Costs and Benefits of Delegation

*Managerial Discretion as a Bridge between Strategic Management and Corporate Governance*
COSTS AND BENEFITS
OF DELEGATION
Managerial Discretion as a Bridge between Strategic Management and Corporate Governance

YULIYA PONOMAREVA

LINNAEUS UNIVERSITY PRESS
Costs and Benefits of Delegation: Managerial Discretion as a Bridge between Strategic Management and Corporate Governance
Doctoral dissertation, Department of Accounting and Logistics, Linnaeus University, Växjö, Sweden, 2016

ISBN: 978-91-88357-09-0
Published by: Linnaeus University Press, 351 95 Växjö, Sweden
Printed by: Elanders Sverige AB, 2016
Abstract


This dissertation addresses the question of effective delegation, exploring it through the concept of managerial discretion (i.e., a latitude of managerial actions, which lie in the zone of shareholders’ acceptance). While the corporate governance perspective on managerial discretion focuses mainly on the costs associated with delegation, the strategic management perspective emphasizes its benefits in creating value for the firm. Building on research in corporate governance and strategic management, this dissertation develops and empirically tests a theoretical framework that explains how the two distinct dimensions of managerial discretion jointly influence organizational outcomes. The proposed framework illuminates the importance of balance between the restraining and enabling decisions undertaken by professional managers. This dissertation makes a two-fold contribution to the field of corporate governance. First, it identifies and explains organizational and environmental forces that jointly shape strategic and governance dimensions of managerial discretion, redefining the concept. Second, it conceptually and empirically explores an integrative model of managerial discretion within the broader corporate governance framework, providing evidence of the joint effects of governance and strategic dimensions of discretion on organizational outcomes. The results suggest that the effect of governance dimension of managerial discretion on a firm’s performance is contingent on the strategic dimension of discretion. This draws attention to potential strategic implications of board monitoring over managerial decision making. While the majority of studies emphasize the benefits of increased control over managerial decision making, particularly stressing board monitoring, this dissertation also considers the benefits of delegation for firms’ strategic development. By reversing the polarity of the current emphasis on disciplining managers, this dissertation provides a more balanced view of the notion of corporate governance. The value of this approach derives from the integrated model, which highlights the benefits and the costs of delegation.

Keywords: Managerial discretion, board of directors, agency theory, delegation, control, transition economy, Sweden
Acknowledgements

Entering a PhD program turned out to be a great learning journey. This journey would never have come to an end if it was not the people who have been there all along.

I would like to thank my academic advisors— Sven-Olof and Timur— for being there for me from the beginning to the end. Your valuable advice, questions, endless comments and ideas kept me motivated to move ahead. But this would have never worked alone unless it wouldn’t be so much fun.

There are also several others who put their time and effort in reading my manuscripts at different stages of the dissertation process. I would like to thank Anders Pehrsson, Christopher von Koch, Andreas Jansson, Magnus Willesson, Damai Nasution, Anna Stafsudd, Johanna Sylvander, Niels Mygind, Georg Wiernike, Christophe Volonte for your valuable comments that helped me to finish the dissertation in the best manner possible. I would like to express my gratitude to Wei Shen, who had made a big difference “before and after” Arizona. I am also grateful to Tom Hedelius Foundation for its generous support that made my exchange visit to ASU possible.

I am grateful to Corporate Governance research group and my colleagues at ELO for sharing the traditions of academic life and creating a fulfilling academic environment. Thank you, Fredrik Karlsson for your encouragement and support.

My special thanks go to Elin Smith, Pernilla Broberg, Torbjörn Tagesson, Nellie Gertsson and Zahida Sarwary for making me welcome in Kristianstad.

What is like to be a PhD student can only be understood by those going through the same process, a deep gratitude goes to my fellow PhD students. Jenny, Lydia and Emma, thank you for all the joy and laughter we shared together. It is a pleasure to have you as colleagues, but even more so is to be your friend. Joshy, Max, Bato, Miranda, Tona, Oleg, Alisa, thank you for making the PhDing also a social event.

I would like to thank my friends outside academia who have kept me connected with the reality. To: Monins, Clemence, Veronica and Karina for great escapes. Thank you, Nicholas, for being a true friend – this means a lot to me.

Finally, saving the best for the last, my endless gratitude goes to my family. Thank you, Didac for your love and care. I am happy to have you in my life. Guiller, Jaume and Alba, thank you for unconditional support. Sometimes you
don’t need to speak the language to feel understood. My parents Olga and Alexey, my brother Yaroslav and his family – even if I live far, you have always been there for me. Without your support and encouragement I would never completed this work. This book is dedicated to you.

Yuliya Ponomareva,
Växjö, March 2016
# Table of Contents

1. Introduction ...................................................................................................... 5  
   1.1 Background ............................................................................................... 6  
   1.2 The concept of managerial discretion ....................................................... 9  
   1.3 Research problem .................................................................................... 12  
   1.4 Research question ................................................................................... 16  
   1.5 Purpose and delimitations of the dissertation .......................................... 16  

2. Theoretical Framework .................................................................................. 18  
   2.1 The role of top executives in an organization ......................................... 18  
   2.2 Strategic dimension of managerial discretion .......................................... 21  
       2.2.1 Environmental level of managerial discretion ................................ 23  
       2.2.1.1 Institutional determinants of managerial discretion ............. 23  
       2.2.1.2 Task environment determinants of managerial discretion .... 26  
       2.2.2 Organizational level of managerial discretion .............................. 28  
   2.3 Governance dimension of managerial discretion .................................... 29  
       2.3.1 Internal governance mechanisms shaping managerial discretion ... 32  
       2.3.2 External governance mechanisms shaping managerial discretion .. 35  
   2.3 Forces shaping managerial discretion and their interconnectedness ....... 37  
   2.5 Relationship between strategic and governance dimensions of  
       managerial discretion .................................................................................... 40  
   2.6 The concept of strategic opportunity costs .............................................. 41  
   2.7 The influence of managerial discretion on organizational outcomes ...... 43  
   2.8 Research model ....................................................................................... 45  

3. Research Method ............................................................................................ 47  
   3.1 Scientific approach and research strategy ............................................... 47  
   3.2 Part One: Explorative research ................................................................ 49  
       3.2.1 Case study research design ............................................................. 49  
       3.2.2 Interview guide construction .......................................................... 50  
       3.2.3 Data collection and analysis ........................................................... 50  
   3.3 Part Two: Quantitative research strategy ................................................ 51  
   3.4 The empirical settings ............................................................................. 53  
       3.4.1 Russian context ............................................................................... 53  
       3.4.2 Swedish context .............................................................................. 57  

4. Summary of the Papers ................................................................................... 60  
   4.1 Paper 1 .................................................................................................... 62  
   4.2 Paper 2 .................................................................................................... 64  
   4.3 Paper 3 .................................................................................................... 66  
   4.4 Paper 4 .................................................................................................... 67  

5. Conclusions .................................................................................................... 70  
   5.1 Summary and reflections ......................................................................... 70  
       5.1.1 The benefits and costs of delegation ............................................... 70
5.1.2 Integrating the governance and strategy perspectives on executive decision making though managerial discretion ........................................... 72
5.1.3 The balance between enabling and restraining managerial action... 73
5.2 Theoretical contributions ........................................................................ 75
5.3 Empirical contributions ........................................................................ 80
5.4 Practical contributions .......................................................................... 82
5.5 Study limitations and future research directions .................................... 83
  5.5.1 Board control ................................................................................ 84
  5.5.2 Consideration of multiple roles of the board .................................. 86
  5.5.3 Mediating processes ..................................................................... 87
  5.5.4 Integrated model of managerial discretion ................................... 87
5.6 Conclusion ........................................................................................... 88
6. References ............................................................................................. 90
1. Introduction

The ability of an organization to survive in the face of changes in its external environment has been attributed to the decisions undertaken by its leaders, the corporate executives led by the CEO. Because they are responsible for the fate of their organizations, top managers are the first to be praised for organizational success and, no less, to be blamed for a failure.

The question of to what extent and under what circumstances top executives actually influence organizations and organizational outcomes has been the subject of scientific debate for several decades (Finkelstein, Hambrick and Cannella, 2009), with two perspectives dominating. The strategic choice perspective posits that the characteristics of the top management team (TMT) play an important role in influencing a firm’s strategic choices (Wiersema and Bantel, 1992). The organizational ecology perspective argues that a firm’s external environment is the key predictor of organizational outcomes (DiMaggio and Powell, 1983; Hannan and Freeman, 1977; Woodward, 1958). In their seminal work, Hambrick and Finkelstein (1987) proposed a way to unite these diverging perspectives into a more comprehensive explanation of executive behavior, using the concept of managerial discretion as a theoretical lever to do so. The authors defined managerial discretion as latitude of managerial actions, proposing that the influence of executives on organizational outcomes may vary depending on multiple factors stemming from a firm’s external and internal organizational environments, as well as from the individual characteristics of managers. Today, when most scholars agree that managers’ influence on organizational outcomes is determined by the degree of discretion delegated to them (Monks and Minow, 2011; Finkelstein et al., 2009), the time is ripe to explore the effective delegation of discretion.
1.1 Background

Effective delegation of managerial discretion is closely linked to the central tenet of corporate structure — separation between security ownership and decision control (Berle and Means, 1932). This division relates to the two central powers within corporate bureaucracies — shareholders, who invest their capital in the firm, and professional managers, more specifically, CEOs, who control the firms on behalf of the shareholders. While shareholders supply the firm with the capital, managers are responsible to capitalize on it by contributing their knowledge, skills, and entrepreneurship. This combination is crucial for the development of the firm.

Since the rise of modern corporations, the balance between these two forces of corporate development has been changing dynamically, which can be partially attributed to the shift in the sources of corporate growth. For most of the twentieth century, Anglo-Saxon economies were dominated by a small number of very large corporations, which financed their growth by retaining earnings and reinvesting them in human and physical capital. This ‘retain and reinvest’ principle gave rise to the managerialism ideology, which has historically supported corporate executives having greater power than other stakeholder groups (Mace, 1971; Vance, 1983; Lorsch and MacIver, 1989). The core assumptions guiding this view were the professionalism and the skills that made corporate executives the most competent decision-makers, which legitimized their leading position in an organization. Chandler (1972) referred to the ‘managerial class’ in corporate America as its ‘visible hand,’ arguing that firms that delegate authority and autonomy to professional managers can achieve greater maximization of productive capacity than owner-operated firms can. Until the 1970s, the power of corporate executives was rarely challenged by any other organizational actors; those in organizational research historically viewed boards of directors as passive beholders, rubber-stamping managerial initiatives (Herman, 1981; Mace, 1971; Pfeffer, 1972).

By the 1970s, managerialism ideology faced two main challenges: further growth and increased global competition (Lazonick and O’Sullivan, 2000). The inertia and complexity of diversified corporations made it difficult for them to facilitate further expansion and growth through their retain and reinvest strategy. In addition, rising global competition had put strong demands on corporations’ adaptability and strategic flexibility, leading to poor economic performance and further constraints on corporate growth. This poor economic performance of managerial-led corporations gave impetus to the appearance of new actors with a different model of corporate growth (Fligstein, 1990). This model promoted access to financial capital at a low cost through equity-based financing as constituting a new source of corporate
growth; this facilitated a shift from managerialism ideology toward one of shareholder value maximization (Davis and Thompson, 1994).

In this ideology, maximization of the shareholder value became the key goal of corporate existence. Agency theory, which gained prominence in 1970, provided strategies to support it. Based on this theory, managers could be depicted as opportunistic agents, which, if left alone, would pursue their own goals at the expense of shareholders (Jensen and Meckling, 1976; Fama, 1980). As a result, a number of governance mechanisms, both external and internal, were advocated and widely promoted to resolve the agency conflict. The market for corporate control was viewed as a strong external force that pressured executives to maximize shareholder returns; the proliferation of hostile takeovers posed a threat to inefficient management (Alchian and Demsetz, 1972; Fama, 1980).

The board of directors was viewed as an internal force that could exercise control over managerial decision making through an increasing use of managerial incentives and monitoring (Zajac and Westphal, 1994). Aligning managerial interests with shareholders’ interests by implementing incentive-based compensation resulted in substantial increases in pay packages for top executives (Lazonick and O’Sullivan, 2000). As executive compensation directly depended on the financial results of the company, the shareholder value ideology was further reinforced by managers themselves. In their striving to satisfy shareholders through increased efficiency and higher returns, managers pursued ‘downsize and distribute’ strategies for labor and capital resources (Fligstein and Shin, 2007). Profitability and return on investment became the key to success in the competitive environment, and managers were doing everything they could to gain a favorable forecast from financial analysts (ibid).

Incentive-based compensation has become a widely accepted means of internal corporate governance (Dalton et al., 2007). While the initial motivation for it was to address the agency problem by creating incentives for executives to maximize shareholders’ wealth, subsequent research challenged the optimal incentive contracting explanation. The proponents of the managerial power perspective argued that executive compensation could constitute part of the agency problem itself (Bebchuk and Fried, 2003). According to this perspective, powerful executives use their influence on the board of directors to increase their own compensation level (Bebchuck, Fried and Walker, 2002). In their meta-analysis, van Essen, Otten and Carberry (2015) lend empirical support to the power perspective, positing that the greater power of CEOs is associated with their higher level of compensation. Furthermore, reviews of empirical results suggest that organizational size, rather than individual contribution, constitutes the main determinant of
executive compensation package (Finkelstei et al., 2009). This evidence supports the notion of the lack of effectiveness of incentive-based contracts in the mitigation of agency problem.

In early 2000s, conflicts and deficiencies within the governance system led to a series of governance failures in high-profile corporations, both in the USA and Europe. These highly publicized events triggered greater shareholder activism, which focused not only on strengthening the monitoring of financial results but also on challenging managerial hegemony in strategic decision making (Filatotchev and Toms, 2003; Nielsen and Huse, 2010). Because incentive alignment mechanisms were shown to contribute to agency conflict, the discussion on increasing monitoring has become a focus for corporate governance scholars and policymakers, as well as practitioners.

As a result of these failures, mainstream discourse within the corporate governance field has become increasingly devoted to effective constraint of managerial behavior (Goranova and Zajac, 2015). Reforms were implemented to create higher standards of corporate governance. The Financial Aspects of Corporate Governance (Cadbury Report) in the UK (1992) and the Sarbanes-Oxley Act (2002) in the USA both have strict guidelines on how to exercise corporate governance. They emphasized the need for more rigorous monitoring of managerial actions through the appointment of independent directors on corporate boards and the establishment of board committees. Furthermore, a number of researchers called for separation of the chairperson and the CEO roles (Finkelstein et al., 2009). Large institutional investors, such as CalPERS, actively endorsed more independent boards and lobbied for increased transparency of financial reporting, which resulted in increased media coverage of the governance practices of targeted corporations (Jansson, 2007). As a result, the share of independent directors on previously insider-dominated American boards has reached 85% (Spencer Stuart, 2013). These changes, which originated in the USA and subsequently spread around the world, were assumed to strengthen the monitoring function of the board and challenge the dominant role of managers in corporate decision making (Aguilera and Cuervo-Cazurra, 2004). Boards have become more actively engaged in firms’ strategic decision making by reviewing and approving strategic decisions and setting the overall context and content of firm strategy (McNulty and Pettigrew, 1999; Stiles and Taylor’s, 2001). The changes in the dominant logic of corporate governance constituted a shift of power from managerial dominance to greater power of corporate boards, where CEOs became increasingly pressured by the boards (Filatotchev and Toms, 2003; Nielsen and Huse, 2010; Ponomareva and Ahlberg, 2015). This shift was signified by the change in perception of board control, which became a synonymous with monitoring and oversight of managerial behavior (Hermalin and Weisbch, 1998; Tian, 2014).
To summarize, with the rise of shareholder value ideology the balance of power between the two driving forces comprising a corporation — the managers and shareholders — has changed dramatically. This ideology became deeply entrenched in corporate governance research and practice and adopted across different systems of corporate governance (Fiss and Zajac, 2006). This change toward greater power for corporate boards has also posed a significant challenge to the decision-making authority and autonomy of corporate executives.

1.2 The concept of managerial discretion

Managerial discretion, a central concept within management research, denotes the influence of corporate executives on organizational outcomes (Boyd and Gove, 2006). Since its introduction by Hambrick and Finkelstein (1987, p. 369), the concept defined as “latitude of action” has been evolving in strategic management research. Managerial discretion has also been discussed by corporate governance scholars (Fama and Jensen, 1983; Shleifer and Vishny, 1997; Williamson, 1963). These two streams of management research explore managerial discretion in relation to the delegation of decision-making authority and autonomy to professional managers, yet from somewhat different perspectives.

The corporate governance perspective, which is grounded within agency (Fama, 1980; Jensen and Meckling, 1976) and transaction cost economic (Coase, 1937; Williamson, 1981; 1991; 2010) theories, is dominated by the view of managers as opportunistic agents. It primarily focuses on ways to contain managerial opportunism. In this perspective, managerial discretion is viewed as a gray area where managers may engage in opportunistic behavior at the expense of the shareholders. Corporate governance researchers advocate limiting decision-making authority and autonomy of managers, in other words, reducing the level of managerial discretion (Shleifer and Vishny, 1997).

Studies within the corporate governance perspective have shown that managers given discretion may not necessarily use it in the interest of their firms, but instead to pursue their private goals. This include unjustified selling of assets (Lang, Poulson and Stulz, 1995) engaging in unrelated diversification (Amihud and Lev, 1981; Tosi and Gomez-Mejia, 1989), over- and under-investment (Stulz, 1990), overpricing the portion of abnormal accruals (Xie, 2001), and influencing bonus pool allocation (Bailey, Hecht and Towry, 2011). These opportunistic actions result in agency costs, ultimately born by the shareholders. Consequently, the central focus of governance literature was minimizing the costs of managerial opportunism arising from discretion delegated to professional managers (Eisenhardt, 1989; Jensen and Meckling,
Governance researchers advocated the use of control mechanisms to achieve this (Fama, 1980). The control mechanisms fall into two main categories: those focusing on incentive alignment and those emphasizing monitoring (Davis, Schoorman and Donaldson, 1997). Through these mechanisms, shareholders can define the boundaries of authority and autonomy delegated to managers.

In contrast to the corporate governance perspective, the strategic management perspective views executives as the key decision-makers whose choices shape the fate of their organizations (Andrews, 1971; Child, 1972; Hambrick and Mason, 1984). Numerous strategy studies have used managerial discretion to explain a wide array of organizational outcomes. These include executive turnover (Shen and Cho, 2005), CEO compensation (Finkelstein, 2009; Finkelstein and Boyd, 1998), strategic orientation (Rajagopalan and Finkelstein, 1992), and managers’ ethical presuppositions when making strategic decisions (Key, 2002). The underlying argument within this perspective is that managers who possess a high level of discretion have a greater influence on organizational outcomes than managers with a low level of discretion. When given discretion at the environmental, organizational, and individual levels, managers may engage in the development of their firms, for example, through pursuing diversification strategy (Lane, Cannella and Lubatkin, 1998; Misangyi, 2002). Diversification strategy can, in turn, allow for greater strategic flexibility as it lets firms compensate more quickly for demand fluctuations in different industry sectors (Pehrsson, 2006a; 2006b). In addition, discretion may allow managers to use opportunities to take strategic action, such as initiating entry to new markets (Kim, 2013), making strategic change (Quigley and Hambrick, 2012) and engaging in export-driven internationalization (Sahaym, Treviño and Steensma, 2012). The underlying goal in this research perspective is to understand what constrains and enables managers to exercise their strategic choices (Wangrow, Shepker and Barker, 2014). To a great extent, this perspective assumes that these choices are in line with the goals of organizations (Misangyi, 2002).

The development of contrasting perceptions of managerial discretion can be attributed to the long-term separation of the corporate governance and strategic management research streams. Governance and strategy researchers have positioned themselves as belonging to a particular perspective and differentiated their concepts of managerial discretion. For example, Finkelstein and Boyd (1998, p.180) wrote “... although the term ‘managerial discretion’ is used in both the strategic management and agency theory literatures, the meanings ascribed to this term differ in important ways.” The authors contrasted the presumption of agency theory and corporate governance perspectives, which posits that managers will act opportunistically if provided with sufficient discretion, with a more neutral perception of discretion within
the strategic perspective. However, Misangyi (2002) has contested this argument, arguing that both perspectives derive from a common point of departure — the assumption of profit maximization and, therefore, constitute comparable views on managerial discretion. Furthermore, the author shows that both theories draw essentially on the same nomological network of variables that explain the concept of managerial discretion, providing evidence that the two perspectives address the same phenomenon.

In this dissertation I take Misangyi’s (2002, p. 101) view on discretion, positing that:

... such a partitioning [between strategy and governance views on managerial discretion] is not warranted since all of the theories ... are concerned with explaining firm outcomes based upon the idea that management effects depend upon the same configuration of structural factors

In support of this view, in their initial conceptualization of the term Hambrick and Finkelstein (1987) acknowledged that managerial latitude of actions is constrained by the “zone of acceptance of powerful parties” (p. 378), highlighting that discretion comprises both latitude of actions and latitude of objectives. This duality has been somewhat neglected in subsequent studies based on Hambrick and Finkelstein’s (1987) original idea. In 2005, Shen and Cho elaborated on it, asserting that simultaneously considering both the latitude of managerial action and of managerial objectives in conceptualizing managerial discretion allows for a more comprehensive understanding of involuntary executive turnover. Subsequent work on upper echelons theory by Hambrick (2007) warned strategy scholars about taking an overly positive perception of managerial discretion. The author emphasized the neutrality of the concept and stated that discretion can be used for the benefit and harm of a firm. These recent developments in the literature point toward the need to reconcile the two perspectives on managerial discretion.

I place my dissertation within this nascent stream of literature, proposing that the governance and strategic perspectives on managerial discretion are two dimensions of the concept. Being agnostic to any assumption of drivers of

---

1 It needs to be acknowledged that Misangyi (2002) also discussed the third perspective on managerial discretion — one suggested by managerial capitalist theory (Marris, 1964, 1998). In this study, this theory falls in the strategic dimension of managerial discretion presented above. The central argument of managerial capitalist theory postulates that, in keeping with the assumption of minimum level of profitability, managers will prefer maximizing the growth of their corporations over maximizing profit. This emphasizes the importance of the competitive environment the firm is situated in. In the question of effective delegation, this view is consistent with the strategic management perspective, which emphasizes the growth and development of a corporation rather than the maximization of shareholders capital.
individual behavior, I contend that discretion can be used to enhance the value of a firm by allowing executives to take advantage of profitable strategic opportunities. It can be used to take self-interested action that reduces the value of a firm. While both enabling and restraining managerial actions are important for effective functioning of an organization, the degree of managerial discretion is determined by a combination of the two forces. Consequently, I define managerial discretion as a *latitude of strategic actions available to executives which lies within the zone of acceptance of the shareholders of a firm*. While the latitude of executive actions is related to the opportunities that exist in the firm’s strategic environment, the zone of shareholders’ acceptance is defined through the authority and autonomy delegated to managers by the shareholders.

1.3 Research problem

The separation between ownership and decision control in a modern corporation makes the question of how much authority and autonomy can be delegated to professional managers of paramount importance. On one hand, it is crucial for managers to have the authority and autonomy to make timely strategic decisions so the firm can contribute to maximizing shareholder wealth (Chandler, 1972; Child, 1972; Miles and Snow, 1978). On the other hand, managers may use the authority and autonomy opportunistically, resulting in a loss of shareholder wealth (Jensen and Meckling, 1976). Effective delegation, which balances the restraining and enabling of corporate executives, determines the degree and even the direction of executives’ influence on organizational outcomes.

Today, the research in corporate governance mainly addresses delegation through the concept of monitoring, focusing on ways to constrain the decision-making authority and autonomy delegated to managers (Goranova and Zajac, 2015; Shen, 2003; Tian, 2014). The present debate tends to ignore another, no less important, aspect of monitoring — its potential impact on the development of a corporation. In its current focus on the need to limit managerial decision making by shifting power to corporate boards (McNulty and Pettigrew, 1999; Stiles and Taylor’s, 2001), governance research does not sufficiently explain the strategic consequences of this shift and how they may be reflected in organizational outcomes.

In their introductory note, Hambrick, Werder and Zajac (2008, p. 382) pointed out potential negative effect of monitoring on managerial ability to undertake decisions:
Oversight is not simply a task but instead is an activity that implies the loss of autonomy for those who are overseen; and such corporate actors as CEOs and other top managers are often loath to give up the discretion they feel they deserve, given their significant responsibilities as senior executives.

This observation on CEOs’ and managers’ reluctance to give up discretion implies that the shift toward greater board monitoring of managerial strategic decisions opens up an inherent tension between the benefits of cost reduction and the firm’s ability to create value for the shareholders. While the benefits of reducing managerial opportunism are well documented (Faleye, Hoitash and Hoitash, 2011), several studies have shown that increasing monitoring may not always benefit organizations. Hoskisson, Castleton and Withers (2009) have argued that increasing board monitoring creates a governance dilemma as it increases the need for motivating managers through incentive alignment, which, in turn, leads to a further increase in monitoring. Chen and Nowland (2010) have shown that increasing monitoring in family firms leads to increased costs for shareholders. Knapp, Dalziel and Lewis (2011) argued that monitoring increases the salience of group membership leading to social categorization between managers and shareholders, which may in result in further increase of managerial opportunism.

Nascent research is questioning the emphasis on monitoring, arguing that it is important to broaden approaches to delegation. This could be done by considering the contingencies of a firm’s domain (Boone et al., 2007; Collin and Bengtsson, 2000; Randøy and Jenssen, 2004; Volonte and Gantenbein, 2014). A firm’s strategic environment is an important determinant in the ability of managers to develop the corporation (Hambrick and Finkelstein, 1987; Dess and Beard, 1984). Thus, the ability to capture profitable strategic opportunities in a timely manner will ultimately have an effect on creation of shareholder value. Incorporating the strategic management perspective into discussions about the consequences of monitoring on managerial decision making could help reduce the gap in understanding the impact of delegation and, consequently, the influence of executives on organizational outcomes. Integration of the strategic and governance dimensions of managerial discretion could overcome the limitations associated with the sole use of either dimension.

One way to integrate the divergent corporate governance and strategic perspectives is by using managerial discretion as a theoretical tool. This would allow for a comprehensive understanding of delegation, one that highlights the trade-offs between reducing managerial opportunism and providing opportunities for strategic development. The neutrality of managerial discretion highlights the inherent tension of delegation in maintaining the
balance between restraining and enabling managerial action. The integration of strategic and governance dimensions of managerial discretion could inform researchers about which governance mechanisms would be most beneficial. Consequently, I sought to build an integrative framework of managerial discretion that combined strategic and governance forces explaining the effects of executives on organizational outcomes. Developing the framework and a more complete picture of the impact of delegation meant having to 1) define the concept of managerial discretion and 2) examine the influence of discretion on organizational outcomes.

Defining the concept also requires having a better understanding of the forces that comprise discretion. While a large number of studies use managerial discretion to investigate other phenomena, presently, there is a lack of an understanding of the forces that influence managerial discretion and how they jointly affect executive decision making (Wangrow et al., 2014). Most of the research has investigated managerial discretion one level at a time, not taking into account the mutual influence of multiple determinants of discretion at different levels (for review, see Boyd and Gove, 2006; Wangrow et al., 2014). Consideration of the determinants of managerial discretion at both the environmental and organizational levels can help in exploring the links between the two levels. More specifically, it may illuminate how changes in a firm’s environment can affect the changes in discretion inside the firm. Since organizations are embedded within their external environments, a combination of organizational and environmental levels of analysis could be a way of gaining a more comprehensive understanding of managerial discretion (Boyd and Gove, 2006).

Further, one also needs to understand the dynamic nature of the concept, something the theory of managerial discretion has largely ignored (Hutzschenreuter and Kleindienst, 2012). Most of the research has treated managerial discretion as a static phenomenon, examining it in the comparatively stable institutional environments of developed countries (Wangrow et al., 2014). Conducting research in a less stable environment such as that of a transition economy could extend the theory of discretion and shed light on its dynamic nature.

The current literature on corporate governance has three deficiencies that prevent researchers from developing a comprehensive explanation for the influence of governance mechanisms on organizational outcomes. Integration of strategic and corporate governance views on discretion could address these deficiencies.

First, the current research in corporate governance that is grounded within the agency perspective mainly focuses on the internal environment of organization
represented by two groups of actors — managers and shareholders. It largely overlooks the environment in which a firm is embedded (Dalton et al., 2007). In contrast, the field of strategy is largely concerned with the ability of a firm to adapt successfully to the conditions of its external environment (Child, 1972; Miles and Snow, 1978). Research has argued for a more ‘open system’ approach to understand how bundles of corporate governance mechanisms function in diverse organizational environments (Aguilera et al., 2008). Thus integrating the strategic perspective into discussions on corporate governance could expand the understanding of corporate governance mechanisms and their effectiveness. More specifically, it could explain how these mechanisms influence organizational outcomes under different strategic contingencies.

Second, the governance view on managerial decision making is grounded within an assumption of utility maximization (Ross, 1973), largely disregarding other motives for individual action. This approach has been criticized for having overly simplistic assumptions about the drivers of individual actions (Perrow, 1986) and for being overly negative and even self-fulfilling (Donaldson and Davis, 1989; Hillman and Dalziel, 2003). The strategic management perspective views managers as key actors in developing an organization (Hambrick and Finkelstein, 1987), while not disregarding profit maximization as an important driver of managerial action (Misagnyi, 2002). Thus, integrating governance and strategic views on discretion could provide a more holistic picture of governance mechanisms and their role in organizational development. This may resolve the inconsistency in empirical research that explored the influence of corporate governance mechanisms on organizational outcomes.

Third, the present research in corporate governance is driven by an implicit assumption that more monitoring is always done for the benefit of a corporation (Finkelstein et al., 2009). However, it does not sufficiently explain how monitoring might influence managerial actions and organizational outcomes under different strategic contingencies. Similarly, little is known about the strategic implications of monitoring for organizational outcomes. Understanding them could provide a more balanced picture of shareholder wealth creation, illuminating the strategic consequences of limiting managerial authority and autonomy. A number of researchers have proposed that it is time to adopt a more integrative multi-theoretical approach toward the concepts shared by the two fields (Collin, 2007; Daily, Dalton and Cannella, 2003).

Using only the strategic management perspective also has limitations, and the inclusion of the governance perspective on managerial discretion could overcome them. In his critique of strategic management discipline, Shrivastava (1986) asserted that the paradigm of strategic management research implies a conflict-free view of organizations, leaving
unproblematised the assumption that the interests of managers resemble those of the shareholders. While agency theory is concerned with the alignment of interests between managers and shareholders, strategy perspective assumes that they are aligned (Misangyi, 2002). Furthermore, strategy research mainly focuses on managers and disregards other actors except as resources for implementing strategy (Knights and Morgan, 1990; Shrivastava, 1986). Accounting for the corporate governance view, and particularly the agency perspective, could broaden the focus of strategy research by incorporating the power dynamics that exists within an organization and their strategic implications.

To summarize, the theoretical problem addressed by this dissertation is the need to have a greater understanding of the impact that delegating decision-making authority and autonomy to professional managers has on organizational outcomes. With increasing monitoring of managerial decision making being emphasized by corporate governance literature, the enabling or developmental side of governance has been overlooked. A more balanced view of delegation, one that incorporates the strategic and governance consequences of increased monitoring on managerial decision making could contribute to the debate about the effects of corporate governance on organizational outcomes. To attain this goal, one needs to refine the concept of managerial discretion by integrating its strategic and governance dimensions. Then one needs to explore the joint influence of these two dimensions on organizational outcomes.

1.4 Research question

The following research question is posed in this dissertation:

*How do the strategic and governance dimensions of managerial discretion jointly influence organizational outcomes?*

1.5 Purpose and delimitations of the dissertation

The purpose of this study is to explore the impact of delegation on organizational outcomes, using managerial discretion as a theoretical tool to examine how the governance and strategic dimensions of managerial discretion jointly influence organizational outcomes. This purpose is intended to be achieved through 1) development of a theoretical framework that integrates strategic and governance dimensions of managerial discretion and 2) empirical testing of the joint effects of governance and strategic forces of managerial discretion on organizational outcomes.
The present study has three main delimitations. First, this study will analyze the concept of managerial discretion at environmental and organizational levels. This model does not, however, account for the influence of managers' individual characteristics on the degree of managerial discretion. Previous research has shown very little socio-demographic differences among corporate executives (March and March, 1977). The typical profile of an executive is male, about 50 to 65 years of age with a great deal of experience in international corporations (Bassiry and Dekmejian, 1990). The profile includes a prestigious education, an important characteristic of the corporate elite in some countries and a factor that limits the pool of executives to graduates from the top universities (Kim and Cannella, 2008). There is also considerable evidence of discrimination toward members of minorities in corporate elites, indicating a strong pressure toward homogenization (Hillman, Shropshire and Cannella, 2007; Park and Westphal, 2013). Furthermore, the small world of corporate elites with its dense networks tends to be remarkably stable and reluctant to changes (Davis, Yoo and Baker, 2003; Stafsudd, 2009). Consequently, one may argue that a long period of common socialization may influence the cognition of executives, thereby reducing the impact of individual characteristics on managerial discretion. Based on these arguments, the study assumes that organizational and environmental forces may have a larger influence than individual characteristics on managerial discretion. This delimitation means that individual dimension of managerial discretion will not be considered in this study.

Second, the central assumption of this study is that managers are competent at making decisions. While acknowledging that without ill intention, managers may use managerial discretion in a way that is harmful for their organizations, this dissertation focuses on the trade-offs between the reduction of managerial opportunism and the strategic development of a corporation. Consequently, I assume that executives are able to make competent decisions. This delimitation allows for a focus on the issue of restraining opportunism, defined as “self-interest seeking with guile” (Williamson, 1985, p.47), leaving issue of strategic mistakes made without the ill intentions outside the scope of this study.

The third delimitation is the focus on the monitoring role by the board. Other research has described the importance of other roles of the board, particularly in their service and resource provision functions (Hillman and Dalziel, 2003). However, those roles are outside the scope of this dissertation.
2. Theoretical Framework

This section provides an overview of the main theoretical perspectives on the influence of executives on organizational outcomes. First, it presents research on the function of executives. Then it describes managerial discretion through the lens of strategy and governance research perspectives. Next, it presents the theoretical discussion on the interrelationship between the different forces shaping managerial discretion and then the two dimensions of the concept. The concluding section presents the conceptual model.

2.1 The role of top executives in an organization

In *The Functions of the Executive*, Barnard (1938, p. 190) stated that “The executive is under the obligation of making decisions usually within approximately defined limits related to the position he has accepted.” The author suggested the term ‘zone of acceptance’ in reference to the ability of an executive to make decisions that will be accepted and followed without question. The acceptance of authority comprises the key mechanism of coordinating actions to achieve organizational objectives. Barnard proposed a theory of cooperative behavior stating that organizational decisions constitute a product of cooperative efforts among different groups of stakeholders. However, cooperation can seldom achieve perfection because of the conflicting goals of stakeholders. Simon (1947) further developed this idea, stating that instead of being an economic man who faces the complexity of a situation at its full, the organizational man uses simplified interpretations of reality and does not have an access to full information. Therefore, the maximization of outcomes in an organization is essentially compromised. Because rationality cannot be perfectly executed in the presence of information asymmetry, it is deemed to be bounded.

Subsequent work by Carnegie School theorists March and Simon (1958) posited that a manager’s role was one of an information processor and they
assumed constant interactions between the individual and the environment. In contrast to Simon (1947), the authors perceived organizations as embedded in their environments. March and Simon (1958) stated that executives acted in the environment of complexity, information overload, and ambiguity. In order to undertake decisions in such environments, managers rely on shortcuts, the blueprints of actions. In these situations, executives attribute their decisions largely to their own judgment, which is, in turn, based on their individual experiences.

A seminal paper by Hambrick and Mason (1984), which was built on the ideas of behavioral theory of a firm proposed by March and Simon (1958), has laid the foundation of the upper-echelon theory. The theory postulates that executives undertake decisions based on their personalized frameworks of action, which constitute a function of their personal characteristics. Thus, the decisions undertaken by the members of the dominant coalition are initially bounded to the group’s rationality. Team processes, namely social and behavioral integration and conflict, create dynamics that impose a group-think bias on a firm’s strategic outcomes. This theory initiated a wave of empirical research examining how individual characteristics of CEOs and members of the TMT might influence organizational outcomes. For example, a study by Wiersema and Bantel (1992) showed that demographic characteristics of TMT members, including tenure, education, and age, constitute significant predictors of corporate strategic change.

In congruence with the behavioral theory of a firm, the strategic choice school of thought argued that managers have a strong influence on the creation of strategy (Child, 1972) and participate in its implementation (Chandler, 1962). These ideas assumed that through the development and implementation of strategy, managers are able to achieve a strategic fit, adapting the company to the forces of its external environment. Subsequent empirical studies provided substantial support to this notion (Norburn and Birley, 1988; Smith et al., 1994).

In addition, the notion of managers having limited cognitive capacity, which was proposed by the behavioral theory of a firm, has served as a foundation for the theory of transaction costs economics. In his seminal work, economist Oliver Williamson (1975) used the concept of the cost of economic transactions to explain why certain transactions take place inside a firm while others are conducted outside. The author posited that due to the increased complexity of economic transactions and to uncertainty and market coordination costs, certain transactions are more efficient when conducted inside a firm. This explains why complex transactions require large hierarchical organizations. The theory is grounded within an assumption that managers are collectively responsible for adapting the firm and its governance
structure during the firm’s development. The adaptation can be achieved by fiat. In congruence with the behavioral theory of a firm, Williamson (1975) emphasized managerial involvement in the creation and the adaptation of governance structure for a particular firm.

In contrast, the environmental determinism, which is grounded within organizational ecology (Hannan and Freeman, 1977) and neo-institutional theories (DiMaggio and Powell, 1983), takes a different view on the influence of executives on organizational outcomes. It rejects the concept of an organizational capacity for adaptive change. This perspective is based on the premise that organizational outcomes are primarily a result of a firm’s external environment rather than of the strategic choices of management. It explains organizational survival based on the fit between organizational structure and the forces of the external environment. The proponents of organizational ecology theory contend that organizational inertia prevents organizational change (Hannan and Freeman, 1977). This perspective attributes the survival of the firm to a natural selection process, where firms with the closest fit to the external environment remain on the market, while others eventually disappear (ibid). In congruence with this, neo-institutional theorists attribute the similarity among organizations to the existence of an institutional pressure that regulates the behavior of economic agents (DiMaggio and Powell, 1983). The notion of isomorphism implies that organizations mimic the strategies of successful firms that are similar to them. This explains why in each environment particular organizational forms prevail over others. Subsequent empirical research has shown empirical support for the influence of environmental determinism on organizational outcomes (Barnett, 1990; Gentry, Dalziel and Jamison, 2013).

By 1980s the debate between the proponents of strategic choice and of environmental determinism became central in management research. Subsequently, the focus of researchers shifted from viewing the two theories as being mutually exclusive to the assertion that the two assumptions can be considered points on a continuum (Hrebniak and Joice, 1985; Zammuto, 1988).

In line with this idea, Hambrick and Finkelstein (1987) developed a concept of managerial discretion, introducing it as a moderator of the relationship between the TMT’s strategic choices and organizational outcomes. In this concept, the ability of the management team to influence organizational outcomes is assumed to depend on the scope of decision-making opportunities available to them and their organizations. The number of strategic opportunities is defined by the joint influence of multiple forces deriving from a firm’s internal and external environments as well from a manager’s individual characteristics. The introduction of managerial discretion to
Strategic management research has brought a wave of studies using the concept as a moderating variable to explain executives’ influence on organizational outcomes (Haleblian and Finkelstein, 1993). The main focus of this stream of research is firms’ strategy and performance (Nag, Hambrick and Chen, 2007), with an implicit assumption that managers’ goal is to align the firm with the forces of its external environment. This perspective does not explicitly question the motives for individual behavior, but rather assumes that managers act to maximize the profits of the corporation. Thus, the greater the latitude of managerial strategic actions, the greater the influence that managers can have on organizational strategic adaptability.

Scholars in corporate governance have also examined managerial discretion, but from a different angle. Shleifer and Vishny (1997) addressed managerial discretion from agency theory perspective, viewing it as a potential cost for a firm. The authors argued that in order to limit managerial opportunism, the degree of discretion available to managers needs to be minimized. In his article Managerial Discretion and Business Behavior (1963), Williamson explores the concept of managerial discretion from a cost-oriented perspective. Based on the utility maximization assumption of individual behavior, he sees managerial discretion as an area where managers can engage in opportunistic behavior. The author compares utility maximization and rationality motives of executive behavior, finding evidence to support utility maximization theory. Williamson referred to managerial discretion as a latitude of managerial objectives. Later studies within the governance field followed this thought, exploring ways to align managerial objectives and a firm’s objectives through mechanisms of corporate governance and so set the boundaries on the executive decision-making function (Fama, 1980; Fama and Jensen, 1983; Jensen and Meckling, 1976).

As shown, the strategic management and corporate governance perspectives highlight the complexity of managerial discretion and tension inherent in delegation. The next sections will provide a more detailed account of research on managerial discretion within strategic management and corporate governance, respectively.

### 2.2 Strategic dimension of managerial discretion

The strategic management perspective views managerial discretion as a scope of strategic actions that managers can undertake to adapt their company to changes in its external environment (Hambrick and Finkelstein, 1987). The concept of managerial discretion is viewed as a theoretical lever that can integrate the organizational ecology perspective with the theory of strategic choice. Namely, based on this view, managerial influence on organizational
outcomes will be determined by the degree of discretion that executives possess (Finkelstein and Hambrick, 1990; Halebian and Finkelstein, 1993, Magnan and St-Onge, 1997; Waldron et al., 2012).

In their seminar article, Hambrick and Finkelstein (1987, p. 378) postulated that the latitude of managerial actions will lie in “the zone of acceptance of powerful parties” in an organization, such as the board of directors. This broad definition incorporates strategic and corporate governance dimensions, acknowledging that managerial objectives may not be congruent with those of the powerful parties or the principals of the organization. However, subsequent studies, which based their conceptualization on Hambrick and Finkelstein (1987), have focused mainly on the strategic dimension of managerial discretion, conceptualizing it solely as a latitude of managerial actions (for review, Wangrow et al., 2014). While acknowledging the potential for managerial opportunism, this strain of literature largely assumes that the interests of managers and shareholders are aligned (Misangyi, 2002). While strategy researchers recognized governance mechanisms as important factors that might influence the level of discretion delegated to managers (Crossland and Hambrick, 2007), the majority have not problematized the potential divergence of managers’ and shareholders’ objectives (for notable exceptions, Cho and Shen, 2005; Hambrick, 2007). In this study, I conceptualize strategic dimension of managerial discretion as a latitude of actions available to managers to undertake strategic decisions.

Research on the strategic dimension of managerial discretion focuses on understanding what forces enable or constrain managers in their ability to undertake strategic decisions and how these forces shape organizational outcomes. Studies have explored the antecedents, contingency effects, and consequences of managerial discretion. Only a few studies used managerial discretion as dependent variable, focusing on managerial perceptions of the level of discretion they possessed (Key, 2002) or on expert evaluation of the level of discretion available to managers in different industries (Hambrick and Abrahamsson, 1995).

The majority of studies focused on interaction effects between managerial and organizational characteristics and managerial discretion. Research focusing on the moderating effects of managerial discretion has shown its influence on the relationship between CEOs’ characteristics and firms’ financial, market (Crosslan and Hambrick, 2007; Geletkanycz and Hambrick, 1997), and social performances (Arnaud and Wasielski, 2013). In addition, research has shown a moderating effect of managerial discretion on CEO involuntary turnover (Shen and Cho, 2005), dismissal (Crossland and Chen, 2013), and CEO compensation (Magnan and St. Onge, 1997; Waldron et al., 2012). Fewer studies have explored the mediating effects of managerial discretion. Quigley
and Hambrick (2012) explored the effect on retaining the previous CEO in a board chair position on the relationship between the CEO’s departure and the firm’s subsequent performance. The results revealed that having CEOs remain in the board chair position could significantly constrain the ability of new CEOs to initiate strategic change.

Some studies have also explored a direct relationship between managerial discretion and organizational outcomes and found positive effect of managerial discretion on organizational performance in highly competitive markets (Zhao, Chu, and Chen, 2010). Finkelstein and Boyd (1998) found both direct and contingency effects on CEO compensation. The study results showed that higher managerial discretion is associated with higher executive pay and that a firm’s performance increases when managerial discretion and executive pay are aligned.

The strategic dimension of managerial discretion is generally conceptualized at one of three levels of analysis: environmental, organizational, or individual. The majority of studies have explored managerial discretion at the environmental level (Wangrow et al., 2014), and conceptualized the environmental forces in terms of institutional and managerial task environment factors. The institutional forces emphasized the national characteristics (Crossland and Hambrick, 2007; 2011; Makhija and Seward, 2002) and isomorphic pressure (Hambrick et al., 2004) that influence managerial decision making. The managerial task environment forces captured the antecedents of managerial discretion stemming from industry-related factors. The subsequent sections provide an overview of research on strategic dimension of managerial discretion at environmental and organizational levels of analysis.

2.2.1 Environmental level of managerial discretion

2.2.1.1 Institutional determinants of managerial discretion

While the initial conceptualization of managerial discretion by Hambrick and Finkelstein (1987) at the environmental level has only focused on industry determinants of managerial discretion, subsequent research has extended it to the national level (Crossland and Chen, 2013; Crossland and Hambrick, 2007). The institutional determinants of managerial discretion were argued to derive from economic, legal, cultural, and political forces that jointly influenced the ability of managers to alter organizational outcomes (Wangrow et al., 2014).

Most studies exploring managerial discretion at the national level have relied on new institutional theory that focuses on how institutional forces influence organizations (North, 1990). According to this theory, executives in different countries operate in distinct institutional contexts with idiosyncratic ‘rules of
the game’ (ibid). These rules can be explicit or formal, such as laws, regulations, policies, or implicit, such as informal beliefs, norms, customs, and traditions. These forces jointly create a relatively consistent and stable structure for human interactions, determining the nature and availability of information as well the ability to predict consequences of decisions (Makhija and Stewart, 2002).

Recent studies that extended the notion of such forces to the national level have shown that a country’s institutions can either enhance or limit the latitude of managerial actions. Crossland and Hambrick (2007) showed that American CEOs retain larger discretionary power than Japanese and German CEOs. The authors attribute their results to the differences in cultural values and corporate governance mechanisms in the sample countries. A subsequent study by Crossland and Hambrick (2011) examined the effects of formal and informal institutions on the level of managerial discretion in a sample of 15 countries. The results revealed that the CEOs’ effect on a firm’s outcomes varies significantly. More specifically, the study showed that a greater degree of individualism in national culture is associated with greater managerial discretion at the national level. Crossland and Chen (2007) argued that a greater national level of managerial discretion increases the stakeholders’ expectations that the CEO will assume a greater responsibility for the firm’s outcomes. The authors have shown that CEOs are held more accountable for negative corporate performance in some national contexts. Similarly, Makhija and Stewart (2002) showed that managers in open market economies perceive they have greater outcome accountability than managers do in state-planned economies, confirming the national environment as a significant predictor of managerial decision making. In addition, Gedajlovic and Shapiro (1998) compared different governance systems at the national level, arguing that in France and Germany the internal governance of managerial discretion will be the strongest constraint, while in Anglo-Saxon systems, the strongest constraint comes from the firm’s external environment.

Only a few studies have explored national-level determinants of managerial discretion in the dynamic context of institutional change. Hambrick et al. (2004) have applied institutional theory to trace the change in a wide array of industries in the U.S. over the course of the 20th century. Their results indicated a trend toward greater heterogeneity of organizational forms and strategies, and consequently an increased level of managerial discretion. The authors showed that over the past century the influence of isomorphic forces on organizations have dropped. This has given managers increasing latitude of action and the ability to differentiate their firms from the competitors, leading to an increase in heterogeneity across industries. In addition, some studies have addressed how institutional change at the national level of analysis is reflected in managers’ strategic choices. Peng (2003) has theorized about how
organizations make strategic choices during institutional transition. The author argued that as a national economy transitions from being one of relationship-based personal contracts to arms-length impersonal exchange contracts, different types of firms may experience different levels and directions of institutional pressure. This may result in a variety of strategic choices. Applying this argument to managerial discretion, institutional transition requires managers to react in a timely fashion in adapting their corporations to changes in the external environment. This strongly links managerial choices to organizational outcomes, indicating increasing levels of discretion. Since the old institutional logic is no longer relevant, while the new logic has not yet been adopted and reinforced, managers’ latitude of choices increases as they can choose which institutional logic to follow. Thus the process of institutional change leads to an increased environmental level of managerial discretion.

In contrast, a convergence of institutional practices will ultimately lead to a reduction in managerial latitude of action. According to institutional theory, choices made in the past may constrain the latitude of choices considered in the future (North, 1990). While institutional reinforcement of efficient practices increases the overall efficiency of the system, path dependence theory explains how inefficient practices become locked in in the absence of an exogenous shock (David, 2001). In particular, the theory illuminates how the relative stability created by establishing institutions may lead to rigidity, inertia, and stickiness, ultimately resulting in constrained managerial discretion (Sydow, Schreyögg and Koch, 2009). Managers, operating under stable institutional forces, may become limited in their strategic actions because they base their choices on past experience, rather than look for alternatives. Indeed, in stable environments the rates of growth and development are much more modest than in those of less stable emerging markets (Khanna, Palepu and Sihna, 2005). Institutional voids create more volatility and, consequently, a greater array of strategic choices because all the players have not yet adopted the rules of the game. In contrast, more stable institutional environments with effectively enforced rules of the game and greater predictability create less volatility and uncertainty, thus limiting the latitude of managerial choices and executives’ ability to influence organizational outcomes.

Overall, institutional forces are important determinants of managerial discretion that enhance or constrain executives’ latitude of action. In low-discretion institutional environments, the executive role can be characterized as that of a “titular figurehead” (Hambrick and Finkelstein, 1987, p. 389), where the CEO does not have a substantial influence on organizational outcomes. In high-discretion institutional environments, CEOs are generally viewed as ‘unconstrained managers’ where they assume and exercise great
influence over the fates of their organizations (ibid). When an institution goes through change, new and old institutional logic influence executives. Dealing with the new brings uncertainty, which opens up new opportunities and increases managerial discretion, while depending on the old logic creates rigidity and, ultimately, constrains managerial choices.

2.2.1.2 Task environment determinants of managerial discretion
Empirical research has shown support for the assumption that the nature of managers’ external task environment imposes a significant influence on the level of managerial discretion. Hambrick and Finkelstein (1987) distinguished six proxy domains of managers’ task environment that determine the latitude of managerial discretion. These characteristics are product differentiability, market growth, industry structure, demand instability, quasi-legal constraints, and powerful outside forces. Combinations of these factors are assumed to determine the amount of managerial discretion within a corporation.

Product differentiability. According to Hambrick and Finkelstein (1987), the scope of decision-making opportunities that the management team has is positively related to the degree of differentiation of the products or services on the market. High-discretion industries offer a wide scope of choices when it comes to product variety, packaging, distribution, and marketing. Traditional, low-discretion industry environments offer a narrow scope options for managers to act upon. Consequently, increased product differentiability is assumed to be associated with an increased degree of managerial discretion.

Market growth. When compared to mature markets, growing markets are assumed to be characterized by the wide range of managerial actions (Porter, 1980). Decision-making patterns in growing markets change unpredictably and executives have wide latitude of decision-making choices (Hambrick and Finkelstein, 1987), while more mature markets may impose constraints on the discretion available to managers.

Industry structure. Industry structure, in other words, the amount of competition within an industry, is another factor affecting the latitude of managerial discretion. Oligopolistic structures characterized by several main competitors will follow well-established rules within the market, while more competitive industries may be more open to innovative moves and unconventional strategic choices. An array of strategic choices is expected to lead to increased discretionary power for managers operating in more competitive environments (ibid.).

Demand instability. Highly competitive products and the reduction in product life-cycle are increasingly associated with demand volatility (Huang, Chang and Chou, 2008). These conditions create opportunities for managers to
capitalize on the flexibility of demand, using it as a strategic asset and thereby broadening their scope of strategic actions. Hambrick and Finkelstein (1987) posited that the role of top executives will increase in the presence of high demand volatility.

**Quasi-legal constraints.** The amount of regulations and of legal requirements that firms are forced to comply with affects managerial discretion. The heavier the burden of legal requirements, the fewer options managers have. This leads to the assumption that the higher level of quasi-legal constraints will have a negative influence on the degree of managerial discretion (ibid).

**Powerful outside forces.** Phillips et al. (2010) argued that firms’ stakeholders play an important role in shaping managerial actions. Thus, it can be assumed that powerful outside stakeholders may impose significant constraints on managerial latitude of actions or may significantly increase them. By ‘powerful outside forces,’ Hambrick and Finkelstein (1987) referred primarily to the power of suppliers, buyers, and major competitors operating within the industry. In addition, business networks can be regarded as influential stakeholders able to limit the amount of discretion available to managers. Previous research has indicated that the information received through directors’ business interlocks increases the influence of managers and contributes to an improvement of the strategic fit of a firm (Geletkanycz and Hambrick, 1997; Haunschild and Beckman, 1998). Vasilchenko and Morrish (2011) argued that networks can significantly contribute to the exploitation and exploration of international opportunities. Thus business networks may also be considered as an important outside force that influences the degree of discretion. It needs to be acknowledged that previous studies have not discussed powerful outside forces in detail. The original article by Hambrick and Finkelstein (1987) did not provide a thorough explanation of this determinant and its measure was seldom used in previous research on managerial discretion (Boyd and Gove, 2006).

Subsequent research attempted to construct comprehensive indices of managerial discretion for a diverse range of industries. Finkelstein and Hambrick (1990) used environmental factors to develop a classification based on the degree of discretion managers have. The authors differentiated between high-, medium-, and low-discretionary environments. They showed support for the original notion that managers will have a limited amount of discretion in stable environments. On the other hand, managers have a larger scope of managerial decision-making opportunities in fast-growing dynamic environments. In congruence with this, Hambrick, Geletkanycz and Fredrickson (1993) attributed the highest discretion scores to the computer, food and beverage, and scientific measurement equipment industries, and attributed the lowest discretion level to the telecommunications industry. In
their later work, Hambrick and Abrahamson (1995) constructed a comprehensive measurement of industry-levels of managerial discretion, ranking 17 industries with computer and software wholesaling having the highest degree of discretion and natural gas transmission having the lowest degree discretion.

Managerial task environment is one of the most widely used conceptualizations of managerial discretion. At the task environment level, managerial discretion can be analyzed through six proxy domains. Subsequent research constructed comprehensive indices of discretion for particular industries.

2.2.2 Organizational level of managerial discretion

Managerial discretion may stem from the nature of organization. The organizational level of managerial discretion is conceptualized through three main proxy domains: organizational inertia, resource availability, and powerful inside forces. According to Hambrick and Finkelstein (1987), the greater the number of inertial forces that exist within an organization, the smaller the scope of discretion available to managers. Organizational inertia may arise from an organization’s size, structure, culture, and capital intensity (Hambrick and Finkelstein, 1987). The authors assumed that larger organizations possess more organizational inertia, which, in turn, may limit the discretionary power of the CEO. This is in congruence with Aldrich (1979), who asserted that large organizations are more difficult to change because of organizational inertia. Furthermore, organizations with a hierarchical structure may experience inertial forces that limit the degree of discretion available to managers. A flat organizational structure is, however, assumed to provide a wider latitude of managerial actions. In addition, a strong organizational culture may be considered an important factor influencing managerial discretion. Well-established routines, patterns, and norms of behavior impose constraints. Managers are expected to act within the norms; acting against them may signal a high level of discretion. According to Hannan and Freeman (1977), firms that possess fixed capital investments in specific assets will impose significant constraints on managerial discretion. Thus, the capital intensity of a firm is assumed to be negatively related to the managers’ latitude of actions.

The nature of a firm’s resources influences the degree of managerial discretion. A large amount of literature on organizational slack shows that having uncommitted resources is important to an organization’s strategic development (Bourgeois, 1981; Chakravarthy, 1982). This implies that the more slack resource managers have, the greater the scope of strategic actions available to them, which, in turn, leads to an increase of managerial discretion (Finkelstein and Hambrick, 1990).
Furthermore, Hambrick and Finkelstein (1987) refer to internal political conditions as powerful forces affecting the degree of managerial discretion. The authors hypothesized that internal power coalitions can constrain the degree of managerial discretion. Dominating owners and the board members are examples of internal power coalitions. While Hambrick and Finkelstein (1987) assumed that only the influence of the board of directors can have a negative impact on the degree of managerial discretion, Shen (2003) pointed out that the duality of CEO-board relationship may enhance the latitude of managerial actions. The author posited that the board is a monitoring agent and may reduce the scope of strategic actions available to managers, aligning their objectives with the objectives of their firm. Quigley and Hambrick (2012) showed that retaining former CEO on the board of directors may significantly restrain managerial discretion of the newly appointed CEO. At the same time, the board can also be a source of managerial power by providing advice and counsel to the CEO. The active involvement of the board in the development of the CEO can be seen as a source of managerial discretion that increases the scope of strategic actions available and can possibly align the interests of managers and shareholders through collaboration and development of a shared vision.

To summarize, organizational factors comprise the organizational level determinants of managerial discretion. The factors may constrain or enhance the amount of discretion that executives possess in an organization.

2.3 Governance dimension of managerial discretion

Shleifer and Vishny (1997, p. 737) state, “Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return of their investment”. Corporate governance research focuses on disciplining managerial behavior, and managerial discretion constitutes one of its central concepts. The studies addressing managerial discretion within governance research are largely grounded within transaction cost economics theory (Williamson, 1963; 1975; 1998) and agency theory (Eisenhardt, 1989; Jensen and Meckling, 1976). Both theories address the question of how to mediate the costs associated with incomplete transaction contracts among economic agents.

Transaction cost economics theory is grounded within the assumptions of bounded rationality and the unavoidability of incomplete contracts (Williamson, 1998). The costs of negotiating, monitoring, incentivizing, and reinforcing these contracts, incurred by the parties involved in exchange to protect their interests, refer to the transaction costs (Oviatt, 1988).
transaction cost economics theory focuses on modeling the transaction to minimize costs associated with it by applying the mechanisms of corporate governance.

While transaction cost economics theory is concerned with the organizational boundaries determined through contracts, agency theory focuses on a specific contract between two cooperating parties (Eisenhardt, 1989). Through the lens of agency theory, a firm can be defined “as a nexus for a complex set of contracts (written and unwritten) among disparate individuals” (Jensen, 1983, p. 326). The agency relationship in turn refers to

... 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 (Jensen and Meckling, 1976, p. 308).

When managers fail to maximize returns for the shareholders, be it due to inability or unwillingness to undertake decisions directed to shareholder value maximization, agency costs will occur (Fama and Jensen, 1983). The agency perspective deals with the ways to minimize such problems with the use of corporate governance mechanisms that protect shareholders and assure the maximization of returns on their investments (Shleifer and Vishny, 1997).

In line with agency theory, the governance perspective on managerial discretion advocates the use of “bundles of governance mechanisms” (Rediker and Seth, 1995, p. 87) to constrain managerial objectives of profit maximization by imposing control over managerial actions. In situations of high managerial discretion, managers operate within a broad zone of acceptance, (i.e., fewer constraints are imposed on their decisions). In situations of low managerial discretion, managers operate within a highly constrained zone of acceptance.

The agency perspective views managerial discretion as a function of the mechanisms of corporate control (Jensen and Meckling, 1976; Williamson, 1963). Managerial discretion is perceived as a gray zone in which managers can take advantage of the information asymmetry between the shareholders and the managers and engage in opportunistic behavior. This absorbs discretionary profits, resulting in a loss of shareholder value. The minimization of such costs can be implemented through two broad categories of governance mechanisms: one that emphasizes monitoring ex post and one that focuses on incentive alignment ex ante by using incentives to link executives’ behavior to firm performance (Tosi, Werner, Katz and Gomez-Mejía, 1997). The monitoring mechanisms of governance include the board of directors (Fama and Jensen, 1983), independent auditors (Healy and Palepu,
2001), and concentrated ownership structures (Connelly, Hoskisson, Tihany and Certo, 2010). The incentive alignment function is implemented through variable executive remuneration (Murphy, 1985) and CEO ownership (Jensen and Meckling, 1976). While the monitoring mechanisms of governance are focused on controlling managerial behavior by limiting decision-making authority and autonomy, the incentive mechanisms impose control through motivation. Incentive-based motivation can increase managerial discretion, encouraging managers to develop their organizations. The latter can also constrain managerial action, since managers whose wealth is tied to the stock prices may become risk averse and try to preserve their wealth rather than maximizing its value potential.

Research on managerial discretion from the governance perspective focuses primarily on the interplay between governance mechanisms and the degree of managerial discretion. In particular, the majority of the studies argue that governance mechanisms designed to align the objectives of a firm with the objectives of the managers are needed to impose limitations on managerial discretion. A study by Bailey et al. (2011) showed the discrepancy between managerial objectives and the objectives of the shareholders in relation to the allocation of the bonus pool. The authors empirically demonstrated that managers responsible for the bonus pool will act in their self-interest when they have full discretion. This effect is mitigated when discretion is partial. Consequently, firms where managers possess a large scope of discretion need stronger internal governance mechanisms (Miller, 2011) to reduce the level of discretion or to influence its use (Tosi et al., 1997). These findings imply that corporate governance mechanisms could be adjusted to match the level of managerial discretion within a firm to minimize the agency costs resulting from conflicts of interest between agents and principles. A study by Agarwal, Daniel, and Naik (2009) provided empirical support for this notion, showing that the agency costs resulting from managerial discretion can be mitigated through managerial incentives, resulting in superior performance. The two factors are viewed as complimentary, highlighting the importance of both managerial freedom of actions and governance mechanisms aimed at aligning managerial objectives with the objectives of the shareholders.

As was demonstrated in the review of corporate governance literature on managerial discretion, this perspective advocates the use of governance mechanisms to mitigate the agency costs arising from managerial discretion. The following sections present the mechanisms of corporate governance that may mitigate the costs associated with the degree of managerial discretion through the alignment of managerial objectives with the objectives of a firm.
2.3.1 Internal governance mechanisms shaping managerial discretion

The goal of the governance mechanisms is to align the interests of the principles and agents of a firm (Fama and Jensen, 1983). Previous research has distinguished between internal and external mechanisms of corporate governance (Walsh and Seward, 1990). The commonly applied internal mechanisms include concentrated ownership structure, and the board of directors, managerial compensation, and firm capital structure (Fama, 1980; Jensen and Meckling, 1976). The following section presents each of the above-mentioned mechanisms of corporate governance.

Ownership structure. Ownership structure is an important mechanism in determining the monitoring function of corporate governance (Shleifer and Vishny, 1997; Filatotchev and Nakajima, 2010). Large blockholders are assumed to possess a significant amount of power and influence over the management team (Moerland, 1995). Hambrick and Finkelstein (1995) asserted that a concentrated ownership structure is associated with a lower degree of managerial discretion when compared with a dispersed ownership structure. Consequently, a concentrated ownership structure is seen as a mechanism to limit managerial discretion through increased control and monitoring of managerial decisions. Thus, it can be assumed that discretion will reduce the latitude of managerial actions while aligning managerial objectives with the objectives of the shareholders of the firm.

Board of directors. According to Fama (1980), the board of directors represents an institution created to monitor the set of contracts representing a firm. Previous research distinguished between two main roles associated with the board, including control and resource provision (Hillman and Dalziel, 2003; Pugliese, Minichilli and Zattoni, 2014). The control role is mainly the monitoring of managers’ activities and assuring that they act for the benefit of the corporation. In accordance with the control role, the board has a right to hire or dismiss the CEO. Maug (1997) emphasizes the role of independent directors as a mechanism for limiting managerial discretion through the negotiation of contracts. Thus, an active board and independent directors are assumed to limit the amount of managerial discretion through greater control over managerial decisions. On the other hand, a CEO who has a major influence on the board is assumed to increase discretion, particularly in the case of CEO duality. Research within managerial power perspective argues that in pursuing their self-interests powerful CEOs can influence boards’ decisions (Bebchuk et al., 2002; Bebchuk and Fried, 2003; 2004; Hall and Murphy, 2003). This proposition was supported by considerable evidence showing that CEOs use their power to take advantage of incentive-based compensation (Burns and Kedia, 2006; Efendi, Shrivastava and Swanson,
Combining CEO and board chair positions enhances the power of the CEOs. Harrison, Torres and Kukalis (1988) compare the power of CEOs that do not hold the board chairperson position and those that combine them, arguing that the latter have a greater effect on the firm performance. In congruence with this, Finkelstein and D’Aveni (1994) asserted that CEOs who also hold the board chairperson position have greater discretion compared to CEOs that do not combine the two positions.

The resource role of the board entails providing advice and consulting work concerning the firm’s strategic decisions as well as providing managers with access to valuable resources. The two main roles of the board highlight the duality of its functions. On one hand, the purpose of the board is to assure that managerial decisions are made in accordance with the goals and priorities of the shareholder. On the other hand, the board is responsible for providing resources, counseling, and advice to the CEO, which can enlarge the scope of strategic opportunities for executives (Shen, 2003). Thus, one can assume that board monitoring is associated with a reduced latitude of managerial actions, while managerial objectives are more aligned with the firm’s objectives. Simultaneously, greater engagement by the board in strategic decisions-making process and greater board capital can be associated with the resource provision function, thus increasing the latitude of managerial actions.

Whether these two roles can be complimentary or act as substitutes for each other is a point of debate in the literature. On one hand, Jonnergård and Stafsudd (2010) depicted the active role of the board as a combination of both monitoring and strategic advice functions. In contrast, Adams and Ferreira (2007) argued that since the information needed by the board in order to provide strategic advice for the CEO can also be used to monitor one’s activities, the CEO will face trade-offs in sharing information with the board. The authors suggested that the two roles of the board may be in conflict, implying that with increased monitoring, the board will not be able to perform its service and advice roles. Yet, it is important to acknowledge that while the studies have generated important insights about both roles, the question about the relationship between them remains on the research agenda.

**Capital structure.** The capital structure of a firm constitutes another mechanism of corporate control. The discussion on an optimal capital structure is dominated by two main theories: pecking order and static trade-off (Myers, 1984; Myers and Majluf, 1984). The static trade-off theory predicts that firms will move to optimal capital structure based on the tax shield benefits and the degree of financial distress of a firm. According to the pecking order theory, the information asymmetry between a firm’s investors and managers creates incentives for managers to prefer internal to external
financing (Myers and Majluf, 1984). When the use of internal financial resources is constrained, the choice of external financing is considered.

With external financing, the general debate lies in the choice between debt and equity capital. According to the agency perspective, debt financing is expected to significantly reduce managerial discretion by limiting free cash flow within the firm (Jensen, 1986; Maug, 1997). In addition, debt financing places significantly more obligations on the debt holders of a company by limiting the degree of discretion. In support, Morelec (2004) asserts that managers tend to prefer equity financing because of the reduced discretion associated with a debt capital structure. The results hold under conditions where debt financing would be more beneficial to the shareholders. This leads to two assumptions: first, internal financing will increase managerial discretion, and second, if the firm’s seeks external financing, equity financing is associated with higher level of managerial discretion than debt financing is.

On the other hand, the trade-off theory developed later based on the work by Modigliani and Miller (1958) proposed that each company will determine an optimal capital structure evaluating the costs and benefits associated with debt financing. While debt financing can create benefits in terms of expected tax benefits, while bare negative consequences of potential financial distress. According to the static trade-off theory based on these considerations a firm will set and gradually adapt to an optimal debt-to-equity ratio (Myers, 1984). Subsequent research by Fama and French (2005) asserted that both models can provide valid explanations to the choice of capital structure and therefore need to be viewed as complimentary rather than mutually exclusive. Therefore in developing the propositions regarding the influence of capital structure on the latitude of managerial actions, one may assume that debt financing may generally restrain the degree of managerial discretion; however, when the probability of negative consequences of financial distress is low such effects can be positive.

Executive compensation structure. The structure of executive compensation comprises one of the central components of corporate governance (Fama and Jensen, 1983). One perspective views executive compensation as an instrument of governance aimed at aligning the interests of managers with those of the shareholders through the negotiation of arm’s length contracts (Murphy, 1993). Another view on managerial compensation is grounded within the managerial power perspective, arguing that managers may use their influence within the firm to influence own level of compensation (Bebchuk and Fried, 2004). Subsequent findings support this perspective, showing evidence that an incentive-based compensation structure is associated with higher likelihood of accounting misconduct (Harris and Bromiley, 2007). Sapp (2006) asserts that executive compensation is a joint product of both views.
and can be partially explained by governance aspirations and partially as a reflection of executive power.

Consistent with the two perspectives, managerial discretion presents a useful concept in explaining the nature of executive compensation. On one hand, higher managerial compensation is associated with higher level of managerial discretion (Finkelstein and Boyd, 1998), reflecting the power of managers over their compensation packages (Bebchuk, Fried and Walker, 2002; Finkelstein and Hambrick, 1988). On the other hand, an incentive-based compensation structure may serve as an instrument to mitigate potential agency costs associated with managerial discretion by aligning the objectives of the managers with the objectives of a firm’s shareholders (Jensen and Meckling, 1976). From the governance perspective and assuming that the incentive-based structure of executive compensation is effectively designed, it is also imperative to consider that alignment of managerial interests with those of a firm may reduce the costs of managerial opportunism without reducing the degree of discretion available to managers. In other words, executive compensation structure presents a mechanism of directing managerial behavior without necessarily limiting the latitude of actions available to executives.

2.3.2 External governance mechanisms shaping managerial discretion

Previous research also distinguished external mechanisms of corporate governance. One external control for disciplining managers is the managerial labor market (Jensen and Meckling, 1976; Shleifer and Vishny, 1997). In addition, research has discussed the role of the market for corporate control (Jensen and Ruback, 1983; Manne, 1965) as a monitoring mechanism of managerial behavior. The external audit can also be viewed as an important mechanism for assuring that managers are acting in accordance with the firm’s objectives (Watts and Zimmerman, 1983).

*Market for managerial labor.* The market for managerial labor is another mechanism that helps disciple managerial behavior (Moerland, 1995). If the manager is no longer performing well, he or she will be replaced by better candidates. In addition, information about the manager’s performance will spread quickly, making it difficult for the executive to find employment opportunities. Consequently, high competition for managerial labor will have a negative effect on managerial discretion because of the constraints associated with future employment opportunities. On the other hand, a scarcity of openings and an under-represented market for managerial labor will have a positive effect on managerial discretion because of the reduced competition for managerial positions.
Market for corporate control. Manne (1965) stated that the market for corporate control will discipline managerial behavior because of the threat of other corporate actors seizing control from the current management. Well-functioning market for corporate control is assumed to reduce the degree of managerial discretion due to the threat of hostile takeovers, whereas in the case of poor performance the control will be transferred from the managers of the company (Fama, 1980; Shleifer and Vishny, 1997).

External audit. The audit is a monitoring mechanism that assures the validity of the contract between the management and the owners of the corporation (Watts and Zimmerman, 1983). In order to minimize opportunistic behavior of managers, shareholders implement financial audit as a mechanism of control (Fama, 1980). This implies that using an independent audit may have a negative influence on the degree of managerial discretion because of the enforced control mechanisms.

Another aspect influencing the level of managerial discretion is related to the ability of managers to influence the accounting standards. According to the positive accounting theory, the choice of the accounting standard is delegated to the agent of the firm (Watts and Zimmerman, 1990). Nelson, Elliot and Tarpley (2002) noted that one goal of managers when choosing an accounting standard is maximization of their discretion. Thus, it can be assumed that managers with wider choice concerning adjustments of accounting standards will have a higher level of discretion. In support of this, Keegan and Kabanoff (2008) explored the breadth of choice concerning firm’s accounting standard and found it is associated with a higher level of managerial discretion. The results support the initial proposition that higher discretion industries involve more adjustments of accounting standards than lower discretion industries do. Thus, it can be assumed that an independent auditor may contribute to the alignment of managerial interests with the interests of a firm, while the choice of accounting standards may be positively associated with the degree of managerial discretion.

The corporate governance literature views discretion as a cost to the firm, constituting a potential for agency conflict. This field of research focuses on the development of mechanisms that can mitigate the costs by minimizing managerial discretion. The effective functioning of these mechanisms prevents managers from engaging in self-serving behavior. A counterbalance of mechanisms of corporate governance characterizes the overall corporate governance of a firm, and consequently defines the degree of managerial discretion.
2.4 Forces shaping managerial discretion and their interconnectedness

Most literature on managerial discretion has focused on identifying the forces that affect executives’ latitude of actions and their scope of influence, while only a few studies have researched the interconnectedness of these forces (Wangrow et al., 2014). Research on managerial decision making has suggested that strategic decisions represent a product of interconnected forces (Judge and Miller, 1991). In other words, the motives behind decisions are multiple and interconnected, manifesting the complexity of decision making. As a result, executives operating in uncertain conditions, time pressures, and information overload (Ansoff, 1980; Haukedal, 1994) have to allocate their attention to multiple stimuli (Dutton and Duncan, 1987; Kabanoff and Brown, 2008). In such conditions executives’ decision making is bounded to their ability to recognize and interpret multitude of organizational, environmental, and individual forces (Simon, 1947). Consequently, treating each force independently may not provide a comprehensive understanding of managerial decision making.

Only a handful of studies have addressed the question of interlinkage between multiple forces that shape managerial discretion. Contingency theory, which argues that organizations respond to the changes in their environment, is the main theoretical perspective that illustrates the relationship between forces that shape managerial discretion. Relying on the contingency theory, Peteraf and Reed (2007) argued for the existence of an optimal fit between the conditions of a firm’s external environment and managerial latitude of actions. The study analyzed managerial discretion in the context of deregulation of the airline industry, revealing that, when a particular domain of managerial discretion was constrained, managers might switch to different domains. This fit between the demands of external environment and managerial discretion is driven by the efficiency motive — in order to adapt their organizations to the changes in external environment, managers need discretion. The study underlined the potentially important interrelationship between external regulatory constraints and internal organizational practices that managers influence in response to the changes in firm external environment.

Corporate governance scholars have explored contingency forces influencing the zone of shareholder acceptance, focusing on corporate governance mechanisms jointly affecting managerial decision making. While some researchers argued for the complementarity of corporate governance mechanisms (Mikkelson and Partch, 1997), others proposed that different mechanisms can substitute for each other (Beatty and Zajac, 1994; Zajac and Westphal, 1994; Rediker and Seth, 1995). The complementarity perspective argues that the mechanisms may enhance the strength of overall corporate
governance system. In congruence with this view, Poppo and Zenger (2002) asserted that trust may be viewed as a governance mechanism complimentary to the formal instruments applied to mitigate opportunistic behavior. In contrast, the substitution perspective argues that when one mechanism is not functioning, other governance mechanisms, including both formal and informal, (Hoetker and Mellewigt, 2009) can be used. To illustrate this, La Porta, Lopez-de-Silanes, Sheifer, and Vishny (1998) suggested that concentrated ownership can be a substitute mechanism of control in countries where the legal system does not provide protection for shareholders. Similarly, Randøy and Jenssen (2004) argued that product market competition was more efficient than internal control and monitoring by the board in curbing opportunism.

Recent research has helped reconcile the two views on the relationship between different governance mechanisms, suggesting a configurational approach, which can assume both a substitutionary and complementary impact (García-Castro, Aguilera and Ariño, 2013; Misagnyi and Acharya, 2014). In particular, the authors proposed the existence of bundles of governance mechanisms, where several mechanisms simultaneously influence managerial decision making. This perspective provides a more comprehensive approach as it accounts for the interconnectedness and possibly interdependence of corporate governance mechanisms. Previous studies have argued that internal governance mechanisms, such as the board of directors are endogenous to the firm. Hermelin and Weisbach (1998) suggested that board composition is a result of internal negotiations between the CEO and existing directors, with firms adjusting their internal governance systems in response to the external environment. Interdependencies can also occur among internal governance mechanisms. Collin, Ponomareva, Ottosson and Öjhage (2014) provided empirical evidence that ownership structure can explain variations in board monitoring. More specifically, monitoring by the board creates costs for shareholders. These costs can be absorbed by active owners, such as families or industry investors, or externalized such as through institutional investors employing more independent boards. Thus, it could be argued that governance mechanisms do not affect managerial decision making independently, but rather jointly.

The cumulative effects of forces shaping managerial discretion may not be equal to the sum of each of these forces because the forces influence each other jointly in defining the level of managerial discretion. For example, the discretion provided by attractive market opportunities (high market growth, demand instability, and product differentiability) can be different from the discretion provided by a flexible organizational structure, low inertia, and openness to change. At the same time, their joint influence can make a greater impact on executives that of each of these forces separately because of the
synergies gained. Since organizational structure and internal processes are contingent on environmental factors, the level of discretion at the organizational level can be expected to depend on the level of discretion at the environmental level. More specifically, organizations may adapt their internal practices and select executives that can lead the firm within certain external environments, thus, underlining the link between organizational and environmental levels of managerial discretion.

Furthermore, the relationship between the different forces can enhance their total impact or reduce it. For example, powerful external forces may influence the level of inertia by initiating or delaying changes in corporate policies, in culture, and in other internal processes. Consequently, if powerful parties pursue strategies to increase a CEO’s discretion, they will likely influence changes in organizational structure, which will increase CEO discretion even further. Similarly, if powerful parties pursue strategies to reduce CEO discretion, they can further facilitate the process by reinforcing the internal organizational structure that, in turn, constrains managerial actions.

Consideration of the interconnectedness among multiple forces of managerial discretion can enhance our understanding of managerial decision making and let us more accurately predict the influence of executives on organizational outcomes. It can also reconcile some of the mixed findings in the literature on the direction of influence of forces of discretion. For example, the majority of research has asserted that greater industry competition is positively related to managerial discretion, yet a study by Wasserman, Anand and Nohria (2010) has found that CEOs in less competitive industries have more impact on a firm’s outcomes. Since the effects of one force of managerial discretion are hard to separate from others, more complex models that account for interrelated links and different strength of influences need to be used to study managerial decision making.

To summarize, the influence of governance and of strategic factors in shaping managerial decision cannot be analyzed independently. Instead, their influence should be analyzed as interconnected forces. While this section described interdependencies between strategic and governance factors at multiple levels of analysis and their joint influence on managerial strategic decision making, the next section will discuss the interrelation between strategic and governance dimensions of managerial discretion.
2.5 Relationship between strategic and governance dimensions of managerial discretion

Enabling and restraining managerial actions are both important for the survival and effective functioning of a corporation. While sufficient latitude of actions can assure a firm’s adaptability and strategic flexibility, the zone of shareholders acceptance ensures that the discretion delegated to managers will not be misused. The relationship between strategic and governance dimensions of managerial discretion can be illuminated by analyzing the costs and benefits associated with delegating decision-making authority and autonomy to professional managers.

Berle and Means (1932) depicted the creation of a modern corporation as characterized by an increasingly dispersed ownership structure and the transfer of decision-making function to professional managers. The growing dominance of this way of organizing business activity can be attributed to the benefits arising from the separation of decision management and the residual risk-bearing functions (Fama and Jensen, 1983). Three key benefits can derive from a corporate structure including 1) ability to attract and retain managerial talent; 2) efficient decision making; and 3) efficient allocation of risks.

The separation of decision-making and residual risk-bearing functions creates advantages in selecting the most competent individuals for management positions, as a comparison with the situation in a closely held firm illustrates. First, in contrast to a closely held firm where the decision-making and decision-control functions are combined and managers are selected based on personal wealth and willingness to bear risk, managers in an open corporation are selected based on their competence to manage the firm (Fama and Jensen, 1983). The managers are usually selected on a professional basis in accordance with the strategic changes envisioned by the board of directors (Hambrick and Mason, 1984). Consequently, corporations are able to attract and retain more competent professionals, which in turn may enhance firm’s competitiveness in the market.

Second, the delegation of decision-making authority and autonomy from shareholders to a team of managers in a modern corporation allows firms to increase the speed and the efficiency of decision making (Hambrick and Mason, 1984). Coase (1937) pointed out that the costs of seeking and negotiating contracts will determine the boundaries of a firm. The delegation of decision-making authority and autonomy allows shareholders to reduce the number of contracts to a single one between the principals, represented by the board, and the agents, represented by the management. Strong and unambiguous authority allows executives to undertake timely strategic decisions thereby increasing the strategic adaptability of their firms (Chandler,
Timely strategic decisions, in turn, allow firms to exploit opportunities and increase their ability to compete in the market (Judge and Miller, 1991; Makadok, 1998).

The transferring of the residual risk-bearing function from managers to shareholders is another benefit of a corporate form of organization (Alchian and Demsetz, 1972). In contrast to managers who have firm-specific investments through their employment contract, shareholders may allocate smaller portions of their investments to a large number of unrelated firms, thereby, diversifying their risks. In contrast, firms with a combined strategic decision and the risk-bearing functions may experience efficiency loss due to managers’ inability to consider strategic opportunities that involve higher risks (Fama and Jensen, 1983). The allocation of risk bearing to the parties that can perform this function at the lowest cost allows managers to overcome aversion to risk, assuring their firm can compete effectively in its external environments (Jensen and Meckling, 1976). Thus, professional managers are more likely to pursue diversification strategies directed at the growth of their firms (Lane, Cannella and Lubatkin, 1998; Misangyi, 2002).

Although the separation of management from residual risk-bearing functions has several advantages, it also involves costs arising from to the divergence of interests between shareholders and manager. While shareholders’ main interest is assumed to be the maximization of returns on their investments, the interests of managers may include the pursuit of prestige, power, and personal wealth (Myers, 1984) as well as the minimization of firm-specific risks. This conflict of interests, referred as the ‘agent-principal conflict,’ results in agency costs for a firm (Jensen and Meckling, 1976).

The separation of decision management from decision-control functions in modern corporations has both agency benefits and agency costs, underlining the trade-offs associated with delegation. Delegation of decision-making authority and autonomy to professional managers is assumed to increase the agency benefits and allow firms to grow and develop. It may also increase the agency costs because of managerial opportunism. Consequently, one goal of corporate governance is effective delegation that would maximize the agency benefits while minimizing the costs of managerial opportunism.

2.6 The concept of strategic opportunity costs

In this dissertation, I argue that the impact of monitoring on managerial behavior can be complex as it can involve more than the mere reduction of managerial opportunism. In particular, I argue for the existence of indirect strategic effects and introduce the concept of strategic opportunity costs.
Strategic opportunity costs refer to the reduction in overall shareholder value due to inability of managers to capture profitable strategic opportunities because of decision control exercised by the principals. By prioritizing certain objectives, namely cost reduction, a company may limit the use of resources for pursuing value creation (Ghoshal and Moran, 1996). Put simply, monitoring has opportunity costs. These costs are an important part of agency costs, which are ultimately reflected in overall shareholder value. In this section I deconstruct the concept of agency costs, and more specifically residual loss, into two categories: loss due to the costs of managerial opportunism and the loss due to strategic opportunity costs.

In a 1976 article, Jensen and Meckling postulated that the separation between management and residual risk-bearing functions in a corporation will be efficient until the point when the agency costs borne by the principal are less than the incremental increase in the invested capital. The nature of residual claims implies the right of the shareholders to have a profit minus the costs of monitoring and enforcing the contracts and residual loss due to the lost output. The authors distinguished between monitoring costs arising from oversight of managerial action, bonding costs arising from aligning the interests between managers and shareholders, and residual loss, referring to additional costs arising from the separation of security ownership and control. The concept of residual loss has not received much attention following the publication of the article by Jensen and Meckling (1976). Most of subsequent research associated residual loss with the costs of managerial opportunism, focusing on ways to reduce it. In contrast, this dissertation argues that residual loss may also include strategic opportunity costs.

Residual loss is divided into two types of costs: managerial opportunism and strategic opportunity. The costs of managerial opportunism may arise from managerial misuse of the discretion delegated to them, such as indulging their need for status, power and prestige, taking excessive risks, and enjoying perquisites such as the use of corporate jets and more than generous compensation packages (Jensen, 1986; Tirole, 2001; Collin, Gustavsson, Petersson and Smith, 2014). These costs may compromise the maximization of the shareholder value, ultimately leading to a decrease in shareholder returns (Yermack, 2006).

While the costs of managerial opportunism arise from delegation, strategic opportunity costs may arise from a lack of delegation. With increased monitoring, managers may no longer feel in control of corporate outcomes and lack the necessary authority and autonomy to undertake timely strategic decisions, which could compromise a firm’s ability to capitalize on profitable strategic opportunities, ultimately reducing its strategic flexibility.
Strategic opportunity costs are closely related to the general problem of agency. In firms controlled by owner-managers, such costs would not occur, since in the absence of conflict of interest the managers will bear the consequences of their decisions. This leads to the assumption that the zone of stakeholders’ acceptance will not be determined by the risk of managerial opportunism but rather by considerations such as social norms and ethical standards. This implies that in manager-owner firms strategic decisions will not be constrained by the internal control mechanisms. Consequently, it can be inferred that strategic opportunity costs are a part of agency costs arising from the separation of security ownership and control within a corporation.

Strategic opportunity costs can be compared to the benefits of reducing the costs of managerial opportunism. While a substantial body of research has investigated methods of minimizing agency costs, very little has addressed the costs of corporate control (Lange, Boivie and Westphal, 2014; Knapp et al., 2011; Chen and Nowland, 2010). It is important to consider strategic opportunity costs, since they directly affect the ability of a firm to adapt in a timely fashion to changing conditions in its external environment and contribute to maximization of shareholders value. Based on that, not only the costs of managerial opportunism but also strategic opportunity costs may have an influence on organizational outcomes. Consequently, it can be assumed that the sum of these two costs may be reflected in overall shareholder value.

2.7 The influence of managerial discretion on organizational outcomes

The strategic and governance dimensions of managerial discretion may jointly influence the formation of aggregated residual loss, ultimately influencing overall shareholder wealth creation. When the strategic dimension of managerial discretion, defined as a latitude of strategic actions available to executives, is significantly larger than the governance dimension, defined as the zone of shareholder acceptance, strategic opportunity costs may occur. Simultaneously, when the zone of shareholders acceptance is significantly broader than the latitude of actions available to executives, the costs of managerial opportunism may occur. An imbalance between the two dimensions can result in misalignment as illustrated in Figure 1.
Figure 1. Relationship between strategic and governance dimensions of managerial discretion

Figure 1 illustrates the importance of alignment between strategic and governance dimensions of managerial discretion for the maximization of the shareholder value. Misalignment A refers to situations where the zone of shareholders acceptance is less than the latitude of executive actions and executives will not be able to fully capitalize on the strategic opportunities, resulting in strategic opportunity costs. Misalignment B refers to situations where the zone of shareholders acceptance is larger than the latitude of executive actions and managers’ ability to use their discretion to improve outcomes is constrained. Here costs of managerial opportunism are likely to occur. Alignment refers to situations where the governance dimension of discretion defines the zone of shareholder acceptance without limiting managerial ability to drive development. Here, the costs of separation between the security ownership and control will be at their lowest, in other words, both strategic opportunity costs and the costs of managerial opportunism are at their minimum.

In environments where executives face a large number of strategic choices, their decisions may have a strong influence on organizational outcomes (Hambrick and Finkelstein, 1987). Here, limiting managerial decision making will result in the highest strategic opportunity costs because having the ability to make timely strategic decisions is important to competitiveness and the survival of the firm. When the zone of shareholders acceptance is too narrow,
an executive’s latitude of strategic actions is limited, leaving the company vulnerable to competitors. However, equipping managers with decision-making authority and autonomy allows them to undertake more risks, which can increase growth and development. In environments with a wide latitude of strategic actions, the potential gains will be the highest, corresponding to the largest strategic opportunity costs.

In environments where executives have a narrow latitude of strategic actions, the strategic opportunity costs will not be as significant because the executives do not have many profitable strategic opportunities and are unable to significantly improve organizational performance. Nevertheless, they can still use their discretion to pursue their own benefits. Therefore, benefits arising from disciplining managers may become more pronounced, while the strategic opportunity costs will be at a minimum.

The two categories of agency costs are different in their limits; the costs of managerial opportunism are limited to the present value of the firm, while strategic opportunity costs are limited to its future value. Consequently, an increase in monitoring will only be efficient to the point where the marginal benefits arising from reduction of opportunism are less than the strategic opportunity costs. Based on this, the balance between constraining and enabling managerial action may largely depend on the number of strategic opportunities a firm has (i.e., strategic discretion) as well as the present value of the firm (i.e., the maximum impact of managerial opportunism). While the present value of the firm is comparatively easy to observe and measure, the value of strategic opportunities is more difficult to capture.

In this section, it was argued that the two dimensions of managerial discretion jointly influence aggregated residual loss. The influence of monitoring on the aggregated residual loss varies depending upon the latitude of strategic opportunities available to managers. This suggests there is a balance between constraining and enabling managerial action in determination of aggregated residual loss, which in turn may influence organizational outcomes.

2.8 Research model

The conceptual model for this research depicts an integrative framework of managerial discretion. The model indicates the joint influence of factors shaping discretion at organizational and environmental levels. It also highlights the two-dimensional nature of managerial discretion. It explains the importance of balance between constraining and enabling managerial action, outlining how strategic and governance dimensions jointly influence the outcomes for a firm.
Figure 2. Antecedents and outcomes of managerial discretion

<table>
<thead>
<tr>
<th>Proxy Domains</th>
<th>Levels of Analysis</th>
<th>Aggregate Dimensions</th>
<th>Outcomes</th>
</tr>
</thead>
<tbody>
<tr>
<td>National Institutions +/-</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Managerial Task Environment</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- product differentiation: +</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- market growth: +</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- demand instability: +</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- industry structure: +</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- quasi-legal constraints: -</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- powerful external forces: -</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- organizational inertia: -</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- resource availability: +</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- powerful inside forces: -/</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- market for corporate control: -</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- managerial labour market: -</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- external audit: -</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- ownership concentration: -</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- executive compensation: +/-</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- capital structure: -/+</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>- board control: -</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Organizational outcomes

Strategic dimension of managerial discretion

Degree of delegation

Governance dimension of managerial discretion

Degree of delegation

Organizational outcomes

External environment

Organisational environment

External governance mechanisms

Internal governance mechanisms
3. Research Method

This section discusses the reason for the methodological choices made throughout the dissertation. It begins by describing the scientific approach used and then the research strategy. This dissertation applies qualitative and qualitative research strategies, which are designed as case studies and archival data analysis, respectively. The description of methodological choices undertaken throughout the research process is followed by the description of research contexts.

3.1 Scientific approach and research strategy

This research was guided by both positivism and phenomenology, not as polar perspectives but rather as being related (Reminyi, 2002). According to Csete and Albrecht (1994, as cited in Raftery, McGeorge, and Walters, 1997), the two paradigms are guided by the same goal—to enrich our perception of the world, and both aim to ensure the credibility of the findings through rigorous adherence to their research methods. Applying a multi-paradigm view to research on the development of the theory of managerial discretion allowed for a wider scope of knowledge to be generated through different research strategies. This study used a complementarity approach, assuming that combining a mixed method research strategy could highlight multiple dimensions of the phenomenon of study and validate the research findings by using different research designs (Hammersley, 1996). Due to the existing ambiguity of approaches for measuring managerial discretion and the limited amount of empirical evidence, a number of different research design methods were applied. This strategy helped overcome the limitations associated with using a single source of data, simultaneously expanding the possibilities of overcoming the data access problem.

This research project used both quantitative and qualitative research strategies, both of which have strengths and weaknesses. The majority of research in business administration largely relies on quantitative data. Previous studies have acknowledged a tendency for quantitative research to focus primarily on
“macro” aspects of analysis, while qualitative research can reveal information on the “micro” level (Bryman, 1988). Quantitative analysis provides a significant advantage in terms of generalizability and validity of data. Qualitative strategy can expand the scope of analysis. The use of both research strategies expanded the perception of the subject of analysis and maximized the value of new knowledge generated.

Strategic management and corporate governance constitute established streams of research, characterized by strong theories explaining the phenomena of focus. Consequently, the analysis of managerial discretion in these two perspectives relied on established theories, initially making the study deductive. However, it became apparent that these theories could not provide a comprehensive explanation of managerial discretion unless they were considered jointly. The guiding argument for joint consideration is the double-sided nature of managerial discretion. Focusing on only one perspective at a time would have led to disregarding the influence of the other and capturing only part of the influence of managerial discretion on organizational outcomes. Joint consideration allowed for a more comprehensive understanding of delegation.

I used an explorative case study research design, anticipating that it would provide valuable theoretical insights about an integrated model of managerial discretion. Before I could construct a model of managerial discretion that combined both its strategic and governance dimensions, I had to do exploratory research that looked at both dimensions at the same time because previous studies had mainly used either the strategic or the governance dimension of managerial discretion. Once I had set the conceptual boundaries of the managerial discretion, I would be able to apply the concept within the broader governance model.

The research first involved a qualitatively oriented study focusing on a definition of managerial discretion with the aim of developing a research instrument for studying managerial discretion. A comprehensive theoretical model of managerial discretion was deduced from two fields of research examining managerial discretion, strategic management, and corporate governance and then explored within a distinct institutional context of a transition economy. The second stage of the research focused on testing and verifying the proposed model of how the two dimensions of managerial discretion jointly influence organizational outcomes. This stage relied primarily on quantitative methods based on archival data. The following section describes the initial qualitative exploratory research and subsequent quantitative study of managerial discretion.
3.2 Part One: Explorative research

3.2.1 Case study research design

The explorative case study examined the concept of managerial discretion. Due to the lack of development of a theory of managerial discretion (Caza, 2012), the case study approach is recommended as an initial step for gaining comprehensive knowledge about the phenomenon (Yin, 1994). An exploratory case study allows for understanding the boundaries of discretion and the joint influence of multiple forces shaping it.

As mentioned, the empirical case was a company operating in a transition economy. This case was analyzed to generate a description of governance and strategic forces that shape managerial discretion. The environment of transition economies is characterized by dynamic change and a large degree of institutional uncertainty (Peng, 2003) and presents a natural laboratory for studying managerial discretion. These characteristics make the factors shaping the degree of managerial discretion at environmental and organizational more salient.

Company Alpha, a closely held, private, small-sized enterprise in Saint Petersburg, Russia, was chosen as the empirical case. The company, which was established in 1998, has developed rapidly in the last decade, growing through diversification. Although the case company was privately held, the issue of delegation was evident, making the Company Alpha an appropriate empirical case for explorative analysis of delegation. More specifically, even though there was no formal separation between security ownership and decision control, there was an informal separation between decision management and decision control. The business was highly diversified and, as a result of the diversification, the founder-CEO of Alpha had developed a small holding of several enterprises. With the increasing sophistication of the enterprise structure, the issue of delegation became especially important. The owner was not interested in being involved in the operations of each subunit, nor was he able to. A team of top executives was formed to formulate and execute strategy for the firm. The owner-CEO was concerned primarily with the formulation of and control over implementation of the strategy. While the organizational structure of the privately held corporation did not formally stipulate a division between decision management and decision control, informally the executives had considerable decision-making authority and the autonomy to undertake and implement strategic decisions. The lack of formal separation between security ownership and control was not of a critical importance to this dissertation as delegation occurs in privately held corporations as well. Dalton et al. (2007, p. 35) noted:
... the fundamental agency problem still may be relevant to smaller scale public and private companies ... A potential for disconnect exists between the interests of those who preside over these enterprises and their principal constituencies, which may not always coincide; therein lies an agency problem.

3.2.2 Interview guide construction

The data collection process was structured following Yin (1994). First, a case study protocol was created that included construction of the questionnaire. The main object of study comprised managers undertaking strategic decisions. The study concepts were the factors influencing managerial discretion. The interview guide was based on assertions proposed by Hambrick and Finkelstein (1984) and mechanisms of corporate governance discussed in the literature (Shleifer and Vishny, 1997; Fama and Jensen, 1983). The factors were divided into groups based on the level of analysis (organizational or environmental) and the sources (strategic factors or mechanisms of corporate governance). Open-ended questions were constructed within each group. More general questions were included to capture information regarding factors not covered in the literature review, including questions directed at assessing industry competition based on Porter’s (1980) five forces model. Prior to the data collection, I conducted two pilot interviews with retired executives to test the questionnaire. After a review of the questions and making necessary adjustments, the revised version of the questionnaire was used to collect data at the case company.

3.2.3 Data collection and analysis

The data were collected from several sources. The primary data came from a series of in-depth semi-structured interviews and observations. Multiple observations of the firm’s operations generated additional primary data. The secondary data were collected from internal documents, including financial reports, corporate structure charts, descriptions of the main processes, production norms, and analyzed during the study.

The interview data collection method was chosen for several reasons. First, it allows a greater openness to the object of the study (Alvesson and Deetz, 2002). It also allows the interviewer to ask follow-up questions and probe for new aspects of the phenomenon studied. Interviewing, however, has certain inherent limitations when it comes to exploring managerial discretion, since it merely adds to our “understanding” of a phenomenon rather than capturing it in its “natural” settings, as could be done in situational observations (Rennstam, 2007). The data collected through interviews was partially
triangulated through observations and the analysis of internal documents provided by the company.

The interviews and observations took place at the main office of the company for a week. The interviewees were contacted via email prior to the study. The information included an informed consent form and a description of the research study. The interview guide was presented upon the request. A total of eight audio-recorded interviews ranging from 30 minutes to 90 minutes were collected with the company owner, the managing director, the chief officer in wholesale light fixtures, the chief officer in retail light fixtures, the officer of planning and control accounting department, the chief officer for business development, the human resources manager, and the supply manager. The interview data was subsequently transcribed in the original language (Russian).

The logic of abductive reasoning was applied when analyzing the data. First potential categories were defined within the two streams of literature on managerial discretion: strategic management and corporate governance perspectives on managerial discretion. These categories were then subdivided into factors that shape managerial discretion at environmental and organizational levels of analysis. The theoretical categories corresponding to each of the two theoretical perspectives were used to develop an interview guide. During the data collection and analysis, new categories of data appeared and some initial categories were omitted due to the lack of empirical evidence of their importance as determinants of managerial discretion. The coding process was grounded within the theory of discretion where similar incidents were grouped into separate categories. The emergent categories were compared and contrasted against other categories and sources of data. Thematic categories were derived from the original framework of determinants and the new themes generated by the study participants during the interviews. When the themes started to reoccur and no new insights were generated through the analysis, the categories were grouped into more general categories.

3.3 Part Two: Quantitative research strategy

To test the conceptual model of managerial discretion that had been developed, a quantitative research strategy was applied in the second part of the dissertation. It focused on capturing the joint influence of strategic and governance dimensions of managerial discretion on outcomes for a firm. The theoretical model of factors that shape managerial discretion was then refined and developed. Next, the concept of managerial discretion was applied within the framework, which combines strategic and governance forces explaining
the outcomes for a firm. In the following paragraphs I describe how the study sample was constructed, introduce the variables tested in the model, and present the data sources used in this study.

Researchers investigating the phenomenon of managerial discretion frequently analyze secondary data (e.g., Hambrick and Abrahamson, 1995; Crossland and Habrick, 2007). Secondary data on proxies of managerial discretion are usually publicly available and can be obtained through governmental statistical bureaus, research databases and corporate websites. Due to a large sample selection, this approach offers higher validity and generalizability compared to the interview method. After introduction of the Swedish Corporate Governance Code in 2005, the standards of disclosure of information on corporate governance were improved considerably, including those for government reporting and reports made by listed corporations (Ludvigsen, 2010). Information was required on the board members, auditors, and ownership structure. Companies have also been systemically disclosing voluntary information such as director independence and board committees (Larsson-Olaison, 2014). The choice to limit the study sample to listed corporations was motivated by the availability of data because these corporations are required by law to disclose much more information than privately owned firms. The information regarding practices of corporate governance and the board of directors was of particular interest.

To test the conceptual model, a database of Swedish listed corporations was constructed. The empirical measurements were selected to correspond as closely as possible to the theoretical constructs. The database included three main groups of variables: governance (including data on board monitoring, CEO characteristics, and ownership structure), strategic (including market growth, demand instability and capital intensity) and performance variables. The archival data on corporate governance were hand collected from that annual reports of Swedish publicly listed companies for 2010, 2011, and 2012, while the performance variables were measured based on the data collected for 2011, 2012, and 2013. The final sample included a largely balanced panel of 435 firm-year observations, of which 140 were from 2010, 147 from 2011, and 148 were from 2012. The data on the firms’ financial performance as well strategic dimensions of managerial discretion (firm discretion) was obtained through the ORBIS database. Additional data for control variables including industry were obtained from Stockholm Stock Exchange industry classification.

The nature of the final sample precluded me from applying ordinary least squares (OLS) regression analysis. Since each firm had multiple observations, applying the OLS method would have resulted in several potential biases including cross-sectional autocorrelation, serial autocorrelation, and
heteroscedasticity (Sanders, and Hambrick, 2007; Sine, Haveman and Tolbert, 2005). The Hausman test is recommended for choosing an appropriate panel model (Clark, and Linzer, 2015). However, it has significant limitations, such as the assumption of heteroscedasticity and the absence of serial autocorrelation. The sample data was shown to violate both of these assumptions. As an alternative, I performed a Mundlak test (1978), which indicated that the random-effects model was appropriate. I therefore ran feasible generalized least squares regression (the xtgls command in Stata) in my analysis. This model allowed me to account for between-firm as well as within-firm effects (Afuah, 2001), permitting autocorrelation in the error terms (Bednar, Love, Kraatz, 2012).

This study applied a multi-method approach to studying the influence of executives on organizational outcomes through the prism of managerial discretion. The first part of this research project focused on the conceptual development of managerial discretion; a multitude of governance and strategic forces shaping managerial discretion were illustrated in explorative case study. The explorative study sought to provide a conceptual understanding of managerial discretion as a joint product of governance and strategic forces. The second part tested theory by applying managerial discretion to a broader framework of corporate governance. A quantitative approach was used to analyze the contingency determinants of the performance effects of two central organizational actors — the board of directors and the CEO. A three-year panel of Swedish listed corporations was constructed and used to test two sets of competing hypotheses.

3.4 The empirical settings

3.4.1 Russian context

In this dissertation I argue that the variability of forces shaping managerial discretion in transition economies may not be found in more developed Western economies, making the Russian context suitable for developing the concept of managerial discretion. Part one of this research was conducted within a transition economy, that of Russia, which was considered suitable because its dynamism provided for a variety of strategic choices and because of a wide variety of governance forms. Furthermore, it was hoped that the exploration of the concept within a non-American context could help researchers to refine and extend the explanatory power of the present theory of managerial discretion.

Transition economies are a subgroup within the category of emerging markets that are undergoing economic transition from a state-planned to an open market economy (Peng, 2000). These countries are characterized by ongoing
institutional change (Hoskisson, Johnson and Moesel, 2000). Another important characteristic is a high level of institutional uncertainty (Khanna, Palepu and Sihna, 2005). In contrast to developed economies, where institutions have evolved through a long process of evolutionary change, in many former state-planned economies the economic shift toward market liberalization started comparatively recently, in the early 1990s. These economic changes have left a high degree of instability. While the governments are moving toward deregulation, strong governmental control remains. Because of the institutional uncertainty (Khanna et al., 2005,) it becomes vital for the companies to adapt to a constantly changing external environment. However, poorly functioning markets impose significant constraints on firms’ strategic flexibility. These institutional settings make transition economies a worthy focus when developing management theories (Hoskisson, Eden, Lau, and Wright, 2000).

The majority of studies on managerial discretion are conducted within the stable institutional environments of Western economies (Hambrick, 2007). Very few researchers have focused on companies operating in more dynamic environments, such as emerging markets (Yan, Chong and Mak, 2010). The dynamic context of a transition economy, which is characterized by both newly evolving institutions and the legacy of the former institutional system, provides setting that allows exploration of the concept. Furthermore, the “homogenizing tendency” of using the North American model may impose limitations on the applicability of theories to diverse institutional contexts (Tsui, 2007). Consequently, research in emerging markets can contribute to the field of management studies in two areas: generating new theories and testing existing theories and extending their applicability and explanatory capacity.

Zhao, Chu, Chen (2010) stated that a greater degree of managerial discretion is necessary for firms operating in turbulent conditions. Environmental turbulence can be defined as unpredictable and volatile conditions in a firm’s external environment (Haleblian and Finkelstein, 1993). Peng (2003) argued that due to institutional change, the framework of economic transition presents a fruitful setting for studying managerial decisions and firms’ strategic choices. The changes in institutional environment have put transition economies in a situation where a wide variety of organizational practices are present. When the old institutions of a planned economy have not yet disappeared and the new institutions of market economy have not finished their formation and adaptation, managerial decision making needs to include multiple factors. In addition, the institutional voids create an environment where researchers may observe a wide variety of governance models, some which may be fully functioning and some which may be stagnant. This
variation presents a natural laboratory for studying the multi-dimensional nature of managerial discretion.

From the standpoint of strategic management research, transition economies provide a useful context for analyzing firms’ strategic development because of how their institutional environment affects the freedom that managers have in undertaking strategic decisions (North, 1990; Peng, 2003). On one hand, strategic constraints in the form of market imperfections, institutional voids, and lack of capital and managerial expertise impose significant limitations on managerial actions in transition economies. Poorly functioning institution of property rights, are apparent in the Russian economy (Gans-Morse, 2012). Furthermore, political risks necessitate a good strategic fit for an organization, indicating the importance of strategic flexibility for a firm (Iankova and Katz, 2003).

On the other hand, the fast pace of economic growth provides firms with opportunities to capitalize that would not be found in developed markets. An increasing participation in the global economy through joining trade organizations and the growing domestic markets has opened possibilities that challenge firms to compete in the global arena (Hoskisson et al. 2000).

From the governance perspective, the context of economic transition is characterized by highly heterogeneous models of governance (Li, Kroll, Walters, 2004). The absence of functioning formal institutions is substituted for with a mix of informal institutions (Peng, 2003). Despite substantial improvement, problems associated with corporate governance in transition economies remained (Black, Love, Rachinsky, 2006). The governance system of transition economies can be characterized as relationship oriented, a system of governance that relies largely on informal personal exchange among economic actors (Peng, 2003). Network-oriented systems can be identified by the presence of multiple dominant stakeholders, including the state, business groups, and networks. Another important characteristic is the concentrated ownership structure and relatively small and underdeveloped stock markets (Weimer and Pape, 1999). Furthermore, in the Russian context, financial markets are not considered an efficient device for corporate growth and many firms are privately held. The underdeveloped nature of Russian financial market and high risk of hostile corporate takeovers or, more precisely, of “corporate raiding,” has prevented many high-potential small- and medium-sized enterprises from financing their future growth by going public (Sergeeva, 2009). Weak law enforcement and underdeveloped legislation means publicly listed corporations face severe risk from corporate raiders and, ultimately, loss of control over the firm. Because most research is conducted within rule-based systems of governance, which are characterized by arms-length contracts, the relationship-based systems of governance has received
significantly less attention (Li, 2003). Thus research in this area can contribute to the understanding of a large variation of governance practices within the relationship-based system of corporate governance in transition economies.

Earlier research has found significant differences in corporate governance across national economies (La Porta, Lopez-de-Silanes, Shleifer, 1999; Aguilera and Jackson, 2003), suggesting that different institutional environments assume a distinct variation of stakeholders’ power within a corporation. This leads to the assumption that constraints on managerial discretion will also vary depending on the institutional context. As was mentioned by Tirole (2001, p. 13), “... some corporate behaviors cannot be fully understood by looking solely on formal allocation of control rights, and that they require an examination of who is actually in control.” This suggests that both formal and informal institutions should be considered when studying interrelations among the major stakeholders of a corporation. The significant role of informal institutions within economic transition and a high number of corporate governance practices makes Russia an excellent case for studying the interaction of formal and informal rules that the companies are forced to adjust to in order to survive.

Taking into consideration that most research in corporate governance is taking place in Western economies, Scott (1995, p. 146) has noted, "it is difficult if not impossible to discern the effects of institutions on social structures and behaviors if all our cases are embedded in the same or very similar ones." The present study, however, overcame this challenge by analyzing the subject of corporate governance within a distinct institutional environment. This helped to expand the applicability of existing theories and, possibly, to facilitate the development of new theories contributing to scientific progress within corporate governance (Peng, Buck, and Filatotchev, 2003).

Conducting research during an economic transition may also present certain challenges. Voldnes, Gronhaug and Sogn-Grundvåg (2014) distinguish several key challenges of conducting qualitative research in Russia. The issues include gaining access to the respondents, balancing power between interviewer and respondent, and attaining openness and ways to manage the interview process. Gaining access to business elite is hard for domestic researchers and more so for foreign ones. Those in the Russian business sphere lack familiarity with researchers, generally have a suspicious attitude toward outsiders (Michailova, 2004; Voldnes et al., 2014), and operate with low transparency (Ernst and Young, 2011). Doing quantitative research can be even more challenging because of issues related to the trustworthiness of publicly accessible archival data (Puffer and McCarthy, 2011).
To summarize, both governance and strategy research can benefit by examining organizational phenomena in novel institutional environments, particularly that of transition economies. Such research can help to outline the multitude of forces shaping managerial discretion within both its strategic and governance dimensions. Since both strategic flexibility and corporate governance are important during transition, the notion of managerial discretion may more clearly emerge from this type of environment. Yet researchers need to be aware of the challenges associated with conducting research in distinctive contexts, like that of Russia.

3.4.2 Swedish context

Part two explores the joint influence of strategic and governance dimensions of managerial discretion on organizational outcomes within the Swedish economy. Swedish listed corporations are competing in the global market, which implies that they 1) face global competition and 2) are forced to respond to global governance trends. For these reasons, Sweden presents a fruitful context for exploring the strategic consequences of increased board monitoring on the outcomes of a firm.

Sweden is a small open European economy. The major reforms of deregulation of business activities, which began during the 1970s, have increased access to capital, improved the competition in domestic market, and facilitated the competitiveness of Swedish corporation in the global market (Iversen and Larsson, 2011). Historically Swedish corporations have been export oriented (Sjögren, 2008) because the limited domestic markets forced them to expand internationally in order to growth. The dominant corporations make more than 90 percent of their sales in foreign markets (Iversen and Larsson, 2011). This implies that Swedish companies have to adjust their strategies to the changing competitive environment.

The Swedish of corporate governance model can be placed in between the Anglo-Saxon model and the Continental European models (Randøy and Jenssen, 2004). However, recent changes brought about by the increased importance of corporate governance and globalization have meant a shift in the Swedish capital market toward the American and British models (Jansson and Larsson-Olaison, 2010; Jonnergård and Stafsudd, 2011). The integration in the European Union has also facilitated regulation on corporate governance practices (Larsson-Olaison, 2014). The Swedish corporate governance model was founded on three central bodies: the general meeting, the board of directors, and the CEO (Swedish Companies Act, 2005). Despite the unitary structure of Swedish boards, historically the CEO is the only executive director on the board and the Swedish Companies Act (2005) does not permit the chairperson/CEO role. Sweden has a long history of active owners, who are interested in the long-term development of their corporations (Johanson
and Østergren, 2010; Lubatkin, Lane, Collin and Very 2005; Collin 1998). Therefore, some of the controlling shareholders are on the board, either directly or through a representative. The tradition of active shareholders is reflected in the role of the nomination committee, which is not part of the board. The concentrated blockholding model of governance is reflected in the strong power of the dominant business groups, which control a large number of listed industrial corporations (Collin, 1998; Jansson, 2013; Lubatkin et al., 2005).

Swedish listed corporations are a subject to the Swedish Corporate Governance Code, which was developed in the 2000s in response to the globalization trend of financial markets (Oxelheim, 1997; Oxelheim and Randøy, 2003). This code was also adopted to restore the trust in Swedish business community, which had eroded after a series of high-profile corporate failures (Jonnergård and Larsson, 2007). The code was modeled after the Anglo-Saxon model of corporate governance (ibid), stressing the importance of board monitoring. This emphasis was advocated because other governance mechanisms were unable to resolve the agency problem (Coffee, 2001). More specifically, Swedish Corporate Governance Code emphasized board independence, requiring the majority of board members to be independent of both management and controlling shareholders. The code also recommended the establishment of board committees.

The changes introduced by the code were in line with the trend toward greater independence; consequently, “empowerment” of the board originated in the Anglo-Saxon context (Lorsch 1995; Lorsch and Maclver 1989; Oxelheim and Randøy, 2003). Subsequent research has depicted how the dominant ideology of corporate governance has spread to the Swedish context (Jonnergård and Stafsudd, 2011). One explanation for its relatively quick and smooth adoption is the high export intensity of Swedish corporations (Randøy and Jenssen, 2004). A large proportion of Swedish corporations have multiple listings to attract international capital and establish legitimacy in key markets. A study by McKinsey and Company (2000) showed that global investors are willing to pay a premium for stocks of a corporation that sought to be well governed. For Sweden, this premium reached 18 percent. This implies that adhering to the global trends of corporate governance may increase a company’s access to financial capital. Thus Swedish publicly listed corporations can be assumed to be highly responsive to global governance practices.

Several important challenges are, however, associated with using Sweden for the present study. One main limitation is the relatively small size of the stock exchange and the overall number of listed corporations, which is considerably fewer than its American counterpart. This disadvantage is somewhat compensated for with a large quantity and high quality of publicly available
data. The second limitation is the strong owners, which may alter the dynamics of the relationship between a board and its managers. A substantial number of Swedish publicly traded corporations have different classes of shares assigned to voting rights, and blockholding remains the dominant form of control (Henrekson and Jakobsson, 2012). This limitation can be partially addressed through accounting for the influence of concentrated ownership when conducting research.

To summarize, in order to explore the strategic consequences of increased monitoring over managerial decision making, the Swedish context was chosen because Swedish firms are oriented toward global financial and product markets that are strongly responding to the global trends in corporate governance. In addition, competing on the global market requires managers to undertake timely strategic decisions. That being said, a relatively small population of Swedish listed corporations and the context-specific characteristics of the governance model, particularly the strong owners, may be considered as the key challenges associated with the choice of Sweden.
4. Summary of the Papers

This section first describes how the papers were developed. Then it gives a short summary of each paper, describing its focus theoretical framework and contribution to the research aim. The section ends with a table providing an overview of each paper within the overarching framework of the dissertation.

This dissertation is a compilation of four research papers. Papers 1 and 2, which comprise the first part of the dissertation, focus on managerial discretion with the purpose of developing it theoretically. They do this through 1) extension of the present understanding of managerial discretion by including both governance and strategy dimensions and 2) refinement of the understanding of the forces that shape managerial discretion at organizational and environmental levels. Papers 3 and 4, which comprise the second part of the dissertation, integrate the concept of managerial discretion into a larger framework of governance research by exploring the joint effects of strategic and governance dimensions of discretion on organizational outcomes, both conceptually and empirically.

Paper 1, a single-authored article, emerged as a conceptual paper that focused on the dynamic nature of managerial discretion. In that study, I developed the initial theoretical framework integrating strategic and governance forces that shape managerial discretion at organizational and environmental levels. I used transition economies as a natural experiment for understanding their potential relationship. The relationship was theorized in relation to different stages of institutional transition. The central contribution of this article was two-fold. First the conceptual study provided a comprehensive framework of managerial discretion incorporating both strategic and governance dimensions. Second, the paper presented a theory about the relationships between organizational and environment levels of managerial discretion across the duration of economic transition. The conceptual framework was empirically developed and refined in the second paper.
Paper 2, which I co-wrote with Associate Professor Timurs Umans (Kristianstad University and Linnaeus University), presented an empirical investigation of the integrative model of managerial discretion. This paper contributed to the theoretical development of the concept by providing an integrative view and outlining the determinants of managerial discretion from both strategic management and governance perspectives, based on a case study of a Russian firm. Using a qualitative approach, it provided empirical verification and refinement of factors shaping the degree of managerial discretion in the context of economic transition. Papers 1 and 2 adhere to the initial focus on concept development. Thus, these two papers contribute to building a comprehensive understanding of managerial discretion.

In addition to the refining the model, the second study provided the initial idea of balance between enabling and restraining managerial action. This idea was further explored in the paper titled “Balancing Opportunities and Threats: A Conceptual Framework for the Analysis of Factors Influencing Managerial Discretion” (Ponomareva and Umans, 2013). By presenting a typology of managerial discretion, this paper contributed to the theoretical exploration of the idea of trade-offs between the strategic and governance dimensions of managerial discretion. The ideas provided a foundation for the second part of the dissertation, the focus on the joint effects of the two dimensions of managerial discretion on organizational outcomes. Because these ideas were substantially refined and developed in Papers 3 and 4, this article is not included in this dissertation.

Paper 3, which I wrote with Associate Professor Wei Shen (Arizona State University) and Associate Professor Timurs Umans, proposed a theory of trade-offs between cost reduction and value creation. In this conceptual paper, we introduced the notion of strategic opportunity costs associated with increased monitoring by the board of directors. This contributed to the debate about the delegation of decision-making authority and autonomy to professional managers. The trade-offs between strategic opportunity costs and the costs of managerial opportunism were then proposed to be moderated by the organizational strategic environment, conceptualized in terms of environmental dynamism, complexity, and munificence. This conceptual idea was empirically examined in Paper 4.

Paper 4, which is single-authored, provided an empirical test of the contingency effects of board monitoring and CEO experience on firm financial performance. Two competing hypotheses were deduced for each variable: one emphasized the benefits of delegation in terms of reducing strategic opportunity costs, while the other focused on the benefits of monitoring. The results revealed support for the agency-driven explanation, providing support for the importance of board monitoring in high-discretion
environments. The study also showed that a positive relationship between a CEO’s experience and a firm’s financial outcomes is negatively moderated by the degree of managerial discretion. This paper shed light on the relationship between internal governance mechanisms, defining the zone of acceptance for shareholders decisions and the number of strategic opportunities available to the firm and its managers. In addition, it combined governance and strategic antecedents of firm performance under the common denominator of firm discretion. Paper 4 contributed to the overall objective of this dissertation by empirical testing the integrated model through operationalizing the key constructs of this study, namely governance (board monitoring) and strategic dimensions of managerial discretion, and examining their joint impact on organizational outcomes.

To summarize, this dissertation was developed in two stages. The first focused on the understanding, development, and refinement of the concept of managerial discretion. The first two papers theoretically developed and empirically explored the concept of managerial discretion. The model was then applied to a broader framework of corporate governance, linking the two dimensions of managerial discretion to organizational outcomes. Paper 3 provides a theoretical foundation, while Paper 4 empirically tests the idea of strategic opportunity costs. The structure of the whole dissertation is presented in Table 1.

4.1 Paper 1


This study develops a conceptual model of change in CEOs’ discretionary power during economic transition, proposing that the strong negative influence of institutional uncertainty on CEOs discretion may cause them to increase their discretion on other levels. The article is a conceptual paper based on a literature review, resulting in the synthesis of recent research in strategic management with an emphasis on the stakeholder and institutional theories. The study combines strategic management and corporate governance perspectives in a theoretical exploration of the concept of managerial discretion within economic transition. Institutional changes and a high degree of uncertainty (Peng, 2003) allow for the study of the multi-dimensional nature of managerial discretion in a highly dynamic environment.

The paper builds on institutional and stakeholder theories in analyzing the dynamics of managerial discretion during economic transition. In congruence
with the model proposed by Peng (2003), formal institutions are assumed to gradually take over the power of informal institutions during the process of economic transition. This, in turn, may lead to the reduction of the level of environmental uncertainty. Managers become less reliant on informal networks and coordination among the key stakeholders becomes more structured and requires less involvement of the company’s CEO.

I first argued that institutional uncertainty which result from quasi-legal constraints, economic fluctuations, and a rapidly changing business environment, would reduce CEOs’ discretion. I then suggested that CEOs can compensate for their loss of discretion through cooperation with the key stakeholders within a corporation. The sources of managerial discretion are both strategic and governance factors that determine the degree of discretion managers possess. By coordinating the actions of stakeholders, the CEO can contribute to the reduction of environmental uncertainty and, consequently, increased internal control of the firm.

In conclusion, this paper proposes that the strong negative influence of institutional uncertainty on the level of CEO discretion may lead to an increase in managerial discretion at other levels. The analysis done for this paper suggests that the CEO is able to balance the amount of his or her discretion through stressing different levels of it depending on the nature of the institutional environment.

This paper makes a two-fold contribution. First, it integrates the two perspectives on the concept of managerial discretion, proposing a conceptual model of forces that shape discretion across environmental and organizational levels of analysis. The model overcomes the limitations stemming from one-sided conceptualizations of managerial discretion generally adopted in previous studies. This two-dimensional conceptualization of managerial discretion allows for a more neutral view on the concept, illuminating potential opportunities or costs associated with delegating discretion to managers. This can contribute to explaining the mixed findings associated with the influence of executives on organizational outcomes.

Second, the paper contributes to the literature on strategic management by exploring the phenomenon of managerial discretion in relation to the unstable institutional environment of transitional economies. The latter allows for exploration of the relationship between organizational and environmental levels of managerial discretion. In particular, it explains how executives may influence the degree of discretion they possess and may seek discretion in another domain when it has been limited within one domain. The paper then argues that since discretion may be significantly constrained at the environmental level during the first stages of transition, managers may
accumulate discretion at the organizational level, thus compensating for the loss of discretion in the one domain. This dynamic view outlines the relationships between different levels of managerial discretion, shedding light on their joint influence on the managerial decision making.

The present article provides the theoretical framework that serves as a point of departure in the second study. It establishes two ideas that comprise the core points of this dissertation: 1) an integrative framework combining governance and strategic dimensions of managerial discretion and 2) the potential interaction between environmental and organizational levels of managerial discretion. The initial model of forces that shape managerial discretion was further explored and developed in the subsequent empirical study (Paper 2).

4.2 Paper 2


This paper provides insight about factors shaping managerial discretion in a transition economy. It builds on the conceptual model of forces shaping managerial discretion first proposed in Paper 1. The article addresses the somewhat conflicting results found in previous studies explaining the implications of managerial discretion on a firm’s performance. Research that is positively inclined toward strategic management has pointed out potential benefits associated with managerial discretion, such as increased strategic flexibility and adaptability (Carpenter and Golden, 1997; Rajagopalan and Finkelstein, 1992). Corporate governance research, however, views discretion mainly in terms of the costs arising from manager’s opportunistic behavior (Shleifer and Vishny, 1997). This study argues that managerial discretion comprises forces of strategic flexibility and discipline and, therefore, needs to be analyzed considering both strategic and governance forces.

The literature review outlines the determinants of managerial discretion within strategy and governance research. It discusses strategic factors presented by Hambrick and Finkelstein (1987) at managerial task environment and organizational levels of analysis. The corporate governance mechanisms, including ownership concentration, capital structure, the board of directors, managerial labor market, executive compensation, and external audit, constitute governance factors that influence the degree of discretion managers possess in a firm. These factors are subsequently explored in a case study of a firm operating within a context of economic transition.
An exploratory case study of a firm operating in the context of economic transition illustrated empirically how environmental and organizational factors shape the degree of managerial discretion. This research approach was chosen because of the need to further explore and define “managerial discretion.” The theory of managerial discretion, which originated in the West, is currently in its adolescent stage (Caza, 2012) and lacks a unified definition of the concept and its determinants. Applying it in a transition economy expanded the understanding of the concept. The factors shaping discretion were redefined and new factors appeared in the analysis, thus contributing to the development of stronger and more robust theories, which could be applied in a global context.

The findings demonstrated the complementarity of the strategic management and governance perspectives views on managerial discretion. The study verified and explained perceived determinants of the concept at environmental and organizational levels of analysis. At the environmental level, it reveals that managers perceive factors such as product differentiation, market growth, demand instability, industry structure, quasi-legal constraints, and powerful internal and external forces to be valid determinants of their discretion. In addition, context-specific environmental factors, such as the role of informal institutions, and of trust in particular, were identified as influencing the degree of managerial discretion. The managers also saw internal organizational factors such as the perceived degree of organizational inertia, resources availability, and the perceived differences in discretion among organizational groups as important determinants of the perceived level of managerial discretion. In addition, the role of governance structure appeared as an important determinant. In particular, the findings revealed that governance mechanisms, including ownership concentration, the managerial labor market, the executive compensation structure, and the firm’s financial capital structure, were important determinants.

This article contributes to the fields of corporate governance and strategic management research by providing a qualitative-oriented empirical exploration and verification of determinants of managerial discretion. Furthermore, this study provides evidence of potential interaction effects between strategic and governance forces in shaping the degree of managerial discretion. In particular, the present study contributes to the research conducted within distinct institutional environments and transition economies.

The theoretical insights have contributed to a more comprehensive understanding of managerial discretion. As one of the conclusions it puts forward the question of delegation, particularly the issue of having a balance between enabling against restraining managerial decision making. This idea served as a point of departure for the next study, which explored the
performance implications of fit between internal governance and external strategic environment.

4.3 Paper 3

Ponomareva, Y., Shen, W., Umans, and Umans, T. *Strategic control by the board of directors and shareholder wealth: Tradeoffs between the costs of managerial opportunism and strategic opportunity costs.*

This paper addresses the relationship between board monitoring and shareholder wealth creation, proposing that trade-offs are made between the costs of managerial opportunism and strategic opportunity costs. Agency theory has focused on the benefits associated with reducing managerial opportunism by increasing monitoring. This paper proposes that such the actions may result in costs related to unrealized strategic opportunities that would ultimately reduce the firm’s overall value for the shareholders.

The paper suggests four mechanisms through which strategic opportunity costs occur. Namely, it argues that increased board monitoring may lead to 1) reducing managers’ motivation to act in the best interest of shareholders; 2) reducing the speed of strategic decision making; 3) reducing the quality of communication between managers and directors; and 4) constraining the process for implementing strategy. This creation of strategic opportunity costs compromised the ability of firms to fully capitalize on the professional talent of their executives.

The paper further argues that the tradeoffs associated with increased monitoring over managerial decision making will be more pronounced in environments characterized by high dynamism, complexity, and munificence. However, strategic environments characterized by low level of dynamism, complexity, and munificence will not incur significant tradeoffs because of the inability of managers to influence organizational outcomes.

This study makes several contributions to corporate governance research. First it provides a more balanced view of the consequences of corporate control in showing that increased monitoring of managerial decision making not only reduces costs of managerial opportunism but also increases strategic opportunity costs. Second, it broadens understanding of the impact of firms’ decision making on shareholder wealth. Third, the proposed framework linking the board, TMT, and literature on strategic decision making may provide an explanation for the mixed findings in the literature on the outcomes of board monitoring.
The study also provides recommendations for practitioners, proposing that the recent shifts toward increased monitoring over managerial decision making may not lead to the anticipated results. It recommends that, instead, the approach to corporate governance mechanisms should be more nuanced, taking into consideration the firm’s external environment and the number of opportunities available to the executives to drive development. More specifically, the study recommends that the trade-offs between cost reduction and value creation should be carefully evaluated when exercising governance over managerial decision making.

### 4.4 Paper 4


This paper focuses on how and when board monitoring and CEO characteristics affect organizational performance. Building on research within corporate governance and strategic management fields, this paper explores the balance between enabling and restraining managerial decision making. It introduces managerial discretion as an important moderator of the relationship between board monitoring, CEO experience, and organizational performance.

The paper develops two competing hypotheses regarding the effects of delegation. According to the governance view board monitoring is especially important in environments that give managers a broad latitude of actions (i.e., high-discretion environments). According to the strategy-driven explanation, providing managers with authority and autonomy may benefit the strategic development of firms in high-discretion environments. This suggests that managerial discretion has a negative moderating effect on the performance effects of board monitoring.

Similarly, the strategic management literature argues that CEOs can fully capitalize on their professional experience when provided with discretion, while the governance perspective draws attention to the risks of CEO entrenchment associated with increased experience. This explanation suggests that discretion will moderate the relationship between CEO experience and firm financial performance.

The study tested alternative hypotheses about the moderating effects of managerial discretion on the performance effects of board monitoring and of CEO experience. It used a sample of 435 firm-year observations of Swedish listed corporations for 2010–2012. The results showed support for the
governance-driven explanation, indicating that board monitoring is most effective under a high level of managerial discretion and that the relationship becomes weaker as the level of managerial discretion decreases. The findings also showed that the relationship between CEO experience and a firm’s financial performance changes from positive to negative as the level of managerial discretion increases.

The central theoretical contribution of Paper 4 is to show that managerial discretion is a useful tool for explaining the balance between the enabling and restraining effect of managerial decision making in different contingencies. The results indicate that minimization of managerial opportunism through governance mechanisms becomes especially important when managers possess high level of discretion. The study contributes to the stream of literature exploring the effects of the board and CEO experience on firm performance outcomes by introducing a moderating variable that can explain largely mixed findings in previous research.

This study also provides suggestions for practitioners, positing that boards should consider the latitude of an executive’s actions in designing governance mechanisms as well as when assessing the CEO’s decisions. In particular, in high-discretion environment boards may stress board monitoring to mitigate the agency costs of managerial opportunism. Alternatively, when managerial actions are constrained, boards may balance their actions by empowering managers to exercise service-oriented roles. This study also shows that agency costs can offset the benefits associated with a highly experienced CEO. Boards may need to be aware of the agency costs associated with managerial entrenchment. Effective mitigation of agency costs may allow companies to maximize the value of managerial talent without diminishing shareholder value.
<table>
<thead>
<tr>
<th>Relation to RQ</th>
<th>Title</th>
<th>Article Type</th>
<th>Author(s) contribution</th>
<th>Actual/Intended Conference Presentation</th>
<th>Publication Submission</th>
<th>Publication year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Empirical illustration of factors shaping managerial discretion within each dimension</td>
<td>An Integrative View on Managerial Discretion: A Study of a Russian Firm in Transition</td>
<td>Framework building/ Empirical/ Qualitative</td>
<td>Yuliya Ponomareva (80%) Timurs Umans (20%)</td>
<td>Presented at “Corporate governance as a key factor in improving the investment climate,” (MGIMO), Russia, November, 2013</td>
<td>Journal for Eastern European Management Studies</td>
<td>2015</td>
</tr>
<tr>
<td>Exploring the relationship between strategic and governance dimensions of managerial discretion: the concept of strategic opportunity costs</td>
<td>Strategic control by the board of directors and shareholder wealth: Tradeoffs between the costs of managerial opportunism and strategic opportunity costs</td>
<td>Theory development/ Conceptual</td>
<td>Yuliya Ponomareva (50%) Wei Shen (40%) Timurs Umans (10%)</td>
<td>Accepted for a presentation at Academy of Management Conference, Anaheim, California, United States, 2016</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Empirical exploration of balance between enabling and restraining managerial decision making</td>
<td>Balancing control and delegation: The moderating influence of managerial discretion on performance effects of board monitoring and CEO experience.</td>
<td>Empirical/ Quantitative</td>
<td>Yuliya Ponomareva (100%)</td>
<td>Accepted for a presentation at Academy of Management Conference, Anaheim, California, United States, 2016</td>
<td>-</td>
<td>The 1st round of revision</td>
</tr>
</tbody>
</table>
5. Conclusions

This chapter discusses the key research findings of this dissertation. First, it presents a summary of the dissertation. Then it presents the theoretical, empirical and practical contributions. Thereafter, it discusses the limitations of the dissertation accompanied by future research suggestions and general conclusions.

5.1 Summary and reflections

This dissertation builds on a body of research conducted within the fields of corporate governance and strategic management. By advancing the understanding of concept of managerial discretion and linking it to organizational outcomes, this dissertation seeks to contribute to the current knowledge about managerial influence on organizational outcomes and the role of corporate governance in shaping managerial strategic decision making. In particular, the aim of this research study was to explore the impact of delegation on organizational outcomes through the prism of strategic and corporate governance dimensions of managerial discretion. This dissertation developed through 1) conceptualizing governance and strategic dimensions of managerial discretion; 2) exploring the factors that shape discretion within each dimension; 3) introducing the trade-offs between the governance and strategy costs of managerial discretion; and 4) exploring the balance between the two forces. The central contribution of this dissertation thus lays in its theoretical and empirical exploration of delegation and its influence on organizational outcomes.

5.1.1 The benefits and costs of delegation

The central theoretical idea behind this research project was the delegation of decision-making function between the two central actors within an organization: professional managers and the shareholders (represented by the board of directors) — between those who undertake decisions and those who control these decisions (Fama and Jensen, 1983; Finkelstein and Hambrick,
The balance between the two is viewed as one of the main determinants of the survival of a corporation (Monks and Minow, 2011; Umans and Smith, 2013). This balance illuminates the two aspects of firm survival: the strategic, which is represented by executives, and governance, which is represented by the board of directors on behalf of the shareholders (Daily et al., 2003).

Adam Smith’s famous critique of the efficiency of corporations was based on the argument that the owners of these entities seldom understand the business these corporations are in, while managers responsible for someone else’s money will not manage it with the same care and diligence as if it were their private capital (1776, V:1). The problem of effective delegation and, more specifically, the agency costs associated with it has become the focus of numerous studies within corporate governance research (Finkelstein et al., 2009; Monks and Minow, 2011). Agency theory has become the dominant theoretical perspective (Dalton et al., 2007; Judge, 2009), successfully diffusing into policy and practice (Hillman and Dalziel, 2003; Shapiro, 2005). This overemphasis on shareholders’ interests has left the managerial perspective somewhat less represented (Goranova and Zajac, 2015), as manifested in the implicit assumption that more control over managerial behavior will always be better for a corporation (Finkelstein et al., 2009). Nascent research has pointed out the disproportionate emphasis on the costs induced by the agent (Goranova and Zajac, 2015), which is driven by increasing power of shareholders (Bebchuk, 2005). This suggests a potential cost of overemphasis on control (Lange et al., 2014; Neville and Currie, 2015).

This dissertation contributes to this growing discussion by introducing the notion of strategic opportunity costs being associated with board monitoring, which extends the notion of agency costs. Strategic opportunity costs can be fruitfully explored through the concept of managerial discretion, which is the latitude of strategic actions available to managers (Hambrick and Finkelstein, 1987; Shen and Cho, 2005) that lies within the zone of shareholders’ acceptance. The multi-dimensional nature of the concept illuminates the importance of having balance between enabling and restraining in delegating decision-making authority and autonomy to professional managers.

Recognizing that strategic opportunity costs arise from board monitoring provides a useful approach for extending the agency theory toward a broader understanding of ways to maximize shareholders’ wealth. The current understanding of agency theory focuses on distribution of a shareholder wealth, while the strategic opportunity aspect can shift this focus toward wealth creation through capitalizing on firm’s strategic opportunities. While assuring the efficient distribution of wealth, the core focus of a board work can be on the development of the corporation through effective adaptation to
its external environments so it can achieve its full potential for shareholder wealth maximization.

In incorporating both efficiency of wealth distribution and effectiveness of overall corporate governance in developing a corporation, this approach allows for a comparison of the benefits of assuring efficient distribution of firm value (restraining effect) against the benefits of generating wealth through the value creation (enabling effect). This approach goes beyond the dominant notion of profit maximization by recognizing that organizations have other objectives, namely value creation and the development of the corporation (Misangyi, 2002). This suggests that effective delegation of decision-making authority and autonomy to professional managers is an essential tool of development of corporation. Enabling managers by providing them with the authority and autonomy to undertake strategic decisions and to take reasonable risks can help sustain entrepreneurial spirit and preserve innovation and development in corporations (Smith, 2012).

5.1.2 Integrating the governance and strategy perspectives on executive decision making though managerial discretion

This dissertation outlines two dimensions of the concept of managerial discretion: governance and strategic. These dimensions derive from two distinct theoretical perspectives — the corporate governance perspective, which is grounded within the agency theory (Jensen and Meckling, 1976), and the strategic management perspective, which is grounded within the behavioral theory of a firm (Cyert and March, 1963; Hambrick and Finkelstein, 1987; March and Simon, 1958).

While the two perspectives hold different assumptions about managerial interests, they share the assumption that managers need a large amount of power (Misangyi, 2002). The governance perspective is concerned primarily with firms’ internal environment and focuses on the alignment of incentives between managers and the shareholders. The strategic perspective assumes that the latter are aligned, attributing it either to “stewardship” orientation or the governance mechanism (ibid). The focus of this perspective is on the adaptation of the internal organizational structure to the needs of external environment. While strategic dimension focuses on the benefits associated with delegation in terms of greater strategic flexibility, the governance perspective is more concerned with minimizing the costs associated with delegation. Neither of these contradicts the other in its basic assumptions; instead they can be viewed as complimentary and thus be integrated.

If one takes the neutral view on managerial motivation, assuming that in some situations managers can behave in the interests of a firm while in other engage in opportunism, integrating strategy and governance views on discretion can
be a one way of determining the level of authority and autonomy to be delegated to managers. Coming back to the definition of agency relationship as “... 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.” (Jensen and Meckling, 1976, p.308). Conceptualizing managerial discretion in terms of two dimensions can lead to a greater understanding of what is implied by “some [emphasis added] decision making authority”. In other words, managerial discretion can be an integrating mechanism between the governance and the strategic perspectives on managerial decision making, while the relationship between the two dimensions can be explored through the consideration of costs of managerial opportunism and strategic opportunity costs.

Strategic opportunity costs are important to consider in the design of internal corporate governance because such costs can be substantial. Failure to adapt and evolve in changing environments can result in detrimental consequences such as loss of market share to competitors or eventual bankruptcy. At the same time, if successful, strategic changes can increase the value of the firm. While the costs of managerial opportunism involve a share of existing profits, strategic opportunity costs refer to the failure to maximize a firm’s potential. Consequently, in situations where strategic opportunities offer great potential, the mismatch between strategic and governance discretion can result in a substantial loss in shareholders wealth. On the other hand, in situations that do not present many opportunities for managers, the costs of managerial opportunism will prevail. This implies that the overall agency costs can be evaluated in terms of trade-offs between costs of managerial opportunism and strategic opportunity costs. Rather than separately analyzing the costs and benefits of delegation, this dissertation uses the concept of managerial discretion as a theoretical bridge between strategic and governance perspectives, thus showing that trade-offs are associated with increased monitoring of managerial decision making. Consideration of such trade-offs can help determine an appropriate balance between enabling and restraining managerial action.

5.1.3 The balance between enabling and restraining managerial action

The issue of delegation is associated with the trade-offs between enabling and restraining managerial decision making. Present research largely focuses on either the benefits (e.g., Adams and Ferreira, 2007) or the costs of delegation (e.g., Fama, 1980), while this dissertation attempts to create a more comprehensive picture of shareholder wealth creation by accounting for both in determining the appropriate balance between enabling and restraining actions.
The initial idea driving this dissertation was to account for what was later termed “strategic opportunity costs” and their influence on shareholder value creation. In particular, I argued that environments that present a larger number of strategic opportunities would be characterized by greater strategic opportunity costs (Paper 3). However, the empirical tests of this idea (Paper 4) showed support for the governance perspective, indicating that high strategic discretion may also increase agency costs, in cases of its misuse, and thus requiring more intense monitoring. This surprising finding indicated that the relationship between the two categories of agency costs could be more complex than expected. While environments with a high level of strategic discretion assume high strategic opportunity costs, such environments may also face the greater risk of value reduction, which would ultimately affect the magnitude of the agency costs.

In reflecting on the findings of the fourth study, it became apparent that determining the appropriate level of delegation is challenging for three main reasons: 1) difficulties of comparing the two types of costs; 2) difficulties in estimating strategic opportunity costs; and 3) difficulties in estimating the risks associated with strategic opportunities.

The two types of costs refer to the value of organization at different times. Costs of managerial opportunism concern the reduction in the present value of the firm, while strategic opportunity costs refer to a reduction in future value or, more specifically, the value of opportunities for development. The latter is much harder to estimate because of the uncertainty of change. Thus, companies may chose to focus on short-term returns over the long-term perspective, and so maximize present value at expense of the future value. Sundaramurphy and Lewis (2003) argued that the increased control over managerial decision making forces firms to prioritize short-term gains. In support of this, studies on shareholder value ideology have raised well-grounded concerns about the sustainability of the downsize and distribute approach and its effects on long-term economic development (Lazonick and O’Sullivan, 2000). Since unfulfilled strategic opportunities are hard to capture empirically, the central focus is put on the present value of the firm. The greater the present market value, the higher the trade-offs.

Assuming that the future value of the firm can be approximated based on the number of strategic opportunities in its environment (Merton, 1973), the balance between enabling and restraining managerial action will resemble the point where the trade-offs are at their minimum. More specifically, the equilibrium point will be reached when the costs associated with reduction of 1) the present value of the firm and 2) the value of its future opportunities for growth are at their minimum. In this case, the maximum reduction in the
present value will be compared against the maximum value creation achievable through capitalizing on profitable strategic opportunities. Large corporations may focus strongly on preserving their existing value rather than on expanding their firms, since their size limits opportunities for growth (Evans, 1987), while it could have a significant reduction in the present value because of agency costs.

The present value of a firm may be determined through the potential risks associated with the strategic opportunities. Depending on the degree of risk, shareholders may prefer to focus on cost reduction versus value creation. Consequently, the trade-offs will depend on the overall risk attitude of the firm. Agency perspective does not account for the external environment and the risks associated with the development of the firm in the future. Therefore, adding strategic opportunity costs to the debate can enhance the current understanding of the system of governance mechanisms.

For the reasons outlined above, it is rather challenging to capture the trade-offs empirically. One needs to take into consideration both environmental uncertainty and the firm’s strategic focus to determine the balance between enabling and restraining forces in each situation. This implies that the value attributed to the reduction of each category of agency costs is subjective for each firm. In this dissertation, I make the first attempt to empirically capture the trade-offs by testing the two competing hypotheses. The results indicate that greater performance effects were associated with board monitoring in situations of higher strategic discretion. This implies that high strategic discretion also increases the potential threat of managerial opportunism, as managers have a stronger influence on their firms, for better or for worse. Taking into consideration that the outcomes were measured in terms of market performance, the results are in line with the idea that a focus on cost reduction can maximize short-term performance. Thus a considerable limitation of this empirical investigation was the choice of measured outcomes, which related mostly to the present value of the firm and did not sufficiently capture the value of strategic opportunities. The natural next step in the empirical investigation of balance between enabling and restraining forces would be to explore long-term strategic performance and value creation within a company.

5.2 Theoretical contributions

The theoretical contributions of this study fall in two main categories. The first is directed to corporate governance research and provides an explanation of the varying effects of board monitoring on strategic decision making in different environments. Second, this dissertation contributes to building the
theory of managerial discretion by providing a joint understanding of strategic and governance forces in a theoretical framework.

This dissertation makes a theoretical contribution to the field of corporate governance by highlighting the effects of board monitoring on managers’ strategic decision making (Papers 3 and 4). Previous studies have concentrated primarily on the benefits of corporate control, stressing the minimization of the costs of managerial opportunism as the primary outcome (Fama, 1980; Jensen and Meckling, 1976; Williamson, 1985). This approach can be one sided because it fails to recognize the opportunities for value creation. In contrast, the present study draws attention to the costs associated with board monitoring of managers’ strategic decision making. This is in line with the nascent research on the influence of board monitoring on executive decision making (Ponomareva and Ahlberg, 2015; Lange et al., 2014; Volonte and Gantenbein, 2014). The concept of agency costs, specifically the notion of residual loss in shareholders’ wealth, is divided into two categories of costs. One is managerial opportunism costs, which is emphasized by the agency theory (Eisenhardt, 1989; Jensen and Meckling, 1976). The other is strategic opportunity costs, derived from strategic management literature (Hambrick and Finkelstein, 1987; Hambrick and Abrahamson, 1995), which refers to the failure of managers to identify and exploit profitable strategic opportunities due to board control over strategic decision making. The two categories of costs indicate there is a trade-off associated with delegation. The notion of strategic opportunity costs indicates the existence of previously undiscussed strategic consequences of control mechanisms. These costs can be an important explanation for the mixed findings of performance effects of control mechanisms on managers’ strategic decision making.

The idea of balance between enabling and restraining managerial action appeared in the explorative study in Paper 2. This idea was further explored conceptually (Paper 3) and empirically (Paper 4), showing that the effects of monitoring on the outcomes of a firm can be more complex than depicted by agency perspective.

The argument for imposing control over managerial behavior is supported by an extensive body of research (Dalton et al., 2007; Jensen and Meckling, 1976). However, this dissertation argues for the existence of strategic costs of governance mechanisms. This implies that governance mechanisms, particularly monitoring by the board, may send managers different signals depending on the strategic environment the firm is operating in. This idea is in line with growing number of studies exploring the contingency effects of corporate governance mechanisms (van Essen, Engelen, Carney, 2013; Randøy and Jenssen, 2004).
This study also advances agency theory by showing that accounting for strategic opportunity costs as well as the costs of managerial opportunism allows for a more accurate prediction about the choice of appropriate governance mechanisms. Recent studies have emphasized the need to refine and expand the theory by providing a more comprehensive overview of activities directed toward the maximization of the shareholders’ wealth (Raelin and Bondy, 2013). The concept of strategic opportunity costs advances the importance of contingency fit between internal corporate governance mechanisms and a firm’s strategic environment. Consideration of a firm’s strategic environment in the design of governance instruments can contribute to extending the domain of corporate governance.

In line with this, this dissertation challenges the dominant hold of the agency theory criticizing the disproportionate focus on the benefits of increasing monitoring by highlighting the costs associated with it (Lange et al., 2014; Zajac and Westphal, 1994). Considering that agency theory does not manage to consistently predict firm outcomes (Dalton et al., 1999; Westphal 1999; Deutsch, 2005; Rhoades, Rechner and Sundaramurthy, 2000), the inclusion of a strategic dimension may provide a novel explanation for these inconsistent findings.

This study also contributes to the debate about the relationship among governance mechanisms. While one stream of research argues for complementarity (Mikkelson and Partch, 1997; Poppo and Zenger, 2002), another proposes that one mechanism may substitute for another (Beatty and Zajac, 1994; Hoetker and Mellewigt, 2009; Lopez-de-Silanes et al., 1998; Zajac and Westphal, 1994). This dissertation proposes a different view, arguing that different governance mechanisms may have different effects on managerial decision making (Garcia-Castron, Aguilera and Arino, 2013). In particular, it explains why a board’s effects on outcomes may vary depending on the number of strategic opportunities. This reasoning is in line with previous studies showing varying effects of governance mechanisms on firms’ outcomes under different contingencies (Boyd, Haynes and Zona, 2011; Randoy and Jenssen, 2004; Zona, Zattoni, and Minichilli, 2013). Other mechanisms of corporate governance may have varying effects on managerial behavior through their influence on the degree of discretion available to executives. For example, mechanisms focusing on incentive alignment may discipline managers’ actions without reducing managers’ discretion. This is in keeping with research calling for extending conceptual boundaries of agency theory toward a focus on how context may influence the alignment of interests between principals and agents ( Cuevas-Rodriguez, Gomez-Meja and Wiseman, 2012).
In line with this, this study explores a “black box” of board governance (Adams, Hermalin, and Weisbach, 2010; Huse, 2005) by conceptualizing processes that mediate the relationship between board monitoring and the firm’s outcomes (Paper 3). Four mediating processes are proposed: a) the effects of board monitoring on managerial motivation; 2) the speed of decision making; 3) communication in the boardroom; and 4) strategy implementation. The theoretical exploration of these processes provides important insights into the strategic consequences of increasing monitoring (Roberts, McNulty, and Stiles, 2005; Zona and Zattoni, 2007). While acknowledging that increasing board monitoring may reduce the costs of managerial opportunism, this dissertation shows that monitoring has potential effects on strategic decision making. Thus, it contributes to the scientific dialog about the control-performance relationship (Knapp et al., 2011).

Furthermore, this dissertation reintroduces the concept of managerial discretion into governance research (Papers 1 and 3). The general perception of managerial discretion in governance research is largely associated with a focus on the internal problem of minimization of managerial opportunism and protection of the shareholder interests (Daily et al., 2003). By integrating strategic and governance dimensions of managerial discretion, which are at the moment theoretically distant, the predictive power of the theory of corporate governance can be extended toward greater recognition of the role of a firm’s external environment in determining its governance needs (Boone et al., 2007; Collin and Bengtsson, 2000; Volonte and Gantenbein, 2014). This dissertation explains how the largely exogenous dimension of a firm’s strategic environment may influence the endogenous formation of governance mechanisms, defining the zone of shareholders acceptance. In their theoretical review on managerial discretion, Wangrow et al. (2014) suggest that managerial discretion can benefit research in corporate governance by explaining when governance mechanisms will be most beneficial. This dissertation shows 1) the situations in which monitoring may be most effective and 2) when governance mechanisms other than constraining managerial discretion can be most beneficial.

The present study also contributes to the strategic management literature through development and extension of the theory of managerial discretion (Hambrick and Finkelstein, 1987; Hambrick and Abrahamson, 1995; Hambrick et al., 2004). Papers 1 and 2 clarify and synthesize the concept, explaining how governance factors shape managerial discretion. The two largely distant perspectives on managerial discretion developed in the strategy and corporate governance research are integrated in a comprehensive model of managerial discretion. This study differs from the largely unidimensional research on managerial discretion (e.g., Boyd and Gove, 2006; Wangrow et al., 2014) because it identifies the importance of considering both
perspectives. The proposed integrative model is argued to be a way forward in developing the theory of managerial discretion because it allows for a more comprehensive view of the concept illuminating the complex interaction between strategic and governance forces of discretion (Wangrow et al., 2014).

Furthermore, the synthesis and redefinition of managerial discretion allows for overcoming the ambiguity concerning the theoretical nature of the construct (Caza, 2012; Wangrow et al., 2014). This dissertation promotes a multi-dimensional nature of the concept, which allows for explaining the conflicting implications of managerial discretion for organizational performance. This helps increase consistency in theory building, allowing for integration and synthesizing of knowledge that has been independently generated. Considering the governance aspect of discretion, the dissertation contributes to strategy research by overcoming the conflict-free view on organizations and considering that managers may not always act in the interest of their firms (Shrivastava, 1986). This integrative model sheds light on how the strategic dimension of discretion may influence the governance dimension and on their joint influence on organizational outcomes. In particular, the zone of shareholders acceptance needs to be adjusted to the level of strategic opportunities in a firm’s external environment. This integrated definition of managerial discretion reconciles the diverging views on managerial discretion and explains the influence on organizational outcomes.

Finally, this dissertation contributes to understanding the multiple forces that shape managerial discretion at organizational and environmental levels (Boyd and Gove, 2006; Hambrick and Finkelstein, 1987; Crossland and Chen, 2013). More specifically, it proposes that the same force may both increase and decrease managerial discretion. For example, powerful internal forces, such as a board of directors may constrain or enhance managerial discretion, which is different from original concept of a board having only a negative influence (Hambrick and Finkelstein, 1987). In addition, this dissertation highlights that managerial discretion is nested in multiple levels of analysis where different determinates are interconnected. The inherent complexity associated with the multitude of forces creates theoretical and methodological challenges to explaining executives’ influence on organizational outcomes. By identifying and explaining the forces that shape managerial discretion at multiple levels and theoretical domains, this study takes a step toward overcoming this challenge.

In sum, this dissertation contributes to the corporate governance and strategic management research fields. While the first part of the dissertation mainly focused on theoretical development and refinement of the concept of managerial discretion, the second part applied the concept to build a more comprehensive framework explaining executive influence on organizational
outcomes. Accordingly, the central contribution to the field of corporate governance research lies in development of an integrative framework to explain the effects of corporate governance on organizational outcomes. The contribution to the strategic management is the consideration of organizational power dynamics and its influence on managerial decision-making.

5.3 Empirical contributions

The empirical contribution of the present study lies in 1) empirically examining the strategic and governance forces that shape managerial discretion at organizational and environmental levels; 2) providing some of the first evidence on how the two dimensions of managerial discretion jointly influence organizational outcomes; and 3) exploring the concept of managerial discretion across different institutional contexts. Using both qualitative and quantitative approaches generated new insights on the nature and direction of influence of forces that shape discretion as well as the joint effects of the two dimensions on organizational outcomes. Furthermore, this study contributes to the knowledge on how institutional contexts might affect the nature of discretion delegated to managers. It did this by exploring managerial discretion, a concept that originated within the US context, in the transition economy of Russia and the more stable economy of Sweden.

This dissertation adds to the development of the concept of managerial discretion (Paper 2) by providing a comprehensive understanding of forces that shape it at organizational and environmental levels. The extant review studies pointed out the lack of a unified definition of the concept as well as an understanding of the forces that define it (Keegan and Kabanoff, 2007; Wangrow et al., 2014). In addition, current studies on managerial discretion are embedded in either the strategy (Hambrick and Finkelstein, 1987) or governance perspective (Shleifer and Vishny, 1997). The present study provides an integrated definition as well as a comprehensive empirical exploration of both the strategic and governance forces that define discretion (Paper 2). The empirical descriptions in Paper 2 illuminate the relationship between the countervailing forces enabling and restraining managerial decision-making authority and autonomy and so integrate strategic and governance dimensions of the concept. The latter is important for obtaining a more comprehensive and unified understanding of the concept and thus putting research on managerial discretion on a firmer footing (Keegan and Kabanoff, 2007). To my knowledge, this is the first study focusing on the development of the concept of managerial discretion through empirical exploration of the factors shaping it.
In addition, this dissertation provides insights about how managers perceive their discretion and the relative importance of the forces that shape it. While most research on managerial discretion is based on objective proxy data (Abrahamson and Hambrick, 1997; Crossland and Hambrick, 2011), this dissertation presents empirical evidence based on both objective and perceived discretion. The findings of the qualitative study (Paper 2) contribute to the conceptualization of perceived managerial discretion in terms of balance between enabling and restraining authority delegated to managers. In addition, the findings provide an empirical illustration of forces that shape managerial discretion at organizational and environmental levels.

Another important empirical contribution lies in the exploration of the joint effects of strategic and governance dimensions of managerial discretion on organizational performance. Paper 4 explores the trade-offs between the costs of managerial opportunism and strategic opportunity costs by capturing the performance effects of board monitoring and CEO characteristics under different contingencies of strategic discretion. The study reveals the positive moderating effects of managerial discretion on performance effects resulting from board monitoring. In addition, it shows the negative moderating effects of managerial discretion on the relationship between CEO experience and a firm’s financial performance. These findings provide support for the governance-driven explanation, and contribute to our knowledge about the effects of corporate governance mechanisms on managerial decision making in different strategic environments. In particular, Paper 4 adds to development of corporate governance literature by providing empirical testing the integrated framework. This dissertation contributes by introducing managerial discretion as a useful concept for examining the effects of governance mechanisms on a firm’s outcomes.

The third empirical contribution of the dissertation lies in the exploration of managerial discretion within non-Western institutional contexts (Papers 3 and 4), an under-researched area. Overall, exploring the notion of managerial discretion in three different contexts made it possible to build a stronger theory that can apply across multiple institutional contexts. This is, to the knowledge of the author, the first qualitative study of managerial discretion in Russia and so provides important empirical knowledge about managerial decision making in that context. This exploration of the governance and strategic forces that shape managerial discretion within a transition economy provides information that challenges existing perceptions of managerial discretion based on the studies conducted in developed economies. The empirical exploration revealed context-specific factors that comprise managerial discretion in the context of transition, in particular, the importance of informal institutions and trust as mechanism assuring control over executive decision making.
The joint effects of the two dimensions of managerial discretion were empirically explored in the context of Swedish economy (Paper 4). To the knowledge of the author, no other study has explored managerial discretion using Swedish data. In addition, examining the model of discretion within Swedish context made it possible to capture importance of a firm’s strategic environment. In particular, the small size of Swedish domestic market explains why a large proportion of Swedish listed corporations are competing on global market (Iversen and Larsson, 2011).

Paper 4 also contributes to the knowledge about business practice in Sweden. A context-specific composite index of board monitoring was developed based on five indicators of board monitoring. The results are congruent with previous research on Swedish corporate governance, indicating that stringent monitoring by a board through increased directors’ independence can be detrimental for a firm’s performance in industries characterized by high product market competition (Randøy and Jenssen, 2004).

To summarize, the empirical contribution of this dissertation lies in 1) the comprehensive empirical exploration of the forces that shape managerial discretion in a transition economy and 2) the empirical testing of the joint effects of strategic and governance dimensions of managerial discretion on a firm’s outcomes. This two-dimensional model of managerial discretion was examined in three contexts, making it possible to refine the existing perception of the concept and to generate new knowledge about it.

5.4 Practical contributions

Based on the research findings in this dissertation, several practical and policy recommendations can be made for boards of directors, the actors responsible for setting the zone of acceptance for managerial actions (Hutzschenreuter, Kleindienst, and Greger, 2012; Van den Berghe, and Baelden, 2003). The findings question the applicability of the current notion of board best practices grounded within agency theory logic (cf. Ponomareva and Ahlberg, 2015; Hillman and Dalziel, 2003). The central practical contribution is to caution against the growing emphasis on monitoring managerial decision making by limiting decision-making authority and autonomy and applying the current understanding of agency theory for normative purposes.

This dissertation proposes that current best practices in the design of governance mechanisms should consider the trade-offs associated with control and, in particular, strategic opportunity costs. An over emphasis on monitoring, particularly through increasing the independence and power of the
board of directors, may have important implications for a firm’s ability to adapt to the forces of its external environment. While not underestimating the importance of effective control, this dissertation raises concerns about the effects of increasing monitoring on strategic outcomes and the sustainability of the current system of corporate governance in generating value.

Furthermore, it also shows that the balance between enabling and restraining managerial decision making may be contingent on a firm’s external strategic environment. This environment has the potential to influence managers’ ability to increase value by capitalizing on strategic opportunities and to reduce the current value of the firm. This implies that a board should consider the strategic environment when designing internal governance mechanisms. This dissertation shows that board monitoring would be most beneficial for maximizing a firm’s value in environments with high strategic discretion. Yet, these results have to be taken with caution as they do not fully explore the future value of the firm, namely the ability of the firm to capitalize upon profitable strategic opportunities for maximizing the shareholder value.

Overall, the notion of trade-offs signifies the importance of appropriate fit between board governance and a firm’s strategic environment, suggesting that increasing monitoring may not be a guarantee of effective functioning of a corporation. One way to mitigate these trade-offs is to focus on mechanisms of corporate governance that may not constrain managers’ ability to undertake strategic decisions. This would maximize the value of managerial professional talent.

The importance of the strategic implications of board monitoring also needs to be acknowledged in the development of corporate governance policy. The increasingly tight requirements for boards and assurance of control over managerial decision making may not result in the desired effects because they may lead to strategic opportunity costs. The results of this study suggest that policy frameworks aiming at development of corporate governance practices need to overcome the notion that “one size fits all” and allow firms more flexibility to determine appropriate levels of delegation. In other words, the current recommendations for good governance practices and corporate governance codes may need to be tailored to the specific characteristics of a firm’s strategic environment.

5.5 Study limitations and future research directions

Because this study is a first step in many regards, the limitations in this research need to be acknowledged. These limitations open several avenues for future investigation. The nascent but growing body of research integrating
corporate governance and strategy outlined in this dissertation is very promising. Further research could be done on building more complex theoretical frameworks, including behavioral aspects in the dominant perspective of agency theory, and striving for a deeper understanding of the strategic forces shaping the effects of governance on organizational outcomes. The limitations of this dissertation and directions for future research are discussed in relation to four main themes: 1) exploration of the board control and the varying effects of corporate governance mechanisms on the outcomes of a firm; 2) exploration of the effects of other roles of the board on strategic decision making; 3) theoretical exploration and empirical verification of mediating processes and their effects on strategic decision making and the outcomes; and 4) further exploration and empirical application of an integrated model of managerial discretion.

5.5.1 Board control
The discussion on board control in this dissertation has been conducted at a relatively high level of abstraction. The board control mechanisms were divided in two broad groups: those oriented toward monitoring and those oriented toward incentive alignment. This dissertation explored the concept of control primarily through board monitoring, a central mechanism of corporate control (Fama, 1980). Board control has been discussed as a homogeneous construct, mainly with a focus on “monitoring,” “oversight,” and “strategic control,” and using the terms interchangeably. However, one needs to acknowledge the difference between the terms and between the activities that can be included in the notion of board control. Therefore, research could focus on clarifying the concept of board control, more precisely defining the concepts of monitoring and strategic control, and analyzing the effects of different control mechanisms on managerial decision making and, ultimately, its effects on outcomes.

Another limitation derives from the implicit assumption of a zero sum game of corporate control. However, one may argue that limiting managerial authority and autonomy through increased monitoring, may force managers to seek discretion in other domains. Further research on changes in managerial discretion through time could address this issue by exploring the effects of corporate control.

While “control” is a central concept in the discussion of the role of the board of directors (Fama, 1980; Jensen and Meckling, 1976), the understanding of what is implied by board control remains somewhat unclear. Some researchers use the concept of monitoring (Castanier and Kavadis, 2013; Pugliese et al., 2014; Tian, 2014; Westphal, 1999), while others use the concept of control (Knapp, Dalziel, Lewis, 2011; McDonald and Westphal, 2010), or distinguish between strategic and financial control by the board (Tosi et al., 1997). These
different terms create confusion, making it difficult to build on previous research. In addition, other mechanisms including those focusing on incentive alignment, are discussed within the general framework of board control (Baysinger and Hoskisson, 1990). This suggests it would be valuable to examine and redefine various forms of internal board control in order to overcome the current inconsistencies.

The focus on understanding control may be a fruitful field for research, and more work needs to be undertaken to empirically capture the control function of governance. Current research focusing on board control has largely relied on the number of proxy variables, whereas the main one is independent directors (Johnson, Daily and Ellstrand, 1996). However, this measure is not ideal as independent directors may also be an indicator of board service function (Daily and Dalton, 1993). Furthermore, recent research has questioned the assumption that the title of independent directors automatically means that directors will engage in monitoring. I propose a more nuanced approach that accounts for the expectations that directors and the CEO have about the fulfillment of the board roles (Neville and Currie, 2015). Consequently, it becomes especially important to develop more precise measurement of board monitoring activity and to clearly distinguish it from activities associated with other roles of the board.

Current research on the benefits of increased control does not account for a variety of behaviors managers may engage in in response to incentive alignment and monitoring. Increasing control over managerial decision making may not necessarily make managers do better work (Finkelstein et al., 2009). Future studies could explore the outcomes of board control by focusing on how managers perceive various forms of board control and react to them. Such studies would increase our understanding of strategic opportunity costs as well as the benefits of control.

This study explored the effects of monitoring on strategic opportunity costs; future research could explore the effects of other mechanisms of board control on managerial decision making. A particularly interesting avenue could be how incentive contracts may affect strategic opportunity costs. Since monitoring mechanisms are primarily concerned with constraining managerial action, the incentive alignment mechanisms may not limit managerial decision-making authority and autonomy. Rather, it may expand it by providing incentives to act in the direction of the shareholders’ interests. On the other hand, incentives could also act as a restraining mechanism. By incentivizing managers to prioritize certain goals, the board may discourage them from pursuing additional options in their task environment, thus limiting their decision-making autonomy without limiting their authority. Future studies could focus on both theoretical and empirical development of
knowledge in this area. In addition, empirical and theoretical exploration could be done of other mechanisms that contribute to reducing managerial opportunism without having a strong influence on strategic opportunity costs. Examples include the concept of trust (Noteboom, 1996) and identification (Filkenstein, et al., 2009; Lange et al., 2014).

This dissertation has introduced the concept of strategic opportunity costs; however, they were not measured directly. Both strategic opportunity costs and the costs of managerial opportunism are hard to observe; nevertheless, approximation of the costs could be made based on the observed variation of multiple indicators of firms’ performance. While this dissertation examined performance of corporations in terms of financial outcomes, corporate control may also have implications for organizational outcomes such as strategic choices and strategic change, organizational risk preferences, firm efficiency, and competitive dynamics. Future research could continue to investigate the relationship between strategic opportunity costs and the costs of managerial opportunism by considering these outcomes. This might not only increase our understanding of the multi-faceted nature of corporations but also provide greater insights into how control influences the strategic choices that firms make.

5.5.2 Consideration of multiple roles of the board

This dissertation focused solely on monitoring role of the board of directors that is emphasized by the agency theory (Blair and Stout, 2001; Johnson et al., 1996). However, boards can also provide strategic advice and counsel to executives (Hillman and Dalziel, 2003), engage in conflict resolution (Collin, 2008), and provide access to valuable resources (Certo, 2003). These activities can be summarized as the service-oriented role of the board (Gabrielsson and Winlund, 2000; Pugliese et al., 2014). Ocasio and Joseph (2005) contend that board involvement in different roles depends on the nature of the environment in which the firm is operating; thus, it could be interesting to explore the effects of the roles under different contingencies of strategic discretion.

While a board can incur strategic costs through its control role, it can also contribute to maximization of shareholder value through its service role. By providing opportunities and encouraging executives to capitalize on existing opportunities, a board can contribute to development of the firm pursuing value creation (Huse & Gabrielsson, 2012). The board may also contribute to the alignment of interests between managers and shareholders by motivating and enabling effective communication between the board and the CEO. The latter can contribute to a reduction in the costs of managerial opportunism. Future studies could explore these ideas empirically, measuring boards’ engagement in the service role through several proxy measures used in previous research, including the characteristics of board composition or board
social capital (Volonte and Gantenbein, 2014). The research could also rely on self-reported measures through surveys.

5.5.3 Mediating processes

Paper 3 linked the board monitoring function to the firm’s performance to four main processes through which board control influences strategic decision making. However, in Paper 4 I did not measure these processes. Despite this limitation, the empirical study is still valid, as the central emphasis was on the moderating role of firm-level discretion. This limitation opens up research opportunities for empirical investigation of mediating processes through which board control influences strategic decision making.

Significant opportunities exist for researchers to explore how control over managerial decision making might affect the shareholders’ wealth. Empirical verification of proposed processes could provide valuable insights into how board control influences strategic decision making. Furthermore, future studies could focus on mechanisms such as incentive alignment. These studies could shed light on the strategic opportunity costs of increased control and how various instruments affect them. It could also be interesting to examine the link between the mediating processes outlined and a firm’s outcomes. While both strategic opportunity costs and the costs of managerial opportunism are hard to measure empirically, changes in observable outcomes could be used as evidence of aggregate agency costs.

In Paper 3, I discussed four mediating processes though which a board exerts strategic control in relation to strategic opportunity costs. However, the processes could also have varying effects on the costs of managerial opportunism. Future studies could tackle this issue by analyzing the relationship between board control, the CEO/board relationship, and accumulated residual loss, doing so through a discussion of both strategic opportunity costs and the costs of managerial opportunism.

5.5.4 Integrated model of managerial discretion

Despite its theoretical importance, empirical research on managerial discretion remains rather limited. This study is the first attempt to integrate strategic and governance dimensions under a common framework; further empirical verification of that proposed framework could be a natural continuation. The findings generated in the exploratory study cannot be generalized and are largely context-specific to the business environment of a transition economy. The empirical findings from Paper 4 provided more opportunities for generalizability; however, these are also bounded to a specific context in the Swedish economy. Thus, applying the integrated model of managerial discretion in different contexts could be fruitful for further development and verification of the proposed model.
Further inquiry into relationship between strategic and governance dimensions of discretion and its implications for organizational outcomes might provide new insights about the effects of governance mechanisms on strategic decision making. Particularly interesting would be further exploration of relationships among the different factors determining managerial discretion. Here two research paths can be distinguished. The first is a more macro-oriented study focusing on the relationship between environmental and organizational determinants. In particular, it would be interesting to see how changes at one level might be associated with changes at another level of discretion. This topic could also be fruitfully explored using natural experiments as empirical settings. For example, studies of industry deregulation (Cho and Shen, 2007; Rajagopalan and Finkelstein, 1992) might reveal how changes in a firm’s external environment might determine changes in internal corporate governance.

The second path could be an inquiry into the relationship between the strategic and governance dimensions of managerial discretion. Research could further examine these two distinct perspectives through a survey questionnaire to investigate individual perceptions of both dimensions at multiple levels of analysis. The questionnaire could combine strategic and governance determinants managerial discretion. Currently, there is no commonly used survey instrument for measuring managerial discretion. Creation of one could aid in replicability of results and allow for comparison of direction levels across different contexts.

Furthermore, current discussion on managerial discretion largely focuses on CEOs. Future research could explore managerial discretion within a broader context of top management teams, focusing on how the individual discretion of team members could create the overall latitude of actions managers possess and the zone of shareholders’ acceptance. Research accounting for team dynamics could contribute to a more vigorous perspective on managerial discretion.

5.6 Conclusion

While much has been learned in previous research about the effects of executives on organizational outcomes, this topic remains a fertile research area. This dissertation examines delegation of decision-making authority and autonomy to professional managers, using managerial discretion as a theoretical tool to integrate strategic and governance perspectives on the role of executives. The results illustrated how board control influenced organizational outcomes under different strategic contingencies. This is just
one of the first inquiries into the strategic effects of increase in corporate control, so there are numerous opportunities for future research. By understanding what drives individual action, we can understand the essence of corporate governance and why organizations perform the way they do.
6. References


Ernst & Young 2011. *Doing business in the Russian Federation*. Ernst & Young Russia: Moscow, Russia.


Smith, A. 1776. An inquiry into the nature and causes of the wealth of nations, Indianapolis: Liberty Press.


