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Corporate Political Spending Is Bad Business

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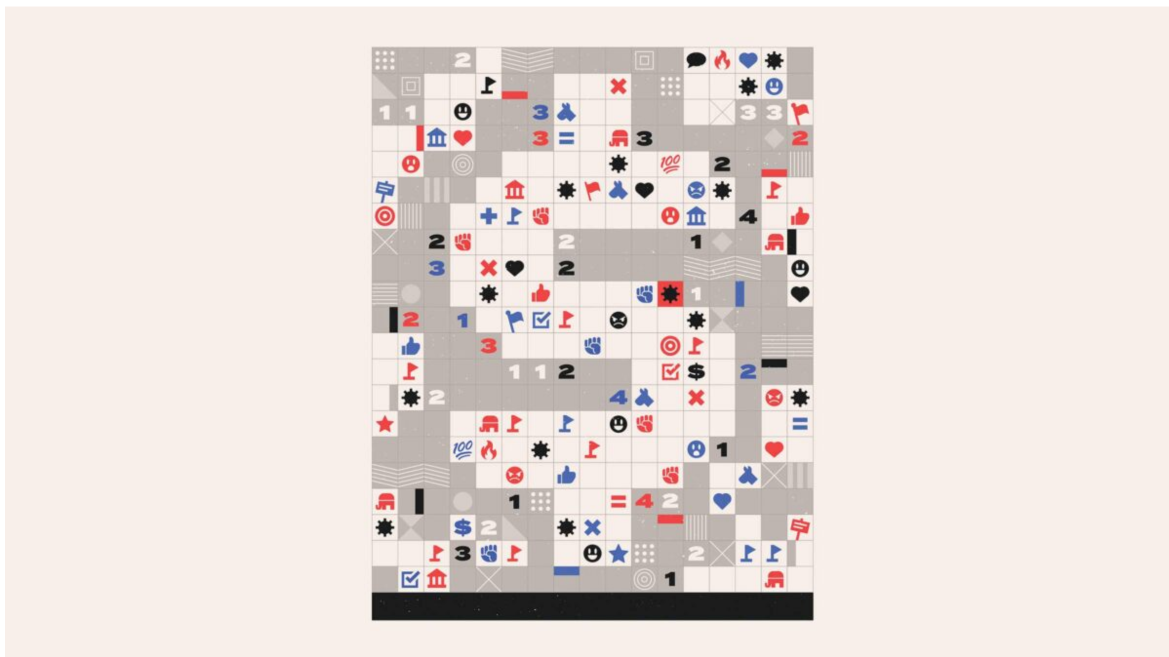

Ricky Linn

Summary. Corporations are facing increased scrutiny over their political spending—particularly when their stated values seem to contradict their lobbying efforts. A 2020 report by the Center for Political Accountability offers abundant examples, including corporations that have publicly demanded racial equality while contributing to groups and... **more**

On April 14, 2021, in response to a restrictive Republican-sponsored voting law in Georgia, the CEO of Google joined 200 other corporate CEOs in publishing an open letter in the New York Times and the Washington Post stating opposition to “any discriminatory legislation” that would make it more difficult for Americans to vote. But there was a catch: Google had quietly funded a “policy working group” on “election integrity” with the Republican State Leadership Committee, an organization that supported the Georgia legislation and similar legislation in other states. During the RSLC working group meeting that Google’s state policy manager attended, slides were shown calling “election reform” “the only line of defense of the Republican Party.” Months earlier, Google had also donated $35,000 to the RSLC from its corporate treasury.

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Such inconsistency—what some have called hypocrisy—has become endemic in the corporate world as a direct consequence of the U.S. Supreme Court’s 2010 decision in *Citizens United v. Federal Election Commission*. That ruling freed corporations to fund political candidates and dark-money campaign committees (organizations that do not have to disclose their donors).

As a result, companies now donate to help elect candidates they hope will do their industry’s bidding or support a specific cause, even as they publicly advocate for the opposite stance. A 2020

report by the Center for Political Accountability offers abundant examples: corporations that have publicly demanded racial equality while making contributions to groups and candidates that promote racial gerrymandering; corporations that purport to be concerned about climate change while donating to groups that challenge the EPA's clean-power plan; and corporations that claim to protect LGBTQ rights while funding groups that helped elect supporters of the 2016 "bathroom bill," which abolished certain antidiscrimination protections for gender identity.

Deeper issues lurk beyond hypocrisy. Because political donations are controlled by managers, and because no corporate stakeholders, including shareholders, base their relationship with a company on the expectation that it will use its entrusted capital for political purposes, corporate political spending cannot reflect the diverse preferences and views of those stakeholders. Even the classic justification that corporate donations maximize shareholder wealth is on shaky ground: Emerging evidence suggests that they can destroy value by suppressing innovation and distracting managers from more-pressing tasks.

Perhaps most important, political donations greatly heighten corporate risk. In an era when customers, employees, and investors are increasingly scrutinizing companies' records on employee, environmental, social, and governance issues (we prefer the term EESG over the more common ESG, to appropriately emphasize the importance of employees), the threat of blowback from political contributions has become too great for executives to ignore. In the wake of the 2021 riot at the U.S. Capitol, for instance, public scrutiny of large corporate

contributions to politicians who refused to certify the results of the 2020 presidential election led many companies to say that they would pause or even suspend political donations—some for a predefined period, others indefinitely.

But the risks and costs imposed by political contributions cannot be rationally or effectively addressed by ad hoc moratoriums. Instead, corporations need to implement systematic and principled reforms to avoid future gaffes and controversies, reduce their involvement in time-wasting and costly political spending, and better align their lobbying and donations with their stated values. In this article we explain the forces driving companies to make risky, potentially hypocritical donations. We argue that these donations are likely to destroy value as concern about such spending and demands for transparency rise. And we propose concrete action to enable corporate leaders to avoid this trap while freeing up attention and resources to focus on running their companies well.

The Legitimacy Problem

Before *Citizens United,* the law reflected a general societal consensus that keeping corporate money out of elections was a good thing. Direct contributions to candidates and independent expenditures (such as advertising) to promote the election or defeat of candidates were prohibited. Companies that wished to participate in political activity could do so through a corporate political action committee (PAC) funded by voluntary contributions from employees and shareholders—but not with

corporate treasury funds. That constraint had strong bipartisan support, as exemplified by its inclusion in the 2002 McCain-Feingold Act on campaign finance reform.

Citizens United upset that settled approach. It gave corporate managers the freedom to spend unlimited sums of shareholder money to influence political activity. With that decision, the Supreme Court exposed corporations and our political process to a new and unhealthy dynamic of interactive influence seeking. The change in law not only enabled corporations to act more freely in the political process but also allowed politicians and interest groups to demand that corporations give them money. Accordingly, it unleashed a host of problems for corporate managers, their shareholders, and other stakeholders.

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Under the traditional division of power in U.S. corporations, managers decide how to allocate corporate assets, and shareholders are entitled to a say on those decisions only if they involve fundamental transactions, such as major acquisitions or a substantial sale of the corporation's assets. Thus, even as corporate political spending has soared since *Citizens United,* shareholders have had no real say in the matter. Corporate leaders

have not chosen to seek their approval for political donations, and most have not even disclosed their contributions—despite the fact that shareholders are paying for them with their entrusted capital. Shareholders, employees, creditors, and society as a whole remain largely in the dark about this spending.

A recent study by Public Citizen, a nonprofit consumer advocacy group, reveals large increases in corporate spending on elections since 2010, primarily via contributions to PACs. Spending on midterm elections rose in particular, more than doubling from 2010 to 2014, and then doubled again from 2014 to 2018. Not only that, but corporations are the predominant contributors to the huge growth in so-called 527 organizations since 2010. These tax-exempt organizations, named for the section of the U.S. Internal Revenue Code that allowed their creation, pool money from various sources and use it to advance broad political agendas under less scrutiny than PACs receive.

Even when it comes to traditional business decisions, academic research has focused for years on the reality that management does not always use its control of a company's money to benefit the company and its shareholders, whether out of myopia or self-interest. In the fields of corporate finance and governance, this is referred to as an agency problem. Academics and policy makers have generally advised that shareholders be given greater influence and control over corporations to address this misalignment of interests. A leading proponent of that position is Lucian Bebchuk, a professor at Harvard Law School, who has argued that shareholders should be able to amend the corporate

charter (which determines the company's most important governance provisions) and have greater influence over other corporate decisions.

Of course, the misalignment is especially pronounced when the decision is about which politicians or parties should benefit from corporate largesse—an issue on which shareholders have no common interest. Investing in a company—or, as most Americans do, in an index or other fund that holds a broad swath of companies—is not a political statement. For generations the scholarly consensus has been that the only thing uniting company investors is their desire for a solid return. They have diverse political views and—as we will highlight—no interest in electing candidates just because they support one company's preferred regulatory policies. The ability of corporate managers, who understandably have their own political views, to make contributions in a way that is faithful to their investors' diverse interests and opinions is rightly suspect, and for that reason demand is growing for shareholders to be given more information about and more say over corporate political spending.

The legitimacy problem this creates is easy to understand. Corporate managers are more likely to identify as Republican than are members of the general public, which is closely divided among Democrats, Republicans, and independents. CEOs are also much wealthier than most other citizens, and wealthy people are more likely to vote Republican. Obviously, if executives direct political contributions according to their personal preferences,

they will donate to candidates and committees with views contrary to those of many of their shareholders, employees, and customers.

In 2019 researchers at Harvard Law School and Tel Aviv University ran the names of all individuals who had been CEOs of companies in the S&P 1500 from 2000 to 2017 through federal campaign-finance databases, which record contributions to party committees as well as to congressional and presidential candidates. They found that nearly 60% of CEOs donated to Republicans. The same Public Citizen study just mentioned found that from 2010, when the *Citizens United* decision was issued, to 2020, corporations gave $282 million to Republican candidates, versus $38 million to Democratic candidates. This is far out of balance with the American public, which, if anything, tilts slightly Democratic and is composed of more independents than Republicans or Democrats, according to Gallup. This, we stress, is only what we know. It seems likely that corporate dark-money contributions not now subject to disclosure are even more out of balance.

What About Lobbying?

Of course, some of the concerns about corporate political spending extend to lobbying as well. If, for ...

A CEO may argue that he or she supports only politicians and legislation that hew to the company's preferred regulatory line, and that it just so happens that those politicians are more likely to be Republican. But often politicians whose views align with a particular corporate interest also take positions that are antithetical to a company's stated EESG values, which underpin its plan for long-term value creation. And even if a politician's views aligned perfectly with all the interests of the corporation, shareholders might prefer not to have its treasury dollars spent in this way.

One important reason is that most investors hold a broad portfolio of stocks reflecting the whole economy. They don't want their dollars to be spent on political rent-seeking by a specific company, which helps one company but causes externalities for other companies, taxpayers, and consumers like themselves, and therefore is likely to slow real overall economic and portfolio growth. It is more likely to entail at best a transfer of value from one company to another and at worst an increase in externalities borne by society in general. For example, a diversified investor

does not benefit when a government contractor spends invested dollars to secure a contract that another (perhaps more qualified) company in the investor's portfolio might otherwise have gotten. Nor does that investor benefit when companies lobby to reduce regulation that shifts costs from investors to taxpayers in the case of, say, environmental destruction.

Beyond the financial risk, diversified investors are human beings who pay taxes, breathe air, consume products, invest in the whole economy, and owe much of their wealth to their access to a job. Thus bipartisan support from Americans who oppose political spending by corporations is long-standing. If people want to give to politicians, they want to use their own money, not have corporations do it for them. A telling proof of this point is that mutual funds, which make up the majority of a typical company's shareholders, can't legitimately give their investors' money to corporate PACs, which allow companies to fundraise from employees and shareholders to support the company's political activity. And individual investors do not give to corporate PACS either, because they prefer to direct their contributions to the candidates and causes that best align with their overall values. Indeed, corporate leaders don't even seek contributions from shareholders, knowing they would be met with disbelief and rejection.

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spending.

Furthermore, research suggests that companies that spend heavily on politics perform more poorly than others. For example, a study of corporate political activity in the form of lobbying and PAC spending by S&P 500 companies from 1998 to 2004 (conducted by John Coates, a Harvard professor who recently served as general counsel of the SEC) found that it was strongly and negatively related to company value. That result may resonate with some business executives: When companies feel they have to compete on regulatory shortcuts rather than on productivity and innovation, they may be poorly positioned to produce sustainable profits by selling quality goods and services and evolving to meet new consumer demands.

As further evidence of their growing dissatisfaction with the post–*Citizens United* status quo, investors are submitting and supporting proposals demanding greater disclosure of political spending. In 2019 shareholders initiated 33 such proposals, a dramatic increase from the previous year, and those proposals secured support averaging 36% of the vote. In 2020, support for such proposals was even greater.

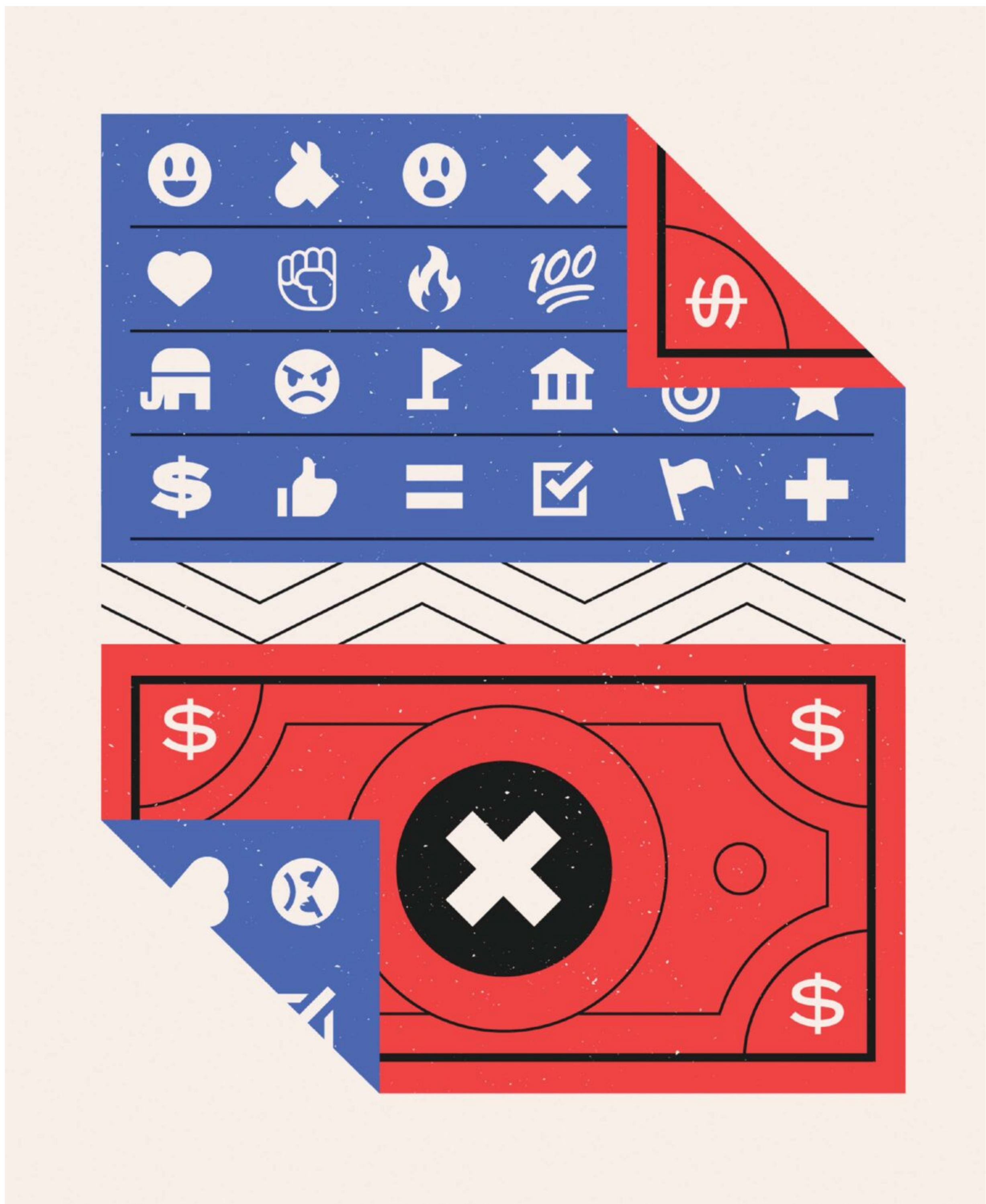
The Hypocrisy Trap

Investors and employees are not alone in opposing this state of affairs. Our conversations with corporate leaders reveal that many of them are tiring of the current system because it distracts them and shifts resources away from other, value-creating activities. A

2013 report from the Committee for Economic Development of the Conference Board found that 75% of surveyed business executives believed that "the U.S. campaign finance system is pay-to-play," and 87% said the system "needs major reforms or a complete overhaul."

Indeed, companies' "freedom" to donate to politicians after *Citizens United* ultimately led to a trap for corporate management. Under prior law, when corporations could not say yes to solicitations for political donations, they were not even asked. They could give through a PAC only, and that arrangement put limits on fundraising and spending. Instead of being forced to support positions and candidates that their investors, customers, and employees disfavored, executives could focus on their core job of running their businesses.

After *Citizens United,* politicians, political party committees, and industry groups knew that corporations could spend as much as they wished. That put executives under pressure to give. Now that political donations are unrestricted, it's hard to say no. And once an executive says yes to one, pressure comes to say yes to all. How can you give to just the Republican members of the Senate Finance Committee? Or just the Democratic members of the House Committee on Energy and Commerce? Furthermore, managers may rationally fear that by failing to give when all other companies are giving, they will lose the ability to influence regulation. Thus corporate political spending has become a dangerous and unprincipled game, leading many business leaders to long for the old rules.



Ricky Linn

These conditions are exacerbated by increased concern over EESG and corporate social responsibility. Corporations are facing pressure from employees, customers, society, and even investors to be more aware of the effects of their conduct. Executives are responding by speaking out on climate change, racial and gender

diversity, employee rights, and even hot-button issues such as reparations and a woman's right to choose. And yet pressure persists to donate to candidates and legislators, particularly those who favor the company's preferred regulatory policies, putting the company at an almost unavoidable risk of ensnaring itself in the hypocrisy trap.

It is unsurprising that companies are now being called out for talking in one way and giving money in another. Consider the scandal that embroiled Target when it contributed $150,000 to a nonprofit organization in the company's home state of Minnesota that supported a Republican candidate's campaign for governor in 2010. Target claimed that the donation was intended to foster a better business climate in the state, but critics quickly pointed out that the candidate opposed LGBTQ rights and had made homophobic comments in the past. Particularly damning for Target was the fact that it has worked hard to portray itself as committed to diversity, such as by sponsoring the Twin Cities Pride Festival. This perceived hypocrisy drew a strong backlash from customers, who boycotted the company's stores, and from shareholders, who brought forth a proposal asking Target to overhaul its political-donation policies.

The Solutions

Substantial negative publicity about donations in conflict with companies' stated EESG values has moved some businesses to consider reforming their political spending practices. But progress has been slow. To its credit, Target established a board-level committee to oversee political donations in response to

complaints about its involvement in Minnesota's gubernatorial race. Recently other companies have gone even further, taking the brave step of unilateral political demobilization. For example, after the January 6 storming of the Capitol, Charles Schwab shut down its PAC "in light of a divided political climate and an increase in attacks on those participating in the political process." Likewise, BlackRock suspended political contributions, stating that it "will conduct a thorough review of the events and evaluate how we will focus our political activity going forward."

We applaud these approaches. There is no such thing as a legitimate corporate political donation program, nor can one fully safeguard the company from the risk of contributions to candidates and interest groups with views contrary to the company's stated values. As a result, the best business practice is for CEOs to pledge that the corporation will make *no* donations with treasury funds and to limit involvement in the political process to lobbying or speaking up on issues that the board has deemed consistent with the company's values.

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But such pledges may not spread, and even if they do, they may not last. There is a first-mover disadvantage to taking a stand to limit corporate donations when others—especially competitors—are still making them. Regulatory limits would help; but thanks to *Citizens United* and other judicial decisions, these donations cannot easily be restricted by legislative action. That said, companies that take the lead may attract positive responses from major investors, key stakeholders, and consumers, and find that countervailing first-mover advantages justify being willing to lead.

If a company lacks the will to ban political contributions entirely, it should commit to giving only through a PAC that raises voluntary money from employees and shareholders. Even then, the company should commit to having the PAC give only to candidates and committees whose full range of views align with the company's stated purpose and values. That means devoting management and independent director time to researching the records and views of potential recipients and watching how those views evolve. As important, the company should ensure that the PAC does not give to political party committees of any kind or to industry political committees that don't fully disclose their contributions and expenditures and don't restrict their contributions to identified candidates and causes that the company can screen for consistency with its stated purpose and values.

Some companies may be reluctant to take this approach and may wish to continue making treasury expenditures. For them, additional action must be taken. They should commit to making

contributions only under a political spending plan approved by a vote of the shareholders (at the company's annual meeting and, ideally, by a supermajority)—an approach endorsed by the late investment fund legend Jack Bogle and proposed in several bills pending in Congress. That would enhance the legitimacy of corporate spending, because management would need broad investor approval for any spending policy. The reality, of course, is that shareholders may vote against such plans. But if they do, can management possibly claim that it is faithfully discharging its fiduciary duties?

Under this approach, directors would have a critical role to play in implementation. The board should charge an existing committee of independent directors—the same committee that is charged with legal compliance and EESG policy oversight—to develop and approve a company policy governing political expenditures and to supervise its implementation as well as its risk. The committee should not only ensure shareholder approval but also assess how employees and customers are likely to react to the policy. Once a policy has been instituted, the committee should review and approve any political expenditures for consistency with the plan and with the company's EESG values and policies, with input from key managers. Finally, it should ensure that all contributions made to candidates, political parties, political organizations, trade associations, or other tax-exempt organizations that engage in political activity, whether by the company directly or by its PAC, are publicly disclosed.

Because some companies will most likely be unwilling to reform their political spending, diversified investors should continue to demand disclosure and push for the limits we describe here, via shareholder proposals and engagement, across all the companies in their portfolios. Institutional shareholders in particular should require that any political spending be done under a plan adopted by a supermajority of shareholders.

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We can find no sound business justification for corporate political giving as it is practiced today. Putting aside the larger problems for society and for the basic fairness of our democratic process, pouring corporate money into politics solely for company-specific profit seeking completely lacks legitimacy. Investors don't benefit from this state of affairs, nor do corporate executives, who are pressured into giving in ways that undermine their business focus and create substantial risk.

We have outlined various steps that companies can take to improve the legitimacy of their corporate giving, but the best remedy would be to stop it altogether. That would free management to focus on running quality businesses that compete on innovation and productivity and would avoid illegitimate, time-consuming, and reputation-harming political activity. Public respect for business leaders would grow—and so would trust in the fairness of our political system.

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