayward executives, shareholders need another effective constraint to protect their interests. Although agency theory enlightens us on issues with managerial self-interest, institutional theory offers a complementary explanation for resolving agency conflicts as the state may offer additional constraints and enforce contracts. The institutionalization of regulation creates a framework of rules where the rewarding and sanctioning can be stabilized and legitimized (Scott, 2008). The next chapter investigates specific sources of regulatory pressures and the manipulation tactics firms employ to retain discretion and control within their institutional environment.

CHAPTER 2
HYPOTHESES

Regulatory Pressures and the Appropriation of Firm Value

Because the state is a necessary source of coercion in third party enforcement, a theory of institutions must include an "analysis of the political structure of a society and the degree to which that political structure provides a framework of effective enforcement." (North, 1990: 54).

Sources of Regulatory Pressure

Organizations exist within an organizational field, defined as "those organizations that, in the aggregate, constitute a recognized area of institutional life: key suppliers, resource and product customers, regulatory agencies, and other organizations that produce similar services or products" (DiMaggio & Powell, 1983: 148). The state is sometimes underestimated as simply another organizational actor in the organizational field. It can influence the economic behavior of organizations by defining and enforcing property rights (Campbell & Lindberg, 1990). Therefore it follows that organizations experience regulatory pressures through both regulation creation and regulation enforcement, which can serve as a unique constraint on potential managerial self-interest. The state presents exceptional power in defining the nature, function and freedoms enjoyed by both economic and political actors (Scott, 2008).

Regulation creation

Rules are "commonly held definitions of the situation that act to constrain and shape actors' behavior. The ability to set rules is a result of power such that actors in single organizations or sets of organizations (including the state) can create rules" (Fligstein, 1991: 312). Rules and/or regulations set by the state provide

> the legal framework within which contracts are written and enforced. . . . The state's influence, quite apart from sporadic interventions, is always present in the economy insofar as it provides an institutional and legal framework that influences the selection of different governance regimes and thereby permanently shapes the economy. (Campbell and Lindberg 1990: 637)

States not only affect individual firm structures but also influence the structuration of organizational fields (Scott, 2008). Baron, Dobbin, and Jennings (1986) examined the evolution of modern personnel systems in the US and demonstrated how the state's power influences the structure of both industry and firms. After World War II the federal government interceded in an attempt to stabilize employment. Agencies like the War Production Board, the War Labor Board, and the War Manpower Commission "engaged in unprecedented government manipulation of labor markets, union activities, and personnel practices. These interventions… fueled the development of bureaucratic controls by creating models of employment and incentives to formalize and expand personnel functions "(Baron et al. 1986: 369). In short, they created pressures (cultural-cognitive, normative, and coercive) to encourage compliance and therefore conformity among professional managers (Scott, 2008).

Other research reveals the effect of legislation on firm decisions. For example, Fligstein (1990) underscored the Sherman Act of 1890 as a response to the development of cartels that were appearing in Europe at the same time, and which, in effect, reduced the potential of managerial power. Fligstein (1990, 1991) found that corporate diversification strategies varied over time, and to some extent co-varied with shifting federal antitrust policies. The investment and securities industry, like other industries, is also affected by the passing or repealing of discretion-reducing legislation. The Glass-Steagall Act (1933) separated commercial and investment banking, which

not only established them as separate lines of commerce but also prohibited firms from engaging in both sectors, effectively limiting managerial choice and discretion (www.fdic.gov). Sixty-six years later congress passed the Gramm-Leach-Bliley Act of 1999, which repealed the Glass-Steagall Act of 1933 (www.fdic.gov). This legislation is an example of regulation that would actually increase managerial discretion and power through a reduction in oversight, thus providing an opportunity for management to act in their self-interest. Therefore, stronger legislative control, evidenced through recent legislation that constrains management and reduces managerial discretion and power should result in shareholders receiving more of the residual firm value than management. In other words:

Hypothesis 1a. Increased legislative control is negatively associated with excess CEO returns.

It is not only the actual passing of legislation that constrains managerial behavior but also the threat of discretion reducing legislation. When power contestations are associated with institutional structuration, the actors are aware that there is path dependence in the establishment of institutions: the "beliefs, norms, and organizations inherited from the past will constitute part of the initial conditions in the processes leading to new institutions" (Grief, 2006: 17). One method of capturing the extent to which Congress is likely to exercise legislative control is by measuring its relative conservatism or liberalism. There is a dominant assumption in the literature that business favors free market principles consistent with conservatism. The Americans for Conservative Union espouses the following values:

> We believe that capitalism is the only economic system of our time that is compatible with political liberty. It has not only brought a higher standard of living to a greater number of people than any other economic system in the

> history of mankind; more important, it has been a decisive instrument in preserving freedom through maintaining private control of economic power and thus limiting the power of government. We believe that collectivism and capitalism are incompatible, and that when government competes with capitalism, it jeopardizes the natural economic growth of our society and the well-being and freedom of the citizenry. (www.conservative.org/about-acu/principles)

Moreover, corporate support of conservative values is found in the literature. Francia (2001) found that corporate political action committees (PACs) gave more money to incumbents who voted in favor of the North American Free Trade Agreement (NAFTA) regardless of party affiliation. So the less conservative (or more liberal) congress is, the higher their propensity to pass restricting legislation. The mere threat of legislative bodies to pass restricting regulation may be enough of an incentive for firm management to fulfill their contractual obligation to firm owners and not appropriate firm value.

Hypothesis 1b: Increased congressional liberalism is negatively associated with excess CEO returns.

Regulation enforcement

> I became very concerned. This market had been under the jurisdiction of my agency and had been expanding for about three years when I came into office because one of my predecessors had led an effort to exempt these transactions from a requirement of exchange trading. – Brooksley Born, CFTC Chairman, 2009 (www.pbs.org)

While the threat of regulation creation is one source of regulatory pressure experienced by firms the extent to which enacted legislation is enforced is another. The state's ability to enforce regulatory compliance is a distinct source of "legitimate coercion" (Streeck & Schmitter, 1985). The regulatory environment possesses authority over other organizations and various other aspects of the organizational field (Lindbolm, 1977; Edelman & Suchman, 1997). Therefore I expect that the state can influence the actions

of others through network links and a range of dependency relationships (Pfeffer & Salancik, 1978). Dependency is not limited to tangible resources, but also includes social aspects including legitimation, competition, or cooperation (Fligstein, 1991).

Various accounts highlight three distinguishable sources of organizational conformity with regulations. Organizations conform because they were commanded to do so by law and feared sanctions imposed by noncompliance (coercive) (e.g., Fligstein, 1991). Organizations conform because law reflects societal values, ethics, and role prescriptions which organizations begin to embody and internalize (normative) (e.g. Edelman, Petterson, Chambliss, & Erlanger, 1991; Edelman, Abraham, & Erlanger, 1992). Finally, organizations conform because law renders some forms more natural, conceivable, or suitable than others (cognitive) (e.g. Dobbin, Sutton, Meyer, & Scott, 1993).

The common perception of regulation is one of top down sovereign control. The legal system is responsible for modifying organizational behavior by creating a system, which creates incentives for conformity and penalties for deviance (Edelman & Suchman, 1997). The regulatory environment largely compensates for market failures such as monopolies and externalities (Friendly, 1962; Burk, 1985). The law creates and legitimates particular organizational forms while regulatory agencies encourage the stability of these forms. It initiates and influences organizational norms and standards and to some extent determines the identities and abilities of those in the field (Edelman & Suchman, 1997). Organizations cannot escape the larger normative influence of the regulative environment. Organizations often evolve to embody the fundamental logic of

the regulatory legal environment and thereby, constrained from seeking their own self-interest at the expense of their fiduciary responsibility. Hence,

Hypothesis 2a: A strong regulatory culture is negatively associated with excess CEO returns.

In the United States, the president is instrumental in shaping public opinion and encouraging congress to consider particular legislation. For example, in recent years Wall Street Reform is one of the top priorities for the current U.S. President:

> We desperately needed to modernize our financial system and take the necessary steps to close the gaps in our system and eliminate regulatory arbitrage. – President Obama (*www.whitehouse.gov*)

In the U.S., the executive branch of the government influences the regulatory environment such that the President is responsible for nominating those in charge of the regulatory agencies and signing (or vetoing) legislation (http://www.whitehouse.gov/our-government/executive-branch). Therefore it should also follow that, to the extent that presidents embody the ideological principles of their political party regarding the importance of government regulation in market activity, the more likely they will support efforts to create new legislation and enforce current regulations (e.g., www.conservative.org/about-acu/principles). Further, by offering additional consistency in the definition and enforcement of regulations (Fligstein, 1991), presidential support should offer additional stability to the field, encouraging compliance among actors, and effectively reducing the managerial appropriation of firm value at the expense of shareholders. Therefore, I propose

Hypothesis 2b: Presidential party affiliation (Democrat) is negatively associated with excess CEO returns.

Corporate Responses to Regulatory Pressures

Despite the possibility that the firm's regulatory environment may constrain wayward managers, it is important to examine how regulatory institutions function and interact with other institutional actors. We are reminded that laws do not spontaneously appear; rules require interpretation; disputes demand resolution; incentives and penalties must be designed and re-evaluated and inevitably will have unanticipated consequences; monitoring systems will be necessary but insufficient; and compliance will be one of many possible reactions from those impacted by the regulatory institutions (Scott, 2008). Problems can occur because "enforcement is undertaken by agents whose own utility functions influence outcomes" (North, 1990: 54) (i.e., third parties may not be neutral). That is, the state often advances its own interests and operates in isolation from other institutional actors (Skocpol, 1985).

Organizational legitimacy, the "degree of cultural support for an organization" (Meyer & Scott, 1983: 201), is adversely affected by the extent that different authorities have power over it, the discord in the institutional environment, and the extent to which institutionalized myths are incomplete (Meyer & Scott, 1983; DiMaggio, 1991; Scott, 1991). Various types of authorities are permitted to bestow legitimacy upon organizations and "legitimate" structures may simultaneously be contested structures (Scott, 2008). Ultimately, the principles that define legitimacy are themselves an issue of organized social power. Stinchcombe (1968) posits that "a power is legitimate to the degree that, by virtue of the doctrines and norms by which it is justified, the power-holder can call upon sufficient other centers of power, as reserves in case of need, to make his power effective" (p. 162). In the case of investment banks, the institutions studied here, legitimacy may emerge as the result of contestation between regulatory

agencies and corporate elites who are in a position to negotiate with both their competitors and the state to influence the institutional framework (Fligstein, 1991). Elite organizations can also politically organize to further their shared interests or agenda (Cawson, 1985).

Strategic Responses to Regulatory Pressure

There are different ways that organizations may respond when confronted with institutional pressures to reduce managerial discretion: acquiescence, compromise, avoidance, defiance, and manipulation (Oliver, 1991:152). Firms are more likely to either acquiesce to the demands and restrict management appropriation of firm value (i.e., reduce or eliminate excess CEO returns) or manipulate by influencing the legislation creation through lobbying efforts or co-opting regulatory enforcement. Acquiescence, or conformity, includes imitation of other organizations or compliance with the perceived demands of various authorities. The motivation for acquiescing could be anticipation of legitimacy, fear of sanctions, or hope of acquiring additional resources. This is the response we most often assume firms are adopting when they do not appear to experience any sanctions from regulators. Manipulation is a purposeful and opportunistic attempt to “co-opt, influence, or control” the environment (Oliver, 1991:157). It is considered the most active response as it is aimed at actively changing or wielding power over the content (legislation) or those that express or enforce them (regulators) (Oliver, 1991). This occurs when organizations try to manage different views of their legitimacy directly (Scott, 2001).

Threats to managerial discretion are likely to inspire a range of manipulative strategies. Selznick (1949) illustrated how the Tennessee Valley Authority co-opted opposing constituents. Organizations may also become politically involved in the

shaping of regulatory policies that threaten their autonomy. For example, the Association of Home Appliance Manufacturers helped to establish their industry's safety standards in an attempt to preempt constraining government regulation (Hunt, 1975). Self-regulation in the accounting industry "was the direct result of the near certainty that if the industry did not take a lead in establishing corporate financial standards, the SEC would" (Gupta & Lad, 1983: 421).

Influencing regulation creation

Anticipated reductions in efficiency or autonomy are common motivations for resistance to state intervention. If compliance with government regulations is seen as incompatible with the standards by which their performance is evaluated, organizations may seek to manipulate the rules (e.g., through lobbying) and other tactics that are generally focused on changing institutionalized values or definitions and standards stipulating appropriate practices or performance (Oliver, 1991). For example, DiMaggio (1983) discovered that various nonprofit art organizations created lobbying coalitions to affect the level of funding and support they could receive from public sources. Scott (1983) found nursing home owners were able to influence the determination of nursing home standards by participating in the political process. There are other cases of firms manipulating the definitions of appropriate performance (Hinings & Greenwood, 1988). We can also expect attempts to influence the creation of regulation if the firm's conformity to the rules could affect its legitimacy (Scott, 2008). In this case we should expect to see these firms influencing the rules to ensure their compliance.

The literature evidences the ways firms attempt to influence the legislation process. Vogus and Davis (2005) illustrate how the organized efforts (in terms of board interlocks) of corporate elites resulted in the state adopting more management-friendly

legislation regulation regarding hostile takeovers. Corporate efforts to form government policy, which is more favorable to the firm, is the focus of an entire literature on corporate political activity (CPA) (Hillman, Keim, & Schuler, 2004). Hillman and Hitt (1999) identify different strategies firms can deploy as part of their corporate political activity. The financial incentive strategy targets political decision makers directly. Aplin and Hegarty (1980) refer to this as “direct pressure”. This strategy refers to management using financial inducements to align policy maker’s interests with that of the firm (Hillman & Hitt, 1999). A more recent example from the financial sector evidences the influence of Wall Street in legislation creation. A review of congressional lobbying records from the first quarter of 2012 reveals that many of the largest firms in the financial sector lobbied on the Stop Trading on Congressional Knowledge (STOCK) Act because they were concerned with a provision in the bill that would have required “political intelligence” consultants to register as lobbyists and disclose their clients. The provision was later removed from the bill (Garofalo, 2012). However, organizations frequently reflect the underlying logic of the regulatory legal environment despite their attempts to evade its more burdensome provisions (Edelman & Suchman, 1997).

On one hand, regulatory pressures are exerted through legal coercion; meaning the consequences of noncompliance are highly punitive and stringently enforced. In this case we would expect the likelihood of acquiescence to be high which would support the efficacy of regulatory pressures as an organizational constraint. On the other hand, to the extent the organization experiences discretionary constraints, the more likely it is that the firm will try to resist such constraints. Pfeffer and Salancik (1978) pointed out

that "compliance is a loss of discretion, a constraint, and an admission of limited autonomy." (p. 94)

Because firms seek legitimacy and fear regulatory sanctions I expect there to be direct effects of firms acquiescing to these external demands through the reduction of CEO excess returns. However, to the extent the regulatory environment reduces managerial discretion and threatens the autonomy of the organization's management, I would expect to see the level of resistance to these pressures by the firm also increase. Therefore, I would also expect the firm to respond with a manipulation strategy such as influencing legislation through lobbying contributions (indirect effect). In other words, I would expect firm lobbying contributions to partially mediate the relationship between regulation creation and management appropriation of firm value. Formally, I propose:

Hypothesis 3a: Legislation control will be positively associated with firm political contributions.

Hypothesis 3b: Congressional liberalism will be positively associated with firm political contributions.

Co-optating regulation enforcement

Another response to institutional pressures is to co-opt the source of the pressure (Burt, 1983; Pennings, 1980; Pfeffer & Salancik, 1978). The organization may engage an institutional constituent to serve on its board of directors; in this case, the firm would be looking to bring in individuals with previous affiliations to key regulatory agencies. Organizations utilize co-optation tactics to gain power over the opposition and enhance their legitimacy in the field (Oliver, 1991). For example, Pfeffer (1974) demonstrated how electrical utility companies acquired political support and legitimacy by co-opting critical economic sectors regulating utilities. Selznick's (1949) showed how the Tennessee Valley Authority co-opted external interests to garner support for its

projects. There is evidence that the opportunistic engagement of institutional links benefits the organization in order to acquire resources and approval (Benson, 1975; DiMaggio, 1983; Oliver,1990; Wiewel & Hunter, 1985). A few examples of relationships between investment banking firms and their regulators range from Goldman Sachs ex-CEOs serving as the U.S. Treasurers, JP Morgan CEO also serving on the Board of Directors of The Federal Reserve Bank of New York, to the SEC's hire of a Goldman Executive as the Enforcement Unit's first Chief Operating Officer (Harper, 2012; Gallu, 2009).

The extent to which management should be able to influence these constituents depends "on the resources that organizations command and the types of network and dependency relations the organization has to other organizations" (Fligstein 1991: 314). The connections between organizations within the institutional field can be characterized in network terms and range from formal to personal ties between firms (DiMaggio, 1986). Oliver (1991) suggests the degree of interconnectedness between institutional actors influences the level of resistance to pressures. Meyer and Rowan (1977) posit that institutional myths are transferred through relational networks. The authors further suggest that relational networks are central forces in encouraging conformity among actors. Thus it follows that firms could leverage these ties to promote their interests and mitigate regulatory pressures.

Again in the pursuit of legitimacy and avoidance of regulatory sanctions, firms will acquiesce to regulatory enforcement pressures, which is evidenced by the reduction of CEO excess returns (direct effect). Yet as regulatory enforcement (i.e., regulator attitudes and presidential political ideology) threatens managerial discretion and

autonomy, the level of firm resistance to regulatory pressures, via the leveraging of firm-regulator networks, should increase. Therefore, I would expect a manipulation strategy such as co-opting regulatory enforcement, to partially mediate the relationship between regulation enforcement and management appropriation of firm value. Consequently,

Hypothesis 3c: A strong culture of regulation among regulators will be positively associated with the presence of ties between firms and regulators.

Hypothesis 3d: Presidential party (Democrat) of regulation will be positively associated with the presence of ties between firms and regulators.

Consensus in the Regulatory Environment

> As head of the Commodity Futures Trading Commission [CFTC], Brooksley Born became alarmed by the lack of oversight of the secretive, multitrillion-dollar over-the-counter derivatives market. Her attempts to regulate derivatives ran into fierce resistance from then-Fed Chairman Alan Greenspan, then-Treasury Secretary Robert Rubin and then-Deputy Treasury Secretary Larry Summers, who prevailed upon Congress to stop Born and limit future regulation. (www.pbs.org, 2009).

Organizations are unlikely to significantly deviate from the prescribed course of action when organizational fields are stable and heavily state regulated; a level of inertia arises from the stability of power in an organizational field (Fligstein, 1991). Examining the structure of the institutional field offers another approach to understanding the likelihood of institutional change (i.e., the degree of tight coupling) (Greenwood & Hinings, 1996). Tight coupling occurs when organizations within a particular field have strong institutional logics and clear expectations of organizational behavior combined with highly specified mechanisms to monitor compliance (the state, professional associations, regulatory agencies) (Fligstein, 1991; Haveman, 1993; Hinings & Greenwood, 1988; Kikulis, Slack, & Hinings, 1995; Tolbert, 1985; Wholey & Burns, 1993; Greenwood & Hinings, 1996).

Research suggests institutional sectors vary in the degree to which they are linked or coupled. Fligstein (1991) states that the probability of “innovative behavior” is higher in “ill-formed” organizational fields (p. 361). Barnett and Carroll (1987) further substantiate these claims through their investigations of the founding years of the telephone industry, where high political discrepancies in the markets enabled multiple organizational forms to flourish. Specifically high political differentiation was related with low institutional consensus over organizational templates. Other research finds variation in practices in institutional fields that experience numerous sources of pressures presenting conflicting cues or signals, leaving opportunities for either conscious or inadvertent interpretations and actions (DiMaggio and Powell, 1991a; Scott, 1991; Powell, 1991; Oliver, 1991; D’Aunno et al., 1991).

The degree of tight coupling also influences the speed of logic dissemination, which impacts the likelihood of conformity in the field (Greenwood & Hinings, 1996). For instance, in mature sectors the logics are clear and thus institutional pressures for compliance are high. In highly structured sectors, such as government, regulatory pressures are typically certain and reinforced (Hinings & Greenwood, 1988b; Kikulis, Slack, & Hinings, 1995). Less mature industries lack clear leadership and an organized network of regulatory agencies (DiMaggio & Powell, 1983). The result is diversity in practices for organizing and reduced pressures to conform.

The state serves as a great source of stability in the field by defining and consistently enforcing the rules (Fligstein, 1991). Thus consensus in the regulatory environment should increase institutional pressures for conformity resulting in stability and constraints of deviation or manipulation by other organizations. Consensus

manifests in the regulatory environment both in regulation creation and enforcement. Consensus in regulation creation is evident in Congress' ability to garner the support required to pass legislation. Consensus in regulatory enforcement is revealed by shared attitudes toward regulation. So although pressures from the regulatory environment threaten managerial discretion and autonomy and firms may attempt to influence (firm lobbying) or co-opt (firm-regulator networks) these pressures, when the field experiences consensus or agreement in the beliefs or attitudes of those likely to impact rule creation and enforcement, there is more stability in the regulatory environment and innovative or manipulative behavior is constrained. Therefore I expect,

Hypothesis 4a: Congressional ability to mobilize will moderate the relationship between liberalism of congress and corporate lobbying contributions, such that this relationship will be less positive the stronger congress' ability to mobilize.

Hypothesis 4b: Regulator consensus will moderate the relationship between strong regulatory culture and the number of ties between firms and regulators, such that this relationship will be less positive the stronger the regulatory consensus.

Effects of Manipulation on the Appropriation of Firm Value

Law is rationalized by the societal needs for intervention in some areas of organizational life; however, it is constantly at risk of being usurped by its targets and leveraged against the common good it was supposed to protect (Edelman & Suchman, 1997). While some theoretical perspectives treat regulation as "explicit, authoritative, and coercive", empirical evidence suggests, in reality, the regulatory environment is "ambiguous, contested, and riddled with loopholes" (Edelman & Suchman, 1997: 487). The overarching theme is one of nonconformity, subversion, and circumvention (e.g., Kagan & Scholz, 1984).

Rational organizational actors are challenging to regulate partly because they lack the moral ideals that support individual-level compliance to law (Tyler, 1990), and partly

because management is insulated in organizational structures that protect them from their often lucrative transgressions (Edelman & Suchman, 1997). Since corporations cannot be imprisoned, and individual employees are rarely successfully prosecuted for corporate wrongdoing, corporate financial resources often are the primary method of exerting social control over organizations (Stone, 1975). Legal sanctions are usually too minor to significantly influence rational organizational behavior (Edelman & Suchman, 1997). Katz (1977) reveals how corporate executives effectively conceal regulatory violations from outside observation and scrutiny.

So the more management successfully manipulates regulatory pressures, the more latitude they gain to pursue their own self-interest. Once the key institutional actors accept the monetary contribution or the board appointment, the CEO is in a position to directly exert power or influence over them. The current legislators or ex-regulators may feel a closer bond with CEOs than with their previous employers and may begin to act on their behalf out of feelings of reciprocity (Gouldner, 1960; Cialdini, 2001), or the tendency to feel obligated to those who have provided favors, gifts or other benefits. The CEO and top management team influence the selection of board members, the attendant status and perks that accompany board membership (Westphal & Zajac, 1995; Zajac & Westphal,1996; Westphal & Stern, 2006; 2007). Further, research suggests that CEOs engage in ingratiation and persuasion tactics to maintain their power (Westphal, 1998). Research indicates that those who deviate from board norms or participate in governance changes that threaten managerial interests experience “social distancing” from other board members (Westphal & Khanna, 2003).

Institutional actors actively attempt to create an institutional environment that encompasses and protects their interests, that “parties often need institutions to help capture gains from cooperation” (Weingast, 2002: 670). Zajac and Westphal (1996) show that when constraints are lessened (i.e., when top management influence in strong) there are levels of diversification beyond which shareholder value is maximized. There is also a greater occurrence of greenmail transactions in manager-controlled firms, which further illustrates risk aversion and sub-optimizing shareholder value (Kosnik, 1990). Hence, the more successful the firm is in manipulating and effectively relieving these environmental constraints, the more discretion management should be able to recover in order to pursue their self-interested goals (e.g., extracting the maximum amount of firm value).

Hypothesis 5: Firm manipulation tactics will be positively associated with CEO excess returns.

Summary

Hypotheses were developed regarding the constraining effects of the regulatory environment, namely regulation creation and enforcement, on CEO excess returns and the mediating effects of firm manipulation responses to these regulatory pressures. The proposed firm tactics are firm lobbying contributions and the firm’s ties to key regulatory agencies, which offer insight into institutional power contestation. Hypotheses were also derived concerning the interaction effects of the stability of the environment on firm these responses. The following chapter discusses the methodology utilized to statistically examine the proposed relationships. Figure 2-1 presents the model of hypothesized relationships described in full throughout this chapter.

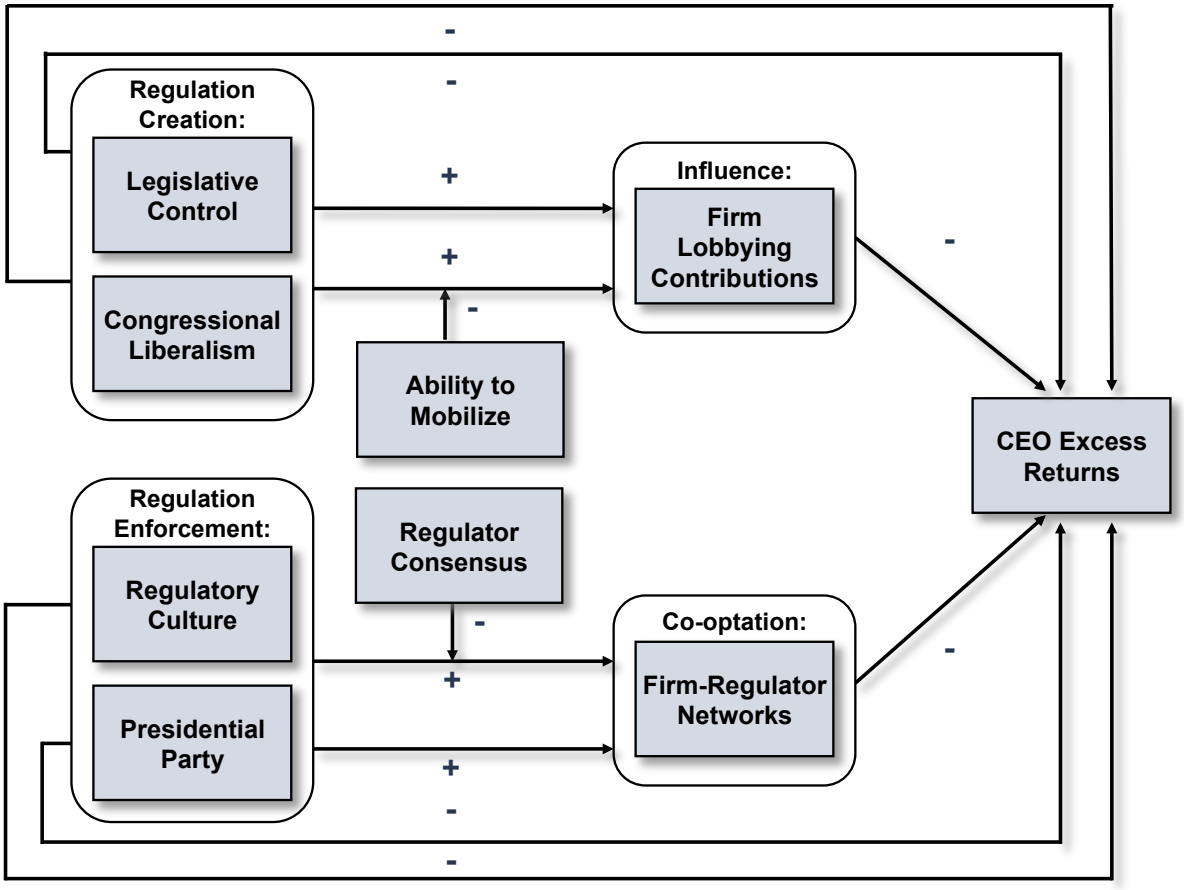


Figure 2-1. Hypothesized Model

CHAPTER 3
RESEARCH DESIGN

Sample and Data Collection

The dissertation sample consists of data of CEOs from the investment banking and related industries from 1992 to 2011 (see Table 3-1 for NAICS codes, descriptions, and sample firms). During the late 1990s and early 2000s, while firms and shareholders were experiencing record losses from mergers and acquisitions, investment bankers were experiencing record compensation gains, at least partly attributable to the corporate takeovers they orchestrated (Moeller, Schlingemann, & Stulz, 2005; Kaplan & Raugh, 2009). As such, this time period and context are particularly suitable for testing the theory and hypotheses regarding how management navigates the tension between regulatory pressures and managerial self-interest.

The data is an unbalanced panel data set, composed of observations across time nested within firms within their larger macro environment. The data consists of approximately 41 firms, and approximately 6.0 observations per firm, for a total of 245 observations across time. The data is archival and collected from several sources: Compustat, Execucomp, RiskMetrics, Congressional Nomination Hearing Transcripts, Regulator Annual Reports, Congressional Rating Reports from the The American Conservative Union, and Americans for Democratic Action, and OpenSecrets.org.

Table 3-1. NAICS Codes and Descriptions (Source: IBISWorld database)

NAICS Code		Description	Example Firms
523991	Trust, Fiduciary and Custody Activities	The US Custody, Asset and Securities Services industry is comprised of custodial bank and brokerage firms that primarily provide trust, fiduciary and custody services to corporations, investment funds and individuals. The majority of operations consist of back-office operations for the transaction of securities, including settlement, accounting and record-keeping. Other services include middle-office support such as securities lending, compliance pricing and performance analytics.	State Street Corp US Trust Corp Bankers Trust Corp
523110	Investment Banking and Securities Dealing	This industry comprises investment banks and firms that engage in investment banking activities. This includes corporate finance activities such as debt and equity underwriting, financial advisory services (M&As and IPOs) and corporate lending. Investment banks also undertake trading for clients and trade on their own account (principal trading). Other activities may include asset management, investment advice and securities services (prime brokerage).	JPMorgan Chase & Co Morgan Stanley Goldman Sachs Group Inc Citigroup Inc
523920	Portfolio Management	The industry comprises firms that actively manage assets for clients. Portfolio managers have the authority to make investment decisions and generate revenue through fees that are based on service and portfolio performance. This industry includes portfolio managers that manage assets for investment vehicles such as mutual funds, hedge funds and variable insurance products.	State Street Corp Blackrock Group
522220	Sales Financing	This industry includes businesses that provide sales financing or leasing. Sales financing establishments are primarily engaged in lending money for the purpose of providing collateralized goods through a contractual installment sales agreement. Industry participants generate revenue through the interest and fees that are included in the installment payments of borrowers.	Citgroup Inc
522291	Consumer Lending	The industry is comprised of nondepository enterprises that specialize in lending activity. Unlike banks and other traditional lenders, though, industry participants do not rely on deposits to issue loans. Instead, nondepository firms provide lending by selling securities (i.e. bonds, notes, stock) or insurance policies to the public. In addition to direct lending, participants also generate income by securitizing and selling mortgages and other loans on the secondary market.	American Express Co Citigroup Inc

Table 3-1. Continued

NAICS Code		Description	Example Firms
522320	Financial Transactions Processing, Reserve, and Cl	Establishments in this industry primarily engage in financial transaction processing, reserve and liquidity services, and check or other financial instrument clearinghouse services. The industry excludes electronic transactions associated with the US Federal Reserve (central bank).	American Express Co
511140	Database and Directory Publishers	This industry includes companies that publish organized compilations of information or facts. These collections may be published in print or electronic form. Electronic versions can be provided directly to customers by the publisher or offered through online services or third-party vendors. However, businesses that publish solely on the internet are excluded from this industry.	Bankrate Inc.
523210	Securities and Commodity Exchanges	This industry provides physical trading floors or electronic marketplaces for the buying and selling of securities, which include stocks, stock options, bonds, and futures and commodity contracts. The industry includes exchanges and electronic communication networks, as well as institutional and individual securities brokers who match buyers and sellers of securities in off-exchange transactions.	Intercontinential Exchange Inc. The Nasdaq Stock Market Inc. CME Group Inc.
523120	Securities Brokerage	This industry comprises brokers that act as agents between buyers and sellers of securities on a commission or transaction-fee basis. Companies primarily engaged in investment banking and the buying and selling of securities on their own accounts are not included.	Edwards (A G) Inc SWS Group Inc
523930	Investment Advice	The industry comprises firms and individuals that provide financial planning, financial advice and wealth management to individuals and business clients. Firms provide advice in conjunction with other activities such as portfolio management, protection planning and brokerage services. This industry does not include mutual fund companies, hedge funds, discount brokers, insurance brokers or other companies that provide these services outside the context of a written financial plan.	Morgan Stanley Price (T. Rowe) Group Ameriprise Financial Inc.

Variable Descriptions and Operationalizations

This section defines and operationalizes the independent variables as well as the moderating variables, the dependent variables, and each of the control variables.

Independent Variables

Regulation creation

Regulatory pressures from the institutional environment were captured by first examining the creation of regulation, which measures both legislation control and the congressional liberalism. Legislative control is described as whether recent legislation was passed in the current year, which either reduced or expanded managerial discretion or the latitude of actions of management. The measure of legislative control is a dummy variable and coded 1 if restricting legislation was passed during the current year and 0 otherwise. Examples of the legislation are coded as either discretion-reducing or -expanding below in Table 3-2.

Congressional liberalism is measured using ratings collected from then annual congressional rating reports published by the Americans for Democratic Action (ADA: www.adaction.org) and The Americans for Conservative Union (ACU: www.conservative.org). Each year the ADA's Legislative Committee selects 20 key votes during that congressional session that cover a range of social and economic issues. Each candidate receives 5 points per vote he or she casts consistently with the ADA position and opinions (total of 100 points). The measure is called the Liberal Quotient (LQ) and is designed to capture each official's political position. These data were supplemented with similar ratings from The American Conservative Union which rates Congress based on their votes on ideologically important issues and again is a score out of 100. I created an annual composite score for the Senate and House of

Representatives by averaging the ADA rating and the inverse of the ACU rating. I calculated inter-rater reliability scores to verify the appropriateness of aggregation and all results supported aggregating the scores from each rating organization (ICC(1) = 60; ICC(2)=75; r_{wg} = .95) (James, 1982). This scoring system is superior to simply using the majority party as a proxy of liberalism as it actually captures voting behavior, which reveals whether congressional members are indeed voting along party lines.

Table 3-2. Banking Legislation Examples (Source: FDIC)

Legislation	Summary	Discretion
Gramm-Leach-Bliley Act of 1999	Repeals the remainder of the Glass Steagall Act of 1933. Allows affiliations between banks and insurance underwriters. The act prohibits state actionsfrom preventing bank-affiliated firms from selling insurance on an equal basis with other insurance agents. Allows national banks to underwrite municipal bonds.	Enhancing
Dodd-Frank Wall Street Reform and Consumer Protection Act	Increasing oversight of specific institutions regarded as a systemic risk, amending the Federal Reserve Act, promoting transparency, and additional changes. The Act purports to provide rigorous standards and supervision, creates rules on executive compensation and corporate governance, and eliminates some loopholes that led to the 2008 economic recession. All of the new agencies, and some existing ones that are not currently required to do so, are also compelled to report to Congress on an annual (or biannual) basis.	Reducing

Regulation enforcement

Regulatory pressures are subsequently investigated by capturing the extent to which regulation is likely to be enforced and includes regulatory culture and presidential party. The degree to which the current regulatory culture is favorable to management is captured using the Linguistic Inquiry Word Count (LIWC) program to analyze the congressional nomination hearings of key regulators (e.g., SEC, Federal Reserve, US Treasury). The degree to which regulatory culture exerts pressure on firms is a function of the non-cooperative attitudes of regulators (Weidenbaum, 1981) and degree of regulatory stringency (Fennel & Alexander, 1987). Fennell and Alexander (1987) refer to

the complexity or burden of the regulatory environment as regulatory stringency. High regulatory stringency refers to especially broad or severe regulatory pressures experienced by organizations (e.g., a large number of rules or regulations) that potentially impede organizational autonomy or efficiency (Oliver, 1997).

I created a word bank (Table 3-3 below) to assess regulatory language, which would indicate the degree regulatory stringency, or the extent to which the firm's behavior is constrained (Oliver, 1997), within the environment. Next, I analyzed the attitude of regulators towards regulation by the relative positive affective language used in each transcript of the nomination hearings. The LIWC program has a dictionary of more than 900 affective words that can be used to analyze the language in each transcript. It calculates the degree to which people use different categories of words across a wide array of texts. LIWC will determine the rate at which the regulators use positive emotion words (Pennebaker, Booth, & Francis, 2007) (see http://www.liwc.net for additional information on the internal and external validity of LIWC's dictionaries). I then created a ratio of positive to total affective language for each transcript, since only a raw score could be misleading as some transcripts could have both high levels of positive and negative language, resulting in a more balanced affective perspective in the end (Pollock & Rindova, 2003; Rindova, Petkova, & Kotha, 2007; Tetlock, Saar-Tsechansky, & Macskassy, 2008; Pfarrer, Pollock, & Rindova, 2010).

Next I measure presidential party by using the president's political party affiliation as a proxy for the extent to which he supports regulation of business. Similar to the measure of congressional liberalism, I assume the traditionally conservative party (i.e., the Republicans) supports the principles of The American Conservative Union (e.g., free

trade and a belief in the non-interference of government in business affairs) and the traditionally liberal party (i.e., the Democrats) encourages more government participation in the private sector. Presidential party is a dummy variable, which I code 1 if the president's political affiliation is Democrat and 0 otherwise.

Table 3-3. Regulatory Stringency Word Bank

Stringency	severity, strict, strictness, rigor, harsh, harshness, inflexibility, rigid, rigidity, tough, toughness, thoroughness, consistency, precision, accuracy, care, objectivity, exactitude, exact, attention, scrupulous, attention to detail, restriction, stiffness, firm, firmness, intolerance, stern, steadfastness, resolve, insistance, resolution, strength, safety, discipline, meticulousness, carefulness, careful, serious, seriousness, gravity, relentless, ceaseless, unremitting, persistence, intensity, steadiness, decisiveness, decisive, authoritative, resolute
Control	power, skill, limit, influence, restraint, regulate, regulator, controller, control, resist, resistor, jurisdiction, rule, dominate, domination, hegemony, manage, management, direct, direction, charge, running, skill, manipulation, manipulate, handling, expertise, skillfulness, limit, limitation, constraint, constrain, restrict, restriction, restraint, restrain, regulation, check, curb, inspect,command, sway, discipline, maneuver, manage, organize, run, direct, command, supervise, dictate
Restriction	limit, constraint, restraint, control, ceiling, curb, check, limitation, curtain, reduce, rein in, hold back, inhibit, decrease, constrain, hinder, prevent, impede, obstruct, bar, deter, stop, hamper, encumber, thwart, confine, constrict, stop, avert, avoid, foil, counteract, block, discourage, dissuade, warn

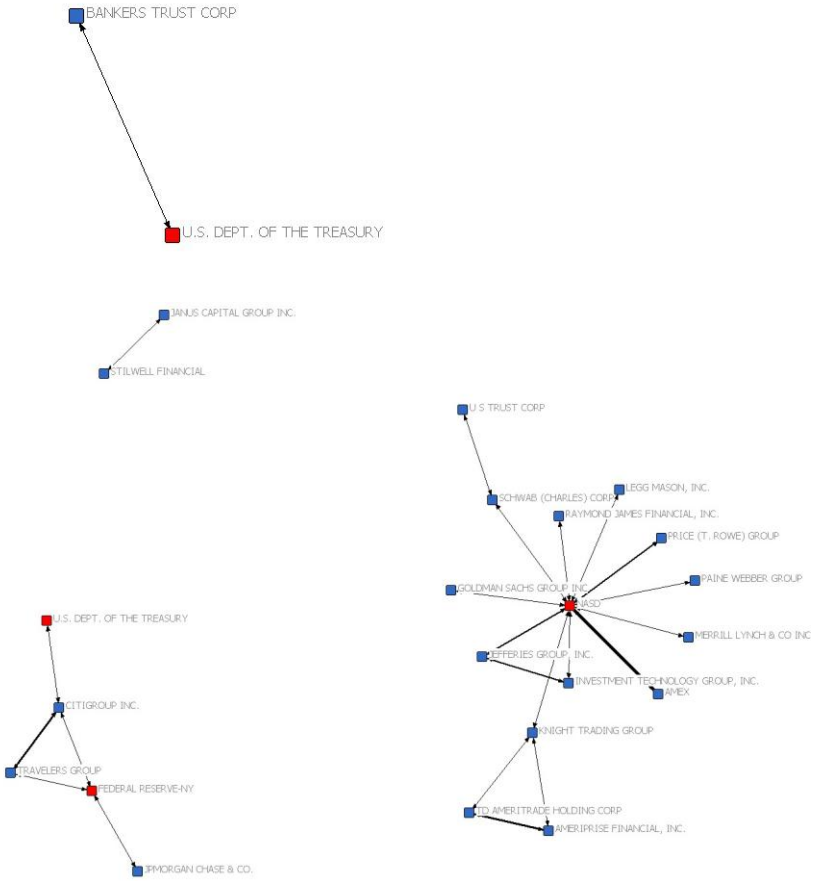
Corporate manipulations

Corporate manipulations of regulatory pressures are defined as attempts to corrupt or influence the regulation creation or co-optation of regulation enforcement. Influence is measured by firm-level lobbying contributions, which I collected from OpenSecets.org, Center for Responsive Politics. This is a research group, which tracks the source of funding in U.S. politics (www.opensecrets.org). Lobbying contributions are available from 1998 to 2011.

The second type of corporate manipulation I capture in this study is the co-optation of regulatory pressures. Co-optation is measured by the number of ties between the focal firm and key regulators. I collected data of past commissioners, officers, and board members of regulatory bodies. These included governmental agencies such as the Securities and Exchange Commission (SEC), Federal Reserve, U.S. Treasury, and non-governmental agencies such as the New York Stock Exchange (NYSE) and the Financial Industry Regulatory Authority (FINRA). Although the SEC is the primary regulator of the U.S. securities markets it works directly with other institutions, including congress, other federal departments, self-regulatory organizations (e.g. stock exchanges), state securities regulatory agencies, and other non-governmental regulatory agencies (e.g., FINRA). Specifically, the Chairman of the SEC, the Chairman of the Federal Reserve, the Secretary of the Treasury, and the Chairman of the Commodity Futures Trading Commission, serve on the President's Working Group on Financial Markets. (http://www.sec.gov/about/whatwedo.shtml). See Table 3-4 for a description of the regulatory authority of each of the agencies included in this study.

I created a network between firm executives, board members and key regulators based upon the employment of these individuals in regulatory and investment banking

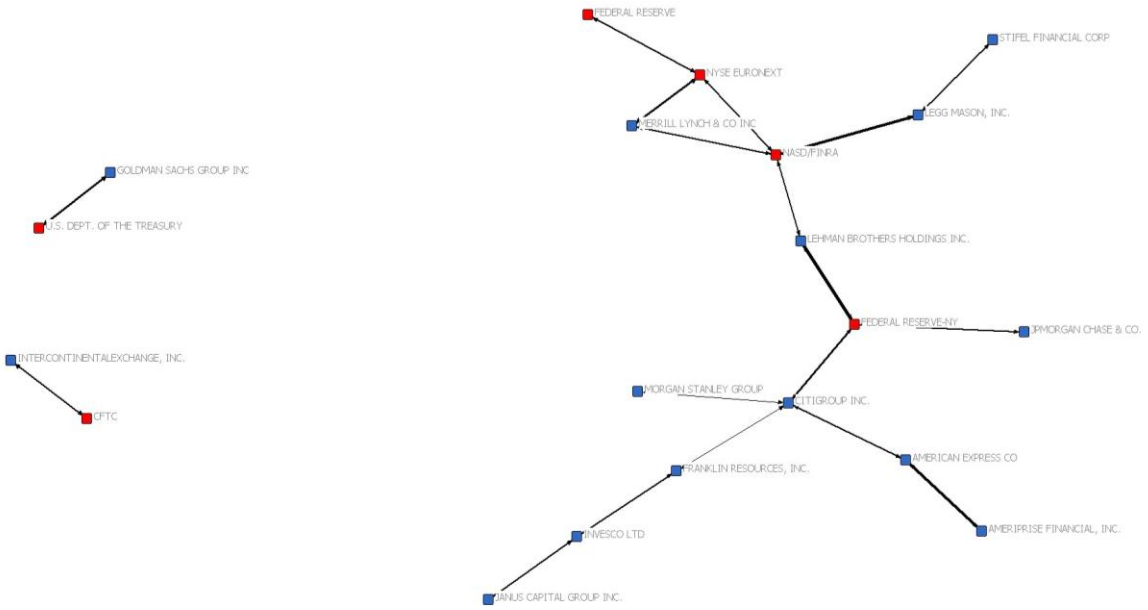
firms. Each network was lagged 3 years to measure the dynamic ties between investment banking firm and regulators. The ties need to be long enough to capture relationships but short enough to account for the dissolution of relationships as employment status changes. Network models reveal the firm-regulator network structures, and specifically how the number of ties changes over time. See Figure 3-1 below for an illustration of the different network structures (i.e., number of ties is represented in the thickness of the ties between nodes).



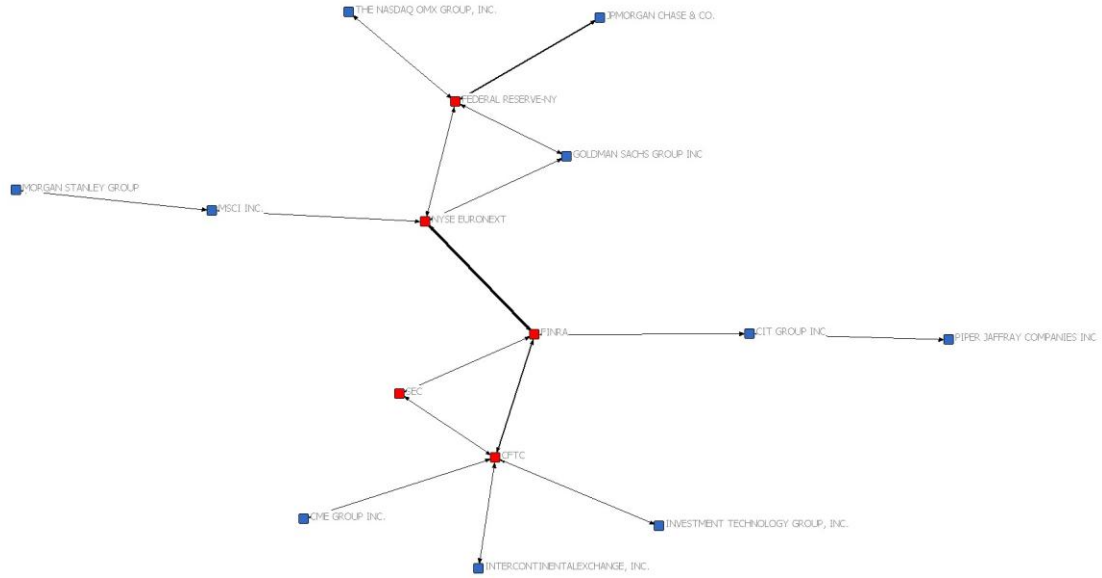
A

B

Figure 3-1. Firm-Regulator Network Structure. A) 1992-1995, B) 1998-2001, C) 2004-2007 and D) 2008-2011. (Note: the red nodes represent regulatory agencies and blue nodes represent firms in the investment banking and related industries; line thickness represents the number of ties between the respective organizations)



C



D

Figure 3-1. Continued

Table 3-4. Regulatory Agencies and Authority

Regulator	Regulatory Authority	Source
Security and Exchange Commission (SEC)	The mission of the U.S. Securities and Exchange Commission is to protect investors, maintain fair, orderly, and efficient markets, and facilitate capital formation.	http://sec.gov/about/annrep.shtml
Federal Reserve	Federal Reserve's duties: 1. Conducting the nation's monetary policy by influencing the monetary and credit conditions in the economy in pursuit of maximum employment, stable prices, and moderate long-term interest rates 2. Supervising and regulating banking institutions to ensure the safety and soundness of the nation's banking and financial system and to protect the credit rights of consumers 3. Maintaining the stability of the financial system and containing systemic risk that may arise in financial markets 4. Providing financial services to depository institutions, the U.S. government, and foreign official institutions, including playing a major role in operating the nation's payments system	http://www.federalreserve.gov/pf/pf.htm
Federal Reserve Bank of NY	In addition to responsibilities the New York Fed shares in common with the other Reserve Banks, the New York Fed has several unique responsibilities, including conducting open market operations, intervening in foreign exchange markets, and storing monetary gold for foreign central banks, governments and international agencies. Foremost among its functions is the implementation of monetary policy, one of the three missions of the New York Fed. The other two are supervision and regulation, and international operations.	http://www.newyorkfed.org/aboutthefed/whatwedo.html
US. Treasury	The basic functions of the Department of the Treasury include: 1. Managing Federal finances; 2. Collecting taxes, duties and monies paid to and due to the U.S. and paying all bills of the U.S.; 3. Currency and coinage; 4. Managing Government accounts and the public debt; 5. Supervising national banks and thrift institutions; 6. Advising on domestic and international financial, monetary, economic, trade and tax policy; 7. Enforcing Federal finance and tax laws; 8. Investigating and prosecuting tax evaders, counterfeiters, and forgers.	http://www.treasury.gov/about/role-of-treasury/Pages/default.aspx

Table 3-4. Continued

Regulator	Regulatory Authority	Source
Financial Industry Regulatory Authority (FINRA; formerly NASD)	FINRA touches virtually every aspect of the securities business—from registering and educating industry participants to examining securities firms; writing rules; enforcing those rules and the federal securities laws; informing and educating the investing public; providing trade reporting and other industry utilities; and administering the largest dispute resolution forum for investors and registered firms. We also perform market regulation under contract for the major U.S. stock markets, including the New York Stock Exchange, NYSE Arca, NYSE Amex, The NASDAQ Stock Market and the International Securities Exchange.	http://www.finra.org/AboutFINRA/
Commodity Futures Trading Commission (CFTC)	Congress created the Commodity Futures Trading Commission (CFTC) in 1974 as an independent agency with the mandate to regulate commodity futures and option markets in the United States. The agency's mandate has been renewed and expanded several times since then, most recently by the Commodity Futures Modernization Act of 2000. The CFTC's mission is to protect market users and the public from fraud, manipulation, abusive practices and systemic risk related to derivatives that are subject to the Commodity Exchange Act, and to foster open, competitive, and financially sound markets.	http://www.cftc.gov/About/MissionResponsibilities/index.htm
New York Stock Exchange (NYSE)	NYSE Regulation, Inc., is a not-for-profit corporation dedicated to strengthening market integrity and investor protection. In addition to its regulatory responsibilities to enforce marketplace rules and federal securities laws of the New York Stock Exchange, NYSE Regulation oversees NYSE Arca Regulation and NYSE Amex Regulation through regulatory services agreements. Financial Compliance reviews a company’s reported financial results both at the time of joining the Exchange and throughout its listing to ensure that it meets original-listing and continued-listing requirements. Corporate Compliance ensures that listed companies adhere to the highest standards of accountability and transparency, including enhanced governance requirements for configuration of corporate boards, director independence and financial competency on audit committees. Protects investors by monitoring member companies	http://usequities.nyx.com/regulation/nyse-regulation/overview

Consensus in the regulatory environment

Consensus in the regulatory environment is defined as the extent to which regulatory pressures or power is stabilized in the organizational field (Fligstein, 1991) and measured by the congressional ability to mobilize and regulatory consensus (agreement). Ability to mobilize is captured by the number of congressional bills passed annually. While congressional liberalism is one source of regulatory pressures, these pressures are amplified by the ability of the dominant ideology to materialize in legislation. Regulator consensus is measured as the variance, or rather lack of variance, in the level of regulatory stringency and positive attitudes towards regulation across regulators in that year. A lower score suggests a higher level of consensus in the regulatory environment.

Dependent Variables

CEO excess returns. To measure the appropriation of firm value by management I calculated CEO excess returns following the methods of Kolev and colleagues (2011). First, I measure shareholder returns by summing dividends paid plus the change in the share price from the beginning of the fiscal year to the end, and then divide this sum by the share price at the beginning of the fiscal year (Yermack, 2006). The same approach is used to calculate CEO returns. All types of compensation awarded to the CEO are totaled. This total incorporates annual salary, cash bonuses, other annual compensation, long-term incentive awards, payment of unrestricted equity, and changes in the value of all stock-based components at the end of the fiscal year (e.g., stock options, restricted stock, and ownership) (Nyberg et al., 2010; Kolev et al., 2011). This number is then divided by the amount of firm wealth at the start of the fiscal year (e.g., stock, restricted stock, vested stock, and stock options) (Nyberg et al., 2010; Kolev et

al., 2011). Income from all stock sold is not included in this measure as I made a conservative assumption that the stock and options were valued at the time they were issued. Next both CEO returns and shareholder returns are transformed through an inverse hyperbolic sine function (IHS):

$$\sinh^{-1}(x) = \log(x + (x^2 + 1)^{1/2})$$

The main purpose of the HIS transformation is to reduce the impact of extreme observations and to address issues associated with transforming negative values (Burbidge, Magee, and Robb, 1988; Nyberg et al., 2010; see Carroll, Dynan, and Drane, 2003; Pence, 2006). This is important as both shareholder returns and CEO returns are skewed and have observations with negative values. Burbidge et al. (1988) suggested that the HIS transformation is likely more appropriate than Box-Cox transformations when estimating values like net worth that may be negative. The HIS transformation provides a means of estimating percentage change interpretation by performing a logarithmic transformation (Pence, 2006).

Subsequently, I regressed the transformed CEO returns on the transformed shareholder returns measure. The residuals became the dependent variable and represent CEO returns not explained by changes in shareholder returns. Positive residuals suggest CEO returns exceed the returns expected based upon shareholder returns while negative returns suggest the opposite. This approach is superior to creating a ratio of CEO returns to that of shareholder (c.f. Nyberg et al., 2010), as ratio variables have been found to exaggerate relations of interest leading to biased and unstable results in multiple regression (Wiseman, 2009).

Control Variables

I included a number of control variables in the analysis that could possibly affect my variables of interest. First, I controlled for total revenues of the focal firm in the beginning of the year as firm size is a known predictor or executive pay (Tosi et al., 2000) and CEO compensation is included in the measure of CEO returns. I also ran the models with total assets as a measure of firm size as both measures are common in the literature examining the investment banking industry (e.g., De Bandt & Davis, 2000; Fields & Fraser, 1999). Both measures yielded similar results. The models including total revenues are reported below. Next I controlled for firm risk or volatility (Aggarwal & Samwick, 1999) as riskier firms may command a higher CEO return (Nyberg et al., 2010). Performance volatility is calculated as the 60 month moving average of stock price volatility (Bekaert, Harvey, Lundblad, & Siegel, 2007). I included a measure of return on assets (*ROA*) to control for the influence of accounting performance on elements of executive pay, particularly CEO bonuses, included in CEO returns. ROA is a widely used measure of firm performance (Combs, Crook, and Shook, 2005). It reflects how well firms use their assets in creating profits and is not influenced by the firm's capital structure. ROA has also been used in other studies of investment banks as a measure of performance (e.g., Bonin, Hasan, & Wachtel, 2005; Simpson & Kohers, 2002, DeYoung, 2005). To account for CEO power, its influence on CEO pay and consequently CEO returns, I controlled for CEO tenure, the number of years a CEO has been in office at the focal firm (Sanders & Carpenter, 1998).

Originally dummy variables for each year were included to control for unobserved macroeconomic effects on CEO excess returns. However, these variables were highly and significantly correlated with the measures of the regulatory environment, suggesting

these variables capture much of the same fluctuations in the macro environment as the year variables. All dollar values were fixed at 2011 prices to control for inflation over the sample period. Finally in an effort to control for the role of governance mechanisms in constraining managerial opportunism I included CEO non-duality as a control. CEO non-duality is coded 0 if the CEO also holds the chairman position and 1 otherwise. I ran additional analyses including alternative measures of governance mechanisms (e.g., committee independence, compensation committee independence, and the proportion of board outsiders) and the results were consistent. Full committee and compensation committee independence is coded 1 for a board with neither insiders nor related outside directors on and functional committee or specifically the compensation committee, and 0 otherwise (Kolev et al., 2011). Board outsiders is calculated as the percentage of board members that are neither 'inside' nor directors with economic ties to the firm outside of their directorship (Dalton et al., 1998).

I did encounter issues with missing data from the governance control variables. The Little chi-square statistic determined the missing observations were not missing completely at random (MCAR) ($p<.001$). Further examination of the missing data revealed that on average the firms missing information for the governance variables were smaller in size and less risky. As this does not appear to be random, multiple imputation should not be used to estimate the missing data; these missing observations were deleted from the data set. It is important to note that this could limit the generalizability of the findings, as such it is also important to investigate the impact of the regulatory environment on governance in smaller firms.

Analytical Methods

Most models were tested using a fixed effects panel regression model as it is the most appropriate for this type of data. There was no reason to believe unexpected systematic variance occurred in the model, which provided support for the fixed effects model. Fixed effects models allowed me to examine the firm effects, which are specific to each individual firm (i.e. differ among firms in time (t) or time (t-1)) but are the same or fixed across cross-sectional units. I examined exogenous variables that differed among firms and showed variation over time as well as variables that are specific to the *i*th unit and stay relatively stable over time (Hsiao, 2003). The fixed effects model controls for all unobserved factors at the macro level. To control for unobserved firm-specific effects, I clustered the observations at the firm level and used the robust variance estimator to correct for the autocorrelations caused by clustering (Newey & West, 1987). The fixed effects model is also more conservative than the random effects model, which lends more confidence in my findings. Because the number of firm-regulator network ties is a count variable I estimated this model with using Poisson regression and used a population-averaged model that uses generalized estimating equations (GEE) to adjust for correlations between independent variables and firm fixed-effects. I used robust standard errors to calculate the statistical significance of the regression coefficients. For a robustness check I also estimated this model with a fixed effects panel regression, which generated essentially the same results.

Summary

This chapter describes the operationalization of all the variables included in the study. Of particular interest is the conceptualization of the regulatory environment. The

next chapter presents the results of the analyses from the fixed effects panel regression.

CHAPTER 4
RESULTS

The descriptive statistics and inter-correlations for all variables in the study are reported in Table 4-1. Tables 4-2 through 4-4 list the findings of the analyses of the impact of pressures from the regulatory environment on CEO excess returns as well as firm responses to those pressures. Results are reported similarly in each table. In each table I report the results from the analysis first without governance controls and then with them as their inclusion causes a significant drop in observations. There was variation in the findings, which I will discuss in more detail throughout this chapter.

Results of Analyses

Sources of Regulatory Pressure

Table 4-2 reports the panel regression results for the influence of the regulatory environment on CEO excess returns among U.S. firms in the investment banking and related industries from 1992 to 2011. Model 1 and Model 2 include only the control variables. Models 3 and 4 introduce the independent variables that capture the pressures from the regulatory environment. Hypothesis 1a states that legislative control is negatively associated with excess CEO returns. Recent legislation that acts as a constraint on management and reduces managerial discretion and power should result in shareholders receiving more of the residual firm value than management, and in fact this is supported in the results found in Model 3 and Model 4 (with governance controls). Legislative control is negatively associated with CEO excess returns (Model 3: $b = -0.37^{**}$, $p<0.01$; Model 4: $b = -0.38^{*}$, $p<0.05$).

Hypothesis 1b predicts congressional liberalism is negatively associated with excess CEO returns. A dominant ideology supporting regulation can threaten firms with

the potential to pass restricting regulation and result in management fulfilling their contractual obligation to firm owners preemptively. This hypothesis was also supported (Model 3: b = -1.95*, p<0.05; Model 4: b = -1.87†, p<0.10).

Hypothesis 2a proposes a strong regulatory culture is negatively associated with CEO excess returns. A strong regulatory culture is conceptualized as a positive attitude toward regulation and is captured through high levels of positive emotion and an emphasis on stringency in their nomination transcripts. I found mixed support for this hypothesis. There was a significant negative relationship between positive attitudes towards regulation and CEO excess returns. However, there were only significant results for Model 4 with the additional governance control variables (Model 3: b = -3.37, p>0.10; Model 4: b = -9.51†, p>0.01). There is a significant positive relationship between regulator stringency and CEO excess returns but this result was only significant for Model 3 without governance controls (Model 3: b = 5.85**, p<0.01; Model 4: b = 4.52, p>0.10).

Hypothesis 2b is the final hypothesis tested in Models 3 and 4. This hypothesis suggests executive regulatory support is negatively related to excess CEO returns. Executive regulatory support should offer additional stability to the field, encouraging compliance among actors, and effectively reducing the managerial appropriation of firm value at the expense of shareholders. This hypothesis was not supported (Model 3: b = 0.10, p>0.10; Model 4: b = 0.18, p>0.10).

Table 4-1. Descriptive Statistics and Correlations[ab]

Variables	n	Mean	s.d.	1	2	3	4	5	6
1. CEO Excess Return	432	1.16	0.77						
2. Legislative Control	432	0.16	0.37	-0.08					
3. Presidential Party	432	0.51	0.50	0.17	0.02				
4. Regulatory Culture - Positive Attitudes	432	0.80	0.01	-0.15	0.08	-0.54			
5. Regulatory Culture - Stringency	432	0.55	0.04	0.09	0.32	0.24	0.18		
6. Congressional Liberalism	429	0.50	0.05	-0.18	-0.08	-0.08	0.09	0.25	
7. Firm Lobbying Contributions[c]	429	0.38	0.89	-0.03	0.09	-0.08	0.16	0.16	0.08
8. Firm Network Ties	432	0.75	2.50	-0.04	0.00	-0.05	0.15	-0.07	-0.06
9. Annual Bills Passed	432	223.02	75.56	-0.04	-0.03	-0.19	0.04	-0.10	0.04
10. Regulator Consensus[d]	432	0.06	0.01	0.17	0.31	**0.75**	**-0.63**	0.45	-0.05
11. CEO Tenure	420	8.48	9.90	-0.04	-0.04	0.11	-0.11	-0.12	-0.05
12. Volatility	251	6.72	8.04	-0.04	0.12	0.00	0.12	0.17	0.10
13. ROA	432	5.85	8.37	0.08	0.02	-0.10	0.1	-0.10	-0.08
14. Revenue[c]	429	8.65	17.24	-0.04	-0.02	-0.13	0.14	-0.03	-0.03
15. CEO Non-Duality	210	0.32	0.47	-0.05	-0.01	0.11	0.01	0.15	0.28
16. Committee Independence	211	1.77	1.77	-0.01	-0.09	0.00	-0.08	0.25	0.23

Variables	7	8	9	10	11	12	13	14	15
1. CEO Excess Return									
2. Legislative Control									
3. Presidential Party									
4. Regulatory Culture - Positive Attitudes									
5. Regulatory Culture - Stringency									
6. Congressional Liberalism									
7. Firm Lobbying Contributions[c]									
8. Firm Network Ties	0.09								
9. Annual Bills Passed	0.03	0.05							
10. Regulator Consensus[d]	-0.02	-0.14	-0.21						
11. CEO Tenure	-0.18	0.06	0.01	0.02					
12. Volatility	0.47	0.10	-0.03	0.05	-0.04				
13. ROA	-0.18	-0.02	0.08	-0.11	0.2	-0.07			
14. Total Revenue[c]	0.47	0.17	0.04	-0.14	-0.19	0.13	-0.26		
15. CEO Non-Duality	-0.11	-0.02	-0.08	0.04	-0.25	-0.08	0.21	-0.2	
16. Committee Independence	0.11	-0.07	0.00	0.10	-0.38	-0.02	-0.38	0.10	-0.01

[a]All dollar amounts are in constant 2011 dollars
[b]Values above absolute values of .10 are statistically significant at $p < .05$
[c]Measured in millions
[d]This is measure is variance in regulator attitudes; high values represent lower consensus

Table 4-2. Results – Sources of Regulatory Pressures

	CEO Excess Returns[b]							
Predictors	**Model 1**		**Model 2**		**Model 3**		**Model 4**	
Controls								
Intercept	1.09***	(0.21)	1.31***	(0.34)	1.57	(2.16)	7.63*	(3.49)
CEO Tenure	0.00	(0.01)	0.00	(0.01)	-0.00	(0.01)	-0.00	(0.01)
Volatility	-0.03†	(0.02)	-0.05†	(0.03)	-0.05**	(0.02)	-0.05*	(0.02)
ROA	0.04	(0.02)	0.01	(0.01)	0.05*	(0.02)	0.01†	(0.01)
Total Revenue	-0.01	(0.00)	-0.01	(0.00)	-0.01	(0.01)	-0.01	(0.01)
CEO Non-Duality			-0.18	(0.22)			-0.19	(0.23)
Committee Independence			-0.02	(0.08)			-0.11	(0.10)
Predictors								
Legislative Control					-0.37**	(0.13)	-0.37*	(0.14)
Congressional Liberalism					-1.95*	(0.83)	-1.87†	(0.96)
Regulatory Culture - Positive Attitudes					-3.37	(3.21)	-9.51**	(2.95)
Regulatory Culture - Stringency					5.85**	(1.77)	4.52	(3.21)
Presidential Party					0.10	(0.13)	0.18	(0.25)
N	245		146		245		146	
R^2	0.01		0.00		0.03		0.03	
Adj. R^2(within)	0.06		0.06		0.16		0.24	
F	1.64		2.46*		2.78*		9.68***	

[b]Transformed using the inverse hyperbolic sine function (IHS)

† p < .10
* p < . 05
** p < . 01
*** p < .001

Strategic Responses to Regulatory Pressure

Table 4-3 presents the panel regression results for the regulatory environment effects on firm-level lobbying. To the extent the regulatory environment reduces managerial discretion and threatens the autonomy of the organization's management, one would expect to see the level of resistance to these pressures by the firm also increase. Model 5 regresses firm lobbying contributions on the regulatory environment variables. Hypothesis 3a predicts a positive relationship between legislative control and firm political contributions and is supported by the results (Model 5: $b = 0.13^{**}$, $p<0.01$). Hypothesis 3b suggests there should be a positive association between congressional liberalism and firm lobbying contributions and again this is supported by the findings in Model 5 (Model 5: $b = 1.36^{*}$, $p<0.05$).

Table 4-4 presents the results of Model 8 where firm-regulator networks were regressed on the various sources of regulatory pressures. Hypothesis 3c posits a strong regulatory culture will be positively associated with the presence of ties between regulators and the focal firm. I found a significant positive relationship between positive attitudes toward regulation and firm-regulator networks (Model 8: $b = 61.03^{**}$, $p>0.01$). However, the relationship between regulatory stringency and networks was not significant ($b = -9.38$, $p>.10$). Hypothesis 3d predicts a positive relationship between executive regulatory support and the presence of ties between the focal firm and key regulators. The results did not support this contention (Model 8: $b = 0.74$, $p>0.10$).

Table 4-3. Results – Strategic Responses: Firm-Lobbying Contributions

	Firm Lobbying Contributions					
Predictors	**Model 5**		**Model 6**		**Model 7**	
Controls						
Intercept	-2.12	(1.62)	-2.19	(1.64)	-2.51	(1.71)
ROA	0.00	(0.00)	0.00	(0.00)	0.00	(0.00)
Total Revenue	0.02†	(0.01)	0.02†	(0.01)	0.02†	(0.01)
Predictors						
Legislative Control	0.13**	(0.04)	0.13**	(0.04)	0.16**	(0.05)
Congressional Liberalism	1.36*	(0.58)	1.35*	(0.58)	4.33†	(2.16)
Regulatory Culture - Positive Attitudes	0.73	(1.92)	0.79	(1.96)	-0.41	(1.76)
Regulatory Culture - Stringency	1.89*	(0.80)	1.89*	(0.81)	1.69*	(0.83)
Presidential Party	0.04	(0.04)	0.04	(0.04)	0.00	(0.05)
Mobility of Congress			0.00	(0.00)	0.01	(0.00)
Regulator Consensus						
Congressional Liberalism x Mobility					-0.01	(0.01)
Regulatory Culture x Consensus						
N	429		429		429	
R^2	0.24		0.24		0.25	
Adj. R^2(within)	0.15		0.15		0.16	
F (Chi^2)	2.48*		2.26*		2.15*	

† p < .10
* p < . 05
** p < . 01
*** p < .001

Table 4-4. Results – Strategic Responses: Firm-Regulator Networks

	Firm-Regulator Network Ties[a]					
Predictors	**Model 8**		**Model 9**		**Model 10**	
Controls						
Intercept	-44.04*	(19.51)	-30.96*	(13.67)	288.54*	(134.84)
ROA	0.01	(0.02)	0.01	(0.03)	0.01	(0.03)
Total Revenue	0.02***	(0.01)	0.02***	(0.01)	0.02***	(0.01)
Predictors						
Legislative Control	-0.13	(0.56)	0.19	(1.12)	-0.03	(0.98)
Congressional Liberalism	-2.31	(2.13)	-2.57	(2.17)	-2.31	(2.06)
Regulatory Culture - Positive Attitudes	61.03**	(22.44)	45.77**	(13.83)	-349.87*	(167.29)
Regulatory Culture - Stringency	-9.38	(6.37)	-7.05	(7.81)	-6.09	(11.00)
Presidential Party	0.74	(0.71)	1.04	(1.21)	0.80	(0.93)
Mobility of Congress						
Regulator Consensus			-39.07	(65.60)	-5711.65*	(2475.97)
Congressional Liberalism x Mobility						
Regulatory Culture x Consensus					7021.92*	(3018.09)
N	429		429		414	
R^2						
Adj. R^2(within)						
F (Chi^2)	109.30***		117.60***		16.81*	

[a]Dependent variable, the number of ties between the focal firm and a regulatory agency, is a count variable; results are from a GEE population-averaged model panel poisson regression

† p < .10
* p < . 05
** p < . 01
*** p < .001

Consensus in the Regulatory Environment

Models 6 and 7 further investigate the relationship between firm lobbying contributions and the regulatory environment by introducing the moderating variable and product term, into the respective models. Hypothesis 4a suggests that congressional mobility will moderate the relationship between congressional liberalism and corporate lobbying contributions, such that this relationship will be less positive the stronger Congress' ability to mobilize. Consensus in the legislative body should increase institutional pressures for conformity and manifest as stability and a constraint on agentic behavior (e.g., deviations or manipulations) by other organizations. However this hypothesis was not supported ($b = -0.01$, $p>0.10$).

The association between firm-regulator networks and regulatory pressures and are presented in Models 9 and 10; the moderating variable and product term are added into the respective models. Hypothesis 4b predicts that regulator consensus will moderate the relationship between a strong regulatory culture and the presence of ties between firms and regulators, such that this relationship will be less positive the stronger the regulatory consensus. Highly structured sectors, such as government, regulatory pressures are typically certain and reinforced (Hinings & Greenwood, 1988b; Kikulis, Slack, & Hinings, 1995). Again I expected agentic behavior to be less likely in these more structured environments. This hypothesis was supported, however, the model is confounded with multicollinearity as evidenced by the extreme coefficients and standard errors, and therefore should be interpreted with caution ($b = 7021.92^*$, $p<0.05$).

Table 4-5. Results – Effects of Manipulation on the Appropriation of Firm Value

	CEO Excess Returns[b]											
Predictors	**Model 11**		**Model 12**		**Model 13**		**Model 14**		**Model 15**		**Model 16**	
Controls												
Intercept	1.40	(2.13)	7.68†	(3.95)	1.57	(2.32)	7.62*	(3.49)	1.45	(2.29)	7.67*	(3.60)
CEO Tenure	-0.00	(0.01)	-0.00	(0.01)	-0.00	(0.01)	-0.00	(0.02)	-0.00	(0.01)	-0.00	(0.01)
Volatility	-0.04*	(0.02)	-0.05*	(0.02)	-0.04**	(0.01)	-0.05*	(0.02)	-0.03†	(0.01)	-0.05*	(0.02)
ROA	0.05*	(0.02)	0.01†	(0.01)	0.05*	(0.02)	0.01†	(0.01)	0.05*	(0.02)	0.01†	(0.01)
Total Revenue	-0.01	(0.01)	-0.01	(0.01)	-0.01	(0.01)	-0.01	(0.01)	-0.01	(0.01)	-0.01	(0.01)
CEO Non-Duality			-0.19	(0.23)			-0.19	(0.23)			-0.19	(0.23)
Committee Independence			-0.11	(0.10)			-0.11	(0.10)			-0.11	(0.10)
Predictors												
Legislative Control	-0.37**	(0.13)	-0.37*	(0.14)	-0.37**	(0.13)	-0.37*	(0.14)	-0.37**	(0.13)	-0.37*	(0.14)
Congressional Liberalism	-1.90*	(0.85)	-1.91†	(1.02)	-1.95*	(0.83)	-1.86†	(0.97)	-1.87*	(0.84)	-1.89†	(1.03)
Regulatory Culture - Positive Attitudes	-3.20	(3.08)	-9.28**	(3.00)	-3.37	(3.21)	-9.51**	(2.82)	-3.32	(3.35)	-9.52**	(2.86)
Regulatory Culture - Stringency	5.88**	(1.80)	4.13	(3.38)	5.85**	(1.77)	4.52	(3.21)	5.79**	(1.80)	4.50	(3.25)
Presidential Party	0.10	(0.13)	0.19	(0.24)	0.10	(0.14)	0.18	(0.25)	0.10	(0.13)	0.18	(0.25)
Firm Lobbying Contributions[b]	-0.06	(0.12)	0.02	(0.15)							0.02	(0.15)
Firm-Regulator Network Ties					0.00	(0.02)	0.01	(0.02)	0.05	(0.13)	0.01	(0.02)
N	245		146		245		146		248		146	
R^2	0.03		0.03		0.03		0.03		0.03		0.03	
Adj. R^2(within)	0.16		0.24		0.16		0.24		0.17		0.24	
F	2.91**		9.81***		2.78*		9.68***		2.94**		11.20***	

[b]Transformed using the inverse hyperbolic sine function (IHS)

† p < .10
* p < . 05
** p < . 01
*** p < .001

Effects of Manipulation on the Appropriation of Firm Value

Table 4-5 presents the final fixed effects panel regression to test the last set of models hypothesis. Models 11 through 14 regress CEO excess returns on the regulatory pressures and firm manipulation tactics. Each model is run with and without the additional governance variables. Hypothesis 5 predicts firm manipulation tactics will be positively associated with CEO excess returns. Institutional actors will seek to influence their institutional environment that protects their own interests, “parties often need institutions to help capture gains from cooperation” (Weingast, 2002: 670). Models 11 and 12 examine the effect of firm lobbying contributions on CEO excess returns. I did do not find a significant effect (Model 11: b = -0.06, p>010; Model 12: b = 0.02, p>010). Models 13 and 14 introduce the presence of firm network ties into the model and again there are no significant results (Model 13: b = 0.00, p>0.10; Model 14: b = 0.05, p>0.10) for manipulation effects on CEO excess returns. The full model with both networks and lobbying contributions is represented in Models 15 and 16 (with governance controls).

Summary

The hypothesized model is depicted in Figure 2-1. The more accurate depiction of the relationships investigated in this analysis is illustrated in Figure 4-1. Given the complexity of the phenomena under investigation, the mixed results are somewhat expected. The next chapter discusses the final results and the implications for research and practice in detail.

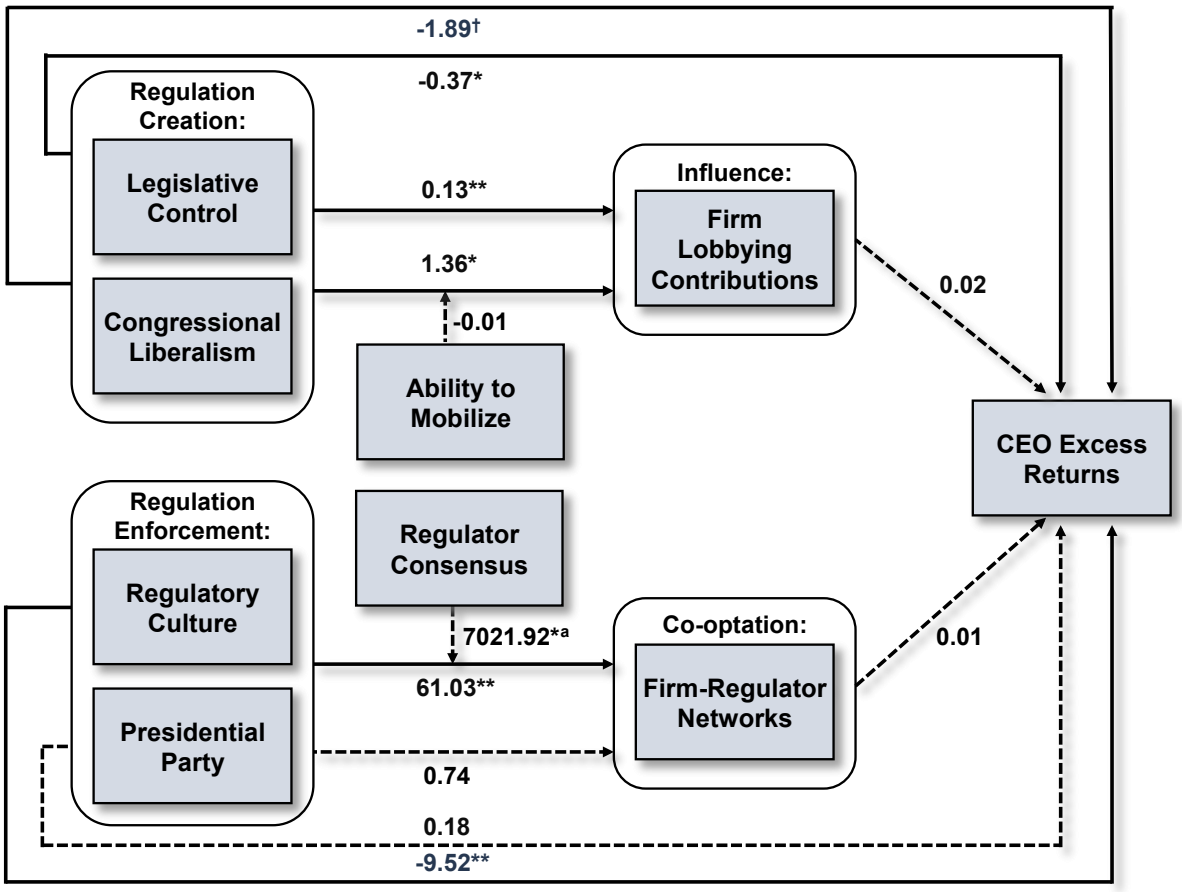


Figure 4-1. Final Model: [a]Coefficient was significant but from a moderated model with significant multicollinearity problems (Model 10); (Note: Dashed line represents insignificant relationships in the model); † p < .10, * p < .05, ** p < .01, *** p < .001

CHAPTER 5
CONCLUSION

Discussion

This dissertation integrates agency and institutional theories to emphasize power and agency in institutional processes and the role of the regulatory environment (regulation creation and regulation enforcement) in limiting managerial self-interest (CEO excess returns). The results confirm that indeed, the regulatory environment serves as a constraint on managerial self-interest. Specifically, an environment characterized by strong legislative control that reduces the discretion of management, a Congress that embodies principles of government intervention in private markets, and regulators with positive attitudes towards regulation are all associated with lower CEO excess returns, even after controlling for governance mechanisms, CEO power, and other firm level variables. These findings have implications for both agency and institutional perspectives and reveal the importance of the institutional regulatory environment in supporting traditional governance mechanisms to better align shareholder and managerial interests.

From an institutional perspective, the regulatory environment's constraint on firm behavior suggests coercive isomorphic mechanisms are working through external regulatory agencies to impose changes on and regularize behavior of organizations (Scott, 2008). From an agency theory perspective, the findings support the contention that managers, if left unconstrained, will pursue their own self-interest, which may not align with that of shareholders (Jenson & Meckling, 1976; McGuire, 1988). Moreover, CEO excess returns provides an opportunity to examine evidence of moral hazard as excess returns may capture the misuse of firm resources for the CEO's personal

benefit. Solutions for the misalignment of managerial and shareholder interests include monitoring and contract systems that can constrain managerial deviations (Jensen & Meckling, 1976; Baiman, 1982; Simon, 1991). However, in further support of the institutional arguments, my findings show the regulatory environment serves to limit self-interested managerial behavior above and beyond board independence and CEO power controls.

Next I found significant positive relationships between a restrictive regulatory environment and firm manipulations (i.e., firm lobbying contributions and firm-regulator networks). This provides evidence that both regulators and firms are actively attempting to shape the environment through formal and informal mechanisms to establish an institutional order that best suits their respective needs and interests. Order within institutions is fragile and vulnerable to disruption through agents who are either unaware of the rules or deliberately try to change them (Garfinkel, 1967). This view is a departure from the typical engagement of institutional theory in terms of its isomorphic effects on actors within a population, and instead addresses the role of agency, or variation in the extent firms conform (DiMaggio & Powell, 1983; Judge & Zeithaml, 1992). Regulatory agency manifests in the passing of legislation, the voting behaviors of Congress, and the extent to which regulation is enforced and imposed upon firms. Firm agentic behaviors are captured in their responses to regulatory constraints.

I have shown that escalations in regulatory pressures, particularly legislative control, congressional liberalism, and a strong regulatory culture amongst regulators, all correspond with an increase in lobbying contributions by individual firms, which suggests firms are considering the entire regulatory environment when formulating their

response. Restrictive isomorphic pressures inspire institutional actors to initiate change that restores their power or position in the field (Scott, 2008). When the regulatory environment changes the rules through strict legislative control or threatens to change regulations through their congressional voting behaviors, the firms respond by increasing their lobbying contributions and their number of connections with regulatory agencies. This finding supports the agentic approach to institutions, as these firms appear to be actively assessing the threats in their environment and adjusting their activity or presence in the institutional processes accordingly. Through the interaction of these agentic activities and interests, actors are continuously disputing, contesting, and attempting to influence systems of meaning (Foucault, 1977; Clegg, Courpasson, & Phillips, 2006).

I found evidence that a strong regulatory culture is linked to the strength of firm-regulator networks (i.e, the number of ties between firms and regulators). The relationship between firm regulator networks and regulatory culture were magnified in the presence of differences in attitudes among regulators, which supports the contention that more instability in the institutional field leads to more agentic behaviors by firms (e.g., DiMaggio & Powell, 1991; Scott, 1991; Powell, 1991; Oliver, 1991; D'Aunno et al., 1991). A change in the regulators' commitment to enforce legislation is also disruptive to the institutional order. Institutional theory suggests that actors may not only attempt to influence institutions by modifying rules and the allocation of resources, but also through relational ties (Scott, 2008). Institutionalization in the regulatory environment is an iterative process where rules are revisited, laws repealed, regulators and congressional members replaced. By building networks and influencing

policy creation and enforcement, executives are trying to regenerate the same institutions that have historically afforded them positions of power. Although the regulators and executives change positions and organizations over time, they often remain in the same organizational field; those regulated become regulators and vice versa, which offers additional stability to the field. Empirically, this is demonstrated by the increase in the number of ties between firms and regulators as the threat of enforcement rises.

Additionally, it is worth noting that the political party of the president does not appear to influence CEO excess returns, firm lobby contributions, or firm-regulator networks. One reason may be that the president poses less of a threat to organizations, as perhaps the president's ideological beliefs are not as directly tied to legislation creation as that of Congress. In reality Congress or perhaps even the regulatory agencies may mediate the president's influence. Another explanation could be methodological, in that the extent the president supports regulation needs to be measured more intricately than a raw score based upon the president's political party affiliation. Similarly to the scores on congressional voting behavior, a measure needs to be created to more accurately capture the president's position on government activity in private industry.

Finally, I do not find support that firm manipulations of the regulatory environment grant management the discretion necessary to extract a disproportionate share of organizational wealth from shareholders. Following institutional and agency logic that if left unconstrained managers will pursue personal gains, I predicted firm lobbying and firm-regulator networks would enhance managerial discretion and allow executives to

extract excess returns. However, neither of these tactics was significantly related to CEO excess returns. So although firms' responses are related to the regulatory pressures which can serve to restrain CEO excess returns, the lobbying contributions and regulator networks do not appear to manifest in significantly higher returns for the CEO. One possible reason for this finding is firm manipulation responses are simply ineffective in serving the executives' means. Another explanation is that these tactics do serve the firm's interests but that these interests are not captured in the current model under investigation. Institutional theory suggests institutional actors will initiate change in their environment that will increase or restore their power and position (Scott, 2008). Management motives may be to shape the greater institutional environment in their favor rather than immediately influence their compensation advantages. Future research should investigate potential outcomes of firm involvement in institutional processes.

The outcomes of firm manipulation tactics are of significant importance and practical relevance. Although firm lobbying contributions appear to be the most consistent response to pressures from the regulatory environment, the benefits or outcomes of these contributions have yet to be determined. Firms would not be expending these corporate resources if they were not deriving some benefit from the transaction. Future research should investigate the specific benefits afforded to the firm from lobbying congress (e.g., favorable legislation, participation in the drafting of legislation, etc.) and its impact on other stakeholders. Similarly, firm-regulator networks exist in this sector yet, there is still much to learn regarding the structure and benefits of these networks. The extant literature on corporate governance suggests a purely

instrumental relationship between a board and organizational management is unlikely. Social psychological processes come into play and feelings of reciprocity, the tendency to feel obligated to those who have provided favors, gifts or other benefits, are invoked between boards and management (Gouldner, 1960; Cialdini, 2001). Future research should examine the relationships between regulators and firm executives from a social psychological perspective. Future research should identify the outcomes of network structure (e.g., survival benefits, access to resources, reduced regulatory violations or infringements, etc.).

Theoretical Issues and Opportunities

This dissertation contributes to both the corporate governance and institutional theory literatures. It reestablishes the role of power in institutional theory as power contestation is examined through the interaction between the investment banking industry and its regulatory environment. Further it addresses the regulatory environment's efficacy in limiting excess CEO compensation and by extension, protecting shareholder interests and answering calls in the literature to utilize both agency and institutional explanations in compensation research (Eisenhardt, 1988).

Common issues in institutional research are also present in this dissertation. DiMaggio and Powell state, the institutional field "cannot be defined a priori, but must be defined on the basis of empirical investigation" (1983: 148). Accordingly, institutional hypotheses are inevitably context-specific (Eisenhardt, 1988). Focusing on one industry allowed for an in depth analysis of the relationships between firms and their specific regulators. However, limiting the empirical investigation to this one institutional field may limit the generalizability of the findings. Although longitudinal research somewhat mitigates this issues (Tolbert & Zucker, 1983). Nevertheless, the investment banking

industry offers a unique opportunity to investigate the interactions between organizations and regulators as this industry is so carefully monitored by the public, media, and other watchdog organizations (e.g. www.opensecrets.org). While some firms in this industry are accused of being reckless and self-serving, the high level of scrutiny investment banks experience may offset extremely risky behavior. Future research should examine this phenomenon in different industry contexts, with various levels of scrutiny and monitoring.

This study is also confined to one country, the United States, and its specific regulatory agencies. Future research should compare the effects of different regulatory systems and cultures on managerial self-interest in an international context. Finally, since these results are dependent upon archival data they are also subject to any weaknesses associated with that data source. Although ExecuComp is the most comprehensive data source available for executive stock options, there are known issues with how these values are reported (Aggarwal & Samwick, 1999; Nyberg et al., 2010). However the biases in these data potentially counterbalance each other, as Aggarwal and Samwick (1999) advise, "the net effect of these biases may not be too severe" (p. 73).

Practical Implications

> It is very important, particularly given the damage caused by the crisis, that our system of oversight and safeguards and the enforcement authorities have not just the resources they need, but they are perceived to be above any political influence. – Timothy Geithner, U.S. Treasury Secretary, May 17, 2012 (www.pbs.org)

In May of 2012, JP Morgan, one of Wall Streets most respected banks, announced a $2 billion loss that was a result of risky trading within the firm. This risky position caused the firm's stock to decline by more than 14% over only five trading periods

(Riley, 2012). Meanwhile, Jamie Dimon, CEO of JP Morgan and board member of the Federal Reserve Bank of New York, is still expected to receive $23 million compensation package. Immediately following the announcement, the media began pointing to the importance and responsibility of regulatory bodies in governing reckless firm behavior (Spicer, 2012). In fact, even the president cited this incident as an example of why they passed Wall Street Reform (Telegraph, 2012).

The relationship between Dimon and the New York Federal Reserve was also brought into question. U.S. Treasury Secretary Geithner responded to the critics that this is a perception problem and assured the public that the "the members of the board play no role in supervision. They have no role in the writing of the rules, and they play no role in decisions the Fed makes about how to respond to a financial crisis. Their function is much more limited, and is to provide perspective on what is happening in the economy as a whole." (www.pbs.com, 2012) Geithner suggests the role of the Federal Reserve Board is confined to advice and counsel, which brings up questions regarding who is regulating the regulators. Future research should also examine the role of regulatory agency boards in the governance of those organizations. If these boards do not serve the monitoring function, then who is responsible for supervising regulator behavior?

The findings of this dissertation offer insight into the efficacy of the different sources of regulatory pressure on constraining managerial self-interest and may be of interest to those heavily invested in these firms (e.g., institutional investors) as well as those involved in public policy. I have investigated the impact of the regulatory pressures on constraining CEO excess returns and protecting shareholders. However,

shareholders are not the only stakeholders impacted by executive malfeasance. Employees and taxpayers also bear the externalities of poor executive decisions. There is even speculation that if JP Morgan was less financially healthy the $2 billion error would have required a bailout from the U.S. government and by extension U.S. taxpayers (Riley, 2012). Those interested in influencing public policy or reigning in wayward management, should pay attention to the sources of pressure that offer the greatest return. Future research should examine the impact of the regulatory environment on other stakeholders as well.

Although some believe the solution to malfeasance is more regulatory bodies to monitor firm behavior that may not be necessary. The findings in this dissertation suggest perhaps the agencies in place are more effective in constraining executive self-interest if the regulators have the right attitudes towards doing their jobs. Additionally, if those elected into congressional office offer a credible threat of legislative control, they may also be effective in constraining the self-serving behavior of executives. More regulatory agencies may not improve firm behavior if organizational structure and governance failures still plague the system. Future research should examine the influence of the number of regulatory bodies on firm behavior.

JPMorgan's risky trading position that resulted in the $2 billion loss was on regulators' radars in April 2012 and reports suggest the regulators posed questions to senior management at that time. The Federal Reserve Bank of New York has up to 40 supervisors based at JPMorgan as well as at other banks they supervise, which again can bring up issues of independence and influence. Dimon claims that the firm indeed

shares all the information it has with its regulators but that occasionally senior management does not have the information to share (Spicer, 2012).

> You should assume that we keep our regulators up to date. . . . Sometimes we don't give them [regulators] great information because we didn't have great information. – Jaime Dimon, JP Morgan CEO (Spicer, 2012)

However, from the prospective of shareholders, there are approximately 23 million reasons why a lack of awareness is not a satisfactory explanation for a mistake of this magnitude. Future research must continue to examine the dynamic relationships between firms and their regulators. The repercussions of ignorance are too significant and the externalities born by shareholders and taxpayers too substantial.

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