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THE INFLUENCE OF CEO POLITICAL OUTSPOKENNESS ON STOCK MARKET REACTION AND FIRM PERFORMANCE

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INTRODUCTION

CEOs' public communications are considered essential parts of their stakeholder management efforts. Specifically, CEOs' oral and written communications pertaining to their firms' actions receive scrutiny from external stakeholders (e.g. investors, stock analysts, regulators) and members of the media (Conaway & Wardrope, 2010; Kassel, 2017). There is a burgeoning body of research on CEO communication. Research evidence, for instance, points to the extent to which CEOs' communications influence firm performance and investor behavior (Whittington, Yakis-Douglas, Ahn, 2016; Elliott, Grant & Hodge, 2018). Furthermore, CEOs' communications have been shown to shape firm reputation and stakeholder perceptions in times of crises (Seeger, Sellnow & Ulmer, 2003). In recent years, there have been reports of a growing number of CEOs publicly "weighing in" on controversial public policy debates (Chatterji & Toffel, 2016; Soergel, 2016). These CEOs are addressing a wide range of societal "hot button" issues in the political arena. This trend is considered unusual because it goes against the implicit societal expectation that CEOs refrain from being involved in controversial political debates and instead focus on managing their businesses. We refer to this growing trend as *CEO political outspokenness* and define it as CEO's public and opinionated expression of personal beliefs and values on controversial political issues. Because this trend is very nascent, scholarly research has not examined the consequences of controversial political comments made by CEOs on firm performance. In exploring this issue, we consider two important contingency factors that moderate the impact of CEO political outspokenness on firm performance: *firm's past reputation* ("Celebrity" Status) and *history of consumer activism*. In the next section, we first provide an overview of CEO political outspokenness. We will then present our study's predictions and conclude by highlighting the scholarly and managerial implications of our empirical findings.

An Overview of CEO Political Outspokenness

CEO outspokenness represents a high-profile executive communication event. Like other high-profile CEO communications (Rhee & Fiss, 2014; Whittington et al., 2016), controversial public comments made by a CEO have the potential to influence the perceptions of important stakeholders such as customers, shareholders, competitors and regulators. We define *CEO*

10.5465/AMBPP.2019.25

political outspokenness as a CEO's public and opinionated expression of personal beliefs and values on controversial political issues. We argue that CEO political outspokenness on broader societal issues and engagement in public policy debates matters to the firm's stakeholders. We base this assertion on insights from the broader CEO communication research that shows the words of CEOs do in fact influence stakeholder reactions which in turn alter the level of resource support and legitimacy the firm enjoys (Conaway & Wardrope, 2010; Patelli & Pedrini, 2014). In studying the consequences of CEOs political outspokenness, we consider controversial comments publicly made by CEOs on contested political issues. These types of comments typically are expressions of CEOs' support for or disagreement with specific policies and regulations related to these controversial issues. Second CEOs' controversial public comments on political issues are an expression of their "value statement" (i.e. their personal values and convictions).

CEO Political Outspokenness and Stock Market Reaction

Beyond the mere act of "speaking up", CEOs' political outspokenness has important implications for their firms. One important question in this regard is: how will investors react to CEOs' public comments on controversial political issues? To address this question, we rely on insights from agency theory (Jensen & Meckling, 1976; Fama & Jensen, 1983). According to the core tenets of this theory, an agency problem arises due to the separation of ownership and control that necessitates shareholders (principals), as the residual owners of the corporation, delegate decision-making authority to agents (managers). While agents are expected to make decisions that serve the interests of principals, they do not always do so, instead they act opportunistically pursuing their personal interests at the expense of principals' interests (Jensen & Meckling, 1976). Such a misalignment in interests between principals and agents creates an agency problem (Fama, 1980; Eisenhardt, 1989). In this study, we argue that CEOs' political outspokenness will be received negatively by shareholders for a number of reasons. First, consistent with agency theory logic, we expect that investors view CEO political outspokenness as an advancement of the CEO's personal political (or ideological) agenda. Second, we argue that CEO outspokenness will lead to a negative stock market reaction as such controversial CEO comments are likely to create uncertainty among investors as to how the CEO's comments might influence the firm's business operations. Further, investors may be concerned about the ability of the CEO to motivate and rally employees and managers around a unified organizational purpose in the aftermath of controversial public comments. Finally, we expect CEO outspokenness to result in a negative stock market reaction because CEOs' comments on controversial political issues may lead to public opinion backlash and a negative reaction among key external stakeholders (e.g. customers, suppliers etc.). Given the above arguments, we propose the following hypothesis:

H1: There is a significant negative stock market reaction to CEO political outspokenness.

CEO Political Outspokenness and Firm Performance-Is "Speaking Out" Good for Business?

While some CEOs may be inclined to "speak up" publicly and share their views on controversial political topics, these comments and the resultant public attention may have significant implication for their firm performance. We expect a negative relationship between

10.5465/AMBPP.2019.25

CEO political outspokenness and firm performance for at least two reasons. First, CEO political outspokenness adversely affects firm performance because it may lead to stakeholder disengagement. Following the CEO's public comments regarding political issues, some of the firm's stakeholders (e.g. customers, suppliers, shareholders etc.) and the general public may passionately disagree with the content of such comments. By publicly "weighing in" on controversial political issues, the CEO may risk alienating at least some groups of stakeholders. Second, beyond disagreeing with the contents of the CEO's political comments, stakeholders may also express concern that such CEO political outspokenness may attract a backlash from regulators and elected officials since these comments are likely to put the CEO and the firm in the middle of partisan political debates. Given the above arguments, we propose the following hypothesis:

> *Hypothesis 2 (H2): CEO political outspokenness is negatively related to firm financial performance.*

The Moderating Role of Firm "Celebrity" Status

While understanding the baseline relationship between CEO political outspokenness and firm performance across firms is important, we propose that the magnitude of this relationship may differ depending on a variety of organizational contingency factors. One such factor we examine in this paper is organizational reputation prior to the occurrence of CEO political outspokenness. We argue that the potential negative impact of CEO political outspokenness may vary among firms with good reputations compared to those with relatively poor reputations. In particular, we propose that firms with good reputations--particularly those we refer to as celebrity firms (Pfarrer et al., 2010)--are more likely to mitigate the negative relationship between CEO political outspokenness and firm performance. In the context of our study, it is important to acknowledge the context in which the outspoken political comments of CEOs of firms with high reputation (celebrity status) are made. Given their status as celebrity firms, these firms and their CEOs are more likely to be viewed favorably not only by the media but also by their own stakeholders. Consequently, for these good reputation (celebrity) firms, the potential fallout from any political comments made by their CEOs is likely to be limited if any at all. Given the above arguments, we propose the following hypothesis:

> *Hypothesis 3 (H3): Firm "celebrity" status negatively moderates the relationship between CEO political outspokenness and firm financial performance such that the negative relationship is weaker for "celebrity" firms compared to "non-celebrity" firms.*

The Moderating Role of Consumer Activism

In addition to examining the moderating role of firm celebrity status, we also explore the moderating role of consumer activism in the relationship between CEO political outspokenness and firm performance. We assess consumer activism in terms of a consumer boycott, which is "an attempt by one or more parties to achieve certain objectives by urging individual consumers to refrain from making selected purchases in the marketplace" (Friedman, 1985, p. 97). Consumers participate in boycotts to challenge and transform perceived wrongdoing by a company, or perceived flaws in the product itself (Kozinets & Handelman, 2004; Yuksel &

10.5465/AMBPP.2019.25

Mryteza, 2009). Consequently, CEO controversial political comments may decrease the likelihood of purchase of a brand that has a history of consumer boycotts (Okada & Reibstein, 1998; Yuksel & Mryteza, 2009). This overall concern regarding the negative impact of "public controversy" on brands and company sales is best captured by the journalist Kurt Badenhausen. In a Forbes article titled "The Business of Michael Jordan is Booming", Badenhausen (2011) writes, "Part of Jodan's lasting appeal rests on his ability to skirt anything controversial… "Republicans buy shoes, too," Jordan reportedly quipped to a friend on why he wouldn't endorse a black Democratic candidate, Harvey Gantt, in a 1990 North Carolina Senate race against Republican Jesse Helms." In conclusion, we argue that if a CEO of a company with the history of boycotts speaks on controversial political issues, it is likely to elicit a negative reaction among consumers, especially when consumers do not agree with the stance taken by the outspoken CEO. The arguments above lead us to the following hypothesis:

> *Hypothesis 4 (H4): The presence of past consumer activism (in the form of boycotts) positively moderates the negative relationship between CEO political outspokenness and firm financial performance such that the negative relationship will be stronger for firms with past history of consumer activism.*

METHODS

Sample and Data Sources

To test the above hypotheses, we used data from publicly-traded, U.S.-based Standard & Poor's 500 (S&P 500) firms. To develop our sample, we began by surveying the phenomenon of CEO political outspokenness at S&P 500 firms. We searched for all incidents of CEO political comments in major U.S. newspapers and other news outlets from 2010-2016. We adopted a matched pair design that includes both firms led by outspoken and non-outspoken CEOs. To construct our matched-pairs, we used the propensity score matching technique (Rosenbaum & Rubin, 1983; Li, 2013). While most works in the past have used a manual matching procedure, the propensity matching technique is increasingly being utilized by corporate governance researchers given its superior probability-based predictive ability and reduced bias, particularly for observational studies (Boivie, Graffin, Oliver & Withers, 2016; Faccio, Marchica & Mura, 2016). The propensity score matching technique allows researchers to generate a matched pair observation of "treatment" and control sample by identifying a "counterfactual". The "treatment" sample in this study is all firms with politically outspoken CEOs, while the "counterfactual" sample consists of firms with non-outspoken CEOs. Hence, the goal of the propensity score matching technique is to provide a matched sample such that the firms in the "treatment" and "counterfactual" groups are very similar in all aspects except for having (or not having) a politically outspoken CEO. We identified five covariates that are likely to predict CEO political outspokenness: *Firm Age, Percentage of Equity Owned by CEO, CEO Gender (coded 0=male, 1=female), CEO founder status (0=non-founder, 1=founder) and French and Fama 49 industry categories*. These five covariates were used in a probit analysis with the binary CEO outspokenness variable (0=no comment, 1=comment) as the outcome variable. The propensity scores generated following this process yielded 122 unique matched pair observations (61 firms with outspoken CEOs and 61 firms without outspoken CEOs). Because some firms' CEOs made more than one political comment during our sampling window, our final sample consisted of 182 observations (122 incidents of CEO comments along with 61 observations from non-

10.5465/AMBPP.2019.25

commenting CEOs). We collected data on CEO outspokenness from the Lexis-Nexis Academic Universe database. Specifically, we focused on U.S. newspaper articles that reported controversial CEO comments for the period ranging from 2010-2016. We categorized a CEO comment as political if: (1) The CEO comment explicitly mentions politicians (president, congressmen and administration officials) and/or political parties (e.g. democratic or republican parties), (2) The CEO comment explicitly mentions legislation that is either being considered in Congress or state houses at the time or that have recently been signed into law, (3) The CEO comment explicitly mentions controversial political issues (e.g. *gun control, deregulation, health care reform*). The aforementioned data collection process yielded data on 122 non-redundant political comments during our sampling window (2010-2016) from 61 CEOs of S&P 500 firms.

Measures

We operationalized *CEO political outspokenness* as a binary variable by assigning a value of "1" for each observation in a given year if a sample firm's CEO made a political comment and "0" otherwise. We use *firm celebrity status* and *consumer activism* as two moderating variables. We utilize the ranking of *Fortune Global Most Admired Companies* starting from 2006 to 2009 as a measure of firm celebrity status (Brown & Perry, 1994; Cheng, Liu, McConnell, & Rosenblum, 2017). If a sample company is ranked at least once in the top 50 lists over the interval of 2006 to 2009, we coded it as "1" and "0" otherwise. We operationalized consumer activism as a binary variable. We utilized multiple sources such as the Ethical Consumer Boycott list (www.ethicalconsumer.org), twitter hashtags, and Google search to collect data on consumer activism. We included consumer boycott observations that occurred prior to the comment made by a CEO. If there is at least one consumer boycott event targeting a sample firm, we coded it as "1" and "0" otherwise. In this study, we used two dependent variables: stock market reaction, and firm performance as measured in *Tobin's q* and *quarterly sales*. To assess stock market reaction to CEO political comments (hypothesis 1), we conducted an event study (Ball & Brown, 1968; Fama et al., 1969; McWilliams & Siegel, 1997) using '*Event study by WRDS*', a program provided by Wharton Research Data Services (WRDS). The event study methodology is used to determine whether there is an "abnormal" stock return associated with an unanticipated event (McWilliams & Siegel, 1997). Consistent with the prior studies, we used the market model (Rhee & Fiss, 2014; Quigley et al., 2017; Kang, 2008) with a 120-day estimation period with the minimum number of valid returns of 70 days (Shiu & Yang, 2017). To measure quarterly sales and Tobin's Q, we first identified which quarter of the year each CEO made a controversial political comment. Then we used Tobin's q and quarterly sales of that particular quarter to capture the immediate impact of the controversial political comment on firm performance. For counterfactual observation with no CEO comment, we used the data of same quarter that we used in treatment observation with CEO comment. We included the following eight control variables in our study: *firm size, past performance, Fama & French industry groups, CEO tenure, CEO gender, CEO duality, CEO equity ownership, and CEO ideology.*

RESULTS

Hypothesis 1 predicted a significant negative stock market reaction to CEO political outspokenness. The results indicate that CEOs controversial political comments, overall, were followed by a statistically significant increase in the firm's cumulative abnormal stock return.

10.5465/AMBPP.2019.25

Contrary to our prediction, our results suggest a significant positive investor reaction to CEO political outspokenness. Accordingly, hypothesis 1 did not receive empirical support. Hypothesis 2 predicted that CEO political outspokenness is negatively related to firm financial performance. Our analyses indicate that CEO political outspokenness has a negative impact (β =-0.227, $p< 0.01$) on Tobin's q. However, contrary to our prediction, CEO political outspokenness does not have negative impact on quarterly sales (β = 0.161, n.s.). Accordingly, hypothesis 2 has received partial support. Hypothesis 3 proposed that firm celebrity status negatively moderates the relationship between CEO political outspokenness and firm financial performance. CEO political outspokenness is not statistically significant (β =-0.089, n.s.) predictor of Tobin's q. However, political outspokenness was found to be a positive predictor of quarterly sales (β =0.507, $p< 0.01$) in the case of firms with celebrity status. In the case of firms with no celebrity status, CEO political outspokenness is a negative predictor of Tobin's q (β =-0.203, $p< 0.05$). However, the opposite is true when firm performance is measured by quarterly sales, as the coefficient for CEO political outspokenness (β =0.220, $p< 0.1$) is positive and marginally significant. Given these mixed results, hypothesis 3 has received only partial support. Finally, hypothesis 4 predicted that the presence of past consumer activism positively moderates the relationship between CEO political outspokenness and firm financial performance. The results indicate that CEO political outspokenness is not a significant predictor of both Tobin's q (β =-0.163, n.s.) and quarterly sales (β =-0.205, n.s.) in the case of firms with a past history of consumer activism. CEO political outspokenness is a negative predictor (β =-0.240, p < 0.05) of Tobin's q in the case of firms with no past history of consumer activism. However, CEO political outspokenness is a positive predictor (β = 0.318, p < 0. 01) of quarterly sales.

DISCUSSION AND CONCLUSION

This paper represents an initial foray into the consequences of CEO outspokenness on controversial topics of the day. If, as we have observed, CEOs are becoming more inclined to be outspoken, understanding what that may mean for various stakeholders will be vital information. Viewing our results broadly, an overarching theme may be that CEO outspokenness may not only be harmless for firms, but may in some contexts may be beneficial. At first blush, a CEO taking a stand on a highly controversial topic would appear to run the risk of alienating stakeholders across the board, from customers, to partner firms, to members of the political community. However, that did not prove to be the case, as investors bid up stock prices following CEO outspokenness. What might explain these results? It is possible that while the comments made did address "hot button" issues, the comments made may have comported with, and been in line with firm stakeholder values. As a next step, it may be beneficial to examine the content of a CEO's message within the context he/she is working. Overall, this study sheds light on the growing trend of political, socio-cultural and environmental activism among business leaders and associated corporate outcomes.

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