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Domestic political connections and international expansion: It's not only 'who you know' that matters

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ABSTRACT

Former politicians on the board of directors bring to the firm domestic political connections and political knowledge. Previous research has mainly highlighted the role of contacts, without fully recognizing the role of political knowledge accumulated at home. By focusing on the effect of domestic political connections on foreign direct investment, we show that domestic political knowledge also shapes foreign expansion. We argue that contacts provided by former politicians may not be useful for foreign expansion whilst their political knowledge can be of help in countries with discretionary governments and with similar institutional environments to the one of the home country.

1. Introduction

In the last few years, politically connected firms have started to attract the attention of International Business (IB) researchers (e.g. Carney, Dieleman, & Taussig, 2016; Chen, Ding, & Kim, 2010; Frynas, Mellahi, & Pigman, 2006; Siegel, 2007; Sun, Mellahi, & Thun, 2010). They have analyzed a variety of political connections ranging from managers' friendship with political actors to the presence of politicians or former politicians on the board of directors (Faccio, 2006, 2010). The appointment of former politicians to the board of directors is an interesting phenomenon from a theoretical perspective, as their presence can be hardly associated with standard corporate governance functions such as the monitoring of the management of the company.

However, directors do not only perform monitoring functions. They also bring resources to the company, including expertise and knowledge accumulated during their careers (Barroso, Villegas, & Pérez-Calero, 2011; Hillman & Dalziel, 2003; Machold, Huse, Minichilli, & Nordqvist, 2011; Pfeffer, 1973; Zahra & Filatotchev, 2004). Politicians are no exception to this rule. As previous research shows, appointing politicians to the board brings two types of benefits for companies. On the one hand, they can put at the firm's service their personal connections and contacts with the government to facilitate the interaction with it (e.g. Faccio, 2006; Fisman, Fisman, Galef, Khurana, & Wang, 2012; Hillman, Zardkoohi, & Bierman, 1999). On the other, they also bring useful knowledge or perspectives on how the political process works that can

guide the firm to make better decisions in their relationship with the government (González-Bailón, Jennings, & Lodge, 2013; Hillman, 2005; Lester, Hillman, Zardkoohi, & Canella, 2008). Previous research states that firms appoint politicians to the board to secure the access to these contacts and knowledge in order to manage their interdependence with governments (Pfeffer & Salancik, 2003). However, the specific ways through which firms can benefit from the appointment of politicians are not clear. Lester et al. (2008, p. 1009) highlight that more research is needed to determine the "actual resources provided by the former government officials through their directorships [...] (and) the specific benefits that corporations receive by inviting former government officials onto their boards."

Previous research has mainly focused on the role of political contacts, leaving aside to some extent the role of political knowledge (Carney et al., 2016; Lester et al., 2008). One of the reasons could be the difficulties of separating contacts and knowledge. In the case of the domestic growth of the firm, it is almost impossible to separate them, as former politicians may bring to the firm both domestic contacts and domestic political knowledge. By contrast, when studying international expansion, it is possible to analyze separately the influence of these benefits. Whereas political knowledge can be transferred and exploited across countries in the form of political capabilities, even in countries in which the former politicians have no experience, contacts are location-specific and can only be exploited in the places where they are located.

To fill this gap, we analyze in this paper the influence of domestic

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political connections on the companies' international expansion. Overall, we do not expect domestic political connections to increase the firms' foreign expansion, because the knowledge and contacts developed during former politicians' careers are more valuable when pursuing domestic growth. However, we examine to what extent domestic political connections increase firms' foreign investments in countries where politicians may have contacts, applicable knowledge or both. Theoretically, our paper builds, on the one hand, on social capital theory (Coleman, 1988) to analyze the specific influence that contacts may have on foreign growth; and, on the other, on the knowledge-based view (Kogut & Zander, 1992, 1993) and the institution-based view (Peng, 2002; Peng, Sun, Pinkham & Chen, 2009; Peng, Wang, & Jiang, 2008) to analyze the specific influence of political knowledge on the firms' international expansion. Our main contribution is to show that, even though political contacts provided by former domestic politicians on the board do not encourage firms to enter in foreign countries, their political knowledge accumulated at home may prompt foreign direct investment (FDI) in countries where this knowledge is more applicable, regardless of their international experience. These countries are those having a similar institutional environment to the one of the home country and those where governmental discretion is high.

By combining the knowledge-based view with the institution-based view, we contribute to the political capabilities and the IB literatures by showing the role played by firms' domestic political connections on the board of directors as a driver of international expansion. We argue that former politicians provide firms with political knowledge that contributes to the formation of political capabilities, defined as the routines through which a firm's political resources and skills are deployed to influence political processes (Lawton, McGuire, & Rajwani, 2013; Fernández-Méndez, García-Canal, & Guillén, 2015). By investigating the influence of political connections on international expansion, we establish the link between domestic political connections and the accumulation of political capabilities susceptible of being exploited in a foreign country. The institution-based view helps to explain where these capabilities can be effectively exploited; namely, countries with similar institutional environments and with governmental discretion. Specifically, our work contributes to the debate about the impact of institutional similarity on organizational strategies (Henisz & Zelner, 2005; Kostova & Roth, 2002; Perkins, 2014) and on the role of specific institutions on the adoption of firms' routines in the host country (Marano, Tashman, & Kostova, 2017; Kostova & Zaheer, 1999). Our main argument is that the knowledge brought by former domestic politicians can be incorporated into the routines that constitute the firm's political capabilities and later adopted and exploited in foreign countries where their use is legitimate. In this sense, we contribute to the recent stream of research analyzing the effect of home country characteristics on firms' foreign expansion (Cuervo-Cazurra, 2006; Cuervo-Cazurra & Genc, 2008; Estrin, Meyer, Nielsen, & Nielsen, 2016; García-Canal & Guillén, 2008; Holburn & Zelner, 2010; Li, Xia, Shapiro & Lin, 2018; Luo & Wang, 2012) by showing how firms can use the domestic political knowledge provided by domestic former politicians when they enter into institutionally similar countries.

We test our propositions using a 23-year panel comprising all Spanish firms listed as of 1990. As the international expansion of Spanish firms is a recent phenomenon (Guillén & García-Canal, 2010), this research setting allows us to provide rich data that accounts for the complete international expansion path of these companies that would shed light on the role of political connections.

2. Theory and hypotheses

There is a long tradition of management research linking the composition and background of the board of directors to organizational outcomes such as performance (McDonald, Westphal, & Graebner, 2008), or growth through diversification (Jensen & Zajac, 2004). Besides the traditional function of monitoring top managers (Williamson,

2008), the board of directors can influence organizational outcomes in, at least, two ways. The first one is to provide advice to managers (Adams & Ferreira, 2007), taking advantage of the board member's knowledge and information. The second is to facilitate relationships with external agents and organizations through cooptation (Thompson, 1967) and interlocking directors (Mizruchi, 1996).

The role of (former) politicians on corporate boards of directors has also received some attention in the literature. Consistent with the advising and relationship building functions, recent research has argued that politicians acting as directors may bring two types of resources to the organization, namely human and social capital (Lester et al., 2008). In effect, former politicians do not only provide the organization with government connections, but also with valuable knowledge regarding the political process. In this vein, former politicians bring to the company different types of knowledge. They have general knowledge regarding how the political process works (Hillman, 2005), and they also provide the company with more specific and technical expertise "of the inner working of politics and government" (González-Bailón et al., 2013, p. 852). This knowledge goes beyond the inside information that they can gain through their personal contacts and it is extremely useful for firms to know how the (political) system works and how people involved in the political process think and act. As a former U.S. congressman once declared, "after 24 years, you gain some understanding and knowledge of the process, the politics and the people."¹ Agrawal and Knoeber (2001) go a step further by arguing that former politicians also possess expertise to anticipate the actions of governments.

In addition, politicians are also equipped with interpersonal skills developed during their political careers, which allow them to influence individuals (Stern & Westphal, 2010) and to easily establish channels of communication with external institutions (González-Bailón et al., 2013; Useem, 1984). Specifically, these politicians can be the interlocutors of the firm in managing the relationship with state or regulatory agencies (Pfeffer & Salancik, 2003). Thus, firms having former politicians on the board are in a privileged position to successfully navigate through the challenges of governmental regulations in their home country. Thanks to the social and human capital provided by former domestic politicians, the firm would be better equipped to understand and anticipate the actions of the domestic government, improving the relationship with it. That is why the appointment of domestic politicians to the board is expected to prompt domestic expansion rather than foreign expansion. For firms' political connections in the home country to have an impact on foreign growth, they should be portable to foreign locations. However, both social and human capital are not fully fungible (Coleman, 1988) and applicable across countries. When considering the effects of domestic political connections on the international expansion of the firm, the benefits associated with social capital will be limited, assuming that the politician has mostly domestic contacts or in specific countries. As social capital is mainly country-specific (Useem, 1985), only the international contacts of the politician (should they exist) would be of help. The case of the human capital is slightly different, as the knowledge and perspectives provided by politicians on the functioning of political processes can be applied abroad, even though this knowledge would not be perfectly suitable. In effect, the knowledge provided by former politicians has an important domestic component. As another former member of the U.S. congress once said: "a lot of people really don't know how Washington works, especially back home in the district (...). Based on 22 years serving in Congress and getting bills passed, you kind of learn how the system works."² Obviously, this type of knowledge is more useful in the U.S. (the home country of this politician) than abroad.

For these reasons, the appointment of former domestic politicians to the board of directors should increase firms' opportunities to invest in

¹ Exlawmakers swing through the revolving door, USA Today, 13rd April 2015.

² Ex-lawmakers swing through the revolving door, USA Today, 13rd April 2015.

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