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Lobbying, political connectedness and financial performance in the air transportation industry

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ABSTRACT

While there is a deeper understanding of the outcomes to firm-level political activities in general, there are very few papers that address this relationship in transportation studies. In this paper, I empirically test firm-level rent-seeking through corporate political activity (CPA) in the air transportation industry. I find, in a sample of 46 firms over 15 years, that lobbying intensity and political connections are positively related to subsequent profitability in both fixed-effects and random-effects estimations. I also test the interaction of these two main effects and find mixed support for the moderating effect of political connections on lobbying intensity. This paper contributes to the theoretical literature on political rent-seeking and the topical literature on political action in air transportation.

1. Introduction

The literature on corporate political activity (CPA) has been integral in understanding how private firms interact and compete in the non-market (Baron, 1995). It has been argued that non-market activities are employed to extract private benefit from governmental authorities (i.e. rents). Even though research in transportation studies should be prime grounds for testing such rent extraction techniques, there has been a relative dearth in transport-specific studies that model firm-level political action with either determinants or outcomes. Several studies have addressed the political process in transportation markets, including Brach and Wachs (2005), who studied earmarking trends at the Department of Transportation; Antonson (2014), who qualitatively studied public participation in the rulemaking process in the transportation industry in Sweden; and deWit (2014), who studied protectionism between European commercial air carriers and their home governments during the perceived threat of its market territory by Gulf carriers. However, none of these studies have modeled the effects of firm-level political activity with performance variables. One paper that has addressed the results derived from public policy participation is Wessling et al. (2014), which studied how collective lobbying efforts materialized as a reaction to California's emission standards after 2000.

While these papers have all lead to more understanding of political activity in the transportation market, they still leave a wide gap in the literature. This is true for two reasons. First, there are simply too few papers that have addressed the specific causes and outcomes to CPA in transportation-based industries. Secondly, the papers that have been published are quite disparate in their goals and, therefore, have studied the phenomenon in quite idiosyncratic ways. In this paper, I intend to add to the existing literature on CPA and transportation by modeling the outcomes to firm-level CPA in a sample of air transportation firms over a 15 year period. By doing so, I contribute to both the literature on political action, which has called for more empirical testing of such relationships (Lux et al., 2011), and the literature on air transportation, which has just begun to study such relationships.

The rest of the paper is structured as follows. Section 2 includes a literature review as well as theory and hypothesis development. Section 3 is the theory section and includes hypotheses development. Section 4 explores the methods employed as well as the estimation technique and variable descriptions. Section 5 is the results section and Section 6 is a discussion, including limitations and future research.

2. Literature review

2.1. Literature gap and contribution

To date, there has been little empirical research on the antecedent conditions and outcomes to firm-level CPA in the transportation industry, generally, and the air transportation market,

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specifically. On the other hand, there has been a robust literature concerning regulation in such industries and markets. While these can be viewed as different literature, there is a link as firm-level political action is often a response to legislative lawmaking and/or regulatory rulemaking (McKay, 2011). For example, some air transportation papers have qualitatively studied the regulation of airports, including airports in Europe (Charlton, 2009; Littlechild, 2012a; Simonelli and Caroli, 2013; Ballart and Guell, 2015), Australia (Littlechild, 2012b; Arblaster, 2014), and South America (Bettini and Oliveira, 2008). In addition to a geographic focus, other papers have been more topical; for example, Domingues et al. (2014) studied air cargo security, while Carlsson and Hammar (2002) looked at tradable emission permits in the regulation of allowable CO2 levels. It is, therefore, surprising that with a robust literature on regulation in transportation, there is a much less robust literature on corporate reaction to such regulation.

In the transportation regulation literature, the unit of analysis has been at the regulation level. At the firm level, however, there needs more emphasis on both the types of firms that may attempt to challenge such regulatory actions, as well as the performance benefits that flow to politically active firms. One exception mentioned above is Wesseling et al. (2014), which used a longitudinal case study to model automobile manufacturers' responses to California emissions standards. While this is tangentially related to the current paper's focus, it is both methodologically different (longitudinal case study vs. econometric study) and different in its unit of analysis (industry-level vs. firm-level).[1] Therefore, the gap that is addressed here is in econometrically modeling the benefits to firm-level performance associated with corporate political activities in the transportation sector, and more specifically, the air transportation market.

2.2. Corporate political activity

The corporate political activity (CPA) literature can be decomposed into several different sub-literature, namely (i) Types of CPA, (ii) Antecedents to CPA, and (iii) Outcomes to CPA.

2.2.1. Types of CPA

While CPA entails a broad range of activities, lobbying and political connectedness have constituted an important segment of the CPA literature in recent years. Lobbying can be defined as an influence and/or pressure activity whereby firms attempt to shape public policy toward their favor (Lessig, 2012). More specifically, lobbying activities can be focused on influencing elected legislators (McKay, 2011), non-elected regulators (Wesseling et al., 2014), Presidents or Prime Ministers (McGrath, 2013) and even judges (Caldeira et al., 2000). The majority of current lobbying research addresses the area of bureaucratic lobbying as it is more prevalent (Boehmke et al., 2013) than is its legislative counterpart. Put simply, the majority of lobbying-focused research has attempted to study the influence of non-elected regulators (Balla, 1998; Nixon et al., 2002; Duso, 2005; Yackee and Yackee, 2006) during periods of rule-making since this is where private benefits to lobbying yield the highest probability of rent extraction (Brown, 2016a).

Another major area of CPA research has been political connectedness. This literature stream focuses on firm-level connections to present or past governmental figures. Several types of links have been proposed, including (i) investor–government links (Faccio et al., 2006; Brockman et al., 2013), (ii) management-government links (Hillman et al., 1999; Faccio et al., 2006; Brockman et al., 2013), and (iii) board of director-government links (Hillman, 2005). Such links add value to firms by increasing the likelihood of garnering important information (Hillman et al., 1999) from governmental entities or because of rent extraction through bypassing government hurdles (Brockman et al., 2013).

2.2.2. Antecedents to CPA

There is also a literature on the determinants to firm-level CPA. At the industry level, scholars have modeled the relationship between industry structure and political activity (Grier et al., 1991), the level of industry regulation and the firm-level propensity to be politically engaged (Martin, 1995; Hart, 2001), the level of competition from foreign firms (Schuler, 1996; Lee and Baik, 2010; deWit, 2014), the level of competition from other pressure groups (Antonson, 2014) and the degree of unionization in the firm's primary markets (Schuler et al., 2002). At the firm level, a number of determinants have been studied including top management team influence (Ozer, 2010), institutional ownership and managerial entrenchment (Hadani, 2012; Mathur et al., 2013),[2] and firm size (Lux et al., 2011; Lux, 2015). The generalized findings are that there is a positive relationship between industry structure, industry regulation, industry unionization, and firm size with corporate political activities and a negative relationship between institutional ownership and corporate political activities.

2.2.3. Outcomes to CPA

A less studied relationship is the firm-level outcome to political activity. Several scholars have called for more empirical testing of this relationship (Hillman, 2005; Oliver and Holzinger, 2008; Lux et al., 2011), especially in differing contexts. To date, there is evidence of CPA's link to market returns (Hillman, 2005), accounting returns (Hillman, 2005; Richter et al., 2009; Brown, 2016b), utility pricing returns (Schuler et al., 2002), earmarks (Brach and Wachs, 2005), acquisition success (Brockman et al., 2013), and bailout success (Faccio et al., 2006; Blau et al., 2013). While some empirical studies have found no relationship between CPA and measurable returns (Hadani and Schuler, 2013), the vast majority have found that CPA is significantly and positively related to the above named outcomes.

3. Hypotheses development

3.1. CPA as rent-seeking

Organizational rent-seeking is a common theme in CPA-performance relationship to date (Faccio et al., 2006; Oliver and Holzinger, 2008; Hadani and Schuler, 2013). According to this argument, firms allocate resources toward activities that allow them to expropriate value from their external environment. These activities can be executed in the market or in the non-market (Baron, 1995), the latter including the public policy arena, where firms attempt to mold laws toward their advantage for private gain. At the federal level in the U.S. political marketplace, this entails activities directed toward either the legislative realm or the administrative realm (McKay, 2011).

[1] Another paper—Wesseling et al., 2015—call for future research on lobbying in this sector.

[2] This line of research has evidenced several interesting findings, including that firms with entrenched management (i.e. less shareholder rights) have a higher propensity to lobby, which could be indicative of managers attempting to extract personal gain at the expense of shareholders. However, this relationship reverses in subsamples of firms that lobby (as opposed to all firms), which could be indicative of management–shareholder alignment (Mathur et al., 2013). Hadani (2012) argues that institutional shareholders act as a natural counter-pressure to entrenched management and finds that firms with institutional blockholders are less prone to lobbying.