



Explaining foreign firms' approaches to corporate political activity in emerging economies: The effects of resource criticality, product diversification, inter-subsidiary integration, and business ties



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ABSTRACT

Despite the increasing scope for transactional approaches to corporate political activity (CPA) in emerging markets and rising concerns about the use of relational approaches, foreign firms in emerging economies appear to be reluctant to adopt transactional approaches to CPA. Using Resource Dependence theory we argue that criticality of resources, product diversification, integration with other foreign subsidiaries, and business ties may explain why foreign firms adopt a transactional or a relational approach to CPA. We test our hypotheses using a sample of 105 subsidiaries of foreign firms in India. We find that unrelated diversification and close integration with other subsidiaries of their parent firm makes subsidiaries more likely to adopt a transactional approach, whereas local resource criticality and ties to local businesses makes subsidiaries less likely to use a transactional approach to CPA. Our findings enhance our understanding of the factors that determine foreign firms' choice of approaches to CPA in emerging economies.

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Introduction

Multinational Enterprises (MNEs) operating in emerging economies are likely to be exposed to greater, more complex and less predictable influences of the political environment on their operations when compared to MNEs operating in developed economies, given the institutional voids characterising emerging economies (Luo, 2001; Meyer, Estrin, Bhaumik, & Peng, 2009; Peng, Wang, & Jiang, 2008). Because of this, MNEs are faced with a greater need to proactively engage and interact with a variety of non-market actors such as regulatory agencies, politicians, non-governmental institutions and other organisations in order to influence policymaking (Gao, 2006; Shaffer & Hillman, 2000). This interaction in order to influence government policy is commonly referred to as 'corporate political activity' (CPA) (Getz, 2001; Hillman & Hitt, 1999; Schuler, 1996). Such CPA is geared not only towards reducing the negative impact of uncertain environments on the firm, but also to influence and shape government policy in a way that is conducive to the firm's business objectives,

e.g. providing exclusive licenses, and obtaining influence rents (Ahuja & Yayavaram, 2011).

A central decision for firms to take in this context is about the general approach to CPA (Hillman & Hitt, 1999; Hillman, Keim, & Schuler, 2004). On the one hand, firms may choose to interact with government policymakers or regulatory agencies only when specific issues arise. This one-off issue-based approach to CPA is referred to as a *transactional* approach (Hillman & Hitt, 1999). Firms following a transactional approach engage only in a short-term exchange with policymakers when particular issues arise, for example, when faced with the prospect of new regulation that is detrimental to their operations. On the other hand, firms may interact with government officials on a regular basis by developing personal relationships with policymakers over time, so that when issues arise, the contacts necessary to affect these issues are already in place. This alternative approach to CPA has been referred to as *relational* approach (Hillman & Hitt, 1999).

The distinction between transactional and relational approaches has been used in a large number of studies on CPA (e.g. Hillman, 2003; Hillman & Hitt, 1999; Hillman & Wan, 2005; Kozhikode & Li, 2012; Schuler, Rehbein, & Cramer, 2002; Sun, Mellahi, & Wright, 2012). The choice between the two approaches to CPA is important because it affects the subsequent decisions of firms; such as adoption of CPA *individually* or as part of a *collective*; and choice of

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particular strategies, i.e. *information-based*, *financial incentive* or *constituency building* strategy (Hillman & Hitt, 1999; Hillman et al., 2004). The choice of approach is thus an important decision in shaping the overall political behaviour of firms. As various studies have shown, the choice of CPA approach also influences firm performance (Niessen & Ruenzi, 2010; Sheng, Zhou, & Li, 2011). The distinction between transactional and relational CPA in the context of emerging economies has also been supported in Luo's (2001, 2006) studies on business-government relations in China. Luo (2001, 2006) found that while some MNEs interact with the government in an arms-length transaction-type fashion, others use long-term cooperative approaches. Although previous empirical research (Hillman, 2003; Hillman & Wan, 2005) has assumed that either the transactional or the relational approach will dominate a firm's CPA it is important to account for the possibility that, as firms change their CPA approach over time, both approaches may be equally important at certain points in time¹.

Despite the existence of both transactional and relational approach to CPA, studies have emphasised that unlike in developed countries, foreign firms' CPAs in emerging economies are predominantly based on the relational approach. While in developed countries, official mechanisms, such as, for instance, political action committees (in the U.S.) provide corporations with legitimate ways to support particular politicians and parties during election cycles in a transactional fashion (Grier, Munger, & Roberts, 1994), the absence of such legitimate mechanisms for business-government interaction have caused the relational approach to become the dominant means for firms to influence policy-making in emerging economies (Ahuja & Yayavaram, 2011). In addition to the lack of such official and legitimate mechanisms, scholars have also emphasised upon the comparatively greater dependency of foreign firms in emerging economies on local resources such as local knowledge, networks and reputation (Luo, 2001; Meyer et al., 2009; Wright, Filatotchev, Hoskisson, & Peng, 2005). Research has, for instance, investigated the role of creating and managing *ties* to political decision-makers (Li, Poppo, & Zhou, 2008a; Li, Zhou, & Shao, 2008b; Sheng et al., 2011) or the creation and exploitation of family or other social networks (Dieleman & Boddewyn, 2012). Yet, we suggest that developments in the institutions in many emerging economies over the past decade, including improved business-government information exchange mechanisms provide firms with greater scope to use transactional, rather than the traditionally dominant relational approach to CPA. While there is still heterogeneity in this regard across emerging economies, emerging economies share a common trend towards better institutions (e.g. Ahuja & Yayavaram, 2011; Luo, 2001; Peng & Luo, 2000). Scholars have therefore begun to examine wider typologies of political strategies, such as those provided by Hillman and Hitt (1999), to analyse the CPA of foreign firms operating in emerging economies (Holtbrügge, Berg, & Puck, 2007; Puck, Rogers, & Mohr, 2013). We suggest that India is a good example of the institutional changes that have taken place in emerging economies and thus provides a good setting for investigating foreign firms' CPA approach. For instance, business associations such as the Federation of Indian Chamber of Commerce and Industry and institutions such as the Reserve Bank of India (RBI) have become platforms on which businesses and the government can discuss specific issues in a transactional fashion, rather than developing on-going relationships with such regulators (Kozhikode & Li, 2012).

In addition to the opportunity provided by the development of institutions, recent research has highlighted that the use of a

relational approach to CPA can pose a risk to firms' reputation (Wright et al., 2005). In several recent instances, favourable outcomes of using the relational approach in emerging economies have found to have been reversed. For instance in Indonesia, connections to the Suharto regime established through the adoption of a relational approach became a liability for firms in the post-Suharto era (Dieleman & Boddewyn, 2012; Fisman, 2001). Similarly, studies in China have shown that the value accrued from political connections developed by foreign firms through the use of a relational approach may not always be positive in the long term (Li et al., 2008a,b). In general, the exploitation of family and political connections associated with the use of the relational approach in emerging economies has also thus often been associated with improper behaviour, such as, corruption (Lawton, McGuire, & Rajwani, 2013). We thus suggest that there are strong incentives for foreign firms to adopt a transactional approach to CPA in emerging economies.

Yet, despite these possible downsides associated with the relational approach, recent research shows that the relational approach to CPA remains important for foreign firms operating in emerging economies (Dong, Li, & Tse, 2013). For example, Sun et al. (2012) have highlighted the importance of *guanxi* networks in China, and Sawant (2012) has underlined the importance of building long-term relationships with government officials in India. In this study, we aim to resolve this paradox by investigating the factors that affect the likelihood of firms using a transactional instead of a relational approach to their CPA in emerging economies. Explaining the choice between these two approaches remains of great importance to investors as well as policy-makers in emerging economies due to the dynamic nature of the political environment and because of the effect of firms' choice of approach to CPA on their performance (e.g. Luo, 2001; Niessen & Ruenzi, 2010; Okhmatovskiy, 2010). We do so by drawing on resource dependence theory to highlight the effects of resource criticality, product diversification, inter-subsidiary integration and business ties on firms' choice of CPA approach.

The remainder of the paper is structured as follows: In the next section we provide a brief review of the various theoretical frameworks that have been used to explain firms' choice of CPA approach and argue for the particular suitability of resource dependence theory in our study. We then build on resource dependence theory to develop our hypotheses on the effects of resource criticality, diversification, inter-subsidiary integration and business ties on foreign firms' choice of CPA approach. The subsequent sections explain the research context, empirical basis and measures used in our study before presenting the findings. We then discuss our findings and conclude the paper by highlighting the paper's contributions to research and practice and indicating some worthwhile areas for future research.

Theoretical explanations of firms' approaches to CPA

The majority of prior theory-based explanations of the determinants of a firm's choice of approach to CPA have been grounded in the resource-based view, institutional theory and the resource dependence theories. Studies using the *resource-based view* (RBV) have emphasised on the potential effects of firm-level factors, such as, for instance, financial resources or experience on firms' choice of CPA approach. Scholars working on the basis of the RBV have emphasised that good relationships with the government provide firms with 'political capital' that can be a source of competitive advantage, for example, by raising costs to rivals (McWilliams, Fleet, & Cory, 2002) or reducing firms' exposure to risk (Puck et al., 2013). Yet, much of the empirical evidence in this area comes from a domestic environment and various authors have suggested that firms may be unable to leverage their resources and

¹ We would like to thank one of the anonymous reviewers for highlighting this possibility. We account for both of these possibilities through alternative measures of firms' CPA approach.

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