



# Corporate political strategy and liability of foreignness: Similarities and differences between local and foreign firms in the South African Health Sector



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## ABSTRACT

We investigate the differences between corporate political strategies (CPS) of local and foreign firms in the South African Health Sector. We expected to find significant differences in CPS due to MNE subsidiaries needs to overcome liability of foreignness (LOF) effects and MNEs possessing superior resources than local firms. We surveyed 103 firms and found considerable commonality in perceptions of uncertainty for both groups of firms, however foreign firms are more likely than local firms to adopt adaptation and avoidance strategies. We find that antecedent conditions such as turn over, age of the subsidiary and industry are more important than LOF in the selection of CPS.

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## 1. Introduction

Corporate political strategy is of critical importance for foreign firms that desire a reduction in their risk (Puck, Rogers, & Mohr, 2013; Sethi & Guisinger, 2002) and is especially important as relations between MNEs and governments could become antagonistic, despite superficial cordiality (Ramamurti, 2004). Multinational enterprises benefit from greater access to traditional resources but face a liability of foreignness while local companies benefit from local understanding of institutional practices and social embeddedness. The direct impact on firm profits by policy changes is the main justification for engaging in CPS in countries where regulatory policy is more volatile. Hoffmann, Trautmann, and Schneider (2008) define regulatory uncertainty as the inability to predict the future state of the regulatory environment. They differentiate it from regulatory-induced uncertainty, which is defined as the inability to predict the future state of the non-regulatory environment that is caused by a regulation. Hoffmann et al. (2008) emphasised that uncertainty in this context is about perception, since firm decisions may be based on what the leaders perceive rather than what might objectively be the case.

More recent scholarly research on corporate political activity has focussed on developed markets with less done emerging markets and evolving political systems (Lawton, McGuire, & Rajwani, 2013). However, research in this area, has largely

focussed on the use of corporate political activities and strategies that are focussed on overcoming country risk by interacting with local governments and stakeholders (e.g. Puck et al., 2013). The shortcoming of these studies is that they do not compare the strategies of local and foreign firms and therefore imply a liability of foreignness for MNE subsidiaries. A comparison between the political activities of local and foreign firms is important to understand both how strategies are shaped to deal with a common business environment and what non-MNE specific factors may influence political strategies. Research into antecedents of corporate political activities suggested that CPA may be influenced by other factors such as size of the firm, the degree of regulatory uncertainty and age of the firm (Hillman, Keim, & Schuller, 2004; Weymouth, 2013). However, research into antecedents has been confined largely to the US and local firm/government interactions and does not deal with evolving emerging market contexts.

A good understanding of the potential differing strategies of local and foreign firms is vital for both policymakers and for firms themselves. An additional benefit from comparing foreign and local firms' political activities is to derive insights into the role of liability of foreignness (e.g. Hillman, 2003; Zaheer, 1995). Foreign MNEs can trigger tough responses from local institutions by not using, or improperly implementing accepted practices, and the resultant tensions enhance the liability of foreignness and shape MNE strategic responses (Luo & Mezas, 2002).

These and other factors, such as regulatory uncertainty, suggest that there should be a difference in the corporate political strategic choices of local and foreign companies. Our study explores possible differences and similarities in corporate political strategies of

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multinational and local firms in the South African healthcare sector. The South African healthcare sector is a useful context for this study as the South African Government is implementing a major overhaul of the healthcare system with wide-sweeping changes that disrupt both local and foreign healthcare firms' business models and profitability (Motsoaledi, 2010, 2011; Ramjee & McLeod, 2010; Rispel & Moorman, 2010). Fundamental areas that are affected include funding sources and funding flows; regulatory systems; and service models to manage the implementation of a universal National Healthcare System (Schaay, Sanders, & Kruger, 2011, p.12).

## 2. The South African Health Sector

South Africa is an emerging market that is generally considered to have strong institutions (Kahn, 2011; *World Economic Forum [WEF]*, 2013), however the operations of existing health regulatory institutions and the proposed creation of new ones pose great uncertainty resulting in discordant relationships between private sector firms and the South African Government (Dodds, 2013; Gray, Vawda, & Jack, 2013; WEF, 2013). The most high profile example occurred when 39 drug companies took the South African government to court over proposed changes to the Medicines and Related Substances Act of 1997 (Sidley, 2001a). The legislation proposed changes to parallel imports, generic substitution, pricing regulation and marketing practises. Although the pharma companies claimed their actions were to protect the rule of law and intellectual property rights, public sentiment portrayed them as profiteering companies who wished to deny life-saving HIV treatment to millions who needed it (Sidley, 2001a). On the back of a local and international backlash, the companies eventually dropped the lawsuit (de Paoli, Mills, & Grønningsæter, 2012; Sidley, 2001b).

At the time of writing, the South African Government was establishing a National Health Insurance (NHI) for its entire populace. This was accompanied by numerous regulatory changes including pricing, quality, marketing, supply chain and tax changes (Ramjee & McLeod, 2010).

These changes were accompanied by a comprehensive overhaul of all health regulations in South Africa (Crisp, 2012) and have led to some firms within the health sector claiming that the operating environment had become very complex and unpredictable (Buthelezi, 2012). As a consequence, healthcare companies in South Africa are highly active in industry processes to provide input for all proposed legislation (Netcare, 2012).

## 3. Literature review

In our paper we use the terms CPA and CPS predominantly. Corporate political strategy (CPS) is a component of the overall non-market strategy and corporate political activity (CPA) refers to the specific actions and tactics taken by firms to influence policy to mitigate against environmental risks and/or increase profits (Puck et al., 2013).

Tian and Deng (2007) defined corporate political strategy (CPS) as "the strategy that enterprises employ to influence the formulation and implementation process of government policy and regulation in order to create a favourable external environment for their business activities" (p. 341). A firm's political strategies include a wider network of stakeholders than just government and include all relations with non-market stakeholders that may affect the operations of a firm (Holtbrugge, Berg, & Puck, 2007; Puck et al., 2013). The firm may benefit through decreased environmental uncertainty, lower transaction costs or better long-term sustainability (Hillman, Zarkhoodi, & Bierman, 1999; Lawton et al., 2013).

The direct impact on firm profits by policy changes is the main justification for engaging in CPS in countries where regulatory policy is more volatile. Hoffmann et al. (2008) define regulatory uncertainty as the inability to predict the future state of the regulatory environment. They differentiate it from regulatory-induced uncertainty, which is defined as the inability to predict the future state of the non-regulatory environment that is caused by a regulation. Hoffmann et al. (2008) emphasised that uncertainty in this context is about perception, since firm decisions may be based on what the leaders perceive rather than what might objectively be the case.

It has been argued that corporate activity is directly related to the extent of regulatory uncertainty and its interpretation as a threat (Engau & Hoffmann, 2011b). Conversely, firms may elect not to engage at all if policy is too erratic (Weymouth, 2013).

Traditionally, international competition was thought to stimulate CPA as a means to counter the threat of foreign competitors (Schuler, 1996). However, more recent analysis suggested the contrary (Kim, 2008). This change may be caused by the extensive adoption of free market perspectives in business and government communities (Lux, Crook, & Woehr, 2011).

### 3.1. Antecedents of CPS

The antecedents of CPS are commonly grouped as firm-level, industry-level, issue-based, and institutional factors (Hillman et al., 2004). At firm level, factors that play a role are firm size, firm age, dependency on government, slack assets, diversification level and formalised firm structures (Hillman et al., 2004; Tian & Deng, 2007; Weymouth, 2013). Firm size can be measured by sales, assets, market share or number of employees and is often a representation for available resources (Hillman et al., 2004). Firms with added resources are more likely to engage policymakers and do so alone, while those with fewer resources often act collectively with others (Hillman & Hitt, 1999; Macher & Mayo, 2012). Firms with greater market power are more politically active and influential as are those firms that are membership of an industry association (Weymouth, 2013). Additionally, resource dependency theory suggests that those firms with higher levels of dependence on government will engage in higher levels of CPA (Hillman & Hitt, 1999). There is limited evidence that firms with high levels of slack will engage more in CPA because they can afford to do so (Hillman et al., 2004). Firm age has not been shown to impact CPA, but it has been used as a proxy for firm visibility, reputation, experience or credibility which all have a positive correlation with CPA (Hillman et al., 2004).

### 3.2. Classification of CPS

Hillman et al. (2004) categorise CPA according to nature (proactive or reactive), approach (transactional or relational), participation level (alone or in groups) and strategy type (information, financial incentive or constituent building).

More recently researchers have differentiated between two distinct behaviours of buffering and bridging (Blumentritt & Nigh, 2002; Hillman et al., 2004; Meznar & Nigh, 1995). Buffering implies that a firm is "trying to insulate itself from external interference or trying to actively influence its environment" (Meznar & Nigh, 1995, p. 976) and involves proactive behaviours such as lobbying and campaign contributions (Hillman et al., 2004). Bridging occurs when firms "seek to adapt organisational activities so that they conform to external expectations" (Meznar & Nigh, 1995, p. 976). Bridging is reactive and involves tracking of legislative changes to ensure compliance once effected. Buffering can be seen as passive.

Another dimension to corporate political activity is whether it is transactional or relational (Hillman & Hitt, 1999). In the transactional approach, firms engage in political activity on an

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