

# Political Capital

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# Motivation

- leaders can sway collective decisions:
  - CEO may persuade the board to approve a merger, acquisition, or investment
  - presidents may coax Congress to pass legislation
  - senior faculty may push to hire a job market candidate, get extra slot from a dean, tenure someone

# Motivation

- power to influence includes both formal and informal elements, e.g.,
  - network of friends and allies
  - favor exchange system
  - organization's culture
- all elements determine leader's power and whether and when she may choose to exercise it

# Tradeoffs

- leaders trade off influence today with power tomorrow
  - forcing the hand of others is costly: allies, favors,... →leader may lose future influence
  - but leader may also increase her influence if the alternative she advocates turns out to benefit many
- dynamics of political capital may depend on “culture of blame/reward”

# Political capital

- focus on a class of leader-specific assets: *political capital*
- intangible assets that:
  - 1 afford the leader greater power to influence
  - 2 immediately reduce when the leader chooses to exercise this power
  - 3 dynamically increase if the leader advocates in favor of alternative that benefit many
- we do *not* tie ourselves to a specific microfoundation

## This paper: What

- model in which leader can gain or lose political capital by voicing dissent against default alternative
- 1 greater political capital→greater power
- 2 voicing dissent immediately reduces political capital—leader *spends* her capital
- 3 may further increase or decrease depending on whether dissenting opinion turns out to be correct for organization as a whole

## This paper: Why

- what determines
  - patient/loud leadership styles
  - dynamics of power within organization
- implications for optimal organization design

## Power and Leadership

- authority (within): Aghion-Tirole (1997), Dessein (2002)
- leadership styles: Full Range Leadership Model (Burns, 1978; Bass, 1985) *active v passive* MBE leaders (Atwater and Yammarino, 1996; Singh, 2009; Yang and Li, 2017)
- non-monetary side-payments as promises and policy commitments (Cyert and March, 1963; Gibbons, 2019)
- veto powers in practice (Bouton et al., 2019)
- leadership: Prendergast & Stole (1996), Hermalin (1998) Majumdar & Mukand (2004)
- presidential “mandates” (Conley, 1994)



## Model: (default) choice

- time  $t \in \{1, 2\}$
- in each period  $t$ , organization picks alternative  $a_t \in \{0, 1\}$  to match uncertain state  $\theta_t \in \{0, 1\}$ : max

$$v_t(a_t | \theta_t) = \begin{cases} 1 & \text{if } a_t = \theta_t; \\ 0 & \text{otherwise.} \end{cases}$$

- organization's *default* choice optimal with probability  $\pi > 1/2$
- upon relabeling, default choice is  $a_t = 0 \Rightarrow \Pr(\theta_t = 0) = \pi$

## Model: leadership and power

- leader has initial stock of political capital  $k_1$
- in each period  $t$ , the leader
  - observes signal  $s_t \in \{0, 1\}$ ,  $\Pr(s_t = \theta_t) = \sigma > \pi$
  - chooses whether to *spend*  $c$  units of capital (in favor of  $a_t = 1$ )

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  - chooses whether to *spend*  $c$  units of capital (in favor of  $a_t = 1$ )
- if she spends, then  $a_t = 1$  with probability  $P(k_t)$ :
  - $P : \mathbb{R} \rightarrow [0, 1]$  is increasing,
  - $P(k_t)$  is leader's *power*
  - $P(k_t) = 0 \rightarrow$  leader is *irrelevant* (simplicity: cannot spend)

## Model: political capital

- leader's political capital at  $t = 2$ :

$$k_2 = \begin{cases} k_1 - c + B(\theta_1) & \text{if she spends capital;} \\ k_1 & \text{otherwise} \end{cases}$$

with  $B(0) < 0 < B(1)$

- in paper we generalize to some  $k_2 = k_1 + N(\theta_1)$  if she does not spend

## Model: leader's payoff

- leader's payoff:

$$u_t(a_t | \theta_t, \alpha_t) = \begin{cases} \alpha_t & \text{if } a_t = \theta_t; \\ 0 & \text{otherwise.} \end{cases}$$

where  $\alpha_t \in \{\alpha^L, \alpha^H\}$ ,  $0 < \alpha^L < \alpha^H$

# Assumption

- $k_1$ ,  $P$ , and  $B$  are subject to organizational design choices (membership, institutional details, culture, etc.)
- we impose a minimal structure on power function  $P$ : organization is designed in such a way that *the leader does not spend her capital for alternatives she does not believe in.*

## Assumption

*Spending political capital in period 1 when  $s_1 = 0$  results in an expected decline of the leader's power.*

## Lemma (The leader's optimal strategy in period 2)

*In period 2, a non-irrelevant leader spends political capital if and only if she prefers alternative  $a_2 = 1$ .*

## Proposition (The leader's optimal strategy in period 1)

*There exists a cutoff  $\sigma^*(k_1)$  such that a non-irrelevant leader spends political capital in period 1 if and only if she prefers alternative  $a_1 = 1$  and either  $\alpha_1 = \alpha^H$  or  $\sigma > \sigma^*(k_1)$ .*

- more precise information decreases the expected loss in power due to voicing dissent

- there exists  $\bar{\sigma}$  such that  $\sigma > \bar{\sigma} \Rightarrow$  spending capital increases expected future capital
- but not all capital translates into power the same

### Proposition (The evolution of political power)

*There exists a cutoff  $\bar{\sigma}(k_1) \in (\sigma^*(k_1), 1]$  such that if the leader optimally chooses to spend her political capital, then*

- 1** *if  $\sigma > \bar{\sigma}(k_1)$ , the leader's power is expected to grow over time;*
- 2** *if  $\sigma < \bar{\sigma}(k_1)$ , the leader's power is expected to decline over time.*

- similar organizations with (nearly) indistinguishable leadership styles develop in opposite directions

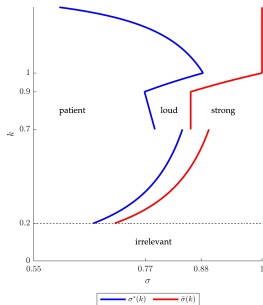
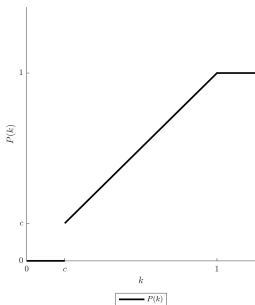


## Leadership styles

- Patient.** A patient leader spends political capital only on issues that are of high importance to her. Her power is expected to decline over time.
- Loud.** A loud leader spends political capital on all issues. Her power is expected to decline over time.
- Strong.** A strong leader spends political capital on all issues. Her power is expected to grow over time.

## Proposition (Optimal leadership styles)

*A non-irrelevant leader is patient if  $\sigma < \sigma^*(k_1)$ , loud if  $\sigma \in [\sigma^*(k_1), \bar{\sigma}(k_1))$ , and strong if  $\sigma \geq \bar{\sigma}(k_1)$ .*



- conditional on disagreeing, loud (and strong) leaders are more likely to voice dissent than patient leaders
- but loud leaders disagree more often than strong leaders

### Proposition (**Loud means loud**)

*The probability that a non-irrelevant leader spends political capital in period 1 is strictly decreasing in  $\sigma$  for all  $\sigma \neq \sigma^*(k_1)$ , and has local maxima at  $\sigma = \pi$  and  $\sigma = \sigma^*(k_1)$ .*

## Political capital and leadership styles

- Example:  $P = P_L$

for low  $k_1 > c$ : power cost of becoming irrelevant is increasing in capital → increase in  $k_1$  increases cost of voicing dissent

for high  $k_1 < 1$ : power benefit of earning capital is decreasing in capital → increase in  $k_1$  decreases benefit of voicing dissent

- more in general, more political capital induces louder leaders if the *marginal power of capital*  $P'(k)$  is

larger at  $k_1 - c + B(1)$  and  $k_1 - c + B(0)$  than at  $k_1$ .

formal statement

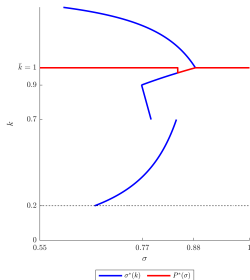
## Optimal allocation of political capital

- limited determination of leader's political capital
  - legitimacy/majority of president
  - CEO delegation of authority
  - hiring committee composition
- organization allocates political capital  $k_1 \leq \bar{k}$  to leader (we assume no cost, but...)
- optimal allocation of capital  $k_1^*(\sigma)$  determines optimal allocation of power  $P^*(\sigma)$

## Proposition (The optimal allocation of power)

*The optimal allocation of power  $P^*(\sigma)$  is not necessarily monotonic in  $\sigma$  (etc.)*

- in paper: sufficient conditions for monotonic and U-shaped
- key intuition: tradeoff b/w effective and active leadership



## Power function: Institutional design

- power function in part determined by institutional design
- in practice, “sticky” rules to control future leaders: choice behind a veil of ignorance  $(\sigma, k_1) \sim F$
- essentially two levers:
  - maximum power  $\bar{P} \leq 1$ ;
  - how fast junior leaders climb the power ladder (how steep  $P$  grows whenever  $P(k) > 0$ )
- tradeoff between effective leader v. career concerns

## Power function: Institutional design

### Proposition (The optimal power function)

*There exist parameters  $c$  and  $b$  and distribution  $F$  such that the optimal power function is strictly increasing for some  $k \geq \underline{k}$ .*

- intuitive examples: if most future leaders are expected to start as “juniors”, career concerns are important to induce more active leaders



## Organizational culture

- organizations vary as much in culture as they do in structure
  - *culture of reward*: success draws more attention;
  - *culture of blame*: failure draws more attention.
- modify law of motion of capital:

$$k_2 = \begin{cases} k_1 - c + B(\theta_1) & \text{if she spends capital;} \\ k_1 & \text{otherwise.} \end{cases}$$

$$B(\theta_1) = \rho\theta_1 - \beta(1 - \theta_1) \text{ for } \rho, \beta > 0 \text{ and } \rho > c.$$

- organization  $(\rho, \beta)$  has a greater culture of reward than  $(\rho', \beta')$  if  $\rho \geq \rho'$  and  $\beta \leq \beta'$

## Organizational culture

- A greater culture of reward induces less patient and more strong leaderships

### Proposition (*The effect of a greater culture of reward*)

*An increase in the culture of reward decreases the length of  $\Sigma^P(k_1)$  and increases the length of  $\Sigma^S(k_1)$ .*

$$\Sigma^P(k_1) \equiv \{\sigma \in (\pi, 1] : \sigma < \sigma^*(k_1)\}$$

$$\Sigma^S(k_1) \equiv \{\sigma \in (\pi, 1] : \sigma \geq \bar{\sigma}(k_1)\}$$

# Remarks I

- the leader's ex-ante optimal investment in political capital increases with the precision of her info
- organization's incentives to invest in leader's/collective info increasing/decreasing in leader's capital

## Remarks II

- a reduced-form framework to think of leaders' power to influence collective decisions
- managerial “style” and evolution of power
- optimal allocation of power is non-monotonic in the quality of the leader
- small differences in initial capital or leader's info → large persistent differences in performance
- leader's “experience” is important in addition to fixed effects (Bertrand and Shoar, 2003)

Let

$$\Sigma^P(k_1) \equiv \{\sigma \in (\pi, 1] : \sigma < \sigma^*(k_1)\}$$

be the interval of leader's information precisions that induce her to optimally choose to be patient. If  $\Sigma^P(k_1)$  is non-empty for some  $k_1 \in \mathbb{R}$ , then the length of  $\Sigma^P(k_1)$  increases with  $k_1$  if

$$(1-\pi)\sigma^*(k_1)P'(k_1 + B(1) - c) + \pi(1-\sigma^*(k_1))P'(k_1 + B(0) - c) < \left[ (1-\pi)\sigma^*(k_1) + \pi(1-\sigma^*(k_1)) - \frac{\alpha^L}{\bar{\alpha}} \right] P'(k_1). \quad (1)$$

Otherwise, it decreases with  $k_1$ .

back