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How do firms compete in the non-market? The process of political capability building

DOI 10.1515/bap-2015-0019

Previously published online June 20, 2016

Abstract: This paper contributes to both corporate political activity (CPA) research and capabilities theory research by offering models that better describe the process that managers undertake to nurture a political capability. This is done through the interplay of four factors inherent in political actions, namely (i) corporate structure, (ii) firm-government linkages, (iii) political access and (iv) public policy pressure. Additionally, recognizing that political capability attainment is not a binary endeavor, I offer a political capability continuum to better categorize the magnitude by which differing firms allocate resources toward molding public policy. This paper adds to the scant literature on management-focused CPA research that integrates the resource-based view (RBV) of the firm and political action research.

1 Introduction

Corporations engage in political activities, such as lobbying and campaign contributions, to varying degrees and for numerous reasons. Political activity may be proactive in nature, as when firms attempt to mold nascent policy in their favor. In other instances, firms employ more reactive political strategies, for example when reacting to regulatory rule-making that hinders corporate strategy. For whatever reason, it is apparent that corporate political activity (CPA) is becoming more prevalent as firms allocate resources to non-market activities.¹ While firms compete in the private market on dimensions such as product and price differentiation, they recognize that competing in the political arena is just as important since legislators and regulators shape the “rules of the game” in the firms’ primary markets.

¹ Baron (1995).

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With this increase in political action, CPA research in management, finance, economics and public policy has also increased as scholars have modeled the antecedents and outcomes to this political action.² However, to date, there has been little effort to integrate leading management theories with the literature on CPA. This failure to rigorously integrate capabilities theory and political activities at the firm level is a major gap in the current literature. This paper addresses this omission by focusing on the following question: If firms must rationally choose the capabilities that they nurture for survival, what exactly does it mean to compete with capabilities meant for the non-market? In answering this question, I integrate capabilities theory with the literature on CPA to model the activities firms need to adopt to effectively compete along political lines. In addition to firms having a political capability or not, the current work also addresses the intensity by which firms allocate resources to better master their public policy responses.

I posit that firms use political actions on a continuum depending on their ambition with respect to government influence. While some firms will use CPA on an ad hoc basis, other firms fully intend to compete against rivals, both current and potential, through the establishment of this specific capability. To study CPA in earnest, however, political capabilities must be fully defined – as prior literature has failed to do. I define the myriad of political activities under the umbrella of four factors, namely structure, linkages, access, and influence. The literature to date includes limited attempts to address political capabilities, most notably Oliver and Holzinger (2008) and Holburn and Zelner (2010), and while these papers have been highly influential, they omit many specifics needed for productive future research.

This paper provides two contributions to current management and CPA research. The first contribution is in focusing on specific activities, as opposed to theoretical abstractions, that firms undertake to establish a political presence. While Oliver and Holzinger (2008) have proposed a theoretical model on firm-level political capabilities, the focus here is on the ground-level activities and tasks that allow firms to operate in the public policy arena. This focus is important for both future researchers as well as active managers tasked with running an organization's political affairs. As recent scholarship has found, rent-seeking through non-market activities is another profitable undertaking that managers engage in alongside market activities. However, just as in market-based competition, executing on a non-market strategy is dependent on nurturing specific activities. The second contribution of the paper is in broadening the scope of political action at the firm-level. The majority of CPA papers have focused on a very limited number of political actions, yet have not modeled the *ex ante* decision-making that precedes these actions. For instance, some papers study the phenomenon

² Lux, Crook, and Woehr (2011).

of lobbying and use monetary expenditures to measure the phenomenon. While expenditure data is easy to collect and use in statistical estimations, only using expenditure data misses multiple activities that firms undertake as part of that dollar figure. Since capabilities research is concerned with the activities and routines that firms intentionally undertake,³ omitting activities is problematic in management-based CPA research.

As a boundary condition, this paper will focus on firms that operate in the US and attempt to act politically in the US.⁴ This boundary condition is needed for two reasons. First, studying comparative political systems would be too onerous for a journal-length paper. Secondly, and more important, the US system is quite idiosyncratic in its form of government, a representative democracy in a federalist system with a partial separation between those that make law (i.e. legislators) and those that implement it (i.e. regulators). In the Discussion section, I address this limitation and suggest ways for future scholars to extend the current work to other political settings. The paper is structured as follows. The next section defines firm-level capabilities and integrates CPA into the capabilities framework. Section III defines the separate and distinct activities that firms must undertake in order to compete through political capabilities. Section IV integrates the differing activities to model political capabilities and introduces a political capability continuum. Finally, Section V concludes the paper, notes its limitations, and provides suggestions for future research based off of these limitations.

2 Theory

2.1 RBV and capabilities theory

The resource-based view (RBV) of the firm portrays for-profit organizations as bundles of resources that attempt to capture value through attaining competitive advantage.⁵ In order to do so, firms must create isolating mechanisms that shield them from value capture while also enabling rent extraction through the use of valuable, rare, inimitable and non-substitutable assets.⁶ Assets alone are only a necessary condition, however, as the presence of assets does not create firm-level

³ Winter (2000).

⁴ This includes firms that operate in many locations but where at least one of those locations is in the US.

⁵ Wernerfelt (1984).

⁶ VRIN Model, Barney (1991).

value. Instead, firms must nurture capabilities, which are needed to unleash the potential value that a firm's bundle of assets possesses. At a broad level, a capability can be defined as an embedded firm-level process that has an intended and specific purpose,⁷ in that capabilities are not ad hoc.⁸ Capabilities are repeated, and repeatable, processes that firms practice to ensure survival and, conditional on survival, to outcompete rivals on a relative basis.⁹ Ordinary capabilities "...allow the firm to make a living"¹⁰ while dynamic capabilities "...enables a firm to alter how it currently makes a living."¹¹

Outcompeting rivals through capability optimization is done through two different mechanisms involving selection and deployment.¹² The selection of resources entails management "outsmarting" rival firms in the *ex ante* choice of which resources to obtain (Barney 1986). Deployment of resources is accomplished through capability-building that is aimed at exploiting resources once they are chosen. Therefore, firms create economic value through both superior choosing and superior exploitation of resources.¹³ Both resource picking and resource exploitation entail a high level of managerial capabilities,¹⁴ as it is normally assumed that top management teams (TMTs) set intended policy within corporations. Managerial capabilities, when present, allow firms to iteratively allocate resources in an optimal manner¹⁵ as new information is gathered from external cues. This gathering of information is crucial in betting on the right resource allocations *ex ante*. Firms with TMTs that have the ability to track the correct signals outcompete rivals' TMTs by incorporating higher quality information (and reducing noisy information) that lead to more effective corporate-level decisions.¹⁶

2.2 Political capabilities

It then follows that, in a broad sense, political capabilities are processes and activities that firms develop in order to manage their non-market environment.¹⁷

7 Winter (2003).

8 Winter (2000).

9 Drnevich and Kriauciunas (2011).

10 Helfat and Winter (2011: p. 1244).

11 *Ibid.*: p. 1244.

12 Makadok (2001).

13 Amit and Schoemaker (1993); Makadok (2001).

14 Adner and Helfat (2003).

15 Noda and Bower (1996).

16 Adner and Helfat (2003).

17 Baron (1995).

While the term “political capabilities” has been used by other scholars,¹⁸ an actionable definition of such capabilities is still absent from the literature. Oliver and Holzinger (2008) argue that firms that have dynamic political capabilities are able to capitalize on future political opportunities through the activities and processes that the firms have in place. They specifically define dynamic political capabilities as “...dynamic processes by which a firm influences or complies with its political environment for the purpose of generating future value or protecting the current value of the firm from future loss or erosion (p. 497).” In other words, firms that have a defined political capability have an advantage over rivals when the political environment changes. As such, they are more nimble and responsive challenges from the public sector. Holburn and Zelner (2010) state that a firm-level political capability includes the “...capacity to deploy or leverage its political resources on an ongoing basis”¹⁹ through both learning and imprinting.

A number of other papers have incorporated the RBV with CPA without defining political capabilities *per se*. Most notably, Dahan (2005) asks if there can be a RBV of politics by using a legitimacy-based argument (i.e. political reputation). While this work was one of the first papers to incorporate the RBV with CPA, Dahan stops short of fully developing a framework for capability attainment through political means. Likewise, Bonardi, Holburn, and Vanden Bergh (2006) incorporate the RBV in part of their theory development. While Bonardi, Holburn, and Vanden Bergh (2006) do employ RBV, the inclusion is minor as the major theoretical focus of their work centers on the political exchange view as espoused by Buchanan and Tullock (1962).²⁰ Therefore, integrating capabilities theory and corporate political action, I define political capabilities as non-ad hoc activities and processes oriented toward value creation or maintenance of the firm’s political environment. The political environment entails all entities that have the power of central governmental authority, including local, state, federal and international entities that have legitimate and legal power in a domain where a firm interacts. While this study focuses primarily on US-based governmental units and US-based political activity, the process described herein is generalizable to many other institutional domains and geographies since firms must comply or defy with relevant authorities outside of the US, although the configuration of activities may differ by locale.

¹⁸ Oliver and Holzinger (2008); Holburn and Zelner (2010).

¹⁹ Holburn and Zelner (2010: p. 1291).

²⁰ Note that I am not arguing that the aforementioned papers have not furthered the literature on CPA; instead, I am noting that these papers did not fully develop the notion of political capabilities (and most likely they did not intend to).

2.3 The institutional need for political capabilities

The need to establish a political capability can only be understood in the context of institutional factors.²¹ In settings where central authorities (i.e. government) impose complex rules, firms may attempt to manage these complexities in a number of ways. As institutionalists have posited, legitimacy is earned through either the compliance or defiance via à vis governmental authority. Governments have the ability to impose pressure and constraints on firms through coercive isomorphism.²² Coercive isomorphism “...results from formal and informal pressures exerted on organizations upon which they are dependent...”²³ Therefore, a firm’s repertoire of strategic choices is conditional upon the legal choices that are set forth by central authorities who have legitimate control over corporate law. In markets such as the US, this authority can be decomposed into both legislative power (i.e. elected officials) and administrative power (i.e. regulatory officials). Firms comply with this authority in order to earn sociopolitical legitimacy,²⁴ which helps them avoid sanctions and earn positive reputational capital with the authority.²⁵ However, firms may also defy the authority by pushing back at the level of constraint the authority attempts to implement.

More specifically, the choice to engage politically can be thought of as an allocation choice that has an *ex ante* probabilistic positive net payoff. One argument is that political activity is an attempt to extract rents in competitive spaces as the manipulation of constraints aids in profit-attainment.²⁶ Since governmental authorities have a monopoly on rules and laws governing certain opportunities, attempts to mold such rules may be beneficial for a firm’s positioning. Another argument is that firms attempt to engage with political authorities in order to block entry²⁷ to potential entrants. This latter argument entails a different facet of competition, as blocking entrants may not affect the competition between existing actors. Instead, by raising entry barriers, incumbents benefit (as a group) to the detriment of entrants (as a group). This maintenance of the status quo is a trade-off between competing for existing market share against current competitors and maintaining market share that may be lost to potential nimble entrants.

21 Hillman (2003).

22 DiMaggio and Powell (1983).

23 DiMaggio and Powell (1983: p. 50).

24 Aldrich and Fiol (1994).

25 Dahan (2005).

26 Holburn and Vanden Bergh (2014).

27 Stigler (1971).

Considering that the legislative process is dynamic, it is logical that corporations that build a capability addressing government policy will have the flexibility to change corporate decision-making as legal conditions change. In other words, firms that operate with an ad hoc mentality may have trouble in deploying assets when changes in government policy occur rapidly. Undertaking multiple activities has both a proactive and reactive strategic bent as noted by Oliver and Holzinger (2008). Proactively, firms have the ability to mold legislation before it is introduced to signal its significance to the firm, or to the industry in which it operates. Reactively, firms that build up such activities have quicker political reflexes and possess the ability to stave off profit-diminishing rules that government may attempt to impose.

3 Establishing a political capability

Figure 1 depicts the breakdown of activities in the establishment of a political capability. Four major areas are defined – structure, links, access and pressure – followed by activities that are needed in order to master the respective area. While other papers have disseminated broad actions of political activity, such as proactive versus reactive,²⁸ there is ambiguity in defining specific activities into one category versus the other. For example, lobbying may be proactive (e.g. lobbying decision-makers to initiate a legal issue) or reactive (e.g. lobbying against a law or rule that has been already proposed), therefore, it is difficult to categorize these complex activities into neat construct buckets. In the rest of this section, I synthesize the existing literature on firm-level political activity to define an activity-based breakdown of required steps to fully develop a political capability.

3.1 Corporate structure

Firms that allocate resources toward the political sphere signal that non-market interactions are crucially important to value creation. As such, the strategy and structure of such firms should be aligned with each other.²⁹ The implications of the strategy-structure alignment with respect to political activity points to the inclusion of a government affairs office³⁰ as the importance of government

²⁸ Oliver and Holzinger (2008).

²⁹ Doh et al. (2014).

³⁰ The term “Government Affairs” is synonymous with other terms such as “Legislative Affairs” or “Political Affairs” and similar terms.

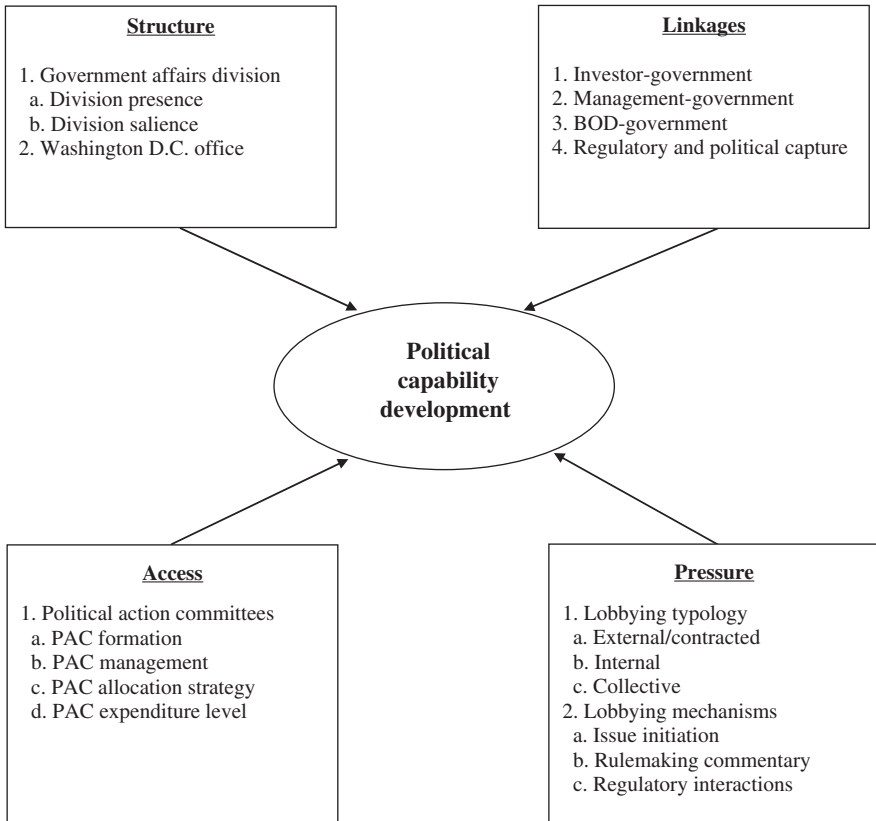


Figure 1: Political capability factors and activities.

dependence increases. There are two distinct issues in the inclusion of a government affairs office in the corporate structure. The first issue is the choice to include such a department while the second is the importance of the division within the structure. Inclusion is a necessary, yet insufficient, condition for evidence of capability building, as inclusion could be trivial. Non-triviality is derived from the importance of the government affairs division vis-a-vis other divisions within the corporation. *Ex ante* decision-making concerning the salience of different divisions, signals shareholders, employees, regulators and competitors of the dimensions by which the firm plans to compete.³¹

In addition to the signaling effect, the establishment of a prominent division of the firm that exists to study, change and respond to government is

³¹ Argyres and Silverman (2004).

operationally crucial. From this operational standpoint, possessing a core group of employees whose focus is on interactions with government officials and responses to public policy allows the firm to maintain flexibility in emergent decision-making. For firms that are active politically, routines that flow from this core group are an important antecedent to effective proactive and reactive political tactics. However, and in spite of evidence that formal, executive-level positions increases the prevalence of capability utilization,³² CPA researchers have generally ignored corporate structure. Exceptions include Schuler (1996), Schuler and Rehbein (1997) and Rehbein and Schuler (1999) who were early proponents in studying the corporate structure-political activity link through their “Filter Model.” The filter discussed in this line of research included organizational structures that assisted firms in filtering corporate action to targeted locations. While the authors found that the models that included the filter had more explanatory power over those that did not, the measurement of the structure differs from that defined here. Schuler and Rehbein (1997) model the size of a firm’s office in Washington DC as the structure construct in their models. This measure, however, does not specify where in the corporate structure the firm places the importance of political activities. Recent work by Doh et al. (2014) studies the use and prevalence of governmental affairs divisions at both Lufthansa Airlines and Tata Consultancy. They conclude that firms where government policy is a valued decision-making factor, the leverage and salience of these divisions should increase so that resource deployment in the non-market can take place at the rapidity necessary in an ever-changing and more complex world.

This rapidity issue in Doh et al. (2014) complements Oliver and Holzinger’s (2008) statement of the importance of being able to “...capitalize quickly on political opportunities...”³³ Having a government affairs division that is prominent and well-funded allows firms that place salience in government policy a competitive advantage over rivals who place less importance on these issues. Additionally, I argue that this structural issue is of primary importance in capability attainment in the other three areas yet to be discussed: Links, access and pressure. In other words, being able to compete politically requires the firm to have a stable division that can maintain links to government, access to elected and appointed officials, and the ability to target issues to apply pressure effectively.

³² Schreiner, Kale, and Corsten (2009).

³³ Oliver and Holzinger (2008: p. 508).

3.2 Links to government

3.2.1 Investors, managers and board members

Linkages between for-profit organizations and government officials are important activities for attaining competitive advantage.³⁴ The mechanisms for this advantage may be controversial, for example when firms gain access to resources and entitlements through “crony capitalism” techniques, or less controversially when firms have an information advantage as a result of specific links. The CPA literature includes several types of links, namely investor-government links,³⁵ management-government links,³⁶ and board of director-government links.³⁷ There are differences between these three types of linkages. For example, an equity shareholder in a firm may have the incentive to see the market value (i.e. stock price) of the firm rise while a manager, depending on the compensation mechanisms in place, may create linkages to gain market share, growth, profitability or a number of different outcomes. Likewise, having a BOD-government linkage may be beneficial to either the board member or to the managers or shareholders who helped nominate that member.

With respect to investor links, Faccio, Masulis, and McConnell (2006) found, in a sample of 450 firms from 35 countries, that firms had a higher likelihood of a government bailout when they were politically connected. They defined a firm as politically connected if one of its top officers, board members or shareholders was a head of state, government minister, or member of parliament.³⁸ Likewise, Brockman, Rui, and Zou (2013) defined connectedness in a similar manner, although they added a general statement to Faccio et al.’s definition.³⁹ They found that firms that were politically connected performed better than non-connected firms in countries marred by weak legal regimes and high corruption. Hillman, Zardkoohi, and Bierman (1999) and Hillman (2005) take a more focused view and look at US-based political activity and connections. Hillman, Zardkoohi, and Bierman (1999) studied the effects of firm performance when a member of management or the BOD was subsequently appointed to a federal cabinet position or

³⁴ Shi, Markoczy, and Ciprian (2014).

³⁵ Faccio, Masulis, and McConnell (2006); Brockman, Rui, and Zou (2013).

³⁶ Hillman, Zardkoohi, and Bierman (1999); Faccio, Masulis, and McConnell (2006); Brockman, Rui, and Zou (2013).

³⁷ Hillman (2005).

³⁸ Faccio, Masulis, and McConnell (2006: p. 2600).

³⁹ The statement from Brockman, Rui, and Zou (2013) is “The company is closely related to a top politician or party: p. 838.

elected to the US Congress. Using an event study methodology, they found that firms with political connections had higher cumulative abnormal returns (CAR). On the other hand, Hillman (2005) looked at the number of BOD members that were formerly in government in a split sample of firms (high vs. low regulation). She found support for a return on market based, but not accounting based, return measures for politically connected firms.

The mechanisms for positive returns to political connectedness seem intuitively obvious yet are still somewhat unobservable. As with many political activities, rent-seeking and rent appropriation may be the result of cronyism⁴⁰ or it may be the result of optimal hiring and appointment processes at firms. As Parker, Parker, and Dabros (2013) explain, specialized training of linked stakeholders is often underestimated in studies of political linkages while the notion of political favors may be overestimated. From a management standpoint, both mechanisms induce the buildup of significant political capabilities and the increased probability of a competitive advantage. From an RBV perspective, managers that are able to pick the right resources *ex ante*⁴¹ and utilize the capabilities of such choices have the ability to create isolating mechanisms that enable rent-seeking.⁴²

3.2.2 Regulatory and political capture

Another type of link that has been absent from the management literature, yet is crucial for understanding rent-seeking behaviors, is that of regulatory capture.⁴³ Dal Bo (2006) defines regulatory capture in two ways. His narrow definition is that regulatory capture is “the process through which regulated monopolies end up manipulating the state agencies that are supposed to control them.”⁴⁴ The broader definition is that capture is “the process through which special interests affect state intervention in any of its forms...”⁴⁵ While both definitions are important, I focus on the broader definition that includes non-monopolists and varied processes. Non-monopolists can attempt to capture their regulators through hiring former regulators to key positions within the firms they once regulated. In doing so, firms that consistently hire high-level former regulatory employees have both informational advantages and increased access other firms may lack.

⁴⁰ Lessig (2012).

⁴¹ Makadok (2001).

⁴² Barney (1991).

⁴³ Stigler (1971).

⁴⁴ Dal Bo (2006: p. 203).

⁴⁵ *Ibid.*: p. 203.

Additionally, a tacit quid pro quo may exist between the firm and the regulator while the individual is still employed at the regulatory authority. For example, individuals who may want to trade their current position at the regulatory body for a future payoff at the firm (i.e. in a high-level position) may bias their decisions in an attempt to increase the probability of that future payoff. However, regulatory capture may be too narrow a construct. This is true because other governmental entities may also be captured in the process of capability building. In this regard, political capture may be a more appropriate term as firms can attempt to infiltrate other, non-regulatory bodies in government.

3.3 Access

Gaining access to elected politicians is crucial to influence the legislative process. The ability of corporate agents to voice their agendas, either verbally or in writing, has been studied primarily in the area of political contributions. As stated in the introduction, this paper is focused on the US political system and, therefore, what follows is a discussion on this specific system. In the US, firms are legally prohibited from directly contributing to politicians' election campaigns.⁴⁶ Instead, corporations (and labor unions) must manage political action committees (PACs), which are entities that raise money for the purpose of campaigning for an issue or candidate. PACs date back to the mid-1940s and have expanded exponentially to the present day (Center for Responsive Politics). While individuals donate to PACs, those that manage the PAC direct the funds and, therefore, management of a PAC is a crucial activity in the build-up of a political capability.

While PACs are highly influential due to monetary giving, PAC allocations are still limited to relatively small amounts to any one individual candidate.⁴⁷ Lessig (2012) argues that the influence of PACs is more subtle than the explicit quid pro quo that some posit, in that PACs are one part of a more comprehensive strategy that includes activities such as lobbying. Instead of candidates being "bought" by rather small donations, Lessig proposes that candidates may be swayed by certain PAC donations on marginal issues where there is little to no opposition. Additionally, PAC contributions give firms access to politicians who are more willing to spend time listening to entities that help fund their elections,⁴⁸ than those that either do not help fund those elections, or those that fund their

⁴⁶ Federal Elections Commission, www.fec.gov.

⁴⁷ A chart of these limits can be found at <http://www.fec.gov/pages/brochures/contriblimits.shtml>.

⁴⁸ Langbein (1986).

opponents elections.⁴⁹ Strategically, a firm's PAC may be aligned with one political party (In 2008, Goldman Sachs' PAC contributed 64% of its funds to Democrats but this was reversed as Republicans received the majority in 2010 and 2012) or it may have a hedged strategy, whereby the PAC contributes evenly to both parties to ensure that it has a higher likelihood of access once the winning politician is elected (In 2012 Google's PAC contributed 49% of its funds to Democrats and 50% to Republicans).⁵⁰ Additional PAC strategies include contributing to those in specific positions, such as a position that affects the firm's industry or a position of power in a legislative body, such as a committee head.⁵¹

The academic literature has studied PACs in a number of fields. Grier, Munger, and Roberts (1991) found that industries that are more concentrated have more PAC activity. In another study of the determinants of PAC formation, Hart (2001) finds that both highly regulated firms and those that have higher sales to government entities are more prone to form PACs. Ozer (2010) finds that firms with top managers who are individually politically active are also politically active, especially in the presence of TMT heterogeneity. Other papers have attempted to measure the outcomes to PAC donations. Brown (2016) found that PAC contributions were associated with greater financial performance, while Hersch, Netter, and Pope (2008) found no evidence of improved performance. Cooper, Gulen, and Ovtchinnikov (2010) found that PACs were associated with higher stock market returns, especially those PACs that donated to Democratic candidates, members of the House of Representatives and candidates in the state where the firm was domiciled.

3.4 Influence

It should be noted that influence over the political process is the goal of many of the aforementioned political activities. Influence has been the focus of multiple CPA papers⁵² as the crux of having a political strategy to influence those in power to change, keep or remove the rules that currently apply or to impede proposals that may apply in the future.⁵³ While lobbying has been ever present in management-based CPA studies,⁵⁴ there has been an over reliance on lobbying

⁴⁹ Lessig (2012).

⁵⁰ Data retrieved from the Center for Responsive Politics at www.opensecrets.org.

⁵¹ AT&T's 2012 Annual Report.

⁵² Balla (1998); Golden (1998); Yackee and Yackee (2006).

⁵³ Oliver and Holzinger (2008).

⁵⁴ Lux (2016).

expenditures as a key variable.⁵⁵ Lobbying expenditures are a crucial figure and a signal of the relative importance of political action in a cross-section of firms. However, the establishment of a capability at the firm level entails more than just simply the number of dollars spent in a specific area. In other words, expenditures on lobbying give only a small piece of the overall lobbying activities that firms may be engaged in. In this section, I will address this gap by establishing multiple activities that are involved in the lobbying process. This is important for the following reason. From a capabilities perspective, one must establish that firms are not just spending money to hire contractors for negotiating with regulators or legislatures. This focus on contracting fails to give credence to firms that proactively strategize around public policy.

Lobbying is multi-dimensional and includes numerous activities. What follows is a two part breakdown of the types of lobbying that firms can take part in as well as the mechanisms by which policy can be changed to the firm's advantage. The types of lobbying include contract lobbying, internal lobbying, and collective lobbying.⁵⁶ The mechanisms that firms employ at either the legislative or regulatory level include issue initiation, comment period activity, and regulatory interactions.

3.5 Types of lobbying

3.5.1 Contract lobbying

Lobbying is the most actively researched political activity in the CPA literature to date.⁵⁷ Theoretically, lobbying is viewed as a pressure tactic that allows firms to manage outcomes in their non-market environment.⁵⁸ Contract lobbying, or external lobbying, is the process of hiring a firm whose expertise centers around government relationships.⁵⁹ Lobbying firms hire individuals who have served in different government capacities, either as elected officials, aides to elected officials or in regulatory bodies.⁶⁰ Firms that have access and influence with governing bodies have the ability to change legislation or regulatory rules in the absence

⁵⁵ Brasher and Lowery (2006).

⁵⁶ Hillman and Hitt (1999).

⁵⁷ I found, in a search using the Web of Science Database, that of all papers that identify a specific political activity, lobbying is studied in 31 percent of published papers.

⁵⁸ Boddewyn (2003).

⁵⁹ Gabel and Scott (2011).

⁶⁰ Kaiser (2009).

of strong opposing pressure.⁶¹ Firms that lack such access must formulate strategies around the rules set by elected officials and regulators since they are unable to directly take part in the legislative process.⁶²

Therefore, the need to lobby can be thought of as both a market response and a non-market response. The market response lies in the fact that the primary goal of changing public policy (the non-market response) is to decrease the focal firm's cost structure⁶³ or increase its market power.⁶⁴ It must do so through proactively initiating policy or reactively changing policy-in-process.⁶⁵ These governmental pressures force the firm to interact with legitimate central authorities; however, the goal is to better compete against others in the firm's competitive space.

There are a number of papers that address external lobbying activities in the management literature. Evidence for antecedents of external lobbying can be found in Schuler, Rehbein, and Cramer (2002), Hadani (2012), and Mathur et al. (2013). Antecedents that were both significant and positively associated with external lobbying include firm size, industry concentration, and industry political rivalry. Well-governed firms and firms with large blockholders, had negative associations with external lobbying activity. Several papers measure the outcomes to lobbying, with the majority having a positive and significant finding. These include: (i) Richter, Samphantharak, and Timmons (2009) found that firms that lobby had lower marginal federal tax rates; (ii) Lee and Baik (2010) found a positive association between lobbying and anti-dumping disbursements; and (iii) Mathur et al. (2013) found that lobbying expenditures were associated with increased market value.

As noted by past scholarship,⁶⁶ the process by which lobbyists influence legislators and regulators is partially, if not mostly, unobservable. Lessig (2012) argues that the influence that many external lobbyists have, especially with legislatures, is in "tabling" potential legislation that would be harmful to the competitive conduct of the client-firm. Tabling is the process by which legislation is postponed or rescinded in the face of differing pressures. In the US, and similar political systems, this action is feasible because legislation is first introduced by a small committee of legislators who have the power to withhold the legislation from ever being presented for a vote. Since this process is relatively secretive, and at least partially unobservable, it is difficult to study and measure with standard empirical techniques.

⁶¹ Lessig (2012).

⁶² Gely and Zardkoohi (2001).

⁶³ Richter, Samphantharak, and Timmons (2009).

⁶⁴ Stigler (1971).

⁶⁵ Yackee and Yackee (2006).

⁶⁶ Hillman and Hitt (1999); Richter, Samphantharak, and Timmons (2009).

However, some studies in the public policy and political science literature have provided evidence of certain observable behavior. Yackee and Yackee (2006), for example, studied the changes in bureaucratic rule making when lobbying was present. They found that business interests are more effective than non-business interests when it comes to the changes in regulatory rules from start to finish. In other words, businesses that lobby were literally able to change the rules that they will have to compete by, giving these firms the potential for rent extraction in future time periods.

3.5.2 Internal lobbying

External lobbying has been the most prevalent form of lobbying studied by academics; however, internal lobbying is also crucial to the formation of a political capability. Internal lobbying includes the same aforementioned pressure tactics with the exception of the specific people applying the pressure. Internal lobbyists are direct employees of the firm who lobby for their employer and often have similar backgrounds as external lobbyists. Schuler, Rehbein, and Cramer (2002) included measures of both internal and external lobbying and found that firms that form a PAC are more likely to have inside lobbyists than outside lobbyists. Bonardi, Holburn, and Vanden Bergh (2006) study the effect that inside lobbying has on price increases for electric utilities. They measured the use of inside lobbying as the experience that a firm's employees had with rate-increase reviews. This measure is an important divergence from the more often included monetary expenditure on lobbying and they found that this experience was associated with increased performance in a sample of electric utilities in the US.

3.5.3 Collective lobbying

Lobbying activities can also take place at the industry level, as opposed to the individual firm level. This collective lobbying is almost exclusively performed on an external contracting basis as entities performing industry-wide lobbying are, by definition, set up outside of the participating firms (i.e. interest groups). Much of the literature on collective lobbying is based on Olson's (1965) theory of collective action and public goods since the outcomes of a collective process cannot be parsed out to individual firms that participate.⁶⁷ It is often predicted in collective action papers, therefore, that the more concentrated an industry, the more it is

⁶⁷ Hart (2003); Ozer and Lee (2009); McKay (2010); Barber, Pierskalla, and Weschle (2014).

likely to collectively act since atomized markets are more difficult to coordinate participants.⁶⁸

Since participants are also fierce competitors, the question of why firms would partake in such collusive activity may be asked. In this case, the need to garner competitive advantage over rivals includes a new class of rivals, namely nascent but potential entrants. As Stigler (1971) explained, firms may collude to pressure policy makers to give the incumbents "...control over entry by new rivals."⁶⁹ Raising entry barriers and blocking new entrants⁷⁰ is the most argued cause of collective political behavior⁷¹ as the individual effect to this type of lobbying should be reduced or eliminated. In fact, incumbents may even invite regulation where little to no regulation exists since the incumbents' payoff to such added constraints far outweigh the loss of market share and profitability from the presence of more numerous competitors.⁷²

Industry trade groups are the most utilized collective lobbying mechanism employed by groups of firms.⁷³ For example, the National Cable and Telecommunication Association (NCTA) represents firms in the named industries and spent nearly \$20 Million in 2013 lobbying government officials. In addition to having a presence in Washington DC, the NCTA takes positions that promote the agenda of its members through external lobbying, issue initiations and involvement in rule making. The NCTA directly lobbied a number of high-level US governmental offices in 2013 including (i) the US Senate, (ii) the US House of Representatives, (iii) the Federal Communications Commission (FCC), (iv) the Department of Justice (DOJ) and many other similar entities. It issued reports that attempted to mold current legislation and regulatory rules, including issuing hundreds of reports to dozens of agencies on over 50 specific pieces of legislation.⁷⁴

3.6 Lobbying mechanisms

Three areas of pressure are the most prevalent regardless of the specific type of lobbying organization (i.e. individual vs. collective, external vs. internal): issue initiation, rule-making commentary and regulatory interactions. Discussion on

⁶⁸ Brown (2011).

⁶⁹ Stigler (1971: p. 5).

⁷⁰ Markman and Waldron (2014).

⁷¹ Drope and Hansen (2009).

⁷² McAdams (2014).

⁷³ Center for Responsive Politics, www.opensecrets.org.

⁷⁴ All data retrieved from the Center for Responsive Politics.

these three specific activities has been notably missing from CPA papers that include US political data. While empirical papers studying CPA have included expenditures on lobbying, which of course partially pick up these activities, a focus on capability-building must include the specific efforts (and not just money spent) that firms employ in order to be legitimately based on the RBV.⁷⁵

3.6.1 Issue initiation

Issue initiation includes attempts by firms to sway legislatures by taking specific and official positions on issues in front of elected and appointed officials. Issue initiation is, in essence, a lobbying strategy in that its purpose is to influence those in power.⁷⁶ For example, in 2013, Google weighed in on 201 specific issues including those that addressed intellectual property, telecommunications, labor policy, immigration, taxes and many others. In addition to these broad categories, firms also write reports on specific proposed legislation. As an example, in the same year, Google wrote 18 different reports on H.R. 624 – The Cyber Intelligence Sharing and Protection Act.⁷⁷ These reports, written by either internal or external lobbyists, are important to a firm's ability to shape legislative policy to their benefit.⁷⁸

3.6.2 Rule-making commentary

Similar to issue initiation, comment period activity is the activity where firms comment on rules that are in the process of being written by regulatory bodies.⁷⁹ Regulatory rulemaking is a multi-step procedure whereby initial drafts of rules are subsequently changed after public comment periods.⁸⁰ While any person or organization can attempt to alter a rule during this period, current evidence indicates that those organizations that are most affected by the rule, and those organizations with the most resources, are more prone to help shape the process.⁸¹ Since regulators have the authority to make the rules associated with firms' market

⁷⁵ Barney (1991).

⁷⁶ Center for Responsive Politics.

⁷⁷ *Ibid.*

⁷⁸ *Ibid.*

⁷⁹ Balla (1998).

⁸⁰ Nixon, Howard, and DeWitt (2002); Yackee and Yackee (2006).

⁸¹ Golden (1998).

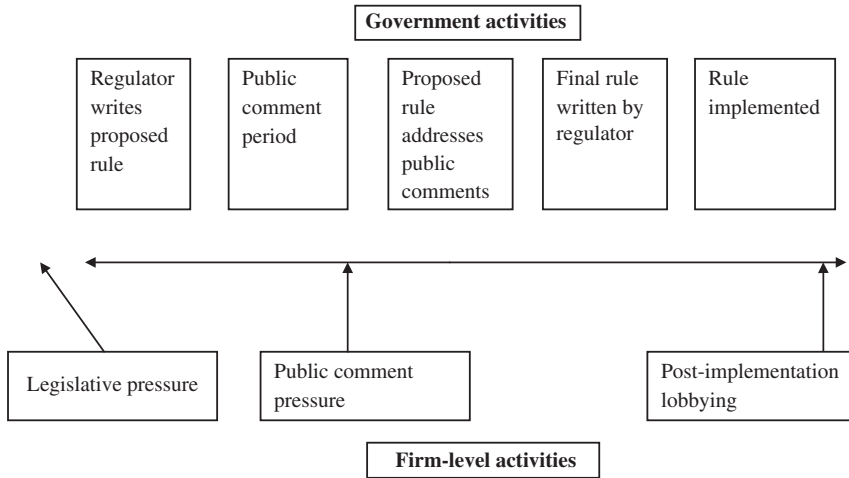


Figure 2: Regulatory rulemaking timeline.

behaviors, taking part in the rule-making process is an incredibly important political activity, although it has generally been ignored in the management literature. Figure 2 depicts the time line of a regulatory rule-writing and implementation procedure. Rulemaking is commenced once legislation has been passed and signed into law. Following the legislative process, regulators are empowered to implement the legislation with specific rules aimed at clarification and codification. In Figure 2, the government's actions are above the time line and the firm's pressure tactics are below the time line. Note that there is a wide variance in the amount of time that it takes to implement a rule (and specific time intervals are therefore omitted). This process can be relatively quick, in terms of months, to exponentially longer. For example, the Dodd-Frank Wall Street Reform and Consumer Protection Act became law in 2010, yet the rules associated with the law had not been finished in 2014.⁸²

3.6.3 Regulatory interactions

Dahan (2005) proposes that interactions between firms and regulators are part of a proactive strategy that helped firms earn position reputational capital with central authorities. This type of interaction constitutes another dimension of

⁸² DiPietro (2014).

lobbying as the repeated nature creates constraints that binds management's decision-making (Axelrod 1984). The process by which firms interact on a regular basis with regulators is somewhat industry-specific and regulator-specific. For example, mobile communications firms have a primary regulator in the US – the FCC – and, therefore, it is easier to establish relations between a firm's employees and the regulator's employees. In addition to the FCC, however, mobile communications firms must also interact with the Securities and Exchange Commission (SEC), the Federal Trade Commission (FTC), the Occupational and Safety Health Administration (OSHA), the DOJ and other regulators at both the federal, state and local levels. The interaction with the FCC, as the primary regulator, is subject to repeated interactions where the firm may garner positive reputational capital. In addition to Dahan's (2005) theoretical description, Bonardi, Holburn, and Vanden Bergh (2006) empirically studied this type of interaction in a sample of electric utilities and found that this repeated interaction was associated with higher performance. Therefore, regulatory interactions for firms with high levels of oversight are a crucial activity to focus on when nurturing political capabilities since the reputational effect of such a relationship are integral.

However, firms that have ancillary regulators (such as those named above for mobile communications firms with the exception of the FCC) or firms that are lightly regulated and, therefore, come into contact with central authorities on more of an ad hoc basis, have a smaller propensity to be able to garner relational rents from repeated actions. The use of external lobbyists in ad hoc situations may aid firms that are sporadically regulated since external lobbyists have the ability to specialize their skills. Hiring specialized lobbyists to interact with regulators may have a positive reputational effect through a certification effect,⁸³ as the firm is borrowing the lobbyist's reputational capital in areas where the firm cannot garner one for itself.

4 Integrating the capability-producing mechanism

The activities presented in the current paper can be performed at the firm-level with varying intensities. Both the breadth and depth of political action can be measured. In terms of breadth, firms can engage in any number of the activities listed. With respect to depth, firms can decide which, if any, of the activities is

⁸³ Hsu (2004).

most likely to garner a competitive advantage in the product and service markets in which they compete. However, firms that compete through a political capability must embrace all four sectors (structure, linkages, influence and pressure) to some degree. Note that this does not imply that operating through a political capability is optimal for all firms; instead, some firms may choose to target certain activities. In this case, the targeted approach may complement other capabilities that the firm possesses but would fall short of allowing the firm to claim that it is competing through a political capability.

4.1 Interplay of factors: structure's role on linkages, access and pressure

Figure 3 describes the integration of the four sectors. The alignment of the firm's strategy and structure is crucial for any capability development, political capabilities included. As such, having a division dedicated to governmental affairs in a prevalent position is crucial for both intra-firm resource appropriation⁸⁴ and for appropriate resource picking.⁸⁵ This makes both intuitive and theoretical sense – it is difficult for complex organizations to decide where to allocate resources into links, influence, and pressure absent a key division dedicated to such activities. As Parker, Parker, and Dabros (2013) posit, human capital in such divisions have two distinct advantages, namely political connectedness and specialized training. Both traits are needed for firms that interact with the public sector and, therefore, being able to target these individuals is of primary importance to the structural composition of the firm. These individual employees form one link to government, yet the governmental affairs division can also help to target key investors and BOD nominees that may forward the firm's agenda.

The government affairs division is also crucial to the access and pressure factors because there needs to be an internal decision-making mechanism to allocate finite resources to the most effective places.⁸⁶ Political campaign contributions, made through the firm's associate PAC(s), need to be targeted toward electing or defeating candidates that would most hinder the firm's ambitions. This may include information-gathering on a candidate's past record, their current or potential position in government and his or her ties to business and community opposition (i.e. the firm's opponents). Much of the previous literature,

⁸⁴ Coff (1999).

⁸⁵ Makadok (2001).

⁸⁶ Doh et al. (2014).

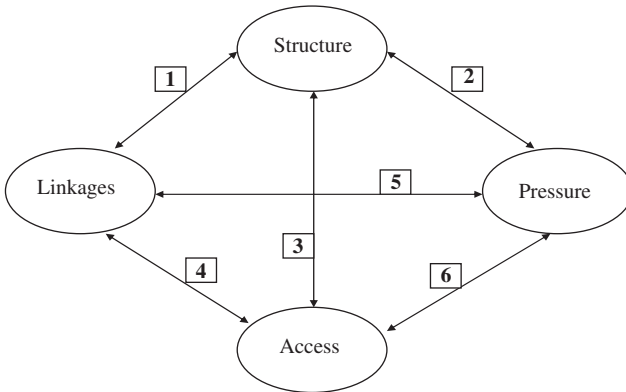


Figure 3: Interplay of factors.

Note 1 Structure and Linkage: Appropriate structure, through a salient government affairs division is crucial to develop key linkages as having internal specialists able to pick the appropriate links to specific government functions entails having specialized employees capable of accomplishing this task. Linkages, on the other hand, enhance the pool of future potential employees able to work in the government affairs division.

Note 2 Structure and Pressure: Appropriate structure aids the firm in picking the specific lobbyists that are best suited for targeted campaigns for similar reasons as in Note 1. Pressure may aid structure in future periods as government officials may ease constraints on the firm in the hope of a position within the firm's structure later.

Note 3 Structure and Access: Appropriate structure aids the firm in accomplishing optimal access to elected officials. PAC formation, management and allocation decisions are optimized if knowledgeable employees within the firm are able to target the right politicians. Access may aid structure in future periods as government officials may ease constraints on the firm in the hope of a position within the firm's structure later.

Note 4 Linkages and Access: Firms with links to multiple facets of government increase access to both elected leaders as well as appointed regulatory officials. High profile linkages, such as former cabinet members, on the firm's BOD increase access to officials at high levels of government. Access then aids in information flow to the firm as to which linkages are optimal to nurture.

Note 5 Linkages and Pressure: Firms with strong government links aid in pressuring both elected and appointed officials because the firm is more able to target the key areas and government employees that need to be influenced. This pressure, conversely, informs the firm as to which links are truly valuable versus those that are less valuable.

Note 6 Access and Pressure: Access and pressure complement each other as PAC targeting and allocation and lobbying targeting and allocation may help the firm to both reduce the politician's campaign needs while allowing the firm to nurture certain relationships more intensely.

while counting firm-level PAC contributions, has neglected the role that internal divisions at the firm have in resource picking. A parallel argument is made concerning pressure tactics that the firm utilizes. In other words, while the hiring of

external lobbyists is important, how does the firm know which lobbyists to hire? Absent key individuals with this decision-making role, hiring key external lobbyists to interact with the government, and on behalf of the firm, is not optimal as firms may resort to hiring the largest or most well-known firms. These lobbying firms may or may not have the ability to deliver value-creating relationships with the specific governmental units needed.

4.2 Interplay of factors: linkage roles on structure, access and pressure

The political linkages formed are also crucial for the remaining factors. First, information gathering is a crucial task for TMTs and external information sources play an integral role in feeding decision-makers with the most appropriate cues. Firm to government linkages allow firms to have an information advantage over rivals, conditional on the breadth and depth of such links.⁸⁷ Links to regulatory bodies, accomplished through regulatory capture practices, give firms a higher probability of obtaining this vital information as individuals from regulatory bodies keep connections to those entities after entering the private workforce. Other forms of political capture, for example hiring ex-legislatures, also insure higher probabilities of information flow that may aid the firm in proactive or reactive public policy responses.

Links, especially those to politically-connected investors and BOD members, complement the firm's access and pressure activities. Internal lobbying activities, for example, can be tasked to those individuals who have the most clout. Board members and notable, large shareholders have the ability, and more importantly the incentive, to help shape public policy to the firm's advantage through their connections.⁸⁸ In addition, access to important government actors may be accomplished through firm ties instead of, or in addition to, political contributions to politicians.

4.3 Interplay of factors: the impact of access and pressure

The impact that access and pressure have on each other and the other two factors are less clear. One situation where access and pressure may help firm structure

⁸⁷ Hillman (2005).

⁸⁸ Hillman, Zardkoohi, and Bierman (1999).

is through the supply of future employees who are politically connected. As Parker, Parker, and Dabros (2013) posit, lobbying could be viewed as “...ex-post payments for *ex ante* legislative assistance...”⁸⁹ Therefore, lobbying politicians or regulators may have, in addition to a current benefit of policy adaptation, a secondary future benefit. As stated in the introduction, firms may eventually hire those individuals who they once lobbied (e.g. Facebook, Uber, etc.), thereby making the structural and linkage factors more robust.

Access and pressure also complement each other. Schuler, Rehbein and Cramer (2002) argue that PAC contributions and lobbying efforts are complementary activities in that performing both increases the chances of access to politicians. Lessig (2012) makes a similar argument and adds that using a combination of political tactics helps to gain access to politicians’ busy schedules and allows them to make cases for their agenda (i.e. pressure). Additionally, since elected politicians have spent an ever-increasing number of days during their tenure raising money for future elections, willing firm-level donations reduces the incremental amount of time politicians need to perform such activity, and thereby frees up time to be convinced of policy changes (Kaiser 2013).

4.4 Political capability continuum

Clearly, firms have differing levels of involvement in the political arena. While some firms may fully commit to establishing a political capability, which entails employing the majority of activities proposed herein, many firms will stop short of committing that level of resources. Figure 4 is a political capability continuum that can begin to define categories relative to this development. Where a firm falls on the continuum is the result of numerous factors including its primary industry, level of regulation, perception of public policy’s importance to corporate decisions and outcomes, competitive pressures by rivals’ political activity and the like. Firms are situated into one of five categories: Apolitical, Ad Hoc, Middling, Targeted and Full. A brief description of each category follows⁹⁰:

- Apolitical firms do not engage in political activity.
- Ad Hoc firms utilize political activities when and if they are needed but do not employ consistent structures and processes as described above. Firms in this category, for example, may hire external lobbyists in the face of new regulation.

⁸⁹ Parker, Parker, and Dabros (2013: p. 427).

⁹⁰ Also see forthcoming paper, Brown (2016), in *Business and Politics* for empirical examples corresponding to the continuum.

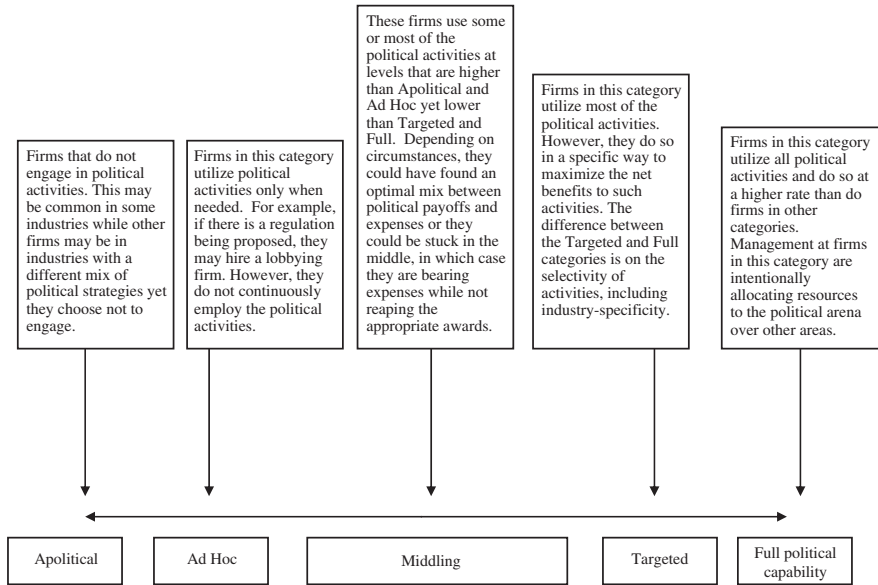


Figure 4: Political capability continuum.

- Middling firms use some of the political activities from Figure 4. Middling firms do not possess political capabilities *per se*; however, they possess enough resources to be competitive in these areas relative to the Apolitical and Ad Hoc categories.
- Targeted firms utilize most of the political activities from Figure 4. However, they do so in a way to maximize the net benefits to such activities. For example, Targeted firms may surmise that they reap little benefits from one political activity and excess benefits from another. As this becomes known, Targeted firms allocate resources surgically as opposed to blanketing the firm with all available political options.
- Fully capable firms are those that employ all political strategies. Management at firms in the full capability category are signaling that competing in the non-market is of utmost importance and they are making intended resource allocation choices that increase resources in CPA, sometimes to the detriment of other areas within the firm.

5 Discussion

In this paper, I contribute to the literatures on capabilities theory and CPA by de-compartmentalizing the activities needed for firms to attain a political capability.

Although Oliver and Holzinger (2008) and Holburn and Zelner (2010) introduce the notion of political capabilities, there still lacks an actionable definition of what this capability entails. Even more important, there has been very little discussion to date as to the interplay of different activities and the commitment that firms need in order to effectively shape public policy. There are many high quality papers in the CPA literature. However, many limit their definition of political activity to one or two specific activities, while avoiding others that are equally as important. For management scholars, the RBV and capabilities theory have been immensely influential over the past 25 years, yet management-based CPA papers have yet to fully model more than a few choice types of political actions.

The main contribution of the present work is in expanding the definition of political activities by incorporating capability commitment to the fragmented literature on specific activities covered in these previous papers. This is an important contribution given the important role of government in the private sector, as evidenced by the number and complexity of new legislation and regulatory rules,⁹¹ has increased over time. A second, and equally important, contribution is in producing an actionable activity-based framework for both scholars and managers. While previous research⁹² has given present researchers the ability to utilize theory with respect to political capabilities, it has fallen short of being actionable. In other words, can a framework guide both academics who study CPA and managers who practice CPA? Finally, I contribute to the literature that focuses on activities in capability development as opposed to measuring expenditures to proxy capability development. The vast majority of CPA papers measure monetary spending on items such as PACs and lobbying. However, expenditures only tell us a partial, and often noisy, story about the effectiveness of *ex ante* managerial decision-making. A firm may expend financial resources to areas where they lack human resources. Therefore, if one measures antecedents or outcomes against these expenditures, it tells us little about the relationship between the antecedents or outcomes against activities.

5.1 Limitations

Like most papers, this paper has limitations. As part of the limitations section, I include a number of areas that should be addressed by future scholars. Hopefully, extensions to the current framework can be made by others to address the

⁹¹ US Federal Register, www.federalregister.gov.

⁹² Oliver and Holzinger (2008); Holburn and Zelner (2010).

following issues: comparative institutional settings, dynamic political capabilities, and the relationship of political capabilities and firm performance.

5.2 Comparative institutional settings

The present paper is focused on firms that operate in the US and similar political institutions. The main limitation is that portions of the models presented here will not hold in differing institutional environments. Political activity in multiple institutional environments has been studied by Faccio, Masulis, and McConnell (2006) and Brockman, Rui, and Zou (2013) and has been found to have an effect on political activity. How can the models presented in this paper accommodate these settings? First, future scholars can adjust the political capability models in this paper to better suit other settings. This may not change the structure or linkage factors as much as it changes the ways in which firms gain access and the ability to pressure. There is a difficulty in incorporating too many different institutional and geographic factors. As an example, here is an excerpt on Germany's campaign financing rules published by the US Library of Congress:

German election laws and campaign finance laws differ significantly from those of the US. In Germany, the political parties are tightly run organizations that finance election campaigns, nominate candidates, exact membership dues from their members, and subject members in Parliament to strict caucus rules. The parties receive government funds and are subject to some not very onerous disclosure requirements. The individual candidates or members of Parliament are minor players in these systems.⁹³

The differences between the US system and Germany only highlight the difficulty in comparative studies. This is true because the US and Germany are both federal-style republics and, therefore, quite similar to one another.⁹⁴ Yet, in spite of this similarity, the mechanisms by which firms influence officials and campaigns are very different. When countries become even more disparate politically, these mechanisms change drastically.⁹⁵ For example, in countries with high corruption, lobbying activities are ineffective due to overt side payments to officials in control.⁹⁶ Therefore, studies of political activity in multiple settings may be more effective when one variable (i.e. lobbying) is studied as opposed to a myriad of

⁹³ Found at <http://www.loc.gov/law/help/campaign-finance/germany.php>.

⁹⁴ US Central Intelligence Agency Factbook, www.cia.gov/library/publications/the-world-factbook.

⁹⁵ Brockman, Rui, and Zou (2013).

⁹⁶ Campos and Giovanni (2007).

activities such as those proposed in this paper. Qualitative studies, however, may be an optimal starting point for studying the political activity repertoire between firms that operate in multiple institutional settings.

5.3 Dynamic political capabilities

Oliver and Holzinger (2008) discuss dynamic political capabilities, whereas I have discussed political capabilities without the explicit distinction of static versus dynamic. Since this paper is a first attempt at an actionable political capability definition, one goal was to make the content focus on the actions and not as much on the theoretical minutiae. However, in defining political capabilities in this paper, I acknowledge in previous sections that part of possessing these is in the flexibility it gives to firms when the political landscape changes. Inherent in this argument is the ability to adapt as public policy adapts and this entails a dynamic perspective to the capability. If one defines capabilities as routines or processes to make a living⁹⁷ and dynamic capabilities as organizational learning in an effort to renew itself in the face of new information,⁹⁸ then clearly it is optimal for firms to possess dynamic capabilities. However, since I was more interested in the activities-routines-capabilities progression, the dynamic aspect is more implicit in the present definition of political capabilities. Future scholarship should include a richer discussion of the dynamic processes that firms may employ in order to renew current resource stocks in the face of new and valuable information.

5.4 Firm performance

Outcompeting rivals is the end goal for capability building (Barney 1991).⁹⁹ In the capabilities literature, measuring the ability to outcompete is often accomplished by studying firm performance. While building a capability has been associated with better economic performance,¹⁰⁰ there is also evidence that this is not always the case.¹⁰¹ The reason that forming a capability is not a guarantee of rela-

⁹⁷ Winter (2000).

⁹⁸ Teece, Pisano, and Shuen (1997).

⁹⁹ Barney (1991).

¹⁰⁰ See Newbert (2007) for a meta-study of this relationship.

¹⁰¹ Drnevich and Kriauciunas (2011); Schilke (2014).

tive financial success lies in the costs associated with establishing the systems, structures and practices in specific areas. It is conceivable that firms that operate through political capabilities may see a negative net benefit from their activities in terms of typical performance measures. A recent paper, Hadani and Schuler (2013), found that political investments were negatively related to both market value and accounting returns (measured by amount of equity and return on sales, respectively) in a longitudinal study of S&P 1500 firms.

There are a number of ways to tie the outcomes to political capability building to firm performance. First, future researchers can utilize the same types of measures used in many management-based CPA papers. These include profitability measures (ROA, ROS, ROIC) and market based measures (stock price, market value of equity, Tobin's Q). However, there is also the opportunity to begin to measure performance in other ways, such as market power, the proportion of PAC dollars distributed to winning candidates, the effect that lobbying on specific legislative proposals has on those proposals being enacted (or conversely, the effect that lobbying against specific legislation has on it being quashed) and the amount of positive change to regulatory rules from initiation to completion. Market power has been used in prior management studies¹⁰² but not as a dependent variable in CPA research. The other three suggestions are more direct outcomes of political activity and are relatively easy to measure. An additional proposal may be to study a two-stage process, where the first stage models the political activities on these four alternative performance measures, followed by second stage models that regress these new measures against financial or market success.

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