

# Political Capital

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## Abstract

An organization must make a binary choice in each of two periods. The optimal choice depends on an unknown state of nature. The leader of the organization has a stock of political capital and observes a private signal of the state. The leader faces an intertemporal choice problem. She may choose to spend (some of) her political capital to increase the probability that the choice is not the one that would otherwise be made. Her political capital increases if the decision is correct ex post. We characterize the optimal use of political capital by the leader and how it evolves over time. We identify different leadership styles that depend on the initial stock of capital of the leader, the precision of her information, and the importance of the issue to her. We study how differing leadership styles determine the evolution of power within the organization. Finally, we consider issues of optimal organizational design that structure the allocation of power to a leader.

**Keywords:** Organizations, collective decisions, political capital, leadership styles.

**JEL Classification:** D21, D23, D71, D72.

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# 1 Introduction

“I earned . . . political capital, and now I intend to spend it. It is my style.”

George W. Bush

Most organizations—in politics, business, and academia—feature leaders who can sway collective decisions. In business, a CEO may persuade her firm’s board to approve a project the board is initially skeptical about. She may do so by appealing to personal friendship with members of the board, or even threatening to resign. In politics, U.S. presidents may coax Congress into passing legislation that does not have the initial support of the majority of its members. They may, for example, claim a popular mandate for policies on which they campaigned, or appeal to party unity. Similarly, in academia, a senior faculty member may push to hire a job candidate the recruiting committee is initially inclined to reject, perhaps by exerting influence over junior colleagues.

While leaders can sway collective decisions, they may choose not to exercise this power at all times. In fact, forcing the hand of others on one issue today may have consequences for the leader’s future influence. The leader may lose future influence because she makes enemies among those who are strongly opposed to the alternative she advocates, or because she loses the support of those who feel they owed her just one more favor. But the leader may also increase her future influence if the alternative she advocated turns out to benefit many in the organization. Just as she may be held accountable for supporting the wrong alternative, so may she be rewarded for advocating the right one. The extent of these effects may depend on a “culture of reward” or “culture of blame” within the organization.

That leaders have the power to influence decisions is not controversial. The important question is the source of that power, and how and when it is exercised. This is the topic of our paper.

Power to influence is not an easy concept to define, as it includes both formal and

informal components. We take an economic approach to defining informal power by focusing on the *political capital* of a leader—her personal friendships, credibility, and network of alliances within the organization. Like physical capital, political capital can be *spent* on an issue and may or may not earn a return.

How political capital maps into power to influence decisions, and how political capital evolves, depends on institutional details. We take a flexible, reduced-form approach that permits our framework to speak to a range of issues, including the institutional and cultural design of organizations. Specific microfoundations, such as those stemming from reputational considerations, are easy to envisage. But we resist explicitly tying ourselves to a specific microfoundation to maintain the generality and “embedability” of our approach.

We analyze a model in which a leader can gain or lose political capital by voicing dissent against a default alternative chosen by other members of her organization. A leader with greater political capital has more power, in the sense that she has a greater chance to affect the decision. Voicing dissent immediately reduces the leader’s political capital—we say that the leader *spends* her political capital—but it may dynamically either increase or decrease her capital, depending on whether her dissenting opinion turns out to be correct.

We study how the leader chooses to spend her capital depending on her initial stock of capital, the precision of her information, and whether the issue at stake is more or less important for her. For example, the President of the United States may choose to spend her political capital only on issues that were central to her campaign. Similarly, senior faculty may choose to spend their political capital only on job candidates in their own fields.

We show that the leader optimally chooses one of four leadership styles and that the chosen style affects the dynamics of power within the organization. *Irrelevant* leaders have too little capital to influence decisions and therefore never voice their dissent. Lead-

ers with sufficient political capital but poor information choose to be *patient*: they save their capital and spend it only on issues that are important to them. Although patient leaders spend their capital sparingly, when they spend it they are unlikely to regain it and therefore their power declines over time. Leaders with intermediate precision of information choose to be *loud*: they spend their capital on all issues and their power declines over time. Finally, the most informed leaders choose to be *strong*: they spend their capital on all issues and their power grows over time.

For a given stock of political capital, leaders with the least precise information are more likely to be patient. Therefore, conditional on disagreeing with the majority of the organization, leaders are more likely to spend political capital when their information is more precise. But the unconditional probability of spending political capital on any given issue is non-monotonic on the precision of the leader's information—while loud leaders have less precise information than strong leaders, they are more likely to voice their dissent on any given issue.

More political capital does not necessarily induce the leader to voice dissent more often. How more capital affects the leaders' decision hinges on the marginal power of political capital and therefore on the shape of the mapping of political capital into power. Intuitively, when the marginal power of capital is greater after the leader's preferred alternative is revealed to be better (respectively, worse) than the default, then a larger initial stock of political capital translates into a greater return (respectively, smaller loss) to voicing dissent.

We give a concrete example within a linear framework. In this example, leaders with little political capital have a greater chance of becoming irrelevant if they choose to push for a decision today. Therefore they compare a small chance of influencing today's decision with the risk of losing their power in the future. For such leaders, a marginal increase in today's capital (and therefore power) increases the potential power loss in the future more than it increases today's gains. Therefore, for small stocks of capital, the probability

of spending political capital may be decreasing in capital. To put it another way: some patient leaders have more political capital and power than some loud leaders have. This relation is reversed for larger stocks of political capital, for which a marginal increase in today's capital increases the incentives for the leader to voice her dissent. However, as the leader's power increases, the relation is reversed yet again, as very powerful leaders can only achieve a small increase in power by voicing dissent.

The power of a leader is, in many ways and in many instances, an organizational-design choice. A novel aspect of our framework is that it facilitates an analysis of the factors affecting how power should be allocated to the leader. We show that the optimal allocation of power depends on the talent of the leader and how important decisions are to her. When the probability of a high importance event for the leader is sufficiently large, the organization needs to optimally tradeoff a more active, but less effective leader with a less active, but more effective one. For a sufficiently large level of talent, the second option dominates, whereas the first option dominates when talent is small. Therefore, it may be optimal to allocate more power to leaders with less talent.

We also discuss how organizations can optimally induce a more active leadership style by promoting organizational cultures of reward or blame or utilizing institutional details that affect how political capital translates into power. As we discuss briefly in the conclusion, regulatory rules such as those requiring a certain proportion of independent directors of public companies also affect the power allocated to the leader and hence decision making.

Our paper connects to a number of literatures. There is a large body of work on "leadership"—particularly those papers which consider signaling by leaders as a means of persuasion. Notable examples include Prendergast and Stole (1996), Hermalin (1998), and Majumdar and Mukand (2004).<sup>1</sup> We take a more reduced-form approach to persuasion by the leader, but focus on how and when the leader chooses to exert influence—i.e.

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<sup>1</sup>Caillaud and Tirole (2007) considers leaders creating cascades to influence followers.

her “style”. Rotemberg and Saloner (1993) and Rotemberg and Saloner (2000) connect leadership style and organizations, which relates to our Section 5, below.

Our framework bears some similarity to Aghion and Tirole (1997)’s notion of “real versus formal authority” in that decision rights are non-contractible; and also to the now large literature on communication in organizations initiated by Dessein (2002), although we do not consider strategic information transmission à la Crawford and Sobel (1982). Bertrand and Schoar (2003) show that a significant amount of the heterogeneity in managerial practices can be explained by “style”. We suggest a channel in addition to the one(s) they identify and our analysis implies that such styles are not immutable managerial characteristics.<sup>2</sup>

The dynamic nature of our analysis and our concern with the stock of political capital suggests a natural connection to work on reputation-effects in repeated games. This literature emphasizes the idea that a player in a long-lived interaction has an incentive to give up something today in terms of her payoff to gain a reputation for playing in a certain fashion, which may benefit her down-the-track. Important early contributions include Kreps and Wilson (1982), Kreps et al. (1982), Milgrom and Roberts (1982), Fudenberg and Levine (1983) and Fudenberg and Levine (1986). In our model the leader is conscious of the cost of using her influence today in terms of her ability to influence decisions in the future. Unlike the reputation-effects literature our setup does not require considerations of (sequential) equilibrium as it involves a control problem for the leader. Moreover, our notion of political capital is not synonymous with reputation, but is broader. For instance, it can be determined in part by organizational design choices.

The rapidly growing body of work on “Bayesian persuasion” initiated by Kamenica and Gentzkow (2011) shares some similarities with our approach. Such models emphasize how the choice of signal structure can influence a decision maker, whereas we are

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<sup>2</sup>Dessein and Prat (2017) take a broad view of organizational capability, introducing the notion of “organizational capital”. Our concept of political capital might be thought of as a subset of organizational capital.

concerned with the use of power—stemming from political capital—to influence collective decisions.

Perhaps most closely related to us is a recent contribution by Campbell (2017), who considers mechanisms for information revelation by an interested expert. He analyzes a setting where an expert can influence a current decision by being (probabilistically) restricted from participating in future decision making. If the future is sufficiently valuable to the expert, then this mechanism achieves first-best revelation. Relative to us, Campbell focuses on the optimal mechanism for the decision-maker and on probabilistic participation in future decisions, while we emphasize the endogenous influence of a leader and the implications for her stock and use of political capital.

The remainder of the paper is organized as follows. Section 2 introduces our model and discusses some of our modeling choices. Section 3 characterizes the leader’s optimal strategy. Armed with this, Section 4 analyzes the relationship between leadership and power—specifically how power evolves, and different leadership styles. Section 5 takes an optimal organization design perspective in light of leadership styles and political capital. Section 6 offers some concluding remarks.

## 2 The model

Consider an organization which operates for two periods. In each period  $t \in \{1, 2\}$ , the organization chooses an alternative  $a_t$  from the set  $\{0, 1\}$ . Which alternative is best for the organization depends on an unknown state,  $\theta_t \in \{0, 1\}$ . In particular, the value  $v_t(a_t | \theta_t)$  of choosing alternative  $a_t$  when the state is  $\theta_t$  is given by

$$v_t(a_t | \theta_t) = \begin{cases} 1 & \text{if } a_t = \theta_t; \\ 0 & \text{otherwise.} \end{cases}$$

In each period  $t$ , the organization's *default* choice is optimal ( $a_t = \theta_t$ ) with probability  $\pi > 1/2$ . Without loss of generality, we can relabel the alternatives in  $\{0, 1\}$  such that, for each period  $t$ , the default choice is  $a_t = 0$ . Notice that this implies  $\Pr(\theta_t = 0) = \pi$ . Deviations from the default choice are possible only if the organization's *leader* spends some of her *political capital* in favor of alternative  $a_t = 1$ .

The leader's initial stock of political capital is  $k_1$ . At the beginning of each period  $t$  the state  $\theta_t \in \{0, 1\}$  is realized, and then the leader privately observes a signal  $s_t \in \{0, 1\}$  such that  $s_t = \theta_t$  with probability  $\sigma$ . Upon observing the signal  $s_t$ , the leader can choose to *spend*  $c > 0$  units of her political capital in favor of alternative  $a_t = 1$ . If the leader chooses to spend capital, then  $a_t = 1$  with probability  $P(k_t)$ . Hence  $P(k_t)$  is the leader's *power* to sway the organization's choice. We assume that  $P : \mathbb{R} \rightarrow [0, 1]$  is increasing and almost everywhere differentiable, and that there exists  $\underline{k} \in \mathbb{R}$  such that  $P(k_t) > 0$  if and only if  $k_t \geq \underline{k}$ . We say that the leader is *irrelevant* whenever  $P(k_t) = 0$ . For simplicity we assume that irrelevant leaders cannot spend political capital.

Spending political capital also affects the leader's future stock of capital once the state is revealed. In particular, her capital in period 2 is given by

$$k_2 = \begin{cases} k_1 - c + B(\theta_1) & \text{if she spends capital at } t = 1; \\ k_1 & \text{otherwise.} \end{cases}$$

For the remainder of the analysis, we focus on the case  $B(\theta_t) = b\theta_t - b(1 - \theta_t)$  for some  $b > c > 0$ , unless stated otherwise.

Within each period, the leader's preferences are aligned with those of the organization. Nevertheless, some issues may matter to the leader more than others. In particular, at the beginning of each period  $t$ , the leader observes the importance  $\alpha_t \in \{\alpha^L, \alpha^H\}$  of the period- $t$  issue to her, such that the value  $u_t(a_t | \theta_t, \alpha_t)$  for the leader of choosing alternative  $a_t$  when the state is  $\theta_t$  is given by



$$u_t(a_t | \theta_t, \alpha_t) = \begin{cases} \alpha_t & \text{if } a_t = \theta_t; \\ 0 & \text{otherwise,} \end{cases}$$

where  $0 < \alpha^L < \alpha^H$ . The prior probability that the period- $t$  issue is of high importance to the leader is  $\Pr(\alpha^H) \in (0, 1)$ .

## 2.1 Discussion of the model and maintained assumptions

We are interested in cases in which the leader's information is sufficiently precise that she would prefer to take the action that is optimal according to her private information. Assumption 1 implies that the leader prefers alternative  $a_t = 1$  if and only if  $s_t = 1$ .

**Assumption 1** *The precision  $\sigma$  of the leader's signal is strictly greater than  $\pi$ .*

Notice that when Assumption 1 fails, the leader never spends political capital simply because she trusts the organization's decision more than her private information. Assumption 1 rules out such a motive to choose a democratic leadership style. Nevertheless, the leader may choose to let the organization take the default choice even when she believes alternative  $a_t = 1$  to be optimal. She may do so because she prefers to save political capital for future decisions, rather than spending it on the current one. However, for some values of the model's parameters, the leader may also prefer to spend capital in favor of an alternative that she does not believe to be optimal for the organization, i.e., she spends capital in favor of  $a_t = 1$  when she believes that  $\theta_t = 0$  with probability greater than  $1/2$ . In fact, if the current decision is of low importance to her ( $\alpha_t = \alpha^L$ ), she may choose to spend political capital in favor of alternative  $a_t = 1$  solely in the hope of accumulating more capital, and therefore power, in the future (if  $\theta_t = 1$ ). Because our focus is on the intertemporal decision of *when* to spend political capital, rather than in favor of which alternative, we rule out this perverse incentive for the leader. We thus impose some structure on the power function. Assumption 2 says that the organization is designed in

such a way that the leader does not spend capital on alternatives she does not believe in (when she prefers alternative  $a_t = 0$ ) for any  $\alpha^L > 0$ .

**Assumption 2** *Spending political capital in period 1 when  $s_1 = 0$  results in an expected decline of the leader's power.*

### 3 The leader's optimal strategy

We now study the leader's optimal strategy. We proceed backward, starting from period  $t = 2$ . Lemma 1 says that in period 2 the leader optimally spends political capital if and only if she prefers alternative  $a_2 = 1$  and she is not irrelevant.

**Lemma 1 (The leader's optimal strategy in period 2)** *In period 2, a non-irrelevant leader spends political capital if and only if she prefers alternative  $a_2 = 1$ .*

**Proof.** In Appendix A. ■

Intuitively, in period 2 the leader only needs to choose whether to influence the decision on the period-2 issue, without any consideration to the future trajectory of her political capital. Therefore, she spends capital in favor of alternative  $a_2 = 1$  if and only if she believes it to be optimal for the organization.

The leader's optimal strategy in period 2 does not depend on the amount of capital accumulated,  $k_2$ , or on the relative importance to her of the period-2 issue,  $\alpha_2$ . In contrast, her optimal strategy in period 1 depends on both her initial stock of capital,  $k_1$ , and the relative importance of the period-1 issue,  $\alpha_1$ . This is because the leader trades off the chance of influencing the period-1 decision with the possibility of increasing or decreasing her power to influence the period-2 decision.

To study this tradeoff, we express the leader's expected payoff from the period-2 decision as a function  $V$  of her political capital in period 2. Using Lemma 1:

$$V(k_2) = \bar{\alpha}\pi + \bar{\alpha}(2\Pr(\theta_2 = 1 \mid s_2 = 1) - 1)\Pr(s_2 = 1)P(k_2) \quad (1)$$

where  $\bar{\alpha}$  is the expected importance to the leader of the period-2 issue. The first term is the leader's expected payoff if she does not spend capital in period 2. The second term is the additional value for her of having political capital to optimally spend in period 2.

If the leader does not spend capital in period 1, then the organization takes the default choice and the leader retains all her initial stock of capital. Therefore, the leader's expected payoff is given by

$$\alpha_1 (1 - \Pr(\theta_1 = 1 | s_1)) + V(k_1). \quad (2)$$

If instead she chooses to spend capital in favor of alternative  $a_1 = 1$ , then the organization chooses that alternative with probability  $P(k_1)$  and the default choice with the remaining probability. Furthermore, her capital will evolve stochastically. With probability  $\Pr(\theta_1 = 1 | s_1)$ ,  $k_2$  equals  $k_1 - b - c$ ; otherwise,  $k_2$  equals  $k_1 + b - c$ . Therefore, the leader's expected payoff is given by

$$\begin{aligned} &\alpha_1 [(1 - \Pr(\theta_1 = 1 | s_1)) + P(k_1)(2\Pr(\theta_1 = 1 | s_1) - 1)] + \\ &+ \Pr(\theta_1 = 1 | s_1)V(k_1 + b - c) + (1 - \Pr(\theta_1 = 1 | s_1))V(k_1 - b - c). \end{aligned} \quad (3)$$

The optimal choice for the leader depends on the comparison of the values in (2) and (3). Proposition 1 says that a non-irrelevant leader spends political capital in favor of alternative  $a_1 = 1$  whenever the issue is of high importance to her or her information is sufficiently precise.

**Proposition 1 (The leader's optimal strategy in period 1)** *There exists a cutoff  $\sigma^*(k_1)$  such that a non-irrelevant leader spends political capital in period 1 if and only if she prefers alternative  $a_1 = 1$  and either  $\alpha_1 = \alpha^H$  or  $\sigma > \sigma^*(k_1)$ .*

**Proof.** In Appendix A. ■

Intuitively, when the period-1 issue is of high importance to the leader, she optimally

spends her capital to influence the period-1 decision, rather than saving her capital for a future issue which, in expectation, is of lower importance. Instead, when the period-1 issue is of low importance, the leader needs to choose between the chance of influencing the period-1 decision and the possibility to save more capital for a future issue which, in expectation, is of greater importance. Since the leader loses political capital only when she spends it in favor of an alternative that turns out to be wrong, a leader with sufficiently precise information prefers to spend political capital also when the period-1 issue is less important to her. In contrast, a leader with very imprecise information faces a great risk of seeing her political capital reduced if she spends it in period 1. Hence, she prefers to save her capital for future issues if the period-1 issue is of low importance to her.

## 4 Leadership and power

### 4.1 The evolution of power

The leader's political capital increases whenever she spends it in favor of alternative  $a_1 = 1$  and this alternative turns out to be optimal for the organization, i.e.,  $\theta_1 = 1$ . By Proposition 1, the leader spends political capital only if she prefers alternative  $a_1 = 1$ . If the leader prefers alternative  $a_1 = 1$ , then this alternative  $a_1$  is indeed optimal with probability

$$\Pr(\theta_1 = 1 \mid s_1 = 1) = \left[ 1 + \frac{1 - \sigma}{\sigma} \frac{\pi}{1 - \pi} \right]^{-1},$$

which is increasing in  $\sigma$ . Therefore, leaders with better private information are more likely to see their capital increase when they spend it. But capital matters for the leader, as well as for the organization, only insofar as it translates into power to affect decisions. Proposition 2 says that, when the leader optimally spends her political capital, she expects her power to grow if and only if her information is more precise than a threshold, which

depends on her initial stock of capital.<sup>3</sup>

**Proposition 2 (The evolution of power)** *There exists a cutoff  $\bar{\sigma}(k_1) \in (\sigma^*(k_1), 1]$  such that if the leader optimally chooses to spend her political capital, then*

1. *if  $\sigma > \bar{\sigma}(k_1)$ , the leader's power is expected to grow over time;*
2. *if  $\sigma < \bar{\sigma}(k_1)$ , the leader's power is expected to decline over time.*

**Proof.** In Appendix A. ■

Therefore, small differences in the quality of a leader (or her initial stock of political capital) lead to very different outcomes in terms of the evolution of power within the organization. Consider two organizations with leaders with information and capital  $(\sigma, k_1) : \sigma^*(k_1) < \sigma < \bar{\sigma}(k_1)$  and  $(\sigma', k_1) : \bar{\sigma}(k_1) < \sigma'$ , respectively. Both organizations have the same power function and culture, and leaders with the same initial stock of capital, and therefore power. Furthermore, the two leaders behave identically: they both spend their political capital whenever they dislike the default choice of their respective organizations. Therefore, the two organizations, as well as the leaders, may appear to be identical and following the same leadership style. The only (arbitrarily small) measurable difference between the two leaders is that the one with less precise information will spend political capital with higher frequency. Yet, the leader with precision  $\sigma'$  will progressively grow her power within the organization. In contrast, the leader with precision  $\sigma < \sigma'$  will see her power decline. Hence, the first organization will develop a more authoritarian decision-making process; the second will develop a more democratic one.

## 4.2 Leadership styles

Propositions 1 and 2 together reveal four possible leadership styles:

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<sup>3</sup>When the leader's information is less precise, so that  $\sigma < \sigma^*(k_1)$ , the leader's power remains constant whenever  $\alpha_1 = \alpha^L$ . Nevertheless, her power is expected to decline whenever she optimally chooses to spend her political capital, i.e.,  $\alpha_1 = \alpha^H$  and  $s_1 = 1$ .

**Irrelevant.** An irrelevant leader never spends political capital and her power is constant over time.

**Patient.** A patient leader spends political capital only on issues that are of high importance to her. Her power is expected to decline over time.

**Loud.** A loud leader spends political capital on all issues. Her power is expected to decline over time.

**Strong.** A strong leader spends political capital on all issues. Her power is expected to grow over time.

A leadership style simultaneously determines the role that a leader chooses to play within the organization and how power evolves within the organization. In particular, only organizations that feature a strong leader are likely to develop an authoritarian structure (where a single person takes most decisions).

We now study what induces a leader to choose one of the four styles.

**Proposition 3 (Optimal leadership styles)** *The leader is irrelevant if and only if  $k_1 < \underline{k}$ . Otherwise, she is patient if  $\sigma < \sigma^*(k_1)$ , she is loud if  $\sigma \in [\sigma^*(k_1), \bar{\sigma}(k_1))$ , and strong if  $\sigma \geq \bar{\sigma}(k_1)$ .*

**Proof.** In Appendix A. ■

Figure 1 shows the optimal leadership style in the  $(\sigma, k_1)$  space for an arbitrary power function  $P$ . If the leader has less than  $\underline{k}$  units of political capital, she cannot influence the organization's decision and is therefore irrelevant. However, if her capital is greater than  $\underline{k}$ , but her information is sufficiently imprecise, she prefers to use her power sparingly, only spending political capital when more important issues arise. Such a patient leader eventually loses the little power she has, as her political capital tends to decrease over time. In contrast, when her information is very precise, the leader optimally chooses a strong style. Such a leader is so sure of herself that she spends political capital on any issue on which she disagrees with the default choice. She does so at no expected cost,

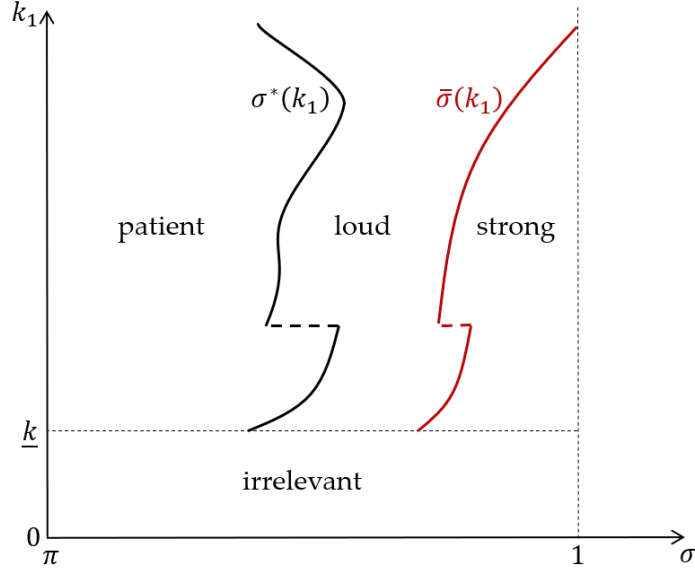


Figure 1: Leadership styles in the  $(\sigma, k_1)$  space for an arbitrary power function  $P$ .

because her information is so precise that spending political capital results in an expected growth in power. Between these two extremes lies a leadership style that we call *loud*. A loud leader is sufficiently sure of herself to spend capital on all issues on which she disagrees with the default choice. But her information is not precise enough to avoid frequent mistakes. In fact, her probability of making mistakes is large enough that her power will decline.

Conditional on preferring alternative  $a_1 = 1$  to the default choice, both a loud and a strong leader will voice their dissent. Nevertheless, we now show that loud leaders are indeed “louder” in the sense that they have a higher probability of voicing their dissent on any given issue.

**Proposition 4 (Loud means loud)** *The probability that a leader spends political capital in period 1 is strictly decreasing in  $\sigma$  for all  $\sigma \neq \sigma^*(k_1)$ , and has local maxima at  $\sigma = \pi$  and  $\sigma = \sigma^*(k_1)$ .*

**Proof.** In Appendix A. ■

To gain some intuition, consider a loud and a strong leader. Both leaders voice dissent whenever they disagree with the default choice. But a loud leader’s information is less

precise than that of a strong leader. Since the default choice is right more than half of the time, a loud leader is more likely to disagree with it than a strong leader in the first place. Thus, leaders who choose a loud style are those with the highest probability of voicing disagreement with the default choice on any given issue.

### 4.3 Political capital and leadership styles

We now explore how political capital affects the leader's choice of a style. By spending political capital in period 1, the leader suffers an expected loss of capital of

$$c - [2 \Pr(\theta_1 = 1 \mid s_1 = 1) - 1] b$$

but may also benefit from influencing the period-1 decision. In particular, the expected period-1 benefit of spending capital is

$$\alpha_1 [2 \Pr(\theta_1 = 1 \mid s_1 = 1) - 1] P(k_1).$$

An increase in political capital increases the benefit from voicing dissent whilst not changing the expected loss of capital. However the leader does not care about political capital *per se*. Rather she cares about political capital only in the measure in which this translates into power to influence future decisions. For example, a leader who is initially very powerful, i.e.,  $P(k_1) \approx 1$ , has little to gain from capital accumulation. Therefore, if the period-1 decision is of sufficiently low importance she will prefer to be patient. Depending on the shape of the power function similar conclusions could be drawn for leaders with intermediate levels of power.

To characterize the relationship between political capital and leadership styles, and how this is mediated by the manner in which capital translates into power, we first build intuition by analyzing a simple case where capital translates into power (piece-wise) lin-



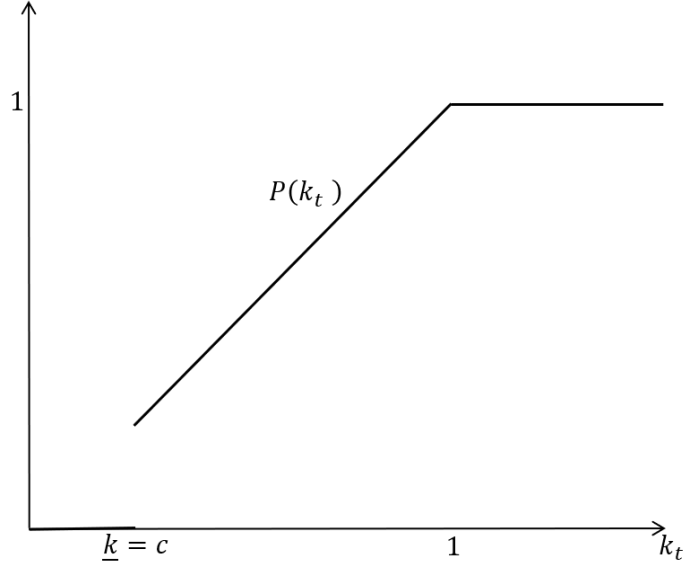


Figure 2: The piece-wise linear power function  $P = P_L$ .

early:<sup>4</sup>

$$P(k_t) = P_L(k_t) = \begin{cases} 0 & \text{if } k_t < c; \\ \max\{k_t, 1\} & \text{if } k_t \geq c. \end{cases}$$

Figure 2 depicts this function.

Suppose  $P = P_L$  and consider a non-irrelevant leader who initially holds little capital:  $c \leq k_1 < 2c + b$ . The second inequality implies that if the leader chooses to spend capital, she faces the risk of becoming irrelevant. In fact, if the state is later revealed to be  $\theta_1 = 0$ , the leader will remain with capital  $k_2 < c$ , and therefore  $P(k_2) = 0$ . This potential cost of spending capital—losing the status of powerful leader—is increasing in the initial stock of capital. Therefore, a leader with marginally more capital (and therefore power) has a greater incentive to be patient and save her capital for the future. Now consider a leader who initially holds much power, but short of what would be enough to dictate decisions whenever she spends capital:  $1 - (b - c) < k_1 \leq 1$ . The first inequality implies that if the leader chooses to spend capital, she may be in the future able to dictate decisions. If she spends capital and the state is later revealed to be  $\theta_1 = 1$ , her capital will increase by a

<sup>4</sup>Recall that  $c > 0$  is the fixed cost of spending capital in favor of alternative  $a_t = 1$ . In this case,  $\underline{k} = c$ .

quantity  $b - c > 0$ . Yet, the leader will only experience an increase of power equal to  $1 - P(k_1) < b - c$ . This increase in power is decreasing in the initial stock of capital. Therefore, a leader with marginally more capital (and therefore power) has a greater incentive to be patient and save her capital for the future. Proposition 5 formalizes this intuition and says that the effect of political capital on the leader's style is non-monotonic: more capital may both increase or decrease the propensity of the leader to spend capital.

**Proposition 5 (The effect of capital on leadership styles when  $P = P_L$ )** *Let  $P = P_L$  and let*

$$\Sigma^P(k_1) \equiv \{\sigma \in (\pi, 1] : \sigma < \sigma^*(k_1)\}$$

*be the interval of leader's information precisions that induce her to optimally choose to be patient. If  $\Sigma^P(k_1)$  is non-empty for some  $k_1 \geq c$ , then the length of  $\Sigma^P(k_1)$  increases with  $k_1$  when  $k_1 \in [c, 2c + b)$  and when  $k_1 \in [1 - (b - c), 1)$ . Otherwise, it decreases with  $k_1$ .<sup>5</sup>*

**Proof.** In Appendix A. ■

This example illustrates how the shape of the power function  $P$  affects the relationship between political capital and leadership styles. Intuitively, the power function  $P$  transforms the potential gains and losses in political capital into gains and losses in the leader's expected payoff from the period-2 decision according to  $V(k_2)$  in (1). When spending political capital, the potential gain is proportional to  $P(k_1 - c + b) - P(k_1)$ ; the potential loss is proportional to  $P(k_1) - P(k_1 - c - b)$ . Therefore, a marginal increase in the initial stock of political capital is more likely to induce the leader to voice her dissent when the marginal power of capital  $P'$  is large at  $k_1 - c + b$  and at  $k_1 - c - b$  compared to what it is at  $k_1$ .

**Proposition 6 (The effect of capital on leadership styles)** *Let*

$$\Sigma^P(k_1) \equiv \{\sigma \in (\pi, 1] : \sigma < \sigma^*(k_1)\}$$

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<sup>5</sup>Note that the length of  $\Sigma^P(k_1)$  is greater than the length of  $\Sigma^P(k'_1)$  if and only if  $\Sigma^P(k'_1) \subseteq \Sigma^P(k_1)$ .

be the interval of leader's information precisions that induce her to optimally choose to be patient. If  $\Sigma^P(k_1)$  is non-empty for some  $k_1 \geq \underline{k}$ , then the length of  $\Sigma^P(k_1)$  increases with  $k_1$  if

$$(1 - \pi)\sigma^*(k_1)P'(k_1 - c + b) + \pi(1 - \sigma^*(k_1))P'(k_1 - c - b) < \left[ (\sigma^*(k_1) - \pi) - \frac{\alpha^L}{\bar{\alpha}} \right] P'(k_1). \quad (4)$$

Otherwise, it decreases with  $k_1$ .

**Proof.** In Appendix A. ■

## 5 Organization design

### 5.1 Optimal allocation of political capital

Organizations have limited ability to determine the initial stock of political capital of a leader. For example, in politics, different electoral systems may give more or less legitimacy to the president, or even guarantee that a majority of the legislature supports her platform. Therefore, while the legislature maintains its independence, the president's initial stock of political capital is in part determined by institutional choices. Similarly, board of directors may delegate more or less authority to a CEO, and shareholders may choose board members that are personally close to the CEO. Therefore, while the board has the ultimate control over the CEO, the CEO's initial stock of capital is in part determined by the composition of the board itself. In both cases, the organization may allocate more or less political capital, and therefore power, to the leader, but only within limits.

We now study the optimal allocation of political capital to the leader when the organization operates with an exogenously given power function.<sup>6</sup> The organization can choose

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<sup>6</sup>In the next section we endogenize the choice of power function.

any initial stock of political capital<sup>7</sup>  $k_1 \in [\underline{k}, \bar{k}]$  to maximize

$$\mathbb{E} \left[ \sum_{t=1}^2 v_t(a_t | \theta_t) \mid k_1 \right].$$

The optimal allocation of political capital  $k^*(\sigma)$  obviously depends on the precision of the leader's information  $\sigma$  and uniquely identifies the optimal allocation of power

$$P^*(\sigma) := P(k^*(\sigma)).$$

Our main result is that the functions  $P^*$  and  $k^*$  are not necessarily monotonic. That is, the optimal allocation of political capital (and therefore of power) may give more capital (and hence power) to a less informed leader.

**Proposition 7 (The optimal allocation of political capital)** *The optimal allocation of political capital  $k^*(\sigma)$ , and therefore power  $P^*(\sigma)$ , is not necessarily monotonic in  $\sigma$ . It is equal to  $\bar{k}$  for all  $\sigma \in (\pi, 1)$  if*

$$(1 - \pi)\pi[(P(\bar{k}) - P(\bar{k} - c - b)) - (P(\bar{k} - c + b) - P(\bar{k}))] \leq \frac{\alpha^L}{\bar{\alpha}} P(\bar{k}); \quad (5)$$

*it is U-shaped if*

$$(1 - \pi)\pi[(P(k_1) - P(k_1 - c - b)) - (P(k_1 - c + b) - P(k_1))] > \frac{\alpha^L}{\bar{\alpha}} P(k_1) \quad (6)$$

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<sup>7</sup>We assume that allocating capital, and therefore power, is costless. However, more concentration of political capital may be costly if a powerful leader alienates other members of the organization or reduces their incentive to acquire information. The key result of this section is actually reinforced when allocating political capital is costly.

for all  $k_1 \in [\underline{k}, \bar{k}]$  and the length of  $\Sigma^P(k_1)$  increases with  $k_1$  at  $k_1 = \bar{k}$ , i.e.,

$$(1 - \pi)\sigma^*(\bar{k})P'(\bar{k} - c + b) + \pi(1 - \sigma^*(\bar{k}))P'(\bar{k} - c - b) < \left[ (\sigma^*(\bar{k}) - \pi) - \frac{\alpha^L}{\bar{\alpha}} \right] P'(\bar{k}). \quad (7)$$

**Proof.** In Appendix A. ■

Intuitively, the organization values the leader's interventions in the decision process. Yet, while for each issue taken individually the organization's incentives are perfectly aligned with those of the leader, the leader's choice of whether to spend her political capital on a given issue depends on its relative importance *to her*. Since the organization views all issues as equally important, it faces a tradeoff. On the one hand, if the leader spends her political capital often enough, the organization wishes to make her interventions as effective as possible, and hence prefers to allocate more power to the leader. On the other hand, as we discussed in Section 4.3, more power may induce the leader to embrace a patient leadership style, therefore saving her political capital when the issue at stake is of low importance to her. Said otherwise, for a given leadership style, the organization wishes to maximize the leader's initial stock of political capital; for a given stock of political capital, the organization strictly prefers a more *active* (loud or strong) leader to a patient one. Therefore, depending on the leader's information, the organization may need to trade off a more active but less powerful leader with a less active but more powerful one.

Obviously, this tradeoff is not present if the leader optimally chooses an active leadership style whenever she is allocated an initial stock of political capital equal to the maximal stock  $\bar{k}$ . In this case the organization prefers to allocate as much power as possible to the leader, no matter how precise her information is—a “flat” allocation of power:

$$\sigma^*(\bar{k}) = \pi \Rightarrow P^*(\sigma) = P(\bar{k}) \text{ for all } \sigma \in (\pi, 1).$$

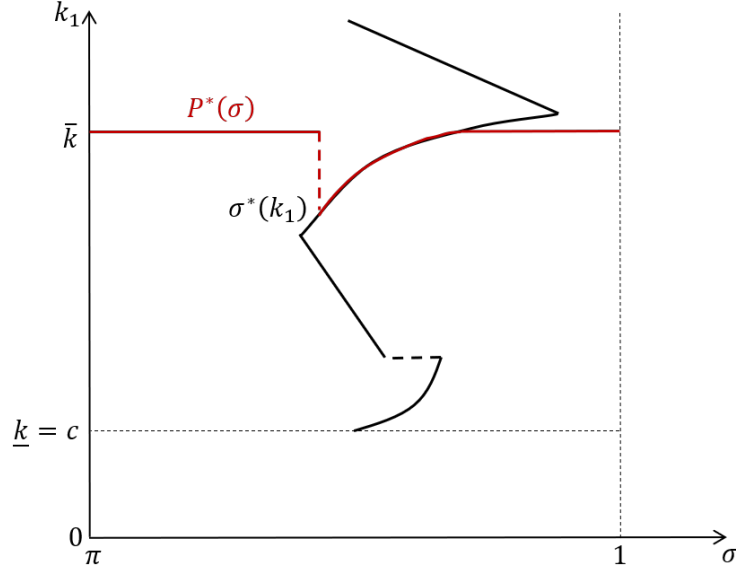


Figure 3: The optimal allocation of power when  $P = P_L$  and (6) and (7) hold.

This corresponds to condition (5) in Proposition 7. By Assumption 2, the left hand side of (5) is strictly between 0 and 1. Therefore, a flat allocation of power is optimal when the leader values low-importance issues almost as much as high-importance ones ( $\alpha_L$  close to  $\bar{\alpha}$ ) so that her incentives almost perfectly align with those of the organization. On the contrary, a flat allocation of power is less likely to be optimal when some issues are much less important than others to the leader, when the loss in power for spending capital on the wrong alternative is much greater than the gain for spending capital on the right alternative, or when the default choice is less likely to be correct.

Since sufficiently well-informed leaders always choose to be active ( $\sigma^*(\bar{k}) < 1$  for all  $\bar{k} \geq \underline{k}$ ), when the leader is sufficiently well-informed, the organization can afford to maximize the effectiveness (power) of the leader's interventions without inducing a patient leader. However, for leaders with less precise information ( $\sigma < \sigma^*(\bar{k})$ ) the organization needs to choose between maximizing the leader's power and inducing an active leader. We now show that this tradeoff may induce the organization to optimally allocate more power to a less informed leader.

Suppose that for low values of  $\sigma$  the leader optimally chooses to be patient for any

$k_1 \in [\underline{k}, \bar{k}]$ . This corresponds to condition (6) in Proposition 7. Then if the leader is sufficiently uninformed, the organization prefers to give the leader all the power that it can, as to make the leader as effective as possible when she chooses to spend her political capital. Yet, for higher values of  $\sigma$ , the leader may optimally choose to be loud (or strong), and therefore to be active more often, but only if the organization gives her less power. Now suppose that the power function is such that, for a leader with initial stock of political capital equal to  $\bar{k}$  and information  $\sigma = \sigma^*(\bar{k})$ , a marginal increase in the initial stock of political capital induces the leader to be patient. By Proposition 6, this corresponds to condition (7) in Proposition 7. Then for a leader with information just short of  $\sigma^*(\bar{k})$ , the organization can afford an active leader by giving up only a very small amount of the leader's power. Therefore, the organization strictly prefers an active, yet less powerful leader. This means that there exists a level of  $\sigma$  at which the organization optimally switches from a very effective but patient leader to a less effective but more active one. Figure 3 depicts such a situation when  $P = P_L$ . In this case, a non-monotonic allocation of power is more likely to be optimal when the maximum amount of power  $P(\bar{k})$  that the organization can allocate to the leader is close to 1 or  $\underline{k} = c$  so that, by Proposition 5, a marginal increase in the initial stock of political capital induces the leader to be patient.<sup>8</sup>

The actual value of  $\hat{\sigma}$  at which the organization optimally switches from a very effective but patient leader to a less effective but more active one, naturally depends on how much the organization values having a more active leader. Since the cost of having a patient leader is proportional to the likelihood that the leader will save her political capital for future issues,  $\hat{\sigma}$  is, all else equal, decreasing in  $\Pr(\alpha^L)$ .

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<sup>8</sup>As can be inferred from Figure 3, when either (7) or (6) does not hold, if the loss in power needed to induce a loud leader is sufficiently *small* but strictly positive for very low values of  $\sigma$ , the optimal allocation of power is (strictly) increasing in  $\sigma$  and never induces a patient leader. Nevertheless, a U-shaped allocation of power may still be optimal, even if both (7) and (6) do not hold, if the loss in power needed to induce a loud leader is sufficiently *large* for very low values of  $\sigma$ , but becomes *small* (and positive) for larger values of  $\sigma$ .

## 5.2 Power function: Institutional design

Our reduced-form model affords us to take a flexible approach as to how political capital maps into power to influence decisions. In practice, the power function  $P$  is in part determined by institutional design. For example, if decisions are taken by majority voting, such as in a parliament or in a committee, the support of the pivotal median voter has very different consequences on the leader's ability to influence decisions than the support of any other member of the organization. In this case, the power function  $P$  has an 'S' shape. The requirement of a broader consensus, such as supermajorities, would shift the vertical section of the S-shaped power function to the right. Furthermore, the inclusion in a committee of other powerful personalities with effective veto powers may limit the amount of power afforded to the leader for any stock of political capital.

In practice, institutional design variables such as voting rules or the presence of veto players are typically "sticky"—often, as is the case for political institutions, to control the behavior of future leaders. We therefore take a long-term view and ask what type of institutions are more conducive to organizational welfare behind a veil of ignorance, i.e., given a possible distribution of future leaders with precision of information  $\sigma$  and political capital  $k$ .

Our previous results highlight the importance of providing incentives for the leader to spend her political capital often enough in the interest of the organization. This is particularly important for leaders who, while not irrelevant, hold a small stock of initial political capital. In our model, these are those leaders with  $k_1 \geq \underline{k}$  but close to  $\underline{k}$ . As we have seen, the incentives for such leaders depend on the shape of the power function which translates political capital into power to affect decisions. It is therefore natural to ask what type of institutions favor a more active role of junior leaders.

Essentially, the institutional designer has two levers. First, he can choose the maximum amount of power  $\bar{P} \leq 1$  to give to leaders with sufficient political capital. Second, he can choose how fast junior leaders can climb the power ladder, by choosing a power



function that raises more or less steeply from  $P(\underline{k})$  to  $\bar{P}$ .

One possible option is to give all leaders who are not irrelevant a constant amount of power:  $P(k) = \bar{P}$  for all  $k \geq \underline{k}$ . Such a design has the virtue of making all leaders, even those with little capital, very effective. Yet, it does not leverage any career concern of the leader to induce her to be active and spend capital on issues that are not very important to her. Thus, junior leaders will be patient. Since this design aims to maximize the effectiveness of leaders, then it serves best this objective when  $\bar{P} = 1$ . Furthermore, since career concerns incentives are relevant only for leaders who optimally choose to be patient, this design is optimal when most leaders are expected to hold large initial stocks of political capital.

One other option is to design a system that incentivizes leaders to be active and spend capital on all issues. Such a design leverages the career concern of the leader, and so  $P$  must be strictly increasing for some  $k \geq \underline{k}$ . On the one hand, this design makes leaders with little capital more valuable for the organization, as they will use their power more often. On the other hand, this design has two drawbacks. First, leaders with little capital are less effective when they choose to spend it. Second, some leader that, under the design with constant power, would optimally choose to be active are now induced to be patient, as they fear that spending political capital may decrease their future power. Therefore, a design that leverages the leader's career concerns is optimal only when most leaders have either very little or very large initial stocks of political capital.

Formally, assume that the future leader draws her initial stock of capital  $k_1$  and her information precision  $\sigma$  from a distribution  $F$  with domain  $[\underline{k}, \infty) \times (\pi, 1]$ . Proposition 8 says that there exist parameters  $c$  and  $b$  and distribution  $F$  such that the organization prefers a power function which leverages career concern (for example,  $P_L$ ) to one which maximizes the leader's effectiveness ( $P(k) = \bar{P} = 1$  for all  $k \geq \underline{k}$ ).

**Proposition 8 (The optimal power function)** *There exist parameters  $c$  and  $b$  and distribution  $F$  such that the optimal power function is strictly increasing for some  $k \geq \underline{k}$ .*

**Proof.** In Appendix A. ■

### 5.3 Organizational culture

Organizations vary as much in culture as they do in structure.<sup>9</sup> For example, an organization may embody a *culture of reward*, where success draws more attention than failure or, conversely, a *culture of blame*, where failure draws more attention.

The culture of an organization has a clear effect on leadership styles via its impact on the accumulation of political capital.<sup>10</sup> A leader in an organization with a greater culture of reward is expected to accumulate more political capital when the alternative she spends her capital on is revealed to be correct, and to lose less political capital when the alternative is revealed to be incorrect. Thus, a greater culture of reward is expected to increase the propensity of the leader to spend her political capital and is conducive to a patient leader becoming loud, and a loud leader becoming strong. The reverse can be concluded for a leader in an organization with a greater culture of blame.

To formally analyze the relationship between organizational culture and its effect on leadership styles we consider variations of the law of motion of political capital. Recall that a leader with an initial stock of political capital  $k_1$  has period-2 capital given by

$$k_{t+1} = \begin{cases} k_t - c + B(\theta_t) & \text{if she spends capital;} \\ k_t & \text{otherwise.} \end{cases}$$

We measure the relative importance of reward and blame with two parameters  $\rho$  and  $\beta$ , such that  $B(\theta_t) = \rho\theta_t - \beta(1 - \theta_t)$  for  $\rho, \beta > 0$  and  $\rho > c$ . When the alternative that the leader spends her capital on is revealed to be correct her capital increases from  $k_t$  to  $k_t + \rho - c$ , otherwise it decreases to  $k_t - \beta - c$ . Thus, a greater  $\rho$  provides the leader with more

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<sup>9</sup>See Kreps (1986) and Young (1993) for early economic models of organizational culture, and Hermalin (2013) for a particularly pertinent contribution on leadership and corporate culture.

<sup>10</sup>Here we restrict our attention to the effect of culture on capital accumulation. However, one could also consider the effect of organizational culture on the shape of the power function.

reward, and a smaller  $\beta$  provides the leader with less blame. We say that an organization  $(\rho, \beta)$  has a *greater culture of reward* than  $(\rho', \beta')$  if  $\rho \geq \rho'$  and  $\beta \leq \beta'$ . Proposition 9 says that a greater culture of reward increases the propensity of the leader to spend political capital and is conducive to patient leaders becoming loud, and loud leaders becoming strong.

**Proposition 9 (Culture of reward or blame)** *Let  $\Sigma^P(k_1) \equiv \{\sigma \in (\pi, 1] : \sigma < \sigma^*(k_1)\}$  and  $\Sigma^S(k_1) \equiv \{\sigma \in (\pi, 1] : \sigma \geq \bar{\sigma}(k_1)\}$  be the intervals of leader's information precisions that induce her to optimally choose to be patient and strong, respectively. An increase in the culture of reward decreases the length of  $\Sigma^P(k_1)$ , and increases the length of  $\Sigma^S(k_1)$ .*

**Proof.** In Appendix A. ■

The intuition for Proposition 9 can be understood most clearly by returning to the tradeoff faced by a leader who faces a low-importance period 1 issue,  $\alpha_1 = \alpha^L$ , and receives the signal  $s_1 = 1$ . The expected payoff of spending political capital in period 1 is then

$$\begin{aligned} & \alpha^L [(1 - \Pr(\theta_1 = 1 | s_1 = 1)) + P(k_1) (2 \Pr(\theta_1 = 1 | s_1 = 1) - 1)] \\ & + \Pr(\theta_1 = 1 | s_1 = 1) V(k_1 + \rho - c) + (1 - \Pr(\theta_1 = 1 | s_1 = 1)) V(k_1 - \beta - c). \end{aligned}$$

Her expected payoff of not spending political capital in period-1 is instead given by

$$\alpha^L (1 - \Pr(\theta_1 = 1 | s_1 = 1)) + V(k_1).$$

Recall that the future value of capital  $V$  is increasing in the level of period-2 capital. Therefore, a greater culture of reward increases the benefits of spending capital in period 1 via an increase in the expected stock of period-2 capital. On the other hand, changes in the culture (i.e.,  $\rho$  or  $\beta$ ) do not affect the expected payoff of not spending capital. A similar logic shows that the expected period-2 power is weakly increasing as  $\rho$  increases and/or  $\beta$  decreases. Thus, the threshold required for a leader to accumulate power over time,

$\bar{\sigma}(k_1)$ , is decreasing as the culture of reward increases.

Given Proposition 9, it may be tempting to view a greater culture of reward as analogous to an increase in the leader's power or an upward shift in the power function. However, this is not the case. As we discussed in Section 5.2, an increase in power or upward shift of the power function can create incentives for both loud and patient leadership styles; that is, there is an ambiguous effect on the the leader's propensity to spend political capital. For example, a leader with a high level of capital, say  $P(k_1) = 1 - 2\varepsilon$  for some sufficiently small  $\varepsilon > 0$ , facing a low importance period-1 issue,  $\alpha_1 = \alpha^L$ , has little incentive to spend capital—at most, she may attain an additional  $2\varepsilon$  units of power. An upward shift in the power function to  $\hat{P}$  such that  $\hat{P}(k_1) = 1 - \varepsilon$  would further reduce this incentive, since now the leader can attain at most an additional  $\varepsilon$  units of power. In contrast, a greater culture of reward has an unambiguous effect—it increases the leader's propensity to spend capital.

The key difference between an increase in the culture of reward and an increase in power is the timing of the effects they produce. An increase in power affects the leader's period-1 power and hence her ambitions to accumulate power for the following period. A greater culture of reward does not affect a leader's period-1 power. Instead, it only increases the expected future power returns of spending capital today.

## 6 Concluding Remarks

We have offered a simple framework for thinking about how collective decisions in an organization are influenced by a leader's political capital. This framework is rich enough to capture issues like managerial "style" and the endogenous evolution of political capital, yet simple enough to permit a complete characterization of the leader's optimal strategy and to analyze issues of organizational design and the allocation of power. Perhaps our most striking result is that the optimal allocation of power is non-monotonic in the

precision of the leader's information.

Since at least Crawford and Sobel (1982) economists have been interested in how an expert with superior information to, but different preferences from, a decision maker can convey information and thus affect decisions. In a sense, cheap-talk models are about how information filters up a hierarchy. By contrast, we are concerned with how information flows down and how it is mediated by *power*. In our model, power stems from political capital.<sup>11</sup>

Future leaders themselves have the ability to invest in their initial stock of political capital. In fact, alliances and friendships may be built well before the leader assumes her position, often at significant costs. In our model, from the point of view of the leader, political capital (and therefore power) and her own precision of information (or 'talent') are complements. Thus, the leader's optimal investment in political capital (weakly) increases with the precision of her information.

Organizations and their leaders may also invest in the quality of the information they possess (via training, workshops, further education, investments in technology, etc.). Should this investment be concentrated on the organization's leader or spread across all decision makers? Investing in the leader's information may not be optimal from the organization's perspective if the leader is patient and avoids making decisions in an attempt to preserve her political capital. But investing in other decision makers may also be wasteful if their decisions are likely to be revised by the leader. In our model, the value the organization attains from a marginal increase in the precision of the leader's information is increasing in the leader's political capital, whilst the relationship is reversed for the accuracy of the default choice—a measure of the precision of the information spread across all decision makers. Intuitively, the organization is better off when a more informed decision is made. When the leader has a higher level of political capital, her opinion is more likely to be decisive. Therefore, the organization relies heavily on the leader's information and

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<sup>11</sup>c.f. the incomplete contracts literature, which also has a well-defined notion of economic power Grossman and Hart (1986), Aghion and Tirole (1997), Aghion and Holden (2011).

experience, and thus places greater value on marginal increases in the precision of her information. In contrast, a leader with a lower level of political capital is less likely to take the final decision. Therefore, the organization relies more heavily upon the collective wisdom of its members, and thus places greater value on marginal increases in the precision of the information spread across all decision makers.

Our theory has a number of empirical implications. First, small differences in the leader's initial political capital or quality of information can have large consequences for performance. There is now a sizable literature on "persistent performance differences" in organizations.<sup>12</sup> We offer a complementary but different explanation to existing theories of why such differences arise and persist.

A striking empirical finding due to Bertrand and Schoar (2003) is that individual (top) managers have a significant impact on both firm behavior and performance. Remarkably, these are related to certain observable characteristics of managers such as their educational background or age. Our theory suggests that one potentially important unobservable characteristic of a CEO is her political capital. Moreover, since the realizations of decisions are stochastic this capital evolves over time. Finally, organizational design can affect managerial style in this regard.

We can also think of regulatory reforms as having an impact on the allocation of power. The Sarbanes-Oxley Act (2002) introduced a number of measures, one of which was aimed at increasing independence in the Board of Directors, ostensibly by requiring a majority of independent directors (Linck et al., 2009). This presumably limits the power of the CEO which, in the context of our results, may lead to a better alignment of the incentives of the leader/CEO and the organization.

Finally, as we have stressed, within an organization who is "the leader" may depend on context. In firms it is perhaps natural to think of the CEO as the unitary leader. By contrast, in an academic department, the role of leader may depend on the topic of the

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<sup>12</sup>See Gibbons (2006), Chassang (2010) and Ellison and Holden (2014) among many other contributions.

decision to be made—such as the subfield of a hiring decision. It may also be the case that in some circumstances it is better to think of the leader as a group of members in the organization rather than a single individual. This immediately raises questions of how such groups form, their stability, and other issues. Such questions may be an interesting prospect for future work.

## A Omitted Proofs

**Proof of Lemma 1.** First note that, by Assumption 1, the leader prefers alternative  $a_2 = 1$  to alternative  $a_2 = 0$  if and only if  $s_2 = 1$ .

Let  $k_2 \geq \underline{k}$  be the (non-irrelevant) leader's period-2 stock of political capital. Spending political capital in period 2 yields expected utility equal to

$$\alpha_2(1 - \Pr(\theta_2 = 1|s_2)) + \alpha_2(2\Pr(\theta_2 = 1|s_2) - 1)P(k_2);$$

not spending political capital yields expected utility equal to  $\alpha_2(1 - \Pr(\theta_2 = 1|s_2))$ . The net benefit of spending capital is then given by

$$\alpha_2(2\Pr(\theta_2 = 1|s_2) - 1)P(k_2). \tag{8}$$

By Assumption 1,

$$\Pr(\theta_2 = 1|s_2) \begin{cases} > 1/2 & \text{if } s_2 = 1; \\ < 1/2 & \text{otherwise.} \end{cases} \tag{9}$$

Furthermore, because the leader is not irrelevant,  $P(k_2) > 0$ . Hence, the net benefit of spending political capital is positive (negative) if  $s_2 = 1$  ( $s_2 = 0$ ). ■

**Proof of Proposition 1.** Let  $k_1 \geq \underline{k}$ . Recall that the value of holding a stock  $k_2$  of political

capital in period 2 is given by

$$V(k_2) = \bar{\alpha}\pi + \bar{\alpha} (2 \Pr(\theta_2 = 1 | s_2 = 1) - 1) \Pr(s_2 = 1) P(k_2), \quad (10)$$

where  $\bar{\alpha}$  is the expected value of  $\alpha_2$ . A convenient reformulation of (10) is

$$V(k_2) = V(k) + \bar{\alpha} (2 \Pr(\theta_2 = 1 | s_2 = 1) - 1) \Pr(s_2 = 1) P(k_2). \quad (11)$$

Spending political capital in period 1 yields expected utility equal to

$$\begin{aligned} & \alpha_1(1 - \Pr(\theta_1 = 1 | s_1)) + \alpha_1 P(k_1)(2 \Pr(\theta_1 = 1 | s_1) - 1) \\ & + \Pr(\theta_1 = 1 | s_1)V(k_1 + b - c) + (1 - \Pr(\theta_1 = 1 | s_1))V(k_1 - b - c); \end{aligned} \quad (12)$$

not spending political capital yields expected utility equal to

$$\alpha_1(1 - \Pr(\theta_1 = 1 | s_1)) + V(k_1). \quad (13)$$

Thus, the leader spends capital in period 1 if and only if the difference between (12) and (13) is positive, i.e., if

$$\begin{aligned} & \alpha_1 P(k_1)(2 \Pr(\theta_1 = 1 | s_1) - 1) + \Pr(\theta_1 = 1 | s_1)V(k_1 + b - c) \\ & + (1 - \Pr(\theta_1 = 1 | s_1))V(k_1 - b - c) - V(k_1) > 0. \end{aligned} \quad (14)$$

We now consider three different cases for the value of the period-1 signal,  $s_1 \in \{0, 1\}$ , and the issue's importance,  $\alpha_1 \in \{\alpha^L, \alpha^H\}$ .

$s_1 = 1$  and  $\alpha_1 = \alpha^H$ . We now show that the leader always spends capital in this case.

To see this, notice that a sufficient condition for the leader to spend capital in period 1 is attained from (14) by substituting  $V(k_1 + b - c)$  and  $V(k_1 - b - c)$  with the weakly smaller



value  $V(\underline{k})$ , to attain

$$\alpha_1 P(k_1)(2 \Pr(\theta_1 = 1 | s_1) - 1) + V(\underline{k}) > V(k_1).$$

Substituting (11) into the above inequality, and simplifying, gives the following equivalent condition:

$$\alpha_1 P(k_1)(2 \Pr(\theta_1 = 1 | s_1) - 1) > \bar{\alpha} (2 \Pr(\theta_2 = 1 | s_2 = 1) - 1) \Pr(s_2 = 1) P(k_1).$$

Since  $s_1 = 1$ , we have  $(2 \Pr(\theta_1 = 1 | s_1) - 1) > 0$ , and so the above inequality simplifies to

$$\alpha_1 > \bar{\alpha} \Pr(s_2 = 1).$$

This simplification is possible because  $(\theta_t, s_t)$  for  $t = 1, 2$  are independent and identically distributed. Finally, notice that this inequality is satisfied whenever  $\alpha_1 = \alpha^H$ , since  $\alpha^H > \bar{\alpha}$  and  $\Pr(s_2 = 1) < 1$ . Thus, the leader spends her political.

$s_1 = 1$  and  $\alpha_1 = \alpha^L$ . We now show that there exists a threshold value  $\sigma^*(k_1)$  such that the leader spends political capital if and only if  $\sigma > \sigma^*(k_1)$ . By substituting (10) into (14) and simplifying, we obtain that the leader spends political capital if and only if

$$\begin{aligned} & \alpha^L P(k_1) + \Pr(\theta_1 = 1 | s_1 = 1) \bar{\alpha} \Pr(s_1 = 1) (P(k_1 + b - c) - P(k_1)) \\ & - (1 - \Pr(\theta_1 = 1 | s_1 = 1)) \bar{\alpha} \Pr(s_1 = 1) (P(k_1) - P(k_1 - b - c)) > 0. \end{aligned} \quad (15)$$

The left hand side of the above inequality is strictly increasing in  $\sigma$ , since

$$P(k_1 + b - c) - P(k_1) \geq 0 \quad \text{and} \quad P(k_1) - P(k_1 - b - c) \geq 0,$$

and

$$\Pr(\theta_1 = 1 | s_1 = 1) \Pr(s_1 = 1) = \sigma(1 - \pi),$$

which is increasing in  $\sigma$ , and  $(1 - \Pr(\theta_1 = 1|s_1 = 1)) \Pr(s_1 = 1)$  is decreasing in  $\sigma$ . We conclude that, for any  $k_1 > \underline{k}$  there exists a threshold value  $\sigma^*(k_1)$  that solves (15) with equality such that the leader spends political capital if and only if  $\sigma > \sigma^*(k_1)$ .

$s_1 = 0$  and  $\alpha_1 \in \{\alpha^L, \alpha^H\}$ . From (14), the leader spends capital if and only if

$$\begin{aligned} & \alpha_1 P(k_1) (2 \Pr(\theta_1 = 1|s_1 = 0) - 1) + \Pr(\theta_1 = 1|s_1 = 0) [V(k_1 + b - c) - V(k_1)] \\ & + (1 - \Pr(\theta_1 = 1|s_1 = 0)) [V(k_1 - b - c) - V(k_1)] > 0. \end{aligned} \quad (16)$$

But by Assumption 2 we have

$$\Pr(\theta_1 = 1|s_1 = 0) (P(k_1 + b - c) - P(k_1)) + (1 - \Pr(\theta_1 = 1|s_1 = 0)) (P(k_1 - b - c) - P(k_1)) \leq 0,$$

and, substituting the value of  $V(\cdot)$ , as per (11), we infer that the left hand side of (16) has strict upper bound  $\alpha_1 P(k_1) (2 \Pr(\theta_1 = 1|s_1 = 0) - 1)$ . This upper bound is strictly less than zero, since  $\Pr(\theta_1 = 1|s_1 = 0) < 1/2$ , and so the inequality (16) never holds. We conclude that the leader does not spend political capital.

Since the three cases are exhaustive, we have proven the proposition. ■

**Proof of Proposition 2.** Let  $k_1 \in \mathbb{R}$  be the leader's initial stock of political capital,  $P(k_1)$  be her power in period 1, and  $\sigma$  be the precision of her information. By Proposition 1, the leader spends political capital in period 1 only if she receives a signal  $s_1 = 1$  and  $k_1 \geq \underline{k}$ . Therefore, when the leader optimally spends political capital in period 1, her expected period-2 power is equal to

$$\Pr(\theta_1 = 1|s_1 = 1) P(k_1 - c + b) + (1 - \Pr(\theta_1 = 1|s_1 = 1)) P(k_1 - c - b).$$

Thus, when the leader spends political capital, her power is expected to grow if and only

if

$$\Pr(\theta_1 = 1|s_1 = 1)P(k_1 - c + b) + (1 - \Pr(\theta_1 = 1|s_1 = 1))P(k_1 - c - b) \geq P(k_1). \quad (17)$$

The left hand side of above inequality increases with  $\sigma$  because  $\Pr(\theta_1 = 1|s_1 = 1)$  increases with  $\sigma$ ; the right hand side is constant in  $\sigma$ . We conclude that there exists a threshold value  $\bar{\sigma}(k_1)$  that solves (17) with equality such that if the leader chooses to spend her political capital, then

1. if  $\sigma > \bar{\sigma}(k_1)$ , the leader's power is expected to grow over time;
2. if  $\sigma < \bar{\sigma}(k_1)$ , the leader's power is expected to decline over time.

It remains to prove that  $\bar{\sigma}(k_1) \leq 1$  and  $\bar{\sigma}(k_1) > \sigma^*(k_1)$  for  $k_1 \geq \underline{k}$ .

$\bar{\sigma}(k_1) \leq 1$ . If  $\sigma = 1$ , then  $\Pr(\theta_1 = 1|s_1 = 1) = 1$ . It is then immediate that (17) holds, since  $P$  is increasing. We conclude that  $\bar{\sigma}(k_1)$  is bounded by 1.

$\bar{\sigma}(k_1) > \sigma^*(k_1)$  for  $k_1 \geq \underline{k}$ . By definition of  $\sigma^*(k_1)$ , a leader with  $\sigma = \sigma^*(k_1)$  must be indifferent between spending and saving capital on an  $\alpha_1 = \alpha^L$  issue when  $s_1 = 1$ . That is, the following equality must hold:

$$\begin{aligned} \alpha^L P(k_1) + \bar{\alpha} \Pr(s_1 = 1) \Pr(\theta_1 = 1|s_1 = 1) P(k_1 + b - c) \\ + \bar{\alpha} \Pr(s_1 = 1) (1 - \Pr(\theta_1 = 1|s_1 = 1)) P(k_1 - b - c) = \bar{\alpha} \Pr(s_1 = 1) P(k_1). \end{aligned} \quad (18)$$

By contradiction, suppose  $\bar{\sigma}(k_1) \leq \sigma^*(k_1)$ . Then there exists  $\sigma'$  such that (17) and (18) both hold. Given (17), the left hand side of (18) is bounded below by  $\alpha^L P(k_1) + \bar{\alpha} \Pr(s_1 = 1) P(k_1)$ , which strictly exceeds the right hand side of (18) because  $k_1 \geq \underline{k}$  and  $\alpha^L > 0$ —a contradiction. ■

**Proof of Proposition 3.** Follows immediately from the definition of the four leadership styles (see Section 4.2) and Propositions 1 and 2. ■

**Proof of Proposition 4.** Let  $k_1 \geq \underline{k}$  be the leader's initial stock of political capital. By Proposition 1, if  $\sigma \geq \sigma^*(k_1)$ , the leader optimally chooses to spend political capital in period 1 whenever she prefers alternative  $a_1 = 1$ , which occurs with probability

$$\Pr(s_1 = 1) = \pi - \sigma(2\pi - 1);$$

if  $\sigma < \sigma^*(k_1)$ , she optimally chooses to spend political capital in period 1 if she prefers alternative  $a_1 = 1$  and  $\alpha_1 = \alpha^H$ , which occurs with probability

$$\Pr(s_1 = 1) \Pr(\alpha^H) = \Pr(\alpha^H)\pi - \sigma(2\pi - 1) \Pr(\alpha^H).$$

Because  $\pi > 1/2$ , both probabilities are decreasing in  $\sigma$ . Furthermore, the probability of spending political capital is discontinuous at  $\sigma^*(k_1)$ . This discontinuous jump is positive and equal to  $\Pr(s_1 = 1)(1 - \Pr(\alpha^H))$ . We conclude that the probability of spending capital in period 1 is strictly decreasing in  $\sigma$  for all  $\sigma \neq \sigma^*(k_1)$  and has local maxima at  $\sigma = \pi$  and  $\sigma = \sigma^*(k_1)$ . ■

**Proof of Proposition 5.** This result is a special case of Proposition 6, where the general power function  $P$  is substituted from the piece-wise linear function  $P_L : P_L(k_t) = 0 \ \forall k_t < c$ , and  $P_L = \max\{k_t, 1\}$  otherwise. For simplicity, within this proof, we assume  $2b + c < 1$ ; however, the result holds more generally and can be shown similarly.

Proposition 6 says that, for nonempty  $\Sigma^P(k_1)$ , if  $P'(k_1) \neq 0$  then  $\sigma^*(k_1)$  is increasing in  $k_1$  if and only if

$$\begin{aligned} \Pr(\theta_1 = 1 \mid s_1 = 1, \sigma = \sigma^*(k_1)) \frac{P'(k_1 - c + b) - P'(k_1)}{P'(k)} < \\ \Pr(\theta_1 = 0 \mid s_1 = 1, \sigma = \sigma^*(k_1)) \frac{P'(k_1) - P'(k_1 - c - b)}{P'(k_1)} - \frac{\alpha^L}{\bar{\alpha} \Pr(s_1 = 1 \mid \sigma = \sigma^*(k_1))}. \end{aligned} \quad (19)$$

Recall that when  $\sigma = \sigma^*(k_1)$  the following *indifference condition* must hold

$$\begin{aligned} \alpha^L P(k_1) + \Pr(\theta_1 = 1 | s_1 = 1) \bar{\alpha} \Pr(s_1 = 1) (P(k_1 + b - c) - P(k_1)) \\ + (1 - \Pr(\theta_1 = 1 | s_1 = 1)) \bar{\alpha} \Pr(s_1 = 1) (P(k_1 - b - c) - P(k_1)) = 0. \end{aligned} \quad (20)$$

Note that (with some abuse of notation) we omit the  $\sigma = \sigma^*(k_1)$  dependencies in the above indifference condition.

We wish to show that when  $P = P_L$ ,  $\Sigma^P(k_1)$ —equivalently:  $\sigma^*(k_1)$  is increasing in the political capital regions  $R_1 := [c, 2c + b)$  and  $R_2 := [1 - (b - c), 1)$ , and otherwise is decreasing. We divide the argument in four cases.

$k_1 \in R_1$ . For all  $k_1 \in R_1$ , we have  $P'(k_1) = 1$ ,  $P'(k_1 - b - c) = 0$ , and  $P'(k_1 - c + b) = 1$ , since  $P = P_L$ . Thus, the condition for  $\Sigma^P(k_1)$  to be increasing (19) simplifies to

$$0 < \Pr(\theta_1 = 0 | s_1 = 1, \sigma = \sigma^*(k_1)) - \frac{\alpha^L}{\bar{\alpha} \Pr(s_1 = 1 | \sigma = \sigma^*(k_1))}, \quad (21)$$

for  $k_1 \in R_1$ . Furthermore, in region  $R_1$  the indifference condition (20) simplifies to

$$\begin{aligned} \alpha^L k_1 + \Pr(\theta_1 = 1 | s_1 = 1) \bar{\alpha} \Pr(s_1 = 1) (k_1 + b - c - k_1) \\ - (1 - \Pr(\theta_1 = 1 | s_1 = 1)) \bar{\alpha} \Pr(s_1 = 1) k_1 = 0, \end{aligned}$$

since for all  $k_1 \in R_1$  we have  $P_L(k_2) = k_2$  for  $k_2 \in \{k_1, k_1 + b - c\}$ , and  $P_L(k_1 - b - c) = 0$ , and after rearranging we attain

$$\frac{\alpha^L}{\bar{\alpha} \Pr(s_1 = 1 | \sigma = \sigma^*(k_1))} = -\Pr(\theta_1 = 1 | s_1 = 1) \frac{k_1 + b - c}{k_1} + 1.$$

Returning to (21), we see that the right hand side can be expressed as

$$\Pr(\theta_1 = 0 | s_1 = 1) + \Pr(\theta_1 = 1 | s_1 = 1) \frac{k_1 + b - c}{k_1} - 1,$$

which is strictly larger than

$$\Pr(\theta_1 = 0 | s_1 = 1) + \Pr(\theta_1 = 1 | s_1 = 1) - 1 = 0.$$

It is immediate that the right hand side of (21) is positive. Thus, the inequality (21) holds and we infer that  $\Sigma^P(k_1)$  is increasing in the region  $R_1$ .

$k_1 \in R_2$ . For all  $k_1 \in R_2$ , we have  $P'(k_1) = 1$ ,  $P'(k_1 + b - c) = 0$ , and  $P'(k_1 - c - b) = 1$ .

Thus, the condition for  $\Sigma^P(k_1)$  to be increasing (19) simplifies to

$$-\Pr(\theta_1 = 1 | s_1 = 1, \sigma = \sigma^*(k_1)) < -\frac{\alpha^L}{\bar{\alpha} \Pr(s_1 = 1 | \sigma = \sigma^*(k_1))}. \quad (22)$$

Furthermore, in region  $R_2$  the indifference condition (20) simplifies to

$$\begin{aligned} &\alpha^L k_1 + \Pr(\theta_1 = 1 | s_1 = 1) \bar{\alpha} \Pr(s_1 = 1) (1 - k_1) \\ &+ (1 - \Pr(\theta_1 = 1 | s_1 = 1)) \bar{\alpha} \Pr(s_1 = 1) (k_1 - b - c - k_1) = 0, \end{aligned}$$

since for all  $k_1 \in R_2$  we have  $P_L(k_2) = k_2$  for  $k_2 \in \{k_1, k_1 - b - c\}$ , and  $P_L(k_1 + b - c) = 1$ , and after rearranging we attain

$$\frac{\alpha^L}{\bar{\alpha} \Pr(s_1 = 1 | \sigma = \sigma^*(k_1))} = -\Pr(\theta_1 = 1 | s_1 = 1) \frac{1}{k_1} - (1 - \Pr(\theta_1 = 1 | s_1 = 1)) \frac{k_1 - b - c}{k_1} + 1.$$

Returning to (22), we see that the right hand side can be expressed as

$$\begin{aligned} &\Pr(\theta_1 = 1 | s_1 = 1) \frac{1}{k_1} + (1 - \Pr(\theta_1 = 1 | s_1 = 1)) \frac{k_1 - b - c}{k_1} - 1 \\ &> \Pr(\theta_1 = 1 | s_1 = 1) + (1 - \Pr(\theta_1 = 1 | s_1 = 1)) \frac{k_1 - b - c}{k_1} - 1 \\ &> -\Pr(\theta_1 = 0 | s_1 = 1), \end{aligned}$$

but this exceeds the left hand side of (22). We conclude that (22) holds and  $\Sigma^P(k_1)$  is

increasing in the region  $R_2$ .

$k_1 \in R_3 := [2c + b, 1 - (b - c)]$ . For all  $k_1 \in R_3$  we have  $P'(k_1) = P'(k_1 - c \pm b) = 1$ .

Thus, the condition for  $\Sigma^P(k_1)$  to be increasing (19) simplifies to

$$0 < -\frac{\alpha^L}{\bar{\alpha} \Pr(s_1 = 1 \mid \sigma = \sigma^*(k_1))}.$$

This inequality never holds since  $\alpha^L > 0$ . We conclude that  $\Sigma^P(k_1)$  is decreasing in the region  $R_3$ .

$k_1 \in R_4 := [1, \infty)$ . For all  $k_1 \in R_4$ , we have  $P'(k_1) = 0$ . By Proposition 6,  $\Sigma^P(k_1)$  is decreasing in the region  $R_4$ .

Since the four cases are exhaustive, we have proven the proposition. ■

**Proof of Proposition 6.** For nonempty  $\Sigma^P(k_1)$ , the length of  $\Sigma^P(k_1)$  is simply  $\sigma^*(k_1) - \pi$ .

Note that the length of  $\Sigma^P(k_1)$  is weakly increasing in  $\sigma^*(k_1)$ .

To prove the proposition, we consider the effect of a marginal increase in  $k_1$  on the length of  $\Sigma^P(k_1)$ , or equivalently the value of  $\sigma^*(k_1)$ .

By Proposition 1, if  $\sigma = \sigma^*(k_1)$ , then the following indifference condition holds:

$$\begin{aligned} \Phi(k_1, \sigma) \equiv & \alpha^L P(k_1) + \Pr(\theta_1 = 1 \mid s_1 = 1) \bar{\alpha} \Pr(s_1 = 1) (P(k_1 + b - c) - P(k_1)) \\ & + (1 - \Pr(\theta_1 = 1 \mid s_1 = 1)) \bar{\alpha} \Pr(s_1 = 1) (P(k_1 - b - c) - P(k_1)) = 0. \end{aligned} \tag{23}$$

$\Phi(k_1, \sigma)$  is the net benefit of spending capital in period 1 when  $\alpha_1 = \alpha^L$  and  $s_1 = 1$ . Note that  $\Phi(k_1, \sigma)$  is strictly increasing and continuous in  $\sigma$ .

**Lemma 2** For a given capital level  $k_1$ , a marginal increase in capital has opposite effects on  $\Phi(k_1, \sigma) \Big|_{\sigma = \sigma^*(k_1)}$  and  $\sigma^*(k_1)$ :

$$\frac{\partial \Phi(k_1, \sigma)}{\partial k_1} \Big|_{\sigma = \sigma^*(k_1)} > 0 \quad \text{if and only if} \quad \frac{\partial \sigma^*(k_1)}{\partial k_1} < 0.$$

**Proof.** Suppose that a marginal increase in capital from  $k_1$  to  $k'_1$  results in an increase in the  $\sigma^*(k_1)$ -leader's net benefit, i.e.,

$$\Phi(k'_1, \sigma^*(k_1)) > \Phi(k_1, \sigma^*(k_1)) = 0.$$

Then, since  $\Phi(k'_1, \sigma)$  is strictly increasing in  $\sigma$ , the value  $\sigma'$  such that

$$\Phi(k'_1, \sigma') = 0, \quad \text{or equivalently} \quad \sigma' = \sigma^*(k'_1),$$

is strictly less than  $\sigma^*(k_1)$ . Similarly, if a marginal increase in  $k_1$  results in a decrease in the  $\sigma^*(k_1)$ -leader's net benefit then  $\sigma^*(k'_1) > \sigma^*(k_1)$ . ■

From the above lemma, we have that  $\Sigma^P(k_1)$  is increasing if and only if

$$\begin{aligned} \frac{\partial \Phi(k_1, \sigma)}{\partial k_1} \Big|_{\sigma=\sigma^*(k_1)} &= \alpha^L P'(k_1) + \Pr(\theta_1 = 1 | s_1 = 1) \bar{\alpha} \Pr(s_1 = 1) (P'(k_1 + b - c) - P'(k_1)) \\ &\quad + (1 - \Pr(\theta_1 = 1 | s_1 = 1)) \bar{\alpha} \Pr(s_1 = 1) (P'(k_1 - b - c) - P'(k_1)) \\ &< 0. \end{aligned}$$

Rearranging terms yields (4) in the proposition. ■

**Proof of Proposition 7.** We begin by stating two facts that will be useful in proving the proposition.

**Lemma 3** *For any given initial stock of political capital, the organization strictly prefers an active (loud or strong) leader to a patient leader.*

**Proof.** Suppose  $\alpha^L = \alpha^H > 0$  so that the leader's payoff function is a monotonic transformation of the organization's payoff function. By Proposition 1 (in particular, see (15) in the proof of Proposition 1) the leader strictly prefers to spend political capital in period 1 whenever she prefers alternative  $a_1 = 1$ . Therefore, the organization strictly prefers the leader to spend political capital in period 1 whenever she prefers alternative  $a_1 = 1$ . ■



**Lemma 4** Fix a leadership style in patient, loud, strong, the organization strictly prefers a leader with a greater initial stock of political capital.

**Proof.** To see this, fix the leader's style. A higher initial stock of political capital strictly increases the leader's power in period 1 and, for any realization of events, weakly increases the leader's power in period 2. Since whenever the leader spends political capital, the organization strictly prefers alternative  $a_1 = 1$  to be implemented, absent a change in the leader's style, the organization prefers a leader with a greater initial stock of political capital. ■

We now prove that if (5) holds, then  $k^*(\sigma) = \bar{k}$  for all  $\sigma \in (\pi, 1)$ . Let (5) hold. Recall from the proof of Proposition 1 (in particular, see (14)) that a leader with initial stock of political capital equal to  $\bar{k}$  adopts an active leadership style if and only if

$$\left( 2 \Pr(\theta_1 = 1 | s_1 = 1) - 1 \right) \left( \alpha^L P(\bar{k}) + \Pr(\theta_1 = 1 | s_1 = 1) \bar{\alpha} \Pr(s_1 = 1) (P(\bar{k} + b - c) - P(\bar{k})) - (1 - \Pr(\theta_1 = 1 | s_1 = 1)) \bar{\alpha} \Pr(s_1 = 1) (P(\bar{k}) - P(\bar{k} - b - c)) \right) > 0.$$

Notice that  $2 \Pr(\theta_1 = 1 | s_1 = 1) - 1$  is strictly positive for all  $\sigma > \pi > 1/2$ . Furthermore, the term in the second parenthesis is (i) increasing in  $\sigma$  (see (15) in the proof of Proposition 1), and (ii) since (5) holds, non-negative for  $\sigma = \pi$ . Therefore, a leader with initial stock of political capital equal to  $\bar{k}$  adopts an active leadership style for all  $\sigma > \pi$ . By Lemmas 3 and 4, then the optimal allocation of political capital equals  $\bar{k}$  for all  $\sigma \in (\pi, 1)$ .

We now prove that if (6) holds for all  $k_1 \in [\underline{k}, \bar{k}]$  and (7) holds, then there exists a unique  $\hat{\sigma} \in (\pi, 1)$  such that  $k^*(\sigma) = \bar{k}$  for  $\sigma < \hat{\sigma}$ ,  $k^*(\hat{\sigma}) < \bar{k}$ , and  $k^*(\sigma)$  increases with  $\sigma$  for  $\sigma \geq \hat{\sigma}$ . I.e., the optimal allocation of political capital is U-shaped.

We prove this in four steps:

Step 1. Because (6) holds for all  $k_1 \in [\underline{k}, \bar{k}]$ , from the proof of Proposition 1 (in particular, see (14)), there exists a unique  $\underline{\sigma}$  such that the leader optimally chooses to be patient for any  $k_1 \in [\underline{k}, \bar{k}]$  if and only if  $\sigma < \underline{\sigma}$ . By Lemma 4, the optimal allocation of political capital

equals  $\bar{k}$  for all  $\sigma < \underline{\sigma}$ .

Step 2. Because (7) holds, by Propositions 2 and 3, a leader with  $\sigma > \sigma^*(\bar{k})$  optimally chooses to be active for  $k_1 = \bar{k}$ . By Lemmas 3 and 4, then the optimal allocation of political capital equals  $\bar{k}$  for all  $\sigma > \sigma^*(\bar{k})$ .

Step 3. Because (6) holds for all  $k_1 \in [\underline{k}, \bar{k}]$  and (7) holds, there exist an interval  $\hat{\Sigma} = [\underline{\sigma}, \sigma^*(\bar{k}))$  such that a leader with information of precision  $\sigma \in \hat{\Sigma}$  optimally chooses a patient style if  $k_1 = \bar{k}$  but optimally chooses an active style for  $k(\sigma) < \bar{k}$  such that

$$k(\sigma) = \max\{k : \sigma = \sigma^*(k)\}. \quad (24)$$

By Lemmas 3 and 4, for any  $\sigma \in \hat{\Sigma}$ , the optimal allocation of political capital is either equal to  $\bar{k}$  or to  $k(\sigma)$ .

Step 4. By Proposition 6 and (7),  $d\sigma^*(k)/dk|_{k=\bar{k}} > 0$ . Therefore there exists  $\sigma \in \hat{\Sigma}$  for which the optimal allocation of political capital is equal to  $k(\sigma) < \bar{k}$ . Since  $\sigma^*(k)$  is an increasing function there exists a unique  $\hat{\sigma} \in \hat{\Sigma}$  such that  $k^*(\sigma) = \bar{k}$  for  $\sigma < \hat{\sigma}$ ,  $k^*(\hat{\sigma}) < \bar{k}$ , and  $k^*(\sigma)$  increases with  $\sigma$  for  $\sigma \geq \hat{\sigma}$ . ■

**Proof of Proposition 8.** Consider power functions

$$\bar{P} : \bar{P}(k) = \begin{cases} 1 & \text{for } k \geq \underline{k}, \\ 0 & \text{otherwise.} \end{cases}$$

and, for some small  $\delta > 0$ ,

$$P_\delta : P_\delta(k) = \begin{cases} \max\{1 - \delta + (k - \underline{k}), 1\} & \text{for } k \geq \underline{k}, \\ 0 & \text{otherwise.} \end{cases}$$

Before proceeding, we introduce some notation. Let  $q = \Pr[\alpha_t = \alpha^H]$ ,  $\omega = \Pr[s_t = 1]$ , and define the function  $p_s(\theta) = \Pr[\theta_t = \theta | s_t = s]$ .

A  $(\sigma, \underline{k})$ -type leader, with  $\sigma \neq 1$ , is patient under  $\bar{P}$  whenever

$$\begin{aligned} \alpha^L - p_1(0)\bar{\alpha}\omega &< 0 \\ \iff \alpha^L &< \frac{p_1(0)\omega q\alpha^H}{1 - p_1(0)(1 - q)\omega}, \end{aligned} \quad (25)$$

this follows immediately from (15). While under  $P_\delta$  the leader is strong whenever  $p_1(1) \cdot 1 + p_1(0) \cdot 0 \geq P(\underline{k})$ , this simplifies to

$$p_1(1) \geq 1 - \delta.$$

Let  $q = \varepsilon$  for some small  $\varepsilon > 0$ , and suppose

$$\sigma = \sigma_\delta := \frac{(1 - \delta)\pi}{(1 - \delta)\pi + \delta(1 - \pi)},$$

and

$$\alpha^L = \varepsilon \frac{p_1(0)\omega q\alpha^H}{1 - p_1(0)(1 - q)\omega}.$$

Under the power function  $\bar{P}$ , a  $(\sigma, \underline{k})$ -type leader is patient since  $\sigma_\delta < 1$  and (25) holds.

Under the power function  $P_\delta$ , a  $(\sigma, \underline{k})$ -type leader is loud since

$$p_1(1) = \frac{\sigma_\delta(1 - \pi)}{\sigma_\delta(1 - \pi) + (1 - \sigma_\delta)\pi} = 1 - \delta.$$

Now suppose that the distribution  $F$  has point mass at  $(\sigma_\delta, \underline{k})$ . This assumption is an extreme case and simplifies the proof; however, it is straightforward to see that the result will continue to hold for a family of distributions approximating  $F$  with non-zero measure support.

The organization's expected utility from  $\bar{P}$ , as  $\varepsilon \rightarrow 0$ , is

$$2\pi + (2p_1(1) - 1)\omega = 2\pi + (1 - 2\delta)\omega.$$

While for the power function  $P_\delta$ , the organization's expected utility is independent of  $\varepsilon$ , since a strong leader spends her capital if and only if she receives a signal  $s_t = 1$ , and takes the value

$$\begin{aligned}
& \pi + (2p_1(1) - 1)\omega(1 - \delta) + \omega p_1(1)[\pi + (2p_1(1) - 1)\omega] \\
& \quad + \omega p_1(0)[\pi] + (1 - \omega)[\pi + (2p_1(1) - 1)\omega(1 - \delta)] \\
& = 2\pi + (2p_1(1) - 1)\omega \left[ (1 - \delta) + \omega(1 - \delta) + (1 - \omega)(1 - \delta) \right] \\
& = 2\pi + (2p_1(1) - 1)\omega \left[ 1 + (1 - 2\delta) \right].
\end{aligned}$$

For  $\delta < 1/2$  the expected utility of the organization under  $P_\delta$  is strictly higher than the limiting expected utility (as  $\varepsilon \rightarrow 0$ ) under  $\bar{P}$ . A standard continuity argument shows that, for some sufficiently small but positive  $\varepsilon$  (and hence also  $\alpha^L > 0$ ) the power function  $P_\delta$  is preferred by the organization to  $\bar{P}$ . ■

**Proof of Proposition 9.** Recall from the proof of Proposition 6 that the length of  $\Sigma^P(k_1)$  is simply  $\sigma^*(k_1) - \pi$  if it is nonempty, and the value  $\sigma^*(k_1)$  is defined to be the  $\sigma$ -value such that the following indifference condition holds

$$\begin{aligned}
& \alpha^L P(k_1) + \Pr(\theta_1 = 1 | s_1 = 1) \bar{\alpha} \Pr(s_1 = 1) (P(k_1 + \rho - c) - P(k_1)) \\
& \quad + (1 - \Pr(\theta_1 = 1 | s_1 = 1)) \bar{\alpha} \Pr(s_1 = 1) (P(k_1 - \beta - c) - P(k_1)) = 0. \quad (26)
\end{aligned}$$

We denote the left hand side of (26) by the function  $\Phi(k_1, \sigma | \rho, \beta)$ .

We wish to show that an increase in the culture of reward decreases  $\sigma^*(k_1)$ . First, note that  $\Phi(k_1, \sigma | \rho, \beta)$  is increasing and continuous in  $\sigma$ . Second, because the power function  $P$  is weakly increasing,  $\Phi(k_1, \sigma | \rho, \beta)$  is increasing in the culture of reward: for  $(\rho, \beta), (\rho', \beta')$  such that  $\rho \geq \rho', \beta \leq \beta'$  we have

$$\Phi(k_1, \sigma | \rho, \beta) \geq \Phi(k_1, \sigma | \rho', \beta') \quad \text{for all } k_1, \sigma. \quad (27)$$

Now, by definition, we have  $\Phi(k_1, \sigma^*(k_1) \mid \rho, \beta) = 0$ , where  $\sigma^*(k_1)$  is defined with respect to the culture parameters  $(\rho, \beta)$ . Let  $(\rho', \beta')$  be a lower culture of reward set of parameters. It is immediate from (27) that

$$\Phi(k_1, \sigma^*(k_1) \mid \rho', \beta') \leq 0.$$

If equality holds, then  $\sigma = \sigma^*(k_1)$  satisfies the indifference condition under the lower culture of reward parameters and so  $\Sigma^P(k_1)$  has unchanged length. If strict inequality holds, then, since  $\Phi$  is increasing and continuous in  $\sigma$ , there exists a value  $\sigma' > \sigma^*(k_1)$  such that

$$\Phi(k_1, \sigma' \mid \rho', \beta') = 0.$$

Thus, the length of  $\Sigma^P(k_1)$  increases as the culture of reward decreases. This completes the proof.

In a similar manner, we can show that an increase in the culture of reward increases  $\Sigma^S(k_1)$ . This follows since the value  $\bar{\sigma}(k_1)$  is defined such that

$$\Pr(\theta_1 = 1 \mid s_1 = 1)P(k_1 - c + \rho) + (1 - \Pr(\theta_1 = 1 \mid s_1 = 1))P(k_1 - c - \beta) = P(k_1).$$

It is straightforward to see that an increase in  $\rho$  and decrease in  $\beta$ , leads to a decrease in  $\bar{\sigma}(k_1)$  and hence an increase in  $\Sigma^S(k_1)$ , as required. ■

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