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Reaffirming the importance of managerial discretion in corporate governance: A comment on Andersen (2017)

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Abstract

Purpose: A recent study by Jon Aarun Andersen argued that corporate governance research will improve if it abandons the concept of managerial discretion due to the lack of an empirical definition and measurement of the concept. In this paper, we comment on Andersen (2017) by suggesting that the theoretical reasoning employed in his work is not adequate and that the concept of managerial discretion is one of the core dimensions that should be studied when researching corporate governance.

Design/methodology/approach: This paper uses theoretical frameworks from recent literature, definitions and empirical studies on the concept of managerial discretion and corporate governance.

Findings: Several studies have empirical tested and measured the concept of managerial discretion and that other attempts have provided validity and reliability of the concept, other have showed the direct impact of discretion on firm performance.

Practical implications: Research on managerial discretion provides owners and board of directors a clear advice on how much discretion can be granted to top executives by taking into consideration the different dimensions of the external and internal environment.

Originality/value: This paper concludes that corporate governance research will not improve if it abandons the concept of managerial discretion.

Keywords: managerial discretion, corporate governance, institutional antecedents, organisational performance.

Paper Type: Commentary Article

Introduction

Corporate governance refers to the ways in which the suppliers of finance direct and control their investment to receive a financial return (Shleifer and Vishny, 1997). Corporate governance research is underpinned by agency theory (Jensen and Meckling, 1976), which address the potential conflicts between shareholders or their representatives, and the management team, mainly the upper echelons. Owners rely on internal and external governance mechanisms to safeguard their return on investments (Dalton *et al.,* 2007). Internal mechanisms mainly compromise of ownership concentration, board of directors, and incentive payment; and external mechanisms include a set of policies, customs, processes, laws, and institutions to govern the behaviour of corporations (Mostovicz *et al.,* 2011). Managerial discretion stems for the freedom in the decision making of top executives which mainly emerges from four dimensions: individual, organisation, industry and institutional environment (Haj Youssef and Christodoulou, 2017). As such, the interconnectedness of these two concepts is inevitable as corporate governance mechanisms need to assess how much leeway or discretion should be given to top management team, as it is a crucial factor in determining firms' outcomes.

A recent theoretical paper by Andersen (2017), argued that corporate governance research is better off without managerial discretion, based on several arguments. First, Andersen (2017) argues that research in managerial discretion does not provide a clear and direct assessment of the construct and therefore is still ambiguous. Second, antecedents and consequences of managerial discretion are not validated and no empirical evidence exists to support the importance of this construct. Third, managerial discretion research was not able to demonstrate whether it is good or bad for organisations or if executives accorded with greater discretion would affect firms' outcomes. In this paper, we attend to the main arguments presented in Andersen (2017) by refuting the conceptualisation and measurement

of managerial discretion. This enables us to reaffirm the significant importance of managerial discretion to corporate governance research and provide theoretically and empirically driven arguments from recent literature on managerial discretion to support the crucial role of managerial discretion in affecting firm' outcomes. We start with a general overview of the concept of managerial discretion and its main dimensions then comment on the main arguments presented in Andersen (2017).

The concept of managerial discretion

Managerial discretion refers to the latitude in executives' decisions making (Hambrick and Finkelstein, 1987). It explicitly emerges as a conceptual link between theories that are predominantly deterministic (e.g., population ecology, Hannan and Freeman, 1977; neo-institutionalism, DiMaggio and Powell, 1983) and those that are mostly managerial (e.g., upper echelons, Hambrick and Mason, 1984). Discretion exists to the extent to which constraints to decision making are relatively absent and alternatives are available from which executives can choose. Thus, it is a function of the individual executive (e.g., the locus of control), the organization (e.g., resource availability), and the external environment (e.g., institutional factors, industry regulations) characteristics or any combination thereof. These internal and external factors constitute a powerful range of possible limitations or catalysts for executive actions.

At the individual level, research shows that executives operating within the same domain can foresee distinct sets of actions depending on their individualities and psychological characteristics (Wangrow *et al.,* 2015). Some executives can envision a wider range of alternatives and to create multiple courses of actions that affect organization outcomes. These psychological micro-foundations are unique features that determine executives' discretion. For example, executives with greater locus of control (Carpenter and Golden, 1997), ambiguity tolerance (Dollinger *et al.,* 1997), networking relationships

(Geletkanycz and Hambrick, 1997), risk-taking behavior (Roth, 1992), and low commitment to the status quo (McClelland *et al.,* 2010) possess higher degree of discretion.

At the organizational level, firms with abundant resources that are easily transferable enable executives to foresee change and choose from a wider variety of alternatives (Hambrick and Finkelstein, 1987). Similarly, the lack of ingrained culture and the existence of a passive board accord executives with more discretion (Boyd and Salamin, 2001). Relatedly, CEO duality increases the likelihood of strategic change, but relationship is moderated by higher managerial discretion (e.g., Kim, 2013; Quigley and Hambrick, 2012). In contrast, organizations with an entrenched rigid culture and control place strict constraints on executives' actions and limit strategic change initiatives (e.g., Key, 2002; Wangrow *et al.,* 2015).

Moreover, the task domain in which firms operate can drastically alter executive actions. Some industries can afford a greater variety of choices/actions than others. Hambrick and Abrahamson (1995) argue that advertising, R&D intensity, and market growth promote managerial discretion. However, industry regulation constrains executives' latitude of actions (Peteraf and Reed, 2007). Similarly, Finkelstein (2009) finds that both demand variability and industry concentration negatively affect CEOs' discretion. Despite Hambrick and Finkelstein's (1987: 379) argument that discretion is closely related to "the degree to which the environment allows variety and change," most conceptualizations view the task environment in terms of industry characteristics (e.g., Crossland and Hambrick, 2011).

Recent endeavours have broadened the milieu in which discretion emanates. Crossland and Hambrick (2011) assert that culture operationalized as individualism, uncertainty tolerance, power distance, and cultural looseness significantly shape the degree of managerial discretion. They demonstrate that discretion is the primary instrument through which national culture sways CEOs' influence on firm performance. They find that

individualism, uncertainty tolerance and cultural looseness have a positive effect on managerial discretion, whereas power distance negatively affects the degree of discretion. Additionally, they showed that formal institutions compromising of ownership structure, legal origin and employer flexibility are also important indicators of managerial discretion.

Further support and validation are provided by Haj Youssef and Christodoulou (2017), who empirically demonstrated that the cultural environment plays an important role in shaping the degree of executive discretion. Although, they focused on new institutional context, some countries from the Arab world, they also extended their theoretical framework and showed that not only cultural values of individualism, uncertainty avoidance and power distance affect managerial discretion but also a range of cultural practices such as future, performance, humane orientations, gender equality, and assertiveness play an important role in shaping the degree of leeway in decision making.

Comments on the conceptualization of managerial discretion

Andersen (2017) argued that managerial discretion as defined by Hambrick and Finkelstein (1987) is determined by three factors: the task environment, the internal organisation and managers (executives) own attributes. This is the first misleading conceptualisation when assuming that the environment is only the immediate domain in which firms operate, in other words, the industry. Hambrick in Finkelstein (1987, p. 379) wrote: “discretion is a function of the degree to which the environment allows a variety and change”. The environment here is not only the task environment or the industry, recent studies (Crossland and Hambrick, 2007; Crossland and Hambrick, 2011; Haj Youssef and Christodoulou, 2017) empirically showed how national-level institutions, the macro-environment, affect the degree of discretion accorded to CEOs.

These studies developed an important model of the macro-environment to show how institutions, both informal (culture) and formal, directly affect the concept of managerial discretion. These were absent from the review of Andersen (2017), who only focused on critically discussing the task environment dimension. But even in this dimension, Andersen (2017) used the concept of supply and demand which apply to all firms operating in a free-trade context, to argue that these factors are beyond the control of the individual firm and as such are not in the manager's control. However, such reasoning does not hold particularly in a free-trade context. In free market economy, it is very difficult for executives to predict the exact consequences of the decision making that is associated with competition, such difficulty is the main course of industry or market uncertainty. The competitive nature of markets thus requires some timely organizational outcomes (Hall, 1992; Robbins, 1990). For such reasons and due to the uncertainty in the task environment, decision-making processes are not clear in such situations and cannot be pre-specified, the deliberate approach on strategic decisions does not hold. Therefore, executives must be allowed considerable discretion to allow them to arrive at solutions to organisation problems (Sharpman and Dea, 1997). By doing so and holding executives accountable to decision outcomes, firms will allow for a larger range of managerial behavior as and when necessary (Eisenhardt, 1989; Siegel-Jacobs and Yates, 1996). This will explain that in more free-market task environments, managers are more accountable and are more associated with decision outcomes. This is also echoed, in studies that empirically tested the effect of CEOs on firm performance and found a great deal of influence in free-market economies (US) (Hambrick and Quigley, 2014; Quigley and Graffin, 2017). Furthermore, such environments allow for greater risk-taking behaviour from managers as opposed to controlled environments, where managers in free-markets are more comfortable dealing with uncertainty and have a sense of

power over decision outcomes (Makhija and Stewart, 2002). Therefore, the free-trade environment does allow for greater variety and change.

Andersen (2017) continued to argue that the organisational dimension presented by Hambrick and Finkelstein (1987) incorporates words that form examples of 'anthropomorphism' in writing on organisations. His argument resides in the logic that only humans can allow or be amenable to anything. Such reasoning contradicts all the theories that have been developed in the strategic management literature, Andersen (2017) forgot about the concept of agility, flexibility, dynamic capabilities, ambidexterity, etc. that in today's world are becoming essential for organizational success and superior performance. The internal organizational dimension includes factors like inertial forces (age, culture, capital intensity), powerful internal stakeholders, resource availability, structure, strategy, which all affect managerial discretion. Organizations with high inertial forces, for instance, change their core features at a considerably lower rate than the actual environmental conditions (Kelly and Amburgey, 1991). In this case, executives seeking to initiate any change can be strictly guarded by those inertial forces. Similarly, powerful internal stakeholders which strongly focus on maintaining the status quo may well lead to resistance or even work against any change. Capital intensity and resource availability also work in the same way, either enabling or constraining manager's latitude of actions. Firms that have made considerable capital investment in a particular area are likely to be highly committed to their current course of actions and will tie closely to their current products and processes. On the other hand, organizations that have abundant transferable resources can explore a wider area of strategic options and thus provide greater latitude of actions. Therefore, organizations can allow or restrict the latitude of actions. Furthermore, the critique presented in Andersen (2017: p. 576) on the word 'empower' and the explanation provided does make sense especially when saying: "only managers can empower subordinates". However, the word

empower is used to refer to the ability of firms to allow a particular a course of actions and not only in the sense of authorising a particular action. Even if we are strictly referring to empowering in the sense of giving the authorisation to implement an action, this is directly linked to corporate governance. Companies' ownership structure has a significant influence on the degree of discretion accorded to executives. Ownership represents the source of power over the firm and the management team (Porter, 1990). Concentrated ownership provides shareholders with both the means and incentives to impose their own interests on managers (Gedajlovic and Shapiro, 1998), such interest can be anything from employment, operational stability to growth or any other desired outcome. Conversely, in companies with a dispersed ownership structure the power shifts towards the executive and the influence of shareholders become muted. Crossland and Hambrick (2007) gave the example of Japan, Germany, and the U.S, where managers in Japan and Germany rarely have the capacity for unilateral actions due to the concentrated ownership, whereas managers in the US are accorded more degree of discretion due to the overwhelmingly dispersed ownership structure of firms. Thus, with the word empowering, it is not always the case that the owner, or their representative board, can only empower a subordinate, in certain circumstances this cannot be the case. Other arguments can easily be incorporated here, Andersen (2017) forgot about the concept of CEO duality and how this can lead to fundamental changes in the power structure of firms, which also has a direct impact on managerial discretion (Li and Tang, 2010). Agency theorists suggest that CEO duality would reduce board's effectiveness as a monitoring mechanism (Finkelstein and D'Aveni, 1994) and hence magnify CEO's influence on firm decision and outcomes (Crossland and Hambrick, 2007; Hambrick, 2007). CEO duality, as an organisational proxy of managerial discretion (Kim, 2013), has a core role in increasing the likelihood of firms' strategic change and allows executives to deal with uncertainty and risk

deriving from the entry in ambiguous situations ((Li and Tang, 2010; Jain and Jamali, 2016; Murillo-Luna *et al.,* 2008).

Furthermore, Andersen (2017) argued that the third dimension relating to the individualities of executives which allow them to envision and create a multiple course of actions does not imply that those actions are implemented or in other words, the executive acts upon those actions. Such argument is based on the premises of perceived managerial discretion and the ability of executives to be aware of a range of different actions. Andersen (2017) stresses that executives, due to the cognitive nature of perception, cannot act upon a course of action that they do not perceive. However, it fails to explain the fundamental of the third dimension of managerial discretion, which concerns the characteristics of executives. The reliance on the concept of perceived managerial discretion which was introduced by Carpenter and Golden (1997) without understanding the main factors that trigger such perception, which is in the essence of the third dimension, is misleading. Carpenter and Golden (1997) found that locus of control, a stable personality difference, significantly affect the perception of managerial discretion, thus the more executives are external, the less they perceive to have managerial discretion, which indeed provides further support for the third dimension related to executive characteristics. Additionally, the concept of attentional homogeneity clearly contradicts Andersen (2017) argument about perceived managerial discretion. Attentional homogeneity, which is part of the three information-processing sequences (attention, interpretation and actions), refers to the degree of similarity between the attention roots of executives across different firms. Executives' awareness of different course of actions and their ability to act upon those actions is directly related to the external task domain and has very little relation with the executive's individualities. Organisations operating within the same industry share similar norms, and knowledge, the executives of these firms mostly share similar beliefs as well (Abrahamson and Fombrun, 1994). Thus,

when industry conditions are low, executives tend to have lower homogeneity because they have the leeway to pay attention to a broader set of options, by contrast to industries where conditions are high, here executives will have higher homogeneity and share similar beliefs with their rivals, which force them to pay attention to similar course of actions. Abrahamson and Hambrick (1997) support such reasoning by empirically testing the relationship between industry discretion and attentional homogeneity. Lastly, because discretion relates to a range of actions an executive may choose from, the cognitive concepts of awareness and attention are central building blocks. An executive may intentionally affect the degree of discretion by purposefully choosing the set of issues and actions to be included in their strategic issue array, and as such Hutzschenreuter and Kleindienst (2013) argued that the degree of discretion is substantially influenced by personal, relational and situational factors. Therefore, not perceiving a course of actions is ultimately a management decision and is based on their attentional pattern.

Comments on the measurement of managerial discretion

While discussing the different measurements of managerial discretion relying solely on somehow old literature and studies that only tested the proxies of managerial discretion, Andersen (2017) argue that it is impossible to directly measure managerial discretion and no attempt has been taken to do that. This is again another misleading argument, as it is clearly evident that no references have been used to studies that did measure managerial discretion directly. In empirical studies carried out so far, scholars have looked at theorised antecedents of discretion such as organisational-level antecedents, including sales, size, R&D intensity, company structure, advertising intensity, volatility and firms' strategic orientation (e.g.;; Boyd and Salamin, 2001; Finkelstein and Boyd, 1998; Hadani et al., 2015; Kim, 2013; Li and Tang, 2010; Quigley and Hambrick, 2012; Rajagopalan, 1997; Roth and O'Donnell, 1996). Others have used industry (or task-environment) level variables, including regulatory

conditions, market growth, product differentiability, attentional homogeneity, industry capital intensity, demand instability, etc. (e.g. Magnan and St-Onge, 1997; Haleblian and Finkelstein, 1993; Datta and Rajagopalan, 1998; Finkelstein, 2009; Hambrick and Quigley, 2014; Keegan and Kabanoff, 2008; Peteraf and Reed, 2007). Another cluster of researchers employed individual executives' characteristics, measuring variables such as locus of control, perception, commitment to the status quo, tenure, age, education, risk-taking behaviour, etc. (e.g. McClelland *et al.,* 2010; Miller *et al.,* 1982; Roth, 1992). These measures represent an indirect approach of assessing the degree of managerial discretion within a certain context. These studies have preserved/treated discretion as a "black box", whereby it was associated with the various individual, organisational and/or industry-specific variables.

In addition to these steam of studies, several studies that directly measured managerial discretion were absent from the discussion presented in Andersen (2017). Despite referencing Carpenter and Golden (1997), Andersen (2017) fails to explain why their measurement of discretion does not illustrate the true levels of managerial discretion. Carpenter and Golden (1997) measured discretion by asking executives about their perception of their own level of discretion. Despite employing a direct measure, Carpenter and Golden (1997) did not take into consideration respondents' bias. Executives tend to exaggerate their potency or impact on firms' outcomes, hence they will discuss a greater latitude of actions available to them than may be the case (Hambrick and Abrahamson, 1995). As Hambrick *et al.* (1993: 414) noted: "suggesting to a group of executives that they may not have much leeway over their organisations is a sure way to get them upset". Accordingly, adopting such a methodological approach would be inappropriate. Interestingly, a group of scholars started to measure discretion directly in a more innovative manner. Using expert panel ratings, Hambrick and Abrahamson (1995) were the first to introduce this direct measurement, which they employed in a later study (Abrahamson and Hambrick, 1997). Here, discretion degrees/scores were

gathered from two groups of experts: scholars and security analysts (Hambrick and Abrahamson, 1995; Abrahamson and Hambrick, 1997). Crossland and Hambrick (2011) departed from the same position where they measured national discretion level using two expert panels: academics and fund managers. More recently, Crossland and Chen (2013) also used the country discretion scores generated by Crossland and Hambrick (2011) in their study to investigate the role of discretion in assessing CEOs accountability for poor performance in various countries. Similarly, Haj Youssef and Christodoulou (2017) directly measured the degree of managerial discretion by using an expert panel consisting of consultants and strategic management scholars. This method provides construct validity and shows that such operationalisation technique is useful to understand the degree of discretion that is accorded to executives.

Therefore, an expert panel, if appropriately selected, provides consistent and valid assessments of organisational phenomena including business strategies (Snow and Hambrick, 1980), strategic decision procedures (Fredrickson, 1986), etc. Notwithstanding its probable perceptual bias, an expert panel possesses the advantage of rating discretion itself directly and more closely than other measures. Additionally, the use of an expert panel provides scores with a minimum bias compared to CEOs for instance, and these panellists possess better knowledge in multiple contexts due to their exposure to several environments, and most importantly the relative objectivity of their answers (Hambrick and Abrahamson, 1995; Crossland and Hambrick, 2011). All these attempts were unnoticed from the review of Andersen (2017) and as such concluded that no direct empirical measurement of managerial discretion has been conducted.

Comments on the importance of managerial discretion in corporate governance

Corporate governance refers to the ways in which suppliers of finance assure receiving a return on their investment (Shleifer and Vishny, 1997). Corporate governance research is

underpinned by Berle and Means' (1932) concept of 'the separation of ownership and control' and agency theory (Jensen and Meckling, 1976). In Berle and Means (1932) classic book, "The Modern Corporation and Private Property", they wrote that a modern corporation would ultimately outgrow its founder's managerial and financial capabilities. As a result, the management of the companies has to be delegated to professional managers. The result of the separation of ownership and control is the agent relationship between the firm's owner and the delegated managers (Jensen and Meckling, 1976). The key problems of the agency relationship are: the managers, as agents of the owners (principals), can engage in decision-making and behaviour that may be inconsistent with maximizing shareholder wealth (Coase 1937; Fama and Jensen, 1983) and there are "agency costs" involved in making the manager work in the shareholders' interest instead of their own (Jensen and Meckling, 1976).

Corporate governance endeavours to resolve these two problems. The first agency problem arises when the interests or goals of the principal and agent conflict. The problem here is that the principal and the agent may prefer different actions because of the different preferences. The second is the problem of monitoring that arises when the principal has difficulty verifying what the agent is actually doing. In theory, the shareholder and managers can sign a contract that specifies what managers do with the funds, and how the returns are divided between the managers and shareholders. Most contingencies, however, are difficult to predicate and as a result, complete contracts are technologically infeasible (Grossman and Hart, 1986; Hart 1995). It is impossible or extremely high costly to describe all the contingent situations in the contract to regulate managerial behaviour. The agency problems, therefore, lead the managers discover themselves with discretionary control over the funds the shareholders have invested.

Agency theory requires corporate governance mechanisms to reduce the cost associated when managers fail to maximize shareholder interests (Fama and Jensen, 1983).

Managerial discretion is a central concept in the corporate governance discipline and cannot be disentangled from it. The discretion research that focuses on the governance perspective argues that the primary governance mechanisms are designed to align the objectives of organisations with those of the executives to impose constraints on managerial discretion. Corporate governance literature treats managerial incentive payment as a contractual restraint on managerial discretion (e.g. Finkelstein and Boyd, 1998; Finkelstein, 2009; Boyd and Salamin, 2001). Many studies have empirically confirmed the positive relationship between managerial compensation and firm performance (Agarwal *et al.,* 2009; Carpenter and Sanders, 2002; Conyon, Peck, and Sadler, 2001; Main, Bruce, and Buck, 1996).

In addition to that, recent research has applied managerial discretion to diversity of corporate governance practices. Aguilera et al. (2018), for instance, argue that the interaction between the prevailing governance logic and firm's identity defines the firm's cognitive latitude of action, which, in turn, generate a deviant governance practice. In other words, firm's discretion determines a set of possible governance practices, some within and others outside the prevailing governance logic.

The main argument of Andersen (2017) is that managerial discretion does not provide shareholders and board of directors any guidance to grant more or little discretion to executives. Andersen (2017, p: 583) states: "managerial discretion rests on the assumption that top managers impact organisational goal-attainment. Therefore, some executives are granted discretion: the owners assume that this will enhance organisation performance. Yet, this assumption has no scientific support". Such 'assumption has no scientific support' is the most deceptive statement of Andersen (2017). Since Lieberson and O'Conner (1972), researchers have been interested in studying and empirically testing the executive, particularly CEO, effect on firm performance, and how much of that performance can be attributable to the individual CEO (Jain and Jamali 2016; Hadani et al. 2015; Quigley and

Hambrick 2015; Wangrow et al. 2017). While acknowledging that executives have much influence on their firms' outcomes, there is also recognition that their behaviour is constrained by other factors (internal and external) that hinder their effectivenss. Therefore, the question should not be whether the CEO matters. Rather we should ask how much CEO matters and how much does the CEO contribute to firm performance (Mackey, 2008). Let us discuss and introduce some of the scientific support for the above statement, which will contradict the argument of Andersen (2017).

By using a large data set spanning for more than 15 years and variance partitioning technique to isolate the variance in firm performance attributable to CEO as opposed to other contextual factors, Crossland and Hambrick (2007) find that the CEO with greater discretion has 13% direct effect on firm performance as opposed to year (4%), industry (12%), company (19%) and 52% of unexplained source. Also, Crossland and Hambrick (2011) empirically showed that managerial discretion is strongly associated with the individual CEO effect on firm performance. Thus, CEO effect on firm performance exist in proportion to the degree of managerial discretion and that the discretion construct is an important mediator between the external environment and CEO effect on firm performance. Furthermore, Quigley and Hambrick (2015) empirically tested the increased effect of CEO on firm performance on a sample of US publicly listed firms and showed that the CEO effect has increased substantially and that it has reached almost 20% of which is attributable to individual CEO. Similarly, Quigley and Graffin (2017) reaffirmed the significance of the CEO effect and reported a 21.8% of direct CEO effect on firm performance much higher than other factors.

Others have also provided the scientific support for the notion that owners assume greater performance from managers with the higher latitude of actions. For instance, Datta and Rajagopalan (1998) find that greater discretion provided to CEOs allow firms to improve

their performance by matching the degree of discretion to the immediate task domain. Also, when there is greater influence from the board of directors, especially by retaining the former CEO on the board, reduces the successor discretion and the ability to initiate strategic change which lead to poor firm performance or diminishment in the overall performance in comparison with the predecessor that had greater discretion (Quigley and Hambrick, 2012). Similar support is provided by Adams, Almeida and Ferreira (2005) by empirically demonstrating the strong positive effect of CEOs on performance variability especially in high discretionary contexts when the CEO has greater latitude of actions. McClelland and colleagues (2010) also showed a direct empirical relationship between executive discretion and firm performance, whereby CEOs with less latitude of actions has been negatively associated with performance. Even owners have demonstrated a greater significance and influence for executives on firm outcomes. In a recent study to unexpected CEO deaths, Quigley, Crossland, and Campbell (2017) empirically showed that shareholders react to unexpected CEO deaths in an amplified way that clearly confirms the belief that CEOs have become very influential particularly to firms' outcomes. Therefore, there is an ample of scientific support and empirical evidence for the importance of executives and their effect on firm performance when they are accorded with greater levels of discretion. It is also true that greater discretion may lead to managerial self-dealing, however, this again proves to show the critical importance of the discretion concept in corporate governance. For that reason, we hear a lot about the ever-increasing pay packages received by CEOs, when firms design governance mechanisms to minimize the latitude of objectives. Therefore, focusing on one angle to prove that managerial discretion has little or no importance in affecting firms' outcomes would not provide the full picture.

Discussion & Implications

Agency theory (Bosse and Phillips, 2016) and transaction cost theory (Williamson, 1981; 1991; 2010) assume managers as opportunistic agents. The main aim of such theories is to find ways in which they can control the opportunistic behaviour of managers. In this perspective, the concept of managerial discretion is mainly observed as a grey area whereby there is greater possibilities for managers to get engaged in opportunistic behaviour without fully attending to the needs and expectations of shareholders. Findings show that when managers particularly executives are given more discretion they are more likely to use it for their own benefit and as such engage in opportunistic behaviour as opposed to using it in the interest of their firms. For instance, studies have shown how managers with greater discretion become greedy which leads to negative impact on shareholder return (Haynes *et al.,* 2017), may engage in unjustified selling of assets (Lang et al., 1995), risky unrelated diversification as a method of strategic growth (Tosi and Gomez-Mejia, 1989), overpricing the portion of abnormal accruals (Xie, 2001), and boosting bonus pool allocation (Bailey et al., 2011).

From a corporate governance and transaction cost economic perspectives, such opportunistic behaviour increases agency cost, and the economic cost of transactions. On the other hand, strategic management scholars view executives as important and critical decision makers whose actions and choices have significant impact of organisations' fate and form (Quigley and Graffin, 2017). Studies within strategic management field show that when executives are accorded greater discretion, regardless of the source of such discretion, they may well engage in the development of their organisations through pursuing diversification strategy (e.g. Misangyi, 2002), which in turn provide greater strategic flexibility and spread the risk to allow for a quicker compensation of demand fluctuations in different task domains (Pehrsson, 2006). Furthermore, giving executives greater discretion would enable them to foresee more strategic actions such as entering new markets (Kim, 2013), initiating strategic

change to allow for greater adaptability to changes in the external environment (Quigley and Hambrick, 2012) and engage in export based internationalisation (Sahaym et al., 2012). The principle objective in this research stream is to understand what hinder or permit executives to exercise their strategic agenda (Wangrow et al., 2015). Therefore, to a great extent, the strategic management perspective of managerial discretion adopts the view that these choices are in-line with organisational objectives.

The different perspectives from strategic management and corporate governance fields view managerial discretion from either latitude of actions or latitude of objectives angles. The first, which stems from the strategic management field, deals with objective factors that accord executives with greater discretion to improve firm performance and as such positively contribute to shareholders' return on investment. Whereas, the latter, deals with personal factors that provide executives with greater discretion and as such result in self-interest and opportunistic behaviour. The strategic management perspective guides shareholders and their agent to grant greater degree of discretion to improve the return on shareholders' investment. In contrast the corporate governance perspective guides shareholders to develop governance mechanisms that monitor executives' behaviour and limit the degree of discretion in the aim of reducing the engagement in opportunistic behaviour, which will significantly increase the agency cost. Therefore, in both perspectives, discretion play a crucial factor in determining the level of governance that should be implemented. Andersen (2017) claim cannot hold in any scenario as both the latitude of actions and objectives are important to direct the governance systems put in place.

This paper, therefore, has important implications for corporate governance and strategic management research, which provide promising avenues for future research. Conventional corporate governance literature, based on agency theory, suggests the agency cost is divided between these two perspectives. First, the residual loss in shareholders' wealth

can be attributed to managerial opportunistic behaviour. Consequently, micro-monitoring and greater level of corporate control should be implemented to reduce the managerial misbehaviour. Such strict corporate control, nevertheless, restricts managerial discretion and limits executive's freedom in decision making for value creation. In addition to that, the agency cost arises when executives fail to fulfil their duty of identifying and exploiting profitable opportunities. Thus, the degree of managerial discretion determines the cost associated with delegation.

Based on the idea of latitude of objectives, executives may engage in opportunistic behaviour due to greater degree of discretion. Large number of studies have, however, recognized the beneficial role of executives in influencing firm strategy and performance through strategic decision and leadership behavior (Crossland and Hambrick, 2011; Quigley and Hambrick, 2015) and asserted executive would have an individual impact on firm outcomes (Hambrick and Quigley, 2014; Quigley and Hambrick, 2012). Thus, we assert that the argument of higher managerial discretion leads greater opportunistic behaviour can hardly be generalised to all firms because managerial greed is individual cases and can't serve as the premise of corporate governance (Haynes *et al.,* 2017). In contrast, the latitude of actions derived mainly from organisational, industry and institutional dimensions is more generalisable and do not depend on the individualities of the executive.

Current research focuses on either of these two layers of managerial discretion. This limits our understanding of how governance mechanisms can be designed in a way to make executives do a better job. Future work could consider the outcomes of combining these two layers of discretion to show the benefits of both control and delegation. Such combination could inform us on executives' compensation design, organisational efficiency, competitive dynamics and strategic change. Moreover, recent work shows the usability of managerial discretion and its relationship with governance systems. Kim and colleagues (2016) studied

the way discretion is utilised to save CEOs jobs when their firms are experiencing poor performance. Findings suggest that CEOs facing termination utilise their discretion to reduce spending and boost reported earnings in the aim to change the attitude towards their departure (Kim *et al.,* 2016). However, the reason for executives' turnover remain unclear. By incorporating both perspective of discretion, we could better understand the way in which changes in one dimension can lead to changes in the overall discretion and as such cause different judgements from shareholders.

Managerial discretion has become a major topic of debate in corporate governance. These debates have important implications not only for academic scholars, but the business practitioner, the wider economy and society. Many corporate governance code and company law have stated that it is the directors and executives' duty to promote the success of the company for the benefit of its members as a whole. To fulfil this duty, that directors must have sufficient power to make appropriate decision which take consideration of wider interests including various stakeholders. In other words, there is a need for further development of corporate governance mechanisms, which take the possible inclusion in regulations, rules, and codes on how executives and directors are to be granted to make strategic decision while being closely monitoring by stakeholders.

Furthermore, the conflicts between shareholder and managers and negative aspect of managerial discretion can be partly attributed to information asymmetric. The main producers and holders of information are the top management team. However, within the management hierarchy of listed firms, there are limited information flows, both vertically and horizontally. Hence, top managers should endeavour to facilitate the information exchange among the board, middle management, and external stakeholder to align the latitude of objectives.

Conclusion

In this paper, we attempted to achieve one objective, to show the importance of managerial discretion and that the question of whether executives matter remains an important research domain within the strategic management, corporate governance, strategic decision making, etc. disciplines. While appreciating the reasoning adopted in Andersen (2017), there are several misleading concepts presented in his paper and that there is a limited review of the main literature on managerial discretion. We showed that clearly there are several empirical works conducted to operationalise and demonstrate the construct of managerial discretion from different dimensions, and that this construct has been tested for reliability, validity as per the recent work of Crossland and Chen (2013) and Haj Youssef and Christodoulou (2017). Furthermore, we demonstrated that the concept of managerial discretion is not based on three dimensions only but there is a fourth dimension which relates to the institutional environment. Not to forget that there is a very limited review of the existing literature in managerial discretion and Andersen (2017) did not include main findings of this research stream. Finally, we believe corporate governance and managerial discretion are behaviourally attached. We hope greater attention will now focus on understanding the different mechanisms in which these constructs interacts.

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