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Discretionary Theory and it's Affects on Marketing: Implications for decision making

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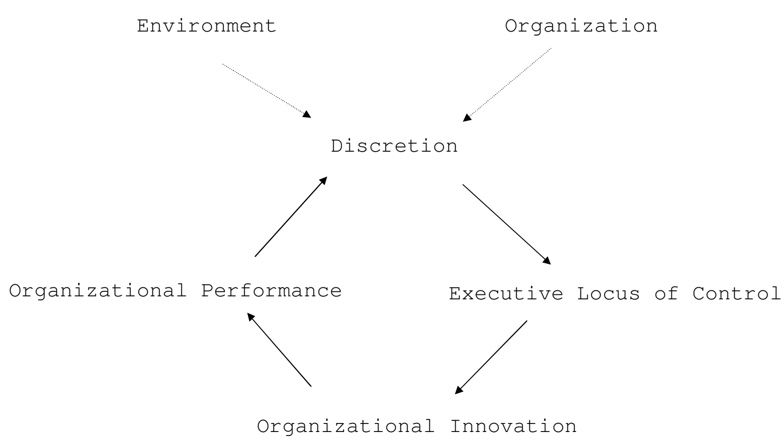
The Cause of Discretion
Managerial discretion refers to the latitude of options CEOs have in making strategic choices. {Hambrick & Finkelstein 1987} "High discretion context increase potential CEO impact on organizational outcomes because the constraints common to managing organizations are generally less severe under these conditions. Thus, high discretion context increased the potential marginal product of CEOs and, hence, their ability to influence a firm's performance. As seen recently with Cart of American Airlines and Lorenzo of Eastern Airlines. Thus a result, the absolute amount of CEO compensation is expected to be higher the greater the level of discretion. In addition, to the extent that the relationship between managerial discretion and CEO compensation is functional, firm performance should be higher when discretion and pay are aligned then when they are not." {Finkelstein & Boyd 1998}

Table 2.1
A Self-Reinforcing Cycle of Executive Efficacy
{Finkelstein & Hambrick 1996}



The three sources of managerial discretion determined by Hambrick & Finkelstein (1987) are: (1) the degree to which environment allows variety and change; (union)(2) the degree to which the organization affects executive actions; (publicity surrounding decision) and (3) the CEO himself or herself. This study will focus its efforts on the effect of the CEO only; however, a brief explanation is important for informational purposes.

Environmental influences on organizations and CEOs have been well documented in the corporation. {Scherer 1970} The more variance and profitability that can be attributed to the CEO in industries with high advertising intensity signal higher discretion than in more commodity-like or low-growth industries {Finkelstein & Hambrick 1990}. Other sources of environmental discretion are demand in stability, low capital intensity, competitive market structures, market growth and freedom from government regulations {Finkelstein 1992}.

The organization itself may possess characteristics that repress or magnify CEO discretion. Two of the most important characteristics are resource availability and inertial forces {Hambrick & Finkelstein 1987}. Resource availability is second in importance behind inertia. Since all strategic initiatives require adequate resources, deficiencies in those resources reduce the CEO’s options. Managerial discretion therefore is enhanced by the availability of limited resources {Finkelstein & Hambrick 1990}. (Pending bankruptcy) Inertia, on the other hand, tends to reduce the CEO’s flexibility, especially in large organizations. Organizational size and a strong corporate culture are examples of some of the inertial forces that limit CEO latitude {Boyd 1993}. The conceptual model of discretion and CEO compensation, as developed by Finkelstein and Boyd (1998) can be seen in Table 2.2. This model pulls together the overall concept of managerial discretion, and was the major theory for this study.

Effects of Discretion

The effects of discretion have been significant in both high and low discretion industries with regard to CEO models {Datta & Rajagopalan 1996}. Low discretion situations have shown that CEO positions are more of a figurehead position with low involuntary turnover, low relative compensation, stable strategy, and changes in organizational performance tied to changes in task environment. High discretion situations have shown that CEO positions are more dynamic with higher relative compensation, greater turnover with a less task orientated environment {Hambrick & Schecter 1983}.

Management discretion serves to weaken the relationship between executive characteristics and organizational outcomes {Finkelstein & Hambrick 1996}. Specifically, in high discretion industries, a significant relationship exists between executive orientation and the outcomes of the organization; (Airlines) in low discretion industries it doesn’t exist. Many studies have been conducted that show significant differences between high and low discretion firms in things such as firm size. "For example, Miller, Kets de Vries, and Toulouse (1982) found that CEO locus of control was strongly associated with organizational strategy and structure in small firms but not in large firms"{Finkelstein & Hambrick 1996}. Hambrick and Finkelstein (1990) also found significant relationship between executive tenure and the discretionary level of the organization. In addition, Reinganum (1985) found evidence that the stock market distinguishes between high and low discretionary organizations. Various pieces of evidence support both Finkelstein and Hambricks proposal that discretion also affects executive compensation arrangements (Table2.2).

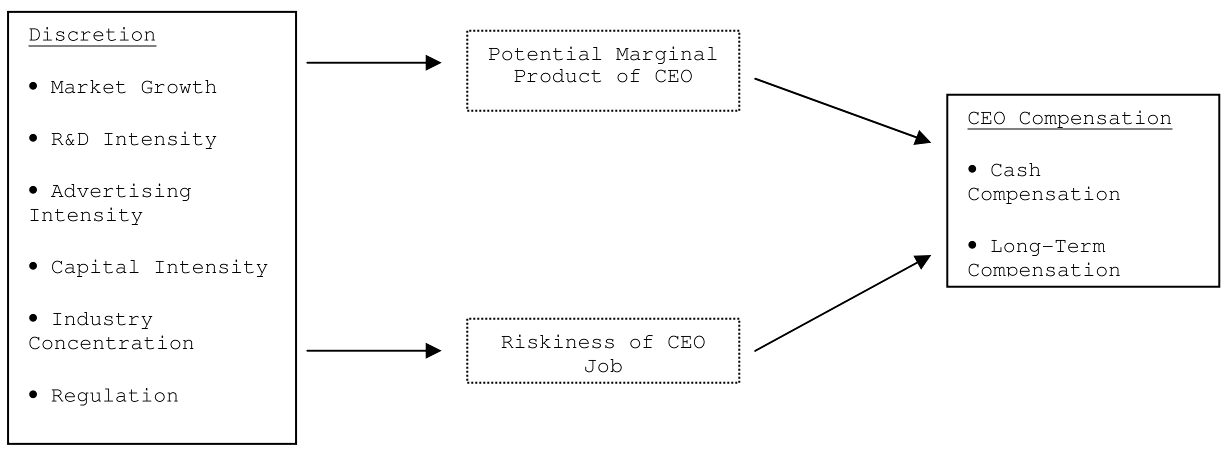


Table 2.2
Conceptual Model of Discretion and CEO Compensation
Finkelstein and Boyd 1998

Other studies, while not specifically researching managerial discretion, have also found discretionary indicators in other support functions that demonstrated a relationship between CEO pay and firm's performance{Kerr & Kren 1992}{Gomez-Mejia & Balkin 1989}{Jensen & Murphy 1990}.
Specifically, executive discretion is an important construct for helping to bridge the debate about the influence of executives on organizational outcomes. Moreover, discretion may be a conceptual lever for improving our understanding of such matters as executive compensation….{Finkelstein & Hambrick 1996}.

CEO Discretion Levels

Hambrick & Abrahamson (1995) have empirically tested the distribution of industries that represent high, medium and low discretion levels. This study has sprung from an earlier empirical investigation {Finkelstein & Hambrick 1990}, which identified a limited number of corporations categorized as high, medium or low discretion. The reason for Hambrick & Abrahamson's (1995) research was to develop a valid and reliable measure of what constitutes managerial discretion. They concentrated their study strictly on gauging the amount of discretion in a task environment; specifically, an industry {Hambrick & Abrahamson 1995}. Hambrick and Abrahamson utilized a panel of academics familiar with Hambrick & Finkelstein's concept of discretion. They were asked to evaluate 17 industries and determine the overall amount of managerial discretion. This same evaluation was also made by a group of security analysts. They then proceeded to test for reliability of individual groups and to test for consistency between the groups. An examination was then conducted of the associations between the academics ratings and the objective industry characteristics postulated by Hambrick & Finkelstein. Their purpose in taking this last step was to validate the panels' ratings and to reveal implicit weights they attached to specific industry characteristics. {Hambrick & Abrahamson 1995}

Hambrick & Abrahamson (1995) utilized a seven-point scale to determine the levels of managerial discretion within the industries. It was determined that industries between six and seven on the scale were determined to be high discretion industries. Conversely industries between one and three were considered low discretionary, leaving four through six in the medium discretion range. In CEO discretion we need to at least mention trust based marketing theory. This theory was developed by Dr. Glen L. Urban and contends that honesty and openness creates a more loyal customer base in today's technologically driven marketplace. The mention of trust based marketing theory is important because it is a key economic determinant of a company's value. However in evaluating CEO contribution to the marketing impact it is difficult to accurately measure incremental value. There have been continuing arguments regarding a CEO's true ability to affect desired results {Salanick & Pfeffer 1980}. Still, there have been just as many or more valid arguments that the CEO is the key figure and makes a definite contribution to the organization's fortunes {Gomez-Mejia, Wiseman, et al. 1997} {Antle & Smith 1985}.

In our review of management-discretion literature there have been several studies done regarding the latitude of action of the CEO and many diversification strategies {Rajagopalan & Finkelstein 1992} but none have truly considered CEO discretion

{Antle & Smith 1986}. A few recent studies have pursued the inter-relationship between risk and market contribution; however, most of the marketing studies have focused around relationship theory. The few exceptions who have added insight in this direction have utilized applied services in marketing theory {Gomez-Mejia, Wiseman, et al. 1997}{Sanders 1995}

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